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## OLD AND NEW ARGUMENTS FOR FREE TRADE: WESTERN BALKANS

### ABSTRACT

The author discusses an old theoretical and political issue: free trade. Arguments for and against free trade have changed little in the last two centuries, and will keep their actuality in the future. Their bases are national interests of the countries and nations in a given period, and representatives of liberalism and protectionism in international trade have changed their places in history.

There are a lot empirical evidences, in the medium and long run, that open national economy and liberalization of international trade have a positive impact on the growth of competitiveness, entrepreneurship and economic growth.

In contrast to many regions, the Western Balkans has experienced disintegration in the last two decades, and a significant decline in economic performances of the national economies. Previous experience has shown that liberalization of regional trade and regional trade agreement CEFTA can contribute to economic reintegration of the region, faster integration with the European Union, stimulate economic growth, improving competitiveness and entrepreneurship.

*Key words:* trade, protectionism, barriers

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### 1. INTRODUCTION

Discussions on the issue of free trade have been going on for a long time. Although the arguments *pro et contra* have evolved over time, little is actually changed in the last

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two centuries. If so, then the question arises whether it makes sense to discuss an old topic again? If we agree with Krugman that “free trade is not passé—but it is not what it once was”<sup>2</sup>, it can be good starting point for analysis.

The importance of this issue is not just of theoretical nature, and free trade that never was. The expansion of regional economic integrations in the world and globalization of the world economy are only emphasized some old problems in international trade. At the regional level, trade agreements have a special importance and potential.

The process of multilateral liberalization of international trade has been slow but includes more activities such as trade in services, intellectual property rights and so on. On the other side, regional free trade agreements facilitate and increase regional trade, so that two channels lead to the same direction. Western Balkan countries are included in both the processes of liberalization.

Regional trade liberalization in the Western Balkans is an integral part of the process of integration with the European Union, and should facilitate and accelerate the integration. Thus, the issue of free trade in the Western Balkans has a special significance.

## 2. HISTORICAL LESSONS

International trade was as free or restricted as to suit the most powerful nations in a given period. Regardless of positive or negative evaluation of their historic rule, it is fair to argue that trade was free in the territories controlled by great emperors and conquerors. It can even be said that the establishment of great empires have abolished then existing barriers to trade. There are numerous historical examples in favor of this claim: the Roman Empire, Byzantium, Chinese Empire, Tamerlane Empire, Ottoman Empire, and so on.

The issues of free trade are not raised in the modern sense until the full scope of the industrial revolution. The governing trade policy was mercantilism. “In particular, mercantilism held that exports were beneficial to the nation while imports were detrimental. The net inflow of capital resulting from this trade surplus enriched the nation.”<sup>3</sup> However, the era of classical mercantilism was clearly over, at least in the Great Britain. The first serious call for its abolition came from David Hume. “Echoing Hume, Smith explained that gold and silver were not wealth.”<sup>4</sup> James Mill, Adam Smith and David Ricardo gave a scientific basis for free trade and have strengthened a belief in the validity of such trade policy. “In combination with the free trade policy, Great

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<sup>2</sup> Krugman, P. R. (1987), “Is Free Trade Passé?”, *Journal of Economic Perspectives* 1(2), 143.

<sup>3</sup> Cwik, P. F. (2011), “The New Neo-Mercantilism: Currency Manipulation as a Form of Protectionism”, *Economic Affairs* 31(3), 7.

<sup>4</sup> *Ibid.*, 8.

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Britain adopted a gold standard. This two-pronged policy led to a worldwide gold standard, and the free movement of goods, resources and people.”<sup>5</sup>

Neither Continental Europe at the time, nor the United States have the same attitude with regard to freedom of trade, and have adopted trade policies to protect the infant industry. It was initially promoted by Alexander Hamilton<sup>6</sup> in the United States, and then by Friedrich List<sup>7</sup> in Germany. Even Alfred Marshall has accepted some of the List’s arguments: “Many of his arguments were invalid, but some of them were not.”<sup>8</sup> The argument of infant industry included a series of protectionist measures. France, as the most powerful country in continental Europe, is also more inclined to safeguards. However, it should be noted that the advocates of protectionism of that time felt that infant industry should be protected temporarily, and were, thus, moving in the ideological circle of free trade, as it once commented Schumpeter. *Pax Britannica*, which started by Admiral Nelson’s victory at Trafalgar in 1805, lasted a century. During it, the developed countries of Europe and the United States have experienced an industrial boom, and increasing international trade manifold.

The manner and means of international trade liberalization in the nineteenth century was the bilateralism. The strongest impetus in this direction was the Anglo-French treaty of commerce of 1860 (the Cobden-Chevalier treaty). It was a bilateral preferential trade agreement (PTA) which included preferential tariffs and introduced the unconditional most-favoured nation clause (MFN). “Over a period of 15 years, this led to the conclusion of 56 similar PTAs in Europe, forming an authentic ‘spaghetti bowl’ and liberalizing trade to an extent that was internationally unmatched until the end of the Tokyo round of the General Agreement on Tariffs and Trade (GATT).”<sup>9</sup>

The World War I, the October Revolution, the great economic depression, particularly the World War II, have resulted in a significant reconfiguration of the balance of power in the world. There was a global bloc division, on the one hand, and economic domination of the United States, on the other.

The post-war period marked the reconstruction of devastated countries and economies on the one hand, and decolonization, on the other. These two processes have resulted in the rebuilding of the domestic industries and striving for economic

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<sup>5</sup> Ibid., 8.

<sup>6</sup> Hamilton, A. (1793/1791/), Report to the Congress on the Subject of Manufactures, Excerpts, Washington, DC: *Annals of the Second Congress, Appendix*, 1793

<sup>7</sup> List, F. (1841/1922/), *Das Nationale System der politischen Oekonomie*, Vierte Auflage, Jena: Verlag von Gustav Fisher

<sup>8</sup> Marshall, A. (1890/1920/), *Principles of Economics*, London: Macmillan and Co., Ltd., Appendix B: The Growth of Economic Science, 39.

<sup>9</sup> Lampe, M. (2011). “Explaining nineteenth-century bilateralism: economic and political determinants of the Cobden–Chevalier network”, *Economic History Review* 64(2), 644.

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independence. The logical consequence was the application of certain protectionist measures. Many countries have adopted policies of import substitution. However, it was not long-lived, and the abandonment of import substitution policies was further fueled by the energy and debt crisis. “By the 1980s, free trade arguments made sufficient headway that only a few politicians could openly advocate protectionist tariffs.”<sup>10</sup>

### **3. MODERN TIMES: TWO CHANNELS OF INTERNATIONAL TRADE LIBERALIZATION**

aspiration of the world greatest powers after World War II to put in order the world economy and international trade at the multilateral level is only partially borne fruit. Then planned establishment of the International Trade Organization (ITO) is not achieved, and General Agreement on Tariffs and Trade (GATT) has adopted as a temporary solution. This is confirmed Churchill’s observation that the longest lasting are temporary solutions. GATT was the beginning of the arduous process of gradual liberalization of international trade at the multilateral level. As we now know, the establishment of World Trade Organization (WTO) was not a triumph of successful completion of that process, but the significance of WTO establishment cannot be underestimated. Certain phases of trade liberalization have been successfully completed only when the interests of powerful countries and economies in the world agreed.

In parallel with the multilateral liberalization of international trade went another process: regionalization. Regionalization has a longer history, and it can be argued that the first successful international trade liberalization has achieved through regionalization by the conclusion of bilateral preferential trade agreements already in nineteenth century. It is obvious that many countries were not satisfied with multilateral liberalization, and they appreciated that it is for them more useful and efficient conclusion of bilateral agreements, which are usually the most common form. Higher stages of regionalization are characterized by the conclusion of regional agreements between several countries, of which the most famous and most successful is the European Union.

If we look at the conceptual differences between these two types of trade liberalization, they at first seem incompatible. However, the practice has forced the world to find a compromise between these two processes. Such a compromise is reached in the formal and real terms, so that two processes are harmonized. This was necessary solution because more than half of international trade exercised within trading blocs.

The new millennium has not brought anything new. Only the global financial crisis has shaken well most developed economies of the world. Again, there was a tendency

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<sup>10</sup> Cwik, P. F. (2011), “The New Neo-Mercantilism: Currency Manipulation as a Form of Protectionism”, *op. cit.*, 9.

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for the protection of national economies, as many times in the past. “While actual protectionist measures to restrict trade through tariff and non-tariff barriers have risen during the crisis, their economic impact so far remains moderate.”<sup>11</sup> And again we see the same result: protectionist measures can help a national economy in the short run but cannot improve its international competitiveness. “Today, systematic protectionist thought is alive and well, though not so much in the academy.”<sup>12</sup>

#### 4. WESTERN BALKANS

After 1995 and ending the war in parts of the Western Balkans, the regional economies were well below prewar levels. In addition, peace had just reached and reconciliation process at the beginning. Many business relationships in the region were cut, many companies have collapsed, unemployment was high, and it was very difficult to achieve significant economic results at that time. Although it was present awareness that regional trade can significantly speed up the process of rebuilding the economies and stimulate their growth, there are numerous obstacles in national states to liberalize regional trade. Also there was resistance in some business circles that did not match the opening of national markets.<sup>13</sup>

As usual, the constraint is helpful in the Balkans. Under strong pressure from the European Union and the United States, and with their support, it began the process of liberalization of regional trade. It was implemented by creating a network of bilateral free trade agreements between countries in the region, each to each. It was also a formal requirement for inclusion in the process of integration with the European Union. Such a form of regional trade liberalization, as has never before been seen in the world, can be made many objections. However, it gave the initial results.

When most of the Central and East Europe countries joined the European Union, their FTA, CEFTA, is almost out of states. Since the CEFTA achieved good results, the European Union has just moved CEFTA to the Western Balkan late 2006 and prolonged its life. CEFTA will lose one member 2013 once Croatia becomes a full member of the European Union. A current institutional form of regional trade liberalization can be estimated as appropriate to developmental level of the Western Balkan economies. In addition, the exports of all countries of the Western Balkan to the European Union are almost entirely free. Serbia has concluded an FTA with Russia as a significant additional

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<sup>11</sup> Bussière, M., *et al.* (2011), “Protectionist Responses to the Crisis: Global Trends and Implications”, *World Economy* 34(5), 850.

<sup>12</sup> Davies, S. (2011), “Trade, Mercantilism and Nation-Building”, *Economic Affairs* 31(3), 21.

<sup>13</sup> Market distortions in the form of oligopolies and monopolies in local markets have enabled earning of extra profits and opening of the regional economies is not suited to a number of large local companies.

opportunity to increase exports. In this way, the economies of the Western Balkans have a much wider scope for expansion of their exports than they are able to achieve.

#### 4.1. Commodity trade

According to the official Croatian data,<sup>14</sup> in 2011 Croatia exported goods to CEFTA countries in the amount of €1,838,204,000, representing 19.18% of its total exports in that year. On the other side of the balance sheet, Croatia has imported goods from CEFTA in the amount of €964,381,000, which accounted for 5.92% of its total imports. CEFTA region, in what has so far accounted for one-fifth of Croatian exports, according to its importance is second exporting region for Croatia, right after the European Union. Recognizing the importance of traditional economic ties of former Yugoslav market and consumer behavior in the region, it should be noted that such a good Croatian export performance in the CEFTA region is largely the result of the agreement, and preferential trade benefits, which it gave to member states. Again proved the rule that most benefit from regional trade agreements drawn the most developed states.

According to the volum of trade, the most important Croatian trade partners within CEFTA are: Bosnia & Herzegovina, Serbia, and Macedonia.

Table 1: *Croatian commodity trade with major trading partners within CEFTA 2010–2011, (€ 000 and % of total export/import within CEFTA)*

	commodity exports			commodity imports		
	2010	2011		2010	2011	
	€ 000	€ 000	%	€ 000	€ 000	%
Total		1,838,204	100		964,381	100
Bosnia & Herzegovina	1,033,936	1,173,648	63.85	461,702	543,953	54.40
Serbia	349,160	375,026	20.40	230,554	286,702	29.73
Macedonia	84,727	95,952	5.22	106,991	120,180	12.46

Source: State Statistical Office of the Republic of Croatia (2012). *Statistical Yearbook of the Republic of Croatia 2012*, Zagreb, 375–377. (author's calculation)

Data in the table above indicate that Bosnia & Herzegovina, far ahead of the others, is the most important trading partner within CEFTA, for it accounted for 63.85% of Croatian export and 54.40% of import in 2011. year. The second important partner is

<sup>14</sup> Source: State Statistical Office of the Republic of Croatia (2012). *Statistical Yearbook of the Republic of Croatia 2012*, Zagreb, 375.

Serbia, in which went 20.40% of Croatian export and 29.73% of import occurred within CEFTA. Macedonia's export performance also deserves attention, given the size of its economy

What is clear is that Croatian accession to the European Union, which includes changing trade regimes, lead to a redirection of trade flows, primarily export, on the line Croatia - Bosnia and Herzegovina - Serbia. In 2010, "export to neighboring countries (Croatia, Serbia, Montenegro, Kosovo and UNMIK) accounted for 34% of total exports of Bosnia and Herzegovina."<sup>15</sup>

A summary of geographical distribution of Serbian commodity trade in the period 2006–2011 by major economic zones suggests several basic conclusions: first, the European union is the main trading partner of Serbia, with over 50% of total trade, while the EU-15 accounted for more than one-third; second, CEFTA countries accounts for about one-third of Serbian exports, and slightly below the tens of imports (by about 50% relative higher than in Croatia). Russia remains an important trading partner, primarily as a supplier of energy, and to a twice lesser extent, as the export market.

Table 2: *Serbian commodity trade within CEFTA 2009–2011*  
(€ mil and % of total trade)

	2009		2010		2011	
	€ mil	%	€ mil	%	€ mil	%
Commodity export f.o.b.						
Total CEFTA	1,881	31.55	2,126	28.76	2,298	27.22
Albania	-	0.84	-	1.34	-	1.08
Bosnia & Herzegovina	-	12.18	-	11.12	-	10.11
Montenegro	-	10.02	-	8.21	-	7.56
Croatia	-	3.34	-	3.13	-	3.97
Macedonia	-	5.14	-	4.87	-	4.46
Commodity import c.i.f.						
Total CEFTA	932	8.10	1,095	8.67	1,218	8.55
Albania	-	-	-	-	-	-
Bosnia & Herzegovina	-	2.82	-	3.37	-	3.37
Montenegro	-	1.13	-	0.9	-	0.66
Croatia	-	2.69	-	2.59	-	2.46
Macedonia	-	1.44	-	1.62	-	1.61

Source: Statistical Office of the Republic of Serbia (2012). *Statistical yearbook of the Republic of Serbia*, Belgrade (author's calculation)

<sup>15</sup> Hasić, D., red. (2011), *Analiza efekata pristupanja Republike Hrvatske Evropskoj uniji na Bosnu i Hercegovinu*, Sarajevo: Vanjskotrgovinska komora Bosne i Hercegovine, 7.

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The table shows several important things: first, the value of Serbian exports to CEFTA countries is roughly twice the size of imports; and, secondly, the relative contribution of CEFTA in total merchandise exports of Serbia is about three times larger than the relative share of CEFTA in total goods imports; and third, Bosnia and Herzegovina, Montenegro, and Macedonia are important export markets for Serbia, which accounts for about a quarter of total merchandise exports.

If we compare only the values of trade of Croatia and Serbia within the CEFTA in 2011, Croatian export of goods was €1,838.2 million and Serbian export was €2,298 million. Croatian import in the same year was €964.38 million and Serbian import was €1,218 million. These data suggest that Serbia merchandise trade within CEFTA is lot more important than in Croatia, especially if we take into account the value of the total foreign trade of both countries.

For Croatia, most important trading partners within the CEFTA are Bosnia and Herzegovina, and Serbia, much less Macedonia, while, on the other hand, the most important export markets of Serbia are: Bosnia and Herzegovina, Montenegro, and Macedonia, and on the import side, Bosnia and Herzegovina, and Croatia. If we start from the fact that Croatia and Serbia have two competitive economies within the CEFTA, then the conclusion is that the main interest in the changed circumstances remain Bosnia and Herzegovina for both countries.<sup>16</sup> Unfortunately, the economy of Bosnia and Herzegovina is generally weak and the absorption capacity of its market is small.

#### **4.2. Trade in services**

In the analysis of economic relations in the CEFTA region, their case is the most common commodity trade. However, such an analysis would be incomplete if it does not turn into it, at least in the basic indicators, and trade in services. “As elsewhere, trade in services has been gaining in importance in the CEFTA region, where service exports brought in, on average, €16 billion a year for 2007–09 and accounted for some 10 percent of GDP in the noncoastal countries, 19 percent in Albania, and over 23 percent in Croatia and Montenegro, which both have significant tourism receipts (about 70 percent of total service exports).”<sup>17</sup> In the total export of services, as well as revenue from them, in CEFTA countries tourism plays a dominant role, especially in coastal countries. Tourism accounted for “about 70 percent of total service exports for Albania, Croatia, and Montenegro, and 50 percent for BiH. The share in land-locked FYR Macedonia and Serbia was 25 percent. The region received €9.6 billion in tourism receipts in 2009, two-

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<sup>16</sup> In trade relations of Croatia and Serbia with Bosnia and Herzegovina, the ethnic factor has a strong influence, thus the most powerful Croatian trade is within the cantons with a Croat majority, while Serbian trade is concentrated in the Republic of Srpska and District Brčko.

<sup>17</sup> Handjiski, B., and Šestović, L. (2011), *Barriers to Trade in Services in the CEFTA Region*, World Bank Study, Washington DC: World Bank, 4.



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thirds of which went to Croatia. Transports the most important traded service after tourism: CEFTA receipts have averaged about €2.2 billion a year in recent years.”<sup>18</sup> Inflows of non-tourist services total exports in the region are the largest in Croatia and Serbia, representing 44% of Croatia and 31% in Serbia. Overall, CEFTA has a positive balance in services, where exports exceed imports doubled.

Mutual trade in services within CEFTA countries is also important for all of them, although significantly behind the commodity trade. Thus, in the period 2007–2009, Croatian exported services averaged €286 million a year, Serbian € 261 million (plus € 36 million from tourism), while Montenegro a year earned an average of €270 million from tourism.

In the intra-regional trade in services, the most important service sector is transportation and accounting for over 40% in Croatia and Montenegro, and 28% in Serbia. Second place belongs to construction services. According to their importance in mutual trade, service sectors have a similar order on the export and the import side.<sup>19</sup> Croatia and Serbia are net exporters of non-tourist services in intra-regional trade, with a different structure of exports and imports. Thus, Croatia has a positive balance of transport and ICT services, and negative in the building. Conversely, Serbia has a negative balance of transport services, and positive in construction and various professional services. In non-tourist services, Montenegro has a positive balance only in communication and trade related services.

## 5. GAINS FROM TRADE AND EUROPEAN INTEGRATION OF WESTERN BALKANS

It should be noted that any regional integration implies a certain degree of discrimination against non-member countries. This discrimination is claiming that does not lead to trade diversion, but it's not always a convincing argument. Especially today, when the sophisticated non-tariff barriers to trade are highly developed.<sup>20</sup> An additional argument is that regional integrations are open for the admission of new member countries. Either way, it's a state of things.

The Western Balkan countries may get two groups of gains from trade liberalization and European integration: first, the gains from regional trade liberalization within CEFTA, and second, the gains from European integration process. As we noted earlier,

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<sup>18</sup> Ibid., 6–8.

<sup>19</sup> Ibid., 11.

<sup>20</sup> “I think that the most important explanation for the puzzle of surprisingly low tariffs is that the political economy literature is largely right: trade barriers are relatively high even in developed countries but they are hidden as quotas and other non-tariff barriers.” (Magee, C. S. P. (2011), “Why are Trade Barriers so low?”, *Economic Affairs* 31(3), 16.)

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these two processes are inextricably linked. “The benefits of free trade appear to be substantial, although precise quantification of those benefits is sometimes difficult.”<sup>21</sup>

Research results related to international experiences can help us in better understanding of gains from free trade. Although did not provide a robust results of FTA impact on economic growth in 21 South and Southeast Asian countries over the period 1980–2004, one of the research results is that: “South-East Asian countries are strongly influenced by neighboring countries that have liberalized trade policies, possibly due to increased demand for domestic goods and services.”<sup>22</sup>

Oyama *et al.* (2011) explored how progressive trade liberalization affects industrial structure through the channel of entrepreneurship and the process of creation of firms. In their research, they found that market integration can lead to the destruction of firms and varieties in the first stages of trade liberalization, when developing countries often experience deindustrialization. But, their “results also suggest that a deeper economic integration leads to more diversity through the creation of new firms. In particular, the integration of developing countries to the world market might well be beneficial to them, as illustrated by the East Asian Miracle. Small countries then benefit from market integration by regaining market share in the manufacturing sector.”<sup>23</sup>

Normally it is expected that regional trade liberalization should lead to increase in income, rising consumer welfare, and ultimately to higher rates of economic growth. “Frankel and Romer find that the effect of trade on income works mainly through higher productivity, but also by increasing the capital stock.”<sup>24</sup> So far, the Western Balkan countries have not largely used the potential gains from free trade, and all have experienced deindustrialization. In addition, they all have high rates of unemployment, and the effects of the global financial crisis and the crisis in the Eurozone were to some extent spilled over to the region. In comparison with the European average, the productivity level is low, and the total volume of FDI stock in Western Balkans really lags below that were once attracted by the countries of Central Europe.<sup>25</sup> Therefore, countries of Western Balkan are still halfway. “The real and substantial gains from free trade should not be exaggerated when other fundamental economic problems are pressing. Stable macroeconomic policies, the rule of law, and the protection of property

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<sup>21</sup> Irwin, D. A. (2009), *Free Trade Under Fire*, Third Edition, Princeton and Oxford: Princeton University Press, 68.

<sup>22</sup> Jalles, J. T. (2012), “Openness, Regional Trade Agreements and Growth: Evidence from Asia”, *Asian Economic Journal* 26(1), 83.

<sup>23</sup> Oyama, D., *et al.* (2011), “On the impact of trade on the industrial structures of nations”, *International Journal of Economic Theory* 7(1), 108.

<sup>24</sup> Irwin, D. A. (2009), *Free Trade Under Fire*, op. cit., 51.

<sup>25</sup> See in: Antevski, M. (Ed.) (2011), *Development Potentials of Foreign Direct Investment: International Experiences*, Belgrade: Institute of International Politics and Economics.

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rights that enable the market mechanism to function properly are preconditions for reaping the full benefits of international trade.”<sup>26</sup>

There are plenty of reasons to reconsider the nature and usefulness of the effects that hit the Western Balkans in the European integration process, in which they are involved from the mid-1990s. Although the problems of the Western Balkan countries are to the fullest extent of internal nature, the European Union has enabled almost completely free access to its market, then it is logical to ask why their economic recovery and progress is so slow? It has already been found that the beneficial effects of regional economic integration coming for a long-run and in small portions, but it is not a sufficient argument for so slow economic growth of the Western Balkan countries. Also interesting is the nature of FDI inflows that are largely came from developed European countries to the region, and why the extent of productivity spillovers to the local economies is insignificant? Especially because there are many positive experiences in the world. Perhaps a part of the explanation can be found in the sectoral distribution of FDI inflows: most of it was directed at the banking, financial and service sectors. In addition, the banking sector in these countries is almost totally foreign-owned, and its investment are not directed to the manufacturing sector than the households. It would be also difficult to find economically viable explanation why the interest rates are several times higher than in the European Union.

The Western Balkan countries have experienced two additional types of FDI negative effects. The first relates to the production capacities and the other to the retail chains. Their common feature is the establishing of oligopoly structures in the local markets of these countries. Oligopolistic characteristics has a production of milk and dairy products, edible oil, beer, cigarettes, cement, sugar. Foreign investors did not contribute to the strengthening of free market; on the contrary, with the national retail chains they have established oligopoly.

Turning to the potential gains from free trade in the European integration of the Western Balkans, the question then is whether these gains could be larger scale than those that have been realised. Recall that for all these countries the European Union is largest trading partner, and the most important is often Germany. Nearly two decades is evident an export expansion of the German economy. Both in theory and global practice, such expansion is usually relies on some of the key elements of international competitiveness. Productivity is usually its crucial element. In German case, “importantly, the decline in unit labor cost growth was not due to any acceleration in productivity growth, but caused by a marked decline in wage inflation. In other words, not German engineering ingenuity, but wage restraint gave German exporters an extra boost.”<sup>27</sup> However, the result is visible. How is that German export

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<sup>26</sup> Irwin, D. A. (2009), *Free Trade Under Fire*, op. cit., 68.

<sup>27</sup> Bibow, J. (2012), *The Euro Debt Crisis and Germany’s Euro Trilemma*, Working Paper No. 721, Annandale-on-Hudson, N.Y.: Levy Economics Institute of Bard College, 16.

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expansion affected the economies of the other European Union member states and the countries involved in the process of European integration? “While the euro area is roughly in external balance, GIIPS countries (Greece, Ireland, Italy, Portugal and Spain) lost 20-30% competitiveness relative to Germany over the last decade. As much trade is intra-European, substantial current account imbalances in Southern European countries emerged, leading to a concern about the sustainability of their debt.”<sup>28</sup> If Italy and Spain have lost a significant percentage of the competitiveness of their economies, it is quite certain that the countries of the Western Balkans have had similar or worse experiences.

These observations and facts confirm a previous international integration experiences, and it's not sufficiently examined in the Western Balkans. This does not diminish the value and benefits of European integration, but points to the need for much more serious approach of every country in that process. The success in the broader integrated area of the European Union depends largely on the homework that each potential member country should successfully carry out at home. In doing so, some of bad experiences of the current member states of the European Union may point the way to avoid repeating mistakes.

It was found in the process of European integration that investment flows follow the trade flows. This pattern of regional economic integration is repeated in the Western Balkans. In addition to investment from the European Union countries, an investment flows within the region have strengthened along with the trade flows. It can be seen in recent times a number of greenfield FDI, whose products are intended for export to developed countries. In addition, a major investment of Fiat in Serbia has attracted a number of greenfield FDI involved in cooperation with Fiat and international distribution chains.

The liberalization of regional trade, openness of the European market to imports from the Western Balkans, Serbian free trade agreement with Russia, but also the pressure of foreign competition to local markets and producers, led to several positive results. One is the strengthening of a number of domestic producers in agriculture, food processing, animal husbandry and winemaking. Another result is the beginning of establishing cooperatives of small and medium scale producers in order to ensure sufficient and stable large quantities of goods for export. It can therefore be expected that “the dynamic gains due to the expansion of export variety may well be more important.”<sup>29</sup>

## 6. CONCLUSION

It can be said that the issue of free trade has not exhausted its vitality and actuality, and it makes sense to discuss it again in the particular circumstances or region. It is the

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<sup>28</sup> Tirole, J. (2012), “The euro crisis: some reflexions on institutional reform”, Banque de France, *Financial Stability Review* 16, 226.

<sup>29</sup> Feenstra, R. C., and Kee, H. L. (2007), “Trade Liberalisation and Export Variety: A Comparison of Mexico and China”, *World Economy* 30(1), 20.

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pivot point for all negotiations on trade liberalization, both regional and international. The argument of free trade can fend off a protectionist pressure of specific business or social groups at the national level.

The process of reconciliation, economic reintegration of the Western Balkans, and integration with the European Union began with the liberalization of regional trade. These three processes are inextricably linked and take place simultaneously. Nowadays, the assessment may be that these processes have brought some good results, not as much as it expected, but also a number of negative effects on the economies of the Western Balkans. The reasons for such developments can be found in the objective state of the Western Balkans economies, the political unwillingness or reluctance to serious structural reforms, in part in the impact of global financial crisis and the Eurozone crisis, but also due to the export expansion of most developed European Union countries, mainly Germany.

Nevertheless, it can be concluded that the improvement of the local free market economies, open Western Balkans economies to foreign countries is indispensable condition for their further integration with the European Union. Although all Western Balkan countries see their future as members of the European Union, and it is their most important trading partner, certain geographical redistribution in exports and imports could provide beneficial effects. Especially if we take into account the favorable free trade agreements with large countries such as Russia and Turkey, where geographical distance is no obstacle to the promotion and development of trade.

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