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## THE ANALYSIS AND PERSPECTIVES OF TRADE RELATIONS BETWEEN EU AND WESTERN BALKANS

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### Abstract

*For a long time, both economic and political factors play crucial role on Balkan region which is a geopolitical crossroads. European Union approves to incorporate Balkans for geographical and political integration of region. EU is one of the most advanced regional integration and has specific structure. In this sense, European Union policy for Western Balkans, today, is going on an ambitious agenda that desires to integrate with Western Balkans countries. After socialism and war, economy of Western Balkan countries has quite weak. EU and other international institutions try to improve the economy of Western Balkans countries with different projects and programs. All these initiatives are an opportunity for Western Balkans to increase their prosperity and strengthen their democracy. In this regard, the aim of this study is to analyze the trade relationship between Western Balkans and EU and present a perspective about their future. In order to achieve these aims, the relationships between Western Balkans and EU were investigated in terms of economic indicators and revealed the strengths and weaknesses of integration process. As a result of the evaluation, it is propounded that the development of Western Balkans and EU's trade relationships will make strong the regional integration, increase their economic potential and reinforce their political relations.*

Keywords: Western Balkans, Regional Integration, Trade Integration, European Union

### 1. Introduction

Balkan region represents a strategic point from political and economic view. After the Cold war, the Western Balkan region was seen by EU as a region for economic and political integration. In this sense, the EU's policy towards Balkan is progressing with taking in consideration the joining EU.

After 1990s, the Western Balkan countries have experienced a remarkable transformation over the last 15 years. They have transitioned toward market-based systems, privatized many inefficient enterprises, rapidly adopted modern banking systems, and enhanced the external orientation of their economies. The result has been a significant improvement in living standards relative to their neighbors in advanced European Union economies.

However, the pace of structural reform has been disappointing, owing to a combination of reform fatigue, difficult politics that have constrained reform efforts, and delayed membership in the European Union. The region is still coping with the legacies of the boom period and incomplete transition. As a result, the Western Balkan countries still lag well behind the New Member States of the European Union in terms of economic transformation and income levels (IMF, 2015).

In this context, the purpose of this study is to analyze the trade relation between EU and Western Balkans and present a perspective about the future of membership of Western Balkan countries for EU. This study of the Western Balkans covers Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Serbia, and Kosovo. In order to achieve this aim, this paper is organized as follows: Section 2 examines the geopolitical, geographical and the economic perspectives of Western Balkans. Section 3 describes the theoretical aspect of integration and analyzes integration projects in Western Balkans. Section 4 examines the political and economic relations between EU and Western Balkan Countries. Section 5 identifies the strengths and weaknesses of Western Balkan Countries. Finally, it will be given a conclusion.

## **2. The geographical, geopolitical and economic aspects of Western Balkans**

Balkan region represents a bridge between Asia and Europe. This natural bridge between Europe and Asia is affected several social, economic and cultural factors. Since oldest periods of time, this region has been playing an important role from geopolitical and economic aspects.

The Balkan region stands for the territory between Aegean Sea, Turkish Thrace, Adriatic Sea and Black Sea. The northern side of the region is still under conflict because in the northern does not exist any natural border (Kacmaz, 2006). Moreover, cultural and ethnic problems are still continued in the region.

Since 14<sup>th</sup> century, for Ottoman Empire, this region had been a project of colonization. One of the biggest aims of this project was to increase the number of Muslims (Birsal and Kodaman, 2014). In the 19<sup>th</sup> century the Balkan Peninsula was the territory of battles against Ottoman Empire. At that time the Ottoman Empire started losing its power of domination. After fall of Ottoman Empire, countries such as Bulgaria, Greece, Albania and Federal Republic of Yugoslavia with its 6 republics: Slovenia, Croatia, Serbia, Montenegro, Bosnia and Herzegovina, and with two autonomous regions Vojvodina and Kosovo, obtained their independence.

The first actions of dissipation in Yugoslavia had started in 1989. As a result, Yugoslavia was a battlefield between different political and ethnic groups. Slovenia, Macedonia and Croatia got the independence in 1991, and in 1992 Bosnia and Herzegovina. The Serbia and Montenegro separated in 2006 and finally Kosovo got the independence in 2008.

After fall of socialism and of Yugoslavia, the economy of Western Balkan countries turned to an economic crisis. Due to various ethnic conflicts, civil wars, uncontrolled migration and macroeconomic instability, the economy of these countries were affected negatively. The Western Balkan countries are in the process of transition. In order to overcome through this process, these countries have shown some improvements in the economic process and in privatization of some economic sectors.

They opened up to global trade and became increasingly export-oriented, expanded the role of the private sector, dismantled regulations that stifled business development, and began to build institutions needed to support a market system. Banking systems were built up with the aid of foreign capital and know-how. The result of these efforts has been robust economic growth, a significant rise in incomes and living standards, and enhanced macroeconomic stability (IMF, 2015).

Basically, the transition in the Western Balkans has had three phases. The beginning of 90's was characterized by wars, international sanctions, lost markets and slow political reform. A second phase took place between 2000 and 2008 till crisis. During this period, GDP began to recover. However, the improved performance in 2001-08 was based on an unsustainable pattern of increased consumption linked to fast credit growth, widening current-account deficits and increasing private debts. Performance has been especially poor since the 2008 crisis, the period that constitutes the third phase. Output fell in 2009 and since then the region has essentially stagnated.

The biggest GDP growth among Western Balkan countries for 2013 was registered in Kosovo, Montenegro and Serbia as 3%. For 2014, the biggest GDP growth was registered in Macedonia as 4%. Inflation rates in Western Region are quite moderate in 2013 and 2014. The highest rate of inflation for 2013 was 5%, and was registered by Serbia. In 2014, Western Balkan countries have an inflation rate between 1 and 2 except Kosovo. The lowest rate was registered in Kosovo. Also, based on the average per capita value of gross domestic product, Kosovo has the smallest value, though not far from Albania, Bosnia and Herzegovina or Macedonia. Montenegro is ranked first in the region with the highest average per capita, followed in ranking by Serbia, Macedonia and so on (Table 1).

**Table 1. The Economic Analysis of Western Balkans, 2013-2014**

	GDP growth		Inflation		GDP per capita	
	2013	2014	2013	2014	2013	2014
Albania	1%	2%	1%	1%	4,510	4,460
Macedonia	3%	4%	4%	1%	4,980	5,150
Serbia	3%	-2%	5%	2%	6,050	5,820
Montenegro	3%	2%	2%	2%	7,250	7,240
Kosovo	3%	3%	2%	0%	3,960	4,000
Bosnia and Herzegovina	2%	1%	0%	1%	4,790	4,780

**Source:** World Bank Development Indicators

Foreign trade is quite important for Western Balkan countries because foreign trade is an important part of the GDP. However, foreign trade in the region still needs to improve. The Especially, the share of foreign trade as a percent of GDP should increase in the region. (Table 2).

**Table 2. The Trade Analysis of Balkan Countries, 2013-2014**

	Export of Goods and Services (% of GDP)		Import of Goods and Services (% of GDP)	
	2013	2014	2013	2014
Albania	35.4	28.2	53,5	47,3
Macedonia	43.8	47.9	61,9	65,1
Serbia	41.2	44.3	51,9	54,3
Montenegro	41.3	40.1	61,4	60,0
Kosovo	17.3	19.6	48.9	50.5
Bosnia and Herzegovina	34.2	34.3	55,2	57,6

Source: Worldbank Development Indicators

From the point of natural resources, Western Balkan countries are rich, particularly Serbia and Kosovo. Copper, zinc, silver and coal are some examples of extracted sources. Kosovo is on the third place in Europe after Germany and Poland due to the sources of lignite. Natural resources of Western Balkan countries can help to their foreign trade in other countries.

One of the indicators which evaluate the performance of a country’s economy is the annual report published by the World Bank which analyzes doing business of that country. Currently, the World Bank has about 189 economies from various countries around the world for comparison basis. The following table shows the ranking of the Western Balkan countries in this comparative list with these economies. Within this comparative list, Kosovo compared to the Western Balkan countries is ranked before Bosnia and Herzegovina, and Serbia, while Macedonia is positioned best in this list. Afterwards, Montenegro, and Albania are ranked. It is important to note that Kosovo has made significant improvements in recent years through the reforms that it followed and if this trend continues, it is expected that in the near future Kosovo will be better ranked in relation to the other countries (KBA, 2015).

**Table 3: Doing Business Ranking**

	2013	2014
<b>Albania</b>	108	68
<b>Macedonia</b>	31	30
<b>Serbia</b>	77	91
<b>Montenegro</b>	42	36
<b>Kosovo</b>	81	75
<b>Bosnia and Herzegovina</b>	104	107

Source: World Bank– Ease of doing business index

### 3. The Regional Integration and Western Balkans

In world economy, the word “integration” is quite an old name. This concept has been using since 19<sup>th</sup> century. Ballassa(1961) defines economic integration as a “*process and as a state of affairs. Economic integration comprises the set of political and economic measures to eliminate discrimination between economic units that belong to different national states. It represents the absence of discrimination between national economies.*”

Economic integration can take several forms that are represented in the following table. These are free trade area, customs union, common market, economic union and economic & monetary union. In a free trade, the tariffs are abolished, but each country retains its own tariff against members. Besides the suppression of discrimination in the field of commodities within union, customs union involves the equalization of tariffs in trade with nonmember countries. Other form of economic integration is common market, where not only trade restrictions but restrictions on factor of movements are abolished. An economic union is distinct from a common market, combines the suppression on factor policies and commodities, in order to remove discrimination that was due to disparities in these policies. Finally, economic union presupposes the unification of fiscal, social and monetary policy and requires to set up an authority whose decisions are binding for member states. Table 4 summarizes types of economic integrations and its characteristics.

**Table 4. Types of economic integrations and its characteristics**

Type of integration	Trade between members	Common customs duties	Free movement of production factors	Conformity of economic policies
<b>Free Trade Area</b>	Yes	No	No	No
<b>Customs Union</b>	Yes	Yes	No	No
<b>Common Market</b>	Yes	Yes	Yes	No
<b>Economic Union</b>	Yes	Yes	Yes	No
<b>Economic and Monetary Union</b>	Yes	Yes	Yes	Yes

The first moment toward the first step of new political and economic cooperation between Western Balkan countries is considered to be the end of Kosovo war in 1999 and as a result the signing of South-East Stabilization Pact in Cologne, Germany, on 10<sup>th</sup> of June 1999. The South-East Stabilization Pact is consisted in three blocks: Democracy, Security and Economy. In the group of Economy, group starts the fact that South-Eastern European countries, were small and relatively undeveloped economies. So the main development goals have been defined as those of trade, transport, and energy. Actually, these economies do not have other choice for development, except their regional cooperation.

For Western Balkan Countries, free trade agreements are the most important instrument of regional cooperation in the trade policy and the creation of a network of bilateral free trade agreements. Western Balkan countries have made an important step. The level of economic integration among Western Balkan countries presents the following table.

**Table 5. Matrix of Free Trade Agreements in Western Balkans**

	Albania	Macedonia	Serbia	Montenegro	Kosovo	Bosnia and Herzegovina
Albania		FTA 2002	FTA 2004	FTA 2004	FTA 2003	FTA 2004
Macedonia			FTA 2006	FTA 2006	FTA 2005	FTA 2002
Serbia						FTA 2002
Montenegro						FTA 2002
Kosovo						FTA 2006
Bosnia and Herzegovina						

**Source:** Engjell Pere (2009). 'The significance of economic trade relation for regional integration in the West Balkans', *Geographica Panonica*, Volume 13, Issue 4, 159-165.

Albania concluded FTAs with other Western Balkan countries under the terms of the 2001 MoU (Memorandum of understanding). The first free trade agreement with Macedonia came into force in July 2002. Other free trade agreement followed Kosovo which came into 2003, Serbia and Montenegro in 2004 and finally Bosnia and Herzegovina in 2004. A trade reform carried out in 1998 resulted in the unification of the customs regime, which reduced the average tariff on specific goods remained. In the consequence of Dayton Agreement from 1995, the two entities of Bosnia and Herzegovina had trade laws. Free trade agreements were introduced in conformity with MoU with Macedonia in 2002 and with Albania in 2004. Serbia and Montenegro signed free trade agreement with all states in the region. A free trade agreement with Bosnia and Herzegovina came into force in July 2002 and has involved the abolition of all duties on both agricultural and industrial products. Free trade agreement came into force with Albania in 2004, and with Macedonia was initialized in 2005 (Bartlett, 2008).

After free trade agreements, regional trade started to improve. Table 6 and Table 7 indicate the import and export share among Balkan countries. The level of trade integration in region is low but considerable. Free trade agreements will create opportunities and bring benefits for Western Balkan countries.

**Table 6. The Export Share among Western Balkan Countries, 2013**

	Albania	Macedonia	Serbia	Montenegro	Bosnia and Herzegovina	Kosovo
Albania		1,7	2,8	1,2	0,14	-
Macedonia	1,7		11	0,71	0,71	-
Serbia	0,96	3,5		4,9	7,3	-
Montenegro	3,1	0,77	13		4,7	-
Bosnia and Herzegovina	0,59	1,1	7,9	2,9		-
Kosovo	15,5	7,2	4,1	3,8	-	

**Source:** The Observatory of Economic Complexity, Statistical Agency of Kosovo, <https://ask.rks-gov.net/>

**Table 7. The Import Share among Western Balkan Countries, 2013**

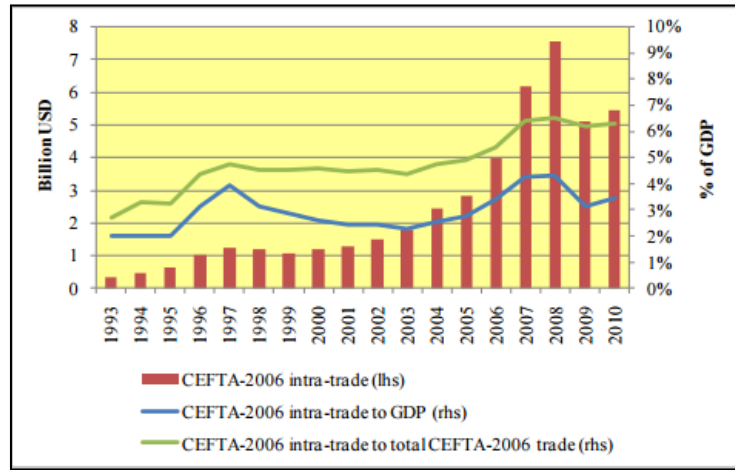
	Albania	Macedonia	Serbia	Montenegro	Kosovo	Bosnia and Herzegovina
Albania		1,7	2,9	0,34	-	0,98
Macedonia	0,70		8	0,62	-	2,1
Serbia	0,96	3,5		4,9	-	7,3
Montenegro	1,3	1,3	29		-	6,5
Kosovo	2,7	7,6	11,2	0,6		2,2
Bosnia and Herzegovina	0,36	0,98	-	0,24	-	

**Source:** The Observatory of Economic Complexity, Statistical Agency of Kosovo, <https://ask.rks-gov.net/>

Central European Free Trade Agreement (CEFTA) has also developed trade integration in the region. On 15<sup>th</sup> of February 1991 the Poland, Czechoslovak Republic and Hungary signed a declaration in the town of Visegrad. In 1993 after the partition of Czechoslovak Republic, the signed declaration got the name of “Visegrad Group”. This group focused on the integration in EU. In September 1991, it was decided to create a free trade area and on 21<sup>st</sup> of December 1992 in Krakow, Poland, was created a little bit known new free trade area CEFTA. CEFTA expanded to Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Macedonia, Moldova, Montenegro, Romania, Serbia, Slovakia, Slovenia and Kosova.

The CEFTA represents a regional trade integration initiative aimed at increasing cooperation between its members in order to prepare for the EU membership. EU enlargement represents the main driving force behind the CEFTA. The CEFTA is one of the answers to the EU’s conditions to enhance regional integration for further progress in the accession process. The CEFTA agreement eliminated duties on some 40% of industrial goods. By 1997, CEFTA had abolished duties on all industrial goods, apart from minor list of sensitive goods. As a result of CEFTA politics, intra-regional trade has improved (Figure 1).

**Figure 1. CEFTA-2006 Intra-Regional trade**



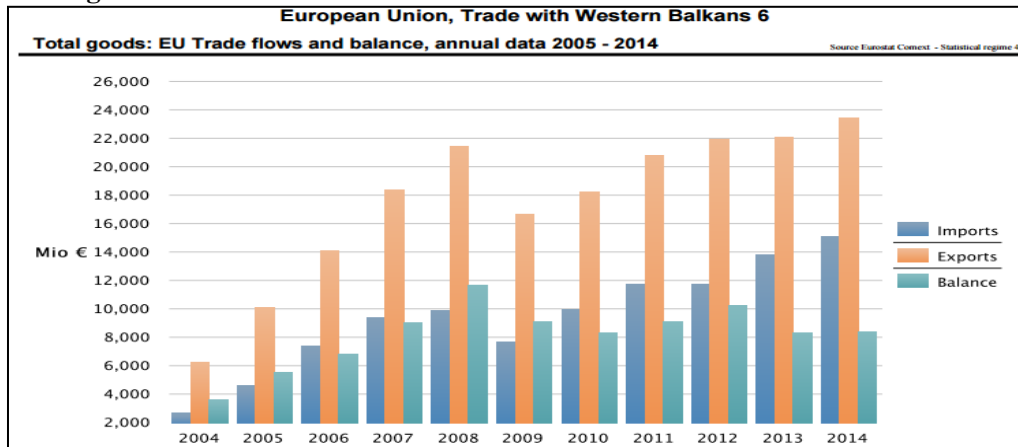
Source: IMF DOTS

#### 4. The Political and Economic Relations between EU and Western Balkans

The European integration of Western Balkans has posed a unique policy challenge to EU. The EU has developed a strategic policy enlargement as well as security concept for the Western Balkans. The basis of its policy represents the Stabilization and Association Process (SAP). The SAP has been built on the accession process approach applied to Central and Eastern Europe, with a policy enhanced conditionality and regional cooperation. The SAP in the economic domain was promoting, the intensified trade cooperation among the Western Balkan countries, which led the signing of different trade agreements and the Stabilization and Association Agreements (SAA) of these countries with EU.

According to the following table, the trade between EU and Western Balkans in the period of 2004 - 2014 has increased as a result of trade integration process.

**Figure 2. The Trade Flow and Balance between EU and Western Balkans**



Source: European Commission Report 2015



The European Union is the main trade partner for Western Balkans, accounting 75% of the region's total trade. As a whole the region's share of overall EU trade was 1.1% in 2014, however individual countries' shares were very low - Serbia (0.50%), Bosnia and Herzegovina (0.20%), the former Yugoslav Republic of Macedonia (0.20%), Albania (0.10%), Montenegro (0.0%) and Kosovo (0.0%). The main imports of EU from Western Balkan countries in 2014 constituted: machinery and transport equipment (26.5%), miscellaneous manufactured articles (21.3%), and manufactured goods classified chiefly by materials (19.8%). The EU's exports to the Western Balkans were mainly machinery and transport equipment (27.0%), manufactured goods classified chiefly by material (23.4%), chemicals (14.2%), and mineral fuels (12.3%) (ECR, 2015).

## **5. The Strengths and Weaknesses of Western Balkan Countries**

The strengths and weakness of Western Balkan Countries present following tables. These results are related to level of macroeconomic stability, business environment and competitiveness and progress in the EU integration process. Experience shows that the countries in the Western Balkans have important potential advantage such as macroeconomic stability because of contracting deficits. However, high external debt is major challenges for Western Balkan countries. Reduced barriers are important advantage that is leading high level of trade integration. Progress in the EU Integration is moderate. Especially, EU integration of them needs to improve in terms of legal system and banking sector and free movements of goods.

**Table 8. Strengths and Weaknesses of Western Balkan Countries**

1) Achieved Level of Macro Economic Stability	
Strengths	Weaknesses
Contracting fiscal deficit Contracting current account deficit	Contracting current account deficit High and growing general government debt Slow recovery of GDP High exposure to the Eurozone crisis High external debt
2) Business Environment and Competitiveness	
Strengths	Weaknesses
Reduced business barriers in the area of protecting investors and a closing a business	Level of competitiveness Capability for innovation Macroeconomic stability Business barriers in the area of construction permits, enforcing contracts and paying taxes Corruption Market size Rule of Law
3) Progress in the EU Integration Process	
Strengths	Weaknesses
Broad political consensus on the essentials of economic policy High level of trade liberalization High level of price liberalization High level of trade integration with EU High level of approximation in the following areas: Custom Union and External Relations	Moderate progress towards EU Underdeveloped non-banking sector Legal system weaknesses Low share of R & D spending in GDP Unemployment Rate Low level of approximation in the following areas: free movement of goods, agriculture and rural development area.

Source: Penev, 2013.

The weaknesses and strengths of Western Balkan countries are summarized as follow (Penev, 2013):

### **Serbia**

**Strengths:** Serbia is proximate to Western European markets. Serbia has an abundance of highly skilled, very low-cost labor available. The labor force includes many workers with engineering and technical skills applicable to the automotive components industry, including talented graduates from technical and business schools.

**Weaknesses:** There is a limited availability of “soft” managerial skills among an abundant pool of managerial workers.

### **Montenegro**

**Strengths:** Montenegro has many natural advantages in the production of high-quality grapes and other fruits. Also this country has a big potential for tourism driven growth in the local market.

**Weaknesses:** However, Montenegro has not yet a developed production base and market.

### **Albania**

**Strengths:** The labor costs of Albania are low and the strategic location represents an advantage. Additionally, Albania has high levels of quality. Other strengths cited include: an experienced workforce and growing local market opportunities.

**Weaknesses:** National trademarks have not yet emerged and relations with marketing channels are undeveloped. Other weaknesses are limited availability of industrial sites and technical workers, less reliable energy resources.

### **Bosnia and Herzegovina**

**Strengths:** Bosnia and Herzegovina benefits a consistently stable national currency, the lowest inflation rate in South-Eastern Europe and high advanced and growing financial sector. Skilled labor is abundantly available, particularly in engineering and other technical areas.

**Weaknesses:** Bosnia and Herzegovina suffers from a bad image of its economy, especially with regard to political stability, labor inflexibility and productivity.

### **Macedonia**

**Strengths:** Macedonia benefits from a regional cost advantage relative to all its neighbors other than Serbia, with abundant low-cost skilled and unskilled labor and relatively less expensive industrial land. The automotive components sector exhibits an existing export orientation, with companies already in the field exporting 80% of production.

**Weaknesses:** Macedonia has limited technological/design expertise and experience and limited production of major inputs (e.g., special steel, plastic materials) for automotive component manufacturing. Macedonia also does not yet have a strong track record in highly engineered precision components, and few factories focus on high-level R&D.

### **Kosovo**

**Strengths:** GDP growth remained positive during and after the crisis period. Also Kosovo has relatively low fiscal deficit. There are low business barriers in the following areas: registering property and closing a business.

**Weaknesses:** Kosovo has a high level of corruption. There are several business barriers in the following areas: Starting business, construction permits, trading across borders, and protecting investors.

## **6. Conclusion**

The regional integration of the Western Balkan countries represents an important aspect of European integration for countries in this region, it can be considered as a preparatory phase for their integration into EU. A very important aspect for the integration is economic collaboration with the region countries. Western Balkan countries have had a relatively fast progress toward their regional integration politics in the economic field. The process started in 1999 with the Stability Pact that was continued with the CEFTA -2006 agreement.

In terms of macroeconomic stability of the Western Balkan countries, the opening of their economies is followed by deficits of current accounts and trade balances. However, current account deficits tend to decrease in recent years. The export and import part of the different countries with other region countries show an increasing tendency. Reduced barriers are the strongest sides for business environment and competitiveness. Trade integration with EU is at high level for Western Balkan countries. Therefore, the development of Western Balkans and EU's trade relationships will make strong the regional integration, increase their economic potential and reinforce their political relations.

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