Further Trade Integration in the Regional Economic Area of the Western Balkans: Steps Toward EU Enlargement

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Abstract

The economies and political systems of most European countries have successfully integrated to the European Union while also maintaining their sovereignty. Today, the countries of the Western Balkans (Macedonia, Serbia, Montenegro, Albania, Bosnia and Herzegovina, and Kosovo) are also seeking European integration, but mainly lag behind in terms of the human rights and economic indicators of readiness to integrate. A solution to this problem is the Regional Economic Area of the Western Balkans, an initiative which all the Western Balkans governments have agreed to, which would not replace eventual European Union membership but rather serve as an important stepping stone towards it. An action plan for regional economic integration was created at a meeting of Western Balkans heads of state in July 2017, but its steps are vague and leave out significant risks facing all Western Balkan governments. We identify, empirically and theoretically, the main risks to effective regional trade integration specifically, and find that the presence of administrative barriers to trade (ATBs) and regional political conflicts may prevent or deter full regional trade integration, an important step before European integration. We look to the most significant barriers to trade in the region in order to provide recommendations and more detailed action steps to make regional trade integration a reality.

Key words: Trade, regional integration, infrastructure, regional politics, common market, Western Balkans, non-tariff barriers.

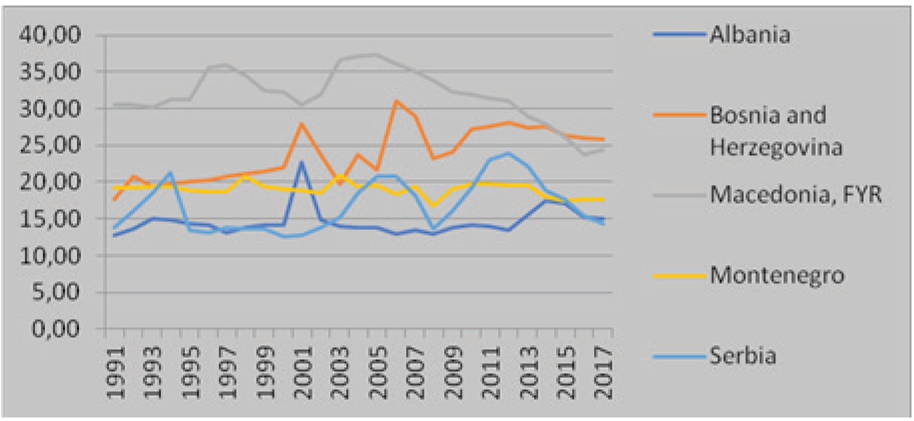
Introduction: The Recent Political and Economic History of the Western Balkans

The term "Western Balkans" is a new geo-political phrase (Dedzanski et al., 2012) which was first used in the 21st century and includes the former-Yugoslav territories of Serbia, Montenegro, Bosnia and Hercegovina, Macedonia and Kosovo, as well as Albania. The Western Balkans, which has become an island in Europe, has been trying to integrate into the EU for more than 15 years. However, the transition to a market economy for the Western Balkans evolved under more difficult conditions compared to more advanced countries in Central and Eastern Europe (CEE) (Svrtinov et al., 2016). If we look through recent history, the fall of the Socialist Federal Republic of Yugoslavia, which was the most developed country at the end of the 1980s in South East Europe (Svrtinov et al., 2016), was followed by conflicts, wars, and blockades. In addition to the slowdown of the economic transition from socialism to a market economy, regional conflicts and political instability slowed down the privatization process occurring in the 1990s, and both inflation and unemployment increased. Similarly, in 1991, several years after the death of dictator Enver Hoxha, Albania began to open up after a long period of isolation. After the fall of Yugoslavia and its wars of secession, as well as the fall of the regime in Albania, the main priority of Western Balkan countries was to have peace, political stability and economic growth. Indeed, during the 1990s the transition process started becoming apparent in each of the countries concerned, although this process in Kosovo in particular was somewhat stunted due to the Kosovo war and the following ten years of relative instability before it declared independence in 2008. . The economies of the Western Balkan countries started becoming export-oriented, with the IMF being closely occupied with the economic transformation of the Western Balkans from the start. Over the period 2000 to 2008, the average GDP growth in the region was above 5 per cent, which partially closed the gap in the standards of living of Europe's richest countries (Murgasova et al., 2015). But, even though growth in the Western Balkans saw a fast increase in this period, it still remained one of the poorest regions in Europe, and after the financial crises in 2008, the economic growth in the Western Balkans slowed down as a result of the increase of public debt and fiscal buffers put in place to protect the economies from crisis.

Regional Cooperation of the Western Balkans, with Common Risks of Unemployment and Inflation

For a faster integration of the Western Balkans to the EU, many initiatives for regional cooperation have been introduced in sectors such as aviation, the railways and energy, but the most significant progress has been made in trade integration (Handjiski et al., 2010). Regional cooperation has been important for political stability and economic development. At the Western Balkan Summit in 2003 in Thessaloniki, the Western Balkan countries dedicated themselves to developing regional cooperation through regional free trade, the development of transport, the creation of regional markets for electricity and gas, energy and telecommunication infrastructures, research in technology and development, cross-border and parliamentary cooperation, and other areas. This was done because through regional cooperation, the business environment would improve in the Western Balkans, encouraging foreign and national direct investment, which would in turn create jobs and improve living standards (EU Commission, 2005).

For better regional cooperation, in December 2006, the Agreement on the Amendment and Accession to the Central European Free Trade Agreement (CEFTA) was signed by the Western Balkan Six and Moldova. This agreement concentrates on fully liberalizing trade in the region and achieving greater cooperation in a number of trade-related areas, such as services, public procurement, investment and intellectual property rights (Handjiski et al., 2010). The economic priority for the faster integration of the Western Balkans to the EU has been macro-economic stability. Only with macro-economic stability can the Western Balkans achieve economic growth and reduce unemployment, one of the key problems that the Western Balkans had to confront since the beginning of its transition. After the fall of Yugoslavia, many state-owned companies closed and people were left without jobs. Even though with privatization the unemployment rate started to decline, the Western Balkan countries still have much higher unemployment rates compared to EU countries.



Unemployment rate in Western Balkan Countries 1991-2017 (no data available for Kosovo). Source: World Bank 2018.

For macroeconomic stability, stable monetary exchange rates also needed to be achieved. After the fall of Yugoslavia, the wars and the collapse of the common market brought inflation to the countries in the region. The highest inflation in the region in the mid-1990s was seen in the Federal Republic of Yugoslavia (Serbia and Montenegro, including Kosovo at that time), which in January 1994 reached its peak with 313 million percent per month (Petrovic et al., 1999). Montenegro adopted the German mark and after several years the mark was replaced by the euro, which helped the economy of Montenegro stabilize and begin its steady growth

(Svrtinov et al., 2016). In order to keep a stable exchange rate, the Macedonian currency was pegged to the euro (Radovanovik-Angjelkovska, 2014). Bosnia and Herzegovina's currency was also pegged to the euro, and Kosovo adopted the euro in order to avoid inflation (Svrtinov et al., 2016).

Now that unemployment rates in the region seem to be steadily decreasing, and following the collapse of the Socialist Federal Republic of Yugoslavia in 1992, currency stability was achieved through pegging and floating exchange regimes, regional cooperation is not only once more a possibility between nations once at war or completely isolated from one another, but it is the key to their prosperous futures.

The Regional Economic Area of the Western Balkans

On 12 July 2017 in Trieste, Italy, the heads of state of the six countries in the Western Balkans region (Albania, Kosovo, Macedonia, Montenegro, Serbia, and Bosnia and Herzegovina) endorsed the Multi-annual Action Plan (MAP) for the creation of a regional economic area in the Western Balkans as an important step before the countries in the region integrate into the European Union. The plan had the goal of enabling the "unobstructed flow of goods, services, capital, and highly-skilled labor," making the Western Balkans more attractive for trade and investment, and accelerating its members' entrances into the EU (Western Balkans Civil Society Forum), aided by the bargaining power available to an economic bloc with a total population of 20 million people (Vucic, n.d.). Priority Area 5 within the "Productivity and Economic Integration" part of the Western Balkans Regional Economic Integration Issues Notes published by the World Bank is stated as follows: "Removing barriers to intra-regional trade and investment and participation in global value chains, which is essential for knowledge spillovers and productivity enhancement" (World Bank, 13). This Priority Area is viewed as an essential step within the first pillar of reforms necessary for the full regional integration of the Western Balkans region to take place, the pillar of "Trade, Investment, and Capital Markets." On 31 October 2017, the Regional Cooperation Council (RCC) hosted the first meeting of the MAP coordinators (representatives of the six Western Balkans Governments) along with representatives of several international organizations, including CEFTA and the Western Balkans Six Chamber Investment Forum (CIF) in Brussels. At this meeting, the coordinators revealed their plans for the implementation of MAP, including timelines and deliverables. Following the meeting there was a business-to-government (B2G) meeting for the purpose of creating a more beneficial, inclusive, and transparent plan with the input of the private sector (RCC, 2017).

The focus of this paper will be the first pillar of the Regional Economic Area Multi-Action Plan, trade, while briefly touching on the others (investment, mobility, and digital integration) as they relate to the regional area as a whole.

The Structure of the Regional Economic Area in the Multi-Annual Action Plan (Trade Component)

Before delving into the specificities of the trade component of the REA MAP, it is necessary to first define the critical role of the Central European Trade Agreement (CEFTA), both as being a crucial actor in the plan and as a regional trade integration force in its own right. CEFTA was established in 1992 by the Visegrad group, where the goal was to help countries with non-democratic pasts acquire democratic and free market institutions and also join the European Union, where countries leave CEFTA when they join the European Union. As stated earlier, the Balkan States joined CEFTA through an agreement in 2006, including all the Western Balkans Six included in the REA MAP, plus Moldova (Global Edge- CEFTA). Thus, the REA MAP and CEFTA have many shared goals. It is necessary, however, to define where CEFTA ends and where the REA MAP begins, because the REA MAP goal is more short-term and represents a stepping stone goal in the goal of CEFTA.

The Multi-Annual Action Plan for a Regional Economic Area in the Western Balkans (Trade Component, the first pillar) foresees four sub-components: the facilitation of free trade in goods, the harmonization of CEFTA markets with the EU, creating a NTMs (non-tariff measures) and TDMs (trade-distorting measures)-free region, and the facilitation of free trade in services. Under these sub-components are objectives, and they include: strengthening the monitoring and enforcement capacity of CEFTA, Adoption of Additional Protocol 5 and the Start of Its Implementation, Systemic Monitoring of NTMs in trade and goods and services, and several others. Under each objective are actions, and include timelines and responsible parties. For instance, for the objective "Adoption of Protocol 5 and the Start of Its Implementation," the actions are: the "adoption of validation rules for mutual recognitions in AP 5, ensuring timely entry into force of the AP 5, and start of implementation of Mutual Recognition Programs (border documents and authorized economic operators [AEO] program) (RCC, MAP, 8). Additional Protocol 5 to CEFTA will simplify clearance procedures and reduce formalities where possible, "exchange data between customs authorities, and mutually recognize the AEO programs in all CEFTA countries" (CEFTA, 2016). The rest of the objectives and components are organized in the same manner, with trade being the component with the highest number of objectives and activities. Each of the six Western Balkan countries has appointed its own MAP Coordinator, as well as a MAP Component Contact Point for each of the four components. Therefore, there is a Contact Point for the trade component for each of the Western Balkans Six. The MAP coordinators will meet at least twice annually to review progress, which will "enable coordination at the regional level" (RCC, 2, Draft Guidelines). The role of regional coordinator for trade will be carried out by the CEFTA Secretariat, and there already exist regional platforms and working groups that will help in carrying out the MAP, including the CEFTA Committee on Trade Facilitation, and the CEFTA subcommittee on customs and rules of origin. This has some sense to it, in that the MAP as it relates to trade is carrying out the same goals as CEFTA, but looking at the CEFTA website, it is sometimes difficult to determine which activities are being carried out within the MAP REA or outside of it (namely, in CEFTA's Support to Facilitation of Trade Between CEFTA Parties project). However, this aspect of the non-creation of an entirely new body is in line with the MAP's notion that it "does not foresee establishment of any new institutions or organizations" in keeping with the principle of "all-inclusiveness" (CEFTA, Draft Guidelines, 1). It is our assumption that the Regional Cooperation Council/CEFTA would have felt it to be redundant as well as exclusivist to create a new institution to carry out this MAP, and therefore put its work as it relates to trade under the umbrella of Western Balkan government representatives and organizations like CEFTA, who are already working towards the same goals.

Risks to Balkan Regional Trade Integration

An important indicator of trade liberalization is a nation's exports as a percentage of GDP, and by this indicator, the Western Balkans are not very well integrated into the global economy (the most integrated of them, such as Serbia and Macedonia, have an export-to-GDP ratio of about 40 per cent , while Slovakia and other comparable countries have 80 per cent or higher), though these ratios have increased in recent years (World Bank, 15). Similarly, most Western Balkan countries have significant current account deficits, with a regional average of 5.5 per cent of GDP, and some are as high as 10 per cent of GDP (*The Economist*, 2017). Additionally problematic is that a majority of firms in the Western Balkans sell only domestically, and if they do export, it is mainly to the European Union rather than among themselves. For instance, Albania, Bosnia and Herzegovina, Macedonia, and Serbia send 60-70 per cent of their exports to EU markets, as opposed to just 10 per cent to CEFTA countries. This lack of trade both with the EU and with other Western Balkans countries can be at least partially explained by two main factors: costs to trade and non-tariff barriers (NTBs). The costs to trade can be both financial and non-financial; and they include border crossing costs and issues, documentary compliance, and regulatory burden in export markets (World Bank, 16). Non-tariff barriers (NTBs) or non-tariff measures (NTMs) are any method used to block exports that go beyond the simple adoption or removal of a tariff, and they can include "various bureaucratic or legal issues" that hinder trade, like import licensing, rules for the valuation of goods at customs, inspection measures, rules of origin, and others (WTO).

To bring the problem of NTBs closer to the issue at hand, in the Western Balkans it has been found that the most detrimental NTBs are administrative ones. These administrative barriers to trade can be defined as: "all barriers to trade that are derived from national laws and regulations and administrative procedures that curtail international trade" (Bjelic et. al, 3). The forms it takes are varied, but can include large numbers of paper documents, complicated external trade procedures, a lack of transparent rules, multiple controls at border crossings, and poor transport connections (Bjelic et. al, 3;6). According to a survey of Western Balkan firms, the frequently-occurring or problematic perceived NTBs include: a lack of information about CEFTA, lack of accessibility to legislation, and technical regulations and conformity assessments (OECD, 2009). These administrative barriers to trade have the most negative impact on intraregional trade, yet they are still not regulated by the WTO, which explains why many countries use them (Bjelic et. al, 2013).

It would be useful to determine why these NTBs exist in the Western Balkans, so that it is sure that the root causes of the problems are addressed in the action plans for the trade integration of the region. It is also essential for the Euro-Atlantic future of the countries that make up the Western Balkans to make these changes now so that accession to the European Union will be smoother later on. It seems that these NTBs exist, both in their legal and procedural forms, due to the inefficient work of customs services of these countries and the services associated with them. In turn, the reasons for this inefficiency of work are "[firstly] low levels of trade capacity in some countries and...[secondly] a clear intention to make imported goods uncompetitive" (Bjelic et. al, 2013, 8). Whether intentional or not, these characteristics of Western Balkan trade infrastructure can have catastrophic results for a country's exports, which in general are accepted as one of the critical measures of the economic health of a country (World Bank). It was found that increased transport/transaction costs associated with importing/exporting goods within the Western Balkans region generally impacted negatively on Western Balkans exports; a one-day increase of *time to export* lowered overall exports by 1.6%. Thus, NTBs are detrimental to exports in the Western Balkans.

Although the idea of a customs union has been endorsed by some Western Balkans leaders as a solution to these issues (notably by President Aleksandar Vucic of Serbia); it might prove difficult to implement. Firstly, services in the Western Balkans, which make up the majority of its exports, are lower-tech than in Western Europe, due to the fact that they were "generated by the survival strategies of people made redundant by the demise of socialist-era industry" (*The Economist*, 2017). These services are difficult to be exported due to the size of the firms and their lack of international management experience, and the services industries are not really compatible with a customs union. Additionally, the economies of the Western Balkans are very diverse-some rely more heavily on agriculture (i.e. Albania) and others mainly import foodstuffs (i.e. Bosnia and Herzegovina). Similarly, Serbia's economy is more heavily based on industry, while Montenegro relies on tourism. Therefore, attempting to arrange tariffs on imports that would suit all the countries would prove difficult, since they are all importing and exporting different materials or products (*The Economist,* 2017). Crucially, therefore, it is important to note that it is not one of the goals of CEFTA or of the REA to arrange regional external tariff regimes (RCC Guidelines, 2017).

Related to the problem of NTBs that were identified earlier, where ATBs have been determined to be the most problematic barriers for the region's trade integration, a common market would be required, and not only a customs union, because a customs union would not remove all border checks and legal requirements, which are the main elements slowing down trade between the countries and increasing transaction costs. Finally, Serbia is unquestionably the lead economy in the region, and it would be difficult for the other economies in the region to increase trade with Serbia in terms of sending goods to Serbia, or at least in a significant way, because of the lack of size and power of the firms. Momentarily Serbia is the main regional exporter to all the other countries without much being imported in return (*The Economist*, 2017).

Problematic Aspects of the Action Plan for Regional Integration

The Regional Cooperation Council's "Multi-Annual Action Plan for a Regional Economic Area in the Western Balkans" (RCC, July 2017) boasts many positive aspects. However, regarding trade, the plan with its four aforementioned objectives may prove difficult to enact, due to several factors, which are also present in the other pillars of the plan. These are 1) The relative vagueness of some of the action steps, to the point where it may be unclear whether something has been completed or not, and 2) Lack of public awareness or sharing of the progress on the plan. An example of the first issue is in 1.3.2, where an action step for the objective of "eliminating any remaining discriminatory practices in public procurement markets" is "monitoring the elimination of remaining discriminatory practices in public procurement markets" (RCC, 9). This does not provide any meaningful measures that could be used in the monitoring of any concrete steps, meetings, or any similar things. An example of the first issue is that according to the plan, Additional Protocol 5 of CEFTA should have been adopted and started implementation by now, but no information is currently publicly available on its progress, or on the progress of much else regarding the steps. Since the adoption of the action plan in the Summer of 2017, silence has prevailed, except for a vague report on the meeting of the national coordinators in October. This vagueness and lack of public accountability could prove problematic for the implementation of the plan in its fullness and in a timely manner, thus impeding the efforts of all the parties to create a true regional economic area.

Political and Administrative Threats to Regional Trade Integration

In order to achieve higher investments, the Western Balkan countries need to harmonize their laws and weaken the trade barriers. However, collaboration between the Western Balkan countries is not easy, due to their history and current politics. Countries are competing each other in regards to the EU, rather than working together. The "new economic bloc" is still facing a political spar between the countries as well within the countries (such as between Bosnia and Herzegovina and Republic Srbska; and between Kosovo and Serbia) (Hopkins, 2017). Moreover, the geostrategic position of the Balkans is delicate. Geostrategic borders in the past were set differently from what they are today and this is a very important and crucial factor. (Grupe and Kusic, 2005). Additionally, today countries belong to different unions. Some states are waiting for a call from the EU, others have already begun their negotiation processes, and it has become a kind of a "race." The tensions between the countries are still present and it will take some time for smoother cooperation, and this depends on the willingness of the political leadership of the countries.

Western Balkan countries face increased barriers today, and it is necessary to see if they can function and improve trade relations outside of the EU and CEFTA (Hopkins, 2017). In order for this to be achieved, political barriers should be tackled. Regardless of political status, the economies of the countries must grow, and for that, cooperation is needed. Closures between countries must be removed. For stable a Western Balkans, countries must follow and accomplish the Berlin process, focus on overcoming political barriers, search for more investments, improve the infrastructure that connects them, and finally what is most important, make trade much easier without bureaucracy and obstacles that are often used as methods of discouraging imports for political reasons.

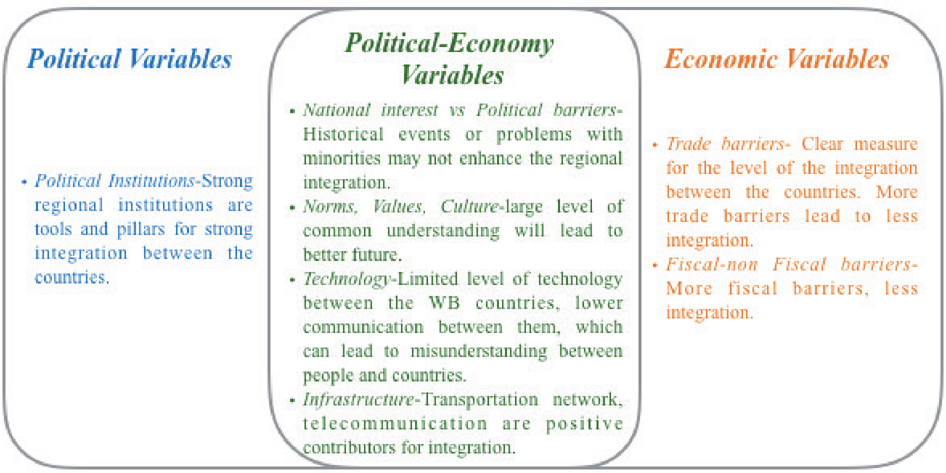


Figure 2: *As we can see, political barriers between countries often manifest themselves as trade barriers when the national interest becomes more important than regional interests.*

Source: Sklias, 2011.

To achieve this, Western Balkan countries need to follow the agenda from the Berlin process. Moreover, Western Balkan countries should learn from Europe lessons on how to unite and function without obstacles. This process will take time and patience, taking into account the economic and political situations of the countries as well as the mutual history they experienced.

Recommendations and Conclusions

Public awareness should be raised among citizens and in public discourse of regional unity and the dangers of nationalism.

Unnecessary administrative barriers (costs, documents, extra procedures), and border issues (such as lack of available lanes) should be minimized by the security authorities within and between Western Balkan countries because they increase corruptive practices and decrease the willingness of companies to trade regionally and to be competitive.

The Western Balkans should continue to work on making common trading laws and documents in multiple languages to be used in trade between the countries.

Western Balkan firms and governments should make exporting to other Western Balkancountries a priority, emphasizing lower transportation costs and similar untapped markets when doing so.

Western Balkan governments or economic forums should host regional business forums to increase interregional trade.

The action plan for the Regional Economic Area should be broken down into more specific activities, with a plan for monitoring and evaluation and appropriate indicators.

The activities/news for the Regional Economic Area should be more publicly available and transparent, so as to be accessible to regional companies and researchers, and the difference between CEFTA and MAP programs emphasized.

The Regional Economic Area is foreseen as a stepping stone for the Western Balkans Six into the European Union, and not a replacement for EU membership. It has a similar goal to the European Union at its inception: to build up the post-conflict region, ensure mutual cooperation and benefit, and ensure catastrophic war does not occur again. However, administrative non-tariff barriers, often erected for political reasons, threaten to prevent this regional cooperation from happening. It is of paramount importance that Western Balkan leaders take the initiative by decreasing nationalist rhetoric and policies and increasing regional and cooperative initiatives regarding administrative trade barriers, for the benefit of all the nations' populations. Furthermore, it is critical for the RCC and regional governments to be more action-oriented rather than theoretical when it comes to their meetings for the MAP and also to make information and news on the topic more transparent and widely available.

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