

EUROPE'S TROUBLED REGION: ECONOMIC DEVELOPMENT,
INSTITUTIONAL REFORM AND SOCIAL WELFARE IN THE
WESTERN BALKANS, William Bartlett, 2008, Routledge, London, 257 pp.

Review*

While most known for its political instability, armed conflicts and civil wars, the region of the Western Balkans, which includes the countries of former Yugoslavia (excluding Slovenia) and Albania is rarely mentioned in the context of reforms implemented in the economic and social systems or of the dynamic process of transition and development achieved in the last two decades. These countries do not lag behind other countries in South East Europe that have already joined the European Union but although they have achieved high economic growth rates, certain problems still persist. These include high unemployment rates, the underground economy, inequality and poverty. The book *Europe's troubled region: Economic development, institutional reform and social welfare in the Western Balkans*, published by Routledge in 2008, analyses the economic development, institutional reforms and the degree to which a welfare state has been achieved in the Western Balkan region. This book also tells about the role of international and European Union aid to countries of the region and about the process of joining the EU, which is the main accelerator of the abovementioned reforms. The author of the book attempts to provide answers to following questions: Why are the Western Balkan countries at different levels of economic development despite the fact that they all emerged from a similar set of historical and institutional conditions? What are the prospects for the region? What are its realistic chances for joining the EU?

The content of the book is divided in eleven chapters which are based on results of the author's research projects into South East Europe countries. Following a research project on the development of small firms, with the crucial support of the British Council, British Academy and Leverhulme Trust, Bartlett carried out a research process into economic and social development issues in a period of extremely turbulent economic, political and social changes in one of the Europe's most troubled regions – the region of the Western Balkans.

In the introductory chapter the author briefly describes the Western Balkan region and gives an overview of the main characteristics of the remaining chapters. The author

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analyses the complex processes of transition to a market economy, post-war reconstruction and economic development in Albania, Bosnia and Herzegovina (BH), Croatia, Macedonia, Montenegro, Serbia and Kosovo. Bartlett also tries to identify different features of economic, political and social reforms which have put these countries on divergent paths of economic development. Like all former socialist states, the Western Balkan countries had to carry out the comprehensive reforms necessary for post-socialist transition and EU integration. However, they are differentiated from the countries of Eastern Europe by processes of wars and state-building difficulties. In order to explain the differences in the degree of their economic development, the author starts from the initial historical and institutional conditions which provided a starting ground for further reforms. Bartlett first describes the evolution of the communist systems in Yugoslavia and Albania since the Second World War until the 1990s while describing the period following the collapse of Yugoslavia in more detail by dividing the countries in two groups – early and late reformers. The author works upon the issues in the book according to each country separately and then compares them within these two groups of countries. This facilitates easy reading and following the arguments of the book.

In the second chapter – *Initial conditions* – Bartlett summarises key features of the communist systems in Yugoslavia and Albania up until the end of the 1980s and explores the quite opposing and different backgrounds of its collapse in these two countries. The author believes that the impact of initial conditions on reforms can be both incentive and restrictive. While Yugoslavia developed a system of market socialism and opened itself to the West, Albania developed the most centralised type of communism and isolated itself from the outside world. Apart from the initial conditions, there were also some differences in the implementation of reform policies. In this book, the author takes the view that the success of institutional reform is an outcome of political struggle between pro-reform and anti-reform coalitions, and that the collapse of Yugoslavia was determined by the strong resistance of the latter to economic, social and political changes. According to this view, Bartlett analyses various standpoints concerning the relative influence of “winners” and “losers” from the transition process on reform success, drawing on the theories of Roland (2000), Kramer (1997) and Hellman (1998).

Third chapter, entitled *Early reformers* and fourth, *Late reformers*, are focused on the analysis of the political aspect of reforms implemented in the Western Balkan countries over the last twenty years. Since the countries of former Yugoslavia emerged from a similar set of initial conditions, Bartlett explains the differences in their development in the context of macroeconomic policy as well as of the period in which they conducted macroeconomic stabilization and started implementing market reforms. The first group of countries (early reformers) includes Albania, Croatia and Macedonia. They conducted macroeconomic stabilization in the early 1990s and by the middle of the decade they had managed to decrease their inflation rates. Since these reforms were not followed by simultaneous structural reforms at the microeconomic level, each of these countries ran into severe problems towards the end of the decade. The latter group (late reformers) which comprises BH, Serbia, Kosovo and Montenegro took longer to conduct stabilization policies since they were resisted by the potential losers from reforms and by that part of the elite

which had benefited the most from the previous regime. All attempts at structural changes were blocked until 2000 when political changes enabled extensive reforms.

The fifth and sixth chapters are directly focused on structural reforms at the microeconomic level. The fifth chapter entitled *Privatization and Foreign Direct Investment* tells about privatization processes and foreign direct investment (FDI) inflows in the region, and the sixth – *Entrepreneurship and SME Policies* – tells about the entry of new small and medium firms (SMEs) and entrepreneurial development. In the former Yugoslavia there was the “Marković” law which encouraged the sale of shares in socially owned enterprises to their managers and employees. After Yugoslavia collapsed, all states introduced their own privatization laws. Croatia and Albania introduced them first in 1991, Montenegro in 1992 and Macedonia in 1993. On the other hand, in the group of late reformers, prolongation of legislation caused many problems. In Serbia, legislation introduced in 1991 was reversed in 1994 and no effective privatization law was introduced until 2001. Privatization was delayed the most in BH (until 1999) and Kosovo (2003). The main difference in privatization waves was in the use of different privatization models: insider privatization to managers and employees (Croatia, Macedonia, Montenegro and Albania); voucher privatization (BH); direct sale through auctions and tenders (Serbia and Kosovo). In the overall process of privatization, the most successful were the early reformers but Serbia is slowly gaining upon them. The slowest progress in all countries was made in enterprise restructuring but in this dimension too the most advanced country in the region was Croatia. The FDI inflow to the Western Balkan countries has been irregular and unstable over time and has been the most present in the telecommunication sector, banking and oil refining. FDI inflows in the form of privatization of domestic banks in Croatia and Albania have been an important factor in integrating these countries into international capital markets and eliminating financial constraints. In order to increase FDI inflows, the countries of the region have implemented various measures in order to become more attractive to foreign investors. Owing to the investment climate improvements, FDI inflows to the Western Balkan countries are growing constantly and this upward trend is expected to persist in the future.

Due to the slow pace of privatization and FDI inflows, the economic development of the region during the 1990s was highly dependent on the performance of domestic entrepreneurs who created small- and medium-sized enterprises (SMEs). These enterprises have opened new workplaces and introduced the element of competition and dynamism which presented a huge threat to established monopolies and powerful anti-reform coalitions. Apart from the economic effect, the entry of SMEs had a crucial social impact on democratic consolidation and through wider income dispersion, moving it away from the small managerial elite in large enterprises. In the first half of the 1990s, the Western Balkan countries experienced an increase in the number of small firms of all types (trades, private shops, sole traders, self-employed persons), the highest entry rates being achieved in Albania, Croatia and Macedonia. In the overall process of SME entry and development, entrepreneurs encountered many obstacles such as financial constraints, high taxation and corruption. Consequently, a very small number of enterprises were able to develop, which made it easier for large enterprises to keep their monopoly positions and to conduct policies that were hostile towards the development of small entrepreneurship.

After the signing of the Dayton peace agreement at the end of 1995, the inflow of international financial aid eased the development of the SME sector since the donors saw it as a key element in the reconstruction of the Western Balkan region. In general, the processes of privatization and the entry of new enterprises resulted in an increase of the share of the private sector in each country's economy. The greatest transformation was achieved in Albania which now has the highest private sector share of GDP at 75%, mainly owing to the privatization of agriculture. In Macedonia, the private sector accounts for 70% and in Croatia, this share has stabilized at around 60% due to delays in completing the privatization process. On the other hand, the transformation to a private-ownership economy has been the slowest in BH, Serbia and Montenegro – BH (55%), Serbia (65%).

Sources of different growth performance among Western Balkan countries cannot only be found in their initial conditions and the pace of reforms, but also in investment, the development of new skills, the transfer of new knowledge and an opening to foreign trade and international markets. In the seventh chapter under the title *Growth, Employment and Trade*, Bartlett analyses the impact of the abovementioned factors on GDP growth, growth of industrial production, employment and productivity, as well as reforms that contributed to liberalization of international trade, which is an important generator of economic development and progress. Bartlett identifies three phases of economic growth in the Western Balkans since the 1980s. According to him these phases did not proceed simultaneously in all countries of the region. In the first phase, countries conducted their own national transition policies following the political decisions of the ruling elite and this phase was marked by partial reforms and strong state intervention. The second phase of economic growth, which began after the 1995 Dayton agreement, was marked by post-war reconstruction and development along with a large inflow of international aid to the countries, especially from World Bank. The third phase began after 2000 and in this phase countries addressed EU integration. The Western Balkan countries have achieved high growth rates especially in the last five years. However, while Albania achieved the highest growth rates and Macedonia the slowest, Kosovo experienced negative growth. In addition to the economic growth of the countries, the author in this chapter also analyses labour market irregularities, the informal economy and the foreign trade of Western Balkan countries both with EU and with each other. However, the abovementioned economic growth did not lead to an equivalent employment growth and poverty reduction in the region. The unemployment rates are still worryingly high and long-term unemployment, unemployment of young people and employment in the informal sector represent special problems. The most severe problem is that of long-term unemployment, which has led to deterioration and obsolescence of worker skills. The share of jobless for more than one year is very high in Macedonia, Serbia and Montenegro and studies show that they eventually find jobs in the informal economy. The informal economy is the most prevalent in Albania, Kosovo and Macedonia, while it is the lowest in Croatia and Serbia.

An important generator of economic growth is also the degree of international competitiveness in a certain country. All Western Balkan countries are small, open economies and their exports are an important growth factor. Hence, international trade and a country's openness to the world represent the basis for further development. During the 1990s all countries had small exports but since 2000 situation has been improving and

total exports from the region have significantly increased. On the other hand, exports are still low as a percentage of GDP, with the highest share in the candidate countries – Macedonia and Croatia (above 40% of GDP), and the lowest in BH (26%) where exports have actually declined in terms of percentage of GDP. Due to their relatively poor export performance in relation to the growth of imports, all countries have persistent current account deficits, which have led to extremely high levels of external indebtedness in the countries of the region. The highest level of external debt to GDP is found in Croatia, due to its borrowing from abroad to finance both private consumption and public expenditure. Therefore Bartlett claims that the Western Balkan countries must implement additional institutional reforms to induce an increase in exports and make their economies more competitive – e.g. enable the entry of new firms, raise productivity and innovation of all sectors in economy through better education, training and etc.

In the next eight chapter *Social Policies and Welfare Reforms*, the author puts into the focus the social issues that countries of the region still must tackle and solve in order to improve the standard of living of their populations and catch up with the other European countries. Bartlett explores the main social problems and processes of social sector reform in the region. The implementation of structural reforms described in the previous chapter led to a major increase in long-term unemployment, an increase in the informal economy and poverty, as well as a fall in labour market participation rates. Social security systems of the Western Balkan countries have mainly focused on passive measures of social security and until recently very little effort has been made to help unemployed people to find work. Furthermore, the privatization process led to the loss of social benefits which were provided by state-owned enterprises; wars in Croatia, BH, Albania, Kosovo and Macedonia caused population losses, destroyed social infrastructure and housing stock, increased the number of refugees and led to a brain drain. Consequently, the region of the Western Balkans today encompasses few of the poorest European countries. All countries except Croatia have a GDP per capita below the levels in most of the new EU member states, including Romania. Purchasing Power Parity (PPP) measures of GDP show that Albania and Serbia are the least prosperous countries of the region and that Macedonia and BH are below the standards achieved in Bulgaria and Romania. During the transition process the poverty in the region has drastically increased and it is the most present in Albania and Kosovo. In this chapter, author gives a specification of public expenditure on social welfare, the situation in the system of social security, reform of pension systems, position of minorities and refugees in society and educational system in the Western Balkan region. Total public expenditure on the social sector as a proportion of GDP is relatively low in the region, matching the EU-25 average only in Croatia. The public expenditure on social protection (pensions and health care) is also low – the highest proportions of social protection expenditure being found in Croatia, BH, Serbia and Montenegro, and the lowest proportions in Albania, Kosovo and Macedonia. Concerning educational spending, the countries are divided into groups of high and low spenders. The first group includes Croatia, BH, Montenegro and Serbia, and the latter Albania, Kosovo and Macedonia. Such differences among the countries show that the countries are converging on different models of capitalism. In this chapter Bartlett refers to the research of Esping–Andersen (1990) and Amable (2003), which have identified several models of

capitalism in OECD countries: the neo-liberal model (low levels of employment and social protection); Central European corporatist model (strong employment and social protection); the Mediterranean model (strong employment protection and low social protection). Bartlett claims that this approach can be applied to the Western Balkan countries too. Viewed from this perspective, he states, Albania and Kosovo have adopted the neo-liberal model; Croatia, BH, Montenegro and Serbia the traditional corporatist model and Macedonia the Mediterranean model of capitalism. The author takes the view that countries in achieving their goal of joining the EU must overcome some barriers and that this will eventually lead them to the welfare state. As key challenges Bartlett sees reform of education, social inclusion of the Roma community and enhancement of social non-discrimination of any kind.

A distinguishing feature of the transition process in the Western Balkan countries has been the long period of political and economic crisis in the 1990s. During this period, wars and armed conflicts caused immense losses in terms of lives, an increase in the number of disabled people and refugees as well as the destruction of property, enterprise assets and social infrastructure. Therefore in the ninth chapter – *International Aid and Regional Cooperation* – the author analyses the inflow of humanitarian and development aid in the countries of region during the last ten years. International aid inflow to the Western Balkans reached its peak in 2002 and has been constantly declining since then. The share of aid in GDP started to decrease in each country in 2003 due to the economic recovery and the reduction in aid from bilateral donors. The majority of financial assistance originates from the international financial institutions, the World Bank, the European development banks, the European Agency for Reconstruction and from the United Nations agencies. However, the largest donor of financial assistance is the EU through pre-accession funds which aim to prepare Western Balkan countries for their EU membership. Bilateral donors (USA, Germany, Italy, Netherlands and others) have been active too and the aid has also been provided by various NGOs such as Caritas and World Vision. The largest part of international finance has been provided for infrastructure projects and a smaller one for private sector development and for institution- and government administration-building. Although the benefits of donations are numerous, Bartlett claims that the presence of multiple donors has led to certain problems regarding the policy confusion due to conflicting advice and weak aid coordination. This finally resulted in inefficiency and in a poor degree of integration of international assistance. In addition, the domestic elites in some countries have manipulated donor programs, and this has led to a growth of corruption. As a main problem for further development of the Western Balkan countries, the author identifies high international aid-dependency and claims that the solution of this problem will eliminate barriers to ending the transition process, development and EU integration and ensure a more stable and prosperous future. Croatia has been less affected by such distortions since it has been more reliant on its own resources and less on international aid inflows.

The tenth chapter entitled *European Integration* deals with the European Union as the largest provider of financial assistance to Western Balkan countries with the goal of shaping the path of their economic development and institutional reforms. All countries of the region are included in the process of EU integration and most of them have signed

a Stabilization and Association Agreement. When they meet all the conditions that the EU laid down negotiations can begin. So far, only Croatia and Macedonia have become candidate members, while Albania has signed a Stabilization and Association Agreement and Montenegro is catching up fast since its declaration of independence from Serbia. On the other hand, Serbia and BH show unwillingness to comply with the necessary conditions, although during 2008 positive changes regarding this issue have taken place. The EU's engagement with the region has been both political and economic. On the political side, the EU has been involved as a negotiator in peace agreements and on the economic side through trade relations and emigration policies. In the last ten years, the EU has taken a leading role in ensuring financial assistance to Western Balkan countries in order to promote democratization and economic development and to support their pre-accession harmonisation. EU assistance programmes (CARDS, ISPA, PHARE and SAPARD) to the region which ended in 2006 were replaced by new single programme entitled Instrument for Pre-Accession Assistance (IPA) covering the period 2007-2013. Assistance will differ between candidate countries (Croatia and Macedonia) and those defined as potential candidates (Albania, BiH, Montenegro and Serbia). Potential candidate countries will receive support for projects in the fields of institution building and democratization, economic and social development, regional and international cooperation and alignment with the *acquis communautaire*. On the other hand, candidate countries will receive support for meeting the all accession-related criteria for EU membership and for preparing systems for the management of EU Structural Funds, Cohesion Funds and Rural Development Funds. The author concludes that the countries of the Western Balkans will have to face more difficult and demanding EU accession processes than the countries which became EU members during the enlargement in 2004. Additionally, there are certain contradictions between the reforms required under the accession process and the reforms which have been implemented in the processes of transition and post-war reconstruction. These differences manifest themselves in the following: consolidation of democracy, competitive-market building and fiscal restraints. First, in relation to the consolidation of democracy, the process of enlargement undermines democratization through the one-sided imposition of EU rules, which results in democracy of reduced quality. Second, the process of building a competitive market economy is restricted by process of alignment to the EU *acquis*, which involves the creation of a set of regulatory institutions and agencies and imposes a high level of bureaucracy. Finally, according to Bartlett there is also a contradiction between the fiscal restraint demanded by the Maastricht criteria and the need to increase public expenditure on harmonization with the *acquis*.

In the final, eleventh, chapter, the author summarises the book and provides the answer to following question: What are the prospects for the Western Balkan countries? Bartlett states that the stability which EU membership would bring to the region would open the door for foreign investment, knowledge transfer, tourism development, competitive economies and a reversal of the 'brain drain' of talented young people and would lead to faster economic growth. It is obvious that the author takes the view that EU membership is the most favourable outcome but he also thinks that it will take years for this to come. Even if the EU accepts all the Western Balkan countries as members, difficult reforms will still need to be carried out, especially those regarding the rule of law.

William Bartlett: Europe's troubled region: Economic development, Institutional reform and social welfare in the western Balkans
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In this book readers can find a comprehensive overview of economic and social scene in Albania, BH, Montenegro, Croatia, Kosovo, Macedonia and Serbia since the beginning of post-socialist transition which opened the door to EU integration until today. In addition, the book is an attempt to raise the awareness about the dynamics of economic development in the region of Western Balkan as well as about the main reasons that make it *Europe's troubled region*. The book is written in a simple style, it is very easy to understand and follow, while it is relevant to all those involved in research on the development economics, economics in transition and international economics. It may also be very useful to consultants and government officials, and it is highly recommended to all those studying economics and political science as quality additional reading.

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