

Policy Department External Policies

TRADE AND ECONOMIC RELATIONS BETWEEN THE EU AND THE WESTERN BALKANS

INTERNATIONAL TRADE

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SUMMARY

This paper presents an overview of the current state (mid-2008) of the economic relations between the EU and the Western Balkan countries. The text starts with a description of bilateral relationships, followed by recent data on trade and investment. Then follows a brief description of intra-Balkan integration. After that, each Western Balkan country's integration into the global economy is discussed. The last section concludes.

The paper argues that integration has proved to be a successful tool in support of the economic development and also, to some extent, in stabilising a politically sensitive region. Therefore, for the EU, it is worth pushing for the next steps in bilateral and regional integration as strongly as possible and thus enhancing stability and sustainable growth. The EU is in an ideal position to press on reforming Western Balkan institutions and condition its assistance in fighting corruption. Within the trade-related measures, the focus should be on the effective reduction of non-tariff barriers to trade, as this may strongly accelerate catch-up processes in the region. Given the economic recovery so far and the earlier experience of the current new member countries, it can be foreseen that the returns to unskilled labour in the region will gradually decrease over time. Therefore, it is desirable to support actions which may increase the skills of the whole working-age population in the Western Balkans and help to lessen current and future social pressures.

Although EU–Western Balkan relations have been dominated by the concern of enhancing security in the region, the paper does not address this issue, at least not directly.

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List of Acronyms

ATP – autonomous trade preferences
BiH – Bosnia and Herzegovina
CA – current account
CARDS – Community Assistance for Reconstruction, Development and Stabilisation
CEE – Central and Eastern Europe
CEFTA – Central European Free Trade Agreement
CPI – consumer price index
EC – European Commission
EFTA – European Free Trade Association
EU – European Union
FTA – free trade agreement
FYROM – Former Yugoslav Republic of Macedonia
GDP – gross domestic product
HLSG – High Level Steering Group (in Albania)
IA – Interim Agreement
ICTY – Criminal Tribunal for the Former Yugoslavia
IPA – Instrument of Pre-Accession
NTBs – non-tariff barriers (to trade)
PPP – purchasing power parity
RCA – revealed comparative advantage in bilateral trade
RCC – Regional Cooperation Council
SEE – South East Europe
SAA – Stabilisation and Association Agreement
SAP – Stabilisation and Association Process
SITC – Standard Industrial Trade Classification
TAIEX – Technical Assistance and Information Exchange

I. Background

The Western Balkans¹ have been the focus of interest of the EU in recent years, for several reasons. Firstly, political instability in most of the countries and destructive conflicts in some of them followed by mass emigration have adverse effects on the EU, which has reiterated the need for stronger involvement in this region. Secondly, the countries of the Western Balkans have always been considered as a part of Europe, at least historically and geographically. For that reason, they have a place in the EU enlargement plans. Two Western Balkan countries, Croatia and the Former Yugoslav Republic of Macedonia (FYROM), have already gained the status of candidate countries, whereas Bosnia and Herzegovina, Albania, Montenegro and Serbia have been granted potential candidate status so far. The only country included in the accession process outside this region is Turkey.

It is necessary to note at the very beginning that the term “Western Balkans” refers to a group of countries that are geographically close and were highly integrated in the past (except Albania). Yet, they are very different in economic terms. Croatia is the largest and the richest country in the region, even when correcting for differences in purchasing power parities. Its per capita income of over 14,000 USD (in 2006) is close to that of Poland, and it is higher than that of either Romania or Bulgaria. Other Western Balkan states are poorer on average than any of the existing EU member states. The region has been dynamically growing in recent years, although at a cost of external borrowing (shown in Table 1 as high current account deficits). Some countries, like Serbia, still have problems with achieving macroeconomic stability, which is reflected in high or instable inflation rates. Overall, in all the countries with the exception of Croatia and to some extent Albania, a significant part of the economic activity is still unregistered, as indicated by very high unemployment rates. The region as a whole is inhabited by almost 24 million people.

This briefing paper provides a detailed overview of the current economic and trade relations between the EU and the Western Balkans, as well as the current state of intraregional integration of the Western Balkans region and its wider integration into the world economy. The paper has four main sections. The next section provides an overview of the current relations between the EU and the Western Balkans. The following part presents intra-regional integration, which is complemented by the current situation with the global integration of trade of the Western Balkans. The next section summarises the data on trade-related Community support. The last section concludes.

¹ The term “Western Balkans” in this paper refers to the group of the following countries: Albania, Bosnia and Herzegovina, Croatia, Kosovo, Montenegro, Macedonia and Serbia.

Table 1 Basic economic indicators of the Western Balkan countries, 2006–2008

Country	GDP growth (in %)			GDP (PPP adjusted) per capita in USD	CPI inflation (in %, eop*)		CA in % of GDP		Unemployment rate	Population in millions
	2006	2007	2008e		2006	2007	2006	2007		
Year	2006	2007	2008e	2006	2006	2007	2006	2007	2006–2007	2006
Croatia	4.8	5.8	4.3	14,309	2.0	5.8	-7.9	-8.5	6.7	4.44
Serbia	5.7	7.3	4.0	9,427	6.6	10.1	-12.5	-16.5	20.9	7.44
FYR Macedonia	3.7	5.0	4.5	7,879	2.6	6.1	-0.4	-2.7	34.8	2.04
BiH	6.2	5.8	5.5	6,460	..	..	-8.4	-13.0	29.0	3.95
Albania	5.0	6.0	6.0	5,808	2.5	3.1	-5.9	-8.3	13.8	3.15
Montenegro	6.5	7.5	7.2	..	2.0	5.0	-30.4	-37.0	..	0.62
Kosovo	..	..	..	..	1.1	10.5	..	..	44.9	2.10

Source: IMF WEO (April 2008), Eurostat, Kosovo Statistical Office (www.ks-gov.net/ESK/) and other national statistical offices (unemployment rates)

Note: * - end of period

II. The Western Balkans and the EU

EU enlargement process

The EU's activities towards this region have two major goals. The first is an extensive process of stabilisation, after all the turbulence of the 1990s. Another supporting goal of the EU is a process of accession through the economic development of the countries and through gradual integration with the EU. Two countries of the region, Croatia and the Former Yugoslav Republic of Macedonia (FYROM) have already gained the status of candidate countries and Croatia is already advanced in negotiation talks. Albania, Bosnia and Herzegovina, Montenegro and Serbia are further down the road, but nevertheless have already signed Stabilisation and Association Agreements (SAA), which are considered as a final step towards gaining candidate country status. Only Kosovo, a new independent state within this region, has not yet signed a Stabilisation and Association Agreement with the EU, although it is already within the Stabilisation and Association Process (SAP) framework.²

² See Annex II for a more detailed overview of bilateral relations.

Table 2. EU Stabilisation and Association Agreements with the Western Balkan countries

Country	Status	Date signed
Albania	Signed	12 June 2006
Bosnia and Herzegovina	Signed	16 June 2008
Croatia	In force	1 February 2005
FYR Macedonia	In force	21 April 2004
Montenegro	Signed	15 October 2007
Serbia	Signed	19 April 2008

Source: ec.europa.eu

EU trade policy towards the Western Balkans

Similarly to the case with the current new member states of the EU, the Balkan–European integration of the last decade started with liberalising trade. On the one hand, the parties have progressed in signing and – in some cases – implementing bilateral free trade agreements, establishing tariff-free two-way trade in manufacturing goods.³ Simultaneously, the EU assisted in the regional reintegration of the Balkan countries, aiming at boosting intra-regional trade and investment flows and at the same time creating grounds for multilateral economic arrangements in the Balkans. This last priority has materialised through the establishment of the regional trade agreement (CEFTA – Central European Free Trade Agreement⁴). We will return to the intra-regional integration later in the text.

An important part of a typical SAA agreement is the reciprocal liberalisation of trade between the EU and a given Balkan country. However, imports to the EU from the region have already been largely liberalised. In 2000, the EU granted autonomous trade preferences to all the countries of the region, by removing tariffs and quantitative limits to almost all the products originating there.⁵ The preferences were initially granted for a period of five years, but in 2005 they were extended until 2010.

The next step is the creation of a free trade area in manufacturing goods between the EU and a given Western Balkan partner. This has been happening either on the basis of Interim Agreements (as parts of SAAs) or SAAs themselves. According to such agreements, the EU abolishes the remaining quantitative restrictions (tariffs, quotas) on imports of manufacturing products from a given Balkan country. The importing of manufacturing goods from the EU to the region is to be gradually liberalised in the years following the starting date of an agreement. A typical EU agreement also contains provisions on the liberalisation of trade in fish and fish products, certain agricultural goods, processed food, as well as provisions on competition and state aid, intellectual property, economic cooperation, rules of origin, sanitary and

³ The EU was one party and a given Balkan country was another one.

⁴ Named after the initial Central European signatories in the early 1990s.

⁵ Some products, such as wine, sugar and certain fishery products, remain subject to preferential tariff rates, whereas textile products from Montenegro and Kosovo are subject to quotas.

phytosanitary measures, administrative cooperation of customs and some liberalisation of trade in services.

At the moment, Croatia has completed the transition phase foreseen in its SAA and established a free trade zone with the EU and Turkey.⁶ This is to say that bilateral trade in manufacturing goods is tariff-free, provided that a significant part of the traded commodity is produced either in the EU or in Croatia. Customs controls remain. FYR of Macedonia will establish a similar free trade area with the EU in 2011. The importing of manufacturing products originating in FYROM was largely liberalised in 2002, and tariffs on FYROM imports of the Community's products will be gradually lowered, to disappear in 2011. Montenegro is expected to create such a free trade area preliminarily in manufacturing goods with the EU at the beginning of 2013, Bosnia and Herzegovina in mid-2013 and Albania by 2015.

Detailed information on the timing of transition periods before the establishment of a free trade area between the EU and Serbia is not yet available. However, assuming that it is possible for Serbia to start phasing out its quantitative restrictions in 2009 (pure speculation; the earliest possible date) and that the typical transition period takes from five to ten years, the establishment of a free trade area between Serbia and the EU can be expected by 2014 at the earliest. This is to say that, roughly speaking, the Western Balkan region as a whole (although prospects for Kosovo are not that clear) can be ready for the next steps beyond the liberalisation of manufacturing and fishery trade around the year 2015.

The next step is complete harmonisation of national legislation concerning technical standards, sanitary and phytosanitary measures and other trade-related laws with that of the EU. This is for the reason that non-tariff barriers (NTBs) to trade arising from the need to comply with different norms (at home and at a destination market) add much to trade costs, and in the absence of any quantitative restrictions (tariffs and quotas) can still pose a significant barrier to developing production and sales (to the EU) by firms established in the Western Balkans.⁷ As a starting point, existing SAAs have provisions of approximation of relevant legislation.

EU trade in goods with the Western Balkans

Trade flows between the EU and the Western Balkans show strong asymmetry. For the Balkan countries, the EU remains the single most important trade partner of all, with trade shares ranging from 50% (FYROM) to 75% (Albania). However, the dependence on trading with the EU has decreased in the 2000s, along with the development of the region. For the EU, in turn, the Western Balkans remain not so important, with less than 1% of the EU overall imports originating in the region and less than 2% of the EU's exports being sold there. The value of goods imported from the Western Balkans in 2007 was similar to that imported to the EU27 from Israel or

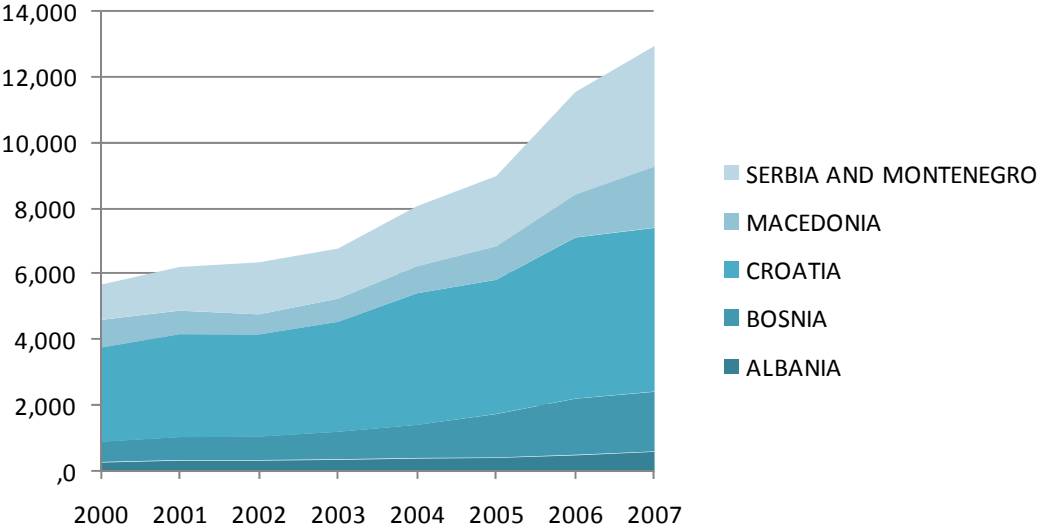
⁶ The EU has a customs union in manufacturing trade with Turkey.

⁷ And also to the EU firms selling at the Western Balkan markets. However, this cost is commonly seen as rather small, as EU norms are often accepted at relatively less developed markets.

Ukraine, and roughly half of the value of imported Canadian goods. The EU enjoys trade surpluses in the exchange of commodities with every analysed Western Balkan country.

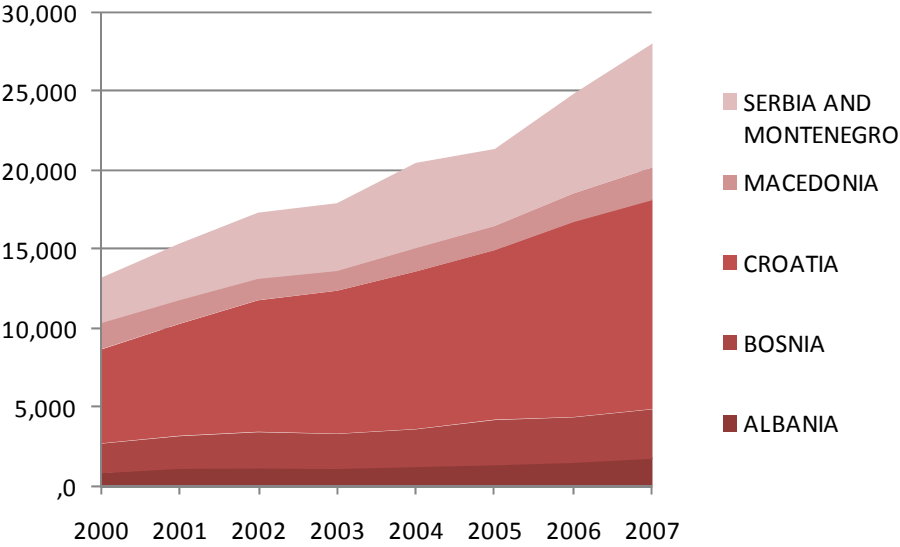
By far the largest regional trade partner of the EU is Croatia, although trade with Serbia has recently been on a steep rising path. Imports to the EU27 from Serbia and Montenegro rose by nearly 4 times in 2000–2007 to €3.7 billion. This is still less than the €5 billion worth of merchandise bought in Croatia in 2007, but nevertheless it is already substantial. Imports from FYROM and Bosnia amounted to €2 billion each. Albania (and Kosovo) are clearly the least important partners in the international exchange of commodities.

Figure 1. Imports from the Western Balkans to the EU27, 2000–2007, millions EUR



Source: EUROSTAT

Figure 2. Exports from the EU27 to the Western Balkans, 2000–2007, millions EUR



Source: EUROSTAT

The booming Balkan market has been even more important as a place for selling EU produce. All the analysed countries (with the exception of Kosovo on which we lack data) bought €28 billion worth of merchandise from the EU in 2007 (over twice as much as back in 2000). The Western Balkan market for EU goods will most likely continue to grow in the coming years, along with the economic developments of the countries.

Conventional trade theory argues that foreign trade happens mainly because countries have comparative advantages in the production of particular goods or services. These comparative advantages are not directly observable. However, one can use data on actual trade patterns to calculate measures of so-called revealed comparative advantages (RCA). RCAs indicate sectors and markets where exports originating in a given country are more (or less) competitive in relation to the other trading partners present on a given destination market.⁸

Here, we use 2006–2007 data on EU–Western Balkan trade to see in which groups of products each side possesses strong comparative advantages. The results from Table 3 show that the EU possesses a strong comparative advantage in mineral fuels and in machinery and transport equipment vis-à-vis the Western Balkan countries.⁹ The Western Balkans reveal comparative advantages vis-à-vis the EU in simple manufactured goods like rubber, leather, textiles, iron and steel, crude materials and also miscellaneous manufactured articles (like furniture, clothing, apparel etc.). FYR of Macedonia possesses a strong comparative advantage in beverages and tobacco on the EU market, while Serbia and Croatia seem to possess an advantage over exporting food and food products to the EU.

⁸ Revealed comparative advantage indices are calculated by using Balassa’s original formula:

$$RCA = \frac{\frac{x_{ij}}{x_{it}}}{\frac{x_{nj}}{x_{nt}}}$$

where *x* represents exports, subscripts *i* and *j* denote a country and a product group for which the index is being calculated, and subscripts *n* and *t* denote a set of countries and a set of commodities, respectively. In our case, the set of commodities includes all commodities (total exports), while the set of countries includes the EU27 countries.

According to this formula, a value of more than one shows that a country has a comparative advantage in exporting a product group to a particular market. If this value is lower than unity, then we can say that a country has a comparative disadvantage in exporting particular commodities to an analysed market. In other words, the measure shows if, for a given product category (and a given destination country), its Western Balkan export share is higher than the EU import share (averaged across all of the trading partners on the EU market).

⁹ And also in SITC 9, which stands for goods not elsewhere classified. However, we skip it here, as it is difficult to interpret this category.

With the exception of advantages in the export of food and food products from Croatia and Serbia, the Western Balkan states reveal comparative advantages in sectors classified as labour and, to some extent, capital-intensive. The situation of the Western Balkans vis-à-vis the EU is therefore similar to the situation of Central and Eastern European countries in the mid-1990s (see Neven 1994). Over time, CEECs have managed to shift their pattern of production and exports more in the direction of capital- and in some cases even human capital-intensive goods. We can expect this evolution to prevail in the Western Balkans too, although in the longer term. It requires time, external investment, continued efforts to reduce the costs of transactions (including NTBs), upgrading of skills and the accumulation of capital in the country.

Table 3. Revealed comparative advantages of the Western Balkans countries on the EU market, by SITC group, 2006–2007

Country/products	ALBANIA		BOSNIA HERZEGOVINA		CROATIA		FYROM		MONTE- NEGRO	SERBIA	
	2006	2007	2006	2007	2006	2007	2006	2007	2006	2006	2007
Food and live animals	1.05	0.84	0.4	0.43	2	1.6	1.27	0.89	0.21	3.77	2.86
Beverages and tobacco	1.05	0.9	0.14	0.16	1.42	1.04	13.77	10.09	0.6	0.3	0.5
Crude materials, inedible, except fuels	3.24	2.65	4.19	3.28	2.09	2.2	2.14	2.48	1.92	1.2	1.17
Mineral fuels, lubricants and related materials	0.17	0.29	0.07	0.06	0.16	0.21	0.04	0.01	..	0.03	0.04
Animal and vegetable oils, fats and waxes	0.03	0.01	0.72	0.51	0.26	0.38	0.06	0	..	0.5	1.85
Chemicals and related products, n.e.c.	0.03	0.03	0.36	0.37	1.02	1.04	0.16	0.14	0.02	0.98	1.13
Manufactured goods classified chiefly by material**	0.91	0.95	2.17	1.98	1.46	1.37	3.44	3.52	7.36	3.62	3.09
Machinery and transport equipment	0.16	0.17	0.69	0.73	0.85	0.89	0.13	0.09	0.06	0.31	0.45
Miscellaneous manufactured articles***	4.42	4.12	2.13	2.22	1.43	1.48	2.37	2.14	0.07	1.14	1.04
Commodities and transactions not classified elsewhere	0.17	0.28	0.2	0.32	0.27	0.25	0.07	0.08	0.04	0.44	0.32

Note: * – data for Montenegrin trade with the EU for 2007 is not available

** – leather, cork, paper, textiles, metals

*** – furniture, leather goods, apparel and clothing, footwear, precision instruments etc.

Numbers significantly higher than 1 indicate that a given Western Balkan country possesses a revealed comparative advantage in trade with the EU. Numbers close to 0 indicate that it is the EU which possesses a revealed comparative advantage in trade with a given Western Balkan country.

n.e.c. – nowhere else classified

Source: own calculations, based on EUROSTAT data

When looking at the more disaggregated level of trade in manufacturing goods¹⁰, it is apparent that the Western Balkan countries already compete at the EU market in apparel, footwear and leather goods with similar products from Turkey, Romania

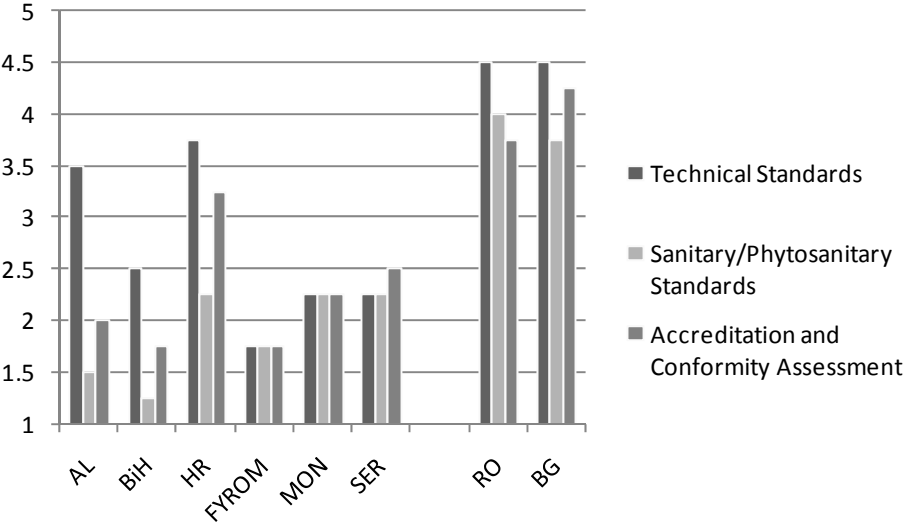
¹⁰ At SITC 3-digit level.

and Bulgaria. This is for the reason that all Western Balkan countries, Romania, Bulgaria and Turkey possess strong revealed comparative advantages in all these categories of goods, when exporting to the EU market. When exporting wood products, plywood and furniture – apart from competing with Romania and Bulgaria – the Western Balkans exporters compete also with products from Poland, Hungary, Czech Republic and Slovenia. The same can be said about lime, cement, some construction materials, pottery, glass etc. Otherwise, products exported from the Western Balkans to the EU are rather different than those manufactured and sold abroad by the current new EU members, although at the first glimpse they belong to similar groupings of goods.

Non-tariff barriers to trade in the Western Balkans (especially vis-à-vis the EU) are still significant. The institutional framework with respect to technical standards was assessed in general as “not bad” but also “not good” in Albania and in Croatia. However, in all the other analysed countries, even the institutions behind granting technical standards were seen as insufficiently developed. The transposition of European technical standards has progressed in Croatia and in Albania, yet for example in FYROM, Serbia and Montenegro, national standards still differ from the international ones, which adds costs for exporters.¹¹

Institutions in charge of sanitary and phytosanitary norms were in general assessed as deficient, and the worst mark in 2006 was given to the Bosnian and Albanian ones. The transposition of European sanitary and phytosanitary norms was assessed as equally bad.

Figure 3. Technical barriers to trade in the Western Balkans



Source: OECD (2006)

Note: the given area was assessed on a scale from 1 to 5, where 1 was the lowest and 5 was the highest possible score. Assessments were given by government officials, local stakeholders and international staff of the OECD Investment Compact in each of the countries.

¹¹ Who, in such cases, have to certify their products abroad, which adds costs.

Finally, conformity assessment is still a huge problem in all the analysed countries, perhaps with the exception of Croatia. There are not enough laboratories, mutual recognition agreements are not in force and, as a result, the number of certified companies is low.

A comparison of the Western Balkan countries with Romania and Bulgaria shows that the Western Balkans (perhaps with the exception of Croatia) are still very far away with regard to the removal of non-tariff barriers to trade.¹² This fact hampers the development of Western Balkan manufacturing export to the EU, and should be a target for action, as far as the development of local manufacturing industries is concerned.

EU–Western Balkan trade in services

Data on bilateral trade in services are not available,¹³ with the exception of data for Croatia. Croatia is the net seller to the EU of travel, commercial and transport services. This comes as no surprise, as the country is a well-known tourist destination for Europeans (hence the surplus in travel services), and comparatively lower wages make it a net seller of transport services. The EU has been a net seller of construction, financial and other business services to Croatia. We expect bilateral trade in services for Montenegro to show a similar pattern, i.e. a surplus of trade in services with the EU on the base of income from tourism. For the other analysed countries, bilateral trade in services is probably roughly balanced.

Table 4. Trade in services between the EU and Croatia, EUR million

Type of service	2004		2005		2006	
	Credit	Debit	Credit	Debit	Credit	Debit
Transportation	332	399	335	521	383	613
Travel	624	2,762	675	3,100	735	3,360
Other services, of which:	711	567	809	751	1,167	784
Communication	68	84	59	110	75	137
Construction	146	90	167	197	189	148
Financial services	44	7	27	6	108	9
Other	454	387	557	438	795	491
Services not allocated	110	64	86	50	-1	4
Total	1,777	3,791	1,906	4,425	2,284	4,762

Source: EUROSTAT

Croatia, Montenegro and Albania are different from other Western Balkan countries due to the great importance of trade in services (tourism) for their economies. Exports of services are roughly of the same magnitude as exports of goods. For trade in this type of service, the absence of domestic restrictions (like visa-free travel for

¹² Both Romania and Bulgaria had to adapt the EU technical, sanitary and phytosanitary standards at the date of entry to the EU (2007).

¹³ Data on overall trade in services are available but it is difficult to see what part can be attributed to the EU–W. Balkan trade.

visitors), geographical conditions and infrastructure are the most important supporting factors. At the moment, they are all there, so additional changes of regulations to be more in line with the EU ones will not have an immediate impact. However, further improvement of infrastructure and sustainable development will. The situation in service trade is quite different for other countries. For example, the value of the total export of services by Serbia is roughly equal to a quarter of the total value of exports of Serbian goods.

Here, it is useful to remember what liberalisation of trade in services means in practice. Depending on the type of service, its trade may face different barriers. For example, if a commercial presence abroad is not required, and the sale of services abroad is executed by phone, Internet, fax etc., the most likely obstacles to trade are business regulations in the provider's country. Similarly, if the presence of natural persons is required abroad in order to provide a specific type of service, the most likely barriers may arise from visa regimes and employment regulations in the host countries. When a commercial presence abroad is needed, then the host country regulations regarding the establishment of a business and its activity will play an important role. SAAs address some of the issues, especially equal treatment of EU firms in the Balkans and Balkan-owned enterprises in the EU (excluding the self-employed). Similarly, the Commission stated in 2007 (in line with the Council conclusions of 18/6/2007) that the time had come for the gradual liberalisation of the movement of people (i.e. to liberalise the current visa regime). However, some of the largest gains in the liberalisation of trade in services can be obtained once workers can move freely, and this is unlikely to happen soon.

One should also mention that the effects of the liberalisation of trade in services are likely to be positive for both parties (the EU on the one side and the Western Balkans on the other), due to a more efficient distribution of the factors of production. However, this may cause adverse effects on the vulnerable groups in the EU and it will therefore be hard to attain on political grounds. On top of this, it should be remembered that the liberalisation of trade in services is difficult to achieve even within the EU. Restrictions still hamper access to the provision of services due to the existence of monopolies, quantitative measures, territorial and residency restrictions, rules designed to ensure independence or autonomy, professional regulations, company tax regimes, price regulations, accounting rules etc.

The Western Balkans as a location for EU investment

The region has become an attractive location for European direct investment. In 2006 only, the EU firms invested nearly €7 billion there, which was close to 3% of all the outward EU FDI flows. The largest economies of Serbia and Croatia attract the majority of investment. It is expected that, along with closer integration with the EU, investment flows to the region will increase further, as happened similarly for all the current new member countries.

Table 5. Direct investment flows from the EU to the Western Balkans, EUR million

Partner	2004	2005	2006	FDI from the EU in total FDI (2004–2006 average)	Total FDI stock per capita in euro (2006)
Extra EU-27	142,278	234,538	260,202	..	..
Albania	134	42	71	32%	325
Bosnia and Herzegovina*	325	378	413	70%	984
Croatia	597	1,128	1,548	65%	4,807
FYROM	124	46	269	62%	951
Serbia and Montenegro	592	1,139	4,427	86%	1,128

Source: EUROSTAT, UNCTAD and the Western Balkan central banks

Note: * – for BH, data cover FDI from Austria, the Netherlands, Italy, Germany, Slovakia and Slovenia only. A further breakdown is not available.

Investors from the EU countries have been dominant players on all the Western Balkan markets except for Albania (where FDI from the EU accounted for 1/3 of the total FDI inflows in the last year). Some of this investment is export-oriented, aiming at using lower paid labour and the proximity of the European and other regional markets. In terms of FDI stock per capita, Croatia stands out with close to €5,000 of invested foreign capital per inhabitant. The presence of foreign firms is twice as intensive as in Slovenia, Latvia, Lithuania and Poland and close to that of Slovakia.¹⁴ This is to say that, due to a large presence of foreign capital, one can probably observe positive spillover effects originating from the cooperation of local firms with foreign partners. What has been observed to date is the positive impact of foreign investment in the Croatian manufacturing sector on Croatian manufacturing export (Vuksic, 2006).

The amount of foreign capital invested per head of inhabitants in other Western Balkan countries is lower than in any “new” EU member state. The capital stock in Albania is particularly low, rather closer to that in Georgia or Armenia than to any EU member country.

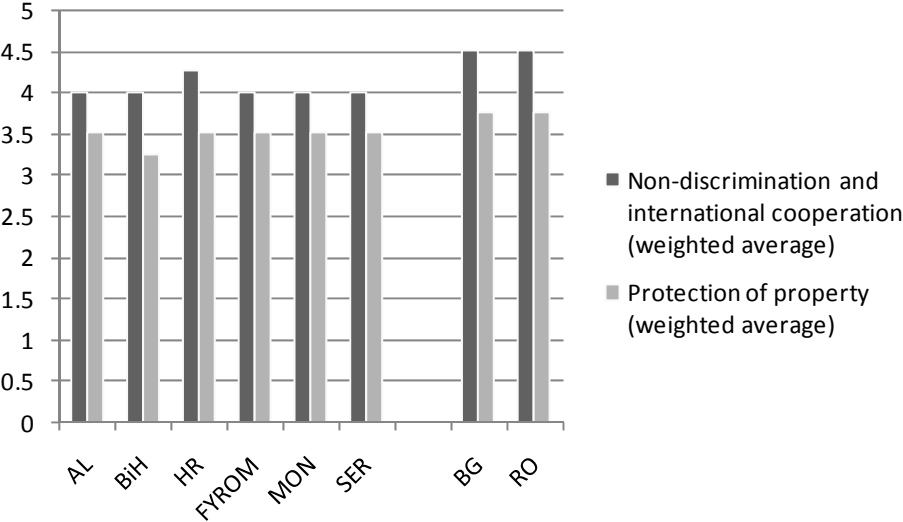
Investors located in the Western Balkans perceive this area as a generally business-friendly environment, where international cooperation is concerned. Foreign firms are not discriminated against in general, although there exist exemptions from the national treatment of foreign investors.¹⁵ The situation related to the protection of property is not that bright (see Figure 4). Bosnia and Herzegovina seem to be the least safe places, primarily due to violations of intellectual property rights and land ownership. At the other end is Croatia, which was rather favourably assessed with respect to its investment policy. Overall, the investment policies of the Western

¹⁴ Where investment dominated by the automotive industries is driving the whole manufacturing sector.

¹⁵ Usually in sectors where licences are required.

Balkan countries are seen as slightly less favourable than those of the two new EU members, Bulgaria and Romania.

Figure 4. Perceptions about investment policies in the Western Balkans



Source: OECD (2006)

Note: the given area was assessed on a scale from 1 to 5, where 1 was the lowest and 5 was the highest possible score. Assessments were given by government officials, local stakeholders and international staff of the OECD Investment Compact in each of the countries.

The expected possibilities of diagonal cumulation of origins of goods should enhance the willingness of foreign investors to develop export-oriented economic activities in the Western Balkans. Cumulation allows products that have obtained originating status in one partner country to be further processed or added to products originating in another participating country as if they had originated in that latter country. For example, if intermediate goods used for a product manufactured in Bosnia and Herzegovina are imported from, let's say, FYROM, and the final product is then exported to the EU, its FYROM and BiH origins can be cumulated, and a final product can enter the EU duty-free. Without such diagonal cumulation, both BiH and FYROM can cumulate with the Community but not amongst each other (when later exporting to the EU). So, without diagonal cumulation, a good produced partly in one Western Balkan country and partly in another would probably face MFN duties on its entrance into the EU.

The next boost should be provided by the extension of the planned Pan-Euro-Mediterranean system of cumulation to the Balkan countries. In its final shape, the system will allow for the cumulation of origin of goods from the EU, EFTA (European Free Trade Association: Iceland, Liechtenstein, Norway and Switzerland), Turkey, countries which signed the Barcelona Declaration (Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia and the Palestinian Authority of the West Bank and Gaza Strip) and the Western Balkans. However, at the moment, the Pan-Euro-Med cumulation (among the EC, EFTA and the Euro-Med countries) is only

about to be put in place, so adding new members will probably take some time and, as such, its impact will most probably be lower than that of the initial Balkan–EU cumulation, because of the lower importance of trade with the Southern Mediterranean countries.¹⁶ However, it can be significant at the level of individual industries.

III. Intra-Balkan economic relations

As mentioned earlier in the text, the EU initiated a Stability Pact of countries of the region in 1999, which was later transformed into the Regional Cooperation Council (in April 2008). Within the Stability Pact, Balkan countries, including Romania, Bulgaria and Moldova, signed a “Memorandum of Understanding on Trade Facilitation and Liberalisation” in 2001, as a commitment to signing a network of bilateral free trade agreements among themselves. As a result, more than 30 bilateral free trade agreements were signed among these countries by the end of 2006. The network of bilateral free trade agreements was replaced by the regional free trade agreement, CEFTA, signed in December 2006.¹⁷ CEFTA came into force on 1 May 2007. The agreement involves eliminating tariffs and quantitative restrictions on all manufacturing products and on some agricultural goods in trade among all the countries of the Western Balkan region plus Moldova.¹⁸

Currently (mid-2008), almost all the custom duties in the exchange of manufacturing products among the Western Balkans are eliminated.¹⁹ Trade in agricultural products is liberalised to some extent, although a large number of concessions (quotas, tariffs) for agricultural produce apply at every Western Balkan market.²⁰ Generally speaking, Albania and Croatia protect their agricultural market even vis-à-vis products originating in other Western Balkan states, with the exception of imports from Kosovo (and from BiH in the case of Croatia). By the rule of reciprocity, Albanian and Croatian agricultural exports sold elsewhere in the region are subject to quotas or MFN tariffs (with the exception of Croatian agricultural exports to BiH).

¹⁶ The EU and other Western Balkans account for the vast majority of each Western Balkan country commodity trade (see statistical annex).

¹⁷ The list of bilateral free trade agreements which were terminated upon entry into force of the new CEFTA is presented in Annex 2 of the Agreement at <http://www.stabilitypact.org/wt2/TradeCEFTA2006.asp>. The name CEFTA, Central European Free Trade Agreement, referred to the initial signatories in the early 1990s, i.e. Czechoslovakia (the agreement was later on ratified by the Czechs and Slovaks separately), Poland and Hungary.

¹⁸ It should be noted here that, after Romania and Bulgaria entered the EU in 2007, Moldova remained geographically isolated from its Western Balkan trade partners, so that at the moment it is a member of CEFTA with relatively little trade and investment links with other partners.

¹⁹ There are some duties still to be abolished in 2009 with respect to Moldovan-origin goods coming to Macedonia and with respect to Moldovan imports in general.

²⁰ A full list of concessions can be viewed here:

<http://www.stabilitypact.org/trade/Annex%203%20Agricultural%20%20Concessions%20FINAL.xls>.

Agricultural trade among Bosnia and Herzegovina, FYROM, Kosovo, Montenegro and Serbia is free.

Some effects of CEFTA (and the earlier network of bilateral arrangements) can already be seen. For smaller countries (Albania, FYROM, Bosnia and Herzegovina), regional trade shares increased, which is reflected in Table 11 in the statistical appendix. On the other hand, Montenegro and Croatia seem to have continued diverting their foreign sales away from the Western Balkan market.

It is rational to believe that at least some of the recent growth of FDI in the region can be explained by the intra-Balkan reintegration. At least, this was true for Slovenian FDI in 2000–2004 (Kathuria 2008: p77). The explanation behind this is that, similarly to what had happened in Central and Eastern Europe in the 1990s, part of the investors' locating of businesses in the Western Balkans has been motivated by the possibility to serve the regional market from a single location or at some point to fragment the production process or links with subcontractors among individual states. The possibility of diagonal cumulation of origins of goods mentioned earlier in the report should help in this regard. However, for this to occur at a fast pace, the regional infrastructure should still be improved.

It was also expected that negotiating about CEFTA could contribute to the capacity building of the administration of some of the Western Balkan states, and in this view prepare the governments to negotiate within other multilateral frameworks, such as the WTO. It seems that the goal has been partly attained, as CEFTA was established and continues functioning, notwithstanding political turbulence in some of the countries (the dissolution of the Serbia and Montenegro federation, the unilateral declaration of independence from Serbia by Kosovo, the Serbian refusal to accept it). Yet, the EU still provides assistance to the talks, in the form of support to the CEFTA secretariat, and will continue doing so in the near future (see Table 8). Anyway, it can be said that, by negotiating an Agreement on Amendments of and Accession to CEFTA, the countries of the region have made the most important step towards stronger regional post-war reintegration so far. It seems that the term "Balkanisation" – widely used at the end of the 1990s in order to describe a region falling apart – has lost its original meaning, at least in the economic domain.

IV. The Western Balkans in the globalised world

Individual countries record mixed progress in terms of integration with a globalised world. They range from the frontrunners like Albania and Croatia (who joined WTO in 2000), and to some extent FYROM (in the WTO since 2003) to countries like Serbia or Bosnia and Herzegovina who are still in the process of negotiating their offers with the WTO. In between, there is the small Montenegrin state that – after leaving the union with Serbia – is likely to join the WTO this year. Kosovo looks to be far ahead in terms of multilateral liberalisation agreements, as it has not been recognized as an independent state by some of the important world players.

Table 6. The Western Balkans' multilateral and bilateral trade and investment liberalisation agreements

Country	WTO membership	Bilateral trade agreements with third partners	Investment agreements, taxation treaties etc.
Albania	Since 2000	FTA with Turkey	<ul style="list-style-type: none"> • 39 bilateral investment agreements (including 20 EU member countries and 4 countries in the Western Balkans: Croatia, FYROM, Montenegro and Serbia) • 19 bilateral agreements on the avoidance of double taxation
Bosnia and Herzegovina	Negotiating	FTA with Turkey	<ul style="list-style-type: none"> • 32 bilateral investment agreements (including 18 EU members and 4 countries in the Western Balkans: Croatia, FYROM, Montenegro and Serbia) • 5 agreements on the avoidance of double taxation
Croatia	Since 2000	FTA with EFTA FTA with Turkey	<ul style="list-style-type: none"> • 57 bilateral investment agreements (18 of them with EU members and 5 with countries of the Western Balkans: Albania, Bosnia and Herzegovina, FYROM, Montenegro and Serbia) • 47 bilateral agreements on the avoidance of double taxation
Kosovo	Perspectives unclear		
FYROM	Since 2003	FTA with EFTA FTA with Turkey	<ul style="list-style-type: none"> • 32 bilateral investment agreements (16 EU members and 5 countries in the Western Balkans: Albania, Bosnia and Herzegovina, Croatia, Montenegro and Serbia)
Montenegro	Expected in 2008	FTA with Russia (with exclusions)	<ul style="list-style-type: none"> • 42 bilateral treaties on income and property, which also regulate double taxation
Serbia	Negotiating	FTA with Russia (with exclusions)	<ul style="list-style-type: none"> • 34 bilateral investment agreements • 15 double taxation treaties

Source: UNCTAD, WTO, national investment promotion agencies

Note: the table shows agreements going beyond those with the EU and beyond CEFTA.

Apart from multilateral agreements, the countries of the Western Balkans have been active in signing bilateral free trade agreements (with Turkey before Turkey formed a customs union with the EU, with EFTA and a partial one with Russia). The analysed countries signed a number of investment and taxation treaties, predominantly with the EU countries and other Western Balkan partners (see Table 6).

The Western Balkan countries protect their markets more than the EU on average (see

Table 7), although two of them (Albania and Montenegro) have tariff rates lower than those of the EU on agricultural products. Manufacturing is protected more than in the EU, and since the EU has been the most important trading partner to every Western Balkan country, probably the effects arising even from liberalising manufacturing trade (the aforementioned FTAs with the EU) can materialise as substantial welfare gains.²¹

²¹ The possibility of trade creation is higher than for trade diversion, because the EU seems to be the “natural” trading partner for the Western Balkan states.

Table 7. Weighted average tariff rates, 2005–2006

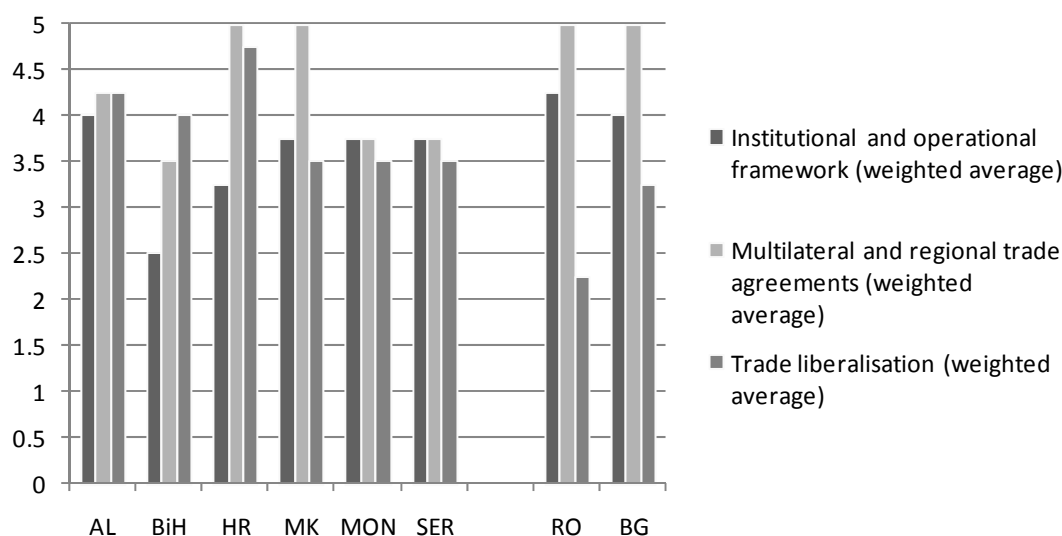
	Total	Agricultural goods	Manufacturing
Albania (2005)	6.6	7.0	6.6
BiH (2006)*	7.2	13.8	6.2
Croatia (2005)	4.9	15.7	3.8
FYROM (2005)	8.4	18.1	6.8
Montenegro (2007)	6.1	..	..
Montenegro (2006)*	4.9	10.8	4.0
Serbia (2007)	6.3	..	..
EU	3.4	12.3	2.9

Source: WTO (www.wto.org), Montenegrin Investment Promotion Agency (www.mipa.cg.yu), Serbian Investment and Export Promotion Agency (www.siepa.sr.gov.yu)

Note: * – simple MFN average.

The general perception about the integration of the Western Balkan countries with the outside world is shaped by the participation in the multilateral bodies (predominantly the WTO), and in this regard is positively assessed. Liberalisations of the trade regimes of Croatia and of FYROM are seen as even more favourable than the ones either of Bulgaria or of Romania on the eve of their membership of the EU (see Figure 5). What is still less encouraging is the institutional framework (predominantly in Bosnia and Herzegovina).

Figure 5. Perceptions about trade liberalisation in the Western Balkans



Source: OECD (2006)

Note: the given area was assessed on a scale from 1 to 5, where 1 was the lowest and 5 was the highest possible score. The assessments were given by government officials, local stakeholders and international staff of the OECD Investment Compact in each of the countries.

V. EU financial support

Up to 2006, Community financial assistance for the Western Balkans has been provided through the CARDS programme (Community Assistance for

Reconstruction, Development and Stabilisation). In 2007, CARDS was replaced by the Instrument of Pre-Accession (IPA).

The IPA is a new programme directed at the Western Balkans plus Turkey, as support to their pre-accession activities and reforms. A total amount of €11.5 billion will be allocated to the countries on the basis of their needs and their ability to absorb and manage funds.²² The average annual allocation from the IPA per country between 2007 and 2011 is €694 million (see Annex IV), to which should be added an average amount foreseen for regional and horizontal programmes. Altogether, the total average Community allocation for the Western Balkans in the coming years is around €800 million (EC 2008b).²³ The highest overall EU financial assistance per inhabitant is foreseen for Montenegro (because it is a very small country), Croatia and FYROM (which have the formal status of EU candidates) and for Kosovo (to ensure stability and security).

Broadly understood trade-related activities financed either through CARDS or through IPA for the years 2006–2008 sum nearly to €200 million (see Table 8). This also includes support for human capital (which should later on support a gradual rise in productivity), competitiveness of Western Balkan firms, improvement of infrastructure, macro-stabilisation etc. Nearly €50 million out of this amount covers directly trade-related actions, such as integration with the globalised world, intra-regional integration, reduction of NTBs etc. On top of this, the Community contributes resources to the European Investment Bank and to the European Fund for South East Europe, which are then used to provide loans for micro, small and medium-sized enterprises, financing of infrastructure etc.

²² See Annex IV for more detailed information on CARDS and the IPA, including country allocations.

²³ Plus increased Community assistance to Kosovo.

Table 8. Community financial support for the Western Balkans for broadly understood trade-related activities in 2006–2008

Area	Action	Countries covered	Funds committed	Years, programmes
Integration with globalised world	Support to RCC Secretariat (successor of the Stability Pact)	Western Balkans	€1million	
	Support for WTO accession negotiations	Serbia	€1.5 million (Twinning)	CARDS
		Montenegro	€2.5 million	CARDS
		BiH	€1.5 million	CARDS
Intra-regional trade and investment	Financial and technical support for the new Secretariat of CEFTA for the first 3 years (regional seminars, trainings)	Western Balkans	€1 million	IPA 2007
Reduction of non-tariff barriers to trade	Harmonisation of legislation to the EU <i>acquis</i> through Twinning and TAIEX (among others: internal market and public finance, customs and taxation, agriculture, JHA)	Western Balkans	€16.5 million	
		Extension to Kosovo	€9.6 million	IPA
	Customs and fiscal authorities	Western Balkans	€6.1 million €7.6 million	CARDS IPA
Education	Erasmus scholarships	Western Balkans (except Croatia and FYROM)	€4 million	CARDS
		Croatia and FYROM	€10 million €20 million	IPA 2007 IPA 2008
	Tempus (higher education)	Western Balkans (except Croatia) Croatia All Western Balkans	€12.7 million €4.5 million €19.6 million	CARDS 2006 PHARE 2006 IPA 2007
Research	Strengthening research potential in the region (FP7)	Western Balkans	€13 million	2007
Improvement of infrastructure	Infrastructure Project Facility (transport, energy, environment)	Western Balkans	€16 million	CARDS (later on more from IPA)
	Support for Southern and Eastern European Core Regional Transport Network Secretariat	Western Balkans	€1 million	CARDS
	European Investment Bank lending (transport, energy, SME, environment)	Western Balkans	Loans and loan guarantees	
Increasing competitiveness of enterprises	Loans for the development of micro-enterprises	Western Balkans except Croatia	Through European Fund for South East Europe	
Stabilisation of domestic economy	Macro-financial assistance package	Kosovo	€50 million	IPA, Stability Instrument, macro-financial assistance (2007–2008)

Source: EC (2008b)

VI. Conclusions and policy recommendations

The text presents the degree and the speed of economic integration of the Western Balkan countries with the EU and with the outside world. As it has been shown, the integration has proved to be a successful tool to support development and also to some extent to stabilise a politically sensitive region. Given access to the EU market, the Western Balkan enterprises have been able to increase the foreign sales of their production and modernise their economies. Therefore, for the EU, it is worth pushing for the next steps in bilateral and regional integration as strongly as possible. Even trade shares alone show that the EU has been the strongest and the most influential economic partner in the region. Clearly, with well-developed institutions and market regulations, the EU has much to offer to the countries of the Western Balkans.

The region is now still in a period of economic upturn, and it would be beneficial to create conditions for sustained growth, which may overcome constraints connected with the small size of the economies. Therefore, it is beneficial to continue monitoring the progress in the regional reintegration and to transfer as much of the “ownership” of this process to the Western Balkan states as possible. The side effect of strong regional integration is that it is easier for the EU to negotiate with a group of highly integrated countries than to pursue a set of bilateral negotiations with partners with diverse priorities. However, this effect is likely to be constrained by the necessity to underline the independence of individual Balkan countries.

This individualised approach of the EU together with the membership perspective has motivated the Western Balkans recently to pursue economic reforms, cooperate in combating war crimes and finally opening up and reintegrating with their neighbours. However, the EU has to play a difficult political game so as not to discourage the slowest progressing countries in the region, so that they remain attached to the European values and do not revert to periods of instability.

The EU is in an ideal position to press on reforming Western Balkan institutions, so that the administration is not prone to corruption or rent seeking. Certainly, some of the institutions should function according to more simplified regulations than those of the EU because of the lower capacity in the small Western Balkan states. Nevertheless, the basic dependence structure, transparency and ways to avoid conflicts of interests should be drawn up using the best EU practice. It has not been shown earlier in the text, but it is nevertheless observed that corruption still causes huge problems in the region. In general, the perceived levels of corruption are higher in SEE than in Central and Eastern Europe (CEE) and higher in the Western Balkan countries than, for example, in Bulgaria (see OECD 2006: p92). This hampers sustainable development, increases the costs of transactions, discourages productive investment and hinders the reduction of the grey zone. It is therefore desirable that some of the EU financial assistance is made conditional on the progress of fighting corruption. After seeing some progress in the alignment to the EU *acquis*, economic

development and the reintegration of the region, it is high time to condition some of the support (or the next integration steps) on normative compliance and less so on strategic interests.

Within the area of international trade of commodities, it seems that high priority should be given to the reduction of non-tariff barriers to trade. Currently, the majority of the Community assistance for strictly trade-related actions is allocated to the reduction of NTBs, and this direction should be continued. Given the current level of NTBs (NTBs related to technical standards alone were adding almost 4% of the additional costs in the CEE countries at about the time when FTAs with the EU were implemented;²⁴ they are surely much higher in the Western Balkans at the moment) and still lower competitiveness of the Western Balkan firms in comparison to their EU counterparts, this should be a target for action. If NTBs are successfully reduced, it can provide a significant boost to the development of Western Balkan exports, reduction of currently high trade deficits (and the vulnerability for balance of payments crises) and expansion of the demand for labour. It is true that elevated domestic standards (and the EU standards are considered as rather demanding) impose higher costs on all domestic producers. However, at the same time, they significantly lower costs for exporters and, as the experience of CEE countries has shown, they were not as high as one might have initially expected (see for example FEMISE 2005).

Taking into account the structural changes that took place in the CEECs in the last two decades, it can be foreseen that, along with the smoothly going integration of the Western Balkan countries with the EU, the returns to unskilled labour will gradually decrease over time. This is to say that the actions which should be supported at the domestic level are those related to the increase of qualifications of the whole working-age population, so that the economic benefits of higher growth are distributed as evenly as possible. In this view, it is worth mentioning high Community allocations foreseen for the education of young people (see for example EC 2008b). Yet, efforts should be made so that vocational qualifications and lifelong learning are also supported.

Finally, it is worth mentioning that the citizens of all the Western Balkan countries except Croatia still face high restrictions with regard to the freedom of movement vis-à-vis the EU. Citizens of Albania, Bosnia and Herzegovina, FYROM, Serbia, Montenegro and Kosovo have to apply for a visa if they want to travel to any country of the Schengen zone, plus there are restrictions on the number of entries. This elevates the costs of trade and also acts as an additional factor still isolating many of the inhabitants of the Western Balkans from the outside world and from the European values. It seems that, taking stock of the progress in the development of the region, the visa restrictions on short-term travel on the EU side should be lifted as

²⁴ Average for the Czech republic and Poland in 2001; after the World Bank Technical Barriers to Trade database.

soon as possible. The Commission has already expressed the need for the gradual liberalisation of the movement of people (in line with the conclusions of the Council of 18/6/2007), yet it is very important that the process accelerates.

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Annex I: Supplementary statistics

Table 9. Shares of Western Balkan countries' imports from the EU25 in total country imports (in percentages)

Country	2002	2003	2004	2005	2006
Albania	74.09	72.02	67.67	63.92	68.03
Bosnia	70.04	68.42	67.51	63.92	60.15
Croatia	70.29	70.99	68.71	64.94	67.38
FYROM	54.99	53.35	50.05	45.71	44.02
Serbia and Montenegro	81.43	80.26	75.95	63.18	..
Western Balkans	71.57	71.24	68.50	62.68	58.98

Source: EUROSTAT

Table 10. Shares of Western Balkan countries' exports to the EU25 in total country exports (in percentages)

Country	2002	2003	2004	2005	2006
Albania	92.81	93.79	90.44	88.66	81.02
Bosnia	74.49	75.71	70.80	67.88	69.37
Croatia	64.10	66.93	64.67	61.37	62.22
FYROM	53.77	56.87	57.19	53.09	55.26
Serbia and Montenegro	89.09	88.08	80.50	71.67	..
Western Balkans	69.10	71.10	68.12	63.61	61.40

Source: EUROSTAT

Table 11. Western Balkan trade shares

Flow/country		2002	2003	2004	2005	2006	2007
Export	Albania	3.8	1.4	1.8	2.6	3.8	4.6
	BiH		33.9	37.5	36.0	31.9	31.3
	Croatia				15.2	13.4	
	Kosovo	42.1	51.0	41.6	53.0	46.7	40.9
	FYROM		26.6	25.5	30.3	32.7	29.5
	Montenegro			49.4	41.8	35.3	
	Serbia				27.3	30.3	
	Average				29.5	27.7	
Import	Albania	4.6	3.0	3.5	3.5	4.6	5.9
	BiH		25.3	27.7	27.0	26.9	27.8
	Croatia				3.2	3.6	
	Kosovo	42.4	36.1	32.8	36.5	39.3	34.5
	FYROM		12.5	10.5	11.5	10.7	11.7
	Montenegro			46.4	36.7	36.8	
	Serbia				6.9	7.8	
	Average				17.9	18.5	

Source: ACIT – Albanian Centre for International Trade (www.ftdb.acit-al.info), CBBH – Central Bank of Bosnia and Herzegovina balance of payments statistics (www.cbbh.ba), Central Bureau of Statistics of the Republic of Croatia (www.dzs.hr) (BiH and FYROM only), Statistical Office of Kosovo (www.ks-gov.net/esk/), State Statistical Office of the Republic of Macedonia (www.stat.gov.mk) (data exclude Kosovo), MONSTAT – Statistical Office of Montenegro (www.monstat.cg.yu), Statistical Office of the Republic of Serbia (webrzs.statserb.sr.gov.yu) (data for 2005 does not include Montenegro)

Annex II: Bilateral relations between the EU and the Western Balkans

The following text briefly presents the historical path and the current stage of each Western Balkan country's process of integration with the EU.

Albania

The first step towards integration into the EU was made in 2000, when a High Level Steering Group (HLSG) for the support of Albanian preparation for the Stabilisation and Association Agreement (SAA) negotiations with the EU was set up. The reforms carried out under the coordination of this group until January 2003 have been accepted by the EU authorities as satisfactory and, after three years of negotiations, the agreement was signed on 12 June 2006. This agreement also included an Interim Agreement (IA) on trade liberalisation between the EU and Albania.

The EU has allocated around €1.27 million to Albania for these preparations in the period 1991–2004. Additional funds were provided through the CARDS (Community Assistance for Reconstruction, Development and Stabilisation) and IPA (Instrument of Pre-Accession) programmes.

Bosnia and Herzegovina

Bosnia and Herzegovina (BiH) started SAA negotiations in November 2005, following the approval of a feasibility study by the European Commission in November 2003. The SAA agreement was finally signed on 16 June 2008. Part of this agreement is an Interim Agreement on the creation of a free trade area between the EU and BiH within a period of five years after entry into force of the agreement. The liberalisation of trade between partners is asymmetric, in the sense that the EU will open its market to almost all the products originating from BiH, while the Bosnian market will be gradually liberalised for the products originating from the EU. The agreement also assumes increased cooperation between the partners in different trade-related issues and the introduction of EU standards in BiH, in areas such as competition, intellectual property and investments.

The European Community has allocated around €2.5 billion to this country by 2002. An additional €100 million of the EU assistance has been allocated through the CARDS programme for 2005–2006. The main aim of these funds has been capacity building and economic development, so that most of these funds have been allocated to public administration reform, home affairs and the improvement of the investment climate.

Croatia

Croatia signed an SAA agreement with the EU in October 2001. This agreement entered into force in February 2005. In February 2003, Croatia applied for EU

membership. After the European Commission's positive assessment of Croatia's application for membership, this country was granted the status of candidate country. Talks on its accession started in October 2005.

Kosovo

EU relations with Kosovo have been designed through the SAP. At the end of 2002, due to the country's still undefined political status, the EU designed a specific mirror instrument for Kosovo, the SAP Tracking Mechanism. The main aim of this mechanism is to ensure capacity building and institutional and legislative reforms which are in line with the EU standards. Since 2000, Kosovo has enjoyed unilateral preferential access to the EU market, through the Autonomous Trade Preferences (ATP) regime.

Kosovo declared independence from Serbia on 27 February 2008. Up to date, 43 countries have recognised Kosovo as an independent country. Out of 27 members of the EU, 20 countries have already recognised Kosovo as independent.

A donor conference in support of the economic development of Kosovo, held in Brussels on 11 July 2008, resulted in more than €1.2 billion collected. Out of this amount, €500,000 was pledged by the European Commission, while an additional €285,000 will be given by individual member states. As a part of the SAP, Kosovo enjoys funds from the CARDS programme. In the period 1999–2006, Kosovo received €1.7 billion through this programme, in particular to support democratic stabilisation, institution building and economic and social development.

FYROM

FYROM applied for EU membership in March 2004. In November 2005, the European Commission gave a positive assessment of the application, recommending the opening of the accession negotiations. FYROM was granted the status of candidate country in December 2005.

Serbia and Montenegro

Negotiations on the Stabilisation and Association Agreement between the EU and Serbia and Montenegro started in October 2005, after the Commission's approval of a feasibility study. The negotiations were interrupted in May 2006, due to the Serbian government's failure to fulfil its obligation towards the International Criminal Tribunal for the former Yugoslavia (ICTY). The negotiations were reopened in June 2007. Finally, the talks resulted in signing the agreement in April 2008. The pace of integration with the EU has been dependent on the cooperation between Serbia and the ICTY. The capture of Radovan Karadzic and his conveyance to the Hague in the summer of 2008 had a positive impact on the process.

After the declaration of independence made by the Parliament of Montenegro in June 2006, the EU Council quickly decided that further relations with Montenegro will be

developed separately from the ones with Serbia. The European Commission was granted a new mandate for separate negotiations on SAA with Montenegro, which started in March 2007. The SAA agreement between the EU and Montenegro was signed on 15 October 2007, about half a year earlier than the one with Serbia.

Annex III: Integration of the Western Balkans with the outside world by country

Albania

Albania became a member of the WTO on 8 September 2000. Albania also signed an FTA agreement with Turkey in 2008. This FTA agreement entered into force on 1 May 2008. According to the UNCTAD data, Albania signed 39 bilateral investment agreements with different countries by June 2007. The list of countries includes 20 EU27 member countries and 4 countries in the Western Balkans (Croatia, FYROM, Montenegro and Serbia). Also, this country signed 19 bilateral agreements on the avoidance of double taxation.

Bosnia and Herzegovina

A Working Party for the examination of the Bosnian application to the WTO was established in July 1999. Bosnia and Herzegovina submitted its Memorandum on the Foreign Trade Regime in October 2002. In October 2007, a Factual Summary of Points Raised was circulated by the Working Party.²⁵ On the basis of the revised offers of goods and services, negotiations on the bilateral market access were continued.

Also, Bosnia and Herzegovina signed a free trade agreement with Turkey, which entered into force on 1 July 2003. Finally, agreements on investments, intellectual and property rights and the avoidance of double taxation were signed with a range of countries. According to the UNCTAD data, Bosnia and Herzegovina has signed 32 bilateral investment agreements with different countries, which include 18 EU27 member countries and 4 countries in the Western Balkans (Croatia, FYROM, Montenegro and Serbia). Also, this country has signed agreements on the avoidance of double taxation with 5 countries.

Croatia

Croatia became a member of the WTO on 30 November 2000. Croatia signed an FTA agreement with EFTA on 21 June 2001. The agreement entered into force on 1 April 2002. On the basis of information provided by the WTO, only Croatia in the Western Balkans region had a dispute recorded, as a respondent to a Hungarian complaint to the WTO about Croatian measures on the control of the importing of live animals and meat products, introduced in June 2003. The WTO has not yet been notified about the settlement of this dispute.

Croatia signed an FTA agreement with EFTA²⁶ in 2001. This agreement entered into force on 1 January 2002. Also, it has signed an FTA with Turkey, which entered into

²⁵ The Factual Summary of Points Raised is an informal document outlining the discussions in the Working Party.

²⁶ EFTA is the European Free Trade Association formed by Iceland, Norway, Switzerland, and Liechtenstein.

force on 1 July 2003. It has also signed 57 bilateral investment agreements with different countries, where 18 of them are EU27 member countries and 5 are countries of the Western Balkans (Albania, Bosnia and Herzegovina, FYROM, Montenegro and Serbia). Finally, it has signed 47 bilateral agreements on the avoidance of double taxation.

Kosovo

Kosovo submitted its application for WTO membership in June 2008. As a result of the current political status of this country, the WTO has not yet taken this application into consideration.

FYROM

FYROM became a member of the WTO on 4 April 2003. FYROM also signed an FTA agreement with EFTA in 2000. This agreement entered into force on 1 January 2001. Finally, it has an FTA signed with Turkey, which entered into force on 1 September 2000.

According to the UNCTAD data, FYROM signed 32 bilateral investment agreements with different countries until 1 June 2007. The list of countries includes 16 EU27 member countries and 5 countries in the Western Balkans (Albania, Bosnia and Herzegovina, Croatia, Montenegro and Serbia).

Montenegro

After a joint application to the WTO by the Federal State of Serbia and Montenegro, the two federal states applied separately for WTO membership in 2005. A Working Party for the examination of the separate Montenegrin application to the WTO was established by the General Council in February 2005. Its memorandum on the Foreign Trade Regime was circulated in March 2005. The Working Party had its first meeting in October 2005 and its fifth meeting in February 2008. It continues to examine the foreign trade regime of Montenegro. On the basis of the revised offers of goods and services, negotiations on the bilateral market access were continued. Accession is expected to take place in 2008.

Serbia

For the examination of the separate Serbian application to the WTO, a Working Party was established in February 2005. Its memorandum on the Foreign Trade Regime was circulated in March 2005. The Working Party has its first meeting in October 2005 and its fifth meeting in May 2008. The examination of Serbia's foreign trade regime is still underway.

Annex IV: Background information on Community assistance to the Western Balkans

CARDS

The Community Assistance for Reconstruction, Development and Stabilisation (CARDS) programme was introduced in 2000 and, up to 2006 (when it was replaced by the IPA programme), around €5.4 billion was allocated to countries of the Western Balkans. It focused on the support of reforms and institution-building. The largest beneficiary was Serbia and Montenegro, where the EU directed nearly half of the total support for reconstruction, development and stabilisation, and where the total CARDS funding in 2000–2006 amounted on average to €280 per 1,000 inhabitants.

Table 12. CARDS programme allocation for 2005–2006, in € millions

Country	2005	2006	Total 2000–06	Total funds in 2000–06 per 1,000 inhabitants*
Albania	44.2	45.5	315.5	101
Bosnia and Herzegovina	49.4	51.0	502.8	132
Croatia	-	-	278.8	63
Croatia, Pre-Accession (PHARE, ISPA, SAPARD)	105	140	245	55
FYROM	45.0	40.0	298.2	147
Serbia and Montenegro	282.5	257.5	2,559.8	279
Interim Civilian Administrations	36.0	35.0	128.5	..
Regional Western Balkans	47.9	43.50	229.6	..
Other (b)	19.7	16.1	345.8	..
Macro Financial Assistance (Grants) (c)	33.0	50.0	404.0	..
TOTAL	662.7	678.6	5,385	..

Source: ec.europa.eu

Note: * – amounts are in euros per 1,000 inhabitants

IPA

The Instrument of Pre-Accession (IPA) is a new programme of financial support to the countries of the Western Balkans plus Turkey, as a support to their pre-accession activities and reforms. This programme started in 2007 and replaced CARDS and several other EU programmes of financial support (such as PHARE, ISPA and SAPARD). A total amount of €11.5 billion will be allocated to these countries on the basis of their needs and their ability to absorb and manage these funds.

The Instrument of Pre-Accession has five main components:

- transition assistance and institution building,
- regional and cross-border cooperation,
- regional development,

- human resources development and
- rural development.

The candidate countries (currently Croatia and FYROM out of the analysed group) are eligible for all the above components, while potential candidates are eligible for the first two components of the programme only.

Table 13. Pre-accession assistance envelopes for 2007–2009 in € million

Country	2006	2007	2008	2009	2006–2009 total per 1000 inhabitants*
Albania	45.5	61.0	70.7	81.2	82
Bosnia and Herzegovina	51.0	62.1	74.8	89.1	72
Croatia	140	138.5	146.0	151.2	130
FYR Macedonia	43.6	59.5	70.2	81.8	125
Montenegro	59.3	31.4	32.6	33.3	250
Serbia	19.5	186.7	190.9	194.8	80
Kosovo	167	63.3	64.7	66.1	169
Total	525.9	602.5	649.9	696.5	105

Source: ec.europa.eu

Note: * – amounts are in euros per 1,000 inhabitants

TAIEX

The Technical Assistance and Information Exchange (TAIEX) is an instrument of assistance of the EU to potential candidates and candidate countries of the Western Balkans, new member states, Turkey, as well as countries covered by the European Neighbourhood Policy (CIS and Northern Africa), Northern Cyprus and Russia, in their activities on the approximation, application and enforcement of EU legislation. The main beneficiaries of this instrument are civil servants working in public administration, the judiciary and law enforcement authorities, professional and commercial associations and interpreters and translators of legislative texts. The main activities of this instrument are training, study visits, seminars and workshops organised for beneficiaries. In 2005 only, 1,322 activities were performed through this instrument, involving 41,802 participants. These activities were funded mainly through the CARDS programme until 2006, and since 2007 the main source of funding has been the IPA.

TWINNING

Twinning is another instrument for the support of cooperation between institutions of the EU countries and their counterparts in the candidate and potential candidate countries. New member states were excluded from this instrument after their accession to the EU.²⁷ Its implementation started in 1998, and so far more than 1,000

²⁷ Except Romania and Bulgaria, for which the programme will continue for two years after the accession.

projects have been conducted through this programme. At the Thessaloniki summit in 2003, the decision was made that all countries which are beneficiaries of the CARDS programme are also eligible for the Twinning instrument. The activities of this instrument were mainly funded through the CARDS programme up to 2006 and the IPA afterwards. During the period 2001–2005, 55 activities were conducted in the Western Balkans region.