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SOUTH EAST EUROPE PTA'S – STEP FORWARD TO EU OR NOT?

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Abstract: In many developing countries, regional integration has become a key means of promoting economic growth and fighting poverty. PTAs are increasingly used as engines of change in many developing countries, to promote, implement, and lock in reforms in a wide range of policy areas such as investment regimes, competition rules, and government procurement. They create larger and more competitive markets and benefit producers and consumers through economies of scale and lower prices. Although PTAs may promote development, they necessarily discriminate against nonmembers and can therefore lead to trade diversion in a way that hurts both member countries and excluded countries. Also, the proliferation of bilateral and regional PTAs may undermine progress toward a more open, transparent, and rules-based multilateral trading system. In this paper it will be discussed about the establishment and expectations of a free trade agreement CEFTA 2006. Specifically, the South East European countries, which made the majority of this regional economic integration, still have many unresolved, above all, political problems. On the other hand, the different status of these countries in the process of integration into the European Union chose the inflow of financial resources and speed necessary economic reforms. However, the global economic crisis has slowed the flow of financial resources, especially greenfield investments, deepened social stratification and mutual political differences between member states. This paper will try to answer the question: do this PTAs really contribute to deeper integration in EU?

Keywords: PTAs, Integration, CEFTA, European Union

1. THE DOHA ROUND AND PTA'S

The Doha Round, which started in Qatar in 2001, is different from previous rounds.¹ Following rapid expansion of membership, of the 159 countries that take part in negotiations, over 100 are developing countries. This group of developing countries can no longer be ignored by the principal negotiating parties: the USA, the EU and Japan. In addition, the borders of trade policy are becoming blurred. The „old” technical trade issues such as tariffs and quotas, as the primary subject of negotiations, are being replaced by highly charged political, difficult social and sensitive emotional negotiating issues. Even though tariffs are rather low in general, there are certain annoying tariff peaks that should be addressed by negotiators. Politicians labelled Doha as the „development” round.

One of the principal objectives of the Doha Round was to equip the WTO with a shield against the regression towards protectionist policies and the splintering of the world trading system. A success of the Round would reaffirm the pivotal role of a multilateral (rather than bilateral or regional) system of rule making in international trade. This need has been reinforced during and in the aftermath of the global financial crises.

However, the main obstacle to Doha Round is time. It was expected to finish in 2005, but the EU and the USA jointly tried to reinvigorate the stalled negotiations a month before ministerial meeting in Cancun (Mexico) in 2003.

The essential problem of the negotiations within the Doha round was manifested at the Ministerial Conference of WTO, held between 10 to 14 September 2003 in Cancun, Mexico, when participants failed to agree even on the general framework for the continuation of negotiations. The last serious attempt to resume negotiations was made in Geneva in July 2008th But then no progress. The problem was again the rules of global trade liberalization in agricultural products. Since then a separate call to resume negotiations and find out some mode of their termination, but without success. All negotiations within the WTO have always been complex, fragile, and a mixture of pressure, threats, bullying, intimidation, buy-offs, dubious promises, brinkmanship and strange compromises. The failure of Cancun meeting showed the outer limits of liberalisation of the touchy issue of agriculture, at least for the time being. Even though there are limitations to the coverage and influence of the WTO, it continues to be a useful international organisation because of the following two factors. On the one hand, member countries use the WTO to extract concessions from prospective member countries. China, for example, was forced to introduce a number of reforms. The last big WTO catch was Russia in 2011, after 18 years of negotiations.

¹ M.Jovanovic, 2013, p. 601-603.

By starting the Doha Round, governments have declared their willingness to negotiate a more liberal multilateral trade regime. In reality, it is only a promise, nice declaration. The reality is that EU already has some 30 free trade and special customs agreements.

On the other hand, there are increasing number of PTA's in the world economy. PTA's represent one of the fastest developing forms of the regional cooperation and incorporate more and more provisions, in particular in regulatory areas.² In the last twenty years the growth in number of preferential trade agreements (PTAs) has been unabated. Even more strikingly, their scope has broadened while their number was increasing. Deep integration provisions in PTAs have now become ubiquitous. Gaining market access or preserving existing preferences has remained an important motivation for acceding to PTAs. But with the liberalization of trade around the world and the related diminishing size of preferential rents, the growing success of PTAs cannot be only explained by traditional market access motives (even factoring for the possible substitution of tariff for other less transparent forms of protection). Countries are looking beyond market access in PTAs. They are interested in a host of objectives, including importing higher policy standards, strengthening regional policy coordination, locking-in domestic reforms, and even addressing foreign policy issues. It goes beyond the traditional paradigm of trade creation versus trade diversion to address the economic and legal aspects of the regulatory policies that are contained in today's PTAs. These are also usually the policies driven by powerful trading blocs as they strive to influence the evolution of the global trading system.

PTA's have so far not lead to much trade facilitation. In addition, the newer PTA's offer prospects for reform beyond the WTO agenda, they incorporate possible institutional mechanisms for assisting with implementation, and they gather under one umbrella disciplines that can complement and reinforce each other.

PTA's generally offer scope for covering a wide spectrum of policies across which various concessions, including noneconomic ones, could be traded off³. Although this broadening does increase the complexity of negotiations, PTA's guarantee better commitments. In theory, any attempt to deny a trade facilitation concession by imposing other trade barriers (e.g. tariffs) should more difficult because use of these measures is regulated by the agreement. Also, enforcement of trade facilitation measures will be guaranteed by the possibility that partners will withdraw other concessions.

² Jean-Pierre Chauffour, Jean-Christophe Maur (2011), p.340

³ Devlin and Estevadeordal (2004)

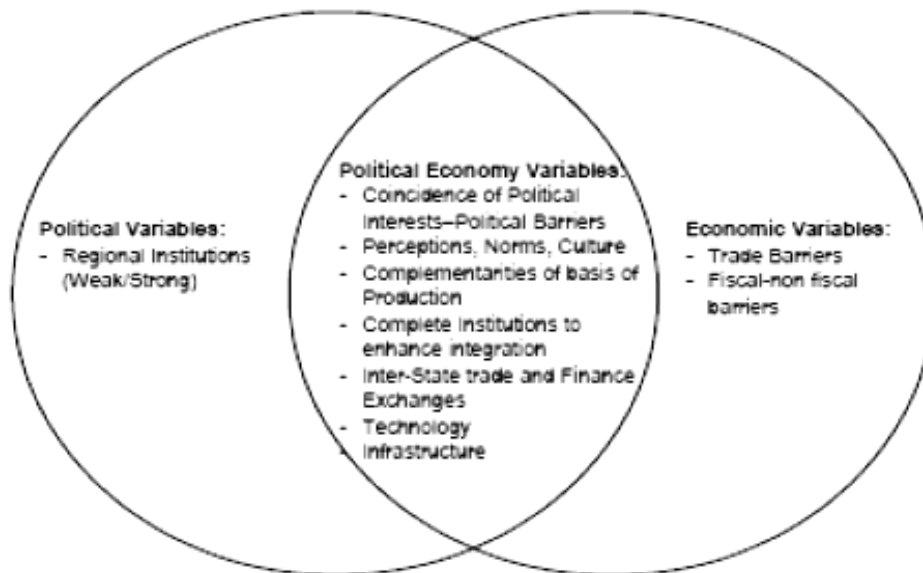
PTA's are not infrequently complemented by resource sharing and redistribution mechanisms among the partner countries, which may include financial and technical assistance.

2. REGIONAL ECONOMIC INTEGRATION

Regional integration and cooperation has been addressed by a considerable number of both scholars and policymakers. Nevertheless, the extensive variety of approaches and perspectives which have been attributed to regional integration has not led to clear definitions and practices. Undoubtedly, evidence links openness – i.e. low trade barriers, transparent operation through the price mechanism - and economic growth. Thus, developing countries have sought to apply these principles either through autonomous unilateral liberalization, or more commonly through participation in regional trading agreements.⁴ Indeed, nearly every country in the world is a member of one or more regional integration arrangements (RIAs), and nearly 60% of world trade occurs within such blocs.

However, although most preferential trading arrangements are regional in the geographical sense, this does not apply for most of their economic results (1).

Figure 1. Capturing the variables of Regional Economic Integration



Source: Sklias, Pantelis, Tsampra (1)

⁴ Simic, Mihajlovic (2012), p.765.

The current situation in Western Balkan countries is very complicated, if we have in mind their persistent problems related to predefined criteria for EU membership. They include an inefficient judiciary system, corruption proneness, an insufficient capacity of the public administration and low competitiveness of the national economy to cope with the pressures on the EU market. The EU has introduced specific benchmarks for most of the countries, such as fulfilment of the Ohrid framework agreement in FYR Macedonia, settlement of the Croatian-Slovenian border dispute; Serbia's response to the Haag Tribunal requirements, etc. In parallel to the process of setting additional criteria, the EU debate on enlargement fatigue was blooming, providing a basis for countries' frustration regarding the EU enlargement policy towards the Western Balkans.

Also, inter-state trade and financial transactions are limited within the region, although economic integration of the individual states with the EU has significantly progressed. This brings forth the issue of preferential 'north-south' integration, at the expense of 'south-south' integration. The rigidities in the development efforts in the region, which are reflected in interindustry trade, labor- and materialintensive export sectors, withdrawal of cross-border trade, and excessive trade dependence on the EU. The outcome is lower increase in exports, larger deficits, lower productivity and weaker economic systems, compared to the Central European transition countries.

The Western Balkan's accession has been mostly driven by the EU, while countries' role in defining their own path to the Union was rather limited. Besides Copenhagen and Madrid criteria that serve as a regular channel for accession to the EU, additional instruments were set for these countries such as benchmarks for progress in chosen areas and initiatives for strengthening of the regional integration in the Balkans. In purpose to get into the EU, the Western Balkan's governments have already shown high degree of commitment to undertake the demanding reforms and willingness to establish deeper regional cooperation. In the same time, EU has trade preferences with every country in West Balkan.

Since the establishment of a free trade agreement CEFTA 2006. much is expected. At first it was assumed that there will be accelerated liberalization of trade in goods and services between the CEFTA countries, which turned out to be not entirely correct.

Table 1. Western Balkans PTA'S, 2013.

Serbia			
Name	Type	Provider(s)	Initial Entry Into Force
Generalized System of Preferences - Japan	GSP	Japan	8/1/1971
Generalized System of Preferences - Russian Federation, Belarus, Kazakhstan	GSP	Belarus; Kazakhstan; Russian Federation	1/1/2010
Generalized System of Preferences - United States	GSP	United States	1/1/1976
Trade preferences for countries of the Western Balkans	Other PTAs	European Union	12/1/2000
Albania			
Generalized System of Preferences - Australia	GSP	Australia	1/1/1974
Generalized System of Preferences - Japan	GSP	Japan	8/1/1971
Generalized System of Preferences - New Zealand	GSP	New Zealand	1/1/1972
Generalized System of Preferences - Russian Federation, Belarus, Kazakhstan	GSP	Belarus; Kazakhstan; Russian Federation	1/1/2010
Generalized System of Preferences - United States	GSP	United States	1/1/1976
Trade preferences for countries of the Western Balkans	Other PTAs	European Union	12/1/2000
Bosnia and Herzegovina			
Generalized System of Preferences - Australia	GSP	Australia	1/1/1974
Generalized System of Preferences - Canada	GSP	Canada	7/1/1974
Generalized System of Preferences - Japan	GSP	Japan	8/1/1971
Generalized System of Preferences - New Zealand	GSP	New Zealand	1/1/1972
Generalized System of Preferences - Norway	GSP	Norway	10/1/1971
Generalized System of Preferences - Russian Federation, Belarus, Kazakhstan	GSP	Belarus; Kazakhstan; Russian Federation	1/1/2010
Generalized System of Preferences - Switzerland	GSP	Switzerland	3/1/1972
Generalized System of Preferences - United States	GSP	United States	1/1/1976
Trade preferences for countries of the Western Balkans	Other PTAs	European Union	12/1/2000
FYR Macedonia			
Generalized System of Preferences - Australia	GSP	Australia	1/1/1974
Generalized System of Preferences - Canada	GSP	Canada	7/1/1974
Generalized System of Preferences - Japan	GSP	Japan	8/1/1971
Generalized System of Preferences - New Zealand	GSP	New Zealand	1/1/1972
Generalized System of Preferences - Russian Federation, Belarus, Kazakhstan	GSP	Belarus; Kazakhstan; Russian Federation	1/1/2010
Generalized System of Preferences - United States	GSP	United States	1/1/1976
Trade preferences for countries of the Western Balkans	Other PTAs	European Union	12/1/2000
Montenegro			
Generalized System of Preferences - Japan	GSP	Japan	8/1/1971
Generalized System of Preferences - Russian Federation, Belarus, Kazakhstan	GSP	Belarus; Kazakhstan; Russian Federation	1/1/2010
Generalized System of Preferences - United States	GSP	United States	1/1/1976
Trade preferences for countries of the Western Balkans	Other PTAs	European Union	12/1/2000

Source: WTO, 2013.

Specifically, the Western Balkan countries, which made the majority of this regional economic integration, still have many unresolved, above all, political problems. On the other hand, the different status of these countries in the process of integration into the European Union chose the inflow of financial resources and speed necessary economic reforms. It was expected that the investment of foreign capital will be much more intense, and will be directed towards less trade, and more productive and IT sectors. In doing so, it is expected that the new CEFTA, as well as regional integration, to attract more foreign capital than the member states individually. It was assumed that additional foreign capital will accelerate economic growth and development of all countries. However, the global economic crisis has slowed the flow of financial resources, especially greenfield investments, deepened social stratification and mutual political differences between member states. Also, very little has been done to address the major problems of the region - corruption. Economic policies of the region in this respect had to adapt to new conditions in the global market.

Enhancing competitiveness and preparing the region for future EU accession will entail attracting investments and promoting private sector development. It is crucial that these objectives be pursued at a regional level. Further regional economic integration will better prepare the economies of the Western Balkans for the EU Single Market as well as increase their appeal as destinations for much needed investment.

In view of the global competition to attract investment, dedicated investment and private sector development policies are needed to enable countries to gain a comparative advantage. It is therefore important for governments to identify what such sources of competitive advantage might be, and to remove sector-specific policy barriers in order to achieve them.

But, expected results are missing. With exception of Croatia that has started the negotiation talks in October 2005 and joined EU in 2013, the other countries are running to the EU very slowly. FYR Macedonia got candidate status in December 2005 and European Commission's (EC) recommendation to start the negotiations in October 2009. Other Western Balkans countries are lagging behind in the process. Montenegro got candidate status in December 2010, Serbia in March 2012. Bosnia and Hercegovina does not have candidate status and its unknown when it can be, because of political problems within the country.

3. CROATIAN ACCESSION TO EU

Upon joining the EU and leaving the Central Europe Free Trade Agreement (CEFTA), Croatia's products will become more expensive in the region, while the local, traditionally known brands may be easily overcome by a free market competition of cheaper brands.

Croatian products are unknown in Europe, and will not immediately be competitive when the country joins the EU market. The Union's duty free tax on exports and imports of goods will also apply to Croatian exports.⁵

Croatian companies fear losing that competitive edge and the government is separately negotiating with each agreement member on how to keep the existing benefits of Croatian exports to CEFTA.

For example, after leaving CEFTA and joining the EU market, the Croatian Tobacco Factory's Adris Group will pay a higher tax rate on cigarettes produced in Croatia -- in Serbia from 15% to 57%, in Bosnia and Herzegovina (BiH) from 0% to 15%, in Macedonia from 27% to 42 %, and in Kosovo/UNMIK from 0% to 10%.

Croatia will, however, benefit from the accession in that 500 million consumers will open to Croatian businessmen within the EU market, while CEFTA currently has some 27 million consumers.

The truth is that Croatia will export goods according to EU regulations from July 1st 2013. But, Croatian producers expect corrections to Article 7 in the CEFTA Stabilisation and Association Agreement, which implies mitigation of prescribed conditions and a reduction of high rates.

Once within the EU market, Croatia will apply European market prices to its products, and CEFTA products will have to win export on Croatian markets due to price competitiveness.

There are many unsolved issues on regional level. Serbia has been negotiating with the EU for some time now on certain changes to the trade agreement with Croatia after the country's EU entry. The talks focus on raising certain quotas, and some other favorable terms for Croatia, which it had under the Central European Free Trade Agreement (CEFTA).

A decision on exports of Serbian sugar and Croatian cigarettes following Croatia's EU entry will be made at political level as the negotiating teams of Serbia and the EU failed to find a solution, Serbia seeks an additional quota of 46,000 tons for sugar exports, while the EU requests an export quota of 1,625 tons for Croatian cigarettes, and so far no agreement has been reached.

⁵ <http://www.stratfor.com/analysis/croatias-eu-membership-long-process-dubious-rewards>

The valid quota for sugar exports from Serbia to the EU is 180,000 tons. However, after Croatia joined the bloc, the amount of sugar from Serbia on the Croatian market should be included in the quota. On the other hand, the EU requested an export quota of 1,625 tons for Croatian cigarettes, of which 25 tons will be taxed at 10 percent, 1,600 tons at 15 percent, and the remaining quantities at 57.6 percent. The Serbian Chamber of Commerce (PKS) is against Croatia's request for preferential cigarette exports to Serbia, as it is to the detriment of producers and manufacturers in Serbia. Serbia's tobacco industry is a more stable sector of agriculture, accounting for around 14 percent of the overall budget revenues, 2.6 percent of the GDP and 2.7 percent of the total exports of agricultural and food products.

Foreign investments in the tobacco industry totaled over EUR 1.2 billion, which confirms a long-term interest of Serbian and foreign investors in the development of that branch.

Also, it is a chance for FYR Macedonia companies to increase market share in the domestic market and increase investment in the transfer of Croatian companies in Macedonia. It happened with Slovenian companies when Slovenia became an EU member.

BiH market consumers recognise and require Croatian products, which annually amount to 350m euros in goods, mostly in food, with a guaranteed quality from local laboratories and a certification, but not endorsed by the EU.

Of all the regional countries, Croatia has the lowest trade with Montenegro, where last year it exported about 50 million goods and imported seven million.

According to the Chamber of Commerce, current exports to CEFTA countries comprise 20% of total Croatian exports. Last year, Croatia exported products worth 1.66 billion euros, twice as much as was imported from CEFTA to Croatia. From the EU, Croatia imported 9 billion euros in goods, and exported 5.4 billion euros in 2011.

4. CEFTA AND EU

Croatia's EU membership followed protracted negotiations that started in 2005 and went through a gruelling 35 'chapters' concerned not only with passing the *acquis communautaire* but also its implementation.⁶ The most comprehensive membership process so far, it tried to avoid the mistakes made in previous expansions, and will probably be used as a blueprint for further membership negotiations with the remaining Western Balkan countries.

Croatia's accession will encourage the other Balkan EU aspirants - Albania, Bosnia-Herzegovina, Kosovo (UNMIK 1244), FYR Macedonia, Montenegro and Serbia.

Western Balkan countries have identified main issues and they started to make reforms aimed at enhancing SME competitiveness. By adopting EU administrative processes, educational procedures, regulations and funding policy concerning SMEs, Western Balkan countries can enlarge competitiveness, economic potential, technologic capacity and, at the end, value added potential of SMEs.

When talking about competitiveness of EU countries and countries of Western Balkan it should be kept in mind that, on the one hand, it is integration of 28 European countries which, on the level of Community, conduct all kinds of programs and policies according to law legislative of EU, while on the other hand, are small transition countries.

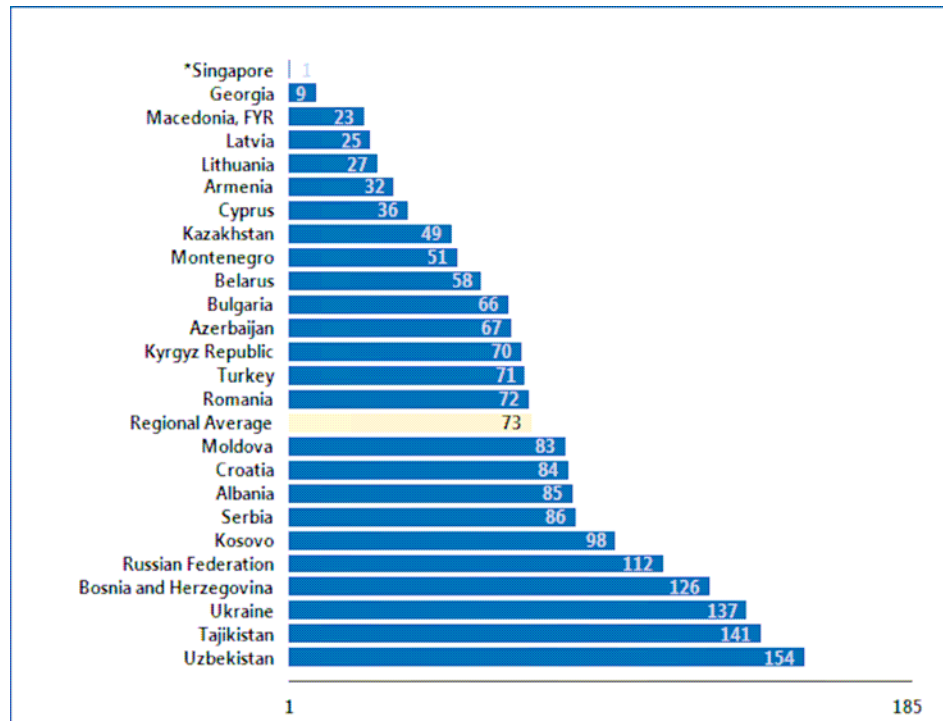
The well being of SMEs is the key to future employment and prosperity, and at the moment, that sector provides 67% of all job places in EU.

When analyzing competitiveness regarding SMEs in Albania, Bosnia and Herzegovina, FYR Macedonia, Montenegro, Serbia and Kosovo under UNSCR 1244/99, it is firstly seen that reform process is necessary and very much needed in an attempt to come closer to business conditions in EU. Because of their lower stage of development when comparing with EU countries, they need a wider range of reform processes and development policies, especially because of their competitiveness position for doing business in the single EU market.

At this point most reforms are directed to decrease an administrative burden. Cheap work force, low corporate income tax and their closeness to the EU market are the main advantages of SMEs in Western Balkan countries, while technology readiness, lifelong education and encouraging innovative companies are still not recognized as main competitive necessities in these countries.

⁶ The Oxford Analytica Daily Brief, Friday, July 26 2013

Figure 2. Ranking on the easy of doing business, 2013



Source: *Doing business in...., 2013*

Within Western Balkans countries, there are many differences one it comes to institutional and legal framework. Albania, Bosnia and Herzegovina, and Kosovo under UNSCR 1244/99 was characterized by denoting an institutional and legal framework underpinning SME policy still largely reliant on ad hoc intervention and pilot projects, and in need of further concretization. On the other side, FYR of Macedonia, Montenegro and Serbia, described countries that had largely completed the legislative and institutional framework supporting SME policy and had just entered into the phase of policy implementation. Serbia has Free trade agreement with Russian Federation, which is very important factor for foreign investors, like Fiat, Benneton, Gorenje, etc. Intraregional trade in CEFTA countries is increased, but EU countries still remains the most important trade partner for this countries. In other countries, there have been limited improvements in the overall performance. In FYR of Macedonia and Montenegro just few policy initiatives have been launched over the last two years. Both countries have made significant progress on two dimensions relating to human capital development and, to a lesser extent, on the provisions of business support services. However, they are relatively weak in the key areas of supporting SME competitiveness and technological capacity, as well as in the export promotion area.

Albania's policy performance over the last two years has been remarkable and has allowed the country to join the second group. Albania's record of policy implementation has improved in all ten dimensions; in particular, in all the policy areas linked to the general operational environment (such as company registration, regulatory reform, access to finance and export promotion). The weak points in Albania's performance remain human capital development and technological capacity of SMEs.

Bosnia and Herzegovina and Kosovo under UNSCR 1244/99 are still in a phase of completing the basic institutional, legal and regulatory requirements underpinning SME policy.

CONCLUDING REMARKS

Proponents of PTAs argue that deeper agreements can be achieved more rapidly on difficult issues when there are only a small number of negotiating partners involved. But many advocates fail to explain how this principal works within the context of PTA consolidation, where parties are essentially reversing the negotiations process and adding more countries. If access to a bigger market is the lure, then wouldn't the Doha Round be a better, if not easier, process? Consolidation may be just as difficult, if not more difficult, than simply starting from scratch. Getting a pair of countries to agree on a specific set of terms will not necessarily facilitate similar breakthroughs with third parties. To ignore this is to ignore ground realities and the political-economy of PTAs and FTA negotiations. And anyone who has looked closely at an FTA will know how difficult the task of enmeshing even two similar agreements can be, let alone many different ones. Pursuing harmonization while retaining flexibility is likely to produce one of two outcomes. Because harmonization implies consensus, it could result in a "race to the bottom", where the lowest common denominator rules. Alternatively, countries taking advantage of flexibility could result in a conservative approach that preserves the current "noodle bowl".

South East European countries have a significant potential in terms of competitiveness, as they are close to the EU market and enjoy almost unlimited entry to the single EU market. The poverty-stricken and politically unstable countries of the Western Balkans are characterized by over-reliance on traditional industry and agriculture, both lacking international competitiveness; overdependence on FDI, uneven distribution and power asymmetries between small firms and international investors.

The very existence of so many PTA's and exemptions confirms the power of political lobbies. Breaking through these pressures will not be easy, and will require a stronger commitment to reform from all members, big or small, strong or weak. The problem is that some countries may not see any carrot — and there is no stick.

Western Balkans countries have made progress in terms of competitiveness by market liberalization and reduction of the tax burden. It is also important to mention the relatively cheap labor in relation to the EU labor market as main competitiveness advantage. However, a clear indicator of the problems related to competitiveness and basis for the long-term growth is a constant high rate of unemployment that averages 20%, and corruption. In addition to that, there are numerous obstacles that prevent higher level of competitiveness.

The crisis itself presents the opportunity to achieve economic restructuring toward greater competitiveness and provide the foundations for achieving production that consists of more value added in the period afterwards.

In the case of the Western Balkans, regional integration may be achieved only through a topdown approach, namely a European Union/International Community enforced process, rather than through bottom-up initiatives of the individual states in the region. Countries of Western Balkan have a lot more job to do to reach a stage of development so that they can compare and compete with EU companies.

A meaningful process will require resolve similar to that which gave birth to the European Union — an example of successful FTA consolidation if nothing else. Unless this happens, all PTA's and FTA in South East Europe may be seen as serving the geopolitical interests of a few players, to little economic effect. Then it will be just politics as usual.

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