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## **ECONOMIC DEVELOPMENT IN THE EUROPEAN SUPER-PERIPHERY: EVIDENCE FROM THE WESTERN BALKANS**

**ABSTRACT:** *This paper argues that the conflicts that afflicted the Western Balkan region in the 1990s pushed the countries into the European ‘super-periphery’, characterised by deindustrialisation and high unemployment, ethnic and regional fragmentation, political turmoil, and instability. Integration into international trade has been disrupted, leading to chronic balance of payments deficits. Low inflows of international capital, due to high country risk, have hindered technological catch-up and weakened international competitiveness. An unattractive environment for productive entrepreneurship has created barriers to the entry of SMEs, and at the same time large informal economies. Several countries have become labour-export economies, with significant outflows of skilled labour. Economic development follows a low-skill growth path. The current global economic crisis is having a further deleterious*

*effect as export revenues, foreign direct investment, and labour remittances all diminish. Furthermore, as transition has proceeded, disparities between capital cities and rural areas have increased, while weak administrative capacities have hindered the implementation of effective local development policies to counteract these effects. Endogenous local development cannot provide an alternative to greater engagement with the global economy. The conclusion is that the countries of the region have been left out of the most beneficial elements of the globalisation process, while simultaneously suffering from its main defects. Without a faster process of accession to the EU, local disparities are likely to widen, and the region may remain within the European super-periphery for the foreseeable future.*

**KEY WORDS:** *Economic development, transition, comparative economics, local economic development*

**JEL CLASSIFICATION:** O11, O52, O57, P51, R58

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In the last half of the twentieth century, the economies of South East Europe had different historical experiences of connection to the global economy. While former Yugoslavia was relatively open and internationally integrated, Albania was almost completely isolated, setting a context for subsequent weak integration into international markets. Globalisation typically impacts on transition economies by connecting their emerging capital markets, labour markets and tradable goods markets to the international economy. The path of transition in the Yugoslav successor states was rather different. After the break up of Yugoslavia, with the exception of Slovenia, they became quite isolated from global markets due to wars in Croatia in 1991 and in Bosnia and Herzegovina in 1992-1995. International sanctions imposed purposeful isolation on Serbia and Montenegro, including Kosovo. In the south, Greek trade embargoes against Macedonia in a dispute over the country's name effectively isolated it for many years<sup>1</sup>. It was not until the democratic changes in Croatia and Serbia in 2000 that the region began once again to engage with the global market in any meaningful way. During the 1990s the flows of goods and services to the global market were disrupted, as were capital inflows with the exception of aid inflows after the Bosnia and Kosovo wars. Even after 2000, a severe civil conflict in Macedonia in 2001 continued to disrupt its integration into global markets. All this has impacted on local economies. While capital cities and larger urban areas have managed the reintegration process well, smaller towns and rural areas have found it more difficult to re-establish connectedness with the global economy.

Among the countries of what has come to be known as the Western Balkan<sup>2</sup> region, engagement with globalisation began soonest in Croatia. After a banking crisis in 1998, a large part of the banking sector was effectively sold off to foreign banks from Italy and Austria. This marked a turning point, as low-cost capital began to flow into the country. Tourism began to increase as a source of international revenue, and within a few years tourist numbers had recovered to pre-1990 levels. Tourism also began to develop significantly in Montenegro after it gained independence in 2006. In other countries, banks gradually came under international control. Foreign investment in sectors such as oil refining and telecommunications began to increase. After 2000 also, the EU became more engaged in the region, and the Europeanisation of policy and economic strategy began to replace independent

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1 The country was admitted to the United Nations in 1993 under the provisional name of the former Yugoslav Republic of Macedonia. For brevity, in this paper I refer to the country name as 'Macedonia'.

2 These are the group of seven countries in South East Europe which have not yet joined the EU. They are Albania, and the successor states of former Yugoslavia: Bosnia and Herzegovina, Croatia, Kosovo, Macedonia, Montenegro, and Serbia.

national economic development programmes. A huge inflow of international assistance was accompanied by international policy advisers and consultants who engaged in wholesale policy transfer which dramatically affected national and local policy approaches to issues such as the development of the small business sector, innovation policies, and regional policy<sup>3</sup>. This process of policy transfer was hardly consistent, however, reflecting the different views of uncoordinated advisers. International aid coordination units were established in most countries, but overall the policy transfer effort has been relatively ineffective in many areas, especially at the level of local economic development where policy coordination has been even more difficult than at national level.

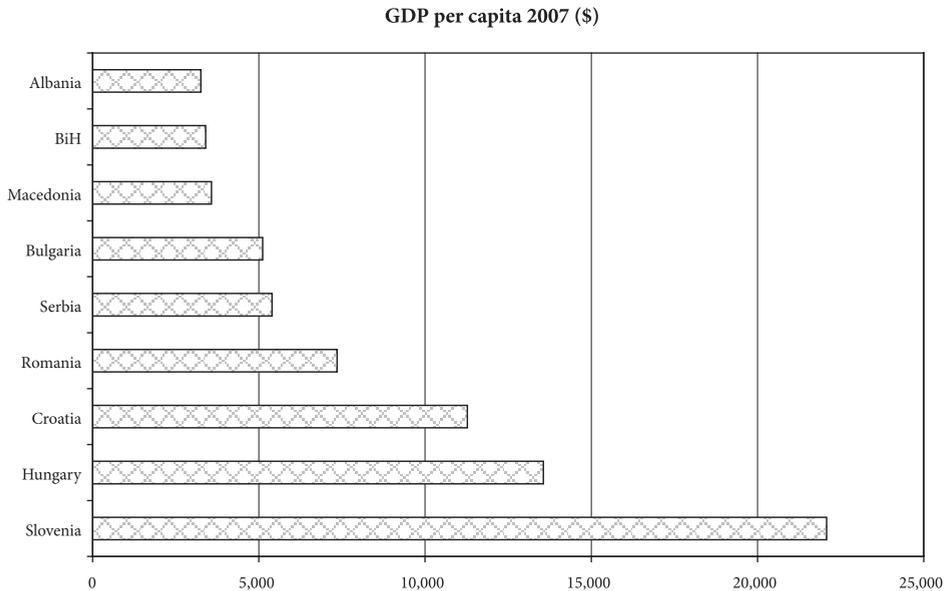
Following the end of the Kosovo war, and the democratic changes in Croatia and the Federal Republic of Yugoslavia (Serbia and Montenegro) in 2000, the Western Balkan economies entered a period of more or less sustained recovery. Economic growth was relatively strong compared to performance over the previous decade, averaging around 4 per cent per annum from 2000-06. Average growth of real GDP increased further to 6 per cent in 2007, before falling back to around 4.5 per cent in 2008. Yet, despite this recent economic growth, the region still includes some of the poorest countries in Europe. In 2006, Bosnia and Herzegovina (BiH) had the lowest income per capita, while Albania, Macedonia, Montenegro, and Serbia were only slightly better off. Croatia was better placed, with more than three times the income per capita of BiH, and above new member states such as Slovakia and Poland.

The relatively low levels of income per capita and GDP per capita in the Western Balkans countries show that, with the partial exception of Croatia, these countries belong to what Martin Sokol has termed the European 'super-periphery' (Sokol 2001). While the new EU member states from East Europe, along with other outlying countries such as Greece and Portugal, may be considered the periphery of Europe in relation to the core states, the gap between these and the poor countries of the Balkan region and other countries further east is so great that they form a super-periphery characterised by 'political turmoil and instability...[a] catastrophic economic situation, social polarization, ethnic and regional fragmentation.' (Sokol, 2001: 651). These countries furthermore have great difficulty in connecting to the global economy.

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<sup>3</sup> For a study of the impact of policy transfer on local economic development in Montenegro see Bartlett (2006), and for the impact on social welfare policies in Bosnia and Herzegovina see Deacon and Stubbs (1998).

**Figure 1**



Source: EBRD online data 2008

The rest of this paper analyses the main barriers to economic development in the Western Balkan states, and the key dimensions of their super-peripheral status. Section 1 sets the context by showing the impact of transition, break-up and war on the industrial base of the region, and how this has led to high unemployment and poverty. Section 2 shows how globalisation has bypassed the region, with a lack of competitiveness on international markets leading to large balance of payments deficits, while low inflows of international capital have been unable to prevent a build up of international debt, and an adverse impact on technological capacity of enterprises and on the skill levels of the labour force. In the absence of sufficient foreign investment inflows, economic development in the region has depended very much on the mobilisation of endogenous resources and the entry of new small firms. However, as discussed in section 3, the institutional framework has been inimical to the entry and growth of SMEs and entrepreneurial impulses have been channelled into the informal economy. Section 4 shows how local and regional disparities have emerged, as capital cities have fared better than other areas. The section questions whether there is sufficient local potential of skilled labour, entrepreneurial culture, capital resources, and institutional capacity to implement desirable strategies of endogenous local economic development.

Section 4 concludes with an emphasis on the importance of the EU accession process for the integration of the region into the global economy.

## 1. DE-INDUSTRIALISATION AND UNEMPLOYMENT

The severity of the economic collapse in the first phase of transition was reflected in a steep collapse of industrial output. The decline was initiated by the stabilization programme in former Yugoslavia, and the collapse of the central planning system in Albania, even prior to the break-up of Yugoslavia and the armed conflicts of the early 1990s (Bartlett 2008). Deindustrialization was most severe in Albania where industrial production dropped by half between 1989 and 1991. In Macedonia, BiH and Serbia and Montenegro, industrial production declined by around a quarter over the two years. In Croatia industrial production fell by 11 percent between 1989 and 1990, before the onset of the war on its territory in 1991, which naturally worsened the decline. By the end of 1991, industrial production in Croatia had fallen by even more than in the other successor states, and the local areas most affected by the war have remained in a chronic state of economic and social collapse (IMC 2004).

**Figure 2: Industrial output index, 1985–2003 (1989 = 100)**



Sources: Derived from UNECE Economic Survey of Europe 1999(1) and 2004(2)

Between 1992 and 1995, industrial production continued to fall by a further third in Albania and Macedonia. In FRY where industrial production had fallen to only one-third of its earlier level, the continuing slump was worsened by the imposition of UN sanctions. In BiH, all-out warfare led to a complete collapse of industrial capacity, and by 1994 industrial production had practically ceased altogether.

The subsequent recoveries were also very different. By 2003, Croatia and Macedonia had recovered most, with industrial production in Croatia at two-thirds of its previous level and on an upward trajectory, while in Macedonia industrial production stagnated at around half its previous level. Albanian industrial production never recovered from the shock of transition, and stagnated at just over one quarter of its previous level. In Serbia and Montenegro, the incipient recovery was set back by the NATO bombing campaign of 1999. In BiH industrial production was still only 14 per cent of the 1989 level by 2003. The legacy has been that large areas of severe deprivation and poverty can be found in many parts of Bosnia and Herzegovina, north-east Montenegro, southern Serbia, north-east Macedonia, and almost the whole of Kosovo outside of Pristina.

Labour force adjustment has been a difficult aspect of the transition process in the successor states, which inherited a set of employment laws that protected incumbent workers and led to low rates of labour force turnover. Workers who lost their jobs through restructuring or privatization found it hard to find new jobs. Unemployment has had a pronounced regional dimension with some localities experiencing intense economic decline, with many unemployment black-spots.<sup>4</sup> In Albania the transition was marked by a sudden increase in unemployment due to weak job protection following the collapse of central planning.

**Table 1. Unemployment rates, 1997–2007 (%)**

	1997	1999	2001	2003	2005	2007
Albania	14.9	18.4	16.4	15.2	14.2	13.3
Croatia	9.9	13.5	15.8	14.3	12.3	8.3
Macedonia	36.0	32.4	30.5	36.7	37.3	34.2
Serbia and Montenegro	13.8	13.7	12.8	15.2	-	-
–Serbia	-	-	12.2	14.6	20.8	18.1
–Montenegro	23.5	27.3	24.8	-	30.5	26.4
Kosovo	-	-	57.1	49.7	41.4	-

<sup>4</sup> On regional disparities in Serbia see Arandarenko (2006), on Montenegro (Bartlett 2006), and on Eastern Slavonia (IMC 2004).

*Source: Labour Force Survey data for Croatia, Serbia and Montenegro, Serbia, and Macedonia; for Kosovo, based on LSMS survey data, Labour Market Statistics 2005, Statistical Office of Kosovo, Prishtina; household survey data for Montenegro (1996-2001) from Montenegro Economic Trends, 12, ISSP Podgorica; official registered unemployment data for Albania, INSTAT, Tirana; EBRD online database 2008*

Unemployment in the Yugoslav successor states has remained high up to the present. In Kosovo it is at a disastrously high level at over 40 per cent, followed closely by Macedonia at 34 per cent, while in BiH, the unemployment rate was 22 per cent in 2004. In Serbia and Montenegro, the unemployment rate began to increase in 2001 as institutional reforms led to lay-offs associated with enterprise restructuring, and in Serbia wide regional disparities in unemployment emerged (Arandarenko 2006). In Albania, a combination of economic growth and mass emigration reduced the rate of unemployment to 13 per cent by 2007. In Croatia, the unemployment rate in 2007 was just over eight per cent, having fallen for several years as economic growth began to create jobs, although this has begun to increase again due to the impact of the current global economic crisis.

Furthermore, there is high proportion of long-term unemployed people and this has led to the deterioration of the skills base of sections of the labour force. The share of the unemployed who had been out of work for more than one year in 2002 reached 85 per cent in Macedonia and Montenegro, and 72 per cent in Serbia. Studies of labour market flows in the region have found very low rates of exit from unemployment to formal sector employment even in Croatia (Crnković-Pozaić 2005). The loss of skills due to long-term unemployment presents a challenge to policy makers seeking to reintegrate the unemployed into the labour market.

### **Widespread poverty**

The isolation of the region from the processes of globalisation has led to an extraordinary increase in the poverty of the populations. In 2002, as many as 70 per cent of the Albanian population were poor, on a poverty line of \$4.30 a day, as were 42 per cent in Serbia and Montenegro, 35 per cent in BiH, and 24 per cent in Macedonia (World Bank 2005a). In Albania, poverty is most severe in the rural areas (World Bank 2003a). In the northern mountain areas, over two-fifths of the population live in absolute poverty. The neglect of infrastructure and services in rural areas has stimulated migration to the cities, where shanty towns and illegal housing have grown up, while about one-fifth of the population has emigrated. In Kosovo, over one-third of the population live below a poverty line of €1.42 per day and about 15 per cent of the population live in extreme poverty

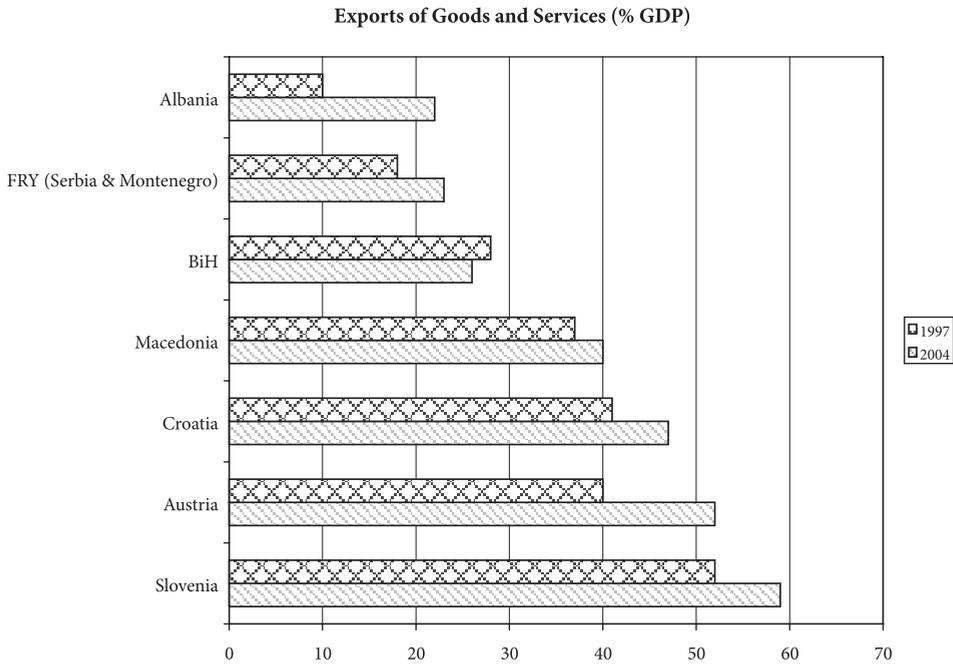
with insufficient income to cover basic food needs (World Bank 2005b). In Serbia, household surveys carried out in 2002 showed 800,000 people living in poverty (GoS 2004). Poverty has become a rural phenomenon, as incomes in the rural areas have not kept pace with urban wages. In Montenegro a survey carried out in 2000 showed at least one-fifth of the population living in poverty (UNDP 2003). The north-east part of the country is even more affected due to deindustrialization and the collapse of the traditional wood processing and papermaking industries (Bartlett 2006). In BiH, a household survey carried out in 2001 revealed that one quarter of the population in Republika Srpska, and one-sixth of the population in the Federation of Bosnia and Herzegovina, live in absolute poverty, while fewer live in poverty in the more developed Croat-populated areas. In BiH as a whole, about half the population live below or close to poverty (World Bank 2003b). In Macedonia, poverty household budget surveys show about one-fifth of all households living below the poverty line (GoM 2002) with a rural location being a significant indicator of poverty risk. In Croatia household budget surveys show that absolute poverty affects mainly the long-term unemployed and people living in war-affected areas.

## **2. INTERNATIONAL COMPETITIVENESS**

Following the break-up of Yugoslavia the successor states lost ground in traditional export markets, and in the 1990s all the Western Balkan countries had a dismal export performance, while BiH experienced a near total collapse of trade due to the war. Sanctions against Serbia and Montenegro caused a steep decline in their trade with the outside world. In 2000, the EU granted autonomous trade preferences to the Western Balkan countries, dismantling import tariffs and duties for almost all their exports. Exports increased sharply, more than doubling in the cases of Albania, BiH, and Serbia and Montenegro. By 2005, exports per capita had reached \$2,300 in Croatia, \$1,600 in Serbia, \$1,150 in Macedonia, but were far lower in BiH (\$641) and Albania (\$231).

All the countries of the region have a relatively low ratio of exports of goods and services to GDP. Croatia and Macedonia have export ratios of around 40 per cent of GDP reflecting their better relationship to the EU markets as candidate states. Albania, BiH, and Serbia and Montenegro have export ratios below 30 per cent of GDP. The worst performance was in BiH, whose share of exports in GDP has actually fallen.

Figure 3



Source: World Bank online database 2006

Measures to boost exports through improving international competitiveness have been high up on the policy agenda. Unfortunately this is more easily said than done. The policy actions required to increase competitiveness involve structural reforms such as improving conditions for the entry of new firms, improving the supply response of existing firms through privatization or foreign direct investment, improving labour productivity through improved education and training, and ensuring unit labour costs are in line with competitors and export market conditions. These structural reforms are often resisted by interest groups that would prefer to maintain the *status quo*.

Table 2. Current Account Deficits (% GDP)

	Croatia	Macedonia	Albania	BiH	FRY (Serbia and Montenegro)
Average 1996-09	-7.7	-6.0	-8.8	-25.6	-6.2
Average 2000-05	-5.3	-5.7	-7.5	-19.3	-8.5

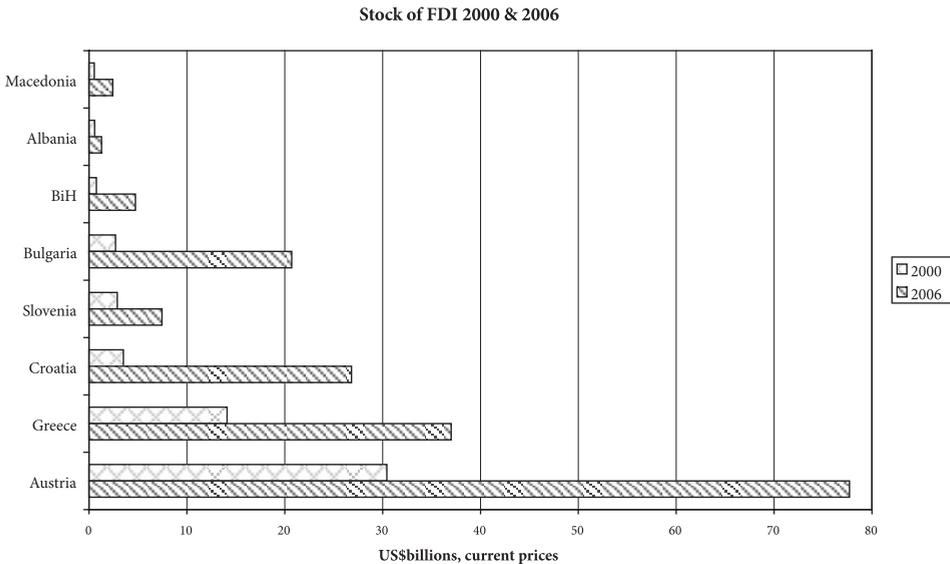
Source: EBRD Transition Report 2005

Owing to their relatively poor export performance the Western Balkan economies all have persistent current account deficits, despite income from tourism and emigrants' remittances. BiH has the largest current account deficit which has been covered by donor financial assistance. In order to reduce their external deficits governments have adopted expenditure-reducing policies, cutting government budget deficits in order to restrain domestic demand, with the aim of reducing the growth of imports.

### Low inflows of international capital

Although inflows of FDI to the Western Balkans have increased in recent years, Croatia has been the main beneficiary, while inflows into Albania, BiH, Kosovo, and Macedonia have been relatively trivial. Much of the FDI inflow to the region has been linked to privatization in telecommunications, banking and oil refining rather than new green field investments, and the pattern of inflow over time has been irregular and lumpy, following the vagaries of the privatization process.

Figure 4



Source: UNCTAD online FDI database 2008

The Western Balkan states have introduced numerous measures to make their economies more attractive to foreign investors. Various agencies to promote

foreign investment have been established<sup>5</sup> with the most effective in Croatia and Serbia (OECD 2007: 62). Numerous tax exemptions have been introduced to attract foreign investment<sup>6</sup>, and the region now has some of the lowest corporate tax rates in Europe, averaging 16 per cent in 2007 compared to an average of 25 per cent in the EU (OECD 2007: 74). Free economic zones have been established in some countries, and in Croatia, nineteen such zones exempt businesses from normal taxes and customs procedures. Although laws on foreign investment aiming to give equal treatment to foreign and domestic investors have been introduced,<sup>7</sup> administrative barriers continue to slow FDI inflows. Even in Croatia, foreign investors have found it difficult to complete transactions in the tourism and construction sectors (OECD 2007: 48). Despite these efforts, the low inflows of foreign direct investment have not been able to bridge the balance of payments deficit on the current account and have led to a correspondingly large build up of international indebtedness.

Croatia has the highest level of external debt to GDP, and is the only country in which this ratio has increased in recent years. It also has a relatively high debt-service ratio and low international reserves, and is therefore vulnerable to external shocks from the current global financial crisis (Vlahinic-Dizdarevic et al. 2006). Serbia also has high levels of external indebtedness, but on a downward trend. The other countries have moderate and falling debt-to-GDP ratios. High international indebtedness implies reliance on inflows of international assistance or foreign investment. However, foreign direct investment in the region has been relatively low and, as indicated above, mainly related to privatisation.

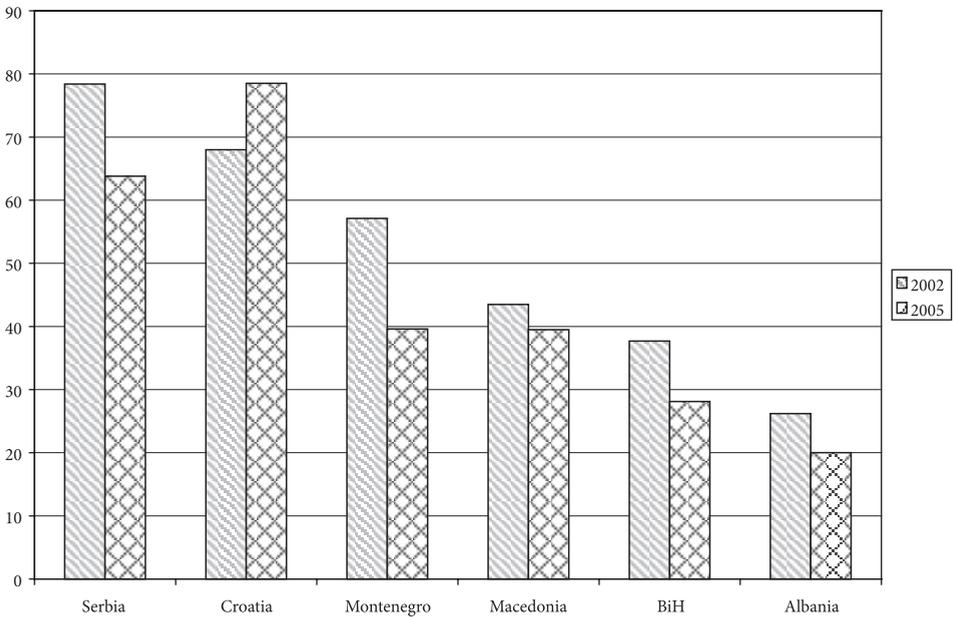
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5 The investment promotion agencies are Albinvest, the Foreign Investment Promotion Agency in BiH, the Trade and Investment Promotion Agency in Croatia, the Agency for Foreign Investments of the Republic of Macedonia, the Montenegrin Investment promotion Agency, and the Serbia Investment and Export Promotion Agency.

6 These have included a 5 year corporate tax exemption for foreign subsidiaries in BiH, and for 3 years in Macedonia, while tax exemptions are available in Free Zones and in less developed regions in Croatia.

7 In Albania, the Law on Foreign Investments (1993); in BiH the Law on the Policy of Foreign Direct Investments (1998); in Croatia the Investment Promotion Act (2000); in Macedonia, the Constitution and the Law on Trading Companies (2004); in Montenegro, the Law on Foreign Investments (2000); and in Serbia, the Law on Foreign Investments (2002).

**Figure 5: External debt to GDP ratio, 2002 & 2005 (% GDP)**



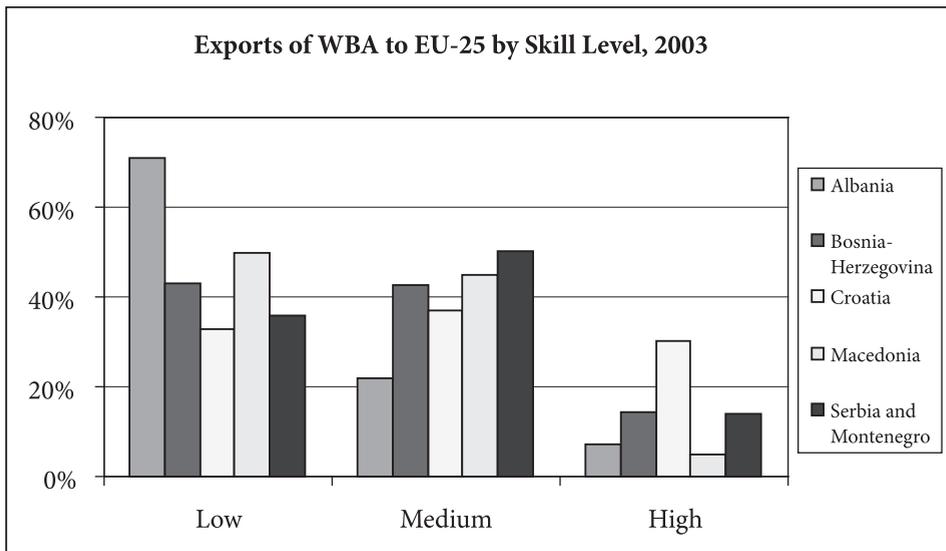
Source: EBRD 2007 online data

### **Delayed technological catch-up**

Former Yugoslavia began the transition in the late 1980s in a favourable position as the most advanced and most open of the communist states. It had a highly skilled workforce in industries that traded intensively with the EU. However this favourable position disguised large internal differences between more and less developed regions. Slovenia and Croatia in the north were far more advanced than Macedonia and Kosovo in the south. Therefore when the country broke up, the more advanced regions were able to integrate themselves into the global economy more easily. The experience of Slovenia demonstrates how this process can enable a country to progress and develop on the basis of upskilling its workforce, and integrate into the EU on the basis of high-skill industry specialisations (such as in motor car components manufacturing). Croatia was in a position to follow the example set by Slovenia, but the war period set the country back and many of its industries lost their connections with the global economy. The development and technology gap between Croatia and Slovenia has therefore widened. The gap is even more pronounced in the other successor states of former Yugoslavia which had weaker initial conditions. Albania also began the transition from a low level of economic development, and with a poor endowment of skills.

These considerations suggest that there is nothing automatic about the Western Balkan countries becoming immersed in the process of skill-biased technical change. They may follow two feasible paths: a high technology path and a low technology path. Along the first path, favourable initial conditions followed by a speedy restructuring combined with preservation and growth of human capital may lead to a rapid recovery and growth catch-up with the EU economic average. This can be seen in the case of Slovenia. The second path, typical of countries in the super-periphery, is characterised by unfavourable initial conditions and political instability leading to a slow pace of transition and restructuring. Along this path, deindustrialisation and mass unemployment is prolonged, leading to deskilling and the loss of human capital through the emigration of skilled workers. Countries that follow this path have weak demand for skilled labour, and specialise in export of low-skill goods. They are less likely to attract FDI, partly due to the weakness of the skills base of the labour force, and this in turn may undermine the process of skill upgrading.

**Figure 6**

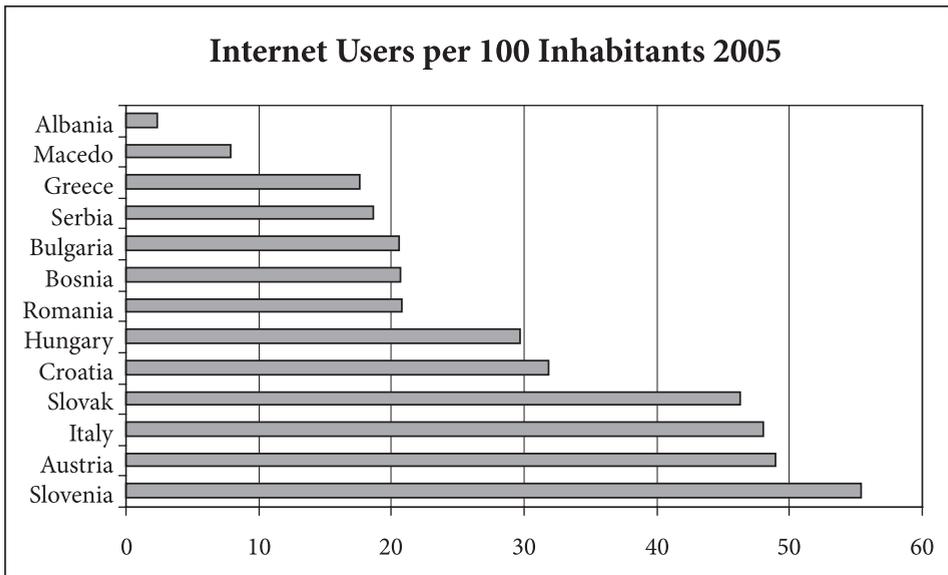


Source: Eurostat Statistics in Focus 1/2005 "External trade of the Western Balkan Countries" (Own calculations – for details of classification scheme see Appendix)

The evidence that the Western Balkan countries are following a low-skill path of transition is strong. Croatia is the only exception. Overall, most exports from the region to the EU-25 consist of low-skill or medium-skill goods. Just under two-

fifths of exports are low-skill goods, and just over two-fifths are medium-skill goods. Albania, BiH, and Macedonia export predominantly goods with a low-skill content to the EU-25. Serbia and Montenegro export the highest share of medium-skill goods, while Croatia exports the highest share of high-skill goods. Overall, only one-fifth of exports are high-skill goods, of which almost three-quarters originate in Croatia.

**Figure 7**



Source: *International Telecommunications Union*; Internet host data: *Network Wizards, RIPE*.

There are substantial differences in technological level among the Western Balkan countries, with Albania and Macedonia being far behind in their level of technological development. Several governments have indicated their desire to facilitate the transfer of technology from their domestic science base to the enterprise sector, rather than relying exclusively on technology transfer from abroad. Technology parks have been established to encourage the transfer of knowledge from universities to private business. However, these policies are still in an embryonic stage and lag far behind the comprehensive set of measures that have been used to promote technological development in Slovenia (Bartlett and Cučković, 2006).

### **3. ENTREPRENEURSHIP AND THE ENTRY OF NEW FIRMS**

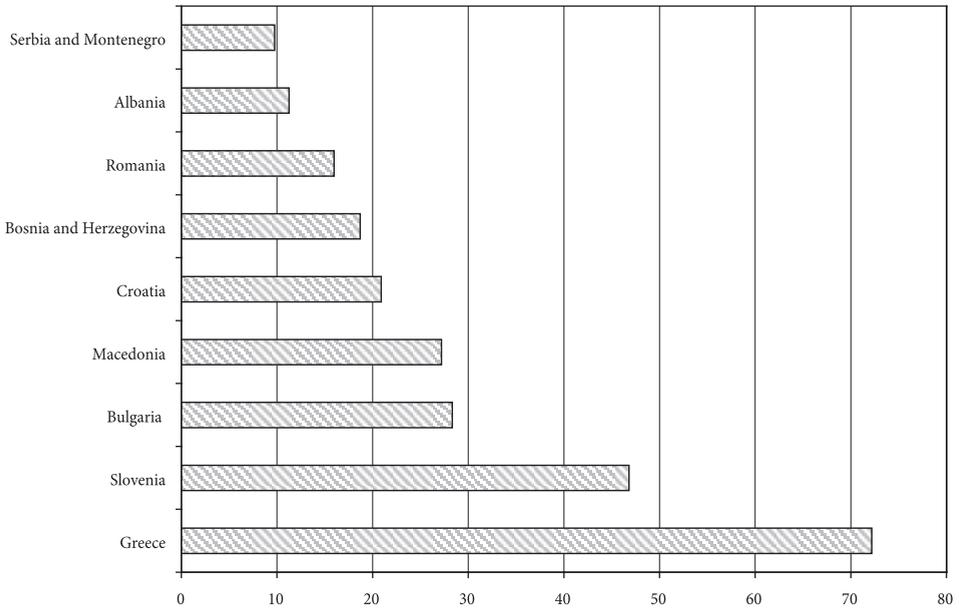
Owing to the relatively slow pace of privatization and the weakness of inward investment into most of the Western Balkan countries, the economic development of the region has been highly reliant on the performance and vitality of domestic entrepreneurs who have created new small and medium sized enterprises (SMEs). These new entrepreneurial businesses have been a main source of job creation for workers who have lost their jobs in the declining social-ownership and state-ownership sectors. They have introduced a critical element of competition and dynamism into these post-conflict economies, challenging established monopolies and the powerful coalitions which have sought to maintain their privileged positions gained during the chaos of transition, war, and civil conflict.

In the early 1990s the Western Balkans experienced a rapid entry of new small businesses in the private sector, despite significant obstacles due to lack of finance, adverse government regulation and taxation policies, and the market dominance of large enterprises. However, entry rates slowed down in the late 1990s, and the new entrepreneurs faced many obstacles to developing their businesses. A key obstacle was lack of finance as local banks channelled credits mainly to the large enterprise sector, while loans to small enterprises were provided at high interest rates with large collateral requirements. Due to capital scarcity, relatively few small businesses were able to grow into competitive medium sized enterprises, and the development of the SME sector was held back. Larger firms attempted to establish and maintain dominant or monopoly positions, making use of their close connections to the economic and political elites, which themselves rotated between positions of political and economic power. The convergence of these interests enabled the large enterprise sector to establish and maintain monopoly positions, and to influence economic policy in ways inimical to the development of a competitive small business sector. Thus, there was relatively little policy impetus for the promotion of the SME sector in most of the Western Balkan states for many years.

After the democratic changes in 2000, an influx of foreign assistance began to ease the financial constraints facing SMEs. The institutional framework was heavily influenced by international aid donors, who saw the SME sector as a key element in reconstruction. Microfinance banks were established to mobilize financial resources for small businesses, supported by the EBRD and other international donors and often with a social motivation to reduce poverty, targeting socially disadvantaged groups including women, refugees, and internally displaced persons. However, the microfinance institutions were too limited to be a solution

to the credit gaps facing small businesses. Although a significant number of new jobs were created, and many people were offered a route out of poverty, high unemployment persisted, and the impact on overall economic performance was limited. Yet, despite the entry of new enterprises, the density of SMEs remains very low in Serbia, Montenegro and Albania, and somewhat higher in BiH, Croatia, and Macedonia. All however are well below the average for neighbouring EU countries such as Bulgaria, Greece, and Slovenia.

**Figure 8: Density of SMEs (per 1,000 population)**



*Source: International Finance Corporation, July 2006 and SME Observatory of the Republic of Macedonia, Report 2004 (October 2005).*

In addition to the entry of new limited liability companies, many new businesses have been set up by self-employed entrepreneurs. In the former Yugoslav countries the tradition of the independent sole proprietor played an important role in this. Due to the lower cost of entry, the sector has seen rapid growth. Even though these are typically small firms with few employees, they have a tradition of skilled work, and are important in preserving and developing skills, and providing a source of demand for skilled labour.

**Table 3. Self employed employers and own-account workers (% of all in work)**

	Self-employed employers	Own-account self-employed workers
Albania (2001)	6.0	48.0
Croatia (2006)	8.0	23.0
Macedonia (2003)	8.0	-

Sources: *Labour Force Survey, Republic of Macedonia State Statistical Office, April 2003, p. 50; Labour Force in the Republic of Croatia First Half-year 2006, First Release, 9.2.7/1, State Statistical Office of Croatia. People and Work in Albania, INSTAT, 2004 (data refer to 2001).*

The number of sole proprietors has increased rapidly in all the Western Balkan countries, whether setting up as craft firms, ‘private shops’, self-employed or small traders. Two main factors drive this growth. The first is poverty, which pushes unemployed or marginalized people into self-employment in easy-to-enter sectors such as trade with little prospect of capital accumulation and growth. The second is the response to new opportunities which pull entrepreneurial individuals into dynamic segments of the economy (Bartlett and Hoggett 1996). Studies in other transition contexts has shown that the ‘self-employed with employees’ are more likely to be dynamic and upwardly mobile entrepreneurs, while self-employed individuals working on their own account are more likely to be struggling to make ends meet (Earle and Sakova 2000; Hanley 2000). Both types can be observed in the Western Balkans where, due to high unemployment and weak social security systems, many vulnerable people are pushed into self-employment as a means to ensure a living, while there are also many other cases of entrepreneurial individuals who have been drawn into self-employment by the new market opportunities opened up by economic liberalization. Table 3 shows that Albania has a greater proportion of self-employed people subject to ‘push’ factors than Croatia and Macedonia, although the similar proportions of ‘self-employed with employees’ attests to the strong pull factors at work encouraging the self-employed to create jobs.

The informal economy, which comprises both private unregistered firms and undeclared work in registered firms, is widespread since many employers avoid paying social insurance contributions. The lack of job creation in the formal sector has pushed unemployed people into informal activity to make a subsistence income, while employers have embraced informality to avoid restrictive regulations. Lack of trust in formal institutions also plays an important role. Entrepreneurs in BiH are more likely to base their business dealings on the ‘strong ties’ of interpersonal trust with known business partners in the informal

economy, than on the ‘weak ties’ of institutional trust in anonymous business partners in the formal economy (Rus and Igljić 2005). Albania has the highest estimated share of informal economic activity, with 52 per cent of household income undeclared, while Kosovo and Macedonia also have a high share, at 45 per cent and 39 per cent respectively (Christie and Holzner 2004) while Serbia and Croatia have the lowest levels at 18-19 per cent. Informal activity has a strong geographical component, being higher in the south of the region than in the north, and is associated with the level of economic development.

In recent years new legislation has reduced barriers to business entry and improved the investment climate in several countries. Business simplification task forces have been established in Croatia and Macedonia, while in BiH a ‘Bulldozer Commission’ was set up in 2003 to sweep away restrictive legislation. Albania adopted a detailed action plan aimed at reducing the administrative barriers to investments which led to a decrease in the average number of days needed to register a business. According to a recent European Commission report ‘company registration time in the Western Balkans is, on average, not altogether worse from what one finds in some Member States and candidate countries’ (European Commission 2004: 11). Surveys carried out by the World Bank covering limited liability companies based in capital cities have enabled a ranking of the ‘ease of doing business’ in different countries.

**Table 4. Ease of Doing Business Rank**

Austria	27
Hungary	41
Bulgaria	45
Romania	47
Slovenia	54
Macedonia	71
Albania	86
Montenegro	90
Serbia	94
Greece	96
Croatia	106
Bosnia and Herzegovina (BiH)	119

*Source: World Bank Doing Business Database 2008*

Typically a relatively large number of procedures are required to register a company, and the costs of registration are high. The time taken to register a company varies from 18 days in Serbia, where entrepreneurs can register online, to as many as 54 days in BiH. The cost of starting a business ranges from 7 per cent of income per capita in Macedonia and Montenegro to 37 per cent in BiH. The minimum capital required to start a business varies substantially, from zero in Montenegro to 112 per cent of per capita income in Macedonia. Taking all these factors together Macedonia, Albania and Montenegro are placed ahead of Serbia and Croatia in the World Bank 2008 ranking of the overall ease of starting a business, while BiH is placed at the lowest rank among the Western Balkan countries.

#### **4. DISTORTED SPACES AND LOCAL DEVELOPMENT CAPACITY**

The introduction of market competition and privatisation in the Western Balkans has had mixed effects on social welfare. One of the more serious aspects of this is the growth of disparities in living standards and the quality of life on a territorial level. While some locations have prospered from the new opportunities presented by the opening of markets, others have been left behind and have suffered from adverse aspects of the restructuring and change which has accompanied transition such as deindustrialisation, outward migration of many young and skilled people, environmental degradation, and the deterioration of public services. As transition has proceeded, disparities between capital cities and other urban and rural areas have increased, while weak administrative capacities have prevented the implementation of effective local economic development policies to counteract these effects. FDI inflows and the growth of service industries have mainly benefited capital cities, while the decline of agriculture and older industrial centres have adversely affected other urban centres and rural areas. Damaged and decaying economic and social infrastructure has further weakened the ability of poorer localities to recover from economic decline and high unemployment. Deindustrialisation has created pockets of persistent poverty and social exclusion. Out-migration has depleted the skills base, which together with low levels of public expenditure on education has led to skills deficits, especially in rural areas. Consequently, there is limited endogenous capacity to stimulate local economic development in response to the adverse impacts of globalisation.

Recovery from deindustrialisation induced by privatisation has been easier in urban areas with basic infrastructure and a critical size of skilled labour force, while industrial regeneration based on high-technology industries and on business

services has taken place if at all only in larger urban environments (Petraikos 2001). Restructuring has led to declining shares of agriculture and industry and an increased share of services, including business services, banking, financial services, entertainment and commerce. These services have grown faster in urban areas where economies of scale can be attained, and where transaction costs are lower due to physical proximity of customers. Larger urban areas, especially capital cities, have benefited more from the growth of such services, whereas peripheral rural areas have been left behind as few service industries have located there. Moreover, small and medium sized enterprises dominate in service industries, and are concentrated in urban areas due to agglomeration effects, especially in capital cities, and in secondary cities with specific comparative advantages. However, some types of services have a more even spatial spread, including public services which are funded by central government such as schools and hospitals, as well as some standardised private sector services such as retailing. Regions where inter-linkages between industries and firms are stronger also tend to be more attractive to service companies (Stare, 2005). This has been the case in Slovenia where the regional differences in employment and GDP have narrowed during the transition. In Western Balkan countries, in contrast, such inter-linkages between different industries and sectors are weaker, and regional inequalities have increased during the transition. A study of the quality of life in Croatia in 2006 found that equivalent household income was above average only in the capital city Zagreb and one other county (UNDP 2006). FDI also tends to generate a polarised pattern of development by concentrating in capital cities due to their better business infrastructure, telecommunications, international transport linkages, and larger pools of skilled workers.

Recent theories of local economic development have argued that economic development draws on local 'endogenous' resources, rather than on external demand or inflows of external resources, as in earlier 'keynesian' theories (Pike et al. 2007). In these new theories, institutions are held to have a strong influence over the pattern of local economic development. Much interest has been focused on informal institutions, policy networks, and inter-group relations which underpin trust between economic actors. High trust relations reduce transaction costs of doing business and thus promote local economic growth. Low trust environments increase the need for formal contracts, contract monitoring, and recourse to sometimes ineffective judicial systems, all of which increase the transaction costs of doing business. Institutional theories emphasise the local embeddedness of social relationships, and participative forms of local governance which support economic development. In order to mobilise local resources, institutions of local governance need to function effectively. Local stakeholders should be willing and

able to collaborate with one another in the pursuit of a common goal aimed at improving the quality of life in the locality. Where local institutions are relatively weak, the influence of external actors can be correspondingly great. In such a situation it is often difficult to build local political coalitions that can underpin and support processes of endogenous regional development.

However, such institutions of local governance are weak in the Western Balkans and there are few examples of functioning policy networks which could mobilise endogenous development potential at a local level, outside the capital cities. Following the collapse of communism, most western Balkan countries have followed policy prescriptions to decentralise powers to local authorities. Activities such as education, health care, and water and electricity supply have been transferred to the competency of local government. Systems of local government that previously functioned relatively well have been broken up and replaced by more numerous smaller municipalities. In Macedonia for example, under a 1996 reform, the previous set of 34 municipalities that had functioned under the communist system was replaced with 123 smaller municipalities (UNDP 2009). Under a further local government reform designed to increase the local representation of the minority communities, in particular the Albanian minority, these were again replaced by a system of 84 municipalities. In Bosnia and Herzegovina two large regions hold considerable devolved power, but this is wielded essentially along lines of ethnic division. Within each region local authorities are fragmented and atomised into small municipalities, hindering the mobilisation of local resources. Throughout the region, most local municipalities are unprepared or unable to take on their increased responsibilities for economic development and service delivery due to their very weak administrative capacity.

## **5. CONCLUSIONS**

This paper has assessed the evidence on the impact of globalisation on the economies of the Western Balkans. It has argued that the region has largely failed to benefit from the advantages of the globalisation process, while it has simultaneously suffered from its main defects. The wars and conflicts that afflicted the region in the 1990s have pushed the countries into the European 'super-periphery'. Deindustrialisation has destroyed jobs and led to high concentrations of unemployment in the most deprived areas and consequently there is a widespread incidence of poverty. Integration into global markets has been disrupted, leading to chronic balance of payments deficits, while low inflows of FDI due to high country risk have hindered technological catch-up and weakened international

competitiveness. Infrastructure is decayed and underdeveloped, and public services such as education and health care are underprovided. Incomes are low and households depend heavily on remittance income from family members working abroad. Inflows of international aid from donor organisations and the EU have led to a strong, but contradictory, influence of international actors have had on policy making for economic development. Capital resources for local economic development are scarce, despite efforts to improve matters by donor-funded micro-credit schemes, while local administrative capacities are too weak to effectively benefit from decentralisation policies. All these issues have been exacerbated by the destructive effects of the current global economic crisis which is having a further deleterious effect on these economies as export revenues, labour remittances, and inflows of FDI have all diminished, financial capital has been pulled out of the region, growth has slowed, and unemployment has increased further.

The eventual EU accession of the Western Balkan countries would enable the region to overcome some of these negative effects of exclusion from the process of globalisation. The East European economies that joined the EU in 2004 benefitted from increased inflows of FDI, increased trade within the EU market, and a greater opportunity for local businesses to engage in international supply networks and upgrade their low technological level, in addition to benefitting directly from EU structural funds and other Community programmes. In the current global economic crisis some of these factors are being thrown into reverse, as capital is being repatriated from the Periphery to the Centre. Taking just one example, in March 2009, Renault closed down a production line in Slovenia and moved it back to Paris, destroying 400 jobs in Slovenia and creating 400 jobs in France in the process. EU membership is therefore certainly no panacea. However, the countries of the super-periphery, in the Western Balkans and elsewhere, are even more vulnerable to such practices than the EU New Member States. Therefore, a faster process of EU accession is badly needed in the Western Balkans. Without a faster process of accession to the EU, local disparities are likely to widen, and the region as a whole will remain within the European super-periphery for the foreseeable future.

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