

A stylized map of the Western Balkans region, composed of a grid of grey dots. Several dots are highlighted in red, indicating specific locations or points of interest within the region.

Social Cohesion at the Centre

A New Initiative for Stability and Prosperity in the Western Balkans

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- Prosperity and stability in the Western Balkans can be achieved only by a joint focus on economic and social questions within the framework of a new policy approach based on social cohesion. When revisiting its enlargement policy, the European Commission should set out intermediate steps to keep the process alive.
- A new social and economic model needs to be implemented in the Western Balkans. The social model should promote progressive taxation and social protection programmes designed to reduce income and wealth inequalities. A new economic model focused on an added value economy should replace the current neoliberal model.
- Fiscal transparency and open governance are the first steps towards building institutions that enable citizen participation in decision-making and create a level playing-field more conducive to economic prosperity in the Western Balkans. Fighting for meritocracy and eliminating political patronage is possible only by strengthening the mechanisms of democratic control.



Foreword

In 2003, at the summit in Thessaloniki, the European Union (EU) promised membership to all the countries of the Western Balkans. More than a decade later, the common objective of European integration is impeded by political and economic developments in many of the designated member states. In the absence of functioning economic strategies, unemployment is high, large parts of the population live in or are threatened by poverty and public budgets are in a precarious state. Political institutions often do not work democratically, but serve to secure the power of political elites. Accession instruments and policies employed by the EU often do not show the desired results. While the successful European integration of the Western Balkan countries is vital for the stability and prosperity of both the region and the EU, it appears difficult under these conditions.

Against this background, in November 2014 the Friedrich-Ebert-Stiftung initiated a process to develop policy recommendations for a positive change of the political and economic situation in the Western Balkans. Representatives of academia, civil society and politics from the Western Balkans were invited, along with political experts on European integration from Germany and Brussels, to discuss core challenges and necessary reform policies. The public debate on the EU integration of the Western Balkans and a two-day workshop

in November 2014 and March 2015 in Berlin resulted in the formulation of four core theses that point to the deficits of current policy approaches and suggest alternatives to policy-makers at the national and European levels.

Only if inequality is addressed as the core challenge to stability and prosperity in the Western Balkans and social cohesion is put in the centre of a new initiative for social, economic and political reform can European integration be successful. In the short and medium term, reform policies should focus on establishing a new social and economic model consisting of progressive taxation and inclusive social protection programmes, as well as on an added value economy, replacing the current focus on foreign direct investment. Fiscal transparency and open governance are the first steps towards enabling citizens' political participation. The fight for meritocracy and against political patronage must be pursued by strengthening the mechanisms of democratic control.

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Introduction: Revising European Enlargement Policy

Enlargement has been a success story for the EU and Europe as a whole. It has helped to overcome the divisions of the past, contributed to peace, stability and prosperity, stimulated reforms and consolidated democracy, the rule of law and respect for human rights and fundamental freedoms. After numerous enlargements, the EU has emerged as an economic power accounting for more than 30 per cent of global GDP and 17 per cent of world trade.

In a world in which markets are progressively integrating and the productive model itself looks increasingly transnational, market volume and size matter. With each successive accession, the EU integration process gained as a whole, from the energy market to monetary policy as well as freedom of movement for people, goods and capital. As the European Union expands, new opportunities are created for the people of Europe. Although the EU faces severe internal challenges, it continues to be attractive, not least because of its unique combination of economic dynamism and distinctive social model.

In recent years, European enlargement policy has put particular emphasis on the following three pillars: the rule of law, economic governance and public administrative reform. These must go hand in hand if the countries concerned are to be able to face new challenges. It is regrettable that the social dimension has been largely neglected in the enlargement process and that there are no »social criteria« in the package. In fact, this aspect would play a key role in the successful accession of the Western Balkan countries. Stronger focus on the social aspect of enlargement would foster states' internal stability, which is essential for the successful consolidation of any reform. Thus, particular attention must be paid to a new policy approach with a strong focus on the social dimension.


Today, the enlargement process is at a very critical stage: »Enlargement fatigue« in the EU, as well as »reform fatigue« in the candidate and potential candidate countries, coupled with the economic crisis in the euro zone, calls into question the achievements as well as the prospects of a process that has generally been considered the most successful expression of EU foreign policy. At

the same time, public support for EU accession has also weakened, in both the EU and the Western Balkans. This shows that addressing the challenges of the enlargement agenda is closely related to the challenges of the economic crisis today. What we are witnessing are the limits of austerity policy, implemented in all enlargement countries, and the increasing recognition by all sides of the costs of economic recovery. In this framework, if more and more citizens stop supporting the EU project, they will definitely not support enlargement. Enlargement policy can be seen only as part of a broader project of a more and more united Europe.

Europe today does not have the luxury of choosing between deepening and widening. The EU has to work both inside and outside its borders because there are two facets of its own development. A stable Western Balkan region is crucial for the EU's own geopolitical and economic stability.

Enlargement must remain a credible policy in order to maintain its transformative power for the mutual benefit both of the EU and the Western Balkan countries. During the past decade, the enlargement agenda has advanced under difficult circumstances. Now, Croatia has joined the EU; the Kosovo issue is on the way to normalisation; and political and economic reforms fuelled by the accession agenda have flourished. Despite the crisis, it has been a productive period: talks have started with Montenegro and Serbia, while Albania obtained candidate status, proving the dynamism of the region and of the process. However, the region has plunged into recession, with unemployment and poverty being the biggest threat to social cohesion.

It is obvious that there is an urgent need for a change in policy on enlargement, both in Brussels and the Western Balkan capitals in order to overcome the stalemate and recalibrate the process. To foster democracy and prosperity we need to reinvigorate the enlargement process and keep up the momentum. A new impetus must be given to the reform process, while enlargement policy must develop a clearer and more efficient structure. The following aspects should therefore be stressed for the successful European integration of the Western Balkans:



- The EU should focus more on economic and social questions. As unemployment is an open wound in the region, focusing on the social dimension of enlargement should help the countries to address the authoritarian tendencies currently observable in various parts of the Western Balkans. Without neglecting basic rights, rule of law and media freedom, the EU should focus more on the economic and social reality of the countries concerned.

- Social inequalities should be combatted by the EU's promotion of a new economic and social model in the Western Balkan states.

- The EU should pay more attention to civil society actors. The Commission should ensure increased participation of small and non-centralised civil society organisations and trade unions in the process. The Commission should also strengthen the capacities of the social partners and civil society and enhance the role of social dialogue.

- Stronger EU support on open governance and meritocracy could trigger substantive change in democratic institutions and public administration, particularly with regard to clientism and political patronage.

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Social Cohesion for Stability and Prosperity in the Western Balkans

Thesis 1

Economic inequality is one of the core challenges to stability and prosperity in the Western Balkans. In order to overcome it, well-functioning social systems able to reduce inequality need to be implemented.

Summary

- A progressive income tax, together with higher property taxes for wealthier citizens, should be introduced in order to bring about redistribution of income and wealth.
- Adequate information on citizens' wealth is necessary for fair taxation.
- The social safety net should be rebuilt through programmes designed to implement social justice.

Challenges

The main name of the game in the Western Balkans is capture of income and wealth by the elites. This is why the many reforms in the Western Balkans in the past two decades have not improved living standards significantly and have not solved the high unemployment. On the contrary, the rising inequality is transforming Balkan societies along Latin American lines.

Institutions are weak and completely dominated by the political elites. Corruption is built into the system, with virtual impunity from prosecution and a lack of political accountability. Economic growth is insufficient to provide prosperity. Poverty is high and massive emigration is the logical consequence of the lack of an economic future.

The tax system favours the minority of wealthy people in the Western Balkans. The tax burden is significantly lower than EU average, while the revenues collected from the low flat taxation is insufficient to develop adequate social systems. As the result, social protection schemes could not provide an exit from poverty for the majority of citizens in need.

Recommendations

(I) Introduction of Fair Taxation

Within the framework of traditional redistribution policies, the first batch of measures could target the ever-growing inequalities in income and wealth through progressive taxation. Measures should include progressive personal income taxes, higher property taxes for wealthier citizens and progressive payments based on income for public services, such as child services, health care and education. In this way, direct taxes would contribute more to state budgets, superseding VAT, which imposes a greater burden relative to income on the poor than on the rich.

(II) Adequate Information on Citizens' Wealth

Proper information on citizens' income and wealth is a key condition of fair taxation. Currently, while information on incomes in Western Balkan countries is adequate, information on wealth is not. Efforts should therefore be made at the national level, as well as at the regional level, to develop platforms for determining personal assets, including owner-occupied housing, bank deposits, cash holdings, savings in insurance and pension plans, investment in real estate, corporate stocks, financial securities, cars, yachts and artworks. This would lead to the implementation of more sophisticated taxation of wealth.

(III) Rebuilding the Social Safety Net

Western Balkan governments must reverse the privatisation of public services and instead focus their efforts on improving quality and efficiency. The first steps in the reform process should be focused on programmes designed to provide social justice, such as adequate minimum wages (in order to cover basic living expenses), a minimum income scheme (to provide additional income to enable recipients to exit from poverty) and a youth guarantee (to provide young people with a job, apprenticeship, traineeship or continued education within four months of leaving formal education or becoming unemployed).

Thesis 2

The established neoliberal economic model has failed to promote economic growth in the Western Balkans. Prosperity depends on the introduction of a new economic model focused on added value.

Summary

- Education systems need urgent and deep reform in order to achieve productivity growth.
- High-value added economic activities can be accomplished through industrial policy and investment in research and development (R&D).
- Establishment and development of small and medium-sized enterprises (SMEs) should be a priority, not foreign direct investment (FDI).
- Regional cooperation needs to be strengthened through infrastructure projects, R&D investments, complementary industries and workforce mobility.

Challenges

The Western Balkan economies have implemented neoliberal policies throughout the transition process, which is diametrically opposed to the famous European Social and Economic Model. Its most important elements in the Western Balkan economies are: high labour market »flexibility« and destruction of trade unions; flat and low corporation and personal income taxes, together with low property taxes; and a glorification of FDI, including tax concessions for foreign investors over domestic investors.

The neoliberal model has failed to achieve its purported goals in the Western Balkans: productivity growth, job creation and lower unemployment. On the contrary, labour market »flexibility« and the destruction of collective bargaining have left workers unprotected and have kept wages miserably low. This boosts company profits, while flat and low taxation does not redistribute income sufficiently. Furthermore, markets – captured by monopolies – are failing to allocate resources properly.

One side effect of this model is the disappearance of large domestic companies and a specialisation in intermediary transformation industries, in which only low-

cost, low-skilled labour is needed. This effect is exacerbated by the low quality of education systems in the Western Balkans and the poor investment in R&D.

Recommendations

(I) Education System Reform for Labor Productivity Growth

Education system reform is a necessary condition for productivity growth and shifting towards an added value economy. The EU should give high priority to this reform during the integration process, while bearing in mind that in the past many superficial reforms were implemented, where policy-makers created a mess in the education system by simply making partial changes in whatever seemed feasible, practical and politically doable. A proper reform process must try to introduce an integrated education system based on Western European models. In addition, positive German examples of occupational education should be implemented in the Western Balkans, because the region lacks qualified workers. An increase in labour productivity would influence wage growth.

(II) Building Sustainable and High Value-added Economic Activities

Western Balkan countries need to rebuild their own productive fabric and move away from intermediation-centred activities (cheap labour subcontracting). Industrial policy and investment in R&D should be the main drivers of this process. Industrial policy should enjoy a rebirth in the Western Balkans with regard to development priorities. State investment in R&D should encourage the flow of knowledge between universities and business, generating private innovation in the economy. The EU should provide support for vertical integration of the Western Balkan companies with EU companies.

(III) Focus on SME Development Instead of FDI

SME development should take priority over FDI. There are many regions in Europe that have achieved economic development through the SME sector. Policy measures should aim to use the best EU practices, together with adequate financial support of SMEs, in both national and EU programmes. The EU could enforce the role of SME development within the enlargement strategy and include Western Balkan companies as beneficiaries in

the respective EU programmes and policies, such as the European Charter for SMEs. Particular attention should be given to the creation of connections between SMEs and FDI, because these links are missing.

(IV) Strengthening Regional Cooperation

The present fragmented and ad hoc approach of the Western Balkan economies is leading nowhere. These economies should intensify their regional cooperation through four main channels. The first channel would

be joint projects among Western Balkan countries in regional infrastructure, accompanied by an initiative to achieve regional consensus on constructing the necessary infrastructure in the region by 2025. The second channel would connect universities and companies at the regional level by establishing a regional R&D excellence fund. The third channel would be regional industrial policy aimed at supporting regional industry clusters. The fourth channel would be better regional labour mobility by means of a set of agreements established by the EU.

Thesis 3

Institutions in the Western Balkans are extractive: They concentrate power and opportunities in the hands of a few. The first step in the creation of inclusive institutions is open governance as a project for all countries in the region.

Summary

- Fiscal transparency is a necessary condition for dismantling the institutions that serve to enable the few to extract resources from the many.
- Open governance will build inclusive institutions that enable citizen participation in decision-making and create a level playing-field between economic agents, which is more conducive to economic prosperity.
- Transparent financing of political parties will decrease incentives for corruption and quid pro quo mechanisms between parties and private companies.

Challenges

The lack of transparency and accountability is an embedded characteristic of Western Balkan institutions, enabling the political elites to make crucial decisions outside democratic forums and public scrutiny. It prevents citizens from obtaining an insight into government processes (for example, decision-making or budgetary expenditure) and from holding incumbents responsible for their actions. As a result, there are almost unlimited opportunities for the ruling parties and their leaders to obtain wealth from abuse of state resources.

Western Balkan political parties have a number of deficiencies compared with the established democracies. Political debate based on party programmes and public policies is rather limited due to the dominance of »grand narratives« – for example, ethnic considerations – and selection of leaders focuses on personalisation and authoritarianism. Finally, this political polarisation amounts to a zero-sum contest between parties and voters; consensus is lacking and, consequently, the many different interests concealed by the abovementioned »grand narratives« are underrepresented.

The mistrust in the political system – both elected representatives and (even more so) the civil service – is the result of the combination of extractive institutions and people's low living standards. The gap between the state (political elites) and the citizens continues to widen.

Recommendations

(I) Fiscal Transparency as Goal *per se*

The first step towards dismantling institutions compromised by the political elites is fiscal transparency. The government must make available detailed data on where money is spent and how well public services are performing. Not only would this let citizens hold the government to account, but it could also help to improve efficiency, give citizens a choice in using public services and contribute to economic growth. Fiscal transparency should include governments on different levels, as well as public companies or companies in partial public ownership. The data should be published in an easily accessible format for the general public.

(II) Open Governance as a Project for All Western Balkan Countries

The open governance project can facilitate the transformation from extractive to inclusive institutions in the Western Balkans. This approach would be driven by opening up public data and services and facilitating collaboration between government and citizens in designing, producing and delivering public services. It is also about making government processes and decisions open, in order to foster citizens' participation and engagement. Generally, the open governance project should be implemented at least with regard to the two main institutions, government and parliament. The EU should provide support for implementing this project in Western Balkan countries.

Thesis 4

Political patronage is used by the elites as a tool for governance. Fighting for meritocracy and the elimination of political patronage is possible only by strengthening of democratic control mechanisms.

Summary

- Parliament's oversight function should be enhanced by improving the legal framework and capacity building.
- More power and independence should be given to the ombudsman and anti-corruption institutions.
- Free space needs to be created for the development of an independent NGO sector.
- Professionalisation of the public administration should be carried out by reducing the power of the ruling political parties and the introduction of more meritocratic criteria.

Challenges

Political patronage allows political elites to offer something to citizens in countries in which social protection is inadequate, the quality of the public services is deteriorating, wages and pensions are low and living standards are bad. Patronage links are formed between voters belonging to specific social groups and ruling parties that redistribute state benefits in favour of these groups.

In general, there are three types of state-related benefit: real income, such as wages and social transfers (for

(III) Transparent Financing of Political Parties

Financing of political parties should be fully transparent and controlled by strong and independent institutions; the weakest dimension of the funding of political parties in the Western Balkans is the prevention of wrongdoing and sanctions. The laws on the funding of political parties are not sufficient. This should be changed in accordance with EU practices. In addition, transparent financing would create an open space for establishing internal democracy in political parties and transform them from organisations that serve the interests of their leaders into organisations based on political programmes that convey the interests of their electorate. The European sister parties could play a strategic role in this process.

example, capturing votes by extending social transfers to groups not entitled to them); privileged protection against market risks (for example, organising tender procedures to ensure that a particular company wins and preferential treatment for big companies); and impunity from the law (for example, tax evasion, unauthorised construction, pension fraud and legal immunity).

In this way, democratic control in Western Balkan societies – parliament, judiciary, media and civil society – has become atrophied and swallowed up by political patronage. The ruling political parties control almost everything. To give only two examples: judicial appointments that pass through ruling party filters and the media, which is significantly financed by the government.

The elimination of political patronage must start by removing the system of democratic control from the reach of the ruling parties. Functional checks and balances for the political elites would open the way for meritocracy in the Western Balkan societies.

Recommendations

(I) Strengthening of the Main Oversight Institution, Parliament

Two paths should be used to strengthen parliament: improving the legal framework and capacity building. Changes in the legal framework should provide more power to oversight, not necessarily by constitutional

changes but by changing the rules of internal parliamentary procedures (for example, question time, public hearings). These changes should distribute the parliamentary workload more towards oversight, in contrast to the current domination by legislative activities (admittedly, due to mainly harmonisation with the *acquis*). Parliaments should also have more financial independence from governments. The EU should put more emphasis on projects aimed at strengthening the role of parliament and involving academics and NGO representatives in decision-making on strategic issues.

(II) More Power for the Ombudsman and Anti-corruption Institutions

The oversight institutions, such as the ombudsman and anti-corruption institutions, should be provided not only with legal authority, but also with independent (from executive) budgets sufficient for performing their functions. Experience shows that so far these institutions have usually had limited authority (determined by law) or limited capacities (lack of basic working conditions or staff). In addition, the majority of members of the anti-corruption institution should be elected on the proposal of opposition political parties to guarantee this institution's corrective role.

(III) Free Space for Civil Society

Creating free space for developing an independent civil society sector would be an excellent basis for facilitating more bottom-up democracy. It is imperative that the

authorities take a proactive approach in establishing a milieu in which NGOs can work without fear of retaliation, but also to prevent or stop smear campaigns against civil society activists critical of the government, which often involve abuse of public resources, institutions and the media. Also, governments should improve the implementation of laws and bylaws, ensuring access to NGOs that monitor the work of state administrative bodies. Finally, the government should not interfere in the autonomous work of the NGO sector or try to create a parallel NGO sector. On the other hand, the EU must include NGOs in the close circle of its interlocutors both on the national and regional level. NGOs should be considered an important pillar of Western Balkan societies.

(IV) Professionalisation of the Public Administration

The starting point regarding professionalisation of the public administration should be a set of measures that reduce the power of ruling political parties, such as determining a maximum number of officials who may be replaced after every election and introducing meritocratic criteria for a larger number of positions in the administration. Meritocracy rules need to be supported by different activities, including anti-corruption and anti-plagiarism campaigns at universities and other institutions that provide certificates for meritocratic competition. Furthermore, all countries have to make sure that there is zero tolerance of clientism in the civil service.



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