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Intelligence Memorandum

Office of European Analysis

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EU: Rebuilding the Balkan House

With the advent of renewed US efforts to promote a peace accord in the former Yugoslavia, European leaders are beginning to consider the costs of economic reconstruction in the Balkan republics and are using the promise of aid to spur a peace settlement. Data on reconstruction needs is lacking--particularly for war-ravaged Bosnia--but housing and infrastructure would be priority areas, whose costs would run into the tens-of-billions of dollars.

- *Using its approach to aid for Eastern Europe and the CIS, the EU would channel aid through the PHARE multilateral program for Eastern Europe, the European Bank for Reconstruction and Development, and the European Investment Bank as well as through member-state programs and multilateral institutions.*
- *The EU would probably negotiate trade and cooperation agreements with the former Yugoslav republics to improve access to the EU market, while the member states would continue to participate in Paris Club rescheduling to ease the debt burdens of these countries.*
- *Nonetheless, the EU would want to spread the aid burden to the United States, Japan, and other countries and probably would claim credit for its participation in UNPROFOR and the cost of hosting refugees.*

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[redacted]

Promoting Postwar Economic Stability

EU leaders are beginning to consider how they can contribute to economic stability in the former Yugoslavia after the Balkans war.

- The EU and its member states have been a major source of aid to the Balkan republics, providing more than \$1.3 billion--mostly humanitarian aid, with almost 60 percent going to Bosnia--since 1991, according to press reports. [redacted]

European Commission officials have done some preliminary thinking about economic reconstruction in the Balkans and probably will make more definitive assessments once a peace process is underway. They already are using the promise of aid to spur a peace settlement.

- Housing for displaced people, repair of basic infrastructure--water, power, and transport facilities--and restoring tourist facilities would be priority needs, which would entail expenditure of tens-of-billions of dollars.
- Commission officials deflected Bosnian Foreign Minister Sacirbey's request for a "pledging conference" this fall, emphasizing that EU member states want to see progress toward a settlement first, according to Embassy reporting. [redacted]

The EU would be able to provide assistance through Union and member state aid programs as well as through international organizations.

- Based on its approach in Eastern Europe and the CIS, the EU would channel aid through the PHARE multilateral program for economic assistance to Eastern Europe, the European Bank for Reconstruction and Development, and the European Investment Bank--the EU's lending arm.
- EU member states would continue to participate in Paris Club rescheduling of official debt, as they did earlier this year for Croatia and Macedonia. Total foreign debt of the former Yugoslavia stands at more than \$12 billion; the Paris Club has only rescheduled \$700 million owed by Slovenia, \$900 million by Croatia, and \$300 million by Macedonia, according to the press.
- The EU probably would negotiate trade and cooperation agreements with the former Yugoslav republics similar to the deal being negotiated with Zagreb before the Croatian offensive. These agreements would improve access to the EU market--aside from sensitive goods, such as

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foodstuffs, textiles, and steel--and clear the way for participation in EU loan and development programs.

The EU member states almost certainly would seek the participation of other G-7 countries and of international financial institutions in funding economic reconstruction in the Balkans. The Europeans would want to spread the financing burden so that it does not foil their efforts to bring their budgets under control or detract from their other aid priorities, such as Eastern Europe and the Maghreb.

- The larger EU members, Germany in particular, would almost certainly be wary of a major increase in EU aid and assistance because they are the biggest contributors to the EU budget.
- Poorer member states, such as Greece, Portugal, and Spain, would probably be concerned that assistance for the Balkans could limit the EU funds they receive.
- To shift the burden toward others, the EU probably would claim credit for past contributions, such as participation in UNPROFOR and the cost of hosting refugees.

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EU Economic Arrangements With the Balkan States

Trade and Cooperation Agreement With Yugoslavia--this agreement was nullified with the breakup of Yugoslavia, but the EU has continued to extend tariff concessions to the former republics, renewing them most recently in January 1995.

Slovenia--An economic cooperation agreement was signed in 1993 extending the preferential, non-reciprocal trade benefits of the EU-Yugoslav pact and offering ECU 44 million (\$58 million) in PHARE funds. A five-year financial protocol signed in 1993 gives Slovenia access to ECU 150 million (\$200 million) in EIB loans and ECU 20 million (\$27 million) in EU grants. The Association Agreement, initialed in June and awaiting ratification by the member states calls for a free-trade area after a six-year transition and conformity of Slovenian law with EU regulations in preparation for eventual EU membership.

Croatia--The EU suspended negotiations on a trade and cooperation agreement because of the recent Croatian offensive. The agreement would give Croatia tariff concessions and restore access to EU assistance through PHARE.

Bosnia, Serbia, and Macedonia--Although these republics technically qualify for the trade concessions of the EU-Yugoslav agreement, the war, economic sanctions on Serbia, and the Greek embargo on Macedonia have prevented them from exploiting these benefits.

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State of the Balkan Economies

Bosnia and Herzegovina--Both the Bosnian government area and the self-styled "Serb Republic" face a long and difficult transition to economic stability. Resources are limited and many industries--especially defense plants--have sustained significant damage in the fighting. Moreover, much of the commercial and residential infrastructure has suffered war damage. The larger, Serb-controlled area is primarily agricultural, while the postwar economy in the Bosnian government-controlled areas will have to rely on industrial production and services.

Croatia--The Croatian offensive this month recaptured much of the Krajina virtually intact. Rail service linking Zagreb and the Dalmatian coast via the Krajina capital of Knin begins this week. Repair of other infrastructure, particularly hydro-power facilities, can probably be completed within months. Restoration of tourism will be key because this industry provided roughly one-fourth of Croatian GDP before the war.

Serbia--Damage from UN sanctions and economic mismanagement will hamper Serbian recovery for years. According to official statistics, economic output plummeted 55 percent since 1989. Basic industries, such as steel and chemicals, face tough competition from abroad, and government controls will deter investors. The central bank governor stated last month that Serbia needs \$6 billion to bring the infrastructure back to 1989 standards.

Macedonia--UN sanctions on Serbia and the Greek embargo have helped cut economic activity in Macedonia by half since 1989. Per capita income is about \$900, according to World Bank estimates, only slightly better than Serbia. Its capital-intensive industries will likely remain uncompetitive, and postwar Macedonia will probably seek stronger trade ties to Greece because of Serbia's likely economic straits.

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Comments and queries are welcome and may be directed to Chief, Regional Analysis Division,
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