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2023



CONVERGING FUTURES: ECONOMIC INTEGRATION OF THE WESTERN BALKANS INTO THE EUROPEAN UNION



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February 2024

About the process:

This paper is based on inputs from three regional online consultation events and one hybrid public event of the Thematic Working Group “Access to European Single Market” organised between June and September 2023. The thematic working group led by the European Policy Institute, Skopje gathered more than 65 experts from civil society, academia, private sector, and state administration from the Western Balkan Six and the Member States, while the event was attended by 83 participants. The European Policy Institute (EPI) facilitated the consultation process, alongside a core group of experts.

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For ten years in a row, the Berlin Process has supported the sustainable growth of the Western Balkans, fostering the connectivity project in the region while advancing the prospect of European integration for the countries of the Western Balkans.² The EU institutions and Member States have pledged technical and financial support that provide impetus for cooperation in strategic industrial areas and to support the regional markets to be more competitive.³

In recent years, the modalities of the enlargement policy of the European Union (EU) have been widely discussed across Europe. The think tank community has proposed gradual, staged, and sectoral integration or full participation in the EU Single Market. These proposals aim to fill the gap created by the slow progress in delivering on the “phasing-in” feature of the enlargement methodology and the enlargement process overall. In line with the civil society proposals, the European Commission President Ursula von der Leyen presented the four-pillar plan for the Western Balkans: closer association with the Single Market, deepening regional economic integration, accelerating fundamental reforms, and increasing pre-accession funds.

The Russian aggression against Ukraine has created a new geopolitical momentum for the enlargement process. The EU response has shown that swift trade derogations, market integration initiatives, and increased funding are possible in the changing geopolitical context. There is also a pressing need for an urgent response for the Western Balkans while emphasising the rule of law as a primary principle.

Given the current political developments in Europe, the upcoming Berlin Process Summit should put forward policy proposals and concrete initiatives enhancing economic cooperation and integration between the Western Balkans and the EU prior to accession. Active involvement by the EU and the Members States, particularly those participating in the Berlin Process, is required to support the region and clearly **offer further integration into the Single Market, help strengthen Western Balkan countries’ economic governance framework and increase EU funding to support economic convergence.** In parallel, the Western Balkan countries must undertake and implement the necessary reforms to meet the EU rules and standards for products and services and other relevant parts of the Single Market acquis, strengthen public finance management, and accelerate structural reforms.

1 The European Policy Institute, Skopje expresses appreciation to all participants of the Thematic working group. A special thanks goes to Silvana Mojsovska, Matteo Bonomi and Zlatko Veterovski for their valuable input for the thematic sessions.

2 Final Declaration by the Chair of the Conference on the Western Balkans, 2014

3 Common Regional Market - A catalyst for deeper regional economic integration and a stepping stone towards EU Single Market

OFFER ADVANCED ACCESS TO THE EU SINGLE MARKET AS PART OF THE ACCESSION PROCESS

Deeper integration with the EU could support value chain integration and is expected to increase the export of both intermediary and final goods to the EU Single Market.⁴ With the abolition of tariffs and trade liberalisation from the early 2000s and the establishment of the free trade area under the SAAs, the EU has become the leading trade partner of the Western Balkan countries, accounting for over two-thirds of the region's total trade. Nevertheless, the region's share in the overall EU trade is marginal.⁵ Despite the trade preferences and potentials between the EU and the six Western Balkan countries (WB6), trade relations are subject to non-tariff barriers to trade (NBTs). The differences in technical regulations, requiring licenses and certificates and other product compliances, increase costs and distort trade between the parties. Thus, further economic integration ahead of full accession could be a promising path towards improving the living standards in the WB6,⁶ at a low economic and political cost for the EU. Several challenges should be considered when discussing granting access to the EU Single Market for the WB6.

First, the EU Single Market is founded on the respect of the rule of law. Robust and impartial regulatory bodies have to be established and are essential to guarantee and oversee the enforcement of the EU acquis. Independent judicial systems are the recourse where market participants seek justice so that EU rules are applied fairly and equally. Judicial cooperation and the recognition of judgments in civil and commercial matters ultimately depend on national courts. Thus, judicial independence, or the lack of it, remains the weakest area for the region. From this perspective, strengthening the rule of law in the WB6 becomes an essential precondition for the success of any policy proposal, including facilitated access to the Single Market.

Second, the pace in terms of alignment with and implementation of the EU acquis in the region varies from country to country for each of the four freedoms. On the other hand, the need to strengthen the capacities of key institutions able to monitor the implementation of the relevant rules and standards is relevant across the board. Ongoing policy developments, such as the customs union reform and the carbon border adjustment mechanism, including new patterns of trade, particularly the rise of commerce and parcel deliveries, would increase compliance costs not only for the state institutions but the private sector as well, bearing the burden of alignment with EU rules and standards. Cautious thinking is also required when considering market liberalisation, particularly for the free movement of people and capital. Emigration and capital outflow are or are least perceived to cause devastating effects on the domestic economies.

Third, the logic of the institutional set-up opens up a big debate on how to approach the integration into the EU market for the WB6. The SAAs provide a solid legal foundation for products coming from the Western Balkans to receive internal market treatment, conditioned upon alignment with the relevant acquis.⁷ The Energy Community and the Transport Community, as well as the European Civil Aviation Area, serve for sectoral integration of the WB6 to the EU Single Market in the specific areas for goods and services. There is a risk, however, that many different modalities of implementation and monitoring of "phasing-in", could, in parallel with current bilateral SAAs and regional multilateral sectoral treaties, make the process even more complex and less understandable for businesses and citizens in the region.

4 Oliver Reiter and Robert Stehrer, Value Chain Integration of the Western Balkan Countries and Policy Options for the Post-COVID-19 Period, Vienna Institute for International Economic Affairs, March 2021

5 https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/western-balkans_en

6 Richard Grieveson, A change of EU strategy in the Western Balkans is long overdue, Vienna Institute for International Economic Studies, September 2020

7 For more detailed analysis see Zoran Sretic, Sectoral integration opportunities in the SAA regime: The case for the internal market treatment of products, Belgrade: Centre for European Policy, June 2023

Fourth, the Western Balkan countries committed to an action plan to create a Common Regional Market (CRM) in trade investment, digital, and industrial and innovation areas. This plan has been perceived as the stepping stone for the EU Single Market. Affected by bilateral disputes and political obstacles, the adoption and implementation dynamics of the targeted CRM actions, particularly in the trade area, i.e. the four freedoms, have taken a discouragingly slow pace. Even though significant political capital is invested in this process by the EU institutions and the Member States, the CRM does not live up to its potential. On the other hand, access to the EU Single Market is a more attractive offer for the countries in the region. The Visegrad countries serve as an example that deeper EU integration can itself stimulate deeper regional ties.⁸ The size of the market and the already established trade relations offer more business opportunities. If bound together, these processes could reinforce each other: access to the EU Single Market would be an incentive for the implementation of the CRM.

In this context, **the European Commission should present a plan with a feasible timeline to allow the markets of the WB6 to immediately access the EU Single Market in all areas that would not impose high adjustment costs and would be highly beneficial and visible for businesses and citizens with EU accession as the end goal.** Further fragmentation should be avoided. Access to the Single Market should be combined with existing ongoing processes in the Western Balkan countries, such as the accession negotiations and screening and the implementation of the CRM. The Commission should apply strict conditionality on rule of law and functioning of institutions for key issues that have to be delivered by the WB6 governments.

Matching institutions in the WB6 countries and their counterparts in the EU Member States, including the ones that are part of the Berlin Process, through twinning projects and technical support could be an essential learning experience. Such an approach could allow for a greater learning experience and for building capacities, as well as the socialisation and policy coordination between national institutions while keeping the EU integration process at the heart of the process.

The Western Balkan governments should manifest their unequivocal commitment to implement and monitor the implementation of the reforms linked to the Single Market acquis. The interest to integrate into the EU market must be followed up with political commitment and implementation of the relevant acquis. Sufficient budgetary funds dedicated to strengthening material and technical capacities, as well as staff retention, must be ensured to enable key institutions to safeguard European rules and standards. Proactive engagement with the chambers of commerce in building the capacities of the private sector to meet the requirements of the existing and upcoming legislation of the EU Single Market is needed. Timely information for the private sector on the opportunities and obligations from granted access to the EU Single Market would allow domestic companies, including local SMEs, to carry the compliance burden.⁹

The European Commission and the Western Balkan leaders should ensure that the policy dialogue on EU integration is open and transparent to non-state actors. Businesses can provide the on-the-field experience to identify and address key bottlenecks in the short term and also feed into strategies for long-term transformation. Failure to listen to the business community in the region could increase market pressure and negatively impact competitiveness. The early involvement of CSOs that are vocal advocates in the EU accession process would help legitimise the reform processes. It would also be an investment in civil society capable of being an equal partner in EU policy-making in the future. Above all, such an inclusive approach would allow for the mobilisation of all stakeholders to monitor economic and business relations and the impact of the undertaken reforms.

8 Richard Grieveson, A change of EU strategy in the Western Balkans is long overdue, Vienna Institute for International Economic Studies, September 2020.

9 Observatory of European SMEs 2003, No. 6 The impact of EU enlargement on European SMEs

IMPROVE ECONOMIC GOVERNANCE POLICY COORDINATION

The economic governance and coordination frameworks for the Member States could be combined with the EU accession mechanisms for the Western Balkans. Access to the EU Single Market will not improve public finance management per se. Sectoral structural reforms should be addressed through legislative changes, but in some policy areas they are not acquis heavy. Public administration reform, education policy, digital and green transformation, and research and innovation are necessary for a well-functioning market economy and are extremely important in terms of competitiveness and inclusive growth.

The preparation of the Economic Reform Programmes (ERPs) has created the institutional structure and mobilised administrative services to work on multiannual budget and reform planning. Over the past several years, the level of implementation of the country-specific recommendations is, on average, higher among the WB6 countries.¹⁰ With no tangible enlargement perspective, however, there is a risk of it becoming an imposed exercise. There is a lack of strong ownership in the ERP process among line ministries, and the structural reform measures tend to be selected and implemented based on the allocated budget funding for areas that are a political priority. Multiannual budgetary planning is inadequate or pro forma; in many cases, the prioritisation of structural measures is non-transparent and has no transformative effects.

In terms of coordination between the Western Balkans and the EU, there is a notable mismatch between the ERP annual cycle and the European Semester calendar. National administrations in the Western Balkans currently adapt to different planning, preparation, and submission deadlines. As the countries have submission deadlines in January, the Annual Sustainable Growth Strategy cannot be considered and incorporated into the ERPs. The Member States and the EU institutions, on the other hand, do not have a forum where they interact and have the opportunity to better understand the technical challenges the candidates face at an operational level. Equally, the countries cannot have a say in the EU growth strategy, even though this policy guidance directly or indirectly affects their economies.

In that light, the European Commission should propose a plan to align the European Semester with the ERP cycles. Closer and regular ex ante coordination, rather than ex post coordination, would allow for early detection, prevention and correct macroeconomic imbalances. It may also serve a good cause in a situation of loose monitoring and measurement of the performance of the countries in the ERP process. More substantial engagement with EU institutions, or even the application of conditionalities of the Stability and Growth Pact and the **Macroeconomic Imbalance Procedure**, could transfer knowledge and stimulate the planning of national budgets around structural reforms and sound public finances in the medium and long term.

The European Commission should allow for the gradual participation of the Western Balkan countries in the EU economic governance framework. Participation in the European Semester and the broader economic governance framework of the EU could spread more enthusiasm among public officials, the administrations as well as non-state actors, enhancing systematic thinking about the structural reforms and increasing their implementation and impact.

10 See Progress towards Meeting the Economic Criteria for EU Accession The EU Commission's 2022 Assessments, and 2022 Economic Reform Programmes of Albania, Montenegro, North Macedonia, Serbia, Turkey, Bosnia and Herzegovina and Kosovo*: The Commission's Overview and Country Assessments

MAKE BETTER USE OF EXISTING AND INCREASING EU FUNDING FOR THE WESTERN BALKANS

The WB6 access to the EU budget has remained limited and highly disproportionate to its level of market integration within the EU. Despite some shifts within current allocations with the Connectivity Agenda and the Economic and Investment Plan, the total allocation of IPA funds for the Western Balkans has remained unchanged over the last three EU budgetary cycles (2007-2013; 2014-2020; 2021-2027) covering a period of 21 years. The budget has remained stable at approximately € 10 billion for each seven-year period. The average per capita receipt by the Western Balkan countries over the entire 2021-2027 MFF has been estimated at € 500.¹¹

In view of discussions on facilitated market integration, the question of increasing the EU's transfers to the region gains significance. Given the renewed focus on EU enlargement since Russia's war in Ukraine and in light of the revised enlargement methodology, "accelerated integration" and "phasing-in" considerations of how to provide the Western Balkans with greater access to the EU budget and participation in the EU institutions are gaining momentum, as emphasized by the Commission President at the Globsec Bratislava Forum and EUCO President at the Bled Forum in the summer of 2023.

Despite the existing consensus that increased EU investment in the region is necessary, the working group discussions underscored essential challenges such as the mounting needs on the Union budget and absorption capacity in the region. As for the former, studies have shown that the financial impact of increased support to the Western Balkans would be minimal on the Union's budget.¹² As for the latter, most of the WB6 administrations are already struggling to provide mature projects and thus do not manage to use the existing funds which are at their disposal, coupled with concerns of weak governance practices. In parallel, research has shown that the EU funds the national administrations in the region manage in a decentralised manner have been constantly reduced.¹³ This approach puts into question the feasibility of building capacity for future Member States.

The European Commission should, by the end of the year, present a formal plan for boosting pre-accession assistance in this multiannual financial framework (MFF) as part of the mid-term review and start discussions with EU Member States on revamping pre-accession assistance in the next MFF, earmarking funds for the potential accession of countries that would be activated in case the conditions of accession are met. These funds need to be strictly tied to the rule of law conditionality, as has been argued in the report of the Court of Auditors on the use of IPA funds for democracy and the rule of law.¹⁴

In addition, the European Commission should review the modalities of implementing its pre-accession assistance in view of facilitating the future EU membership of the Western Balkans. From this perspective, these implementation modalities should assist in building the administrative capacities of the candidates, including, but not limited to, facilitating decentralised management of assistance.

11 Reljic D, "The EU's quest for strategic autonomy in the Western Balkans: Why it flopped," in: In Search of EU Strategic Autonomy: What Role for the Western Balkans? A Conversation with Odeta Barbullushi, Dejan Jović, Tanja Mišćević, Zoran Nechev, Dušan Reljić and Majda Ruge, edited by Matteo Bonomi, Istituto Affari Internazionali, Rome, 2021, p. 37.

12 Vasja Rant, Mojmir Mrak & Matej Marinč (2020) The Western Balkans and the EU budget: the effects of enlargement, Southeast European and Black Sea Studies, 20:3.

13 Milena Mihajlovic, Reforming the EU pre-accession instrument, Belgrade: Centre for European Policy, September 2023

14 European Court of Auditors, 2022 "Special Report 01/2022: EU Support for the Rule of Law in the Western Balkans: Despite Efforts, Fundamental Problems Persist"

Moreover, the **European Commission and national governments in the Western Balkans should ensure meaningful inclusion and participation of key societal stakeholders**, including CSOs, in the planning, impact assessments, and monitoring of the use of EU funds. The objective would be twofold: first, such processes will facilitate the monitoring in view of the rule of law conditionality, and second, broad processes will ensure a consensus on priorities, including funds for companies' adjustment, including for SMEs, to access to the Single Market and the processes of digitalisation and greening.

As a precondition, the European Commission and WB6 national governments should significantly increase the transparency of the planning, management, implementation, monitoring, reporting, and evaluation of pre-accession funds. Transparency is essential for meaningful participation of non-state actors in the abovementioned processes, informing potential direct beneficiaries of the assistance and overall accountability in the use of the funds.