Business in the Balkans:

The case for cross-border co-operation

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Foreword

The Centre for European Reform would like to thank the Richard C. Welden Foundation and Raiffeisenbank Austria Zagreb for supporting this publication.

RICHARD C. WELDEN FOUNDATION

The Richard C. Welden Foundation is a private non-profit organisaton based in New York. The Foundation sponsors studies on EU integration and on reconciliation between Turkey and Greece, and between the Catholic and the Orthodox Churches. The Foundation also gives scholarships for the education of Balkan students in the EU and US. This year, the Foundation launched an international competition on EU-US Relations: 'The US and the EU: Transatlantic Drift or Common Destiny'. For further details, please see www.welden.org.

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I Introduction

Stability is the pre-condition for success in Central and Eastern Europe. As the region emerged from communism in the 1990s, the leaders of some countries quickly convinced the world that they offered safe havens for investment and were reliable business partners. Those countries won political friends, reaped economic benefits and are now preparing to join the EU. Other leaders instead earned themselves a bad name for promoting an aggressive nationalism. Their countries, and those in the neighbourhood, sank into conflict, political instability and economic decline. This was the fate of most of the Balkans.[1]

A new generation of governments is now in place in the Balkans, elected by voters keen to see living standards improve and to join the European Union. To achieve these goals, the Balkan countries need stability. The catch is that the best guarantee of stability is improved relations between countries which were until very recently enemies. Few politicians in the region are willing to risk public disapproval by rebuilding relationships with neighbouring countries.

This paper argues that the way to achieve stability in the Balkans is to promote links among the business communities. Improved cross-border business links will help to bring rapid economic gains through higher levels of entrepreneurial activity and increased foreign investment. If business leads, politicians will find it acceptable to follow.

[1] For the purposes of this paper, the 'Balkans' refer to: Albania, Bosnia-Herzegovina, Bulgaria, Croatia, the Republic of Macedonia, Romania and Yugoslavia (Serbia and Montenegro). This paper was drafted before Yugoslavia's change of name, so references are to 'Yugoslavia', rather than 'Serbia and Montenegro'. Bulgaria and Romania are applicants for EU membership.

Political leaders in the Balkans are used to the idea that their countries are interdependent, but they tend to be suspicious of political integration. Some even see their linkages with neighbouring countries as a burden that cannot be escaped. In recent years, Bulgarian and Romanian companies have suffered frequent disruptions to their export routes through Yugoslavia. Foreign investors steered clear of Macedonia and Albania as the Kosovo crisis developed. Holiday-makers deserted Croatian resorts during the Bosnian and Croatian wars and have only recently begun to return. And Bosnian companies are still struggling to regain business with Hungary and Croatia that was lost when war destroyed crucial rail links.

This paper focuses on the positive aspects of economic interdependence. It argues that Balkan countries can accelerate their own economic development by exploiting the potential for cross-border trading. And it seeks to offer a strategy for regional integration that is politically and economically realistic and does not compromise more ambitious future aims, such as EU accession.

In addition to promoting economic development, regional co-operation could bring direct benefits for Balkan stability and security. The experience of the EU suggests that economic integration can help to promote security. Co-operation among a handful of national coal and steel industries in Western Europe half a century ago laid the foundations not just for economic prosperity, but also for improved political relations among participating states.

The Balkan countries do not function as a single market at present, however, and the barriers to doing business – especially across borders – are enormous. These barriers deter foreign investment and make it difficult for local firms to co-operate with firms in neighbouring countries. This paper highlights the existing obstacles to business across borders and identifies steps that need to be taken to overcome them.

The first chapter argues that trade liberalisation and improved customs efficiency are essential to make trade within the region free and easy, rather than slow and costly. The paper discusses several options for liberalising trade, taking into account political feasibility and the likely impact on national economies.

The second chapter identifies ways of encouraging both foreign companies and local entrepreneurs to invest in the Balkans. Greenfield investment, in particular, brings concrete economic benefits: foreign capital and know-how from committed long-term investors. But greenfield investment is in short supply in the Balkans, where privatisation has shaped the investment environment, frequently attracting second-rate foreign investors that are unwilling or unable to overhaul a company. This section suggests that a Balkan-wide investment promotion campaign could re-package the region as an exciting emerging market with high growth potential. This campaign should use the experience of foreign investors in the Balkans to date, identifying what attracted them to the region when others shied away.

The small business sector also has great potential, but its growth is stunted by the lack of financing options. Chapter two suggests that chambers of commerce in the region could connect local entrepreneurs with foreign investors, to facilitate the formation of joint ventures. It also argues that the countries themselves could set up a regional structure for financing, in the form of a Balkan Development Bank, devoted to cross-border projects and run by bankers from the region.

The third chapter focuses on the infrastructure and services which sustain businesses in the region – transport, energy, telecoms and banking. It argues that infrastructure development must support the regionalising trend in business activity. Foreign investors have recognised this fact and are seeking to develop new regional services to meet the demand, for example, for banking. However, most infrastructure industries tend to be in state ownership, so governments need to think regionally too. Privatisation remains the priority, but governments should consider the potential for regional connections when restructuring and preparing firms for sale. The aim is to ensure that these services operate smoothly and to increase pressure for reform. The liberalisation of such industries is still politically controversial in the region.

The paper addresses its recommendations to three groups: national governments, business people and international organisations. Its purpose is not to analyse the strategies of international organisations like the European Union or the World Bank, or regional ones like the Stability Pact,[2] but to consider how the development of the private sector might promote political and economic integration. The research has been conducted using a bottom-up approach, focusing on the experiences of business people, whether foreign investors or locals, who currently operate in the Balkans. It attempts to draw a clear picture of how business across borders works, or does not work, and how it could be stimulated.

Similarly, the paper argues that business people, not politicians or foreign administrators, should take the lead in promoting economic co-operation. Where two firms see an economic reason to work together, they should be helped to do so. Policy-makers can facilitate this by improving the framework in which business functions – for example, by harmonising legislation or improving infrastructure. However, the impetus to change the framework should come from business. Where companies see no benefit in co-operation, politicians and international policy-makers should not force the issue.

[2] The Stability Pact for South-East Europe was set up in June 1999 by the EU, other G-8 members, the Balkan states and their neighbours, and international organisations in the area. It is dedicated to achieving political and economic stability in the region, and to fostering respect for democracy and human rights.

II Creating a single market

It takes one week to transport goods from Thessaloniki in northern Greece to Ljubljana, the capital of Slovenia, says Samo Ivančić, president of the American Chamber of Commerce in Slovenia – a journey that should take no more than two and a half days. The truck crosses four borders, encountering different trade regimes, currencies and a host of inefficient or corrupt customs officials. It is not only trade that is problematic. When Ivančić travels around the region, he has to deal with an array of complicated visa requirements. “Commuting in the Balkans is a nightmare”, he says. “The problem didn’t exist ten years ago and I sincerely hope it will be better in ten years’ time”.

Ivančić’s story is all too familiar to business-people operating in the region. Put simply, the Balkans does not function as a single market. But it could if governments liberalised trade faster and more thoroughly, and improved the efficiency of customs services.

Facilitating trade

If the Balkans region is to achieve sustainable – rather than aid-dependent – growth, it will have to find a way for goods to flow freely and cheaply across borders. Over the past ten years, political instability and security problems have blocked normal business development, leaving economies reliant on inflows of foreign aid. With these risks now subsiding, the Balkans has to focus on rebuilding solid economic foundations so that it can start catching up with the more advanced transition countries.

Catch-up will depend largely on investment. The Balkan economies are unhealthily dominated by labour-intensive sectors like agriculture and mining. Shifting the balance towards skilled manufacturing and services will require significant levels of foreign investment and sufficient local economic activity to stimulate domestic investment. Both foreign and local investment will benefit from trade liberalisation, so that companies can take advantage of the larger regional market, not just local opportunities.

★ **Foreign investors.** The Balkan countries, individually, are simply too small to attract many foreign companies. Only Romania, with a population of 23 million, is a sizeable market. Bulgaria and Yugoslavia have less than 10 million people each; and the remaining countries in the region each have a population of under 5 million. Taken altogether, however, the region represents a market of around 55 million, rising to 130 million if Greece and Turkey are included. Markets in Ukraine, Armenia, Georgia and Azerbaijan also loom on the horizons of business people in Bulgaria and Turkey.

Many foreign companies already operating in the region have adopted a Balkan-wide strategy, setting up headquarters in one country, while selling to and importing from others in the region. French car manufacturer Renault, for example, which bought Romania's Dacia car plant in 1999, aims to produce 200,000 cars a year by 2010, selling them throughout the region. Some firms produce in several countries, their suppliers and producers trading with each other across borders. Greek dairy firm Delta has factories in Romania, Bulgaria and Serbia, with each plant supplying neighbouring countries too. Russian oil giant Lukoil, which owns the Neftochim refinery in Bulgaria, is creating a network of petrol stations across Yugoslavia, Macedonia, Greece and Turkey, and it hopes to buy oil companies in Croatia, Hungary, Romania and Greece.

At present, though, investors cannot treat these countries as a single market in any real sense, because the cost of cross-border business is too high. At an average border in the region, trade in goods is likely to encounter not only high customs tariffs, but pervasive

corruption and crippling delays. In some cases, these costs merely push up prices; they deter other investors altogether.

Every step towards the creation of a single and efficient trading zone would boost the Balkan region's appeal to foreign investors. Individual countries would be able to market themselves as part of a large, fast-growing region, instead of appearing to be small countries with difficult neighbours. And foreign investors would be able to treat the region more like a single market.

★ **Local businesses.** The Balkans cannot rely solely on foreign investment, and no government in the region would want to. But most local companies are in a mess. They have been hit hard by the difficult operating conditions of the past decade – most have outdated equipment, high debts and low productivity. For the moment, these firms have no hope of exporting to the EU. A more realistic and constructive strategy would be to boost trade with neighbouring countries.

Increasing exports to the EU is undoubtedly important in the longer term, and essential to improving competitiveness in preparation for EU entry. But the Balkan states have achieved little so far: exports to the EU have only risen over the last decade in sectors such as textiles, metals and mining, where competitiveness is based on cheap labour or natural resources. Very few Balkan companies have been able to compete in EU markets for higher value-added products; most are simply too weak financially to invest in upgrading production to meet EU standards. For consumer products, in particular, the cost of an extensive advertising campaign, necessary to achieve brand recognition in the EU's mature markets, is prohibitively high.

Many governments have exacerbated the problem by failing to push through the structural reforms – privatisation, bank reform and so on – which are a precondition for building competitive industries and re-orientating trade. In the worst cases, politicians have seen privatisation as a way of lining their own pockets, rather than as a means of improving a company's productivity. Even where governments have the best intentions, they are often too weak to push through difficult reforms. They lack know-how and are vulnerable to pressures from workers' unions.

Therefore, while exporting to the EU must remain a key long-term goal for Balkan companies, it is not necessarily the best place for them to start. Expanding trade within the Balkans, on the other hand, can be a profitable – interim strategy. Balkan economists tend to dismiss the importance of intra-regional trade, arguing that neighbouring countries are too poor to be of interest, and that they are economic competitors, producing similar goods. They cite as evidence the current levels of intra-regional trade, which the World Bank has estimated at just 12 to 14 per cent of total exports and imports, on average.[3]

Look at the figures in detail, however, and it is clear that intra-regional trade is important for particular countries and sectors. Bosnia, for example, conducts well over a quarter of its trade with Croatia, and Macedonia relies heavily on Yugoslavia for its exports. Bosnia, Slovenia, Yugoslavia and Greece are among Croatia's top ten export destinations; Turkey, Yugoslavia and Greece are in Bulgaria's top five, together taking more than 25 per cent of that country's exports.[4]

There are also many business opportunities that have yet to be exploited. Serbia, for example, could provide sheet steel for Bulgarian refrigerators, and Croatia components for Bosnian car-assembly plants. Yugoslav firms are keen to enter the Bosnian market for agricultural equipment, and planting and seed material, as well as coal and other mining products. In some cases, co-operation could make the difference between production being viable or not.

[3] World Bank, *The road to stability and prosperity in South-Eastern Europe*, 2000.

[4] 2000 trade figures.

Some companies could increase cross-border trade considerably by resurrecting old trading relationships severed by war. Grasping these business opportunities does not require massive investment in product upgrades or marketing. Indeed, many products already benefit from brand recognition in other countries of the region, especially within the countries of the former Yugoslavia. Serbs, for example, were happy to see familiar brands from Croatian food firms Podravka and Kraš back on their shelves in 2001. Not all of the old former Yugoslav trading relationships should be resurrected – some only ever existed because of subsidies. But there is certainly money to be made in pursuing deals with neighbours. And that money could enable struggling Balkan firms to start investing in improving productivity and standards.

This is as much a question of political will as of corporate strategy. Current trading patterns in the region suggest that companies quickly exploit opportunities once costs are reduced. Countries which have reached bilateral free-trade agreements with their neighbours enjoy far higher trading levels than those which continue to impose heavy import duties. To some extent, that is because free-trade agreements are negotiated when trading relationships are good. But the agreement itself can play a crucial role. When the free-trade agreement between Croatia and Bosnia broke down in 1999, following a dispute over terms, Croatia's exports to Bosnia, until then its third largest export partner, dropped by around a quarter over the following 12 months.

The Macedonian example is also interesting. Macedonia has concluded free-trade deals with Albania, Bosnia, Bulgaria, Croatia, Slovenia, Turkey and Yugoslavia – by far the most of any Balkan country. Now it is negotiating with Romania. Macedonia's trade with the region was, of course, disrupted in 2001 by conflict. But in 1998 it had the highest proportion of trade with South-East European countries of all countries in the region, despite the fact that it is producing similar goods to its neighbours.

Where free-trade agreements do not exist, the costs of doing business across borders increase significantly, sometimes prohibitively. Croatia's Podravka might benefit from brand familiarity in Yugoslavia, but it has had to face tariffs of 40 per cent or so levied at Yugoslav borders. Podravka is considering producing in Macedonia to exploit the country's free-trade arrangements. That makes sense for Podravka, which can be reasonably certain about its market potential. For other companies, these extra costs may deter them from entering the market altogether.

Governments in the region have started to talk about negotiating free-trade agreements as a priority. But when it comes to cutting duties, many are reluctant to for go a major source of state revenue. The Yugoslav Deputy Prime Minister Miroljub Labus, for example, has commented that it would be difficult for Yugoslavia to reduce average tariffs below 9 per cent. The Yugoslav government faces difficulties trying to raise revenue from other sources because corporate profits and income levels are so low. In some Balkan countries, customs revenue represents as much as 3 per cent of GDP. Nevertheless, given the relatively low levels of intra-regional trade (as a proportion of total trade), the revenue losses from liberalisation would be small. More importantly, liberalising trade would bring economic benefits that, in the medium term, clearly outweigh losses to the budget.

How best to liberalise trade?

The current trend in the region is to follow Macedonia's example by negotiating an increasing number of bilateral free-trade agreements with neighbours. The current network of agreements looks like this:

Bilateral free-trade agreements in South-Eastern Europe

	Alb	Bos	Bul	Cro	Mac	Rom	Slo	Tur	Yug
Alb		--	--	--	Y	--	--	--	--
Bos	--		--	Y	Y	--	Y	--	NEG
Bul	--	--		Y	Y	*	--	Y	NEG
Cro	--	Y	Y		Y	NEG	Y	NEG	NEG
Mac	Y	Y	Y	Y		NEG	Y	Y	Y
Rom	--	--	*	NEG	NEG		--	Y	--
Slo	--	Y	--	Y	Y	--		Y	--
Tur	--	--	Y	NEG	Y	Y	Y		--
Yug	--	NEG	NEG	NEG	Y	--	--	--	

Y= has agreement; NEG = in negotiations; * Both CEFTA members[5]

[5] CEFTA is the Central European Free Trade Agreement, comprising Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia.

In June 2001, Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Macedonia, Romania and Yugoslavia decided to speed up the process. Under the auspices of the Stability Pact, they signed a memorandum to create bilateral free-trade networks with all other countries in the region by the end of 2002. That would allow at least 90 per cent of goods to be exchanged tariff-free.

This is an admirable undertaking and one that is making steady progress, but the bilateral approach has its disadvantages. This network of bilateral free-trade agreements will not result in a free-trade zone, but in a tangled web of different trade regimes. Most agreements do not liberalise trade fully, but stipulate exemptions on certain products for certain time periods. Macedonia's agreement with Croatia, for example, looks different to the one it has with Slovenia. And although all three countries have free-trade agreements with each other, they do not represent a mini free-trade zone. Macedonian products still face different treatment on Croatian and Slovenian borders, leaving considerable scope for delays, confusion and corruption. If the aim of trade liberalisation is to reduce complexity, a system of bilateral agreements fails. Foreign investors, seeking to establish a single country export base in the region, will find this web of bilateral agreements a continuing deterrent to cross-border trade.

The EU argues that this problem will be solved through its own bilateral negotiations in the region, as part of the Stabilisation and Association Process. Established after NATO's bombing of Serbia and Kosovo in 1999, the process is intended to give Balkan countries a clear prospect of joining the EU. Prior to its launch, only Bulgaria and Romania were considered accession candidates, having signed Europe Agreements in the early 1990s, along with the Central European countries. The Stabilisation and Association Agreements were designed specifically for the countries of the Western Balkans (Albania, Bosnia-Herzegovina, Croatia, Macedonia and Yugoslavia). The aim is to assess what reforms these countries need to undertake in order to meet the

EU's membership criteria and what help they need in implementation. The agreements represent a mutual commitment. The candidate agrees to implement reforms and harmonise legislation; the EU agrees to assist the country in making the necessary adjustments.

The new approach focuses heavily on removing barriers to trade with the EU. In time, the argument goes, all of the countries of the Western Balkans will effectively become part of the EU single market. But progress towards this goal is likely to be slow. Negotiations have already highlighted the varied levels of development among the Western Balkan countries. Croatia and Macedonia have signed their agreements and are busy with implementation and harmonisation. Albania stumbled at the first hurdle when an EU Feasibility Report said the country lacked a sound basis from which to start negotiations. However, after more thorough preparations, talks look set to start in 2002. Bosnia has not even reached the Feasibility Report stage. It is still trying to complete the 18 pre-conditions set by the EU, which include such basics as the passage of an electoral law, and it is behind schedule on those. Yugoslavia, too, is a long way from signing its Stabilisation and Association Agreement. And while it might be feasible to expect all of the countries to have concluded agreements within five years, full implementation – will take much longer. South-Eastern Europe needs to liberalise trade within the region at a much faster pace than that.

Numerous Balkan observers have advocated a genuine free-trade zone for South-Eastern Europe, embracing all of the countries. The Centre for European Policy Studies, a Brussels think-tank, put forward the idea in 1999.[6] In September 2001, German Foreign Minister Joschka Fischer revived the concept, advocating a limited economic union for the Western Balkans, based on the model of the European Economic Area – a single market among European states, including some which are not members of the EU. In theory, Fischer's idea is a good one. A free-trade zone would overcome the problem of complexity: goods

[6] Michael Emerson, *A system for post-war South-Eastern Europe*, CEPS, 1999.

would be able to move around the region freely and the system would be simple and transparent. There would be fewer delays at borders and the scope for corruption would be reduced.

In practice, however, negotiating such an agreement would be impossible. There is very little government support for the regional free-trade idea, largely for political reasons. If the Balkan countries share anything, it is a fear of being stuck in a group with one another. This is a hot political issue. Croatians and Slovenians, in particular, tend to see regional associations as plots to recreate the former Yugoslavia. Croatia's Foreign Minister, Tonino Picula, for example, described Fischer's suggestion of a Western Balkans Economic Union as "isolation from the basic process that leads to the EU". Given the difficulties, it could take several years at best to conclude such a deal. By then, if things go well, the countries will be focusing on free-trade with Central Europe and Western Europe, and a South-East European zone will be outdated.

Looking to the future, the most effective and realistic way of introducing free trade might be to incorporate the countries in a broader arrangement. Membership of the WTO represents a start, and Albania, Bulgaria, Croatia, Romania, Slovenia and Turkey are already members. But the best option might be for all the Balkan countries to join the Central European Free Trade Agreement (CEFTA).[7]

Founded in 1993, as a way to ensure that greater integration with the EU did not jeopardise intra-regional trade, CEFTA now has seven members, including Bulgaria and Romania. Through a comprehensive set of bilateral agreements, CEFTA has succeeded in liberalising trade in industrial products almost completely. Initially, there was little enthusiasm for CEFTA, for many of the same reasons that a Balkan free-trade zone is rejected. Governments viewed CEFTA as a diversion from EU integration and pointless, given similarly structured economies with little intra-regional trade. Yet CEFTA has emerged as an important

[7] See Stanislav Daskalov and Nicky Mladenov, *A comprehensive trade policy plan for the Western Balkans*, European Institute, Bulgaria, September 2000.

association. Its members are not prevented from joining the EU but can benefit from free trade with neighbours in the meantime. CEFTA's impact on non-agricultural trade has been significant. Trade between the Czech Republic, Hungary and Poland has grown almost 50 per cent in the past four years alone (see chart).[8]

The CEFTA option would have three advantages for the Balkans:

- ★ it would overcome the political sensitivities which surround the issue of increased regional co-operation by *de facto* creating a Balkan free-trade zone;
- ★ it would encompass more countries than a purely Balkan club and lead to a closer relationship to the EU, aiding the Balkan countries' progress towards EU membership; and
- ★ it should be faster to achieve than Stabilisation and Association Agreements for each Balkan country.

The EU could help by encouraging CEFTA's existing members to admit the entire region of the Western Balkans. Croatia's application to join CEFTA was stalled for several years, although it

[8] Source: Budapest Economics.

is now set to join in 2002, as it needed first to meet two pre-conditions for membership – a signed EU Association Agreement and WTO membership. These pre-conditions should be realxed. But more generally, the current members may be opposed to broadening their club. However, the majority of current CEFTA members will be leaving the organisation within the next few years, following EU enlargement.

The customs problem: borders or barricades?

The World Bank has documented the delays experienced at border crossings in Eastern Europe. It found average waiting times at border crossings of five hours between Macedonia and Yugoslavia; 36 hours in total at borders between Bulgaria and Germany; and 24 hours from Albania to its Adriatic neighbour, Italy. Add to this transit times through the countries, on poor road and rail networks, and exporting within or from the region begins to look pretty costly. Trade in perishable goods is in many cases impossible.

Many customs officials offer a speedier service for those who are willing to pay. This pervasive corruption is encouraged by the complexity of the customs regimes, since few drivers know the individual laws well enough to challenge officials. Even where corruption is not an issue, outdated technology and poorly trained personnel create border delays. Free-trade under such conditions is a fiction – regardless of the agreements signed by governments.

Two initiatives are currently focusing on these problems:

★ The World Bank is running a scheme in six countries, aimed at helping them improve customs procedures on their borders, called the 'Trade and Transport Facilitation in South-East Europe Project'. Improvements may be as simple as introducing a single point of payment, with an itemised bill, for various customs charges; or allowing selective checking – many countries currently require every vehicle to be opened.

The project is also creating a website to give traders access to information on all of the customs regimes in the region. A certified training scheme is being offered to freight-forwarding companies, teaching drivers how best to prepare the paperwork required at borders. At present, the project is operating as a pilot on only a few border crossings, but the idea is to translate the lessons into national policy.

★ The South-East Europe Cooperative Initiative (SECI), a forum for regional decision-makers, is examining ways to improve border crossings in 13 countries. SECI's major contribution has been to bring together customs officials and private-sector companies to discuss the difficulties of using borders. The expertise gathered at these sessions is passed onto national policy-makers, as well as internationally funded programmes such as the World Bank's project.

Further steps are needed to complement these initiatives. Business associations and chambers of commerce could help by educating and informing their members about different border regulations, and channelling complaints about practice on the ground to policy-makers. Countries could also eliminate wasteful delays by relaxing visa procedures for drivers with good track records. EU members are an offender, requiring Balkan freight-shipping companies to renew their visas, even multiple-entry ones, every three months, thereby leading to the loss of one or two working days. The Stability Pact's Business Advisory Council, similar to the SECI forum but with greater foreign-investor representation, could play an important lobbying role here.

III Promoting Balkan investment

South-Eastern Europe is not an economic black hole. Intrepid foreign investors do venture into the region, and many return to invest again. Despite repeated bouts of instability, Balkan economies have continued to function and the foreign investment stock has risen steadily, amounting to 14.5 per cent of regional GDP by the end of 1999. Given the risks, this compares relatively well with foreign investment levels in Central Europe (the Czech Republic, Hungary, Slovakia, Slovenia and Poland), at 23.8 per cent of GDP.[9] The democratic elections in Yugoslavia in 2000 have further reduced the perceived risks of investing in the region. The Economist Intelligence Unit is forecasting that the flow of foreign investment into the region, as a percentage of GDP, is likely to overtake that to Central Europe from 2002.[10]

That is good news for the Balkans. The region desperately needs capital and foreign business know-how. But the benefits of foreign investment depend as much on the type of investment as the quantity. Most of the foreign investment to date in the Balkans has been related to privatisation, and the expected increase in investment over the next few years is largely due to a pick-up in the pace of such sales. Privatisation is an essential part of transition, but governments should not rely on it to bring in beneficial foreign investment. In the Balkans, privatisation has often been an opaque – if not outright corrupt – process. Officials frequently fail to select the most appropriate investor. And, since sales are rarely accompanied by liberalisation or effective regulation, they tend not to increase competition.

Privatisation programmes can certainly be improved, but the region needs to attract investment in greenfield sites, and mergers and

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[9] Jared Manasek, *Back to business in the Balkans*, Economist Intelligence Unit, 2000.
[10] Economist Intelligence Unit, *Economies in transition*, March 2001.

acquisition too. The benefits are clear: foreign investors setting up new businesses bring in foreign know-how and capital and show a high degree of commitment. It is far more difficult for a country to attract greenfield rather than privatisation investment. Greenfield investors are more easily deterred by the risk of political or ethnic problems in a country or its neighbours. They need to be convinced that the Balkans is a safe and profitable place to invest; and they need easy access to information about doing business in the region. At present, the Balkans fails on all accounts – at least in public perception. This author recommends a Balkan-wide investment promotion campaign, to be administered either by a regional investment agency, or by a co-operative task-force formed by national investment agencies.

Time for a new image

South-Eastern Europe is in serious need of a good promotion campaign to reverse the negative associations of recent conflicts. Yugoslav Foreign Minister Goran Svilanović has suggested, tongue-in-cheek, that the theme of such a campaign might be "nice people live in the Balkans". Yugoslav Deputy Prime Minister Miroljub Labus implored a business forum in Thessaloniki in 2001: "Come to my country – if you want to do business, you will find friendly and able counterparts." Both ministers recognise that it is essential to restore foreign investor confidence in the Balkans.

The campaign should highlight the region's potential for high returns that are no longer attainable in the more mature markets of Western and Central Europe. It should also focus on the experience of foreign investors already operating in the region. Most are from four countries: Greece, Turkey, Austria and Italy. Investors from each of these countries tend to have varying patterns of interest, but they share certain characteristics and views about why investing in the Balkans is worthwhile:

★ **Not as explosive as it looks.** Investors from Northern Europe or the United States were deterred from the whole Balkan region by television images of fighting in one part. Those from

countries closer to the Balkans had a more realistic picture of where it was possible to do business and where not. The whole environment was more familiar to them. They had historical links – the Habsburg Empire once stretched into today's Croatia, Bosnia and Serbia, while Turks occupied much of the area for hundreds of years. History fosters cultural links that facilitate contacts and even trust between business people:

"An environment which might seem impossible to a Luxembourg company is business as usual to us," says Muhtar Kent, president of Turkish brewery Efes. "Turkish companies are used to coping with ever-changing rules or long waits for payments", says Faruk Erkoç, president of Penta, a Turkish trade and distribution company specialising in oil products. Their experience is not all positive, however. Some Turkish investors say the Balkan business environment is less stable and predictable than that in Central Asia.

★ **Easy to penetrate.** The lack of competition within Balkan markets makes it relatively easy for new entrants to gain a foothold. The marketing costs required to achieve a significant market share in the Balkans are a fraction of those needed to penetrate a more mature and crowded market. Thus, doing business in the Balkans is in a sense easier, for some companies, than doing business in Western Europe. For some companies, brand familiarity can also reduce marketing costs in Balkan markets.

★ **EU prospects.** South-Eastern Europe's proximity to Western Europe and, in particular, its prospects for entry into the EU are key attractions. This helps Turkish and Greek companies decide to invest in the Balkans instead of the Caucasus, and convinces Austrian investors that an investment in a country like Croatia will complement their Central European strategies. Even if membership itself cannot be expected for many years, the fact that these countries are engaged with the EU and could soon be bound into accession preparations sends an important signal.

★ **Cheap, skilled labour.** The Balkans has cheap but skilled labour. That makes it a good location for producing export goods. To date, most of the export-oriented investment in assembly and production plants has gone to the more advanced transition countries, like Hungary or the Czech Republic. But as these countries attract more and more high value-added investments, investors will start focusing on the skilled labour base in the Balkans for low value-added production. Asia may still be cheaper, but in the Balkans, the labour force has, by and large, received a broad, high-quality education. The Balkans can also market its particular labour force strengths in areas such as languages and technology. Bulgaria, for example, has earned a strong reputation for having good mathematicians and computer scientists, making it a magnet for IT investment.

Promoting the region

If inward investment agencies are to promote a region rather than separate countries, they need to find new ways of co-operating. Currently they compete to attract foreign investment. That is inevitable and healthy, but competition should be accompanied by co-operative efforts to persuade investors of the benefits of their region over, say, Central Europe. Bringing foreign investment to the region as a whole is in each individual country's national interests. Serbia would gain from the establishment of a new plant in Bulgaria with plans to export to the west through Serbian territory; it might gain less than if the plant were in Serbia itself, but far more than if the investor chose to locate the factory in Hungary.

Bulgaria's foreign investment agency has already recognised that investors seek access to the regional market. In October 2000, it launched the first *Investment Guide for South-Eastern Europe* at the South-East Europe Forum, a conference on regional investment held in Sofia and attended by more than 2,000 business people. The Guide was compiled from contributions sent in by investment

agencies and non-government organisations around the region and contains useful information about the legal framework for investment in individual countries.

However, the process of information-gathering would be much easier if there were a one-stop-shop for the region – a regional investment agency. Investors need to assess overall regional conditions before setting up a greenfield production site. Comparing different locations is one aspect, but they also need to know how easy it is to export within the region. If costs are pushed up by poor infrastructure, customs tariffs, corruption or border delays, the investment may not be viable. Encouragement, and financial assistance from the World Bank or EU, would help investment agencies overcome their distaste for co-operation. And the campaign would probably get backing from banks with regional branch networks, which have a clear interest in encouraging cross-border investment.

If investment agencies start to co-operate, a natural spin-off could be the establishment of cross-border incentive programmes. Most countries in the region already offer investment incentives in the form of tax exemptions on reinvested profits, imported inputs and investment in certain regions. Given the benefits of region-wide projects, governments could be encouraged to offer joint incentive programmes for such investments.

The role of small businesses

Foreign investment might be the engine of economies in transition, but the long-term prosperity of these countries will require the development of a strong small and medium-sized business sector. Balkan entrepreneurs have superior knowledge of the local operating environment and many ideas for promising business ventures. But they have virtually no access to finance: venture capitalists tend to back foreign investors, and banks are unwilling to lend to start-ups.

One way around the problem is for local entrepreneurs to join forces with foreign investors. This has been the pattern followed by numerous Turkish firms in the Balkans. In contrast to Greek state-owned companies, like OTE and the National Bank of Greece, which have invested hundreds of millions of dollars in the Balkan banking sector, Turkish investors have tended to be small, private players. Until recently, they were excluded from most EU funding schemes, which prevented them from competing for major infrastructure or reconstruction projects. As a result, Turkish companies are prominent among those seeking partner investors for their activities in the region. They hope to find a West European or US firm to provide the capital that they find difficult to raise, while they in return contribute know-how and the experience of operating in the region. Many companies in the Balkans could benefit from such joint ventures, offering their local knowledge in exchange for capital.

To facilitate such joint ventures, chambers of commerce could organise meetings, bringing companies together to swap ideas and establish the personal relationships that are so important to strong business ties. At present, meetings between national chambers of commerce tend to be conducted on a bilateral basis. Sector-specific meetings would have the advantage of bringing together companies with similar interests from around the Balkans, as well as foreign investors. The institutional structures already exist, and the chambers could take it in turns to run the events for different sectors.

A Balkan Development Bank

Another financing option for local business would be the formation of a Balkan Development Bank, with a mandate to fund cross-border projects. This regional development bank could be set up along the lines of the Black Sea Trade and Development Bank.[11] That bank was set up in 1998, in an effort to overcome the problem of financing investments in countries with high political risk. Around 60 per cent of its lending is directed towards investments

[11] The members of Black Sea Trade and Development Bank are Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Turkey and Ukraine.

and 40 per cent to trade financing. Projects must benefit more than one country, but not necessarily incorporate the whole region.

The Black Sea Trade and Development Bank's first project in December 1999 was to grant a loan of $12 million to help Ukraine build a gas compressor station to feed the trans-Balkan gas pipeline. The compressor increased the capacity of the pipeline, boosting transit revenues for the countries through which it passes – Russia, Ukraine, Moldova, Romania, Bulgaria and Turkey. The bank was not the sole lender in this deal, which cost a total of $78 million. Indeed, it can finance only 35 per cent of any one project, or up to 100 per cent for trade financing. However, its involvement and intimate knowledge of the region often helps to attract other creditors and investors who would otherwise be deterred by the risk of doing business in this region. Moreover, the bank is a home-grown initiative set up by the countries themselves to serve the needs that they know best.

The main restriction on the Black Sea Trade and Development Bank's activities is the fairly low level of capital at its disposal, currently around $1.4 billion. Member countries, many of which are relatively impoverished, have donated the Bank's capital in proportion to their ability to pay. Greece, Russia and Turkey has each contributed 16.5 per cent of the total capital; Bulgaria, Romania and Ukraine 13.5 per cent; and the remaining countries 2 per cent each. A Balkan Development Bank would similarly need to include wealthy members – perhaps the current major investors in the region, namely Greece, Turkey, Austria and Italy. A Balkan Development Bank would identify its own investment projects, giving the countries themselves far more input into the way that international money is spent in the region. To ensure that a proposal had broad credibility, the bank could demand that it attract matching funding from the European Bank of Reconstruction and Development and other such organisations. A Balkan Development Bank could help finance intra-regional trade. And it would provide cheaper financing to locals who have good ideas for regional investment projects.

The establishment of a Balkan Development Bank would, of course, require at least a minimum of collective political will. But the inclusion of members such as Italy and Austria might help to convince Croatia, for example, that participation would not stigmatise it as part of an underdeveloped region. Small entrepreneurs, who would have much to gain from the establishment of the bank, could be expected to lobby their governments to support the initiative. And the key strength of such an institution – for a region anxious to avoid aid dependence – would be that it was built on the initiative of the countries themselves, rather than that of external donors.

IV Seamless infrastructure

Smooth business transactions across borders depend on seamless services: in transport, energy, telecoms and banking. Balkan governments know they must overhaul these basic services, which currently tend to be inefficient and unreliable and thus present serious barriers to investment and cross-border business activity. But they have yet to realise that a regional approach to infrastructure could bring significant economies of scale and efficiency gains. Co-operation would also mean harmonising standards and enhancing technical compatibility – factors which could prove essential to achieving healthy competition among providers in the region in future, as well as preparing the way for EU integration.

However, most of these industries are still, at least partially, in state ownership. Privatisation is a priority. Indeed, co-operation among regional firms is likely to be achieved faster if it is left to their new owners – as the banking sector shows. Governments should take the regional dimension into account when preparing companies for privatisation, by making an effort to harmonise standards and ensure technical compatibility. A regional perspective would make the assets more attractive to foreign investors, helping the state to secure a good price and a long-term commitment from the new owners.

Banking – a regional approach

Foreign investors are already pursuing a regional strategy in the banking sector, with Austrian, Italian and Greek banks battling for influence. South-Eastern Europe is a more attractive banking market than it might seem at first glance. Much of the population has hoarded foreign-currency savings under their mattresses during recent years of instability, because they distrust local banks. It is also common for people to receive remittances from friends and relatives working or living abroad. In addition, public finance problems throughout the region mean that most governments are implementing pensions reform, providing opportunities for banks to create private pension funds. When German insurance giant Allianz set up a fund in Bulgaria in 2000, it attracted 230,000 customers in its first year.

Allianz has teamed up with UniCredito, an Italian bank with a strong presence in Central Europe, to pursue its regional strategy. The two companies are hoping to expand their Balkan presence by acquiring Croatia's top bank, Zagrebačka Banka. Zagrebačka is a natural platform for regional expansion, having already made important acquisitions in Bosnia-Herzegovina, where it is now the market leader. Brand recognition and a good reputation helped it in Bosnia, and should also be of benefit in the other former Yugoslav markets it is now targeting. For Franjo Lukovíc, chairman of Zagrebačka Banka, the potential of South-Eastern Europe as a whole is obvious. "We believe some kind of customs union or common market will develop in the next few years, as stability increases", he says. "This is an opportunity for Zagrebačka Banka to get in early and gain a leading position." Lukovíc is confident that economic ties among the former Yugoslav republics will grow quickly, enabling a regional bank to service regional clients.

The UniCredito-Allianz-Zagrebačka Banka team has strong competitors, especially among the Austrian banks. Raiffeisen has been quick off the mark in the Balkans, entering Croatia in late 1994 while war still rumbled on. Raiffeisen also recently bought banks in Bosnia and Romania, and in 2001 became the first foreign bank to set up shop in Yugoslavia.[12] Its aim is to service clients who conduct their business on a regional basis. Two other Austrian banks, Erste and Bank Austria are also present in the Balkans market, while Greek and Turkish banks, such as National Bank of Greece, Alpha Bank and Kent Bank dominate in Macedonia, Bulgaria, Romania and Albania.

[12] 'Playing with the big boys', in *Business Central Europe*, May 2001.

The upcoming privatisation of Yugoslav banks will boost interest in the region's banking sector, since most will be sold directly to foreign investors. In summer 2001, a delegation of Yugoslav bankers visited Zagreb to meet Croatian bankers, in an attempt to encourage them to start lending in Serbia. The deputy CEO of Belgrade's Yugobanka, Dragan Pavlovi´c, says that Croatian bankers, with their capital and know-how, could earn "superprofits" if they entered the Serbian market. Slovenia's largest bank, Nova Ljubljanska Banka, is clearly convinced. It recently announced that it would be buying a majority stake in Yugoslavia's Continental Banka.

The rush into Balkan banking is good news for foreign investors generally, who will benefit from much-needed innovations in the financial sector. More foreign ownership and competition will ultimately bring better access to trade financing, cheaper loans for investment and more secure conditions for consumers. It also sends a signal: if banks see advantages in entering the region quickly, and in maximising their presence in several countries, they prepare the way for their clients to follow.

Telecoms – time to connect

A decade ago, telecom companies throughout the Balkans were state-owned national monopolies. Now foreign investors, with a clear interest in pursuing a regional-based strategy, own a significant proportion of the Balkans' telecoms businesses. Greece's state-controlled telecoms firm OTE is the most high-profile investor. It owns fixed-line and mobile operators in Romania, a GSM licence in Bulgaria, a mobile operator in Albania and a stake – with Telecom Italia – in the Serbian fixed-line monopoly. In early 2001, it failed to win the tender for Macedonia's fixed-line monopoly, beaten by a new regional player, Hungary's Matáv. The owner of Matáv, Deutsche Telekom, in turn owns Hrvatski Telekom, Croatia's fixed-line provider.

German, Italian and Greek telecom giants already dominate the Balkan fixed-line telecoms market, with only the Bulgarian Telecommunications Company and Albtelecom left to be privatised. But the mobile market is still open. The UK's Vodafone and Orange are OTE's main competitors while Austria's Mobilkom is looking for new opportunities following its success with VIPnet in Croatia. The potential is huge: Slovenia, for example, has one of the highest levels of mobile penetration in Europe, at well over 60 per cent of the population. In neighbouring Croatia, only 23 per cent of the population owns a mobile, while the penetration rate in Bulgaria is just 10 per cent.

The new regional players can now start exploiting their intra-regional connections. One possible strategy would be to offer cheap-rate international calls within South-Eastern Europe, or at least between all the companies in which they have stakes in the region. Contacts between business people across borders will drive demand; while family connections, particularly in the former Yugoslav countries, also create demand for cheap phone calls within the region.

Electricity – out of balance

Different patterns of supply and demand create considerable scope for regional co-operation in the electricity sector. Romania and Bulgaria are capable of producing significant electricity surpluses, while Yugoslavia, Croatia and, most importantly, Turkey, need to import electricity. Greece, unlike the rest of the region, experiences peak demand for electricity in the summer, owing to tourists' high usage of air conditioning. Albania, on the other hand, relies on hydropower generators and hence has excess supply in the rainy months but shortages at other times. Such imbalances represent excellent opportunities to trade electricity within the region.

However, most electricity companies in the Balkans still face problems in efficiently supplying their domestic markets. Most are still in state ownership, are seriously under-funded and face

uneconomic pricing regimes. They often have unhealthy relationships with other large state-owned firms, where non-payment is overlooked or electricity is provided at cheaper rates. Governments sometimes find their efforts to liberalise and privatise the companies blocked by powerful labour unions.

Aside from inefficient companies, technical and legal problems make regional co-operation virtually impossible:

★ **Weak or absent transmission links.** Those countries that can produce electricity surpluses do not necessarily have the transmission links to export them. In early 2001, for example, the EU provided financing to Serbia and Kosovo to import electricity from Bulgaria and Romania. But Romania's physical network was so poor that exporting large amounts would have created risks for the internal Romanian network. In some parts of the region, transmission links simply do not exist. Transmission links between Serbia, Croatia, Bosnia and Slovenia, once part of the same country, have been disrupted since junctions in eastern Croatia and southern Bosnia were damaged during the 1991-95 wars. These facilities need substantial investment before Bosnia and countries further east can be reconnected to the European transmission network.

★ **Lack of regional standards.** Most of the former Yugoslav republics are part of the European transmission network, along with Greece. Bulgaria, Romania, Albania and Turkey are not. That means that electricity companies in the region are not working on common standards. Several projects are in progress to connect the eastern Balkans to the network. But even when the technical problems are solved, there needs to be a broader strategy of linking national regulators, to ensure that regulation promotes compatibility and common standards.

★ **Weak trading mentality.** Managers at Balkan electricity companies have little understanding of the potential and benefits of regional trading. They are often keen to sell but not interested in buying. Only training and exposure to efficient trading systems elsewhere will change this mentality.

★ **Financing difficulties.** Energy projects are expensive and tend to bring gains only in the long term, which makes financing in the risky Balkan environment extremely difficult. Most projects to date have been supported by international financial institutions, like the World Bank, the European Investment Bank and the European Bank for Reconstruction and Development. Commercial investors often require state guarantees. The Turkish and Bulgarian governments are particularly constrained, because they are unable to extend guarantees to private companies.

The two key factors to overcoming these barriers in the short term are privatisation and liberalisation. All of the state electricity companies in the region are set to be privatised over the next five years. The common model is for the monopolies to be unbundled into three parts: generation, transmission and distribution, with power stations due to be sold first. Government reluctance to privatise transmission and distribution facilities is likely to be tempered by bugetory pressures, and encouragement from international organisations.

The EU sees energy liberalisation as a pre-condition to membership. Energy liberalisation is also crucial to boosting competition in the regional electricity market and increasing opportunities for trade. Slovenia, which liberalised its internal electricity market in 2001 and will open its external market in 2003, might be able to share its experiences with the rest of the region. Its market operator, Borzen, could in the long term service the whole region. Bulgaria is also making progress, with the first stage of liberalisation now underway.

Transport – exploiting location

The Balkans has a key competitive advantage – its location. It is home to six of the pan-European transport corridors that have been specifically designated as such by the EU, linking northern and Western Europe to the Middle East, Central Asia, Russia and Ukraine. But few people use these corridors. The region's many conflicts, exacerbated by terrible road and rail infrastructure, have meant that these routes are seldom fast or safe.

Donors are aware of the importance of transport for economic growth. At the Second Regional Conference for South-East Europe, held in Bucharest in October 2001, the EU, World Bank and Stability Pact reiterated their commitment to improving transport infrastructure. The donors earmarked €2.4 billion for infrastructure projects, much of which will go to improving transport links. Although various international organisations already pay considerable attention to transport infrastructure in the Balkans, donors would be advised to focus on the following areas:

★ **Prioritise intra-regional transport.** Balkan governments do not always see an interest in building roads to countries within the region, preferring to give priority to links with the EU. Negotiations between Bulgaria and Romania over the location of a second bridge over the Danube to connect the two countries were stalled for years, partly because of a lack of interest in regional co-operation. Intra-regional road routes should be given priority in the short term.

★ **Find a more innovative and accessible approach to financing.** It is difficult for companies in the region to win construction contracts because of their poor access to government guarantees and loans. Western companies also need encouragement to build in a region perceived as politically risky. To encourage investors to take on 'build-operate-transfer' contracts (whereby a firm agrees to invest in a road if it is subsequently able to collect tolls for a certain period), the EU could guarantee to make up the difference if toll revenues fail to meet projections. Tenders for aid-financed projects should, where possible, be open to all countries in the region. Efforts should be made to train local companies in the techniques of bidding and participating in a tender – skills which many local firms lack.

★ **Encourage governments to co-operate on transport planning when drawing up their national programmes.** Investors seeking to win road-building contracts may be faced with competing national visions if, say, confronted on how a motorway should be built and what services it should offer. Greater standardisation would help to attract investors as well as improving maintenance standards on the roads once they are complete.

★ **Give priority to maintenance and upgrades of existing facilities, rather than focus solely on new construction projects.** There are plenty of roads in the Balkans. The problem is quality: motorways are a rarity; the existing roads are not built to take heavy European trucks; and maintenance is poor. With railways, the situation is even worse. Over 90 per cent of railways in the region are single track and less than 40 per cent are electrified. Maintenance standards are also poor. In Yugoslavia, the average speed on the network is now below 60 kilometres per hour and only 20 per cent of rolling stock is operational.

Air connections within the region itself, vital for business travellers, are poor. There are no scheduled flights at all on some routes between Balkan capitals. Vienna currently serves as a hub for the region, but this makes for long, indirect journeys. Most of the national air carriers are struggling – some face bankruptcy and others survive only with substantial state support.

These problems have prompted the airlines to focus on greater co-operation. At the end of 2000, JAT (Yugoslav Airlines) initiated discussions on an alliance with several other Balkan carriers (plus

Slovenia's Adria Airways and Hungary's Malév). Three working groups have been established:

★ **Commercial** Adria Airways is moderating this group, which is charged with investigating the potential for co-operation on business strategies, marketing and sales.

★ **Technical** Malév is co-ordinating a discussion of areas in which the airlines could harmonise technical standards and share expertise.

★ **Training** JAT is leading a debate on proposals for sharing training facilities and ensuring that airline personnel use compatible procedures. JAT has a large training centre for flight and commercial personnel, which is IATA approved.

JAT has already concluded co-operation agreements with Air Bosnia, Air Srpska, and the Macedonian and Montenegrin airlines. It hopes to gain similar deals with Malév and Tarom (Romania). Croatia Airlines, though, has expressed reluctance to co-operate closely, partly reflecting historical grievances over the routing of flights to the Dalmatian coast.

Preoccupation with such concerns misses the point. The establishment of new alliances in the region would not remove Croatia Airlines' control over its own flight schedules. It would, however, give the company opportunities to operate more efficiently, which could help it to offer more services and stay profitable. Trends in the global airline industry, with more and more national carriers joining international alliances and operating code-sharing agreements, reinforce the importance of such co-operation.

Slovenia's Adria Airways appears ready to move in this direction. It is taking part in the JAT initiative and is actively seeking a strategic investor to boost its capital, aware that its own growth depends on collaboration. Adria was one of the first airlines to introduce flights to Belgrade and Podgorica after the fall of former Yugoslav

President Slobodan Milošević in October 2000. The company already has code-share agreements with Germany's Lufthansa, Air France, Croatia Airlines and Israel's El Al. These alliances improve Slovenia's ability to service both tourists and business travellers. More regional carriers should follow Adria's lead for closer co-operation, paving the way for full-scale mergers in the future.

V Conclusion and recommendations

Regional co-operation is crucial to economic development in the Balkans. The ability of individual countries in the region to attract foreign investment depends to a great extent on their being perceived as part of a larger region – and functioning as such. Taken together, the Balkans represents a market of around 55 million people, rising to 130 million if Greece and Turkey are included. Similarly, local firms stand a far better chance of attracting financing or investment if they can trade across borders or exploit efficiencies gained by co-operating with neighbours. Those who have already invested in the region are generally based in one country while operating in several. But many other potential investors have walked away because the region does not yet function as a single market.

In order to foster these emerging regional business networks, the infrastructure and services upon which they rely also need to become more integrated. A Balkan energy market could identify variations in supply and demand to ensure more reliable provision of electricity. Foreign investors in telecoms could develop products to suit the needs of cross-border businesses, as the banking sector is already doing. Transport companies could work together to achieve lower costs while providing a seamless service across borders.

A welcome side-effect of this business co-operation is a firmer foundation for political stability. The development of relationships across borders gives business-people – both foreign and local – an interest in the security of the region. This helps to counterbalance the interest that many powerful players in the black economy currently have in instability and conflict. Economic interdependence also fosters better political relations among Balkan governments.

Sceptics rightly note that regional co-operation has been lauded as an ideal and promoted as a policy for years, while advances in this direction have been few. The concept has been advocated mainly by the EU, which at one stage made it a pre-condition of progress towards membership for the Western Balkan countries (Albania, Bosnia, Croatia, Macedonia and Yugoslavia). This linkage proved unhelpful. Leaders in the region were appalled at the prospect that their own chances of joining the EU might depend on the behaviour of their neighbours – countries they often regarded as backward, unreliable and aggressive. Croatia, for example, currently enjoys a per capita GDP nearly four times higher than Albania or Yugoslavia. Given the vast disparities among Balkan countries, the more advanced and stable states feared that their own accession to the EU would be sacrificed for the sake of weaker neighbours. Regional co-operation was thus seen as a threat, a measure designed to exclude Balkan countries from the bounties of European integration.

The EU has now altered its stance. The Stabilisation and Association Process introduced in 1999 provides a common framework for integration, but relations with the EU are conducted solely on a bilateral basis. States follow their own road-maps, work at their own speed and are assessed on their own merits. The new procedures have successfully re-invigorated Balkan enthusiasm for European integration. A less positive consequence is that the EU is now reluctant to promote multilateral contacts within the region.

Other institutions and associations have also promoted regional co-operation, with perhaps greater degrees of success. The Stability Pact for South-East Europe has brought together policy-makers from regional and western governments, and international organisations, with the purpose of achieving co-ordinated policies on political, economic and security issues. Another worthwhile initiative has come directly from the region itself – the South-East Europe Co-operation Process, launched in 2000. This regularly brings together heads of state and parliamentarians from the region

to discuss issues of common concern. However, neither institution has the resources or policy instruments to implement what decisions taken at its meetings. Hence the success of their efforts relies ultimately on the political will of national leaders. And few politicians expect to gain any domestic political capital by promoting co-operation in the Balkans.

Regional leaders, therefore, lack political incentives to foster links with neighbouring countries. Business people, however, focus on the concrete economic benefits of regional co-operation, and are more natural enthusiasts for integration. Where there is a strong business interest in co-operation, the emotional issues become less important. And that makes life easier for politicians. When the Yugoslav and Croatian chambers of commerce lobby for a bilateral free-trade agreement, for example, their governments find it easier to tell voters that a normalisation of political relations is in the national interest. Business people are more likely to see that co-operation offers opportunities, and are more likely to overcome the prejudices which pervade the region. A businessman will, after all, only pursue a venture if it offers clear economic benefits – his decision does not depend on any special kinship or brotherly love.

Business people in the Balkans are also a great source of expertise. They have continued to operate in the difficult economic and political conditions of recent years. They should now be mobilised into effective (and transparent) lobby groups, to shape and give feedback on policies affecting their operations. Foreign investors, too, would welcome channels through which to communicate their needs and frustrations.

In sum, this paper would support the following recommendations:

★ Governments in the region should accelerate the negotiation of bilateral free-trade agreements and seek to improve their readiness for accession to CEFTA. The EU should exert pressure on CEFTA to open up to South-East European countries.

★ Governments in the region should seek to improve customs services at borders in line with the World Bank's Trade and Transport Facilitation Programme. International donors should make the implementation of such projects a priority.

★ Business associations and chambers of commerce should educate their members about current border regulations and upcoming changes. They should conduct surveys of their members in order to establish a clear picture of the experiences and complaints faced by business people in using borders. They should also channel this information to governments to help them to revise policies.

★ Foreign investment agencies should co-operate to launch a Balkan-wide investment promotion programme, sharing information and providing joint assistance to foreign investors.

★ The EU should provide financial assistance to cover the costs of such a campaign. Successful foreign investors in the region could sponsor the campaign, share experiences and help to identify opportunities.

★ Pairs or trios of Balkan governments should consider offering joint incentive programmes to attract foreign investment in cross-border projects to their countries.

★ Chambers of commerce and business associations in the region should co-operate to host sector-specific meetings to bring

together companies with similar interests from around the region and abroad. This should facilitate the formation of joint ventures and intensify contact with potential foreign investors.

★ National governments should set up a regional development bank, to improve access to financing for local businesses with cross-border ambitions.

★ In key infrastructure sectors that remain in state hands, governments that are restructuring companies should take into account the benefits of regional co-operation when preparing them for privatisation.

★ Balkan governments should accelerate liberalisation and privatisation programmes in these key sectors, to open the way for foreign buyers to exploit regional opportunities.

★ National regulators of energy and telecoms sectors should share information and seek to harmonise standards across the region.

★ International donors should give greater priority to supporting intra-regional transport infrastructure.