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Regional Cooperation and European Integration – The Case of the Western Balkan

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1. Current situation and starting conditions

As a result of the systemic change in Central and Eastern Europe in 1989-1991, previously established and partly also historically rooted trade patterns were destroyed in a spectacular way with extremely high economic and social costs. While the Central European countries, today in the first wave of EU candidates, could not only change both the geographic direction and the commodity pattern of their trade within a surprisingly short period, this process experienced much more problems in the case of the similarly EU candidate South Eastern European countries, let alone the successor states of the ex-Soviet Union. Moreover, this change has been considered by the first group as a return to normality, i.e. to traditional economic and trade linkages, In turn, the ex-Soviet states perceived the change as a destruction of traditional links. In this context, ex-Yugoslavia is a special case, since, before the transformation started, it was one of the most Western-oriented countries of the region, and the only one with a functioning trade and cooperation agreement with the European Communities. Following the Western Balkan crisis, not only these relations started to decline dramatically, but also the previously existing internal market was disrupted, as new nation-states started to emerge.

In the globalizing world, traditional trade theories reveal more and more shortcomings in explaining volume, geographical flow and pattern of international trade. The most important underlying reason is that foreign trade is increasingly conducted by big transnational (and, to a growing extent, also medium-sized and smaller) companies and not by traditional nation-states. Historically established nation-states are witnessing their declining ability to and shrinking competence in managing trade relations. Ex-Yugoslavia, however, differs because new nation-states have been emerging in the last years, and became partly the cause, partly the consequence of the Balkan war. To what extent are new, weak, and mostly not yet fully established nation-states able to generate regional (and international) trade in a period in which even economically strong nation-states have to give up a growing part of their "autonomous" trade policy (partly by transferring it to a larger regional entity as the European Union, partly by giving way to the rapid increase of influence of transnational firms).

There is no doubt that trade is an important instrument of political stability, economic development, social and cultural interaction, provided that the basic elements to fulfil this function are given. Unfortunately, the Western Balkan[1] is rather poorly equipped with these preconditions.

First, non-economic factors represent a serious barrier to trade development. The painful consequences of war do not only negatively influence political relations but, more importantly and lastingly, they have social and psychological impacts. Therefore, the otherwise valid and wise argument that most of these countries (excepting Albania) have formed a unitarian (homogeneous) economic space over decades[2] and, as a result, should have a (regional) trade-creating capacity, can easily be challenged by the fresh and negative experience of wars and

[1] Here and all over this paper, Western Balkan includes all former ex-Yugoslav republics excepting Slovenia, as well as Albania.

[2] In fact, ex-Yugoslavia was a political, monetary and economic union, on a qualitatively different level of integration than the EU is today and even the most arduous supporters of European political union imagine and foresee the development of European integration for the next decades.

mutual hostility (including ethnic cleansing). In addition, widely applied visa regimes and other, politically motivated barriers, partly being an organic feature of "classic" nation-state behaviour work against the creation of appropriate framework conditions for regional trade.

Second, economic conditions do not favour the rapid development of regional trade either. Without taking into account the impact of different trade policy measures, it has to be pointed out that trade flows have two basic and intrinsic preconditions. First, there has to be a sufficient volume of production of goods (and/or services), based on a given volume of productive capacity. This, however, has been destroyed to a large extent during the last decade, and its reconstruction takes time. More importantly, it requires confidence in the legal and institutional system, predictability of economic development and political stability, since investment activities do not depend just on the availability of financial resources (the latter can be used in a more profitable way in many other areas, if return on investment is, mildly speaking, uncertain). The currently high level of investment (capital) risk is a serious bottleneck of genuine and sustainable economic development, both concerning local capital and potential international investors. Second, (current and prospective) trade volumes are positively correlated with the size of the market. This, however, has been shrinking in the last years due to a number of factors. The political disintegration of the region resulted in the creation of small (economically most likely unviable) markets protected by newly established trade barriers. Moreover, the solvent purchasing power of these markets has been declining rapidly as a result of falling income, rapidly deteriorating living standards, record-levels of unemployment. Although part of the decline could be compensated for by unofficial and unregistered trade flows (smuggling, corruption, etc.), they can hardly contribute to the strengthening of a basis for sustainable and undistorted regional trade. Finally, import liberalization, evidently an important instrument to foster growth and create competitive production structures, could be better used by Western European companies than by war-ridden local firms. As a consequence, the anyhow small domestic markets have been further narrowed from the point of view of local producers and suppliers.

Third, neither international activities were supportive to recreate the two basic preconditions for regional trade relations. On the one hand, financial flows were directed to damage limitation[3] instead of being concentrated on development-related activities. On the other hand, the individual new nation-states were differently treated by the European Union (and the member countries). This attitude resulted in different bilateral trade policies and contributed to an extremely sharp but mostly unsuccessful (or even destructive) competition for foreign resources among the countries of the region. While each national economy was fully aware of the vital importance of attracting foreign investments, capital was, for obvious reasons, not ready to invest in tiny domestic markets (leaving other factors, already mentioned above, out of consideration).

As a result, several unfavourable developments started with longer-term impacts on the economic and structural pattern of growth, in general, and on the future of regional (and international) trade of the Western Balkan states, in particular.

[3] Immediately after the war(s), this approach could hardly been replaced by a longer-term strategy based on the reconstruction of destroyed capacities. However, this approach should have included, from the very beginning, this strategic element and, not less importantly, should have been changed following a very short initial period of damage limitation.

First: huge discrepancies were produced between export capacity and import needs. According to World Bank figures, total exports of the five countries (Albania, Bosnia and Herzegowina, Croatia, Macedonia and Yugoslavia) stagnated between 1992 and 2000, amounting to US$ 8.6 and 8.8 bn in the respective years. After a rapid decline in the first phase of these period, 1992 levels were almost reestablished by 1996, but no further meaningful dynamism of exports can be observed. In turn, imports grew by 60 per cent between 1992 and 1996, and remained on this level in the second half of the nineties (US$ 10.0 bn and 17.0 bn in 1992 and 2000, respectively). Thus, the trade deficit widened rapidly in the first half of the nineties and became "frozen" on a persistently high level afterwards. While the deficit of merchandise trade amounted to US$ 1.4 bn in 1992 (imports covered by exports reached in this year 86 per cent), it jumped to US$ 8.4 bn by 1996 (coverage indicator falling to less than 50 per cent), and remained practically on this level each year between 1996 and 2000. (For statistical figures see Table 1 attached to this paper.) Deficits were covered by international financial transfers, excepting Croatia, which could pay the import bill - partially -from its revenues from services (mainly tourism).

Second: temporary trade deficits are common features in rapidly catching-up economies (mainly financed by service revenues, inflow of foreign direct investment or provisional external indebtedness). However, the Western Balkan trade development does not fit into this pattern. Due to the lack of growing domestic production and the mainly consumptive use of foreign resources, a multiple dependence on foreign (mainly EU) sources is emerging. It includes (a) financial dependence, since trade deficits can only be financed by external sources and not by increasing exports; (b) consumption pattern dependence, since most products available on the domestic market are imported goods and not locally produced commodities;[4] (c) growth and employment dependence, for both are highly and positively correlated with international transfers;[5] and finally, and perhaps most importantly, (d) the emergence of subsidy mentality, not unknown from the EU practice of structural funds either, which postulates that survival on a sufficient standard of living is possible without own efforts. This, however, could become the most important medium-term barrier to any healthy development of a country or a region, since mentality and social behaviour do not necessarily (closely) follow economic policy changes.

In sum, we can draw two basic conclusions.

First: regional security/stability and economic modernization are interdependent. One side of this correlation is well known, namely that without regional security no sustainable economic modernization can be achieved. The other side is not less important either: without a successful and longer-term economic modernization already achieved (or artificially kept)

[4] Taking on consumption patterns of more developed countries by the population of less developed countries can be interpreted differently. On the one hand, it can help the catching-up process by giving stimulus to higher quality production of domestic companies. On the other hand, however, particularly in case of lacking domestic production, it easily creates a demand pattern, which can hardly be financed for a longer period (excepting sustainable flow of international transfers).

[5] A large part of the GDP in some countries of the region is fundamentally dependent on the sustainability of foreign transfers. Would they be stopped or interrupted, GDP would sharply fall and already very high unemployment would be further increasing with unknown social and political consequences.

stability can hardly be "internalized". In the case of the Western Balkan, the first task has been more or less fulfilled, while the second is still a promise for the future.

Second: both the stability/security and the economic modernization anchors are located outside the region. Concerning economic modernization it means that both fundamental preconditions for sustainable growth (and regional trade), namely market size and the necessary volume of capital to restart or restructure production activities in the region, cannot be established by using the regional resources, even in case of the best economic and trade policies. In consequence, state and prospects of regional trade are strongly dependent on the behaviour of external actors. Evidently, it does not mean that regional efforts should be abandoned or everybody should wait until external actors arrive. But policy-makers, both in the region and in the EU, have to be aware of the qualitatively different impact and the right sequencing of both approaches.

2. Some Lessons of cooperation in the framework of CEFTA

From an economic point of view, CEFTA represents a much larger economic weight than the Western Balkan region. In addition, it did not experience war and only some member countries were hit by the disintegration of previous domestic markets (the velvet separation between the Czech Republic and Slovakia and the case of Slovenia). Still, from the very beginning it was clear for economic policy-makers of CEFTA that the success of their economic transformation and catching up crucially depends on relations with the European Union, which was considered to be their modernization anchor. After the collapse of the CMEA in general, and the Soviet market in particular, regional trade fell dramatically. However, at the same moment, a spectacular reorientation towards Western European markets started. It was not based on a transparent economic strategy but on some fundamental economic and also non-economic factors. First, some CEFTA countries were quite well prepared for this geographic shift, both on the governmental level and on the level of companies. Second, on political and psychological level, trade reorientation was a clear expression of the "return to Europe". Third, key economic policy decisions, as the pattern of privatization and the opening up to foreign direct investments have largely supported this process.[6] Fourth, trade liberalization negotiated in the Association (Europe) Agreements has contributed to increase and strengthen trade links with the EU. At present, 60 to 75 per cent of the CEFTA countries' total exports are directed to EU markets. Regional trade, after experiencing a sharp decline in the early nineties, could partly recover and accounts for about 8 per cent of total trade (excepting trade between the Czech Republic and Slovakia which is still much higher, but with a decreasing share in total trade of the two countries).

Some of the basic lessons of CEFTA cooperation may be instrumental to better understand the scope of and the limits to regional cooperation among the Western Balkan countries.

First: traditional trade policy approaches, widely recommended by experts in international economic organizations at the beginning of the nineties, (fortunately) have not been followed by policy-makers of the CEFTA countries.
On the one hand, the "gravity theory" based on more intensified trade relations between/among neighbouring countries had a rather limited validity for CEFTA. There was a clear "gravity

[6] Different attitudes to privatization and foreign capital did not affected the geographic shift of trade relations but the structural pattern of trade with the EU as well as the sustainability of a dynamic growth of trade contacts.

inclination" towards the Western neighbouring countries, all of them EU members (with the leading role of the German market, but also Austria and Italy). In contrast, the Central and Eastern European neighbours, once within the same integration framework, could not become key partners to each other. Partly because they had similar production patterns (everybody was specialized on the Soviet market) and similar import demand which lacked regional supply sources (energy, raw materials). Partly because each country was hardly hit by the so-called transformation recession which resulted in overcapacities and declining domestic demand accompanied by rapid trade liberalization,[7] which, similar to the Western Balkan, left over only part of the shrinking domestic market to local and regional producers. Finally, partly because everybody was competing for foreign capital which was expected to create or provide access to new markets in Western Europe or, in a more domestic-market-oriented approach of privatization, foreign capital could finance the heavy costs of restructuring. None of these options considered regional co-operation as a viable alternative (in most cases, for the short run, not even as an additional factor).

On the other hand, the application of the "training ground theory" was clearly rejected not only by policy-makers but by the emerging political and economic realities as well. Many Western experts suggested the revival of a small "Eastern integration", excluding the ex-Soviet Union, but by maintaining previous regional contacts. The arguments were based on traditional co-operation, on limiting the costs of restructuring, on partly replacing Soviet markets by regional ones. However, the main ideas behind this line of thought were two others. First, the (mis)perception that Central and Eastern European countries will not be able to successfully reorient their exports towards Western Europe, let alone to change the production structure efficiently in a short period. Second, the never openly told fear that new competitors may emerge on the Western European markets. Therefore, first a regional co-operation framework should have been established in order to prepare the participating countries for competition on broader and more demanding European and global markets. Instead, Central and partly Eastern European CEFTA members followed a different sequencing.[8] They rightly considered integration into the Western European structures as their priority and expected more intensive regional trade as a consequence of successful EU integration.

Second: for small, open and catching-up economies, the main incentive to successful modernization has to originate in deepening economic links with one or more major global players. For geographic, historical, economic and socio-cultural reasons, this player for Central and Eastern Europe can only be the European Union (modernization anchor outside the CEFTA area).

Third: the example of Spain and Portugal clearly shows the right sequencing between European integration and regional co-operation. At the threshold of EU membership,

[7] Economic history registers very few cases when a fundamental trade liberalization occurs during serious domestic recession. Nevertheless, one has to state that trade liberalization was a necessary precondition of successful transformation. One can, of course, discuss the social and economic costs of this option. However, it is only reasonable if the costs of non-liberalization were quantified as well.

[8] In the international trade practice, the Latin American way of gaining competitiveness through conquering regional markets cannot be considered as a success. In turn, East Asia's way of starting the export offensive on the most demanding US market (supported by unilateral trade policy incentives of the US) proved to be not only successful but an important tool of intensified regional cooperation, in the second stage of development.

economic links between Spain and Portugal were minimal, and a fraction of current levels of regional co-operation among CEFTA countries. However, as a result of EU membership, bilateral economic co-operation started to grow very dynamically and has become in a decade an important element of economic growth, bilateral trade and investment flows. The same can be expected after EU membership of the CEFTA countries. In other words: regional co-operation must not be considered as a precondition for EU accession but as a dynamic element of growth following accession. Although, it will not be able to replace the major trading partners in Western Europe even after accession, but the share of regional trade may be increasing from the present level of 8 per cent to 10 to 14 per cent within a few years.

Fourth: despite the economic limits, regional co-operation is certainly supporting the candidate countries' assessment in EU decision-making circles.
A certain level of (smooth) regional co-operation is a proof of "normal behaviour" and of "political culture" of the new members in a wider community. In addition, a larger and barrier-free economic area is encouraging investors, both local, regional and foreign ones, to consider the additional value of larger new markets.

Fifth: the modernization anchor role of the EU is obvious if we compare the commodity pattern of exports of the CEFTA countries to the EU and to the region. According to the traditional trade theory, less developed countries (in this case CEFTA countries) should have a structurally more "developed" trade (higher share of technology-intensive goods, higher value added) with each other, while trade with the more developed region (EU) should be characterized by exporting low-value added, labour-intensive goods in exchange of technology-intensive products. The reality, however, contradicts this assumption. All CEFTA countries have a technologically more developed pattern of exports to the EU than to the CEFTA. CEFTA trade is characterized by the predominance of agricultural goods, raw materials, semi-finished manufactured products (chemicals, steel, fertilizers), and a rather low share of machinery and final consumer goods. This biassed trade pattern may, however, change after accession and as a result of the investment and production activities of transnational companies in an enlarged European integration.

Sixth: although, on the paper, the liberalization scheme of CEFTA trade closely followed that of trade liberalization stipulated by the Association Agreements, it was by far not as smooth and quick as the latter. Just the opposite, bilateral trade among CEFTA countries is repeatedly burdened with protectionist measures on one side followed by retaliatory dispositions on the other side. The reasons are twofold. First, the structure of intra-CEFTA trade is more inclined to protectionism, since it contains a large amount of sensitive goods (food products, chemicals, steel), where national interests are believed to be hurt (either due to dumping price setting or to the reluctant adjustment of some sectors with substantive influence on the political decision-makers). Second, since all countries have similar economic power, and a low share in the total trade of the others, protectionist steps on the one side do not provoke a retaliatory capacity on the other side, which would seriously hurt the interests of a given country. In turn, no CEFTA country dares to introduce protectionist measures against the EU (although the EU generally has a much higher market share in the respective commodity than the CEFTA), because any counter-action by the EU would have much higher economic costs than the benefits expected from an eventual protectionist measure.

3. How to create autonomous development in the Western Balkan?

The geographic orientation of trade relations of the Western Balkan countries largely follows the CEFTA pattern.[9] Both on the export and the import side, the EU is the leading partner. In exports, the EU's share ranks from 90 per cent (Albania) to 38 per cent (Yugoslavia). In imports, the shares fluctuate between 77 per cent (Albania) and 38 per cent (Macedonia). Surprisingly, CEFTA is a relatively important partner (more important than for most CEFTA countries themselves) in exports of Croatia (14 per cent) and Bosnia-Herzegovina (10 per cent) and in imports of Bosnia (25 per cent), Macedonia (19 per cent) and Croatia (15 per cent). Western Balkan regional trade is much more important in exports from Macedonia (33 per cent), Yugoslavia (29 per cent) and Croatia (15 per cent) to the region than in the imports of the respective countries (12, 11, and 2 per cent, respectively). Only for Bosnia regional imports have a higher share than regional exports (20 vs. 11 per cent). The figures suggest that companies of the region's countries mainly consider regional trade as an outlet for their production, which may be the only survival for otherwise uncompetitive companies. In turn, regional imports are not considered to contribute to economic modernization (in the case of Bosnia, imports mainly financed by international transfers essentially serve consumer demand covered by regional suppliers). (All figures are for 2000, see Table 2.)

In a time perspective, based on the period between 1994 and 2000, the share of regional exports is constantly increasing for three countries (Croatia, Macedonia, Yugoslavia), which may be interpreted in different ways. Most probably, it is the consequence of crowding-out of still not-reformed, outdated production from traditional Western European markets towards less-performing regional ones, than the result of rapid production increase looking for new market opportunities. However, some kind of a revival of regional (ex-Yugoslav domestic) trade is also likely. Similar results can be observed in the development of regional import shares as well (mainly Macedonia and Yugoslavia).

Regional trade development consists of two factors. First, the revival of traditional trading links, which, according to the figures, has at least partly materialized in the last years. It is more difficult to assess, to what extent these links have further potential for development or may become stumbling stones for successful economic transformation in the coming years. Second, any sustainable development of regional (and international) trade of the region anticipates three elements: a critical mass of current and predictable political stability, sufficient size of market and large volumes of investment capital.

The establishment of stable public governance, on which corporate governance can be based, is a crucial macro-policy instrument. It is probable that, contrary to the CEFTA practice, some kind of regional economic institution (i.e. a secretariat for regional co-operation) should be created. It could not only encourage regional co-operation in general, but influence participating governments to have a more positive attitude towards regional co-operation in those areas where additional potential is available or where market barriers have to be eliminated. In addition, non-governmental organizations, mainly in the business sector (chambers of commerce, sectoral federations, regional entities, etc.) could efficiently contribute to more co-operation not only by doing business, but also through initiating social

[9] However, it has to be taken into account that total exports of the Western Balkan countries is less than 30 per cent of Hungary's foreign trade alone, or not more than Slovenia's total exports.

dialogue and dispelling old prejudices and new concerns in some parts of the societies. In this context, further civil organizations can play a positive role.

Still, the question remains, who, which kind of companies could become the driving force of regional co-operation. In principle, three categories can be considered. Large and mostly still state-owned companies may look at the Western Balkan region as the only market, which ensures their survival (for a short time, perhaps, just without restructuring). It is an open question, to what extent restructuring or privatization of these state-owned companies will affect regional trade. Successful restructuring may result in the opening up of new, larger and more prospective markets outside the region (see the example of several companies in the CEFTA countries). On the contrary, privatization (either to domestic or to foreign companies) could keep the regional market-orientation, as a major asset of the company to be privatized. The second group of potential actors includes large foreign (transnational) companies. At the moment, however, there is little interest in the regional market, both because it is considered to be very small, and also because it can be supplied from regional headquarters of transnational firms established in the last years in some of the Central and Eastern European economies.[10] EU membership of the CEFTA countries could strengthen this tendency. Finally, some experts attach big hopes to emerging small- and medium-sized enterprises (SMEs) within the region. However, the renaissance of SMEs in many parts of the world has little to do with the pattern SMEs are expected to develop in the Western Balkan. The global trend of creating more and more SMEs is partly the result of the deliberate strategy of transnational companies to save costs and to decentralize part of the decision-making process. Partly, it is the outcome of lasting restructuring of traditional SMEs in order to reach regional or global competitiveness. SMEs of the Western Balkan states can hardly fulfil any of both criteria. Therefore, regionally working independent SMEs may become more the actors of economic nationalism and the blocking stone to economic modernization, if they cannot be integrated into the subsidiary network of transnational firms. Very few of them can take the way of becoming internationally competitive actors in the short- or medium-term, following an "independent" path. Therefore, external actors, both EU policies towards the region and strategic attitude of transnational companies seem to be the decisive driver (or non-driver) of regional trade in the foreseeable future.

Short mention has to be made of the rather different monetary and exchange rate policies of the Western Balkan countries. The crucial dilemma (contradiction) is between monetary stability and business competitiveness. While the Euro plays a crucial role in monetary stabilization, the (formal) lack of an autonomous exchange rate policy largely hinders structural transformation. Due to the different inflation rates between the EU and the Western Balkan countries, fixed exchange rates make imports cheaper and exports more expensive. As a result, domestic production can be increasingly replaced by (cheaper) imported goods. In addition, fixed exchange rate policies anticipate tight fiscal policies resulting in the non-availability of competitive credits to potential new ventures. Most likely, the countries of the region will be facing a real challenge in the near future and will have to make their choice between more and more costly superficial (artificially sustained) monetary stability and a more flexible exchange rate system, allowing a certain (controllable) level of inflation and an efficient restructuring process leading to higher degree of competitiveness.

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[10] Also privatization deals are frequently carried out by the subsidiaries of foreign companies located in Central Europe (see MATÁV's purchase of the Macedonian telephone company early 2001, which, in fact, is the expansion of Deutsche Telekom in the region).

4. The role of the European Union in increasing trade potential and strengthening regional trade relations

Since this topic is part of another set of papers, here only some short remarks will be made.

The EU institutionalized the Stabilization and Association Process in May 1999[11] in order to maintain stable democratic institutions and help the Western Balkan countries to repeat the successful transformation other Central and Eastern European countries could register in the nineties. This is a precondition to start negotiations on accession. The process is both bilateral and regional. While it creates bilateral links to the EU, it encourages the Western Balkan countries to enter regional co-operation schemes among themselves. In the last three years, EU support can be classified in three groups: (a) contractual links, including Stabilization and Association Agreements (SAA) signed with Macedonia and Croatia, and in preparation with the other countries of the region; (b) trade preferences leading, in an asymmetric (asynchronical) process, to bilateral free trade (part of the SAA); and (c) financial assistance (since 1991 more than Euro 6 bn).

The effectiveness of the EU's efforts has, however been impaired in the last years by two main factors. First, there are other powers and international institutions acting in the region as well (United States, World Bank, etc.).[12] Their relations with the EU are characterized by co-operation and competition simultaneously. The Stability Pact, the security anchor in the region is a NATO-based (US-based) activity. During the last period, it became clear that the NATO has to get accustomed to the idea that its troops will have to remain for a longer period in the region. In addition, there is no solution in sight concerning the status of Kosovo. Not less importantly, organized crime and corruption are the main sources of "open insecurity". Both NATO and EU seem to have been captured (taken hostage) of the Western Balkan situation, where damage limitation and superficial stabilization absorb high amounts of financial resources without finding the way for a lasting solution. Second, Brussels's different approach to the individual Western Balkan countries, which may be logical taking into account the rather different level of political democratization, degree of stability and economic development of the individual countries, time by time creates new dividing lines within the region. This temporary (temporary-thought) division (or country-specific, gradual approach) can be interpreted as an incentive to those who still have to meet some criteria, but also in the opposite way, that the countries of the region may have different position in a longer-term EU strategy.

For our paper, it is more important to focus on the potential EU strategy following the first wave of enlargement. The enlargement process has to be considered as the key EU (and all-European) strategy to keep and enhance the stability and security of Europe. In this context, the first, politically motivated and most probably big-bang-enlargement may generate three substantial challenges. Taking up to ten countries in one "basket" may affect the critical mass of the (enlarging) EU's internal cohesion, which is necessary to keep European stability. In

[11] For a detailed description and assessment see Commission of the European Communities. Report from the Commission. The Stabilization and Association process for South East Europe. First Annual Report. Brussels, April 4, 2002. COM(2002) 163 final

[12] Also wider regional cooperation frameworks, as the Black Sea Economic Cooperation (BSEC) or the South Eastern European Cooperation Process (SEECP) could be added. However, their impact is more limited concerning regional trade creation, and they will be dealt with in other paper(s).

addition, the joining of differently prepared countries and the fact that these differences will become manifest after (and not before) accession, may create strong feeling of "self-induced second-class membership" in the society of some new entrants. Unsuccessful (failed) enlargement would necessarily generate political opposition and counter-productive public opinion concerning the further enlargement of the EU, or just to keep the EU open for not-first-wave candidate countries. While the common external border of the enlarged EU would be recognized as a long-term frontier (nobody has the idea of including Russia, Belarus or even the Ukraine into the EU), the Southern and South-eastern borderlines will remain "soft" frontiers. As a result three border sections of Hungary (with Romania, Yugoslavia and Croatia) and one section of Slovenia (with Croatia) could become the new dividing line within the continent. If the perception in the Western Balkan plus Romania and Bulgaria gained ground that EU membership has been substantially delayed or even blocked, new factors of instability are likely to emerge. Therefore, the EU has to outline, communicate and carry out a clear strategy towards this region at the latest at the moment of announcing the date of accession and list of first-wave countries.

This strategy should include the following elements:

(a) clear road map for the Balkan countries, with at least two dates of possible enlargement (obviously, without identifying any current or future candidate country, which group it may belong to);

(b) keep the openness of the integration process not only in political declarations but also in concrete economic activities;

(c) provide additional financial support to the Balkan countries, partly by redirecting the pre-accession funds (the annually available amount of Euro 3 bn gives substantial manoeuvring room, if eight Central and Eastern European countries will stop to have access to these resources);

(d) gradually involve the Balkan countries into various EU (community) policy areas, both in order to show them that they are not "forgotten" or left aside, and, more importantly, because some of the EU policies cannot be successfully implemented without their co-operation (e.g. foreign and security policy, border control, asylum policy, fight against corruption, etc.);

(e) finally, and most importantly, to start an infrastructure development and environment protection strategy based on regional planning and considerations instead of narrow-minded national priorities. This approach shall become a key priority of rethinking and remodelling the EU budget (both in terms of money and the main objectives) from the very beginning of the new budget starting in 2007. In order to comply with this requirement, discussions and strategic planning have to start immediately. Large-scale infrastructural investments all over the region would have several beneficial impacts on regional stability. They would be the best message to be communicated to the society that all countries of the region are involved in a catching-up process. Possibilities for regional co-operation will be substantially enhanced, since one of the basic barriers to more intensive trade relations is the lack or low quality of physical infrastructure. Cross-border co-operation will also be supported by more homogeneous infrastructure network. The attraction and multiplier effect for business, both domestic and foreign, can hardly be overestimated.

5. Interest and policies of some neighbouring countries

While the "gravity theory" does not fully work in trade relations, it has some implications concerning the neighbouring countries of the (Western) Balkan. Evidently, these policies, efforts and considerations cannot be decoupled from the influence exercised by the main actors (NATO and United States, European Union and some leading member countries), since all of the neighbours are members of one or both external anchors (Austria is an EU country, Hungary and Turkey are members of the NATO, while Greece participates in both organizations). Still, for historical reasons, political or economic interests, as well as due to national minorities living in the (Western) Balkan countries, each country has some special connection and expectations.

Austria, once, as the Monarchy, a main actor in the Western Balkan area, has drawn some basic historical lessons and keeps itself on distance concerning political developments. Nevertheless, the historical heritage provides it with comparative advantage in knowing the region and its people. Obviously, the country's main priority is the European Union followed by the neighbouring Central European countries, all of them first-wave candidates to EU membership by 2004. Austrian interests in the Balkan region are focused on regional stability, based on multilateral co-operation. While the country has a clear strategy towards Central Europe (and Croatia), which is expressed in the preference to bilateral contacts, it seems to lack a coherent South Eastern European strategy (also for this reason, the multilateral framework, again excepting Croatia, seems to be acceptable). In the 1990s, particularly in the first years of the transformation, Austria could highly benefit from its special relations to Central Europe established still during the pre-transformation decades. Its trade with the neighbouring countries skyrocketed and key Austrian companies participated in the privatization process and in foreign direct investment flows to this region. In turn, trade with the (Western) Balkan countries remained limited (and fell partly victim of the war and its consequences). Also, very little Austrian investment flew to this geographic area. None of the Balkan countries appears within the leading 15 trading partners of Austria. Still, between 1995 and 2000, although started from a rather low level, Austria's exports to the Balkan countries (plus Slovenia) experienced an annual growth of almost 18 per cent, as compared with 15 per cent to Central Europe and 10 per cent to the EU. The same trend can be observed in imports (those originated in South Eastern Europe grew by 18 per cent, in Central Europe by 17.5 per cent and in the EU by 6.4 per cent only). Despite this dynamism, the region's total share in Austrian trade and investment flows remains in the range of 2 to 3 per cent.

Hungary, similar to Austria, has its main priorities in NATO and in the EU. Nevertheless, as a direct neighbour of more Balkan countries, it is highly interested in regional stability. Moreover, responsible Hungarian politics and politicians consider the country's stabilization role as a major input into the security structure of (an enlarging) Europe(an Union). Hungary's main motivations related to the (Western) Balkan region can be summarized in four points. First, the interest in developing economic relations has to be pointed out. It includes some trade expansion towards the region, maintenance of the traditional Hungarian trade surplus, incorporation of some companies into the (belated) privatization process in the Balkan countries and enhanced cross-border trade involving small and medium-sized companies on both sides of the border. Second, Hungarian economic strategy tries to create favourable conditions for transnational companies to use their Hungary-located companies as a regional headquarters (hub-and-spoke approach) for further trade and investment expansion towards South Eastern Europe. Third, both for political-security and economic reasons, Hungary is fundamentally interested in a clear EU enlargement strategy following the first wave of enlargement. It can be taken for sure that Hungary will become (remain) an essential supporter of the EU's further enlargement, provided, of course, that the new candidates will be ready for accession. Fourth and finally, Hungarian national minorities living in the neighbouring Balkan countries deserve special attention (mainly in Romania but also in Yugoslavia, and to a lesser extent in Croatia as well).

Greek Balkan politics experienced a relevant shift of priorities in the last decade, by moving from nationalism towards "Realpolitik". The traditional perception of the "threat from the North" was largely replaced by building a geographic and institutional bridge towards the EU (being Greece the only EU country without bordering any other EU member state). In other words, Greece became a regional stabilizing factor. In this context, bilateralism was to a large extent substituted by multilateral diplomacy. Trade relations started to boom after 1989, with clear Greek surpluses (in sharp contrast with a highly negative trade balance with the EU partners). Between 1989 and 1996 Greek exports to the Balkan countries quadrupled, and Greece provided one quarter of the EU's total export increment to the region. Also Greek investments started to orient themselves towards selected Balkan countries. According to early-2001 figures, altogether 5.000 Greek companies invested a total sum of Euro 2.5 bn in the region and lead the list of foreign investors both in Macedonia and in Bulgaria. Financial assistance was provided to various Balkan countries (US$ 318 mn, with preference to Macedonia and Albania). Last but not least, Greece has demonstrated high-level interest in improving the region's physical infrastructure, particularly after the elimination of the Danube as a major transport channel and with prospects to the 2004 Olympic Games to be held in Athens. The new regional approach to infrastructure planning and implementation would be clearly supported by Greece, because it would not only further improve its market access conditions in the Balkan area but provide better continental connection to the core EU member countries.

For Turkey, the Balkan represents the main bridge towards Europe. Despite various economic and financial crises, the Turkish economy reveals clear priority for regional co-operation. Turkish firms have heavily invested in Bulgaria (US$ 600 mn) and Romania (US$ 225 mn), but much less in the Western Balkan states.[13] Economic contacts are essentially supported by Turkish nationalities leaving in the region (in Bulgaria the Turkish national party is part of the present coalition). Moreover, Turkish influence can be felt in social, cultural and religious context as well, mainly in the Moslem-populated regions of the Western Balkan (Kosovo, Albania, part of Macedonia and Bosnia).

6. Future dilemmas and tasks

Trade development, both regional and European/global and increasing competitiveness depend on the behaviour of several actors. However, the EU's integration/enlargement policy following the first wave of accession seems to be the most crucial component. Long-term stability of the whole continent depends on the success of the first wave of enlargement and on the urgently needed post-enlargement EU strategy.

Most of the regional players are within the network established both by the NATO and the EU. Therefore, their interests and efforts will be coordinated within these frameworks. Nevertheless, the specific mixture of co-operation and competition between Greece and

[13] Only in Romania, there are working 15.000 Turkish businessmen. Romania became the leading regional trading partner by 2000.

Turkey in the Balkan region can influence the effectiveness of political stability and economic development.

The character and the sustainability of the development/modernization process will be affected by the mixture of the driving forces/main development actors (states, state-owned business interests, transnational capital, small- and medium-sized companies, impact of regional headquarters of multinational firms, etc.). This development has to be continuously monitored. It has to be noted that the character of trade and investment relations in the Balkans may differ from that of trade and investment contacts of Central European transforming countries. While the latter mainly host investors from leading OECD countries (Germany, France, United States, Japan, Netherlands, Austria, etc.), in the Balkan economies a much higher share of Greek and Turkish (partly Italian) capital can be registered. The fact that these investors used to be financially weaker, the invested capital may be smaller, the investment activities are generally focusing on retail trade, services and utilities (instead of internationally competitive manufacturing), may create some shortcomings in future global competitiveness, but can certainly be considered as an important contribution to economic development of the Balkan countries at the given moment.

In the final account, long-standing security and successful economic transformation and modernization (catching up) of the (Western) Balkan countries can only be achieved if the countries, and more importantly, the societies, of the region are able to create and implement an "innovative pattern" of development. This would certainly include a large number of imported inputs, which are to be efficiently absorbed and adjusted to the genuine values of the Balkan societies. Success is likely to have two preconditions. First, imported values, institutions and other elements must not be felt or let perceived by the given society as an "imposed" or "externally enforced" pattern. Second, top-down processes of following and implementing imported patterns (inputs) have to be constantly accompanied by bottom-up, grass-root processes representing genuine, historically determined values of the (Western) Balkan countries. The required innovation, which could be the guarantee of success, is the genuine integration of the two processes (sets of components).

Budapest, June 03, 2002

Attachment: Table 1 and Table 2

Table 1 Merchandise Trade in the Balkans (in million US $)					
Albania	**1992**	**1995**	**1996**	**1999**	**2000**
Exports	70	205	229	275	256
Imports	541	680	922	1,121	1,070
BiH	**1992**	**1995**	**1996**	**1999**	**2000**
Exports	339	58	336	649	732
Imports	350	523	1,882	2,502	2,327
Croatia	**1992**	**1995**	**1996**	**1999**	**2000**
Exports	4,597	4,633	4,545	4,394	4,567
Imports	4,500	7,892	8,169	7,693	7,805
FYROM	**1992**	**1995**	**1996**	**1999**	**2000**
Exports	1,199	1,204	1,147	1,191	1,319
Imports	1,206	1,719	1,627	1,776	2,085
Yugoslavia	**1992**	**1995**	**1996**	**1999**	**2000**
Exports	2,400	810	2,018	1,498	1,923
Imports	3,450	1,400	4,119	3,296	3,711
Total	**1992**	**1995**	**1996**	**1999**	**2000**
Exports	8,605	6,910	8,275	8,007	8,797
Imports	10,047	12,214	16,719	16,388	16,998

Source: Michalopoulos, C. (2001, The Western Balkans in World Trade.)

Table 2 Direction of Merchandise Trade 1992-2000
In Percent

EXPORTS

MARKETS	ALBANIA			B-H			CROATIA			FYROM			YUGOSLAVIA		
	1994	1996	2000	1994	1996	2000	1994	1996	2000	1992	1996	2000	1992	1996	2000
EU	77	86	90	39	44	65	59	51	55	40	43	44	32	38	38
OTHER DEVELOPED	13	2	4	14	7	3	3	4	6	15	10	17	n.a	n.a	n.a
CEFTA	2	1	1	14	10	10	17	18	14	19*	9	4	4	6	9
W. BALKANS	5	3	2	11	34	11	10	14	15	17	28	33	n.a	27	29
RUSSIA	0	0	1	17	0	3	3	3	1	n.a	3	1	n.a	5	8
DEVELOPING & OTHER	3	8	2	5	5	7	6	10	10	9	7	2	27**	19**	n.a

IMPORTS

SOURCE	ALBANIA			B-H			CROATIA			FYROM			YUGOSLAVIA		
	1994	1996	2000	1994	1996	2000	1994	1996	2000	1992	1996	2000	1992	1996	2000
EU	77	76	77	18	37	44	59	59	56	36	39	38	44	42	42
OTHER DEVELOPED	10	8	7	6	5	3	8	8	9	11	11	10	n.a	n.a	n.a
CEFTA	1	3	3	10	23	25	16	17	15	34	13	19	8	10	9
W.BALKANS	4	3	3	48	32	20	1	1	2	5	14	12	n.a	10	11
RUSSIA	0	0	1	16	1	2	3	3	9	n.a	8	9	n.a	5	9
DEVELOPING & OTHER	8	9	9	1	2	5	11	12	9	14	15	14	n.a	33**	19**

Totals may not add up to 100% because of rounding
*Includes Other Eastern Europe and former Soviet Union
**Includes Other Developed.
Source: Albania and Croatia, IMF(2001); Michalopoulos, C. (2001, The Western Balkans in World Trade.)

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