

## **The Stability Pact for South-East Europe**

1. The 'Stability Pact for South-East Europe' has grown out of a number of previous regional initiatives. Some of those have been concerned with South-East Europe and some with the so-called Western Balkans. The latter is the name given to a region that consists of Croatia, Bosnia and Herzegovina, Yugoslavia, Macedonia and Albania. The name of Western Balkans is used by the European Union (EU) to designate this set of countries as the ones that are subject to the regional approach of the EU. South-East Europe, on the other hand, consists of all the Balkan countries (i.e., all the countries that have territories or parts of territories in what geographically belongs to the Balkans, e.g., Bulgaria, Greece, Albania, Macedonia, but also Slovenia, Romania and Turkey) plus Hungary (and in some cases Moldova). The regional initiatives that already existed before the 'Stability Pact' include the so-called Royaumont Process, the South-East European Co-operation Initiative (SECI), and in a more inclusive way the Central European Initiative (CEI). All these and a number of other initiatives have aimed at securing stability in the region via promoting co-operation of one kind or another (e.g., in areas of culture, economy, politics and security).

Most of these initiatives attempted to bring together the representatives from the region and also the representatives from the EU, the USA and of the respective international organizations. There were different incentives for regional co-operation that these initiatives brought in and also different types of conditionalities that they relied on. For instance, in the case of the EU's regional approach to the Western Balkans, the main incentive for the countries in the thus designated region to co-operate was the prospect of the EU integration that they were offered. The main condition that they were faced with was that their integration with the EU would not advance faster than the regional integration. The other initiatives tried to bring in other incentives, e.g., investments for regional projects or the similar.

The 'Stability Pact' brings these initiatives to a higher level. All the transition countries in South-East Europe are included (Yugoslavia is invited to join once it satisfies the appropriate conditions) as are the EU, the USA, Russia and a number of other countries and also practically all the international and European institutions and organizations. Thus, this is a major political effort that is being mounted, at least in terms of participation.

2. The key aim of the 'Stability Pact' is to contribute to the stability in the region. Stability is being seen as conducive to development and prosperity, which are the ultimate goals of the whole process. Other objectives include securing peace, democracy, open and market

economy, multicultural and civil societies, and the European and wider international integration.

Stability is not defined directly. It is to be understood that stability will be established in South-East Europe once the objectives of the 'Stability Pact' are achieved. Economic stability is to be understood in the same way. It will be established, one understands, when the countries in question develop open, market economies that are integrated with the EU and the world economy, and are managed on the basis of sound macroeconomic principles. As such, it is implied, they would be growing and developing and providing for an ever higher level of welfare of their citizens.

Stability should be delivered through the appropriate transformation of the countries in the region, by bilateral and multilateral co-operation that should promote free trade and good neighbourly relations, and by regional and international integration. The 'Stability Pact' does not go into the details of what would all that mean in political and economic terms.

Some things can perhaps be inferred. Because of a number of references to free trade and free-trade areas, it is to be understood that the 'Stability Pact' would support regional trade liberalization and the creation or enlargement of the regional free-trade areas (like CEFTA, which already includes all of the transition countries of South-East Europe except those from the Western Balkans). It is less clear what the 'Stability Pact' would support in terms of trade liberalization with the EU as not very much is actually said about that.

Other policy instruments of achieving economic stability are even less clear. The 'Stability Pact' makes reference to sound macroeconomic policies, but does not give any details. Of course, it could be surmised that price stability would be included in the idea of economic stability, but how that is to be achieved is a different matter. Looking at the region, the most stable countries in terms of their monetary policy are Slovenia and Hungary, and their policies are quite different. The countries which have failed, in one way or another, to achieve economic stability have also followed different monetary policies.

More important than that is the slightly paradoxical argument that could be made for economic stability, i.e., it could be argued that only dynamic economies are stable. This statement underlines the understanding that what the countries in the region really need is growth and development and that they need price and monetary stability only to the extent that those are instrumental to achieving growth and development.

For sustained growth and development, investments are necessary. The 'Stability Pact' says precious little on that subject. Aid and donations are mentioned, but all those measures that could be supportive of investments are not. Indeed, one of the meanings of stability would be that of a stable flow of investments into the region. This especially

because employment is scarce in the whole region, and unemployment is high or very high and rising (from above 11% in Romania and Bulgaria to close to 20% in Croatia and Albania, to close to 40% in Macedonia and Bosnia and Herzegovina, and to effectively 50% in Serbia and Montenegro). Obviously, economic stability in the whole region must mean growing employment, and that requires investments.

The stability of growth and development would be greatly enhanced if there were a credible commitment to the process of EU integration. Again, the 'Stability Pact' is silent on that point. In the related initiative a new type of a stability and association agreements is proposed for the Western Balkans. Those would not be seen as promising membership to the countries in question, but only as offering a perspective of membership. More important, the agreements are to be 'tailor-made' for each country separately.

This may create a tension between the regional approach implied in the 'Stability Pact' and the bilateral approach of the process of EU accession. Though there are advantages in the competition for membership, there are also advantages connected with the approach based on international co-operation. It is yet to be made clear how those are to be combined so that these two approaches will not invite instability rather than stability. Moreover, the 'Stability Pact' notes that there is great diversity in South-East Europe, but does not say all that much about the consequences of this fact on the regional approach.

3. Free trade seems to be one thing that the 'Stability Pact' endorses rather unequivocally. The implementation of this proposal may invite debates, however. It is certainly true that South-East Europe abounds in tariff and non-tariff barriers to trade. Those, undoubtedly, sap the growth of trade and thus of production. They also keep alive a big and growing shadow economy as well as corruption and criminal activities. Therefore, there is no doubt that trade liberalization would be quite helpful. It would increase trade and decrease the importance of smuggling, corruption and of the attendant culture of criminality.

There are three circles of trade liberalization. One is that of regional liberalization. That can and should come through bilateral or multilateral free-trade agreements. The immediate benefits of those would come more from the increased freedom to trade and do business, than from a big jump in the volume of regional trade. In time, however, the latter would also happen once the production in the region starts growing and gets diversified. However, regional trade liberalization may indirectly boost the trade with the EU, which is the one which is the most important for all the countries in the region.

The second liberalization involves trade with the EU. In the current situation, there are and will be lobbies for every kind of protection. Not only the industrial production, but also the agricultural production in most of the countries in the region is perceived as in need of protection from EU competition. To break through that, speedy and comprehensive

liberalization of trade with the EU is the best policy. The key policy and development prospect for all the countries in the region is the increase in their access to EU markets.

The third has to do with the integration of the region into the system of trade in the world. That essentially means membership in the World Trade Organization. For the countries that are not members, this should be a priority as far as their trade policy is concerned.

Trade liberalization is not everything, however. Bringing down the tariffs is important, but not enough. Non-tariff barriers are equally if not more important. Among those, perhaps the most important is the one that goes with the lack of the rule of law. The absence of the rule of law is partly the consequence of the power of those who have an interest in perpetuating the system of arbitrary rule. Thus, together with trade liberalization, legal protection is essential.

More generally, liberalization of trade is a necessary prerequisite for the improvement of the economic conditions in the region. However, for their sustainability a major improvement in both public and private governance is necessary. Neither the former nor the latter are sufficient by themselves alone.

4. As already mentioned, growth and development help stability. This is one of the notions that were behind the post-war reconstruction drive in Europe after the Second World War. Indeed, this is the key notion on which the process of EU integration has been based. What worked in Western Europe was the system that fostered reconstruction (and then sustained growth), liberalization and integration. It was clear from the very beginning that the three should work together. It was also perceived that this process should be anchored by financial assistance from outside. This was provided by the enduring presence of the USA in Europe. One aspect of that presence was through the Marshall Plan. It was, at that time, clear that the pick-up of investments in post-war Europe should be helped with the financial support from the USA. The Marshall Plan provided some of the necessary financing (in the form of soft credits) that spurred the investments and thus growth in Western Europe. More importantly, the Plan provided for the investment climate and the climate of confidence that is usually lacking after a major military conflict has ended.

A similar type of engagement and commitment is needed in South-East Europe. Clearly, it should be provided by the EU. As can be learned from the experience of Bosnia and Herzegovina, the key to stability is prosperity, and the key to prosperity is not aid, however necessary it may be, but support for investments. How to secure that and what should be done with that aim in mind should be the key task of the 'Stability Pact'.

(Published in *The Vienna Institute Monthly Report*, No. 8-9, August-September 1999, pp. 33-35)