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**REPORT FROM THE COMMISSION**

**The Stabilisation and Association process for South East Europe**

**Second Annual Report - Annex 1**

{ SEC (2003) 339; SEC (2003) 340; SEC (2003) 341; SEC (2003) 342; SEC (2003) 343 }

**ASSESSMENT OF THE INSTRUMENTS OF THE STABILISATION AND ASSOCIATION PROCESS**

**1. Trade measures**

The extension of the European Union's autonomous trade measures (ATMs) in the autumn of 2000 established a uniform system of trade preferences for the countries of the Western Balkans.<sup>9,10</sup> In 2001, these provisions were, by and large, put into a contractual agreement with Croatia and the former Yugoslav Republic of Macedonia, by the signing of the respective countries' Stabilisation and Association Agreement (SAA).<sup>11</sup> Pending the ratification of the SAAs, the Union's trade relations with these two countries are governed by the Interim Agreements.

The trade provisions offered by the European Union under the trade measures (TMs) provide the countries of the Western Balkans with duty-free access to the Union's market for practically all goods, including agricultural products, with no quantitative restrictions, except for duty-free or preferential quotas for some fishery products, baby-beef and wine.<sup>12</sup> The greatest change compared to previous system(s) brought about in 2000 was the almost complete liberalisation of imports of agricultural products and the abolition of quotas for sensitive industrial products.

A short period of time has elapsed since the extension of the trade measures (TMs). As of early 2003, less than two full calendar years of trade statistics are available for analysis.<sup>13</sup> Consequently, it is too early to provide a definitive and detailed view on the functioning of these measures. Nevertheless, in order to provide a first basis for an evaluation of the effectiveness of the trade measures, an overview of trends in EU imports from the Western Balkans at country and product level is provided below. This overview will need to be complemented at a later stage when necessary trade statistics and economic data become available.

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<sup>9</sup> Council Regulation (EC) No 2007/2000 (as of November 2000), amended by Regulations 2563/2000 and 2487/2001.

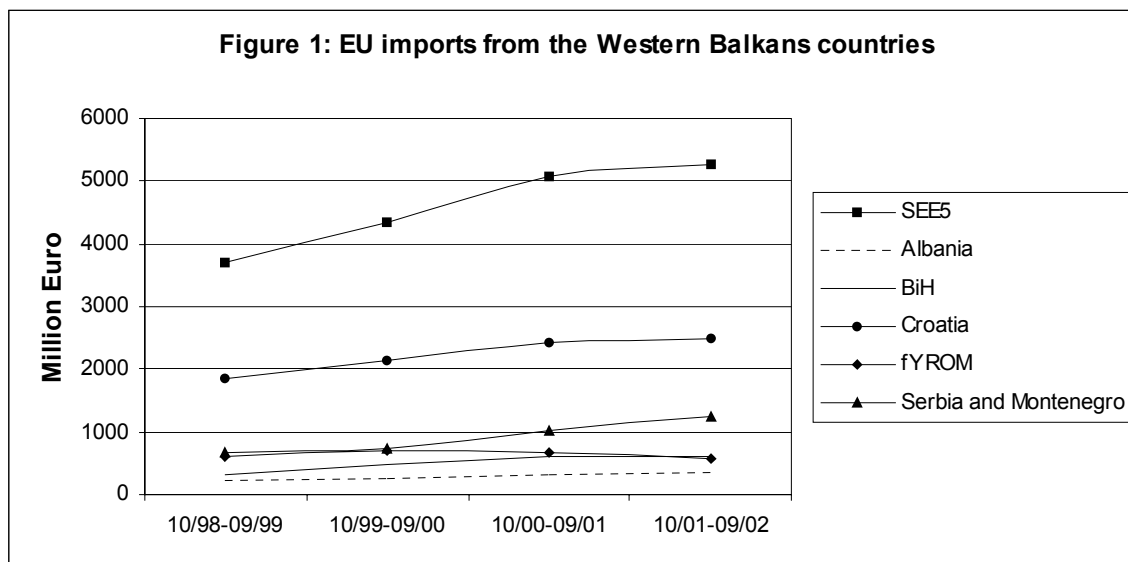
<sup>10</sup> Previously, Albania had benefited from the EU Generalised System of Preferences, while Bosnia and Herzegovina and Croatia had been entitled to trade preferences under the first generation of ATMs introduced in 1997 (Council Regulation (EC) No 70/1997, amended by Regulations 2636/97 (for 1998) and 2863/98 (for 1999), and Council Regulation (EC) 6/2000 (January-October 2000)), which also briefly applied to Serbia and Montenegro before the preferences were revoked. Trade with the former Yugoslav Republic of Macedonia was governed by a co-operation agreement with the European Union concluded in 1998.

<sup>11</sup> Hereafter, EU trade preferences for the Western Balkans countries, as offered via the ATMs or as found in the contractual relationships with Croatia and the former Yugoslav Republic of Macedonia will be denoted as trade measures (TMs).

<sup>12</sup> In addition, trade in textile products is covered by bilateral agreements, providing for duty and quota free access into the EU. Serbia and Montenegro have not concluded such agreements with the EU and benefit from quotas granted unilaterally by the Community.

<sup>13</sup> In January 2003, statistics on the Member States' imports from the Western Balkans countries were available to September 2002. This overview is therefore based on EU imports from the Western Balkans countries in 12 month periods dating backwards from the latest month available (September 2002). Four periods were chosen: October 1998 – September 1999, October 1999 – September 2000, October 2000 – September 2001, and October 2001 - September 2002.

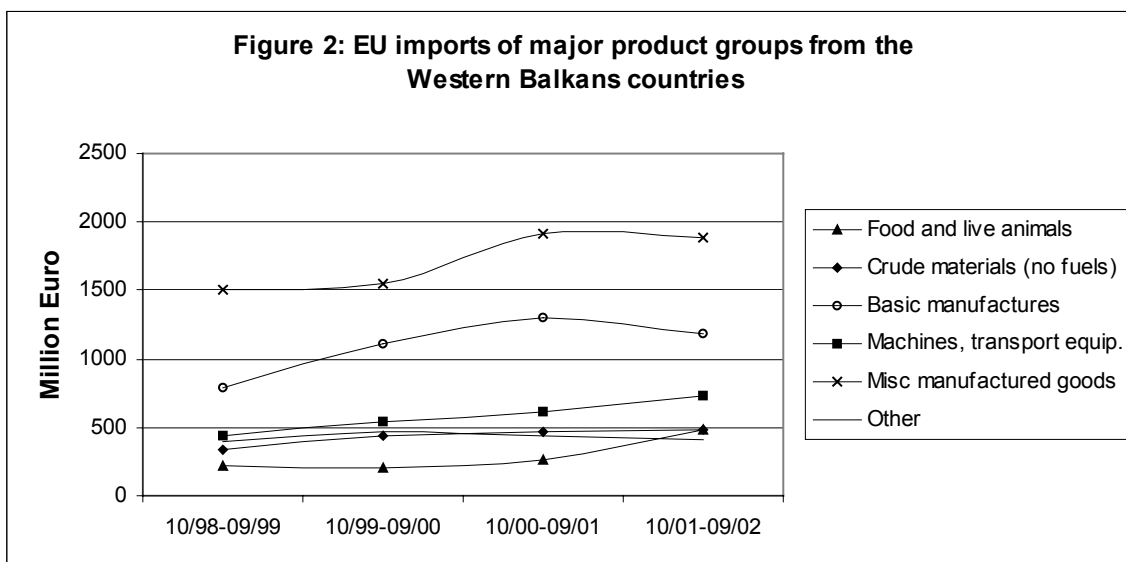
There has been a substantial increase in EU imports from the Western Balkans during the last few years, although from low absolute levels (see Figure 1). In percentage terms, EU imports have increased by some 40% since September 1999, and by 21% since the introduction of the TMs in September 2000. Despite a certain flattening out of the rate of growth of EU imports recently, the region's exports to the EU have grown at a faster rate than the Western Balkans' exports to the rest of the world (based on IMF data).



Source: COMEXT

Croatia is the largest exporter in the region, providing the EU with nearly half of its imports from the Western Balkans. Together with the Serbia and Montenegro, the two countries account for approximately 70% of the region's export to the EU. The export performance of these two countries are thus an important determinant for the development of exports from the region as a whole. Since the extension of the TMs, some countries have displayed a better export performance than others. Croatian exports to the European Union have grown by about 15%. The corresponding figure for Serbia and Montenegro is over 70%. Albanian and BiH exports to the EU have increased by close to 30%, while EU imports from the former Yugoslav Republic of Macedonia have declined continuously since the Kosovo conflict in 1999.

Figure 2 shows European Union imports of major product groups from the Western Balkans countries. EU imports of almost all the product categories have increased since the extension of the TMs in the autumn of 2000. The largest categories of imports, miscellaneous manufactured goods and basic manufactures, making up close to 60% of EU imports from the region, have slightly decreased lately, which is in line with the pattern of total trade in Figure 1.



Western Balkans' exports of machines and transport equipment, and of food and live animals, have increased considerably since the extension of the TMs. EU imports of the latter category have more than doubled, reflecting the improvement in market access brought about by the trade measures.

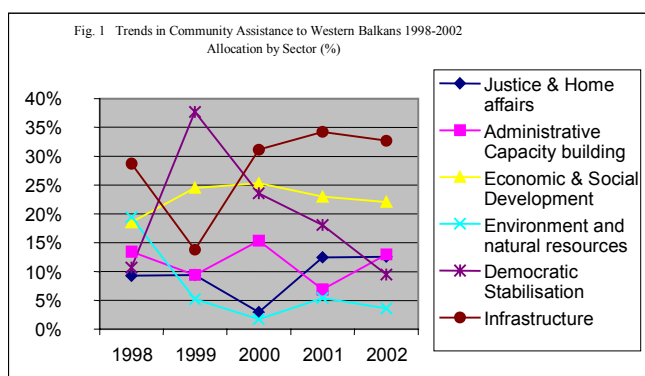
Sugar accounts for approximately half of the growth of EU imports of food and live animals. The substantial increase of EU imports of sugar from the region and the parallel growth of EU sugar exports to the region led the Commission to take several measures in order to ensure the proper application of the preferential trading arrangements for sugar, e.g. the publication of a Notice to Importers in June 2002, reinforced controls and closer co-operation with the customs bodies of the region. It was also decided to abolish refunds for EU sugar exports to the five countries of the region, as this is an incentive for the two-way trade pattern.

Based on the above, there are several signs that TMs may have had a positive effect on EU imports from the Western Balkans. Still, the countries will need more time to use the TMs to the fullest extent possible. Economic operators in the countries need to be made aware of the potential of the TMs, contacts need to be established with counterparts in the EU Member States, channels of distribution have to be worked up, and investments may be required in order to take full advantage of the improved export possibilities. In addition, the system of veterinary, and sanitary and phyto-sanitary inspections must be improved, and work on further harmonisation of standards is needed. Export promotion activities should be more developed, and adopted trade-related legislation must be implemented.

## **2. Community Assistance for Reconstruction, Development and Stabilisation (CARDS)**

Since programming of Community assistance was formally agreed only at the end of 2001, CARDS<sup>14</sup> still remains a relatively new instrument – implementation of the strategic orientations effectively started in 2002.

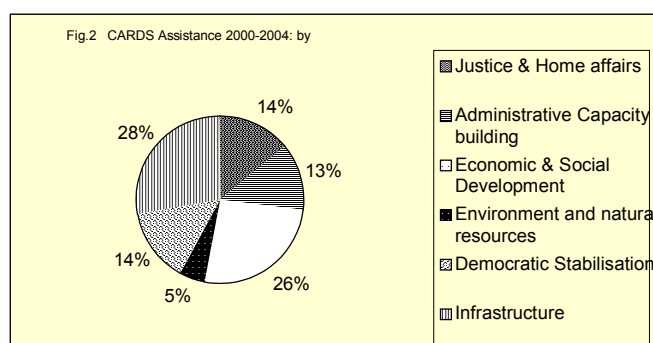
<sup>14</sup> Council Regulation (EC) No 2666/2000 of 5 December 2000 (OJ L 306p1)



Between 1998 and 2002<sup>15</sup>, the main focus of Community assistance to the region as a whole was infrastructure and democratic stabilisation (including aid to refugees), representing 27% and 20% respectively of total assistance allocated (fig.1).

The amounts allocated to Justice and Home Affairs, administrative capacity building, and economic and social development were on average each equivalent to approximately 10% of the total.

These allocations reflect the priority given during the initial phase of assistance to reconstruction and tackling the problem of refugees. From 2001 onwards, the amounts allocated to Justice and Home Affairs and Administrative Capacity Building increased steadily (fig.2) – reflecting the Stabilisation and Association process’ emphasis on strengthening administrations’ implementation capacity.

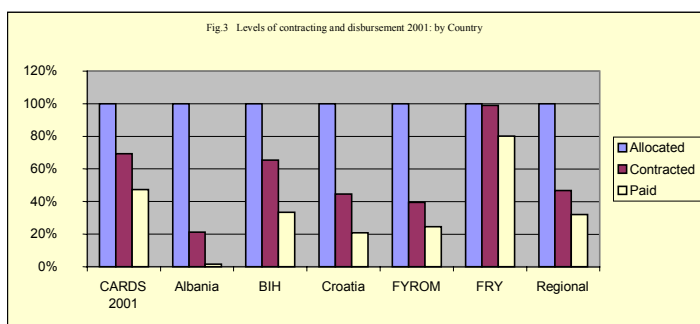


Community assistance has developed in three broad phases: an initial response to a crisis situation, with the focus on emergency operations and reconstruction; then a move to greater support for political, institutional and economic transition; and a third phase where the emphasis has been on preparing for and implementing the association process.

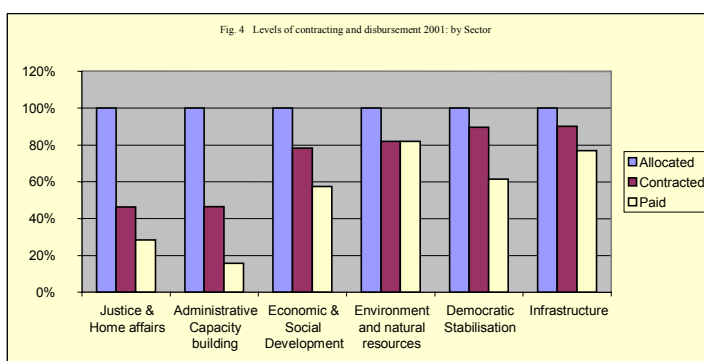
Broadly speaking, the first of these phases is close to completion. The second and third phases are at varying stages of implementation – depending on the country in question.

Whilst the focus of CARDS is on maintaining strategic priorities, the response to last year’s crisis in the former Yugoslav Republic of Macedonia shows how CARDS assistance can be adapted to a changing situation on the ground. In that case, CARDS provided support for EU action in response to the crisis and for the Ohrid agreement, through aid for refugees and displaced persons, and reconstruction assistance successfully implemented by the European Agency for Reconstruction (EAR).

<sup>15</sup> In order to be able to identify trends, the period of analysis runs from 1998 – 2002. Until CARDS became operational, Community assistance to Albania, BiH and the former Yugoslav Republic of Macedonia was delivered through the PHARE and OBNOVA programmes, and to Croatia and Serbia and Montenegro through PHARE.



As of the end of 2002, 66% of total funds allocated in 2001 have been contracted (contracts signed) and 45% disbursed (fig.3). However, performance varies from country to country, according to the focus of activity, the implementation mechanisms, and – in those countries where management had been decentralised, notably Albania – the capacity of national administrations to absorb assistance.



Levels of contracting and disbursement are higher for infrastructure and democratic stabilisation projects, and lower for those in support of Justice and Home Affairs and Administrative Capacity Building (fig. 4). This reflects differences in the types of operation involved in these sectors - in particular the additional preparatory work often required for JHA and Administrative Capacity Building assistance.

Both the EAR and the deconcentrated approach in general – as evidenced by the performance of the Commission Delegation in BiH – have proved their effectiveness in delivering assistance on the ground.

Deconcentration was extended to both Albania and Croatia with effect from 1/12/02 and 1/1/02 respectively. The aim has been to both increase the pace of implementation and to benefit from local “on-the-ground” know-how and experience.

The current focus of Community assistance on institution building and Justice and Home Affairs – although there is still significant support for infrastructure projects, notably in Serbia and Montenegro – reflects the priorities identified in 2001. There is a particular emphasis on strengthening national administrations’ capacity to implement the reforms necessary for association.

Community assistance in Justice and Home Affairs provides a long-term framework for establishing or strengthening the rule of law – a prerequisite for delivering the broader objective of democratic, institutional, economic and social development. The fact-finding missions that took place during 2002 have provided a detailed picture of the current situation and an assessment of needs. On the basis of this assessment, the Commission is further developing its overall approach to Justice and Home Affairs in the region, helping

the law enforcement agencies of the countries move closer towards European or international standards and best practices.

The development of reform in the different countries is the result of a number of interacting factors: national government initiatives, the efforts of national institutions, and the support of the international community – in particular that of the European Union. The aim of this report is to evaluate the overall state of progress in the reform process. CARDS as an instrument will be subject to a separate and specific review as set out in the CARDS Regulation [Article 13.2 – no later than 30 June 2004].

### **3. Community exceptional (macro-)financial assistance**

The Community has also supported a number of IMF backed stabilisation and reform programmes in the Western Balkans with macro-financial and exceptional financial assistance. In 2002, the Council approved two new macro-financial assistance operations in favour of Serbia and Montenegro (up to €130 million) and BiH (up to €60 million) both in the form of grants and loans. Disbursements in 2002 (including on previously decided operations for Serbia and Montenegro, Kosovo and the Former Yugoslav Republic of Macedonia) amounted to €152 million. The release of this type of assistance is subject to the satisfactory implementation of IMF backed programmes and the fulfilment of economic policy conditions agreed with the authorities. (A more detailed account to these operations is provided in each country SAp annual report as well as in the Annual report on the implementation of macro-financial assistance in 2002 which is yet to be published).