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AUTHORS

Rudi Guraziu is Founder and CEO of the International Business and Diplomatic Exchange (IBDE) and Editor of Exchange magazine. Mr Guraziu has worked for a decade in the Balkans. Whilst in Kosovo he was one of the principals in the running of a large pharmaceutical business until the 1999 war. Since the Kosovo war, he has been actively engaged with many members of parliament, business leaders and diplomats in the UK and the Balkans as a consultant on Southeast European Affairs. His particular expertise covers EU Foreign Policy as well as Western Balkans issues. For much of that time he has worked with different parliaments particularly in the relationship between legislative bodies and economic operators. Prior to establishing IBDE, he initiated the establishment of the Centre for Business and Parliamentary Dialogue (CBPD) and serves as its Founding Director. Mr Guraziu holds an MA in International Relations (with distinction) from Middlesex University - UK.

Epidamn Zeqo before joining IBDE successfully completed an MA Joint International Relations and Modern History at the University of St. Andrews Scotland, and an MSc European Political Economy at the London School of Economics and Political Science. His versatility is highlighted by the various internships he has undertaken in different fields. Epidamn also regularly publishes articles in various newspapers and magazines in SEE. He has specialized in the economic history, communist-rule, post-communist transition, and EU integration of Central and Eastern Europe, and South East Europe.
SPEAKERS’ BIOGRAPHIES

Peter Sanfey is Deputy Director of Country Strategy and Policy within the Office of the Chief Economist at the EBRD, and a guest member of St Antony’s College, University of Oxford. He is responsible for the analysis of economic developments and reforms in South-Eastern Europe, and he engages in research and publications on a range of topics covering the whole transition region. He received his Ph.D. in Economics from Yale University in 1992, and was a lecturer in economics at the University of Kent at Canterbury from 1992-97. He is the co-author (with Christopher Cvijic) of a book entitled: In Search of the Balkan Recovery: the Political and Economic Re-emergence of South-Eastern Europe, published in 2010 by Hurst & Co. and Columbia University Press.

Laza Kekic heads the Economist Intelligence Unit’s regional team of analysts who provide economic, political and business coverage for the countries of eastern Europe, including the former Soviet Union. He also heads the Country Forecasting Services, which include the EIU's main traditional product, the Country Reports, as well as the Country Forecasts (medium and long-term forecasts for 82 countries aimed at direct investors). Laza has played a leading role in product development at the Economist Intelligence Unit. His main areas of specialisation and interest are: Russia, the Balkans and other transition economies, foreign direct investment, economic forecasting, and growth economics.

Slavo Radosevic is Professor of Industry and Innovation Studies at the UCL School of Slavonic and East European Studies. His main research interests are in science, technology, industrial change, foreign direct investments and innovation policy in central and eastern Europe. He favours empirically oriented and policy relevant research projects, based in neo-Schumpeterian, evolutionary and institutional economics. He also has significant policy making experience in Croatia and ex-Yugoslavia, having worked as department director at the Republic Institute for Planning (Croatia), as a researcher at the Institute of Economics Zagreb, and as Federal Under-Secretary for Development in the last SFES government. He also acts as an expert for the European Commission, as consultant for OECD, UNESCO, UNIDO, World Bank, UNECE and Asian Development Bank, and on technical assistance projects with Ernst & Young and TNO.

Eric Gordy is Senior Lecturer in South East European Politics at the UCL School of Slavonic and East European Studies (SSEES). Prior to joining SSEES, he taught sociology at Clark University in Massachusetts and the University of California. He has also been associated with the Collegium Budapest-Institute for Advanced Study (Hungary), the Jefferson Institute (Serbia), the Watson Institute for International Studies at Brown University (USA), the Minda de Gunzburg Center for European Studies at Harvard University (USA), the Istituto per l'Europa Centro-Orientale e Balcanica (Italy) and the University of Niš (Serbia). His main research focus is on the politics and culture of the contemporary Balkans. His most recent book is Postwar Guilt and Responsibility: Serbia and the Future of International Justice (forthcoming).

Marko Attila Hoare is a Reader at Kingston University specialising in the history of South East Europe, in particular of Yugoslavia, Serbia and Bosnia-Hercegovina. He is the author of three published books, the most recent of which is ‘The History of Bosnia: From the Middle Ages to the Present Day’ (London: Saqi Books, 2007). Prior to joining Kingston University, he was a Research Fellow at the Faculty of History of the University of Cambridge, a British Academy Postdoctoral Research Fellow, a war-crimes investigator at the International Criminal Tribunal for the former Yugoslavia, and a research assistant at the Bosnian Institute in London. He is currently the European Neighbourhood Section Director of the Henry Jackson Society, an independent think-tank promoting democratic geopolitics. He holds a PhD from the University of Yale.
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Published by:
International Business and Diplomatic Exchange,
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Executive Summary:

The aim of the EU-Balkans Ambassadorial Roundtable is to bring together EU policy-makers, high representatives from the interested parties, business leaders interested in investing in the region of South East Europe (SEE), and more generally to create a strong avenue for discussing the issues and progress of the region, which has left his troubling past behind and is fully committed to achieve EU integration and modernisation. The most pressing issues of the moment are addressed: the developments concerning the accession process of Western Balkans countries (WBCs) with the European Union (EU), the vulnerability of the region from the Eurozone crisis, the problems with regional cooperation, and the economic model adopted by these countries.

This EU-Balkans roundtable benefited from the presents as input speakers of country risk authorities, ambassadors, academics and policy-makers, business leaders looking to invest in the region, and also interested research students. The event received media coverage and will be publicised with the publishing of this report inside IBDE’s Exchange Magazine in the Winter Issue, which this year focuses on Turkey: investment opportunities in Turkey as well as the investment climate and policy priorities in SEE.

The structure of this report follows the structure of the roundtable. In the introduction we have included a necessary cost-benefit analysis, both politically and economically, regarding EU accession from countries in WB. This was seen as important to refresh the reasons why these countries want to join in the first place. The second part concerns the economic cooperation and reform in SEE. Three reports from the Economist Intelligence Unit (EIU), European Bank for Reconstruction and Development (EBRD), and the Progress Report 2011 by the European Commission, form the backbone of this section. Most interestingly, from an investor's point of view is the vulnerability index presented by EIU representative Laza Kekic. Peter Sanfey, of EBRD, presented the short-term growth outlook for the entire region but also highlighted the huge potential for catch-up growth that countries in the region have. An important part in this session was the analysis of the economic growth model adopted so far by the countries in the region – attracting Foreign Direct Investment (FDI). Prof. Slavo Radosevic from the UCL Slavonic and Eastern European Studies suggested the adoption of a new growth model he called foreign led modernisation that should focus on attaching Foreign Direct Involvement from mainly German Multinational Corporations.

The third section, presents the conclusions from the session on Political Reforms. What should be highlighted is the tremendous progress towards stability, democratisation, regional cooperation, and cooperation by the countries of the former Yugoslavia with the International Criminal Tribunal for former Yugoslavia (ICTY). The acceptance of Croatia to be the twenty-eight member of the EU – date set for July 2013 - is a landmark development for the country itself, the EU, and most importantly for the region. This is because it shows two main points: first, it is possible to overcome the legacy of war and communism both in democratising the political system and modernising the economy. Second, the EU is committed to enlarge in the region when countries concerned fulfill EU conditionality, the Copenhagen Criteria, and other conditions set by EU countries and the Commission, including regional cooperation. The remaining WBCs should take note from this and learn from Croatia’s accession process. A key proposal was also discussed: the possibility of an EU reform of the veto powers in the enlargement process by member states, and its replacement with a majority voting process. Such development would end the blocking of Macedonia’s (officially recognized by EU and UN as the Former Yugoslav Republic of Macedonia) accession process by Greece, and prevent a future blocking of other countries (i.e Serbia vis-a-vis Kosovo, whichever joins first), which taking into account the regatta nature of the accession process has strong probabilities. The conclusion highlights the main findings and concentrates on the Eurozone crisis, the economic outlook and potential for catch-up growth of these countries.

We would like to thank again all the participants in this discussion, whose contribution was invaluable to create a better understanding of the prospective of the countries in the region. We wish that the cooperation between IBDE, UCL, and European Commission Representatives and other relevant
institutions including EU-Balkans Embassies to continue with the aim to promote the region not only to investors, policy makers, academic experts and research students but also the general public.

**Introduction:**

This report is a summary of the ‘EU-Balkans Ambassadorial Roundtable’ that took place on 24 November 2011 at Europe House in London - organized by International Business and Diplomatic Exchange (IBDE), in conjunction with the UCL European Institute and the European Commission Representation in the UK. This informal roundtable, as part of the IBDE’s EU-Balkans Discussion group, was timely and necessary to discuss the economic and political reform, as well as progress, opportunities and challenges in South East Europe. The context was the 2011 Progress Report, outlined by the European Commission in October, and most crucially against the backdrop of the Eurozone crisis. The event gathered around 90 participants, including the authorities on country risks for the region of South East Europe (SEE) - namely Peter Sanfey of EBRD and Laza Kekic of EIU, together with academic researchers, ambassadors and senior diplomats of the EU-Balkans. The event was opened by Jonathan Scheele, Head of European Commission Representation to the UK and consisted of two sessions; each with a different thematic emphasis. Invited speakers gave three input presentations at the beginning of each session. One diplomat/ambassador acted as a respondent after each session, which was followed by structured discussion among representatives of different institutions, embassies and companies.

The summary of the meeting is provided below. However, before continuing any further it is necessary first to outline the rationale as to why WBCs should join the EU in the first place?

EU membership is the strongest tool to encourage more FDI in the region. Additionally, the European perspective is the strongest incentive for political and economic reforms as well as enhanced neighbourly relations and regional cooperation. During the accession period, countries will continue to undertake substantial reforms in many areas that directly affect the livelihoods of citizens of the region, and also strengthen institutions responsible to implement reforms and policies. This is particularly important considering that many technical aspects of the process of association have direct positive impact in the lives of the citizens of the WB (Visa liberalization a most recent example), but also agricultural; fiscal; monetary; trade; transport; industrial; environmental; labour market; regional development policies as well as competition and the rule of law to name but a few. Being a candidate country has the additional advantage of being in receipt of increased financial and technical assistance from the EU. And most importantly as Former Commission Vice President Gunter Verheugen once put it: “We must never forget that European Integration is not about milk quotas and customs duties. It is about peace, stability and prosperity for our citizens. Instability in one part of Europe immediately affects the other parts”.

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>POLITICS</strong></td>
<td></td>
</tr>
<tr>
<td>- Consolidation of reforms and political transition process</td>
<td>- Imported regulations and social / institutional model (misfit?)</td>
</tr>
<tr>
<td>- Geo-political influence; security, stability and peace</td>
<td>- Executive bias – reinforcing statism / concentration</td>
</tr>
<tr>
<td>- Counterfactual: avoiding the implications of being left out</td>
<td>- External design – paternalism and weakening new states</td>
</tr>
<tr>
<td>- Importation of institutional / policy credibility (Euroisation)</td>
<td>- Change of balance of power – implications for legitimacy</td>
</tr>
<tr>
<td><strong>ECONOMY</strong></td>
<td></td>
</tr>
<tr>
<td>- Economic stabilisation / improved country ratings</td>
<td>- Accession shock adds to transition shock; more strain on restructuring</td>
</tr>
<tr>
<td>- Increased inflow of EU funds</td>
<td>- Backward specialisation (re adjustment)</td>
</tr>
<tr>
<td>- Attraction of FDI; more trade</td>
<td>- Loss of policy tools against competitors (CET + currency)</td>
</tr>
</tbody>
</table>
Western Balkans: SWOT Overview:

Strengths:
- Catch-up growth potential
- Competitive advantage
- Regional Market (CEFTA)
- EU perspective
- Government's support

Weaknesses:
- Disputed property rights
- Corruption
- Ethnic tensions
- Weak protection of Intellectual property

Opportunities:
- Growing Consumer Market
- Manufacturing Sector
- Infrastructure and Energy Market
- Privatization

Threats:
- Eurozone Crisis:
- Banking Sector
- Currency Risk
- Slow growth

Strengths:
The countries in the region are developing fast and offer a plethora of opportunities for investment. Proximity to the West and Central Europe, low cost for unit labour, and the lowest flat tax regime are some of the competitive advantages the region offers. Additionally, it offers access to the regional market, regulated by CEFTA, adopted since 2007 as part of the Stability Association Pact. The latter, highlights a key fact: Western Balkans is the only region in non-EU Europe to have a clear EU perspective, as demonstrated by the successful application of Croatia that will join the Union in 2013.

Weaknesses:
Following the ‘lost decade’ in the 1990s, the region has been stabilised and recovered at a fast pace. However, some border disputes still hamper the regional cooperation and the normal flow of products in particular between Serbia and Kosovo. That said, the technical dialogue between the two parties, sponsored by the EU, is addressing the issue. Corruption remains a major challenge. Despite the anti-corruption policies, the countries in the region still suffer from this plague, as noted by the Transparency International and World Bank reports. More proactive actions by governments are needed to solve definitely the property rights titles and the protection of intellectual property.

Opportunities:
The Western Balkans is in the middle of the process of reconstruction and privatisation. It enjoys free access to 500 million consumers and has a liberal regime for foreign investment, which guarantees equal treatment of foreign and local investors. Multinational Corporations in manufacturing that have invested in Central and East Europe should target the region to benefit from its competitive advantage and increase productivity with little capital investment. Although, many sectors have been liberalised already, the region is in the midst of its privatisations process. The region offers great investment potential in infrastructure (road, railway and sea) telecommunications and energy sector. The energy market has been liberalised and is supported by the EU, which aims to create a regional energy market connected with the wider European Energy Market as part of Europe 2020 agenda.

Threats:
Following the Banking Crisis and Stock Market crash in 2008, the region went into a mild recession, with the exception of Albania. However, it quickly recovered and the economy grew in 2011 and is expected to grow in 2012. Having said that, the region is highly exposed to the Eurozone crisis (a risk analysis is provided in this report) and may be unable to withstand a second external shock so soon after 2009.
Economic Cooperation and Reform - Progress:

Jonathan Scheele – Head of the European Commission Representation to the UK, chaired this session. The general assessment of the accession process in WBCs was positive and this year should see the granting of candidate status to Serbia and even Albania (if the recent political consensus continues) and setting the date for the start of negotiations with Montenegro. With regards to Serbia, the positive continuation of negotiations with Kosovo will determine its candidate status. Yet, more progress is needed. The granting of candidate status is done in order to spur on growth in the momentum of reforms – both political and economic - as in the case of Albania. Such reforms have been often delayed because of internal political developments and conflicts, especially in the case of Bosnia and Herzegovina (BiH) and Albania. Good governance, rule of law, administration capacity, unemployment, economic reforms (structural) and social inclusion remain major challenges in most countries.

Mr Scheele reiterated the lessons learned from the accession process for Croatia: pending actions on judiciary and fundamental rights and on justice, freedom and security should be tackled as early as possible, in order to allow time for candidates to build the necessary track record of reform. Key challenges emphasized were: a) strengthening the rule of law and public administration reform - Croatia reformed the appointment system of judges and together with Serbia launched a review of the re-appointment procedure for judges and prosecutors. b) Ensuring freedom of expression in media currently threatened by: 1) political interference, economic pressures, insufficient statutory protection (in particular Turkey) 2) lack of transparencies and concentration of ownership, lack of fair competition 3) self-regulation in the media profession remains essential. c) Enhancing regional cooperation and reconciliation in between WBCs. d) Achieving sustainable economic recovery and embracing the Europe 2020 agenda.

In his concluding remarks, Mr Scheele hailed the role of the Commission in assisting the region financially through: a) the Western Balkans Investment Framework, which encourages partnering with International Financial Institutions (IFIs) to support new forms of Small & Medium Enterprises (SMEs) financing particularly in the areas of equity, venture capital and guarantee mechanisms. b) Extending transport and energy networks within the region.

Input speakers on the economic panel were leading experts; Peter Sanfey, Laza Kekic, and Slavo Radosevic. The first two input speakers presented a gloomy picture both on where we stand in the region and on expectations. For both, the solutions across the board involved deeper structural economic reforms. Whereas, Slavo Radosevic had a more optimistic outlook, he did criticize the growth model adopted thus far, seeing a potential solution in the creation of a new growth model based on manufacturing or what he called foreign led modernisation. Ralf Boeckle, Financial Attaché
at the Austrian Embassy in London acted as a respondent to this panel, which was followed by a lively discussion amongst participants.

**Peter Sanfey** presented the findings and conclusions from the recently published EBRD Transition Report 2011 - *Crisis in Transition: the People’s Perspective*. The conclusion can be summarised as the following: the region is struggling to emerge from the effects of the global crisis and is at risk of falling back into recession again if the Euro crisis continues and worsens, even as foreign investor interest has dropped off significantly in the past two years. Nevertheless, with the right policies in place (structural reforms), the region has strong potential for catch-up growth with the rest of Europe.

The term “catch-up growth” refers to the convergence theory, which states that when countries of different socio-economic levels trade and integrate together this causes a convergence towards the levels of the most advanced partners. If the theory is correct than we should expect significant growth in the region. This is because if measured with GDP per capita in 2010 PPP terms and having EU27=100 one could easily see that the region has great scope for catch-up growth, especially Albania and BiH whose GDP is only 35% of EU27. This percentage is a 3-4% higher for Serbia and FYR Macedonia and 40% in Montenegro. Even the two member states, Bulgaria and Romania, only score 44% and 45% respectively. The regional leader is undeniably Croatia reaching the levels of 60%. Despite this, Sanfey argued that fast growth cannot be guaranteed and cited the decline in consumer’s confidence as a dangerous index. Therefore, short-term growth outlook is gloomy as shown by Fig.2.

This means that structural reforms are vital to maintain macroeconomic stability and spur growth to higher levels, in line with other developing regions most notably East Asia. The following reforms are factors in meliorating the business environment in these countries: 1) accelerate reforms 2) improve business activity indicators 3) increase competitiveness and 4) increase investments in human capital i.e. in education. The aim in question is to build a knowledge economy with better modern infrastructure.

Yet, a plethora of obstacles exists to be overcome. Fig.3 shows the most important obstacles faced by foreign business wanting to invest in the region. With the exception of Bulgaria, Rumania, and Croatia all
the other SEE countries are **lagging behind reforms in each of the 16 sectors** identified by EBRD report. Furthermore, the region so far has benefited from **cheap capital inflows**, which have masked the existing structural problems. Since this is not the case anymore, it is imperative for countries in the region to maintain macroeconomic stability by undertaking deep economic reforms.

Despite this, there are numerous positive developments in the region, the most striking being a steep decline in corruption perception by business operating in countries of the region. Fig.4 captures very well this welcome development - with Albania representing the best case example in terms of progress made with a drop from near 50% to 10% leaving Serbia and Romania with the highest % of firms bribing frequently, usually or always.

In his concluding remarks, Sanfey reaffirmed that EBRD funding for the region would continue, together with the reinstated counter-cyclical role of the bank he represented. He also stated that even if EBRD was
to open its operations in North Africa as planned, the region of SEE would not suffer. He also declared that the EBRD’s operations in those countries of central Europe and the Baltic states that joined the EU in 2004 would be expected to fall as needs decline and financial markets resume their normal functions, and these countries are expected to graduate from the EBRD’s regular operations by 2015.

However, Sanfey’s presentation did not include the recent surge of Greek investments in the region as a potential positive development. Further, the statement that the entire region benefited from cheap capital inflows is incorrect as it was mainly Croatia, Bulgaria and Romania which did. It is worth noting that the interest rates for commercial loans in the region have been the highest in Europe, a fact which could explain the relatively high current account and budget deficits (as we will see from the presentation of Laza Kekic of EIU). Most importantly, Sanfey did not touch on the economic model adopted so far. This is important as the current model represents a paradox in the context of the Eurozone crisis: how can the model work if there are no more capital inflows now and low levels predicted for the future?

Only Slavo Radosevic addressed the paradox thus created. His solution? Switch from a growth model of externally financed consumption (consumer durables) and investment in real estate towards a more sustainable and profitable growth model driven by investments and improvements in productivity - in effect a foreign led modernisation growth model. This would be based on deeper integration with the EU in terms of finance, trade, labour markets and institutions or Foreign Direct Involvement. This means, that countries in the region have to go beyond the mantra of structural reforms, essential according to Radosevic because the growth model adopted thus far is in crisis. Let’s not forget that all the countries in the region have adopted ‘shock therapy’ stabilisation, liberalisation, and privatisation since the 1990s in line with the ‘Washington Consensus’ (this progress is summarised in Fig.5). Yet they only registered meager growth levels (averaging around 6% per annum) relative to the levels observed in other developing regions, namely East Asia. So what can account for the relatively low levels of growth since in the global competitiveness index the countries in the region receive a good score?

Radosevic bases his new growth model in attracting German and Austrian Multinational Corporations (MNCs), which he argues is inevitable in the region for the reason outlined below.
First, the lessons learned from German and Austrian MNCs relocations in CEECs have been positive: a) it boosted productivity and decreased unit labour costs in Germany b) Austria and Germany experienced only minor job losses and c) productivity of subsidiaries in CEECs increased three-fold and for parent companies by 20% (estimates from Hansen, 2010; Martin, 2010). This win-win environment will occur with SEE countries only if this region integrates into EU economy not only as a market, as it has already done – FDI are focused on non-tradable goods - but also as a production location. The competitive advantages that the region offers make this development possible and inevitable.

Second, SEE proximity to CEECs and Germany is a real competitive advantage, offering apparel costing 22% cheaper than that from China, only 12-14 hours. Moreover, Germanic MNCs can benefit from ‘near sharing’ i.e. language capability and cultural understanding.

Third, the cost of labour in the region (with the exception of Croatia) is extremely competitive, coming in at only between 15.5% - 50% of Hungarian wages. This means a great reduction in operational costs and room for productivity increases with little capital investments.

The biggest challenge these countries face, therefore, is not just in structural reforms but most crucially in improving ‘organizational capital’ through linkages, leverages and learning as outlined in Fig.6.

Therefore, improvements should be made in learning management practices and in addressing the skills gap in design and engineering, linkages since only marginal share of companies use B2B and online procurement, and improving leverage by signing partnerships with second-tier suppliers, and establishing collaborative innovation FDI/SME/R&D.

In a nutshell, the SEE countries should adopt a foreign led modernisation growth model by integrating into the German/Austrian industrial system, and by enhancing linkages with CEE industry networks, leveraging pan-European networks, and pursuing a multi-tier ‘tandem growth’. Despite the potential for
these positive developments, in the current global economic downturn and especially the debt crisis chiefly in Italy and Greece, the prospect for SEE is uncertain and risky.

Uncertainty going forward was the issue Laza Kekic of the EIU addressed in his presentation titled ‘South East Europe and the Eurozone crisis’. The findings were the following and can be described as worrisome: the region is more exposed to the Eurozone crisis more than any other region and the risk of another recession is considerable. The main danger is a banking crisis deriving from the heavy involvement of Greek and Italian banks, but also Austrian banks, magnifying the risks. Furthermore, a consideration and quantification of the multiple linkages between the Eurozone and SEE (including trade, remittances, FDI flows, banking sectors) allows for a risk analysis identifying which economies are the most vulnerable thus. What makes the situation even more uncertain are the doubts surrounding the ability of SEE to withstand –economically, politically and socially - yet another severe external shock so soon after 2009. Kekic argued that the crisis is also damaging the WB’s EU accession perspective excluding Croatia who will join the EU in 2013.

A worst-case scenario, including an adverse political impact, was averted during the previous crisis 2009. The countries in the region are in some ways now also better placed than in 2009 to withstand a new external shock. Macroeconomic fundamentals have improved in most countries since 2008/09 (see Fig.7).

### Table: Macroeconomic Indicators

<table>
<thead>
<tr>
<th>Country</th>
<th>Budget balance, % GDP 2009</th>
<th>Budget balance, % GDP 2011</th>
<th>Current account, % GDP 2008</th>
<th>Current account, % GDP 2011</th>
<th>REER Index 2008=100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
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<td>-3.8</td>
<td>-15.8</td>
<td>-12.7</td>
<td>90.1</td>
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<tr>
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<td>-22.9</td>
<td>0.9</td>
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<td>-5.0</td>
<td>-8.6</td>
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<td>97.0</td>
</tr>
<tr>
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<td>-11.6</td>
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</tr>
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<td>-5.0</td>
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<td>-0.2</td>
<td>98.0</td>
</tr>
</tbody>
</table>

(source: Laza Kekic ‘Southeast Europe and the Eurozone Crisis’, EIU)  
Fig.7

However, in other ways the region now looks more exposed than in 2008-09. Institutional weaknesses are now even worse. There is no scope for a fiscal stimulus and, crucially, Western banks are now much less likely to support their subsidiaries in the region.
The probability of a banking crisis is high because of the absence of a new ‘Vienna Initiative’, which Kekic is skeptical will be adopted as it was in 2008. Sanfey, however, contested this pessimistic assumption, saying that there are ongoing talks about enhancing the cooperation among banks (parents and subsidiaries), regulators and IFIs and it could be that even the European Central Bank (ECB) will get involved (as seen in the case of Hungary).

Laza Kekic went on to present the vulnerability index from the Eurozone crisis. The most exposed are Hungary, Albania, Croatia, and Serbia.

The channels of contagion are plentiful: 1) trade links 2) external financing 3) remittances 4) currency and banking sector risk and 5) fiscal vulnerability. The vulnerability index of the EIU includes these indicators and adds four more: 6) public debt levels as % of GDP 7) budget balance deficit as % of GDP 8) West European bank loans as % of GDP and 9) inward FDI as % of GDP. The vulnerability for the region is higher because of the heavy involvement of Greece and Italy in the region with their banks having together an almost 40% share in SEE banking market.

Other threats are political. This is because the countries in SEE fall within the parameters of the majority of conditions for political instability such as: a) new and inexperienced states and bureaucracies b) history of unrest c) ethnic and border disputes d) high unemployment and low social cohesion e) a low level of democratic consolidation plus chronic and widespread corruption with limited accountability. The issues related to political reforms in the region were addressed during the afternoon session.

Q & A

The questions raised after the presentation by the input speakers were numerous and concerned two key issues: 1) EU’s strategy for the region such as support for railway networks within the WBCs and intra-railway networks, EU’s role in the development of SMEs, regional cooperation, and what should the EU do in order to reverse Brain Drain in SEE countries to Brain Gain 2) Domestic concerns such as: is the Euroisation of Montenegro’s and Kosovo’s currency a good or a bad thing? Will it be better to undergo structural reforms or adopt a Foreign Direct Involvement model?

POLITICAL REFORM:

This session was chaired by Rudi Guraziu – CEO, International Business & Diplomatic Exchange (IBDE), who noted that the roundtable was the first event of the EU-Balkans Discussion Group series, which includes academic input papers in addition to business and diplomatic expertise. He emphasized the importance of the EU membership perspective for the region as the only serious incentive for political and economic reforms as well as enhanced neighbourly relations and regional cooperation in SEE. Experts on this panel included Eric Gordy – Senior Lecturer in South East European Politics (SSEES), Marko Attila Hoare – reader in Social Science, specializing in the history of South East Europe, Kingston University, and H.E. Johan Verbeke – Ambassador of Belgium to the UK. Regrettably, James Ker-Lindsay from LSE had to cancel his attendance in the last moment because of personal reasons.
Eric Gordy touched on a very important aspect in the transformation of Serbia: the foreign-led and domestically supported policy to confront public memory in Serbia by making history public through court sentences at the ICTY, and other means of communication including art, film, and music. Has this ‘public experiment’ worked as it was hoped? Gordy argues that the process of public memory change is complex and certainly is not linear as it was propagandised in the beginning. Serbian public memory was expected to ‘change’ and to successfully take on a political function. To make sense on this complex process, Gordy makes a distinction between moment – events that changes public memory, and non-Moment – not as significant but very important for the dynamism of the process of changing public memory through remembrance of the past. How has this process manifested itself politically in Serbia and other former-Yugoslav republics politics?

EU conditionality literature warns us to be realist on our expectations on the region. EU has been unable to repeat the same success story of democratization as in CEECs. This is because the situation in the former Yugoslavia was very different. EU’s incentive based instruments are only able to trigger democratic change under certain domestic pre-conditions in countries characterized by a legacy of ethnic conflict. Cases of resistance have been observed when national identity contradicts democratic requirements. The Figure 1 below explains this interaction between democratic conditionality and national identity. (Note: Figure below is inserted by the authors and does not necessary reflects the methodology of Gordy on the subject).


With regard to regional efforts at reconciliation, Gordy argues that there has been a good deal of sincere but fitful activity, punctuated by moments of escalation. Looking just at the bilateral relations between Serbia and Croatia over the past two years a good number of examples can be cited of each. However, relations with BiH remain tense whereas with Kosovo is another story all together. It seems this public memory is stauncher than the others, yet remains the key to peaceful developments in the region. Moreover, concerning public memory strategies, there exists a distance between the genuine accomplishment of transitional justice initiatives in the region and the ways in which they have been
revived. Discrepancy between expectation and outcome like in this policy are found in other policies too. Marko Attila Hoare, looked at some discrepancies in EU’s strategy in the region.

**Hoare** presented the most critical opinion on EU’s strategy. His thesis made a distinction between *Positive* and *Negative* European values and norms. The latter being compromise without moral content. He substantiated his argument by citing two main examples: first, the negotiations between Greece and the former Yugoslav republic of Macedonia regarding the name issue, second, the recent negotiations between Serbia and Kosovo for the conflict in the north of Kosovo. In both cases, Hoare criticized EU’s approach and argued for the former issue that Greece was wrong to block Macedonia’s accession and that the EU should have suspended Greece’s veto power in the enlargement process in the light of its sovereign debt crisis.

Although his statement elicited mixed feelings in the roundtable, in academic circles and even in Brussels there seems to be a growing pressure to removal of the veto power. Some argue that, even if the veto powers of existing member states like Greece is not removed, it should be removed for the prospective member states from the Western Balkans in order to avoid future deadlocks of the enlargement process. Policy makers in Brussels are contemplating the lessons from the accession of Cyprus during the 2004 enlargement: a) Cypriot accession has stalled the resolution of the division between the Turkish north and Greek south instead of helping to reach a solution, and b) Cypriot veto power is blocking the continuation of accession negotiations between Turkey and EU.

The issue of ‘enlargement fatigue’ was strongly contested by Ambassador Verbeke as far as the Western Balkans are concerned. He was adamant in supporting EU’s strategy in the region, and responded to the criticism especially coming from Hoare. He repeated that what we witness is not so much an enlargement fatigue as a reform fatigue and that WBCs have a clear EU perspective as shown in the most recent Commission report. Moreover, he gave an insider perspective and said that there exists a positive opinion, especially in the Commission and European Parliament, on enlargement in the region.

The discussion that followed remarked the fact that despite the great contribution of the EU to the stability and democratic development in SEE, problems with the EU policy inconsistency, unclear benchmarking, disillusionment over the still remote European perspective, and the gap between rhetoric and efforts on the ground have undermined EU’s policies and diminished the effectiveness of the EU’s inducements. Recognising this, the EU used its visa regime liberalization as means of developing a new avenue of external leverage: policy-related conditionality. This proved successful in Western Balkans countries that have shown a strong compliance effort in the Justice and Home Affairs reforms.

**Q & A**

One of the issues raised during the Q & A session concerned the relations between Serbia and Kosovo. Encouraged by Hoare’s thesis H.E. Muhamet Hamiti, Ambassador of Kosovo to the UK, stated the position of Kosovo’s government: Serbia does not deserve the status of EU candidate at present, in view of its obstructive policies vis-à-vis Kosovo. He reinstated that because Serbia has territorial claims against Kosovo that reason alone should be sufficient to EU leaders meeting on the 9th of December to deny candidate status to Serbia. Hoare had been direct in blaming Greece for the blocking of Macedonia’s accession process. Ambassador Verbeke more cautiously wanted to send a message of reconciliation. He stated that the way the accession process works is by delivery of justice envisioned and interaction. He went on to say that the situation for both Serbia-Kosovo and FYR Macedonia-Greece was complicated but that the only way forward was the continuation of interactions and negotiations at different levels. The roundtable discussion was closed by Rudi Guraziu who sought to send as a final message to all the participants the hope that European Union would not set itself back to the ‘90s mentality (when it had not engaged enough in the region) but continue its enlargement process until European integration project is complete with all the WBCs as a fully-fledged members of the EU, along the Croatian model.
**Conclusion:**

Although the threat from a Eurozone crisis is real for all the countries in SEE, the slow yet substantial response and attention that it has received so far by key countries in the Eurozone, namely Germany and France, shows that the EU might be able to pull together once more and avert a catastrophic collapse. If the Euro is saved and strengthened, through the creation of a fiscal union and increased competences of the European Central Bank, then the region of SEE will be saved from another severe external shock. The need for a new Vienna Initiative is essential to mitigate the threats of a downgrade from rating agencies, and generally worsening of macro-economic imbalances. A reassurance should be made by parent banks in Italy, Greece, and Austria, and the EBRD, together with the ECB which cannot ignore its periphery any longer.

Both the EBRD and EIU reports were realistic, however, they only looked at the short-term perspective. Medium and long-term the region looks more optimistic. Let’s not forget a very important strength that the region, in this case the smaller Western Balkans, has. It is the only region outside the EU to have a clear EU perspective. The role of the EU has been positive politically and economically for these countries, not to mention its role – together with NATO and the USA - in bringing stability in the region and fostering regional cooperation. Additionally, the EU secures something very important for foreign investors, the continuation of market reforms in line with the *acquis* of the single market in these countries. The success in the accession process for the remaining countries of WB is of fundamental importance not only for their democratic development but also for the development of these transitional and emerging economies towards becoming knowledge economies.

SEE countries have tremendous potential for catch-up growth. So far they have focused on attracting foreign direct investment. Tomorrow they will try to attract foreign direct involvement. These economies are dynamic and managed to withstand relatively well the global slowdown in 2009. These are factors to consider seriously even today when the region is threatened by a Eurozone crisis in the worst-case scenario, or the general EU27 economic slowdown. The region benefits from a dynamic young population that can sustain higher levels of economic growth. Key will be the continuation of structural reforms, which should have two main objectives: increases in efficiency and equity.
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- to provide assistance in increasing international trade and investment flows
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- to promote good governance and corporate social responsibility
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