THE BALKANS IN THE NEW EUROPEAN ECONOMIC SPACE: PROBLEMS OF ADJUSTMENT AND POLICIES OF DEVELOPMENT[1]

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Introduction

Two important events mark the last decade of the 20th century in Europe: the processes, politics and dynamics of the economic integration of the European Union (EU), and the economic and political transformation of the countries of Central and Eastern Europe (CEE). Thus, Europe is changing at a rapid pace, since the old divides, both actual and conceptual, are in a process of change and are being replaced by new ones. Even though these two processes of integration and transformation were accompanied by strong expectations of development and improvement in living conditions, under the present conditions they are facing difficulties of varying intensity, which appear to have a significant spatial dimension.

On the one hand, the EU has proceeded from the very beginning towards the integration of its internal market and towards an economic and monetary union. These policies have been aimed primarily at the strengthening of the effectiveness of the European economy and the improvement of its international position in a global economic system that is now driven by competition and the dynamics of the market. Of course, the policies of European integration do not have only economic importance, since in the long run they also contribute to peaceful co-existence and cooperation among the peoples of Europe. The cooperation and interdependence among the current fifteen, and many future members of the European union has enormous importance, if one keeps in mind that the most bloody wars of the 20th century originated on European territory.

On the other hand, the increase in competition within Europe has created serious problems of adjustment in the less competitive and less developed regions. This is often observed either in the form of an increasing gap in the levels of development, or in the form of an increase in unemployment (EC 1999). In spite of the fact that at the European level the economic integration of the EU is considered to be a hopeful evolution, it is nevertheless clear that it has created winners and losers, exposing to international competition regions, which are unequally endowed with resources and technologies, and which have differing economic structures. Generally, the peripheral regions do not have the same chances or the best performance within the framework of the integration process because of their weak economic systems, inadequate infrastructures and insufficient human resources (CEC, 1991; CEC, 1992; CEC, 1993; Camagni, 1992; Amin, et al, 1992; Peschel, 1992). For this reason integration policies have been accompanied by intervention policies (Community Support Framework and Cohesion Fund), which seek to counterbalance the negative effects of the unleashed forces of the market, and to provide support to regions with weaker and less developed economic structures.

Similar problems are found in the former socialist countries, which, however, have a more extensive and at the same time more intensive character. The inability to sustain pre-1989 economic and political structures, has forced a process of transition from central planning towards a western type market economy in these countries. This process has been supported by market oriented policies (privatization, liberalization, internationalization) and policies of institutional changes. After quite a

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few years of implementation of these policies, one can witness wide variations in the results. Although there is a general sense of progress, this progress has often been associated with market failures and policy failures that have led to the collapse of significant parts of the productive base and an often forceful re-orientation in the economic structure of regions and countries.

The main characteristics of the new economic environment in Europe are the dominance of the market, the contraction of the public and social sector of the economy, the increase in the interaction and interdependence between the East and West, as well as a mixture of social forces which determine the form, the limits and the pace of the interaction. On the one hand, there is a powerful social impetus in the East that favors western forms of political organisation, institutions and lifestyle, but at the same time there is a resistance to change because of the enormous costs of adjustment, and because of the increased social division that this entails. Despite the relative impoverishment of a significant proportion of the population, new social groups – involved in business activities, especially in the trade and services sectors – have appeared on the scene and have altered significantly the existing social stratification. Often the role of these new groups in the distribution of income and opportunities – which distribution lacks any moral basis within the logic of the former system, – provides as an additional factor that further intensifies social segregation and friction. On the other hand, there is a strong pressure in the West, especially from large business, for an eastern expansion of the market, but there is also distress in the labor market, associated with immigration and with the increasing problem of unemployment (Petrakos, 2000).

The East-West interaction is, however, an unbalanced relationship, where trade relations take the form of a rapid but asymmetric extension of a chiefly inter-industry type (Petrakos 2001a). Western Europe tends to specialize in products that are technology, knowledge and capital intensive, while Central and Eastern Europe tend to specialize in products that are raw material and labor intensive.

A growing literature recognizes now that, despite the original euphoria about a rapid transition to a western type of development, a significant number of countries have been experiencing continuous or periodic recessions, or face serious problems resulting from a protracted contraction of their productive base. In 1999, from the total number of countries in transition, only the group of countries in Central Europe had regained their 1989 level of Gross National Product (GNP). The remainder (the Balkan States, the Baltic Republics, members of the Commonwealth of Independent States), continued to have a level of GNP that significantly lower than that in 1989. Thus, at the European scale, new divisions are replacing old ones, as a serious divergence in the level and rates of development between the countries of the East and the West can now be observed.

New Economic Dynamics and New Inequalities in Europe

Table 1 illustrates and summarizes the conditions prevailing in the new European economic space by providing aggregate regional figures for a number of critical indicators. First, in terms of size, the Balkan transition countries occupy an area of 614 thousand sq. km, which is equal to 18.3% of the size of the EU and a population of 55 million people, which is equal to about 14.6% of the EU figure. For comparison, the Central European (CE) countries occupy an area that is relatively smaller (564 thousand sq. km) and a population that is relatively larger (66.5 million people). The Baltic region has a significantly smaller area (175 thousand sq. km) and an even smaller population (7.5 million people). These regional differences in land size and population size generate different population densities, the rule being that relatively central regions at the European scale have higher densities than relatively peripheral ones.

Second, in terms of economic size or capacity, we observe in column (4) that the Balkan transition countries had in 1999 a GDP figure that was equal to about 1,1% of the GDP of the EU and a GDP density (a measure of productive use of resources) (in column 6) equal to about 3.6% of the EU figure. For comparison, the Central European figures are 3.5% and 12.6% respectively.

Third, in terms of performance, we observe in column (5) that in the 1989-99 period the EU has increased its GDP by about 22%, which amounts to an average annual growth rate of about 2%. On the other hand, the transition countries present a highly differentiated picture. Although in 1999 as a group they were still behind the 1989 level of GDP, the CE countries have recorded a much better performance, managing to increase GDP by 12% in the 1989-99 period. In contrast, the Balkan transition and the Baltic countries are still behind, with GDP levels equal to 77% and 65% of the 1989 figures respectively.

Fourth, in terms of welfare (measured by 1999 GNP per capita in column (8)), we observe that the transition countries in Europe are far behind the EU level, which is a little higher than 22 thousand USD. CE countries are in a relatively better position with GNP per capita equal to 4458 USD or 20% of the EU figure. The Balkan and the Baltic countries have been less fortunate, recording GNP figures equal to 1658 USD and 2715 USD or 7% and 12% of the EU level respectively. Even if these figures are adjusted for purchasing power differences, the fact remains that a serious developmental gap exists in Europe with a West-East and North-South character[2].

Finally, in terms of economic structure, we see that in 1999 the Balkan region maintains a very high dependence on agriculture and therefore a productive structure that is reminiscent of earlier stages of development in Europe. As column (9) shows, the EU and CE have similar low shares of agriculture in GDP (3% and 4 % respectively), while the Balkan transition countries still maintain 19% of GDP in agriculture. Earlier reports (Petrakos and Totev 2000) indicate that in some Balkan countries the share of agriculture in GDP has increased during the post 1989 period.

Thus, the experience of this decade has shown that not all the transition countries have suffered the same fate, nor do they face the same difficulties today. The transition process has created (or uncovered) inequalities previously unknown in the European context, inequalities which exceed greatly those existing between the North and the South within the EU. The most negative characteristic of the new economic space is the increasing gap between the EU and the Balkan countries, and the lack of any immediate prospect for its reversal (Petrakos and Totev 2001, Petrakos et al, 2000).

Table 1. Basic indicators of size, economic activity and welfare in Europe

Countries	Area	Population, 1999		GDP, 1999			GNP per capita (USD), 1999		Share of agriculture in
	th.km^2	million	density	billion USD	89=100	density	USD	EU15=100	GDP, 1999
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
EU-15	3,350	375.7	112	8,501.9	122	4,167	22,372	100	3
Transition countries	1,353	129.1	95	412.1	95	343	3,162	14	9
Central Europe	564	66.5	118	296.4	112	526	4,458	20	4
Baltic region	175	7.5	43	22.1	65	133	2,715	12	7
Balkan region	614	55.1	90	93.5	77	152	1,658	7	19
Total Europe	5,068	516.4	102	9,325.5	116	3,208	17,886	80	4

Sources: World Bank (2001), UNECE (2001)

[2] Note that the Mediterranean countries comprising the 'South' in the EU (Greece, Portugal and Spain) had in 1999 a GNP per capita figure equal to about 60% of the EU average. This implies that the economic divides characterizing the new Europe may be more serious than the existing in the pre-1989 period.

Table 1 and available data in other indicators (Petrakos 2001a) reveal that in the CEE countries there is a north-south (or a core-periphery) divide, which parallels the one found in the EU. In the EU the Northern and Western European countries are more advanced economically than the Southern European countries. In the CEE, the Visegard countries are more advanced than the Balkan and Baltic countries. It is undoubtedly true that within the context of the profound changes that are shaping the new Europe, the least progress in all sectors is found in the Balkans. On the basis of existing information, the new economic divide of Europe is taking a northwest-southeast shape, with the southwest, the central and the northeast regions occupying intermediate positions. On the basis of one recent estimate (Petrakos, 2000), the Balkan countries will take twice as long as the countries of Central Europe to approach the EU level of the per capita GNP.

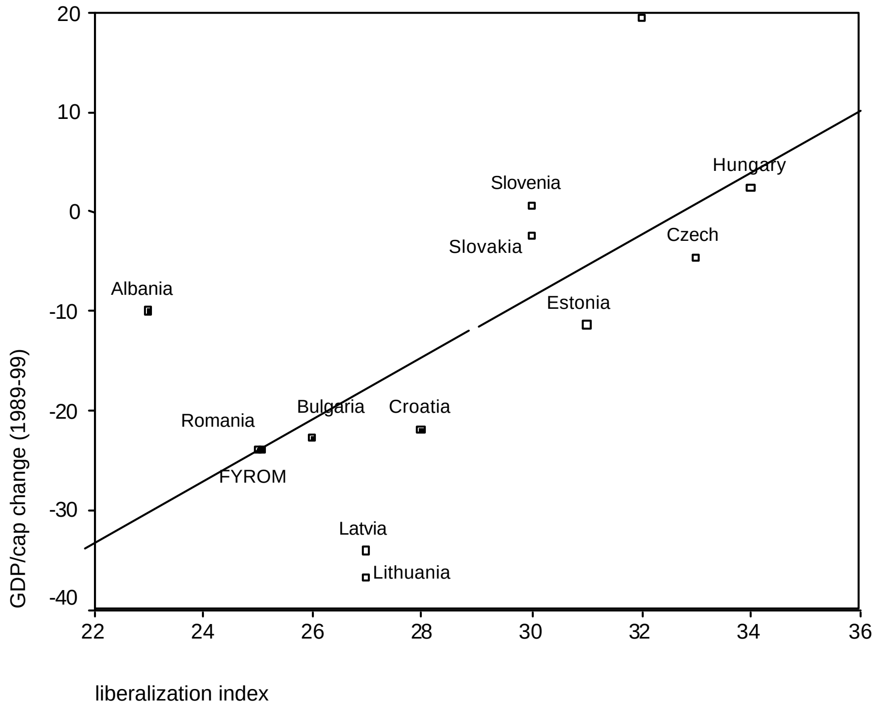
The Determinants of 'Southeastern Question' in Europe

The divergent course of the Balkans, and other nations that emerged out of the former Soviet Union, has been a subject of intense interest within the international scientific community, as attested to by the extensive bibliography. Early interpretations linked the weak recovery of transitional economies with a 'reluctance' or 'inability' of policy makers to exercise serious restructuring policies (De Melo, et al, 1996; World Bank, 1996). Thus, countries that applied the appropriate policies in a timely manner and persisted in their implementation were those that were the first to recover economically after 1993. In contrast to this, in countries that procrastinated, were inconsistent and were without the political will – because of the political cost – the results were disappointing. This argument can be depicted in Diagram 1, which shows a positive relationship between an indicator related to the implementation of 'appropriate' transition policies (Piazolo, 2000) and the variation in GNP during the period 1989-1999. Thus, the first conclusion is that countries that were the first to implement appropriate policies were those that were able to cope more efficiently with the effects of the economic and political transformation, and to recover more quickly from the crisis.

The literature refers to appropriate policies as those, which reduce the presence (and deficits) of the public sector in the economy, stabilize the economy, free the market from various sorts of regulation, and which drastically reduce all restrictions on international trade (especially imports) relative to the country. The reduction of public debt and the stabilisation of the economy entail, on the one hand, a broad programme of privatization of public enterprises and, on the other, severely contractive public and monetary policies.

Without doubt these policies create severe cyclical and structural unemployment, as well as inevitable social tensions. Thus, the ability of a country to promote these policies depends in large part on the general economic conditions that prevail in that country, as well as on the alternative opportunities for employment, which are created by the opening up of the market.

Diagram 1. GDP/cap change (1989-99) and liberalization index



Sources: Petrakos (2000), Piazolo (2000)

Generally speaking, and without underestimating at all the importance of the proper choice of transition policies, it begins to be clear that these policies do not constitute autonomous entities that are designed and implemented independent of other economic and political conditions. On the contrary, the application and success of these policies, especially the painful ones, depends to a large degree on social costs. In countries where these costs are balanced or offset by the simultaneous operation of other positive factors or dynamics, the implementation of policies is less painful, more socially acceptable and has a greater probability of success.

In that spirit, recent studies (Kreuger and Ciolko, 1998; Altvater, 1998) have emphasized the importance of the 'initial conditions' in a series of countries, which have had a negative experience during the first decade of transition. Because of the nature of the previous type of government, but also because of the historical circumstances prevailing after the war, many of these countries had no experience with capitalist market relations. Quite a few Balkan countries and/or countries of the Commonwealth of Independent States (CIS) evolved, thus, from a pre-capitalist, pre-war framework into a socialist system of central planning that excluded the logic of the market, with the result that they awoke suddenly in a global environment of developed capitalist organisations and institutions in relation to which they had had practically no historical knowledge or experience. By contrast quite a few countries of Central Europe, such as the Czech Republic and Hungary, had had considerable historical experience (with capitalism), since they had already developed significant industrial structures before the war.

Significant differences in the initial conditions of transition to a market economy were also to be found in relation to a series of other parameters, such as the level of development, the degree of dependence of the economy on economic relations with other socialist countries, as well as the overall organization of the economy. Generally, less developed countries are unable to assimilate immediately and implement free market institutions, especially when these are 'imported' from developed economies and are not compatible with local conditions. The modernization of such economies is more violent and destructive, given that it does not merely seek to correct existing structural problems, but is rather driven by an abrupt integration into the global economy.

In one sense, the modernization of a productive system is nothing more than a process of 'creative destruction'. Some products, methods of organization and systems of production, which are not viable, are destroyed by the dynamic appearance of new products, methods or systems of production. In this process there are two critical parameters, which make it more or less painful. The first parameter is the duration and the intensity of the process, and the second is the endogenous versus exogenous origin of the forces of modernization. In summary, we would maintain that the modernization of an economy is a continuous process, which can provide the greatest possible benefit and be accompanied by the least cost, when it occurs gradually and is driven mainly by domestic forces. On the contrary, when it is imported, and occurs abruptly, the short term negative impact (in the form of a violent destruction of antiquated productive forces) can offset most positive effects. Generally, we can say that less developed countries, and those with closed economies, have suffered the greatest shock from globalization and modernization during the transition period. The extreme example here is Albania, whose productive base was devastated by the opening of its market to global competition.

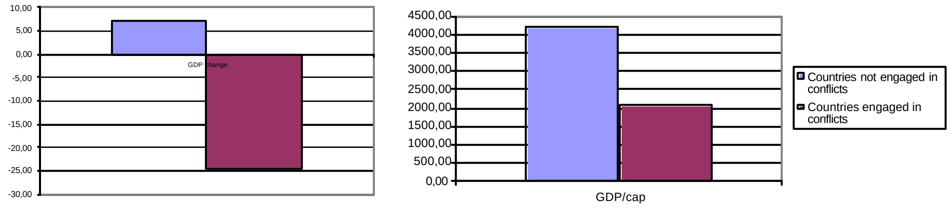
In addition, countries whose economies were more closely dependent upon other socialist member countries of COMECON, and particularly the Soviet Union, were more severely and more negatively influenced by the total collapse of the Soviet Bloc than those that had already begun to develop relations with the West in the 1980's. In the first category are found those countries which emerged from the former Soviet Union (Baltic and CIS countries), as well as Bulgaria, and in the second category are found countries from Central Europe (mainly Hungary and Poland) and from the former Yugoslavia its Northern democracies.

Beyond the level of development, and the problem of a trading system that is dependent on devastated markets, a significant role in the success of the transitional economies has been played by the original organization of production in those countries, as well as by the more general organization of their international economic relations. Panteladis and Petrakos (2000) demonstrate that production and employment in the Balkan economies as a whole is characterized by a considerable dependence on the primary sector, a fact that is attested to by the retarded level of development when compared to other European countries. This greatly inhibits adaptation to contemporary international circumstances. In addition, Petrakos (2001a), Petrakos and Totev (2001), Jackson and Petrakos (2001) have demonstrated that both the (almost non-existent) trade relations among the Balkan countries in transition, as well as the unbalanced and Inter-industry type of relations with the EU are factors, which influence the development prospects of the region.

Another important cause – in some cases the most important – for the economic atrophy and shrinking is, on the one hand, the devastating conflicts of every kind that have occurred since 1989, both in Europe and the former Soviet Union and, on the other hand, the fragmentation of the economic space into what, by international standards, are small states that in many cases have problematic relations with their neighbors (Petrakos, 2001b).

The conflicts and wars which have broken out in the region of the Caucasus and the Balkans based on separatist movements, minority problems or border disputes, have influenced, either directly or indirectly, the countries involved in two ways. First, in the most direct manner, these conflicts have destroyed the production systems and the human resources, as well as the technical and social infrastructure, of the countries involved. This fact, as the cases of Bosnia and Kosovo demonstrate, leads to a complete reversal of development, at all levels, which will take a long time to overcome. Second, indirectly, these conflicts influence neighboring countries even when they are not involved directly, creating uncertainty and negative expectations regarding the prospects for the region as a whole. This serves to prohibit or postpone investment plans, to reduce trade and international tourism, to influence negatively the flows of capital and the basic macroeconomic factors that depend upon them, such as interest rates.

Diagram 2. GDP change (1989-99) and GDP per capita (1999) of countries engaged / not engaged in regional conflicts



Source: Own estimations from UNECE (2001) and World Bank (2001)

Diagram 2 presents this argument in a vivid manner. The transition countries involved in regional conflicts had, during the period 1989-99, a loss in GNP in the order of -25%, while the countries not involved in such conflicts had managed to record a 7% growth in the 1989-99 period. Thus, pre-existing differences in the levels of development increased, with the result that the former group of countries was left with half the level of per capita GNP of the latter.

On the other hand, the fragmentation of the economic space, which has resulted from the ethnic and political fragmentation, has created a series of problems for these new (often small) countries. These problems derive from the fact that, for the production bases of these countries to be effective, they must be able to benefit from internal and external economies of scale, which are not always present in small markets (Petrakos 2001b).

For this reason, small countries must be in a position to function in geographically larger markets, which, on the one hand exceed national boundaries and, on the other, have a relative proximity which limits transportation costs. It is clear that the possibilities for an effective functioning of production units and economies is limited, on the one hand, by the fragmentation of space in the Balkans resulting from the creation of a series of small independent states, and, on the other, by the conflicts and antagonisms among them, since economic relations among these neighboring states are not developing or have actually shrunk.

Finally, there are three additional factors, which in different ways influence the potential for development, as well as the effectiveness of internal policies in the transitional economies. The first factor is related to the level of technical and social infrastructure in each country, the second is the distribution of European programs and funds among the different countries, both in the past and future, and the third refers to the role of geography in facilitating or impeding the operation and forces of the markets, as well as the effectiveness of various policies.

Although by itself infrastructure does not guarantee development, it is undoubtedly a necessary factor and an important prerequisite. Especially today, when the qualitative nature of the infrastructure is increasingly important for development, the existing differences in the levels among the transition countries cannot but have influenced – to some degree at least – their fate since 1989. Skayiannis (2001) compares the levels of technical and social infrastructure in the Balkans and Central Europe. His analysis concludes that there are important differences that advantage the latter group, a fact that in all likelihood contributes (along with other factors) to the more successful orientation of their economies to the new order.

Finally, to conclude this section, we must say that the policies of the EU vis-à-vis the Balkan transition countries could play a definitive role in their progress. The results of EU policies up to now (Kotios 2001) show a degree of conservatism in three different ways. First, the emphasis of these policies has been on the institutional rather than on the economic level. Without questioning the importance of harmonizing national and European institutions at every level (legislative, administrative, democratic, etc.), it is clear that neither the devastated productive bases of a whole series of countries, nor the spectrum of hunger, have been much attended to by Brussels. Second, the limited funds in the PHARE program were distributed to the various countries in proportion to their populations, when it was obvious from the start that these countries were facing different orders of problems. Third, and perhaps more important, the appropriation of funds in the Third Community Support Framework for the countries of the first expansion will probably increase the inequalities among transitional economies, since the economies that will benefit the most are those that are already most developed. The fact that the entire Balkan region should have risked a war which destroyed the infrastructures of one whole country before the EU would discuss a plan for reconstruction of the Balkans, suggests an inadequate understanding of both the dynamics of the region, as well as of the type of policies that should be formulated for it, an inadequacy that one cannot be certain has been totally overcome.

The Role of Macro-Geography

It is well understood, and illustrated by recent literature on the subject, that special geographic features play a significant role in the economic progress of any given country, influencing both the prospects for development and the effectiveness of any set of policies (Sachs 1997, Gallup et al 1999, Petrakos 2000). Even though the role of geography has been ignored systematically in most of the studies on the behavior of transition economies, it is, nevertheless, quite important, since it immediately determines the cost of transportation and communication, and thus, the ease and potential access of goods, people and services to large markets.

By studying the geographic characteristics of the transitional countries, one can observe that some of them enjoy more favourable conditions than others. On the one hand, the countries of Central Europe (Poland, the Czech Republic, Hungary, Slovakia, Slovenia) border directly on the developed countries of Western Europe, ensuring immediate and swift access to their markets. On the other hand, the Balkan countries do not share these common borders, and are found at a considerable distance from the economic centres of Western Europe. Thus, the former enjoy a strategic location which, in the long run, will lead to a more intense interaction and integration with the western centres of development, and which will contribute directly to their own development.

This occurs in many ways. First of all, proximity allows easier access of exports from the transition countries to the developed economies of Western Europe, since they are not burdened by excessive transportation costs. Modern trade theory tells us that neighbouring countries are as a rule the best customers and greatest buyers of the products of a given country. This occurs either because of the low cost of transportation, or because of historically formed consumer patterns, which are common or similar in nature, or (sometimes) because of cultural or other relations between two countries. It makes a great difference, therefore, whether or not neighboring countries (and major customers for one's products) are wealthy, developed and dynamic. Historical chance willed that some Balkan countries would have only other Balkan countries as their neighbors, e.g. Bulgaria, Albania, FYROM, Bosnia and Serbia, while others, e.g. Romania, would neighbor on Central and Eastern European countries. Given that for a variety of reasons trade among Balkan countries is especially limited, it should be clear that (to a large degree necessary) trade with the West is burdened with significant transportation costs. If we keep in mind that the greater part of the Balkans is more than 1000 km away from the economic centre of the EU, and that the transportation infrastructure is limited, it becomes clear that distance impedes trade and thus does not facilitate development strategies, which depend upon increased exports from these countries. On the other hand, such problems are to a large extent non-existent in the countries of Central Europe, since their neighbours (and major trade partners) are the wealthy countries of the West.

Another equally important effect of proximity has to do with factor flows. It is undoubtedly the case that neighboring and proximity to the developed centres of the West facilitate the flow of information, the spread of knowledge and technology, the movement and interaction of people, the adoption of successful economic and social organizational prototypes, and understanding of the operation of important institutions and mechanisms, all of which are 'transferred' into the transition economies from the West. The smaller the distance from the development centres of the EU and the fewer the geographic, the morphological, border or other types of obstacles that intervene, the more beneficial and spatially uniform will be the distribution of the results of Western influence (Petrakos, 2000). On the contrary, great distances, the difficulties of topographic relief, repeated frontier crossings, and a multitude of languages, formalities and bureaucracies, all create obstacles which result in a selective and extenuated diffusion of information, knowledge and technical know-how into the economies of the transition countries. At this level too it is obvious that the countries of Central Europe have clear advantages over the Balkans.

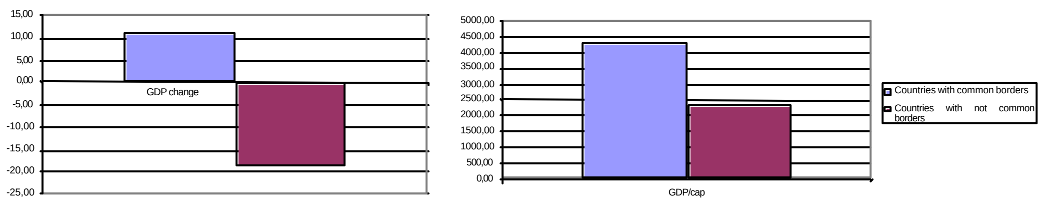
Finally, geography also undoubtedly influences the distribution of foreign investments that are directed to transitional economies and that originate primarily in the EU and USA. Rizopoulos (2001) shows that the bulk of investments, either in relative or per capita terms, is directed to the countries of Central Europe and particularly the Czech Republic and Hungary. Undoubtedly investments are being directed towards stable, institutionally modern and developed markets that can guarantee greater viability and return on invested capital.

Here too, however, the role of geography remains crucial since centrality in European economic space, the proximity and neighboring to big Western markets greatly influences the locational choices of capital. In particular investments that exploit differences in labour costs and are directed towards the larger European market where they can offer cheaper products owing to lower transportation costs, profit significantly by establishing themselves in the countries of Central Europe. These investment choices are reinforced in the case of capital originating in Germany and Austria which themselves neighbour on Central Europe. Thus, we can say that the CE geographic advantages of centrality and proximity to the West account for the attraction of capital and technical know-how. By contrast, the Balkan countries, apart from their fragmentation and conflicts, have to confront the negative effects of their unfavorable geography, which must be added to the already sparse presence of foreign capital.

The above tends to support the argument that geography works positively and cumulatively for the countries that are favoured by it and negatively for those that are not. To the degree that this is true, the transition countries that are favoured by geography should be more developed and better oriented to the new economic conditions in the post-1989 period. The ensuing diagrams illustrate this argument.

Diagram 3 shows the rate of change in GNP during the transition period 1989-1999 and per capita GNP in 1999 for two groups of countries: those which have a common border with the unified space of the EU market and those which do not. We can observe that the first group of countries registers a positive change in GNP in the period after 1989, while the second shows a significant negative change. In addition, we can observe that the first group of countries exhibits more than twice the level of development in 1999 (measured by per capita GNP) as that of the second group. Thus, this diagram confirms our basic argument that the countries that are found nearer the unified economic space of the EU have adjusted more successfully to the post-1989 period.

Diagram 3. GDP change (1989-99) and GDP per capita (1999) of countries sharing / not sharing common borders with the EU

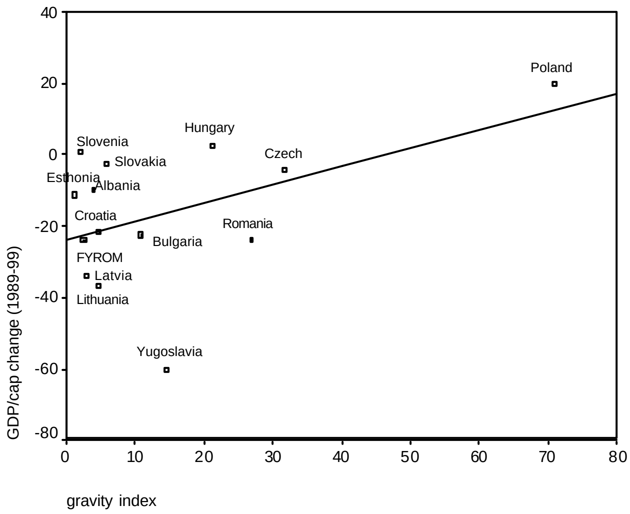


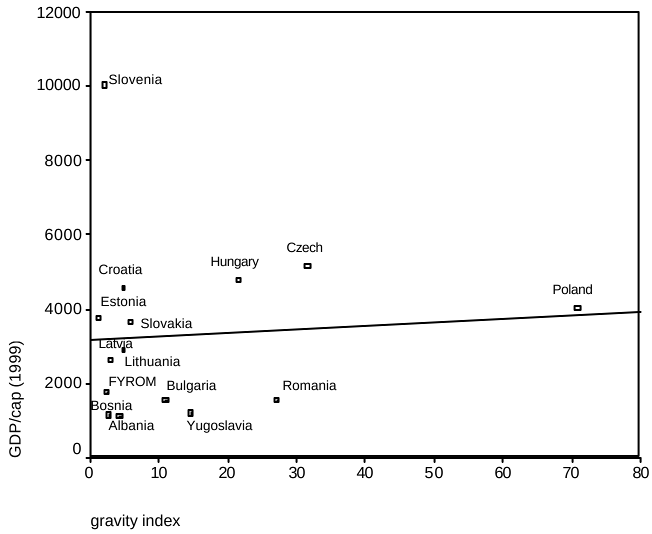
Source: Own estimations from UNECE (2001) and World Bank (2001)

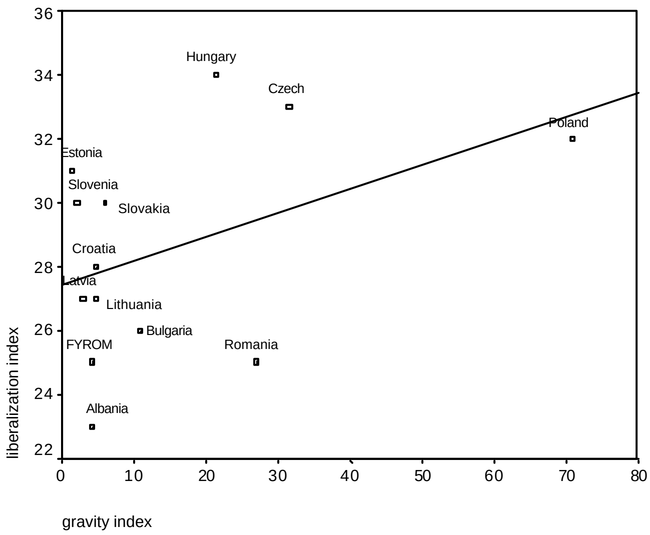
Similar confirmation may be found in Diagram 4, which presents the linear correlation between rate of change in GNP, per capita GNP and the liberalisation index (on the one hand), and the spatial gravity index (on the other). The latter has been estimated for each country i at the pan-European level based upon the following formula: $G_i = \Sigma\ (P_j / d_{ij}k) + P_i$ where Pi, Pj represents the populations of the countries, dij the time distance between the capitals of each pair of countries, and k, a factor which distinguishes the distances between countries of the East and the West from their physical distance, keeping in mind other – non-geographic – barriers which prevail. This index constitutes essentially a quantitative measure of the centrality of each country's geographic position and its degree of accessibility to other countries (or markets) in Europe. Thus, high index numbers for a country correlate, in the first place, with greater accessibility to European markets – hence a favorable geographic location – and, secondly, with a significant size of one's own market (Petrakos 2000).

In Diagram 4 we observe a positive relation between the gravity index and two economic indicators. Higher index numbers correlate with favourable rates of change in GNP during the transition period as well as with a higher level of per capita GNP. This also confirms the argument that centrality within the new economic space of Europe constitutes an important advantage, one which influences the progress, the effectiveness and the level of development of an economy, independent of whether or not proper transition policies have been implemented.

Diagram 4. Correlation between (a) GDP change (1989-99) and gravity index, (b) GDP per capita (1999) and gravity index and (c) liberalization index and gravity index







In addition, Diagram 4 suggests that geography also influences the actual implementation of policies. We observe in the last section of the diagram that countries which evidence a higher centrality index in the new economic space are those, which have proceeded with greater effectiveness and decisiveness in the adoption and implementation of appropriate policies. It appears, thus, that the geographic characteristics of a country determine to a large degree the quality and the effectiveness of operative policies. The diagram is clear: the more central countries have progressed further on the road to reform, while the peripheral ones lag behind.

This ‘paradoxical’ behavior has a simple and logical explanation, which is related to the cost of implementing reforms. For countries with favorable geography, the costs of their various reform policies are either lower or less obvious, because they are balanced by other advantageous factors. These factors (imports of foreign capital, a significant increase in export activities, rapid adoption and assimilation of the new institutions by the population, etc.), either create employment opportunities, or they operate as positive examples that legitimize and reinforce the reforms. Thus, an advantageous geographical location tends to facilitate the implementation of structural and institutional reforms. The opposite holds true for the peripheral countries, which are significantly further away from the centers of Western Europe.

Our analysis here provides an additional explanation for the inability of the Balkan countries to implement reform policies effectively and persistently. Without ignoring factors deriving from the abuse of power and from corruption in general, which have also played a significant role, it is also true that reforms and structural changes, whenever and wherever they were implemented, confronted many more obstacles and difficulties than in the countries of Central Europe. The Balkan countries, which have, up to now, faced more negative and fewer positive repercussions from the new environment, are by and large in recession. Thus, it is hardly possible for them to gain support for the implementation of policies, which, in the short term at least, will be very costly for an important segment of their population.

It is therefore clear that there is a circular and cumulative causation between geographic conditions and economic progress, or geographic conditions and the effectiveness of various policies. Countries with favorable geography benefit more from the new economic environment and they have more freedom and incur lower costs when they implement the necessary reforms. Countries with unfavorable geography face more difficulties in the new economic environment and therefore experience greater costs or face greater obstacles in the implementation of painful reforms. Meanwhile, the relative success of policies in the former case, and the relative failure in the latter, increases the development gap between them, and leads to a sizeable economic gap. This, in turn influences, in an acute way, the ability to enact policies, as the entire process takes on a cumulative character.

Of course, geography is not the only or even the most important determining factor. Nor could we argue that there is some sort of geographic determinism at work here, with the result that the less favourable countries are doomed to fall behind. The success of small and relatively distant countries such as Israel and Cyprus demonstrate that such absolute determinism does not hold. What we can argue is that the geographic location of a country, and whether or not it adjoins large, developed markets, is an important factor which, in the short and medium run at least, influences significantly its development opportunities and economic progress.

Towards a New Policy Consensus for the Balkans

The above analysis has attempted to demonstrate something that should be almost self-evident to the careful observer of the evolution and dynamics of the Balkan countries. Nevertheless, both international economic organizations and a significant part of public opinion, to say nothing of the scientific community, have had some difficulty in accepting this. What is being argued here is that it is difficult to attribute the course of the Balkan countries to date exclusively on the negative role played by inadequate governments, poor choice and implementation of policies, and corruption at all levels, without, of course, questioning the importance of these factors. At the same time, it is equally difficult to argue that the greater progress of the Central European countries is solely a product of the successful implementation of appropriate policies. Beyond these policies, which have undoubtedly played some role, a great deal of importance must be given to a whole series of other factors that are either related t? the geographic coordinates of each country, or are related to developmental, organizational or historical attributes, which in the medium term determine (positively or negatively) the pace and path of these countries and the course of adaptation to the new economic environment.

In addition, beyond the role played by 'initial conditions', it is clear that we live in a period in which market forces play an especially acute role in regulating the distribution and redistribution of economic activities. It appears that new forces have been operating across Europe, resulting from both the transition process as well as from the process of European integration. These forces are operating with ever increasing intensity, through locational choices of capital and trade flows, to differentiate the prospects of the various regions. Confronting these cumulative forces, with their strong tendency to re-shape the economic map of Europe, are the national development policies of the less advanced countries on the one hand, and the policies of the EU on the other. There is, however, little likelihood that these policy sets could immediately reverse the above forces, without an efficient and multi-level co-ordination.

With the opening up of markets there arises, perhaps for the first time in a visible and pressing way, the need for policy planning on a pan-European scale, as the most viable means for countering the tendency for a whole series of regions in the East and South to be marginalized, Historically speaking, this will probably be the most critical and difficult role that the EU can play. Given that it has economic size and strength, and the appropriate institutions, it could make the elimination of underdevelopment and economic backwardness on the European continent its top priority.

Undoubtedly, there do exist important European policies supporting the less advantaged regions that have been evolving in the right direction over the past few years. However, the fact that the development gap has been increasing for a group of countries and regions – to a greater extent in the East than in the South – suggests that, for the moment at least – market forces are stronger than EU policies. Furthermore, a series of recent decisions that relate to the transitional countries should undoubtedly increase the gap for the weakest of them (Graffe and Hughes, 1998). This is due to the fact that 'Agenda 2000' and the 3rd Community Support Framework envisages funding the countries of Central Europe that will participate in the next expansion of the EU (The Czech Republic, Poland, Hungary, Slovenia, Estonia) with significant resources, something that does not hold true for the remaining transition countries, particularly the Balkans. Even though the projected funding for the countries of the first expansion is absolutely necessary – and in all likelihood insufficient – for the development of infrastructure and the reorganization of the production system (Petrakos, 2000a), it will, in fact, increase the gap for the transitional Balkan countries that will not obtain similar funding. Although the policies of Stability Pact and Stability and Association Pact are absolutely in the right direction, the sad fact is that funds are insufficient compared to the magnitude of the problem, come too slow and too late and are largely uncertain (Kotios 2000, Kotios and Petrakos 2000).

The proceeding analysis has supported the view that the EU must aim its new development policies first and foremost at the Balkans. It must keep well in mind the experience of the first decade after World War II when their own economies adopted more interventionist policies, in order to overcome problems of a similar magnitude. The postwar reconstruction of Europe required an overall plan that depended upon external aid (Marshall Plan), and required extensive interventionist policies that lasted for more than two decades. By the same analogy, the current problem of Europe is not much different. A good portion of the social, technical and productive infrastructure of the Balkans has been decimated by wars and conflicts; another part was destroyed by the collapse of the previous system. This has been hastened by the opening of markets and the exposure of an outdated production system to the inexorable forces of international competition.

Independent of the question as to how much of the responsibility should lie with war and how much with weak economic structures, the fact remains that the level of living and the general prospects of the Balkan countries constitutes a huge challenge for a civilized and developed Europe. Europe has every reason to face this challenge in a timely fashion, as it seeks a vision that would unite hundreds of millions of people and dozens of countries, in a stable and, by definition, multi-cultural future

Since the integration of markets has brought development and welfare, but also new divides and even the exclusion of some weaker groups and regions from the progress made, we must conclude that the unification of the new Europe cannot depend solely upon the functioning of the economy. Statesmanship must also play an important role, and it will serve its purpose if it contributes to the idea of a Europe without exclusions or exceptions, a Europe that offers decent prospects and a positive role for all its peoples. In this respect, the EU should make membership for Balkan countries a more visible and feasible goal by provide a 'road map' where the end of the road is not a concern of the next generation but something possible or accessible in the near future.

On the other hand, the national policies of the Balkan countries have also to improve or change in a number of critical issues. First, they have to adopt a *"Think Big"* approach to policy making. As Petrakos (2001b) shows, the Balkan region is a relatively large market that can benefit from internal and external economies of scale if it manages to overcome its fragmentation. As a result, a successful national development strategy should actively promote policies of regional cooperation and regional integration in order to improve the attractiveness of the region at the European level (Kotios 2001b).

In addition, the Balkan countries have to adopt a *"Think Again"* approach to policy making. This requires the implementation of practical measures that attempt to eliminate or reduce all sources of discrimination against ethnic or other types of minorities. On the condition that minorities should never be allowed to threaten national sovereignty, governments and people should make an effort to change regional image by making ethnic diversity an asset. In doing that, it is useful to keep in mind that EU membership is incompatible with ethnic disputes and that the EU has adopted active policies to 'mainstream' and integrate minorities. It is also useful to keep in mind what is perhaps the most important lesson of the post-WWII European history: Eliminating the borders is a much better options than shifting the borders. Strong countries, such as Germany and France, or Germany and UK that have fought in the past many bloody wars over borders, made a choice for a large, border-free and conflict-free Europe, enjoying for half a century the benefits of stability and prosperity. This is an important lesson, especially for countries and peoples claiming that their ultimate national goal is to join the EU.

Finally the Balkan countries have to adopt a *"Think Positive"* approach to policy making. Despite many weaknesses and existing threads, overall, the region has made progress in many important ways that should not be underestimated or dismissed. The eastern part of the Balkans is experiencing relatively robust growth rates for the last three years (Minassian 2001), there is a better understanding and appreciation now of the benefits of cross-border cooperation (Dimitrov et.al. 2001), as cross-border FDI (Slaveski and Nedanovski 2001) and cross-border trade (Chionis and Liargovas 2001) have increased considerably between Greece and its neighbors[3] in the more recent years. On the other hand, serious progress has been made on political grounds in Croatia and Serbia (Patten 2001), where the governments and the people seem to develop a common view that hard-core nationalism is incompatible with the very essence of the European idea and simply does not pay off. There are certainly many things that remain to be done and many things that need to change. Some are attitudes and perceptions and some are related to policy making. For the former, unfortunately it will take longer and we need to be patient and persistent. For the later, the Balkan countries can learn from the experience of the more successful Central European countries. Without overlooking the different environments or conditions, we should honestly admit that there are 'best practice' examples in a number of transition policy domains that worth a closer look. Two more recommendations seem to fit well under the '*Think Positive'* approach in policy making. Despite criticism, the EU has an active and improving development policy for the region. One way for the Balkan countries to show their appreciation is to prepare for an effective use of EU and international assistance irrespective of its size. It is important to realize that the most ambitious assistance plans will have very little real impact on the development prospects of the region if funds subsidize consumption and are not directed to priority sectors. The last – but not least in terms of importance – ingredient of a *'Think Positive'* approach in policy making in the Balkan region is for national governments to provide leadership by setting strategic goals that are compatible with each other and are able to mobilize the most progressive and forward looking social and economic forces of the region.

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[3] According to data from the National Statistical Service of Greece, the Balkan share in total Greek exports (imports) has increased from 5.3% (3.1%) in 1990 to 16.9% (4.0%) in 1999. Greek exports to (imports from) Albania have increased 23 times (5 times), Greek exports to (imports from) Bulgaria have increased 14 times (5 times) in the 1990-99 period, while Greek exports to (imports from) FYROM have increased 42 times (17 times) in the 1992-99 period.

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