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**DIRECTORATE-GENERAL FOR EXTERNAL POLICIES OF THE
UNION
DIRECTORATE B
- POLICY DEPARTMENT -**

BRIEFING NOTE

ECONOMIC DEVELOPMENT AND EUROPEAN PERSPECTIVE FOR SOUTH EAST EUROPE

**BRIEFING NOTE FOR THE JOINT PARLIAMENTARY MEETING ON THE WESTERN BALKANS
CO-ORGANISED BY THE EUROPEAN PARLIAMENT AND THE PARLIAMENT OF SLOVENIA
BRUSSELS, 26-27 MAY 2008**

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Author: Georgios Ghiatis
Directorate-General External Policies
Policy Department
georgios.ghiatis@europarl.europa.eu

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Economic development and European perspective for South East Europe
Briefing note for the Joint Parliamentary Meeting on the Western Balkans
co-organised by the European Parliament and the Parliament of Slovenia
Brussels, 26-27 May 2008

Over the past two years, the countries of the **Western Balkans¹** have moved closer to the EU. Indeed progress, albeit uneven, was made regarding reforms and in meeting the established criteria and conditions. These relate to the Copenhagen criteria, the Stabilisation and Association process, including regional cooperation, good neighbourly relations, full cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY). Still, for these countries important challenges lie ahead.

The need to solve the status of Kosovo has focused attention on the region and its links with the EU. Peace and stability in the region are of utmost importance. To this end, it is **crucial to enhance the EU perspective of Western Balkan countries** making it as visible as possible for all the peoples of the region. Constructive engagement by political leaders throughout the region is also required. Public opinion in the Western Balkans is largely favourable to EU integration. Governments committed themselves to this objective and are implementing reforms. However, dividing lines within societies remain on a number of key issues related to the co-existence and integration of different communities and, in some cases, constitutional reform. Further efforts are needed to achieve consensus on such issues in order to press ahead with the necessary political and economic reforms. The **European Union is mobilising various policy instruments** in order to encourage the reform process, the reconciliation efforts and progress towards European integration. These efforts are aimed at strengthening the rule of law, good governance, judicial and administrative reform and the development of civil society. The financial support to the reform efforts of the Western Balkan countries is provided through **the Instrument for Pre-accession Assistance (IPA)**.

Following on the Thessaloniki agenda, the European Council, in December 2007, reaffirmed that "the future of the Western Balkans lies within the European Union." The Council, in February 2008, asked the Commission to propose to the broader region concrete measures. Each country's progress² towards the EU is performance-driven, depending on its individual merits and success in addressing reform priorities. Intensified efforts are also expected on regional cooperation, enhancing good neighbourly relations, notably through the new Regional Cooperation Council, the structure that succeeded the Stability Pact. The Commission has taken also a new initiative in the area of donor coordination.

Community financial support and donor coordination

Since 2007, the EU provides *financial support* to the Western Balkans through the new Instrument for Pre-accession Assistance (IPA)³.

¹ Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro and Serbia, as well as Kosovo under UNSC Resolution 1244/99

² Commission progress reports: COM(2006) 649, 8.11.2006 and COM(2007) 663, 6.11.2007.

³ IPA covers all candidate and potential candidate countries, i.e. the Western Balkans and Turkey

IPA streamlines **all pre-accession assistance within a single framework**. It places more focus on ownership of implementation by the beneficiary countries, on support for cross-border cooperation, and on "learning by doing". It prepares candidate countries to implement the regional, social, rural development and cohesion funds upon accession.

The Western Balkans will receive around **€4 billion under IPA for the period 2007-2011**. This is the equivalent of €30 per capita per year, by far the highest amount provided by the EC to any region in the world. Particular emphasis is given to state-building, rule of law, reconciliation, administrative and judicial reform, the fight against corruption and organised crime, and economic reforms. These areas should be addressed at an early stage in the process towards accession.

The European Investment Bank (EIB) will increase its lending to the region (from a total of €1.9 billion for 2005-2007, to an estimated €2.8 billion for the period 2008-2010). This includes lending covered by the Community budget guarantee. EIB lending activities in the Western Balkans focus primarily on projects in the areas of transport, energy, small and medium-sized enterprises, environment, municipal infrastructure, education and health.

A major effort is being made in support of Kosovo. More than €1 billion from different EU financial instruments are planned to assist Kosovo's development and to finance the international presence for the period 2007-2010.

Coordination between the Commission and other donors is crucial in order to ensure that assistance to reform efforts is complementary, coherent, effective and efficient. The Commission works closely with other international financial institutions (IFIs) and bilateral donors so that the maximum amount of support possible could be mobilised (grants and loans) to focus on the region's main modernisation and development needs.

In 2006, the Commission signed a Memorandum of Understanding with several International Financial Institutions⁴ on coordination and cooperation in supporting the candidate and potential candidate countries. At local level, a consultation mechanism on IPA programming was established in 2007 with Member States' embassies, local offices of IFIs and non-EU donors in the beneficiary countries. This coordination will be intensified.

Early involvement and consultation of beneficiaries throughout the programming cycle will continue both at local level and through regional meetings. In December 2007 the Commission met with all bilateral donors who have major programmes in the Western Balkans and also with representatives of the IFIs. A framework for closer cooperation in providing assistance to the region was established. In June 2008, the Commission will organise a high-level follow-up meeting aimed at coordinating the implementation of assistance from all key actors in the region, both by country and by sector.

The Commission is preparing a *donors' conference for Kosovo* aiming to secure financial assistance to help Kosovo implement its status and to promote socio-economic development for all communities. EU Member States and other international donors will be invited to contribute.

⁴ The EIB, the EBRD, the IBRD and IFC, the Nordic Investment Bank, the Nordic Environment Finance Corporation, the Council of Europe Development Bank and the Black Sea Trade and Development Bank.

Economic and social development⁵

Increasing competitiveness, reducing high levels of unemployment, fostering human development and labour market participation, building infrastructure and ensuring social cohesion are *major challenges throughout the Western Balkans*. Support is provided to efforts aimed at promoting sustainable development and to become acquainted with the objectives of the Lisbon strategy. This strategy aims to enhance growth and job creation and prepare the EU to face the challenges of globalisation, ageing and climate change. Agriculture and rural development are also central issues. Due attention should be paid to their role in the region's economic-social development.

Support to economic stabilisation and reforms in the region

The Western Balkan countries continue work towards fulfilling the Copenhagen economic criteria, which require the existence of a functioning market economy and capacity to cope with competitive pressure and market forces in the EU. They also need to prepare for future participation in the multilateral surveillance and economic policy co-ordination procedures as part of Economic and Monetary Union. The candidate countries have developed pre-accession economic programmes which set out their proposals for reform. In addition, since December 2006, the potential candidate countries prepare annual economic and fiscal programmes which are assessed by the Commission. A regular bilateral economic dialogue between the Commission and the respective countries is held. The Western Balkan countries may also benefit from EC macro-financial assistance.

Cooperation with IFIs for economic and social development

The Commission, in coordination with the EIB, the EBRD and other IFIs, is supporting modernisation and development in the Western Balkans. The focus is on three priority areas: micro- and small and medium-sized enterprises (SMEs), energy efficiency and infrastructure.

In March 2007, an IFI advisory group was established covering regional transport, energy and environmental projects, municipalities and public-private partnerships as well as social issues including health, education, employment, and labour market.

In November 2007, the Commission agreed with the EIB, the EBRD and the Council of Europe Development Bank to create an *Infrastructure Projects Facility for the Western Balkans*. The Facility is launched with a budget of €16 million. It will help prepare investment projects to be financed from grants and loans in the areas of transport, energy, the environment and social infrastructure. The Facility will soon be widened to include other interested donors and additional forms of cooperation. It is foreseen that *a Western Balkans Investment Framework be established by 2010* to further enhance harmonisation and cooperation in investments for socio-economic development in the region.

Small and medium-sized enterprises (SMEs)

The *European Fund for South East Europe (EFSE)* provides commercial banks and non-bank financial institutions with loan facilities to support development of micro-enterprises and households. Over the past two years it provided micro-credit to more than 65 000 small enterprises in the region. It also succeeded in attracting private capital for micro-lending. The Commission is analysing the feasibility of future initiatives to support small business in the region.

⁵ see Commission's Communication to the European Parliament and the Council "Western Balkans: Enhancing the European perspective", COM(2008) 127 final, 5.3.2008

The countries in the region are now being integrated in the new *Enterprise Europe Network*, the EU's network of SME support services.

Employment policy and social issues

In the area of employment policy, social issues and social dialogue, over the last two years, under the “Bucharest process”, reviews of each country’s employment policy continued and work was initiated on occupational health and safety as well as on networking public employment services. Regional meetings and conferences have been held on employment, social dialogue and social protection issues. In October 2007, *common policy priorities were agreed by the Western Balkan ministers for employment, labour and social affairs* (“Budva conclusions”). A *declaration on social security coordination was also signed by ministers of social affairs* (“Tirana Declaration”). Community assistance is being provided to a programme on coordination of the social security systems. An informal meeting of ministers for labour/ social affairs on youth employment will be held in June 2008.

Trade integration – Central European Free Trade Agreement (CEFTA)

The enlarged and amended *Central European Free Trade Agreement (CEFTA)* was signed in December 2006 and entered into force for all parties in November 2007. It will contribute to attracting foreign direct investment, fostering intra-regional trade and integrating the region into the global trading environment. Regional trade integration through CEFTA complements trade integration between the countries in the region and the EU under the Stabilisation and Association Agreements (SAA) and Autonomous Trade Measures (ATM). A new secretariat is to be set up, in Brussels, supporting the rotating CEFTA chairmanship. It will be supported financially by the Commission for the first three years. The Commission will continue also providing technical and financial assistance to the parties.

EU-Western Balkans *diagonal cumulating of rules of origin*⁶ is being established for interested countries in the region. The necessary provisions, including cumulating with Turkey for products covered by the Customs Union, have been included in the SAAs or in Additional Protocols, negotiated in 2007. They will come into effect upon the entry into force of the relevant Interim Agreements and Additional Protocols. In October 2007, the Euro-Med Trade Ministers endorsed extension of the Pan-Euro-Med scheme of diagonal cumulating of rules of origin to the countries of the Western Balkans. Technical preparations to that end are in progress and decisions are expected in the course of 2008. The Commission is exploring ways to ensure a more rapid application of such a system between the Western Balkans, Turkey, EFTA and the EU. It will continue to provide technical and financial support to customs and tax administrations.

Accession to the WTO is fundamental for fostering economic and trade reforms. Technical assistance is provided by the Commission to Bosnia and Herzegovina, Montenegro and Serbia for their accession negotiations with the WTO. Other measures to support trade integration include participation in tenders under the new pre-accession and neighbourhood instruments (IPA and ENPI) and continued

⁶ Diagonal cumulating of rules of origin is a system facilitating regional trade integration. It enables a country to transform and export a product under preferential trade treatment to the EU, even though part of the product's input originated from another country participating in the scheme

significant financial support for alignment of the Western Balkan countries with the main trade-related parts of EU legislation.

Energy

Energy supply is crucial for sustaining economic development in South East Europe. The aim of the *Energy Community Treaty*, which entered into force in July 2006, is to establish a stable regulatory and market framework capable of attracting investment in energy generation, transmission and networks. A single regulatory area in the region, aligned with EU legislation, will help overcome market fragmentation, ensure security of supply and contribute to improving the state of the environment. This means that key parts of the energy *acquis* are now fully applicable in the Western Balkans. All institutions provided for in the Treaty have been set up and are operating. The main stakeholders of the electricity and gas sectors are meeting regularly. In 2007, a conference on investment in energy infrastructure was held and a list of priority energy infrastructure projects was adopted. In addition, a Memorandum of Understanding was signed to address the social dimension of the Energy Community. In 2007, a new *energy efficiency facility* for the Western Balkans was established under IPA in cooperation with IFIs. The Commission intends to expand this facility.

Transport

Development of a reliable transport network is an essential requirement for the region's economic progress and social integration, and also for easier access to the EU transport network and the internal market.

The Commission proposes negotiating directives for a *Transport Community Treaty with the Western Balkans*. The purpose is to work towards an integrated market for road, rail, inland waterways and maritime transport in the Western Balkans region. The proposal follows exploratory talks on cooperation in the field of transport launched in early 2007 with all countries neighbouring the EU and successfully concluded with the Western Balkans.

The South East Europe Transport Observatory (SEETO) and the Secretariat for the development of the *South East Europe Core Regional Transport Network* have prepared multi-annual plans, indicating priorities for the region. The Commission will continue to provide financial and technical assistance for further work in this area.

The Agreement on the *European Common Aviation Area (ECAA)* was signed in June 2006. The aim is to integrate the Western Balkan countries into the EU's internal aviation market. Under the ECAA, Western Balkan countries will fully implement EC aviation law, including high standards of safety and security, while their airlines will have open access to the enlarged European single market in aviation. Technical assistance for the implementation of the agreement will be provided by the Commission.

G.G.
DG EXPO-Policy Department