Towards an analytical framework of regional integration in Western Balkans

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ABSTRACT

The paper focuses on the regional integration of Western Balkans and its prospects. We enrich mainstream political economic approaches by a framework assessing regional integration with the use of political, cultural, institutional and economic variables: coincidence in political interests and national barriers; common perceptions, values, principles and culture; restructuring and maturity of institutions; production complementarities, trade flows and financial transactions; technology and infrastructures. Evaluating these variables in the Western Balkans, we conclude that integration can proceed through a top-down enforced process by the EU or the International Community rather, than through individual efforts of the region's nation-states.

KEYWORDS

Regional Integration, Western Balkans, Political Economy Evaluation Variables

1. Introduction

In the last 20 years, the Western Balkans went through significant socio-political and economic changes at the regional as well as the national level. Along with the emergence of newborn states and democracies, market economy structures have also been established and functioning. In other words, a new world has been formed in the region, consisting of eastern nation-states with western oriented patters of development. Foreign direct investment (FDI) in the area has enormously increased, as a consequence of the region's path towards economic integration with the rest of Europe. Greece has been a pioneer in this field; while Romania and Bulgaria joined the European Union in 2007. All these developments meet many of the prerequisites and criteria set by neoclassical economic theories for a successful path towards regional cooperation and growth.

However, we argue in this paper that despite the undertaken crucial steps, intra-regional integration and development is still under question. Regional integration is considered as the institutional unification of independent national economies to bigger economic entities and efficient markets, in a way that enhances the effective use of regional resources (Grupe and Kušić, 2005). This objective is not yet accomplished in the Western Balkans, as inter-state cooperation has still a very limited scope and the prevalent conditions in the region are not so promising. The political prerequisites have not yet been met, while the achieved economic results are now under threat due to the latest financial crisis and the limited capacity of Greece to play a key role in a positive direction. We suggest that a more powerful political will is now necessary, which seems to be out of the hands of the region's political leaders.

We shall prove that although economic growth and FDIs have considerably contributed to the well being of the regional population in the new born states, political development has nevertheless not followed the same path. This has resulted to a series of inadequacies and gaps concerning the model of democracy in the region. Even in economic terms, wealth is unequally distributed – excluding large portions of the population and especially, ethnic and religious minorities. Regional economic projects have neither been visualized nor accomplished. As already mentioned, the role of Greece as a net FDI contributor and promoter of regional cooperation has been severely affected by the recent crisis, both in economic and political terms.

In this context, we will assess the theoretical considerations concerning the prerequisites for regional integration. We will evaluate the level of accomplishment of a series of variables, which we suggest that capture the political economy dimension of regional economic integration. These variables constitute an analytical framework which we apply to the case of the Western Balkans economies in order to justify why undertaken integration efforts in the region are limited, and the prospects non-pragmatic. Finally, we suggest that a top-down policy implementation approach from the EU or other International organisation can be more efficient than the state-nations' individual efforts.

2. Theoretical Considerations - Determinants of Regional Integration patterns

Regional integration and cooperation has been addressed by a considerable number of both scholars and policymakers. Nevertheless, the extensive variety of approaches and perspectives which have been attributed to regional integration has not led to clear definitions and practices. Undoubtedly, evidence links openness – i.e. low trade barriers, transparent operation through the price mechanism - and economic growth. Thus, developing countries have sought to apply these principles either through autonomous unilateral liberalization, or more commonly through participation in regional trading agreements. Indeed, nearly every country in the world is a member of one or more regional integration arrangements (RIAs), and nearly 60% of world trade occurs within such blocs. However, although most preferential trading arrangements are regional in the geographical sense, this does not apply for most of their economic results (Schiff and Winters, 1998).

In a global context of proliferating RIAs, the question of the economic and political consequences of regional integration is in the core of the discussion (Schneider, 2010). But the depth of this debate has been restrained by the absence of clear analytical models and empirical evidence on many of the factors under discussion. Namely, it has not been formally tested and substantiated whether regionalism stimulates investment, whether it confers credibility on reform programs, or whether it leads automatically to multilateral liberalization. Moreover, economists have not paid much attention to the noneconomic objectives that usually underlie RIAs. Understanding the potential linkages between favoritism in trade and noneconomic political and social objectives is crucial for a successful pattern of regional integration (Schiff and Winters, 1998).

We therefore attempt to address these issues which define the political economy and dynamics of regionalism and development. A significant aspect of the discussion concerns the distinction between the "positive" and the "negative" aspects of integration (Tinbergen, 1954, p.122). Namely, initiatives such as the abolishment of certain barriers including discriminatory treatment and functioning of reductionist institutions and policy measures are among those which form the so-called "negative" integration. On the other hand, policy adaptation and establishment of new institutions and policies with compulsory authority are among those which form the so-called "positive" integration. Experience has demonstrated that "negative" integration is easier to achieve since "positive" integration and the measures encompassed affect national sovereignty and the transfer of traditional state power to hyper-state institutions and bodies.

Balassa (1973, p.1) considers economic integration both as a process and as a state of the art. Although the process entails a dynamic element within it, the notion of the state of the art is a rather static meaning of a given situation. Eventually, it still remains unclear to what extent a given process or situation may lead to a certain level of integration at local, regional, or global level. It is important to justify what is the exact type and magnitude of a process required to reach a certain level of integration.

Others (Molle, 1991, p. 5) make a clear cut interconnection among economic integration and the gradual abolition of national economic boundaries. In this framework, a certain period of time is required in order for the system to absorb the consequences of such a gradual abolition of economic borders. This period can be anything between five to ten years. Experience has shown that such a transitory period has not been necessary in cases such as the one of the EFTA countries, which had to satisfy the requirements of the *acquis communautaire* without such a period. The abolition of economic boundaries is also a prerequisite for Pelkmans (1984, p.3).

Pinder (1969, p. 143-145) considers the union to be the combination of different parts into a totality. Integration is a process towards the union. Economic integration entails the abolishment of discriminations among the economic subjects of the member states as well as the establishment of common policies. Along this line, Baldwin and Wyplosz (2006) propose six criteria for a country's capability to participate in a monetary union. These criteria can be based either on ***economic*** factors like labour mobility, production diversification, and openness; or on ***political*** elements like the fiscal transfers, homogeneous preferences and the solidarity criterion. According to them the European countries do not satisfy either the labor mobility or the fiscal transfer criterion, they partly satisfy the homogeneity of preferences criterion and it is very unclear whether there exist a common sense of solidarity. Instead, the European countries satisfy the trade openness and the production diversification criteria.

Venables (2003) supports that "the outcomes of regional economic integration depend on the comparative advantage of members, relative to each other and relative to the rest of the world. Countries with a comparative advantage between that of their partners and the rest of the world do better than countries with an 'extreme' comparative advantage. Consequently, integration between low income countries tends to lead to divergence of member country incomes, while agreements between high income countries cause convergence. Results suggest that developing countries are likely to be better served by 'north-south' than by 'south-south' agreements".

However, there is research evidence of per-capita income convergence in 'south-south' integration. The results of Carmignani's research (2007), covering a total of more than 100 countries, show that convergence of per capita income is not necessarily a privilege of 'north-north' integration. Needless to point that the integration process of the less developed economies of Eastern and Southern Europe in the EU - as a typical example of 'north-south' integration - has not resulted to convergence of per capita income. In other words, 'south-south' integration does not necessarily imply widening intra-regional disparities; indeed, 'south-south' integration can provide dynamic welfare by enhancing efficiency through mutual learning, by enabling economies of scale and scope, by increasing FDI attractiveness and securing better bargaining positions.

Summarizing the above, we can safely assume that the basis of regional integration is Regional Integration Agreements (RIAs): the establishment of preferential trade relations among countries of a geographic region; and also, the removal of restrictions on factor flows between members and consensus on rules and regulations governing economic activity are elements of such agreements. In this way, at the same time that RIAs serve to remove policy-oriented market distortions in order to free trade and factor mobility between members, they introduce new distortions in the form of trade restrictions between members and third countries (Balasubramanyam et al, 2002). Economic integration may lead to increased geographical concentration of industrial production, via self-reinforcing agglomeration processes. (Forslid & Ottaviano 2003).

According to Andriamananjara (1999): "The remaining outsiders would probably form their own bloc, which would lead members of the original bloc to increase its size in anticipation of the creation of the second bloc. The threat of regionalism by outsiders would foster larger regional integration arrangements… Even if blocs form and merge simultaneously, yielding progressively larger symmetrical blocs, they would fail to converge in a single bloc unless the external tariff was low enough. In other words, global free trade could be achieved through bloc expansion if trading blocs lowered their external tariffs when abolishing their internal tariffs".

A critical issue is that RIAs have differentiated impact on industrial location, specialization and consequently, growth inequality in member countries. In more recent approaches articulating regional economies with international trade, analysis has shifted from nation-states to sub-national localities (Boschma and Iammarino, 2009). It is suggested that the historical path of places strongly defines development and integration processes, as pre-existing 'locational' patterns form strong external economies, or capacities. Such different industrialization histories are the case in Europe, where trade has developed under protectionism, language barriers and state support (Storper et al 2002).

In mainstream economics, scholars have attributed merely economic characteristics to integration processes, with emphasis on the abolition of discriminatory measures among participants and on the establishment of joint economic policies and institutions. Nevertheless, we argue that such an approach is rather restrictive and does not adequately justify the phenomenon, as it does not address all of its aspects. Namely, it does not take into account the level of political development of the participant states, which is required for the accomplishment of the complex task of economic integration. Our main argument is that the elimination of mere economic barriers cannot adequately guarantee for the effective mobility of goods, services and production resources. Simplifying approaches ignore important non-economic obstacles, such as language and culture, principles and perceptions, etc. This applies to the institutions and the level of political development of the nations concerned.

3. The framework of analysis: the political economy of regional integration

A richer approach, in order to examine all aspects and evaluate the prospects of regional integration endeavor, is necessary to address socio-political and cultural aspects of the process. Such dimensions are generally omitted by neoclassical economic thinking and this fact leads to obscure epistemological views, misleading observations and fragmented illustrations of reality. Political development analysts and scholars have clearly put forward both quantitative and qualitative dimensions of economic development (Koutsoukis, 1999, p. 84). Qualitative aspects encompass "change" and "modernization", while quantitative aspects entail "growth" and "numerical measures". Political development is regarded as the transition from a given situation to a better, broader, and more comprehensive one. This process refers to the political system, i.e. the government, institutions and legislative processes, which all conclude to a better functioning of the production and distribution of political goods.

The impact of political preferences on trade preferential arrangements has been also addressed in the related literature (Krishna, 1998). Preferential trading arrangements are analyzed from the viewpoint of the "new political economy" that views trade policy as being determined by lobbying of concentrated interest groups. Along this theoretical line of the political economy of trade policy, Grossman and Helpman (1994) model lobbying as "the influence on governments in power regardless of their political hue". The application of their theory to RIAS suggests that free trade areas are likely to arise either if they provide consumer benefits that allow governments to ignore the lobbies, or if they tend toward increased protection (Grossman and Helpman, 1995). Empirical evidence leads to two conclusions: first, that trade-diverting preferential arrangement are more likely to be supported politically; and second, that such preferential arrangements could critically change domestic incentives - so multilateral liberalization that is initially politically feasible could become infeasible by a preferential arrangement. Unquestionably RIAs are far more than just economic policies, and analysts argue that they are an important tool of diplomacy.

Empirical analyses for the impact of political factors and economic diplomacy on trade have mainly acknowledged ‘north-south’ and ‘south-south’ trade arrangements (Yakop and van Bergeijk, 2011). Political factors have been measured in relation to the infrastructure of embassies and consulates (Rose, 2007), changes in such infrastructure (Afman and Maurel, 2010) and official state visits supported by this infrastructure (Nitsch, 2007). Good and stable political relations built on mutual trust, reduce the risk of trade distortions and disruptions (van Bergeijk, 2010; van Marrewijk and van Bergeijk, 1993). Economic diplomacy contributes to the promotion of international trade by providing information and advice about trade opportunities and by acting as host to trade missions; in this way, risk and costs of exporting and investing are reduced (Saner and Yu, 2003).

According to Afman and Maurel (2010), the opening of an embassy in an emerging market in Eastern Europe is equivalent to an *ad valorem* tariff reduction of 2%–12%. In their paper, Yakop and van Bergeijk (2011) discuss the economic rationale for embassies and consulates as means to provide market access and reduce market failures. Nonetheless, the effects of economic diplomacy vary between different country groups according to their income levels. Positive effects of economic diplomacy relate only to trade flows that originate or end in developing countries where value is added (Yakop and van Bergeijk, 2011). This particularly applies to ‘south–south’ trade, and to a lesser extent to ‘north-south’ trade.

The question rising is how political objectives affect the existence, shape, and evolution of RIAs. As Schiff and Winters (1998) put it, trade among neighboring countries provides security directly, e.g. by raising the level of interaction and trust among the people of participating countries, by increasing the stake of each country in the welfare of its neighbor, or by increasing the security of access to the neighbor's strategic resources. Under these assumptions, an RIA maximizes welfare by providing an optimal way to internalize the positive externalities. To justify an RIA in political terms requires evidence showing that trade preferences contribute to valuable political rapprochement, which would not have happened if the RIA had not been formed.

Identifying the motivation for an RIA does not alter its economic and political effects, but it does allow a rational discussion of the policy options (Schiff and Winters, 1998). The main issue is still, whether regionalism encourages multilateral liberalization.

Dascher and Haupt (2008) argue that: "At borders where rich and poor countries meet, services prices differ hugely. In principle, price differentials could be exploited to mutual benefit, offering improved job opportunities to the poor as well as better shopping opportunities to the rich. However, cross-border shopping is often limited by the substantial transaction costs of crossing the border. Moreover, local governments frequently fail to cut these transaction costs even where they have the opportunity to do so.

The impact of culture on processes, practices and dynamics has also been etxrapolated by scholars . Koutsoukis *et. al*. (2011) have demonstrated that:

"Culture is one of the factors to be considered for the transformation of the social capital to economic development achievements. Culture and economy create a circuit of two-way inflows and outflows. On one side, the economy supplies culture (the political-social architecture, the institutional environment, the legal civilisation, the behaviours related to values) with inflows, such as investment capital, capital equipment, technology and specialised workforces. On the other side, culture, through the institutionalised system of redistribution of public revenues for social provisions and programmes (state budget) and the effective operation of the rule of law state, transforms the above inflows of resources to social capital. Furthermore, by means of increasing the social dividend it boosts the process of independent development, thus leading to the utilisation of all social forces and modernising the productive framework through the inflow of scientific and properly trained human resources. The institutional architecture and the axiological origins of the society affect the policies followed, since they relate culture to development in a harmonious manner".

Hazakis (2011, p.180) further enriches the research on competitiveness by encompassing a series of qualitative factors in his analyses. More precisely, he states that:

"… the notion of competitiveness is as much about qualitative factors (i.e., networks, interactions of institutions), as it is about quantifiable attributes (i.e., patenting rates or export market shares). Consequently, more attention should be given to the issue of the link between structures, agents and norms, to understand not only competitiveness outcomes, but also factors that determine the content of competitiveness. To put it simply, competitiveness depends both on intra-organisational resources and on extra-organisational assets. One needs to understand the dynamic interplay of these factors in a particular institutional setting, to explain the failure or success of firms".

On this ground, we argue that the political economy of regional integration can only be comprehended as part of a holistic approach capturing the different levels of political and economic development. In such an approach, a series of indicators can be considered, namely:

Economic indicators including:

- GDP growth
- Trade in goods and services
- Foreign Direct Investments
- Equal distribution of income and wealth
- Production structure

Political indicators including:

- Free elections
- Free expression
- Political willingness
- Definition of national interests
- Functioning of the party system
- Participation in elections
- National pride and sovereignty
- National security
- Level of political maturity
- Functioning of institutions

Social indicators including:

- Social participation
- Respect for human rights
- Women participation

These indicators demonstrate that the pattern of regional integration is not defined by mere economic criteria; social and political elements play their own role and in many cases overweigh the neoclassical economic prerequisites. Abolition of barriers in trade, fiscal and other economic transactions is only one part of the whole picture. Perceptions of national interest, ethnic identities and cultural norms, national security notions as well as dependency paths, play a crucial role in the success or failure of the integration process. Thus, political willingness still remains the question.

This methodological approach is figured as follows:

Figure 1. Capturing the variables of Regional Economic Integration

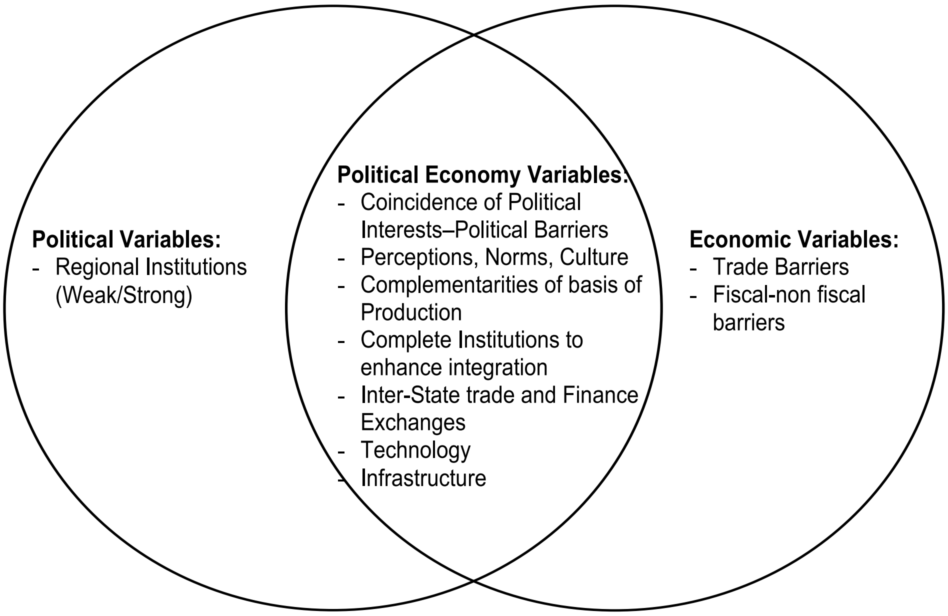

Figure 1 makes clear that the variables to be assessed for the evaluation of the pattern of regional integration should be considered as follows:

a. 'Traditional' Economic variables:

1. *Trade barriers*: the level of removal of trade barriers and trade distortion measures and policies is a clear indication of the level of regional economic integration achieved. The more the trade barriers are, the less is the progress of integration.
2. *Fiscal and non-fiscal barriers*: the elimination of fiscal and non-fiscal barriers and distortion measures and policies is a clear indication of regional economic integration achieved. The more fiscal and non-fiscal barriers exist, the less is the level of integration.

b. Political variables:

1. *Regional Political Institutions*: strong regional institutions mobilizing economic and political forces for regional cooperation, is a serious tool of regional integration. Whether such initiatives have a solid basis or they are 'swallow' is an indication of the depth of the undertaken efforts.

c. Political Economy variables

1. *Coincidence of national interests and political barriers*: at a given moment, it provides strong impetus and deepens economic integration schemes. The existence of political barriers is an important parameter of the advancement of regional integration, as historical events, political rivalries and minorities issues are all elements that define its prospects.
2. *Perceptions, norms, values, culture*: shared perceptions and common values between people and governments of different nations are prerequisites for their economic cooperation. A broad level of common understanding provides better chances for the regional integration process.
3. *Complementarity of the production basis*: It is proven that countries with complementary production basis have more possibilities to benefit from a regional economic integration arrangement. As previously argued, a 'south-south' integration scheme is expected to be less successful than a 'north-south' one. The comparative advantage theory applies to economies of complementary production bases - not competitive ones.
4. *Complete and mature Institutions*: Incomplete and/or immature political and economic institutions are a serious impediment for regional integration. This variable encompasses administrative capacity, effectiveness, as well as degree of corruption and citizens' satisfaction.
5. *Inter-state trade and financial transactions*: form a positive basis for regional integration, while their evolvement provides indication for the future prospects of the process.
6. *Technology*: Regional economic cooperation prospects among countries of low technological level are limited. Limited transfer and use of technology allows only for poor communication and thus, limited traded and untraded interaction among participants. Thus, the necessary formation of shared understanding and cooperation is obstructed.
7. *Infrastructure*: The existence of extensive transportation networks, telecommunications, etc., has a positive contribution to the regional integration process. The lack of such an infrastructure is a serious obstacle.

We apply the above described methodological framework of analysis in order to assess the role of political economy in regional economic cooperation in the Western Balkans.

4. The Political Economy of Regional Integration in the Western Balkans

The region of Western Balkans consists of the countries of Albania, Former Yugoslav Republic of Macedonia (FYROM), Kosovo (under the UN Resolution 1244), Serbia, Montenegro and Bosnia & Herzegovina. The prospects for regional integration will be here estimated with the use of the variables of: coincidence of national interest; political barriers; common perceptions of norms, principles and culture; complementarity of production basis; accomplished and mature institutions; inter-state trade and finance transactions; technology; infrastructures.

a. Coincidence of national interests and political barriers

It is more than evident that national interests, as they have been pronounced by the political elites of the countries concerned, are not coinciding. This is clearly proved by a series of indicators, as presented in Table 1.

Table 1: Coincidence of national interests – Political barriers in the Western Balkans

NEGATIVE INDICATOR	COUNTRIES IMPLICATED
Cross–boundary disagreements; political barriers	FYROM - Kosovo; Kosovo – Serbia; Serbia - B&H
Conflicting declarations and public statements	Kosovo – Serbia; Serbia – FYROM; Serbia – Croatia; Albania - FYROM
Ethnic minorities rights issues raised	All countries in the region
Separatist aspirations within states	Kosovo, FYROM, B&H, Serbia
Perceptions on potential armed conflict	All countries in the region

It is also characteristic that although most Balkan citizens did not anticipate another armed conflict in the region, the proportions of respondents holding this view vary between 62% in Serbia and 88% in Croatia (Balkan Monitor, 2010). A notable change was registered in Bosnia & Herzegovina since 2009, as the share of respondents thinking that the risk of war was not imminent increased sharply by 22 percentage points to 49%. Respondents in FYROM and Serbia were the most likely to say that it was *probable* or *certain* that war would break out in the region (28% and 24%, respectively).

b. Common Perceptions of Norms, Principles and Culture

Researchers have indicated that the level of common perception in terms of norms, principles and cultures among the people in the Western Balkans is still very limited (Andrianos, 2007). Related indicators demonstrate that there is still a long distance from reaching a common understanding for the region's shared future under common rules and guidelines. Such indices concern:

- *The role of religion*. Religion is gaining importance for most ethnic groups in the Western Balkans; with the exception of the nationals in FYROM and Bosnians in Bosnia & Herzegovina (Balkan Monitor, 2010).
- *The expectation for the future*. As in earlier survey, respondents across the Western Balkan region were more prone to see *better opportunities abroad* than at *home* (Balkan Monitor, 2010). Notable developments were registered in Albania and Kosovo, where the number of people seeing better opportunities outside their country has dramatically reduced since 2008: by 25 percentage points in Kosovo (to 48%) and by 12 in Albania (to 52%). The opposite was recorded in Croatia and Montenegro, where the shares of interviewees seeing better chances abroad have increased since 2008, by 17 points (to 48%) and by 14 points (to 52%), respectively.
- *Social and Economic Integration of Minorities*. Statistics demonstrate that national minorities are not socially and economically integrated. It is characteristic that unemployment rates for national minorities still remain considerably higher than for the rest of the population in the respective countries. Additionally, people's free mobility is not yet guaranteed, for example in Kosovo; this seriously affects minority groups and enclaves in the region (European Commission, 2009b). The situation in Serbia is also ambiguous. More precisely it is stated that (European Commission, 2009b):

  " As regards Vojvodina no agreement has been reached at national level on the adoption of a new Statute. An agreement on the restructuring of the Government Coordination Body for southern Serbia was reached. However the situation in southern Serbia deteriorated in July 2009 following a number of attacks on the Serbian gendarmerie. The situation in Sandžak is volatile; divisions within the Muslim community have continued and there have been several outbreaks of violence. The number of refugees and internally displaced persons (IDPs) in Serbia remains high. The situation for IDPs continues to be very difficult and they are faced with many obstacles in exercising their social rights".

  The situation in Montenegro is also similar (European Commission, 2009c). It is stated that:

  "The social and economic situation of displaced persons and the RAE population remains a matter of serious concern. They continue to face very difficult living conditions and discrimination. Implementation of legislation and strategies must be pursued with more determination".

c. Complementarity of the Production basis

The degree of complementarity of the production basis among the region's states is low. Thus, the possibility for competition among them is more likely than the possibility for cooperation. The key structural elements in the economies of the Western Balkans include (OECD, 2010):

- The small size of the private sector;
- The low level of business innovation and their orientation towards process innovation rather than R&D;
- The weak linkages between business and higher education, along with the related skills gap;
- The domination of low-skill services and natural resource-intensive products in exports

Grupe and Kusic (2005) argue that despite the remaining non-tariff trade barriers in South Eastern Europe, the main reason for the low intra-regional trade is related to the states' similarities in production structures and their little complementarities. In other words, their comparative advantages are overlapping to a large extent. Trade structure - indicated in the dominance of raw-materials- and labour-intensive products (Kušić and Grupe, 2004) - reflects specialization patterns typical for developing countries in their exchanges with developed ones, as capital intensive products account for more than one-third of imports (von Hagen and Traistaru, 2003).

The need for the upgrading of production structures and product differentiation through the development of high-quality value-added services and innovation is urgent (OECD, 2008, p.19):

"To support growth, sector specific policy barriers need to be removed. In the apparel manufacturing sector, investing in technology to upgrade offering capabilities is key to responding to investor requirements: for example, investing in electronic data interchange (EDI) to reduce lead times, or in equipment to move from cut-make-trim (CMT) manufacturing and become original equipment manufacturers (OEMs) able to provide finished goods. However, access to and the cost of finance are a significant constraint on investment. On average, companies in the sector need collateral of 177%, with an interest rate of 11%. There is a need to improve awareness of the type of financing available and the requirements for obtaining it. In the automotive components sector, there is a need to enhance collaboration efforts with international companies to upgrade capabilities. More than 50% of companies are experiencing a skills gap in regard to design, supply chain and logistics capabilities. There is a need to improve both sector linkages between original equipment manufacturers (OEMs)

and suppliers, but also to improve awareness of local capabilities that could be exploited much further through, for example, regional supplier databases".

d. Institutional accomplishment and maturity

The 'institutional' dimension of economies is particularly stressed in contemporary approaches. It is argued that institutional development is significant for cross-country differences in GDP per capita. Moreover, institutions in neighboring countries turn out to be significant as well. Poor institutional structures in neighboring countries increase the chance of armed conflict, political turmoil and refugee flows. Good institutions may be ineffective when a country is surrounded by institutionally poor neighbors. This has a bigger significance nowadays, that not only domestic, but also international governance (IMF, the World Bank) for economic success depends more than before on improved institutions at the national, as well as the regional level (Simmons and Elkins, 2004).

- *Institutional Capacity* still has to be developed in the region. Based on EC's appraisal (European Commission, 2009a) we note:

  "Kosovo is not yet ready to negotiate and implement a trade agreement. For example, the administrative capacity to ensure the effective implementation of antitrust policy and state aid regulation needs to be prepared. As regards intellectual property rights, key elements of industrial property rights legislation are in place, but Kosovo still needs to build the basic administrative capacity to ensure compliance. Kosovo also needs to make significant progress in legislative alignment in the area of copyright legislation and enforcement. It also needs to make significant progress in the legislative and institutional structures affecting trade in goods, including sanitary and phyto-sanitary matters. The institutional framework to ensure adequate accreditation, certification, standardization and market surveillance needs to be applied effectively".
- *Level of satisfaction from government's performance* is still limited (Balkan Monitor, 2010). Relative majorities of respondents in Albania, Kosovo and Montenegro were satisfied with their countries' government. In Serbia, Croatia and Bosnia & Herzegovina, respondents were at least three times more disapproving their countries' government. Albania was an exception, as citizens' approval of the government has increased strongly by 17 percentage points (to 48%) since 2006.
- *Perceptions on the level of corruption*. Concern on corruption is considerably high in the countries of the region (Euractiv, 2010). A survey (carried out in September 2009) revealed that more than two-thirds of Balkan respondents see corruption as "pervasive" and "widespread" in both government and business. The perception of

corruption in the business sector is highest in Croatia (92%), Serbia (91%) and Bosnia & Herzegovina (90%), while rising in all countries since 2006, with the exception of Albania and FYROM. The perception of corruption in government is highest in Kosovo (84%) and Bosnia & Herzegovina (81%), with Montenegro being a notable exception (49%). Alarmingly, more than a quarter of the respondents in Bosnia & Herzegovina and Kosovo said they are personally affected by organised crime in their day-to-day life. More than half of the respondents in Albania said they had to offer a bribe or gift in order to work out their affairs last year, in contrast to just 8% of the respondents in Croatia.

e. Inter-state trade and financial transactions

Inter-state trade and financial transactions are limited within the region, although economic integration of the individual states with the EU has significantly progressed. This brings forth the issue of preferential 'north-south' integration, at the expense of 'south-south' integration. In their work, Jackson and Petrakos (2001) estimate the effects of structural changes in the external trade of the Balkan transition countries on the recovery rate of their economies. They point out the rigidities in the development efforts in the region, which are reflected in inter-industry trade, labor- and material-intensive export sectors, withdrawal of cross-border trade, and excessive trade dependence on the EU. The outcome is lower increase in exports, larger deficits, lower productivity and weaker economic systems, compared to the Central European transition countries.

The statement of the European Commission for Kosovo (European Commission, 2009) is characteristic:

"The openness of the economy, measured by the value of imports plus exports in goods and services as a percentage of GDP, increased to 71.1% in 2008, up from 64.5% in 2007. EU Member States and CEFTA continued to be the two main trading partners for Kosovo, accounting for 40% of total trade each, the latter despite Serbia's blocking the exports and Bosnia and Herzegovina's refusing preferential treatment. The share of exports bound for the EU increased from 42% in 2007 to 47.8% in 2008. The EU's share of total imports remained at around 36%. Overall, economic integration with the EU has increased".

All Western Balkan countries have significant deficits of goods trade and of combined goods and services trade, emphasizing the importance of improving their export performance. The impact of bilateral Foreign Trade Agreements that came into effect in the region has not yet been studied so that to allow for a safe judgment. The reported data reflect vast increases in imports and exports, although one cannot identify from these data alone a positive effect of the FTAs – i.e. whether their effects have been beneficial, or whether the adverse impact of their design will dominate, as suggested by Kaminski and De la Rocha (2003). (Bartlett, 2009)

We stress here that open borders and increased trade relations within the broader region - and especially among neighboring countries – is a prerequisite for efficient entrepreneurship. Neighboring countries provide a favorable market, because of: (i) similar consumer preferences (formed by shared history and culture), that require less effort and cost for products promotion; and (ii) territorial proximity, that reduces transport costs. Trade promotion in the broader region and, especially cross-border trade among neighboring countries, should be therefore a strategic priority for the Western Balkans. According to Petrakos (2002), the more peripheral the location of a developing or transitional economy, the more important is cross-border trade for maintaining variety and sectoral differentiation in the production system.

Achieving regional integration, beyond merchandise trade liberalization, requires government actions that reduce the market-segmentation caused by domestic regulatory policies. The benefits of a deeper integration lie in the creation of a single economic space and include greater contestability, a larger market, greater economies of scale – all evidenced in intra-regional supply chains, higher FDI, increased efficiency of the 'backbone' sectors and increased intra-regional trade (Kathuria, 2008).

f. Technology

The level of technology in the countries of the region is considerably low. For Kosovo, for example it is stated that (European Commission, 2009):

"Overall, the technology base and the state of physical infrastructure remain weak and the pool of qualified human capital small. As a result, Kosovo companies are too rarely competitive even in sectors where competitive potential exists".

The situation for the rest of the countries of the region is very much the same. It is also characteristic that high technology exports as a percentage of manufactured exports of Albania and Bosnia & Herzegovina accounted in 2008 for 4% (World Bank, 2011). Accordingly, is stated by OECD (2008, p.20) that:

"Due to the mismatch between skills demanded and skills supply, the Western Balkans faces a serious challenge in supporting growth in most sectors. For example, 44% of

automotive component companies identify availability of skills as a top challenge they face in expanding operations. Lack of skills has a negative impact on competitiveness – increasing operating costs, lowering output quality and contributing to a loss of business. Mechanisms for institutionalization and dialogue between ministries of economy/industry and education are limited. This reduces the possibilities to match supply with demand at the structural level. Moreover, many nationally sponsored reform initiatives fail to include all relevant stakeholders in the reform process, limiting the political support needed to see reforms through".

g. Infrastructure

In overall, infrastructures in Western Balkans – e.g. road transport, railways as well as aviation - are considered to be poor and under-developed (European Commission, 2009). Infrastructure is considered to be among the weaker elements when considering the prospects of regional integration in Western Balkans. For example, according to INSTAT (2006) trade expansion between Albania and the other Balkan states is limited as there has been little history of trade relations to build upon; and moreover, transport links are poor and the mountainous geography that surrounds the country is forbidding. Poor transport infrastructure and the multiplicity of borders represent a significant barrier to trade for all exporters in the region (Bartlet, 2009). According to Petrakos (2000), given the weak regional trade flows, the serious infrastructure gaps, and the diversity of the Balkan countries, prospects for economic integration in the region are modest.

Our empirical analysis is summarized in Table 2.

Table 2: Political Economy Variables for Regional Integration in the Western Balkans Level of Accomplishment/Intensity

VARIABLE	LEVEL OF ACCOMPLISHMENT - INTENSITY	
	Low	High
Coincidence of national interest and political barriers	√ for coincidence of national interest	√ for political barriers
Common Perceptions on Norms, Principles, Culture	√	
Complementarity of Productive Basis	√	
Complete and Mature Institutions	√	
Inter State Trade and Finance Transactions	√	
Technology	√	
Infrastructure	√	

The above table clearly demonstrates that the variables denoting regional integration prospects among the Western Balkans economies show a remarkably negative tendency. This justifies the limited success of the so far undertaken attempts as well as their dim future prospects.

5. Conclusions and Assumptions for the future

So far, the main instrument of regional integration in the Western Balkans has been a network of bilateral Free Trade Agreements (FTAs) which the Balkan countries have adopted under the guidance of the Stability Pact for South East Europe (SEE), and more recently the extension of the CEFTA free trade area to the region. The bilateral FTAs have been criticized for creating differentiated trade relations and at the same time, other arrangements – such as the contractual relations of individual countries with the EU – further fragment mutual trade relations in the region (Bartlett 2009). The poverty-stricken and politically unstable countries of the Western Balkans are characterized by over-reliance on traditional industry and agriculture, both lacking international competitiveness; overdependence on FDI, uneven distribution and power asymmetries between small firms and international investors.

As the region recently demonstrates an economic slowdown, the need for alternative strategies of economic and regional development has come forth. In this paper we argue that normative neoclassical approaches provide an inadequate framework for the assessment of the potential of undertaken efforts, as well as the prediction of the future of regional integration attempts. We suggest a set of variables that capture the political economy dimension of such attempts and processes, and allow for an in depth analysis and evaluation of both current and future endeavors. We introduce a comprehensible framework for such a task which entails variables such as: the coincidence in political interests and political barriers; common perceptions, values, principles and culture; institutional accomplishment and maturity; complementarily of production basis; trade flows and financial transactions; technology; and infrastructure.

The proposed framework provides adequate explanation of the pattern of regional integration in Western Balkans, and allows for an evaluation of the undertaken efforts and future perspectives. The outcome of the analysis demonstrates why the efforts of the individual states towards regional integration have poor results; it depicts the important reasons that counteract the undertaken attempts or impede any planned ones. In the heart of the issue lies the fact that was empirically substantiated: the weak intensity and low level of accomplishment of the proposed measured political economy variables. A useful contribution of our analysis for the identification of obstacles at the different levels of the regional integration process, would be the establishment of constructive recommendations that will improve the effectiveness of existing coordination and will forge the necessary linkages between the various stakeholders (central governments, border communities, public and private enterprises).

In the case of the Western Balkans, we conclude that regional integration may be achieved only through a top-down approach, namely a European Union/International Community enforced process, rather than through bottom-up initiatives of the individual states in the region. This framework of analysis could also be useful for the assessment of regional integration arrangements and processes among less developed or developing economies, especially in war-torn countries, with multiethnic societies and related particularities . Such cases can be identified in the regions of Central and Sub Saharan Africa, or Central Asia. The level of intensity and accomplishment of the proposed political economy variables provide an indicator of the potential for regional integration.

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