

**European Economic and Social Committee: 3<sup>rd</sup> Western Balkans Civil Society Forum, Brussels, 18.5.2010**

**Panel on: “The relations between the European Union and the countries of the region: state of play and regional perspective”**

Ladies and gentlemen,

First of all I'd like to thank the organizers of this event for giving me the opportunity to share a couple of thoughts with you. Both coming from Germany and from academia, clearly makes me an outsider in this policy conference about the Western Balkan. Hopefully, you find an outsider's perspective useful for the main aim of this conference – namely fostering stable institutions of a civil society. I've been asked to give a short overview of the relations between the EU and the Western Balkan countries and to comment on those from an academic perspective. Doing this in 15 minutes is utterly impossible, although I'll try to do my very best.

Let me begin with a rather general remark on the role of civil society. The term “civil society” is usually understood to describe the loosely defined area between market coordination on the one hand and coordination that can be imposed by government action on the other hand. Whereas market coordination works on a strictly individual and voluntary basis, government actions have to be enforceable. Institutions of the civil society play or should play a role in making the policy choices that are acceptable and therefore enforceable. As we all know, this enforcement of rules and laws is an essential precondition for a well-functioning society. If, for example, the tax code is not enforceable to some reasonable degree, tax evasion will be the rule rather than the exception, not least because people then deem it morally justified as has been shown in a number of studies on the ethics of tax evasion. Thus, an encompassing

participation of the relevant groups in political decision-making processes and the implementation of these decisions – in other words: a functioning civil society – is instrumental in ensuring a properly working state. For this reason, your efforts to strengthen the institutions of civil society are really important for the successful development of single countries and for their closer integration with the rest of Europe – both within and outside the European Union. Let me exemplify this rather general observation by pointing to one of the deeper underlying causes of the dramatic events in Greece. Over quite some time, successive Greek governments simply failed to really apply the tax code properly leading to the precarious and unsustainable imbalance between government expenditures and revenues. We are just experiencing how difficult it is for the present government to convince the people that one cannot both keep and eat the cake – at least over the long run. We also see an unproductive “blame game” going on between different groups of the Greek society. A willingness and ability of civil society to reach a consensus about how to implement sustainable policies will be crucial for the success or failure of Greek policy makers. The same basic argument certainly applies to the Western Balkan countries that are in the focus of this conference for the eventual solution of their respective problems.

But let me now turn to a short overview of the relationship between the EU and the countries in the Western Balkans. At this time, out of the seven countries in the Western Balkans, there are two candidate countries – Croatia and the former Yugoslav Republic of Macedonia – and five potential candidate countries, namely Albania, Bosnia and Herzegovina, Kosovo, Montenegro and Serbia. In my 2-line characterizations, I just record the status of the respective Stabilization and Association Agreement (SAA) with the EU and the visa rules that apply for the respective citizens. These rules may serve as a proxy for the level of trust in the legal institutions of a country.

*Croatia* has certainly the closest links to the EU with accession negotiations in a mature state. Its citizens don't need to have a visa. Much will depend on the referendum in Slovenia in early June on the settlement mechanism for the border dispute between Croatia and Slovenia. Hopefully, national animosities do not win over political and economic rationality.

*Macedonia* is a candidate country since late 2005 and recently received visa facilitation that allows the holders of a biometric passport to enter the EU without a visa. Clearly, the challenges ahead are numerous and big. A researcher at my institute was part of a UNDP team that recently published a report with a host of policy recommendations in many areas. A more determined and focused fight against the lack of social inclusion is one of the key elements of these recommendations. This includes both the fight against poverty and strengthening institutions of civil society.

In *Albania*, the Stabilization and Association Agreement (SAA) only entered into force about a year ago, when Albania also applied for EU membership. Visas are required, although a facilitation agreement exists.

*Bosnia and Herzegovina* is a more complicated case which is testified by the necessity and presence of both the EUFOR/Althea mission and the High Representative who still exercises government functions. Visas are still required as in the case of citizens from the

*Kosovo*. I don't have to go into the details of the ongoing dispute over the international recognition of this country after the declaration of independence in February 2008 before this audience. The presence of KFOR troops – still almost 11.000 soldiers to take care of 1.8 million people in the Kosovo – indicates the still precarious state of this region. Nevertheless, military presence decreased significantly from more than 50.000 troops without major problems.

*Montenegro*'s SAA just entered into force, although its application for EU membership was submitted in December 2008. Visas are not necessary for holders of biometric passports as in the case of Macedonia and

*Serbia*. Although the SAA was signed two years ago, it has not entered into force yet.

Clearly, the discussion of the situation in any of those countries would require a separate conference rather than a short talk. A recently published special edition (in English) of *Südosteuropa*, a journal published by my colleagues from the Südost-Institut at our Scientific Center in Regensburg, contains a collection of articles that go into substantially more detail.

The heterogeneity across the countries of the Western Balkan region should have become quite clear even from this short survey, however.

The next slide makes clear that despite this heterogeneity, the entire region lags well behind the OECD average concerning economic and political governance indicators. These indicators, assembled by the World Bank, try to measure and compare governance along several dimensions. Depicted here are the last available indicators for the year 2008 for the following categories: 1) voice and accountability, 2) political stability, 3) government effectiveness, 4) regulatory quality, 5) rule of law, and last – but certainly not least – 6) control of corruption. In none of these categories, any country of the region even gets near the OECD average. Looking at the development of these indices over time shows that most countries were able to improve their performance over the last years along most dimensions, although there are some exceptions. For example control of corruption barely improved over the last decade in Bosnia and Herzegovina. The unavoidable conclusion from the numbers of this slide is that much further progress is needed.

The next slide shows the latest figures – in this case for 2007 – of the well-known Freedom House indicators for political rights and civil liberty, measured on a scale ranging from 1 to 7. Croatia indeed comes out better than the rest, although relative to the benchmark – Germany in this case –, there is clearly enough room for improvement. In the other countries, the way to political rights and civil liberty is considerably longer still.

Being an economist, I cannot really talk about the situation in the region without commenting somewhat on the impact of the current worldwide economic and financial crisis. Despite some differences – mainly due to the different degrees of openness to the rest of the world – more or less the entire region was severely hit. Five main channels through which the crises worked its way into the Western Balkan can be identified:

- Slump of demand for exports
- Country risk (or the perception thereof) and its costs
- (Danger of) devaluation
- Burden of debt denominated in foreign currency
- Decreasing flows of remittances

In a recent paper Michael Knogler and I classified the countries in the region according to the relevance of these channels. It is particularly noteworthy that the dominating role for foreign owned banks led to vast amounts of debt denominated in foreign currencies, mainly in Euro. This clearly entails the danger of massive problems should the national currency eventually devalue. The relatively large current account deficits will cease to be more or less smoothly financed by the rest of the world, causing large disruptions in the availability of both consumption and investment good. It should be one of the priorities of the EU and other institutions to more or less soften these adjustment processes. However, at least since the dramatic developments earlier this month,

the Union is primarily concerned with the solution of problems that would have seen all but unthinkable only a few month or even weeks ago.

Let me now turn to a more abstract level for some additional thoughts on the role of the EU for the development in the Western Balkan countries. My first observation here is that there is some discussion about the causality between regional integration in the Western Balkans and the integration of this region with the existing EU. Some commentators consider regional integration as a necessary prerequisite for the integration at the European level, whereas others argue that the integration of the whole region with the EU facilitates the integration at the regional level. In my view, there is an intricate interdependence between these two directions of causality. The main point to bear in mind by all policy makers in the region and at the EU level is that integration at one level does not and should not stand in the way of integration at the other level. This strong support of integration perhaps needs some justification, especially in a region that clearly has some problems with this idea. First, from an economic point of view, integration brings about all kinds of advantages from free trade and potentially other liberties. This is especially true for small economies. And even the biggest country in the region, Serbia, is quite a small country by comparison. I may go into some more detail during the discussion, but there is a growing empirical literature pointing to positive effects of diversity of a population along several dimensions, including ethnic background. This modern version of Ciceros “*variatio delectat*” may sound strange for the Balkan region. Nevertheless the insight that *differences across people* are the source of mutually beneficial trade opportunities dates back until Adam Smith. At a more general level, integration may be the only way to stop at least the widespread violence of conflicts along ethnic and other borders. Since I grew up in Germany near the French border, I can certainly name a good example for the beneficial effects of integration.

In discussing the integration of the Western Balkan countries, an argument is often made that there may be a trade-off between widening (= enlargement) and deepening of the union. At first sight, that seems a plausible thought since heterogeneous countries are less willing to coordinate more or less by definition. A recent theoretical study by Erik Berglof and coauthors looked a bit more carefully this intuition and yielded a set of interesting and relevant results. The basic setting is as follows: The two crucial assumptions are that countries are heterogeneous with respect to their (perception of the) net value of membership and that countries can choose their level of support of the union. Furthermore, for given effort levels, net benefits of being in the union are positively related to the size of the union. From these assumptions, the following implications can be deduced. First, unanimity gives huge power to the weakest member, i.e. to the country with the lowest net benefit. This is not solved by the Lisbon treaty concerning membership decisions. A case in point here is the ongoing conflict between Slovenia and Croatia.

Second, if strong countries can form an “inner” union, weak countries have an incentive for a higher level of contribution in order to avoid the formation of or participate in the inner union. This rationalizes the notion of a multi-speed Europe.

Third, the entrance of relatively strong new members opens the possibility that widening and deepening are complements, i.e. that there is no trade-off between enlargement and deepening. This explains the demanding accession procedure and the reluctance of admitting “weak” countries. Incumbent members simply are not interested in watering down content in exchange for size. The lesson for countries eager to join clearly is that they should aim to become a strong member.

As my last point, let me shortly reflect on the impact of the current crisis on the willingness to integrate. Human instincts seem to suggest that it is sensible not

introduce (additional) changes in uncertain environments. Some commentators therefore argue that further integration steps might and should be postponed. But there are at least four reasons that this reaction is wrong. Namely, the current crisis ...

- ... is a chance to show and benefit from solidarity;
- ... is in many ways due to a lack of trust;
- ... requires international action, e.g. in regulatory issues;
- ... entails the danger of protectionism.

All these arguments point in the direction of more international coordination and integration.

As we all know, however, the EU possibly changed quite dramatically during the rescue of Greece. In particular, the decisions taken may imply a big step towards a more integrated fiscal stance. The alternative to this *de facto* unification of fiscal policies is the introduction of a more credible “new edition” of the stability and growth pact. This might well consume enough political energy to delay the further integration of the Western Balkan countries. Clearly, the institutional reforms cannot be watered down in order to facilitate the process. Nevertheless, it would be a particularly bad moment for both the EU and the Western Balkan countries for a reduced impetus of this integration process.

Jürgen Jerger, 16.5.2010