

# Peripheral European Transitions: Performance, Structure and Trade Relations in the Balkan Region\*

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## Abstract

This paper argues that the process of transition in Europe has a very strong geographical dimension, resulting to new regional divisions at the European level. It presents evidence that the adjustment of the Balkan transition economies to the international environment after 1989 has been associated with poor growth performance, inferior economic and export structures, and diverging productive bases. Our analysis suggests that the liberal trade policies that were uniformly imposed by the EU had an adverse effect on countries with unfavorable initial conditions and unfavorable geographical coordinates. It also suggests that a better understanding of the complex aspects of internationalization of peripheral economies is needed, as is a 'new policy consensus' addressing the real barriers that prevent them from seeking a better place under the globalized sun.

**JEL Classification:** P20, O4, F10, O18

**Keywords:** Transition, Peripherality, Growth, Trade, Balkans.

## 1. Introduction

Despite early euphoria about a rapid transition of Central and Eastern European countries to western type of economies and levels of development, the 1990s have been characterized by wide variations in processes and outcomes.

Although the overall record is well below initial expectations and by no means impressive, some transition countries have done better, managing to overcome the initial shock of systemic change and at least regain at the end of the decade their 1989 production levels. Most others were not so fortunate. Serious contractions in output,

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repeated recessions and a mix of policy and market failures in a number of countries have resulted in a multi-speed and perhaps multi-direction transition process (Petraikos 2000, Petraikos 2001a, Petraikos and Totev, 2001).

Most early interpretations linked the weak recovery of transition economies with a “reluctance” or “inability” of policy makers to exercise serious restructuring policies (De Melo, et al 1996, World Bank, 1996). However, other studies (Krueger and Ciolko, 1998, Altvater, 1998) have emphasized the importance of the ‘initial conditions’ in a series of countries, which have had a negative experience during the first decade of transition.

These initial conditions refer to a number of factors such as prior experience with market institutions, level of development, degree of COMECON trade dependence (Petraikos, 2002), regional conflicts, dissolution of national states and fragmentation of economic space (Petraikos 2001a) and the quality of technical and social infrastructure (Skayannis, 2001). To this list, one may add the relatively conservative nature of initial EU policies towards transition (Kotios, 2001). These policies emphasized institutional rather than economic assistance and favored an allocation of funds that was not in proportion to the actual problems faced by each country.

This paper intends to show that the process of transition in Europe has very clear geographical coordinates, resulting in new regional divisions at the European level. It is now recognized that geographic features play a significant role in the economic progress of any given country, influencing both the prospects for development and the effectiveness of any set of policies (Sachs, 1997, Gallup et al., 1999, Gallup and Sachs, 1999, Petraikos, 2000). The examination of the geographic characteristics of the transition countries shows that some of them enjoy more favorable conditions than others, being closer to, and having common borders with the developed countries of Western Europe. This provides them with a possible strategic advantage, which, in the long run, is expected to lead to a more intense interaction and integration with the western centers of development. This is facilitated through intense trade, capital flows, information flows, the spread of knowledge and technology, the interaction of people, the adoption of successful organizational prototypes, and the adoption of important institutions and mechanisms, all of which are ‘transferred’ into the transition economies from the West.

The above is in line with the argument that geography works positively and cumulatively for the countries that are favored by it and negatively for those that are not. To the degree that this is true, the transition countries that are favored by geography should be more developed and better placed in the new post-1989 economic environment. Geography and initial conditions tend to shape a new spatial division of Europe, in which the Balkan transition countries occupy the last places.

In the next section, the paper presents and discusses aspects of economic performance and structure of the Balkan region, while in the third section the paper analyses its trade relations. The analysis in these two sections compares, with the use of aggregate figures, the Balkan region to the Central European countries and the European Union. In the last section the paper presents some concluding remarks and policy recommendations.

## 2. Growth, Performance and Structure

Although data on individual countries are readily available from international organizations, regional aggregates require a little exercise and a precise view of what regions need to be compared. We chose to compare the Balkan region<sup>1</sup> with the Central European region<sup>2</sup> and the EU, in order to test our hypothesis that in the new European economic space the Balkans are diverging in terms of performance and structure from the average figures of the other two regional aggregates.

**Table 1.** Basic indicators of size, economic activity and welfare in Europe, 2000

Countries	Area		Population, 2000		GDP, 2000			GNP per capita (USD), 2000		Share of agriculture in GDP 2000
	th.km <sup>2</sup>	million	density	billion USD	89=100	density	USD	EU15=100		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)		
EU-15	3,350	376.7	112	7,842.4	127	3,847	22,424	100	2	
Transition countries	1,353	128.8	95	402.7	95	335	3,247	14	9	
Central Europe	564	66.3	118	291.4	116	517	4,568	20	4	
Balkan region	614	55.0	90	87.9	72	141	1,681	7	17	
Total Europe	5,068	517.2	102	8,646.7	119	2,971	17,971	80	4	

Sources: *World Bank (2002), UNECE (2001)*.

1. The Balkan region in our analysis includes the following transition countries: Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Federal Republic of Yugoslavia, Former Yugoslav Republic of Macedonia and Romania. Greece is not included in the Balkans in this analysis for obvious reasons. Slovenia is not included both by virtue of geography and choice. Should Croatia be also excluded, the figures of performance and structure would be worse.

2. The Central European region in our analysis includes the following countries: The Czech Republic, Hungary, Poland, Slovakia and Slovenia.

Table 1 provides aggregate regional figures for a number of critical indicators<sup>3</sup>. First, some general information may be required at this point. In terms of size, the Balkan transition countries occupy an area of 614 thousand sq. km, which is equal to 18.3% of the size of the EU and a population of 55 million people, which is equal to about 14.6% of the EU figure. For comparison, the Central European (CE) countries occupy an area that is relatively smaller (564 thousand sq. km) and a population that is relatively larger (66.3 million people). These regional differences in land and population size generate different population densities, the rule being that relatively central regions on the European scale have higher densities than relatively peripheral ones (Petraikos, 2001b).

Second, in terms of economic size or capacity, we observe in column (4) that the Balkan transition countries had in 2000 a GDP figure that was equal to about 1,1% of the GDP of the EU and a GDP density (a measure of productive use of resources in column 6) equal to about 3.6% of the EU figure. For comparison, the Central European figures are 3.4% and 13.4% respectively.

Third, in terms of performance, we observe in column (5) that in the 1989-2000 period the EU has increased its GDP by about 27%, which amounts to an average annual growth rate of about 2%. On the other hand, the transition countries present a highly differentiated picture. Although in 2000 as a group they were still behind the 1989 level of GDP, the CE countries have recorded a much better performance, managing to increase GDP by 16% in the 1989-2000 period. By contrast, the Balkan transition countries are still behind, with GDP levels equal to 72% of the 1989 figures<sup>4</sup>. Note that the contraction of GDP in the region has coincided in the 1990s with a serious contraction of labor force due to strong migration movements (King 2000). An East-West pattern of (mostly illegal) migration has evolved, where the countries of origin are all Balkan Transition countries, but especially Albania and the countries of destination are all Western European countries, but especially Greece and Italy (Kotzamanis, 2000)<sup>5</sup>.

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3. Aggregating countries of different size, population, ethnic origin, etc., is always a problem, as in the end each country is a unique case. However, the Balkan countries justify such an aggregation, not only in geographical terms, but also in terms of a number of economic characteristics. As Table 1A (in the Appendix) indicates, they share similar levels of development and have a similar economic structure.

4. GDP figures for the year 2000 are lower in the Balkan region than those of the year 1999, due to the war in Kosovo.

5. Albania has lost due to emigration in the 1990s nearly 1/3 of its labor force, which has caused a significant reduction of population. Bulgaria and Romania have also experienced a contraction of their population due to migration, while other countries in the region such as Serbia, Bosnia, Croatia and FYROM have experienced a mix of emigration and immigration movements in the 1990s, comprised by ethnic minorities, refugees and internally displaced people (Kotzamanis 2000). On the other hand, Greece

Fourth, in terms of welfare (measured by 2000 GNP per capita in column (8), we observe that the transition countries in Europe are far behind the EU level, which is a little higher than 22 thousand USD. CE countries are in a relatively better position with GNP per capita equal to 4,568 USD or 20% of the EU figure. The Balkan countries have been less fortunate, recording GNP figures equal to 1,681 USD or 7% of the EU level respectively. Even if these figures are adjusted for purchasing power differences, the fact remains that a serious developmental gap exists in Europe with a West-East and North-South character<sup>6</sup>.

Finally, in terms of economic structure, we see that in 2000 the Balkan region maintains a very high dependence on agriculture and therefore a productive structure that is reminiscent of earlier stages of development in Europe. As column (9) shows, the EU and CE have similar low shares of agriculture in GDP (2% and 4 % respectively), while the Balkan transition countries still maintain 17% of GDP in agriculture. Earlier reports (Petraikos and Totev, 2000) indicate that in some Balkan countries the share of agriculture in GDP has increased during the post 1989 period.

Thus, the experience of this decade has shown that not all the transition countries have suffered the same fate, nor do they face the same difficulties today. The transition process has created (or uncovered) inequalities previously unknown in the European context, inequalities which exceed greatly those existing between the North and the South within the EU. The most negative characteristic of the new economic space is the increasing gap between the EU and the Balkan countries, and the lack of any immediate prospect for its reversal (Petraikos and Totev, 2001).

Table 1 reveals that in transition countries in Europe there is a north-south (or a core-periphery) divide, which parallels the one found in the EU. In the EU the Northern and Western European countries are more advanced economically than the Southern European countries. In the CEE, the Visegrad countries are more advanced than

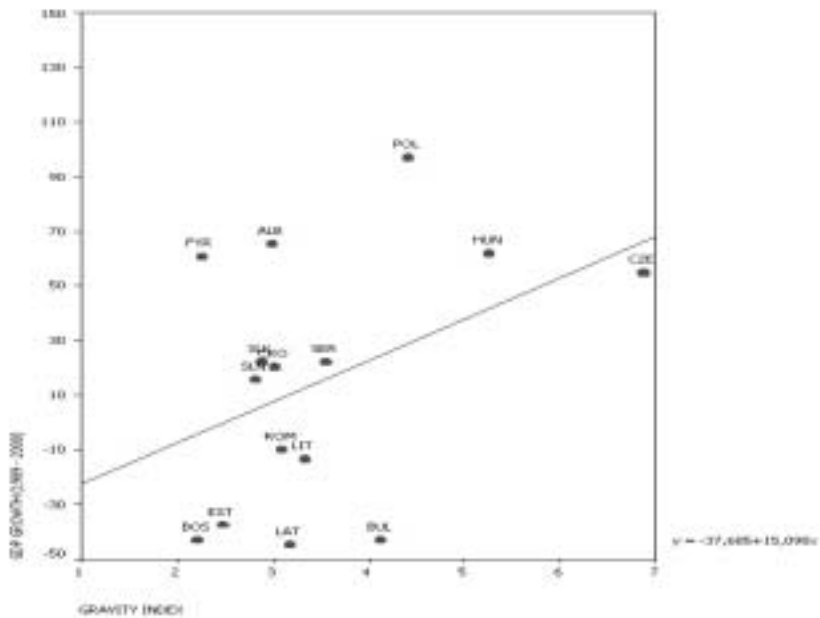
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has turned from a labor-exporting country in the 1960s and 1970s to a labor-importing country in the 1990s (Lianos et al., 1997). In fact, it has become the sole recipient country in the region with immigrants amounting to a figure close to 1 million people, which is equal to about 9 percent of the population of the country and about 12 percent of its labor force (Labrianidis et al., 2003). On the basis of immigrants' applications for legalization, it is estimated that about 65 percent of the immigrants are Albanians, about 7 percent are Bulgarians and about 5 percent are Romanians. Overall, immigrants from Balkan countries are about 77 percent of the total number and make up the large majority of immigrants in Greece (Kavounidi, 2002, Labrianidis et al., 2003). It seems that in the new geography of migration in Europe, the Balkans have experienced this phenomenon in a relatively more intense way, either as countries of origin, or a countries of destination.

6. Note that the Mediterranean countries comprising the 'South' in the EU (Greece, Portugal and Spain) had in 2000 a GNP per capita figure equal to about 65% of the EU average. This implies that the economic divides characterising the new Europe may be more serious than those existing in the pre-1989 period.

the Balkan countries. It is undoubtedly true that within the context of the profound changes that are shaping the new Europe, the least progress in all sectors is found in the Balkans. On the basis of existing information, the new economic divide of Europe is taking a northwest-southeast shape, with the southwest, the central and the north-east regions occupying intermediate positions. On the basis of one recent estimate (Petraikos, 2000), the Balkan countries will take twice as long as the countries of Central Europe to approach the EU level of per capita GNP.

Can we establish in a more formal way the relation of performance under transition to geography? In Diagrams 1 and 2 we present the relation of GDP growth (1989-2000) and GDP per capita (2000) to the geographical position of each country, measured by gravity index<sup>7</sup>. This index is a measure of centrality and accessibility of each

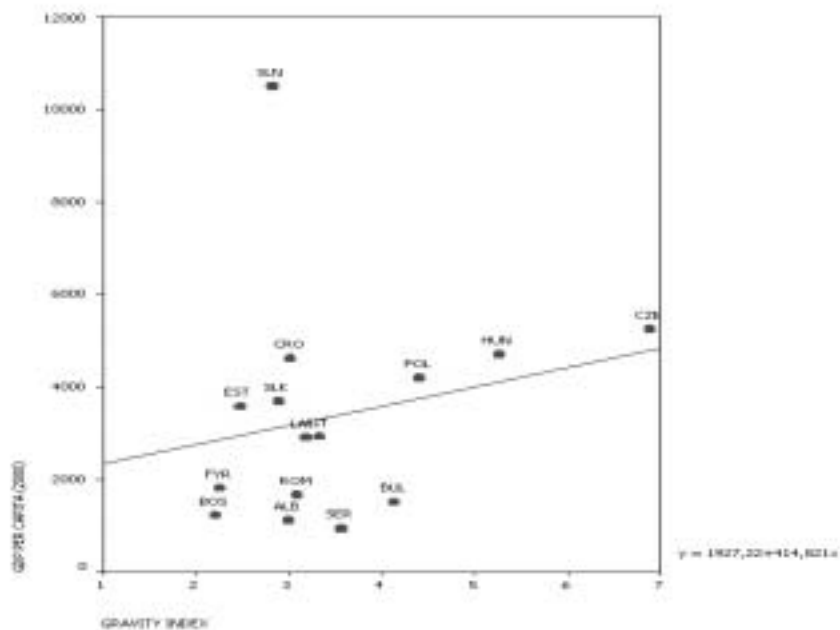


**Diagram 1.** The relation of GDP growth performance (1989-2000) to the geographical coordinates of Transition countries in Europe.

7. Following Petraikos (2000), we estimate the gravity index from the formula:

$$G_i = \sum (P_j / d_{ij}) + P_i \quad i = 1, \dots, 15 \text{ (Transition countries)}, \quad j = 1, \dots, 33 \text{ (All European countries)}$$

where:  $P_j$  is the population (or market size) of each country  $j$  and  $d_{ij}$  is the air-travel distance between the capitals of two countries  $i$  and  $j$ . The term  $P_i$  has been added in order to take into consideration the distance of each country from its own market.



**Diagram 2.** The relation of GDP per capita (2000) to the geographical coordinates of Transition countries in Europe.

country in the Pan-European economic space. Relatively high values of the index indicate countries with a more central place, while relatively low values indicate countries with a peripheral place in the European economic space.

Although the relation of geography to economic performance and development may be more complicated than our diagrams suggests, it seems that more central and accessible Transition countries have had a better growth performance and a higher level of development. This finding is in line with the analysis in Table 1 and indicates that the geographical coordinates of each country play a significant role in affecting final outcomes in terms of economic performance. Countries that are better placed in the new European economic space are *ceteris paribus* more likely to be faster growing and with a higher development level than perimetric ones.

### 3. International economic relations

Most trade theories would suggest that the post-1989 internationalization of transition economies is a necessary (in the best case), or inescapable (in the worst case) process,

which under certain assumptions and conditions results in important economic (though not only economic) benefits to these countries.

Recently, however, the widely accepted perception that the liberalization of trade is beneficial to all countries without exception (positive sum game) has begun to be criticized at various levels. First of all, at the theoretical level the simple models of international trade are beginning to be questioned by more recent ones, which take into consideration imperfections in the market, the cumulative effect of economies of scale in production, as well as the role of transportation costs and geography on economic relations (Krugman, 1991, 1994, 1995). The existence of production systems that deviate from full competition (such as oligopolistic and monopolistic competition), and the development of internal and external economies of scale in production processes can lead to trade relations between two or more countries which do not contribute to balanced development, but instigate a cumulative process that can evolve in favor of one country (and perhaps, but not necessarily) at the expense of another.

A second problem is related to the structure of trade relations between countries that are at greatly differing levels of development. The liberalization of trade may lead<sup>8</sup> less developed countries (or the South) to specialize in labor-intensive or raw material-intensive products, and to import most of the products that embody technology and high quality physical and human capital. Such a division of labor (which is considered optimal by mainstream trade theories) does nothing more than confine these countries to intransigent and perhaps long-lasting underdevelopment, which hampers the industrialization of their production system and maintains the gap between them and the developed countries. Thus the most important problems in North-South relations are these intense inter-industry characteristics, which largely impose a geographical division that does not favor convergence in the productive sectors or in the levels of development.

On this basis, the picture for the impact of internationalization on transition countries is quite complex and does not allow simplification. On the one hand, recent experience has shown that full-scale trade liberalization may be associated with a shift towards inferior productive structures<sup>9</sup>. On the other hand, there is an agreement

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8. Especially in the absence of FDI.

9. Here, the experience of Greece, which became a member of the EC (EU) in 1981 without any essential preparation, is perhaps indicative. During the entire decade of the 80's and at least half the decade of the 90's it experienced an abrupt increase in its trade deficit with the EU (which deficit, in monetary terms, was not balanced by the inflow of EU funds), and simultaneously a significant contraction of its industrial base, especially in sensitive sectors. These two parallel and interconnected developments were due – among other things – to the inability of Greek companies to withstand the competition from larger and technologically more advanced European companies (PetraKos and Zikos, 1996, PetraKos and Pitelis, 2001).



among experts that withdrawing from the international market can be quite harmful for any country. It is clear that no country, especially a developing one, can be self-sufficient. The example of Albania, which chose isolation for four decades and drove its population to a desperate level not found anywhere in Europe today, indicates that this is true. The same is suggested by the imposition of trade sanctions by the United Nations on autocratic regimes as a means of exercising international pressure for their democratization. Isolation (or strong protection), thus, has serious costs.

The above tends to suggest that, although lack of trade is a serious problem for any less advanced or even advanced country, the type of trade relations, or the type of integration into the international economy matters. Inter-industry trade, export dependence on a few low technology sectors and unbalanced relations may reduce the long term prospects of less advanced countries to follow a western type of industrialization and development.

Keeping in mind the advantages, opportunities, but also possible threats associated with the internationalization of transition economies, we proceed with the examination of aggregate and sectoral trade performance of the Balkan countries. Besides the figures related to the Balkan region, we also present, for the purpose of comparison, aggregate figures from CE countries and the EU.

### *3.1 Basic Tendencies in the International Trade of the Balkan Countries*

In Table 2 we present the exports (X), imports (M), the trade surplus or deficit (X-M) and the export-import ratio (X/M) of the transition Balkan countries, the countries of Central Europe and the European Union for the period 1990-1999. In Table 3 we present information that refers to the evolution of exports (X) and imports (M) in relation to the base year (1990 = 100), the share of exports in GDP, as well as the ratio of trade surplus or deficit as a share of GDP [(X-M)/GDP].

On the basis of this data we can make a series of observations regarding the evolution of the trade relations of the Balkan countries as compared to those of Central Europe and the EU. First of all, both the exports and imports of CE (especially at the end of the period under examination) are significantly greater than those of the Balkan transition countries, in spite of the fact that population in both groups of countries is roughly the same.

Second, we can observe that the countries of Central Europe reveal a greater potential in their foreign trade, as they more than doubled their exports (increase of 166%) and more than tripled their imports (increase of 240%) during the ten-year period. The comparable increase in exports and imports for the transition Balkan countries was 32% and 120% respectively.

**Table 2.** Exports, Imports and Balance of Trade for the Balkans, Central Europe and the European Union, 1990-1999  
(in U.S. dollars)

Countries/Regions	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Balkan Transition	X	20.807	15.727	16.431	21.011	22.443	27.957	28.981	26.331	27.640
Countries	M	17.350	14.015	16.554	20.340	20.531	31.407	36.014	31.642	38.274
	X-M	3.457	1.712	-1.23	671	1.912	-1.486	-7.033	-5.311	-10.634
	X/M	1.20	1.12	0.99	1.03	1.09	0.89	0.80	0.83	0.72
Central Europe	X	46.892	45.763	52.204	62.556	74.590	107.838	115.507	127.107	124.505
	M	43.842	51.149	54.054	68.205	74.572	117.803	125.880	139.278	144.742
	X-M	3.051	-5.386	-1.849	-5.649	18	-9.965	-10.373	-12.171	-20.237
	X/M	1.07	0.89	0.97	0.92	1.00	0.92	0.92	0.91	0.86
European Union	X	1.974.520	1.977.633	2.133.515	1.970.826	2.202.522	2.737.167	2.722.719	2.545.847	2.856.415
	M	1.948.667	1.980.100	2.112.557	1.866.719	2.076.752	2.493.967	2.522.433	2.653.525	2.784.528
	X-M	25.853	-2.466	20.959	104.107	125.770	160.648	192.667	200.287	71.887
	X/M	1.01	0.99	1.01	1.06	1.06	1.06	1.08	0.96	1.03

Sources: Own estimates from World Bank (2001).

**Table 3.** Exports, Imports (1990 = 100), the Ratio of Exports to GDP and the Balance of Trade to GDP for the Balkan Countries, Central Europe and the European Union, 1990-1999

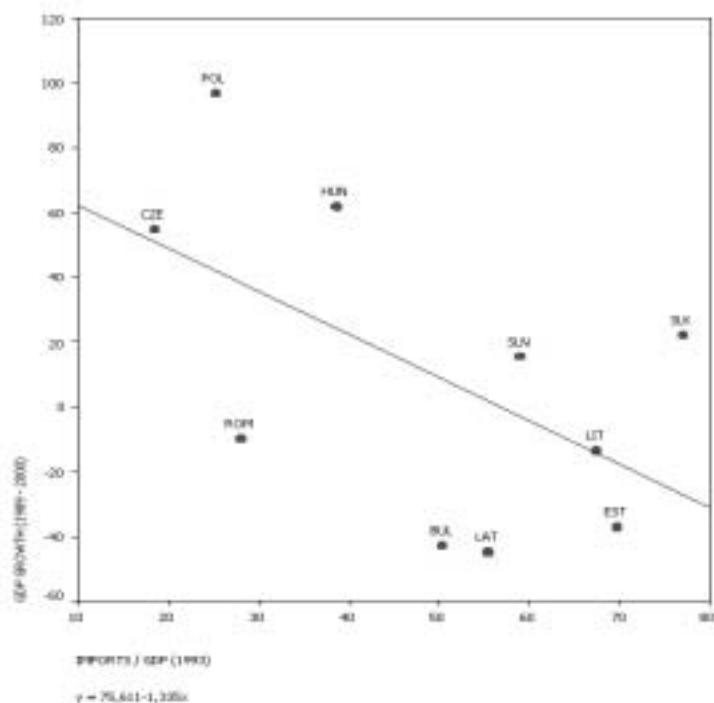
Countries/Regions	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Balkan Transition										
X	100.0	75.6	79.0	101.0	107.9	127.3	134.4	139.3	126.6	132.8
M	100.0	80.8	95.4	117.2	118.3	161.3	181.0	207.6	182.4	220.6
X/AEP	14.5	10.9	12.6	18.9	19.6	26.0	30.6	32.5	27.3	29.3
(X-M)/AEP	2.4	1.2	-0.1	0.6	1.7	-1.5	-3.8	-7.9	-5.5	-11.3
Central Europe										
X	100.0	97.6	111.3	133.4	159.1	218.4	230.0	246.3	271.1	265.5
M	100.0	116.7	123.3	155.6	170.1	234.4	268.7	287.1	317.7	330.1
X/AEP	33.7	29.0	30.0	34.7	36.9	40.9	39.4	42.6	43.6	42.0
(X-M)/AEP	2.2	-3.4	-1.1	-3.1	0.0	-0.1	-3.6	-3.8	-4.2	-6.8
European Union										
X	100.0	100.2	108.1	99.8	111.5	134.4	138.6	137.9	128.9	144.7
M	100.0	101.6	108.4	95.8	106.6	128.0	130.6	129.4	136.2	142.9
X/AEP	37.6	27.4	27.2	27.5	29.0	30.6	30.7	32.4	29.6	32.6
(X-M)/AEP	0.5	0.0	0.3	1.5	1.7	1.9	2.2	2.4	-1.3	0.8

Sources: Estimations from Table 2.

Third, in spite of the rapid increase in imports, the countries of Central Europe maintained in 1999 a trade deficit as a share of GNP (-6.8%), which was less than that of the Balkan transition countries (-11.3%).

Fourth, we see that the export orientation of the transition Balkan countries expressed by the export-to-GDP ratio (X/GNP) is lower than that of the countries of Central Europe for the entire period.

Fifth, the ratio of exports to imports (X/M) in the Balkan countries is smaller than that of the countries of Central Europe. This ratio denotes the value of products that each country is able to export for each dollar of imported goods, and its evolution can be taken as a measure of competitiveness in international commodity markets. Thus, in similar trade regimes, index values that are less than one and declining indicate trade deficits and limited potential for offsetting the penetration of foreign goods into



**Diagram 3.** The relation of GDP growth performance (1989-2000) to the Imports/GDP ratio (1993) of Transition countries in Europe.

domestic markets. Conversely, index values greater than one indicate trade surpluses and a more competitive production system<sup>10</sup>.

Sixth, in contrast to the transition economies both in the Balkans and in Central Europe, the EU-15 does not show a trade deficit, but on the contrary has maintained an X/M ratio greater than one, and a trade surplus for eight out of the past 10 years.

There is a series of interesting conclusions from the above analysis, which are worth discussing. On the one hand, transition from central planning to a market economy has been accompanied, without exception, by an increased deficit, owing, in large degree, to the opening of these economies, to their limited competitiveness and to the collapse of a significant part of their production base. Another factor, which may have had a negative influence on the fate of exports from the transition countries, is the 'Association Agreements' that they signed with the EU. These agreements include regulations on free trade that exclude a series of sectors and industries which are 'sensitive' for the EU (e.g. agricultural products, textiles, iron and steel, etc.), but in which the transition economies had traditionally a strong presence and a comparative advantage (Kotios, 2001).

The second general conclusion relates to the transition Balkan countries, whose foreign trade record is less auspicious than that of the central European countries<sup>11</sup>.

Their lower rate of increase in exports, their lower ratio X/GNP and X/M, and their larger deficits, suggest greater difficulties of adjustment to the new international economic environment<sup>12</sup>.

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10. Obviously, this interpretation of the X/M ratio is not taking into consideration developments in the capital market. Several advanced countries (like USA) have increasing trade deficits and still a very competitive economy. In the case of transition countries however, capital inflows have been limited (and below expectations), while the Balkans have almost been ignored by international capital. As a result, the evolution of commodity trade balances can be used as a rough indicator of international competitiveness.

11. Trade flows in the region have not been affected in a systematic way by exchange rate policies. The reason is that actual policies have varied widely in the region, with different countries adopting different exchange rate regimes and following different policy rules (Rosati, 2000). At the one extreme, Bulgaria and Bosnia have adopted currency boards, while at the other Albania and Romania have a freely floating exchange rate (Gligorov, 2001). The available experience tends to indicate that fixed exchange rates have been more effective in eliminating inflation, especially at the early stages of Transition. It also indicates they should not be maintained for long in a post inflationary environment, as they lead to currency appreciation and increase trade deficits. In any case, the evidence does not provide a clear picture about the impact of exchange rate policy on economic and trade performance. Different experiences indicate that the actual 'initial conditions' prevailing in each country have played a decisive role in affecting exchange rate policy rules.

12. Although the wars in Bosnia and Kosovo have certainly affected economic and export performance, it would be a methodological mistake to attribute most or all difficulties of the region to the war. Countries like Bulgaria and Romania, that have not been directly affected by the war have faced similar problems.

To what extent can trade liberalization and openness be responsible for economic underperformance in the region? Diagram 3 presents the relation of GDP growth in the period 1989-2000 and the Import-to-GDP ratio for the year 1993. It presents a negative relation indicating that the countries with the weaker economic performance had also the higher degree of import penetration. Although causality may actually run both ways, our diagram seems to suggest that openness and liberalization in weak economies may have been one of the contributing factors in their economic underperformance.

### *3.2 The Sectoral composition of Balkan Trade with the EU*

The sectoral composition of trade of the transition countries, and especially the Balkans, is of interest for two main reasons, which are related to the adaptation of their production system to the opening of their economies. The first reason refers to the sectoral differentiation or concentration of exports and is related to the breadth and types of export specialization of a country. The second reason – which is directly related to the first – refers to the types of relations that are established between the Balkan countries and developed countries, especially the EU.

The following analysis is based upon Tables 4 and 5. Table 4 presents the sectoral exports composition of Balkan Transition countries and Central European countries to the EU. It also presents the sectoral composition of intra-EU exports. It is important to examine the structural aspects of Balkan-EU trade because the EU has emerged as the principal trade partner of these countries and because this relation involves partners at different levels of development. Knowledge of the actual evolution of trade structures will be helpful to evaluate on the one hand the future prospects of this relationship and on the other the EU trade policies vis-à-vis Transition countries. The data refers to aggregate regional exports in three 4-year periods: 1988-91, 1992-95 and 1996-99. They provide sectoral exports shares that allow comparison of the Balkan countries with Central Europe and the EU. The first period describes more or less the 'initial conditions' of the region with respect to its trade structure with the EU, while the third period describes the structure of exports that has been shaped in a relatively advanced stage of transition<sup>13</sup>.

The presented figures concern fourteen 2-digit NACE sectors and are based on sectoral trade data provided by Eurostat (2000). Also, at the bottom of the Table are

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13. We use 4-year period instead of the first and the last year of the period in order to minimise the influence of random or irregular events as well as the volatility that characterises annual trade data. In that respect, comparisons based on 4-year export figures are more safe.

**Table 4.** Sectoral Composition of Aggregate Exports from the Balkan Countries and Central Europe to the EU and Intra-EU Trade.

2-Digit NACE Sectors for the Periods 1988-91, 1992-95 and 1996-99.

Sectors	NACE	Transition Balkans					Central Europe					EU	
		1988-91	1992-95	1996-99	1988-91	1992-95	1996-99	1988-91	1992-95	1996-99	1988-91	1992-95	1996-99
Food, beverage, tobacco	DA	8.6	8.4	6.5	18.6	7.9	5.9	12.8	13.0	11.4	12.8	13.0	11.4
Textiles & textile products	DB	22.6	27.9	31.1	12.8	14.9	10.9	6.6	6.0	5.1	6.6	6.0	5.1
Leather & leather products	DC	5.0	8.3	10.4	3.6	3.5	2.3	1.7	1.5	1.4	1.7	1.5	1.4
Wood products	DD	4.0	3.7	4.2	4.5	4.6	3.7	1.2	1.2	1.1	1.2	1.2	1.1
Paper, Printing, Publishing	DE	2.2	1.3	0.9	2.1	2.5	2.1	4.4	4.3	3.8	4.4	4.3	3.8
Fuels production	DF	7.2	2.6	1.3	7.0	4.3	3.3	3.5	3.0	2.7	3.5	3.0	2.7
Chemicals	DG	4.6	5.2	4.2	6.9	4.7	3.6	8.5	9.2	9.7	8.5	9.2	9.7
Rubber & plastic products	DH	3.7	4.1	3.8	4.0	4.3	4.3	6.0	6.1	5.9	6.0	6.1	5.9
Mineral materials	DI	3.1	4.2	3.1	5.6	5.2	3.7	3.4	3.2	2.9	3.4	3.2	2.9
Basic metals & fab products	DJ	14.2	14.1	16.9	15.3	15.5	11.9	9.1	8.7	8.1	9.1	8.7	8.1
Machinery, except electrical	DK	5.3	4.0	5.0	5.7	7.7	13.4	13.6	13.2	14.5	13.6	13.2	14.5
Electrical & optical equipment	DL	5.4	4.4	4.8	4.4	8.8	14.6	10.5	11.1	12.4	10.5	11.1	12.4
Transport equipment	DM	7.3	4.3	2.1	4.3	8.6	13.2	15.2	15.7	16.4	15.2	15.7	16.4
Other	DN	6.8	7.5	5.7	5.2	7.6	7.2	3.4	3.7	4.6	3.4	3.7	4.6
Total	Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Consumer	DA - DE, DN	49.25	57.05	58.87	46.84	40.91	32.10	30.16	29.71	27.41	30.16	29.71	27.41
Intermediate	DF - DJ	32.83	30.20	29.25	38.73	33.98	26.72	30.52	30.22	29.33	30.52	30.22	29.33
Capital	DK - DM	17.92	12.75	11.87	14.43	25.11	41.18	39.33	40.06	43.26	39.33	40.06	43.26

Source: own estimates from Eurostat cd (2000).

listed three general categories of sectors: consumer, intermediate and capital goods, for which are also given their percentage share in total exports for the same periods.

Here we must point out that our sectoral analysis is restricted to exports and does not include imports since our interest is focused on the adaptation of the production system of the Balkan economies to the new conditions of international competition. As for the imports, we can say that their sectoral composition is similar in all transition countries, influenced by the extension and consolidation of Western type consumption patterns.

How does the overall export structure of the Balkans compare with that of the countries of central Europe and the EU? In Table 4 we observe, first of all, that CE maintains a greater sectoral spread of exports than that of the Balkans. In the 1996-99 period it exhibits a significant export activity (sectoral share of exports above 10% of the total) in five sectors, compared to three in the Balkans.

Second, we observe that CE exhibits a sectoral composition of exports that is similar to that of the EU. If we examine the division of exports among consumer, intermediate and capital goods sectors, we see that the Balkans have a composition which differs considerably from that of the EU, while CE has one that is similar to that of the EU. Where are the differences found? They are found basically at two points. First, in the 96-99 period, the Balkan countries exhibited a large concentration of exports in the consumer goods sectors (58% of the total), and a very small concentration in the capital goods sectors (11% of the total). In contrast, CE and the EU exhibit a relatively smaller concentration in the consumer goods sectors (32% and 27% of the total respectively) and a clearly larger concentration in the capital goods sectors (41% and 43% of the total respectively). In addition, while the tendency over time in the Balkan countries has been to increase the share of the consumer goods sectors and withdraw from the capital goods sectors, the tendency in CE and the EU has been exactly the opposite<sup>14</sup>.

Thus, it becomes evident from the above that the transition process for the Balkan countries has taken a completely different route from that of the CEE countries. The Balkan countries started the process of transition with an export composition characterized by a limited share of capital goods sectors. Judging from the presented data, we can say that at the end of the period this share has become even smaller. The Central European countries, in spite of the fact that they started with an export composition that was quite similar to that of the Balkans, have increased significantly the participation of capital goods sectors in their exports. Thus, two different paths characterize

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14. This trend must have been influenced also by EU cross-border FDI in Central Europe that tend to influence the structure of CE-EU trade with their exports to home markets.



**Table 5.** Index of Intra-industry Trade (IIT) in the Trade of the Balkan and Central European Countries with the European Union (2-digit sectors).

Years	Balkan Transition	Region Central Europe	EU
1988	0.48	0.46	0.97
1989	0.50	0.45	0.96
1990	0.54	0.47	0.97
1991		0.50	0.97
1992	0.52	0.51	0.97
1993	0.20	0.53	0.96
1994	0.16	0.56	0.96
1995	0.24	0.60	0.97
1996	0.28	0.61	0.97
1997	0.28	0.65	0.96
1998	0.25	0.69	0.97
1999	0.22	0.73	0.96

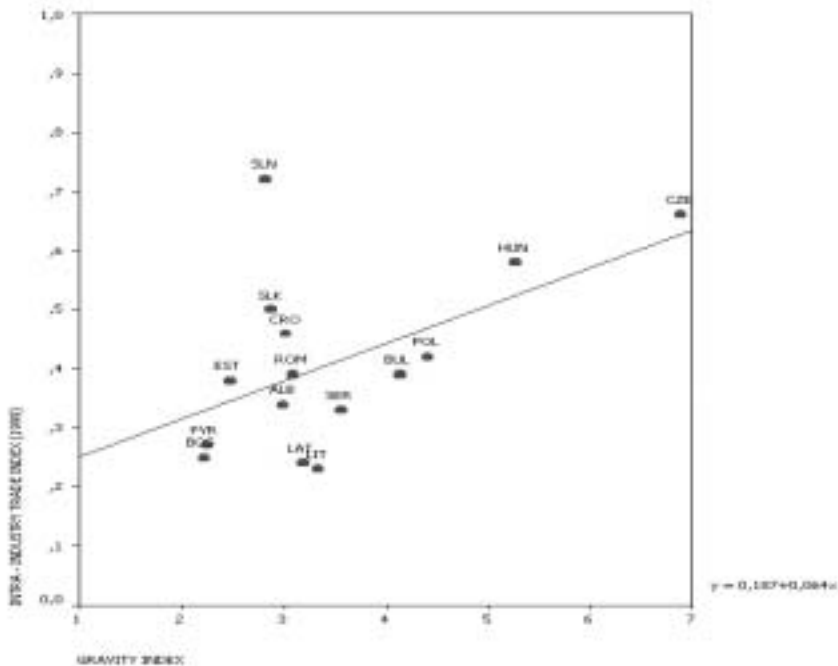
Source: Estimations from Eurostat (2000).

the transition process. While the Central European countries are developing an export structure that is converging with that of the EU, the Balkan countries present an export structure that is diverging from that of the EU.

Thus, the expectations based on mainstream economic thinking about the potential of markets to correct the structural weaknesses of all economies – irrespective of initial conditions – and steer them to a rapid convergence with the countries of the EU, has been anything but realized.

The immediate and complete liberalization of international trade (which was the undisputed goal of the leading transition school of thought and the EU as well) simply made more obvious the structural weaknesses (but also the faulty transition policy choices) of the Balkan countries. The decline of exports in the capital goods sectors clearly reflects processes that contribute to the consolidation (and reinforcement) of the North-South development and structural gap, not only within the EU but within the transition countries of Central and Eastern Europe as well.

In Table 5 we estimate the contribution of intra-industry trade between the EU and the Balkan transition countries, between the countries of Central Europe and the EU, and within the EU (i.e. intra-industry trade among the EU countries themselves) for the period 1988-99. The estimation uses export and import data for 2-digit sectors and is based upon the classic Grubel-Lloyd (1975) formula. The data presented indicates the share of trade for each country that takes place within sectors (intra-industry trade) for the period 1988-99. Obviously the residual percentages refer to trade between sectors (inter-industry trade).



**Diagram 4.** The relation of Intra-Industry Trade (1999) to the geographical coordinates of Transition countries in Europe.

We can observe that overall the transition Balkan countries exhibit a tendency for their intra-industry trade with the EU to decline over time. In contrast, the countries of Central Europe have managed to improve considerably the share of their intra-industry trade with the EU. Though they also began in 1988 with as low a percentage of intra-industry trade as the Balkans (46% of their trade in 1988 was intra-industry), they managed within a few years to develop their intra-industry trade with the EU, increasing it to the level of 73%. As we have already explained, this relatively high share is due in large part to the proximity of the entire CE, without exception, to the countries of the EU, which has allowed the development of cross-border trade relations. On the contrary, the Balkan countries have recorded a share of IIT with the EU that has remained low throughout the period, recording a figure equal to 22% in 1999<sup>15</sup>.

15. The abrupt decline of the IIT index for Balkan countries after 1992 is partly artificial and can be attributed to the collapse of former Yugoslavia and the identification of Slovenia with the CE and not the SEE group.

Though the explanation of this divergence between Balkan countries and the CE in relation to the indices of intra-industry trade is rather obvious, the depressing fact remains: the Balkan countries are receding over time into trade relations with the EU that have an increasingly inter-industry character. Given the declining share of capital goods industries in the exports of the Balkan countries, it is clear that this will lead these countries to specialize in labor, and, in all likelihood, raw material intensive sectors, insuring and preserving specialization in capital, technology and knowledge intensive industries for the EU (but also for the CE countries). It is also clear that this new division of labor at the European level, which maintains and intensifies the structural divide of economies, not only between the West and the East, but also within the East itself, has clear geographical coordinates.

Diagram 4 presents the relationship between the index of intra-industry trade (1999) and the gravity index. It shows that the Transition countries with a more central place in the Pan-European economic space and a greater proximity to Western markets tend to have a higher share of their trade with the EU taking place within sectors. Therefore, geography seems to matter as far as the structural adjustments of the Transition countries and their prospects for growth and balanced development are concerned.

#### **4. Conclusions**

The preceding analysis has shown that the adjustment of the Balkan economies to the international environment after 1989 has been anything but satisfactory. Inferior growth performance, weak economic structure, cumulative deficits, labor intensive export structures, and low (and declining) rates of intra-industry trade, constitute factors which imply a defensive type of adaptation, a limited and declining competitiveness and economic systems which are diverging as much from those of the EU as from those of the CE.

In a recent work, Jackson and Petrakos (2001) estimate the effects of structural changes in the external trade of transition countries on the rate of recovery of their economies. They find that countries characterized by export asymmetries have the fewest possibilities for economic recovery. In other words, their entrapment in inter-industry types of trade, the rapid withdrawal of their export sectors into labor-intensive and material-intensive industries, and the excessive trade dependence on the EU (with a parallel abandonment of every effort at cross-border trade) constitute structural rigidities which to a large degree neutralize the development efforts of a whole series of countries.

This adjustment reflects worse initial conditions of transition when compared to the CE, a less favorable geography and an unstable political environment with smol-

dering conflicts related to inter- and intra-national arrangements that were not resolved prior to (or right after) World War II. Under the weight of these factors, it is clear that the Balkan countries had less potential to adjust to the competitive conditions that were imposed upon all the transition economies after 1989 by uniform market liberalization policies.

Here exactly one finds the paradox, as much in the liberal approach, which supported immediate liberalization of trade, as in the policies that were finally chosen by the EU. While it was rather clear that there was not one single set of initial conditions and processes of transition in all the countries, a single set of policies was imposed. In other words, irrespective of the type and degree of ailment, the therapy was the same everywhere. The concept of 'infant industry' which has been taught for over two generations in universities, as an important reason for protecting 'young' industries, does not seem to have convinced of the need for its application to 'young' economies. The liberal (Shumpeterian) choice to support restructuring through the 'creative destruction' forces of competitiveness and internationalization has brought, in the medium term at least, serious negative results.

There is a policy-related lesson in this analysis for the EU: Restructuring and internationalization, the two basic policies of transition, must take into consideration the conditions and limitations of each economy, and be combined with discretion in ways, doses and choices of temporal lead that will free domestic economic forces without being fatal for many important elements of its productive base. This suggests that a better understanding of the complex (and especially the negative) aspects of internationalization of peripheral economies is needed in order to approach a 'new policy consensus' addressing the real barriers that prevent them from seeking a better place under the (globalized) sun.

There is also a lesson for economic analysis in this paper: The experience of the Balkans shows that the geographical coordinates of a country (or a region) can play an important role in the process of development and integration. For some countries geography may be an asset facilitating the right type of interaction with large markets and advanced economies, while for some others it may turn out to be a barrier. International economic theory needs to provide a better understanding of the relation between growth, integration and geography, if we are going to hope for more reasonable policy recommendations in the future.

There is, finally, a lesson for the development prospects of the Balkan transition countries that have reasons to worry that the traumatic experience of market (and policy) failures in the 1990s is going to be decisive for their future. While geography has certainly affected and continues to affect their performance, there is no reason to believe in a 'geographical determinism', or some kind of an inescapable process. Al-

though in economics there is a (to some extent justified) tendency to use past experience in order to forecast the future, fortunately, in real life the future is not just a projection of the past. People and countries learn from their past and also learn from others.

The 'initial conditions' of history, geography and structure will of course continue to play an important role, but they do not need to be the main determinants of the countries' performance. The international development experience has shown some, rare indeed, examples of less advanced countries that have managed to overcome their disadvantages and escape or partially overcome 'a lagging behind destiny'. Although each case is unique, one can learn many things from the experience of Korea in the 1970s, Ireland in the 1980s, and Central Europe in the 1990s.

Certainly, the existing divides in Europe will be maintained for the foreseeable future. In this line, the Balkan transition countries will be for a considerable period a 'periphery in the European periphery'. This status may not change easily, as the European hierarchy of places has been practically unaltered for decades or perhaps centuries. What can change however, is the welfare of the people and the distance of each country from the transition forerunners. Greece may still lag behind other EU members, but its people enjoy more affluence than in the past and are closer to the income levels of the average EU citizen. For the time being, this prospect is the best the citizen of the Balkan countries can hope for.

## APPENDIX

Table 1A. Basic indicators of size, economic activity and welfare in Transition countries in Europe

Countries	Area km <sup>2</sup>	Population, 2000		GDP, 2000		density (6)	GNP per capita (USD), 2000		Share of agriculture in GDP, 2000
		(2) Million	(3) density	(4) Billion USD	(5) 89=100		(7) USD	(8) EU15=100	
Albania	29	3,4	118	3,8	103	129	1120	5	51
Bosnia	51	4,0	78	4,4		86	1230	5	12
Bulgaria	111	8,2	74	12,0	74	108	1520	7	15
Croatia	57	4,4	77	19,0	81	334	4620	21	9
The Czech R.	79	10,3	130	50,8	98	643	5250	23	4
Estonia	45	1,4	30	5,0	84	110	3580	16	6
Hungary	93	10,0	108	45,6	105	491	4710	21	6
FYROM	26	2,0	78	3,6	81	137	1820	8	12
Latvia	65	2,4	36	7,2	64	110	2920	13	4
Lithuania	65	3,7	57	11,3	65	174	2930	13	8
Poland	323	38,7	120	157,7	127	488	4190	19	4
Romania	238	22,4	94	36,7	77	154	1670	7	13
Slovakia	49	5,4	110	19,1	103	390	3700	16	4
Slovenia	20	2,0	99	18,1	111	906	10050	45	3
Yugoslavia, F.R.	102	10,6	104	8,4	46	83	940	4	-

Sources: World Bank (2002), UNECE (2001).

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