

Trade Flows in Southeast Europe

By Edward Christie

The paper seeks to give an overview of the major issues connected to international trade for the countries of Southeast Europe. In its first part the paper discusses trade in goods. This part revisits the issues of bilateral trade patterns and trade composition in Southeast Europe and looks at recent developments in terms of trade agreements and trade facilitation within the region and between the region and the European Union. The second part of the paper deals with trade in services. A gravity model for trade is estimated on European bilateral services trade flows. The estimation results are then used to produce forecasts for bilateral services trade flows for the countries of Southeast Europe.

Trade in Goods

Trade patterns in Southeast Europe were heavily disrupted during the 1990s notably due to the military conflicts in former Yugoslavia. In the last few years the patterns have normalised to a new equilibrium where the European Union, and especially the Western European member states, acts as by far the most important trading partner both for imports and for exports for practically all the countries of the region. While some recovery of trade flows between countries formerly part of Yugoslavia

has taken place, countries further from the geographical centre of Southeast Europe such as Albania and Romania trade very little with regional partners and very much with the EU. Trade between the EU-15 and especially Romania and Bulgaria has surged impressively over the last few years, although trade deficits are persistently large. The countries of the region are progressively liberalising trade with one another through a series of bilateral trade agreements. Out of the 21 bilateral free trade agreements (FTAs) that are necessary to mimic a free trade area, all have been at least initialised (in terms of negotiations). Some have been signed and are awaiting ratification, and 17 were already in force as of 2 June 2004. These FTAs stipulate gradual reductions in tariffs up to 2008, when trade in industrial goods should be fully liberalised. Around that time it is likely that Romania, Bulgaria and Croatia will have joined the EU. This will void the corresponding FTAs, which will be replaced by the bilateral relations between the EU as a whole and the remaining SEECs. As the EU itself has (unilaterally) already granted wide ranging trade concessions to the remaining countries, one may expect "almost free" trade across the region by that time, while the remaining trade impediments would probably

only disappear once the whole region is in the EU.

What is striking about the whole process is how cumbersome and slow it has been, especially bearing in mind that all the countries of the region want to (and almost certainly will) join the EU anyway. For this and other reasons, one may wish to evaluate whether a customs union with the EU for the remaining countries of the region may be a preferable option.

On the issue of market access, there has been marked progress in terms of trade facilitation measures. Border waiting and clearance times have fallen quite significantly throughout the region, while progress is ongoing in terms of transport infrastructure, notably thanks to coordinated help from international bodies. Finally, the entry into the EU of Central European countries such as Slovenia and Hungary should also have a positive impact on trade flows.

Further liberalisation, improved access to the EU market and quite strong GDP growth in the SEECs together imply that trade flows should continue to increase, both with the EU and within the region. However the overall pattern which will most likely remain for the region is that of a set of small peripheral economies with the EU-15 acting as a hub. Concerning the composition of trade, the countries

of Southeast Europe (SEECs) have large shares of their exports from basic manufacturing sectors (e.g. textiles, basic metals) which employ essentially lower skilled workers, which use rather low technologies, and which miss out on the higher value added available in other sectors. This is in clear contrast to the export structures of the Central European countries (CEECs) which have more technology-intensive and more human capital – intensive export compositions. In light of this, the current export structures of the SEECs seem neither sustainable nor desirable in the long run. If the SEECs were to evolve towards something like the current structures of the CEECs, one would need to see the emergence of more human capital intensive and technology intensive export sectors. The experience of the more advanced CEECs suggests, among other things, a need for more FDI.

Trade in Services

A gravity model for trade is estimated following the Matyas specification using data from 1999 to 2002. The model finds a quite strong positive (and significant) effect associated with EU membership. The model is then used to produce forecasts for services trade flows up to 2009, assuming 2% p.a. real growth for EU-15 countries and 4.5% p.a. real growth for the Southeast European countries.

According to the model's forecasts, all the countries of the region have good prospects for increases in services trade. The forecasts indicate high potential for trade in services between Romania and Bulgaria (and to a lesser extent Croatia) on the one hand, and the large EU economies on the other hand, notably Germany, the UK and France. These larger forecasts are due in part to the latter countries' larger GDPs, but also to the model's assumption about the effect of EU membership. EU membership is modelled using a dummy variable. For the forecasts, this variable is set to one for Croatia, Romania and Bulgaria, which is equivalent to assuming that the effect of EU membership on those countries' links to the rest of the EU will be as strong by 2009 as it has been for trade links among the old EU-15 members.) Conversely, the forecasts for Serbia and Montenegro, Bosnia and Herzegovina, Macedonia and Albania are much lower, due to lower GDPs and to not being part of the EU. The underlying message is that there is quite a lot of potential for trade in services, but that releasing it requires strong integration with the EU-15. Clearly, the EU membership dummy variable used in the model captures many different effects, some of which are not direct consequences of EU membership, or only partly so, for

example infrastructure developments.

Many flows are currently still relatively low but, as the case of Croatia shows, tourism is a natural export service for many parts of the region and could be developed much further (assuming some infrastructure improvements)

for example in Montenegro or Albania. The case of Croatia is certainly a success story as far as tourism is concerned. Tourist arrivals and tourism revenues have been growing strongly over the last few years. The current levels of growth will probably not continue as far as Austria and Germany are concerned, but there is still scope for growth from other source countries. On the other hand, other types of services trade have stagnated.

Business services could develop much more than they have so far for all the countries of the region. This has already started to happen to some extent in the case of Romania. Services trade between Italy and Romania in particular is already quite high, but still below the report's 2009 forecast.

Conclusions

The prospects for trade within the region and between the region and the EU have improved over the recent years. Key developments such as forthcoming EU membership for three countries of the region, the EU's unilateral trade concessions to the Western Balkan countries,

the bilateral free trade agreements between the countries of the region, improvements in trade facilitation and in infrastructure and, overall, relatively good GDP growth prospects all point to further growth in trade volumes, both in goods and in services. The overall picture is certainly much more positive than a few years ago, and all the main indicators are pointing in the right direction. Many challenges remain however. Regional trade liberalisation is happening more slowly than could have been the case, and infrastructure improvements require large investments and time.

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