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Preliminary remarks

Now that the years of bloody conflict in the states and territories of South Eastern Europe have largely been consigned to the past, the attention of the media is gradually declining. The region, which is still dynamically developing, is mainly of interest today to experts concerned with its sustainable reconstruction.

Admittedly, this does not mean that South Eastern Europe is “out of the woods” yet. Reforms and reconstruction must continue, if the pacification of the Balkans is not to be just an episode. This *BMZ-Spezial* provides an overview of the current situation and, in particular, is intended to inform the reader about the Stability Pact for South Eastern Europe: Why is such an elaborate framework required for the reconstruction phase? What is the Stability Pact and how does it work? What has been achieved and what is still to be done? What role has German policy played in the establishment, implementation and further development of the Pact? Why is South Eastern Europe of such great significance in the work of the Federal Ministry for Economic Cooperation and Development?

The situation of the states and territories of South Eastern Europe was, and is, exceptional. Consequently, the Stability Pact too is an exceptional instrument. Nevertheless, the experience that has been gathered in the region will make an impact on the further evolution of German and European development cooperation, and will therefore have a significant influence beyond the bounds of South Eastern European. The Federal Ministry for Economic Cooperation and Development is especially committed to the search for new channels of cooperation. Consequently, apart from readers who wish to improve their understanding of events in South Eastern Europe, this account is also intended for anyone interested in modern development policy.

1. Introduction

The crisis in South Eastern Europe had its roots in the collapse of the Yugoslav federal state that began in 1989. After almost ten years of bitter political and

military conflicts, the Stability Pact for South Eastern Europe was launched at the Sarajevo Summit on 30 June 1999. The founding of the Stability Pact therefore came as a direct response to the military intervention in Kosovo.

This new mechanism brought into being by the representatives of the international donor community, on the one hand, and the states of South Eastern Europe, on the other, was and is intended to contribute to the promotion of peace, democracy and human rights in this crisis-wracked region.

The Stability Pact is now regarded as an excellent example of successful non-military security policy. It could be described as a way of organising the civilian phase following military intervention. The Pact would not have been successful for long if the donor community had not quickly decided on effective action to deal with the conflict, including measures at the civilian level.

The Stability Pact promotes market-economy structures and regional economic cooperation between the national economies of Eastern Europe as a way of backing up the peace process by bringing greater economic prosperity to the region.

This is based on the idea that an enduring consolidation of peace in South Eastern Europe will only be possible if

- the difficult transitional phase to be coped with in the process of moving from a planned economy to a market economy is facilitated and speeded up by massive support from the international community;
- positive economic prospects therefore open up over the short or medium term for all people in the region, including ethnic and religious minorities, as a “democratic dividend” and a precondition for the acceptance of democracy and the market economy;

- economic cooperation between the individual states and territories is intensified in such a way that this inevitably gives rise to an expansion of communication and dialogue, and therefore also to better understanding between the different groups.

From the standpoint of the founders of the Stability Pact – in view of the disastrous starting position with largely devastated economic structures in all the states and territories of the region – the primary goal could only be to use the funds made available as efficiently as possible in a coordinated fashion to prevent the occurrence of acute emergencies (famines, epidemics, power cuts and heating failures in the winter). In the meantime, however, most of the states and territories of South Eastern Europe have recovered their equilibrium to such an extent that cooperation is much more strongly dominated by the aspect of sustainability and it is possible to put together longer-term programmes aimed at building structures in the region. It has been possible to make a considerable impact within a short period of time thanks to the Pact's unique structure, with its dialogue-based sharing of responsibilities between the donor community and the target region. Above all, it is thanks to the gradual stabilisation of the region's civil societies that the overall concept of the intervention enjoys a good reputation today among the populations of the states of South Eastern Europe. It will be necessary to build on this approach in future.

2. The causes of conflict: upheaval in South Eastern Europe

Since the end of the 1980s and the collapse of the communist systems, South Eastern Europe has been in a constant state of flux. In Poland, the Czech Republic, Romania, Bulgaria, Hungary and Albania, the transition to democracy and the market economy took place without the integrity of these states being called into question. In Yugoslavia, by contrast, state structures disintegrated. As early as June 1991, the Yugoslav constituent republics Slovenia and Croatia

declared their independence. Just two days later, open civil war broke out in Yugoslavia as the Yugoslav federal army advanced into the secessionist areas in an attempt to prevent them finally breaking away.

In the period that followed, nearly all the former constituent republics sought to leave the multi-ethnic state of Yugoslavia, and Kosovo tried to secede from Serbia. Montenegro, which is mainly populated by Serbs and was not initially involved in the conflict, was alone in remaining attached to Serbia, and it has only sought independence since 1999. As Yugoslavia disintegrated, conflicts at a whole series of individual hot spots broke out in what we refer to today as the Balkan crisis. Neither in the Yugoslav federal state nor in the breakaway republics did it prove possible to create a modern sense of shared identity: the ideas about the reforms that were needed and what sort of new civil culture ought to be created diverged widely. In this vacuum, in which the populations of the various states lacked any true sense of community, an ethnically oriented nationalism was able to flourish. The nation was not defined as the federal state or the population of the new state as a whole; rather, the dominant ethnic groups in each particular situation, the Serbs in what was left of the former Yugoslavia for example, viewed themselves as the “real” people of the new state and also extended their claim to dominance to all territories inhabited by members of the same ethnic group in other states. The resultant attacks on sovereign states and clashes within states led to a reinforcement of ethnic identification: individuals’ ethnic backgrounds and their roles in the conflicts went hand in hand and strengthened each other. People were no longer just Kosovo Albanians or Serbs, Muslims or Croats, but also victims of serious attacks, the disadvantaged or the privileged in a struggle for influence and the meagre economic resources, threatened by displacement or part of a suppressed minority, members of a “liberation movement” or part of the “ruling class”.

[Kasten]

24 March 1999: NATO combat aircraft attack military facilities and transport links in the Federal Republic of Yugoslavia with bombs and missiles. Attempts to find a political solution to the Kosovo conflict have failed. NATO and the European Union find themselves forced into action to halt the massive attacks on the majority Albanian population of Kosovo being carried out by the Serbian police and military: the crisis in South Eastern Europe has reached its peak.

The Western allies' decision to intervene militarily in Kosovo was taken in a situation that compelled them to act: the mass displacements and massacres of Kosovo Albanians fulfilled the definition of genocide under international law. Despite considerable reservations, in view of the way the clashes were escalating, they felt it would be unjustifiable for them to continue to confine themselves to political measures. When they decided to intervene on a massive scale, it was clear that their involvement would not simply consist of the short-term pacification of Kosovo. It was only too obvious that reconciliation between the hostile groups would only be possible over the long term, and then solely under the precondition that a suitable framework was created in which none of the parties would have to fear being forced to make concessions to their enemies that would undermine their very existence. In addition to this, the need for an overarching, long-term concept for the whole region was becoming increasingly apparent: given the links between the countries concerned, there no longer seemed to be any point in trying to build stability in isolated states or territories.

What was needed, therefore, was a concept that would create an environment conducive to development: a move from short-term pacification and emergency aid to the long-term reconstruction of modern civil societies throughout the region.

3. The partner states: background and starting position

The actors who had been involved in the Balkan conflict established the Stability Pact for South Eastern Europe following an initiative of the German government. Its goals and principles were agreed at the Sarajevo Summit on 30 June 1999. The Pact was finally sealed on 10 July 1999 in Cologne. In its founding document, more than 40 partner states and organisations undertook to strengthen the countries of South Eastern Europe “in their efforts to foster peace, democracy, respect for human rights and economic prosperity.”

Serbia and Montenegro joined the Pact in the autumn of 2000 immediately after the fall of the Milosevic regime. Prior to this, assistance had already been provided de facto to Montenegro and twinning projects set up with democratically governed towns and cities in Serbia. Although Kosovo, as part of Serbia, has only formally participated in the Stability Pact since that point in time, Belgrade had already been deprived of all control over the province, which had been intensively involved in the measures implemented under the Stability Pact because it was being administered by the UN.

[Kasten]

Partners in the Stability Pact

Target countries: Serbia and Montenegro (including Kosovo), Bosnia and Herzegovina, Macedonia, Albania, Croatia, Bulgaria, Romania, Moldova.

Donor countries and organisations: the EU states and the European Commission, Slovakia, Slovenia, Czech Republic, Turkey, Hungary, Poland, Norway, Switzerland.

Non-EU G8 states: USA, Canada, Japan, Russia.

International Organisations: UN, OSCE, Council of Europe, NATO, OECD.

International financing institutions: World Bank, International Monetary Fund (IMF), European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), Council of Europe Development Bank (CEB).

Regional initiatives: Organization of the Black Sea Economic Cooperation (BSEC), Central European Initiative (CEI), South-East European Cooperation Process (SEECP).

If we compare the nature of the conflicts in the individual states and territories of South Eastern Europe, it becomes clear how diverse the tasks were that the governments of these countries and the international community had to face at the time when the Stability Pact was established, and still do, in seeking to set the parameters for a peaceful, economically stable future. Although the transition from a planned economy to market-economy structures involves certain basic problems, which have beset all the states and territories of South Eastern and Eastern Europe equally, there were considerable, historically conditioned differences that are still relevant for development-policy decisions today.

Serbia

Serbia's situation was largely shaped by its role as an aggressor in the conflicts. In 1999, the country was completely politically isolated on the international stage and not regarded as a partner worthy of recognition by any of its fellow former Yugoslav republics. The economic situation was essentially determined by the embargo that had been imposed on the country. Only when the curtain fell on the Milosevic era in the autumn of 2000 was there scope for significant changes

again. Following the recognition of the Federal Republic of Yugoslavia, which now consisted of just the Republic of Serbia and the Republic of Montenegro, Serbia's relationship to the international community developed positively. Diplomatic relations were resumed with important states soon thereafter. Serbia returned to all the international institutions (UN, OSCE, IMF, World Bank) and was finally accepted as a member of the Stability Pact for South Eastern Europe.

The Serbian population expected the assumption of power by the Democratic Opposition of Serbia (DOS), an alliance of 18 different groupings, to bring about a rapid improvement in its standard of living. Partly due to the outstanding start made by this government, the likelihood of an economic upturn in Serbia when it joined the Stability Pact was felt to be above average as compared to the rest of the region.

Kosovo

Kosovo is a province of Serbia that has been ruled by the United Nations Interim Administration Mission in Kosovo (UNMIK) since the Western allies' successful military intervention. It was already a structurally weak area before the outbreak of the conflicts within the Yugoslav federal state. With an illiteracy rate estimated at 60 percent, lacking modern infrastructure and largely dependant on pre-modern agricultural production, Kosovo was hit particularly hard by the damage inflicted during the war. In some parts of the province, up to 90 percent of the housing stock was destroyed; there was no functioning basic supply of electricity and water. Many Albanians had lost their families and social support networks in the fighting; quite a few of the people directly affected by it could be classed as traumatised and were consequently only capable of coping with the difficult living conditions to a very limited extent. This was not just a question of tragic individual fates; rather, the victims were numerically significant for the province's social structures as a whole. This war damage deserved the greatest attention, particularly as social and political instability are never far apart in Kosovo. Given the absence of state welfare structures, the population's struggle for survival

almost inevitably involved the use of illegal structures. The shadow economy, which is a problem in all the post-communist states, was given additional impetus by the weakening of the state's ability to act effectively during the collapse of the old system and the conflict that followed. As well as emergency aid, rapid fundamental improvements in all fields of life were required to gain the population's trust for the forthcoming reforms in all the target countries that had been seriously affected, but this was true to a particular extent in Kosovo.

Montenegro

Together with Serbia, Montenegro forms one state but, with a population of just over 650,000, is by far the smaller partner. The military conflicts since the early 1990s and the trade embargo imposed on the FRY in 1992 led to a serious economic collapse. After the fighting over Kosovo came to an end, the Montenegrin government set about a fundamental reform of its economic structures. Still closely bound to Serbia, which had gone through a ruinous development while the embargo was in force before Milosevic's final fall, Montenegro faced apparently insoluble problems.

As was already evident when Montenegro first joined the Stability Pact – the intensified development of tourism offered significant potential for economic recovery. Important preconditions, such as reliable, high quality drinking water, sanitation and solid waste disposal systems, were not in place. The local authorities lacked the requisite funds both for the rehabilitation of their facilities and for the new investment that was needed. Another problem was the integration of hundreds of thousands of refugees from the fighting in Croatia, Bosnia and Herzegovina and Kosovo, which put a significant further financial strain on the local authorities.

Montenegro also faced the general tasks of transformation: privatisation, the reorganisation of the banking sector and the reform of administrative bodies are just the usual key factors in a successful transition to democracy and the market

economy, but they represent a particularly great challenge for a country of Montenegro's size. Montenegro is only a member of the international financing institutions and organisations through the Federal Republic of Yugoslavia. Since it is not a state in its own right, it is unable to benefit from the financial and technical support provided by these bodies. Bilateral cooperation within the framework provided by the Stability Pact was thus all the more important.

Bosnia and Herzegovina

Since the signing of the Dayton Peace Agreement on 14 December 1995, Bosnia and Herzegovina (BiH) has been an autonomous federal state consisting of the two entities, the Federation of Bosnia and Herzegovina (FBiH) and the Republika Srpska (RS), as well as "Brcko Special District". Each of these three constitutional entities has its own legislature and executive. In view of the complicated consensus-based decision-making procedures, a central government capable of pushing through the urgently required reforms could hardly have been formed within an acceptable period of time. The overall political responsibility for the implementation of the Dayton Peace Agreement lay with the international community, which was represented on the ground by the Office of the High Representative (OHR) with its extensive powers. Although there were no alternatives to this solution, it has hampered the assumption of full political responsibility by the governments of Bosnia and Herzegovina that would be desirable, and has thus also held up the reconstruction effort.

By the time the conflicts ended, the economy was almost completely in ruins. Capacity utilisation was poor in the collapsing state enterprises, unemployment figures, estimated at 40 percent of the working population, were probably on the low side, and the level of training and skills was inadequate. In this context, the fact that it was capable, young people, above all, who had fled from the crisis zone is a problem that should not be ignored. Encouraging refugees and displaced persons to return, and enabling them to reclaim their property, was

therefore more than just a humanitarian concern. The support provided by the Federal Ministry for Economic Cooperation and Development, which began in 1993, long before the founding of the Stability Pact, therefore encompassed extensive aid for returnees and the integration of internally displaced persons. Until the conclusion of the peace agreement in 1995, by far the greater share of the funds was used for emergency aid. Subsequently, the focus gradually shifted to support for reconstruction. This included measures concerning the water supply, the rehabilitation of the electricity network and its connection to the European interconnected grid, employment promotion, financial systems development and the reform of business law. German aid was therefore already broadly based before the provision of the considerable special funds for activities under the Stability Pact.

Macedonia

Macedonia had seceded peacefully from the Yugoslav federal state in 1991 and was considered for a long time as a prime example of the peaceful handling of ethnic plurality. Tensions did exist, but the question of how the Slavic Macedonian majority of the population and the Albanian north of the country would ultimately come to relate to each other was initially dealt with at the political level. In 1999, the mass flight of ethnic Albanians from Kosovo into the northern part of the country, which was in any case Albanian dominated, presented Macedonia with a particular challenge, to which the country at first showed itself equal.

The Federal Ministry for Economic Cooperation and Development began cooperation with Macedonia when the country's sovereignty was internationally recognised in 1992. Its work in the priority areas of drinking water supply, the rehabilitation of dams, sanitation, solid waste disposal and water resources management also embraced the creation of independent operating companies in order to secure sustainability.

As a cross-border environmental protection project, the conservation of the Prespa biosphere reserve, situated in the area where the borders of Macedonia, Albania and Greece meet, was exceptional in character and sent out a particularly strong signal.

The measures taken to stabilise the social infrastructure consisted primarily of decentralised activities to strengthen local institutions. At the same time, these projects were designed to contribute to democratisation and to foster inter-ethnic cooperation between Slavs and Albanians. The legal advice provided concentrated on the further development of business law in conformity with EU legislation. Other schemes related to the privatisation of state-owned enterprises and reforms in the financial sector. When the Stability Pact was established, Macedonia's central task was seen to be institution building, particularly the creation of an effective administration at all levels of state activity. Only a sufficiently high profile for the democratically legitimated forces seemed to offer any assurance that it would be possible for ethnic differences to be dealt with through civilian channels in the future.

Albania

The Albanian leadership of the communist period pursued a policy of radical socialism and total isolation from the rest of the world. After almost 40 years ruled by Enver Hoxha's "Albanian Party of Labour", Albania was regarded until 1990 as the last bastion of Stalinism in Europe. This extreme, centrally controlled totalitarian communism has left its mark. Albania was, and is, one of the poorest countries in Europe.

Since 1985, as a wave of democratisation swept Eastern Europe, the country had been attempting to turn around its catastrophic economic situation – initially with a slow political opening to the outside world, later also with market-economy reforms. The democratic revolution began with the student protests of 1990/1991. A multi-party system and the strict separation of church and state

were laid down in the constitution adopted in 1991. At the same time, despite all the efforts being made, the economic situation worsened dramatically in 1991. Unrest broke out: hundreds of thousands of people demonstrated in the towns and cities and desperate attempts were made to escape abroad, especially across the Adriatic Sea to Italy.

In the first few years of the ensuing transformation process, Albania's development appeared to be exemplary. The country's economic reforms were supported by the IMF, the World Bank and the EU. Germany too started economic cooperation at this time as a bilateral donor.

In the autumn of 1996, armed unrest unexpectedly broke out when fraudulent machinations came to light in the investment businesses of the country's big financial service providers (what was known as the "pyramid scandal"). Two major financial institutions had to declare themselves bankrupt and dragged most of Albania's larger companies into the crisis with them. Almost all the country's citizens were indirectly affected by the losses. The victims of the fraud felt the government was responsible and demanded their money back from the state. There was fighting in the streets and the government accused the opposition of stirring up unrest in order to bring about a change of government. On 27 January 1997, President Berisha called in the army to contain the unrest. The government resigned on 1 March and the parliament declared a state of emergency on 2 March. Only the transitional government under Prime Minister Fino was able to regain control of the situation. In 1998, a new constitution was adopted that finally established the foundations for the building of democratic institutions.

The 1999 Kosovo crisis put the country through another test, but one that Albania was able to stand up to. Itself one of the most ethnically homogenous countries in the world, with Albanians making up about 98 percent of the population, Albania took in a total of almost 450,000 Albanian refugees from Kosovo. At the same time, the Albanian government adopted the same attitude as the rest of the

international community towards Yugoslavia and unambiguously rejected the moves of Albanian extremists in Kosovo who proclaimed the province's unification with Albania. By following this course, Albania made itself an important factor for stability in the region.

Albania's central problem when the Stability Pact was established was therefore its economic rehabilitation. More than 60 percent of the population lived in rural areas and earned their living on small family farms. In 1999, more than half the population lived below the subsistence level. It was probably not least for this reason that Albania had the highest crime rate in Europe in the 1990s.

Croatia

With 90 percent Croats, seven percent Serbs and three percent from other ethnic groups, Croatia's population of 4.5 million is relatively homogenous.

Following its declaration of independence from Yugoslavia in 1991, one-third of the country was initially occupied by Serbian separatists. The Croatian economy suffered considerably from the consequences of the fighting in Croatia itself, but also from the events in Bosnia and Herzegovina and Kosovo: just the flow of refugees from other states, about 700,000 people, presented the country with a great challenge. In addition to this, President Franjo Tudjman and his nationalist governing party, the Croatian Democratic Union (HDZ) pursued a strict policy of isolation, which was only abandoned when Tudjman died in 1999 and new elections were held in January 2000. Croatia was then very rapidly integrated into the Stability Pact for South Eastern Europe and the EU's development programmes. At this time, Croatia's macroeconomic performance put it in second place (behind Slovenia) among the former Yugoslav republics. It found itself at a level roughly corresponding to that of the EU accession countries Hungary and the Czech Republic, which made it one of the Stability Pact's most advanced target countries. Today Croatia is itself a candidate for accession. The Federal Ministry for Economic Cooperation and Development cooperates with Croatia

primarily in tourism promotion along the Adriatic coast, the development of the country's water supply and sanitation systems, financial sector reform, and the promotion of small and medium-sized enterprises (SME). All measures are designed to comply with EU standards, and are of an extremely innovative nature.

Bulgaria

Bulgaria was able to keep out of the armed conflicts and, not least for this reason, is one of the main pillars supporting the integration of the states and territories of South Eastern Europe into European structures. The democratisation of the country began in 1990 when the Communist Party renounced its claim to power and an amendment was made to the constitution to provide for the introduction of a multi-party system. On 3 January 1991, an all-party agreement was signed on a peaceful transition to democracy.

Due to the collapse of the Council for Mutual Economic Assistance (COMECON), which coordinated the economies of the Eastern Bloc states, Bulgaria's economy suffered a severe blow and lost many of its traditional markets. Bulgaria fell behind the other states in Eastern Europe with its plans for economic reform. Since 1994, the governing Socialist Party had half-heartedly and unsuccessfully tried to lead Bulgaria out of its economic crisis. Its attempts to avoid the hardships of the necessary transformation by implementing piecemeal reforms led to economic collapse. This came to a head in 1996 when the country suffered from hyperinflation and a number of banks folded. Petar Stoyanov, hitherto leader of the opposition, was elected president during this "hungry winter", probably benefiting from protest votes. He described moving his country closer to the EU as one of his immediate goals. Only following this deep political and financial crisis were systematic, market-oriented, reformist policies instituted. In September 1997, the World Bank granted Bulgaria a loan worth 100 million US dollars, which was intended to support structural reforms in the industrial and financial sectors. That same year, a three-year agreement was signed with the

International Monetary Fund. The country is set to become a member of the European Union in 2007.

Bilateral economic cooperation was taken up by the German side in 1998, prior to the establishment of the Stability Pact. Previously, Bulgaria had already been a partner country in the German government's Transform programme, which was specially set up to support the countries of Eastern Europe as they made the difficult transition from a planned economy to a market economy.

Romania

In Romania, the process of democratisation began in December 1989 with the uprising against the Ceausescu dictatorship. Ceausescu fled, but was caught and shot together with his wife after a secret military tribunal. A group of former communists known as the "National Salvation Front" took power. Shortly afterwards, this group became a political party and won the first free elections in 1990.

Following these upheavals, the Romanian domestic economy practically collapsed. Nevertheless, the first major reforms were concerned with the political system. Since the amendment of the constitution in 1991, which was approved by a referendum, Romania has been a presidential republic with a multi-party system. For a long time, no radical political or economic reforms were undertaken. The country submitted an application for accession to the EU as early as 1995, but the European Commission had to turn it down in 1997 due to the country's poor economic performance. Only with the victory of the opposition at the polls in November 1996 did changes begin to be introduced on anything like the necessary scale. The subsequent reform process was focussed on fighting inflation, the consolidation of the state budget and speeding up the privatisation process. Since Romania overcame the recession that persisted from 1997 to 1999, there has been a consistent upwards trend in its economic development. Like Bulgaria, Romania is scheduled to join the European Union in

2007.

The Federal Ministry for Economic Cooperation and Development has been engaged in bilateral economic cooperation with Romania since 1992. The priority areas have been vocational education, economic promotion, the strengthening of small and medium-scale farming and projects in the social sector and at local level. Romania warmly welcomed the decision of the 1999 Helsinki European Council to open negotiations on EU accession. This success was partly attributed to the German support for Romania's efforts. When the Stability Pact for South Eastern Europe was first established, it was therefore necessary to carry on supporting the course that the country had adopted, not least in order to effectively counter the latent potential for social unrest by stabilising the economy and integrating Romania into regional and Europe-wide structures.

Moldova

The Republic of Moldova, which has a population of approximately 4.2 million, became part of the Soviet Union in 1944. In 1989, a language law made Romanian the only official language, sparking serious conflicts with the country's sizeable minorities. Moldova declared its sovereignty on 23 June 1990, and its final declaration of independence from the Soviet Union followed on 27 August 1991. The following year, Transnistria, a territory on the left bank of the River Dniester where the majority of the population were ethnic Russians, tried to break away from Moldova. Transnistria makes up twelve percent of Moldova's territory, possesses about half the country's industrial capacity and forms almost all of Moldova's eastern border. This conflict and Transnistria's possible secession would have cut Moldova off from its most important trading partner, Russia. The Moldovan government therefore sought to regain control over the self-declared "Transnistrian Moldovan Republic" by military means, in which it failed, not least because the Russian troops stationed in Transnistria came to the separatists' aid. This happened against the background of close links between local heavy industry and armaments enterprises and the former Soviet Union. On

21 July 1992, Moldova and Russia finally agreed a peace settlement.

Apart from these political conflicts, Moldova faced considerable economic problems after achieving its independence. Following the first tentative improvements in the situation, the country suffered a severe slump after 1997: since Russia is Moldova's most important trading partner, the Russian financial and economic crisis affected the country directly. With a per-capita income of less than one US dollar a day, Moldova is the poorest country in Europe. Its social insurance systems are inefficient, and reform is almost impossible on account of the desperate budgetary situation. It is true that, under the influence of international organisations, Moldova has proclaimed its commitment to free market economics, but the privatisation of its large enterprises, many of which are highly indebted, is progressing slowly, partly due to political obstacles. The Federal Ministry for Economic Cooperation and Development was cooperating with Moldova as a bilateral donor even before the country's accession to the Stability Pact. As early as 2000, about five million euros flowed into the development of agrotechnical service stations in the form of a loan, and a further 3.5 million euros were committed to fund the Micro Enterprise Bank. In addition to this, advisory services on constitutional, economic and social reforms were provided. Joining the Stability Pact in June 2001 was therefore an important step for Moldova.

This overview shows the close relationship between political stability and economic rehabilitation. Only when all the states and territories concerned are able to meet their people's needs independently will an adequate basis have been created for lasting peace and reconciliation in South Eastern Europe.

4. The Stability Pact as a response

In view of the limited funding available, the challenge of reconstruction in the states of South Eastern Europe required the best possible use to be made of all

available resources. From the outset, it was vital to ensure the optimal coordination of donor funds and the meticulous organisation of the necessary political dialogue. With regard to its political orientation, the Stability Pact was a “two-track” concept from the start. On the one hand, substantial reforms were demanded of the South Eastern European partners; on the other, there were promises of ongoing assistance.

The Stability Pact does not directly administer the funds provided by the donor states, but merely optimises how they are deployed. The central precondition for this is a set of clearly elaborated priorities that take account of the situation in each country. In Kosovo for instance the rapid restoration of a minimum energy supply had to be the top priority, and there was little scope for fundamental modernisation measures, whereas in Bulgaria it was possible to work much earlier on guiding the energy sector towards far more ambitious approaches to the resolution of its problems and bringing it up to EU standards in the medium term.

Agreement on political goals was, and is, also important. For example, in the initial phase it was necessary to find a common position on assistance for opposition forces in Yugoslavia while it was still ruled by Milosevic and subject to sanctions. Today, we must turn our attention to the long-term goal of absorbing the states of South Eastern Europe into the European and Transatlantic structures (the EU and NATO). Long-term structural aid concepts are already being used to promote the integration of better developed states. To this end, stabilisation and association agreements (SAA) that highlight particular development activities have been agreed with these countries by the EU. In turn, these activities can be classified as priorities by Stability Pact donors.

The highest organ of the Stability Pact is the **Regional Table**. It consists of representatives of all the participating countries and organisations and meets twice a year. It is responsible for setting the Stability Pact’s overall political

course. Goals are redefined and the needs and interests of the partner countries harmonised on the basis of what has been achieved since the previous meeting. The Regional Table is chaired by the **Special Co-ordinator** of the Stability Pact. The Austrian Erhard Busek has performed this function since 1 January 2002 as the successor to the first Special Co-ordinator Bodo Hombach (Germany). The **High Level Steering Group**, as it is known, which is made up of the finance ministers of selected donor countries and representatives of the World Bank, EU institutions, UNMIK, the UN, the EBRD, the IMF and the EIB, supports the Special Co-ordinator in the performance of his duties. During the start-up phase of the Stability Pact, the Office of the Special Co-ordinator was mainly concerned with the definition of “Quick Start Projects” and “Near Term Projects”, depending on the urgency of the demand, in which it was assisted by the “lead agencies” responsible for various sectors (e.g. infrastructure, the private sector, the environment, education). The Quick Start Projects were conceived as immediate humanitarian emergency aid, whereas the Near Term Projects represented a transition to the long-term structural aid that is at the centre of the Pact’s work today.

The implementation of the overall goals drawn up by the Regional Table is incumbent upon the three **Stability Pact Working Tables**. They are responsible for steering development measures in the sectors for which they have been formed. The three Working Tables have the following fields of responsibility:

Working Table 1: Democratisation and Human Rights

The purpose of Working Table 1 is to anchor democracy by building up modern institutions: the development of modern legal systems under which human rights are observed and minorities protected, the organisation of the return of refugees and displaced persons and the promotion of a free media can only be guaranteed by sufficiently strong state institutions that are genuinely, and not just nominally, able to intervene in their areas of jurisdiction. This also requires an effective judicial system, which can enforce administrative decisions.

Working Table 2: Economic Reconstruction, Development and Cooperation

The central task of Working Table 2 is to secure the basis for the economic subsistence of the region's populations by promoting the transition from a planned economy to a market economy. In this context, economic reconstruction is particularly important in the key sectors energy, water supply, traffic and transport, communications, financial systems, vocational education and business and community associations. More weight will gradually be given to ensuring the acceptance of environmental concerns as a cross-cutting task. Rebuilding social infrastructure is also of central significance: elements of state welfare provision, school systems and health care provision need to be developed as rapidly as possible. The precondition for the sectoral aid envisaged is the development of modern administrative systems. Initially, these must be helped to satisfy the minimum standards expected of them: for some time, the emphasis will be on ensuring that decision-making processes are rapid and untainted by arbitrariness. From the beginning, ambitious goals were set in this area. For example, active minority protection, a great challenge for countries with only superficially pacified inter-ethnic conflicts, is the precondition for internal security in many of the states and territories of South Eastern Europe and is therefore to be developed as a priority. Another essential focus is support for regional networking and, building on this, the region's progressive integration into the European and global economies.

Working Table 3: Security Issues

The goals of Working Table 3 are the development of democratically led military and police structures, the reform of legal systems, the stabilisation of domestic security and the disarming of former rebels. This is a particularly important task given the fact that development processes can only proceed undisturbed in a peaceful environment.

5. The role of the Federal Ministry for Economic Cooperation and Development: financing and planning economic reconstruction

Within the German government, responsibility for the activities taking place under the Stability Pact is principally assigned to the Federal Ministry for Economic Cooperation and Development and the Federal Foreign Office. The Federal Ministry for Economic Cooperation and Development has the primary responsibility for economic reconstruction (Working Table 2). As about two thirds of Stability Pact funds are spent in this field, the Federal Ministry for Economic Cooperation and Development administers by far the largest share of German Stability Pact funds.

For the years 2000 to 2003, the Federal Republic of Germany made available a total of approximately 615.4 million euros of special funds for projects and programmes under the Stability Pact. It therefore pays almost seven percent of the Pact's expenditure and is the second-largest bilateral donor among the individual states after the USA (almost 19 percent). The Stability Pact funds have now largely been committed, i.e. either already spent or earmarked for the continuation of current programmes. Due to its primary responsibility for economic cooperation, the Federal Ministry for Economic Cooperation and Development can also promote development goals in the states and territories of South Eastern Europe using its own funds, i.e. the budget allocated to it on a regular basis under the German Budget Act for the performance of its duties, irrespective of the special funds set aside for the Stability Pact. In the first three years of the Stability Pact, the Federal Ministry for Economic Cooperation and Development spent, in total, about 621.5 million euros. Of this sum, about 385 million euros were special funds designated for the implementation of the Stability Pact. The Federal Ministry for Economic Cooperation and Development has therefore committed about 236.5 million euros of its regular funds to these activities.

In addition to this, the Federal Ministry for Economic Cooperation and Development has worked with its implementing agencies to create its own structures, which are intended to identify particularly suitable projects and ensure optimal coordination with other actors at the project level as well. For instance, the German Office for Reconstruction and Development (GORED) based at Pristina in Kosovo is run jointly by the Deutsche Investitions- und Entwicklungsgesellschaft (DEG), the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) and the Kreditanstalt für Wiederaufbau (KfW). GORED's role is to propose rational and expedient projects to the Federal Ministry for Economic Cooperation and Development and ensure coordination with other international organisations on the ground. The Ministerial Task Force for the Reconstruction of South Eastern Europe (AgWSOE), founded at the initiative of the Federal Ministry for Economic Cooperation and Development in 1999, has undertaken preliminary conceptual work and improved coordination within the German government.

However, Germany is not just involved in reconstruction in South Eastern Europe as a bilateral donor, but also plays a considerable part indirectly through the contributions it makes as a member of various bodies (e.g. the EU, the OSCE). Germany works within the relevant bodies, helping decide about the activities undertaken by the European Union and multilateral organisations, which are then implemented in line with the procedures of these bodies. The international organisations in turn are also members of the Stability Pact, and coordinate their efforts through its organs.

The involvement of the Federal Ministry for Economic Cooperation and Development in these international institutions is not restricted to financial contributions. One example is its participation in the European Agency for Reconstruction (EAR), which was established by the European Commission and is responsible for the organisation and implementation of EU support for Serbia, Kosovo, Montenegro and Macedonia. The Federal Ministry for Economic

Cooperation and Development has held the lead role for the German mandate on its governing board since 2001. It would not be possible for the bilateral activities of the Federal Ministry for Economic Cooperation and Development to make a satisfactory impact if it failed to take account of the parallel commitments made by other parties, especially financially strong donors like the EU, and if it did not make an appropriate contribution to shaping their activities.

At the first Regional Conference in March 2000, the international donor community made 2.4 billion euros available for the first phase of the Stability Pact, the Quick Start Package. In October 2001, at the second Regional Conference, a further three billion euros were pledged, of which about 2.4 billion were just for infrastructure projects and 0.5 billion for refugee return. By contrast, at the most recent meeting of Working Table 2 (Economic Reconstruction and Development) in Sofia (June 2002), the focus was on infrastructure projects. In this field alone, 46 projects with a volume of 3.47 billion euros are being implemented, of which more than 80 percent will be underway by the end of the year.

6. The evolution of the Stability Pact: from humanitarian aid to sustainable structural development

Although the basic concept of the Stability Pact has remained unchanged since its establishment, its role and the attitudes of the individual actors are in a state of constant flux. The dynamic development seen in the states and territories of South Eastern Europe makes ongoing adjustment indispensable. There was still a very great need for emergency aid in the initial phase, but today the Pact focuses more on modernisation and integration. This is only possible because, from the outset, parallel to humanitarian aid in the strictest sense, investment in all key sectors was based on sustainable concepts. The framework within which this special concept has been implemented is the Quick Start Package (QSP).

The QSP was launched by the Special Co-ordinator of the Stability Pact, Bodo Hombach, at the first Regional Funding Conference on 29 and 30 March 2000 in Brussels. The QSP approach was based on the idea that only simultaneous intervention in all closely related sectors would lead to a perceptible improvement in the overall situation. It was evident from the beginning that it would take some time to bring about an irreversible structural transformation. What the QSP was all about was winning over the populations of the states and territories of South Eastern Europe for the reform process with measures that would make a rapid impact.

Subsequent implementation can only be regarded as highly successful. Despite the difficult conditions that all projects had to contend with during the initial period, the vast majority of the planned activities were implemented on schedule. This is shown clearly by the disbursement of funds. For example, more than half of the total funds pledged for the four-year duration of the Pact were spent within the first year; in the area of refugee return, the figure was in fact over 70 percent. As funds can only be disbursed if, once a project has been formulated, it is possible for the planning work to be carried out without major delays, these figures document considerable successes in an environment that is extremely difficult to gauge. Later projects have benefited tremendously from this strong thrust during the initial period.

Some examples of QSP activities will illustrate the wide range of tasks that confronted the international donor community and the target countries themselves.

6.1 Democratisation and human rights projects (Working Table 1)

- **The Szeged Process**

The democratisation of Serbia was promoted while the Milosevic regime was still in power with targeted assistance provided to opposition forces. To

stabilise pro-democracy local government structures, opposition-led local authorities were given humanitarian aid and technical support. This took the form, above all, of petrol deliveries, support for medical services, the training of local officials and the coordination of local authorities through town twinning schemes. Aid was also directed at the independent media, which required assistance to resist the dictatorship of the Milosevic regime. The priority areas were the provision of funds for the necessary hardware (printing materials) and legal protection.

- **Refugee affairs**

The integration of returnees and measures to motivate people to return were an urgent necessity in view of the mass population movements during the conflicts. One example is the “Integrated Return Programme for BiH”, which alone received 114 million euros funding. Under the QSP, a total of 234 million euros were provided for this field. The return of refugees cannot always be planned. For example, the numbers of returnees rose abruptly after the changes of government in Croatia and Serbia. Despite the immense funds that were made available for these activities, demand has exceeded the available capacities again and again in such phases.

- **Human rights and national minorities**

The ambitious aim in this field was to secure adequate legal protection by eliminating discrimination and raising awareness of this and related issues, above all among decision-makers. Practical measures to promote a democratic civil society have been complemented by research projects.

- **Gender equality**

The main aim of the work on this issue has been to increase political participation by women. The funds deployed have been used for campaigns, gender equality training courses for young women politicians, legal advice (reforms to electoral law, promoting the mainstreaming of the goal of gender

equality in the constitutions of the states of South Eastern Europe) and the strengthening of networks of politically active women.

- **Media**

The goal in this area has been to secure the highest international standards of freedom of the press. Particularly after the political experiences of the period of crisis, it was of outstanding importance to improve the framework of media law and foster the economic independence of the media. There has been a particular need to promote access to information, an important precondition for critical reporting but not self-evident in the former socialist states. Reporting ethics in line with the changed conditions also had to be developed in the new unions and associations of journalists.

- **Parliamentary cooperation**

The projects in this field have been aimed at strengthening the region's parliaments in their role as counterweights to government, and as the bodies that have the authority to scrutinise the actions of the executive. Progress has mainly been achieved through regional seminars and dialogue in international representative bodies. A network of parliamentarians from South Eastern Europe has been founded with the European Parliament. These efforts have proved effective, above all in the policy fields of education, refugee return, minority affairs and trafficking in human beings.

6.2 Economic reconstruction projects (Working Table 2)

- **Trade**

In this field, the Task Force on Trade Liberalisation and Facilitation devised projects that can now be assessed very positively. The preliminary work that was performed within the scope of these projects made possible the adoption of a memorandum of understanding by the states and territories of South Eastern Europe in which concrete steps towards interregional trade

liberalisation were laid down. Among other things, this has led to the creation of the free trade zones since agreed, which are of great significance for economy recovery and foreign investment.

- **Regional infrastructure**

The infrastructure sector is of great significance for overall development. Funding needs are high and implementation phases long. Again and again, unrealistic expectations arise in this field. In general, funds are disbursed much more slowly than in other project categories because funding is only released in parallel to the actual design and construction work. Further problems on the recipient side are the lack of legal clarity on ownership issues, incomplete arrangements with parties who have to be involved concerning the details of project implementation, bureaucratic obstacles and the like. On the donor side, there are often complaints about excessively expensive and time consuming procedures for granting funds and insufficient control over the progress of the actual project implementation. Against this background, and despite some delays, it is fair to say that the projects in this field have been successful, measured against the specific intentions of the QSP. Important sectoral analyses have been carried out (air traffic, transport, energy and water supply), the results of which have been available for use in further planning and have noticeably improved how the most necessary changes are defined.

- **Development of the private sector**

From the beginning, the priority areas in this sector were cross-border trade, investment in SMEs and the creation of a secure environment for the latter. The well defined projects achieved a rapid impact. Mention should be made, in particular, of the EBRD's trade diversification programme and the Southeast Europe Enterprise Development Programme run by the International Finance Company (IFC). Micro Enterprise Banks (MEBs), one of the approaches specially developed and promoted by the Federal Ministry for Economic

Cooperation and Development, were initially established in Bosnia and Herzegovina, Kosovo and Albania. Subsequently, further MEBs were launched in Macedonia, Romania and the Federal Republic of Yugoslavia.

- **Environmental concerns**

To begin with, attention was paid primarily to the identification and cleaning up of “hot spots” to prevent further irreversible damage in particularly polluted areas. Great significance was also attached to the prompt adoption of environmental development goals as a decision-making category when building up modern legal structures and administrative bodies.

6.3 Security Projects (Working Table 3)

6.3.1 Sub-Table on Security and Defence

- **Arms control and non-proliferation**

The most successful of the projects in this field must be the Regional Arms Control Verification and Implementation Assistance Centre (RACVIAC) in Zagreb, which was opened in October 2000. A multinational team works at the Centre, which provides seminars and vocational education programmes for its partners in the region with a view to encouraging the negotiation of arms control agreements and contributing to general confidence building.

- **Humanitarian mine clearance**

These projects were intended to provide support for the clearance of landmines in Croatia, Kosovo and Bosnia and Herzegovina. A parallel European Commission project was also implemented with a budget of 19 million euros. At the beginning, the declared goal was to have removed all mines by the end of 2001. Today, the areas affected are still not free of mines to an extent that would allow people to walk on all areas of land away from roads without risk. However, the numbers of accidents involving mines have

dropped significantly since these activities began, and such incidents are today rare exceptions.

6.3.2 Sub-Table on Justice and Home Affairs

- **Fighting corruption**

Encouraging successes in the fight against corruption were already being achieved during the set-up phase of this project. The first tangible changes came very early on: the recruitment of senior experts, the establishment of inter-ministerial teams and the mobilisation of a network of non-governmental organisations are important examples of successful intervention in the central institutions of public life. Through their consultancy services, the external experts have helped to take stock of the need for modernisation and institution building. The first concrete measures have been agreed with the partner countries on this basis.

- **Fighting organised crime**

The measures taken under the QSP concentrated initially on the drugs trade. This was the most promising area to develop a regional approach at that time because, regardless of the other tensions between the countries, unanimity could be reached in this area, and there was also a general interest in appropriate border controls for other motives. The fight against crime continues to face great difficulties: efficiency is often attained at the cost of the rule of law. Concept development must thus be closely linked to the further evolution of the legal system and institution building, in particular the development of police forces, public prosecution services and courts. Even in Western Europe, which now has a long tradition of self-restraint in the use of force by the state, this balancing act frequently causes difficulties. It should be recalled that Europol too is a very young institution that, despite long preparatory work dogged by massive controversies, is still the subject of considerable criticism today. An intensive, ongoing dialogue is also required in

this field concerning the integration of the states of South Eastern European into European structures.

The QSP has achieved visible successes very rapidly. In particular, the political transformation in Serbia, which was given a major boost by the Szeged Process, was an indispensable precondition for the recovery of the region as a whole. The idea of sustainability played a major role as early as the definition of the Quick Start projects. In the subsequent period, it has increasingly been a question of securing and consolidating successes achieved, and helping the positive impulses to develop their own momentum.

7. Sustainability: projects funded by the Federal Ministry for Economic Cooperation and Development

In substantive terms, the Federal Ministry for Economic Cooperation and Development harmonises its priority areas with the overall process of the Stability Pact and, at the same time, is particularly committed to making regional cooperation a reality. Within the framework of the Ministry's sectoral development work, projects that presuppose the establishment of unanimity between various states and territories and create positive mutual dependencies are selected as often as possible.

[Kasten]

Important examples of cross-border projects

- Expansion of the Macedonian/Bulgarian interconnected electricity grid
- Kosovan/Montenegrin road infrastructure
- Investment promotion (KfW/DEG)
- Albanian/Macedonian/Kosovan interconnected electricity grid

- Healing of war trauma among women and children
 - Conservation of natural resources along the Macedonian/Albanian border
 - Environmental protection and promotion of tourism on the Adriatic coast
 - Construction of a bridge over the Danube between Romania and Bulgaria
 - Regional projects run by the German political foundations
 - Regional adult education project (German Adult Education Association)
 - Regional project promoting cooperative structures
 - Professional development courses for journalists
 - Professional development for environmental experts
-

These projects all belong to sectors that had been made priorities in any case, so each project would also have qualified for funding solely due to its direct impact. Cross-border regional cooperation has improved considerably, not least on account of these activities. As a consequence of this approach, which is also favoured by other bilateral and multilateral donors, the region's heads of state and government now meet regularly to resolve their common problems.

To pursue this course rigorously and to exploit other synergies, preference will continue to be given to projects

- from which several countries in the region can expect to benefit, even when a country-specific approach is adopted, so that cooperation efforts can be expected;
- that can promote competition among the countries of South Eastern Europe;
- that harmonise with the projects of other Stability Pact donors in terms of approach;
- in which Germany's strengths (clear policy orientation, well organised

institutions, strong private-sector actors, implementing agencies with a wide range of experience) can be used;

- that facilitate immediate or medium-term involvement of private investors (public private partnerships);
- that meaningfully complement other ongoing measures currently being taken by the Federal Ministry for Economic Cooperation and Development.

The particular fields of action of the Federal Ministry for Economic Cooperation and Development are identified taking account of these aspects and of the goal of achieving self-sustaining development at some point.

7.1 Priority area: market economy reforms

The Federal Ministry for Economic Cooperation and Development and its partners had already gathered extensive experience giving assistance to the transition states of Eastern Europe and supporting the move from a planned economy to a market economy by providing **legal advisory services**.

Consequently, they were able to draw on a pool of tried-and-tested consultants for their cooperation with the target countries of South Eastern Europe. The seconded experts have focused on the priority areas of the law of ownership, customs law, tax law and banking systems, and have made substantial contributions in these fields.

Trade barriers, for instance, must be dismantled if there is to be an increase in interregional trade. This also fosters the expansion of foreign trade relations, which is why it has been a focus from the outset in all target countries. One important sub-goal was to allow foreign investors to purchase land, something that had not hitherto been self-evident in the territories of former Yugoslavia. As in many socialist states, the principle that only the state itself could own land on its territory applied in former Yugoslavia. Some reticence to removing these

barriers persisted for some time after socialist principles had been abandoned in the region. As well as producing detailed proposals for the new legal arrangements, the German advisory services have had a catalysing effect in this field.

The Federal Ministry for Economic Cooperation and Development is also supporting the **fight against corruption** in all the states of the region. This is being done by building up relevant administrative capacities, promoting the development of audit institutions (Montenegro) and providing assistance for the bodies charged with banking supervision (Serbia).

Another priority area where a sustainable approach is already being followed is **employment promotion**. The Federal Ministry for Economic Cooperation and Development is conducting extensive vocational education measures through its implementing agencies in Albania, Bosnia, Croatia, Serbia and Kosovo. For example, working teachers are being given in-service training, and attempts are now being made to gradually improve the university training of vocational school teachers. In this way, a direct improvement in vocational qualifications is being achieved, so that more of the qualified personnel urgently needed are available to domestic small and medium-sized enterprises as well as to projects set up by foreign investors.

The Federal Ministry for Economic Cooperation and Development is supporting the **privatisation** of state-owned and nationalised enterprises in most of the countries taking part in the Stability Pact. The significance and difficulties of this process are clearly illustrated by the ongoing cooperation with Serbia.

[Kasten]

Case study: Serbian Privatisation Agency

Privatisation and the creation of a new ownership structure are key areas for the revitalisation of economic life. The Serbian government, which finds itself under considerable pressure to succeed, therefore asked the international community to support an ambitious programme of privatisation. This privatisation programme is seeking to transfer the ownership of state companies completely into private hands.

Essential legal foundations were laid at the beginning of the project implementation phase: the Privatisation Law, the Privatisation Agency Law and the Shares Fund Law had already come into effect by mid-2001. The Privatisation Law provides for three procedures:

- International invitations to tender will be issued for, at present, 150 selected companies, the majority of which are very likely to attract the interest of strategic investors.
- 38 large, loss-making companies will initially be subject to restructuring measures (demerger). Only following this will decisions be made about the privatisation procedure to be applied.
- The vast majority of small and medium-sized enterprises, of which about 7,000 were state owned at the beginning of the project, will be privatised by auction.

The law on the establishment of the Serbian Privatisation Agency (SPA) regulates the institutional framework within which these procedures are to be carried out. A predetermined proportion of the shares in the companies is earmarked for transfer to the workforce free of charge. This is intended to win the support of the population, particularly for the privatisation of publicly-owned companies, because the Serbian government is afraid of sparking unrest with such an attack on traditional vested interests. The people who work in these

companies still feel themselves to be the real owners of “their” enterprises. Concepts to absorb the shock of job cuts, which will be inevitable in the course of privatisation, need to be developed in this field.

The Federal Ministry for Economic Cooperation and Development’s main contribution will be to train the staff of the Serbian Privatisation Agency. They do not yet have the knowledge and experience they will need to implement the planned privatisation programme rapidly and transparently in view of the difficulties to be expected. German-Serbian technical cooperation is to focus primarily on consultancy services to support privatisation by auction. In April 2002, the Serbian government and the Federal Ministry for Economic Cooperation and Development agreed on the urgent preparation and implementation of the project. On behalf of the Federal Ministry for Economic Cooperation and Development this work will be performed by the GTZ, which concluded a memorandum of understanding (MoU) with the Serbian Ministry of Economy and Privatisation in the summer of 2002. The MoU took the place of a standard project agreement and ensured that the measures taken by the Serbian side will harmonise sufficiently with the support services provided by the GTZ. The involvement of the Federal Ministry for Economic Cooperation and Development is being coordinated with the commitments made by other donors in this sector. The funding promised by the World Bank and USAID, for instance, concentrates on tendering and restructuring procedures, while the UNDP – also financed by the Federal Ministry for Economic Cooperation and Development – is contributing to organisational development (capacity building).

One important instrument used by the Agency is a transparent investor information system with accompanying public relations work. Professional public relations will be required in order to achieve acceptance for this system among the target group of potential investors. Serbia’s image as a location for investment will be developed further in a purposeful fashion: the country is still too closely identified with its wartime role. The hope is that Western European

investors will gradually become more aware of the developing business environment in Serbia.

Alongside this, a monitoring system for the development of auction contracts will be built up that will provide for the systematic improvement of the types of contract and their adjustment to this special situation as it continues to unfold. By these means, the SPA will become a trustworthy partner for interested investors from Serbia and abroad. A high level of specialist expertise, transparent procedures and a reliable information policy towards all concerned will form the basis for the transition to the market economy, while minimising the potential for conflict and maximising the benefits to all parties.

Small and medium-sized enterprises (SMEs) also have an outstanding role to play in the economic recovery. They plant the seeds of healthy, domestically managed development by creating jobs, promoting entrepreneurial initiative and reinvesting their profits. They are flexible, and some belong to effective international networks. By contrast with the large companies in state or public ownership, there is far less need for SMEs to reform their own structures. In addition to this, there are large numbers of them in the region. For example, before the outbreak of hostilities the corporate sector in Kosovo basically consisted of three groups, all of which have suffered considerably as a result of the military conflict:

- a large number of small private family farms that originally fed about 60 percent of the population, but now feed only about eleven percent as a result of the losses sustained during the war;
- a relatively small number of private companies in the trade and service sectors that resumed their activities again immediately after the end of the fighting

although, given the lack of official regulation, they overwhelmingly operate in the informal sector;

- and approximately 200 state enterprises, including 66 large enterprises (mining, metalworking, raw materials extraction, semi-finished goods production, agribusinesses and construction).

This underlines the need to act rapidly. Despite high levels of demand, the growth prospects for small and medium-sized enterprises were limited. The constraints resulted partly from their limited access to advanced technological know-how and modern management methods, but more importantly from their difficulties in gaining access to financial services. The so desperately needed impetus for economic revival threatened to slip away. Consequently, and not least with this clientele in mind, the Federal Ministry for Economic Cooperation and Development has promoted the banking sector in Albania, Kosovo, Montenegro, Serbia and Bosnia as a matter of the highest priority. Two approaches have been followed: on the one hand, the rehabilitation of the ailing major state banks; on the other hand, the creation of effective new decentralised structures.

[Kasten]

Case study: The Micro Enterprise Bank

The Micro Enterprise Bank (MEB) was founded on 12 January 2000, since when it has begun work in Pristina, Prizren and Peje, as well as four other towns. This project, which was initiated by the KfW and substantially supported with funds from the Federal Ministry for Economic Cooperation and Development, was set up in record time. So that the MEB could be founded, UNMIK worked together with the IMF (financed by USAID) to create the legal foundations for the licensing of banks (Banking Regulation) within a short period of time. The owners of the

MEB entrusted the management of the bank to a German consulting company that had already been involved in consultancy work for FEFAD (Foundation for Enterprise Finance and Development) in Albania and the MEB in Bosnia and Herzegovina. The MEB Kosovo's main areas of activity are domestic and foreign payment transactions and the provision of loans.

The first branch opened in Pristina on 24 January 2000, attracting a great deal of Kosovan and international interest. The MEB was not just Kosovo's first commercial bank, but for a long time the only one in the province.

The MEB Kosovo's focus on small and micro enterprises is laid down in its founding documents. It is assured by the presence of donor organisations on the bank's supervisory board. What are problematic are the relatively high effective annual interest rates on its loans of up to 22 percent per annum: they are geared to the risks involved in granting small and micro loans in Kosovo and it will not be possible to reduce them in the near future. Due to these necessarily high rates of interest, the loans issued by the Micro Enterprise Banks still do not meet the needs of certain groups of clients. There are therefore back-up programmes for the granting of loans to SMEs that allow credit to be obtained on acceptable terms thanks to subsidised interest rates. Revolving funds have been used for credit programmes of this kind so that donor funds are neither depleted, nor do they have to be handed over to insecure structures in the recipient country. These loans best fulfil their development policy purpose when, on the one hand, they can actually be taken out by the clients and processed in an orderly fashion but, on the other, the creation of an artificial climate as a result of excessive subsidies is prevented. Ongoing efforts are being made to optimise these instruments.

The MEB's business development is exceeding all expectations: the bank now has seven branches with 200 employees and handles more than 40,000 accounts. The MEB's success has also impressed the EU, which has provided

the bank with credit lines to a value of three million euros through the KfW. In this way, the Federal Ministry for Economic Cooperation and Development and the KfW have achieved a very great deal with a modern instrument and limited financial expenditure.

7.2 Priority area: upgrading and modernising local services

Over the last few years, the upgrading and modernisation of local authority services has emerged as a clear priority area for technical cooperation with the partner states of South Eastern Europe. The Federal Ministry for Economic Cooperation and Development has been promoting cooperative projects conducted in close cooperation with the ministries responsible for local development or – where they already exist – the bodies representing local authorities. Increasingly it is also working directly with individual local authorities as project partners. In substantive terms, the projects range from advisory support for national reforms of the legislation concerning local authorities and their administrations to assistance for individual local authorities or the bodies that represent them as they reorganise and modernise specific administrative units. Alongside this, there are also technically oriented projects that aim to rehabilitate urban infrastructure or to outsource or privatise certain local authority services. Lawyers with relevant experience, specialists drawn from all areas of the German local administrations and proven experts in the organisation and provision of specific local authority services are being involved in the projects as consultants. Since all states of South Eastern Europe are striving for eventual membership of the European Union, international and, above all, European developments, directives and standards are taken as the quality yardsticks for the upgrading and modernisation of local authority administrations.

7.3 Priority area: infrastructure development measures

The Federal Ministry for Economic Cooperation and Development funds in

particular economically relevant infrastructure projects (energy, water). Wherever possible, environmental concerns are given special consideration. One outstanding example is the German involvement in the Kosovan energy sector.

[Kasten]

Case study: promoting the energy sector in Kosovo

Kosovo possesses some of the largest lignite (brown coal) reserves in Europe, two coal-fired power stations and a smaller hydroelectric power station. Before the war, about 60 percent of the energy produced was exported to Serbia, Macedonia and Albania. These exports were Kosovo's main source of revenue. After the Kosovo War, the regular energy supply had almost completely collapsed. Although the combined heat and power plants and lignite mines were hardly affected by the actual effects of the war and the fighting, practically none of the installations necessary to supply electricity to the country were still operational when hostilities ceased. The power stations had been barely maintained and repaired in the 1990s. During these ten years of what has been called "Serbian Apartheid", Kosovo Albanians had practically no access to higher status jobs. Consequently, the staff of the power stations consisted exclusively of Serbian specialists. During the war, they all fled from Kosovo, some of them taking documents and mobile devices essential for the operation of the power stations with them when they went. At first, underqualified staff had to improvise with inadequate equipment under unbelievable conditions in order to generate electricity at all.

There were difficulties throughout the supply process, from the extraction of raw materials and operation of plant to grid feed-in, distribution and billing. Electricity bills have only been issued again since the spring of 2000. Moreover, these bills have been based on unrealistically low prices. The electricity company Korporata Energjetike e Kosoves (KEK) was certainly not capable of providing modern

management at the best of times, let alone in such a critical situation. In addition to this, there was no energy policy concept for the entire territory of Kosovo, which had a very high per-capita consumption. Nothing could be done to change this over the short term because there was no energy ministry or any other structure that would have been entitled and able to carry out long-term planning of this kind. At the same time, the energy sector had, and has, a key role in Kosovo. Since a large proportion of the population heat their homes with electricity, rapid action was required in order to prevent people freezing to death in the winter. Furthermore, an adequate, reliable supply was urgently required for commercial users to back up the economic rehabilitation measures. The international community was confronted with a financial and operative challenge.

There has been extensive German development cooperation in the Kosovan energy sector. As early as 1999, cooperation began with commodity aid for the two coalmines at Bardhi and Mirash worth ten million deutschmarks. The main measures were the training of specialists, organisational development and the qualification of KEK staff for management functions.

As far as the overhaul of the power generation plants themselves was concerned, at the beginning of 2000 the KfW identified emergency aid measures that had to be concluded by the end of the year if they were to take effect in time for the heating season the following winter. They included immediate repairs to the Kosovo A coal-fired power station. Although Kosovo A was already over 40 years old by this time and therefore well past its normal operating life, there was no reasonable alternative to this step. In comparison, complete reliance on electricity imports would have been considerably more expensive and, given the limited capacities in the neighbouring countries, would not have been sufficiently secure either. In view of the acute need, building a new power station would have taken far too long and would also have been beyond the donors' budget: the total cost of just the first two project phases of the German programme for the much cheaper rehabilitation of Kosovo A amounted to 26.07 million euros. Parallel to

this, Kosovo B, which was only 15 years old and a great deal more modern than Kosovo A, was thoroughly renovated by the European Agency for Reconstruction (EAR) at a cost of 120 million euros. From the beginning, it was accepted that supplementary electricity would have to be imported during the rehabilitation work. The EU provided another 20 million euros for this in the winter of 2000/2001 alone.

The sustainability of the rehabilitation measures is, by their nature, limited. Sooner or later, the whole sector will require comprehensive modernisation, which will also have to include the construction of new plants that meet EU standards. Measured against the limited targets set, the rehabilitation project has been a success. Initially, it proved possible to increase the overall amount of electricity produced above the levels forecast, so that power cuts could be noticeably restricted following the conclusion of the second of the three phases. The technical equipment for the measurement of electricity consumption was considerably improved, making it increasingly possible for customers to be sent regular electricity bills again. At least, the revenues obtained in this way finally covered the running costs of the power stations. It is almost exclusively due to the still underdeveloped Kosovan legal system that these revenues are not even higher. KEK now has 15,000 civil actions pending against customers who have not paid their bills, but not one case has been decided to date.

The measures taken to improve the sector's environmental impact in the second phase of rehabilitation encompassed the repair and recommissioning of electronic filters and a marked improvement of waste water treatment. Local firms and power station staff worked about 85 percent of all the man hours required, which meant the project had the side effect of making an important contribution to the employment situation in Kosovo.

The fact that the supply situation is still not satisfactory in the winter of 2004/2005 is the result of difficult conditions on the ground and high costs. Repair costs are

put at between 50 and 100 million euros. In view of the fact that, up to this point, Kosovo B had provided 60 percent of the province's electricity, a longer rehabilitation phase will be needed. The Federal Ministry for Economic Cooperation and Development responded with a rapid decision to set about the unscheduled rehabilitation of Blocks 2 and 5 of Kosovo A, for which no plans had been made until then. Block 3 of Kosovo A, which had been kept in "cold reserve", was started up immediately.

UNMIK was extraordinarily grateful for this German involvement, which was the only possible way of reducing the generation shortfall. The looming supply crisis that threatened to have devastating social, economic and fiscal (import costs) consequences for Kosovo was thus successfully averted. All five blocks of Kosovo A are in operation following their successful repair. Initial attempts are already being made to start up the first block of Kosovo B again. However, despite all the efforts, there will continue to be electricity cuts in the winter of 2004/2005.

One current task in the energy sector is the development of a regional energy concept. The intention is to create a regional electricity market in South Eastern Europe by building up a modern infrastructure network. The Federal Ministry for Economic Cooperation and Development and the KfW are doing preliminary conceptual work on the topic and working politically towards this end. At the first major South Eastern European energy conference at ministerial level in Athens in November 2002, a memorandum of understanding was signed that sets such a regional concept as a concrete goal. Apart from the South Eastern European Stability Pact states (with the exception of Moldova), the memorandum of understanding was also signed by Italy, Greece and Turkey. Initially, the aim is to build up a South Eastern European interconnected grid based on the Western European model in order to make energy trading possible and reduce the

dependencies of the individual states and territories on their own resources, which are vulnerable to disruption. In the long term, the region could become a hub that links together the systems in Western Europe and the whole of Eastern Europe. The goal of energy sector regionalisation is extremely ambitious. The resources required to realise it may be available in principle, but so far the infrastructure has not been modernised thoroughly and no far-reaching liberalisation of the markets has been carried out. The special difficulties faced by the states of South Eastern Europe come together here with the traditional structural features of the energy sector: in Western Europe too, energy sector liberalisation is moving forward only under great political pressure and with considerable delays. The sector-specific factors holding back progress include, for example, the lack of technical facilities for the through-transmission of electricity and gas and the failure to adequately develop a suitable contractual system that redefines the relationships between generators, network operators and consumers. Top priority must be given to the political problem of establishing a suitable legal framework for action on the issue.

The efforts necessary are not merely justified by the stabilisation of the supply situation that is to be expected - the interconnection of the individual energy systems also offers political added value: interconnection presupposes regionally coordinated deregulation and will so create a larger, coherent market largely free of trade barriers. One important consequence of the emergence of these restructured markets will be that the sector becomes more attractive to heavyweight foreign investors. The process of sustainable modernisation will require much bigger capital injections than even multilateral donors could ever provide. This increase in attractiveness is therefore quite indispensable if the more ambitious plans that are now on the agenda are to be realised.

Binding agreements between the governments of the region on the coordinated privatisation and deregulation of this sector will lead to an acceleration of these processes in each individual country.

For its part, systematic privatisation will create further synergies, as is clearly shown by the example of the measures taken to correct price distortions in an effort to move towards the introduction of market-oriented tariffs. Shifting the interest in economic efficiency onto private companies will result in very positive domestic pressure coming to bear on the governments of South Eastern Europe. If, in addition to this, the individual governments can then point to their obligations towards their neighbours, political reservations will be weakened by constructive arguments based on practical constraints. The positive developments to be expected in this area will also be perceived by the populations themselves, and will thus promote confidence in the reconstruction process as a whole.

In principle, all stakeholders agree that, due to its significance and despite its complex problems, the energy sector can become a driving force in economic recovery. The Federal Ministry for Economic Cooperation and Development will therefore continue to assist it as a priority regardless of all the difficulties.

7.4 Priority area: promotion of tourism

Another priority area for economic cooperation, in particular with Croatia and Montenegro, is tourism. The significance of these measures for structural development should not be underestimated: international tourism is one of the most rapidly growing and, at the same time, most labour-intensive sectors of the world economy. Following the decade of conflict in the region, Croatia and Montenegro, two traditional tourist destinations, are currently endeavouring to restructure their tourist industries and develop a new level of competitiveness by concentrating on quality.

Against this background, the DEG was commissioned by the Federal Ministry for Economic Cooperation and Development with the development and subsequent implementation of an "Integrated Overall Regional Approach to the Restructuring

and Development of Tourism in Croatia und Montenegro” (Master Plan). The Master Plan intends to protect the outstanding tourist potential of this coastal region. This is being done, above all, by drafting spatial and land-use plans, which will prevent new settlements along the coastline and uncontrolled building. The aim is to create solid tourist infrastructure that takes environmental concerns seriously from the outset. As an integrated approach, the Master Plan covers all the relevant areas of the tourism industry. These include transport infrastructure, local authority infrastructure and human resources. At the moment, a series of model projects are being prepared with the aim of supporting and establishing sustainable quality tourism in the region. The drafting of a concept for Montenegro’s market presence should enable the Republic to present itself as a distinct brand on the market. Regional and, indeed, cross-border development plans for individual sub-destinations are based on new quality standards and encourage the broad involvement of the private sector along the lines of the public private partnership (PPP) model. All these measures are being carried out in close cooperation with the ministries responsible in Croatia and Montenegro.

7.5 Priority area: healing war trauma

One special focus is the “Trauma and Reconciliation” approach, which supports women, children and young people in Kosovo, Bosnia and Herzegovina and Serbia who have suffered trauma as they come to terms with their experiences of conflict. Individuals must overcome the consequences of torture and war crimes. The primary goal of this individual approach is to alleviate the suffering of those most severely affected. Other measures are being used to pursue an approach that takes more account of the social dimension. It should be realised that the tensions between ethnic and social groups were not just triggers of conflict: to a certain extent, the group identities that appear so unshakeable today only became stronger as a result of the distribution of roles in conflict situations. Ethnic and religious discrimination have no place in a modern society. All groups are equally dependent on the recovery of the states they live in and the creation of a basis for individuals to pursue satisfying goals in life. Questions of ethnic or

religious identity should not continue to determine people's chances of success. It is of outstanding significance that alternatives to these victim-perpetrator identifications are offered. Otherwise, belonging to an ethnic group will remain the essential criterion of political orientation. In order to achieve progress in this area, it is most important for the victims to come to terms with the wounds of the war years. This also includes the punishment of crimes that have been committed and at least an attempt at restitution. Moreover, these aspects of the issue must be incorporated into the development of new civil cultures with a high awareness of current problems. Building a modern, non-discriminatory sense of belonging to communities with real shared interests, through the establishment of business groups, trade unions or chambers of commerce, for example, makes an important contribution to the reduction of tension in the region, even if this is not always immediately apparent.

8. The Federal Ministry for Economic Cooperation and Development in the Stability Pact - innovations in economic cooperation

One important factor in the early phase of the Stability Pact was the speed of the project planning work. With the normal economic cooperation procedures it would not have been possible to get projects on this scale under way as quickly as possible. Later, we had to adjust repeatedly to the rapidly changing conditions in the countries of South Eastern Europe. For this reason, the German special funds provided for the Stability Pact are allocated following greatly simplified procedures. In many cases, the tried and tested development cooperation methods tailored to the specific needs of "classic" developing countries would not have offered the flexibility needed in this difficult, dynamic environment.

For example, the **decision to do without government negotiations** did a great deal to speed up procedures. This made it possible for the priority areas of development cooperation and of individual projects to be discussed and defined

in more informal working groups. In Bosnia for example, this approach meant it was not necessary to negotiate with all the entities and the central government, and enormously accelerated many processes.

Another special feature of great practical significance is the allocation of the **Stability Pact funds to special budget items** in conjunction with the four-year **term of the Pact**. This concept has given the Federal Ministry for Economic Cooperation and Development the stable basis needed for the planning of the programmes to be implemented in the region, without which larger projects would have been inconceivable.

Special arrangements have been made for **inter-ministerial cooperation** in connection with the Stability Pact, and this cooperation follows considerably simplified special rules. In standard economic cooperation procedures, interdepartmental coordination has to be carried out on a case-by-case basis for every project, but when Stability Pact funds are deployed, the **overall framework planning for the region as a whole** is coordinated in a **steering committee** with representatives from the Federal Ministry for Economic Cooperation and Development, the German Federal Foreign Office and the German Federal Ministry of Finance. Using this as a basis, the individual projects can then be implemented without further consultation or coordination. The fact that coordination is required at all is due to the fact that, under certain circumstances, a BMZ private sector promotion project may only make sense if other projects have already been implemented in an area that is the responsibility of another actor, such as the development of a new courts system. The ministries that are not primarily responsible for a planned project should therefore have the opportunity to comment on it from the perspective of their own specialist expertise. Given the hardly manageable scale of the activities taking place under the Stability Pact, this would be quite impossible purely on time grounds. The special arrangements put in place remedy this situation without completely abandoning coordination, which is worthwhile in itself.

Further aids to effective planning and coordination include what are known as **regional and country concepts** and **sector strategy papers**, on the basis of which the individual projects are formulated. Instead of these draft documents, **informal working papers** on the target countries in the Stability Pact are drawn up as the basis for planning work and can be **continually updated** without a great deal of coordination. Apart from speeding up the process, this also takes account of the dynamism of the change taking place in these countries.

One quite major development policy achievement under the Stability Pact has been the newly created option of setting up **revolving regional funds**. Regional funds are not permitted in regular economic cooperation, since it is not possible to put a figure on the share of a fund that can be promised to any individual partner country. However, they create competition between the target states in individual sectors and make it possible to respond effectively and flexibly to acute needs at very short notice. This conception has found application in various contexts. At the moment, ways are being sought to apply the lessons learned from these experiences to normal economic cooperation and convert it into forms that will also have an impact on the countries of South Eastern Europe once the Stability Pact has come to an end.

Building on what has been achieved so far, a rise in the use of public private partnerships offers further new opportunities. A major impact is also achieved with comparably little financial outlay when development policy donors support private-sector investment projects.

[Kasten]

Case study: Berlinwasser and Elbasan (Albania)

One particularly successful example is the cooperation between the German

company Berlinwasser and the public water utility in Elbasan (Albania) to rehabilitate the local water supply. As one of the poorest countries in Europe, which was just emerging from a long era of particularly rigid centralist communist government, Albania had very little experience to contribute to such an ambitious undertaking. From the standpoint of the German partner, investing in a pioneering project of this kind was a brave decision that has been rewarded with the total success that can be seen today. New cooperation arrangements will benefit enormously from the valuable experience gained from coping with the difficulties thrown up by this pilot scheme.

Another example is the involvement of the German Commerzbank as an investor in the MEB Kosovo project. It is increasingly apparent that this approach is becoming increasingly simple and more attractive and that it will in the foreseeable future account for a considerable proportion of German economic cooperation. However, the preconditions for targeted action to increase foreign companies' willingness to invest do not just include reliable backing for the individual projects, but also a minimum degree of predictability as far as sectoral aid is concerned.

It is important for those who take decisions about development policy to look at issues from the point of view of investors. Foreign private investors currently view the prospect of getting involved in South Eastern Europe as a question of weighing up risks: the advantage of establishing a presence on rising markets in good time as against the potential disadvantage of having funds tied up ineffectively due to delayed economic success. This particular entrepreneurial risk becomes more calculable if investors can be confident that the donor countries are committed to intensive, long-term involvement in the region. A reliable basic electricity supply, an adequate transport system, an orderly legal framework, including a functioning courts system, reliability in the banking sector

and smooth cross-border traffic are especially significant for investment decisions. At a superordinate level, it is necessary to carry on working systematically towards compliance with European structures. Initially, this will involve mainly removing interregional trade barriers. One of the most important preconditions for future projects on a larger scale is that foreign investors are able to perceive South Eastern Europe as a unified economic area. In future, it will be necessary to consider the extent to which the positive experiences donors have had in this region can also be applied to normal development cooperation.

9. The target countries in the late phase of the Stability Pact

Conditions in the region's countries today are just as varied as their original situations. An overview of developments in the different states and territories up to the beginning of 2003, the last year of the regular term of the Stability Pact, shows clearly what an enormous amount has been achieved, but also how much remains to be done:

Serbia

The Federal Ministry for Economic Cooperation and Development commenced cooperation with Serbia at the end of 2000, directly after its acceptance of democracy. A very rapidly assembled package of emergency measures encompassed aid for the energy sectors, local authority institutions and the health system. Later, priority areas were defined for the water supply sector and the rehabilitation of lignite mines and power stations, fields in which sustainable approaches were already being followed. Aid measures to raise the minimum level of welfare services and material provision for some communities with high proportions of refugees continue to be required to the present.

One important political move signalling the irreversibility of the democratisation process was the extradition of former president Milosevic to the International Criminal Tribunal for the Former Yugoslavia in The Hague on 28 June 2001. At

the political level, commitment to comprehensive reforms aimed at establishing market economy structures is not a contentious issue. However, the running conflict between the Serbian prime minister, Djindjic, and the Yugoslav president, Kostunica, which can be exemplified above all by their attitudes to the pace of reform, demonstrates that there are nevertheless controversial discussions going on about matters of detail. The Serbian presidential elections in October 2002 demonstrated that no clear majority opinion has crystallised in the population. No result was reached in the first round of voting and the subsequent run-off elections were declared invalid on account of the low turnout.

Nevertheless, for all the conflicts about the pace of reform, Serbia is following a comparatively brave course and has already undertaken far-reaching measures. For instance, the first thing done was to introduce a reform of the financial sector that has now instilled remarkable discipline: money is no longer printed without backing and even companies close to the government are no longer granted unsecured loans. In the field of public services, such as energy supply, the unpopular decision was taken to raise prices in order to achieve a level of tariffs commensurate with market prices in the medium term, and thus make the sector attractive to foreign investors.

The Federal Ministry for Economic Cooperation and Development has deployed considerable funds to advise the Serbian government, which has supported this reform course and will continue to promote it. The central issues have been the promotion of small and medium-sized enterprises, local authority services, legal reform, the financial sector and financial administration, vocational education, privatisation and foreign trade relations.

The Serbian government is pursuing a course that is to be welcomed, on the one hand, creating sufficient pressure for reform, but on the other, not making excessive demands on the population. This is a political balancing act that will demand a great deal of Serbian politics and the diplomacy of the donors. One

important task for Serbia's politicians in future will also be to convince the population of the need for reforms and ensure that even processes of change that entail social hardship have the support of the people.

Kosovo

The question of whether the territory will remain part of Serbia or whether, as demanded by the overwhelming majority of Kosovo Albanians, it will be granted autonomy is still undecided and hangs over the situation in Kosovo. The issue of Kosovo's unclarified status is obstructing many important development processes. Kosovo has no government capable of entering into alliances and making agreements with other states that would be effective under international law. Neither is it *de facto* subject to the control of the Serbian government. Essentially, the discussion is dominated by continuing ethnic tensions, which have not eased even following the flight of most Serbs from Kosovo. The Serbs who live in enclaves in Kosovo today would still be endangered without the permanent protection afforded by the KFOR troops, although ethnically motivated attacks are becoming less frequent. After the long period of "Serbian Apartheid" in the 1990s and events during the war, reconciliation is hardly likely to be achieved in the foreseeable future. The sole solution can be to manage the conflict through civilian channels.

The only gradual consolidation of peace is blocking Kosovo's economic recovery. The still underused potential for the development of foreign trade relations cannot be exploited on account of the ongoing insecurity. The balance of trade is still extremely poor. In 2000, imports worth 1.2 billion US dollars compared with exports worth one million US dollars. Furthermore, Kosovo was, and is, particularly badly affected by the problem of the shadow economy. Today, economic activities outwith state control make up approximately 50 percent of its gross domestic product.

At the initiative of the Federal Ministry for Economic Cooperation and Development, the implementing agencies DEG, GTZ and KfW joined together in the summer of 1999 to form the Ministerial Task Force for the Reconstruction of South Eastern Europe (AgWSOE). Apart from a presence in Bonn, the AgWSOE runs the German Office for Reconstruction (GORED) in Pristina and another GORED in Belgrade set up in early 2001. Through these offices, the AgWSOE supports the measures taken by the Federal Ministry for Economic Cooperation and Development in Kosovo by ensuring continuity when it comes to the particularly difficult task of coordinating German projects with those of other donors. It works closely with UNMIK for this purpose.

In the winter of 1999/2000, the Federal Ministry for Economic Cooperation and Development financed a large number of emergency schemes to ensure a minimum level of provision for the population: the rehabilitation of housing stock, support for small farms – for instance, by supplying feed to keep farm animals alive over the winter –, the equipment of hospitals and the delivery of generators, block-type thermal power stations and heating oil to bridge over power cuts in particularly badly hit areas were typical of the measures taken during this period.

Earlier than other donors, parallel to the very first humanitarian aid, the contribution of the Federal Ministry for Economic Cooperation and Development concentrated on long-term, economically sustainable development work in the core areas of the economy. The successes seen in all the sectors where projects have been implemented have earned the German activities a great deal of respect among the Kosovan population. The expensive projects in the energy sector and the establishment of the Micro Enterprise Bank alone have demanded an enormous financial commitment. Kosovo has received the largest share of Stability Pact funds almost across the board. In the water sector, a repair programme was started in 1999 to assist selected localities in which the supply situation was particularly bad. Due to its success, this project has been adopted by the EU and extended to numerous other local authorities. When roads were

being rehabilitated, particular attention was paid to ensuring that important road links to other parts of the region, such as Montenegro, were repaired as a priority.

Despite the improvements that have been achieved, Kosovo is the problem child of the region and will only slowly be able to work its way out of this role. As this happens, it will be of great significance that, after a long period of hopelessness, the Kosovans are highly motivated to help open up new prospects for their homeland. One danger is that the developments for the better are progressing slowly, and the causes of delays do not always become transparent. This leaves room for destructive interpretations that can be manifested in social unrest. But if those responsible succeed in fostering understanding for the difficulties and expectations that take account of them, the mood of excitement associated with a new beginning could be the key to the province's long-term stabilisation.

Montenegro

One central question for the future of Montenegro is whether, as Serbia's smaller partner, the country will remain a constituent republic of the FRY or break away and become a completely sovereign state. The elections to the Montenegrin parliament on 22 April 2001 resulted in a victory for the pro-independence parties. Montenegro's current political situation is dominated by the subsequent massive efforts to achieve independence, some of which have led to considerable tensions. The international community views the prospect of Montenegro leaving the FRY as having the potential to spark new conflicts that could have consequences for the entire region, and has accordingly worked intensively on alternative solutions.

The agreement on the drafting of a new constitution for Serbia and Montenegro ("Belgrade Agreement"), which was mediated by the EU, was signed on 14 March 2002. Although the agreement allows the possibility of a referendum to decide on complete separation in three years time, it also puts an end to the

current agitation and provides for the formulation of a Constitutional Charter to conclusively regulate the relationship between the two constituent republics until that time. Under the terms of the draft document, the present federal republic would be dissolved, but both constituent states would remain united in a loose state union, which would then be called "Serbia and Montenegro". Following the signing of the Belgrade Agreement and at the local authority elections on 15 May 2002, the representatives of Montenegro's Albanian minority, which makes up about 16.5 percent of the population, withdrew their support from the governing president, Djukanovic. Their previous solidarity with the proponents of Montenegrin separatism was always regarded by the pro-Yugoslav opposition as an indication that Montenegro's Albanians were striving for the areas of the country where the majority of the population are Albanian to become part of a future Greater Albania. This was the first time the conflict about Montenegro's possible separation, which had been vented again and again in isolated violent clashes over the years, took on an openly ethnic dimension.

Certainly, the pace of the reform process is slowed by these political problems, but neither is it being pursued rigorously enough. Although the country's economic development is now relatively well advanced, fundamental structural changes that would make a sustainable improvement in the situation probable have still not been undertaken. From the beginning, the Federal Ministry for Economic Cooperation and Development has therefore funded activities to create the basic preconditions for such changes as a priority. Following the absolutely essential emergency aid for drinking water systems, sustainable approaches have also been pursued in this sector, especially in the Adriatic region, which is particularly attractive to tourists. Overcoming the difficulties has involved consultation and coordination with numerous, sometimes competing local authorities, and has thus offered opportunities to help enhance the local administrations' ability to act effectively. Final funding is made dependant to the extent necessary on whether it is possible for acceptable agreements to be reached with those local authorities that must logically be involved to good effect.

Since these local authorities will have to rely on growing reciprocal coordination as the economic recovery gains pace, an appropriate dialogue about the parties' conflicting interests is to be regarded as a welcome synergy effect. Aid for the private sector, which is also a priority, has been provided above all by making credit lines available to small and medium-sized enterprises through local private banks and has produced cheering successes.

At the moment, it is becoming likely that the Federal Republic of Yugoslavia will be transformed into a state union made up of both countries that would mean a considerable loosening of the links between the two.¹ The Serbian parliament voted for the Constitutional Charter drawn up by the two republics with the EU on 28 January 2003, as did the Montenegrin Parliament the next day.

Bosnia and Herzegovina

The ethnic conflicts in Bosnia and Herzegovina were still far from being settled when the fighting came to an end. In particular, some sections of the Croatian population in Bosnia have repeatedly sought to assert their dominance, as was evident, for example, from their threatening behaviour during the run up to the general elections in 2000. The continued existence of the Republika Srpska, which is overwhelmingly inhabited by Serbs, has been called into question on many occasions as well.

The internal political situation is still dominated to a large extent by state building. The development of democratic institutions and new administrative procedures for the federal state was, and is, made more difficult by the fact that it is necessary to ensure the balanced participation of the three ethnic groups, Bosnians, Croats and Serbs, at all times. At the moment, the country's overall political, economic and social development is stagnating. There are still clear tensions between the ethnic groups beneath the surface. So far, real cooperation

¹ The official dissolution of the Federal Republic of Yugoslavia and its reconstitution as the state union of Serbia and Montenegro took place on 4 February 2003.

has been inadequate and not enough has been done to reintegrate the different nationalities.

The ongoing political problems, which were generally exacerbated by the strong performance of all three nationalist parties at the elections in the autumn of 2002, are massively obstructing the reform process and consequently holding up economic recovery: tax revenues are still too low, particularly in view of the high level of state debt. A lack of legal security, corruption, delays in the process of privatisation and a strong shadow economy are still damping the interest of foreign investors. So far, no strategy for the promotion of exports has been drawn up, either for the individual entities or for the federal state.

The Federal Ministry for Economic Cooperation and Development has concentrated its involvement in these key areas. Projects in the fields of financial systems development have been particularly successful. They were recommended in the EU's 2001 evaluation report as models for financial sector projects in other Eastern European countries. The privatisation process has been supported with consultancy services. The chambers of commerce in Bosnia and Herzegovina have acted as executing agencies and have cooperated closely with the German Association of Chambers of Industry and Commerce (DIHK) and the Delegation of German Economic Affairs in Sarajevo. The extensive legal advice provided has focussed on banking law, the notarial system, bankruptcy law, general civil law, tax legislation and the development of a land registry system. In the industrial sector, productivity gains and efforts to secure competitiveness have been the primary concerns. Aid in the agricultural sector has centred on the adaptation of private enterprises to changing conditions. Apart from an improvement in supply to the population, the measures in the water and energy sectors have also been aimed at laying important foundations for commercial and industrial activities.

Although they have been successful in themselves, whether these sectoral

approaches can also make sustainable contributions to the improvement of overall conditions will basically depend on whether Bosnia and Herzegovina's governments set about the essential structural changes more purposefully in future.

Macedonia

Macedonia's economy initially exhibited a tentative upwards trend. Although development lagged behind western standards, it did not have to cope with additional war damage like other parts of former Yugoslavia, and potential for positive development was becoming apparent. This suffered a severe setback in 2001 as a result of the armed clashes between Albanian rebels and Macedonian security forces. The Ohrid Framework Agreement, in which the Albanians were promised an improvement in their position through constitutional amendments and targeted compensatory measures, removed some of the factors that could have led to a re-escalation of the conflict. Nevertheless, internal security remains a central concern. It would be desirable if the additional military spending that is still a burden on the government budget could soon be reduced. Important reform projects cannot be implemented at the moment, above all due to a lack of funds. A restructuring of the public administrations is still particularly urgent, partly as a way of further consolidating the peace settlement. Firstly, the goals of the Ohrid Framework Agreement, such as a resolution of the language problem, can only be achieved in the course of far-reaching reforms; secondly a strengthening of the state's ability to take effective action would generally counteract the efforts to gain power being made by forces that possess no legitimation. Large sections of the Albanian population want peace and the chance to live quietly in safety, and it will be less easy to motivate them to take part in civil conflicts if they have a prospect of adequate participation in the political system and a stake in the positive development of the economy. It therefore continues to be necessary to carry on the economic and administrative reforms begun to assist the country's development because the high levels of long-term unemployment and the fact that more than 20 percent of the population live under the poverty line of 2.50 US

dollars a day represent considerable risks to social peace and are indirectly exacerbating the inter-ethnic conflicts. The Federal Ministry for Economic Cooperation and Development will continue its activities in the priority areas defined at an early stage: water supply, the promotion of civil society, democratisation and economic reform. Nevertheless, a fundamental clarification of the way Macedonians of both ethnic groups see themselves will be indispensable as they engage with each other in future. The classification of the Albanians as a minority is not appropriate in view of the fact that they represent an estimated 30 to 50 percent of the population.

Albania

Germany concentrated its aid on long-term, economically sustainable development in the core areas of the Albanian economy earlier than other donors. The sectoral reforms carried out since 1998 in the energy and water supply sectors have already made it possible for the operating companies to increase their revenues, although their income is still by no means sufficient for them to finance modernisation to the extent that would be desirable out of their own funds.

The potential output from hydroelectric power, which could even cover peak demand, is still not being fully exploited due to the very outdated plants. The assistance provided to the water sector is also intended to ensure the long-term institutional and financial consolidation of the executing agencies and to support the regulatory authorities. Public private partnership projects with German companies have been conducted very successfully in this field.

Issues relating to environmental protection and the conservation of natural resources were also taken into account very early on. In 1980, the coastline shared by Greece, Albania and Montenegro was declared a world heritage site by UNESCO. The efforts to protect this landscape have seen the states concerned cooperating more intensively since 1999, which can be viewed as a

contribution to the political stabilisation of the region.

Foreign donors, above all the World Bank, the EU, Italy and Germany, remain the largest investors in the country. The management of the budget, which is still too weak, suffers from the ineffective use of the public funds deployed. Legal advice as a contribution to institution building, in particular the strengthening of decentralised structures, will improve the situation. The promotion of coordination between the central government and the local authorities is particularly important in this respect.

Despite impressive legislative changes and the creation of implementing structures to fight corruption and organised crime, much remains to be done. In particular, illegal immigration and arms trading are areas that demand greater attention.

Compared to its closest neighbours, Albanian agriculture is not competitive. About a quarter of all the foodstuffs and 50 percent of the cereals the province requires are still being imported. At the same time, the ongoing modernisation of the agricultural sector represents a direct way of alleviating poverty. Parallel to this, the social infrastructure is being strengthened, from the construction of housing stock and rehabilitation of hospitals to educational programmes.

The FEFAD Bank, which was founded in 1995, partly as a result of a German initiative, and opened in 1999, has seen its business develop very successfully, and is making a considerable contribution to the development of the banking sector, both in quantitative and in qualitative terms. A modern range of financial services is essential for the provision of the special assistance needed by small and medium-sized enterprises. Although some structural weaknesses persist and urgently need to be tackled, the number of banks has at least increased markedly.

Since 2000, the strongly accelerated privatisation process has been successfully driven ahead. The privatisation of state-owned enterprises has been largely completed since mid-2002.

Following Albania's clear articulation of its support for the maintenance of Macedonia's territorial integrity during the unrest in Macedonia in the summer of 2001 and its calls on the Albanian fighters to lay down their weapons, it has consolidated its role as a stabilising factor in the region.

In 2001, negotiations were opened between the EU and Albania about a possible stabilisation and association agreement (SAA). This is a major step towards the integration of Albania into European structures.

Bulgaria

Bulgaria's economic and political reforms have been driven ahead successfully since 1997. The country currently occupies a respectable position in the middle of the reform-policy spectrum along which the transition states of Eastern Europe are ranged.

On 1 December 1999, shortly after the establishment of the Stability Pact for South Eastern Europe and almost five years after Bulgaria made its application for EU membership, the European Council meeting in Helsinki agreed on the opening of accession negotiations with Bulgaria. The EU was then able to start official accession negotiations with Bulgaria in the second round of eastward enlargement that started in February 2000. Bulgaria is therefore one of the strongest of the target countries in the Stability Pact, and is credited with an important role in the region's recovery.

On 24 July 2001, the former King, Simeon Saxe-Coburg Gotha, was elected prime minister. The governing parties are his National Movement Simeon II (NDSV) and its coalition partner the Movement for Rights and Freedoms (DPS).

The domestic political situation has been stable since these elections.

The priority area for the Federal Ministry for Economic Cooperation and Development's bilateral economic cooperation has been the long-term development of the Bulgarian SME sector. Important activities in this field include, for example, the provision of a credit line to finance loans granted to small and medium-sized enterprises and government advisory services on economic legislation. The farming sector is profiting from the establishment of marketing structures for agricultural products, in particular fruit and vegetables. Apart from this, there are projects on vocational education and employment promotion, such as twinning schemes between chambers of trade. Support for reforms of the public administration with the goal of decentralising decision-making structures will continue to play a role in future.

Despite the successes that have been achieved, there is still much to be done. Obstacles to the development of small and medium-sized enterprises include, above all, weak production and trade structures, a lack of access to loans and the underdeveloped infrastructure. An anti-corruption strategy is still being drawn up. The situation is precarious in the water sector and there is still a serious lack of the urgently needed investment in the sanitation and drinking water networks. The energy and transport sectors are also becoming more significant in view of the moves towards integration into the EU. The EU expects the plans for the Kozloduy nuclear power station, which is regarded as a security risk, to be implemented by 2003. Blocks 1 and 2 will be closed down and decommissioned, Blocks 3 to 6 are to be modernised. The Bulgarian transmission network used to be part of an interconnected regional grid, the reconstruction of which will be highly significant if there is to be greater regional integration between the Balkan countries. As a target country under the Stability Pact, recipient of considerable pre-accession aid from the EU and beneficiary of other bilateral support programmes, Bulgaria is receiving considerable financial support. There are therefore justified hopes that Bulgaria will manage a sustainable upturn. One

example of the generally positive trend is the privatisation of the country's often highly indebted state enterprises, which has now almost been completed. The private sector generates a good 60 percent share of GDP.

On account of its comparatively strong position, Bulgaria is able to collaborate very actively in the Stability Pact. Germany therefore does not only deal with Bulgaria in its capacity as a donor. As the Bulgarian economy becomes stronger, attention will increasingly be paid to the organisation of classic trade relations. Currently, Bulgaria is also viewed by German business circles as a stabilising factor in South Eastern Europe. The particularly strong partnership reflected in the cooperation with Bulgaria will further assist the country's moves towards EU structures.

Romania

The macroeconomic data suggest that the Romanian economy finds itself in a lasting upwards trend. Measured against the catastrophic starting position, a great deal has been achieved there. The problem is that these improvements are still having no direct impact on the standard of living: the current situation is characterised by massive impoverishment and a strong shadow economy (30 to 40 percent of GDP). Labour-intensive consumer goods, such as apparel and furniture, can only be exported at internationally competitive prices because of the low wages. Nevertheless, it can be deemed positive that, after two decades of economic policy geared to autarchy (1970-1990), Romania is now comparatively well integrated into the world economy.

Having received assistance from the EU PHARE programme and the SAPARD structural fund, Romania has received special assistance as a candidate for EU accession since spring 2000. It has been accorded major loans for this purpose by multilateral institutions, such as the European Investment Bank and the World Bank. Thanks to this support, it has been possible to tackle financially intensive projects, such as the liberalisation and modernisation of the energy sector. Even

so, Romania ranks last among the EU candidate countries in terms of its progress in implementing reforms. This will presumably mean that the integration process takes even longer.

By comparison with the EU funds provided, the activities of bilateral donors involve far smaller amounts of money. The investments made by the Federal Ministry for Economic Cooperation and Development out of Stability Pact funds are therefore being used purposefully in key areas. As in most of the countries of South Eastern Europe, small and medium-sized enterprises form an important basis for economic recovery in Romania. As the majority of jobs are created by these businesses, providing them with aid means fighting poverty directly. The main funding instruments are various credit programmes of the Federal Ministry for Economic Cooperation and Development, which are being implemented by four Romanian partner banks. Parallel to this, these banks are receiving assistance to train and upgrade their loan advisors. The access to financial services opened up in this way can only be converted into commercial success by the companies that make use of it if they possess appropriate management skills. The lack of experience of what is required by the market economy, for instance, is being addressed by the “Integrated Advisory Service”, which is to be built up in the medium term into a comprehensive economic and employment promotion project. The project will then promote the economic efficiency and international competitiveness of private companies in various sectors. Another priority area for the Federal Ministry for Economic Cooperation and Development in Romania is the improvement of local infrastructure. For instance, the existing pipeline systems in selected localities are being repaired in order to improve the water supply. These systems already satisfy EU environmental standards. An important contribution to the modernisation of the agricultural sector is being made by the professionalisation of distribution channels, for instance by building up wholesale markets that ensure an efficient balance of supply and demand.

Apart from this, there are already structures in place to facilitate further-reaching

links with Romania. The German-Romanian Cooperation Council, with its sector-specific working groups, is an important forum for economic issues. The Delegation of the German Economy in Bucharest promotes bilateral economic relations and represents all the German trade fair companies in Romania. There are plans to develop it further into a bilateral German-Romanian chamber of commerce.

This bilateral commitment is indispensable in view of Romania's hopes of integration into the EU since, apart from the modernisation of the country, it also presupposes a certain level of networking with its neighbours and structures within which economic relations can be developed. The activities of the Federal Ministry for Economic Cooperation and Development in this field have a special political significance.

Croatia

Croatia became a member of the NATO Partnership for Peace programme in May 2000. A stabilisation and association agreement was signed with the EU at a very early stage, on 14 May 2001. Croatia's ambitious plan to become a full EU member by 2007 has received substantial support.

However, pro-western attitudes are not shared by all the relevant political forces. In particular, the nationalist HDZ is still able to block cooperation between the government and the Hague war crimes tribunal with the support of sympathetic sections of the population. As far as its image in the outside world is concerned, Croatia has to struggle against the impression that its government's indifferent stance on the extradition of war criminals shows that reservations still need to be overcome there. This is a major factor inhibiting rapid alignment with Western Europe.

Croatia is rapidly catching up with the other EU candidates in terms of its economic development. Nevertheless, problems in this field continue to demand

special attention: the necessary reform processes are, unfortunately, still making slow progress, particularly as regards privatisation and the restructuring of the large state utilities in the energy and transport sectors. Furthermore, fundamental changes in these fields will lead to a temporary rise in the unemployment rate, which may appear moderate in regional comparisons at about 20 percent, but is still too high in absolute terms. Nor does the public administration by any means meet the compulsory requirements made of a candidate country.

The improvements in the economic situation can, above all, be attributed to the activities of small and medium-sized enterprises. The welcome rise in GDP is thus mainly a consequence of strong growth in the tourism industry and rising consumption. The Federal Ministry for Economic Cooperation and Development has made considerable contributions in these areas: 12.5 million euros have been provided at short notice for local authority water treatment projects on the coast, putting in place important preconditions for the promotion of tourism. To back this up, three million euros have been invested in a project taking a regional approach to the development of tourism.

Other successful projects are taking place in the field of legal advice: the advisory services to help draft modern legislation on value added tax, income tax and corporate income tax with the purpose of developing the tax administration and tax system have helped to ensure that Croatia has one of the most efficient systems of taxation in Europe today. The very latest approaches have also been applied in the advisory work on economic reform and the establishment of the Croatian Bank for Reconstruction and Development (HBOR). Although it cannot be regarded as certain that Croatia will be integrated rapidly into the EU, this perspective should continue to be supported. Only improvements that are perceptible to broad sections of the population will be an effective antidote to those political forces which still oppose the settlement that has brought peace to the region.

Moldova

Integration into the European and Transatlantic structures is, alongside an improvement of relations to Russia, one of the key areas of Moldova's foreign policy. In the long term, it is hoped that Moldova will come to have a prospect of EU accession. Today, the Council of Europe is already supporting the process of domestic policy reform – even if this is making slow progress – and is giving Moldova the prospect of collaboration in international bodies.

Moldova will only be able to move closer to the EU once its domestic political problems have been resolved. Transnistria, which is still striving for autonomy, has now created quasi-state structures, although they are not internationally recognised. To the present day, Moldova and Transnistria continue to negotiate about the question of the territory's status in talks mediated by Russia, Ukraine and the OSCE. The agreements reached hitherto have collapsed, mainly due to Russia, which did not withdraw its troops from the territory by December 2002 and destroy ammunition stocks as agreed in the Istanbul Agreement on account of a lack of cooperation from Transnistria. The 42,000 tonnes of ordnance still stored there make Transnistria the biggest arms depot in Europe outside the Russian Federation.

The accumulation of considerable foreign debts – above all for Russian energy supplies – is one of the country's most serious economic problems. The possibility of national bankruptcy, which threatened the country again in the summer of 2002, was averted at the last moment by the resumption of relations with international financing institutions.

Bilateral cooperation with Moldova is currently being reviewed. Due to the Moldovan government's hesitancy about implementing the necessary reforms energetically, German support under the Stability Pact is currently being limited to certain smaller-scale technical cooperation projects. New approaches to the implementation of projects need to be found in the forthcoming discussions.

10. Where do we go from here?

The Stability Pact is established as a medium- and long-term process. No one should expect the problems of South Eastern Europe to be mastered with short-term activities.

Overcoming the causes of the crises that have taken place in South Eastern Europe and getting sustainable development underway will demand staying power. The Stability Pact is the right approach and a suitable forum – particularly in combination with the instruments the EU is using to prepare the countries of the region for accession. The Stability Pact has made a quantum leap possible, but not all at once: just as a crisis arises from the interaction of many factors, stabilisation can only come about through ongoing gradual improvements in all important areas. It will demand a substantial joint effort on the part of all stakeholders before the region's states and territories can secure their political and economic stability with their own resources and a return to conflict is no longer to be expected. Important foundations have still not been laid: they include, for example, the clarification of the future status of Kosovo, the final placation of the Croatian separatist groups in Bosnia and Herzegovina and a stable consensus between the Slavic and Albanian sectors of the population in Macedonia.

A premature withdrawal of the donor community from the region would increase the risk of renewed conflicts breaking out and jeopardise the successes achieved so far. To the present, there is a danger that a loss of confidence in the reform process among the populations of the region will find an outlet in a renewed flaring up of nationalism or a backward-looking, conflictual mindset. Ever since the establishment of the Stability Pact, there have been political actors ready and waiting to exploit these insecurities for their own power interests. Only when the processes of development have irreversibly generated their own momentum and

this perspective has become part of the public consciousness in the states and territories of South Eastern Europe will the ambitious aims of the Stability Pact really be achieved.

Apart from the responsibility taken on with the military intervention, which was only justifiable if it was combined with an adequate attempt at permanent pacification, the Western European states also have to consider their primary interest in a stable South Eastern Europe. This would mean, in particular, a reduction of the pressure of migration on the European Union (especially on Germany), the development of a business and sales market on the EU's doorstep and a stabilisation of the European and Transatlantic security structures.

The German Bundestag has already decided to maintain cooperation with the states of the region after the Stability Pact is wound up at the end of 2003. The Federal Ministry for Economic Cooperation and Development will continue to have a presence in the region as a bilateral partner. The German government is also prepared to uphold its political support for the Stability Pact. The scale of German financial support will be considered during the financial planning process this year. Cooperation with the states and territories of South Eastern Europe will probably see funding reduced somewhat. In future, a stronger emphasis will therefore be placed on private-sector investment and contributions coming from the region itself. It is now increasingly a question of stimulating the integration of South Eastern Europe into European foreign trade structures. It will also be of outstanding significance, particularly from the standpoint of private investors, that the international support is predictable. The encouraging improvements in the states and territories of South Eastern Europe also permit the use of the most modern instruments, which make it possible for funds to be deployed with maximum effectiveness. The need for timely creation of an appropriate framework for the application of these instruments must not be ignored. It would be desirable if the necessary regional flexibility could be preserved in the

mechanism that is then established.

In the course of the gradual “return of full political responsibility”, it will be necessary to demand of the states of South Eastern Europe that they show an increasing willingness to commit themselves to bilateral relations. The genuine will to undertake far-reaching reforms in all sectors must become even more clearly apparent, in part through the countries’ own targeted use of material assistance and an increasing readiness to cooperate and compete.

The potential for fruitful development and peaceful coexistence is evident in the states and territories of South Eastern Europe. The motive that justifies all these efforts is common to the donor community and the partner countries of South Eastern Europe: neighbourly relations throughout Europe.

11. Annex

War in Yugoslavia: an overview

1989

28 March: Serbia suspends the autonomy of the provinces Kosovo and Vojvodina.

9 May: Slobodan Milosevic becomes president of Serbia.

1991

June: Slovenia and Croatia declare their independence from Yugoslavia. In direct response to this, Yugoslav military units initiate armed clashes, seeking to prevent the final secession of the two republics. After a few days, Belgrade gives up Slovenia and concentrates on Croatia.

November: The EU foreign ministers impose an economic embargo on Yugoslavia following the final breakdown of diplomacy.
Separation of the republic of Macedonia.

1992

15 January: Recognition of Slovenia and Croatia by the EU and other Western European states.

February: Deployment of UN peacekeeping troops to Yugoslavia.

3 March: Referendum on independence in Bosnia and Herzegovina (BiH).

3 April: BiH declares independence, Serbian troops attack BiH.

7 April: Recognition of BiH by the EU member states and the USA.

27 April: Reconstitution of the Federal Republic of Yugoslavia (Serbia and Montenegro).

30 May: UN sanctions imposed on Belgrade.

22 September: Suspension of Yugoslavia from the United Nations; embargo of Yugoslavia begins in November.

1993

April: Macedonia joins the United Nations.

9 November: NATO ultimatum to the Bosnian Serbs.

1994

February: Bosnian Serbs give in to pressure; NATO air attacks on Serbian units near Gorazde; ceasefire in Bosnia.

1995

July: Capture of the Muslim enclaves (UN safe havens) at Srebrenica, Zepa and Gorazde by Bosnian Serbs, mass shootings in Srebrenica.

28 August: Serbian grenade attacks on Sarajevo, beginning of NATO air strikes.

14 December: Dayton Peace Agreement on BiH signed and secured by IFOR deployment.

1996

17 April: Germany recognises the Federal Republic of Yugoslavia (FRY).

1 October: Lifting of UN sanctions against the FRY.

September: 5,000 US soldiers deployed to reinforce UNPROFOR (BiH).

1997

15 July: Milosevic elected as president of the FRY, Djukanovic elected as president of Montenegro.

1998

28 February-1 March: Situation in Kosovo escalates, Serbian security forces begin offensive against Kosovo Liberation Army (UCK); massacre: 25 civilians are murdered by Serbian security forces following withdrawal of UCK (28 February).

April: 94 percent of Serbs are opposed to international mediation in Kosovo; Milosevic unexpectedly accepts OSCE observers.

May: Beginning of major Serbian offensive.

9 October: UN Security Council Resolution 1199 condemns acts of violence committed by both sides and demands the immediate cessation of hostilities, the withdrawal of Serbian units and the beginning of a dialogue involving the international community. According to UN Secretary-General Kofi Annan, Belgrade has not satisfactorily met either the military or humanitarian requirements laid down in the resolution. The numbers of refugees rise to 300,000. In order to improve the security situation and so reduce the flow of refugees, the civilian Kosovo Verification Mission (KVM) is sent to the area, backed up by monitoring of air space.

1999

January: Tension mounts; increasing numbers of violent clashes, 45 civilians are found killed at Radak. The head of the KVM accuses Serbian militias of this atrocity.

6 February: Opening of Kosovo talks at Rambouillet.

15 March: Talks continue in Paris; Albanians sign.

22 March: Last warning to Milosevic; Rambouillet negotiations finally collapse.

24 March: NATO operation begins with air attacks on Serbia and Montenegro; pressure on Albanian population increases dramatically.

10 June: Suspension of air strikes and adoption of UN Security Council Resolution 1244.

12 June: International peacekeeping troops (KFOR) enter Kosovo.

UN Resolution 1244: From now on, Kosovo, part of the Federal Republic of Yugoslavia (Serbia and Montenegro), is administered by the United Nations Interim Administration Mission in Kosovo (UNMIK).

2000

24 September: Early presidential and federal parliamentary elections in Yugoslavia.

5 October: Mass protests, particularly in Belgrade, calling for the democratic

forces' victory to be recognised; peaceful revolution, fall of Milosevic.

7 October: Vojislav Kostunica becomes new president of the FRY.

9 October: Council of Europe and US sanctions are lifted. However, special provisions relating to Milosevic and his close associates are kept in place, e.g. visa restrictions intended to help bring cases before the International Criminal Tribunal for the Former Yugoslavia in the Hague.

26 October: FRY joins the Stability Pact for South Eastern Europe.

17 November: Resumption of diplomatic relations with Germany, UK, France and the USA; resumption of relations with Slovenia on 10 December 2000, and with BiH on 15 December 2000.

23 December: New elections to the Serbian parliament; victory of the DOS coalition.

25 December: Zoran Djindjic becomes the new Serbian prime minister.

How does normal German bilateral development cooperation function?

The Federal Ministry for Economic Cooperation and Development has a broad repertoire of tried-and-tested bilateral development cooperation instruments that are also used for projects in South Eastern Europe. A distinction is made between the major fields of financial cooperation and technical cooperation.

Financial cooperation

The role of financial cooperation is to fund investment in building economic and social infrastructure. The priority areas of economic infrastructure in South Eastern Europe are financial systems (including the reform of the banking sector and the development of private small and medium-sized industrial enterprises using credit schemes), the energy sector, water supply and traffic and transport. In the social field, particular consideration is given to the education sector and the development of the health system.

If financial cooperation is to have a chance of changing structures, projects must be integrated into political reforms and changes at the level of society as a whole, at sectoral or at local levels. The development projects funded are selected by the German government jointly with its partners. Partner countries are expected to make reform efforts, which will help these impulses to gather their own momentum.

The German government has given the KfW the task of implementing financial cooperation. Its role encompasses the selection of executing agencies, support for them during the preparation and implementation of projects in the partner countries and monitoring. In special cases, financial cooperation funds can also be spent on fiduciary holdings and loans with equity features made by the DEG to suitable institutions in the partner countries.

Wherever this appears possible, efforts are made to mobilise additional private

capital, for example through mixed financing concepts (state guarantees for private projects) or loans at favourable rates of interest. This optimises the effectiveness of these activities (the ratio of funds deployed to the success of a project in development policy terms). In regular financial cooperation, it is usual for the moneys deployed to be repaid; only the least developed partners receive payments without any obligation to repay them. Under the Stability Pact, all funds used for financial cooperation are automatically regarded as “outright grants” and do not have to be repaid. This arrangement takes account of yet another aspect of the situation in South Eastern Europe: in view of the integration into European economic structures to which the region’s states and territories aspire, it is vital to prevent state budgets becoming hopelessly overindebted.

Technical cooperation

The goal of technical cooperation is to improve the productivity of individuals and organisations by passing on technical, economic and organisational knowledge and skills through forms of cooperation based on partnership. One important aim in all the states and territories of South Eastern Europe is the promotion of market-economy thinking and back-up for the privatisation process. Technical cooperation is also provided free of charge for recipients outside the Stability Pact, basically in the form of consultancy services and the provision of materials and equipment. The German government mainly commissions the federally-owned Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) to carry out this work. Specifically, consultants, trainers and experts can be provided within the framework of technical cooperation. The executing agencies in the partner countries are promoted, and equipment and materials are made available to facilitate their work. Apart from this structural aid, what are known as small-scale measures can also be implemented rapidly without a lot of red tape as part of technical cooperation, where the need for them is particularly urgent and the expense and time required for normal planning procedures would be disproportionate to the funds deployed or the envisaged impact of the project.

Apart from the major areas of financial and technical cooperation, there are other development cooperation instruments that the Federal Ministry for Economic Cooperation and Development deploys jointly with proven partners:

Special development cooperation instruments

Training and upgrading programmes for personnel from the partner countries are of particular significance. Specialists and managers who have received modern training return to their work places after completing their courses and multiply the knowledge they have gained by passing it on to colleagues, thus exerting a positive influence on the development of their companies. These programmes have primarily been implemented by the German Foundation for International Development (DSE) and the Carl Duisberg Society (CDG), which were merged in the late summer of 2002 to form Capacity Building International, Germany (InWEnt GmbH).

The Federal Ministry for Economic Cooperation and Development can offer sustainable support by seconding consultants in all priority sectors. In this context, special significance attaches to CIM **“Integrated Experts”**. They not only work in an advisory capacity, but also take on operative roles within companies in the host countries. These experts' work is coordinated to fit in with the priorities set for financial and technical cooperation. As a rule, they can offer particularly specialised advice.

“Senior Expert Services” (SES) involve the seconding of especially experienced experts, who are usually retired, and work on a voluntary basis in the target countries. Apart from their expertise, their availability and the contacts they have built up during successful professional careers, the special thing these staff have to offer is their personal independence, which makes them all the more persuasive.

The Federal Ministry for Economic Cooperation and Development expects its

promotion of non-governmental organisations (NGOs), above all the German political foundations and churches, to generate major contributions to the development of democracy, civil society and non-governmental structures. The initiatives and programmes undertaken by the German political foundations particularly promote social and societal reorientation in the partner countries. They support the building of democratic potential and democratic movements and seek to increase the professionalism of parliamentary work in accord with the separation of powers. By contrast, the church organisations are primarily committed to projects working with socially weak sections of the population and foster the development of non-state social infrastructure by building up church-supported schools, youth and adult education services, training for social workers, reconciliation work, conflict management and human rights activities.

The DEG particularly supports the **involvement of the private sector**. This primarily focuses on aid for social structures and development partnerships. The DEG contributes to the establishment of joint enterprises involving foreign and German firms by investing in them and providing finance. The economies of the partner countries also benefit from the knowledge and experience of German business associations and self-help groups, which is conveyed through twinning schemes run by the German chambers of crafts and trades, the German chambers of industry and commerce, the bodies representing the German saving banks and other business bodies. The promotion of trade relations and the initiation of joint enterprises with German firms both play a specially important role.

Links on the topic

http://www.auswaertiges-amt.de	German Federal Foreign Office
http://www.bmvg.de	German Federal Ministry of Defence
http://www.bmwa.bund.de	German Federal Ministry of Economics and Labour
http://www.swp-berlin.org	SWP – German Institute for International and Security Affairs
http://www.stabilitypact.org	Stability Pact for South Eastern Europe
http://europa.eu.int/index_de.htm	European Union
http://www.kfw.de	Kreditanstalt für Wiederaufbau (KfW)
http://www.gtz.de	Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ)
http://www.ebrd.com	European Bank for Reconstruction and Development
http://www.deginvest.de	Deutsche Investitions- und Entwicklungsgesellschaft (DEG)
http://www.inwent.de	Capacity Building International, Germany
http://www.osce.org	Organization for Security and Co-operation in Europe
http://www.ixpos.de	iXPOS – Federal Ministry of Economics and Labour Foreign Trade Portal
http://www.dgap.org/struktur.htm	German Council on Foreign Relations
http://www.balkantimes.com	Balkan Times
http://www.rferl.org/balkan-report	Radio Free Europe/Radio Liberty
http://www.diht.de	German Association of Chambers of Industry and Commerce
http://www.seerecon.org	Economic Reconstruction and Development in South East Europe (World Bank and European Commission)

<http://www.suedosteuropa-gesellschaft.com>

Southeast Europe Association

<http://www.hrk.de/167.htm>

Conference of Rectors and Presidents
of Universities and Other Higher
Education Institutions in Germany

<http://www.osteuropa-netzwerk.de>

Osteuropa-Netzwerk (Eastern Europe
Network)

Abbreviations

AA	German Federal Foreign Office
AgWSOE	Ministerial Task Force for the Reconstruction of South Eastern Europe
BiH	Bosnia and Herzegovina
BMZ	German Federal Ministry for Economic Cooperation and Development
BSEC	Black Sea Economic Cooperation
BMVg	German Federal Ministry of Defence
BMWA	German Federal Ministry of Economics and Labour
CEB	Council of Europe Development Bank
DEG	Deutsche Investitions- und Entwicklungsgesellschaft
DIHK	German Association of Chambers of Industry and Commerce
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EU	European Union
FEFAD	Foundation for Enterprise Finance and Development
FRY	Federal Republic of Yugoslavia
FYROM	Former Yugoslav Republic of Macedonia
GORED	German Office for Reconstruction and Development
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
IMF	International Monetary Fund
InWEnt	Capacity Building International, Germany
KFOR	Kosovo Force
KfW	Kreditanstalt für Wiederaufbau
MEB	Micro Enterprise Bank
NATO	North Atlantic Treaty Organisation
OECD	Organisation for Economic Co-operation and Development
OSCE	Organization for Security and Co-operation in Europe
PPP	Public Private Partnership

QSP	Quick Start Package
SAA	Stabilisation and Association Agreement
SECI	Southeast European Cooperative Initiative
SEECF	South-East European Cooperation Process
UN	United Nations
WB	World Bank