Vladimir Gligorov

Trade and Investment in the Balkans

While most of the transition countries have liberalized their economies, the Balkan region has continued to be full of barriers and restrictions – some imposed, some self-imposed and some inherited. The consequence has been that the region has continued to experience trade and other real and policy-induced shocks. It has also motivated most, though not all, of the states in the region to consider advancing either on the path of regional or on that of European integration or on neither. As further EU integration has been conditioned on further regional integration for many of the Balkan countries by the European Union,[1] the level and development of regional trade and economic integration in general has become an important institutional and policy issue.

What region(s)?

In the Balkans, or Southeast Europe, for the purposes of this paper, the following countries are included: Croatia, Bosnia and Herzegovina, Yugoslavia (Serbia, Montenegro, Kosovo), Albania, Macedonia, Romania, Bulgaria.[2] The criteria for inclusion are mainly geography and partly history. Both are usually taken to be important for economic integration because of increasing returns that are connected with geography and path-dependency that is the domain of history.[3] In other words, geographical proximity should lead to *trade creation* in the region while history should induce *trade diversion* to the region. If, on the contrary, trade integration is low, these trade enhancing factors can be taken not to be present or it can be assumed that there are specific trade impeding factors that outweigh the benefits from regional trade. In addition, if it is observed that the level of trade in the region is falling or is volatile, the region can be taken to be *trade averting* or that it is not a region at all in terms of trade and economic integration.

1 In 1996 the EU adopted the principles of its so-called regional approach which applies to a changing set of Balkan countries and currently includes Croatia, Bosnia and Herzegovina, Yugoslavia, Macedonia and Albania. The key principle is that the advance in the contractual relations with the EU for these countries depends on the progress in their bilateral and regional co-operation. More on that in Gligorov (1996b).

2 Some countries raise strong objections to being included in the Balkans. Some, like Slovenia and Croatia, prefer to be treated as Central European countries on geographical and historical grounds also. However, regions are not exclusive, so a country can participate in more than one region as is pointed out in this paper. For more on this see Gligorov (1997).

3 Howev er, nothing changes if practically any subset of these countries is taken to represent the Balkans.

Similar considerations apply to flows of foreign investments. A high and growing level of foreign trade is usually accompanied by a similarly high level of investment. Also, flows of investment often tend to be regionally distributed in a way similar to the distribution of trade. Thus, trade creation should be, in principle, followed by investment creation, and trade destruction by a lack of investment opportunities. Finally, security concerns affect investments even more than they affect trade, so that a low level of foreign investment, especially that which is regional, will be, *ceteris paribus*, a sign of high security and political risks. Given that security risks are a form of an externality, connected again with history and geography, a high level of these types of risks will also indicate a high level of regional disintegration.

Many of the Balkan countries can be considered belonging to other regions too. Indeed, the Balkans are a region of overlapping regions, so to speak. This is also the consequence of history and geography. Thus, some Balkan countries belong to Central Europe, though, similar to the Balkans, this region does not seem to have an altogether large economic significance now. Similar considerations apply to the Mediterranean region and to the Black Sea region. Indeed, regionalism in today's Europe seems to be acquiring a different meaning than the one inherited both from its history and its geography. These broader questions will only be alluded to in this paper.

Given such definitions of the Balkans and of regional integration, the first question to ask is, 'Are the Balkans an economic region?' (and the same applies to all the other regions). There are two aspects to this question: 'Are the Balkans an economic region now?', and 'Are they going to be an economic region in the future?'[4] The answers to these questions are more or less negative. They are not to be taken, however, as either the explanation of or the justification for the lack of trade and other liberalization in the Balkans.[5]

The current level of regional integration can be illustrated by the level of intra-regional trade. Table 2 shows how important the Balkan countries are to each other as trading partners.

Certain facts seem obvious at a glance:

---

4 The issue of the past is not treated here except indirectly through the persistence of trade links between the former Yugoslavia states. However, the Balkans were not an economic region even then because, though former Yugoslavia was of course economically integrated, the Balkans were divided.

5 At the moment the institutionalization of trade in the region and with the EU is rather complex. Greece is an EU member. Turkey has a free trade agreement with the EU. Slovenia, Romania and Bulgaria have association agreements with the EU. Albania and Macedonia have co-operation agreements with the EU. Croatia, Bosnia and Herzegovina and Yugoslavia (Serbia and Montenegro) do not have agreements with the EU. Slovenia and Romania are members of CEFTA (Bulgaria will join from 1 January 1999). A number of Balkan states have bilateral free trade agreements. Slovenia and Croatia have signed a free trade agreement while Slovenia, Croatia and Yugoslavia already have free trade agreements with Bosnia and Herzegovina. All of them have free trade agreements with Macedonia.

(i) For many Balkan countries the other Balkan countries are not important trading partners. In Table 2 a lot of zeros, or near zeros, can be observed. They do not always represent an absolute absence of trade but rather levels that are so low (much lower than 1%) that they are not worth mentioning. From this it follows that currently the Balkans are not a trade-creating region. Geographical proximity does not lead to increasing returns to intra-regional trade.

Table 2

Balkan countries: Trade with the countries of the region, 1997

per cent of total

	Slovenia		Croatia		B&H		Yugoslavia		Albania		Macedonia		Romania		Bulgaria		Greece		Turkey	
	EX	IM	EX	IM	EX	IM	EX	IM	EX	IM	EX	IM	EX	IM	EX	IM	EX	IM	EX	IM
Slovenia	.	.	10	5	3.5	0	1.34	0.5	0	0	1.8	0.6	0	0	0	0	0	0	0	0.5
Croatia	12.1	8.3	.	.	15.5	1.5	0	0	0	0	1.9	0.5	0	0	0	0	0	0	0	0
B&H	7.2	13.3	33.4	30	.	.	43.2	18.8	0	0	0	0	1.8	0	0	0	0	0	0	1.5
Yugoslavia	1.6	1.6	2.5	0.5	18.9	5.9	.	.	0	0	9.3	6	1.7	1.7	1.4	1.8	4.3	4.2	0	1.5
Albania	1.3	1.5	4.2	0	0	0	0	0	.	.	2.6	2.1	0	0	0	2.7	20.5	26.6	0.9	4.4
Macedonia	4.7	7.8	3.1	3.9	1.7	0	22.8	11.6	2.5	0	.	.	0	0	2.7	5.6	8.1	7.3	1.9	2.8
Romania	0	0	0	0	0	0	0	0	0	0	0	0	.	.	0.7	0.5	2.1	1.7	4.2	3.1
Bulgaria	0	0	0	0	0	0	2.5	0.8	0.5	0	2	0.5	1.3	1.2	.	.	8.3	4.2	9	2.1
Greece	0	0	0	0	0	0	0	0	1.7	0	0	0	1.9	0.7	2	1.5	.	.	4.4	1.2
Turkey	0	0	0	0	0	0	0	0	0	0	0	0	1.4	0.8	0.7	0.8	1.1	0.9	.	.

Source: WIIW database, national statistics and IMF direction of trade statistics.*

*) Trade with Bosnia and Herzegovina recorded in the Yugoslav statistics must have been left out from the IMF direction of trade statistics especially when it comes to exports. The actual figures can be found in Tables 3 and 4 below. Here the exports to Yugoslavia recorded there have been added when calculating the relevant share, but not in other cases.

(ii) For some Balkan countries the other Balkan countries are not trading partners at all. For instance, Slovenia and Croatia trade with each other and with Macedonia and sell to Bosnia and Herzegovina. The other Balkan countries do not seem to exist for them in terms of trade. Here historical factors play a significant role both in the persistence of some trade between the former Yugoslavia states and in its absence as well as in low trade integration with other Balkan countries due to political and economic divisions in the previous, cold war, period.

(iii) For almost no Balkan country is another Balkan country the main trading partner.[6] This can be seen from Table 3 where the trade shares with Germany, Italy and Russia are shown and can be compared to those in Table 2. A similar picture emerges if regional, e.g., trade with the EU and within the Balkans, rather than trade with individual countries is compared. Though the region as a whole plays a more important role for some countries, trade with the EU is by far more important for every single Balkan country (except, as already noted, for Bosnia and Herzegovina and perhaps for Macedonia).

(iv) In the Balkans, no Balkan country is really 'Balkan'. However, some are 'more Balkan' than the others. For instance, Macedonia, Yugoslavia, and especially Bosnia and Herzegovina, trade more in the Balkans than do most of the other countries. Some of it is a consequence of involuntary trade diversion as will be discussed below.

Table 3

Balkan countries: Trade with selected countries, 1997

per cent of total

	Germany		Italy		Russia	
	Exports	**Imports**	**Exports**	**Imports**	**Exports**	**Imports**
Slovenia	39.4	20.7	14.9	16.7	3.9	2.7
Croatia	17.9	20.2	18.8	18.7	3.9	5
B&H	17	14.8	21.5	12.7	2.3	0.6
Yugoslavia	9.2	13.4	11.5	10	7.5	9.5
Albania	6.9	4.2	49.4	46.5	0	0
Macedonia	16.2	13.4	3.6	5.5	2.1	3.9
Romania	16.8	16.4	19.5	15.8	3	12
Bulgaria	9.5	11.5	11.7	7.1	28.1	37.2
Greece	18.6	13.9	13.9	18.1	1.9	0.9
Turkey	20	16.5	5.3	9.2	7.8	4.4

Source: WIIW database, national statistics and IMF direction of trade statistics.

These considerations suggest that, given the current level of regional integration as reflected in the trade flows, the Balkans as an economic region is practically non-existent. Intra-regional trade flows are low and most of the trade is conducted with the non-Balkan countries. The region neither creates trade nor does it divert trade from other regions to intra-regional trade. Indeed, it tends to induce trade aversion both in the sense of keeping the overall trade level low and in the

6 Bosnia and Herzegovina is a notable exception. The only possible other exception may be Macedonia in 1997 for which Yugoslavia has emerged as one of the most important trading partners. However, this may prove to be a temporary development due to the volatility of foreign trade links that will be commented on below.

sense of diverting the trade out of the region through constant policy shocks that tend to induce a high level of uncertainty and thus volatility.[7]

For comparative purposes, the trade integration of some Balkan countries with CEFTA can be assessed. The history of CEFTA, however, is not so long as to support generalizations. This is especially true for CEFTA members from the Balkans. Slovenia has been a member for a few years now, but its trade with this region cannot increase all that much because Slovenia's trade is so much EU-oriented. Romania, on the other hand, is a recent CEFTA member and no significant trade shifts have been observed on account of that yet. Similar patters have been observed for trade patterns of the other CEFTA members. Thus, what goes for the Balkans, goes for CEFTA too, though for different reasons. Basically, trade liberalization is not enough to bring in trade diversion in the presence of a very strong attractor like the EU is. As for the Balkans, however, in many cases even the basic elements of trade liberalization are lacking. One has to realize that this is an area in which the regional regime of doing business is the one that can be characterized as that of illiberal trade.

Involuntary trade

An illiberal trade regime can be described in another way as that trade that is done out of necessity, i.e., in some sense, involuntarily. One indicator of such a trade is that there is not much of it going on. Apart from low levels, trade is quite volatile in the Balkans. This is true for all the Balkan countries, though again for some more than for the others. The countries that are 'more Balkan' have more volatile trade. That shows that the volatility is generated in the region or that it is caused by the developments in the region. This being the case, the Balkans can be seen as a trade-averting region and one of trade destruction rather than creation. The fundamental reason for this is that of security. The Balkans have gone through a series of security shocks, not all of those connected with the break-up of former Yugoslavia, that have induced large political and economic consequences. However, apart from security shocks, there are those that relate to the lack of tradition and commitment to free trade. Finally, there are those that follow from the prevalent nationalism in the region which co-exists or reinforces, or both, the significant level of authoritarianism found in many if not most Balkan countries.

The worst case in every respect is of course that of Bosnia and Herzegovina. Table 4 summarizes the quite dramatic foreign trade developments from 1993 until 1997.

Table 4

Bosnia and Herzegovina: Trade with selected countries

USD million

	1993	1994	1995	1996	1997
			Exports		
Total	85.2	35.9	51	175.4	372.8

7 More on this in Gligorov (1996c).

Germany	13.8	8.1	11.5	27.5	63.4
Italy	7.3	2.8	14.8	45.4	8.3
Greece	3.1	2.3	1.1	1.3	1.4
Turkey	0	0	0.1	2.3	1.2
Bulgaria	.	.	.	.	0.3
Russia	9.9	5.8	0.4	0.1	8.6
Croatia	12.7	3.3	7.1	57.7	124.4
Slovenia	.	4.6	7.3	13.8	26.8
Macedonia	.	.	0.7	0.8	0.9
Romania	13.8	.	.	0.4	6.8
Yugoslavia[2)]	.	.	.	229	283
			Imports		
Total	424.1	650	941	1932.1	2377
Germany	38.3	63.6	85.7	249.4	351
Italy	23.4	30.1	76.6	235.9	301
Greece	17.3	0.5	0.2	0.2	0.2
Turkey	0	1	5.8	24.4	35.1
Bulgaria	.	0	0.1	3	3.5
Russia	39	127.9	98	27.2	14.5
Croatia	207.8	248	414.9	603.5	713.6
Slovenia	.	74.8	129.5	289.5	317.3
Macedonia	.	.	0.8	0.8	1
Romania	8	0.6	0.8	2.6	11.8
Yugoslavia[1)]	.	.	.	380	447

Note: 1) The trade figures that appear in the Yugoslav national statistics are, in all probability, not integrated into the IMF direction of trade statistics so that total figures for Bosnia and Herzegovina most probably have to be augmented for the trade with Yugoslavia figures (only partly for 1997).

Source: National statistics and IMF direction of trade statistics.

The three obvious features of this table are:

(i) low initial, after break-up, level and steep growth of imports afterwards,

(ii) a huge trade deficit, which is not surprising, and

(iii) a large share of Croatia, Yugoslavia and Slovenia, the three main trading partners of Bosnia and Herzegovina, in its imports (and in its exports when Yugoslavia and increasingly Croatia are concerned).

For a different, but also typical story, Table 5 shows the development of the Macedonian trade with its Balkan partners in the last several years.[8]

8 Macedonia is probably the 'most Balkan' of the Balkan countries (apart from Bosnia and Herzegovina), at least as far as trade is concerned.

Table 5

Macedonia: Trade with selected countries of the region

USD million

	1992	1993	1994	1995	1996	1997
			Exports			
Total	1199	1055	1086	1204	1147	1201
Albania	21.2	35.7	28	24.7	32.6	30
Bulgaria	63.5	82.7	240	255	38.2	32
Yugoslavia	70	51	40	85	246	274
Greece	38.7	49.6	12.7	14.2	102.4	97
Turkey	17.5	43.8	35.4	38.6	18.2	23
			Imports			
Total	1205	1199	1484	1718	1627	1740
Albania	3.9	7.3	8.2	8.2	5.1	4
Bulgaria	173	131	242.6	256	107.4	98
Yugoslavia	9	63	101	161	166	202
Greece	49	52.2	23.5	29.1	77.4	127
Turkey	32.5	34.3	47.7	55.1	44.3	49

Source: WIIW database, national statistics and IMF direction of trade statistics.

The period chosen is that after the break-up of former Yugoslavia that Macedonia was a part of. The level of Macedonia's overall foreign trade had already been significantly lowered at that time. Still, the volatility of the trade with the major Balkan partners is quite significant. The volatility has been influenced by the following major factors that can be generalized to the foreign trade developments in the other Balkan countries too though they may not be so pronounced.

(i) Security-related shocks that consist of sanctions and embargoes, border closures, high political and legal risks, and high transaction costs of all kinds (those are to be seen in the volatility of the trade with Yugoslavia and Greece and with Albania in 1997).

(ii) Macroeconomic shocks due to high inflation, economic crisis or an outright economic collapse (this is especially characteristic of the volatility of trade with Bulgaria).

(iii) Trade regime and policy shocks due to introduction of tariff and non-tariff barriers as well as to erratic trade liberalization measures (this is again especially characteristic of the trade with Yugoslavia and Greece).

These observations can be applied to other cases as well. For instance, the Yugoslav (Serbia and Montenegro) foreign trade shows similar patterns. The trade developments in this country are difficult to analyse because figures have been released for the last two years only (i.e. 1996 and 1997). The most recent previous official figures are those from 1992. However, some analyses point to the following development of the Yugoslav foreign trade:

Table 6

Yugoslavia: Exports and imports as % of 1990

	1991	1992	1993	1994	1995	1996	1997
Exports	80	40	12	10.8	11	21	28
Imports	75	50	14.8	22	45	48.2	54

Note: Only trade with non-former Yugoslavia states included.

Source: MAP (1997).

If trade with former Yugoslavia states is included, it turns out that the value of 1997 exports was just about 15% of that in 1990 and the value of imports just 27%. On the other hand, looking at the most recent foreign trade figures, it can be seen that Yugoslavia is experiencing the same trade volatility as Macedonia. There is:

(i) a fast increase in the volume of foreign trade of more than 25% in 1997 due to the removal of the trade sanctions and due to the introduction of a free trade agreement with Macedonia (but a stagnation in 1998 due to macroeconomic instability, renewed sanctions and security concerns);

(ii) a significant shift in trade with Germany and the other EU countries growing in volume and in share (until 1998), and

(iii) trade concentration that is a consequence of essentially involuntary trade diversion which is characteristic of the fact that Bosnia and Herzegovina, i.e. the Serbian entity there, is either the second (in 1996) or the fourth (1997) or the third (in the first eight months of 1998) most significant trading partner of Yugoslavia.

Some shocks are more important than others. In the case of Romania and Bulgaria, the foreign trade developments are volatile, but the volatility is mostly caused by the changes in the trade regimes and policies as well as in macroeconomic developments rather than by security concerns and involuntary trade diversions. The sequence there is one of a significant trade shift due to liberalization of trade with the EU which is accompanied by an increase in overall trade with this region and then trade volatility due to macroeconomic instability and lack of vigorous reform programmes.

The figures in Table 7 show:

- volatility of total foreign trade, mainly due to macroeconomic developments (periods of high inflation are accompanied by foreign trade fall);
- a low level of bilateral trade with the tendency of further fall or at best stagnation (low levels of mutual trade were characteristic of the pre-transition period also and the trade shift that has occurred has mainly led to trade integration with the EU and not regionally).

Table 7

Bulgaria and Romania: Total and mutual foreign trade growth

	1993	1994	1995	1996	1997
Bulgaria, growth total					
Exports	-5.1	7.1	34.4	-8.7	0.5

Imports	6.5	-12	35.2	-10.3	-3.7
Share with Romania					
Exports	2.47	1.59	1.78	1.54	1.34
imports	2.13	1.91	1.08	1.39	1.18
Romania, growth total					
exports	12.1	25.7	28.6	2.2	4.3
imports	4.2	9	44.5	11.3	-1.4
Share with Bulgaria					
exports	2.1	1.57	0.9	0.88	0.68
imports	1.09	0.91	0.75	0.64	0.51

Source: WIIW.

In this category, the extreme case is Albania. There trade liberalization led to a surge primarily in imports. However, due to a complete economic collapse in 1997, Albania's trade with many Balkan countries experienced a drop as did its overall foreign trade. That is an additional indication that the opening up of Albania, which was previously probably the most closed country in Europe, in terms of trade and travel, has led to only a small increase in its trade in the region (with the exception of Greece) and to a much larger increase in trade outside of the region. The picture may look somewhat different if all of the black market trade over the Yugoslav border were to be included. Indeed, that activity has continued even after the economic collapse in Albania, or because of that collapse (as a curiosity, the large-scale smuggling of scraped iron from looted Albanian factories has been going into Montenegro to be used as a raw material in the Nikšic steel-mill) though it might have stopped or practically disappeared in view of the current developments in Kosovo. Table 8 gives some indication of the recent official trade developments in Albania. To see how explosive these developments are, it has to be taken into account that Albania's exports and imports in the 1980s were about USD 250 mn on average.

Table 8

Albania: Exports and imports

USD million

	1993	1994	1995	1996	1997
Exports	123.3	157	220.9	297.1	141.3
Imports	603.6	701.8	975	1283.1	619.7

Source: IMF direction of trade statistics.

Finally, due to trade barriers and to political and legal uncertainties, there is a significant level of smuggling activity going on in the Balkans. There are no reliable estimates on either the volumes or the volatility of this trade. However, the indirect evidence points to a significant level of persistent black market trade across borders in the Balkans. In the balance of payments statistics large positions for errors and omissions are found. In addition, trade figures reported by different countries are different, with the difference being sometimes very large. The smuggling activity as the regular trade activity is not directed to the Balkan region primarily. It is, in fact, fair to assume that its distribution is pretty much the same as that of the overall trade.

As a different example, trade between Croatia and Slovenia can be considered. That trade shows an especially interesting pattern of development. As these two states have had high levels of trade before the break-up of Yugoslavia and as they have not introduced too many barriers to bilateral trade after the break-up of the common state and have indeed recently signed a free trade agreement, it is interesting to note that the share of their mutual trade is all the time diminishing. Both countries are less and less important to each other irrespective of geography, history and trade regime.

It is quite clear that there is a process of disintegration going on between Slovenia and Croatia, though it may have reached or is close to reaching the equilibrium point given the proximity and the foreign trade habits. Still, one problem that may push for further trade restructuring is the fact that Croatia runs a trade deficit with Slovenia and finds it increasingly difficult to sell there. In case this is perceived as a problem, bilateral trade may decline further.

All in all, it can be concluded that involuntary trade is the dominant form of regional trade in the Balkans and that voluntary trade, where such a regime exists, diverts trade out of the region rather than creating intra-regional trade.

Table 9

Croatia and Slovenia: Total growth and mutual share of foreign trade

	1993	1994	1995	1996	1997
Croatia, growth total					
Exports	-15.1	9.1	8.7	-2.6	-7.6
Imports	4.6	12.1	43.6	3.7	16.9
Share with Slovenia					
Exports	18.23	13.05	13.12	13.55	12.12
Imports	6.56	6.75	7.65	7.87	7.79
Slovenia, growth total					
Exports	-9	12.2	21.8	-0.1	0.8
Imports	5.9	12.4	30	-0.7	-0.7
Share with Croatia					
Exports	12.14	10.8	10.72	10.29	10
Imports	9.16	6.82	6.06	6.27	4.97

Source: WIIW.

Trade and output

The openness of the Balkan economies varies, as can be seen from Table 10. Slovenia is a very open economy. It also shows a certain stability in its foreign trade performance. Other Balkan economies are much less open and some are quite closed. Also, measuring the level of openness in current US dollars is not satisfactory because it leads to high volatility in the volume of GDP which then translates into sharp changes in the level of openness. However, no other measure is really satisfactory. Also, openness is strongly correlated with the largeness of an economy as well as with its level of development. Larger and more developed economies often tend to be more closed than smaller and less developed economies. As the countries in the Balkans vary in their size and level of development, comparisons are altogether difficult to make.

It is also not clear how important the fact of low openness to foreign trade is for growth and development in the Balkans. As already noted, the countries in the region gravitate towards out-of-Balkan markets. In addition, more developed countries in the Balkans are either small (Slovenia) or not all that open to trade. For the latter, the trade figures for Greece and Turkey are interesting to look at. The Greek economy is not an open one. The same is true for Turkey. In addition, both countries run significant trade deficits. One can conclude that Greece and Turkey have a lot of things to buy but mainly in the developed countries while they do not have all that much to sell. In other words, bordering on Greece or Turkey – or being in the same region as they are – is not the same as bordering on Germany, Italy or Austria.

Table 10

Openness (exports & imports/GDP) in the Balkans

	1992	1993	1994	1995	1996
Slovenia	102.4	99.7	98.2	95	93.5
Croatia	91	73.5	66.2	67.2	64.8
B&H	.	.	.	.	.
Yugoslavia	35.3	.	.	.	36
Albania	85.7	49.5	53.6	60.4	35.6
Macedonia	80	93	81	71	60
Romania	53.6	43.3	44.1	50.1	55
Bulgaria	97.5	78.4	80.9	85.2	103.3
Greece	32.9	31.8	30	32.2	29.7
Turkey	24.7	26.4	31.9	33.9	36

Note: B&H's GDP is either unknown or not reliable enough.

Source: WIIW database and national statistics.

History plays a part, though a diminishing one, in the existing trade patterns too. Thus, Macedonia figures as a trading partner of Slovenia and Croatia though Bulgaria and Romania do not, or not to that extent. This is the case in the opposite direction too. Bulgaria and Romania do not figure as significant trading partners in most of the states of former Yugoslavia. This suggests that there are trade re-orientations that are ongoing or are yet to come. The latter comment relates to the trade between Slovenia and Croatia, as already pointed out, that is still quite significant and important for both countries. The trade has gone down from the levels characteristic of the late 1980s but has perhaps stabilized in recent years. In addition, Croatia and Slovenia have recently signed a free trade agreement that, however, has so far failed to boost their bilateral trade. Thus, at the moment, it is difficult to say whether there is any long-term prospect for high levels of trade between these two countries. Slovenia tends to run increasing trade surpluses with the Balkan economies with which it trades while Croatia tends to run trade deficits, except with Bosnia and Herzegovina, and may actually shift its imports from Slovenia to the EU.

Bosnia and Herzegovina is a special case. After the Dayton peace agreement, there has been some revitalization of economic activity. However, the foreign trade figures are not very reliable. Looking at this country from the trade statistics of the neighbouring countries, one finds that a number of former Yugoslavia states are exporting to Bosnia and Herzegovina, though they are not importing all that much. The largest trade in volume is that between Croatia and Bosnia and Herzegovina, and that between Yugoslavia (Serbia and Montenegro) and the Republic of Srpska. Thus, in 1996 the latter trade was USD 609 mn or more than 10% of the total Yugoslav foreign trade. Indeed, the Republic of Srpska was the second most important trading partner of Yugoslavia. In 1997 the level of Yugoslav trade with Bosnia and Herzegovina (which now includes the Republic of Srpska) has remained significant. Bosnia and Herzegovina appears as an importer of goods from Slovenia, and that can hardly be explained in any other way but as an effect of path-dependency, i.e. of the history of belonging to the same state in the very recent past.

Finally, the low level of trade integration is related to the generally low level of output and income in the Balkans. Indeed, the comparison of GDP levels in the Balkans given in Table 11 leads to one striking observation.

Table 11

Balkan countries: GDP in 1996

	in USD bn	GDP per capita
Slovenia	20	9500
Croatia	18	4000
Bosnia and Herzegovina	2	800
Yugoslavia	16	1500
Albania	3	800
Macedonia	4	2000
Romania	35	1500
Bulgaria	10	1200
Greece	123	12000

Note: Rough and rounded figures.

Source: WIIW.

Greece has a larger GDP than all the other Balkan countries combined (except Turkey). However, Greece exports only slightly more than Slovenia and not much more than some larger Balkan economies. Thus, the largest economy in the region cannot act as the centre of gravity or an attractor of foreign trade in the region. As a consequence, it is not to be expected that there is much scope for an increase in regional trade and it is not to be expected that regional trade can exert a decisive influence on the growth of output in the region.

The flow of foreign investment

If one looks only at the so-called post-socialist countries in the Balkans, the inflow of foreign investment can be characterized as rather low. This is true for more or less all the countries, though for different reasons. The reasons can be classified as follows:

- security
- sanctions
- instability
- legality
- protectionism.

Security is a very significant consideration for most countries in the region because of all the military and other conflicts that are going on there. The level of risk is fluctuating, as is the region affected. But, for a rather large area, it has remained constant. This, of course, translates into country risks which are considerable for all these countries, except for Slovenia.

Sanctions have had serious effects, and will continue to have these effects in an obvious manner. There are sanctions imposed by the outside world, but also those that are imposed bilaterally in the region itself. The most important sanctions in the former category are those that were imposed on Yugoslavia (Serbia and Montenegro) by the EU and the UN, some of which were lifted at the end of 1995 (after the Dayton agreement), but some remained (the so-called outer wall of sanctions as well as the recent decision by the USA and the EU not to allow state-sponsored or helped investments into Yugoslavia). The most important example of the second kind are the sanctions imposed on Macedonia by Greece from early 1995 to late 1996. However, there are also undeclared sanctions on imports of Slovenian goods to Yugoslavia and a number of other trade barriers of a similar kind that vary from time to time and from country to country.

Macroeconomic instability has been a serious problem for a number of countries, like Romania and Bulgaria. But this is true more generally, though in many cases this cause plays a secondary role the others being so much more important.

The low level of *legality* has also contributed to the high risk of foreign investments in the whole area. This is a problem in all the post-socialist countries in the region, with the exception of Slovenia.

Finally, some countries have also followed a path of *protectionism* in one way or another, though often for different reasons. This is the case of Slovenia, which has been very cautious with foreign direct investments and has maintained policies that put barriers to foreign investments both short- and long-term. Short-term investments are discouraged by a deposit requirement (a foreign investor is required to put a deposit on a 'custody account' with a Slovenian bank, the amount of which is some share of the value of the intended loan or investment). Foreign direct investment has been discouraged because Slovenia opted for insider privatization and because the government has been reluctant to sell state companies and banks to foreigners. Table 12 summarizes the FDI developments in Southeast Europe.

Table 12.

FDI in South Eastern Europe, USD mn, stock, end of period

	1992	1993	1994	1995	1996	1997
Albania	157	205	205	300	291	329
Bulgaria	65	192	412	517	831	1252
Romania	544	761	1272	1595	2209	3401
Croatia	.	96	209	311	844	1192
Macedonia	29	46	56	64	44	75
Slovenia	1044	954	1331	1745	1934	2400

Source: WIIW.

Table 13 shows the FDI share of some EU countries. The countries from the region, with some exceptions, do not play a significant role in investment flows. Exceptions are Greek investments in Bulgaria (about 5% of total FDI there in 1996-97 on average) and Turkish investments in Romania (about 4% on average the last couple of years). Another exception is Greek participation in the acquisition of 20% of the Serbian Telecom in mid-1997. Other Greek investments in Serbia have been reported but their extent is not clear. In any case, all these intra-regional investments are small in comparison to out-of-region investments, though overall levels are low, as already pointed out.

Table 13

FDI by Germany, Austria and Italy, % share[9], end-1997

	Germany	Austria	Italy
Slovenia	34.3	14.1	7.4
Bulgaria	20.9	4.4	.
Romania	11.8	3.8	8.5
Croatia	9.2	16.3	2.9

Source: WIIW.

In any case, FDI flows are not very significant and do not represent, as of yet, a significant factor in the developments of this region.

The issue of causality

Looking at the trade and investment levels and patterns in the Balkans leads to the conclusion that this is not an economic region. Given the current regional initiatives, it would be important to determine whether the Balkans are potentially an economic region. Though there is no obvious

9 For Bulgaria, the second most important investor is Belgium wit a 20.1% share (third most important is Netherlands with 7.4%). For Romania, second most important is Netherlands with 10.3% share and many countries (including South Korea are more important than Austria). For Croatia, third most important investor is EBRD and a number of other countries are more important than the neighbouring Italy.

way to answer this question, one way to approach it is to determine whether the lack of regional integration is the consequence of the low level of trade or whether it is the other way around. In other words, it would be necessary to ascertain what are the causes that have determined the existing low level of regional integration.

By just looking at the present situation, the Balkans do not fulfil the conditions for regional integration for the following reasons:[10]

(i) Though there are quite developed regions at the periphery of the Balkans (Slovenia, Istria), most of the region is quite underdeveloped (apart from Greece). If the region were to converge to the growth characteristic of the region, it would remain underdeveloped in the future too.

(ii) The most important trading and investment partners of the Balkan countries are those in the EU. In addition, no country in the Balkans constitutes an optimal currency area. In fact, when one says money in the Balkans one means German marks.[11] The significance of this is that no local currency in the Balkans can play the role of an anchor currency and can serve as a vehicle of integration.

(iii) Together with the lack of monetary closeness there is also the lack of financial closeness in terms of a working payment system or a working banking system. Also, foreign direct investment that would be internal to the Balkans is not existent at the moment. Greece plays a larger role than the other countries, but there is practically no chance for it to take the place of Germany especially because much of foreign investment in the Balkans relates to outward processing industries mostly oriented towards Germany and the EU.

If the current situation is anything to go by, the causality does not run from the low levels of trade and investments to the low level of integration, but the low level of integration – due to inherited divisions, general underdevelopment and overall security problems – is what causes the low levels of trade in the Balkans and what prevents the development of regional integration.

Looking into the future, it is difficult to see this being changed. Though geography gives one impression, economics suggests another. It may be more realistic to hope for a general liberalization of trade to take place in the Balkans than to hope for some regional integration developing. In fact, the growth engine for the Balkans will remain in the EU, so it is probably more realistic to look at the ways how to integrate the Balkans with the EU than to condition this integration on the antecedent integration in the Balkans or on the inclusion of the Balkan countries in other regional integrations.

---

[10] Those refer loosely to the conditions set out in Rosenstein-Roden's classic (1943).

[11] Bulgaria used to be an exception but this is changing because with the introduction of the currency board regime, it chose the German mark as a shadow currency for its peg.

References

Gligorov, V. (1994), *Why Do Countries Break Up? The Case of Yugoslavia*, Uppsala: Acta Universitatis Upsaliensis.

Gligorov, V. (1996a), 'Fears and Passions: The Prospects of the Former Yugoslavia', in Z. Bogetic (ed.), *The Cost of War in Former Yugoslavia*, Paris/Belgrade: Peace and Crisis Management Foundation.

Gligorov, V. (1996b), 'Former Yugoslavia: On the Way to Normality', *Österreichisches Jahrbuch fur Internationale Politik 1996*, Vienna: Böhlau, pp. 237-48.

Gligorov, V. (1996c), 'Yugoslavia, Macedonia and Albania between Anarchy, Autarky and Integration', WIIW preliminary report.

Gligorov, V. (1997), 'The Role of CEFTA in the Balkans', in H. Machowski (ed.), *The Further Development of CEFTA: Institutionalization, Deepening, Widening?*, Warsaw: Friedrich Ebert Stiftung, pp. 85-90.

MAP – Mesecne Analize i Prognoze (1997), no. 12, Belgrade: Institut ekonomski nauka.

Rosenstein-Roden, P. N. (1943), 'Problems of Industrialization of Eastern and South-Eastern Europe', *Economic Journal*, vol. 53, pp. 202-11.