

**Bulgaria: between Regionalisation and European Integration.
How to articulate the bilateral and the multilateral level in the foreign trade?**

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Abstract

The war in former Yugoslavia has focused international attention on the importance and problems of the Balkan region. It comprises ten States: Albania, Greece, Romania, Bulgaria, Turkey, Croatia, Bosnia-Herzegovina, Federal Republic of Yugoslavia, Former Yugoslav Republic of Macedonia (FYROM) and Slovenia. A majority of these States is small transition countries but different cultures and religions exist there.

Thus, the stability of this neighbouring region is a main interest for the European Union (EU). For that, EU encourages regional initiatives, thinking that the economic co-operation will be a durable source of peace. The participation of the countries in the local initiatives becomes a condition with European accession. However, this idea, imposed from « the top » seems constraining for the Balkan countries because they think that the Stability Pact for South Eastern Europe is a solution of replacement to European integration. Moreover, is it necessary to provide efforts to build a Free Trade Area (FTA) in the Balkans whereas the principal trade partner is the EU? How countries can manage the bilateral level with the EU and the multilateral approach in the Stability Pact framework?

This paper tries to answer this question through the example of Bulgaria with the study of its flows of trade with EU and its Balkan partners. The choice of Bulgaria is easy to explain: this country is near to the average in terms of GDP, population, and it is central in terms of geography. The results could make possible the examination of the efficiency of the FTA, the utility for Bulgaria of its real installation and the compatibility with the EU accession.

Key words: regional trade, free trade area, European integration
JEL Classification: F13, F15

Introduction

“Make trade not war”¹

The war in former Yugoslavia has focused international attention on the importance and problems of the Balkan region. It comprises ten States: Albania, Greece, Romania, Bulgaria, Turkey, Croatia, Bosnia-Herzegovina, Federal Republic of Yugoslavia (FRY), Former Yugoslav Republic of Macedonia (FYROM) and Slovenia². A majority of these States is small transition countries but different cultures and religions exist there.

Thus, the stability of this neighbouring region is a main interest for the European Union (EU). For that, EU encourages regional initiatives, thinking that the economic co-operation will be a durable source of peace. The participation of the countries in the local initiatives becomes a condition with European accession. However, this idea, imposed from « the top » seems constraining for the Balkan countries because they think that the Stability Pact for South Eastern Europe is a solution of replacement to European integration in the medium term.

Several questions may be raised concerning the Balkan economic integration. Indeed, what are the trade potentials expected from the Balkans Free Trade Area (FTA) given the economic disparities and political status heterogeneity vis-à-vis the EU existing among the participating countries? Is it necessary to provide efforts to build a FTA in the Balkans whereas the principal trade partner is the EU? Which is the interference of the regional co-operation with the European adhesion of certain countries in the short run? To answer these questions we will first present in **section I** Balkans historical background as well the origin and the objectives of the FTA. Then, in **section II**, we propose to examine the effects of the FTA. We will conclude in **section III** with the analyse of the EU's role in this region and the place of Bulgaria in front of two phenomena: the European accession and the regionalisation.

¹ Martin Ph., Mayer T., Thoening M. 2005. *Make trade not war*, CEPR Discussion Paper, n°5218

² After the referendum on the independence of Montenegro of May 21, 2006, the area will comprise 11 states

1. The Future Free Trade Agreement on the Balkans : An Overview

1.1 Balkan Regional Integration : Historical Background and Origins

To examine the level of economic integration of the region today we have to take into account the historical context, namely the level of integration in South-Eastern Europe (SEE) in 1989 on the eve of transition. In addition, numerous political and economic developments have fundamentally influenced relations between Balkan countries in the 1990s. The SEE region includes Albania, Bulgaria, Romania and the successor countries of Former Yugoslavia: Bosnia and Herzegovina, Croatia, Macedonia, Serbia and Montenegro. Moreover, the regional strategy focuses on these countries because they were the most badly affected by the war. Slovenia is not concerned by the institutional approach of the EU in the Balkans and because it is already a European member, as well as Greece, Moldova entered in the process tardily and it trades generally only with Romania, Turkey is not a transition country. That is the reason for the exclusion of these four countries of our study.

At the beginning of the process of transition to a market economy in 1989, the general situation on the Balkans was very different from today (table 1). At that time, five countries in the SEE region were in economic union within the Socialist Federal Republic of Yugoslavia (Bosnia and Herzegovina, Croatia, Former Yugoslav Republic of Macedonia - FYROM, Slovenia and Federal Republic of Yugoslavia -FRY) and as such, they had substantial trade and other economic links. In addition to this federation, economic external exchanges of all socialist countries were carried out in the framework of the Council for Mutual Economic Assistance (CMEA). If we analyse the position of each country vis-à-vis the CMEA, we observe that Former Yugoslavia was less dependant on trade with the other socialist countries than its neighbours because of its specific economic system (market socialism). Bulgaria and Romania had been members of CMEA for several years and had a higher proportion of trade with the other members. Especially Bulgaria, the most dependant country on intra-CMEA trade: 79 % (Statistical Central Direction, 1991, 318) of its total trade is carried out in this framework. Moreover, 13.4 % of its exports went to and 6.5 % of its imports came from the other two major countries: Romania and Yugoslavia. Its trade with Albania was negligible. Albania, after being excluded by CMEA in 1961 followed its own autarkic development for many years and was the most closed economy in Europe without any trade links.

TABLE 1 Basic indicators of SEE countries in 1989

	Area in 000 sq. km	Population (Mio 1990)	GDP/cap (1989 US\$)	Exports to CMEA %	Imports from CMEA %	Exports to SEE %	Imports from SEE %
Albania	28.7	3.2	723	46.3	44.8	n.a.	n.a.
Bulgaria	110.9	8.9	2320	83.0	71.5	13.4	6.5
Romania	237.5	23.2	1730	40.5	38.5	3.2	4.4
FRY	255.8	23.8	2490	29.9	26.3	2.1	2.2

Source: Uvalic. 2001. Table 1 (based on various sources : OECD, IMF, EIU, World Bank)

These data show the limited economic relations between SEE countries despite of the geographical proximity. Therefore, this region was not economically integrated, except the relations within former Yugoslavia. Curiously, Yugoslavia despite of its economic integration could not resist to political tensions and underwent bloody deep rifts.

Finally, we observe that the Balkan region had been experimented since several years the economic integration within the CMEA. Nevertheless, political systemic transformations and the passing to market economy reformed the foreign trade system of these countries. Moreover, the dissolution of the CMEA in June 1991 led its members and in particular Bulgaria to search for new markets for their exports and imports: At first, to maintain the production; secondly to supply the currencies needed for the process of transition and finally to compensate the negative effects of economic disintegration. Naturally, the trade reorientation of Bulgaria went primarily towards the EU, testifying the clear expression of its will to "return to Europe". The signature of the Association (European) Agreement between the two partners in 1995 gives the main explanation of this reorientation. Thus, the EU decided to support these processes and provided with PHARE and other programs the financial aid needed. The economic cooperation with the EU will be enhanced and will be targeted towards the Balkans after the explosion of the war in Bosnia in 1993. Multitude of initiatives will be launched by the EU and other international actors. The most important were the Royaumont Process, the South East European Cooperation Process and the Stability Pact³. The table 2 presents these initiatives and the participation of the Balkan countries in each of them. They constitute a large network of different relations: political, institutional, economic which try to be peaceful elements in the region.

³ The characteristic of the Stability Pact is that it is the largest initiative. Indeed, it comprises EU members, G8, Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, FYR Macedonia, Yugoslavia and Turkey. According to Paul Welfens (2001, 9) "the Pact is the most complex initiative of the 20 century".

TABLE 2 Participation of SEE countries in local initiatives; EU and WTO status

Country	AII (2000)	BSEC (1992)	CEI (1989)	CEFTA (1992)	RP (1995)	SECI (1996)	SEECF (1996)	EU-RA (1996)	SP (1999)	DCP (2001)	EU status	WTO membership
Albania	+	+	+	-	+	+	+	+	+	-	SAA (12/06/06)	8/09/2000
BiH	+	-	+	-	+	+	+	+	+	+	Negotiations SAA	Negotiations
Bulgaria	-	+	+	+	+	+	+	-	+	+	Cand.	1/12/1996
Croatia	+	-	+	-	+	+	O	+	+	+	SAA (29/01/01)	30/11/2000
FYR Macedonia	-	-	+	-	+	+	+	+	+	-	SAA (9/04/01)	4/04/2003
Romania	-	+	+	+	+	+	+	-	+	+	Cand.	1/01/1995
FR Yugoslavia	+	-	+	-	+	+	+	+	+	+	Negotiations SAA	Negotiations

AII: Adriatic-Ionian Initiative; BSEC: Black Sea Economic Cooperation; CEI: Central European Initiative; CEFTA: Central European Free Trade Area; RP: Royaumont Process; SECI: Southeast Europe Cooperative Initiative; SEECF: South East European Cooperation Process; EU-RA: European Union Regional Approach; SP: Stability Pact for SEE, DCP: Danube Cooperation Process; WTO: World Trade Organisation

+: Participant; -: Non- Participant; O: Observer

SAA :Stabilization and Association Agreement, Cand : Candidate

Source: Adapted from Lopandic. 2002, 234

The impressive number of multilateral initiatives does not enhance the regional cooperation on the Balkans, because the recorded results are disappointing. The progress of the regional integration has been slow due to the overlapping membership. The crossing participation in these organisations has been a source of tensions between implied institutions and countries' efforts have been wasted. The failure can be explained by the limited human and financial resources of the initiatives, the competition between countries and the exclusion of former Yugoslavia from all of them before 1999. However, this country is geographically central and important in terms of GDP and population. Finally, Yugoslavia was included on the 26 October 2000 in the Stability Pact and it will permit a new basis for full regional cooperation. Moreover, the regional cooperation is a concept imposed from the "top" and it is easy to explain the weak implication and commitment of Balkan countries in this approach. All these initiatives, more or less successful, contain an incentive trade. By becoming aware of the fragility of the region, all implied actors decide to stimulate the regional cooperation by trade relation. The explanation is the fact that economic interaction is durable source of peace as shown by the European experience. The effective realisation of the economic cooperation appears with the Stability Pact, namely the "Memorandum of Understanding on Trade Liberalisation and Facilitation" signed on 27 June 2001 in Brussels between Ministers of Foreign Affairs of SEE countries⁴. This Memorandum incites Balkan countries to sign bilateral trade agreements to foster intra-regional trade. Nevertheless, the signature of bilateral trade agreement complicates the trade relations without increasing the trade flows. Thus, the bilateral trade liberalisation seems to be a stage towards multilateral trade relation: firstly, in the South European Free Trade Area (SEFTA) which is the final aim of the Memorandum and next in the enlarged European market. Thus, the Stability Pact has the objective to centralize and rationalize the implication of Balkan countries, to support financially the cooperation and found a free trade area in the region. The myriad of bilateral agreements will be replaced with a single pact to boost economic ties in the region. The new agreement will resemble the CEFTA that served as a platform for economic cooperation for the countries that joined the EU in 2004. SEFTA

⁴ The memorandum requires that the trade policies of SEE countries vis-à-vis each other meet three conditions: the removal of quantitative restrictions on imports and exports together with export duties or charges having the same effects; "zeroing" of tariffs on at least 90 percent of the mutual trade and of Harmonised System tariff lines by the end of a maximum transitional period of six years, and abolishment of tariffs and other charges on a large majority preferably upon entry into force of each free trade agreement with those on sensitive goods within a period of not more than six years. (Art.1.2.1-1.2.3, Stability Pact for South Eastern Europe, 2001, *Memorandum of Understanding on Trade Liberalisation and Facilitation Brussels*, June 27)

negotiations were initiated on 31 May 2006 and will be concluded at the latest by 31 December 2006 and take effect in 2007. It will replace thirty and one bilateral trade agreements and will confirm the pursuit of elimination of all customs tariffs on industrial goods and open the way for talks to further liberalisation in farm trade.

Finally, the main reasons of the creation of free trade area are the historical and economic heritage in the Balkan region with notably the disintegration of CMEA and the wars, which focused international attention. In addition, we note the relative failure of local initiatives, which could not prevent the new conflict in 1999. It will provoke the creation of a large initiative in 1999- the Stability Pact, which is the origin of the SEFTA. Moreover, in this framework, the collaboration within Balkan countries becomes a substantial condition for the accession to the EU. This collaboration appears as a big “carrot” for participants, which constitutes the real motor of regional dynamic.

1.2 Objectives of the Regional Integration on the Balkans

The installation of the Stability Pact was primarily justified by the need for regulating the political problem of Balkans what means to try to alleviate the area in terms of religious and territorial tensions. Thus the objective is to increase the economic integration between the concerned countries which will make possible to avoid the conflicts.

Moreover, regional trade integration is generally seen as a mean of fostering economic growth and development by increasing the intra- regional trade and cross border investment. The economic growth and development appear to be durable source of peace. The new situation will allow releasing the “peace dividends” which supply resources for growth. Actually, the Pact seeks to install a virtuous circle: growth- peace -growth.

Nevertheless, no theory or empirical results provide a clear- cut answer to the question about the link between trade liberalisation and growth⁵ or development⁶. However, the process of European integration offers examples of successful rapid development of countries that were characterized by nascent democratic systems, fragile macroeconomic situations, little intra-regional integration⁷ and heterogeneous characteristics as these of SEE (table 3).

TABLE 3 Macroeconomic indicators by country for 2004

Country	Population (Mio hbts)	GDP (bn euros)	GDP/capita (euros)	Real GDP (% growth)	Inflation rate (%)	Current account balance (% GDP)	Exports to GDP ratio (%)
Albania	3.5	6	1713	5.9	2.9	-5.0	7.1
Bosnia and Herzegovina	3.9	7	1711	5.2	0.8	-17.3	17.6
Bulgaria	7.8	19	2471	5.7	6.1	-7.4	37.5
Croatia	4.5	27	5932	3.8	2.1	-5.4	23.3
FYR Macedonia	2.1	4	1845	2.3	-0.3	6.0	31.5
Romania	22.2	57	2578	8.3	11.9	-7.5	30.6
Serbia and Montenegro	8.3	19	2326	7.2	9.5	-13.1	8.6

Source: Eurostat

The free trade area, which the Stability Pact has for objective to establish in 2007, is regarded as catalyst of regional integration. It will take the previous bilateral free trade agreements (table 4) and will constitute the South European Free Trade Area. The objective is also to make the area attractive, by simplifying the current complex regulations for the investors who think in regional terms.

⁵ See Baldwin, Richard E. and Rikard Forslid. 2000. Trade liberalisation and endogenous growth: A q-theory approach. *Journal of International Economics*, vol.50, No.3, august; Rodriguez F. and Rodrik D. 1999. *Trade policy and economic growth: A sceptic's guide to the cross-national evidence*. NBER Working Paper, n°7081; Collier P. and Dollar D. 2001. *Globalization, Growth and Poverty: Building an Inclusive World Economy*. A World Bank Policy Research Report

⁶ The World Bank. 2003. *Trade Policies and Institutions in the Countries of South Eastern Europe in the EU Stabilization and Association Process*, Regional report, 28 March, n° 24460, p.27

⁷ See Steil, Benn and Susan L. Woodward. 1999. A European ‘New Deal’ for the Balkans. *Foreign Affairs*, November/December, Vol.78, No.6, pp.95-105

TABLE 4 Free Trade Agreements in SEE as of 15 February 2006

	Albania	Bosnia-Herzegovina	Bulgaria	Croatia	Macedonia	Moldova*	Romania	Serbia & Montenegro**	UNMIK/Kosovo***
Albania		Applied 01/12/04 WTO ****	Applied 01/09/03 WTO	Applied 01/06/03 WTO	Applied 15/07/02 WTO	Applied 01/11/04 WTO	Applied 01/01/04 WTO	Applied 01/08/04 WTO	Applied 01/10/03 WTO
Bosnia-Herzegovina	Applied 01/12/04 WTO		Applied 01/12/04 WTO	Applied 01/01/05 WTO	Applied 01/07/02 WTO	Applied 01/05/04 WTO	Applied 01/12/04 WTO	Applied 01/06/02	Initialled 15/02/06
Bulgaria	Applied 01/09/03 WTO	Applied 01/12/04 WTO		CEFTA 01/03/03 WTO	Applied 01/01/00 WTO	Applied 01/11/04 WTO	CEFTA 01/07/97 WTO	Applied 1/06/2004 WTO	Under examination
Croatia	Applied 01/06/03 WTO	Applied 01/01/05 WTO	CEFTA 1/03/2003 WTO		Applied 11/06/97 Revised 11/06/02 Applied 11/07/02 WTO	Applied 01/10/04 WTO	CEFTA 01/03/03 WTO	Applied 01/07/04 WTO	Under consideration
Macedonia	Applied 15/07/02 WTO	Applied 01/07/02 WTO	Applied 01/01/00 WTO	Applied 11/06/97 Revised 11/06/02 Applied 11/07/02 WTO		Applied 01/01/05 WTO	Applied 01/01/04 WTO	Signed 21/10/05 Ratified by SCG 02/12/05	Applied 02/02/06
Moldova*	Applied 01/11/04 WTO	Applied 01/05/04 WTO	Applied 01/11/04 WTO	Applied 01/10/04 WTO	Applied 01/01/05 WTO		Applied 17/11/94 WTO	Applied 01/09/04 WTO	
Romania	Applied 01/01/04 WTO	Applied 01/12/04 WTO	CEFTA 01/07/97 WTO	CEFTA 01/03/2003 WTO	Applied 01/01/04 WTO	Applied 17/11/1994 WTO		Applied 01/07/04 WTO	
Serbia & Montenegro**	Applied 01/08/04 WTO	Applied 01/06/02	Applied 01/06/2004 WTO	Applied 01/07/04 WTO	Signed 21/10/05 Ratified by SCG 02/12/05	Applied 01/09/04 WTO	Applied 01/07/04 WTO		
UNMIK/Kosovo***	Applied 01/10/03 WTO	Initialled 15/02/06		Under consideration	Applied 02/02/06				

*Moldova is associated to the process with an extended timeline.

**Serbia Montenegro started negotiation process when it was known as FR Yugoslavia; therefore, both names may appear on the agreements

***All agreements in line with United Nations Security Council Resolution (UNSCR) 1244; UNMIK –United Nations Mission in Kosovo

****FTA notified to WTO

Source: Stability Pact, www.stabilitypact.org/trade/default.asp (11 May 2006)

Finally, the incentives of the regional cooperation on the Balkans are the common history (experience of communism and economical disintegration), the physical and geographical proximity, common goals to join the same international organisations (EU, WTO, NATO), external pressures from significant states, common regional problems, common ethnic relations and the most important incentive from historical point of view has been the creation of secure climate in an area of conflict.

2. Balkan Free Trade Area: Expected Gains and Potential Drawbacks

2.1 Gains Expected from the SEFTA

Several gains are expected from the SEFTA. The traditional analysis on preferential trade arrangements (custom union or FTA) are related to the overall (static) gains resulting from the net effect of trade creation versus trade diversion (Viner, 1950). Nevertheless, the emphasis on dynamic benefits (Balassa, 1961) that the countries forming a FTA are likely to receive is increasing. They are due to an increased competition, economies of scale, stimulus of investment and better utilisation of economic resources. But static⁸ as well as dynamics gains may vary from country to country.

The potential benefits of the SEFTA that the countries of the Balkans might reap are the following:

- access to an enlarged market (55 millions customers) which can foster economic growth because of economies of scale in domestic production⁹
- Increased competition and hence opportunities for improving efficiencies. While exposure to this market will inevitably eliminate some production, more efficient firms will improve productivity and output. It will help prepare smaller countries for greater integration into the world economy, by enhancing both quality and productivity, and thereby competitiveness. In fact it is a question of the “training ground theory“, according to Inotai (1982).
- Increased investment and higher total factor productivity growth from better access to technology. Whether a free trade area moves towards the lowest group-wide tariffs per sector, all Balkans members would benefit from a lower price of capital goods, hence stimulating investment. Moreover, more rational tariff regimes might encourage greater partnership and foreign investment.
- Generally, the climate of investment is improved because of increased intra-regional trade. It can help to boost industrial development and in the diversification of the export base.
- The FTA can simplify the existing complex trade-distorting pattern of bilateral preferences by making it multilateral. If not, this “spaghetti bowl”¹⁰ of bilateral relations will not produce the dynamic advantages of trade liberalisation (economy of scale, transfer of technologies). Bilateral agreements can bring even a “*loss of effectiveness*” (The World Bank, 2003, 18) especially when one knows the proportion of corrupted customs services in the region. In addition, the bilateral agreements do not have the same exceptions; they do not concern the same products and have different levels of preferences. The FTA will allow the harmonization of these agreements and will increase the positive effects of liberalisation.
- Concretely, the gains for companies are substantial: direct decrease in the administrative costs, less storage problems, decreased risk of the quality of merchandise being diminished, decreased risk of theft etc. For example, Bulgarian products have to cross two or three borders to arrive to Italy, while it was different when the former Yugoslavia was existing. The passing of frontiers always includes a certain risk, which will disappear with the creation of the FTA.
- Reduction of the smuggling, which until now was stimulated by the high customs duties.
- Larger choice of products for customers, generally on better price.
- The FTA will permit to avoid the “hub and spokes” effect¹¹. In this case, the larger and richer countries are privileged, with the detriment of the impoverishment of the smaller and poor countries. The firms which are located on the “spokes” have more important expenditure firstly because of the more significant barriers when they import from other “spokes” countries comparing to the “hub” countries. Secondly, in this way the demand for their products by the other “spokes” countries decreases because of these trade barriers. If all the trade barriers between the “spokes” countries are eliminated, which is the role of the FTA, in this case, the “hub and spokes” effect decreases considerably. For its complete cancellation, it is necessary to have a trade arrangement between the countries of the Balkans identical to that which the EU practises towards them.
- Political benefits are also substantial. The FTA might decrease illegal traffics and corruption in the whole region. The customs services benefiting from the reduction of their administrative tasks can assign a greater part of their resources and their personnel to the fight against criminality.

⁸ For a detailed presentation of Viner’s analyse, see De Melo J., Panagariya A., and Rodrick D. 1993. « Regional integration :An Analytical and Empirical Overview », in De Melo J., and Panagariya A. (eds.) *New dimensions in Regional Integration*, New York : Cambridge University Press ; The World Bank. 2003. *Trade Policies and Institutions in the Countries of South Eastern Europe in the EU Stabilization and Association Process*, Regional Report, 28 March, n°24460

⁹ It might nevertheless be argued that the enlarged market set up by the Balkan countries might still be considered as small compared to the one of the EU where Bulgaria and Romania have a preferential access.

¹⁰ This term is generally used to describe the crossed free trade agreements in South America, see Schiff, Maurice. 2001a. « Regional Integration and Development in Small States », Mimeo. The World Bank, Washington

¹¹ For more information about the « hub and spokes » effect in the Eastern European countries, see Baldwin, Richard E. 1994. *Towards an Integrated Europe*. CEPR, London

- Regional agreement may enhance policy credibility for a developing country that is not obtainable unilaterally or multilaterally. Indeed, Fernández and Portes's (1998) results show that regional trade agreements can serve as a useful purpose above and beyond the direct gains from trade liberalisation by reducing uncertainties about national policy or political development. Increased credibility makes it easier for private sector to plan. Schiff and Winter's (1998) research contains a dimension about the credibility effects of solving the political problems caused by conflict between two neighbouring countries. Indeed, the trade between them raises mutual trust and reduces the likelihood of conflict.
- The free trade area will get for the small countries of the Balkans a reinforced bargaining power compared to the bilateral agreements.
- FTA offers the opportunity to anchor liberal reforms and to show the clear commitment of government in this way.

2.2 Potential Drawbacks and Obstacles for the Establishment of FTA

The principal disadvantage of the introduction of a free trade area is the loss of custom receipts (Table 5) resulting from the trade with the partners that have become members of the zone. This loss of earnings is relatively valid in the short term, because the liberalisation of the trade stimulates the growth and the tax income is compensated, even if it is of different nature. Nevertheless, any trade reform has to be accompanied by appropriate fiscal revenue policy to compensate this loss. We have to mention here that with regard to the Balkan countries, the loss of customs income will be unimportant because of the limited volume of exchanged products between them. In spite of that, for countries like Bosnia for example, the duties are an important source of income and can even reach a third of the total national budget (The World Bank, 2003, 13). For this reason, solutions have to be created country by country and not overall, because neither the customs duties, nor the volume of trade with the other Balkan countries are identical for all.

TABLE 5 Customs duties in Southeastern Europe

Albania		
	Final bound	Applied 2001
Simple average of <i>ad-valorem</i> duties		
All goods	7.0	7.5
Agricultural goods (AOA)	9.4	9.0
Non-agricultural goods	6.6	7.2
Non <i>ad-valorem</i> duties (% of total tariff lines)	0.0	0.0
Bulgaria		
	Final bound	Applied 2004
Simple average of <i>ad-valorem</i> duties		
All goods	24.5	10.0
Agricultural goods (AOA)	35.6	18.4
Non-agricultural goods	23.0	8.8
Non <i>ad-valorem</i> duties (% of total tariff lines)	2.1	1.4
MFN duty free imports (share in total imports, 2001)		23.5
Croatia		
	Final bound	Applied 2003
Simple average of <i>ad-valorem</i> duties		
All goods	6.0	4.7
Agricultural goods (AOA)	9.4	9.3
Non-agricultural goods	5.5	4.1
Non <i>ad-valorem</i> duties (% of total tariff lines)	2.4	2.5
MFN duty free imports (share in total imports, 2004)		46.5
FYR Macedonia		
	Final bound	Applied 2004

Simple average of <i>ad-valorem</i> duties		
All goods	6.9	9.2
Agricultural goods (AOA)	11.3	12.7
Non-agricultural goods	6.2	8.7
Non <i>ad-valorem</i> duties (% of total tariff lines)	1.4	1.5
Romania		
	Final bound	Applied 2001
Simple average of <i>ad-valorem</i> duties		
All goods	40.4	16.9
Agricultural goods (AOA)	98.4	24.4
Non-agricultural goods	31.6	15.8
Non <i>ad-valorem</i> duties (% of total tariff lines)	0.0	0.0
Serbia and Montenegro		
	Final bound	Applied 2002
Simple average of <i>ad-valorem</i> duties		
All goods	-	9.4
Agricultural goods (AOA)	-	15.9
Non-agricultural goods	-	8.4
Non <i>ad-valorem</i> duties (% of total tariff lines)	-	0.0
Bosnia and Herzegovina		
	Final bound	Applied 2001
Simple average of <i>ad-valorem</i> duties		
All goods	-	6.0
Agricultural goods (AOA)	-	4.8
Non-agricultural goods	-	6.2
Non <i>ad-valorem</i> duties (% of total tariff lines)	-	0.0

Source: World Trade Organisation, <http://stats.wto.org/countryprofiles/>

There can be a tax loss because of the disappearance of certain local companies caused by the sectoral changes. There are in particular traditional industries which are sources of tax re-entries, but which are easily substitutable by imports.

The FTA can raise regional disparities, because it is possible to record polarization effect. The emergence of few attractive poles of industrialization and the polarization of investment towards the larger, central and more diversified economies of the region is possible¹². Phenomena of type centre- periphery (Veltz, 1996) are possible to appear in this case and it would be necessary to think of the possible payment of compensatory units which mitigates the harmful effects of liberalisation. The Balkan countries will not be able to assume these compensations. Thus it would be desirable that the developed countries partners of the Stability Pact contribute to special funds. If not, the bad distribution of the profits of trade liberalization could be transformed into factor of destabilization in the area. More especially, the integration between developing countries can “*lead to divergence in economic growth*” (The World Bank, 2003, 35), divergence which can enhance the heterogeneity, sometimes source of pressure.

Finally, short term costs can include the risk of raise of unemployment, because the trade openness has differentiated effects on sectors and firms in each country. More advanced countries as Romania, Bulgaria and Croatia will feel probably less the employment effects than countries like Albania, Macedonia or Bosnia and Herzegovina.

To reduce the costs which rise from the introduction of a free trade area, it is necessary that the countries bring in place co-operations and at the political level and at the economic level. But do obstacles exist with the realization of an effective free trade area?

Firstly, Vamvakidis (1998) finds that agreement between small, closed developing countries are unlikely to have a positive impact on growth. Research by Puga and Venables's (1998) also support these conclusions, which means that in the context of the Balkans the perspectives of faster growth are not evident. If we observe the static effects, free trade agreements between small economies lead generally to a loss of welfare because of a little trade creation and important trade diversion. Indeed SEE countries are small and the transition process is delayed which compromises a successful

¹² For more details about the localization of industry, see Krugman P. and Venables A. 1993. *Integration, Specialization and the Adjustment*, NBER Working Paper, n°4561

development. The openness of these economies (table 6) implies that they are pushed further into inter-regional trade with the EU (Petrakos, 2003).

TABLE 6 Trade Openness: 1998 (%)

	X+M/GDP
Albania	34
Bosnia and Herzegovina	83
Bulgaria	91
Croatia	61
FRY(1997)	40
FYROM	91
Romania	58

Source: World Bank. 2000. Table 3.1

Secondly, the natural trade partners for countries, that product primary goods, are the industrialised countries therefore the intra-regional trade potential on the Balkans is limited because SEE countries exports are constituted essentially of primary products. Moreover, these countries dispose similar Revealed Comparative Advantage (RCA) and similar exchanged products which make the intra-regional trade more difficult. We can compare the first five RCA of each country on the Balkans (box 1)

Box 1 Five first RCA of SEE countries 2003

Albania	Rank	RCA
Leather products	1	23.29
Clothing	14	10.01
Basic manufactures	45	1.25
Wood products	58	0.94
Miscellaneous manufacturing	78	0.41

Bosnia and Herzegovina	Rank	RCA
Leather products	5	7.65
Wood products	10	4.65
Basic manufactures	15	3.03
Miscellaneous manufacturing	16	1.33
Non-electronic machinery	21	0.86

Bulgaria	Rank	RCA
Basic manufactures	18	2.6
Leather products	21	2.89
Clothing	27	6.14
Textiles	30	1.32
Non-electronic machinery	35	0.60

Croatia	Rank	RCA
Transport equipment	23	1.13
Leather products	25	2.47
Electronic components	29	0.81
Wood products	33	2.16
Chemicals	37	0.82

FYROM	Rank	RCA
Basic manufactures	13	3.36
Clothing	20	8.76
Leather products	28	2.34
Textiles	35	1.20
Electronic components	55	0.35

Romania	Rank	RCA
Leather products	7	6.62
Clothing	25	6.75
Basic manufactures	31	1.62
Electronic component	31	0.76
Non –electronic machinery	37	0.58

Serbia and Montenegro	Rank	RCA
Basic manufactures	14	3.33
Leather products	19	3.27
Chemicals	22	1.16
Processed food	28	3.69
Wood products	42	1.65

The index measures the country's revealed comparative advantage in exports according to the Balassa formula. The index compares the share of a given sector in national exports with the share of this sector in world exports. Values above 1 indicate that the country is specialised in the sector under review. Rank 1 indicates that the country has the highest specialisation index in the world for the sector under review.

Source: UNCTAD

This box allows to note the very similar structure of trade and the lack of complementarities, which limit the potential of intra-regional trade. It cannot be a question neither of intra- industry trade¹³, which is the case of the EU. The majority of the products is primary and thus they will be exchanged with an industrialized country. In addition, the table 7 shows the weakness of trade flows between Balkan countries which allow Slim (1999, 248) to affirm « *that it is impossible to talk about Balkan trade area.* » The flows appear very volatile. Indeed, the trade between Bosnia and Herzegovina and Croatia is very substantial. In contrast, there may be almost no trade between Croatia and Serbia for example, for political reasons. The table here testifies the huge importance of the EU as a trade partner of the SEE countries. In the case that Balkan countries import the same products and produce goods that are not able to interest their neighbours, it means that the reduction of duties or of the quantitative limitations will have a weak impact on trade potential. All these elements do not allow the expansion of trade within the Balkan countries.

TABLE 7 Intra –regional trade for each country in the SEE and with EU for 2004 (%)

Imports									
	Albania	BiH	Bulgaria	Croatia	Macedonia	Romania	Serbia	Total SEE	EU
Albania		0.0	2.0	1.4	0.8	0.7	0.5	5.4	74.09
BiH	0.0		0.2	26.4	0.5	0.4	0.0	27.5	66.2
Bulgaria	0.0	0.0		0.0	0.0	2.1	0.3	2.4	61.7
Croatia	0.0	2.1	0.3		0.7	1.2	0.0	4.3	69.7
Macedonia	0.0	0.2	7.6	3.4		0.6	9.4	21.2	62.3
Romania	0.0	0.0	0.8	0.2	0.0		0.0	1.0	74.0
Serbia	0.2	0.0	4.3	0.0	0.0	2.7		7.2	78.5
Exports									
Albania		0.0	0.0	0.1	0.7	0.0	2.5	3.3	85.04
BiH	0.1		0.1	22.1	0.4	0.1	0.0	22.7	71.8
Bulgaria	0.4	0.0		0.5	2.1	3.2	3.5	9.7	57.5
Croatia	0.4	14.7	0.3		1.0	0.8	0.0	17.2	64.4
Macedonia	1.2	1.9	1.8	7.0		0.2	30.8	42.9	45.3
Romania	0.0	0.0	1.7	0.8	0.0		0.9	3.4	71.5
Serbia	0.6	0.0	1.9	0.0	0.0	1.6		3.1	82.4

The value 0.0 means that the trade flow between the two partners is unimportant, less than 0.2 % of the total export or total import of the country

Source: Eurostat, author's calculations

Moreover, in spite of the existence of large network of bilateral trade agreements, the actual effect on intra-regional trade flows has not been significant. For example the bilateral agreement between Macedonia and Bulgaria signed in 2000 did not change the trade flow, despite of the common border (table 8)

TABLE 8 Bulgarian trade with Macedonia, Mln euros (1995-2005)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Imports	51.2	22.0	20.0	32.1	23.3	28.2	21.8	19.1	21.2	41.0	67.6
Exports	234.3	92.1	70.7	68.1	98.7	119.7	125.4	134.5	136.7	166.4	188.1

Source: Bulgarian National Bank (BNB)

Anastasakis and Bojicic-Dzelilovic (2002, 9) explain that with the lack of capacities by firm to respond to a more beneficial trade. A study of the World Bank (2000) underlines the institutional limitations and the unreformed customs services. The insignificant level of trade flows within SEE is due to an important delay in transition reform accompanied with successive wars and economic sanctions, which contribute to the lack of growth and trade.

Regarding the obstacles for the increase of flows of FDI in the Balkans, one can mention that the wars and the bombardments of NATO destroyed a part of the infrastructures in terms of transport and communication, already in bad conditions. In spite of the allocated financial means, their rebuilding is slow and the effects felt in the whole area. In addition, the Balkan market is small and for some investors it implies limited gains of economies of scale. Moreover, Kaminski (2001) considers that the participation of a country in regional agreement do not guarantee its access to FDI.

¹³ For the differences between intra-industry and inter-industry trade, see Grubel H., Lloyd P. 1975. *Intra-industry trade : The Theory and Measurement of International Trade in Differentiated Products*, McMillan, London

The state of « *unfinished peace* » (International Commission on the Balkans, 1996) that has been characterizing the Balkans since the past decade increases the country risk and the uncertainty and international investors do not engage in the area. These two phenomena do not create the bases of attraction of the FDI, which makes difficult the regional co-operation.

The regional cooperation and the success of the FTA on the Balkans also depend on political obstacles, but here we will not examine them, except one: the EU, from the “top”, imposes the whole process. That means that the commitment of the local major actors is uncertain because they do not create the project. Nevertheless, it will be interesting to mention the vision of local elites about the regional cooperation (box 2) and their mix of the two levels- economic and political.

Box 2 Principal obstacles with the regional co-operation according to local elites

The study of Anastasakis and Bojicic-Dzelilovic reveals the next principal obstacles for the regional cooperation on the Balkans. They questioned journalists, scientists, politicians and businessmen. Even if the perceptions are different in each country, they explain the lack of regional cooperation mostly by:

- low level of development -16 %
- lack of security 15.2 %
- weak legal frameworks 14.5 %
- non-complementary economic structures 13.9 %
- different levels of bilateral relations with the EU- 13.4 %
- ethnic differences 12.7 %

Source: Anastasakis, Othon and Vesna Bojicic-Dzelilovic. 2002. *Balkan Regional Cooperation and European Integration*. The Hellenic Observatory Discussion Paper, London School of Economics and Political Science, London, July, p.48

Finally, it results of the study of this point that the conditions of successful free trade area on the Balkans are not present. The economic gains or the drawbacks expected from the FTA depend on the own trade structure of each country. The simple raise of trade flows on the Balkans does not allow affirming that the liberalization has a positive effect for all. But in the case of small, developing countries, the FTA play generally more political than economical role. Fortunately, this function corresponds with the major objective of the Stability Pact and the European institutions: bring the peace and stability again in the region. Let see now the compatibility between regionalisation and European integration for these countries, because in the long-term they all wish to be included in this union. For that, further attention will be paid to the case of Bulgaria.

3. Articulation between Regionalisation and European Integration: The Case of Bulgaria

3.1 The Role of the European Union in the Process of Regional Cooperation

After the war in Kosovo in 1999, the European Union became aware of the importance of the Balkan area and its instability. The political problem was not only the one of the Balkans, but because of proximity and the possibility of potential conflict in Europe it became the one of the EU too. There was no denying that it would take time to bring the trust necessary for peace. This suggested that the international community and the EU in particular needed to be implied in this process. The tension in the 90's was general and regional; therefore, a global and regional solution was needed. The EU was convinced that the economic, political and security issues in the Balkans cannot be resolved on a national basis or through bilateral policy on.

Thus, the regional approach of the EU consists in the pressure put on the countries in the region to cooperate with each other. The EU organised the Stability Pact as a considerable ‘carrot’ in order to stimulate them and because all countries especially Western Balkans (Former Yugoslavia minus Slovenia, plus Albania) are potential candidates for the EU membership. Indeed, the EU posed the regional cooperation as condition for further EU integration: “*integration with EU is only possible if future members can demonstrate that they are willing and able to interact with their neighbours as EU Member States do.*” (Commission of the European Communities, 2002) Thus, countries wishing to be a part of the EU must first prove their readiness to cooperate with their neighbours. The problem is that in 2006 a clear road map about fully integration does not exist yet. However, the external incentive is the principal motor for SEE countries to accelerate the development and to work together at a regional level. This evidence explains the Prodi’s statement on enlargement: “*In the long term the EU can best contribute to stability in the region by drawing it closer to the perspective of full integration into its structures, and should confirm that the countries of the former Yugoslavia and Albania have the ultimate vocation to become members of the European Union.*” (European Union, 1999, 37) Moreover, the EU has to offer a real perspective of accession for Western Balkans in medium term, because if the times are excessively long and differentiated, it might create nationalistic sentiments and raise the tension in the region again. To avoid this, the EU can reduce the duration of the

preferential agreements and permit the further integration more quickly. In addition, European Communities have to involve gradually Balkan countries into various EU policies in order to show them that they are not left outside or that they are important for successful partnership in the EU (for example involve them in security policy or visas policy etc.)

Nevertheless, the Stability Pact as a multilateral approach for SEE countries became a political commitment but with economic and commercial contents. It appears therefore that the regional cooperation and the FTA are primarily approached in the context of European integration rather than having a value of its own.

The problem is that it is not a local initiative but imposed from the “top”. This situation is reinforced by the article 41 which gives a special mandate to the EU to coordinate a comprehensive regional approach. One can wonder about the utility of such a step being given the fact that the project not emanate from actors or local institutions but is imposed by the top. May this project function if the local personalities do not adopt it, but participate only because the EU obliges them?

Moreover, this heterogeneous region in term of revenue, population and development level puts the EU policy in front of important dilemma: how to coordinate the multilateral with the bilateral, the national and the regional level? It is due to the fact that actually the EU does not have the same policy with each country which may be logical taking into account the different level of economic and political development. Indeed, Bulgaria and Romania signed a European agreement with the EU, while a large part of countries of Western Balkans are covered by Stabilisation and Association Agreements (SAA)¹⁴. This significant distinction might create a competition between the countries of the region. In addition, the regional cooperation is **encouraged** among the European Agreement countries, but it is **required** for SAA countries. When a country signs a SAA it means that it becomes a “potential candidate”, whereas the signature of European agreement means that the country becomes “sure” to join the EU. The nuance here is significant: SAA does not mean membership, but can remain only a type of co-operation. This fact will enhance the differences of treatment and the resentment of the less favoured countries. It could be a source of fragmentation of the region. Moreover, the European Agreement and SAA are means which work on bilateral level, while the Stability Pact is a multilateral approach. This approach contains some contradictions: the EU signs the SAA with the Western Balkans and in the same time these countries have to be linked through free trade arrangements with each other. That is the reason to quickly stimulate the real appearance of the free trade area on the Balkans which will be the first step towards European accession; it could be a custom union with common external tariff (including that of the EU). Messerlin (2001) considers that if the Balkan free trade area brings the customs duties on the industrial products to the level of those of the EU, it will be an important economic solution for the peninsula. In the other case, the risk is that the Balkan countries do not trade with each other, because of the respect of the rule of origin, if the product is intended for the EU market.

If we look at the study of Anastasakis and Bojicic-Dzelilovic (2002), it appears that the European integration and the regional cooperation are two processes, which are not well linked in the minds of the elites. For some of them, SAA seems to be a delaying tactic on the part of the EU. In this case, the countries have to be assured that additional links with other Balkans countries will not delay their future accession. Nevertheless, “86 % of the respondents believe that the regional cooperation is fostering their countries’ prospects of joining the EU.” (Anastasakis & Bojicic-Dzelilovic, 2002, 56) To resume, the regional cooperation between SEE countries results from a vague commitment of the EU to integrate them. The European integration has such an importance because its effects on democratic consolidation and economic development have been previously demonstrated for Spain, Portugal and Greece. Thus, the EU political commitment is “*a critical ingredient of success*” (The World Bank, 2000, 9) of the regional integration. Additionally, this strategy needs to be supported technically and financially by all the international community implied in the Stability Pact. There is no possible regional cooperation and trade integration without enhanced institutions (customers services, administrations), without rebuilt regional infrastructure and domestic reforms. It is evident, however, that individual countries cannot achieve stability if the region, as a whole, remains fragmented.

3.2 Bulgaria: between Regionalisation and European Integration?

After the collapse of the CMEA in 1991, Bulgaria relatively quickly reoriented its trade flows towards the European Union. Before the signature of Association Agreement in 1995, Bulgaria took profit from the Generalised System of Preferences granted by the European Economic Community. But the real trade liberalisation occurs with the Association Agreement which constitutes an asymmetric agreement with ten years transitional period. In spite of some criticisms, this economic cooperation will permit to Bulgaria to moderate the effects of disintegration of the socialist system and to conquer new markets, which supply currencies necessary for its modernisation.

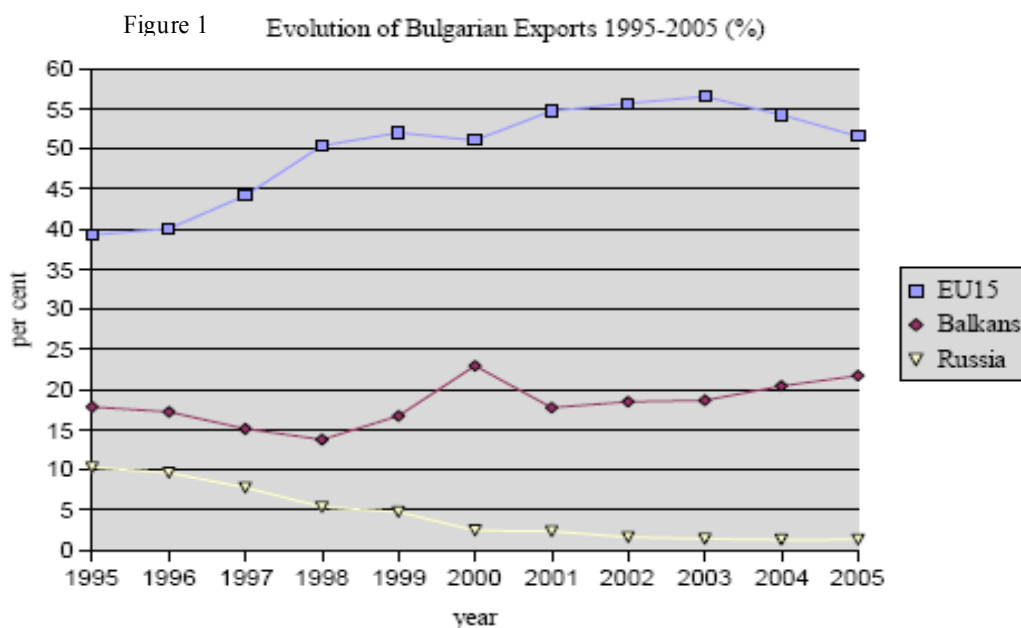
Moreover, generally for a small country the main incentive for a successful modernisation has to originate in deepening economic link with a major large partner. For geographical, historical, economic and cultural reasons this partner can only be the EU. In the case of Bulgaria it is accompanied with the management of transition process. Economic cooperation with the EU means for Bulgaria easier accession and quick convergence. But institutional, economic and

¹⁴ SAA are agreements between the EU and the countries of Western Balkans which comprise a trade content. They are considered asymmetric because the EU will eliminate more quickly its tariff and nontariff barriers than the Balkan countries.

political problems will delay the advance of reforms as well as the Balkan context will not facilitate the process. Thus Bulgaria will be incited to take part into a regional cooperation on the peninsula. There are three paradoxes in its situation:

- Firstly, Bulgaria rightly considered the integration in Western European economies as its priority and expected more intensive regional trade as a consequence of a successful EU integration. It is easy to understand this if we look at the Spanish and Portuguese experience: indeed their bilateral economic cooperation started to grow after the accession to the EU.
- Secondly, Bulgaria is really a volunteer because this country is very involved in the political management of the war conflict on the Balkans especially by the organisation of Round Table of Ministers. But at the same time Bulgaria became aware of the strong relation between regionalisation and EU accession: for the EU it is necessary that future members show their capacities of regional cooperation. Because this is the proof of a “normal behaviour” and of a political culture of the new members in a wider community.
- With its accession to WTO on 1 December 1996, Bulgaria achieves a bilateral and a multilateral trade liberalisation and the compatibility within them is not obvious.

These three levels do not seem to be a choice for Bulgaria. Actually this country has to realise the trade liberalisation and the economic cooperation simultaneously with the three entities. In addition, it is well known that FTAs are usually “second-best” policies to the multilateral liberalisation. There is also the risk that Bulgaria records a reduction in the economic welfare if it carries out only one liberalisation at the regional and European level, without doing it at the multilateral level. The next two figures testify the parallel processes, which occur in the Bulgarian foreign trade and in this way the progressive integration of Bulgaria in the European or Balkan economic structures. After the signature of the Association Agreement, the exports to the EU have taken rise since 1995-96 in particular with the detriment of Russia, which was the first trade partner until 1989. Since 2001 we observe a slow growth of exports to Balkans countries and a light fall of exports to the EU. The explanation for us is firstly, in the real appreciation of Bulgarian lev because of the currency board founded in 1997. Secondly, despite the EU asymmetric liberalisation there are numerous non-tariff barriers which make difficult the penetration of the European market by Bulgarian firms. Thus, they prefer to turn towards the Balkan market, which seems less complex, where there is less technical exigency or other norms. Moreover, since several years the transport costs are increasing, that is why firms look to reduce them and prefer regional market. Finally, Bulgaria as a larger and more diversified country has higher revealed comparative advantages on the SEE market than on the European one. In the future it is possible to think that with the reinforced supplementary dynamic of SEFTA, the Balkan market for Bulgaria will take more and more place in its total exports.

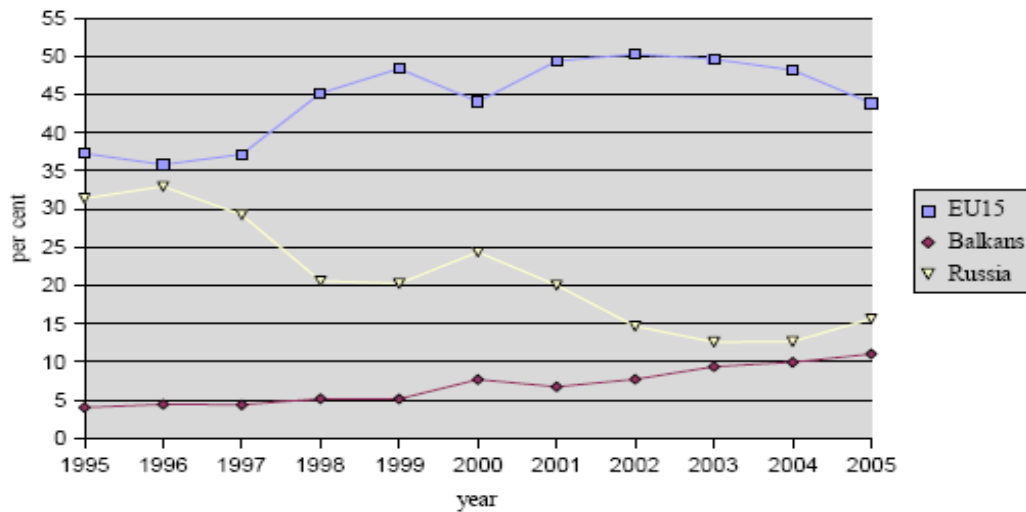


Source: BNB

Concerning the imports, we can note the same tendency: fall of imports from the EU and increase of imports from SEE countries. The regime of currency board and deficit of trade balance make that imports from the EU decrease naturally. There is a second reason of this situation: indeed, a large part of Bulgarian imports is constituted of energy

supplies. It explains the increase of imports coming from Russia. The imports from Balkan countries became again possible after the Kosovo conflict in 1999 and it is clearly shown by the figure 2

Figure 2 Evolution of Bulgarian Imports 1995-2005 (%)



Source: BNB

It results finally that the determination of Bulgarian trade relation with the EU and the Balkan countries depend more on non-economic factors (political, historical or ideological) than on economic ones. It appears, then, that the regional cooperation with its neighbours will work better after the accession of all these countries in the EU. Moreover, Bulgaria will normally become a full member of the EU at the beginning of 2007 and will have to adopt the EU external tariff and all other EU preferential arrangements. It means that the SEFTA will not exist for Bulgaria after its accession. To avoid the “cancellation” of the Balkan FTA because of the departure of two substantial partners (Bulgaria and Romania), the EU has to accelerate the trade liberalisation with SAA countries to reach the level of current liberalisation in the EU. This equalisation of treatment will certainly boost the trade on the two levels: the Balkan area and the EU enlarged market.

Conclusion

The time has come for Balkan countries to seriously cooperate between them and in this way ensure the peace and stability in the region. But the success of the regional cooperation is important for SEE countries, but also for the EU. It becomes possible with the Stability Pact – the largest initiative- and namely through the establishment of the SEFTA. This commercial commitment is seen as a mean to increase growth and investment, which are durable sources of peace. But the heterogeneity of Balkan economies and their different status vis-à-vis the EU accession, do not allow the appearance of real intra-regional trade potential. For these small and under-developed countries, the SEFTA will play more political role than economic one. It will facilitate the future integration with the EU and will contribute to their wider political integration. As we showed, the trade opportunities and regional cooperation will be increased with the faster and closer integration with the EU.

This experience is testified by the strategy of Bulgaria. Its participation in regional processes improves the image of Bulgaria - it is a country that can collaborate with its neighbours - but in the same time, the principal objective is the accession to the EU. Thus, regionalisation and the SEFTA, for Bulgaria and for all SEE countries, are processes that exist through the perspective of EU integration.

If EU’s objective is that SEFTA works, than EU has to show to all Balkan countries that the regional integration is not an alternative to EU accession. The EU has also to reduce the times to give the status of candidates for Western Balkans. It will be a larger stimulus to cooperate and avoid other conflicts. In addition, the EU, as a major actor in the Balkans has to act quickly because even in May 2006 we assist to a disintegration process on the one hand and instability on the other hand. Indeed, the referendum in Montenegro on 21 May 2006 gives the political independence of this country which may be a source of tension. Moreover, the indefinite status of Kosovo may destabilize the region again.

Finally, it appears with our study that it is very difficult to see any scenario, under which these Balkan countries are politically stable and economically prosper without economic and political integration with the EU. In this case, regionalisation process seems to be only a stage towards European integration.

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