A Comparison of Policy Responses to the Global Economic Crisis in the Balkans: Acceding Versus EU Candidate Countries

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Abstract Current research shows that the severity of the first global economic crisis of the twenty-first century tested the resilience of even the most developed economies in the world, as it caught them unprepared to battle their own systemic deficiencies. With the biggest and most powerful global economies teetering on the verge of collapse, the question about the fate of the globally insignificant economic players remains unresolved. Yet, many of those small countries survived the financial tsunami, and while not unscathed, they did emerge more robust than earlier. Still not a complete member of the EU bandwagon, but refusing to be branded by its dark Balkan past, these small countries were caught between two contrasting worlds – one not ready to embrace them yet, the other one refusing to let them go without a fight. The purpose of this paper is to examine the various roads taken by a host of very similar, yet very different countries in their pursuits of joining the EU and remaining afloat during the largest financial calamity of recent times. The structure and nature of each economy is contrasted along with the divergent level of integration in global economic flows. The main questions raised center around the changes to the oversight to the financial system and coordination with the already rigid EU policy framework. With one country already an acceding EU member, and the other one in danger of being a perpetual EU candidate yet never a member, the main issue to be discussed is whether this situation is due to the policy responses linked to the economic crisis.

Keywords Balkans • Crisis • EU • Integration • Policy response

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1 Introduction

The eruption of the global economic crisis during 2007 and its prolonged presence in diverse parts of the world until mid-2012 has been particularly detrimental to a host of countries in Southeastern Europe gathered under the umbrella term ‘Balkan States’. Since the bloody breakup of the former Yugoslavia, they have been exposed to various degrees of fortune, but each has persevered holding on to the same goal in mind: joining the European Union. Until recently, Slovenia has been an upstanding member of the EU, Croatia has been set to join the elite club on July 1, 2013, while Serbia, Montenegro, Bosnia and Herzegovina, Kosovo,[1] the Former Yugoslav Republic of Macedonia as well as Albania are still patiently waiting in line to transform their pre-accession limbo into something much more substantial – an actual date for joining the European Union.

In the meantime, the world economy has been put under a stress-test of financial turbulence unseen for almost a generation. While trying to catch up with their prestigious Western and Northern European cousins, the Balkan states have been left to deal with the effects of the global financial crisis on their domestic economies mainly on their own. The purpose of this paper is to examine the different approaches each country has taken in order to combat its economic malaise as well as to compare the impact of the various policy responses, the degree of proactivity and regulatory interventionism, while bearing in mind the candidate/acceding country distinction, incorporated as an information signal in the global credit rating and overall economic standing of each country. Section 2 describes the EU accession mechanism and the Balkan countries’ respective statuses. Section 3 specifies in detail the various policy responses undertaken in order to deal with the global economic crisis. Section 4 compares and contrasts the impact of those responses on the domestic economies, while Sect. 5 concludes.

2 Walking Down the EU Path at Various Speeds

According to the European Commission, “a country is deemed to be a candidate country when, having examined its application for EU membership, the EU formally recognizes the country as candidate, thus granting the country candidate status” (Directorate-General for Economic and Financial Affairs 2011). In contrast, “acceding countries are those candidate countries which have completed accession negotiations and signed an accession treaty with the EU” (ibid).

In order to achieve this, the governments of the countries which have applied for this status are expected to fulfill a strict set of criteria concerning the following issues:

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[1] Here and throughout the text, Kosovo refers to Kosovo under United Nations Security Council Resolution 1244.

- Stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- The existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union;
- The ability to take on the obligations of membership including adherence to the aims of political, economic & monetary union.

These criteria are identical for all the countries, and still remain as defined by the 1993 Copenhagen European Council. The only additional membership criterion has been underlined by the 1995 Madrid European Council, which requires that the membership country must have created the conditions for its integration through the adjustment of its administrative structures.

Prior to becoming a candidate or a potential candidate, each Western Balkan country was subjected to an additional EU capacity-building framework under the name of Stabilisation and Association Process, created in order to "stabilize the countries, encourage their swift transition to market economies, promote regional cooperation, and ensure the possibility of eventual EU membership" (European Commission 2012).

While it has already been mentioned that Croatia is the only EU-acceding country at the moment, one must distinguish among the other Balkan countries still waiting in line. Turkey, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia have all attained *candidate* status, while Albania, Bosnia and Herzegovina as well as Kosovo have only been deemed *potential candidates*. For the purposes of this paper, however, the analysis will cover only Western Balkan countries, sans Turkey. According to a report from the EU Council, all Western Balkan countries have the prospect of joining the EU (European Council 2003). Table 1 gives a short overview of the current state of affairs.

Economically, Croatia has been the leader of the Western Balkan pack, with an average per capita GDP of US$14,309.83 during the 2007–2010 period, and a growth rate of 1.63% during the same period, reflecting a level of maturity not yet attained by the other countries. Kosovo, on the other hand, has lagged behind the rest, accumulating only US$2,958.36 annual average GDP per capita for the 3 year period under observation; but it has been exhibiting a catch-up effect, as seen with the highest average GDP growth rate, at 5.78 %. Driven by high investment growth and strong consumption patterns, all of the Balkan pre-accession countries exhibited strong growth rates. As the global economy ground to a halt in 2007, the structural break regarding growth rates is be positioned at 2007, as this was the year when the global economic crisis started unraveling.

In addition, the next table it is showed the credit rating of each country, defined as the assessment of the relative likelihood that a borrower will fulfill its obligations and pay back borrowed money to the lender. This credit rating in Table 1 is taken from the Standard & Poor's rating agency that, along with Moody's and Fitch rating agencies, represents one of most prestigious and most often quoted credit agencies in the world. The credit rating of the observed countries ranges from BBB- to B, where only Croatia's credit rating (BBB-) is regarded as investment-grade rating

Table 1 EU status and key financial parameters of Balkan pre-accession countries

Country	Country status	Date	Credit rating[a]	Average GDP[b] 2007–2010	Average GDP[b] growth 2007–2010 (%)
Croatia	Acceding	09 December 2011	BBB-	14,309.83	1.63
The Former Yugoslav Republic of Macedonia	Candidate	17 December 2005	BB	4,441.20	4.42
Montenegro		17 December 2010	BB	6,524.97	4.47
Serbia		01 March 2012	BB	5,632.20	1.21
Albania	Potential candidate	12 June 2008	B+	3,725.91	3.58
Bosnia and Herzegovina		16 June 2008	B	4,468.02	3.77
Kosovo		–[c]	–[d]	2,958.36	5.78

[a]S&P Credit rating
[b]GDP per capita (current US$)
[c]This designation is without prejudice to positions on status, and is in line with United Nations Security Council resolution 1244 and ICJ Opinion on the Kosovo declaration of independence
[d]S&P rating agency will visit Kosovo in June 2012

with the description ‘adequate payment capacity’, whereas all the other countries and their credit rating are included in the speculative-grade rating. The credit ratings (BB) for FYROM, Montenegro and Serbia can be described as ‘likely to fulfill obligations with ongoing uncertainty’, while credit rating of Albania (B+) and Bosnia and Herzegovina (B) can be described as high-risk obligations. Speculative grades and gradation within indicate the risk of investing in bonds or other financial instruments of the country. In effect, the credit rating of the country is one of its key factors in determining the cost and availability of international financing for an economy. From the economic, political and social factors and variables that credit rating agencies use to calculate credit rating it can be interpreted that the credit rating of the county is an indicator of the country’s overall economic stability. Cantor and Packer (1996, p. 41) presented these variables as per capita income, GDP growth, inflation, fiscal balance, external balance, external debt, economic development and default history. Regardless of the variables presented they have come to the definition that “a high per capita income appears to be closely related to the high rating … Lower inflation and lower external debt are also consistently related to higher ratings”. In the observed period, almost all the countries have experienced the reduction of their credit rating as financial crises have negative impact on the overall economies of each observed country.

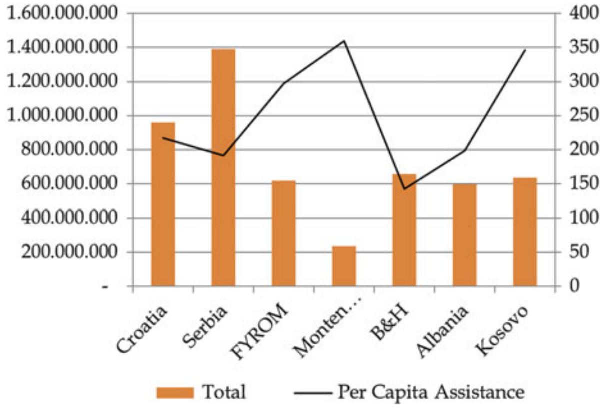
The following table gives an overview of the financial assistance received and/or to be received, by each European Union candidate country during the 2007–2013 period (Table 2).

Table 2 EU assistance to Balkan pre-accession countries, 2007–2013[a] (in euro)

Component	Croatia	FYROM	Montenegro	Serbia	Albania	B & H	Kosovo
Transition assistance and institution building	237,993,220	242,944,981	166,703,086	1,313,354,798	531,155,228	624,802,360	628,683,264
Cross-border cooperation	97,974,549	32,476,703	30,065,037	78,713,172	66,135,585	33,698,883	7,118,679
Regional development	345,928,127	202,038,532	23,200,000	•	•	•	•
Human resources development	95,017,000	55,080,000	5,757,077	•	•	•	•
Rural development	183,251,182	86,749,815	10,900,000	•	•	•	•
Total	960,164,078	619,290,031	236,625,200	1,392,067,970	597,290,813	658,501,243	635,801,943
Per capita financial assistance	217.62	297.4	359.34	191.36	198.91	142.46	346.2

[a]source: http://ec.europa.eu/enlargement/instruments/funding-by-country/index_en.htm

Graph 1 EU per capita assistance to Balkan pre-accession countries, 2007–2013



What one can derive from the above table is that not all financial assistance components have been made available to each candidate. The biggest net recipient over the 2007–2013 period has been Serbia at 1,392,067,970 EUR, while Montenegro has received the greatest per capita financial assistance package at 359.34 EUR, as shown in the above Graph 1:

While the EU has been rather generous with regards to pre-accession assistance, a financial stimulus package targeted at alleviating the effects of the global financial crisis on the domestic economies has been largely non-existent.

3 The Global Economic Crisis and the Various Policy Responses

A large number of authors, most notable among them Minchev, Lessenski, Ralchev, etc., had initially warned about the dangers of the crisis spilling over in the highly fragmented Balkan markets. Left outside the EU umbrella, these pre-accession countries appeared ex-ante more vulnerable to the crisis, yet, “not withstanding their vulnerabilities, and fears that they could suffer deeply in the global deleveraging process, (they) demonstrated a high degree of resilience” (Directorate-General for Economic and Financial Affairs 2010a, b). This could, in part, be attributed to lower levels of integration with the global financial flows, which automatically reduced the exposure of the domestic economies to the worldwide deleveraging process.

The global economic crisis struck the Balkan countries like a tsunami, easily noticeable through the decreasing, or in some cases even negative GDP, a constant rise of unemployment (a common feature of all concerned countries), a negative trend of financial stability expressed through decreasing credit rating, an increasing trend of budget deficit, which is considered for the Balkan countries a usual phenomenon in their short history of independence. Governments and politics in some countries like Croatia carry heavy responsibility for an exacerbated impact of the financial crisis on the economy. For instance, in November 2007, the Prime Minister at the time, Ivo Sanaderalong with the Finance Minister Ivan Suker, supported by the government cabinet did not pay any heed to the IMF's warning on the possible impact of the financial crisis on the Croatian economy, declaring that "There is no such question that we are facing financial crisis .... what we are supposed to hear from the IMF could refer to the time 4 years ago, not today". This rhetoric and political attitude on the financial crisis of the government continued until September 2009 when the new Prime Minister of the government coalition, Jadranka Kosor, finally admitted that Croatia is in a financial and economic crisis. Only in April of 2010, when the crisis percolated into all structures of the economy and society, did the government create an "Economic recovery program". Similar behavior of politicians is visible in all of the observed countries, including FYROM in 2008, where their Finance Minister, Zoran Stavrevski declared that "We believe that if certain negative consequences come over the (FYROM) economy, they will not be serious, i.e. despite that, FYROM will keep performing with high percentage of economic development". Finally, in June 2009, the government acknowledged that the country is in recession. The Bosnian and Herzegovinian complicated, counter-productive and overall unstable political system emerging from the Dayton Accords was primarily focused on local politicking colored, in most cases, with ethnic animosities. For the financial crises the political elite did not have too much interest or "time" and the crisis was more than welcome to cover the flawed economic policy. In that confused situation, where all the entities,the Republic Srpska, Federation and District Brcko, have finance ministers, along with the ten Federation cantons with their respective ministers of finance, one cannot speak about political cohesion and a responsible, uniform economic policy that can be implemented across the entire country. It is well known that trust in government and stability of political government is the key factor for prosperous and stable economy, what is not fact in Bosnia and Herzegovina. A single bright light of reason and rationality in Bosnia and Herzegovina at the time was the B&H's Central Bank Governor who in several occasions urged the citizens not to withdraw their deposits and the politicians to pay more attention to the economy and stop talking about entities and referenda. Lack of politically synchronized acting is visible on fall of credit rating and in need for IMF's interfering. Montenegro's politicians and their rhetoric where similar to Croatia's, for example when the Montenegrin Minister of Economy Branimir Gvozdenovic declared in October 2008 that: "The global crisis will not influence growth of Montenegro's economy that should keep up the rate of 7 % ...". The Prime Minister Milo Dukanovic stated in December of 2008: "We should not have fear because we have experience and we went through worse crisis, threat of war and sanctions ... reform of justice and state administration are key factors for Montenegro to overcome global economic crisis". Such reflection on crisis in time when, according to all the available economic and statistical data, the countries in West Balkans were deep in crisis can be described like politicking. In Albania the politicians had at least mentioned the term 'crisis' and its influence on economy but their predictions of the impact where too optimistic. Prime Minister

Sali Berisha during his address mentioned that foreign investment and cash flows from Albanians outside the country will be reduced under the impact of the crisis. The actions that were taken weren't enough for reducing the impact of financial instability that had spilled over the fragile Albanian economy. In Serbia, however, the situation was quite different from the other countries as their political elite had a timely response, yet the main political focus during that period remained "keeping territorial integrity" (Kosovo) and cooperating with the Hague International Tribunal. Economic actions with the government making budget cuts, external financing through privatization of the main oil and gas company and other measures were insufficient and inadequate to resist the crisis. Kosovo and their political elite in this period had just one fundamental goal – independence and stability – thus, the financial crisis that befell the region was acknowledged as of secondary importance, as can be deduced from the actions taken by the Kosovar government at the time.

These late reactions of the political structures and their response policies, combined with the opportunistic and irresponsible behavior of ruling political parties have had an even deeper impact on the financial crises in the small and fragile economies of the West Balkans.

Having experienced different growth rates and convergence patterns with the EU economy, each pre-accession country devised its own measure for combating the impact of the global economic crisis.

The following table shows the various approaches formulated by each country separately in order to limit the effects of the crisis and strengthen the economy. Please note that the list, while comprehensive, may not be complete. The enumerated measures are subject to change as newer and more innovative policies are developed each day (Table 3).

As stated in the 2010 Ohrid Agenda, candidate and neighboring countries of Southern and Eastern Europe as well as those of the Caucasus region are faced with severe, often common, challenges. Thus, it can be observed from the above table that the current crisis put public spending and fiscal severity at the heart of each anti-crisis measure design. The ultimate objective for each economy indiscriminately is to emerge from the crisis, reduce disparities and draw one step closer to becoming a fully-fledged European Union member.

4 No Country is an Island Unto Itself: A Comparison of Approaches

The following section examines each country's state of affairs as seen through the IMF's lenses:

For the case of Croatia, balance sheet vulnerabilities were built up during the boom years of 2002–2007. Yet, the government refused to acknowledge the impending doom throughout 2009. At the insistence of the IMF, the overexposure to debt is to be countered by growth-enhancing structural reforms, developing a

Table 3 Various anti-crisis policy responses of Balkan pre-accession countries

Country	EU Status	Crisis response policies
Croatia	Acceding	Five key leverage measures: Public sector expenditure reduction Redirecting budget assets Reducing state intervention in economic flows Jump-starting a new investment cycle Accelerating reform measures
The Former Yugoslav Republic of Macedonia	Candidate	Four different packages of anti-crisis measures aimed at: Fiscal severity Introduction of new credit support lines Reduction od VAT and tax breaks Subsidized loan interest rates Various employment support schemes Expansionary monetary policy External financing
Montenegro		Stimulus package measures: Reduction of personal income tax and social contribution rates Introduction of full guarantee of bank deposits Lowering of reserve requirements Additional credit support for distressed banks
Serbia		A programme of policy responses: Restrictive measures aimed at budget cuts 10% public sector salary & pension increases Stimulus package of cca EUR 300 million of direct and indirect budget subsidies and cca EUR 800 preferential conditions loans Budget rebalance External financing
Albania	Potential candidates	Anti-crisis policies: Raising bank deposit guarantees, covering more than 80 % of all bank deposits Upward revision of budget deficit
Bosnia and Herzegovina		Combined measures: Current expenditure cuts and excise taxes increases Budget revision Lower bank reserve requirements Increased deposit insurance coverage
Kosovo		None, except for a large Telecom dividend

fiscal consolidation path, building buffers and preserving financial sector stability (IMF Country Report Croatia 2011). All of these goals were introduced in a separately drafted strategy to counter the global crisis, significantly lagging behind the first signs of a downturn in the economy. Despite all of this, the confidence levels are returning to their pre-crisis levels as Croatia is set to join the European Union in 2013.

The case of the Former Yugoslav Republic of Macedonia is a curious one, as the conservative, yet reform-oriented government adopted four sets of comprehensive response policies, all aimed at improving the overall economic conditions. The results have been mixed and inconclusive, despite the government's best efforts. The drawing of a Precautionary Credit Line arrangement was initially intended to provide insurance against external risks (IMF Country Report FYROM 2011), however it is increasingly being used for short-term financing of budget gaps. A prominent local expert calls for "a cyclical regulated fiscal balance... [as well as] not to mix up intervention and structural reform measures" (Bexheti 2010). FYROM is running the danger of becoming the next perennial EU candidate, after Turkey, unless the name issue is resolved – case in point of political matter hindering economic development.

The Montenegrin economy has been taken on a rollercoaster ride since declaring its independence from Serbia in 2006, going from boom to bust in just a few short years. According to the IMF, "the global financial crisis has left the banking system in Montenegro in a worse shape than in emerging Europe in general" (IMF Country Report Montenegro 2011). The country's increasing reliance on tourism has been a major source of cyclicality, thus the measures adopted by the government have attempted to ameliorate this condition.

The Anti-crisis Programme adopted by the Serbian government, despite its ambitious name and the timely appearance, offers a number of contradictory measures aimed at both expanding and restricting the fiscal budget (Kabinet Predsednika Vlade Republike Srbije 2008). According to the IMF, the country's unbalanced mix of weak structural, expansionary fiscal, and tight monetary policies undermined competitiveness and macro stability (IMF Country Report Serbia 2010), yet under the Stand-By Arrangement the authorities' policies have been broadly consistent with the Fund advice. The comprehensive policy package focused on financial adjustment and substantial external financing designed to address the roots of the economy's weaknesses through a slow but balanced recovery. These efforts were acknowledged by the EU, which awarded Serbia a candidate status in 2011.

The sound economic policies already put in place before the global crisis hit Albania ensured that the country weathered the storm well. Apart from that, it also proved to be an impetus for a faster fiscal consolidation and the adoption of a new policy framework. As per IMF advice, "in the near term, contingency planning with respect to euro-area periphery developments is essential" (IMF Country Report Albania 2011).

The policy response of Bosnia and Herzegovina is a fragmented one, reflecting the fact that the Serbian-populated part of the country, Republika Srpska, aims at developing a separate economic policy from the rest and refuses to acknowledge the central government in Sarajevo. Against this backdrop, the IMF was obliged to hold talks with two separate entities and engage in dual discussions. Yet, the fiscal deficit appeared a common problem, with the only mutually agreed policies encompassing relaxed bank reserve requirements, increased deposit insurance coverage, relaxed prudential rules on restructuring and stable foreign bank exposure (IMF Country Report Bosnia and Herzegovina 2010).

Finally, the Kosovo economy was only weakly affected by the global economic crisis, due to the country's limited exposure to the international trade and financial channels. According to Stojkovski, the Kosovo economy "is founded on three main pillars: EU donors, the Kosovar diaspora, and the mineral and metal deposits" (Stojkovski 2010). The main involvement on the part of the IMF has been to "build the capacity to provide emergency liquidity assistance to the banking system, strengthen the institutional framework, and establish a Staff-Monitored Program designed towards restoring fiscal sustainability and improving budget execution" (IMF Country Report Kosovo 2011).

5 Conclusion

One could infer from the above analysis that while the global economic crisis has affected every EU pre-accession Balkan country to a different degree, each has attempted to combat the crisis with a mix of measures devised to address its specific needs. The rapid expansion of the financial sector in the pre-crisis period generated the growing imbalances in all of these economies. From 2000 onwards, the entire region enjoyed tremendous growth rated, mainly riding on the wave of the booming global economy.

The outbreak of the global economic crisis had only squeezed the pre-accession countries to attempt to transform their economies faster, in order to exhibit sufficient robustness to weather the financial tsunami. What is noticeable, however, is that the crisis assistance, which has been available to the Balkan countries, has mainly arrived from the IMF and the World Bank. The EU, while generous at providing pre-accession assistance, does not have an existing mechanism set up to specifically address crisis-affected countries.

In conclusion, the policy responses examined in this paper all lack a common point: a guiding and giving hand in the form of EU which would provide a first-instance source of funding in conditions of distress to pre-accession countries, while leaving the IMF to its original lender of last result role. Only in this case would the European Union truly fulfill its mission.

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