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Economic Perspectives of the Western Balkans – Back to the Past

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1. Introduction

Economic trends in recent years have profoundly changed in the Western Balkans. The relatively favorable developments prior to the economic crisis of 2008 – such as rapid economic growth, stronger political stability – have significantly worsened since. The indicators of increasing uncertainty are reflected in slow GDP growth, falling or only slightly increasing incomes and very high unemployment rates. These are clear signs of unresolved economic structural problems, unsettled political and institutional arrangements, and the failure of economic transformation. It is increasingly certain that the rapid economic growth experienced during the pre-crisis years (prior to 2008) had mostly been driven by reconstruction in the wake of the military conflicts and the softening economic isolation of the region. As a result, political stability increased and this created a better framework for changing the old economic structures. This period, however, did not lead to the stabilization of a long-term sustainable convergence path. Because of the limited success of economic transformation and the absence of a new development path, the basic questions have remained unchanged: what kinds of instruments are required for an economic structural change that can support economic convergence, job creation, poverty reduction and financing of investments?

International recommendations for managing the region's problems follow suit with earlier mainstream policy principles. They focus on the need for transforming public finances with further cuts in welfare spending, and continuing market liberalization and privatization. (IMF 2013e; IMF 2013d; BECHEV 2012). Most of the region is very poor in European comparison. The Western Balkans does not possess easily exportable stocks of natural resources. Migration in the past two decades has weakened the quality of human capital.

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Domestic financial resources are scarce, investments are insufficient for creating new competitive production and services sectors.[2] According to international experience, these conditions render policies based on the Washington consensus ineffective and counterproductive.[3] The preconditions for success of such programs include the inflow of non-debt generating capital that can satisfy financing needs and contribute to changing the obsolete economic structural patterns. The achievement of this, however, seems to be unrealistic in the short to medium term; but even if conditions were to take a favorable turn, the end-result might well be limited and geographically isolated in a five-ten-year perspective.[4]

What is more, the implications of the current international proposals may easily lead to risky social and political consequences. The past decade has not brought about a significant improvement of living standards, which makes development in the region increasingly uncertain in terms of economic, security and political stability. The unfavorable economic trends and the lack of perspectives may easily turn the population against the prevailing political and economic arrangements. Due to the scarcity of jobs, low income, and insufficient welfare transfers, the level of corruption is devastating and it is an integral part of everyday life. This seems to be a deeply rooted tradition in society and its elimination may require decades of efforts making any economic change in this region far more difficult.[5]

2. Economic path

Beside the ethnic and cultural differences in the former Yugoslavia (Socialist Federal Republic of Yugoslavia), the economic inequalities were also significant. Economic disequilibrium manifesting itself in per capita GDP and unemployment rates was alarmingly high[6] by the end of the nineties even if the data of the two most developed regions (Slovenia and Croatia) are removed from the comparison. (STIBLAR 2013) As for long term economic

[2] With respect to natural resources, soil, forestry, water energy and ore mining may be relevant (NAGY 2012), but these are insufficient to achieve import independence from crucial raw material and energy resources.
stabilization proved to be successful in past decades, but the main problem has always been related to sustainable structural transformation. Successful longer term strategy requires several positive changes to occur concurrently. (Political will, the modernization of production and the services sectors, support of society etc.)

[4] These resources may include low interest rate financial resources, but most importantly international grants, remittances and foreign direct investments.

[5] In this regard t[5] Experiences with these programs, however, are not unambiguous. Short-term macroeconomic he concept of two Europes is worth mentioning here as it identifies the main differences between northern and southern countries. According to this concept, the most important difference is the clientelistic and non-clientelistic development path. It has both historical and economic roots. These traditions are difficult to be changed. See: FUKUYAMA, F. 2012: The two Europe, *American interest*, December 5.

[6] Federal units of the former Yugoslavia – Slovenia, Croatia, Macedonia, Bosnia-Herzegovina, Montenegro, Serbia and Kosovo – became independent (Although Kosovo has not been recognized by the whole international community), while Vojvodina remained the part of Serbia.

prospects, the countries in the Western Balkans were already encumbered by their very unfavorable starting positions, but the situation was further exacerbated by the consequences of subsequent military conflicts and the economic embargo imposed on parts of the region in the nineties. From among the current countries of the ex-Yugoslav Western Balkans countries, Serbia had the most favorable initial position (highest per capita GDP and wages, lowest unemployment rate). Internal trade within the region (trade within Yugoslavia) played an important role in economic progress and exports of federal units to each other's market reached 40 percent of total exports on average. The most open federal unit in terms of export/GDP was Montenegro and the most reserved units included Kosovo and the Former Yugoslav Republic of Macedonia (FYROM). At the same time, Albania – which is the only country in the Western Balkans that had not been part of Yugoslavia – was still an inward looking dictatorship and the poorest country in Europe.[7]

The impacts of these initial conditions are still being felt in the development patterns of the Western Balkans today. The conflicts in the nineties severed the chances of rapid economic transformation and development rendering transformation similar to that of Central Europe impossible. At the same time, large segments of economic activities, i.e. and most importantly industrial production had collapsed and never recovered.[8] (LUX–MEZEI 2012) After the turn of the millennium, standard transformation policies were pursued in the Western Balkans. The economies were liberalized and privatization began, but all these and the improving conditions of external financing were unable to bring about any significant modernization or prompt structural change. After the collapse and the occasional physical disappearance of significant parts of the real economy, the trade and services sectors were unable to produce sufficient revenues for the creation of a new development path. Currently the economic transformation of the region has been stalled and neither investments nor export can show dynamism apart from some small modernization centers that have been mostly developed using foreign direct investments.

Following the conclusion of the military conflicts and up until 2009, several macroeconomic indicators had showed favorable trends in the region. Between 2004 and 2008, GDP growth was rapid compared to the previous periods and it oscillated between 4-7% annually. In 2009 when the economic crisis hit the region, growth in the Western Balkans slowed down

[7] In the second half of the nineties, the government sponsored Ponzi scheme burnt about two-thirds of household savings and after the collapse of the system in 1997 riots started. The conflict led to the introduction of a state of emergency and later UN peacekeeping troops arrived to help consolidate the country.
[8] The decreasing role is probably not a problem in the emergence of the services based economies if it is coupled with structural modernization or industrial specialization. It is, however, not the case in the region. The territories that are most hit by industrial degradation are in Bosnia-Herzegovina, North-East Montenegro, South Serbia, North-East Macedonia and Kosovo.

significantly except for Albania and Kosovo. After the stabilization in 2010-2011, 2012 brought about a slowdown in line with economic trends of the Eurozone. About 75-95% of bank assets are held by large European banks. The presence of these strong financial institutions had contributed to the rapid modernization of the financial sector and their ownership background saved the region from a very costly recapitalization of insolvent banks with public money. (The negative example from this perspective is Slovenia, where the consolidation of state owned financial institutions used up massive budgetary resources.) The financial integration and strengthening trade relations with EU countries (especially with Austria, Germany, Slovenia and Italy) led to the harmonization of business cycles between the Western Balkans and the European Union. As a result, economic growth here now increasingly depends on the performance of the European economy. When there is improving growth in the EU, foreign owned financial institutions are able to increase their lending activities to boost investment and consumption, which in turn can spur domestic demand, and this may eventually contribute to improving economic processes and political stability.[9] The importance of lending by foreign owned banks in emerging European countries including the Western Balkans was realized in the early phase of the international crisis and this had led to the launching of the Vienna Initiative already in early 2009. Despite the positive impacts of the initiative, lending activity in the region collapsed and the share of non-performing loans soared.

Being less open to international economic relations in comparison with the Central European countries, the Western Balkans have more means to mitigate the effects of exposure to international economic shocks, but even these less severe impacts from international trade could not be counterbalanced by the otherwise strong regional economic ties due to the weak local purchasing power. As a result, the pace of economic recovery here has been slower than in several Central European countries, where stronger global demand quickly restored the pre-crisis production and export levels despite the weak domestic demand. The very slow recovery in the Western Balkans has resulted in significant economic and political risks because of the very low level of living standards.

Table 1
GDP growth in the Western Balkans
(% change)

	2009	2010	2011	2012	2013
Albania	3.3	3.8	3.1	1.3	0.7

[9] Local money and capital markets are not able to provide sufficient amount of resources to satisfy the financing needs. For more details see: VIENNA INITIATIVE 2014.

Bosnia-Hercegovina	-2.7	0.8	1.0	-1.2	1.2
FYROM	-0.9	2.9	2.8	-0.4	3.1
Montenegro	-5.7	2.5	3.2	-2.5	3.4
Serbia	-3.5	1.0	1.6	-1.5	2.5
Kosovo	3.5	3.2	4.4	2.5	2.5

Source: IMF statistical data base

The relatively rapid GDP growth in the years after the millennium could not counterbalance the losses suffered in the nineties, and countries like Serbia, Bosnia, Montenegro and Kosovo are still far from the living standards they had enjoyed 25 years ago.[10] Although Albania has experienced a more balanced economic development path compared to the countries of the former Yugoslavia, its development level continues to be extremely low. In the Western Balkan countries GDP per capita measured by purchasing power barely amounts to one third of the EU-28 average; in some cases it is less than one fifth. The economic policies and the measures pursued by external actors (international organizations, EU) in support of economic modernization have hardly achieved their objectives. To make things worse, this failure also applies to the domestic and political framework and institutional arrangements. In periods of quick economic growth, reforms seemed easier to put through since the improving conditions facilitated the finding of resources to cover the social and economic costs of adjustment. However, the crisis in the Eurozone and the deep problems in Greece in particular had created a vicious cycle in which slowing GDP growth worsened the conditions of economic adjustment which further increased unemployment levels and undermined the domestic purchasing power.

Statistically the level of state debt in the region is favorable compared with the EU member states as it is generally not more than 50-70% of the EU average when expressed in percentage of the GDP. On the other hand, however, the financing risk of debt is higher than in the EU because the income generating capability of these economies is weak. It explains the occasional unsustainability of the debt even though its absolute level does not seem dangerously high in international comparison. Achieving a shrinking debt path is very difficult even in much wealthier countries (Germany, USA, France and many others) and it is almost impossible in an environment where the level of unemployment is extremely high in global comparison. Due to these unfavorable framework conditions, the proposals for further state spending cuts and for containing state debt need to be supported in a more detailed and reasoned way. It is also important to note that mainstream economic policy recommendations

[10] In most cases it is misleading and methodologically not well founded to make statements that a given country is less developed or more developed than it was 25 years ago by comparing per capita GDP data because of the possible structural changes. In the Western Balkans, however, it is justified to compare the current situation with a much earlier one since the structural change here has not been deep as a result of the conflicts in the nineties that had stopped economic transformation. As a result it is justified and meaningful to say that some of the countries still have not reached their pre-transition per capita GDP level.

regarding state debt management have been changing and the related debates are intensifying.[11] In addition to these developments, the Greek experience clearly proves that without substantial debt relief, countries with non-competitive economic structures and limited output face almost impossible tasks in terms of debt management. The cutting of state expenditure further erodes growth prospects and breaking out from this vicious cycle is extremely difficult, even when debt is “only” around 50-60% of the GDP.

Table 2
General government balance and public debt in the Western Balkan countries (% of GDP)

	Balance of the general government						Public debt				
	2009	2010	2011	2012	2013*		2009	2010	2011	2012	2013*
Albania	–7.4	–3.7	–3.5	–3.1	–6.0		59.3	57.8	58.6	60.9	60.8
Bosnia-Herzegovina	–5.7	–4.2	–2.9	–2.7	–2.2		37.3	39.3	40.5	45.1	44.9
Kosovo	–0.6	–2.3	–1.8	–2.6	–2.1		5.4	5.5	5.3	5.6	6.3
FYROM	–2.7	–2.4	–2.6	–3.8	–3.5		26.8	27.8	31.9	38.7	41.8
Montenegro	–5.4	–4.6	–5.2	–4.3	–2.3		43.2	52.4	57.8	62.9	65.0
Serbia	–4.6	–4.9	–5.1	–7.6	–8.3		38.1	46.5	49.5	61.8	67.5

Source: IMF statistical database
* Data for 2013 are preliminary

Imbalances have characterized other macroeconomic areas in the Western Balkans too and their extent greatly varies across countries and time. From among these imbalances the foreign trade and current account balances have considerably improved after 2009 as a result of falling domestic demand and worsening economic performance (the demand for imported products has decreased considerably.) Unemployment rates increased mostly in relation to the second wave of the economic crisis in 2011-12. Although the data on unemployment are not fully reliable, the trends clearly indicate the severity and depth of the problems. (Unemployment rate is above 40% in Kosovo, above 30% in FYROM, while in Bosnia and Serbia it is around 30%. In certain sub-regions the actual unemployment rate may be much higher.)[12] Structural changes in the corporate sector leading to improved competitiveness have not been realized and the duality between domestic and foreign firms has widened and inequality in society increased. As a result, more and more people are unable to get jobs on the labor market, which is now an increasing problem not only for the unskilled but also for skilled employees. The issues associated with job creation of domestic firms and investments may cause more severe problems because the starting level of unemployment here was

[11] For the key points of the debates on state debt and the context of debt and economic growth see: KRUGMAN, P. 2013: Debt and Growth: The State of the Debate, New York Times, May 31, 2013. http://krugman.blogs.nytimes.com/2013/05/31/debt-and-growth-the-state-of-the-debate/?_php=true&_type=blogs&_r=0
[12] According to ILO definition.

already much higher than in any of the more advanced Central European countries. (In 1989-1990 the average unemployment rate for the whole Yugoslav Federation was about 20% with wide regional differences.) The employment rate is generally low while informal (non-taxed) employment is high mostly in Albania, Kosovo and FYROM, and lower in Bosnia-Herzegovina, Montenegro and Serbia.

3. Financing development

In less developed countries with little domestic savings who cannot achieve current account surplus, the financing of development is among the most difficult problems. This issue in the region is not at all new. One of the basic assumptions of the article written by Rosenstein Rodan on the economic development of the Balkans already in 1943 was that without large external capital inflow it is impossible to launch significant and sustainable economic growth in the Balkans (and generally in less developed regions). Because of weak domestic demand, firms are unable to generate sufficient profit and they are not interested in investing in modernization or efficiency enhancement. This lack of incentives stabilizes domestic production at a very low level and does not support job creation in the private sector, which limits income growth. According to his assumption, a minimum amount of resources is needed to make any progress in convergence. "Launching a country into self-sustaining growth is a little like getting an airplane off the ground. There is a critical ground speed which must be passed before the craft can be airborne." (ROSENSTEIN-RODAN 1943; 1957). The underlying question is the source of the required capital.[13] International transfers, grants, and EU funds[14] play an important role in the countries of the region. Most of these funds are tools for the modernization of the institutions, strengthening the rule of law and transborder cooperation. These objectives are very important since they are able to improve the business environment indirectly, yet they are insufficient to launch a broader investment program. For this latter to take place, cheap loans and non-repayable transfers are needed as these are the most efficient resources, but they are usually sourced from FDI and the remittances of those working abroad.

Table 3

[13] The original concept assumes a large external capital injection (Bigh Push) as part of a development scheme that is aimed at initiating modernization across multiple sectors of the economy and creating demand for domestic products. In its economic reasoning and impacts, the Marshall plan after the World War II and the more recent EU transfers from more developed countries into less developed ones within the structural and cohesion policy follow a similar pattern of logic.

[14] The IPA (Instrument for Pre-accession Assistance) funds in the 2006-2013 period amounted to EUR 1393 million in Serbia, 659 million in Boznia-Herzegovina, 638 million in Kosovo, 618 million in Macedonia, 593 in Albania and 237 million in Montenegro. (Source: Instrument for Pre-accession Assistance (IPA). Revised Multi-annual Indicative Financial Framework for 2013, Brussels, 10.10.2012 COM(2012) 581 final) When expressed in the ratio of GDP, this amount is very significant in the case of Kosovo.

Investments and gross savings in the Western Balkan countries (as % of GDP)

	Investments						Gross domestic savings				
	2009	2010	2011	2012	2013*		2009	2010	2011	2012	2013
Albania	30.3	26.8	25.6	24.0	22.3		3.8	4.3	2.7	6.9	-
Bosnia-Herzegovina	20.9	17.1	15.6	16.0	16.6		–1.8	–1.3	–3.4	–1.8	-
FYROM	25.9	25.5	27.2	28.8	29.3		4.3	6.8	7.6	6.2	-
Montenegro	27.1	22.8	19.5	20.3	21.0		–6.2	–5.6	–6.5	–5.8	-
Serbia	23.0	22.8	24.7	24.6	24.2		5.3	6.5	10.3	-	-
Kosovo	32.3	32.7	33.0	28.4	25.6		–6.3	–5.1	–5.2	–4.8	-

Source: IMF and World Bank statistics
* Data for 2013 are preliminary

Most of the FDI in the Western Balkans has been channeled into the services sectors or in retail trade and only much less into the manufacturing industry that otherwise would be important from the perspective of an export-oriented strategy. This pattern of inflow is in line with the international experiences according to which foreign capital usually first flows into the most profitable domestic services sectors, and will only move into the manufacturing sector subject to further favorable conditions being satisfied. Foreign capital played a very important role in the modernization of services, but it could not make a significant contribution to economic structural change. In the manufacturing sector greenfield investments with export-orientation have been rather sporadic because of problems with the business environment. The problems with the infrastructure functioned as an important barrier to these types of investments. In recent years there have been significant infrastructural upgrades in the region that will help eliminate this bottleneck, but this cannot entirely neutralize the negative implications of the economic and political risks in the region. As a result, this region has disadvantages compared to countries with similar properties, but less economic uncertainties. Due to the development of financing pressures, Western Balkans countries increasingly turn to investors outside the EU – this strategy is similar to the attempts of several other countries in the Central European region. Turkey is becoming more and more active while Russia is able to offer cheap loans, but it definitely will require something in exchange – most probably assets in the energy sector.[15] Similarly, investors from the Middle East and Central Asia also exhibit increasing interest in the region. Interest of Chinese investors in infrastructure development projects is evident mostly in Serbia.

The number of citizens working abroad is extremely high; in Bosnia-Hercegovina and Albania their share is about 35-40% of the population. Remittances to their home countries are a very important element in financing domestic demand. During the most severe period of

[15] Signs of this strategy have been observed in Hungary, Croatia, Serbia, Montenegro and even in Austria.

the crisis, the volume of remittances declined but not as much as it was anticipated at the beginning of the crisis.

Table 4
Remittances (USD million)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013*
Albania	889	1,161	1,290	1,359	1,468	1,495	1,318	1,156	1,126	1,027	779
Bosnia-Hercegovina	1,749	2,072	2,038	2,149	2,686	2,718	2,127	1,822	1,958	1,849	1,896
FYROM	174	213	227	267	345	407	381	388	434	394	409
Montenegro	129	203	180	181	196	298	303	301	343	333	357
Serbia	-	-	2,650	2,754	3,062	2,708	3,933	3,349	3,271	2,763	3,234
Kosovo	-	624	701	771	919	1,042	1,055	997	1,122	1,059	1,125

Source: Remittances inflows data, World Bank
*Estimates from data as of March 2014

In Bosnia-Hercegovina, Albania and Kosovo the value of remittances has considerably exceeded the volume of FDI in the past decade; it was close to that enjoyed by Serbia and FYROM, while FDI played a more important role in Montenegro. In addition to absolute volumes, the different role of FDI in financing these countries is reflected in its ratio to GDP. Based on FDI/GDP ratios, Montenegro has ranked exceptionally high. Under these circumstances, the role of remittances was remarkable regarding both the current account balance and domestic demand.

Table 5
Foreign Direct Investments and remittances in the Western Balkans (as % of GDP)

	FDI						Remittances				
	2009	2010	2011	2012	2013*		2009	2010	2011	2012	2013*
Albania	7.7	9.2	7.6	6.5	6.1		10.88	9.75	8.69	8.12	7.8
Bosnia-Hercegovina	-	2.1	2.6	2.1	2.4		10.67	11.67	10.07	10.95	10.8
FYROM	2.0	2.2	4.5	1.5	4.5		4.09	4.15	4.16	4.10	4.1
Montenegro	35.8	17.8	12.0	14.1	14.6		4.81	7.19	6.20	7.32	7.9
Serbia	4.7	3.1	5.8	0.8	3.1		9.77	9.05	7.56	7.37	7.4
Kosovo	7.1	7.7	7.9	4.3	5.6		18.72	17.34	16.91	16.43	17.0

Source: IMF statistics, own calculation, using IMF and World Bank data
* Data for 2013 are estimations

An additional factor of uncertainty regarding economic trends and the future of foreign direct investment is corruption, which is deeply rooted in political and economic life. The corruption perception index is a clear indication of the unfavorable position of the Western Balkan countries in international comparison. Probably Serbia and the FYROM can be considered as

countries that have shown a continuous improvement while the most negative trends have been observed in Albania and Kosovo. In a European context the region is one of the most corrupt as seen by businesses and households.

Table 6
Corruption perception index in the Western Balkan countries (year, number of countries on the list)

	2004 (146)	2009 (180)	2011 (183)	2013 (175)
Albania	108	95	95	116
Bosnia-Hercegovina	82	99	91	72
FYROM	97	71	69	67
Montenegro	-	69	66	67
Serbia	97	83	86	72
Kosovo	-	-	112	111

Source: Transparency International (Corruption Perception Index, various years)

The earlier growth model, which was overwhelmingly based on bank credits, has been abandoned and the share of non-performing loans in the total loan stock has reached 25% in Albania and Montenegro. In Serbia it reached 20% while bank financing dropped significantly when the situation of the parent banks had become difficult during the economic and financial crisis. For the future, the large volatility of corporate finances from year after year is a cause for concern. After smaller increases in loan placements, unexpected declines have now frequently occurred. It is very concerning that in the largest country in the Western Balkans, i.e. Serbia, several indicators show unfavorable trends, which may have region-wide negative implications. (VIENNA INITIATIVE 2014) In this environment, the support within the Western Balkans Investment Framework and the additional external credits attracted by its operation can have an important role in the development of the broadly defined infrastructure development.[16] There is an expectation that these infrastructure developments will make the region more attractive for foreign investors by improving accessibility and facilitating transportation.

4. External trade

In the more advanced Central European countries, the export expansion based on the operation of firms with foreign capital has played a key role in economic development and implementing structural change. Exports logically emerge as a valuable source of economic growth in the Western Balkans too; since the countries in the region are small, their domestic purchasing power is negligible, which makes it very difficult or even impossible for a domestic demand-led development model to consolidate. It is at least unlikely that without

[16] The Western Balkans Investment Framework is the joint initiative of the European Union, international financial institutions, bilateral donors and the governments from the region.

strong export orientation these countries could embark on a long-term, sustainable economic growth path. In the Western Balkan countries the foreign trade liberalization resulted in rapid export growth, but the initial figures were extremely small while imports increased even faster, which led to a massive trade deficit. External balance started to improve after the first years of the crisis, but the major drive behind it was the larger drop of imports compared to exports. The signing of CEFTA 2006 was an important step in terms of external trade development[17] as it laid down the foundations for free trade among the Western Balkan countries both in respect of industrial and agricultural products by replacing the complicated system of bilateral free trade agreements in the region with a single multilateral framework. (Croatia had also been a member in the CEFTA, but after it joined the EU its CEFTA membership automatically ceased in line with the stipulations of the agreement.) CEFTA has a relatively high share in the member states' external trade indicating the importance of existing economic ties in the region.

The share of EU in their export is 40-60% (but it changed significantly when Croatia became member of the EU – especially in the case of Bosnia-Herzegovina), which is considerably smaller than it was in the case of the Central European countries (60-70%) when they joined the EU in 2004. (Albania shows a different pattern particularly because of its intensive economic relations with Italy. The EU accounts for 80-85% of its exports). These data clearly prove that the intraregional economic relations in the Western Balkans are very strong and that trade turnover is relatively high with improving economic and political conditions in the region even in the wake of the wars and despite very tense political relations. Economic relations and tradition from the Yugoslav era are important, but the fact that most of the products produced there could only be sold on this regional market is probably even more significant. The prospects of this trade, however, are very much limited by the similar production structures, and this is expected to remain preserved unless foreign investors change it by increasing their presence in regional production. Countries that are most dependent on the regional market are Kosovo and FYROM.

It is also an interesting phenomenon that the number of bilateral trade agreements concluded by the countries of the region with non-EU states has been increasing. Bosnia has signed a bilateral free trade agreement with Turkey, Serbia has concluded similar agreements with Russia, Belarus, the EFTA countries, and Turkey, while Montenegro reached a similar agreement with Russia in 2011. These also show that with the objective of diversification, the countries in the Western Balkans are increasingly looking for possibilities in order to establish

[17] Probably the most important advantage of CEFTA (Central European Free Trade Agreement) is that it replaced the network of bilateral free trade agreements that the countries had concluded in the region earlier and this way it created a more transparent regulation on trade relations in the region.

stronger economic ties with countries outside the EU. The importance of these agreements is expected to further increase in the future and their impacts may also be evident in rising FDI inflow.

Beside the similarities and parallel development paths, several instances of divergence can also be observed in the region. Although there were countries in which the perspective of EU membership or the launching of the accession process greatly contributed to democratization or adjustment to principles of international law (Serbia), some other countries no breakthrough has been evident at all (especially in Bosnia-Herzegovina). There are countries where the economic processes have not developed properly, yet some promising tendencies can be observed either in relation to structural change or balance positions (FYROM and Albania). In other countries the economy does not actually work at all and economic risks are on the rise (Kosovo). These unfavorable economic processes can easily blemish the shaky political landscape even in the most stable of countries. The differences between the countries are well reflected in the very diversity of their positions on international rankings. For example, in the 2014 World Bank doing business ranking FYROM was 25th and Bosnia-Herzegovina 131st from among 189 countries.

Conclusion

The economic situation in the Western Balkans can be best described with the term "cumulative crisis". Unfavorable economic consequences of the wars and the disruption of international economic relations in the nineties were aggravated by the problems of transition and reform after the turn of the millennium. This already difficult situation was further exacerbated by the international economic and political crisis in recent years. In order to manage the region's multiple economic challenges, the solutions offered by international institutions are mostly based on budget consolidation and structural reforms. Austerity measures may be coupled with the privatization of currently profitable firms through the involvement of foreign capital in order to increase budget revenues and because of the scarcity of domestic capital. Based on recent developments across several countries, it is realistic to expect that these measures will significantly increase the risk of hostile attitudes against foreign investors and owners unless the living standard of households improves according to expectations.[18] The same disappointment may easily prompt hostility against the European Union or the democratic transformation resulting in increasing resistance against the current economic and political model. (DŽIHIĆ–HAMILTON 2012) The economic

[18] It is only a small step for politicians now to turn this to their own personal advantage in the future; what is more, it may even be for the benefit of local politicians as it may unite the local population regardless of ethnicity.

history of wider Central and Eastern Europe proves that without acceptable level of economic convergence political and social stability cannot be maintained in the longer term.

From the perspective of economic development in the Western Balkan countries several conclusions can be drawn.

1. The conditions for successfully introducing a Western type market economy had not been firmly established. The idea of democratization and modernization of the region in a sustainable fashion and in line with the principles of the Washington consensus was even less realistic than in the more developed Central European region.
2. The abolished economic structures of the region have not been restored or upgraded. Partial restructuring has been evident with the inflow of EU funds, FDI and household remittances, but these efforts have not been able to compensate for the losses suffered in production and the number of jobs. The duality of the economy (foreign firms versus domestic) is probably even deeper than in any of the Central European countries.
3. In the development of the Central European member states, EU transfers play an important role by channeling approximately 2-3% of the GDP into these economies each year. Despite this huge non-debt generating capital transfer, convergence in some of the countries has been sluggish. It is clearly indicative of the magnitude of the necessary capital for development, which could only be effectively utilized if corruption was eradicated and smart economic policies were pursued.
4. The need for development will certainly further intensify the search for new and alternative sources of capital and funds. In the long run and particularly if inadequate EU policies are pursued, this may easily help other actors gain increasing influence in the region and it may lead to serious geopolitical consequences.
5. In the Western Balkans regional economic relations seem to be more important than they were in the Central European countries prior to their accession to the European Union. This does not mean that the importance of regional economic relations must be overemphasized, but their relevance must not be ignored. Domestic firms that satisfy local or regional markets may play an important role in job creation and supply side economic development in addition to the greenfield investments of multinational firms who may find local production cost advantages attractive enough to move into the region. While in Central Europe intraregional economic relations strengthened as a result of the improving market conditions after joining the EU, in the Western Balkans these ties had already been strong before the conclusion of the CEFTA agreement in 2006.

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