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Quo Vadis Southeast Europe? EU Accession, Regional Cooperation and the need for a Balkan Development Strategy

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ABSTRACT

In some sense there is a very simple answer to the title question: Southeast Europe is heading towards the EU, though a period of weak regional cooperation, asymmetric relations with the EU and a slow and discontinuous accession process. The speed and discontinuity of this process, together with the changing character and purpose of the process of regional cooperation, raise two crucial questions for the region. First, is there a *need* for regional cooperation and integration in SEE? Second, *what type* of cooperation is needed? The paper seeks to address these questions by discussing the challenges and opportunities resulting from recent developments in the region ('EU distancing', 'regional ownership', etc) and their implications for the perspective that the region can follow. In doing so, it attempts an analysis of the goals of regionalism in Southeast Europe and offers some policy proposals for its future.

Keywords: Southeast Europe, regionalism, developmental model, regional ownership, EU distancing

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1. Introduction

Despite some obvious similarities, the transition process in the Balkans has been very different from that of the Central and Eastern European countries (CEECs). This is both because of the dissolution of former Yugoslavia and the inter-ethnic conflicts and open wars that followed and because of the very ‘Balkanised’ transition that was followed: on the one hand a delayed transition; on the other, a dual (or even triple) transition, which includes not only the process of transformation from the communist structures to the capitalist economy but also a process of development, with the countries in question moving from a state of semi-agricultural and in any case not industrialised-proper economies to structures of service-oriented and knowledge-based economies. A third transition, of course, which justifies the term ‘triple transition’, includes the very transition from war (and the associated war economies) to peace.¹ It is in the context of such ‘transitions’ that the European perspective emerged in –and for– the region.

¹ This is a rather different use of the term than the one initially described by Offe (1997) and it perhaps suggests that the region in fact experienced quadruple or even quintuple transitions (see Kuzio, 2001).

On the other hand, also the European approach to the region has been markedly different from that concerning the CEECs. First, evidently, there has been no *en bloc* treatment of, and accession for, the countries of Southeast Europe. Second, the EU approach to the region has changed dramatically over the years, with the approach initially adopted (in the beginning of the 1990s) being very different from the approach adopted more recently. Overall, there is a clearly identifiable gradual deepening of the EU's involvement in the region reaching, very recently (after the 2007 enlargement), a point of saturation, with a new and indeed novel idea coming forward concerning 'regional ownership' and the establishment of the Regional Cooperation Council, which will absorb – and, for all practical purposes, replace – the Stability Pact for South Eastern Europe (Busek, 2003).

Given these idiosyncracities and the developments with regards to the EU's involvement in the region, a question that clearly and rather emphatically emerges is *what happens to Balkan economic cooperation without accession*: without the immediate prospect of accession and the carrots and sticks associated to it? To address this issue it is useful to draw a number of analytical distinctions that can help disentangle the key concepts that are of relevance and that are often crudely summarised in the antithesis between the European and regional perspectives (or, even more crudely, between Europeanisation and Balkanisation) (Bianchini and Uvalic, 1997; Demetropoulou, 2002). These distinctions can be made along three conceptual dimensions. The first concerns the alternative –competitive or complementary– perspectives for the region: the

European perspective, meaning the region ‘moving to Europe’ or becoming increasingly an integral part of Europe; and the regional perspective, meaning the region becoming an organic region in itself. The second concerns two alternative processes, which again can be seen as either competing or complementary: the process of integration and the process of cooperation. While the latter (cooperation) is mainly about policy communication and exchange in an attempt to harmonise policy, the process of integration undoubtedly concerns something deeper and more organic. Finally, there is a distinction to be made between the two geographical and geo-political levels at which these processes and perspectives can be –and are being– materialised: the European and the regional.

Drawing these distinctions is extremely helpful and, I would argue, necessary in order to establish the context within which the various policy options can be evaluated and analysed. This is for at least two reasons: first, because often the terms cooperation and integration are used interchangeably and without any clear account of their analytical distance; second, because the meaning of the term *perspective* is often quite blurred, reflecting in some sense a conflation between the *location/scale* and the *orientation/objectives* of the examined processes (be they processes of integration or of cooperation). In other words, there is a deficiency in separating between (a) where these processes take place and (b) under which perspective they are being evaluated.

Some examples should be useful here. If one employs as the analytical-evaluation basis the European perspective, then quite evidently regional cooperation is little more than simply a means for European accession: the Balkan states have to cooperate with one another because this is part of the (extended) conditionality of the European Union; cooperating ‘as old Member States do’ is a precondition for eventually becoming members of the EU family (EC, 2005a). Conversely, if one is to employ a regional perspective, then the meaning and implications of regional cooperation change dramatically. From such a perspective regional cooperation is really a strategy and an opportunity for the countries in the region to restructure their economies: regional cooperation allows the Balkan countries to exchange policy ideas and best practices, so as to achieve an effective and sustainable restructuring of their respective economies and thus enter into a sustainable development path that will eventually lead to economic convergence with the western European partners. Similarly, one can examine the implications and meanings of the different types of processes or the different geographical scales (for example, examining the meaning of *European integration* under the two distinct perspectives) and explore the policy priorities and recommendations emerging from the different combinations. The table below depicts in a summary form the resulting priorities and recommendations.

Table: Regionalism versus the European Perspective

Level and Process	Perspective	
	European	Regional
<i>Regional</i>		
Cooperation	Means for EU accession	Means for restructuring / development
Integration	Substitute to EU accession	Complement to global integration
European		
Cooperation	Substitute to EU accession	Means for restructuring / development
Integration	Means for restructuring / development	Substitute to regional integration

It is evident from the above table (but still very important to highlight) that if one takes the European perspective as the starting point it is almost inevitable that the optimal policy proposal will point towards the direction of *regional cooperation* and *European integration*. This is what we actually observe: both the EU and the countries concerned adopt a European perspective as their starting point and thus they invariantly perceive regional cooperation almost singularly as a means for acceding to the EU (European integration) – and they moreover try to ensure that the former will not become a *substitute to EU accession*. Conversely, if one adopts a regional perspective as the point of departure, which implies that there is an inward focus towards the region itself and the EU is presented as a key element of a wider context, then rather obviously the policy proposal that emerges is one concerning strengthening regional integration as a means of complementing and managing the process of internationalisation of the Balkan economic space (under globalisation). The logic here is that *regional integration* is a sustainable strategy for developing

the region as a single economic entity (one market) and *European cooperation* becomes then a useful means for downloading an operational policy framework (and much-needed institutional, political and financial assistance) that can support restructuring and development for the region.

Some important questions for the region arise immediately from this analytical decomposition. First, how do the different choices impact on the developmental model of the region and the development path / trajectory that the region can follow? Second, and equally importantly, how do the recent policy developments, especially the creation of the Regional Cooperation Council in 2008, change the balance between the two perspectives (the European and the regional)? Linked to these central questions is the more subtle but also more pressing issue for the Balkans concerning what is to be done without an immediate prospect of accession. The remainder of this paper is concerned exactly with these questions. We start with an examination of the current situation in the region with regards to economic integration and policy harmonisation – in other words, the state of play of *southeast European regionalism*.

2. Southeast European regionalism

There are a number of overlapping literatures that address directly or indirectly the issue of (SEE) regionalism, encompassing economic analyses of trade and foreign direct investment (Kaminski and de la Rocha, 2003; Bjelic, 2005;

Kandogan, 2005), political economic analyses of regional cooperation and policy preference convergence (Bartlett and Samardzija, 2000; Welfens, 2001; Bechev, 2004), and policy analyses of specific policies and processes (Kekic, 2001; Lopandic, 2002; Liebscher, 2005). The following review of the situation in SEE links to all of these sub-literatures and further draws a distinction across the four main markets: the product market, the labour market, the capital market and the financial market; and between these and the domain of policy.² As will be shown, despite some significant steps towards both policy harmonisation and economic cooperation, still much remains to be done and not everything is at the level or the direction that would deem these processes sufficiently satisfactory.

The product market (trade in goods and services) has seen some very fast and very deep liberalisation, even leading to cases of extreme trade openness (in the sense that trade takes up an unusually high share of national GDP in most SEE countries). On the other hand, intra-regional trade links are uncharacteristically low and we see very little trade in both absolute and relative terms between the countries in the region. The EU is by far the most significant trade partner for all SEE countries. However, even within the EU, SEE trade exhibits a very skewed geographical distribution: almost half of all SEE trade (and over two-thirds of trade with the EU) is with only four EU member states (Italy, Greece,

² The discussion of the developments in the product market is based, inter alia, on Messerlin and Maur (2000), Astrov (2001), Christie (2001), Gligorov (2001), EC (2005b), Gaucaite-Wittich (2005), Kernohan (2006), Uvalic (2006) and DeRosa and Kernohan (2007). Similarly, the discussion regarding the empirical evidence and observed patterns in the capital market is based on Labrianidis (1996), Gligorov (2001), World Bank (2003), Desmet and Rojas (2004) and Demekas et al (2005).

Austria and Germany). One important implication of that is of course the very high trade deficits registered by most countries in the region.³ This is also due to the specific nature of SEE exports. The type of products that are coming out of the region predominantly are low value-added consumer-goods. This implies that the per-employee value of exports is lower compared to that of imports but also, and crucially, that this ratio has the tendency to decline over time (worsening terms of trade).

The capital market has also experienced significant liberalisation and is characterised by very high openness. In this field we also see some denser and deeper steps towards policy harmonisation. However, the situation with regards to intra-regional linkages in the case of FDI is dismal. With the exception of Greek FDI in the region and some more recent brownfield investments (mergers and acquisitions; take-overs) across the former Yugoslavia (mainly from Serbia and Croatia to the corresponding 'ethnic parts' of Bosnia-Herzegovina), there is effectively no intra-regional FDI in the region. A partial explanation for this is the very high competition from abroad for a given set of brownfield investments (mainly through privatisation) and the very few market opportunities and very high entry costs for some greenfield investments (e.g., mobile technologies). However, even the type of FDI coming from outside the region, is in many respects not the most productive or the most appropriate for inducing high rates of growth (by creating positive externalities through

³ Although in most cases these trade deficits are being counter-balanced by the positive current account balances that are due to FDI inflows, the nature of the trade deficits appears to be structural and thus it is more difficult to address – especially in the context of very high capital mobility and a fast changing structure of economic incentives for investing abroad.

knowledge transfers, importation of new production methods and processes, development of new products, etc) and speeding up economic restructuring. Extra-regional FDI is concentrating mainly on distribution and services targeting specifically the domestic market – and these are sectors that are not normally producing very large spillovers, at least in the context of developing / semi-industrialised economies.

Regarding the labour market, there is no integration process and hardly any relevant dynamic (Huber, 2006). There is a huge, well-reported and well-studied emigration movement (outflow of population), especially from Albania but also from all other SEE countries. This, however, does not constitute a pure labour market flow, in the sense that it has not really been driven by traditional labour market equilibration criteria (e.g., relative value of the expected wage in the recipient economy) and is not actually operating as a mechanism that can bring about labour market equilibrium. The migration experience in SEE can be best described as an exodus of a large part of the population to avoid the hardship associated with the fall of communism and the process of transition to capitalism (and, in the case of former Yugoslavia, the ones associated to war and ethnic violence) and only heuristically it can be seen as labour mobility in a textbook sense (equilibrating labour mobility). Rather, it is perhaps causing deeper obstacles to labour mobility within and across the countries of the region and thus also to regional labour market integration (Horvat, 2004). Further, it needs to be noted that cross-country commuting is extremely limited (although there is hardly any reliable data source to measure actual commuting

flows across countries in the region), even in the case of the republics of former Yugoslavia (where the historical, linguistic, infrastructural and other factors that are normally associated with commuting interactions are in fact present). Regarding the institutional aspects of the labour market, notably there is very little in terms of coordination of employment policies – let alone wage policies or training and education policies (including recognition of professional and vocational qualifications etc) (Arandarenko, 2004; Susic, 2004). The countries are characterised by very different pension and benefits systems and do not have a unified migration and repatriation policy.

In contrast to the labour market, the financial market is clearly the most liberalised and represents the most developed area of economic cooperation in the region (Liebscher, 2005). This of course has been mainly a market-driven process in the sense that financial investments from the private sector is what actually drives the integration process (Bini-Smaghi, 2006). An interesting example here is some recent moves towards financial market integration with some M&As of stock exchange markets in former Yugoslavia, some moves toward cross-border stock-market coordination and, very recently, the signing of a new Memorandum of Understanding for regional cooperation by all Central Banks in the region.

Although the financial sector is indeed the main area where market developments link directly to, or stimulate, processes of policy coordination, a quite dense network of policy coordination schemes and initiatives in the

region exists in many other sectors (see, among others, Lopandic, 2002 and Bechev, 2006), irrespective of whether market-driven or not. Regional cooperation in the realm of policy encompasses a wide range of issues, including trade (with the recent establishment of the SEEFTA as an extension of CEFTA), energy (e.g., the Community Energy Treaty), transport, aviation and investment (through the Investment Compact, which harmonises the policy environment for investment in the region), but also aspects besides the economy, for example significant agreements for border security, asylum seekers, immigration, trafficking, environmental issues and so forth.⁴

Nevertheless, as has been extensively discussed in the literature (Bianchini and Uvalic, 1997; Gligorov et al, 1999; Bartlett and Samardzija, 2000; Uvalic, 2001; Anastasakis and Bojicic-Dzelilovic, 2002; Altman, 2003; Dimitrova, 2003; Bechev, 2004 and 2006), SEE regional cooperation is not something that has developed indigenously and, importantly, with domestic-regional concerns in mind. Rather, it is a case of *imported regionalism*.⁵ SEE regional cooperation is not only dictated by the EU's extended conditionality (EC, 2006 – see also Anastasakis and Bechev, 2003) but, more importantly, it has become a notion that is inexorably linked to the European perspective, as can be seen throughout the various policy documents concerning the region and most emphatically crystallised in the Thessaloniki Declaration.

⁴ It should be noted that this network has been established in a pretty much developmental process, as the EU became more and more involved in the region (starting with the 'Regional Approach' in 1996, the establishment of the SPSEE in 1999, the institutionalisation of SEECP progressively since the late 1990s, and the consolidation of regionalism that comes with the creation of the Regional Cooperation Council in early 2008).

⁵ On the EU's function as a 'promoter of regionalism' see Schimmelfennig (2007).

In some cases the process of cooperation is only *because of* a European process. For example, the Energy Community Treaty, which has been much heralded as a great development in (and for) the region, was devised neither *in* nor *for* the region (rather, it was simply ‘presented’ to the region as a form of EU-promoted regionalism). Similar are the dynamics in the fields of land transport and aviation. In some other cases, the cooperation process is *entirely dictated* by external (or externally inspired) processes. This is the case with trade integration in the region: the official establishment of SEEFTA (still, only as an annexation to CEFTA) was only possible after the full net of bilateral agreements had been completed, all under the strong encouragement, if not direct guidance, of the EU. In some other areas, especially where it concerns policy harmonisation, cooperation is clearly *ad hoc*, being directly the outcome of the process of adopting the EU acquis. Finally, some cooperation processes and agreements still *remain fragmented* (bilateral), as is for example the case of the two recently established gas and oil pipelines of Burgas-Alexandroupolis and Turkey-Greece-Italy.

All in all, there have been very few attempts to develop truly intra-regional policy harmonisation and cooperation and, where some such attempts are identifiable, they are often mainly market-driven, in the sense that market developments dictate, encourage or necessitate, similar developments in the realm of policy. Despite the rhetoric of regional cooperation, a ‘regionalist deficiency’ is clearly identifiable in the region.

3. SEE regionalism evaluated

This ‘regionalist deficiency’ is not unrelated to the way the EU has been approaching the question of SEE regionalism. Despite the rhetoric (see for example EC, 2005a) the EU has a very functional view concerning what SEE regionalism is, or can be: it is a series of commitments that are taken by the SEE countries in exchange for deeper association with the EU and which can ensure that another ‘Balkan war’ does not erupt in the region in the future. Interestingly, also functional (and rhetorical) is the region’s own view of SEE regionalism (see for example the 2006 speech of the Bulgarian Deputy Minister of Foreign Affairs at the Irish Institute for European Affairs provocatively titled “SEE the road to Europe”): ‘Europe’ remains the destination and regional cooperation is simply the ‘road to Europe’. It is as if by ‘going to Europe’ the SEE countries can leave the Balkans behind! Trapped in this rhetoric both sides reduce regionalism to a functional(ist) tool for strengthening SEE ‘Europeanisation’ and fail to see its potentially instrumental role for regional development and modernisation.⁶

⁶ In this context, it is really worrisome how little theory has managed to inform policy-making in the region (for example, the tremendous advances in new trade theory and New Economic Geography have hardly been picked up in the academic and policy literatures that concern themselves with the region). We return to this point later in this section.

3.1. Regional cooperation versus regional integration

How can we then evaluate the state of SEE regionalism, in other words, the progress of regional cooperation and integration? To do so, we go back to the analytical distinctions introduced earlier and examine from this perspective the developments in the four main economic areas reviewed above.

In the area of trade, the European perspective is clearly what drives regional *cooperation*. The countries in the region have real difficulties finding natural trade partners intra-regionally and thus the main thrust for the development of the existing thick network of intra-regional trade agreements (now in the form of SEEFTA) has been provided by the need for deeper economic integration with the EU. However, the European perspective is also limiting regional *integration*, because by providing a push towards deepening the links with the EU it generates some trade diversion (or cancels some trade creation and diversion that could be happening in favour of intra-regional trade) that actually increases further the economic fragmentation (unconnectedness) of the region. Moreover, trade with the EU is also pushing the SEE economies towards specialisation in increasingly similar activities (and product-qualities), on that basis of what in the literature is known as hob-and-spoke linkages, thus making intra-regional trade increasingly difficult and unprofitable.⁷

In the capital market, the European perspective, again, has intensified significantly capital market competition, making it particularly difficult for

⁷ In this sense, there is almost a perfect analogy between this process of trade dependency and that experienced by some SEE countries, most notably Bulgaria, during the Cold War era in their trade relations with the then Soviet Union under CMEA.

domestic companies to compete and find a place in the regional capital market – which perhaps is a further limiting factor for regional (capital market) *integration*. However, the inflow of foreign investments and the competition for attracting such investments has also created the conditions for policy *cooperation* in this area, in the form of tax incentives and the like (or, at least, for attempts to this direction). In terms of the labour market, the European perspective can be linked to the significant outflow of skills, which is not conducive to the process of *integration* within the region. In this case no real regional process is triggered, as the EU is also lacking a specific framework for labour market *cooperation* internally (despite the Luxemburg process – see Nedergaard, 2006). It is only in the financial market where we see the European perspective being more conducive for both processes of regional *cooperation* and *integration*, as discussed above.

Of course, the fact that the European perspective may be less conducive to regional integration is not by itself a problem. In order to be viewed as such, one needs to establish that deeper (and more organic) SEE integration is actually needed, in other words that it has identifiable beneficial effects, at least in the long run. To make this case, we review consecutively the political and economic rationales for regional integration in Southeast Europe.

3.2. SEE integration: does it make sense politically?

The starting point for any argument making a case for political cooperation and policy harmonisation in the region has to start from history. Despite their fragmentation and ethnic hostility, the countries in the region share many historical, political and cultural commonalities. The region shares a common historical past and future trajectory; in other words, all countries in the region come from a very similar place (the inherited influences of the Ottoman Empire) and they all move, admittedly with different speeds and different degrees of success but notably through a very similar road (Europeanisation), to a very similar place (the enlarged EU). From this perspective it seems obvious that cooperation is the best strategy, even if in the way to reaching this same place, information asymmetries and short-term considerations may create strong incentives to ‘cheat’, i.e., to view this process as competitive and exclusive rather than as necessitating exploitation of synergies and information sharing.

But besides this rather empirical observation about historical and future commonalities, political theory also offers strong arguments in support of collaboration in the Balkan context. Political cooperation and policy harmonisation are means to securing political stability and peace, which are essential factors for both indigenous and externally-led economic development (Rosamond, 2000). But they also help activate a number of processes that themselves facilitate speedier economic and political development internally, for example processes of policy learning (through information sharing and

policy exchange – see Dolowitz and Marsh, 2000; Eising, 2002; or Evans, 2004), policy spillovers (through the functional interdependence of policies and policy transfers – see Radaelli, 2000 and Niemann, 2006) and policy preference convergence (through the identification and exploitation of synergies – see Bennett, 1991; Collignon, 2003; and Franchino, 2004). This of course helps create a harmonised political and economic environment, which cannot be but a good thing for the region, but importantly it also helps avoid inter-state competition, a concern which at the EU level has been expressed in the debate about the ‘race to the bottom’ (Persson and Tabellini, 1995), where competition among partners leads to a universal lowering of standards where everybody, albeit through optimal actions at the individual level, is becoming worst-off in comparison to a ‘cooperation’ scenario. The case of tax-incentives competition, in order to attract international FDI, is a good example here. Thus, the case for political and policy cooperation is well supported by historical, political as well as economic arguments.

Moreover, it should be noted that there is also a clear *efficiency* argument to be made. Federalism, at the level of theory, as well as EU practice, has shown that some policies are more efficiently delivered at the supra-national level (Boerzel and Hosli, 2002). For example, competition policy only really makes sense at the supra-national level: when it disintegrates into independent national policies it becomes, rather counter-intuitively, protectionism! Similar are the arguments for redistribution and cohesion policies (i.e., where compliance cannot be guaranteed through state action or intergovernmentalism) but also for

investment and innovation policies (i.e., where there are clear economies of scale in the production of public goods or in the delivery of policies).

3.3. SEE integration: does it make economic sense?

The case for economic cooperation and, indeed, deeper economic integration is not any less well-supported. The most well documented argument in the literature is the ‘large-market effect’, i.e., the appreciation of the fact that larger markets are more attractive for large international businesses and other investors (FDI). The idea here is that ‘creating a region’ has important psychological as well as market effects, both acting in the same direction to enhance the attractiveness and visibility of the (countries within the) region. Trade theory offers many other insights that can be used to support the argument for regional integration – although admittedly in this field a number of arguments against regionalism in less developed regions (i.e., arguments in favour of North-South integration) can also be found. Without getting too deep into the theory, it is commonly observed that the type of integration (North-South versus South-South; symmetric versus hub-and-spoke) plays an important role for the impact that integration has on overall welfare (development) and on the distribution of the gains from integration (Baldwin et al, 2005).

North-South integration, in our case, Balkan-state integration with the EU, can create a number of asymmetries –and has in fact created such asymmetries–

most evidently observed in the hub-and-spoke trade relationship between the EU and the countries in the region (Gligorov, 2004). In this model of integration, most of the benefits from integration accrue to the developed partner (the EU) and the least developed partners are pushed towards production specialisations that are adverse in the long-run for the countries concerned (Georgakopoulos et al, 1994). The example here is for ‘South’ type countries, as was the case with Greece in the 1980s (and Greece took over 10 years to recover from her own ‘accession shock’), to regress (‘specialise’) towards production in traditional industries (agriculture, natural resource extraction and basic manufacturing) with low value-added activities, low technological content and thus also worsening terms of trade over time.⁸

It thus appears that the benefits from trade integration are greater the more similar are the trade partners, the faster and less costly they can absorb any technology transfers that are associated with trade and FDI, and the more they can exploit in similar degrees the benefits of market enlargement (Georgakopoulos et al, 1994; Chui et al, 2002). This makes the case for South-South integration in SEE increasingly appealing – although counter-arguments would point to the fact that lack of technology and know-how as well as very strong similarities in the domestic production structures would suggest that there are very few things to be gained from this type of integration (Venables, 2003). We return to this point in section 4.2, after looking first at the changes in the conditions of the region that accrue from EU’s new regional approach.

⁸ On the experience of Greece and its relevance for the Balkan transition countries see Baliotas (1997), Petrakos and Pitelis (2001) and Tsounis (2002).

4. EU distancing: a challenge and an opportunity

4.1. *Challenges and opportunities*

As has been suggested already, the recent developments with regards to the EU, namely the absence of a specific date or timeframe for the next wave of enlargement and the shift towards promoting ‘regional ownership’ (with the consolidation of the SPSEE into the newly created RCC), what can be rather reasonably be seen as ‘EU distancing’, present both a challenge and an opportunity for Southeast Europe. A *challenge* concerning the question as to how to cooperate without the carrots and sticks associated to EU conditionality and the EU ‘pull factor’. But also an *opportunity* to define what is it that the region represents and what is the *object* of regional cooperation in the Balkans.

Concerning the challenges, first it is clear that with the indefinite postponement of further enlargements the EU loses some of its ‘carrots’ (Bechev, 2006).⁹ Moreover, own internal problems of the EU (related to the revision of established processes, such as its cohesion policy, SGP and the Lisbon strategy, but also to the opposition to moving forward with its institutional deepening, as is the case with the rejection of the European Constitutional Treaty), mean that it also loses some of its ‘stick’. Of course this needs not be a problem by itself.

⁹ There is a potentially much more important challenge related to this, namely the issue of whether EU distancing may cause disillusionment to the ones ‘left-out’ and thus also a further distancing from their side. This is obviously a very serious concern with regards to the Kosovo issue and the EU-Serbia relations. Although this and other security issues may be particularly important, we do not consider them in any detail here, partly because the focus of the paper is on more economic issues but also because we consider the chances of a revival of the 1990s conflicts to be –thankfully– extremely thin.

The very transformation of the SPSEE and the establishment of the RCC in 2008 can reasonably be seen as a conscious effort, at least from the side of the EU, to institutionalise regional cooperation without the old framework of carrots and sticks, i.e., of positive and negative incentives or conditionality.¹⁰ Nevertheless, this logic of a wider policy transformation that departs from such notions of conditionality and incentives does not seem to characterise the policy approach of either side (the EU and the SEE countries) (Anastasakis and Bechev, 2003). In this sense, the RCC is merely a waiting room for the non-EU SEECS ‘until the doors are open again’, i.e., until the next EU enlargement is possible.

However, as has been mentioned already, there are also very good reasons to see such developments as a concrete set of opportunities for the SEE. With the promotion of ‘regional ownership’, SEE countries are invited to set their own agenda for cooperation, an agenda that can relate not only to the content but also to the speed and the extent of this cooperation (Busek, 2003; Cvijic, 2007). Thus, it appears that this is probably the first time, at least since the late 1980s / early 1990s, that the region has the opportunity and the freedom to ‘own’ its regional cooperation process (obviously, in the first period the choice it followed was at best catastrophic). But together with this opportunity and freedom comes an equally concrete responsibility for the region to take an introspective look in itself, produce an internal valuation of its needs, wants and potentials, develop a positive image for itself, and promote it externally. At

¹⁰ On the role and types of EU accession conditionality see Schimmelfennig and Sedelmeier (2004), Hughes et al (2004) and Schimmelfennig et al (2006).

least some realisations of this process would call explicitly for the establishment of a coherent Balkan Development Plan (see Petrakos, 2002 and Monastiriotis and Petrakos, 2008) – and this is really what ‘regional ownership’ calls the region to work towards.

This rather optimistic account should not lead to an underestimation of the need to engage with a careful examination of the pros and cons of the different policy options for economic and political integration that are open to the region – as well as of the different developmental models that are available for the region, within the wider context of globalisation and international regionalism. Put differently, regional ownership transfers, at least partly, the locus of decision-making with regards to whether the region is going to specialise in producing textiles for the EU or cultural and other forms of tourism for the American market, to the centre of the region – rather than to some notional or real European decision-making centre (not necessarily related to Brussels as such: business headquarters, ‘EU demand’, or any other gravitational force could do).

Importantly, this transfer allows the region to consider questions that until now it has rarely asked, for example how the dynamic of the emerging markets of India and China, but also of countries further afield (Brazil and South Africa), changes our perceptions about what are the areas and products where the region should focus to build its comparative and competitive advantages of the next decades – and in particular about how politically appropriate and economically efficient it is in the long-run for the region to specialise in products towards

which the region is pushed as a result of its intensive and extensive trade with the EU. In the analytical schema of Table 1, this was depicted in the ‘*complement to global integration*’ box under regional integration from a regional perspective – a dimension that the insistence on the European perspective fails to capture.

Although such an evaluation, of the advantages and disadvantages of different policy options and developmental regimes, is not something that can be reasonably undertaken within the limits of the present paper, it is however useful as a minimum here to review the main implications of the different policy approaches towards the EU or, in other words, of the chosen balance between European integration and regional cooperation for the region. Put differently, it is still useful to examine, albeit rather schematically, the expected pros and cons of European cooperation and integration vis-à-vis those of regional cooperation and integration.

4.2. Evaluating the two perspectives: the cost of Europeanism

One of the most obvious advantages of European integration is that it triggers political and economic reform – as has been shown very clearly in the transition literature but also experienced on the ground by almost all transition countries, where the EU has played a pivotal role in incentivising and promoting democratisation, liberalisation of markets, etc.¹¹ The EU has also

¹¹ There are of course examples and instances where political (democratisation) and economic (liberalisation) transition proceeded fast *and effectively* also in the absence of a catalytic EU role; while, inversely, there are also many instances where such transitions have been much less speedy and effective, despite the EU. Moreover, there are also questions of simultaneity and endogeneity here, as the most successful ‘transformers’ were allowed to develop stronger links with the EU (endogeneity)

played an important role through supporting economic restructuring and general development through aid (not only through PHARE, but also through the various other instruments, such as CARDS, IPA, SAAs, and the co-financing from other institutions such as the World Bank, the EBRD, the European Investment Bank, etc). Finally, the process and prospect of European integration has undoubtedly contributed to the economic stabilisation of the region through the reduction of risks, the lowering of borrowing costs and of interest rates, and thus the attraction of increasing numbers of foreign investments in the region.

In a sense, the main disadvantage of this process of European integration is the diversion from the objective of regional integration, despite the rhetoric and some efforts to this direction. As has been argued extensively in the literature (Uvalic, 2001; Anastasakis and Bojicic-Dzelilovic, 2002; Dimitrova, 2003; Gligorov, 2004; Bechev, 2006), the EU has always maintained a predominantly bilateral approach to the region, either through its trade agreements or through its association agreements, thus increasing the fragmentation of the region and, importantly but less visibly in the literature, of the Balkan economic space (Petrakos and Economou, 2004; Monastiriotis and Petrakos, 2007). Another disadvantage of the European perspective, which although captured well in works examining issues of implementation (e.g., studies on the Europeanisation of policy in the transition countries – see Grabbe, 2001; Hille and Knill, 2006;

and as the geography of transition and accession suggests a much more exogenous pattern of success with transition (simultaneity). While such observations undoubtedly call for a more careful examination of the role of the EU and its ability to mobilise economic restructuring and political reforms, such a discussion is well beyond the objectives of this paper.

Johannsen, 2006) has not been integrated sufficiently in the literature on SEE regional cooperation, is that related to the actual and opportunity costs of adjusting to an alien and very complex institutional and policy framework, which is not necessarily or not always suitable for the region.

There are many examples to support this statement, but the case of regional policy offers a particularly useful case. In this area, transition countries (which traditionally had very little experience with regional policy, needed strong central governments in order to implement unpopular but necessary reforms, and since the early 1990s had developed a culture of anti-planning and local competition) were required to implement a model of fiscal decentralisation (due to the nature of EU funding) and administrative divisions of space (due to EUROSTAT requirements) that created significant problems of organisation, control and ultimately of efficacy of the very policies that such structures were supposed to facilitate (Thielemann, 2002; Hughes et al, 2004; Monastiriotis, 2006).

There are however numerous other concerns regarding the true impact of the European orientation of the region, some of which emanate from trade theory considerations. Here one can identify, as also noted earlier, the implications of developing increasingly adverse specialisations in the production and export bases, the trends of worsening terms of trade for the products and qualities produced in the region, the asymmetric role of trade costs for countries / products with different price elasticities of demand, and in general an array of

the theoretical and empirical concerns that have to do with trade integration between unequal and distant partners (Georgakopoulos et al, 1994).

4.3. Evaluating the two perspectives: the cost of regionalism

On the other hand, regional integration has its own advantages and disadvantages. The main advantage of regional integration has been partly elaborated earlier and it refers to the creation of a large single market, where demand potential is greater (thus also leading to increased inward FDI), economies of scale are more fully or easily exploited (with significant productivity and innovation effects), and regional or sectoral imbalances are less easily translated into economy-wide shocks and disturbances (which are normally linked to small economies, monocultures or duality economies – all of which are present characteristics of the fragmented Balkan economic space) (Petrakos and Totev, 2000; Petrakos and Economou, 2004). All these advantages, if realised, can establish a critical mass (in terms of both market and production potentials) that will allow the development of a number of dynamic competitive advantages that the region will be able to exploit (Fugazza and Robert-Nicoud, 2006). Related to the above is the observation that the similarities across countries in the region in terms of production structures, comparative advantages and consumer preferences can facilitate faster and more organic knowledge transfers (which are linked to higher productivity through technological / process innovation) and promote product diversification (which is linked to greater incomes through product innovation).

This is not perhaps as self-evident as it may sound at first, as many authors have argued that the homogeneity of the region does not allow for significant synergies to be identified and exploited through economic integration (Venables, 2003; Gligorov, 2004; Grupe and Kusic, 2005). Although this argument may have some validity in remote and chronically underdeveloped areas (Glania and Matthes, 2005), such as the countries of sub-Saharan Africa, it is very doubtful that, for example, the level of development in the Balkans is not suitable for an indigenous tourist industry to develop its own distinctive competitive advantages through product differentiation and branding – aspects that can only be reinforced and supported by regional integration and intra-regional intra-industry trade.¹²

A similar argument can be made with regards to policy harmonisation – as has been already implicitly stated earlier with respect to regional policy. It should be clear that it is much easier and less costly to exchange policy ideas within the region rather than with a really qualitatively different partner, such as the EU. Cultural and historical ties, a common sense of a ‘Balkan way of doing things’, but also historical path dependency (especially with regards to institutions that have in one form or the other survived all the way through the Ottoman period), all imply that institutional arrangements across the region have a common language that can be more easily and most costlessly communicated across.

¹² Further, the very theoretical argument on which this assertion is based, as has been developed over many years by Prof A. Venables and published recently in the *Economic Journal* (Venables, 2003) has attracted wide criticism even within the new trade theory literature (see Krishna, 2003; or Fugazza and Robert-Nicoud, 2006).

Of course, significant potential disadvantages also exist in the case of regional integration. On the one hand are arguments emanating from trade theory, relating to the negative consequences in the form of trade diversion, which is seen as the natural outcome of regional integration. Although, as stated above, this argument has been made quite convincingly both with direct reference to the regional literature (Grupe and Kusic, 2005) and at a much more theoretical level (Venables, 2003), in effect the argument about trade diversion is essentially static (it does not take into account the impact that trade has on production specialisations) and of course assumes that there are no serious distortions within the region that prevent intra-regional trade in the first place (so that one can talk about trade diversion rather than trade creation). Both assumptions are largely irrelevant for SEE. On the other hand there is the more pragmatic consideration that the region does not possess, for the time being, the capacity to create the 'critical mass' required to support its own regional development. Not only the region is extremely dependent on external demand and international aid, but also the region has not yet managed to recover fully from the real and psychological traumas that the dissolution of Yugoslavia has created (or, for some, is still creating).

4.4. On the choice between perspectives

As a conclusion, it appears that there are a number of advantages and disadvantages tied to each of the policy options and perspectives, that can be neither balanced-out nor ignored. However, rather than suggesting that any, or the established, policy option is thus preferable (due to either avoiding the costs

of a policy shift or because support for the existing policy is already in place), the above observation should be taken to suggest that there is a concrete need to counter-balance the process of European integration with a firm move towards deeper regional integration – not simply cooperation. Of course, a number of problems exist that can make this a very problematic goal. Interestingly, these problems are not emanating only from within the region; rather, some are also coming from the part of the EU. The EU approach has not been –and even today it still isn't– particularly conducive to regional integration. Almost each single country in the region has a different status vis-à-vis the EU, so it is really questionable whether and how the EU can be seen as treating the region as a single entity and as a potential object of organic regional cooperation (regionalism).

Nevertheless, the internal problems appear more serious. The region clearly lacks a regional leader. A number of countries that could have taken up this role (Greece, Slovenia, Romania or Bulgaria, even Hungary or Austria) have not been very successful – or very interested – in doing so. For that matter, the new EU member states of the region (Romania and Bulgaria) are more interested in catching up with the CEECs than leading the way within the region. Ethnic tensions – latent and unresolved – remain a big obstacle to the deepening of regional ties; while a number of institutional weaknesses (for example weak administrations that face significant difficulties in sufficiently absorbing and efficiently implementing European or simply national policies) persist and constrain institutional convergence and policy harmonisation also

within the region. Finally, in the absence of a sufficient policy framework that will be capable of steering the economy and creating the appropriate structures of incentives and rents across the region, a number of economic and technological factors (including infrastructure) also act as obstacles to a speedier and deeper process of regional integration.

5. Concluding thoughts

The SEE region has been for many years and still is today notably fragmented. This is not only the consequence of the traumatic wars in former Yugoslavia, but of a series of other factors that have to do both with pre-transition history (e.g., the divergent models of socialism applied in each of the old socialist Balkan states) and with the EU approach to the region (a slow involvement initially, then a fragmented approach, later on some elements of encouraging a regional approach but ultimately always predominantly bilateral and multi-layered). The main form of regionalism that is present in the region, that of a regional cooperation process that is externally inspired and built on conditionality, is actually and rather openly serving the European perspective of the region rather than any well-defined and well-understood internal (and internally consistent) objective. This seems in many respects to be a one-way trajectory for all countries in the region, with all the countries on the same highway driving towards the ‘big EU destination’, albeit on different lanes of

the highway and perhaps on different makes of cars.¹³ Cooperation is only happening to the extent that the highway narrows and the cars have to fit into fewer lanes without crashing into each other...

Although this analogy may appear telling, in fact it does not carry any connotation as to whether any more structured cooperation among the countries in the SEE (the ‘Balkan cars’) would be in fact desirable – not to mention any suggestions for the amalgamation of the ‘Balkan cars’ into an orderly and cosmopolitan train. Similarly, theory –trade theory or other– does not have very clear answers as to whether regional integration should be made a more central objective for the region. One can draw from a wide theoretical and quasi-theoretical literature to identify a long list of costs and benefits associated with either kind of perspective (the European versus the regional). Empirically, then, this becomes a question concerning the right balance between these two perspectives – which can only be decided on the basis of a concrete understanding of the economic and other conditions in the region and a firm commitment to follow through the policies that appear to be more appropriate from a long-run perspective.

Given the recent moves towards normalisation of the situation in the region, with the gradual increase in economic interactions even among entities that were until recently fighting bloody wars, the signs for a lasting adherence to international law for conflict resolution, and the stabilisation and growth of the

¹³ In this sense, perhaps today, after Romania’s accession to the EU, there exists a historical answer to the agonising question as to which has been the best car in the Balkans: Zastava or Dacia!

economies, it appears that the region can now cope with, and thus has a choice of, more than one option. In other words, it appears that the region is increasingly becoming more capable to support its own developmental trajectory and thus to define its own developmental needs and wants. Nevertheless, with this capacity comes also an increasing desire to 'escape' the region and to become singularly 'European'. Regional cooperation, although often heralded in bold letters, is still largely seen as a burden, even a liability, from a commitment that 'one had once to make'.

In this sense, the developments at the level of the EU, with the postponement of future enlargements, EU distancing and the new doctrine of 'regional ownership', offer indeed a tremendous opportunity to the region to take control of its own development and thus to pause and reevaluate its priorities and long-term interests. No matter how smoothly or how fast integration with the EU proceeds and how deep it becomes, there is a shared responsibility in the region to create its own integrated and coherent regional market, to activate the long-slumbering regional multipliers, and to strengthen those regional specialisations that can upgrade the value produced in the region and thus lead to a qualitative upgrading of regional production as a whole. In other words, there is a shared responsibility in the region to identify and strengthen its competitive position in the international division of labour.

This is not a goal that can be pursued optionally and only by the very ambitious. In the context of intense competition in the global economy, where

regional and sectoral advantages shift rapidly and product life cycles shrink, moreover, in a world of international sub-regionalisation, an unconnected collection of small states in a historically problematic peninsula in the corner of Europe has no chance to compete and to converge to the standards to which it aspires. Rather, a real threat exists that the region may very easily become a “new European south” (Petrakos, 2002; Economides and Monastiriotis, 2006) and suffer the persistent developmental (or, simply, underdevelopment) problems that Greece and southern Italy have experienced for so long.

Of course, dangers and ambiguities exist with either of the two options. For example, the European perspective entails the threat of dragging the most industrialised / advanced countries of the region to a backward path by encouraging the development of regressive specialisations; while the regional perspective can create similar problems by slowing down or even diverting the process of economic (and institutional) modernisation, which is very successfully triggered by association to the European economy and polity.

Nevertheless, as mentioned above, this is not an issue of a singular choice over two competing alternatives; rather, it is an issue of balance. The question *is not* about whether to integrate to Europe or internally and *should not be* about whether regional cooperation is a means or an end. Instead, it should be clear that there are real benefits from regional integration and this should be actively pursued in conjunction with, but not in anticipation of or with the aspiration

for, European integration.¹⁴ But for the economies and markets to integrate, conscious and specific effort is required in the front of policy. Policy harmonisation *within* the region, so as to avoid negative competition and to facilitate economic interaction and market integration, should be made a central objective of national policy-makers and of the newly established Regional Cooperation Council. Policy harmonisation through the Europeanisation of policies may be at the end of the road a process *sufficient* to harmonise policies also internally in the region; but given the timeframe for future enlargements and the acuteness of the developmental problems faced by the region, this process is not necessarily *best*.

To sum up, it appears in many respects that ‘cooperation without accession’ as the issue was put in the opening paragraph of this paper, is indeed a blessing for the SEE region. By conditioning European integration on regional cooperation, the latter effectively became an instrument for the former – both for the EU and for the SEE countries. Thus, regional cooperation became dissociated from the key underlying reasons for which regional cooperation was originally sought – namely socio-political reconciliation and economic development. Despite the rhetoric, regional cooperation remains today just that: a process of loose cooperation without any prospects for institutional deepening or functional strengthening. In this process, any calls for regional integration

¹⁴ This of course raises the question as to whether the two perspectives are inherently incompatible. There are clear instances where trade-offs between the European and the regional perspective can be identified – for example, the introduction of VISA controls in Bulgaria following its accession to the EU – but there is also a plethora of cases where the two processes are complementary (most emphatically in the area of trade liberalisation).

fall into a vacuum, as regional integration becomes a secondary issue – if not simply a distraction. Within this context, the recent developments with regards to ‘EU distancing’ and ‘regional ownership’ (which are largely exogenous, in the sense that they constitute responses, at least partly, to EU’s own internal problems) create the space for a re-consideration of what regional integration is and what it means for the region; and to the optimist they also allow for a possible re-launching of regional integration as a stated policy objective in the region. In this sense, ‘regional cooperation without accession’, despite the possible ‘disillusionment’ for those left temporarily out, is an opportunity for SEE to promote its own regional identity and its own developmental model and trajectory. Surely a blessing!

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