

Working Paper**A COMPREHENSIVE TRADE POLICY PLAN FOR THE WESTERN
BALKANS:**

*A Bold Initiative to Bring More Stability and Prosperity to South
Eastern Europe*

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Trade flows and trade policies are a crucial aspect of economic progress in general. They play a central role in stimulating economic growth, integration, regional economic cooperation and political stability. Thus, trade liberalisation needs to be at the heart of reform and adjustment in the Western Balkans, especially given that all these countries are small economies without significant domestic markets. Here we propose a radical plan in three stages. The first stage includes asymmetric liberalisation of the EU trade policies towards the countries of the Western Balkans and the removal of trade barriers of regional export to the EU. In the second stage this will be followed by the inclusion of the Western Balkans in CEFTA, thus further liberalising intra-regional trade and trade with Central European countries. The third stage provides for free trade agreements between the region and EFTA and Turkey. This plan will lead to the region's integration in the pan-European free trade area. Increased market access will compensate for eventual customs revenue losses for the countries of the Western Balkans and facilitate the economic revival and development of South East Europe as a whole.

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Acronyms and Abbreviations

ATP	Autonomous Trade Preferences
CEFTA	Central European Free Trade Agreement
EC	European Commission
EFTA	European Free Trade Association
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GNP	Gross National Product
GSP	Generalised System of Preferences
HDI	Human Development Index
IMF	International Monetary Fund
NTM	Non-tariff Measure
SAA	Stabilisation and Association Agreement
SAP	Stabilisation and Association Process
SEE	South East Europe
SFRY	Socialist Federal Republic of Yugoslavia
WTO	World Trade Organisation

Executive Summary

One year after the cessation of hostilities in Kosovo, it is time to reassess EU policy towards South Eastern Europe, and in particular policy towards the Western Balkans – i.e. Albania, Bosnia and Herzegovina, Croatia, Macedonia and the FR Yugoslavia. The region is no longer under acute threat of conflict, but the economies of these countries have not begun to recover vigorously. This can be partly attributed to the lack of radical reforms and the continuing economic and political deterioration in Serbia, a destabilising factor for the whole region. It is also partly due to the slow progress in developing and enhanced relationship between the countries of the region and the EU, in particular in the area of trade policy.

EU trade policy towards the region is of vital importance, because expanded trade with the Union will be crucial for economic recovery. Economic recovery will in turn play a central role in stimulating regional cooperation and political stability. Thus, trade liberalisation needs to be at the heart of reform and adjustment in the Western Balkans, especially given that these countries are all small economies without significant domestic markets.

We propose a radical plan, which comprises:

- Asymmetric liberalisation of EU trade policies towards the countries of the Western Balkans;
- The removal of trade barriers in the region on trade with EU.

This would be followed by:

- The gradual inclusion of the Western Balkans in CEFTA and thus the liberalisation of intra-regional trade and trade with Central European countries;
- Free trade agreements between the region and EFTA and Turkey, thus ensuring the region's integration in the emerging pan-European free trade area.

The economic gains from increased access to EU markets will compensate for eventual customs revenue losses for the countries of the Western Balkans, and facilitate the economic revival and development of South East Europe as a whole.

The report also takes into consideration the countries in South East Europe that are currently negotiating membership of the EU – Bulgaria, Romania and Slovenia – and the impact of their accession on the

prospects for free trade in South East Europe (SEE). The trade policy relationships of the five Western Balkans countries to the EU, CEFTA, EFTA and Turkey are also considered.

This report is based on a number of papers relating to trade and trade policy in the countries of South East Europe.¹ Its proposals stem from the assumption that trade promotion and cooperation is one of the key elements of EU policy towards the Western Balkans.²

Our report is formulated on the context created by the Stability Pact for South East Europe, which cites among its objectives:

[to foster] economic cooperation in the region and between the region and the rest of Europe and the world, including free trade areas; promoting unimpeded contacts among citizens...

¹ See Selected Bibliography

² 'Commission Proposes Increased Market Access for Products from Western Balkans', IP/00/586, EC press release from 07 June 2000

Introduction

By formulating comprehensive proposals for the effective integration of the countries of the Western Balkans into European and world trade agreements, this report aims to contribute to the ongoing debate on trade liberalisation in South East Europe. Free trade will facilitate the competitive development of regional economies and thus contribute to achieving peace and sustainable economic growth in South East Europe.

Our report was developed in the context of the Stability Pact for South East Europe, which cites among its objectives: *[to foster] economic cooperation in the region and between the region and the rest of Europe and the world, including free trade areas; promoting unimpeded contacts among citizens;*

Trade flows and trade policies are crucial to economic progress, especially for the small economies of the Western Balkans, which do not have significant domestic markets. They play a central role in stimulating regional economic integration and are concomitant with regional economic cooperation and political stability. Hence, trade liberalisation needs to be at the heart of reform and adjustment in the Western Balkans. Here we propose a radical plan where, stimulated by the liberalisation of EU trade policies towards the region, barriers on trade with the Union and intra-regional trade flows are removed swiftly throughout the Western Balkans. Thus countries of the Western Balkans will gradually be included in the emerging pan-European free trade area.

The report is focused on the countries of the Western Balkans – Albania, Bosnia and Herzegovina, Croatia, Macedonia and the FR Yugoslavia. It also takes into consideration the countries from South East Europe (SEE), that are currently negotiating EU membership – Bulgaria, Romania and Slovenia because of the impact their accession might have on the prospect for free trade in SEE. The trade policy relationships of the five Western Balkans countries with the EU, CEFTA, EFTA and Turkey are examined with the perspective of formulating a feasible trade policy plan that will contribute to trade expansion, sustainable economic growth and stability in the region. Such a plan will have the positive effect of reducing the region's overall dependence on external aid.

This report is based on a number of papers related to trade and trade policy in the countries of South East Europe.³ Its proposals are based on

³ See Selected Bibliography

the assumption that trade promotion and cooperation are key elements of EU policy towards the Western Balkans.⁴

Context and Background

The decade of hostilities in the Western Balkans⁵ has taken a tremendous toll on the people of the region. It has been the single biggest obstacle to successful economic and societal reforms in South East Europe. The slow pace of transition, political instability and the effects of war, have delayed economic growth and the integration of South East Europe in regional and international trade initiatives.⁶

After the cessation of hostilities in Kosovo, the international community has attempted to lay the foundations of peace, reconstruction and development in the region. It has supported initiatives that promote regional trade integration with the EU, foster social inclusion and social change, improve institutional capacity in governance structures in SEE, and invest in regional infrastructure.⁷

One of the persistent challenges which initiatives for regional reconstruction face is the heterogeneous character of the countries in the Western Balkans. Levels of per capita income in the Western Balkans range from USD 4250 in Croatia to USD 810 in Albania, excluding FR Yugoslavia, (see Table 1). Similarly, the countries in the region vary in their Human Development Index (HDI)⁸ classification - with Croatia ranking 55th in the world and Albania ranking 100th.

⁴ 'Commission Proposes Increased Market Access for Products from Western Balkans', IP/00/586, EC press release from 07 June 2000

⁵ For the purposes of this paper the Western Balkans signify the successor states of Former Yugoslavia (excluding Slovenia) and Albania.

⁶ For an assessment of the economic consequences of the Kosovo Crisis see *The Economic Consequences of the Kosovo Crisis: An Updated Assessment*, IMF Staff Report, (May, 1999); *Economic Prospects for the Countries of South East Europe in the Aftermath Kosovo Crisis*, IMF Staff Report, (September 1999) and *Economic Survey of Europe 1999, No. 2*, UN ECOSOC (July 1999).

⁷ *The Road to Stability and Prosperity in South Eastern Europe – A Regional Strategy Paper*, The World Bank, (Washington DC: March 2000), p. 2

⁸ HDI is a composite index of three components: life expectancy at birth; educational attainment (measured by adult literacy and enrollment rates); and real capita GDP (in \$PPP).

Table 1: The Western Balkans – Basic Data

Country	1998 Population (Millions)	1998 GNP (Billions)	GNP Per capita	HDI Ranking 1997
Albania	3,4	3,1	810	100 th
Bosnia and Herzegovina				n.a.
Herzegovina	4,2	4,0	920	
Croatia	4,6	21,3	4 520	55 th
FR Yugoslavia	10,6	17,4	n.a.	n.a
Macedonia	2,0	3,5	1 290	73 rd

Source: Adapted from: The Road to Stability and Prosperity in South Eastern Europe – A Regional Strategy Paper, The World Bank, (Washington DC: March 2000)

Trade has a different level of importance for the economies of the countries in the region. It is vital for Macedonia, with a trade-to-GDP ratio of 90%, Croatia and Bosnia and Herzegovina – 60%. It is less important for Albania (35%) and FR Yugoslavia - over 40% (See Table 2). For all these countries trade is more important than for the average EU members and none of the Western Balkan countries offers a significant domestic market.⁹ The whole region would amount to a market about half the size of Greece. Regional integration alone, without a radical opening to the rest of the world, is clearly not viable.

The EU has emerged as the major trading partner of the countries in the Western Balkans. The latter's share on the EU market is negligible – 0,6% of total extra EU imports. Exports to the EU are only half the value of imports in the case of Croatia and FR Yugoslavia, only a quarter in the case of Albania and a fifth in the case of Bosnia and Herzegovina; only for Macedonia do exports to the EU approach the value of imports (see Table 2).

Intra-regional trade is relatively insignificant, on average 12 to 14% of the total. These figures however conceal some disparities – trade between Croatia and some parts of Bosnia and Herzegovina can be substantial, and Macedonia trades extensively with almost all countries in South East Europe.

The countries in the Western Balkans differ significantly in their relationship with the EU compared to Bulgaria, Romania, and Slovenia,

⁹ For example Croatia's GDP is only about twice the size of Luxembourg

which have signed association agreements with the EU and are currently in the process of membership negotiations. The countries of the Western Balkans only enjoy EU trade preferences. They are also not yet members of the World Trade Organisation (WTO) or the Central European Free Trade Area (CEFTA).

Over the last few years some countries in the Western Balkans have negotiated free trade agreements (FTA) to liberalise bilateral trade flows: Croatia has an FTA with Slovenia and Macedonia. The latter has an FTA with Croatia, Slovenia, FR Yugoslavia (applied at present only to Kosovo), Bulgaria and Turkey.

Table 2: The Western Balkans – Trade with the EU

Country	Trade/GDP ratio	Share of exports to EU	Share of imports from EU	EU trade preferences	Export share covered by “managed” trade measures of EU	Nominal average import tariff
Albania	35%	92,5%	82,5%	GSP ¹⁰	61%	15,9%
Bosnia and Herzegovina	60%	49,6%	40,5%	ATP	26-44%	7-8%
Croatia	60%	38%	39%	ATP	26-44%	12%
Macedonia	90%	44%	36%	TCA	58%	15%
FR Yugoslavia	>40%	85%	76%	ATP ¹¹	N/A	13,5%

Source: Adapted from Study on Trade Policy in South East Europe, Trade Development Institute of Ireland (September 1999)

It is often claimed that a high degree of duty free access to the EU market already exists, as around 80% of tariff lines are free.¹² But tariff ceilings and quotas (measures falling under the category of “managed trade”) still govern industrial products, like textiles, steel, chemicals, which are particularly important for these countries. All agricultural exports are subject to a number of restrictions. Table 3 provides information on the importance of all these sectors in the exports from the Western Balkans to the EU.

¹⁰ To be replaced by Autonomous Trade Preferences

¹¹ These preferences have been suspended.

¹² *Op. cit.*, EC press release (07 June 2000)

Albania has enjoys minimal concessions from the EU, mainly through the GSP, but the EU is currently engaged in developing an Autonomous Trade Preference (ATP) regime similar to the one with Bosnia and Herzegovina and Croatia. Although “managed liberalisation” accounts for less than 5% of the total number of customs lines, it covers 61% of Albanian exports and in the seven more restricted sectors, the rate of “managed” trade is almost 87%. The ATPs for Bosnia and Herzegovina consist of unilateral liberalisation tempered by a series of annexes. The annexes cover 12% (minimum) - 20% (maximum) of the number of lines but 26% (min) and 44% (max) of exports to the EC. For the seven most restricted industries, the rate of “managed trade” is up to 70%. The ATPs for Croatia are similar. The annexes cover 12% (minimum) - 20% (maximum) of the number of lines but 26% (min) and 44% (max) of exports to the EC. For the seven most restricted industries the rate of “managed trade” is up to 79%. The EU and Macedonia have signed a Trade and Co-operation Agreement with specific textile and steel agreements, a transport agreement and various provisions on wines and spirits. The basic structure of the TCA is similar to the ATPs. The annexes cover up to 1,884 items or 17% of the total number of tariff lines. These relate to up to 58% of Macedonian exports to the EC. For the seven most restricted industries the rate of “managed trade” is up to 70%.¹³

Table 3: Structure of Exports from the Western Balkans to the EU (1998) as % of Total

	<i>Bosnia and</i>			<i>FR</i>	
	<i>Albania</i>	<i>Herzegovina</i>	<i>Croatia</i>	<i>Yugoslavia</i>	<i>Macedonia</i>
Agriculture	9,9%	2,1%	3,2%	13,5%	9,4%
Textile	35,2%	33,7%	27,9%	17,5%	39,3%
Footwear	29,6%	16,3%	8,5%	4,0%	3,7%
Iron and Steel	5,6%	3,7%	0,7%	19,2%	23,5%
Wood	3,5%	16,4%	9,1%	4,2%	1,5%
Total of the above	83,8%	72,2%	49,3%	58,4%	77,4%
Other	16,2%	27,8%	50,7%	41,6%	22,6%

Source: Adapted from: The Road to Stability and Prosperity in South Eastern Europe – A Regional Strategy Paper, The World Bank, (Washington DC: March 2000)

¹³ This paragraph is based on information from *Study on Trade Policy in South East Europe*, Trade Development Institute of Ireland (London: September 1999)

The trade regimes of the countries of the Western Balkans are generally protective. Trade protection in the region is relatively high both in terms of tariffs and in non-tariff measures (NTMs). The nominal average tariff is over 10 % (with the exception of Bosnia and Herzegovina). Tariff revenues are also a non-negligible source of income for the countries in the region (see table 4 below).

Table 4: The Western Balkans: tariff revenues (as % of GDP)

Country	% of GDP from Tariff Revenue
Albania	1.6
Bosnia and Herzegovina	3
Croatia	2.8
FR Yugoslavia	3
Macedonia	2.9

Source: Own calculations based on EBRD, Transition Report, 1999

The small size of the domestic markets and the great differences between imports and exports suggest that trade policy in the Western Balkans should be geared even less than elsewhere towards the protection of domestic producers. Public finance arguments can provide the only justification for keeping border taxes in the Western Balkans. Tariffs in the countries of the region essentially act like a sales tax. The public finance argument should be openly acknowledged, but it suggests that tariffs should be uniform and *ad valorem*.

At the same time the EU seems more liberal towards the Western Balkans on products that do not represent a significant share of the region's exports to the Union, while it is more protective on major imports from the region. This implies that liberalisation should be across the board so as to avoid giving special interest groups the possibility to intervene and hinder imports of some items from the countries concerned.

It has to be acknowledged however that the European Commission has drafted a radical proposal to the European Council (June 2000) to renew the ATPs by removing the ceilings and tariff quotas, including in the agricultural sector. All industrial goods should be covered and the exceptions in agriculture might concern some meat, wine and fisheries products.

Trade Policy Plan for the Western Balkans

Objectives

Economic reforms in the Western Balkans need to be combined with regional initiatives that can create an environment for sustainable growth. In this respect perhaps the most important initiative is to integrate the Western Balkans into the larger European trading area and to remove trade barriers between the countries in the region.

An enhanced relationship between the EU and the countries of the Western Balkans is key to stability and prosperity in South East Europe. The European Union is the main trading partner of all countries in the region and has the capacity, by liberalizing trade and monitoring the implementation of institutional and legal reforms, to play a unique role in the development of the Western Balkans.

The objective of the proposed trade policy plan is to create a clear roadmap for the integration of the Western Balkans into European and global structures, especially the European Union.¹⁴ This would immediately have several important effects.

Firstly, by providing a clear prospect for European integration for the Western Balkans, a consistent framework of economic and societal reforms will be put in place that will facilitate commitment to macroeconomic stabilisation and growth oriented economic policies. Secondly, it would open a wider framework for free trade in the region by the gradual inclusion of the Western Balkans in the pan-European free trade area. This will be consistent with developments in Bulgaria and Romania and Slovenia which already participate in this area on the basis of their Europe Agreements, and their membership in the WTO and CEFTA. Thirdly, the prospect of European integration will create a positive impetus in the countries of the Western Balkans to strengthen their efforts in developing stable institutions guaranteeing democracy, the rule of law, human rights and the respect for and protection of minorities. A signal will be sent to the people of Serbia that if FR Yugoslavia democratises it will be able to quickly integrate in the emerging pan-European free trade area. Finally, the gradual opening of the economies of the Western Balkans towards Europe will create an environment for developing the competitiveness of industries in the region and contribute to reducing unemployment and social exclusion.

¹⁴ Annex 2 provides an outline of the timetable proposed for the plan.

Phase One: Trade Liberalisation between the EU and the Western Balkans

General Considerations on Fostering Stabilisation via Stabilisation and Association Agreement (SAAs)

The Plan is based on the understanding that the Stabilisation and Association Process will become the framework for the relations between the countries of the Western Balkans and the EU, including in the area of trade liberalisation.¹⁵ The EU has recently opened negotiations with Macedonia on a Stabilisation and Association Agreement (SAA). It is very likely that Croatia will commence similar negotiations with Brussels in 2000, and a feasibility study for SAA negotiations with Albania has already been carried out.

SAAs are an important step forward for providing a stable legal basis for the relations between the Union and the countries of the Western Balkans, including in the area of trade liberalisation. They also provide a clear European integration perspective to the countries of the region. The current myriad of trade arrangements and unilateral preferences between Brussels and the region will be replaced by a uniform and more stable contractual framework which will put trade liberalisation in the context of the overall economic and democratic performance of the countries in the Western Balkans, and will create an environment in which trade policy concessions will be less vulnerable to the diverging interests of pressure groups.

The opening of SAA negotiations has been made subject to a clear set of conditions (political and economic) for each country (e.g. for Bosnia and Herzegovina they involve implementation of the Dayton / Paris peace agreements).¹⁶ The following sections provide ideas how this approach can be further enhanced.

Scope of the SAA

A Stabilisation and Association Agreement should cover the subjects of political dialogue, free trade area and relevant trade related provisions, approximation of legislation, economic and financial cooperation. The SAA should also include more extensive commitments to the process of

¹⁵ *Commission Communication to the Council and European Parliament on the Stabilisation and Association process for countries of South-Eastern Europe (Bosnia and Herzegovina, Croatia, Federal Republic of Yugoslavia, former Yugoslav Republic of Macedonia and Albania)*, COM (99) 235, (Brussels: May 1999)

¹⁶ Conclusions of the EU General Affairs Council of 29 April 1997

harmonisation of legislation with the *acquis communautaire*, and the development of institutional and administrative capacity to implement it, than those in the Europe Agreements. In addition more specific commitments, such as economic and trade policy reforms and should be included.

In the area of trade policy the SAA should include a “standstill” on the introduction of protectionist measures by the countries in the Western Balkans. In addition the SAA should be based on a more radical approach to trade liberalisation than that in the Europe Agreements, given the special situation of the region. This will demonstrate the special role which the EU plays *vis-à-vis* the Western Balkans, since the EU is the most important trading partner of the region. A faster liberalisation will have a negligible impact on the EU market (0.6% of total EU imports come from this region) but can make a big difference in stimulating economic activity and trade in the Western Balkans.¹⁷ Further opening of the EU market for products from these countries can promote much needed foreign direct investment and contribute to political and economic stabilisation in the region.

Free Trade Area

The trade concessions under the SAA should be asymmetrical. The liberalisation schemes should be speedier than those under the Europe Agreements with the aim of establishing a free trade area between the Western Balkans and the EU within five years. Annex 1 provides an overview of the measures, which the EU and the Western Balkans should agree on in the areas of industrial and agriculture goods.

Industrial Goods

Given the small share of the Western Balkans in the EU market, **the EU** should:

- Eliminate tariffs on all industrial goods imports from the countries of Western Balkans upon entry into force of the agreement **without exception**;

¹⁷ Assuming a unitary response from trade to changes in prices, a 10% decline in the EU tariff facing SEE exporters would increase SEE exports by between 4% and 9%, but would increase EU imports by only 0,06%.

- Eliminate non-tariff measures on all industrial goods imports from the countries of Western Balkans upon entry into force of the agreement **without exception**.

On their part, the countries of **the Western Balkans** should:

- Eliminate all tariffs on EU industrial goods imports within a five-year period **without exception**;¹⁸
- Eliminate all non-tariff measures upon entry into force of the agreement **without exception**;
- Convert **all** specific tariffs to *ad valorem* tariffs;
- Reduce immediately to 10 % *ad valorem* **all** tariffs that are above 10%;
- Gradually align MFN tariff rates to those of the EU in the process of tariff elimination;

Agricultural Products

There is no reason why agricultural concessions under the SAA to the countries of the Western Balkans should be less favourable than those enjoyed at present by the countries negotiating EU accession. Given the negligible level of agricultural imports from SEE into the EU, an argument can be made that more favourable concessions should be provided. If such more favourable concessions are provided, they should also be extended to the acceding applicant countries, or at least to those from SEE.

We conclude that in the area of agricultural products **the EU** should:

- Incorporate in the agreement the duty free access of all agricultural exports that the Western Balkans countries will enjoy under the preferential arrangements of the EU existing prior to SAA negotiations;
- Eliminate tariffs on the ten main agricultural exports from each country upon the entry into force of the agreement, unless this has been granted under the preferential arrangements of the EU existing prior to SAA negotiations;¹⁹
- Commit to eliminating tariffs on the remaining agricultural imports from these countries not later than in two years after the entry into force of the agreement

¹⁸ A substantial front-loading concession covering at least 60%-70% of EU exports could be envisaged in this case.

¹⁹ In the case of Albania and Macedonia the 10 most important agricultural products account for around 85 per cent of total agricultural exports to the EU, for Bosnia and Croatia the shares are 74 per cent and 45 per cent respectively.

- Abolish all quantitative restrictions on imports upon entry into force of the agreement

On their part **the Western Balkans** should agree to:

- Convert **all** specific tariffs to *ad valorem* tariffs;
- Reduce immediately to 10 % *ad valorem* **all** tariffs that are above 10%;
- Gradually reduce to zero tariffs rates on agricultural imports from the EU within six years after the date of the entry into force of the agreement;
- Abolish all quantitative restrictions on EU imports upon entry into force of the agreement.

Trade Defence Instruments

Trade defence instruments are an important element of any free trade area. The countries of the Western Balkans may wish to adopt commercial defence mechanisms in line with WTO procedures and rules. However, we expect that they will not be used frequently because imports from the EU often do not compete with local production. The EU should commit to review existing anti-dumping measures and refrain from new actions.

Customs and Tax Reforms

The countries of the Western Balkans should commit to improve the functioning of their VAT regimes and in particular to ensure the effective refund of VAT on exports in order to facilitate trade and encourage export oriented FDI. Customs reform is also extremely important and it could be made subject to monitoring not only by the EU but also by the World Customs Organisation. The EU can provide technical assistance in developing customs authorities in the countries of the region. In addition it has to be noted that the weak enforcement of customs norms and procedures and inadequate administrative capacity are some of the major problems that these countries face. The main efforts should be focused on strengthening the enforcement of the legislation and developing administrative structures, which will ensure better collection of revenues from customs duties and taxes.

Revenue Losses from Customs Duties

Revenue losses from customs duties in the Western Balkans as a result of trade liberalisation should not pose an insurmountable problem for the states of the region (in 1998, for instance, customs revenues were 13% of total government revenue in Albania, and 7% in Croatia)²⁰. Such losses will probably be spread over a period of more than 5 years, as gradual liberalisation occurs. They will probably be offset by gains through better market access for local producers and improved collection of duties and taxes.

Membership in the WTO and the SAA

The conclusion of FTAs could lead to a decreased interest in membership in the WTO. The Agreements should contain an explicit commitment for the countries from the Western Balkans to join the WTO as soon as possible.²¹ Such a commitment should ensure that the countries of the Western Balkans would nevertheless accede to the WTO and abide by the multilateral trade rules. The radical trade liberalisation and reforms envisaged for the countries of the Western Balkans, contained in this proposal, will greatly facilitate their entry into the WTO.

Interim Trade Agreement

The entry into force of the SAA will require parliamentary ratification by all EU member states. To overcome the lengthy time needed to complete the necessary procedures, an Interim Trade Agreement should enforce the trade and trade-related part of the SAA, as was the case with the Europe Agreements.

Enhanced Autonomous Trade Preferences by the EU

It can be expected that the conclusion of an SAA agreement will require at least a half a year of intensive negotiations. This could result in a one-year lag between the start of SAA negotiations and the entry into force of the Interim Trade Agreement.

Therefore it should be necessary for the SAA to be preceded by enhanced Autonomous Trade Preferences (ATPs) providing for much more liberal access to EU markets than the currently existing concessions. In addition, the implementation of ATPs will ensure better

²⁰ *Government Finance Statistics Yearbook 1999, IMF* - other countries of the region not available.

²¹ Currently Albania and Croatia are close to concluding agreements to join the WTO.

market access for those countries that need more time to meet the criteria of commencing SAA negotiations. They should cover the period until the enactment of an Interim Trade Agreement. For the countries that do not meet the criteria for commencing SAA negotiations the enhanced ATPs should be just as favourable and their annual extension should be conditional on the annual progress in meeting the conditions for opening SAA negotiations. Under WTO articles, the provision of autonomous trade preferences requires a waiver. Such a waiver should be granted.

Autonomous Trade Liberalisation by the Countries of the Western Balkans

The introduction of ATPs by the EU for the Western Balkans should be matched by the latter's commitment to a "standstill" of protectionist measures and a unilateral liberalisation on the part of the countries in the Western Balkans that could include elimination of all NTBs and reduction of tariff peaks above 10 % *ad valorem* to a 10% maximum tariff (all specific tariffs should be converted into *ad valorem* tariffs). These unilateral liberalisation measures should then be made contractual and incorporated in the SAA.

Special case

The FR Yugoslavia is a special case in the Western Balkans. The proposed plan is open for the participation of FR Yugoslavia if certain conditions related to democratisation are met.

Phase Two: CEFTA Membership for the Countries of the Western Balkans

The next phase after the conclusion of the Stabilisation and Association Agreements between the EU and the countries of the Western Balkans, and the entry into force of the Interim Agreement, is immediate commencement of negotiations to join CEFTA.

A free trade area between the countries of the region, or even a customs union, coupled with unchanged protection *vis-à-vis* the rest of the world is not economically viable.²² Opening the economies of these countries towards the wider free trade area of Europe will have a beneficial effect on sustainable economic growth, if it is paralleled by institutional reforms. It will also help avoid vestiges from the past. The idea of creating a

²² *Study on Trade Policy in South East Europe*, Trade Development Institute of Ireland (London: September 1999), pp. 15-16

regional free trade area in the Western Balkans would be extremely difficult to implement at present. A key to solving this problem is membership of CEFTA.

Two Obstacles – Two Solutions

At present there are two obstacles to CEFTA membership for the Western Balkans that must be overcome. These are the two preconditions to join CEFTA – candidates should be members of the WTO and have a Europe Agreement in place. The proposed plan envisages that agreement should be reached in CEFTA that these preconditions should be amended to allow the countries of Western Balkans to join as soon as possible.

Firstly, the WTO membership requirement should be modified to requiring a commitment to join the WTO as soon as possible and a corresponding provision should be made in the CEFTA Agreement. It should be noted that the launch of the millennium round in the WTO could delay the accession of these countries to the WTO. Secondly, the SAA should be considered as equal with the Europe Agreement for the purposes of joining CEFTA and the entry of the Interim Agreement under the SAA should be sufficient to allow the opening of negotiations on CEFTA membership.

Trade concessions with CEFTA countries²³ should be symmetrical. The Agreement could envisage two-year periods for full liberalisation of industrial goods trade and the creation of the free trade area. Substantial agricultural concessions should also be agreed.

Phase Three: Free Trade Area Between the Western Balkans, EFTA and Turkey

The next phase of the plan envisages concluding a free trade agreement with EFTA states (Iceland, Liechtenstein, Norway and Switzerland) and a free trade agreement with Turkey during the year after the signing of the CEFTA agreement. Although legally there is no obstacle for the countries of the Western Balkans to undertake parallel negotiations with EFTA, Turkey and CEFTA, this does not appear to be practical.

²³ Currently the CEFTA members are - Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia.

EFTA

The Agreement with EFTA states should provide for asymmetrical trade concessions. It could include elimination of all tariff and non-tariff measures on industrial goods imports from the countries concerned upon entry into force of the agreement. The countries in the Western Balkans could envisage full liberalisation of industrial goods imports from EFTA states in a timeframe that will coincide with the timetable applied to EU imports. Thus a free trade area with EFTA states should be created in three years. EFTA should aim at providing agricultural concessions as favourable as those granted by the EU. Macedonia has already concluded an FTA with EFTA.

It should be noted that some countries from the region may decide to conclude FTA with EFTA before a Stabilisation and Association Agreement has been signed with the EU. It can be expected that EFTA would agree to such an approach, provided that the FTA includes a clause, which would give EFTA, if need be, the same access to Western Balkans' markets as that of the EU, which the latter will receive through the SAA.

FTA with Turkey

The FTA with Turkey could provide for symmetrical trade concessions. It could envisage a two-year period for full liberalization of trade with industrial goods and the creation of the free trade area. Macedonia has already concluded a FTA with Turkey.

Rules of Origin

The Pan European Diagonal Cumulating of rules of origin should be extended to cover the Western Balkans. Thus the countries of the Western Balkans will be fully integrated in the network of pan European free trade area and will be able to reap all the benefits arising from an increased new level of integration, including higher volumes of Foreign Direct Investment (FDI). As noted earlier, there should be serious efforts to reform the customs, which should include capacity building of customs officials. In addition the computerisation of the central customs authorities and the border customs offices will be crucial to implementing the Pan European Diagonal Cumulating of rules of origin.

EU Enlargement to South East Europe and the Plan

At present three countries from SEE have applied for EU membership and are in the process of negotiating their accession to the Union. Slovenia has declared 1st January 2003 as its internal target date for accession, while Bulgaria and Romania - 1st January 2007. Slovenia has an FTA with Croatia and Macedonia. Bulgaria has a FTA with Macedonia. Romania has a FTA with Moldova. Upon accession to the EU, Slovenia, Bulgaria and Romania will have to renounce such agreements.

Slovenia has requested a transitional period during its EU accession negotiations in respect to its FTAs with Croatia and Macedonia in order to keep its preferential access to these markets after accession. Otherwise, after its membership, Slovenia will again have to face tariffs in these countries for its industrial goods exports. Similarly, Bulgaria has asked for a transition period with respect to its FTA with Macedonia. Initially Romania requested a transition period in respect to its FTA with Moldova but later withdrew its request, thus agreeing to renounce it upon accession to the EU.

In the accession negotiations the EU should favourably consider such requests, unless the EU is able to address the concerns of the accession candidates through the Stabilisation and Association Agreements with the Western Balkans. If the proposals in this report are adopted, and the proposed timing followed, the problem *vis-à-vis* Bulgaria should disappear, but will remain as far as Slovenia is concerned. Irrespective of the decisions related to the transition periods, the EU could consider extending further agricultural concessions to these three acceding countries by gradual elimination of agricultural tariffs by the date of the first EU enlargement to the East. This would reflect the EU's willingness to consistently contribute to the stability and the development of South East Europe and not create new differences in agricultural treatment compared to the Western Balkans' countries. This will make the accession of candidate countries from the region and their entry into the Single Market smoother. Thus the EU should adopt the simple principle of not discriminating among any of the applicant or SEE countries in terms of border measures against imports.

It is likely that Croatia will soon be in a position to apply to join the European Union, provided it consistently and successfully implements its political, economic and legal reforms.

The Schengen *acquis* and the Proposed Plan

The EU has not yet fixed its negotiating position for the countries currently recognised as accession candidates on the questions of freedom of movement of workers and adoption of the Schengen *acquis*. These issues are of course closely related to trade arrangements and may be considered as trade barriers hindering contacts and interaction among the business community. At present, there is some amount of legal economic migration between the applicant countries from Central and East Europe and the Western Balkans on the one hand, and the European Union on the other. Some EU member states are alarmed by the substantial immigration that they imagine will occur after an early liberalisation of freedom of movement between the Union and the present applicant countries. However, most serious projections indicate that the change in migration rates will be small, and over the long term may not necessarily even increase from the present situation, when a more liberal regime is introduced.²⁴

For the Western Balkan countries it can be anticipated that the present financial incentives for migration to the EU will be dampened, especially if the trade recommendations in this paper are accepted, by a general improvement in the economic environment in South East Europe. There is therefore every incentive to find policy solutions, which will smooth rather than suppress migration. Long transitional periods for the free movement of workers between new members and the rest of the EU are not an appropriate solution. The legal regime for migration needs to be sufficiently liberal to discourage trafficking in human beings.

There is little need for a visa regime between the EU and most of South East Europe. Visas are not very effective in the fight against organised crime; what really makes a difference is concrete aid to the systems of law enforcement. The European Commission is already in the process of persuading member states to lift the current visa restrictions on Bulgaria and Romania.²⁵ Slovenia and Croatia already enjoy visa-free access to the EU. This policy should become consistent for the rest of the Western Balkans; this may require aid from the EU to ensure adequate quality in the process of producing personal identification documents. The fight against organised crime is best carried out by law enforcement agencies, not by EU consular officials.

²⁴ See, for instance, *The Impact of Eastern Enlargement on Employment and Labour Markets in the EU Member States - Final Report* published by the European Commission Directorate General for Employment and Social Affairs, 22 May 2000, esp. pp. 135-137.

²⁵ *Commission Proposal for Council Regulation determining the list of 3rd countries whose nationals must be in possession of visas when crossing the external borders and those whose nationals are exempt from that requirement* (Brussels: January 2000)

Annexes

Annex 1: Summary Table: Proposed Trade Liberalization with the EU under Stabilisation and Association Agreements (SAA)

Industrial Goods		Agricultural Goods	
European Union	Western Balkans	European Union	Western Balkans
<ul style="list-style-type: none"> • Tariffs: Abolish all tariffs on imports from the Western Balkans upon entry into force of the Interim Agreement of the SAA. • Non-tariff Measures: Abolish all NTM on imports from the Western Balkans upon entry into force of the Interim Agreement of the SAA. 	<ul style="list-style-type: none"> • Tariffs: Abolish all tariffs on imports from the EU over a 5-year period after entry into force of the Interim Agreement of the SAA. • Non-tariff Measures: Abolish all NTM on imports from the EU upon entry into force of the Interim Agreement of the SAA • Tariff reforms: <ul style="list-style-type: none"> - Convert all specific tariffs to <i>ad valorem</i> tariffs upon entry into force of the Interim Agreement of the SAA - Reduce tariff peaks to 10% upon entry into force of the Interim Agreement of the SAA 	<ul style="list-style-type: none"> • Point of Principle: At least equal treatment with the EU candidate countries. • Tariffs: <ul style="list-style-type: none"> - Incorporate in the SAA duty free access of all agricultural exports that the Western Balkans countries will enjoy under the preferential arrangements of the EU existing prior to SAA negotiations - Eliminate tariffs on the ten main agricultural exports from each country upon the entry into force of the interim agreement - Eliminate tariffs on remaining goods in two years after the entry of the interim agreement • Non-tariff Measures: Abolish all quantitative restrictions on imports upon entry into force of the Interim Agreement of the SAA 	<ul style="list-style-type: none"> • Tariffs: Gradually reduce to zero tariffs on EU import not later than 6 years after the date of the entry of the interim agreement. • Tariff reforms: <ul style="list-style-type: none"> - Convert all specific tariff rates to <i>ad valorem</i> upon entry into force of the Interim Agreement of the SAA. - Reduce tariff peaks to 10% upon entry into force of the Interim Agreement of the SAA. • Non-tariff Measures: Abolish all quantitative restrictions on EU imports upon entry into force of the Interim Agreement of the SAA

Annex 2 Timeline of the Trade Policy Plan for the Western Balkans

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Albania									
EU					Duty free access of Albanian industrial goods to EU				
								Duty free access of EU industrial goods to Albania	
CEFTA						Full liberalisation of industrial goods			
EFTA					Duty free access of Albanian industrial goods to EFTA				
					Duty free access of EFTA industrial goods to Albania				
Turkey							Full liberalisation of industrial goods		
Bosnia and Herzegovina									
EU					Duty free access of Bosnian industrial goods to EU				
								Duty free access of EU industrial goods to Bosnia	
CEFTA						Full liberalisation of industrial goods			
EFTA					Duty free access of Bosnian industrial goods to EFTA				
					Duty free access of EFTA industrial goods to Bosnia				
Turkey							Full liberalisation of industrial goods		

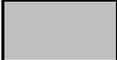
Key

	Autonomous Trade Preferences provided by EU
	Negotiations for a free trade area
	Gradual liberalisation
	Duty free access

Annex 2 (cont.)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Croatia									
EU			Duty free access of Croatian industrial goods to EU						
								Duty free access of EU industrial goods to Croatia	
CEFTA						Full liberalisation of industrial goods			
EFTA			Duty free access of Croatian industrial goods to EFTA						
								Duty free access of EFTA industrial goods to Croatia	
Turkey						Full liberalisation of industrial goods			
Macedonia									
EU			Duty free access of Macedonian industrial goods to EU						
								Duty free access of EU industrial goods to Macedonia	
CEFTA						Full liberalisation of industrial goods			
EFTA	Macedonia already has a free trade agreement with EFTA.								
Turkey	Macedonia already has a free trade agreement with Turkey								

Key

	Autonomous Trade Preferences provided by EU
	Negotiations for a free trade area
	Gradual liberalisation
	Duty free access

Annex 2 (cont.)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
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FR Yugoslavia (subject of democratic changes)									
EU			Duty free access of Yugoslav industrial goods to EU						
							Duty free access of EU industrial goods to Yugoslavia		
CEFTA					Full liberalisation of industrial goods				
EFTA				Duty free access of Yugoslav industrial goods to EFTA					
							Duty free access of EFTA industrial goods to Yugoslavia		
Turkey						Full liberalisation of industrial goods			

Key

	Autonomous Trade Preferences provided by EU
	Negotiations for a free trade area
	Gradual liberalisation
	Duty free access

Annex 3: Direction of Trade Flows of the Western Balkans, by Major Partner, 1998 in %

	Albania	Bosnia and Herzegovina	Croatia	FR Yugoslavia	Macedonia
	%	%	%	%	%
Imports					
Industrial countries	81,9	44,8	71,1	78,9	57,7
European Union	79,0	41,5	58,1	72,6	52,8
Partner 1	38,7	14,7	20,5	25,2	14,4
Partner 2	24,4	11,8	19,0	22,7	13,8
Partner 3	7,9	4,9	5,1	8,8	8,9
Other countries	2,8	3,3	13,0	6,4	5,0
SEE & Slovenia	6,9	43,4	12,1	17,4	28,9
Albania			0,0	0,0	0,2
Bosnia and Herzegovina			2,0		0,1
Bulgaria	3,1	0,4	0,1	3,6	5,2
Croatia	0,8	28,5		0,0	3,1
FR Yugoslavia	0,1		0,0		11,4
Macedonia	1,7	0,0	0,7	4,8	
Romania	0,6	0,6	0,2	4,5	0,4
Slovenia	0,6	13,9	9,1	4,4	8,6
Other countries	11,3	11,7	16,8	3,7	13,3
Total	100,0	100,0	100,0	100,0	100,0
Exports					
Industrial countries	94,4	54,0	53,4	74,1	65,9
European Union	88,8	50,9	45,8	71,7	51,8
Partner 1	58,9	22,3	18,4	28,0	22,4
Partner 2	12,8	18,8	17,3	25,5	11,4
Partner 3	8,3	4,5	2,3	5,3	3,7
Other countries	5,5	3,0	7,6	2,3	14,2
SEE & Slovenia	3,0	39,3	25,3	25,9	22,8
Albania			0,1	0,1	1,1
Bosnia and Herzegovina			14,8		0,1
Bulgaria	0,0	0,1	0,1	2,8	2,9
Croatia	0,3	28,6		0,0	4,2
FR Yugoslavia	0,2		0,0		10,5
Macedonia	1,7	0,2	1,3	18,0	
Romania	0,1	2,0	0,2	0,3	0,3
Slovenia	0,7	8,4	8,8	4,7	3,6
Other countries	2,2	6,7	21,3 ²⁶		11,3
Total	100,0	100,0	100,0	100,0	100,0

Source: Adapted from: The Road to Stability and Prosperity in South Eastern Europe – A Regional Strategy Paper, The World Bank, (Washington DC: March 2000)

²⁶ The total for exports from FR Yugoslavia does not include exports for developing countries

Annex 4: Visa Requirements for South East Europe

	FR												
	Slovenia	Hungary	Bulgaria	Romania	Croatia	Yugoslavia	Macedonia	Bosnia	Albania	Moldova	Turkey	Cyprus	EU
Slovenia	X	-	-	-	-	visa	-	visa	visa	visa	-	visa	-
Hungary	-	X	-	-	-	-	-	-	visa	-	visa/border-	-	-
												free	
Bulgaria	-	-	X	-	-	-	-	-	-	-	visa	visa	visa
Romania	-	-	-	X	-	-	-	-	visa	-	-	-	visa
Croatia	-	-	-	-	X	visa	-	-	visa	visa	-	visa	-
FR Yugoslavia	visa	-	-	-	visa	X	-	-	visa	-	visa/border-	-	visa
Macedonia	-	-	-	-	-	-	X	-	visa/border-	-	-	visa	visa
Bosnia and Herzegovina	²⁷	-	visa	-	-	-	-	X	visa	-	-	visa	²⁸
Albania	visa	visa	visa	visa +	visa	visa	visa/border	visa	X	visa	visa/border	visa	visa
Moldova	-	-	visa	-	visa	visa	visa	visa	visa	X	visa/border	visa	visa
Turkey	-	visa	visa	-	-	visa	-	-	-	visa	X	visa	visa
Cyprus	-	-	-	-	-	-	²⁹	visa	visa	visa	³⁰	X	-
EU	-	-	-	visa	-	visa	³¹	-	³²	visa	³³	-	X

NB: Information on Yugoslavia is from Internet so may not be accurate. Information valid as of 25th March 1999

²⁷ Citizens of Bosnia-Herzegovina need a visa to enter Slovenia - unless they have proof in their passports that they have right of entry to Schengen.

²⁸ Bosnian citizens require visas to visit the UK and Ireland, but not the Schengen countries.

²⁹ Greek Cypriots need visas to enter Macedonia; Turkish Cypriots do not..

³⁰ Greek Cypriots need a visa (hefty fee, long wait) to visit Turkey. Turkish Cypriots do not even need their passport.

³¹ All EU citizens can enter Macedonia without a visa - except Greeks.

³² Albania charges visitors a \$5 tax to enter, and \$10 to leave the country.

³³ French, German, Luxembourg, Swedish, Danish, Finnish and Greek (!) citizens need no visa to enter Turkey; other EU citizens can get a visa on entry.

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