CHAPTER 11:

The European Fund for Southeast Europe: An Innovative Instrument for Political and Economic Stabilisation

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The European Fund for Southeast Europe (EFSE) is being formed from four existing local funds that mainly promote micro, small and medium-sized enterprises (MSMEs) and households seeking improved housing through qualified financial institutions in Southeast Europe. The new fund is expected to be chartered as an independent institution by December 2005. The purpose of this innovative instrument is to enhance the economies of Southeast Europe by providing finance to micro and small enterprises. The Fund is designed to be a sustainable example of an effective partnership between the public and private sectors (PPP). Its creation conveniently coincides with the United Nations' International Year of Microcredit.

This chapter begins by describing the strategic role of MSME promotion in the economic and political stabilisation of Southeast Europe. This exposition incorporates the development-policy perspective of the international community. The second part of this chapter examines the strengths and weaknesses of the approach taken thus far by the four existing local funds. The third part presents the options that have been explored in the development of this strategy. Finally, the concept of a regional fund and the framework that emerged from discussions by its founders is explained, along with details that remain to be clarified.

The Role of SME Promotion in the Stabilisation of Southeast Europe

The Situation in Southeast Europe After the Balkan Wars of the 1990s

The economic level of the former Yugoslavia was relatively high compared to the Eastern European states, but the political opportunities offered by the fall of the iron curtain at the beginning of the 1990s were not translated into economic gains. Instead, ethnic and religious hostilities, suppressed for decades by the multi-ethnic

state of Yugoslavia, flared up again. These led to military confrontations and the rapid break-up of Yugoslavia into a number of small states. During this conflict, the economies of the successor states declined drastically, creating an economic disaster characterised by:

- the destruction of and damage to manufacturing facilities during the military conflicts
- the destruction of and damage to public utilities, e. g. energy and water supply infrastructure, and also to the transport sector
- the burden on public and private budgets from the costs of the war and of reconstruction
- the loss of long-standing markets in Eastern Europe due to the opening up to the West and access to products of higher quality
- manufacturing facilities that became obsolete due to lack of investment in maintenance and modernisation, which widened the quality gap and further weakened competitiveness
- the retention of the Yugoslav model of highly subsidised public utility tariffs, which could no longer be financed from state revenues, so that the systems became derelict and were cannibalised or maintained on a greatly reduced scale
- the displacement and flight of ethnic groups, which led to considerable losses of human capital in some regions
- the policy that retained government control of the socialist economy which remained uncompetitive, especially in Serbia under Milosevic, while weakening the nationalised financial sector through nepotism and corruption
- the breakdown of the Serbian economy that weakened neighbouring economies

As a consequence of these developments the economies of the Western Balkan states shrank by up to 70 % by the end of the 1990s. Eastern Balkan countries were much less affected although regional trade greatly diminished and Bulgaria, Romania and Moldova suffered from the withdrawal of strategic investors. In 1998/1999, the economies of most of the states of Southeast Europe consisted primarily of unprofitable public or “collective” production facilities, most of which were no longer able to operate in a cost-efficient manner and almost all of which employed far more workers than were actually required.

A financial sector existed, at least in theory. The book values on banks’ balance sheets were highly unrealistic – credit institutions were essentially bankrupt. Hardly any capital was available for investment or for the creation of new private