The Aspen Institute | Germany

EU ENLARGEMENT: BETWEEN CONDITIONALITY, PROGRESS, AND ENLARGEMENT FATIGUE?

Valeska Esch
Juliane Kabus (eds.)

In cooperation with:

Stabilitätspakt für Südosteuropa
Gefördert durch Deutschland
Stability Pact for South Eastern Europe
Sponsored by Germany

Auswärtiges Amt

The Aspen Institute Germany wishes sincerely to thank the German Federal Foreign Office for its sponsorship of the Aspen Southeast Europe Program 2014 through the Stability Pact for South Eastern Europe.

The mission of The Aspen Institute is to improve the quality of leadership through dialog about the values and ideals essential to meeting the challenges facing organizations and governments at all levels. Over its sixty year history, the Aspen Institute has been devoted to advancing values-based leadership – to creating a safe, neutral space in which leaders can meet in order to discuss the complex challenges facing modern societies confidentially and in depth, with respect for differing points of view, in a search for common ground.

This book includes conference papers and proceedings of Aspen Germany's project on "EU Enlargement: Between Conditionality, Progress, and Enlargement Fatigue?" implemented in 2014.

For further information about The Aspen Institute Germany, please write to

Aspen Institute Deutschland e.V.,
Friedrichstraße 60, 10117 Berlin,
Federal Republic of Germany

call at

+49 30 80 48 90 0,

or visit our website at

www.aspeninstitute.de

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF CONTENTS

FOREWORD

For the countries of the Western Balkans, 2014 has been another eventful, and at the same time encouraging year: The European Union officially opened accession negotiations with Serbia; Montenegro made visible progress in its accession talks; Albania became an EU candidate country, Kosovo initialed its Stabilisation and Association Agreement with the European Union. Regarding Bosnia and Herzegovina, the Aspen Institute served as a midwife, as it were, at its South East Europe Foreign Ministers' Conference in November to bring into the world an initiative by the German Foreign Minister Steinmeier and his British colleague Philip Hammond. The two ministers proposed a renewed European approach to Bosnia and Herzegovina that aims at revitalizing the reform process and thus allowing the country to finally move forward in its EU accession process.

In addition to their individual progress towards the European Union, the countries of Southeast Europe opened a new chapter of regional cooperation at the Conference on the Western Balkans that took place on the invitation of Chancellor Merkel in Berlin in August 2014. There is hardly any other region in Europe that encompasses that many countries in such a small geographical space. It is thus more than logical that the Western Balkans countries chose to initially emphasize the theme of "connectivity" for their joint activities – transport and energy networks as well as the exchange between the region's youth and between the scientific communities. The German government will continue to advise and assist them in this process.

There are other demanding challenges that the whole region is faced with, among them the resolution of outstanding bilateral and internal conflicts, the reconciliation between and within the societies in the region, increasing prosperity via sustainable economic growth, strengthening the rule of law and improving the quality of governance.

In 2014, the Aspen Institute again succeeded in tackling some of these pertinent issues in its conferences. What originally started as a debate on the security architecture of the region with government officials and parliamentarians from the region has evolved into a much broader forum covering a wide range of topics crucial to the future of the Western Balkans. In June, the conference's focus was on economic development. The current economic situation as well as necessary structural reforms were discussed, regional trade and transport infrastructure as well as energy security were other important topics, as well as the EU's economic instruments. The September conference focused on the rule of law, including its role in the EU accession process, capacity building in the judiciary and the administration, the relationship between rule of law and foreign investments. Organized crime and corruption and the strengthening of human rights were also addressed.

I had the opportunity to take part in some of these discussions. Time and again, I was impressed by the insightful, sincere, uninhibited and engaged exchange of views. The trust among the participants that allowed for an earnest and frank debate could clearly be felt. Apart from offering a forum to exchange views and best practices on the path towards Europe, this particular atmosphere of confidence and openness sets the Aspen conference series apart.

I sincerely thank the Aspen Institute for its impressive and engaged work.

Dr. Ernst Reichel, Ambassador
Special Envoy for South-Eastern Europe,
Turkey and the EFTA States
Federal Foreign Office

INTRODUCTION

Dear friends of the Aspen Institute Germany,

The Aspen Institute Germany has been devoted to providing a confidential and neutral platform for leaders of today who face complex challenges. These off-the-record and in-depth dialogs respect differing points of view in search for common ground. Since 2008, leaders of the Western Balkan countries have come together at Aspen Institute Germany's conferences to discuss current issues their countries are facing regionally and with their German, U.S., Turkish, and Russian counterparts as well as representatives from the EU and international organizations, and to develop concrete policy recommendations and mutually beneficial solutions.

The countries of the Western Balkans have come a long way since the violent break-up of former Yugoslavia. They have overcome violent ethnic conflicts and developed from post-conflict and post-communist countries to young multi-ethnic democracies, including all the challenges these transitions entail. Today, Croatia is the 28th EU member state, Montenegro opened accession negotiations in June 2013, Serbia opened accession negotiations in January 2014, Macedonia is an official candidate for membership and the European Commission has already recommended opening accession negotiations since 2009, Albania received candidate status by the Commission in June 2014, Kosovo has started its negotiations on a Stabilisation and Association Agreement (SAA) with the EU, and Bosnia is also a potential candidate country for membership. Moreover, Albania and Croatia are members of NATO.

At the same time, challenges remain. The financial and economic crisis has hit the countries and their economies, and unemployment rates remain high throughout the region. The development of strong rule of law institutions, resilient democracies, the fight against organized crime and corruption, and the guarantee of fundamental rights and freedoms including media freedom are yet to be completed, and bilateral issues still tend to affect bilateral and regional cooperation. While Serbia and Kosovo have already made substantial progress in normalizing their bilateral relations under EU mediation, the process is far from completed, and Macedonia has been suffering from the consequences of its bilateral dispute over its name with Greece as well. Nonetheless, all of the countries face similar challenges on their road to economically stable liberal democracies and depend on each other along the way. Regional cooperation and regional dialog therefore remain key.

The Aspen Institute Germany has actively contributed to a regular constructive high-level regional dialog on common challenges the countries are facing since 2008. For six Southeast Europe Foreign Ministers' conferences and over fifteen sub-cabinet level meetings Aspen Germany has provided a neutral platform. It has fostered dialog and debate *inter alia* on issues like trust, competition, reconciliation, identity and ethnicity, EU and NATO integration, bilateral security roles, organized crime, energy security, economic development, and rule of law. These conferences not only served as an opportunity for a productive exchange of opinions and the development of mutually acceptable ideas for solutions, but also developed a sustainable regional and international network of decision-makers, which can contribute to establishing trust and closer contact between formerly conflicting countries.

We would like to express our gratitude to the German Federal Foreign Office, without whose financial support through the means of the Stability Pact for Southeast Europe this project would not have been possible. Moreover, we would like to thank all participants over the past years, who have so actively contributed to the success of the project, and, in particular, all authors of conference papers, which have provided substantial incentives for discussion, and often suggested constructive solutions. Finally, we would like to thank David Jackson for his contributions to this publication.

We hope you enjoy reading the conference papers, reports, and recommendations and look forward to continuing our commitment to the Western Balkans,

Rüdiger Lentz
Executive Director

Valeska Esch
Senior Program Officer

SUMMARY

In 2014, Aspen Germany held three sub-cabinet level meetings in Alt Madlitz and Berlin with high-level decision makers and experts from the Western Balkan countries, Germany, the EU, the U.S., and Turkey. During these meetings, discussions centered around two key elements of the EU enlargement process: economic development and the rule of law. This publication contains conference papers and proceedings of these meetings that give an overview of the topics discussed and the constructive suggestions and recommendations that were made. All meetings followed the Chatham House Rule, which is reflected in the reports.

The most pressing **reform need on the national level** was considered to be in the field of the rule of law, an area regarded as a prerequisite for further economic development and the establishment of sustainable democracies and liberal societies. In particular, national governments of the region were called upon:

- To show clear political will to continue the reform process beyond the passing of the relevant legislation and improve implementation efforts
- To depoliticize the public sector and increase its efficiency
- To increase efforts in the fight against corruption and organized crime, including the modernization of police, intelligence, security, and the judicial systems, while refraining from any selective justice in this context
- To invest further in human capital, including an increase in public spending for education and vocational training that would address the current skills mismatch and aim for a "knowledge-driven reindustrialization"
- To become staunch advocates of freedom of opinion and expression, including when necessary special measures for the protection of journalists and bloggers to guarantee media freedom

On the regional level, further regional coordination was considered paramount. In particular, national governments of the region were strongly recommended:

- To invest further in the de-politicization of regional cooperation
- To work on infrastructure development and cross-border energy networks on a regional level
- To realize full regional economic integration and make use of all the advantages a full implementation of CEFTA entails
- To build cross-border value chains
- To develop a regional investment concept and mutually benefit from the different national advantages rather than compete for external investment

Finally, a number of recommendations were developed of how the **European Union and its member states** could better support the reform process in the region and further improve the enlargement process. In particular, the EU and its member states were invited:

- To offer a clear timeline for the accession process that reflects the political will of the EU to move forward and thereby gives the younger generation in the region a credible perspective
- To work more on developing public support within its member states to give the enlargement process credibility, which the governments of the region badly need alongside the support of their own electorates
- To do more to reach out to the populations in the region to explain the benefits of the lengthy process
- To develop a clearer communication of tasks in the reform process, especially in the field of the rule of law
- To improve the monitoring system to secure the implementation of laws by local elites, including a measurable interim system of goals to ensure a transparent process
- To consider a system of sticks rather than carrots as many of the rewards go to the elites rather than the population; external validation by the EU disconnects the accession process from society and sharper sticks should target under-performing leaders
- To include into the EU's technical guidance for accession states the enhancement of absorption capacities of already existing EU funds
- To develop a common strategy and increase regional cooperation between member states and the region in the fight against organized crime
- To encourage greater investment in the region, including support to energy investments
- To further support the freedom of the press and develop journalistic expertise

These recommendations were developed in the conference papers and the discussions during the meetings. On the following pages, you can find summaries of the discussions and the conference papers that so valuably contributed to the meetings.

PRESENTATION OF RESULTS

The following points were unanimously agreed upon and presented by the participants of the 2014 Working Group.

Introduction

- The euroatlantic integration of the Western Balkans is the completion of the already existing integration process, which promises stability for Europe as a whole.

- Reforms made on the way to EU accession are for the own countries' populations, especially for the perspective of the younger generations – the region has made its choice and the EU needs to be credible about its commitment.

- The reform process needs a clear timeline which reflects the political will of the EU to move forward and by doing so gives the younger generation a credible perspective.

- One should not only think about the cost of integrating the Western Balkans, but also about how much both sides are already benefiting from existing forms of integration:
  - EU trade
  - Energy Community
  - Future transport community

Economic development

- The countries of the region are experiencing a prolonged economic and financial crisis, which negatively influences the reform process.

- The countries need more investments to boost growth and improve transport and energy connectivity in the region and abolish remaining obstacles to free trade in the region.

- The public sector needs to become more efficient and more adjusted to the EU rules and procedures to reduce state influence on the economy.

- The region needs structural reforms in the education sector, pension system, public finance, and labor.

- The EU is already a major economic partner of the region and the reform process of further integration can help improve the investment climate.

- There already is a number of German companies in the region that have made positive experiences; people can learn from them about the region.

Rule of Law

- Economic progress and growth and the implementation of rule of law are closely linked.

- The region has been undergoing fundamental reforms in the field of rule of law within the EU integration process.

- Rule of law is the basis for the success of reforms, in particular economic reforms, social justice and security, and attracting FDI.

- The key reform policies are ensuring judicial reform and fighting corruption and organized crime.

- These areas reflect already the new approach of the EU accession process and the already existing regional cooperation.

- A major challenge is the independence and accountability of the judiciary and professionalization of administration.

- Neither of these sectoral reforms can succeed without reforms in other areas that guarantee good governance and a functioning democratic system, for example independent media, a strong parliament and civil society.

Outlook

- There are enhanced mechanisms of cooperation in the region, especially on rule of law, economic development and infrastructure investments (connectivity).

- We have learned from our past mistakes and are today working together on our mutual interest and a common future.

- To back up the reform process of the Western Balkan countries, decision makers in the region not only need the public support of their own electorates but also the public support of EU member states to give the process credibility.

SYNOPSIS – ECONOMIC DEVELOPMENT IN THE WESTERN BALKANS

The following pages provide a synopsis of the points that were discussed at the conferences in 2014.[1]

General Situation

- High youth unemployment
- Very high levels of income inequality in all countries of the region; GDP per capita almost doubled in the last decade, but did not translate into higher employment
- Economic growth is important for poverty reduction, but needs to benefit more than just few segments of the population to be sustainable and foster the long-term development of a country
- After the first waves of reform in 2006, there has been a lack of new industrial policies
- There has been a misallocation of capital towards consumption rather than production of goods; FDI has been channeled into the markets and service sectors and not areas of the economy that could help bring down the region's trade deficit
- Due to relatively small market size, domestic companies are unable to generate sufficient profits leading to the companies' weak interest in modernization and innovation
- Large gap between what education systems prepare students for and what the market requires; Vocational training is in a desperate state and schools are disconnected from business
- Western Balkans countries are still attractive for foreign investors due to their geographic location and low labor costs; however, this is undermined by the lack of skills in the labor market
- Corruption represents additional cost to the economy
- Region at critical juncture: desperate need for modernization and reforms, but under tough austerity measures; only solution to this vicious cycle: FDI, carefully targeted and focused on specific industries for creating clusters and introducing new skills and technologies
- Benefits of economic reform take time, leading to diminishing trust in and support of reform processes by population; there are few political incentives to undertake economic reforms

[1] Please note that the following summary will only provide an overview over the points raised by participants. They do not reflect the Aspen Institute Germany's position on the issues addressed.

Foreign Direct Investments

Attraction of FDI

- Foreign investors base their decisions on numerous factors; low levels of corruption, good regulation and favorable business climate are only part of them

- Main drivers of FDI:
  - Size of the host economy
  - Size of the source economy
  - Distance between the two economies
  - Costs of production, especially labor
  - Natural resources
  - Institutional framework
  - Membership of international trade and economic associations

- Location-specific attractiveness with influence on volume and type of FDI:
  - political and economic stability
  - property and profit tax system
  - market size
  - labor force composition
  - geographic proximity
  - competition
  - freedom of entry and exit from markets
  - domestic financial markets
  - energy and water resources
  - infrastructure

- Western Balkan countries have unique opportunities in terms of strategic position, natural resources, relatively cheap labor, young population with comparatively high levels of basic education. These unique selling points need to be strengthened by local governments to increase attractiveness

- There is a negative relationship between the level of corruption and the attraction of FDI

- The effect of structural change in the region has been distorted because FDI has been directed into services (transport, tourism) but a service-led economy has limited growth

Absorption of FDI

- Absorptive capacities of FDI very important; depends on the conditions of the host country

- Trade openness is one of the most significant factors influencing growth through FDI; Quality of workforce very important for attracting high quality FDI and for maximizing its benefits; countries with low-skill workforce tend to attract foreign companies, that are looking for exploitation of cheap labor and investment in mature industries; short-term impact might be positive through increased employment, but no long-term growth generation

- Only way for region to be better exposed to technological catch up is through participation in international trade, FDI, and brain circulation

- Domestic credit has a significant impact on the degree to which FDI can lead to positive developments; domestic credit in the Western Balkans is very limited and costly, hindering the domestic entrepreneurship development

- Importance of the quality of the institutions is the most significant determinant for not only for the attraction but also for the benefits of FDI

Implementing structural reforms

- Key structural problems:
  - External imbalances: due to delays in large-scale privatization, late arrival and unfavorable structure of FDI, ineffective industrial and competition policies and inadequate chances in the business environment, process of industrial restructuring of the Western Balkan economies has been slow, contributing to insufficient export growth; high trade deficits have contributed to rising current account deficits; private sector remains undersized
  - Labor markets: very low employment rates and problems of jobless growth; informal economy still diffused in all countries, preventing the collection of badly needed public revenues; low-skilled and comparatively expensive
  - Structural change: extreme process of deindustrialization and very fast expansion of services at the expense of industry and agriculture; share of tradable goods has declined significantly
  - Slow economic recovery

- States as agents for reform are weak; due to clientelism there is constant turnover in the public administrations and the judiciaries do not enforce contracts

- Public sector suffers from over-employment and is often considered to have better working conditions than the private sector; provides scope for clientelism

- Informal system of double taxation, a bribe tax and a time tax, raises entry costs by around 25% and puts investors off

- From the perspective of investors, predictability is key; good governance is therefore essential

- Non-performing loans are a big problem

- Education reforms need to aim at reducing the skill mismatches and skill gaps that exist as employers complain of an inadequately educated and skilled workforce despite high unemployment

Short- and mid-term measures

- FDI were mostly directed towards services, entering primarily in retail, finance, telecommunications, and sometimes real estate which has biased the sectorial structure of these economies favoring untradeable goods and services

- Import-led growth model as a result of pushing foreign investments towards consumption, including government spending

- Small and medium size companies (SMEs) were so far predominantly established in the service industries; the promotion of SMEs can only become a promising choice under certain conditions: Main partners and customers should be larger firms that can involve them in their programs, organize them, and help them in technology, know-how, management etc. → incentives for SME need to be included in a larger investment strategy and into a larger economic structure; this is possible predominantly in manufacturing and the production of tradable goods, but requires a highly skilled work-force and the establishment of a regional value-chain.

- Countries face the necessity of austerity measures for example through reducing administration, wages in public sector, pensions, and to privatize public utilities; however (example case of Serbia), wages are already low under high unemployment rates and further cuts and reductions of pensions will inevitably lead to a substantial decrease of the country's economic activity and contribute to negative growth rates

- Currently three major problems; countries must:
  - Diminish their budget deficits
  - Make structural shifts towards more tradable goods and exports
  - Find a way for recovery and faster economic growth

- Growth needs to be driven by investment, productivity, competitiveness, economic integration, and local demand

<u>*Recommendations*</u>

- Three core tasks for SEE governments:
  - Economic integration of countries on the global, European and regional level
  - Improving the business environment for investment; therefore, real reforms and bold efforts devoted to the fight against corruption are imperative; "economic rule of law"
  - Investment in people, development of work skills and abilities and preserving wages at the level of labor productivity

- Starting point needs to be the recognition by each of the countries that they are too small and weak to generate sufficient scale and capacity to attract productive foreign investment; each country lacks the required numbers of skilled workers, local financial capacity, and ability to sustain economic cluster; regional integrated growth is therefore imperative; moreover possible but unnecessary competition between countries in the region in attracting foreign investors should be avoided

- Regional infrastructure projects alone are not enough; regional integration is on the agenda, but countries only seem to engage in activities related to regional integration when pressured by the EU → there is a need for genuine intra-regional and intra-industry connection

- Complete trade liberalization should be realized; EU integration agenda should be used to help better regional cooperation through the harmonization of custom and trade regulations

- Countries should build cross-border value chains by leveraging each other's comparative advantages and export the finished products outside the region

- A regional investment concept should be developed

- Countries should focus on export-led growth and further develop production for exports by strengthening the private sector, implementing industrial policy, and intensive re-industrialization through higher investments that raise the level of technology and innovation

- More attention should be paid to designing and implementing specific industrial policy directed at: a) attracting larger investors by means of all known industrial policy instruments including subsidies for certain industries; and b) opening new opportunities for SME that are founded on larger firms entry

- Governments should invest more to support SME in the following areas:
  - Construction of the business infrastructure for enhancing competitiveness
  - Assurance of financial resources for start-up and growth
  - Support the implementation of standardization and certification of products and services for the domestic and European market
  - Support for internationalizing SME and export orientation through a free consultative assistance and promotion of their offers in international trade fairs

- Development of database and network for brokerage in market information and connection with potential partners in the international environment
- Creation of clusters of SME within the value chains on the domestic and international basis

- Need for qualified human capital: public expenditure for education needs to be increased, the rate and quality of graduates in science and engineering improved and vocational education and training developed; “knowledge driven reindustrialization”

- EU should offer industrial policy measures that will help in attracting big investors to come and develop their businesses in the region

Regional Cooperation

- Full potential of CEFTA has not been realized, there is a continued existence of a number of open and hidden trade barriers

- Most of the problems concerning CEFTA trade facilitation are a result of as lengthy procedures, extensive corruption, and absence of political will for cooperation

- Integration has been a mostly politically driven process by the EU in which political differences between the countries have been masked

- Prospect of EU accession seems to threaten regional integration as it encourages synchronicity with the EU but not the other SEE countries

- Lack of contemporary border infrastructure, adequate customs laboratory equipment, and established operational and interconnected IT systems

- Regional Cooperation Council functions as the focal point for regional cooperation; main strategic document: SEE 2020 Strategy with five interlinked pillars that ought to be implemented nationally and regionally: integrated growth; smart growth; sustainable growth; inclusive growth; governance for growth
  - Advantage of SEE 2020 Strategy compared to other efforts is its broader understanding (and planning) of the reform processes which could imply higher coherence of the policy planning, ore coordinated and effective use of the available resources
  - However, narrow timeline creates strong pressure for prompt planning, which is unlikely to be favorable for setting sound policy mechanisms, in particular with regards to linking the national and regional planning
  - Nonetheless, RCC could play an important role in facilitation of the dialog among the SEE countries with regards to the targets

<u>*Recommendations*</u>

- Increase in regional cooperation urgently needed

- Western Balkan countries have to work on improving their competitiveness before joining the EU; CEFTA is the ideal environment to work on this and together find their trade niche within the single European market

- Necessary to support more intensive cooperation between national agencies and economic operators as well as to provide greater transparency and availability of trade related information

- Technical support should be given to countries of the region to put in place a functional IT system in each national entity

- A regional committee should be established to regionally coordinate the full implementation of CEFTA

- Depoliticization of the process of regional cooperation essential

Infrastructure and Energy Security

- Structural problems of the energy sector:
  - Local power generation and supply companies have a poor record of outstanding debt collection from end users
  - Countries are regularly obliged to import electricity at peak demand periods; high import dependency from certain suppliers
  - Foreign investors in the energy sector face numerous hurdles to overcome, which does not encourage further foreign investment
  - Restrictions from public regulators abound in areas such as licensing, low regulated consumer prices with little upward flexibility towards cost recovery, time consuming arbitration procedures

- Objective of enhanced energy efficiency is a shared policy goal, political controversies still concentrate around three key areas:
  - Enhanced energy efficiency
  - Necessary volume of public and private investments in renewable energy
  - Cost-efficient tariff policies/adjustments for private households and corporate entities

- Cross border transport, energy, and communication networks play an important role with regard to regional economic development

- Energy sector is prone to political interference

- Energy price liberalization is a deeply politically sensitive issue

- Infrastructure for the supply of gas: projects diversifying supply are increasingly prominent, but some face technical difficulties; financing and technical expertise are challenges

- Energy cooperation in the region is much needed; Kosovo for example has an enormous supply of coal but it needs the help of its regional partners to make use of it

- Private-public partnerships are increasingly important in infrastructure development, especially involving countries like Russia, China and Qatar; co-funding of major infrastructure projects with governments; problem: these investors want to invest in what they want, not necessarily national priorities; moreover, PPPs are expensive, create a tax burden for citizens, and often fail to alleviate unemployment because they often use outside labor

- There is not enough money available for the required infrastructure projects; EU could do more in this regard

Recommendations

- Cross-border energy networks are essential for regional economic development

- International institutions, in particular the EU, need to further support countries of the region in energy investments, as the levels of investments required for energy infrastructure reform cannot be shouldered by the countries

- Urgent need of improvement of investment climate to facilitate FDI in energy sector

- Regional integration in the energy sector would increase market size and also support attraction of FDI

Economic instruments in the EU enlargement process

- Economic reforms aim to accelerate progress to EU integration but the reality is that people are suffering and the mantra of constant reform is becoming tired

- Risk of SEE countries starting to drift away from the main goal of quick entry into the EU? Economic insecurity is a cause of the drift: Serbia is partnering with Chinese investors to build bridges, motorways and power stations in the country precisely due to the poor state of the economy

- It is difficult to detect the EU's economic impact, which brings into question the credibility of the EU

- SEE politicians are disengaged from the EU accession process: they tend to receive 'orders' from Brussels without engaging with viability of the content or explaining the rationale to the public

- EU has changed its toolbox, but it is too early to tell whether the EU's new economic approach to the region has been successful
    - IPA II was developed to adjust existing implementation arrangements in order to ensure a closer link of pre-accession assistance to enlargement priorities, based on results-oriented, strategic approach targeting key reforms
    - IPA II also aims at being more results-driven with a possibility to shift funds between policy objectives and countries; best performers would receive rewards and assistance to underperformers will be reconsidered
    - Leads to a higher degree of government and national ownership over public sector policy and resource allocation decisions within a sector (previous *acquis* driven approach had the risk of lacking 'real' domestic consequences and turning into a 'box-ticking-approach'
    - Risks:
        - IPA II moves away from a strictly enlargement driven pre-accession financial assistance instrument towards a more general development instrument with references to enlargement
        - Priorities of domestic policy makers might be short-term national development issues instead of a possible EU membership in an unknown future

- Reason for the shift to an *acquis*-driven pre-accession assistance strategy that strictly aims at enlargement via a sector based approach, in turn creating less pressure for compliance to the *acquis* enlargement fatigue?

Recommendations

- Technical guidance from the EU should focus also on increasing absorption capacities of EU funds

- Main role of EU should be to encourage greater investment in the region

- Chinese, Russian, Qatari investments very visible; EU needs to do more to reach out to the populations to explain the benefits

SYNOPSIS – RULE OF LAW IN THE WESTERN BALKANS

The following pages provide a synopsis of the points that were discussed at the conferences in 2014.[1]

Status quo of rule of law in the Western Balkans

- Rule of law is fundamental to socio-economic development, democratic maturity or better laws
- Double heritage from the past: the rise of informal networks that continue to pollute and disrupt the formal order combined with a legacy of lawlessness and violence that tore through the 1990s
- Lack of transparency, culture of impunity; organized crime and corruption must be fought; judicial independence increased; administration based on the universal application of rules must be established
- Democracy has turned into a zero-sum-game power struggle creating a gap between elites and citizens
- Systems are often burdened by organizational complexity, rudimental management issues, such as poor budgetary planning and inadequate use of IT system
- Function of judiciary: control of executive, however, executive branches in the SEE countries have become excessively powerful → finding the right reform balance, strengthening the role of legislative and judicative checks and balances, and ownership of the reform process of local societies is important
- Selective reform implementation by the executive and the belief in the power of legal norms and concepts by the EU → discrepancy between the modern legal order and its implementation in practice
- Political leaders in the region are entering a crucial period in which they must now find the political will to deliver on reform
- A relevant system of values needs to be developed that authorities, institutions, and the population in general adopts and is prepared to defend

EU Enlargement and Rule of Law

- Separation of legal and political criteria (Ch. 23/24) marked a general shift in approach – one that moved reform conditionality and its monitoring by the European Commission to assessing the implementation of formal-legal reforms as well as their sustainability; in order to achieve this, besides the new chapter, opening benchmarks and closing benchmarks were introduced for each chapter
- EU enlargement toolbox has undergone substantial transformation in recent years, moving towards ever-stricter conditionality and from form to substance

[1] Please note that the following summary will only provide an overview over the points raised by participants. They do not reflect the Aspen Institute Germany's position on the issues addressed.

- Problem of diverging notions of what the rule of law is amongst EU members: differences between national jurisdictions and legal systems within the EU make it impossible to construct a universal formula for the requirements, which have to be met for an independent judiciary to exist

- Vagueness of relevant negotiating chapters; most of the benchmarks are of highly political or constitutional importance and related to the general Copenhagen political criteria rather than to the hard EU *acquis communautaire*

- Difficulty to assess progress of implementation of rule of law; mechanisms are inconsistent

- Technical capacities are necessary but not sufficient as politics matters: the rule of law requires checks and balances, and *inter alia* respect for the independence of the judiciary

- EU accession toolbox remains a force of democratization, but EU has regularly undermined its own rule of law promotion policy when it struggles with competing policy objectives

Recommendations

- A strengthened comparative framework of assessing judicial reforms should be utilized since all enlargement countries face similar challenges; would give more succinct systematization of what indicators are to be pursued in order for a country to improve its judiciary reforms

- Clear communication of tasks is crucial; behaviors of local actors can change if they know what they are supposed to do and can be held to account

- EU has to create a comprehensive implementation strategy with a measurable interim system of goals and rewards so that domestic actors have a clear and rationalist-based motivation to adhere to the rule of law conditionality; new approach of opening chapters 23 and 24 first is a step in the right direction

- Credibility of EU conditionality needs to be increased

- Should be much more about stick than carrot, especially as many of the rewards go to the elites rather than the population; sharper sticks should target under-performing political leaders

- Moreover the concept of reward can be problematic because external validation unties the accession process from society

- In order to guarantee a sustainable transformation process the role of civil society and media has to be considered and further included in the EU's rule of law promotion efforts; societal norms and attitudes need to change

Judicial Reforms

- Legacy of Socialist Federal Republic of Yugoslavia: judiciary not independent from politics; separation of power and independence of judiciary principles were hindered by "higher state interests", which led to instrumentalization of law by politics

- Progress has been made in judicial reform; may be due to a strongly institutionalized and clear *acquis communautaire* criterion in this area, especially compared to other areas like police reform

- Common challenges the WB countries face:
  - inadequate constitutional and legal framework
  - overly complex and extended system of courts
  - unclear selection, dismissal, performance, and promotion standards for judges
  - lack of integrated planning, budgeting, and performance measurement capacities
  - weak use of modern information technology
  - onerous administrative burdens on judges
  - lack of continuous training
  - inadequate curriculum of law faculties
  - poorly equipped and maintain law facilities
  - overcrowded and outdated penal system

Recommendations

- Countries' progress should be assessed in four dimensions: judicial independence, efficiency, judicial accountability, and effectiveness
  - Parameter for monitoring of the *independence* of the judicial system:
    - number of politically dependent processes
    - number of political appointments
    - has there been change/increase or decrease of the protection of judges during their conduct
  - The *efficiency* of the judicial system should be monitored in relation to:
    - number of resolved backlog
    - duration of the judicial processes on annual base
  - *Accountability* in the judiciary:
    - number of promotions
    - number of sanctions of judges
    - transparency of work of judges – published court decisions,
    - media presence on public open processes
  - *Effectiveness*:
    - number of trainings provided for strengthening the judicial human capacitates

    - professional qualifications
    - competence improvement – judges' participation in trainings per year

- EULEX has established some important benchmarks about how judges should assess cases – EU accession criteria could provide more guidance on these benchmarks

Rule of Law and the Economy

- Quality of institutions vital for FDI, but FDI does not automatically lead to growth: absorptive capacities, particularly trade openness, human capital, technological capacities, and domestic credit all determine whether FDI generates growth

- Fundamental: economic rule of law

- Corruption is statistically associated with low levels of FDI; 'time' and 'bribe taxes' hinder business

- If domestic institutions uphold monopolistic practices and corruption, FDI can widen social disparities

- Confiscation and restitution claims, overlapping property claims create an unpredictable business environment and make the region less attractive for FDI

Recommendations

- Economic rule of law requires immediate reforms that should aim at constructing functioning economic institutions, curbing corruption, and creating a friendly business environment

- Western Balkan countries should join forces to forge a regional market

- Infrastructure development is critical

Organized Crime and Corruption

- Corruption includes: bribes, clientelism, favoritism, nepotism, patronage, subjective use of law, fused lines between executive, legislative and the judicial; while all this can certainly be found in almost all nations, important aspect is the existence of all in excess, combination, and direct relation to high and low levels of the state's apparatus

- Petty corruption throughout society

- Grand corruption is a serious problem; inefficacy and/or lack of proper social control at the crucial legislative, judicial, and administrative levels are important factors, which may not only expand corrupt practices but also affect the expected institutional performances and decrease their legitimacy and popular trust

- Very difficult to prosecute high-level corruption cases; very elaborate schemes, established structures

- Fight against corruption often used in a corrupted way of selective justice

- Media independence is overwhelmed by corrupt practices in the region; newspapers are aligned to political blocks and often instrumentalized to berate political opponents

- Efforts to balance between the convenience of fulfilling EU conditionality and the profits provided by corruption networks result in the passing of legislation without proper implementation

- Corruption allows organized crime groups to undermine rule of law and formal state institutions

- Wars in Libya, Syria, and Iraq have revitalized the SEE arms trafficking industry

- Cocaine and heroin are reaching historically low price levels, which accounts for high availability

- SEE is the prime entry into the EU for illegal immigration and remains a source region for human trafficking victims

Recommendations

- Need for modernization of local police, intelligence, security and judicial systems

- Initiatives must be multi-level and durable

- A strategy to fight organized crime is needed between the EU and countries of the region

- EU should help by providing material aid but also expert advice and technical support especially on illegal immigration and human trafficking challenges

- Regional cooperation between EU member states and those to be included is important

- EU and Western Balkan countries should play a vital role in supporting youth fundraising projects to provide alternative career options for a vast number of people that are trapped in a life of crime due to lack of other opportunities

- Transparency and accountability in executive, legislative, and the judicial branches is needed, coupled with the use of new technology, the existence of well-established and impartial watchdogs, the periodical review of state decisions by citizen's panels under the monitoring of international organizations, and the training of the younger generation of state officials by neutral and global organizations

Basic Rights

- Western Balkan countries have introduced national constitutions with strong provisions on basic civil, political, social, and economic rights in order to meet the Copenhagen criteria

- Legislation is largely in place, new mechanisms to safeguard basic civil, political, social, and economic rights have been more or less introduced in most of the countries, depending on different constitutional and institutional settings

- Judicial independence, integrity, and impartiality has been strengthened through constitutional and legal guaranties for the judicial branch; measures have been undertaken to prevent the incorrect application of the right at stake

- The high level of normative human rights regulations is not in line with their practical application in everyday life; countries suffer from apparent lack of judicial and political acceptance of human rights

- Most shortcomings refer to restrained access to public information; undue length of proceedings; discrimination in accessing labor market, education, social security or public services; torture; the protection of labor rights; and media repression

- Reasons for civil and political rights violations: delayed investigations, long drawn out trials, failure to enforce court decisions

- Poor execution of judgments and frequent overruling of first-instance judgments affect the implementation of the fair trial guarantees in practice

- Lack of political will is probably the most serious obstacle to the implementation of the rights

Media Freedom

- Freedom of expression and of media are fundamental and inalienable rights of all citizens and an indispensable requirement for democratic states

- Growing violence against media and their property

- Journalists are exposed to evolving risks that rendered an environment where journalists do not feel safe to dispel corruption, organized crime, or state abuses

- Assault of journalists and violations of freedom of expression are often not effectively investigated

- Media itself needs to work more proactively on raising professionalism, objectivity, and accountability for their own work

- Although transformation from state media to public services is completed in the entire Western Balkans, governments still have various mechanisms to control public broadcasters: they are the biggest advertisers in their countries and some newspapers and television channels are subject to unequal treatment; ownership structure is very important for free media

- Media does not represent public opinion but tries to influence it for the benefit of interest groups and politicians; self-censorship is a natural consequence for many journalists if they want to keep their jobs

Recommendations

- Need for joint efforts by state institutions, private sector, civil society, and media to create a sound environment for building the states' capacities for good governance, rule of law, and well-functioning democracy

- States should become staunch advocates of freedom of opinion and expression that are intrinsically linked to media freedoms

- European integration should be used to support the process; a developed monitoring system to secure the implementation of the laws by the local elites should be a priority

- Need to stronger promote the watchdog role media plays

- Special measures for the protection of journalists and bloggers should be established, including through effective and consistent convictions of the attacks on media, as well as through specific guarantees of media freedoms

- Privately owned media should be supported by all means

- Media self-regulation needs to be stepped up and the hidden hand of the states needs to be pulled from the media; need for more investigative journalism → EU should provide more help in this regard

- Increase journalistic expertise to challenge the political elites and to stem the general trend of tabloid style reporting; would also give civil societies further opportunities to challenge decisions taken by elites

The Aspen Institute | Germany

ECONOMIC DEVELOPMENT IN THE WESTERN BALKANS: ON THE ROAD TO COMPETITIVE MARKET ECONOMIES?

June 23-26, 2014 | Alt Madlitz

In cooperation with:

Stabilitätspakt für Südosteuropa
Gefördert durch Deutschland
Stability Pact for South Eastern Europe
Sponsored by Germany

Auswärtiges Amt

The Aspen Institute Germany wishes sincerely to thank the German Federal Foreign Office for its sponsorship of the Aspen Southeast Europe Program 2014 through the Stability Pact for South Eastern Europe.

Accommodation and conference venue: Gut Klostermühle, Mühlenstr. 11, 15518 Madlitz-Wilmersdorf (Alt Madlitz)

Monday, June 23, 2014

Arrival of participants during the day

20:00 Drinks reception and welcome dinner
Venue: Klostermühle Refektorium

Tuesday, June 24, 2014

09:00 – 09:15 **Welcoming remarks and opening of the conference**
Venue: Conference Room Theaterforum

Speakers: Rüdiger Lentz, *Executive Director, Aspen Institute Germany*
Dr. Ernst Reichel, *Envoy for South Eastern Europe, Turkey and the EFTA-States, German Federal Foreign Office*

09:15 – 10:30 **Session I:**
Current economic developments and short-term measures – first steps towards recovery?

Faced with high unemployment, a depressed domestic demand, low foreign direct investments, high fiscal deficits and public debt, the Western Balkan countries share the challenge of difficult economic situations. This session will therefore focus on the current economic situations in the countries and discuss the short-term steps that need to be taken by the governments of the region. What is the status of economic development? What has been achieved thus far? What are the main hindrances to economic development? Which short-term measures can be taken to reduce the high numbers of unemployment? Which sectors should governments focus on? How can new industry be developed? Should the governments invest more to support small and medium-sized businesses? To what extent can the privatization of state-owned companies contribute? How can privatization processes be improved to ensure a transparent and legal procedure? How can the governments work towards attracting more foreign direct investments? Which role can the Western Balkans Investment Framework play? How can governments tackle the issue of high fiscal deficits in the short-term?

Moderator: Rüdiger Lentz
Introductions: Bozidar Cerović, *Western Balkans: Late in Transition, Struck by Crisis, Slow in Recovery – Which Road to Take?*
Anto Domazet, *Current Economic Developments and Short-term Measures – First Steps Towards Recovery in Bosnia and Herzegovina*
Valbona Zeneli, *Current Economic Development and Short-term Measures – First Steps Towards Recovery?*

10:30 – 11:00 Coffee break

11:00 – 12:30

Session II:
Implementing structural reforms in the Western Balkan countries

There is a general agreement that the Western Balkan countries need to undergo structural reform processes in order to encourage sustainable economic stabilization and development. The EU in particular demands a strengthening of economic governance and competitiveness in order to comply with EU economic criteria. Which reforms are needed in order to increase productivity and competitiveness, and improve labor market conditions? What are the most pressing structural reforms the countries need to undergo? How can the investment climate in the countries be improved significantly in order to attract more foreign direct investments? How can unemployment be reduced efficiently? How can the high numbers of unemployment and the low domestic demand on the one hand, and the urgent need for an increase in state finances and fiscal consolidation on the other hand be balanced more efficiently? Is there a need to address the growth of the public sectors in many countries? How can the illicit business sector and corruption be tackled more efficiently? Is there a need to include the education system in the reform process and improve opportunities of vocational training to better prepare young people for their work life? How can rural development be improved?

Moderator: Dušan Reljić
Introductions: William Bartlett, *Implementing Structural Reforms in the Western Balkan Countries*
Ryszard Rapacki, *Implementing Structural Reforms in the Western Balkans Countries*
Milica Uvalić, *Structural Problems of the Western Balkan Economies*

12:30 – 13:30

Lunch
Venue: Klostermühle Refektorium

14:00

Departure to Berlin in front of Fischerhaus

15:30 – 16:30

Meeting with Claudia Dörr-Voß, Head, Directorate-General for European Policy, Federal Ministry for Economic Affairs and Energy
Venue: Federal Ministry for Economic Affairs and Energy

17:00 – 18:00

Meeting with Prof. Dr. Rainer Lindner, Executive Director, Committee on Eastern European Economic Relations, and representatives of German companies
Venue: Haus der Commerzbank, Pariser Platz 1, 10117 Berlin

18:00 – 19:00

Welcome Reception of the 11th generation of the Zoran Djindjic Internship Programme of German Business organized by the Committee on Eastern European Economic Relations
Venue: Haus der Commerzbank, Pariser Platz 1, 10117 Berlin

19:30 – 21:30 **Dinner with Members of the German Parliament**
Venue: Schmugglerscheune, Altes Zollhaus, Carl-Herz-Ufer 30, 10961 Berlin

Wednesday, June 25, 2014

09:00 – 10:30 **Session III:**
Regional economic cooperation – a key to economic growth?

Considering the size of the Western Balkan economies, regional economic integration is often considered key to economic growth. While countries have already created a free trade area and are all members of CEFTA, deeper economic integration in terms of liberalization of services and freedom of movement of workers is yet to be established. What role can deeper economic integration play in the economic development process of the Western Balkan countries? What are the risks and benefits? What are the next steps that should be taken regionally? What role can the Regional Cooperation Council (RCC) and its South East Europe 2020 Strategy play in fostering regional economic integration and development? Can the "Western Balkans Six"-approach provide additional support to the process? How can more political will for regional integration be developed? Is there a need to de-politicize regional cooperation?

Moderator: Johanna Deimel
Introductions: Predrag Bjelić, *Regional Economic Cooperation – A Key to Economic Growth?*
Irena Kikerkova, *Administrative Barriers to Trade within CEFTA-2006*
Silvana Mojsovska, *SEE 2020 Strategy's Challenges in Fostering Regional Economic Cooperation*
Expert Comment: Erhan Turbedar

10:30 – 11:00 Coffee break

11:00 – 12:30 **Session IV:**
The backbone of economic development: strengthening infrastructure and energy security in the Western Balkans

Cross border transport, energy and communication networks play an important role with regard to regional economic development. What is the situation in the Western Balkans? Do underdeveloped transport, energy and communication networks constitute an additional obstacle to regional economic development? In which areas of regional infrastructure is improvement most needed? What role does the huge energy dependence on outside countries play regarding economic development? How can energy security at affordable prices be established? What would its impact be on economic development? Would economic growth exacerbate energy insecurity? What are the steps that need to be taken next? What role does corruption play when it comes to the development of transport, energy and communication networks?

Moderator:	Andrea Despot
Introduction:	Jens Bastian, *The Backbone of Economic Development: Strengthening Infrastructure and Energy Security*
Expert Comments:	Yanni Papapanagiotou Hubert Warsmann

12:30 – 14:00 Lunch

14:00 – 15:30 **Session V:**
EU economic instruments in the enlargement process – evaluation of the new approach

The European Commission's Enlargement Strategy 2013-2014 has identified economic governance and competitiveness as key challenges in the EU integration process. At the same time, not only Croatia as the youngest EU member, but also a series of further EU member states have difficulties complying with EU economic criteria. This session will therefore take a closer look at the EU's economic instruments in the enlargement process, in particular its new approach to help enlargement countries meet the economic criteria. What role can the ECOFIN Council play in implementing strategies aimed at economic growth? How effective are the Pre-Accession Economic Programs and the Economic and Fiscal Programs? What is to be expected from the EU's approach to introduce as a new element structural and competitiveness reform programs? What can further technical assistance by the Commission look like? How can additional administrative capacities in candidate and potential candidate countries be developed considering the already burdened public finances of these countries? What can the EU do to further support the RCC in implementing its SEE 2020 Strategy? In which areas in particular would the Western Balkan countries' governments expect additional support from the EU?

Moderator:	Andrea Despot
Introductions:	Dušan Reljić, *EU Economic Instruments in the Enlargement Process – Evaluation of the New Approach* Mahmut Tekçe, *EU Economic Instruments in the Enlargement Process – Evaluation of the New Approach*

15:30 – 16:00 Coffee break

16:00 – 17:30 **Discussion with Dr. Carsten Enneper, acting State Secretary, Ministry for Economic and European Affairs of the Federal State of Brandenburg**

18:00 Barbecue on the shore of Madlitz lake

Thursday, June 26, 2014

Departure of participants during the day

Bartlett, William

Bastian, Jens

Baumann, Tobias

Bjelić, Predrag

Cerović, Božidar

Deimel, Johanna

Dervishaj, Sokol

Despot, Andrea

Domazet, Anto

Haas, Joachim

Hadžiahmetović, Azra

Harxhi, Edith

Kikerkova, Irena

Majstorović, Srđan

Meredith, Lawrence

Mojsovska, Silvana

Munk, Christian

Ninčić, Roksanda

Papapanagiotou, Yanni

Predojević, Bojan

Quiring, Anja

Radović, Snežana

Rapacki, Ryszard

Reichel, Ernst

Reljić, Dušan

Samofalov, Konstantin

Selimi, Petrit

Smith, Brian T.

Tekçe, Mahmut

Turbedar, Erhan

Uvalić, Milica

Warsmann, Hubert

Zeneli, Valbona

The Aspen Institute Germany

Esch, Valeska
Senior Program Officer

Jackson, David
Rapporteur

Kabus, Juliane
Program Assistant

Lentz, Rüdiger
Executive Director

Wittmann, Klaus
Senior Fellow

REPORT: ECONOMIC DEVELOPMENT IN THE WESTERN BALKANS: ON THE ROAD TO COMPETITIVE MARKET ECONOMIES?

Rapporteur: David Jackson
PhD Candidate
Berlin Graduate School for Transnational Studies
Social Science Research Center, Berlin

The Aspen Institute's conference "Economic Development in the Western Balkans" took place in Alt Madlitz, just outside Berlin, between June 23–26. The event brought together 40 select decision-makers from Southeast Europe (SEE), Germany, Russia, the United States (U.S.), Turkey and the European Union (EU), with professional backgrounds in government, international and civil society organizations, academia, the security sector and foreign service. The conference was divided into five sessions, with the first diagnosing the current state of the economy in the region and the second session discussing which structural reforms are required to galvanize growth. The third session considered the potential of greater regional cooperation, while the fourth examined security and infrastructure development. The concluding session evaluated the EU's economic approach to the region.

Session I: Current economic developments and short-term measures – first steps towards recovery?

The session's opening statement underlined the importance of sound economic governance as an essential ingredient of development, a proposition that is often under-represented in international discourse, especially in relation to 'political matters.' The economy is central to politics, but the benefits of economic reform take time to be felt and so the reforms are often out of step with democratic politics: there are few democratic incentives to undertake economic reforms; therefore, it takes foresight as well brave statesmanship and leadership to make these reforms. It was also recommended that the EU should support structural economic reforms in Southeast Europe (SEE), even though it may generate unpopularity towards the EU.

Experts moved on to discuss the current state of the economies of the region. It was noted that transition is about finding a better institutional arrangement for the economy but the results – the Albanian case aside – seems to have been rather disappointing. Compounding this, the region has been disproportionately hit by the economic crisis due to high exposure to Greek banks and the fall in remittances from diasporas. The region has therefore witnessed a double-dip recession, with high youth unemployment particularly worrying. Economic security is a daily source of anxiety that people face, especially the specter of poverty: 30-40% of the population live under less than $5 a day. One expert explained that the region is suffering from demand-deficient unemployment caused by a general decrease in demand in the Eurozone economy.

Sky-high debt levels were also noted as a cause for concern. By the end of the 1980s, debts of 20bn dollars bankrupted Yugoslavia – the region is currently burdened by 90bn euro debt. Croatia's GDP is below that of 2009, and Slovenia has lost 10% of her GDP since the crisis. Even hitherto performing economies, like Kosovo, are reaching a plateau. The peculiarities of BiH were remarked upon, especially the dysfunctional central state that thwarts the necessary reforms. One expert from the region also highlighted how the floods of May 2014 had wiped off 15% of BiH's GDP, with almost 2bn euros in damages recorded.

Much of the economic dysfunction can be blamed on inadequate policies. One expert explained that after the first wave of reforms in the 2000s, there was room for some industrial policies but they simply did not happen – the window of opportunity was missed. Experts lamented the lack of innovation in the Balkans even though it borders constantly innovating economies. It was recommended that austerity may have been necessary but cannot be relied upon as viable long-term solution. Other analysts advised that there has been a misallocation of capital towards consumption and not to productive activities, and that foreign direct investments (FDIs) have been channeled into the markets and service sector and not areas of the economy that could help bring down the region's trade deficit. It was noted that this policy failure, especially in countries like BiH, strikes right at the heart of questions of government responsibility and authority. Indeed, one analyst suggested that the political instability is the main underlying problem for the economy: first and foremost on the agenda should be to build political stability within and between countries.

What opportunities can the region offer for outside investment? There was consensus that SEE is still attractive for foreign investors due to its geographic location and low labor costs. But some experts warned that this potential to attract investors is being undermined by the lack of skills in the labor market. There was unanimous agreement that education is key for the future but the contemporary challenge is the gap between what education systems prepare students for and what the market requires. Worryingly, education standards have been worsening in the last 20 years. Education budgets are diminishing and strategies for educational development are poor. Illiteracy is increasing in the region, especially in Albania, and scandals at universities, where diplomas can be often bought, are rife. A recent study in the region has revealed the desperate state of vocational training and how schools are woefully disconnected from businesses. Reform of the higher education system is critical – integrity should be a leading element of that reform to counter the brain drain of the population. In Albania, 30% of the most productive segment of the population have left the country in the past decades. But brain drain could also be brain gain: diasporas could help fuel investment back into the region if conditions are right.

One expert advocated that there can be no quick fixes from the outside and recovery should come from internal resources. The EU cannot save the Balkans suggested another speaker; indeed, why should the reform of the Balkans by an EU priority? The answer advanced was that the SEE countries have candidate status, and therefore the EU should take care of the EU family and take steps to minimize regional disparities. The dire economic situation of SEE cannot be understood without reference to the declining EU economy. Remittances from EU countries have diminished and the initial growth in SEE was also due to large influx of foreign credit from the EU and a boom in consumer spending – this is all over now. One expert described the relationship between the EU and SEE in terms of a core-periphery dynamic: the core exports, the periphery consumes – in this respect, the Balkans is on the 'super periphery,' importing without exporting, a dynamic that serves to ratchet up trade imbalances. SEE governments are also generally impotent in the shadow of the Eurozone – they cannot devalue the economy because Balkans countries are highly euro-ized, for example. Many speakers suggested the main role of the EU should be to encourage greater investment in the region.

Session II: Implementing structural reforms in the Western Balkan countries

One speaker noted that there is a need for the 'visible hand of the state' to force economic change as the 'invisible hand' of the market has been ineffective. Many speakers called for these state-led changes to be focused on 're-industrialization.' Another expert summed up the difficulties of industrial policy: how to implement industrial policies in small countries with small markets in which the economic structure is dominated by small companies? One expert suggested that there are two alternative models of re-industrialization. The 'industrial zone' model – witnessed in Macedonia – which has been quite successful but is limited in creating links to the wider economy; and the 'subsidy model' deployed in Serbia, in which important connections to the local economy have been generated but because it is based on government subsidies is rather unsustainable. Another expert suggested that a one-size fits all approach would not be appropriate. In fact, there are different varieties of capitalism, shaped by the different institutional orders in the countries of the region – better synergy between these institutions should be sought.

One speaker lamented that there seem to be few new tools available besides the well-established economic mantras. Another noted that the effect of structural change in the region has been distorted because FDI has been directed into services (transport, tourism) but a service-led economy has limited growth. Yet structural change has occurred: the notice period for workers is the same as in France, for example. Further, structural reforms are necessary in the private sector to support businesses.

Different answers emerged to the question: who should be the agents of change? The starting point was it should be the role of the state to think in the long term and to act strategically. But it was also noted that states in the SEE create rent-seeking environments and barriers to entry. States as agents are weak – due to clientelism there is constant turnover in the public administrations – and the judiciaries do not enforce contracts. Skills in government are also very low: how can we expect from 'dysfunctional elites' an industrial policy that is sustainable? Though the levels of corruption may be exaggerated it still hinders economic development. One expert explained how an informal system of double taxation – a time tax and bribe tax – raises entry costs by around 25% and puts investors off. Civil society can be an important agent, especially in overcoming the social and political divisions that plague countries. One speaker noted that it should be the spark for political reform: 'if people are suffering, they can demand reform.'

The capacity of the private sector to be an effective agent of change was examined. While more foreign direct investment was seen as central to growth, the wisdom of privatization was questioned. Privatization failures, for example in Albania in relation to electricity, were noted, as was the preponderance of FDI towards privatization. Over 70% of investments are related to the privatization process, while only 30% are directed to greenfield investments in the region. Of concern was an impending 'credit crunch' in the region. Private credit flows are drying up in the region. Many of the banks – Greek, Austrian and Slovenian – that are lending in the region face stress tests and will reign in their investments. Non-performing loans are a big problem but at the same time entrepreneurship is thwarted by high interest rates and an important conundrum is where the entrepreneurs of the region find the cash to develop ideas. According to participants, most of the lending that is taking place in the region is under the threshold of 5,000 euros. The region is dominated by micro-finance but the overarching micro-finance framework is not as effective as it should be. Important credit in the next few years will come from the European Investment Banks that will lend to small businesses – but this should be done within a tightened framework that coordinates lending. Some form of regional trade integration is also necessary because the countries of the region offer too small markets to compete globally. One expert highlighted how trade integration is not working: only 10% of trade happens regionally – an incidence way below potential. From the perspective of private investors, predictability is the 'name of the game'. A representative from a major company emphasized that decisions about investments turn on the likelihood of investment plans becoming a reality. Good governance is therefore essential. Others question whether predictability is really important as there were many investments in the region when it was supposedly 'unpredictable' in the early 2000s.

The discussion turned to the basic question of what kind of growth model would be most effective. One speaker explained how Kosovo has experienced 4-5 percent growth for past six years via a 'Keynesian' model of heavy investments in infrastructure. In BiH, a mixed model that emphasizes both private investments and an active role of state in the economy has had mixed results. There is a need for market rules even for state-owned economies. Sectoral focus is important: rather than talking about the business environment in general, each sector should be assessed and treated on its own terms.

Unfavorable comparisons were made with central and eastern European (CEE) countries. Not only are reforms starting ten years later than in central Europe but in SEE there is also an absence of social cohesion and the economies are far less integrated into western Europe than the CEE economies. Unlike in SEE, the structure of FDI in CEE is geared towards manufacturing. In fact, SEE economies produce much less, export fewer goods and the phenomenon of out of work and out of training young people is far higher than in the CEE.

Session III: Regional economic cooperation

The session began with the recognition that the break-up of Yugoslavia prompted the dissolution of a common economic space in SEE. Yet, one expert suggested the creation of CEFTA-2006 has been essential in reestablishing economic cooperation among the Western Balkan countries. The free trade area has refreshed the exchange of goods and provided respect for international standards of regulation. In many respects, CEFTA is where SEE countries practice how to become members of the European Union. Participants also stressed that the full potential of CEFTA has not been realized. Part of the problem is the continual existence of a number of open and hidden trade barriers. For example, all of the CEFTA member states still have to deal with the lack of contemporary border infrastructure, adequate customs laboratory equipment, as well as properly established operational and interconnected IT systems. A lack of experienced customs personnel is an also issue – Yugoslavia had better trained custom officers. Politics also plays a role. Most of the problems concerning CEFTA-2006 trade facilitation process are a result of the low political will and negotiating potential of the member states. It was also noted that CEFTA is being undermined when states such as Croatia accede to the EU.

Participants recommended increasing regional coordination. It was noted that regional cooperation is a cornerstone of the EU's policy framework for the Western Balkans. In this respect, the regional cooperation could be perceived solely as a precondition for further pursuing the process of EU integration of the SEE countries. One expert highlighted how the Regional Cooperation Council (RCC) is a focal point for regional cooperation in SEE and its key role is to generate and coordinate developmental projects of a wider, regional character, to the benefit of each individual participant, and create an appropriate political climate susceptible to their implementation.

However, speakers noted that politicization could scupper the real-world impact of integration. Analysts suggested that integration has been a mostly politically driven process under the auspices of the EU; the political commitment of the SEE countries to the regional integration has been ensured externally, something that masks political differences between SEE countries. The SEE 2020 Strategy aims to turn back the losses of the past 5 years – the right balance between "operationalization" and "politicization" must be found. One expert suggested that the financial crisis has offered a window of opportunity: for the first time the politicians of the region have begun to seriously discuss the economy.

Experts noted that SEE countries are part of a complex of overlapping trade regimes – Russia and China also have regulated trade regimes with SEE countries – but the problem is that countries cannot capitalize on these trade regimes. Another dilemma is emerging: what happens to these regimes as SEE countries move closer to the EU, which regime stays in place? It was also pointed out that the prospect of EU accession actually poses a threat to regional integration as it encourages synchronicity with Brussels but not the other SEE countries. One expert demonstrated that SEE is integrated into the EU but the relation is asymmetric: year on year SEE countries record trade deficits with the EU.

Session IV: Strengthening infrastructure and energy security

The session started off with an expert highlighting three important developments in relation to energy in the SEE. The first is that Gazprom's actions in the Ukraine – the suspension of supplies and the demand for payments upfront – illustrates what lies in wait for energy security of the region. Countries in SEE that are dependent on outsiders for energy may face a 'rude wakening' especially for those countries that have had payment problems. The second is the rising importance of political forces in shaping energy supply. Illustrating this are recent calls by Germany and Poland for a European Energy Union, including a single market for energy. This will be top of the agenda over the next few years, even though it may not become a reality in the near future. Finally, the region is witnessing much needed energy co-operation, including the pooling of resources. Such cooperation should continue: Kosovo, for example, has the second largest supply of coal in the world but it needs the help of its regional partners to 'cash in'.

The mode of infrastructure development was discussed. It was noted that private-public partnerships (PPPs) are increasingly important in the region. Many of these partnerships involve countries – Russia, China and Qatar especially – co-funding major infrastructure projects with governments. One expert was not optimistic about the long-term effect of these kinds of investments. For one thing, it creates confusion as these investors want to invest in what they want – not national priorities. These PPPs are also expensive, creating a tax burden for citizens; they are inefficiently implemented; and they often fail to alleviate unemployment because they often use outside labor. Quite possibly, these PPPs represent a 'new disease' in the region.

The financing of infrastructure is a complex picture: there is an internal dimension and external dimension, as well as 'budgetary' constraints. Generally, financing is an issue as there is not enough money available for all the required projects. The EU could do more in this regard. Energy supply can also determine the scope of states' fiscal capacity. One expert suggested that Gazprom's principal of asking for timely payments is legitimate; while another suggested that this puts a fiscal straitjacket on countries – the Ukraine has to access international credit to pay for gas, for example. There was a consensus that energy security is essential for further economic development. Analysts also recommended that there has to be a discussion about how to keep prices to affordable levels and stressed that major infrastructure projects can have social effects, causing, for example, the price of land to rise.

The infrastructure for the supply of gas was discussed. It was noted that Gazprom faces challenges, as it owns the gas but not the pipelines in Europe. Projects diversifying supply, such as TAP, are increasingly prominent in the region but some of these projects face technical difficulties. The issue is often not financing; the issue is to what degree the relevant SEE countries have technical expertise to, for example, establish zoning maps or to verify property regimes. One expert suggested that the Balkans is caught up in a global energy controversy, which means SEE countries are locked in 'double bind.' On the one hand, they are looking to the east for resources, but are bound politically and economically to the west. The dilemma of being caught between these two poles is difficult to resolve.

Session V: Economic instruments in the enlargement process

The session began with an acknowledgement that the EU has changed its toolbox but it is too early to tell whether the EU's new economic approach to the region has been successful. It was stressed that a new approach has been necessary. An analyst suggested that the region is 'really stuck.' Most young people in the region are living with fewer opportunities than their parents, and human security and welfare nets are fragile. An expert advised that all economic reforms aim to accelerate progress to the EU but this can cause dislocation and make people worse off – with such a development, the EU's legitimacy becomes questionable. The reality on the ground is that people are suffering and that the mantra of constant reform is becoming tired. Moreover, a model of 'off-key' political behavior is plaguing the region. There has been an 'Orbán-ization' of politics: the aggressive, ruthless, anti-EU politics of Hungary's Prime Minister is being imitated by SEE leaders and this kind of politics is out of step with the EU norm.

One speaker voiced the concern that SEE countries will start to drift away from the main goal of quick entry into the EU. Economic insecurity is a cause of the drift: Serbia is partnering with Chinese investors to build bridges, motorways and power stations in the country precisely due to the poor state of the economy. Another speaker suggested that the EU should stop restricting the SEE: 'why shouldn't we find partners in different parts of the world?'

In fact, the difficulty of detecting the EU's economic impact brings into question the credibility of the EU. At the same time, the EU are increasingly involved in evaluating micro-processes in the region – a new kind of intervention that should be implemented with care and sensitivity to the political environment. This new EU economic governance is reflected in a more 'hands on' approach that aims to avoid a 'Greek-style surprise'. One expert suggested that SEE politicians are generally disengaged from the EU accession process: they tend to receive 'orders' from the EU without engaging with viability of the content or even explaining the rationale of adoption to the public. The EU was also criticized for not always allowing for flexibility in relation to the accession process.

From the perspective of Turkey, it feels like the EU is putting the country in a holding pen. The EU's credibility in Turkey is dissipating, while Turkish nationalism is on the rise and can make people believe in misleading things, especially an over-estimation of the nation's power. During the economic crisis, the reflex in Turkey was to blame the EU. It was also noted that Turkey is increasingly active in the SEE region, notably in education institutions and infrastructure. It was explained that Turkey is taking the role abdicated by Greece, diplomatically and economically. Others suggested that Turkey's involvement in SEE has largely failed.

A government official from the region noted that even though the appeal of the EU is damaged, the transformative power of the EU is still felt in the region. The EU model is still the one to which SEE countries want to adjust. Analysts warned of a potential doomsday scenario of the SEE plunging into further economic crisis, at the same time as the EU becomes tired of the region, especially as the issue of security no longer seems so pressing. High public debts as well as massive trade deficits means SEE is sending far more capital back to the center than they receive in return, something that could foreshadow a Greek-style economic collapse.

One analyst suggested SEE countries do not have a free choice to join the EU as they are 'encircled' by the EU. The perspective from Brussels was that the EU does make demands but aims to support choices made by the governments of the region. The view was that SEE countries do not have the right frameworks to withstand market pressures, so the EU, rather than standing on the sidelines, is attempting to guide SEE countries to help them sequence the reforms effectively. One expert suggested that technical guidance from the EU should focus on increasing absorption capacities of EU funds. In this regard, dramatic improvements are possible. The EU commission task force in Greece has helped the authorities there to radically improve their administration. Greater flexibility in designing where EU funds may be allocated would also help SEE countries. Still, the EU should be concerned about its appeal. One expert explained that the EU is about two promises – security and economic development – both of which seem hardly credible after the events in Ukraine and Greece. At the same time, there was a strong recognition that the crisis of the EU will be solved not only in Brussels, but in all the countries of Europe – including those of the Western Balkans.

WESTERN BALKANS: LATE IN TRANSITION, STRUCK BY THE CRISIS, SLOW IN RECOVERY – WHICH ROAD TO TAKE?

Božidar Cerović
Professor
Faculty of Economics
University of Belgrade

In this brief paper I shall try to identify what are the obstacles for better economic performance in the Western Balkan countries and to make a basic sketch of a possible recovery path connecting short-term measures with a longer-term perspective.

State of affairs

After more than 20 years of transition, the overall results in terms of the development of the economies in question cannot be assessed as successful: there are only 11 countries out of 27 observed that have an average growth rate higher than 2% in the period 1989-2008, that is before the crisis affected the majority of those countries. Among Western Balkan countries such a rate was achieved in Albania only but one should bear in mind that the Gross Domestic Product (GDP) of Albania at the starting point was extremely low. After the crisis of 2008 there are only three economies in the region that succeeded in returning to the pre-crisis level of their GDP. On the other hand, Bosnia and Herzegovina (BiH), Croatia, Montenegro and Serbia in 2013 remained at (or came back to) a lower GDP level than in 1989. In table 1 in the appendix and for comparison, we present basic data on growth of these economies together with other Balkans transition countries. For another sort of comparison we also present the data on transition advancement of those countries that was achieved before the crisis (in 2007) as assessed by the European Bank of Reconstruction and Development (EBRD) (sum of nine transition indices; last column).

There are three basic factors for such developments. The first one can be easily understood from Table 1 presented in the appendix. BiH, Serbia, Montenegro, Albania, and to some extent Macedonia lag behind in transition reforms (low EBRD indices). However, the remaining four countries are the European Union (EU) members, which is a fact that has probably accelerated their reform processes. On the other hand, for Serbia and Montenegro (until recently politically attached to Serbia) the main reason for the transition delay is bad politics from the 1990s that brought conflicts with neighbors and with the international community. For BiH the delay was caused by war and internal instability afterwards. Further on, an underdeveloped economy together with some political problems (unrest in Albania in the 1990ies, ethnic conflicts in Macedonia together with a change in politics after 2000) may explain the slow advancement in reforms in the two remaining Western Balkans countries. These delays made those countries a less favorable destination for foreign investments and can explain a relatively low inflow of Foreign Direct Investment (FDI), which undoubtedly slowed down their economic development (see: Estrin and Uvalić, 2014).

Such a situation has only deepened another more general cause of slow recovery in all transition economies after the initial (and expected) transition recession. This general cause is connected with the model of growth recommended and/or induced by common transition schemes. The major course in enhancing growth was generated by increasing demand, which was in turn based on foreign inflows. On the other hand, even when assessed as modest ones, these inflows were targeting predominantly the domestic market. The FDI were mostly directed towards services entering primarily in retail, finance, telecommunications and sometimes real estate. This has biased the sectorial structure of these economies favoring untradeable goods and services. Such a disproportional development was particularly evident in the countries that emerged from former Yugoslavia, which had a remarkably higher share of services in its GDP when compared with other transition economies owing to its specific semi-market institutional arrangement.

It is the crisis that unveiled all these disparities. During the crisis it was found that these models had an important but adverse effect on economic development in almost all transition countries including the Western Balkans. Unfortunately, this finding came pretty late at a phase of a remarkable deterioration in the economic performance of these countries. According to some of my analyses, a certain kind of industrial policy should have been employed already at the medium phase of reforms – that is, after the first wave of transition reform implementation (that includes macroeconomic stabilization, liberalization of markets, prices and foreign exchange and small privatization as the usual first moves in the reform process). Moreover, I have argued that a need of industrial policy was required by the reforms themselves because one could trace the change of growth models in transition economies in regard to the reforming level achieved (see Cerović and Nojkovic 2010 and 2011; see also Fidrmuc and Tichit, 2004 and 2009 and in more detail Cerović et al., 2014, forthcoming). The basic conclusion of all these analyses is that the growth model alters in relation to transition progress while these alterations point at some neglected elements such as a decreasing share of traded goods in GDP and primarily of manufacturing. With few exceptions in the countries with advanced reforms (e.g. Poland) and a bit more among slow reformers (usually resource rich countries) there has been an unprecedented downward shift in industrial production among transition economies. This phenomenon has occurred in the Western Balkans as well, sometimes even on a larger scale.

In table 2 in the appendix this fall in industrial production is presented and is shown from two standpoints. Firstly, I refer to the calculations made by de Melo et al. (1997) who found an inherited over-industrialization in transition economies and has predicted what a proper share of industry in their GDP should be. Using the figures from the cited paper I have calculated what was the real change (in 2007) in regard to the predicted values (in %). The results are shown in the second column from the right. Secondly, the real figures on industrial output share are presented (for 1990, 2000 and 2007) and the factual change over transition period until 2007 before the crisis is calculated (in %, in the last column). The results are presented only for those Western Balkan economies for which all necessary data are available; though data for other Balkan transition countries for comparison's sake are also presented.

The data from table 2 in the appendix give a clear picture of fairly dramatic structural changes that took place in observed economies in the years before the crisis. They also might explain how and why the idea of a new growth model for transition economies has been recognized and put forward. On the other hand this late knowledge has caused some new disparities across transition countries. These disparities are clearly represented by fast growing public debt resulting from fiscal imbalances that were suppressed and covered by foreign inflows. The corresponding data are given in table 3 in the appendix.

Collected from various sources, the data from the table is not fully comparable but they nevertheless show that the crisis has induced a growing deficit over the whole period and in most cases with relatively long-term effects. Indeed, this was not a surprising phenomenon: during the crisis all foreign inflows (including remittances) have diminished while previously they were covering budgetary imbalances. Consequently, such a change caused an increasing indebtedness of the Balkan countries and those from Western Balkans in particular. Thus, for example, countries that emerged from former Yugoslavia are currently indebted around 90bn euro whereas former Yugoslavia just before the break up was seen as a highly indebted country with some 20bn euro of public debt.

Are the governments the only ones who should be blamed for this? The answer is not clear-cut. In my view governments might be blamed to a certain extent and basically for two reasons. First, the governments from the former republics and later countries emerging from former Yugoslavia could be blamed (although not equally) for being unable to find better solutions in regard to the country's crisis at the beginning of the 1990s. Saying this I do not speak about the political side of the story but rather about the economic one that resulted in the loss of large local common market and associated resources. However, this is basically a done cause and cannot be changed much, despite mutual agreements on free(r) trade and similar. Second, which is firmly connected with the data presented above, all the governments of new countries could be blamed because they did not make a better use of foreign inflows when these were relatively abundant. I shall elaborate on this statement further.

It is beyond any doubt that governments of the Western Balkans could use foreign inflows, particularly those coming from privatization, in a much better way. These inflows could have been directed to the diminishing of public debt (which however, were not always excessively high), for development programs and for supporting some industrial policy measures. Nonetheless, we face an issue, which in many cases cannot be posed solely to governments making them the only culprit, particularly if they just followed basic ideas and advices from transition schemes, international financial institutions and other advisers. The point is that there was never any idea in transition programs and corresponding recommendations that would incite governments to take any pro-active policy regarding growth of their economies. On the other hand, a counter-argument could be posed that despite this fact governments could reduce their spending and maybe choose some more appropriate policies. Although this could be a good point, such a move would be in sharp contrast with the prevailing import-led growth model that spontaneously emerged from recommended fast reforming policies. This kind of growth model was actually pushing foreign inflows towards consumption, including government spending, as this was pulling transition economies out of their initial recession (that usually lasted much longer than expected). Moreover, the prevailing policy advice was to press governments to rapidly liberalize and privatize, preventing them to reflect about other complementary policies.

What can be done?

What can be done after all these experiments? It seems that we are currently facing three major problems. The countries in question must (a) diminish their budget deficits and public debts, (b) make structural shifts towards more tradable goods and exports and (c) find a way for recovery and faster economic growth, yet in less favorable economic surroundings than before the crisis. How can these be overcome?

Generally, when a country has a budget deficit, a 'universal' recipe is frequently recommended under the common name of austerity measures. These measures aim at diminishing public spending. Indeed, governments frequently spend more than they may afford but an important question has no universal answer – what kind of spending should be reduced? Is it wise to cut investments in knowledge (education), in health, in research, in safety nets (particularly during the years of crisis) or in culture in a broad sense? The answer is probably negative since all the mentioned fields are factors that could push up efficiency and overall economic performance. Is it possible to remarkably cut subsidies for private investors when countries aim at a necessary structural change towards production of tradable and exporting goods in economies that are lacking local capital? This would be possible, but with an undesired effect of downgrading further economic performance in these countries.

Avoiding explicit answers to the questions posed above, promoters of austerity measures usually advise troubled economies to reduce administration, wages in public sector, pensions and to privatize the remaining public utilities (if any). I shall refer to the example of Serbia in order to show how behind such advice there are fairytales rather than realistic and efficient solutions.

Indeed, reducing administrative employees is always a good move but – what is the real effect? Namely, in public sector employment we usually mix up figures. How does this look like in the Serbian economy? When discussing the number of employees in the allegedly public sector, a figure of some 670.000 people is considered. In that figure one can find almost 100.000 workers from unsuccessfully privatized firms that became temporarily and unwillingly belonging to the 'public sector'[1]. Teachers, professors and doctors, the three professions that are deficient are found in that figure as well. There are also all employed in public utilities that sometimes exhibit over-employment, but also those in the army where employment was radically reduced. Finally, we come to a figure of some 10.000 administrative jobs that could be assessed as redundant and will make a relatively small decrease in public spending. This brings us back to wages and pensions. Apart from the fact that wages are low under high unemployment rates and apart from a dubious legal foundation for pensions reduction, their reduction (fall in demand) will ultimately inevitably lead to a substantial decrease of countries' economic activity and contribute to negative growth rates.

Another measure of austerity policies regards privatization of public utilities. However, even if successfully sold and even if the revenues from sales are efficiently used, this would be a once-and-forever-made-move with no further possibilities (leaving aside the lost revenues from these utilities and probable drop in quality of their services).

Despite these inconsistencies some austerity measures could be undertaken in the short run but only if they were offset by pro-active policies. Here also the countries encounter a form of general recipe that recommends a 'favorable business climate' for establishing small and medium size enterprises (SME). Favorable business climate is usually understood at the cost of workers rights (already weak and suppressed by high unemployment rates in Western Balkans) and a more 'flexible' employment policy (temporary employment in particular, which is already in an excessively broad

[1] When unsuccessful privatisations are discovered and terminated there was no alternative privatisation method except sales and for that reason these firms become temporary SOE waiting for an acquirer to be found.

use; for both phenomena in Serbia see Cerović et al., 2013). The general idea is that SME under these provisions could and should accept redundant workers as well as those already unemployed and should be a force that would counterbalance negative austerity effects. To what extent this kind of policy could work?

In answering the question one has to bear in mind that a large number of SME have already been established in transition economies including the Western Balkan region. Again, and in compliance with overall transition development, they are predominantly established in the service industries (restaurants, cafés, retail shops, boutiques etc.) Is it realistic to expect that the new SME could be established in more productive fields?

This could become realistic and be a promising choice under certain conditions. The basic one concerns their partners and/or customers. The main partners and customers of SME should be larger firms that can involve them in their programs, but could also organize them and help them in technology, know-how, management etc. In turn, this suggests that governments cannot just stimulate investments in SME, but have to do something regarding the revival and/or establishing of *larger firms* that could make a promising market for SME, in this way stimulating local entrepreneurs to undertake investment and become part of larger economic structures. Moreover, this is possible predominantly in manufacturing and the production of tradable goods (in services SME usually are losing when faced with big retailers, hospitality chains etc.).

The above argument can be supported by the following data from EU countries. For example, in Germany 53% of employed people work in enterprises larger than 250 employees and in Finland around 51%, whereas in small firms (below 49 employees) there is 22% in Germany and 25% in Finland of total labor force. For comparison, in Greece some 59% of labor force is engaged in small firms while only 21% in larger firms (Herrmann & Kritikos, 2013). Obviously a vigorous and efficient SME sector emerges in surroundings of larger firms and act as their complement, but cannot be fully effective on its own. This can happen in a sound business environment that is institutionally well designed and supported by an efficient state. Last but not least, this ought to be achieved in conformity with traditional workers rights and even their active role in understanding, promoting and finally, fulfilling firms' objectives as it has happened in the countries mentioned.

The above remarks bring us to a neglected issue of industrial policy in transition economies. It is hard to imagine that all necessary changes, which should be realized in Western Balkans countries, can become a reality without certain policies directed to (a) attracting larger investors – primarily from abroad – by means of all known industrial policy instruments including traditional ones like subsidies for certain industries; and (b) opening new opportunities for new SME that would be founded on larger firms entry, on properly designed institutions and corresponding policy instruments.

Since Western Balkans countries are relatively small in terms of their population and economic activity, the question could be raised whether they are able to create and introduce sound industrial policies on their own. Certainly, this question is correct, but it could be relaxed under two conditions. The first one concerns a higher degree of mutual cooperation between these countries and the second requires a specific EU industrial policy that would include explicit measures for the faster development of these countries and for accelerating their catching-up process. However, such EU policy may not be oriented only on diffused forms of support that are usually the way of EU assistance, but rather on industrial policy measures that will help in attracting big investors to come and develop their businesses in the region. In doing so at least two frequent shortcomings could be avoided: firstly, inadequate use of allotted means of assistance if directly rewarded to the countries and secondly, avoidance of possible yet unnecessary competition among the countries in attracting foreign investors. Eventually this can lead to a better use of available resources in all these countries whether actual or future EU members[2].

Conclusions

Various weaknesses, including conceptual ones, in the Western Balkan's process of transition resulted in unfavorable economic performance and a biased sectorial structure of these economies. A brief analysis of this paper shows that such an outcome cannot be overcome by conventional measures based on austerity and liberalization. More attention should be paid to designing and implementing specific industrial policy for further developing these countries. The policy should attract larger investors to develop activities in the region, which should be accompanied by incentives for SME that could become partners of new larger firms. Taking into account the size of the countries and their economic power, such a policy could be successfully performed under a higher degree of economic cooperation in the region, supported by specifically designed plans within the entire EU industrial policy.

---

[2] For information we show the figures regarding EU assistance from 2007 to 2013 to Balkan pre-accession countries. The main field was assistance in institution building. Figures are in bill. euro and in euro per capita (in brackets): Albania 0.60 (199); Bosnia & Herzegovina 0.66 (143); Croatia 0.96 (218); Macedonia FYR 0.62 (297); Montenegro 0.24 (359); Serbia 1.39 (191); Kosovo 0.64 (346); data from Gjosevska and Karanović (2014). Despite unclear reasons for such uneven distribution one can realise what could be done with these amounts if used for industrial policy purposes.

Appendix

Table 1: Growth during transition: Balkan countries (1989-2013)

Country	Index real GDP 2007 (1989=100)+	Index real GDP 2008 (1989=100)*	Average annual growth rate (1989-2008)	GDP annual growth rates (2009-13)**					Index GDP 2013 (2008 =100)	EBRD 2007[a]
				2009	2010	2011	2012	2013		
Albania	152	163	2.674	3.3	3.5	3.1	1.6	1.5	114	26.66
Bosnia & Herz.	79	84	-0.091	-2.9	0.7	1.3	-0.5	0.8	99.5	24.34
Croatia	111	111	0.055	-6.9	-1.4	0.0	-2.0	-0.7	89	31.66
FYR Macedonia	96	102	0.010	-0.9	2.9	2.9	-0.3	3.0	108	28.32
Montenegro	85	92	-0.044	-5.7	2.5	3.2	-0.5	1.5	101	25.01
Serbia	68	72	-1.714	-3.5	1.0	1.6	-1.7	2.2	99.5	24.67
Slovenia	151	156	2.368	-7.8	1.2	0.6	-2.5	-1.7	90	30.33
Bulgaria	107	114	0.069	-5.5	0.4	1.7	0.8	0.7	98	31.34
Romania	120	128	1.308	-6.6	-1.7	2.5	0.7	2.5	97	30.67

Sources: data from EBRD (2008); * data from EBRD, 2009; ** growth rates 2009-11 from (EBRD, 2012) and 2012-13 from EBRD (2014); *** growth rates 2009-12 from World Bank (2014); [a] data based on EBRD (2009) from: Cerović and Nojković (2009)

Table 2: The fall in industrial production, Balkan countries, 1990-2007

Country”	Industry in GDP 1990	Industry in GDP 2000	Industry in GDP 2007	Industry in GDP de Melo	Ind/GDP de Melo predicted	Ind/GDP: predicted change in %	Ind/GDP: factual change in %
Albania	39.80	7.80	10.30	37	34	-9.1	-74.1
Bulgaria (1991)	39.80	25.80	26.10**	59	36	-39	-34.4
Croatia (1995)	21.46	19.62	17.59	35	34	-2.9	-18
FYR Macedonia	32.27	18.10	21.90	43	34	-20.9	-32.1
Romania	49.95	30.87	33.43	59	37	-37.3	-33.1
Slovenia	33.43	25.60	27.88	44	39	-11.4	-16.6

“In brackets the first observed year; * 1999; ** 2005; ***2004
Sources by columns: 1, 2, 3 , 4 from EBRD (2010); 5, 6 from de Melo et al. (1997, Appendix, Table 1)

Table 3: Budget deficits and public debt, Balkan countries, 2009-13

	Budget deficit in % of GDP					Public debt, 2013	
Country	**2009**	**2010**	**2011**	**2012**	**2013**	**Bill. €**	**% of GDP**
Albania	-7.4	-4.2	-3.5	-3.2	-5.5	...	59.7
Bosnia & Herzegovina	-5.9	-3.9	-2.6	-2.8	-1.6	5.5	43.8*
Bulgaria	-0.9	-4.0	-2.0	-0.5	-1.8	…	…
Croatia	-4.2	-5.1	-5.2	-3.8	-4.7	28.7	61.9
FYR Macedonia	-2.7	-2.4	-2.5	-3.9	-4.2	2.7	33
Montenegro	-5.4	-4.6	-5.2	-4.3	-2.3	1.7	51
Rumania	-7.3	-6.4	-4.3	-2.5	-2.5	…	…
Serbia	-3.9	-3.9	-4.3	-7.1	-7.2	20.0	63.3
Slovenia	-6.3	-5.9	-6.3	-3.8	-7.9	28.8	71.1
Kosovo	-0.6	-2.6	-1.8	-2.6	-3.8	…	…

Various sources; *2012

References

Cerović, Bozidar and Aleksandra Nojkovic (2009), 'Transition and growth: What was taught and what happened', *Economic Annals*, vol. LIV, no. 183, pp. 7-31.

Cerović, Bozidar and Aleksandra Nojkovic, (2011), 'Growth Pattern in Transition Economies: an Analysis after the Crisis', the 9th International Conference of the University of Split *Challenges of Europe: Growth and Competitiveness – Reversing the Trends,* Bol (Croatia), May.

Cerović, Bozidar, Sanja Mitic, Aleksandra Nojkovic, (2013), 'Intangible Capital as a Factor of Competitiveness in Serbia: A Firm Level Analysis – Preliminary Results', EACES workshop: *Competitiveness of Firms, Industries and Countries - Cause and Solution of European Crises*, Belgrade, September.

De Melo, M., C. Denizer, A. Gelb, and S. Tenev (1997) "Circumstance and Choice: The Role of Initial Conditions and Polices in Transition Economies." *Policy Research Working Paper* no. 1866, The World Bank, Policy Research Department

EBRD, (various years), *Transition Report* (and/or EBRD database).

Estrin, Saul and Milica Uvalić, (2014), 'FDI into transition economies – Are the Balkans different?', *Economics of Transition*, vol. 22, no. 2, pp. 281–312.

Fidrmuc, Jan and Ariane Tichit, (2004), 'Mind the Break! Accounting for Changing Patterns of Growth during Transition,' William Davidson Institute *Working Papers Series*, no. 2004-643, William Davidson Institute at the University of Michigan

Fidrmuc, Jan and Ariane Tichit, (2009), 'Mind the break! Accounting for changing patterns of growth during transition,' *Economic Systems*, Elsevier, vol. 33, no. 2, pp. 138-154, June

Gjosevska, Bisera and Goran Karanovic, (2014), 'A Comparison of Policy Responses to the Global Economic Crisis in the Balkans: Acceding Versus EU Candidate Countries', in: Karasavvoglou, A. and P. Polychronidou (eds.), *Economic Crisis in Europe and the Balkans*, Springer, pp. 39-50.

Herrmann, Benedikt and Alexander S Kritikos, (2013), 'Growing out of the crisis: hidden assets to Greece's transition to an innovation economy', *IZA Journal of European Labor Studies*, Vol. 2 no. 14

CURRENT ECONOMIC DEVELOPMENTS AND SHORT-TERM MEASURES – THE FIRST STEPS TOWARDS RECOVERY IN BOSNIA AND HERZEGOVINA

Anto Domazet
Professor
School of Economics and Business
University of Sarajevo
Member of the House of Representatives of the Parliamentary Assembly of Bosnia and Herzegovina

Introduction: Recovery or Collapse

It is indisputable that the crisis in which BiH entered into in 2009 was primarily generated by the global economic crisis. Below the crisis is expressed as a structural crisis of the economy and as a political crisis in political decision-making and governance of the socio-economic sphere of life in the country. It turns out that the economy of Bosnia and Herzegovina has low competitiveness, efficiency and productivity; that the transition is incomplete; that the private sector is weak and the public sector too large. A model of development based on the expansion of domestic demand, and supported by high-volume retail lending, generated in the pre-crisis period an economic growth between 5 and 6%, but with high deficits in the balance of current account and public spending (see table 1 in the appendix).

The economic recovery is weak and uncertain. The level of GDP in 2013 was lower 1.4% than the level of GDP in 2008: 40.000 jobs have been lost and the unemployment rate is 27,4%, but for young people it is over 60%. Deficits of public spending are still high, while overall consumption and investments are falling down and public debt is rising.

The required economic and political reforms are missing, which slows economic recovery and weak progress of the country towards EU and NATO. Ultimately, this creates worse conditions for doing business in the private sector, it reduces investment and employment and it is worsening the already low living standards. Civil protests in February 2014 showed that citizens demand: the elimination of the privileges of the political elite, the clash with crime and corruption, and more jobs. This is a clear request and a call for politicians that reforms must be initiated.

In these days in May 2014, Bosnia and Herzegovina, together with Croatia and Serbia, was hit by devastating floods, which have taken away dozens of lives and brought huge economic damage. Floods hit the area that produces over 50% of the GDP of the country. An already complex agenda of economic problems became even more complex due to this disaster. The high solidarity of citizens in the country, solidarity of neighbors from Croatia, Serbia and EU, as well as from a large number of countries around the world, oblige the authorities to develop and to implement a comprehensive program of reconstruction of flooded areas. The International Donors Conference on Reconstruction in BiH in July 2014 should determine the way, with the help of the international community, to rebuild the flood-stricken country. Renewal must be put in context of economic reform and development in Bosnia and Herzegovina and those two processes will be mutually dependent.

1. What is the status of economic development?

The economy of Bosnia and Herzegovina is a small, open economy. In terms of the monetary regime in the form of a currency board, economic growth is entirely dependent on the balance of economic transactions with foreign countries. That is why the integration into the global and regional economy is extremely important for the economic development of BiH.

The model of economic development for BiH, which should ensure dynamic economic growth, is export-led growth. That requires increase of production and competitiveness of tradable goods. Exports drive growth, but are limited: in 2013 exports comprised only 38.8% of GDP. Further development of production for exports requires strengthening the private sector, the implementation of industrial policy and the implementation of intensive re-industrialization through higher investments that raise the level of technology and innovation. Investments have been falling down since 2008 and have been at a critical level that prevents technological progress. For further growth there are limited potentials, so there is need to apply sound supply-side policies in order to support production growth.

Bosnia and Herzegovina belongs to the group of countries that are with 5,000 USD GDP pc in "the middle income trap". As W. Fengler[1] says, the country is too rich to compete on low-cost manufacturing but is too poor to be a global innovator. The chance for Bosnia and Herzegovina is the so-called "convergence machine" of the European Union. Three directions are facing BiH: 1) integration on the global, European and regional level, 2) improving the business environment for investment, and 3) investing in people, development of work skills and abilities and preserving wages at the level of labor productivity.

The economic situation in BiH is not more serious than the situation in other countries in the region. However, the country is deeply divided, the state is dysfunctional and extremely decentralized and there is no political consensus about its future, about the primary objectives of development, and the manner of implementing the necessary reforms[2]. The period of slow and unstable recovery is accompanied by economic losses in GDP and jobs, which is exacerbated by the serious slowdown in reforms, without which there can be no favorable economic outlook.

2. What has been achieved thus far?

Macroeconomic stability has been improved by the better management of public finances. The stabilization of public finances is due to the performance of the stand-by arrangement (SBA) with the IMF, concluded in 2009 and newly extended in 2012 (with stand-by loan of 384 million euros). That solution was chosen as an alternative to: 1) the policy of increasing taxes, 2) the policy of accelerated privatization, especially cash cows companies (Telecom and power utilities), and 3) austerity in cutting public expenditure. As a result of the implementation of the SBA important structural reforms have been made, although public spending deficits still remain a threat to increased macroeconomic instability.

Some changes have been made in improving the business environment, such as public investment in the construction of highways, particularly in the Federation of BiH, and in the field of electricity with the use of public private partnership in the Republic of Srpska, and in the field of oil and gas. The total investment in these sectors amounted to about 500 million euros per year, while the five-year period will amount to around 3.5 billion euros.

An increase of industrial production (5.3% in the 2013 and in the first quarter 4.6% of 2014) and of exports of goods (6.6% in the 2013 and 6% in the first quarter of 2014), and also a slight increase in the credit activities by 2% in the first quarter, have been recorded. All this has generated economic growth in the first quarter approximately to 2.5%.

The business community in the Federation of BiH have started discussions about radical reforms in the fiscal system. They suggest decreasing the high charges on salaries (from actual rate of 63% applied to net amount of salary to approximately 40%) and to increase value added tax (VAT) from actual level of 17% to 22-23% in order to compensate the losses in public revenue generated by taxes on salaries. The basic intention of this approach is to make labor cheaper and in doing so to increase demand for it, as well as to transfer more tax burdens to the consumption area. This proposal could improve business environment and attract investments

[1] http://blogs.worldbank.org/futuredevelopment/overcoming-middle-income-trap

[2] According to the Dayton constitution of the 1995, B&H is a state consisting of two entities - the Federation of Bosnia and Herzegovina, which is further divided into 10 cantons and the Republic of Srpska. The state has a certain, strongly reduced jurisdiction in the field of economic governance: external and foreign trade policy, customs and monetary policy, funding and establishment of institutions of BH, the regulation of transportation among entities and air traffic control (Article 3 of Annex 4 of the Dayton Peace Agreement). For all other economic governance issues, which are not in the state jurisdiction, the entities are authorized (industry, agriculture, construction, financial system, banks and financial institutions, tourism and services). Even the laws in relation to the jurisdiction of state domain are adopting in BH Parliamentary Assembly by representatives and deputies of the entities on the basis of qualified majority, which means that each entity, under certain conditions, has the right to veto to any decision at the state level. This prevents the creation of a single economic space and creates two parallel legal and economic systems in the country.

and labor demand, but it has some serious political and social implications. Political implications are related to the state level political consensus for these changes, because VAT taxes are a part of indirect taxes, which are in the state jurisdiction. Social implications require introduction of new, reduced VAT rate for goods substantially important for standard of living and higher taxation of different luxury goods and higher incomes in the society.

3. What are the main hindrances to economic development?

Socio-economic structure of the population determines the basic value system in BiH. Only 43% out of the total working age population are active, and 57% are inactive, i.e. dependents. Many of inactive population are users of the budgetary social benefits. In the category of employees, many of them are working in the public sector and are not interested in reforms because of their privileged position. Only a minority in the BiH society who belong to the group of productive workers and entrepreneurs are interested in social and economic changes, but they do not have power to initiate the necessary reforms.

The macroeconomic and business environment does not stimulate business. The huge public sector consumes 45% of GDP and it pressures the weak business sector by high taxes and other levies. Existing deficits cause fear of the private sector that taxes will raise in the next future. These fiscal and para-fiscal burdens produce high corruption, the black market and the resistance to legal employment, and in the end, the contraction of business activities. Governments do not pay attention to the improvement of the business environment. Critical points are many administrative barriers to business, high taxes, corruption, poor access to the cheap capital and too expensive and time-consuming settlement of disputes (enforcement of law).

Small and medium enterprises (SME) can only partially count on the infrastructure for their own development (business zones, technology incubators, industrial parks, research and development centers, and business connections in the form of clusters). Innovation and research activities are not subject to systematic governance in Bosnia and Herzegovina. The total expenditures for R&D in BiH in 2012 amounts 0.26% of GDP, of which 57.6% is generated by the business sector.

The lack of development strategies and policies at the state level prevents a clear vision and framework for business development. The low level of reforms and market liberalization in many areas limit private sector development. Consider the area of energy efficiency, waste management and public-private partnership. On the other hand, the public sector shows low efficiency and is subject to heavy subsidies without any restructuring plans of such companies (railways, military industry and commercial non-privatized companies).

4. Which short-term measures can be taken to reduce the high numbers of unemployment?

The first set of measures relates to the improvement of the business environment and stimulating the growth of existing and new SMEs that may offer new production and employment. We emphasize the importance of the energy efficiency programs, financed by EU IPA funds and other sources, for SMEs growth. The prospective activities for SMEs growth include the processing of aluminum, wood, food, ITC and other business services, and tourism as well.

The second set of measures relates to the potential of agriculture, forestry and rural development. Governments should encourage the organization of cooperatives and linking farmers through value chains on their own or rented land for expansion, and start new businesses in animal husbandry, milk business and other milk products, fruit picking and processing, beekeeping and honey production, the cultivation of berries, mushroom picking, forest plants and fruits, and organic food.

The third set of measures relates to the potential of jobs creation that are offered through public investments in the (re)construction of hydro, thermo, solar and wind power plants and transmission lines and substations, construction of highways and roads, and other public investments.

The fourth set of measures relates to active employment measures, such as additional training and development of skills of job seekers, stimulating first employment through the time-limited subsidies of government in covering payroll of these employees and other measures.

5. Which sectors should governments focus on?

Governments should focus on the following sectors that have built or have the potential to develop a set of competitive advantages in the regional framework.

1. Sector of metal industry with a potential of base production of steel, aluminum and alumina silicate chemistry, energy availability, and a tradition in export markets;

2. Sector of wood industry with potentials of quality wood from the forests of Bosnia and Herzegovina, with traditional production and export of furniture, which creates low value added and seeks a new knowledge in the field of design and marketing;

3. Sector of food and drinks with potential production and processing of meat, milk, fruits, vegetables, honey and organic food with lack of investment in Consumer Packed Goods (CPG), with low level of quality certifications for export to EU and high

needs for logistic capacities, marketing and branding skills for regional and global market niches;

4. Energy sector with a perspective of becoming a regional leader in the production and export of electricity from renewable energy sources with estimated investments in new power plants and power infrastructure of around two billion euros by 2020;

5. Sector of tourism with potentials of cultural, religious, winter sports, spa, adventure and almost all other forms of tourism with the need to invest in diversifying and improving the quality of tourism services and better positioning on the European and regional tourism market.

6. How can new industry be developed?

A study on the development of new economy in the Sarajevo Canton (Institute of Economics Sarajevo, 2011) showed that there is a possibility of creating high value in traditional industries, such as the furniture and metal industry, food and beverage, if technologies, processes, products and services are being developed by using new knowledge[3]. The analysis of high-growth companies shows that those companies are forerunners of the new economy, which ensures high rates of growth in sales and value added. In order to increase the number of fast growing firms, there is a need to develop more sophisticated measures of support for those SMEs, especially in supporting their innovation capacities.

In order to facilitate the creation of new industries in BiH, it is very important for local companies to be included in the value chain of global or regional companies. This is particularly the case in automotive component industry, furniture industry and services based on ICT, a field in which there operates a larger number of global companies in BiH. It is necessary to invest a lot of effort into building an attractive macro-economic and business environment in BiH to attract green field investment in some modern technologies.

Governments could do more to diversify the existing production of aluminum in order to create higher added value and new jobs. Instead of exporting aluminum as a semi-product, new industrial policies could be used as a basis for a new aluminum manufacture production with tens of small and medium exporting companies with several thousand employees.

[3] In B&H there is in progress a business project of restructuring one wood company, which is bought by a local businessman while it was in bankruptcy process. Instead of traditional furniture production of low value-added for this company foresees a new program of wood production in combination with composite materials as building materials for houses payload of up to six floors.

7. Should the governments invest more to support SMEs?

The governments should invest more to support SMEs in the following areas:

1. Construction of the business infrastructure for enhancing competitiveness of SMEs (business zones, technology incubators, industrial parks, research and development centers in collaboration with universities and research institutes)

2. Assurance of financial resources for start-up and growth of SMEs through subsidies of interest rates and the establishment of credit guarantee funds for lending the SMEs

3. Support the implementation of standardization and certification of products and services for the domestic and European market by subsidizing the cost of certification

4. Support for internationalizing SMEs and export orientation through a free consultative assistance and promotion of SMEs’ offers in international trade fairs and exhibitions

5. Developing database and network for brokerage in market information and connecting with potential partners in the international environment

6. Creating clusters of SMEs within the value chains on the domestic and international basis – metal, wood, food and beverage and tourism clusters.

8. To what extent can the privatization of state-owned companies contribute?

The existing portfolio of state-owned enterprises can be divided into those uncompetitive state-owned enterprises that are not interesting to the market of privatization and those state enterprises – “cash cows” (BiH Telecom, the three power utilities, highways and other public companies) which are not offered for privatization. The future of their privatization is related to the liberalization of markets and the ability to cope with competitive pressures in previously monopolized sectors.

The first group of companies is being offered continuously for privatization, but few have an interest in their purchases. Privatization in these cases makes sense if they are being taken over by a capable strategic investor who could implement their restructuring. These are generally unattractive companies with high liabilities, losses and excessive numbers of employees. Governments do not offer any benefits to the potential buyers of these companies, and certainly many of them will end up in bankruptcy because the government will not be able to successfully restructure them.

The partial privatization of the other group of companies would make sense to ensure funds for the realization of significant development projects in the country. As can be observed, there are many areas of necessary government interventions, starting from the construction of attractive entrepreneurial infrastructure, to the subsidies of large investments for which there are no real fiscal resources. In these cases, a sale of a certain percentage of the state capital in "cash cows" companies could provide much-needed capital for development projects, and not threaten the effective management of these companies by the government until the final decision about the future of these companies. For example, if BiH Telecom would sell its 23% of equity, this would raise the share of the private owners to 33%, generating about 200-230 million euros.

9. How can privatization processes ensure a transparent and legal procedure?

The key issue of privatization is that bad companies are being offered for privatization, and the privatization of profitable companies is deeply frozen. Some of these companies were in much better position before economic crisis, but the governments hesitated to make the final decision, although potential investors were ready to buy them. Governments are struggling in a triangle of hellish torment: should they restructure such companies by themselves; or allow new owners restructure them through privatization; or to start up bankruptcy process over them and so to provide a new beginning for them. So, there is simply no demand for companies that are being offered for sale.

10. How can the governments work towards attracting more FDI?

More than 75% of foreign direct investment has come to BiH by 2010 through an acquisition of existing state-owned companies that were taken by private investors from abroad. As the potential privatization has been exhausted or attractive state-owned enterprises have not been offered for sale, a key issue in attracting FDI is how to attract green field investment into the country.

The low level of competitiveness, weak economic growth in the post-crisis period and unattractive business environment suggest the need to promote FDI in BiH by using the push model, i.e. by pushing certain investment projects by local governments or businessmen to foreign investors. This model is limited in achievements because it reflects the vision and initiatives of local entrepreneurs and decision makers. It should work to ensure that foreign investors are encouraged to develop their own vision on the basis of potentials and opportunities offered by Bosnia and Herzegovina. This pull approach would reflect the visions and expectations of foreign investors in connection with Bosnia and Herzegovina as a business location and certainly would lead to increased possibilities of green field foreign investment, especially in areas that may be involved in regional or global value chains in the industry (metal, wood-furniture, food and beverage, chemical, building materials and others), tourism, ITC and business services.

Today, there are many opportunities for buying BiH companies through bankruptcy procedures in which case the companies are free of any liabilities and employees, with opportunities to start new businesses with respective resources and infrastructure (cases in the wood and metal industry).

In the strategies of promoting FDI a special place must have existing investors – they have experience in doing business in Bosnia and Herzegovina. It should the possibilities of reinvestment of profits, whether in expanding existing production or in new businesses.

In the FDI promotion, special attention should be given to investments in the field of production that contributes to development on the basis of re-industrialization and that strengthen the export capacity of the country. Through such investment, the spillover effects in related industries and businesses are generated in a good way.

11. Which role can the Western Balkans Investment Framework play?

WBIF has been significantly affirmed as a framework for regional cooperation in the designing and implementation of investments in the Western Balkan countries. For BiH it is very important to ensure a coordination mechanism for the use of IPA funds from which resources for investment are being created on a grant basis which are associated with funds from international financial institutions.

BiH has a lot of potential projects in the areas covered by WBIF (energy, infrastructure, transport, social sector, sustainable development) and has an interest that such projects enjoy support of WBIF in creating their regional components and in finding additional sources of financing. This importance will be even greater in the future due to the need that finance of development projects should involve private capital on the basis of public-private partnership arrangements. Technical expertise and partnership in finding potential investors may be sources of additional benefits that BiH can obtain from WBIF.

12. How can governments tackle the issue of high fiscal deficits in the short-term?

The long-term goal of fiscal stabilization is to increase revenue based on GDP growth and the efficiency of public expenditures in inducing structural reforms in the economy and public administration. In the short term, it should continue with a stand-by arrangement with the IMF in the next 12 months and by support of loans to carry out the most necessary structural reforms (pension reform and reform of the social sector) and reforms to improve the business environment (labor market, the elimination of administrative barriers and fight against corruption and elimination of grey economy). Missing funds to cover the fiscal deficit should be provided by issuing short-term T-bills and part of the medium-term bonds. Such a situation could, with economic growth, lead to the elimination of the fiscal deficit in the coming mid-term period.

Conclusion

To accelerate economic recovery in BiH, there is a need to strengthen the consensus on the need of reintegration of the country and the need of strengthening the integrated economic governance in the country. In order to increase economic and social development there is a need to implement crucial economic and social reforms in line with European policies and standards. The priority short-term goal is to submit a credible application and to gain the status of the candidate for full EU membership (preconditions: implementation of the decision of the European Court of Human Rights in subject Sejdic-Finci and adoption of the coordination mechanism for IPA funds). In line with NATO integration there is short term goal to join MAP (Membership Action Plan) with a precondition to register the perspective military asset to the state of Bosnia and Herzegovina.

By the upcoming general elections in October 2014, there should be a lot of things done that require urgent solution, primarily a program of recovery of flooded areas in BiH, to solve the deficit in public spending and to take urgent measures to revive the economy.

The new operational agenda of EU to BiH put in the top of priorities an improvement of economic governance for economic growth and employment. In the next weeks an intensive work and joint activities of governments in BiH and EU representatives are expected. Economic priorities should include economic growth, employment, private sector development and stabilization of public spending. In this context, emergency measures should be considered in order to allay the damage of the flooding in BiH in July International Donors Conference.

References

1. Bosnia and Herzegovina: Fifth Review Under the Stand-By Arrangement and Request for Waivers of Applicability and Extension and Augmentation of the Arrangement, http://www.imf.org/external/pubs/cat/longres.aspx?sk=41317.0, access, May, 24. 2014.

2. Central Bank of Bosnia and Herzegovina, Annual Report 2013., Sarajevo, 2014.

3. Domazet, A. (2010): Bosnia and Herzegovina: society and economics in trap of politics, in the book South East Europe after the Crisis – a new down or back to business as usual, ed. by Bartlett, W. and Monastiriotis, V., LSEE – Research on South Eastern Europe European Institute, LSE, London

4. Domljan, V. (2014): Put u zaposlenost, Ekonomski institut Sarajevo.

5. EU Commission staff working document Bosnia and Herzegovina, 2013 progress report, Enlargement strategy and main challenges 2013-2014, http://ec.europa.eu/enlargement/pdf/key_documents/2013/package/ba_rapport_2013.pdf, access May, 25. 2014.

6. Landesmann, M. (2010): Which Growth Model for Central and Eastern Europe after the Crisis? The Vienna Institute for International Economic Studies Policy, Brief No. 4, Mai 2010.

7. Transition Report 2013, EBRD, London.

Appendix

Table 1. Basic economic indicators in Bosnia and Herzegovina 2008-2014

Indicators	2008.	2009.	2010.	2011.	2012	2013.	2014. est.
GDP current prices (Eur Mil)	12.730	12.374	12.666	13.130	13.117	13.427	14.005
GDP in PPP USD	30.338	29.682	30.258	31.242	31.565	32.158	33.338
Real GDP growth (%)	5,6	-2,8	0,7	1,0	-1,1	1,5	2,6
Gross national savings (% of GDP)	13,5	15,2	11,5	6,4	6,3	8,6	8,7
Gross Investments (% of GDP)	28,0	22,1	17,1	15,6	16,0	16,6	16,3
General Gov. Revenue (% of GDP)	45,9	44,6	46,5	46,1	46,3	45,9	46,2
General Gov. Expenditure (% of GDP)	49,5	50,2	50,6	48,9	49,0	48,1	47,5
General Gov. Deficit (% of GDP)	-3,6	-5,7	-4,2	-2,9	-2,7	-2,2	-1,4
Inflation rate	3,8	0,0	3,1	3,1	1,8	0,3	1,1
Export of goods and services (Eur Mil)	4.468	3.785	4.538	5.078	4.902	5.195	5.420
Import of goods and services (Eur Mil)	8,846	6,784	7.369	8.343	8.199	8.149	8.314
Current account balance (% of GDP)	-14,9	6,8	-6,2	-9,9	-9,7	-7,9	-7,6
Total public debt (% of GDP)	30,8	35,4	39,3	40,5	45,1	44,9	42,8
Foreign public debt (% of GDP)	17,2	21,7	25,4	25,9	27,9	29,5	30,5
Domestic public debt (% of GDP)	13,6	13,7	13,9	14,5	17,2	15,4	12,3
Unemployment rate (LFS)	23,4	24,0	27,2	27,6	28,0	27,4	n.a.
Registred unemployment rate	39,9	42,7	43,3	43,8	44,5	44,6	43,0
FDI inflow net (Eur Mil)	684	180	307	355	285	252	256
FDI stock (Eur Mil.)	4.385	4.815	4.977	5.440	5.605	5.857	6.112
WEF Competitiveness Range	106/131	107/134	109/133	102/139	100/142	88/143	87/148
Doing Business Range (number of reforms)	105/178 (1)	117/181 (4)	119/183 (1)	110/183 (2)	125/183 (2)	126/180 (2)	131,/189 (0)

Source: Central Bank of Bosnia and Herzegovina, quarterly bulletins for related years; IMF World Economic Outlook data base, BiH Statistic Agency and other indicated sources – compilation of data by author

CURRENT ECONOMIC DEVELOPMENT AND SHORT-TERM MEASUES – FIRST STEPS TOWARDS RECOVERY?

Valbona Zeneli
Professor of National Security Studies
Deputy Director
Central and Southeast European Program
George C. Marshall European Center for Security Studies

Economic security is today, more than ever, the main challenge facing the Western Balkans.[1] Poverty, unemployment and inequality threaten the everyday security of average citizens in the region. Indirectly affected by the world economic recession through trade and finance spillover channels and strong dependence linkages with European Union markets, this region became highly vulnerable, falling into a double dip recession.[2] The economic downturn has worsened socio-economic conditions, diminishing consumer's confidence in markets, socially dividing the societies in terms of income and wealth levels, declining living standards and shaking social foundations, and threatening the hopes of eventual convergence with advanced countries. To reverse the downhill slide, the Western Balkans needs to change gears, revise the model of growth by accelerating socio-economic reforms, and speed up measures to modernize its economy. In desperate need of modernization, institutional transformation and sustained economic growth, countries should rely on deeper regional cooperation and integration with the EU as the first best option for positive development. The most important drivers of growth will be to catch up with technologies and market friendly institutions of the advanced economies.

State of play in the Western Balkans

The high growth of a decade ago and the catching up process of the Western Balkan economies came to an abrupt end in 2009, with GDP contraction of 3.9 percent. Continuing to struggle with another recession in 2012, GDP shrank again by 1.2 percent.[3] It appears the region exited the recession only in 2013, with anemic growth reflecting the prolonged recession in the euro zone and particularly the weak economies of Greece and Italy. Also, the prospects ahead show weak growth rates and a sluggish recovery, as shown in Figure 1 (see appendix).

The lagged reaction of the euro zone crisis still continues to burden the fragile transitioning economies of the western Balkans, which are battling a sluggish recovery, weak economic output, unemployment, and dangerously high public debts.

---

1 The countries taken in consideration are: Albania, Croatia, FR of Macedonia, Bosnia & Herzegovina, Serbia, Montenegro and Kosovo.

2 South East Europe Regular Economic Report, "From double dip recession to accelerated reforms", No. 3, December 18, 2012, http://www.worldbank.org/content/dam/Worldbank/document/SEERER_3_Report_FINAL_eng.pdf

3 "A double dip recession in the western Balkans", December 2012, the Economist Intelligence Unit, http://country.eiu.com/article.aspx?rticleid=1459991130&Country=Albania&topic=Economy&subtopic=Forecast&subsubtopic=Economic+growth

The main negative contagion channels[4] have been the fall of foreign direct investment (FDI) with the Western Balkans experiencing the sharpest decline of any emerging market in 2009, with a contraction of more than 30% on average; the decline of exports and trade in general, and fall of remittances from expatriate networks. The ongoing credit crunch, mainly because of foreign ownership of the banking system and the serious impact of the Greek economic crisis, the latter being a strategic investor in the region and one of the main trading partners, are continuing to fuel the economic recession in the western Balkans.

Western Balkan economies lag behind the rest of Europe with very low incomes and living standards. The average income levels in the region are as low as 36% of the EU-27, varying from Kosovo with only 22% of EU 27 average, to 61% in Croatia.[5]

At the same time, unemployment in the Western Balkans is the highest in Europe, with and average of 24 percent, twice the west European average (see figure 2 in the appendix). The economic crisis worsened this picture, with more plunging incomes, rising poverty, and unemployment.

Although GDP per capita almost doubled in the last decade, unfortunately it was a jobless growth, which did not translate into higher employment. Western Balkan countries suffer comparatively low participation rates and a lack of opportunities for young workers. Simultaneously, the incidence of informal unemployment continues to remain large, in the still transition economies of the Balkans, with estimated levels to be between 30-40%.

The most devastating consequence of the high incidence of joblessness is poverty.[6] Levels of poverty are highly persistent in the region next-door to Western Europe. The incidence of poverty is extremely high in Albania and FYROM with respectively 58.5% and 40.6% of the population living with less than $5 a day. The best performing economy in the region is Croatia, with only 0.6% of the population living under the poverty line. However, on average this situation has worsened across the Western Balkans, with about 60% of the people surveyed by EBRD, reporting that the crisis has affected them significantly, deteriorating their living standards[7].

If data are read carefully, they also reveal the very high levels of income inequality in the region, since mainly the countries of the Western Balkans have similar patterns of incomes per capita, but very different levels of poverty. (Fig. 3 and 4 appendix)

Hopes of high growth rates and the eventual convergence of living standards with the more prosperous West are put at risk. Economic convergence is fading. The stall of GDP growth in the region is alarming for these weak, emerging economies. Little growth spurts followed by stagnation simply lower the average growth and prolong the process of catch up with the advanced economies.

Countries of the Western Balkans are middle-income economies[8], and research shows when countries get into similar levels of growth, usually they enter “the middle-income trap”, while factors that have enabled them to catch-up diminish, and growth begins to slow down. The explanation is that markets become structured and industries that drove growth in the early periods become uncompetitive, due to rising wages and the cost of living.

Old economic model

The economic model in the Western Balkans is highly challenged. The former socialist countries started implementing the neoliberal transition model, based on the postulations of the Washington consensus, with quick liberalization and deregulation of markets, prices and foreign trade, rapid privatization and deregulation of economic flows. The hope was to replicate the successful model applied in many Central European countries during a quick transition phase into well-established market economies. Instead, in the Western Balkans the same model manifested many weaknesses. Neo-liberal reforms and privatization process have not been effective, but it favored instead insiders and increased corruption.

Among other problems that will be later explained in this paper, the countries of the Western Balkans were encumbered by their unfavorable starting positions – with low incomes and high unemployment in the beginning of the nineties. The situation further deteriorated due to military conflicts and regional disputes in the second half of the nineties, destroying the little existent industrial capacity, disrupting trade among countries and worsening the economic situation. At the same time, governments were distracted from applying and implementing the much-

4 Marios Efthymiopoulos and Valbona Zeneli “From Transition to Opportunity: Security through Economic Development & Institutional Strengthening,” Research in the World Economy, Sciedu Press, Vol.2, No.2 (September 2012), http://www.sciedu.ca/journal/index.php/rwe/article/view/1725

5 Western Balkans Investment Framework, “Challenges to successful employment policy in the region: toward more jobs, quality labor force and greater competitiveness”, Discussion paper, November 2012, http://www.lse.ac.uk/europeanInstitute/research/LSEE/Events/PDF_Files/MASTERChallengestoSuccessfulEmploymentPolicy.pdf

6 World Development Indicators, http://povertydata.worldbank.org/poverty/region/ECA

7 “EBRD “Life in transition survey”, 2011 http://www.ebrd.com/downloads/research/surveys/LiTS2eb.pdf

8 According to the World Bank, countries are considered middle-income when GDP per capita ranges from $5000-$10000.

needed structural reforms.[9] Lagging behind other transition countries, the Western Balkans started deep economic reforms after 2000, making forward strides in their transformation process and catching up slowly with other European economies.

However, developments in the last decade were driven by the accumulation of physical and financial capital, which has over time fueled the sovereign debt of the countries. From a growth theory perspective, the relative high growth was based on domestic demand-led expansion, made possible by large capital inflows mainly through the huge privatization process of the state-owned companies, large credit growth, and private transfers. One of the negative consequences of the large credit capital inflows is their misallocation towards consumption, not feeding properly productive investment activities. All the above hindered the upgrade in competitiveness of these economies.

Economic indicators show a significant performance lag in improving the enterprise sector and creating strong competitive markets. With a very low productivity, growth has so far been based on increased efficiency.[10] Competitiveness of the region is very unsatisfactory. The Western Balkan countries rank very poorly in the Global Competitiveness report 2013-2014, especially when it comes to innovation and business sophistication. With the exception of Croatia, which is part of the group of countries transitioning between efficiency and innovation driven economies, all the other countries are at the second stage of economic development, based on efficiency, according to World Economic Forum indicators. As figures 5 and 6 (appendix) show, the lowest rank is held by Serbia in 101st place and the best is held by Montenegro in the 67th place[11] out of 148 countries taken into consideration. The average rank for the region would be 99, whereas the EU 27's average score would rank it 35th.

Together, with the unfriendly business environment characterized by weak institutions and rule of law, the very limited role of innovation in the economy is another big challenge. The region has the lowest levels of spending in R&D in Europe, significantly contributing to its low competitiveness. Because of weak domestic demand and small markets, domestic companies are unable to generate sufficient profits leading to the weak interest in modernization and innovation. The ranking of some countries in the GCI with regard to innovation and sophistication factors is even worse (table 6). And total productivity can only increase through innovation and technological progress. However, innovation is costly and the poor economies of Western Balkans do not have the financial and human capacities to invest in it. Technology and knowledge can be imported from advanced economies to the Western Balkans only through trade and foreign direct investments. Fortunately, the region is in proximity of one the biggest power-houses of technology and research in the world, the European Union.

The Western Balkans, offering unique opportunities in terms of strategic position, a proximity to western markets, natural resources, and relatively cheap labor costs, still attract very few investments. Montenegro had the highest level of FDI stock per capita in the region in 2012 with $7,715 and Albania and Kosovo the lowest, with only $1,514 and around $1,160 respectively.[12] Throughout the region, with the exception of Albania and Kosovo, countries experienced the sharpest decline in FDI of any other emerging market, after the start of the global economic crisis in 2009. This was followed by another decline in 2012 as it is shown in figures 7 and 8 (appendix). The different situation in Kosovo and Albania is related to the existing low rate of investments and the privatization process.

Such a decreased level of FDI does not depend entirely on the lack of global finance resources, considering that contraction in the Western Balkans in 2009 was almost 30 percent compared to only 8 percent globally. It is rather a crisis of confidence. No important investment will take place without a good knowledge of the political-social and economic environment of the host country.

Foreign investments in the region are mainly market seeking, related mostly to the privatization process, services and financial sectors, or retail trade and very rarely export oriented. The absence of Greenfield investments[13] and lack of investment in the manufacturing industry did not stimulate real industrial growth and development in the market through positive spillover effects.

Foreign investors are reluctant to seriously commit in the Western Balkans for various political and economic concerns, including structural problems of the economies, pervasive corruption and governance issues, and political

[9] Zeneli, V.(2014), "Economic Security in Southeast Europe", per Concordiam Journal of European Security and Defense Issues, Volume 4, Issue 4, pp 10-16, http://www.marshallcenter.org/mcpublicweb/MCDocs/files/College/F_Publications/perConcordium/pC_V4N4_en.pdf

[10] "The Pre-Accession Economies in the Global Crisis: From Exogenous to Endogenous Growth?" Occasional Papers, European Commission Directorate for Economic and Financial Affairs (2012).

[11] "The global competitiveness report 2013-2014", World Economic Forum, http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf

[12] "Data on FDI from ," *UNCTAD (United Nations Conference on Trade and Development) Statistics*, p. 5, http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx?sRF_ActivePath=p,5&sRF_Expanded; For Kosovo, author's calculations based on World Bank data, http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD

[13] Greenfield investment involves establishing a new plant with its own production abroad. There are different definitions of FDI given from different scholars, in this case the definition of OECD is considered : FDI is generally defined as an investment by a firm from one (home) country in another (host) country, where the foreign investor owns at least 10% of the company in which the investment is made (OECD 1996).

risks, inefficient rule of law, weak growth rates, and skill deficiencies. Statistical research has proven that the quality and performance of the institutions and a business environment free of corruption are the main factors that foreign investors consider before entering this region.[14] In terms of attracting foreign investors, based on VC/PE Country Attractiveness index 2013, out of 118 countries taken into consideration, the most attractive country in the Western Balkans is Croatia, ranking the 65th in the list, followed by Bosnia and Herzegovina in the 73rd place, FYROM in the 80th, Serbia the 82nd, Montenegro in the 86th, and concluding with Albania in 108th position.[15]

Few countries in Europe have such high levels of corruption as the Western Balkans, although varying from one country to the other. Research has shown a direct negative relationship between high levels of corruption and income per capita, which is statistically confirmed in the region. According to the Transparency International's corruption perception index 2013, Albania ranks worse in the 116th place out of 177 countries, followed by Kosovo in the 110th position. The best performer in controlling corruption in the region is Croatia ranking in the 57th place[16]. Red tape, overregulation, corruption, lack of transparency, an inability to create a business-friendly economic environment, weak institutions: all of these hurt the competitiveness of the region.

Revising the economic model in the Western Balkans – the economy of the future

The Western Balkans countries are struggling to regain their economic stride, despite facing the double challenge of structural changes under the financial austerity pressures. The old extractive, import-led and financial sector driven growth model needs to be revaluated. The current structure of the Balkan's economies, which accounts for more than 50%, is dominated by services, trade and real estate. The production of goods remains at the lower end of the value chain, based on cheap and unskilled labor. The competitive advantage in the past has been the relative cheap labor, which is not sustainable anymore with increased wages.

The present situation looks gloomy for the region, but long time prospects should be bright, because the Western Balkans has plenty of catch up to do with the rest of Europe. To accomplish these hopes, there is a strong need in all these economies to change the drivers of growth through shifting patterns towards a more export-oriented and foreign direct investment driven growth, which would be more competitive and productive. The economy of the future in the Western Balkans should be envisioned socially just, including the talent of all society, sustainable and based on innovation.

Growth needs to be driven by investment, productivity, competitiveness, and economic integration. Attracting FDI will be crucial to accelerate the trend, learning important lessons from the economic history of Central European countries, which single out FDI as one of the main promoters of economic growth and successful integration into EU.

FDI is even more important for the Western Balkans considering the very low savings rates and the anemic domestic investment. Data shows that Western Balkans is not very attractive to foreign investors. The starting point for each of the seven countries considered in this paper would be the recognition that they are too small, and weak to generate sufficient scale and capacity to attract productive foreign investment. Each country lacks the required numbers of skilled workers, local financial capacity, and ability to sustain economic clusters. Remodeling the economies of the Western Balkans will not be possible without creating a favorable business environment and simultaneously exploring effective cross-border linkages.[17]

Regional integrated growth

The regional integrated growth is imperative. By strengthening the regional trade and investment cooperation, regional economic integration would help achieve more on the international stage collectively and bring multiple positive effects for each country.

Although there has been considerable progress in trade exchanges and the reduction of barriers, trade levels remain low, below 10% of total trade[18]. This low level of cross border activity cannot be explained by the lack of access to each other's markets. A good existing framework is already in place: the Central European Free Trade Agreement (CEFTA), which has substantially lowered the tariffs and eased administrative procedures. However, this framework is still very poorly implemented, with the most problematic issues lying in the non-tariff barriers: lengthy procedures, extensive corruption, and absence of political will for cooperation.

---

14 Valbona Zeneli, "The Determinants for the Attraction of FDI in Southeast European Countries: The Role of Institutions, Ph.D. Thesis, University of Bari (2011).

15 The Venture Capital and Private Equity Country Attractiveness Index 2013, http://blog.iese.edu/vcpeindex/files/2013/08/VCPE-Index-2013-Annual-HD.pdf

16 Ranking of the Western Balkan countries in the Corruption perception index 2013: Croatia 57th, Montenegro 67th, FYROM 67th, Serbia 72nd, Kosovo 111th and Albania 116th. http://cpi.transparency.org/cpi2013/results/

17 Zeneli, V (2013), "Growth and the future of Southeast Europe", Turkish Policy Quarterly, Issue 2013-2, http://www.turkishpolicy.com/dosyalar/files/vol_12-no_2-zeneli.pdf

18 Sanfey, P. and Zeh, S. (2012) " Making sense of competitiveness indicators in south-eastern Europe", EBRD working paper No 145, http://www.ebrd.com/downloads/research/economics/workingpapers/wp0145.pdf

First, regional economic integration through lower tariffs and, even better, complete trade liberalization, the removal of non-tariff barriers, and the liberalization of trade in services would increase intra-regional trade and enhance consumer choices in the Western Balkans. Producers will benefit from the increased size of the market and consumers will benefit from greater competition, receiving higher quality and better prices. It would mean new opportunities in terms of resource exploitation, new markets, and new trade partners.

Second, exporting within an integrated region would serve as a first step towards an expansion of exports internationally, taking advantage of low tariffs within the region, and building exporting capacity and achieving competitive advantage in the long term. Countries can also build cross-border production chains by leveraging each other's comparative advantages and subsequently export the finished products outside the area.

Third, the EU integration agenda, which all countries have as a strategic objective, helps better regional cooperation, through the harmonization of custom and trade regulations in the process of adapting to European standards. The idea of regional integration itself has been pushed and supported by the European Council, and aims to serve as a preparation step for the region before it joins the common market.

Fourth, it is necessary for the Western Balkans to collectively promote and develop a friendly environment for the attraction and targeting of "qualitative" FDI towards sectors that augment domestic investment, foster exports and lead to sustainable economic growth. Countries should cooperate on a "pooled" competition for FDI.[19] Creating a regional strategy for investment promotion and developing a single capital market would help improve the region's global competitiveness.[20] Regional links through FDI typically play a prominent role as they did in the 1990s when Central European countries became integrated in the European production chains. Increased foreign investment in the region along with the direct positive effects for economic growth, employment and higher incomes would be a source for economic modernization, improvement of skills, and overall productivity.

Fifth, public and private capacity building should be one of the main priorities including critical elements such as human resources and skills development, technology, know-how, infrastructure development, and enterprise development. This task is also in line with the EU 2020 growth strategy, which talks about smart growth built on knowledge, education, and innovation.[21] With austerity continuing unabated, it is not an easy task. Future growth could be achieved only operating regionally. Individually, no country has the potential to succeed.

[19] Ibid 18

[20] *European Commission* (2010), p. 2.

Finally, regional integration can help the countries strengthen the economic and political institutions. Working with the EU in the integration process has been of crucial importance to build institutional capacity; however, in the future the region should support itself and carry out reforms for its own sake and without too much reliance on external actors.

International institutions put the region in poor light from the business environment perspective, with corruption being one of the main challenges to doing business. Key issue in creating a favorable investment environment is the urgent need of strengthening political and economic institutions. Investment policies should assure fair treatment of foreign and domestic companies, a friendly business environment, and institutional support for private competitiveness by supporting in particular small and medium enterprises. All countries rank very poorly in World Economic Forum indicators, when it comes to effectiveness of anti-monopoly strategy, with Bosnia and Herzegovina ranking best in regional terms in the 68th position out of 148 countries and Serbia worst in the 141st position.[22]

Real reforms and bold efforts devoted to the fight against corruption are imperative for creating a friendly business environment and to carry out growth strategies that can support productivity growth, increased competitiveness, create jobs and facilitate income convergence. Implementing a more effective privatization strategy cutting bureaucratic red tape and bribery would unleash the creative destruction necessary for economic growth in the region.

Smart growth

Many of the socio-economic problems affecting the Western Balkans cannot be solved or alleviated unless robust economic growth returns in the region. In line with SEE 2020[23] growth and development strategy, following the European perspective of the regions' future, the drivers of growth should be based on innovation, skills, and trade integration.

[21] "Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth, *European Commission,* March 2010, http://ec.europa.eu/eu2020/pdf/COMPLET%20EN%20BARROSO%20%20%20007%20-%20Europe%202020%20-%20EN%20version.pdf

[22] Effectiveness of anti-monopoly policy, The Global Competitiveness report 2013-2014, page 488, http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf

[23] South East Europe 2020: Jobs and prosperity in a European Perspective, Regional Cooperation Council, August 2013.

Cheap labor, which has been a competitive advantage of the region in the recent two decades, is vanishing. Qualitative human capital based on a skilled labor force is the main source of productivity and innovation and factor of growth and job security in this century. The Western Balkans should promote an innovation and knowledge based economy.

According the Word Bank's Knowledge Economy Index (KEI) 2012,[24] an indicator that measures countries' potential to generate growth, taking into consideration four important pillars for development (economic incentives and institutional regimes, innovation and technology, education and training and ICT infrastructure), the countries of the Western Balkans rank variously. Out of 146 countries researched, the best performer in the region is Croatia ranking in 39th place, followed by Serbia at 49th, Macedonia at 57th, Bosnia and Herzegovina at 70th, and Albania at the 82nd position.

Statistics show that knowledge-based development is possible only if there is qualitative human capital. And this latter is grounded in modern education and solid skills.[25] International institutions raise issues about the lack of skills in the workforce in the region, which depend both on the quantity and quality of education. According to World Bank reports in 2012, tertiary education attainment rates were very low (although enrollment rates are much higher), on average 15%, in comparison to 36% of EU countries[26]. On the other side when it comes to the quality of education, and the local availability of specialized research and training services, the World Bank lists countries, out of 148 countries, as follows: Croatia in the 74th, followed by Macedonia in 78th position, Montenegro in 99th , Bosnia and Herzegovina in 100th, Albania in 113 and Serbia in the 121st rank[27].

Following the logic of the statistics, the task for the next years is to increase the quality of education, especially focusing on tertiary education.

Even in the regional perspective, infrastructure projects alone are not enough; regional cooperation needs to be put in a much wider development context, aiming at the advancement of human capital by strengthening the regional value chains and supporting the creation of transnational clusters and business networks. A bigger and integrated market facilitates innovation. The promotion of linkages between academia, industry, and policy makers is important for promoting the free flow of talent throughout the region, encouraging brain gain, supporting private and public sector investment in R&D, and regionally coordinating policies that would enhance innovation and promote the knowledge economy.

In the global economy, even countries with limited geographic area and resources can strengthen their economies and increase national strength, though fully engaging in the international marketing. In this century the choice is not anymore between being a “big“ or “small” state, but being a “smart” or “laggard” state. A “smart state”, through its inclusive institutions, is capable of correcting problems, giving the right policy guidance, creating favorable conditions for successful private entrepreneurship and promoting innovation through greater inclusion of all talent of the society.

The international economy enables countries that are stable, secure and open to learn rapidly from those in the vanguard of economic performance. Under two conditions: the host countries should invest in education and inclusive economic institutions.

---

[24] World Bank, Knowledge Economy Index (KEI) 2012 Rankings, http://siteresources.worldbank.org/INTUNIKAM/Resources/2012.pdf

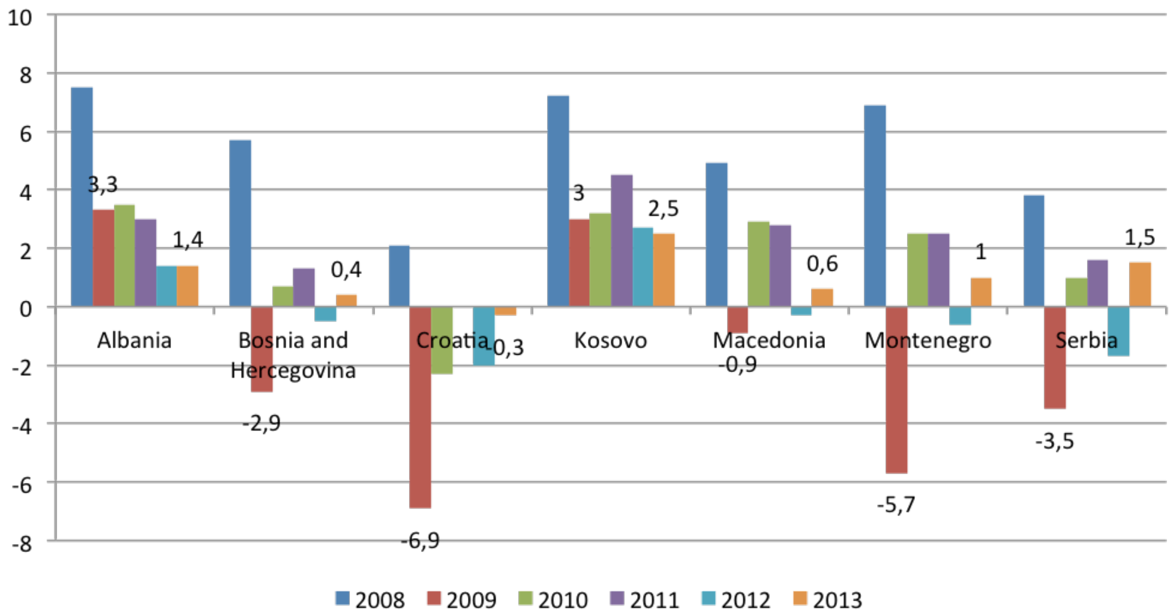
[25] Ibid 23

[26] Educational data from World Development Indicators and UNICEF- TransMonEE, www. Transmonee.org

[27] The Global Competitiveness report 2013-2014, http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf

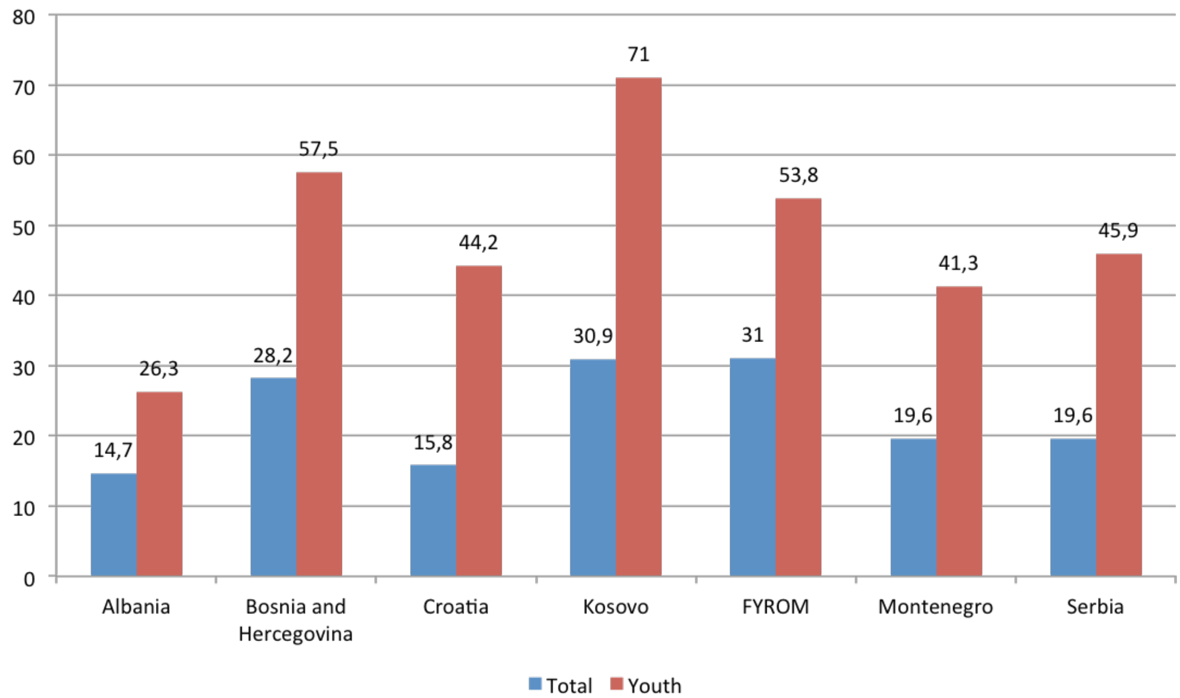
Appendix

Figure 1: GDP growth rates in the Western Balkans (2008-2013)



Source: IMF World Economic Outlook, April 2014

Figure 2: Unemployment in the Western Balkans 2012, % of population (total and youth)



Source: World Development Indicators, World Bank database

Figure 3: Incidence of poverty in the Western Balkans Percentage of population (2013)

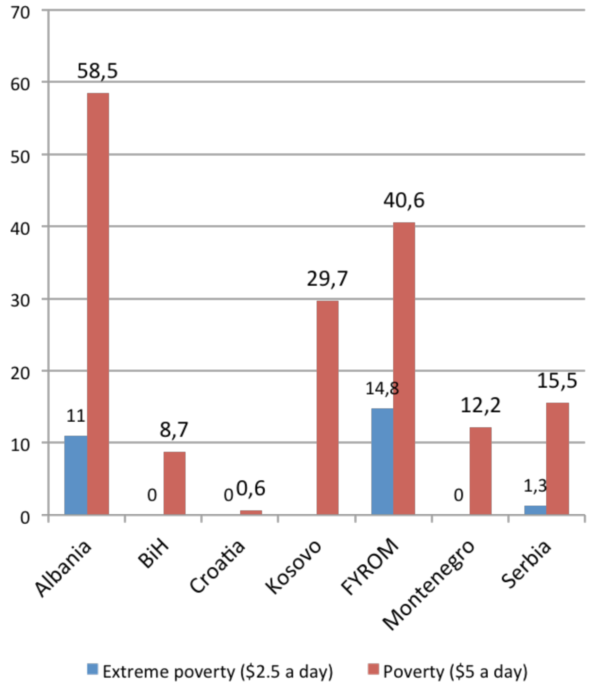
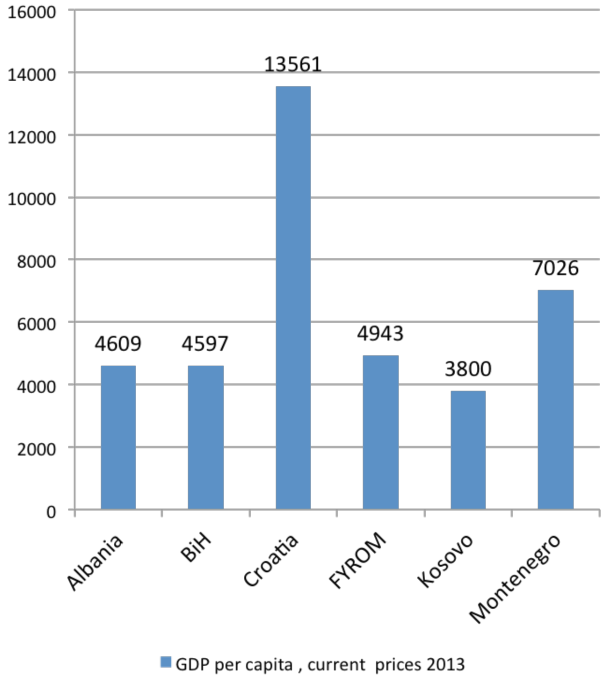


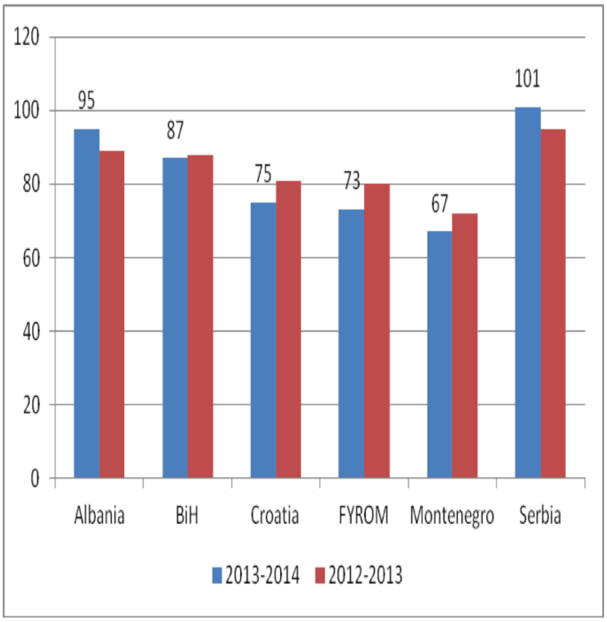
Figure 4: Gross Domestic Product, Current prices (2013) Values in US $



Source: World Development Indicators, World Bank database

Figure 5: Competitiveness in the Western Balkans Ranking based on 148 researched

Source: Global Competitiveness Index, World Economic Forum database, Kosovo is not included in the data.



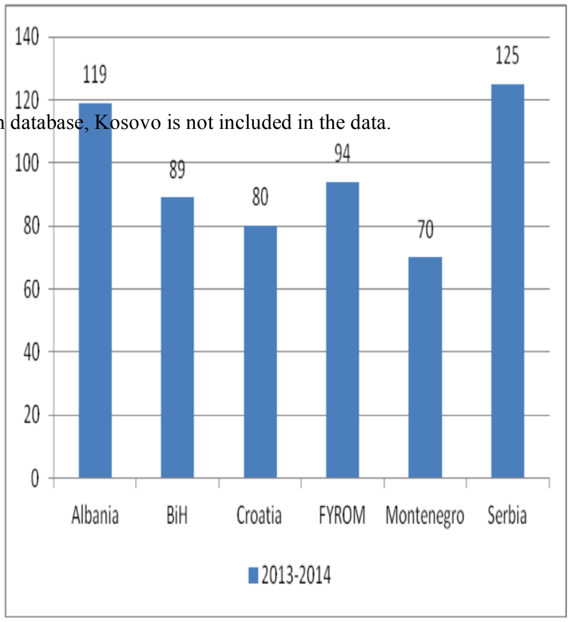


Figure 7: Inflows of FDI pc in the Western Balkans
Values in US $

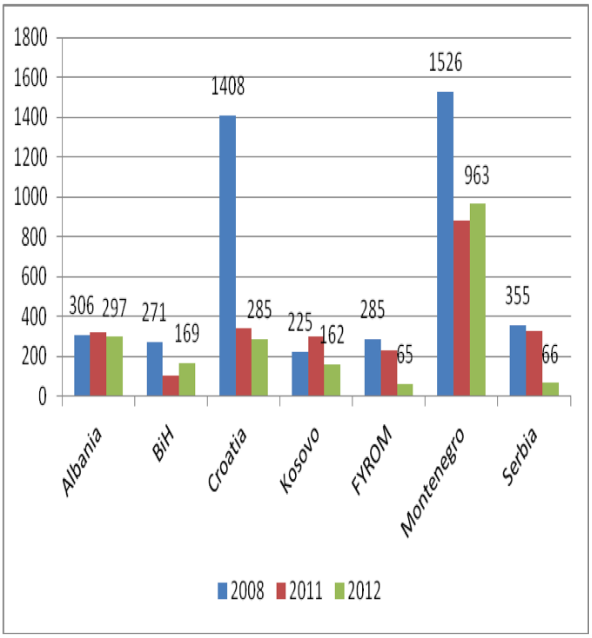
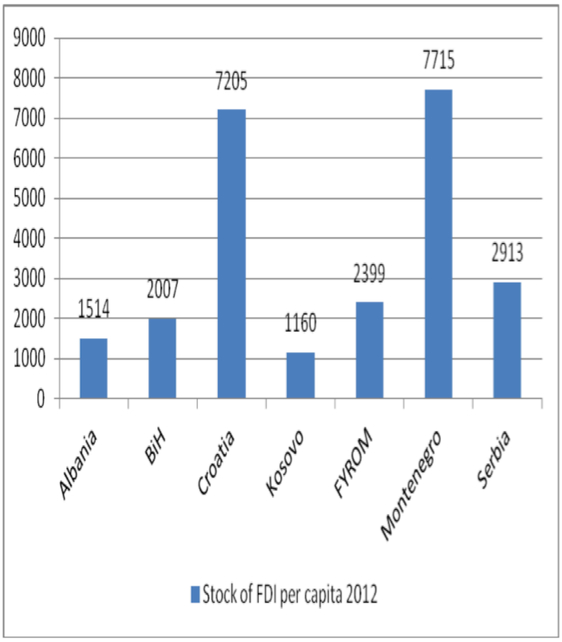


Figure 8: Stock of FDI pc in the Western Balkans
Values in US $



Source: UNCTAD database. For Kosovo, author's calculations based on World Bank data.

IMPLEMENTING STRUCTURAL REFORMS IN THE WESTERN BALKAN COUNTRIES

William Bartlett
Senior Research Fellow
European Institute
London School of Economics and Political Science

1. The economic problem in the Western Balkans

After 25 years of transition the economies of the Western Balkans are in a perilous state. Unemployment has climbed to alarming levels. This is partly due to the fallout from the spillover effects of the eurozone crisis, but structural unemployment was already high in the preceding period (Bartlett, 2013). Chronic balance of payments problems and foreign trade deficits have underlined the lack of competitiveness of these economies. External deficits were covered by inflows of foreign capital and worker remittances in the first half of the 2000s, but these sources of funds declined sharply over the last five years. Foreign banks, which took over the banking systems of the Western Balkans in the late 1990s and early 2000s and which supported economic growth by a large expansion of credit in the last decade, have now begun to pull their funds out of the region in a continuing process of "deleveraging"[1]. In consequence, the supply of credit to small and medium sized businesses has been choked off and, although the banking system appears well capitalized, there is an alarming increase in the proportion of total loans that are "non-performing", in other words the debtors are essentially bankrupt.

A further characteristic of the Western Balkan economies is that they have become heavily "euroized". Some (Kosovo and Montenegro) have adopted the euro as legal tender, Bosnia and Herzegovina has a currency board that ties its currency to the euro, and the other countries have more or less fixed pegs to the euro due to the euroization of the financial system. This means that a significantly large proportion of households and businesses have taken out euro-denominated loans and their ability to repay would be jeopardized by a devaluation of the local currency. Thus an external devaluation is ruled out as a means to improve the competitiveness of their economies. Just as the countries in the periphery of the eurozone, the Western Balkan countries are forced to rely on "internal devaluation" to improve their competitiveness so as to cover their structural external deficit. Internal devaluation requires improved efficiency, productivity and lower labor costs in order to make exports more competitive. Since the Western Balkan countries do not have recourse to eurozone bailout funds to assist in this process, one could say that they find themselves in the "super-periphery" of the eurozone (Bartlett and Prica, 2013).

2. The need for structural reforms

A large structural reform agenda therefore faces the Western Balkan countries in order to raise their internal

---

1 See "CESEE Deleveraging and Credit Monitor" published regularly within the Vienna 2 initiative by the IMF and others.

competitiveness. In the private sector, reforms are needed to reduce the monopoly power of incumbent large businesses that captured domestic markets in the aftermath of privatization, and to provide greater flexibility in the labor market to redress the imbalance between "insiders" and "outsiders" and enable young people to access jobs. An improved business climate is needed to lure back the vanishing foreign direct investment that is needed as a source of technology transfer and insertion into the global supply chains that are the backbone of modern industrial and service economies.

In the public sector, reforms are needed to improve the efficiency and effectiveness of public services. This includes an array of measures to better regulate public enterprises such as local utility companies, but also in the field of public services, including education and health services. High quality education systems are needed to provide a highly skilled labor force that would enable improvements in competitiveness of the domestic economy and attract foreign direct investment. High quality health services are needed to ensure a physically productive workforce. Public sector services often fail in both respects. In addition, the public sector suffers from over-employment and protected employment. A job in the public sector is often prized for its better working conditions compared to the private sector. This provides scope for widespread clientelism, as political parties distribute public sector jobs to their party members as a reward for support in elections. Consequently, a program of public administration reform is also high on the reform agenda.

3. Private sector reforms

Private sector reforms have focused on the business or investment climate, and on labor market reforms to provide incentives for employers to take on new workers.

Concerning the business climate, the World Bank has been active in developing an indicator known as the "ease of doing business" index which measures various aspects of the investment climate in countries around the world. This ranks countries according to the business climate, and several of the Western Balkan countries fall down badly in this respect. Bosnia and Herzegovina is the worst performer, but Serbia also does quite badly, especially in respect of enforcement of business contracts. It should be noted however that Germany and Austria do not come out well either, being placed in a lower ranking than all the Western Balkan countries except Bosnia and Herzegovina.

Exceptionally, FYR Macedonia[2] has recently introduced a set of structural reforms to improve the business climate and has risen up the scale to become one of the best performers in the world in terms of the ease of doing business. It is significant that Macedonia is also the only country in which the unemployment rate has been falling in the last five years during a period of economic crisis. The structural reforms that have been adopted in Macedonia may have something to do with this and could perhaps be emulated in other countries in the region. In addition to making it easier to start a business, the tax rate on corporate profits has been reduced to just 10% in a flat tax reform, and investors in special industrial-technological zones have been exempted from corporation tax altogether. This, along with certain other incentives has led to an inflow of foreign direct investment into the zones especially in the motorcar components sector that has created several hundreds of jobs. However, apart from the creation of new jobs, there have been relatively few backward linkages into the local economy; the zones remain islands of foreign investment that are unlikely to support the needed general improvement in productivity and efficiency that is needed throughout the economy. In Serbia, a large investment has been made by FIAT in a new factory in Kragujevac to produce the new FIAT 500L motorcar. However, the investment has been heavily subsidized by the Serbian government to the tune of €10,000 per worker. It has led to a boost in Serbia's export performance in 2013. However, subsidized job creation may not be a sustainable strategy, especially since the budget deficit has increased to around 7% of GDP, and the government has announced a severe fiscal consolidation over the next few years.

Labor market reforms are also high on the political agenda. For example, the Serbian government has proposed an extensive labor market reform. Although delayed by the resignation of the economy minister and recent parliamentary elections, it is now a priority of the new government. A central plank of the reform is to link redundancy payments only to the length of service with the existing employer rather than to the entire employment record. It is thought that the existing arrangement discourages employers from taking on new workers. However, there is little robust evidence that such a change would make much difference to new hires. In general, during the crisis, the share of wages in gross national income has been decreasing, and with sky-high unemployment rates the power of workers to demand excessive wages or improved conditions is extremely weak. The main impediment to improved job creation seems to be much more on the demand side than in restrictions on labor supply.

Overall, the countries of the Western Balkans have employment regulations that are fairly in line with those in the EU countries. For example, the notice period for redundancy for a worker with one year of tenure is 4.3 weeks in Albania, Croatia, Kosovo, Macedonia, and Montenegro, just the same as in Poland, France and Germany. In Bosnia and Herzegovina it is 2 weeks, while there is no notice period at all in Serbia. The amount of severance pay for a worker with 5 years' service is 10.7 weeks in Albania (the same as in Germany), 8.7 weeks in Kosovo, Macedonia (the same as Poland and Hungary),

2 Henceforth "Macedonia"

7.2 weeks in Bosnia and Herzegovina, Croatia and Serbia and 6.5 weeks in Montenegro[3]. Among EU countries, only France and UK have lower levels of severance pay. While the level of severance pay could be reduced, it seems unlikely that this would do much to boost employment levels. Moreover it might further reduce aggregate demand. If redundancy periods and severance pay were relevant to employment it would be difficult to explain the better performance of Macedonia in reducing unemployment compared to other Western Balkan countries.

4. Public sector reforms

Turning to the public sector, the weakness of the state in the Western Balkans is a real cause for concern. Despite the relatively large share of employment in the public sector, the state is not well structured to support economic growth. In addition to the problems of corruption, clientelism and the weak judicial systems, the state fails to provide adequate education and health services to support productivity of the workforce. In a recent study of the vocational education and training systems in the Western Balkans, many deficiencies were identified including poor teaching quality, poor teaching methods, lack of investment in up-to-date equipment and poor quality of school buildings (Bartlett et al. 2013). In addition curricula are often out of date. In Bosnia and Herzegovina, for example, the most recently updated curricula are in IT subjects, but even this was updated as long ago as 2003. Other curricula in widespread use date from the 1980s. It is little wonder that employers complain of an inadequately educated and skilled workforce, and difficulties in finding workers with appropriate skills despite the high levels of unemployment.

In the health sector, a two-tier health system has developed. Public health services are underfunded and provide low quality care. The upper income groups have moved to the private health care system, which has flourished and now accounts for almost one third of health care expenditure in most Western Balkan countries. In Macedonia for example, the quality of public health services has fallen due to lack of investments in new technologies and equipment, deterioration of facilities, and low motivation. Out-of-pocket expenditures have increased, with a negative impact on access to healthcare providers by members of lower income groups. Public hospitals are left with large debts and provide poor quality health care. Many senior health personnel have moved to work in the private sector. The poor conditions in public hospitals and regulation have created opportunities for the commercialization of the private hospital sector. Private entrepreneurs have invested in new state of the art health facilities, and in the latest medical equipment and technology. Thus, the transition has created a two-tiered hospital system composed of an over-politicized and inefficient public hospital system alongside a “state of the art” private hospital system in which citizens finance the provision of health services through out-of-pocket payments (Lazarević and Donev, 2012).

It should also be mentioned that in addition to the need for public administration reform, there is a need to establish a proper social safety net (Bartlett and Uvalić, 2013). None of the Western Balkan countries have a social minimum that is provided by a system of social assistance to support the poor. Only residual and incomplete support is available for the chronically disabled, and even then often only for those without family to support them. The absence of a social safety net undermines the proper functioning of the labor market, as workers are reluctant to leave existing employment in search of higher paying work, or resist restructuring of enterprises if they know that they will not be offered effective social support during a period of job search. The limited efforts to introduce active labor market policies (ALMP) are unlikely to succeed in the absence of a properly functioning social safety net of the sort that is available to unemployed workers in the EU countries.

5. Competitiveness: How can unemployment be reduced?

The above analysis suggests that the main causes of unemployment in the Western Balkans are (a) in the short term, a lack of effective demand as a consequence of the spill-over effects of the eurozone crisis leading to high levels of deficient-demand unemployment; (b) in the medium term, weaknesses on the supply side of the labor market leading to high level of structural unemployment; and (c) in the long term, weak states that have failed to provide the legal and judicial framework in which private sector could flourish and in which the entry of new small firms could provide a real challenge to the quasi-competitive position of the large firm incumbents.

Short-term constraints are hopefully about to be removed as the eurozone emerges from its recession. To overcome the medium term constraints, education reforms are needed to reduce the skill mismatches and skill gaps have emerged due to the inadequate education system, which has been unreformed since the onset of transition. Health service reforms are needed to improve the physical productivity of the labor force. Safety nets should be provided to underpin the proper functioning of the labor markets. In addition, further measures are needed to improve the investment climate to attract foreign direct investments that are actively linked to the local economy rather than subsidized in isolated industrial zones. Finally, measures to support the development of small and medium businesses free from corruption and unfair competition from incumbents are needed. In the long-term, public administration reform is needed. All these and more are needed to kick-start the economies of the Western Balkans and support their recovery from the deep recession of recent years from which they are just beginning to emerge.

[3] See World Bank: Ease of Doing Business Report, 2014

References

Bartlett, W. (2013) "Structural unemployment in the Western Balkans: challenges for skills anticipation and matching policies" European Planning Studies, Volume 21(6): 890-908.

Bartlett W., Gordon, C., Cino-Pagliarello, M. and Milio, S. (2013) VET Policies and Practices for Social Inclusion in the Western Balkans, Israel and Turkey: A Cross Country Synthesis Report, Turin: European Training Foundation.

Bartlett, W. and Prica, I. (2013) "The deepening crisis in the European super-periphery", Journal of Balkan and Near Eastern Studies, 15(4): 367-382.

Bartlett, W. and Uvalić, M. (eds.) (2013) The Social Consequences of the Global Economic Crisis for South East Europe, London: LSEE.

Lazarevic, V. and Donev, D. (2012) "Public hospital system in the Republic of Macedonia: the heritage of the socialist mentality", in: W. Bartlett and B. Rechel (eds.) Health Reforms in South East Europe, London: Palgrave.

IMPLEMENTING STRUCTURAL REFORMS IN THE WESTERN BALKAN COUNTRIES

Ryszard Rapacki
Professor
Department of Economics
Warsaw School of Economics

I. Introductory remarks

The aim of this paper is three-fold. First, it strives to assess the progress of structural reforms implemented in the past 24 years in six Western Balkan transition economies, i.e. Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, Montenegro and Serbia. Second, against this background and based on a brief overview of macroeconomic performance, it seeks to outline the major economic and institutional weaknesses of these countries. Third, using the conceptual framework of new institutional economics, it suggests a non-standard general approach to the reform process and lists the most needed structural reforms, which may enhance the international competitiveness and improve the macroeconomic performance of the Western Balkan countries in the future.

The issues outlined above are especially important because most of the Western Balkan countries aspire for EU membership as soon as they meet the institutional convergence criteria. That is why we decided to include to our sample two other countries of the region, Croatia and Slovenia (who were granted full EU membership status in 2004 and 2013 respectively); they will serve as reference points in our exercise.

The focus of our study will be both backward- and forward-looking; on the one hand, we will contrast the progress in structural or institutional reforms made so far with the starting point of systemic transformation, while on the other hand, we will attempt to show the present size of structural or institutional gaps in the Western Balkan countries (WBCs) vis-à-vis the benchmark or the level of institutional development in particular areas in the ‘old’ member countries of the European Union (EU15).

The paper is organized as follows. Section 2 provides a brief overview of macroeconomic performance in Western Balkan countries, pointing out to their major flaws and challenges ahead. In Section 3 we embark on a tentative assessment of the progress of structural reforms in the WBCs so far. Section 4 complements the picture of institutional quality of the WBCs and discusses the institutional underpinnings of structural reforms. Section 5 concludes with main suggestions regarding the broader institutional foundations of a viable strategy of implementing structural reforms in the Western Balkan countries and the guidelines for their design and sequencing.

II. Macroeconomic performance

The poor economic growth record ranks among the biggest weaknesses of macroeconomic performance of Western Balkan countries between 1990 and 2012, with Albania being the only spectacular exception. Table 1 gives account.

Table 1: Economic growth performance in Western Balkan countries, 1990-2012

Country	Real GDP average annual growth rate (%)	Real GDP index in 2012	Development gap (GDP per capita in PPP, EU15 = 100)	
	1990-2012	1989=100	1989	2012
Albania	2.6	182	19	28
Bosnia and Herzegovina	-0.7	84	11[a]	27
Kosovo	...	...	15[c]	27
FYR Macedonia	0.2	105	41	32
Montenegro	-0.4	91	21[b]	38
Serbia	-1.2	69	21[b]	33
WBCs average	0.1 (0.0)[d]	106 (99)[d]	21	31
Croatia	0.0	101	51	56
Slovenia	1.6	143	74	77
CE average	2.3	167	58	67
CIS average	0.9	122	27	18[a]
EU15	1.6	145	100	100

a – 1990
b - 1997 (Serbia and Montenegro jointly)
c - 2000
d - calculated as a weighted average.

Source: Eurostat (ec.europa.eu/eurostat); EBRD (www.ebrd.com); IMF, *World Economic Outlook Database*, October 2012; Rapacki (2009); own calculations.

If a weighted average is used for calculation, the combined GDP in the Western Balkans in 2012 was still below its pre-transition level, with Serbia and Bosnia and Herzegovina being the worst performers. This result remains in sharp contrast with the average growth record in Central European (or new EU members) or even the CIS countries. At the level of individual peer economies, Croatia recorded a similar, disappointing growth trajectory, while Slovenia substantially outperformed the WB countries.

As a result, the process of real economic convergence or catching up in WBCs towards the EU15 levels has been very slow and in some cases (Macedonia) has shown signs of reversal. By 2012 the average GDP per capita in the Western Balkan countries represented some 31% of the average for the EU15 compared to 21% in 1989 (due to incomplete data for 1989 this latter figure should be treated with caution). The size of the present WBCs' development gap unfavorably compares with that reported by eight Central European transition economies (including Slovenia) at the time of their EU accession in 2004 (55% in terms of unweighted average).

The short list of other major weaknesses in WBCs' macroeconomic performance includes the following (the pertinent data come from IMF 2013 and EBRD 2012):

- very high, double-digit unemployment ranging between 12.3% in Albania and 31.3% in Macedonia in 2012,
- huge current account deficits relative to GDP, reaching double-digit levels in Kosovo (-20.4%), Montenegro (-17.7%) and Albania (-12%),
- excessive external debts in some WBCs, and in particular in Montenegro (94.6% of GDP in 2012) and Serbia (85%),
- relatively high income disparities, with Gini coefficient exceeding 30 (the only exception being Serbia) or even 40 (Macedonia - 43.2).

III. The progress of structural reforms – a tentative assessment

The most important structural changes to be implemented in the Western Balkan countries (as in all transition economies), on their road from central planning to the market system, included privatization and liberalization of markets, and broadening the scope of economic freedom. The latter encompassed steps such as stifling corruption and removing bureaucratic barriers impeding the development of private entrepreneurship. Other key structural changes were to comprise support for the development of markets and competition; upgrading infrastructure; a public finance reform, combined with a comprehensive government reform designed to increase its effectiveness and strengthen functions stimulating economic development (through measures such as creating positive externalities for private entrepreneurship); an expansion of financial intermediation and the development of financial markets (Rapacki, Matkowski and Prochniak, 2013).

Generally, the success of structural reforms in the Western Balkan countries – in terms of their scope and depth – has been mixed. As a group, these countries have made some progress in liberalizing and opening their economies, pushing through with small- and (to a lesser extent) large-scale privatization, creating some market mechanisms and taking a number of important steps aimed at building the institutional infrastructure of the market.

On the other hand, however, in a number of key institutional areas the results of implementing structural reforms are far from being satisfactory. This claim refers in particular to enterprise restructuring and corporate governance, government regulation and competition policy, infrastructure and the development of financial markets, and the scope of financial intermediation. Table 2 (please see appendix) provides a list of indicators used by the European Bank for Reconstruction and Development (EBRD), showing the advancement of structural reforms in WB countries as of 2013.

At the individual country level, Macedonia and Albania have made the relatively biggest progress in structural reforms whereas Kosovo and Bosnia and Herzegovina have lagged behind. However, compared to their peers – Croatia and Slovenia – even the top reformer WBCs exhibited a substantial gap in terms of quality of their institutional market infrastructure. The gap in question was much more pronounced vis-à-vis Central European transition economies or the current EU members.

Still another way of assessing the progress of structural reforms in WB countries (and all transition economies in general) is to express the scores shown in Table 2 as a percentage distance covered since 1990 to date on the way to fully catch up with the benchmark level or 4.3. In these terms a score of 2.7 translates into a 50% (halfway) progress or – equivalently – a 50% gap to reach the benchmark. Data in the parentheses shown in the last column of Table 2 indicate how much distance in the process of implementing structural reforms is still ahead in individual Western Balkan countries and their group combined. The longest way to go is in Kosovo (51% to the target) whereas the top reforming country in this group – Macedonia – has yet to cover some 33% of the distance. These indicators compare unfavorably with both the respective figures for Croatia and Slovenia and even more so – with new EU members from Central Europe.

At the institutional areas cross-section, the WBCs exhibited an unbalanced pattern of structural reform implementation. On the one hand, they made a remarkable progress in two areas: price liberalization and trade and exchange rate policy; they were also much advanced in small-scale privatization. On the other hand however, in five other areas (governance and enterprise restructuring, competition policy, banking sector reform, securities markets and non-bank financial institutions, and infrastructure) WBCs as a group has not even reached half of the road leading to the benchmark level of institutional development.

This kind of government failure in implementing much needed structural reforms in WBCs can be further confirmed if we look at some other indicators of ‘institutional quality’ provided in the next section (Table 3, please see appendix). The countries involved displayed in particular serious institutional weaknesses in the area of product market regulation (‘ease of doing business’ or the strength of bureaucratic hurdles to private entrepreneurship), the quality of governance and the incidence of corruption.

As a concluding remark in this part of the discussion it is worth mentioning that a wide body of empirical evidence suggests a strong effect of the quality and complexity of market institutions (or progress of structural reforms as a proxy) on economic growth and macroeconomic performance of a country. For example, a regression analysis carried out in another study co-authored by the present author (Rapacki, Matkowski, Prochniak 2013) revealed that transition economies, most advanced in structural reforms, achieved on average a faster GDP growth in 1990-2012 than those lagging behind in this process. The positive correlation between these two variables was especially clear in Central Europe. By contrast, in countries such as e.g. Bosnia and Herzegovina, Montenegro and Serbia the lack of major structural reforms contributed to negative GDP growth rates throughout the analyzed period.

IV. Institutional underpinnings of structural reforms

As a complement to the foregoing account of the progress in structural reforms in the Western Balkan countries, in this section we embark on a tentative, more complex assessment of the outcomes of past reforms, i.e. the kinds of institutional architecture that seem to have been emerging in these countries. To this end, we will refer to the conceptual framework offered by the new institutional economics and in particular to two approaches: the ‘Varieties of Capitalism’ (or VoC) and the ‘Diversity of Capitalism’ (or DoC). The VoC typology developed by Hall and Soskice (2001) and based on the prevailing mode of coordination of economic agents’ actions, makes a distinction between: (i) liberal market economies (LME) and (ii) coordinated market economies (CME). In turn, the DoC classification put forward by Amable (2003) and further developed by Sapir (2007), singles out five models of capitalism co-existing in the contemporary Western world: (i) Anglo-Saxon or market-based capitalism, (ii) Continental European capitalism, (iii) Nordic or social-democratic capitalism, (iv) Mediterranean or South European capitalism and (v) Asian capitalism.

According to many authors, the former socialist countries entered the road from plan to market without a clear *explicit* vision of the end point or the target kind of capitalism they were aiming to build. Following a distinction made by Myant and Drahokoupil (2011) and similarly by Heiduk and Rapacki (2009), it can be claimed that the overwhelming majority of these countries have undergone the process of ‘systemic transformation,’ i.e. a process of change without a clear end result, rather than ‘transition’ or a movement toward a defined end result. Hence, after twenty-four years of systemic transformation, there emerged no single post-Communist variety of capitalism in the Western Balkans, similar to the rest of the post-communist world. Simultaneously, the results achieved so far on the road from plan to market are very diverse in particular countries in terms of prevailing institutional setups that determine the dominant mode of coordination in these countries.

The data compiled in Table 3 seem to clearly corroborate this claim. Three out of five Western Balkan countries shown in the table displayed characteristics akin to a coordinated market economy while two other WBCs (Serbia and Montenegro) exhibited features of a LME category. This categorization clearly differentiates our sample – while in the former group of WBCs (Albania, Bosnia and Herzegovina and Macedonia) a non-market, strategic type of coordination is prevalent, in the latter group it is the market that dominates as a coordination mechanism. Interestingly, under the former institutional environment there is a relatively large room for government intervention and administrative discretion, extended public sector, and high incidence of bureaucratic hurdles for private entrepreneurship.

A more refined and versatile framework, which appears to be particularly useful for assessing the 'institutional quality' of individual countries and their groups as well as for designing and implementing necessary structural reforms, may be found in the DoC approach (Amable 2003; Sapir 2006). The classification criteria used to distinguish five co-existing models of capitalism are based on the prevailing institutional architecture in five key areas:

- Product market competition/regulation.
- Wage-labor nexus and labor market institutions.
- Financial intermediation and corporate governance.
- Social protection sector.
- Education and knowledge sector.

The key in the DoC approach is the factor of institutional complementarities. It links together the five institutional areas and may give rise to positive synergies thus triggering the comparative advantage of a country and enhancing its international institutional competitiveness.

In general, institutions are said to be complementary when the presence of one institution increases the efficiency of another. More precisely, institutional complementarities imply that the existence of or the particular form taken by an institution in one area reinforces the presence, functioning, or efficiency of another institution in another area [Amable 2003].

As a matter of illustration, the Anglo-Saxon (sometimes also dubbed a 'shareholder') capitalism relies heavily on competitive, unregulated product market and is biased towards a short-run perspective. This is compatible with a highly fluid labor market, easy fire and hire, high work force mobility, decentralized wage bargaining and low employment protection. In turn, the financial system is based on sophisticated capital (stock) markets, important role of M&As and active market for corporate control. These features combined imply a weak social protection policy and low involvement of the state – mostly focused on poverty alleviation. Finally, the education system features highly competitive higher education and weak vocational training, and puts an emphasis on acquiring general skills (which can be used in different occupations and easily switched between jobs; this again can be explained as a function of short-term horizon of both the product, labor and financial markets, and low job security).

In contrast, the Continental European model of capitalism (or 'stakeholder capitalism') operates with a great deal of strategic cooperation, both between firms, banks and firms, and between trade unions, employer associations and firms. The product market is subject to regulation and a substantial involvement of public authorities. There is high employment protection and greater job security in the labor market; wage bargaining tends to be coordinated at the national level. Investment depends more heavily on long-term financing from banks whereas financial markets play a secondary role. These characteristics are compatible with a high degree of social (employment-based) protection, involvement of the state, and more progressive personal and income taxes. In the education sector, the institutional complementarities with the remaining four areas can be seen, *inter alia*, in high levels of public expenditures on education, high enrolment rates in secondary education, developed vocational training, and strong emphasis on specific skills (Amable 2003).

Against this conceptual background it can be argued that the emerging diversity of post-communist capitalism in the Western Balkan countries (much similar to the entire group of transition economies) shares a number of peculiarities of their institutional setups, compared to their benchmark or developed Western economies. This claim has gained support in a number of empirical studies applying the DoC approach in the conditions of transition economies (e.g. Mykhnenko 2005). Two such peculiarities are worth highlighting in particular:

- 'institutional ambiguity' or a 'hybrid' nature of the nascent capitalism. This implies that while in some institutional areas a country may resemble one model of capitalism, in some other areas it tends to converge to quite a different model.[1] This outcome may be due to the uncompleted process of building the 'post-Communist capitalism' in transition economies that makes their institutional infrastructure still a 'work in progress'.

[1] To be more specific, whereas in one case involved in Mykhnenko's study (Poland) the mix of institutional characteristics in most areas (four out of five) point out to a similarity of the emerging variant of capitalism to the Mediterranean model, the dominant features of the fifth area, i.e. the social protection system are more akin to the Continental model. In turn in the second case (Ukraine), while the nascent capitalism appears to resemble in most respects the Continental European model, the most salient properties if its social protection sector seem to exhibit much more similarity to the Anglo-Saxon model of capitalism (Mykhnenko 2005).

- missing or incomplete institutional complementarities between the five areas concerned; as a result, some parts of institutional structures prevailing in WB countries are not compatible with other parts, as is usually the case in advanced Western countries representing different models of capitalism. This may give rise to negative synergies and adversely affect the efficiency of existing institutions.

Having outlined the conceptual framework and its institutional underpinnings, below we briefly sketch the key elements of the recommended approach to the much-needed structural reforms in the Western Balkan countries.

V. Concluding remarks

The underlying objective of this section is to lay the broad institutional foundations for a viable strategy of implementing structural reforms in the Western Balkan countries and to suggest some useful guidelines for their design and sequence.

A. General foundations

- as a starting premise it ought to be stressed that, while designing the reform strategy, a systemic perspective is strongly recommended rather than a piece-meal approach focused on particular reforms;

- carry out an in-depth and comprehensive diagnostic study aimed at describing and understanding the nature of institutional architecture prevailing in five institutional areas in each of the WBCs involved;

- if appropriate, add the sixth area to the exercise, i.e. the housing market which is closely interconnected with the remaining five areas and may be a critical factor in triggering potential bubbles and adverse economic shocks in the country;

- conduct a 'peer review', i.e. compare the results with four models of capitalism singled out in the DoC approach[2], with a view to establish the pattern prevailing in each of the five (six) institutional areas in a particular WBC;

- based on the above steps, find possible ‘institutional ambiguities’ in a country concerned, to eventually arrive at the aggregate definition of the nature of ‘hybrid capitalism’ emerging in a WBC;

- screen the results against possible inconsistencies or lack of institutional complementarities between the five (six) areas involved;

- based on the foregoing results and on a necessary political consensus, make a decision regarding the end point on the road from plan to market, i.e. the choice of target model of capitalism to be built in a country; the choice in question should take account, inter alia, of the ‘path dependence’ factor and country-specific determinants.

B. Design and implementation of the reform program

- capitalizing on the assessment offered in Sections II and III, make a ranking of the most pressing structural reforms to be implemented in WBCs; they should address in particular the following areas/problems: (i) securities markets and non-bank financial institutions, (ii) corporate governance and enterprise restructuring, (iii) competition policy, (iv) infrastructure, (v) banking sector, (vi) corruption, (vii) governance, (viii) excessively high unemployment, (ix) external imbalances, (x) consolidation of public finance, and (xi) income disparities;

- allocate each intended structural reform to one of the five (six) institutional areas; some of them may have a more complex nature and be interconnected with more than one area (e.g. corruption); for example, securities markets and non-bank financial institutions, and the banking sector should be allocated to the financial intermediation and corporate governance area while income disparities – to social protection sector;

- design a ‘consistency test’ or an appraisal system (procedure) aimed at checking the potential impact of a particular structural reform or their sets on institutional complementarities between the five (six) institutional areas (e.g. between product market regulation and labor market condition including unemployment),

- while planning the sequence of the reform program, give priority to those reforms that contribute most in order to increase (build) institutional complementarities of the whole institutional architecture or to remove (weaken) barriers inhibiting such complementarities;

- in sequencing the reforms bear in mind that institutional complementarities entail complexity or systemic perspective; in other words, if an institution in one area – which determines the efficiency of another institution in a different area(s) – is to be changed or restructured, the prerequisite for the reform to be successful is to take a ‘bundling’ approach;

- design and implement a system of monitoring the progress of structural reforms including the ‘early warning’ component that would allow to signal emerging loopholes in the institutional system and to anticipate the threats and challenges ahead.

[2] The fifth model, i.e. Asian capitalism does not seem applicable for the Western Balkan countries or elsewhere in Europe.

It sounds like a plausible expectation that adopting this broad institutional or systemic approach and designing and implementing structural reforms in the Western Balkan countries along the lines outlined above is likely to become a key driver of their improved economic performance and a success factor on their road to a fully-fledged capitalist market economy. In particular it may bring about a boost in WBCs' competitiveness and productivity; be conducive to improved labor market conditions including a sharp reduction in unemployment; may result in an ameliorated investment climate; and lead to an improved fiscal stance including consolidation of their public finance.

Appendix

Table 1: Economic growth performance in Western Balkan countries, 1990-2012

Country	Real GDP average annual growth rate (%)	Real GDP index in 2012	Development gap (GDP per capita in PPP, EU15 = 100)	
	1990-2012	1989=100	1989	2012
Albania	2.6	182	19	28
Bosnia and Herzegovina	-0.7	84	11[a]	27
Kosovo	...	...	15[c]	27
FYR Macedonia	0.2	105	41	32
Montenegro	-0.4	91	21[b]	38
Serbia	-1.2	69	21[b]	33
WBCs average	0.1 (0.0)[d]	106 (99)[d]	21	31
Croatia	0.0	101	51	56
Slovenia	1.6	143	74	77
CE average	2.3	167	58	67
CIS average	0.9	122	27	18[a]
EU15	1.6	145	100	100

a – 1990
b - 1997 (Serbia and Montenegro jointly)
c - 2000
d - calculated as a weighted average

Source: Eurostat (ec.europa.eu/eurostat); EBRD (www.ebrd.com); IMF, *World Economic Outlook Database*, October 2012; Rapacki (2009); own calculations.

Table 2: Progress in structural reforms in the Western Balkan countries, 2013

Country	Enterprise sector			Development of markets and competition			Financial institutions		Infrastructure	Average score
	Large scale privatization	Small scale privatization	Governance and enterprise restructuring	Price libera-liza-tion	Trade and exchange rate regime	Comp e-tition policy	Banking reform and liberalization of interest rates	Securities markets and non-bank financial institutions	Infrastructure reform	
Albania	3.7	4	2.3	4.3	4.3	2,3	2.7	2.3	2.3	3.13 (64)
Bosnia & Herzegovina	3	3	2	4	4	2,3	2.7	2	2.7	2.84 (56)
Kosovo	1.7	3.3	2	4	4	2.3	2.3	1.7	2.3	2.62 (49)
FYR Macedonia	3.3	4	2.7	4.3	4.3	2.7	2.7	2.3	2.7	3.22 (67)
Montenegro	3.3	3.7	2,3	4	4,3	2	2.7	2.3	2.3	2.99 (60)
Serbia	2.7	3.7	2.3	4	4	2.3	2.7	2.7	2.7	3.01 (61)
Average	**2.95**	**3.62**	**2.27**	**4.10**	**4.17**	**2.33**	**2.63**	**2.22**	**2.5**	**2.97 (60)**
Croatia	3.7	4.3	3,3	4	4.3	3	3.3	3.3	3.3	3.62 (79)
Slovenia	3	4.3	3	4	4.3	2.7	3	3	3.3	3.40 (73)
Average for CE countries[a]										3.76 (84)
Average for CIS countries[a]										2.67 (50)

[a] – scores for 2012

Note: Scale from 1 to 4.3; the higher the score, the greater is the progress in structural reform and the smaller the gap towards the benchmark or advanced market economies.

Source: EBRD, *Transition Report 2013,* London 2013; EBRD, *Transition Report Database*: http://www.ebrd.com/pages/research/analysis/forecasts.shtml; own calculations.

Table 3: Development level and selected indicators of 'institutional quality', selected EU15 and transition countries, 2005–2011

Country	pcGNI	EoDB	Gov	CPI	Social cohesion	Labour market	Business regulation	Coor-dination index
Selected EU15 countries								
Greece	63.1	100	16.3	35	1.4	6.5	3.7	11.6
France	74.4	29	50.8	68	4.5	3.2	0.2	8.0
Germany	80.7	19	57.5	79	2.4	3.3	-0.9	4.8
Spain	69.0	44	35.5	61	2.9	4.9	-3.1	4.7
Sweden	83.4	14	70.8	92	5.6	0	-4.7	0.9
Denmark	85.0	5	72.7	91	1.6	-2.9	-0.3	-1.6
Ireland	72.4	10	58.2	80	-1.0	-0.9	-3.0	-4.8
UK	78.6	7	55.1	76	1.4	-2.9	-4.3	-5.8
Selected transition economies								
Belarus	27.9	69	-38.8	25	1.6	1.5	5.9	8.9
Slovenia	58.0	37	36.5	64	3	2.1	1.3	6.3
Croatia	42.1	80	16.5	41	1.3	2.9	1.5	5.6
Bosnia-Herzegovina	19.2	125	-15.3	32	0.5	1.1	3.2	4.8
Albania	18.9	82	-6.6	33	-1.8	-0.6	3.3	0.9
Macedonia	23.8	22	-7.9	41	-1.9	-0.2	2.7	0.6
Serbia	25.6	92	-5.7	35	-3.7[a]	-2.6[a]	2.1[a]	-4.3[a]
Montenegro	29.2	56	2.5	37	-3.7[a]	-2.6[a]	2.1[a]	-4.3[a]
Estonia	41.9	24	43.3	65	-4.4	0.4	-1.7	-5.7

[a] – a joint score for Serbia and Montenegro.

Notes:

pcGNI = per capita gross national income in international dollars at purchasing power parity, 2009, U.S. = 100.

EoDB = country ranking on 'ease of doing business', including 183 countries; measures for 2011.

Gov = sum of governance scores (voice and accountability, political stability, effectiveness of government, regulatory quality, rule of law, control of corruption), converted into % of maximum possible score; possible range from +100 to -100. Refers to 2010.

CPI'10 = corruption perception index (CPI) by Transparency International for 2010, expressed as a percentage (100 = no corruption at all).

Social cohesion = the Knell-Srholec score computed for 2005; the four sub-components include the Gini coefficient, top marginal personal income and corporate tax rates, and government final consumption expenditure as % of GDP.

Labor market = Knell and Srholec index for 2005 based on four sub-components: difficulty of hiring and firing workers, the cost of firing workers and rigidity of working hours.

Business regulation = Knell and Srholec index for 2005 based on four sub-indices: number of start-up procedures to register a business, time to resolve insolvency, number of procedures to register property and the role of stock market relative to banking sector.

Coordn = score (based on multiple indicators) on strategic coordination versus competition; + tending towards coordination; - tending towards competition.

Sources: Hanson, P., 2006, *The European Union's Influence on the Development of Capitalism in Central Europe*, mimeo, London 2006; Knell, M., M. Srholec, *Emerging Varieties of Capitalism in Central and Eastern Europe*, paper presented at the conference on Varieties of Capitalism, University of Paisley, 23–24 September 2005; www.doingbusiness.org/EconomyRankings; http://info.worldbank.org/governance/kkz2004/year_report.asp?yearid=1; World Bank, *World Development Indicators 2011*; www.transparency.org/cpi/2005/cpi2005.en.html; author's calculations.

References:

Amable, B. [2003], *The Diversity of Modern Capitalism,* Oxford, Oxford University Press.

EBRD [2013], *Transition Report 2013,* London.

EBRD, *Transition Report Database*: http://www.ebrd.com/pages/research/analysis/forecasts.shtml.

Hall, P., D. Soskice [2001], *Varieties of Capitalism. The Institutional Foundations of Comparative Advantage*, Oxford, Oxford University Press.

Hanson, P. [2006], *The European Union's Influence on the Development of Capitalism in Central Europe*, mimeo, London 2006.

Heiduk, G., R. Rapacki [2009], *The Road from Plan to Market: Comparing Poland and China*, in: *Driving Forces of Socialist Transformation: North Korea and the Experience of Europe and East Asia*, eds. R. Frank, S. Burghart, Vienna, Praesens Verlag.

IMF [2013], *World Economic Outlook 2013,* Washington D.C.

Knell, M., M. Srholec [2005], *Emerging Varieties of Capitalism in Central and Eastern Europe*, paper presented at the conference on Varieties of Capitalism, University of Paisley, 23–24 September.

Lane, D., M. Myant (eds.) [2007], *Varieties of Capitalism in Post-Communist Countries*, Basingstoke: Palgrave.

Myant, M., J. Drahokoupil [2011], *Transition Economies: Political Economy in Russia, Eastern Europe and Central Asia*, NJ, Wiley&Sons, Hoboken.

Mykhnenko, V. [2005], *What Type of Capitalism in Eastern Europe? Institutional Structures, Revealed Comparative Advantage, and Performance of Poland and Ukraine*, "Discussion Paper" no. 6, Centre for Public Policy and Regions, University of Glasgow, September.

Rapacki, R. [2012], *Poland and Greece – Two Contrasting EU Enlargement Experiences*, ZEI Discussion Paper no. C213 (2012), Bonn 2012.

Rapacki, R. (ed.) [2009], *Economic growth in transition countries: real convergence or divergence?* PWE (Polish Economic Publishers), Warsaw (in Polish).

Rapacki, R., Z. Matkowski, M. Próchniak [2013], *Transition Countries: Economic Situation and the Progress of Market Reforms*, Working Paper no. 320, World Economy Research Institute, Warsaw School of Economics, Warsaw.

Sapir, A. [2006], *Globalization and the Reform of European Social Models*, "Journal of Common Market Studies", 2006, Volume 44, Number 2, pp. 369–90.

World Bank, *World Development Indicators Database* (databank.worldbank.org).

STRUCTURAL PROBLEMS OF THE WESTERN BALKAN ECONOMIES

Milica Uvalić
Professor
Department of Economics, Finance and Statistics
University of Perugia

1. Economic situation in the Western Balkans

After a decade of high political and economic instability in the Western Balkan region, the 2000s brought many positive developments (Uvalić, 2013). Until the strong impact of the global economic crisis in 2009, the Western Balkan countries registered relatively high growth rates, declining inflation, rapid expansion of foreign trade and increasing Foreign Direct Investment (FDI). A number of important economic reforms related to the transition to market economy have also been implemented successfully, including price and trade liberalization, privatization of small-scale enterprises and of banks. The privatization of the banking sector has contributed to strong financial and capital market integration with the European Union (EU), so today major EU banks own 75-95% of Western Balkan countries' banking assets. These reforms were sustained by the EU Stabilization and Association Process (SAP) that offered Western Balkan countries trade preferences, financial assistance (CARDS, IPA, IPAII), contractual relations through Stabilization and Association Agreements which by 2008 have been concluded with all countries except Kosovo, and prospects of EU membership. EU measures have greatly contributed to fast economic integration of the Western Balkans with the EU economy through increasing trade, FDI, banking and financial integration (Cerović and Uvalić, 2010).

These positive trends have been interrupted by the global economic crisis, which severely hit the Western Balkan economies in the last quarter of 2008. A notable slowdown in economic growth took place in 2009, when most countries registered negative gross domestic product (GDP) growth; the only exceptions were Albania and Kosovo that experienced a substantial slowdown. The mild economic recovery in 2010-11 was interrupted by the sovereign debt crisis in the Eurozone that pushed most Western Balkan countries into a second recession in 2012 (Uvalić, 2013). The Balkan economies were especially vulnerable to the effects of the Eurozone crisis because of the high degree of euroization: Montenegro and Kosovo have adopted the Euro, Bosnia and Herzegovina has a currency board which ties its currency to the Euro, while most other countries have fixed their currencies to the euro (all except Serbia and Albania). Although EU policies have greatly facilitated growth, increasing EU-Balkan integration has also rendered the Western Balkan economies more vulnerable to external shocks. For the Western Balkans, integration proved to be a double-edged sword: in prosperous times, the European core exported its prosperity towards its southeastern periphery; but in times of crisis, it has exported instability (Bechev, 2012; Uvalić, 2013).

Given the high dependence of the Western Balkan economies on the EU, factors that have made them vulnerable to the global economic crisis including trade openness, economic, financial and banking integration are precisely the factors that will reinforce growth once the EU economy recovers. However, this may not be enough, since the global economic crisis has revealed a number of structural problems of the Western Balkan economies that have been accumulating during the past two decades and will not disappear overnight. Four groups of structural problems should, in particular, be stressed which are closely interlinked.

(1) External imbalances: After 2001 there has been a remarkable increase in foreign trade of all Western Balkan countries, but exports have frequently been half the volume of imports, contributing to high and rising trade deficits. Due to delays in large-scale privatization, late arrival and unfavorable structure of FDI, ineffective industrial and competition policies and inadequate changes in the business environment, the process of industrial restructuring of the Western Balkan economies has been slow, contributing to insufficient export growth and increasing external imbalances. Most Western Balkan countries have not succeeded in substantially increasing their exports on world markets, so in 2012 all countries except Macedonia still had exports of goods and services/GDP ratios below 50%. These ratios, which measure a country's degree of openness, remain low in comparison with those of most Central East European (CEE) countries, today far more integrated into the global economy (the only exceptions are Poland and Romania, which is a normal consequence of their size). The high trade deficits have contributed to rising current account deficits, until late 2008 covered by substantial inflows of foreign capital (FDI, remittances, foreign loans, donors assistance), which have drastically been reduced after 2009. The private sector in most Western Balkan countries remains undersized, which raises questions regarding the outcome of privatization and impact of recent FDI inflows. For all these reasons, strengthening external competitiveness remains the key priority of all Western Balkan countries, which will require deeper restructuring of the real sector of these economies.

(2) Labor markets: The Western Balkan countries also face mounting social problems, under the pressure of increasing unemployment and very low employment rates (Bartlett and Uvalić, 2013). Although all CEE countries have also had problems of "jobless growth" in the 1990s as the process of job creation has not been fast enough to absorb all people seeking employment, in the Western Balkans this phenomenon has taken dramatic proportions. Unemployment rates today are extremely high, in countries like Macedonia and Kosovo over 30%, while long-term and youth unemployment rates have reached alarming proportions. With such high unemployment rates it is clear that economic growth remains below potential. Employment rates in the Western Balkan countries are in all countries below 50%, at a time when in the EU the objective is to reach a 75% employment rate by 2020. The informal economy is still diffused in all countries, preventing the collection of badly needed public revenues.

(3) Structural change: The Western Balkan countries have gone through an extreme process of deindustrialization. Industrial decline was typical not only in the early 1990s, as in other East European countries (a normal consequence of excessive industrialization and neglect of many services during communist times), but continued in most Western Balkan countries also in the 2000s. Consequently, structural change in the Western Balkans has gone in the direction of a very fast expansion of services at the expense of industry and agriculture. The share of tradable goods has declined significantly, further aggravating the problem of insufficient export growth and low competitiveness. Structural change in the Western Balkans seems to have taken a "distorted pattern", characterized by an oversized services sector and premature reduction of manufacturing, to levels inconsistent with these countries' levels of economic development. The structure of foreign investment has greatly contributed to such patterns, since around 2/3 of FDI has gone into non-tradable services – banking, telecommunications, retail trade and real estate (Estrin and Uvalić, 2014).

(4) Slow economic recovery: By 2008, just before the severe impact of the global economic crisis, three countries had still not reached their pre-transition (1989) levels of real GDP: Bosnia and Herzegovina, Montenegro, and Serbia (Uvalić, 2010). In the meantime, the situation has further deteriorated since most countries have had a double-dip recession; thus by 2012 Croatia was again under the level of its 1989 GDP. Such a slow process of recovery of pre-transition levels of production has also contributed to very slow income convergence of these countries with the more developed EU. With the exception of Croatia, the most developed country that has also in mid-2013 become an EU member state, GDP per head (in PPS) remains low, in 2011 ranging from 21% in Kosovo to 42% in Montenegro of the EU-27 average (Uvalić, 2013).

The described structural problems illustrate that the success story of the CEE countries has not been replicated in the Western Balkan countries a decade later, for a series of specific reasons linked to disintegration, military conflicts, high political and economic instability, international sanctions, war profiteering and greatly weakened state institutions. The same model of transition has been much less successful in the Western Balkans than in CEE (Uvalić, 2012). The assumption that the same recipes will work equally well in the Western Balkans was insufficiently founded. The Western Balkan countries are today at a lower level of development, they have attracted far less FDI, much later and predominantly in services, and they are less integrated with the EU and the world economy (Svejnar and Uvalić, 2013). These are some of the reasons why the Western Balkans countries will need additional instruments for a "big push" in order to achieve more sustainable growth and faster economic development.

2. Which way ahead? Some recommendations

What could be the elements of such a "big push" that would speed up economic growth and lead to better overall economic performance of the Western Balkan economies? Some main medium-term priorities regarding economic policies are discussed below.

(1) More focused industrial policy: Given their low level of development, the key priority for the small Western Balkan economies is economic growth and faster integration into the global economy through a more export-oriented growth model. FDI has not contributed much to attaining this objective so far and is unlikely to do so over the next years: not only has FDI at the global scale still not returned to its pre-crisis levels, but today there are less privatization opportunities in the Western Balkans. This implies that it is the countries themselves that have to devise policies to restructure their economies and increase competitiveness on world markets through a more efficient and more targeted industrial policy. The key objectives of such an industrial policy would be to ensure some reindustrialization, enable the development of new industries and/or strengthen those sectors, which presently contribute most to exports. In many countries worldwide, governments have played a key role in inducing structural change, sectorial upgrading and economic diversification, in order to promote growth, employment, and an increase in productivity. The Western Balkan governments and their agencies ought to device policy measure that would ensure faster restructuring of their economies, learning from the recent EU experience which also aims at reindustrialization of the EU economy (European Commission, 2013).

(2) Investment in human capital: One of the key ingredients of the new growth model for the Western Balkans will necessarily have to be investment in human capital, through measures that would stimulate R&D and innovation and reforms of the system of education. This is closely related to what has previously been said, linked to current EU objectives of "knowledge-driven reindustrialization" (European Commission, 2013). If knowledge-driven reindustrialization is today a key element for strengthening EU competitiveness, so much the more it needs to be an explicit objective of the Western Balkan countries. More investment in human capital, as the most important factor of long-term economic growth, is fundamental.

(3) Regional initiatives: Coordinating national policies in the above areas, in order to implement some regional initiatives jointly, makes a lot of sense for small economies such as the Western Balkans, particularly considering the legacies and economic linkages inherited from former Yugoslavia. More intense regional economic cooperation among the Western Balkan countries could play an important role in stimulating growth in the medium term. Although the benefits of regional cooperation have been emphasized for long (Uvalić, 2001), its potentials have not been sufficiently utilized. Trade liberalization among the Western Balkan countries after 2001 (today through the CEFTA 2006 agreement) has already contributed to a remarkable increase in the volume of regional trade, but the Western Balkan countries have had increasing trade deficits with the EU and have not succeeded in shifting quickly enough their exports towards the EU (the EU share in total exports in 2011 ranged from 40% in Kosovo to 50-60% in the other Western Balkan countries; only Albania has a high 74% share). Consequently, for most Balkan countries intra-regional trade remains quite important. Other forms of economic cooperation could also contribute to growth – in the area of Research & Development, energy, transport or specific industries. The SEE 2020 Strategy adopted by the Regional Cooperation Council and the ministers of the respective SEE countries in Sarajevo in November 2013 ought to ensure the implementation of such regional cooperation initiatives. Within such initiatives, industrial policy also ought to be considered at the regional level through the creation of trans-national networks and supply chains that could be mutually beneficial: multinational companies created by enterprises from several Western Balkan countries are bound to be more competitive on EU markets than small national firms.

3. Some issues for discussion

- Has structural change in the Western Balkans taken a distorted pattern, with a premature expansion of services?
- Can the Western Balkan countries specialize and be competitive in exporting some types of services? If so, which?
- What type of policies should be implemented in order to strengthen competitiveness and export-led growth?
- Are the horizontal-type industrial policy measures launched with the Lisbon Strategy in 2000 in the EU, that have also been implemented in most Western Balkan countries, sufficient?
- Do the Western Balkans need a different type of industrial policy, more targeted and more focused towards resolving their specific structural problems?
- Could more regional cooperation be a fruitful strategy for strengthening international competiveness of the region? If so, in which sectors?

References:

Bartlett, W. and M. Uvalić (eds) (2013), *Social Consequences of the Global Economic Crisis in South East Europe*, London: London School of Economics, LSEE (Research on South Eastern Europe).

Bechev, D. (2012), "The periphery of the periphery: The Western Balkans and the Euro crisis", *Policy Brief,* European Council on Foreign Relations (ecfr.eu).

Cerović, B. and M. Uvalić (eds) (2010), *Western Balkans' Accession to the European Union: Political and Economic Challenges*, EUI Robert Schuman Centre Mediterranean Research Workshop, Belgrade: Faculty of Economics of the University of Belgrade Publishing Centre.

Estrin, S. and M. Uvalić (2014), "FDI in transition economies: Are the Balkans different?", *The Economics of Transition*, Vol. 22 (2), 281-312.

European Commission (2010), *An Integrated Industrial Policy for the Globalization Era: Putting Competitiveness and Sustainability at Centre Stage,* COM (2019) 614, Brussels.

European Commission (2013), *European Competitiveness Report 2013. Towards Knowledge Driven Reindustrialization,* COM (2013) Commission Staff Working Document SWD 347 final.

Svejnar J. and M. Uvalić (2013), "Why development patterns differ: the Czech and Serbian models compared", in M. Aoki, T. Kuran, G. Roland (eds) (2012), *Institutions and Comparative Economic Development*, IEA Conference volume no. 150-1, Basingstoke, Palgrave Macmillan, pp. 184-212.

Uvalić, M. (2001), "Regional co-operation in South-Eastern Europe", *Southeast Europe and Black Sea Studies*, vol. 1 (2001), no. 1, pp. 64-84.

Uvalić, M. (2010), *Serbia's Transition. Towards a Better Future*, Basingstoke: Palgrave Macmillan; Serbian translation.

Uvalić, M. (2012), "Transition in Southeast Europe: Understanding economic development and institutional change", in G. Roland (ed) (2012)*, Economies in Transition. The Long Run View*, Basingstoke, Palgrave Macmillan, pp. 364-399.

Uvalić, M. (2013), "Economic development of the Western Balkans since Thessaloniki", in Prifti E. (ed), *The European Future of the Western Balkans. Thessaloniki@10 (2003-2013)* (Paris: European Union Institute for Security Studies), pp. 73-82.

REGIONAL ECONOMIC COOPERATION – A KEY TO ECONOMIC GROWTH?

Predrag Bjelić[1]
Full Professor of International Trade
Faculty of Economics
University of Belgrade

[1] This paper is prepared for and presented at ASPEN Institute Conference "Economic Development in the Western Balkans: On the Road to Competitive Market Economies?" in Alt Madlitz, Germany, 24-26. June 2014.

Introduction:

For a long time trade had been considered as a tool for economic development. Different trade theories suggest that trade is beneficial to all economies involved in this economic activity and that trade can significantly contribute to economic development. There are some differences in this regard connected to the size of a country, since smaller countries are more dependent on international markets than large ones.

The predominant mode of trade integration, apart from multilateral liberalization in the GATT/WTO system, is regional trade integration. In one of the pioneering works in this field, Jacob Viner[2] stresses that the issue of regional trade integration has united all economists, liberal as well as protections oriented. All papers suggest that regional trade integration is beneficial to all countries involved in the integration. But some authors, as Richard G. Lipsey[3], point to some conditions connected to the rise of welfare in regional trade integration. Regional economic integration will raise the welfare of its members if these countries have significantly traded before the establishment of this integration. Makower and Morton analyzing regional trade integration have determined that countries, which are involved in trade integration will receive more benefits if their product structures overlap and if similar products are produced at significantly different production costs.[4] Even if most of the authors agree that regional trade integration is beneficial to all parties, the distribution of gains from trade in the process of integration can be different.

The Western Balkans[5] includes economies in the region of Southeast Europe that are not EU members. These economies are still in the process of transition to a fully functioning market economy, and at a very low level of economic development. Their export sector is underdeveloped. The main export market for Western Balkan economies is the European Union (EU). Especially important partners in the EU group for the Western Balkans are Germany and Italy. For most of the economies in the Western Balkans the EU is the dominant trade partner.

[2] Jacob Viner *The Customs Union Issue*, Carnegie Endowment for International Peace, New York, 1950. Especially: The Economics of Customs Unions, pp. 41-56.
[3] Richard G. Lipsey "The Theory of Customs Unions: A General Survay" The Economic Journal, no. 52, 1960, pp. 496-513.
[4] H. Makower and G. Morton "A Contribution Towards a Theory of Customs Unions" Economic Journal, Vol. LXII, No. 249, March 1953, pp.33-49.
[5] Economies included in this group are: Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Serbia and Kosovo*. Croatia is not longer included in Western Balkans since it become EU member in June 2013. Western Balkans group, without Croatia, is also referred as Western Balkans 6 (WB6).

Table 1: Western Balkans Trade Shares by Main Markets in 2012, %

Economy	European Union		CEFTA 2006	
	Exports	Imports	Exports	Imports
Albania	75.5	61.9	12.0	9.2
Bosnia & Herzegovina	57.9	46.9	31.6	25.2
Croatia	58.3	62.4	21.0	6.1
Macedonia (FYR)	62.8	58.4	24.4	11.6
Moldova	46.9	44.5	0.3	0.4
Montenegro	28.7	38.4	61.9	44.6
Serbia	56.0	58.1	27.9	8.2
Kosovo*	20.8	20.6	19.9	17.9

Source: CEFTA 2006 Trade Portal

Western Balkan economies are on the path of integration into the EU. All economies have EU accession as a strategic goal. Croatia became the 28th EU member in 2013. Macedonia, Montenegro and Serbia are candidate countries and all other Western Balkan economies are potential candidates for EU membership. All these economies expect significant gains in GDP and trade when they become EU members. In our previous research we have analyzed the trade preferences influence on trade flows and proven that Serbia has its "traditional" trade partners (EU and CEFTA 2006). Significant trade preferences from untraditional trade partners cannot divert trade from traditional trade partners in the long run.[6]

Intraregional trade in the Western Balkan economies is also very significant. These economies have also created their own regional trade integration. The process started in 1999 but with the initiative that came from the EU. In 2006 this integration was promoted with the signing of a single regional trade pact – Revised Central European Free Trade Agreement in 2006 (CEFTA 2006). Croatia and Serbia as the two largest economies in the region were leaders in CEFTA 2006, while others are more integrated at the import side, like Montenegro and Bosnia and Herzegovina. The CEFTA 2006 integration has had a big impact on the reestablishment of trade ties between former Yugoslav republics and was very important for the countries in the region during the last world economic crisis. Since its EU accession in 2013 Croatia has no longer been part of the CEFTA 2006 integration.

Other important trade partners of Western Balkan countries include Russia, members of the European Free Trade Association (EFTA), and Turkey. The Republic of Moldova is a part of CEFTA 2006, but its trade with other CEFTA 2006 members is insignificant in its exports since it is less than 1%, while Russia has a share of 30.3% in Moldova's exports and 15.7% share in its imports, according to 2012 data. Russia is an important partner for Serbia, since it had a 7.4% share in exports of Serbia in 2012 and 10.9% in Serbia's imports in the same year. Turkey is relevant in Bosnia and Herzegovina's and Serbia's trade, especially on their import side.

Not many countries in the world have exploited global trade liberalization and the growth of world trade in the second half of the 20th century to develop its economies. The current processes in world trade, usually referred to as economic globalization, can provide a condition for intensive economic growth, but only if countries are able to fit into the global system. Economic development of Western Balkan economies has been slow at the end of the 20th century and the beginning of the 21st century. All Western Balkan Economies are small and open economies with foreign trade as an important sector in the economy. Their export growth is much higher than the rise in their GDP.

Table 2: Western Balkan Economies GDP and Trade Indicators (%)

	Trade to GDP	GDP Growth	Export Growth
Albania	84.8	4	6
Bosnia & Herzegovina	98.6	2	7
Croatia	83.4	0	0
Montenegro	102.9	4	1
Macedonia (FYR)	122.2	3	5
Serbia	92.6	1	8

Source: WTO, Trade Profiles 2013, Geneva, 2013.

Note: Trade to GDP ratio calculated for 2010-2012 period. GDP and Export growth calculated for 2005-2012 period and 2005 is the base year (2005=100).

Some Western Balkan economies have even recorded negative growth rates during the period of the world economic crisis. During the crisis, the reduction in trade flows in the region was far less than the drop in the trade with other markets, including the EU. Also during the crisis, the structure of Western Balkan exports has

6 Predrag Bjelić and Radmila Dragutinović Mitrović. 2012. 'The Effects of Competing Trade Regimes on Bilateral Trade Flows: Case of Serbia'. *Proceedings of Rijeka Faculty of Economics – Journal of Economics and Business*, 30 (2): 267–294.

changed in favor of primary products,[7] which are not favorable to these economies.

The trade of Western Balkan economies is characterized by many negative trends, such as:

- low value of foreign trade that should be significantly higher for small economies, with especially low value of exports;
- low coverage of imports by exports, i.e. high deficit of foreign trade balance;
- low level of product diversification of trade;
- large share of primary products and, generally, low processed products in exports;
- low share of technology-intensive products in both imports and exports;
- high share of consumer goods in imports.[8]

All these factors are indicators of the low international competitiveness of Western Balkan economies on the global market and that trade cannot serve as an important economic development tool. World Economic Forum (WEF) data shows that all Western Balkan economies are ranked in the second half of the global competitiveness list. In 2013, Montenegro was the best-ranked economy in the Western Balkans, at 67th place, followed by Macedonia at 73rd position. Croatia has significantly reduced its international competitiveness in the observed period 2007-2013, and it is now at the 75th place on the global competitiveness rankings. Bosnia and Herzegovina and Albania have improved their competitiveness position over the years, but are still behind other economies in the region. Serbia had the worst ranking in 2013 compared to other Western Balkan economies, taking the 101st position. Even if some of the countries in the region have improved their rankings over the years, their position is still low, in comparison with their most important trade partner (please see table 3 in the appendix).

Since all the economies in the Western Balkans have a strategic goal of acceding to the European Union, they have to observe the second segment of the economic conditions for EU membership, which requires that candidate countries can sustain competitive pressures coming from the single EU market. The great majority of EU members are highly developed and competitive economies. It will be very hard for Western Balkan economies to integrate into a single EU market when they become EU members if they do not significantly improve their international competitiveness.

Findings in our research show that the regional trade integration involved in the EU and CEFTA 2006 have had positive effects on GDP growth in the Western Balkan economies.[9] But our analysis of bilateral trade between the EU countries and Western Balkan economies have shown that Western Balkan economies' exports to the EU were on the rise until asymmetrical trade preferences in favor of Western Balkan economies came into force. This non-reciprocal trade regime of the EU towards the Western Balkan economies was regulated by Autonomous Trade Measures (ATMs), introduced unilaterally by the EU in 2000. With the signing of Stabilisation and Association Agreements an asymmetry is introduced into the trade regime between the EU and the Western Balkans and exports stagnate and diminish[10], as a clear result of their uncompetitiveness towards European trade partners. Some research that uses global trade networks analysis, focusing on new EU members, suggests "accession of countries into the EU makes them more peripheral in the world trade network"[11]. This can be explained with the acceptance of a Common EU trade regime that stimulates intra-EU trade.

Western Balkan countries have to work on improving their competitiveness before joining the EU, and the CEFTA 2006 is the ideal environment to work on this. These economies will have to find their trade niche within the single European market and learn how to increase competitiveness as EU members, and contribute to EU competitiveness. The EU is a global trade player that resorts to a large number of protectionist measures, which distort global trade flows, and Western Balkan economies have to fit within this unique trade regime. But at present Western Balkan economies can work on joint projects and products that can be exported globally. The practice of diagonal cumulation of origin with the EU is a good example for this.

The precondition for EU membership is membership in the WTO, which is not important just because of the international trade regime that the WTO sets and over-

7 See more: Predrag Bjelić, Danijela Jaćimović and Ivan Tašić. 2012. 'Effects of World Economic Crisis on Export in CEEC: Focus on the Western Balkans' Economic Annals, 196⁄2013, January-March Issue, pp.71-98.

8 Predrag Bjelić "Trade as a Factor of Economic Development of Western Balkans" Paper presented at International Conference on Economic and Social Studies (ICESoS) organised by International Burch University, Sarajevo, 24-26. April 2014.

9 Predrag Bjelić, Danijela Jaćimović and Ivan Tašić. 2012. 'Effects of World Economic Crisis on Export in CEEC: Focus on the Western Balkans' Economic Annals, 196⁄2013, January-March Issue, pp.71-98.

10 Radmila Dragutinović-Mitrović and Predrag Bjelić (2013) 'International Competitiveness and Asymmetry in Trade Regime in the EU Integration: Evidence from Western Balkans' in: *The Tenth International Conference: Challenges of Europe: The Quest for New Competitiveness Proceedings, 2013,* Split: Faculty of Economics.

11 Omer Nebil Yaverogly, Noel Malod-Dognin, Darren Davis, Zoran Levnjajic, Vuk Janic, Rasa Karapandza, Aleksandar Stojmirovic and Natasa Przulj "Revealing the Hidden Language of Complex Networks" Scientific Reports, 4:4547, DOI: 10,1038/srep04547.

sees, but because of the sets of technical agreements that lay down basic trade principles. Some of the countries in the region are still not WTO members and this membership obligation must be in accordance with the Western Balkans' future EU trade obligations. All individual Western Balkan economies have also bilateral trade agreements with different partners. When these economies become EU members all these regimes will have to change since the EU is a highly integrated trade block with a common trade Policy.

Appendix

Table 3: Western Balkan Economies Competitiveness Ranked by the World Economic Forum

	2007	2008	2009	2010	2011	2012	2013
Montenegro	82	65	62	49	60	72	67
Macedonia (FYR)	94	89	84	79	79	80	73
Croatia	57	61	72	77	76	81	75
Bosnia & Herzegovina	106	107	109	102	100	88	87
Albania	109	108	96	88	78	89	95
Serbia	91	85	93	96	95	95	101

Literature

Bjelić, Predrag (2011) “Međunarodna trgovina” 3rd edition, Beograd: CID Ekonomski fakultet.

Bjelić, Predrag (2014) "Trade as a Factor of Economic Development of Western Balkans" Paper presented at International Conference on Economic and Social Studies (ICESoS) organized by International Burch University, Sarajevo, 24-26. April 2014.

Predrag Bjelić "Competitiveness, Trade Regimes and Specialisation in the Southeast Europe" Regional Cooperation Council (RCC), www.rcc.int/admin/files/docs/PREDRAG%2520BJELIC.ppt&sa=U&ei=fpt3U_-aIIOl0AWNvoGgBg&ved=0CBsQFjAA&usg=AFQjCNGUATxjY1puRn-tL-BRu0jgCCiBfQ

Bjelić, Predrag and Radmila Dragutinović Mitrović (2012) ‘The Effects of Competing Trade Regimes on Bilateral Trade Flows: Case of Serbia’. Proceedings of Rijeka Faculty of Economics – Journal of Economics and Business, 30 (2): 267–294.

Bjelić, Predrag, Danijela Jaćimović and Ivan Tašić (2012) “Effects of World Economic Crisis on Export in CEEC: Focus on the Western Balkans” Economic Annals, 196⁄2013, January-March Issue, pp.71-98.

CEFTA 2006 Trade Portal, Internet, www.ceftatradeportal.com/

Dragutinović-Mitrović, Radmila and Predrag Bjelić (2013) ‘International Competitiveness and Asymmetry in Trade Regime in the EU Integration: Evidence from Western Balkans’ in: The Tenth International Conference: Challenges of Europe: The Quest for New Competitiveness Proceedings, 2013, Split: Faculty of Economics.

Lipsey, Richard G. (1960) “The Theory of Customs Unions: A General Survay” The Economic Journal, no. 52, pp. 496-513.

Makower, H. and G. Morton “A Contribution Towards a Theory of Customs Unions” Economic Journal, Vol. LXII, No. 249, March 1953, pp. 33-49.

Viner, Jacob (1950) “The Customs Union Issue” Carnegie Endowment for International Peace, New York, 1950.

World Economic Forum “Global Competitiveness Report” 2008-2014, Davos.

WTO “Trade Profiles 2013” Geneva, 2013.

Yaverogly, Omer Nebil, Noel Malod-Dognin, Darren Davis, Zoran Levnjajic, Vuk Janic, Rasa Karapandza, Aleksandar Stojmirovic and Natasa Przulj “Revealing the Hidden Language of Complex Networks” Scientific Reports, 4:4547, DOI: 10,1038/srep04547.

ADMINISTRATIVE BARRIERS TO TRADE WITHIN CEFTA-2006

Irena Kikerkova
Full-time Professor in International Economics
Faculty of Economics
Ss. Cyril and Methodius University, Skopje

1. Overview of the up-to-date trade liberalization within CEFTA-2006

The Central European Free Trade Agreement (CEFTA) 2006 is considered to be the first successful attempt to bring together the Western Balkan countries in order to make them articulate their mutual economic interests. Many similar initiatives, mostly undertaken under the Stability Pact, were disregarded or rejected. The CEFTA-2006 Agreement foresaw trade liberalization of both agricultural and non-agricultural goods, services and investment, with the elimination of all tariff and non-tariff barriers to trade occurring by the end of 2010. In fact, all of the countries in the region – even before signing the Agreement – did not impose any quotas on the exchange of goods and most of their exports did not suffer from extreme subsidies with the exception of several agricultural products.

The creation of CEFTA-2006 has undoubtedly had a positive impact upon the total volume of goods traded within the Western Balkan region, especially during the first three years after its creation. In this period, the volume of the Macedonian trade exchange of goods within CEFTA-2006 almost doubled and the total volume of its trade within the Western Balkan region rose from only 7% at the end of 2006 to 28% by the end of 2008.[1]

The crises in Europe in 2009 interrupted the increase in trade exchange within the free trade area and the region experienced a serious decrease in the exports and imports of goods. In the Macedonian case, exports towards CEFTA-partners were cut by 37.2% in comparison to those made in 2008, and the proportion of its total trade with CEFTA-2006 fell from 28% to only 20%.[2]

The trade exchange within the region stabilized in the period from 2010-2011, but then again suffered from another serious decrease in 2012, when the trade exchange volume with CEFTA-2006 trade partners amounted to 16.3% of the total exports of Macedonia. Last year it reached about 17%.[3]

Very similar tendencies in the exchange of goods were experienced by all of the member states as well. All of them proved to have a very weak economic capacity, which hindered their performance on the regional as well as on the wider European market. In periods when the economy of the European Union (EU) was stable, most of the traders from the region preferred the EU-

---

[1] The Ministry of Economy of the Republic of Macedonia and the United States Agency for International Development (USAID): *Report on Foreign Trade of Macedonia 2008,* Ministry of Economy of the Republic of Macedonia and the USAID, Skopje, 2008, p. 67 and www.mchamber.mk.

[2] www.statistics.gov.mk.

[3] www.mchamber.mk.

market and traded less with CEFTA-2006 partners. And vice versa: in periods when, for whatever reasons, the EU-market "closed" its gates to non-EU countries, CEFTA-2006 member states started to increase their mutual trade. This tendency is mostly a result of the underdeveloped economic structure of all the member states of the free trade area that are heavily dependent on imports of raw materials and machinery, but at the same time have a poor capacity to transform them into sophisticated, highly processed goods. In most of the cases, the Western Balkan economies are capable to produce and export only semi-processed goods, which are rather vulnerable and exposed to volatility of prices on foreign markets. Therefore, all of them still follow the inter-industrial pattern of trade at regional and at world level. The weak economic capacity of the region is illustrated by the fact that less than 20% of the intra-regional trade consists of non-agricultural products.[4]

Despite the weaknesses of the economies in the free trade area, we still believe that its real trading potential is not used to its utmost, mainly because full trade liberalization has been held back by a full range of non-trade barriers. Two years ago, the economic chambers of the member states addressed this problem for the first time. They especially emphasized the long and non-transparent administrative procedures and the insufficient customs and transportation infrastructure. Even more striking was the fact that most of the economic operators from CEFTA-2006 were not aware of the existence of administrative or any other non-trade barriers. Due to the long experience of doing trade within the region they got used to various impediments and treated them as a normal way of doing business.

This made the problem even worse, as most of the non-trade barriers were difficult to identify and measure. Therefore, CEFTA-2006 member states decided to introduce a system of regular identification of non-trade barriers with the help of a monitoring-tool of the Organisation for Economic Co-operation and Development (OECD). According to the OECD methodology, supporting the monitoring tool, the non-trade barriers (NTBs) were divided in three groups: technical barriers to trade (TBT); sanitary and phytosanitary measures (SPS) and administrative barriers to trade. Several indicators were defined for each group of NTBs that were expected to be measured and evaluated during the monitoring process. The detection of NTBs was realized by following the trade flows in intermediary goods of 12 selected sectors among CEFTA member states, such as: food products and beverages; fabricated metal products, except machinery and equipment; other non-metal mineral products; agriculture; pulp, paper and paper products; chemicals, chemical products and man-made fiber; electrical machinery and apparatus; rubber and plastic products; wood and products of wood and cork; machinery and equipment; coax, refined petroleum products and nuclear fuels.[5]

This paper is going to focus only on the administrative barriers to trade existing within CEFTA-2006.

2. Administrative barriers to trade within CEFTA-2006

Administrative barriers to trade basically concern the performance of the customs administration. Within contemporary international trade, the efficiency of the customs administration is considered to be especially important for the swift, safe and cost efficient cross-border movement of goods. The efficient performance of the customs administration can tremendously reduce export/import costs and thereby may influence the market competitiveness of products. CEFTA-2006 member states are facing not only various restrictions in regard with their obsolete border infrastructure, but also face a lot of problems connected to the compliance of the work of their national customs services with international standards and procedures. For example, national customs services of all member states control each shipment of goods exported from whatever member-state by taking at least three samples from each traded good.

The inter-border flow of goods is many times slowed down as a result of inconsistency in understanding and implementation of national customs rules by customs officers in different member states, which substantially increases the costs. Not all member states have signed the *Convention on Transit of Goods*, yet, and therefore, customs officers are asking for a different set of documents at each border-crossing. Because of the insufficiency and sometimes non-existence of an electronic communication system, it has not been possible to establish and connect the New Computerized Transit System (NCTS) among the member states, yet. [6]

According to the OECD-monitoring tool, the administrative barriers to trade within CEFTA-2006 were identified and divided in nine categories presented in Table 1.

The follow-up in the paper is going to present the main findings of the analysis of all the categories of administrative barriers according to the OECD monitoring tool.

4 www.statistics.gov.mk.

5 OECD&CEFTA: "Draft-Assessment Framework to monitor elimination on non-tariff barriers in CEFTA", *CEFTA Issues Paper No. 4,* www.investmentcompact.org and www.cefta2006.com, 2012, p. 7.

6 www.mchamber.mk.

Table 1: Administrative barriers to trade according to the OECD monitoring tool

	Categories of administrative barriers to trade
1.	Establishment and functioning of a national customs website
2.	Establishment and functioning of enquiry points
3.	Involvement of the trade community
4.	Advanced rulings
5.	Appeal procedures
6.	Fees and charges
7.	Formalities: documents and automation
8.	Customs procedures and processes
9.	Domestic and cross-border/international agency co-ordination and co-operation

Source: OECD&CEFTA: "Draft-Assessment Framework to monitor elimination on non-tariff barriers in CEFTA", *CEFTA Issues Paper No. 4,* www.investmentcompact.org &www.cefta2006.com, 2012, p.7

2.1. Establishment and functioning of a national customs website

The OECD-monitoring tool confirms the existence of a national customs website in each of the CEFTA member states with necessary information on transparency of trade related regulations and issues available in English, which is in compliance with the rules of the World Trade Organization (WTO) and the CEFTA Agreement. The quality of information in English, however, is very often inferior to the information placed on the web in national languages. Also, the scope and type of information placed on national customs web is not unified among the member states. For example, only Bosnia and Herzegovina's web-information contains a border-crossing procedures manual, and only in Macedonia and Serbia is there a bigger amount of more detailed information on different customs procedures compared to the other member states. Only in Macedonia the customs reports the judicial decisions on the customs web.[7]

The monitoring recommends that member states should pay special attention to the availability of information on binding tariffs and possibility of cumulation of origin.

2.2. Establishment and functioning of inquiry points

The establishment and functioning of inquiry points has not been realized under unified terms and in coordination with all CEFTA member states. Albania and Bosnia and Herzegovina have not fulfilled this obligation, yet. Almost all of the established inquiry points deal with questions concerning customs legislation and procedures. Only in Macedonia the inquiry point provides information on other trade related issues as well and has established a 24/7-hour hotline. The full-time hotline in Kosovo is opened only for corruption and smuggling issues.[8]

2.3. Involvement of the trade community

The cooperation with the trade community in all CEFTA member states is represented by the national chambers of commerce, but also through special consultative bodies established in each country to facilitate this process. However, trading companies are directly involved in the process of creation of customs laws and regulation only in Macedonia and in Serbia.

The report finds that it is essential for the CEFTA-region to engage international experts for training purposes and knowledge dissemination.[9]

2.4. Fees and charges

All of the CEFTA-2006 member states followed Article 6 of the CEFTA Agreement[10] and abolished *ad valorem* fees and charges with the exception of Moldova. They all regulated these issues with separate laws published in their Official Gazettes. The most clear and comprehensive information of fees and charges was published in Macedonia and has also been available on its customs website. Bosnia and Herzegovina and Serbia charged customs fees only for services provided out of the regular working hours of the customs. The monitoring, however, stated that there was a lack of regular exchange of information on the applied fees and charges on customs procedures among CEFTA member states, which was considered to be a priority issue needed to be dealt with in the near future.[11]

2.5. Appeal procedures

The OECD monitoring tool confirms that all of the CEFTA member states implemented the main international standards on appeal procedures. They begin in all member states with the possibility to appeal within the administration that issued the original decision, and proceed with a possibility to submit it to a higher level that supervises the administration. The next step in the procedure is to appeal to an independent authority. This step,

[7] OECD: *OECD Draft Regional Report on Administrative Barriers to trade in CEFTA,* 2013, pp. 4-5.

[8] OECD&CEFTA: "The Elimination of Non-Tariff Barriers in CEFTA-2006", *CEFTA Issues Paper No.4,* www.investmentcompact.org and www.cefta2006.com, 2012, pp. 8-9.

[9] OECD&CEFTA: "Draft-Assessment Framework to monitor elimination on non-tariff barriers in CEFTA", *CEFTA Issues Paper No. 4,* www.investmentcompact.org &www.cefta2006.com, 2012, pp. 64-67.

[10] *Agreement on Amendment of and Accession to the Central European Free Trade Agreement,* www.cefta.int.

[11] OECD: *OECD Draft Regional Report on Administrative Barriers to trade in CEFTA,* www.investmentcompact.org and www.cefta2006.com, 2013, p. 9.

however, is not possible in Albania, Bosnia and Herzegovina and Moldova.

All of the countries allow the possibility to appeal to an independent judicial authority. Most of the member states, however, have limited access to information on appeal procedures on the Internet. Actually, only in Macedonia the decisions and explanations delivered in the appellate procedures are available publicly.[12]

2.6. Advanced rulings

All CEFTA-2006 member states have an advanced rulings mechanism mainly for the classification of goods under the national customs tariff and verification of the origin of goods under preferential trade regime. The advanced rulings are officially published and are usually available on national websites, and all of these provisions include an appeal mechanism. Nevertheless, this instrument is not sufficiently used, as in all the countries in the free trade area this instrument is issued only on request of traders. Partly, the insufficient usage of the advanced rulings is a consequence of a lack of special profiles of customs officers within the national customs services, such as technical engineers, chemists, textile production specialists, etc. In order to stimulate issuing of advanced rulings, the OECD monitoring tool recommends regular training for customs officers. Macedonia, Moldova, Montenegro and Serbia publish the issued advanced rulings on their customs websites.[13]

2.7. Formalities: documents and automation

CEFTA member states have complicated documentation formalities. The complicated documentation procedures are due to the non-existence of an electronic customs system, with exception of Macedonia, which makes electronic exchanges of documents impossible within the region. Even if customs declarations' electronic lodging and processing was available in all member states, the submission of paper-form documentation still would have remained mandatory for customs clearance, which complicates and prolongs the customs procedures.

Electronic payment of customs duties is available only in Montenegro and Serbia, while digital signature is not functioning only in Albania and Montenegro. Especially important for the process of trade facilitation within the region is the establishment of the customs single window concept, which at present is fully implemented and operational only in Macedonia.[14]

2.8. Risk management and post clearance audit

Administrative procedures that facilitate trade are unimaginable without an efficient risk management system. The risk management within the customs is also important for the post clearance audit. CEFTA member states are fully aware of the importance of risk management within the customs. However, they all face a lack of trained staff and expertise in this area. Therefore, the number of physical controls at the border is high above the international, as well as the EU standard. The member states exchange information among themselves to help the process of risk management, although they have not been able to create joint risk profiles, as well as sophisticated centralized risk management IT system, yet. They depend on international expertise on creating the risk profiles instead. The OECD monitoring tool recommends developing of a Regional Training Strategy in order to provide uniform application of EU standards on risk management and post clearance audit.[15]

2.9. Customs procedures and processes

The OECD monitoring-tool of customs procedures and processes analyzed the pre-arrival processing, the separate release of goods and payment of customs duties, difference in physical and documentary inspections of perishable and non-perishable goods within the clearance process, the extent of use of the status of authorized traders, regular trainings and web-publication of average clearance time, as well as domestic and cross-border cooperation of the customs authorities.[16]

As automated customs systems have not been established throughout the region, pre-arrival processing is not available despite changes introduced in national legislations. The separation of release of goods from customs clearance in most of the countries is available if a certain amount of money is placed as a security deposit, with the exception of Albania. Albania is also the only exception from the application of simplified procedures in the cus-

[12] Kikerkova, Irena.: "Trade liberalization under CEFTA-2006 – the challenge of elimination of non-trade barriers" , *Proceedings of the 9th International Conference on Economic Integration, Competition and Cooperation – Accession of the Western Balkan Countries to the European Union,* organized by the University of Rijeka –Faculty of Economics – Partner in EU Integration Jean Monnet Ad personam Chair, Opatia, Croatia, 2013, pp. 544-545.

[13] Ibid., p. 545.

[14] Kikerkova, Irena: "Trade liberalization under CEFTA-2006 – the challenge of elimination of non-trade barriers" , *Proceedings of the 9th International Conference on Economic Integration, Competition and Cooperation – Accession of the Western Balkan Countries to the European Union,* organized by the University of Rijeka –Faculty of Economics – Partner in EU Integration Jean Monnet Ad personam Chair, Opatia, Croatia, 2013, p. 545 and OECD: *OECD Draft Regional Report on Administrative Barriers to trade in CEFTA,* www.investmentcompact.org and www.cefta2006.com, 2013, p. 14.

[15] OECD: *OECD Draft Regional Report on Administrative Barriers to trade in CEFTA.* www.investmentcompact.org and www.cefta2006.com, 2013, p. 17.

[16] OECD: *OECD Draft Regional Report on Administrative Barriers to trade in CEFTA,* www.investmentcompact.org and www.cefta2006.com, 2013, p. 18.

toms clearance process, which is used by all other member states.

However, there are serious difficulties in implementing the concept of authorized economic operator, though in some of the member states the legislation is already in place. In fact, only in Macedonia the biggest pharmaceutical company completed the procedure and gained the status of Authorized Economic Operator (AEO).

All of the member states give priority to the clearance of perishable goods at their borders. However, the monitoring pointed out that all of the CEFTA parties lack technical equipment in their customs laboratories, as well as modern techniques of testing samples of different goods. They also need adequate training of customs experts in the respective areas of the work of the laboratories. In relation to the information published on the average clearance time, it is provided on regular terms only on the customs website in Macedonia and Moldova.[17]

Concerning domestic cooperation between the customs and other relevant agencies, the national legislation in the member states is not harmonized and in most of them there is no single location and time for documentary and physical controls, or there is a single time and location for documentary, but not for physical control. Also, the working hours of border agencies is not synchronized throughout the region. Harmonization of both of these issues is not only necessary for greater integration and cooperation between the national customs authorities and border agencies, but it is a main precondition for better cross-border agency cooperation. There is also a strong need for providing adequate technical and administrative capacities to introduce joint risk profiling with cooperation of relevant agencies.

At present cross-border agency cooperation is functioning mainly through the activities established by CEFTA working groups, such as the CEFTA working group on risk management, which should facilitate the introduction of joint risk profiling for the whole region. It is also expected to extend the cooperation not only at bilateral neighboring countries joint customs controls level, but by signing an agreement to enable multilateral joint controls of all the member states.

3. Concluding remarks

The creation of CEFTA-2006 was the most important project of re-establishing economic cooperation among the Western Balkan countries. The free trade area revitalized the trade exchange of goods and encouraged greater respect for international trade rules and standards under the trade liberalization framework. Nevertheless, the realization of the full trading potential of CEFTA-2006 is limited not only by the fragile economic structure, weak economic capacity and severe dependence upon the EU-trading partners, but also due to the existence of a number of open and hidden non-trade barriers. The administrative barriers to trade are certainly among the most important non-trade barriers that hinder the process of further trade liberalization within the region.

The in-depth analysis of the existing administrative barriers to trade within CEFTA-2006 provides a very important insight into a lot of issues, some easy to detect, but some of them deeply hidden. For example, all of the CEFTA member states still have to deal with the lack of contemporary border infrastructure, adequate customs laboratory equipment, well trained personal, as well as properly established operational and interconnected IT systems.

The analysis of the administrative barriers active within the region generated with the help of the OECD monitoring-tool, however, pointed out that the absolute priority of the member states should be to provide all the necessary preconditions for establishing efficient risk management, fully harmonized with all international standards and operational and functional on national and regional level. It is believed that the region should achieve a uniform application of all necessary criteria on risk management, which should be established by the development of a Regional Training Strategy. This would be the first step in establishing a procedure for the conduct of the performance results assessment for existing high-risk profiles, which would enable the adjustment of border controls up to international standards and would speed up the flow of goods across the borders.

The OECD report also puts an emphasis on the issue of the insufficient usage of simplified procedures, as well as on the lack of a legal framework for the implementation of the concept of authorized economic operators and the mutual recognition procedure of the gained status within CEFTA-2006. In combination with the improved risk management system, simplified customs procedures should lead to a decrease in the number of physical controls of each shipment and the full implementation of the Convention on Mutual Transit within the region. In order to achieve further trade facilitation, it is very important to stimulate inter-agency cooperation based on the concept of one-stop-shop. It is also necessary to support more intensive cooperation between national agencies and economic operators, as well as to provide greater transparency and availability of trade related information.

Another relevant joint project in the region should be to enable the introduction of the single window mechanism in all member states. This, as well as many other issues connected to the administrative barriers of trade within CEFTA-2006, cannot be efficiently dealt with if there is not a functional IT system in each national entity. It is considered that most of the member states would need

[17] OECD, *OECD Draft Regional Report on Administrative Barriers to trade in CEFTA,* www.investmentcompact.org and www.cefta2006. com, 2013, p. 20

technical support provided by international IT customs experts in order to create and establish a fully operational IT system and "paperless" customs procedures.

Most of the problems concerning CEFTA-2006 trade facilitation process are a result of the low political will and diminished negotiating potential of all of the governments of the member states. They have not been able to articulate their mutual interest and it has not been identified what should be considered as a regional interest, yet. Therefore, the OECD report states that the expected results in the process of trade facilitation could be more easily achieved through regional coordination of the process by establishment of a regional committee of representatives of all member states who would be able to provide important insights on this issue and enhance the process at the national level.

References:

Kikerkova, Irena.: "Trade liberalization under CEFTA-2006 – the challenge of elimination of non-trade barriers", Proceedings of the 9th International Conference on Economic Integration, Competition and Cooperation – Accession of the Western Balkan Countries to the European Union, organized by the University of Rijeka – Faculty of Economics – Partner in EU Integration Jean Monnet Ad personam Chair, Opatia, Croatia, 2013.

Kikerkova, Irena: "The importance of the Creation of CEFTA-2006 for the Western Balkans", Chinese Business Review, David Publishing Company, Libertyville, Illinois, Volume 10, No. 10, pp. 844-855, October 2011.

Ministry of Economy of the Republic of Macedonia and the USAID: Report on Foreign Trade of Macedonia 2008, Ministry of Economy of the Republic of Macedonia and the USAID, Skopje, 2008.

OECD, OECD Draft Regional Report on Administrative Barriers to trade in CEFTA. www.investmentcompact.org and www.cefta2006. com, 2013.

OECD and CEFTA: "Draft-Assessment Framework to monitor elimination on non-tariff barriers in CEFTA", CEFTA Issues Paper No. 4, www.investmentcompact.org and www.cefta2006. com, 2012.

OECD and CEFTA: "The Elimination of Non-Tariff Barriers in CEFTA-2006", CEFTA Issues Paper No.4, www.investmentcompact.org and www.cefta 2006.com, 2012.

www.mchamber.mk

www.statistics.gov.mk

www.customs.gov.mk

SEE 2020 STRATEGY'S CHALLENGES IN FOSTERING REGIONAL ECONOMIC COOPERATION

Silvana Mojsovska
Full-time Professor
Institute of Economics
University Ss. Cyril and Methodius, Skopje

Regional cooperation is a cornerstone of the EU's policy framework for the Western Balkans – the stabilization and association process, which offers to the countries of the region the possibility of eventual EU membership[1], as stated by the former Enlargement Commissioner Olli Rehn[2] in 2005. In this respect, regional cooperation could be perceived solely as a precondition for further pursuing the process of EU integration of the SEE countries,[3] not as an option. It has been shaped within the Stability Pact for South Eastern Europe (1999-2008), at the EU-Western Balkans Summits of Zagreb (2000) and Thessaloniki (2003), as well through the individual Stabilisation and Association Agreements of the SEE countries. In the past 15 years, the region has shown serious political willingness for regional integration resulting in CEFTA 2006 and numerous regional initiatives. Nevertheless, the current state of affairs with regards to regional economic cooperation could not be assessed as particularly encouraging. In absolute terms, the intra-regional trade within CEFTA 2006 reached EUR 14bn in 2012, an increase by 23% compared to 2009, while in relative terms, the share of the intra-regional trade out of the total trade of the CEFTA Parties remained the same – about 16% over the period.[4] In addition, the regional investment, intra-CEFTA labor mobility flows, as well as inclusion of the region into the global supply channels have not been significant, as the countries remained focused on the EU market.

Currently, the Regional Cooperation Council (successor of the Stability Pact as of 2008) functions as a focal point for regional cooperation in SEE and its key role is to generate and coordinate developmental projects of a wider, regional character to the benefit of each individual participant, and create an appropriate political climate susceptible to their implementation.[5] The Regional Cooperation Council (RCC) participants comprise 46 countries, organizations and international financial institutions, implying the existence of a political structure fostering the regional integration process of the SEE countries. The main strategic document serving as a guideline to RCC actions is the South East Europe (SEE) 2020 Strategy, endorsed on 21 November 2013 at the Ministerial Conference of the South East Europe In-

---

[1] EC Document: Regional Cooperation of the Western Balkans: a Policy Priority for the European Union, ISBN 92-79-01374-2, European Communities, 2005, p.2 (http://ec.europa.eu/enlargement/pdf/nf5703249enc_web_en.pdf)

[2] EC Commissioner for Enlargement in the period 2004-2010

[3] The terms "Western Balkans" and South East Europe (SEE) are used as synonyms in this paper and include the following countries: Albania, Croatia, Bosnia and Herzegovina, Macedonia, Montenegro, Kosovo and Serbia

[4] CEFTA 2006 Statistics (www.cefta.int)

[5] http://www.rcc.int/pages/2/overview

vestment Committee (SEEIC). It consists of five interlinked pillars:[6]

1. Integrated Growth – promoting regional trade and investment linkages and policies that enhance the flow of goods, investment, services and people within the region;

2. Smart Growth – building new competitive economies in the region, driven by knowledge and innovation, based on human capital and grounded on modern information and communication technologies;

3. Sustainable Growth – raising the level of sustainable and accessible transport and energy infrastructure, a competitive economic base and a resource efficient economy;

4. Inclusive Growth – placing greater emphasis on skills development, employment creation and inclusive labor market participation, health and wellbeing;

5. Governance for Growth – increasing the meritocratic capacity of public administration, decreasing the level of corruption and ensuring delivery of more efficient public services.

The five pillars of the SEE 2020 Strategy have been further disaggregated in 16 dimensions – Free Trade Area, Competitive Economic Environment and Integration into the Global Economy (Pillar 1); Education and Competences, R&D and Innovation, Digital Society, Cultural and Creative Sectors (Pillar 2); Energy, Transport, Environment and Competitiveness (Pillar 3), Employment and Health (Pillar 4); Effective Public Services, Anti-corruption and Justice (Pillar 5).

By its structure, the SEE 2020 Strategy is a very complex document, the implementation of which envisages actions at two levels – regional and national. More specifically, most of the sub-dimensions included in the Strategy SEE 2020 should be translated into national and regional measures/activities, implying a need for clarification of the link between both levels. Furthermore, many of the defined headline targets of the Strategy SEE 2020 depend on numerous national reforms, as well as capacity building in the SEE Parties through strengthening of existing and establishment of new institutions. On the other hand, certain actions envisaged in the Strategy SEE 2020 are primarily regional processes that require setting of strong regional driving forces.

The broad range of fields covered with the SEE 2020 Strategy could be perceived in both ways – as an opportunity for genuine deepening of the regional integration, or as a threat for the SEE 2020 Strategy to become another policy document concluded by the SEE countries as "requirement" within the frame of their accession processes towards the Union, without true commitment of the countries to its implementation. In this perspective, the success of the SEE 2020 Strategy is related to ensuring ownership of the Strategy by its signatories, as well as proper linking of the Strategy with the existing regional initiatives, with the purpose of ensuring rational use of the available resources, avoid overlapping of the activities, as well as to reinforce the effects from all these efforts. With regards to both issues, the RCC could play an important role, as regional guidance in this process seems to be necessary.

The most notable difference of the SEE 2020 Strategy could be located in the overall development dimension, compared to other efforts for regional integration of Southeast Europe, which mostly focuses on a specific field of cooperation. The development dimension of the SEE 2020 Strategy entails the need for a broader understanding (and planning) of the reform processes by the actors relevant for the aforementioned 16 dimensions of the Strategy. In the mid-term, this could imply higher coherence of the policy planning (on national and regional level, too) in different areas relevant for national economies' development, ensuring better policy results, as well as more coordinated and effective use of the available resources. On the other hand, the main constraint with regards to the overall development dimension could be perceived in the narrow timeline of the Strategy, creating strong pressure on the signatory Parties for prompt planning of the activities for implementation on the Strategy in the short-run (the National Action Plans for 2014-2015 and Regional Action Plan for the Strategy are planned to be adopted by June 2014). This is unlikely to be favorable for setting sound policy mechanisms, in particular with regards to linking the national and regional planning related to the 16 dimensions, as well as to fostering increased awareness of the countries about the potential of the SEE 2020 Strategy to enhance national and regional development. In this regard, the RCC could provide operational support to the countries in their planning processes (as part of the political process of coordination related to SEE 2020 Strategy), as well as in the creation of sound regional mechanisms for implementation of joint projects of the SEE countries.

Furthermore, the complex nature of the SEE 2020 Strategy, which mirrors the EU 2020 Strategy, imposes costs to the signatory parties, which would be quite significant in specific fields. The SEE 2020 Strategy provides link of its 16 dimensions to the Chapters of the EU *acquis*, implying that the costs for implementation of the Strategy should be partially covered within the process of EU accession of the SEE countries. However, the SEE 2020 Strategy is likely to impose additional reforms to the countries to those already planned, mean-

[6] SEE 2020 Strategy, Regional Cooperation Council 2013/ http://www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf

ing additional costs. In this respect, the national budgets of the SEE countries are unlikely to allocate the requisite amount of finances to safeguard progress with regards to all headline targets in the SEE 2020 Strategy, in particular at the start of the implementation of the Strategy (2014-2015). This implies a need for ensuring stable financial mechanisms and financial support for implementation of the Strategy SEE 2020. The RCC could have a crucial role in this process, given its primary mission to generate and coordinate regional developmental projects, which could be based on the priority needs of SEE parties for the advancement of particular areas indicated in the SEE 2020 Strategy that have been identified as challenging in terms of ensuring national finances and other resources.

Another issue related to the prospects of the SEE 2020 Strategy to foster the integration of the region could refer to the realistic setting of the Strategy's targets, which also affect the process for ensuring full ownership of the Strategy by its signatory Parties. For instance, the Free Trade Area dimension included in Pillar 1 of the SEE 2020 Strategy envisages considerable increase of labor mobility across the region, which is unlikely to be perceived as realistic due to the high rates of unemployment in all SEE countries and their labor market restrictions applied at present. In addition, the Strategy entails formulation of an investment concept for the region, which needs to be carefully approached, taking into consideration the national investment programs of the countries, mostly related to extensive (and costly) national campaigns for the attraction of FDI. There are other issues, too, indicated in the SEE 2020 Strategy as development milestones, and formally accepted by the SEE countries (through signing of the Strategy), although not completely in line with national strategic actions applied in practice. In this respect, the RCC could play an important role in facilitation of the dialog among the SEE countries with regards to the SEE 2020 Strategy targets, identified as difficult/unrealistic to be fulfilled in the time frame up to 2020, with the purpose of setting a platform to deal with those issues.

In addition to the previously mentioned challenges which mostly refer to some strategic/operational issues related to the implementation of the SEE 2020 Strategy, the issue of (de)politicization of the process of regional integration of the SEE region is also relevant. In the past 15 years, the process of the regional integration of Southeast Europe could be perceived as a mostly politically driven process supported by a regional organization (Stability Pact for SEE and subsequently, RCC), under the auspices of the EU. Therefore, it could be discussed that the political commitment of the Parties to the regional integration has been ensured externally, within the frame of the national EU integration processes of the SEE countries. As indicated, the results of such a politicized regional cooperation have not been substantial, leading to a change of the instruments for regional cooperation (from bilateral free trade agreements to CEFTA 2006), while the pattern of the dominant political dimension remained unchanged. The political dimension of the SEE 2020 Strategy is also important, although the scope of dimensions covered by the Strategy, as well as operational issues related to the fulfillment of many of the headline targets, increase the significance of substantial cooperation among the SEE countries. In this perspective, ensuring genuine ownership of the SEE 2020 Strategy in the SEE countries could not be achieved only by political commitment, as many actors (institutions) should be involved in the process of the implementation of the Strategy. Therefore, finding the right balance between "operationalization" and "politicization" of the SEE 2020 Strategy implementation is another challenge for the SEE countries, which should be facilitated by the RCC.

THE BACKBONE OF ECONOMIC DEVELOPMENT: STRENGTHENING INFRASTRUCTURE AND ENERGY SECURITY

Jens Bastian
Independent Economic Analyst and Financial Sector Consultant, Athens

Introduction:

It goes without saying that cross border transport, energy and communication networks play an important role with regard to regional economic development in the Western Balkans. However, many of these networks are underdeveloped, lack domestic funding sources and are frequently subject to long-standing, unresolved cross-border disputes between neighboring countries.

The focus of this brief will mainly be on the energy sector, its reform momentum, deficits and newly emerging challenges for countries in the Western Balkans. While the reform agenda in this key policy field has long been identified, its implementation is frequently characterized by a lack of financial, administrative and institutional resources, the danger of reform reversals gaining ground and the absence of longer-term visions for the energy sector.

Progress and stagnation in infrastructure and energy security in the Western Balkans

For many years, energy sector policy making (i.e. regulatory reform, market liberalization and unbundling, pricing transparency) has been among the most complex and contentious policy fields in and between countries in the Western Balkans. While the objective of enhanced energy efficiency is a shared policy goal, the political controversies concentrate around three key areas:

- Enhanced energy efficiency;
- The necessary volume of public and private investments in renewable energy;
- Cost-efficient tariff policies/adjustments for private households and corporate entities.

The momentum to implement reforms in the energy sector in the Western Balkans is repeatedly being challenged by the economic consequences of the region's multi-year recession and social pressures that arise from key stakeholders, including civil society groups.

Since the transition process began in the 1990s, countries in the region (particularly Albania, Kosovo, parts of Macedonia and Montenegro) continue to have severe domestic electricity generation, distribution and supply problems. The catastrophic floods affecting the region in May 2014 (in particular Bosnia and Herzegovina, Serbia and Croatia) have only further underlined the fragility of the region's infrastructure and energy supply network. To illustrate, in Serbia rescue efforts were critical to safeguard the enormous *Nikola Tesla* power plant outside Obrenovac, which supplies nearly half the country's electricity. We can expect that once these floods have receded, the assessment of the damage (apart from the human tragedy) done to power lines, electricity production, road infrastructure and private housing will be such that supply shortages will quickly emerge.[1]

This is to say nothing yet about the amount of repair investment that will be needed and which the individual countries cannot mobilize for lack of fiscal space in their respective national budgets. Official estimates put the direct damage of the unprecedented floods in the range of billions of euros. The short-term effects on agricultural production infrastructure are devastating since the floods arrived during the growing season. It is therefore just a matter of time until appeals will be made to the international community for longer-term infrastructure and reconstruction projects for the power grid, housing and transport networks.

According to the latest evaluation assessments in the *2013 Transition Report* of the London-based European Bank und Reconstruction and Development (EBRD),[2] the sector-level assessment for infrastructure and energy security shows a mixture of reform stagnation and in some country cases even reversals. More specifically, the EBRD argues that the energy sector is prone to political interference, leading to reform reversals, in particular in the electric power sector, in Albania, Bulgaria and Hungary. The deep-rooted structural problems concern:

- Local power generation and supply companies have a poor record of outstanding debt collection from end users;

- Various countries are regularly obliged to import electricity supplies at peak demand periods, i.e. winter and summer. This frequently leads to high import dependency from certain suppliers and consequently high import costs;

- Foreign investors in the energy sector of various countries in the Western Balkans – e.g. the Czech company *CEZ Group* acquiring in 2009 a majority stake in the Albanian power company *KESH* – face numerous hurdles to overcome on the ground. These experiences are not conducive to encourage further foreign investment.

- Restrictions from public regulators abound in areas such as licensing, low regulated consumer prices with little upward flexibility towards cost recovery, as well as time-consuming arbitration procedures in local courts deter other prospective investments and/or investors.

The deeply politically sensitive nature of price liberalization in energy policy can be observed in the cases of Serbia and Bulgaria. Serbia currently has an International Monetary Fund (IMF) adjustment program, which includes a large structural reform agenda. In the energy sector, the compliance requirements stipulate comprehensive price adjustments, phased in over a defined period of time. The Serbian government has repeatedly called on its international creditor to delay this requirement in light of the countries severe recession and associated budget cuts taking place in public sector wages, pensions and the health as well as educational sectors.

In the case of Bulgaria, the issue of energy price liberalization is even more acute, eventually leading to the downfall of a government. As a member of the European Union (EU) since 2007, Bulgaria has the lowest energy prices among 28 member states. After introducing price hikes for consumers of electricity and natural gas in January 2013, the government of then Prime Minister Boiko Borisov was forced to resign six weeks later following mass and violent street protests.

Put differently, seeking to establish energy security at affordable prices in the region's countries can have significant adverse political costs. Furthermore, these examples of increased government interference, abrupt policy changes towards domestic consumers and/or foreign investors, the introduction or withdrawal of significant tax levies also tell a bigger story. They illustrate the complexities of day-to-day management for energy companies, the limited options foreign investors may face and the pressures under which governments in office must operate in the region.

The role of international stakeholders

In reaction to these testing challenges, a two decade-long effort is underway in the Western Balkans to provide substantial financial assistance and technical expertise from various international stakeholders, past and present. Financing energy efficiency investments in the Western Balkans is a major growth area for various IFIs (International Financial Institutions).[3]

- At the outset of the transition process, the former European Agency for Reconstruction (EAR)[4] was

[1] One element of hope in this tragedy is that the cataclysmic flooding has forced many Bosnians out of their ethnic isolation to help one another, rekindling a long-absent sense of solidarity across ethnic lines in the country.

[2] See European Bank for Reconstruction and Development (EBRD): 'Stuck in Transition?' Transition Report 2013, London, available online for free: http://www.ebrd.com/downloads/research/transition/tr13.pdf.

[3] http://www.energy-community.org/pls/portal/docs/2144178.PDF

[4] The EAR was tasked by the European Commission to provide such support for Serbia, Macedonia, Kosovo and Montenegro between

tasked to establish project finance capabilities in areas such as (i) creating the legal framework for the development of a natural gas market, (ii) infrastructure investments in the modernization of power plants, (iii) training seminars for regulators, monitors and ministerial staff.

- The World Bank has focused its recent activities on improving energy efficiency in buildings (residential and corporate). Priority areas are providing technical expertise to develop National Energy Efficiency Action Plans (NEEAPs). Important steps have been undertaken in all countries to strengthen the legislative and regulatory frameworks, namely by assisting in the transposition of relevant EU directives and passing important secondary legislation.[5]

- The European Fund for Southeast Europe (EFSE) provides sustainable funding to entrepreneurs and private households in Southeast Europe since 2005. The EFSE is strongly focused on micro finance lending, capacity building efforts and energy efficiency, renewable energy funding. As access to finance is a key success factor in developing the micro, small and medium enterprise segments, the EFSE focuses on assisting local financial sectors in strengthening their ability to ensure adequate and sustainable financing. The EFSE provides long-term finance primarily for micro and small enterprises – but also for private households in the form of home improvement loans.

- The Regional Cooperation Council (RCC) was officially launched in Sofia in February 2008, as the successor of the Stability Pact for South Eastern Europe. Through a regionally owned and led framework, the RCC focuses on promotion and enhancement of regional cooperation in South East Europe. The RCC advices members of parliament and parliamentary expert staff dealing with energy issues in the region "Parliaments – Support to Harmonized Energy Reforms in South East Europe". The initiative seeks to facilitate the law making process and increase the ability of parliaments to oversee their governments in energy reform process.

However, despite these diverse activities, a major caveat is in order here from the perspective of renewable energy investments in the region. According to a 2013 report – "Invest in Haste, Repent at Leisure" – from civil society organizations CEE Bankwatch Network, SEE Change Net and the World Wildlife Fund (WWF), created as part of the SEE SEP (South East Europe Sustainable Energy Policy) program, heavy investments in fossil fuels by international financial institutions in the Western Balkans are hindering these countries' compliance with EU accession requirements.[6]

The report finds that between 2006 and 2012 Europe's development banks lent 32 times more for fossil fuels than renewable energy sources not related to hydropower. This trend means that the Western Balkan countries are heading in the opposite direction of the EU goals on climate change for the years 2020, 2030 and 2050, an eventual requirement for these aspiring EU countries.

In consequence to the report's findings, the European Investment Bank (EIB), the European Bank for Reconstruction and Development and the World Bank are all currently reviewing their energy sector lending strategies to the region.

The Trans Adriatic Pipeline (TAP) project

Figure 1: The Trans Adriatic Pipeline

For full-sized figure, please see Appendix.

The *Trans Adriatic Pipeline* (TAP) is a natural gas pipeline project, starting in Greece, crossing Albania and the Adriatic Sea and coming ashore in southern Italy. TAP will allow liquefied gas to flow directly from the Caspian region to Central European markets. It is a major public-private consortium and one of the largest joint venture investment projects in the region of southeast Europe (http://www.trans-adriatic-pipeline.com/). TAP is the biggest energy project to include Greek territory.

For TAP to become operational in the region, the establishment of zoning maps and verification of the property registration of landowners along which the transmission pipelines will pass, have to be put on a fast track across participating countries. This is not a simple task.

---

early-2000 and end-2008. The author of this paper worked for the EAR between 2005 and end-2008.

[5] See the report by the World Bank on 'Scaling Up Energy Efficiency in Buildings in the Western Balkans, September 2013, http://www.worldbank.org/content/dam/Worldbank/Event/ECA/Scaling%20Up%20Building%20EE%20in%20WB%20-%20Interim%20report%20final.pdf

[6] The full report is available at SEE Change Net's website (www.seechangenetwork.org) at the following link: http://seechangenetwork.org/index.php/publications/invest-in-haste-repent-at-leisure.html

In some countries this involves the national cadaster undertaking this complex task. In others, for lack of a fully operational cadaster (e.g. in Greece), private surveyors are hired to collect the landownership data according to the specifications of the national land registry authority. These include identification of rightful ownership titles, establish property boundaries and arrive at a valuation of the individual property titles.

The timetable foresees that TAP will be in a position to start operations and transport liquefied gas from the Shah Deniz gas field in Azerbaijan to Central Europe by 2019. In terms of construction geography, TAP avoids Central Europe and most of the Balkans. In 2013 the Shah Deniz consortium decided to prefer the TAP project over its rival *Nabucco*.[7] The selection over the competing *Nabucco* initiative constitutes a clear energy victory for Russia, given its cooperation with Azerbaijan in energy supplies and transmission networks.

What role does energy dependence on outside countries play?

Russia supplies around 25 per cent of the EU's natural gas needs. There is a rising risk of an immediate and sustained gas supply disruption – due to the possibility of Ukraine siphoning off Russian gas intended for transit. This could compel European policymakers to revise their energy security strategy, East and West, with considerable follow-up implications for Southeast Europe. A reconsideration of the debate on shale gas and even nuclear energy is therefore possible.

Energy security implications of the Russia/Ukraine crisis

Figure 2: Share of natural gas supplied by Russia

Source: Oxford Analytica, May 8th 2014, https://www.oxan.com/oxweb/infographics/RussiaUkraineEnergy.aspx.

For full-sized figure, please see Appendix.

While Europe receives 25 per cent of its natural gas from Russia, that figure rises dramatically in Central and Eastern Europe. In general, the closer a country is to Russia, the more dependent it is on Russian natural gas. Central Europe (with the exception of Romania, which has its own reserves) draws roughly 70 per cent of the natural gas it consumes from Russia. Belarus, Bulgaria and the Baltic states depend on Russia for 90-100 per cent of their natural gas needs.

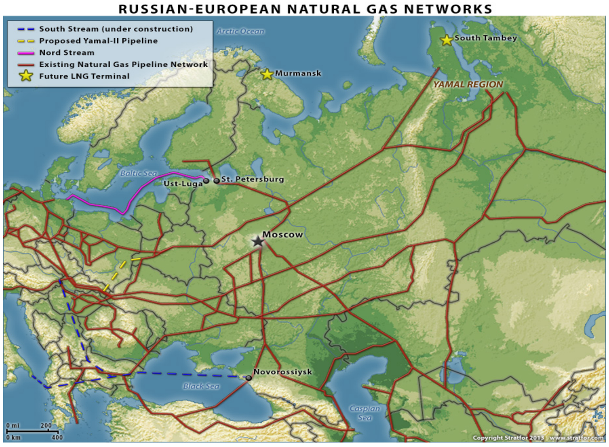
Share of Russian natural gas in domestic gas consumption of non-EU countries in 2012:

- Republic of Macedonia 100%
- Belarus 98%
- Serbia 86%
- Montenegro 83%
- Ukraine 66%
- Turkey 64%
- Croatia 37%

The next major geopolitical piece in this massive network is the proposed South Stream Pipeline. South Stream would transport Russian natural gas across the Black Sea to Bulgaria, Serbia, Hungary and Austria, with TAP running to Italy via parts of the Balkans, Greece and the Adriatic. South Stream could make Central Europe and the Balkans more dependent on Russia, especially as Russia does not require Ukraine for the energy infrastructure project.

[7] The Nabucco pipeline is a proposed natural gas pipeline from the Turkish Bulgarian border to Austria. The aim of the Nabucco pipeline is to diversify the natural gas suppliers and delivery routes for Europe, thus reducing European dependence on Russian energy. The original project was backed by several European Union member states and by the United States. The main supplier for Nabucco was to be Shah Deniz gas through the proposed *Trans-Anatolian gas pipeline* (TANAP).

Figure 3: Russian European natural gas networks



Source: Kaplan and Chausovsky 2013.

For full-sized figure, please see appendix.

Some preliminary conclusions:

Cross border energy networks in the Western Balkans are an essential factor for regional economic development. This political objective is shared by all stakeholders. But the institutional and financial capacity to deliver this remains limited and fragile.

A two-way architecture of dependency is increasingly taking hold in the region. The levels of upfront investments needed for energy infrastructure reform are such that individual countries cannot shoulder this. Nor is the prospect of pooling resources sufficient. Hence, IFIs have and will continue to do the heavy lifting in this critical sector.

On the other hand, the dependency of most countries on Russia natural gas deliveries puts them in a bind. They are looking for finance towards the West and for energy resources eastwards. The Ukrainian crisis has only further highlighted this underlying structural dependency. And already lurking at the horizon is a new stakeholder, namely China, which is starting to invest in the region, e.g. in Bosnia.

Finally, all major IFIs and regional cooperation networks involved in energy security investments have started to reconsider the focus of their activities in light of the increasing need to switch from fossil fuel to renewable energy production.

Appendix:

Figure 1: The Trans Adriatic Pipeline

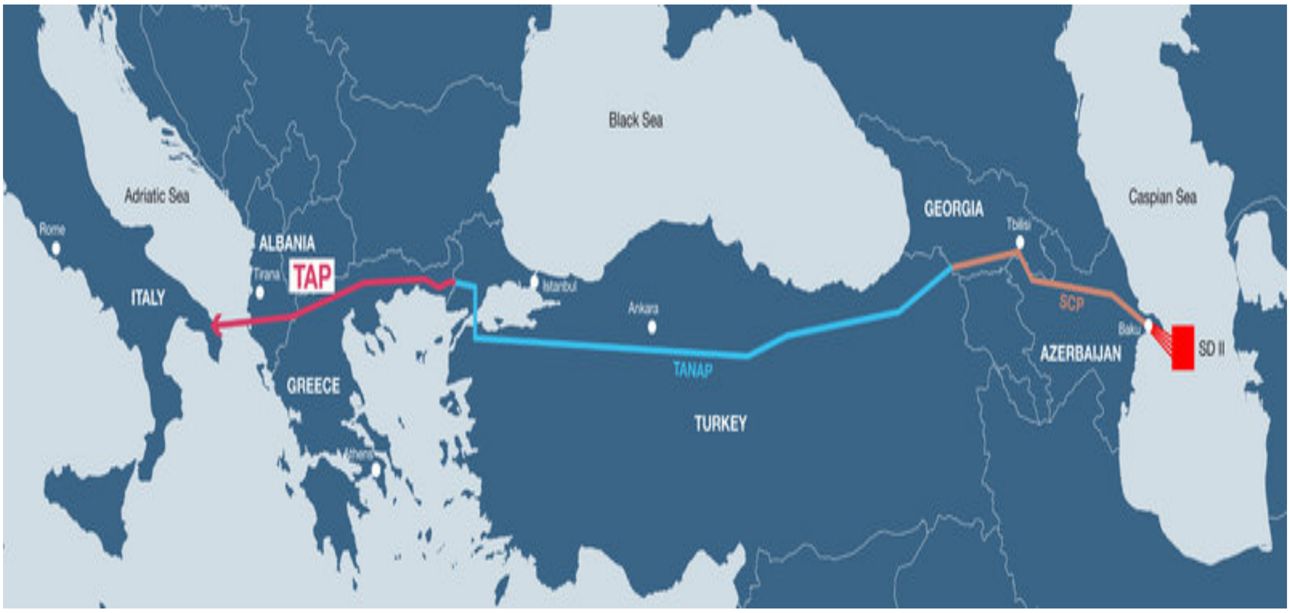
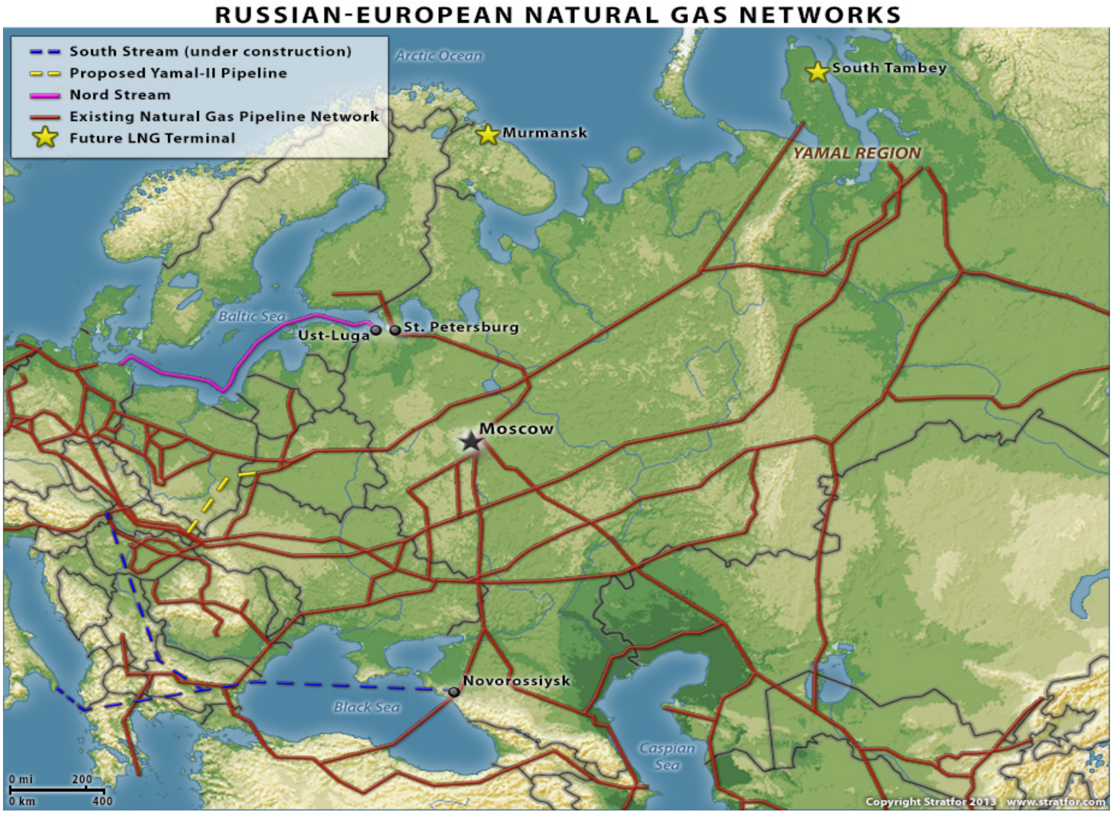


Figure 2: Share of natural gas supplied by Russia

Source: Oxford Analytica, May 8th 2014, https://www.oxan.com/oxweb/infographics/RussiaUkraineEnergy.aspx

Figure 3: Russian European natural gas networks



Source: Kaplan and Chausovsky 2013.

References:

EBRD (2013): 'Stuck in Transition? Transition Report 2013, London.

http://www.trans-adriatic-pipeline.com/

http://www.energy-community.org/pls/portal/docs/2144178.PDF

Oxford Analytica, May 8th 2014, https://www.oxan.com/oxweb/infographics/RussiaUkraineEnergy.aspx

'Pipelines Of Empire', by Robert D. Kaplan and Eugene Chausovsky, http://www.forbes.com/sites/stratfor/2013/11/13/pipelines-of-empire/

http://seechangenetwork.org/index.php/publications/invest-in-haste-repent-at-leisure.html

World Bank (2013): 'Scaling Up Energy Efficiency in Buildings in the Western Balkans, September 2013, http://www.worldbank.org/content/dam/Worldbank/Event/ECA/Scaling%20Up%20Building%20EE%20in%20WB%20-%20Interim%20report%20final.pdf

Additional useful sources:

European Bank for Reconstruction and Development. "New EBRD investment in Macedonian renewable energy sector". Press Release issued on 20 April 2011. Available at: http://www.ebrd.com/pages/news/press/2011/110420b.shtml

European Commission. Energy in South East Europe. Available at: http://ec.europa.eu/enlargement/archives/seerecon/infrastructure/sectors/energy/

"Gazprom to Study South Stream Gas Pipeline Spur to Montenegro". Bloomberg BusinessWeek, 3 February 2012. Available at: http://www.businessweek.com/news/2012-02-03/gazprom-to-study-south-stream-gas-pipeline-spur-to-montenegro.html

International Energy Agency. Energy in the Western Balkans: The Path to Reform and Reconstruction. Paris (2008). Available at: http://www.iea.org/w/bookshop/add.aspx?id=332

Klincov, Predrag. "Elektroprivrede u BiH čekaju teška vremena [Hard times awaiting Bosnia's power utilities]". Nezavisne Novine, 16 March 2012. Available at: http://www.nezavisne.com/posao/analize/Elektroprivrede-u-BiH-cekaju-teska-vremena-132815.html

Kuzmanovic, Jasmina. “Zarubezhneft Bids To Buy OMV Stations in Croatia, Bosnia”. Bloomberg, 17 January 2012. Available at: http://www.bloomberg.com/news/2012-01-17/zarubezhneft-bids-to-buy-omv-stations-in-croatia-bosnia-1-.html

MacDowall, Andrew. “Bosnia energy: China sees potential”. Financial Times, 28 June 2012. Available at: http://blogs.ft.com/beyond-brics/2012/06/28/bosnia-energy-china-sees-potential/#axzz22klI30Bj

“Securum Equity signs $2.3 bln solar deal for Serbia”. Reuters, 23 February 2012. Available at: http://www.reuters.com/article/2012/02/23/serbia-solar-idUSL5E8DN8IZ20120223

Socor, Vladimir. Contributions to Eurasia Daily Monitor. A publication of the Jamestown Foundation. Available at: http://www.jamestown.org/articles-by author/?no_cache=1&tx_cablanttnewsstaffrelation_pi1[author]=132

South-East European Industrial Marketwebsite. Available at: http://see-industry.com

EU ECONOMIC INSTRUMENTS IN THE ENLARGEMENT PROCESS – EVALUATION OF THE NEW APPROACH

Dušan Reljić
Head of Brussels Office
Institute for International and Security Affairs (SWP)

A brief *vade mecum* for Session V based on a good deal of research and some copy and paste[1]:

I. The Multiannual Financial Framework 2014-2020: The External Action Financing Instruments

Political justification, in Brussels Eurish:

At a time when the world order is changing rapidly and emerging economies like China, India, and Brazil are asserting their influence, Europe must stand together and be an active partner in shaping global change. These instruments will also enable the European Union (EU) to further reinforce its role on the global stage and promote its interests and values.

The EU external relations budget will help make Europe count in a world of shifting alliances and emerging new powers. The overall objective for external action will be to ensure that the EU is also able to live up to its ambitions in promoting democracy, peace, solidarity, stability and poverty reduction, and to help safeguard global public goods.

Specific goals and financial means:

The EU will focus its work with its external partners on four policy priorities: enlargement, neighborhood, cooperation with strategic partners and development cooperation.

The total amount agreed for this external relations package is €51,419 million (current prices) over the period 2014-2020.

- Instrument for Pre-accession Assistance (IPA): €11,699 million
- European Neighborhood Instrument (ENI): €15,433 million
- Development Cooperation Instrument (DCI): €19,662 million
- Partnership Instrument (PI): €955 million
- Instrument contributing to Stability and Peace (IfSP): €2,339 million
- European Instrument for Democracy and Human Rights (EIDHR): €1,333 million

[1] This compilation concentrates on financial links between the EU and the Western Balkans and leaves out trade issues. As a result of the Stabilisation and Association Agreements, most trade between EU and WB countries is free of custom barriers. WB trade deficit with the EU amounted to 8.4 billion € in 2013 (EU DG Trade). Introduced in 200, these preferences were renewed in 2005 and subsequently in 2011 until December 2015, allow nearly all exports to enter the EU without customs duties or limits on quantities. Only wine, baby beef and certain fisheries products enter the EU under preferential tariff quotas. This preferential regime has contributed to an increase in the Western Balkans' exports to the EU. In 2013, the EU was the region's largest trading partner for both imports (72.7%) and exports (81.8%).

[*] This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo Declaration of Independence.

The Instrument for Pre-Accession Assistance (IPA 2)

The EU will continue its support to aspirant countries (Albania, Bosnia and Herzegovina, Kosovo*, Montenegro, Serbia, Turkey, the former Yugoslav Republic of Macedonia) through a renewed Instrument for Pre-accession Assistance (IPA). IPA will help these countries implement comprehensive reform strategies needed to prepare for future membership, with an emphasis on the rule of law, fundamental rights, economic governance and competitiveness, tangible socio-economic development, regional cooperation, implementation of EU laws and standards, and capacity to manage the Union's internal policies upon accession. More use will be made of innovative financial instruments set up with international financing institutions (c.f. Western Balkans Investment Fund (WBIF)), with EU funds acting as a catalyst for leveraging investment in infrastructure.

Budget

The final agreed budget is €11.699 billion (current prices), which means funding remains nominally unchanged compared to the current IPA (€11.5 billion). In real terms, because of inflation and the growth of population in the "beneficiary countries", it is less.

About half of the IPA money goes to Turkey mainly because of the size of its population. Croatia is not any longer a beneficiary of IPA but draws now on EU structural funds.

II: Investments in Western Balkans – the EU's new approach

Štefan Füle, European Commissioner for Enlargement and European Neighbourhood Policy, presented in London, UK, 24 February 2014, at an EBRD conference on investment opportunities in the Western Balkans; what he called the "European Commission's new approach to economic governance, competitiveness and growth for the Western Balkans region".

Goals:

1. Macroeconomic, fiscal and financial stability. The EU already has a dialogue on annual macro-economic and fiscal programs with all aspirants except Kosovo. It wants to beef up this process and focus it on key structural reforms.

The EU will base its dialogue on the WB countries *National Economic Reform Programmes*. The result should be to jointly agree on a set of *Country Specific Recommendations* to guide reforms. The EU will, together with the IMF, give technical assistance to support the implementation of these recommendations.

Countries will also be asked draw up action plans on public financial management. Progress here will open up the possibility of sector budget support under the Instrument for Pre-Accession Assistance – IPA II.

2. Sectoral reforms and investment in targeted sectors, leading to increased exports and more jobs.

The Commission will invite countries to give overviews (every second year, starting from 2015) of their structural reform plans across sectors of most concern for improved competiveness and growth, such as transport, energy and education. By setting out the priority reforms for the short- and medium-term in one document, this will be a roadmap for all the investors to identify where best to place their funds to get the best returns.

Significant funding through IPA II will support this process and the ensuing reforms with a focus in particular on sector support. The EU will work with the Western Balkan countries and the international financial institutions to deliver and finance these reforms.

At the EU-Western Balkans Ministerial Conference, Thessaloniki, 8 May 2014, *Füle presented some specific financial targets:*

"I confirm the commitment I took back in November, that **is to use up to €1 billion from the new Instrument for Pre-Accession Assistance for infrastructure investment in the six IPA beneficiaries** in the Western Balkans region for the 2014-2020 programming period. Combined with funds from the International Financial Institutions, the **EU funds aim to attract private capital that could finance at least €10 billion of investment in the Western Balkans**, targeting key priorities of the beneficiary countries."

III. The Western Balkans Investment Framework (WBIF)

Established in December 2009, the WBIF supports socio-economic development and EU accession across the Western Balkans through the provision of finance and technical assistance for strategic investments, particularly in infrastructure, energy efficiency and private sector development. It is a joint initiative of the EU (the European Commission – EC), the Council of Europe Development Bank (CEB), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB) in association with KfW and the World Bank, bilateral donors and the governments of the Western Balkans.

Calls for proposals are organized on a regular basis, usually twice a year (with deadlines in February and September). Projects must be nominated or endorsed by the National IPA Coordinator of the respective country and projects with regional impact take precedence when deciding among applications.

*

Table 1 in the appendix presents the total amounts of WBIF investments since 2007 in € broken down by beneficiaries and by sectors

Since 2007, roughly, each Western Balkan country, including Croatia, received annually 600 million € WBIF loans and grants.

The capacity of the Western Balkan countries to repay public debt is mostly exhausted: presently the states of former Yugoslavia owe approximately € 90 billion (Yugoslavia collapsed with about $ 20 billion in foreign debts). Most countries run high state budget and trade deficits.

IV. Current state of play

From the First Report on the Joint IFI Action Plan for Growth in Central and Southeastern Europe – worth € 30 billion – launched in November 2012:

The crises of 2008-9 hit Central and Southeast Europe harder than any other emerging market region, largely because of the macroeconomic vulnerabilities that had developed from the earlier credit boom, the sudden stop of capital inflows, and the collapse in export markets....The countries in Southeast Europe, which are more closely linked to the Euro area, were particularly affected.

The virulence of the crises in the region called for a reappraisal of the implicit growth model. Convergence based on growth in domestic demand financed by bank-intermediated capital inflows had created severe vulnerabilities. This mechanism had directed too much capital to consumption and asset markets rather than to the expansion of productive capacities.

Second Report, April 2014:

There has been a gradual recovery in the region during 2013, but growth remains anaemic. It is expected to strengthen modestly in 2014 in Central Europe and the Baltics from 1.3 percent to 2.4 percent, but fall in South East Europe from 2.7 percent to 2.1 percent. This reflects the very gradual recovery in the eurozone, and is more marked in those countries with the closest trade and financial links to the zone, as well as renewed geopolitical risks in the region's neighborhood. Unemployment remains high across the region, with rates averaging 3 to 4 percentage points higher than before the crisis.

Capital flows to the region appear to have turned negative during the course of 2013, with a reversal of portfolio inflows and continued withdrawal of parent bank funding of subsidiaries as part of the deleveraging process. Together with the high level of non-performing loans, this has constrained domestic credit growth, which in real terms remains close to zero throughout much of the region. Inward remittances, however, an important factor for much of Southeast Europe, appear to have picked up. The lackluster performance of domestic and export markets is reflected in still low levels of investment activity.

….

Growth in the region remains dependent on eurozone developments, and a faltering of recovery there would be problematic for most countries. Such a slowdown could be triggered by developments in Europe itself or result from a sharp deceleration in major emerging markets. The eurozone-wide stress tests and asset quality reviews (AQR) might generate renewed market pressure on parent banks and further affect local banking systems' ability to extend credit, given the limited ability of the latter to raise funding domestically. Events in Ukraine and the slowdown in Russia could also have a negative effect on some countries in the region, with greater uncertainty concerning energy supplies and exports, as well as the possible impact on parent banks that are exposed to the wider region.

….

There has been growing cooperation and coordination between the three institutions and the European Union in the West Balkan region during the last few months. This can smooth the way for eventual European Union accession by strengthening governance and local capacity and improving the absorption and effectiveness of all sources of external financing. Seven Balkan prime ministers met at the Forum for Investment in the West Balkans hosted by the EBRD in February 2014. Examples of successful collaboration in the region between the IFIs include joint financing by World Bank, the EU and EBRD for rural road rehabilitation in Albania. Another is the use of single or multi-donor trust funds, such as the Serbia Innovation Fund, to leverage more financing for programs with demonstrated results, and EIB and EBRD funding for the West Balkans Enterprise Expansion Fund, ENEF

Single Supervisory Mechanism as well as a Single Resolution Mechanism *for the European banking union would have profound implications for CESEE.*

The Vienna 2 Initiative[2] noted in October 2013 that a Single Supervisory Mechanism as well as a Single Resolution Mechanism for the European banking union would have profound implications for CESEE. It holds the promise of more effective and better coordinated cross-border bank resolution. This Forum called for strong incentives for opt-ins to ensure as inclusive a membership as possible. It will also be important to de-

[2] The Vienna Initiative was established at the height of the global financial crisis of 2008/09 as a private-public sector platform to secure adequate capital and liquidity support by Western banking groups for their affiliates in Central, Eastern, and South Eastern Europe (CESEE).

velop an effective interface with host countries outside the banking union, including those not being EU members.

The evolving European banking union plans do not include opt-in clauses for the accession countries (e.g. Western Balkan states) or any special coordination arrangements. The Forum welcomed the decision of the EBA to re-engage with non-EU countries with regards to supervisory confidentiality assessments. The Forum called for a special regional arrangement for non-EU members on the path toward EU membership on the one hand and the Single Supervisory Mechanism and the EBA on the other.

References

This paper draws mostly on the following sources:

Overview of Macroeconomic and Fiscal Challenges in the Western Balkans and Implications in the Western Balkans and Implications for the WBIF, November 2013; http://wbif.eu/uploads/lib_document/attachment/340/Macroeconomic_Outlook_Nov_13.pdf

Vienna 2 Initiative Draws Attention to Weak Credit Growth and Special Challenges for South Eastern Europe Press Release No. 13/412, October 23, 2013; http://www.imf.org/external/np/sec/pr/2013/pdf/pr13412.pdf

Regional Economic Prospects in EBRD Countries of Operations: May 2014, EBRD Office of the Chief Economist; http://www.ebrd.com/downloads/research/REP/rep-may-2013.pdf

European Commission: EU CANDIDATE AND PRE-ACCESSION COUNTRIES ECONOMIC QUARTERLY 1/2014; http://ec.europa.eu/economy_finance/db_indicators/cpaceq/documents/cceq_2014_q1_en.pdf

Appendix

Table 1: total amounts of WBIF investments since 2007 in € broken down by beneficiaries and by sectors

Beneficiary	**Energy**	**Private sector development**	**Social sectors**	**Transport**	**Water and Environment**	**TOTAL €**
Albania	283.466.376	201.087.745	442.479.857	936.995.461	393.850.533	2.257.879.972
Bosnia and Herzegovina	784.620.295	1.374.523.198	546.929.001	1.761.708.796	1.097.640.539	5.565.421.829
Croatia	437.221.500	3.008.505.234	560.359.755	1.292.263.172	1.636.453.749	6.934.803.410
FYR Mace-donia	223.444.660	451.936.089	525.408.982	877.065.812	270.985.691	2.348.841.234
Kosovo*	179.922.928	201.390.162	342.144.259	75.440.000	123.499.892	922.397.241
Montenegro	247.580.000	351.605.361	106.062.317	239.966.633	301.335.754	1.246.550.065
Regional	279.040.826	1.464.341.902	479.907.980	5.850.000	40.157.387	2.269.298.095
Serbia	859.488.692	2.210.313.616	1.708.699.836	3.078.879.700	501.866.486	8.359.248.330
TOTAL €	3.294.785.277	9.263.703.307	4.711.991.987	8.268.169.574	4.365.790.031	**29.904.440.176**

EU ECONOMIC INSTRUMENTS IN THE ENLARGEMENT TO THE WESTERN BALKANS: EVALUATION OF THE NEW APPROACH

Mahmut Tekçe
Associate Professor
Department of Economics
Marmara University Goztepe, Istanbul

Introduction

Extending enlargement to the Western Balkans has been a critical European Union policy, especially as the EU has had political, economic and strategic interests in the region since the fall of the Iron Curtain. The integration of the Western Balkans into the EU has been challenging for both the candidate or potential candidate countries and the EU in various aspects. The Western Balkans region was struggling with ethnic wars in the 1990s and although the war has ended, disputes about territories, sovereignty and ethnic minorities have still persisted. Also, one of the most challenging issues of extending enlargement to the Western Balkans has been the economic structures of the countries, where significant financial assistance during the pre-accession process has been imperative. Financial assistance of the EU to the Western Balkans had already started in the 1990s and evolved since then, and the approach to economic assistance in the pre-accession phase has been recently reformed. This paper examines the economic aspects of the EU's enlargement policy to the Western Balkans and evaluates the effectiveness of the pre-accession financial assistance both for the beneficiary countries and the EU.

Enlargement of the European Union

Enlargement has been one of the most important and challenging issues of the European Union since the 1970s. Enlargement has widely been appreciated as the most powerful foreign policy instrument of the EU and also the most effective conflict prevention mechanism (Miralles and Johansson, 2002). Admission of the new members to the club has been widely discussed among the existing members, and while every enlargement round has been initiated with great expectations for a politically, strategically and economically more powerful Union, there has also usually been a resistance from some members stemming from a wide range of issues, starting from Charles de Gaulle's double rejection of the UK, to the Greek opposition to Macedonia due to the country's name.

Each enlargement round of the European Union (European Economic Community or European Community, depending on the date) had different motivations and consequences due to varying geographical, political and economic characteristics of the newcomers. The first was the 'Western' enlargement, where the inclusion of Denmark, Ireland and the UK in 1973 both had important economic gains and was politically a big step towards Churchill's call for a 'United States of Europe'.

The next enlargement round was directed to the 'South', where admissions of Greece in 1981 and Spain and Portugal in 1986 were showing that the Union was not based solely on economic grounds, but also political stability and democratic governance were vital factors, as these countries experienced years of authoritarian military regimes and membership in the Union had become a very important motivation for their policymakers as being a member was expected to be a clear mark of the end of any future possibility of a military regime. Following the southern enlargement in 1995, the Union included Austria and also enlarged to the 'North', with the membership of Sweden and Finland.

The 'Eastern' enlargement of 2004 and 2007 to the Central and Eastern European countries (CEECs) has usually been called a 'Big Bang'; the number of the member countries increased from 15 to 27, which had serious institutional effects as the changes in the voting rights in the Council and the composition of the European Parliament significantly changed the power structure in the decision making process. In addition, a big challenge was that most of the new members were former Eastern bloc countries with limited experience with the institutions of democracy and market economy, and were still in a process of economic, social and political transformation. Contrary to the previous waves of enlargement, where the newcomers more or less had economic, political and cultural resemblances to the existing members, the wave directed to the East was more challenging and difficult.

After the successful completion of the Western, Southern, Northern and Eastern waves of enlargement, the EU has currently started another wave of enlargement, to the Western Balkans, where the membership of Croatia in July 2013 has been the first important and historical step for the countries of the Western Balkans to become a part of the EU in the future. Currently Macedonia, Montenegro and Serbia have officially been recognized as candidate states, Albania has submitted its application, Kosovo has been taking important economic and political steps, but Bosnia and Herzegovina has been staying behind other countries due to political resistance.

Last, but not the least, there is another enlargement on the EU's agenda, to Turkey. As a very unusual case, Turkey has been present in the storyline of enlargement since the beginning; applied for the opening of negotiations with the EEC in 1959 and became an associate member in 1963. After decades of internal complications and volatile relations with the European Community, Turkey officially applied for entry into the EC in 1987 and obtained a customs union agreement in 1996. Finally, accession negotiations officially began in 2005, but the length of the path taken so far gives no clear expectation of a full membership in the foreseeable future. The experience of Turkey and its reasons to be unsuccessful in EU membership so far may become an important example for the Western Balkans by providing a 'what-not-to-do list'.

Enlargement strategy of the EU: Big Bang and Before

The strategy of the EU during the accession negotiations has evolved with each round of enlargement. Despite some small differences, the enlargement strategy of the EU before the Eastern enlargement was mainly based on attaching conditionality clauses to the specific EU policies towards the applicant countries. This distinctive pattern of conditionality is referred to as the "classical enlargement method" (Preston, 1995) and followed a similar path with five principles; (i) acceptance of the full *acquis*; (ii) negotiation focus on the *acquis*; (iii) new policy instruments instead of reform; (iv) incremental institutional adaptation; and (v) negotiation with groups of countries.

However, in the process of accession negotiations with the CEECs, the European Commission followed a new enlargement strategy. As the economic, social and political structures of the candidate countries were different from the states of the previous enlargement rounds, the Commission had to adopt a strategic accession approach that went beyond the application of the *acquis communautaire*. As it was put out by the European Council after its Copenhagen Summit, accession to the EU would take place "as soon as an associated country is able to assume the obligations of membership by satisfying the economic and political conditions required" (European Council 1993). Thus accession to the EU had necessitated the applicant countries to go beyond the adoption of the *acquis* and meet the Copenhagen criteria that covered three issues: (i) the stability of institutions guaranteeing democracy, the rule of law, human rights, and respect for and protection of minorities; (ii) the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union; and (iii) the ability to take on the obligations of membership, including adherence to the Union's aims (Heidbreder, 2011).

According to Maniokas (2004: 19-20) the new enlargement strategy has four distinctive features: (i) it was made more complex at an intermediate stage with a number of specific instruments between association and negotiations devised in order to build up an additional gate to negotiations and to allow for a better control of the process; (ii) instead of negotiating with a group of countries, the new strategy differentiated the countries involved in the process; (iii) instead of a simple *acquis* adaption, the accession process was expanded into more stages, a whole set of more detailed conditions was developed and those conditions were kept flexible as a function of a political situation in the EU; and finally (iv) growing asymmetry in the relationship between the candidate countries and the EU as instruments based on contractual more or less mutual obligations were gradually replaced by instruments based on unilateral obligations.

After the Eastern enlargement

The Eastern enlargement of the EU has usually been regarded as a successful policy. The most important success was socio-political; for decades, the conventional view was that "Europe ended where the Iron Curtain divided it" (Verheugen, 2013: 31), and the accession of the former Eastern bloc countries to the EU was a clear expression of the end of that view. There were pessimist expectations that such a large scale enlargement would have cumbersome effects on policy development and decision-making of the EU, but on the contrary, enlargement "allowed the EU to develop more substantial and effective policies, internally and externally, than would have been possible with a smaller group" (Avery, 2008: 181-2). However, following the initial burdens of this Big Bang enlargement and the failures of the French and Dutch referendums on the Constitutional Treaty in 2005, two concepts started to be largely discussed: 'absorption capacity' and 'enlargement fatigue'.

Absorption capacity was simply the EU's ability to absorb new members whilst maintaining the momentum of European integration, and began to feature regularly in debate about future expansion, especially after the European Council requested the Commission to re-visit the Copenhagen Criteria and re-evaluate the Union's 'absorption capacity' against future commitments (Emerson, et al. 2006). The perception that the EU has reached its absorption capacity by its Eastern enlargement gradually created a so-called 'enlargement fatigue' and a "hesitance or unwillingness to grant EU membership to new states" (Szolucha, 2010: 6), which was triggered by the severe impacts of the 2008 economic crisis to the EU.

The fatigue of the EU policy makers is also reflected in the public opinion, where the surveys showed that European citizens are largely opposed to further enlargement of the EU; 53% of Europeans are 'against' this policy, while 37% are in favor of it (Eurobarometer, 2013). However, when country-specific enlargement is taken into consideration, it becomes clear that the hesitation is mainly directed to the Western Balkans and Turkey; when the public opinion is asked in the EU members about the future membership of all actual or possible candidate countries, the rate of 'against' is significantly higher than the rate of 'in favor' for all countries in the region with the exception of Croatia (which became a full member in 2013) (Eurobarometer, 2011). On the other hand, the European public is quite enthusiastic about seeing Switzerland, Norway and Iceland as a member of the EU.

Enlargement to the Western Balkans

Despite increasing concerns about the absorption capacity and low internal public support, the EU continued its efforts and policies for further enlargement. The Western Balkans has been a region that the EU had political, economic and strategic interests since the fall of the Iron Curtain. In the early 1990s, the main challenge was to cope with ongoing conflict, and the aim of the EU in the second half of the 1990s was to foster political and economic cooperation in the post-conflict period. The EU's approach in this period was "distancing" and "lacked long-term strategy and perspective of membership for the Western Balkan countries" (Jano, 2008: 145). However, from 2000, the EU started to follow a policy aiming at a deeper economic and political integration with the region and an eventual membership of the Western Balkans in the EU.

The integration of the Western Balkans into the EU has been challenging for both the candidate or potential candidate countries and the EU in various ways. The Western Balkans region was struggling with ethnic wars in the 1990s, and although the war has ended, disputes about territories, sovereignty and ethnic minorities have still persisted. As Southern enlargement of the EEC in the 1980s meant the end of the military regimes in the new member countries, being a part of the EU would mean long-lasting peace and political stability for the Western Balkans, too. On the side of the EU, there have been many serious negative developments that have hindered the process of enlargement, like the economic crisis, weak economic and institutional structures of the candidate states and low public support, but the European Commission continued the enlargement process. One reason of this determined policy stance is the broadened purpose of enlargement since the Eastern enlargement; fostering stable democratic regimes to the former Eastern bloc countries. Enlargement to the Western Balkans was no exception, the EU aimed to "use the power of its enlargement process to transform the Western Balkans, opening a new chapter after a shameful decade of failure in the region" (Vachudova, 2014: 126). Stability in the Western Balkans is deeply related to the political stability and security of Europe, and the credibility of the EU as an international actor largely depends on the success of its action in the region (Belloni, 2009).

In order to upgrade its contractual relations with the Western Balkan states and realize a successful integration of the region into the Union, the EU launched the Stabilisation and Association Process (SAP) policy framework in 1999. The main aim of the SAP has been an eventual EU accession, and an adjustment to the level of development of each of the countries in the region, and strong regional cooperation. As a part of the SAP, the Stabilisation and Association Agreements (SAA) were signed with all Western Balkan states (in 2000 with Croatia and Macedonia, in 2003 with Albania, in 2005 with Bosnia-Herzegovina, Montenegro and Serbia, and finally in 2013 with Kosovo). The SAP involves areas such as (i) the drafting of stabilisation and association agreements, with a view to accession to the European Union once the Copenhagen criteria are fulfilled; (ii) the development of economic and trade relations with the region and within the region; (iii) the development of the existing economic and financial aid; (iv) aid for democratization, civil society, education, and the development of institutions; (v) cooperation in the field of justice and home affairs; (vi) the development of political dialogue (EC, 1999).

The challenging task of integrating the Western Balkans into the EU has been successful to a certain extent with continuing efforts from both sides. At the EU-Western Balkans Summit of Thessaloniki in 2003, a clear membership perspective has been granted to the Western Balkans, subject to fulfillment of the conditions determined by the SAP and the Copenhagen criteria. Croatia has been the first country in the region to meet all conditions and become the 28th member of the EU on 1 July 2013. Macedonia, Montenegro, and Serbia have been recognized as candidate countries, where the formal accession negotiations started with Montenegro in June 2012 and with Serbia in January 2014. Albania applied for EU membership in 2009, and in October 2012 the European Commission recommended that Council should grant Albania candidate status, subject to completion of key measures in certain areas. Bosnia-Herzegovina and Kosovo have not applied for membership yet, but the EU recognizes these countries as potential candidates.

Economic and financial assistance instruments for the Western Balkans

One of the most challenging issues of the enlargement to the Western Balkans and Turkey has been the economic structures of those countries. Table 1 below compares the per capita GDPs of the Western Balkans and Turkey with the EU and the 2007 entrants, Bulgaria and Romania.

Table 1: GDP per capita (current US$)

	2001	2006	2012	*Change 01-12 (%)*
Albania	1,245	2,872	4,000	*221.29*
Bosnia-Herzegovina	1,482	3,200	4,556	*207.41*
Kosovo	1,490	2,279	3,567	*139.31*
Macedonia	1,664	3,133	4,565	*174.30*
Montenegro	1,897	4,371	7,041	*271.23*
Serbia	1,518	3,943	5,190	*241.86*
Turkey	3,058	7,736	10,666	*248.82*
Croatia	5,192	11,229	13,879	*167.31*
Bulgaria	1,729	4,313	6,977	*303.47*
Romania	1,834	5,789	8,437	*360.10*
European Union	17,635	29,604	32,954	*86.87*

Source: WDI

Although there exists a remarkable gap between the region and the EU, the gap has shrunk in the last decade for all countries, but mostly for Bulgaria and Romania; in other words, all countries of the Western Balkans, Turkey, Bulgaria and Romania have managed to converge their economies to the EU, and the convergence has been higher for two countries which actually made the accession negotiations and entered the EU during this period

Financial assistance of the EU to the Western Balkans had already started in the 1990s with three programs focusing on post-conflict reconstruction of the region: PHARE, ECHO and Obnova. The Poland and Hungary Assistance for Restructuring their Economies (PHARE) program was initially targeting assistance to Poland and Hungary, and then expanded to the pre-accession assistance of the 2004 and 2007 entrant countries and three countries from the Western Balkans, Albania, Macedonia, and Bosnia-Herzegovina. The second program was the European Consensus on Humanitarian Aid (ECHO) that included support to refugees, internally displaced persons and vulnerable groups, and aimed at restoring livelihood conditions and fostering post-war infrastructure reconstruction. PHARE and ECHO were initialized in 1990. In 1996, a new assistance program, Obnova[1] was put in place aiming at complementing the PHARE program. Obnova funds were mostly used for the reconstruction of Bosnia-Herzegovina and Kosovo. In the 1990s, around €4.4 billion was allocated to the projects aiming at the physical, social and political reconstruction of the Western Balkans. As the scope of these programs was limited to post-conflict reconstruction, their effects on economic and institutional development were quite limited and they offered no clear perspective for the Western Balkans to integrate their economies with the EU.

As the financial assistance programs of the 1990s proved inadequate in terms of further economic integration of the region to Europe, the Community Assistance for Reconstruction, Development and Stabilisation (CARDS) program was launched in 2000, with a focus on "building up an institutional, legislative, economic and social framework directed at the values and models subscribed to by the EU" (EC, 2000). Compared to the previous assistance programs, CARDS was the main financial assistance instrument for the Western Balkans until 2006 in the framework of the SAPs and was characterized by a much more structured approach. CARDS program was built on four aims: efficiency, ownership, conditionality, and coordination. The program included both bilateral cooperation tailored to the specific needs of the Western Balkan countries and regional cooperation among them. Financial assistance (€4.6 billion in total) to these countries was concentrated on a wide range of issues such as integrated border management, public administration reform, taxation, local infrastructure development, civil society development, media reform, strengthened environment policies, and economic reforms.

[1] Means "reconstruction" in most Balkan languages

Table 2: CARDS Programme allocation for 2002–2006 (EUR million)

	2002	2003	2004	2005	2006
Albania	44.9	46.5	63.5	44.2	45.5
Bosnia-Herze-govina	71.9	63	72	49.4	51
Croatia	59	62	81	105	140
Macedonia	41.5	43.5	59	45	40
Serbia	189.7	240	218	154.5	179
Montenegro	15	15	19	22	24.5
Kosovo	154.9	76.28	75.4	54	89.5

Source: European Commission, DG Enlargement. Financial statistics per country 2000-2006, http://ec.europa.eu/enlargement/how-does-it-work/financial-assistance/cards/statistics2000-2006_en.htm and http://www.europa.eu.int/comm/enlargement/cards/financial_en.htm

In 2007, all previous instruments for both official candidate (Croatia, Macedonia, Montenegro, Turkey, and Iceland) and potential candidate countries (Albania, Bosnia-Herzegovina, Serbia and Kosovo) were replaced by the Instrument for Pre-Accession Assistance (IPA) program, aiming at providing assistance to these countries in harmonization and implementation of the EU *acquis* and preparation for use of the cohesion and structural funds after EU accession. Candidate and potential candidate countries were differentiated in the IPA with regard to the access to the assistance components and to the progressive decentralization of funds management.

The IPA was made up of five components, each covering priorities defined according to the needs of the beneficiary countries:

- Component I: "Assistance for transition and institution-building", aimed at financing capacity-building and institution-building (managed by DG Enlargement);

- Component II: "Cross-border cooperation", aimed at supporting the beneficiary countries in the area of cross-border cooperation between themselves, with the EU Member States or within the framework of cross-border or inter-regional actions (managed by DG Enlargement (for programs between beneficiary countries) and DG for Regional and Urban Policy (programs with EU countries))

- Component III: "Regional development", aimed at supporting the countries' preparations for the implementation of the Community's cohesion policy, and in particular for the European Regional Development Fund and the Cohesion Fund (managed by DG for Regional and Urban Policy);

- Component IV: "Human resources development", which concerns preparation for participation in cohesion policy and the European Social Fund (managed by DG Employment, Social Affairs and Inclusion);

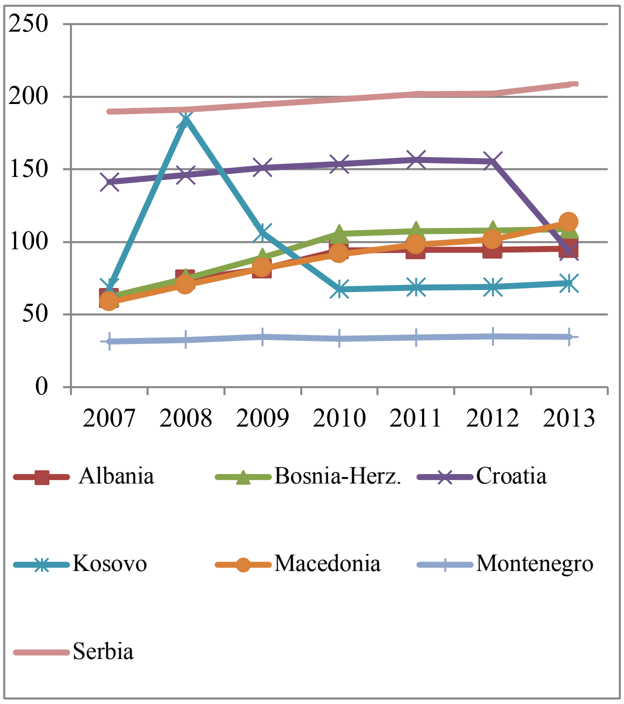
- Component V: "Rural development", which concerns preparation for the common agricultural policy and related policies and for the European Agricultural Fund for Rural Development (EAFRD) (managed by DG Agriculture and Rural Development).

While candidate countries could use all five components, potential candidates could use only the first two components and only under a decentralized management system. IPA assisted the beneficiary countries in several forms, including investment, procurement contracts or subsidies, administrative cooperation, participation in Community programs or agencies, measures to support the implementation process and management of the programs, and budget support.

The allocation of the IPA funds for each component and beneficiary country was defined in the Multiannual Indicative Financial Framework (MIFF), which reflects the priorities identified by the Enlargement Strategy of the European Commission, and sets out the overall strategic framework for the pre-accession process. The first MIFF covered the 2008-2010 period. The allocation levels for the year 2007 was approved according to the proposal of the Commission, aimed at ensuring the consistency with previous funding schemes. The MIFF was updated in 2008 to include the period after 2010 under the same component structure of the IPA. Tables 3 and 4 in the appendix show the breakdown of IPA assistance by country and by component under the different periods of the MIFF. It is seen that for the period 2007-2010, Western Balkan countries received a financial assistance of €2.87 billion, where allocations to Turkey was €2.26 billion. In the period of 2011-2013, €2.25 billion was allocated to the Western Balkans, and €2.54 billion to Turkey.

Figure 1 below shows the evolution of total IPA allocations to the Western Balkan countries. Assistance to Turkey is excluded from figure 1 in order to focus on the Western Balkans, as total IPA payments to Turkey are much higher than all other countries, and have been constantly increasing in the 2007-2013 period. On the other hand, figure 2 that illustrates the per capita IPA allocations shows that the country with the lowest total IPA payments, Montenegro, is the highest in terms of per capita, and the country with the highest total allocations, Turkey, receives only around €10 of support per capita. Per capita IPA assistance allocated to Albania, Bosnia-Herzegovina and Serbia stays below the average level of the Western Balkans and poses a problem for their economic and institutional convergence to the EU.

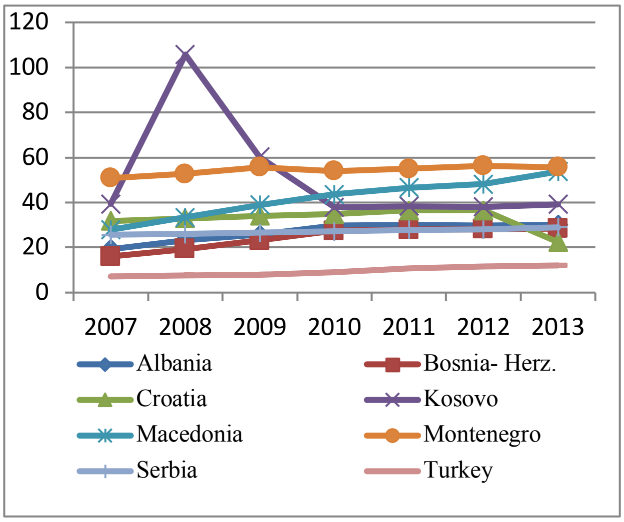
Figure 1: IPA Allocations to the Western Balkans



Source: COM(2012)

For full-sized figure, please see appendix.

Figure 2: Per capita IPA allocations to the Western Balkans and Turkey



Source: COM (2012), population data from WDI

For full-sized figure, please see appendix.

Once the IPA funds are allocated through the MIFF, multi-annual indicative planning documents (MIPDs) are drafted for each country by the European Commission, in cooperation with the national authorities and civil society representatives of the beneficiary countries. The MIPDs set out the EU's priorities for assistance to the beneficiary countries and indicate the major areas of intervention by highlighting the priorities, which will receive IPA funding. The MIPDs are prepared for a period of three years, but annually reviewed. Each MIPD includes an explanation of the economic and political situation of the beneficiary country and a detailed allocation of the IPA funds for each component with clear objectives, expected results and indicators.

In the MIPDs for 2011-2013 period, the European Commission decided to follow a "sector-based"[2] (or program-based) approach in the allocation of the IPA funds with the aim of enhancing the strategic nature of the accession process and leading to greater efficiency and effectiveness of pre-accession assistance. According to the economic and political priorities of each country, the Commission focused its assistance on selected sectors (among seven pre-defined sector classifications) with the aim of increasing the efficiency of the use of the IPA funds. Table 5 (appendix) shows the sectors selected for assistance in the 2011-2013 MIPD of each beneficiary country.

New approach in pre-accession financial assistance: From IPA to IPA II

As the regulation of the IPA expired at the end of 2013, the Commission had to establish a new legal basis for pre-accession financial assistance and also to reform the IPA according to the needs of the EU and the partner countries. In December 2011, the Commission adopted a proposal for the IPA II Regulation (COM, 2011) and accepted it in March 2014 (Official Journal of the European Union, 2014) that would be effective until the end of 2020. IPA II has a budget of €11.7 billion for the 2014-2020 period, with a slight increase in the budget of €11.5 billion from the previous IPA, but now with one less beneficiary country as Croatia became a full member of the EU. Table 6 shows the allocation of the IPA II budget to years.

Table 6: IPA II Budget (provisional allocation) (EUR millions)

2014	**2015**	**2016**	**2017**
1573.8	1605.2	1637.4	1670.1
2018	**2019**	**2020**	
1703.5	1737.6	1771.1	

Source: EC, DG Enlargement (2014) http://www.imp-med.eu/Ar/image.php?id=435

With IPA II, existing implementation arrangements were adjusted in order to ensure that "pre-accession assistance will be more closely linked to the enlargement priorities, and be based on a more results-oriented and

2 A "sector" can be defined as a clearly delimited area of public policy addressing a set of fairly homogeneous challenges, by using dedicated resources (staff and budget) under the authority of a competent member of the government (EC, 2013).

strategic approach targeting key reforms in the enlargement countries" (EC, 2012).

In order to achieve these aims, the IPA II brings changes to the IPA that could be summarized in three categories (Koeth, 2014):

i. Replacing of the five IPA components with policy areas and allowing access to all areas of the IPA II for all countries, regardless of their official candidate status;

ii. Easing the management of financial assistance with fewer processes for accreditation and conferral of management to beneficiaries.

iii. Generalization of a sector approach with the increased use of sectoral budget support[3]

These changes have been made with the aim of increasing the efficiency of the assistance process. Replacing the IPA components with specific policy areas is expected to increase the efficiency of the management of the process by the Commission; the DG Enlargement will mainly manage the process, whereas under the previous IPA structure, every component was managed by different DGs. Also, as all policy areas will be available to all countries within the IPA II, regardless of their status, the assistance scheme is expected to be more comprehensive and effective. The previous distinction between candidate and potential candidate countries was impractical and, in some ways, not very meaningful; there was not a significant relationship between the proximity to membership and the actual amount of funds being allocated. As figure 2 illustrates, per capita assistance to a potential candidate, Kosovo, has been three times higher that of a candidate country, Turkey. It can also be stated that being an official candidate does not necessarily mean that EU membership will be achieved in the near future, as the example of Turkey, which has been an official candidate state since 2005, proves.

Sector approach in pre-accession assistance

One of the most significant changes of the IPA II from the IPA is the use of the sector approach in assistance. In terms of possible consequences and the changes it brings to the conduct of the pre-accession assistance, we can state that the importance given to the sector approach is the most distinctive feature of the new approach in financial assistance to the candidate or potential candidate members. The Commission defines the sector approach as "a way of working together between government, donors and other key stakeholders (…) aiming at broadening government and national ownership over public sector policy and resource allocation decisions within the sector, increasing the coherence between policy, spending and results, and reducing transaction costs" (EC, 2007).

The shift from component-based to sector approach has already started at the end of the IPA as a result of increasing needs and demands from both sides. The main problem with the previous approach was that it focused more on deliverables or outputs of the projects, rather than on achieving policy objectives (EC, 2014). IPA II, on the other hand, aims at being more results-driven with a possibility to shift funds between policy objectives and between countries. IPA II also includes a performance reward, where the best performers would receive certain rewards and the assistance to underperformers will be reconsidered.

The Commission sets up three phases for the sector approach of the IPA II; (i) strategic planning and programming; (ii) preparation of programs; and (iii) implementation and monitoring of sector support. The first phase includes the preparation of the Common Strategic Framework (CSF) and the Country Strategy Papers (CSP) for defining the assistance-related targets and identifying approaches and tools for interventions in close cooperation with the national authorities. The second phase, preparation of programs, covers the translation of the priorities and objectives identified in the CSP, at the level of policy area or sector, into specific projects or actions by the means of Sector Support Programmes. Finally the third phase, implementation and monitoring, brings a more decentralized management of the funds compared to the previous IPA scheme.

Benefits and risks of the sector approach

The sector approach is expected to bring several benefits during the process of pre-accession financial assistance, but also carries certain risks in the long-term membership perspectives of the beneficiary countries. One potential benefit of the sector approach is that, instead of an *acquis*-driven strategy, sectoral priorities and national strategies gain importance in the IPA II, therefore the assistance funds could be tailored according to the specific distinctive needs and priorities of the beneficiary countries. This also leads to a higher degree of government and national 'ownership' over public sector policy and resource allocation decisions within a sector by increasing the coherence between policy, spending and results, as the supported projects will have domestic reflections both in their determination and implementation, while the previous *acquis*-driven approach had the risk of lacking 'real' domestic consequences and turning into "box-ticking approach" where the parties "mechanically match the individual projects through a catalogue of short and mid-term priorities"

[3] Indicative sectors of the IPA II are: Public Administration Reform, Public Financial Governance, Justice and Home Affairs , Human Rights and Minorities, Transport, Energy, Environment, Private Sector Development, Competitiveness and Innovation, Education and Human Resource Development, Labour Market and Employment, Social Policies, Agriculture, Rural Development (EC, 2014).

(Koeth, 2014: 6). The management of funds is expected to be easier and more flexible with the new approach, which clearly increases their effectiveness. Another expected benefit of the sector approach is that individual projects will be embedded into a larger strategy through Sector Support Programmes; thus there will be a shift from stand-alone projects to programs where donor assistance contributes to the development and implementation of a coherent, nationally owned program across a whole sector.

On the other hand, there are also certain risks of the new approach to pre-accession financial assistance. Koeth (2014: 9) argues that the sector approach "is a significant departure from the highly prescriptive processes and procedures developed by the Commission services for the implementation of IPA in the period 2007-13", and IPA II moves away from a "strictly enlargement-driven" pre-accession financial assistance instrument towards a "more general development instrument, with references to enlargement". Without doubt, higher inclusion of national authorities and key stakeholders would lead to broadened ownership on projects and policies, but it carries a risk of top-down decision making in the absence of strong and non-politicized non-governmental organizations and civil service institutions. It would not be wrong to assume that the priority of the domestic policy makers will be short-term national development issues instead of a possible EU membership in an unknown future. Therefore, the use of national development plans instead of EU strategic documents as a template for assistance may lead to a shift in the policy outcomes of the pre-accession funds from *acquis*-convergence to national socio-economic development.

One possible reason for the Commission's shift to an *acquis*-driven pre-accession assistance strategy that strictly aims at enlargement via a sector-based approach, in turn creating less pressure for compliance to the *acquis*, is enlargement fatigue. Especially in the aftermath of the 2008 economic crisis, the priorities of the EU had to shift to internal economic issues. Enlargement to the Western Balkans and Turkey, which already had low public support in the EU, had to dropped down on the policy priority list. The new approach to pre-accession financial assistance to the candidate and potential candidate countries reflects this change in priority. Both Western Balkan states and Turkey are very important political and economic partners for the EU, and a convergence of these countries to the EU with a possibility of eventual full membership keeps the relations on track and is beneficial for both parties. Under current circumstances, the sector approach of IPA II could be beneficial for the EU by making further enlargement unrealistic until 2020 and creating a breathing space, and on the other side, the beneficiary countries could be relieved from the pressure of *acquis* compliance and focus on more domestic issues of socio-economic development while delaying the EU membership target but still keeping it on track.

Conclusion

The EU has been successfully expanding geographically, economically and politically since the 1970s. The current stage of enlargement process involves the accession of the states of the Western Balkans and Turkey. Amid discussions on enlargement fatigue and absorption capacity after the Eastern enlargement of the EU, the prospect of the expansion of the Union to the region is still alive, and the membership of Croatia in 2013 has indicated that despite socio-economic characteristics that are different from that of the EU, full convergence to the *acquis* and an eventual accession is possible and feasible. Through the course of economic and institutional convergence to the EU, pre-accession financial assistance has been provided to the Western Balkan countries and Turkey in various forms since the 1990s. The instrument for economic assistance in the last decade has been the IPA, which provided project-based financial support to the candidate and potential candidate states under different components. In 2014, the European Commission started to follow a new approach in its pre-accession financial assistance, IPA II, which is based on a sector approach instead of *acquis*-driven strategy, and aiming at becoming more flexible, more efficient and more directed to the specific needs and demands of the counterparts.

The new approach to the pre-accession financial assistance has two sides. The sector approach of IPA II is, indeed, more flexible and the increased role of national authorities and stakeholders in the selection, implementation and monitoring processes is expected to increase the efficiency of the allocated funds through a higher degree of government and national ownership over public sector policy and resource allocation decisions. On the other hand, the new policy could be interpreted as a shift of priority in the pre-accession process, from adoption of the *acquis* to socio-economic development, which could mean the assistance will be less likely focused to the EU accession aim. This shift is more possible if the focus of the beneficiary country on EU accession has already been diminishing and the civil service institutions are over-politicized. Turkey applied for EU membership in 1987 and started accession negotiations in 2005. In the process of negotiations, several chapters still have not been opened due to political objections within the EU. This gradually led to the fading of accession hopes and loss of enthusiasm in *acquis*-adoption. As the target of the EU membership became blurrier on the horizon, Turkey started to relax its efforts on further convergence to the 'European values', where the role of nationalism and religion increased significantly in politics and daily lives. This creates a vicious circle: as Turkey believes that it is not treated the same way as other candidates are, its motivation for adopting the necessary reforms disappear, and as Turkey turns its back to the EU, the arguments for Turkey's rejection gain further support. Turkey is a case to watch and follow carefully for the Western Balkans. Indeed, a similar situation is valid for Macedonia, as the name issue still appears the main stumbling block for further accession talks, Macedonian politicians relax their EU agenda and shift to nationalism. In this respect, the new approach on pre-accession financial assistance carries a risk of pushing these countries further away from EU accession.

Appendix:

Table 3: Breakdown of the IPA Assistance according to the MIFF for 2007-2010 (EUR mn)

Country	Component	2007	2008	2009	2010
TURKEY	Transition Assistance and Institution Building	256.7	256.1	239.6	231.3
	Cross-border Cooperation	2.1	2.8	3.1	5.1
	Regional Development	167.5	173.8	182.7	238.1
	Human Resources Development	50.2	52.9	55.6	63.4
	Rural Development	20.7	53	85.5	131.3
	Total	**497.2**	**538.7**	**566.4**	**653.7**
CROATIA	Transition Assistance and Institution Building	49.6	45.4	45.6	39.5
	Cross-border Cooperation	9.7	14.7	15.9	15.6
	Regional Development	45.1	47.6	49.7	56.2
	Human Resources Development	11.4	12.7	14.2	15.7
	Rural Development	25.5	25.6	25.8	26
	Total	**141.2**	**146**	**151.2**	**153.6**
MACEDONIA	Transition Assistance and Institution Building	41.6	41.1	39.3	36.9
	Cross-border Cooperation	4.2	4.1	4.3	4.5
	Regional Development	7.4	12.3	20.8	29.4
	Human Resources Development	3.2	6	7.1	8.4
	Rural Development	2.1	6.7	10.2	12.5
	Total	**58.5**	**70.2**	**81.8**	**91.7**
SERBIA	Transition Assistance and Institution Building	181.5	179.4	182.6	186.2
	Cross-border Cooperation	8.2	11.5	12.2	11.8
	Total	**189.7**	**190.9**	**194.8**	**198**
MONTENEGRO	Transition Assistance and Institution Building	27.5	28.1	29.8	29.8
	Cross-border Cooperation	3.9	4.5	4.7	3.7
	Total	**31.4**	**32.6**	**34.5**	**33.5**
KOSOVO	Transition Assistance and Institution Building	68.3	184.7	106.1	66.1
	Cross-border Cooperation	0	0	0	1.2
	Total	**68.3**	**184.7**	**106.1**	**67.3**
BOSNIA-HERZEGOVINA	Transition Assistance and Institution Building	58.1	69.9	83.9	100.7
	Cross-border Cooperation	4	4.9	5.2	4.7
	Total	**62.1**	**74.8**	**89.1**	**105.4**
ALBANIA	Transition Assistance and Institution Building	54.3	65.2	71.4	84.2
	Cross-border Cooperation	6.7	8.6	9.8	10
	Total	**61**	**73.8**	**81.2**	**94.2**
Total Country Programmes		**1109.4**	**1311.7**	**1305.1**	**1397.3**
Multi-Beneficiary Programmes		29.6	137.7	188.9	141.7
Support Expenditure		44.8	52	47.6	47.4
GRAND TOTAL		**1263.2**	**1501.4**	**1541.6**	**1591.3**

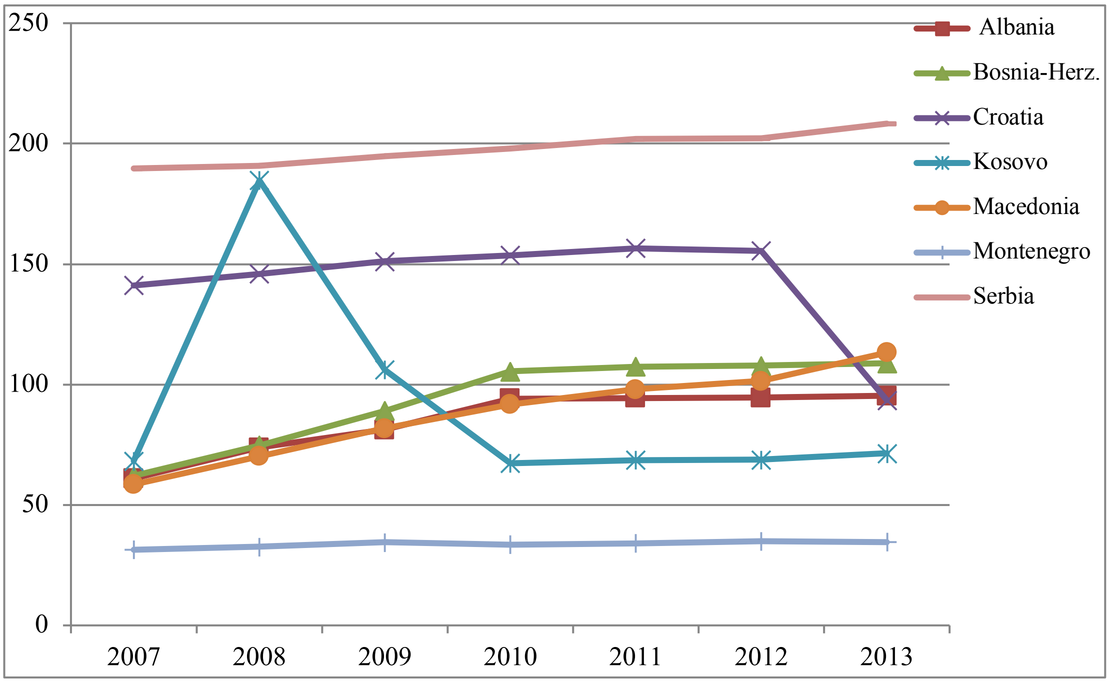
Source: COM(2012)

Table 4: Breakdown of the IPA Assistance according to the MIFF for 2011-2013 (EUR mn)

Country	Component	2011	2012	2013
	Transition Assistance and Institution Building	231.3	227.5	238.5
	Cross-border Cooperation	5.1	2.2	2.2
	Regional Development	293.4	356.1	366.9
	Human Resources Development	77.6	83.2	91.2
	Rural Development	172.5	187.4	204.2
TURKEY	**Total**	**779.9**	**856.3**	**902.9**
	Transition Assistance and Institution Building	40	40	17.4
	Cross-border Cooperation	15.9	16.4	9.7
	Regional Development	58.2	57.5	30.1
	Human Resources Development	16	15.9	8.5
	Rural Development	26.5	25.8	27.7
CROATIA	**Total**	**156.5**	**155.6**	**93.5**
	Transition Assistance and Institution Building	29.4	28.7	27.1
	Cross-border Cooperation	4.5	3.6	5.1
	Regional Development	39.3	40.9	50.3
	Human Resources Development	8.8	10.3	10.6
	Rural Development	16	18	20.2
MACEDONIA	**Total**	**98**	**101.5**	**113.2**
	Transition Assistance and Institution Building	190.6	190.6	196.7
	Cross-border Cooperation	11.3	11.5	11.6
SERBIA	**Total**	**201.9**	**202.1**	**208.3**
	Transition Assistance and Institution Building	29.8	16.3	5.1
	Cross-border Cooperation	4.3	4.6	4.7
	Regional Development	0	8	14.8
	Human Resources Development	0	2.8	2.8
	Rural Development	0	3.3	7.3
MONTENEGRO	**Total**	**34.2**	**35**	**34.6**
	Transition Assistance and Institution Building	66.9	67	68.5
	Cross-border Cooperation	1.8	1.8	3
KOSOVO	**Total**	**68.7**	**68.8**	**71.5**
	Transition Assistance and Institution Building	102.7	102.7	103.5
	Cross-border Cooperation	4.7	5.2	5.3
BOSNIA-HERZEGOVINA	**Total**	**107.4**	**107.9**	**108.8**
	Transition Assistance and Institution Building	84.3	85.1	84.7
	Cross-border Cooperation	10.1	9.4	10.7
ALBANIA	**Total**	**94.4**	**94.6**	**95.3**
Total Country Programmes		1553	1633.7	1634.1
Multi-Beneficiary Programmes		193.2	212.7	177.3
Support Expenditure		52.2	52.7	53.3
GRAND TOTAL		**1798.4**	**1899.1**	**1864.6**

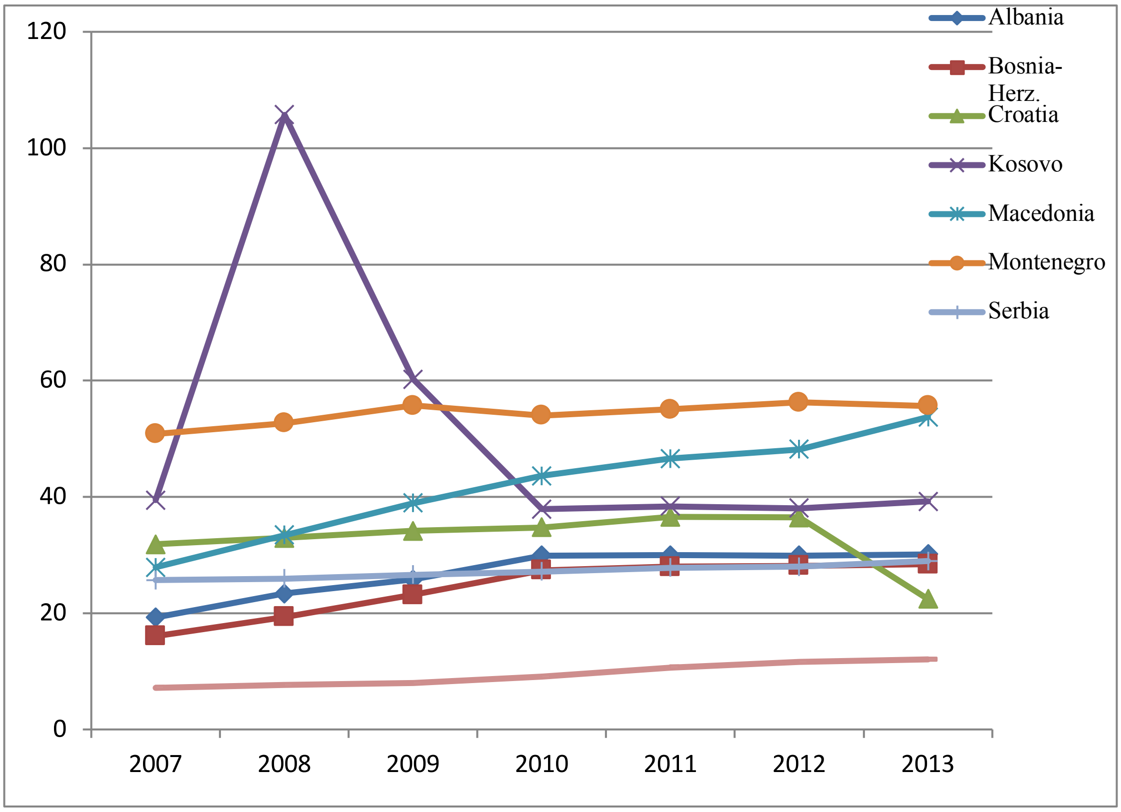
Source: COM(2012)

Figure 1: IPA Allocations to the Western Balkans



Source: COM(2012)

Figure 2: Per capita IPA Allocations to the Western Balkans and Turkey



Source: COM(2012), population data from WDI

Table 5: Selected sectors for assistance in 2011-2013 MIPDs

	ALB	BIH	HRV	KSV	MKD	MNE	SRB	TUR
Justice and Home Affairs and Fundamental Rights	✓	✓	✓	✓	✓	✓	✓	✓
Public Administration Reform	✓	✓	✓	✓	✓	✓	✓	✓
Environment and Climate Change	✓	✓	✓	✗	✓	✓	✓	✓
Transport	✓	✓	✓	✗	✓	✓	✓	✓
Private Sector Development	✗	✓	✓	✓	✓	✗	✓	✓
Social Development	✓	✓	✓	✗	✓	✓	✓	✓
Agriculture and rural development	✓	✗	✓	✗	✓	✓	✓	✓

Source: Individual MIPDs

References

Avery, G. (2008), 'EU expansion and wider Europe', in E. Bomberg and A. Stubb (eds), *The European Union: How Does it Work?* Oxford: Oxford University Press.

Belloni, R. (2009), "European Integration and the Western Balkans: Lessons, Prospects and Obstacles", *Journal of Balkan and Near Eastern Studies*, 11 (3): 330-331

COM (2008), Communication from the Commission to the Council and the European Parliament Instrument for Pre-Accession Assistance (IPA) Multi-Annual Indicative Financial Framework for 2010-2012, Brussels, 5 November 2008, 705 final

COM (2011), Proposal for a Regulation of the European Parliament and of the Council on the Instrument for Pre-accession Assistance (IPA II) Brussels, 7.12.2011 838 final 2011/0404 (COD)

COM (2012), Communication from the Commission to the European Parliament and the Council Instrument for Pre-Accession Assistance (IPA) Revised Multi-Annual Indicative Financial Framework for 2013, Brussels, 10.10.2012 , 581 final

EC (1999), COM/99/0235 final Communication from the Commission to the Council and the European Par liament on the stabilisation and association process for countries of South-Eastern Europe - Bosnia and Herzegovina, Croatia, Federal Republic of Yugoslavia, former Yugoslav Republic of Macedonia and Albania

EC (2000), Council Regulation (EC) No 2666/2000 of 5 December 2000 on assistance for Albania, Bosnia and Herzegovina, Croatia, the Federal Republic of Yugoslavia and the Former Yugoslav Republic of Macedonia, repealing Regulation (EC) No 1628/96 and amending Regulations (EEC) No 3906/89 and (EEC) No 1360/90 and Decisions 97/256/EC and 1999/311/EC

EC (2007), Support to Sector Programmes Covering the three financing modalities: Sector Budget Support, Pool Funding and EC project procedures http://ec.europa.eu/development/icenter/repository/Support-to--Sector-Programmes_27072007_en.pdf

EC (2014), The Instrument for Pre–accession Assistance IPA II: 2014 – 2020 DG Enlargement, https://webgate.ec.europa.eu/ maritimeforum/sites/maritimeforum/files/IPA%20II%20Programming_DG%20ELARG_Ms.%20Fondi.pdf

Emerson, M., Aydin, S., De Clerck-Sachsse, Noutcheva, G. (2006), Just what is this 'absorption capacity' of the European Union?, Center for European Policies Studies, No. 113, September 2006.

Günter V. (2013), EU Enlargement Policies – Results and Challenges *Studia Universitatis Babes-Bolyai – Studia Europae*, Issue no.4 /2013

Heidbreder, E. G. (2011) *The impact of expansion on European Union institutions : the eastern touch on Brussels*, New York: Palgrave Macmillan,

Jano, D. (2008), EU - Western Balkans Relations: The Many EU Approaches, *The Journal of the International University Institute of European Studies*, 2 (1): 143-160.

Koeth, W. (2014), The New Instrument for Pre-Accession Assistance (IPA II): Less Accession, More Assistance?, European Institute of Public Administration working paper 2014/W/01

Maniokas, K. (2004), "The Method of the European Union's Enlargement to the East: A Critical Appraisal," in *Driven to Change: The European Union's Enlargement Viewed from the East*, A. Dimitrova (ed). Manchester / New York: Manchester University Press.

Miralles, D., and Johansson, E. (2002), *The EU enlargement and the Mediterranean*, Barcelona: Observatory of European Foreign Policy.

Official Journal of the European Union 2014 Regulation No 231/2014 of the European Parliament and of the Council of 11 March 2014 establishing an Instrument for Pre-accession Assistance (IPA II)

Szoulcha A. (2010) "The EU and Enlargement Fatigue: Why Has the European Union Not Been Able to Counter Enlargement Fatigue", *Journal of Contemporary European Research*, 6 (1): 1-16

Vachudova, M. A. (2014), "EU Leverage and National Interests in the Balkans: The Puzzles of Enlargement Ten Years On". *Journal of Common Market Studies*, 52: 122–138

The Aspen Institute | Germany

RULE OF LAW ENHANCEMENT IN THE WESTERN BALKANS: IDENTIFYING THE NEXT STEPS

September 8-11, 2014 | Alt Madlitz

In cooperation with:

Stabilitätspakt für Südosteuropa
Gefördert durch Deutschland
Stability Pact for South Eastern Europe
Sponsored by Germany

Auswärtiges Amt

The Aspen Institute Germany wishes sincerely to thank the German Federal Foreign Office for its sponsorship of the Aspen Southeast Europe Program 2014 through the Stability Pact for South Eastern Europe.

Accommodation and conference venue: Gut Klostermühle, Mühlenstr. 11, 15518 Madlitz-Wilmersdorf (Alt Madlitz)

Monday, September 08, 2014

Arrival of participants during the day

20:00

Drinks reception and welcome dinner
Venue: Klostermühle Refektorium

Dinner Speech: Michael Roth, *Minister of State for Europe, German Federal Foreign Office*

Tuesday, September 09, 2014

09:00 – 09:15

Welcoming remarks and opening of the conference
Venue: Conference room Theaterforum

Speakers: Rüdiger Lentz, *Executive Director, Aspen Institute Germany*
Dr. Ernst Reichel, *Envoy for South Eastern Europe, Turkey and the EFTA-States, German Federal Foreign Office*

09:15 – 10:45

Session I:
EU enlargement and rule of law

The first session will take a general look at the rule of law situations in the Western Balkan countries in their EU integration process. The EU in its 2013/2014 Enlargement Strategy considers rule of law a "fundamental value" that is "at the heart of the accession process". What does the current situation look like? What are the main challenges ahead of the candidate and potential candidate countries? What should the key focus of these countries be? How should the new EU approach of opening chapters 23 and 24 in the beginning of accession negotiations be evaluated? What are the first experiences with this approach? How can a sustainable implementation and an irreversible, deeply rooted reform process in accession countries be supported? Is there anything else the EU should do in order to better support countries in the process?

Moderator: Rüdiger Lentz
Introductions: Zoran Ilievski, *Europeanization by Rule of Law Implementation in the Western Balkans*
Bodo Weber, *Promoting Rule of Law through EU Integration in the Western Balkans – Previous Experiences and Current Challenges*

10:45 – 11:15

Coffee break

11:15 – 12:45	**Session II:** **Capacity building: judicial and public administration reform**

An independent and efficient judiciary as well as strong administrative capacity, in particular within law enforcement agencies, is at the core of the EU integration process, as the establishment of rule of law is not limited to the legal framework but strongly depends on its implementation. The second session will therefore focus on the implementation of unbiased, efficient jurisdiction. What have the developments in this field been over the past years? What are the major challenges the countries in the region are still facing? Has a separation of power in the Western Balkan countries been established sufficiently to guarantee an independent judiciary? If not, what are the main impediments? How can the key rule of law principles of legal certainty and unity be ensured? What are the major shortcomings of the reform processes? What is the EU's role in the processes? Is there a need for stronger EU support or assistance?

Moderator: Sonja Licht
Introductions: Gordan Kalajdziev, *Judicial Reforms in the Republic of Macedonia – Concepts and Obstacles*
Handes Özhabeş, *Judicial Reform in Turkey: Achievements and Shortcomings*

12:45 – 14:00 Lunch
Venue: Klostermühle Refektorium

14:30 Departure to Berlin in front of Fischerhaus

16:30 – 17:30 **Meeting with Dr. Joachim Bertele, Head of Division 212 Bilateral Relations to the Countries of Central, Southeastern and Eastern Europe, Southern Caucasus and Central Asia, German Federal Chancellery**
Venue: Federal Chancellery, Willy-Brandt-Straße 1, 10557 Berlin

18:00 – 19:00 **Meeting with Dr. Jörg Bentmann, Head of Division G: General Questions; EU and International Affairs, German Federal Ministry of the Interior**
Venue: Federal Ministry of the Interior, Alt-Moabit 101D, 10559 Berlin

19:30 – 22:00	**Reception and Dinner with Members of the German Bundestag** Venue: Schmugglerscheune, Altes Zollhaus, Carl-Herz-Ufer 30, 10961 Berlin

MPs: Peter Beyer
Thorsten Frei
Ursula Groden-Kranich
Metin Hakverdi
Josip Juratovic
Jürgen Klimke
Manuel Sarrazin
Johann Wadephul

Wednesday, September 10, 2014

09:00 – 10:30 **Session III:**
Rule of law and the economy – improving the investment climate

The countries of the Western Balkans all face the challenge of high unemployment, little economic growth, and a dire need for foreign direct investment. However, at the same time, the countries' investment climates all have room for improvement. What are the shortcomings of the countries' legal systems when it comes to attracting foreign direct investment? Do countries offer sufficient legal certainty when it comes to investment, property rights, or permits? Which reforms are needed in order to improve conditions for investors? Is there anything the EU can do to further support this process?

Moderator: Helge Tolksdorf
Introductions: Silvana Mojsovska, *Measurement of the Investment Climate Versus Investment in the Western Balkans*
Valbona Zeneli, *Economic Rule of Law for Development in the Western Balkans*

10:30 – 11:00 Coffee break

11:00 – 12:30 **Session IV:**
Organized crime and corruption

Key challenges to the rule of law identified by the European Union are organized crime and corruption, in particular the "criminal infiltration of the political, legal and economic systems" (EU Enlargement Strategy and Key Challenges 2013/2014). It is therefore fundamental for progress in rule of law to tackle these issues effectively. Why do countries struggle so much in their fight against organized crime and corruption? How can OC and corruption be tackled more efficiently, in particular since they are becoming more sophisticated with modern business instrument as cover-ups? How can existing anti-corruption legislation be implemented more efficiently? How can individual political or interest group influence on anti-corruption measures be limited?

Moderator: Dr. Andrea Despot
Introductions: Daniela Irrera, *Formal and Informal Actors in the Western Balkans: Measuring the Impact of Anti-Corruption Policies*
Ioannis Michaeltos, *The Fight Against Corruption and Organized Crime, The Case of the Western Balkans*

12:30 – 13:30 Lunch

14:00 – 15:30 **Session V:**
The protection of basic civil, political, social, and economic rights

One of the cornerstones of rule of law is the guarantee of basic civil, political, social and economic rights, and the protection of these rights by and in particular against governmental or administrative activities without legitimate cause. Part of these fun damental rights is the right to freedom of expression, including freedom and independence of the media. What is the situation in Western Balkan countries? Whichrights are already sufficiently guaranteed? What needs to be done in order to ensure the guarantee of all rights, and in particular improve the independence of media throughout the region?

Moderator: Rüdiger Lentz
Introductions: Nenad Koprivica, *Background Paper on the Protection of Basic Civil, Political, Social, and Economic Rights in the Western Balkans*
Murat Önsoy, *The Protection of Basic Rights in the Western Balkans*

15:30 – 16:00 Coffee break

16:00 – 17:30 **Meeting with Peter Eigen, Founder of Transparency International**

18:00 Barbecue on the shore of Madlitz lake

Thursday, September 11, 2014

Departure of participants during the day

Borchardt, Bernd

Despot, Andrea

Djikić, Emir

Goranić, Ivana

Harxhi, Edith

Ilievski, Zoran

Irrera, Daniela

Kalajdziev, Gordan

Kapetanović, Amer

Kiprijanovska, Dragana

Koprivica, Nenad

Korenica, Fisnik

Licht, Sonja

Lüttenberg, Matthias

Majstorović, Srđan

Michaletos, Ioannis

Mojsovska, Silvana

Nehm, Florian

Niktin, Alexander

Önsoy, Murat

Özhabeş, Hande

Peçi, Idlir

Pejović, Aleksandar Andrija

Pfeuffer, Paul

Pürner, Stefan

Quiring, Anja

Reichel, Ernst

Samofalov, Konstantin

Tahiri, Edita

Tolksdorf, Helge

Weber, Bodo

Zeneli, Valbona

The Aspen Institute Germany

Esch, Valeska
Senior Program Officer

Jackson, David
Rapporteur

Kabus, Juliane
Program Assistant

Lentz, Rüdiger
Executive Director

Wittmann, Klaus
Senior Fellow

REPORT: RULE OF LAW ENHANCEMENT IN THE WESTERN BALKANS: IDENTIFYING THE NEXT STEPS

Rapporteur: David Jackson
PhD Candidate
Berlin Graduate School for Transnational Studies
Social Science Research Center, Berlin

The Aspen Institute's conference 'Rule of Law Enhancement in the Western Balkans: Identifying Next Steps' took place in Alt Madlitz, Germany between September 8-11, 2014. The event brought together 30 select decision makers from Southeast Europe (SEE), Germany, the United States (U.S.), Turkey and the European Union (EU), with professional backgrounds in government, international and civil society organizations, academia, the security sector and Foreign Service. The conference was divided into five sessions. The first and second sessions examined progress in the rule of law and judicial reform in the region; while the latter sessions focused on the economy, organized crime and corruption, and the protection of basic rights.

Session I: EU enlargement and the rule of law

The session examined the state of play for rule of law reform in the region and started with the observation that with regards to the rule of law no EU member state is perfect – in fact, some are less than perfect. Nevertheless, enhancing the rule of law is central to the EU accession process and a vital concern for Southeast Europe. The most important question is not if implementation of the rule of law but how. It is also a formidable challenge: organized crime and corruption must be fought, judicial independence forged, and an administration based on the fair and universal application of rules established. Progress must be driven by society – a willingness to fight corruption must become a part of society's DNA.

Rule of law systems face common challenges in the region. Overall, transparency is lacking and the systems are often burdened by organizational complexity, as well as rudimental management issues, such as poor budgetary planning and inadequate use of IT systems. One speaker recommended that the poor infrastructure for legal training and teaching should be addressed. Again participants stressed that these challenges can only be addressed if societal norms and attitudes change, a transformation that requires the full leveraging of civil society. Today's efforts to embed the rule of law, suggested one expert, confront a 'double heritage' from the past: the rise of informal networks that continue to pollute and disrupt the formal order combined with the legacy of lawlessness and violence that tore through the 1990s.

Some speakers noted that the EU's approach to rule of law in the region is not flawless. Even though the EU has had to face a sharp learning curve, lessons from the accessions of Romania and Bulgaria still need to be gained. One expert suggested that EU officials understand these shortcomings but the overall approach is restrained by diverging notions of what the rule of law is amongst member states. Another pointed to the political sensitivity of the rule of law: as it touches on fundamental rights of sovereign states the EU acts with excessive caution. The principle of the rule of law must be supplemented with a qualitative improvement in the type of legislation, advised one participant. Moving forward, one speaker suggested that the EU must set out a clear and detailed map for the region. Clear measurement criteria for rule of law progress and implementation should be designed for SEE countries, underpinned by a credible future perspective.

Other speaks highlighted certain strengths in the EU approach – 'the glass is more likely to be half full than empty'. Progress has been made in judicial reform; this may be due to a strongly institutionalized and clear acquis communautaire criterion in this area, especially compared to other areas like police reform. Though accession cannot be reduced to a mathematical formula, one expert recommended that a clear communication of tasks is crucial for institution building. Even though leaders in SEE are extremely apt at creating smoke screens, behaviors can be changed if local actors know what they are supposed to do and can be held to account – politicians do not like to be reminded that they have not made progress. One speaker stressed that the rule of law advances in the region, despite continuing problems, have been quite remarkable: Albania has gone from the brink of civil war to relative prosperity; war crime suspects have been delivered to the Hague; old enemies have made peace. It may take time and there can of course be improvements made to the system but conditionality has induced substantial progress.

Though it was noted that new procurement practices have curbed corruption pretty successfully, anti-corruption efforts in the region can also inadvertently undermine the rule of law, especially if they are used as a political tool. Experts underlined that allegations of corruption should not be harnessed by politicians to slander opponents, an issue that the EU continues to monitor and will seek to prevent. One participant advised that Europeanization is not the same as democratization, and internally-led democratization must continue in parallel with the EU accession process. Moreover, the EU's strategy is a complex package covering many areas and thus defies analysis as a single strategy. One speaker recommended that, despite shortcomings, the EU accession toolbox is a force of democratization, but sometimes the EU policy is subject to compromise and in muddling through political disputes in the region, such as in Kosovo and BiH, the EU can undermine the rule of law. 'Double standards' undermine the EU's approach: corrupt politicians should be arrested and not compromised with, and though geo-political agendas are hidden, they are active in the region and this disrupts the implementation of the rule of law. Without greater credibility from the EU, alternative powers could fill a vacuum in the region, warned experts.

One expert advised that the rule of law concept is myopically understood by policy makers. The rule of law is about the basic question of how society organizes itself and so only part of rule of law reform should be connected to the state, the rest should be connected to social institutions like civil society. The rule of law is also about self-governing as well as state-governing, and civil society must be placed at the center of reform efforts. Universities in the region need support from the EU to galvanize an intellectual debate about the rule of law. As well as the media and civil society, independent institutions, such as ombudspersons, are important to condition the political class to become more aware of rule of law principles. The merits of the 'carrots and stick' were discussed. One expert suggested that sharper sticks should target under-performing political leaders. Another recommended that the concept of reward is problematic because such external validation dis-embeds the accession process from society – 'self-reward' is a better way to motivate integration.

Technical aspects of the EU's approach could be refined. Broad frameworks of measurement by the EU do not provide an adequate picture of the situation and participants called for more specific measurement tools. One participant at the frontline of implementation described the complexity of chapters 23 and 24 of the acquis, before noting that chapter 24 is a 'hard' acquis, meaning it is very clear and institutionalized but at the same time it is costly for accession states. One effect is that local media and public debate is dominated by the rule of law, which makes it difficult to reach out to the public on other issues, such as financial or economic reforms. Practical aspects of the rule of law (are the statistics functional? do the custom's IT systems work?) remain crucial. These practical aspects demonstrate just how socially embedded the process is, a process so thorough and complex that it will certainly take a generation to foster change. There was a general consensus that politicians in the region are entering a crucial period in which they must now find the political will to deliver on reform.

Session II: Capacity building: judicial and public administration reform

This session discussed how judicial and public administration reforms can move forward. One expert advised the rule of law is about constraining elites through a division of power not about strengthening the mechanisms through which politicians rule, yet victorious politicians tend to see all branches of government as legitimately serving their aims. Hence, a basic misunderstanding of what the rule of law is blights its implementation. Checks and balances are therefore sidelined: executive branches in the SEE have become excessively powerful – the result is that judiciaries are not giving protection to the citizens and cannot constrain politicians.

Finding a right reform balance within the checks and balance framework is important. Much of the focus is now on disciplining the judiciary but this creates a lot of noise against the judiciary and, in turn, reduces social trust, one speaker recommended. Externally disciplining the judiciary is important but at the same time means by which norms of appropriate judicial behavior are internalized should be found. To the east, the Turkish judiciary has been a means of disciplining society and not to protect rights. Legal assurances do not guarantee legal practices in Turkey, meaning permanent structural reform is necessary: the judiciary should become more democratic and pluralist that represent different segments of society. In Kosovo, EULEX has established some important benchmarks about how judges should assess cases – EU accession criteria could provide more guidance on these benchmarks. From an organizational perspective recruitment mechanisms for judges can be improved in the SEE, professional development mechanisms are rather weak, and the disciplining of judges should be based on objective criteria. Substantively, some fields of law need further development as, for example, competition law is very weakly developed in the region.

One expert stressed that the rule of law does not come after socio-economic development, democratic maturity or better laws: it is fundamental to all of them – calls for 'sequencing' are merely calls for more time, slowing down accession. Advice was given that though the better specification of accession criteria may be important it is not a panacea. Technical capacities are necessary but not sufficient as politics matters: the rule of law requires checks and balances, and respect for the independence of the judiciary. Monitoring these political aspects requires the EU to 'see behind' the outward operation of the rule of law to understand the politics that determine the operation of the institutions: are judges intimidated? Are jobs handed out on the basis of patronage? Lifting this veil is crucial to understanding the 'living body' of the rule of law.

One speaker proposed that political elites have hijacked the political system for their own interests. Elites adopt legislation but actual implementation is between zero and ten percent; why then does the EU penalize whole populations when it is often the elites that disrupt integration? This is both a moral issue and an educational issue. Again, the recommendation was the policies of the EU should be much more about stick than carrot, especially as many of the rewards go to the elites rather than the population. Another expert suggested that soft methods, such as better communication, are in the long term more effective than hard measures. For example, networking can be a very effective method because creating networks between those interested in reform and connecting these networks to the EU institutions can spur progress. Another speaker underlined the importance of generating new elites in the region that are more oriented towards democracy. Finally, it was emphasized that though democratization should come from within, Brussels should have better oversight in the region: an effective DG enlargement commission is central to the momentum of the process.

Session III: Rule of law and the economy – improving the investment climate

Experts kicked off this session by noting that resources, capabilities and markets are necessary for attracting FDI but not sufficient: the quality of institutions is absolutely vital. Yet, experts stressed that FDI does not lead directly to growth: absorptive capacities – particularly trade openness, human capital, technological capacities, and domestic credit – determine whether FDI generates growth.

FDI is unevenly spread in SEE and overall just 0.9% of global FDI flows to the western Balkans. Experts underlined that particularly important for increasing FDI is the economic rule of law: the universal application of laws and procedures. On the flip side, corruption is statistically associated with low levels of FDI. Challenged by the shadow economy, the economic rule of law requires immediate reforms that should aim at constructing functioning economic institutions, curbing corruption and creating a friendly business environment. As unrest in BiH has revealed, political elites are realizing they cannot rely on the same old tricks and fearmongering but have to deliver. Speakers recommended that if domestic institutions uphold monopolistic practices and corruption, FDI can actually widen social disparities – a finding that reinforces the importance of the economic rule of law.

Countries of the region 'should turn to each other' to improve the economic situation. SEE countries do not compare favorably with regions with cheaper labor costs such as Asia – countries should therefore join forces to forge a regional market. Barriers to regional cooperation are still present. CEFTA 2006 reduced tariffs between countries but still only 10% of total trade is intra-trade, a figure way below potential. Even amongst extremely close states such as Kosovo and Albania trade is constrained by administrative malpractice, and more widely in the region, 'time taxes' and 'bribe taxes' hinder business. Eighty-percent of investors do not bring new technologies to the region because of deficiencies in human capital; moreover, larger markets are more attractive for the kind of cutting-edge technologies that can have positive spill-over effects. It could be that only through a prolonged EU accession process can a thorough implementation of laws be ensured, advised one participant.

Infrastructure development is critical: highways that connect ports to towns to cities are urgently required. China is becoming a major strategic investor in the region, especially in infrastructure and energy. The strategic aim of China's investment is to send goods to western Europe but also to move to closer to European research and development networks. Even though countries in the SEE are somewhat instrumentalized by China as a conduit to western Europe, one expert advised that if SEE governments stay true to rule of law principles, they can ensure positive fruits are harvested from these investments.

One expert noted that small and medium-sized businesses from western Europe may feel more comfortable in the smaller markets of SEE countries. Participants also discussed whether indicators, such as those from the World Bank 'Doing Business' report, matter. Some experts argued that they influence economic decision making as companies take into account these scores before investing; others suggested insights from the day to day reality of the business environment, rather than abstract measures, are more significant. One expert advised that foreign investors are often put off by the complex legal environment in the region, a situation rooted in on-going accession reforms that can appear to be experimental.

Session IV: Organized crime and corruption

Even though international cooperation is helping to stem the flow of goods of organized crime, challenges still remain. The wars in Libya, Syria, and Iraq and the aftermath of the "Arab Spring" have rejuvenated the SEE arms trafficking industry; cocaine and heroin are reaching historically low price levels; and the SEE is the prime entry into the EU for illegal immigration and remains a source region for human trafficking victims. Experts recommended that any initiatives taken should be multi-level and durable. In fact, one expert recommended that a major 'master plan' to fight organized crime and corruption should be forged between the EU and countries of the region. The EU must help countries in the region by providing material aid, expert advice, and technical support, especially on asylum and migration challenges. Off-shore tax havens, secret jurisdictions and the shadow economy need to be addressed in the fight against corruption. Greater transparency for the executive, legislative and the judicial branches is also vital, and it was also noted that parallel private higher education systems are particularly prone to corrupt practices.

Media independence is overwhelmed by corrupt practices in the region. Newspapers are aligned to political blocks and often instrumentalized to berate political opponents through campaigns of allegation and counter-allegation. The dominant narrative in the media is that all politicians are crooks and criminals, a generational change is necessary to take over the reforms. Foreign ownership of newspapers was cited as an area of concern because these outside owners put too much emphasis on profit and not enough on quality journalism. There are also very few investigative journalists, mainly because the risks are too high.

One expert noted that it is very difficult to prosecute high-level corruption cases because these often involve highly elaborate schemes to steal money. In addition, the fight against corruption can be used in a very corrupted way – attacking high level corruption is often based on 'selective justice'. It was also noted that petty corruption can create an environment in which high-level corruption thrives and vice versa: the behavior of politicians can induce poor behavior in people making bribery more likely. Blanket attacks on corruption can also have perverse effects. One expert noted that informality often is important for the functioning of society, especially if the state has weak administrative capacities. Non-licensed actors can enhance functionality and so we need to study carefully how corruption functions rather than dismiss it outright as a curse.

Session V: The protection of basic rights in the Western Balkans

Participants noted improvements in the region's human rights frameworks. The EU accession process has promoted a far-reaching architecture to protect human rights. More pessimistic viewpoints stressed that these legal advances have not been successfully translated into the rule of law and social justice. Different groups suffer from inadequate protection. One participant underlined that the Roma remain the most marginalized group, suffering from widespread discrimination. Few groups are fighting for their case and often policy is shaped by latently racist attitudes, a situation not helped by donor efforts that tend to be too uncoordinated. Participation and representation for and by the Roma in the political process is critical.

Attacks on LGBT activists are not adequately investigated by the authorities in the region but other participants suggested that the context for LGBT organizations has improved. Just five years ago there was a generally intolerant atmosphere; now the culture of intimidation has faded and public LGBT platforms have been established. While other speakers disagreed about how substantial this improvement has been, most suggested that on LGBT issues the region is at least moving in the right direction. It was also suggested that LGBT receive a lot of funding from donors and this can be sometimes at the expense of other vulnerable groups. Unconsolidated property right regimes were also highlighted as a major – but often overlooked – issue in the region as confiscation and restitution claims, as well as overlapping property claims, can create an unpredictable business environment making the region less attractive for FDI. It was also noted that rights for the disabled are often overlooked in the region.

Again, the media was cited as an area for concern. Accurate information is difficult to come by in the region. Strengthening the protection of journalists and effective guarantees for freedom of expression still represent major challenges. Surveys of journalists in the region have revealed that they feel their rights are not respected. Media self-regulation should be stepped up and 'the hidden hand' of the state should be pulled from the media, especially as governments are still the biggest advertisers in newspapers. More investigative journalism is necessary – the EU should provide more help in this regard. In Montenegro, organized criminal groups have attacked journalists for revealing illicit activities, and the over-crowded media landscape encourages damaging competition between media outlets making it difficult for the media to come together for self-regulation. Technocratic approaches to media development fail to turn the tide: often project-based trainings may improve style but not really substance. It is necessary to increase journalistic expertise to challenge the political elites and to stem the general trend of tabloid style reporting.

While some participants equated EU accession with the strengthening of basic rights provision, it was also noted that the EU is not a body with a history of human rights protection and so the EU should stop lecturing the region about 'EU' standards of human rights because they do not exist; rather human rights protection in Europe resides in the European Court of Human Rights. One expert highlighted that independent institutions, such as Ombudsman and commissioners, have helped enormously to improve the human rights landscape. They are in fact the backbones of a legal order and fully-fledged democracy – in Serbia, politicians are afraid of them. It is therefore crucially important to strengthen these regulatory bodies.

EUROPEANIZATION BY RULE OF LAW IMPLEMENTATION IN THE WESTERN BALKANS

Zoran Ilievski[1]
Political Advisor to the President of the Republic of Macedonia

Executive Summary

This paper aims to provide policy recommendations for the assessment of rule of law implementation in Western Balkan (WB) countries aspiring European Union (EU) membership. The main question out of which the policy recommendations emerge is whether and what kind of influence the EU institutions have on the implementation of the rule of law with a particular focus on the reforms of judiciary in five Western Balkan Countries: Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, and Serbia. The research preceding this policy paper assessed the current use of conditionality criteria in the field of rule of law in Western Balkan countries and the institutional reforms carried out in the development of the judicial sector. Special focus was given to newly established institutions such as the High Judicial Council, and Judicial Academies with the goal to assess whether they provide adequate normative framework for the political independence of the judiciary. The method used for this research largely leaned on content analysis of legal rules and administrative regulations adopted for this purpose and their implementation.

Introduction

Amidst the new uncertainties caused by the differences between North and South or East and West, between Islamic and Christian countries, between liberal and nonliberal communities and other global conflicts, there is widespread agreement on “one point alone: that the rule of law is good for everyone”[2]. The European Union is taking this as one of the criteria for countries’ EU accession while using principles of conditionality. The enlargement policy of the European Union is widely recognized as one of the most powerful instruments of the EU’s foreign policy. It is said to have considerably contributed to political transformation processes by promoting democratic consolidation, the rule of law, respect for human rights, and the protection of minority rights[3] (Freybur and Richter 2010). But what exactly does the rule of law stand for?

Kochenov argues that in the pre-accession of Eastern countries, the EU Commission opted for fusing the assessment of the rule of law and democracy (2008, p, 46). In that way the EU gained political maneuvering space for more specific policy prescriptions in the process. However, the “rule of law” and judicial sector re-

1 This policy paper was written in the framework of the project Europeansiation by Rule of Law Implementation in the Western Balkans, within the Regional Research Promotion Programme supported by the Swiss Agency for Development and Cooperation, Federal Department of Foreign Affairs.

2 Tamanaha, B. Z. 2004. On the Rule of Law: History, Politics and Theory (Cambridge: Cambridge University Press), p.1

3 Freyburg, T. and S. Richter.2010. “National Identity Matters: The Limited Impact of EU Political Conditionality in the Western Balkans,” *Journal of European Public Policy* 17(2): p.262-80

form remain vaguely defined concepts due to "the lack of a coherent theory of judicial independence, and the difficulty to measure the performance of the judicial system"[4] as has been observed with regard to the monitoring activities in the Eastern enlargement process. A problem also springs from the discrepancy between the theoretical concept of rule of law, and the practical requirements of the EU for judicial reforms. A recurrent problem also lies in the vagueness of the very essence of the negotiating chapters where most of the benchmarks are of highly political or constitutional importance and related to Copenhagen political criteria rather than to the hard *acquis*. [5]

A policy paper like this is timely since the EU is using conditionality in the realm of the rule of law with the aspiring Western Balkan countries. If the EU strives to see these reforms conveyed, it has to tackle the main issue, namely how does it assess progress and success of implementation of rule of law in a particular aspiring member country? Therefore, we propose a twofold approach for improving the EU's assessment of the implementation of the rule of law in the WB, with a particular focus on reforms of the judiciary. This approach runs along two crucial dimensions of any policy, namely, what in essence does a policy aim to achieve, and how will policymakers go about it:

- A clear conceptualization of rule of law benchmarks, paired with tangible credibility of the enlargement process towards the WB countries will simplify assessment and increase the awareness in aspiring countries of their progress, while at the same time help the EU Commission have a way of comparison and fine-grained insight into the rule of law progress of its aspiring countries. The EU has to create a comprehensive implementation strategy with a measurable interim system of goals and rewards so that the domestic actors have clear and immediate rationalist based motivation to adhere to the rule of law conditionality.[6] The new approach of the EU Commission towards the candidate countries, which put rule of law conditionality in the center of the negotiations, opening chapter 23 and 24 first, is a step in the right direction.[7]

- Support of EU institutions for societal norm socialization through a "bottom-up" approach and support of "rights holder" role vis-à-vis public authority.

Therefore we find it essential that the EU sets clear criteria for judiciary reforms as part of the rule of law, along the benchmarks of *independence, accountability, efficiency and effectiveness*. We strongly maintain that firm standards in this area in the phases of Stabilization and Association Agreement (SAA), then in the phase of screening, and finally in the negotiation phase would ensure absence of political impact to the judiciary reform process.

In the following section we first assess current policies of the EU Commission towards the assessment of implementation of the rule of law and their drawbacks.

1. Current Policies towards Western Balkan EU aspiring countries

As academics have already identified, "[o]ne of the persistent fears in the European Union […] is that the accession countries will be unable to catch up with the prevailing practices of constitutionalism and the rule of law that supposedly ground the common tradition of Europe"[8]. This fear generally springs from the prior experience of the Central and Eastern Countries (CEEC) countries.

Broadly speaking, the mechanisms that the international institutions use for achieving domestic compliance are: coercion, external incentives, and socialization.[9] Among the external incentives mechanisms for compliance, conditionality and socialization are currently the most widespread in Europe.[10]

Conditionality focuses on reinforcement by rewards. Those usually include achieving candidate status and starting negotiations, and finally, membership as a highest reward. *Socialization* on the other hand means that the EU demands are more likely to be perceived as legitimate if they are part of the *acquis communautaire*, and that they are not more burdensome for the existing member states.[11] Hence, rule adoption will be facilitated when there is resonance between traditional domestic rules and EU norms.

---

4 Mungiu-Pippidi, in Kmezic. M. 2014 (ed) Europeanization by Rule of Law Implementation in the Western Balkans", *Institute for Democracy Societas Civilis-Skopje, p.61*

5 Kmezic. M. 2014 (ed) Europeanization by Rule of Law Implementation in the Western Balkans", *Institute for Democracy Societas Civilis-Skopje, p.33*

6 Kmezic. M. 2014 (ed) Europeanization by Rule of Law Implementation in the Western Balkans", *Institute for Democracy Societas Civilis-Skopje, p.260*

7 Ibid. p. 179

8 Sajo, A. 2006. "Becoming Europeans: The Impact of EU Comstitutionalism on Post-Communist Pre-Modernity," in W. Sadurski, A. Czarnota, M. Krygier (eds), *Spreading Democracyand the Rule of Law? The Impact of EU Enlargement on the Rule of Law, Democracy and Constitutionalism in Post-Communist Legal Orders* (Netherlands: Springer): 175-192. p. 175

9 Kmezic. M. 2014 (ed) Europeanization by Rule of Law Implementation in the Western Balkans", *Institute for Democracy Societas Civilis-Skopje, p.41*

10 J. T. Checkel. 2005. "International Institutions and Socialization in Europe: Introduction and Framework," International Organization 59(4), p. 801-826

11 T. Freyburg and S. Richter. 2008. National Identity Matters: The Limited Impact of EU Political Conditionality in the Western Balkans. National Centre of Competence in Research (NCCR). Challenges to Democracy in the 21st Century. Working Paper 19.

Checkel had identified three aspects of European conditionality: a) pre-conditions as policy actions agreed upon during the negotiations between an international institution and a national government that must be undertaken before the former approves credits or formally grants membership, b) actions like performance criteria or legal requirements and c) policy provisions that specify additional commitments contained in the overall agreement.[12] Furthermore, Linden concludes that non-compliance is punished by reduction or withdrawal of support and rejection of association and membership".[13]

Socialization on the other hand leans on the pursuit of candidate countries to adjust to the official requirements of a club of countries that already maintains a particular set of norms. Repercussions in this regard come if a country experiences new norms as entirely different from its previous experience, hence struggles to acquire them both in principle and in practice. Yet, are these policies sufficient for the assessment of implementation of the rule of law? We argue that it is not, illustrating it with the example of judiciary reforms.

1.1 Criticism on current mechanisms

Two main problems stem from the current policy of conditionality and socialization that the EU uses in the field of rule of law in the Western Balkans. First is the vagueness of the concept of the rule of law. Second is the vagueness of the conditionality criteria within the realm of rule of law. These mechanisms are inconsistent, and bring disappointment to the candidate countries, while at the same time do not provide specific rules of the game. Lessons already learned from other countries point to the same direction. Namely, the EU was inconsistent in conveying reforms and was sluggish with the creation of new institutions and implementation of EU policies in the CEEU.[14] WB countries can certainly learn from the CEEU, but moreover the EU and its approach towards the newly to-be integrated region.

Rationalist institutionalism, based on "cost-benefit calculations"[15] claim that the lack of "normative clarity" of EU demands poses a special problem in the field of rule of law, and the credibility of conditionality in general.[16] Having in mind these drawbacks, we maintain that it is important to propose a more robust framework for measuring success of implementation of the rule of law.

1.2 Why change now?

In addition to the 1993 Copenhagen criteria, Western Balkans countries are expected to meet additional country-specific criteria mainly linked to different peace agreements. Furthermore, promoting regional cooperation and reconciliation is expected as well. The Union uses both regional and country-by-country strategy for the countries of the Western Balkans. The main aim of the regional strategy is to improve the regional cooperation, established through the contractual relationship of these countries in the field of border management, visa policy, migration issues, and organized crime.[17] On the other hand, the specific priorities for each country are outlined in the justice, freedom and security chapter of the Accession Partnership. Yet, despite more than a decade of the Stabilization and Association Process in the WB, one of the most problematic issues is the functioning of the judiciary.

The differences between national jurisdictions and legal systems make it impossible to construct a universal formula for the requirements, which have to be met for an independent judiciary to exist. Yet, we argue that a strengthened comparative framework of assessing judicial reforms is not far-fetched and can be utilized since all five countries face similar challenges. Certainly, this framework has to be sensitive to country specific requirements, yet will give a more succinct systematization of what indicators are to be pursued in order for a country to improve its judiciary reforms.

2. Western Balkans judicial reforms

Traditionally the judicial systems of Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, and Serbia were influenced mostly by the legal traditions of Austria, Germany, and France. All faced perpetual flux between tendencies to create independent and moderate judicial systems concomitantly with a counter pressure from authoritarian rulers attempting to impose political hegemony over state institutions. All five countries have legacy of forty-year communist party rule in the Socialist Federal Republic of Yugoslavia (SFRY). During this period, the judiciary did not achieve political non-conformism in performing the judicial service. Separation of power and independence of judiciary principles were hindered by "higher state interests", which led to instrumentalization of law by politics.

---

[12] J. T. Checkel. 2005. "International Institutions and Socialization in Europe: Introduction and Framework,"International Organization 59(4), p. 801-826.

[13] R. H. Linden, P. Cernoch, R. W. Clark and A. Freyberg-Inan (eds). 2002. Norms and Nannies. The Impact of International Organizations on the Central and East European States (Lanham: Rowman and Littlefield Publishers) p. 19

[14] Gregorescu in Linten et.al.R. H. Linden, P. Cernoch, R. W. Clark and A. Freyberg-Inan (eds). 2002. Norms and Nannies. The Impact of International Organizations on the Central and East European States (Lanham: Rowman and Littlefield Publishers)

[15] Schimmelfennig, F. and U. Sedelmeier (eds). 2005. The politics of European union enlargement: theoretical approaches Routledge advances in European politics (UK; New York: Routledge).

[16] March, J. G. and J. P. Olsen.2004. "The Logic of Appropriateness," *Arena Working Papers* 04/09 (Oslo).

[17] Kmezic. M. 2014 (ed) Europeanization by Rule of Law Implementation in the Western Balkans", *Institute for Democracy Societas Civilis-Skopje,p.224*

Later on, with the political transformation of Yugoslavia in the 1990s, the judiciary was characterized by judges under heavy political pressure who worked on sensitive political cases, hence were abided to stay close to the regime interests. Only in the 2000s, when countries overcame violent ethnic conflicts, the EU launched its policy based on the Stabilization and Association Process, offering WB countries a perspective of EU membership. Improvements in the rule of law arena became a necessary prerequisite for WB countries accession to the EU. During the course of the research, we derived the following common challenges that WB countries face regarding the rule of law:

1) an inadequate constitutional and legal framework resulting in excessive delays in court proceedings, difficult enforcement of court judgments, lack of accountability of the judicial bodies and corruption;

2) an overly complex and extended system of courts, resulting in higher than necessary operating costs and less efficient access to justice;

3) unclear selection, dismissal, performance, and promotion standards for judges, resulting in inconsistent judicial effectiveness and reducing public trust in the judicial profession;

4) a lack of integrated planning, budgeting, and performance measurement capacities, reducing the judiciary's ability to effectively monitor and improve system performance;

5) weak use of modern information technology (IT) software solutions for the judicial administration operational practices, hampering effective justice administration and case processing;

6) onerous administrative burdens on judges reducing judicial efficiency and lowering morale in the judiciary's ranks;

7) lack of continuous training for judges and other judicial officials, hindering the development of a modern and professional staff specializing in judiciary management and administration;

8) inadequate curriculum of law faculties, contributing to a lack of preparation for the future leaders in the legal community and the judiciary;

9) poorly equipped and maintained facilities, restricting access to justice and straining the judiciary's resources;

10) an overcrowded and outdated penal system, which does not effectively encourage rehabilitation or satisfy international standards of humane treatment; and

11) underutilization of information technology and automated systems, resulting in the continued use of inefficient and labor-intensive administrative practices. In an effort to eliminate the aforementioned weaknesses, governments of the WB countries adopted the Judicial Reform Strategies.[18]

2.1 Major judiciary reforms undertaken

All countries except Kosovo adopted their respective *National Judicial Reforms Strategy* by 2008. These reforms contained the pursuit of independence, transparency, accountability, efficiency, accessibility to judicial bodies, and building public trust in judicial institutions. They worked on restructuring the court's structure into three tiers, except for Bosnia and Herzegovina because of the administrative division of the country, and Kosovo due to the factual division of ethnic Serbs and ethnic Albanians.

Following from these strategies, to achieve judicial independence, efficiency and accountability, the terms of appointment are crucial. Hence, all countries already have *High Judicial Councils* that are included into the procedures, playing a role in the appointment, promotion, disciplinary sanctions, and dismissal of judges. These judicial councils have to adapt control functions in order to achieve greater independence and effectiveness of judiciaries. So far, the WB countries largely comply with European standards regarding the composition of the Judicial Council. The appointment of Judicial Council members in the WB countries follows international standards, where there are both ex officio as well as elected members by peer commissions or by executive and legislative bodies. Pre-selection of judges became an obligatory phase, in order to ensure professionalism and decrease political influence of the judiciary. In Kosovo and Bosnia and Herzegovina, the Council even oversees initial and continuous training of judges, and administers the work of the courts.

Along with independence, efficiency, and accountability, a crucial feature of judicial reforms is effectiveness. This means that the policies undertaken should comply with the normative values of rule of law, and improve its quality. For this aim, effectiveness becomes essential, in the sense that those devoted to judicial reforms are competent, and follow the best practices of rule of law. Nevertheless, all WB countries face high level of formalism in their reading of the law, delays, and inconsistent decisions of the judiciary. Hence, the countries started tackling the problem of effectiveness by setting up *Judicial Academies,* in order to improve the quality of judicial education. A problem arises from the fact that these trainings are not sufficiently linked to advancement in the career or promotion of judges. Hence,

[18] Kmezic. M. 2014 (ed) Europeanization by Rule of Law Implementation in the Western Balkans", *Institute for Democracy Societas Civilis-Skopje, p.224*

it happens often that those who have gone through the training and those who have not are on equal footing.

Given the EU approach towards WB countries and their implementation of the rule of law, and the de facto reform processes in the judiciary reforms while aspiring towards EU membership, we now shift to the following recommendations.

3. Recommendations

It is important to reiterate that we do not criticize conditionality per se. Yet, if candidate countries are held to particular standards, the EU itself should not be exempt of its own standards. Those should be consistency of assessing reform's success, external as well as internal validity of principles, and finally relevance of the policy reforms it requires. Namely, for a smoother process of the pre-accession reforms, candidate countries should know when and how are they considered to be progressing. Therefore, the EU has to distil particular criteria and indicators on which basis countries will be graded.

3.1 Clear conceptualization and measurement of rule of law progress

First, regarding the vagueness of the rule of law we maintain that the following rekindling of EU Commission's policies is essential:

1. Clarity and credibility of the EU demands as an important factor increasing the likelihood of effectiveness.[19] By clarity it is understood that the candidate countries need to know precisely what are they expected to do if they decide to comply with the EU conditions? Particular traps for uncertainty may be found in the ever-growing body of EU law, or absence of single EU model in many policy areas. Thus, "credibility depends on a consistent, merit-based application of conditionality by the EU."[20]

2. The credibility of conditionality is also linked to the ability of the EU to monitor the rule adoption process, which is why the EU has in the recent years made serious investments into its monitoring capacity. Levitsky and Way suggest that the asymmetrical bargaining power and sizeable incentives need to have strong linkage with another strong international power (Western Europe and the United States), and the civil society (non-governmental organizations, media) in the candidate country in order for the conditionality to be effective.[21]

3. Low number of veto players. Schimmelfenning and Sedelmeier have constructed the adoption cost hypothesis so that "the likelihood of rule adoption decreases with the number of veto players incurring net adoption costs (opportunity costs, welfare, and power losses) from compliance." This means that the low number of veto players is a key-facilitating factor. [22]

These can serve as criteria for composing a more meticulous, systematized concept of what the rule of law reforms mean for aspiring WB countries.

3.2 Comparative approach for the assessment of implementation and progress of rule of law

As already presented, the EU currently leans on general conditionality and socialization in order to assess compliance of countries with its norms. The following four benchmarks of the European Union can be the basis for a comparative assessment of WB countries in implementation of rule of law. This approach can be adjoined with finding functional equivalence between the countries in terms of institutions, processes, policies, having in mind their specific context and slight modification of assessment where necessary. Even though rule of law is still part of the "soft principles" of reforms, we still argue that there should be a more succinct framework for assessing implementation of rule of law reforms, since they are taken as criteria for EU membership.

The four dimensions on which countries should be assessed are judicial independence, efficiency, judicial accountability and effectiveness. In the five EU country progress reports, we also find a criterion called "impartiality", as well as "professionalism" which are not used consistently. We discover that this is often related to the quality of judge's exercise of their profession and the quality of their decisions. Therefore, we find it useful to use the term "effectiveness" that gives a broader notion of the degree of success to which something fulfills its purpose. For instance, if we are to evaluate whether judges are competent, we talk about their professionalism, and therefore we assess the quality of their training. Furthermore, if we are to assess how well the deci-

[19] Hughes, J., G. Sasse and C. Gordon. 2004. "Conditionality and compliance in the EU's Eastward enlargement: regional policy and the reform of sub-national governance," *Journal of common market studies* 42(3), p. 523-551in Kmezic. M. 2014 (ed) Europeanization by Rule of Law Implementation in the Western Balkans", *Institute for Democracy Societas Civilis-Skopje, p.52*

[20] Kmezic. M. 2014 (ed) Europeanization by Rule of Law Implementation in the Western Balkans", *Institute for Democracy Societas Civilis-Skopje, p.52*

[21] Levitsky, S. and L. A. Way. 2006. "Linkage versus Leverage: Rethinking the International Dimension of Regime Change" in Kmezic. M. 2014 (ed) Europeanization by Rule of Law Implementation in the Western Balkans", *Institute for Democracy Societas Civilis-Skopje*, p. 53;

[22] Schimmelfennig, F. and U. Sedelmeier, The politics of European union enlargement: theoretical approaches Routledge advances in European politics, cit: 17; U. Sedelmeier. 2011. "Europeanization in new member and candidate states," Living Reviews in European Governance 6(1). lreg-2011-1 in Kmezic. M. 2014 (ed) Europeanization by Rule of Law Implementation in the Western Balkans", *Institute for Democracy Societas Civilis-Skopje,* p. 53

sions by the judges serve their purpose, we assess the quality of decision making.

a) *Judicial independence* can be guaranteed only if the framework in which judges exercise their functions provides for sufficient safeguards against attempts to improperly influence the administration of justice. Hence judges should be protected from the interference of the executive. Furthermore, besides the fact that the law guarantees judges' independence of political pressures, an important feature of this aspect is financial independence based on the principle of separation of powers. The principle of separation of powers between the legislative, executive and judiciary is the core of this principle. In this way, justices can direct the budget they receive on a yearly basis. Finally, the law should clearly protect judges, but abide them by law as well.

b) It is considered that *efficiency* is better achieved than independence. Even though the overall backlog of cases has been reduced, a more comprehensive analysis reveals that the basic courts and the courts of appeal have seriously managed to reduce that backlog, while this is not the case with the Supreme Administrative Court, which has increased the number of pending cases since their establishment.[23] Hence, the number of cases indicates how efficient courts are, but the number of cases cannot be directly connected to the quality of the judgments. Indicators of quality need to be developed. An indicator of accessing countries on how they deal with this principle of rule of law is also the approximate duration of the court processes. The access to these legal institutions should be easy, and the duration of judicial processes should be as short as possible.

c) *Accountability* mainly deals with responsibility, sanctioning, and promotions of judges. Accountability here refers to being accountable in front of the "constituency" or those who legitimize one's conduct. Therefore, the judges are accountable in front of the Judicial Councils, and only indirectly to the citizens. Also transparency and media presence in the courtroom play a crucial role in justices' accountability.

d) Studies focused on questions of *effectiveness* of the EU conditionality identify a few important elements that if applied consistently maximize the effectiveness of the desired reforms.[24] Regarding judicial reforms in aspiring WB countries, within these dimensions, we should assess the frequency of professional trainings for legal staff and the quality of trainings. Students in undergraduate studies and graduate schools should also receive adequate education that will prepare them for practical legal work. Finally trainings should keep judges updated with the new practices.

Along with this more general criteria and comparative approach, since each country faces within each dimension with slightly different challenges, in the Appendix, Table 1, we present country specific recommendation.

4. Implementation and conclusion

Having in mind that European Commission gives Annual Progress Report for each country, it can monitor the progress of the implementation of the rule of law in the judiciary sphere in the Western Balkan countries. Based on the four criteria we recommended, we here give specific guidelines how these could possibly be monitored on annual basis.

Parameter for monitoring of the *independence* of judicial system:

- number of politically dependent processes
- appeals submitted to the Judicial Council
- number of political appointments
- has there been change/increase or decrease of the protection of judges during their conduct

The *efficiency* of the judicial system should be monitored in relation to:

- number of resolved backlog
- duration of the judicial processes on annual base

Accountability in the judiciary:

- number of promotions
- number of sanctions of judges in front of the Judicial Council
- transparency of work of judges – published court decisions,
- media presence on public open processes

Effectiveness:

- number of trainings provided for strengthening the judicial human capacitates
- professional qualifications
- competence improvement – judges' participation in trainings per year

To conclude, the described comprehensive and far reaching scope of normative transformation of judicial institutions in Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, and Serbia has indeed caused changes in the WB judiciary over the past twelve years. The results of this comparative legal study play into the hands of the willingness of the WB countries to adopt European standards in the rule of law sphere and thus advance their EU integrations.

[23] Kmezic. M. 2014 (ed) Europeanization by Rule of Law Implementation in the Western Balkans", *Institute for Democracy Societas Civilis-Skopje,* p. 157

[24] Ibid, p. 131

Appendix

Recommendations Macedonia

Independence	Efficiency	Accountability	Effectiveness
1. Strengthen judicial independence in order to eliminate the “soft pressure” from other branches of government. 2. Provide budgetary independence of courts.	1. Improve courts infrastructure. 2. Improve procedural rules in order to affect lengthy court proceedings and case backlog. 3. Improve administrative capacity of courts. 4. Further improvement of the software system in order to provide precise statistical data on the resolved cases and the average overall duration of cases process. 5. Old unresolved cases should get particular attention and be resolved, without hindering the quality of decisions.	1. Fight the perceived corruption of judiciary. 2. Increase the role of NGO “watchdogs” and society in control of accountability of judges. 3. Set clear criteria for qualitative evaluation of the work of judges. 4. Clear definition and predication in the legislation outlining less extensive and more precise grounds for dismissal and a better balance between disciplinary and dismissal proceedings.	1. Recruitment of judges and prosecutors graduating primarily from the Academy for Judges and Prosecutors (AJP). 2. Further monitoring on the impact on the judicial profession concerning the Law on Courts regarding the detailed educational requirements for judges. 3. Improve curricula at law faculties.

Recommendations Montenegro

Independence	Efficiency	Accountability	Effectiveness
1. Implement Constitutional amendments on independence of the judiciary. 2. Specify the criteria for the appointment of judicial office holders. 3. Establish voluntary based, horizontal permanent transfer system 4. Establish periodical professional assessment of judges and prosecutors.	1. Decrease the case backlog. 2. Improvement of Court network. 3. Enforcement of civil and administrative cases’ decisions. 4. Increase staffing in the Judicial and Prosecutorial Councils 5. Publishing court’s decisions in timely manner 6. Establishment of a statistical system to measure recovery rate, costs, and duration of enforcement procedures 7. Shortening the length of trials 8. Allocate sufficient portion of the budget to the prosecutor to cover costs of criminal proceedings 9. Allocate sufficient portion of the budget for infrastructure and equipment	1. Fight the perceived corruption of judiciary. 2. Increase the public trust in judiciary. 3. Increase the role of NGO “watchdogs” and society in control of accountability of judges.	1. New enforcement system has been introduced to improve efficiency. 2. Country-wide single recruitment system for first-time judicial appointments should be established. 3. Strengthening and better streamlining of the judicial training. 4. Developing medium and long term human resources strategy 5. Adaptation of the planned 2012-2018 judicial reforms 6. Improve curricula at law faculties.

Recommendations Bosnia and Herzegovina

Independence	Efficiency	Accountability	Effectiveness
1. Consider establishment of functionally separate High Judicial Council and High Prosecutorial Council. 2. Set clear criteria for promotion of judges. 3. Reforms should be made in the budgetary process in order to support the institutional independence of the judiciary.	1. Reduce the backlog of cases. 2. Opening additional courts in the country 3. The Office of Disciplinary Council should prosecute cases timely. 4. Timely processing of war crime cases. 5. Modernize case management software. 6. Link the Case Management System with the Police database. 7. Provide the court staff with set of practical skills such decision writing, administrative management, etc.	1. Increase the role of NGO "watchdogs" and society in control of accountability of judges. 2. Fight the perceived corruption of judiciary. 3. Efforts should be made for diligent following of the Law on HJPC that defines when a mandate for a judge or a prosecutor can be terminated. 4. Further harmonization of the Court practice between various judicial instances in accord with the Structured Dialogue recommendations and Venice Commission findings 5. Improvement of witness protection in war crime court proceedings	1. Implement professional qualifications as the standard for appointment of judges in addition to "equal rights and representation of constituent people and others." 2. Introduce courses on harmonization of the legislation with the *acquis* at the Judicial and Prosecutorial Training Centre. 3. Improve curricula at law faculties.

Recommendations Kosovo

Independence	Efficiency	Accountability	Effectiveness
1. Include the Kosovo Judicial Council in the drafting of judiciary related legislation. 2. Establish transparent process for the adoption of the judicial budget. 3. Reduce the Government control over non-judicial court staff members. 4. Respect the principle of equal ethnic representation in judiciary. 5. A substantial majority of judicial council members should be elected by their peers. 6. Ensure that professional eligibility criteria for judges are met. 7. Limit the right of the President of Kosovo to refuse appointment of the proposed candidate for a judge. 8. Increase financial independence of the judicial branch.	1. Establish the Case Management System 2. Improve courts infrastructure and modernize equipment. 3. Reduce the case backlog. 4. Establishment of infrastructure and modern equipment. 5. Keeping accurate records of court proceedings. 6. Increase staff in the Judicial council. 7. Choose sufficient number of judges for the constitutional court to function with full quorum. 8. Fill underrepresented minority quota job positions. 9. Prevent repletion of court cases recording. 10. Foster alternative ways of dispute settlement. 11. Implement the Brussels Agreement on Normalization of Relations between Serbia and Kosovo in relation to court structure.	1. Increase the role of NGO "watchdogs" and society in control of accountability of judges. 2. Fight the perceived corruption of judiciary. 3. Increase the public trust in judiciary. Strengthen the code of conduct for judges. Disciplinary procedures should lead to concrete results.	1. Modernize the curriculum at the law faculties 2. Improve the quality of writing of judicial decisions. 3. Establish Judicial Academy. 4. Introduce mandatory continuous training for sitting judges. 5. Secure the access to justice particularly for minorities.

Recommendations Serbia

1. Introduction of transparency in the work of the High Judicial Council. 2. Set clear criteria for appointing the courts' presidents. 3. Protection from interference by the executive. 4. Removing political influence on the appointment and dismissal of judges. 5. Improvement of constitutional legislation that leaves gaps of interpretation of the appointment of judges. 6. Budgetary independence should be ensured and the allocation of the budget should be vested primarily within the courts.	1. Reintroduce new court network. 2. Foster alternative ways of dispute settlement. 3. Secure enforcement of court judgments. 4. Enforcement of existing legal framework in an effort to reduce excessive delays in court proceedings. 5. Increase the budget intended to improve courts' infrastructure. 6. Setting up an electronic case management system where missing 7. Reduce backlog of cases 8. Increase the number of bailiffs 9. Balance the workload of judges 10. Integrated planning	1. Set clear criteria for qualitative evaluation of the work of judges. 2. Increase the role of NGO "watchdogs" and society in control of accountability of judges. 3. Combat the perceived corruption of judiciary. Control mechanisms should become more prominent. 4. Functional proceedings for the protection of immunity of judges, prosecutors and members of councils should be actively used.	1. Modernize judicial administration operational practices. 2. Set clear criteria for promotion of judges. 3. Improving law faculty curricula. 4. Improving the quality of AJP by providing relevant staff and equipment. 5. HJC and SPC should adopt rules on regular appraisal on the work and performance of judges, court presidents and prosecutors. 6. The Judicial academy should be the entry point for the judicial profession. 7. Quality of statistical data needs to be improved. 8. Development of efficient legal aid system. 9. Utilize information technology.

References:

Jano, D. 2010.*The Europeanization of Western Balkans: A Fuzzy Set of Qualitative Comparative Analysis of the New Potential EU Member States* (Saarbrücken: VDM Verlag).

Tamanaha,B. Z. 2004. On the Rule of Law: History, Politics and Theory (Cambridge: Cambridge University Press).

Freyburg, T. and S. Richter.2010. "National Identity Matters: The Limited Impact of EU Political Conditionality in the Western Balkans," *Journal of European Public Policy* 17(2): 262-80

Kochenov, D. 2008.*EU Enlargement and the Failure of Conditionality: Pre-accession Conditionality in the Fields of Democracy and the Rule of Law* (The Hague: Kluwer Law International).

Mungiu-Pippidi, A. 2008. "The EU as a Transformation Agent. Lessons Learned from governance reforms in East Central Europe," *Hertie School of Governance – Working Papers* 33.

Sajo, A. 2006. "Becoming Europeans: The Impact of EU Comstitutionalism on Post-Communist Pre-Modernity," in W. Sadurski, A. Czarnota, M. Krygier (eds), *Spreading Democracyand the Rule of Law? The Impact of EU Enlargement on the Rule of Law, Democracy andConstitutionalism in Post-Communist Legal Orders* (Netherlands: Springer): 175-192

Trauner, F. 2011.*The Europeanisation of the Western Balkans: EU Justice and home affairs in Croatia and Macedonia* (Manchester: Manchester University Press).

Schimmelfennig, F. 2012. "Europeanization beyond Europe," Living Reviews European Governance 7 (2012), 1

Freyburg,T. and S. Richter. 2008. National Identity Matters: The Limited Impact of EU Political Conditionality in the Western Balkans. National Centre of Competence in Research (NCCR). Challenges to Democracy in the 21st Century. Working Paper 19.

Checkel, J. T. 2005. "International Institutions and Socialization in Europe: Introduction and Framework," International Organization 59(4): 801-826.

Linden,R. H., P. Cernoch, R. W. Clark and A. Freyberg-Inan (eds). 2002. Norms and Nannies. The Impact of International Organizations on the Central and East European States (Lanham: Rowman and Littlefield Publishers)
Schimmelfennig, F. and U. Sedelmeier (eds). 2005. The politics of European Union enlargement: theoretical approaches Routledge advances in European politics (UK; New York: Routledge).

March, J. G. and J. P. Olsen. 2004. "The Logic of Appropriateness*," Arena Working Papers* 04/09 (Oslo).

Hughes, J., G. Sasse and C. Gordon. 2004. "Conditionality and compliance in the EU's Eastward enlargement: regional policy and the reform of sub-national governance," *Journal of common market studies* 42(3): 523-551

Schimmelfennig, F. and U. Sedelmeier (eds). 2005. The politics of European union enlargement: theoretical approaches Routledge advances in European politics (UK; New York: Routledge).

Grabbe, H. 2006. *The EU's Transformative Power: Europeanization through Conditionality in Central and Eastern Europe* (London: Palgrave Macmillan).

Sedelmeier, U. 2011. "Europeanization in new member and candidate countries," *Living Reviews in European Governance* 6(1).

Levitsky, S. and L. Way. 2004. "International Linkage and Democratization," *Journal of Democracy* 16(3): 20-34.

Bibliography

Books and Monographs

1. Anderson, Richard D., M. Steven Fish, Stephen E. Hanson, and Philip G. Roeder, eds. 2001. Postcommunism and the Theory of Democracy. Princeton: Princeton University Press.
2. Bunce, Valerie, Subversive Institutions: The Design and Destruction of Socialism and the State, Cambridge: Cambridge University Press, 1999.
3. Ekiert, Grzegorz and Hanson, Stephen E., eds. 2003. Capitalism and Democracy in Central and Eastern Europe: Assessing the Legacy of Communist Rule. Cambridge: Cambridge University Press.
4. Hobsbawm, Eric and Ranger, Terence (eds.), The Invention of Tradition. Cambridge University Press, 1983.
5. Fleiner, Thomas/Basta Fleiner, Lidija R., Constitutional Democracy in a Multicultural and Globalized World, Springer, Berlin, Heidelberg, 2009.
6. Fukuyama, Fancis, The End of History and the Last Man, Avon Books, New York, 1992.
7. Tsebelis, George, "Nested Games: Rational Choice in Comparative Politics", Berkley University Press, Berkley, 1990.
8. Grabbe, Heather, The EU's Transformative Power: Europeanization through Conditionality in Central and Eastern Europe, Palgrave Macmillan, London, 2006.
9. Jacoby, Wade, The Enlargement of the European Union and NATO: Ordering from the Menu in Central Europe. Cambridge: Cambridge University Press, 2004.
10. Jano, Dorian, The Europeanization of Western Balkans: A Fuzzy Set of Qualitative Comparative Analysis of the New Potential EU Member States, VDM Verlag, Saarbrücken, 2010.
11. KMEZIC, Marko (ed) Europeanization by Rule of Law Implementation in the Western Balkans", *Institute for Democracy Societas Civilis-Skopje, 2014*
12. Kochenov, Dimitry, The Failure of Conditionality: Pre-accession Conditionality in the Fields of Democracy and the Rule of Law: A Legal Appraisal of EU Enlargement, Rijksuniversiteit Groningen, 2007.
13. Linden, Ronald H.; Cernoch, Pavel; Clark, William R. and Freyberg-Inan, Annette (eds.), Norms and Nannies. The Impact of International Organizations on the Central and East European States, Rowman and Littlefield Publishers, Lanham, 2002.
14. Fish, M. Steven, Democracy Derailed in Russia: The Failure of Open Politics, Cambridge University Press, 2005.
15. Vachudova, Milada Anna, Europe Undivided: Democracy, Leverage, and Integration after Communism, Oxford University Press, Oxford, 2005.
16. Risse, Thomas; Ropp, Stephen and Sikkink, Kathryn, The Power of Human Rights, Cambridge University Press, Cambridge, 1999.
17. Putnam, Robert, et al. "Making Democracy Work: Civic Traditions in Modern Italy", Princeton University Press, New Jersey, 1993.
18. Putnam, Robert, "Diplomacy and Domestic Politics: the Logic of Two Level Games", International Organization, 1988.
19. Schimmelfennig, Frank and Sedelmeier, Ulrich, (eds.), The Europeanisation of Central and Eastern Europe, Cornell University Press, 2005.
20. Tamanaha, Brian Z., On the Rule of Law: History, Politics and Theory, Cambridge University Press, Cambridge, 2004.
21. Trauner, Florian, The Europeanisation of the Western Balkans: EU Justice and home affairs in Croatia and Macedonia, Manchester University Press, Manchester, 2011.
22. Zielonka, Jan, Europe as Empire. The Nature of the Enlarged European Union, Oxford University Press Oxford, 2006

Working Papers and Book Chapters

1. Cortell, Andrew P., Davis Jr., James W., Understanding the Domestic Impact of International Norms: A Research Agenda, International Studies Review, Volume 2, Issue 1, 2000, pages 65–87.
2. Cirtautas, Arista Maria and Schimmelfennig, Frank(2010) 'Europeanisation Before and After Accession: Conditionality, Legacies and Compliance', Europe-Asia Studies, 62: 3, 421- 441.
3. Czarnota, Adam, Barbarians ante portas or the Post-Communist Rule of Law in Post-Democratic European Union, in WojciechSadurski, Adam Czarnota,

Martin Krygier (eds.), Spreading Democracy and the Rule of Law?, Springer Netherlands, 2006, pp. 283-297.

4. Dimitrova, Antoaneta L., 'The New Member States of the EU in the Aftermath of Enlargement: Do new European Rules Remain Empty Shells?', Journal of European Public Policy, 17:1 (2010), pp. 137-148
5. Dzihic, Vedran and Segert, Dieter, 'Das jugoslawischeRätsel: Enklavendemokratie, Staatsschwäche und ProblemeexternerDemokratieförderung', Südosteuropa Mitteilungen, 03-04/2009 (2009), pp. 51-63.
6. Freyburg, Tina and Richter, Solveig, National Identity Matters: The Limited Impact of EU Political Conditionality in the Western Balkans, National Centre of Competence in Research (NCCR): Challenges to Democracy in the 21st Century, Working Paper No. 19, 2008.
7. Ganev, Venelin I., 'Explaining Democratic Success as an Analytical Challenge: Why are Romania and Bulgaria in the EU?',NewsNet, Vol. 48, No. 4 (2008) .
8. Goetz, Klaus H. and Meyer-Sahling, Jan-Hinrik, 2008, "The Europeanisation of national political systems: Parliaments and executives", Living Reviews in European Governance, 3(2).
9. Gordon, Claire, 'The Stabilisation and Association Process in the Western Balkans: An Effective Instrument of Post-conflict Management?',Ethnopolitics, Vol. 8, No. 3. (2009), pp. 325-340.
10. Grabbe, Heather; Knaus, Gerald and Korski, Daniel, 'Beyond Wait- and- see: The Way Forward for EU Balkan Policy', European Council on Foreign Relations (2010).
11. Pop-Eleches, Grigore, "Between Historical Legacies and the Promise of Western Integration: Democratic Conditionality after Communism." East European Politics and Societies 21(4):142-161.
12. Kitschelt, Herbert P., "Accounting for Postcommunist Regime Diversity: What Counts as a Good Cause?", in Legacies of Communism, edited by GrzegorszEkiert and Stephen Hanson (2003), pp. 49-86, Cambridge: Cambridge University Press.
13. Hughes, James; Sasse, Gwendolyn and Gordon, Claire E (2004) Conditionality and compliance in the EU's eastward enlargement: regional policy and the reform of sub-national governance. Journal of common market studies, 42 (3). pp. 523-551.
14. Checkel, Jeffrey T., 2005. "International Institutions and Socialization in Europe: Introduction and Framework." International Organization 59,4: 801-826.
15. Checkel, Jeffrey T., Why Comply? Social Learning and European Identity Change, International Organization, Volume 55, Issue 03, Cambridge University Press, 2001, pp 553-588.
16. Kochenov, Dimitry, 'Behind the Copenhagen Facade. The Meaning and Structure of the Copenhagen Political Criterion of Democracy and the Rule of Law', European Integration online Papers, Vol. 8, No. 10 (2004).
17. Kochenov, Dimitry, 'EU Enlargement: Flexible Compliance with the Commission's Pre-Accession Demands and Schnittke's Ideas on Music', CSEP Working Paper (Centre for the Study of European Politics and Society, Ben-Gurion University of the Negev), 2005, pp. 1–16.
18. Krygier, Martin, Introduction, in WojciechSadurski, Adam Czarnota, Martin Krygier (eds.), Spreading Democracy and the Rule of Law?, Springer Netherlands, 2006, pp. 1-24.
19. Ladrech, R. (1994), 'Europeanization of Domestic Politics and Institutions: The Case of France', Journal of Common Market Studies, 32:1, 69-88;
20. Ladrech, Robert, 2009, "Europeanization and political parties", Living Reviews in European Governance, 4(1).
21. Lavanex, Sandra and Lehmkuhl, Dirk (eds.), Awitzerland's Flexible Integration in the EU: A Conceptual Framework, Swiss Political Science Review (Special Issue) vol. 15(4), Eley, Weinheim, 2009.
22. Lavenex, Sandra, 2004, "EU External Governance in 'Wider Europe"', Journal of European Public Policy, 11(4): 680–700.
23. Levitsky, Steven and Way, Lucan A., "Linkage versus Leverage: Rethinking the International Dimension of Regime Change." Comparative Politics 38,4, 2006.
24. Levitsky, Steven and Way, Lucan A., 2002. "The Rise of Competitive Authoritarianism.", Journal of Democracy 13,2: pp. 51-65.
25. Magen, Amichai, 'Transformative Engagement Through Law', European Journal of Law Reform, Vol. 9, No.3, (2007), pp. 361-393.
26. Mansfield, Edward D. and Jack Snyder. 1995. "Democratization and the Danger of War.", International Security 20,1: 5-38.
27. March, James G. And Olsen, Johan P., 'The Logic of Appropriateness', Arena Working Papers, 04/09, Oslo (2004).
28. Marko, Joseph et al., 'Re-enforcement of the Rule of Law. Division of Competences and Interrelations between Courts, Prosecutors, the Police, Executive and the Legislative Powers in the Western Balkans Countries', European Commission, Strategic Studies in CARDS 2003, Final Report, July 2004.
29. McFaul, Michael. 2002, "Transitions from Post-communism." Journal of Democracy 16,3: 5-19.
30. Barnett, Michael N. and Finnemore, Martha. The Politics, Power, and Pathologies of International Organizations, International Organization Vol. 53, No. 4 (Autumn, 1999), pp. 699-732.
31. Vachudova, Milada Anna, "Democratization in Post-Communist Europe: Illiberal Regimes and the Leverage of the European Union," in Valerie Bunce, Michael McFaul and Kathryn Stoner-Weiss, eds., "Democracy and Authoritarianism in the Post-

Communist World," Cambridge University Press, 2009: 82-106.
32. Mungiu-Pippidi, Alina, 'The EU as a Transformation Agent. Lessons Learned from governance reforms in East Central Europe', Hertie School of Governance – working papers, No. 33 (2008).
33. Noutcheva, Gergana, 'Fake, partial and imposed compliance: the limits of the EU's normative power in the Western Balkans', Journal of European Public Policy, (2009), pp. 1065-1084.
34. Pech, Laurent, 'The Rule of Law as a Constitutional Principle of the European Union', Jean Monnet Working Paper, No. 04/09 (2009).
35. Piana, Daniela, In Search of A New Judicial Professionalism: Intertwining Legal and Extra-Legal Values in Post-Authoritarian Training Programs, Web Journal of Current Legal Issues, 2011.
36. Radaelli, C. (2003), 'The Europeanization of Public Policy', in Featherstone, K. and Radaelli, C. (2003) (eds.), The Politics of Europeanization (Oxford: Oxford University Press), 27-56.
37. Rupnik, Jacques. 1999. "The Postcommunist Divide." Journal of Democracy 10,1: 57-62.
38. Sadurski, Wojciech, EU Enlargement and Democracy in New Member States, in WojciechSadurski, Adam Czarnota, Martin Krygier (eds.), Spreading Democracy and the Rule of Law?, Springer Netherlands, 2006, pp. 27-49.
39. Sajo, Andras, 'Becoming Europeans: The Impact of EU Comstitutionalism on Post-Communist Pre-Modernity', in Spreading Democracy and the Rule of Law? The Impact of EU Enlargement on the Rule of Law, Democracy and Constitutionalism in Post-Communist Legal Orders, (eds.) Sadurski, Wojciech/Czarnota, Adam/Krygier, Martin, Springer Netherlands (2006), pp. 175-192.
40. Schimmelfennig, Frank and Scholtz, Hanno (2010): 'Legacies and Leverage: EU Political Conditionality and Democracy Promotion in Historical Perspective', Europe-Asia Studies 62(3): 443-60.
41. Schimmelfennig, Frank and Sedelmeier, Ulrich, 2004, "Governance by Conditionality: EU Rule Transfer to the Candidate Countries of Central and Eastern Europe", Journal of European Public Policy, 11(4): 661–679.
42. Schimmelfennig, Frank, 'EU political accession conditionality after the 2004 enlargement: consistency and effectiveness', Journal of European Public Policy (2008), pp. 918-937.
43. Schimmelfennig, Frank, "Europeanization beyond Europe", Living Reviews in European Governance, Vol 7., No. 1, 2012.
44. Schimmelfenning, Frank, 'International Socialization in the New Europe: Action in an Rational Institutional Environment', European Journal of International Relations, 6:1 (2000), pp. 109-139.
45. Schimmelfenning, Frank, 'International Socialization in the New Europe: Action in an Rational Institutional Environment', European Journal of International Relations, 6:1 (2000), pp. 109-139.
46. Sciarini, Pascal; Fischer, Alex and Nicolet, Sarah, 2004, "How Europe Hits Home: Evidence From the Swiss Case", Journal of European Public Policy, 11(3): 353–378,
47. Sedelmeier, Ulrich, 'Europeanization in New Member and Candidate States', Living Reviews in European Governance, 1(3), (2006).
48. Sedelmeier, Ulrich, 'The EU and democratization in Central and Southeastern Europe since 1989' in Central and Southeast European Politics since 1989, (ed.) Ramet, Sabrina P., Cambridge: Cambridge University Press (2010), pp. 519-536.
49. Sedelmeier, Ulrich, 'The EU's role as a promoter of human rights and democracy: enlargement policy practice and role formation' in The European Union's role in international politics: concepts and analysis, (eds.) Elgstrom, Ole/Smith, Michael, London, Routledge (2006), pp. 118-135.
50. Sedelmeier, Ulrich, 2011, "Europeanisation in new member and candidate states", Living Reviews in European Governance, 6(1), lreg-2011-1.
51. Tamvaki, Dionysia, The Copenhagen Criteria and the Evolution of Popular Consent to EU Norms: From Legality to Normative Justifiability in Poland and the Czech Republic, in WojciechSadurski, Adam Czarnota, Martin Krygier (eds.), Spreading Democracy and the Rule of Law?, Springer Netherlands, 2006, pp. 149-171.
52. Tolstrup, Jakob, 'When can External Actors Influence Democratization? Leverage, Linkages, and Gatekeeper Elites', CDDRL Working Papers, No. 118 (2010), pp. 1-31.
53. Toshkov, Dimitar, Embracing European law: Compliance with EU directives in Central and Eastern Europe. European Union Politics, 9 (3), 2008, pp. 379-402.
54. Treib, Oliver, 2008, "Implementing and complying with EU governance outputs", Living Reviews in European Governance, 3(5).
55. Treib, Oliver; Bähr, Holger and Falkner, Gerda, 'Modes of governance: towards a conceptual clarification', Journal of European Policy, 14:1, (2007), pp. 1-20.
56. Turkalj, Kristian 'Negotiations for the Accession of the Republic of Croatia to the European Union in the Area of Justice ('State of Play for Chapters 23 and 24')', paper presented at the Conference 'Croatia on the Eve of EU Accession: The Path of Reform', 29-30 April 2010, Zagreb, Croatia.
57. Wade Jacoby, „Priest and Patient: The European Union as a Force in the Domestic Politics of Eastern Europe", East European Constitutional Review 8, No.1-2, 1999, pp. 62-67.
58. Wood, Steve 'The European Union: A Normative or Normal Power?', European Foreign Affairs Review, (2009) 14, pp. 113-128.
59. Zirk-Sadowski, Marek, Transformation and Integration of Legal Cultures and Discourses—Poland, in WojciechSadurski, Adam Czarnota, Martin Krygier

(eds.), Spreading Democracy and the Rule of Law?, Springer Netherlands, 2006, pp. 299-311.

60. Zubek, Radoslaw; Goetz, Klaus H., Performing to Type? How State Institutions Matter in East Central Europe, Journal of Public Policy, 30(1), 2010, pp. 1-20.

European Commission progress reports:

61. Bosnia and Herzegovina 2013 Progress Report, Communication from the Commission to the European Parliament and the Council. Enlargement Strategy and Main Challenges 2013-2014. Brussels 16.10.2013 SWD (2013) 415 final http://ec.europa.eu/enlargement/pdf/key_documents/2013/package/ba_rapport_2013.pdf
62. Kosovo 2013 Progress Report, Communication from the Commission to the European Parliament and the Council. Enlargement Strategy and Main Challenges 2013-2014. Brussels 16.10.2013 SWD (2013) 416 final http://ec.europa.eu/enlargement/pdf/key_documents/2013/package/ks_rapport_2013.pdf
63. Montenegro 2013 Progress Report, Communication from the Commission to the European Parliament and the Council. Enlargement Strategy and Main Challenges 2013-2014. Brussels 16.10.2013 SWD (2013) 411 final http://ec.europa.eu/enlargement/pdf/key_documents/2013/package/mn_rapport_2013.pdf
64. The Former Yugoslav Republic of Macedonia 2013 Progress Report, Communication from the Commission to the European Parliament and the Council. Enlargement Strategy and Main Challenges 2013-2014. Brussels 16.10.2013 SWD (2013) 413 final http://ec.europa.eu/enlargement/pdf/key_documents/2013/package/mk_rapport_2013.pdf
65. Serbia 2013 Progress Report, Communication from the Commission to the European Parliament and the Council. Enlargement Strategy and Main Challenges 2013-2014. Brussels 16.10.2013 SWD (2013) 412 final

PROMOTING RULE OF LAW THROUGH EU INTEGRATION IN THE WESTERN BALKANS – PREVIOUS EXPERIENCES AND CURRENT CHALLENGES

Bodo Weber
Senior Associate
Democratization Policy Council

Introduction

Over the last two and a half decades rule-of-law promotion has experienced a remarkable career among Western aid agencies. Starting in the post-socialist countries of Eastern Europe after 1989, the rule of law has become a key target of Western democratization policy and aid strategies in South America, Asia, sub-Saharan Africa, and most recently the Middle East.[i] This relatively new importance given to the rule of law is no less relevant when it comes to the West's efforts to promote democratization and market economic reform in the post-war Western Balkans region, especially in the framework of the countries' European Union (EU) integration processes. Consequently, in the EU's current 2013-14 enlargement strategy the European Commission (EC) stresses the rule of law as a "fundamental value" that remains a "priority for the EU and is now at the heart of the accession process."[ii]

Unlike with previous enlargement countries of Central Eastern Europe, the rule-of-law promotion in the Western Balkans faces the challenge of a double inheritance – a socialist and a post socialist one. In the countries that resulted from the breakup of Yugoslavia the socialist system generally secured the rule of law. The judiciary to a large part functioned based on civil-law traditions that mostly went back to the Austro-Hungarian legal heritage. It did so despite a one-party system and a constitutional framework that functioned beyond the civil-law context. From mid-1980s on, the crisis of the economy and the socialist system as a whole led to a dramatic erosion of the rule of law and legal culture. Just as in Soviet socialist countries this resulted in the expansion of semi-formal and informal networks linking state institutions, party apparatus, and the economy, and of informal acting from within institutions and between institutions, elites and citizens – a phenomenon termed as "systemic corruption" in the post socialist era. On top of this socialist heritage the post-Yugoslav countries were and are still burdened by the negative, authoritarian transformation that took place during the war-decade of the 1990s. During the war years rule of law was de facto suspended. Political leaderships perverted the judiciary and the rule of law in general. Large-scale war crimes, ethnic cleansing, and mass looting were turned into policy instruments that created a culture of impunity. The separation line between the rule of law and lawlessness was intentionally blurred. Judiciaries lived through times of dramatic degradation and decline; many judges and prosecutors left or were "ethnically cleansed", replaced by inexperienced, under- or unqualified personnel, often chosen based on the principle of negative selection. Interference by political elites, economic elites and organized crime reached previously unseen dimensions.

As a consequence, reforms of the countries' judicial systems and efforts to more broadly consolidate the rule of law have taken an even less linear path of transformation than they had in other post-socialist countries of Eastern Europe. Naturally, the rule-of-law promotion gained ever-greater importance in the West's and especially the EU's democracy and economic reform assistance. The EU's enlargement policy history in the Western Balkans in that respect reveals both a learning curve and remaining challenges.

Rule of law promotion in the EU integration context – lessons learned

The European Union's integration toolbox in the field of rule of law has undergone substantial transformation in recent years, moving towards ever-stricter conditionality and from form to substance. The Western Balkan countries have both been the object and recipient of those adjustments of the Union's instruments. These changes are both the result of an evolving understanding of importance of rule of law reforms and the challenges the EU faces in this field. At the same time, changes have also to a large extent resulted from the negative experience the Union has had in the accession of Bulgaria and Romania to the EU countries that gained membership without structural problems like systemic corruption solved. The case of the two countries had done much damage to the EU's enlargement policy as such and the support of enlargement among EU member state constituencies.

As a consequence, the EU substantially altered its toolbox, especially that of the accession negotiations phase of the EU-integration process. The new tools were first applied in the case of Croatia and are currently further fine tuned in the accession processes of Montenegro and Serbia.

Croatia was the first country to face two negotiation chapters dealing with the rule of law. Following Bulgaria's and Romania's accession, the EU divided up the previous chapter on Justice and Home affairs into two chapters, chapter 23 – Judiciary and Basic Right – and chapter 24 – Justice, Freedom and Security. While chapter 24 concentrates on legal harmonization with the *acquis* the new chapter 23 contains political criteria aiming at reform of two crucial areas for the Western Balkan countries – judiciary and anti-corruption policy. This separation of legal and political criteria marked a general shift in approach – one that moved reform conditionality and its monitoring by the European Commission through the mere adoption of laws to assessing the implementation of formal-legal reforms as well as its sustainability. In order to achieve this, besides the new chapter, opening benchmarks and closing benchmarks were introduced for each chapter. [iii]

Croatia needed about a year from opening to closing chapters 23 and 24. Following this first experience with the two chapters, the EU Council in its December 2011 conclusions[iv] paved the way for further evolution of the EU's tools. Starting with the opening of accession negotiations with Montenegro, chapters 23 and 24 were now opened at the very beginning to be closed only at the end of negotiations. In addition, the EU for the first time introduced interim benchmarks as an extra instrument to secure the smooth implementation of reforms.

The EU also strengthened its pre-accession instruments targeting the rule of law. Besides the handling of justice and judicial issues in the formal framework of Stabilization and Association Agreements with the Western Balkan countries, the EU in 2011 introduced a semi-formal format, the pre-accession Structured Dialogue on Judicial Reform. Introduced first in the case of Bosnia-Herzegovina (BiH), it was later also applied to Kosovo. The visa liberalization process introduced additional instruments and conditionality for rule of law reform, especially in the field of anti-corruption policy.

Policy constraints and lessons not learned

Despite these impressive developments in the EU's rule of law promotion policy and policy instruments, the EU also still demonstrates certain weaknesses when it comes to aiding the strengthening of the rule of law in the Western Balkans.

When the EU struggled with competing policy objectives or the general political crisis in one of the (potential) candidate countries in recent years, Brussels regularly undermined its own rule of law promotions policy. In 2011 the EU was struggling with Serbia's "EU and Kosovo" policy defined by then President Boris Tadić. At the same time it was struggling with Serbia's fraud judicial reform. In 2009 the country's High Judicial Council (HJP) and State Prosecutorial Council (SPC) organized a re-appointment process of all judges and prosecutors that left several hundred of them without their prior jobs. Following a successful Constitutional Court appeal HJP and the SPC were forced to conduct a re-examination procedure in 2011. In August that year an internal European Commission report warned that the re-examination was legally fraud and exerted to political pressure. In its progress report published in October the Commission willfully ignored these information and painted a bright picture of the judicial reform. It was only after the report was leaked to the European Parliament that the Commission admitted the situation as it was and put more pressure on Serbian authorities. Following another Constitutional Court decision in 2012 the whole re-appointment process was stopped; the EU-supported judicial reform ended up in failure.[v]

In December 2012 a conflict between the government of the Republika Srpska (RS), the Bosnian-Herzegovinian entity, and the EU over an entity Law on

Courts reached its climax. The draft law had been rejected by the entity, state judges' and prosecutors' associations, and the state-level High Judicial and Prosecutorial Council (HJPC) for undermining the independence of the judiciary and numerous breaches of the state-level HJPC law. Despite EU insistence on the RS amending the law in full compliance with HJPC objections, the RS parliament passed the law largely unchanged. In the background of the longtime lack of political will of the EU (and the U.S.) to counter the RS-leadership's constant attacks on the Bosnian-Herzegovinian state, the then director at the Commission's Directorate General (DG) Enlargement Pierre Mirel in a non-public meeting organized in the framework of the Structured Dialogue pressured HJPC officials to accept a "compromise deal" with the RS ministry of justice. The compromise left a substantial part of problematic and illegal regulations in place, made a mockery out of the principles of the rule of law and undermined the judicial institutions' fight for independence. The damage became even bigger as the RS government, encouraged by its success, subsequently refused to implement the deal. The RS Law on Courts remains in force till today.[vi]

The EU – and the wider international community – has also demonstrated substantial travails in strategically harmonizing its EU integration tools with the phasing out of executive mandate institutions in the judiciary that are rooted in the external state building policy of the post-war era in the region. In 2009 the Peace Implementation Council (PIC) in BiH, based on the positions of EU and U.S. decided to end the mandate of international judges and prosecutors in the organized crime and corruption chamber of the State Court and the Prosecutors Office of BiH. The decision was taken under pressure of then Prime Minister of the RS Milorad Dodik who threatened with a referendum. The decision was taken against the passionate appeal by the Court's president and the chief prosecutor to extend the mandates of their international colleagues for another three years in order to complete the transition strategy. The decision was declared by the Western members of the PIC as a contribution to "ownership". It presented an invitation for domestic political elites to enhance their pressure on the judiciary and resulted in a drastic decline in the prosecution of high level corruption cases.[vii]

In April 2014 the EU decided on the new mandate for its rule of law mission in Kosovo, EULEX, that paved the way for a phase out of the executive mandate of European judges and prosecutors. The assessment of progress made by the domestic judiciary in Kosovo that legitimized the phase out was questioned both internally and externally. The bad handling of the decision-making process on the new mandate by the EEAS caused a serious timing problem in spring 2014. The resulting rush ended up in a decision by the Kosovo Assembly that laid the legal foundations for the new EULEX mandate for 2014-2016. These law amendments, as well as subsequent agreement between EULEX and Kosovo judicial institutions, contained multiple legally problematic provisions that ultimately damage the EU's own rule of law promotion efforts in the already complicated Kosovo environment.[viii]

The role of civil society

Thomas Carothers, a leading expert on democratization policy has warned that Western rule of law promotion policy often comes with a clear idea of necessary legal changes and the transformation of judicial institutions, but that those normative-institutional changes in themselves do not guarantee a sustainable transformation process that leads to an independent, efficient judiciary, the successful fight of systemic corruption, and the establishment of an adequate legal culture.[ix] In order to bring sustainable change, the role of civil society has to gradually move into the focus of the EU's rule of law promotion efforts.

In Croatia in 2011 over 60 non-governmental organizations (NGO) joined forces to become an active player in the country's EU-accession process by way of monitoring and advocating reforms. They assembled as the Platform 112, based on 112 policy reform requests put to the Croatian government. A substantial part of the coalition's activities focused on the rule of law. The coalition remains active even after Croatia's EU entry and thus plays an important role in guaranteeing sustainability of reforms.[x] While the European Commission accepted the Platform 112 as an important partner, the EC paid growing respect to the bottom-up aspect of rule of law reforms in the region in recent years. In Kosovo, the DG Enlargement established a consultation body with civil society organizations on Stabilisation and Association Agreement related reforms that meets parallel to official negotiations between the Commission and Kosovo government representatives. In Serbia the EU Delegation in Belgrade just established a civil society convent that is designed to be a forum that assigns a role to NGOs in the country's accession process. Following social unrest in Bosnia-Herzegovina in February 2014 that centered on citizens' protests against corruption and the weakness of the judiciary in tackling politically sensitive cases, the EU decided to extend the Structured Dialogue and to bring in civil society representatives as participants.

Conclusions

Promoting efficient and sustainable rule of law reforms in the countries of the Western Balkans remains one of the major challenges for the transformation towards stable democracies and market economies. The EU with its integration toolbox represents the key external actor in this endeavor. Practically all countries in the region still face specific, unsolved challenges. In Bosnia-Herzegovina and Macedonia the unresolved status conflicts are instrumentalized by the political and economic elites to undermine the independence of the judiciary. Montenegro is faced with the heritage of systemic, top-down corruption. Serbia is facing the task to profoundly reform its judiciary in the light of the inherited failed judicial reform of 2008-2012. Kosovo is tasked with battling a culture of impunity and a weak judiciary as well as the integration of the about 300 Serb institutions currently remaining on its soil that function under Serbian laws, and which will, even in an ideal scenario, only gradually be integrated into Kosovo's legal and state system.

The European Union, the Commission and its institutions in charge of enlargement policy have demonstrated more awareness in recent years of the relevance of the rule of law promotions and the existing challenges. With the evolution of its integration toolbox the EU now has much better instruments at hand to meet these challenges than it had half a decade ago when it let Bulgaria and Romania enter its club. In order to make use of them the Union should in the future refrain from trading its rule of law promotion objectives for higher, more urgent policy aims. At the same time it should build on its recently established partnership with civil societies in the region.

---

[i] Thomas Carothers, "The Rule-of-Law Revival", in: Carothers (ed.), *Promoting the rule of law abroad*, Washington D.C 2006, p.3-13.

[ii] European Commission, *Enlargement Strategy and Main Challenges 2013-2014. Communication from the Commission to the European Parliament and Council*, Brussel, 16 October 2014, p.6. Available at: http://ec.europa.eu/enlargement/pdf/key_documents/2013/package/strategy_paper_2013_en.pdf

[iii] *Pregovaračka poglavlja 23 i 24 – O čemu pregovaramo*, GIZ Serbia, Belgrade September 2013. Available at: http://www.seio.gov.rs/upload/documents/publikacije/vodic_za_novinare.pdf

[iv] Council of the European Union, *Council conclusions on enlargement and stabilisation and association process*, Brussels 5 December 2011. Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/genaff/126577.pdf

[v] Conversation with EU parliamentarians, Brussels 2012.

[vi] Various interviews with BH judicial officials, international judicial experts, EC and EU member state officials, Sarajevo-Brussels 2011-2014.

[vii] Kurt Bassuener/Bodo Weber, House of Cards: the EU's "reinforced presence" in Bosnia and Herzegovina, Democratization Policy Council (DPC) Policy Paper, Sarajevo-Berlin May 2013, p.11-12. Available at: http://democratizationpolicy.org/pdf/briefs/may.pdf

[viii] Bodo Weber/ Lowell West, *EULEX – Towards an Integrated Exit Strategy*, joint Group for Legal and Political Studies-DPC study, Prishtina-Berlin April 2014. Available at: http://democratizationpolicy.org/uimages/EULEX%20Exit%20Strategy_DPC-GLPS%20Policy%20Report%20%2804-14%29_ENG.pdf

[ix] Carothers, "The Problem of Knowledge",in: Carothers (ed.), *Promoting the rule of law abroad*,, p.21-22.

[x] Information on the coalition available at: http://www.kucaljudskihprava.hr/tekstovi/112-zahtjeva-za-drugaciju-hrvatsku

JUDICIAL REFORMS IN THE REPUBLIC OF MACEDONIA – CONCEPTS AND OBSTACLES

Gordan Kalajdziev
Full time professor
***Iustinianus Primus* Faculty of Law, Skopje**
President of the Helsinki Committee for Human Rights in Macedonia

1. Introduction – rule of law and human rights as an ideal of the new democracy

Just like any new democracy developed after the fall of communism, the Republic of Macedonia showed great enthusiasm in establishing a parliamentary democracy governed by the rule of law, where human rights and liberties would be respected. Adopted after its independence in 1991, the Constitution of the Republic of Macedonia aimed to present the country as a modern European democracy. Some observers go even further to say that the Constitution was overly exaggerated, or that it was too liberal a constitution having too little trust in the police and the executive in general, requiring a court decision for any deprivation of liberty and detention, search, wiretapping, etc. The truth is, the constitutional layout is due more to the enthusiasm of its creators (four university professors, none the less!) and to the previously stated ambition than to the actual system of values reigning in Macedonian society.

Such legal reforms continued in the following two decades with reforms to legislation and in the institutions inspired firstly by the membership in the Council of Europe and then governed by the Euro-Atlantic aspirations of the country.

However, practice has shown that the country governed by the rule of law is a mere shadow and the institutions serve the governing political elites, instead of serving the law. It has been demonstrated that the system of norms does not suffice in itself – unless a relevant system of values is developed and the legal culture of the authorities, institutions, and the population in general fully reach a certain level to adopt these values as their own and be prepared to defend them.

2. Underperformance of the judiciary as a warrant to human rights

2.1. Political (in)dependence of the judiciary.

The idea behind the rule of law is for the citizens to be able to have their rights and liberties protected before the courts of law, in a fair procedure before an independent and impartial court. Independence and impartiality have at least two aspects – institutional, i.e. systemic, and procedural, i.e. functional.

Much effort was done to ensure the independence of the judiciary in the Republic of Macedonia, however the judiciary still seriously struggles with its independence.[1] Having in mind its function to restrict and control the executive, the judiciary has continuously been the target

[1] See: Organization for Security and Co-operation in Europe, *Legal analysis: Independence of the Judiciary*, Skopje, 2009, available at http://www.osce.org/skopje/67584.

of the relevant political power holders. The will to make it politically instrumental has continuously marked governments in the Republic of Macedonia.[2] Hence the introduction of all most modern formal safeguards to the judicial independence, such as a separate judicial budget, the life-long mandate of judges, the establishment of the Judicial Council as a body comprising mainly judges in charge of all major issues referring to the judges, etc. These safeguards have remained without any major impact due to the lack of political will to strengthen them and the misuse of the gaps in the mechanisms. The rather well developed legal norms still leave plenty of room for external influences. Perhaps a little perversely, but the main safeguard to the judicial independence, the Judicial Council, is used as a major tool for influences from the executive over the judicial branch! The process of appointment, dismissal and disciplining of judges is a modern one in legal terms, however it still is "flexible" enough to allow for interventions bringing about the sanctioning of "unfit" judges and promoting the politically loyal ones.[3]

2.2. Systemic problem with the impartiality of the inquisitorial criminal procedure

The procedural independence of the judges has been paid less attention to, mainly in terms of ensuring a fair trial and changing the procedural model from a mainly inquisitorial into a rather adversarial procedure. Therefore, but also due to the nature of the reforms in the criminal procedure in the region, the text hereinafter deals with this issue.

Namely, the courts do not meet their constitutional role of protectors of the citizens against unfounded prosecutions and arbitrary use of police authorities, and the secret investigative methods which are seriously intruding the liberty, privacy or property of citizens in the criminal investigations and against police misuse of power in general. Statistics show that the court is failing to serve its protective function with which it was entrusted by the Constitution.[4] The fact that this "mixed" model has demonstrated to be dysfunctional and that the court is failing to meet its protective function is clearly seen in the court statistics, showing that more than half of the criminals remain undetected and more than 90% of the defendants are convicted.[5] These indicators attest to the thesis that the courts see themselves more as an authority to fight crime and convict suspects, than as a safeguard to a lawful and fair trial in which the defendants will have a fair chance to defend themselves against any charges brought against them. This is indicative to a serious problem not only with the failure of the court in performing its function as a protector of the rights in the criminal procedure on a micro level, but it also points to the serious flaws in the role of the court on a macro level, namely in the context of its role in the system of division of powers, as a protector of the citizens against the executive branch.

3. Reform in the criminal procedure

3.1. Partial reforms – revolution and counterrevolution in the criminal procedure

We already mentioned that the constitutionalism and human rights international law were a strong impetus to a small *due process* revolution in the criminal procedure. The largest impact in Macedonia, as in the whole of Europe, was exercised by the ever-increasing jurisprudence of the European Court of Human Rights in Strasbourg, which is the subject matter of numerous texts.[6] During the nineties, this was reflected in a series of partial reforms prompted by a line of safeguards to the fair trial of suspects.

The new ideas and solutions to the protection of the citizens' rights and freedoms in the criminal procedure failed to be actually established and brought to life, especially when the global priorities changed and a completely opposing trend emerged that tended to reinforce the instruments of the state in an efficient fight against terrorism and corruption. This caused confusion in relation to the priorities and core values of the criminal justice system and principles on which it should stand. The new institutions served by Europe with regards to witness protection, use of special investigative techniques and likewise was considered as a brand new trend that has contributed to a notable erosion of the human rights protection in the criminal procedure, which was adversely reflected on the possibilities for efficient defense of the suspects, i.e. defendants for the purpose of promoting efficiency.

Organized crime, corruption and terrorism prove to be a serious threat to society, nonetheless fighting them is misused as a justification for the state to implement aggressive methods at the expense of the right to privacy of a large (practically undefined) number of citizens and the right to a fair trial for the defendants. This is certainly not only a feature of Macedonia, since the same devi-

2 See: М. Цаца-Николовска и др., *Анализа на независноста на судството во Република Македонија*, Институт за човекови права, Skopje, 2013.

3 See: М. Ристова, *Одговорност на судиите во Република Македонија*, Скопје, 2012.

4 The courts, as a rule, authorize investigations, search, wiretapping, etc., without establishing if there truly is a reasonable suspicion for a criminal offence and whether the police truly has the basis to believe that the object of the person wanted is truly located in the premises of the person being searched, whether there truly is a risk for the detainee to flee, commit a new crime, affect the investigation, etc.

5 See: State Statistics Office of the Republic of Macedonia, *Criminal Offenders in 2013*, Skopje, 2014 (www.stat.gov.mk).

6 See: S. Summers, Fair Trials - *The European Criminal Procedural Tradition and the European Court of Human Rights*, Hart Publishing, 2007.

ations are also encountered in Russia, and also in some other "new democracies".[7]

The adverse effect from these new trends – referred to by some as a *counterrevolution* in the criminal procedure – on the human rights and principles of a country governed by the rule of law in the Western Balkan countries, similarly as in other young democracies from Central and Eastern Europe, are rooted in the fact that these countries simply lacked the time and conditions to set up the safeguard mechanisms and instruments applicable by the law enforcement authorities in a way that would guarantee minimum misuse. Hence, the human rights and due process model was replaced over night by a crime control model.[8]

3.2. New model of adversarial procedure

The Macedonian legislator therefore decided to fully abandon the paternalism of the court and opt for the introduction of an adversarial procedure. The primary aim of the reform was to speed up the procedure and ensure greater fairness, by meeting all standards for a fair trial and human rights protection. The reduction of the court to a controller of the lawfulness and guarantor of the rights and freedoms instead of it being an active investigator enables it to decide impartially on the questions of detention, special investigative techniques, search, etc. Not being obliged to actively investigate the case on its own, the pre-trial judge will better perform their protective function than what is the case at present with the investigative judges who has the burden of clearing up the case themselves. Hence, the abandonment of the mixed model of a largely inquisitorial procedure, on the account of it being out-dated, should contribute to the promotion of the impartiality of the court, thus creating conditions for a fairer trial in which, instead of confronting the defendant, the court shall act as a safeguard to the lawfulness of the procedure and the defendant's rights and liberties. Secondly, it is believed that the lifting of the court's burden will in itself lead to an acceleration of the procedures and will increase the efficiency of the judiciary.

3.3. Selective (mala fide) implementation of the reforms

However, as the matters stand, the executive is once again being partial in their reform implementation. The police are thus choosing which innovations to introduce, mainly opting for the ones that go in favor of its power and efficiency. The Police Act has taken over (and modified) only the matters and authorizations to their liking. There is not even a mention of the Judicial Police, which is to be governed by the Public Prosecution Office. Namely, the constitution of a judicial police was to overcome the problems of the so-called *hierarchical dualism* within the criminal police and to "break down" the monopoly of the Ministry of the Interior with regards to the investigation capacities in favor of the public prosecution office.[9]

The situation with the international standards is similar. Namely, the latest EU directives on the rights of the suspects, which are obviously aimed to bringing back the balance between the authorizations of the state law enforcement authorities and the rights of the suspects, are not even mentioned in Macedonia!

4. In lieu of a conclusion

It can be concluded that the Republic of Macedonia, as most other transition countries, is witnessing a discrepancy between the modern legal order, *bona fide* established on the models of the western democracies, and its *mala fide* implementation in practice. It appears that little attention is paid to the development of the democratic capacities of the institutions and the state in general, whereas there is somewhat a naïve belief in the power of the legal norms and concepts. This also goes for the international community and international organizations that are pressuring for larger systemic reforms without there first being conditions for their consistent implementation. As we have already seen, the aforementioned new investigative methods insisted upon by the USA and Europe, have turned into a serious threat to the democratic values and institutions instead of defending them. While the national law and practice are mainly harmonized with the European standards for independent judiciaries and fair trials, ensuring full respect for the human rights, it is still necessary to promote the mechanisms and the overall political climate which will guarantee their implementation in practice in order to make them real and efficient, and not merely theoretical and illusory.

---

[7] See: A. V. Orlova, Organized Crime and the Rule of Law in the Russian Federation, *Essex Human Rights Review*, Vol. 2 No. 1, p. 23, available at http://projects.essex.ac.uk/ehrr/V2N1/Orlova.pdf.

[8] See: G. Kalajdjiev, *On Fight against Organized Crime and the Rule of Law*, Skopje, 2012, available at: http://soros.org.mk/dokumenti/za-borbata-so-organiziraniot-ang.pdf

[9] The establishment of the *judicial police* aims, *inter alia*, to break away the criminal police from political influences on top of the Ministry of the Interior and to subdue it to the Public Prosecution Office. See more in: G. Kalajdziev, New Relationships between the Police and the Public Prosecutors Office in the Republic of Macedonia, *Iustinianus Primus Law Review* Vol. 2, 2011, available at: http://www.law-review.mk/pdf/02/Gordan%20Kalajdziev.pdf.

PROMOTING RULE OF LAW THROUGH EU INTEGRATION IN THE WESTERN BALKANS – PREVIOUS EXPERIENCES AND CURRENT CHALLENGES

Hande Özhabeş
Project Coordinator
Democratization Program
Turkish Economic and Social Studies Foundation (TESEV), Istanbul

The need for a permanent reform in the justice system began to be accepted as a fact in particular in conjunction with Turkey's process of membership in the EU, and a number of steps have since been taken in this regard.

An overview of judicial reform in Turkey

Ever since its establishment, the judiciary in Turkey has functioned as a means of disciplining society of which it has always been suspicious. The aim of the judiciary, therefore, was not to secure the rights of individuals and the community vis-à-vis the state, but to ensure that individuals would not become a threat to the state. As a result, although the nature of the perceived threat has changed over time, the essence of the judiciary has stayed the same.

As such, the judicial system has been unable to adequately satisfy citizens' need for justice; on the contrary, rights and freedoms have often been ground up in the cogwheels of this justice system, particularly during periods in which the state's reflex toward self-preservation is high. The need for a fundamental reform in the administration of justice in Turkey, therefore, has long made itself felt.

Important indicators of the extent to which the justice system actually harms individuals are the statistics of the decisions taken by the European Court of Human Rights (ECHR). Between 1995 and 2010, the ECHR ruled against Turkey a total of 2,573 times, the highest number among all other member countries of the Council of Europe. Among these decisions, 699 related to the right to a fair trial, 516 related to the right to liberty and security, and 440 dealt with the extreme length of trials.[1] These data demonstrate the existence of a systematic and functional defect within the judicial system. Moreover, a close look to the ECHR decisions reveals that it was certain segments of Turkish society, particularly Kurdish citizens, Alevi community, leftists and Islamists, who suffered most from this system as the state's perception of threat changed over time.

The steps taken to correct the defects of the justice system in Turkey, meanwhile, had generally been taken haphazardly in order to correct only the most urgent problems. As such, they stemmed the flow of blood but did not create permanent solutions for the illness. After Turkey officially won the status of candidate for mem-

[1] ECtHR Annual Report 2010, p. 157, http://www.echr.coe.int/Documents/Annual_report_2010_ENG.pdf

bership in the European Union (EU) in 1999, the first motions could be heard in the direction of a strategic reform of the judiciary. Having determined that Turkey met the Copenhagen criteria, the EU decided to officially begin accession negotiations with Turkey in 2004. During this process, EU officials asked the Turkish Ministry of Justice to prepare a strategy to enhance the independence, neutrality, and effectiveness of the Turkish judicial system (Chapter 23, Judiciary and Fundamental Rights) and to present this strategy to the European Commission. In 2008, the ministry established a commission for this purpose and prepared a "Strategy for Judicial Reform and Action Plan." This document outlined the strategic goals for judicial reform which included strengthening the independence, neutrality, efficiency and effectiveness of the judiciary and facilitating ease of access to justice.

In addition to reforms aimed at improving judicial institutions in general, 2010 saw a wave of reforms that effected a change in the structure of the highest judicial bodies in particular. The government of the Justice and Development Party (AK Parti), pursuing the mission with which it has charged itself, raised the issue of constitutional amendments in 2010 with a discourse directed at transforming the high courts into institutions that are "more modern, pluralist, and tied to the principle of the rule of law." On 12 September 2010, Turkey decided in a referendum to amend the constitution to, among other things, radically change the makeup of the High Constitutional Court and the High Council of Judges and Prosecutors (HSYK) and to restrict the competence of military courts to military crimes only. Following the referendum results, significant changes were made to the membership and electoral procedure of the Constitutional Court and the HSYK. While this process did render the structure of the HSYK more pluralist than before, it also initiated a debate about the institution's independence, given the increasing role of the Justice Ministry in the institution, the HSYK elections, and practices like removing prosecutors from certain critical cases. Aside from these changes, the 2010 constitutional amendments also made it possible for individuals to appeal directly to the Constitutional Court and appointed a government ombudsman.

The Judicial Reform Strategy was updated by the ministry in 2012 and is due to be completed. One of the important goals of the strategy report was "to prevent the violation of human rights arising from judicial practices and regulations and to strengthen human rights standards." It was in this framework that, since 2011, a series of judicial reform packages were enshrined into law. The judicial reform packages ensured that significant progress was made toward fulfilling the long-felt need for a reform of various problematic aspects of legal provisions that violated basic rights and freedoms.[2] Among these, the amendments to the Turkish Penal Code (TCK) and Anti-Terror Act (TMK) were particularly important.

Though Turkey won the status of official EU candidate in 1999 and laws in all fields were integrated quickly into EU norms, the slowest and most troublesome change has most likely been in the regulations that seek "to protect the state and the constitutional order" – criminal law, sentencing, and law enforcement. Due to a number of articles in these laws, Turkey's stance on freedom of expression, freedom of assembly, respect to right to freedom and respect to right to a fair trial has been causing harsh human rights abuses. The government has taken important steps to change these laws according to the principles of European Court of Human Rights. However, their implementation lags behind.

The latest amendment to the law system was introduced on March 2014 which abolished the Specially Empowered Courts. State Security Courts which entered the Turkish judiciary with the March 12, 1971 "coup by memorandum" have been operational as Specially Empowered Courts since 2004. These special courts, different from general judiciary, had the authority to carry out special investigation procedures which led to a double standard in criminal law proceedings, and thereby an open violation of the fair trial principle. Additionally, due to the past legal practices in cases such as the Kurdistan Communities Union (KCK), Sledgehammer (Balyoz) and Ergenekon trials, these courts came to be seen by the public as legal bodies utilizing the law as a political instrument rather than a means to ensuring justice for all.

Due to the latest amendments, the defendants of Ergenekon and Sledgehammer cases have been released one by one. On the other hand, there are approximately 4,000 people today still imprisoned because of KCK cases. This clearly shows that the legal assurances given on paper are no guarantee for fair legal practices. Furthermore, these decisions have strengthened the perception that there exists no legal guarantee in terms of equal application of the same rules to everyone.

A closer look at judicial independence

In Turkey, judges and prosecutors are governed by a constitutionally independent body, the High Council of Judges and Prosecutors (HSYK). It is the authority responsible for their appointment, promotion and removal. The lack of independence of HSYK from the executive branch is problematic. The president of HSYK is the Minister of Justice and the Undersecretary of the Ministry of Justice is the *ex officio* member of the

[2] For a detailed examination of the content of judicial reform packages, please see "Judicial Reform Packages: "Evaluating Their Effect on Rights and Freedoms", TESEV Publications, November 2013.

Council. The Minister has powers such as determining the agenda, the appointment of the Secretary General among three candidates selected by the General Assembly, and he/she gives the ultimate decision whether or not an investigation proposed by the Council shall be opened or not. The executive's interference in the judiciary harms the independence of the tenure of judges and prosecutors, which puts them under political pressure.

With the amendment to the law on High Council of February 2014, the Minister of Justice has acquired additional powers in the Council. According to this change, the minister was able to appoint the head and the deputy head of the Inspection Board. This amendment was installed right after the December 17 corruption scandal, which the government perceived as an attempted coup by an ideological group – *cemaat* – within the judiciary. Correspondingly, more than 2,500 judges and prosecutors were replaced.[3] Although the Constitutional Court cancelled this amendment, it was a clear sign of the power struggle over the HSYK between the government and another ideological group.

Main impediments and conclusions

The need for a permanent reform in the justice system began to be accepted as a fact in particular in conjunction with Turkey's process of membership in the EU, and a number of steps have since been taken in this regard. Since she was given an official candidate status, Turkey has taken important steps to align its laws to *acquis communautaire*. However, when it comes to the implementation of these laws, there are still important deficiencies.

As important as the way in which the activities of the judiciary are carried out, the institutional structure of the judicial bodies, and the related legal regulations, is the perspective with which they have been approached. This perspective, a reflex to protect the state before the individual, originates in the system of organization in the judiciary and in the goal of judicial activity itself. This perspective is manifested in the spirit of the 1982 constitution. This mindset is clearly the reason that the progress in the legal environment could not fully effect the expected changes in practice.

What is highly problematic in Turkey is how and with what aim the judiciary is organized. Legal amendments instituted without changing this judicial structure will only have a very limited impact in practice. In order for the judicial system in Turkey to ensure justice for all regardless of subject, the judiciary needs to attain a pluralistic character; it should be open to outside monitoring, answering, and prioritizing the needs of the society. A pluralistic character within the judiciary necessitates an institutional reform to make the selection and appointment of judges based on solely transparent and objective criteria.

This structural change can only be realized if, through a new constitution, the judiciary attains a democratic, pluralistic character and turns into a mechanism that interacts with and operates for the public.

---

3 Hurriyet Daily News, "Gov't replaces more than 2,500 judges and prosecutors in latest mass purge", 12 June, 2014. Accessible at: http://www.hurriyetdailynews.com/govt-replaces-more-than-2500-judges-and-prosecutors-in-latest-mass-purge.aspx?pageID=238&nID=67702&NewsCatID=338

MEASUREMENT OF THE INVESTMENT CLIMATE VERSUS INVESTMENT IN THE WESTERN BALKANS

Silvana Mojsovska
Fulltime professor
Institute of Economics
University St. Cyril and Methodius, Skopje

Introduction

This discussion paper considers the relationship between the assessments of the business investment climate in the Western Balkans and the actual levels of investment in the region. The paper provides a brief overview of the Doing Business Report's ranking of the countries in the region, as well as selected scores according to the Bertelsmann Transformation Index (BTI), along with investment data for each country, including data on Foreign Direct Investment (FDI). Based on an analysis of the presented data, a discussion about the relevance of the investment climate measurement for the foreign investors is offered, as well as notes about the reform focus of the policymakers concerned with investment in the region.

Outlook of the investment climate in the Western Balkan countries

According to the 2014 World Bank Doing Business Report, on average around the world, starting a business takes seven procedures, 25 days and costs 32% of income per capita in fees.[1] These data for the Western Balkan countries (Croatia is included in the region for comparison purposes, although European Union (EU) member from 2013) ranged from two procedures, two days and costs of 1.9% of income per capita (Macedonia) up to eleven procedures, 37 days and costs of 14.9% to start up business (Bosnia). The Doing Business Report provides indicators about the business regulations for domestic companies, but it could also serve as guidelines for foreign investors, given that foreign companies must respect the domestic regulations. Additional incentives for foreign investors do apply, as well as further regulations with regards to some issues, but the investment climate is primarily determined by the overall economic conditions in the country. In this respect, the Western Balkans' performances in the Doing Business Report could be considered relevant to the general investment climate.

The data referring to the Western Balkan countries ranking in the Doing Business Report 2014 are presented in Table 1 (please see appendix). As evident from the indicators, Macedonia has the highest overall rank compared to the countries from the region, as well as relatively high rank (25th position) in the total ranking of 189 economies. Montenegro is second ranked in the region and holds 44th on the global list, while other countries have much lower ranking. With regards to the specific (sub) indicators, the results also vary, showing discrepancy in the reform focus of different countries.

[1] Doing Business Report 2014, World Bank, Washington, p.1.

As evident from the data, Macedonia has outstanding results related to reforms for starting a business and getting credit (rankings 7 and 3), while it is seriously lagging behind with regards to enforcing the contracts (rank 95), trading across the borders (rank 89), and registering property (rank 84). However, troubles in reforms related to the latter (three) areas seem to be common for all Western Balkans countries, as other countries do not have encouraging indicators either. Another serious issue for the Western Balkan countries is related to construction permits, which includes rather complicated and long-lasting procedures.

Further on, an additional area of concern for most of the Western Balkan countries is related to the protection of investors. Apart from Albania, Macedonia, and Montenegro, other countries are performing quite poorly with regards to this index, measuring the strength of minority shareholders protections against directors' misuse of corporate assets for personal gain.[2] On the other hand, Croatia, an EU member since 2013, has a considerably low rank on the latter (sub) index, as well as in other (sub) indexes, too, which provokes doubts about the determining relevance of these indicators with regards to the EU integration process, as well as for foreign investors.

Another index that could be analyzed with regards to the investment climate of the Western Balkan countries is the Bertelsmann Transformation Index, which measures progress in a number of fields such as democratization, economic performance, and governance reforms. The index ranks from 1 (lowest) to 10 (highest). As evident in Table 2 (please see appendix), presenting data for 2014, Croatia scored better in all (sub) indices (apart from the macro-stability) compared to other countries in the region, showing overall progress compared to its neighbors. Nevertheless, other countries also scored relatively well in most (sub) indices, indicating that the process of transformation of the countries has reached a certain level of democratization and market economy. Most of the countries (primarily Albania, Bosnia and Herzegovina, and Kosovo) lack efficient administrative capacity and other assets for transformation, along with the need for more efficient anti-corruption policy, which has been also recognized by the European Commission as a problematic field for all the countries in the region. In this respect, it could be concluded that all Western Balkan countries made certain progress with regards to transformation towards a stable political and economic environment, which is a precondition for the successful running of domestic businesses and attraction of foreign investors. There are issues to be solved, but apparently, the countries are not doing considerably worse compared to other economies, including some of the EU member states.

[2] Ibid, p. 142.

The indicators above provide an overview over some matters relevant for investors, either domestic or foreign. As suggested in the Doing Business Report, countries get indication in which areas further reforms are needed. In addition, many other "measurements" of the investment climate, as well as progress in other areas have been done for the Western Balkan countries, including the European Commission's Progress Country Reports, the Organization for Economic Co-operation and Development (OECD) Investment Compact for South Europe, etc. In this respect, there is plenty of information for investors, as well as for policy-makers to push reforms. On the other hand, the upbeat ranking and favorable scores need to be confirmed with genuine results in investment, which is an ultimate goal of the reform processes in all these countries.

Investment in the Western Balkans

Investment in the Western Balkans could be analyzed through gross fixed capital formation (which excludes financial investment) and FDI. The gross fixed capital formation in the Western Balkans as a percentage of the Gross Domestic Product (GDP) varies across the countries, ranging from 17% in Albania to up to 30% in Macedonia in 2012 (latest year with available data for all countries), as presented in Table 3.

Table 3: Gross fixed capital formation in the Western Balkans, 2009-2012 (as % of GDP)

	2009	2010	2011	2012	2013
Albania	18	18	17	17	17
B&H	18	17	21	22	n.a
Croatia	24	21	20	19	18
Macedonia	20	19	21	30	29
Montenegro	27	21	18	19	18
Serbia	19	18	18	21	n.a
Kosovo	25	28	29	27	n.a

Source: World Bank Data base (http://data.worldbank.org/indicator/NE.GDI.FTOT.ZS).

Most of the countries in the region have a higher share of gross fixed capital formation compared to 18% in the EU (2011), which is not unusual as developing countries' governments tend to spend more in public investment (roads, public buildings, etc.) in order to spur economic growth. As notable from Table 3, Macedonia has increased its gross fixed capital formation from 20% to 29% of GDP over the period 2009-2013, while Montenegro has experienced a reverse trend of decrease from 27% down to 18% of GDP during the same period, along with Croatia, where this indicator dropped from 24% to 18%. Most of the increase in the gross fixed capital formation in Macedonia has been attributable to the government's spending, while the decrease in other countries could be related to their prudent fiscal policy, as well as to the decrease in FDI.

Although finances are excluded from the gross fixed capital formation, a recent study by Estrin and Uvalic[3] suggests that FDI has contributed quite substantially to gross fixed capital formation in the Western Balkan countries from 2003 onwards. During the 2003-11 period, the ratio of FDI to gross fixed capital formation has been, on average, 32 percent for the whole region (Kosovo is excluded as no data were available, while Bulgaria and Romania are included), but it has been particularly high in Montenegro (over 70 percent) and Serbia (over 30 percent).[4] This indicates that FDI contributed a lot to the increase of capital assets in the countries, by transfer of technology and equipment. This is certainly important for the Western Balkan countries striving to increase their industrial/economic base.

Despite the important role of FDI in the Western Balkans as suggested above, it could not be argued that these countries received substantial amounts of FDI so far. Apart from Croatia, Serbia and Montenegro (FDI measured relative to the size of its economy), the other countries, in particular Macedonia and Bosnia, have not managed to attract many investors. Crises of 2008 onwards are mostly stated as a reason for the overall fall of the investment on the global level, which certainly affects the region, too.

Table 4: FDI Inflows in the Western Balkans, 2008-2013 (millions of US$)

	2008	2009	2010	2011	2012	2013
Albania	974	996	1051	876	855	1225
B&H	1002	250	406	493	366	332
Croatia	5938	3346	490	1517	1356	580
Macedonia	586	201	212	468	93	334
Montenegro	960	1527	760	558	620	447
Serbia	2955	1959	1329	2709	365	1034
Kosovo	n.a	n.a	n.a	n.a	n.a	n.a

Source: World Investment Report 2014, UNCTAD, p. 208.

If the data presented in the Tables 3 and 4 was analyzed from the perspective of the Doing Business Report rankings, as well as BTI index, there would be visible discrepancy in the case of Macedonia, promoted as a front-runner in the regulatory reforms in the region over the past decade. It also has solid BTI results, indicating stable political and economic environment for the investors. Apart of the extensive reforms which brought the country high rankings for doing business, Macedonia has been also pursuing intense campaign for attraction of FDI, including immense FDI incentives, media advertisement, road shows, etc. However, the results were not as expected, indicating that the foreign investors base their decisions on numerous factors, with good regulation and favorable business climate being only part of them. On the other hand, Montenegro, which has a relatively good overall ranking, but needs to undertake substantial reforms with regards to construction permits and enforcement of the contracts, has attracted a decent amount of FDI in the past years. The majority of them were related to tourist properties, including the element of construction permits, too. Serbia has also attracted substantial investment, despite its relatively low rankings in some areas, suggesting that the focus of the policy-makers should be primarily on the drivers for foreign investment, as it could be said that investment climate measurements do not have a determining impact in the final stages of FDI decision-making.

The classical literature distinguishes three main drivers of FDI: a) the size of the host economy; b) the size of the source economy; and c) the distance between the two economies, while the contemporary literature also considers the costs of production, especially unit labor costs, natural resources, institutional framework facilitating or inhibiting the operations of foreign investors, membership of international trade and economic associations, including EU, etc.[5] The primary factors are particularly important for the region, given the small size of the region in general, and particularly of some countries (Montenegro, Macedonia, Albania). In this respect, no regulation could help this factor prevail (apart from case when a country has natural resources, such as Montenegro), implying the need for strategic alliances and regional integration, so the countries would be part of a broader market.

Regional integration has been on the agenda of the Western Balkans' path towards the EU, but the overall impression is that countries engage in the activities related to regional integration mostly when pressured by EU, while there is no genuine intra-regional and intra-industry connection. The integration of the industries from the Western Balkans in the global supply chains have been low, which could be also considered as a factor in FDI decision-making. In this respect, a switch in the investment policy-making in the Western Balkans towards the region could be useful, primarily consisting of shaping an individual country's investment policy according to the region's specifics. The idea of the development of the regional investment concept has been already put on the agenda of the Central European Free Trade Agreement (CEFTA) for 2014,[6] although no activities have been undertaken yet. This could be a good step forward toward an increase in the awareness of the Western Balkans countries of the economic/industrial characteristics of the their neighbors, which is crucial for making less isolated investment policies in the region. In this respect, regulation and investment climate

[3] Estrin and Uvalic, Foreign Direct Investment in the Transition Economies: Are the Balkans different?, LSE, LEQS Paper-No.64/2013, July 2013.

[4] Ibid.

[5] See more in Estrin and Uvalic, op. cit, 26.

[6] http://192.232.255.119/~cefta/sites/default/files/Priorities%20Macedonia%20Chairmanship%202014.pdf.

measurements are certainly important, but only as tools to well-designed and targeted investment policy.

Conclusion

There are various measurements of the investment climate covering different indicators, which provide an overview about the state of affairs in a particular country with regards to running a business, but they do not seem to have a determining impact on the final decision of the foreign investors. The short analysis related to the Western Balkans countries has shown that other factors matter for the investors. In this respect, regulation is an area where countries should further improve, in particular with regards to some issues, and there is a need for design of a sound and targeted investment policy that will bring genuine results.

References:

1. Botric, Valerija, Foreign Direct Investment in the Western Balkans: Privatization, Institutional Change and Baking Sector Dominance, *Economic Annals*, Volume LV, No. 187 / October - December 2010
2. CEFTA Chairmanship 2014 Work Programme (http://192.232.255.119/~cefta/sites/default/files/CEFTA%20Chairmanship%20Programme%20%202014.pdf)
3. Cviic, Christopher and Peter Sanfey, In Search of the Balkan Recovery. The Political and Economic Reemergence of South-Eastern Europe, New York: Columbia University Press, 2010
4. Doing Business Report 2014, World Bank, Washington
5. Estrin, Saul and Uvalic, Milica Foreign Direct Investment in the Transition Economies: Are the Balkans different?, LSE, LEQS PaperNo.64/2013, July 2013
6. Investment Horizons: Western Balkans, MIGA, World Bank, Washington 2006
7. Transformation Index BTI 2014, Bertelsmann Stiftung, 2014
8. WIIW Handbook of Statistics 2012, Vienna Institute for International Economic Studies, WIIW
9. World Bank Statistics (http://data.worldbank.org/indicator/NE.GDI.TOTL.ZS)
10. World Investment Report 2014, UNCTAD

Appendix

Table 1. Western Balkan countries' performances in Doing Business Report 2014

	Overall rank	Starting business	Dealing with construction permits	Getting electricity	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across the borders	Enforcing contracts	Resolving insolvency
Albania	90	76	189	158	119	13	14	146	85	124	62
B&H	131	174	175	164	96	73	115	135	107	115	77
Croatia	89	80	152	60	106	42	157	34	99	49	98
Macedonia	25	7	63	76	84	3	16	26	89	95	52
Montenegro	44	69	107	69	98	3	34	86	53	136	45
Serbia	93	45	182	85	44	42	80	161	98	116	103
Kosovo	86	100	136	121	58	28	98	43	121	138	83

Source: Doing Business Report 2014, World Bank, Washington

Table 2. Transformation index BTI 2014

	Democracy status	Market economy status	Socio-economic barries	Market based competition	Macrostability	Property rights	Efficient use of assets	Anti-corruption policy	Effective use of support
Albania	6,7	6,4	5,0	6,0	7,0	7,0	4,0	4,0	6,0
B&H	6,4	6,4	6,0	6,0	7,0	8,0	4,0	4,0	5,0
Croatia	8,5	7,9	8,0	8,0	7,0	9,0	7,0	8,0	8,0
Macedonia	7,2	7,1	6,0	7,0	8,0	8,0	6,0	6,0	8,0
Montenegro	7,9	7,1	7,0	6,0	7,0	8,0	6,0	6,0	9,0
Serbia	8,0	7,1	6,0	7,0	7,0	7,0	7,0	6,0	8,0
Kosovo	6,6	5,9	5,0	5,0	5,0	7,0	4,0	4,0	7,0

Source: Transformation Index BTI 2014, Bertelsmann Stiftung

ECONOMIC RULE OF LAW FOR DEVELOPMENT IN THE WESTERN BALKANS

Valbona Zeneli
George C. Marshall European Center for Security Studies

Economic challenges in the Western Balkans

After more than two decades of transition and a double dip economic recession, a sluggish recovery seems at last to be under way in the western Balkans. Suffering from a lack of competitiveness and dangerously high public debts, the recent crises have worsened the socio-economic conditions of people in the small region next door to Western Europe, threatening the hopes of convergence with advanced economies. Unemployment is skyrocketing, especially for the young generation, reaching up to 70% in some countries. Levels of poverty are alarming, while high levels of inequality further divide society into the haves and have-nots.

In the "prosperous" decade of the 2000s, inflows of foreign capital and worker remittances had significantly helped economic growth in the region – but, unfortunately these sources declined sharply over the last five years. Development, mainly driven by the accumulation of physical and financial capital rather than human capital, has swollen the current account deficits, while competitiveness remains poor.

The required economic structural reforms are too slow, weakening the chances of a speedy economic recovery and slowing Euro-Atlantic integration progress. Therefore, the region is in a critical juncture: in a desperate need for modernization and reforms under the tough austerity measures. To escape this vicious cycle, good economic drivers and comprehensive policies are needed to implement the necessary reforms and improve competitiveness. These vehicles could be Foreign Direct Investment (FDI)[1], carefully targeted and focused on specific industries, for creating clusters and introducing new skills and technologies. For achieving attractiveness to foreign investors, first countries need to diagnose their potential and build up their positioning strategies before it is too late, not to remain "stuck in the middle", with low cost and differentiated economies. However, little can be done without creating a friendly investment climate and an efficient "economic rule of law".

Foreign direct investments – a driver for development

Foreign Direct Investment has been vital for the smooth transition process in Eastern Europe, driving the economic development of the region, creating better employment opportunities, followed by higher wages and better living conditions. The contribution of FDI to the host economy is widely discussed in literature. FDI's direct impact affects the rate of growth, employment, export propensity, productivity, and competitiveness.

[1] Henceforth FDI

By the same token, the indirect effects influence the performance of domestic companies, by spilling over positive externalities at intra and inter-industry levels. The main positive spillover channels are: transfer of technology and know-how, contribution to the international trade integration, enterprise development, business sector competition, and human capital formation.

Location-specific attractiveness in the form of political and economic stability, property and profit tax system, market size, labor-force composition, geographic proximity, competition, freedom of entry and exit from markets, domestic financial markets, are all factors influencing the volume and type of FDI. In addition, energy and water resources, and infrastructure are some other critical elements. The openness of an economy and the stage of economic-social development are very important because they affect the quality of the supportive institutional infrastructure. The human capital stock, too, has an increasingly significant value, becoming a prerequisite for attracting FDI and absorbing advanced technologies to achieve economic growth.

Southeast Europe (SEE) started gaining the attention of foreign investors at the beginning of the 1990s, as a result of the transition of these countries from state-controlled systems to free market economies. First in the process, the availability of natural resources did play an important role in the attraction of FDI, as well as the incentives offered by governments to stimulate more FDI, alongside a large-scale privatization process. The Euro-Atlantic integration process of the region increased the chances of these small economies in the international market and improved the confidence of serious investors in the business environment. The European Union (EU) integration process introduced in steps the free trade zone, as an intermediary phase towards complete accession to the EU and supported the harmonization of the countries' legislative regulations with the common market's regulations, thus, positively influencing the region's attractiveness for FDI. For countries that joined the EU, such as Romania and Bulgaria, the flows of FDI significantly increased because of the perceived improvement of the business climate. Importantly, agreements for EU accession allow free market access for foreign investors to new and bigger European markets.

However, foreign investors were not scrambling to get into Western Balkans markets, although the countries embraced open investment and free trade regimes. Inbound international marketers have shown little interest in the small region to date. Investors were spooked by lack of stability and development in the region. Southeast Europe is burdened by an image characterized by a history of conflicts, wars, regional disputes, and mistrust among neighbors, as well as high levels of organized crime and corruption. All of these factors increase the risk of exposure (both real and perceived) for businesses considering investing in the region. Though Southeast Europe offers unique opportunities in terms of strategic position, natural resources, relatively cheap labor, and a youthful population, it has still attracted less than 1% of global FDI[2] in 2013. As statistics show, FDI are unevenly distributed in the region, with some countries faring well in this regard and others lagging behind. Montenegro had the highest level of FDI stock in the region in 2013 with 8,665 $ per capita, and Kosovo the lowest, with only 1,214 $ per capita[3].

Determinants for FDI attraction in the western Balkans

To understand the patterns and the main determinants for the attraction of FDI and its impact on the host country's economy, econometric research focused on the eight Southeast European countries during the 1992-2010 timeframe[4]. This research was based on the New Paradigm of Development, where the concept of institutional assets, meaning the quality of the institutions, was determined to be a significant component of the competitive advantages for companies along with the attractiveness of a particular country's location.[5] New insights have shown that determinants such as resources, capabilities and markets are *necessary* for the competitiveness of a company or a country, but not *sufficient* anymore. Hence, an additional attention needs to be given to the quality and content of institutions[6].

The special focus of the research was concentrated in understanding the role of good institutions and structural reforms in attracting FDI. To measure the quality of institutions, the European Bank of Reconstruction and Development (EBRD) reform indicators were considered, which measure seven main areas of structural re-

---

2 Author's calculations based on UNCTAD data. 8 countries of Southeast Europe were considered, Bulgaria and Romania included.

3 Data on FDI from ," *UNCTAD (United Nations Conference on Trade and Development) Statistics*, p. 5, http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx?sRF_ActivePath=p,5&sRF_Expanded=; For Kosovo, author's calculations based on World Bank data, http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD

4 The countries taken in consideration are according the EBRD definition of South East Europe: Albania, Bulgaria, Romania, Croatia, FR of Macedonia, Bosnia & Herzegovina, Serbia, Montenegro over the period 1992-2010. The study aimed to explore the relationship between foreign direct investment and economic growth in Southeast Europe. GMM (Generalized Method of Moments) panel data system techniques were used for the analysis. Major growth factors are taken in consideration in this analysis as initial income per capita in the host country, human capital, trade, inflation, governments spending, domestic investments, and credit to the private sector, remittances, quality of institutions and privatization process.

5 Dunning J. H. (2006) Towards a New Paradigm of Development: Implications for the Determinants of International Business Activity, Transnational Corporations 15 (1) pp. 173–228.

6 According to this new theory, institutions are seen as 'sets of common habits, routines, established practices, rules and laws that regulate the interaction between individuals and groups'. They create the milieu within which innovation is undertaken; establish the ground rules for interaction between economic actors and represent the economic culture of the country.

forms[7]. This study furnished us with empirical evidence that the FDI geographic distribution in Southeast Europe is strongly influenced by the host country's political and institutional quality, reflecting the foreign investors' confidence in the local investment environment. The findings showed that the quality of institutions is strongly positively correlated with the attraction of FDI throughout the region. Strong institutions are considered even more significant than the traditional variables in the foreign investors' decision-making process on where to locate their investments. Among the main reforms considered most important in Southeast Europe are those related to markets trade, the large-scale privatization, and the financial sector. On the other side, it has been statistically proven that, there is a negative relationship between the level of corruption and the attraction of FDI, once again reiterating the negative role of corruption for fostering development through domestic and foreign investments.

The importance of "Absorptive capacities"

The same research provided statistical proof confirming the positive impact of FDI in the economic growth development in the Western Balkans. Nevertheless, this positive relationship is more complex than we think. Not all FDI leads automatically to growth; whether it does depends on the "absorptive capacities" of the host country; important both for attracting and reaping the full benefits of FDI. Benefits of FDI do not accrue automatically and evenly across countries, sectors, and local communities. Instead, they largely depend on the conditions of the host country, where national policies and the investment architecture are very important. Host countries should have a threshold of trade openness, human capital, technological capability, domestic credit, and efficient domestic institutions for FDI to have a positive impact in the host country.

First in our research, trade openness proved to be one of the most significant factors influencing growth through FDI. With a mostly liberalized international trade regime, World Trade Organization (WTO) members, the Western Balkan economies remain mainly import oriented. Even the slight growth of exports usually is driven by existing products toward existing markets, showing the narrow range of destinations as a limit to trade, with most of the exports based on natural resources and unskilled labor.

Second, the quality of the human capital has a twofold importance: for attracting high quality FDI and maximizing its benefits. Countries with a non-highly qualified workforce tend to attract smaller foreign companies, looking for exploitation of cheap labor and investing in mature industries. In such cases, the short-term impact could be positive, through increased employment, with the long-term impact less clear. The development of cognitive skills remains a key factor for growth and innovation in transition countries. The Western Balkans lag behind the rest of Europe, although there are huge differences within the region itself, with Croatia leading throughout all the indicators. Some of the main issues concern: inadequate public expenditures for education, low rate and quality of graduates in science and engineering, underdeveloped vocational education, and training among other factors.

Third, the technological capability of the Western Balkans economies is limited, and the innovation capacity is very low compared to Western European countries. This is supported by evidence of the Western Balkan's very low ranking in Global Competitiveness Report of 2013. The only way for the region to be better exposed to technological "catch up" is through participation in international trade, FDI, and brain circulation.

Fourth, domestic credit has a significant impact on the degree to which FDI lead to positive developments in the western Balkans. It is repeatedly mentioned by international development institutions as one the most problematic factors for doing business, together with the rampant corruption. Despite the indisputable growth of the past two decades, domestic credit to the private sector in the region remains very limited and costly compared to European standards, hindering the domestic entrepreneurship development.

Lastly, an extremely important insight of the research demonstrated the importance of the quality of the institutions as the most significant determinant for the attraction and the benefits of FDI. Good institutions create the standards for a level playing field for business development, competition, and trickledown economics throughout all the sectors of the economy.

The need for economic rule of law

Weak "rule of law" is singled out as one of the main characteristics dominating the Western Balkans. Important steps have been taken for upgrading the regulatory framework for a functioning market economy, mainly due to the EU pull effect. But they remain mainly "on paper". The region is a laggard in ensuring their effective enforcement. Corruption is the other "elephant", representing an additional cost to the economy, distorting market competition, leading to poor allocation of resources and keeping away serious foreign investors. According to the Transparency International's perception index 2013, Albania ranks worse, positioned at the 116th place out of 177 countries researched, followed by Kosovo in the 110th position. The best per-

7 Zeneli V. (2014), The role of institutions and good governance for attracting Foreign Direct Investments: Evidence from Southeast Europe", Business and Economics Journal, Volume 5, Issue 2

former in controlling corruption in the region is Croatia ranking in the 57th place[8]. Red tape, overregulation, corruption, lack of transparency, inability to create a business-friendly economic environment, weak institutions; all of them hurt development in the region.

What is the purpose of the laws and regulations that are central to the functioning of the economy? Why do we need a rule of law? Why do we need an economic rule of law? A functioning rule of law is supposed to ensure fair treatment for all and protect the weak against the strong. The wrong kind of rule of law – which we unfortunately find too often in the Western Balkans – only hinders the overall economic development; extending inequalities in the society, and supporting a small percentage of the population who can use their political and economic power to shape the rule of law to provide a framework within which they can exploit the market place. This systemic process creates a rent-seeking environment, which favors monopolies and hinders the inclusive sustainable development of the country.

Many international observers raise concerns about the quality of democracy, market economy and political management in the new democracies of Western Balkans[9]. Firstly, doubts are raised that democracy in the Western Balkans has turned more into power struggles, creating a gap between elites and average citizens. Second, the institutions of market economy are undermined by the informal economy and the widening social disparities. The fragile institutions that developed over the last two decades were associated with a highly unequal distribution of social resources and opportunities. Institutions of free market economy – free trade and competitive markets, private ownership and property rights – are further undermined by the informal economy, sending a clear message of serious deficits of rules in the market economy. With the economic system viewed not to be fair by its own taxpayers, compliance is not forthcoming which promotes parallel shadow economies. By the same token, inequality is devastating in some areas of the region, reaching extremely high incidences of poverty, with more than 50% of the population living with less than $5 a day, such as in Albania and Macedonia[10]. Economic growth is important for poverty reduction, but growth should benefit more than just few segments of the population to be sustainable and foster the long-term development of a country.

Various indicators, such as the Bertelsmann Stiftung transformation index (BTI)[11], indicate that the Western Balkan democracies suffer from significant deficiencies with respect to the rule of law, the functioning of democratic institutions and stateness, with Croatia scoring significantly higher than the other Western Balkan countries, being indeed closer to Central European countries rather than to the rest of the Balkans.

For all the above mentioned reasons, competitiveness in the Western Balkans is very unsatisfactory, ranking very poorly in the Global Competitiveness report 2013-2014, with an average rank of 99, whereas the EU 27's average score would rank it 35thout of 148 countries taken in consideration[12].

Small markets, such as the ones found in the Western Balkans, require that both companies and governments work in stride beyond their traditional confines, gaining new perspectives and developing new ways of doing business. Being engaged in international marketing – through FDI attraction – is important to businesses, governments, and individuals. When foreign investors consider entering new markets, what they worry most is the quality of the institutions. Hence, governments should focus their efforts on creating a friendly business environment and increasing their attention on curbing rampant corruption in all sectors of their society. Individually, the countries of the Western Balkans are too small and weak to attract desirable high technology investment all on their own, because they lack skilled workers, local financial capacity, and the ability to attract and sustain economic clusters. Hence, the region should strive together for a pooled competition for FDI, which would give a better recognition in the international economy. Institutions, such as EBRD or World Bank, are already engaged in bringing the various stakeholders together in joint platforms where they discuss regional opportunities and challenges, and promote FDI in the Western Balkans[13].

True growth and development is not possible without good governance and rule of law. From this perspective, governments have a huge responsibility to ensure that institutions and societal entities are able to organize and utilize resources, capacities, and markets available to them and at the same time create a friendly business environment for domestic and foreign investors.

Investing in the country's future, through enforcing a fair rule of law, strengthening the economic institutions, ensuring quality education for people, improving judici-

[8] Ranking of the Western Balkan countries in the Corruption perception index 2013: Croatia 57th, Montenegro 67th, FYROM 67th, Serbia 72nd, Kosovo 111th and Albania 116th. http://cpi.transparency.org/cpi2013/results/

[9] Brusis M., and Thiery P., (2006) " Comparing Political Governance: Southeastern Europe in a global perspective", Applied Policy Research paper, No 1

[10] World Development Indicators, http://povertydata.worldbank.org/poverty/region/ECA

[11] Transformation index BTI 2014, Bertelmann Stiftung, http://www.bti-project.org/index/

[12] "The global competitiveness report 2013-2014", World Economic Forum, http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf

[13] http://www.worldbank.org/en/events/2014/03/04/ebrd-conference-investing-in-western-balkans

ary capacities and fighting corruption, would create a climate that supports a high return investment, which in the medium to long run would improve competitiveness and foster development. However, reforms are always painful in the short run; thus, a strong political will is needed to undertake them. The biggest challenges remain for the politicians, whose actions will propel or delay sustainable development in the region. History from the Western Balkans has shown that positive change and reforms are possible and they always pay off.

Table 1: The determinants for the FDI attraction in South-east Europe

Variables taken in consideration	1 Flows of FDI per capita	2 Stock of FDI per capita
GDP per capita	2.507 (0.778)***	1.512 (0.411)***
GDP growth	-0.379 (0.195)**	-0.009 (0.105)
Inflation	-0.144 (0.139)	-0.091 (0.078)
Trade openness	1.234 (0.855)	0.818 (0.461)*
Human development index	-0.644 (4.265)	-3.540 (2.392)
Telephone lines	-1.021 (0.466)**	-0.783 (0.237)***
Private credit	-0.478 (0.342)	-0.331 (0.193)*
Foreign banks	0.395 (0.227)*	0.220 (0.121)*
Natural resources	-0.097 (0.186)	0.123 (0.104)
Tariffs	0.061 (0.175)	0.027 (0.100)
Domestic investment	0.429 (0.753)	-0.053 (0.454)
Remittances	-0.133 (0.121)	-0.104 (0.068)
Privatization	0.147 (0.057)***	0.058 (0.032)*
Quality of institutions (EBRD indicators) $INSTU_{t-1}$	1.523 (0.657)**	0.570 (0.124)***
FDI_{t-1}	0.031 (0.212)	0.163 (0.093)*
Constant	0.042 (0.753)	0.107 (0.061)*
Sargan Test	1	1
SOC Test	0.949	0.208

1. All regression are estimated by GMM Arrellano Bond (one-step) estimator.

2. All the variables are expressed in natural log (ln). Robust Standard errors are reported in parentheses. (***), (**), and(*) indicate coefficient significant at 1, 5 and 10 % respectively.

3. Sargan Test (p-value, Prob >chi2): null hypothesis is no misspecification with the instrument sets, so that the instruments are not correlated with the residuals.

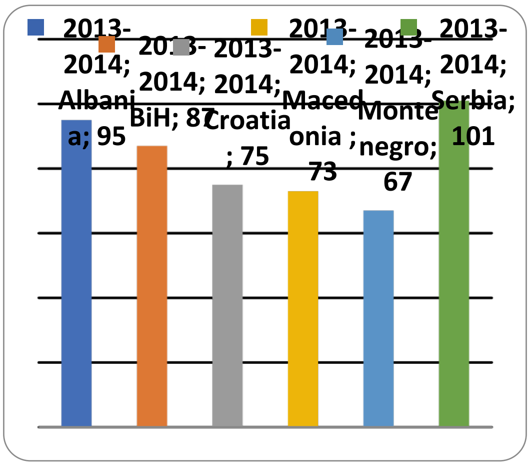
4. SOC test (p-value): Arrellano and Bond Test with null hypothesis of no second-order correlation in differenced term errors, so that the errors in the first difference regression exhibit no second order serial correlation.

Table 2: FDI in the Western Balkans

Country	Flow of FDI per capita 2013 (in US $)	Stock of FDI per capita 2013 (in US $)	Stock of FDI per capita % of world total (in 2013)
Albania	386	1923	0.024
Bosnia & Hercegovina	87	2107	0.032
Croatia	135	7572	0.128
FRY Macedonia	158	2626	0.022
Montenegro	720	8665	0.021
Kosovo	220	1214	NA
Serbia	145	3480	0.13

Source: UNCTAD (United Nations Conference on Trade and Development) Statistics. For Kosovo, author's calculations based on World Bank data.

Table 3: Competitiveness in the Western Balkans 2013-2014; Ranking based on 148 countries researched.



Source: Global Competitiveness Index, World Economic Forum

Table 4: Corruption in the Western Balkans

Country	Rank, 177 countries researched	CPI 2013 score	CPI 2012 score
Croatia	57	48	46
Macedonia FYR	67	44	43
Montenegro	67	44	41
Bosnia & Hercegovina	72	42	42
Serbia	72	42	39
Kosovo	111	33	34
Albania	116	31	33

Source: Transparency International, CPI 2013 results. The Corruption Perceptions Index ranks countries based on how corrupt their public sector is perceived to be. A country' score indicates the perceived level of public sector corruption on a scale of 0 - 100, where 0 means that a country is perceived as highly corrupt and 100 means it is perceived as very clean.

FORMAL AND INFORMAL ACTORS IN THE WESTERN BALKANS: MEASURING THE IMPACT ON ANTI-CORRUPTION POLICIES

Daniela Irrera
Assistant Professor of Political Science and International Relations
University of Catania

After twenty years of political and military interventions, the Western Balkan (WB) countries continue to be at the core of the European Union (EU) regional strategy. The post-war settlement is, notably, an environment in which the promises of democratic political elections and economic reconstruction are extremely high. Peacekeepers and external actors invest their efforts in long-term projects and arrangements, which emphasize the involvement of local stakeholders, but through a top-down conditionality. It is also an environment in which informal actors may easily establish patterns of behavior, which profit from state weakness and affect public interests. The legacy of communist political regimes, the influence of ethnic fragmentation, the need to face and manage a subtle transition to democracy has led the WB towards a difficult and troubled period of adaptation and evolution. Inexperienced political *élites* have been helped to turn weak institutions and inefficient bureaucracies into modern ones, to fulfill the requested criteria and, more importantly, to satisfy the needs and aspirations of a vivid – but still uneven – civil society.

The same conditions did not inhibit a variety of groups – which have used the conflicts as a means to profit from illicit activities – to flourish in all countries, building a criminal network aimed at smuggling all kinds of illicit goods. Drug routes and the set of relationships with local police officers, civil servants, businessmen, and former intelligence officers were one of the biggest concerns for the EU at the beginning of its intervention in the area and they are still on the agenda.

The need to face high level corruption, involving political *élites* – at local, federal and national levels – is still part of the efforts which are required to fulfill the enlargement criteria.

What happened – and is still happening – in the WB is a clear example of how informal actors may flourish in a post-war context, by severely influencing all aspects of the state and weakening the rule of law. It also demonstrates how external intervention may struggle significantly to reduce their impact and, paradoxically, to benefit them.

This article aims at assessing the improvements made by WB states in the policies against corruption and organized crime by stressing the role of key actors. It is divided into three main parts. Firstly, the EU aid and anticorruption policies are theoretically discussed towards the notion of informal actors. Secondly, empirical data provided by international agencies are used to describe the current condition of corruption influence in the WB. The last part completes the analysis by assessing the impact of EU polices and local responses.

Therefore, it is mainly based on three research questions:

1. Which actors are more relevant in tackling corruption and organized crime in the Western Balkans?

2. Are they formal or informal ones?

3. Do they play a role within the EU policies and strategies in the region?

Formal and informal actors: a theoretical overview

The conflicts that affected the WB region caused complex and long-term interventions, both in terms of peace support missions and state-building policies. The dominant theoretical paradigm under which such policies have been formed in the last decades follow the "Liberal Peace Thesis" that is to say the idea that the building up of political institutions is required as a preliminary condition to improve democracy reforms (Paris, 2004). They are, therefore, essential to the establishment of a new equitable political and economic setting. However, the cases that flourished since the end of the Cold War demonstrate that such 'aid paradigm', based on the assumption that security, stability, and rule of law are prerequisites for development, has not always – and not everywhere – produced suitable results. This approach put more emphasis on the security sector as a tool for change, but this transformative potential may increase the power of local actors, even without sufficient control (Cooper and Pug, 2002). It may, additionally, create those conditions in which a 'culture of dependency' benefits some local actors and deprives others (Chandler, 2001). In other words, the nature of democratic settlement that long-term interventions currently aim to achieve can only be defined as hybrid. Liberal peace can be hardly established *tout court.* It rather creates the conditions in which long-term measures can enhance political and social dialogue. The involvement of various actors – both local, regional, and international – is necessary to shape negotiations and a hybrid form of peace as a context in which different interests coalesce, conflict and re-coalesce (Attinà, 2012).

The assessment of the EU involvement in the WB offers a clear example of how hybrid peace was established, shaped and reshaped in several forms. The EU has been particularly involved in the region since the Dayton agreement as a peace and security provider and, going beyond the post-conflict phase, as a democracy promoter within a broader "European perspective", made of institution-building, rule of law, governance, anticorruption measures.

The role of local actors – mainly in terms of receiving aid – remains crucial. Analyses on policy interventions stress the importance of local ownership, which is only sometimes implemented in practice and, most of the times, idealized. As comparative studies have evaluated, external actors usually refer to local authorities and political *elites*: thus, they become both recipients of aid policies, and responsible for conditionality and compliance to criteria. As Rossi demonstrates, in the WB, international policy-makers – who have mainly conceived and promoted the transition and state-building process – continue to address only *formal* institution building (Rossi 2014). The difference among formal and informal actors is particularly interesting and essential for understanding the factors that marked the post-conflict period in the area and the performances of these countries towards the EU requests. It also sheds light on the EU approach itself.

In general terms, a formal actor is the one who holds official state-sanctioned political power and has an obligation to act in the state's public interest, while an informal actor plays the same roles, but without holding formal office or mandate (Cheng, 2012). This definition is close to the notion of non-state actors, whose ability to play a role in the international affairs has grown in the last decades. Civil society groups, non-governmental organizations (NGOs), and interest groups can contribute to democratization and accountability of global politics and policies. However, the same environment can facilitate and strengthen 'uncivil' groups, such as organized crime groups (Irrera, 2011). As the WB clearly demonstrates, reconstruction and state-building policies are primarily addressed to formal local political *élites*, but with the inevitable involvement of a large *informal* environment. Here many positive actors can exert an influence, which can be transformative and direct. However, some (or several) informal actors may easily act against the public interest for personal or group gain. Driving such positive and negative influence from the top can make the difference in the short and long period.

Formal and informal actors in the WB: an empirical analysis

In post-conflict countries, political and institutional corruption is one of the most devious and lasting problems. While the World Bank defines corruption as the use of public power for obtaining private gain, the present analysis focuses on the implications of grand corruption, which involves local political and social actors, that is to say police, customs officials, judges, tax officers, and even doctors in the use of illegal and corrupt practices.

Several scientific articles and agency reports have investigated how, over the last twenty years, in the WB bribery has become the most frequent and rapid tool in the provision of any public service in all sectors.

The perception of corruption deals with factors that contribute to its cause, but also with those actors that are more entangled and those that are expected to be more involved in anticorruption policies. Low salaries are usually indicated as the first origin of corruption, since public servants attempt to supplement with bribes and justify such practice as a personal necessity. This may affect all services a citizen ordinarily requires in daily life. However, grand corruption is a different and more serious phenomenon. The inefficacy and/or the lack of proper social control at the crucial legislative, judicial and administrative levels are important factors which may not only expand corrupt practices, but also affect the expected institutional performances and decrease its legitimacy and popular trust.

The last Corruption Perceptions Index 2013, compiled by Transparency International, continues to point out the almost similar undesirable conditions (Table 1).

Table 1: Corruption in Western Balkan countries

Country	Rank	Score	Standard error
Albania	**116**/177	**31**/100	2.1
Bosnia and Herzegovina	**72**/177	**42**/100	2.9
Macedonia	**67**/177	**44**/100	5
Croatia	**57**/177	**48**/100	3.3
Serbia	**72**/177	**42**/100	3.4
Montenegro	**67**/177	**44**/100	2.2
Kosovo	**111**/177	**33**/100	2.3

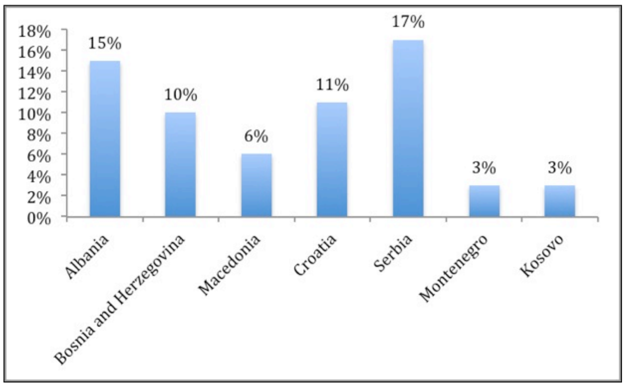
Source: Transparency International, Corruption Perception Index, 2013

The table provides three kinds of information, which are relevant to identify the position the country ranks on a global scale and, at the same time, to understand the level of political control in fostering corruption and illegal practices. The country score indicates the perceived level of corruption in the public sector on a scale of 0-100, where 0 means that a country is perceived as highly corrupt and 100 means it is perceived as very clean. The country's rank indicates its position compared to other countries included in the index and a standard error associated with the score captures the variation in scores from the data sources available for that country.

According to such data, among the WB countries Albania is the one producing the worst result, together with Kosovo, which remains a transition case (despite the independence and the recent political elections). Serbia and Bosnia are slowly improving; Macedonia and Montenegro are probably the most stable cases, while Croatia is unsurprisingly the best one. It is worth reminding that data depicts countries which are enormously diversified among each other, going from an EU member to a country in which a civilian mission is still deployed. However, from a regional point of view, they all congregate in a specific part of the Index (31-48) and, except for Macedonia, the standard error is not particularly high and quite factual.

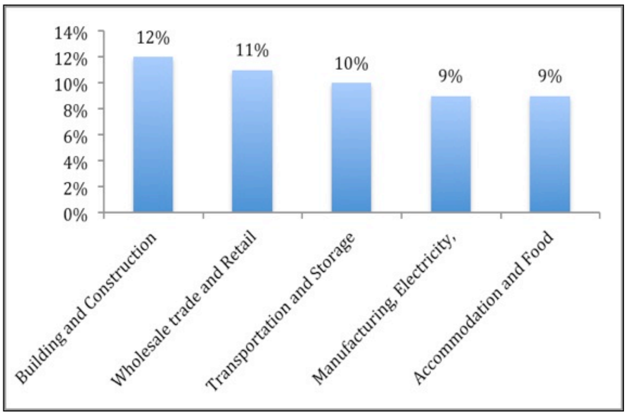
Perception of corruption needs to be combined with additional data provided by the United Nations Office on Drugs and Crime Report on the actual frequency of bribes and on the sectors which are mostly affected (Tables 2 and 3).

Table 2: Prevalence of bribes



Source: UNODC, 2013

Table 3: Sectors affected by bribes prevalence



Source: UNODC, 2013

Aggregated data on the prevalence of the use of bribes in public sector confirm the endemic impact of corruption, even though – compared to the Corruption Index – Croatia is more affected than Montenegro and Kosovo, while Albania and Serbia are still the crucial cases. The rampant privatization processes, which have been proceeded by local political élites in all countries, have left serious consequences in most relevant sectors, mainly building and construction, as well as wholesale trade. Economic actors are leading such processes, but in close relationship with governments which are chiefly responsible.

In sum, the WB is still a region marked by scores of petty and grand corruption, not compatible with a democratic regime (or even with a hybrid one) and which requires extraordinary measures.

Corruption may be driven by financial necessity and, as a consequence, justified by people, but it is unacceptable among those institutions which should be accountable and represent local interests on a national level and are requested to provide public services. They should be, in principle, free from corruption, also because they are those formal actors which are recipients of external aid. Therefore, they are expected to gradually become democratic and transparent.

In its Nations on Transit Report issued in 2014, Freedom House rates countries on a scale of 1 to 7, with 1 representing the highest and 7 the lowest level of democratic progress. The average of these ratings is each country's Democracy Score (DS).

Table 4: Democracy scores in Western Balkans1

Country	CS	NGOV	LGOV	JFI	CO	DS
Albania	3.00	4.75	3.50	4.75	5.25	4.18
Bosnia-Herzegovina	3.50	5.75	4.75	4.25	4.75	4.43
Macedonia	3.25	4.25	3.75	4.25	4.25	4.00
Croatia	2.75	3.50	3.75	4.50	4.00	3.68
Serbia	2.25	3.75	3.50	4.50	4.25	3.64
Montenegro	2.75	4.25	3.25	4.00	5.00	3.86
Kosovo	3.75	5.50	4.75	5.50	6.00	5.14

Freedom House mainly focuses on democracy and scores corruption as a separate variable. In the transition process, in which several formal and informal actors are involved at various levels, the relationship between the two factors can shed light on the quality of actors themselves.

In terms of overall Democracy Score, Kosovo presents the worst result, followed by Albania, while Croatia provides a score, which is still not perfectly satisfactory, even though it has the lowest level of corruption in the region. It is not surprising that political institutions, both national and local governments, continue to be considered as not truly democratic and close to the spread of corruption, especially in Kosovo, Bosnia, and Albania. Those responsible for the judicial framework deal with very similar scores. Performances are significantly better in the case of informal actors. Civil society organizations are considered more advanced in terms of democratic progress, and they are still associated with the role of impartial watchdog, even though Albania, Bosnia, and Kosovo are still critical cases.

[1] CS – Civil Society; IM - Independent Media; NDG - National Democratic Governance; LDG - Local Democratic Governance; JFI - Judicial Framework and Independence; CO – Corruption

This brief analysis emphasizes the influence corruption may exert on the political and social life, and considerably affect the democratic performance in the WB, considering that formal actors are the same ones which are expected to fulfill the EU conditionality.

Formal and informal actors and the EU

In previous analyses, the approach developed by the EU towards the WB has been evaluated by stressing the relevance of both institutional ties and economic assistance (Irrera, 2010). The relations between the EU and the WB are characterized by a complex mixture of programs, practices, and measures under which the EU has tried to follow and sustain the region from the resolution of conflicts to the formal entry, passing through a transition to democracy. In this framework, the fight against organized crime and corruption is a preliminary and crucial step.

The strengthening of the rule of law through the adoption, the implementation, and the internalization of norms is at the core of anticorruption policies and practices. Almost everywhere in the region, anticorruption agencies provided with the task of promoting legislative, judicial, and law enforcement measures are established. In some specific cases, for example in Kosovo, such programs are combined with a widespread package of Security Sector Reform, based on short and long term actions, and on cross-pillar (community, external relations and judicial) cooperation.

The Instrument for Pre-Accession Assistance (IPA) was designed to provide specific financial assistance for supporting transition and institution building, and cross-border cooperation. The launch of IPA II in 2014 is expected to invest about €11.7 billions in the period 2014-2020, and a new system of incentives will award those countries that can actually demonstrate their advanced path to reform. At the core of the renewed strategy, "on developing independent, efficient and professional judiciaries and supporting the development of a strong framework at national and regional level and track record of implementation in the fight against organized crime and corruption" (EU Commission, 2013, p. 7). Except Croatia, which is already a member, all other WB countries are expected to strongly benefit from it.

Montenegro has just opened accession negotiations with the EU but is still affected by organized crime activities and high-level cases of corruption. Serbia has signed an agreement of principles with the EU and has improved its commitment, even though the fulfillment of rule of law criteria is still far to be achieved. Macedonia was the first country to sign a Stabilisation and Association Agreement in 2001, and has still to demonstrate the real existence of functioning anticorruption measures. Albania is a candidate country and the new government seems fully committed towards the strengthening of cooperation between law enforcement bodies. Bosnia is still a pending Stabilisation and Association Agreement (SAA) because of on-going problems, particularly the extremely high level of corruption. Kosovo is slowly advancing towards its SAA and, among difficulties, is proving a strong commitment under the control of a stronger international presence.

There are few doubts that almost everywhere formal actors are making strong efforts to demonstrate their full and proactive engagement in the fight against corruption and organized crime. However, they are still wobbling between the convenience of fulfilling the EU conditionality and the profits provided by the corruption networks, which flourished in the previous decades. This translates into a resistance to the effective internalization and implementation of norms against corruption as well as the improvements of law enforcement measures and practices. This fatal combination of formal actors and negative informal ones is balanced by the pressure exerted by other positive informal actors, namely NGO and other civil society organizations, which can be envisaged as tool for control and change. Their official role is, however, still limited and far from recognized.

Conclusions

The WB region represents one of the most investigated and evaluated cases, by both scholars and practitioners, in order to understand how to manage post-conflict transition. The spreading of corruption, criminal infiltrations into politics, and frequent violations of the rule of law have created a condition of insecurity in which the EU has slowly and exhaustingly played the role of peace provider and democracy promoter.

This brief analysis focused on grand corruption and discussed how an effective commitment in this field has a major impact on the democratization process. The main assumption here is that an assessment of the EU impact in the WB, two decades after its beginning, requires a broader perspective which involves the role of a set of different actors, both formal and informal ones. A very specific and sensitive policy field, like the fight against organized crime and grand corruption, demonstrates that positive and negative influences of both types can combine and cross. The EU has already experienced and identified the impact of criminals and corrupt officers and politicians. Without underestimating or idealizing the role of informal actors, it should recognize their ability to influence the formal ones and turn it into a potentiality.

References

Attinà F. (ed.) (2012), The Politics and Policies of Relief, Aid and Reconstruction, Basingstoke: Palgrave Macmillan.

Chandler D. (2001), Bosnia: The Democracy Paradox, Current History, 100 (644), pp. 114-119.

Cheng C. (2012), Private and Public Interests – Informal Actors, Informal Influence, and Economic Order after War in Zaum, D. and Berdal, M., eds. Political economy of state-building: power after peace. Routledge, Abingdon,

Cooper, N. and Pug, M. (2002), Security-sector transformation in post-conflict societies, London: The Conflict, Security & Development Group.

EU Commission (2013), Enlargement Strategy and Main Challenges 2013-2014, 16.10.2013, COM(2013) 700 final

Freedom House (2014), Nations in Transit 2014, available at http://www.freedomhouse.org/report/nations-transit/nations-transit-2014#.U-kFdlbeOg1 [accessed on 11 August 2014].

Irrera D. (2010), EU and Albania facing corruption and organised crime in Transitions, Vol. L.1, pp. 125-146.

Irrera D. (2011), The EU Strategy in Tackling Organized Crime in the Framework of Multilateralism, Perspectives on European Politics and Society, 12(4), pp. 407-419.

Paris R. (2004), At War's End: Building Peace After Civil Conflict, New York: Cambridge University Press.

Rossi R. (2014), EU, non state actors and peace support policies in the Western Balkans, paper presented at Re-SHAPE 2nd Annual Workshop': Non-State Actors And Emergency Policies, Assessing The Impact Of NGOs And The Media', 12-13 June 2014, Catania, Italy.

Transparency International (2013), Corruption Perception Index 2013, available at http://cpi.transparency.org/cpi2013/ [accessed on 11 August 2014].

UNODC (2013), Business, Corruption and Crime in the western Balkans, 2013: available at https://www.unodc.org/documents/data-and-analysis/statistics/corruption/Key_Findings_Business_Corruption_Crime_WB.pdf [accessed on 12 August 2014].

THE FIGHT AGAINST CORRUPTION AND ORGANIZED CRIME, THE CASE OF THE WESTERN BALKANS

Ioannis Michaletos
Independent Analyst
Research Coordinator Greece
Balkanalysis
Athens

"corruptisima re publica plurimae leges"
"In the most corrupt state are the most laws"

The region of Southeast Europe and its western part in particular is an important hub for global organized-crime networks. In terms of corruption in the public and private sphere, the region faces great difficulties, owing to history, societal norms and a number of economic factors that prohibit the full implementation of the rule of law, even though nominally all countries have adopted the necessary legal frameworks and in most respects they have legal provisions for all kinds of illicit actions and behaviors.

Organized crime

Narcotics

Southeast Europe is one of the main transit zones for the transfer of heroin from Asia to Europe, as well as an expanding cocaine re-distribution center for Latin American cocaine en route to the rest of the EU markets. According to the EU Serious and Organised Crime Threat Assessment 2013 (SOCTA) report: "Routes through Western Balkan countries remain important for the movement of many illicit commodities into the EU. Heroin and cocaine pass through the Western Balkans after transiting through Turkey and Africa."[1]

The high quantities talked about and the extensive network located in the Balkans regarding drug contraband, was illustrated by a recent DEA/Greek Coast Guard operation that successfully confiscated 2 tons of pure heroin in Athens and led to the arrest of a multinational criminal network composed of Greeks, Turks, Albanians, Iranians, Bosnians, and with geographical spread from Pakistan and Dubai to Belgium, Italy and Romania. According to all available and credible information the network was just an offshoot of a much more extensive mafia-type organization with firm roots in at least two Southeast European countries and investigations are still ongoing. The confiscated amount if supplied on the street level and in non-pure form could net more than 350 million United States dollars (USD) and it was destined for the northern European countries.[2]

According to the United Nations Office on Drugs and Crime (UNODC): "The Balkan heroin route traverses the Islamic Republic of Iran (often via Pakistan), Turkey, Greece, and Bulgaria across Southeast Europe to the Western European market, with an annual market

---

[1] "Turkey and Balkans battle drug trafficking" http://www.setimes.com/cocoon/setimes/xhtml/en_GB/features/setimes/features/2013/04/22/feature-04

[2] "Greece makes record heroin bust, arrests tanker crew" http://uk.reuters.com/article/2014/06/22/uk-greece-ship-drugs-idUKKBN0EX0UN20140622

value of some $20 billion"[3]. To put this number into perspective, the amount of wholesale priced heroin that passes through the Balkans each year is larger than or similar to the nominal GDP of countries such as Montenegro, the Former Yugoslav Republic of Macedonia, Albania, and Bosnia. That surely means that globally connected and financed organized criminal structures are able to greatly influence domestic security policies. Despite numerous arrests over the years, the heroin kingpins operating at the highest level have remained untouched; while mid-level and in some cases upper level operatives were arrested, "business continued as usual" by eager replacements.

The amount of cocaine reaching ports in the Balkans is also steadily increasing. Europol has noted since the early 2000s the formation of stable transport routes in the Balkans for the re-distribution of the drug to other markets, as well as for the increased local consumption. The existence of well-formed organized crime networks previously or currently involved in human trafficking, heroin trade, and tobacco contraband, provided with ample human resources, experienced in dealing with the shadowy world of illicit organized activities. Moreover the lax border controls in the region due to the recent political history and the widespread corruption has been another strong impetus.

The main locations of interest are the port of Piraeus in Greece, and most harbors in the Adriatic Sea including Italy and the coast between Croatia and Albania. Cocaine is being transported via small and mid-sized vessels, often used just for one voyage and incorporated in offshore tax heavens owned by maverick ship owners and brokers. Numerous cases have proved the link between the transfer of cocaine from mostly Colombia, Panama and Venezuela to Montenegro through Western African ports in Senegal, Nigeria, Guinea, and Sierra Leone.

Each year it is estimated that up to 1,000 tons of cocaine (first product) is being produced in Southern America, with an initial price up to 10,000 USD per kilo. In the European metropolises the drug is distributed for up to 1.5 million Euros per kilo after it has been reduced in its purity, thus offering immense profit for all intermediaries involved.

Heroin and cocaine prices in the Balkans have reached a historically low level, despite a considerable increase in confiscations, which implies a steady and increasing supply by virtually uninterrupted powerful criminal groups that actually gain in strength and become even more influential in local societies.

[3] https://www.unodc.org/unodc/en/drug-trafficking/

Arms trafficking

Arms trafficking of light weaponry flourished in the Balkans during the 1990s and the wars of that period, and since then the region has been a steady hub for the global illicit procurement of AK-47, hand grenades, RPG rockets, plastic explosives, and a variety of pistols. The wars in Libya, Syria, and Iraq and the aftermath e of the "Arab Spring", have once again this trade flourish. For instance in 2011, 800,000 12.7 mm rounds of ammunition originating from Albanian surplus stocks found their way into the hands of Libyan rebels (of Jihadi origin) and a UN panel of experts suggested that Tirana had some information about the final destination of the ammunition but did not follow it through[4].

In 2013, a New York Times report revealed that arms shipments originating from Croatia were heading to Jihadists in Syria via Jordan and through Saudi financing[5]. Further indications of a substantial flow of weaponry through radical Islamist channels based in the Balkans towards Syrian groups, was noted by Israeli sources: "The senders are the groups from Kosovo and the Republic of Bosnia and Herzegovina linked to Al Qaeda. The package includes Kornet and Fagot antitank systems delivered by the Soviet Union to former Yugoslavia in the past."[6]

There were also numerous cases that have been extensively reported in the local press of most countries in the region, regarding well-formed arms contraband networks that are based in Belgrade, Pristina, Tirana, and Skopje that facilitate both global and international illegal arms shipments. The Greek Coast Guard estimates that there are, at any given month, dozens of vessels in the Central and East Mediterranean Sea, facilitating such trade, belonging to fictional companies and changing names and flags frequently in order to evade attention[7].

Illegal immigration and terrorism transit flows

The Balkan territory is the prime entry into the EU for illegal immigration and remains a source region for human trafficking victims. According to a 2012 Annual Risk Analysis report on the Western Balkans region published by Frontex, illegal immigration from and

[4] "Albania Faces Questions Over Arms for Libya" http://www.balkaninsight.com/en/article/albania-weapons-diverted-to-libyan-rebels-reports-says

[5] "Saudis Step Up Help for Rebels in Syria With Croatian Arms" http://www.nytimes.com/2013/02/26/world/middleeast/in-shift-saudis-are-said-to-arm-rebels-in-syria.html?pagewanted=all&_r=0

[6] "Syrian Rebels Get Arms from Kosovo and Bosnia" http://www.strategic-culture.org/news/2013/02/23/syrian-rebels-get-arms-from-kosovo-and-bosnia.html & http://www.debka.com/article/22773/Syrian-Islamists-meet-Hizballah-head-on-%E2%80%93-take-in-arms-from-Bosnia-Kosovo

[7] Unofficial commentary by Greek Coast Guard state security directory officials in 2014

through the Western Balkan region remains the major challenge faced by the EU[8].

Since 2013 and onwards a considerable influx of Asian illegal immigrants has been noted in Bulgaria, whilst since spring 2014 the number of those getting into Greece through the Aegean Sea route has reached more than 300 persons daily. Consequently pressure has been exercised in the borders between Greece-FYROM, Greece-Albania, while Afghan and Pakistani nationals can be found in transit in all Balkan countries and *en route* towards Central Europe. In the case of Greece, which is the prime entry point and hub, it has been noted in most cases that the immigrant flow follows a systematic pattern and is related to a well-formed criminal network that facilitates all aspects of the "industry" such as paper forging, transportation logistics, officials bribing, and surveillance on authorities' activities and so on. In a 2011 leaked Greek intelligence service report (NIS) in the local media, it was noted that the smugglers had formed NGOs and other front organizations to actually infiltrate local societal and political structures and also to facilitate trans-European networking for their "commodity"[9].

The "Hawala" financing structures are becoming especially important in Athens, which is used as an epicenter for the Balkan immigration paths, and are in direct contact with those in Istanbul, Vienna and other with many smaller points in the midst and points in the western Balkan vicinity. Confiscations of several million Euros inside transiting vehicles for the purposes of Hawala transactions has become a routine over the past few years and in the routes aforementioned.

Illegal immigration and Middle Eastern connections also bring another matter of importance to the region: the facilitation of international terrorism and most importantly the one originating from the Middle East and is of Jihadi nature. In 2013 Austria's domestic intelligence agency (BVT) in its public assessment reported that: "In 2013, it was established that Jihadist fighters from the Western Balkans travelled to Syria. The fact that activists on the Balkans are networking with and are concretely linked to groups in (Western) Europe, there is a significant reference to Austria. This reference becomes particularly evident in the recruitment and travelling of European or Austrian fighters going to Syria via the Western Balkans"[10].

It should be noted with emphasis that there is a great deal of concern regarding the recruitment of a substantial number of Western Balkan nationals going to join "Jihad" in Syria and Iraq, and although the subject is not directly related to organized crime it is surely becoming an important concern for the overall European security architecture[11].

All the above are also related to the existence of home-grown Balkan radical Islamist groups centered in Bosnia and tightly collaborating with those in Vienna, Milan, and other European cities.

Corruption

Corruption in the Balkans can be summoned by the following key words and phrases: bribes; clientelism; favoritism; nepotism; patronage; subjective use of law; and fused lines between executive, legislative and the judicial.

Although all the above could be applied to virtually most nations on the planet, the important aspect is the existence of all in excess, combination, and in direct relation to both high and low levels of the state's apparatuses. In short, they deeply prohibit the progression of the local societies, they cause a great deal of social injustice which inevitably leads to social tensions and strains, further destabilizing society and assisting into the continuation of the vicious circle.

The UNODC in its Assessment of Corruption and Crime affecting the Business Sector in the Western Balkans (2012/2013) notes that: "Despite much progress in increasing transparency and good governance in the Western Balkans countries over the past few years, there is an increasing body of evidence that corruption is still widespread and pervasive in the region and affects large segments of society and public administration[12]".

Moreover, recent reporting on public sector corruption identifies that in the energy sector the Balkan countries must tackle corruption to save money and take advantage of development opportunities according to EU institutions such as the Energy Community Secretariat, identifying Albania as a prime example[13].

---

[8] "West Balkans – gateway for illegal immigrants to the EU?" https://emn.gov.pl/ese/news/9245,West-Balkans-gateway-for-illegal-immigrants-to-the-EU.html

[9] Various reports in the Greek media between 2011-2014 that have been numerously confirmed by authorities in charge

[10] http://www.bmi.gv.at/cms/BMI_Verfassungsschutz/BVT_VSB_2014_V20140613_online.pdf

[11] Several recent articles and papers of interest: https://www.ctc.usma.edu/posts/foreign-fighters-from-the-western-balkans-in-syria; http://www.todayszaman.com/interviews_albanian-expert-turkey-waypoint-for-balkan-jihadists_353477.html; http://www.balkaninsight.com/en/article/albanian-jihadist-use-internet-to-recruit-fighters; http://www.rimse.gr/2014/07/islamic-radicalism-in-balkans-by.html; http://www.setimes.com/cocoon/setimes/xhtml/en_GB/features/setimes/features/2014/07/21/feature-03

[12] https://www.unodc.org/southeasterneurope/en/xee/t93-assessment-of-corruption-and-crime-in-the-western-balkans.html

[13] "EU asks the Balkans to fight energy sector corruption" http://www.setimes.com/cocoon/setimes/xhtml/en_GB/features/setimes/articles/2014/07/07/reportage-01

A Transparency International Global Corruption Barometer 2013 identified that “There is a lack of public trust in the political system (in the Balkans), posing a threat to democracy in a region where the influence of powerful tycoons has dominated politics for more than two decades…. Despite considerable improvements in the area of party financing in the Balkans, the report found significant gaps in both election campaign financing laws and the way they are implemented. ”[14]

EU agencies and organizations also tend to lack the necessary will or ability to provide for change in the region and important deficiencies have been revealed, such is the case of EULEX in Kosovo. According to the European Court of Auditors (ECA) that has audited the EU’s assistance to Kosovo in the field of the rule of law, “this assistance has not been sufficiently effective… Kosovo’s limited capacity to protect key witnesses and the difficulties relocating witnesses abroad are important shortcomings. There has been almost no progress in establishing the rule of law in the north of Kosovo…. EU support should be more effective[15]”.

The reasons and corruption origins in the Balkans and particularly in the Western part are a mixture of historical, cultural, societal, and economic causes. Due to the sheer length that a discourse would take to simply acknowledge all the above, some key points will be outlined briefly as far as the economy is concerned.

The points below present the negative state of economic affairs in the Balkans that consequently fuel corruption as a means to an income and survival either for businesses and citizens alike.

- Small markets with little opportunities for upward socio-economic mobility for citizens
- Prolonged economic recession and/or stagnation
- Rigid bureaucracy combined with heavy taxation in indirect mode
- Donor recipient mentality in many cases that prohibit private sector initiatives
- State interference in micro-management decisions of the private sector
- Lack of infrastructure
- High levels of illiteracy compared to the rest of the EU
- Low to minimum social protection frameworks
- Mass immigration of highly specialized scientific personnel
- Minimum realistic opportunities for capital accumulation by corporations and citizens without getting involved in “close circuit” corrupted networks, due to lack of fundraising capabilities and shallow local monetary markets.

All the above create an explosive mix that prohibits the progression into the EU and establishes inferiority complexes with the more industrially advanced states in the EU, thus prolonging a vicious circle of mediocracy, kleptocracy, and keeping up the gloomy outlook for economy.

Light at the end of the tunnel?

Organized crime and corruption present still major issues to be battled against in the Balkans and vis-à-vis the final integration of the Western region into the European Union’s institutions.

First of all any initiatives taken should be multilevel ones and long-lasting, so as to have a positive impact, by taking into account the seriousness of the situation and the problems at hand.

Transparency in executive, legislative and the judicial branches could be a first key step that could be coupled with the use of new technology, the existence of well-established and impartial “watchdogs”, the periodical review of state decisions by citizen’s panels under the monitoring of international organizations, and the training of the younger generation of state officials by a variety of neutral and global organizations.

The need to limit in constitutional terms the tenure of politicians to prohibit the formation of “dynasties” is of importance. The liberalization of local markets and “closed shops” is another key step to engage entrepreneurship in the local societies and increase the chances of investments that will create jobs and lift up the economies.

Regional cooperation between existing EU member states and those to be included is of importance and it has to be of a “holistic nature” and far beyond the formalities of political and diplomatic life. The collaboration of NGOs, Unions, professional associations, security authorities, and municipalities in between Balkan countries should go beyond joint EU projects and become of a standing nature for all bureaucratic levels in order to exchange historical experiences, share intelligence, boost transactions, and propose initiatives, since the threats are trans-border and common in most respects.

[14] “Buying Influence: Money and Elections in the Balkans” http://www.transparency.org/news/feature/buying_influence_balkans

[15] “Rule of law assistance to Kosovo not sufficiently effective” http://europa.eu/rapid/press-release_ECA-12-41_en.htm

The experimental introduction of direct democracy models in the primary municipal level of the regions most affected by crime and corruption could involve all citizens in the debate. In that respect all inhabitants would be obliged to assume certain responsibilities in a rotation form and be responsible for the first time themselves of the actions and decisions taken in the community level. That could be a manner under which anti-social and criminal elements could be opposed at the very primal level of social interactions.

The EU could play a vital role in supporting youth fundraising projects to provide alternative career options for a vast number of people that are trapped in a life of crime due to lack of other opportunities and consequent peer pressure.

Modernization of the local police, intelligence, security and judicial systems, and introduction of present-day know-how both in operational and analytic perspective in terms of combating organized crime is of a key nature.

The assistance into the research of all of these issues aimed at the academic community, as well as the whole of the educational system and the private sector awareness is the crucial first step before venturing further.

Younger generations should be promoted by EU structures to assume responsibilities by education, training and establishment of international connections. Only if there is a balance between the old guard (not necessarily on an age structure) and the younger one there could be an ease in issues discussed.

In any case the struggle to overcome all of the problems mentioned is tremendous and no easy solutions are available. The rule of law in the Balkans is essentially a political issue and of a high nature. Thus it requires the mobilization of both the societies and the EU in order to be able to see tangible results in the near future.

“Politics is the art of the possible”
Otto von Bismarck

BACKGROUND PAPER ON THE PROTECTION OF BASIC CIVIL, POLITICAL, SOCIAL, AND ECONOMIC RIGHTS IN THE WESTERN BALKANS

Nenad Koprivica
Executive Director
CEDEM – Centre for Democracy and Human Rights
Montenegro, Podgorica

Introduction to the context

Human rights have played a critical role in the dramatic transformation of the Western Balkan region. Civil society organizations and grassroots movements have all turned to human rights to shape constitutions, expose violations of human rights and strengthen civil liberties. Human rights language has become a common currency, shaping public debates in the region and fostering demands for greater protection of economic, social and cultural as well as civil and political rights.

Unfortunately, these advances have not been successfully translated into the rule of law and social justice. Poverty, inequalities, labor abuses, and cultural degradation still threaten to undermine the fragile progress in this field. Strengthening the protection of journalists and effective guarantees for freedom of expression still represent daunting challenges. At the same time, the rising gap between rich and poor, deepened by the global financial crisis that began in 2007, has created a rising clamor for progressive changes.

Mindful of these gains and trends as well as of the advanced European integration process, this paper provides a brief overview of policy and institutional developments concerning the protection of civil, political, social, and economic rights in the Western Balkans, as well as measures aimed at safeguarding these rights. The paper pinpoints the problems most frequently encountered by citizens when exercising their civil, political, social, and economic rights, with a view of presenting, in a distinctive way, the situation in the region regarding civil, political, social, and economic rights. At last, but not least, the paper seeks to outline options for future actions in order to help address the shortcomings in the protection of these rights.

Policy environment and framework instruments

Following the general democratic progress in the region, particularly that included in the EU accession framework, the Western Balkan countries have introduced national constitutions with strong provisions on basic civil, political, social, and economic rights in order to meet the Copenhagen criteria. Strong commitments under the international law have taken place as well, based on the Universal Declaration of Human Rights, European Convention of Human Rights and Freedoms, the Revised European Social Charter, as well as on multilateral international covenants on human rights, most notably the International Covenant on Civil and Political Rights (ICCPR), the International Covenant on Economic, Social and Cultural Rights (ICESCR), and related human rights instruments.

These states have found themselves bound by the ratification of treaties' terms which obliged them to work toward granting of economic, social and cultural rights to citizens and legal entities, irrespective of the lack of resources resulting from economic crises. Almost all of these instruments were ratified without revision, with the exception of the revised European Social Charter in certain countries (such as in Serbia and Montenegro).[1] The covenants require the states to take reasonable measures within its available resources to progressively realize these rights. The responsibility of the states in securing respect for economic, social and cultural rights has been also elaborated upon by the Maastricht Guidelines and Limburg Principles, both of which emphasize states' responsibility to provide effective remedies for the victims of human rights violations.

In parallel with these policy developments, new mechanisms to safeguard basic civil, political, social, and economic rights have been more or less introduced in most of the countries, depending on different constitutional and institutional settings. Special human rights institutions, such as the Ombudsman, have been established as institutional mechanisms for the protection from discrimination and national mechanisms for the prevention of torture. This authority examines citizens' complaints against the decisions and procedures of state authorities and produces recommendations, which are not, however, legally binding for institutions. The Commissioner for Free Access to Information of Public Importance has been instituted in certain countries as well, so as to secure transparency of public information and facilitate greater openness of public institutions.

Judicial independence, integrity and impartiality has been strengthened through constitutional and legal guaranties for the judicial branch of power, as well as through specific bodies, such as Judicial and Prosecutorial Councils, designed to reduce excessive influence by the political elites and ensure less executive branch domination over judicial appointments. Measures have been undertaken to prevent the incorrect application of the right at stake, including through strengthened fair trial standards or the introduction of specific legal remedies, such as the constitutional appeal.

However, despite the fact that the region's formal democracies have the potential to ensure the protection of basic rights, they still suffer from an apparent lack of judicial and political acceptance of the notion of human rights. Namely, the Western Balkan region has entered a transition process with state organizations less than fully responsive to citizens' needs. As a consequence, the high level of normative human rights regulations is not in line with their practical application in everyday life. In addition, some of the countries have experienced war activities that have led to economic degradation and serious human rights infringements that are yet to be properly addressed.

For these reason, new solutions to improve the protection of citizens' rights are being constantly sought after, even though the constitutions of the Western Balkan countries guarantee the full respect for civil liberties. In such a context, the European integration prospect is seen as a model for economic and political integration, which can bring prosperity to the region and contribute to better protection of basic rights. Certain or almost full alignment with the EU legislation have been already achieved in some of the countries, such as in Montenegro, while in some others, such as in Kosovo, considerable efforts are needed in order to build legal framework and strengthen institutions that are responsible for human rights protection.

Common shortcomings and challenges in the protection of basic rights in Western Balkans

Relevant reports, general comments, recommendations and observations made by the special procedures of the Human Rights Council, other human rights treaty bodies, the European Commission, civil society, international organizations and academics also point to certain shortcomings in the enforcement of civil, social and economic rights in the region. Most of these shortcomings refer to restrained access to public information; undue length of proceedings; discrimination in accessing labor market, education, social security or public services; torture; and the protection of labor rights, especially of the victims of economic transition.

As stated in the recent report of the Protector of Human Rights and Freedoms of Montenegro (the Ombudsman) for 2013, the largest number of citizen complaints pertains to the right to a trial within a reasonable time (82 complaints), the right to free access to information (78), discrimination (51), torture and cruel inhuman or degrading treatment or punishment (23), and the rights of persons deprived of liberty (112 complaints). When economic, social and cultural rights are in question, 170 complaints have been filed in relation to the right to health care and health insurance (41), labor rights (28), the right to peaceful enjoyment of property (20), the right to social protection (12), the right to housing (5), and the right to education (2).

There are several reasons for such a state of play. As for the civil and political rights, these reasons lie in delayed investigations, long drawn out trials and the failure to enforce court decisions, especially in cases of torture, hate speech, and threats to sexual minorities. On the

[1] Holders of rights are not entitled to use collective complaints to redress the violations of rights protected under the Charter, so the submission of periodic state reports to the Committee of Independent Experts remains the only oversight mechanism when the implementation of Charter is concerned.

other hand, effective legal means to remedy these shortcomings are still not fully in place. Despite criminal legislation in the region invoking the right to a fair trial as a founding principle, the poor execution of judgments and frequent overruling of first-instance judgments affect the implementation of the fair trial guarantees in practice. Furthermore, the right of access to court has not been effectively exercised in all of the countries as some of them still lack the legal framework and infrastructure (such as Serbia), while in some others (such as in Montenegro) the number of beneficiaries and the scope of proceedings eligible for free legal aid is still limited. The conditions of stay and treatment of convicted persons in prisons still have to be harmonized with international standards, in terms of accommodation, out-of-cells activities and rehabilitation/re-socialization programs.

Even though the anti-discrimination policy framework is generally in place in the region, its effective implementation is missing; the number of enforceable judgments in discrimination cases is still limited, while anti-discrimination bodies lack functional and financial independence. Serious gaps relating to the enforcement of gender equality policy and combating discrimination and sexual/gender-based crimes have been noticed as well, which puts the victims at the risk of additional victimization. The effective prosecution of war crime cases drawing from the nineties is also missing. The tendency of non-punishment is due to inefficient investigations and inconsistent application of international law standards. Selective accusations, along with the lack of command responsibility and prolonged proceedings constitute a main concern, requiring additional efforts to ensure victims' rights to truth, justice, indemnity, and non-recurrence.

In relation to the absolute prohibition of torture and other forms of ill-treatment, and in particular to the obligation of effective prosecution of serious allegations of torture and ill-treatment, lenient penal policy has been noticed in almost all countries of the region. Cases related to the assault of journalists and violations of freedom of expression, which have still not been effectively investigated, represent a sound example in this sense (the case Slavko Ćuruvija in Serbia or the case Duško Jovanović in Montenegro), recalling that both perpetrators and principals of crime ought to be identified and convicted. Moreover, due to the growing violence against media and their property that has been noticed in recent years, journalists have become exposed to evolving risks that rendered an environment where journalists do not feel safe to dispel corruption, organized crime or state abuses. At the same time, media themselves need to work more progressively on raising the professionalism, objectivity and accountability of their own work. Simultaneously, media self-regulation needs to be stepped-up significantly.

The results of the opinion poll conducted by CEDEM in 2012 may be used here to illustrate the situation: about 45% of the respondents estimated the state of media freedom in Montenegro as positive, while over 1/3 of them pointed out the violations of the media rights and freedoms as highly important.[2] When asked to rate the seriousness of the problem of attacks on journalists, over 30% of citizens stated that this is a very serious problem. The absolute majority of citizens believe that the state should adopt special measures to protect journalists, whilst almost 55% of them support for an attack on journalists to be treated as an attack on the official in the performance of his/her official duties.

The protection of economic, social and cultural rights has been hindered by the economic transition and by the relative economic weakness of the region. As a result, minimum levels of old-age pension, unemployment benefits, and social assistance are reportedly manifested as inadequate. A decline in access to work, social welfare programs, and affordable food, housing and other basic necessities has occurred, heavily impacting vulnerable persons, i.e. women, children, older persons, persons with disabilities, migrants, and ethnic minorities, especially Roma. On the other hand, the negative impact of the crisis has been further exacerbated by inappropriate policy responses, compounding a threat to economic, social and cultural rights beyond the one posed by the crisis alone. Austerity measures reduced spending on social welfare and induced disproportionate costs upon the disadvantaged communities as well as wage differences between men and women, thus hindering, if not derailing, the effects of the social policy reforms. The expenditures for culture have decreased as well, leading to cultural deterioration.

Active employment policy measures devised to raise employability of hard-to-employ persons in almost all countries of the region produce limited impact, as they are not always adjusted to the target groups' needs. Besides, the enrolment of hard-to-employ persons in these measures rarely exceeds 10% of the registered unemployed population. Although specific measures to protect mothers and children have been crafted, forced and minor marriages and child labor, which expose Roma women and children to severe security and health risks, remains a significant concern, as well as the number of persons living in informal settlements and overcrowded or structurally unsafe housing. Several forcible evictions were conducted, but no long-term viable solutions to social housing have been established.

Roma persons still face severe poverty and the risk of social exclusion, which is reflected in difficult access to the labor market, social and health protection and edu-

[2] Available at: http://cedem.me/sr/ostala-istraivanja/viewdownload/38-ostala-istraivanja/357-izvjestaj-stavovi-gradjana-o-medijskim-slobodama-u-crnoj-gori.html

cation, as well as in insufficient participation in the political and social life of the country. Excessive school dropout rates at various levels of education are still present among Roma and Egyptian pupils, despite measures taken to sensitize communities with high dropout rates of the importance of education.

Conclusions and recommendations

Notwithstanding the fact that some countries in the region have yet to incorporate certain international norms in their domestic laws, the level of proclaimed rights at the national level is relatively high. However, even though the guaranties of civil, political, social, and economic rights have been enshrined in national constitutions, their enforcement is still far from being practical and effective. There are considerable discrepancies between these declarations on the one side and the possibilities for the protection of rights on the other, including the effective means to remedy the violations. These discrepancies are particularly noticeable when it comes to torture and discrimination, labor rights, the right to fair trial as well as the rights of ethnic and sexual minorities. Based on the noticed gaps, common obstacles to ensuring the protection of civil, political, social, and economic rights in the Western Balkans may be structured around such factors as political conditions, policy environment, administrative capacities and resources to uphold adopted policy standards.

Mindful of the universality, indivisibility, interrelatedness and interdependence of all human rights for all people, irrespective of their origin, gender or social status, the states should preserve policy space for the development of rights-based regulations that will employ basic human rights guarantees in a manner that makes them actionable. This is not possible without joint efforts by state institutions, private sector, civil society, and media to create a sound environment for building the states' capacities for good governance, rule of law and well-functioning democracy. Therefore, the states should, in the strongest possible terms, promote participation, particularly of the most vulnerable, transparency and accountability in all decision-making related to or affecting the protection of basic civil, political, social and economic rights, and underpin every effort to engage all protagonists on the social scene in necessary changes.

A conducive environment for responding effectively to human rights violations should take place, *inter alia* by promoting non-tolerance policies to fight discrimination and violence based on social and national origin, sexual orientation or gender identity; allowing free flow of information related to human rights; lifting restrictions to peaceful protests; and eradicating hate speech both in public and private discourse. States should become staunch advocates of freedom of opinion and expression that are intrinsically linked to media freedoms. Special measures for the protection of journalists and bloggers should be established, including through effective and consistent convictions of the attacks on media, as well as through specific guarantees of media freedoms.
Migrants, refugees, internally displaced persons and other persons under UNHCR's International Protection who are passing through or residing in the region should be granted effective access to basic rights and services. Efforts to increase employability and employment need to be invested through adult literacy and vocational training programs. Finally, states' responses to the current crisis should not lead to a situation which would increase poverty and a rise in racial discrimination, gender-based violence, xenophobia and related intolerance. Namely, the states should maintain a social protection floor for the vulnerable and disadvantaged in order to promote equality of opportunities and mobilize available resources, including through lower taxation of vulnerable groups, stimulus spending or improved tax collection.

To sum up, in a wider and more long-term oriented perspective, fostering good governance at all levels, fighting discrimination and violence, creating a productive employment environment and decent work for all, and safeguarding economic and social gains remain some of the key priorities for the Western Balkan countries when the protection of basic rights is concerned. The European integration framework that represents the lifeblood to the development of the region should therefore be heavily used to take stock of the progress made and stimulate the implementation of measures aimed at full respect for economic, social and cultural rights as well as civil and political rights. More progressed countries in terms of the EU accession process should help mainstream the process of political and economic integration of the region, while the candidate countries should use the opportunity to learn from both developments and mistakes made by other countries on their path to the EU.

THE PROTECTION OF BASIC RIGHTS IN THE WESTERN BALKANS

Murat Önsoy
Assistant Professor
Department of International Relations
Hacettepe University, Ankara

Western Balkan countries continue to struggle with some major institutional and structural problems, which affect progress in almost all areas. The rule of law, which is a central feature of a modern democratic society, is not ensured. Human Rights, which consist of a wide range of civil, cultural, economic, political and social rights, are denied and this denial is not "by law" but "by practice".

The aim of this analysis is to give a brief overview of the situation with regard to the enjoyment of the basic human rights in the Western Balkans. The main line of argumentation is that Western Balkan states have been reviewing much of their domestic laws, regulations, structures etc. to comply with the European Union (EU) standards. As a result, the backbone that is necessary to protect the basic civil, political, social, and economic rights are in place; however implementation of these ambitious legal framework, which is the key for ensuring the guarantee of all rights, is lacking.

Minority Rights Protection

Minority rights are about ensuring respect for distinctive identities. To strengthen the rights of the minorities and disadvantaged groups is the basic requirement of the human rights. Adopted in 1992, the United Nations Minorities Declaration refers to minorities as based on national or ethnic, cultural, religious, and linguistic identity, and provides that states should protect their existence.[1]

Multiculturalism is the core feature of the Western Balkans; almost all states are multiethnic, multi-religious, multi-cultural, and multi-national. The region is infamous for poor management of this diversity. The times when the Western Balkan people peacefully co-existed are fairly seldom.[2] Freedom has largely been perceived just as the freedom of a certain group while the others have been deprived of it. Western Balkan states present a mixed picture regarding human rights and the protection of minorities. For the states of the region, especially those that suffered from interethnic violence, human rights issues are mainly concentrated on the protection of the minorities. Thanks to the EU integration process, the legal infrastructure, which is a precondition for reaching full minority rights protection, has been introduced in all the Western Balkan countries. The EU legislation has been harmonized to comply with the European standards. As part of the accession process, the most important universal documents such as the European Convention on Human Rights and the Charter of

---

1 United Nations Human Rights Office of the High Commissioner, Minority Rights: International Standards and Guidance for Implementation, United Nations, New York and Geneva, 2010, p.2.

2 Maria Djurdjevic, The Balkans: Past and Present of Cultural Pluralism, Quaderns de la Mediterrània, pp.155-165.

Fundamental Rights of the European Union that protect minority rights have been ratified.

In all of the Western Balkan states, the legislative and institutional framework for the observance of international human rights law is in place. The minority statuses have been, more or less, protected by laws, but have been poorly or partially implemented. All states are in principle committed to the protection of the universal human rights. In the preambles of their constitutions, all states refer to the superiority of the rule of law principle. In some state constitutions, the rule of law is even present as a separate article of the constitution. However there is need for further efforts to ensure full implementation of the legal framework and international instruments.

The governments should intensify their efforts to fight against discrimination and ill-treatment of vulnerable groups, in particular the Roma and the lesbian, gay, bisexual, and transgender (LGBT). Roma remain the most vulnerable group throughout the Western Balkans. Attacks and harassment against the Roma minority continue in Serbia. Furthermore the right of adequately housing is denied to them in Albania. Governments have failed to implement decades of plans for Roma inclusion. In Bosnia-Herzegovina discriminatory restrictions on Jews and Roma running for political office still continue despite an EU deadline to end. The action plan revised in 2011 remains to be adopted. The inclusion of Roma people in all levels of society is still nonexistent. There is a decrease in the number of refugees and internally displaced persons due to concerns about conditions in pre-war communities and the governments are reluctant to implement the action plans for housing, as is the case with regard to the Kosovar refugees willing to return to Montenegro[3]

Homophobia, discrimination, and hate crimes based on sexual or gender identity is another widespread phenomenon in the region. The introduction of several progressive anti-discrimination bills to comply with EU standards led to the introduction of very advanced anti-discrimination legislations with regard to the sexual minorities.[4] The introduced EU standards prohibit discrimination on grounds of sex, ethnic origin, religious beliefs, disability, age, and sexual orientation**.** However these laws have brought very limited change related to the rights of the LGBT people. In June 2013, the EU adopted guidelines for the promotion and protection of the enjoyment of all human rights by LGBT people to provide guidance for the EU's external actions in this field. According to the 2013 progress reports to the European Parliament's Committee on Foreign Affairs, the situation of the LGBT people is worse than in previous years.[5] Discrimination has in fact risen in the past year. LGBT people are continuously facing discrimination, threats and violence in the region. This is to some extent a consequence of a lack of anti-discrimination and hate crime legislation in some countries, and a lack of effective implementation in the others. Major cases of intolerance against LGBT people exist in Macedonia, Montenegro, Serbia, Bosnia and Herzegovina and Kosovo, including threats and attacks. A gay pride parade that was scheduled to take place in October in Belgrade was canceled after ultra-nationalists threatened the march following condemnation by the country's Orthodox Church.[6] This was the third annual gay pride parade in a row that has been banned in Serbia. The ban on the gay parade is a failure to guarantee freedom of expression. A successful strategy in this field in the enlargement countries requires strong political commitment from governments, local authorities, and law enforcement bodies concerned, as well as from the EU. In this regard, the burden falls on the authorities in the Western Balkans. They can play a key role in bringing about a change in mind-set across society as a whole towards LGBT persons, which is often at best ambivalent and at worst hostile. There have been several attacks to the LGBT activists and none of them is adequately investigated by the local authorities. The perpetrators of hate crimes against the LGBT people should be brought to justice.

Freedom and Independence of Media

In genuinely democratic states, citizens are able to influence public policy, public administration, and public opinion, and in order to do this they need to express themselves. Freedom of expression and freedom of media are fundamental and inalienable rights of all citizens and an indispensable requirement for democratic states. They are also vital for democracy and rule of law. Restricting them is a very severe restriction of human rights.

Media play a critical role as the channels of mass communication through which messages, ideas, thoughts are disseminated to the citizens and have remarkable power to influence public opinion and the political discourse. A free and open media within everyone's reach is valued as a basic right in all democratic states. Founded on the values of respect for human dignity, freedom, democracy, equality, the rule of law, and respect for human rights, Freedom of expression and independence of media is a great concern for the EU as well. As one of

[3] World Report 2014, Human Rights Watch, available at: http://www.hrw.org/world-report/2014

[4] Communication From the Commission to the European Parliament and the Council Enlargement Strategy and Main Challenges, 2013-2014

[5] Enlargement Package 2013, European Commission, available at: http://ec.europa.eu/enlargement/countries/strategy-and-progress-report/index_en.htm

[6] New EU accession reports: LGBT rights in the Western Balkans and Turkey, The EP's Intergrouon LGBT Rights, available at: http://www.lgbt-ep.eu/press-releases/new-eu-accession-reports-lgbt-rights-in-south-eastern-europe-and-turkey/

the world's largest "values block" with a collective commitment to the Universal Declaration of Human Rights, the International Covenant on Civil and Political Rights, and the European Convention on Human Rights, the EU plays an important role in the promotion and defending of the freedom of expression and media independence outside its borders.

These core values are actively promoted through the efforts of the international community. Ensuring freedom of expression and media independence, besides many others, is realized as two of the most important goals in the region. The prospect of the EU integration has been so far the most powerful tool for realizing press freedom. As the Commissioner for Enlargement and European Neighbourhood Policy Štefan Füle said: "freedom of expression and media is a core value of the EU and its promotion is a key priority. The EU is addressing this important issue in the early stages of the accession period as an integrated part of the chapters that deal with the judiciary and fundamental rights."[7]

In terms of press freedom the picture is not positive in the Western Balkans. The Freedom House ranks the countries of the Western Balkans as partially free in its recent Press Freedom Index 2014.[8] Reporters Without Borders confirms the worrying trend. In the overview of the 2014 World Press Freedom Report, the severity of the situation for the media and particular concern about developments in the Balkan journalism is depicted under a chapter entitled "Balkan powder keg for journalists".[9] According to the overview, journalists are often the victims of threats and physical attacks in the region, some of which have been extremely serious.[10] One of the causes of this is without doubt the European model's erosion. The EU membership process, despite being in progress is not helping them to improve their position in the index. Membership bidding no longer encourages the candidate states to respect for civil liberties. Macedonia's position (57th), in particular, has never been so low in the index.[11] The present situation with regard to the media independence in Macedonia is described as: "the democratic window-dressing of the past few years is not enough to hide the many freedom of information violations."[12]

There are several challenges ahead. The interference of the politicians in the media, economic concerns such as concentration of media ownership, and various forms of harassment, including violence against journalists, are the most fundamental of them. There is no will on the side of the politicians to implement regulations that have been adopted. They do not want to give up the control over media and hands are tied due to the lack of transparency in media ownership.

In this regard, the internationally owned media groups are providing some transparency to a media market that is dominated by tycoons. The state owned media should be drawn from the strong hand of the state and dedicated to public service. Even though the transformation from state media to public services is completed in the entire Western Balkans, governments still have various mechanisms to control public broadcasters. Governments are the biggest advertisers in their countries and some newspapers and television channels are subject to unequal treatment.

Privately owned independent media lack financial means to develop. Especially in the smaller countries of the Western Balkans where the market is too small, there is no space for small independent media to survive economically. This is the case especially for Montenegro, where there is a strong competition of media from countries like Serbia and Bosnia-Herzegovina that are speaking the same language. Privately owned media should be supported by all means if a truly independent media environment is desired in the Western Balkans.

Ownership structure is very important for free media. The majority of the media is controlled/owned by government sympathetic powerful political groups. The real owners are most of the time not known. The media is not representing the public opinion but influencing it for the benefit of the politicians. The journalists are under constant pressure and self-censorship is a natural consequence if they want to keep their jobs. Investigative journalism is the key for keeping those in authority accountable and for battling crime organizations. The international society should promote the 'watchdog' role played by the media through supporting and institutionalizing investigative journalism. The roots of the current difficulties lie back in the post-Yugoslav transition period. The transformation of the media in that period had been very controversial; politicians from the early 1990s onwards started to play an important role in this new Western Balkan media architecture, which has not changed up until today.

Despite this negative picture, there have been some progressive steps in the past decade. Various media laws have been introduced which comply with the universal standards of media legislation. Aspiring to become EU members, the Western Balkan countries signed and ratified core international conventions and harmonized their legislations to comply with the EU and international standards with regard to the freedom of expression and media. The EU integration process

7 Speak Up!2 conference on media freedom in the Western Balkans and Turkey European Commission - IP/13/551 17/06/2013
8 Europe, Freedom House, available at http://www.freedomhouse.org/regions/europe#.U_NQ_LflpgU
9 World Press Freedom Index 2014, Reporters Without Borders, available at: http://rsf.org/index2014/en-eu.php
10 Biggest Rises and Falls in the 2014 Index, Reporters Without Borders available at: http://rsf.org/index2014/en-index2014.php#
11 Biggest Rises and Falls in the 2014 Index, Reporters Without Borders available at: http://rsf.org/index2014/en-index2014.php#
12 World Press Freedom Index 2014, Reporters Without Borders, available at: http://rsf.org/index2014/en-eu.php

brought many mandatory reforms. Most governments in the Western Balkans acknowledge the importance of freedom of expression for the EU accession process. As a result, media laws achieved a high level of formal compliance with the EU standards. However, the enforcement and effective implementation of these directives and conventions are very problematic. Today, the laws that regulate the media are in compliance with the European standards. Several legislations have been adopted, the most important of which is the EU Audiovisual Media Services Directive, which addresses advanced regulatory issues of media[13] The Serbian government, under the pressure of the EU, adopted a media strategy in 2011 as the basis for new laws regulating Serbia's media system, with the aim of aligning of the legal framework in the media sector with EU standards. However the Serbian government is reluctant to implement the strategy.

Decriminalization of Defamation

According to the European Court of Human Rights (ECHR), in a democratic society, characterized by its tolerance to unpleasant or even shocking and hurtful opinions, the imprisonment penalty is unacceptable sentence for the use of freedom of expression. The threat of criminal proceedings has been an insidious form of intimidation against the media in the Western Balkans. In practice, this had the potential to restrict freedom of expression and lead to self-censure in the media. When defamation is punished by criminal law, those laws are abused in semi-autocratic societies, and often do not protect human dignity but are used in political struggles.[14]

There are efforts of the EU authorities and the European Court of Human Rights to decriminalize defamation in the Western Balkans. There was a call on the Western Balkan countries, with some positive returns, to remove "defamation" from their civil code. Except Albania, where the Criminal Code penalizes defamatory expressions, Western Balkan states no longer provide imprisonment sentences for defamation and insult to the honor and dignity of a person. Bosnia and Herzegovina was the first country in Europe to decriminalize defamation in 1999; Montenegro decriminalized speech offences in 2011 in the context of national legislation alignment with the case law of the ECHR. In November 2012, the Parliament in Skopje adopted a new civil law regulating insult and defamation and removed sanctions for speech offences from the Criminal Code.[15]

These amendments will have a positive impact on freedom of expression. However the abolishing of defamation from the civil code does not mean that the intimidation of journalist is coming to an end. Everywhere in the Western Balkans, independent journalists and media are experiencing threats, attacks, and reprisals for publishing views critical of the governments and businessmen. In the past couple of years, there have been very few known cases of the restrictions of freedom of expression but in reality, below the surface, attempts to manipulate or command the news media continue. There is widespread intimidation of journalists, with a high incidence of beatings and threats leading to self-censorship. The impunity of senior officials in the region is an obstacle that has to be addressed for solving the cases of murdered journalists. Without doubt, the impotency of the journalist trade unions has a direct effect in the first place. Media as an industrial organization is weak in the region. Stronger journalist trade unions is important to create an independent and more ethical media however the government controlled media workers associations are influential everywhere.

Liberal Democracy, a Necessary Condition for the Development of Human Rights

There is an interdependent relationship between human rights and democracy. Liberal democratic systems characterized by the principle of rule of law provide the best setting for the development of human rights whereas the repressive authoritarian regimes in which rights of the individuals are at the mercy of the politicians often curtail them.

The Washington-based non-governmental organization (NGO) Freedom House publishes annual surveys of democratic governance among 29 different countries from Central Europe to Central Asia that measure progress along indicators such as electoral process, civil society, and local democratic governance. The 2013 report clearly shows that two and a half decades after the end of the first major conflicts, the Western Balkans still suffer fundamental problems. Much remains to be accomplished in the Western Balkan States, even in more progressive ones like Croatia, Serbia, Montenegro, and Macedonia. The report highlights that implementation of all reforms essential to rule of law has stalled in the absence of political will. Despite their various levels of democratic development, all Balkan countries share common epidemic problems that hamper democratic developments including media independence, freedom of speech, and an independent judicial framework.

---

[13] Kristina Irion, Tarık Jusic, International Assistance and Media Democratization in the Western Balkans: A Cross-National Comparison, Working Paper, Analitika, 1/2013.

[14] Council of Europe, Parliamentary Assembly , 2007 Ordinary Session, Thirty Fourth Sitting, http://assembly.coe.int/Main.asp?link=/Documents/Records/2007/E/0710041000E.htm

[15] Western Balkans and Turkey Media and Freedom of Expression Fact-finding and Scoping Study http://ec.europa.eu/enlargement/pdf/key_documents/2013/wbt_media_study.pdf

Table 1. Ten-year comparison of Western Balkan democratization [16]

	Freedom House Democracy Score 2003	Freedom House Democracy Score 2013
Albania	4.17	4.25
Bosnia	4.54	4.39
Croatia	3.79	3.61
Kosovo	3.88 (Part of FRY)	5.25
Montenegro	3.88 (Part of FRY)	3.82
Macedonia	4.29	3.93
Serbia	3.88 (Part of FRY)	3.64

The above table clearly indicates that the region has made very little progress in terms of democratic development. If there is no change in this trend, the development of the human rights conditions and reaching the universal standards would not be possible. As the experience in the past two decades amply proves, in the Western Balkans, in the absence of a liberal democracy, the basic civil, political, social, and economic rights would always be limited.

Conclusion

In conclusion, Western Balkan states, driven by the EU membership aspirations, have been reviewing much of their domestic structure. As a result of the convergence with EU rules on technical regulation, today the basic civil, political, social, and economic rights are guaranteed by law; however convergence in rule adoption alone is not enough if they are poorly or partially implemented by the governments. Lack of political will is perhaps the most serious obstacle to the implementation of the rights. The not too distant prospect of membership played a decisive role in the reformist tendencies of the local elites, which disappeared almost completely once the membership prospects disappeared.

Above all, it is the responsibility of the EU and the other key members of the international society to ensure the guarantee of the basic rights, and particularly media independence. Introducing a developed monitoring system to secure the implementation of the laws by the local elites should be a priority.

---

[16] Freedom House Nation in Transit, http://www.freedomhouse.org/report-types/nations-transit#.U_tFz8XV-0U

The Aspen Institute | Germany

ASPEN WORKING GROUP SOUTHEAST EUROPE

December 1-2, 2014 | Berlin

In cooperation with:

Auswärtiges Amt

The Aspen Institute Germany wishes sincerely to thank the German Federal Foreign Office for its sponsorship of the Aspen Southeast Europe Program 2014 through the Stability Pact for South Eastern Europe.

December 1, 2014

Arrival of the participants during the day

20:00 **Welcome Dinner**

Remarks: Rüdiger Lentz, *Executive Director, Aspen Institute Germany*
Peter Beyer, *Member of the German Parliament*

December 2, 2014

Working Group

Venue: Savoy Hotel Berlin, Fasanenstraße 9, 10623 Berlin

09:30 – 11:00	**Economic Development**
11:00 – 11:30	Coffee break
11:30 – 13:00	**Rule of Law**
13:00 – 14:00	Lunch
14:00 – 15:00	**How to solve the remaining problems? Identifying the next steps**
15:00 – 16:30	**Preparation of presentation**
16:30	Coffee

Public Event

Venue: China Club Berlin, Behrenstraße 72, 10117 Berlin

19:00 **Presentation of Results**

Panel Disussion
Economic Reform and Strengthening the Rule of Law – a Panacea for a Stalling EU Integration Process?

Speakers: Simon Mordue, *Director for Enlargement Policy, DG Enlargement, European Commission*
Prof. Alina Mungiu-Pippidi, *Professor of Democracy Studies, Hertie School of Governance*
Anja Quiring, *Regional Director for Southeast Europe, Committee on Eastern European Economic Relations*
Ambassador Dr. Ernst Reichel, *Special Envoy for Southeast Europe, Turkey, and the EFTA States, German Federal Foreign Office*

Sokol Dervishaj

Tobias Flessenkemper

Josip Juratović

Amer Kapetanović

Srdjan Majstorović

Christiana Markert

Aleksandar Andrija Pejović

Anja Quiring

Manuel Sarrazin

Hans-Ulrich Südbeck

Bodo Weber

Aspen Institute Germany

Valeska Esch
Senior Program Officer

David Jackson
Rapporteur

Juliane Kabus
Program Assistant

Rüdiger Lentz
Executive Director

REPORT: RULE OF LAW ENHANCEMENT IN THE WESTERN BALKANS: IDENTIFYING THE NEXT STEPS

Rapporteur: David Jackson
PhD Candidate
Berlin Graduate School for Transnational Studies
Social Science Research Center, Berlin

The Aspen Institute's Working Group on Southeast Europe' was convened in Berlin on December 3, 2014. The meeting brought together four select decision-makers from Southeast Europe (SEE), as well as government officials and politicians of the Federal Republic of Germany. The workshop focused on two main areas: the economic situation and the rule of law.

Economic situation

A question was posed to the representatives of the region: where do we stand on the economy? In general, a rather gloomy picture was presented by participants. All countries in the region have suffered from recession, the effects of which are still keenly felt – but there are still some reasons for optimism. In Montenegro, the country has not been in recession for two years and a 3.3 percent growth rate is predicted for this year. Though capacity and investments in the industrial sector have been diminishing, substantial funds continue to flow into the tourism sector – in fact, Montenegro is a regional leader for foreign direct investment (FDI) per capita. An important reason for this has been the EU integration process which has raised economic governance standards and helped cut 'red tape'. The new approach of the European Commission focusing on small and medium-sized enterprises (SMEs) has also been beneficial. A regional representative stressed that in general the EU-led economic governance reform has been central in shaping a more helpful economic environment in Montenegro. Unemployment in the country has remained at critically high levels, but unlike the other SEE countries, Montenegro has been a net importer of labor, especially for tourism and construction.

Neighboring Serbia continues to suffer from recession, high public debt and widespread unemployment. Full implementation of structural reforms remains the biggest challenge for the economy. A more flexible labor market and a stronger economic rule of law should be priorities. Education reform is also vital; in the meantime, initiatives involving the provision of vocational training by German companies should continue. Certain steps have been made in the right direction to improve the economic environment: entry and exit barriers into the market have been lowered; a new planning and construction law has been introduced; a new loan with the IMF has been agreed; and fiscal policy reforms have reduced public debt. Though reforms are necessary, a specialist highlighted that further reforms may provoke social instability: additional privatization of the public sector may see up to 70,000 to 90,000 people lose their jobs, for example.

While trade is mostly directed towards CEFTA countries and the EU, and EU investors remain important for the economy, especially Germany and Italy, investors from outside the EU have been increasingly in the foreground in Serbia, especially China, the United Arab Emirates, and Turkey. Serbia cannot be 'picky' when it comes to choosing the 'color of the money', though it was stressed that these investments also must adhere to the general spirit of EU economic governance. It was also noted that Serbia is not becoming a re-exporter of Russian goods – in fact, Serbia's exports to Russia have been decreasing. Even though a difficult economic situation has meant that social issues are far higher on the public agenda than EU integration, support for the EU has been consistently quite strong. According to a national expert, Serbian public opinion has been quite rational in relation to EU accession and there has been a realization that accession is probably necessary for improving the economic well-being of citizens.

The situation in Bosnia and Herzegovina (BiH) has been desperate. Economic growth has been non-existent and youth unemployment stands at 60 percent. BiH is a 'low trust' society: people simply do not believe in the politicians and state institutions, and identities are not civic but based on religion or ethnicity. Such low trust makes reforms extremely difficult – BiH has done nothing to reform the employment sector, for example. Public enterprises have been very poorly managed as most have been misused by politicians for political purposes – companies should be reconstructed with a privatization perspective. Though foreign debt in BiH has been low, there is a high budget deficit and the business climate is very poor. Critical issues should be immediately addressed by the government and the EU's Compact for Growth should orient reforms. Specialists stressed that decreasing the high tax burden on employment, and finding a balance between workers rights and employer flexibility, especially in public sector, should be priorities.

Experts judged the British-German initiative for BiH as having a fifty-fifty chance of success; these are higher odds than last year because 'business cannot continue as usual' especially with riots on the street. Non-EU investors have been playing a helpful role in BiH. For example, Turkey has established a 100m Euro fund that grants small credits (normally 100,000 Euros) to SMEs at low rates of interest and with a grace period of ten years. China has won the contract to build a power station in Tulsa. Amidst the pessimism, it was stressed that BiH has an important source of economic potential: renewable energy. As the only country in region that exports electricity, there is huge promise in developing this sector. Small-scale bio-food production in BiH could also be a basis for growth – 'thinking small' could be as important as large-scale infrastructure projects.

Though Albania has been particularly exposed to downturns in the Greek and Italian economies, growth of around 2.5 percent is expected for next year. Looking further ahead, it was noted that a maritime perspective could also provide potential for economic growth.

Despite a mixed picture overall for the region, issues relevant to all countries emerged during the course of the discussion. All speakers agreed: without economic growth, there can be no progress with rule of law and public administration. Infrastructure improvement is also essential for the future economic health of the region, and the EU's Western Balkan investment framework should become an important flexible framework to secure the right kind of investments. Crucial infrastructure investments are not only held back by deficiencies in the region, such as poor absorption capacity and small markets, it was also noted that the EU have not been as helpful as they could be in reducing interest rates. One participant highlighted how low levels of infrastructure investment and cooperation is an 'old story' – these are not technical issues but depend on favorable political dynamics. Investment is necessary for social stability: austerity measures need to be accompanied with economic help for businesses and citizens.

Participants agreed that the countries of the region do not have the means to deal with the pressures of globalization alone; yet, together the countries can compete in the global market. Greater cooperation therefore is necessary: the 'Berlin Conference' of August 2014 was an important opportunity for renewed cooperation, but one participant doubted whether there are sufficient administrative and political mechanisms for the countries to work together.

A clear EU perspective is especially important for the younger generation. Regional representatives suggested that both EU and regional integration need to proceed simultaneously. It was also stressed that joining the EU is no panacea – Croatia's governance has become disoriented after joining the EU. Policy synergy with other international organizations, especially the IMF and World Bank is important. The European Bank for Reconstruction and Development has become an important player under the new European Commission and is predicted to play an important role in the region. A frank and comprehensive study comparing the implementation costs of a fully-fledged accession of SEE to the benefits of 'gaining' the region (and not losing it to other geo-political powers) could convince actors unenthusiastic about enlargement.

There was widespread consensus that education systems in the region are not 'fit for purpose.' Newly emerging areas of the economy, especially in the service sector, have not been served by the education system. Skills are lacking across the board; better vocational training is essential. Privatization has been a troubling process throughout the region. Often the reform of public enterprises has not been an economic policy but about the political control of society, meaning skill levels in the workforce have deteriorated. One expert stressed there is a need to 'create spaces where the state has no say.' Civil society led exchanges for young people could be part of these new dimensions of public life, independent of governments and ideally set in a broader European framework.

Rule of law

Albania has a long way before reaching EU rule of law standards – but the current government has been certainly committed. The most recent Albanian National Security Strategy has identified organized crime and corruption as the two main risks for Albanian society.

One participant emphasized that the rule of law situation in BiH is blighted by the Dayton constitution imposed by international community. The political system has been designed according to ethnic rights and not human rights; consequently individual civic rights cannot take root in BiH – an overhaul of the system may be necessary. Divisions across ethnic lines have been made worse as politicians continue to prey on the fear of individuals to presents themselves as 'strong' ethnic representatives. Even stealing for your ethnic group seems to be tolerated. The anti-corruption agenda has become instrumentalized in BiH, creating opportunities for politically driven corruption cases. Anti-corruption has also somehow polluted perceptions of the political class; now the view is once a politician, by default a criminal. Efforts should concentrate on finding ways to generate sincere corruption cases.

It was noted that the international community has created a highly independent judiciary in BiH that in practice has become substantially corrupt. Judicial sector reform is critical in BiH: new rules in selecting judges and prosecutors, allied to better training is absolutely necessary. With such low trust in politicians and other state institutions, the judiciary remains the last bastion of the rule of law; yet if trust is lost in the judiciary, then the state will be devoid of legitimacy and chaos will ensue. One recommendation made is for the SEE governments to follow the 'open governance' agenda as complete transparency of action can really help build trust with citizens.

The Serbian government is completely dedicated to the rule of law reform according to one participant. Independent institutions, such as the Ombudsperson and state auditors, have been active and visible in public life, and ultimately central to steering rule of law reform in the right direction. These kinds of accountability mechanisms should be further encouraged as part of the EU accession process. Serbia's freedom of media environment has been enhanced through three new legislative acts. The holding of a LGBT pride parade in Belgrade represents a step forward for minority rights. Regional cooperation with regards to the war crime investigations has been a positive development. Still, organized crime remains a real problem and anti-corruption reforms must become more successful in the region. Overall it was stressed that though forward steps have been made in Serbia, there is still a lack of institutional and financial capacity to implement all rule of law aspects involved in EU accession.

Montenegro has been the 'test case' for the EU's new approach to the rule of law. 'Highly demanding' sums up the workload required in this area; often, half of all work is spent on these areas, other areas may well feel neglected. Montenegro's experience reveals that certain elements are very important for other countries, especially efficient administrative structures, the careful tracking of judicial processes and upgrading human capital in the system.

One expert suggested making a distinction between the symptoms and the structural causes of the more undesirable aspects of the rule of law in the SEE. Countries are actually quite impressive in dealing with the symptoms – local police forces cooperate over organized crime, for example. Acquiring tools and techniques to deal with crime or make the judiciary more efficient will not ultimately overcome the structural limitations of rule of law reform related to the values underpinning society. The real problem is that liberal values are too absent from rule of law reform processes and people have vested interests in illiberal networks. Reform will be inherently circumscribed therefore, unless there is a focus on transforming the values underpinning society, and not just on new tools and measures.

Another participant stressed that democratic values should play a larger role in the region. Political elites who speak of EU integration do not encourage a liberal society: political parties are undemocratic, media freedoms are often restricted, and there is very little democratic consciousness. Democratic enhancements are necessary so that the EU has an active parliament and vocal civil society with which to partner.

The ways in which judges are selected is very important and must be improved. In Macedonia and BiH, slowing EU accession has contributed to a weakening of the judicial sector. In fact, one participant noted how since the international judges pulled out of BiH, the judicial sector's independence has deteriorated and judicial councils have become too self- interested and 'independent of reality.'

'Strategic patience' is needed in Brussels, especially as sources of regional tension still remain. But it was advised that the EU should do more to sanction irresponsible political behavior. And although it has been unhelpful that the EU is pushing standards that are not always met in member states (e.g over LGBT rights), participants stressed that EU integration is about changing attitudes and creating common trust – it is here where future success or failure will be determined. The message from the region to the EU is this: 'do not be afraid to complete the job of integration.' A clear timeline is also necessary to focus efforts. Participants also recognized that integration will continue to be a messy, non-linear process but progress made by SEE states should be clearly communicated to wider European community: ten years ago the EU were paying for peacekeepers in the region, now the whole of Europe is benefiting from cooperation with SEE region, a place where the EU's founding values of peace and solidarity have been revitalized in recent years.

ACRONYMS USED

AEO	Authorized Economic Operator
AK Parti	Justice and Development Party
ALMP	Active Labor Market Policies
AQR	Asset quality reviews
ATM	Autonomous Trade Measures
BiH	Bosnia and Herzegovina
BTI	Bertelsmann Transformation Index
BVT	Bundesamt für Verfassungsschutz und Terrorismusbekämpfung
CARDS	Community Assistance for Reconstruction, Development and Stabilization
CEB	Council of Europe Development Bank
CEDEM	Centre for Democracy and Human Rights
CEE	Central East European
CEEC	Central and Eastern European country
CEFTA	Central European Free Trade Agreement
CEFTA-2006	Central European Free Trade Agreement, revised 2006
CESEE	Central, Eastern and Southeastern Europe
CIS	Commonwealth of Independent States
CME	Coordinated market economies
CO	Corruption
CPG	Consumer Packaged Goods
CS	Civil Society
CSF	Common Strategic Framework
CSP	Country Strategy Papers
DCI	Development Cooperation Instrument
DEA	Drug Enforcement Administration
DG	Directorate General
DoC	Diversity of Capitalism
DS	Democracy Score
EAR	European Agency for Reconstruction
EBRD	European Bank und Reconstruction and Development
EC	European Commission
ECA	European Court of Auditors
ECHO	European Consensus on Humanitarian Aid
ECHR	European Court of Human Rights
EEC	European Economic Community
EFSE	European Fund for Southeast Europe
EIB	European Investment Bank
EIDHR	European Instrument for Democracy and Human Rights
ENEF	West Balkans Enterprise Expansion Fund
ENI	European Neighborhood Instrument
EU	European Union
EULEX	European Union Rule of Law Mission
FDI	Foreign Direct Investment
FYR	Former Yugoslav Republic
FYROM	Former Yugoslav Republic of Macedonia
GATT	General Agreement on Tariffs and Trade
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
HJP	High Judicial Council
HJPC	High Judicial and Prosecutorial Council
HSYK	High Council of Judges and Prosecutors

ICCPR	International Covenant on Civil and Political Rights
ICESCR	International Covenant on Economic, Social and Cultural Rights
IFI	International Financial Institutions
IfSP	Instrument contributing to Stability and Peace
IM	Independent Media
IMF	International Monetary Fund
IPA	Instrument for Pre-accession Assistance
IT	Information Technology
JFI	Judicial Framework and Independence
KCK	Kurdistan Communities Union
LDG	Local Democratic Governance
LGBT	Lesbian, gay, bisexual, and transgender
LME	liberal market economies
MIFF	Multiannual Indicative Financial Framework
MIPD	multi-annual indicative planning document
NCTS	New Computerized Transit System
NDG	National Democratic Governance
NEEAP	National Energy Efficiency Action Plan
NGO	Non-governmental organization
NIS	National Intelligence Service
NTB	Non-trade barriers
OECD	Organisation for Economic Co-operation and Development
PHARE	Poland and Hungary Assistance for Restructuring their Economies
PI	Partnership Instrument
PIC	Peace Implementation Council
PPS	Purchasing Power Standards
R&D	Research and Development
RCC	Regional Cooperation Council
RS	Republika Srpska
SAA	Stabilization and Association Agreement
SAP	Stabilization and Association Process
SBA	Standby Arrangement
SEE	Southeast Europe
SEEIC	South East Europe Investment Committee
SEE SEP	South East Europe Sustainable Energy Policy
SFRY	Socialist Federal Republic of Yugoslavia
SME	Small and medium size enterprises
SOCTA	Serious and Organised Crime Threat Assessment
SPC	State Prosecutorial Council
SPS	Sanitary and phytosanitary measures
TANAP	Trans-Anatolian gas pipeline
TAP	Trans Adriatic Pipeline
TBT	Technical barriers to trade
TCK	Turkish Penal Code
TMK	Anti-Terror Act
UNHCR	United Nations High Commissioner for Refugees
UNODC	United Nations Office on Drugs and Crime
USAID	United States Agency for International Development
VAT	Value Added Tax
VC/PE	Venture Capital and Private Equity
VoC	Varieties of Capitalism
WB	Western Balkan

WBC	Western Balkan country
WBIF	Western Balkans Investment Fund
WEF	World Economic Forum
WWF	World Wildlife Fund
WTO	World Trade Organization

EU ENLARGEMENT: BETWEEN CONDITIONALITY, PROGRESS, AND ENLARGEMENT FATIGUE?

Friedrichstraße 60
10117 Berlin
Germany

www.aspeninstitute.de