

REGIONAL INTEGRATION IN SOUTH-EASTERN EUROPE

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Introduction

Although, the ex-communist countries in the region of South-Eastern Europe² are entering the second decade of transition to a market led economy, economic growth in the region is not sustainable yet (see World Bank, 2000). Besides, ethnic and political fragmentations persist deteriorating further the economic potential of the region. As it is presented in Table 1, the rate of economic growth was negative or very slow in the 1990's and it started picking up only towards the end of the decade. In 1999 the GDP level of the transition countries of the region accounted for the 75 percent of the pre-transition (1989) level, in average. Only Slovenia succeeded in recovering its real GDP at the 1989 level. Unfavourable initial conditions have combined with conflict, uneven implementation of reform programs, inconsistent macroeconomic stabilisation policies, lack of tradition in institutional development, large debt burdens, unbalanced industrial structures, great distance to western European markets and inadequate transport links to yield poor economic performance and made transition a difficult exercise for the region.

Table 1. Growth Rates in South-Eastern Europe

Countries	Real GDP Growth Rates, (%)			Estimated level of real GDP in 1999
	1990-1998*	1999	2000	1989=100
Albania	-0.8	7.3	7.0	95
Bosnia-Herzegovina	29.9**	12.0	n.a	95
Bulgaria	-4.0	2.4	4.0	67
Croatia	-2.4	-0.3	3.5	78
FR Yugoslavia	n.a	-19.3	n.a	41
FYROM	-1.2	2.7	5.0	74
Greece	2.0	3.4	4.1	n.a
Romania	-2.9	-3.2	1.5	76
Slovenia	0.5	4.9	5.1	109
Turkey	4.9	-5.1	6.0	n.a

Source: EBRD: Transition Report, 2000; EIU: Country Reports, Various Years

Notes:

(*) Annual Average

(**) 1995-1999

A deeper and more consistent implementation of domestic reform programmes along industrial restructuring, technological upgrading, building of infrastructure, and accelerated investment activity present the necessary and sufficient condition for fostering sustainable growth in the region. All these require internal and external economies of scale. Most of the countries are small in terms of

¹ Views expressed in this paper are personal and not in any way engage the BSTDB.

² In the context of the current paper the region of South-Eastern Europe includes: Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Federal Republic of Yugoslavia, FYROM, Greece, Romania, Slovenia, and Turkey.

population³ and market size. Market fragmentation may give rise to non-competitive structures and inefficient solutions, which may have negative welfare effects; and it may also set a limit to the agglomeration economies, the potential of which is one of the most critical prerequisites for industrial restructuring and investment. In that respect the sufficient condition for sustainable growth would be the overcoming of the market fragmentation. Regional co-operation and integration could be the decisive factor towards unifying individual markets in the area.

Regional integration in the South-Eastern Europe could create an enhanced market quite homogeneous in some respects, e.g. consumer preferences, production structures, etc.; equally diverse in some others, e.g. natural and created resources, geographic position, relationships with third regions. For instance, Greece is a member of the Euro-zone while Romania and Bulgaria have a better understanding of the Russian Federation, for historical reasons, and Turkey a better access to the new states of Central Caucasus because of cultural ties. This market would be relatively easily accessible due to geographic proximity, which would lower transportation and marketing costs. Ultimately, it would, *first*, increase cross-border transactions, i.e. international trade, foreign direct investment (FDI), and business networks; *second*, it would facilitate the establishment of economies of scale and scope; and, *third*, it would help industrial restructuring, competition and efficiency. Overall, it would create the potential for growth through the creation of conditions favourable for investment⁴.

The aim of the current paper is to explore the present situation with respect to regional integration in South-Eastern Europe. In particular it addresses the issue of trade relations among the countries in the region, in terms of volume and direction as opposed to trade relations between these countries and the EU. The latter appears as the main trading partner at present, and that poses a critical question related to the welfare effects of such a situation.

Some Stylised Facts

The volume of international trade of the South-Eastern Europe has been increasing since 1987, (see Table 2), although the trend was disrupted by the initial transition shock in 1990, 1991 and the ethnic and political disputes between and within countries in the region.⁵

The distribution of individual country shares to the total regional international trade is quite asymmetrical ranging from 39.6 percent for Turkey to the extremely low 0.7 percent for Albania (see Table 3). There is a significant concentration with Turkey and Greece accounting for over 60.0 percent of the total trade of the region in 1999 compared with 63.4 percent in 1993 and 46.0 percent in 1987. It should be noted that before the break up of Yugoslavia, the latter had a significant share in the regional trade equal to 24.8 percent of the total. This percentage stands above the cumulative share of all the countries that emerged after the break-up of Yugoslavia, which was 21 percent in 1993, and increased slightly to 23 percent in 1999. This increase was mainly due to the increase of the individual shares of the Republic of Yugoslavia and Bosnia-Herzegovina in the same period.

³ Of the transition countries of South-Eastern Europe only Romania has a population of 22.3 million. The population size for the other countries ranges from 8 million for Bulgaria to 2 million for FYROM and Slovenia. The source of data is EBRD, 2000 and it refers to mid 2000.

⁴ On the benefits of regional integration see Gros, 1999.

⁵ The Cosovo crisis in 1999 is a good case in point.

Table 2. Direction of SE European International Trade by Region, Inter-temporal Evolution, 1987=100

	SE EUROPE	EU	WORLD-R	WORLD-T
1987	100.0	100.0	100.0	100.0
1988	102.2	100.3	104.5	102.8
1989	120.5	113.7	108.4	111.0
1990	118.3	147.5	107.3	123.2
1991	114.8	152.9	90.7	115.7
1992	124.7	158.9	90.5	118.3
1993	204.2	162.5	85.2	120.3
1994	239.8	171.2	83.8	124.5
1995	308.5	232.5	104.5	163.0
1996	339.6	250.1	114.6	177.0
1997	353.1	261.0	123.9	187.1
1998	349.3	271.3	118.1	187.5
1999	342.2	255.3	107.2	174.8

Source: IMF, *Direction of Trade Statistics*. Own calculations

Figure 1. Distribution of SE European International Trade by Region, in percentage terms

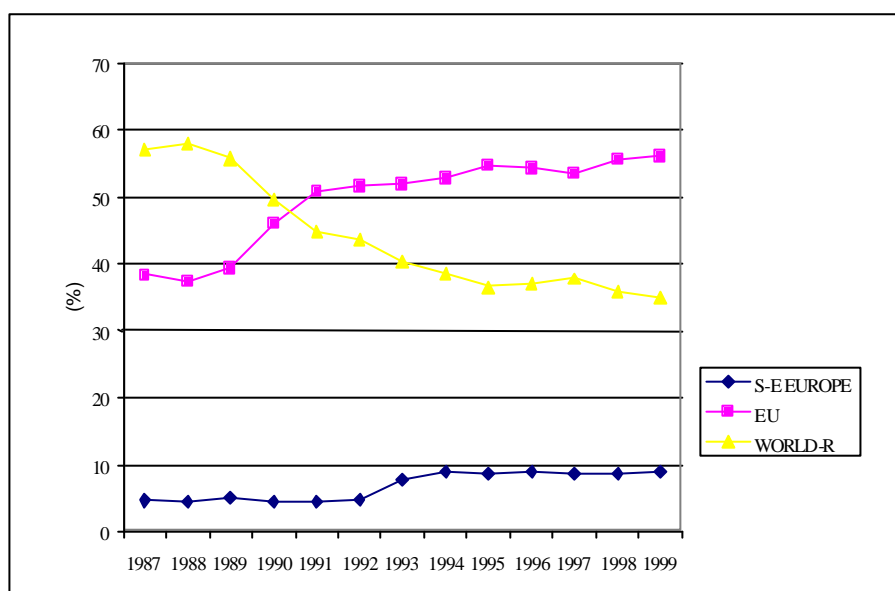


Table 3. Total International Trade of SE Europe by Country of Origin

	1987		1993		1999	
	USD Millions	%	USD Millions	%	USD Millions	%
Albania	0	0.0	726	0.6	1174	0.7
Bosnia & Herzegovina	0	0.0	509	0.4	3135	1.8
Bulgaria	7789	8.0	6744	5.8	8917	5.3
Croatia	0	0.0	8570	7.3	11950	7.0
Greece	19701	20.3	29293	25.1	35248	20.8
FYROM	0	0.0	2254	1.9	2988	1.8
Romania	20666	21.3	12626	10.8	17790	10.5
Slovenia	0	0.0	13107	11.2	18394	10.8
Turkey	24893	25.6	44703	38.3	67274	39.6
Republic of Yugoslavia	24028*	24.8*	95	0.1	2861	1.7
Total	97077	100.0	116822	100.0	169731	100.0

Source: IMF, *Direction of Trade Statistics*. Own calculations

Notes: (*) The figures refer to the united former Yugoslavia

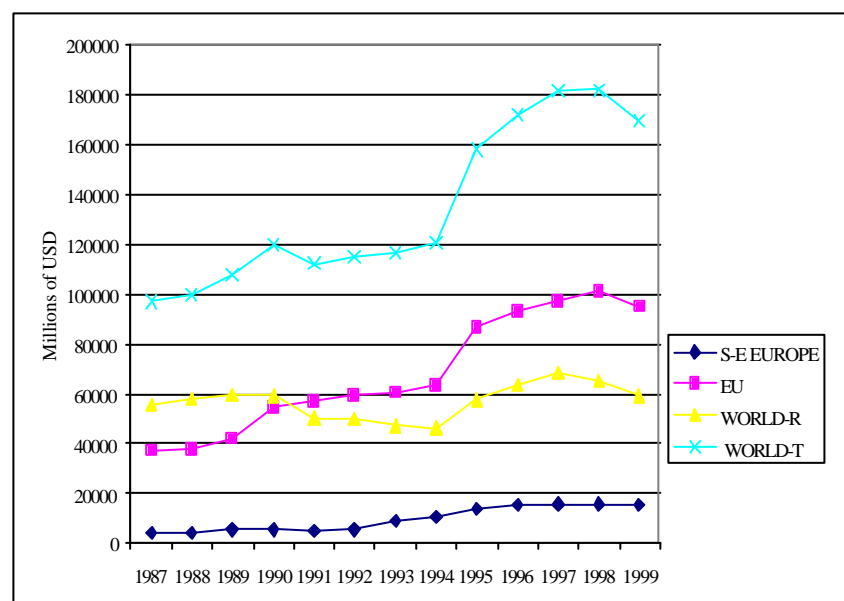
The importance of the EU as an export market for the whole region has been constantly increasing since 1987. The trend became more potent from 1990 onwards, making the EU the main trading partner of the region. That coincides with the transition towards a market economic regime most countries of the region are going through and it has been achieved at the expense of trade transactions with the former Soviet Union, (see Table 4). In particular, the EU's share in the total South-Eastern European trade was 38.4 percent in 1987 and became 56.0 percent in 1999. On the contrary, the share of the rest of the world⁶ decreased substantially to 35.0 percent in 1999 from 57.0 percent in 1987. The intra-regional trade, i.e. trade among the South-Eastern European countries, doubled its share to the total trade of the region from 4.6 percent in 1987 to 9.0 percent in 1999. This might indicate that some regional trade integration has been under-way, although this tendency seems very weak, as the low share of intra-regional trade with respect to the total declares. The latter remains very low throughout the whole period.

Table 4. Direction of SE European International Trade by Region, in Absolute and Percentage terms

	SE EUROPE		EU		WORLD-R		WORLD-T	
	USD Millions	%	USD Millions	%	USD Millions	%	USD Millions	%
1987	4469	4.6	37242	38.4	55366	57	97077	100
1988	4569	4.6	37344	37.4	57881	58	99794	100
1989	5387	5	42358	39.3	60025	55.7	107770	100
1990	5288	4.4	54930	45.9	59422	49.7	119640	100
1991	5131	4.6	56942	50.7	50229	44.7	112302	100
1992	5573	4.9	59187	51.5	50091	43.6	114851	100
1993	9127	7.8	60528	51.8	47167	40.4	116822	100
1994	10718	8.9	63742	52.7	46387	38.4	120847	100
1995	13789	8.7	86594	54.7	57845	36.6	158228	100
1996	15175	8.8	93151	54.2	63460	36.9	171786	100
1997	15782	8.7	97203	53.5	68621	37.8	181606	100
1998	15609	8.6	101038	55.5	65406	35.9	182053	100
1999	15291	9	95089	56	59351	35	169731	100

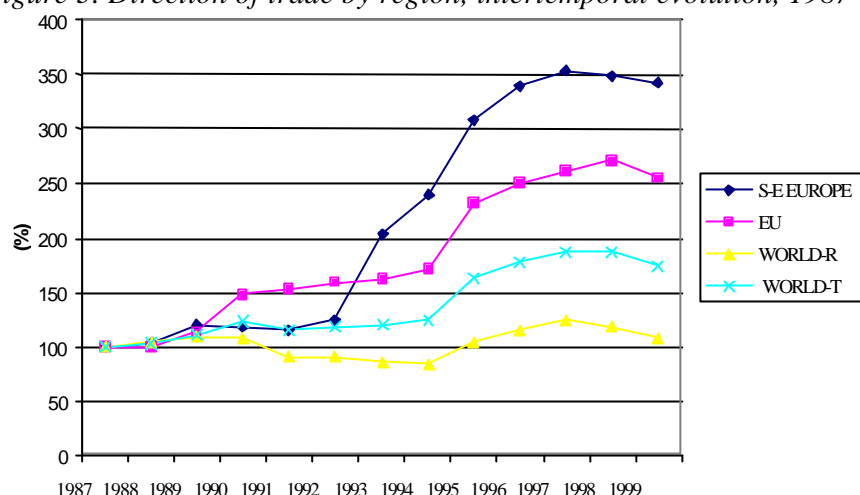
Source: IMF, *Direction of Trade Statistics*. Own calculations

Figure 2. International trade of SE Europe, total and by region, in USB millions



⁶ That is total international trade minus the trade with the EU minus the intra-regional trade.

Figure 3. Direction of trade by region, intertemporal evolution, 1987=100



However, the intra-regional trade increased more rapidly than the total trade or even the trade between the region and the EU, (see Table 2). More specifically, total trade increased by 74.8 percent between 1987 and 1999⁷ while the trade with the EU by 155.3 percent, and the intra-regional one by 242.2 percent in the same period.

The increasing ratio of intra-regional trade over trade between the South-Eastern Europe and the EU, (see Table 5) present some further indication of enhancing regional trade integration during the transition period as opposed to integration between the region and the EU. The ratio had a value equal to 16.1 percent in 1999 compared to 12.0 percent in 1987. Nevertheless, it seems that this increase during the years 1993 and 1994, and the ratio remained rather constant afterwards.

Table 5. Intra South-Eastern European Trade vs. Trade with the EU

	S-E Europe (E+I) / EU (E+I)	S-E Europe (E+I) / WORLD-T (E+I)
1987	12.0	4.6
1988	12.2	4.6
1989	12.7	5.0
1990	9.6	4.4
1991	9.0	4.6
1992	9.4	4.9
1993	15.1	7.8
1994	16.8	8.9
1995	15.9	8.7
1996	16.3	8.8
1997	16.2	8.7
1998	15.4	8.6
1999	16.1	9.0

Source: IMF, *Direction of Trade Statistics*. Own calculations

In 1987 Bulgaria, Romania and the former Yugoslavia accounted for almost 70 percent of the intra-South-Eastern trade, while Turkey and Greece for 15.2 and 13.4 percent respectively (see Table 6). In 1999 Turkey and Greece still account for 30.5 percent of the intra-regional trade, but Bulgaria and Romania diminished their shares from 20.1 and 26.3 percent to 12.1 and 8.8 percent respectively. Croatia and Slovenia accounted for another 26.5 percent. Concentration seems to have been lowered, i.e. four countries undertake the 51.0 percent of intra-regional trade. If the shares of the countries that emerged after the break-up of former Yugoslavia, namely Slovenia, Croatia, Bosnia-Herzegovina,

⁷ The total trade increased by 87.5 percent if 1998 is considered as the end of the period since trade performance in 1999 was seriously affected by the Cosovo crisis.

FYROM and the Republic of Yugoslavia are taken cumulatively, they make-up the 46.4 percent of the intra-regional trade, a much higher percentage than the share of former Yugoslavia, even if this is considered at its highest value, i.e. 28.0 percent in 1990. Most of the intra-regional trade, above 80.0 percent of the newly emerged countries of the region is undertaken between themselves⁸. In that respect it cannot be considered as genuine intra-regional trade but rather as an enhancement of already existing trade linkages between the countries of former Yugoslavia, (see Table 8).

Table 6. Distribution of intra SE European Trade by Country of Origin, in percentage terms

	ALB	B. & H.	BULG	CRO	GR	FYROM	ROM	SLOV	TURK	YU	S-E EUROPE TOTAL
1987	3	0	20.1	0	15.2	0	26.3	0	13.4	22*	100
1988	2.6	0	19	0	14.9	0	24.4	0	14.4	24.6*	100
1989	2.7	0	16.4	0	17	0	20.7	0	16.7	26.5*	100
1990	2.5	0	15.1	0	19	0	19.1	0	16.2	28.0*	100
1991	1.8	0	18.6	0	19.2	0	15.6	0	18.1	26.7*	100
1992	2.3	0	20.3	0	17.7	0	21.6	0	19.7	18.4*	100
1993	2.5	3	14	18.4	13.2	7.1	9.5	19.3	12.9	0.0	100
1994	3.4	4	16.9	16.6	15.1	9.9	7.9	14.6	11.5	0.0	100
1995	3.4	4	16.7	15.1	13.3	8.8	9.1	14.3	12.5	2.8	100
1996	3.7	6.3	12.3	15.2	13.8	6.3	9.3	13.4	12.5	7.2	100
1997	2.6	7.6	11.3	15.2	15.8	5.9	8.9	12.7	13.5	6.7	100
1998	2.1	8	8.5	15	16.6	5.8	9.6	13.7	13.3	7.4	100
1999	2.2	7.5	12.1	13.2	16.9	6.6	8.8	13.3	13.6	5.8	100

Source: IMF, *Direction of Trade Statistics*. Own calculations

Notes: (*) The figures refer to the united former Yugoslavia

If it is taken into account that the newly emerged states of the region account for something below then 50.0 percent of the intra-regional trade and that at least 80.0 percent of this share represents trade among these countries a rather safe conclusion may be drawn that the increase in the intra-regional component of the total regional trade observed above is the outcome of trade created among the countries of the former Yugoslavia rather than of a region wide tendency towards closer regional integration.

The region of South-Eastern Europe runs increasingly negative international trade balances. The region's trade deficit increased more than three times between 1987 and 1999. The trade deficit between the region and the EU increased even faster in the same period (see Table 7). The deficit of the bilateral trade with the EU accounted for above 60.0 percent of the region's total deficit in 1999 as opposed to only 36.0 percent in 1987.

⁸ Only FYROM has a lower percentage ranging from 43.0 percent in 1993 to 66.5 percent in 1998. The case of the Republic of Yugoslavia is not comparable given the ethnic disputes this country has been involved with its neighbouring countries.

Table 7. Balance of SE European Trade by Region of Direction, in absolute and percentage terms

	EU		WORLD-R		WORLD-T		EU	WORLD-R	WORLD-T
	USD Millions	%	USD Millions	%	USD Millions	%	1987=100		
1987	-4458	36.6	-7568	62.2	-12165	100	100	100	100
1988	-4332	49.2	-4453	50.6	-8804	100	97.2	58.8	72.4
1989	-5656	37.7	-9269	61.8	-15000	100	126.9	122.5	123.3
1990	-13244	41.8	-18184	57.4	-31694	100	297.1	240.3	260.5
1991	-10144	43.9	-12841	55.5	-23130	100	227.5	169.7	190.1
1992	-12753	46.2	-14809	53.7	-27597	100	286.1	195.7	226.9
1993	-15660	50.9	-15509	50.4	-30770	100	351.3	204.9	252.9
1994	-14082	63.3	-8383	37.7	-22239	100	315.9	110.8	182.8
1995	-22038	59	-16097	43.1	-37356	100	494.3	212.7	307.1
1996	-28901	61.9	-18772	40.2	-46710	100	648.3	248	384
1997	-31215	62.4	-19511	39	-50026	100	700.2	257.8	411.2
1998	-30810	62.3	-19286	39	-49485	100	691.1	254.8	406.8
1999	-25175	60.6	-16917	40.7	-41545	100	564.7	223.5	341.5

Source: IMF, *Direction of Trade Statistics*. Own calculations

Table 8. The Intra-regional Trade of the Newly Emerged Countries in South-Eastern Europe by Area of Direction, in percentage terms

	Bosnia- Herzegovina		Croatia		FYROM		Slovenia		FR Yugoslavia		TOTAL	
	(1)	(2)	(1)	(2)	(1)	(2)	(1)	(2)	(1)	(2)	(1)	(2)
1993	84.0	16.0	98.4	1.6	42.9	57.1	89.6	10.4	-	-	84.5	15.5
1994	98.9	1.1	94.6	5.4	32.6	67.4	92.2	7.8	-	-	81.4	18.6
1995	98.6	1.4	94.1	5.9	42.4	57.6	90.5	9.5	0.0	100.0	81.7	18.3
1996	96.8	3.2	94.6	5.4	62.2	37.8	92.1	7.9	0.0	100.0	79.7	20.3
1997	95.0	5.0	93.4	6.6	62.3	37.7	90.5	9.5	0.0	100.0	80.2	19.8
1998	93.2	6.8	95.1	4.9	66.5	33.5	86.4	13.6	25.3	74.7	81.4	18.6
1999	96.2	3.8	93.7	6.3	62.6	37.4	85.1	14.9	26.8	73.2	81.7	18.3

Source: IMF, *Direction of Trade Statistics*. Own calculations

Notes: (1) Countries of former Yugoslavia

(2) Other South Eastern European Countries

Explaining the Present State of Regional Integration in South-Eastern Europe

The poor performance of South-Eastern Europe with respect to regional integration reflects the current capacities and trade policies, as well as other factors, such as political and ethnic conflicts, uneven progress in reforming and restructuring the economy, etc. One may envisage some demand side limitations on the expansion rate of intra-regional trade. South-Eastern Europe has a low level of population of about 130 million, of which, Turkey alone accounts for 63 million. Turkey is the only country that may be compared to the average population size of the main European Union countries, while the average size of the rest South-Eastern European countries is around 8 million people. Per capita incomes of the countries in the region are well below the more advanced EU countries ranging in 1998 from USD 13,400 or the 60 percent of Germany or France, in purchasing power parity (PPP) terms, for Greece, which is considered as the most economically advanced country in the region, to USD 1,490 or almost the 7 percent of Germany or France for Albania, which is considered as the most economically backward country in the region⁹. GDP growth rates are also low or even negative – see Table 1. These factors undermine substantially the demand stimulus, either existing or potential for

⁹ Figures adopted from World Bank, 1999.

international trade and to the extent that the EU provides a better market, in terms of size, exports from the region would tend to be directed to the EU market rather than to the regional one.

Trade policies may also affect the intra-regional level of trade. Trade policies vary considerably among the countries in the region. Nevertheless, they are characterised by significant levels of protection, differentiated tariff structures that result to high effective protection rates (see Michalopoulos, 1999), and differing levels of access for differing trading partners. The majority of countries, especially the poorest lacks both efficient institutions regulating and promoting trade, such as customs services, agencies providing trade finance guarantees, state organisations able to design and implement trade policies, etc., and physical infrastructure, e.g. ports, roads, railways, depots, etc. that facilitate international trade¹⁰, while their tax revenues rely heavily on customs revenues¹¹. Existing barriers to trade, along with bilateral preferences¹² ration intra-regional trade; distort its patterns and divert it towards other areas, e.g. the EU with whom individual countries in the region have rather more rationalised and free trade relationships¹³. The establishment of a regional free trade zone and the improvement of existing trade policies and trade related institutional would benefit intra-regional trade.

At present, production structures in South-Eastern European countries tend to specialise in low- to-medium technology sectors taking advantage of a relatively cheap but adequately trained labour force. This tendency is quite distinct from the tendency of the main EU countries to concentrate in high technology high skilled labour sectors (see Petrakos and Totev, 2001), and it favours the development of inter-industry international trade between the two areas. Countries of similar production specialisation tend to establish a rather intra-industry type of international trade taking advantage of similar but widely varied demand preferences, which are formed on the basis of differentiated needs, high income and low price elasticity of demand (see Kyrkilis and Nikolaidis, 1998). To a significant extent products of that type are human skill and technology intensive. Given that most of the countries in the region are far away from able to produce that type of products the expectation is that the volume of the regional intra-industry trade would be low. At the same time given the overlapping production structures and the more or less common comparative advantages of the countries there is no much scope for big volumes of inter-industry trade within the region. One would expect that as production structures and comparative advantages would differentiate the volume of regional international trade would also increase.

Success in transition is relatively low in the region (see EBRD, 2000) and that affects negatively the performance of individual countries in terms of trade integration. Slow progress in macroeconomic stabilisation and market reforms has failed to create a favourable environment for business investment

¹⁰ For a rather detailed examination of South Eastern European trade policies and institutions see Trade and Development Institute, 1999.

¹¹ In the transition countries of the region taxes on international trade accounted for about 3.0 percent of GDP for each year in 1998 and 1999. In Bosnia- Herzegovina and FYROM they account for 10.0 percent and 4.0 percent of GDP respectively (see World Bank, 2000). The establishment of alternative revenue sources should accompany any further trade liberalization.

¹² Croatia has a free trade agreement with Slovenia and FYROM; the latter with Bulgaria and Slovenia; and the Federal Republic of Yugoslavia with FYROM. The structure of these agreements is unclear and complicated involving different sets of preferences over different periods with varied product coverage and unclear long-term objectives for each of the different countries involved.

¹³ With the exception of Greece that is a full member of the euro-zone, the EU has established a variety of bilateral trade relationships with South Eastern European countries. For Bulgaria and Romania the existing 'Europe Agreements' aim at establishing a free trade area and foresee a gradual liberalisation of trade restrictions by both parties. In the case of other countries, the EU provides a wide-ranging unilateral trade preferences characterised by a more favourable treatment of industry than agriculture and the application of tariffs on exports of certain 'sensitive' products when quotas are exceeded. For a detailed analysis see European Commission, 1999.

both domestic and foreign¹⁴, which would have advanced the supply capacity, and hence it would have promoted both exports and the import absorption intensity of the countries in the region. An equally negative factor is the political and ethnic frictions between and within countries in the region that have distorted trade relationships between neighbouring countries. To the extent that the business climate would improve the volume of regional cross border trade would also increase. Besides, the development of regional infrastructure that facilitates communication and transportation, therefore it lowers transportation costs and makes market access easier, would also improve the intra-regional trade component of the South-Eastern European international trade.

Conclusion

Regional trade integration in South-Eastern Europe has been progressing at a very slow pace in the 1990's as opposed to trade relation with the EU, which is the main trading partner for the region. A number of constraints such as poor performance in the transition process, not comprehensive trade policies and institutions, low levels of development, and ethnic and political disputes may be attributed as the main causes for this failure.

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¹⁴ The ratio of gross investment to GDP in the transition countries of South Eastern Europe, with the exception of Slovenia, has fallen from 23.0 percent in 1992 to 18.3 percent in 1999. At the same time, productivity in 1998 stood at about the 90.0 percent of its level in 1989 (see World Bank, 2000).