

Southeast Europe: Areas of regional cooperation

By Vladimir Gligorov

It is assumed in this paper that, in general, when it comes to trade, investments and pretty much everything else, Southeast Europe (SEE) maintains a hub-and-spoke relationship with the European Union (EU). In other words, from the point of view of the countries in the region, bilateral relations with the EU are more important than the regional ones and even more important than the relations of the region as a whole with the EU. It is also assumed that there is low interest in regional cooperation if it is not connected with the process of EU integration. Thus, multilateral regional cooperation has to be supported by bilateral processes of EU integration. The key areas of cooperation are reasonably easy to identify. Those are dominated by the need to develop and to grow. The agenda of development is also reasonably clear, especially when it comes to investments in infrastructure, institutions and human capital. I will put these issues aside.

Sustainable growth is a solution to almost every problem and there the issues of economic policy become paramount. Here regional cooperation may play a role especially when seen in the context of EU integration. Given the hub-and-spoke character of inter- and intra-regional relationship, the contribution of regional cooperation to economic growth and development may happen to be indirect via the influence on regional stability and opportunities. Indeed, the developments so far have tentatively confirmed

this observation as it is the normalization and liberalization that have been more important consequences of increased regional cooperation rather than growth of trade, investments or production. Still, in the future, regional cooperation can contribute to economic growth and development too. Already it can be observed that the regional business connections and activities are increasing especially in places where there are few if any political and constitutional problems. Thus, it could be argued that:

Liberalization of trade and investments and economic policy cooperation have greater contribution to stabilization and normalization in the region while their importance may increase with the economic growth of the region and in the particular countries in the region.

With that in mind, the following general areas of regional cooperation should be contemplated.

Trade

The choice is between multilateral free trade area or customs union with the EU. In a sense, the second is more in tune with the EU integration. In that sense, regional coordination of this process could be the best institutional approach. However, the process of EU integration is such that a customs union with the EU is hardly a feasible alternative. As in other cases, the bilateral approach of EU integration clashes with the multilateral approach of

regional cooperation. This is even more so as the distance between various Balkan countries in respect to EU integration increases. Clearly, candidate countries or countries that hope to become candidates are more interested in their negotiations with the EU than in those with the other countries in one or the other regions or sub regions in the Balkans.

In these circumstances, the multilateralization of the bilateral free trade agreements may be the most that can be achieved though the added advantage that they bring cannot be expected to be all that great.

Investment

There are advantages to the larger market when it comes to investments. Obviously, only some types of investments look for such markets. The Balkans produce small firms, but larger firms are a more difficult affair and those are often relying on government support either through subsidies or through a privileged position in the market. Outside firms adopt the same strategy as long as they have to deal with often weak and corrupt governments. To detach firms from the budgets and budgets from the firms, a regional market with firms competing in those could be one possibility. Besides providing for the benefit from the economy of scale, there is also the benefit from increased competition. The development of the regional financial market,

however, is still far off. This is to an extent a consequence of the underdevelopment of domestic financial markets and of the significant role that states still play. Thus, even the firms coming outside of the region are yet to develop regional investment strategies.

Two developments perhaps hold the key to further improvements in this area:

- (i) improvement in the local business climate that depends on institutional and policy reforms in each particular country, and
- (ii) normalization of international financial relations in the sense that the countries in the region need to become normal participants in the international financial markets (a number of countries in the region are still cut off from the international debt and equity markets).

Exchange rate policy

One characteristic of the Balkans is that it is, with the exception of Romania, mostly on fixed exchange rates. In some cases, euro is used as the official currency. Fixed exchange rates bring problems, however. Competitiveness is a problem, external balances are a problem, and fiscal sustainability is a problem. Though intra-regional trade is relatively small, exchange rate misalignments and shocks, due to risks of devaluation, play some role in that. Thus, some regional cooperation in exchange rate policies could be useful. The usefulness will increase as the process

of EU integration speeds up.

However, as argued above, the theory of OCAs suggests that fixed exchange rates will be more of a rule in the Balkans though none of these countries can be considered OCAs by themselves. Being small and increasingly open economies, they have difficulties implementing floating exchange rate regimes. If that is so, then there are two possibilities. One is to have an implicit coordination of exchange rate policies via a fixed exchange rate regime with the euro. The other is to take a harder look at the issue of the competitiveness of the Balkan economies and to try to coordinate the exchange rate regimes and policies accordingly. This alternative approach seems to me to be rather less than feasible.

Thus, some kind of an indirect exchange rate coordination using the euro as the anchor could be useful. In particular, a version of an ERM mechanism suited for this region could be contemplated.

Fiscal policy

States in the Balkans tend to be weak¹ in a number of ways, that of the fiscal sector being the most important one. There are a number of reasons that suggest cooperation in fiscal policies. First, to support trade liberalisation. Lowering of tariffs can be reversed by the introduction of taxes. Thus, trade liberalisation

may not be as effective as it could be. In order to avoid unnecessary tax competition, some cooperation on tax policies could be useful. This is not to be understood as a suggestion that fiscal harmonisation is to be looked for.

Clearly, co-operation does not exclude competition. What this co-operation could accomplish is, first, the decrease in the shock element in local fiscal policies and, second, the decrease of the power of local business lobbies to influence the tax policy with the view of retaining the position of monopoly. This cooperation, as in the other areas of economic policy, could be supported by the process of EU integration and would probably have to be led by it.

Second, to decrease distortions and rent seeking by firms. Taxes can bring in significant distortions and subsidies can produce significant sources of rent seeking. Both are especially powerful in cases where arguments for support for exports are made. Given that the misallocation of resources in the Balkans is still quite significant, the simplicity and the transparency of the fiscal systems would be quite desirable. In that, regional co-operation can clearly play a significant role.

Third, to bring in the informal economy. In a number of cases, the informal economy is fuelled by the opportunities to exploit differences in fiscal systems in the region. Thus, if for

no other reason, then because of the need to diminish the presence of informal and even criminal activities, fiscal co-operation would certainly be useful.

Competition policy

As competition policies are quite under-developed in the region, EU could play a significant role in this area too. Again, as the process of integration speeds up, EU competition policy could be extended to the region. It would especially prove important in the reform of the public sector, which is certainly the key issue of the process of transition. State monopolies as well as private monopolies are quite characteristic for the Balkan countries, especially those that are laggards in transition. Internally, competition policy would be very difficult to implement. In the context of the EU integration that could indeed be much more efficient. Indeed, in some cases, the fact that a country is outside of the EU or of the process of EU integration has been used to grant monopoly rights to either domestic or foreign firms or banks, with some of the latter being from the EU countries. This has not only supported misallocation of resources but has led to the slowdown of the process of integration in so far that it would mean the introduction of antimonopoly measures. To an extent, the transformation of the local judiciary system, certainly the weakest link in the institutional setup, has been impeded because

of the strong influence of state and private monopolies or lobbies.

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Vladimir Gligorov is staff economist at the Vienna Institute for International Economic Studies.