

Abstract

The time is not only ripe but pressing for the EU and the states of the Western Balkans to recalibrate and reinforce the current pre-accession strategy. Trade policy should be moved beyond existing free trade commitments for all the Western Balkans to enter the customs union of the EU and Turkey. Eurozone doctrine should be adapted to realities. Rather than regarding the use of the euro by Montenegro and Kosovo as an unfortunate turn of events, the costs and benefits of unilateral adoption of the euro by not-yet member states of the region should be more openly appraised, and the option to 'euroise' recognised as a possibility. It is good that the EU has moved at the declaratory level towards visa 'liberalisation', which means scrapping visas rather than just 'facilitation' measures. However the Commission has not yet published guidelines or timelines for this. The region should be put on track for access to the Structural Funds on terms and scales progressively approaching those from which new member states such as Bulgaria and Romania already benefit. The ratio of these aid receipts between the new member states and the Western Balkans is currently 4:1; the former are receiving more than they can handle efficiently, whereas the Western Balkans have huge unsatisfied needs. Overall the case is made for significant moves towards 'functional membership' of the whole of the region with the EU, which would be a highly useful advance, irrespective of how or when the EU overcomes its Lisbon Treaty hiatus.

1. The New Context

The context for EU policy towards the Western Balkans has changed to the point that the time is now ripe for a new stage in the pre-accession process for the region. Positive momentum needs to be visibly reinforced, and there are possibilities to do so at the EU and regional level.

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Recalibrating EU Policy towards the Western Balkans

Michael Emerson

At the regional level important changes in 2008 have included the winding up of the Stability Pact and its replacement by the Regional Cooperation Council in Sarajevo, consisting of all the states of south-east Europe.

Meanwhile Croatia's accession negotiations continue to advance, having been switched to 'go' following the arrest and dispatch to The Hague of Ante Gotovina in 2005.

Kosovo's independence, declared in February, has been recognised 40 states in all, including 20 of the EU-27 and the US. While Russia has tried to block the EU from taking up a more important role there, UN Secretary General Ban Ki-Moon in his report to the UN Security Council in June, invited the EU to go ahead with its crucial rule of law mission (EULEX) under a UN umbrella arrangement, which means delegated responsibility to get on with the job.¹

In May the general elections in Serbia resulted in the formation of a pro-European government there, notwithstanding the developments in Kosovo. The EU and Belgrade signed a Stabilisation and Association Agreement (SAA) just before the elections, which means that all the Western Balkans

¹ UN Security Council, "Report of the Secretary-General on the United Nations Administration in Kosovo", 12 June 2008, S/2008/354. The Annex II to this report says: "In the absence of other guidance from the Security Council, and following extensive consultations, it is my intention to reconfigure the structure and profile of the international civil presence to one that corresponds to the evolving situation in Kosovo and that enables the European Union to assume an enhanced operational role in Kosovo, in accordance with resolution 1244" (1999).

except Kosovo now have these legal contracts with the EU. The new government in Belgrade moved rapidly with the arrest of Radovan Karadic and his dispatch to the International Criminal Court at The Hague. Karadic's joining Gotovina in The Hague marks a welcome even-handedness in the treatment of Western Balkan war criminals.

Further intentions to apply for membership are being announced by Montenegro before the end of 2008, and by Serbia, whose new government also intends to apply by the end of the year. These two countries will presumably join Macedonia at some stage, as countries with candidate status but without initially a launch of accession negotiations.

For its part the EU continues to re-affirm the full membership vocation of the entire region. At the same time the hiatus over the ratification of the Lisbon Treaty casts a shadow over these prospects, and notably leads President Sarkozy to say bluntly that there will be no further enlargement without the Lisbon Treaty. If Lisbon's ratification is completed in 2009, the signing of a Treaty of Accession with Croatia could take place in 2010, with effective accession maybe in 2011. But beyond that there are no clear scenarios for who might be next and when.

Meanwhile the August war between Russia and Georgia, raising questions over how Russia might next extend its coercive methods right up alongside the Balkans (in Moldova or Ukraine), adds to Russia's current behaviour towards Serbia and Kosovo as a reason for the EU to strengthen its Balkan policies.

Overall this new context poses two issues of strategy for the EU and Western Balkan states.

The first is how the EU can sustain the positive momentum of developments in the region, even while the EU's enlargement process seems likely to remain at best on 'slow', or at worst on 'stop', for some time. Could the EU go further than the current SAA process with the integration of Western Balkan states into the functioning of EU policies before membership?

The second related question is whether the current mix of bilateralism versus regional multilateralism is quite right or not. The SAA process is essentially bilateral, with so far only some rather fragmentary elements of regional multilateralism.

2. The Stabilisation and Association Agreements

Since the adequacy of the SAA process is at the heart of both these questions, let us first assess the facts. The SAAs are the formal framework of contractual relations between the EU and the

individual states of the Western Balkans. They follow the same format, and in many articles have identical wording. The agreements are structured along the same lines as the long list of 'chapters' negotiated with accession candidates. The difference is that for accession candidates all chapters have to be brought to a state of legal compliance with the EU *acquis*, and proof of implementation; whereas the SAAs are more of a warming-up exercise, inviting the partner state to move gradually into compliance and otherwise to 'cooperate' in various domains. The table of contents of a specimen SAA (with Croatia) is presented in Annex A, together with brief comments on the content.

Of the ten Titles, the first three on democratic principles, political dialogue and regional cooperation are in the nature of declarations of intent, without precise operational or legally binding content. However the reference to democratic principles and human rights in Article 2 states that they: "constitute essential elements of this Agreement", which is Euro-code language for marking it out as the political condition for proceeding with the whole integration process.

Title IV contains the main 'red meat', setting out the terms of a free trade agreement to be fulfilled within six years. Quantitative restrictions and some customs duties are abolished immediately, while other provisions are phased in over 3 to 6 years. Anti-dumping provisions and safeguard clauses remain in place.

Title V goes through the other three economic 'freedoms' of movement: for services, capital, and labour. However the content is far from reaching conditions of 'freedom'. Services are to be liberalised progressively, but only starting after four years and in ways that are not specified. Legally employed workers shall not be discriminated against, but this certainly does not amount to freedom of movement. Some capital controls remain possible, although direct investment is free.

Title VI on the approximation of laws and competition rules has considerable content under the broad heading of gradual approximation on the EU's internal market *acquis*. Compliance with EU *acquis* is obligatory for competition rules, state aids, intellectual property rights and public contracts, either immediately or within 3 years. This amounts to a significant deepening of the free trade area.

Title VII on justice and home affairs mainly involves 'cooperation', which means no binding or operationally defined content. The main 'red meat' here is the obligation to re-admit illegal migrants.

Title VIII is called 'Cooperation policies', and is a very long list of mostly vague declarations,

including some intentions to gradually adopt the EU *acquis* in areas such as agricultural standards. Issues of macroeconomic policy are dealt with in very cursory terms.

Title IX announces the availability of EU financial assistance, but amounts are not specified here.

Finally, Title X provides for the institutional structure, notably the Stabilisation and Association Council.

Overall the operational and legally binding content of the SAAs consists mainly of a fairly deep free trade area, while the remaining extensive (or almost encyclopaedic) landscape of issues amounts to little more than sketching the agenda that will later have to take real shape in the process of accession negotiations. For countries like Croatia that are already well advanced in the accession negotiations, the passage from SAA to membership is an easy fit. For others with more remote prospects for the opening of negotiations, however, the question is how the SAA process might be boosted in order to enhance the momentum of Europeanisation.

3. Trade policies

Although the free trade element is the most substantial part of the SAA, a re-think is needed. The question of why and how is illuminated in a recent study by the World Bank, which sheds important light on the nature of changes in trade and industrial structure that has been seen in the transitional integration of the new member states into the EU, compared to developments so far in the Western Balkans.² The findings have implications for the EU's trade policy towards the Western Balkans.

Already about 25 years ago, economic researches on the effects of completing the EU's internal market established that *intra-industry* trade had become a major driver of economic growth and structural change in the European economy. Traditional trade theory mainly addressed the pursuit of comparative advantages for *inter-industry*, for example trading textiles for motor cars. By contrast *intra-industry* trade sees a complex pattern of trade in similar competing products, and of trade in parts and components in multi-stage production and supply chains, especially in the case of geographically close or directly neighbouring states. *Intra-industry* trade became for economists a new analytical paradigm, and for the EU it became the main source of new economic gains from market integration, and

justification of the EU's '1992' single market programme.³

Table 1. Trends in Trade in Parts and Components in the Western Balkans and new EU member states, 1996-2005

	year	Exports of P & C, \$ millions	Imports of P & C, \$ millions	P & C as % manufact. Exports	P & C as % manufact. imports
Western Balkans	1996	416	945	7.9	8.9
	2005	1,322	2,725	10.7	9.3
Slovenia	1996	954	890	12.7	12.4
	2005	2,782	2,099	16.4	13.8
Slovakia	1996	659	836	11.0	12.7
	2005	3,679	5,481	13.7	21.3
EU new 8	1996	7,702	11,277	12.2	13.8
	2005	49,520	48,566	19.8	19.3

Source: World Bank op. cit., pp. 43-44.

The World Bank shows how the same *intra-industry* trade paradigm has been driving the economic progress of the new member states of central Europe, and how it has so far been little in evidence in the Western Balkans. Table 1 shows trade in parts and components (P & C) as illustrating the dimensions of 'producer-driven supply chains', with complex input-output relationships in industries across trading partner states, often involving direct investment. This contrasts with 'buyer-driven supply chains', in which large retailers create their supply networks typically without investment. The data show the very substantial growth of exports and imports of P & C in the 8 new continental member states of the EU acceding in 2005, with these exports multiplying in dollar terms 7 times, and imports 4 times, in the decade 1996 to 2005. Their share of total exports and imports of manufactured goods increased from around 13% to nearly 20%, thus accounting for a substantial part of trade growth. For a scale closer to that of the Western Balkans one may look at the cases of Slovenia and Slovakia among the new 8 member states. In 1996 Slovakia saw export and import volumes of trade in P & C on roughly the same scale as the Western Balkans total; by 2005 Slovakia had jumped ahead, with levels of P & C trade tripling (for exports) or doubling (for imports) the totals for the Western Balkans. Meanwhile the share of Western Balkan trade in P & C in relation to the total for manufactured goods only increased modestly.

The trade policy issue for the Western Balkans here revolves around a seemingly technical and bureaucratic choice between two options:

² S. Kathuria (ed.), *Western Balkan Integration and the EU – An Agenda for Trade and Growth*, World Bank, 2008.

³ M. Emerson et al., *The Economics of 1992*, Oxford: Oxford University Press, 1988.

- The first option is the actual policy course, according to which all Western Balkan states have made free trade agreements with the EU as part of their Stabilisation and Association Agreements. All have also joined in a renewed CEFTA system for multilateral free trade between each other, and plan to negotiate rules of origin agreements with the EU using the standard Pan-Euro-Med model regulation for this purpose. These rules of origin agreement permit ‘diagonal cumulation’ of value added between two or more stages of production in different countries sharing free trade agreements with each other and the EU, thus helping achieve the required minimum total value added in the free trade partner states to qualify for duty free import into the EU. Each stage of cumulation of value added between free trade partner states has to be supported by proof, with documentation certified by accredited agencies. This is burdensome for both enterprises and customs administrations, and a temptation for corruption.
- The second option would be for all the Western Balkans to enter into the customs union (of the EU, Turkey and Andorra), requiring that the Western Balkans adopt the EU’s common external tariff with third countries, in addition to complying with various standards for customs procedures. The advantage of the customs union over the first option is that there is no need any longer for the complicated rules of origin, with the especially complicated procedures for diagonal cumulation. In the customs union goods circulate freely, since any good entering from a third country will have borne the common external tariff. The benefit from scrapping the rules of origin procedures for trade between the EU and the Western Balkans would be especially important for the region given that it is a cluster of small states virtually surrounded by EU, and where complex structures of ‘producer-driven supply chains’ across these countries should develop.

A further argument in favour of the customs union option follows on from the fact that all the Western Balkans would be doing is what is necessary in any case for accession, with the adoption of the common external tariff and administrative aspects of customs procedures. By contrast the first option requires an important investment in rules of origin procedures, only for these to be scrapped later as accession approaches.

The development of intra-industry trade and producer-driven supply chains places a premium on clarity, simplicity and reliability of an open-trading

regime, suitable for complex ‘just in time’ logistics. The business sector needs clear information, that can be reduced to credible branding, where country ‘x’ can be regarded ‘as if’ in the EU internal market without any doubt or complicated qualification. The customs union provides this, whereas free trade with diagonal cumulation of value added does not. The customs union formula is an advantage not just for trade, but also for favouring foreign direct investment, which in turn is a major mechanism for stimulating intra-industry trade.

With these major arguments so clearly in favour of the customs union option for the Western Balkans it seems odd that the European Commission does not favour it. One argument heard is that the customs union with Turkey has led to complications and tensions. More precisely Turkey has not always wanted to apply the EU’s common external tariff, which is a basic requirement of customs union.⁴ This is because Turkey is a major economy at the edge of the EU, with important trading and political relationships with Russia, the Middle East and Central Asia. However these arguments are not relevant for the Western Balkans, which are surrounded by the EU and much more dependent on it.

The superiority of the customs union option is advocated in the key messages of the cited World Bank study, which on this point concludes:

Benefits from EU and regional integration would be maximized by creating a ‘shadow customs union’ with the EU for industrial products. Currently CEFTA countries’ tariffs are higher and more dispersed than those of the EU, providing scope for trade diversion. It is suggested that all CEFTA countries (who are simultaneously adopting CEFTA and the trade components of their Stabilisation and Association Agreements) adopt EU MFN tariffs for industrial products. This would amount to creating a virtual customs union encompassing the Western Balkans and the EU...⁵

A final argument favouring this course of action concerns the problem of corruption of border controls and customs procedures. These are major problems in all of south-east Europe, as is well known. However the easing of customs procedures and scrapping rules of origin requirements for trade

⁴ For example Turkey made a free trade agreement with Georgia in 2007, which in principle is inconsistent with the customs union, since the EU has not granted free trade to Georgia (it is only evaluating the case for perhaps doing so).

⁵ World Bank op. cit., p. xviii.

within the enlarged customs union⁶ would be a useful step in cutting the opportunities for border corruption.

The dangers of floods of imports flowing illegally into the EU market from third countries via this enlargement of the customs union is particularly reduced, due to the fact that the Western Balkans, after Croatian accession, will be close to becoming an enclave within the EU. There will only be a few ports in Montenegro and Albania to control, and for this the EU could easily deploy some customs personnel to monitor and strengthen the customs services there.

Responsibility for organising this re-calibration of policy should fall not only on the European Commission, but also the Western Balkan states themselves, and here the newly founded Regional Cooperation Council could play a key role. This is a quintessential task for the Council to take up, since it calls for a regional logic and consistency.

4. Monetary policies

Inclusion into the euro area is one of the most potent mechanisms and symbols of European integration. The EU's official doctrine is that only member states can accede to the euro area, and even after becoming a full member state there are further demanding conditions for acceptance into the euro area. These are the Maastricht criteria, namely that:

- The inflation rate has to be not higher than 1.5% above the average of the three best performing euro states
- The budget deficit should not exceed 3% of GDP
- The public debt should not exceed 60% of GDP, and
- The exchange rate should have remained stable within the exchange rate mechanism band of +/- 2.5 % for two years
- The long-term interest rate should not exceed that of the three best inflation performing states by more than 2%.

These conditions are being applied with great severity, as exemplified by the rejection of Lithuania's entry into the eurozone in 2007, on the grounds that its inflation rate was 2.7%,

⁶ Leaving of course the EU's standard rules of origin to be applied by the customs union states for imports from various partner states of the EU in free trade or preferential regimes.

insignificantly higher than the 2.6% of the three reference countries.⁷

The EU institutions have taken a strongly negative view towards the unilateral adoption of the euro by non-member states as a matter of doctrine. However as an economic proposition there can be serious arguments in favour of unilateral euroisation (as also for dollarisation). The arguments are most strongly positive for economies that are very small, open and dependent on the EU (or US), and whose own monetary and financial governance may be weak, and poorly placed to resist short-term political pressures for populist policies. If the country's own institutions are fragile and lack long-term credibility the economy will have to bear a risk premium on its interest rates, which will have a negative impact on investment and growth. If on the other hand the economy has adopted the euro (or dollar) as its currency, the temptation to indulge in unsustainable budgetary policies will be greatly dampened, since there will be no possibility to inflate away the burden of the public debt. Further, if the economy is to become totally integrated into the EU's market there are synergetic reasons to add the single currency to the single market: the single currency eliminates exchange transaction costs, improves the transparency of cost accounting, and clinches the credibility of perceptions of the business community that the economy is effectively part of the EU.⁸ These are reasons why Montenegro opted to adopt the euro unilaterally in 2002, and why the UN and EU teams managing the economy of Kosovo saw no alternative to adopting the euro in 2002. Bosnia also has maintained a fixed exchange rate first with the DM and then with the euro, supported by a currency board mechanism, since independence. (Analogous reasons see Panama long benefitting from dollarisation, and more recently Ecuador since 1999.) In addition Europe's micro states – Andorra, Monaco, San Marino and the Vatican - have all adopted the euro with the EU's assent. All of these except Andorra have even more favourable agreements with the EU to mint their own euro coinage within specified limits.

Why then does the EU maintain a negative doctrine on unilateral euro-isation? The arguments presented

⁷ This was especially unjustified since all the transition economies are necessarily experiencing a 'Belassa effect' supplement to their inflation rates through the gradual alignment of domestic service prices on typical EU levels as income levels in the traded sectors rise. EU finance ministers from 'old Europe' evidently failed to take elementary courses in transition economics.

⁸ See M. Emerson, D. Gros, A. Italianer, J. Pisani-Ferry and H. Reichenbach, *One market, One Money*, Oxford: Oxford University Press, 1990.

by the institutions seem to be fourfold. First it would deprive the economy of the exchange rate adjustment instrument; but this argument is of little force for small economies that are already largely euro-ised informally. Second it would perhaps tarnish the euro's credibility, but after ten years of the euro this argument now lacks plausibility, especially since the non-member states are not represented on the board of the European Central Bank. Third, as a political morality story, newly acceding states should go through the same Maastricht tests as the founding fathers of the euro, but this condition could still apply (see below). Fourth, EU finance ministers do not want to be distracted by matters that for them are marginal, which is not a respectable argument.

Since the weight of these negative arguments is thin to say the least, the EU would be justified in recalibrating its position as follows:

- With the whole of the region now clearly set on joining the EU market there are synergetic advantages to joining the single currency as well
- Western Balkan states should have the option to adopt the euro unilaterally if they so wish.

The EU's concern not to undermine the governance of the European Central Bank can be met by a rule that when an already euroised state accedes as a full member state it shall not be admitted to the board of the European Central Bank until and unless it has respected the Maastricht criteria.⁹

5. Structural funds

In this section data are presented for the hypothesis that the Western Balkans would be treated as member states for the purpose of allocating grant aid from the EU. Bulgaria and Romania as used as comparators. On questions of scale Bulgaria has about the same population as Serbia, and Romania has a somewhat larger population (21 million) than all 7 Western Balkans together (17.6 million).

A first comparison may be made between the pre-accession aid (under the ISPA, Sapard and Phare programmes) received by Bulgaria and Romania in 2006 immediately before their accession, compared to that received (under the IPA programme) by the Western Balkans in 2007. On a per capita basis the Western Balkans were receiving around half the level of Bulgaria and Romania, although Kosovo and Montenegro were more generously treated than the others.

⁹As a technical adjustment of the rules prior euro-isation would be deemed to satisfy the exchange rate stability criterion.

A second comparison may be made between what Bulgaria and Romania are expected to receive during the 2007-2013 budget period when the amounts per capita roughly triple compared to their last pre-accession amounts. During the same period the amounts of pre-accession aid for the Western Balkans increase a little but not much. As a result the disproportion between the new member states and the Western Balkans sees a huge jump, with Bulgaria and Romania receiving €162 and €183 respectively per capita per annum, whereas the Western Balkans average €43. The proportions become thus a little over 4:1.

In monetary terms the Western Balkans are currently due to receive around €765 million per annum on average. If they were treated on a par with the two new member states the bill for the EU budget would increase by about €2 billion to around €2.7 billion.

Table 2. Pre-accession and structural fund aid from the EU to South-East Europe

	Population, million	€ million	€per capita	€million	€per capita
		2006	2006	2007-13 Annual average	2007-13 Annual average
Bulgaria	7.7	509	66	1,250	162
Romania	21.3	1015	47	3,900	183
		2007	2007	2011	2011
Croatia	4.5	133	29	157	35
Macedonia	2.0	55	27	98	48
Albania	3.6	57	27	95	26
Bosnia & Herzegovina.	4.0	58	14	108	27
Montenegro	0.6	29	48	34	56
Serbia	7.6	178	23	202	26
Kosovo	1.8	64	35	68	38
Western Balkans 7	17.6	612	34.7	765	43

Source: European Commission

However this budgetary story is not yet complete. The above data do not include receipts from the agriculture fund for Bulgaria and Romania since their accession in 2007, but also their contributions to the EU budget. In net terms this probably means further net budgetary gains for the new member states. For the present purpose, however, it is supposed that the Western Balkan states would not be integrated into the financial mechanisms of the Common Agricultural Policy before accession.

With this exception the hypothesis retained here is that the Western Balkan states could be offered a path for progressive increases in structural aid from the EU towards the levels granted to the new member states from the Structural Funds. The conditions to be respected for moving along this path would first require agreement by the region to

join the customs union of the EU and Turkey. This would be consistent with the logic of the original decision under the Delors Commission to accompany completion of the internal market with expansion of the structural funds to aid adjustment processes. Secondly, there would have to be credible programmes for improving judicial systems and reducing corruption. As the current Bulgarian example has shown, the use of EU funds provides mechanisms for auditing financial practices in public and private sectors, and for intervening forcefully at the political level when abuses are observed. Further, the Bulgarian and Romanian experiences underline the importance of using conditional EU funding before accession to secure anti-corruption and judicial reforms before accession, given that the leverage of this conditionality is so much more effective before accession.

6. Movement of people

The European Council agreed in June 2008 to advance to a new stage towards the freedom of movement of people between the Western Balkans and the EU, using the expression ‘visa liberalisation’ (meaning scrapping visas). The intention now is for the Commission to prepare roadmaps for the conditions for this to be achieved.

There has already been a set of ‘visa facilitation’ agreements with Western Balkan states, but these have been criticised as remaining heavily restrictive and burdensome. The Regional Cooperation Council should work on the elimination of all remaining intra-Western Balkan visa restrictions.

The Bulgarian and Romanian accessions, which were preceded by the scrapping of visas with the EU, have intensified the tensions over remaining restrictions for the Western Balkans, since the enlargement meant new visa restrictions between, for example, Macedonia and Bulgaria. As a result there has been a strong rise in evasive practices, like the acquisition of Bulgarian citizenship by many Macedonians, as well as the continuing process of Moldovans acquiring Romanian citizenship.

Kosovo is presumably now proceeding to issue its own passports, which should be accepted by all EU states, not just those which have recognised its independence (which would be following the Taiwan model for countries that have not been recognised).

The key question for the Commission now, and of course for EU member states in the Council, is how they specify the conditions and timelines for scrapping visas. Presumably there will be an agenda concerning the security quality of passports and systems of cooperation with security services, including the Schengen information system for ‘black-listed’ persons. There will surely be arguments about how far the Western Balkan states should go in improving the general state of law enforcement and reduction of criminality as pre-conditions, but here a counter-argument needs to be taken into account, namely that visa restrictions that are difficult to enforce become a source of criminality and illegal trafficking.

7. Energy and transport communities

The Energy Community Treaty was signed on 25 October 2005 by the EU and all the Western Balkans, including Kosovo represented by UNMIK. While limited in scope to the electricity and gas sectors, it represents a significant systemic development for EU policy in the Balkans in two respects. First it jumps ahead of the bilateralism of the SAA process by being multilateral between the EU and all the Western Balkans equally at the same time. Second, it involves legally binding compliance with the EU *acquis* in the sectors in question for all parties, both for existing EU law and for further adaptations of it that may follow later; in this respect it is following the model of the European Economic Area, but just for the sectors in question. The treaty establishes an institutional structure, with a separate secretariat in Vienna.

A key feature of the Treaty is the accession of all the Western Balkans to the EU’s electricity grid system organised under the Union for the Coordination of Transmission of Electricity (UCTE), with the physical connection of South Eastern Europe to the EU’s grid achieved already in October 2004, following MoUs signed in 2002 and 2003.

This model of complete regional-multilateral integration with the EU invites reflection on the optimal balance to be followed, as the Western Balkan integration process advances, between the bilateralism of the SAA and accession negotiations, and this regional multilateralism for virtual membership on account of specific policies. While both models are surely going to persist in complementary roles in the pre-accession period, this energy policy development may be initiating a model that deserves wider application.

Box 1. Summary features of the Energy Community Treaty

- Members: the EU and all the Western Balkans, including Kosovo (UNMIK)
- Implementation within twelve months of EC energy Directives for:
 - the internal market for electricity (2003/54/EC),
 - the internal market in natural gas (2003/55/EC),
 - access to the network for cross-border exchanges in electricity (1228/2003EC)
- Implementation of EC environment directive for:
 - the effects of certain public and private projects on the environment (97/11/EC)
 - the sulphur content of certain liquid fuels (1999/32/EC)
 - emissions of certain pollutants into the air from large combustion plants (70/409EEC)
 - on the conservation of wild birds (79/409/EEC)
- Implementation within one year of EC Directives for:
 - electricity produced from renewable energy sources 9(2001/77/EC)
 - use of bio-fuels and other renewable fuels for transport (2003/30/EC)
- Competition policy rules of Articles 81, 82 and 87 of the EC Treaty to be respected
- Compliance within one year with EC standards for energy transmission, as issues by:
 - European Committee for Standardisation (CEN)
 - European Committee for Electrotechnical Standardisation (CENELEC)
 - Union for the Coordination of Transmission of Electricity (UCTE)
 - European Association for the Streamlining of Energy Exchanges (EASEEGAS)
- Customs duties and quantitative restrictions prohibited for Network Energy trade
- Safeguard measures temporarily allowed in even of sudden crisis in Network Energy market
- Regulatory board for EC acquis implementation:
 - with European Regulators Group for Electricity and Gas (EREG)

In fact the Commission envisages furthering the energy community model in the land transport sector. The European Council in June 2008 endorsed the Commission's proposal to go ahead along these lines. Presumably this will concern regulatory policies in this sector, although it might also build on the existing programmes for Trans-European Corridors of infrastructure investment. For example there is still no plan to extend Croatia's new highway into a complete Adriatic highway, which is badly needed to disenclave Montenegro and Albania before reaching Greece.

The Commission has already been negotiating with the Western Balkans accession to the Single European Sky. This follows a slightly different model, with parallel bilateral negotiations with each state of the region. There have already been impressive developments in the network of low cost airline connections between the EU and South East Europe which are of transformative importance.¹⁰

¹⁰ For example German Wings, which links several German cities with all the capitals and major tourist destinations of South East Europe.

8. The Serbia-Kosovo recognition problem

The point is often made that Serbia cannot accede to the EU without recognising Kosovo's independence, which would contradict Serbia's present constitution. And even the new government refuses to countenance recognition. In addition Kosovo could not accede without being recognised by all member states and thence by the EU itself. Beyond legalisms there is also the need for Belgrade and Pristina to find a way of cooperating over their respective minorities, not only the Serbs in Kosovo, but also the ethnic Albanians in Southern Serbia. So there is a situation still to be tidied up legally and functionally.

For the time being politicians can wait for emotions to calm down, with no need for the EU to push Belgrade on the issue of recognising Kosovo. In due course realities may become increasingly accepted, and the issue of recognition may descend to the level of finding some accommodating form of words that is acceptable to all sides.

As an example of legal-political ingenuity of the kind needed here, a former UN special representative for Kosovo advanced the 'German model' that prevailed before re-unification: The

Federal Republic's constitution could only embrace the whole of the post-war German territory, yet both the FRG and the DDR were at the same time member states of the United Nations. Another example of diplomatic accommodation of the irreconcilable was seen with the Liechtenstein imbroglio of 2005.¹¹

There is time for the resolution of the Serbia-Kosovo imbroglio, before the accession of either or both. In the meantime there are practical matters to be properly ordered. One example now is the export of petroleum products from Serbia duty free into Northern Kosovo, which results in new flows of traffic just to fill up with duty free petrol, and move illegally across corruptly administered frontiers.¹²

9. Recalibrating conditionalities

For some time now independent analysts have been pointing out confusions in the EU's application of political conditionalities in the Western Balkans. For example Othon Anastasakis argues:

The Western Balkan region reveals special trends in the EU's handling of the strategy of political conditionality, and some creeping contradictions and dangers are beginning to show the limits of conditionality. More specifically the EU:

- (a) is adding further, yet necessary, political conditions and criteria to weaker or more reluctant partners, and emphasises the journey rather than the outcome of accession, affecting the credibility of the instrument,
- (b) it blends together normative, functional and *realpolitik* claims in the choice of its conditions, affecting the clarity of its intentions,

¹¹ Another formula for accommodating realities was devised over the extension of the European Economic Area (EEA) to include the new member states in 2005. The EEA enlargement Treaty required that Liechtenstein recognise all EU member states, whereupon it was discovered that Liechtenstein has not recognised the Czech Republic or Slovakia because of an unresolved dispute over the uncompensated expropriation at the end of the Second World War of some real estate owned by the ruling prince of Liechtenstein. The hiatus was eventually resolved by an exchange of declarations and statements accompanying the signing of the EEA enlargement Treaty.

¹² This is reminiscent of Andorra's specialisation in contraband tobacco exports until a couple of decades ago, when the abuse was brought under control following pressures from France and Spain.

- (c) it pursues, in some cases, a rigorous assessment of compliance and, in other cases, a more adaptable and pragmatic assessment for the sake of preserving peace and avoiding insecurity risks, affecting the consistency of the process.¹³

Similar critiques are made by Gergana Noutcheva, who shows that EU policy in the Western Balkans has often been driven more by security concerns than its internal norms and rules of governance, and thus created confusion and compliance problems for its alleged conditionalities.¹⁴

In response to these critiques the following clarification of EU conditionality policy is proposed, as part of the scheme already set out above for four main blocks of policy – trade, the euro, visas and the structural funds. For these four blocks of policy the emphasis is on functional conditionality.

For the extension of the EU-Turkey customs union to the Western Balkans the basic functional condition should be the application of the common external tariff (and various technical customs procedures).¹⁵

For agreeing to visa-free travel the conditions should again be strictly functional, and concern the security quality of passports and cooperation arrangements such as with the Schengen Information System.

For increased volumes of structural aid the conditions should again be functional, linked to agreement on joining the customs union of the EU and Turkey, and the adequacy of financial control and anti-corruption policies.

As for euroisation before accession, this would be essentially a unilateral move freely chosen by individual countries, with the Maastricht criteria held over as conditions for accession later to the governing board of the European Central Bank.

¹³ Othon Anastasakis, "EU political conditionality in the Western Balkans: New trends and challenges", paper presented to the EKEM Delphi conference on the Return of the Balkans, 12-13 September 2008.

¹⁴ Gergana Noutcheva, *Fake, partial and Imposed Compliance - The limits of the EU's Normative power in the Western Balkans*, CEPS Policy Brief, No. 274, July 2007.

¹⁵ Currently the Netherlands is blocking the activation of the interim agreement for the trade policy provisions of the Stabilisation and Association Agreement with Serbia until two further indicted war criminals have been arrested and sent to the ICTY at The Hague, which is an example of confused or poorly sequenced conditionality.

Pure political conditionality, relating to the quality of democratic governance, should be essentially reserved for the final decision on whether the country is to be admitted as a full member state. This is what is relevant for the functioning of the governing institutions of the EU. This political conditionality should not be used in graduations mixed up with the scheme of functional conditionalities proposed for the four blocks of policy, since it is this which causes confusions at present. In the event of egregious relapse into undemocratic or otherwise gravely objectionable political behaviour (abuse of human rights, the use of force towards minorities or other countries, etc.) the SAA process should be suspended.

10. Conclusions

The new context makes the time ripe for the EU and the states of the Western Balkans to look again at the current pre-accession strategy for the region based on the SAA process.

The SAA process itself is more symbolic than substantial, apart from commitments to implement free trade. It is otherwise very long on vague intentions to cooperate, which lack political or economic muscle.

The case is therefore made for significant moves towards functional integration of the whole of the region with the EU, which can amount to a considerable degree of 'functional membership' that could be achieved irrespective of how or when the EU overcomes its Lisbon Treaty hiatus.

The existing set of free trade commitments should be replaced by a collective move of all the Western Balkans into the customs union of the EU and Turkey, thus making an uninterrupted economic space across the EU and the whole of South East Europe. This is a far more advantageous proposition than the present intentions to supplement the existing free trade commitments with a complex rules of origin procedures (for diagonal cumulation), which would in any case be scrapped later upon accession.

Problems of smuggling products such as tobacco and petrol should be countered by the adoption of the EU's harmonised minimum excise duties throughout the region.

Eurozone doctrine should be adapted to realities. Rather than regarding the use of the euro by Montenegro and Kosovo as unfortunate moves, the costs and benefits of unilateral adoption of the euro by not-yet member states of the region should be more openly appraised. Unilateral euroisation

should be recognised as a possible option, but not an obligation. The usual Maastricht criteria could, with minor technical adjustments, still be used after accession as pre-conditions for entering into the governance of the eurozone.

It is positive that the energy and transport sectors are the subject of actions (already taken or now proposed) to integrate the whole of the Western Balkans into these EU policies. This makes it all the more anomalous that the EU's trade and monetary policies towards the region lag behind, depriving the region's economies of synergetic benefits between the whole set of economic policies. This anomaly reflects a lack of coherence across the Commission's various departments.

It is also positive that the EU has moved at the declaratory level towards visa 'liberalisation', which means scrapping visas rather than the so-called 'facilitation' measures. However the Commission has not yet published any guidelines or timelines for this. Presumably there will be requirements for various security standards in passports, and cooperation with EU security services; but otherwise this decision of principle to scrap visas should be put onto a fast track, since it is central to the aspirations of the people of the region.

The region could be put on track for access to the Structural Funds on terms and scales progressively approaching those from which new member states such as Bulgaria and Romania already benefit; for the time being the ratio is 4:1 more favourable for the new member states. Drawing on the EU's recent experiences of gross corruption in the use of EU funds in these new member states there should be conditions for major increases in the volume of aid in the Western Balkans, including programmes to improve judiciaries and the implementation of anti-corruption standards.

This overall recalibration of EU policies towards the Western Balkans would see an adjustment in the sequencing of conditionality and incentive structures. Today access to EU policies is largely conditioned on full accession and the associated political conditionality of the Copenhagen criteria, even if some exceptions are being introduced (e.g. for energy and transport). The foregoing proposals favour increased participation in EU policies before accession, with increased regional multilateralism in this process, and more clearly defined functional conditionality. This still leaves, however, the final test of conformity with all the Copenhagen criteria before accession.

Annex A. Summary features of the EU-Croatia Stabilisation and Association Agreement 13 December 2004

Title I – General principles

- Respect for democratic principles and human rights
- Six year implementation

Title II – Political dialogue

Title III – Regional cooperation

- Cooperate with other SAA states, including free trade agreements

Title IV – Free movement of goods

Chapter I - Industrial products

- free trade in maximum of six years
- quantitative restrictions abolished immediately
- customs duties abolished immediately, but for selected products phased out over 3 to 6 years
- special protocols for textiles and steel

Chapter II – Agriculture and fisheries

- quantitative restrictions abolished immediately
- EU abolishes customs duties immediately, with exceptions
- Croatia abolishes customs duties progressively
- special protocol for wines and spirits
- for fisheries protective measures possible if serious market disturbance

Chapter III – Common provisions

- standstill prohibiting new customs duties, and fiscal discrimination
- anti-dumping provision
- general safeguard clause in event of serious injury or market disturbances

Title V – Movement of workers, establishment, supply of services, capital

Chapter I - Movement of workers

- no discrimination in treatment of legally employed Croatian or EU workers respectively

Chapter II – Establishment

- treatment no less favourable than own companies or any third country
- right to employ key personnel of Croatian or EU nationality respectively

Chapter III – Supply of services

- freedom to supply cross border services to be allowed progressively after four years
- special protocol for road transport, progressive harmonization of EU acquis

Chapter IV – Current payments and movement of capital

- direct investments free
- real estate purchase in Croatia to be liberalized after four years
- after four years determine modalities for full liberalization

Chapter V – General provisions

- if serious balance of payments difficulties, restrictive measures possible

Title VI – Approximation of laws and competition rules

- gradual approximation, especially on fundamental elements of Internal Market acquis
- competition: respect Articles 81, 82, 86 and 87 of Treaty (EU acquis)
- state aid schemes: align within three years
- intellectual property rights: align on EU acquis within three years

- open public contracts within three years
- standardisation: gradual achievement of conformity
- consumer protection: alignment on EU acquis encouraged

Title VII – Justice and home affairs

- rule of law: cooperate over reinforcement of institutions
- visa, border control, asylum, migration: cooperate
- illegal migration: obligation of re-admission
- money laundering: cooperate
- illicit drugs: cooperate
- criminal matters: cooperate

Title VIII – Cooperation policies

- economic policy: gradual approximation on policies of Economic and Monetary Union
- statistics: cooperate towards EU acquis
- financial services: cooperate to improve supervision and regulation
- investment promotion and protection: cooperate
- industrial cooperation: aimed at modernisation
- tourism: cooperate
- customs: approximation on EU acquis
- taxation: cooperate
- social security and employment services: cooperate
- agriculture: gradual harmonization on EU veterinary and phytosanitary acquis
- education and training: cooperate
- culture: cooperate
- audio-visual field: harmonise on EU acquis
- telecommunications: align on EU acquis immediately
- information society: cooperate
- transport: development Trans- and Pan-European corridors
- energy: develop regulatory framework in line with EU acquis
- nuclear safety: cooperate
- environment: cooperate, with continuous approximation on EU standards
- research and development: cooperate
- regional and local development: cooperate e.g. over cross-border regions

Title IX - Financial cooperation

- grants and loans to support the Stabilisation and Association process

Title X Institutional and final provisions

- Stabilisation and Association Council to supervise the agreement, and resolve disputes
- Parliamentary Committee establishes with European Parliament and Croatian members
- agreement concluded for unlimited period
- Interim Agreement: allows entry into force of free trade provisions before ratification completed