

TRADE LIBERALISATION IN THE BALKANS - A BLESSING IN DISGUISE?

By Prof. Milica Uvalic¹

1. Introduction

Trade liberalisation in Southeast Europe (SEE) has been strongly promoted by the European Union (EU) in recent years, as part of its initiatives aimed at stimulating regional cooperation among the SEE countries. The Stabilisation and Association Process launched in 1999 for the five countries of the so-called Western Balkans - Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia and FR Yugoslavia (since early 2003, Serbia and Montenegro), or the SEE-5 - explicitly requires the implementation of regional cooperation by SEE countries in various areas. In the economic sphere, trade liberalisation has become the principal instrument for promoting regional cooperation in SEE, which has been carried forward within the initiatives of the Stability Pact for SEE adopted in mid-1999 to help reconstruction efforts of the SEE countries affected by the 1999 conflict - in addition to the SEE-5, also Bulgaria and Romania (or the SEE-7). A Memorandum of Understanding on Trade Liberalisation and Facilitation was signed on 27 June 2001 in Brussels by the Foreign Trade Ministers of the seven SEE countries (Moldova has also joined, but somewhat later),² which envisaged the conclusion of bilateral free trade agreements over the next two years. The process of trade liberalisation in SEE has by now almost been completed, with some 23 (out of 28) agreements signed, though a number of them still need to be ratified. Therefore, trade liberalisation in SEE has emerged as a key element for establishing economic and political stability in the countries in this region, and for integrating them into European and international structures. Given that the ongoing process of trade liberalisation in SEE will probably have important longer term-implications, these issues merit more analytical work than has been undertaken to date. The paper focuses on trade in SEE, as the principle instrument of economic integration today among SEE countries - since the free movement of labour is still restricted because of visa regimes and other unresolved problems (return of refugees, property restitution, etc.), while capital flows to other SEE countries remain limited due to the general scarcity of domestic capital. In analysing trade patterns in SEE, the paper will consider the SEE-7, namely countries signatories of the Stability Pact Memorandum. When discussing issues related to the EU Stabilisation and Association Process, however, the narrower group of five SEE countries in the Western Balkans will only be considered (the SEE-5).³

In order to introduce the argument, we will first briefly consider the general features and degree of integration of countries in the SEE region on the eve of the transition in 1989 (section 2). We will then look at the most important political and economic events which have taken place in the SEE region in the 1990s, and the way they have affected trade relations among the SEE countries (section 3). The post-2000 period, referring to the newest phase of economic relations among the SEE countries, following the launch of the trade liberalisation initiative, is discussed in some detail, including the main features of trade patterns of individual SEE countries over the last three years (section 4). Since in recent debates on trade liberalisation in SEE some issues have been raised which remain controversial,

¹ Ms. Milica Uvalic, Professor, Department of Economics, Faculty of Political Sciences, University of Perugia, Italy

² Therefore today the process includes eight countries, but Moldova as a latecomer will not be considered in this paper.

³ In both cases, Kosovo is not taken into account. Though Kosovo is still officially part of Serbia and Montenegro (according to UN Security Council Resolution 1244), it has not officially participated in the trade liberalisation process, although it has recently concluded a free trade agreement with Albania. Moreover, its foreign trade statistics are not readily available, so all data for FR Yugoslavia (today Serbia and Montenegro) exclude Kosovo.

an attempt is made to give the principle reasons why interpretations sometimes differ (section 5). The main conclusions, and some policy recommendations regarding current EU policies for the SEE region, are given at the end (section 6).

2. Pre-1989 trade patterns in SEE

The question on how integrated the SEE region is today cannot be properly addressed without taking into account the historical context, namely (1) the level of integration in SEE in 1989 on the eve of transition; and (2) the major political and economic developments which have fundamentally influenced economic and political relations among SEE countries in the 1990s.

When the transition to a market economy started in 1989, the general situation in SEE was very different than it is today (see Table 1). At that time, five countries in the SEE region were in an economic union within SFR Yugoslavia (Bosnia and Herzegovina, Croatia, Macedonia, Slovenia, and FR Yugoslavia, then represented by the two republics - Serbia with its two autonomous provinces, Kosovo and Voivodina, and Montenegro) and as such had substantial trade and other economic links. SFR Yugoslavia was the most developed and the largest country in SEE, both in terms of territory and population, and because of its specific position in international economic relations, it was less dependent on trade with the other socialist countries than its SEE neighbours (see Uvalic, 1992). Bulgaria and Romania had for several decades been members of the CMEA, which naturally determined their main trade orientation in line with the ‘socialist division of labour’; consequently, they had a higher proportion of their foreign trade with the other socialist countries. This was particularly true for Bulgaria, which was the country most dependent on intra-CMEA trade. Finally, Albania was the most closed economy in Europe. After having abandoned the CMEA in the early 1960s, it had for many years followed its own autarkic development strategy and had limited economic links with the rest of the world, including its closest neighbours.

Regarding more specifically trade links in the SEE region, there was relatively little trade among the then four socialist SEE countries in 1989 (see Table 1). In the case of Bulgaria, 13.4% of its exports went to, and 6.5% of its imports came from, the other two major SEE countries, Romania and FR Yugoslavia.⁴ For the other SEE countries, regional trade at that time was even less important. The share of the three SEE countries in Romania’s exports and imports in 1989 amounted to only 3.2% and 4.4% respectively, and in FR Yugoslavia’s even less - 2.1% of exports and 2.2% of imports. These very low shares of mutual trade among SEE countries clearly show that the SEE region in 1989 was not at all economically integrated, *except* for the economic links within SFR Yugoslavia.

Table 1. Some indicators on SEE countries in 1989

	Area (in 000 sq. km)	Populatio n (mln 1990)	GDP/cap (1989 US\$)	Exports to CMEA(%)	Imports from CMEA(%)	Exports to SEE (%)	Imports from SEE (%)
Albania	28.7	3.2	723	46.3	44.8	n.a.	n.a.
Bulgaria	110.9	8.9	2,320	83.0	71.5	13.4	6.5
Romania	237.5	23.2	1,730	40.5	38.5	3.2	4.4
SFRY	255.8	23.8	2,490	29.9	26.3	2.1	2.2

Source: Uvalic (1997b) based on various sources (World Bank, OECD, UNECE, IMF, EIU).⁵

In 1989, therefore, the most integrated part of the SEE region was SFR Yugoslavia – paradoxically, since many political and economic problems had for years pushed in the opposite

⁴ Bulgarian foreign trade with Albania in 1989 is not considered as data are not reported in IMF statistics; it is very likely that the amounts were negligible.

⁵ In reporting trade shares with the CMEA countries, it should be noted that problems of pricing of intra-CMEA trade, which essentially makes it non-comparable with non-CMEA totals, render estimation of these trade shares very hazardous.

direction. Since the mid-1970s, there was rising regional autarky and fragmentation of the Yugoslav market, as evidenced by increasing sales on the local markets, the duplication of industrial plants in many sectors, impediments to the mobility of capital and labour across republican borders, and weak inter-republican integration of enterprises (see Uvalic, 1993).

Nevertheless, inter-republican trade in former Yugoslavia has always represented an important part of overall trade for all its republics. Throughout most of the 1970-89 period, for all Yugoslav republics “exports” to the other republics within the country were more important than exports abroad, clearly suggesting that Yugoslav republics were more integrated among themselves than with the outside world (Uvalic, 1993).⁶ As shown by Udovicki (1996), market forces had strongly resisted the political segmentation of SFR Yugoslavia: the level of integration among its regions was found to be similar to that of countries inside a common market (e.g. the EU), while the estimations permitted the author to refute the hypothesis on increasing autarky of the Yugoslav republics. As remarked by the author, “Yugoslav regions exhibited an unfortunate level of economic interdependence - high enough to make a trade war extremely costly, but not high enough to make it impossible” (Udovicki, 1996, p. 455). Other studies have also suggested that the level of economic interdependence among the Yugoslav republics was greater than usually sustained on the basis of purely political arguments (Hinic, 1994).

Table 2. Trade by destination of Yugoslav republics in 1987 (in % of GMP)

Republics of SFR Yugoslavia	Deliveries to the Local market	Deliveries to markets of other republics	Deliveries abroad (Exports)
Bosnia Herzegovina	& 56.1	24.2	19.8
Croatia	67.0	18.7	14.3
Macedonia	60.8	21.4	17.8
Montenegro	57.5	25.0	17.5
Serbia (with K & V)	69.0	13.4	17.6
Serbia proper	62.3	17.4	20.3
Kosovo	64.6	24.0	11.4
Voivodina	58.1	28.8	13.1
Slovenia	57.5	20.3	22.2

Source: Uvalic (1993), based on data of the Serbian Institute of Statistics.

In 1987, the last year for which data on inter-republican trade is available, “exports” to the other republics represented 13-29% of Gross Material Product (GMP)⁷ of the individual Yugoslav republics, and as such were more important than foreign trade for all republics, except for Serbia and Slovenia, as the most export-oriented republics (see Table 2). It should also be noted that the oscillations observed in local, inter-republican and foreign trade were closely related to export performance on world markets. In times of deteriorating external conditions, the existence of alternative internal markets, in the other

⁶ The only exception was 1983, when the relative share of exports for all Yugoslav republics was higher than inter-republican trade, but this was due to particular circumstances. The widening trade deficit and enormous foreign debt had constrained Yugoslav authorities to implement an austerity package in the early 1980s, which had provoked a serious economic crisis and had forced all republics to try and increase exports to foreign markets as much as possible (Uvalic, 1992, pp. 10-16; see also Hinic, 1994, p. 93).

⁷ GMP, or Social Product in Yugoslav terminology, is the value added of ‘productive’ sectors of the economy, thus excluding ‘non-productive’ sectors such as education, health, defence, banking, other services.

republics, was an important factor compensating for the temporary loss of foreign markets (Uvalic 1993).

Therefore, in the late 1980s, despite geographical proximity there was very little trade among the four SEE countries - Albania, Bulgaria, Romania and SFR Yugoslavia - though at the same time, there was substantial trade *within* SFR Yugoslavia. The SEE region actually consisted of two subregions: the first, relatively integrated, encompassing the economies of the six republics of former Yugoslavia; and the second, characterised by very weak mutual trade links, consisting of the other three SEE countries. Trade flows between the two SEE subregions were negligible (Uvalic, 2001).

The fact that the SEE was not very integrated in 1989 – except for the area of former Yugoslavia - had been determined to a large extent by non-economic factors – historical, political, geo-strategic, ideological - including the existence of the CMEA, the specific position of SFR Yugoslavia as a non-aligned country, deliberate autarkic policies of Albania. These political factors were clearly more important in determining economic relations and trade patterns of SEE countries, than any purely economic interests. In addition to historical factors which used to divide SEE in the past, we must consider the recent military conflicts, embargoes, politically-motivated trade wars, which have normally had a direct impact on trade among SEE countries, contributing to a much lower level of trade than otherwise could have been the case. These conclusions are important also for the present moment: today, economic interests may not be the primary factor determining trade flows in SEE.

3. The impact of transition and disintegration

Since 1989, a number of important political and economic events have fundamentally changed the overall situation in SEE. During the first decade of transition to market economy and multiparty democracy, important systemic changes have been implemented in all former socialist countries in SEE, though at very different times in the individual countries. Initial market-oriented reforms also included radical changes of the foreign trade system and substantial trade liberalisation, though there have been reversals in policies in most SEE countries, thus imposing the need to again implement more radical foreign trade reforms at a later stage. During the 1990s, the volumes of trade of SEE countries have fallen sharply - including trade with other SEE countries - under the impact of the very deep recession of the early 1990s, but also because of the break up of the Yugoslav monetary and economic union, which was accompanied by the imposition of trade and other types of barriers by the newly created states and economic embargoes against some countries.

Other important events have accompanied the transition, directly affecting trade patterns of SEE countries. The G24 group of countries - the EU in particular – in 1989 decided to actively support the transition in former socialist countries with a series of measures, including major trade liberalisation and various forms of financial assistance, offered through the PHARE programme initially primarily to Albania, Bulgaria and Romania (see Uvalic, 1997a). The dissolution of the CMEA in 1991 directly affected Bulgaria and Romania, fundamentally changing their trade orientation away from traditional partners towards the EU, while similar changes took place in Albania following policies of trade liberalisation and opening up. The political disintegration of former Yugoslavia in 1991 resulted in the almost doubling of the number of states in the SEE region, which thereafter no longer consisted of four, but of seven transition countries.

Some further consequences of the break-up of SFR Yugoslavia should also be recalled. The split substantially slowed down the process of integration of its successor states with the rest of Europe (except for Slovenia).⁸ Five military conflicts, policies of ethnic cleansing, inward-oriented nationalistic policies which gave clear priority to political over economic aims, delays in carrying forward the transition to multiparty democracy and market economy, poor and deteriorating economic performance, international sanctions against FR Yugoslavia, its decade-long isolation and NATO bombardments in spring 1999, are among the principal reasons of delayed integration. Parallel with the slowdown in establishing relations with the EU, the political disintegration of former Yugoslavia has also substantially decreased the level of economic integration among countries within SEE, given that the creation of new independent states led to the introduction of trade and other barriers to the free movement of goods, services, labour and capital. The suspension of trade links in 1991-92 was one of

⁸ For some of the factors that led to the break-up of SFR Yugoslavia, see Uvalic (1992) and (1993).

the main reasons for the very sharp fall in output in all successor states of former Yugoslavia, much more pronounced than in many other transition economies.⁹

All these events have contributed to important changes in regional economic groupings, the position of individual SEE countries, and their trade patterns. Over the past decade, the EU has emerged as the most important trading partner for the large majority – though not always all - SEE countries (see Table 3). Albania, Bulgaria and Romania have very quickly reoriented their trade from traditional partners towards primarily the EU. SFR Yugoslavia, thanks to preferential access to European Community (EC) markets since the early 1970s, in 1989 mostly traded with the EC; after the difficult years of extreme political instability in the 1990s, the majority of its successor states have also succeeded by now in making the EU their most important trading partner.

In addition to this general orientation towards the EU, trade between the two SEE subregions has not been subject to major changes. Most SEE countries have substituted traditional trading partners almost exclusively with non-SEE countries (primarily the EU). Thus the already marginal links between, on the one hand, the countries of former Yugoslavia, and on the other, the remaining three SEE countries, have in no way been strengthened, while the trade links between Albania, Bulgaria, and Romania in the late 1990s seem to have become even weaker.

Table 3. EU and SEE shares in total trade of SEE countries (in %) - 1998

Country (and sources)	EU share in Exports	EU share in Imports	SEE share in Exports	SEE share in Imports
Albania (IMF; BH excluded)	88.8	77.9	3.0	7.2
Bosnia&Herzegovina (BH Central Bank & IMF)	21.9	29.5	66.6	52.8
Bulgaria (IMF)	51.7	46.5	7.7	3.4
Croatia (IMF; Albania and FRY excluded)	48.7	62.6	25.2	12.2
FYR Macedonia (IMF)	50.3	46.4	23.4	32.8
Romania (IMF; FRY excluded)	64.6	57.9	1.9	1.0
Slovenia (IMF; FRY and imports from Croatia excluded)	65.5	69.5	15.1	1.9

⁹ A detailed analysis of recent economic performance and current problems of the SEE countries is found in Uvalic (2003).

FR Yugoslavia	32.9	38.7	35.1	16.3
(Yugoslav statistics & IMF)				

Source: Uvalic (2001). In calculating these shares, whenever possible we have used data provided in the *IMF Direction of Trade Statistics Quarterly* (September 1999). Given that for Bosnia and Herzegovina and FR Yugoslavia IMF statistics were rather incomplete, they have been integrated with national sources: for Bosnia, unpublished data on foreign trade of both entities obtained directly from the Central Bank of Bosnia and Herzegovina in mid-January 2000; and for FR Yugoslavia, *Index* no. 1, 1999, Federal Statistical Office.

In order to illustrate these trends in trade of SEE countries in the second half of the 1990s, we have considered the SEE as one regional trading partner and compared its relative importance, for the SEE countries, with that of the EU in 1998 (see Table 3). Slovenia has also been included in the analysis, due to past trade links with the other countries in the region. Although the figures may not be fully accurate, since we still do not possess one comprehensive source of foreign trade statistics for all SEE countries, they nevertheless show quite clearly certain characteristics in trade patterns that existed in 1998.

For Albania, Bulgaria and Romania, trade with the other SEE countries was indeed of marginal importance. For most countries of former Yugoslavia, on the contrary, trade with the other SEE countries still represented a rather significant portion of overall trade. The disintegration of SFR Yugoslavia in 1991-92 has led to the breaking up of many traditional trade links, to the introduction of trade and other barriers, to several military conflicts, embargoes and the imposition of restrictions of various other kinds, all of which have naturally contributed to a drastic reduction in the *overall level* of trade among the newly created states. Yet despite of reductions in absolute trade levels, most successor states of former Yugoslavia have maintained some trade with their former trading partners, in a few cases - Bosnia and Herzegovina and FR Yugoslavia – even rather significant.

After the signing of the Dayton Peace Agreement in late 1995, there was a revival of trade especially between Croatia and the Bosnian Federation, and between FR Yugoslavia and the Serb part of Bosnia and Herzegovina (the Republika Srpska). Thus we see that in 1998, Bosnia and Herzegovina actually traded much more with the other SEE countries than with the EU, both in terms of exports (67%) and imports (53%); even higher shares had been registered in 1997 (see Gligorov, 1998). FR Yugoslavia in 1998 also exported more to the other SEE countries (35%) than to the EU (33%), though its imports from the EU (39%) were more than double the share of imports from SEE (16%), confirming its enormous import dependence on primarily the EU (though this is a typical feature of all other SEE countries as well).

There were no other cases where the SEE share of trade exceeded the EU share in 1998, though in a few countries it was still rather significant. For Macedonia we find that 24% of its exports and 33% of its imports in 1998 were from other SEE countries. Croatia in 1989 exported even more to the other SEE countries (25% of total) than Macedonia, although it imported much less (only 12% of total). For Slovenia trade with SEE countries was less important, yet this country had also during this period somewhat increased its share of exports to the SEE region, from 14.9% in 1995 to 17.1% in 1997, the share again falling to 15% in 1998.

It should also be recalled that, due to the recent wars and various trade embargoes imposed in the SEE region, there has been a substantial amount of smuggling and trade along ethnic lines (see Muço and Frasher, 2003), especially across some of the ‘soft’ borders (e.g. between Serbia and Republika Srpska, Albania and Kosovo, Croatia and Herzegovina). Consequently, a part of trade among some of the SEE countries has been illegal trade, sometimes taking place in barter form, which is in no way registered. The reported statistics therefore probably underestimate the actual amount of regional trade in SEE in the late 1990s.

Major disruptions in trade of all SEE countries have taken place in 1999, as a consequence of the war in FR Yugoslavia which has affected all neighbouring countries. Through the destruction or

damages of infrastructure, transport and communication lines in FR Yugoslavia, the NATO bombardments have further divided SEE, creating trade, ecological, and transportation barriers in the whole region. However, precisely because of these region-wide consequences of the 1999 war, there is major interdependence among the SEE countries today. Parallel with such rising interdependence, further disintegration has taken place in FR Yugoslavia, as after the end of the 1999 military conflict it has practically lost all control over Kosovo, whereas Montenegro and Serbia are also likely to separate in the near future.¹⁰

4. Post-2000 trade liberalisation in SEE - Towards reintegration?

After a decade of marked political instability, today we are assisting the renewal or fresh establishment of political, economic, and other links of SEE countries in both directions: with the EU, and with the other countries in the SEE region. This process of reintegration of SEE countries is being accompanied by comprehensive trade liberalisation, both regarding trade within the SEE region and the SEE countries' trade with the EU. As already mentioned, in mid-1999 the EU launched its Stabilisation and Association Process (SAP), which offered the SEE-5 generous trade preferences, contractual relations through the signing of Stabilisation and Association Agreements, a new programme of financial assistance (CARDS), and for the first time since the beginning of the transition, prospects of future EU membership.

As part of the process of SEE-EU trade liberalisation, tariff barriers are being removed in trade between the SEE-5 and the EU. On the one hand, within economic reforms required by the transition to a market economy, all SEE countries have by now applied radical reforms of their foreign trade regimes, including substantial trade liberalisation. On the other hand, the EU has supported the transition in SEE by granting duty-free access to its markets, though at different times and under different arrangements for the single SEE countries. Since the autumn of 2000, the EU autonomous trade measures have established a uniform system of trade preferences for the Western Balkans, which enable duty-free access to EU markets for practically all goods, including agricultural products, with only a few exceptions, which cover more than 95% of SEE products. These free trade provisions have been incorporated into the Stabilisation and Association Agreements, so far concluded with Macedonia (April 2001) and Croatia (October 2001), which are in the process of being ratified. The SEE-EU trade liberalisation process is being implemented on an asymmetric basis, envisaging a greater opening of EU markets initially than those of the SEE countries. Bulgaria and Romania have been offered similar measures of trade liberalisation by the EU much earlier, within Association Agreements concluded in 1993.

In the meantime, a more favourable climate has also been created for developing regional links within SEE. Although the objective of regional co-operation has been pursued by the EU since 1996 through the Regional Approach, until recently not much has been achieved in terms of concrete results. Thanks to the radical change in the political regimes in Croatia (in January 2000) and in Serbia (in October 2000), the situation has improved in the meantime and a number of initiatives have been undertaken to enhance regional cooperation. Today, regional co-operation has become one of the main pillars of both the SAP and the Stability Pact for SEE, as both initiatives emphasise the importance of regional co-operation for achieving more permanent peace, stability and development in SEE.

Within current initiatives of regional cooperation, one of the main forms of economic cooperation concerns the process of trade liberalisation within the SEE region, which is being carried forward within the Second Working Table for Economic Reconstruction and Development of the Stability Pact for SEE.¹¹ The process of trade liberalisation, as envisaged by the Memorandum of Understanding on Trade Liberalisation and Facilitation, has by now practically led to the creation of a free trade area in the SEE region. Out of the 28 free trade agreements to be signed by the now eight participants in the initiative, 23 have already been signed (see Messerlin and Miroudot, 2003).

¹⁰ The FR Yugoslavia has been transformed into a weak union of states in March 2002 and officially changed its name into Serbia and Montenegro in February 2003. After three years, they should re-examine the issue of their joint state, which is likely to lead to a definite split.

¹¹ The World Bank has a similar program on Trade and Transport Facilitation in SEE (TTFSE), which covers all the SEE-7.

What have been the effects of trade liberalisation in SEE? Has trade liberalisation affected the level of intra-SEE trade, and have there been any changes in trade patterns of individual SEE countries over the past few years? Since regional trade liberalisation has emerged as the major policy instrument for promoting economic cooperation among the SEE countries, these questions are of major political (and economic) importance. As stressed in a recent report by the EU Commission, when fully implemented, free trade agreements among SEE countries are expected to boost intra-regional trade, to enhance efficiency, increase competition and enable economies of scale (Commission, 2003, p. 11).

The key question which needs to be addressed, therefore, is how much SEE countries actually trade among themselves. More recent trade statistics of the SEE-7 - the destination of exports and origin of imports over the last four years (1999 - 2002) - are presented in Table 4. SEE countries' trade partners are divided into three groups: the EU, the SEE, and "other countries" (though the Table presents only the EU and SEE exports and imports shares). As before, IMF statistics have been used whenever they were available and complete; since this was not the case with Bosnia and Herzegovina and FR Yugoslavia, for these two countries we have used national statistics.¹² The period covered is somewhat shorter for Bosnia and Herzegovina (2000-02), since foreign trade statistics were obtained for the whole country (both the Federation and the Republika Srpska) only for these last three years.¹³

Table 4. EU and SEE shares in total trade of the SEE-7 (in %), 1999-2002

	EU SHARES IN EXPORTS			EU SHARES IN IMPORTS			SEE SHARES IN EXPORTS			SEE SHARES IN IMPORTS						
	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001				
Albania	93.1	90.8	89.9	89.4	80.2	76.6	78.3	77.8	2.5	2.7	2.8	3.1	4.6	5.9	5.3	6.3
B&H. Federat. R Srpska	Na	38.3	40.1	30.3	Na	29.8	31.3	29.8	na	29.3	29.2	35.8	Na	21.8	22.8	24.7
			34.5					32.4				27.0				19.9
			19.2					23.1				59.4				37.4
Bulgaria	54.2	51.7	55.2	56.3	50.0	45.0	49.8	51.6	9.9	12.8	9.8	9.0	2.2	4.4	3.0	2.7
Croatia	49.4	54.9	54.3	52.3	56.6	56.0	55.7	55.8	14.6	13.4	13.9	16.4	2.4	2.0	2.5	2.8
FYROM	44.8	42.5	43.3	40.1	40.0	38.2	49.1	47.3	30.5	33.7	39.8	43.6	19.8	17.5	18.4	20.1
Romania	65.5	63.9	68.0	67.9	60.5	56.7	57.4	63.9	3.1	4.7	3.6	3.0	1.2	1.3	1.3	1.3
FRY	36.4	36.8	41.5	40.8	41.5	36.9	36.9	42.6	34.4	30.7	27.4	29.4	24.2	22.0	14.9	12.1

¹² In the most recent IMF statistics, what is not reported for Bosnia and Herzegovina is trade with one of its major partners - FR Yugoslavia; similarly, for FR Yugoslavia, we do not find figures for trade with Bosnia and Herzegovina, Croatia and Macedonia.

¹³ A word of caution is necessary, because of the problems with foreign trade statistics for Bosnia and Herzegovina stressed earlier. Our calculations of the Republika Srpska trade shares have been done on the basis of the list of its major trading partners, since the complete list of trade with all countries was not available. These problems inevitably imply some margin of error in our calculations.

Note: The data for 2002 for all the SEE countries refer to the first nine months (I-IX), except for Bosnia and Herzegovina and FR Yugoslavia for which the figures are for the whole year. Data on FR Yugoslavia do not include Kosovo.

Sources: Uvalic (2002), based on data provided in the *IMF Direction of Trade Statistics Yearbook and Quarterly*, except for Bosnia and Herzegovina and FR Yugoslavia for which national statistics have been used (given that IMF statistics for these two countries are still rather incomplete).

The data presented in Table 4 enable us to draw the following main conclusions regarding trade performance of SEE countries in 1999-2002 (the trends are also presented in Graphs 1, 2, and 3 in the Appendix).

Different importance of regional trade for the two SEE sub-groupings: The relative weight of intra-SEE trade is extremely variable across countries, being clearly much more important for the four countries originating from former Yugoslavia - Bosnia and Herzegovina, Croatia, Macedonia, FR Yugoslavia (or the SEE-4) than for the other three countries. Over the last four years, Albania, Bulgaria and Romania have registered a very low share of both exports and imports going to the other SEE countries, usually lower than 5%, and almost never surpassing 10% of overall exports (or imports); the only exception are Bulgarian exports in 2000 (which amounted to 13% of its overall exports). On the contrary, for the SEE-4 countries, the respective shares have usually been much higher, particularly for Bosnia and Herzegovina and Macedonia. In 2002, the share of exports going to the other SEE countries ranged from 16% in Croatia to almost 44% in Macedonia, while the share of their imports, from less than 3% in Croatia to almost 25% in Bosnia and Herzegovina. Among the SEE-4, Croatia is clearly the country which trades least with the other countries in the SEE region.

Importance of primarily intra-SEE exports (rather than imports): The observed reliance of the SEE-4 on intra-SEE trade applies primarily to exports and much less to imports. In 2002, the SEE share of exports going to the other SEE countries was almost 44% for Macedonia, 36% for Bosnia and Herzegovina (27% for the Federation and as high as 59% for the Republika Srpska), 29% for FR Yugoslavia, and 16% for Croatia. On the import side, the SEE-4 shares in total imports are much lower, in 2002 ranging from 25% in Bosnia and Herzegovina (20% in the Federation and 37% in the Republika Srpska), 20% in Macedonia, 12% in FR Yugoslavia and less than 3% in Croatia. The strong export orientation of the SEE-4 towards SEE markets was even more pronounced a few years ago, while the economic sanctions against FR Yugoslavia were still in place (see section 3). This is understandable, considering that during that period a large part of Yugoslav imports originating from the EU were entering the country indirectly, through third countries in SEE (Bulgaria, Macedonia, Republika Srpska), thus effectively contributing to a higher relative share of overall intra-SEE trade than otherwise would have been the case.

Increasing intra-SEE exports: Looking at the trends over the last two years (2001-2), the SEE share in total exports of individual countries has actually been increasing in the majority of SEE countries; the only exceptions are Bulgaria and Romania, where it has slightly decreased. In some cases, as in Macedonia, there has been a rather remarkable increase in the share of exports going to SEE in recent years - from 30% in 1999, to almost 44% in 2002. To what extent this increase in exports has been stimulated by the recently concluded free trade agreements is very difficult to establish, though they have certainly played a role in facilitating trade links.

Stagnating intra-SEE imports: On the import side, the trends have been less variable across countries. In almost all cases, the SEE shares in SEE countries' overall imports have been stagnating over the past four years. The only exception is FR Yugoslavia, where the share has drastically fallen in recent years (it has been cut by one half, from 24% of total imports in 1999, to 12% in 2002). Again, the lifting of sanctions and granting of EU trade preferences has obviously facilitated FR Yugoslavia to import directly from the EU, or to shift to other, non-SEE, suppliers for the necessary imports.

- ***Importance of the EU as a trading partner:*** In recent years, the EU has been the major trade partner for *most* SEE countries and throughout *most* of the period, but this cannot be generalised as there have been some exceptions. Whereas in Albania, Bulgaria and Romania, the shares of both exports and imports from the EU have been dominant and have been maintained relatively stable over the past five years, major variations are found in the SEE-4, especially regarding exports. As stressed earlier, as late as 1998, Bosnia and Herzegovina and FR Yugoslavia still had a relatively

larger amount of exports directed towards the SEE, than the EU market. Although by 2001, the EU had emerged as the major trade partner of all SEE countries (for both imports and exports), thereafter, somewhat surprisingly, in a few cases the trend has been reversed. In 2002, Bosnia and Herzegovina again seems to have exported less to the EU (30%) than to the SEE countries (almost 36%). Similarly, in the first nine months of 2002, Macedonia also directed a smaller amount of its exports to the EU (40%) than to the SEE (almost 44%).

- **Variable trends in exports to the EU:** The above examples of the SEE share of exports occasionally surpassing the EU share illustrate the rather unstable export performance of countries like Bosnia and Herzegovina, Macedonia and FR Yugoslavia on EU markets. It ought to be noted that the share of exports directed to the EU has practically fallen in all SEE countries in 2002 (the only exception was Bulgaria). Whereas the fall has been minor in the case of Albania, Romania, and even FR Yugoslavia, it has been more pronounced in the other four countries. Croatian exports to the EU have registered a steady decline over the last few years, from 55% of overall exports in 2000 to 52% in 2002, whereas the growth rates of its exports to the SEE region have been exceptionally high (see Bartlett, 2003). The fall in EU-directed exports has been even more pronounced in Bosnia and Herzegovina, where the EU share of its exports has been reduced from 38% in 2000 to 30% in 2002. In 2002, three countries still directed less than 50% of their total exports to the EU - Bosnia and Herzegovina, Macedonia, and FR Yugoslavia - suggesting the need for more substantial economic reforms in order to increase competitiveness on EU markets in the future.
- **Stable trends in imports from the EU:** On the side of imports, the situation has been much more uniform, since all the SEE countries have been importing larger quantities of goods from the EU than from the other SEE countries (the only exception in 2002 was the Republika Srpska). In recent years, the trends have also been relatively stable, without major variations (as in the case with exports), suggesting the high dependence of all SEE countries on imports primarily from the EU. Nevertheless, in 2002, in three cases less than 50% of SEE countries' imports came from the EU (Bosnia and Herzegovina, Macedonia and FR Yugoslavia).
- **SEE trade balances:** Trade balances of SEE countries show some further interesting features, which are not revealed by the above shares in overall trade (see Graph 3, Appendix). Some SEE countries today have much more balanced trade in general than others, as there are enormous differences in the coverage of imports by exports across countries, in 2001 being lowest in Albania (23%) and highest in Romania (80%) (see more in Uvalic, 2002). Albania, Bosnia and Herzegovina, and FR Yugoslavia in 2001-2 had a trade deficit with all three groups of countries (the SEE-7, the EU and other partners), but the lowest deficit was recorded in their trade with the SEE. The other four countries - Bulgaria, Croatia, Macedonia, and Romania - have also in 2001-2 had a deficit in their trade with the EU as well as with the other countries, but a surplus in their trade with SEE countries. Both of these features - that some SEE countries have relatively lower deficits, while others even surpluses, in intra-SEE trade - show that there are less striking imbalances in intra-SEE trade, than in their trade with the EU or with other countries. The role of intra-SEE trade does seem important, therefore, for all SEE countries. Although as an alternative to the EU or other developed countries markets, for all SEE countries the regional markets in SEE represent only the "second best" solution, they clearly contribute to achieving a more balanced trade account.

5. Explaining different interpretations

In present discussions and various policy papers, it has frequently been stressed that intra-SEE trade is a very low portion of their overall trade, that the SEE region is not integrated economically, that the potential for increasing trade is very limited. We also frequently come across rather inaccurate statements about the SEE countries recent trade patterns, also in important policy documents. One of the most striking examples are the conclusions on SEE regional trade in several EU Commission's documents.

In a 1999 EU Commission Report it is noted that "At present, 60-90% of the exports of the countries of South-Eastern Europe are to the Union" (Finnish Presidency and the European Commission, 1999, p. 4). Or, in the 2002 First Annual Report from the Commission on the SAP, it is observed that "Trade is growing steadily if unevenly across the region, but intra-regional trade remains disappointingly low, about 7% of total regional trade" (Commission, 2002, p. 5). In the more recent

Second Annual Report from the Commission on the SAP, we find a similar conclusion: "Intra-regional trade remains low, at about 6% of total trade. Still, it is essential to BiH, representing some 20% of its total" (Commission, 2003, p. 11).

These figures referring to intra-SEE trade are clearly much lower than the earlier reported figures, based on our own calculations. How can such differences be explained? We will try and list the most important reasons which lie behind the divergence in interpretations.

(1)Averages hide substantial differences in regional trade: We have seen that the role of intra-SEE trade is extremely variable. While Albania, Bulgaria and Romania trade very little with the other SEE countries, the four countries originating from former Yugoslavia still today trade quite a lot with the neighbouring countries. We have also seen that dependence of the SEE-4 on intra-regional trade is present primarily regarding their exports (much less in the case of imports). The use of *average trade figures* is therefore highly inappropriate and misleading, since averages among all SEE countries, or between exports and imports, hide substantial variations among the trade destination of individual SEE countries, as well as major differences in the relative role of exports and imports in overall SEE trade.

The above statements in Commission reports are clearly based on average figures on intra-SEE trade, which can be rather misleading precisely because the role of intra-SEE trade is extremely uneven across countries, being much more important for some countries (the SEE-4) than for the others (Albania, Bulgaria, Romania). A more detailed analysis of trade patterns of SEE countries in recent years, undertaken in the previous section, leads to different conclusions at least regarding one of the subgroups of SEE countries - the SEE-4.

(2)Unsatisfactory foreign trade statistics. As already mentioned, the foreign trade statistics of several SEE countries remain rather unsatisfactory. Still today we do not have one single source of foreign trade statistics which is complete for all SEE countries. The IMF foreign trade statistics, as probably the best source of foreign trade data, do not adequately cover two key countries, Bosnia and Herzegovina and FR Yugoslavia. In calculations of foreign trade shares of respective groups of countries, the omission of a few trading partners automatically distorts total trade figures of a given country, and consequently also the relative shares of the EU or SEE; even if only one SEE country is omitted, the relative share of the SEE region will automatically be lower, while the share of the EU correspondingly higher.

Omissions in internationally available statistical sources are obviously only the by-product of serious problems with national foreign trade statistics. The situation is particularly unsatisfactory for Bosnia and Herzegovina, for which available foreign trade statistics are still incomplete and unreliable, also because foreign trade in one part of its territory - the town of Brcko - seems not to be covered by its statistical offices. Given that the general situation with statistics on foreign trade of SEE countries is highly unsatisfactory, it is not surprising that we find inaccurate statements even in important political documents.

(3)Conclusions depend on the definition of the SEE. Whether intra-regional trade is "low" or "high" depends on the definition of SEE. For example, Gligorov's definition of the region in his various papers on trade (Gligorov 1997, 1998, 1999) includes ten, sometimes even eleven, countries - in addition to the SEE-7, also Greece, Hungary, Slovenia and Turkey, for which regional trade is not of major importance. The conclusions are somewhat different if we restrict the analysis to the Western Balkans (the SEE-5) - which is, in fact, the group of SEE countries of primary interest, for which the SAP has been devised. It is precisely for most countries within the narrower group of SEE-5 - practically all countries except Albania - that regional trade still plays a relatively important role.

(4)SEE should also be considered as one regional trading partner. If the EU is considered as one trading partner, it makes sense to apply the same criteria to the SEE region and consider all the SEE countries also as one regional trading partner. It seems inappropriate to compare the relative importance of the EU, with its present 15 member states, with individual SEE countries. Although the single SEE countries may be marginal trading partners of the other countries in the region, for most SEE-5 countries all the SEE countries taken together are still today a relatively important trading partner.

(5) Which threshold? The conclusions on the importance of regional trade also depend on the threshold we apply for distinguishing between "low" and "high" levels of trade. This is again a matter of definition, but it would seem reasonable to consider that a double-digit figure - anything above 10% of overall trade - cannot be discharged as negligible.

In any case, even if the SEE region, however we define it, today does not qualify as an economically integrated region, this does not mean that trade liberalisation will not be beneficial in various ways, and will not lead to greater integration in the future.

To what extent average trade figures for the whole SEE region can lead to misleading conclusions can be further illustrated by looking into the EU Commission's findings in both Reports on the SAP, that intra-regional trade in SEE remains at the level of around 6-7% of their total trade (see Commission, 2002, p. 3 and 2003, p. 11). Since these reports are on the SAP, "regional trade" presumably refers to the SEE-5. However, if we look at total trade of the SEE-5 in 2000 and calculate the respective averages, we see that they do not correspond to those reported in the Commission SAP Reports (see Table 5).

As can be seen from Table 5, intra-SEE-5 exports in 2000 have been at the level of 1671.2 million dollars, or 24.3% of total SEE-5 exports; while imports were 14652.6 million dollars, or 12.4% of total SEE-5 imports (see Table 5). If we now consider total trade (the sum of exports and imports) for the same SEE-5 group, again in 2000, we see that it amounted to 3494.4 million dollars, or 16.2% of their overall world trade. Clearly these shares are therefore much higher than the 6-7% figure cited by the EU Commission in its two Reports on SAP. The most plausible explanation is that a part of the foreign trade data for some SEE countries is also omitted in EUROSTAT statistics (which were probably used in these calculations), automatically introducing errors in the total trade figures of the individual SEE countries, and in the respective shares of the EU and SEE subgroups. Another possible explanation for such a divergence in conclusions is that "regional trade" in the EU documents are based on the wider definition of the SEE region - the SEE-7. However, in a document evaluating the SEE-5, this is not the correct definition to use, and not even in this case do the figures correspond to our calculations (see second part of Table 5).

Table 5. SEE countries regional trade, as % of total trade, 2000

Country group	Exports	Imports	Exports + Imports
SEE-5			
SEE-5 trade with other countries in the SEE-5 group (mln. \$)	1671.2	1823.2	3494.4
SEE-5 total world trade (mln. \$)	6885.5	14652.6	21538.1
Share of SEE-5 trade in total trade (in %)	24.3	12.4	16.2
SEE-7			
SEE-7 trade with other countries in the SEE-7 group (mln. \$)	2762.2	2260.2	5022.4
SEE-7 total world trade (mln. \$)	22012.5	32882.6	54895.1
Share of SEE-7 trade in total trade (in %)	12.5	6.9	9.2

Source: Calculated on the basis of data provided in the *IMF Direction of Trade Statistics Yearbook 2001*, except for Bosnia and Herzegovina and FR Yugoslavia, for which national statistics have been used.

The figures reported in Table 5 also clearly show how the respective trade shares of different partners crucially depend on the definition of the SEE region. If we consider the SEE-5, the shares of their exports, imports, or the sum of the two, going to the other countries in the SEE-5 group, are much higher than if we consider the SEE-7. Precisely because Bulgaria and Romania trade *very little* with the other SEE countries, whereas they account for a much greater relative portion of overall SEE-7 trade (both regarding exports and imports), including them in the SEE group decreases significantly the importance of intra-SEE trade.

6. Conclusions and policy recommendations

The paper has tried to contribute to the debate on the possible effects of the ongoing process of trade liberalisation among the seven transition countries in SEE. The main conclusions and policy recommendations are as follows.

- ***Importance of regional trade.*** Although the SEE region is today less integrated than it was in 1991, some economic links inherited from the past - namely from former Yugoslavia - have been maintained. This suggests the general importance of historically inherited trade patterns, as they seem to survive even under exceptionally unfavourable conditions as were those in the Balkans in the 1990s. For one group of SEE countries - primarily Bosnia and Herzegovina, Macedonia and FR Yugoslavia - intra-SEE trade has remained a relatively important part of their overall trade, despite disintegration, imposition of trade barriers, continuous conflicts and ethnic strife.
- ***Positive impact of trade liberalisation.*** Another important conclusion regards the observed increase in the share of intra-SEE exports in 2001-2, which is present in all SEE countries except Bulgaria and Romania (which anyway trade little with the other SEE countries). This suggests that the abolition of trade barriers, following the recent signing of free trade agreements within the Stability Pact initiative on trade liberalisation, has indeed stimulated exports to neighbouring SEE countries. Nevertheless, the increased orientation towards SEE markets probably also reflects much deeper structural problems of limited competitiveness of SEE economies on the EU market. Increasing exports to countries in the SEE region is clearly the second-best solution, deriving from the inability of most SEE countries to export more to the EU.
- ***Towards a customs union?*** Presently, trade liberalisation is based on bilateral free trade agreements among the SEE countries. As an alternative, a more synchronised, multilateral, free trade arrangement in SEE would have been a better option. A customs union among the SEE countries, which in addition to the creation of a free trade area would also introduce a common external tariff, would have been an even better solution. But these options were not realistic for political reasons. Michalopoulos (2001) has stressed this argument, arguing that uncoordinated bilateral free trade agreements involving different product coverage, depth of preferences, rules of origin and so forth "is an invitation to disaster". Still, the signing of the 2000 Memorandum was important since it introduced some standards on existing and future free trade agreements in SEE. Given the fragile political situation in SEE, where even regional co-operation has been accepted with great suspicion by some countries like Croatia (see Bartlett, 2001), this is the most that could have been achieved in early 2001, when the Memorandum was being prepared. What Messerlin and Miroudot (2003) have recently proposed is a solution which would not be very different from a customs union, yet would avoid its negative political implications. They propose harmonising Most Favoured Nation (MFN) tariffs among the SEE countries, which already now are not that different. A convergence process for MFN tariffs could be launched, with all the MFN tariffs applied by SEE countries converging to the lowest tariff plus 5% points, hence creating an "almost common" external tariff. This solution would reduce the risks of trade deflection, i.e. preference for trade with the SEE country with the lowest external tariff, and would render the benefits of trade liberalisation undertaken so far greater.
- ***Importance of political motives.*** We cannot know today, with any degree of certainty, whether trade in the SEE region will actually increase in the future. The economic potential for expanding intra-SEE trade may or may not be there, as indicated by inconclusive results obtained through different gravity model estimates of various authors (see Christie, 2001; Jovicic et al, 2001, Miljovski and Uzunov, 2001). But purely economic considerations are perhaps not the most important, or not even the most relevant, for actual trade flows in the future. As in the past, both

before 1989 and throughout the 1990s, trade patterns in the SEE region have been heavily influenced by non-economic - essentially political - factors, it is very likely that it will be so also in the future. Many concrete examples can be given to confirm this statement on the political determinants of trade patterns in the SEE region (and probably in other regions as well).¹⁴

Therefore, independently of the economic potential for increasing trade, the most important of all *is* the political argument for the promotion of regional co-operation, *also* through trade liberalisation. Regional co-operation has a much broader significance and political importance in the SEE region. It is certainly not a coincidence that the EU Commission has introduced a new term for its contractual relations with the SEE-5 - the Stabilisation and Association process, the new element being precisely the word "stabilisation". All forms of co-operation - in political, economic, cultural and other areas - are therefore highly welcome, as they can contribute to more permanent stabilisation and higher security in the whole SEE region.

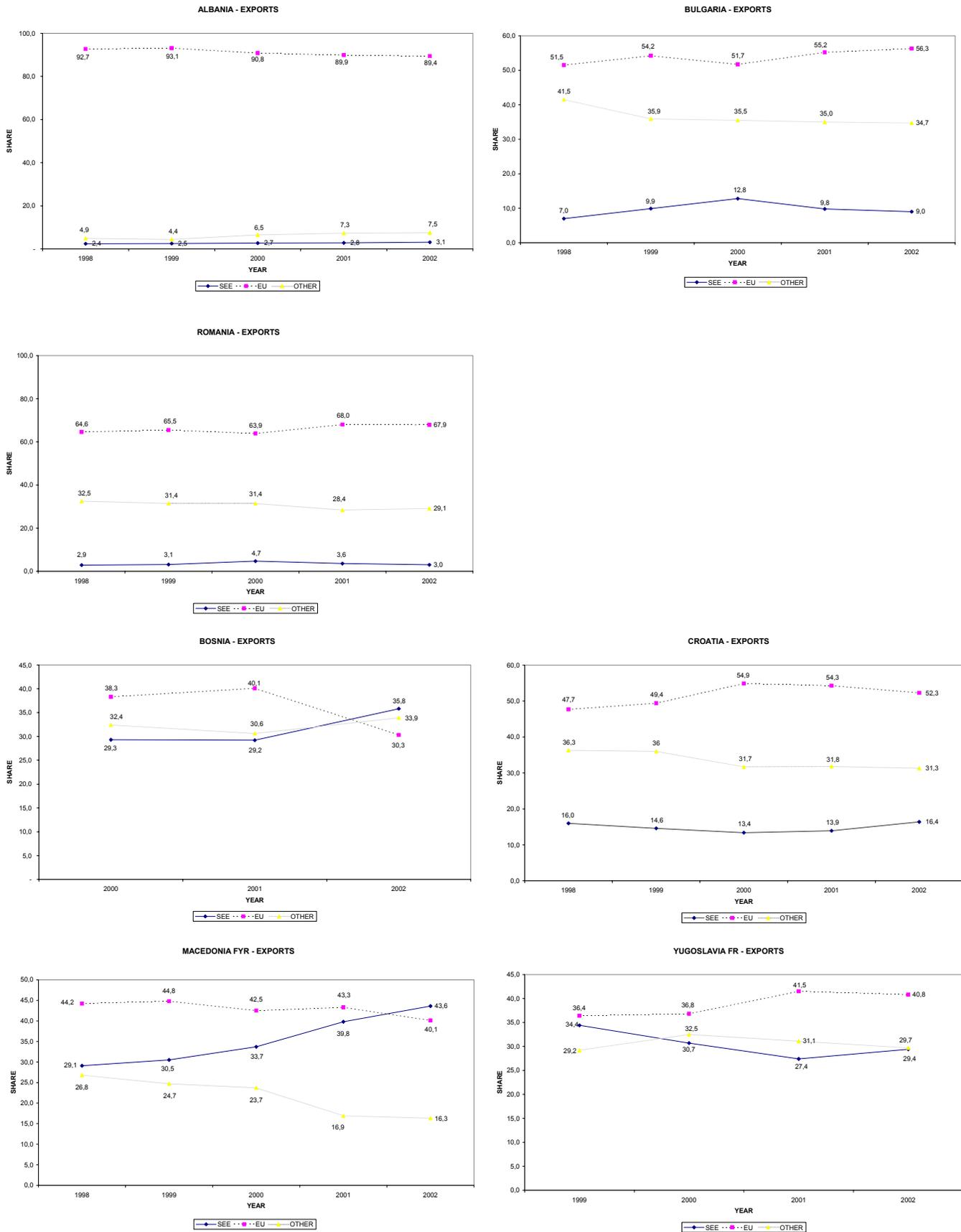
- ***Compensating uneven effects of trade liberalisation:*** The eventual negative effects of trade liberalisation for some SEE countries, suggested in a recent World Bank study (see Kaminski and de la Rocca, 2002), need to be seriously considered within the overall EU measures for this region. If the less developed countries are likely to lose more from trade liberalisation, because of the negative distributional effects or due to the loss of customs revenues, they ought to be compensated. Current EU measures of trade liberalisation have to be closely combined with measures supporting development in the SEE region. Within the CARDS programme, in particular, the poorer countries ought to be granted more development aid, as suggested elsewhere (Uvalic, 2002).
- ***Positive effects of regional integration:*** As to the question whether SEE integration was the right policy choice, the answer is definitely affirmative: trade liberalisation and intensified economic co-operation among the SEE countries is likely to have important overall positive effects in the medium term, while they are preparing for future entry into the EU. However, since trade has remained of some importance primarily for the four SEE countries of former Yugoslavia, perhaps a better option would have been to have pursued trade liberalisation primarily among these countries, rather than all the seven countries in the SEE region. The most recent trends in SEE countries trade patterns again confirm the importance of regional markets primarily for the four successor states of former Yugoslavia.

In concluding, in spite of initial resistance by several SEE countries to the process of trade liberalisation, the process seems to be proving to be a "blessing in disguise". Although all SEE countries have in recent years put major efforts to orient their exports primarily towards the EU countries, this has not always been possible, so being able to find alternative liberalised markets in the SEE region has certainly been an important factor enabling a minor drop in SEE exports than otherwise would have been the case.

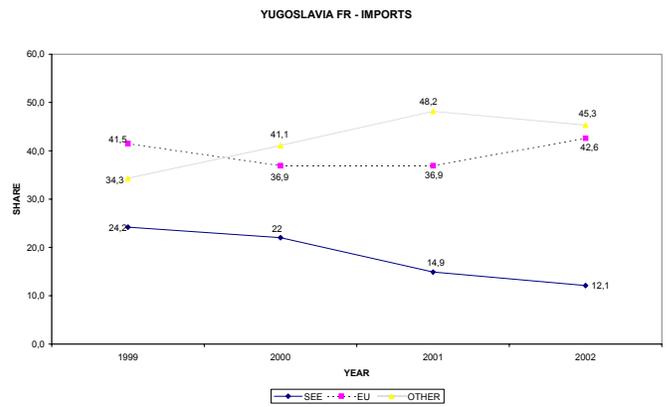
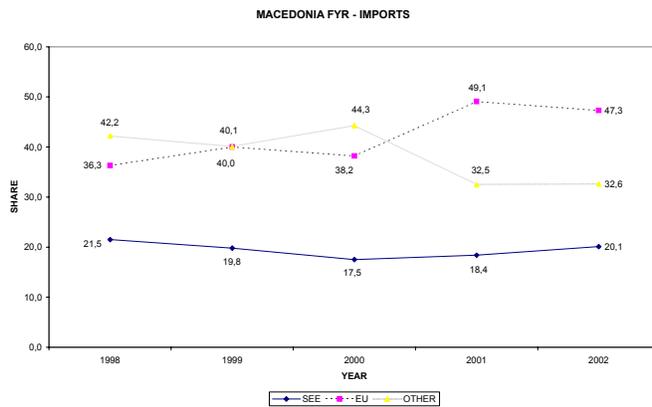
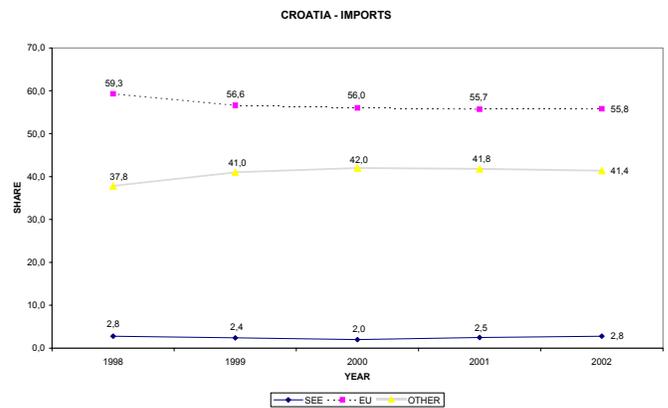
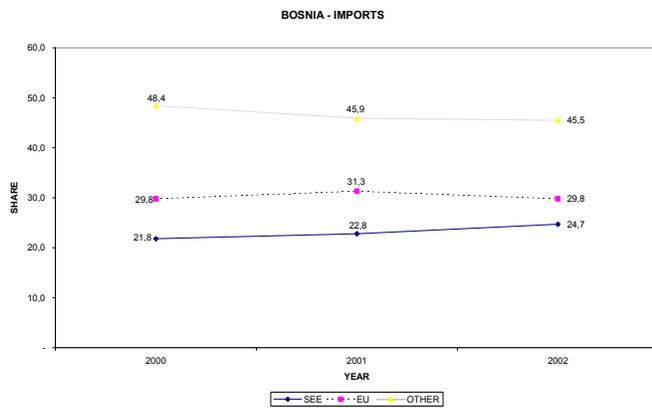
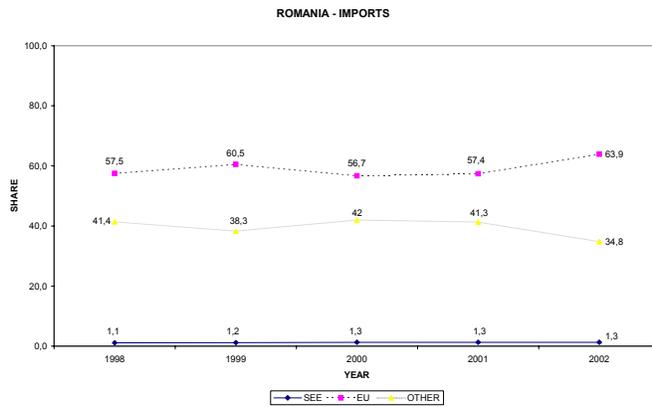
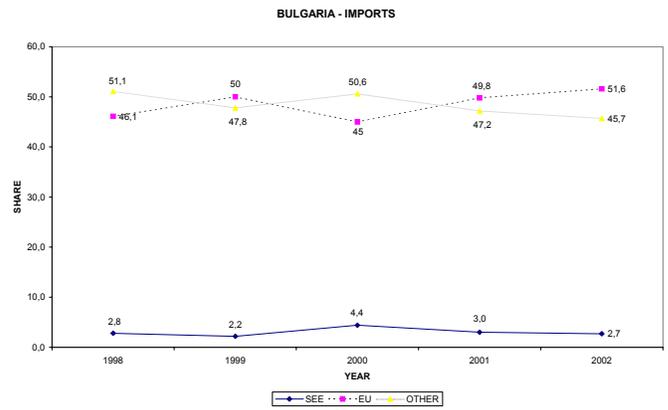
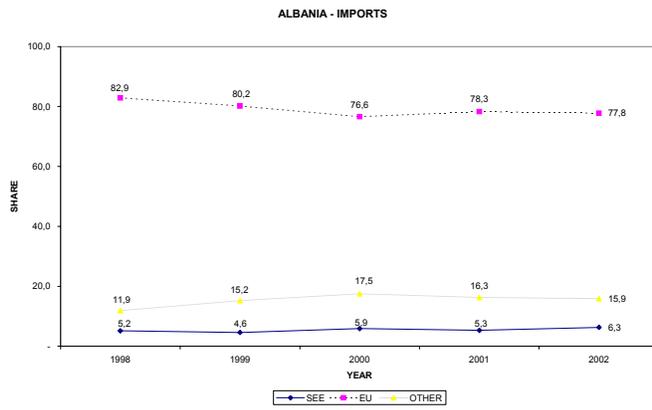
¹⁴ In recent years, there has been "ethnic" trading between Croatia and the Bosnian Federation on the one hand, and between the Republika Srpska and FR Yugoslavia on the other, on purely political grounds. Over the last few years, trade between these countries has been diminishing, again under the impact of political factors. The international sanctions against FR Yugoslavia and the NATO bombardments, which are purely political instruments of pressure, have forced FR Yugoslavia into above potential trade with some of its neighbours (Republika Srpska, Macedonia, Bulgaria), while the military conflict with Croatia has determined rather low trade levels throughout the 1990s.

APPENDIX - GRAPHS

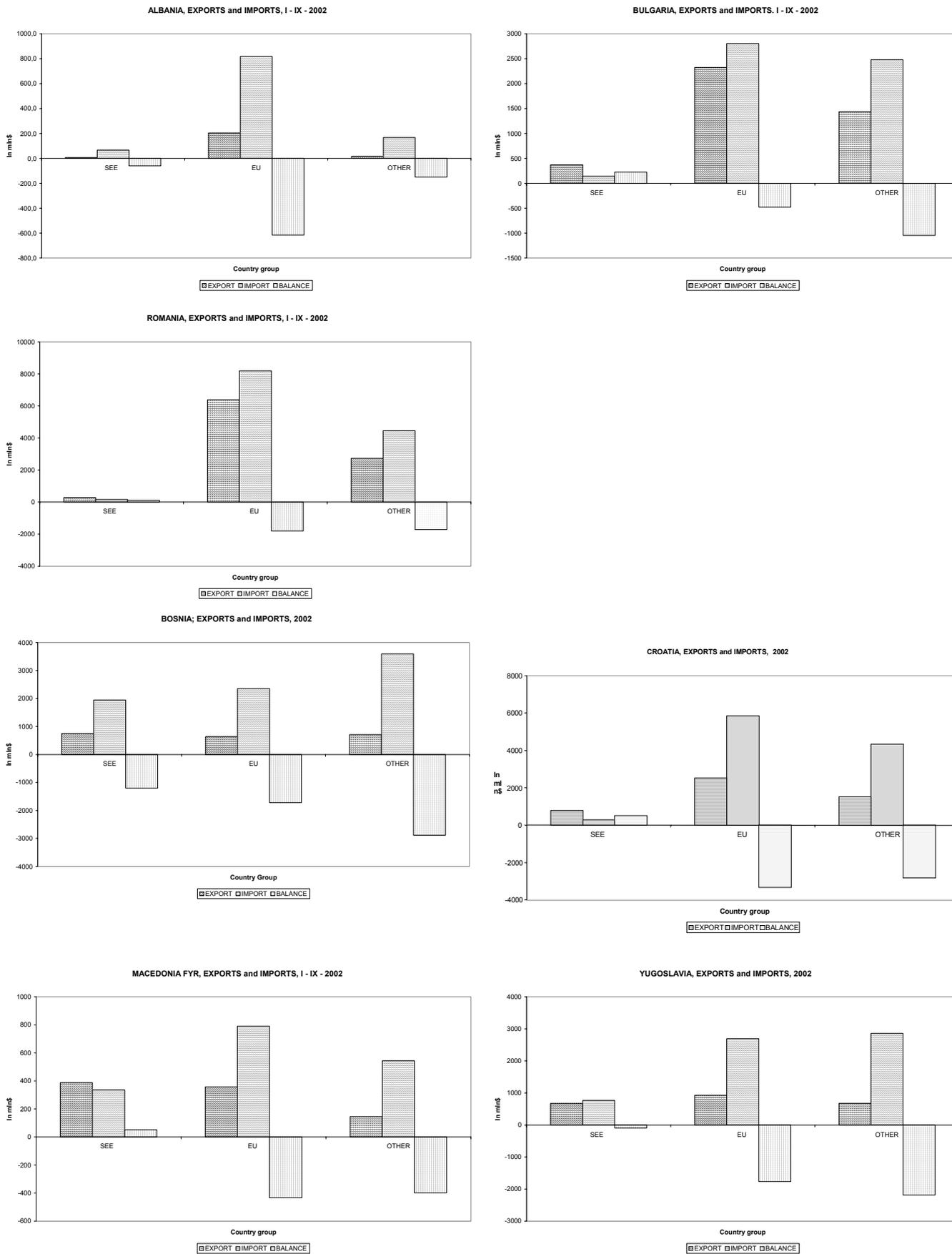
Graph 1. Exports of SEE countries, by country groups



Graph 2. Imports of SEE countries, by country groups



Graph 3. Exports, imports, and trade balances of SEE countries, by country groups, 2002



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