Trade regimes, investment promotion and export prospects in the Western Balkans

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Abstract

Once regarded as a more prosperous part of socialist world, the region that was within the Yugoslav common market now excludes Slovenia and includes Albania to be renamed as the Western Balkans. After a decade of social unrest and civil wars of mainly ethnic character, it has yet to come up in terms of economic development that is behind some advanced transition economies, namely those in Visegrad countries. With the admission of Bulgaria and Romania in the European Union (EU) since 2007, the Western Balkans finds itself completely surrounded by the EU. Despite that political environment is still fragile, the progress in economic cooperation is gaining a momentum through bilateral free trade agreements which recently are superseded by a single common agreement – Central European Free Trade Agreement (CEFTA), though the risk that the former to undermine the latter should not be underestimated. Whether current reforms are a process of push factors from inside – the necessity of small economies for greater cooperation, or encouraged as a prerequisite by the EU – regional economic integration facilitates the road to the EU accession and membership, they first of all are designed and initiated for sustainable development and better economic welfare. The aim of this paper is two fold: first, to investigate the prospect of trade regimes, investment promotion programs and export incentives; and second, to find out to what extent these reforms are contributing to economic integration and political stabilization of the Western Balkans.

JEL Classification: F13, P27, P33.

Keywords: Western Balkans, taxes, investment promotion agencies, export, economic cooperation, integration.

Introduction

The term Western Balkans was coined by the EU in 2004 after disintegration of the former Yugoslavia to denote a region in the Mediterranean bordering Slovenia, Hungary, Romania, Bulgaria, Greece and having its longest border with Italy along Adriatic Sea. The countries under consideration include: Albania, Bosnia and Herzegovina (BiH), Croatia, the Former Yugoslav Republic of Macedonia (FYROM), Kosovo, Montenegro, and Serbia. With the exception of Albania that had one of the most centralist economic systems in the world, the rest of the region for nearly four decades lived under a more democratic model known as self-management or market socialism. For much of its lifetime, self-management had positive balance on foreign trade, in which favorable fiscal policies and import-export quotas played a role. Moreover, what has mostly contributed to better welfare of self-management *vis-à-vis* centralist socialism was a higher degree of economic openness towards Eastern block, West and the third world countries (Lydall, 1984).

Transition to democracy and (full) market economy in the former Yugoslavia followed the break up of the country that resulted in the establishment of the successor states. Trade was disrupted and many cross-border barriers to trade emerged. The immediate impact was on transport costs as a result of reorienting trade flows through Hungary, Romania, and Bulgaria. It was estimated that by mid-1990s this route increased transport costs per truck with goods by DM 1,000 (approximately €500) on average (Bartlett, 1996). High social costs and significant damages to infrastructure caused a decline and reverse in economic development to the extent that the former Yugoslavia which occupies nearly 90% of the Western Balkans, was given a pejorative "the black whole of Europe".

Prior to disintegration, the former Yugoslavia had an estimated population of 23.7 million inhabitants and 255,804 km^2. In a slightly reconfigured area, the Western Balkans covers a lager area of 264, 279 km^2 and as of 2007, approximately the same population number of 23.7 million ranging from less than 0.7 million in Montenegro to 7.5 million in Serbia. Total GDP in 2007 was estimated at around $134 billion or $5,654 per capita (European Bank for Reconstruction and Development – EBRD, 2008).[1] A comparison of these figures in 1990 suggests that total GDP has nearly doubled when it was $78.5 billion or $3,312 per capita (World Bank, 1991). During socialist system the region was featured by development disparities where it was known as developed north and less developed south. The gap further increased during disintegration and transition. As of 2007, GDP per capita in the least developed Kosovo at $2,318 was just 20% or 1/5 to that of the most developed Croatia. Some three decades ago this ratio was around 1/3. Referring to further relevant comparisons of the EBRD statistics, the Western Balkans' GDP per capita is only 20% and Croatia's around 47% of the EU average.

Concerns expressed by the EU in a possible forthcoming wave of enlargement are that, it will not be ready to include in its family these countries as long as they have unresolved problems and progress with the reforms has not reached a satisfactory level, but an important assurance is when it made clear that the future of the Western Balkans rests within the EU, regardless the costs this process may incur and the long journey it may take. Conditionality on successful implementation of the reforms as a principle of making accession by meeting the EU standards, may not guarantee automatic membership. In 2005 referendums in France and the Netherlands did not approve the EU Constitution, which among others contained provisions on enlargement strategy. Thus the strategy of admitting new members shifted to consolidating the present membership first (Brown and Attenborough , 2007). That is why accession of the Western Balkan countries may be delayed. The EU, however, is keen to encourage their intraregional cooperation and continues to support the reforms initiated as a part of conditionality for membership. Croatia makes an exception from her counterparts with the needed progress it made on the road to faster membership.

To find out the progress in some of the key economic reforms in the Western Balkans, section 1 of this paper looks at present import-export duties and the rate of taxes. Since trade liberalization has an impact on interstate circulation of capital and investment, section 2 focuses on investment promotion agencies (IPA). The section will also consider the incentives that these agencies offer to promote export. This is particularly important given the trade deficit all countries in this part of Europe have.

[1] The EBRD statistics lists the measures of aggregate GDP in the countries' national currency but GDP per capita in US Dollars ($). Exchange rates as of December 2007 are used to convert the figures in USD.

Section 3 presents trade statistics with specific reference to exports. It indicates that more developed countries such as Croatia are more likely to export to the EU as opposed to less developed ones whose exports are mainly directed to their non-EU neighbors. A separate sub-section discusses the CEFTA that entered into force in July 2007 for the Western Balkans, Bulgaria, Romania, and Moldova. Section 4 observes political implications and prospects in regional and EU integration. The last section draws conclusions.

1. Import-Export duties and the rate of taxes

Trade reforms and liberalization are likely to be associated with a decline in the government budget revenues in the short run, especially for poor countries. A key concern is that trade liberalization is a trade off between the loss of some revenues that can imbalance the government budget, and the ease of conditions to make businesses better off. Theoretical evidence suggests that trade liberalization may not lead to losses of revenue in cases where replacement taxation takes time, provided that the reform is handled with care and managed efficiently (Winters *et al,* 2004).

Customs duties on imported and exported goods as a traditional and significant source of budget revenues have undergone gradual decline to that point that export is basically free. In most European countries customs today are more responsible for controlling the flow of goods and services in and out of the country. The need for government revenues and expenditures on one hand, and the desire to foster economic development through trade liberalization on the other hand, had pushed the governments in the Western Balkans to gradually lower customs duties and replace their impact on budget revenues by various taxes collected at home. The governments' budget and spending now more than ever before depends on direct taxes such as income tax, corporate tax, property tax, and the VAT as an indirect tax.[2]

Having bilateral FTAs in force, implies that the rates of import duties do not apply in trade between the countries presented in Table 1 below. However, exported products are charged with other taxes when distributed and sold in importing country. Beside bilateral FTAs, producers under the re-export scheme are exempt from the

[2] Direct taxes are called so because they are directly paid to the government by the entities and/or persons on which they are imposed. Indirect taxes such as sales tax or VAT are collected by intermediaries, e.g. by individuals who ultimately bear the tax burden from businesses.

rates of import duties from whatever country when importing raw materials, provided that the products derived from their processing are planned for export. The list of goods and raw materials with a zero rate of customs duties, mostly include: agriculture inputs, raw materials used in chemical industry, wood, paper, wool, cotton, electrical energy, or the things needed to stimulate production. Of special importance in international trade are the rules of origin of the products. Like people, products also have their origin, e.g. "Made in China". Although there is no any standard or general rule to determine the origin of a product, among the most widely used criteria are: i) HS number (Customs Nomenclature); ii) percentage of value added in manufacturing the products; iii) specific processing; and iv) a combination of any of the criteria from i) to iii). The rules of origin and their implementation are one of the key components to identify the scope of legal and illegal trade (smuggling). The latter gives rise to informal sector, the share of which in the Western Balkans is considered to be larger than in any other European country. Smuggling avoids paying taxes which consequently leads to unfair competition. Since it is a separate issue, this section takes into consideration legal trade and the rate of taxes that apply to it.

Table 1: The rate of taxes in the Western Balkan countries (in %) [a), b)]

Type of taxes	Albania	BiH	Croatia	Kosovo[c)]	FYROM	Montenegro	Serbia
Import duties	0-15	0-15	3	10	7	6.1	10
VAT	20	17	22	16	18	17	18
Corporate income tax	20	30 (22)[*)]	20	10	15	9	10
Personal income tax	1-20	5-30	20-35	0-10	15-24	15-23	12-20
Social contributions							
➢ Employee	11.2	32 (40)[*)]	0	5	0	0	17.9
➢ Employer	30.7	11.5 (12)[*)]	17.2	5	32	16.1	17.9
Real estate transfer tax	0.5-3	5.6	5	0.05-1	3	0.4	2.5

*) Figures in parenthesis indicate the rates in the Serb Republic.

Source:

a) European Commission (2006a), Western Balkans in Transition, Directorate General for Economic and Financial Affairs, Report no. 30 (December), Brussels.
b) World Bank, Doing Business – Benchmarking Business Regulations, available at: http://www.doingbusiness.org/ExploreTopics/PayingTaxes/, accessed on March 2009.
c) Official Gazette of UNMIK, various issues, available at: http://www.unmikonline.org/regulations/unmikgazette/02english/Econtents.htm; and Official Gazette of the Republic of Kosovo, available at http://www.assembly-Kosovo.org/?cid=2,122, accessed on March 2009.

Excise tax is a type of tax imposed on specific goods such as alcohol, cigarettes, gasoline and drugs with a higher rate than of other commodities subject to customs duties. Sometimes referred to as an excise duty, many governments apply it, among others, for the following reasons: i) to protect people from harming their health by discouraging them to consume aforementioned; ii) to collect revenues for health care and other public expenditures; and iii) to protect others around consumers and the environment. Since excise taxes are levied on the value of goods (depending on their price) and quantity (per kilo, liter, piece), their highly differentiated rate by countries was not possible to present in details in Table 1.

Import duties vary from 3% in Croatia to a maximum of 15% in Albania and BiH. They apply to imports from any country that is not part of the FTAs and/or CEFTA. VAT as one of the largest contributor of state budget revenues is the lowest in Kosovo and the highest in Croatia with a flat rate. The top marginal corporate income tax in the Federation of BiH (30%) is significantly higher than in Montenegro (9%), Serbia (10%), and the FYROM (15%). In Albania, Croatia, and Kosovo this rate is 10%. Progressive rates apply on personal income tax. The rate goes up from 10% in Kosovo to 20% in Albania, which in Croatia is the bottom marginal rate or the starting base from where the progressive tax is calculated and continues to rise to a top-bracket rate of 35%. Social contributions as a category of budget revenues paid at different rates by the employee and the employer in are the highest in Albania, BiH, and Serbia. The participation rate by the employee is zero in Croatia, FYROM, and Montenegro whereas in BIH it is very high – 32% in the Federation and 40% in the Serb Republic. The standard real estate transfer tax rates vary from 0.4% in Montenegro to 5.6% in BiH as a percentage of net book value of property. Reduced and/or increased tax rates apply to a number of categories such as buildings, agricultural land and special zones.

Taxation levels in the Western Balkans in general appear to be lower than in the EU countries. For instance, Slovenia, a country that descended from the former Yugoslavia and joined the EU in 2004, has a VAT rate of 20%, corporate income tax 25%, and personal income tax 16%-50%.[3] The rate of taxes is more or less in line with the countries that just recently joined the EU – Bulgaria and Romania. VAT rate in Bulgaria is 20%, corporate income tax 15%, and personal income tax 30%. The corresponding rates in Romania are 19%, 16%, and 25.5%.[4]

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[3] Slovenia Income Taxes and Tax Laws, available at: http://www.worldwide-tax.com/slovenia/slovenia_tax.asp, accessed on March 2009.
[4] For more details visist: http://www.worldwide-tax.com/, accessed on March 2009.

2. Investment promotion agencies and incentives to export

Lowering or eliminating tariff barriers to trade is still not a sufficient measure for the Western Balkans to catch-up with the needed economic progress for EU accession. Trade is dependent on production which in turn requires investment – a cluster for economic growth. The region has got many investment opportunities not properly explored and utilized. A study by the World Bank (2006) on Foreign Direct Investment (FDI) costs and conditions in automotive component manufacturing and food/beverage processing reported potentials for investment, but maintained that food and processing industry has a better perspective for export. This section provides an overview on the role of IPAs by countries, with a particular emphasis on incentives to export. All agencies are established to operate as a one-stop facility and offer incentives to export. The profile and services of these IPAs is presented in Table 2 below and subsequent text.[5]

Table 2: Basic profile of IPAs

Countries	Established in[a)]	Number of staff		Budget in 2006 (€)[b)]
		2006[b)]	2008	
Albania	2006	31	28	289,585
BiH	2005	18	26	750,000
Croatia	2005	30	40	1,746,000
FYROM	2005	6	n.a.	n.a.
Kosovo	2007	8	13	n.a.
Montenegro	2005	5	n.a.	180,000
Serbia	2001	35	43	683,000
Slovenia	2006	56	n.a.	2,389,417

"n.a." data not available or could not be obtained.
Source:

a) Web pages of IPAs of respective countries:
http://www.albinvest.gov.al;
http://www.fipa.gov.ba;
http://www.apiu.hr;
http://www.invest-in-macedonia.com
http://www.invest-ks.org;
http://www.mipa.cg.yu;
http://www.siepa.sr.gov.yu;
http://www.investslovenia.org;
b) South East Europe (SEE) Forum, Southeast Europe Investment Guide 2007, available at: http://www.seeurope.net/files2/pdf/ig2007/At_Glance.pdf, accessed on March 2009.

[5] The volume and trend of FDI in this paper is neglected as the focus was on *investment promotion* , and partially because it is notoriously difficult to find the relationship between the FDI inflows occurring through the support of IPAs and those investments mad by using other alternative ways not reported. In addition, a research by OECD (2007) on South East Europe (SEE) countries' statistics on measuring the FDI, found many and varying deficiencies in methodological framework, data collection and dissemination practices, analytical quality of FDI statistics and international comparability, foreign expenditures, and many more.

Albania - Albanian Agency for Business and Investments (ALBINVEST)

ALBINVEST is tasked with three strategic goals: i) assisting and accelerating the inflow of FDI into the Albanian economy; ii) improving the competitiveness of Albanian exporters; and iii) providing professional services to assist the growth of Albanian Small and Medium Sized Enterprises (SMEs). To reach these goals, the “Law on Foreign Investment” envisages a range of favorable treatment of all foreign investors. No sector is closed to them and no prior government authorization is needed to invest in economic sectors. There is no limitation on the percentage share of foreign companies; they can be wholly owned by foreigners whose property may not be expropriated or nationalized directly or indirectly, except in few circumstances in the interest of public use as defined by law. Foreign investors have the right to repatriate all their profits generated from investments in Albania.

ALBINVEST provides assistance to foreign investors throughout the investment process. It helps them to find Albanian suppliers and partners in case of joint ventures. Incentives in manufacturing sector are offered through the section “Make it in Albania”, which involves detailed information on sector opportunities, finding the sites and premises for business. The Agency offers advice on investment regulations, informs of government incentives and programs that might support foreign investment decision, and signpost to the right person in the government to answer specific questions.

Incentives to export:

Producers under the re-export scheme do not pay VAT or customs duties. Products manufactured of raw materials from Albania designated for export are exempt from the VAT. Exporters can also benefit from a VAT credit for purchases made on behalf of their exports. goods transported through the territory of Albania are exempt from customs duty, VAT, and excise taxes. Another incentive comes from Export Development Programs which assists companies to evaluate their capabilities and provides some financial assistance and access to both international and local consultancy help to prepare and implement an export marketing strategy.

Bosnia and Herzegovina – Foreign Investment Promotion Agency (FIPA)

FIPA is mandated to facilitate and support FDI. It offers practical assistance in dealing with government institutions by working directly with investors and assisting the government in improving the legal framework on foreign investments. In pursuing this mission, FIPA provides data, information, analysis and advice on business and investment environment, including: economic and business trends, investment projects in the development-phase or ready for implementation, companies in the process of privatization, local companies seeking foreign partners, etc. The Agency assists both potential investors and those that have already invested in the country through: i) linking with governmental and non-governmental institutions to facilitate investment and business development; and ii) cooperation with local, regional and international organizations to promote and enhance the investment environment.

Incentives to export:

According to the preferential export regime with the European Union, goods of BiH origin that fulfill EU technical-technological standards and conditions, can be imported to all 27 EU countries by the end of 2010 without any quantitative restriction and without paying customs and other similar duties. BiH has also preferential regimes with USA, Australia, New Zealand, Switzerland, Norway, Russia, Japan and Canada. FIPA offers assistance to the companies that want to export to these countries.

Croatia – Trade and Investment Promotion Agency (TIPA)

TIPA's three main tasks are: i) to provide full service to investors during and after the implementation of their investment projects; ii) to propose measures to enhance the business environment; and iii) to present Croatia internationally as a desirable investment location. The operative role of TIPA is to gather and integrate all the information regarding available resources for investments so that the investors could receive on one location all the needed information – one-stop shop.

Incentives to export:

TIPA has an export division that is in charge of assisting Croatian exporters in various ways. It first monitors about the laws and regulations on foreign markets, then it informs Croatian exporters about the export conditions there such as markets approach, tenders, tenders and projects financed by the international financial institutions. For exporters who do not have sufficient information and face higher costs in making their way through on their own, TIPA acts as the intermediary in connecting them to with foreign buyers, thus making exports less costly. Exporters are also supported at the international fairs and exhibitions, market research and feasibility studies. One important distinctive feature of TIPA compared to IPAs of two countries presented earlier is the organization of professional seminars for exporters. In foreign countries, it organizes promotional appearances. Similarly, at home it prepares, promotes and presents Croatian export possibilities. Foreign companies interested for import of goods from Croatia and cooperation for exports with Croatian companies (investments, Joint Ventures, etc.) willing to use services of the Agency, are offered a form in the internet to be filled in and submit it to the Agency.

FYROM - Agency for Foreign Investments

The Agency is established with aim to attract greater inflow of FDI. It offers information to foreign interested investors for various sectors, investment climate and incentives, free economic zones (which enjoy a tax holiday up to 10 years in corporate income tax and VAT), Technological Industrial Development Zones (Export Processing Zones), etc. In order to stimulate additional foreign and domestic investment, corporate tax on re-invested profit is set at 0%.

Export promotion:

In the Ministry of Economy there is a unit called Trade and Investment Promotion Sector which is working on export promotion. Its objectives are to provide financial support to exporting SMEs such as: i) “pure cover”, i.e. insurance or guarantees given to exporters or lending institutions without financing support; ii) financing support, which implies direct credits/financing, refinancing and interest rate support; and iii) credits and grants. It is expected to finance small export enterprises through loans at favorable terms to cover export-related expenses (e.g. purchase of raw materials, marketing expenses, development of distribution network). The Sector is seeking a new credit line from the World Bank for financing export activities of enterprises. Another agency working on export promotion is Swiss Agency for Export Promotion (SIPPO) based in Skopje. SIPPO's counterpart includes the Macedonian Business Resource Centre, and Chamber of Commerce and Industry as partners.

Kosovo – Investment Promotion Agency of Kosovo (IPAK)

IPAK is established by the UNMIK (United Nations Mission in Kosovo) Administrative Direction No. 2005/10. The Agency is established with a mission to facilitate and promote investments into Kosovo and improve Kosovo's investment climate. It became operational in the second half of 2007 as an Executive Agency within the Ministry of Trade and Industry. The Ministry shall provide the budget of the IPAK and may be supplemented with donor funds, as appropriate. Currently, the European Agency for Reconstruction (EAR) is the main donor of IPAK, which in cooperation with the Ministry are developing two industrial parks and five business incubators across Kosovo.

Export promotion:

IPAK has an export promotion division that undertakes activities to promote Kosovo's exports by, inter alia, researching and identifying export opportunities. Some services of IPAK like marketing local products in activities abroad, supporting exporting enterprises and business associations are still being consolidated. Collecting, processing and distributing export-related information inside and outside of Kosovo is a more consolidated service. The EAR has implemented a project on export promotion that would serve to the IPAK to identify key areas in which the Agency will be more focused on. IPAK has a representative office in Vienna and is on the way of establishing one in Sweden and another one in the UK.

Montenegro – Montenegrin Investment Promotion Agency (MIPA)

MIPA is established to help investors find business opportunities in Montenegro. Like other agencies discussed earlier, the Agency maintains an investment database to provide relevant information on investment climate, institutional framework and related legal issues. Investors are assisted to obtain permits and licenses on national and local levels of authority. They are further supported in locating greenfield and brownfield site according to specific requirements, cooperation with domestic supplier companies and other local partners. Montenegro has also an earlier Agency for Economic Restructuring and Foreign Investments which is active mainly in the privatization process.[6]

Export promotion:

Montenegro's Government (2005) has prepared an investment promotion strategy in November 2005. The strategy aims at boosting export by providing a number of incentives. It has given a special important to the establishment of an export support bank of Montenegro. The plans are to create new products with promotion and utilization of Free Zones – production for export. Fiscal incentives include the release for exporters that generate new employment and remission of VAT refund period. One specific incentive for Montenegrin exporters is focused on technical solutions to product characteristics (standardization, certification, testing procedures). Montenegro has seen improving institutional capacities and reducing administrative barriers as another incentive to support exporters. The strategy has plans for organization of export-related seminars and trainings for customs officers.

Serbia – Serbia Investment and Export Promotion Agency (SIEPA)

SIEPA was established in 2001. It has a dual mission: first, to attract foreign direct investment and facilitate its establishment in Serbia; and second, to boost Serbian exports by promoting local companies in the global market. Created as a one-stop-information-shop, SIEPA acts as a partner for international companies throughout the investment projects, and helps to find the right business partner in Serbia. It provides research and help with regulations, laws, and licenses. Statistical and economic data as well as the information are broken down into specific industries to make it easier for investors to find particular opportunism. In addition to linking the companies to Greenfield and Brownfield opportunities, SIEPA's support includes site visit organization. Investors are assisted with presenting ready-to-invest projects, registration, licenses, permits and other documentation.

[6] For a more detailed relation between FDI and the privatization process in Montenegro, visit: http://www.agencijacg.org/englishver/homepage.htm, accessed on March 2009.

Export promotion:

The Export Development Program (an EAR-funded project) provides suppliers and exporters database, and financial assistance for Serbian exporters. In fiscal terms, Serbia has established tax free zones for trading across borders (Subotica, Pirot, and Zrenjanin), no restrictions on export and import of goods and services from and into the zones or on other transactions. Fiscal release applies under temporary importation of goods for processing to be re-exported. Importing from Serbia through SIEPA's assistance is another incentive for exporters.

Slovenia – Trade and Investment Promotion Office (TIPO)

Slovenia as a successor state of the former Yugoslavia but not part of the Western Balkans has an agency (TIPO), the services of which are more diversified than of the agencies presented earlier. TIPO aims at fostering entrepreneurial spirit, give impetus to new undertakings, and help operating companies to improve performance, and attract more inward FDI. Slovenia as a small country with a population size similar to that of Kosovo has become a successful exporter. It has established an export and development bank (SID Bank) in 1992.[7] The bank finances export transactions, which have to be insured against non-commercial risks - at least the part which is financed by the export. It is registered for a broad range of activities aimed at the promoting the sales of goods and services and outward investments of Slovene companies abroad. More specifically, SID Bank on its own account: i) finances international trade and investment transactions; ii) issues guarantees for transactions of companies on foreign and domestic markets; and on account of the state it: i) insures export credits against non-commercial risks; ii) insures short-term export credits against commercial (non-marketable) risks in non-OECD countries, etc.

SID bank issues all types of bonds and guarantees, especially for exporters and other companies, mostly for equipment suppliers and construction companies. The bank also issues numerous other guarantees such as, customs bonds, payment bonds, stand-by letters of credits, and counter guarantees. Another important activity of SID bank is that it has an extensive network of debt collection agencies worldwide and professional staff with experience in debt collection in Slovenia and abroad. Much of

[7] This Bank obtained this name on 1.1.2007. Before this, it was known as export credit agency (ECA). See more at: http://www.sid.si/sidang.nsf, accessed on March 2009.

the work of debt collection is carried out by the agencies on the territory of the Western Balkans, Romania, and Bulgaria.

3. Regional trade statistics with specific reference to exports

The Western Balkan countries have negative balance in foreign trade. They also run a trade deficit with the EU. While the magnitude and implications of trade deficit are important to be discussed, this section is focused on the volume and structure of exports, mainly within the region. The export structure appears to have a significant difference. Only over 8% of Albania's total exports are directed in the region. Croatia's share of total exports in this geographical zone was also small (12.5%) in 2007. These countries export mainly to the EU as do FYROM, and BiH. This is not the case with Kosovo, where almost half of its exports in 2007 ended up in the Western Balkans. However, a year later this share dropped significantly in favor of nearly tripling the volume of exports to the EU, though in percentage terms still remains the lowest share compared to the structure of other Western Balkan countries. Montenegro's export to the EU, which in Table 3 is reported for 11 months of both 2007 and 2008, has dropped considerably in absolute figures as well as structure. On the contrary, Serbia's exports rose to all destinations – the region, the EU and other countries.

Table 3: Exports between the Western Balkan countries and their trade balance for 2006 and 2007 (in parenthesis), in millions unless otherwise indicated in the first row

Exports from / Exports to	Albania (in $)[a)]	BiH (in $) [b)]	Croatia (in $) [c)]	FYROM (in $) [d)]	Kosovo (in €) [e), f)]	Montenegro (in €) [g)]	Serbia (in $) [h)]
Albania	- (-)	10.47 (n.a.)	23.00 (n.a)	n.a. (106.77)	14.8 (21.06)	10.65 (5.63)	43.61 (n.a)
BiH	4.27 (n.a)	- (-)	1,234.00 (n.a.)	88.00 (104.84)	4.64 (5.69)	22.9 (19.5)	657.10 (915.20)
Croatia	1.00 (n.a.)	762.37 (n.a)	- (-)	163.87 (229.00)	1.36 (0.80)	9.76 (6.36)	203.40 (302.60)
FYROM	25.40 (35.66)	34.05 (52.60)	85.00 (137.71)	- (-)	15.16 (19.36)	0.66 (0.83)	269.20 (345.50)
Kosovo	67.8 (81.09)	38.79 (50.36)	49.90 (64.40)	237.90 (348.91)	- (-)	3.87 (14.44)	289.29 (272.66)
Montenegro	6.45 (24.83)	108.89 (151.90)	120.55 (154.49)	19.87 (27.39)	2.23 (3.70)	- (-)	593.50 (936.50)
Serbia	1.63 (n.a.)	486.71 (446.90)	321.10 (378.20)	639.40 (934.70)	9.45 (9.88)	95.8 (100.00)	- (-)
Total Western Balkans	88.6 (n.a.)	1,430.81 (n.a.)	1,107.00 (n.a.)	991.69 (1,413.87)	47.64 (60.49)	143.64 (146.76)	2,056.10 (2,776.46)
European Union	894.83 (n.a.)	2,596.44 (n.a.)	5,331.00 (n.a)	2,183.50 (2,366.86)	34.27 (93.64)	330.71 (211.00)	3,182.40 (4,239.90)
Other	70.49 (n.a.)	124.50 (n.a.)	2,414.00 (n.a.)	181.07 (197.50)	14.51 (49.80)	76.59 (59.86)	335.10 (711.44)
TOTAL	1,053.92 (1,311.87)	4,151.75 (n.a.)	8,852.00 (n.a.)	3,356.26 (3,978.23)	96.42 (195.93)	550.94 (417.62)	5,573.60 (7723.80)
1) % of exports to the Western Balkans	8.4 (n.a.)	34.5 (n.a.)	12.5 (n.a.)	29.5 (35.5)	49.4 (30.9)	26.1 (35.1)	36.9 (35.9)
2) % of exports to the EU	84.9 (n.a.)	62.5 (n.a.)	60.2 (n.a.)	65.1 (50.9)	35.5 (47.8)	60.0 (50.5)	57.1 (54.9)
3) % of exports to other countries	6.7 (n.a.)	3.0 (n.a.)	27.3 (n.a.)	5.4 (5.0)	15.0 (25.4)	13.9 (14.3)	6.0 (9.2)
Total percentage: 1)+2)+3)	100.0 (n.a.)	100.0 (n.a.)	100.0 (n.a.)	100.0 (100.0)	100.0 (100.0)	100.0 (100.0)	100.0 (100.0)
Coverage of imports by exports (in %)	25.7 (n.a.)	42.7 (n.a.)	47.9 (n.a.)	64.2 (58.1)	10.5 (10.2)	25.9 (18.1)	47.6 (47.7)

Note: Figures may not add up to total due to rounding. Some missing data on exports of particular countries were supplemented from the source of one or more countries as imports to present them as exports. For instance, the figures for Croatia do not indicate the volume of export to Kosovo because of its very low share in total export, or Kosovo was included in the category of "other countries". To fulfill this and other gaps in respective figures, the volume of Kosovo's import from Croatia was presented as export of Croatia to Kosovo. The figures published in national currency such as those of BiH in Konvertible Marks (KM) were converted into USD ($) as the most frequent currency used in publications expressing economic indicators. EURO (€) has been maintained for the figures of Kosovo and Montenegro where it is official currency in use.

"-" not applicable.

"n.a." data not available or could not be obtained.

Source:

a) Albanian Center for International Trade – ACIT (2008), Albania 2007 Trade Report, ACIT, Tirana.

b) Agency for Statistics of Bosnia and Herzegovina (2008), Foreign Trade 2007, Thematic Bulletin No. 06, Agency for Statistics of Bosnia and Herzegovina, Sarajevo.

c) Eurostat (2008), EU Bilateral Trade and Trade with Croatia, DG Trade Statistics, Eurostat, Brussels.

d) Statistical Office of the Republic of Macedonia (2008; 2009), External Trade, No. 7.1.8.02, Year XLVI, 08.02.2008; and No. 7.1.9.02, Year XLVII, State 03.02.2009, Statistical Office of the Republic of Macedonia, Skopje.

e) Ministry of Trade and Industry (2008), Trade Exchange of Kosovo for 2007, Annual Foreign Trade Report, MTI, Pristina, for figures of 2007; and Statistical Office of Kosovo – SOK (2009), Kosovo in Figures 2008, Series 1: General Statistics, Statistical Office of Kosovo – SOK, Pristina, for figures of 2008.

g) Statistical Office of Montenegro – MONSTAT (2009), Monthly Statistical Review 2009, No.1, Year 56, MONSTAT, Podgorica. The figures are for 11 months, both for 2007 and 2008.

h) Statistical Office of the Republic of Serbia (2007), Statistics of External Trade, Number 280, Year LVIII, 30.09.2008, Statistical Office of the Republic of Serbia, Belgrade.

And Author's own calculations.

The difference in the share of exports to the region and the rest of the world makes a little hard to explain the relation between the level of development and export. The evidence available may suggest that Croatia as a more developed country with a more diversified economy is able to export to the EU and beyond, but Albania with a lower level of development also exports more to the EU than in the region. Major exports of Kosovo, and after the EU also of Serbia, Montenegro, BiH, and FYROM go in the region. An explanation for this export destination may be that previous trade relations from the former Yugoslavia are being reestablished. The cause of this reintegration path is geographical proximity, by which lower transport costs make them more likely to be beneficial. Albania is an exceptional case, which even during socialism did not have important trade exchange with the former Yugoslavia and that is perhaps the reason of her low share of export to the Yugoslav successor states. But proximity plays a role for Albania's largest share of export on the other side – her EU neighbors – Greece and Italy.

3.1 Further trade liberalization: the impact of CEFTA Agreement

CEFTA is a regional free trade agreement originally established in 1992 that is expanded to the Balkan countries on December 2006.[8] It was expected to enter into force from 1 May 2007 but was delayed as a result of some countries having not yet signed it. CEFTA entered into force between the signing countries on 26 July 2007 when two signatures (of BiH and Serbia) were still missing. The two countries were expected to join the rest of the group once their parliaments approve it. Other signing parties include: Albania, BiH, Bulgaria, Croatia, FYROM, Moldova, Montenegro, Romania, Serbia, and UNMIK on behalf of Kosovo in accordance with the UN Security Council Resolution 1244, or an expansion of economic and trade cooperation in a market that includes over 55 million inhabitants.

The EU has strongly supported this process, which it sees very much complementary to the Stabilization and Association process (SAp) and replacing current bilateral free trade agreements (FTAs) into a single agreement. The signing and entering into force of the CEFTA has raised the hopes for new opportunities to further facilitate trade and economic integration in the Western Balkans. This integration is also a key element of the EU's policy for the region.

The primary objective as stated in provisions of Article 1 of the CEFTA is to provide trade liberalization as part of the Stability pact for South Eastern Europe, eliminate barriers to mutual trade and establish closer trade relations, and facilitate in transit and cross-border

[8] The full text of the Agreement and its annexes are available at: http://www.stabilitypact.org/wt2/TradeCEFTA2006.asp, accessed on March 2009.

movement of goods and services between the territories of the parties that signed the CEFTA. Just to recap some of the most important articles that regulated trade liberalization, they require: i) removing all quantitative (quota) restrictions on trade (export – import) between the signing parties; ii) abolishing border taxes – customs duties on exports; iii) reducing or abolishing charges and existing subsides on agricultural products and other export subsidies in mutual trade; iv) eliminating unnecessary technical barriers to trade in accordance with the WTO – World Trade Organization Agreement on Technical Barriers to Trade; v) facilitating customs procedures and reduce, as far as possible, the formalities imposed on trade; vi) protecting investment taking place between in the countries signing this Agreement; and vi) establishing a Joint Committee composed of representatives of the signing Parties to supervise, implement and administer the functioning rules of this Agreement.

The benefits from functioning of the CEFTA are expected to be many. First of all, as Uvalic (2006) observed, regional economic cooperation in the Balkans was low. Thus the CEFTA enables faster economic cooperation in the region, greater opportunities to attract FDI, boosting exports, shortening delays at the border-crossings, and preparing this region for the EU integration. Some stakeholders in the countries that signed the CEFTA, mainly in Kosovo, have expressed worries that the CEFTA will come at a disadvantage of domestic producers given their limited competitiveness at home and abroad. A common challenge for all signing parties is the work of a Joint Committee composed of representatives of the signing Parties shall supervise, implement and administer the functioning rules of the CEFTA. As argued earlier, efficient management makes liberalization work better, therefore this applies to reaping the benefits of the CEFTA. Efficient and non-discriminatory implementation may decrease the informal sector. Therefore, by applying more rigorously the rules of origin outlined in Chapter V and contained in more details in Annex 4 of the CEFTA will certainly lead to lowering of informal sector. This is turn would improve efficiency in revenue collection and lower fiscal evasion.

4. Political implications and prospects in regional and EU integration

It was in the Western Balkans, namely in BiH, where the fuse of World War I was lit. In the 1990s Europe witnessed the worst armed conflict after World War II taking place in this region. Historically, the political landscape of this part of Europe has rather been complex. The first political integration here occurred in 1918 when the first Yugoslavia or the Kingdom of Serbs, Croats, and Slovenes came into being. Not only as the name suggests, but the first Yugoslavia did not recognize other nationalities and treated them as citizens of second hand. This political integration lasted until the outbreak of World War II. Unlike other socialist states of Eastern Europe that were satellites subordinated by the former Soviet Union, the Yugoslav communists fought their own way to power, imposed political integration of the second Yugoslavia, and built a differentiated model of socialism. This integration too, ended up in disintegration after more than 45 years of existence. Like the royalist Yugoslavia, the socialist Yugoslavia imposed economic integration through politics. The current or the third integration within a slightly differentiated geographical configuration (with Albania included and without Slovenia that joined the EU) as the Western Balkans is evolving through a different scenario. It starts from economic reforms and cooperation at regional level that may lead to a more natural and better integration (Mulaj, 2007).

The reforms discussed in this paper were first of all undertaken as the requirements of transition to a market economy, i.e. endogenously based reforms. The second reason to reform was the incentive from the EU in terms of autonomous system of preferences and duty-free access to the EU granted to the countries in this region. The third but not the last cause was to remove or lower tariff barriers to trade and facilitate the road to EU membership. Regional cooperation is a key issue to make a faster progress to European integration (European Commission, 2005).

While the progress with economic reforms to some extent can be considered as not yet satisfactory, the area which previously preceded or better saying imposed economic integration – politics – has a much longer and difficult way. There are still unsettled political issues that may pose a threat to economic reforms. The EU is committed to consolidate political stability of the region by encouraging and supporting reconciliation between peoples (European Commission, 2006b).

The EU's political challenge in BiH as a country divided into two entities (the Federation of BiH and the Serb Republic) and three ethnic lines (Bosniaks, Serbs, and Croats) where further interethnic reconciliation is needed, perhaps is not as tough as the problem of Kosovo's so-called supervised independence. Since the second half of 1999, Kosovo's reconstruction and economic development was led by the EU. Despite considerable assistance, Kosovo remains the least developed country in the Western Balkans. Its current political status "supervised independence" was announced before declaring independence on 17 February 2007. This sort of regulated and programmed independence under continued international presence does not give Kosovo the statehood but it may eventually and unavoidably make that possible later (D'aspremont, 2007). It would not be wrong to call the supervised independence as a transitory status as it involves the European Union Rule of Law Mission (EULEX), downsized UNMIK which claims to end its mission in the future, and concessions that the Ahtisaari Plan granted to Serbia to maintain direct ties with the Serb minority in Kosovo. As it is, this complicated status is still constraining Kosovo to become a more active participant and partner in relation with the EU and regional economic initiatives in the SEE due to unresolved political disputes with Serbia, Kosovo's neighbor that supports the Serb enclaves in Kosovo to defy the authorities of Pristina. A similar case in BiH with ethnic Serbs and Croats may have implications for Serbia and Croatia, then, Albanian minority in southern Serbia, and for FYROM where ethnic Albanians make up at least 1/4 of total population.

Croatia is near to complete the process of membership in the EU. The status of the rest is: granting FYROM the candidate status, conclusion of a Stabilization and Association Agreement (SAA) with Albania, SAA negotiations with Serbia, Montenegro, BiH, and a decision to work in Kosovo in this respect (European Commission, 2006c).

The evidence so far suggests that more progress in cooperation is needed between the Western Balkan countries themselves in politics and the economy. These are two highly correlated areas, where the first affects the latter. An example of this is the initial difficulty in functioning of the CEFTA. Serbia does not yet allow transport of goods through her territory with Kosovo's trucks due to non recognition of number plates. BiH also blocked Kosovo's export recently. Kosovo's representatives in the CEFTA were thinking of tit-for-tat, which obviously is not an option as it may encourage smuggling which the CEFTA is committed to combat. Furthermore, Montenegro's attitude towards Kosovo's concerns in intrastate trade was that the CEFTA was signed by UNMIK and not the Government of Kosovo. It would be preferable if the Government of Kosovo signs as soon as possible the same agreement and becomes an equal partner in implementing it, have more authority in raising concerns and defend the interests of its economy. To sum up, the CEFTA is established as an agreement to enable what the Western Balkans and the EU want, and that is, regional and EU economic cooperation and integration. Shortcomings in implementation and/or discrimination in trade should not be confused with the content of the agreement itself.

Conclusions

The Western Balkans after a decade of turmoil and economic downturn has undertaken economic reforms and made substantial progress with them. It was the acute economic difficulties created by the emergence of cross-border barriers that led to the reforming of trade regimes, the establishment of IPAs, and the determination to make a transition to EU membership. Import-export duties have been either abolished or lowered through bilateral FTAs to increase economic cooperation in the region. After the mission to attract FDI, the IPAs have focused on providing incentives to export with the aim of lowering large trade deficits. The measures to encourage export to some extent vary from country to country but in largest part they are similar, mostly related to tax incentives, providing information, advice, and business opportunities. The EU is a powerful incentive and supporter of these reforms which are part of conditionality for the EU accession. Replacing the FTAs with a single agreement – CEFTA – is a further step forward, but in joining the EU, the countries in the region have to overcome a number of difficulties before they can reach their target.

The destination of exports reveals some paths of economic cooperation and (re)integration as in the past, mainly between less developed ones such as Kosovo, FYROM, Serbia, and BiH. More benefits from the EU's autonomous system and duty-free access of goods and services are going to Croatia, whereas geographical proximity to Greece and Italy plays a role for Albania. The export prospects will among others depend on capacities to implement a significant number of measures and services offered by the IPAs.

Despite that the progress with trade liberalization and economic cooperation is making the way through with some exceptions such as difficulties in implementing the CEFTA, there are still political risks slowing down accession of the Western Balkans in the EU. Historically, this region was often characterized by chaos. Now a third party – the EU – is helping to stabilize the region and avoid repetition of the past. But since the EU comprised of different states may not be sufficiently capable to deal with and resolve this inherited interethnic difference, the political prospects of the Western Balkans may also depend on other players such as the U.S. and Russia. Kosovo remains the EU's biggest test in foreign affairs and the failure to pass it may have consequences in future missions and enlargement.

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