# European Union and the Western Balkans

*Edited by*

GAZMEND QORRAJ

IRAJ HASHI

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# Preface

The six Western Balkan countries, Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia, all aspire to be members of the European Union. Albania and North Macedonia are already candidate countries while Montenegro and Serbia have opened negotiations for EU membership. Kosovo and Bosnia and Herzegovina are at earlier stages of the process and must wait for a green light to start negotiations for membership.

Although the six countries are at different stages of fulfilling their aspiration for EU membership, they have already been influenced significantly by EU policies and programmes designed for them. These policies and programmes have aimed at supporting economic, political and social development; speeding up the reform process facilitating transition from centrally planned economies to democratic market economies; and enhancing the rule of law and governance in these countries.

There is, therefore, a strong interest in the development of the European Union and its policies, particularly related to the Western Balkans, in the society as well as among policy makers and the academia in these countries. This book intends to provide students and staff on such courses as European Integration or Economics of the European Union with an up-to-date analysis of the European Union and its wide range of policies and programmes. Additionally, the book can enhance the knowledge of local decision-makers about the opportunities and challenges arising from the European Union.

One of the editors of this book holds the Jean Monet Chair of European Integration at the University of Prishtina and the book is one of the outcomes of activities of this Chair. Although several books about the European Union are available in Kosovo and other countries in the region, there is none exploring the implications of developments in the EU for the Western Balkans. We address this situation by offering the reader in-depth analysis of ten different aspects of policy making in the European Union and how these policies affect the Western Balkan countries and their policies.

Each chapter is written by a colleague from a different university in the region or in the EU. These colleagues are experienced researchers in their field and some also have practical and hands-on experience of policy making in the European integration process.

## Structure of the Book

Chapter 1 takes an overview of the relationship between the EU and the Western Balkans. It discusses the range of policies aimed at supporting the Western Balkans in improving their policy making process and moving them closer to the standards and regulations in the EU. The Chapter explores EU policies and programmes designed to develop a free trade zone in the Western Balkans and encourage countries to reduce barriers to trade between them and, at the same time, to reconcile their historical differences and problems.

Chapter 2 aims to develop an understanding of the architecture of the institutions of the European Union and its policy-making processes. This is particularly relevant for the Western Balkans countries that aspire to be new members of the EU. It surveys the most important EU institutions: the European Parliament, the European Council, the European Commission, the Court of Justice of the European Union, the European Central Bank and the Court of Auditors. The chapter discusses the functions and compositions of these institutions and their potential interactions with the Western Balkans.

Chapter 3 reviews the international trade policy of the EU and the pattern of both external and internal trade of the Union. The EU is correctly described as the largest and the most successful regional economic integration in the world. The benefits of different types of economic integration, from a free trade area to customs union and eventually a single market, are explained theoretically, laying the foundation for understanding the trade policy of the EU. The chapter then analyses the pattern of trade between the member states and trade with countries outside the Union over a long period. The most important feature of the analysis is the massive increase in trade resulting from successive steps in the development of the single European market. The chapter ends with a review of EU trade with the countries of the Western Balkans, demonstrating how the EU has become the largest trade partner of these countries in terms of both exports and imports.

Chapter 4 analyses the development of the EU Budge and the process of budget preparation. European integration requires the allocation of financial resources for public finances at the EU level. These are implemented through multi-annual financial frameworks and annual budgets, the tools through which money is collected and allocated for EU policies, programmes and activities. The system of public finances at the EU level as known today is a result of numerous changes and adjustments that have occurred over the past sixty years. The Chapter outlines the evolution of the budgetary system over the decades; examines the methodological issues associated with financial flows between the EU budget and individual EU member state; and, finally, provides an overview of the recently agreed EU budget characteristics for the 2021–2027 period.

Chapter 5 analyses the EU financial assistance for the Western Balkans from the late 1990s to the current period. After the initial range of actions to support the progress of reforms in these countries, the EU embarked on the main support actions in the form of three Instruments of Pre-Accession (IPAS): IPA I, 2007–2013; IPA II, 2014–2020; and IPA III, 2021–2027. The Chapter discusses the support programmes before 2007 followed by a detailed analysis of the objectives, programmes and lessons of the three IPAS. While the discussion covers all six Western Balkan countries, the support for the Republic of Kosovo is given special attention.

Chapter 6 reviews EU programmes of education and research in Europe and in Western Balkan countries. It presents the EU multiannual programmes of work, which are the basis for financing of the EU programmes over seven-year periods, the EU policy on education and research as well as the education and research programmes. Most importantly, is an exploration of the significance of the European Education Area and European Research Area and the two most comprehensive programmes, Erasmus+ and Horizon Europe. The Chapter then reviews the EU education and research policies in the Western Balkans, particularly those in Kosovo.

Chapter 7 evaluates the role of foreign direct investment (FDI) on the transformation process in Central and East European countries and the Western Balkan countries. FDI played an important role in the development of a market system in CEE transition economies and their integration in the international economic system. In some such as the Visegrad group (Poland, Hungary, the Czech Republic and the Slovak Republic) the role of FDI was fundamental. However, FDI, particularly in strategic industries and major infrastructural sectors, has resulted in a kind of 'dependent capitalism,' i.e., 'dependency' on a small number of oligopolistic foreign multinationals whose actions and policies might not be in the long-term interest of their host countries. The challenge now facing the Western Balkan countries is knowing what kind of FDI they should be encouraging to enter their countries.

Chapter 8 discusses the EU fiscal policy and its implications for the Western Balkan countries. It illustrates how increasingly the independent fiscal policies of sovereign member states interacts with a single EU-wide monetary policy conducted by the European Central Bank. In some ways, the independent fiscal policy enables countries to develop policies aimed at mitigating the impact of a unified monetary that may not impact all members in the same way. The Stability and Growth Pact of 1997 established the need for fiscal sustainability across Europe and rules for the excessive fiscal deficit to ensure that fiscal sustainability is not threatened. The Chapter also discusses the implications of the EU fiscal policy for countries of the Western Balkans who need to meet the EU deficit and debt thresholds before joining the EU, thus highlighting the challenges facing these countries given their current unsatisfactory levels of deficit and debt.

Chapter 9 reviews the evolution of the European Monetary System, the single currency and the EU monetary policy, demonstrating how economic integration ultimately requires a single currency and a unified monetary policy led by an independent European Central Bank. The Bank's general objective is smoothing economic fluctuations to ensure price stability together with financial stability. The Chapter explains in detail the objectives and tools of monetary policy and how the Central Bank conducts its monetary policy. The concept of 'optimum currency area' and its costs and benefits, particularly the problem of desynchronised business cycles are highlighted. Finally, the Chapter discusses the relevance of EU monetary policy for the Western Balkan countries with different exchange rate regimes.

Chapter 10 considers the role of values, education, participatory governance and solidarity in the future of the European Union. Underpinning the discussion the principle that the EU is a value-based society and not a union for purely economic benefit for the member states. Education, particularly citizen education and life-long learning, is the vehicle for further development of this value-based society. Participation in governance at all levels is the mechanism by which the citizens develop their sense of belonging to the value-driven Union, with increasing number of people considering themselves Europeans. Finally, as the waves of the current Covid-19 pandemic spread through the European states with devastating consequences, the importance of unity and solidarity in meeting this challenge became obvious to all. The approval of the €750 billion Recovery and Resilience Facility to support member states' efforts to recover from the shock of the pandemic highlights the importance of solidarity for the future of the European Union.

Gazmend Qorraj and Iraj Hashi
Prishtina and London, 30 December 2020

Chapter One

# European Union and Regional Cooperation in the Western Balkans

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## Introduction

This chapter will analyse the relationship between the European Union (EU) and the Western Balkans, starting with regional cooperation and supported by different instruments such as Stabilisation and Association Process for the Western Balkans and aimed at political, institutional, and economic integration and the reconciliation between these countries. The EU's regional cooperation process has been the crucial institutional support for Western Balkan countries to overcome their previous historical challenges. Furthermore, the Regional ownership has indicated the readiness of the Western Balkan countries towards local ownership in the regional cooperation process, with the aim of eventual EU integration.

In addition, market integration, free trade agreements and the Central European Free Trade Agreement (CEFTA) have accelerated cooperation and increased the volume of trade between these countries by eliminating tariffs and non-tariff barriers. Furthermore, the Regional Economic Area (REA), developed in the Berlin Process framework, supported the connecting of the economies of the Western Balkans within the region and with the EU. Furthermore, I will analyse in detail the current Common Regional Market (CRM) as one of the mechamisms of EU support for deepening regional economic integration and building on EU rules and standards, and thereby bringing the region and its businesses closer to the EU Internal Market.

Finally, I will explain the Regional Cooperation Council (RCC) as the institution providing the framework for the preparation of the Action Plan for implementing the Common Regional Market in the WB.

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## European Union and the Western Balkans

In his declaration of 9 May 1950, Robert Schuman proposed creating a common market in two crucial sectors: the European Coal and Steel Community (ESCS) 1951, followed by the European Atomic Energy Community (EAEC) 1957. Following the signing of the Single European Act in 1987, the twelve member states[1] of the European Economic Community (EEC) completed the internal market on 31 December 1992. One year before in Mastricht, they had decided to develop the single market with economic and monetary union, a judicial and home affairs policy, and a common foreign policy, transforming the European Economic Community into a European Union (EU) (Moussis, 2005). Furthermore, Jean Monnet and other European countries' leaders promoted European Unity based on economic integration, peace, cooperation and solidarity between the member countries.

Following the fall of communism and central planning and the onset of the long transition process towards a democratic market system, the Western Balkan countries have been considered for the EU integration process and the eventual accession. The EU's peaceful integration process had progressed smoothly until 1995 when the accession of an increasing number of states with different historical backgrounds, cultures, languages, economic conditions and political traditions increased the need for political cohesion and decision-making process in the enlarged EU (Devuyst, 2006). Furthermore, in order to join the European Union, the applicant countries needed to fulfill the criteria set by the Copenhagen European Council in 1993 according to which prospective members had to be a stable democracy, have a functioning market economy and adopt the common rules, standards, and policies that make up the body of EU law, the *acquis communautaire,* known as conditions for EU membership (Baun, 2000).

After the successful enlargement of the EU with Central and East European Countries in 2004 and 2007, and later with Croatia in 2013, it was clear for most Western Balkan (WB) countries that joining the European integration process was the best alternative for them – politically, institutionally, and economically. The last country embarking on the European Integration process has been Kosovo, later than others because of the issues related to her final status and other political challenges she is currently facing.

[1] Germany, France, Italy, Belgium, Luxemburg, Netherlandes, Denmark, Spain, Portugal, Greece, Ireland and UK.

For most countries, the EU introduced different instruments to support their efforts towards economic transition or reconstruction and economic, political and social reforms, although many countries faced double challenge fulfilling the EU standards due to their limited administrative capabilities and financial limitations. The integration of the Western Balkan countries has been on the EU agenda since the Thessaloniki Sumit in 2003, in which the European perspective for the Western Balkans was reconfirmed (Richet, 2019). However, for the candidate countries and potential candidates to meet the requirements of membership, they are required to strongly focus on fundamental reforms of the rule of law, the economy and the functioning of democratic institutions and public administration, even though many of the Western Balkan countries had made limited progress in these areas (European Commission, 2020a).

Among the essential activities within the EU agenda for the Western Balkans, economic integration (including market integration and integration of economic policies) is a crucial process that ensures economic sustainability, and convergence. Market integration is the basic step for economic integration that consists of eliminating barriers in trade between countries, while integration of economic policies includes the coordination and harmonization of economic policies with the EU countries. The European Union also initiated the European Partnership Action Plan for the Western Balkans, which served as a framework for planning the future assistance for these countries. Furthermore, among different EU financial instruments, the EU launched the Instrument for Pree-Asession Assistance (IPA) for the Western Balkan countries in three rounds: IPA I 2007–2013, IPA II 2014–2020 and IPAI II 2021–2027. IPAS main aim was to support countries to undertake the necessary reforms towards EU accession, prepare countries for competition within the EU and decrease the economic and social differences between different Western Balkan countries and regions. In 2020, the European Commission adopted the Communication *Enhancing the Accession Process,* which the Council endorsed in and sets out concrete proposals for strengthening the accession process for these countries (European Commission, 2020b).

### *Stabilization and Association and the Enlargement Process in the Western Balkans*

The main instrument introduced by the European Union in support of the Western Balkan countries is Stabilisation and Association Process

(SAP). Stabilization and Association Process for the Western Balkans was launched in 1990 in support of institutional and administrative reforms in line with European Policies and practices. The core components of SAP are:

- Trade issues;
- Financial assistance;
- Stabilization and Association Agreement;
- Political and economic negotiations;
- Conditionality;
- Annual Supervision Report;
- European Partnership Action Plan – European Reform Agenda.

Among the main objective of the EU was to accelerate and promote the EU integration process in WB countries through stabilization and reconciliation policies.

North Macedonia was the first country in the region to sign the Stabilization and Association Agreement (SAA) in 2001, entering into force in April 2004. For Albania, the EU liberalized most of its trade in 1999 under the framework of Autonomous Trade Preferences, with the SAAS entering into force in 2009. Montenegro signed the SAA and the Provisional Agreement on Trade and Trade-Related matters on 15 October 2007 with the SAA entering into force on 1 May 2010. Due to her specific political conditions and complications, Bosnia and Herzegovina launched SAA later than other countries on 1 June 2015. An integral part of the SAP was the Interim Trade Agreement that had entered into force on 1 July 2008. The SAA with Serbia entered into force in 2013 but before this a Provisional Association Agreement on Trade-Related issues had been reached between the EU and Serbia. Kosovo was the last country in the Western Balkans to go through the SAA process.

During November 2002, a Stabilization and Association Tracking Mechanism had been launched for Kosovo (taking into consideration Kosovo's unresolved final status) and paved the way for the Stabilization and Association Agreement between the EU and Kosovo entering into force in 2016.

Table 1.1 summarises the timeline of various stages of the SAA process in different WB countries. Analyzing this process, it is evident that the Western Balkan countries are at different stages of the European integration process although all of these countries regard EU member-

TABLE 1.1 Timetable of the EU Integration and Accession Processes of Western Balkans

| Item | Albania | Bosnia and Herzegovina | Kosovo | Montenegro | North Macedonia | Serbia |
|---|---|---|---|---|---|---|
| Negotiations under SAA | 31/01/2003 | 25/11/2005 | 28/10/2013 | 10/10/2005 | 05/04/2000 | 10/10/2005 |
| SAA signed | 12/06/2006 | 16/08/2008 | 27/10/2015 | 15/10/2007 | 09/04/2001 | 29/04/2008 |
| SAA enters into force | 01/04/2009 | 01/06/2015 | 01/04/2016 | 01/05/2010 | 01/04/2004 | 01/09/2013 |
| Visa Liberalization into force | 15/12/2010 | 15/02/2010 | | 19/12/2009 | 19/12/2009 | 19/12/2009 |
| Applied for EU Membership | 24/04/2009 | 15/02/2016 | | 15/12/2008 | 22/03/2004 | 22/12/2009 |
| Council invited Commission's Opinion | 16/11/2009 | 20/09/2016 | | 23/4/2009 | 17/05/2004 | 25/10/2010 |
| Reply to Commission questionnaire | 13/04/2010 | | | 9/12/2009 | 14/02/2005 | 31/1/2011 |
| Commission delivers opinion | 09/11/2010 | | | 9/11/2010 | 09/11/2005 | 12/10/2011 |
| Candidate status (EC) | 27/06/2014 | | | 17/12/2010 | 17/12/2005 | 01/3/2012 |
| Agreement to start accession negotiation | 25/3/2020 | | | 26/6/2012 | 25/3/2020 | 28/06/2013 |
| Accession negotiations started | | | | 29/6/2012 | | 21/01/2014 |
| Start of screening process (EC) | | | | 26/3/2012 | | 25/07/2013 |
| End of screening process (EC) | | | | 27/06/2013 | | 24/03/2015 |
| Opened the 1st Chapter (EC) | | | | 18/12/2012 | | 14/12/2015 |
| Opening Chapters 23 and 24 | | | | 18/12/2013 | | 18/07/2016 |
| Closure of Chapters 23 and 24 | | | | | | |
| EU Membership | | | | | | |

NOTES Adapted from Regional Cooperation Council (2020a).

ship as their primary political and development objective. Apart from the Stabilization and Association Process, the EU has supported the Western Balkans with many instruments and agreements for the institutional promotion of these countries. This comprehensive support provides a framework for political dialogue and covers cooperation in various sectors, including justice and home affairs, trade, education, employment, energy, environment, and a range of other policy areas (European Commission, 2020b). Grabbe (2001) pointed out that the EU accession process is based on the previous models of the enlargement rather than the transition countries' specific needs. Comparing different enlargement models, there is evidence that during the Eastern enlargement, the EU applied several instruments to promote domestic changes but, as proved to be the case, the most effective tool was conditionality (Kathuria, 2018). The European Union continues to expand efforts to find the right balance between strict conditionality and the need to support stability in the Western Balkans by maintaining the momentum of the EU approximation process (Levitin & Sanfey, 2018). Furthermore, as Rupnik (2010) has pointed, to complete the Balkan region's accession process, the europragmatism will be essential to resolve the bilateral disputes between countries; therefore, the EU should rethink the concept of enlargement by strengthening the regional approach and increase the capacity of political elites.

## Regional Cooperation and the Western Balkans

According to the EU, regional cooperation is considered an emergent and crucial issue for the Western Balkan countries as the region has experienced political, economic, and institutional upheavals. Therefore, reconciliation between the countries of the region is of higher importance than in other regions. The first initiative for cooperation was undertaken in 1999 in the form of the Stability Pact for Soth East Europe to improve the relations between Western Balkan countries, bringing the region closer to the EU (*Zagreb Declaration,* 2007). According to Doring et al. (2010), initially, the European Union accession strategy for the Balkans was one linked accession to the peace and reforms In individual countries, but gradually this strategy shifted toward conditionality, requiring countries to meet EU criteria and conditions and to increase regional stability in the Western Balkans through regional cooperation. Furthermore, Oli Rehn pointed out that regional agreements and initiatives testify that the agenda of the regional cooperation (mechanisms such as CEFTA, the Energy Community Treaty, the European Common Aviation Area Agreement as well as transport, energy, and environment infrastructure projects and cooperation in the area of justice, freedom and society) and European integration are increasingly intertwined (*Zagreb Declaration*, 2007). The EU's focus on promoting regional cooperation in the Western Balkans could be considered a priority, compared to other regions, as political challenges dominate the situation in the Western Balkans. Consequently, WB counries have engaged in regional cooperation and benefited economically and institutionally from the European integration process, promoting local institutions ad their administrative capabilities. In addition, with the support of the EU, the relations between most countries continue to develop in the spirit of good neighbourly relations, contributing to the region's stability and its ability to use the opportunities coming from the EU and the global economy.

The main developments in regional cooperation in the Western Balkans from 1999 until 2020 are:

- Stability Pact for South East Europe;
- Negotiation and implementation of CEFTA 2006;
- Regional ownership-transformation of the Stability Pact to Regional Cooperation Council;
- Regional Cooperation Council;
- Berlin Process;
- Regional Economic Area of the Western Balkans;
- Common Regional Market of the Western Balkans.

### *Stability Pact for South East Europe*

In 1999, the German Presidency of the European Union proposed a Stability Pact for South East Europe. As a result, the Stability Pact for South East Europe facilitated this process, therefore the region has made significant progress by establishing democratic institutions, civil society, and economic development while regional cooperation is becoming stronger (*Zagreb Declaration*, 2007). Stability Pact for the Soth East Europe was the first initiative undertaken by the EU after the crises in the Western Balkans in order to restart the regional cooperation, to overcome the challenges in the region in the short run, and support these countries in the EU integration process.

The Stability Pact for South East Europe as a framework for cooperation has acted as a catalyst for numerous positive developments in the region as peacebuilding required a comprehensive multilateral approach that addresses three key sectors such as secure environment, sustainable democratic system, and economic and social well-being (Hombach, 2006). Within the Stability Pact framework, many challenges of the region were addressed and good neighborly relations were initiated to bring stability, security, democracy, and economic prosperity (Qorraj, 2010).

Besides, the Working Tables of the Stability Pact have been actively involved in three core areas. Working Table I ensured parliamentary cooperation and human capital; Working Table II intensified the countries' economic cooperation such as free trade, investments, business activities, and other economic issues; Working Table III supported anti-corruption initiatives, defence and security issues.

### *Regional Ownership Process*

Regional ownership was the transfer of institutions involved in regional cooperation from the EU to the Western Balkan region. In 2008, the EU transfered the location of the Stability Pact for SEE from Brussels to the newly formed Regional Cooperation Council in Sarajevo. In addition, the leadership of this mechanism was also 'regionalized' with the leadership coming from the region. The idea of regional ownership in the framework of regional cooperation was launched under the assumption that satisfactory regional cooperation has been achieved and countries should have ownership of the process and play an active role in regional cooperation (Qorraj, 2018).

Although many attempts and instruments have been used to intensify regional cooperation, the core question remains whether regional ownership could encourage, and result in, significant cooperation efforts in the region, given the challenging issues and unresolved political problems between countries. These obstacles became apparent during the implementation of CEFTA 2006, when the countries of the region could not overcome trade and political disputes without EU intervention (Qorraj, 2018).

### *Regional Cooperation Council*

The Regional Cooperation Council, as a successor to the Stability Pact for Southeast Europe, continued in 2008 as the main regional institution in the region, specifically supporting regional cooperation between countries and encouraging the regional ownership process.

Promoting and enhancing cooperation in the priority areas, namely, economic and social development, infrastructure and energy, justice and home affairs, security cooperation, building human capital and cross-cutting issues, and parliamentary cooperation, the Regional Cooperation Council also supported the European and Euro-Atlantic integration. It created a political climate to carrying out projects of a broader, regional character to each member's benefit. The Western Balkan region is committed to European integration based on EU rules and principles and ultimately membership in the European Union (EU), and to regional and European initiatives such as the Regional Economic Area (REA) established as part of the Berlin Process, the Central European Free Trade Agreement (CEFTA), the Treaty Establishing the Transport Community, and the Treaty Establishing the Energy Community (Atlantic Council, 2020).

The Regional Cooperation Council played a unique role in providing a framework for progress and preparing the action plans for regional initiatives. The European Union and other international partners supported the Regional Cooperation Council in developing an appropriate monitoring tool to track the implementation of measures agreed in regional economic initiatives and focusing on Regional Common Market 2021–2024. In close cooperation with international organizations, EU and regional organizations, Regional Cooperation Council will support the post-2020 strategy concerning Western Balkans' regional cooperation. According to the Regional Cooperation Council (2020a), other relevant organizations focused on the Western Balkans are:

1. Central European Free Trade Agreement (CEFTA)
2. Center of Excellence in Finance (CEF)
3. Education Reform Initiative for South Eastern Europe (ERI SEE)
4. Energy Community (EC)
5. European Training Foundation (ETF)
6. Global Water Partnership (GWP)
7. Network of Associations of Local Authorities of South-East Europe (NALAS)
8. Regional Anti-corruption Initiative (RAI)
9. Regional School of Public Administration (ReSPA)

10. Regional Youth Cooperation Office (RYCO)
11. Regional Rural Development Standing Working Group in South Eastern Europe (SWG)
12. South Eastern and Eastern Europe for Control of Small Arms and Light Weapons (SEESAC)
13. South-Eastern Europe Health Network (SEEHN)
14. Transport Community (TC)
15. Western Balkans 6 Chamber Investment Forum (WB6 CIF)
16. Civil Aviation Agency (CAA)

### *Regional Economic Area*

Regional Economic Area (REA), implemented in 2017, was established as part of the Berlin Process, with support of the European Union in order to promote regional cooperation between Western Balkan countries as a regional initiative and consisted mainly of four components:

- A common market for goods, services, and capital;
- Free flow of skilled workforce integrated into professional and academic EU networks;
- A common digital market;
- A dynamic investment space.

The Multi-Annual Plan of Regional Economic Area (MAP REA) was supported by the Regional Cooperation Council, the CEFTA Secretariat, the European Union, and Regional Economic Area coordinators of Western Balkan countries. The support from the European Union was the factor of success for delivering the commitments within MAP REA. On the other hand, existing political sensitivities have affected the implementation in some areas and hampered the progress in obtaining concrete results. Despite challenges and difficulties, it has been also proven that the experience of the implementation of the MAP REA served as a useful tool for planning the future processes related to the enhanced REA 2021–2024 (Hanzl-Weiss et al., 2020).

According to the study by Hanzl-Weiss et al. (2020), the implementation of MAP REA during 2017 encountered several challenges and risks related, but not limited, to the nature and technical feasibility of the measures, the capacity of public administration to comply with the manifold and the very demanding agendas. In adittion, poor coordination amongst relevant institutions at the level of each WB economy and regional level, and the lack of dedicated technical assistance and financial instruments to support the implementation of certain parts of measures. Relying on lessons learned could, in turn, help facilitate the process of internal coordination, planning, and subsequent implementation of the measures within the framework of future REA 2021–2024.

Furthermore, in this connection, the cross-sectoral nature of MAP REA posed a significant challenges to coordination as it necessitated stronger coordination of line ministries, agencies, and other relevant stakeholders at the level of each individual economy and at the regional and international levels.

### *Common Regional Market*

The Common Regional Market (CRM) of WB6 was negotiated during 2020 and signed during the Sofia Summit on 10 November 2020, covering the period 2021–2024. The Action Plan for a Regional Market (RM) should be implemented by the end of 2024 and will include: free movement of goods, services, capital and people; regional investment area; regional digital area; and regional industrial and innovation area. According to the Regional Cooperation Council (2020b) the Western Balkans Leaders Declaration on Common Regional Market, 2020, four key areas of the CRM were highlighted:

- regional trade area: including free movement of goods, services, capital and people, and cross-cutting measures such as the Green Lanes, to align with EU-compliant rules and standards and provide opportunities for companies and citizens;
- regional investment area, to align investment policies with the EU standards and best international practices and promote the region to foreign investors;
- regional digital area, to integrate the Western Balkans into the pan-European digital market; and
- regional industrial and innovation area, to transform the industrial sectors, shape value chains they belong to, and prepare them for today's realities and challenges of tomorrow.

Among the critical issues for the CRM is the implementation of the Action Plan for 2021–2024 by the WB countries and the need for better

TABLE 1.2 The Common Regional Market Action Plan 2021–2024

| Connecting economies | Goods | Services | Capital | People |
|---|---|---|---|---|
| Maintain the green corridors and streamline BCPS/CCPS controls; Elimination of non-tariff barriers (NTBS); Trade related aspects; Public private partnership; Reduction of trade costs and transparency. | Mutual recognition programmes (MRPS); Risk management; System of electronic exchange of data SEED+; Harmonization and cooperation with the EU. | Additional protocol 6 (AP6) on trade in services; Tourism; Financial services; Postal services; Professional qualifications; Enabling environment; Electronic commerce. | Development of a modern payment system Strengthening regional cooperation and coordination on COVID-19 response as part of relief, recovery and resilience. | Mobility of students, researchers and professors Mobility of individuals on the basis of IDS Portability of social rights and removal of working permits. |

| Regional investment area | Regional digital area | Regional industrial and innovation area |
|---|---|---|
| Regional investment promotion; Regional investment policy reforms; Regional investment retention and expansion. | Digital infrastructure and connectivity; Digital skills and competence; Digital economy in the era of new ICT technologies; Trust and security. | Regional innovation; Regional industry development; Automotive industry value chains; Green & circular economy value chains; Sustainable tourism. |

NOTES Adapted from Regional Cooperation Council (2020c).

coordination and harmonization of the activities needed for the effective impact on the economic convergence of these countries. Regional Cooperation Council and CEFTA will be leading regional organizations to support WB6 to implement it, jointly with regional and international partners. Furthermore, the Western Balkan countries appointed the national contact points to implement the action plan activities. The European Commission has indicated that the Western Balkans would be closer to the EU single market by increasing regional economic cooperation and trade. Therefore the Common Regional Market Action Plan is an integral part of the region's EU accession process (Regional Cooperation Council, 2020c). Table 1.2 elaborates different elements of the

Regional Common Market, that is, the WB6 Regional Economic Integration Plan according to the Action Plan for the period 2021–2024.

Compared to Regional Economic Area and considering the current situation during 2020, the Common Regional Market is supporting some additional components such as:

- Green Agenda as a tool for a comprehensive transformation of the region;
- Regional Agreement for Free Movement with ID Cards;
- Extension of WB6 Green corridors to the EU corridors;
- Digital Transformation;
- Youth and youth-related policies for young people;
- Think Tank and civil society activities;
- Research, Innovation, Education and Science.

The components mentioned above will support the Western Balkans' European perspective to fulfill the EU rules and standards, therefore, supporting their businesses towards the EU internal market and promoting the Balkans as an attractive region for investments and economic activity.

## Conclusions

As the EU integration is a dynamic process that involves the reallocation of economic and political power between the member states and the Union, the coordination of the EU policies is challenging issue. Although the European Union is the most significant contributor to the Western Balkans institutionally, politically, and economically, the previous enlargement experience has shown that the European integration does not guarantee sustainable economic development but provides a robust framework for reforms in countries such as WB6. Therefore, the EU and countries of the region should focus on economic sustainability rather than political issues to create economic convergence in order to be able to compete and use the opportunities coming from EU membership.

In 1943 Jean Monnet declared that there will be no peace in Europe if the states are reconstituted based on national sovereignty, as the countries of Europe are too small to guarantee their people the necessary prosperity and social development (Brinkley & Hackett, 1991). This must be a lesson for the countries of the Western Balkans: although the process will be long and challenging, EU integration is the best framework for cooperation between peoples and countries.

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Chapter Two

# The Institutions of the European Union

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## Introduction

Dealing with the European Union (EU) requires an understanding the architecture of its institutions and its policy-making processes. This is particularly relevant for the Western Balkans countries, i.e., Albania, Bosnia and Hercegovina, Kosovo, Montenegro, North Macedonia and Serbia, which aspire to EU membership. The Western Balkans countries, not yet members of the EU, have special links with it primarily through stabilization and association agreements and other arrangements, such as the Regional Economic Area, the Central European Free Trade Area (CEFTA) and other regional organizations. Kosovo, in addition, has its peculiar arrangements with the EU since it is not recognized by five EU member states despite the fact that it hosts the EU's largest rule of law mission known as EULEX. This chapter will provide an overview of the most important EU institutions, their functions and composition which are critical for understanding any interaction of the Western Balkans when dealing with the EU.

The EU is an international organization which, according to the Treaty of Lisbon of 2009, is the successor to the European Communities established in 1957. The international treaties, which form the constitutional framework of the EU, are the Treaty on the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU) (Consolidated Version of the Treaty on the European Union and Consolidated Version of the Treaty on the Functioning of the European Union, 2016), together called the EU Treaties. The European Atomic Energy Community is a separate international organization.

The EU has an international legal personality (TEU, Art. 47) and establishes diplomatic relations to the extent that it is recognized by

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states and other international organizations (Herdegen, 2020). The EU is a special form of an international organization as its member states have conferred significant powers upon the EU, including legislative authority that has resulted in the establishment of an autonomous supranational organization (Frenz, 2011). The EU, acting through its institutions, has policy and law-making powers in specific areas and its legislative acts have direct effect in the territory of its member states. The EU is also a community of values which include respect for human dignity, freedom, democracy, equality, the rule of law, and respect for human rights and minority rights (TEU, Art. 2).

However, the EU member states retain their sovereignty and the EU's powers are limited by the principle of conferral. This means that the EU may act only within the limits of the powers conferred on it by the member states. Powers not conferred on the EU remain with the member states (TEU, Art. 5.2). Pursuant to the principle of sincere cooperation, member states are required to assist each other and the EU in carrying out the tasks which derive from the EU Treaties (TEU, Art. 4.3). The member states must ensure the fulfilment of their obligations arising out of the EU Treaties or from the acts of the institutions of the EU, and they must facilitate the achievement of the EU's tasks and refrain from any measure which could jeopardize the attainment of the EU's objectives (TEU, Art. 4.3).

As an international organization, the EU acts through its institutions. Their aim is to promote the EU's values, advance its objectives, serve its interests, those of its citizens and member states, and ensure the consistency, effectiveness and continuity of its policies and actions (TEU, Art. 13.1).

The EU has the following institutions (TEU, Art. 13):

- The European Council;
- The Council;
- The European Commission (Commission);
- The European Parliament;
- The Court of Justice of the European Union;
- The European Central Bank;
- The Court of Auditors.

In addition, there is the Economic and Social Committee and the Committee of the Regions as advisory bodies to the European Parliament, the Council, and the Commission (TEU, Art. 13.4). The European Investment Bank is also a special financial body, which will be briefly outlined in this chapter.

The design and arrangement of the EU's institutions reflects the need to balance the interests between the EU and its member states and that of the member states between them. The principle of institutional balance governs the relations between the EU institutions (Klamert, 2014). It means that legislative and executive functions are not vested in a single institution, but they are distributed between different institutions (Haratsch et al. 2020). This principle requires EU institutions to cooperate with each other to fulfill the legislative or executive function and no institution has so much power that it can abuse it. It is therefore the equivalent of checks and balances in a modern constitutional order. The principle of institutional balance also requires every institution to act in accordance with the powers conferred on it by the EU Treaties (Kaczorowska, 2016). An act that is outside the powers conferred by the EU Treaties is ultra vires and challengeable.

The EU institutions are also governed by the principle of institutional autonomy and the principle of sincere cooperation. The principle of institutional autonomy means that every EU institution is authorized to organize its work (Kaczorowska, 2020). The principle of sincere co-operation requires EU institutions to cooperate in good faith with each other by respecting the other institutions' responsibilities and powers.

## The European Council

The European Council started in 1972 as informal meetings of heads of state and government of EU member states. The Treaty of Lisbon finally defined the legal status of the European Council which was not clear until then.

### *Composition*

The European Council consists of the heads of state or government of the member states (TEU, Art. 15.2). The President of the European Council, the President of the Commission, and the High Representative for Foreign Affairs and Security Policy are also part of the European Council.

The President of the European Council is elected by the European Council and may also be dismissed in the same manner in the event of an impediment or serious misconduct (TEU, Art. 15.5). The President of the European Council is responsible for:

- Chairing the European Council;
- Ensuring the preparation and continuity of the work of the European Council in cooperation with the President of the Commission,
- Facilitating cohesion and consensus within the European Council;
- Presenting a report to the European Parliament after each of the meetings of the European Council;
- Ensuring the external representation of the EU on issues concerning its common foreign and security policy, however, without prejudice to the powers of the High Representative for Foreign Affairs and Security Policy.

### *Responsibilities*

The European Council is the EU's main political body. Its primary functions are:

- To provide the EU with the necessary impetus for its development and defines its general political directions and priorities (TEU, Art. 15.1);
- To identify the EU's strategic interests, to determine the objectives of and define general guidelines for the EU's common foreign and security policy, including for matters with defense implications (TEU, Art. 26.1);
- To define the strategic guidelines for legislative and operational planning within the area of freedom, security and justice (TFEU, Art. 68);
- To decide on the composition of the European Parliament (TEU, Art. 14.2);
- To establish a system of rotation in the Commission (TEU, Art. 17.5);
- To appoint and dismiss the High Representative for Foreign Affairs and Security Policy (TEU, Art. 18.1).

The European Council does not exercise any legislative function; these are reserved to the Council and the European Parliament. As an exception, in matters related to judicial cooperation in criminal matters, draft regulations may be referred to the European Council when there is no unanimity in the Council (TFEU, Art. 83.3).

The European Council meets twice every six months, but it may also meet at special meetings when required (TEU, Art. 15.3). The European Council decides, in principle, by consensus. A member of the European Council may vote for another member, but not more than for one (TFEU, Art. 235.1). In exceptional situations, and when prescribed by the EU Treaties, the European Council decides by qualified majority (e.g. appointment of the High Representative for Foreign Affairs and Security Policy) or by unanimity.

The qualified majority requirements are the same as for the Council (TFEU, Art. 235). In the event of a unanimity vote, the abstention of a member of the European Council does not prevent the adoption of the decision (TFEU, Art. 235).

## The Council

The Council, together with the European Parliament, is the main legislative institution of the EU and is, in terms of competencies, the most powerful EU institution. The Council builds the institutional bridge between the EU and its member states because, on the one hand, it is the forum where member states promote their national interests and, on the other hand, they are required to promote the interests of the EU as a supranational organization. Member states meet in the Council as members of the Council and act on behalf of the EU. They can also meet in the Council without acting for the EU but on an intergovernmental basis (Herdegen, 2020). In such an event, the decisions taken by the member states are not attributable to the EU. It is therefore important to clearly distinguish in what capacity the member states meet in the Council.

The Council has its seat in Brussels. During the months of April, June and October, the Council meets in Luxemburg.

### *Composition*

The Council consists of a representative of each member state at the ministerial level who are authorized to commit their state and cast its vote (TEU, Art. 16.2). The wording of the TEU is such that it allows ministers of units of federal states, e.g. Germany and Austria, to represent their state in the Council. Administrative practice in the Council also authorizes secretaries of state to vote in Council meetings on behalf of their state.

The Council meets in different configurations of ministers (TEU, Art. 16.6). This means that the membership of the Council depends on the subject-matter which will be discussed. The list of Council configurations, excluding the General Affairs Council and the Foreign Affairs Council, is determined by the European Council (TFEU, Art. 236). At present, the Council meets in the following ten configurations:

- General Affairs
- Foreign Affairs
- Agriculture and Fisheries
- Economic and Financial Affairs
- Education, Youth, Culture and Sport
- Employment, Social policy, Health and Consumer Affairs
- Environment
- Justice and Home Affairs
- Transport, Telecommunications and Energy

The Presidency of the Council configurations is determined by the European Council (TFEU, Art. 236). The only exception is the Foreign Affairs Council which is chaired by the High Representative for Foreign Affairs and Security Policy. The Presidency of the Council configurations must be determined on the basis of equal rotation between the member states.

The Council is supported by a General Secretariat (TFEU, Art. 240.2) and a Committee of Permanent Representatives of the Governments of the Member States which is responsible for preparing the work of the council (TEU, Art. 16.7). This Committee is also known as the COREPER. It is made up of permanent representatives of the Member States to the EU. The main function of COREPER is to support the Council by preparing proposals, which are discussed before they are submitted to the Council (Kaczorowska, 2016). There are two configurations of COREPER (Kaczorowska, 2016), i.e., COREPER I consists of ambassadors of the member states to the EU, and COREPER II is composed of the ambassadors' deputies (Fairhurst, 2010).

If there is unanimous agreement in COREPER, the proposal is included in part A of the Council's agenda and will be adopted by it without further discussion (Hartley, 2016). If there is no agreement in COREPER, or the Commission objects to the proposal, the proposal is included in part B of the Council's agenda and is subject to further discussion and decision by the Council (Hartley, 2016).

### *Functions and Powers*

The Council is the EU's main legislative body (TEU, Art. 16.1) despite increasing participation of the European Parliament in the legislative process. The Council establishes the EU's annual budget, together with the EU Parliament (TFEU, Art. 310.1). The Council has powers in the EU's external relations, such as to authorize the opening of negotiations, to adopt negotiating directives, to authorize the signing of agreements and to conclude them (TFEU, Art. 218.2), and to adopt economic sanctions against states (TFEU, Art. 215).

The Council decides by a qualified majority except where the EU Treaties provide otherwise (TEU, Art. 16.3). A qualified majority is defined as at least 55 % of the members of the Council, comprising at least fifteen of them and representing Member States comprising at least 65 % of the population of the Union (TEU, Art. 16.4).

As an exception, i.e., in cases when the Council does not act on a proposal from the Commission or from the High Representative for Foreign Affairs and Security Policy, the qualified majority is defined as at least 72 % of the members of the Council representing the participating Member States, comprising at least 65 % of the population of these States. A blocking minority can prevent a decision by the Council when a qualified majority is required. A blocking minority must include at least four Council members (TEU, Art. 16.4). The population percentage required for a qualified majority is calculated on the basis of the share of the population of each voting member state in total EU population. These shares are shown in Table 2.1 (the United Kingdom is excluded).

In certain matters the Council may also decide by simple majority, e.g., to adopt its rules of procedure (TFEU, Art. 240.3). In particularly important matters, the Council must decide by unanimity, e.g., when deciding on the admission of a new member state to the EU (TEU, Art. 49). In the event of a unanimity vote, the abstention of a member present in person or otherwise represented does not prevent the adoption of the decision (TFEU, Art. 237.4).

The EU Treaties enable the member states, in limited cases, to suspend the legislative procedure in the Council and to refer the decision

TABLE 2.1 Population of EU Member States and Their Share in Total EU Population

| Member State | (1) | (2) | Member State | (1) | (2) |
|---|---|---|---|---|---|
| Germany | 82.9 | 18.54 | Bulgaria | 7.0 | 1.56 |
| France | 67.0 | 14.98 | Denmark | 5.7 | 1.30 |
| Italy | 61.0 | 13.65 | Finland | 5.5 | 1.23 |
| Spain | 46.9 | 10.49 | Slovakia | 5.4 | 1.22 |
| Poland | 37.9 | 8.49 | Ireland | 4.9 | 1.10 |
| Romania | 19.4 | 4.34 | Croatia | 4.0 | 0.91 |
| The Netherlands | 17.4 | 3.89 | Lithuania | 2.7 | 0.62 |
| Belgium | 11.4 | 2.56 | Slovenia | 2.0 | 0.47 |
| Greece | 10.7 | 2.40 | Latvia | 1.9 | 0.43 |
| Czech Republic | 10.5 | 2.35 | Estonia | 1.3 | 0.30 |
| Portugal | 10.2 | 2.30 | Cyprus | 0.8 | 0.20 |
| Sweden | 10.2 | 2.29 | Luxemburg | 0.6 | 0.14 |
| Hungary | 9.7 | 2.18 | Malta | 0.4 | 0.11 |
| Austria | 8.8 | 1.98 | Total | 446.2 | 100.00 |

NOTES Column headings are as follows: (1) total population in millions, (2) percentage share of total. Adapted from Herdegen (2020)

to the European Council. For example, when a member of the Council considers that a draft directive would affect fundamental aspects of its criminal justice system, it may request that the draft directive be referred to the European Council (TFEU, Art. 82.3). In that case, the legislative procedure is suspended, and the European Council has four months to reach a consensus on the draft and refer it back to the Council.

Voting by qualified majority means that certain decisions may be taken against the will of states and create legal obligations for them even if they are against that decision. France's rejection of the majority voting for funding the common agricultural policy and its boycotting of the Council resulted in the Luxemburg Compromise of 1966. The Luxemburg Compromise means that a member state may request a unanimity vote even where a qualified majority vote is prescribed, if the subject matter is of vital interest for that state. The legal status of the Luxemburg Compromise is controversial, but the dominant view seems to be that it is not legally binding but merely reflects a political understanding (Herdegen, 2020). However, it reflects the political nature of the Council where decisions are the result of political bargaining between the member states that primarily promote their national interests (Hartley, 2016).

## The European Commission

The European Commission (the 'Commission') is the EU's politically most independent institution. The TEU explicitly provides that in carrying out its responsibilities, the Commission must be completely independent (TEU, Art. 17.3). The members of the Commission must neither seek nor take instructions from any Government or other institution, body, office or entity (TEU, Art. 17.3). Because of its independence, the Commission is known as the 'Guardian of the Treaties' and the promotor of the EU's supranational interests and of the EU's integration process. It is also known as the executive branch of the EU, although it has additional powers which are related to legislation and external relations (Horspool & Humphreys, 2012). The Commission has its seat in Brussels.

### *Composition*

The Commission is composed of one national of each member state, including the President of the Commission and the High Representative for Foreign Affairs and Security Policy who is one of its Vice-Presidents (TEU, Art. 17.4). As of 1 November 2014, the Commission was supposed to consist of a number of members, including its President and the High Representative for Foreign Affairs and Security Policy, which corresponds to two thirds of the number of member states (TEU, Art. 17.5). However, the European Council postponed the implementation of this provision, which aimed at reducing the number of EU Commissioners.

The Commission's term of office is five years (TEU, Art. 17.3), and it is responsible to the European Parliament (TEU, Art. 17.7). The European Parliament may vote on a motion of censure of the Commission (TEU, Art. 17.8). If such a motion is successful, the Commission must resign as a body.

The President of the Commission is elected by the European Parliament based on a proposal by the European Council (TEU, Art. 17.7). The President of the Commission is a member of the European Council and has the following responsibilities:

- To lay down guidelines within which the Commission is to work;
- To decide on the internal organisation of the Commission;

- To ensure that the Commission acts consistently, efficiently and as a collegiate body.

Next to the President, the other important position in the Commission is that of the High Representative for Foreign Affairs and Security Policy (High Representative). The High Representative holds two different mandates. On the one hand, the High Representative is responsible for the EU's common foreign and security policy, which he carries out as mandated by the Council (TEU, Art. 18.2). In this capacity, the High Representative presides over the Foreign Affairs Council (TEU, Art. 18.3). On the other hand, the High Representative is one of the Vice-Presidents of the Commission (TEU, Art. 18.4). In this capacity, the High Representative is responsible for ensuring the consistency of the EU's external action. The European Council, acting in agreement with the President of the Commission, appoints the High Representative (TEU, Art. 18.1).

The other members of the Commission are selected by the Council and the President-elect of the Commission based on the suggestions made by the member states (TEU, Art. 17.7). They must be chosen based on their general competence and European commitment from persons whose independence is beyond doubt (TEU, Art. 17.3).

The Commission is organized in departments, known as Directorates-General (DG), and executive agencies. DG's develop and implement EU policies, while executive agencies manage specific programmes (a full list of the DGS and executive agencies is available at: https://ec.europa.eu/info/departments). At present, the Commission employs around 32000 persons.

### *Responsibilities*

The Commission's responsibilities are set out in TEU, Art. 17.1:

- To promote the general interest of the Union and take appropriate initiatives to that end;
- To ensure the application of the EU Treaties, and of measures adopted by the institutions pursuant to them;
- To oversee the application of EU law under the control of the Court of Justice of the European Union;
- To execute the budget and manage programmes;
- To exercise coordinating, executive and management functions;

- To ensure the EU's external representation, with the exception of the common foreign and security policy;
- To initiate the EU's annual and multiannual programming with a view to achieving inter-institutional agreements.

The Commission plays a critical role for the adoption of legislative acts, as legislative procedures can, in principle, be initiated only by the Commission. The Commission is also responsible for negotiating international agreements and to represent the EU in its external relations. The Commission has also executive powers, such as in the area of competition law. The Commission is also authorized to initiate judicial proceedings before the Court of Justice of the European Union in cases when member states breach EU law.

The Commission makes decisions by a majority vote of its members (TFEU, Art. 250). The Commission is a collegiate body. This means that any decision made by a Commissioner is attributed to the Commission (Kaczorowska, 2010). The principle of collegiality is based on the equal participation of the commissioners in the adoption of decisions. The immediate consequence of this principle is that decisions should be the subject of collective deliberation and that all the members of the College of Commissioners bear collective responsibility at political level for all decisions adopted (Kaczorowska, 2010). Additionally, this principle means that each decision must be formally approved by the Commission. Failure to ensure this may render a measure invalid. The Commission must also follow its rules and procedures. Failure to comply with them makes a decision taken by the Commission challengeable before the Court of Justice of the European Union (Herdegen, 2020).

### European Parliament

The EU is founded on representative democracy (TEU, Art. 10.1) and EU citizens are directly represented in the EU through the European Parliament. EU citizens are all those persons who are nationals of a member state of the EU. The Parliament is thus the institution that provides for democratic representation in the EU.

The European Parliament has its seat in Strasbourg where the 12 periods of monthly plenary sessions, including the budget session, are held. The periods of additional plenary sessions are held in Brussels. The committees of the European Parliament meet in Brussels while the

TABLE 2.2 The Distribution of Seats in the Parliament

| Member State | Seats | Member State | Seats |
|---|---|---|---|
| Belgium | 21 | Estonia | 7 |
| Denmark | 14 | Latvia | 8 |
| Germany | 96 | Lithuania | 11 |
| Greece | 21 | Malta | 6 |
| Spain | 59 | Poland | 52 |
| France | 79 | Slovakia | 14 |
| Ireland | 13 | Slovenia | 8 |
| Italy | 76 | Czech Republic | 21 |
| Luxemburg | 6 | Hungary | 21 |
| The Netherlands | 26 | Cyprus | 6 |
| Austria | 19 | Bulgaria | 17 |
| Portugal | 21 | Romania | 33 |
| Finland | 14 | Croatia | 12 |
| Sweden | 21 | Total | 702 |

NOTES After Brexit (i.e. the UK withdrawing from the EU), the total number of members of the Parliament will be 705. Adapted from Morano-Faodi and Neller (2020).

General Secretariat of the European Parliament and its departments are in Luxembourg.

## *Composition*

The Parliament is composed of a maximum number of 751 representatives of the EU's citizens, including the President of the Parliament (TEU, Art. 14.2). The representation of EU citizens must be regressively proportional, with a minimum number of 6 seats, and a maximum of 96, per member state. Regressive proportionality means that the larger the population of a member state the higher the number of seats it has in the Parliament. However, it also means that a representative of a large state represents more citizens than a representative of a small state (Herdegen, 2020).

The members of the Parliament are elected for a term of five years by direct universal suffrage in a free and secret ballot (TEU, Art. 14.3). They are independent in the exercise of their mandate and not subject to any instructions. EU citizens can vote and stand as candidates for the Parliament when they reside in their country or in any other member state of the EU. The Parliament elects its President (TEU, Art. 14.5) and up to 14 Vice-Presidents from among its members (European Parliament, 2021, Rule 17).

Members of the Parliament may establish political groups based on similar political affinities (European Parliament, 2021, Rule 33). A political group must consist of members elected in at least one-quarter of the member states with a minimum of 23 members for a political group. The following political groups are presently in the Parliament:

- Group of the European People's Party (Christian Democrats);
- Group of the Progressive Alliance of Socialists and Democrats in the European Parliament;
- Renew Europe Group;
- Group of the Greens/European Free Alliance:
- Identity and Democracy Group;
- European Conservatives and Reformists Group;
- Confederal Group of the European United Left – Nordic Green Left.

### *Responsibilities*

The Parliament exercises together with the Council legislative and budgetary functions and it also exercises political control functions (TEU, Art. 14.1). Specifically, this includes the following responsibilities:

1. The Parliament and the Council establish together the EU's annual budget (TFEU, Art. 314).
2. In the ordinary legislative procedure, which is the standard law-making procedure in the EU, as well as in special legislative procedures, a legislative act is adopted only if the Parliament votes in favour of it (TFEU, Art. 294).
3. The Parliament may request the Commission to submit a proposal on matters on which it considers that an EU act is required (TFEU, Art. 225).
4. The EU may conclude the following international treaties only with the consent of the Parliament (TFEU, Art. 218.6):
   - association agreements;
   - agreement on Union accession to the European Convention for the Protection of Human Rights and Fundamental Freedoms;

- agreements establishing a specific institutional framework by organising cooperation procedures;
- agreements with important budgetary implications for the Union;
- agreements covering fields to which either the ordinary legislative procedure applies, or the special legislative procedure where consent by the European Parliament is required.

5. Accession of a state to the EU requires the consent of the Parliament (TEU, Art. 49).
6. The Parliament elects the President of the Commission (TEU, Art. 14.1).
7. The Parliament may set up a temporary committee of Inquiry to investigate alleged violation of EU law, except where the case is being examined by a court (TFEU, Article 226).
8. The Parliament may, by means of a motion of censure, dismiss the Commission, including the High Representative for Foreign Affairs and Security Policy (TFEU, Art. 234).

The Parliament makes decisions by a majority of the votes cast, unless the EU Treaties require another majority (TFEU, Art. 231). A quorum, i.e., the capacity to make decisions, exists when one third of the members of the Parliament are present (European Parliament, 2021, Rule 178.2).

## The Court of Justice of the European Union

The Court of Justice of the European Union (CJEU) is the judicial institution of the EU. It includes the Court of Justice, the General Court and specialised courts (TEU, Art. 19.1). The European Union Civil Service Tribunal is so far the only specialized court. The CJEU has its seat in Luxemburg.

### *Composition*

The Court of Justice consists of one Judge from each member state and is assisted by Advocates-General. The Advocates-General, in total eight, assist the Court of Justice by making submissions related to cases to be decided by the Court of Justice (TFEU, Art. 252). The Judges and Advocates-General of the Court of Justice are appointed for a term of six years by agreement between the governments of the member states (TFEU, Art. 253). They are chosen from persons whose independence is beyond doubt and who possess the qualifications required for appointment to the highest judicial offices in their respective countries or who are *jurisconsults* of recognized competence.

The General Court includes at least one judge per member state. Since 2019, there are two judges from each member state due to increased workload (Morano-Faodi & Neller, 2020). The judges of the General Court are appointed by the governments of the member states for a term of six years. They must be independent and demonstrate independence, and possess the ability required for appointment to high judicial office (TFEU, Art. 254).

### *Jurisdiction*

The CJEU is responsible for ensuring that in the interpretation and application of the EU Treaties the law is observed (TEU, Art. 19.1). In fulfilling this responsibility, the CJEU has jurisdiction in the following cases (TEU, Art. 19.3):

- To rule on actions brought by a member state, an institution or a natural or legal person;
- To give preliminary rulings, at the request of courts or tribunals of the member states, on the interpretation of Union law or the validity of acts adopted by the institutions;
- To rule in other cases provided for in the EU Treaties.

This general jurisdiction is divided between the General Court and the Court of Justice. The General Court, as the first instance court, has jurisdiction to hear and decide on the following cases:

- Actions brought by a member state, the European Parliament, the Council or the Commission concerning an EU act on grounds of lack of competence, infringement of an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application, or misuse of powers;
- Actions brought by the Court of Auditors, by the European Central Bank and by the Committee of the Regions for the purpose of protecting their prerogatives;
- Actions brought by natural or legal person against an act addressed to that person or which is of direct and individual concern to them, and against a regulatory act which is of direct concern to them and does not entail implementing measures;

- Actions brought by natural or legal persons against acts of other EU bodies, offices or agencies intended to produce legal effects in relation to them;
- Actions brought by the member states and other institutions of the EU for a failure to act by the European Parliament, the European Council, the Council, the Commission or the European Central Bank, as well as other bodies, offices and agencies of the EU which fail to act;
- Actions brought by natural or legal persons that an EU institution, body, office or agency has failed to address to that person any act other than a recommendation or an opinion;
- Disputes relating to compensation for damage.

Decisions of the General Court may be appealed before the Court of Justice. In all other instances where the CJEU has jurisdiction, the Court of Justice is the court of first instance. Decisions given by specialised courts may be appealed before the General Court (TFEU, Art. 257). The CJEU has no jurisdiction with respect to acts relating to the common foreign and security policy (TFEU, Art. 275). The CJEU has through its case law and methods of interpretation significantly developed the legal framework of the EU. Its case law on the direct effect of EU law with primacy over national law, the establishment of general principles of EU law, the liability of member states for failure to implement EU law are just a few examples of the impact of the CJEU on the legal system of the EU and its member states.

### The European Central Bank

The European Central Bank (ECB) is the core institution of the European System of Central Banks (ESCB) whose primary objective is to maintain price stability and to support the general economic policies of the EU (TFEU, Art. 127). The ECB has the exclusive right to authorize the issue of euro banknotes within the EU (TFEU, Art. 128).

The main bodies of the ECB are the Governing Council and the Executive Board (TFEU, Art. 129). The Governing Council comprises the members of the Executive Board of the ECB and the governors of the national central banks of the Member States whose currency is the euro. The Executive Board comprises the President, the Vice-President and four other members who are appointed by the European Council from among persons of recognised standing and professional experience in monetary or banking matters.

The Governing Council formulates the monetary policy of the EU including, as appropriate, decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the ESCB and establishes the necessary guidelines for their implementation.

The Executive Board implements the monetary policy in accordance with the guidelines and decisions laid down by the Governing Council and gives the necessary instructions to national central banks.

The ECB and national central banks of the member states are independent in the performance of their tasks (TFEU, Art. 130). The ECB has its seat in Frankfurt.

## The Court of Auditors

The Court of Auditors is responsible for auditing EU institutions (TFEU, Art. 285). More specifically, the Court of Auditors:

- Examines the accounts of all revenue and expenditure of the EU institutions;
- Provides the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions;
- Examines whether all revenue has been received and all expenditure incurred in a lawful and regular manner and whether the financial management has been sound.

It consists of one national of each member state who must be completely independent in the performance of their duties, and act solely in the EU's general interest (TFEU, Art. 285). The members of the Court of Auditors are chosen from among persons who belong or have belonged in their respective States to external audit bodies or who are especially qualified for this office (TFEU, Art. 286). They are appointed for a term of six years. The Court of Auditors has its seat in Luxembourg.

## Other EU Institutions

### *European Economic and Social Committee and Committee of Regions*

The Economic and Social Committee and the Committee of Regions advise the European Parliament, the Council and the Commission.

The Economic and Social Committee consists of representatives of organisations of employers, employees, and other parties' representative of civil society, notably in socioeconomic, civic, professional and cultural areas (TFEU, Art. 300.3). The Committee of the Regions consists of representatives of regional and local bodies who either hold a regional or local authority electoral mandate or are politically accountable to an elected assembly (TFEU, Art. 300.4). The members of both committees are independent in the exercise of their functions. Both committees have their seat in Brussels.

### *European Investment Bank*

The task of the European Investment Bank (EIB) is to contribute to the balanced and steady development of the internal market in the interest of the EU. For this purpose the EIB, operating on a non-profitmaking basis, grants loans and gives guarantees which facilitate the financing of the following projects in all sectors of the economy:

- Projects for developing less-developed regions;
- Projects for modernising or converting undertakings or for developing fresh activities called for by the establishment or functioning of the internal market, where these projects are of such a size or nature that they cannot be entirely financed by the various means available in the individual member states;
- Projects of common interest to several member states which are of such a size or nature that they cannot be entirely financed by the various means available in the individual member states.

The members of the EIB are be the Member States. The EIB has its seat in Luxembourg.

## Concluding Observations

The institutional architecture of the EU reflects the attempt to bring together institutional concepts of international organizations and of a federal state. The European Council and the Council represent the political interests of the member states. The European Parliament provides the democratic element within the EU but falls short of the powers of a parliament in a state (Hartley, 2014). The Commission is the institutional component that independently promotes EU integration, but it must negotiate with the Council and the European Parliament to achieve this goal (Craig & de Burca, 2020). The Court of Justice of the EU, although a judicial body, has also continuously provided an interpretation of the EU Treaties that furthers European integration by strengthening the EU, increasing the effectiveness of EU law, especially in relation to national law, and enlarging the powers of the EU institutions (Hartley, 2016). While this has indeed promoted EU integration, it has also exposed the Court of Justice of the EU to criticism that it is acting outside its authorizations under the EU Treaties raising questions about the political acceptance of its judgments in member states (Official Journal of the European Union, 2016). In sum, the EU institutional architecture is a complex system that requires a thorough understanding of its structure and processes to understand and interact effectively with the EU.

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# Chapter Three

# Trade Policy and Trade Patterns of the European Union

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## Introduction

The European Union (EU) is often described as the largest and the most successful regional economic integration in the world. During more than 60 years of its existence the EU has developed into the community of 27[1] member countries deeply interconnected through different economic aspects of integration and cooperation. Among others, trade aspects have proved as an especially prominent feature of the integration process. The European integration has created a large and still growing network of institutional trade relations and export-import flows both inside and outside the Union which have provided for significant effects on the intensity and structure of the EU trade. Extensive research highlights the enormous growth of inter-, intra- and extra-regional trade of the EU, as well as its inter- and intra-industry trade. The gravitational force of such a large and dynamic market strongly attracts many countries and regions, especially the region of South-Eastern Europe (SEE) – the only European region which is still outside the EU but with the promise of future membership. Although SEE countries created their own regional integration in the meantime, trade relations with the EU remain the most important element of their foreign trade.

## Theoretical Considerations: Trade Effects of Regional Economic Integration

Regional economic integration is defined as a form of institutional interconnection among countries, on the reciprocity principle and through the liberalization of exchange and/or liberalization of the movement of production factors. It is a dynamic category – it can grow,

[1] After the withdrawal of the United Kingdom in January 2020.

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i.e. expand by including new members, and it can develop itself, i.e. deepen by including new aspects of integration,[2] whereby it assumes new forms. The common name for regional economic integration is Regional Trading Agreement (RTA). Although integration could include much more than trade aspect, its forms with primary focus on the liberalization of trade are prevalent among 164 members of the World Trade Organization (WTO),[3] justifying the use of the term RTA.

The most widely accepted classification of forms (or levels) of economic integration was developed by Bella Balassa as early as in the 1960s, and it comprises the following: free trade area, customs union, common market and economic union (Balassa, 1961, p. 2). Each higher degree of economic integration includes the characteristics of the previous one and adds new trade preferences and/or new aspects of integration.

Free trade area (FTA) is the lowest level of integration, which is characterized by the removal of tariff or non-tariff barriers to the trade in goods between the integration members, though preserving their own customs tariffs and trade regime toward third countries. The prerequisite for the preferential treatment within the integration is negotiating rules of origin of products. Customs union (CU) is the next level which, besides the liberalization of goods flows within the integration, also includes the common external customs tariff. Common market (CM) is an integration which is conventionally described as based on 'four freedoms' – freedom of the movement of goods, services, labour and capital. Economic union is the highest degree of economic integration, which implies the liberalization of the movement of goods, services and production factors, common foreign-trade policy, monetary union, and establishment of supranational institutions within the integration. Over its years-long development, the EU traversed the way from a free trade area (of the six founding states) as the lowest degree of economic integration, to the economic union as the highest degree.

Depending on the scope and depth, economic integration has different effects on the participants in integration (insiders), countries that remain outside the integration (outsiders), and the multilateral trading

[2] Aspects of economic integration can be trade or non-trade related (monetary, fiscal, etc.). The trade aspects which imply interconnection between countries through trade in goods, prevail in practice.

[3] See World Trade Organization RTA Database, http://rtais.wto.org/UI/publicsummarytable.aspx.

system. Potential effects of economic integrations are numerous and can be classified according to various criteria; thus, they are viewed as: positive or negative, economic (macroeconomic and microeconomic) or non-economic, and static or dynamic.

Static effects are considered as short term and pertain to goods flows; they measure the effect of integration on the trade between member-countries and effects on the trade with outsiders. Dynamic effects imply long-term structural changes, and emerge if an economic integration leads to the economy of scale, increased competition, attracting investment, faster technological changes and improved terms-of-trade (Balassa, 1961, pp. 101-190). However, static effects are more often the subject of empirical research, since they are easier to measure.

Static effects pertain to effects of creating and diverting trade, as they were named and explained by one of the pioneers of theory of customs union, Jacob Viner (1950, p. 46). Integration creates new trade flows between member-countries (trade creation effects), or 'diverts' trade flows away from the previous trading partners, who remain outside the integration, toward countries that are members of the integration (trade diversion effects).

Trade creation effect emerges when part of the local production is replaced by imports of cheaper products from more efficient partners in the integration. Some members begin to buy goods that were previously manufactured locally, from integration partners who manufacture these goods with lower production costs. Trade diversion effect emerges because some members replace imports of cheaper goods from outside the integration by more costly goods from integration partners, whereby part of the trade with third countries is diverted to trade between members. Trade diversion results in the increase of trade within the integration, redistribution of income from a third country to an integration partner, and loss of consumer surplus due to the substitution of cheaper goods from a third country with initially more costly goods from an integration partner.

Economic integration increases trade between members both through the trade creation effects (increase in trade resulting from relative efficiency) and through the trade diversion effect (increase in trade resulting from preferences).[4] Trade liberalization typically has a positive

[4] Baier and Bergstrand (2007, p. 74) established that the free trade area, on average, doubles the mutual trade of two member-countries after ten years.

effect on both imports and exports, though its effect on exports significantly depends on a member-country's potential – in the case of a less developed country, liberalization can lead to greater growth of imports than of exports, and to the deterioration of trade balance (Santos-Paolino & Thirlwall, 2010, p. 50).

Economic integration has a multiple effect on trade between members. It affects not only the intensity but the structure of trade flows amongst member countries as well. Trade structure refers to its geographical orientation and product specialization.

It is expected that the primary result of establishing the mutually preferential trade regime will include an increase of intra-regional trade – trade between members of regional integration. In the same time, it is also expected that the extra-regional trade – trade between regional integration members with the rest of the world, i.e. with countries outside the integration will also increase. A special case of such trade is the inter-regional trade that presents trade between regional integrations.[5]

From the viewpoint of trade specialization, it is expected that both inter-industry and intra-industry trade component will increase within the integration. Inter-industry trade is international trade in different products – exports and imports of the trading country consist of products of various industries. Inter-industry trade is mainly based on differences in the countries' factor endowment and can be explained to a significant degree by the principle of comparative advantages in the Heckscher-Ohlin trade model. On the other hand, intra-industry trade (IIT) is the kind of trade where products of the same classification are found both in the structure of exports and in the structure of imports of the trading countries. In simple terms, IIT is the international trade in the same industry products.

In literature, IIT is sometimes defined as two-way trade in products with the same or similar factor requirements (factor intensity) in production, which is exactly the opposite of the definition of inter-industry trade according to conventional theories' view. From the viewpoint of demand, ever since Linder (1961), IIT has been defined as a two-way trade in similar products, which means that these are close substitutes in demand. Probably the shortest, but relatively most comprehensive and most often used definition says that intra-industry trade

[5] The classification of trade types is based on Bjelić (2008, p. 9).

is a two-way trade in products related in demand and/or supply (Brkić, 2012).

Experiences of developed economic integrations in the world, such as the EU, point to the conclusion that economic integration, particularly if it implies integration of geographically close and similar economies (in terms of the structure of production and demand, as well as culture and language) leads to an increase of intra-industry rather than inter-industry trade. Research on integration effects, starting from studies of effects of the European Economic Community (EEC) in the 1960s and 1970s (Dreze, 1961; Balassa, 1966; Grubel and Lloyd, 1975)[6] to more recent studies[7] primarily focused on the correlation between economic integration and IIT, on the example of both the EU and other integrations, confirmed this view.

## Trade Policy of the European Union

Higher stages of economic integration include harmonized and/or common economic policies. Moving towards the highest integration level – economic union, the EU has established several common policies. One of the first among them was the trade policy which determines the Union's trade relations with third countries and in multilateral organizations such as the WTO.

The founding agreement of the former EEC – the Treaty of Rome of 1957 – provided for the establishment of the Community's common market. In this respect, Article 9 of the Treaty provided for the introduction of the common customs tariff. The Treaty also included provisions on the common trade policy (Article 13), thus defined its elements such as: equal principles in terms of the customs regime, concluding of customs and trade agreements, unification of liberalization measures, exports policy and measures of trade protection in the cases of dumping and subsidies. Maastricht Treaty of 1991 made minor amendments of the Treaty of Rome in terms of the EU trade policy.

6 According to the prevailing theoretical view related to the creation of economic integration, it was expected that inter-industry specialization and trade of the six Western European countries will increase. Quite accidentally and unexpectedly, an increase in intra-industry specialization was discovered.

7 We single out some of them here: Drabek and Greenaway (1984) for EEC and CMEA; Greenaway (1987) for EEC; Lundberg (1992) for EEC; Guell (1998) for Latin America; Rodas-Martini (1998) for CACM; Mardas and Nikas (2008) for EU and Balkans countries.

At present, the Union's common trade policy is mostly beyond control of the individual governments of member-countries: new trade measures are initiated by the European Commission (EC), and adopted by the EU Council by qualified majority or unanimously. The competence of the Commission was extended by the Treaty of Nice (2001) to trade in services, trade in intellectual property rights, and later to trade aspects of foreign direct investment. The EU shares competence with its members in the area of concluding the General Agreement of Trade in Services (GATS). There is joint jurisdiction over trade-related aspects of intellectual property rights (TRIPS).

The basic instruments of implementing the EU trade policy are the following: Common External Tariff (CET), Trade Defence Instruments (TDIS), i.e. antidumping, policy against subsidies or protective measures, and Trade Barriers Regulation (TBR). The main instrument of the EU foreign trade policy is the customs tariff, which is very liberal, especially in terms of customs duties on industrial products. More than 70% of goods are imported into the EU at a zero rate of duty or at reduced customs duties. The most common non-tariff barriers in the EU are: quotas (especially for certain types of meat, fish, sugar), export and import licenses for certain products ( for example, import licenses in the steel, textile and agricultural sectors), technical standards, specific conditions for the import of certain food products (hops, garlic, etc.) and others. Within the common export policies, so-called 'marketing' measures are of a special importance.

Within its trade policy, the EU also develops 'special relations' with third countries. The EU concludes preferential trade agreements and makes use of the allowed exemptions from the WTO most-favoured-nation (MFN) principle. One of characteristics of EU's foreign trade activities is the great number of international trade agreements – from only several in the 1970s, the number has increased to over a hundred.

Over the past decades, agreements with a trade component, concluded by the EU, have been developed into complex legal institutes, the scope of which has expanded to several economic areas. These agreements have become extremely diversified, due to the EU economic interests in individual regions. Although the process of concluding these agreements is long lasting and complex, many countries have concluded bilateral trade agreements with the EU since it is a market of strategic significance for their economies.

According to the sectoral scope, bilateral agreements with a trade part concluded by the EU can be general agreements that regulate most part of trade with a country, or sectoral agreements which pertain to trade in only one product or a group of products. According to the degree of preferences, general agreements can be non-preferential – these are agreements which regulate trade with third countries according to MFN principle, or preferential – agreements that provide a more favoured treatment than MFN.

The EU has preferential trade agreements in various forms with most members of the WTO – e.g., in 2009, out of the 148 WTO members of the time, the EU did not have such agreement with only nine of them, although it was exactly these nine that a third of the EU trade proceeded with (Brkić, 2021, p. 180). Zero tariff rates on industrial products could have the greatest impact in the EU trade with the most developed countries, such as the United States, Canada and Japan. However, the EU relatively recently concluded free trade agreements with some of them. The first free trade agreement between the EU and some countries from G7 group is the Comprehensive Economic and Trade Agreement (CETA) with Canada, signed on October 30, 2016. This agreement eliminates 98% of customs duties in mutual trade of signatories, while before CETA only 25% of the tariff lines were duty-free. CETA additionally deals with the issues of liberalization of trade in services, investment, production standards, professional certification, etc., which is considered to be advanced trade agreements. Negotiations with Japan began in 2013 and several years later (17 July 2018) the EU-Japan Economic Partnership Agreement was signed. It created the largest bilateral free trade area in the world, covering almost one third of the global GDP. Negotiations between the EU and the USA on the Transatlantic Trade and Investment Partnership (TTIP) began in July 2013, aimed at the removal of trade barriers in 20 sectors, including technical standards, services, investment and public procurement. However, negotiations have been suspended in the meantime.

Categories of preferential trade agreements between the EU and third countries are as follows (Brkić, 2021, p. 180):

- Agreements 'between the equals,' aimed at creating free trade areas with developed countries, such as agreements with the EFTA countries, agreement with Canada, agreement with Japan;
- Association agreements, which are aimed at the membership in the EU ( former European Agreements with the Central and East

European Countries and Turkey, and Stabilization and Association Agreements with the Western Balkans countries);
- Trade agreements with various regional integrations;
- Euro-Mediterranean cooperation agreements with Mediterranean countries;
- Agreements on cooperation and partnership with former Soviet republics;
- Agreements with former colonies – countries in Africa, Caribbean and Pacific (ACP) – asymmetric agreements which are to grow into free trade areas;
- Preferential agreements with underdeveloped countries based on the General System of Preferences (GSP).

A part of the EU GSP is the initiative 'Everything But Arms' (EBA) which was established in 2001. EBA enables full duty-free and quota-free access to the EU market, with the exception of arms and armaments, for 49 the world's least developed countries. The new generation of European agreements includes Stabilization and Association Agreements (SAA), which were specially created for the Western Balkans countries.

In the mid-1990s, the EU proclaimed the so-called 'regional approach' for the Southeast Europe, which implied multilateral rather than bilateral relations with countries of the region. At the same time it was accomplished by the EU principle of conditionality which was more bilateral in nature, as the EU set extra conditions for each of Western Balkans countries (besides proclaimed Copenhagen accession criteria of 1997). The new concept of the EU approach to the Western Balkans countries was launched in November 2000 as the so-called Stabilization and Association Process (SAP). It definitely confirmed the EU bilateral approach in relations with countries of the region.

The Stabilization and Association Agreement, resulting from the SAP, provide for the initial 'GSP plus' treatment, then the formation of the free trade area, with a prospect of the membership in the EU. Besides the free trade area, SAA includes the following elements: economic and financial aid, cooperation, political dialogue, adjustment of national legislation to the EU laws, cooperation in the areas of judiciary and internal affairs. Implementation of SAA should lead to the fulfillment of the accession criteria (Copenhagen criteria), which imply the political criteria, a functioning market economy, acceptance of the EU acquis communautaire, and administrative criterion.

## Trade Flows and Patterns of the European Union

Intra-EU trade is foreign trade that takes place between the EU members, i.e. internal trade of the EU as a whole. Extra-EU trade, by contrast, is foreign trade that takes place between the EU members and non-members.

### *Extra-EU Trade*

The EU is the world's largest 'trader' whose trade accounts for about 40% of world trade, if both intra-EU and extra-EU trade are taken into account, and about 15% if only extra-EU trade is taken into account (see Figure 3.1).

The value of international trade in goods of the EU with the rest of the world (sum of exports and imports outside the EU) was EUR 4,071 billion in 2019 (see Table 3.1). It was EUR 308 billion above the US level of trade and EUR 23 billion lower than the level of China's trade.

The EU exports grew faster than imports and consequently the trade

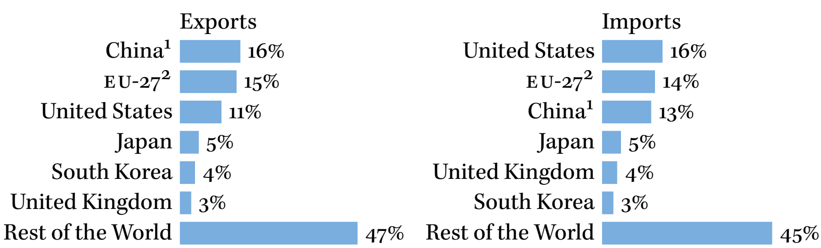


FIGURE 3.1 EU-27 Share in the World Exports and Imports of Goods (2019)

NOTES [1] Excluding Hong Kong. [2] External trade flows with extra-EU-27. Based on data from Eurostat (https://ec.europa.eu/eurostat/).

TABLE 3.1 Extra-EU-27 Trade (2009–2019)

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| (1) | 1,184 | 1,436 | 1,624 | 1,771 | 1,780 | 1,797 | 1,876 | 1,867 | 1,994 | 2,060 | 2,132 |
| (2) | 1,193 | 1,471 | 1,666 | 1,702 | 1,631 | 1,625 | 1,648 | 1,602 | 1,772 | 1,912 | 1,940 |
| (3) | 2,377 | 2,907 | 3,291 | 3,473 | 3,411 | 3,422 | 3,524 | 3,469 | 3,766 | 3,972 | 4,072 |
| (4) | -9 | -35 | -42 | 68 | 149 | 171 | 228 | 264 | 222 | 148 | 192 |

NOTES Row headings are as follows: (1) exports, (2) imports, (3) total trade, (4) balance. Based on data from Eurostat (https://ec.europa.eu/eurostat/). In billion EUR.

TABLE 3.2 EU-27 Trade Balance by Main Partners (2009–2019)

| Country | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| China | −140.3 | −129.4 | −117.9 | −104.2 | −111.4 | −150.4 | −145.5 | −144.0 | −154.7 | −164.7 |
| United States | 60.9 | 67.6 | 81.1 | 81.3 | 97.1 | 113.4 | 113.6 | 120.7 | 136.5 | 151.8 |
| United Kingdom | 60.8 | 61.8 | 80.2 | 89.9 | 109.0 | 131.7 | 135.5 | 129.0 | 123.3 | 125.5 |
| Switzerland | 21.1 | 29.5 | 36.9 | 31.2 | 27.2 | 27.7 | 29.1 | 32.8 | 32.8 | 36.7 |
| Russia | −73.1 | −89.3 | −85.7 | −84.2 | −75.6 | −59.9 | −44.7 | −55.5 | −78.6 | −57.3 |
| Turkey | 20.6 | 26.2 | 29.4 | 28.5 | 23.4 | 22 | 16.7 | 15.3 | 2.3 | −1.5 |

NOTES Based on data from Eurostat (https://ec.europa.eu/eurostat/). In billion EUR.

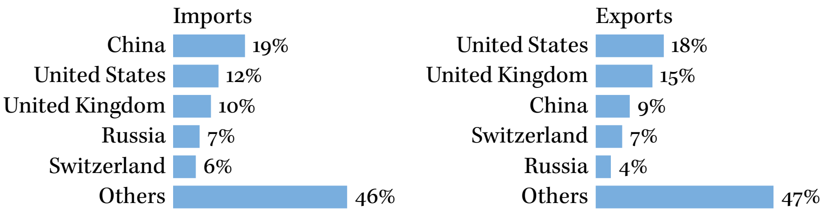


FIGURE 3.2 EU-27 Main Trading Partners (2009–2019)

NOTES Based on data from Eurostat (https://ec.europa.eu/eurostat/).

balance has been in surplus since 2012. In 2019, it amounted to EUR 197 billion. The EU has trade surplus with the United States, the United Kingdom and Switzerland while trade with Turkey was almost balanced. Trade deficit is prominent with China (due to imports of manufactured goods) and Russia (due to imports of energy products) (see Table 3.2).

Analyzing by regions, the main destination for EU-27 exports in 2019 were other European countries accounting for over one third of the total, followed by Asia (28%) and North America (25%). Analyzing by countries, the United States are the main export destination for the EU with the share of 18% in EU exports (2019). The share of China in EU exports is 9% now, but it has been rising for years and since 2002 it has been tripled (see Figure 3.2).

The EU main import partner is China. The share of China has been increasing for years – from 15% of total extra-EU imports in 2009 to 19% in 2019. Imports from the United States has been increasing since 2014 and it achieved 12% in 2019 (see Table 3.3).

The EU exports mainly manufactured products (83% of total EU exports); it mostly refers to machinery and vehicles (41%) and other manufactured goods (23%) (see Figure 3.3). Chemical products follow with 19% of share in the EU exports. Primary products – mostly food and

TABLE 3.3 Shares of Main Partners in EU-27 Imports of Goods (2010–2019)

| Country | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| China | 16.7 | 15.4 | 14.7 | 14.7 | 15.8 | 18.0 | 18.7 | 18.2 | 17.9 | 18.7 |
| United States | 9.7 | 9.3 | 9.8 | 10.1 | 10.4 | 12.0 | 12.2 | 11.5 | 11.2 | 12.0 |
| United Kingdom | 11.5 | 11.4 | 11.1 | 11.3 | 11.2 | 11.2 | 11.3 | 10.8 | 10.3 | 10.0 |
| Switzerland | 5.3 | 5.2 | 5.1 | 5.3 | 5.4 | 5.7 | 6.0 | 5.6 | 5.3 | 5.7 |
| Russia | 10.6 | 11.6 | 12.0 | 12.2 | 10.7 | 7.9 | 7.1 | 7.8 | 8.4 | 7.5 |
| Turkey | 2.6 | 2.6 | 2.5 | 2.7 | 2.9 | 3.2 | 3.5 | 3.5 | 3.5 | 3.6 |

NOTES Based on data from Eurostat (https://ec.europa.eu/eurostat/). In percent.

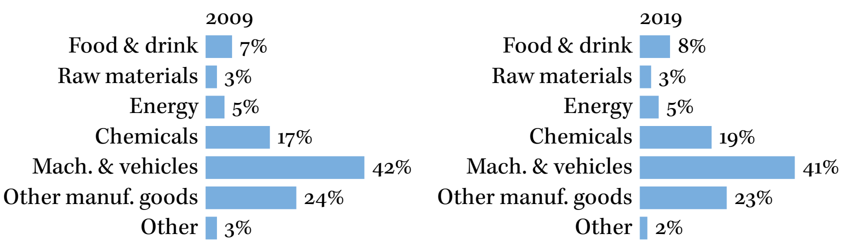


FIGURE 3.3 EU-27 Exports by Main Product Groups (2009–2019)

NOTES Based on data from Eurostat (https://ec.europa.eu/eurostat/).

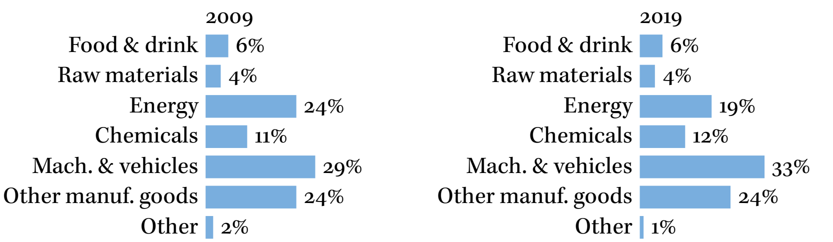


FIGURE 3.4 EU-27 Imports by Main Product Groups (2009–2019)

NOTES Based on data from Eurostat (https://ec.europa.eu/eurostat/).

drink, energy products and raw material, accounted for almost 16% of total exports.

The majority of EU imports are also manufactured goods (see Figure 3.4). Their share amounted 69% in 2019 and mostly referred to imports of machinery and vehicles (33%), and chemical products (12%) The share of energy in imports has significantly decreased in recent years – from 24% in 2009 to 19% in 2019.

The main exporter as well as importer in extra-EU trade is Germany with the share of 30% and 21% respectively. Germany is followed by France, Italy and the Netherlands (see Figure 3.5).

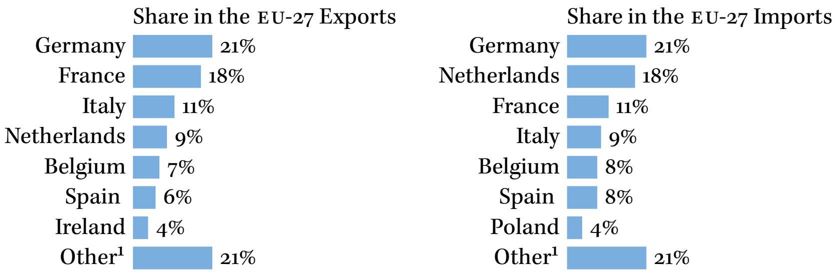


FIGURE 3.5 Extra-EU Trade by Member Countries (2009–2019)

NOTES [1] Other EU member states. Based on data from Eurostat (https://ec.europa.eu/eurostat/).

## *Intra-EU Trade*

For the EU, the intra-regional trade was and remains more important than the extra-EU trade: before the UK withdrew, 2/3 of the EU-28 exports were to other EU member states, and 90% of those exports actually referred only to the EU-15.[8] Table 3.4 illustrates the trends of the intra- and extra-regional trade for the EU-12 over a long period of almost four decades.

Intra-regional trade increased significantly. In the period 1980–1994, the share of intra-EU exports and intra-EU imports increased by about 6% each. However, one must take into account the fact that the EU experienced several enlargements over this period, drawing into its circle some Western European countries it had already extensively traded with. Extra-EU trade also increased, although its relative share in the world exports and imports decreased. However, the EU is still the largest subject of external trade in the world.

Both intra- and extra-EU exports continue to grow, except for a sharp decline during the global crisis of 2008–2009. For example, between January 2002 and January 2020 intra-EU exports of goods increased from EUR 120.8 billion to EUR 256.3 billion (see Figure 3.6).

In 2019, most EU members had a share of intra-EU exports between 50% and 75%. It was above 75% for several countries such as Hungary (78%), Czech Republic (79%), Luxembourg (80%), and Slovakia (80%). The fact that only two member countries – Ireland and Cyprus – have

[8] Until 31 December 1994, the EU had 12 Member States (EU-12): Belgium, Denmark, Germany, Ireland, Greece, Spain, France, Italy, Luxembourg, the Netherlands, Portugal and the United Kingdom. In January 1995, Austria, Finland and Sweden also joined the EU, making it EU-15.

TABLE 3.4 Intra-EU and Extra-EU Trade (1960–1994)

| Item | Description | 1960 | 1970 | 1980 | 1990 | 1994 |
|---|---|---|---|---|---|---|
| Export EU-12* | Intra-EU exports | 13.8 | 19.7 | 19.3 | 24.4 | 24.7 |
| | Extra-EU exports | 19.9 | 17.3 | 15.1 | 15.6 | 15.1 |
| Import EU-12** | Intra-EU imports | 13.1 | 19.9 | 18.6 | 23.7 | 24.5 |
| | Extra-EU imports | 21.5 | 18.8 | 19.1 | 16.5 | 14.4 |

NOTES Adapted from Dent (1997, p. 169). * Percentage of the world exports. ** Percentage of the world imports.

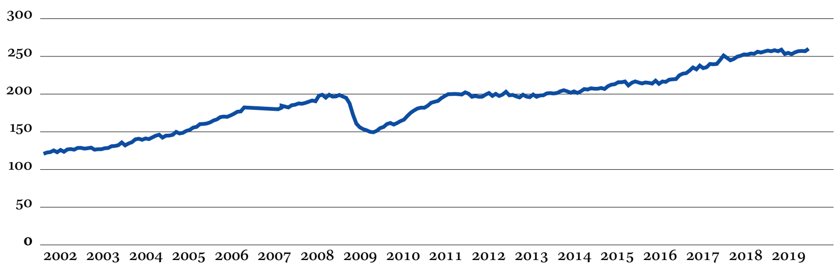


FIGURE 3.6 Intra-EU Exports of Goods (2002–2019)

NOTES In million EUR. Based on data from Eurostat (https://ec.europa.eu/eurostat/).

higher extra-EU exports than intra-EU exports (37% and 41% respectively) points out to importance of the EU internal market for the members. There is a wide interval in the value of exports of goods by members to their partners within the EU – from EUR 698.8 billion for Germany to EUR 1.3 billion for Cyprus.[9]

For 21 EU members the top three partners account for over 50% of exports within the EU, for a further five it accounts between 40 and 50%. Only in Germany is this share below 40% (38.2%). Germany appeared most often (25 times) as a 'top three' partner, France 11 times, and Italy 10 times.[10]

Nine EU members (Bulgaria, Greece, Spain, Croatia, Cyprus, Luxembourg, Malta, Portugal, Romania) have a trade deficit in both intra- and extra-EU trade, while three members (Germany, Ireland, Italy) have a trade surplus in both types of trade. There are seven members (Belgium, the Czech Republic, Hungary, the Netherlands, Poland, Slovenia,

[9] See https://ec.europa.eu/eurostat/statistics-explained/index.php?oldid=420293.
[10] See https://ec.europa.eu/eurostat/statistics-explained/index.php?oldid=420293.

Slovakia) with a deficit in intra-EU trade, but with a surplus in extra-EU trade. Eight members (Denmark, Estonia, France, Latvia, Lithuania, Austria, Finland, Sweden) have a surplus in intra-EU trade, but a deficit in extra-EU trade.

Trade specialization analysis shows that four fifths of total exports of goods within the EU in 2019 were manufactured products. In 2019, international trade in manufactured goods was more than four times as high as trade in primary goods in the EU as a whole, but for all member countries, the share of manufactured goods was significantly higher than the share of primary goods.[11] Machinery and vehicles have been in the first place for years, followed by other manufactured goods and chemicals.

### *Trade between the European Union and the Western Balkans*

Although the intra-regional trade was first spurred by bilateral free trade agreements concluded within the Stability Pact for South Eastern Europe and, later on, by the Central European Free Trade Agreement (CEFTA), the EU is still the leading foreign-trade partner of the Western Balkans countries. In 2008, the share of the EU in exports of every country formed after the breakup of former Yugoslavia ranged between 55 and 65%, while for Albania it amounted to almost 80%. Some ten years later, the export share of the EU increased significantly in other countries of the region as well (by 8 to 17 percentage points), except in Montenegro (see Table 3.5).

The significance of the EU for the trade of Bosnia and Herzegovina and other Western Balkans countries continues to grow with every new EU enlargement. The EU single market is now the largest market in the world. It is obvious that remaining an outsider to this expanding market, which presently includes a population of 513.5 million[12] and has the nominal GDP of over EUR 16,447 billion,[13] i.e. 23% of the world GDP (2019) can only lead to retardation of development.

For all the Western Balkans countries, the EU is a market of strategic importance and the leading trade partner, with a 72% share in the total regional trade. Trade between the EU and the region more than dou-

[11] https://ec.europa.eu/eurostat/statistics-explained/index.php?oldid=420293.

[12] See https://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=demo_pjan&lang=en.

[13] See https://ec.europa.eu/eurostat/databrowser/view/tec00001/default/table?lang=en.

TABLE 3.5 The EU Share in Foreign Trade of The Western Balkans (2008, 2018)

| National economy | Exports to EU (%) | | Imports from EU (%) | |
|---|---|---|---|---|
| | 2008 (EU-15) | 2018 (EU-28) | 2008 (EU-15) | 2018 (EU-28) |
| Albania | 79.7 | 76.3 | 60.7 | 60.9 |
| Bosnia and Herzegovina | 55.0 | 71.0 | 48.0 | 61.0 |
| Croatia | 60.9 | 68.6 | 64.1 | 78.0 |
| Kosovo | n/a | 36.1** | n/a | 50.0** |
| Montenegro | 55.9* | 44.0 | 37.71 | 48.2 |
| North Macedonia | 65.1 | 82.1 | 49.5 | 62.4 |
| Serbia | 54.3 | 67.0 | 53.3 | 60.4 |

NOTES Adapted from the World Trade Organization (2009, 2019). * The data pertain to 2010 (World Trade Organization, 2011). Data for previous years are not available from the same source for Montenegro and the other economies. ** Data for Kosovo pertain to 2019 (European Union, 2021a).

bled since 2006, exceeding the amount of EUR 54 billion in 2018. This trade expansion has generally been in favour of the Western Balkans countries – over the past ten years, the region increased its exports to the EU by 130%, while the EU exports to the region increased moderately, by 49%.

On the other hand, the Western Balkans region has never been of a great economic significance for the EU. The region is comprised of smaller, economically insufficiently strong economies, with the total GDP of about USD 112 billion and the average GDP per capita of USD 6,315 billion in 2018.[14] With respect to the mutual trade, the Western Balkans accounted only for a fifth of the total trade between the EU and CEE countries before their accession to the EU. Although the region's share in extra-EU trade is gradually increasing, it amounted only to 1.4% in 2019 – more accurately to 1.2% in the Union's imports and 1.5% in its exports (European Union, 2021b).The future will show if further trade liberalization within the framework of the SAA will contribute to development of the Western Balkans countries' trade with the EU and to an increase in economic importance of the region for this large integration.

14 See The World Bank data for 2018 for GDP (https://data.worldbank.org/indicator/NY.GDP.MKTP.CD) and for GDP per capita (https://data.worldbank.org/indicator/NY.GDP.PCAP.CD).

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Chapter Four

# The Medium-Term Financial Framework and Annual Budget of the European Union

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## Introduction

The process of European integration requires financial resources for its activities and public finances at the EU level; these are implemented through multi-annual financial frameworks and annual budgets, tools through which money is collected and allocated for EU policies and objectives as well as for the tasks transferred to it from the national level. The system of public finances at the EU level as known today is a result of numerous changes and adjustments that have occurred over the last more than sixty years of EC/EU history.

The overall objective of this Chapter[1] is to present the main features of public finances at the EU level. More specifically, the Chapter discusses three topics in the following sections. The first section presents the concept of the budgetary system, its evolution over the decades and its main features. In the second section selected methodological issues associated with financial flows between the EU budget and individual EU member state are outlined. Finally, the third section provides an overview of the recently agreed EU budget characteristics for the 2021–2027 period.

## Concept, Evolution and Main Features of the EU Budgetary System

### *Small Size of the EU Budget*

The EU budget is modest in size. As agreed by the member states, in the Own Resources Decision (ORD), the maximum ceiling of the EU

[1] This Chapter is largely based on Mrak (2011) and Mrak and Rant (2018, 2020).

 G. Qorraj & I. Hashi (Eds.), *European Union and the Western Balkans.*
ToKnowPress · 2020 · https://www.toknowpress.net/ISBN/978-83-65020-33-8/69-82.pdf

budget financing was for decades set at 1.24 per cent of the EU GNI. In practice, however, the EU budget has always remained well below that ceiling and amounted to around 1.00 per cent of GNI. As public finances of the EU member states are typically between 40 to 45 per cent of their respective GNI, EU budget is equivalent to just over 2 per cent of the total public finances of the member states. The EU budget does not represent a significant factor in almost any consolidated national public finance category. Three key segments of public finance expenditures in practically any country, i.e., defense, security and public order expenditure, as well as healthcare are not even included in the EU budget while the presence of certain other expenditure items, such as education and housing, is minimal. There is another fundamental characteristic which distinguishes the EU budget from national public finances. In contrast to national public finances which can run deficits, the EU budget is legally required to be in balance each year.

### *Evolution of the EU Budgetary System*

The evolution of the EU budgetary system can be roughly classified into two periods: the first between 1951 and 1987 was characterised by a move towards the unification of budgetary instruments and the crisis of Community finances in the 1980s; the second from 1988 to 2020 has been characterised by features of 1988 EU budgetary reform; and the third one, since 2021 characterised by the recent response at the EU level to the COVID-19 health crisis.

*1951–1987 Period.* The public finance system of the EC began to develop in early 1950s, when in 1951 the European Coal and Steel Community (ECSC) Treaty was signed. It was followed by the 1957 European Atomic Energy Community (EURATOM) and European Economic Community (EEC) treaties. Each of these treaties envisaged different budgets for a particular Community which led to the co-existence of budgets. The 1965 Merger Treaty incorporated the ECSC and EURATOM administrative budgets into the EEC budget, and five years later, in 1970, the Luxembourg Treaty incorporated the EURATOM research and investment budget into the general budget.

During the first 20 years of the Community's financial system, there were two important developments, to the integration of budgetary instruments.

- The first was the development of common policies. The most notable events with considerable financial consequences were probably the creation of the instrument for implementation of the common agricultural policy (CAP) as well as the establishment of two funds for implementation of the cohesion policy These two policies still constitute about 80 per cent of current EU budget expenditures.

- The second development was that the initial system of contributions through which the budgets of all the three Communities were financed by the member states soon proved to be insufficient and unsatisfactory. The need for a better and more efficient system, which would provide sufficient resources, gradually, led to a reform of budget financing. Through the 1970 Luxembourg Treaty, a system of so-called own resources was introduced.

The processes of unification of the budgetary instruments, development of common policies and progress towards financial autonomy were inevitably connected with hard negotiations. The legal, political and institutional structure for governing Community's finance established in early 1970s soon proved to be unsustainable over a longer period of time. Relations both among member states, as well as among the European institutions involved in budgetary adoption procedure, gradually worsened and finally turned into an open conflict. Between 1980 and 1988, the approval of several annual budgets of EU was delayed long enough so that provisional arrangements in the form of so-called 'twelfths' had to be applied for several months.

*1988–2020 Period.* Following the EC enlargement with Spain and Portugal in the 1980s, the conclusion of the Single Economic Community and taking into account the above-mentioned annual budget negotiations problems, the EC embarked on a major reform of its budgetary system that has, by and large, remained unchanged since then. This system consists of two components:

- *Multi-annual financial framework.* The strategic course of the EU public finances is determined in a multi-annual financial framework (MFF). The MFF is basically an agreement among the institutions on budgetary priorities facilitating the budgetary procedure and the management of various programmes. Within the framework of the MFF, the maximum volume and the composition of the main EU budget expenditure items called 'headings' are capped. The MFF is a product of an inter-institutional agreement between the Commission, Council and Parliament. Until now, Community/EU institutions have adopted five MFFS. The first one had duration of 5 years (1988–1992) while all the other four covered a 7-year period (1993–1999, 2000–2006, 2007–2013 and 2014–2020).

- *Annual budget.* Implementation and operational details of the EU budgetary system are elaborated in the annual budget that must be consistent with the MFF.

*2021–2027 Period.* In this period, the EU budgetary system, which consists of the 'core' MFF and an entirely new instrument, will be not only substantially larger than ever before, but it will also provide, for the first time, a framework for the EU itself to borrow and to perform a role of a common counter-cyclical instrument (European Commission, 2018a).

### *Procedures for MFF and Annual Budget Adoption*

*Multi-Annual Financial Framework.* The limits for the annual budget are set by the MFF on the expenditure side and by the Own Resources Decision (ORD) on the revenue side with both of them required to be adopted with unanimously in the Council. This prerequisite of unanimity is one of the main reasons why MFF negotiations usually turn into one of the most complex negotiations among the EU member states, even at the European Council level where political clearance has to be achieved. In contrast to the period prior to the Lisbon Treaty when the importance of the Parliament in the MFF decision-making process was rather symbolic, with this Treaty its role has strengthened significantly as the Parliament has to formally adopt the agreement reached by the European Council.

*Annual Budget.* The procedures are comparable in many respects to the procedures at the national level. The EU budgetary procedure consists of two main phases. Preparation of the budget for the year $N$ starts with the *proposal of the Commission* submitted by the end-April of the year $n - 1$. In the second phase, *Council and Parliament discuss the proposal and adopt the budget* with the required majority by the end-December of the year $n - 1$.

### *EU Budget Expenditure*

In the early decades of the Community, CAP absolutely dominated EU budget expenditure. More recently, due to several enlargements of the

TABLE 4.1 The 'Three Large Expenditure Headings' in MFFS 2007–2013 and 2014–2020

| Heading | 2007–2013 | 2014–2020 |
|---|---|---|
| 'Large expenditure heading' | 87 | 86 |
| Competitiveness | 9 | 13 |
| Cohesion policy | 36 | 34 |
| Common agricultural policy | 42 | 39 |
| Others | 13 | 14 |
| Total | 100 | 100 |
| Total (in million EUR)* | 983,731 | 959,988 |

NOTES Percentage of total. * 'Commitment appropriations,' 2011 prices.

Community/EU and through the introduction of multi-annual financial framework instrument, CAP expenditures have been capped and allowed funding for some other items, especially for the cohesion policy expenditures. During the last three multi-annual financial frameworks, approximately 75 per cent of all EU budget funds has been earmarked for these two policies and another 10 per cent for boosting competitiveness. In addition to these three 'large expenditure headings,' the rest of the budget has been allocated for external EU activities and internal policies as well as for administration purposes. Table 4.1 confirms a strong dominance of the three 'large expenditure headings' in the overall EU budget expenditure structure in the two most recent multi-annual financial frameworks, i.e., in the previous multi-annual financial framework covering 2007–2013 period and the existing one covering the 2014–2020 period.

### *EU Budget Revenues and Correction Mechanisms*

The revenue side of the EU budget has been driven by the continuous attempt to strike a compromise between the financial autonomy of the EU budget and sufficiency of resources for its financing. The budget of the ECSC in the early 1950s was financed through a tax-based 'own' resource (a levy on steel production) while, in contrast, the Rome Treaty stipulated that the EEC budget was financed in a totally intergovernmental way, i.e., through direct contributions from member states. At that time, the EEC budget had no 'own resources' and thus had no financial autonomy from its member states.

It was in 1970 with the Luxembourg Treaty that the EEC budget started to move towards an own resources model. At that time, own resources included traditional own resources, i.e., customs duties and agricultural levies, and VAT-based revenues from member states. This structure remained unchanged till 1984 when the Fontainebleau Council introduced the UK correction which in fact means a reduction of the UK contribution to the Community budget.

The last major change to the EU budget revenue side occurred in 1988 within the framework of the 1988–1992 MFF which introduced the fourth resource, known today as the GNP/GNI resource. Since then and thus also in the multi-annual financial framework 2014–2020, the EU budget revenue has been made up of four major resources (European Commission, 2011):

- *Traditional own-resources* include customs duties and agriculture levies, and in recent years. In recent year, it has contributed less than 15 per cent to total EU budget needs.
- *VAT-based resource.* Funds levied on the basis of value-added tax defined on the basis of a statistically adjusted VAT base of the member states. In recent years, it has contributed around 10 per cent to the EU budget needs.
- *GNI-based resource.* Funds levied on the basis of the GNI of the member states, i.e. funds earmarked for balancing the EU budget measured in proportion with the GNI of every member state. In recent years, this funding source has participated with around 75 per cent in total funding needs of the EU budget.
- *The UK correction,* as formally the fourth EU budget own resource, but in substance terms a zero sum mechanism.

An integral part of the own resources system is formally also the 'UK correction' as well as a set of 'corrections on this correction.' Introduction of this instrument dates back into early 1970s when the UK joined the EEC. At that time the UK was among the poorest member states but due to the EU budget expenditure bias toward the CAP the country had a negative net financial balance towards the EU budget. As this was considered unfair by the UK authorities and after intense negotiations with other member states the issue was resolved at the 1984 Fontainebleau European Council through the so-called 'UK correction' arrangement whereby UK became entitled to a refund financed by all other member states. The economic logic of the arrangement was that the UK position vis-à-vis EU budget was excessively negative in relation to its level of development, and that the country is eligible for a rebate on its contribution to the EU budget.

Even though the UK position in terms of its economic development has improved substantially since 1984 eliminating, or at least reducing substantially, the justification for the 'UK correction,' the system remains in place with only minor changes. This can be explained by the fact that the 'UK correction' is an integral part of the ORD for the change of which unanimity is required. The correction mechanism system in place in the multi-annual financial framework 2014–2020 contains in addition to the 'UK correction' and corrections to other four large net payers to the EU budget whereby Germany, Austria, Netherlands and Sweden pay only a part of their normal 'UK correction' funding share also several other 'corrections on corrections' (Mrak & Rant, 2018).

### *Key Systemic Weaknesses of the EU Budgetary System*

The EU budget is one of the most problematic areas of economic management within the EU. At the same time, it is also an area that is extremely resistant to any serious change. Although there have been dramatic changes to the EU itself and its environment in the last 30 years, the EU budget has changed little since its last major transformation in 1988 (Mrak, 2011).

From 1988 until now the EU budget has remained practically unchanged in terms of size and is still at a level of approximately 1% of EU GDP/GNI. Within the budget's structure, CAP and cohesion policy expenditures are still prevalent with a combined share of around 75 per cent of the total. The EU budget is, therefore, strongly dominated by a small number of highly redistributive policies while policies that are broadly recognized as EU wide public goods are poorly represented. Not much has changed on the revenue side of the budget as well as transfers from national budgets still represent by far the most important funding source of the EU budget.

Domination of national contributions on the revenue side of the EU associated with highly distributive character of its main two spending categories – allocation of funds for both CAP and cohesion policy based on the 'country envelope principle' – have resulted in a system where at least the recent three multi-annual financial framework negotiations (for the 2000–2006, 2007–2013 and 2014–2020 periods) were overburdened with very straightforward attempts by individual member states to bring back home as much money from the EU budget as possible. This 'juste retour' logic or obsession with net national financial positions has de-facto poisoned the overall EU budgetary debate. Experiences of these negotiations have confirmed a mentality whereby achieving an acceptable net financial position has de-facto become a more important negotiations objective than agreeing about the size and structure of those spending with a high European value added.

In addition to its strong pro 'status quo' bias, the EU budget has become over the recent decades also less and less transparent due to the dominance of net financial position logic in the multi-annual financial framework negotiations. There have been several attempts to address the net financial problem and the highly complex and non-transparent system of EU budget corrections but with no success until now.

## Selected Methodological Issues Associated with Financial Flows Between the EU Budget and an EU Member State

### *'Commitment Appropriations,' 'Payment Appropriations' and 'Actual Payments'*

Within the process of using the funds from the EU budget one has to make a clear distinction between so-called 'commitment appropriations' and 'payment appropriations.' The first one represents the legal basis for the use of EU budget funds while the second one refers to planned withdrawals of funds from the EU budget in a particular year.

While 'commitment appropriations' as well as 'payment appropriations' are planning or *ex-ante* categories, 'actual payments' is a category of actual disbursement of funds from the EU budget. 'Actual payments' is, thus, a category which establishes *ex-post* what proportion of 'payment appropriations,' i.e., of planned disbursement, has the country actually absorbed. Higher the absorption capacity of a country smaller the difference between the 'payment appropriations' and the 'actual payments.'

### *Absorption Capacity*

Within the context of the EU's public finances, absorption capacity is defined as the extent to which a state (member or non-member) is able to spend the allocated financial resources fully and in an effective and efficient way. With the experiences gathered over time, the European Commission has arrived at the conclusion that states have a limited capacity to absorb external investment support effectively and efficiently.

Generally speaking, the absorption capacity of an EU member state for the use of EU budget funds has three features. Macro-economic absorption capacity refers to the overall ability of the economy to generate viable investment opportunities that could be financed by external investment support. Since this ability depends on the overall level of development of the economy, it is defined and measured as percentage of GDP. Financial absorption capacity is defined as the ability of an EU member state to provide national co-financing of the EU supported programs and projects. And finally administrative absorption capacity is defined as the ability of authorities in member states to prepare suitable plans and to put in place structure that are necessary manage EU funds effectively and efficiently (Mrak et al., 2015).

### *'Net Financial Balance'*

'Net financial balance' of an EU member state *vis-à-vis* the EU budget is a difference between the volume of EU budget funds the state receives from the EU budget and the volume of funds it pays into the EU budget the national budget. Although the basic logic of the 'net financial balance' is conceptually straight forward, it is associated with several problems at a more operational level. They are a consequence of the fact that one has to clearly differentiate between the following two 'net financial balance' concepts.

- *Calculated net financial balance.* This is a difference between 'commitment appropriations,' which an EU member state will, according to plans, receive from the EU budget in a particular year and the planned contribution of that very state to the EU budget for the same year. The 'calculated net financial position' is, thus, a planning category which is known for every EU member state immediately upon completion of the medium-term financial negotiations.
- *Actual net financial balance.* This is a difference between 'actual payments' which an EU member state receives from EU budget in a particular year and the actual contribution of the same member state into the EU budget. The 'actual net financial balance' is, thus, an ex-post category which can be calculated only after the end of the year/period for which it is calculated. The difference between the 'calculated net financial balance' and the 'actual net financial balance' of an EU member state depends on its absorp-

tion capacity. The higher it is the lower the difference between the two. In case that an EU member state would have a 100 per cent absorption capacity then its 'actual net financial balance' would be equal to its 'calculated' one.

## Towards an EU Budgetary Arrangement for the 2021–2027 Period

### *May 2018 Proposal of the Junker's European Commission for the MMF 2021–2027 Not Adjusted to the Needs in Early 2020*

In May 2018, Juncker's European Commission proposed a MFF for the period 2021–2027. The proposal was prepared for a 27-member EU following Brexit and in an environment of intensified international as well as internal challenges for the EU. This in practice means that the proposal worth EUR 1,135 billion was slightly bigger compared to EU-27 spending in 2014–2020 (see Table 4.2). As far as the structure is concerned, the European Commission proposed a re-balancing of spending priorities, reducing the relative weight of the Common Agricultural Policy and Cohesion policy in the budget and increasing spending on new priorities, especially on internal and external security and migration policies.

It was originally planned that the European Council agreement on the MFF 2021–2027 should be reached until the end-2018 and the agreement with the European Parliament before the May 2019 European elections. But the negotiations were *de-facto* postponed until the end of 2019 when the big transition at the helm of the main EU institutions – with newly elected European Parliament, new president of the European Council and the new European Commission, was completed (European Parliament, 2018).

Until March 2020, the MFF 2021–2027 negotiations had followed the path largely predetermined by the Commission's May 2018 proposal. COVID-19 crisis, however, gave a new impetus to the on-going negotiations, opening up the possibility for the new Commission to make innovative proposals to further develop the EU budget. In March 2020, the European Parliament asked the Commission to reformulate and adjust its spending priorities to the new priorities, especially to European Green Deal and digitalisation, and to submit a new MFF proposal. Moreover, in April 2020, the European Council instructed the European Commission to design an entirely new recovery fund that would be in terms of size and its characteristics appropriate to deal with the depth of the COVID-19 crisis. The Commission was also specifically instructed to articulate the relation of this fund with the MFF, making the fund a part of the overall MFF package to be negotiated. Soon after, Germany and France came out with a joint proposal advocating the establishment of a fund of EUR 500 billion to be financed by joint borrowing of the member states that would importantly hand out money to member states in the form of grants.

This political backing was instrumental for the European Commission to design an entirely new financial package for the 2021–2027 period (European Commission, 2018b). With this unexpected turn of events, the European Commission got an excellent opportunity to redraft the MFF together with the recovery fund and realign it to support the European Green Deal objectives with more appropriate funding from the EU level.

### *May 2020 Proposal of von der Leyen's European Commission for the 2021–2027 EU Budgetary System*

In May 2020, the European Commission presented its new financial proposal for the forthcoming medium-term period. The proposal consisted of two components (see Table 4.2).

- *MFF.* A revised 2021–2027 MFF with 'commitment appropriations' of EUR 1,100 billion, a slight decrease against the May 2018 proposal.
- *Next Generation EU.* However, in addition to the 'core' MFF and as part of the EU budget, there was an entirely new component, a EUR 750 billion recovery instrument called the 'Next Generation EU.' The instrument would be debt-financed and the financial support would be partly allocated through grants (EUR 500 billion) and partly through repayable loans (EUR 250 billion). Spending should be aligned with the EU policy goals, in particular with green and digital transitions. It was supposed to focus on the first years of recovery, rather than becoming permanent. Repayment of the debt would not begin before 2028.

### *The December 2020 Final Agreement*

In July 2020 EU leaders agreed on both financial instruments proposed by the European Commission after long and difficult negotiations. The MFF is worth EUR 1,074 billion for the 2021–2027 period and is slightly lower than that proposed by the Commission. The 'Next Generation EU'

TABLE 4.2 EU Budgetary Arrangement for the 2021–2027 Period

| Headings | (1) | (2) | (3) | | | (4) | | |
|---|---|---|---|---|---|---|---|---|
| | MFF | MFF | MFF | NGEU | Total | MFF | NGEU | Total |
| 1. Single market, innovation & digital | 116 | 166 | 141 | 70 | 210 | 133 | 11 | 143 |
| Horizon Europe | 67 | 87 | 81 | 14 | 94 | 76 | 5 | 81 |
| 2. Cohesion, resilience and values | 387 | 392 | 379 | 610 | 989 | 378 | 722 | 1.100 |
| Cohesion policy | 369 | 332 | 323 | – | 323 | 330 | – | 330 |
| Recovery & resilience instrument | – | – | – | 560 | 560 | – | 673 | 673 |
| Grants | – | – | – | 310 | 310 | – | 313 | 313 |
| Loans | – | – | – | 250 | 250 | – | 360 | 360 |
| REACT EU | – | – | – | 50 | 50 | – | 48 | 48 |
| 3. Natural resources and environment | 400 | 337 | 357 | 45 | 402 | 356 | 18 | 374 |
| Common agricultural policy | 383 | 324 | 333 | 15 | 348 | 336 | 8 | 344 |
| Just transition fund | – | – | 10 | 30 | 40 | 8 | 10 | 18 |
| 4. Migration and border management | 10 | 31 | 31 | 0 | 31 | 23 | 0 | 23 |
| 5. (Resilience), security and defence | 2 | 24 | 15 | 10 | 25 | 13 | 0 | 13 |
| 6. Neighbourhood and the1world | 96 | 109 | 103 | 15 | 118 | 98 | 0 | 98 |
| 7. European public administration | 71 | 76 | 75 | 0 | 75 | 73 | 0 | 73 |
| Total | 1,082 | 1,135 | 1,100 | 750 | 1,850 | 1,074 | 750 | 1,824 |

NOTES Column headings are as follows: (1) 2014–2020 (EU-27), (2) Commission proposal, May 2018, (3) Commission proposal, May 2020, (4) European Council agreement, July 2020.

(NGEU) remained at the proposed EUR 750 billion level for 2021–2024 though with a structure that under the pressure of the so-called 'frugal four' countries – the Netherlands, Sweden, Austria, and Denmark – changed towards a higher proportion of loans. Their total volume increased to EUR 360 billion, which means that the grant segment was reduced to EUR 390 billion, in view of the 'frugal four' below the psychological EUR 400 billion limit.

Table 4.2 provides an overview of how the EU financial package 2021-2027 was developed from the Commission's first proposal of May 2018, reflecting the pre-COVID-19 situation, to its second proposal of May 2020 and to the July 2020 agreement at the European Council level. The budget now incorporates the European Green Deal and digitalization development priority as well as the new reality caused by the COVID-19 (Mrak & Rant, 2020).

After tense negotiations between the Council and Parliament in autumn 2020, the EU financial package for the period 2021–2027 was finally approved in December of that year (EU budget for 2021). The package is, indeed, very different from its predecessors and represents the most substantial conceptual change of the EU budget since the introduction of the MFF instrument in the late 1980s. The EU budget will be in the forthcoming years not only significantly larger than in the past but it will also provide, for the first time in history, an institutional framework for the EU to borrow in order to fund grants on such a large scale. Further on, the package, especially its European recovery facility component, is the first EU's common counter-cyclical instrument and is not associated with austerity provisions. On the contrary, it is targeted to fight the COVID-19 crisis and to finance growth-enhancing investment opportunities complemented with structural reforms.

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# Chapter Five

# EU Financial Assistance for the Western Balkans

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## Introduction

This Chapter analyses the EU financial assistance for the Western Balkans, in particular the Republic of Kosovo, from the late 1990s to the current period. After the initial range of actions to support the progress of reforms in these countries, the EU embarked on the main support actions in the form of three Instrument of Pre-Accession (IPA): IPA I, 2007–2013; IPA II, 2014–2020; and IPA III, 2021–2027. After an initial discussion of the support programmes before 2007, these instruments, their objectives, programmes, results and lessons will be discussed in details in the following sections of the Chapter. While the discussion covers all six Western Balkan countries, the support for Kosovo will be given special attention.

## The EU Financial Assistance in Support of Reforms by WB Counties: Background

It is interesting to remind the readers that the first declaration on the relations between the Socialist Federal Republic of Yugoslavia (SFRY) and the European Economic Community (EEC) was signed in Brussels back in 1967. After the first two trade agreements (1970 and 1973), within the third comprehensive cooperation agreement (1980), the Financial cooperation protocol was added, which included the possibility of withdrawing the EIB loan for the trans-Yugoslav highway. In December 1990, Yugoslavia also joined the PHARE program.[1] The third financial protocol on financial assistance was concluded in 1991, but

[1] Poland and Hungary Assistance for Reconstruiction of Economies establisehd in 1989 as the financial support mechanism for the transition economies of Central and Eastern Europe.


G. Qorraj & I. Hashi (Eds.), *European Union and the Western Balkans.* ToKnowPress · 2020 · https://www.toknowpress.net/ISBN/978-83-65020-33-8/83-105.pdf

TABLE 5.1 The EU Financial Assistance to Kosovo 1998–2006

| 1998–2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | Total |
|---|---|---|---|---|---|---|---|
| 552.0 | 144.5 | 163.0 | 62.0 | 73.0 | 77.0 | 51.2 | 1,123.0 |

NOTES Million EUR. Adapted from European Agency for Reconstruction (2008).

its ratification process was never completed, so it did not enter into force, as the SFRY was dissolved and the conflict in Yugoslavia began (Zacharia, 2016). After EC economic sanctions in December 1991 and UN sanctions in May 1992, the all support programmes were blocked until 1995. A different forms of financial assistance started gradually from 1996.

As of 2007, the Instrument for Pre-accession Assistance (IPA) replaced previous EU programmes, including CARDS. The CARDS programme (Community Assistance for Reconstruction, Development and Stabilisation) was the EU's main instrument of financial assistance in the period 2000–2006 to the Western Balkans, covering specifically Croatia, Bosnia and Herzegovina, Serbia, Montenegro, North Macedonia, Kosovo and Albania. It was created in 2000 by Council Regulation 2666/2000. However it was only in 2001 that the programme became operative under its own regulations, as in the first period it supported projects previously funded by the PHARE and OBNOVA programmes. The programme was the main financial instrument of EU's Stabilisation and Association process (SAP). A total of €5.13 billion was secured for all CARDS actions. In that period, the European Agency for Reconstruction (EAR) managed all the EU assistance in Montenegro, Serbia, North Macedonia and Kosovo.[2] The level of financial assistance for Kosovo before the start of the IPA programmes is shown in Table 5.1.

The EAR managed a cumulative portfolio of some €1.12 billion in different projects and programmes across Kosovo through more than 1600 projects in value from €5.000 to €50m. The EAR initially focused its assistance on the rehabilitation and repair of key infrastructure and public utilities. It concentrated on energy, housing, transport and water supplies. For instance, €400 million is invested in energy sector in

[2] The Agency had its roots in the aftermath of the Kosovo war. In early 2000, it took over from the European Commission's Task Force for the Reconstruction of Kosovo, a temporary emergency assistance body set up in the summer of 1999, following the NATO-led intervention against the former Yugoslavia. Prishtina was the city where the Agency established its first operational centre.

that period.[3] It also supported enterprise development, agriculture, health and institution building. In 2008, the EAR Prishtina Centre transferred all CARDS programmes and contracts to the EC Liaison Office (ECLO).[4]

## IPA I: 2007–2013 and the Main Components Supported

The Instrument for Pre-accession Assistance (IPA) is the means by which the EU supports reforms in the 'enlargement countries' with financial and technical help, started with the Multi-Annual Financial perspective, MFF 2007–2013. The IPA funds build up the capacities of the countries throughout the association and stabilisation process as well as throughout the accession process, resulting in progressive, positive developments in the region.

The main objective of IPA is to assist the countries in their progressive alignment with the standards and policies of the European Union, including where appropriate the *acquis communautaire,* with a view to future membership. IPA will thus help these countries to meet the Accession Criteria and to fulfil the Copenhagen political, economic and acquis-related criteria for membership thereby enhancing their administrative capacity and prepare for the programming, management and implementation of EU Cohesion, Structural and Rural Development Funds after accession.

Beneficiary countries of IPA I (2007–2013) included EU candidate countries from that period (Croatia, Turkey and the Former Yugoslav Republic of Macedonia), and potential candidate countries recognised

[3] The main results of 1999–2006 investment in rebuilding the energy sector in Kosovo were the following: after rehabilitation in that time, Kosovo B power plant production more than doubled (up by 120%), emissions reduced and electricity distribution grid stabilized; preparation for big t projects was made; coal production more than tripled (up by 223%); district heating systems restored in Prishtina, Mitrovica, and Gjakova; the Independent Energy Regulator and the Independent Electricity Transmission Company established; Energy Strategy adopted (European Agency for Reconstruction, 2007).

[4] The main results of 1999–2006 investment in rebuilding the energy sector in Kosovo were the following: after rehabilitation in that time, Kosovo B power plant production more than doubled (up by 120%), emissions reduced and electricity distribution grid stabilized; preparation for big t projects was made; coal production more than tripled (up by 223%); district heating systems restored in Prishtina, Mitrovica, and Gjakova; the Independent Energy Regulator and the Independent Electricity Transmission Company established; Energy Strategy adopted (European Agency for Reconstruction, 2007).

in Annex II: Albania, Bosnia and Herzegovina, Iceland, Montenegro, Serbia and Kosovo (Council Regulation (EC) No 1085/2006, 2006).

The principal users of IPA resources are, above all, the ministries and administration authorities making laws and regulations and enforcing them, local governments, public institutions, as well as NGOS and associations. The end beneficiaries of the available resources are the people of the beneficiary countries, since the concrete results of the implemented projects in the end affect the quality of life of the population the most – whether they are improving the quality of performance of the institutions, attainment of European standards or infrastructure in different areas.

The legal basis for IPA is the Council Regulation (EC) No 1085/2006 (2006). More detailed implementing rules are laid down in Commission Regulation (EC) No 718/2007 (2007) and the amendments introduced by Commission Regulation (EC) No 80/2010 (2010). Framework Agreements signed between the Commission and the beneficiary countries aiming at setting and agreeing the rules for co-operation concerning EC financial assistance to the beneficiary country.

Financing under this single umbrella is provided through five 'components':

1. Transition Assistance and Institution Building managed by the European Commission's Directorate General for Enlargement;
2. Cross-Border Co-operation (with EU Member states and other countries eligible for IPA);
3. Regional Development (providing support for transport, environment infrastructure, enhancing competitiveness and reducing regional disparities);
4. Human Resources Development (strengthening human capital and combating exclusion) managed by the European Commission's Directorate General for Employment and Social Affairs;
5. Rural Development managed by the European Commission's Directorate General for Agriculture.

Components 3–5 were gradually opened for the candidate countries in line with the development of capacities for decentralized management of IPA funds. For the potential candidate countries, the biggest part of IPA is concentrated in the first component, under centralized model of the Fund's management.

TABLE 5.2 Revised Multi-Annual Indicative Financial Framework: Breakdown of the Instrument for Pre-Accession Assistance Envelope for 2012-2013 into Allocations by Country and Component

| Country/component | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| Croatia | 1,859.28 | 4,289,857 | 433 | 0.35% |
| Transition Assist. and Institution Building | 279.26 | 15% | | |
| Cross-border Co-operation | 96.72 | 5% | | |
| Regional Development | 345.93 | 19% | | |
| Human Resources Development | 95.02 | 5% | | |
| Rural Development | 183.25 | 10% | | |
| North Macedonia | 619.29 | 2,052,722 | 302 | 1.30% |
| Transition Assist. and Institution Building | 242.94 | 39% | | |
| Cross-border Co-operation | 32.48 | 5% | | |
| Regional Development | 202.04 | 33% | | |
| Human Resources Development | 55.08 | 9% | | |
| Rural Development | 86.75 | 14% | | |
| Iceland | 30.00 | 318,452 | 94 | 0.11% |
| Transition Assist. and Institution Building | 30.00 | 0.3% | | |
| Montenegro | 236.63 | 619,001 | 382 | 1.05% |
| Transition Assist. and Institution Building | 166.70 | 70% | | |
| Cross-border Co-operation | 30.07 | 13% | | |
| Regional Development | 23.20 | 10% | | |
| Human Resources Development | 5.76 | 2% | | |
| Rural Development | 10.90 | 5% | | |
| Turkey | 4,831.63 | 72,561,312 | 67 | 0.13% |
| Transition Assist. and Institution Building | 1,675.24 | 35% | | |
| Cross-border Co-operation | 20.64 | 0.4% | | |
| Regional Development | 1,790.34 | 37% | | |
| Human Resources Development | 479.63 | 10% | | |
| Rural Development | 865.79 | 18% | | |

*Continued on the next page*

Through the implementation of IPA projects, over the 2007–2013 financial period, EUR 11.5 billion were invested into EU candidate and potential candidate countries, as it is presented in the Table 5.2.

The IPA 2007–2013 consists of nine national programmes and multibeneficiary programmes. Turkey, as the biggest country, was benefi-

TABLE 5.2 *Continued from the previous page*

| Country/component | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| Albania | 597.29 | 2,918,674 | 205 | 1.02% |
| Transition Assist. and Institution Building | 531.16 | 89% | | |
| Cross-border Co-operation | 66.14 | 11% | | |
| Bosnia and Herzegovina | 658.50 | 3,844,046 | 171 | 0.80% |
| Transition Assist. and Institution Building | 624.80 | 95% | | |
| Cross-border Co-operation | 33.70 | 5% | | |
| Serbia | 1,392.07 | 7,306,677 | 191 | 0.57% |
| Transition Assist. and Institution Building | 1,313.35 | 94% | | |
| Cross-border Co-operation | 78.71 | 6% | | |
| Kosovo | 637, 60 | 2,208,107 | 289 | 1.43% |
| Transition Assist. and Institution Building | 628.68 | 99% | | |
| Cross-border Co-operation | 8.92 | 1% | | |
| Total Country Programmes | 10,003.18 | 96,118,848 | 104 | 0.21% |
| Multi-beneficiary Programmes | | | | |
| Transition Assist. and Institution Building | 1,138.24 | | | |
| Cross-border Co-operation | 21.95 | | | |
| Support Expenditures | 383.88 | | | |
| Grand Total | 11,526.65 | | | |

NOTES Column headings are as follows: (1) IPA 2007–2013 in mil EUR, current prices 2011, (2) population 2011, (3) total IPA/per capita, (4) IPA as percentage of GDP, 2011.

ciary of 48% of all IPA funds. As country in the accession process, Croatia had the highest IPA/per capita indicator for overall period (433 EUR/pc). In comparison to the Gross Domestic Products, Kosovo had the highest level of the IPA support as percentage of GDP in 2011 (1.43%).

According to Article 64 of the Commission Regulation (EC) No 718/2007 (2007), assistance under IPA's Transition Assistance and Institution Building Component (TAIB) is granted in the following areas:

- Strengthening of democratic institutions and the rule of law;
- Promotion and protection of the fundamental rights and freedoms;
- Public administration reform;

- Reform in the field of justice and home affairs;
- Modernisation of the regulatory framework, including support for investment to equip key institutions whose infrastructures or capacity to monitor and enforce legislation need strengthening;
- Establishment or reinforcement of financial control systems;
- Strengthening of the market economy;
- Development of civil society;
- Establishment of social dialogue as an element of good governance and to promote fair and just working conditions;
- Promotion of minority integration, reconciliation and confidence-building measures on all levels of society;
- Environmental policy;
- Improvement of access to financial facilities for small and medium-scale enterprises and public administrations;
- Institution building in the field of nuclear safety, radioactive waste management and radiation protection;
- Support for participation in community programmes.

Assistance under IPA Component I – TAIB may be provided through:

- Administrative cooperation measures (twinning, twinning light and TAIEX[5] programmes);
- Technical assistance;
- Investment sin regulatory infrastructure;
- Grant schemes;
- Project preparation facilities;
- Implementation of finance facilities in cooperation with financial instruments;
- budgetary support.

The second IPA component is Regional and Cross-border cooperation. This component aims to strengthen stability, security and prosperity of interest to all countries in the region, in order to promote harmonious, balanced and sustainable development. Beneficiaries of the second IPA components are municipalities, NGOS, public utilities, various associations, libraries, universities, etc. An important feature

[5] Technical Assistance Information Exchange Office, Brussels.

of the CBC projects, regardless of the beneficiaries, is the common interest of the two neighbouring countries and compliance with the priorities of the region.

Objectives of the cross-border cooperation:

- Encouraging cross-border initiatives in the field of social development, economy and environmental protection in border areas;
- Encouraging the solution of common problems in the field of environmental protection, public health, prevention and fight against organized crime;
- Borders – strengthening the efficiency and security of borders;
- Promoting legal and administrative cooperation;
- Encouraging local so-called 'People to People' activities.

Operating on the local level in the border areas, the Cross-Border Cooperation (CBC) programmes support the population on both sides of the border to promote sustainable economic and social development; work together to address common challenges (e.g. environment, natural and cultural heritage, public health, prevention of and fight against organised crime, etc.); and ensure efficient and secure borders and promote joint small scale actions involving local participants from the border regions. Kosovo implemented three bilateral CBC programmes with FYROM (now North Macedonia) and Albania in the period 2010–2013, and with Montenegro since 2012. The Joint Technical Secretariats and so-called Antennas (info-points for information distribution) were established through technical support of the EU.

Multi-beneficiary IPA (MB IPA) – funds for these purposes are raised by 'reallocating' up to 10% of funds from each country individually. It is implemented through regional and horizontal programs.

1. Regional programs should facilitate the process of regional cooperation among the beneficiaries of the Western Balkans. These programs particularly seek to promote reconciliation, reconstruction and political cooperation.
2. Horizontal programs address common needs in several IPA beneficiary countries and seek to achieve cost-effectiveness and efficiency in implementation through central aid management (directly from Brussels), rather than national program implementation. Multi-beneficiary activities focus on support that requires

> cooperation between beneficiaries, such as regional structures, networks of experts or civil servants, or will focus on needs and problems of a cross-border nature.

MB IPA contains the following components: regional cooperation; infrastructure development; justice and home affairs; internal market; public administration reform; support to civil society; education, youth and research; market economy; nuclear safety and radiation protection; interim administration (High Representative in BiH and UNMIK); program management (contributions from candidate and potential candidate countries to the Tempus program, the Erasmus Mundus program, the Nuclear program, the Youth in Action program, etc. are also supported through the Multi-Beneficiary IPA.

Of particular interest are the activities that were organized within the Western Balkans Investment Fund (WBIF) established in 2009 and later IPF (Infrastructure Project Facility) within which the (necessary) feasibility studies for infrastructure projects in the field of environment, communal infrastructure, energy and social protection were developed. The basic idea of this support is the preparation of documentation for larger infrastructure projects, which would later be supported by the EIB, the EBRD and the Council of Europe Development Bank (Djurović, 2013).

### *Main Results Achieved with IPA 2007–2013 Projects in Kosovo*

With the help of the European Union, Kosovo has been able to make considerable progress. IPA funding supported Kosovo to align its legislation with the EU, further adapt its procedures to meet EU standards, and strengthen its institutions. It also allowed Kosovo to improve its economy and upgrade its infrastructure. Between 2007 and 2013, the EU established a mission to promote the rule of law in Kosovo and appointed an EU Special Representative. Kosovo negotiated a Stabilisation and Association Agreement with the EU, took steps towards the normalisation of relations with Serbia, and made significant progress in its efforts to meet the criteria for visa liberalisation. IPA programmes have played a key role in all these processes. Figure 5.1 illustrates the sectors supported, and impacted, by the IPA funds.

Between 2007 and 2013, Kosovo faced a number of key challenges. The most important included solving Kosovo's status issue, strengthening the rule of law, and protecting and integrating minorities. Eco-


FIGURE 5.1 IPA Results and Impacts by Sectors in Kosovo (adapted from European Commission, 2015)

nomic competitiveness and growth issues including developing the economic and agriculture sector, improving Kosovo's business environment, and linking its economy to the EU internal market were also important goals. Finally, aligning Kosovo's laws with those of the EU, including setting higher environmental standards and improving veterinary and food safety, was an IPA target.

*Funds for Kosovo.* 2008 donor conference In July 2008, the European Commission organised a Donors' Conference for Kosovo in Brussels. The Commission and the EU Member States pledged nearly EUR 800 million of the EUR 1.2 billion total pledge. This funding paid for important reforms in Kosovo, including in the area of rule of law, public administration, trade and other areas relevant to the Stabilisation and Association Agreement.

*The Protection of Minorities:* Closing of refugee camps. The protection of minorities and vulnerable groups was a critical issue for Kosovo. In addition to Serbs, Kosovo also hosts Egyptian, Ashkali and Roma communities. In 2010 IPA funded the relocation of some 148 refugee families (about 600 people) from the lead contaminated camps where they had been residing and provided them with alternative housing, infrastructure, water and electricity. IPA assistance also helped the families concerned to become economically independent and start their own businesses.

*Implementing the Brussels Agreement:* The EU-brokered 2013 Brussels agreement between Serbia and Kosovo was a huge step towards normalisation of relations. Through IPA programmes, the European Commission supports the implementation of technical and political agreements. With the help of IPA financing, for example, Kosovo's civil registry was reconstituted with the help of certified copies. IPA funded the certification of Kosovo university diplomas, allowing Kosovo students to continue their studies or apply for jobs elsewhere. IPA is also funding the construction of six permanent border/boundary crossing points in the North, allowing for normal customs procedures.

IPA results and impact by sectors (European Commission, 2015):

- Kosovo made some fundamental progress in the justice sector, most notably the rule of law. With IPA support, Kosovo reinforced its justice system, built a high-security prison, and trained hundreds of police officers. In 2011, Kosovo introduced a new Border Management System that complies with European standards and will regulate border crossings, vital in Kosovo's fight against organised crime.
- Kosovo's unemployment rate remains one of the highest in Europe. In 2013, a job and entrepreneurship training project was completed, part of IPA's effort to improve Kosovo's economy, trade and industry. Some 3500 young and disadvantaged people received three to six months of training, after which half of them found immediate employment. An IPA-funded rural grant scheme has also delivered results. With relatively small grants, dairy, meat, fruits and vegetable processing businesses were able to expand their activities and align their business practices with EU standards and quality control. In 2007, 2008 and 2009, thirteen businesses were supported, creating over 300 new jobs. In 2009, an IPA project successfully integrated different institutions spread over several ministries into a single Food and Veterinary Agency, allowing for the efficient and effective application of a single set of food safety control standards.
- Public administration reform is high on the agenda in Kosovo. In 2010, Kosovo carried out its first population and housing census in three decades. The data allows it to engage in direct policy planning over the next decade. A project to establish the Qualifications Authority of Kosovo was completed in 2012, which should allow for a better connection between vocational and university-level education in technical subjects, opening up the possibility of higher education for more people.

## IPA II: 2014–2020 and the Main Components Supported

The purpose of assistance under the Instrument for Pre-Accession Assistance (IPA II) is to support the Enlargement policy of the Union which contributes to ensuring stability, security and prosperity in the immediate neighbourhood of the Union.

General objective: The IPA II supported candidate countries and potential candidates in adopting and implementing the political, institutional, legal, administrative, social and economic reforms required by the beneficiaries to comply with Union values and to progressively align to Union rules, standards, policies and practices with a view to Union membership. Through such support, IPA II was expected to contribute to stability, security and prosperity in the beneficiaries.

Specific objectives of IPA II:

1. Support for political reforms;
2. Support for economic, social and territorial development, with a view to a smart, sustainable and inclusive growth;
3. Strengthen the ability of the beneficiaries to fulfil the obligations stemming from Union membership by supporting progressive alignment with, and adoption, implementation and enforcement of, the Union acquis, including preparation for management of Union Structural Funds, the Cohesion Fund and the European Agricultural Fund for Rural Development;
4. Strengthen regional integration and territorial cooperation involving the IPA beneficiaries, Member States and, where appropriate, third countries within the scope of Regulation (EU) No 232/2014 (2014).

IPA II beneficiaries, listed in Annex I of the IPA II Regulation, were: Albania, Bosnia and Herzegovina, North Macedonia, Kosovo, Montenegro, Serbia, and Turkey. Global budget of IPA II is 11,968[6] billion euro in the MFF 2014–2020 in 2011 prices. The revised (re)allocation per country and Multi-country priorities were prepared in a new generation of Indicative strategy papers for each country in 2018 (Table 5.3, in current 2018 prices). Kosovo as IPA beneficiary received in total 602.1 mil EUR for the IPA II period and had the biggest level of IPA support in GDP for 2017 (see Table 5.4 for details). According to the IPA/pc indictor, Kosovo was in the second position with 338 euro per capita of IPA support, after Montenegro.

Thematic priorities of IPA II 2014–2020 were the following:

[6] In total 11,9687 mil € in 2011 prices – Operational appropriations (11,359.7), administrative support (328.7) and Executive Agency (5.6).

TABLE 5.3 IPA II Indicative Allocation per Countries and Multi-Country Priorities

| Country | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|---|---|---|---|---|---|---|---|
| Albania | 639.5 | 6.0 | 2.88 | 2.9 | 222 | 11,564 | 0.7 |
| BiH | 552.1 | 5.1 | 3.51 | 3.6 | 157 | 16,042 | 0.5 |
| North Macedonia | 608.7 | 5.7 | 2.07 | 2.1 | 294 | 10,014 | 0.8 |
| Kosovo | 602.1 | 5.6 | 1.78 | 1.8 | 338 | 6,414 | 1.2 |
| Montenegro | 279.1 | 2.6 | 0.62 | 0.6 | 448 | 4,299 | 1.0 |
| Serbia | 1,539.1 | 14.3 | 7.04 | 7.2 | 219 | 39,183 | 0.5 |
| Turkey | 3,533.0 | 32.9 | 79.81 | 81.7 | 44 | 753,904 | 0.1 |
| Multi-country | 2,980.2 | 27.8 | | | | | |
| Total | 10,733.8 | 100 | 97.72 | 100 | 110 | 841,420 | 0.2 |

NOTES Column headings are as follows: (1) total national IPA, 2014–2020, (2) percentage of total national IPA, (3) population (million), (4) population (percentage), (5) total IPA II per capita, (6) GDP 2017 (million EUR), (7) IPA II 2017 as percentage of 2017 GDP.

TABLE 5.4 Multi Country Indicative Strategy Paper (Revised in 2018)

| Indicative allocations | Million EUR | % |
|---|---|---|
| A Horizontal support | 964.1 | 32 |
| TAIEX and Statistics | 133.2 | 4 |
| Advisory functions of international organisations | 225.7 | 8 |
| Civil Society and Media | 120.5 | 4 |
| Erasmus+ including the youth dimension | 312.2 | 10 |
| Horizontal measures | 172.5 | 6 |
| B Regional structures and networks | 186.3 | 6 |
| C Regional investment support | 1,438.2 | 48 |
| WBIF, EDIF, GGF and other blending instruments | 1,413.2 | 47 |
| Regional Housing Programme | 25.0 | 1 |
| D Territorial co-operation | 391.6 | 13 |
| Total | 2,980.2 | 100 |

NOTES Adapted from European Commission (2018c).

1. Compliance with the principle of good public administration and economic governance.
2. Establishing and promoting from an early stage the proper functioning of the institutions in order to secure the rule of law.

3. Strengthening the capacities of civil society organisations and social partners' organisations, including professional associations,
4. Investment in education, skills and lifelong learning.
5. Fostering employment and supporting labour mobility.
6. Promoting social inclusion and combating poverty.
7. Promoting sustainable transport and removing bottlenecks in key network infrastructures
8. Improving the private-sector environment and competitiveness of enterprises, including smart specialisation, as key drivers of growth, job creation and cohesion.
9. Strengthening research, technological development and innovation.
10. Contributing to the security and safety of food supply and the maintenance of diversified and viable farming systems in vibrant rural communities and the countryside.
11. Increasing the ability of the agri-food sector to cope with competitive pressure and market forces as well as to progressively align with the Union rules and standards, while pursuing economic, social and environmental goals in balanced territorial development of rural areas.
12. Protecting and improving the quality of the environment, contributing to the reduction of greenhouse gas emissions, increasing resilience to climate change and promoting climate action governance and information.
13. Promoting reconciliation, peace-building and confidence-building measures.

Table 5.5 provides details of the resources allocated to each priority area in Kosovo.

Due to the COVID-19 outbreak, it was now necessary to modify some of the IPA 2019 and IPA 2020 objectives as a result of the reorientation and reprogramming exercise of IPA funds with the objective to help Kosovo address the social and economic fallout of the COVID-19 crisis on the medium and long term. Instead the action 'EU for Environment' in IPA 2019, two new actions are introduced instead as follows: 'EU4 Resilience' under Competitiveness and Innovation, Agriculture and Rural development and 'EU4 Social protection following the COVID-19 crisis' under Education, Employment and Social Poli-

TABLE 5.5 Indicative Allocations: Kosovo 2014–2020, National IPA per Policy Areas and Sectors

| Areas and sectors | 2014–2017 | 2018 | 2019 | 2020 | 2018–2020 | 2014–2020 |
|---|---|---|---|---|---|---|
| Democracy and rule of law | 168.52 | 24.20 | 29.90 | 40.90 | 95.0 | 263.52 |
| 1 Democracy and governance | 113.92 | 8.20 | 24.4 | 22.9 | 55.5 | 122.12 |
| 2 Role of Law and fundamental rights | 54.60 | 16.00 | 5.5 | 18.0 | 39.5 | 70.60 |
| Competitiveness and growth | 132.35 | 76.50 | 69.00 | 60.80 | 206.3 | 338.65 |
| 3 Environment, climate change and energy | 48.50 | 51.50 | 22.00 | 21.80 | 95.3 | 143.80* |
| 4 Transport | | | | | | |
| 5 Competitiveness, innovation, agriculture and rural development** | 54.85 | 9.00 | 37.50 | 23.00 | 69.5 | 124.35 |
| 6 Education, employment and social policies | 29.00 | 16.00 | 9.50 | 16.00 | 41.5 | 70.5 |
| Total | 300.87 | 100.70 | 98.90 | 101.70 | 301.30 | 602.10 |

NOTES * 40% of which climate change relevant. ** The budget for the agriculture and rural development programme is 50.1 mil EUR. Adapted from European Commission (2018b).

cies (38.3 mil EUR). In the IPA 2020 a new action is also introduced: 'EU4 small business recovery following the COVID-19 crisis' (2.2 mil EUR and 3 mil EUR co-financing from the Budget).

The IPA structures are established in Ministry of European Integration (Office of the National IPA Coordinator – NIPAC), in Ministry of Finance (Department for European integration and policy coordination – DEIPC) and small project implementation units in line ministries. In IPA II generation. The IPA Committee as joint monitoring body of the EC and Kosovo representatives was also established.

The key documents for programming IPA actions were: national strategic documents and sector strategic documents as well as the Indicative Strategy paper for IPA and sector planning documents for IPA priorities (Rule of Law, Fundamental Rights, Energy, Environment, Agriculture, and Education, employment and social policies); the Economic Reform Programme (as medium-term macroeconomic projection and structural reform program prepared in close cooperation with the Commission); and the EC Report and recommendations.

The Management modes implemented for different IPA actions were the following:

1. Majority of actions were implemented by direct management mode by the European Commission;
2. Indirect management with some international organisations was used for a few actions (Council of Europe, International organisation of migrations, UNDP, Swedish International Development Cooperation Agency – SIDA; World Bank, Austrian Development Agency, etc.);
3. Direct budget support, as specific model, was used for the implementation of the Public administration reform in IPA 2016 and for the Public finance management strategy in IPA 2017;
4. For indirect management with the Beneficiary country mode it was necessary to further strengthen the organisational and administrative capacities within the Government.

The Government established the National Investment Committee (NIC) as the political forum through which priority investment projects were prepared and financing plans for each of the steps related to the specific projects from the Single Project Pipeline (SPP) were discussed and agreed. The first SPP was finalized in 2015. Overall, there were 39 infrastructural projects with the total indicative budget of 2.35 billion € (13 projects in energy sector for an indicative total amount of 635 mil €, 15 projects in environment sector for an indicative total amount of 526 mil €, 11 projects in transport sector for an indicative total amount of 1.190 mil €). SPP served as the main policy planning instrument for the coordination of infrastructural investments in transport, energy, and environment (Republic of Kosovo, 2015). The Government continuously reviewed and expanded the SPP with other sectors.

The EU Connectivity agenda and regional Western Balkans Investment Framework (WBIF) supports important infrastructural projects in transport sector.[7]

[7] For the period 2015–2019 it was the following support: Orient/East-Med Corridor: North Macedonia–Kosovo R10 Rail Interconnection, Fushë Kosovë to the border with North Macedonia Section in Kosovo, EU grant 39.31, loan 94.15 mil; Orient/East-Med Corridor: North Macedonia–Kosovo–Serbia R10 Rail Interconnection, Fushë Kosovë–Mitrovica, the section in Kosovo. EU grant 17.59 mil €, grant 42.38 mil €; Orient/East-Med Corridor: Kosovo R10 Rail Interconnection, EU grant 27.40 mil €, loan 56.10 mil €.

Kosovo had three cross-border programmes with Albania, Montenegro and North Macedonia. Municipalities, i.e. local self-government units, local business associations, public utility companies and NGOs from the so-called eligible municipalities were the beneficiaries of these programmes.

The Joint monitoring committee (decision making body in line with defined thematic priorities of actions) and the Joint Technical Secretariat (implementation of calls, selection of projects, monitoring, and administrative support) were established for each of the CBC programmes.

Priorities for assistance for territorial cooperation:

1. Promoting employment, labour mobility and social and cultural inclusion across borders;
2. Protecting the environment and promoting climate change adaptation and mitigation, risk prevention and management through;
3. Promoting sustainable transport and improving public infrastructures;
4. Encouraging tourism and cultural and natural heritage;
5. Investing in youth, education and skills through;
6. Promoting local and regional governance and enhancing the planning and administrative capacity of local and regional authorities;
7. Enhancing competitiveness, the business environment and the development of small and medium-sized enterprises, trade and investment;
8. strengthening research, technological development, innovation and information and communication technologies.

Lessons learned from IPA II:

- IPA II was highly relevant,[8] in line with national and EU priorities, as well as donor funding (EU political priorities, National Development Strategy, ERPS documents and their priority structural reforms, SAA implementation needs, etc.). There are numerous good projects, specifically in the rule of law area, support to SMES and youth employment, and support to energy/environment sec-

[8] EC, External evaluation of the Instrument for Pre-accession Assistance (IPA II), Consortium composed of Particip, Ecorys, ECDPM, Fiscus, Itad and OPM, June 2017.

tor (EU support for clear air for Kosovo). The EC support is growing.

- The Western Balkans Investment Framework (WBIF) provided co-financing and technical assistance to strategic investments in the energy/energy efficiency, environment, social, and transport sectors, and also supported private sector development initiatives.
- Territorial cooperation in the form of cross-border, transnational and interregional cooperation programmes, favoured reconciliation and confidence building in the Western Balkans, overcoming geographical barriers and legacies of the past, and developing good neighbourly relations. There were numerous good projects with North Macedonia, Montenegro and Albania.
- IPA II was change oriented – the transition from country-based allocations to performance-based allocationsand the introduction of performance reword mechanism shifted the paradigm of beneficiaries to think more about the end results and impact, rather than simply seeing IPA funding as earmarked financial envelopes of money that is to be spent through a tick-the-box exercise.
- Administrative capacities of IPA structures – due to prevalence of the direct management mode, the NIPAC office in Kosovo played a quite passive role on programming, implementation, monitoring and reporting. External support was required for setting any MRPF[9] related structure in the country. The administrative capacity of the NIPAC Office should be improved in order to become more proactive and effective. Specific training modules should be addressed to specific officials and necessary systems/tools should be developed and used. Sector Lead Institutions responsibility assigned within IPA II should be completed and strengthened. These institutions should be assigned the official mandate to coordinate the relevant activities at all stages of IPA implementation (programming, implementation, monitoring and reporting.
- Lack of ownership and 'parallel world' syndrome – when it comes to the European integration (EI) issues, somehow there is a misinformed, but deeply embedded, impression within state institutions that anything that is EU-related is the responsibility of Gov-

[9] Monitoring, reporting and performance framework.

ernment structures for EU integration. Such an approach creates an environment characterized by the lack of ownership and commitment to EU-related issues by other stakeholder, including at local level.

- High staff turnover rate, lack of retention policy – the risk of loss of institutional memory and qualified staff in line ministries and small EI units in municipalities; frequent changes in the NIPAC office, key positions; and political support for administrative capacity building within the IPA structures create preconditions for indirect management model.
- Fragile national planning framework – IPA is not a magic stick to solve all development problems, i.e. IPA is successful, as much as national policies are. National Development Strategy and Economic Reform Programmes – gradually improved the planning process.
- Absence of empirical decision-making and structured processes – further work needs to be done on creating stronger synergies between all parts of the Government in the implementation of EU funds (MEI, MF, Cabinet of Prime Minister, etc.), It is necessary to develop legal documents that regulate the programming of IPA, to include all stakeholders in IPA consultation process.
- Support co-financing issues for important stakeholders at local level – it could be useful to established Municipal support fund for pre-accession financing of donor projects based on the Law on financing of local self-government, in order to support them to overcome problems with advanced financing of some project activities. The same should be introduced for NGOS in order to support them with co-financing of the EU funded projects.

## IPA III 2021–2027 and the Main Components to Be Supported

IPA III will continue to support the beneficiaries in adopting and implementing key political, institutional, social and economic reforms to comply with EU values and to progressively align to the EU's rules, standards and policies. The allocation for the Instrument for Pre-Accession, supporting beneficiaries on their path to fulfilling the accession criteria in MFF 2021–2027, will be EUR 12,565 million (in 2018 prices) as detailed in Table 5.6.[10]

[10] European Council conclusions, Brussels, 21 July 2020, EUCO 10/20. EUR 12,565 billion

TABLE 5.6 Thematic Prorites of IPA III per 'Windows'

| (I) Rule of Law, fundamental rights and democracy | (II) Good governance, legal harmonisation, strategic communications and good neighbourly relations | (III) Green agenda and sustainable connections | (IV) Competitiveness and inclusive growth |
|---|---|---|---|
| (1) Judiciary<br>(2) Fight against corruption<br>(3) Fight against organised crime/security<br>(4) Migration and border management<br>(5) Fundamental rights<br>(6) Democracy<br>(7) Civil Society | (1) Good governance<br>(2) Administrative capacities and legal harmonisation<br>(3) Good neighbourly relations and reconciliations<br>(4) Strategic communications, surveillance, evaluation and communication activities | (1) Environment and climate actions<br>(2) Transport, digital economy and society, energy | (1) Education, employment, social protection and inclusive policy, and health<br>(2) Private sector development, Trade, Research and Innovation<br>(3) Agriculture and rural development<br>(4) Fishery |

*Continued on the next page*

IPA III 2021–2027 will be continuity of IPA II instrument. For the period 2021–2027, the new instrument should allow for sufficient flexibility to take into account evolving circumstances. Increased financial flexibility could be achieved by strengthening possibilities for reallocating funds within the instrument, in particular between and within facilities. Establishing a reserve within IPA could be considered; this would mean that a share of the total budget (e.g. 10%) could be kept unallocated to cater for unforeseen needs (e.g. migration) provided the carry over for commitments is allowed (European Commission, 2018a).

However, the most important novelty of IPA III is that financial allocations will not anymore be done on the basis of national envelopes, but on the premises of 'performance-based' principle. No fixed or indicative national/geographical envelopes will be established, although a principle of 'fair share' allocation for beneficiary countries will be integrated, as well as a 'performance-based principle.' Performance will be part of

in 2018 prices of 14.5 billion EUR in current prices – a significant increase compared to the current MFF amounts, which stand at €12.8 billion in current prices of 2020. (https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_988).

TABLE 5.6 *Continued from the previous page*

| |
|---|
| Thematic priorities of IPA III: cross border cooperation |
| (1) Promoting employment, labour mobility and social and cultural inclusion across borders |
| (2) Protecting the environment and promoting climate change adaptation and mitigation, risk prevention and management |
| (3) Promoting sustainable transport and improving public infrastructures by, inter alia, reducing isolation through improved access to transport, digital networks and services and investing in cross-border water, waste and energy systems and facilities |
| (4) Promoting the digital economy and society by inter alia the deployment of digital connectivity, the development of e-Government services, digital trust and security as well as digital skills and entrepreneurship |
| (5) Encouraging tourism and cultural and natural heritage |
| (6) Investing in youth, education and skills through, inter alia, developing and implementing joint education, vocational training, training schemes and infrastructure supporting joint youth activities |
| (7) Promoting local and regional governance and enhancing the planning and administrative capacity of local and regional authorities |
| (8) Enhancing competitiveness, the business environment and the development of small and medium-sized enterprises, trade and investment through, inter alia, promotion and support to entrepreneurship, in particular small and medium-sized enterprises, and development of local cross-border markets and internationalisation |
| (9) Strengthening research, technological development, innovation and digital technologies through, inter alia, promoting the sharing of human resources and facilities for research and technology development |

the process of accessing to funds, which will be based on criteria such as: project/programme maturity, absorption capacity, administrative capacity, expected impact and progress on rule of law, fundamental rights and governance. Therefore, no additional performance reward mechanism will be needed.

Key performance indicators for IPA III:

1. Composite indicator[11] on the readiness of enlargement countries on fundamental areas of the political accession criteria (including Democracy, Rule of Law (Judiciary, Fight against corruption and Fight against organized crime) and Human Rights).
2. Readiness of enlargement countries on public administration reform.

[11] The three composite indicators are elaborated by the European Commission on the basis of the reports on Enlargement, which also draw from multiple, independent sources.

3. Composite indicator on the readiness of candidate countries and potential candidates to the EU acquis.
4. Composite indicator on the readiness of candidate countries and potential candidates on fundamental areas of the economic criteria ( functioning market economy and competitiveness).
5. Public social security expenditure (percentage of GDP) or employment rate.
6. Digital gap between the beneficiaries and the EU average.
7. Distance to frontier score.
8. Energy intensity measured in terms of primary energy and GDP.
9. Greenhouse gas emissions reduced or avoided (Ktons $CO_2$eq) with EU support.
10. Number of cross-border cooperation programmes concluded among IPA beneficiaries and IPA/EU MS.

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Chapter Six

# EU Education and Research Programmes

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## Introduction

This chapter is about the EU programmes on education and research in Europe and in Western Balkan countries. It will present:

- EU multiannual programmes of work;
- EU policy on education and education programmes;
- EU policy on research and research programmes;
- EU programmes in the Western Balkans and Kosovo.

The basis for financing of EU programmes are multiannual programmes of work. The programme period 2014–2020 is now running out while the programme period 2021–2027 is about to start. As reported by European Commission (2020e; 2020d) and European Parliament (2020), the Multiannual Financial Framework (MFF) for 2021–2027 amounts to €1.074 trillion, and is combined with the temporary recovery instrument, the Next Generation EU of €750 billion. The long-term budget for innovation, education and research 2021–2027 is made up of:

- Erasmus+ will have a budget of €30 billion for the 2021–2027 programme. This is more than double the budget of the 2014–2020 period, which was €14.7 billion.
- The new EU research and innovation programme Horizon Europe will have a budget of around €95.5 billion for 2021–2027. This repre-

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sents a 30% increase vis-à-vis the current research and innovation programme, Horizon 2020.

- More than 50% of the amount will support modernisation through policies that include research and innovation. Research and innovation is an investment in our future and therefore put at the heart of EU's blueprint for smart, sustainable and inclusive growth and jobs. The main programmes are: Horizon Europe, Just Transition Fund, Digital Europe, Recovery and Resilience Facility, rescEU and a new health programme EU4Health;

## EU Education Policy and Programmes

### *Policy: European Education Area (EEA) by 2025 and Digital Education 2021–2027*

The European policy cooperation framework for education and training (European Union, 2020a; European Commission, 2020c, 2020i) supports Member States in their efforts to provide the best education and training for their citizens. The focus of the EU framework for cooperation beyond 2020 is on creating policies and initiatives in the following areas: early childhood education and care, school policy, vocational education and training, adult learning, higher education, international cooperation and policy dialogue on multilingualism, education and migrants. The framework is based on the lifelong learning approach. It therefore addresses outcomes from early childhood to adult vocational and higher education, and is designed to cover learning in all contexts: formal, non-formal and informal.

The EU sets out the framework for EU countries to exchange best practices and learn from each other, with the aim of:

- Making lifelong learning and mobility a reality;
- Improving the quality and efficiency of education and training;
- Promoting equity, social cohesion and active citizenship;
- Enhancing creativity, innovation and entrepreneurship.

The framework is implemented through a variety of tools and instruments: Working Groups, Peer Learning Activities (PLAS), Peer Reviews, The Annual Education and Training Monitor reports on Member States' progress towards achieving the Education and Training objectives and benchmarks, consultation and cooperation activities with stakeholders, funding for policy support activities and innovative projects through the Erasmus+ programme.

The European policy cooperation framework is presented and discussed in documents by European Commission (2017, 2020f, 2020h) and DAAD Brussels (2020), mainly through two areas:

- European Education Area (EEA) by 2025 and
- Digital Education Action Plan 2021–2027.

### *Creation of EEA by 2025*

The creation of EEA by 2025 has its basis in 2017, during the meeting at the Social Summit in Gothenburg. On 30 September 2020, the European Commission presented its vision for the creation of an EEA by 2025 and announced concrete measures to achieve it. This communication places education at the heart of the European Union's economic and social development and focus on:

- *Quality.* In addition, to improve teaching of basic knowledge and transversal skills, mobility and cross-border cooperation is highlighted as a motor for improving the quality of education. Existing obstacles to this must be removed. At the same time, the report calls for mobility to be made more sustainable in future and to be able to tackle digital challenges.
- *Inclusion and gender equality.* In the future Erasmus+ programme, inclusion, equality and diversity will play a prominent role, for example through new, more flexible mobility formats and support measures. An increasingly diverse student landscape and the demand for lifelong learning will be met by new teaching formats such as micro-credentials. To this end, the Commission is planning a proposal for Council Recommendations in 2021. In higher education, the main aim is to increase the number of women in management positions.
- *Green and digital transition.* The transition to an environmentally sound, sustainable and climate-neutral economy in Europe can only succeed with the development of necessary skills and awareness raising through education. At the end of 2020, the Commission will launch a coalition 'Education for Climate' to promote innovative projects and raise awareness in educational institutions. In 2021, the Commission will present Council recommenda-

tions on sustainability in education and develop a European Competence Framework for environmental skills and competences. The Action Plan for Digital Education details the measures to prepare for the digital transformation. The EU education programme Erasmus+ will become digital and greener. Virtual mobility is to complement physical mobility, environment and digital are to be treated as priorities in the cooperation projects and a sustainable implementation of the projects as well as climate-friendly physical mobility is to be promoted.

- *Teachers.* Teachers are at the centre of a sustainable education system. The profession should be upgraded. In this context, the Commission also mentions the need to make mobility an integral part of teacher education and training. Under the new Erasmus+ programme, the Commission plans to develop, from 2021 onwards, 25 'Erasmus Teacher Academies,' which will network teacher training institutions and their associations to exchange good practice in initial and in-service training.
- *Higher Education.* Universities are described as central players in the knowledge quadrangle: education, research, innovation and society. The focus is on developing a policy framework that allows unhindered mobility and close cross-border cooperation between universities (as in the European Universities Initiative), and that promotes inclusion, digitalisation, sustainability and new teaching formats such as micro-credentials. The Commission is currently working on a transformation agenda for universities, which it will present in 2021. A public consultation will be published later this year. Other measures include support for the development of higher education curricula in the field of technology and ICT, the development of a 'European Degree' and a quality assurance system for new modular study programmes and degrees, and a feasibility study on a European statute for alliances of higher education institutions in Europe, such as the European Universities. Mobility will be further developed through the European student card, the Erasmus+ app and a further development of the automatic mutual recognition of credits.
- *Geopolitical dimension.* Together with the Member States, the European Commission wants to set new targets for 2030 to achieve the European Education Area. For higher education, it is proposed

to increase the proportion of 30–34 year olds with a university degree to at least 50%.

### *Digital Education (2021–2027)*

The Digital Education Action Plan (2021–2027) outlines the European Commission's vision for high-quality, inclusive and accessible digital education in Europe. It is a call to action for stronger cooperation at European level to:

- Learn from the COVID-19 crisis, during which technology is being used at an unprecedented scale in education and training;
- Make education and training systems fit for the digital age.

The new Action Plan on Digital Education was built on the Digital Education Plan 2018–2020 which had the following priority areas: making better use of digital technology for teaching and learning, developing digital competencies and skills, improving education through better data analysis and foresight.

The new Action plan has two strategic priorities:

- Fostering the development of a high-performing digital education ecosystem;
- Enhancing digital skills and competences for the digital transformation.

## *EU Education Programmes (Inside the EU and Cooperation with EU Neighbouring Countries)*

### *Roots of Programmes Inside the EU*

The first EU exchange programmes was the COMETT Programme for Industry-University links and exchanges (1987–1995). Other programmes: Socrates I (1994–1999) and Socrates II (2000–2006) programme, Lifelong Learning Programme (2007–2001), Erasmus+ 2014–2020, Erasmus+ 2021–2027.

Cooperation with non-EU Member States enhances the quality of education and training in the EU and beyond by promoting peer learning and comparative analysis between national education systems worldwide. It boosts innovation and job creation through mobility, and offers opportunities for staff and students to broaden their horizons through participation in EU programmes.

Europe's universities have a strong record of internationalisation (European Commission, 2020k). They have facilitated the development of international curricula and joint degrees, fostered international research and innovation projects, and supported the exchange of students, staff and knowledge. This has all been made possible by the Bologna Process, under which European countries have agreed to restructure their higher education systems to make cross-border cooperation more feasible and more effective.

The EU's international policy dialogues with countries outside Europe, therefore, often draw on this expertise and the experience of the need for internationalisation to go hand in hand with policy reform. The first programme that supported cooperation with EU neighbouring countries was the Tempus programme. The programme was initiated in 1990 to support balanced cooperation and improvement of higher education in the EU Member States and Partner Countries. Recent relevant programmes are of some components the Erasmus+ programmes with its international dimensions.

### *Erasmus+*

Erasmus+ is the key programme on education (it supports activities in the fields of education, training, youth and sport), and is managed by the Education, Audio-visual and Culture Executive Agency (EACEA). The general objective of the Erasmus+ programme is 'to support the educational, professional and personal development of people in education, training, youth and sport, in Europe and beyond, thereby contributing to sustainable growth, jobs and social cohesion and to strengthening European identity.' Three specific objectives of the programme are: (1) to promote the learning mobility of individuals in the field of education and training; (2) to promote non-formal learning mobility and active participation among young people; and (3) to promote the learning mobility of sports coaches and staff. In addition, the promotion of cooperation, inclusion, excellence, creativity and innovation is also one of the specific objectives targeting the three areas of activity (European Commission, 2020g).

The Programme is made up of three so-called 'Key Actions' and two additional 'Actions.'

- *Key action 1: Mobility.* It supports mobility in the education, training and youth sectors and aims to bring long lasting benefits to the participants and the organizations involved.

- *Key action 2: Cooperation.* It makes it possible for organisations from different participating countries to work together, to develop, share and transfer best practices and innovative approaches in the fields of education, training and youth.
- *Key action 3: Policy.* Supports actions aimed at stimulating innovative policy development, policy dialogue and implementation, and the exchange of knowledge in the fields of education, training and youth.
- *Action: Jean Monnet.* Jean Monnet Activities are designed to promote excellence in teaching and research in the field of European Union studies worldwide. The activities also foster the dialogue between the academic world and policy-makers, in particular with the aim of enhancing governance of EU policies.
- *Action: Sport.* Programme aims to support European partnerships on grassroots sport in order to pursue different activities. The most important: tackle cross-border threats to the integrity of sport; promote and support good governance in sport and dual careers of athletes; promote voluntary activities in sport, together with social inclusion, equal opportunities and awareness of the importance of health-enhancing physical activity, through increased participation in, and equal access to sport for all.

### *Erasmus 2021–2027*

The focus of the new programme is on being inclusive and on doing more to reach young people with limited opportunities. The same ambition is reflected in the 2025 vision for a European Education Area, which calls for the number of participants to be doubled and for efforts to be made to reach out to learners from disadvantaged backgrounds. The budget for 2021–2027 is €30 billion, while Erasmus+ 2014–2020 had a budget of €14.7 billion.

## EU Research Policy and Programmes

### *Policy: The European Research Area (ERA)*

The European Commission launched the ERA in 2000, with the idea of developing attractive opportunities for researchers within Europe. Today, ERA is at the heart of the EU innovation agenda of the 2021–2027 Strategy and of the Innovation Union (IU) where it can help contribute to growth and jobs. It is the ambition to create a single, borderless market for research, innovation and technology across the EU.

Over the past 20 years, ERA has seen major achievements (European Commission, 2020a):

- The work of the European Strategy Forum on Research Infrastructures (ESFRI) resulted in the development of plans for 55 European Research Infrastructures, of which 37 have already been implemented, across all fields of science, mobilising close to EUR 20 billion in investments.
- Jointly addressing common challenges through coordination and pooling of resources has resulted in more than EUR 7 billion of national investments in joint research programmes since 2004, with current annual joint spending of EUR 800 million.
- Significant progress has been made in removing the geographical barriers to researchers' mobility and the fragmentation of research careers in Europe, driven by the European Charter for Researchers and a Code of Conduct for the Recruitment of Researchers already adopted by 1242 organisations. 2 In addition, the EURAXESS 3 initiative supports researcher mobility and career development by delivering information and support services to professional researchers.
- The ERA has enhanced access to open, free of charge, re-usable scientific information through the Open Science Initiative 4 and the recently launched European Open Science Cloud (EOSC) creating a cloud area for research data in Europe allowing for better science through open and collaborative knowledge sharing.

Nowadays, we simply cannot imagine the EU without research cooperation among its Member States, its research institutions, researchers and industry. This cooperation grows by the day and has over the decades evolved into a wide spectrum of areas where basic research and innovation activities are intertwined and feed into entrepreneurship, industry, thereby representing an important cornerstone in the EU's economic strength and global competitiveness. Legal basis of research cooperation in Europe can now be found in Articles 179 to 190 the Treaty on the Functioning of the European Union. The Lisbon Treaty thereby recognised research, alongside space, as a shared competence between the EU and Member States, and made the completion of the European Research Area (ERA) a requirement (Consolidated Versions of the Treaty on the European Union and Consolidated Version of the Treaty on the Functioning of the European Union, 2016). ERA is expected to importantly contribute to growth and jobs in Europe. It is composed of research and development activities, programmes and policies, which all include a strong transnational angle. In addition, ERA encourages the national research centres to be more open to each other and the world, supports more inter-connectedness and interoperability.

Traditionally, national research systems tend to be inward oriented as Member States in the past wished to protect their research findings and commercial innovations. However, with the high level of European integration and the common EU market, changing such practices and coupling them with more inter-European cooperation could lead to important improvements in EU's economic growth as well as its competitiveness at the global scale. Allowing ideas to circulate among EU Member States gives them more potential to be successfully followed up and followed through, as well as a higher likeliness that they turn into a commercial innovation. Furthermore, opening our minds and borders to circulation of researchers allows the brightest minds of the whole of Europe to work together solving global challenges. ERA is defined by the Lisbon Treaty and the European Council as 'a unified research area open to the world based on the Internal Market, in which researchers, scientific knowledge and technology circulate freely and through which the Union and its Member States strengthen their scientific and technological bases, their competitiveness and their capacity to collectively address grand challenges' (Majcen & Trunk Širca, 2020).

As part of the EU response to the coronavirus pandemic, the Commission introduced the ERAvscorona Action Plan in April 2020. Building on the overall objectives and tools of the European Research Area, the action plan is a working document developed jointly by the Commission and national governments. It covers short-term actions based on close coordination, cooperation, data sharing and shared funding efforts (European Commission, 2020j).

### *New Challenges for R&I Policy*

Europe is currently facing deep societal, ecological and economic challenges, aggravated by the coronavirus crisis. Delivering on Europe's recovery is a pressing priority, while the green and digital transitions (twin transition) are more important than ever.

The new European Research Area, from 2021 on (European Commission, 2020b) is building on Europe's innovation leadership and scientific excellence; it aims to incentivise better coordination and cooperation among the EU, its Member States and the private sector, leading to more investment in research and innovation, and strengthening the mobility of researchers, their expertise, and the flow of knowledge. The ERA (2021–2027) defines four strategic objectives:

- Prioritise investments and reforms in research and innovation towards the green and digital transition, to support Europe's recovery and increase competitiveness.
- Improve access to excellent facilities and infrastructures for researchers across the EU.
- Transfer results to the economy to boost business investments and market uptake of research output, as well as foster EU competitiveness and leadership in the global technological setting.
- Strengthen mobility of researchers and free flow of knowledge and technology, through greater cooperation among Member States, to ensure that everyone benefits from research and its results.

The EU will work towards accomplishing the above strategic objectives, in close cooperation with the Member States, through 14 actions that are linked to each other and will be instrumental in realising the European Research Area:

1. Reaffirm the target of 3% of GDP on EU research and development investment and propose a new EU 1.25% GDP public effort target to be achieved by Member States by 2030.
2. Support Member States in the coordination and prioritisation of national research and innovation funding and reforms through an ERA Forum for Transition. Voluntarily commit 5% of national public research and development investments to joint programmes and European partnerships by 2030.
3. Support Member States that are below the EU average level of research and innovation investments to increase their investment by 50% in the next 5 years.
4. Support Member States that have lower performance in training their researchers to access and develop excellence and increase their number of highly cited publications by one-third over 5 years.
5. Develop common industrial technology roadmaps to maximise

innovation in strategic areas like Artificial Intelligence, circular industries and resilient health industries.

6. Develop and test a networking framework in support of Europe's research and innovation ecosystems, building on existing capacities, to strengthen excellence and maximise the value of knowledge creation, circulation and use.
7. Update and develop guiding principles for creating value from knowledge and a code of practice for the smart use of intellectual property.
8. Deliver a toolbox of measures to support researchers' careers, through a mobility scheme, trainings and more, in order to make Europe more attractive for talent.
9. Launch a platform of peer-reviewed open access publishing and incentivise open science practices by improving the research assessment system.
10. Support the creation of world-class research infrastructures and establish an updated governance structure for research and technological infrastructures.
11. Develop a roadmap of actions for creating synergies between higher education and research, notably building on the dual role of universities.
12. Develop concrete plans with Member States to promote gender equality, as well as diversity and inclusiveness, in science, research and innovation.
13. Organise citizen science campaigns and hackathons to engage citizens, especially young people, In science and innovation.
14. Develop with Member States a new approach to set and implement strategic priorities for the European Research Area, through a Pact for Research and Innovation in Europe

### *EU Programmes on Research and Horizon Europe*

The EU's long-term budget for 2021–2027, the large-scale recovery plan 'Next Generation EU' will lay the foundations of a modern and more sustainable Europe, while promoting an inclusive recovery and social fairness. Research and innovation provide new knowledge and innovative solutions to overcome our societal, ecological and economic challenges. Horizon Europe helps researchers and top class innovators to develop and deploy their ideas. It supports excellent science by team-

TABLE 6.1 Three Pillars for the Implementation of Horizon Europe

| Excellent Science | Global Challenges and European Industrial Competitiveness | Innovative Europe |
|---|---|---|
| European Research Council<br>Maria Skłodowska-Curie Actions<br>Research Infrastructures | Clusters: Health; Culture, creativity, and inclusive society; Civil security for society; Digital, industry, and space; Climate, energy, and mobility; Food, bioeconomy, natural resources, and environment.<br>Joint Research Centre | European Innovative Council<br>European Innovation Ecosystems<br>European Institute of Innovation and Technology. |
| Widening Participation and Strengthening the European Research Area | | |
| Widening Participation and Spreading Excellence | Reforming and Enhancing the European R&I System | |

NOTES Adapted from European Union (2020b).

ing up the best talent and equipping them with world-class infrastructures. Moreover, it supports breakthrough innovations and helps to create new services and markets.

Horizon Europe 2021–2027 (European Union, 2020b) is the world's largest research and innovation programme, and the key instrument of the Union for supporting research and innovation. It builds on Horizon 2020 (2014–2020) by tapping the innovation potential of EU member states and associated countries with more specific targeted actions funding projects for both public and private sector organizations. It is seen as a mean to drive economic growth and create jobs.

- Horizon Europe will finance thousands of research and innovation projects every year up to 2027 in all thematic areas such as, climate change, transport, health, agriculture, energy efficiency the humanities and many others. The key vision is to transfer more practically applicable innovative solution to benefit society and introduce new products and services to the market.
- Horizon Europe will have a budget of around €95.5 billion for 2021–2027 which is 30% more than Horizon 2020. The first Horizon Europe Strategic Plan will define the strategic orientations for our research and innovation investments over the period 2021–2024.

Horizon Europe, compared to Horizon 2020, foresees more and better collaboration with other EU financial instruments, namely the EU Cohesion Policy, the new European Defence Fund (€13 billion, €4.1 billion of which will be devoted to defence research), the international fusion energy project (ITER), Digital Europe Programme and Connecting Europe Facility Digital. The implementation is foreseen through three pillars (see Table 6.1):

- Pillar 1: Excellent science;
- Pillar 2: Global challenges and European industrial competitiveness;
- Pillar 3: Innovative Europe;

## EU Programmes in Western Balkan and Kosovo

The European Union has long supported its partners in the Western Balkans (WB) on their respective integration paths. Direct participation in EU programmes such as Erasmus+, Horizon 2020, Creative Europe, COSME, and Interreg, help the Western Balkans partners boost their development by creating opportunities for young people and researchers (European Commission, 2020l).

*Policy Background.* The WB consists of Albania, Bosnia and Herzegovina, North Macedonia, Montenegro, Kosovo and Serbia (European Commission, 2020l). All have a perspective to accede to the EU and hence are called 'enlargement countries.' A European Council meeting in 2003 adopted the Thessaloniki agenda for the Western Balkans.

- The EU's enlargement policy (European Commission, 2015, 2016) underlines the necessity to invest in peace, security and stability. It stresses that an accession process offering a credible prospect of EU membership is vital to enhance the resilience of countries in the Western Balkans (European Union, 2016) and to spur transformation in these countries.
- As of 2016, the innovation dimension was added to the structural reform agenda of the national Economic Reform Programmes (as of 2015, all candidate countries and potential candidates submit annual Economic Reform Programmes (ERPS) that mimic the European Semester process). These programmes contain a structural reform agenda to boost competitiveness and improve conditions for growth and job creation.

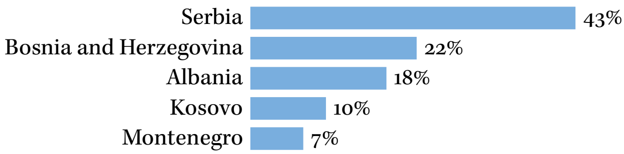


FIGURE 6.1 Percentage of Mobilities in Western Balkan Countries (adapted from European Commission, 2019)

- The *Western Balkans Regional R&D Strategy for Innovation* study (World Bank, 2013) claims that unleashing the Western Balkans' innovative potential would generate important economic gains (e.g. investing 3% of GDP into research and innovation will generate a 6% increase of GDP and a 13% increase in exports).

Below we will present key information about participation of WB countries (WBCS) in:

- Erasmus+, the largest programme for education, and
- Horizon 2020 the largest multinational programme dedicated to research and innovation.

### *WB Countries in Erasmus+ (2014–2020)*

All the WBCS have previous experience since the beginning of the 1990s in the framework of TEMPUS programme and the experience gathered through this programme created the human capacity for similar programmes. Tempus programme (2007–2013) now as Erasmus+ (2014–2020) have played a significant role for 'regional research excellence,' also with regard to equipment.

Statistics on EU-Western Balkan cooperation through Erasmus+ (European Commission, 2019) include data from Montenegro, Kosovo, Albania, Bosnia and Herzegovina, Serbia but no data from North Macedonia (see Figure 6.1).

*Mobility.* Student and staff mobility between Western Balkans and Europe 2015–2018:

- 17,081 mobility from Western Balkan to EU;
- 10,026 mobility from EU to Western Balkan.

*Erasmus Mundus Joint Master Degrees.* From 2014 to 2018, 8 institutions from the Western Balkans were involved in seven of the 153 selected

EMJMDS. The country with highest participation was Serbia involved with four institutions in five of the selected projects. The rest of the countries in the region participated with one university each.

*Capacity Building in Higher Education.* Between 2014–2018 institutions from the Western Balkans took part on 504 occasions in 68 projects for the region: Serbia (40%), Bosnia and Herzegovina (24%), Albania (15%), Kosovo (12%), Montenegro (9%).

*Jean Monnet Activities.* Out of 1,218 successful applications worldwide between 2014 and 2018, 24 are from the Western Balkans, managed by institutions from Bosnia & Herzegovina, Serbia, Montenegro and Albania. They comprise 17 Chairs, Modules and Centres of Excellence, 5 Networks and 2 Support to Associations projects.

### *WB Countries in Horizon 2020*

Some milestones of West Balkan cooperation in science and technology: in 2006 was launched Steering Platform, on Research for the Western, Balkan countries, 2013 was adopted Western Balkans Regional R&D Strategy for Innovation (European Commission, 2019)

All Western Balkans (except Kosovo) are fully associated to the European Union's Horizon 2020 Framework Programme for Research and Innovation. Kosovo is participating in the programme as a non-associated third country.

Key facts on participation of Western Balkan countries in Horizon 2020:

- Funding of Western Balkan research projects has tripled since 2014 to 2020;
- Participation of Western Balkan researchers has increased by 50 % since 2016;
- 339 researchers from Western Balkan countries involved In Marie Skłodowska-Curie actions;
- In WBCS €169.9 millions of EU contribution were allocated. Absorption of founds per country: Serbia (79%), North Macedonia (8.2%), Bosnia and Herzegovina (5.6%), Albania (3%), Montenegro (2.5%), Kosovo (1.7%).

Data of participation in Horizont 2020 from 2014–2020 (European Commission, 2020l) show that Kosovo has the lowest level of absorption of funds under the Horizon 2020 program, which represents a pure scientific research program. This means that Kosovo's researchers need significant financial support in order to be qualified and to participate in deep exchange of experiences between regional and European scientific researchers

*The Western Balkans Agenda on Innovation, Research, Education, Culture, Youth and Sport* (WBC-RTI.info, 2020) outlines a comprehensive, long-term strategy for cooperation with the Western Balkans. It will contribute to the economic development and regional cooperation in the Western Balkans alongside the overall EU support for a rapid restart of the region's economy. The Commission has launched an ambitious Economic and Investment Plan for the region proposing to mobilise up to EUR 9 billion of IPA III funding for the period 2021–2027. Including a new Western Balkans Guarantee facility, with the ambition to potentially raise investments of up to EUR 20 billion (IPA I budget for the six Western Balkan countries amounted to €5.3 billion for the period 2007–2013, IPA II instrument for Western Balkan countries amounted to €6.9 billion the period 2014–2020). This is complemented by the European Commission's proposal on vocational education and training for sustainable competitiveness, social fairness and resilience as well as the New European Skills Agenda3 as well as the European Pillar of Social Rights (WBC-RTI.info, 2020).

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Chapter Seven

# Foreign Direct Investment, Transition and Dependency in Central and South East European Countries

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## Introduction

Eleven Central and South-Eastern European Countries (CSEEC)[1] – three Baltic States, six Central European countries previously in USSR orbit, two successor states of the former Yugoslavia – became new member states (NMS) of the European Union during three waves of membership (2004, 2007, 2013). Five of them have already joined the Eurozone,[2] the rest are expected to join in the near future. The countries of the Western Balkans,[3] for their part, are on the waiting list, most of them having submitted their request to open negotiations for their future membership of the European Union.

The NMS joined the EU after having suffered three successive shocks. These were a systemic shock with the collapse of communism, an economic shock with the adoption of macroeconomic and structural adjustment measures to face the new market environment, and finally an institutional shock in order to meet the strict and restrictive conditions for becoming a member of the European Union: the ability to withstand competition from other Member States and respect for the 'acquis communautaire.'

[1] Estonia, Hungary, Poland, Czech Republic, Slovakia, Slovenia (in 2004), Bulgaria, Romania (in 2007), Croatia (in 2013). Mention should be made of the presence of a 'stowaway,' the former GDR, which was quickly integrated, at a very high cost, into the Federal Republic after the fall of the wall.

[2] Estonia, Latvia, Lithuania, Slovakia, Slovenia.

[3] Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Montenegro, Serbia.

 G. Qorraj & I. Hashi (Eds.), *European Union and the Western Balkans.* ToKnowPress · 2020 · https://www.toknowpress.net/ISBN/978-83-65020-33-8/125-138.pdf

The transformation process, which is short in time, was particularly difficult, violent, especially at the very beginning. Most of these economies have resorted to shock therapy – 'The Washington Consensus' – under pressures of the European Union, major international institutions (IMF, World Bank and EBRD) and the large multinational firms that are there, implanted. Multinational corporations, the 'surprise guests,' via foreign direct investment (FDI), have played, with the European structural and cohesion funds, a determining role in the transformation of these economies, their lasting attachment to the European Union. The transformation of these economies represented a particularly difficult challenge for these formerly 'dependent socialist,' mostly Soviet type economies of the for the most part, self-managed and open economies ( former Yugoslavia) or self-sufficient economies (Albania). When it comes to the transformation and redistribution of property, CSEECS leaders have oscillated between fairness and efficiency with a slider that has often shifted over political majorities. The liberal majorities favoured policies accelerating the movement of privatization. The socialist (ex-communist) majorities sought to curb them in order to continue to exercise control over the assets from a clientelist rather than a social perspective. Systemic constraints (EU membership), the rapid and growing arrival of FDI have accelerated adjustments, the reorientation of trade, and increased their competitiveness.

FDI has greatly contributed to integrating these economies through their massive investments in manufacturing, financial, distribution and infrastructure sectors. Several countries in the region, notably the four countries of the Visegrad group (Czech Republic, Hungary, Poland, and Slovakia) quickly became the hinterlands of Germany and the large Western neighbouring countries.

The transformation policies applied have left no space for alternative forms of control and management of public firms. With the exception of a few monopolies (in energy and telecommunications) which have not been affected, most large firms with growth potential have been absorbed by foreign buyers, some dismembered or even liquidated. These FDI flows have fostered a close industrial network with the EU-15,[4] which can be measured by the specialization as well as the value-added content of exports from the countries of the region, particularly to the

[4] Now EU-14, with the departure of the United Kingdom.

| Area/Contry | (1) | (2) | (3) |
|---|---|---|---|
| *Euro Area NMS* | | | |
| 1 Slovenia | 2.1 | 29 933 | 82.4 |
| 2 Slovakia | 5.4 | 29 224 | 89.4 |
| 3 Estonia | 1.3 | 28 095 | 77.3 |
| 4 Latvia | 2.0 | 23 095 | 65.3 |
| 5 Lithuania | 2.9 | 27 904 | 76.8 |
| *Non-Euro Area NMS* | | | |
| 6 Czech Republic | 10.6 | 31 353 | 86.3 |
| 7 Hungary | 9.8 | 25 654 | 70.6 |
| 8 Poland | 38.4 | 26 051 | 71.7 |
| 9 Bulgaria | 7.1 | 17 794 | 49.0 |
| 10 Romania | 19.7 | 21 608 | 59.5 |
| 11 Croatia | 4.2 | 21 547 | 59.3 |
| *Western Balkans* | | | |
| 12 Albania | 2.9 | 11 359 | 31.3 |
| 13 North Macedonia | 2.1 | 13 055 | 35.9 |
| 14 Montenegro | 0.6 | 15 725 | 43.3 |
| 15 Serbia | 7.1 | 13 723 | 37.8 |
| 16 B&H | 3.5 | 11 327 | 31.2 |
| 17 Kosovo | 1.8 | 9 332 | 25.7 |

NOTES Column headings are as follows: (1) population (million), (2) real GDP per capita (PPP, USD, 2016), (3) real GDP per capita, percentage of EU-28 (2016).

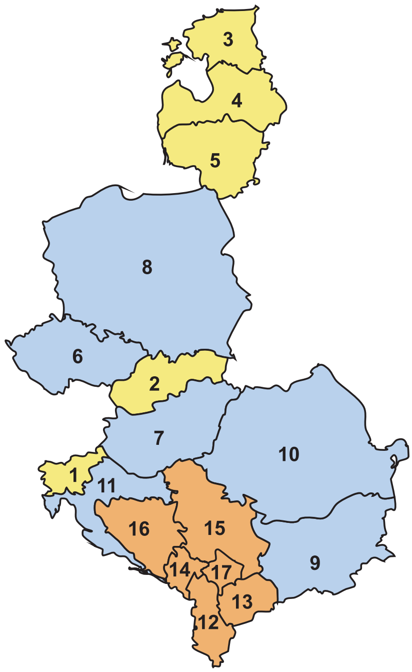


FIGURE 7.1 Market Size of CSEEC

EU-15 (Jirasavetakul & Rahman, 2018). The study of the recent development of capitalism in the region has fuelled many theoretical debates concerning its varieties, the degree of dependence of these new formations around the typology of liberal market economies, coordinated market economies (Ban, 2013; Delteil, 2018). King (2007) introduced a distinction between liberal post-communist dependent capitalism applied in almost all of the countries of Central Europe and patrimonial capitalism (which may derive from then towards prebendalism) implemented in Russia, Ukraine and Central Asia with, which is new, development attempts in Hungary (Magyar, 2016; Scheiring 2018).

The capitalism introduced in the region is, in our eyes, liberal through the form of privatization, governance, institutions, it is also an imported capitalism (Szélenyi 2015). In these countries, capitalist traditions never really existed. Where they existed (Bohemia), they were eradicated by the communist power when it was established in the region. These economies have thus become hierarchically dependent market economies considering the weight of the multinational firms operating there. Today, according to Nolke and Vliegenhart (2009), they form an institutional hybrid (dependent market economy) whose specific comparative advantage is not based on radical or incremental innovations but rather on the construction of assembly platforms for semi-standardized industrial goods (Ban, 2013).

Through their presence, multinational firms play a major role in terms of control, organization, skills and links with the markets (King, 2007). We can measure the dependence of the economies of central and south-eastern Europe quantitatively by recalling a few indicators such as the level, amount, content and sectoral destination of FDI, control of the main manufacturing and financial firms, and the net investments to GDP ratio. To these, we may add the direction and content of trade, the differences between levels of research and development expenditure with the country of origin of investors, migratory movements of skilled labour, and finally the degree of resulting hierarchy in the relations between parent firms, order givers, and domestic, order receiving, firms.

## Towards the Market and the EU: Structural and Institutional Changes

What type of capitalism should have been introduced as a result of these political changes? Ivan Szelényi (2015), following King (2007), distinguishes three modes of development of capitalism that appeared during the years of 1980s and 1990s among the post-socialist economies of Europe and Asia: imported capitalism (Eastern Europe), capitalism from above (Russia, Central Asia), capitalism from below (China). In Russia, the introduction of capitalism took place from above via the constitution of a patrimonial-type capitalism via redistribution within a small elite (the oligarchs).

The patrimonial type of capitalism is characterized by the appropriation of goods and their possible redistribution (prebendalism) by an authority (a person, an institution). This form of redistribution characterized Russian privatizations through which the beneficiaries, the oligarchs, (the *red barons*[5]) seized opportunities to appropriate assets often at a low price. In China, the reform and opening up of the socialist system carried out in the 1980s led to a mixed system with, on the one hand, state sector firms remaining in the hands of the central government and, on the other, the massive entry of private operators via the lowering of entry barriers. The whole is indirectly regulated by monetary and budgetary instruments as well as by various interventions of the centre (credit policy, various industrial policies, distribution of subsidies). This type of capitalism remains subject to the political power which can push for the development of a dynamic private sector, then puncture it, constrain it (access to finance and to markets), or even dismember and destroy certain firms that it has itself helped to emerge. In Eastern Europe, the imported model was that of Western capitalism, especially its liberal variant. Its establishment also met the hopes of the populations of the region, who saw in it the pledge of a prosperous future, moving them definitively away from the shortage socialist model.

The transformation that has taken place in the economies of the region has been articulated around four axes (Richet 1992):

- Macroeconomic stabilization in order to curb inflation and control public and external deficits;
- Creation and development of new market institutions hitherto non-existent or limited ( financial and banking system, competition law and protection of property);
- Reintegration into the world economy (openness, exchange system and currency convertibility);
- Privatization and restructuring of companies and the entry of new domestic and foreign companies.

We can guess the importance of the structural reforms to be accomplished by these economies whose specializations and industrial organization were deeply marked by the imprint of Soviet-type industrialization. There was also the question of the managerial elites available capable of managing companies in this 'capitalism without capitalists' (Eyal et al., 1998), following the sale, the distribution of assets by different means, employees of companies, citizens, national and foreign buyers (companies, investment funds) often difficult to assess.

5 In reference to the American robber barons, the great figures of capitalism who, in the 19th century, made their fortunes by robbing the state.

TABLE 7.1 Varieties of Capitalism in in CESECS, Russia and China

| Country/Region | Mode of introduction | Type of capitalism | Main features | Role of foreign capital |
|---|---|---|---|---|
| CSEEC | From the outside | Liberal | 'Illiberal' for some (Poland, Hungary): obstacles to justice, infringement of press freedom; multi-party kleptocracies (Western Balkans) | Determinant in the shaping of capitalism, in restructuring, control and governance of companies, in the orientation of exchanges, in the specialization of firms |
| Russia, Central Asia | From above | Political capitalism Patrimonial evolving towards prebendalism (Putinian redistribution) A rent economy that is struggling to emancipate itself from Dutch disease (weight of the energy sector) | Illiberal, 'managed democracy'; Multi-party kleptocracies | Weak, controlled, discontinuity, upset entries |
| China | From below | Political and hybrid capitalism:* cohabitation of state, private, foreign (100%), joint (JV), private companies. Half-market, half-administered regulation | Illiberal, totalitarian. Western-style democracy has never been the order of the day Anti-occidentalism Claims. Perenniality of the Party-State on the economy, society | Determining in the development of several sectors, technological catch-up; controlled ( forced transfer of technology, participation in R&D efforts); privileged state sector firms (access to financing) |

NOTES * On the definition of political capitalism, cf. Branko Milanovic (2019): 'Communism is a social system which allowed backward and colonized societies to abolish feudalism, to regain economic and political independence and to build an indigenous capitalism,' that is to say the combination of a 'social and national revolution' in Third World countries. Adapted and developed from Ivan Szélenyi (2015).

We have thus moved from an administered economic system (central fixing of prices and quantities, inputs and recipients of the output) to a market economy system made up of private firms now operating in an open competitive environment. But, in the process, the economy has avoided what has been the strength of capitalism over time during its historical trajectory: entrepreneurial capitalism, managerial then institutional capitalism and now financialized capitalism. A more open system, the Yugoslav model was also constrained by its republican fragmentation and by the control exercised by the national communist parties.

The deprivations practiced in the CSEEC favoured either a particular mode or simultaneously resorted to several modes. The choice of one method of privatization over another was not neutral: it aimed, in one case, to constitute 'popular capitalism' (Czech Republic) by returning to the population what had been nationalized in the name of people in the old socialist system. It also sought to perpetuate industrial flagships, even if it meant selling them to foreign buyers in return for commitments concerning the maintenance of employment, the association of local management with the management of privatized firms. The participation of foreign firms, largely from the European Union, has strongly contributed to reshaping the industrial landscape of the region. This has been done by creating regional value chains, developing sectors that were hitherto non-existent, developing ex-nihilo the banking and financial sectors in return for a strong dependence in terms of the share of FDI in the GDP and control of assets, especially financial assets.

## Foreign Direct Investment: An Instrument of Specialization and Dependence

FDI in the region has largely come from the European economies (EU-15) at more than 70%, more particularly from the closest countries (Germany, Austria) and the most important ones (Germany, France, Great Britain). The absorption capacities of these economies have not diminished over time even if some countries have become formally more reluctant to welcome FDI (Poland, Hungary). The role of FDI is seen there as an instrument that helps to perpetuate the status of semi-peripheral development of the region (Gal & Schmidt, 2017).

On the other hand, in the Western Balkans, FDI represents a windfall to allow the adjustment of economies still too marked by their previous

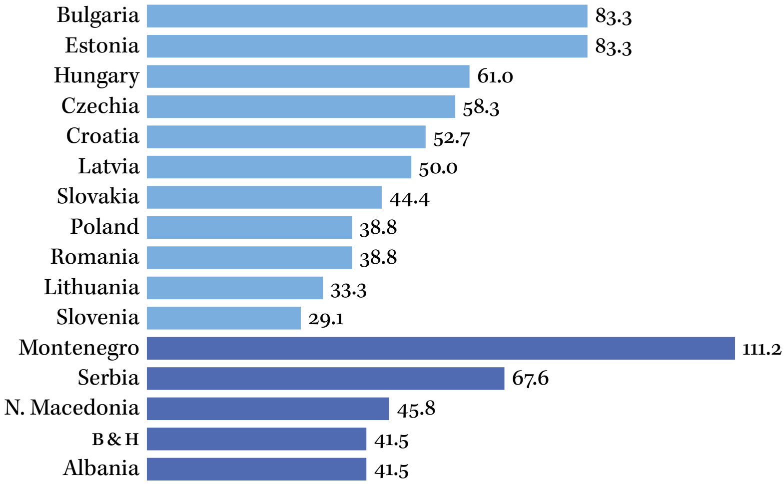


FIGURE 7.2 FDI Stock in New Member States of the EU and Western Balkans (adapted from Jirasavetakul & Rahman, 2018)

specializations, by narrow markets, by still high levels of risk (Estrin & Uvalic, 2014) even if the volumes are still relatively low compared to the NMS due to the fragmentation and narrow markets. FDI outside the EU-15 in the region comes from two sources, North America, notably through US branches in Europe and Asia (Japan, South Korea).

In turn, Asian firms, mainly from China, are investing in the region to develop services, telecommunications, basic industries, energy (nuclear, thermal). Chinese firms are investing in the automobile construction sector: assembly in Bulgaria (no follow-up since the bankruptcy of the joint venture), construction of electric batteries (Serbia, Croatia). This strategy can be seen as the start of building value chains in the region that can later serve as a starting point to reach more mature EU markets. Chinese firms are more in search of service provision (construction of highways, ports, refurbishment of nuclear power plants, construction of thermal power plants). As for acquisitions, they target firms in declining sectors such as chemicals iron and steel industries, in Hungary and in Serbia, which have never been brought up to standard. Green field investments, generally creating jobs, are almost nonexistent. The creation of Chinese banks in Hungary and Serbia should facilitate the assembly and financing of projects within the framework of the new Silk Roads, projects which do not announce the lasting presence of Chinese companies (Richet & Vercueil, 2019; Richet 2019).

The attractiveness of the region to FDI is based on factors of proximity, demand, qualification of the workforce.

- The skilled workforce was quickly absorbed in Western settlements, particularly in the automotive sector, one of the main industries to have relocated massively in the region.
- The low cost of labour has been an additional factor of attractiveness, explaining the high concentration of FDI in the manufacturing sector where wages are still a quarter of the wages paid to employees of parent companies.
- The weakness, even the absence, of sectors essential to the functioning of a developed market economy (banking and finance, services, office property, etc.) and to the supply of the population (mass distribution) has attracted direct investments in large proportions.
- An integration effect in the European market explains the growing flow and the rise in the stock of FDI in recent years.

The share of the stock of FDI in relation to GDP, the contribution of FDI to productive investment, employment and exports show the importance of FDI in the recovery of economic activity and the specialization of firms in the region. The latest entrants (Bulgaria, Romania and Croatia) have benefited from this integration effect. These investments have had and continue to have a positive impact on growth in the region, which, to its benefit, differs from the growth rates recorded in the EU-15.

The massive arrival of foreign firms was a blessing in at the start of the transition: forced to sell assets, sometimes at discounted prices, the CSEEC governments benefited from the contribution of capital, managerial skills, access to western markets. The rapid, continuous and growing entry of FDI, despite frustrating factors such as rising labour costs and competition from countries with lower labour costs, in Asia, has not been denied in recent decades.

The presence of foreign capital raises, in the countries of the region, a sensitive question about the ownership and control of firms. The classic model of division of tasks within the multinational firm still prevails, despite the network effect, the autonomy of the different units in the regional strategy of firms. The strategic and financial decision-making centres, the bulk of research and development remain at the headquar-

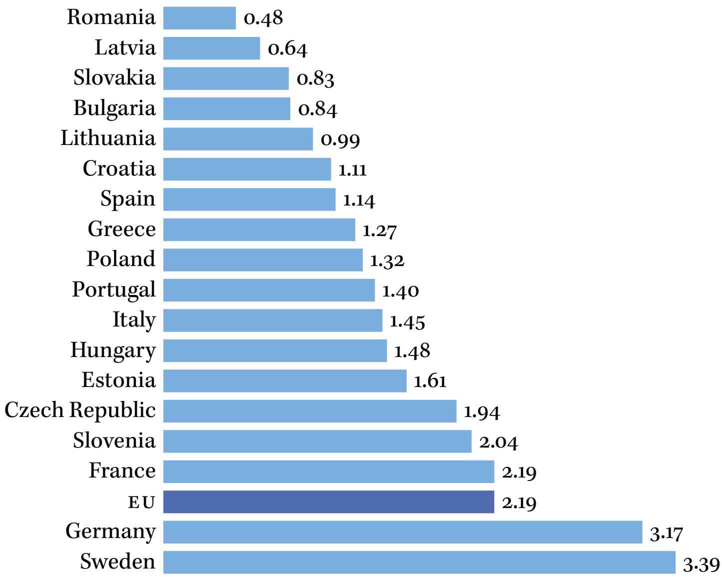


FIGURE 7.3 R&D Intensity in the EU (2019; based on data from Eurostat, https://ec.europa.eu/eurostat)

ters of companies in the West, which reflects the level of dependence of firms in recipient countries and the limits – even the impossibility – of a 'national accumulation' in the countries of the region.

The automotive industry sector illustrates the importance of FDI in the region, the development of new specializations and its linkage to the rest of Europe. The Czech Republic, Slovakia, Hungary, Romania, Poland received significant investment from the EU as well as Japan and South Korea. Through acquisitions and virgin investments, the auto companies have developed highly integrated value chains by specializing recipient countries to produce types of automobiles, components, engines to supply parent factories (final assemblies) or others located in the region (Richet, 2007).

Renault Dacia's success in Romania, on the other hand, shows how Renault's regional strategy (which also produces automobiles in Slovenia, Turkey and Russia) around the development of a low-cost model has been able to develop a regional hub very active. The research and development in charge of this model has been relocated from France to Romania, the factory exports not only automobiles to the region, to the EU-15, but also components (engines, electrical equipment, tires) through Europe, Russia, Morocco where the Tangiers sister plant is highly dependent on Romania for components (Richet et al., 2015).

Despite these positive factors, we can measure the importance of dependence if we consider the weight of FDI in these economies, the net investment position of countries (the presence of firms in the main sectors of the economy such as banking and manufacturing industry). The fact remains that governments and local investors cannot control the decisions and choices of MNCS, as shown by the dominant share occupied by multinational firms in host countries. Governments, on the other hand, find it more difficult to continue playing on tax advantages. The most competitive firms in the region have thus become subsidiaries of large international groups. This integration does not prevent the emergence of highly competitive domestic firms in niches that supply different markets.

Certain companies with majority or full domestic capital integrate firms from their sector in the region. This is the case of, for example, MOL, a Hungarian firm in the energy sector that has made acquisitions in Slovakia and Croatia. This is also the case for branches of Western firms located in these countries which in turn are spreading throughout the region and beyond from their central and eastern European locations. Finally, the Franco-Romanian Dacia plant, both a producer of automobiles and components, as we have mentioned, is today at the centre of an international network of partnerships involving firms, subsidiaries and subcontractors (Asia, Russia, Turkey and Morocco). It is at the same time a strength and a weakness: the blackmail to relocation is never far away when the pressure to increase wages is emerging in the company. Morocco, with much lower wage costs and a strong integration policy can attract parts of the Romanian production.

Both the volumes invested, the proximity dimension and the availability of resources, on the one hand, and the institutional constraints and the instruments of integration on the other, have contributed to reshaping the East European economic area, a process that is currently underway with the Western Balkans. The source of profits for the firms that invest there, the countries of the region have acquired a strong specialization measured in added value terms which places them above the emerging economies of South and even of some countries of Southern Europe previously integrated to the EU (Portugal). The specialization affects the manufacturing sector (labour); it also concerns dynamic service industries. The latter, in the post-crisis period of 2008 account for more than a third of GDP growth in the region due to the strong demand for close external services from European firms.

The economies of the CSEEC, in the space of three decades, have been able to transform their productive systems, to integrate themselves into the international (primarily European) division of labour by developing a certain number of comparative advantages linked to proximity, to the industrial heritage, the quality of the training system, the differentials in labour costs. The mode of privatization and the massive entry of Western, mainly Western European firms did the rest, allowing these economies to adjust quickly. Institutional and structural reforms, with the arrival of FDI, have helped anchor these economies to EU economies. They have created a dependency effect while helping to develop strong specializations in several sectors. It is reflected in particular by the significant share of exports in GDP in terms of added value, reflecting both the effect of relocations and of catching up. The effects of integration and the presence of foreign capital are still being felt as the countries of the region are consistently recording high growth rates.

Several threats exist on the industrial future of these economies: the impact of the international financial crisis and its negative effects on employment, which may accelerate strategies to relocate activities in countries of origin severely affected by unemployment, labour reserve limits and declining demography (coupled with hostile policies against immigration). The more capital-intensive investments (robotics) to counteract this shortage could affect the pursuit of growth if foreign investors repatriate the capital-intensive investments home. In addition, the flow of skilled labour emigration to Western Europe (Hungary, Slovakia, and Slovenia, among others) can quickly dry up future growth reserves. The other threat is to see more labour-intensive foreign investments in the region leaving the host country and heading towards lower cost economies in neighbouring countries (Russia, Ukraine) or in Asia with larger markets. Further south, in the Western Balkans, the factors of attractiveness to FDI exist, but they are still weak, markets remain small, the qualified workforce emigrates, the political instability is still important and the dynamics of domestic demand still weak.

## Conclusion

The configuration of the countries of the region has been profoundly modified by institutional and economic transformations and the arrival of foreign capital. The CSEEC, in a few decades, have undergone a transformation which has made them pass from administered, non-capitalist economies, to market economies within the framework of a globalized economy where the centres of accumulation are fluctuating, where network firms predominate, where value chains are more and more complex and mobile. Finally, a theoretical question arises: how to articulate the concept of dependent capitalism and the domination of the world by the oligopoly of large industrial and financial groups? The role of FDI from the heart of Europe to its periphery has been mentioned throughout this contribution. However, the importance of these investments should be compared to the international investments made by the major European countries in other ways. European firms are internationalizing more, and for a long time outside the EU, in China, in the United States.

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Chapter Eight

# Monetary Policy in the European Union

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## Introduction

In a famous speech in London in the summer of 2012, Mario Draghi, then President of the European Central Bank (ECB) declared that 'ECB is ready to do whatever it takes to preserve the euro' (Draghi, 2012). These words by the highest representative of the European monetary authorities had a powerful impact on financial markets, as they restored the confidence in the single European currency. In this chapter, we will explain that central banks change monetary variables to influence economic fluctuations. The general objective is to smooth the economic fluctuations and ensure price stability, often together with financial stability. Over the last three decades, central bank communication has also become an increasingly important aspect of monetary policy. As illustrated by Mr. Draghi's statement, a credible central bank communication with the public can enhance the predictability of monetary policy decisions and potentially help achieve central bank's macroeconomic objectives.

The process of European integration also includes a monetary unification. When most of the European countries decided to have only one money, they also agreed to have only one monetary policy. The so-called European monetary integration brings a lot of benefits, but also implies a loss of monetary sovereignty. If the economies face similar economic fluctuations, then having a common monetary policy makes sense. However, if some economies are on the brink of recession and other economies are experiencing an over-heating, most likely there will be a disagreement about the course of the monetary policy. It should not be surprising therefore that there are heated debates among

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economists about whether the adoption of the single European currency is a good decision.

In the next section we explain how the central bank conducts its monetary policy. We also refer to the monetary unions and the difficult road to European monetary integration. The second section outlines the main objectives of the monetary policy, whereas the next section elaborates the most widely used instruments of the monetary policy by ECB. The requirements for an optimum currency area (OCA) are a subject of investigation of the fourth section, whereas the fifth section elaborates the EU convergence criteria (also known as the Maastricht criteria). The concluding remarks explore the relevance of EU monetary policy for the countries from Western Balkans.

## Monetary Policy and Monetary Union

### *Monetary Policy*

Getting the monetary policy right is crucial to the health of the economy (Mishkin, 2013). The monetary policy is the setting of monetary variables (either a change in the money supply or a change in the interest rate target) by policymakers in the central bank. By smoothing the fluctuations in economic activity, the monetary authorities aim to bring the actual output closer to the potential output. If the actual output is below the potential output (the long-term tendency or trend of the actual output), then the economy is experiencing a recessionary gap. This period is characterized by a significant reduction in consumer expenditure or investment. When the actual output is above the potential output, the economy is experiencing an over-heating. The inflationary gap is also an unfavorable macroeconomic outcome, as the relative rise in real GDP causes an economy to increase its consumption, leading prices to climb in the long run. Based on the intentions of the monetary policies, we hereby introduce the important distinction between the expansionary and the contractionary monetary policy.

Expansionary monetary policy is monetary policy that increases aggregate demand for goods and services. In this case, the monetary policy expands the money supply, reduces the interest rates, and thereby encourages higher investment and consumer spending. When these two components of the aggregate demand are higher, the aggregate demand will also be higher in the short run ($\uparrow C + \uparrow I + G + X - M = \uparrow AD$). Of course, the impact of monetary policy in practice will also depend on the behavior of public consumption (G) and net exports or net foreign demand (X – M). In contrast, contractionary monetary policy is monetary policy that decreases aggregate demand for goods and services. This type of monetary policy works by decreased money supply, increased interest rates, and lower investment and consumer spending. In the short run, the monetary transmission mechanism will likely lead to a lower aggregate demand ($\downarrow C + \downarrow I + G + X - M = \downarrow AD$).

If the monetary policy is too tight for too long, the economy may fall into recession and the price level may decrease (deflation). If the monetary policy is too relaxed, the central bank will most likely induce high inflation and impede economic growth. Therefore, price stability, commonly defined as low and stable inflation, is increasingly viewed as the most important goal of monetary policy. Let us recall that the inflation rate is the percentage change in the overall level of prices.

Economists argue about the impact of a change in the money supply on the aggregate price level in the long run. Much of the profession maintains that money is neutral in the long run, implying that changes in the money supply have no real effects on the economy. The concept of money neutrality suggests that a change in the money supply would result in equal proportional change in the aggregate price level in the long run.

More recent literature on central bank communication and central bank transparency also underscores the importance of managing expectations of economic agents in conducting the monetary policy. A high degree of central bank transparency and a clarity in central bank communication, both when it comes to announcing new policy tools and when using forward guidance, can reduce market uncertainty and increase the effectiveness of monetary policy.

### *Monetary Union*

While the conduct of monetary policy in a national economy seems to be rather straightforward, it becomes more complex in a monetary union, such as the euro area. A monetary union is an agreement between two or more countries creating a single currency area. One of the most obvious benefits is that having a common currency facilitates international trade. A common currency would easily reveal price differentials, let us say, between the price of a Volkswagen car in Germany and Italy. Influential empirical studies find a large positive effect of a monetary union on international trade, i.e. countries sharing the same currency trade more than they would with different currencies. On average, the empirical literature estimates that the single European currency increased the international trade by between 10 and 20% during the first four years (Frankel, 2010). As we will explain latter, being a member of a monetary union also implies some economic costs.

According to the theory of economic integration, there are several stages of economic integration: (1) preferential trade area; (2) free trade area; (3) customs union; (4) common market; (5) monetary union; (6) fiscal union, and (7) political union. Based on this categorization, the process of European Union integration is now at the fifth stage with certain achievements towards the sixth stage (see the chapter on EU fiscal policy). As El-Agraa (2011, p. 149) underscores, the monetary union 'should specifically include three elements if it is to qualify under this definition: (1) a common monetary policy; (2) a common pool of foreign exchange reserves and a common exchange rate policy, and (3) a single central bank or monetary authority to operate these policies.'

One of the most notable monetary unions is the euro area, presently being comprised of 19 EU member states. This form of currency union involves a creation of a new currency and a new common central bank. It implies that – for instance – the monetary policy decisions for Greece are no longer taken in Athens only, but in Frankfurt am Mein, where the headquarters of the European Central Bank is. It would be a mistake to conclude that Greece does not have a say in formulating the monetary policy decisions. A fairer statement would be that monetary policy decisions are now jointly determined by the 19 EU member states which employ the euro. But what if some countries are on the brink of recession, while others experience overheating of their economies? The former may need expansionary monetary policy and the latter contractionary monetary policy to smooth the fluctuations in economic activity. The monetary policy decisions obviously require detailed analyses and difficult trade-offs to decide which country can join the monetary union and how to accommodate the needs of most of its members. Before examining this issue, we will provide an overview of the euro area and its institutional architecture.

### *The Euro Area and Its Institutional Architecture*

The idea of a European Monetary System (EMS) was initially introduced by the German chancellor, Helmut Schmidt, and the French president, Valéry Giscard d'Estaing. Based on their views, the European Commission set up a committee, led by Pierre Werner, then prime min-

TABLE 8.1 The Three Stages to Economic and Monetary Union (EMU)

| | |
|---|---|
| Stage One<br>1 July 1990 | Complete freedom for capital transactions<br>Increased cooperation between central banks<br>Free use of the ECU (the forerunner of the Euro)<br>Improvement of the economic convergence |
| Stage Two<br>1 January<br>1994 | Establishment of the European Monetary Institute<br>Ban on the granting of central bank credit to the public sector<br>Increased coordination of monetary policies<br>Process leading to the independence of the national central banks to be completed at the latest by the date of establishment of ESCB<br>Strenghtening of the economic convergence<br>Preparatory work for stage three |
| Stage Three<br>1 January<br>1999 | Irrevocable fixing of conversion rates<br>Introduction of the Euro as physical banknotes and coins<br>Conduct of the single monetary policy by the European system of central Banks<br>Entry into effect of the intra EU exchange rate mechanism (ERM II)<br>Entry into force of the Stability and Growth Pact |

ister of Luxembourg, to operationalize the idea. The Werner Committee presented a report, which is an important milestone in the process of European monetary unification. Fast forward through numerous attempts and upheavals, in June 1988, the European Council appointed a committee chaired by Jacques Delors, then President of the European Commission to propose an action plan for an Economic and Monetary Union (EMU). As presented in Table 8.1, it envisaged three stages: (1) all EU members to join the European Monetary System's Exchange Rate Mechanism (ERM); (2) exchange rate margins to be narrowed and certain macroeconomic policy decisions placed under more centralized EU control, and (3) national currencies to be replaced by a single European currency and all monetary policy decisions to be vested in a European System of Central Banks (ESCB).

A unified monetary policy and a single currency have been seen as important steps towards deepening European integration. The single European currency was named the euro in December 1995 and launched on January 1, 1999.

The institutional system behind the single monetary policy is somewhat complex because some EU member states are not part of the euro area. As presented in Figure 8.1, the European System of Central Banks (ESCB) is comprised of the European Central Bank (ECB) together with

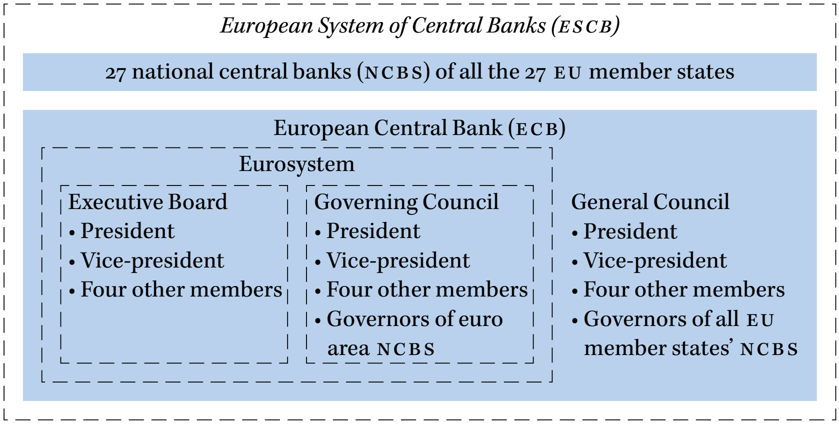



FIGURE 8.1 Structure of the European System of Central Banks

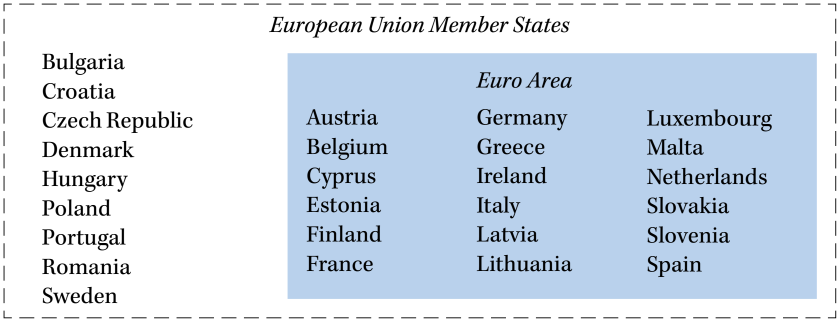



FIGURE 8.2 The Euro Area and the European Union

the national central banks of presently 27 EU member states. The Eurosystem is the central banking system of the euro area. It comprises ECB and the national central banks of 19 EU member states whose currency is the euro. Figure 8.2 provides visualization of the present scope of the euro area.[1] Although some EU member states have not (yet) adopted the euro, ESCB is governed by the decision-making bodies of the European Central Bank. Therefore, the ECB lies at the core of the conduct of the monetary policy of the Union.

The ECB neither encourages nor deters third countries from using the euro. Some European countries – such as Montenegro and Kosovo – have unilaterally adopted the euro as a legal tender. This operation is

[1] Euro-area member states are Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, and Spain.

also known as a unilateral euroization. Despite having the euro as a legal tender, these countries are not formal members of the euro area, as they neither have a seat nor a say on the table at the European Central Bank premises.

## Main Objectives of the Monetary Policy

The primary objective of the ECB's monetary policy is to maintain price stability. In practical terms, price stability is achieved by maintaining inflation rates below, but close to, 2% over the medium term. Without prejudice to the objective of price stability, ECB is also aiming to support economic growth and job creation. Moreover, it is responsible for prudential supervision of credit institutions located in the euro area and participating non-euro area member states to maintain financial stability. It is important to note that central banks may pursue more than one macroeconomic objective. For instance, the USA's Federal Reserve System has a 'dual mandate,' as it pursues two goals: price stability and maximum sustainable employment. The two main objectives of the Bank of England are monetary stability and financial stability.

To achieve its primary objective, ECB bases its decisions on a two-pillar monetary policy strategy. The first pillar is economic analysis of the short- and medium-term determinants of price developments. The second pillar is monetary analysis, which focuses on monetary and credit developments with a view to assessing their impact on future inflation and economic growth.

## Main Instruments of Monetary Policy

Supra-national monetary policy (monetary policy for a union of countries) is not fundamentally different from the 'national' monetary policy. Monetary policy decisions affect price levels (and the economy in general) through a long chain of cause-and-effect events without a guaranteed success. The process usually starts with a change in some of the main standard instruments of the monetary policy:

- Open market operations (OMOS);
- Standing facilities;
- Minimum reserve requirements for credit institutions.

In the aftermath of the Global Financial Crisis in 2008/2009, the ECB has implemented few non-standard monetary policy measures to complement the regular operations of the Eurosystem.

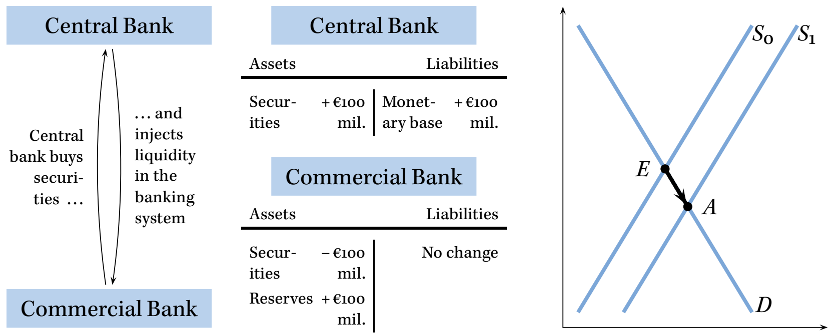



FIGURE 8.3 Open Market Operations to Conduct Expansionary Monetary Policy

*Open Market Operations.* These operations involve purchase and sale of securities that affect both interest rates and the amount of reserves in the banking system. For instance, ECB could inject money into the economy by buying some securities in open market operations. As presented in Figure 8.3, this will inject liquidity in the banking system, i.e. increase the quantity of bank reserves.

There are four types of open market operations: main refinancing operations; longer-term refinancing operations, fine-tuning operations, and structural operations. The Eurosystem's regular Open Market Operations (OMOS) consist of one-week liquidity-providing operations in euro (*main refinancing operations,* or MROS) and three-month liquidity-providing operations in euro (longer-term refinancing operations, or LTROS). MROS serve to influence short-term interest rates, to manage the liquidity situation and to signal the monetary policy stance in the euro area, while LTROS provide additional, longer-term refinancing to the financial sector.

Less regular open market operations are *fine-tuning operations* and *structural operations.* The aim of the former is to deal with unexpected liquidity fluctuations in the market, in particular with a view to smoothing the effects on interest rates, while the latter are mainly aimed at adjusting the structural position of the Eurosystem vis-à-vis the financial sector on a permanent basis.

*Standing Facilities.* The Eurosystem offers credit institutions two standing facilities: (1) marginal lending facility in order to obtain overnight liquidity from the central bank, and (2) deposit facility in order to make overnight deposits with the central bank.

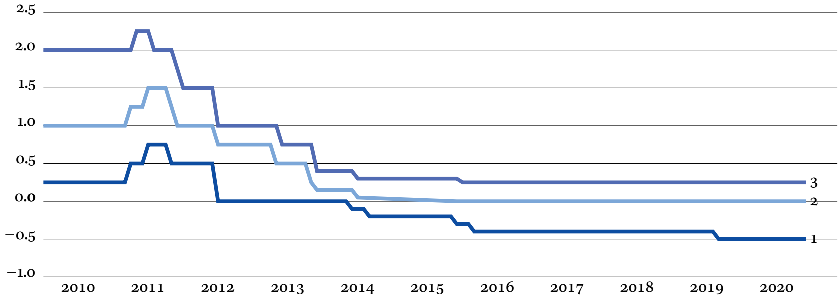



FIGURE 8.4 Key ECB Interest Rates (Percentages per Annum), 2010–2020 (1 – interest rate on the deposit facility, 2 – interest rate on the main refinancing operations, 3 – interest rate on the marginal lending facility; adapted from European Central Bank, 2021)

*Minimum Reserve Requirements.* Reserve requirements are commonly defined as the amount of funds that a bank holds in reserve to ensure that it is able to meet liabilities in case of sudden withdrawals.

The main instruments of the monetary policy are implemented at appropriate interest rates. It is the Governing Council of the ECB that sets the key interest rates for the euro area. As presented in Figure 8.4, these interest rates were in the range between 0 and 2.25% in the past decade. In June 2014, the ECB was the first major central bank to lower one of its key interest rates into negative territory. The risk of deflation in the euro area intensified and ECB decided to push the interest rates below zero. At the time, this was widely considered as a controversial move, but today, negative interest rates are a standard instrument in the ECB's toolkit.

The change of the official interest rates is only the start of a long chain of cause-and-effects events. A change in the monetary variables would affect not only the money market interest rates, but also the expectations of the economic agents. By impacting credit activity, asset prices, bank rates, and the exchange rate, this monetary transmission mechanism also influences the wages, the supply and demand in goods and labor markets (Figure 8.5). The ultimate policy variable of interest is price developments, which is associated with the central objective of the monetary policy.

## Optimum Currency Area

The Nobel laureate in economics, the Canadian Professor Robert Mundell, the Stanford Professor Ronald McKinnon and the Princeton Uni-

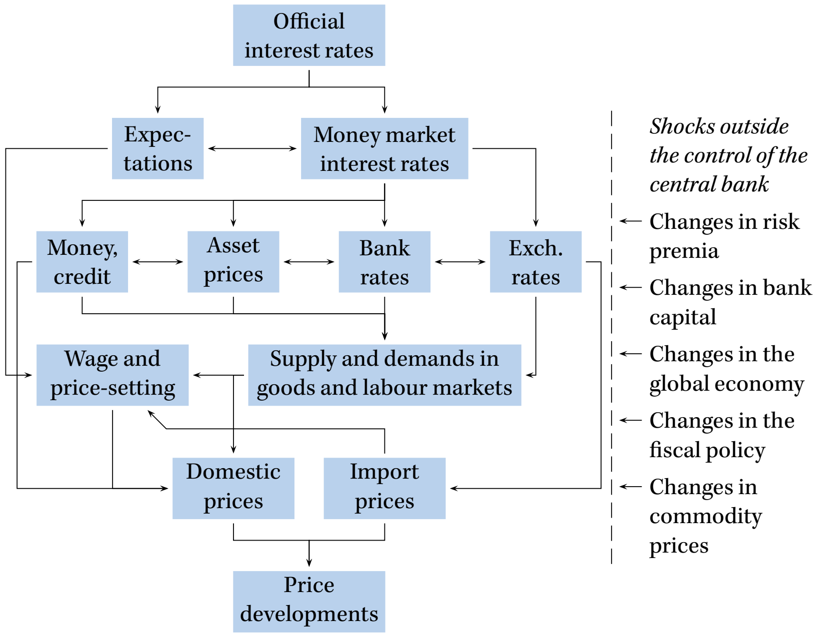


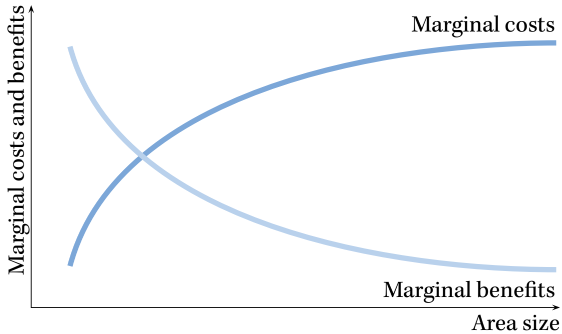

FIGURE 8.5 The Monetary Transmission Mechanism (adapted from European Central Bank, 2021)

versity Professor Peter Kenen are considered to be the founders of the Optimum Currency Area (OCA) theory. Their pioneering work in the field of optimum currency areas has examined the *pros* and *cons* of a monetary unification. What is an Optimum Currency Area (OCA)? OCA is a geographical region in which it would maximize economic efficiency to have the entire region share a single currency. It is a theoretical construct, as no country conforms to the ideal. Nevertheless, the United States of America with its high labor and capital mobility comes much closer to the ideal than Europe. In principle, as the currency area grows larger, it becomes more difficult to satisfy and accommodate the needs of the diverse group. The marginal costs are rising with the size of the currency area, and at one point, exceed the marginal benefits (see Figure 8.6). The marginal benefits also grow with the size of the currency area, but they tend to decline over time. The optimal size of the currency area is at their point of intersection.

To satisfy the conditions of the optimum currency area, the OCA theory underscores the need for: (1) labor mobility, so that people can move easily from depressed to prosperous regions; (2) the production

FIGURE 8.6

Marginal Benefits and Costs According to the Optimum Currency Theory (adapted from Burda and Wyplosz, 2016, p. 350)




and exports are widely diversified and countries produce similar goods; (3) countries should be open to trade and trade heavily; (4) there has to be a common insurance and system of transfers, so that countries facing unfavorable shocks are compensated for; (5) a high degree of homogeneity of national preferences; and (6) a sense of solidarity.[2] However, as Frankel and Rose (1998) highlight, even countries that do not satisfy *ex ante* this criteria, could still enjoy benefits from the monetary unification, once they become members of the currency area. Becoming a member of a broader currency area would later facilitate trade and investment flows, enhance labor mobility, strategic gains from the integration, etc. This is the essence of the so-called endogenous Optimum Currency Area theory, which postulates that belonging to the common currency area can speed up economic convergence, expand trade and increase foreign direct investment (Warin et al., 2009).

### *Expected Economic Benefits*

A famous remark by Alesina and Barro (2002) is that a currency is like a language. As a common language facilitates effective communication among people, a common currency can promote trade and investment among its members. There are several benefits from the participation in a currency area.

*Reduced Exchange Rate Uncertainty.* There is a strong empirical evidence that increased exchange rate variability negatively affects foreign trade. If you were an exporter, it would not be the same if the euro fluctuates a lot. Financial markets provide 'hedging' (protection) from exchange rate risk, but it is expensive and not universally available.

[2] The interested reader can find a more extensive explanation of the Optimum Currency Area conditions in Burda and Wyplosz (2016).

*Reduced Transactions Costs.* The expected reduction of transactions costs is an estimated saving of 2–3% of EU's GDP. Large bank resources (personnel and equipment) were used for conducting FOREX operations and there were significant transaction costs when switching currencies. Even as a tourist it is very convenient to move from one to another EMU member states with the same currency in the pocket. The citizens of Kosovo and Montenegro also enjoy this privilege.

*Price Transparency.* A single European currency enables an effective comparison of prices across EU. In case an Italian citizen finds that the same model of Volkswagen is 2,000 euros more expensive in Italy than in Germany, it may be worthwhile to buy it from Germany.

*The Benefits of Commitment.* Over time, economies with traditionally weak currencies have realized that they need the euro as an anchor. Without the euro, they would have experienced a spiral similar to that of developing countries: a speculative attack, a balance-of-payments crisis, jumping interest rates, and so forth (Alesina & Giavazzi, 2010). The euro initially imposed a monetary discipline on the peripheral euro area countries (e.g., Italy, Spain, Portugal, and Greece) with previously poor inflation records. The EMU membership also reduced country risk premia, led to a reduction of both nominal and real interest rates, and contributed to low and stable inflation.

### ***Expected Economic Costs***

There are also economic costs associated with the loss of monetary sovereignty. These costs occur because the country may not fully satisfy all the requirements to become part of the OCA. Let us review some of the main economic costs from the participation in a currency area.

*Loss of Monetary Autonomy.* We already explained that joining a monetary union – such as the euro area – implies a loss of the monetary sovereignty. The national central bank cannot set the interest rates by itself and cannot pursue an independent monetary policy.

*Limited Possibilities for Real Exchange Adjustment.* Had Greece not abandoned the Greek drachma, many economists point out, the Greek central bank could have devalued its currency and boosted the exports of goods and services. A devaluation of the Greek drachma would make the Greek products and services more price competitive. However, an exchange rate correction to help a single country is no longer a possibility in the monetary union. Only if many members of the monetary union are having the same problem, that could be a viable policy option. To improve county's price competitiveness, the Greek authorities were left with the option to reduce the wages and/or the prices. This so-called internal devaluation can create an unbearable hardship for ordinary citizens and many firms. It is particularly challenging to undergo an internal devaluation, when the labor unions are very strong and vocal and the prices and wages are sticky.[3]

*Synchronisation of the Business Cycles.* The degree of synchronization of the business cycles or co-movement of economic activities strongly depends on the degree of trade integration.[4] If the countries have similar macroeconomic developments and trade heavily, then their business cycles could be similar (Figure 8.7, left).[5] Sometimes countries are being hit by asymmetric or country-specific shocks. Let us assume there were widespread floods in Spain. This weather-related natural disaster could easily decouple the business cycle in Spain from that in the other members of the currency area and produce desynchronised business cycles (Figure 8.7, right). It would be a problem for the common central bank to decide which country to favor.

## EU Convergence (Maastricht) Criteria

To ensure greater compatibility of the members of the euro area and measure the progress in countries' preparedness to adopt the euro, the Treaty of Maastricht, concluded in 1992, introduced five convergence criteria that the EU member states are required to satisfy before joining the EMU:

- *Price developments:* the inflation rate not to exceed by more than 1.5 percentage points the average inflation rate of the three best-performing member states in terms of price stability for a period

[3] Price stickiness (or sticky prices) are prices that adjust sluggishly and, therefore, do not always equilibrate supply and demand (Mankiw, 2019).

[4] For instance, see Frankel and Rose (1998), Bordo and Helbling (2004), and Artis and Cleays (2005).

[5] It is not surprising therefore that countries with significant share of exports to Germany have similar cycles as the German economy. De Grauwe and Yuemei (2016) argue that business cycles also reflect waves of optimism and pessimism that become correlated internationally.

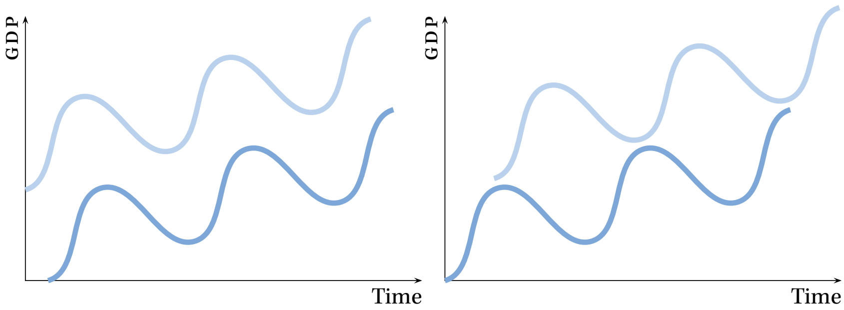



FIGURE 8.7 Synchronised vs. Desynchronised Business Cycles

of one year before the examination. If the average inflation rate of the three best-performing countries is 1%, the inflation rate should not exceed 2.5%.

- *Long-term interest rate developments:* country's average long-term interest rate over one year must not exceed – by more than 2 percentage points – the average interest rate observed in the three best-performing member states.
- *Exchange rate developments:* membership in the Exchange Rate Mechanism[6] (at least two years in the ERM without a devalution).
- *Fiscal developments:* budget deficit must not exceed than 3% of the Gross Domestic Product (GDP), and public debt must not exceed 60% of GDP. If this is not the case, the planned debt level should be sufficiently diminishing and approaching the reference value of 60% of GDP at a satisfactory pace.

What if an EU member state – after satisfying these criteria and joining EMU – pursues a fiscal indiscipline? Safeguarding sound public finances is a particularly important requirement for EMU to function properly. The EU adopted a Stability and Growth Pact (SGP) legislation as a rule-based framework for coordination of national fiscal policies among EMU members. SGP opens the way for the European Council to penalize any euro area member state that fails to take corrective measures to end an excessive deficit. The central objective of this so-called

[6] The European Exchange Rate Mechanism (ERM) was established to stabilize exchange rates and enhance monetary stability before the introduction of the euro. After the introduction of the euro on 1 January 1999, the original ERM was replaced by ERM II (Exchange rate mechanism II) at the start of Stage Three of Economic and Monetary Union (EMU).

**Box 1** Can the Euro Survive?

The different macroeconomic conditions among EMU members led to excessive lending by the advanced EMU economies (Germany and France) to Southern countries (such as Greece, Ireland, Italy, Portugal, and Spain). This contributed to imbalanced capital flows within the euro area, high government budget deficits, elevated public and private debts, and real estate bubbles (most notably, Spain) in the Southern member states. Once the financial markets expressed concerns about their debt sustainability, investors rapidly increased the interest rate spreads for their government bonds. Huge rescue packages by the Troika (the European Commission, ECB, and the International Monetary Fund), also accompanied by a painful reform agenda or 'austerity measures,' were prepared to avoid a sovereign default. Critics pointed out that these emergency packages were essentially rescuing the private European banks – mainly from France and Germany (Ardagna & Caselli, 2012).

Prominent economists, such as the Nobel Prize laureates in Economics, Joseph Stiglitz and George Akerloff, the Princeton University Professor and IMF economist Ashoka Mody and many others have expressed serious concerns about the future of the euro. Their main argument is that Europe is attempting to build a political union around a new currency (Stiglitz, 2016; Mody, 2018). In other words, Europe is still very far from an optimum currency area, as some of the EMU members do not fulfil the criteria for joining the monetary union. Another conclusion is that the 'one-size-fits-all' monetary policy is causing a divergence among economies, with some 'peripheral' economies experiencing serious economic problems (high unemployment rates, high levels of public debt, competitiveness problems, etc.). In a nutshell, they underscore that the euro was flawed even its birth and that the current structure of the euro area promotes divergence rather than convergence. Other influential economists (e.g., Helge Berger, Giovanni Dell'Ariccia, and Maurice Obstfeld) are more supportive. They argue that 'the institutional architecture supporting Europe's currency union remains incomplete and leaves the region vulnerable to future financial crises.' They highlight that Europe needs more fiscal discipline, a common fiscal policy, a full banking union, and a full capital market union.

Excessive Deficit Procedure is to encourage a member state to get its budget deficit under control.

It is difficult to estimate EMU's degree of success in economic terms. On one hand, the common European currency – which is now 22-year-old – is the second important currency in the world, after the United States dollar. Moreover, the ECB has been rather successful in maintaining the price stability (Whelan, 2019). The euro area also contributed to enhanced trade and investment flows among the EMU members.

However, the European debt crisis – or the euro area crisis – in 2009–2012 revealed that there are significant structural problems in the euro area (see Box 1).

## EU Monetary Policy and the Western Balkans

The six countries from Western Balkans (Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia), also known as WB-6, have a high degree of trade and financial integration with the European Union and the euro area member states. The geographical proximity facilitates significant international trade flows and sizeable inflows of Foreign Direct Investment from the EU/EMU to WB-6.

The ability to conduct an independent monetary policy of WB-6 countries is strongly dependent on the choice of the exchange rate arrangements.[7] In that context, WB-6 can be divided into two groups of countries with: (1) fixed exchange rate regimes (unilateral use of euro in Kosovo and Montenegro, a currency board arrangement in Bosnia and Herzegovina, and *de facto* fixed exchange rate regime in North Macedonia); and (2) flexible exchange rate regimes (inflation targeting and floating exchange rate regime in Albania and Serbia).

*Unilateral Use of the Euro.* Kosovo and Montenegro have already adopted the euro as a legal tender and a de facto currency. These two Western Balkans countries have no independent monetary policy. They are unilaterally euroized and fully rely on the credibility of the ECB and the euro as a global reserve currency. In a sense, these WB countries are passive members of the euro area. Their central banks are focused on strengthening the soundness, solvency, and efficient functioning of their financial systems as well smooth functioning of the payment systems.

*Currency Board Arrangement.* Bosnia and Herzegovina has tied its currency (the convertible mark, KM) to the euro through a currency board arrangement. The central bank maintains monetary stability by issuing domestic currency with full coverage in freely convertible foreign exchange funds under fixed exchange rate (1 KM: 0.51129 euro). The intention is to reduce exchange rate volatility and promote monetary sta-

[7] The interested reader would find a vast literature on the so-called Mundellian Trilemma. The Mundellian trilemma – also referred to as the Mundell-Fleming trilemma – has been a popular concept in international macroeconomics to explain important policy trade-offs among monetary independence, degree of exchange rate flexibility, and financial openness. Given that the trilemma allows for co-existence of maximum two policy goals, it has also come to be known as the 'inconsistent trinity.' One of its main implications is that it is not feasible to attain at the same time exchange rate stability, full capital mobility, and monetary policy independence.

bility by fixing the domestic currency against the euro as chosen anchor currency. The adoption of the currency board arrangement has given Bosnia and Herzegovina a stable and trusted currency as well as a low inflation rate. Such a macroeconomic environment promotes significant bilateral trade and investment relations with the EU member states.

De facto *fixed exchange rate regime.* The monetary policy of North Macedonia is based on exchange rate targeting. Even though officially classified as a managed exchange rate arrangement, the country has a *de facto* fixed exchange rate regime linked to the euro, thereby preserving the ability to change the exchange rate in case of large shocks. With a fixed exchange rate regime, the ability to set monetary policy is very limited and dependent on the country's degree of financial openness. Since the country uses the euro as an anchor currency, the exchange rate against the other major currencies reflects the performance of the euro in international markets. To illustrate this, imagine hugging a dolphin, placing your full trust in its good intentions, and letting the dolphin decide how to swim or float.

*Managed Floating Regime.* The National Bank of Serbia chose inflation targeting and a managed floating exchange rate regime to ensure price stability. After the pandemic outbreak in 2020, the central bank of Serbia signaled a public commitment to a stable exchange rate relative to the euro. Although Albania has a flexible exchange rate regime, it has remained broadly stable. In sum, Albania and Serbia have a significant space for pursuing an accommodative (independent) monetary policy, because of their flexible exchange rate regimes.

If we exclude Montenegro and Kosovo, the other four Western Balkans countries have historically had a high degree of currency substitution (euroization). Put differently, a large portion of the deposits and loans in the financial systems are either in euros or are linked to the value of the euro (euro-indexed deposits or loans). The currency and assets substitution (in the case of Western Balkans known as 'euroization') are features of the countries in transition, which in the past faced with financial and monetary crisis in the system, and hence diminished credibility of the domestic currency (Besimi and Pugh, 2007). The substantial presence of foreign-owned banks in the financial system can also be an important euroisation factor.

The central banks of WB-6 countries closely follow the monetary policy decisions made by ECB and the daily movements of the key interest rates. The ECB and the national banks of the EMU member states also provide substantial technical cooperation for the national central banks of the EU candidate and potential candidate countries from Western Balkans. The areas vary from central bank statistics, payment systems, money laundering, bank supervision, financial stability, internal audit, information technology, to implementation of other central banking standards. After all, the ECB and the national supervisory authorities of the euro area countries are also home supervisors of many multinational banks that have a presence in the Western Balkans. Therefore, the monetary policy coordination and technical cooperation are mutually beneficial. The ultimate goal of these programmes is to prepare the central banks of the WB-6 region for membership of the ESCB, once the respective countries join the EU. Their success depends on many factors, but as the British statesman, Sir Winston Churchill, put it, 'Success is not final; failure is not fatal: It is the courage to continue that counts.'

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Chapter Nine

# Fiscal Policy in the European Union

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## Introduction

The European Union (EU, hereafter) Fiscal Policy represents an illustrative example of the increasing interaction between the sovereign EU member states' independent fiscal policy and the single authority of the monetary policy, promoted since 1999 by the European Union Central Bank, for achieving sustainable fiscal balance, sustainable development and sustainable growth. Therefore, sustainability as the focus of EU policy has been the subject of a lively public and academic debate (Collignon, 2012).

The European Council reached an agreement on the Stability and Growth Pact (SGP, hereafter) in June 1997, which clarifies the excessive fiscal deficit policies as anticipated by the Maastricht Treaty. After preliminary German suggestion for a Stability and Growth Pact (SGP), the debate in the European Union (EU) led to a double strategy: *The first strategy* requires an anticipatory, early warning system for detecting and adjusting the budget to ensure that the government budget deficit will not exceed the ceiling of 3 per cent of GDP. *The second strategy* requires an action for adjusting excessive deficits speedily, if they occur. Thus, countries should struggle for a balanced budget in the medium run (Heipertz & Verdun, 2003).

The SGP has met many conflicting considerations among economists, thus questioning the reasoning for checks and limits on countries' national fiscal policy in a monetary union. This chapter will attempt to examine the importance of the sustainability of fiscal policy for debt and deficit levels bearing in mind the EU framework. The chapter examines the necessity for budgetary guidelines in a monetary union from a political economy viewpoint. There are motives that may validate cer-

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tain fiscal policy rules because there is no assurance that governments will be able to control their deficits (Calmfors & Wren-Lewis, 2011). The first section of the chapter outlines the fiscal policy in the EU by focusing the analysis on the need for fiscal rules in the European Monetary Union (EMU) countries. The second section of the chapter reviews details of the SGP. The third section of the chapter outlines the European semester for economic and fiscal policy coordination. The fourth section outlines the implications of the EU fiscal policies for the Western Balkan (WB) countries and reviews some of the economic policies applied in the Western Balkan for approximating the region with the EU integration economic path.

## The Fiscal Policy in the European Union

The role of fiscal discipline in a monetary union has a significant impact on a country's economic growth and other macroeconomic imbalances. The deficiencies of the monetary policy in the EMU due to its centralized status within the European Central Bank (ECB), in responding to country-specific shocks, made fiscal policy a pivotal element to better mitigate those shock, i.e. impacting the country's economic growth, inflation, budget deficit and government debt (Dabrowski, 2015; Hartmann & Smets, 2018).

### *Fiscal Displacement, Fiscal Autonomy and Fiscal Coordination*

Based on the Maastricht convergence criteria related to fiscal discipline, according to article 127 of the Treaty of the Functioning of the European Union (2012) (TFEU, hereafter), the primary objective of the ECB has always been to maintain price stability. However, a constant growth of public debt may lead the central bank to use monetary policy to finance the government's budget deficit, thus, causing a state of fiscal dominance and making the central bank impotent in applying autonomous decisions and highly dependent on the fiscal position of the government, thus abandoning price stability. A constant rise in public debt may lead the central bank to applying monetary policy that would finance the budget deficit (Bordo & Siklos, 2015). Hence fiscal autonomy of the EMU sovereign countries is related to tax autonomy (taxing power of sub-central governments) and intergovernmental grants, aiming to better understand sub-central finance and intergovernmental fiscal relations (Blöchliger & Rabesona, 2009). With respect to tax autonomy, the most notable evolution is the increase in the 'discretion on tax rates and tax reliefs' at the state level, the move towards more restrictive 'discretion on tax rates' category at both sub-central government (SCG) and state level, and the reduction of SCG power to determine their share in 'tax sharing arrangements' (Blöchliger & Rabesona, 2009). The role of fiscal policy coordination with a monetary policy is to provide sustainable economic growth in a context of price stability and external accounts as well as financial stability provided by interest rate and exchange rate stability (Laurens & De La Piedra, 1998). Fiscal policy coordination, on the other hand, is regarded as a critical tool for economic management by systematic monitoring of a country's fiscal policies between different levels of government that help achieving national goals in maintaining macroeconomic stability (Daniel & Davis, 2006).

### *The Need for Fiscal Rules in the EMU Countries*

The convergence criteria related to fiscal policy applies in the EMU. Doubts about the effectiveness related to excessive deficit procedure as predicted in the Treaty, led to the proposal by the German minister of Finance (Waigel) for a stricter application on the rules for budgetary discipline.[1] After intense discussions, the European Council finally, with a force of law, adopted two council regulations and a resolution for the SGP, which does not have the force of law.[2] The regulations were related to the excessive deficit procedure and to surveillance.

According to the authors of the Maastricht Treaty, there is a necessity for a certain instruments to guarantee fiscal policies of the member states. The most convincing argument for the Stability and Growth Pact is that if public debt is anticipated to be on an unsustainable sequence, it may threaten price stability. As pointed by De Grauwe (1996) a high level of government debt may increase the inflationary bias. Following De Grauwe (1996), we can illustrate government budget constraint, as follows.

$$B_t = G_t - T_t + (R_t + \pi_t^e - \pi_t)B_(t-1), \tag{9.1}$$

[1] Germany, deeply attached to the concerns of price stability, proposed that under normal cyclical circumstances the budget deficit should not be higher than 1 per cent of GDP in order to create a safety margin below 3 per cent. It was also suggested that sanctions were to be imposed automatically, when the budget deficit exceeded the 3 per cent reference value.

[2] The resolution, which express political commitment, provides guidance to the council and member states on the application of the pact.

where $B_t$ is the debt to GDP ratio, $G_t$ is the primary government spending as a ratio of GDP, $T_t$ is total tax revenue as a ratio of GDP, $R_t$ is the real interest rate, $\pi_t$ is the inflation rate and $\pi_t^e$ is the expected inflation rate.[3] From equation (1), it follows that only the unanticipated component of inflation, $(\pi_t^e - \pi_t)$ affects the budget constraint. Setting $B_t = 0$, we obtain the debt to GDP ratio stabilizing condition, which, may be considered as a precondition for sustainable fiscal policy. It follows:

$$T_t = G_t + R_t B_{t-1} + (\pi_t^e - \pi_t) B_{t-1}. \tag{9.2}$$

Assuming rational expectations, we can write the sustainability condition as follows:

$$T_n = G_t + R_t B_{t-1}, \tag{9.3}$$

where $T_n$ is the 'natural' rate of taxation given the level of spending, the accumulated debt, and the real interest rate. $T_n$ is independent of inflation. Substituting equation (3) into equation (2), yield the following equation.

$$T_t = T_n + (\pi_t^e - \pi_t) B_{t-1}. \tag{9.4}$$

Based on these formulations, we expect that the unanticipated increase in inflation reduce the burden of the debt, in the same way, as it increases the output in the short run. The long run solvency constraint is similar to the natural rate of output growth. Assuming the authorities will tend to minimize the loss function, $L$ of the form.

$$L = T_t^2 + A\pi_t^2. \tag{9.5}$$

Substituting equation (4) into equation (5), and assuming that the unanticipated component of inflation $(\pi_t^e - \pi_t)$, reach the equilibrium point of inflation rate $\pi^*$, it follows:

$$L = (T_n + \pi^* B_{t-1})^2 + A\pi_t^2, \tag{9.6}$$

where $L$ denotes the loss function of the central bank and $A$ denotes the coefficient of the inflationary bias measured by the terms of maturity of government debt. The equilibrium inflation rate becomes:

[3] We have written the nominal interest rate as the sum of the real interest rate and the expected inflation. From equation (1), it follows that only the unanticipated component of inflation $(\pi_t^e - \pi_t)$ affects the budget constraint.

$$\pi^* = \frac{B_{t-1}}{A(G_t + R_t B_{t-1})}. \tag{9.7}$$

This means that the debt to GDP ratio, denoted by the coefficient of $B$, affects the equilibrium point of inflation rate. Therefore, reaching a convergence to a low debt to GDP ratio reduces the risk potential for the EMU to face an inflationary bias.[4]

Although the ECB has a high degree of independence from the respective country government, it still may be forced to abandon the anti-inflationary policy. In case a specific EMU country gets into fiscal trouble, it is more likely to expect risk averse behavior from the potential investors within that country, by postponing the payments and hence sell their bonds. Accordingly, bond prices will start to go down and therefore the banks holding these lowered bond prices will find their capital reduced due to lowering pressures of bond prices, provoking the real and potential depositors to run away from the banking sector. This will increase the possibility of bailout and therefore make it very hard for the ECB to avoid getting involved (Eichengreen & Wyplosz, 1998).

Table 9.1 suggest that countries witnessing a rise in their government debt ratio also experience an expansion of government claims in bank portfolios. The first three columns of Table 9.1 show that in most countries the relative importance of banks, lending to government is not excessive. However, an additional safeguard that the SGP offers may be required on two grounds. First, EMU, may lead to more government borrowing and second, financial markets may not be able to discipline governments (Eichengreen & Wyplosz, 1998). The creation of a monetary union has contributed to the national governments following less sensible prudent policies, considering the following argument: Before the EMU, the country borrowing action was limited to the domestic capital market supply. The extra borrowing above the limit of the domestic market conditions would have exposed the borrowing country to the foreign exchange rate risk, thus causing potential losses for the respective borrowing country due to financial market speculations. With euro in the economic life of EMU countries, the capacity of the domestic capital market supply increases, which enables countries to in-

[4] According to De Grauwe (1996), by applying other forms of reducing inflationary bias like reducing the terms of maturity of government debt or issuing indexed debt the benefits of unanticipated inflation are reduced, and thereby the inflationary bias.

TABLE 9.1 Claims on Central Government as a Percentage of GDP and General Government Debt as a Percentage of GDP for Different Times in the EU and Non-EU Countries

| Country | Claims on central government as a percentage of GDP | | | General government debt as a percentage of GDP | | |
|---|---|---|---|---|---|---|
| | 2000–2010 | 2011–2015 | 2016–2020 | 2000–2010 | 2011–2015 | 2016–2020 |
| Euro Area | 8.10 | 13.49 | 21.42 | 60.87 | 90.45 | 90.97 |
| EU | 7.65 | 12.17 | 19.28 | 60.61 | 85.51 | 85.37 |
| United Kingdom | 3.82 | 26.83 | 28.55 | 57.92 | 107.97 | 116.99 |
| Switzerland | 12.55 | 8.36 | 1.08 | 50.57 | 41.80 | 30.30 |
| United States | 20.18 | 34.80 | 39.99 | 91.17 | 134.37 | 136.24 |
| Albania | 34.80 | 29.34 | 26.19 | 58.83 | 67.52 | 73.14 |
| Bosnia | −4.79 | 0.04 | 0.26 | 29.67 | 43.14 | 37.86 |
| Kosovo | −14.40 | −10.06 | −0.22 | 4.82 | 9.46 | 13.10 |
| North Macedonia | −2.23 | 5.00 | 9.06 | 32.89 | 29.73 | 37.41 |
| Serbia | −0.97 | 2.53 | 6.48 | 69.76 | 49.04 | 58.02 |

NOTES Claims on central government include loans to central government institutions net of deposits, the values are weighted averages. Based on data from International Monetary Fund (https://www.imf.org), World Bank (https://www.worldbank.org) and OECD (https://www.oecd.org).

crease the borrowing activity without taking on any potential exchange rate risk pressure.

## Stability and Growth Pact

The Stability and Growth Pact provides a working clarification of the Treaty's budgetary rules. It defines the actions for multilateral budgetary surveillance (preventive arm) as well as the conditions under which the excessive deficit procedure may be applied (corrective arm) (Heipertz & Verdun, 2010). The Pact is an essential part of the macroeconomic framework of the Economic and Monetary Union. By requesting Member States to coordinate their budgetary policies and to avoid excessive deficits, it contributes to achieving macroeconomic stability in the EU and plays a crucial role in securing low inflation and low interest rate, which constitute essential assistance for providing sustainable economic growth and job creation (Heipertz & Verdun, 2010).

The main motivation of the Stability and Growth Pact is to guarantee sound budgetary policies on a permanent basis, thus, creating a space for a long-term stability of public finances of the EMU countries (Dauti & Herzog, 2009). The Pact lays down the obligation for Member States to follow the medium term goals for their budgetary positions of 'close to balance or in surplus,' as defined under country-specific considerations.[5] SGP was adopted in 1997 by the European Council to institutionalize the deficit limit to three per cent of Gross Domestic Product, put down in the Treaty on European Union (TEU) for the Member States of the European Union, which participate in the European Monetary Union (Hepertz & Verdun, 2003). Officially, when the Council decides that an excessive deficit occurs, the country concerned is obliged to reduce its deficit below three per cent of GDP according to the recommendations of the Council or face sanctions at the end of a long drawn-out procedure[6] (Artis & Winkler, 1999). The purpose of the SGP was to strengthen the fiscal regime of EMU and make the existing fiscal rules of the TEU coherent, credible as well as rigorous and concrete, thus, not attempting to reduce potential ambiguities within the Treaty. There were two crucial reasons for the creation of SGP, *an economic reason* endorsed by the need for maintaining a budgetary discipline, which is a subordinate policy resulting from the framework of the fiscal provisions in the Maastricht Treaty and *political reason* ascribed to Waigel memorandum,[7] grounded on the observed need to secure a Germanic perception of 'fiscal stability culture' for the future EMU (Artis & Winkler, 1999).

The conditions for applying the excessive deficit procedure (EDP) are governed by the Article 126 of the TFEU.[8] The purpose of the EDP is to prevent excessive deficits and to guarantee they are quickly resolved in line with the amended SGP standards. EDP is triggered by the deficit

5 Adjusting to such positions will allow Member States to deal with normal cyclical fluctuations without breaching the 3% of GDP reference value for the government deficit.

6 These ultimate sanctions are serious. They first take the form of a non-interest-bearing deposit with the Commission of 0.2% of GDP and a variable component linked to the size of the deficit. Subsequently, the deposit is converted into a fine if the excessive deficit has not been corrected after two years.

7 In case the concerned EU country is not capable of meeting the SGP requirement related to 'fiscal culture stability,' in relation to balanced budget or allowing for a marginal surplus over the medium term, whereas the original proposal suggested only a medium term deficit of one per cent of GDP, Waigel proposed automatic sanctions to be replaced by a politicized process.

8 Based on the protocol No 12 of the TFEU (2012), the Council Regulation (EC) No 1467/97 (1997) and the Regulation (EU) No 1173/2011 (2011).

criterion or the debt criterion. *Deficit criterion* is triggered if the general government deficit is higher than the reference value of 3 per cent of GDP at market prices. *Debt criterion* is triggered if the general government debt is higher than the reference value of 60 per cent of GDP and the annual debt reduction target of one twentieth of the debt in excess of the 60 per cent threshold has not been achieved over the last three years (European Central Bank, 2019). Based on article 126 (11) of the TFEU, the EDP also provides sanctions in cases of non-compliance using a fine, consisting of a fixed component (0.2 per cent of GDP) and a variable component (up to a maximum of 0.5 per cent of GDP for both components taken together) (European Central Bank, 2019). The maximum fine may not exceed 0.5 per cent of GDP. Table 9.2 shows the general government deficit in the selected EU and EMU countries.

Table 9.2 shows that potential sanctions are not negligible, but in relation to the state's expenditures, they are almost 'peanuts.' However, a country will not be fined in case of 'exceptional circumstances'[9] and may avoid any sanction, if partner countries agree, in the event of a fall in GDP of between 0.75 and 2 per cent (Herzog, 2004). In general, the data presented on Table 9.2 confirm no evidence of excessive deficits (ED) above the tolerated limit of 3 per cent of GDP, for the group countries of the European Union and European Monetary Union, during the two periods, 2000–2010 and 2011–2015 and the years onward on estimated basis (2016–2019) and projected basis (2020–2022). However, as concern to individual EU countries, the results with respect to exceeding the tolerated limit of fiscal deficit of the 3 per cent of GDP, were worsening for Norway, on average basis, during both periods (2000–2010) and (2011–2015) and individual years (2016 onward).[10] In addition, for the period (2011–2015), Spain and Slovenia, on average, could not perform well in terms of sustainability of public finances, recording excessive level of fiscal deficit above the reference value of 3 per cent of GDP.

The hypothetical deposits that would have been paid by the selected

[9] If the deficit is caused by an unusual experience out of governing of the national authorities, or if output has fallen by more than 2 per cent.

[10] The case of Norway is not sensitive to its assessment in relation to the policy of fiscal deficit, based on the TFEU provisions, because the country is not a member of EMU. For the sake of comparison with the EU and EMU countries, the table also shows the data for some other non-EU and non-EMU countries, like Switzerland, United Kingdom, Israel and United States.

TABLE 9.2 General Government Deficit in the EU, Euro Area (EMU), and the Selected Non-EU Countries

| Country | (1) | (2) | 2016 | 2017 | 2018 | 2019 | 2020* | 2021* | 2022* |
|---|---|---|---|---|---|---|---|---|---|
| Euro Area | −2.84 | −3.08 | −1.47 | −0.93 | −0.46 | −0.62 | −0.87 | N/A | N/A |
| EU | −2.83 | −3.48 | −1.67 | −1.04 | −0.68 | −0.81 | −1.05 | −0.89 | −0.86 |
| Austria | −2.61 | −2.09 | −1.53 | −0.82 | 0.18 | 0.67 | −0.38 | −0.09 | 0.10 |
| Belgium | −1.37 | −3.45 | −2.36 | −0.69 | −0.79 | −1.95 | −1.45 | −1.22 | −1.35 |
| Czech Republic | −3.84 | −2.12 | 0.71 | 1.52 | 0.91 | 0.27 | 0.85 | 0.88 | 0.73 |
| Denmark | 1.60 | −1.39 | −0.11 | 1.79 | 0.69 | 3.78 | 1.54 | 1.95 | 1.99 |
| Finland | 2.86 | −2.22 | −1.71 | −0.65 | −0.86 | −0.96 | −1.04 | −0.88 | −0.94 |
| France | −3.57 | −4.35 | −3.64 | −2.96 | −2.29 | −3.01 | −2.97 | −2.81 | −2.77 |
| Germany | −2.53 | 0.14 | 1.16 | 1.36 | 1.84 | 1.52 | 1.47 | 1.55 | 1.59 |
| Greece | −7.97 | −8.39 | 0.54 | 0.73 | 1.02 | 1.52 | 0.95 | 1.06 | 1.14 |
| Hungary | −5.89 | −2.99 | −1.81 | −2.43 | −2.12 | −2.07 | −2.11 | −2.18 | −2.12 |
| Island | −2.05 | −2.33 | 12.43 | 0.59 | 0.79 | −1.53 | 3.07 | 0.73 | 0.77 |
| Ireland | −3.76 | −6.54 | −0.67 | −0.32 | 0.12 | 0.52 | −0.09 | 0.06 | 0.15 |
| Italy | −3.29 | −2.98 | −2.4 | −2.44 | −2.21 | −1.61 | −2.16 | −2.12 | −2.02 |
| Luxemburg | 1.93 | 0.95 | 1.92 | 1.32 | 3.07 | 2.43 | 2.18 | 2.24 | 2.48 |
| Netherland | −1.54 | −3.09 | 0.02 | 1.26 | 1.37 | 1.72 | 1.09 | 1.36 | 1.39 |
| Norway | 13.18 | 10.48 | 4.06 | 5.21 | 7.79 | 6.22 | 5.76 | 6.19 | 6.48 |
| Poland | −4.74 | −4.25 | −2.39 | −1.49 | −0.24 | −0.69 | −1.22 | −0.91 | −0.76 |
| Portugal | −5.58 | −6.27 | −1.94 | −2.96 | −0.35 | 0.08 | −1.29 | −1.13 | −0.67 |
| Slovakia | −5.47 | −3.47 | −2.58 | −0.94 | −0.99 | −1.35 | −1.46 | −1.19 | −1.25 |
| Spain | −2.05 | −7.72 | −4.31 | −3.02 | −2.48 | −2.86 | −3.17 | −2.88 | −2.85 |
| Sweden | 0.98 | −0.83 | 1.01 | 1.42 | 0.83 | 0.51 | 0.94 | 0.92 | 0.81 |
| Switzerland | 0.05 | 0.16 | 0.24 | 1.12 | 1.26 | 1.42 | 1.01 | 1.21 | 1.22 |
| United Kingdom | −3.58 | −6.24 | −3.28 | −2.42 | −2.25 | −2.31 | −2.57 | −2.39 | −2.38 |
| Estonia | 0.62 | 0.36 | −0.41 | −0.72 | −0.52 | 0.08 | −0.39 | −0.38 | −0.32 |
| Israel | −3.49 | −2.96 | −1.44 | −1.12 | −3.56 | −3.94 | −2.51 | −2.78 | −3.21 |
| Slovenia | −2.77 | −6.71 | −1.92 | −0.06 | 0.74 | 0.52 | −0.18 | 0.25 | 0.33 |
| Latvia | −3.07 | −1.95 | 0.15 | −0.78 | −0.81 | −0.57 | −0.52 | −0.67 | −0.64 |
| Lithuania | −2.89 | −3.11 | 0.23 | 0.45 | 0.59 | 0.26 | 0.39 | 0.43 | 0.42 |

NOTES Column headings are as follows: (1) average 2000–2010, (2) average 2011–2015. General government deficit is measured as a percentage of GDP. All OECD countries compile their data according to the 2008 System of National Accounts (SNA 2008). * Data for the years of 2020, 2021 and 2022 is based on projection values, calculations based on 4 years moving average, starting from the yearly period 2016–2019. Based on data fromm OECD (https://www.oecd.org).

EMU countries, in case of applied penalties due to EDP, would have been higher for Germany, followed by France, Italy and Spain, during the two observed periods on average basis (2000–2010), (2015–2019), as well as during the years of 2016 onwards (Figure 9.1).

With respect to the SGP fiscal sustainability criteria of the debt to

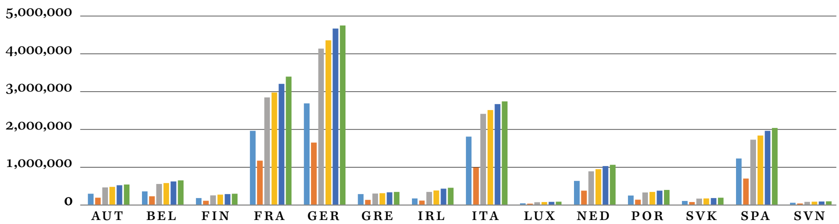


FIGURE 9.1 Maximum Expected Sanction Fee (0.5% to GDP) within the Stability and Growth Pact, in Million Dollars for Selected EMU Countries (light blue – 2000–2010, orange – 2011–2015, gray – 2016, yellow – 2017, blue – 2018, green – 2019)

NOTES This indicator is based on nominal GDP on millions of US dollars (current PPPS). This indicator is less suited for comparisons over time, as developments are not only caused by real growth, but also by changes in prices and PPPS. The calculations on two yearly periods (2000–2010) and (2015–2019) are based on average value. Based on data from OECD (https://www.oecd.org).

GDP ratio, which is tolerated up to 60% of GDP (Mathieu & Sterdyniak, 2003), the pact sets out a medium-term objective, for the purpose of reaching budgetary positions 'close-to-balance or in surplus' and implementing yearly stability programs which are subject to evaluation and recommendations by the Commission of the European Union. The Commission usually advise reaching price stability in EMU countries. In other words, the EMU needs a disciplining mechanism, like the SGP, accounting also for the country's sovereign fiscal policy, in order to react to potential idiosyncratic and asymmetric shocks (Herzog, 2004).

Several authors have been involved in the discussion of the two-category reform of the SGP, *radical reforms and moderate reforms* (Herzog, 2004). Radical reforms within SGP, point to the necessity for fundamental changes of the fiscal policy framework in Europe, leading to more centrally coordinated fiscal policy (Buti et al., 2005). Moderate reforms highlight the changes to a new target structure based on the current pact (Balassone & Franco, 2001; Buiter & Grafe, 2003).

With respect to debt criterion, the results shown in Table 9.3 confirm a worsening trend for Austria, Belgium, France, Greece and Italy followed by Portugal and Spain, all of them showing excess values of the debt/GDP ratio above the tolerated limit of 60% in relation to GDP. In addition, based on group countries, both EU and EMU, during the second decade, have shown failing results of the debt/GDP ratio, thus confirming a sensitive case with respect to the sustainability of European public finances.

TABLE 9.3 General Government Debt as a Percentage of GDP in Selected EU, Euro Area (EMU), the Non-EU Countries and Western Balkan Countries

| Country | (1) | (2) | 2016 | 2017 | 2018 | 2019 | 2020* | 2021* | 2022* |
|---|---|---|---|---|---|---|---|---|---|
| Euro Area | 60.87 | 90.45 | 94.63 | 91.42 | 88.66 | 89.17 | 90.97 | 90.05 | 89.71 |
| EU | 60.61 | 85.51 | 89.22 | 85.92 | 83.21 | 83.1 | 85.36 | 84.40 | 84.01 |
| Austria | 75.5 | 97.27 | 102.53 | 96.55 | 90.95 | 88.89 | 94.73 | 92.78 | 91.84 |
| Belgium | 110.44 | 121.62 | 127.67 | 120.87 | 117.65 | 120.22 | 121.61 | 120.09 | 119.89 |
| Czech R | 32.82 | 53.15 | 47.43 | 43.33 | 39.74 | 37.81 | 42.08 | 40.74 | 40.09 |
| Denmark | 50.01 | 58.01 | 55.11 | 52.54 | 50.82 | 51.41 | 52.47 | 51.81 | 51.63 |
| Finland | 46.94 | 66.45 | 75.61 | 73.16 | 69.77 | 69.71 | 72.06 | 71.18 | 70.68 |
| France | 81.37 | 113.84 | 123.67 | 122.94 | 121.36 | 123.96 | 122.98 | 122.81 | 122.78 |
| Germany | 69.62 | 84.75 | 77.22 | 72.79 | 69.59 | 68.23 | 71.96 | 70.64 | 70.11 |
| Greece | 118.14 | 166.45 | 189.4 | 192.75 | 199.1 | 200.24 | 195.37 | 196.87 | 197.89 |
| Hungary | 69.61 | 98.21 | 98.75 | 93.07 | 86.52 | 83.25 | 90.42 | 88.31 | 87.12 |
| Ireland | 41.62 | 116.55 | 84.92 | 75.74 | 74.38 | 68.82 | 75.96 | 73.73 | 73.22 |
| Italy | 116.79 | 141.65 | 154.55 | 152.23 | 146.83 | 154.61 | 152.12 | 151.36 | 151.20 |
| Luxemburg | 20.6 | 29.76 | 27.87 | 29.65 | 28.84 | 29.96 | 29.08 | 29.38 | 29.32 |
| Netherland | 59.95 | 79.02 | 77.63 | 70.87 | 66.03 | 62.46 | 69.25 | 67.15 | 66.22 |
| Norway | 47.03 | 36.42 | 44.26 | 44.66 | 45.34 | 46.68 | 45.24 | 45.48 | 45.69 |
| Poland | 53.29 | 67.16 | 73.01 | 68.72 | 66.76 | 63.43 | 67.98 | 66.72 | 66.22 |
| Portugal | 81.87 | 137.49 | 144.31 | 143.19 | 137.32 | 136.3 | 140.28 | 139.27 | 138.29 |
| Slovak R | 46.02 | 62.34 | 67.74 | 65.56 | 63.47 | 63.36 | 65.03 | 64.36 | 64.05 |
| Spain | 55.51 | 102.98 | 117.33 | 115.78 | 114.51 | 117.33 | 116.24 | 115.96 | 116.01 |
| Sweden | 60.6 | 58.72 | 61.92 | 60.05 | 59.13 | 55.57 | 59.17 | 58.48 | 58.09 |
| Switzerland | 50.57 | 41.81 | 40.49 | 41.34 | 39.38 | N/A | 30.32 | 27.76 | 24.36 |
| Great Britain | 57.92 | 107.97 | 119.77 | 117.07 | 113.85 | 117.28 | 116.99 | 116.30 | 116.10 |
| USA | 91.17 | 134.37 | 138.21 | 134.82 | 136.37 | 135.69 | 136.24 | 135.78 | 136.02 |
| Estonia | 8.56 | 12.45 | 13.58 | 13.09 | 12.94 | 13.39 | 13.25 | 13.17 | 13.19 |
| Israel | 87.81 | 77.18 | 73.2 | 71.72 | N/A | N/A | 36.22 | 26.98 | 15.80 |
| Slovenia | 35.92 | 78.61 | 97.21 | 88.99 | 83.02 | 80.91 | 87.53 | 85.11 | 84.14 |
| Latvia | 22.13 | 48.18 | 49.72 | 47.03 | 45.65 | 47.14 | 47.38 | 46.80 | 46.74 |
| Lithuania | 29.02 | 50.14 | 50.89 | 47.11 | 40.67 | 44.55 | 45.78 | 44.50 | 43.88 |

NOTES Column headings are as follows: (1) average 2000–2010, (2) average 2011–2015. General government debt-to-GDP ratio measures the gross debt of the general government as a percentage of GDP. It is a key indicator for the sustainability of government finance. Changes in government debt over time primarily reflect the impact of past government deficits. * Data for the years of 2020, 2021 and 2022 is based on projection values, calculations based on 4 years moving average, starting from the yearly period 2016–2019. Based on data from OECD (https://www.oecd.org).

In general, participation in the EMU depends on the flexibility of fiscal policy, achieved targeted fiscal policies within the SGP framework and the assessment of the Maastricht criteria in relation to speeding up the nominal convergence toward EMU approximation path (Dauti

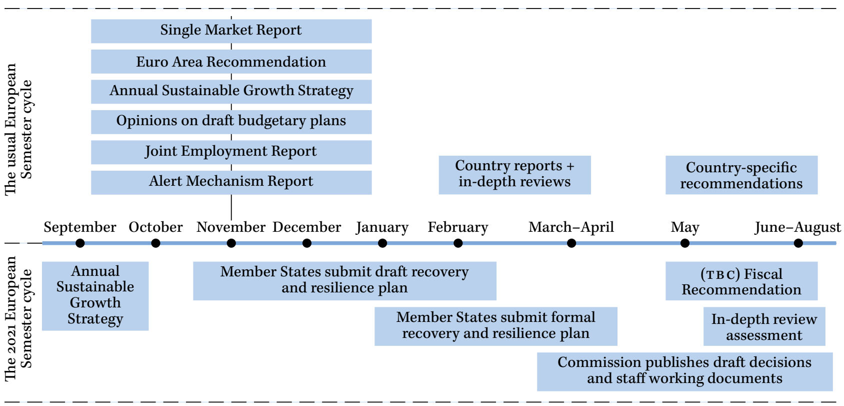


FIGURE 9.2 The Projected Cycle of European Economic Semester During 2021

NOTES Adapted from European Commission (2020a).

& Herzog, 2009; Dauti & Emini, 2019). The SGP recommends the requirement for perceiving the Maastricht criteria even after EMU membership and provides rather explicit guidelines for the course of deciding whether an EMU member country runs an excessive deficit or not. However, the SGP leads to a situation in which the new countries may refuse to participate in the EMU due to the lack of fiscal performance in terms achieving lows fiscal deficits. Empirical findings suggest that new entrant country into EU usually possess low government debt at early stage ending up with high level of fiscal deficit latter on, thus, obstructing the catching – up process of the new entrant countries to European levels (Tujula & Wolswijk, 2004; Nickel & Vansteenkiste, 2008; Agnello & Sousa, 2009).

## European Semester for Economic and Fiscal Policy Coordination

Coordination of national budgetary policies is an important part of the economic governance framework in the Economic and Monetary Union. The European semester provides a framework for the coordination of economic policies in the EU by allowing the EU member countries to discuss their short run economic and budget plans and monitor the achieved progress of the stated plans throughout the year. Figure 9.2 shows the projected European semester cycle during 2021.

Due to the global pandemic crisis provoked by COVID-19, the euro area experienced a recession in the first part of 2020. The relevant institutions within European Central Bank (ECB) and the EU governments applied certain monetary and fiscal policy interventions with the aim of protecting jobs, refreshing the liquidity in the private sector, mainly the service sector, and supporting recovery in order to prevent the firms from bankruptcy. At the same time, the public health policies were addressed to strengthening the national health sectors for enhancing the capacity of the health institutions to deal with the pandemic. Based on the council recommendation on the economic policy of the euro area by the European Commission (EC), the Union took exceptional action plans by pushing short-term emergency measures, including the Coronavirus Response Investment Initiative (CRII) and CRII+ packages, proposing a major recovery plan which will use the EU state aid guidelines and activate the general escape clause of the Stability and Growth Pact, a conclusion endorsed by the economic and financial affairs council configuration (ECOFIN).

Based on the Council Recommendations on the economic policy of the euro area, the recommendations for the euro area during 2021 and 2022 were in the direction of improving the socio-economic flexibility of the EMU. The identified risk that could potentially threatened the socio-economic welfare of the EMU, based on the staff-working document (SWD) (Gortsos, 2020), of the European Commission program is related to the divergence risks in the labor market. The unemployment divergence in the euro area is largely due to differences in labor market institutions across countries and one of the main drivers of cross-country differences is youth unemployment within EMU (Boeri & Jimeno, 2015; Gortsos, 2020).[11] This course undermines the enlargement process of the EMU, and, hence, increases the risk potentials for macroeconomic and financial instability[12] by exerting downward pressure on wages and incomes and weakening of the international role of euro (Slavova, 2008; Bertola, 2008). Based on the Council Recommendations of the European Commission, the 2021 Draft Budgetary Plans, including the assessment of fiscal policies for the euro area can be summarized as follow (European Commission, 2020b):

[11] Based on the projections of the European Commission, dispersion in youth unemployment rates had remained high already before the COVID-19 crisis with youth unemployment still above 30% in 2019 in some Member States (Greece: 35.2%; Spain: 32.5%).

[12] Based on the projections of the European Commission, GDP growth in the euro area is forecast to decline by 7.8% in 2020 and to rebound by 4.2% in 2021 and by 3.0% in 2022 (European Commission, 2020b).

- Despite the forecasted growth in 2021, the recovery is expected to differ among EMU member states, making the economy to run below its potential due to uncertainty and potential risks, which remain high.
- The Draft Budgetary Plans point to an aggregate headline deficit of almost 6% of GDP and a debt-to-GDP ratio of around 100% in 2021, broadly in line with the Commission's 2020 autumn forecast.
- EMU member states have responded with significant fiscal measures in answer to the pandemic (4.2% of GDP in 2020 and 2.4% of GDP in 2021). Most emergency measures have been oriented to compensating workers for their wage decrease or wage loss and compensating firms for their income loss, due to lock down measures and social distancing and supply chain distortions (3.4% of GDP in 2020 and 0.9% of GDP in 2021). Other measures, such as indirect tax cuts or extra public works, have focused more broadly on supporting the economic recovery (0.8% of GDP in 2020 and 1.5% of GDP in 2021).
- Member States should avoid withdrawing fiscal support shortly. The mix of large output losses and downside risks calls for continued fiscal policy support in 2021.

The projected cycle of the economic recovery during the year of 2021, in a post-pandemic situation, is expected to come into life, thus, bringing the euro area closer to the optimum currency area and improve the transmission mechanism of monetary policy, thereby, strengthening the economic resilience and convergence of EMU member states. Further gains could also arise from completing the Banking Union and Capital Market Union and from strengthening the international role of the euro, which will be important to ensure Europe's financial and economic autonomy (Messori, 2020).

## EU fiscal Policy and Implications for the Western Balkans

Fiscal policy in the EU is crucial for sustainability of public finances which on autonomous basis, within the individual EU countries, is manifested through efficient use of taxation in the direction of preserving reasonable level of fiscal deficit and national debt, in line with the SGP requirements related to 'fiscal culture stability.' The relevance of fiscal policy is also essential for maintaining reasonable

TABLE 9.4 Macroeconomic Indicators in the Group Countries of EU, EMU and WB region

| | Average 2000–2010 | | | Average 2011–2019 | | | 2020 | | |
|---|---|---|---|---|---|---|---|---|---|
| | EU | EMU | WB | EU | EMU | WB | EU | EMU | WB |
| (1) | 17.94 | 17.27 | 19.25 | 20.24 | 19.47 | 20.82 | 18.13 | 17.45 | 15.22 |
| (2) | 47.44 | 47.49 | 34.88 | 47.91 | 48.37 | 36.89 | 54.93 | 55.71 | 40.50 |
| (3) | 44.74 | 44.65 | 33.19 | 45.94 | 44.27 | 34.14 | 45.22 | 45.60 | 32.58 |
| (4) | 1.77 | 1.43 | 4.24 | 1.61 | 1.29 | 2.60 | −7.60 | −8.26 | −6.90 |
| (5) | n/a | 8.80 | 18.25 | n/a | 10.11 | 21.88 | n/a | 8.88 | 18.59 |
| (6) | 0.21 | −0.25 | −10.67 | 2.76 | 2.22 | −7.35 | 2.35 | 1.90 | −7.90 |
| (7) | 67.72 | 71.29 | 38.62 | 84.75 | 89.11 | 47.01 | 95.35 | 101.1 | 57.70 |
| (8) | −2.70 | −2.84 | −1.65 | −1.97 | −2.10 | −2.75 | −9.71 | −10.11 | −7.93 |

NOTES Row headings are as follows: (1) tax burden – tax revenue (percentage of GDP*), (2) government expenditures (percentage of GDP), (3) government revenues (percentage of GDP), (4) GDP growth, constant prices (percentage change), (5) unemployment (percentage of labor force), (6) current account deficit (percentage of GDP), (7) general government gross debt (percentage of GDP), (8) net lending/borrowing under EDP (percentage of GDP). Based on data from International Monetary Fund (https://www.imf.org) and World Bank (https://www.worldbank.org).

trend of growth prospects in the Western Balkan countries,[13] enlightened through transmission channels of fiscal policy. The explanation is that the expansion of fiscal policy through investment stimulation will lead to growth prospect of WB transition economies, mainly via second round effect of investment increase on disposable incomes, and, therefore on consumption and economic growth. The improvement in growth prospects means new jobs, new income for households and thereby an increase of tax receipts for the budget, which helps to future increase in government spending. Table 9.4 outlines some of the main indicators of fiscal policy and macroeconomic environment in the EU, EMU and WB countries.

The data presented on Table 9.4 confirms the weak performance of all indicators during 2020, obviously due to disturbing effects of COVID-19 crisis, for the three group of countries (EU, EMU and WB). The real sector in the WB countries, suffered considerably, leading to economic slowdown and an increase of unemployment, thereby, ham-

[13] Western Balkan countries are Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia.

pering the efforts of WB economies to catch up in terms of real convergence with the EU countries.[14] In regards to external conditions, the high current account deficit in the WB countries of −7.90 percent in relation to GDP is a signal that WB countries may have been involved in a problematic deficit,[15] hence, making the reveal economies of the region to be highly dependent on imports.[16] The fiscal indicator, which indicates the government's success in collecting taxes, is tax burden[17] (tax revenue as a percentage of GDP). For the WB countries, tax burden is 2.91 percentage points lower than the EU countries and 2.23 percentage points lower than the EMU countries, indicating the potential presence of some degree of tax evasion in the WB countries and underground economy, which hides the potential tax receipts. With respect to 'fiscal culture criteria,' fiscal deficit reached its pick in 2020 for the three group of countries (WB, EU and EMU) above the tolerated limit of 3 per cent. This evidence indicates the distressing effect of the pandemic, forcing countries to postpone the collection of the taxes from the real sector in the name of anti-COVID-19 policies, thus damaging the national budgets, which, in the following periods, leads to an increase in borrowing activities of these countries, hampering their fiscal sustainability position by increasing the government debt. In the pandemic year of 2020, the government debt exceeded the tolerated limit of 60 percent for the EMU and EU countries, whereas, the WB countries reached their limit.

With regard to budgetary performance in individual WB countries

[14] On the demand side factors, the main contributors to growth slowdown, during the pandemic year of 2020, were the reductions in gross fixed capital formation, net exports, private and public consumption and investment. On the supply side factors, industrial output and construction activity were mostly negative in Albania and Bosnia and Herzegovina (European Commission, 2020b).

[15] This is a case where countries spend more on exports rather than available domestic production.

[16] When a country has a deficit, it must find a recovery method. Deficits are reduced through the inflow in the capital account potentially arising from the increase in the sales of assets, foreign currency and increase in the level of FDI. However, a current account deficit is not automatically a bad thing in case a certain country is importing the necessary inputs to produce an output, with an intention to export the outputs in the future, thus, potentially creating current account surplus, which would be attractive investment opportunity for foreigners.

[17] This ratio is relevant from macroeconomic perspective because reveals the government success in collecting taxes and the perception of tax burden for contributors.

TABLE 9.5 Macroeconomic Indicators in Individual WB Countries

| | Average 2011–2019 | | | | | | 2020 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | AL | BH | MN | NM | KOS | SER | AL | BH | MN | NM | KOS | SER |
| (1) | 20.2 | 22.6 | 20.0 | 18.6 | 19.4 | 21.5 | 18.8 | 20.2 | 18.1 | 17.0 | 17.7 | 19.2 |
| (2) | 29.4 | 43.7 | 46.0 | 31.7 | 28.1 | 42.4 | 32.9 | 45.5 | 50.0 | 35.2 | 33.3 | 46.1 |
| (3) | 26.3 | 43.2 | 41.0 | 28.7 | 25.9 | 39.8 | 24.5 | 32.7 | 39.6 | 27.4 | 26.3 | 38.0 |
| (4) | 2.5 | 2.2 | 2.8 | 2.5 | 3.6 | 2.0 | −7.5 | −6.5 | −12.0 | −5.4 | −7.5 | −2.5 |
| (5) | 14.5 | 24.3 | n/a | 25.5 | 26.9 | 18.2 | 11.8 | 19.0 | n/a | 20.2 | 27.7 | 13.4 |
| (6) | −9.0 | −5.8 | 14.4 | −1.8 | −7.1 | −6.0 | −11.7 | −4.4 | 14.2 | −4.7 | −6.0 | −6.4 |
| (7) | 68.9 | 40.7 | 64.4 | 36.8 | 12.4 | 58.9 | 83.3 | 38.9 | 90.8 | 50.3 | 23.4 | 59.5 |
| (8) | −3.1 | −0.6 | −5.0 | −3.0 | −2.2 | −2.6 | −8.4 | −5.8 | −10.4 | −7.7 | −7.0 | −8.1 |

NOTES Row headings are as follows: (1) tax burden – tax revenue (percentage of GDP*), (2) government expenditures (percentage of GDP), (3) government revenues (percentage of GDP), (4) GDP growth, constant prices (percentage change), (5) unemployment (percentage of labor force), (6) current account deficit (percentage of GDP), (7) general government gross debt (percentage of GDP), (8) net lending/borrowing under EDP (percentage of GDP). Based on data from International Monetary Fund (https://www.imf.org) and World Bank (https://www.worldbank.org).

during the observed period 2011–2019, as Table 9.5 shows, they all recorded fiscal deficit to GDP ratio of less than 3 per cent and debt to GDP ratio below the tolerated limit of 60%, with the exception of Albania and Montenegro which exceeded the tolerated fiscal and debt limits only marginally. However, during the pandemic year of 2020, both Albania and Montenegro were the worst-case scenario with regard to sustainability of public finances, exceeding the tolerated limit of fiscal deficit by 5.1 and 4.7 percentage points, respectively, and debt ratio by 23.3 and 30.8 percentage points, respectively.

Reviewing the data on the individual WB economies, presented in Table 9.5, we can deduce that the biggest problems arose from the real sector (GDP and unemployment). The relative growth rate of GDP for the WB countries, ranging from 2.2 to 3.6 percent, is insufficient for the WB region to catch up in terms of real convergence with EU countries. Unemployment is also relatively high for WB countries, ranging from 14.5 percent in Albania to 26.9 percent in Kosovo. External positions in many WB countries, as shown in Table 9.5, remained weak, making the WB countries less capable to cope with the competitive pressures within the EU countries.

From the forward-looking perspective, the Western Balkan countries face substantial structural challenges as they struggle to fine-tune their national fiscal policies in line with the EU agenda in order to make their economies capable of meeting the competitive pressures within the EU. Efforts in the WB countries directed at maintaining deficit and debt levels at reasonable levels, aggravated by different factors like population aging, costly pension schemes, migration and youth unemployment, may be unsuccessful. This situation leads to potential increase in expenditure pressure. Therefore, the WB countries are persistently exposed to the need for fiscal consolidation as their approximation paths to the EU integration process reach the satisfactory level.

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Chapter Ten

# The Future of the European Union: Values, Education, Participation and Solidarity

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## Introduction

The process of European integration shows a dynamic and evolving reality, exhibiting many faces and diversified forms of mixed intergovernmental and supranational cooperation. Today, more than ever, this process is in the midst of a radically changing internal and external landscape. It navigates between pessimism, optimism and realism, and is shaped by Globalisation vs Europeanisation developments. Its model of society, based on fundamental human rights, on culture as vehicle of emancipation, on sustainable development and socio-economic cohesion, and on a multilateral vision of the world order, is put under strain. There is a confrontation between the actual EU confusing reality and its responsibility in the complex international environment.

The EU already plays an important role in international relations, mainly in trade, development, environment and social issues, more recently also in security strategy. Although the Treaty of Lisbon (2007) made an important step towards strengthening the EU's global aspirations, its overall role in the world role seems to be threatened. It is facing today a number of internal and external challenges. These comprise rising global exposure, threats to economic and social cohesion, growing cultural diversity, increasing complexity, migration issues, the climate agenda, democratic deficits, populist movements and – last but not least – imperilled legitimacy and trust. But 2020 was mainly dominated by the Covid-19 pandemic in Europe as elsewhere, trying to manage its health, welfare, economic and socio-cultural impacts. Times of turbulence and change in Europe are not restricted to the impacts of the pandemic. The landscape of EU politics is dominated by both in-

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ternal political strife and tricky international relations. The new European Commission led by Ursula Von der Leyen seems to have understood this dramatic reality and has already taken measures for a more efficient governance in its structure, priority policy setting and initiatives. It is attempting to make its mark, in terms of both domestic and foreign policy, with the European Green Deal being one of its flagship initiatives. The European Council in July 2020 adopted not only a new budget for 2021–2027 but also a large Recovery Package.

The chapter is structured in four main parts. In the first part value premises and trajectories for responding to the internal and external challenges the EU is confronted within the current times are briefly explained. The second part analyses the role of education in the EU. It describes and assesses the main EU education programmes while stressing the importance of citizenship education for EU citizenship building. The third part focusses on participation and the perspective of participatory governance in the EU and beyond. It explains its legal basis and summarises various steps the EU has been taken to favour EU practices of participatory governance. Both (citizenship) education and participation are seen as important vehicles for a sustainable and value-driven EU future. The final part centres on the importance of EU solidarity in dealing with internal and external problems caused by the pandemic. In the Conclusions, we suggest some tasks and responsibilities for strengthening EU's future. Throughout the analysis, reference is made to the Western Balkans, as a partner region of the EU.

## The Need for a Values-Based EU

### *A Values-Based Community*

The recognition of the EU as a values-based Union is legally embedded in Art. 2 of the Treaty of Lisbon (2007): 'The Union is founded on the values of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities. These values are common to the Member States in a society in which pluralism, non-discrimination, tolerance, justice, solidarity and equality between women and men prevail.'

The actual complex internal and external reality implies a permanent updating of the European narrative within a radically changing context. However, this needs to be based and developed on generally shared values and obligations. This implies a view that is embedded in a community of shared values, supports the strength of the European integration process, and recognises the positive heritage as well as the complexity of a multifaceted EU as an added value to the European project.

A vision for EU's future relies very much on the concept of community (Bekemans & de la Torre, 2018). The EU does not only refer to a socio-economic community but also to a community of destiny, life, purpose, responsibility, and certainly to a space of multicultural learning and a meeting place of multiple identities. The original vision of the Founding Fathers should therefore remain an important inspiration for further integration. After all, they worked for a European project to guarantee a sustainable peace within European borders, embedded in a long-term vision but driven by a pragmatic policy approach. Economic arguments supported the political goodwill.

It is important that a forward-looking vision captures a sense of belonging and offers an added value to EU citizens, even in times of transformation and confusion. Such a vision should be based on a values-driven community, recognising the EU as a space which exhibits multiple characteristics in a transforming international system. These aspects have to be understood, contextualised and translated to a diversified citizenry within a context that often produces radically changing and paradoxical realities. This can be done by involving the citizen more in the EU's future, at local, regional, national and European level. Such a participation could have a positive impact on European identity, citizenship and solidarity building as well as on EU governance. It also may shape the internal and external dialogues' framework between and within countries, regions, communities and citizens, and with the Western Balkan countries (Vukčević, 2020). In his last State of the Union address on September 12, 2018, Jean-Claude Juncker called for a Europe that has to embrace its destiny: 'by pooling sovereignty where necessary, we strengthen all our component nations and regions.' Also, the White Paper on the Future of Europe (European Commission, 2017a), the Commission's contribution to the 60th anniversary of the Treaty of Rome, clearly expressed the need for a convincing discourse as well as for concrete citizens-driven policies in order to remain an attractive and inspiring project for its citizens and not an empty box.

### *Expected Values-Driven Trajectories*

Rethinking, reforming, and transforming the EU implies recognition of a radical increase of the level of complexity within societies. One can think of various (interrelated) tracks that could further strengthen EU's internal and external position: (1) recognising and developing European multiple citizenship (2) embarking in a differentiated, deepening and inclusive integration and (3) acting as a change-agent within the multilateral system. Of course, these approaches require commitment, courage and determination to valorise EU's role within and beyond its borders.

### *Recognising and Developing European Multiple Citizenship*

The EU should commit more effectively to European citizenship-building, respecting multiple identities and developing multi-level and multi-actor practices. The July 2020 Eurobarometer survey on EU Citizenship and Democracy indicates that a vast majority of Europeans (91%) are familiar with the term 'citizen of the European Union' (European Commission, 2020b). This is the highest level of awareness yet since 2007 and a steady increase from 87% recorded in 2015. It seems that most Europeans are well informed about their electoral rights at national and European levels. In this perspective, citizenship education and participatory governance are crucial factors for such a forward-looking EU outlook. Member States, regional and local authorities as well as civil society organisations (CSO) play an important role in this context. The new European Commission seems to have understood the challenges ahead with the setting of its structural priorities.[1] Many CSO do play an active role in EU citizen participation.

### *Embarking on a Differentiated, Deepening and Inclusive Integration*

As size matters, both for economic and political power, division into a multiplicity of actors does not help to respond to global challenges. Increased European integration in specific policy areas (such as trade, competition, development cooperation, economic, monetary and financial issues, and human security) is the only way forward. Only then will national interest of Member States become part of the overall EU interest: unity in diversity within a well-defined international and legal order. In other words, a multi-level and multiple actor approach is needed to deal with various challenges and issues, though respecting diversity.

It seems therefore natural for the European project to use patterns of

[1] The political guidelines for the next European Commission 2019–2024 are clearly stated in von der Leyen (2019).

differentiated integration, so as to be able to act in an effective manner while taking diversity into account. Examples of differentiated integration processes are numerous, such as the cases of the Schengen area, the Eurozone or defence policy illustrate. However, differentiated integration should not only focus on effectiveness, but also on legitimacy issues (Bertoncini, 2017). These are key issues for the EU's functioning at a time when it is confronted with challenges but also fragmented along several divides between states and peoples. Political and institutional conditions should be met to allow a legitimate deepening of differentiation within the EU (Pirozzi et al., 2017). A differentiation based on sound political foundations should then be able to serve the interests of the European peoples, for example as regards collective security issues, migration issues, the Economic and Monetary Union, the Stability Pact, or even the forthcoming Rescue Fund.

Differentiation also concerns possible enlargements or privileged relations with other countries, such as with the Western Balkans. The EU has developed a policy to support a gradual integration of the Western Balkan countries with the Union based on Title V of the Treaty on European Union (1992) dealing with external action, on Article 207 of the Treaty on the Functioning of the EU dealing with international trade agreements and on Art. 49 dealing with the criteria for application and membership. This is all done in view of promoting peace, stability and economic development in the area and opening up the prospect of EU integration.

In 1999, the EU launched the Stabilisation and Association Process (SAP), as a framework for relations between the EU and countries in the region in the form of stabilisation and association agreements. Furthermore, the Stability Pact for South-Eastern Europe provided a broader EU framework with the aim of establishing and reinforcing peace and security in South-Eastern Europe, involving all key international players. The Stability Pact was replaced by the Regional Cooperation Council in 2008. The EU perspective that all SAP countries are potential candidates for EU membership has been confirmed in various occasions, in particular in the EU-Western Balkan Summits. Also, the European Parliament is fully involved in the process of enhanced EU engagement with the Western Balkan countries.

### *Acting as a Change-agent in the International System*

In the emerging new international world order, states, international and regional organisations, transnational policy networks and nongovernmental actors are the building blocks of the multilateral system. In other words, states are merely players amongst others. Furthermore, the interactions between all these actors are not any longer organised in mere hierarchical ways, but as issue-specific networks of variable coalitions. This implies that there is no single centre of power, consequently blurring the centre-periphery perspective.

Instead, there is a fluid web of relations, alliances and partnerships between different types of actors at different levels of governance, from the neighbourhood, city, region, state to the European and international level. The new Global Strategy for the EU's Foreign and Security Policy, proposed by Federica Mogherini, the then EU High Representative for Foreign Affairs and Security Policy, has certainly been a step forward in delineating the EU as a prudent change agent in international relations (Mogherini, 2016). The importance of the Western Balkans in EU foreign Policy was already echoed in 2010 by Catherine Ashton, former EU High Representative: 'In a way, the Balkans is the birthplace of EU foreign policy. More than anywhere else, it is where we cannot afford to fail' (Ashton, 2011, p. 44).

## EU and Education: Challenges and Perspectives[2]

### *Context*

#### *General Context*

The role of education as a permanent learning to live together is fundamental, in particular for cohesive and sustainable society-building in the EU and beyond. However, it should be recognised that the learning environment has drastically changed: it is more competitive, complex and fragmented, with a wide diversity of learning sources. The Corona pandemic has stressed even more national education systems.

New, innovative and human-centric approaches are necessary to respond to the challenges of fragmented and disturbed societies (Bekemans, 2013). Therefore, an urgent need exists for a revisited role and increased responsibility of education in culturally diverse and complex societies. Such a new culture for education embodies a respect of an integral human development, including various ( formal, informal and non-formal) learning places and environments.

This implies a learning that copes with changes, uncertainties and risks. A focus on learning competences, life skills and practices to stim-

[2] This section draws on Bekemans (2018a).

ulate creativity is therefore required. Such a learning should aim at bridging existing educational gaps and changing fixed mind-sets. It should prepare people to live together by acting together to tackle complex issues and to deal with diversity. This requires a variety of life competences. New forms and places for dialogue, and learning, as well as a variety of actors in the field of education and training, should be considered. This is equally valid for the Western Balkan countries.

### *EU Context*

Education is largely a national competence of the EU Member States. It should be clearly recognised that education is not subject of a common European policy. With the principle of subsidiarity each Member State maintains full responsibility for the content and the organisation of its education system. In other words, the European Community may contribute to the development of quality education and training by encouraging cooperation between Member States through a wide range of actions. These include promoting the mobility of citizens, designing joint study programmes, establishing networks, exchanging information or teaching EU languages.

The European Commission's actions in the field of education rests on two pillars: (1) policy cooperation with the Member States; and (2) funding programmes. The basic principle is that Member States are in charge of their education and training, and the European Commission cooperates with the Member States to help achieve common goals. Therefore, the European Community has a complementary role to play: adding a European dimension to education and training, helping to develop quality education and training and encourage life-long learning. It also funds educational, vocational and citizenship-building programmes which encourage EU citizens to take advantage of opportunities which the EU offers its citizens to live, study and work in other countries.

In the EU context, education was formally recognised for the first time in the 1992 Maastricht Treaty (Treaty on European Union, 1992). The legal context for education in the EU refers to Art 165 of the Treaty of Lisbon (2007) which also explicates its objectives.[3] At the occasion

[3] Art. 165, paragraph 1 states that: 'The Union shall contribute to the development of quality education by encouraging cooperation between Member States and, if necessary, by supporting and supplementing their action, while fully respecting the responsibil-

of the 25th Anniversary of the Maastricht Treaty (9 December 2016) the then European Commission President Juncker said: 'We cannot explain the European Union, the European project, simply by going back to the history […] we want to convince younger people that the EU is a must today […] we have to explain the European history in a perspective: What is Europe today and what will it be tomorrow and the day after tomorrow?' (European Commission, 2016).

Finally, the building of a strong European Education and Lifelong Learning Area is vital for Europe's future. This implies a broadly-defined European studies curriculum which includes all levels, sectors and forms of learning. It is meant to truly benefit all EU citizens and foster active and responsible EU citizenship. This should strengthen the European dimension of national education systems and programs as well as the EU own lifelong learning agenda. Education is essential to the vitality of European society and economy. This is very much underscored by Ursula von der Leyen's (2019) political guidelines: 'The European Education Area aims to bring to the education and training communities the support they need to fulfil their fundamental mission, in challenging and exciting times.'

In short, support for inclusive European-oriented education about responsible citizenship, multiple identities and citizens' dialogue should focus on differentiated discourses, general and specific curriculum content and social and cultural relevance of education projects. We are in need of education policies at national level as well as European education programmes that match the 21st century reality to live as Eu-

ity of the Member States for the content of teaching and the organisation of education systems and their cultural and linguistic diversity.' The objectives are stated in Art 165, paragaph 2: 'Union action shall be aimed at: developing the European dimension in education, particularly through the teaching and dissemination of the languages of the Member States; encouraging mobility of students and teachers, by encouraging inter alia, the academic recognition of diplomas and periods of study; promoting cooperation between educational establishments; developing exchanges of information and experience on issues common to the education systems of the Member States; encouraging the development of youth exchanges and of exchanges of socio-educational instructors, and encouraging the participation of young people in democratic life in Europe; encouraging the development of distance education; developing the European dimension in sport, by promoting fairness and openness in sporting competitions and cooperation between bodies responsible for sports, and by protecting the physical and moral integrity of sportsmen and sportswomen, especially the youngest sportsmen and sportswomen.'

ropeans in a globalising world (Bekemans, 2013). The Western Balkan countries should be included in such a wide education perspective.

### *Education Strategy and Education Programmes*

The following section deals with some of the recent developments in the European education area. These were meant to build and strengthen the future of education in a broad perspective: the EU 2020 Strategy and the Erasmus+ programme (2014–2020).

#### *The EU 2020 Strategy*[4]

In March 2010 the European Commission proposed the EU 2020 Strategy as a broad 10-year growth strategy, being the successor of the Lisbon Strategy (2000–2010). It aimed at 'smart, sustainable, inclusive growth' with greater coordination of national and European policy. Concrete actions at national and EU levels underpin the strategy through a growth-based building of a genuine European Knowledge Area, the empowerment of people in inclusive societies and the creation of a competitive, connected and greener economy. It identified the key measurable priorities for the period 2010–2020 on employment, innovation, education, social inclusion, climate and energy.

The EU 2020 Strategy presented the broad framework for the specific European Cooperation in education and training (ET 2020) (European Union, 2016). As each EU country is responsible for its own education and training systems, the EU policy was designed to support national action and help address common challenges, such as ageing societies, skills deficits in the workforce, technological developments and global competition. The ET 2020 focussed on six priority areas: (1) improve people's skills and employment prospects; (2) create open, innovative and digital learning environments; (3) provide support for teachers and trainers; (4) cultivate the fundamental values of equality, non-discrimination and active citizenship, (5) favour transparency and recognition of skills; and (6) invest in a sustainable way quality and efficiency of education and training systems. Flagship initiatives to support these priority objectives were: 'Innovation Union,' 'Youth on the move,' 'A digital agenda for Europe,' 'Resource efficient Union,' 'An industrial policy for the globalisation era,' 'An agenda for new skills and jobs,' and 'A European platform against poverty.'

[4] This section is based on European Commission (2010).

The quantification of the common objectives and benchmarks was particularly important in ET 2020. In the period 2010–2020 progress was attained in the main EU education targets:

- 94.8% of children in 2020 attend early childhood education from the age of 4+, almost the 95% EU target;
- Tertiary educational attainment had a massive expansion over the past decade, from 34% in 2010 to 40.3 % in 2019, bringing the EU even beyond the 40% target;
- The proportion of youth leaving education without an upper secondary diploma and no longer training has declined from 13.9% in 2010 to 10.2% in 2019, nearly meeting the EU target of 10%;
- The EU did not achieve its target to reduce the share of 15-year olds achieving low levels of reading, mathematics and science to less than 15% by 2020. The EU as a whole is lagging behind in all three domains: reading (22.5%), mathematics (22.9%) and science (22.3%);
- The employment rate of recent graduates (age 20–34) reached 80.9 % in 2019, signaling a steady recovery from the low 74.3% registered in 2013 and nearing the 82% EU target.
- In part hindered by the fallout from the financial crisis, adult participation in learning did not reach the 15% target but has only risen to 10.8% in 2019.

### *EU Education Programmes*

A second major development in the EU education field concerns the EU education programmes, in particular the Erasmus programme and the Jean Monnet Programme.[5]

### ***Future Perspectives: Towards a European Education and Lifelong Learning Area***

The European Commission has been developing initiatives to help work towards a European Education Area. The goals set are: spending time abroad to study and learn should be the standard; school and higher education diplomas should be recognised across the EU; knowing two languages in addition to one's mother tongue should become the norm; everyone should be able to access high quality education,

[5] The EU education programmes are discussed in detail in Chapter 6.

irrespective of the socio-economic background; people should also have a strong sense of their identity as Europeans, of Europe's cultural heritage and its diversity. Also, the Directorate-General for Education, Youth, Sport and Culture (DG EAC) has been active in promoting studies on the future of education and training in view of the 'Future of Learning' agenda.

At the occasion of the 60th anniversary of the Rome Treaty, the leaders of 27 Member States and of the European Council, the European Parliament and the European Commission declared in Rome on March 25, 2017 their commitment to creating a 'Union where young people receive the best education and training and can study and find jobs across the continent' (European Council, 2017). The European Commission formulated its vision for a European Education Area by 2025 in its Communication 'Strengthening European Identity through Education and Culture' (European Commission, 2017b). The ideas formulated were intended as a contribution to the EU Leaders' meeting on 17 November 2017 in Gothenburg, where the future of education and culture was discussed. It is very clear that the Commission believes that it is in the shared interest of all Member States to harness the full potential of education and culture as drivers for job creation, economic growth and social fairness as well as a means to experience European identity in all its diversity. The Communication was quickly followed up with the launch of a new 'Future of Learning' package in January 2018, addressing key competences for lifelong learning, digital skills, common values and inclusive education. The same month the first ever European Education Summit took place in Brussels, gathering over 20 national Ministers for Education to discuss equity and diversity in education.

In May 2018 the Commission presented a second package of new initiatives to further boost the role of education in view of building a European Education Area by 2025. In its May 2018 Communication on *Building a Stronger Europe: The Role of Youth, Education and Culture Policies* the important role played by education, youth and culture in building the future of Europe is highlighted (European Commission, 2018). The proposed measures aim to enhance learning mobility and educational opportunities in the EU, empower young people, in particular by encouraging them to participate in civic and democratic life, and strengthen the potential of culture for social progress and economic growth in Europe.

The Commission's vision of building a European Education Area is based on a combination of a strengthened Erasmus+ programme, an ambitious framework for European policy cooperation in education and training, support for Member State reforms through the European Semester, and a better targeting of European funds. It also describes ongoing initiatives towards European Universities and a European student card. This package of initiatives also includes proposals for Council Recommendations on early childhood education and care, on the automatic mutual recognition of diplomas and learning periods abroad, and on improving the teaching and learning of languages. Such a European Area of education and lifelong learning, reaching out to citizens has been clearly supported by the Van den Brande (2017) Report.

In her Political Guidelines, Commission President von der Leyen committed to making the European Education Area a reality by 2025 (European Commission, 2020a). A reinforced approach is proposed to consolidate ongoing efforts and further develop the European Education Area along six dimensions to bring about a significant shift in equity, outcomes and resilience of education and training in Europe. The six dimensions and the principal means to achieve them are: (1) quality in education and training, (2) inclusion and gender equality, (3) green and digital transitions, (4) teachers and trainers, (5) higher education and (6) geopolitical dimension.

### *Focus on Citizenship Education*

As was said before, education has a crucial importance in citizenship-building in each society, also at EU level. In other words, EU active citizenship refers to rights, participation and a wider sense of belonging. The ECIT Foundation (European Citizens' rights, Involvement and Trust Foundation) launched in September 2020 the European Citizens Initiative (ECI) 'Voters without Borders' – an ECI for full political rights for EU Citizens.[6] Citizenship education is therefore important for EU's future. It implies the formation of (young) people within a specific socio-cultural context who are able to respond to the challenges of globality and complexity, cultural disintegration, dispersion and fragmentation of knowledge. This also requires an integration of a diversity of learning sources and levels as to formal, non-formal and informal learning.

[6] See https://voterswithoutborders.eu.

If education has the priority task of transmitting knowledge and competences, some fundamental questions need to be addressed concerning citizenship education. These relate to (1) education of and for all; (2) education of humanity: this involves cross-cutting the dichotomy between a 'humanistic' education and a 'professional' education; (3) education for change: this deals with the meaning of creativity and the use of a critical mind; (4) education to master a variety of languages; and finally, (5) permanent education in the search of values: this implies surpassing the so-called contradiction between tradition and innovation.

Furthermore, citizenship education should be based on a community of shared values, as was argued in part I of this chapter. The notion of responsible citizenship therefore includes an awareness and knowledge of rights and duties. It is closely related to civic values such as democracy and human rights, equality, participation, partnership, social cohesion, social justice as well as the knowledge and exercise of rights and responsibilities. Moreover, active and responsible citizenship should be conceived as a lifelong process which requires accompanying measures. Learning citizenship is interactive and deeply embedded in specific formal, non-formal and informal contexts, implying a pedagogy of communion and a culture of service.

In short, citizenship education is understood as the fostering of capacities and dispositions to participate in society at various levels. The competences involved are also essential for addressing current political challenges which cross borders and require transnational and transdisciplinary thinking, awareness and cooperation.

The Member States of the EU signed up to the Charter on Education for Democratic Citizenship and Human Rights Education (Council of Europe, 2010), asserting the importance of quality citizenship education. This Charter was also adopted by the Western Balkan countries, members of the Council of Europe. In the actual political situation training teachers in fostering democratic learning environments and promoting active citizenship is of crucial importance. Also, the above mentioned European Education Area provides a framework that prioritises citizenship education. Moreover, the EU Council identified active citizenship as one of the pillars of the European Education Area. Concrete Commission proposals for reinforcing this key competence of lifelong learning are now being discussed.

The Covid-19 period is a moment not only to reflect but also to act on the all-encompassing role of education, particularly of citizenship education, and on its importance for cohesive and participatory societies in the EU and beyond. In this context the NECE – Networking European Citizenship Education platform (www.nece.eu) offers a very interesting, non-institutionalised European initiative for citizenship education. It is a transnational community of stakeholders and practitioners ( formal, non-formal and informal educators) of citizenship education from across Europe. It works with corresponding networks in the Mediterranean, Eastern Europe and Africa. It provides a forum for debate and an opportunity to exchange knowledge on an equal footing. It organised early Nov. 2020 a very successful and practice-oriented conference 'Reconnecting in a post pandemic world. Citizenship education for democracy and sustainability.'

## EU and Participation: A Challenging Perspective[7]

Participation is another crucial and concrete vehicle for a sustainable and value-driven EU future. It has been gaining momentum as a means for countering the 'democratic deficit' in contemporary political systems. In fact, over the past twenty years, the need for bridging the gap between institutions and citizens and constructing a new relationship between citizens and public bodies has been high on the EU political agenda. The Eurobarometer findings about the EU and its citizens show over the recent years promising results (European Commission, 2019). Still two-thirds of Europeans (66%), though with differences between Member States, feel that they are citizens of the EU and that the EU is a place of stability in a troubled world.

The legal basis of participation at EU level lies in the Treaty of Lisbon (2007). Its Preamble calls for enhancing the legitimacy of the Union. The specific legal reference for participatory governance in the EU is presented by two TFEU articles: Art. 10 on representative democracy[8]

[7] This section draws on Bekemans (2018b).

[8] Art. 10 of the TFEU reads as follows: '(1) The functioning of the Union shall be founded on representative democracy; (2) Citizens are directly represented at Union level in the European Parliament. Member States are represented in the European Council by their Heads of State or Government and in the Council by their governments, themselves democratically accountable either to their national Parliaments, or to their citizens; (3) Every citizen shall have the right to participate in the democratic life of the Union. Decisions shall be taken as openly and as closely as possible to the citizen; (4) Political parties at European level contribute to forming European political awareness and to expressing the will of citizens of the Union.'

and Art. 11 on participatory democracy.[9] However, despite self-imposed obligations and the Treaties' clear commitment to citizen participation, the EU's institutions appear to be slow to fully embrace it.

Various concrete steps have been taken in the last years to favour EU practice of participatory governance:

- A White Paper on European Governance was adopted by the European Commission in July 2001 with the aim of establishing more democratic forms of governance at all levels, global, European, national, regional and local (Commission of the European Communities, 2001). The Commission defined governance as 'the rules, processes and practices that affect how powers are exercised at the European level.' The content of the White Paper relates good governance to the core principles of openness, participation, accountability, effectiveness and coherence. It focussed on four main action themes: (1) Better involvement and more openness: instituting openness through all stages of decision making; ensuring consultation with regional and local governments and with civil society networks; (2) Better policies, regulation and delivery: simplifying EU law and related national rules; promoting different policy tools; establishing guidelines on the use of expert advice; defining criteria for the creation of new regulatory agencies; (3) Contributing to global governance: reviewing how the EU can speak more often with a single voice in international affairs; improving dialogue with actors in third countries; and (4) Refocusing policies and institutions (i.e. Commission, Council of Ministers and Parliament): ensuring policy coherence and long-term objectives; clarifying and reinforcing the powers of the institutions; formulating proposals for the Intergovernmental Conference (IGC) based on the governance policy consultation.

[9] Art. 11 of the TFEU reads as follows: '(1) The institutions shall, by appropriate means, give citizens and representative associations the opportunity to make known and publicly exchange their views in all areas of Union action; (2) The institutions shall maintain an open, transparent and regular dialogue with representative associations and civil society; (3) The European Commission shall carry out broad consultations with parties concerned in order to ensure that the Union's actions are coherent and transparent; (4) Not less than one million citizens who are nationals of a significant number of Member States may take the initiative of inviting the European Commission, within the framework of its powers, to submit any appropriate proposal on matters where citizens consider that a legal act of the Union is required for the purpose of implementing the Treaties.'

- In 2009 the Committee of the Regions (COR) published a White Paper on Multi-level Governance, reflecting its determination to 'build Europe in partnership.' Multi-level governance was defined as 'coordinated action by the European Union, the Member States and local and regional authorities, according to the principles of subsidiarity and proportionality and in partnership, tasking the form of operational and institutionalised cooperation in the drawing-up and implementation of the EU policies.' The two main strategic objectives are: encouraging participation in the European process and reinforcing the efficiency of Community action. It proposed Regional Action Plans, tools, territorial pacts, inclusive method of coordination and vertical and horizontal partnerships. By this political document, the COR took the initiative to submit its vision of an inclusive European decision-making process, based on a mode of governance which involves local and regional authorities in the formulation and implementation of European policies.
- The European Grouping of Territorial Cooperation (EGTC) (formerly the Interreg Community Initiative) represents a good practice of territorial cooperation (being cross-border, transnational and interregional), involving regional and local authorities, in view of strengthening the economic and social cohesion of the EU (Bekemans, 2013). The EGTC Regulation was established in 2006 and was the first European cooperation structure with a legal personality defined by European Law. The EGTC's work is financed by the European Regional Development Fund (ERDF); in the case of the Western Balkan countries it is financed by the Instrument for Pre-Accession (IPA).
- More specifically, the Western Balkan countries are involved in this European Territorial Co-operation objective (Kittel, 2020) through cross-border and transnational co-operation programmes. For the Western Balkans, the South East Europe programme is of most relevance and also the Mediterranean programme covers some Western Balkan countries. The interregional co-operation programme (Interreg IVC) and the networking programmes (i.e. Urbact II, Interact II and ESPON) cover all EU Member States but are not open to the Western Balkan countries.
- The Charter for Multi-Level Governance by the Committee of the

Regions (2014) expresses accurately the need for concrete participatory governance. It refers to the principles of 'togetherness, partnership, awareness of interdependence, multi-actor community, efficiency, subsidiarity, transparency, sharing best practices […] developing a transparent, open and inclusive policy-making process, promoting participation and partnership […], inclusive through use of appropriate digital tools […] respecting subsidiarity and proportionality in policy making and ensuring maximum fundamental rights protection at all levels of governance to strengthen institutional capacity building and investing in policy learning among all levels of governance […]' It is not a legally binding instrument but rather a reference text and a tool to be freely used by signatory towns, regions and EGTC in the context of the local implementation of EU policies.

- The Charter focusses on better law-making, growth in partnership, territorial, economic and social cohesion, European Neighbourhood Policy and decentralised cooperation. It establishes a set of common values and identifies practical processes of good European governance. It commits its signatories to implement multi-level governance principles and mechanisms and to actively inspire and promote practical multi-level cooperation projects. It serves as a guide for local and regional authorities in setting up partnerships. Through the Charter, the concept of multi-level/multi-actor governance has gained importance as a policy tool in managing diversity and cross-border challenges, enhancing the citizen-ownership of the EU project.

In short, the EU can be considered a system of multi-level governance in continuous evolution. It is also a policy response for active additivity to the changing international environment and its challenges, bringing participatory democracy closer to the citizens. However, more evidence-based research on the impact of participatory approaches in political decision-making is needed, in order to determine whether, and under what conditions, participatory governance improves the sustainability of EU policies, certainly in times of global crises.

## EU and Solidarity in COVID-19 Times

In the current era of uncertainties and complexities at various governance levels, the EU needs a renewed political project embedded in a long-term vision. Only in this way the increasing influence of national interests in EU policy-making can be blocked in favour of the 'European commons.' The crisis of European solidarity, much illustrated by the difficulties in the implementation of a EU refugee policy or in the management of the current health crisis, can only be overcome if initiatives and measures are taken which restore citizens' confidence in the European institutions. This should be done within a framework of 'shared sovereignty.'

The waves of COVID-19 have spread throughout the EU with dramatic consequences. The major health risk has forced policymakers to largely shut down social, economic and cultural life, but in a rather diffuse order and without much consultation. The various diffentiated lockdowns are forcing organisations, companies and institutions to cancel activities, public events and travels and switch to teleworking and online activities. A health, economic and social drama that needs swift policy responses at all governance levels!

How the EU responds to the coronavirus crisis will determine its future credibility. Small steps are being taken, but joint European crisis management remains difficult. Today the watchword for Europe should be internal and external solidarity. David Sassoli, President of the European Parliament recently commented on the consequences of the crisis: 'No one will be left alone and no one will act alone' (European Parliament, 2021).

The European institutions have taken different steps to combat the pandemic crisis. Resources and tools have been put in place to coordinate national responses and provide objective information on the spread of the virus as well as on the effective efforts to combat it. European Commission President Ursula von der Leyen presented in early March 2020 her 'Corona response team,' a team of Commissioners to coordinate the economic and humanitarian consequences of the crisis. Mid-March, the European Commission launched an initial, cautiously coordinated response to strengthen public health sectors and mitigate the socio-economic impact in the EU. At the end of March, Member States finally agreed to a sum of €37 billion of unused money from the European budget ('Corona Response Investment Initiative'). Member States could eventually use that money to spend on medical equipment, aid to SMES and labour market measures. This investment initiative was one of the first concrete emergency measures that the EU has been taking to combat the corona virus. Also the existing European

Stability Mechanism (ESM), being the permanent emergency financial fund set up during the euro crisis, can be used as a source of support for Euro countries in financial difficulties. There is more than 400 billion euros in that Fund.

The most important step in the EU approach to the consequences of the pandemic has been the EU Council agreement of 21 July 2020 on a €750 billion recovery effort 'Next Generation EU.' The recovery package is now going through the legislative steps to be, hopefully, ready in 2021. Following the political agreement reached by the ministers for economy and finance on 6 October 2020, Member States' EU ambassadors formally agreed with the Council's position on the Recovery and Resilience Facility. The facility is the centrepiece of the Next Generation EU recovery instrument designed to respond to the COVID-19 crisis and the challenges posed by the green and digital transitions.

Alongside the recovery package, EU leaders also agreed on a €1,074.3 billion long-term EU budget for 2021–2027. Together with the €540 billion of funds already in place for the three safety nets (for workers, for businesses and for member states), the overall EU's recovery package amounts to €2,364.3 billion. However, the whole implementation of the Rescue Fund and the acceptance of the EU multi-annual budget was threatened by possible vetos of EU Members States Hungary and Poland.

Still there is hardly a clearer common challenge than the current pandemic. And yet the EU continues to struggle with decision-making at EU level, undermining the EU as a value-based community. Perhaps in the current dramatic crisis conditions it is more important to focus on the priority objective of necessary and massive economic support rather than on the instruments. EU citizens want immediate decisiveness and vigorous action to see the European dream of shared solidarity and civic responsibility concretely applied. After all, the alternative is that Europe of solidarity dries up through passivity, no longer connects European citizens, crumbles into separate national/regional entities and ultimately does not survive the crisis. The comprehensive and unprecedented challenge demands a comprehensive and unprecedented strategy from the EU.

The crucial question is if the EU within a unifying European economic space can guarantee internal solidarity, founded on a common institutional basis in which states, regions and communities can live their diversity, as well as external solidarity, based on an open societal model of living peacefully together with partner regions throughout the world. This task requires an inspiring narrative which responds to institutional governance structures, internal and external European solidarity and a vision that motivates citizen's participation through European citizenship education.

If there is one thing that makes this Convid-19 crisis clear: solidarity between Member States does not arise spontaneously, but needs to be supported by trust-building measures. Still, every crisis presents a provocation, but also offers an opportunity: 'in the midst of every crisis, lies a great opportunity' (Albert Einstein). Responsibility and solidarity are important values in the refounding and rediscovery of shared 'authentic' quality of life, in respect for everyone and everything, recognising human vulnerability.

Pro-active reflections and actions on possible future prospects are now more than ever urgent. The management of such radical changes requires inspiring and innovative leadership. In *A Union That Strives for More* Ursula von der Leyen (2019) clearly insisted: 'I want Europeans to build the future of our Union. They should play a leading and active part in setting our priorities and our level of ambition. I want citizens to have their say at a Conference on the Future of Europe, to start in 2020 and run for two years.' This forthcoming 2-years citizen-focussed conference on the Future of Europe might give some creative answers on European citizenship-building and participatory democracy, even being a catalyst for EU change.

## Conclusions: EU Internal and External Tasks and Responsibilities

Today the EU has an appointment with its destiny. As was said earlier, its model of society is put under pressure by numerous challenges. In the radically transforming international landscape, the EU is confronted with the preoccupation, but also with the moral responsibility to maintain its model of integration and diversity.

The main challenge for further European integration is the search for a new equilibrium between diversity and unity. The EU model needs to respond to the economic, historic, social and political changes which are taken place at international and national level, but it should remain faithful to its principles of internal and external solidarity. 'Rethinking Europe' implies recognition of a radical increase of the level of complexity within societies, a further development of European citizenship within multiple identities and the elaboration of multi-level governance practices. Despite all current and dramatic changes, Europe still remains a civilisation project, characterised by a rich intellectual (material and immaterial) cultural heritage and common values.

Therefore, in today's multi-faceted and multi-layered globalisation era, the EU needs a revisited political project and a common long-term (inspiring) vision, to counterbalance the increasing influence of national interests in EU policy-making, at the expense of the 'European commons.' There is a danger that the Union, faced with the growing frustration, criticism and indifference of its citizens, will disintegrate or become a mere union of economic interests, detached from its very nature and identity. Moreover, the undermining of its values-based fundamentals could negatively influence EU's economic, social and ecological welfare and finally lead to its marginalisation in the international system.

However, the rhetoric of the European ideals of peace, unity in diversity, freedom and solidarity should be implemented into workable and forward-looking practices midst a radically changing environment. The role of education, participation and solidarity is therefore fundamental in developing true citizens' dialogue and linking EU citizenship to democracy. Also new forms and places of dialogue, active citizenship and participation outside the existing institutionalised structures of representation should be stimulated. In this perspective the European Citizen Action Service (ECAS, https://ecas.org) an international, Brussels-based non-profit organisation with a pan-European membership and nearly 30 years of experience, promotes activities to develop and support mechanisms of democratic participation by citizens and citizen organisations in the EU.

In short, in spite of failures and imperfections in the integration process, the EU project remains a valid working place to define Europe as a common treasure and to develop a unique institutional and operational framework for Member States and partner countries. Four fundamental tasks can be distinguished:

- First, the EU has the moral responsibility to build a best practice of cooperation internally and externally. A radical change in vision and method to survive as a European civilisation is an urgent mater. Individual and collective well-being depends more and more on a comprehension of the signs of time and subsequent action in the pursuit of economic and social welfare within a world of drastic changes.

- Second, the Europeans have the moral responsibility to show that people can live peacefully and constructively together in the world, despite differences in language, culture, religion and origin. In practice, EU citizens still need to show that they can form an international public space where a cultural diaspora can exist in mutual respect, tolerance and dialogue.
- Third, the EU countries and regions have to search continuously to make their social and economic systems more efficient so that the weaknesses of the one can be compensated with the strength of others. This implies the importance to strive for a just distribution of the benefits of economic welfare and to revalorise the sense of responsibility and solidarity in policy-making.
- Finally, the EU should play a more courageous and dynamic role on the international political scene by defending its model of peace and transnational cooperation and strengthening its method of collaboration with other partner regions. It should work for a transition of the traditional management of international affairs to a transversal and multi-lateral approach.

In short, only a mobilising vision of the EU future within and beyond its borders can give a new impetus and a strengthened connection with the citizen. European integration should remain the common perspective to respond to internal and external challenges. It should also be the base for enlarged EU-Western Balkan cooperation. Education, participation and solidarity are crucial vehicles for such an EU future, both for its Member States and partner countries.

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The six Western Balkan countries, Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia, all aspire to be members of the European Union. Albania and North Macedonia are already candidate countries while Montenegro and Serbia have opened negotiations for EU membership. Kosovo and Bosnia and Herzegovina are at earlier stages of the process and must wait for a green light to start negotiations for membership.

Although the six countries are at different stages of fulfilling their aspiration for EU membership, they have already been influenced significantly by EU policies and programmes designed for them. These policies and programmes have aimed at supporting economic, political and social development; speeding up the reform process facilitating transition from centrally planned economies to democratic market economies; and enhancing the rule of law and governance in these countries.

There is, therefore, a strong interest in the development of the EU and its policies, particularly related to the Western Balkans, in the society as well as among policy makers and the academia in these countries. This book intends to provide students and staff on such courses as European Integration or Economics of the EU with an up-to-date analysis of the EU and its wide range of policies and programmes. Additionally, the book can enhance the knowledge of local decision-makers about the opportunities and challenges arising from the EU.

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