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Asymmetrical economic and institutional changes in the Western Balkans: Cooperation with the European Union

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Abstract

The Western Balkans have historically been a poor area of Europe. The total population of the Western Balkans is 24.7 million. Ethnic differences of long standing have led to conflicts and to political and economic instability. Poverty and instability have combined to produce a vicious circle of institutional backwardness. Recent conflicts in Croatia, Bosnia-Herzegovina and Kosovo have aggravated an already adverse economic situation. GDP in 1999 was substantially lower than that in 1989. The EU plans to enter into contractual relationships with all the Western Balkans in the form of Stabilization and Association Agreements (SAAs). The pacts are aimed at helping to establish economic and political stability, to implement institutional reforms, to practice regional free trade and cooperation and to privatize the economies of Western Balkans. These are also the presumed goals of the Western Balkans.

This study focuses on a review of the progress made by the Western Balkans toward meeting the above stated challenges. A main conclusion is that the attainment of these goals has been asymmetrical for economic, political and institutional reasons.

1. Introduction

The Western Balkans have historically been a poor area of Europe. The total population of the Western Balkans is 24.7 million. Ethnic differences of long standing have led to conflicts and to political and economic instability.

Poverty and instability have combined to produce a vicious circle of institutional backwardness. Recent conflicts in Croatia, Bosnia-Herzegovina and Kosovo have aggravated an already adverse economic situation. GDP in 1999 was substantially lower than that in 1989[1]. The Western Balkans, which with the exception of Albania resulted from the break up of the Federal Republic of Yugoslavia i.e., Bosnia-Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia (FYRoM) and Yugoslavia. The Western Balkans are designated by the European Union (EU) as subject to its regional policy. The premise of this policy is that these countries can not expect closer relations with the EU than they have among themselves. In other words, the regional policy represents a trade off between local conflicts and EU integration. The EU plans to enter into contractual relationships with all the Western Balkans in the form of Stabilization and Association Agreements (SAAs). The pacts are aimed at helping to establish economic and political stability, to implement institutional reforms, to practice regional free trade and cooperation and to privatize the economies of Western Balkans. These are also the presumed goals of the Western Balkans. The SAAS also offer financial assistance to the Western Balkans to help them attain these goals.

This study focuses on a review of the progress made by the Western Balkans toward meeting the above stated challenges. Following a general discussion of the challenges, brief country profiles examining some of the results of the changes made by the Western Balkans are presented. Finally an assessment of these changes in the form of a summary and conclusions is offered.

2. Overview of challenges

As mentioned previously the Western Balkans especially in the last several years have been uniquely affected by wars and conflict. Armed aggression in Croatia, a 43 month war in Bosnia-Herzegovina in the early 1990s and the war in Kosovo in 1999 have all generated political turmoil and economic devastation and instability. The almost one-half million Kosovo refugees to Albania imposed a most severe burden on Albania, one of the poorest countries of the Balkans. In the case of Bosnia-Herzegovina almost four years after the fighting ended, relative tranquility continues to depend on 32,000 NATO personnel.

Since the end of World War II the Western Balkans were governed by a command-driven system whereby all the sectors of their economies were nationalized. Following the collapse of the Berlin Wall they have begun a process of privatization. A transition to a market economy is often a pro-

[1] European Commission, European Economy, October 2001, page 2

tracted process. It requires among other things, the privatization of the state owned enterprises, establishment and protection of property rights, reforms in the banking systems and in the money and capital markets and a change in the people's attitude and ethic. It must be added that in the Western Balkans weak institutions, public and private, and the absence of the rule of law, contribute to high risks in conducting business and encourage corruption and black markets. These types of characteristics are counterproductive to efficiently functioning markets. Moreover, economies which move from command type of systems to markets may experience other costs such as inflation, unemployment and economic insecurity. The experiences of Russia, East Germany, Eastern Europe and Baltic countries underscore the complexity of the transition process (Kondonassis 1994; Brown 1993; Elliot 1993; Ostas 1992).

Given the ultimate interest of these countries to join the European Union (EU), it is instructive to note the findings of a Task Force Report of the East West Institute that the barriers to trade and investment both within the region and with the rest of Europe are substantial[2]. These barriers include high tariffs, cumbersome trade regulations and insufficient legal protection of investments. Trade barriers with the outside world are also significant especially with the EU, which is a major outlet of the region's products. The wars in Croatia, Bosnia and Herzegovina and Kosovo and the sanctions imposed on Yugoslavia have exacerbated the negatives on regional integration. Nevertheless, liberalization of trade within the Western Balkans and with the rest of Europe is an important condition for regional cooperation and for an expansion of the size of the market of the individual Western Balkans.

The EU in 1997 initially developed its regional approach which outlined potential political and economic relations with the region. These relations were further clarified by the development in 1999 of an overall cooperative arrangement with the countries of the region, the Stabilization and Association Process. This process includes preferential trade concessions and an assistance program tailor-made to take under account each country's asymmetries and to allow them to progress at their own pace and with appropriate reforms aimed toward eventual EU accession. These agreements took the form of the Stabilization and Association Agreements (SAAs). In 2000, the EU granted duty free access to most Western Balkans' exports. A gradual lowering of tariffs by the Western Balkans and an eventual free trade area between the EU and each country of the region is visualized.

The EU has been a large donor in the period of 1991-2001. The EU budget has provided €6 billion to the Western Balkans. In addition, individual EU member state's contributions have brought the total aid for the period

[2] East West Institute, Task Force on Economic Strategy for South Eastern Europe

to more that €10 billion[3]. The Dayton Peace Agreement in 1995 and the aid it provided has also supported the reconstruction effort of BiH.

EU's economic assistance to the Western Balkans has evolved to the development of the CARDS Regulation (Community Assistance for Reconstruction, Development and Stabilization). CARDS aid is provided primarily in the form of grants and is aimed at institutional changes, public administration reforms and investments including infrastructure investments. It is guided by strategy papers formulated by the countries of the region. The amount specified for 2000-2006 is €4.65 billion[4]. Some of the CARDS assistance covers macro-financial assistance which is made conditionally on the implementation of economic reforms. In addition, the EU provides non-conditional humanitarian assistance. International Financial Institutions, e.g., World Bank, IMF and EU member countries, are also involved in extending financial assistance to the region.

To provide some specific information on the performance of the Western Balkans with special reference to stabilization and privatization efforts as well as to the liberalization of trade, institutional reforms and the inflows of financial resources to the area, brief indicative profiles of these countries are given below. To the extent that the data used are for five years only, any conclusions reached must be viewed as tentative.

3. Profiles of Western Balkans[5]

Albania

Until the early 1990s Albania had one of the most centralized and repressive regimes in the world. The collapse of communism in Albania brought about a chaotic situation which began to be corrected with a democratically-elected government in March 1992. The government launched an ambitious program of economic reform including privatization, monetary reforms and trade liberalization. Subsequently, the Albanian economy experienced positive economic changes but many needed institutional reforms were not implemented, e.g. judicial reforms, fight against corruption. In 1997 Albania experienced another crisis resulting from the collapse of investment schemes which led to civil unrest and political strife; but beginning in October 1998

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[3] European Commission, European Economy, October 2001, page 3

[4] Ibid, page 4

[5] Most of the information in the profiles of the Western Balkans is based on IMF and National Statistics. European Commission data were also valuable. See Tables 1 and 2.

with the election of Pandeli Majko as Prime Minister a new optimism for long term stability has arisen.

Growth rates of 8%, 7.3%, 7.8%, 6.5% and 5% in 1998, 1999, 2000, 2001 and 2002 respectively as well as relatively low inflation rates have characterized Albania as shown in Tables 1 & 2. The euro has been used as an external anchor. Unemployment was one of the lowest among the Western Balkans, it ranged from 18% in 1999 to 14.2% in 2002. It declined to 14.2% in 2002 because of growth and tightening of the grey economy. The fiscal deficit as a percent of GDP decreased from 11.4% in 1999 to 8% in 2002[6]. This is attributable to an increase on tax revenues and an increase in privatization receipts which helped reduce domestic borrowing. A restrictive monetary policy was a major force in keeping prices relatively stable as shown in Table 1 and 2.

Albania made progress toward trade liberalization. In 2000, it became a member of the World Trade Organization (WTO). The EU granted Albania a duty free access to most Albanian exports with some conditions for textile and agricultural products.

In 2000 and 2001, Albania was successful in privatization and reconstruction particularly in the telecommunication and power sectors but also in the banking sector. For example, in July 2000 the mobile phone company AMC was sold for €93 million to foreign investors and in January 2001, following an international tender, the second mobile phone company was sold to a consortium of British and Greek Companies[7]. As a result of Albania's membership in the IMF and the World Bank in 1991, Albania has received financial assistance from both organizations. Twenty two reconstruction projects with the World Bank for a total of $282 million are in the process of being implemented[8]. Negotiations for a Stabilization and Association Agreement between Albania and the EU commenced in late 2002. The following priorities are identified for Albania for financing under CARDS for the period 2001-2004: justice administration, economic and social development and democratic stabilization. CARDS assistance is € 181.4 million for the period of 2001-2004. Foreign direct investments to Albania increased from €40 million in 1998 to €167 million in 2002[9].

A survey of the European Bank for Reconstruction and Development and of the World Bank[10] points out that more than 36% of firms in Albania are bribing Albanian officials. Low salaries and lack of administrative control

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[6] Table 1 and 2
[7] European Commission, European Economy, October 2001, page 7
[8] European Commission, European Economy, October 2001, page 7
[9] Table 4
[10] European Commission, European Economy, October 2003, page 21

seem to favor corruption. The fight against corruption and organized crime remains a major challenge in Albania.

Bosnia & Herzegovina (BIH)

Subsequent to the Dayton Agreement in 1995 Bosnia-Herzegovina (BiH) has been challenged to move from war to peace and from socialism to a market economy. The first objective appears to have been attained under the influence of aid of about €5 billion, the power of the High Representative and 35,000 of NATO personnel. The second is not yet in sight.

The political uncertainty resulting from the election of November 2000 has had deleterious effects on the growth rate and on other economic aspects. The GDP growth rate declined from 9.9% in 1998 to 2.5% in 2002[11]. Agricultural production due to droughts experienced a major decline. Unemployment as a percent of labor force has ranged from 37.4% 1998 to 41% in 2002.

The prevailing political uncertainties have delayed negotiations with the EU concerning the possible signing of a Stabilization and Association Agreement. Also, the lack of political consensus among the ruling parties create the presumption of a continued international intervention in BiH.

A weak fiscal situation continues to pose continuing macroeconomic problems. The government budget deficit as a percent of GDP was 20.1% and 11.6% in 1998 and 2002 respectively while the current account deficit as a percent of GDP was 20.9% in 1998 and 21.3% in 2002[12]. Imports from BiH were given tariff free entry to the EU in 2000. Strict adherence to the rules of the currency board arrangement which was established in 1997 helped keep inflation at moderate rates, i.e., 1.9%, 1.7% and 1.5% in 2000, 2001 and 2002 respectively.

Results in privatization have been uneven. While a number of small-size enterprises have been privatized, the privatization of large-scale enterprises has met with difficulties and lack of success. Privatization of banks is targeted for the end of 2002[13]. Foreign capital in the banking sector is significant. In 2001, the World Bank provided assistance of $140 million aimed at facilitating reforms and privatization. Under the CARDS arrangement about €100 million was granted to BiH for reforms in 2001[14].

Corruption is widespread in BiH. It takes various forms including bribery, sale of smuggled goods and selective tax assessments. It is estimated by

[11] Table 1 and 2
[12] Table 1 and 2
[13] European Commission, European Economy, October 2003, page 28
[14] European Commission, European Economy, October 2001, page 10

the World Bank that 22% of business firms are involved in bribing government officials.

Croatia

In 2000 Croatia moved to establish integration and contractual relationships with the EU. Croatia is the most developed country of the Western Balkans. Its per capita GDP was above €5000 in 2001. It became a sovereign nation in 1991. However, armed conflicts delayed its independence.

Croatia's GDP increased by 2.5% in 1998 and by 4% in 2002. Unemployment as a percent of the labor force has ranged from 11.4% in 1998 to 14.5% in 2002. The inflation rate stood at 5.4% in 1998 and 3.0% in 2002. Croatia's Central Bank considers price stability the main objective of monetary policy. It uses the exchange rate as nominal anchor. A 4% target rate for inflation under influences such as a stable exchange rate, low wages and increased productivity seems attainable. The end of Kosovo crisis had a favorable impact on Croatia's current account balance of payments. It went from a 6.7% of GDP deficit in 1998 to a deficit of 3.6% in 2002. The budget deficit under a stand-by framework with the IMF was reduced from 7.4% of GDP in 1999 to 4.3% of GDP in 2002. Because of the economy's openness and the resulting foreign competition, Croatia's unemployment rate has been rather high at 15.8% and 14.5% in 2001 and 2002 respectively[15].

Croatia joined the WTO in 2002. It also signed a Stabilization and Association Agreement with EU in 2001. Privatization has continued with some success. For instance, privatization of banks is almost complete but privatization of large firms is slow. Foreign owned banks account for 90% of total bank assets in Croatia. The private sector as a share of GDP was 60% in 2001[16]. The development of capital markets has not made any serious progress. Reforms in the areas of education, health and the judicial system have experienced lags.

Croatia joined the IMF in 1992 and the World Bank in 1993. Since 1993 $972 million has been allocated by the World Bank for 19 projects[17]. Croatia also joined the European Bank for Reconstruction and Development (EBRD) in 1993. In 2000 a commitment by the bank was made in the amount of €688 million for support of the private sector[18]. CARDS allocations to Croatia were €60 million and €59 million in 2001 and 2002 respectively with primary focus democratic stabilization, social development and justice.

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[15] Table 2
[16] European Commission, European Economy, October 2003, page 35
[17] European Commission, European Economy, January 2003, page 36.
[18] European Commission, European Economy, October 2001, p.12

Croatia has signed Free Trade Agreements covering 27 countries including other Western Balkans. 55% of Croatia's total trade is with the EU. Foreign direct investments increased from €746 million in 1998 to €1171 million in 2002[19], clearly the largest among the Western Balkans.

Corruption, although at a smaller scale than in the other Western Balkans, it is still a problem in Croatia. Institutional reforms including that of the police and of the judicial systems are needed. The World Bank estimates that 13% of business firms bribe government officials in Croatia.

4. Federal Republic of Yugoslavia (FRY): Serbia and Montenegro

The FRY comprises of Serbia and Montenegro. During the period of 1990-1999, wars and international isolation characterized the FRY. The annual growth in 1999 was a negative of -15.5%. Political changes in Yugoslavia in 2000 including the removal from power of Milosevic made it possible for international contacts to be established once again and for Yugoslavia to become eligible to benefit from EU aid programs. In 2000, 2001 and 2002 GDP growth in Serbia was 6.7%, 5.5% and 4% respectively. Still per capita GDP in 2000 was about 45% of the 1989 level[20]. Urgent needs of the population were met by the international community which came to the rescue. Unemployment was 25% and 29% in 1998 and 2002 respectively and inflation (end of period) in FRY-Serbia was 113% in 2000[21]. Stabilization and structural reforms began in 2001 with a reduction of inflation to 39% and 15% in 2001 and 2002. A monetary policy aimed toward price stability and complemented by a moderate wages policy has helped to bring prices down in 2001 and 2002. The government budget deficits were at 1.4% and 5% of GDP in 2001 and 2002 and the current account deficits at 10.9% and 11.7% of GDP in 2001 and 2002.

Tax reform in the FRY with the objective of lowering taxes, broadening the tax base, reducing unwarranted exemptions and combating corruption was implemented in 2001 and 2002. Progress was also made in cleaning-up of the banking system. In both Serbia in 2003 and in Montenegro in 2002, a treasury system was established. Expenditure control is expected to ensue.

In 2001, a trade liberalization was passed by the Serbian Parliament to reduce quantitative restrictions and custom tariffs. In 2001 the FRY began negotiations for Free Trade Agreements with countries of Southeast and Eastern Europe. Montenegro also reduced trade restrictions which are lower than Serbia's. On March 14, 2002 the so called Belgrade Agreement was

[19] Table 4

[20] European Commission, European Economy, October 2001, page 13

[21] Table 1 and 2

signed between Serbia and Montenegro. The agreement provided for joint political functions and institutions and for a common market for a free flow of people, capital, goods and services. Concerning privatization, a legal framework was established in 2001 which anticipates eventual privatization for about 150 enterprises. In 2001 and 2002, restructuring of public administration is on the agenda. Three large cement companies and another six enterprises were sold in 2002. In Serbia the process of privatization through tenders and auctions has gained momentum in 2002. Total receipts from privatization in the first 10 months of 2002 amounted to €270 million. Eight banks are now under liquidation. In Montenegro privatization which started in 1991 for 191 enterprises was scheduled for completion in 2001. In addition, 53 companies are on the agenda for sale beginning in 2003. In 1998 Montenegro embarked on economic reforms and stabilization measures and obtained defacto autonomy over monetary, trade policy and customs[22].

The FRY resumed its membership to the IMF in 2000 and became a member of the EBRD and World Bank in 2001. The EU under CARDS granted FRY €630 million in 2000-2002 for public administration and transport reforms and € 345 million for economic reforms. A step anticipated in the foreseeable future is a feasibility study concerning a possible Stabilization and Association Agreement between the EU and the FRY.

Foreign direct investments to the FRY were € 105 million and €570 million in 1998 and 2002 respectively[23]. According to the World Bank bribery of public officials runs about 16% in FRY.

5. Federal Republic of Yugoslavia: Kosovo

Kosovo is part of the Republic of Serbia. In 1999 it came under a special mandate of the UN Mission in Kosovo according to the UN Security Council Resolution 1244. As a result of the conflict in 1999, the infrastructure and agricultural and industrial production in Kosovo experienced great damage. Estimates suggest that per capita GDP was €800 in 2000. Following the conflict, economic activity in Kosovo has experienced substantial improvement. Agricultural production reached the pre-conflict level in 2001. Construction activity and infrastructure building are on the rise largely induced by international assistance.

Inflation is estimated to be in the range of 11.3% and 6.5% in 2001 and 2002 respectively. Efforts are made to improve the budgetary situation as well as the banking system. Unemployment may be as high as 50%. Kosovo has not implemented its own monetary policy because it used the DM as its

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[22] European Commission, European Economy, October 2001, page 13
[23] Table 4

currency and now uses the Euro. The Kosovo Central Budget 2002 established the Central Fiscal Authority which will have budget supervisory role. Progress toward privatization appears to be slow. The establishment of the Kosovo Trust Agency in July 2002 is expected to improve transparency and accountability of enterprises and hence promote privatization. Twenty-seven socially owned enterprises are targeted for privatization in 2002. Kosovo is not a member of the IMF and the World Bank. However, both organizations have given technical assistance to Kosovo. CARDS has pledged €315.5 million to Kosovo in 2001[24]. Foreign direct investments amounted to €5 million in 2001 and €10 million in 2002[25]. Kosovo's requirements for capital investments are high but given the prevailing uncertainties the prospects for commercial lending are not immediately promising.

6. The Former Yugoslav Republic of Macedonia (FYRoM)

FYRoM is the only former Republic of the Former Republic of Yugoslavia to become independent peacefully in 1991. Since independence, democratic elections have been held and a number of reforms were introduced. Relations with its neighbors have improved including with Greece and the EU.

GDP grew by 4.6% in 2000 but in 2001 declined by 4.1% largely as a result of the ethnic crisis in the spring. Unemployment was about 32% in 2000 and was a high 30.5% in both 2001 and 2002[26]. The small decline may have been the result of increased recruitment to service in the military during the ethnic crisis. In 2000 the economy had a 2.5% of GDP budgetary surplus but a deficit of 6% and 4.7% of GDP in 2001 and 2002 respectively. As a result of a decline in security related expenditures the budget deficit decreased in 2002 as compared to 2001. Inflation was 6.1% in 2000 and it declined to 3.7% and 2.5% in 2001 and 2002 respectively. In 1998 and 1999 the FYRoM did well in the areas of growth, inflation and budget deficits[27]. The National Bank carries out monetary policy and through changes in interest rates and reserve requirements has been able to maintain relative price stability in the 2000-2002 period. The current account deficit was 3.1%, 10.8% and 9.7% of GDP in 2000, 2001 and 2002 respectively. A large part of exports, more than 40% of total exports, went to the EU in 2000[28].

The FYRoM strengthened its relations, economic and political, with the EU. It signed with the EU the Stabilization and Association Agreement in

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[24] European Commission, European Economy, October 2001, p.18.
[25] Table 4
[26] see Table 1 and 2
[27] see Table 1
[28] European Commission, European Economy, October 2001, p.19.

2000. It will establish a free trade area with the EU within 10 years. FYRoM also liberalized trade with other countries including other Western Balkans. It was anticipated that the FYRoM might become a member of the WTO in 2002. It is argued that the privatization process has met with considerable success in FYRoM. By the end of 2000, 1616 enterprises were privatized. These companies have 352,000 employees or about 65% of total country employment[29]. However, it should be pointed out that the major successes have been with small size firms with about 95% of small and medium size firms privatized. Privatization of large firms remains a problem. The so called Action Plan has identified 40 companies which need to be restructured, privatized or liquidated. The banking system, on the other hand, is almost completely privatized. About 84% of total bank capital is private[30].

Both the IMF and the World Bank have extended financial assistance to FYRoM for financial and structural reforms. In 2002 various foreign donors including the European Commission and the World Bank pledged €172.6 million. CARDS committed €56 million in 2001 and €42 million in 2002. The focus of these funds has been development, democratic reform and the rule of law and justice. Foreign direct investment varied from €150 million in 1998 to €190 million, €478 million and €76 million in 2000, 2001 and 2002 respectively[31]. Because of the prevailing corruption, in April 2002 an Anti-Corruption Law was approved leading to the establishment of an Anti-Corruption Commission accountable to the Parliament. The World Bank estimate of bribery of government officials in FYRoM is 23%.

7. An assessment of changes: a summary & conclusions

Summary

BiH has experienced continuing political uncertainties and a high unemployment rate of 40%. It has however been able to reduce inflation to reasonable levels due to the currency board arrangement in 1997. FRY-Serbia, because of wars suffered considerable devastation during the 1990-1999 period and had the highest inflation rate, among the Western Balkans, of 113% in 2000. Kosovo also experienced substantial damage as a result of the 1999 conflict. Following the conflict, it embarked on a program of reconstruction and development. It's position, however, appears to be tenuous. The FRY following the political changes in 2000 and the removal from power of Milosevic has reestablished international contacts and became eligible for exter-

[29] European Commission, European Economy, October 2001, page 20
[30] European Commission, European Economy, October 2003, page 56
[31] Table 4

nal financial assistance. A number of stabilization and structural reforms have been implemented by both Serbia and Montenegro which have helped reduce inflation to 15% in 2002 and produced satisfactory growth rates. Some measures to privatize their economies and liberalize their trade were also taken. However, at this point, it is difficult to say how things will evolve with regard to Kosovo, FRY and especially BiH. The level of political uncertainty continues to be high in these countries.

On the other hand, the country profiles indicate that Albania and Croatia under a relatively stable political climate are on a positive path toward economic progress. Their unemployment levels although double digit are the lowest among the Western Balkans, their growth rates are reasonable and their inflation low. The EU has recognized the efforts of Croatia in the areas of growth and inflation by signing with it a Stabilization and Association Agreement in 2001. The other Stabilization and Association Agreement of the EU was signed with the FYRoM in 2000. The FYRoM, because of the ethnic crisis in the spring of 2001 experienced negative growth in 2001, but it is anticipated that it will be able to resume positive growth and extend its privatization horizons just as it did in 1998 and 1999[32]. Persistently high unemployment however has been a problem for FYRoM.

Western Balkans in general seem to have been able to privatize small firms easier than large firms whose privatization continues to be slow. It may be argued that the scale of the economy and historical opportunities and circumstances determine the effectiveness of the transition process. Nevertheless, positive accomplishments in privatization by Albania, Croatia and FYRoM need to be recognized. As discussed above, in 2001 Croatia's private sector contributed 60% of GDP and 90% of total bank assets were foreign owned. In Albania privatization has been successful in the telecommunications, power and banking sectors. In 2000, 1616 enterprises in FYRoM were privatized and they employed 65% of total country employment.

Albania and Croatia joined the WTO in 2000 and FYRoM is anticipated to join soon. All three have made progress in the liberalization on their trade. Trade liberalization within and without the region, free access of Western Balkans exports to the EU and eventual creation of free trade areas are major emphases of the SAAs which the FYRoM and Croatia have signed with the EU. As observed in the profiles of the Western Balkans a number of them have free access of large portions of their exports to the EU. In addition, Croatia has signed Free Trade Agreements with 27 countries including Western Balkans. To the extent that Western Balkans visualize accession to the EU, perhaps on the distant future, a number of issues concerning enlargement are relevant. When less developed countries try to integrate and com-

[32] See Table 1

pete in markets of more developed countries serious consideration must be given to a number of issues including the existence of disparities in productivity and income, market orientation, levels of technology, quality of human capital, social and political institutions and infrastructure. Given these issues, the Western Balkans are faced with a major challenge if they are to become serious candidates for some form of integration with the EU in the future.

As mentioned before, financial and technical assistance for economic development, for restructuring and reforms in the Western Balkans has come from various sources. Foreign economic assistance to the Western Balkans was €3300 million and €3447 million in 2001 and 2002 respectively[33].

Given the multiplicity of sources of support to the Western Balkans, it appears that coordination of the support effort is desirable. There is some question whether policy has been coordinated in the past. Carl Bildlt, UN Representative to the Balkans argues that it is less a question of too many cooks spoiling the broth and more that we do not have a recipe[34]. As a result of these concerns, the European Commission and the World Bank are currently involved in a joint enterprise in the coordination of economic assistance to the Western Balkans. Another consideration is that for aid to be effective requires the active participation and involvement of the local people. Without it, development becomes problematical.

Moreover, because of the asymmetries in the economic and institutional character of the Western Balkans financial assistance policies are likely to be more effective if they are tailor-made to the resource endowment and the institutional framework of the individual countries. The EU's SAAs take account of this need and their cooperation with the Western Balkans is on economic and non-economic fronts.

The importance of the institutional framework in the process of development is well understood. Weak institutions, e.g., political instability, corruption, clearly undermine the process of development. Development economists subscribe to the center-periphery thesis as an explanation of why foreign capital moves away from the periphery and gravitates toward the center where a stable institutional framework and other externalities usually exist. A review of foreign direct investments in the Western Balkans from 1998 to 2002 shows that they were anemic in 1998 but experienced gradual improvement. FDIs were €1125 million and €2253 million in 1998 and 2002 respectively[35]. This increase seems to coincide with the improvement in stability conditions and other changes in privatization and liberalization among some of the Western Balkans.

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[33] See Table 3

[34] Balkans Reconstruction Observatory, Balkan Eye, Has Anyone Seen Our Policy?

[35] Table 4

The most developed country of the group, Croatia, attracted about 50% of the total foreign direct investments. Kosovo received minimum foreign direct investments[36]. Foreign direct investments may be viewed as a vote of confidence that foreign businesses may give to a given country's economic, political and social environment. The opportunity for profit in a stable and safe institutional framework is an important consideration on deciding whether to invest in a given country.

8. Conclusions

It can be concluded that the attainment of the goals of stabilization, privatization and liberalization of trade by the different Western Balkans countries has been asymmetrical and so has been the success of those countries to attract direct foreign investments.

The reviews of the performance of the Western Balkans suggest that the weakest links in the Western Balkans have been wars and the associated political turmoil that has characterized them. Once reasonable tranquility was established economic progress became possible in some of the cases reviewed. We have also seen that political stability was complemented by lower inflation and institutional changes such as the privatization of small and medium enterprises, trade liberalization and some banking reforms. These mostly positive steps will serve these countries well if they are matched by institution building and followed with reforms in the fight against corruption, improvement in the judicial systems, putting the financial systems on a sound basis, completion of the privatization process and building an efficient infrastructure system.

It has also been shown that the role of EU in encouraging and supporting institutional changes in the Western Balkans has been of critical importance. The SAAs and CARDS initiatives represent major commitments toward institutional reforms, stability, privatization and development. The World Bank's role in this regard has also been prominent. Moreover, the EU's influences to induce the Western Balkans to liberalize their trade and move toward greater regional cooperation occupies center stage in the goals of SAAs. Finally, an improvement in stability conditions in the Western Balkans contributed toward doubling the amount of foreign direct investments to the area between 1998 and 2002.

[36] Table 4

Table 1
Major trends: Western Balkans

	Albania			Bosnia-Herzegovina			Croatia			FRY/ Serbia			FRY/ Montenegro			FYROM		
	1998	1999	2000	1998	1999	2000	1998	1999	2000	1998	1999	2000	1998	1999	2000	1998	1999	2000
Real GDP Growth Rate	8.0	7.3	7.8	9.9	10.6	4.5	2.5	-0.4	2.9	2.5	-15.7	6.7	1.5	-14	-6	3.4	4.3	4.6
Inflation Rate end of year	8.7	-1	4.2	5.2	-0.7	1.9	5.4	4.4	7.4	44	50	113	41.8	146	22.5	-1.0	2.3	6.1
Unemployment Rate	17.8	18	17.1	37.4	38.9	39.7	11.4	13.6	16.1	25	27	27	25.7	27.3	29.4	34.5	32.4	32.2
Budget Balance (% of GDP)	-10.4	-11.4	-9.1	-20.1	-22.4	-20.1	-3	-7.4	-5.7	n/a	n/a	-0.4	n/a	n/a	-16.6	-1.7	0.0	2.5
Current Account Balance (% of GDP)	-6.1	-7.3	7.2	-20.9	-20.8	-21.6	-6.7	-7.0	-2.4	-4.8	-7.5	-8.3	n/a	n/a	12.5	-9.9	-5.1	-3.1
Population (in million)			3.4			4.3			4.5			10.7						2.0
GDP per capita (in EUR)			1297			1055			4590			810						1828

Source: IMF, National Statistics

Table 2 Major trends: Western Balkans

	Albania		Bosnia-Herzegovina		Croatia		FRY/ Montenegro		FRY/ Kosovo		FYROM	
	2001	2002	2001	2002	2001	2002	2001	2002	2001	2002	2001	2002
Real GDP Growth Rate	6.5	5	2.3	2.5	3.8	4.0	5.5	4.0	11	7	-4.1	-0.5
Inflation Rate end of year	3.5	3.9	1.7	1.5	2.6	3.0	39	15	11.3	6.5	3.7	2.5
Unemployment Rate	14.5	14.2	40.1	41.0	15.8	14.5	28	29	n/a	n/a	30.5	30.5
Budget Balance (% of GDP)	-8.5	-8.0	-14.4	-11.6	-5.4	-4.3	-1.4	-5.0	1.3	-6.1	-6	-4.7
Current Account Balance (% of GDP)	-6.3	-8.1	-23.1	-21.3	-3.8	-3.6	-10.9	-11.7	9.1	-2.0	-10.8	-9.7
Population (in million)	3.4	n/a	4.3	n/a	4.4	n/a	8.6	n/a	2.0	n/a	2.0	n/a
GDP per capita (in EUR)	1350	n/a	1175	n/a	5140	n/a	1412	n/a	941	n/a	1885	n/a

Source: IMF, National Statistics

TABLE 3
International assistance to the Western Balkans
2001, 2002

€ million	2001	2002
European Union	1,331	1,280
EC	784	783
EU Member States	547	497
Other Bilateral Donors	574	532
IFIs including EIB	1395	1665
TOTAL	**3,300**	**3,447**

Source: Joint Office of EC-World Bank, European Commission

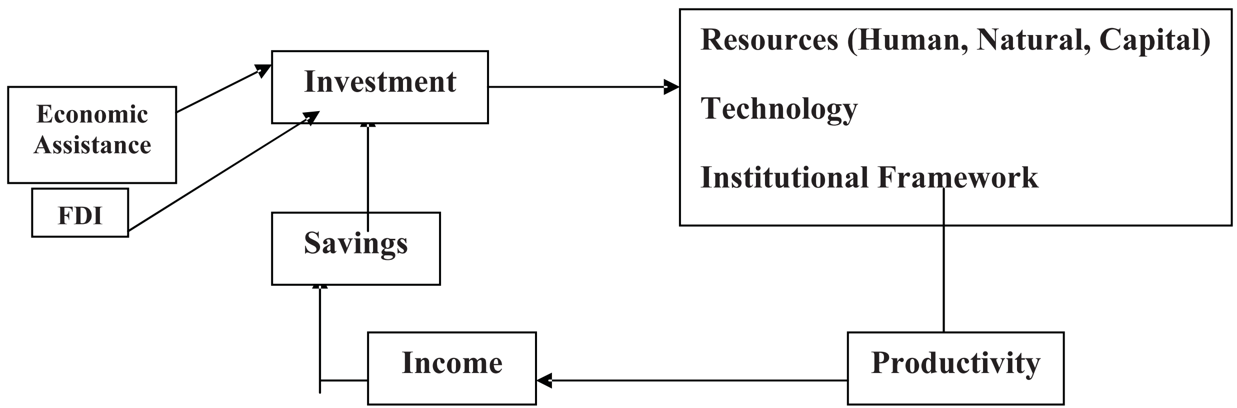
TABLE 4
Western Balkans: Inflows of foreign direct investments
(in € million)

	1998	**1999**	**2000**	**2001**	**2002**
Albania	40	48	155	228	167
Bosnia-Herzegovina	89	85	163	145	259
Croatia	746	1327	1169	1529	1171
Former Republic of Yugoslavia	100	105	27	184	570
Former Republic of Yugosla-via/Kosovo			0	5	10
Former Yugoslav Republic of Mace-donia	150	23	190	498	76
TOTAL	**1125**	**1588**	**1704**	**2589**	**2253**

Source: IBRD Report

FIGURE A

The Process of Economic Development



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