

Kotios, Angelos

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Angelos Kotios\*

## The European Union's Balkan Development Policy

*After more than a decade of cooperation between the European Union and the formerly socialist Balkan countries, the latter – in stark contrast to a number of other ex-socialist countries – are characterised by severe transition problems, poor economic conditions, political instability and proneness to military conflict. Against this background, our author evaluates the EU's past and present Balkan development policies, concluding with some suggestions towards a new strategy of cooperation.*

The ex-communist Balkan countries are in transition, and are participating, each at a different pace, in the new European architecture which is being shaped after the collapse of the bi-polar world. This transition concerns a group of countries, which, in relation to the other Central and East European (CEE) countries, have certain special characteristics. First, they lack pre-communist experience with the functioning of a developed capitalist system and a pluralistic democracy. They have a comparatively lower level of development and a weaker economic structure than the larger, more distant economic and technological centres of Central and Northern Europe. They have a number of internal political problems, some of which have not been resolved since the fall of the Ottoman Empire.<sup>1</sup> These special characteristics have a negative impact, both on the process of their transformation, and on their integration into West European structures.

Relations between the Balkans and the European Union (EU), the so-called Euro-Balkan cooperation, have also exhibited some special features over time; referring shortly to them should contribute to a better understanding of the evolving formation of these relations. These characteristics include the following:

First, the relations between the countries in this area and Western Europe have always been, and continue to be, determined essentially by international and national political parameters. For example, during the bi-polar era with the related political and economic division of Europe, special cooperative re-

lations were established with the EC through association agreements with Greece (1962) and Turkey (1963), which then evolved into EC membership for Greece and membership in the EU-Turkey Tariff Union for Turkey. Already, following the European Council Meeting in Helsinki (December 1999), Turkey has been considered a candidate state for accession to the EC. In 1983, the former Yugoslavia became the third Balkan country to start special cooperation relations with the EC. For political reasons relations with the other countries of the area (Bulgaria, Romania and Albania) were much less developed.

Second, as a result of national and international parameters, relations between the Balkan countries and the European Union (EU) have traditionally suffered from an intense fragmentation. The Balkans as a defined geographical space has, historically, never been a homogeneous political and economic entity with respect to the application of European Community foreign economic policy. Differences in internal policy and economic structure among the Balkan countries, as well as different orientations in their foreign affairs and especially foreign economic policy, divergences in the levels of economic growth, and finally divergent national choices and targets, have decisively defined the intensity and extent of their cooperation with the institutions of West European economic and political integration.

The collapse of the bi-polar world, and the institutional and structural-political changes in the former Yugoslavia which led to the creation of new independent states in the Balkans, have created new condi-

\* Assistant Professor in International Economics, Department of Planning and Regional Development, University of Thessaly, Volos, Greece.

<sup>1</sup> A. Agh: *Emerging Democracies in East Central Europe and the Balkans*, Cheltenham and Northampton 1998, Edward Elgar.

tions pertaining to Euro-Balkan cooperation. From the beginnings of the 1990s, the two countries of the Eastern Balkans (Bulgaria and Romania), as well as other countries in the Western Balkans (e.g. Albania and the Former Yugoslav Republic of Macedonia - FYROM), are pursuing a transition to a Western type of parliamentary democracy and a mixed economy, with an emphasis on market mechanisms. Thus they have clearly shifted their foreign political and economic orientation towards the West and aimed at the development of close relations with the EU, and a gradual incorporation into Western mechanisms of cooperation and integration. Accession to the EC is their final objective, their national target and their socio-political vision.

In contrast to this other new states of the area, such as the Federal Republic of Yugoslavia (FRY), Croatia and Bosnia-Herzegovina, during the 1990s have been involved primarily in war activities, political conflicts, interior crises or civil wars. Developments in these countries have obviously not only deterred conditions for cooperation with the EC but have also brought about, especially in the case of the FRY, a greater or lesser involvement of the EU and its member states in the war in Kosovo, with the resulting imposition of economic sanctions and a trade embargo. After the Dayton/Paris Peace Agreements for Bosnia and Herzegovina and the regime changes in Croatia and FRY the way for regional reconciliation and cooperation is now open. It enables, for the first time, all the countries in the region to establish new relations with the EU and to accelerate their integration into EU structures.

The analysis of Euro-Balkan relations and their prospects is the core of this article. First, a concise description and evaluation of EC policies designed to support the processes of systemic transformation of the Balkans is attempted. Second, the existing institutions of cooperation as well as their basic economic influences are described. The position of the countries of this area in the ever-developing expansion of the EC to the East is a further part of the analysis. The war in Kosovo was the proximate reason for the reappraisal and re-determination of EC Balkan development policies, as well as for the introduction of new support mechanisms for the reconstruction and the integration of this area into Europe. The recording of the conclusions of the analysis and suggestions towards a new strategy of cooperation in the Balkans, in conjunction with the role that the EU is asked to assume, make up the last part of this paper.

### European Balkan Development Policy in the 1990s

To reduce the cost of adaptation and to enable a smooth harmonisation of the socio-political and economic systems of the CEE countries with those of the West, the EC has developed and, since 1989, applied a number of support measures. In order to assist the transition countries of the Balkans, the EC is using the Phare and OBNOVA programmes (since 2000 the CARDS-Programme for the Western Balkans), and at the same time is activating cooperative funding mechanisms through the European Investment Bank (EIB). There is also aid granted on a bilateral level on behalf of the individual member countries of the EC. Table 1 contains the amounts of aid given to the Balkan countries to support the process of their transformation and to cover urgent humanitarian needs.

Through the Phare Programme, the EU offers the necessary know-how, including consulting and training, to a wide range of public, private and non-governmental organisations. In addition it funds studies, subsidises capital, and gives necessary guarantees, credit and finances, often in cooperation with other international organisations, for infrastructure projects. However, it does not aim to serve macroeconomic goals or to cover the balance-of-payments or budget deficits of the countries in

**Table 1**  
**EU Assistance to**  
**South-Eastern Europe, 1991-1999**  
(allocation in € million)

Beneficiary country	European Community	Member States <sup>1</sup>	EIB	EU Total
Albania	816.73	712.80	46.00	1,575.53
Bosnia-Herzegovina	2,061.87	507.90	0.00	2,569.77
Croatia	353.76	1,165.90	0.00	1,519.66
Federal Republic of Yugoslavia	471.80	712.40	0.00	1,184.20
FYR of Macedonia	403.89	178.20	60.00	642.09
Regional Co-operation	462.15	0.00	0.00	462.15
Total A <sup>2</sup>	4,570.21	3,277.20	106.00	7,953.41
Romania	1,813.20	3,069.40	1,134.50	6,017.10
Bulgaria	1,480.50	754.80	751.00	2,986.30
Total B	3,293.70	3,824.20	1,885.50	9,003.40
Total A+B	7,863.91	7,101.40	1,991.50	16,956.81

<sup>1</sup> Provisional figures; figures on 1998-1999 are not included as only provided by LUX, I, SV, DK, UK, EL, SF.

<sup>2</sup> These figures include Phare, Obnova, media, democracy & human rights, demining, humanitarian aid, food security and macro-assistance.

Financial perspectives 2000-2006 (indicative allocation): Albania, Bosnia-Herzegovina, Croatia, Federal Republic of Yugoslavia and FYR of Macedonia approx. € 5 billion; Romania and Bulgaria € 6.2 billion.

Source: European Commission, DG External Relations.

transition. The latter kind of support has been undertaken by specialised international organisations and banks.

The incorporation of a country into the Phare Programme was at first dependent upon political and economic conditions. For example, the supply of EC aid through the Phare Programme was tied to the process of democratisation, as well as the transformation of internal economic systems. Thus, due to the existence of this framework of principles and terms, and because of the different stages of internal adjustment of the Balkan countries, there was not a simultaneous incorporation of these countries into the Programme. Bulgaria was incorporated into Phare in 1990, Albania and Romania in 1991. Because of the civil war in Bosnia-Herzegovina and the political friction between the Former Yugoslavian Republic of Macedonia (FYROM) and Greece, these countries did not start participating in the Programme until the beginning of 1996. Croatia and the Federal Republic of Yugoslavia (FRY) have not profited from Phare, first, because of their bilateral conflict, second, because of their involvement in the Bosnia-Herzegovina war, third, because of their policy towards their ethnic minorities and, finally, because of deficiencies in their processes of internal democratisation.

At this point we should mention the distinct cooperation of the EU with Bosnia-Herzegovina.<sup>2</sup> Following the Dayton agreement (12<sup>th</sup> November 1995) to terminate the war, the World Bank and the European Bank for Reconstruction and Development (EBRD) worked out a programme for the reconstruction and rebuilding of this country. The programme arranged for total free aid of \$5 billion for the period 1996-1999. The contribution of the EU was \$1 billion, administered through the Phare Programme ("Essential Aid"). It was a critical aid programme aimed at rendering humanitarian aid, as well as at reconstruction activities and the support of sectors like transportation, education, housing, agriculture, energy, water, telecommunications etc. On the other hand, the EU initiative OBNOVA focused on the reconstruction of Bosnia-Herzegovina, Croatia, FRY and FYROM (Regulations 1628/96, 2240/97 and 851/98). The particular targets of this initiative were economic development, the rehabilitation of civil society and cooperation among the Republics of the Former Yugoslavia within the sphere of the regional approach that the EU has followed in the area of the Western Balkans.<sup>3</sup> Very often EIB activities complement Phare Programme activities as well as those of the EBRD and the World Bank. Euratom may also approve loans for

the security and improved functioning of existing nuclear power plants. Bulgaria, which operates unsafe nuclear power plants, has already received such support.

### **Contractual Relations as a Basic Integration Policy Instrument**

Immediately after the collapse of really existing socialism and the COMECON system of labour division in 1989, the Balkan countries, like all other CEE countries, sought entry into the West European system of economic cooperation and integration, and, more particularly, the development of closer relations with the EU. The EU, which already regulates its trade relations with all developing countries in the framework of more or less preferential agreements, has reacted positively to the challenge of this opening, and the Western orientation of the CEE countries in general, by signing agreements on trade and economic cooperation with them. In the case of ten transition countries, including Bulgaria and Romania, these agreements were later replaced by new Accession Agreements ("Europe Agreements"). However, the original agreements on trade and economic cooperation with Albania (from 1992) and FYROM (from 1997)<sup>4</sup> are basically still in effect. These agreements are based mainly on certain general political and economic principles, such as respect for the principles of democracy and human rights as they have been described in the Final Act of Helsinki and the Paris Charter for a new Europe, respect for minorities and the principles of good neighbouring, transition to a market economy, respect for the principles of the Bonn Conference for Economic Cooperation in Europe, and respect for mutual interest and non-discrimination. The main goals of these agreements, beyond the strengthening of bilateral relations, were support for the transformation process, the strengthening of economic development, promotion of harmonised trade development, regional and sector diversification, regional cooperation, and the establishment of new types of trade and economic relations.

Within the framework of trade cooperation, the EU offered to open its markets for industrial products, excluding from totally free market access certain

<sup>2</sup> European Commission: Evaluation of the Phare "Essential Aid" Programme for Bosnia and Herzegovina, Brussels 1998.

<sup>3</sup> EU Council: Council Conclusions on Conditionality, in: Bulletin EU 4-1998, Brussels.

<sup>4</sup> The agreement on trade and economic cooperation between EU and FYROM will be replaced by the new Stabilisation and Association Agreement signed on April 2001.

special products, such as iron, steel, textiles and processed agricultural products, for which there remain tariffs and/or quotas. It also excluded agricultural products for which there were common market organisations in the EU from full import liberalisation. Furthermore, the EU reserved the right to impose anti-dumping and anti-subsidy tariffs, as well as additional safety measures, i.e. the right to re-impose trade protection measures in cases where the increase of imports from the cooperating countries would severely affect community production. The cooperating countries, on their behalf, offered the EU most favoured nation clauses, excluding the special case of liberalisation of imports from neighbouring countries necessary to develop regional integration. In addition, these countries established the convertibility of their currencies to facilitate their transactions with the EU. In order to protect new industries or to support reconstruction of existing ones, the cooperating countries were also allowed to introduce additional new measures for trade protection.

Economic cooperation refers to matters such as industry, agriculture, mining, fishery, infrastructure, economic policy, the transfer of technology and know-how, energy, transportation, research and development, tourism, the environment, the financial sector and the Phare programme. The Cooperation Council was responsible for the administration of this cooperation.

### The "Second Generation" Agreements

The agreements on trade and economic cooperation, the so-called "first generation" agreements, despite their indisputable importance especially for trade development, covered a very limited range of issues and were less favourable than the preferential and beneficial terms of the agreements with other countries (e.g. the Lomé Agreement with African, Caribbean and Pacific countries, and the agreements with Mediterranean countries). They also lacked a specific target, or final stage, such as EU accession. Thus, with the progress of the transformation process, it became obvious that the above agreements did not suffice for the attainment of ambitious goals such as the gradual integration of Western and Eastern Europe. Beyond that, the accession prospect could function from the very beginning as a motive for reconstruction and adjustment, and as an incentive for social tolerance and self-discipline in the economies and societies suffering the transition.<sup>5</sup>

The EU was asked to respond with a second generation of agreements, which would not only allow for closer cooperation but which would, at the same time, serve as an "accession waiting room".

In 1993, two countries of the Eastern Balkans (Bulgaria and Romania) signed accession agreements with the EU. These countries, unlike the countries of the Western Balkans, avoided involvement in military conflicts, avoided intense internal unrest and political tensions with neighbouring countries, and succeeded in establishing democratic systems. Both these accession agreements, similar in content, presupposed the adoption of a series of political and economic measures. Each contracting party was asked to respect the basic terms mentioned in the first part of the agreement, such as the principles of mutual interest, reciprocity, political and economic freedom, the establishment of a political system that would be based on the rule of law and a respect for human rights. Political pluralism and a multi-party political system with free and democratic elections, application of the principles and provisions contained in the Final Act of OSCE, the development of a market economy and a commitment to free trade in accordance with the principles of the WTO were further obligations to the contracting parties. The agreements recognised that the final goal of the associated countries of the Eastern Balkans (as applicable in the case of the other associated CEE countries) was accession to the EU, and that this agreement would contribute to the realisation of that goal.

The more specific targets of the agreements are:<sup>6</sup>

- The creation of an appropriate framework for political dialogue between the interested parties that would allow the development of close political relations.
- The gradual establishment of a free trade area between the EC and the two Balkan countries, which would ultimately cover all trade. The functioning of the agreements as a basis for economic, financial, cultural and social cooperation, as well as for the rendering of Community aid. Support for the effort of the two countries of the Eastern Balkans to develop

<sup>5</sup> H. Kramer: Die "Europäischen Abkommen" für die Assoziation der mittel- und südosteuropäischen Staaten mit der EG: Ein Baustein der neuen Architektur Europas?, SWP-IP2710, Ebenhausen 1991.

<sup>6</sup> European Union: Europe Agreement establishing an Association between the European Communities and their Member States, of the one part, and the Republic of Bulgaria, of the other part, in: Official Journal No. L 358, 31/12/1994, p. 2-222; and European Union: Europe Agreement establishing an Association between the European Communities and their Member States, of the one part, and Romania, of the other part, in: Official Journal No. L 357, 31/12/1994, p. 2-189.

their economies and to complete the establishment of a market economy.

□ The development of a necessary framework for their gradual integration into the European Community. Towards this end they would adopt new rules, policies and practices.

□ The establishment of new institutions able to guarantee the effectiveness of the association.

Through an institutionalised political dialogue the EU is seeking the integration of the associated countries of the Balkans into the community of democratic countries, an increase in the convergence of their stances on international issues, the strengthening of security and stability etc. The political dialogue in the framework of the association agreements is to take place at the level of country leaders and governments, at the ministerial level (Association Council), at the level of higher administration staff, at the level of experts etc.

As far as trade cooperation is concerned, the target of free movement of goods is to be materialised through the creation of a free trade area during a transitional period of ten years. During these years the EU will accept a partial application of the reciprocity principle and equal market access. Thus, following enactment of the agreement, the EU would revoke all restrictions on imports from the associated countries. Certain special goods, such as iron, steel, textiles, clothes and the majority of agricultural goods, would be exempted from full release. For the latter there are certain marginal cases of free exports in effect. Special protocols define the terms and conditions of importing these goods into the EU.

The associated countries are bound by the Agreements to liberalise their imports from the EU gradually over ten years. This applies mainly to tariff barriers, given that quotas and currency limitations will be revoked once these agreements are in effect.

### **The Balkans in the New EU Enlargement Process**

At this point there are three important questions to be addressed: first, what is the role of the Balkan countries in the new enlargement process of the Union? second, what are the prospects for their accession? and third, what are the expected repercussions of this accession?

To answer the first question: the only Balkan transition countries in the pre-accession stage are Bulgaria and Romania. They are among the group of ten CEE countries that have submitted accession

applications to the EU (Bulgaria on 14<sup>th</sup> December 1995 and Romania on 22<sup>nd</sup> June 1995). The new process of enlargement of the EU comprises two stages of negotiations: the pre-accession period and the period of accession itself. The two Balkan countries are in a second group that started negotiations in January 2000. The pre-accession period is designed to help countries speed up the process of meeting the political and economic criteria for accession (the Copenhagen Criteria). The other Balkan countries in transition are far from this stage; they are only now preparing to sign the stabilisation and association agreements.

In November 2000 the Commission published its third regular report concerning the progress that each candidate country had made. As far as the political criteria of Copenhagen are concerned the report concludes that Bulgaria and Romania continue to fulfil these basic criteria. However, much needs to be done in both countries towards fighting corruption, developing a strong, independent, effective and professional judicial system, as well as elaborating national strategies for the integration of Roma.

In contrast to the political situation, Bulgaria and Romania are in an inferior position economically, as compared to other CEE candidate countries.<sup>7</sup> Both countries have an extremely low GDP as a percentage of the Community average (Bulgaria 22%, Romania 27%, 1999). The GDP of both countries is much lower than in 1989. In other words, instead of economic growth and convergence, Bulgaria experienced a dramatic decline in its GDP in 1996 and 1997, though there was an increase in the following years. Romania, until 1999, has presented a steady decline. Common to both countries are the problems of foreign debt, deficits in the balance of payments, a low percentage of GDP in investment, a low inflow of foreign capital for direct investments, a large proportion of the GDP and a much larger proportion of total employment in agriculture etc. On the other hand, both countries have increased their trade with the EU considerably, even though they are well behind the other candidate countries.

As far as the Copenhagen economic criteria are concerned, the Commission reports that Bulgaria cannot yet be viewed as a well-functioning market economy able to cope with the pressure of competition within the EU. It has, nevertheless, made further progress towards becoming a market economy and

<sup>7</sup> M. Jackson, G. Petrakos: *Opening to the EU, Competitiveness and Structural Change in the Industry of Transition Economies*, Phare-ACE Project P-96-6071-R, Volos 1999.

in privatisation and succeeded in adopting the measures necessary for restoring macroeconomic and monetary stability through the establishment of a currency board. However, much more is required, for example in structural reforms, in enterprise restructuring, in developing financial intermediation and in improving the business climate. From this perspective Romania is even further behind. Both countries have made progress with the adoption of EU legislation, but further efforts are needed to create new institutions and to implement the *acquis*.

As to the second question concerning the prospects for accession of the candidate Balkan countries to the EU, the answer is not at all optimistic. The two Balkan countries in transition are far from fulfilling the economic criteria. In both countries the process of restructuring is progressing at a very slow pace. System rigidities, a large, counterproductive and over-indebted public sector, delay in privatisation, a large external debt, corruption, outdated infrastructures etc. are only some of the factors that, in the 1990s, have thrown the two countries into the vicious cycle of underdevelopment.

The economic and technical assistance rendered by the EU is not able by itself to deal with these problems. An annual net inflow of 1-2% of GDP for these countries is more than counterbalanced by declines in GDP (e.g. 6.6% for Romania in 1997, 10.9% for Bulgaria in 1996, and 6.9% for Bulgaria in 1997). It is estimated that in order to attain 75% of the average Community GDP by 2015, the Bulgarian economy would need to grow by 10.1% annually and the Romanian economy by 9.2%. In the present circumstances these growth rates are quite unrealistic. If the GDP in the EU were to increase annually by an average of 2.5%, and in the Balkans by 3.5%, it would take more than 100 years to cover the per capita income difference.<sup>8</sup> This means that real convergence would require more than an increase in the transfer of resources. Effective internal reforms and structural adjustment, as well as an increase in national saving for investment, would also be required.

Thus, one may conclude that, given strict application of the criteria and under the present circumstances in the two candidate Balkan countries, there

is no way of estimating the exact time of their accession to the EU. Accession to the EU will depend mainly on their internal efforts.

### Effectiveness of EU Policy in the 1990s

The overall conclusion reached from the above short analysis is that Euro-Balkan cooperation has not realised its targets and ambitions. Despite the efforts made and the means used, the Balkan transition countries continue to face important problems, not only in their economic transformation, but also in the establishment of firm democratic institutions. Even worse, the Western Balkans are still in a state of flux and insecurity, with limited prospects for development, and with regional conditions that have deteriorated even more following the war in the FR Yugoslavia.

All this is happening at the same time as the other former socialist countries of Central and Eastern Europe are transforming and growing to such a degree that the accession of five of them to the EU seems possible from the end of 2002. Therefore, we can see a gradual divergence among the countries in transition. The development gap between Western and Eastern Europe is rapidly evolving into a chasm between Central and Southeast Europe. Thus, the development gap between Albania, FYROM, Bulgaria, Romania and Bosnia-Herzegovina, on the one hand, and Slovenia, Hungary and the Czech Republic, on the other, is becoming larger than the gap between the latter and the EU.

Obviously, the question arises as to the causes of this new divergence. One group of reasons is related to the application of European cooperation policy. More specifically, because of the conditionality of the assistance and because of the geopolitical and economic interests of certain EU member countries, EU policies have given more emphasis to the stabilisation, transformation and development of Central European countries. Even though the starting conditions that existed in the various CEE countries were different, the EU ignored this differentiation during the planning and implementation of its assistance policy. By giving equal treatment to countries with unequal conditions the Community indirectly exacerbated these differences. The strict application of the principle of conditionality led to a less favourable treatment for the Balkan countries (as far as the time and the content of cooperation were concerned).

For example, the aid provided through the Phare or OBNOVA programme depended on political and economic criteria, which, because of the comparatively worse starting conditions in the Balkan

<sup>8</sup> For more details see H. Siebert: Reintegrating the Reform Countries into the World Economy, Kiel Working Paper No. 829, Institut für Weltwirtschaft, Kiel 1997; S. Fisher, S. Ratna, C.A. Vegh: How Far Is Eastern Europe from Brussels?, IMF Working Paper 98/53, Washington, D.C., 1998; P. J.J. Welfens: Economic Aspects of the Eastern Enlargement of the European Union, Bericht des BIOst No. 7/99, Cologne 1999.

countries, were difficult to fulfil concurrently with the other CEE countries. The result was that most of the Balkan countries participated in this programme after some delay (or not at all due to political tensions and crises). The amount of aid depended mainly on the size of the population and not on internal needs. Furthermore, at the beginning of the transformation process (1990-92) the EC simply disregarded the fact that the Balkan countries had huge deficits in their balances of payments, a high negative rate of development and the lowest per capita income of all the CEE countries. It also ignored the comparatively higher cost of the re-orientation of their external economic relations.

At the same time the financial aid was not only insufficient compared to the magnitude of the needs, but was also broken down into too many projects, with very few multiplication effects and with high management and information costs. Nor did trade cooperation entail full liberalisation of entry for all the exports of the Balkan countries. An important percentage of the exports from the Balkan countries, and especially of those from the Western Balkans was subject to controls and limitations such as quotas and anti-dumping tariffs.<sup>9</sup> Meanwhile, the actual preferential element of the bilateral trade cooperation is of limited value, given that most countries of the world already enjoy preferential access to the common market to a greater or lesser degree.

On the basis of inflexible terms and conditions, the non-differentiated EU approach to the CEE countries actually produced, in the 1990s, disparate results. The EU obviously did not well perceive the special circumstances of the Balkan countries, (e.g. the problems of ethnic minorities and nationalism, as well as the importance of the Balkans for the stability, security and economic well-being of all Europe), and failed from the very beginning to develop a regional approach. Instead, for example, the EC, finding itself in the process of strengthening its economic and political integration (e.g. negotiations for the Maastricht and then for the Amsterdam Agreements, establishment of a monetary union etc.) accepted and, to a certain degree, exacerbated the tendencies of disintegration of the former Yugoslavia.

The above-mentioned undifferentiated, yet dissimilar treatment by the EU of the Balkan countries *per se* has created a pyramid of relations.<sup>10</sup> At the bottom of this pyramid are the least developed countries (e.g. Bosnia-Herzegovina, Albania, FYROM), in the middle Bulgaria and Romania, then Turkey, and at the top, Greece. The FRY and Croatia have been outside the pyramid during the 1990s. This means that the EU

has closer relations with the more developed Balkan countries, and less intense relations with the less developed countries of the region. The latter are simply left to cope with a vicious cycle of underdevelopment and political instability. As a result of this kind of co-operation policy, the EU has not been able to contribute substantially to the breaking of the vicious cycle in which these poorer Balkan countries have been entrapped. Nor has it been able to help promote a new era of peace, stability and prosperity in the region.

The second and most important group of reasons for the lack of progress in the Balkans concerns the countries themselves. Even the best cooperation policy and transfer of resources, *per se*, is not enough to launch a country into the orbit of dynamic development. A country must also strive hard to create the necessary conditions for the liberation of its productive forces and the attraction of direct foreign investment (i.e. political stability, legal security, democratic institutions, good governance, functioning price mechanisms and competition, macroeconomic stability, a stable and clear institutional framework, realistic exchange rates as well as normal functioning of the markets for goods, labour and capital). Unfortunately, the former socialist countries of the Balkans have been slow to create the above conditions.

Finally, the Balkan countries have failed to promote cooperation amongst themselves on a political and economic level. Most of them have pursued integration into West European structures, while at the same time downgrading the importance of creating new Balkan regional cooperation to encourage development through the safeguards of regional stability and peace.

#### **The "Wake-up Call Effect" of the Kosovo War**

The crisis in Kosovo exposed the weaknesses of the European cooperation and integration policies of the 1990s, while also exposing the particularities of the area, which had existed even before the NATO military intervention in FRY. The direct and indirect costs to the Balkan countries of this crisis, as well as the involvement of the EU and its member states in the war, has highlighted, apart from the above, the

<sup>9</sup> World Bank: *The Road to Stability and Prosperity in South Eastern Europe: A Regional Strategy Paper*, Washington, D.C., 2000, pp. 51-72.

<sup>10</sup> V. Gligorov, M. Kaldor, L. Tsoukalis: *Balkan Reconstruction and European Integration*, The Hellenic Observatory, The European Institute, LSE, The Centre for the Study of Global Governance, LSE and The Vienna Institute for International Economic Studies 1999.



importance of the area for European stability, security and prosperity.

By the beginning of the Kosovo crisis, the Balkans had become the main topic of discussion in the EU, in international organisations and in other institutions of multilateral or plurilateral economic cooperation.

Both the Special Council on General Affairs on 8<sup>th</sup> April 1999 and the Council on General Affairs on 26<sup>th</sup> April 1999 emphasised the necessity for a comprehensive EU intervention in the region after the end of the crisis. This new intervention would be in the form of a Stability Pact.

### **The Stability Pact for South Eastern Europe**

During its EU Presidency, Germany submitted its suggestions (on 9<sup>th</sup> April 1999) for a Stability Pact in South Eastern Europe.<sup>11</sup> The German plan acknowledged the importance of stability in South Eastern Europe for the stability and security of all Europe. It also defined as its goals: the avoidance of violent conflicts in this area in the future, the creation of proper conditions for democracy and a market economy, the establishment of regional cooperation and, finally, the accession of Balkan countries into Euro-Atlantic structures. The Stability Pact was adopted at the International Conference of Cologne (10<sup>th</sup> June 1999), in which all of the interested countries and organisations participated. The basic aim of this conference was to sign bilateral as well as multilateral contracts and intergovernmental agreements, and to ensure their consistent application, in order to overcome structural, political and economic deficiencies, and to reduce or eliminate the potential for conflict in this area.

The Stability Pact consists of eight sections.<sup>12</sup> The first section states that the participating countries and organisations are bound to cooperate closely to safeguard peace and stability, and to promote the development of South Eastern Europe.

The second section outlines the principles and rules of the Pact. The participating countries are bound to the principles and rules of the United Nations Charter, the Final Act of Helsinki, the Paris Charter, OSCE etc., and agree to respect human rights and the principles of good neighbouring. The Balkan countries participating in the Stability Pact agree to continue their democratic and economic reforms; to promote bilateral and regional cooperation among themselves, and to work towards their accession to the Euro-Atlantic structures.

The third section refers to the objectives of the Pact. The more particular aims of the Pact are directed to the avoidance of tensions and crises in the Balkans, the establishment of democratic systems, the creation of market economies and regional economic cooperation, the fighting of crime and corruption, the safe return of refugees etc.

The fourth section defines the mechanisms and the instruments of the Pact. In order to materialise the Pact's goals the participants agree to create a "South Eastern Europe Regional Table", which will supervise the course of implementation of the Pact and will be responsible for the promotion and attainment of its objectives. The Stability Pact provides for a coordinator who will chair the Regional Table. At the same time it establishes three specialised Working Tables: on democratisation and human rights; on economic reconstruction, development and cooperation; and on security issues. The members will be the participants in the Pact, as well as other interested parties who will serve as full members or observers.

The fifth section of the Pact defines the offices and terms of cooperation among the members. At this point the leading role of the EU is acknowledged, not only for the initiation of the Pact, but also for its implementation. This section also stresses the significance of the efforts and initiatives of the EU for the support of the countries of the region and for the development of contractual relations. More specifically, it gives testimony to the Community strategy for the development of a new type of relations among the countries of the Western Balkans. Through the Pact the EU is offering the countries of the area the prospect of accession on the basis of the Amsterdam Pact and the Copenhagen criteria.

The sixth section stresses the significance of regional cooperation for the stability of South Eastern Europe, as well as the useful role of initiatives such as the Organisation for the Black Sea Economic Cooperation (BSEC), the Central European Initiative, the Southeast Europe Cooperation Initiative (SECI), etc.

The seventh section of the Pact describes how international development assistance is rendered. The developed countries and the competent international organisations are bound to support the reconstruction, stabilisation and integration of the region and the Pact makes an appeal to the international com-

<sup>11</sup> Auswärtiges Amt: Ein Stabilitätspakt für Südeuropa, Bonn 1999, [http://www.auswaertiges-amt.de/6\\_archiv/inf-kos/hintergr/stabdtt.htm](http://www.auswaertiges-amt.de/6_archiv/inf-kos/hintergr/stabdtt.htm).

<sup>12</sup> For the full text of the Pact see: Stability Pact for South Eastern Europe, [www.seecon.org/KeyDocuments/KD1999062401.htm](http://www.seecon.org/KeyDocuments/KD1999062401.htm).

munity to participate in this effort. The EU and the World Bank are responsible for the coordination of activities and for the organisation of donor conferences.

Finally, the eighth section of the Pact defines the function, the working procedures and the role of the different Working Tables. The main aims of "Working Table II" are: the promotion of cooperation among the Balkan countries, as well as the cooperation between them and third countries, the promotion of free trade areas and the development of cross-border transportation, support for energy availability and conservation, assistance in the development of infrastructures and for the establishment of deregulation and of transparency, support for the private sector and for the sustainable rehabilitation of refugees, support for environmental issues and for participation in the coordination of international development assistance.

The Stability Pact is the first comprehensive regional approach by the international community for the Balkans and it is a product of EU initiatives. The Pact is a long-term programming framework for cooperation which aims at mobilising and coordinating existing agencies of the international community. In other words, the Pact is not a new international organisation with its own structures and mechanisms of implementation. The application of measures to help the Balkan countries is the responsibility of the participating countries and organisations. The Pact only offers a special forum for encouragement and energising, a dialogue framework and a channel for action. In addition, the Pact is an expression of the newly formed international concept for coherent and integrated global policies to support peace, freedom, stability, reconstruction and development in the Balkans.<sup>13</sup>

There is certainly a great distance between the Pact's ambitions and very broad goals and the limited and vague means which can be employed to achieve these goals and ambitions. The Pact does not refer to specific quantitative targets, does not contain concrete actions and projects and does not record long-term commitments for financial assistance. Furthermore, it does not define the circle of the aid recipient's national, regional and sector targets and allocations. Therefore, the Pact is not a unique approach, nor a coherent plan for the reconstruction of the area, but is rather a political programme of

hopes and desires, and a framework for potential and voluntary agreements and actions. It is up to the will of the participants to define its effectiveness through periodic special conferences.

About two years after its adoption, the Stability Pact had not managed to promote any significant portion of its ambitious plans. Notwithstanding certain agreements, such as the agreement among the countries of the area to move forward with certain internal reforms that would support local and foreign investments (Investment Compact Agreement), the initiative to fight corruption (Anti-Corruption Initiative), the agreement concerning the mass media (Media Charter) and the establishment of the Working Group on Trade Liberalisation and Facilitation, the results were rather limited. This delay could probably be attributed to the fact that the international community gave emphasis to the solution of more important problems in post-war Kosovo. An important step towards the implementation of the proclamations of the Pact was taken, however, at the Donors Conference in Brussels on the 29<sup>th</sup> and 30<sup>th</sup> of March 2000. Forty-seven countries and 36 international organisations participated in this conference.

Three reports concerning the strategic approach to the development of the Balkans were produced at the conference: one by the World Bank ("The Road to Stability and Prosperity in South-eastern Europe: A Regional Strategy Paper"), one by the EIB on work to be done on infrastructures ("Basic infrastructure Investments in South-eastern Europe; Regional Project Review"), and one by the EBRD on the development of the private sector ("International Financial Institutions Regional Private Sector Initiatives in South-eastern Europe"). The financing of three packages was agreed upon by all the participants: a Quick Start Package, whose application was scheduled to begin in the first year (by 31<sup>st</sup> March 2001), a Near Term Package, to last for 2-3 years after the first package is completed, and a Medium Term Package, for the period after that.

The projects of the Quick Start Package, with the cost amounting to € 1.7 billion, and with pledges by the donors for € 2.4 billion, will cover a number of activities from all three Working Tables of the Pact. In addition, the conference defined the programmes of the two other packages along with their financial requirements, even though there remains a great need for detailed analyses and estimates for the Medium Term Package. It should also be mentioned that the programmes of the Near Term Package, and even more those of the Medium Term Package, show important financial gaps.

<sup>13</sup> R. Biermann: The Stability Pact for South Eastern Europe – potential, problems and perspectives, Centre for European Integration Studies, Discussion Paper C 56, Bonn 1999.

### The Stabilisation and Association Process

Following a proposal made by the Commission (on 26<sup>th</sup> Mai 1999), the EU adopted a new regional approach for the countries of the Western Balkans, the so-called "Stabilisation and Association Process" (SAP). This approach aims at the protection of peace and stability, the fostering of economic development and the improvement of the conditions for the region's integration into European structures. In other words, it is a new attempt to transcend previous individual and fragmented approaches by applying decisions and statements of already existing EU proposals which are aimed at an overall regional approach (e.g. the Regional Approach of the General Affairs Council of 26<sup>th</sup> February 1996, Conclusions of European Council Meetings in Vienna, December 1998). This new strategy recognises that whatever differences these countries may have among themselves, they also have common and interrelated problems that require a global regional approach.

The SAP is considered by EU officials to be their most important contribution to the attainment of the aims of the Stability Pact. For the first time it offers to the five countries of the region the prospect of EU integration, based on a progressive approach adapted to the situation of each country. The basic instruments of the SAP are:

□ *The Stabilisation and Association Agreements (SAAs)*. They presuppose the fulfilment of well-defined political and economic terms (Application of Conditionality, Annex III, to the Council of General Affairs' Conclusions – Luxembourg, 29<sup>th</sup>-30<sup>th</sup> April 1997). Included in these terms is the obligation of the FRY, Croatia and Bosnia-Herzegovina to apply the agreements of Dayton and Paris and to contribute to the promotion of intra-regional cooperation. In order to be effective the SAAs must be tailored to the special situation of each partner country. Before the opening of negotiations there must be a report (feasibility study) prepared for each individual country concerning the fulfilment of political and economic terms. Finally, the signing of an SAA does not require that a country has previously signed a "first generation agreement" (i.e. a trade and/or economic cooperation agreement). These agreements are similar to "Europe Agreements", although greater emphasis is placed on the need for closer regional cooperation.

On 9<sup>th</sup> April 2001 the EU signed an SAA with the FYROM. This Agreement aims at the establishment of an association as well as of a free trade area between the two parties within a transitional period of a

maximum of ten years. It also includes provisions on enhanced regional cooperation, including the perspective of establishing free trade areas between the countries of the region. The political significance of the SAA is very high as it confers on the FYROM the status of potential candidate for EU membership. Negotiations on a similar agreement are under way with Croatia. Albania, Bosnia and Herzegovina and the FRY are also aiming at entering into negotiations on SAA.

□ *Trade Preferences and Financial Assistance*. Not signing an SAA, however, does not deprive the countries of the area of the ability to enjoy, albeit to a lesser extent, other benefits of the Community's preferential trade treatment through, for example, Autonomous Trade Preferences. As part of the SAP the Council of Ministers adopted the Council Regulation 2007/2000, then amended by Council Regulation 2563/2000, to improve the existing autonomous trade preferences, and providing autonomous trade liberalisation for more than 90% of all their exports to the EU. In the context of the SAP the EU shall provide financial assistance to all countries of the Western Balkans. According to Council Regulation (EC) 2666/2000, the financial reference for the implementation of this programme for the period 2000 to 2006 shall be € 4,650 million. The SAP also offers political cooperation and dialogue, even when the necessary political and economic prerequisites are not fully complied with. In order to offer more incentives for political and economic reforms in the Western Balkans, the European Council, meeting in Feira on 19<sup>th</sup> and 20<sup>th</sup> June 2000, recognised the countries concerned by the SAP as potential candidates for EU membership.

### Conclusions

Special treatment by the EU of the whole region of the Western Balkans, the most fragile area in all Europe, after a period of ten years may be considered a positive development. The prospect of association first and accession later serves as an incentive for these countries to introduce faster reforms such as democratisation, rule of law, respect for human rights and ethnic minorities, a market economy, as well as the development of intra-regional cooperation. The custom shaping of the SAAs will allow the intervention means to be adjusted to the different internal conditions and needs, without creating discrimination and fragmentation. The prospect for integration into the structures of the EU is now open to all the countries of the region. The fulfilment of political and economic terms, and the fostering of cooperation between the

EU and any one country, is expected to cause demonstration effects and to influence positively the efforts of other countries in the region. The possibility of developing somewhat closer relations with the EU, without the full materialisation of conditionality, may enable the Balkan countries to enter more quickly into stabilisation and association agreements.

Most of the countries of the Western Balkans do not yet fulfil all the political and economic criteria for the signing of an SAA with the EU. Considering the fact that the negotiation and ratification of such agreements by the national parliaments of the EU member countries is a particularly time-consuming process (taking up to 3 years), the EU could open negotiations with Albania, FRY and Bosnia-Herzegovina as early as possible and offer full trade liberalisation for Balkan exports of industrial and processed agricultural products, and a further substantial increase in the quotas for unprocessed agricultural goods. The low percentage of EU imports from the Balkan transition countries (less than 1% of the total Community imports) means that there will not be any strongly felt consequences for EU producers.<sup>14</sup>

Economic integration within the Balkans is at a very low level. For example, intra-regional trade is on average small, at 12-14% of the total.<sup>15</sup> On a bilateral level there have been several specific attempts at trade integration, such as the agreement for the creation of a Free Trade Area (FTA) between Croatia and Slovenia, Croatia and FYROM, Slovenia and FYROM, FYROM and Bulgaria, and FYROM and FRY. Romania and Bulgaria are also members of CEFTA. Further FTAs are under negotiation in the region on a bilateral basis.<sup>16</sup> This, combined with the different rate at which trade relations have been established with the EU, has resulted in multiple trade regimes. In a region as small as the Balkans this causes uncertainty and reduced transparency. It also causes discriminatory treatment for non-participating countries. This further fragments the Balkans and keeps them from taking full advantage of regional economic integration. Meanwhile, the Balkan markets are small. They have low per capita incomes and great similarities in their structures of production. They lack cross-border trade infrastructures and experience continuing political

frictions. Thus, the economic advantages of intra-regional economic integration in the Balkans would not replace the benefits of integration with the EU. Nonetheless, a more intensive regional economic integration could have a positive impact on political stabilisation and cooperation.<sup>17</sup>

The importance of regional economic integration is recognised in the Stability Pact. Furthermore, the European Commission considers the establishment of a regional free trade area and closer regional economic cooperation as prerequisites for integration into the EU and as a condition for the signing of SAAs. Such a regional integration policy could take the form of a Free Trade Area (Southeast Europe Free Trade Area, SEFTA). A SEFTA would not only promote the static and dynamic advantages of regional integration and attract foreign investments; it would also be an important step towards political dialogue and political cooperation in the region.

Even more, within the SEFTA framework, or even irrespective of it, a Balkan Monetary System with fixed exchange rates could be established. This would avoid competitive devaluations and would liberalise long-term capital movements. The Balkan countries could either bind their currency exchange rates to the euro through a currency board (see the latest successful case of Bulgaria and the very drastic reduction of inflation in that country),<sup>18</sup> or they could agree to institute other exchange rate systems (e.g. "crawling peg" or "managed floating").<sup>19</sup>

At the same time, all the Balkan countries should become members of the WTO, the Bretton Woods Agreement and the OECD. They should seek access to the WTO as developing countries, in order to enjoy the special status and the privileges granted its less developed member countries.<sup>20</sup> The other, non-EU participants in the Stability Pact could in turn offer the Balkan countries autonomous tariff preferences. As mentioned above, the financial assistance given in the

<sup>17</sup> V. Gligorov, M. Kaldor, L. Tsoukalis, *op. cit.*; World Bank, *op. cit.*; M. Dauderstädt: Neuordnung und Wiederaufbau in Südosteuropa, Friedrich Ebert Stiftung, Politikinformation Osteuropa 81, Bonn 1999.

<sup>18</sup> D. Gros and M. Emerson: A System for Post-War South East Europe, CEPS Working Document No. 131, Brussels 1999; B. Steil, S. L. Woodward: A European "New Deal" for the Balkans, in: *Foreign Affairs*, Vol. 78, 1999, pp. 95-105.

<sup>19</sup> L. T. Orlowski: Economic Conditions of Accession of the East European Transforming Economies to the European Union: A Policy Proposal, in I. Zloch-Christy (ed.): *Eastern Europe and the World Economy*, Cheltenham and Northampton 1998, Edward Elgar, pp. 123-151.

<sup>20</sup> R. J. Langhammer, M. Luecke: *WTO Accession Issues*, Kiel Working Paper No. 905, Kiel Institute of World Economics, Kiel 1999.

<sup>14</sup> D. Gros: *An Economic System for Post-War South Europe*, companion paper to the CEPS Working Document No. 131, CEPS, Brussels 1999.

<sup>15</sup> World Bank, *op. cit.*

<sup>16</sup> For an extensive presentation see J.-C. Maur, P.A. Messerlin: *Which Free Trade Agreement in South Eastern Europe?*, Note on the Trade Policy Forum of the Stability Pact for South Eastern Europe, Geneva, 17-18 January 2000.

1990s was insufficient to deal with the magnitude of the economic problems, especially under the political conditions existing in the area. The same was true for the decision of the Brussels Funding Conference. The breaking of the vicious circle of underdevelopment and political instability in the Balkans would presuppose an integrated approach, as well as a generous and cohesive plan for financial assistance.

For all the above reasons, financial assistance to the Balkan transition countries within the framework of a "small Marshall Plan" must be proportionately more substantial than the assistance allocated to the destroyed countries of Western Europe during the period 1948-52 under the US Marshall Plan.<sup>21</sup> As in the case of the American Marshall Plan, it would be preferable to offer a substantial amount of assistance in a comparatively short period of time in order to give a positive shock to the economy and thus quickly create the proper conditions for development. Financial assistance offered in small amounts for a prolonged period of time merely acts as a pain reliever.

The Balkan countries need funding mainly for investments in infrastructure, for investments in the three sectors of production, as well as for the modernisation of the state and the public administration. Assistance allocated to the Balkan countries during the 1990s was rather limited. This was particularly true for those countries neighbouring Kosovo, which also are the poorest. Assistance allocated in 1999, for example, was aimed more at the easing of the consequences of the Kosovo crisis and less at the assistance for a strategic plan for reconstruction and development. In order to increase national savings, this assistance should to some degree emphasise co-funding. Let us not forget that American assistance under the Marshall Plan was not totally free. The Community's experience with the planning and implementation of its Structural Funds could be used as an example.

Apart from this, these countries suffer from the pressing problems that the accumulated foreign debt creates. These debts should be politically restructured within the framework of the Club of Paris (for the public debt), the Club of London (for the banking debt), as well as within the framework of international banks and financial organisations. Otherwise, the net capital inflow will be very low.

Additional European funds for reconstruction and development of the Balkans could derive from the restructuring of funds from the Phare programme and the two new structural actions for accession candi-

dates (€ 22.400 million for the 2002-2006 period). In addition, if the five central European countries were ultimately to become members of the EU after 2002, then the total framework of financial assistance for non-EU members of the CEE countries (the "outs") would increase substantially, given that the additional cost of the new enlargement has already been guaranteed. Should the EU allocate funds from the Phare programme and both of its new structural initiatives on the basis of the level of development of each CEE country, as well as on the basis of the degree of difficulty of the transformation process, combined with the fact that the assistance would be allocated over seven years (2000-2006), then the total amount of assistance for the Balkans would reach essentially more than € 10 billion. In any case, further assistance of at least \$ 10 billion by other G 24 or other third-party countries, as well as loans from the EIB, the World Bank Group, the EBRD and the IMF, would have to be added to Community assistance to cover the needs of the region.

In order to avoid overlapping coverage, contradictory targets, or discriminatory treatment, funding of the reconstruction and development of the Balkan countries should be implemented on the basis of an overall strategic plan for the region, as well as one for each country separately. Otherwise, as the experience since 1996 in Bosnia-Herzegovina as well as that gained from the time following the war in Kosovo has shown, any financial assistance given will be characterised by a lack of coordination, by fragmentation, by overlapping, by connections (of bilateral assistance to national export goals), by a misallocation of resources, and by attempts to cure the symptoms. On the other hand, even the most generous financial assistance policy will be highly ineffective if the recipient countries lack the requisite political stability, good governance, macroeconomic stability, economic freedom and a well-functioning market system. For this reason, emphasis should be placed on the creation of appropriate new institutions and on administrative reforms in the Balkan countries. Furthermore, Balkan enterprises should be preferred over the enterprises of donor countries where public procurements and contracts associated with the implementation of assistance projects are concerned. In addition, the phenomenon of "rent-seeking", i.e. giving up productive activities and pursuing access to foreign aid funds, should be discouraged.

<sup>21</sup> W. P. Kostrzewa, P. Nunnenkamp, H. Schmieding: A Marshall Plan for Middle and Eastern Europe, in: *The World Economy*, Vol. 13, 1990, pp. 27-49.