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THE ROLE OF PARLIAMENTS IN THE PROCESS OF DECIDING ON PRIORITIES: CUTTING PUBLIC SPENDING OR STIMULATING THE ECONOMY

Edited by

Slavica Penev
Isidora Beraha

REPUBLIC OF SERBIA РЕПУБЛИКА СРБИЈА REPUBLIKA SRBIJA
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Regional Conference Proceedings
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FORWARD

Regional cooperation among the parliaments from Western Balkan countries, started in 2004, at the Regional Parliamentary Conference: "The Role of Parliaments in Economic Policy and Institutional and Legal Reforms in South East Europe" held in Dubrovnik (2004), organized by the Friedrich-Ebert Foundation, OECD and the Stability Pact/ Investment Compact for South East Europe. The main conclusion of the conference was that Parliaments from the region should have a key role to play in the process of economic reform, as their task is to enact or amend legislation that provides the legal framework of economic activities and their challenge is to establish rules that are coherent, effective and stable. Investors require quality legislation, which provides legal certainty and stability and is favorable to the development of a market economy.

During this Conference the idea of conducting a regional project that focuses on the role of parliaments in the economic reform process was conceived. The regional project was conducted by the OECD Investment Compact and GTZ Open Regional Fund for SEE – Legal Reform, whose frame included country studies for Albania, Bosnia and Herzegovina, Macedonia, Montenegro and Serbia. The main focus of these country reports was to review the process of drafting legislation, analyze the parliamentary process and assess the process of implementing legislation in general and parliamentary oversight of the implementation process. Based on the findings from the country studies, the regional overview was drafted, and these findings were presented at the regional conference, which was held in Miločer, Montenegro, on 7-8 October 2008. During the Conference the idea for establishing a regional network of parliamentary committees for economy and finance was initiated, which would result in institutionalization of the existing regional cooperation.

The need for the continuation of the cooperation among the Western Balkan parliaments after the completion of the regional project, resulted in the organization of the Regional Conference in Belgrade (March 2009), where the ***Regional Declaration of cooperation among the Western Balkan Parliaments*** was signed and the ***Regional Network of***

Parliamentary Committees for Economy and Finance of the Western Balkan countries, was established, with the aim of advancing the cooperation among the parliaments from this region.

The benefits of having this kind of Network are, based on the following facts, that: (i) all the countries in the region, except Albania, share the common heritage and experience coming from ex Yugoslavia, including the common market, common regulations and similar language; (ii) All the countries in the region are in the process of European integrations, and in parallel to harmonizing their national legislations with the European one, they are also mutually harmonizing the legislations among themselves, thus creating harmonized legislative framework at the level of the region.

In that regard it has been agreed that the area of cooperation should cover: (i) Sharing the information in area of economy and economic legislation; (ii) Monitoring the methodology of proposing the regulations, and the role of Committees and working bodies in that process; (iii) Harmonization of, already adopted regulations, with the European legislation; (iv) Monitoring the procedure of proposing the laws, especially those referring to harmonization of regulations with the European legislation. Because of unequal staffing and expert capacities in Committees and in general, the experience of those more advanced would be of great benefit for the countries lagging behind in the process.

The agreed activities of the Network were: (i) to exercise cooperation through parliamentary expert bodies; (ii) to organize meetings of the Committee representatives in some of the parliaments in order to share the information and experiences on the spot; (iii) to exchange annual work plans and to participate in the work of other parliaments' committees, (iv) as well as to organize joint sessions within bilateral and multilateral parliamentary cooperation when discussing key infrastructural projects and issues of importance for the entire Region.

Even though it was envisaged that the committees meet once a year, the economic crisis which strongly hit the countries of the region, led to the postponement of the network meetings, reducing their cooperation mostly to personal contacts and exchange of information among the members of the committees from the countries of the region.

The first Regional Workshop of The Regional Network Of Parliamentary Committees for Economy and Finance of the Western Balkan Countries, named: The Role of Parliaments in the Process of Deciding on Priorities: Cutting Public Spending or Stimulating the Economy, was held in Belgrade on 3rd March 2012, and was co-organized by National Assembly of the Republic of Serbia, Friedrich Ebert Foundation Office in Belgrade and the Institute of Economic Sciences from Belgrade. The workshop emphasized the importance of closer and continuous cooperation between parliaments and scientific community.

The objectives of the workshop were to discuss (i) the possibilities for strengthening the capacity of parliamentary committees for economy and finances in order to play more important role in economic policy, (ii) the dilemma: whether to give priority to cutting public spendings or stimulating the economy, and (iii) the Economic and political barriers to the trade in the region.

The Westminster Foundation for Democracy (WFD)recognized the need for the continuation of the cooperation among the Western Balkan parliaments through their Network of Parliamentary Committees for Finance and Economy. To support this regional cooperation, WFDinitiated the drafting of a three-year regional programme aimed at Strengthening parliaments’ role in promoting competitiveness and economic growth in Western Balkan countries.

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It is difficult to name and express gratitude to all those who strongly supported this cooperation and contributed to the signing of Regional Declaration of cooperation among the Western Balkan Parliaments and establishement of the Regional Network of Parliamentary Committees for Economy and Finance of the Western Balkan countries.

Special thanks are due to Beriz Belkić, former President of the House of Representatives in the Parliamentary Assembly of Bosnia and Herzegovina, Gordana Čomić, Deputy Speaker of the National Assembly of the Republic of Serbia, Edmond Spaho, Chairman of the Stranding Committee on Economy and Finance in the Albanian Parliament, Ljubisav Ivanov Singo, Chariman of the Macedonian Parliament Standing Committee on Economy, Aleksandar Damjanović, Chairman of the Montenegrin Parliament Committee on Economy, Finance and Budget, and Mirjana Radaković, Assistant Secretary-General of the National Assembly of the Republic of Serbi, for their contribution to strengthening parliamentary cooperation among the countries of the region.

We would also like to thank the organizers of this regional workshop, the Belgrade office of Friedrich Ebert Foundation, for making this event happen, Serbian Parliament, for hosting this event, and Institute of Economic Sciences, for bringing science closer to the parliaments.

OPENING SESSION

Slavica Đukić-Dejanović

Speaker of the National Assembly of the Republic of Serbia

Estimed ladies and gentlemen,

In early 2012, amidst the second wave of economic crisis - which, as economists warn us, could have as devastating effects on the economy as its first wave had had on the financial system - we have gathered here at this regional conference, being held at the supreme legislative body of our country which is experiencing the same hardship as its neighbours, to share our knowledge and thus multiply it.

For us who represent our citizens - lawyers, doctors, farmers, etc. - and who do not have to be experts in economics, it is crucial to understand the consequences of decisions that we make. No one expects us to be economic experts, but since the legislatures' task is to pass a crucial financial decision for the life of a country, i.e. the budget law, we have no right to be ignorant. Hence, the greatest experts in our midst, i.e. our colleagues from parliamentary committees for economy and finance, have an immeasurable role to play and I believe that this is the main reason why one of the goals of this conference is to address how our capacities in that respect could be enhanced.

The very fact that we are going to discuss economic problems - which, in this globalized world of today, cannot be confined to a single economy - and the fact that we are going to do so together, economic experts and ourselves, parliamentarians, who design legal frameworks for the operation of national economies, is what makes this conference truly important. Therefore, we must thank the Deputy Speaker of the National Assembly of the Republic of Serbia, Mrs. Gordana Čomić, for her idea and her contribution to the organization of this conference.

The theme of this conference, which will address the role of parliaments in the process of deciding on priorities: cutting public spending or stimulating the econony, is highly topical and is subject to numerous expert debates. We know that some experts call for savings – in terms of reducing public debt, while others call for development even at the cost of increasing this same macroeconomic indicator. The amount of public debt and movements in fiscal and budget deficits, which we as MPs are trying to put within a certain framework, must not remain simple words whose meaning and impact are unknown to us. Therefore, I am sure that all your presentations will help us prevent that, and especially the presentation of one of our colleagues, Mr. Čaušević, who will share with us his thoughts on whether Western Balkan countries need restrictive or expansionary fiscal policies.

I am convinced that all goals of this conference will be achieved and I am sure that it will be extremely useful to hear presentations of our distinguished participants. Once again, I would like to thank you for being guests of the National Assembly of the Republic of Serbia and wish you a fruitful conference.

Thank you.

Gordana Čomić

Deputy Speaker of the National Assembly of the Republic of Serbia

The goal of parliaments of Western Balkan countries is to reduce problems of people living in this region, which means that,in their decision making process, MPs should always bear in mind consequences of their decisions on the lives of people.

What is particularly important is the fact that this conference is being held today - 48 hours after Serbia was granted candidate status for EU membership. Serbia has succeeded in this thanks to cooperation with all of you and good links of friendship and understanding among us.

It is very hardfor people throughout the region to make ends meet and this is why they expect officials to tell them when things are going to improve. I am convinced that today I will learn a lot from my colleagues and from experts and scientists present here, so that together we can find answers to the question of what kind of economic policy is needed. This policy should be in keeping with EU recommendations and tailored to the specific situation in each of the Balkan countries.

I suggest that we look into our region together because I think that our region boasts sufficient knowledge, good will and experience to reach proper economic solutions. I am sure that we will be able to find great ideas for the years to come and that today's conference will be most helpful in that pursuit.

Michael Ehrke

Director of the Friedrich Ebert Foundation Office in Belgrade

I would like to welcome you on behalf of the Friedrich Ebert Foundation to this international parliamentarian conference. Today we will talk about a very important subject: The role of parliaments in deciding on economic priorities.

Please allow me two remarks on this subject.

First, parliaments are the core institution of a modern democracy. In the end, they have to decide about the direction a country takes. But in almost all countries parliaments are often overburdened by highly complex economic matters, including seemingly technical questions, about which the bureaucracy of the state ministries has some kind of monopolistic control. But when parliaments shall be able to fulfill their tasks, they must dispose of the necessary resources, as Mrs. Slavica Penev writes in her paper, and that means not only of expertise, but of independent expertise, independent from the state bureaucracy, from the mainstream think tanks and from the conventional academic wisdom.

Second, and even more important, no economic question is a purely technical question. Each economic question – and each answer to it – is a political one, is related to social interests and political values. This also refers to the question which is the motto of this conference – cutting public spending or stimulating the economy? – which is not a technical question, but a question which implies another one: In which kind of country do we want to live? This question can only be answered politically, and in a democracy this means: By the parliament. If we want to avoid technocratic rule, parliaments have to discover the interest-related and value-related content of each economic matter – and find those answers which correspond to the interests and values of the population they are representing.

The Friedrich Ebert Foundation is strongly engaged in supporting parliaments at fulfilling their democratic tasks, in Germany as well as in South East Europe. Especially in this region we are trying to back regional cooperation, but for us this does not mean only the cooperation between governments, but also and mainly the cooperation between parliaments. Therefore, we are supporting genuinely regional parliamentarian initiatives as well as the parliamentarian arms or dimensions of regional organizations.

Today's conference is a part of this work, and I wish us a fruitful discussion.

Thank you very much for your attention!

Dejan Erić

Institute of Economic Sciences, Belgrade

We live in difficult times facing many problems, uncertainty and challenges. However, on the other hand, it is also the time of hope. At this moment in time it particularly refers to our country, since two days ago Serbia granted candidate status for EU membership. All the countries in the region share the common orientation towards EU integration. This is something that connects us and gives us hope and faith in a better common future. Being aware of problems the EU is currently facing, it is even more necessary to intensify regional cooperation, improve connections among us and thus ease the regional integration in the EU. In this sense, we need new ideas, initiatives and creative energy.

I would also stress the need to connect science and decision making. At a time when everyone is affected by the crisis, all previous practices, approaches and solutions are being reviewed in all countries. The task of science is to perform research, conduct various analyzes, define alternatives and help decision makers to foresee the consequences of their decisions. The idea of cooperation between science and parliaments is great as it is necessary that the supreme legislative body has as much information in order to better perform its basic functions.

I truly believe that today's conference will be beneficial to everyone, that we will be able to learn from each other and that by the end of the day we will end up at least a bit smarter than before the conference.

FIRST SESSION

STRENGTHENING THE CAPACITY OFPARLIAMENTARY COMMITTEES FOR ECONOMY AND FINANCES IN WESTERN BALKANCOUNTRIES AS A WAY OF INCREASING THEIR ROLE IN ECONOMIC POLICY

BACKGROUND PAPER

Slavica Penev
Institute of Economic Sciences, Belgrade

Strengthening the Capacity of Parliamentary Committees for Economy and Finances in Western Balkan Countries as a Way of Increasing Their Role in Economic Policy

1. Parliaments in Western Balkan countries[1]

The parliament is a national legislature which performs three basic functions:
(i) ***representationfunction***
(ii)***legislative function***
(iii) ***oversight function***

Representationis one of the three main functions of the parliament in the governing process to represent the opinions and interests of the citizens. In democratic parliaments, members of parliament are elected by the citizens/voters who represent the whole country. Very often parliamentary seats are distributed to members of the parliament who are directly accountable to a specific constituency within a particular geographic, ethnic, religious, or other grouping. This proximity to citizens is the basis of parliaments' representative function. The representative function of parliaments is characterised by their role as venues for the expression and debate of issues of local and national importance, and the translation of those debates into policies. For MPs, effective representation requires

[1] Western Balkans refers to Albania, Bosnia and Herzegovina, Macedonia, Montenegro, and Serbia.

engaging their constituents in dialogue in order to understand their views and perspectives, and to utilise the powers vested in their office (i.e. legislating, participating in debates, authoring questions, etc.) to voice the resulting ideas (www.agora-parl.org**).**

Legislative function represents debating and passing laws. Parliament enacts laws by subjecting issues of public interests to debate by drafting, modifying, and ratifying public policy into law. Bills are introduced into Parliament either as public bills (related to public policy) or private bills (initiated by a particular interest group). When Bills are introduced in the house, they then go through a number of stages, this varies from country to country but the different stages can be summarized as follows: First reading, Committee stage, Second reading, the Consideration stage, and Third reading before being passed for presidential or royal assent (World Bank, 2007).

Oversight function is one of the cornerstones of democracy. Itrepresents examining and challenging the work of the government, and is a means for holding the executive accountable for their actions and that it implements policies in an effective manner. Through oversight function the parliament can ensure a balance of power. Parliament is the legislative branch of government that authorizes, or chooses not to authorize, major policy decisions of the executive. Oversight functions of parliament include subjecting executive plans, policies and actions to public debate, and posing questions to members of the Executive. Parliaments are also tasked with vetting and approving key government ministers and other key national appointees. Therefore, parliament's oversight of the executive becomes one of its most important functions. Democratic parliaments are given the power to oversee the government through a number of tools and mechanisms

The main objectives of the parliamentary oversight are:

- to ensure transparency and openness of executive activities by sheding light on the operations of government by providing a public arena in which the policies and actions of government are debated, scrutinised, and subjected to public opinion,
- to hold the executive branch accountable by oversight scrutinising whether the government's policies have been implemented and whether they are having the desired impact,

- to provide financial accountability by approving and scrutinising government spending, and
- to uphold the rule of law by monitoring policies and examining potential abuses of power, arbitrary behavior, and illegal or unconstitutional conduct by government.

Parliamentary committees enable legislatures to monitor the activities of the government, and check the quality of governance. The role of the executive and the legislature is therefore to complement each other: the executive must govern, while the legislature asserts its key role as representative of the people by acting as an overseer of the executive. Thus, the use of the committee system to scrutinise and investigate whether the executive or its authorised agencies have acted properly in the implementation of public policies and programmes is crucial (World Bank, 2007).

For parliament's institutional and legal framework, it would important to encourage the members of the parliament to use their powers of oversight.

These three functions of the parliament are closely linked and cannot be clearly separated from each other.

Parliaments in Western Balkan countries do not have a long democratic tradition, as countries from this region are young democracies whose political and economic transformation from socialist to free market economy systems was launched in the early 1990s. They are unicameral, with the exception of the Parliamentary Assembly of BH and the Parliamentary Assembly of BH Federation, which are bicameral.[2]

[2] The bicameral structure of the Parliamentary Assembly BH and the Parliamentary Assembly of BH Federation, with the House of Representatives and the House of Peoples, has the role to protect the interests of the three constituent peoples of Bosnia and Herzegovina. Even though Republika Srpska has a unicameral parliament, the Council of Peoples (established in 2002) plays the role of the House of Peoples which exercises its constitutional and legislative power with the aim of protecting vital national interests of the constitutive Peoples. The Council of Peoples does not participate in the procedure of enacting laws, bringingregulations or any other legal acts with the National Assembly of RS, but controls laws, regulations and legal acts previously adopted in the National Assembly for the purpose of defining whether an

Table 1: The structure of parliaments in Western Balkan countries

	Unicameral	**Bicameral**
Albania	x	
Bosnia and Herzegovina		
• Bosnia and Herzegovina – state level		x
• Federation of Bosnia and Herzegovina		x
• Republika Srpska	x	
Macedonia	x	
Montenegro	x	
Serbia	x	

The legislative process – the addoption of the laws in the parliament is similar in all the Western Balkan countries. According to their constitutions, the right to propose and draft laws is given to the parliaments and governments, as well as to a certain number of voters. In practice, almost all legislative proposals originate in the government. Situations in which the parliaments are the proposers of laws are exceptions. Once a draft law is submitted to the parliament, the parliament's task in each of these countries is to enact or amend legislation. The consideration of a draft law in the parliament includes: (i) consideration of the draft law in principle, and (ii) consideration of the draft law's articles. Consideration in principle comprises the debate on: the constitutional basis, reasons for enacting the law, compliance with EU legislation, and the financial impact assessment. If the draft law is adopted in principle, the draft is discussed in detail and amendments are considered. In all Western Balkan countries, the relevant parliamentary standing committees consider drafts prior to their consideration in plenary sessions. The draft laws are considered at plenary session after being considered at the parliamentary committees, in all the countries of the region. A debate in principle at the plenary session is obligatory for parliaments in Albania, Serbia and Bosnia and Herzegovina, while in Macedonia and Montenegro this consideration is held only in cases where a certain number of MPs requires the consideration in principle to take place at the plenary session. If the draft law is adopted in

adopted law, regulation or other legal act violates vital national interests of the constitutive Peoples.

principle, the draft is considered in detail and amendments are considered at the plenary session (Penev, 2009: 21).

The legislative function 'plays' the most important role in the parliaments of Western Balkan countries, due to extremely intensive legislative activity in the countries of that region caused by (i) the transformation of Western Balkan countries’ legal systems, which started in early 1990s with their transition process to market economies, and (ii) the initiation of their accession to the EU and harmonization of their legal systems with the EU acquis, at the beginning of this century. The intensive legislative activity, especially during the 1990s and early 2000s, negatively affected the quality of legislation as, very often, instead of debating the laws in the parliamentary committees and during plenary sessions, the parliaments simply acted as voting machines of the ruling political parties. At the same time, the role of parliaments in the policy-making process in Western Balkan countries was limited, as the decision-making process has been centralized so that basic decisions are made by the governments.

However, with the democratization progress in the countries of the region and their progress with the EU accession process, the role of parliaments has been continuously gaining in importance. This resulted not only in the strengthening of the legislative function, but also in increasing the importance of the representation and oversight functions in comparison to the 1990s and early 2000s.

2. The role and functions of parliamentary committees in the parliaments of Western Balkan Countries

In the process of performing its functions, the detailed work of the parliament that cannot be conducted in plenary sessions is carried out by specialized committees, small groups of MPs set up within the parliamentary system with clearly defined mandates that carry out in-depth analysis and review public policy.

Even though the widespread use of parliamentary committees does not have a long tradition, these committees have emerged as central institutions of today's democratic parliaments. Committees are not decision-making bodies. Instead, their main role is to critically review issues related to a particular subject matter or to review a specific bill, and they are expected to present their observations and recommendations to the assembly for the final debate.[3]

Parliamentary committees are rarely mandated by constitution, yet they exist in almost every parliament in the world. The mandate and the functions of committees are often clearly stated in the rules of procedures that govern the functioning of the parliament. For efficient functioning of parliamentary committees, appropriate staffing is essential. Parliamentary Committees often need staff to assist them in their functions, including procedural issues, administrative matters, drafting bills, and providing expert opinions and analysis on major policy issues. In addition to parliamentary staff, they need researchers, legislative reporters and legal draftsmen. Committee staff plays an important role in assisting committee members in recommending new policy.

In many parliamentary systems, parliamentary committees are an important forum for policy making. Committees allow the parliament to organize its work and perform numerous functions simultaneously, improving the efficiency of parliaments. Well-functioning committees can contribute to the improvement of the democratic governance of parliaments, as (i) committee mandates and memberships focus attention on specific issues and encourage meaningful deliberations in the public interest, (ii) committees are mechanisms for public engagement and validation of the democratic process and (iii) committees are a means of establishing institutional leadership and visibility in the public arena.[4]

A Committee is where the individual MP weaves together the three strands of his/her function:

- *As* ***legislator***, reviewing, modifying and amending legislation;
- *As* ***overseer***, reviewing government policies, programs and expenditures and

[3]Source: http: //mirror.undp.org/magnet/Docs/parliaments/LegislativeCommitteeSystem.htm

[4]Backgrounder, The New Member of Parliament and Committees, Parliamentary Center, Ottawa, Ontario, Canada

– *As **representative***, hearing the various voices of the citizen, representing constituent concerns and reflecting the public interest in the deliberations of the committee.[5]

The effectiveness of a parliamentary committee depends on a number of factors, including[6]:

– A clear mandate and clear roles and responsibilities for the committee;
– The size of the committee – (a too large or too small committee might be less effective);
– The skills of the chairperson of the committee in managing activities and meetings of the committee. Committee chairpersons are crucial to committee effectiveness, as the chairperson's skills in managing activities and meetings of the committee have a tremendous impact on the committee's output[7];
– The quality of support staff and resources available to the committee. When well-resourced with a requisite skilled personnel with access to relevant and accurate analysis and information and with adequate logistical support, committees can perform very well;
– Consensus building – the multiparty nature of parliaments often translates into multiparty committees, effective consensus building techniques and a nonpartisan approach to committee work, and is therefore becomes critical in promoting committee effectiveness.

The main functions of Parliamentary Committees in Western Balkan Countries' parliaments are similar to the functions in parliaments with a long democratic tradition, and they include:

(i) initiating and reviewing legislation;
(ii) controlling the executive;
(iii) drafting legislation;
(iv) communicating with the executive;

[5] Parliamentary Oversight - Committees and Relationships, *A Guide to Strengthening Public Accounts Committees,* 2006 CCAF-FCVI Inc. Ottawa, Ontario, Canada.

[6] World Bank, 2007, Professional Development for Parliamentarians and Staff, WashingtonDC.

[7] According to Ogle (2004), the qualities of an effective committee leader are: competence. flexibility and adaptability, firmness and decisiveness, honesty and dependability, openness, fairness, tolerance, patience, humility, and stamina.

(v) representing their constituencies;
(vi) investigating policy initiatives not yet submitted for ratification, and
(vii) reviewing and approving the budget and expenditures for the government's policy agenda.

Table 2: Number of parliamentary committees in Western Balkan countries' parliaments

	Number of parliamentary committees
Albania	8
Bosnia and Herzegovina:	
• Bosnia and Herzegovina – state level*	16
• Federation of Bosnia and Herzegovina**	27
• Republika Srpska	22
Macedonia	21
Montenegro	11
Serbia***	30

** The Parliamentary assembly of BH as a bicameral assembly has the following committee structure: House of representatives – 7 committees, House of peoples – 3 committees, Joint committees – 7 committees.*
*** The Parliamentary assembly of BH Federation as a bicameral assembly has the following committee structure: House of representatives – 26 committees, House of peoples – 0 committees, Joint committees – 1 committee.*
****The New Rules of Procedure of [[the?]] Serbian Parliament prescribe a reduction of the number of committees from 30 to 19.*

In parallel with the strengthening of the role of the parliaments in Western Balkan Countries, the role of parliamentary committees was becoming a more important component of the legislative decision and policy-making process. Although their number (see table 2), organization and structure differ among Western Balkan countries' parliaments, there are great similarities in their duties and significance.

3. Parliamentary Committees for Economy and Finance in Western Balkan Countries

All the parliaments in the region have one or more committees in charge of economic and financial issues (see the table 3). The number of committee members varies from 9 in the Finances and Budget Committee of the Parliamentary Assembly of Bosnia and Herzegovina at the state level, to 23 in the Economy and Finance Committee of the Albanian Parliament.

Table 3: Parliamentary Committees for Economy and Finance in Western Balkan Countries

Country	Parliamentary Committees for Economy and Finance	No. of committee members
Albania	Economy and Finance Committee	23
Bosnia and Herzegovina		
Bosnia and Herzegovina – state level	Finances and Budget Committee	9
	Joint committee for economic reforms and development	11
Federation of Bosnia and Herzegovina	Committee for economic and financial policy	11
Republika Srpska	Finances and Budget Committee	11+2*
Macedonia	Committee on Financing and Budget	14
	Committee on economy	12
Montenegro	Committee on economy, finance and budget	12
Serbia	Finance Committee	15
	Committee for economic development and international economic relations	17

** The Parliamentary Finances and Budget Committee in Republika Srpska has 11 MPs and 2 external committee members.*

The small number of committee members might negatively affect the quality of ideas needed for effective work, while the large number of committee members might be unwieldy.

The main competences of ***parliamentary committees for economy and finance***in all countries of the region are: (i) consideration of bills and other regulations in the field of economy, finance and budget; (ii) consideration, execution and control of the execution of the budget; (iii) public finance consideration, and (iv) consideration of the financial and banking system. However, they also include some other issues in the field of economy and finance, such as economic policy consideration, taxes etc. (see Table 4).

Table 4: The main functions of Parliamentary Committees for Economy and Finance

Parliamentary Committees for Economy and Finance	Economic policies	State budget: consideration, execution and oversight of implementation	Public finances	Financial and banking system	Consideration of regulations in the field of budget and finance	Consideration of regulations in the field of economy
Albania:						
Economy and Finance Committee	x	x	x	x	x	x
Bosnia and Herzegovina						
State level:						
Finances and Budget Committee		x	x	x	x	
Joint committee for economic reforms and development	x			x		x
BH Federation:						
Committee for economic and financial policy	x	x	x	x	x	x
Republika Srpska:						
Finances and Budget Committee		x	x	x	x	x
Macedonia:						
Committee on Financing and Budget		x	x	x	x	
Committee on economy	x					x
Montenegro:						

Committee on economy, finance and budget	x	x	x	x	x	x
Serbia:						
Finance Committee		x	x			
Committee for economic development and international economic relations	x			x		

Source: Rules of Procedure of the Western Balkan countries' Parliaments

The most important role of these committees is the reviewing and approving of the yearly budget, as the budget is an important source of parliamentary influence. Strong and capable parliamentary committees are required to enable the parliament to develop its expertise and play an active role in budget decision-making. This requires a clear and efficient division of labor between different committees, notably the budget and finance committee on the one hand and the sectoral committees on the other.[8] However, even in that field, the role of parliaments and their committees for finance and budget as well as sectoral committees has been limited, as the government prepares the budget.

Committees for economy and finance are becoming increasingly important factors in the process of reviewing key economic and financial legislation, which provides the legal framework of economic activities in the countries of the region. The EU accession of Western Balkan countries and the harmonization of their legal systems with the EU acquis, as well as the economic crisis that strongly affected the whole region, opened some important questions related to the economic recovery of Western Balkan Countries, which should be considered in parliamentary committees and during the plenary sessions.

[8] OECD 2008, Symposium:The changing role of parliament in the budget process. http://www.oecd.org/dataoecd/22/52/41822194.pdf

Parliaments and their committees for economy and finance exercise only limited influence on economic policy development, in spite of the fact that rules of procedure in most of the parliaments from the region assign that mandate to the parliaments and their committees. The economic policy-making process in Western Balkan Countries is highly centralized, with basic decisions made by the government.

4. Importance of parliamentary staff support to Parliamentary Committees

Table 5: Parliamentary research departments and experts which support the work of parliamentary committees in Western Balkan countries

	Research department	Experts working for parliamentary committees
Albania	x	x
Bosnia and Herzegovina		x
• Bosnia and Herzegovina – state level	x	x
• Federation of Bosnia and Herzegovina		x
• Republika Srpska		x
Macedonia	x	x
Montenegro	x	x
Serbia	x	x

Members of parliamentary committees need to have access to timely, up-to-date, accurate and well researched information for effective decision-making. This becomes especially important at the committee level where members carry out in-depth analysis and debate issues. Parliamentary staff, therefore, must have a clear understanding of the information needs of Members of Parliament, and should possess the requisite researching skills to provide independent sources of information on national issues. Ideally the producers of information should be dedicated researchers who are engaged by parliament itself. Specialized research departments play special importance in that process, as these research departments conduct research of specific subject matters and/or obtain relevant information that would facilitate the work of members of the parliament and parliamentary committees. In practice however a number of countries, especially those in emerging democracies, increasingly rely on information from researchers in universities, research institutions, think tanks and civil society organizations to complement the work of the parliamentary research team.

Most of the parliaments of countries from the Western Balkan region have a research department (see Table 5). Only the National Assembly of Republika Srpska and the parliamentary Assembly of BH Federation do not have a research department. Research departments, however, still have limited staff capacity and priority is mostly given to inquiries relating to the current work of the Assembly rather than to more serious research analysis.

All parliaments from the region have a number of experts working for parliamentary committees. In most cases, each standing committee has a secretary of the committee and at least one or two advisors. They provide services focused on legal and other types of assistance to the committees.

Table 6: Parliamentary employees and experts which support the work of parliamentary committees for economy and finance in Western Balkan countries

	Number of employees	Number of experts
Albania	4	4
Bosnia and Herzegovina		
• Bosnia and Herzegovina – state level	3	3
• Federation of Bosnia and Herzegovina	10	6
• Republika Srpska	3	1
Macedonia	4	2
Montenegro	4	1
Serbia	13	4

Number of experts supporting the the work of parliamentary committees for economy and finance in Western Balkan countries varies from six in the Federation of Bosnia and Herzegovina, to only one in Montenegro and Republika Srpska. In order to secure further improvement of the work of these committees it would be important to strenghten the existing capacities, by hiring new experts and by improving the skills of the existing experts.

Due to the parliaments' limited research capacities, there is a practice of hiring external experts, mainly with the support of the donor community. However, in very few cases, a permanent cooperation is established with research institutions from the countries of the region.

5. Concluding remarks: How to Strengthen the Capacity of Parliamentary Committees for Economy and Finance in Western Balkan Countries

Despite the achieved progress in strengthening the capacity of parliamentary committees for economy and finance in all Western Balkan countries, much remains to be done. The following key recommendations for strengthening the capacity of these parliamentary committees are put forward:

- The mandate of these committees should be clearly defined in the parliaments' rules of procedure
- When choosingthe chairperson, good leadership skills in managing activities and committee meetings should be a priority, as they are important for the effectiveness of the committee;
- When choosing committee members, expertise and experience should be a priority;
- If new MPs are elected as committee members, trainings should be organized to improve their ability to fully take advantage of the powers of the committee system;
- The role of Parliamentary Committees for Economy and Finance should be strengthened in relation to the consideration, execution and control of the execution of the budget;
- The role of Parliamentary Committees for Economy and Finance should be expanded in relation to economic policy development and include involvement in the early phase of policy creation;
- Government should provide better access to information to Parliamentary Committees for Economy and Finance especially information related to the yearly budget and strategic documents prepared by the government;

- The committee chairperson and members should receive adequate support from the parliamentary staff and experts, not only regarding procedural and administrative needs of the committees, but also for more in-deep analysis, which is important for the effectiveness of the committees;
- The capacity of parliamentary staff and experts, which support the committees, should be strengthened in order to enhance their efficiency;
- The existing research capacities within the parliaments should be strengthened by equipping it with adequate personnel and technical resources for collecting data and performing analyses that can be used to support parliamentary committees;

The committees should receive greater media attention

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WORKING PAPERS

Beriz Belkić
Former speaker of the House of Representatives of the Parliamentary Assembly of Bosnia and Herzegovina

The importance of regional cooperation of parliamentary committeesfor economic issues

Overall goals of economic policy, irrespective of its modality, include: stimulation of economic growth and employment, securing greater liquidity of the banking sector, attracting foreign direct investment and speeding up reforms, both as a part of the transition process and as a precondition for EU integration.These common areas of engagement also create a need and possibility for coordinated action of all countries in the region,with a view to ensuring dynamics of the entire process. The question is: What is the role of parliamentary committees for economic issues?

In this context, the question is whether our respective parliamentary committeeshave capabilities/capacitiesto respond to thischallenge, given their role of intermediaries between political interests (of political parties, electoral base) and the executive power, and to prompt theirown parliaments to political action and also to play an important part in defining a common vision and engagement, all of which requires availability of human and institutional resources.

The question of parliamentary committees' capabilities/capacities is especially important in the light of the need to stimulate economic activity, for instance, through economic policy aimed at creating a business enabling environment (tax reform, guarantee of deposits, judicial reform aimed at improving legal certainty, effectiveness of bankruptcy proceedings, etc, and removing administrative barriers to both internal and cross-border economic activitiesvia implementation of regional arrangements, such as CEFTA, regional energy market in South East Europe, single investment arrangement, etc.)

The areas of priority action include:

- identifying main political problems and government structures which impede effective planning and execution of public expenditures,
- defining possible ways of improving fiscal management and sectoral spending in such areas as pensions and social transfers, salaries in the public sector, health care and education, as well asin sectors of crucial importance for development (energy, agriculture, forestry),
- finding ways to eliminate duplication of institutions and parallel institutions in the public sector,
- establishing aproper level of coordination in decision-making on public resource allocation,
- improving efficiency in public service delivery,
- strengthening the role of medium-term fiscal programming,
- re-shaping public expenditures and reducing public sector growth, and
- developing an action plan and set of recommendations referring to pensions, social transfers, salaries, health care, education, etc.

Mira Grgić

Deputy Speaker of the House of Representatives of the Parliamentary Assembly of Bosnia and Herzegovina

Strengthening the role of parliamentary committees for economic and financial policies

Since parliaments represent citizens' interests, they should have a crucial role in the analysis, adoption and oversight of overall legislation and budget plans in order to make surethat public resources are spent in accordance with the country's most pressing social and economic needs.

Of course, in most countries in the region parliaments and their committees for economic and financial policies are limited in carrying out these tasks. For instance, the executive power has a significant majority in parliament, there are statutory limits on greater involvement of parliaments, parliamentary committees have limited powers, parliaments are limited in terms of time or resources for greater involvement in the budget process, etc.

Given the abundance of available information in this field, i.e. numerous manuals,studies, proposals and professional guidance, one cannot help but wonder why these things are not functioning much better?

Parliaments can make a difference in terms of making the budget more transparent if they request and review comprehensive budget information that meet the following criteria: priorities in government spending should be clearly stated and explained; all prerequisites of microfiscal and fiscal policies should be stated; information supplied should be comprehensive for the purpose of proper decision-making concerning budget adoption; relevant stakeholders should be consulted; all information should be made available to the public; and information from previous years on budget financing and execution should be clearly reported.

Currently, the main tools available to parliaments to analyze government spending plans are the draft budget and budget proposal. Public debates on audit, budget and finance are another powerful tool available to parliamentsand their committees for economic policy and financethat is aimed at strengthening transparency and accountability and ensuring the involvement of the civil sector, media, citizens and stakeholders.

These committees should be entitled to ask direct questions to competent ministers and senior government officials on policies and programs that are implemented by budget beneficiaries.This means that they should be able to seek explanation from ministers and senior government officials concerning spending proposals, output and total value for money.

The purpose of public debates is to gain feedback from experts and also from the public on draft legislation and to examine ministers and senior government officials with a view to evaluating effectiveness and efficiency of government programs and performance and also to obtaining as accurate information as possible and to investigating any suspicion of officials' illegal activities.

Civil society organizations, experts and members of other organization often represent very rich sources of information for parliamentary committees. Through consultations with experts and stakeholders committees can obtain information and support from citizens who have direct experience with proposed government policies and budget programs.

Public debates are an effective means of involving citizens in the legislative process,enabling parliaments to identify proposals which the public does or does not support and to measure the extent of such support. By involving the public in this process, parliaments can exercise their legitimacy and ensure transparency and accountability of their lawmaking and decision-making processes.

Experts and non-governmental organizations can be another important source of information and knowledge to be used fora quality implementation of the entire process.

Alternative solutions that may arise during publicdebates can infuence the outcome, meaning that they can contribute to the passing of better laws thanks to citizens' knowledgeand expertise (in technical, local, social and economic terms) and to attracting relevant stakeholders. Citizens' participation in an open decision-making process will prompt governments and parliaments to take informed decisions and will also contribute to greater accountability of institutions that represent them. Public participation of citizens, which allows for a certain form of dialogue, can help ease the tension among various stakeholders. If planned properly, public debate can also contribute to the transformation of technocratic culture into a culture of open government, transparency and accountability.

Public debate is a useful tool for parliamentary committees to perform an in-depth examination and analysis of the budget. Since such debates are open to the public, greater transparency and accountability of government officials is thus achieved and members of parliamentary committees have an opportunity to hear alternative opinions and obtain additional information that their decisions will later be based upon.At the same time, legislative bodies in modern democracies must have sufficient time, capacities and opportunities to use relevant expertise in order to be able to monitor and control the budget.

In the context of parliaments and their committees, the question is whether parliamentary committees have the capacity to perform such complex tasks given the fact that, in most cases, parliamentary committees in the region are made up of secretaries and selected MPs who rotate in every election cycle.

These committees need to be equipped with additional resources in order to perform their tasks effectively. As for the question that was proposed for discussion: if there are relevant experts in the parliaments, I believe that this discussion will result in a conclusion that the involvement of experts in the work of the parliament, i.e. the work of parliamentary committees for economic and financial policies, is essential, without bringing into question their involvement in public debates and their motivation to contribute to these processes.

Marjančo Nikolov

Chairman of the Macedonian ParliamentCommittee on Financing and Budget

The role and importance of the parliamentary Committee onFinancing and Budget in the Republic of Macedonia in the process of budget adoption and execution

In the Republic of Macedonia, the chairperson of the parliamentary Committee on Financing and Budget is elected from the opposition in order to ensure greater transparency, accountability and control of the way that tax payers' money is spent. When the draft budget arrives in parliament in October, the draft budget and its amendments will first be discussed by the Committee on Financing and Budget. There are no time limits for this discussion. Then the draft budget will be referred to the plenary session. Then there is a time limit of five days to pass the budget. Between 65% and 70% of the budget is allocated for social transfers (pensions, social welfare, social benefits for vulnerable categories of citizens), salaries, public utility expenditures of the public administration and education sector. Between 10% and 12% of the budget is allocated for repayment of mature old debts, whereas18% is allocated for capital investments, which can be targeted to assist economic development. In case of budget rebalancing, capital investment will usually suffer from cuts, as the second part of the budget is intended for financing social entitlements, which the government will be reluctant to cut and thus risk losing its impact and popularity. The best and most appropriate thing to do would be to direct resources intended for capital investments towards stimulating local economy and consumption and to try to keep these funds in the country, with the exception of regional capital projects. It would be best if such funds could be invested in building road, railway or energy infrastructure, which in turn would help speed up economic development. Although the parliamentary Committee on Financing and Budget is equipped with professional resources to analyze the budget in its adoption stage, it still lacks means and methods to control budget spending in the implementation stage since the government is reluctant to provide required information. The process of establishing a Parliamentary Institute is currently underway in Macedonia. This institute will also include a department for economic issues, which is supposed to help MPs to obtain better analyses and information relating to the budget.

DISCUSSIONS

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Public Financial Management in Serbia

In the 2001-2011 period, Serbia made major changes in the public financial management system. The Budget System Law was entirely amended twice (in 2001 and 2009, respectively), and two major reforms were conducted in 2010 and 2011, respectively, through extensive amendments to this law:

- the Fiscal Council was established,
- the budget calendar was altered, so now, before starting to prepare the budget, the government must identify funding priorities, in consultation with line ministries, and must inform the parliament about its decision and then the parliament can comment on and propose amendments to the Fiscal Strategy Report, following relevant analysis which is performed by the Fiscal Council.

The reforms were focused on control of financial resources and coordination of the policy-making process. However, mid-term fiscal framework is only partly operational because program budgeting has not yet been introduced due to an obvious lack of reform capacity. The Fiscal Strategy Report is the main strategic document for planning and aligning budget revenues and expenditures with planning and implementation of desired policies.

Despite deep changes in sectoral policies, the time frame for financial planning still lacked strength to encompass a three-year period. The budget document still covers the period of one year and is subject to frequent modifications and changes, which significantly reduces the possibility to measure and manage outputs, effectiveness and efficiency of changes in the society, which are supposed to be achieved through policies, measures and activities funded from the state budget.

The legislative framework of public finance still has certain deficiencies:

- Although measurement of effectiveness and efficiency of spending/output of policy implementation has been specified as a budget management principle, it has not yet been elaborated (in terms of methodology, indicators, sources of verification of results, etc). All available information from a very detailed line-item budget and classifications with regard to effectiveness and efficiency of the use of budget resources still require further processing.
- The Law on Public Adminstration still contains provisions that restrict coordination among various ministries.

Reports on control of the use of the budget resources are financial in nature, which makes them rather incomprehensible to the public at large. Financial reporting should include three interconnected elements:

- overview of policy implementation,
- funds planned versus funds spent on policy implementation, and
- results achieved through the use of these funds (impact analysis and change indicators).

European integration process opens new challenges. Horizontal policies on environmental protection, non-discrimination and gender equality are gaining prominence. These policies, which are also provided for in the EU budget, are to be implemented by line ministries. This means that there are no individual resource allocations (chapters, lines) in the budget, but that resources are scattered across different line ministries or budget sectors and lines. The following questions arise:

- How to determine the amount of resources allocated for the implementation of horizontal policies?
- How to measure effects of such policies?
- Who should report to whom on the implementation of gender equality policies and how it should be reported?

The manner in which the budget is presented is the main obstacle to obtaining synthesized information on gender equality policies and resources allocated thereto:

- The budget is not program-related and program budgeting would facilitate determination of the amount of resources allocated and their purpose and results.

– Methodology of program classification is still not developed.
– There is no elaborate system of indicators to measure individual policy effects. The question is how to obtain data and what is the cost of collecting and verifying such data?

Without a more profound budget system reform, including planning and programming, it is impossible to successfully incorporate gender equality policies into the budget and to measure their efficiency and effectiveness.

The public financial management system in Serbia is far from European and international practices and the capacity to implement reform is insufficient. A new plan of reforms is urgently needed. However, it cannot be imposed from the outside or by donors. The reform plan must be prepared by the government and it must enjoy broad public sector support in order to succeed. Experiences of other countries, including EU member states, show that such reforms must be launched from the political level, and the government must fully support and implement them.

Mirjana Radaković

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Capacity building of committees of the National Assembly of the Republic of Serbia

In order to strengthen its role in comparison to other branches of power (executive and judicial branches), the National Assembly of the Republic of Serbia has adopted a new Law on the National Assembly and new Rules of Procedure of the National Assembly, which introduced a set of new institutions:

– Financial autonomy of the National Assembly has been introduced. A competent committee of the National Assembly shallset a parliamentary budget upon proposal from the Secretary-General and submit it to the government, i.e. to the Ministry of Finance. The governmentshall have no right to amend the parliamentary budget, only to incorporateit into the Draft Budget Law of the Republic of Serbia for the following year. This draft shall be referred to the National Assembly within a deadline stipulated in the Budget System Law.

– New elements have been envisaged for therationale that each draft law must contain. In addition to the existing mandatory elements (legal basis, reasons for passing the law, explanation of basic legal institutions, general interest why retrospective effect is proposed, reasons why a law should be passedin a summary proceedings, overview of legal provisions being amended), anestimate of financial resources needed for the enforcement of the law must also include funding sources. Preparation of every draft law requires an accurate financial analysis of resources needed for itsapplication. The rationale must include a regulatory impact analysis and explainthe following: who is likely to be most affected by the proposed legal arrangement and in what way, what costs will individuals and businesses (especially small and medium-sized enterprises) incur through the application of the law, whether positive effects of its adoption justify the costs that will be incurred, whether the proposed law will create a business enabling environment in terms of helping establish new businesses and boost market competition, whether all stakeholders have had a chance to state their opinion on the draft law and what measures will be taken during its application in order to achieve its intended goal. With each draft law, its proponent must submit a statement of compliance with the EU *acquis*, accompanied by a table of compliance of the draft law with the EU *acquis*.

– From the next composition of the National Assembly, the number of standing committees shall be reduced (from 30 to 20). This reduction is aimed at improving the efficiencyof committees and ensuring closer links with competent ministries. It shall be mandatory for ministries toquarterly submit information about their work to relevant parliamentary committees. The information shall be discussed by a relevant committee, whose session must be attended by the competent minister. The discussion will result in conclusions which shall be submitted to all MPs. From the next composition of the National Assembly, the Finance Committee will become a committee for finance, state budget and control of public spending, whose scope of operation will also include control of execution of the state budget and accompanying financial plans in terms of legitimate, purposeful and efficient spending of public resources. This committee shall report to the National Assembly and propose relevant measures.

– The parliament's control function has been reinforced by means of public hearing,which shall be organized by the aforementioned committee,and by means of regulating a procedure for consideration of reports from independent government agencies, organizations and bodies. The committee may organize a public hearing while the relevant bill is still being drafted, or for the purpose of clarifying the bill ("legislative" public hearing), or for the purpose of implementation and application of the law, i.e. with a view to exercising the control function of the national parliament.Relevant experts on the subject matter of the public hearing shall be invited to attend the hearing and, as a result, all participants in the hearing shall later receive information from the chairperson of the committee. Independent government agencies ("regulatorybodies"), whose members are elected by the National Assembly, are some kind of an"extended arm" of the parliament in itsexercise of control of the executive power.Following consideration of the above reports, the committee shall submit its own report to the National Assembly, together with draft conclusions tobe adopted by the National Assembly. The conclusions of the National Assembly shall be binding for everyone concerened.

– The application of new parliamentary institutions requires proper technical support of the staff of the National Assembly Service. To this effect, the National Assembly Service has been reorganized and a new job classification with detailed job descriptions has been adopted. The Legislation Sector has been set up, comprising seven organizational units which shall perform key technical tasks for MPs (drafting of legal documents and amendments thereof, analyzing current and proposed legislation, preparing comparative expert analyses, developing tables of compliance of drafts submitted by MPs with the EU *acquis*, preparing studies on issues pertaining to the perfomance of MP functions, preparing reports, information and documentsfor adoption by parliamentary committees, etc.).

Sanja Filipović
Economics Institute, Belgrade

I am happyto see that,aftermore than seven years since the idea of this regional project has been initiated,a growing number of parliamentarians from the region, representatives of the scientific community and international organizations are still interested in continuing this regional cooperation. This shows not only how important this topic really is, but also how important it is to establish regional cooperation among economic and finance committees of parliaments of Western Balkan countries. When listing the advantages of setting up such a regional network, we may say that all countries in the region are currently in the process of EU integration, which has resulted in harmonization of legislation and institutional building, whereas the enforcement of legislation still remains one of the biggest problems.

Given the importance of economic legislation at the times of economic crisis, it is clear how important the role of parliamentary committees on economy and finance really is, not only in terms of formally accepting the laws, but also in terms of offering concrete qualitative suggestions thereto. Although these committees are assisted by professional staff within their respective parliaments, an increase in the number of pending laws that need to be passed requires an upgraded level of professional expertise of the supporting staff. As far as I can see from the agenda of this conference, the need to include scientific institutions in this process has already been recognized.

One of the roles of scientific institutions is to support parliamentary committees and thus help them implement the parliament's control function. For instance, there are about 130 different agencies in Serbia, most of which are funded from the state budget, which poses the question of cost-effectiveness in the use of public resources. Of course, there are some good examples of self-funded agencies whichare trying to strengthen their own independence and broaden the scope of their own competences. Such an example is the Energy Agency, which has managed to do so also thanks to cooperation with regulators in the region. This is a good example of regional cooperation that may serve as a model for cooperation among parliamentary committees in the region.

Emir Kabil

Chairman of the Finance and Budget Committee of the House of Representatives of the Parliamentary Assembly of Bosnia and Herzegovina

European integration is the only right path for weak economies, such as those in the Western Balkan region. We are faced with a difficult economic situation and we, parliamentarians, transfer the decision-making power to those who are not accountable to anybody. I hope that scientific institutions in the Federation of Bosnia and Herzegovina will finally find their rightful place and that experts will be involved in the decision-making process. I am looking forward to seeing positive reflections on the entire region of Serbia's getting a candidate status for EU membership. Conferences such as this one should focus more on expertise and less on politics.

Nikola Novaković

Deputy Speaker of the National Assembly of the Republic of Serbia

I shall answer some of the questions proposed for discussion:

- **How often parliamentary committees for finance and economy discuss issues related to economic policy?**

They never do, because nobody listens to anybody. The parliament elects the government and then the government goes its separate way, which is something that will hopefully change with the new law on parliament that will come into force following the elections.

- **Does the composition of most parliamentary committees reflect the multi-party composition of the parliament?**

Yes, but this is irrelevant. In Serbian-style democracy, opposition doesn't bother to participate in anything that takes place beyond the reach of TV cameras.

- **How important consensus is for the operation of a parliamentary committee?**

I do not think that consesus is a democratic tool, but it is definitely hard to reach consensus in this parliament when"the chairs are empty".

Srđan Marinković

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Fiscal policy – rule based or discretion

Today, world economy is faced with the recourse to monetary financing of the government budget deficit, increasing levels of government indebtedness and the resurgence of the snow-ball nightmare on government debt in a number of countries. Incoming wave of sovereign default on its debt threatens to be the sixth in the row of major turmoils in the last two centuries. It comes after Napoleonic War (1800s), 1820–1840, 1870–1890, Great Depression and World War II (1930–1950), and Emerging market debt crisis (1980–1990). Opposite to the most recent episode, nowadays, even globally most advanced economies undermined its stability and growth prospects with prodigal governmental spending.

Governmental budget plays an important role in addressing economic and social goals. This is a mighty societal instrument, but also frequently politically misused instrument. Since Keynesian revolution, governments (through public spending) in every corner of the world start flattening the business cycle. This role of government was not questioned almost entire century. The idea to use governmental spending as a substitute for weak private spending originated in times when the role of a government in economy was much less than today. However, is it all the same in case of government hypertrophy? The responsibility of a contemporary government for social well-being is far more stretched out today than ever before. Some public expenditure have secular tendency to grow (health care, education, security, etc.) and do not depend on governmental readiness to accept additional responsibility. Moreover, many states promote themselves into a real “welfare state”, which drives the public spending to the unprecedented levels. The last but not least, tremendous increase in public debt happens to US, EU and some other countries, after they stood up for distressed private financial industry. It means that "contingent liabilities", which depend on instantaneous political considerations, may play equally important role in designing demand for public goods. Either way stimulated prodigal public spending brings the austerity package to the forefront of academic and policy discussions, making urgent recourse to the healthy finance. Ardent policy debate comes to the cross-road, when policy-makers must decide which way to take: austerity measures vs. further stimulus of aggregate demand.

Probably thanks to EU accession window, IMF closer monitoring, and uncomfortable fiscal history, the peripheral economies are better performers in terms of public debt than old EU members. With worldwide debt issue, possibility of external monitors to bring discipline to fiscal policy is seriously undermined. Sustainable and responsible fiscal and monetary policy is the only way out of fragility, and responsibility for this task today rests predominantly to internal policy actors.

More than ever before, the rules are seen as better response than discretion. There are different ways for implementing rules in budget policy. Examples are public debt ceiling (US), Maastricht convergence criteria (two out of five) tackle fiscal policy (budget deficit and consolidated public debt), and more recently public debt (to GDP) ceiling in Serbia. Debt ceiling itself may be put relative to GDP or in absolute nominal terms. In the latter case it is more susceptible to window dressing. Stick to the simple rules is a proposal already seen and widely debated in the area of monetary policy (for instance, currency board proposal). Motivation for switching to the rules in both monetary and fiscal policy does not differ much. The arguments for the fiscal rules are the same as the case with monetary rules: policy incompetence, inability to resist public pressure, etc. Equally, the flaws are very similar. The rules rule out flexibility. Thus, the rules are often proposed in harsh times with an idea to stay in place a limited period of time. Interestingly, implementation of debt ceiling in Serbia coincides with voices that advocate rule-based monetary policy (currency board).

The fiscal rules are easy to monitor and transparent. That is recognized as basic strength of the proposal. However, the rules are not implemented by themselves. There is a number of ways to circumvent the rules: creative accounting, consolidation issues, public guarantees, etc. The ultimate effect of the rule-based policy depends on how effective are mechanisms available for enforcement. Since nothing but political costs constrains those who infringe the rules, political mechanism stays the only effective brake. Despite legal mandate to prevent excessive public debt, parliamentary control proved not to be effective in case of Serbia. In this case, specific electoral legislation weakens the possibility of Parliament to act as effective government monitor.

Draško Nikolić

Institute of Economic Sciences, Belgrade

Mr. Nikolov said in his presentation that two-thirds of the Macedonian budget were allocated for salaries and pensions, whereas only 18% was allocated for capital investments. Participants in the discussion also stressed that when it came to borrowing, efficiency and effectiveness in the use of funds was much more important than the amount of the debt itself. In view of the previous arguments, my question is why, in the case of budget rebalancing and decisions on extra borrowing, the cutting always affects the capital investment side of the accounts, although they are the main generator of economic growth thatmay even help reduce the budget deficit in the long run, rather than affecting items on the current spending side, which, if financed by borrowed funds, will additionally increase the budget deficit and public debt level, instead of generating an increase in GDP, which could later allow for sustainable servicing of public debt.

Marjančo Nikolov

Chairman of the Macedonian Parliament Committee on Financing and Budget

Reply: Since pensions are entitlements, there are no legal grounds for savings in the budget by cutting pension outlays. As for salaries in the public sector, the question of possible cuts is rather complex as this would involve social elements and a firm political decision to launch very difficult and radical reforms. The government should certainly strive to invest more in capital projects, but at the times of global economic crisis,when the revenue side of the budget is reducing, that goal is very hard to achieve.

Andreja Marušić
Balkan Centre for Regulatory Reform, Belgrade

Improved quality of legislation as a result ofgood performance of parliamentary committees

All Western Balkan countries have put in place legislative quality control mechanisms, including an obligation of the government to analyze legislative effects. Hence, the analysis of legislative effects has been mandatory in Serbia since 2004. In exercising their control function, parliamentary committees for finance and economy can significantly influence improvements in the quality of legislation by insisting that a quality analysis of legislative effects be performed by the government.A successful example of exercising such control function by a relevant parliamentary committee is the Company law, one of the basic umbrella laws for the economy. This committee had insistited on additional explanation of the analysis performed by the government and used the power of amendments to introduce changes that would have a positive impact on the application of this law.

Majda Sedej
USAID's Serbia Business Enabling Project

Enabling the parliament to play a more important role in budget and policy creation: improving budgetary process and increasing transparency of budget document

The ability of the Parliament to effectively fulfill its mandate related to the consideration, execution and control of the execution of the budget, and its role in policy creation, to a large extent depends on quality of budget process and transparency of budget document.

Although theinstitutionalframework relatedto the budget preparation and adoption in Serbia is conceptually well-laid, there is room for improvement of the process and more consistentapplication ofthe existing rules. Failure to comply with deadlines for conducting activities on the budget preparation and adoption is currently one of the majordeficiencies in the process. Another issue with the current budgeting practice is its weak linkage with strategic planning - the priorities of mid-term strategic planes of government and ministries are not clearly reflected in annual budget allocations, making it hard to evaluate usage of budget resources relative to achievement of national goals. Furthermore, the current budget process does not facilitate a strong control over the use of *all* government revenues and expenditures: own-revenues of budget users are not considered in budget allocation decisions. Expenditures related to the National Investment Plan are considered outside of the budget process, which hinders the prioritization process and efficiency in the use of budget resources.

Transparency of the budget document significantly depends on the budget model. Linear (line-item) budgets, in which the public funds are displayed according to sources and beneficiaries /purpose, do not allow forconsistentmonitoring ofthe effects achieved by usage of funds. The line-item model makes it possible for discretion to play a role in the execution of the adopted budget – it is not clear which projects will be financed from the broad budget lines and priorities often shift.

Introduction of program budgeting, and mandatory performance measurement and reporting increases transparency and efficiency in the use of budget resources through better measurement of the benefits and costs. At a more practical level, it improves how the budget is classified, compiled, evaluated, prioritized, and ultimately monitored. The program and performance-oriented model has been recognized as best-practice in creation of a transparent budget document, and is widely used around the world (all of the OECD countries adopted it, as well as many developing and transitional economies).

The Budget System Law envisages the adoption of program budgeting in Serbia by 2015 and continued advances towards fuller performance budgeting in the longer-run. However, the improvements in this area have been modest so far due to: 1) weak political support and 2) low technicalcapacity of the Ministry of Finance and line ministries to switch to a new system.

To provide conditions for their more substantive role in the budget and policy creation**,** legislatures should increase the efforts in advocating for reforms (laid out above) leading to more transparent and efficient budgetary process.

Joe Lowther

Chief of Party, USAID's Serbia Business Enabling Project

Increasing the capacity for budget-related analysis within the parliament

To effectively execute their legislative and oversight functions legislatures need a source of information and analysis independent from the executive branch. Individual members of Parliament (MPs) as well as the Budget Committee and other Committees, need strong technical support in the drafting, approval, implementation, and auditing of the national budget. Unfortunately, legislatures in the region lack the internal capacity to perform these activities. A nonpartisan, independent, objective analytical support can provide transparent, clear, and accurate information without polarizing relations between the executive and the legislature.

Potential Value and Functions of Independent, Objective, Non-Partisan Analytical Support

What are the benefits of legislative-based, independent, nonpartisan, objective analytical support on budget-related issues for legislatures, committees, and citizens? First, complex budget information provided by the executive branch is simplified so that legislators can better understand and use it. Second, the analysis helps promote budget transparency—not just from the executive branch to legislatures but to the public as well. Third, scrutiny of estimates by the executive enhances accountability. The realization that their assumptions and figures will be carefully reviewed by budget experts from a separate branch of government encourages executive branch budgeters to be more careful and precise than they might otherwise have been; this could also lead to a greater discipline in public spending. Finally, independent analysis serves both majority and minority parties, strengthening the technical ability of the parliament as a whole.

Responsibilities of the analysts could include: creation of policy briefs (short, straight forward descriptions of complicated budget proposals and concepts); economic analyses which contribute to the legislature's understanding of the near term and long term budgetary consequences of related policy proposals; impact analyses of policy proposals (ex-ante, ex-post); analysis of the previous year's spending and achievements (performance measurement and evaluation); monitoring of withdrawals of budget allocations through the year; analyses of tax policies, such as estimating the impacts of proposed tax changes on economic growth, or measuring the distributional impacts of various different types of tax proposals; analyses of how potential cuts in the budget affect individual budgets/activities of line ministries; etc.

Forms of Budget-Related Analytical Support

Budget-related analysis can be provided to the legislature through a general research unit or pool of staffers supporting the work of various committees. In this scenario, selected qualified staff specialized in budget-related analysis by acquiring specific research and analytical skills.

Another form of budget-related analytical support is through establishment of independent budget units. More and more countries are setting up independent budget offices as their legislatures become more involved in the budget process. Examples include the well-established Congressional Budget Office in the US, the Dutch Central Planning Bureau, the Parliamentary Budget Office in Canada, and the Scrutiny Unit in the UK. There are also independent budget units in developing countries, such as Brazil, Mexico, Morocco, Jordan. Once created, such a unit must operate in a credible and impartial manner if its value is to be sustained.

Mladen Mladenović

Deputy Secretary of the National Assembly of the Republic of Serbia

In view of the topic of this conference and this session, I would like to say that the management of the National Assembly Service has recognized the need to build the Service capacities during this term of office.

Despite a very busy and dynamic legislative activity of the National Assembly, the Service has successfuly carried out major organizational, technological and practical changes in its operation.

The National Assembly adopted the National Assembly Law, new Rules of Procedure and amendments thereof in 2011, Decision on the Organization and Operation of the National Assembly Service and the Rules of Internal Organization and Job Classification of the National Assembly Service, proposed by the Secretary-General and approved by the Administrative Committee.

The Rules of Internal Organization and Job Classification of the National Assembly Service stipulate that each committee, incuding the Committee for Finance, State Budget and Control of Spending of Public Resources, should have five employees to assist MPs in their work. In order to prepare for debate on items on the agenda of the committee meeting, MPs will also be able to use the services of advisors from the Department for the Affairs of Parliamentary Groups and researchers/analysts of the National Assembly Library.

On January 30, 2011, the Secretary-General adopted a Multi-annual Development Plan of the National Assembly Service for the period of 2011-2015. This plan established six strategic goals of the Service, the first of them being “Improving quality of operation of the Service and efficiency of its support offered to MPs”. To this effect, a set of internal documents was adopted in keeping with the best parliamentary practices. These documents have a completely new way of definingparliament business in the areas of legislative and control functions and research.

I would like to stress that the National Assembly and its Service are fully prepared to tackle all challenges in the forthcoming period when, in my view, the National Assembly will become increasingly focused on exercising its control function.

Finally, I would like to say that the planning function is extremely important for the operation of the National Assembly, its MPs and committees. To that end, in the future, the Government of the Republic of Serbia should submit its Annual Work Plan (referring to legislative proposals) to the National Assembly, so that the Assembly could plan its activities accordingly.

II SESSION

DO WESTERN BALKAN COUNTRIES NEED RESTRICTIVE OR EXPANSIONARY FISCAL POLICIES?

BACKGROUND PAPER

Fikret Čaušević
SEESOX Visiting Fellow 2011/2012, St Antony's College, University of Oxford, and professor at the School of Economics and Business, University of Sarajevo

Expansionary or restrictive fiscal policy for the Western Balkans

"Fiscal discipline" in the European Union and the United States

The European Central Bank (the ECB), the youngest of the world's leading central banks, was established in June 1998. The European Monetary Institute, which inherited the role of the European Monetary Cooperation Fund, was the predecessor of the European Central Bank. Six months after the ECB was established, the single European currency - the euro was introduced as the first single currency in one of the most developed group of countries in the world. The introduction of the single currency was one of the main objectives of European integration, initiated by the establishment of the Community for Coal and Steel, from which the European Economic Community, and the European Community had been developed, as predecessors of the European Union.

In order to stabilize public finances and achieve fiscal discipline in the European Community with the aim of introducing a single currency, rules on monetary and fiscal discipline were introduced by the Maastricht Treaty (February 1992). The Treaty entered into force on December, 1st, 1993. The two fiscal criteria that should be met, and were determined by the Maastricht Treaty, referred to the allowed budgetary deficit of 3% of GDP (as a maximum level), while the alternative fiscal criterion related to the total public debt. The total public debt was allowed at the level of 60% of GDP.[9]

When the ECB was established, and a single European currency was introduced (January 1999) more than half of the then member states of the euro-zone had a total debt much higher than the "allowed" 60% of GDP. The two countries with the highest level of public debt in 1998/1999 were Belgium (124% GDP) and Italy (122% of GDP). Greece was admitted to the euro-zone in 2001 - since the country that year met one of the two fiscal criteria. Specifically, Greece had cut the budget deficit to below 3% of GDP, while its public debt at that time was on the level of public debt comparable to that of Italy and Belgium (about 120% of GDP).

Entering the member countries of Euro-zone was strictly conditioned to the first criterion - reducing the budget deficit to below 3% of GDP, with the obligation of countries that had substantially higher public debt in relation to established criteria (60% of GDP) to public debt gradually reduced to acceptable and sustainable framework. Italy and Belgium were required to reduce their public debt to a level of 90% of GDP by 2005. By the end of that year Belgium reduced its public debt to below 100% of GDP, while Italy’s public debt stood at 104% of GDP.

In October 2002, the then European Commission President Romano Prodi gave his famous interview to Le Monde in which he emphasized that the fiscal criteria laid by Maactricht Treaty and Stability Pact had been too rigid. These rules, which were confirmed by the European Stability Pact, Prodi called as "these stupid rules"[10]. At that time (the last quarter of 2002), the three most developed countries of the European Union and the euro-zone member states (Germany, France and Italy) have violated the fiscal criterion related to the budget deficit. These countries have their own excuses for budget deficits – they had claimed that there is no danger with violating the fiscal criteria related to the budget deficit. Specifically, their

9 The Maastricht Treaty – Provisions amending the Treaty establishing the European Economic Community with a view to establishing the European Community, Maastricht, 7 February 1992 (http://www.eurotreaties.com/maastrichtec.pdf)

10 Le Mond: Interview with Romano Prodi : “I know very well that the Stability Pact is stupid because all the decisions made under it are so rigid.” 24 October 2002 (http://www.telegraph.co.uk/finance/2830598/Euro-Stability-Pact-is-stupid-says-Prodi.html)

argument was that entering into recession would be much greater damage for the countries than having the budget deficits at the level of 4% of GDP.[11]

The first two years of the last decade in the global economy were marked by problems in the US financial markets following after the burst in dotcom bubble, and then after the terrorist attacks in this country on 9/11. In the last quarter of 2001 and during 2002, the Bush's administration had basically implemented the recommendations of John Maynard Keynes. Specifically, at the beginning of his first term George W. Bush and his administration have drafted a fiscal program that from 2001 to 2010 the United States would reduce its total public debt to zero. When George W. Bush took office the total public debt of the United States amounted to nearly USD 4.5 trillion. Thanks to a highly favorable trends in the US financial markets President Clinton succeeded for the first time in thirty years to eliminate the budget deficit in 1998. The US was fiscally one of the most successful countries in the world in the three consecutive years (1998-2001). Doing almost a linear projection of the present (at that time) to the future the Bush Administration was planning to eliminate the total public debt by 2010. Instead of that plan, George W. Bush and his administration ended up with almost USD 10.6 trillion in public debt in the end of the his second term (twice the public debt in absolute terms in relation to the takeover period).[12]

Despite Bush's free-market rhetoric, what the Bush Administration did in the first two years after the terrorist attacks (2002-2003), as well as in the last two years of its rule (2007-2008) were essentially the classical measures of state intervention in the tradition of John Maynard Keynes – that is preventing the fall of the business cycle (in the period after the terrorist attacks) and preventing the recession turning into depression (in the last two years of the rule) based on the rapid growth of public debt. Extremely expansionary fiscal policy was also supported by an expansionary monetary policy during the Greenspan era as well as during the Bernanke era.

[11] The Guardian: „What is the stability and growth pact?“ (http://www.guardian.co.uk/world/2003/nov/27/qanda.business)

[12] On the day of Obama's inauguration as the US President the total public debt was USD 10.62 trillion (http://nationaldebtbusters.blogspot.co.uk/)

Brief review of "Lessons from the macroeconomic management": fiscal and monetary policy

The standard framework for the analysis of interactions of fiscal and monetary policies on macroeconomic equilibrium (the general equilibrium) in a closed economy has been theoretically based on works by Hicks, Harrod and Meade (the IS-LM model of a closed economy), and the development of this model and its refining into the framework of the open economy in the works of Mundell and Fleming a little more than five decades ago (the IS-LM-BP model of an open economy). [13]

"Classical" macroeconomic analysis of the implementation of economic policy when the actual output deviates from the potential output, with a realistic assumption that the economy is rarely operates at the level of full employment (which is the exception not the rule, as Keynes wrote in his General Theory).[14] When the actual output is below (significantly below) the potential output recommended measures of economic policy are fiscal and monetary expansion. Fiscal expansion is primarily based on public borrowing, and using the revenue generated by selling government bonds to finance capital projects, which are prerequisite for getting out of the recession (the crisis) and for pulling in private investors into investment cycle. The role of monetary authorities is to purchase government bonds in order to increase the demand for this type of financial asset, increase the amount of money in circulation and thus reduce the interest rate as the cost of financing the public debt, as well as the cost of financing private

[13] Robert Mundell and Marcus Fleming have developed a model of an open economy based on the IS-LM model. The IS-LM model was presented at the Conference of Econometric Society held in Oxford in September 1936 as a model of closed economy based on Keynes' General Theory of Interest, Employment and Money. The model was developed by John Hicks based on Roy Harrod's paper. The Mundell-Fleming model is also called the IS-LM-BP model and it describes an open economy whereas the IS-LM model deals with a closed economy. The seminal papers for the development of IS-LM-BP model were: Mundell, Robert A. (1963). "Capital mobility and stabilization policy under fixed and flexible exchange rates". *Canadian Journal of Economic and Political Science* 29 (4): 475–485.; Fleming, J. Marcus (1962). "Domestic financial policies under fixed and floating exchange rates". *IMF Staff Papers* 9: 369–379.

[14] Keynes, John Maynard (1936) *The General Theory of Employment, Interest and Money*, Macmillan Cambridge University Press. The book is available on the web site: http://www.marxists.org/reference/subject/economics/keynes/general-theory/

investments. These measures are paving the way for increase of capacity utilization, increase in employment, and in fiscal capacity. Thus, in the period of recession or economic crisis, fiscal and monetary expansion are recommended and proposed measures in mitigating the business cycle fluctuations.

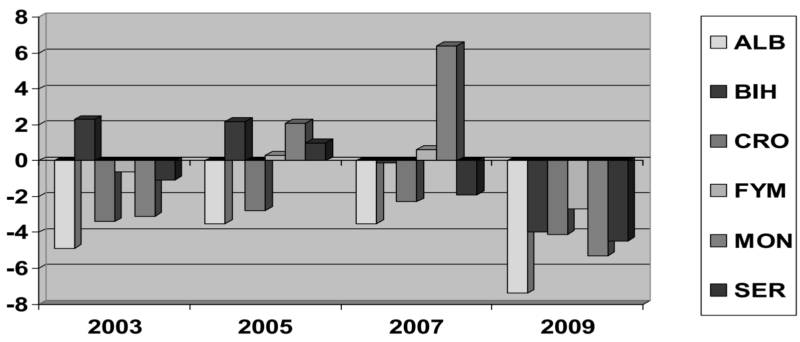
On the other hand, when the business cycle is at its peak, the actual output is greater than the potential. This "surplus" in relation to the actual product is causing a potential inflationary pressures and overheating of the economy. The unemployment rate is, therefore, above the natural rate of unemployment (the rate that does not cause inflationary pressures). Labor costs rise and productivity declines. Aggregate demand is greater than necessary, and it directly contributes to destabilization of economy. At this phase of the business cycle macroeconomic theory recommends a restrictive fiscal policy - fiscal discipline based on the reduction of public expenditures in order to reduce the fiscal burden on society. Since the economy is in growth stage of the business cycle and supported by expansionary monetary policy, which has a key influence in the formation of inflationary expectations, the recommended measures of economic policy, in line with the fiscal restrictions, is a restrictive monetary policy. Restrictive monetary policy is based on the significant rise in interest rates targeted to eliminate inflationary expectations.

Since the restrictive fiscal policy results in a significant decline in aggregate demand, combination of fiscal austerity with the restrictive monetary policy would be followed by a decline of the business cycle, which should have a basis for the real goal of returning the product to the level of potential products. Since the opposite direction of the formation of business expectations of investors (business pessimism), due to the decline in demand for their products, could cause a quick shift of "projected recession" into a much greater disorder – a depression recommended restrictions on the fiscal side in the next stage after knocking down inflation, should be followed by monetary expansion. The expansionary monetary policy should contribute to the decrease in interest rates and in costs for investments, which would support business investments, and contribute to the change in composition of GDP in favor of business investment by reducing public spending.

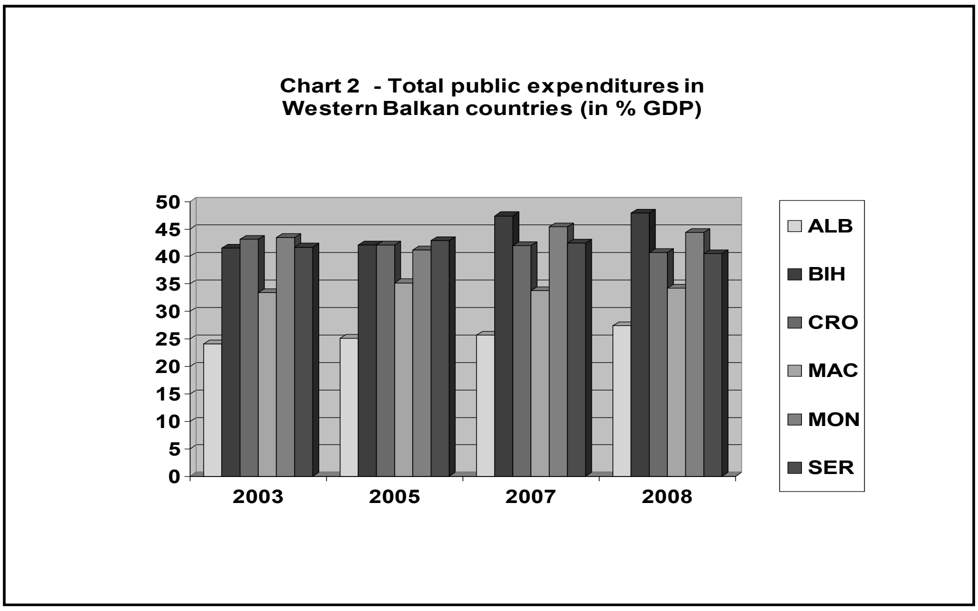
Fiscal discipline in the Western Balkans and the impact of global crisis on the Region

In the five-year period that preceded the global crisis (2003 to 2008) Western Balkan countries were fiscally more responsible than the most of euro-area countries, using the budget balance as a percentage of GDP as a criterion. Figure 1 shows that some of the Western Balkan countries were successful in achieving above-average budget surplus in relation to other countries in the region, as well as in relation to the EU average. Bosnia and Herzegovina and Montenegro are two examples. From 2003 to 2005 Bosnia and Herzegovina had run budget surpluses on the average level of 2.5% of GDP. In the period 2005-2007 Montenegro was even more successful - in fact the most successful country in the Western Balkans. In 2007 this country achieved a budget surplus of 6.1% of GDP. In 2005, Serbia achieved a budget surplus, while budget deficits in this country in 2003 or 2007 were below 2% of GDP. Albania has been a country running the largest budget deficits in the region. The country's average budget deficit in the 2003-2007 period was at level of 4.2% of GDP, while in 2009 it peaked up to 7.4% of GDP.

Chart 1 – Consolidated budget balances in the Western Balkans (in % GDP)



Source: EBRD, Transition reports for 2005, 2008, and 2010.



Source: EBRD, Transition reports for 2005, 2008, and 2010.

Unlike fiscal discipline measured by the budget balance criterion, the total public expenditures measured in percentages of GDP during the pre-crisis period (2003-2006) were quite high - at the level of 42% of GDP in Bosnia and Herzegovina, Croatia, Serbia and Montenegro. In 2007 and 2008 a country with the largest public expenditures was Bosnia and Herzegovina (47.5% of GDP on average for the two years). The lowest public expenditures to GDP ratio (26% of GDP) had Albania (as opposed to the budget deficit). The highest public expenditures in Bosnia and Herzegovina, and relatively high public expenditures in other countries of former Yugoslavia are due to the fact that these countries, and especially Bosnia and Herzegovina, have suffered huge losses during the wars in former Yugoslavia (1991-1999) - both in terms of human capital, and in terms of physical capital (business equipment, plant, inventories) and infrastructure.

A relatively high fiscal discipline measured by budget balances (in percentage of GDP) in Western Balkan countries (except Albania) had been largely possible due to rapid expansion of banking and consequent rapid expansion of credit activities (both – to households and to enterprises). Thus, the two dominant segments contributing to GDP creation (consumption and business investment) have been relied upon credit expansion of banks in the region. In other words, a rapid credit expansion of the banks in the region had created conditions for the GDP growth of the countries, and thus increase in their fiscal capacities.

The data in Table 1 show the achieved level of openness of the financial sector of Western Balkan countries, and credit activity (in percents of GDP) in 2008 – the year that preceded the recession. The same table also presents data for Slovenia as the former Yugoslav country. By the end of 2008 in all Western Balkan countries the share of foreign banks in the banking sector was dominant: the lowest in Serbia (75%), and the highest in Bosnia and Herzegovina (95%). Only Slovenia (a country that does not belong to the Western Balkans) had a dominant share of residents in the banking sector. The greatest expansion of lending activity was recorded in Montenegro, where the end of 2008. ratio of approved loans to the private sector to GDP was 87.2%. Unlike the Croatian and Bosnia and Herzegovina, in which loans to households were higher than loans granted to private companies in Montenegro, the share of loans to private enterprises in the total private sector loans approved was 64%.

Table 1: Foreign ownership in the banking sector of the Western Balkans and Slovenia in 2008

Country	Foreign owned share in the total assets (in percents)	Credit to private sector (in % of GDP)	Credit to households (in % of GDP)
Albania	93.6	35.3	13.2
Bosnia and Herzegovina	95.0	53.5	27.2
Croatia	90.8	68.1	37.1
Macedonia, FYR	93.1	43.9	15.5
Montenegro	84.6	87.2	31.5
Serbia	75.3	39.7	13.9
Slovenia	31.1	85.6	19.9

Source: EBRD, *Transition Report 2009 – Transition in crisis?*, London, 2009.

A striking example of the direct connection of growth in fiscal revenues and budget surpluses with the credit activity is Montenegro. This country was not only an absolute record in the Western Balkans but also among the top ten countries in the world in terms of a rapid credit expansion in the 2006-2007. In these two years credit to households in Montenegro increased by 198% and 155% respectively, while credit to enterprises increased by 102% and 187% respectively. The enormous increase in purchasing power sharply increased the tax base and Montenegro increased its budget surplus from 2.1% (in 2005) to 6.4% of GDP (in 2007). Effects of the global financial crisis on the credit activity and fiscal revenues in Montenegro and Serbia were different. In Montenegro, the credit activity was sharply reduced in 2009 and 2010. Credit to households were reduced by 11.4% and 6.1% respectively, while credit to enterprises were reduced by 17.5% and 9.4% respectively. The budget surplus of 6.4% of GDP in 2007 turned into a budget deficit of 5.3% of GDP in 2009.[15]

Unlike in Montenegro, credit activity in Serbia was not reduced, although the growth rate of credit to households, and enterprises was reduced. In 2009 and 2010, credit to households increased by 8% and 23.5% respectively, while credit to enterprises increased by 18.4% and 27% respectively.[16] These trends in the Serbia's credit market had resulted in mitigating the effects of external shocks. However, the budget deficit in Serbia due to falling purchasing power caused by rising unemployment and reduced volume of trade increased from 1.9% to 4.5%.[17] Because of these trends Serbia, like Bosnia and Herzegovina, contracted a Stand-by Agreement with the IMF. In the last quarter of 2011 Serbia signed a new Stand-by Agreement, as a credit line that is provided as a precaution against potential negative effects of the crisis in the euro zone during 2012. It is important to note that during 2011 the credit activity in Serbia was considerably less intense than the previous year. Although credit growth has been achieved, the growth rate was nearly ten times smaller than the

[15] EBRD, *Transition Report 2009*, London 2009; and the IMF: http://www.imf.org/external/country/MNE/index.htm; http://www.imf.org/external/np/sec/pr/2011/pr1151.htm
[16] Sources: The National Bank of Serbia; the Central Bank of Montenegro.
[17] EBRD, Transition Report 2009, London 2009; and the IMF: http://www.imf.org/external/country/SRB/index.htm; http://www.imf.org/external/np/sec/pr/2011/pr11353.htm

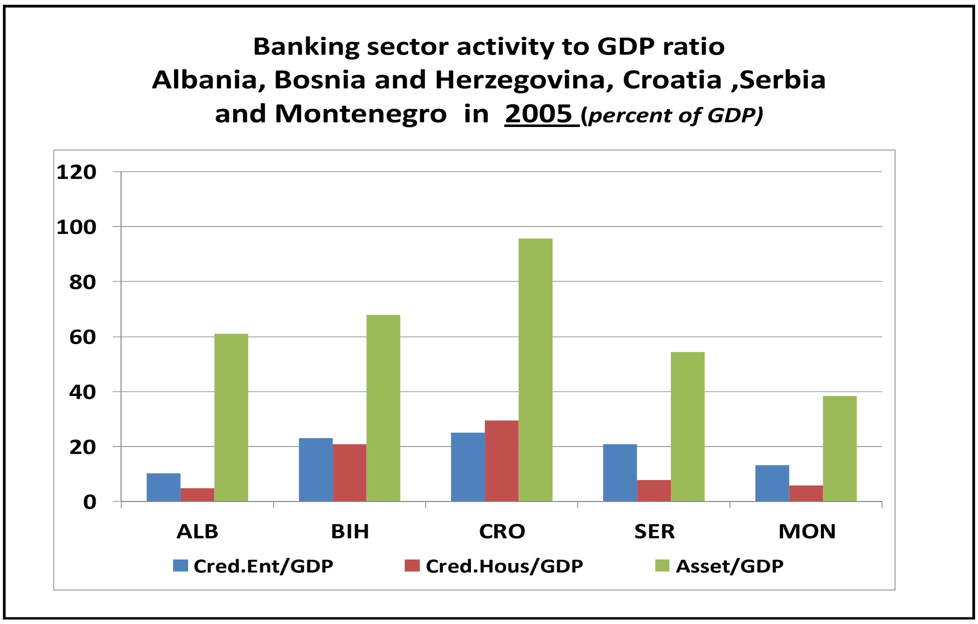
previous year. During 2011 Montenegro has also continued the downward trend in credit activity.

The average growth rate of credit to households in Albania in the period 2005-2007 was 69%, while credit to enterprises grew at an average rate of 56.6%. The Albania's budget deficit was reduced from 4.9% (2003) to 3.5% of GDP (average for the period from 2005 to 2007). In 2009-2010, the credit activity was significantly reduced. Credit to households grew by only 3.8% and 1.3% respectively in the two years, while credit to enterprises rose by 13.8% and 14.7% respectively. The budget deficit was more than doubled - from 3.5% (2007) to 7.4% of GDP (2009.).[18] In the 2005-2007, the average growth rate of credit to households in Macedonia was 45.4%, while the average growth rate of credit to enterprises was 23.3%. In accordance with these data, the credit expansion in Macedonia was comparable with the credit expansion in Bosnia and Herzegovina and Croatia, while credit to households recorded significantly higher growth rates compared to those two countries. In the same period, Macedonia run budget surpluses at an average level of 0.6% of GDP. In 2009 and 2010, credit to households grew at a rate of 3.1% and 5.1% respectively, and credit to enterprises by 3.4% and 8.5% respectively.[19] The budget surplus of Macedonia in the period of the crisis turned into a budget deficit of 2.3% of GDP (2009.).[20] In the year when the financial crisis was gradually spilling over from Western Europe to the Western Balkans (2008) credit activity in almost all the countries in the region was quite intense, and had a decisive influence on the large increase in trade within the region, and with Western Europe. The lowest level of indebtedness of the private sector in the region had been in Albania and Serbia, while the highest levels of private sector indebtedness were in Croatia and Bosnia and Herzegovina (2005).

[18] Transition Report 2009, London 2009; and the IMF: http://www.imf.org/external/country/ALB/index.htm;http://www.imf.org/external/pubs/ft/scr/2011/cr11313.htm

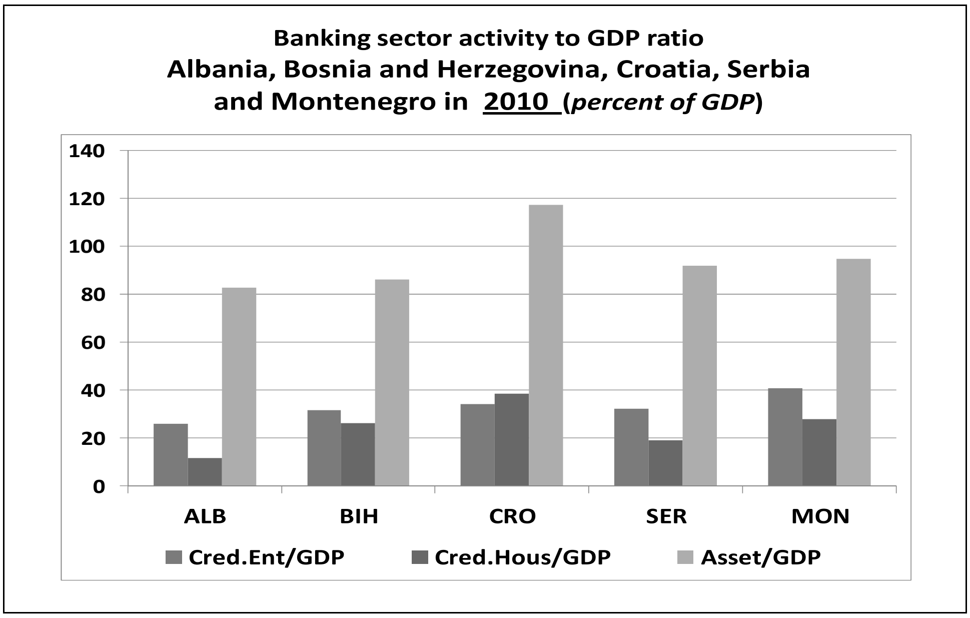
[19] Sources: The National Bank of Republic of Macedonia; The Bank of Albania

[20] EBRD, Transition Report 2009, London 2009; and the IMF: http://www.imf.org/external/country/MKD/index.htm; http://www.imf.org/external/np/ms/2011/121311.htm



Source: Central and national banks of selected countries

Significantly greater differences between countries in the region in terms of indebtedness had been manifested in household borrowing. In 2008, the average level of household indebtedness in Croatia, Montenegro and Bosnia and Herzegovina was for 2.25 times higher in comparison with Serbia, Albania and Macedonia (32% of GDP compared to 14.2% of GDP – see Table 1). However, much smaller differences were observed in the debt of private companies, with an exception of Montenegro. In this country, the total credit to private enterprises were on the level of 55.7% of GDP, while the differences between other countries were much smaller. In 2008, indebtedness of private enterprises in other countries of the region ranged from 22.1% of GDP in Albania to 31% of GDP in Croatia. The level of indebtedness of enterprises in Macedonia was higher than that in Bosnia and Herzegovina, while the level of indebtedness of enterprises in Bosnia and Herzegovina and Serbia was nearly the same (in percents of GDP).



Source: Central and national banks of selected countries

These data indicate the transmission mechanism of financial and real shocks spilling over from Western Europe to the Western Balkans. In 2009 in all Western Balkan countries credit activity was sharply reduced, as a result of the financial crisis and its impact on the balance sheets of the mother-banks that have held the largest share in the banking industry of the Western Balkans. Credit activity of banks in each country (with an exception of Albania) had the effect of decreased purchasing power of population, decline in investment activity of enterprises and the consequent fall in aggregate demand and GDP. Out of the four integral segments of aggregate demand:

- Consumption of the population,
- Gross private investment,
- Government consumption, and
- Net exports (balance of goods and services);

the first two segments were significantly reduced due to the decline in credit activity, while the final (net exports) improved in all countries of the region as a result of reducing the trade deficit caused by fall in the domestic demand for imported goods and services. With an exception of Albania, in other countries in the region falling household demand (due to the sharp fall in credit to households, rising unemployment and reduced wages), reduced the gross private investment (due to the large reduction in corporate loans and falling purchasing power of the population), reduced government spending (due to falling fiscal revenues) have caused the 2009 recession.

Relevance of the Mundell-Fleming model for the fiscal policy in the Western Balkans

The theoretical basis for considering the room for an active implementation of economic policy instruments in the small open economies in the Western Balkans is the Mundell-Fleming model.[21] According to the model in a small open economy that has consistently adopted all the measures of financial and trade liberalization there is no room for an active monetary policy role. Money supply is completely (or almost completely) endogenous, meaning that the central bank has no possibility to influence the money supply process and the interest rate. The interest rate is determined in the international money market.

Under conditions of perfect capital mobility and openness of the markets in goods, money, and bonds, a small economy can increase public expenditures in two ways:

- by issuing bonds and
- by raising tax rates.

The quantity of money is determined endogenously as a result of the quick changes of types of assets, at a globally determined basic interest rate.

Analysis of the effects of public consumption in the theoretical model of perfect capital mobility depends on the exchange rate regime: i.e. fixed or flexible exchange rate policy. Focusing on the pure impact of fiscal policy, in this context, would mean the absence of active monetary policy, or in other words, the extent that a country follows an expansionary fiscal policy

[21] Presentation of the Mundell-Fleming model for a small open economy can be found at: http://www.stanford.edu/~sandersn/101/Ch12_Handout.pdf
Also at:
http://www.lagcc.cuny.edu/socialscience/economics/pdf/mundell_fleming_part5[1].pdf
And at: http://www.worldscibooks.com/etextbook/7599/7599_chap07.pdf

by issuing public debt, the central bank shall not act as a buyer of bonds. Analysis of the fiscal policy impact in the context of perfect capital mobility assumes the distinction of short-term from long-term impact under two models:

- The model of fiscal policy based on tax increases (balanced fiscal policy) and
- The model of expansionary fiscal policy based on higher public debt, i.e. on bond issue with a passive role of the central bank (the central bank is prevented from buying government bonds).[22]

In the first context, analysis of the impact of fiscal policy relates primarily to the influence of increased government spending based on higher taxes on the levels of production, debt, and interest rates under the two exchange rate regimes. Under a fixed exchange rate regime, expansionary fiscal policy creates induced changes in the money supply, while under a flexible exchange rate regime, induced changes take place in the exchange rate.

The short-term and long-term effects of the unit growth of public consumption in a small economy are financed in one model by debt issuance (bonds), in the other by rising taxes. The interest rate is determined exogenously due to the assumption of unlimited freedom of international capital flows. The production multiplier under a fixed exchange rate regime is typically the simple foreign trade multiplier. This result is logical, as the interest rate is exogenously determined in a small country. The fixity of the interest rate presupposes that the typical crowding-out effect, induced by changes in the interest rate, does not operate in this case.

Under flexible exchange rate conditions the short term production multiplier, as a consequence of expansionary fiscal policy, depends for the most part on the effect of debt revaluation induced by changes in the exchange rate. In fact, in the absence of such an effect (as would have been the case were the starting debt position zero), fiscal policy loses the ability to influence disposable income. In line with this, where rising national

[22]One of the best books written about impact of fiscal policies on economic policies in a small open and big open economies, to my best knowledge, is that of Frenkel and Razin: Frenkel, Jacob, Assaf Razin (1987) *Fiscal policies and the world economy*, MIT Press, Cambridge, Massachussets.

consumption is financed by bond issue, the production multiplier equals zero, but when financed by higher taxes, it equals one. Generally, the sign and the quantity of the short-term production multiplier depends on the size of already existing debt. In contrast, these quantities do not affect the quantity of the long-term production multiplier. In a world of perfect capital mobility and flexible exchange rates the long-term value of disposable income would not be affected by fiscal policy.

A very important characteristic of the interaction between fiscal and exchange rate policy in an open economy is the fundamental dependence of the directions of change of basic variables on the fiscal policy instruments, particularly as the shifting away from public consumption based on public debt issue towards higher public consumption financed out of tax changes. Higher government spending financed out of higher taxes under a fixed exchange rate induces a balance of payment deficit, reducing both short and long term cash holdings (the amount of money as an asset in the hands of private transactors).[23] On the other hand, a similar rise in government spending financed by public debt issue (bonds) induces a positive balance of payments and increases cash holdings, over both short and long term.

Under a flexible exchange rate, higher public spending financed out of taxes causes depreciation over the long-term of the local currency, while higher debt-financed spending causes the currency to appreciate over the long term.[24] Similar shifts in the direction of change of the exchange rate also have short term effects, but whether the currency appreciates or depreciates depends on the size of the debt, which in turn determines the impact of debt-revaluation.

Fiscal discipline and controlled fiscal expansion in the Western Balkans

Fiscal discipline is based on the reduction of expenditures for unproductive purposes, especially expenditures for administration and in some cases

[23] This theoretical proposition is very important for the economic policy making in developing countries and countries in transition.

[24] This theoretical proposition is relevant for the economic policy making in countries of the centre.

unjustified increase in social spending, is useful and it will be necessary. However, virtually no country in Europe in the near and some distant history has failed to get out of recession and prevent the recession into a depression, a sharp reduction of public expenditure - expenditure specifically aimed at job creation and linking the economy with the environment. Of course, I speak here of capital expenditure which is necessary to increase the quality of business environment and to link regional countries, which would create the basis for the realization of joint ventures and development of clusters based on the interstate. Some of the countries of the region, such as Bosnia and Herzegovina and Serbia and Croatia in part, still owns a dominant or significant ownership stakes in large and profitable companies. This property can be used as security for the issue of government securities solely intended for the financing of development projects.

Western Balkans region has considerable development potential in the field of development of road, rail and energy infrastructure on the interstate level. Unfortunately, these resources are not used. The regional projects of infrastructure development can contribute significantly to the gap in economic development between the Western Balkans and the European Union. Funding of these projects by issuing government bonds maturities 10 or 15 years denominated in national currencies may contribute to encouraging a greater degree of economic cooperation in the region and reduce the gap in economic development. How would decrease the cost of financing capital improvements by issuing government bonds to finance transnational projects would be necessary to increase the degree of confidence of financial investors in these types of assets and lower the required yield.

The new higher quality financial instruments that would be risk free (or at least risk) and also to increase profitability (reduce the need to hold substantial excess reserves) of commercial banks in the region and encourage faster economic growth and development of the Western Balkans should have a new quality that allows a lower degree of systemic risk . In other words, the issue of government bonds of the Western Balkans should be provided with specialized guarantee fund for the Western Balkans. The main objective of the Fund would guarantee the issue of government bonds of the Western Balkans, which would be financed or co-financed infrastructure development projects. Advantage in obtaining a guarantee of the fund would have a transnational infrastructure development projects and projects that would be realized on the principle of public-private partnerships.

Issuance of these bonds and their purchase by commercial banks (and institutional investors) that dominate the Western Balkans would contribute to more successful portfolio management of these banks and institutional investors.[25] The interest rate on the bonds would be related to the average interest rate on government bonds of identical maturities in the euro zone increased by the risk premium in the region. The risk premium would be smaller compared to that existing in the already issued government bonds of Western Balkan countries, since it would be backed up by a guarantee fund. Guarantee Fund would have the option of converting debt into equity of infrastructure companies in the state ownerships whose capital was used as collateral for the issuance of bonds.[26]

Despite the fact that the economic crisis caused by irresponsible fiscal policies of member countries of the euro-zone is still going on, neither economic theory nor historical experience or practice with the economic crisis does not indicate that a possible way out of recession due to the harsh measures of fiscal restrictions. This is especially true in countries where unemployment rates over 20 percent - and most of the Western Balkan countries in this group of countries. Recommendation of the text is not the conduct of irresponsible and wasteful fiscal policy, but targeted and controlled fiscal expansion is exclusively used to finance capital projects. Joint infrastructure projects and linking the region are very important, and therefore there is scope for mutual cooperation. However, infrastructure

[25] The theoretical basis for the introduction of risk-free or less risky financial assets is Harry Markowitz's portfolio theory. Markowitz's seminal paper was written under the title „Portfolio Selection“ and it was published in March 1952 in *The Journal of Finance* 7 (1): 77–91. Markowitz's book *Portfolio Selection: Efficient Diversification of Investments* was first published in 1959 by John Wiley & Sons. I was one of the first authors in Bosnia and Herzegovina who in a systematic way presented Markowitz's theory and Sharp's contribution to the theory in my MSc thesis (Causevic,F , *Capital Market and Portfolio Theory*, The Faculty of Economics, University of Sarajevo, 1991) as a theoretical foundation for development of capital market in former Yugoslavia.

[26] Čaušević, Fikret (2012) “Small open economies in the Western Balkans: Controlled fiscal expansion for a new deal for the Western Balkans”, March (http://www.sant.ox.ac.uk/seesox/opinionpieces/Causevic-SmallOpenEconomies.pdf)

development alone will not be a sufficient condition for long-term economic viability. Infrastructure linking the region should be the basis for changing the model of economic growth. The domestic demand led growth model should (or must) be replaced by the export demand led growth based on regional cooperation of companies that should be linked and included in the joint export-oriented projects.

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WORKING PAPERS

Aleksandar Damjanović
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Between budget savings and development budget

In an attempt to find the way out of the economic crisis and situation close to recession in the countries of the region, one may conclude that, in parallel with cutting public spending, especially the so-called non-productive spending, monetary and fiscal measures should be used to enable greater liquidity of the economy in order to boost economic growth. Montenegro is an example of how an economic "boom"of2006 and 2007, and partlyof2008, resulting froman enormous credit expansion and high level of FDI, was reversed due to disturbances in the global financial market, recession and rapid plummeting of economic parameters.

This problem is even more complexas Montenegro uses euro as its currency, which restricts its monetary authoritiesin terms of most measures they are allowed to take and places the focus on a moderate fiscal, i.e. budget policy. The fact that the government is both the biggest "employer" and the biggest consumer in Montenegro, just like in other countries of the region, which is "sucking" liquidity out of the economy, calls for caution and balancing of countercyclical taxation policy that was missing in Montenegro at the time of economic growth.The key issue here is what could be an alternative to the absence of banking support and plummeting level of FDI, coupled with the public debt that is increasing and approaching the "red" zone and with a growing number of business entities whose activities have been blocked due to the lack of funds needed for regular business operation.

Further reduction of taxes would jeopardize the necessary level of tax revenues, and, on the expenditure side, it would be very difficult to opt for cutting the so-called mandatory expenses for salaries, pensions, social security and health care.

Possible solutions that economic logic mayimpose include budget savings inthe "discretionary“ expenses, primarily in the area of services contracted by budget users, accompaniedbya review of the amount and level ofpublic procurement in real terms anddownsizing of public administration to a level that would not threaten the social landscape.On the other hand, a large portion of thesaurasized wealth from the time of credit expansion can no longer be found in the official channels of payment operations, so a dialogue with big capital owners is essential in order toutilize these assets to develop entrepreneurship, i.e. to utilize as much as possible locally accumulated assets thathave been outside the development function. Further borrowing on the international market must be resorted toonly for the purpose of development projects, i.e. in order toincrease the capital side of the budget, bearing in mind the maximum borrowing level and terms, as well asthe fact that the government may often become a benchmark onthe local money market, as it defines interest rates payable on loans which primarily serve the purpose of solving the problem of budget liquidity.

In addition to standard economic measures that must be applied in a resolute and uncompromising fashion, it isessential to persist in further suppression of high level of grey economy in countries of the region, which would correspond to a resolute government policy towards expanding the tax base and the scope of taxation, reducing tax evasion and collecting overdue taxes at such a pace as to leave room for a smooth operation of the economy.Broad political consensus between the government and opposition concerning unpopular measures of "freezing" wages for a certain period of time and implementation of further austerity measures in the domain of personal and public spending would be an ideal case scenario, although this is seldom achieved.

Finally, we should not reject an idea which Iceland had implemented in a radical way and via referendum, pertaining to reaching a new deal with the banking sector, which is made up of more or less the same banks in all countries of the region. Perhaps a solution lies in banks with excess liquidity, which have caused the global economic and financial crisis and which could now repay the "debt" to those who are having a hard time enduring the crisis, i.e. the real sector. The question of whether it would be possible to find a compromise in negotiations between the government and banks, with the participation of employers, and towrite off across the board some part of what companies and individuals owe the banks in order to improve liquidity,is a question for political elites and international political and financial institutions that would be guarantors of such a deal.

Edmond Spaho

Chairman, Economy and Finance Committee, Parliament of Albania

Cutting public expenditures or stimulating the economy

There is a considerable debate these days about the ways our economies should follow: cutting public expenditures or stimulating the economy. The debate is increased due to the global economic crises and the attempts by many governments in the region to overpass the negative effects of the crises.

According to the experiences of various countries there is not a single recipe. The policies that may work for a country it may be counterproductive for the other.

In the case of Albania, both ways have been used before the crises period and during the period that global economic crises exercised its negative effects in the country's economy. Despite that, it should be said that Albanian economy has performed better that any other economy in the region. During the period 2009-2011 it has been among very few economies with positive economic growth and has enjoyed considerable growth during the pre crises period (table 1).

The main characteristics of our economy during that period were strong economic growth and low inflation rate; investments were behind the growth and manufacturing activity maintained its importance that means the economic development was not based on non tradable sectors such as financial intermediation, construction and real estate.

Table 1:GDP Growth in %

	2001-2006	2007	2008	2009	2010	2011	2012*
Albania	5.8	5.9	7.5	3.3	3.5	3.2$_{(1)}$	4.2
EU	2.2	3.3	0.7	-4.2	1.8	1.7	1.4
CEE	4.8	5.5	3.1	-3.6	4.5	4.3	2.7

Source: IMF WP/11/300 December 2011, Ministry of Finance: Fiscal Statistics 2011, Macroeconomic and Fiscal Forecast 2012-2020

The reasons should be found in the policies and reforms adopted during the pre-crises and in the global economic crises years.

During the pre-crises period country was heavily involved in the process of reformation focused on:

1. Reforming tax system in terms of improving and modernizing tax administration and applying 10% flat tax.

2. Improving business environment through establishing business registration center and business licensing center that operate as one stop shops. These reforms reduced the timing of opening a business and getting the necessary licenses and also the cost of operations. The above actions were followed by reforms in public fund procurement making the process fully electronically.

3. Cutting personnel expenditures. Ministries were reduced from 18 to 14 and central public institutions also. The public administration was reduced from 120.000 employees in 2005 to 90.000 employees in 2008. During the same period the personal spending was reduced from 6.6% of GDP to 5.9% of GDP (Table 2). Such reductions helped partially to double the wages in public sector and pensions during the period 2005-2009.

4. Privatization process was considered as a priority. Main sectors such as banking, telecommunication, public services, agriculture, transportation, part of energy, mining, etc. are fully privatised. Private sector gives more that 85% of GDP.

Table 2: Personnel Expenditure (% of GDP)

2005	2006	2007	2008	2009	2010	2011
6.6	6.4	6.1	5.9	5.4	5.1	5.2

Source: Ministry of Finance: Fiscal Statistics 2000-2011.

As a result during the period 2005-2008, net FDI increased from 3.4% to 6.7% of GDP (Table 3); private credit increased from 15.2% to 35.1% of GDP; exports grew from 22.9% to 29.3% of GDP (Table 4); revenues from tax sector and customs increased from 1350 million US$ to 2050 US$ allowing the government for three consecutive years to implement supplementary budgets and increase public investments from 4.6% of GDP in 2005 to 8.7% of GDP in 2008 (table 5).

Table 3: Capital inflow

	2005	2006	2007	2008	2009	2010
Financial Account Balance (% of GDP)	3.9	3.3	8	14.4	11.7	9.6
Net FDI (% of GDP)	3.4	3.6	6.1	6.7	7.7	9.2
Net FDI (% Current Account Deficit)	56	64	59	44	57	78

Source: IMF WP/11/300 December 2011

Table 4: Export growth

	2005	2006	2007	2008	2009	2010	2011
Export of Goods and Services (% of GDP)	22.9	25.5	28.2	29.3	28.7	32	35

Source: IMF WP/11/300 December 2011, Ministry of Finance: Fiscal Statistics 2011

Table 5: Increase in Revenues

	2005	2006	2007	2008	2009	2010	2011
Revenues from Tax offers/customs (mln$)	1350	1550	1760	2050	2080	2230	2370

Source: Ministry of Finance, Fiscal Statistics 2000-2011

The focus was also directed toward reducing public debt. In 2008 it reached 54.7% of GDP from 58.7% of GDP in 2005.

The expansion of private credit during the period 2005-2008 exposed the risk of inflation, therefore Bank of Albania intervened increasing the interest rates and as a result bringing the inflation down within the target of 3%. (Table 6)

Table 6: Credit growth

	2005	2006	2007	2008	2009	2010
Claims on private sector (% of GDP)	15.2	22.1	29.9	35.1	36.6	37.4
Private credit/GDP growth rate (%)	60.4	45.5	53.3	17.4	4.3	2.4

Source: IMF WP/11/300 December 2011

The results achieved above eased the pressures of global economic crises during the period 2009-2011. In addition the government followed careful policies that reduced the negative effects of the crises.

The policies undertaken during 2009-2011 years were mainly focused on:

Increasing public investment programs from 600 mln US$ on average during 2005-2008 to 710 mln US $ on average during 2009-2011 (Table 7); providing fiscal stimulus to private sector (the only country in the region) through reducing labor tax from 29.5% to 15% and also removing custom tariffs for raw materials destined for the production of export goods; privatization process continued in energy sector, telecommunication, oil production and refining; personnel expenditures were reduced by another 0.7% of GDP. Bank of Albania during that period followed the policy of reducing interest rates in order to expand the credit to private sector.

Table 7: Supplementary Budgets: 2006, 2007, 2008

	2005	2006	2007	2008	2009	2010	2011
Total Expenditures (% GDP)	28.3	28.8	29.2	32.7	33.2	29.2	28.7
Public Investments (% GDP)	4.6	5.7	5.9	8.7	8.4	5.2	5.4
Public Investments (mlnUS $)	380	510	570	940	960	650	710

Source: Source: Ministry of Finance, Fiscal Statistics 2000-2011

The above mentioned policies were able to be implemented due to the increase in revenues, receipts from privatizations, a syndicate loan and issuance of Albanian Eurobond.

It should be mentioned that despite the fact that Albania is having the largest debt over GDP in the region the structure of the debt is very favorable having the lowest external debt in the region, giving the government some extra leverage. Only 1/3 of public debt is foreign debt and in addition 2/3 of it is long term debt with very low interest rates. Therefore Albania has the lowest debt service ratio in the region with only 3.2% of GDP allowing it to borrow in the external markets. (Table 8)

Table 8: Government Gross Debt and Budget Deficit

	2005	2006	2007	2008	2009	2010	2011
Gross Debt (% GDP)	57.8	56.0	53.4	54.7	59.8	58.5	58.7
Budget Deficit (% GDP)	-3.4	-3.3	-3.5	-5.6	-7.1	-3.1	-3.5

Source:IMF WP/11/300 December 2011, Ministry of Finance: Fiscal Statistics 2011.

Based on these policies the economy continue to grow during 2009-2011 by more than 3% every year; exports grew by 48% compare to the period 2006-2008; FDI increased from 6.7% of GDP to 9.2% and 9% of GDP in 2010 and 2011 respectively. The only negative parameter could be considered the increase of public debt by 4%. Still the above increase was far below the increase of public debt in the other countries in the region during the same period of time.

For the years to come we think that the external environment is still very vulnerable, therefore the attention should be, among other things, focused on:

1. Structural Reform side: need for more aggressive structural policies to broaden the private sector participation and attract FDI;
2. Fiscal Policy side: need to strengthen the fiscal position in order to keep the right balance among economic growth, budget deficit and overall debt;
3. Monetary Policy side: more aggressive interest rate cuts versus liquidity measures (work better in times of low economic activity).

Thank You!

Danijela Martinović

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Cutting public spending or stimulating the economy - a dilemma in the light of defining parliamentary committee policies

In an attempt to answer the question of cutting public spending or stimulating the economy, perhaps we should put a conjunction "and" instead of the conjunction "or" in search of modality to harmonize and reconcile the two opposing concepts? The question is how to find a proper combination of monetary and fiscal instruments that would yield results? How to develop proper sectoral strategies and real sector development strategy? Certainly there are no unambiguous answers to this country because every country is specific and thus solutions must be specific. Western Balkan countries develop their own economic, financial and fiscal policies in an effort to stabilize their budgets and to simultaneously meet social and other public needs. Reducing outlays related to social transfers, cutting public spending and simultaneously stimulating real economy and creating conditions for development are goals they are striving for. How is

Bosnia and Herzegovina coping with modern challenges? When it comes to choosing a proper combination of monetary and fiscal instruments, a limited number of monetary instruments is available to Bosnia and Herzegovina. Currency board mechanism, which implies a fiscal relationship between the convertible mark and the euro, annuls the possibility of using currency exchange rates with a view to achieving macroeconomic goals. The Central Bank plays the role of a fiscal agent for government purposes, but it is unable to issue its own securities or to play the part of a "bank of last resort". Unfortunately, limited competences of the Central Bank do not result from the lack of proper equipment or training, but from the lack of political will. As for the choice of fiscal instruments, significant revenues from fiscal and parafiscal sources are available to Bosnia and Herzegovina. However, due to a highly complex organization of the country - two entities, 10 cantons, more than 130 municipalities - tax revenues are collected and distributed at different levels. Value added tax (VAT) is the most important source of tax revenues for the budget of Bosnia and Herzegovina. VAT revenues are deposited into a single state treasury account and further distributed between the state of Bosnia and Herzegovina and its entities on the basis of coefficients. Tax revenues at entity level include personal income tax, profit tax and capital income tax. These revenues are distributed between the entities and their respective cantons or municipalities. A complicated system of tax collection and revenue distribution hinders a more efficient revenue allocation and management. Thus, Bosnia and Herzegovina has a limited number of individual monetary and fiscal instruments at its disposal, which in turn affects its choice of a proper combination of monetary and fiscal measures.

However, the problem is not just on the revenue side of the budget at all levels. Much more problematic is the expenditure side of the budget, in terms of size and structure. As a result of the specific and highly complicated organization of Bosnia and Herzegovina, the country has a huge administrative apparatus. At the consolidated budget level, outlays for salaries and salary-related benefits account consume over two-thirds of budget revenues, as high as 3 billion convertible marks (1.5 billion euros)! Moreover, Bosnia and Herzegovina has an extremely large number of socially vulnerable and unemployed people. According to the statistics, the country has half a million unemployed, half a million pensioners and about 600,000 beneficiaries of some form of social assistance. Over KM 3.7

billion is earmarked for social payments. The country has never recovered from war devastation despite billions of euros of international donor aid. With the war and disintegration of the former Yugoslavia, major industrial complexes, finely bundled industries, complementary market, etc, had vanished. Strong real sector is missing, so someone has to finance a bulky administrative apparatus and a large number of socially vulnerable categories of people, who had been given many benefits at a time of budget surplus. Unfortunately, decision makers in parliaments and governments had opted for quick and inappropriate solutions - increasing levies on the weak economy. The only logical, though unpopular, solutions - downsizing of administrative apparatus and review of the social payment structure - had been avoided for political reasons. Although some measures to cut salaries in the administration, as well as inappropriate social payments on several grounds, have recently been undertaken due to significant budget deficits, suspension of the arrangement with the IMF, lower tax revenues and contraction in banking activities due to economic crisis, appropriate measures towards strengthening the real sector have not been undertaken. Hence, for example, only KM 59 million was allocated from the state budget for capital projects! Even though the state budget (unlike lower-level entity budgets) is not developmental in its concept, the fact is that this amount is inadmissibly low! At the same time, the economy is heavily burdened with taxes and contributions. Taxes and contributions on salaries are as high as 70%! In the last year alone, bank accounts of more than 30,000 companies were blocked, while 32,000 companies were illiquid. To lay off workers and move into the "grey zone" is unfortunately the only solution for many companies. The government is currently considering a review of the VAT rate - to increase it from the current rate of 17% to 21% or even 25%, and to simultaneously lower the rate of contributions. Well, perhaps this would ease the burden off the economy, but it would certainly deal another blow to consumers and their "purses", which might eventually result in lower VAT revenues, as a result of reduced consumption. Introduction of automatic stabilizers - introducing new taxes or increasing the existing ones - might be a simple solution to stabilize the budget, but not a permanent or appropriate solution from the point of view of impoverished population. Selling of "state silver" is a similar solution - privatization of state-owned companies for peanuts. Review of privatization has failed to yield results, while new privatization was stopped due to low interest of investors. Inadequate economic policies (Washington consensus), plethora of regulations, corruption, political problems - all of this has resulted in a low interest of investors - plummeting foreign direct investment, avoidance of investment, plummeting of the country's credit rating, growing interest rates. Growing interest rates were the result of contraction in banking activities and lower investment into the real sector, which strongly affected the real sector and its illiquidity, in addition to the existing underdeveloped money market and capital market. The spillover effect of the economic crisis on Bosnia and Herzegovina (which was marked as highly sensitive to disturbances in the euro zone) has exacerbated the situation in the country and resulted in further market illiquidity and budget deficits.

Problems in Bosnia and Herzegovina are obviously much deeper and cannot be boiled down to a mere question of whether to apply expansionary or restrictive fiscal and monetary policies. According to economic theoreticians, an expansionary policy is used in circumstances of depression to increase public expenditures (public works) and economic activity. Restrictive policy, on the other hand, implies progressive taxation and cutting of public expenditures. Our economic, i.e. fiscal and monetary policies involve high tax rates, coupled with increased (rather than reduced) public expenditures - public spending without increasing economic activity. Hence, we are using a combination of measures which are mutually exclusive in economic literature! In other words, such measures rule out a possibility of achieving four macroeconomic goals - employment growth, improvement of balance of payments, stability of prices and economic growth.

The question is how realistic the role of parliamentary committees is in such an unfavourable economic and political environment? In other words, how efficient parliamentary committees on finance, budget and economic development can be in defining economic policies? The role of parliamentary committees is defined in the rules of procedure of houses of parliament and refers to competences of different levels of power. According to the Constitution of Bosnia and Herzegovina, the competences of the state of Bosnia and Herzegovina include: foreign policy, foreign trade policy, customs policy, monetary policy, financing of institutions and international obligations of Bosnia and Herzegovina, policy on immigration, refugees and asylum, and air traffic control. All other competences were transferred to lower levels, entities and cantons. A joint parliamentary committee on economic reform and development (consisting of 12 members, 6 from each house) deliberates on issues of economic reform, which are in the competence of institutions of Bosnia and Herzegovina, initiatives of governmental and non-governmental institutions, as well as issues pertaining to economy, monetary economy, foreign borrowing policy, relations with international financial institutions, reconstruction and development programs for Bosnia and Herzegovina, defining economic policy measures, fiscal and credit policy of Bosnia and Herzegovina, banking policy, statistics, measurements and standards. Seems like a broad range of activities. But, what is their actual scope? In effect, there are following limitations:

1. Very few economic competences exist at the state level. They are mainly related to issues of financial institutions. Also, there are limitations in the system itself (currency board) or the system appears to be working smoothly, with established procedures.

2. The true power in defining development policies and drafting legislation lies with the Council of Ministers, i.e. the government of Bosnia and Herzegovina - the executive power. Initiatives launched by MPs and parliamentary groups are only partial and related to individual pieces of legislation. The role of parliamentary committees has become more controlling (oversight of 10 agencies) than legislative and creative potential is very low. The procedure concerning the passing of legislation is inadequate, with a low possibility of review or amendment by proponents.

3. Bosnia and Herzegovina has failed to adopt a single development strategy and action plan. We do not know which sectors and areas we wish to develop. Other problems include inadequate coordination at entity level and overlapping competences, laws and regulations at all levels. A single economic area is non-existent. Parliamentary committees lack proper guidance. Instead, they rely on obligations that are stipulated in the Stabilization and Association Agreement to guide them in their work, which virtually means *ad hoc* adaptation to EU requirements, without the country's own national development strategy.

4. Competences of parliamentary committees of both houses are overlapping, e.g. between foreign trade and customs committees, finance and budget committees, European integration committees, so very few bills

and legislative initiatives are discussed by the joint Committee on Economic Reform and Development, which is supposed to unify their activities as an umbrella committee.

5. Petty politics and advocating interests of one's own party and entity, rather than advocating interests of citizens; insufficient profiling of the role of parliamentary committees in political life.

6. Shortage of experts that would offer (continuous) professional support to MPs; possibility to hire them on *ad hoc* basis.

What is to be done? As far as parliamentary committees dealing with economic issues are concerned, their operation should certainly be coordinated to avoid partial deliberation of draft laws. Cooperation among committees of both houses of parliament can result in a much better quality of bills, which would then pass the parliamentary procedure much faster. One solution could be to finally reach a political consensus among parliamentary parties with regard to the country's obligations arising from the EU integration process and strict compliance with obligations stipulated in the Stabilization and Association Agreement. If we manage to overcome our political and inter-entity differences and establish cooperation among parliaments and their economic committees at all levels of Bosnia and Herzegovina and if we ensure better coordination between the legislative and executive branches of power, we might stand a chance of achieving something. This country needs a single development strategy and a single economic area. This should serve as a basis for development of sectoral strategies (for the energy sector, special purpose industry, metalworking and wood-processing industries, tourism) and for performing inter-sectoral analyses. We need to focus on selected areas with competitive advantages and to strengthen the SME sector by means of clusterization. Clusterization should not be applied locally, but regionally, bearing in mind the opportunities for cross-border and regional cooperation, primarily cooperation with our neighbours who are also our most important foreign trade partners. Substantial pre-accession funds are available for cross-border cooperation projects. Western Balkan countries should share experiences of their respective European integration processes and restore broken political and economic ties.

There is a whole range of opportunities and directions to explore. Although each Western Balkan country is specific, recommendations for Bosnia and Herzegovina could be applied to other Western Balkan countries, as well. All of us are still searching for the most appropriate economic policy, trying to find the way to stabilize our own budgets, to cut public spending and stimulate production, etc. We have many common denominators: former single and interlinked economy, geographic proximity, common history, common language, common mentality, etc. These similarities could serve as a basis for closer political and economic cooperation in the Western Balkans. These advantages can be used as the foundation of our future cooperation. This is exactly why the EU keeps insisting on regional development and cross-border projects within IPA support. And cooperation is also the guiding principle and leitmotif of our conference.

Branka Ljiljak

Deputy Chairperson of the Finance Committee of the National Assembly of the Republic of Serbia

Parliamentary committees in the service of proper economic policy decisions

According to the Constitution of the Republic of Serbia, the National Assembly passes laws, budget and annual statement of accounts and, together with the executive power, i.e. the Government, thus creates conditions of life of citizens of Serbia.Therefore, cooperation between the two branches of power must be close in order to result in good decisions.

In most cases, the Government proposes bills and submits them to parliament for adoption. In order to pass good decisions, MPs, who do not have to be experts on topics concerned, should have sufficient time to deliberate on bills and should have relevant information to base their choices upon. However, if the time to deliberate on a bill is short, MPs will not be able to consider in greater detail all its aspects and consequences of its practical application.

The problem of lack of time for deliberation and detailed consideration of proposed legislation also affects the Finance Committee. In order for the Committee to join the government in solving the issue of whether to cut public spending or stimulate the economy, its members should have relevant informationfrom the Government. Although professional support services are available to MPs, these services often lack initiative as all of their capacities are consumed by technical tasks. Research department potentials, which are also available to MPs, are not sufficiently utilized. Finance Committee members also have at their disposal analyses and reports of the Fiscal Council, State Audit Institution reports on the use of resources, as well as quarterly reports of the Ministry of Finance. However, they have insufficient time to properly consider all options and their implications in order to make an informed choice concerning the dilemma of cutting public spending versus stimulating the economy.

The problem of lack of time is obvious when we recall that the National Assembly passed eight hundred laws and ratified numerous international treaties over the past four years. Although the lack of time for more detailed discussions and deliberations does not affect the quality of laws themselves, it mostly results in the lack of by-laws and monitoring of effects of the application of laws.Hence, the control function of the parliament must become more prominent.

In passing the laws, the National Assembly, in conjunction with the Government, designs the country's economic policy, which might make it more inclined towards stimulating the economy. On the other hand, as the parliament controls the work of the government, this might make it more inclined towards cutting public spendingrather than stimulating the economy. Nevertheless, the effects of such control should be enhanced both in Serbia and in other transition countries.

To summarize, although the Assemblypossesses mechanisms for passing quality decisions, some of these mechanisms, such as the composition of the staff serving on committees and research department, should be reinforced to enable them to better solve the dilemma of cutting public spending or stimulating the economy in a timely and appropriate fashion.Hence, from the next composition of the National Assembly, committees should have much more leverage and many more issues on their agenda to deliberate.

Saša Drezgić
Faculty of Economics,University of Rijeka

To give priority to cutting of public spending or to stimulating the economy?[27]

Economic and fiscal policy makers in modern economies are faced with an extremely difficult task of budget balancing and achieving higher economic growth rates. Heavily burdened with high indebtedness, policy makers are forced into pursuing a restrictive fiscal policy under recession circumstances. Such orientation is contrary to the traditional Keynesianrecipe for economic policy. Hence, there is reason to fear that such course of actioncould worsen the budget balance and cause living standards to plummet.

As economic and financial relations have changed significantly within individual countries, as well as within the framework of international relations, especially due to globalization, one may argue that fiscal consolidation should be tailored to the specific economic system characteristics.If these functions are disregarded and if standard recipes are still applied, this may result in disastrous consequences, such as macroeconomic destabilization and its repercussions. Another relevant issue to be raised is whether all countries should (and are allowed to) carry out fiscal consolidationunder recession circumstances.

My discussion raises just a few dilemmasin an attempt to answer the question of the character of fiscal policy. This is mainly inreference to the relationship between monetary and fiscal policies, fiscal consolidation structure, procyclicality ofeconomic (fiscal) policy, efficiency of fiscal policy, indebtedness, prospects of economic growth and structural features of the economy. In assessing the aforementioned categories,the example of Croatia is used, although the same assessments are applicable to the entire region.

[27]This discussion is largely based on the paper published by S.Drezgić: "Fiskalna konsolidacija u vrijeme krize", Zbornik Hrvatske akademije znanosti i umjetnosti, HAZU, Zagreb, 2012

Interaction between monetary and fiscal policies

The ideology of independent monetary policy, whichhad prevailedin almost all countries of the world before the outbreak of the recent crisis,had anadverseimpact on the fiscal policy performance. This reflected on the procyclical effect of fiscal policy–the cost of financing public spending was very low at the time of booming economic activity and extremely high at the time of recession. This is especially true for EU member states and countries depending upon the economic policy of the EU. However, to raise a discussion on the appropriateness of financing the supply of public resources and delivery of services through market interest rates and exposure to financial speculation would exceed the scope of the current debate.

When it comes to highly euro-dependent countries, the course of monetary policy does not depend on measures of dependent central banks, but on the share of public debtin GDP andespecially on the current deficit. Namely, the fiscal deficit becomes a key indicator that definesthe movement of credit rating and interest rate. This has an additional impact on procyclicality of fiscal policy. Hence, an impotent expansionary fiscal policy, where inefficient public spending is punished with high interest rates,is alsoaccompanied by plummeting economic activity, just like a restrictive fiscal policy. In other words, the monetary policy is not complementary to the fiscal policy, but it works in such a way that it worsens the fiscal position at the times of trouble, or improves it at the times of economic expansion. An identical scenario has also been present in the EU for quite a while.

Monetary regime that has been in place in Croatia until now, defined by monetary policy and many other factors, may be deemed restrictive to the needs for financing public expenditures. A potential lowering of credit ratingand/or increasing of financing costs would lead to an untenable fiscal policy even in short term. Thus, it will take a huge effort to meet the demands of financial institutions for cutting of public spending, on the one hand, and try to achieve higher economc growth rates, on the other.

Accomplishment of these mutually contradictory goals largely depends on institutional reform within the economic system.

Fiscal policy efficiency

Modern-day fiscal policy is significantly less effective than it used to be in the past. Globalization processes and openness of economies have often brought about excessively high public spending to expect any major impact on economic growth.

It should be noted that a discretionary fiscal policy could be highly inefficient due to a long time span between its adoption and the effects of its application. This is why automatic stabilizers on the expenditure side of the budget are far more efficient (e.g. unemployment benefits). One of the ways to enhance the efficacy of automatic stabilizers is to change the taxation structure – towards direct and progressive taxes, such as income tax (with the elimination of tax exemptions and tax relief). However, fiscal policies have recently been more oriented towards indirect taxes for the purpose of achieving tax neutrality and impact on reducing gross labour costs (i.e. impact on competition).

Procyclicality of economic (fiscal) policy

An additional problem is with financial system failures, where, due to asymmetrical information and "herd phenomenon", capital borrowing tends to be too high at a time of economic prosperity and too low at a time of recession. All the more so, it is essential to have a well-balanced fiscal policy within the business cycle framework.

- *Character of fiscal consolidation measures*

In an effort to reduce budget imbalance in Croatia, certain measures have been provided for the revenue and expenditure sides of the budget. In the context of such orientation, one must warn that empirical findings confirm that better results are achieved if budget consolidation is focused on cutting the current public spending. Increasing taxes is a much more appropriate exercise for countries with low tax burdens. Hence, one might assume that an increase in tax pressure might trigger contraction of private spending and GDP. On the other hand, the impact of decreasing public expenditures will mainly depend on changes in the spending structure.

The question is what happens to countries with unfavourable fiscal position and state of infrastructure, where it is impossible to reduce current spending and where tax pressure has reached its maximum. There are two extreme options - linear cutting of expenditures, with a risk of pushing the recession spiral upwards, or borrowing more money at a high price of capital, which will threaten the country's fiscal position in spite of economic growth. The latter option could be painless, but with support from international financial institutions. However, international financial institutions will require fiscal consolidation in order to provide support, which indicates that they focus solely on issues of short-term budget balance and fiscal solvency and pay no heed to development related aspects.

- *Movement and structure of budget revenues*

When it comes to fiscal consolidation, an important element that should be taken into account is tax burden, as well as tax structure. Croatia is among countries with the highest tax burden in Europe. Such a situation calls for fiscal consolidation on the public expenditure side. Namely, high tax burden means that the country has almost reached its maximum tax capacity. Hence, for fiscal consolidation, rationalization or rather cutting of expenditures would be much more beneficial than increasing tax revenues. To this effect, World Bank in its 2007 report singled out Croatia and Turkey as the countries with the highest tax burden in Europe. In that context, intervention within the tax structure (reducing labour-related taxes against other forms of taxes and fractions of income) is essential.

- *Public spending structure (fiscal consolidation)*

Fiscal adjustment programs usually focus on budget deficit. Since current and capital expenditures have the same effects on short-term cash flow in the state budget, budget structure related goals are seldom set and the burden of adjustment is usually placed on public investment and other productive expenditures of the public sector. Focus on cash flow as a relevant fiscal discipline indicator is problematic for countries with growing infrastructural needs, such as developing countries and new EU member states. To meet these infrastructural needs under strict fiscal restrictions would require higher tax pressure, which would have adverse effects in terms of increased tax burden on current generations and would result in tax distortions. The other equally unfavourable alternative is to reduce the rate of investment. However, such a policy might reduce future budget revenues through lower private sector productivity and lower fiscal capacity of tax payers. Such short-term goals would thus threaten long-term fiscal stability and sustainablility.

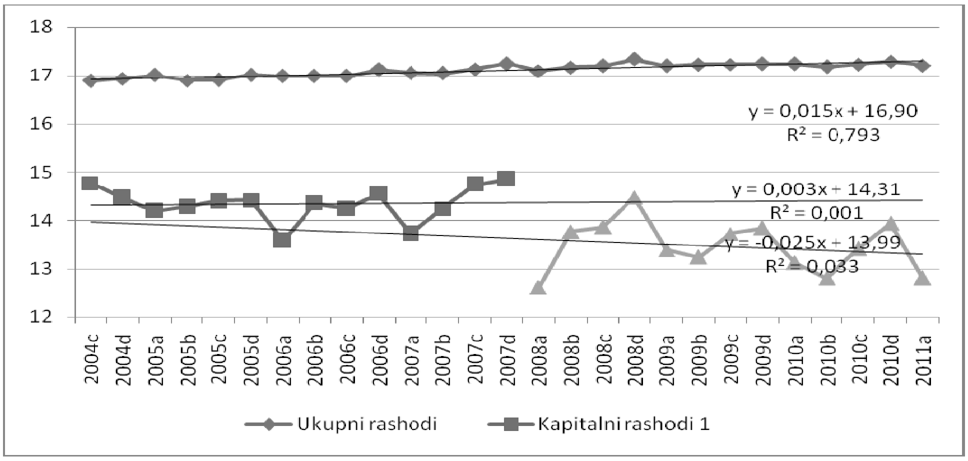
Croatia belongs to a group of South-East European countries with a high level of public spending, which is used to finance social security, while its situation is further exacerbated by an untenable fiscal position due to the crisis and unfavourable demographic tendencies. In comparison to other countries in the region, Croatia excelled at particularly high investments in public infrastructure over the past years. These investments were periodically the highest in Europe (8% of GDP in 2004, World Bank, 2007). Nevertheless, Croatia is still at the bottom of the list of European countries in terms of public infrastructure quality, which requires maintenance of high level of investment.

On the expenditure side, there are unemployment benefits, but still efforts should be made towards balancing investments across the business cycle. Croatia is still significantly lagging behind developed countries in terms of infrastructure capital, so the diminishing level of investments since 2008 is detrimental to a long-term basis of economic growth and labour productivity. Therefore, a mid-term or long-term national infrastructure plan, with an integrated cost-benefit analysis of individual investments, along with financial projections, should particularly make sure to balance the investment cycle. A potential stabilization fund that may be designed in the context of the infrastructure plan, that would fill up during the period of economic prosperity, could later be used to finance investments during the period of crisis.

Chart 6 shows movements in total expenditures and capital expenditures from the central government budget. A major difference in investment movements before and after the economic crisis is clearly visible. This leads to a conclusion that the growing (or the same) needs for financing public expenditures due to plummeting budget revenues were met by means of changing the budget structure in favour of current expenditures against capital expenditures. Such trends adversely affect both short-term and long-term economic growth. These trends are coupled with plummeting private investments. According to the State Bureau of

Statistics, despite some level of economic recovery, gross capital investments have been dropping continuously since early 2009.

Chart 6: Movements in total expenditures and capital expenditures from the central government budget



Source: Online database of the Ministry of Finance of the Republic of Croatia

- *Indebtedness*

Croatia's sovereign debt is not substantial compared to other EU countries. Private sector debt (of households and companies) is a much bigger problem. For example, household debt in 2010 amounted to 41% of GDP, which accounted for 85% of net disposable income. Interest payable on this debt by households is 7% of net disposable income (IMF, 2011). This amount of debt by private entities, coupled with high tax pressure, significantly diminishes net disposable income of private entities, leaving no room for future increase in tax pressure. Thus, even a relatively low public debt is a threat to the country's macroeconomic stability. Such a state of affairs makes Croatia's fiscal sustainability far more complex.

- *Prospects of economic growth*

So far, economic growth rates have been based primarily on the increase in private spending and capital investments (and less on public spending). Since private spending was mostly financed through borrowing, further growth rates on that basis are not likely. Moreover, cutting of current public spending will somewhat neutralize even positive effects of public spending. Therefore, short-term factors of increase in GDP could be capital investments and exports. Since most important trade partners in the EU predict almost zero growth rates, capital investments remain the only factor that could help increase economic growth rates. To this effect, a question remains whether it is likely for government measures to increase capital investments in the short run, as investments by private sector are unlikely in times of uncertainty (including a major reluctance towards taking risks). Hence, affordable funding sources from EU funds are crucial.

- *Economic structure*

Many years of deindustrialization have shaped Croatian economy as import-focused. This is why it would be realistic to expect improvements in the foreign trade balance. However, due to the above reasons, a major relative decrease in imports might be expected to yield negative effects on public revenues in the short run. Therefore, it would be realistic to assume that a decrease in budget deficit will be neutralized by a decrease in budget revenues.

DISCUSSION

Zarija Pejović
Member of the Montenegrin Parliament Committee on Economy, Finance and Budget

Economies of European countries are facing the crisis of public finance. Furthermore, one must bear in mind the fact that EU countries that used to export knowledge are now overtaken by India and China, and all of this is affecting the development of Western Balkan countries.

It is essential to increase competitiveness of Western Balkan countries to help them join European and international trends. This region lacks industrial centers and well-balanced public revenues and expenditures.

Despite the fact that Montenegro achieved significant growth rates in the past decade, high growth rates were followed by plummeting industrial production. Moreover, foreign direct investment did not have a character of greenfield investment.

Nevertheless, account must be taken of the fact that the present EU member states used to have the Marshall Plan, whereas today such level of resources is unavailable to Western Balkan countries.

Srdjan Redžepagić
Institute of Economic Sciences, Belgrade

Cutting of public spending is hardly feasible given the fact that there is a certain level of fixed costs whose cutting is impossible. Therefore, I believe that the economic policy should focus on stimulating the economy. To that end, the use of professional expertise should be increased as a result of links betweenscientific institutes and parliaments.

It is essential to raise awareness of the need for cooperation between scientific institutions and decision makers in order for specific political measures to produce effective and efficient results. Scientific studies offer detailed analyses of various thematic fields, which can be useful to the political system as a basis for adjustment and implementation of solutions resulting from scientific studies. The process of reviving the cooperation between science and politics requires consensus among all stakeholders, government institutions, primarily the Government and National Assembly, and the overall scientific community, which must be ready to conduct independent and objective studies.

Biljana Angelova

Economics Institute, Skopje

Close cooperation among countries of the region is extremely important. Initiatives should be launched forthe setting up of regional stock exchanges and clusters and for investments in the infrastructure. As for the dilemma of cutting public spending versus stimulating the economy, one should bear in mind that even though public spending influences growth, it should still be kept under control.

Srđan Marinković

Faculty of Economics, University of Niš

The setting up of the EU Guarantee Fund for the Western Balkans, as proposed by Professor Čaušević, is not feasible because Western Balkan countries are unable to borrow money in local currencies. However, this is "good news" because the market prevents countries from acting irresponsibly.

Milica Travica

Banca Intesa, Belgrade

First of all, I would like to emphasize that fix rate in Serbia has jumped in February from 106 to 111 dinars. One of the causes was withdrawal of speculative capital and low coordination between fiscal and monetary policy. I will remind you that ECB has issued 3 year LTRO on 21 December and 29 February in amount of c.1 trillion euros, which is going to be invested mostly in government bonds. Therefore all countries in the region are subject of entrance of speculative capital that can cause huge fluctuation of fix rate. In that since mechanisms of managing capital inflows and outflows should be introduced in order to protect macroeconomic stability.

Second of all, I would like to remind you that municipal bonds are popular for financing infrastructure projects as insurance companies are interested in purchase of that kind of bond. Municipality of Novi Sad and Zagreb have issued such bond. As systems and procedures already exist State could use that mechanism and subsidies those activities.

As far as establishment of Regional Guarantee Fund is concerned and regional bond that could be issued through that fund, I consider that as nice but long-term idea. It should be mentioned that EU has established EFSF and although it is monetary union that fund hasn’t become fully operational. Sovereign crisis haven’t been financed through that fund but through IMF. Therefore I consider that long term idea.

Gordana Lazarević

Balkan Center for Regulatory Reform

IPA funds should be used for financing infrastructure projects in the Western Balkans.

THIRD SESSION

ECONOMIC AND POLITICAL BARRIERS TO TRADE IN THE SEE REGION

BACKGROUND PAPER

Ahmet Mançellari
Faculty of Economics, University of Tirane

Economic and Political Barriers to Trade in the SEE region

1. Introduction

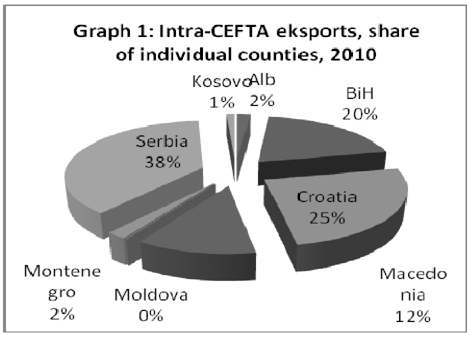
The ongoing process of the SEE region (Western Balkan) integration is becoming more and more intensive in all its main dimensions: regional, multilateral and the EU integration. For all the countries of the region, the EU integration is the main strategic project. While Croatia is finalizing the process, Kosovo is preparing to get involved in through a Stabilization and Association Agreement (SAA). Some of the countries are members of the World Trade Organization (WTO) since the beginning of the last decade; others are waiting only for a formal approval of the membership in this multilateral trade integration institution. The new CEFTA (CEFTA 2006) replaced the network of 32 bilateral FTAs in the region. Signed in 2006 by all countries of the region, and also Moldova, and made effective in July 2007, CEFTA 2006 is having an increasing importance in the regional integration process. It represents a comprehensive and modern preferential trade agreement, covering a range of areas. In the frame of this agreement, a fully liberalized trade of manufacturing products is already achieved. Almost the same situation is now with the agriculture products since the last year.

Meanwhile CEFTA 2006, with the support of the European Union (EU) and other partners, is focusing in other issues, related with reduction and elimination of non-tariff barriers to trade, and the new trade topics like investment, trade in services, public procurement and intellectual property rights. Such a focus is, on one hand, the ‘next step’ from a ‘shallow’ (with a focus on trade liberalization for goods), to a ‘deep’ integration (referring to wider range of at-the-border, and behind-the-border, distortions). On the other hand, it’s the proper road towards a solution for the strategies of growth when the growth model fuelled by remittances and expanded credit, is now under a question mark.

The analysis of the regional trade relations in the second section is followed by an analysis of the tariff liberalization process with a focus on Most Favoured Nation (MFN) tariffs and a quite short description of the situation of non-tariff barriers in the region. In the frame of supportive policies for regional integration, the importance of an export promotion strategy and the possibility and effects of a ‘a virtual custom union’ are discussed in the forth section, to conclude with some policy recommendations.

2. Intra-regional trade relations: trends, potentials and issues

Countries of the SEE region have shown significant economic improvement since the beginning of their transition to market economies in the early 1990s. Trade flows also have steadily grown although bearing the effects of regional conflicts and sanctions during the 1990s. The total trade in each country of the region [at least] doubled between 2004 and 2008 (Handijski, 2010, p.7). The trade downturn of 2009 was followed by a recovery in 2010, including the intra-regional trade flows. The Albania’s total trade flows with the CEFTA increased by 40 percent in 2010 while its trade with the rest of world (ROW) increased by 11 percent. For other countries of the region, the figures are as follows: Bosnia and Herzegovina (15 percent, and 16 percent), Croatia (4 percent, and 6 percent), Macedonia (9 percent, and 21 percent), Moldova (18 percent, and 12 percent), Montenegro (3 percent, and 3 percent), Serbia (14 percent, and 12 percent), Kosovo (18 percent, and 19 percent), respectively.



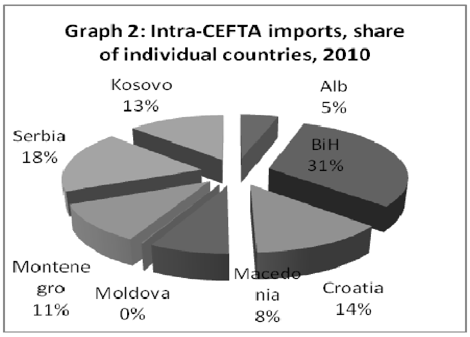


Table 1: Exports of SEE countries, 2010, in 000 EUR

	Intra-CEFTA				Rest of the World		
	Total	Share in total	Agric	Non-agric	Total	Agric	Non-agric
Alb	119,066	1.8%	7,784	111,282	1,038,083	49,726	988,356
BiH	1,302,049	19.9%	184,759	1,117,290	2,325,825	98,027	2,227,798
Croatia	1,665,439	25.5%	457,736	1,207,704	7,236,943	561,931	6,675,012
Macedonia	771,021	11.8%	216,655	554,366	1,726,515	201,573	1,524,942
Moldova	7,142	0.1%	6,687	456	1,179,451	572,751	606,670
Montenegro	130,521	2.0%	37,889	92,632	199,846	8,621	191,225
Serbia	2,468,149	37.8%	855,207	1,612,942	5,288,101	972,835	4,315,266
Kosovo	70,934	1.1%	20,721	50,213	223,097	3,850	219,247
CEFTA 2006	6,534,321	100%	1,787,437	4,746,884	19,217,860	2,469,314	16,748,546

Source: CEFTA trade statistics 2010, and own calculations

However, the significance of the above figures for the intra-regional trade is relative; it depends on the share of each county's total trade in the total intra-regional trade. Table 1, table 2 and table 3 (and the respective graphs) show respectively exports, imports and total trade of the SEE countries with the region, and with ROW. It's obvious that the significance for the region of the increase of the Albania's total trade with SEE by 40 percent, is much lower than, compared, let say with the increase by only 4 percent in Croatia: the share of SEE region in Albania's total trade is only 3.5 percent (table 3), when the same figure for Croatia is 19.7 percent.

Table 2: Imports of SEE countries, 2010, in 000 EUR

	Intra-CEFTA				Rest of the World		
	Total	share of total	Agric	Non-agric	Total	Agric	Non-agric
Alb	316,855	5.2%	92,906	223,949	3,164,696	540,136	2,624,561
BiH	1,883,276	31.1%	655,065	1,228,211	5,078,578	624,391	4,454,187
Croatia	811,698	13.4%	174,074	637,624	14,315,499	1,464,546	12,850,953
Macedonia	475,080	7.8%	174,132	300,949	3,644,029	352,991	3,291,038
Moldova	9,018	0.1%	1,154	7,863	2,882,449	442,694	2,439,754
Montenegro	669,700	11.0%	252,713	417,286	987,329	153,597	833,733
Serbia	1,096,740	18.1%	189,420	907,320	11,536,924	592,891	10,944,033
Kosovo	799,013	13.2%	213,302	585,711	1,345,921	263,184	1,082,737
CEFTA 2006	6,061,678	100.0%	1,752,766	4,308,912	42,955,428	4,434,431	38,520,997

Source: CEFTA trade statistics 2010, and own calculations

Table 3: Trade flows of SEE, 2010, in 000 EUR

	Intra-CEFTA				Rest of the World		
	Total	Share in total	Agric	Non-agric	Total	Agric	Non-agric
Alb	435,921	3.5%	100,690	335,231	4,202,779	589,862	3,612,917
BiH	3,185,325	25.3%	839,824	2,345,501	7,404,403	722,418	6,681,985
Croatia	2,477,137	19.7%	631,810	1,845,328	21,552,442	2,026,477	19,525,965
Macedonia	1,246,101	9.9%	390,787	855,315	5,370,544	554,564	4,815,980
Moldova	16,160	0.1%	7,841	8,319	4,061,900	1,015,445	3,046,424
Montenegro	800,221	6.4%	290,602	509,918	1,187,175	162,218	1,024,958
Serbia	3,564,889	28.3%	1,044,627	2,520,262	16,825,025	1,565,726	15,259,299
Kosovo	869,947	6.9%	234,023	635,924	1,569,018	267,034	1,301,984
CEFTA 2006	12,595,999	100.0%	3,540,203	9,055,796	62,173,288	6,903,745	55,269,543

Source: CEFTA trade statistics 2010, and own calculations

Table 4: Trade flows of SEE countries: intra-regional, with the EU, and with ROW, 2010

	Intra-CEFTA	**with the EU**	**with ROW**
Albania	9.4%	70.3%	20.3%
BiH	30.1%	67.3%	2.6%
Croatia	10.3%	61.1%	28.6%
Macedonia	18.8%	56.4%	24.8%
Moldova	0.4%	45.3%	54.3%
Montenegro*	40.3%	43.8%	15.9%
Serbia	17.5%	63.6%	18.9%
Kosovo	35.7%	38.7%	25.6%
CEFTA 2006	16.8%	61.0%	22.2%

Share of the EU is of the year 2009 based on country's statistics; discrepancies exist between the EC and CEFTA statistical sources for 2010.

Source: EC trade statistics 2010, CEFTA trade statistics 2010, end own calculations

The share of each country's total trade in the intra-regional total trade is dominated by the respective share of non-agriculture products, which are much more intensively intra-regionally traded, compared with the agriculture products, as shown in table 3. Table 4 (and graph 3) gives information on the geographical structure of the SEE countries trade. It's evident that the EU is by far the main trade partner of SEE region countries, reaching on average at 61 percent of its total trade. Albania is in the first place (with 70 percent), followed by Bosnia and Herzegovina (67 percent), Serbia (64 percent) and Croatia (61 percent). Kosovo (39 percent) trades less than other countries of the region, with the EU. If exports to, and imports from, the EU are considered separately, usually (except for Serbia with a small difference), the share of exports to the EU from countries of the region, is higher than the share of imports[28].

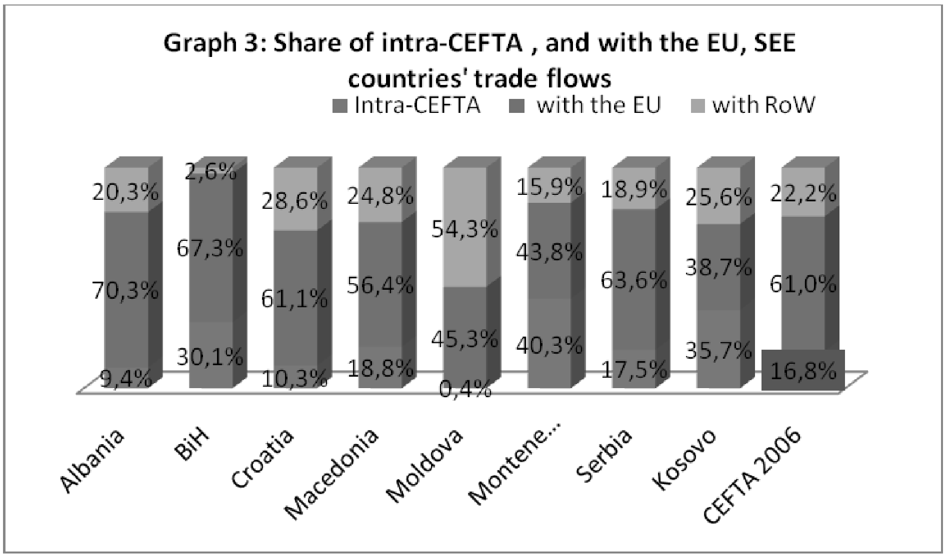


Table 5 shows the most exported products for each country of the region. Based on the data of CEFTA trade statistics 2010 (www.cefta2006.com), the results of some calculations show that the 5 most exported products for Albania, account for 70 percent of total exports in the region. The figures for Bosnia and Herzegovina, Croatia, and Macedonia are 58 percent, 42 percent and 55 percent, respectively. For Moldova, Montenegro, Serbia and Kosovo, the figures are 85 percent, 51 percent, 29 percent and 55 percent, respectively. As regarding to imports, the concentration scale is rather lower. So the most 5 exported imported products for Albania, account for 54 percent of total imports in the region. For Bosnia and Herzegovina, Croatia, and Macedonia, the figures are 39 percent, 45 percent, and 32 percent, respectively. For Moldova, Montenegro, Serbia and Kosovo, the figures are 67 percent, 29 percent, 44 percent and 49

[28]See EC trade statistics, 2010.

percent, respectively. Such high concentration indicators highlight the fragility of trade flows, particularly exports, from external factors.

Table 5: Intra-CEFTA trade concentration: the most exported products

Albania	Iron and steel	Mineral, fuels etc	Salt, sulphur, etc	Ores, slag and ash	Aluminum and articles thereof
BiH	Mineral, fuels etc	Iron and steel	Aluminum and articles	Wood and articles of wood	Articles of iron and steel
Croatia	Mineral, fuels etc	Electrical machinery and equipment	Nuclear reactors etc.	Plastics and articles thereof	Beverages, spirit and vinegar
Macedonia	Mineral, fuels etc	Iron and steel	Articles of iron and steel	Beverages, spirit and vinegar	Pharmaceutical products
Moldova	Cereal	Animal or vegetable fats and oil etc	Residual, waste from food industry	Sugar and sugar confectionery	Carpets and other textile floor coverings
Montenegro	Beverages, spirit and vinegar	Mineral, fuels etc	Wood and articles of wood	Iron and steel	Aluminum and articles thereof
Serbia	Iron and steel	Mineral, fuels etc	Nuclear reactors etc.	Beverages, spirit and vinegar	Plastics and articles thereof
Kosovo	Iron and steel	Mineral, fuels etc	Products of the milling industry	Articles of iron and steel	Edible vegetables etc.

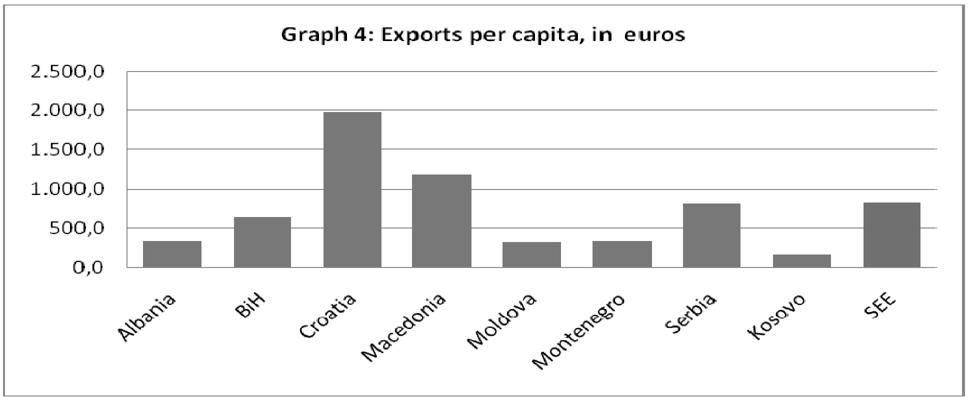
Source: CEFTA trade statistics 2010, and own calculations

Table 6 (and also graph 4), provides information on some main macro-trade indicators for the countries of the region, referring to the data of 2010. The relatively very high indicator of Gross Domestic Product per capita (GDP/capita) in case of Croatia makes it difficult for other countries to get over the average level of the SEE region; only Montenegro is above the average. In the lowest place is Moldova, followed by Kosovo and Albania. Croatia shows a consistency in the main macro trade indicators, being the first in GDP/capita, trade/capita, exports/capita and having the lowest trade deficit/GDP and the lowest current account deficit (CAD), relative to GDP. Moldova has almost the highest (near to Macedonia) figure in the CEFTA region regarding the openness index and at the same time is in the first place regarding the trade deficit/GDP.

Table 6: Macro-trade indicators of the countries of SEE region, 2010

	Population, in million inhabit	GDP, in million Euros	GDP/ capita, in Euros	Trade/ capita, in Euros	Exports/ capita, in Euros	Openness index (trade/ GDP)	coverage index (exp/ imp)	Trade deficit/GDP	CAD/GDP
Albania	3.2	9,000	2,803.2	1,360.7	336.9	48.4%	32.9%	-24.4%	-11.8%
BiH	3.9	12,500	3,199.6	1,989.4	647.1	62.1%	48.2%	-21.7%	-5.6%
Croatia	4.4	45,900	10,391.4	5,380.0	1,974.0	51.6%	58.0%	-13.7%	-1.1%
Macedonia	2.1	7,000	3,381.4	3,138.3	1,187.8	94.1%	60.9%	-22.9%	-2.8%
Moldova	3.6	4,400	1,229.9	1,130.0	323.0	92.5%	40.0%	-39.6%	-8.3%
Montenegro	0.6	3,000	4,840.6	1,805.3	335.7	14.2%	22.8%	-22.7%	-25.6%
Serbia	7.4	28,700	3,876.4	2,484.6	826.5	64.1%	49.8%	-21.4%	-7.2%
Kosovo	1.7	4,215	2,383.0	1,443.3	174.1	58.2%	13.7%	-44.2%	
SEE	26.9	114,715	4,264.5	2,541.5	838.6	59.6%	49.2%	-20.3%	

Source: EC trade statistics; CEFTA trade statistics 2010; end own calculations



One of the conclusions one can derive from the table is that, in general, low level of GDP per capita in the region is associated with low level of trade and export per capita, low level of openness index and import coverage index, and high trade deficit, generally associated with high CAD! This situation with such macro-trade indicators draws attention for better and more effective policies regarding growth and particularly exports.

3. Trade liberalization

The process of reduction and elimination of tariff barriers to trade, as part of the transition reforms in the countries of the region, and under the frame of (i) stabilization and association process and the SAAs, also (ii) the bilateral FTAs in the region, and starting from 2007 (iii) the CEFTA agreement, can now be considered as a fruitful process in the region. Along with the very important contribution of the SAAs[29], recently a particular role is being played by CEFTA. Following the tariff reduction schedule under the CEFTA 2006, now industrial products can move freely in the region, and starting from this year[30], a similar situation is for the agriculture products.

On the other hand, the SEE countries have full access in the market of their main partner, the EU. Starting from the year 2000, the region has benefited from the *autonomous preferential regime* established by the European Union, which gives an 'exceptional unlimited duty-free access to the EU market for nearly all products (excluding only wine, sugar, certain beef products and certain fisheries products, which enter the EU under preferential tariff quotas, as negotiated under the SAAs) originating in the Western Balkans'. The regime was renewed in 2005, and now it is extended until 31 December 2015[31].

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[29] Already are *affective* the SAAs with the EU of Macedonia (2004), Croatia (2005), Albania (2009), and *signed in* the SAAs of Montenegro (2007), Bosnia and Herzegovina (2008) and Serbia (2010). Kosovo is preparing the application.

[30] The Additional Protocol, signed by the CEFTA member states (except Bosnia and Herzegovina) and entered into force in the period November 2011- January 2012, gives more liberalized concessions on agriculture products.

[31] The tariff reductions under the new Regulation amending Council Regulation (EC) No 1215/2009, adopted on 24 November 2011, are applied retroactively to allow importers to claim compensation for the duties paid in 2011.

The multilateral trade liberalization process under the WTO membership (or the process of getting the WTO membership[32]) obligations, is also an important dimension of trade liberalization in the region. However, it deserves attention because of the different applied MFN tariff rates across the region, and in comparison with the EU respective tariff rates. As can be seen from the table 7, the EU's *simple average MFN rate* of 4 percent, and trade-weighted average MFN rate of 2.7 percent are considerably lower than those of SEE[33], on average 4.9 and 4.7 percent, respectively. Just at the EU level of the simple average MFN applied, are Croatia and Montenegro, while Moldova is even below that level, at 3.7 percent. Serbia (6.3 percent), Macedonia (6 percent) and Bosnia and Herzegovina (5.9 percent), have the highest simple MFN applied rates. Regarding the *trade weighted average MFN applied*, Moldova (2.4 percent) is again below the EU level, while Croatia (3.7 percent) and Montenegro (4.6 percent), and also the other countries, are at considerably higher rates. At the highest levels are again the same three countries (although ranked somehow differently): Bosnia and Herzegovina (6.1 percent), Macedonia (5.9 percent) and Serbia (5.6 percent).

Regarding the frequency distribution of the tariff lines, SEE (including Moldova, otherwise not) on average has more duty free tariff lines than EU (31.8 percent, as against 26.7 percent). In the best situation is Croatia (52.5 percent), followed by Moldova (52.1 percent) and Albania (43.8 percent). Serbia (1.1 percent) and Montenegro (2.2 percent) are far from the SEE average, and the EU level regarding the duty free tariff lines. When low tariff lines are considered (0<=5, and 5<=10), the EU frequency is above the SEE average. For the higher tariff rates, the EU frequency is below the SEE average, meaning that the EU's MFN is skewed to the left with few tariff peaks.

[32] Albania and Croatia, WTO members since 2000, Macedonia since 2003. BiH is in the process of negotiating accession since 1999, and Serbia and Montenegro since 2005. Kosovo is preparing for application.

[33] The EU's MFN tariff rates have been rather lower in the previous years. For example, in 2007 these rates were respectively 3.8 percent, and 2.4 percent. Such a slight increase can be explained by the global economic recession pressure.

Table 7: MFN applied tariff profiles of the Western Balkans (SEEU) and the EU, non-agriculture products (percent of tariff lines), 2010

	Simple average final bound	Simple average MFN* applied	Trade weighted average
Albania	6.6	4.6	4.5
BiH*		5.9	6.1
Croatia	5.5	4.0	3.7
Macedonia	6.3	6.0	5.9
Moldova	5.9	3.7	2.4
Montenegro*		4.0	4.6
Serbia*		6.3	5.6
SEE, average	***6.1***	***4.9***	***4.7***
European Union	***3.9***	***4.0***	***2.7***

Frequency distribution (in %)	Duty free	0<=5	5<=10	10<=15	15<=25	>25
Albania	43.8	21.8	18.5	15.8		
BiH*	29.9	30.7	30.3	9.1		
Croatia	52.5	15.6	20.6	10.9	0.3	
Macedonia	41.3	17.8	14.7	8.4		
Moldova	52.1	17.7	21.3	8.7	0.1	
Montenegro*	2.2	74.8	20.5	1.7	0.7	
Serbia*	1.1	61.4	24.0	4.5	8.6	0.4
SEE, simple average	31.8	34.3	21.4	8.4	2.4	0.4
European Union	26.7	38.6	27.1	6.7	0.9	

*Countries under the procedures of the WTO membership; for these countries MFN does not apply.
**Only WTO member states of the region are considered for simple average final bound.
Source: WTO: World Tariff Profiles, 2011

The situation needs more attention, when agriculture products are considered. In this case, discrepancy between SEE countries and the EU is much larger. If having a look only to the trade weighted average tariff MFN applied, all the countries except for Albania (7.3 percent) have a much higher tariff level than the EU level (10.1 percent). Montenegro (18.5), Serbia (18.0) and Bosnia and Herzegovina, have the highest rates[34].

If all preferential tariff rates are considered, the applied average rates are of course much lower. For example, in case of Albania, the average tariff rate has shown a strong declining tendency, reaching 3.07 percent in 2007, 1.80 percent in 2010 and 1.52 percent in 2011[35].

The tariff profile of SEE countries shows that the tariff liberalization process should go further, particularly in countries that are applying higher tariff rates. The 'virtual custom union' already discussed in the literature (see Handijski et al, part 3, 2010), would be a way not only for further reducing the tariff rates against the third parties (not members of the EU, CEFTA 2006 or other FTAs) but particularly for promoting institutional and structural reforms, and reducing the non-tariff barriers to trade.

Non-tariff barriers to trade (NTB) are now in the first place. CEFTA 2006 is already focused in the issues related with the NTBs and the new trade topics such as investment, trade in services, intellectual property rights and government procurement. Such topics are in all their dimensions closely related with NTBs and with the need of improving the business and investment climate in the region. The expected role of export as a 'source' of growth would be possible only if essential progress is done in the NTBs and new trade topics[36].

4. Regional economic integration – need for supportive and effective economic policies

a) Trade, growth and development – need for promoting exports

The positive relationship between trade openness, development and growth has been widely acknowledged in the economic literature. *Classical (and*

[34] See: WTO: World Tariff Profiles 2011.
[35] General Directory of Customs, Albania (www.dogana.gov.al)
[36] For a complete analysis of the NTBs and the new trade topics, see the written material by Predrag Bjelic.

neoclassical) trade theory argues that opening to trade allow a country to gain from exploiting the comparative advantage by exporting the respective goods at international (higher than domestic) prices, and importing other goods at international (lower than domestic) prices. The gains increase further through the specialization process in the sectors with comparative advantage: The production bundle under specialization has a higher value compared with that of autarky, while the consumption bundle represents higher community welfare. Regarding the interaction between trade and growth, even though empirical studies are inconclusive about the relationship between trade openness and growth[37], theoretical models explain how trade can boost growth (see Handijski 2010, p. 98). According to *endogenous growth models* (with trade as endogenous factor) and the *new trade theories* (which emphasize the role of *economies of scale* and *product differentiation*) the interaction between trade openness and growth is a dynamic one and the gains from trade liberalization come from accumulation (or transfer) of technology, or a concentration on innovation. Technology accumulation and innovation, is the key to long-term growth.

The benefits of increased trade are more evident in case of small economies, 'which are able to take advantage of the economies of scale from accessing, or being part of larger markets'. Greater trade generates gains from reallocations, macro-volatility reduction, innovation through absorption of foreign technologies, etc. In studies related to transition economies, is proved that exporting and importing induces innovation, which in turn improves productivity and competitiveness. Trade also benefit non-exporting sector through the import competition on product quality and prices. Except for improving consumer welfare by allowing for lower prices and increased variety of import products, trade also contribute to lowering firms costs by allowing cheaper, and in an increased variety, of imported inputs (see Handijski 2010, p. 3).

The worldwide economic and trade developments during the last decade, reflected, among others, (i) in the higher growth rates of exports in developing countries (by 80% between 2000 and 2009, compared to 40% for the world as a whole), and (ii) in the fact that now exports from the developing countries accounts for more than half of the world exports and the South-South trade has outstripped North-South trade since 2007, 'sends

[37]See Sach and Warner, 1995; Frankel and Romer, 1999, and Dollar and Kraay, 2004.

a powerful signal that *trade-driven development is possible and that open and increasingly integrated world markets can play a major role in the process*'[38].

The recent global economic and financial developments, dominated by a crisis which is still present in some of its dimensions, put more emphasis in the role of trade in growth and development, particularly in medium, to long term. As already widely discussed (see Sanfey P. and S. Zeh, 2010, p. 41; Bartlett and Monastiris, 2010), the main sources of macroeconomic stability and relatively high rate of growth in the SEE region during the past decade (until late 2008), were capital and foreign currency inflow (mainly foreign direct investments and remittances but also the contribution of international financial institutions), and expended credit (domestic and foreign one). However these growth sources, together with the contraction in international trade of the region, served as transmission channels of the world crisis effects. Along with the decline of real GDP (except for Kosovo, Albania and Macedonia, with positive but low growth rates), the year 2009 demonstrated a crunch in the credit, a decline in remittances and also in FDI/capita (with some exception, like Albania), and a collapse in merchandise exports (Bartlett and Monastiris, 2010, p. 3).

Economic recovery in the region began in 2010 but uncertainty exists for a sustained growth. Based on the lessons driven from the financial crisis, a stronger discipline is going to impose on business crediting, which is getting downward. The remittances show a declining trend, related not only with their 'natural cycle' but intensively influenced by the impacts of financial crisis in the host countries of emigrants, like Greece. A stronger discipline is going to impose on financial flows through international institutions, as well. The prospect of FDI inflow in the region is highly depended on their nature: while privatization related scope of FDI is substantially narrowing, the potential of 'green field' FDIs is very much related with the business and investment climate, and the regional integration. Having in mind the size of the SEE individual countries, the FDI flow is closely related with, and depended on, the facilities of intra-, and extra-regional movement of goods and services. So as Bartlett and Monastiris (2010) underline, the 'growth model' of reliance on credit

[38] See the European Commission Communication "Trade, growth and development, Brussels, 27.1.2012.

growth, FDI inflows, and remittances (labour exports), has been called in question by the economic crisis.

Under such developments and risks, the ‘growth model’ to follow in the SEE countries has been widely discussed among experts, regional and international ones[39] and the role of exports and FDI in growth has been in the centre of the discussions. Sanfey and Zeh (2010) argue that SEE can have a sustained strong growth in long-run, if it realizes its *trade potentials*. An important factor why the actual trade flows are far from the potentials ones, according to the authors, are the non-tariff barriers and obstacles to trade. Along with other barriers to trade such as administrative and logistic procedures, custom and trade regulations, trade infrastructure, etc., they emphasize the role of the present lack of compliance with the EU technical regulations and sanitary and phytosanitary standards as “the most severe impediments of expending trade of the region to the EU”, while the multi-speed adoption of the EU regulations is considered as an additional barrier within the SEE region. Among the domestic policies to increase trade integration, the authors point out the (i) comprehensive information for local businesses on administrative procedures required for exports and imports, as the first important step; (ii) further addressing the SMEs and supports SMEs in higher value added sectors with export potentials; and (iii) adequate competition policies.

The persistent high trade deficit (as shown in table 6) is fueled by import inclination fostered by the tendency of consumption toward the ‘European pattern’, a tendency supported by the intensive emigration and money transfers and “pushed by the structure of the economic elite” (Ehrke, 2011). Under the pressure of the limitations of other sources of import-financing like remittances and crediting, which were also the main source of growth, generation of high exports becomes very important.

How possible is, and what are the potentials of, an export-led growth model in the Western Balkans (WB) countries, such as the one of Central

[39] See, among others, “Export-Led Growth: Central European Experience – Magic Formula for Western Balkans?”, edited by Michael Ehrke, Belgrade 2011; “South Eastern Europe after the Crisis: a New Dawn or back to Business as Usual, edited by Will Bartlett and Vassilis Monastiriotis, LSEE Research on South Eastern Europe, November 2011.

Europe (CE) countries? As discussed in the conference titled 'Export-led Growth' organized by Friedrich Ebert Foundation in 2010 in Belgrade, the export-led growth of Central Europe was fueled by *foreign direct investment* through transnational companies, particularly in the nineties (concentrated in high-tech industries such as automotive and electrical components industries) - both privatization related, and Greenfield ones - which made it possible the integration of local production activities into their own international value-chains. So 'export oriented direct investment was connected to a fundamental reorganization of the industrial labour division within Europe wherein Central Europe very quickly became the "extended workbench" of the Western European car and electronic industry' (Ehrke 2011, p.11). Meanwhile the trade and FDI developments evidence in the WB show a big difference with the CE region, quantitative, and qualitative ones. Compared to the CE region, the Western Balkans region have quite lower trade openness, import coverage and intra-industry trade, the latter mostly present in the low-tech industries indices It also have quite lower FDI/capita (less than a third), mostly present in services, low-tech industries and low stage of value-chain (for details, see Ehrke 2011, chapt. 2).

Under such circumstances, one of the conclusions of the Belgrade 2010 conference, was that 'an export oriented growth strategy cannot rely on the continental industrial wave of the sort of the Central Europe originally saw' (Ehrke 2010, p.11), because of many factors, including historical, cultural, geographical and political ones. Important reforms were carried out and important achievements have been scored in the WB countries, but still there are problems with the investment and business climate, widely related with corruption, infrastructure, institutional capacities, etc.So the Central European experience with the export-led growth model, cannot work as a 'magic formula' for the Western Balkans. Nor the experience of the East and Southeast Asian economies, where the export-led growth was supported by the state-guided industrial policy, now judged as a market disturbing policy and so prohibited in the regulatory framework of the EU.

Considering not only the trade indicators (low openness index, low import coverage index, low intra-industry trade index, etc) and FDI indicators (low FDI/capita, low FDI in high-tech industry, etc) but also persisting problems in business and investment climate, one can conclude for 'insufficient export abilities' in the SEE countries. So in short – to medium

–term, it seems as impossible to expect a 'boom' in exports as an engine of growth. However, is 'insufficient export abilities' an indicator of the 'impossibility' to follow the strategy of export promotion?

Pressure still coming from outside the region (ongoing financial crisis) and inside the regional countries (credit restraint), highlights the importance of increasing the competitiveness and export abilities of the WB countries. Referring not only to the trade theoretical literature but also to the experts' discussions regarding the economic and trade situation in the region (see footnote 12, p. 11), a rational conclusion is that 'export-led growth' is definitely not a magic formula; however export promotion is the road to growth, and to more developed and competitive economies. So the 'export ability insufficiency' is not an indicator of impossibility and ineffectiveness of export promotion strategy. On the contrary, it is a strong signal to the policy-makers to undertake adequate policies (i) to speed up the structural reforms and improve the business and investment climate; (ii) specifically, to improve institutions and reduce and eliminate non-tariff barriers to trade, (iii) to enforce competition and support SMEs in higher value added sectors with export potentials, and (iv) to increase quality of education, particularly the professional one.

b. Benefits of a "Virtual Custom Union"

A customs union is a free trade area where parties adopt a common external tariff against the third parties. An important difference between a customs union and a free trade agreement (such as CEFTA), is that the movement of goods within the customs union is not based on their originating status. Any good that is wholly produced or imported from a third party once they are granted free circulation, can move freely within the borders of customs union. Currently there are 14 customs unions in force around the world that are notified to the WTO. The EU, being an economic union, is also a custom union (historically, the oldest custom union in the world). The only non-EU members who have a customs union with the EU are Turkey, Andorra, and San Marino.

The Western Balkan region has become a *free trade area* since the CEFTA 2006 came into force (in 2007), and the quotas and customs duties that existed in the bilateral FTAs are almost removed (although the process is not completed yet; there are still tariffs and quotas to be removed). When all tariff liberalization in the region with the EU is completed, and all intra-regional quotas and customs duties are removed, if the seven SEE countries adopt EU's Common External Tariffs (CET), the countries in the region will become part of a customs union. However, adopting the common customs tariff of the EU is only one element of a complete customs union with the EU. Without the implementation of other institutional and regulatory requirements, the resulting 'custom union' can be called a 'virtual' custom union.

Forming a virtual customs union, as underlined in the World Bank working paper "Evolution of Intra-regional Trade in Southeast Europe: The Role of CEFTA for Enhancing Regional Trade Integration" (see Guerin, 2010), will have three significant effects on the SEEs: (i) reducing tariff dispersion (by reducing or abolishing tariff peaks); (ii) reducing the trade diverting effects of existing preferential agreements, such as the SAAs and CEFTA and hence improving welfare; and (iii) boosting intra-regional trade.

The SEE countries' tariff profiles present several tariff peaks much higher and more frequent than the EU's CET. Based on the calculations and the results presented in the World Bank paper (Guerin, 2010), after such a reform, the region's simple average tariffs would be reduced from 5.1 percent (in 2009) to 2.3 percent, while trade-weighted average tariff would be reduced from 4.7 percent to 2.2 percent[40]. The intensity of this tariff adjustment process would be different for different countries of the region, depending on the actual level of the tariffs. Also the after-reform level of average tariffs will be different for different countries, depending on the number of tariff lines that are already duty-free in each country (see Guerin, 2010, p. 108).

Regarding the *welfare improvement*, Guerin (2010) makes an estimate of costs and benefits of such a 'virtual customs union', by using the partial equilibrium simulating model of SMART (developed by UNCTAD and the World Bank), based on the traditional concepts and theoretical analyses of trade creation and trade diversion (Viner, 1950; Meade, 1953; Lipsey, 1957 and Krueger, 1997). According to the quantitative estimate, 'the impact of this trade reform is going to be positive with net trade creation in

[40] Average tariffs include preferential tariffs as well as MFN tariffs.

the magnitude of US$998.9 million for the region, an increase of 4.3 percent from pre-reform import levels'. Considering the revenue loss because of the trade diversion, the overall net effect of CET amounts to US$590.9 million, or about 1 percent of SEE's combined GDP. The third parties (extra-regional trade partners, like China, Russia, United States, and Turkey) are going to benefit as well. Individually, the net effect is going to be higher for Serbia and reach 2.8 percent of GDP, followed by Bosnia and Herzegovina (about 1.9 percent of GDP) and then by Albania, Macedonia, Montenegro and Croatia.

In the above mentioned results obtained by single-country simulations based on SMART model, are not taken into effect the indirect results and the interactions between regions and industries. One such indirect effect is increased FDI attractiveness from outside the region. Currently different tariff structure brings additional costs to doing business in an economically segmented market, because of divergences in prices across the region. Adopting EU's CET, would eliminate such a cost and make the region more attractive to the multinational companies.

Furthermore empirical studies on EU-Turkey customs union give evidence on significant gains in the manufacturing sector of Turkey in terms of productivity gains. While the intra-industry trade of Turkey with the EU is increased, Turkey's industrial base is dramatically changing from low technology products group to high technology industries, since the customs union agreement with the EU has been put into effect in 1996 (Kocyigit and Sen, 2007). Considering this effects, the regional 'virtual customs union' is expected to be an instrument of encouraging growth based on exports.

How applicable is the adoption of EU's CET by the SEE countries unilaterally and individually? A political resistance may arise in countries where tariff revenue loss is the highest, but compensation measures could be applied for a temporary period of adjustment. Country-specific tariff liberalization schedules are needed, maybe with different speed of liberalization for sensitive and non-sensitive products.

Adoption of EU's CET is not simply a 'technical' measure. Several institutional and administration measures need to be taken, to guarantee the accurate development and implementation of a revenue collection and management strategy. This requires the candidate countries 'to develop policies, systems, procedures, technologies, and instruments compatible with the EU requirements and standards' (Guerin, 2010, p 127). But these requirements can be considered as another 'advantage' of the adoption of the EU CET, since it contributes to the institutional reforms and the adoption of the EU *acquis*.

5. Conclusions and political suggestions

Need for better expertise-based, and interest-harmonized, policies

The economic and economy-related reforming progress made in the region during the period of transition, is evident. Evident is also the political dimension of the progress. However, the speed of transition could have been higher if barriers and obstacles, particularly the administrative and institution-related ones, including those 'purely' political, were intensively reduced and overcome.

The challenges coming from the prolonged unfavorable global economic and financial situation, and also from the narrowing growth capabilities based on remittances and other financial inflows, effective policies addressing non-tariff barriers to trade and market segmentation, and aiming at improving the business and investment climate, institutions, competition, innovation and professional education, among others, are very important for a sustained growth and development. Increasing of exports as a pillar of growth in medium-to long- run, is not possible if export potentials are required in low costs – based on low wages, or just in 'selling' the natural resources. Supporting of innovation, professional education, high technology and 'high quality' FDIs integrated in high technology value chain, supporting SMEs, particularly those involved in innovation and high technology, is a challenge to face with.

In the process of reducing and overcoming political barriers and obstacles, at least three things to emphasize: *first*, the need for a better expertise in policy making; s*econd*, the need for a better harmonization of the interests represented by politics, and *third*, the need for a better law implementation and enforcement. Representing the social interest means first of all 'knowing', and serving this interest by effective policies - which requires expertise-based policies. On the other hand, when compared with the past, the society in the countries of the region is being diversified and the process is going on, so the social interests. However, these diversified interests should be harmonized, *vertically* (social groups –national – regional – and global dimensions), and *horizontally* (between generations), by thinking always what is better for the new and coming generations. The last but not least, not rarely we have 'good' laws in the paper but without the expected effect in reality. At least two things to mention: *first*, when legislation is approved, the proper applying instruments are not always clearly definedand lawenforcementis not associatedwith thenecessary bylaws, and *second*, the parliament should pay more attention to law enforcement and its effect, after the law is approved.

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WORKING PAPERS

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Administrative and Other Non-Tariff Barriers in CEFTA 2066 Intraregional Trade

Customs tariffs have been eliminated as most important obstacles to international trade due to the achievements of General Agreements on Tariffs and Trade (GATT) true eight rounds of multilateral trade negotiations. But even during the period of GATT 1947 non-tariff barriers have been perceived as obstacle to international trade and some of them have been regulated by this agreement. Some of non-tariff barriers are still present even today when we have World Trade Organization (WTO) as a guardian of global trade regime. The remaining non-tariff barriers not regulated by WTO rules are administrative trade barriers and partly technical barriers to trade.

In regional trade liberalization processes countries members of regional trade integrations tend to go into deeper trade integration and eliminate more trade obstructing instruments comparing to the WTO regime, especially non-tariff barriers. In revised Central European Free Trade Agreement from 2006 (CEFTA 2006) there is still high presence of non-tariff barriers. The most applied non-tariff barriers are different than barriers seen with most important trade partners, as European Union. This paper will focus on the applied non-tariff measures in intraregional trade and explore the differences from the measures applied by EU trade regime which will be relevant regime for CEFTA 2006 economies in the future. Since CEFTA 2006 is a sub-regional trade integration, and all its members have EU membership aspirations, the different stages of CEFTA 2006 economies on its way to EU membership creates additional non-tariff obstacles to intraregional CEFTA 2006 trade. Recent studies show that most significant NBTs are Administrative barriers to trade.

There are several methods of measurement of administrative barriers to trade. The quantification of these barriers is important because we want to compare the presence of these barriers between countries and to follow the level of these barriers in each country true time. The main indicators for calculating administrative barriers in international trade are:

Trading Across Border Indicators, developed by the World Bank and their results are published each year in Doing Business Report

Economy	rank	EXPORT			IMPORT		
		Documents (number)	**Time** (days)	**Cost** (USD per container)	**Documents** (number)	**Time** (days)	**Cost** (USD per container)
Albania	75	7	19	725	9	18	710
Bosnia and Herzegovina	71	5	16	1,24	7	16	1,2
Croatia	98	7	20	1,281	8	16	1,141
Macedonia	66	6	12	1,376	6	11	1,38
Montenegro	34	6	14	775	6	14	890
Serbia	74	6	12	1,398	6	14	1,559

Source: World Bank, *Doing Business 2011* Report, Trading Across Borders Indicators, 2011.

Logistics Performance Index (LPI), developed by the World Bank, and especially important because it contains sub-indicator on customs efficiency;

Country	**LPI**	**Customs**	**Infrastruc-ture**	**Internatio-nal shipments**	**Logistics competence**	**Tracking & tracing**	**Time-liness**
Poland	3.44	3.12	2.98	3.22	3.26	3.45	4.52
Turkey	3.22	2.82	3.08	3.15	3.23	3.09	3.94
Kazakhstan	2.83	2.38	2.66	3.29	2.60	2.70	3.25
Bulgaria	2.83	2.50	2.30	3.07	2.85	2.96	3.18
Uzbekistan	2.79	2.20	2.54	2.79	2.50	2.96	3.72

Macedonia, FYR	2.77	2.55	2.55	2.83	2.76	2.82	3.10
Europe & Central Asia (regional average)	2.74	2.35	2.41	2.92	2.60	2.75	3.33
Serbia	2.69	2.19	2.30	3.41	2.55	2.67	2.80
Bosnia and Herzegovina	2.66	2.33	2.22	3.10	2.30	2.68	3.18
Azerbaijan	2.64	2.14	2.23	3.05	2.48	2.65	3.15
Georgia	2.61	2.37	2.17	2.73	2.57	2.67	3.08
Russian Federation	2.61	2.15	2.38	2.72	2.51	2.60	3.23
Ukraine	2.57	2.02	2.44	2.79	2.59	2.49	3.06
Moldova	2.57	2.11	2.05	2.83	2.17	3.00	3.17
Armenia	2.52	2.10	2.32	2.43	2.59	2.26	3.40
Albania	2.46	2.07	2.14	2.64	2.39	2.39	3.01
Montenegro	2.43	2.17	2.45	2.54	2.32	2.44	2.65

Source: World Bank, Logistic Performance Index, Intenet, http://info.worldbank.org/etools/tradesurvey/mode1a.asp, 2010.

The Enabling Trade Index (ETI), developed by the World Economic Forum and published each year in Global Enabling Trade Report and most relevant subindex is Border Administration Subindex.

Economy	BORDER ADMINISTRATION SUBINDEX	Efficiency of Customs Administration	Efficiency of Import-Export Procedures	Transparency of Border Administration
Singapore	1	1	1	2
Georgia	37	31	38	42
Montenegro	55	74	49	54
Croatia	60	54	74	59
Armenia	84	76	89	109
Macedonia, FYR	75	108	59	58
Albania	59	49	62	73

Turkey	61	69	52	62
Serbia	64	64	68	68
Bosnia and Herzegovina	90	106	58	108
Ukraine	106	110	98	102
Kazakstan	121	103	125	81
Kyrgyz Rep.	115	81	116	123
Tajikistan	122	114	124	89
Russia	109	85	110	115
Azerbaijan	105	38	123	87
Burundi	125	125	104	125

Source: World Economic Forum, The Global Enabling Trade Report, 2010, 2009, 2008.

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Igor Radojičić
Speaker of the National Assembly of the Republic of Srpska

Economic and political barriers to regional trade

Distinguished participants,

It is a great pleasure to be meet you again on this occasion. This conference is a continuation of activities that we have been conducting over the past years in relation to regional issues, business environment, regulatory reform,including the role of parliamentary committees for economy and finance and barriers to regional trade that we are now dealing with.

1. Political environment

If we use the weather forecast jargon to describe political relations in the region, we could say that they are "improving, but with occassional precipitation". The "improvement" is clearly visible as an increasing number of leaders, governments and institutions in the region are cooperating among themselves and looking forward into the future, rather than looking back into the past. "Precipitation" illustrates occasional deterioration of political relations in the region during election campaigns, when wartime rhetoric is revamped asplaying the national card is a proven and tested way to attract attention duringan election campaign.The latest example of this is the recent election campaign in the Republic of Croatia, where, despite obvious efforts to improve relations between Serbia and Croatia over the past few months,strong national themes and occasional animosity towards Belgrade sometimes erupted.

There are a lot of political issues between the countries in the region that still remain outstanding. As an illustration, I think that, for instance, not one final inter-state agreement on borders has yet been signed between former Yugoslav republics.Bosnia and Herzegovina and Montenegro are about to sign such agreements. There are other issues pertaining to recent wars, refugees and displaced persons, property, citizenship, succession, etc.There are also many areas, mainly in the economy and transport, where cooperation is essential and there are some good examples in that respect. There is the Energy Community of South East Europe, established inJuly 2006, which has been functioning very coherently and successfully.

Countries of the region differ in terms of political status, with everything this may imply in terms of economic standards and relations. Romania, Bulgaria, Greece and Slovenia are both EU and NATO member states. Although Croatia will not formally join the EU until next year, this year it has alreadystarted to apply some EUexternal trade standards as if it had already enteredthe EU. Albania, Montenegro, Serbia, Macedonia and Bosnia and Herzegovina are at different stages of the EU integration process, which implies different economic relations in the form of stabilization and association agreements and different levels of openness of their respective markets with the EU. Several countries of the region have recognized unilateral declaration of independence of Kosovo and Metohija, while Serbia, Bosnia and Herzegovina, Greece and Romania have not.

Even though relations among countries of the region may still be plagued with many political problems and animosity, economic relations are always moving ahead of political ones and trade relations are usually much more advanced than political ones. One may even raise the issue of reciprocity of trade relations in the region. Some countries and markets aremore accessible than others, which are not that open and are even prone to non-tariff barriers or to hidden methods of protecting their own markets, while invading other markets in an unfair way.

Bosnia and Herzegovina often appears to be the weakest link not only because of its complex structure and slow and difficult decision-making process, but also because of its traditional openness to both the East and the West.I guess that Bosnia and Herzegovina is the only country where products from Bosnia and Herzegovina, Serbia and Croatia alike are treated as "domestic" products. This even goes for products from Slovenia, which has a strong economic presence in Bosnia and Herzegovina.Such a mental approach by local consumers or people is another important element of economic and trade relations.

2. Economic environment

CEFTA 2006, a free trade agreement between Albania, Bosnia and Herzegovina, Croatia, Macedonia, Moldova, Montenegro, Serbia and UNMIK, has been in force since 2007. Croatia will no longer be a part of CEFTA once it joins the EU, whereas other countries are moving towards the EU and gradually opening their respective markets with the EU.

Everyone may agree that CEFTA has helped improveeconomic relations in the region by simplifying and harmonizing terms of trade and providinga respectable, relatively stable, predictable, broader and more attractive business environment to foreign investors. Thanks to CEFTA, conditions have been created for fair trade in the region and the region has been prepared to face tough competition on the EU market that we are all striving for.

Bosnia and Herzegovina was honest, but a bit naive and mostly unprepared in its entering the regional market. An important factor in this was the aforementioned mental approach towards treating products from neighbouring countries as "domestic" products. As probably the weakest link in the regional chain, Bosnia and Herzegovina has opened its door to foreign competition in its own market and although, in principle, it got access to other markets, in practice it has been faced with a range of non-tariff barriers and technical barriers to trade that hinder free excess to the entire regional market. There are working groups within CEFTA dealing with various issues, such as the Working Group on Technical Barriers to Trade, one of the four permanent working groups of the CEFTA Forum of the Chambers of Commerce, or the Working Group on Agriculture, dealing with non-tariff barriers, such as issues of non-recognition of certificates of compliance or harmonization of legislation between CEFTA Partiesand the EU. For example, there is a form that companies may use to report non-tariff barriers, which is intended to simplify the reporting procedure. The CEFTA Trade Portal has been in operation since 2010.

Trade in agricultural products is subject to constant debate within CEFTA, which resulted in the signing ofthe Additional Protocol and Annex 10 on further liberalization of trade in agricultural products, which has been in force since late 2011, but not in all CEFTA countries.

Republic of Srpska's total foreign trade turnover with CEFTA countries amounted to KM 2.21 billion in 2011. Its imports and exports were almost balanced, but with a high foreign trade deficit with Serbia and foreign trade surplus with Croatia, which will deteriorate with Croatia's entry into the EU and its obligation to apply new rules and standards. Serbia and Croatia are the most important foreign trade partners of both Republic of Srpska and Bosnia and Herzegovina.The share of Republic of Srpska's foreign trade with Serbia and Croatia totals to25% of exports and around 20% of imports. These statistics are similar for Bosnia and Herzegovina. As for Republic of Srpska's foreign trade with the EU, it consists of about 62% of exports and 35% of imports, while 31% of its exports and 19% of its imports are with other CEFTA countries. With the exception of imports of certain energy products from Russia, it is obvious that our foreign trade is absolutely tied to the EU and CEFTA countries, while the share of third markets is marginal.

3. Problems of exporting products from Bosnia and Herzegovina to CEFTA countries, especially to Serbia and Croatia

Most problems are related to agricultural products. Our statistics from what is called the MAB Database (Market Acces Barrier Database) show that over 50% of non-tariff barriers that were reported arise from sanitary and phytosanitary measures, the areas where protectionist policies designed to informally protectthe local markets mostly occur.Problems in foreign trade that our companies are faced with can be divided into several categories:

Problems with import / export documentation

Not all information on necessary documents and procedures in foreign trade are readily available, the number of such documents varies, numerous documents must be produced and procedures for obtaining them are slow and complex.

Problems with compliance assessment of export / import products

The cost of compliance assesment of export / import products is very high. Sometimes the cost of exporting goods to a CEFTA country far exceeds the cost of importing the same goods into the Republic of Srpska or Bosnia and Herzegovina.The cost of charges levied on a truckload of certain goods entering Bosnia and Herzegovina is 50 monetary units, whereas the cost of charges levied upon entry of the same truckload of goods into Croatia is 500 monetary units.

The problems include insufficient number of certified bodies and authorized laboratories and institutions, and non-recognition of certificates of compliance even when they are issued by accredited institutions (e.g. our certificates are recognized, but the goods are still subject to extra control for verification purposes). Another problem is that Bosnia and Herzegovina does not have a single EU-accredited laboratory for quality control of foodstuffs of animal origin. Despite a number of agencies and institutions, we are still lagging behind in terms of harmonization of regulations, i.e. new institutions are put in place mechanically for the purpose of formally accepting EU standards, without making their operation meaningful and functional.

Two years ago, the Republic of Srpska and Crotia found themselves amid a small war over our exports of dairy products. At one point, exports of milk and some dairy products to Croatia were seriously hindered due to requests for additional documents and extra controls. Negotiations and attempts to find a diplomatic solution to the problem remained fruitless until Bosnia and Herzegovina decided to respond with reciprocal measures, which almost immediately helped lift the informal barrier to trade in our dairy products, and it was so atipical for us in Bosnia and Herzegovina to have reached an agreement on something like that so easily.

Since January 1, 2012, Croatia has already started to apply the new (EU) Fresh Fruit and Vegetables Marketing Standards even before formally joining the EU, which imply phytosanitary control according to EU standards and which have already caused a decline in our exports of fresh fruit and vegetables to Croatia.

Problems with customs services

There are constant problems pertaining to the operation of customs services in terms of inaccurate recording of quantities, prices and types of goods. Examples of this include dumped import prices of beer, which have almost pushed local breweries in Bosnia and Herzegovina out of business and overwhelmed its market with beer from neighbouring countries, or declaring lower import prices and smaller quantities of flour than the real ones,which enables uncontrolled processing and selling of flour and products thereof.

Application of regulations governing quarantine of live animals is inequitable. Imported live fish from Serbia is sold immediately, without being quarantined for 15 days, whereas quarantine for exported livestock from our producers is compulsory.

Moreover, there are obvious problems with long delays at border crossings (especially for perishable goods), extensive sampling for quality control purposes (for each type of packaging), long waiting time to obtainadditional test results (one has to wait from ten days to one month to get proof that the products are safe), as well as problems with provingthe origin of raw materials, etc.

Unfair competition

The problem of unfair competition is related to openness of the domestic market, so lobbies of foreign manufacturers operate unhampered in this country, giving extra favouritism to foreign products and influencing the public procurement process. A particular problem is the fact that neighbouring countries offer significantly higher subsidies for certain types of agricultural products, which results in lower prices of such products.Exports are especially hindered by limited quotas on exports of certain products at certain border crossings.

3. What needs to be done?

In future, all countries of the region will be moving towards the EU, which means that they will also be moving towards a more open market for goods and products coming not only from the countries of the region, but also from the EU. Still, it will take a lot more willingness and understanding in order to resolve the current problems within CEFTA:

- To speed up harmonization of national legislation with the EU *acquis* to simplify comparison and terms of trading,
- To build capacities of all institutions dealing with trade, inspection, agriculture, etc. to be able to respond to new requirements and standards,
- To solve the problem of non-recognition of certificates of compliance because certificates issued by accredited laboratories are either not recognized or the tendering process of public procurement makes it mandatory that test certificates be issued only by accredited local laboratories. For example, even though Bosnia and Herzegovina and Serbia have signed an agreement on mutual recognition of compliance certificates, this agreement is not implemented.
- To solve the problem of standardization of sampling and quality control. These problems especially affect our producers of mineral water, wine, milk and beer as they are faced with delays in export procedures due to additional controls, they have to wait for a very long time to obtain the test results andto undergo sampling of the same product in different packages, etc.
- To solve the problem of high costs of testing the products upon export, which raises the pricesof such products and makes them uncompetitive.
- To solve the problem of border crossings (the so-called "BIPs") designated for inspection for trading purposes.Bosnia and Herzegovina will face a huge problem once Croatia joins the EU. Our border with Croatia is 932 kilometres long, butthere are only two border crossings (at Gradiška and Metković) that are designated for exports of products of herbal or animal origin. This practically means that, with the exception of Herzegovina, the entire Republic of Srpska, as well as central and northern Bosnia all the way to Sarajevo, will have to rely only on one border crossing at Gradiška. This will raise transport costs and make prices much higher and uncompetitive and will trigger huge traffic jams and non-tarrif barriers to exports.
- Bosnia and Herzegovina must solve the problem that will arise once Croatia is inside the EU and outside CEFTA because

itsexporters will then need EU certificates and standards rather thanthose from CEFTA.

As early as in 2009, at a regional conference of CEFTA countries, a set of recommendations was given for removal of non-tariff barriers and technical barriers:

- To work on close and open cooperation among CEFTA Parties and address all issues that burden trade relations or may lead to improvement of cooperation.
- To speed up introduction of internationally recognized technical, phytosanitary and other regulations governing quality certificates,
- To build quality infrastructure in keeping with the EU model (technical regulations, compliance assessment, metrology, accreditation, standardization and market surveillance),
- Standardization, metrology and accrediation bodies need to take an active part in all regional and international organizations and associations.
- To identify possibilities of concluding agreements on mutual recognition of compliance assessments.
- To improve communication with the business community for the purpose of timely identification of barriers and their removal.
- To analyze the possibility of developing an appropriate model of common certificate for interested parties.
- To improve operation and cooperation among customs and inspection authorities in order to facilitate the flow of goods.

Despite these recommendations, no headway has been made in their implementation.

4. Conclusion

The reaching of free trade agreements, such as CEFTA or agreements signed between the countries of the region and the EU, undoubtedly offer multiple benefits to foreign trade, help create a bigger market, free competition, harmonization of legislation and attractiveness for foreign investment.At the same time, this will often mean that the weakest parties to such agreements will not be able to compete on an equal footing and that they will be open for foreign products which are cheaper and of better quality,and also that some local producers will be pushed out of business, especially if:

- these countries are inadequately prepared or if they have negotiated bad deals,
- various non-tariff barriers and technical barriers persist and keep hindering exports, while leaving the door open for imports.

These problem should be solved both bilaterally and within agreements such as CEFTA, but reciprocal measures should not be ruled out in case of persistent unfair competition or unjustified barriers to trade.

Ljubisav Ivanov Singo

Chariman of the Macedonian Parliament Standing Committee on Economy

Between economy and politics, looking forward into the future or looking back into the past

Political decisions should focus on economic interests. Nowadays, at the time of crisis, economic interests are saving the European Union.

However, in Western Balkan countries, politics has a crucial impact on the economy and is a major barrier to economic linkage and progress of the region. Furthermore, while "the others" are dealing with the present and the future, "we" are still dealing with the past. What is the reason why economic interest are not the centre of attention in our region?!

Nonetheless, certain headway has been made. Thus, CEFTA 2006 was established under pressure from "the outside" and trade in the region was liberalized. However, despite the fact that trade was liberalized in principle, there are non-tariff barriers in practice, as a major obstacle to free trade.

Closer cooperation and greater linking of Western Balkan countries would be achieved through the setting up of a customs union, which would facilitate integration of the region into the European Union. Moreover, a regional body should be set up with a view to initiating intensified cooperation.Finally, the setting up of a regional bank consortium to accompany and facilitate industrial development would be a major factor of closer cooperation and economic development of the Western Balkans.

Finally, are we going to push economic interests to the forefront and enable free flow of goods and capital, accomplish regional integration and move closer to the European Union or are we going to keep looking back into the past?!

I hope and I believe that, in few years' time, this region will be far more closely connected, more integrated in economic terms and more successful and that the European Union will show not only readiness, but also interest in fully integrating the region into its membership.

DISCUSSION

Danijela Martinović
Chairperson of the Committee on Economic Reform and Development, Parliamentary Assembly of Bosnia and Herzegovina

The current account deficit is a major problem for Western Balkan countries. The question is how to establish export-led development in such a short time when exports of goods from the countries of the region have been a failure. Significant foreign direct investmentsover the past decade did not live up to the expectations as investors were mostly focused on meeting the local demand rather than boosting exports.Therefore, policies should be created towards attracting export-oriented foreign investors.

Isidora Beraha
Institute of Economic Sciences, Belgrade

When talking about trade and economic development of the WB region in general, we cannot avoid mentioning the small and medium-sized enterprises (SME) sector's development, since it is a single most important generator of high employment, GDP and export growth.

New developing directions are necessary or, in other words, strategy based on geographic concentration and regional specialisation is needed.

We need more projects such as Fiat in Serbia, but regional ones under assumption that involvement of SMEs in supply chains of global companies and the creation of SME subcontractors networks would have a significant positive implications not only on SME sector in terms of their business and particularly export performances but on national economies and the region as a whole.

Bojana Radovanović
Institute of Economic Sciences, Belgrade

Both scholars and decision makers are not completely aware of all the interconnections between different economic phenomena, such as for example the influence of exports to the economic growth. Nevertheless, it has become very popular to talk in the region about export-led growth. The same is with the foreign direct investments (FDI) and their influence on the countries' economic development. FDIs are usually seen by a transition country as an efficient way of a capital injection, important for the economic recovery. However, the real impact of the FDIs is not completely known.

Moreover, free trade is usually perceived as an important tool for economic development and trade liberalization in transitional countries is recommended by the developmental organizations. However, most of nowadays developed countries once used protectionist policies. There are some eminent developmental economists who believe that denial of certain tools, such as for example an infant industry protection, that once were available to the nowadays developed countries, means a denial of free choice of economic policies. We do not need to go back in the economic history to find the evidence of protectionist measures in the developed countries. The economic crisis has triggered an introduction of protectionism. It seems that we in the Balkans practice some more liberal policies then those who advise us, as it has been pointed out in the Region (Conference 2009).

Therefore, we need an academic community which is capable of undertaking thorough analyses of contemporary economic theories, concepts and practices, and willing to offer adequate suggestions for economic policies to the decision makers.

Alex Romaniuc
Westminster Foundation for Democracy

The Westminster Foundation for Democracy is developing a three-year regional programme in the Western Balkans aimed at Strengthening parliaments' role in promoting competitiveness and economic growth. The Network of Parliamentary Committees for Finance and Economy of the Western Balkan countries would be a key partner to ensuring success. As a first step a baseline study on Parliaments and Regulatory Reform of the Economic Legal Framework will be conducted. A presentation of the results will be given to each parliament in April and May 2012. The Foundation hopes that by early Summer all participating Western Balkan parliaments will agree on the targets the programme should reach by 2015, and what steps are needed to get there.

CONCLUDING SESSION

Conclusions and Recommendations

1. Strengthening the capacity of parliamentary committees for economy and finances so that they play a more important role in economic policy creation and implementation through:
   - Clearly defined mandate of these committees in the parliaments' rules of procedure;
   - Choosing the chairperson with good leadership skills in managing activities and committee meetings, as they are important for the effectiveness of the committee;
   - Putting as a priority the expertise and experience when choosing committee members;
   - Organizing trainings for the new members of parliament, who are elected as committee members, in order to improve their ability to fully take advantage of the powers of the committee system;
   - Strengthening the role of parliamentary committees for economy and finance in relation to the consideration, execution and control of the execution of the budget, with strong support of donor community;
   - Expanding the role of parliamentary committees for economy and finance in relation to economic policy development and involvement of parliamentary committees in the early phase of policy creation;
   - Better access to government information to parliamentary committees for economy and finance, especially information related to the yearly budget and strategic documents prepared by the government;
   - Adequate support from the parliamentary staff and experts to the committee chairperson and members not only regarding procedural and administrative needs of the committees, but also for more in-deep analysis, important for the effectiveness of the committees;

- Strengthening the capacity of parliamentary staff, experts and research capacities, who support the committees, in order to enhance their efficiency;
- Receiving greater media attention.
- Regional cooperation of the parliamentary committees for economy and finances, within the network created in 2009: (i) sharing information on the committees' activities and (ii) the joint work of their network related to finding the optimal solutions for developing a more active role in economic policy creation and implementation;
- Exploiting the experiences of the countries in the region, through: (i) education and training programs for mps and parliamentary staff; (ii) sharing of relevant publications and organizing study visits and (iii) international assistance programs;
- Donor community support to the further expansion of the regional cooperation among parliaments and parliamentary committees.

2. The dilemma: whether to give priority to cutting public spending or stimulating the economy:
   - It is important to work towards the reduction of unnecessary budget expenditures as well as to encourage economic growth and development;
   - It is necessary to review all previous approaches to public spending, because of the effects of the economic crisis on the economies of the region;
   - Regional and scientific cooperation in this field should be a priority, as this will make it easier to find common solutions;
   - A regional stock exchange - an electronic exchange of the Western Balkans - should be established in order to deepen the financial market
   - Joint infrastructure projects based on cooperation with the European Union should be financed.

3. Removal of economic and political barriers to the free trade in the region, as free trade is a step towards speeding up economic development and preparation for integration into the wider community and the European Union:
   - Parliaments should cooperate with each other, in order to avoid creating new barriers to regional trade under the CEFTA 2006, as free trade in the region is a step towards speeding up economic

development and preparation for integration into the wider community - the European Union;

- Parliaments should play an active role in the removal of administrative barriers that restrict free trade in the region;
- Parliaments should support export promotion strategies in order to enface the pressure coming from the macro-trade weaknesses (low exports per capita, low openness index, low import coverage index, etc.) and particularly from the narrowing tendency of such sources of growth as remittances, etc;
- Parliaments should strongly support the CEFTA 2006 programs and projects, which are very important in liberalizing intra-regional trade, and particularly in reducing and overcoming non-tariff barriers to trade and developing the institutions related with the new trade topics such as investment, trade in services, intellectual property rights and public procurement. CEFTA 2006 may also play a role in smoothing the gap among the MFN tariff rates of the countries of the region. Common External Tariffs already applied by the EU, is an option for discussion.

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