



Friends of Europe Les amis
de l'Europe de l'Europe

BALKANS

CROSSROADS

A Friends of Europe Background Report

NOVEMBER 2007



Friends of Europe Les amis
de l'Europe de l'Europe

Background Report

BALKANS CROSSROADS

Report on the occasion of the European Policy Summit
“Balkans Crossroads: The Policy Challenges Ahead”, 4th December 2007
Organised by *Friends of Europe*, the Konrad Adenauer Stiftung,
the Constantinos Karamanlis Institute for Democracy and Gallup Europe
With the support of The Coca-Cola Company
Media partners *Europe's World* and *EUobserver.com*

By Elitsa Vucheva, *EUobserver.com*

NOVEMBER 2007

This European Policy Summit would have not been possible without the support of:



**GALLUP
EUROPE**

The Coca-Cola Company

The views expressed in this report are the private views of the author and the interviewees, and are not necessarily those of the organisations they represent, nor of *Friends of Europe*, its Board of Trustees, its members or partners. Reproduction in whole or in part is permitted, provided that full credit is given to *Friends of Europe*, and provided that any such reproduction, whether in whole or in part, is not sold unless incorporated in other works.

Friends of Europe – Les Amis de l'Europe
Bibliothèque Solvay, Parc Léopold, rue Belliard 137, 1040 Bruxelles, Belgium
T +32 (0)2 737 91 45 - F +32 (0)2 737 75 99
info@friendsofeurope.org - www.friendsofeurope.org

About *Friends of Europe*

Friends of Europe (FoE) is Brussels' liveliest think-tank, aiming to stimulate new thinking on the future of Europe and broaden the EU debate. It is non-profit, with no national or political bias and a membership base that is as youthful as it is influential.

Our goal since 1999 has been to discuss and debate the key issues confronting the EU outside the charmed circle of the Brussels elite by linking up with major think-tanks and media in Europe's national capitals.

Friends of Europe is proud to be a co-initiator of *Europe's World*. Published three times yearly, it is the only pan-European publication that can offer policymakers and opinion-formers across Europe a platform for presenting ideas and forging consensus on key issues.

KEY ISSUES

Friends of Europe's activities cover a wide range of topics and aim to take stock of the state of play in many of Europe's key policy areas. *Friends of Europe's* style and ethos is to provide an open forum for EU and national policymakers, business leaders and NGOs.

INFORMAL AND LIVELY

Our **Café Crossfire** evening debates, **Policy Spotlight** debates, **European Policy Summit** international conferences and **Press and Policymakers'** dinner debates at the historic Bibliothèque Solvay in the heart of Brussels are unique opportunities. They are often adversarial as well as being informal and lively and offer ample opportunities for networking and discussion with national policymakers, corporate as well as NGO leaders and top EU officials. Through our regular **Atlantic Rendez-Vous** satellite-linked televised debates between Brussels and Washington DC, *Friends of Europe's* network now extends to TV audiences across Europe as well as specialist audiences on the other side of the Atlantic.

Friends of Europe is dominated by neither academic nor corporate opinion. To stimulate public interest in the topics under discussion, the press is actively involved in many of our activities. Our goal is to inform a wider audience across Europe about the issues that will decide the future of Europe.

PUBLICATIONS

Our publications are written in a readable and objective form by specialised journalists or Trustees, laying out the issues so that a layman can easily understand what is at stake. They are widely distributed to politicians, business people, NGOs, civil society groups, students, the international media and any other interested party.

For more information please consult our website: www.friendsofeurope.org

About the author

Elitsa Vucheva is a Brussels-based Bulgarian journalist who has been writing for the *EUobserver.com* since 2005, covering primarily EU enlargement and EU relations with South East Europe. She graduated in Political science and Communication from the Institute of Political Science in Lyon, France, and holds an MA in European Studies from the College of Europe in Warsaw, Poland, specialised in regional issues.

Table of Contents

Executive Summary.....	2
EU engagement in the Western Balkans	3
Challenges towards EU Membership	5
State-building in Bosnia and Herzegovina	6
EU and regional cooperation in the Balkans:.....	9
From the Stability Pact to the Regional Cooperation Council.....	9
How encouraging are the Balkans region’s economic indicators?	10
The region’s economic indicators	10
Foreign investment in the Balkans.....	11
EU – Western Balkans trade	14
Trade within the region.....	15
Serbia and the Kosovo issue.....	17
The future status of Kosovo.....	18
Serbia’s democratic development.....	22

BALKANS CROSSROADS

Executive Summary

The prospect of EU membership was offered to the Western Balkan countries during a meeting of EU leaders in Santa Maria da Feira (Portugal) in June 2000. The subsequent conclusion of the Stabilisation and Association Process (SAP) in November 2000 in Zagreb as “the route to a progressively closer relationship with the EU” reaffirmed “a long-term [EU] commitment to the region both in terms of political effort and financial and human resources”¹. Today, while the region’s EU perspective is not in doubt, some questions do remain concerning its future, and a number of important challenges lie ahead, including “the Kosovo status process, Serbia’s democratic development and state-building in Bosnia and Herzegovina”².

This report aims to present the current political and economic situation in the Balkans while at the same time highlighting the unresolved issues there. While EU engagement in the region came relatively late, it is now very pronounced, both economically through the different funding and aid programmes, and politically with the criteria required in order for the Western Balkans to be allowed closer EU ties.

The EU is today the Balkans’ most important trade partner, while intra-regional trade is not yet strongly developed. Yet the Western Balkans are still failing to attract satisfactory levels of foreign direct investment, and while all the countries have reached a certain level of economic growth, unemployment is still an important problem in the region and the so-called grey sector of the economy remains very large. Corruption also continues to poison the functioning of the different states. Last but not least, significant political challenges have not been solved – despite considerable progress, Serbia is still not judged as cooperating fully with the International Criminal Tribunal for the former Yugoslavia (ICTY), as key war crime suspects remain at large.

The deadlock over Kosovo’s future status is far from being broken, despite the fast approaching UN Security Council meeting on 10 December. While Serbia considers the breakaway province an integral part of its territory and Pristina is holding out for full independence, the international community is, for its part, still divided on the issue. It remains unclear how it would react to possible unilateral proclamation of independence by Kosovo.

Finally, Bosnia and Herzegovina is still failing to introduce important reforms and amend its complex constitutional structure, which “prevents swift decision-making [in the country] and therefore hinders reform and the capacity to make progress towards the EU”.³ All elements considered, it is difficult to predict what consequences the outcome of the “Kosovo process” could have on the region as a whole. But it is clear that the EU in particular will have an important role to play in the whole process and will have to overcome its internal divisions and speak with one voice when the time comes.

¹ European Commission website, DG Enlargement:
http://ec.europa.eu/enlargement/enlargement_process/accession_process/index_en.htm.

² Speech of EU enlargement commissioner Olli Rehn on the occasion of the release of the 2007 progress reports of the EU candidate and potential candidate countries, Brussels, 6 November 2007.

³ European Commission progress report on Bosnia and Herzegovina, 6 November 2007, available at http://ec.europa.eu/enlargement/key_documents/reports_nov_2007_en.htm.

EU engagement in the Western Balkans

Today the Western Balkans constitute the main part of the EU's enlargement policy. At the European Council in Santa Maria da Feira in June 2000, EU leaders stated that all countries that are part of the Stabilisation and Association Process (SAP), i.e. the Western Balkan countries, are "potential candidates" for EU membership. At the Thessaloniki summit in June 2003, they reiterated this commitment.

The EU has made some political efforts to encourage democratic developments in the region. Since 1991, the European Union has been the largest donor in South East Europe and has committed €6.8 billion to the Western Balkans more particularly through its various assistance programmes in areas such as reconstruction, the building of institutions and the strengthening of democracy. Cooperating with the International Criminal Tribunal for the former Yugoslavia (ICTY) and handing over wanted war crimes suspects is a condition imposed on the countries concerned in order to let them develop closer ties with the EU.

EU Enlargement Commissioner Olli Rehn recently expressed hopes that "in 2008 conditions will be fulfilled and thus we will be able to complete SAAs with all countries in the region"⁴.

Indeed, despite the supposed "enlargement fatigue" observed in the EU in the last few years, it is unlikely that the Balkan countries could be left out of the European club, as this would be extremely risky for the region's stability as well as for the EU.

Europe's "powder keg" – as the Balkans are sometimes called – has proved to be a region which is characterized by high levels of nationalism and which is very reluctant to compromise on issues considered to touch upon national identities. Leaving the Balkan countries out of the EU would increase the risk of isolation – or "ghettoisation" as some analysts refer to it – and of boosting nationalism, which could eventually lead to renewed hostilities. This is all the more true and visible during the current discussions on the future status of Kosovo.

By contrast, possible EU membership could contribute to smoothing the differences and to calming both internal, inter-ethnic tensions, as well as animosities between the different countries of the region. Pacific coexistence and good neighbourly relations are a key condition for the Balkans to join the EU. In addition, commentators have pointed out that if these countries all become part of the same bloc – namely the EU – the various national questions would eventually cease to matter so much.

⁴ Speech of EU enlargement commissioner Olli Rehn on the occasion of the release of the 2007 progress reports of the EU candidate and potential candidate countries, Brussels, 6 November 2007.

BALKANS CROSSROADS

According to Marie-Janine Calic, professor for Eastern and South Eastern European History at the Ludwig-Maximilians University in Munich and former political adviser within the Stability Pact for South Eastern Europe, this approach has borne some fruit as “the prospect of accession has contributed strongly to improving good neighbourly relations and regional cooperation in South East Europe”⁵.

In this light, the planned shift from the international community’s Stability Pact for South East Europe, established in 1999 to a Regional Cooperation Council (RCC) run by the Balkan states at the beginning of 2008 has reignited hopes that the region may be moving towards a higher level of self-governance and cooperation.

But according to Hido Bišćević, a senior Croatian diplomat who will head the RCC from February 2008 onwards, the EU still has a big role to play in the Balkans:

“There are re-emerging reasons for concern [in the region]. They point to the urgency of devising a new, resolute and long-term strategy for the EU and the international community, which should take a firmer lead in managing the processes, moving further from mere conflict prevention and post-conflict resolution to the designing of a visionary and durable future security and stability landscape”⁶.

⁵ Marie-Janine Calic, “The Western Balkans on the road towards EU integration”, Berlin, Friedrich Ebert Stiftung, December 2005.

⁶ Contribution by Mr Bišćević to this report.

Challenges towards EU Membership

The Western Balkans have reached a level of relative political stability and have advanced in many fields. The Commission sees enlargement as “one of the EU’s most powerful policy tools”, serving its “strategic interests in stability, security and conflict prevention”⁷.

The European Commission’s most recent report on the progress in these countries praises their efforts and encourages them to continue on their EU path.

Nevertheless, much work remains to be done as the countries of the former Yugoslavia (except for Slovenia which entered the EU in 2004) and Albania are still far from fulfilling all of the criteria required for EU membership. Aside from Croatia, none of them is likely to accede to the bloc in the next five years.

Croatia is currently the most advanced Western Balkan state as regards EU integration. It started accession talks in October 2005 and is hoping to achieve full membership in the near future. So far, negotiations with Zagreb have been opened on fourteen chapters⁸ and have been provisionally closed on two chapters (science and research, education and culture).⁹

The former Yugoslav Republic of Macedonia was granted candidate country status in December 2005, although it has not yet opened membership negotiations. It is hoping to do so under the Slovenian EU presidency in the first half of 2008, but its most recent progress report notes several shortcomings, in particular political ones, that it still has to overcome.

For instance, due to internal political disputes, the functioning of the Macedonian parliament has been disturbed and there has not been enough dialogue between the party in power and the opposition for a long time, according to the annual commission evaluation report¹⁰. As a result many laws are still blocked, in particular concerning the reform of the judicial system¹¹.

Among the potential Balkan candidates, Albania and Montenegro have signed a Stabilisation and Association Agreement (SAA), the necessary first step on the road to EU membership.

Albania, which signed its SAA in June 2006, has made some progress as regards democracy and the rule of law, but still has much to do concerning the fight against corruption and the reform of the judiciary, before moving further on its EU path¹².

Montenegro has achieved a lot after seceding from Serbia in May 2006, notably concerning the process of institution-building. Its SAA was signed in October 2007 and it is hoping to lodge an

⁷ “Enlargement strategy and main challenges 2007-2008”, communication from the European Commission to the Council and the European Parliament, Brussels, 6 November 2007

⁸ Science and research, education and culture, economic and monetary policy, industrial policy, customs, intellectual property rights, services, company law, statistics, financial services, financial control, information society and media, consumer and health protection, external relations.

⁹ European Commission progress report on Croatia, 6 November 2007, available at http://ec.europa.eu/enlargement/key_documents/reports_nov_2007_en.htm

¹⁰ *EUobserver.com*, “EU to delay launch of membership talks with Macedonia”, 31 October 2007.

¹¹ *Ibid.*

¹² *EUobserver.com*, “EU keeps door open to Balkan countries”, 6 November 2007.

official application for EU membership in the first half of 2008. But it is still lagging behind in other fields, such as the fight against corruption¹³.

Serbia and Bosnia and Herzegovina have finalised the technical talks on their respective SAAs. On 7 November 2007, Serbia initialled its SAA, which formally puts Serbia ahead of Bosnia and Herzegovina in terms of their contractual relationship with the EU. Yet before the agreements can be signed, the EU would like to see full cooperation with the ICTY for both, and greater efforts towards political stability for the latter.

In particular, the failure to reach political stability in Bosnia and Herzegovina – illustrated among other things by the difficulty of Serbs, Croats and Bosniaks to agree on a common police force – is proving challenging. Furthermore, the political fragility of Bosnia and Herzegovina is starting to be used by some fractions in Serbia in the “fight” over Kosovo. In October this year, Serbian Prime Minister Vojislav Kostunica openly linked the two issues saying that “preserving Kosovo and Republika Srpska are now the most important goals of our [Serbian] state and national policy”¹⁴.

“South Eastern Europe is today a more stable, economically viable and secure region. Individual countries and the region as a whole still face a number of complex challenges, starting with the issue of defining the future status of Kosovo. However, general progress in democratic standards, macroeconomic stability and the improvement of the security environment imply that the region is ready to take matters into its own hands, including in the field of regional cooperation.”

Erhard Busek, Special Coordinator, Stability Pact for South Eastern Europe

State-building in Bosnia and Herzegovina

EU engagement in Bosnia and Herzegovina (BiH) represents one of the bloc’s biggest challenges. Inter-ethnic atrocities have taken place in Bosnia and Herzegovina, including the Srebrenica massacre (July 1995), and the risk of new outbreaks of violence is not taken lightly.

Furthermore, as a state composed of two entities which often refuse to collaborate on important issues – such as setting up a common police force – it constitutes a major political challenge for the EU, which is trying to make Republika Srpska (comprising primarily Serbs) and the Federation of Bosnia and Herzegovina (comprising mainly Bosniaks and Croats) work together towards a final goal of full EU integration.

The constitutional imbroglio caused by the Dayton agreement – signed in 1995 and putting an end to a three-year war – does not make the work any easier, while the presence of a High Representative with the right to intervene in the country’s affairs does not facilitate the so-called “ownership” issues, i.e. the self-government of Bosnia and Herzegovina.

¹³ Ibid.

¹⁴ Reuters, “Serb leader raises national alarm over Bosnia”, 25 October 2007.

BALKANS CROSSROADS

An international conference of the Peace Implementation Council, meeting in Germany in 1997, granted real authority to the High Representative in the form of the so-called "Bonn powers". The "Bonn powers" made it possible for this international community representative to impose legislation and sack officials judged to be obstructing the peace implementation process.

Today, powers in Bosnia and Herzegovina are still shared between state- and entity-level governments. At the entity level, Republika Srpska and the Bosniak-Croat Federation each have their own presidencies and governments – headed by a prime minister, including police and other bodies. At the state level, Bosnia and Herzegovina also has a government and a rotating collective presidency, composed of one representative of each constituent group.

The High Representative still supervises the implementation of the civilian aspects of the peace treaty and has a legal mandate to ensure that the country evolves into a viable democracy on its course towards integration into the Euro-Atlantic institutions.

While Dayton had the indisputable merit of having put an end to a bloody war 12 years ago, it is today being called into question by some analysts who note that the country should move progressively towards a more unified and a more "self-owned" government.

On the other hand, the difficulty in agreeing on the necessary police reform as well as Republika Srpska's opposition to the political reforms proposed by current High Representative Miroslav Lajcak are only two examples of how lengthy negotiations are within BiH. Moreover, the complexity of its governmental structure makes it very hard to pass laws or implement reforms without the consensus of the three ethnic groups.

While Republika Srpska's leaders have said they are "not interested" in proclaiming independence even if Kosovo does so¹⁵, they insist that the changes to the voting system in the country's council of ministers and parliament, imposed by Mr Lajcak, have prompted a genuine internal political crisis. Reducing the number of votes needed to pass a law from two, as it is now, to one per constituent group – Bosniaks, Serbs or Croats – would make it very easy for one entity within BiH to outvote another, which would be unacceptable and dangerous in a multi-ethnic society such as that of Bosnia and Herzegovina, Republika Srpska argues¹⁶. The government of Republika Srpska is still hoping that another solution can be found and is not ready to agree on the reform as it is.

All facts considered, despite the increasing domestic pressure, in particular from Republika Srpska, for the closure of the Office of the High Representative, it is hard to predict when this will occur – something which would be related to positive developments in BiH.

¹⁵ *EUobserver.com*, "Bosnian Serbs will not follow Kosovo's independence claims, official says", 22 November 2007

¹⁶ *Ibid*

Table 1 – The Western Balkans' EU integration process

	Independent from Yugoslavia	SAA	Application for EU membership	Candidate country since	Opening of EU accession negotiations
Croatia	1991	Signed Oct 2001, enters into force 1 Feb 2005	February 2003	June 2004	October 2005
Former Yugoslav Republic of Macedonia	1991	Signed April 2001, enters into force April 2004	March 2004	Dec 2005	-
Albania	Was not part of Yugoslavia	Signed June 2006	-	-	-
Montenegro	Part of the Federal Republic of Yugoslavia 1992 – 2003, then of a state union with Serbia 2003 – 2006. Independent since May 2006.	Signed October 2007	Planned by Montenegro's government for first half of 2008	-	-
Serbia*	Part of the Federal Republic of Yugoslavia 1992 – 2003, then of a State Union with Montenegro 2003 – 2006. Serbia is the legal successor of the State Union.	Initialed November 2007	-	-	-
Bosnia and Herzegovina (BiH)	1992	Technical talks for a SAA were finalised in 2006, but initialling and launching the agreement depends on political conditions	-	-	-

*For Kosovo/UNMIK see table 7, part III of this report

Source: European Commission, DG Enlargement website¹⁷

¹⁷ http://ec.europa.eu/enlargement/index_en.htm

***EU and regional cooperation in the Balkans:
From the Stability Pact to the Regional Cooperation Council***

The promotion of regional cooperation has been one of the cornerstones of EU policies towards the Balkans since the second half of the 1990s. Regional cooperation has been used as a tool for underpinning peace agreements, promoting reconciliation and reconstruction and, lately, as a training ground and a precondition for future EU membership by the Balkan countries. The rationale of this approach stems from the regional scope of some of the bitter legacies of the conflicts of the 1990s, such as the issues of refugees' return and the protection of minorities. Regional cooperation is seen as an extension of the EU's own philosophy that deeper cooperation with neighbouring countries is a route to national as well as regional stability and growth.¹⁸ At the Thessaloniki Summit in June 2003, the Stability Pact for South Eastern Europe was mandated to support and complement the regional dimension of the EU's Stabilisation and Association Process. It was mainly conceived as a forum to bring together donors, international financial institutions and countries in the region. However, EU-sponsored efforts towards regional cooperation have not always been entirely welcome in the Balkans, and the Stability Pact was often misperceived as a waiting room or an alternative to full EU membership, especially by those countries which have advanced further along the path towards EU accession.

Yet, despite lacking its own resources and the status of a proper international organisation, since 1999 the Stability Pact has been working as a confidence-building mechanism, providing a forum for discussion on problematic issues on a regional level. The Pact was instrumental in laying the foundations for an articulated regional cooperation agenda. Examples include the successful negotiation, ratification and entry into force of an enlarged and modernised free trade agreement, CEFTA 2006, which makes all of SEE a single free trade area, making it much more attractive for investors. Another milestone of regional cooperation is the Energy Community Treaty between the EU and the SEE, which entered into force in July 2006 and created the legal framework for a regional electricity and gas market to be integrated in the wider EU market.

Progress on the ground has been matched by increasing political and financial ownership by countries of the region. A major shift towards ownership is happening with the transformation of the Stability Pact into a regionally owned and led framework, the Regional Cooperation Council (RCC). This will be led by a Secretary-General chosen by the SEE countries, Hido Bišćević, currently Croatian State Secretary for Political Affairs, and will be supported by a Secretariat located in Sarajevo and co-funded by SEE countries, the European Commission and other international donors. The RCC will inherit the functions of the Stability Pact and will work towards promoting and supporting regional cooperation in SEE by providing political guidance and receiving input from relevant task forces and initiatives active in specific thematic areas. Through its Secretariat, the RCC will also provide operational capacities to the South East European Cooperation Process (SEECF), the main framework for political consultations in SEE and in many ways "the voice of the region". SEE countries and UNMIK/Kosovo have already agreed on the main political and financial arrangements for the RCC, which also has a legal basis in a form of a Host Country Agreement between Bosnia and Herzegovina and the other SEECF parties. The final handover between the Stability Pact and the RCC is scheduled for February 2008, when the last Regional Table of the Stability Pact and the first Annual Meeting of the RCC will take place.

¹⁸ European Commission, CARDS Strategy Paper, 5.

How encouraging are the Balkans region's economic indicators?

“One fact has to be crystal clear for everyone. Economic development is fundamental to the solution of most of the problems in the Balkans. The EU can, and should – much more vigorously than so far – be instrumental in encouraging such development.”

Ilinka Mitreva, former Foreign Minister of the Former Yugoslav Republic of Macedonia¹⁹

The Western Balkans region is facing economic difficulties as well. The standard of living is much lower than that of the EU countries, and the lack of transparency and the so-called “grey economy” still constitute an important part of the region's economic challenges. Furthermore, political instability and the slow pace of reforms have resulted in only modest inflows of foreign direct investment in recent years.

With the EU perspective becoming clearer, however, this tendency may be reversed. The experience of previous candidate countries has shown that the prospect of EU membership attracts investors, consequently boosting the country's economy. For instance, trade between the EU and the Western Balkan countries has continued to increase in the last few years and the EU is today by far the most important trading partner for South East European (SEE) countries²⁰. Intra-regional trade has also been increasing, although more could be done in this respect.

The region's economic indicators

Recent economic developments in the region were assessed as “overall favourable” by a European Commission paper from December 2006.

In the last two years, the Western Balkans have enjoyed a sustained average growth rate of around 5% and the inflationary tensions that had been noted before subsided in 2006.

Fiscal consolidation was built up and average deficits were reduced. Moreover, Serbia, Bosnia and Herzegovina and the former Yugoslav Republic of Macedonia enjoyed budget surpluses during that year.

As regards structural reforms, the countries have progressed at uneven speeds, according to the Commission's paper. In most countries, privatisation programmes are now relatively advanced, except for Serbia and Montenegro which are still lagging behind in this respect.

¹⁹ Address to NATO – EAPC Foreign Affairs Ministers, 9th Dec 2004

²⁰ “Western Balkans in transition”, European Economy. Enlargement papers, Nr 30, December 2006, European Commission Directorate General for Economic and Financial Affairs, Brussels

BALKANS CROSSROADS

The Balkan states have also started restructuring their energy utilities and markets, a process which was especially encouraged by the signing on 25 October 2005 of the South Eastern Europe Energy Treaty.

But in the telecom and utilities sectors, privatisation has been insufficient and important enterprises remain state-owned. Moreover, and despite the progress, inflation remains a challenge to overcome – although not to the same extent in all the countries – and external imbalances are still high.

Albania, Montenegro, Serbia, and Bosnia and Herzegovina registered growth rates of between 5% and 7% in 2005 and 2006, while in Croatia and former Yugoslav Republic of Macedonia, the growth was less pronounced – between 4% and 4.5%. In Kosovo, economic performance has been the weakest in the region, with an estimated growth of -0.2% of GDP in 2005, followed by a period of 3% growth in 2006.

Table 2 – Main economic indicators in the Western Balkans, 2001-2005

		2001	2002	2003	2004	2005
Real GDP growth	%	4.0	4.3	3.9	5.7	4.7
Inflation (average)	%	24.9	6.7	4.5	3.9	6.4
Total revenues	% of GDP	40.3	41.0	42.1	42.6	41.3
Total expenditures	% of GDP	45.3	45.0	45.4	45.5	43.0
General government balance	% of GDP	-5.0	-3.9	-3.3	-2.9	-1.7
Exports	Billion EUR	10.2	10.2	11.1	12.9	13.0
Imports	Billion EUR	22.9	26.6	29.0	32.5	31.8
Trade balance with world	Billion EUR	-12.8	-16.4	-17.9	-19.6	-18.8
Trade balance with EU	Billion EUR	-8.6	-10.5	-10.6	-11.7	-11.9
Current account balance	% of GDP	-5.3	-9.8	-8.5	-8.8	-8.3
Foreign direct investment	Million EUR	2,317	1,796	3,572	2,397	3,854

Source: European Commission, DG for Economic and Financial Affairs, "Western Balkans in transition", European Economy. Enlargement papers, Nr 30, December 2006

Foreign investment in the Balkans

Following the political instability caused by the wars in the former Yugoslavia in the 1990s, foreign direct investment in the Western Balkans has only started increasing in recent years, but has still not reached satisfactory levels.

Table 3 – Foreign direct investment in the Western Balkans (% of GDP)

	2004	2005
Albania	4.6	3.1
BiH	7.1	5.2
Croatia	2.5	3.9
Former Yugoslav Republic of Macedonia	2.8	0.5
Kosovo (UN 1244)	0.9	2.7
Montenegro	3.3	22.8*
Serbia	3.9	5.9

*The high level of FDI in Montenegro in 2005 should be interpreted as a one-time effect rather than a long-term positive phenomenon, due among other things to large privatisation deals in that year which, considering the size of the Montenegrin economy, constitute a considerable boost to its FDI figures.

Source: European Commission, DG for Economic and Financial Affairs, "Western Balkans in transition", European Economy. Enlargement papers, Nr 30, December 2006

The increase in foreign investment in the region three years ago to an average of 4.5% of GDP was a positive sign, but the level was much lower than in Bulgaria (8.4%) or Romania (8.5%), the two most recent EU members. Today investment is still lower than it could be. Indeed, given the state and the sizes of the Balkan economies, and as foreign direct investment is measured as a percentage of GDP, their investment should be closer to 10% rather than the current level of 5%. For instance, the level of foreign direct investment in 2005 in Ireland was 18.2%, with Hong Kong at 15.2%, Singapore at 14.1% and Sweden at 8.2%. By contrast, investment percentages were lower in bigger economies such as Germany (2.7% of GDP) or Canada (3.8%).²¹

The high levels of unemployment in the Western Balkan countries – although to be treated with caution as a large number of those officially unemployed actually hold jobs in the informal sector – and the large share of companies operating in the grey economy, as well as the corruption rates and the lack of transparency, are some of the factors discouraging foreign investment.

²¹ FinFacts Ireland, "Taxes in leading economies serious disincentive to capital investment", 21 September 2005 http://www.finfacts.com/irelandbusinessnews/publish/printer_10003326.shtml

Table 4 – Unemployment in the Western Balkans, 2001-2005 (% of workforce)

	2001	2002	2003	2004	2005
Albania	15.2	16.0	15.2	14.7	14.3
BiH	40.3	40.9	42.0	43.1	44.1
Croatia	16.3	14.8	14.3	13.8	12.7
Former Yugoslav Republic of Macedonia	30.1	31.9	36.7	37.2	37.3
Kosovo (UN 1244)	n.a.	47.0	49.7	39.7	42.2
Montenegro	30.9	28.9	26.0	22.3	18.5
Serbia	12.2	13.3	14.6	18.5	20.8

Source: European Commission, DG for Economic and Financial Affairs, "Western Balkans in transition", European Economy. Enlargement papers, Nr 30, December 2006

To improve the region's economic growth and performance, the countries of the region should, among other things, work to make themselves more attractive to foreign investment. One way to do this would be to increase regional cooperation, thus creating a larger economic area appealing to investors. As mentioned previously, the prospect of EU membership is also an important element for attracting investment, both directly and indirectly.

EU funding instruments – such as CARDS, but also the Phare and SAPARD programmes – have been playing a role in making the Balkans more attractive by contributing to their economic development. Moreover, as a fundamental part of the Stabilisation and Association Process, trade preferences known as "autonomous trade measures" and introduced by the EU in September 2000 have provided the Balkan countries with free, wide-ranging access to the EU market for "nearly all products", leading to concrete benefits in economic terms.

"The main challenge for the region now is to increase the competitiveness of SEE relative to other regions of the world, in particular by pursuing reforms to fight corruption, reducing non-tariff barriers to trade and through concrete action to further promote the development of skills adapted to market needs. [...] Regional institutions such as the Regional Cooperation Council (RCC), CEFTA and the SEE Investment Committee help ensure that SEE countries follow a strategy and process for reform that is sustainable and driven by the region."

Anthony O'Sullivan, Head of the Investment Compact for South East Europe, Organisation for Economic Cooperation and Development (OECD)²²

²² Contribution by Mr O'Sullivan to this report.

EU – Western Balkans trade

The EU is by far the most important trading partner for the South Eastern European countries today. Imports from the Western Balkans region to the EU started increasing in particular after the autonomous trade preferences entered into force. In the 2001-2005 period those imports increased by 38%, reaching €8,449 million. However, trade between the EU and the Balkan countries still accounts for only around 1% of the bloc's global trade, as illustrated by the figures below.

Table 5 – EU trade with the Western Balkans, 2001-2005

	EU exports to (in €m)			EU imports from (in €m)			EU trade with (in €m)		
	2001	2005	Growth	2001	2005	Growth	2001	2005	Growth
Total	895,850	1,071,860	19.65%	983,810	1,183,780	20.33%	1,879,660	2,255,640	20.00%
Albania	1,114	1,320	18.49%	336	459	36.61%	1,451	1,779	22.61%
BiH	2,047	2,703	32.05%	696	1,324	90.23%	2,743	4,027	46.81%
Croatia	7,042	10,371	47.27%	3,128	3,968	26.85%	10,169	14,340	41.02%
Former Yugoslav Republic of Macedonia	1,409	1,340	-4.90%	693	954	37.66%	2,102	2,294	9.13%
Serbia & Montenegro	3,179	4,945	55.55%	1,266	1,744	37.76%	4,444	6,688	50.50%
Total WB	14,791	20,679	39.81%	6,119	8,449	38.08%	20,909	29,128	39.31%

	% of total EU exports		% of total EU imports		% of total EU trade	
	2001	2005	2001	2005	2001	2005
Albania	0.12%	0.12%	0.03%	0.04%	0.08%	0.08%
BiH	0.23%	0.25%	0.07%	0.11%	0.15%	0.18%
Croatia	0.79%	0.97%	0.32%	0.34%	0.54%	0.64%
Former Yugoslav Republic of Macedonia	0.16%	0.13%	0.07%	0.08%	0.11%	0.10%
Serbia & Montenegro	0.35%	0.46%	0.13%	0.15%	0.24%	0.30%
Total WB	1.65%	1.93%	0.62%	0.71%	1.11%	1.29%

Source: Eurostat

Trade within the region

Boosting cooperation in South Eastern Europe has been a declared objective of the EU since 1996, when it formulated its 'Regional Approach' for the Western Balkan countries²³. Due to the difficult political conditions in the region at that time, however, progress has only started recently.

Following the implementation of free trade agreements between the different Balkan countries, as well as the entry into force of the new Central European Free Trade Agreement (CEFTA 2006) which aims to establish a free trade zone in the region by the end of 2010, trade relations within the Balkans have finally seen an improvement in recent years.

Trade liberalisation in South-Eastern Europe has been promoted by the EU – as a possible stimulator for regional trade – both for economic and political reasons. It is expected to lead to an increase in intra-regional trade flows, which if added to a sufficient increase in foreign trade could create solid ground for sustainable economic development and growth.

All in all however, intra-regional trade in the Balkans remains far below its potential. Albania trades the least with its neighbours, according to 2005 figures, while the former Yugoslav Republic of Macedonia and Bosnia and Herzegovina trade the most. Moreover, intra-regional trade remains to date much lower than trade between the countries of the region and the EU.

However, available data suggest a certain link between the progress of "internal" trade relations and the process of EU integration. For instance, commission figures show that those Balkan countries whose bilateral trade with the EU has grown the most are those which have also been active on intra-regional trade.

It continues to be in the EU's best interests to keep encouraging and aiding economic prosperity in the Balkans, if it wants to contribute to lasting peace and stability in the region. As persistent poverty and unemployment could translate into civil unrest, it is even more important to work on the economic indicators of a region such as the Balkans, where stability is so fragile and tensions so easily ignited.

²³Conclusions of the General Affairs Council of 26 February 1996,
http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressdata/en/gena/028a0001.htm.

Table 6 – Intra-regional trade in the Western Balkans

	Intra-regional imports in %*					Intra-regional exports in %*				
	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005
Albania	5.82	7.19	6.10	5.65	7.27	5.48	3.78	3.18	6.67	7.51
BiH	22.97	24.22	25.79	25.67	29.38	16.94	19.51	19.34	23.37	21.63
Croatia	2.47	2.74	3.40	4.28	5.63	13.89	16.43	16.95	15.89	17.33
Former Yugoslav Republic of Macedonia	19.29	19.76	19.78	22.35	20.83	32.34	32.32	29.99	32.11	34.25
Serbia and Montenegro	16.18	11.48	11.52	12.57	16.47	16.32	15.02	14.60	14.48	18.68

*Trade between Serbia and Croatia and between Serbia and Bosnia and Herzegovina not included
Source: IMF (2006), *Direction of Trade Statistics Yearbook 2006*, International Monetary Fund, Washington DC.

Serbia and the Kosovo issue

"An agreement between Serbia and the Kosovo-Albanians must remain the ultimate goal. If this fails and there is a unilateral declaration of independence, the EU and its member states must adopt a unified position. As a condition for recognising an independent Kosovo, they must ensure that the substance of the Ahtisaari plan is implemented and – with a mission that preferably has the support of the global community – secure a peaceful transition. Kosovo can only have a European perspective if its government conducts itself in a constructive manner on this issue."²⁴

Elmar Brok MEP, Member of the European Parliament Committee on Foreign Affairs and Friends of Europe Trustee

During the presentation of the countries' EU progress reports on 6 November 2007, EU enlargement commissioner Olli Rehn cited "the Kosovo status process, Serbia's democratic development and state-building in Bosnia and Herzegovina"²⁵ as the three biggest challenges that must be tackled in the region.

Finding a solution for the future status of Kosovo, a province of Serbia which has been under UN administration since 1999, has proven even more difficult than expected. Pristina wants nothing short of full independence, while Belgrade is ready to offer the province the widest autonomy but not full independence. And while neither of them seems willing to concede their positions, the clock is ticking and some observers have started warning that hostilities may resume in the region, prompted by an unsatisfactory outcome of the "Kosovo process". In September this year, US deputy assistant secretary for European and Eurasian Affairs David J. Kramer said that the Kosovo deadlock should be broken "sooner rather than later", as "we have concerns that an endless process will lead to a resumption of hostilities that none of us wants to see"²⁶.

Serbia has been increasing its efforts to achieve a closer relationship with the EU, and the recent initialling of a Stabilisation and Association Agreement by Belgrade constitutes a political success for the country. Despite considerable progress, it is still not judged as cooperating fully with the International Criminal Tribunal for the former Yugoslavia (ICTY), as four important war crime suspects remain at large. Moreover, the results of the January 2007 parliamentary elections in Serbia, where the radical SRS Party became the strongest group with nearly 30% of the votes, could prove challenging for the country's progress towards EU integration especially in some areas – such as cooperation with the ICTY.

²⁴ Contribution by Mr Brok to this report.

²⁵ Speech of EU enlargement commissioner Olli Rehn on the occasion of the release of the 2007 progress reports of the EU candidate and potential candidate countries, Brussels, 6 November 2007.

²⁶ *EObserver.com*, "Endless talks on Kosovo may lead to 'hostilities', US warns", 20 September 2007.

The future status of Kosovo

Kosovo is currently a Serbian breakaway province which has been under UN administration since the end of the war in 1999. It has some two million inhabitants, 90% of whom are ethnic Albanians. Serbs constitute the second largest ethnic group in Kosovo, with the 120,000-150,000 Serbs living in the province forming 7-8% of its population .

The province is the seventh entity to demand independence following the break-up of Yugoslavia in the early 1990s. However, the difficulty here comes from the fact that unlike Croatia, Slovenia or Montenegro, Kosovo has been an integral part of Serbia since the days of pre-war Yugoslavia.

This was explicitly stated in the preamble to Serbia's 2006 constitution, which was confirmed by referendum. Thus, Belgrade estimates that an independent Kosovo would breach Serbian territorial integrity. It says it is offering Pristina "the largest autonomy in the world [including] some elements of sovereign countries, for example access to international financial institutions"²⁷, but stops short of granting it independence.

In February 2007, the UN's special envoy at the Kosovo status process negotiations, Martti Ahtisaari, presented a plan for the province's future paving the way for its independence after a period of international supervision²⁸. While accepted by the Kosovo-Albanian government, however, the proposal was rejected by Serbia.

Given the stalemate and the difficulty of keeping the status quo, the international community is hoping to find a solution for Kosovo's future status by 10 December, when diplomats from the EU, the US and Russia – known as the international troika – are due to submit their report to the UN on what their efforts have led to.

However, as no significant progress seems to have been made towards a negotiated solution since talks on the future of Kosovo opened under the auspices of the UN in February 2006, scepticism about the possibility of reaching a solution by the 10 December is rising.

Kosovo-Albanian politicians, on the other hand, have repeatedly claimed that they are running out of patience and that they will proclaim unilateral independence shortly after 10 December if no solution is found by then. "We will not accept more talks on the issue. We insist that the process be concluded as soon as possible. Kosovo cannot be held hostage," Kosovo's president Fatmir Sejdiu said recently²⁹. Another Kosovar representative, Veton Surroi, a member of the Kosovo negotiating delegation, went even further, saying that "Kosovo should have its independence before Christmas"³⁰.

²⁷ Boris Tadić, President of Serbia, speaking before the UN General Assembly, 27 September 2007

²⁸ The proposal is available at http://www.unosek.org/docref/Comprehensive_proposal-english.pdf

²⁹ Balkan Investigative Reporting Network (BIRN), "EU Countries Prepare to Recognise Kosovo Independence", 7 November 2007

³⁰ Ibid

But Serbia has stated that such a move would be nothing more than a violation of its territorial integrity and that any other state recognising the possible independence of Kosovo would be violating international law.

The international community itself is still divided on the issue. While the US has indicated it would recognise an independent Kosovo, Russia has been firmly opposed to it. Besides being a traditional Serbian ally, Moscow fears that allowing the unilaterally declared independence of Kosovo outside the UN framework may set a precedent with potentially negative effects in its own neighbourhood. Together with Serbia, Russia has been pushing for a negotiated solution of the Kosovo issue, even if talks have to continue after 10 December – a deadline Russia has dubbed as “artificial”³¹.

For its part, the EU has been facing some internal divisions on the matter as well. After a meeting of EU foreign ministers in Brussels on 19-20 November, Britain’s Minister of State for Europe, Jim Murphy, stated that “a substantial majority [of EU countries] want to recognise [an independent] Kosovo ... certainly well above 20, but we haven't got to 27 yet”³².

But some EU members – such as Greece, Cyprus and Spain – fear that recognising a unilaterally declared Kosovar independence could boost some secessionist minorities’ feelings in their own territories.

Moreover, after the legislative elections in Kosovo on 17 November 2007, many EU ministers urged Pristina to refrain from declaring independence unilaterally. Following the victory of former Kosovar guerrilla leader Hashim Thaçi’s Democratic Party of Kosovo (PDK) and statements by Mr Thaçi that independence would be declared “immediately” after 10 December, several foreign ministers called for restraint³³.

Bulgarian foreign minister Ivailo Kalfin said he “would not recommend” such a move, while his Swedish counterpart Carl Bildt expressed concerns that if Kosovo proclaims unilateral independence, there might be in fact “two unilateral declarations of independence – one in Pristina, one in [the ethnic Serb area of] Mitrovica”³⁴.

For its part, the European Commission has so far adopted a cautious approach as regards taking positions on the province’s future, saying that it supports the efforts of international diplomats working to obtain a negotiated solution and that there should be no “speculating” on the future of Kosovo before 10 December.

Nonetheless, the EU – which is already present in Kosovo within the framework of the broader international community engagement, wants to increase its presence and role in the province. A European Union Planning Team is preparing a future civilian European Security and Defense Policy (ESDP) mission in the area of the rule of law (police, justice and customs)³⁵, and

³¹ Associated Press, “Russian FM: no predetermined solutions or artificial time limits must be in Kosovo problem”, 22 November 2007

³² *EUobserver.com*, “EU ministers warn Kosovo over unilateral independence move”, 20 November 2007

³³ *Ibid*

³⁴ *Ibid*

³⁵ EU Planning Team for Kosovo, <http://www.eupt-kosovo.eu/new/index.php>.

according to reports in the media, the EU is planning to progressively take over the role of the United Nations Interim Administration Mission in Kosovo (UNMIK) established on 10 June 1999 by Security Council Resolution 1244³⁶.

“The UK firmly believes that dealing with outstanding legacy issues from the conflicts of the 1990s – especially the status of Kosovo – is essential for regional and European security. This is one of the most important issues facing the EU today. We want to see Kosovo and the Western Balkans as a whole moving towards EU and NATO membership. After so much conflict, the citizens of the region deserve a sustainable, stable and multi-ethnic future in which everyone's right to peace and security is respected.”

Jim Murphy, UK's Europe Minister³⁷

³⁶ Associated Press, “EU report reveals plans for enforcing U.N. proposal on Kosovo, despite Serbia's objections”, 12 March 2007.

³⁷ Contribution by Mr Murphy to this report.

Table 7 – Key steps in Kosovo status definition after 1998

March – Sept 1998	Open conflict between Serb police and separatist Kosovo Liberation Army (KLA). Serb forces launch a crackdown. Civilians are driven from their homes.
March 1999	Peace talks mediated by the international community fail. Launching of 78-day unilateral NATO air strikes against Yugoslavia. Regional refugee crisis breaks out.
June 1999	President Milošević agrees to withdraw troops from Kosovo and NATO calls off the air strikes. United Nations Security Council Resolution 1244 establishes the United Nations Interim Administration Mission in Kosovo (UNMIK). The UN also sets up a Kosovo Peace Implementation Force (KFOR) and NATO forces arrive in the province. The KLA agrees to disarm, while Serb civilians flee revenge attacks.
February 2002	The Provisional Institutions for Self-government are established (a President, a government with a Prime Minister and ministers, and an Assembly).
December 2003	The UN sets out conditions for final status talks in 2005.
February 2006	Status negotiations begin under the auspices of the UN.
July 2006	First direct talks since 1999 between ethnic Serbian and Kosovar leaders on future status of Kosovo take place in Vienna.
October 2006	Voters in a referendum in Serbia approve a new constitution which declares that Kosovo is an integral part of the country. Kosovo's Albanian majority boycotts the vote, while UN sponsored talks on the future of the province continue.
February 2007	United Nations envoy Martti Ahtisaari unveils a plan to set Kosovo on a path to independence, which is immediately rejected by Serbia.
July 2007	Following Russian insistence, the US and EU redraft a UN resolution dropping the promise of independence, replacing it with a pledge to review the situation if there is no breakthrough after four months of talks with Serbia.
Sept–Nov 2007	Direct talks between Serbian and Kosovar leaders under the international troika's auspices. No substantial progress made.
October 2007	The international troika proposes a 14-point document to serve as a basis for a compromise solution. Kosovo continues to call for full independence.
December 2007	Deadline set by the international community for completion of talks on Kosovo's future status.

Sources: BBC, EUobserver.com, European Commission

Serbia's democratic development

The future of Kosovo is of crucial importance for Serbia and its unresolved status has been fuelling a certain nationalistic rhetoric in the country.

This is illustrated among other things by the results of the most recent parliamentary elections in the country – those of January 2007 – where the ultranationalist Serbian Radical Party obtained the most votes (28.7%). The party is currently led by Tomislav Nikolić in the absence of its formal leader Vojislav Šešelj, currently on trial in The Hague accused of war crimes and of making several inflammatory speeches calling for the creation of a "Greater Serbia". In her opening statement at the trial, prosecutor Christine Dahl said that Serb forces had been indoctrinated by Mr Šešelj with "poisonous ideas" and sent to commit "unspeakable crimes" in Bosnia and Croatia.³⁸

The Democratic Party of Serbian president Boris Tadić followed with 22.71% of the votes, while Prime Minister Vojislav Kostunica's Democratic Party of Serbia-New Serbia came third with 16.55%.

The failure to break the deadlock on Kosovo has also strengthened some tendencies in Serbia to see a Western anti-Serbian conspiracy in the international community's actions. In October, Prime Minister Koštunica said that a Western-backed plan for a sovereign Kosovo and moves by Bosnia's international administrator Miroslav Lajcak aimed at making the country's political system more efficient, represented an "open threat to the essential interests of the Serb people"³⁹. Alongside the subsistence of a certain degree of nationalistic rhetoric in Serbia – illustrated notably by the Radical Party's popularity – cooperation with the ICTY constitutes another hurdle in the country's democratic development.

As one of the conditions for EU membership, Serbia has to cooperate fully with this UN war crime tribunal, i.e. by arresting wanted suspects or at least by showing that it is doing its best to do so. While it has so far handed over 20 out of the 24 fugitives wanted by the ICTY, four remain at large: former Bosnian Serb military chief Ratko Mladić, who has been indicted on charges of war crimes, crimes against humanity and genocide; former Bosnian Serb leader Radovan Karadžić; former Croatian Serb rebel leader Goran Hadžić; and Bosnian Serb police commander Stojan Župljanin.

Nevertheless, ICTY prosecutor Carla del Ponte indicated in early November that she had seen improvements in Serbia's behaviour, following which the EU decided to initial a Stabilisation and Association Agreement with Belgrade⁴⁰. The European Commission has repeatedly stated that the two issues – Serbia's EU integration and the "Kosovo process" – are not and will not be linked. When presenting the Balkan countries' progress reports in early November, enlargement commissioner Olli Rehn once again stressed he was not considering such an option⁴¹.

³⁸ BBC, "Serb accused at war crimes trial", 7 November 2007

³⁹ Reuters, "Powers back Bosnia envoy, Russia faults timing", 31 October 2007

⁴⁰ Institute for War and Peace Reporting, "Serbia close to signing EU agreement", 9 November 2007

⁴¹ *EUobserver.com*, "EU keeps door open to Balkan countries", 6 November 2007

It nevertheless remains tempting to believe that the timing of the SAA initialling was not a coincidence. The political step came at an important moment in the Kosovo talks and this move may be hoped to achieve a reignition of pro-EU feelings in Serbia, raising the chances of a political compromise on Kosovo and of improved cooperation with the ICTY. However, there has been no sign so far that such a compromise would be possible in the coming weeks. The “Kosovo process” and how it will end remains an open question.

“The present state of play in South East Europe in many aspects calls for additional efforts and advanced input by the European Union. In the face of the remaining challenges, the EU and international community should change their attitude and try to manage the process instead of running after the events. The unsettled Kosovo issue and negative ramifications in the region, including in particular the present troublesome and disturbing developments in Bosnia and Herzegovina, may put in jeopardy the achieved level of stability, security and cooperation in the region. That may cast a dark shadow over the much broader interests of Europe and the international community as a whole. That may bring back a prolonged economic crisis and social instability, internal political crisis and might have a negative impact on different strategic outcomes in terms of the present Euro-Atlantic enlargement policy.

Therefore, these issues need to be addressed and resolved by a cohesive approach on the part of the international community, as they are evidently becoming a historical test for the EU and the Transatlantic community, but also for the continuation of the policy of creating a new undivided Europe and a cooperative world order”.

Hido Bišćević, Croatian State Secretary for Political Affairs and incoming Secretary-General of the Regional Cooperation Council⁴².

⁴² Contribution by Mr Bišćević to this report.



Friends of Europe Les amis de l'Europe

Friends of Europe thanks its VIP partners (Visibility - Input - Platform)



European Active Citizenship

With the support of the European Commission:
Support for bodies active at European Level
in the field of active European Citizenship