

THE WEST AND THE ECONOMIC STABILISATION OF THE WESTERN BALKANS

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Introduction

The West has relied on a number of economic instruments to influence the political and economic developments in the Western Balkans. Their choice and use have been dominated by political or mainly security considerations rather than by economic ones. This statement applies to the region as a whole as well as to the individual countries in the region. The political and security results have been less than impressive. As a consequence, the economic results have also been less than impressive. Rather than moving along the path of economic stabilisation and development, the countries in the region have remained unstable in the economic sense, and their economies are depressed and also disintegrated, both within and without the region.

In this study, the developments after the Dayton agreement, i.e., after 1995 will be considered. Some methodological and general comments will be followed by a regional overview, by country by country assessments and by an overall assessment. Some critical comments and some policy proposals end the study.

What is an International Strategy? Some Methodological Considerations

A strategy is a set of actions that should lead to the designated goal (or goals) being reached. The goals chosen should be desirable and feasible. To be desirable, they have to be desired by an agent (or agents). To be feasible, there have to be instruments that the agents can use or rely on to achieve the goals that have been chosen.

Thus, for there to be a strategy

- goals have to be identified,
- the agents that want to achieve those goals should exist, and
- the instruments that make the achievement of the goals feasible should be available.

In addition, given that a strategy is oriented towards the future

- it has to be sustainable and
- time-consistent.

It will be sustainable if it remains feasible over the whole course of its implementation. It will be time-consistent if it remains desirable over the horizon of its implementation. Finally, as there can be many strategies that could be chosen to achieve the same goal, some additional criteria could be relied on to choose from the set of desirable and feasible strategies. For instance

- the strategy chosen should be simpler and more economical than the alternative ones (these could be called criteria of efficiency).

This last set of criteria will depend significantly on the character of the actor or actors involved and, therefore, the two criteria suggested here (simplicity and economy), may not always be the relevant ones.

Assuming the above definition of strategy, what is an international strategy? It is a strategy pursued by an international agent (or agents). A difference can be drawn between a strategy of a foreign policy and an international strategy. The former is the strategy of one country; the latter is the strategy of an international actor. The difference is important because the character of the actor is different. This difference has consequences for both the desirability and the feasibility of a strategy. In the case of a nation, the desirability is defined by the national interest while the feasibility is determined by the aggregate of instruments at the nation's disposal that determines the nation's power. In the case of an international actor, both the interest and the power of the actor are more difficult to define. Because of that, it is not at all clear how to determine whether a certain international strategy is desirable and feasible. Sanctions are a good example of these difficulties. In the lucky instance when all the relevant countries support the sanctions imposed on a country or on a region, this instrument can be efficient for bringing about the goals that the international community has happened to agree on. In many cases, however, this agreement will be lacking either because the individual countries will have different interests or because the costs and benefits of the sanctions will not be distributed equally. If agreement is lacking for whatever reason, sanctions may not be an efficient instrument for achieving the set goals and may in fact be counterproductive and self-defeating.

Thus, in the international context, a mismatch of goals and instruments is a distinct possibility for the reason that the most appropriate instruments may not be available and the substitute ones will have to be used. Sanctions illustrate this point. They are economic means that should achieve what are basically political or security goals. Undoubtedly, such a strategy may not be efficient.

The example with the sanctions highlights a generic problem, or rather a whole range of problems, in international relations. These have to do with the definition of the international agency and with the definition of international authority. In principle, an actor is either a principal or an agent or both. In other words, the actor either gives orders (requests, demands) or receives orders (requests, demands) or both. Thus, a sovereign agency (i.e., a self-governing agency) is a principal that can employ (or direct, or manage) agents under its jurisdiction in order to achieve the goals chosen. However, a group of sovereign agencies does not amount to an aggregate sovereign agency, i.e., to a self-governing agency. It may not even amount to any kind of agency at all. The same goes for the agents of an international agency. The international agency may have no authority over the sovereign nations or over their subjects. Thus, the international problem is almost by definition that of multiple principals and multiple agents. In addition, the international authority is not easy to define because international law and politics have to deal with sovereign entities.

As a consequence, in the case of an international strategy neither its desirability nor its feasibility is easy to define. Most of the problems can be got around if there is a leader or a strategy-setter. In that case, the international actor will behave similar to a country. It will then be easier to define the strategy pursued by an international agency in specific international relations. Leadership, however, brings in problems of its own. One is that of stability, for instance in the sense of the power to sustain the cohesion in the coalition. Another has to do with the behaviour of those who are not in the relevant coalition. They may behave competitively or may in some other way stand in the way of the realisation of the policy of the international coalition. There are other problems that may shake up the stability and sustainability of the coalition organised around a leader.

In addition to the problems with the existence and the stability of the principal of an international strategy, there are problems with the agents. Again, those include sovereign states or their citizens (or other entities). When the strategy is targeted on a region, there is a multiplicity of agents. They will, as a rule, have different interests, and the same problems with the coalition building and with its stability will arise. In addition, principals and agents

can easily exchange their role in the international context. Thus, agents can become de facto principals. The reasons for this inversion of the roles are two. First is the consequence of the asymmetry of information. Local agents will know more about the local conditions than international principals will. Second, local authorities will have more power over the local agents than the international principals will. Thus, international actors can easily become instruments of the local agents.

In summary, more often than not, an international strategy will have to be defined and pursued in the context of the interaction of the complex principal who will be relating to a complex agent, and this is a very difficult context for the implementation of a consistent strategy. Two problems are likely to be encountered. On the one hand, a mismatch of goals and instruments is a distinct possibility. On the other hand, the international strategy will be, as a rule, very fragile indeed. Also, agents can turn out to be more influential than nominal principals are. Thus, the outcomes of actions of international agencies may be quite different from those that were sought by the relevant international actor.

International Strategy and the Western Balkans

The problems just outlined are all present in the international involvement in the Western Balkans. A comment or two about the Western Balkans is in order before the more concrete analysis can be entered into.

What is the Western Balkans? This is a region consisting of all the former Yugoslavia states, except for Slovenia, plus Albania. What do they have in common? Geographically, they are mainly on the Balkan Peninsula. They are also west of some other Balkan countries (Romania, Bulgaria, Turkey and Greece). They also share a common history, but in a number of cases this is also a history of separation and non-communication.

These are quite weak regional links. Geographical grouping is rather arbitrary, while the historical links do not warrant the exclusion of Slovenia and the inclusion of Albania, for instance. Also, the political and the economic disintegration hardly warrant regional treatment. What is it then that groups these countries? The one criterion that stands out is that of security. At the time when the region of the Western Balkans was defined, the Dayton agreement connected Croatia, Bosnia-Herzegovina, and Yugoslavia through their common security concerns and roles. Also, Yugoslavia and Albania were connected via their common security concern over Kosovo. Macedonia was added to the group primarily because its stability depended on the developments in Kosovo, Albania and Serbia. Finally, the two centres of instability were connected together via the common member, i.e., Yugoslavia. In that way the Western Balkans became a region.

This is worth summarising. The Western Balkans is a region in terms of security only. It is important to note this because it defines the goal the international community could have in the Western Balkans. Clearly, the key interest is, for those for whom it is of interest, stability from the point of view of security. Indeed, this will be the main thesis that will be argued in this study:

THESIS: Security concerns have dominated those of economic stability and development in the international approach to the Western Balkans.

Once the goal is defined, the issue of the choice of instruments becomes important. Until the Dayton agreement, containment was the main instrument. Once the war in Croatia was over (end of 1991), the war in Bosnia could be expected to erupt, as it did, and the main strategy was to contain the conflict to Bosnia-Herzegovina. As it was judged that this strategy was feasible only if Yugoslavia was weakened, the comprehensive set of sanctions were imposed on that country. Trade and other business relations with Yugoslavia were banned. Clearly, the international strategy in that phase did not consider the issue of economic stability as the most important one. Indeed, in more ways than one, economic instability was not seen as being inimical to the main security aim. This can be generalised to the following conclusion:

Economic instruments were used to achieve political and security goals and not the economic goals themselves.

Though the view of the role that economic stability could play has changed in the meantime, the security concerns are certainly the ones that are still considered to be the most important. This has consequences for the way the West has been involved. Repeatedly over the last ten years or so it has been asserted that it is the EU that should take the lead in the Western Balkans. This has been very difficult to achieve because of the fact that the EU can only develop international strategies that mainly rely on economic instruments. It can use direct and reconstruction aid and other types of financial support and can offer contractual relations that increase the integration with the EU. But it can do much less when it comes to foreign policy and security. Thus, a rather complex strategy should have been formulated, that would have dealt with security as well as the economic interests if some kind of a harmonious behaviour by the West had to have been orchestrated. Absent that, the two sets of instruments, security and economic, were bound to be used inconsistently.

The West and the Western Balkans

After the Dayton agreement, the EU inaugurated the so-called regional approach to the Western Balkans. This region was disintegrated within and was less integrated with the EU than the other countries in the Balkans and in Central Europe. Therefore, the regional approach aimed at combining intra-regional integration with the integration with the EU. The idea was to somehow co-ordinate intra-regional integration with closer ties with the EU. It was never made quite clear how was this supposed to actually work, but it could be conjectured that, roughly, improved relations with the EU should follow after every improvement in intra-regional integration. And vice versa. Deterioration in the intra-regional relations should be followed with the similar development in the relations with the EU. The problem with this strategy was that it could lead to quite a diverse set of relations that the EU could end up with in this region, which could prove to be a problem in itself. Indeed, looking at the relations that the EU has developed in the Balkans, the diversity is quite striking.

Table 1.

Relations of Balkan transition countries with the EU

"Europe Agreement" (Bulgaria and Romania)

Co-operation agreements (Albania and Macedonia)

Participation in some EU programmes (Bosnia-Herzegovina)

Trade preferences (Croatia)

Sanctions (Serbia)

Aid (Montenegro)

Special relations (Kosovo)

Looking at the way that these relations have been arrived at, it is clear that both positive and negative rewards (carrots and sticks) have been used. For instance, in the case of all former Yugoslavia countries on this list, the level of relations with the EU has been scaled down compared to what it had been while these countries were part of former Yugoslavia. Some have gone through improvements and then deterioration. For instance, Yugoslavia's trade enjoyed preferential treatment in 1996. Afterwards, preferences were withdrawn and the regime of sanctions has been strengthening ever since. Also, Croatia was included in some EU programmes, like PHARE, and then was removed from these programmes. On the other hand, the relations with Macedonia went from almost no-relations to total Greek embargo to co-operation agreement to negotiations for the newly formed Stabilisation and Association Agreement. Finally, the relations with Albania have stagnated after the co-operation agreement was signed. In addition to that, the EU has developed special relations with Bosnia-Herzegovina, Kosovo and Montenegro. Those will be discussed below in more detail.

Here, it is enough to just point out that it is not altogether clear how these special relations fit into the regional approach.

Looking not only on the progress, or rather the lack of it, in intra-regional integration and in the integration with the EU, but also into the economic stability of the region and of the countries in the region, it can be said that not much stability can be observed. In the period after the Dayton agreement and after the adoption of the regional approach, the following economic crises have occurred.

Table 2.

Crises in the Western Balkans

1997: Albania's economy collapses.

1998: Croatia's banking system collapses and the economy goes into a recession.

1999: Bosnia-Herzegovina experiences serious slowdown in economic activity.

1999: Yugoslavia collapses.

2000: Most economies in the Western Balkans face serious troubles.

If the stability in the foreign trade regimes and foreign trade flows between countries in the region are looked into, it also becomes clear that not much is to be found. Thus, Macedonia has free trade agreements, of one kind or the other, with most countries in the region (the exception is Albania), but the actual trade regime and the actual trade flows are quite unstable. Thus, the border between Serbia and Macedonia, which is quite important to the latter country, is often closed to trade for one reason or another or the regime of tariffs is changed or some other barriers will be introduced. This leads to volatile trade flows between these two countries.

Trade between Croatia, Bosnia-Herzegovina and Yugoslavia (Serbia and Montenegro) is also subject to changes in regimes and thus to shifts. The situation has become even more complex with the emergence of Kosovo as a separate political and economic unit. The trade regime applicable to Kosovo is yet to be worked out. In the meantime, some significant trade shifts and trade distortions have been introduced that will not be altogether easy to straighten out. Other aspects of economic stability present an equally sobering picture. Three key disequilibria should be mentioned. One is the current account balance. All the countries in the region run high or very high current account deficits as can be seen from the following table.

Table 3.

Current account balance, % GDP

1996

1997

1998

1999

Croatia

-4.4

-12.3

-7.3

-7.1

Bosnia-Herzegovina

-27

-31

-28

Yugoslavia

-8.5

-11

-8.6

Macedonia**-6.5****-7.4****-8.1****-4.2****Albania****-9.1****-12.2****-6.3****-12.8**

Sources: WIIW, World Bank.

These figures alert us to a very significant source of potential instability. If the development of the external debt is taken into account, these disequilibria become even more serious as can be seen from Table 4.

Table 4.

External debt, USD mn, end of period**1995****1996****1997****1998****1999****2000**

Croatia

3809

5308

7452

9584

9672

10000

B&H

3361

3620

4076

2879

3055

3300

Yugoslavia

9000

9000

10500

11500

12500

13500

Macedonia

1236

1172

1133

1399

1444

1600
Albania
683
732
757
874
1000
1100

Sources: WIIW, national statistics, author's estimates.

Along with the figures of total external debt, the indicators of the debt burden should be also taken into account. Some can be found in Table 5. As can be seen from these tables, the burden is significant in all cases. It has also been growing and will continue to grow in the near future. Indeed, it can be safely predicted that it will prove to be unsustainable if there is no dramatic increase in exports and in the way of international financing.

Table 5.

Debt indicators, 1999

Debt/GDP

Debt/export

Croatia
48
109
B&H
71
350
Yugoslavia
90
833
Macedonia
42
120
Albania
30
732

Notes: Albania and B&H 1998. Croatia trade in goods and services.

Sources: WIIW, national statistics.

The other important source of instability is the fiscal deficit. The following table gives some indication on the fiscal balances in the region.

Table 6.

Fiscal balance, % of GDP

1995

1996

1997

1998

1999

Croatia
-0.7
-0.4
-1.2
0.5

-1.3
Bosnia-Herzegovina

-4.4
-1.3
-2.8
-3.3
Yugoslavia
-1.6
-3.4

Macedonia
-0.7
-0.3
-0.4
-1.6
-3.5

Albania
-9.4
-12
-7.4
-10.4
-10.9

Source: World Bank

These figures seriously understate the fiscal deficits and thus the fiscal instability. This is clearly the case in Bosnia-Herzegovina, where the public expenditures are covered by international donations and where borrowing is low. As a consequence, the fiscal deficit is seriously understated. Similar problems can be detected in all the other countries.

Another problem is connected with arrears, both in the public sector and in the enterprise and banking sectors. In Croatia, Macedonia and Yugoslavia those are high or very high. If those were to be treated as fiscal risks (i.e., implicit budgetary obligations), the fiscal situation in these countries would probably deteriorate by 5-10% of the GDP. Therefore, the fiscal balance in the region is quite tenuous.

Another disequilibrium that is weighing heavily on the region is connected with the characteristics of the labour markets. The key indicator is that of the rate of unemployment, given in Table 7. Other indicators that characterise the quality of employment and the structural aspects of unemployment, which cannot be entered into here, give an even worse picture of the overall situation.

Table 7.

22

22

B&H

38

38

Yugoslavia
27.2
32

35
35
Macedonia
34.5
32.4
32
32
Albania
18
20

Note: For Macedonia labour survey rate. Sources: WIIW, national statistics.

The above confirms that unemployment is at a very high level in the region. Indeed, it has been growing. Finally, in many cases, it can be expected that it will even increase in the next few years. However, these figures do not tell the whole story when it comes to the problems with unemployment in the region. A large part of the employed labour force can expect to be reallocated in the near future. Thus, the overall situation in the labour market is even more serious than the figures on unemployment by themselves can illustrate.

What has the West to do with this highly unstable situation in the Western Balkans? Clearly, efforts were made to finance the current account deficits and to provide for budget support so that the countries in the region would preserve some level of economic stability. Also, in Bosnia-Herzegovina and Kosovo, reconstruction and revitalisation were major concerns. Looking at the developments indicated here in the tables above, one inescapable conclusion is that whatever the West has been doing in the Western Balkans, it has not contributed significantly to the economic stabilisation of the region. Certainly, that has to have some bearing on the evaluation of the so-called regional approach to the Western Balkans. Just looking at the diversity of relations that the EU has developed in the region it becomes clear that something has gone wrong with the regional approach. The region could hardly have been more disintegrated than it is now, both internally and externally. Thus, the general assessment of the regional approach of the EU towards the Western Balkans can be thus summarised: it has not contributed to the economic stabilisation of the region and has probably contributed to the regional disintegration rather than to regional integration.

Fortsetzung: Transition and Development

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