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Southeast Europe: History of Divergence

The wiiw Balkan Observatory

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About

Shortly after the end of the Kosovo war, the last of the Yugoslav dissolution wars, the Balkan Reconstruction Observatory was set up jointly by the Hellenic Observatory, the Centre for the Study of Global Governance, both institutes at the London School of Economics (LSE), and the Vienna Institute for International Economic Studies (wiiw). A brainstorming meeting on Reconstruction and Regional Co-operation in the Balkans was held in Vouliagmeni on 8-10 July 1999, covering the issues of security, democratisation, economic reconstruction and the role of civil society. It was attended by academics and policy makers from all the countries in the region, from a number of EU countries, from the European Commission, the USA and Russia. Based on ideas and discussions generated at this meeting, a policy paper on Balkan Reconstruction and European Integration was the product of a collaborative effort by the two LSE institutes and the wiiw. The paper was presented at a follow-up meeting on Reconstruction and Integration in Southeast Europe in Vienna on 12-13 November 1999, which focused on the economic aspects of the process of reconstruction in the Balkans. It is this policy paper that became the very first Working Paper of the wiiw Balkan Observatory Working Papers series. The Working Papers are published online at www.balkan-observatory.net, the internet portal of the wiiw Balkan Observatory. It is a portal for research and communication in relation to economic developments in Southeast Europe maintained by the wiiw since 1999. Since 2000 it also serves as a forum for the Global Development Network Southeast Europe (GDN-SEE) project, which is based on an initiative by The World Bank with financial support from the Austrian Ministry of Finance and the Oesterreichische Nationalbank. The purpose of the GDN-SEE project is the creation of research networks throughout Southeast Europe in order to enhance the economic research capacity in Southeast Europe, to build new research capacities by mobilising young researchers, to promote knowledge transfer into the region, to facilitate networking between researchers within the region, and to assist in securing knowledge transfer from researchers to policy makers. The wiiw Balkan Observatory Working Papers series is one way to achieve these objectives.

The wiiw Balkan Observatory

Global Development Network Southeast Europe

This study has been developed in the framework of research networks initiated and monitored by wiiw under the premises of the GDN–SEE partnership.

The Global Development Network, initiated by The World Bank, is a global network of research and policy institutes working together to address the problems of national and regional development. It promotes the generation of local knowledge in developing and transition countries and aims at building research capacities in the different regions.

The Vienna Institute for International Economic Studies is a GDN Partner Institute and acts as a hub for Southeast Europe. The GDN–wiiw partnership aims to support the enhancement of economic research capacity in Southeast Europe, to promote knowledge transfer to SEE, to facilitate networking among researchers within SEE and to assist in securing knowledge transfer from researchers to policy makers.

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For additional information see www.balkan-observatory.net, www.wiiw.ac.at and www.gdnet.org

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SOUTHEAST EUROPE: HISTORY OF DIVERGENCE

The Balkans or Southeast Europe has had a hard time after the collapse of socialism in 1989. The times before that were not much better. Indeed, socialism succeeded in increasing the divergence between the Balkans and the developed world at least when it comes to the GDP *per capita*. As the Balkans were not really prospering between the two world wars, the whole last century can be described as being rather unfavourable to this region.

At the beginning of the twentieth century, the Balkans lagged in development when compared to Central Europe, but the divergence was not all that dramatic. The following table gives some indication of the level of development.

Table 1

National product per capita in 1910, US dollar (1970 value)

Germany	958	Dalmatia	650
Austria	810	Bosnia	546
Czech lands	819	Croatia	542
Hungary	616	Serbia	462
Italy	546	Transylvania	542
Greece	455	Russia	398

Source: Palairet, *The Balkan Economies*. CUP, 1997, p. 233.

Other estimates come up with different figures, but the discrepancy in the GDP per capita is more or less similar. The relation between Central Europe and the Balkans was around 2 to 1 at the beginning of the last century. It was much higher at the end of the century. There are of course many reasons for that. As most of this divergence has occurred in the last fifty years, there is no doubt that the two main causes were the long period of socialism and the mismanaged transition.

The development of the Balkans in the last ten years has been dominated by the disintegration of Yugoslavia. However, it should not be disregarded that the Balkans have always been disintegrated. Some have tended to point out the division between the East and the West that cut through the Balkans in earlier times. In more recent history, the iron curtain ran through the Balkans too, leaving Yugoslavia on one side and Bulgaria, Romania and Albania on the other. Even between the countries on one side of the curtain the relations were not altogether developed. With the fall of the Berlin Wall, the disintegration did not end, rather it changed its focus towards the countries that previously belonged to socialist Yugoslavia.

It is appropriate to speak of the disintegration of Yugoslavia because it is still going on. The process started with the disintegration of socialist Yugoslavia and has continued with the current Federal Republic of Yugoslavia that consists of Serbia, Montenegro and Kosovo. Disintegration is a big theme and the effects of it are yet to be studied. For instance, the trade links and flows have changed dramatically as a consequence of the break-up of Yugoslavia (both the socialist and the new one). To see the importance of the trade links within former Yugoslavia, here are some of the tables that illustrate those.

Clearly the local market played a more significant role than the outside one, be it the Yugoslav or the world market. Thus, though Yugoslavia was one country, it still did not succeed in integrating the various political units that it consisted of. If the rest of the then socialist Balkans is taken into account, the picture of disintegration becomes even clearer. Table 3 gives the data on trade flows between the Balkan countries and between them and some of the more important trading partners outside of the region. This is in the early part of the 1980s.

Table 2

Trade flows within the Socialist Federative Republic of Yugoslavia[1)]

	Deliveries to the local market, as % of GDP			
	1970	**1976**	**1983**	**1987**
Slovenia	53.6	60.9	42.4	57.5
Croatia	62.6	66.1	59.7	67.0
Vojvodina	49.0	58.8	54.8	58.1
Serbia (proper)	58.9	64.0	52.1	62.3
Serbia (incl. Vojvodina & Kosovo)	67.0	71.3	60.9	69.0
Montenegro	50.8	59.9	54.4	57.5
Bosnia and Herzegovina	50.5	61.4	49.1	56.1
Macedonia	63.2	61.9	55.3	60.8
Kosovo	57.6	56.8	58.2	64.6
Yugoslavia total	*58.6*	*63.0*	*53.4*	*62.2*

	Deliveries to other regions, as % of GDP			
	1970	**1976**	**1983**	**1987**
Slovenia	28.7	22.0	15.7	20.3
Croatia	21.8	19.0	14.8	18.7
Vojvodina	40.1	30.1	22.5	28.8
Serbia (proper)	23.7	21.1	16.5	17.4
Serbia (incl. Vojvodina & Kosovo)	18.0	14.8	10.9	13.4
Montenegro	40.6	22.6	21.0	25.0
Bosnia and Herzegovina	36.6	22.7	18.6	24.2
Macedonia	23.1	23.1	18.1	21.4
Kosovo	34.7	25.7	19.2	24.0
Yugoslavia total	*26.3*	*21.9*	*16.6*	*19.9*

(continued)

Table 2 (continued)

	Exports, as % of GDP			
	1970	**1976**	**1983**	**1987**
Slovenia	17.7	17.1	41.9	22.2
Croatia	15.6	14.9	25.5	14.3
Vojvodina	10.9	11.1	22.7	13.1
Serbia (proper)	17.4	14.9	31.4	20.3
Serbia (incl. Vojvodina & Kosovo)	15.0	13.9	28.2	17.6
Montenegro	8.6	17.5	24.6	17.5
Bosnia and Herzegovina	12.9	15.9	32.3	19.8
Macedonia	13.7	15.0	26.6	17.8
Kosovo	7.7	17.5	22.6	11.4
Yugoslavia total	*15.1*	*15.1*	*30.0*	*17.9*

Note: - 1) Final and intermediate goods included.

Source: OECD.

The situation does not change all that much in the late1980s, i.e., all the way before the collapse of socialism and the break-up of Yugoslavia. Table 4 shows the trade relations just at the turning point.

The big changes are in the increasing role of Germany, Italy and even Austria in the trade with Yugoslavia and the diminishing role of Russia, but the intra-regional trade cannot be said to have increased all that much. With some exceptions, the outward trade, especially with the EU countries, has increased very much, while trade within the region has in many cases shrunk significantly and in some cases has disappeared altogether.

Table 3

South East European trade (1980-85)

	Exports, as % of total			Imports, as % of total		
of:	**BUL-80**	**ROM-81**	**YUG-85**	**BUL-80**	**ROM-81**	**YUG-85**
to/from:						
Bulgaria	.	1.4	1.5	.	1.7	1.0
Romania	2.2	.	1.2	1.9	.	1.0
Yugoslavia	1.6	.	.	1.1	.	.
Austria	0.9	2.0	2.5	1.7	1.8	3.3
Germany 1)	2.6	7.2	8.4	4.8	5.7	13.6
Greece	3.8	2.5	1.4	0.5	0.8	0.9
Hungary	1.9	2.0	2.8	1.9	2.0	2.4
Italy	1.4	3.3	9.2	1.4	2.0	8.5
USSR	49.9	18.1	30.5	57.3	18.2	15.5
Turkey	1.1	.	.	0.1	.	.
SEE-1 2)	5.7	3.4	5.5	4.9	3.7	4.4
SEE-2 3)	10.6	6.0	6.9	5.6	4.5	5.3
Total	**100**	**100**	**100**	**100**	**100**	**100**

Notes: 1) West Germany. – 2) SEE-1 (South Eastern Europe - 1) includes Bulgaria, Hungary, Romania, and Yugoslavia. – 3) SEE-2 (South Eastern Europe - 2) includes SEE-1 plus Greece and Turkey.

Source: WIIW.

Table 4

South East European trade (1990)

	Exports, as % of total			Imports, as % or total		
of:	**BUL**	**ROM**	**YUG**	**BUL**	**ROM**	**YUG**
to/from:						
Bulgaria	.	1.9	0.7	.	2.3	0.8
Romania	3.9	.	1.2	1.3	.	0.6
Yugoslavia	1.0	.	.	0.9	.	.
Austria	0.5	1.2	4.0	1.6	1.7	5.8
Germany[1)]	4.2	11.0	17.1	10.4	11.4	19.3
Greece	0.8	1.5	1.5	0.3	0.7	1.1
Hungary	1.2	2.6	1.4	0.7	2.4	2.6
Italy	0.8	8.8	17.3	1.9	1.2	13.0
USSR	64.0	25.2	18.6	56.5	23.6	13.0
Turkey	0.4	.	.	0.2	.	.
SEE-1[2)]	6.1	4.5	3.3	2.9	4.7	4.0
SEE-2[3)]	7.2	5.9	4.8	3.4	5.4	5.1
Total	**100**	**100**	**100**	**100**	**100**	**100**

1) Including both West and East Germany. – 2) SEE-1 (South Eastern Europe - 1) includes Bulgaria, Hungary, Romania, and Yugoslavia. – 3) SEE-2 (South Eastern Europe - 2) includes SEE-1 plus Greece and Turkey.

Source: WIIW.

The disintegration can be observed in the increase of the differences in the levels of development. Again, the best way to see that is to look at the data of the regional development of former Yugoslavia. Table 5 below illustrates that.

Table 5

Gross social product per capita (Slovenia = 100, unless otherwise indicated)

	1952	1965	1974	1980	1989	1997 [1)]	1999 [2)]
Slovenia	100	100	100	100	100	100	10078
Croatia	66.7	65.8	62.5	64.1	64.1	48.0	6464
Vojvodina	49.1	60.9	58.0	57.1	59.6	24.3	6006
Serbia (proper)	56.7	52.2	48.0	49.5	52.0	18.9	5243
Serbia (incl. Vojvodina & Kosovo)	51.5	50.0	45.0	45.5	46.0	17.1	4632
Montenegro	48.5	41.3	34.0	39.9	36.9	16.1	3716
Bosnia and Herzegovina	52.6	39.1	33.0	33.3	34.3	10.2	3461
Macedonia	39.2	36.4	34.0	33.8	33.3	20.3	3359
Kosovo	25.7	19.6	16.0	14.1	12.6	5.1	1272

Notes: 1) In 1997, data refer to GMP per capita for all Yugoslav republics (including Kosovo), and to GDP per capita for other countries. – 2) Actual GDP per capita (in USD at exchange rate) for Slovenia, and hypothetically attainable level of GDP per capita (in USD at exchange rate) for other republics, under the assumption that regional discrepancies (as measured in GDP per capita) are the same as in 1989.

Source: WIIW for 1997 and 1999, and OECD for other years.

Clearly, the regional differences increased over the whole period. However, the changes were not dramatic in the pre-1989 period, while they have been in the last ten years. Indeed, if one takes the difference between Serbia and Slovenia, the divergence is not all that large. Of course, the divergence between Kosovo and Slovenia increased quite dramatically, though mostly due to the faster growth of population in Kosovo than to slower growth of production. The disintegration, however, clearly led to a dramatic divergence not only between Slovenia and the other parts of former Yugoslavia, but also between Croatia and the rest. Contrary to that, the differences between the other countries diminished primarily because the richer areas had more to lose than the poorer ones.

In the last column of Table 5 the GDP per capita figures of the states and regions of former Yugoslavia are calculated on the assumption that the difference between them and Slovenia had stayed the same as in 1989. If those numbers are compared with the actual GDP per capita, the costs of disintegration become quite clear. Taking into account the fact that Slovenia's GDP in 1999 was not all that higher than in 1989, the costs for Slovenia are also significant, though it is not easy to distinguish these costs from those due to transition.

The influence of the lack of integration can also be seen in the development in the labour market. In the socialist Balkans only former Yugoslavia registered the existence of unemployment. Thus the development of the unemployment rates is interesting to look at.

Table 6

Unemployment rate in %

	1952	**1965**	**1974**	**1980**	**1989**
Slovenia	1.8	1.7	1.4	1.4	3.2
Croatia	2.9	5.6	4.8	5.2	8.0
Serbia (proper)	2.5	7.4	11.3	15.8	15.6
Serbia (incl. Vojvodina & Kosovo)	2.6	7.1	11.5	16.1	17.6
Vojvodina	2.9	4.5	8.9	12.4	13.6
Kosovo	2.6	15.2	21.0	27.6	36.4
Montenegro	3.2	5.1	12.7	14.7	21.5
Macedonia	6.3	13.5	19.7	21.5	21.9
Bosnia and Herzegovina	1.5	4.8	9.7	14.1	20.3

Source: OECD.

These are figures for registered unemployment. Labour survey figures would give lower rates of unemployment because black market activities were significant especially in regions where registered unemployment was high. This observation underlines the divergence and the disintegration. Obviously, in countries such as Slovenia and Croatia where registered unemployment was relatively low, the black market employment was also low, which means that the local markets worked better and the institutions were stronger. In the other countries, there was no registered unemployment, so the extant of black market employment could not have been significant, though it was not non-existent.

The situation did change, in some cases dramatically, after 1989. Unemployment increased in all cases, reaching catastrophic levels in some. Indeed, the changes in the labour markets were in most cases quite dramatic. The unemployment rates are as a rule quite high, though the difference between the registered unemployment and that which the labour surveys find is often quite large. That difference covers the employment in the informal sector, though this is only an imperfect measure of the extent of these activities.

The size of the informal sector is quite large and is in fact still growing. This whole sector is populated with small and medium size enterprises (SMEs). It does not exhaust the SMEs, of course. Indeed, the region has been dramatically de-industrialised, so the services sector is the dominant one, though SMEs are to be found in the surviving industrial sector too. The collapse of the big enterprises will continue in the next few years, so the growth of the SMEs is certainly going to continue.

What are the markets that they can be looking for? The black markets and informal markets will continue to be important. Local markets will also be quite important for most SMEs. As the region has to export to sustain the external deficits, it is interesting to see what is the export structure of the region. Mostly, agricultural products, manufactured goods, some raw materials, and services (especially tourism in some countries). Putting aside some agricultural products that could be originating in bigger enterprises and assuming that most of the manufactured goods that are exported belong to outward processing trade, some of which tends to be from small companies, there is no doubt that SMEs are contributing significantly to exports from the region. However, the region does not really export all that much. Total exports, though the date is incomplete, can be found in the following table.

Table 7

Exports from SEE, millions USD

1992	1993	1994	1995	1996	1997	1998	1999
12596.7	13780.8	15658	19363.8	21306.5	22320.8	22026.1	20279.1

The best covered years are from 1995 to 1999. So, it is not to be read from this table that there has been a big increase in foreign trade between these years and the previous ones. In fact, it is most probably the case that the exports have mostly stagnated in this period, and have clearly declined compared to the period before the 1989. If the GDP of the region is taken to have been around USF 95 billion in 1999, that means that the share of exports was only about 20 to 25%. Thus, though SMEs have most probably a significant share in the total exports, their exporting capacities are not all that significant.

It is fair to assume that the significant barriers to trade that exist in the region pin the trade down to local markets. The barriers are both formal and informal, so the extent of the overall barriers to trade is difficult to estimate. In the attached appendix II exchange rate and trade regimes in the region are described. Again, it is clear from the table that the disintegration of the region is the dominant economic policy factor that weighs heavily on the possibilities for trade. There is a great variety of exchange rate regimes and there are, generally, protective and discretionary trade regimes and policies.

Trying to characterise the overall climate in which firms are operating in the region, some structural indicators have been compiled in the appendix III. Without going into the details, it can be concluded that the institutional and technological environments in which firms have to operate are illiberal and underdeveloped. To this, widespread corruption and economic criminality have to be added to compose a clearer picture of the way business is done there.

Finally, the overall profitability in the region I not very high. In appendix IV some information from business surveys has been supplied. As in most other transition economies, the nascent private sector is much more profitable than the ailing state sector. At the moment, this is not curtailing the private sector all that much because there the tax evasion is quite widespread. However, once the fiscal discipline improves, the burden will be shifted and the business situation may in fact deteriorate if the needed structural reform are delayed and the strengthening of the rule of law takes too much time to materialise.

In conclusion, it is evident that SEE has diverged not only from the European Union but from the more successful transition economies in Central Europe too. Also, the region has continued to disintegrate internally and that creates a domestic bias especially when it comes to the SMEs. Most importantly, the new SME sector is most developed in the informal and black economy and is not transparently integrated with the rest of the economy and with the legal institutions of their countries. Thus, the real potential of this sector will have to be assessed only after it goes through a process of legalisation. This restructuring may be as trying as that associated with the general process of transition.