

# The Impact of the Crisis on the EU Perspective of the Western Balkans

Rumiana Jeleva





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## Executive summary

The impact of the financial and economic crisis on the European perspective of the Western Balkan countries is important: this study, based on combined secondary analysis of quantitative data and a qualitative study, shows that the economic improvement of the population is an essential precondition for public support of European Union (EU or the Union) integration. Hence, reducing the negative influence of the crisis on the economies and improving the economic situation of the populations in the respective countries is vital to popular support for, and the advance of, their European perspective. At the same time, despite the severe economic impact of the crisis on these countries, on their economies and the living standards of their populations, this study clearly shows and confirms the pro-European orientation of the Western Balkan countries. As outlined in the analysis below, they continue to be 'pro-European by nature'. The European Union, and Europe in general, remains the 'standard-setting' realm for the political elites, the governing authorities and the societies in the seven countries covered by the project. However, the political deficits and weaknesses of the democratic process in the region reinforce the negative economic effects of the crisis. What lessons for the future integration have been learned since the economic and financial crisis befell the countries in the region?

1. The impact of the crisis on the Western Balkan countries follows the general European and global trends, but with a certain time lag of a year behind the development of the crisis in the EU and the subsequent stabilisation and indications of recovery there. According to the provisional data, a general trend of recovery was

evident in all the countries in 2011, but it depends mainly on the rate and level of recovery in these countries' main European and regional economic partners. In almost all countries concerned there is still a real or projected GDP growth. One continuing problem is the very low starting level. Undoubtedly, all countries in the region need much higher, better quality and, most important, sustainable growth. Exports should be further stimulated.

2. In the context of their European integration and with regard to the global financial and economic crisis, almost all countries in the region must invest more effort in ensuring macroeconomic stability, continuing consolidation of their fiscal policies and balancing of their national budgets, in order to improve negative trends resulting from problematic budget deficits in recent years; they should maintain prudent fiscal discipline, responsible banking and public finances.
3. More has to be done to fight high unemployment and to continue structural reforms in education, the social sphere and the health system, and to improve the level and skills of the labour force. Enlargement of the private sector and more effective protection of property rights could increase the competitive capacity of the markets.
4. Despite the fragile recovery and the further need for more efforts and deeper reforms, the analysis has confirmed the projections that the countries in the region would start to improve more noticeably starting in 2011.<sup>1</sup> However, the

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<sup>1</sup> The prognosis of the International Monetary Fund, for instance.

question remains open whether these countries could be affected for a second time by a crisis, in view of the prediction that Europe might slide into recession again in 2012 after its slight and uneven recovery in 2011. A repeated crisis in the form of a second recession in the EU/eurozone would certainly have a very negative impact on the economic situation of the populations in the Western Balkans, mainly due to the lower income level and high unemployment there. An increased number of migrants might be expected to leave Western Balkan countries for Western Europe.

5. While all countries of the Western Balkans are making progress towards recovery, it is slower for some than for others.

Kosovo and the former Yugoslav Republic of Macedonia were the two countries least influenced by the economic crisis: Kosovo has suffered minimal impact, due to that country's relative economic reticence, and the former Yugoslav Republic of Macedonia experienced a small, short-lived recession, followed by a rapid recovery. However, Kosovo is not yet on a sure path of economic growth, due to its new and under-scaled public administration, the lack of a source of self-sustaining economy and the undertaking of a financially challenging infrastructure project. The former Yugoslav Republic of Macedonia, on the other hand, is yet to recover its labour market and to develop its public spending schemes. The country's general policy is sound, stability-oriented and supportive of recovery and businesses.

Albania and Croatia share the challenge of having accumulated relatively high debts. In the case of Albania,

the banking sector, the monetary policy and the amount of debt have returned to levels of stable recovery. Yet the country still has to continue tackling inflation, so as to keep it within foreseeable limits, and to balance the budget deficit. In order to tackle the imbalances in the labour market and the external account, Albania needs to introduce further structural reforms, such as bolstering economic governance, enhancing labour market performance and protecting property rights. Croatia, on the other hand, while managing to contain and restore its economic situation in many other areas, is facing the problem of high and rising debt in all economic sectors.

Serbia is gradually recovering from the recession, has increasing exports and rising GDP and productivity, yet is unable to tackle effectively the problem of continuously growing unemployment and inflation shocks.

Bosnia and Herzegovina seems to be on the right path for recovery, yet it is not making significant progress. There are serious issues in the banking system, a large amount of credit in foreign currencies, low employment and fragile growth. Further consolidation of the single economic space in the whole country is needed, as well as more efforts toward fiscal consolidation and state budget optimisation.

Montenegro's fiscal policy gave it little room for response in the beginning of the crisis. While production and foreign investments seem to be recovering, the country still experiences difficulties with its rising public debt and the deteriorating labour market.

6. Further on, the study outlines clearly that inequalities and imbalances in the developments at national and local level, in terms of culture, modernisation, economic improvement and institution building between the countries and/or (ethnic) communities in the region, imply the existence of an unstable political and social atmosphere and have negatively affected the potential of countries and authorities to implement appropriate and necessary reforms. Hence, the approach of the EU towards integration of the Western Balkan countries should take these realities and their societal aspects into consideration. Unresolved and lingering bilateral issues, especially those involving national identity formation, state consolidation and institutional integrity, might affect the whole region. It is up to the European Commission to effectively moderate those processes and the dialogue about them, and to not allow them to hamper or block the enlargement procedure. The cases in which lingering bilateral issues have blocked the process of further accession, such as the 'name' dispute between Greece and the former Yugoslav Republic of Macedonia, show that such situations only lead to hardening of anti-European attitudes within the respective countries, and to unfriendly discourse regarding neighbouring countries, in which the European principles of good neighbourly relations are generally ignored.
7. This study did not confirm the worst scenarios, according to which the negative effects of the crisis would hamper or even block the enlargement process on the sides both of the Western Balkan countries and of the EU.<sup>2</sup> However, certain challenges to the enlargement

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<sup>2</sup> I am referring here to the opinion that, due to the crisis, the EU might renounce or block further accession and that all the efforts of the domestic political actors in the Western Balkan countries might come to be focused on finding solutions to the national financial and economic problems. See more in the section Conclusions.

process remain, since the crisis befell the Western Balkans. The further development of the accession process will have to go on under crisis conditions, amid the slow and fragile recovery and the uncertain economic future of the European Union.<sup>3</sup> Despite this, the Western Balkan countries and the EU have reaffirmed their willingness to advance in the direction of enlargement. Of course, performance on both sides should improve: The Western Balkan countries must do more to meet the accession criteria. At the same time, the EU should improve its approach in order to be more helpful to the domestic pre-accession efforts and modernisation reforms.

8. However, an important finding of this study is that, despite the crisis, the state authorities and populations in the Western Balkan countries remain pro-European. The existence of political consensus within domestic (political) elites and the prevalent discourse of agreement as to the European perspective in these societies are important preconditions for the success of the accession process and for integration. At least at the time this study was conducted, the crisis did not seem to have had an adverse effect on the pro-European orientation of the Western Balkan countries. This finding was confirmed by the referendum in Croatia (conducted while this text was being completed), which registered decisive support for the country's membership in the EU, and by recent steps taken by Serbia to reach an understanding with Kosovo on disputed regional representation in order to obtain EU candidate status.

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<sup>3</sup> Here I am referring to the news about the second recession within the eurozone and the lack of a clear strategy and concrete measures on the part of the EU for achieving greater and sustainable growth.

9. Another challenge before enlargement towards the Western Balkans remains the capacity and the 'health' of the EU to absorb new members after the eurozone crisis and the impact of the economic recession in some EU Member States. The potential of the EU should be kept at its highest level. Disintegrative processes within the EU due to the euro crisis could deepen the nationalistic and anti-European predispositions outside it. Therefore, it is important that the EU remain alive, as associated with the idea of integration and especially enlargement.
  
10. The study emphasises that cooperation of the countries with the European Commission with respect to economic and financial surveillance and monitoring has progressed. The dialogue was defined by the European Commission as good and productive. This is even more important in view of the efforts to establish a new model of a better and more effective European economic governance. The candidate countries should remain an integral part of the dialogue on these efforts. Of course, the Western Balkan countries could choose to introduce the best dimensions and practices of the new European model of enhanced economic governance, even when these are not mandatory for them. This would increase their capacity to overcome the negative impact of the crisis, as well as to access the bigger and effectively functioning single European market. In addition, the confidence in their ability with respect to crisis management even before membership would be improved by applying a more efficient mode of financial policy and seeking greater economic coordination and better economic governance.

11. Finally, the study and analysis below depict how economic problems are intensified by existing political deficits. In other words, where inner political difficulties at state level or in the processes of internal national reconstruction and institution building, and/or external specific bilateral issues such as border disputes, 'name' issues or ethnic disputes, occur in combination with the economic crisis, it is most likely that effective public discussions and political solutions of the latter would be substituted by nationalistic rhetoric and populist projects. In future this might hamper the EU integration process in the respective countries. Certainly the performance of state institutions and the independence and effectiveness of the judiciary must improve in order to ensure good and efficient governance for all citizens in the Western Balkan countries.
12. It must be stated that the European approach towards the Western Balkan countries and their aspirations to achieve EU membership should be based on equal treatment, transparency and visible outcomes. Along with the fact that membership is granted according to the progress achieved by each country and on its own merit, a holistic regional approach should be provided to limit bilateral disputes and minimise ethnic and/or nation-based tensions. EU institutions should demonstrate greater flexibility in order to offer the Western Balkan countries a predictable roadmap for their European integration. The strategy and performance of the EU in the recent enlargement issue, when Serbia was granted candidate status, was an example of efficient use of the 'carrot and stick' approach that finally brought good results for regional cooperation: Serbian authorities came to an understanding with Kosovo on a disputed matter. But more is needed; the Commission must show greater political understanding of political

processes in the Balkans. The representation of the accession process as something only technical, and as a formal covering of criteria, seems hypocritical and false for both sides. For example, it would be too narrow-minded to present the problem of the European future of Kosovo as a matter to be decided only by and with Serbia. Too many EU Member States have not recognised Kosovo yet. On the other hand, Bosnia and Herzegovina's future and further strengthening of its state consolidation and autonomy must be the object of commitment on the part of all neighbouring countries. In general, accession might be advanced and confidence among the parties involved be increased by establishing broader regional and/or European (political) frameworks for tackling specific regional questions and unresolved bilateral issues on the Balkans, for these could obstruct the EU integration process. In this context, platforms for discussion and the use of non-traditional diplomatic approaches (interfaith dialogue, etc.) such as those offered by the EPP, are especially suitable and yield fruitful results. It would be a mistake for the EU, on the basis of political miscalculations, to ignore the pro-European attitudes of the Western Balkan societies, and if accession negotiations are protracted beyond a mid-term timeframe, this might permit the rise to power of anti-European, extremist nationalistic or purely populist projects. I stress this, because as this study has shown, such a development is not desirable for either the populations or the present political elites in the Western Balkans. In general, I am convinced that the incorporation into the EU of as many countries as possible from this region will advance regional cooperation, enhance stability, improve the quality of political dialogue as a whole and contribute to establishing good and functioning—by European standards—political, economic and social spheres.

13. The European institutions, especially the European Commission, should follow the accession procedures strictly, and in a manner foreseeable by the candidate countries. Otherwise, popular frustration about the enlargement and the fatigue of remaining too long in an uncertain status could overwhelm the strong pro-European attitudes in the Western Balkans. On the other hand, the EU itself should get back as quickly as possible to its 'best times' of growth, economic development and financial health. The Union is the standard-setting body for the states and populations alike in the region. It must continue to provide the best examples and patterns of economic development, functioning democracy and good governance.

Perhaps the crisis makes visible more than ever the fact that the European Union will not be completed, and peace, prosperity and good neighborly relations in the Balkans will not be guaranteed permanently until the seven western Balkan countries progress in the process of European integration and get a chance to fully join the EU.

The following analysis, and especially the recommendations at the end of the text, propose some, hopefully, useful solutions in these respects.<sup>4</sup>

### Key words

Western Balkan countries – European integration – Enlargement – Crisis impact – European Union – European Institutions – Transition – Albania – Bosnia and Herzegovina – Croatia – The former Yugoslav Republic of Macedonia – Kosovo – Montenegro – Serbia.

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<sup>4</sup> See the section Recommendations.

## Introduction

This text presents the outcome of a collaborative project aimed at analysing the impact of the economic and financial crisis with regard to the Western Balkan countries seeking membership in the EU.<sup>5</sup> The project is focused on the study and political analysis of the consequences of the crisis in all seven Western Balkan countries:<sup>6</sup> Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Kosovo, Montenegro and Serbia. It also outlines the handling of the crisis (feasible measures, practical implications and political discourses regarding the crisis) in the respective countries, which could influence their orientation to, preparedness for and pathway to the EU. Finally, the project seeks to develop recommendations regarding the EU perspective for the Western Balkans that could encourage a public discussion with political decision-makers, European experts and independent researchers in Brussels and in the countries concerned. The selected approach to the research topic has been to focus on the perspective of the Western Balkan countries. This means that the logic of the study and this presentation of its results mainly look at the situation in the respective countries, at the influence of the crisis on them and their responses to it, as well as how all this reflects on the process of their EU integration and, most importantly, their preparedness for EU

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<sup>5</sup> This project was inspired and supported by the Konrad Adenauer Foundation (KAS) and the Centre for European Studies (CES) in Brussels. After the study is completed, its findings and recommendations to the broader public will be presented at a public conference to be organised in Brussels with the help of the KAS and the CES. As a follow-up to that conference, a debate on the findings will be held in 2012 in workshops within the countries concerned.

<sup>6</sup> The analysis seeks to draw political conclusions and propose political recommendations. The presentation of the economic situation in the Western Balkans and of the financial, economic and social implications of the crisis for this region should serve as a reliable basis for this.

membership. In connection with the current process of EU enlargement in the Western Balkans, the various financial and economic implications of the crisis are presented in order to verify whether it is having an impact, and to what extent, on the European economic, political and social path of the respective countries. It is not the aim of this study and presentation to look at the EU perspective from the point of view of Brussels. The intention is rather to draw the attention of the interested public in Brussels to the current situation in the Western Balkan countries, to assess the latter's willingness and capacity to be integrated, to outline some conclusions about the perspectives on the enlargement process as a whole and to make recommendations to the EU institutions and the politicians in the countries concerned. However, the *Brussels perspective* is nevertheless presented in the present analysis along two lines: (1) an examination of the interest demonstrated by the EU institutions (and especially the European Commission) regarding the impact of the crisis on the Balkans. Here the outcome of a series of conferences and other events relevant to the topic has been integrated into the analysis; and (2) an overview of the progress made by each of the Western Balkan countries in the pre-accession process. Here the developments relevant to the economic criteria for accession have been considered, as well as the general assessment of the European Commission regarding the progress achieved by the countries and their efforts to adjust to the European rules and new regimes of financial discipline and economic coordination.

## Methodology

As the project aims at analysing the complex impact of the economic and financial crisis upon the perspective of the Western Balkan countries with respect to EU membership, a variety of research methods have been used. Secondary analysis of previous quantitative data and published studies,<sup>7</sup> combined with an own qualitative study in the field, has provided a reliable and convincing basis for analysis.

A combination of expert interviews and focus group discussions was applied to the project. Interviewees and discussants in all countries concerned were people either 'sensitised' by European affairs or confronted with the necessity to tackle the financial and economic crisis in their respective countries. Under this category fall (1) decision-makers such as politicians and representatives of the national and local administrations, and (2) opinion leaders such as journalists and representatives of the non-governmental sector or of international organisations and institutions (local people as well as Europeans). One focus group discussion and a number of informal and non-structured interviews were conducted. The focus group discussion with representatives of the second group took place in Sarajevo, Bosnia and Herzegovina, in 2011; its findings are presented in detail in this text. The interviews were conducted mainly with representatives of the first group—decision-makers—in the period between October 2010 and October 2011, in Brussels as well as in Croatia, Bosnia and Herzegovina, and Serbia. The focus group discussion was recorded and transcribed. During the interviews notes were taken and subsequently

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<sup>7</sup> Secondary analysis was made of already collected and published data and surveys carried out by institutions like the IMF, Eurostat, the UN, the World Bank, Gallup and others, on issues related to the Western Balkans and on the impact of the crisis there.

analysed. These notes cannot be taken as a source of quotations, but they do serve to confirm arguments and theses.

The relatively brief timeframe of the project has not allowed study of the opinions of 'ordinary' people about the impact of the financial and economic crisis on the European perspective of the Western Balkan countries. However, we were able to study these opinions, as well as the variety of different discourses, in the course of the fieldwork.

## Structure

The text consists of an introduction, three chapters, a conclusion and recommendations. The introduction presents the research objectives, research approach and chosen methodology, as well as the structure of the text. The first chapter is devoted to the current state of the process of EU enlargement towards the Western Balkans. The second chapter contains the actual analysis of the research problem and presents the widest range of dimensions of the impact of the crisis: the socio-economic aspect, the combination and alignment of national efforts to tackle the crisis with the European system of new economic governance and the national responses to the crisis in the individual countries, as well as the political implications of the crisis for the region and the respective countries. The third part presents the results of a focus group discussion conducted with foreign experts working in the Western Balkans. The aim here is to use the data collected from qualitative research to compare (and complement) the results of the analysis of quantitative data.

## The Western Balkan countries on the way to EU accession: present state of affairs

A gradual and carefully managed enlargement of the Western Balkan countries is in the interest of the EU.<sup>8</sup> The enlargement of the European Union by the accession of the Western Balkan countries will contribute to strengthening stability, freedom and prosperity in Europe as a whole. EU enlargement eastward will be a completion, and not just in geographical terms, of the Union, and will strengthen its borders in Southeast Europe. It would complete the European single market with territory and populations in which European values are widespread and strongly supported. It is especially important that a gradual but foreseeable accession process be offered and guaranteed to all countries concerned.

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<sup>8</sup>The region of the Western Balkans is important for Europe, as constituting a bridge between Central Europe and the Southeast. The region is a periphery and external border of Europe on the Mediterranean Sea. For more references regarding the importance of the Western Balkans for the EU, see O. Minchev, 'Introduction', in *The Western Balkans: Between the Economic Crisis and the European Perspective* (Sofia: IRIS, 2010), 2–6, accessed at <http://www.iris-bg.org/files/The%20Western%20Balkans.pdf> on 20 October 2011; European Commission, *Albania 2011 Progress Report*, Commission Staff Working Paper, SEC(2011) 1205 final (12 October 2011), accessed at [http://ec.europa.eu/enlargement/pdf/key\\_documents/2011/package/al\\_rapport\\_2011\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/al_rapport_2011_en.pdf) on 20 November 2011; European Commission, *Bosnia and Herzegovina 2011 Progress Report*, Commission Staff Working Document, SEC(2011) 1206 final (12 October 2011), accessed at [http://ec.europa.eu/enlargement/pdf/key\\_documents/2011/package/ba\\_rapport\\_2011\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/ba_rapport_2011_en.pdf) on 20 November 2011; European Commission, *Montenegro 2011 Progress Report*, Commission Staff Working Paper, SEC(2011) 1204 final (12 October 2011), accessed at [http://ec.europa.eu/enlargement/pdf/key\\_documents/2011/package/mn\\_rapport\\_2011\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/mn_rapport_2011_en.pdf) on 20 November 2011; European Commission, *Opinion on Serbia's Application for Membership of the EU, Analytical Report*, Commission Staff Working Paper, COM(2011) 668 final (2011), accessed at [http://ec.europa.eu/enlargement/pdf/key\\_documents/2011/package/sr\\_analytical\\_rapport\\_2011\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/sr_analytical_rapport_2011_en.pdf) on 20 November 2011; European Commission, *Opinion on the Application for Accession to the European Union by the Republic of Croatia*, COM(2011) 667 final (12 October 2011), accessed at [http://ec.europa.eu/enlargement/pdf/key\\_documents/2011/package/hr\\_opinion\\_2011\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/hr_opinion_2011_en.pdf) on 20 November 2011; European Commission, *Former Yugoslav Republic of Macedonia 2011 Progress Report*, Commission Staff Working Paper, SEC(2011) 1203 final (12 October 2011), accessed at [http://ec.europa.eu/enlargement/pdf/key\\_documents/2011/package/mk\\_rapport\\_2011\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/mk_rapport_2011_en.pdf) on 20 November 2011.

However, future enlargements will concern countries that are at different stages of progress on their road to the EU.<sup>9</sup>

Croatia is a candidate country that completed the accession negotiations with the EU in June 2011.<sup>10</sup> According to the Commission's latest opinion on Croatia's accession to the EU, this country is meeting the required political criteria. It is therefore expected that Croatia will have fulfilled all the economic and *acquis* criteria and be ready for membership by 1 July 2013.<sup>11</sup>

In December 2005 the European Council granted the former Yugoslav Republic of Macedonia the status

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<sup>9</sup> The following analysis concerning the accession status of the Western Balkan countries is based on the European Commission's progress reports on its opinions regarding Serbia and Croatia, published in October 2011. The European Council deliberated on these documents at its December meeting. Since March 2002, the Commission has reported regularly to the Council and the European Parliament on progress made by the countries of the Western Balkans.

<sup>10</sup> The conditions of admission and the adjustments of the Treaties were negotiated at a conference between the Member States and Croatia. These negotiations were conducted in line with the negotiating framework, which provides for strict conditionality at the stage of opening and closing chapters. The negotiations were completed on 30 June 2011; according to the European Commission's formal opinion on Croatia from October 2011, the provisions agreed upon are fair and proper.

<sup>11</sup> In its opinion, in a large paragraph, the European Commission states: 'Croatia has reached a high level of preparedness for membership. The Commission calls on Croatia to maintain its efforts to align with the *acquis* and further strengthen its administrative capacity, including through sustainable progress of its public administration reform. The Commission will continue to monitor closely Croatia's fulfilment of all the commitments undertaken in the accession negotiations, including those that must be achieved before the date of accession, and its continued preparations to assume the responsibilities of membership upon accession. Monitoring will focus in particular on commitments undertaken by Croatia in the area of the judiciary, the fight against corruption, and fundamental rights, in the area of justice, freedom and security, including border management, as well as in the area of competition policy. If issues of concern are identified during the monitoring process and are not remedied by Croatia, the Commission will, when necessary, address early warning letters to the Croatian authorities and may propose to the Council to take all appropriate measures prior to accession. The Commission also reserves the right to invoke the various safeguard clauses set out in the Accession Treaty as well as the specific mechanism for State aid to the Croatian shipbuilding and steel industries' (European Commission, *Opinion on the Application for Accession to the European Union by the Republic of Croatia*, COM(2011) 667 final (12 October 2011), para 11, accessed at [http://ec.europa.eu/enlargement/pdf/key\\_documents/2011/package/hr\\_opinion\\_2011\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/hr_opinion_2011_en.pdf) on 20 November 2011). But postponing the date of accession is less likely, excepting the case of an eventual lack of capacity in the EU to absorb new members and/or the country's non-fulfilment of economic criteria regarding a functioning market economy, capacity to cope with competitive pressure and market forces within the Union or shortcomings regarding the *acquis* criterion of being able to assume the obligations of membership arising from the Treaties and the Union legislation.

of a candidate country. In October 2009 the European Commission recommended to the Council that it open negotiations with the country as well as move to the second phase of implementation of the Stabilisation and Association Agreement; the Commission reiterated its proposals in 2010. However, the Council has not yet concluded its deliberations on the Commission's proposals, and accession negotiations have not started yet.<sup>12</sup>

Since 2010, Montenegro has also been a candidate country for EU membership. Montenegro's European perspective was endorsed by the Council in June 2006 after the recognition of the country's independence by the EU Member States. Montenegro submitted its application for EU membership on 15 December 2008. The Commission recommended that the Council should grant Montenegro the status of candidate country and considered that negotiations for accession to the European Union should be opened with Montenegro once the country had achieved the necessary degree of compliance with the membership criteria.<sup>13</sup>

Albania is also a candidate country. It presented its application for EU membership in April 2009. In compliance with the procedures prescribed, a European Commission opinion on the country's application was presented in November 2010. A month later the European Council endorsed the recommendations contained in the Commission

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<sup>12</sup> A major topic of discussion is the so-called name issue between the former Yugoslav Republic of Macedonia and Greece. Although this is a bilateral question that is not due to be solved as part of the accession process, it is of the greatest importance as a major identity issue for both countries.

<sup>13</sup> The Commission's 2011 progress report on Montenegro reaffirmed the necessity for the country to fulfil some of the following key criteria mentioned in the opinion on Montenegro's accession in 2010: improvement of the legislative framework for political elections, including strengthening the Parliament's legislative and oversight role; completing the public administration reform in order to enhance professionalism and de-politicisation of civil servants; enforcing the judiciary system reform; improvement of the anti-corruption legal framework and implementation of the government's anti-corruption strategy and action plan; establishment of a solid track record of proactive investigations, prosecutions and convictions in corruption cases at all levels; strengthening the fight against organised crime, etc. (European Commission, *Montenegro 2011 Progress Report*).

opinion. They state that the opening of accession negotiations with Albania will be started after the Commission assesses that the country has achieved the necessary degree of compliance with the membership criteria and, in particular, has met the key priorities set out in the Commission's opinion. In the 2011 first progress report on Albania's application, the Commission assessed the fulfilment of these criteria and did not recommend opening EU accession negotiations at this time.<sup>14</sup>

Similarly to Albania, Serbia presented its application for EU membership in 2009.<sup>15</sup> Due to a lack of cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY) the process slowed down at the next steps of the procedure. Subsequently, in October 2010, the Council of the European Union requested that the Commission submit its opinion on this application. The arrest and transfer to the ICTY of Ratko Mladić and Goran Hadžić were crucial steps for moving the application procedure forward and removed a major obstacle on the European path of Serbia. This step is especially important with respect to the regional cooperation between the Western Balkan countries and the process of reconciliation, of which the region is in strong need. A second significant obstacle was the lack of dialogue between

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<sup>14</sup> 'Albania has made limited progress in meeting the political criteria for membership and the twelve key priorities for the opening of accession negotiations, as identified in the Commission's opinion endorsed by the Council in December 2010. There has been some progress in fighting organised crime, on improving the treatment of detained persons in prisons and on rights of the child, but progress remains insufficient regarding the judiciary, anti-corruption policy, property rights and improving the living conditions of the Roma community, in addition to the work needed on parliamentary procedure and elections. Albania has started implementing an action plan to address the recommendations of the Commission's opinion. However, further efforts are required to ensure the effectiveness and completeness of the actions envisaged, including through close cooperation with the opposition. Albania will need to make sustained efforts and achieve demonstrable progress on all of these matters before the Commission can recommend candidate status and the opening of EU accession negotiations'. (European Commission, *Enlargement Strategy and Main Challenges 2011–2012*, Communication from the Commission to the European Parliament and the Council (12 October 2011), 15, accessed at [http://ec.europa.eu/enlargement/pdf/key\\_documents/2011/package/strategy\\_paper\\_2011\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/strategy_paper_2011_en.pdf) on 20 November 2011.)

<sup>15</sup> On 22 December 2009.

Belgrade and Pristina: the establishment of dialogue has been made, which in itself marks significant progress, though what the results will be is not yet clear. The 2011 Commission's opinion recommends that the Council should grant Serbia the status of candidate country, a recommendation based on the progress achieved in reforms, displayed cooperation with the ICTY and regional reconciliation, and on the understanding that Serbia will re-engage in the dialogue with Kosovo and move swiftly to the implementation in good faith of agreements reached to date.<sup>16</sup> Negotiations with Serbia should be opened as soon as it achieves further progress in normalising relations with Kosovo, in line with the conditions of the Stabilisation and Association Process.

Bosnia and Herzegovina, and Kosovo are potential candidates for EU membership. Both countries have to make additional efforts to complete the state-, nation- and institution-building process.<sup>17</sup> Significant for the European perspective on these two countries is the permanent interest of the European institutions in assessing the progress made in political and economic reforms and in measuring their adaptability and adjustment to the EU in all aspects of future membership. However, for countries involved in disputes over borderlines or afflicted with absence of good neighbourly relations, it might be difficult to fulfil the Copenhagen criteria for EU membership (see Appendix 1 and 2). According to experts on the Western Balkans, a compromise on the Kosovo issue does not seem possible in a mid-term perspective, mainly in view of the currently prevailing public attitudes in Serbia. This situation may affect the process of

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<sup>16</sup> This part of the text was prepared before December 2011, when the European Council took a positive decision on Serbia's status.

<sup>17</sup> Since 1995 an international presence under UN mandate, namely the Office of the High Representative (OHR) has been in place in Bosnia and Herzegovina. The Peace Implementation Council Steering Board has set objectives and conditions to be met for the closure of the Office of the High Representative. Kosovo has been recognised by 81 UN Member States, including 22 EU Member States.

EU accession of all Western Balkan countries. That is why it is extremely important to do more than just emphasise the regional perspective of these countries. Even more important is to make the Kosovo issue as important as possible for the regional EU perspective, putting it under consideration by all countries in the region, and not only Serbia and Kosovo.

All the countries in the region, except Croatia, must invest more efforts to further strengthen their institutional development, so as to attain the standards of EU membership. All Western Balkan countries without exception should deal with the issue of transparency of relationships between state and society, should provide more security for their citizens and prove they are efficient partners in the periphery of Europe. This means they must show greater effectiveness in the fight against organised crime and corruption (See appendix 2).

In the effort to bring the countries of the Western Balkans progressively closer to the EU, and to support their adjustment to the requirements of EU membership, a Stabilisation and Association Process was established with all of them.<sup>18</sup> Thanks to this process, these countries now enjoy free access to the benefits of the European single market for practically all their exports, as well as EU financial support for their reform efforts. The core of the process is a Stabilisation and Association Agreement, which represents a contractual relationship between the EU and each Western Balkan country, entailing mutual rights and obligations. The Stabilisation and Association Agreements focus on respect for key democratic principles and the core elements that are at the heart of the EU single market. As a result of a free trade area with the EU and the concomitant discipline acquired

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<sup>18</sup> Stabilisation and Association Agreements, either signed or in force, have been concluded with all Western Balkan countries.

(competition and state aid rules, intellectual property, etc.) and benefits gained (e.g. rights of establishment), and through reforms designed to enable the adoption of EU standards, this process will allow the economies of the region to smoothly integrate into that of the EU.

Also worth mentioning is the visa liberalisation granted to Albania, Serbia, the former Yugoslav Republic of Macedonia, and Bosnia and Herzegovina, which is a significant step that brings the citizens of these countries closer to the freedoms enjoyed by European citizens and the values shared within the EU. The analysis below will show the impact this process has had and how this impact has actually intensified during the crisis.

In concluding, it should be said that the European approach to the Western Balkan countries and their aspirations for EU membership should be based on equal treatment, transparency and visible outcomes. Along with the fact that membership is granted according to the progress achieved by each country and on the basis of its own merit, a holistic regional approach should be provided in order to limit bilateral disputes and minimise ethnic and/or nation-based tensions. EU institutions should demonstrate greater flexibility in order to offer the Western Balkan countries a predictable roadmap for their European integration. This is an important aspect in guaranteeing freedom and security in the region and in Europe as a whole, as well as for continuing the process of internal modernisation and institutional development in the respective countries.

## The crisis and its impact on the Balkans

The global economic and financial crisis has evidently affected all the European economies to various degrees. In general, it has raised the question of the crisis management potential of the EU; it has also challenged, for a certain period at least, the policymaking process infrastructure in Europe.<sup>19</sup> This infrastructure involves gradualism and the management of external relations, especially those with the Western Balkans as a core area of future EU enlargement. However, the EU has repeatedly reaffirmed at the highest level its commitment to the European perspective of the Western Balkans, provided they fulfil the accession criteria. In order to tackle the crisis in the Western Balkan countries, a number of EU institutions and entities have made it a subject of their discussions in the past two years. This fact also shows the firm commitment of both the EU and the Western Balkan countries to continue their efforts for accession.<sup>20</sup>

As many studies have shown, almost all countries of the region have been severely hit by the financial and economic crisis that began in 2009.<sup>21</sup> Some of them, such as the former

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<sup>19</sup> Indicative in this respect were the discussions about where to 'place' European economic governance in summer 2010, the formation of the Task Force under the chairmanship of Van Rompuy, the creation of new monitoring and surveillance bodies at EU level, and last but not least, all the debates on whether or not the new regime of enhanced economic integration should apply as well to EU Member States outside the eurozone, whether or not the Treaties should be changed, etc.

<sup>20</sup> See, for example, the initiatives of the Regional Cooperation Council at <http://www.rcc.int> and <http://www.rcc.int/pages/0/32>, accessed at 10.11.2011, as well as the information of the European Commission on the conference The Western Balkans: Overcoming the Economic Crisis—From Regional Cooperation to EU Membership, accessed at [http://ec.europa.eu/enlargement/western-balkans-conference/index\\_en.htm](http://ec.europa.eu/enlargement/western-balkans-conference/index_en.htm) on 24 May 2011.

<sup>21</sup> W. Bartlett, 'The Social Impact of the Global Economic Crisis in the Western Balkans with a Focus on the Republic of Macedonia', Pecob's Papers Series: European Institute (London: London School of Economics and Political Sciences, 2010); Council for Foreign Economic Relations (COFER), *Global Financial Crisis and Its Impact on Balkans* (Skopje: COFER, 2009).

Yugoslav Republic of Macedonia, Kosovo and Albania, were initially less affected, because they were less integrated into the global economy. Nevertheless, the broad impact of the crisis on the region's economic growth, the contraction of export demand, falling remittance flows, decreased bank credit and sharply reduced flows of foreign direct investment have already been analysed in some cases<sup>22</sup> and become politically problematic at EU level in general.<sup>23</sup> However, the social effects of the crisis seen in terms of unemployment, but assessed also on the basis of poverty rates, income inequality and ethnic tensions, have been far worse than indicated by the official macroeconomic data. As could be expected, the personal repercussions resulting from the crisis might also be indicative of the capacity of the respective societies to overcome it. In this context, it was worthwhile to analyse the effectiveness of the domestic crisis responses and their coordination within the context of the European efforts and international policies. The domestic political responses to the crisis should not only be focused on the crisis exit strategies but must also seek to develop the long-term competitive capacity and stable economic and social development of the region towards European integration.

### **Socio-economic impact of the crisis on the Western Balkan economies: some indicators in a comparative perspective**

The consequences of the crisis for the Western Balkans have not been of the typical sort for a financial crisis, but rather consist in an economic turbulence and recession resulting from the global impact of the crisis on the developed

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<sup>22</sup> Bartlett, 'The Social Impact'.

<sup>23</sup> See the European Commission conference The Western Balkans: Overcoming the Economic Crisis.

economies in Western Europe and the United States. In other words, the crisis penetrated into the region ‘from outside’. Among the causes of its severe impact on the Western Balkan countries are the lack of demand on the world markets for their local products, reduced trade in general, limited access to funding, reduced direct foreign investment and—last but not least—the decreased amount of remittances flowing back into the region from migrant workers.<sup>24</sup>

When considering the countries in the Western Balkan region, one must have in mind that these are small economies and not very large markets.<sup>25</sup> In 2011 almost all economies in the region—with few exceptions—suffered from more or less the same problems: unemployment remains high and is still rising in most of these countries. For example, unemployment in Kosovo, Bosnia and Herzegovina, and the former Yugoslav Republic of Macedonia, is the highest in Europe.<sup>26</sup> At the same time, employment rates also remain low. This is especially true for women and young people, for whom labour force participation rates in almost all the countries in question remain very low. These two groups are especially vulnerable and, as a rule, are often the main sources for the informal economy, which is widespread in this region.

In general, recovery is difficult here. As evident from the analysis below, economic growth and recovery in general are mainly driven by external demand. Exports from the

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<sup>24</sup> See also Gallup Balkan Monitor in Partnership with the European Fund for the Balkans, *The Effects of the Financial and Economic Crisis* (May 2011).

<sup>25</sup> Statistics on population size are highly doubtful, due to the lack of recent census in some of the countries we are discussing, but in any case, the region’s common market encompasses little more than 20 million people.

<sup>26</sup> European Commission, *Albania 2011 Progress Report*; European Commission *Bosnia and Herzegovina 2011 Progress Report*; European Commission, *Montenegro 2011 Progress Report*; European Commission, *Opinion on Serbia’s Application for Membership of the EU*; European Commission, *Opinion on the Application for Accession to the European Union by the Republic of Croatia*; European Commission, *Former Yugoslav Republic of Macedonia 2011 Progress Report*.

Western Balkans continue to consist mainly in low-value-added products, including commodities that are subject to price volatility and strong competition from emerging markets. In addition, the Western Balkan economies are highly interconnected and interdependent, which presupposes a high sensitivity of most of them when a single one is hit by economic difficulties. Therefore, in times of global financial and economic crisis, with regard to preparing for EU accession and meeting the economic criteria, the comparative advantage would go to those of the countries that can rely on sustainable and stable institutional developments and adequate and timely reforms. The recent global financial crisis and the present difficulties of the eurozone have highlighted the interdependence of national economies both within and beyond the EU. These events emphatically show the importance of further consolidating economic and financial stability and fostering growth, including in the enlargement countries. The European institutions in charge of enlargement have declared that they are using it as a powerful tool to that end.<sup>27</sup> This is even more important when considering the political impact of the economic crisis on the relatively newly established states and nations in the Western Balkans. In this context, some observers claim that this interrelation between a fragile development of state, nation and institutions, on one hand, and the severe impact of the global economic crisis, on the other hand, is precisely the biggest challenge to the Balkans.<sup>28</sup> In contrast with the developed economies, insufficient resistance is given by all these countries against

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<sup>27</sup> European Commission, *Enlargement Strategy and Main Challenges 2011–2012*; European Commission, *Albania 2011 Progress Report*; European Commission, *Bosnia and Herzegovina 2011 Progress Report*; European Commission, *Montenegro 2011 Progress Report*; European Commission, *Opinion on Serbia's Application for Membership of the EU*; European Commission, *Opinion on the Application for Accession to the European Union by the Republic of Croatia*; European Commission, *Former Yugoslav Republic of Macedonia 2011 Progress Report*.

<sup>28</sup> Minchev, 'Introduction', 2–6; and O. Minchev, 'Conclusions', in *The Western Balkans: Between the Economic Crisis and the European Perspective* (Sofia: IRIS, 2010), 127–9, accessed at <http://www.iris-bg.org/files/The%20Western%20Balkans.pdf> on 20 October 2011.

the chain reaction whereby economic crisis would lead to social unrest or internal ethnic tensions. Social protests against the crisis could easily be exploited for political aims. Hence, extremist or populist political projects, including those which are using anti-European rhetoric, might benefit from the economic difficulties. According to experts, economic turbulence in the Balkans can easily lead to a growth of the grey economy and/or a rise in some patterns of crime.<sup>29</sup>

As stated above, the effects of the global financial and economic crisis of 2007–8 struck the Western Balkan countries most severely in 2009 (see Figure 1). Regarding gross domestic product (GDP), the figures indicate that the Balkans follow the general global and European trends, but the change is registered a year later.<sup>30</sup>

Provisional data show that, after the hesitant recovery in 2010, the economic activities in most of the countries in the region continued to grow during the first half of 2011. The real GDP grew in all countries year on year in the first quarter of 2011. Whereas, according to the provisional data, the GDP growth in 2010 and 2011 in most of the countries in the region, such as Albania and Bosnia and Herzegovina, was mainly driven by foreign demand and the increased exports of goods, in the former Yugoslav Republic of Macedonia private consumption was the main factor of growth.<sup>31</sup>

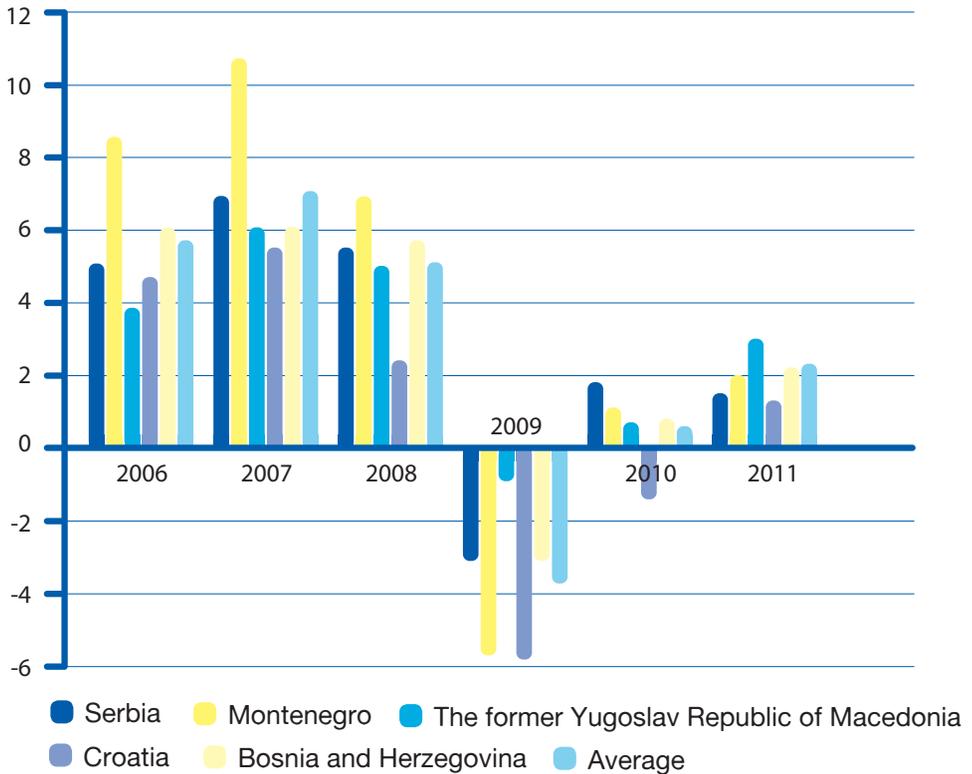
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<sup>29</sup> Institute for Regional and International Studies, *The Western Balkans: Between the Economic Crisis and the European Perspective* (Sofia: IRIS, 2010), accessed at <http://www.iris-bg.org/files/The%20Western%20Balkans.pdf> on 20 October 2011.

<sup>30</sup> It must be admitted that GDP is just one indicator among many and describes the economic development one-sidedly. As many experts have pointed out, the crisis has affected not just the economic growth but also the levels of unemployment, has increased government debt and has aggravated public finances in general. It has also led to a decrease of foreign investment and funding, which are the most powerful engines for growth in economies like those of the Balkans.

<sup>31</sup> See also European Commission, *Former Yugoslav Republic of Macedonia 2011 Progress Report*. The report indicates that private consumption increased 8.4% year on year, according to the provisional data for 2011.

Figure 1 GDP of some Western Balkan countries in comparison (real GDP in per cent)<sup>32</sup>



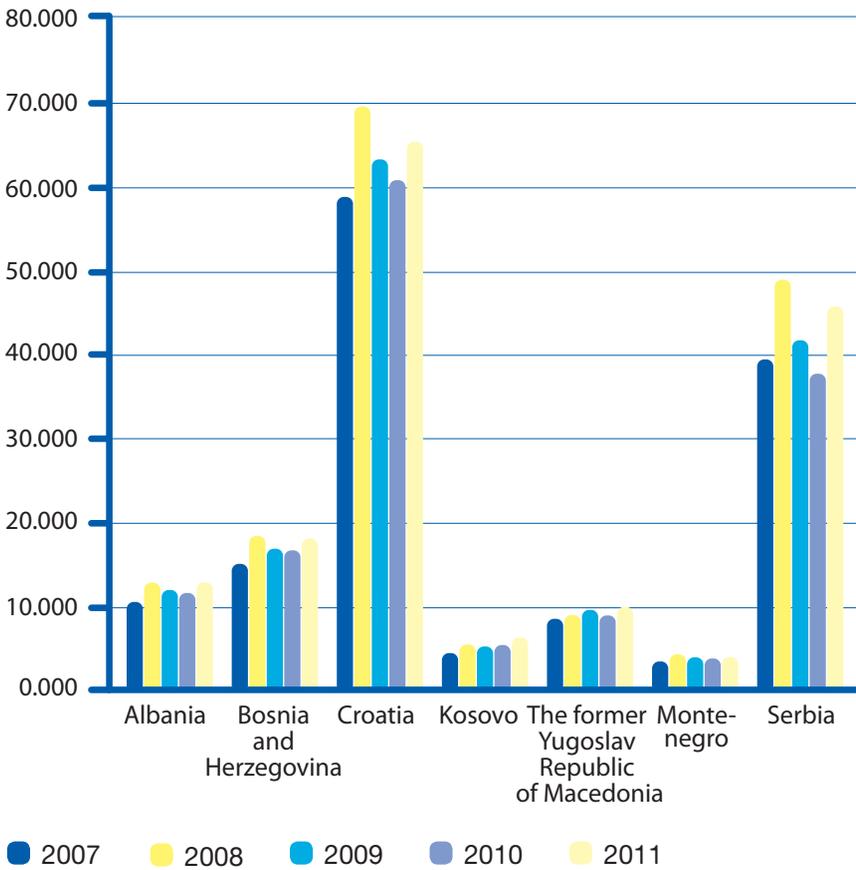
Concerning the recovery of the separate countries, the provisional data for 2011 show that the economy of countries like Albania and Serbia continued growing, though below the high rates prior to the crisis. After the 2009 recession, Bosnia and Herzegovina’s economy slowly continued to gain steam in 2010 and 2011, although the recovery remains fragile.<sup>33</sup> In the former Yugoslav Republic of Macedonia economic activity has started to regain strength since the autumn of 2010.

<sup>32</sup> See also H. Bohnet and M. Sroka, Aktuelle Herausforderungen für die serbische Regierung mit Fokus auf Wirtschaftsfragen. Unpublished internal report to the KAS (2011).

<sup>33</sup> European Commission, *Bosnia and Herzegovina 2011 Progress Report*.

However, government spending for construction has played an important part in the strong rise of gross fixed capital formation. In addition, the measures implemented to support

Figure 2 GDP of Western Balkan countries (current prices in US dollars, billions)<sup>34</sup>



<sup>34</sup> Most of the figures and data in the tables are sourced from International Monetary Fund (IMF) reports, except those for which there is an explicit reference to other sources. The data for 2011 are provisional and mostly based on the economic outcome in the first half of the year.

small and medium-sized enterprises (SMEs) and improve the entrepreneurial environment have shown their first positive results.<sup>35</sup> In contrast, in Croatia the global financial and economic crisis caused a protracted recession, which continued even through the first quarter of 2011. Along with the fragile economic recovery, one of the biggest problems remains the low standard of living and the high poverty rate in these countries.<sup>36</sup>

Per capita GDP is another indicator that gives additional insight into the economic situation in the Western Balkan countries.

In all countries in the region this indicator remains very low and quite far from the average EU indicator;<sup>37</sup> hence, it illustrates very clearly the lower standard of living of the populations in the Western Balkan countries. For example, the per capita GDP in terms of purchasing power parity was estimated for Albania to be at 27.1% of the EU27 average in 2009, up from 25.9% in 2008. In contrast to this, in Croatia GDP per capita in purchasing power terms fell from 65% of the EU27 average in 2009 to 61% in 2010.<sup>38</sup>

These data correspond to the figures of another indicator illustrating the lower standard of living in the Balkans—the UN Human Development Index (HDI). In the 2010 ranking of the UN HDI, Serbia was in position 60, Croatia 51, Bosnia and Herzegovina 68, the former Yugoslav Republic of Macedonia

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<sup>35</sup> See the special measures implemented in the former Yugoslav Republic of Macedonia (Appendix 4).

<sup>36</sup> For example, in Serbia. See also Bohnet and Sroka, Aktuelle Herausforderungen für die serbische Regierung mit Fokus auf Wirtschaftsfragen.

<sup>37</sup> EU27 is equal to 100.

<sup>38</sup> Data quoted from Institute for Regional and International Studies, *The Western Balkans*, and Eurostat. *GDP per Capita in PPS*, accessed at <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tec00114> on 10 January 2012.

71 and Montenegro 49.<sup>39</sup> Only a year later the rankings were the following: Serbia 59, Croatia 46, Bosnia and Herzegovina 74, Montenegro 54 and Albania 70.<sup>40</sup> These HDI rankings, which measure development by combining the indicators of life expectancy, educational attainment and income into a single composite index, indicate a slight rise in ranking for some of the countries and a downward shift in others. This fact raises the question about the sustainability of the economic progress and development achieved in this region. Obviously, effective crisis management and crisis exit as well as sustainability of growth and social equity must be addressed in parallel, especially considering that the countries in the Western Balkans started in the 1990s from a very low level of development.

The Western Balkans had serious unemployment rates even before the crisis, and after 2008 the levels were exacerbated. However, after the crisis became intense in 2009, almost all these countries continued to have higher unemployment rates than the EU average. For example, in Serbia the unemployment rate increased starting from 2008 and was expected to reach 19.6% in 2011. In Albania the unemployment was high at 13% in 2010, the same as a year earlier. In general, the disturbing fact is that, although the economy has achieved moderate growth and in the different Western Balkan countries some economic activities (trade, industry, services) have increased slightly in 2010, unemployment remains very high. According to a researcher from an independent non-governmental organisation (NGO),

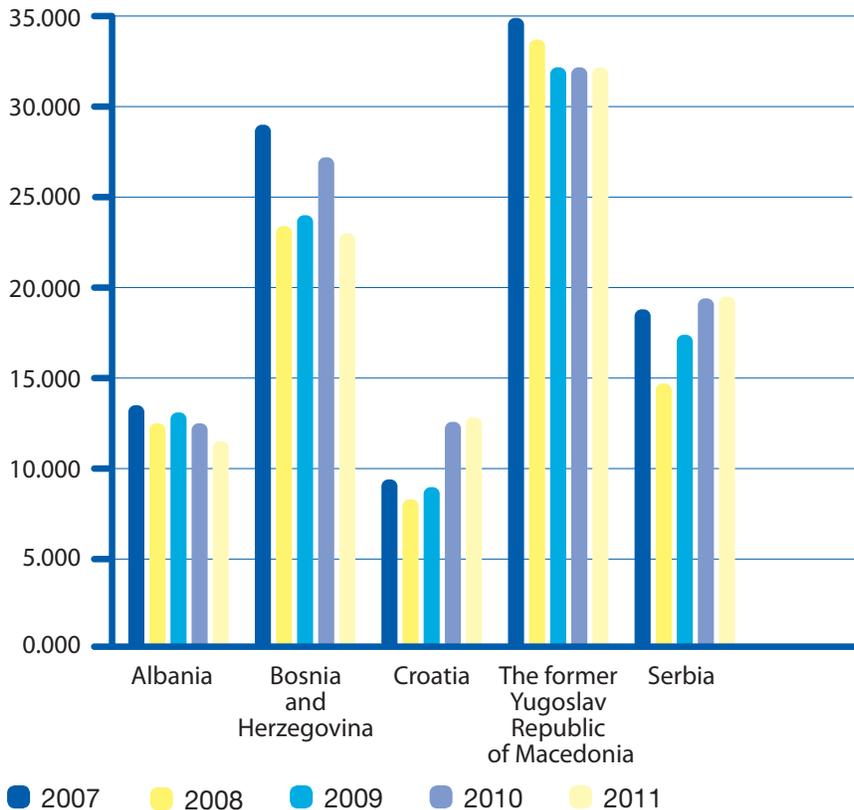
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<sup>39</sup> HDI evaluates the position of states according to many criteria; among them are health, education, equality, poverty and gender equality. See United Nations, *International Human Development Indicators*, accessed at <http://hdr.undp.org/en/data/profiles/> on 10 January 2012.

<sup>40</sup> United Nations Development Programme, *Sustainability and Equity: A Better Future for All*, Human Development Report 2011, accessed at <http://hdr.undp.org/en/reports/global/hdr2011/> on 10 January 2012.

Figure 3 Unemployment in Western Balkan countries

Unemployment rate (percentage of total labor force)



unemployment is highest in Kosovo—about 70%.<sup>41</sup> According to some analyses, the employment rates may be expected to grow—providing the EU economy improves—only after 2011.<sup>42</sup>

<sup>41</sup> See the KAS internal report on Kosovo in Y. Ertan, *Wirtschaftskrise in Kosovo*, Länderbericht: Kosovo, accessed at <http://www.kas.de> on 31 September 2011.

<sup>42</sup> IRIS, *The Western Balkans*.

Therefore, the efforts to return to the levels of employment before the crisis and create new jobs are essential for the Balkans. According to experts and analysts, 'any significant job loss would translate into substantial social problems, including rise in some forms of crime and the grey economy, political tensions, and, in many of the countries, inter-ethnic issues'.<sup>43</sup>

Looking at the trade balance and current account deficits, we see that all countries were significantly above the EU average in 2009 and 2010.<sup>44</sup> For the past three to five years some of the countries in the region, such as Albania, Bosnia and Herzegovina, Montenegro and Kosovo, have had highly negative balances. Because of the relatively higher inflation,<sup>45</sup> the crisis has had a certain positive effect on trade deficits in the Balkans, as it helped lower the gap between exports and imports. As a rule the Western Balkan countries import much more than they export, but since 2010 there has been a decrease of foreign demands and exports of goods; this aggravates their economic situation and is the major obstacle to recovery. Evident from the data below (see Figure 4 and 5), after 2009, the most critical year for imports as well as exports, the recovery in both areas remains slow. Along with its importance within the domestic economies in the region, trade plays a central role in the EU's efforts to promote European principles of democratic governance and economic prosperity in the Western Balkan countries. In 2010 the trade figures for EU goods exports to the Balkans amounted to 26.49 billion euros, while EU imports of goods from the

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<sup>43</sup> Ibid., 17.

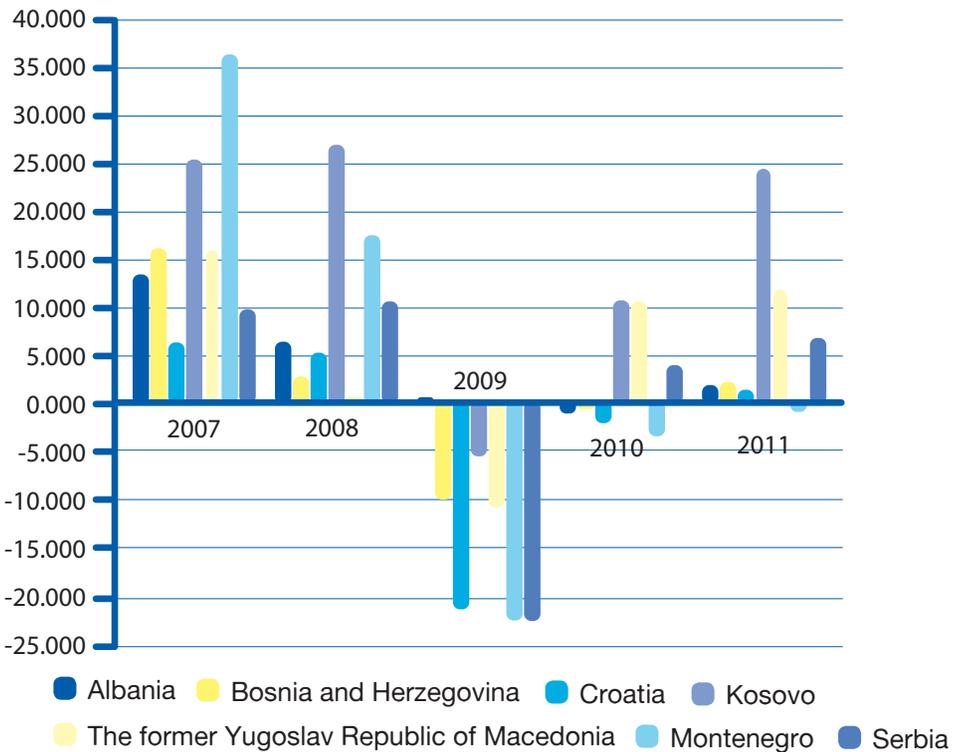
<sup>44</sup> For the EU averages for 2010 and 2011, see Eurostat, *Euroindicators 128/2011* (news release) (9 September 2011), accessed at [http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/2-09092011-AP/EN/2-09092011-AP-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-09092011-AP/EN/2-09092011-AP-EN.PDF) on 10 January 2012.

<sup>45</sup> According to the provisional data for 2011, the overall tendency for most countries in the region is one of increased inflation compared with the rates in 2010. This is especially true for the former Yugoslav Republic of Macedonia; the trend is lower in Croatia, Albania, and Bosnia and Herzegovina. The only exception is Serbia, where the prognoses are for a decrease by half compared with the extremely high inflation rate in 2010.

Balkans were 14.03 billion euros. Obviously, there is room for improvement. This could be achieved by exploring new export patterns and identifying additional priority areas. Some studies point out the need for deeper regional integration between Western Balkan countries to increase the region’s attractiveness for investors and foreign direct investment (FDI) inflows.<sup>46</sup> Further efforts are required to intensify the development of domestic human capital, so as to improve productivity and help overcome the predominance of low-skill content in exports.

Figure 4 Import into Western Balkan countries

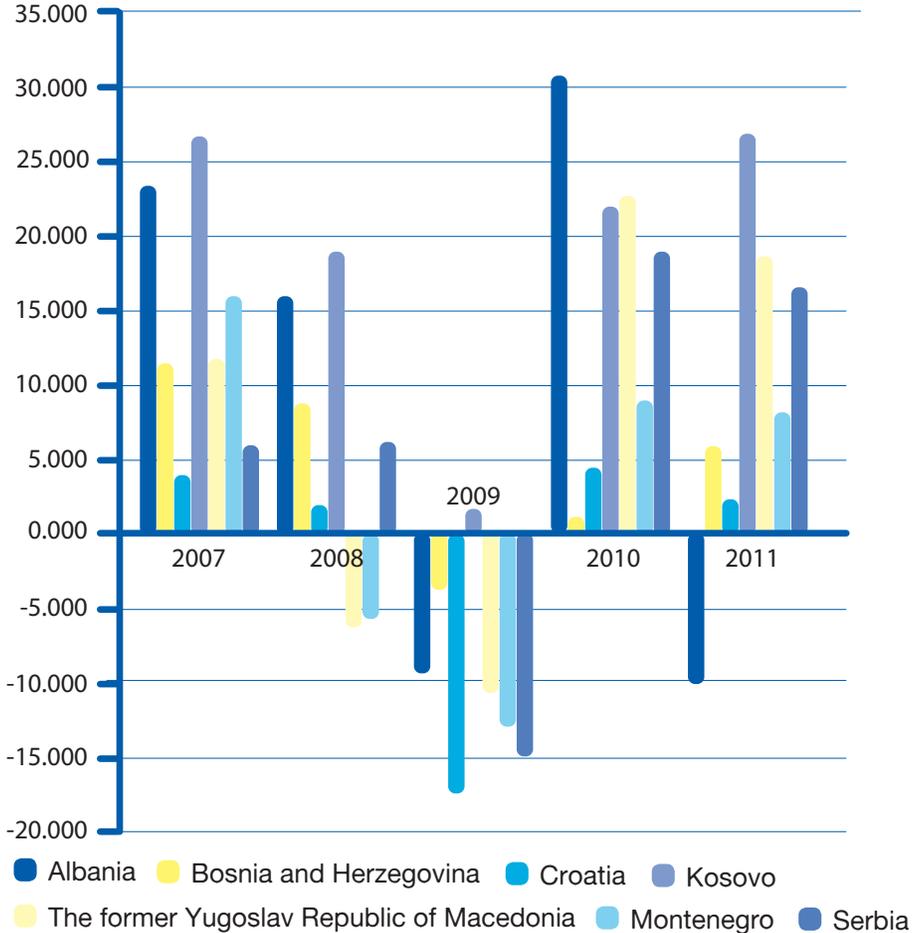
Import volume of goods and services (percentage change)



<sup>46</sup> Disadvantages associated with the small size of individual national markets in the Western Balkans and the need to overcome them are also discussed in the third chapter of this text.

Figure 5 Export from Western Balkan countries

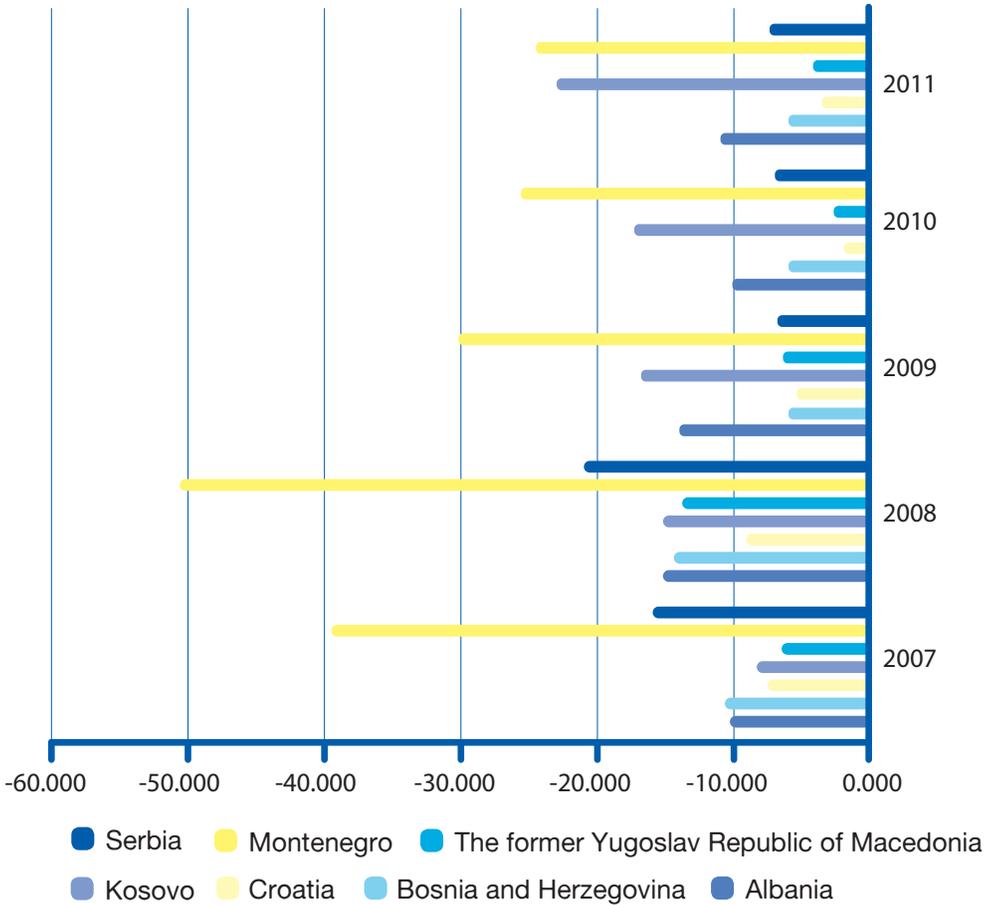
Export volume of goods and services (percentage change)



Since the crisis befell the Western Balkans, the current account deficits have fallen slightly or have been narrowing down in almost all the countries (see Figure 6). This is mainly due to decreased demand for imported goods, rising exports and new loans obtained from abroad. The current account balance measuring the ratio between imports and exports is very important for the future perspectives of the region, as it indicates decreased confidence of foreign investors.

Figure 6 Current account balances of Western Balkan countries

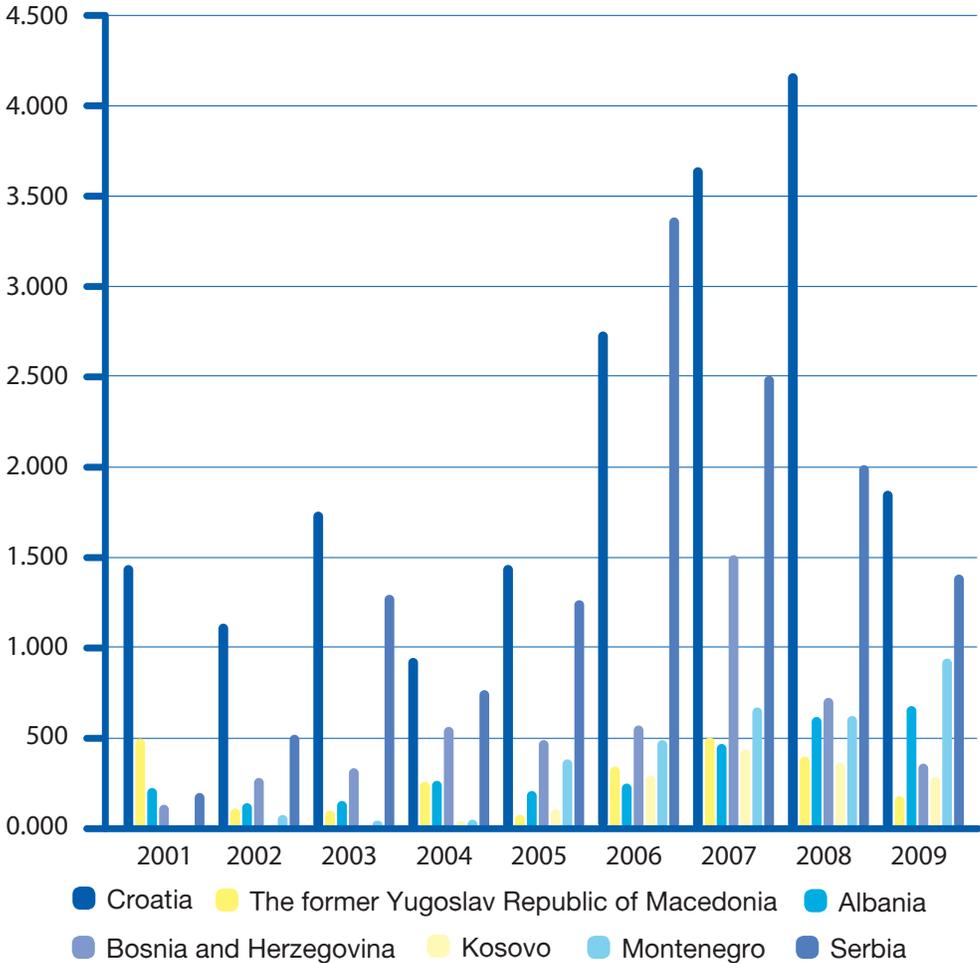
Current account balance (percentage of GDP)



In the pre-crisis years some of the countries in the region (especially Montenegro and Croatia) were among the front runners in FDI as a share of GDP (see Figure 7). After the crisis began, the FDI flows diminished as the result, more or less, of a chain reaction: the FDI in the Western Balkans was mainly obtained from the developed countries, where the crisis started in 2007 and was in full swing in 2008.

Figure 7 Foreign direct investment (FDI) <sup>47</sup>

In the reporting economy, total direct investment (EUR million)



The rankings contained in the World Bank’s *Doing Business 2011* report indicated that most of the countries in the Western Balkans fall within the group of moderately developing business-friendly economies and have to make greater effort to attract investors. For instance, Albania was in

<sup>47</sup> Source for these data: Eurostat.

position 82, Croatia in 80 (both countries had better rankings in 2010, 77 and 79, respectively). Montenegro had the same rank as the previous year, 56. Serbia dropped from position 88 to 92 in a year. Bosnia and Herzegovina and Kosovo were respectively in positions 125 and 117. A positive exception was the former Yugoslav Republic of Macedonia, positioned at the rank of 22 and moving up from position 34 in 2010; this was due to the extensive governmental programme for stimulating entrepreneurs and business.<sup>48</sup> The rankings of the latest *Doing Business* report confirm that the Balkan states may in fact benefit by carrying out the necessary reforms and optimising their institutional arrangements and administrative capacities in order to attract foreign investors.

Since all Western Balkan countries have considerable emigrant communities which send back money to their countries of origin, special attention has to be paid to their remittances and the economic role these play. Remittances make up a considerable portion of GDP—as high as 14.8% for Bosnia and Herzegovina, 12.2% for Albania and 11.1% for Serbia.<sup>49</sup> Therefore, the economic health of the migrants' host countries is essential for the Balkan economies. Unfortunately, the crisis has impacted severely on the receiving countries, and this can be directly observed in the decrease of the remittance inflows to the Western Balkans. These were growing constantly in the period from 2005 to 2008, when the sums reached their peak in virtually all countries; 2008 was the last good year, and projections indicated an expected decrease.<sup>50</sup>

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<sup>48</sup> The *Doing Business* reports predominantly consider indicators such as enforcement of contracts and the efficiency of the public administration. See World Bank, *Doing Business 2011: Making a Difference for Entrepreneurs*, accessed at <http://www.doingbusiness.org/reports/global-reports/doing-business-2011/>, on 10 January 2012.

<sup>49</sup> See IRIS, *The Western Balkans*.

<sup>50</sup> For more information, see also the Gallup surveys (Focus On series): Gallup Balkan Monitor in partnership with the European Fund for the Balkans, *2010 Summary of Findings*, accessed at [http://www.balkan-monitor.eu/files/BalkanMonitor-2010\\_Summary\\_of\\_Findings.pdf](http://www.balkan-monitor.eu/files/BalkanMonitor-2010_Summary_of_Findings.pdf) on 20 November 2011, and Gallup Balkan Monitor, *The Effects of the Financial and Economic Crisis*.

## Efforts to adjust to the EU financial and economic policy in the crisis

The EU developed a new model of economic governance that sought to strengthen the Security and Growth Pact (SGP),<sup>51</sup> guarantee more economic coordination and protect fiscal discipline and responsibility between EU Member States, as well as further secure the recovery to high and sustainable growth, jobs and competitiveness of the European economy.<sup>52</sup>

How can the Western Balkan countries deal with the new EU anti-crisis efforts? Are they able to follow the EU reform trends regarding financial discipline and financial responsibilities?

Since 2006 the countries in the region have been playing an active part in the European Commission's fiscal surveillance and reporting arrangements applying to potential candidate countries. With varying success, they have been trying to introduce economic and fiscal programmes to cope with the efforts of the EU not just to combat the current euro crisis but also to achieve growth and higher employment beyond the crisis. Further below in the analysis, two important indicators will be presented: budget deficits and sovereign debt of the Western Balkan countries.

Figures indicate that no balanced budgets have been maintained by any Western Balkan country since 2005, well before the crisis. There were a few exceptions with relatively

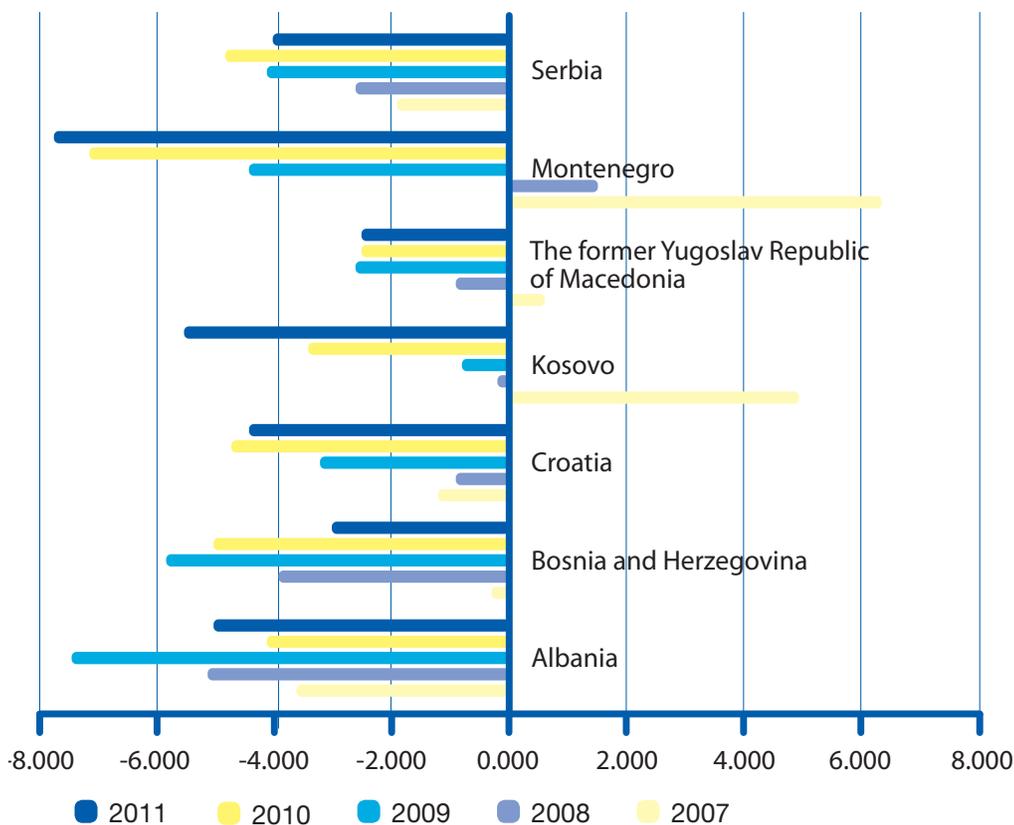
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<sup>51</sup> According to the Security and Growth Pact (SGP), the most important criteria are the following: government deficit should not exceed 3% of GDP on an annual basis, government debt should not exceed 60% of GDP at the end of the previous fiscal year and inflation should not exceed by more than 1.5% the average rate of the three EU Member States with the lowest inflation. There are also other criteria related to exchange rates, interest rates, etc.

<sup>52</sup> Here it would not be possible to present all the aspects of this new regime of economic governance in the EU, nor is this the goal of the present text. Different dimensions (more effective monitoring and stricter implementation of the SGP provisions, including introduction of corrective mechanisms and sanctions, introduction of the new rules for fiscal discipline, etc.) have been proposed and should be implemented.

sizeable budget surpluses during the good times—in Montenegro, the former Yugoslav Republic of Macedonia and Kosovo. The projections do not point to substantial improvements. On the contrary, in some of the countries the budget deficits are among the disturbing problems. The most thorough example is that of the formerly outstanding Bosnia and Herzegovina, but there are others as well. Despite the calls of the EU for prudent fiscal policies and consolidation of budgets, the achievement will be only marginally better in comparison to 2009 (see Figure 8).

Figure 8 Public deficit as a percentage of GDP<sup>53</sup>

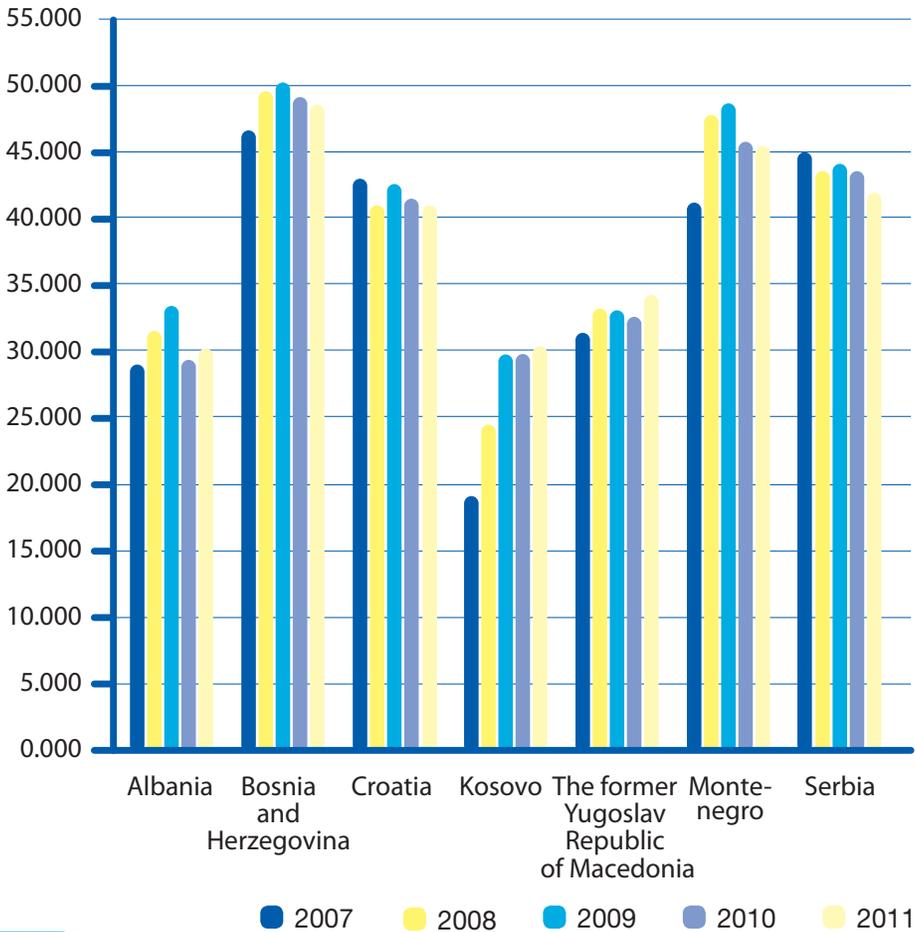


<sup>53</sup> Figures sourced from 'Country Economic Reports & GDP Data', *Global Finance*, accessed at <http://www.gfmag.com/gdp-data-country-reports>, on 20 November 2011.

Almost all countries in the region maintain very high levels of public expenditure (see Figure 9). This is especially the case of Bosnia and Herzegovina, where the administration costs are huge, due to the enlarged governance apparatus of the two entities and the many districts there. In Montenegro and Serbia the expenditures for public administration are also very high, though not as much. To reduce expenditures and bring them down to levels more appropriate to the collected revenue remains a further goal for the countries in the region.

Figure 9 Government expenditure of the Western Balkan countries

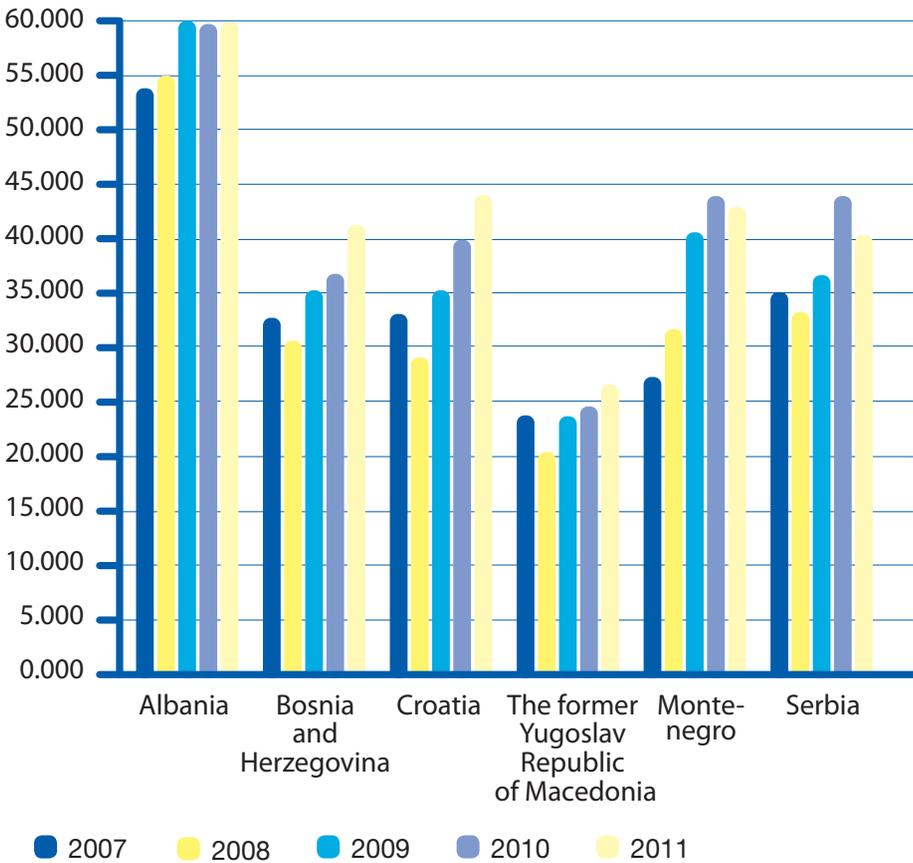
General government total expenditure (as a percentage of GDP)



On the other hand, the Western Balkan countries are generally good performers with regard to sovereign debt (see Figure 10).

**Figure 10 General government gross debt**

General government gross debt (as a percentage of GDP)



While the eurozone average debt is estimated to have risen from 86.3% of GDP in 2009 to 92.4% in 2010,<sup>54</sup> the values for the majority of the countries in the region are expected to stay well below the required 60% of GDP, due to the SGP. A worrying fact is that the debt levels in some of the countries are equal to the annual gross domestic product. The former Yugoslav Republic of Macedonia is doing quite well, since it managed to reduce its debt in the good years, though it did have an increase in debt in the crisis year 2009.

In short, the government balance depends on prudent fiscal policies. It is quite easy for a government to respond in a populist manner and increase spending in order to satisfy demands.

It is extremely important for the Western Balkan countries not merely to exit from the current crisis and cope with the EU's efforts to implement new rules of economic governance, but also to be capable of adopting, and coping with, the broader set of proposals for improving Europe's economic competitiveness and growth (for example, the EU 2020 Strategy).

The way to cope with new EU proposals and initiatives for better economic governance and coordination for the candidates would be for those countries to study and introduce by themselves the best proposals for economic governance, even though they are optional for countries outside the eurozone or the EU27 (see appendix 3). Thereby they will not only acquire guarantees for financial stability but also convince their EU counterparts that they are serious about pursuing prudent policies.

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<sup>54</sup> OECD, StatExtracts, *Economic Outlook No. 87* (June 2010), accessed at [http://stats.oecd.org/Index.aspx?DataSetCode=EO87\\_FLASHFILE\\_EO87](http://stats.oecd.org/Index.aspx?DataSetCode=EO87_FLASHFILE_EO87) on 20 November 2011.

An important tool for adjusting the countries' own fiscal and economic policies to the new EU regime of economic governance is the multilateral economic dialogue between the Commission, EU Member States and candidate countries in the context of the pre-accession fiscal surveillance. This dialogue also includes meetings at ministerial level focused on the main challenges posed by the Copenhagen political and economic criteria and reviewing the progress made towards fulfilling the Accession Partnership priorities.

So far the efforts of the European institutions and Member States remain unaccomplished or are in process of legislative adoption (either because of the long duration and incompleteness of the procedure under the Community method, or because of a lack of agreement on the method applied—intergovernmental or Community—which might cause disagreement between Member States); deserving of admiration are those countries in the Western Balkans that, even at this stage and in this situation, are willing to participate in European initiatives to reduce their sovereign debts, balance their national budgets and establish a new European financial and economic governance framework. It should be pointed out that the European Commission is giving special attention to this fact, noting in the 2011 progress reports on the separate Western Balkan countries the participation of their finance ministers or other officials in these initiatives and events in Brussels. This proactive approach is beneficial for both the EU and the candidate countries of the Western Balkans.

## National responses

### Albania

To counter the immediate effects of the economic crisis, Albanian policymakers have relied on a number of measures, which include

- restoring liquidity in the banking sector—aimed at balancing the large number of deposit withdrawals. The Bank of Albania banned the payout of dividends by banks and supported the extension of credit, while raising deposit insurance limits sevenfold in order to boost confidence;
- monetary devaluation—the Albanian lek was devalued by 14% through direct liquidity infusion by the Bank of Albania. This also led to a drop of interest rates by 50 basis points in January and October 2009;
- fiscal stimulation—through the privatisation of the electricity distribution system, the ongoing work on a large infrastructure project, and fiscal relaxation prior to the 2009 elections;
- improvement of tax administration in the form of both general revenue collection and administrative reforms (broadened tax base, fiscal amnesty aimed at legalising undeclared assets and income);
- rebalancing the budget, mainly by cutting expenditure;
- issuing 300 million euros worth of Eurobonds on the international markets in order to manage repayment of loans and support of public investment; and
- facilitating business registration and business licensing procedures.

The Bank of Albania undertook a number of strict macro-level measures in order to restrict high credit risk growth; they included

- a ban on non-euro denominated foreign currency lending;
- raising the maximum risk weight in order to slow down the growth of banks' credit;
- removal of the bank management in a number of banks and suspension of local branch expansion;
- increasing awareness of loan quality through forum meetings and other means;
- establishing a detailed, daily updated bank credit registry;
- urging supervisors of foreign banks to sign memorandums of understanding;
- endowing a number of interest-paying securities, so as to counter losses from lek depreciation; and
- increasing the maturity and the volumes of liquidity this provides to banks through the repurchase market.

However, Albanian anti-crisis policy faces a large number of unresolved issues. Here are some of the crucial areas:

- Inflation has risen to 4% since 2009 due to spikes in the price of electricity.
- Establishing control over public expenditures is proving difficult, resulting in large budget deficits and a debt level nearing 60% of GDP.
- Bank recovery is very slow and includes slow demonetisation, worsening quality of the loan portfolio and large non-performing loans (NPLs).

Close trade links with crisis-stricken Greece and Italy will increase trade risks in the event that these countries fail to recover. In view of the recent progress of the Albanian economy, there are a number of concerns that the country needs to take into account before it is ready for full EU membership:

- the current account imbalance, caused by the narrow export base and public investment;
- the widespread use of informal work arrangements, which contributes to a distorted labour market and high unemployment;
- structural imbalances in the regional development of the labour market (high concentration in the urban area, especially in the capital city, and outflow from the rural regions);
- difficult access to funds for small enterprises and weaknesses in the protection of property rights, ownership transfer and rule of law;
- inefficiency and an inadequate response of the education system to the market;
- low investment in infrastructure;
- insufficient diversification and security in the electricity supply sources;
- insufficient approximation of Albanian banking legislation to that of the EU;
- a need for further progress in the planned privatisation reform;
- lack of secure property rights;
- corruption and weak enforcement of the rule of law.

Along with the progress made in facilitating business registration, some procedures, such as those for granting building permits, remain lengthy and hamper the recovery. Delays in court procedures, and weak enforcement and execution of contracts, provoke further expansion of informal methods of contract regulation that bypass the legal system.

### Bosnia and Herzegovina

The adjustment measures have been made under the international support programmes, such as those of the IMF, the World Bank and the EU. The Bosnian government established a programme in cooperation with the IMF for alleviating and countering the effects of the recession. The programme, supported by a Stand-By Agreement, provides procedures for monitoring their implementation and reporting of the results achieved:

- Encouragement of export-led growth, accompanied by increasing external commodity demand, led to a seeming emergence from the recession. As a consequence inflation decelerated.
- Agreements with international banks and multilateral financial support helped reduce the imbalances of payments. However, the worsening situation in the EU, where most Bosnian labour migrants are employed as seasonal workers, still impacts on the current transfers.
- Expenditure-saving measures helped contain the current accounts deficit. An accommodated fiscal strategy, which includes a slightly larger deficit, is aimed at stabilising the fiscal programme.
- The quantitative criterion of non-accumulation of domestic debts, established by the programme, was

the only one not met by the time of the June 2010 evaluation.

- Uneven progress has been reported on structural reforms, such as the pension reform strategy and eligibility for war benefits.

Some additional anti-crisis policies were adopted that are yet to be evaluated for their effectiveness:

- relaxation of bank reserve requirements from 18% to 14%, with an additional reduction for long-term liabilities to 10% and 7%;
- formation of a Standing Committee for Financial Stability, in which the participants signed a memorandum of understanding and are supposed to meet quarterly to discuss the progress of the financial sector;
- increase in the deposit insurance coverage and enabling the Deposit Insurance Agency to access emergency credit of up to 50 million euros;
- loosened conditions for restructuring household and enterprise credits.

At present, the most critically affected area is bank lending: it has still not begun to recover from the recession. The worsening financial situation of enterprises and households leads to a rising interest rate, worsened quality of bank portfolios and an increase in NPLs.

Furthermore, there are a number of other economic issues that Bosnia and Herzegovina needs to take into account in order to make progress towards potential membership in the European Union:

- problems of fiscal data with regard to timeliness, quality and comprehensiveness, which limits the ability for adequate decision-making based on the data; no progress has been made in their improvement;
- very high unemployment;
- a low quality of public finances;
- no advance in privatisation, restructuring of public enterprises or the liberalisation of industries;
- weak economic competitiveness;
- high and poorly targeted social transfers;
- limited success so far in establishing a single economic space within the country: there is currently a lack of taxation synchronisation in the different administrative entities; although court registration timelines and costs were harmonised between the entities, the process of obtaining permits remains lengthy and companies still need to register in both entities if they want to do business in the territory of the whole country;
- failure to adopt the Global Framework for Fiscal Policy for the periods 2011–13 and 2012–14, and proceeding with budgeting in the absence of a medium-term budgetary strategy;
- the weak rule of law—corruption and unreliable contract enforcement.

The failure to form the Council of Ministers for more than a year has brought Bosnia and Herzegovina's economy into a situation where it is suffering direct and indirect damages.<sup>55</sup> Direct damages may be expressed in material terms and consist in the country's poorer credit rating, loss of investors' confidence, reduction of direct foreign investment and the impossibility of absorbing IMF financing or EU aid. Indirect damage finds expression in the lack of adequate legislation and mismatching of the country's economic framework with the desired policies of the European Union (EU), and can also be translated into concrete figures.

Striving for EU membership, the country needs to demonstrate rapid progress in the following areas:

- producing an adequate business environment in which employers can do their jobs (there are hundreds of regulations at municipal, federal and state levels regarding direct taxes, customs duties, excise taxes, and indirect taxes, contributions, parafiscal levies, etc.);
- directly helping the specific projects related to job creation and tangible support, especially those of production and export-oriented firms;
- improving the bad budgetary situation in order to prevent the entities from implementing unpopular savings strategies.

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<sup>55</sup> The Council of Ministers is very important, because it forms the Financial Council. The latter is important, as it has the competency to distribute loans to the different administrative levels in the country, including the entities. The loans include those coming from the IMF. The fund affords the opportunity for Bosnia and Herzegovina to have a total of 1.5 billion euros ready for the period of three years.

## Croatia

The global economic crisis has threatened economic stability in Croatia in a number of ways. The Croatian economy had suffered problems even before, but the last few years have presented the country with a worsening economic situation, the most challenging issue being indebtedness.

- Public sector debt was large even before the crisis, and is highly dependent on domestic and fixed-rate borrowing, which reduces the risk of a rise in interest rates. There is also a rise of short-term debt that requires immediate responses.
- Guaranteed debt is mostly owned by external creditors. Additionally, privatisation or financial difficulties in enterprises may turn those guarantees into liabilities.
- There was a continuous accumulation of central bank foreign exchange reserves even before the crisis, yet these are insufficient to cover the liabilities. Higher exports are needed to decrease the gap.
- A significant part of the foreign debt comes from private lending from foreign banks, where liquidity and availability of funds depend not only on domestic conditions but also on the conditions in the parent banks.
- Large amounts of debt (both corporate and household) are linked to or in foreign currency (mostly euros and Swiss francs), so a potential currency depreciation can result in a low-quality bank credit portfolio and an increase in NPLs.

Apart from debt, there are other issues that threaten Croatia's recovery:

- low investment due to low confidence in the economy;
- falling private consumption due to falling employment;
- insufficient export rebound;
- rising inflation, especially due to rising food and fuel prices.

Croatian authorities have introduced a number of measures to counter the effects of the crisis; however, some of these measures are evaluated by the IMF as *'requiring caution'*. They include

- conditional reduction of reserve requirements for banks in order to increase the supply of loans, so as to finance working capital and improve liquidity of the biggest companies;
- provision of government guarantees on long-term investment loans;
- conversion into government equity of debts owed by companies in financial difficulty.

Other measures taken to counter the effects of the economic crisis are

- adoption of the Fiscal Responsibility Law, which aims at decreasing expenditure by 1% every year, until a balanced budget is reached (considered by IMF staff to be insufficient over the medium term);
- adoption of three budget revisions to contain the 2009 budget deficit, which included expenditure cuts, a freeze in wages and pensions, a VAT rate hike and a temporary 'solidarity tax' on incomes and pensions above 3,000 kuna per month. Despite these measures, the budget deficit has grown;

- The introduction of the Economic Recovery Program, which has implemented measures such as:
  - amendment of the pension law to delay retirement,
  - unemployment law reducing benefits and duration of support for people on the labour market,
  - reduction of non-tax fees for business.

Other reforms, such as greater flexibility in wage setting, privatisation and reduction of public administration, have met strong social resistance.

Additionally, measures taken by the Croatian National Bank (CNB) include

- relaxation of regulatory requirements, repossession auctions and simplified rules for banks to access the CNB's emergency liquidity assistance, aimed at addressing liquidity shortages; and
- firm resistance against the idea of exchange rate depreciation, due to the large amount of debt in foreign currencies.

Finally, issues and concerns presented by the European Union with regard to the country's application for EU membership include

- high and rising levels of unemployment, public deficit and debt;
- a need for better progress in the implementation of the Economic Recovery Program, since it is important for the medium-term economic orientation of the country;
- slow progress in structural reforms, including privatisation and restructuring of loss-making enterprises;

- high and poorly targeted social transfer payments;
- the heavy regulatory burden and numerous quasi-fiscal taxes for business; and
- low efficiency of public spending.

The government of Croatia has adopted a series of programmes and packages of measures since March 2009, including budget rebalances and participation in the EU pre-accession fiscal surveillance procedures.

## Kosovo

Because the independence of Kosovo was announced shortly before the economic crisis struck, it is difficult to determine the extent to which the issues described below are influenced by it. However, it is widely accepted that the financial crisis had a very limited impact on Kosovo, due to its limited integration into international financial and goods markets. The economic conditions in Kosovo are as follows:

- a narrow export base, dominated by low-value-added products;
- significant public spending on capital investments, including on Kosovo's first highway;
- high import dependence, with the euro area being Kosovo's largest trading partner;
- insufficient private interest in the privatisation strategy, indicating the necessity for a revision in its main measures;
- a largely foreign-owned financial sector, which may lead to large dependence on economic conditions abroad;

- limited scope for emergency liquidity assistance, due to euroisation;<sup>56</sup>
- a significant difference between national and best-practised international banking law;
- extremely high levels of unemployment;
- a conservative loan-to-deposit ratio;
- lack of public infrastructure, notably transport and energy, which is a constraint on private investment.

While most of these conditions have persisted for a long time, a number of changes have occurred in the country's economic situation since the beginning of the crisis:

- following a contraction in 2009, a rebound of exports in 2010, together with remittances;
- decrease of the population's purchasing power of between 30% and 40% on a yearly basis;
- decrease in private sector credit growth;
- highly volatile inflation: negative inflation from 2009 rising back to its positive values in 2010;
- steady real GDP growth, mostly due to high domestic demand;
- an increase in the percentage of NPLs.

Following the Stand-By Agreement signed with the IMF in 2010, authorities in Kosovo deviated from the recommended budget, while undertaking the following initiatives:

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<sup>56</sup> Euroisation is the unilateral adoption of the euro by a country outside the European Union and the euro currency union.

- improved ability of the Central Bank of Kosovo to provide for emergency liquidity assistance;
- accelerated growth in government expenditures, which in turn led to a budget deficit in 2009 and 2010 after a substantial surplus over the previous years;
- an increase in public sector benefits and wages.

A number of other economic issues and concerns are being addressed by the European Union with regard to Kosovo's condition in relation to the Union:

- a heavy burden on public finances created by the highway construction project;
- deficiencies in policy formulation and implementation;
- inadequate economic statistics;
- a negative impact of uncertainty over property rights, corruption and high interest rates on the business environment;
- the large share of the informal sector;
- high unemployment, particularly among the young people.

Overall, the reforms are not very advanced and more has to be done.<sup>57</sup> Experts are hesitating to predict whether Kosovo can successfully exit the crisis without the support of the international financial organisations.

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<sup>57</sup> Ertan, *Wirtschaftskrise in Kosovo*.

## The former Yugoslav Republic of Macedonia

The response of the former Yugoslav Republic of Macedonia to the global financial and economic crisis has many different dimensions and has varied over time since the crisis reached the Western Balkans in the end of 2008 and beginning of 2009. While it is considered that the national economy experienced a less severe contraction due to its limited exposure to bad international assets, there were still a number of areas that experienced the recession:

- Foreign reserves started declining in the crisis; however, their availability has offset the effects of the crisis.
- The interest rate policy gap between the former Yugoslav Republic of Macedonia and the European Union has been rising throughout the crisis.
- Should it persist, the eurozone's sovereign debt and financial crisis and negative growth shocks might spill over into the former Yugoslav Republic of Macedonia, including through decreased exports.

There have also been a number of measures undertaken by authorities in the country to respond to the recession, including the following:

- Authorities of the former Yugoslav Republic of Macedonia planned to issue Eurobonds to cover the fiscal deficits for 2011 and 2012, but their volatility has been high, especially since the Greek crisis influenced the decision to abandon this process.
- Instead, the government has financed itself by drawing upon IMF Special Drawing Rights, official foreign financing, treasury bills and public depositing at the central bank.

- Agreement has been reached on a two-year precautionary credit line arrangement with the IMF.
- Higher interest rates policy, tighter reserve requirements, new liquidity requirements and credit growth speed bumps were implemented to slow aggregate demand and reduce capital outflow. This was necessary due to the rapid loss of reserves and imperfect monetary transmissions.

By 2010, the anti-crisis measures helped spur some positive developments, as follows:

- resumption of economic growth;
- reduction on interest rates;
- low core inflation, despite expected rises for 2011;
- a fall of the current account deficit;
- high export prospects, subdued domestic credit growth and capital inflows;
- in the banking system, high capital adequacy ratios, ample liquidity, minimal reliance on foreign financing, conservative balance sheets, and careful supervision and regulation.

In general, there is a large political consensus within the country concerning the foundations and direction of the economic and financial policies and measures needed. This has greatly helped to gain the confidence of investors and the international institutions, including the EU. On this basis the former Yugoslav Republic of Macedonia has succeeded in developing a number of programmes and political documents describing its medium-term policy framework and outlining feasible measures. Among them are

- good communication with the business community in the country to improve the business environment, entrepreneurial climate and competitiveness;
- structural reforms to be pursued in a number of spheres;
- an ongoing process of fiscal decentralisation; and
- recovery, though slight, and a fragile real GDP increase, based likewise on private consumption in the second quarter of 2011.

Additionally, the European Union has laid out a number of concerns and observations on the progress of the economy of the former Yugoslav Republic of Macedonia, particularly as it relates to the country's eligibility for EU membership:

- structural unemployment, especially among the young and poorly educated;
- a drop of imports due to poor domestic demand and decelerated export rates;
- the deteriorating quality of public spending;
- increasing public debt;
- decelerating levels of FDI.

## Montenegro

The October 2008 crisis had an immediate, significant impact on the economy of Montenegro. As of the beginning of 2010, the areas of concern were as follows:

- massive and broad-based deposit withdrawals;
- deteriorated loan quality;
- declining bank credit due to withdrawal of support from parent banks;
- weaker interest on the part of foreign investors;
- dropping asset prices, weaker balance sheets and reassessment of growth prospects in real estate construction activity;
- a sharp drop in real GDP;
- underemployment, rising part-time employment and substitution of domestic by foreign labour, effectively reducing employment by 14%;
- nominal wages that moderated and declined in 2009 and 2010;
- rising public and publicly guaranteed debt.

In addition, problems in certain policy areas have resulted in the inability of the authorities to cope with the effects of the crisis:

- Euroisation has limited the scope for the lender-of-last-resort operation of the central banks, especially for domestic banks lacking foreign support.
- Loose fiscal policy in the past has left little room for taking countermeasures to the crisis.

While the ability and political will of the authorities in Montenegro have been limited, some measures were taken to counter the effects of the crisis:

- a stimulus package consisting of bank support and increased public investment;
- launching of a privatisation programme;
- a social package, agreed on with KAP (Montenegro's largest industry, producing aluminium), for cutting down employment, subsidising energy and providing state guarantees for bank credit;
- 200 million euros worth of Eurobonds issued in September 2010, and an additional 180 million in April 2011;
- a new Central Bank Law and laws on banks, bankruptcy of banks and deposit insurance;
- temporary regulations providing relaxations on bank solvency and liquidity;
- transparent, high-frequency publication of fiscal statistics; adoption of a single treasury account and a mandatory reporting commitment.

While some of the adverse effects of the crisis are still taking their toll, a number of areas have improved since the end of 2010.

There are a number of economic issues that Montenegro needs to address in relation to its potential membership in the European Union:

- reversed fiscal consolidation,
- a high level of public debt,

- a narrow export base and public investment,
- widespread informal work arrangements and high unemployment,
- challenging access to funds for small enterprises,
- difficulties with ownership transfer and property rights,
- insufficient investment in infrastructure and the security of the power supply,
- a large informal economy,
- vulnerabilities in the regulation and supervision of the banking sector.

Montenegro's 2011 Economic and Fiscal Programme presented a cautious macroeconomic baseline accompanied by an expenditure-based fiscal consolidation framework, plus a wide structural reform agenda that was consistent with past priorities. Meanwhile, domestic political consensus was maintained on market economy fundamentals. In general, the country's economic policy has remained consistent.

## Serbia

Even before the global financial crisis, despite its steady economic growth, Serbia had four main areas of concern that largely contributed to the effects that were to be seen at the peak of the crisis:

- lagging tradeable sector growth: growth was strongly tilted toward nontradeables, in particular transport and communications, retail trade and financial services;

- low domestic savings: with domestic savings close to zero, the economy's investment level was effectively constrained by remittances from abroad—which were trending downward—and the availability of foreign savings;
- extensive foreign-exchange lending: loans were highly euroised, even if direct cross-border foreign exchange loans to Serbian corporations were excluded;
- high inflation.<sup>58</sup>

Given these four issues, the most significant effects of the crisis were

- a sudden halt to capital inflows;
- withdrawal of a large number of deposits;
- a plunge in exports and imports;
- a large decline in domestic demand, especially in investment;
- unemployment rising to over 17%, with sharp contracting of employment in manufacturing and construction;
- rising NPLs;
- volatile depreciation of the dinar exchange rate, despite attempts made by the National Bank of Serbia to stabilise the currency;
- a stalled privatisation agenda and unresolved restitution aspirations;
- contracting retail sales;

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<sup>58</sup> Average inflation in 2004–8 was the highest in the region.

- a recession in the non-tradeable sectors; and
- a high external trade deficit.

In response to the effects of the global financial crisis, Serbia has undertaken a number of initiatives and measures, listed below:

- support of bank lending through interest subsidies and loan guarantees;
- a package of parametric pension reforms to reduce medium-term pension costs, while raising the employment rate;
- nominal freezes of public wages and pensions;
- high reserve requirements that served as a liquidity buffer during the crisis;
- reduction in the number of weekly repossession auctions;
- a growing T-bills market;
- diagnostics and stress tests for all 31 banks completed by the National Bank of Serbia;
- the mechanism of blocking a delinquent debtor's account made transparent. This mechanism has gained popularity due to the costly and lengthy procedures for bankruptcy;
- introduction of a bankruptcy law to accelerate proceedings and reduce the burden on courts;
- lowering of the exposure limit for banks as a form of gradual exit from the exposure commitments;
- development of the Budget System Law, including fiscal responsibility provisions;

- raising of the policy rate of the National Bank of Serbia;
- submission of a Corporate Debt Restructuring Law.

Changes in the economic situation since the beginning of the crisis, as of April 2011 include

- rising exports due to a weak real-exchange rate and export-led recovery after 2010. External trade deficit is still high;
- tight credit conditions that hinder private investment;
- volatile inflation expectations, followed by a continuous sharp rise since 2010;
- recovering productivity;
- recovering credit growth;
- an increase in subsidised loans;
- undervalued T-bill auctions due to the low value of the dinar;
- a continuing decrease of employment rates; and
- rising interest on the part of foreign investors.

Additional economic issues need to be addressed with regard to the European Union's report on the prospects for future membership:

- the continuing deterioration of the labour market;
- the need for measures to amend the budget system and for pension legislation to enhance fiscal discipline;
- poor legal predictability, burdensome administrative procedures and lack of effective enforcement of property rights;

- deficiencies in competition and infrastructure;
- a large informal sector.

Overall, while all countries of the Western Balkans are making progress towards recovery, in some it is happening more slowly than in others. There are differences in how the countries are responding to the crisis through fiscal and monetary policies. Regardless of differences, most of the countries seem to be negatively affected by the crisis in Greece and Italy, as a result of the currency anchor that most of them have to the euro. Troubles could also be expected to occur with regard to trade and foreign demand for goods, because some of the most important economic partners of the Western Balkan countries are among the European countries hit worst by the debt crisis.

### **Political implications and intensification of unresolved national and ethnic questions**

Besides the challenges encountered along their path to EU membership, the Western Balkan countries are facing many 'old' shared issues from the past. There is a widespread perception among them that each country is turned more to the EU than to its own region, and that each is suffering from distorted self-perceptions and egotism (especially in relation to former countries of the Eastern bloc). Countries in the region are often accused of secretly competing for a role of 'regional leader'. Along with many lingering, unresolved bilateral issues, all these features of the painful shared past of the Balkans might hinder regional cooperation and create obstacles for the integration process.

In their approach to the EU membership of East European countries, EU institutions do not recognise the strong developmental impact of the accession process on the post-Communist countries: the pre-accession procedures were treated as strictly technical and institutional. In assessing the lessons learned after the accession of Romania and Bulgaria, one may say that the formal criteria for membership do not sufficiently accommodate all the dimensions and features of the above-mentioned Balkan realities. According to many observers of the transformation process in Central and Eastern Europe, important social, cultural and political aspects of those societies have remained neglected in the 'traditional' EU accession approach. The challenge now is whether and how to adapt the pre-accession instruments and enlargement policies to the process of full integration into the European mainstream. Some concrete tasks are those referring to the processes of national and state reconstruction: strengthening the institutional capacity and development of local authorities and civil society organisations, implementing dialogue and consensus for unresolved bilateral issues outside the enlargement process, and developing regional integration and cooperation as part of the European integration process. These are questions that could be, if not intensified directly by the impact of the global crisis on the Balkans, at least made more visible and thereby easily utilised for populist purposes and projects.

In contrast with Western Europe, where the process of national identification of the countries was accomplished long ago, where a new set of rules and principles of intergovernmental relations came to prevail, ultimately leading to the creation of the European Union as a supranational area, in the Balkans the nation-building process is not yet completed. The challenge is that the region encompasses communities at different degrees of

development and fulfilment of their national identity and nation-building agendas:<sup>59</sup> Having lived as independent states and democracies for a mere 20 years or so, almost all countries are suffering from problems related to weak institutions and the need for further state consolidation. Bosnia and Herzegovina is a most significant example of difficult state and institution building. The lack of state-level government more than a year after the elections in October 2010 has created a political vacuum and impeded the necessary reforms. The current Council of Ministers, although legitimately formed, has no political capacity that would allow it to solve controversial questions, including the implementation of important measures in the area of justice and internal affairs, measures that are an important precondition for further progress towards EU integration.<sup>60</sup> In addition, the Parliamentary Assembly is too weak to fill the existing political void. Most of the draft laws currently under consideration have been halted until a so-called general agreement among political leaders can be reached. This kind of informal ‘bargaining’ among selected political actors is essentially a substitute for functioning democratic institutions. It ignores parliamentary procedures and creates the illusion that complex issues can be resolved at political party meetings.

However, the formation of the Joint Commission of both Houses for the preparation of the constitutional amendments concerning the ‘Finci/Sejdic verdict’ is an important positive

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<sup>59</sup> For example, citizens of the former Yugoslav Republic of Macedonia are trying to constitute themselves as an independent nation (see also IRIS, *The Western Balkans*).

<sup>60</sup> As stated above, at least three of these measures are very important: the Finci/Sejdic verdict, the Law on Agency, and the Census Law. (See also S. Wölkner, *Länderbericht Bosnien und Herzegovina: Neuer Ministerrat in Sicht?*, accessed at <http://www.kas.de> on 29 July 2011; S. Wölkner, ‘Key Problems for Bosnia and Herzegovina on its Path towards the EU’, presentation before the session of the EPP Working Group on EU enlargement, unpublished paper (5 October 2011).

step forward.<sup>61</sup> Until a new Council of Ministers is formed, only very limited progress can be expected in the EU integration process. Difficulties stem from several sources, especially from the fiscal deterioration within both entities. As deficits grow, the two entities are ‘up to their necks in water’, according to foreign observers.<sup>62</sup> The longer it takes to break the deadlock, the more the democratic institutions in the country, and especially those at a central state level, will be undermined. And this trend could strengthen centrifugal forces and further destabilise the country. In addition to these difficulties, the conflict about the so-called Croat issue is becoming increasingly pressing and moving to the core of the country’s constitutional problems. The so-called Croat question is deeply rooted in the peculiarity – admitted by the international community – of a constitution that mixes ethnic and civic elements. While today’s ethnically oriented parties emphasise the ethnic elements, the so-called multi-ethnic parties focus on the civic dimension of the constitution. Consequently, each side tends to interpret the constitutional provisions differently. Constitutional reform should be seen as the key to bringing greater clarity to these issues and paving the way for more intensive European integration of Bosnia and Herzegovina.<sup>63</sup>

Kosovo is another special case in which the difficulties of the state-, nation- and institution-building processes in the Western Balkans can be clearly identified. Differences over status continue to negatively affect both Kosovo and the region. The recent events in North Kosovo cause grave

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<sup>61</sup> See Wölkner, *Länderbericht Bosnien and Herzegovina*; European Commission, ‘Conclusions on Bosnia and Herzegovina’, *Enlargement Strategy and Main Challenges 2010–2011*, Communication from the Commission to the Council and the European Parliament, COM(2010) 660 final, accessed at [http://ec.europa.eu/enlargement/pdf/key\\_documents/2010/package/conclusions\\_bosnia\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2010/package/conclusions_bosnia_en.pdf) on 20 November 2011.

<sup>62</sup> Wölkner, ‘Key problems for Bosnia and Herzegovina’.

<sup>63</sup> *Ibid.*

concern. The integration of Kosovo Serbs south of the Ibar River has improved. This is illustrated by the fact that Kosovo Serbs took part in the recent census in the country. Furthermore, their participation in the recent general elections increased. On the other hand, in North Kosovo inter-ethnic tensions and incidents persist. Separate Serb structures, supported by Belgrade, opposed the census and encouraged local Serbs to boycott the elections organised by the Kosovo authorities. The European Commission urges all concerned in Kosovo to defuse tensions and to fully cooperate with the European Union Rule of Law Mission in Kosovo, EULEX.

In conclusion, it must be admitted that inequalities and imbalances in the developments at national and local level between the countries and/or (ethnic) communities in the region promise continuing instability of the political and social atmosphere in the future. Unresolved and lingering bilateral issues, especially those related to identity formation, state consolidation and institutional integrity, could affect the whole region. It is up to the European Commission to effectively moderate those processes and the dialogue on them, and to not permit them to hamper or block the enlargement procedure. Cases where lingering bilateral issues have blocked the process of further accession, for instance, the 'name' dispute between Greece and the former Yugoslav Republic of Macedonia, show that such situations only lead to hardening of anti-European attitudes in the respective countries, to hostile discourse against neighbouring countries and to general disregard for the European principles of good neighbourly relations.

## The impact of the crisis: expert views from outside

This part of the text is based on the output from a focus discussion<sup>64</sup> with leading experts from an international NGO operating in the respective Western Balkan countries.<sup>65</sup> The results illustrate the impact of the crisis on these countries and on their preparedness for EU membership. The study does not claim to be representative.<sup>66</sup> The aim is to combine and compare the findings of the qualitative focus discussion involving experts with the analysis of the sourced quantitative data, so as to obtain a more realistic understanding about the scope and extent to which the crisis has affected the Western Balkan countries and influenced their pro-European perspective. The experts were given two main groups of questions to discuss. The first concerned whether, and to what extent, the Western Balkan countries are affected by the crisis; the second, the dimensions of the impact of the crisis on the European perspective of the Western Balkan countries.

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<sup>64</sup> A focus group discussion is a form of qualitative research in which a small group of people (between 5 and 12) are asked about their perceptions, opinions, beliefs and attitudes towards a product, service, concept, advertisement, idea or packaging. (N.R. Henderson, 'Managing Moderator Stress: "Take a Deep Breath. You Can Do This!"' *Marketing Research* 21/1 (2009), 28–9). The aim is to put questions to the participants in an interactive group setting. Focus group discussions allow interviewers to study people in a more natural atmosphere than that of a one-to-one interview, because participants are free to talk with other group members and to make additional links to and comments on others' statements.

<sup>65</sup> The focus group discussion took place in Sarajevo on 1 June 2011. Seven group members participated. Three participants were women and all were in the age range between 30 and 55, in managerial positions, with international experience and sensitised by the promotion of democracy and institution-building support. All the participants in the discussion had been working in the Western Balkans or on transition issues for more than three years. The items discussed and the opinions expressed were recorded with the permission of the interviewed experts. All quotations are taken from the discussion transcript, which is part of this study.

<sup>66</sup> The approach applied is strictly qualitative, which means the opinions presented and analysed below express subjective perceptions and attitudes. They are indicative of the orientation of the citizens in the respective countries towards European enlargement in the region and present the problem studied from the so-called bottom-up perspective.

Participants were also asked to comment on the European Union's approach to enlargement.

Regarding the first group of questions, the prevailing opinion of the experts was that all countries in the region have been affected by the crisis. There are slight deviations in the concrete problematic fields in the different countries concerned: for example, in Serbia inflation is quite high, which is not the main problem for the former Yugoslav Republic of Macedonia. According to the experts, in Serbia the restitution issue has remained a big economic challenge and seems to be a specific domestic problem not typical of the neighbouring countries. In other Balkan countries the rebalancing of the budget continues to be an important task that governments had been facing in the previous two years.

Despite the differences between the countries in the region, according to the experts, the biggest challenge everywhere remains the high unemployment rate and the bad economic situation. For almost all countries the prognosis is that there will be economic growth, but the increase of the population's incomes and wages has remained insufficient. Therefore, *'most of the people feel things are getting worse'*.

According to the experts, there has been a slight economic recovery—starting from a very low level—since the war.

This is especially true for countries where governments have other issues to tackle in addition to the crisis; for instance, Serbia has to deal with the issue regarding the status of Kosovo, and Bosnia and Herzegovina must consolidate the central state.

In discussing unemployment and other economic statistics, the foreign experts interviewed tended to mistrust data provided or published by international organisations (even those of Eurostat). In this regard they assumed that NGOs

and domestic sources (scholars, researchers, etc.) provided more reliable figures and data. The discrepancy in figures provided by official international and domestic authorities and independent research institutions is quite large in some cases; for example, in Kosovo the figure for unemployment among young people is 75%, according to young national scholars, and in Albania 14% are without jobs.<sup>67</sup>

Contributing significantly to the increase of the unemployment rates was the visa liberalisation. The experts underlined the fact that, since the liberalisation of the visa regime, many people, especially the young, are leaving the Western Balkan countries. Most of these emigrants are well educated and qualified. This is an especially serious problem in the former Yugoslav Republic of Macedonia, but it occurs in other countries in the region as well. What contributes greatly to the increase of unemployment rates is the high numbers of migrant workers in Italy and Greece, countries that have also been experiencing great difficulties in recent years. Since the crisis hit Western Europe, these migrant workers have started to return to their home countries.

The experts talked at length about the ‘slow recovery’ in many of the countries in the region, for example, in Bosnia and Herzegovina, whose economy is mainly driven by external demand and exports. That is why the economic recovery of the region as a whole is of utmost importance.

The lack, or insufficient progress, of structural reforms in some of the countries remains a problem. According to the experts, when the political situation is not sufficiently stable, the consistency and continuance of reforms cannot

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<sup>67</sup> To my understanding, when discussing the situation not only in the Western Balkans but also in any other country that has undergone as significant a transformation as the one that took place in the former socialist countries, we need to analyse more than the official statistics. It is necessary to include other data sources, and especially to consider the people’s perspective (their subjective perceptions) in order to obtain a complete, and not one-sided, picture. This is the approach followed in this project.

be preserved. They underlined the link between political development and economic progress. In countries with weak institutions or unstable political infrastructure (central state, parties, etc.) structural reforms with regard to social policy, pensions and public finances tend to get delayed. Examples were given of Balkan countries with a low quality of public finances, in which the state's budget deficit is high and growing as a result of the bleak economic prospects and an overblown, inefficient administration.

European Member States are among the most important economic partners of the countries in the region. As for the levels of foreign investment, the experts stressed that relative political instability, an excessively large state administration, the long time required to obtain permits to start a business, corruption and some other problems connected with the inefficiency of state institutions in some of the countries could have a negative impact on the economy and its recovery. In this respect experts recommended that the EU play a more effective role in assisting structural reforms. For example, regarding Bosnia and Herzegovina, this would mean making the central state institutions higher functioning, but also reforming the constitution and caring less about domestic political disputes.

For some of the countries, for instance, Albania, not only the application for EU membership but also the whole process of openness is something completely new and challenging for society. After the fall of the Communist regime and the wars for independence that took place in the 1990s, the transition process itself, which involves a specific remodernisation effort, has been challenging the societies and their reform potential for almost the last 20 years. In general, the economies of most of these countries had not been very open, so the impact of the global financial and economic crisis was not very severe for them at first. However, the

imbalances in regional development between urban and rural areas persist and have contributed significantly to the increase of unemployment and the aggravation of other economic indicators. In countries like Albania, for instance, there has been an economic boom in the capital city, in contrast to the rural areas, where the actual unemployment rates are several times larger than the official figures show, and which are becoming more and more depopulated. Economic and regional imbalances are compounded by political divisions and deficits: for example, in Bosnia and Herzegovina three separate ethnic entities have different laws and regulations for starting and running a business. This hampers entrepreneurs; moreover, the differences may deepen in the future and become the basis for unequal treatment and conflicts beyond the economic ones.

In conclusion, it must be stressed that the international experts expressed concerns that significantly match the results of studies on the individual perceptions of the Western Balkan population.

According to these study reports,<sup>68</sup> the majority of Western Balkan citizens seem to have already experienced the negative material effects of the global crisis between 2008 and 2009. Therefore, people did not see their material situation in 2010 as worse than it was in 2009. However, data show that there has been a dramatic increase of financial problems since 2009 in Kosovo, and a slight but perceptible increase in the numbers of respondents in Croatia and Bosnia and Herzegovina claiming they are facing financial difficulties. In the other Western Balkan countries, the number of people

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<sup>68</sup> The data quoted in this part of the text are sourced from two studies conducted by Gallup Europe in 2010 and published, respectively, in *Gallup Balkan Monitor: 2010 Summary of Findings*, and *Gallup Balkan Monitor: The Effects of the Financial and Economic Crisis*.

affected by the crisis remained almost unchanged in 2010.<sup>69</sup> Like the experts' views, these studies show that people are more concerned about the general economic situation of their own country, about the labour market and employment. With regard to the general economic developments in all Western Balkan countries in 2010, large majorities were convinced their national economic conditions were 'poor' or 'only fair'. Concerning the labour market situation, for the first time since 2006, in all of the surveyed countries more people were claiming that economic conditions were 'getting worse' than were indicating these were 'getting better'.<sup>70</sup> However, people judged their local economy to be better than the national one—for example, while in Montenegro 11% of respondents said their national economic situation was 'good' or 'excellent', 32% were convinced that the economy of their city or area was changing for better. As stated by the international experts, the reduced inflow of remittances and the partial return of work migrants as a result of the financial crisis in the receiving countries, mostly in the European Union (specifically in their immediate neighbourhood, Greece and Italy), is also a matter of concern for the entire population in the Western Balkans. This aspect of the global crisis seems to have impacted on Kosovo and the former Yugoslav Republic of Macedonia most severely. In these two countries a high rate of respondents (15% and 9%, respectively) stated that their households had received remittances and were now having problems in connection with this source of income.

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<sup>69</sup> In Kosovo, however, the crisis seems to have arrived a little later. Between 2009 and 2010, the share of respondents stating they had trouble buying food for themselves or their families rose by 9 percentage points (from 18% to 29%).

<sup>70</sup> A similar assessment is found in N. MacDonald and N. Buckley, 'South-east Europe: The Clouds Disperse', *Financial Times* (8 August 2011).

Therefore, the main question remains whether, due to the current economic and financial crisis, citizens in Western Balkan countries might develop anti-European attitudes, intensify nationalistic commitments and possibly oppose the European integration of their countries. How, and by what means, can policies at both national and European levels continue to attract the population, communities and citizens to Europe, to the values and principles of European integration? This was the second group of questions the experts were requested to answer.

According to the experts, the populations as well as the political elites of the Western Balkan countries continue to be mostly pro-European. The cited opinions directly express the beliefs of foreign experts that, despite the crisis, the Western Balkans remain supporters of the European perspective of their countries. Here, for example, are some very revealing views expressed by experts on the topic:<sup>71</sup>

I want to say that the Albanians, the population is pro-Europe, pro-Euro. They want to be a member of the European community. There are figures—80–90% of the population is pro-Europe—and, what I am quite sure of, the 4–5 biggest political parties are pro-Europe. So Albania is pro-Europe.

Yet in some of the countries applying for EU membership, placed in a situation where they have to wait too long for progress in the pre-accession process—as in the case of the former Yugoslav Republic of Macedonia—the frustration felt by the population could inspire anti-European feelings:

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<sup>71</sup> Because this point in the discussion with the international experts is directly linked to the main research question of the current project, their original statements are quoted to the letter. All citations are taken from the transcript of the discussions. At the start of the discussion the experts were asked for permission to be quoted, and the whole discussion was recorded. Once again, I express my gratitude to the participating international experts.

About pro-European attitudes, I have the feeling that in the former Yugoslav Republic of Macedonia for example, the people in general have a pro-European attitude, but at the moment, due to the name dispute, the horrible name dispute, and due to the fact that they are still a candidate country and that negotiations haven't started yet, so I think we are reaching a level of frustration that is very dangerous. . . . And if you talk to politicians or university professors, I can feel a certain frustration, which in my opinion is very, very dangerous, in the sense that it also provokes a lot of nationalistic comments and attitudes and during the campaign now. At times I was surprised to hear so many nationalistic voices, comments. I don't have the feeling whether in Kosovo it's the same, but the problem is, if the people don't feel that they are getting further or nearer the EU, then the frustration level will grow and this would also be very, very dangerous for our European integration process.

And about Bosnia and Herzegovina:

You can especially observe this kind of phenomenon in Bosnia and Herzegovina, especially in Republika Srpska, where you see that representative . . . increase the nationalistic rhetoric. And he uses it—this is also an assumption made by a lot of experts, national, international ones—in order to shift the attention from economic and financial problems inside the country and to put it on the classic conflict lines that run between the state level and the entity, and I don't need, I think, to go into details when it comes to the main political disputes which are dominating the political debate in the country. . . . I think the deeper the economic crisis is, especially in the entities, the more the risk increases that the national rhetoric may become stronger.

What the authorities in the respective countries, but also the EU institutions, have to address is not the sceptical attitudes of the population but the political deficits, such as non-functioning political institutions, corruption, and unreformed and non-independent judiciaries. This will bring the region closer to the desired EU membership and, more importantly, will allow the authorities there to better prepare for the challenges of EU integration when it comes.

This raises the issue of conditionality in the enlargement philosophy of the European Commission. Experts are appealing for a stricter approach in this respect in order for the necessary structural reforms to be intensified. Experts fear that at times the EU seems to apply double standards. In the case of the visa liberalisation process, concrete results were demanded of the candidate countries, but in other cases, European institutions seem to be ‘hiding’ behind the formalism of the Treaties’ criteria or just following the logic of prevailing political circumstances.

Reflecting on the EU enlargement approach to the Western Balkan countries, the experts also recommend that the ‘carrot and stick’ approach should be implemented more effectively, especially using the fact that the biggest EU Member States, such as Germany and Italy, are among the main trading partners of the countries in the region.

Experts believe there is room for more effective coordination with the EU, so that the countries will have to respond to the criteria and the demands of the IMF before new money tranches are given. The development aid for Serbia or the former Yugoslav Republic of Macedonia coming from some Western European countries (for example, Germany) is the highest worldwide. The experts discussed whether setting additional conditions for releasing the money, so as to obtain concrete results regarding structural reforms, might help achieve further progress in the accession process.

The movement of the countries towards EU membership will be intensified by focusing on concrete projects that show direct results and an impact visible to the public in the Western Balkans; such projects could be observed more easily by the European Commission.

The experts commented on the quality of civil society in the context of intensified nationalistic rhetoric or concerns about the economic situation. In some of these countries there is no visible protest potential or protest activity due to the very low level of organised political civil society. It seems that national political actors are not accountable enough. A gap seems to exist between the civil society and political actors, and there is not enough pressure coming from the population on politicians to deliver results.

Strengthening the civil society's capacity is important for making civic organisations and movements operational and effective in demanding results and deliverables from the activities and policies of politicians.

Another impact of the crisis is related to the fact that Western Balkan countries have small economies and limited markets. Foreign investors show little interest in such small markets. The presence of large markets and better opportunities for investment in Asia, for instance, combined with not very effective domestic demand, makes the Western Balkan countries unattractive for entrepreneurs and big companies.

The presence of appropriate infrastructure, or its lack, could respectively facilitate or hamper the process of economic integration and the establishment of a functioning single market in the Balkans. In general the building of a proper infrastructure—roads, air transport facilities and so on, is a big problem for the region as a whole and should

be supported by the EU in the pre-accession process and through financial aid for enlargement.

The existing political problems and/or unresolved ethnic issues could additionally hamper the construction of a common and interconnected infrastructure. Linking individual Western Balkan countries with the appropriate transport infrastructure (for example, Serbia with Albania via air connection, Kosovo with Albania by highway) would have a beneficial impact on the development of the separate countries and on the region as a whole.

Regional cooperation could be a useful tool supporting EU efforts to bring the Western Balkan countries in line with the highest European standards in the process of accession, and therefore it should be strengthened. Considering the situation in Bosnia and Herzegovina, the international experts feel there is much room for such cooperation. Countries need to focus on the harmonisation of laws, especially with regard to infrastructure and economic and business activities. The EU pre-accession process of the countries in the region offers a good possibility for obtaining successful development in this respect.

The experts distinguish organisations and initiatives promoting regional cooperation in the Western Balkans. Especially valuable is the work of the regional cooperation council and others trying to overcome bilateral open issues, and obstacles and tensions within the countries. As for law and its harmonisation, the biggest common problem for the countries in the region is the implementation of laws.

A useful lesson learned from previous accessions is that integration into NATO was seen as a first step to future integration into the EU. This process has proven successful likewise in providing time and a basis for reaching political

consensus inside the candidate countries, and for putting European integration on the common political agenda. Concerning the EU accession approach to the countries of the Western Balkans, experts claim that a long-lasting strategy is also needed regarding the development and implementation that the domestic actors are involved in. These activities must be visible and foreseeable for the populations in the respective countries. The question then arises about how to view the horizons of the Western Balkan countries' accession. According to the experts, the changes and progress made are not always visible after just one year; when analysing these countries, one should remember that only 10 years ago the whole region was in the grips of war and ethnic tensions. Independence and life under democracy are something new in these societies. They are advancing by 'small steps'. That a country like Albania could build a highway to another country in the region in just three years may not seem a great achievement for Western economies, but this is a really important accomplishment for a country that has started from such a low economic level of development and undergone the turbulence of ethnic tensions and economic backwardness.

More time should be allowed these countries. Their 'small' successes and achievements should be supported and encouraged by the EU. Securing and maintaining peace in this region is a very important prerequisite for its further development, and the international experts stress that the EU plays a key role in this process. For all these countries, it is the EU that sets the standard. The Western Balkans are European by 'nature': 'If they have to solve a special problem, normally the first step is to look to the EU laws or guidelines, and to look at what the standard is in the EU. . . . The EU is a standard-setting institution. Not the US or China, but the EU'.

The experts outline the important role of Croatia as a model for the European perspective of the entire region. In their view, much will depend on Croatia's future role in the EU. Even the progress of Serbia in the integration process since the country was granted candidate status will have some positive impact on the situation in other parts of the Western Balkans, like Bosnia and Herzegovina. By obtaining full membership Croatia will have a stronger interest in having a stable and secure neighbourhood. The incorporation into the EU of as many countries as possible from this region will improve regional cooperation, enhance stability, improve the quality of political dialogue as a whole and contribute to establishing a good and functioning—by European standards—political culture. In general, everyone sees that the region will benefit by the European perspective, and that political and ethnic conflicts are in no one's interest, neither the government's nor the people's. Experts say that the future economic development is also in the interest of all.

The danger comes from the fact that 'a lot of politicians and a lot of representative of civil society hope to solve the domestic problems through the EU'. That is why implementation is the most important thing that the countries in the region have to learn on their path to the EU. It is also essential for the countries' successful European perspective that the EU maintain itself in 'good health'. The EU is not just a standard-setting factor for the countries in the region but also an incentive to modernise. There is no alternative to the EU for the populations and states in the Balkans, say the experts. But some disintegrative tendencies inside the EU are already visible. Such attitudes might increase, if people here lost hope that they could solve the problems with the help of the EU, or because a high number of local politicians are benefiting from the current non-functioning structures. This disintegrative process within the EU could deepen the nationalistic and anti-European predispositions

outside it. Therefore, it is important that the EU remain alive as associated with the idea of integration and especially enlargement. On the other hand, the countries in the region need to learn they must make some impact of their own, must contribute to the resolution of their own domestic problems. The European Union should not be an excuse or a cover for the unfinished work of domestic authorities. Only open and sympathetic partnership would benefit both parties.

## Conclusions and policy-oriented reflections

As stated by the international experts working on the Western Balkans and as evident from the quantitative data, the economic improvement of the population is an essential precondition for public support for EU integration.

This study did not confirm the worst scenarios, according to which the negative effects of the crisis would hamper or even block the enlargement process, on the sides both of the Western Balkan countries and of the EU.<sup>72</sup> However, challenges to the enlargement process could be seen as coming from at least four dimensions, from which lessons may be drawn.

First, the further development of the accession process will go on under crisis conditions, amid the slow and fragile recovery and the uncertain economic future of the

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<sup>72</sup> I am referring here to the opinion that, due to the crisis, the EU might place its enlargement agenda on the back burner, and that all the efforts of the domestic political actors might come to be focused on finding solutions to the national financial and economic problems. Therefore, the EU, which is still very busy with its own crisis management, might renounce or block further accession (see Minchev, 'Introduction', 2–6).

European Union.<sup>73</sup> In this context it should be admitted that the European Commission has reaffirmed its willingness to advance in the direction of enlargement, despite the severe crisis in the Western Balkan countries and the EU. Of course, the performance on both sides should improve; the Western Balkan countries must do more to meet the accession criteria. At the same time EU should improve its approach, so as to be more helpful to the domestic pre-accession efforts and modernisation reforms. However, an important finding of this study is that, despite the crisis, the authorities and populations in the Western Balkan countries remain pro-European. The existence of political consensus within domestic (political) elites and the societies' discourse in support of the European perspective are important preconditions for the successful accession process and integration. At the time of the study it appeared the crisis was not adversely affecting the pro-European orientation of the Western Balkan countries. This finding is confirmed by the referendum in Croatia (conducted as this text was being completed), which registered decisive support for the country's membership in the EU, and by recent steps taken by Serbia to reach an understanding with Kosovo on disputed regional representation, in order to obtain EU candidate status.

Second, as this analysis has shown with respect to the economic impact of the crisis on the Balkan countries, it must be said that the crisis here follows the general European and global trends, but with a certain time lag (of about a year) behind the development of the crisis in the EU. Therefore, the Western Balkan countries, their political elites and populations, continue to be challenged by economic difficulties. There is a general trend of recovery, but it depends mainly on the rate and level of recovery in the

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<sup>73</sup> Here I am referring to the news about the second recession within the eurozone and the lack of a clear strategy and concrete measures on the part of the EU for achieving greater and sustainable growth.

countries' main European and regional economic partners. In almost all countries concerned there is still a real or projected GDP growth. But, as stated in the analysis above, the starting level was very low; hence Western counterparts expect much higher and better quality growth. What is even more important, the attained growth levels must remain sustainable. In the context of their European integration and with regard to the global financial and economic crisis, almost all countries in the region have to do more to ensure macroeconomic stability. They also need to continue consolidating their fiscal policies and balancing their budgets in order to improve negative trends resulting from problematic budget deficits in recent years. Solutions must also be found to the liquidity problem, including taking preventive measures against possible large fluctuations of the national currencies' exchange rates, and high unemployment. Exports should be further stimulated.

Most generally, the reforms begun in the last decade should continue. In most of the countries in the region the public sector must be reduced in favour of the private sector, to enhance competitive capacity on the domestic markets. In this context the privatisation agenda should remain a priority, and property rights must be guaranteed. The performance of state institutions and the judiciary must be optimised to meet the high standards of the EU. Further structural reforms are needed: effective educational, social and health systems are important for the maintenance of a skilled labour force. Unemployment levels, which have grown during the crisis, are the main challenge for the governments, as unemployment is putting pressure on the state welfare systems and further contributing to increased budget deficits. The large numbers of migrants were also affected by the crisis, in two aspects—on one hand many people have had to return to their countries of origin; on the other, the remittance flows, which were a substantial part of the domestic GDP, have

declined. This means that the authorities in the respective countries must have the courage to carry out many reforms, and often to implement unpopular economic measures. The hope is that this would not be at the expense of the pro-European orientation in these countries, thereby leading to a delay of the accession process. In general, the provisional data for 2011 confirm the projections that the countries in the region will start to improve more noticeably from that year onward.<sup>74</sup> But we must ask ourselves which countries of the region might be most severely affected for a second time in view of the predicted risk that Europe will slide once again into recession in 2012, after its slight and uneven recovery in 2011.

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<sup>74</sup> See for example, International Monetary Fund, 'Albania: 2010 Article IV Consultation—Staff Report; Staff Statement; Public Information on the Executive Board Discussion; and Statement by the Executive Director for Albania', IMF Country Report no. 10/205 (Washington, DC, July 2010), accessed at <http://www.imf.org/external/pubs/ft/scr/2010/cr10205.pdf> on 20 November 2011; International Monetary Fund, 'Bosnia & Herzegovina: 2010 Article IV Consultation, Second and Third Reviews under the Stand-By Arrangement, Request for Waiver of Nonobservance of a Performance Criterion, and Rephrasing of Purchases', IMF Country Report no. 10/348 (Washington, DC, December 2010), accessed at <http://www.imf.org/external/pubs/ft/scr/2010/cr10348.pdf> on 20 November 2011; International Monetary Fund, 'Former Yugoslav Republic of Macedonia: Selected Issues', IMF Country Report no. 11/33 (Washington, DC, February 2011), accessed at <http://www.imf.org/external/pubs/ft/scr/2011/cr1133.pdf> on 20 November 2011; International Monetary Fund, 'Former Yugoslav Republic of Macedonia: 2010 Article IV Consultation and Request for an Arrangement under the Precautionary Credit Line', IMF Country Report no. 11/42 (Washington, DC, February 2011), accessed at <http://www.imf.org/external/pubs/ft/scr/2011/cr1142.pdf> on 20 November 2011; International Monetary Fund, 'Montenegro: 2011 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Montenegro', IMF Country Report no. 11/100 (Washington, DC, May 2011), accessed at <http://www.imf.org/external/pubs/ft/scr/2011/cr11100.pdf> on 20 November 2011; International Monetary Fund, 'Republic of Croatia: Selected Issues Paper', IMF Country Report no. 11/160 (Washington, DC, July 2011), accessed at <http://www.imf.org/external/pubs/ft/scr/2011/cr11160.pdf> on 20 November 2011; International Monetary Fund, 'Republic of Croatia: 2011 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Croatia', IMF Country Report no. 11/159 (Washington, DC, June 2011), accessed at <http://www.imf.org/external/pubs/ft/scr/2011/cr11159.pdf> on 20 November 2011; International Monetary Fund, 'Republic of Kosovo: 2011 Article IV Consultation and the Initiation of a Staff-Monitored Program—Staff Report; Public Information Notice on the Executive Board Discussion', IMF Country Report no. 11/210 (Washington, DC, July 2011), accessed at <http://www.imf.org/external/pubs/ft/scr/2011/cr11210.pdf> on 20 November 2011; International Monetary Fund, 'Republic of Serbia: Sixth Review under the Stand-By Arrangement', IMF Country Report no. 11/9 (Washington, DC, January 2011), accessed at <http://www.imf.org/external/pubs/ft/scr/2011/cr1109.pdf> on 20 November 2011; International Monetary Fund, 'Republic of Serbia: Seventh Review and Inflation Consultation under the Stand-By Arrangement', IMF Country Report no. 11/95 (Washington, DC, April 2011), accessed at <http://www.imf.org/external/pubs/ft/scr/2011/cr1195.pdf> on 20 November 2011.

Third, the capacity of the EU to absorb new members after the euro crisis and after the impact of the economic recession in some EU Member States should remain at a high level. The study has shown that, with regard to European integration, the cooperation of the countries with the European Commission with respect to economic and financial surveillance and monitoring has progressed. The dialogue was defined by the European Commission as good and productive. This is even more important in view of the efforts to establish a new model of a better and more effective European economic governance approach. The candidate countries should remain an integral part of the dialogue on these efforts. Of course, the Western Balkan countries could choose to introduce the best dimensions and practices of the new European model of enhanced economic governance, even when these are not mandatory. This will increase their own capacity to overcome the negative impact of the crisis as well as to access the bigger and effectively functioning single European market. In addition, the confidence in their crisis management ability even before membership would be improved by applying a more efficient mode of financial policy and seeking greater economic coordination under the criteria of the Security and Growth Pact, and better economic governance.

Finally, it should be underlined that economic problems are intensified by the existing political deficits. In other words, when there are internal political difficulties at state level or in the processes of national reconstruction and of building institutions, combined with external bilateral issues such as border disputes, 'name' issues and ethnic disputes, and when all this occurs together with the economic crisis, it is most likely that effective public discussions and political solutions to the economic problems would be substituted by nationalistic rhetoric and populist projects. This might hamper

the EU integration process in the respective countries. Effective solutions could be to (1) reorient part of the EU pre-accession aid, so as to tackle these deficits of the political process and internal political infrastructure (combating corruption, organised crime, illegal work and the black economy, and strengthening rule of law, etc.); (2) establish wider regional and/or European frameworks to tackle specific questions and unresolved bilateral issues, in case these might obstruct the integration process; and (3) engage more effectively the populations, communities and citizens in the respective countries in a comprehensive dialogue with European institutions and try to arouse awareness of European integration. The European institutions, especially the European Commission, should follow the accession procedures strictly and in a manner foreseeable for the candidate countries. Otherwise, the population's frustration about the enlargement outcomes and its fatigue from remaining so long in an uncertain status might overwhelm the strong pro-European attitudes in the Western Balkans. On the other hand, the EU itself should return as quickly as possible to its 'best times', with regard to growth, economic development and financial health. The Union is the standard-setting body for the states and the populations alike in the region. It must continue to provide the best examples and patterns for economic development, functioning democracy and good governance.

## Recommendations

Minimise/soften the impact of the crisis on the European perspective of the Western Balkan countries at large by

- further encouraging the as-yet-fragile economic recovery and supporting economic growth; consolidating fiscal policy; balancing national budgets, solving liquidity problems and problems connected with national currency fluctuations. Special attention must be paid to reducing unemployment and increasing the number of new jobs;
- enhancing the conditionality in the relations with the EU, IMF and other major donors in order to advance in the reforms and deliver concrete results;
- further supporting the modernisation efforts of the countries in the region, including structural reforms in all the respective areas, but also strengthening the main domains of democratic development such as the rule of law, good governance, political consolidation and ethnic tolerance;
- removing obstacles to regional cooperation and stability and supporting the multilateral dialogue on pressing issues;
- encouraging, concerning trade and improvement of the Western Balkan countries' potential for exports and imports, their further interconnectedness, especially through appropriate infrastructural links, which can make them, combined, and the region as a whole, more attractive for investment than any Western Balkan country taken separately;

- supporting further the adjusting of the Western Balkan countries' own fiscal and economic policies to the new EU regime of economic governance in a multilateral economic dialogue between the Commission, EU Member States and candidate countries in the context of the pre-accession fiscal surveillance. This dialogue, including meetings at ministerial level, focuses on the main challenges posed by the Copenhagen political and economic criteria and reviews the progress made towards fulfilling the Accession Partnership priorities; it might be helpful for both the pre-accession process and the internal reforms and modernisations in these countries.

The respective Western Balkan countries should make further progress with regard to the impact of the crisis on their European perspective by

### Albania

- decreasing the relatively high foreign debt;
- tackling inflation;
- further balancing the budget deficit;
- tackling the imbalances of the labour market and the external account of Albania;
- introducing structural reforms such as bolstering economic governance, enhancing labour market performance and protecting property rights.

## Bosnia and Herzegovina

- tackling more effectively problems in the banking sector and regarding liquidity;
- improving the low employment rates and overcoming high unemployment;
- supporting the fragile economic growth;
- further consolidating the single economic space in the whole country;
- achieving fiscal consolidation; optimising public spending, especially concerning the huge number of people employed in public administration; and decreasing the high levels of budget deficits.

## Croatia

- decreasing the accumulated high indebtedness;
- overcoming the recession, further stimulating economic growth, exports, foreign investment and private consumption;
- stopping the fall of employment;
- fighting high inflation.

## The former Yugoslav Republic of Macedonia

- recovering the labour market and reducing the number of unemployed;
- developing public spending schemes and further enhancing structural reforms;

- further attracting exports and foreign investment;
- further reducing the public debt.

### Montenegro

- further supporting recovery of production and foreign investment inflows;
- decreasing public debt and ensuring further fiscal consolidation;
- tackling the deterioration of the labour market, widespread informal work arrangements and high unemployment;
- removing difficulties with ownership transfer and property rights;
- enacting more adequate regulation and supervision of the banking sector.

### Kosovo

- intensifying the economic integration into the region and into Europe as a whole;
- advancing in policy formulation and implementation;
- tackling high unemployment and the imbalances on the labour market;
- advancing in economic governance, administration and statistics;

- improving the business environment through promotion of property rights, reduction of corruption and reduction of high interest rates;
- reducing the large informal sector.

## Serbia

- enhancing recovery from the recession;
- enhancing fiscal discipline;
- improving the business environment, which includes enhancing legal predictability, removing burdensome administrative procedures, reducing the informal economy and effectively enforcing property rights;
- tackling the continuously growing unemployment;
- guarding against inflation shocks;
- advancing in restitution and protection of property rights.

To advance the European enlargement approach and the European perspective of the Western Balkans, in particular, EU institutions should

- positively publicise the EU enlargement process, including that of the Western Balkans. The global crisis and its painful effects upon Europe are exhausting the public energy in the EU; in this connection, measures should be taken to ensure that the EU accession of the Western Balkans will be endorsed by public opinion and politicians in the EU Member States. The role of the EU institutions, and especially that of the

European Commission, is essential in this respect. The EU enlargement process needs to gain in visibility in both the Western Balkan countries and the EU Member States. The citizens of all countries want visible indications of the Union's success;

- develop a long-term strategy for the Western Balkans, including the enlargement agenda: how to think from a European perspective about the Balkans as a whole, and make this perspective a visible horizon;
- support the formation of a European political culture, in which values like the rule of law, good governance and efficiency should play a more important role;
- use the European path and the pre-accession experience of Croatia as a positive model for the entire region. The success of Croatia is crucial for the success of future enlargements. Likewise of essential importance are the help and support of Croatia and its role in bringing the regional cooperation between the Western Balkan countries to a higher level; and
- take into consideration in the EU approach the following aspects:
  - the interconnectedness of political developments and economic recovery: there can be no sustainable economic development without functioning democratic institutions and consolidated national efforts. It might be helpful to reshape the EU approach to tackle the objectives of economic recovery, political development and integration efforts as different dimensions of one and the same process. Having in mind that the Western Balkans comprise countries in transition that must overcome the difficulties resulting

from the transformation to a functioning market economy and democracy, and that have a legacy of a painful shared past, a more political approach might be more appropriate. A real deficit in countries like these is their incapacity to cope with the highest standards of 'good governance';<sup>75</sup>

- focusing on concrete results, on concrete projects that move the countries towards the EU and yield direct results and impact; involving the public and informing it of the consequences in case certain reforms fail to be made; putting pressure on the political actors in this respect;
- trying to advance in supporting the development of a modern political class and a general political atmosphere (demanding results and greater responsibility in delivering outcomes)—far more should be done to improve the links between civil society and political actors;
- strengthening regional cooperation and the establishment of a Western Balkans single market. The success of an undertaking like this will mostly depend on the preliminary disadvantages and advantages in the region such as the lack of infrastructure links between the countries, on one hand but the presence of contacts between the economic actors based on the former Yugoslavia, on the other.

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<sup>75</sup> 'Good governance' has been described as 'a normative conception of the values according to which the act of governance is realised, and the method by which groups of social actors interact in a certain social context. The lack of a generally accepted definition of the concept is compensated by the identification of principles that strengthen good governance in any society. The most often enlisted principles include: participation, rule of law, transparency of decision-making or openness, accountability, predictability or coherence, and effectiveness'. Source: 'Good Governance in Multiethnic Communities', accessed at <http://www.edrc.ro/docs/docs/11-17.pdf>, on 10 January 2012.

- making use of the EU's position of biggest trade partner and biggest aid donor, and being more efficient in the 'carrot and stick' approach;
- helping reach and maintain political consensus in the Western Balkan countries and turning the European integration of these countries into their common political agenda;
- in aid of the efforts at modernisation, reform and reconciliation, carrying on the procedures of Kosovo's and Serbia's accession in parallel, and perhaps giving the two countries a chance to enter the EU together. On the other hand, Bosnia and Herzegovina's future and further strengthening of its state consolidation and autonomy must be the object of commitment on the part of all neighbouring countries. In this context, platforms for dialogue between the parties, such as that offered by the EPP, are especially appropriate and fruitful.

Unlike the European Commission and other institutions of the Union, the EPP is able to actually propose, implement and hold a thorough regional approach to the accession of the Western Balkans. In the course of the accession process, the countries should receive a clear and predictable perspective of negotiations and membership, which under normal conditions does not exceed the mid-term period of five years. The EPP should use all its power to ensure that the process of EU enlargement towards the Western Balkans will be fair, open and predictable.

## Albania

Efforts should be directed to increasing the progress made in meeting the political criteria for membership and the 12 key priorities for the opening of accession negotiations, as identified in the Commission's opinion endorsed by the Council in December 2010 regarding the judiciary, anti-corruption policy, property rights, improving the living conditions of the Roma community, improvement of parliamentary procedure and elections. Further efforts on these matters are required to obtain the European Commission's recommendation for candidate status and ensure the opening of EU accession negotiations.

## Bosnia and Herzegovina

To apply for EU candidate status, Bosnia and Herzegovina must fulfil the following requirements:

- implementation of the 'Finci/Sejdic verdict',
- adoption of the Law on State Agency and the Law on Census,
- achievement of further consolidation at state level and a more effective coordination mechanism between the State and the Entities on EU affairs.

## Croatia

The option of postponing the date of accession, set for July 2013, does not seem probable, excepting extraordinary circumstances, such as non-fulfilment of economic criteria regarding a functioning market economy, the capacity to

cope with competitive pressure and market forces within the Union, or shortcomings with respect to the *acquis* criterion of being able to assume the obligations of membership arising from the Treaties and the Union legislation.

### The former Yugoslav Republic of Macedonia

The major topic of discussion remains the so-called name issue between the former Yugoslav Republic of Macedonia and Greece. Due to this protracted bilateral dispute, the accession procedure for the country is blocked. The authorities and political elites have the difficult task of preventing growth and hardening of nationalist attitudes, which could be intensified by the economic difficulties.

A further goal should be to improve neighbourly relations with the countries in the region, including Greece and Bulgaria.

### Montenegro

There is work needed towards

- improving the legislative framework, including for political elections, and strengthening the Parliament's legislative and oversight role and anti-corruption activity;
- completing the public administration reform;
- enforcing the judiciary reform; and
- strengthening the fight against organised crime.

## Kosovo

Attention should be given to

- further consolidating the state and establishing modern democratic principles of governance;
- enhancing reforms, including those in the administration and the judicial system, and enacting and implementing anti-corruption legislation;
- establishing good neighbourly relations, including improved dialogue with Serbia;
- being more actively involved in Western Balkan regional cooperation initiatives; and
- demonstrating concern for the rights of all citizens, regardless of ethnicity.

## Serbia

Further progress can be made in normalising relations with Kosovo in line with the conditions of the Stabilisation and Association Process, establishing good neighbourly relations with other countries in the region and demonstrating concern for the rights of all citizens, regardless of their origin.

## Appendix

1. As stated by experts and scientists,<sup>76</sup> in the post-Communist period a general process of renewed modernisation has taken place in the Western Balkan countries. A significant part of it was the national identification process and the aspiration to state independence. As a consequence, large portions of the region are now facing difficulties in national reconstruction and institution building; they have shown limited ability to establish functioning local authorities and to consolidate the state. This is especially true for Bosnia and Herzegovina. Many years after Dayton, this state still seems like a merely physical assemblage of three ethnic communities that find it difficult to live together and to integrate. The two entities and the three ethnic communities there have even failed to form a state-level government more than a year after the elections held on 3 October 2010.

In its 2011 report on Bosnia and Herzegovina the European Commission states that the country has made limited progress in addressing the political criteria for EU membership. This long delay has hampered Bosnia and Herzegovina's progress on much-needed political and economic reforms. The lack of a credible process of harmonisation of the country's constitution with the European Convention on Human Rights also remains an issue of serious concern. There are three minimum requirements that Bosnia and Herzegovina must fulfil in order to apply for EU candidate status:

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<sup>76</sup> See also Minchev, 'Introduction', 2–6.

the implementation of the 'Finci/Sejdic verdict'<sup>77</sup>, the Law on State Agency and the Law on Census. Notable in the country's lack of integration efforts is that there is no reform-oriented policy or effective coordination mechanism between the state and the entities on EU affairs; an important but unfulfilled step is the programming of financial assistance under the Instrument for Pre-Accession Assistance. Given the lack of a new state-level government, the failure to adopt the Global Framework for Fiscal Policies 2011–13 seems to be a shortcoming that logically follows.

2. Kosovo was awarded sovereign status by the international community. At the same time some analyses point out that the country still lives under the significant influence of the old clan-based system of authority and economic dependencies of the population under conditions of overwhelming dissemination of organised crime networks and corruptive relationships and practices. Internal ethnic relations are tense. As stated above, the territorial integrity of Kosovo is highly disputed.
3. How are potential member countries able to achieve progress in adjusting their fiscal and economic policies to those of the EU? The support of the EU itself using the Association Partnership Process is essential for achieving it. The most interesting case is that of Kosovo, the most recently formed sovereign state in the region. Kosovo shares the European perspective of the Western

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<sup>77</sup> The applicants, Mr. Dervo Sejdić and Mr. Jakob Finci are both citizens of Bosnia and Herzegovina. Being the one of Roma and the other of Jewish origin they complained that, 'despite possessing experience comparable to that of the highest elected officials, they were prevented by the Constitution of Bosnia and Herzegovina, and the corresponding provisions of the Election Act 2001, from being candidates for the Presidency and the House of Peoples of the Parliamentary Assembly solely on the ground of their ethnic origins' (Council of Europe office in Belgrade, accessed at [http://www.coe.org.rs/eng/news\\_sr\\_eng/?conid=1545](http://www.coe.org.rs/eng/news_sr_eng/?conid=1545) on 1 July 2012).

Balkans. This has been reaffirmed by the country as well as by the European Commission. In March 2011 the Commission issued its proposal for a framework agreement allowing Kosovo to participate in EU programmes. The Commission asserted its willingness to further support Kosovo's efforts to reach the other two key objectives—eventual visa liberalisation and a trade agreement with the EU. In this respect the proposal is to launch a structured dialogue with Kosovo on the rule of law and also to urge the country to launch a comprehensive agenda for improving the situation in the North.

4. The former Yugoslav Republic of Macedonia's special measures for strengthening the business environment and improving economic competitiveness<sup>78</sup>

A series of efforts are oriented to improving the business environment, reducing administrative burdens and carrying out a transparent economic policy. In addition to the regular dialogue with the business community, the government is employing the experiences and best practices of the developed countries, as well as the recommendations of relevant international institutions and most important indicators such as the reports of the European Commission, the *Doing Business* report of the World Bank, and the *Global Competitiveness Report* of the World Economic Forum, in an attempt to improve the business environment.

The government of the former Yugoslav Republic of Macedonia, in cooperation with the business community and in response to their demands, has adopted the

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<sup>78</sup> We are highly grateful for this information to the Permanent Representative of the former Yugoslav Republic of Macedonia to the EU Mr. Andrej Lepavcov.

fourth package of 25 anti-crisis measures in March 2010. The new set of measures was designed to facilitate the procedures for doing business in the country, improve access to credit of micro enterprises and SMEs, increase their liquidity, stimulate construction, increase privatisation of land, promote employment in agriculture, improve tourism, promote export and reduce unfair competition. The implementation of the fourth package of anti-crisis measures displayed dynamics of realisation by the end of 2011. By February 2011 the government reported 19 measures had been implemented. The government also continually monitors the global economic crisis and its effects on the national economy. In this respect the national authorities are ready, if the need for additional liquidity support arises, to propose a new package of anti-crisis measures in cooperation with the business community.

**Penalty policy.** In early March 2010, the Government of the former Yugoslav Republic of Macedonia, in cooperation with the Chambers of Commerce and associations of enterprises and business entities, identified the problems that the business community faces when supervision is carried out by the inspection authorities. In accordance with the recommendations of the business community, the first package of measures for penalty policy improvement was adopted in mid-July 2010. By April 2011, 131 laws were aligned with the measures for improvement of the penalty policy. Originally it was planned to fully incorporate the measures in 151 laws by the end of the first quarter of 2011.

**Project 'Visit to 150 companies'.** In consideration of the needs of the business community, in addition to regular dialogue with the Chambers of Commerce, the

government has implemented a direct communication approach with the businesses of the former Yugoslav Republic of Macedonia. With regard to this intention a direct survey to define the biggest problems the companies are facing was conducted in the period October–November 2010. Teams of government officials visited 150 companies selected according to previously defined criteria such as regional structure, export orientation, financial results and equal representation of small, medium and large enterprises.<sup>79</sup> The analysed results of the survey identified several problems: unfair competition, difficulties with land purchase, reduced liquidity and competition, unfavourable funding conditions, the need for improvement of customs operations, excessively long procedures for obtaining concessions and overly complicated regulatory processes. For most of the problematic areas, such as customs issues, purchase of land and regulatory reforms, the government has already implemented measures.

### **One-stop shop for domestic and foreign investors.**

To facilitate the process of starting and doing business in the former Yugoslav Republic of Macedonia, as well as to enable potential investors to obtain at a single place all the necessary information about the procedures and required documents, the government is carrying out activities for establishing a one-stop shop for domestic and foreign investors.<sup>80</sup> The establishment

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<sup>79</sup> Hence, various industries were included in the examination of the business conditions in the country: metallurgy, metal processing, construction, chemical, food, textile, pharmaceutical, wood processing, service sector, trade, catering and tourism.

<sup>80</sup> In December 2010 the project was presented to the international donors with a call for technical and financial aid for its implementation. In the beginning of 2011 technical assistance was expected to be obtained from the European Commission for implementation of the first phase of the project, mapping of all business licences and permits and determination of the organisational and legal framework for establishing a one-stop shop for investors.

of this system will provide the foreign and domestic investors the following services: information support, assistance and compliance, and technical and financial support. The authorities have made significant efforts to improve the competitiveness of the country, efforts that are in compliance with the enhanced interest of the European institutions and EU Member States to increase Europe's competitiveness. About 330 measures were tabled and are currently in governmental procedure. In addition, an Action Plan includes measures proposed by the Chambers of Commerce, since part of the activities for improvement of the Global Competitiveness Index directly depends on the business community.<sup>81</sup> Additionally, the Centre for Economic Analysis in collaboration with the United States Agency for International Development prepared a *National Competitiveness Report for 2010*, which indicated the competitive weaknesses and made recommendations for improving the competitive position of the country. Additionally, specific recommendations to improve competitiveness will be prepared for the next five-year period, 2011–15.

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<sup>81</sup> Also, in cooperation with the National Entrepreneurship and Competitiveness Council (NECC), the Information on Improving the Competitiveness of the Republic of Macedonia with the proposed Action Plan for 2010 will be analysed, and a common platform of the government of the former Yugoslav Republic of Macedonia and the business community will be prepared for improving the competitive position of the country.

**Regulatory Reform.** The regulatory reforms were initiated by the government of the former Yugoslav Republic of Macedonia in the end of 2006 through the Regulatory Guillotine Project for reviewing existing regulation, and by streamlining of bureaucratic procedures and introduction of Regulatory Impact Assessment.<sup>82</sup>

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<sup>82</sup> The implementation of the Regulatory Guillotine Project began in 2006 and is being continuously carried out in several stages, aimed at reducing the bureaucratic procedures for businesses and citizens. Hitherto, in the first phase, 2000 laws and by-laws were reviewed in cooperation with the business community and citizens, and measures were prepared and carried out in 545 regulations. In the second phase, started in April 2009, 54 measures were adopted for simplification of the cross-border trading procedures. By the end of 2010, 30 measures had been implemented. Most of the on-going measures are related to the establishment of a system for risk analysis, which will be fully functional by January 2012. The third phase started in October 2010, when the government of the former Yugoslav Republic of Macedonia adopted a new package of 47 measures. These are currently under implementation. The measures relate to procedures in several areas: agriculture, labour and social policy, health, environment, insurance, etc. By January 2011, 10 measures were implemented, including amendments to the Law on Trade in terms of regulation and reduction of administrative barriers to trade in alcoholic beverages, amendments to the Law on Public Procurement in the direction of defining terms of evaluation and decision-making; amendments to the Law on Veterinary Health in the direction of de-monopolisation of veterinary health services, reducing costs associated with hiring employees; amendments to the Law on Spatial and Urban Planning, so as to specify the limits and procedure for adoption of a detailed urban plan; amendments to the Law on Building to simplify the procedure for issuing building permits; and amendments to the Companies Act and the Law on Mandatory Fully Funded Pension Insurance. The Regulatory Impact Assessment (RIA) process is a complementary tool of the Regulatory Guillotine Project, aimed at preventing the generation of additional administrative burdens and barriers in the new legislation. The Regulatory Guillotine Project will be implemented continuously until capacity is built for implementation of RIA in by-laws, which actually hold the largest administrative burdens.

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Like elsewhere in Europe, the crisis has affected economic developments in the Western Balkans, from Croatia in the north to Albania in the south. The countries in the region face difficulties such as high unemployment, decreased availability of bank credit and reduced trade. Furthermore, the inability of their political institutions to deal immediately with these economic challenges has reinforced the negative effects of the crisis. What does this mean for the Western Balkans' accession to and integration within the EU?

This paper by Rumiana Jeleva shows that improving the economic situation is an essential precondition for public support for EU integration. At the same time it argues that the pro-European orientation of the Western Balkans ensures that they will continue to look towards the EU, rather than to the US or Russia. This is demonstrated by the fact that they are not merely taking measures to recover from the crisis: they are taking measures that are aligned with European regulations. The Western Balkan countries may have a long way to go to become EU members, but they have proven their commitment to a future within the EU by their pro-European solutions to the crisis. This makes it all the more important for the EU, even in this time of crisis, to continue to support the accession process and bring the Western Balkans closer to the EU.

