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Challenges and Opportunities for the CEFTA Countries

A CEFTA-országok kihívásai és lehetőségei

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Abstract: The Central European Free Trade Agreement (CEFTA) was signed in 1992 by the countries of the Visegrád Group. Current CEFTA members are Albania, Bosnia and Herzegovina, the FYR Macedonia, Kosovo, Moldova, Montenegro, and Serbia. CEFTA serves as a preparation for EU membership. Once a country joins the European Union, it has to withdraw from the Agreement. CEFTA membership has given many opportunities to the countries. Trade with the EU has increased, while intra-CEFTA trade is less pronounced. The Agreement membership has also brought some challenges. The latest dispute happened in November 2018, when Kosovo increased its tariffs towards Bosnia and Herzegovina and Serbia because they were among the countries that had voted against Kosovo's membership in UNESCO and Interpol. Kosovo states that it has to protect its interest and economy. The CEFTA countries should put their differences and past behind, and focus on EU membership because they do not have an alternative. The quality of their products does not fulfill the EU standards, so they should also learn from the experience of former CEFTA countries; for example Poland, which is one of the biggest producers of cereals, cheese, poultry, and pork in the EU.

Összefoglalás: A Közép-európai Szabadkereskedelmi Megállapodást (Central European Free Trade Agreement, CEFTA) 1992-ben írták alá a visegrádi országok. A CEFTA-nak jelenleg Albánia, Bosznia-Hercegovina, Macedónia Volt Jugoszláv Köztársaság, Koszovó, Moldova, Montenegró és Szerbia a tagja. A megállapodás az európai uniós tagságra való felkészülést szolgálja, de amint egy ország csatlakozik az EU-hoz, ki kell lépnie belőle. A CEFTA számos lehetőséget biztosított a részes országoknak. A szerződés révén megvalósuló kereskedelmük az Európai Unióval növekedett, de egymás között nem igazán jelentős. A CEFTA-tagság kihívásokkal is járt. A legutóbbi nézeteltérés 2018. novemberben történt, amikor Koszovó megnövelte a vámtarifáit Bosznia-Hercegovinával és Szerbiával szemben, mivel azok az UNESCO- és Interpol-tagsága ellen szavaztak. Koszovó azzal érvel, hogy meg kell védenie az érdekeit és a gazdaságát. A CEFTA-országoknak félre kell tenniük az ellentéteiket és a múltjukat, s az uniós tagságra kell koncentrálniuk, mert nincs más alternatívájuk. A termékeik minősége még nem éri el az EU standardjait, ezért érdemes tanulniuk a korábbi CEFTA-tagok tapasztalataiból, például Lengyelországból, amely a legnagyobb gabona-, sajt-, baromfi- és sertéshústermelő az EU-ban.

HISTORY OF CEFTA

According to the Balassa classification, a free trade area (FTA) is the first stage of integration. It is formed when two or more countries sign a free trade agreement and abolish, fully or partially, tariffs, quotas, and customs with each others, while retaining their own trade policies towards the third countries. The European Union (EU) has always operated as more than an FTA. Currently, the EU is at the highest stage of integration; it is an economic and monetary union.

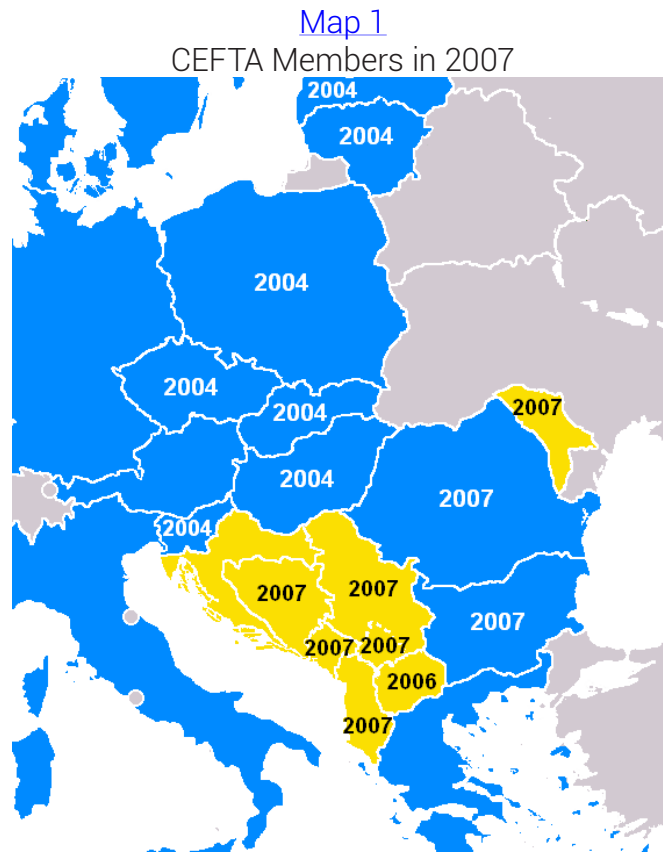


Its member states have trade liberalization, free movement of goods, services, capital, and people, unified trade policies towards the rest of the world, and nineteen member states share the same currency, the euro.

After the fall of the Berlin Wall and the dissolution of the Union of Soviet Socialist Republics (USSR) and Yugoslavia, more than twenty new countries were created. For the countries of Central and Eastern Europe (CEE) the ultimate goal was to go through the transition process successfully and eventually join the European Union. In the transition process from centrally planned to market economies, the countries had to fulfill various economic, political, and social criteria known as the Copenhagen criteria. The [economic criteria](#) include a functioning market economy and the capacity to cope with competitive pressures and market forces within the Union.

One of the characteristics of the centrally planned system was the state ownership of companies. There was no free trade among the countries; therefore the companies did not sell their products on foreign markets. They produced what they were ordered to because they had to fulfill five-year plans. As a result, trade openness of the former Communist countries was lower than the average rate of the old EU member states. In order to stabilize the CEE economies and prepare them for EU membership, the Central European Free Trade Agreement (CEFTA) was created. CEFTA is a trade agreement among non-EU countries, which are mostly located in Southeastern Europe and have aspirations of joining the European Union. [The goal](#) is to facilitate trade among the members; i.e., to be able to trade without having to go through obstacles such as tariffs, taxes, or any other barriers. As a result, a better bond among the countries is created.

The original CEFTA agreement was signed by the countries of the Visegrád Group; namely Czechoslovakia, Hungary, and Poland on December 21, 1992 in Kraków, Poland. The Agreement entered into force on July 1, 1994. The free trade area gradually expanded to other countries. Slovenia joined CEFTA in 1996, followed by Romania in 1997, Bulgaria in 1999, Croatia in 2003, and the Former Yugoslav Republic of Macedonia (FYR Macedonia) in 2006. CEFTA membership ends once a country joins the European Union. Because the founding countries joined the EU in 2004, and Bulgaria and Romania were set to join in 2007, it was decided to expand CEFTA to the Balkan states: Albania, Bosnia and Herzegovina, Montenegro, Serbia, and the United Nations Interim Administration Mission in Kosovo (UNMIK) representing Kosovo. Prime ministers of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the FYR Macedonia, Moldova, Montenegro, Serbia, the UNMIK, and Romania signed an agreement to amend and enlarge CEFTA on December 19, 2006 in Bucharest. [The Agreement consolidated](#) 32 bilateral free trade agreements, which liberalized more than 90 percent of trade and almost all trade in industrial goods in the region, into a single Regional Trade Agreement. [CEFTA 2006](#) entered into force on July 26, 2007 for Albania, the FYR Macedonia, Moldova, Montenegro, and the UNMIK on behalf of Kosovo; for Croatia on August 22, 2007; for Serbia on October 24, 2007; and for Bosnia and Herzegovina on November 22, 2007.



The fast ratification of the Agreement indicates its importance to economic development and growth in the region. [The main objectives of CEFTA 2006](#) are: to expand trade in goods and services; foster investment by means of fair, stable, and predictable rules; eliminate barriers to trade between the Parties; to provide appropriate protection of intellectual property rights in accordance with international standards; and to harmonize provisions on modern trade policy issues such as competition rules and state aid. As [a result](#), a simplified single system of rules makes it easier to trade within the region. Increased trade plays a key role in promoting economic growth, job creation, and reduced unemployment.

CEFTA has served as a transitional organization for countries that are in the process of joining the European Union. Former CEFTA members, the Czech Republic, Hungary, Poland, the Slovak Republic, and Slovenia joined the EU in 2004, followed by Bulgaria and Romania in 2007, and Croatia in 2013. [The European Union is not a party to the Agreement](#), but the European Commission has provided continuous political, technical, and financial support at every stage of the trade liberalization process in Southeastern Europe. [Preconditions for accession to CEFTA](#) in 2001 included membership in the World Trade Organization (WTO), signing an Association Agreement with the EU, and consent from all CEFTA states in the form of concluded negotiations on bilateral Free Trade Agreements.



The members of CEFTA 2006, except Moldova, have signed the Stabilization and Association Agreements (SAA) with the European Union. Bosnia and Herzegovina and Kosovo are potential candidate countries, while the others are candidates for EU membership, and only Kosovo is in the process of negotiating a visa-free regime. Moldova is part of the Eastern Partnership (EaP) group. However, [the EaP initiative is not an EU accession process](#), but its aim is to build a common area of shared democracy, prosperity, stability, and increased cooperation. Today, CEFTA assists the countries on their path towards WTO membership because both are rooted in [the same goals](#) and rules of progressive liberalization and open trade. Albania, the FYR Macedonia, Moldova, and Montenegro are members of the WTO, and Bosnia and Herzegovina and Serbia are observers. Kosovo is neither a member nor an observer, but the country has expressed its interest in joining the WTO.

INTRA- AND EXTRA-CEFTA TRADE

ECONOMIC BACKGROUND OF CEFTA COUNTRIES

The European Union has always supported trade liberalization among its current and potential member states. The European Union does not participate in CEFTA because once a country joins the EU, it has to withdraw from the Agreement. CEFTA serves as a preparation for EU membership and encourages better integration into the world economy. When the former CEFTA members, the Czech Republic, Hungary, Poland, the Slovak Republic, and Slovenia, joined the European Union, together with the rest of the CEE countries, it was one of the biggest challenges the Union had faced. It was expected that the new member states would [specialize in labor-intensive products](#), because of their low wages. Foreign direct investment (FDI), mainly from the old member states, has made it possible to increase the technological content and quality of products, and specialize in capital intensive products. Integration of the new member states rapidly intensified in the first years after the enlargement. In 2007, almost 80 percent of all exports of the new member states went to the rest of the European Union, with 19.5 percent of exports to other new members, which is a 6.2 percentage points increase compared to 1999. Seven and a half percent of the EU-15 exports went to the new members, compared to 4.5 percent a decade ago.

The CEFTA countries are among the least developed states in Europe (Moldova's per capita GDP is the lowest in Europe). Their economies are characterized by high unemployment, low economic openness, low foreign direct investment inflow, and low per capita GDP. The countries retain relatively low general government debt (see Table 1).

Table 1
Macroeconomic Indicators of CEFTA Countries,
Compared to the EU Member States in 2017

Country	GDP per capita (PPP)	GDP growth (%)	Inflation rate (%)	Unemployment rate (%)	Economic openness (% of GDP)	Debt (% of GDP)	FDI (% of GDP)
Albania	12,020.7	3.8	2.0	13.9	78.1	67.8	7.8
Bosnia and Herzegovina	12,876.0	3.0	1.2	25.6	86.9	36.8	2.5
FYR Macedonia	15,231.3	0.02	1.3	22.4	124.0	38.7	3.8
Kosovo	10,754.4	4.5	1.5	30.5	79.9	15.8	4.6
Moldova	5,697.8	4.5	6.6	4.5	113.2	31.5	2.6
Montenegro	18,765.1	4.3	2.4	16.1	106.2	66.4	11.7
Serbia	15,090.0	1.9	3.1	14.1	113.7	62.4	6.9
EU-13	30,527.1	4.5	2.0	6.6	137.8	50.5	8.3
EU-15	50,135.3	2.6	1.5	8.4	121.6	83.2	4.6

CEFTA INTRA-TRADE

CEFTA should promote trade among the members, increase economic openness and help them attract foreign direct investment. Based on data for 2017 for intra-CEFTA trade, Serbia was the main export partner for Bosnia and Herzegovina, the FYR Macedonia, and Montenegro. At the same time, the CEFTA countries exported less than 1 percent of their goods to the Republic of Moldova, while Montenegro did not trade with the country at all (see Chart 1).

Chart 1
Intra-CEFTA Exports of Goods in 2017



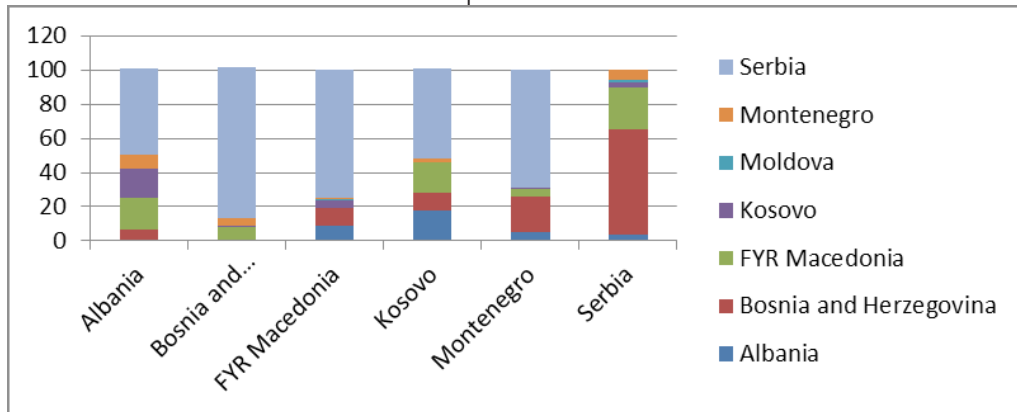
Note: Data for Moldova are not available.



Data show that exports and imports of goods within CEFTA have similar trends. The CEFTA countries imported most of goods from Serbia (51–88 percent), while less than 1 percent of goods were imported from Moldova (see Chart 2).

Chart 2

Intra-CEFTA Imports of Goods in 2017

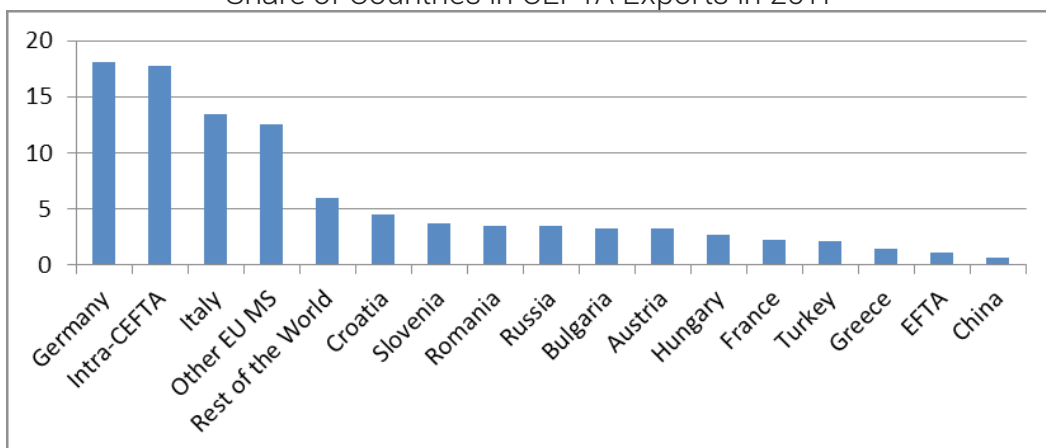


CEFTA EXTRA-TRADE

Even though the CEFTA countries, except Moldova, are neighbors, intra-CEFTA exports do not have the largest share in total exports of goods. It comes second (17.7 percent), after Germany (18.1 percent). The CEFTA countries export 68.8 percent of their goods to the EU member states. The exports to other countries is less pronounced, as they export 7.4 percent of their goods to Russia, Turkey, the EFTA countries, and China, and 6 percent to the rest of the world (see Chart 3).

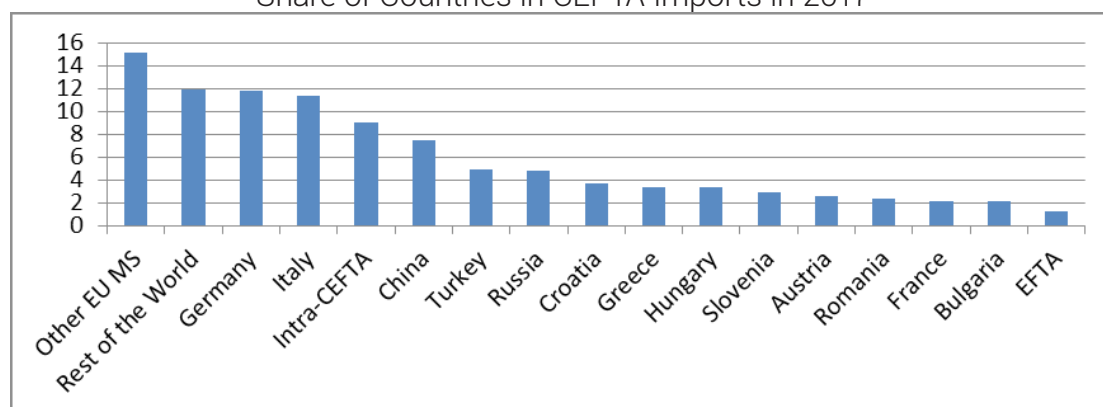
Chart 3

Share of Countries in CEFTA Exports in 2017



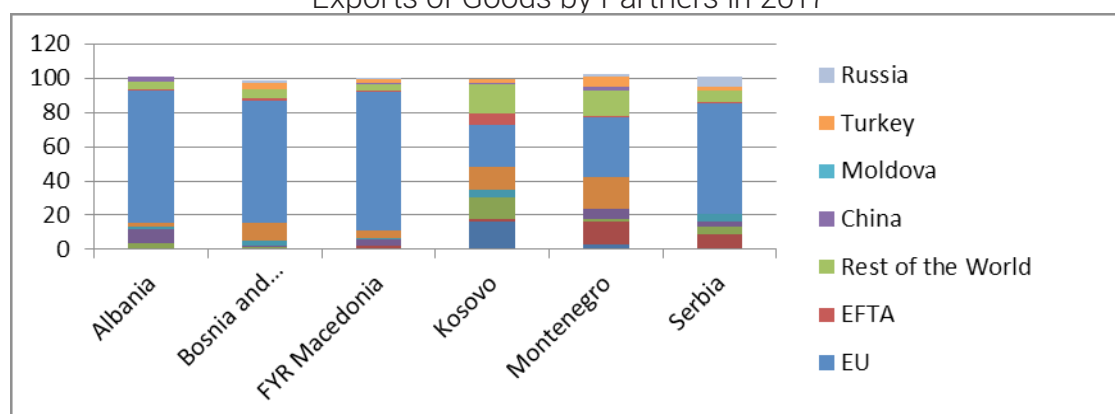
CEFTA countries import the products mostly from the EU countries (60.8 per cent). Intra-CEFTA imports comprise only 9 percent of total imports in the region. The countries import 18.3 percent of goods from China, Turkey, Russia, and the EFTA countries, and 11.9 percent from the rest of the world (see Chart 4).

[Chart 4](#)
Share of Countries in CEFTA Imports in 2017



However, analyzing CEFTA countries separately, it can be concluded that intra-regional trade is more dominant in Kosovo and Montenegro. They export 48 percent and 42 percent of their goods to the Western Balkans, respectively. Albania, Bosnia and Herzegovina, the FYR Macedonia, and Serbia export most of their goods to the European Union (77, 71, 81, and 64 percent, respectively). Trade in the region has benefited from its close association with the EU and trade integration has increased further. Bosnia and Herzegovina is the only country whose one of the main export partners is the Republic of Moldova (0.04 percent of total exports).

[Chart 5](#)
Exports of Goods by Partners in 2017



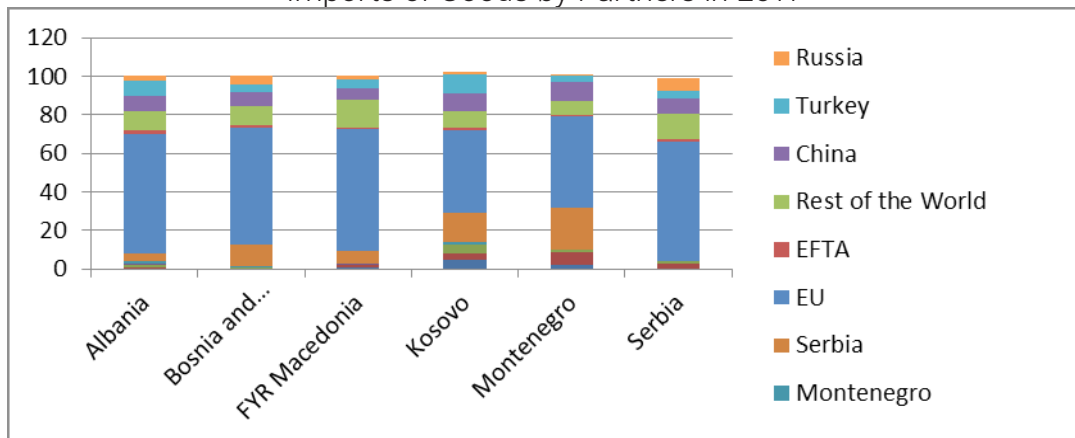
The CEFTA countries import between 43 percent (Kosovo) and 63 percent (FYR Macedonia) of goods from the European Union. Intra-CEFTA imports of goods



range between 4.3 percent in Serbia and 32 percent in Montenegro. Albania and Kosovo are the only countries whose main import partners are all Western Balkan states; Albania and Kosovo are not the main partners for Bosnia and Herzegovina and Serbia, Montenegro for FYR Macedonia and Kosovo for Montenegro (see Chart 6).

Chart 6

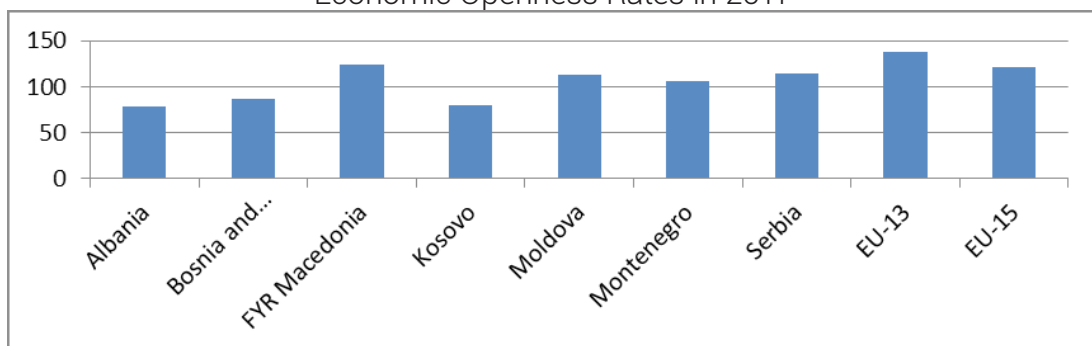
Imports of Goods by Partners in 2017



CEFTA helps the countries increase their economic openness (a sum of exports and import, as a percentage of GDP). The CEE countries increased their average economic openness rate from 91.4 percent in the transition period 1995–2003 to 138.3 percent in 2017 (see Chart 7).

Chart 7

Economic Openness Rates in 2017



The increase was moderate in the CEFTA countries. Before the recent financial crisis, the group's average economic openness rate was 94.5 percent, and decreased to 83.5 percent in 2009. The rate exceeded its pre-crisis value in 2016, 96.7 percent. In 2017, the average economic openness rate was 100.3 percent, and it ranged between 78.1 percent in Albania and 124 percent in the FYR Macedonia. The latter's rate is the only one which is higher than the EU-15 average (121.6 percent), but

it is still lower than the EU-13 average (137.8 percent). [Underperforming logistics](#) are broadly recognized as an obstacle to growth in general and trade specifically because they reduce the level of exports and increase the price of imports.

OPPORTUNITIES AND CHALLENGES FOR THE CEFTA COUNTRIES

CEFTA membership has given the countries many opportunities, but it was also strained by challenges, especially due to political instability in the region. Intra-CEFTA trade is not pronounced and comprises only 17.7 percent of total CEFTA exports and 9 percent of imports. However, the EU is the main trading partner for most of the CEFTA countries, and its share in CEFTA exports is 68.9 percent and 60.7 percent in imports.

Even though it is not a party to the Agreement, the European Union takes interest in the region and regularly publishes analyses and assessments, gives recommendations, and identifies problems and obstacles the countries have been facing.

In its [2018 Report](#) on the Western Balkan countries, the European Commission gave recommendations on trade reforms. The Report identifies key constraints in that area and the measures on trade facilitation. For Albania, the main constraints are non-tariff barriers and complex and unsynchronized border procedures, while the regulatory regime for investment needs to be harmonized and strengthened. The trade facilitation reform measure is necessary and is in line with national priorities and regional incentives, such as the CEFTA Trade Facilitation protocol.

Bosnia and Herzegovina is one of the least economically integrated countries in the region. The country's export share was 36 percent of GDP in 2017 and its complex political situation reflects on the economy. The European Commission recognizes four main areas of concern: the lack of a single domestic market; complex export procedures; the absence of coordinated border controls; and the absence of a comprehensive approach to meet EU food safety and sanitary and phytosanitary standards. Bosnia and Herzegovina must focus on priorities, such as boosting exports, reducing the foreign trade deficit, and addressing the structural problems of exports.

The FYR Macedonia's key constraints are the trade impediments faced by SMEs (small and medium-sized enterprises), which are linked to non-tariff barriers, including technical standards and administrative obstacles. The country should simplify inspections and clearance procedures, and this measure focuses on speeding up all trade that requires veterinary and phytosanitary certificates issued through the EU Trade Control and Expert System (TRACES).

Montenegro faces a narrow export base, a low level of diversification and a predominance of low value-added products, while the export of services has been increasing. The implementation of CEFTA protocol 5 on trade facilitation would



reduce transaction costs, while finalizing the negotiations on CEFTA protocol 6 on service sector liberalization would potentially play an important role in Montenegro's economic development.

Even though trade integration with the EU has increased and occurs across a high number of industrial sectors, Serbia needs to pursue further CEFTA commitments, including finding workable solutions to political obstacles. The country needs to improve conditions for product safety and remove barriers to trade that target specific products.

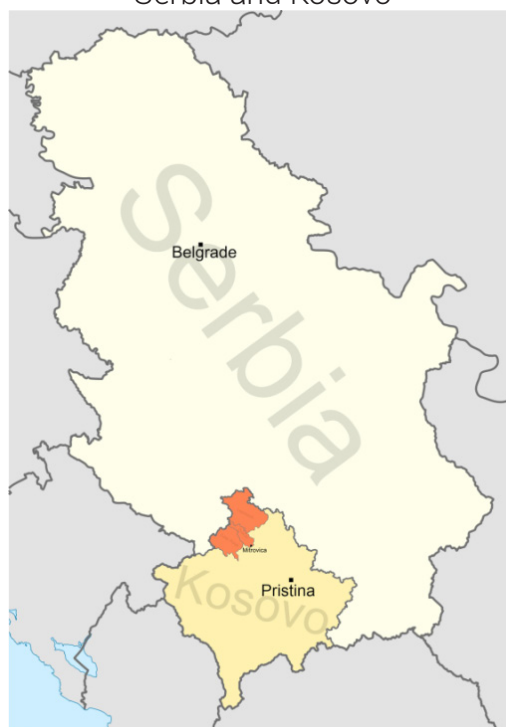
Kosovo's trade is dominated by imports (53.3 percent of GDP in 2017, compared to exports of 26.6 percent). Obstacles to trade openness, which is the second lowest among the CEFTA countries (see Table 1) include the high administrative costs linked to procedural, quality, logistical, and border barriers. These factors reduce the level of exports and increase the price of imports, and are coupled with an underdeveloped quality infrastructure. Simplifying standardizing border formalities and procedures was cost efficient in 2017, but there is no proper analysis on how the measure impacted the country's competitiveness.

The analyzed countries cannot export all their products to the EU market because they do not meet the EU criteria. The countries have access to the Instrument for Pre-Accession Assistance (IPA) funds, which should be used in improving the quality of the products. This is crucial because one of the [economic Copenhagen criteria](#) states that the country must have "the capacity to cope with competitive pressures and market forces within the Union." This is also a way the EU has been helping the countries to integrate in the EU market. The experience of the new member states shows that this approach is successful. The CEE countries had access to the pre-accession funds before the enlargement, and to the cohesion funds, once they joined the EU. As a result, after the accession in 2004, farm incomes increased in the new member states. Between 2005 and 2014, [the real agricultural income per worker](#) increased by more than 30 percent, which can most likely be attributed to the access to the Single Market. The Single Market refers to the European Union as one territory without any obstacles to the free movement of goods and services, the introduction of the CAP (common agricultural policy) instruments, and structural change with a decreasing number of farmers. Among all new member states, Poland is the largest producer of agricultural goods. In 2016, 9.9 percent of [total harvested EU cereal production](#) came from Poland, after France (18 percent) and Germany (15.1 percent), and 8.4 percent of [cheese](#) was produced there. Poland was the biggest producers of [poultry meat](#) in the European Union in 2014 (13.9 percent of the EU total) and the [fourth biggest producer of pork](#) (8 percent of the EU total).

One of the biggest challenges for CEFTA is the fact that the Western Balkan countries are neighbors and they share a long history, which has caused political instability in the region. It must not be forgotten that some of the Western Balkan countries were at war in the 1990s. The situation has stabilized, but constant turmoil in the region is present. Another one happened when Kosovo declared its independence from Serbia in 2008. Kosovo was recognized as an independent country by twenty-three EU member states (except Cyprus, Greece, the Slovak

Republic, Spain, and Romania). In the Western Balkan region, it was not recognized only by Bosnia and Herzegovina and Serbia. Kosovo has made progress towards EU membership; the country signed the Stabilization and Association Agreement (SAA), it is a potential candidate for EU membership and is negotiating a visa-free regime with the EU. In CEFTA, Kosovo was represented by the United Nations Interim Administration Mission in Kosovo (UNMIK).

Map 2
Serbia and Kosovo



The first problems for Kosovo in CEFTA started in 2007, as the country was preparing to declare its independence. Serbia was preparing as well, and was planning a trade blockade and to close borders. However, in case of a blockade, Serbia's products would have been substitutes with products from other countries, even though the imports of EU goods through other countries might be more expensive.

In February 2008, Kosovo declared its independence from Serbia. In December 2008, [Kosovo changed its customs stamps from UNMIK Customs to Kosovo Customs](#). Serbia declared this as a violation of the CEFTA agreement and blocked Kosovo's exports to the country. Together with Bosnia and Herzegovina, the countries forbade Kosovo to use their territories for exports of its products to the EU. [On July 20, 2011](#), Kosovo took reciprocal measures and introduced embargo on imports of Serbian products and a 10 percent import tariff on products manufactured in Bosnia and Herzegovina. After a 58-day blockade, Serbia was forced to accept stamps by Kosovo Customs and Kosovo withdrew its blockade for Serbian goods. During the



period of blockade, imports from Bulgaria and the FYR Macedonia increased, as well as the consumption of products from local producers.

On its way towards being internationally recognized as an independent country, Kosovo applied for Interpol and UNESCO membership. [Interpol rejected Kosovo's membership](#) for the third time on November 20, 2018. In the first round, the country's application was supported by 76 countries, 56 states voted against and 22 abstained. The two-thirds threshold, or 88 votes, was not reached, and in a second round only 68 countries voted in favor, while 51 voted against and 16 abstained. Serbia and Bosnia and Herzegovina were among the countries that voted against Kosovo's membership in the organization. The Government of Kosovo said that [Serbia led a wild campaign](#) to pressure countries to oppose Kosovo's bid and that [Serbia once again showed](#) its stand against Kosovo and the idea on normalization of relations. On November 6, 2018, Kosovo imposed tariffs of 10 percent on products from these countries for their "[negative behavior towards Kosovo](#)." The measures resulted in a decreased number of trucks entering the country, from 130 trucks per day in November 2017 to 60 after the tax imposition. Kosovo imposed a 100-percent tariff on all goods produced in Bosnia and Herzegovina and Serbia on November 21. The government has stated that the tariffs will be abolished once Serbia recognizes Kosovo as an independent country. [The economic reasoning](#) for the tariffs is that they will [protect local goods and producers](#). Also, Kosovo is punishing Bosnia and Herzegovina because it demands visas for its citizens.

Even though tariffs are against CEFTA rules, [Kosovo Deputy Prime Minister Enver Hoxhaj](#) wrote on Twitter that the Government of Kosovo had decided to increase the customs tariff to 100 percent because it had to defend the country's vital interest. The EU asked Kosovo to abolish the tariffs, but the country declined. Because the EU does not officially participate in the Agreement, it cannot force the country to adopt the measures; it can only recommend or ask.

[Azem Vllasi](#), a Kosovo Albanian politician and lawyer, says that Serbia has invested money, political energy, and efforts for Kosovo not to be accepted to UNESCO or Interpol, but does not require that the country is expelled from CEFTA because of the 100-percent tariff. The reason for this decision is that Serbia exported to Kosovo the goods in the amount of 440 million euros during 2017, which was 2.8 percent of its overall export for that year and 14 percent of its intra-CEFTA exports. Bosnia and Herzegovina's exports to Kosovo amounted about 78.7 million euros during 2017, or 1.4 percent of the country's total exports and 9 percent of its intra-CEFTA exports.

Unfortunately, CEFTA does not have mechanisms to sanction a country. All disputes can be resolved only if the countries show a good will.

OPPORTUNITIES: SEIZED OR MISSED?

The Western Balkan region is burdened with its history. Even though the countries share the same problems; high unemployment, people migrating, low investment, low economic openness, low development levels, and political instability and they share a common goal (EU membership), they do not work on resolving problems, but create new or deepen the existing ones. The politicians should start working for the welfare of the people because they do not see a perspective in the countries and constantly migrate to the EU. [A projection of the United Nations](#) says that the population in the Western Balkans will decrease by 50 percent in the next 80 years. The EU's interest and support must be used to build economies and stable political systems, as well as to improve the relations in the region.

The nationalist narrative should not be a priority, but this is what elects politicians. If the countries put behind their conflicts, they could finally be seen as serious candidates for EU membership, take advantage of everything CEFTA has to offer and has already offered. Without the EU's support, the countries will not be able to end their transition process. The CEE countries must be a role model because they share a similar economic history and their transition process was so much faster. The CEFTA countries should take the EU accession process seriously because they do not have an alternative to EU membership.

Note: The manuscript was closed in December 2018.

The author earned her doctoral degree (PhD) in economics at University of Sarajevo and she is an external expert of the Institute for Foreign Affairs and Trade.