THE IMPACT OF THE ECONOMIC CRISIS ON THE WESTERN BALKANS AND THEIR EU ACCESSION PROSPECTS
The Impact of the Economic Crisis on the Western Balkans and their EU Accession Prospects

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Abstract

The European Union’s enlargement towards the Western Balkans may be facing its most difficult challenge since its launch in Zagreb in 2000. The prospect of Balkan enlargement has been hard-hit by the deterioration of the European economy, and particularly the Greek sovereign debt crisis. The countries of the region have been deeply affected by the shock waves emanating from the Greek and eurozone crises: the negative repercussions include a deterioration of their economies, their prospects for growth, their capacity for reform, their social, political and institutional structures, and their ability to fulfill the accession criteria. Crucially, the EU’s hitherto undisputable symbolic role as an “anchor” of stability, as a one-way path to prosperity and as a goal to be aspired to, may be losing its credibility and appeal for some of these countries.

Keywords

Balkans, EU enlargement, Eurozone crisis, Greek crisis.
Introduction

The process of the European Union’s enlargement towards the Western Balkans may be facing its most difficult challenge since its launch in Zagreb in 2000. The prospect of Balkan enlargement has been hard-hit by the deterioration of the global - and European - economy, with serious ramifications for both partners in the negotiation process. The negative repercussions of the economic crisis on the Western Balkans are evident on many levels, including the impact on the economies per se, their prospects for growth, their capacity for reform, their social, political and institutional structures, and their abilities to fulfill the accession criteria. All these factors, coupled with a growing “enlargement fatigue”, which set in after the extraordinary rounds of enlargement during the period 2004-2007, have created a particularly unfavourable environment within which enlargement is being pursued. Moreover, this perceived dampening of enthusiasm for enlargement, combined with a growing “evaluation fatigue” on the part of the candidate countries, has fed these countries’ frustration and disenchantment, as the prospect of accession seems more and more remote.

This paper will explore the impact of the economic crisis on the Western Balkan countries, and how the new, unfavourable international environment is affecting their accession prospects. The analysis will be presented in three sections: the first part will examine the effect of the first wave of the global economic crisis on the economies of the region, specifically the impact on the region’s macroeconomic indicators, foreign direct investment flows, the financial sector, etc. This first wave reversed much of the progress these countries had achieved over the past few years, and thus made them even more vulnerable to the upcoming shocks. Part two will analyse the repercussions of the second wave of the crisis, namely the Greek sovereign debt crisis, which rapidly spilled over into the entire eurozone. As the paper argues, the high interdependence of most Western Balkan countries with Greece has made the region exceptionally vulnerable to the shock waves emanating from the Greek crisis. In fact, it is difficult to overestimate the seriousness of the Greek crisis on the Western Balkan countries: its impact transcends issues that are purely financial or economic or relating to EU membership, but has far-reaching social and geopolitical implications concerning the stability of the region as well. Moreover, due to the intense “euroisation” of the Western Balkan economies, these countries are also deeply affected by the profound crisis underway in the eurozone. The third part will discuss the repercussions of the crisis on the region’s accession process and prospects. It will be argued that in addition to contributing to the deterioration of economic conditions in these countries, both dimensions of the crisis (eurozone and Greek crisis) have a deep and lasting negative impact on the Western Balkans’ EU accession prospects. Essentially, on many interlinked and interdependent levels, the eurozone and Greek crises are modifying the conditions in which the process of EU enlargement is taking place. The paper will attempt to analyse the dynamic whereby the repercussions and the fallout from the crisis create new realities - such as the slowing down of the reform process, a growing enlargement (and evaluation) fatigue, the questioning of the EU “convergence narrative”, the discrediting of the Balkan region - that will in turn threaten the enlargement process. Finally, it will be proposed that although the EU’s role in the Western Balkans remains crucial (not least as a provider of economic assistance) its hitherto undisputable symbolic role as an “anchor” of stability, as a one-way path to prosperity and as a goal to be aspired to may be losing its appeal for some of these countries.

The impact of the crisis on the Western Balkan countries came in two waves. The first wave was the period 2008-2011, when the region was exposed to the full brunt of the global economic crisis. By the end of 2011, however, just as some level of stabilisation had been achieved and GDP was on the upswing again, the second wave came, when the full scale and depth of Greek sovereign debt crisis was revealed and the drama unfolded on a European level. Due to large-scale economic interdependence with Greece, the Western Balkan countries were sucked into the vortex of Greece’s unraveling economy, from which there is still no end in sight.
I. The first wave: the global financial crisis

It was clear from the beginning that the global financial crisis would not by-pass the Balkans, and by late 2008 the region was bracing for the inevitable. As the Nobel Prize-winning economist Joseph Stiglitz said during a visit to Belgrade in 2008, “the region cannot avoid the global crisis… some countries will be hit directly on the trade level, others because of the fall of the price of raw materials… this crisis began at the centre, in the US, but the periphery will be hit the most, because exports and direct foreign investment will suffer. The region depends on Europe, which will suffer even greater consequences than the US”.1

The economic crisis hit the Balkan region just as it was consolidating the progress it had made after emerging from years of war, political instability and painful economic reform programmes. For most countries in the region, the period 2003-2007 was one of the strongest in more than a decade, with annual real GDP growth averaging about 6%, while the region also received large inflows of FDI in 2003-2007.2 The economic slowdown in EU countries – the main recipients of Balkan exports – and the decreased influx of foreign direct investment triggered the first symptoms of the crisis in the region by the last quarter of 2008. By mid 2009 the effects on the financial sector were being felt more strongly, particularly with a slowdown in foreign bank lending activities.3

The spreading of the crisis followed the predictable pattern whereby the lack of financing meant slower development, lower demand in the world market meant shrinking exports, while decreased output meant lower public revenues.4 In fact, the growth model that had been implemented over the past few years in Southeast Europe, combined with the institutional weaknesses which was evident in most of these countries, had left the region vulnerable to external shocks in several respects. It had not managed exchange rates in a way that preserved a wide margin of competitiveness so as to support export-led growth and build up external reserves to very high levels. Capital controls had been removed quite early, while there had been a rapid expansion of lending to households, often by foreign banks and in foreign currencies. Moreover, high levels of current account deficits fuelled by rapid credit expansion – in a setting where structural policies were still lagging – had exacerbated the exposure of economies to the crisis in global markets.5

Macroeconomic deterioration

The first years of the crisis were characterised by falling GDP, rising unemployment rates, declining rates of investment, falling industrial output and growing current account deficits. The economies of the region contracted significantly in 2009, resulting in negative GDP growth rates in Bosnia-Herzegovina (-2.9 percent), Croatia (-5.9 percent), the Former Yugoslav Republic of Macedonia (FYROM, -0.9 percent), Montenegro (-5.7 percent) and Serbia (-3.5 percent) (Figure 1). Albania also faced a slowdown in growth (3.3 percent, down from 7.5 percent in 2008), but was the least impacted by the crisis due to the low volume of Albanian exports and comparatively low level of integration into the international economy. The strong growth levels of the previous years had been based on robust domestic demand fuelled by excessive credit growth in household consumption and mortgage

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2 Institute for International Finance, Capital flows to emerging market economies, January 2009.
3 J. Bastian, “‘Cry wolf’ no more: external anchors and internal dynamics in the Western Balkans”, Journal of Southeast European and Black Sea Studies, special issue, Europe’s Unfinished Transitions: the Convergence-Divergence Debate Revisited, 8 (4) 2008.
5 European Report, August 28, 2009.
services. The sharp slowdown indicated *inter alia* that consumer demand was radically adjusting downward, with credit availability frozen and debt repayments becoming more commonplace.\(^6\)

**Figure 1: Western Balkans, GDP growth rates**

Unemployment, which was already very high in the region - more than twice the West European average - continued to rise as the significant fall in exports resulted in the closure of many companies. Unemployment figures for 2009 stood at 13.1 percent for Albania, 25 percent for Bosnia-Herzegovina, 9.1 percent for Croatia, 32.1 percent for FYROM, 15.2 percent for Montenegro, and 17.4 percent for Serbia (Figure 2). Significantly, in most countries the unemployment rate for those under 30 years old was almost 50 percent.\(^7\) The rate of unemployment increased further in 2010, as the impact of the crisis deepened and widened: thus, in Bosnia-Herzegovina it grew to 27 percent, in Croatia to 12.2 percent, and in Serbia to 20 percent, while the figures for Albania, Montenegro and FYROM remained approximately at the same level as 2009.

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\(^7\) IMF, *World Economic Outlook*, April 2012.
As the region’s traditional export markets contracted, it was increasingly difficult to keep the state budgets in balance. The characteristically high current account deficits all over the region significantly increased the countries’ economic vulnerability, necessitating a fiscal tightening which together with the poor external economic outlook hit Serbia, Croatia, FYROM and Bosnia-Herzegovina particularly hard. The current account deficits as a percentage of GDP in 2009 ranged from 30.1 percent in Montenegro to 5.2 percent in Croatia.

Table 1: GDP per capita in 2010 ($US) (nominal and Purchasing Power Parity-adjusted)

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP per capita</th>
<th>GDP per capita (PPP-adjusted)</th>
<th>Country</th>
<th>GDP per capita</th>
<th>GDP per capita (PPP-adjusted)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>3,714.6</td>
<td>7,468.2</td>
<td>Bulgaria</td>
<td>6,359.4</td>
<td>12,965.1</td>
</tr>
<tr>
<td>B-H</td>
<td>4,254.8</td>
<td>7,816.1</td>
<td>Romania</td>
<td>7,667.2</td>
<td>11,904.0</td>
</tr>
<tr>
<td>Croatia</td>
<td>13,775.9</td>
<td>17,818.6</td>
<td>Czech Republic</td>
<td>18,813.9</td>
<td>26,121.7</td>
</tr>
<tr>
<td>FYROM</td>
<td>4,457.5</td>
<td>9,868.1</td>
<td>Hungary</td>
<td>12,845.4</td>
<td>18,809.5</td>
</tr>
<tr>
<td>Montenegro</td>
<td>6,383.3</td>
<td>10,601.2</td>
<td>Poland</td>
<td>12,285.6</td>
<td>18,950.7</td>
</tr>
<tr>
<td>Serbia</td>
<td>5,141.7</td>
<td>10,257.7</td>
<td>Slovak Republic</td>
<td>16,049.8</td>
<td>22,121.7</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Slovenia</td>
<td>23,281.5</td>
<td>28,131.1</td>
</tr>
</tbody>
</table>

Source: IMF, World Economic Outlook, April 2012.

Decline in remittances

Another important impact of the crisis was the decline in remittances. Migrant workers’ transfers in the Balkans constitute a major economic force: in the years before the crisis Albania, Bosnia-Herzegovina, Montenegro and Serbia were among the top twenty countries in the world in terms of remittance inflows as a percentage of GDP. In 2008, remittances as a share of GDP had reached 17.2 percent in Bosnia, 16.5 percent in Kosovo, 14 percent in Serbia and 12 percent in Albania. In 2010, Albania’s stock of emigrants numbered 1.4 million (45.4% of the population), whose countries of destination have been Greece, Italy, FYROM, Germany, UK, France and the US. Bosnia-Herzegovina’s stock of emigrants was 1.4 million (38.9 percent of the population) heading mostly to Croatia, Germany, Austria, Slovenia, Sweden, Italy and Switzerland. Most remittance flows to FYROM come from Germany and Italy.

Table 2: Western Balkan Remittances (US$ mn)

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>% of GDP in 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>889</td>
<td>1,161</td>
<td>1,290</td>
<td>1,359</td>
<td>1,468</td>
<td>1,495</td>
<td>1,317</td>
<td>1,156</td>
<td>1,221</td>
<td>10.9</td>
</tr>
<tr>
<td>B-H</td>
<td>1,749</td>
<td>2,072</td>
<td>2,043</td>
<td>2,157</td>
<td>2,700</td>
<td>2,735</td>
<td>2,167</td>
<td>1,906</td>
<td>2,021</td>
<td>12.9</td>
</tr>
<tr>
<td>Croatia</td>
<td>517</td>
<td>665</td>
<td>711</td>
<td>859</td>
<td>1,194</td>
<td>1,292</td>
<td>1,271</td>
<td>1,287</td>
<td>1,236</td>
<td>2.1</td>
</tr>
<tr>
<td>FYROM</td>
<td>174</td>
<td>213</td>
<td>227</td>
<td>267</td>
<td>345</td>
<td>407</td>
<td>381</td>
<td>388</td>
<td>435</td>
<td>3.9</td>
</tr>
<tr>
<td>Montenegro</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>196</td>
<td>298</td>
<td>302</td>
<td>301</td>
<td>334</td>
<td>7.5</td>
</tr>
<tr>
<td>Serbia</td>
<td>-</td>
<td>-</td>
<td>2,650</td>
<td>2,754</td>
<td>3,064</td>
<td>3,270</td>
<td>3,936</td>
<td>3,351</td>
<td>3,719</td>
<td>10.4</td>
</tr>
</tbody>
</table>

Source: World Bank, Migration and Remittances Factbook, 2011

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9 IMF, World Economic Outlook, April 2012.
10 World Bank, Migration and Remittances Factbook, 2011.
The economic crisis, however, which led to significant layoffs elsewhere in Europe, adversely affected the migrant workers’ continued ability to transfer important amounts to their home countries. Many of these labourers were employed in sectors hit by the recession in their host countries, particularly in car manufacturing, construction and household work. A decline in remittances from relatives working abroad has affected families in the countries of origin and their income expectations and also impacted on countries’ foreign currency holdings, medium-term budgetary planning and the financing of high current account deficits. As can be seen in Table 2, the countries most affected by a decline in remittances after 2008 are Albania and Bosnia-Herzegovina.

Spillover from neighbouring countries in crisis

As small, open economies - more than one fifth of economic output and employment is based on exports - the Western Balkan countries were especially vulnerable to the effects of the world crisis, especially the fall in global growth and trade. The euro area countries are the main trading partners for the region, accounting for about half of all exports on average - slightly more in the case of Albania and Bosnia-Herzegovina, and slightly less for Serbia, which has relatively strong trade links with Russia and other emerging European economies. Within the euro area, Italy is generally the most important export market for the region, especially for Albania, while Greece is the most important export market for Montenegro. Trade linkages with the rest of the euro area are mostly dominated by Germany.

Since the EU member states constitute the most important trade partners for these countries, the deteriorating conditions in the EU - leading inter alia to falling consumer demand - had a particularly detrimental effect on exports to traditional markets and cross border trade relations. For example, due to reduced foreign demand, FYROM’s metallurgical industries were operating on 50% of their capacities for a great part of 2009, leading to a large fall in production as well as massive layoffs. Croatia, whose tourism industry is a major source of income and is mostly powered by citizens of EU countries, also lost important revenue as the economic downturn led to a dramatic fall in tourism.

Due to its dependence on steel and metal exports, the region was also hit hard by the global slump in manufacturing and commodity prices in the world market. The price of metals fell by almost two-thirds between 2008 and 2009, contributing further to the slowdown in the region’s economies. Thus, Serbia, who relies massively on exports of food and raw materials such as copper and iron (which make up 40% of total exports) suffered not only from the fall in demand of these products but also because of the dramatic fall in the price of copper in 2008.11 US Steel, one of Serbia’s leading exporters, was one of many companies to close a large plant in 2009. Similarly, in FYROM, Silmak - a significant producer of ferro-nickel - cut production and lay off workers due to the drastic fall in ferro-nickel’s price on the world markets. Finally, the Western Balkan economies were greatly affected by the dispute between Russia and Ukraine in mid-2008 over gas prices, which reduced energy supply to the region and forced the region’s heavy industry to cut production and even halt assembly lines.

Declining foreign direct investment

With relatively low labour costs and easy access to European markets, the region has attracted significant foreign direct investment (FDI) in recent years. Most of this investment has come from Europe, with the euro area accounting for about 70 percent of the total stock of FDI in the region. Italy is a major investor in the region, especially in Albania where it accounts for 80 percent of the total but also in Montenegro, while Greece also has significant investments in Albania, FYROM and Serbia.

Revenues from foreign investments had played a very important role in the economic growth achieved in the region during the period 2003-2007: they contributed *inter alia* to infrastructure projects, the privatisation process, balancing the budget and the financing of foreign debt payments. Consequently, the sharp decline in foreign direct investment after 2008 – caused mainly by the economic downturn in the investing countries – has had a seriously detrimental effect on the national economies in the region.  

FDI flows to the region decreased by 34 percent between 2008 and 2009, with total flows declining from US$12.6 billion to US$ 8.3 (Table 3). Bosnia and Croatia were particularly hit: Bosnia experienced a 75 percent decline in FDI, from US$ 1.0 billion to US$ 251 million, while FDI in Croatia fell by 46 percent, from US$ 6.2 billion to US$ 3.3 billion.  

**Table 3: Foreign Direct Investment Flows in the Western Balkans (US$ mn)**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>130</td>
<td>415</td>
<td>974</td>
<td>996</td>
<td>1,051</td>
<td>1,031</td>
</tr>
<tr>
<td>Bosnia</td>
<td>186</td>
<td>908</td>
<td>1,002</td>
<td>251</td>
<td>230</td>
<td>435</td>
</tr>
<tr>
<td>Croatia</td>
<td>1,013</td>
<td>3,430</td>
<td>6,180</td>
<td>3,355</td>
<td>394</td>
<td>1,494</td>
</tr>
<tr>
<td>FYROM</td>
<td>152</td>
<td>407</td>
<td>586</td>
<td>201</td>
<td>211</td>
<td>422</td>
</tr>
<tr>
<td>Montenegro</td>
<td>19</td>
<td>686</td>
<td>960</td>
<td>1,527</td>
<td>760</td>
<td>558</td>
</tr>
<tr>
<td>Serbia</td>
<td>411</td>
<td>3,091</td>
<td>2,955</td>
<td>1,959</td>
<td>1,329</td>
<td>2,709</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,911</strong></td>
<td><strong>8,937</strong></td>
<td><strong>12,657</strong></td>
<td><strong>8,289</strong></td>
<td><strong>3,975</strong></td>
<td><strong>6,649</strong></td>
</tr>
</tbody>
</table>


An important example of lost FDI was the case of FIAT in Serbia: in September 2008, FIAT had signed a €1 billion joint investment agreement in Belgrade, which was hailed as a landmark project and was expected to create nearly 5,000 jobs. By February 2009, FIAT had announced that a sizeable proportion of this investment would be postponed, citing concerns about the state of the international automotive industry. Another example is that of Bangalore property developer The Embassy Group, which despite having scheduled an investment of more than US$ 500 million in the country, announced that it was being put on hold. Overall, investment in Serbia fell from US$ 2.9 billion in 2008 to US$1.9 billion in 2009. The Czech energy company CEZ and the Norwegian power utility Statkraft both withdrew from major projects in the Republika Srpska in Bosnia-Herzegovina. There were many other similar examples of major investment projects that had been approved before the full impact of the crisis was felt, and then red-lighted and shelved. The decrease in revenues from foreign investments also caused serious difficulties in servicing these countries external debt, which as a percentage of GDP in 2009 stood at 60 percent for Albania, 36 percent for Bosnia-Herzegovina, 23.8 percent for FYROM, 38.2 percent for Serbia, 40.1 percent for Montenegro, and 34.5 percent for Croatia.  

The situation deteriorated even further in 2010. According to UNCTAD’s *World Investment Report 2011*, Croatia received only US$ 394 million of FDI in 2010, compared to US$ 3.3 billion in 2009 (which was already down from US$ 6.2 billion in 2008). For the first time, Croatia fell behind Albania, Serbia and Montenegro in the levels of foreign direct investment it received, marking a departure from its position as one of the most popular recipients of foreign funding in previous years. Reductions in investment from EU countries played a crucial role in the sharp contraction of FDI in

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Only FYROM and Albania achieved an increase in FDI between 2009 and 2010: FDI in FYROM grew to US$ 293 million (from US$ 201 million in 2009), while FDI in Albania reached US$ 1.1 billion (up from US$ 979 million in 2009). The increase in FDI in Albania can be attributed to some privatisations within the strategic sectors and increased investments in the energy, finance and telecommunications industries. Overall, between 2009-2010, FDI in the region fell from US$ 8.3 billion to almost US$ 4 billion (from a peak of US$12.6 billion in 2008).

Financial sector implications

The rapid privatisation of the banking sector in the Balkan countries resulted in considerable market shares being controlled by European interests. Over the past decade, European banks and non-bank financial institutions (insurance companies) developed a strong presence in the Balkan region. According to the European Bank for Reconstruction and Development (EBRD), in 2007 European banks (mainly Austrian, French, Italian, Dutch, German and Greek) owned 94% of the banking system assets in Albania, 82% in Bulgaria, 86% in FYROM, 79% in Montenegro, 87% in Romania and 75% in Serbia.

Since the Balkan countries are very dependent on foreign currency lending - which had mainly been provided by foreign (parent) banks to their subsidiaries - the credit squeeze has made it increasingly difficult for domestic banks and local companies to refinance their foreign debt holdings, leading to decreasing capital flows. Ironically, the banking institutions of Southeast Europe had not themselves accumulated the kinds of toxic assets seen in the West; however, many of the parent companies of the now almost internationalised industry were heavily exposed. As western financial institutions downsized their operations or put their investments on hold the economies of Southeast Europe were being frozen out of credit markets and were being sidetracked in their effort to attract foreign currency loans. The crisis also affected the stock markets in the region: the Zagreb Stock Exchange index experienced an annual decrease of 67 percent in 2009, while the Belgrade Stock Exchange index lost 75 percent. Due to a substantial fall in the share prices in the region most privatisation processes in both countries were suspended.

The crisis also led to a significant increase in the activities of a number of international financial institutions in the region, most notably the IMF. The number of IMF programmes in operation in the region had declined from 12 during the period 1994-97 to 3 in 2007; by 2008, only Albania still had a lending programme, which ended by the end of the year. But the crisis had exposed most countries to destabilising financial gaps on the external accounts. With the supply of capital drying up rapidly, this raised the possibility of countries not being able to meet their external obligations, which could lead to major depreciations of their currency and/or default. In May 2009 Serbia signed a multi-year programme with the IMF which provided it with US$ 3.8 billion. The Bosnian authorities signed a letter of intent in spring 2009 and a three-year agreement of around US$ 2 billion was signed in July.

17 Emerging Europe Monitor, South East Europe, 16 (10) October 2009.
2009. The stand-by arrangement included a commitment by the authorities to public sector reform and continued implementation of politically difficult cuts to benefits and public sector wages. Although this programme was suspended because of the lack of a government and delays in reforms, in July 2012 a new 2-year $US 500 million IMF standby loan was agreed after the new government adopted a budget for 2012. A 2-year precautionary IMF arrangement of €476 million was approved in January 2011 for FYROM, and was partly used (€ 220 million) to finance the 2011 budget.\textsuperscript{20} Other institutions active in the region – the EBRD, European Investment Bank (EIB) and World Bank – also stepped in with their support.\textsuperscript{21} The three institutions provided over $US 33 billion in support for banks and the transition economies (including the Western Balkans) in 2009 and 2010.

II. The second wave: contagion from the Greek (and eurozone) crises

In its thirteenth year of existence, the European single currency is facing its biggest challenge yet. Greece, Portugal and Ireland are on life support, and have received substantial bailout packages to keep their economies afloat. Italy and Spain are exhibiting worrying symptoms, combining high public debts, large budget deficits and low growth. Germany and France, considered the most robust economies of the region, are feeling the strain of supporting their weaker partners, in an attempt to save the eurozone. The EU, and the eurozone, are in unprecedented turmoil.

The eurozone’s weakest link, Greece, has become a great source of instability in Europe. Greece is a country in a freefall, experiencing an unprecedented economic meltdown, as well as the disintegration of its infrastructure, the degeneration of its political system and the unravelling of its social fabric. The austerity packages voted by the Greek parliament over the past year represent the most aggressive fiscal and social adjustment in a democratic country in times of peace in post-war Europe. After five consecutive years of recession, Greece’s GDP has dropped by almost 20 percent, and official unemployment stands at 25.1 percent (and for under 30 year olds, 51 percent).\textsuperscript{22} Industrial production and manufacturing have collapsed, while nationwide hundreds of small businesses – once the backbone of the economy - are closing by the day. The labour force is experiencing a serious brain drain as young educated professionals leave the country in search for better opportunities abroad, further decimating the country’s social fabric and prospects of recovery. The past few years have witnessed a dramatic surge in crime and homelessness, while one in four Greeks lives below the poverty line. The rise of extremism - symbolised by the election of the neo-fascist party Golden Dawn to Parliament in June 2012 – is another symptom of the deterioration of social structures and illustrates the depth of social and political unrest. The population is worn down and demoralized by the dire economic situation, the plummeting standards of living, the lack of prospects for the future and the very real fear of a catastrophic exit from the eurozone and the European Union. This previously unthinkable scenario has become more and more conceivable.

As far as the Western Balkan countries are concerned, the crisis in Greece is far more than merely a sub-set of the European economic crisis: Greece’s dire predicament and the uncertain outcome of the crisis have a tremendous impact on the entire region’s economic growth, political stability and even EU prospects. Moreover, a Greek exit from the eurozone could trigger a domino effect of instability and insecurity not only in the euro-area, but would undoubtedly also send shock waves throughout its neighbouring region. It is indicative that the 2010 EBRD Transition Report highlights the main short-term challenge for the region as being the survival of “possible contagion effects from economic


\textsuperscript{22} ELSTAT (Greek Statistical Service), July 2012.
Weaknesses in the eurozone, especially in neighbouring Greece²³. In terms of fallout from the crisis, the worst is not over, both for Greece and its Western Balkan neighbours.

The most likely channels of contagion from Greece include trade, banking, remittances and FDI flows. Due to the interdependence between Greece and the countries of the region, the Greek crisis has produced a vicious circle whereby the economic decline of Greece exacerbates the decline of the economies of Southeast Europe which feeds back into Greece through inter alia a fall in demand for imports from Greece and a fall in the return on Greek investments. Moreover, as Greece is also very involved in Bulgaria and Romania (particularly the banking sectors), the negative impact of the Greek crisis on these countries will undoubtedly spill over into the Western Balkan economies.

For Bosnia-Herzegovina and Croatia, the trade, investment and financial links with Greece are negligible, and the risk of any spillover effects for these two countries is very low. Trade relations with Greece are most important for Albania, Montenegro and FYROM, whose exports to Greece account for 12-16 percent of the total. There was a sharp decline in exports to Greece in 2009 and the first quarter of 2010, as the economic crisis in Greece caused a further reduction in demand for goods from these countries.

Almost 4,000 Greek companies have invested in the region, helping create about 200,000 jobs. Albania, Serbia and FYROM are the most vulnerable to negative spillover through reduced FDI flows, as Greece ranks first in investments in these countries: in 2008, Greek FDI accounted for over 30 percent of total investments in Albania, 20 percent in FYROM and 15 percent in Serbia. Greek investments were made in a variety of sectors, including infrastructure, services, banking, telecoms, food and beverage, heavy industries and pharmaceuticals. A considerable decline in Greek FDI flows to the region was evident even before the full impact of the crisis was felt: for example, Greek investment in Serbia for the two-year period 2008-2009 amounted to some €46 million, well below the total of €336 million for 2007 alone, while in Bulgaria it fell from €545 million in 2007 to €105 in 2009. In FYROM, Greek investment fell from €15 million euro in 2010, to €2 million in 2011. Overall, by 2010, Greek companies had disinvested almost €1.3 billion from the region.

Another crucial spillover effect from the crisis in Greece relates to the inevitable decline in remittances, as it becomes increasingly difficult for migrant workers to stay employed in Greece and many are forced to repatriate. Their home countries, in turn, are often unable to absorb them into the workforce, thus leading to a further rise in unemployment. A decline in remittances also has a negative effect on the countries’ foreign currency holdings, medium-term budgetary planning and the financing of their current account deficit. In terms of the potential impact of the Greek crisis on remittances, Albania is the most exposed. Some 600,000 Albanians live and work in Greece: in 2009 workers’ remittances originating from Greece amounted to at least US$ 900 million (about 8 percent of GDP), contributing to domestic economic growth and providing livelihood for many families.²⁴ The construction sector, in which many Albanians are employed, has culled almost half its workforce, down to just 240,000 in 2011 from around 400,000 in 2008. Since migrants can lose their legal status if they are jobless for long periods, many are forced to accept work for lower pay or without social security benefits. The number of migrant residence permits issued has fallen by 20 percent annually since the crisis began. Bulgaria is also affected by a significant decline in remittances from Greece: whereas the annual average over the last five years was €400 million, in 2009 these remittances fell by 11 percent.

Perhaps the most critical channel of contagion is through the Greek bank subsidiaries operating in the region. Greek banks have been particularly active and have invested heavily in the Balkans over the last few years, buying local banks and expanding their balance sheets, particularly in high-growth areas like consumer and mortgage lending. Seven major Greek banks – including the National Bank of

²⁴ World Bank, Migration and Remittances Factbook, 2009.
Greece, EFG Eurobank, Piraeus and Alpha Bank - have established a network of around 20 subsidiaries in the region, with around 1,900 branches and employing approximately 23,500 people. By 2007, Greek banks had accumulated a significant market share in the region, accounting for around 30 percent of total banking assets in Bulgaria and FYROM, 25 percent in Albania, 15 percent in Serbia (where three out of 10 banks are Greek) and 17 percent in Romania.

Subsidiaries are to a significant extent funded with loans from Athens rather than local deposits. Even if Greek banks did not withdraw from the region, they would try to grow the local deposit base faster than loans, and would be likely to refrain from making fresh loans for a while. Thus, there is a risk of Greek banks limiting their credit activity and reducing their exposure in the region as a result of funding and liquidity pressures on the Greek parent banks. Significantly, Greek banks that benefited from a €28 billion government bailout package in 2009 were encouraged - via a verbal agreement between the Greek Finance Ministry, the Bank of Greece and the participating institutions - to use the money to support lending at home, not at their subsidiaries in the Balkans. Thus, subsidiary branches of Alpha Bank, National Bank of Greece or Eurobank in Bulgaria, Serbia, Albania, FYROM and Romania did not get a share of the bailout package.

After 2009, widening spreads on Greek sovereign debt led to increased funding costs for Greek banks; faced with such a liquidity squeeze, Greek banks started withdrawing their funds from their operations in the Balkans. Consequently, Greek banking sector claims declined by 25% in Romania and Bulgaria, and by 18% in Serbia in the two years to December 2011.25 This liquidity retreat has not only disrupted the financial sectors in the region, but has also had a large impact on the local economies, given that all of these countries have bank-based financial systems where much of the borrowing activity is made through banks rather than equities or corporate bonds.

The latest figures from the IMF World Economic Outlook (October 2012) illustrate the depth of the impact of the crisis on the Western Balkan economies. Although the September 2011 Report had allowed for some cautious optimism - as it had predicted a further upturn of GDP growth for the region in 2012, compounding the marginal growth reported for 2011 - in fact the figures deteriorated. Thus, as the full impact of the eurozone/Greek crisis hit the Western Balkan economies, the IMF adjusted the estimates for GDP growth in 2012 at 0.5 percent for Albania, 0.0 percent for Bosnia, -1.1 percent for Croatia, 0.9 percent for FYROM, 0.2 percent for Montenegro, and -0.5 percent for Serbia (Table 4).

### Table 4: Western Balkans, Economic Indicators 2011, 2012 (estimates)

<table>
<thead>
<tr>
<th></th>
<th>Albania</th>
<th>B-H</th>
<th>Croatia</th>
<th>FYROM</th>
<th>Montenegro</th>
<th>Serbia</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (% change)</td>
<td>3.0</td>
<td>0.5</td>
<td>1.2</td>
<td>0.0</td>
<td>3.1</td>
<td>2.4</td>
</tr>
<tr>
<td>Unemployment (%)</td>
<td>13.3</td>
<td>15.0</td>
<td>27.6</td>
<td>27.6</td>
<td>13.6</td>
<td>31.2</td>
</tr>
<tr>
<td>Consumer price inflation (%)</td>
<td>3.9</td>
<td>3.5</td>
<td>3.7</td>
<td>2.2</td>
<td>2.2</td>
<td>3.9</td>
</tr>
<tr>
<td>External Debt (as % of GDP)</td>
<td>58.9</td>
<td>63.7</td>
<td>40.3</td>
<td>43.6</td>
<td>47.5</td>
<td>27.1</td>
</tr>
<tr>
<td>Current account balance (as % of GDP)</td>
<td>-12.2</td>
<td>-11.7</td>
<td>-8.8</td>
<td>-7.9</td>
<td>-0.8</td>
<td>-2.7</td>
</tr>
</tbody>
</table>

Source: IMF World Economic Outlook, October 2012

25 Economist Intelligence Unit, June 14, 2012.
The Impact of the Economic Crisis on the Western Balkans and their EU Accession Prospects

III. The Impact of the European and Greek crises on the Western Balkan EU prospects

The Eurozone and Greek crises are still unfolding, and the outcome is far from clear. What is clear, however, is the fact that both dimensions of the crisis will have a deep and lasting impact on the Western Balkan countries, as well as their EU accession prospects. The high “euroisation” of the economies of the Western Balkans means a very high vulnerability to eurozone crisis. Crucially, on many interlinked and interdependent levels, the eurozone and Greek crises are modifying the conditions in which the process of EU enlargement is taking place.

Impact on economies and fulfillment of economic criteria: backsliding of the reform process

For most countries in the region, the period 2003-2007 was one of the strongest in more than a decade, with annual real GDP growth averaging about 6%. Before the crisis, the Western Balkan countries had achieved significant progress in terms of growth, macroeconomic stability, FDI inflows, and were progressively moving down the transition path. All these positive factors made it easier to pursue reforms and make progress in achieving EU convergence criteria. The European crisis in general and the Greek crisis in particular, have created new, negative realities and conditions under which the accession process is being pursued.

As was discussed above, due to the extremely high interdependence of most of the Western Balkan economies with those of the euro-area, the euro-crisis - and particularly the meltdown of the Greek economy - have had extremely detrimental repercussions on the economies of the region, in terms of macroeconomic performance, FDI, trade flows, remittances etc. In turn, this detrimental impact on the economies of the region will make conditionality harder to achieve, while meeting the increasingly demanding accession criteria and conditions in the Stabilisation and Association Process will become even more difficult. The Western Balkan economies have been caught in a vicious circle, whereby the crisis causes deteriorating economic conditions, deteriorating economic conditions mean less reform, and less reform means falling behind in the convergence process. It is indicative that the 2011 EBRD Transition Report assessed that the achievement of European approximation targets have slowed down and that important structural changes – that are a sine qua non for accession – are being postponed, stalled, or even reversed. Thus, the setback in economic progress, the slowdown in growth and the deteriorating macroeconomic environment will affect the Western Balkan countries’ EU accession prospects, as they will find it increasingly difficult to implement the necessary structural reforms that are still pending in order for the accession process to progress.

End of “convergence narrative” (and loss of faith in the transformative power of the EU?)

Another crucial repercussion of the crisis as far as the Western Balkan countries are concerned is the erosion of the “convergence narrative”. Over the past decades, membership in the EU has been perceived as a one way path to stability and prosperity. The EU’s Mediterranean enlargement was until recently considered an outright success, and the post-authoritarian Spain, Greece and Portugal were the models of successful transitions: these countries had used EU membership as a means to consolidate democracy, achieve economic prosperity, and secure their place in the progressive European family. The EU experience was expected to do the same for the newer members from Central and Eastern Europe. The credibility of this narrative has been dealt a serious blow, as the current crisis has challenged some strongly held assumptions on the nature of Europeanisation and the transformative power of the EU. The crisis has also raised the question of whether in its current state,


and under the current conditions, the EU is still an engine for convergence between core Europe and its peripheries.

Although all of South Europe is in deep crisis, as far as the Western Balkans are concerned it is Greece’s predicament that has a dramatic impact on the candidate countries’ perception of the “convergence narrative”. Greece was one of the region’s success stories: a quintessentially Balkan country that had made the transition from underdevelopment and marginality to prosperity and stability, under the aegis of the European Union. A bridge between the Balkans and Europe, Greece was the only Balkan country that was also a member of both the EU and NATO. Greece’s downfall illustrates, in the most painful way possible, that EU membership is not a one-way, irreversible guarantee of stability and prosperity. For the Western Balkan countries, the example of Greece no longer symbolises the promise of modernisation and convergence with the rich and well-governed countries of ‘old Europe’, but the taste of capitalism and the prospect of prosperity gone sour. If “the system” did not take hold in Greece, and did not take hold in Spain and Portugal, how can it be expected to work in regions as problematic as the Western Balkans? Moreover, the Greek crisis and the deepening political chaos (including the rise of extremist elements) are sending worrying signals to a region still struggling to establish western-style democracies. Crucial questions are being raised regarding deep structural reforms and institutional change: if Greece, a member of the EU since 1981, has not been able to successfully tackle problems like corruption, tax evasion, clientelism, vested interests, etc, what does this mean for the Western Balkans? In fact, Greece is a warning about the perils of “Europeanisation without deeper transformation”.

**Intensification of “enlargement fatigue”**

The “enlargement fatigue” - which set in after the unprecedented rounds of enlargement during the period 2004-2007 - has been exacerbated by the economic crisis, due to which many EU member states prefer to give priority to their own problems. Faced with an unprecedented economic slowdown, rising unemployment, the sovereign debt crisis, bailouts for several eurozone countries, and a widespread sense of insecurity throughout the Union, the EU is currently focussed on domestic political and economic issues, with further enlargement moving down as a priority on the agenda. It is indicative that the Eurobarometer 76 (published in December 2011) showed that only 36 percent of the surveyed population of the EU-27 supported the idea of further enlargement (down from 47 percent in May 2009, before the full brunt of the crisis was felt throughout Europe). The numbers vary from country to country: the newer members (from the 2004 and 2007 enlargements) were more in favour of further enlargement (with Poland leading with a 69 percent approval rate, followed by Lithuania with 60 percent), while in the older members such as Germany, France, and Belgium supporting rates were mostly between 30-35 percent. Austria and France were the most vehemently opposed, with 70 and 71 percent of the population opposing further enlargement.

It is clear that all EU members have become more skeptical, cautious, introverted and fearful of the implications of further expansion during this critical period. Enlargement is not at the top of the EU agenda, and in the current context of increased protectionist mentalities, fear of further contagion, international instability and the loss of sense of solidarity that used to be taken for granted, it is difficult to imagine it moving there anytime soon. Clearly the shock of the Greek crisis and the subsequent contagion to other South European states has made most EU member states even more hesitant to embrace more “dysfunctional”, unreliable states. If the eurozone (and maybe even the EU itself) is willing to shed “deviant” members, the consensus is that it will be slow to accept other, potentially precarious states. Therefore, the euro crisis may not have “killed” enlargement – as

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Croatia’s imminent accession in July 2013 proves - but “it is relegating the region to the outermost circle in a multi-speed Europe – the periphery of the periphery”.  

...and growing “evaluation fatigue” (and disillusionment with the EU?)

Crucially, support for EU integration has declined on the Balkan side as well. Analysts have warned that the increasingly complicated and drawn-out enlargement process shows the contrast between the EU’s plan to accept the Western Balkans and its actual implementation. This is where “enlargement fatigue” within the EU meets “evaluation fatigue” in the Balkans: the increasingly negative economic environment in the EU, coupled with the inevitable drawing out of the accession process, has resulted in the erosion of popular support for EU accession in the Western Balkans, as the population of these countries is finding it more difficult to maintain enthusiasm for the convergence process.

A survey conducted by Gallup Balkan Monitor in November 2010 disclosed a largely pessimistic population with little trust of domestic institutions and falling enthusiasm for the EU, especially when compared to the previous year. Although the majority of citizens of the region still see the EU as the only long-term option, enthusiasm for joining the EU was generally on the decline, mostly due to what the population perceived as “a lack of concrete commitment” on behalf of the EU. However, the Western Balkan region is not a monolithic group with uniform views of Europe. Surveys show a considerable divergence of opinions, ranging from enthusiasm (Albania and Kosovo) to skepticism (Serbia and Croatia). Crucially, even in the more “enthusiastic” candidates, support has fallen compared to previous years.

This lack of enthusiasm could also translate into lack of commitment to the necessary reforms regarding the political, economic and acquis criteria in the Western Balkans. In many cases, political elites of the region pay lip service to EU membership, conditionality and reforms but in reality they are concerned with safeguarding their position domestically and with business as usual, which means rent seeking and clientelism rather than genuine reform effort. Economic stagnation is thus accompanied by political standstill and in one or two cases backsliding towards authoritarianism.

The EU may still be considered the only game in town for the Western Balkans but it seems that the prevailing sentiment is Eurorealism, not Europhilia. Croatia’s membership referendum in January 2012 is very indicative of the general apathy, as there was only a 43 percent turnout to ratify the country’s accession agreement. EU is the necessary option, not a source of inspiration or a stimulus for deep change and reform. This disillusionment concerning the EU and what membership actually can deliver is inextricably linked to the breakdown of the “convergence narrative”, discussed above. Consequently, the loss of enthusiasm on behalf of the Western Balkans is also fuelled by the uncertainty regarding the characteristics of the Union these countries are trying to join. Will it be multi-leveled, multi-speed, less democratic, less tolerant of failure, with diminishing solidarity between member states, and with the Western Balkan states firmly entrenched in the “periphery of the periphery”?

A (further) discrediting of the Balkan region

The Greek crisis has created other - non-quantifiable but very potent - repercussions, namely the further discrediting of the Balkan region. Greece, the first Balkan country to join the EU (in 1981) has

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29 Ibid.
30 “Perceptions of the EU in the Western Balkans”, Gallup Balkan Monitor, November 2010.
been exposed as a country that not only ran ruinous and reckless fiscal policies for many years, but deceived its partners with false data in order to join the Eurozone in 2002. Even as the crisis is unfolding, and Greece is under IMF supervision, the country has apparently achieved very little in terms of real structural reforms, including dealing with tax evasion, corruption and lack of government transparency. The Greek predicament is being used by enlargement skeptics to propagate the perception of the entire Balkan region as an unreliable area of corruption and instability, where very little real convergence with EU criteria has been actually achieved. The Greek crisis has exacerbated what was already an apprehensive environment in Brussels towards the Balkan region, which already had been fuelled by the unsatisfactory experience of the last enlargement that brought Romania and Bulgaria into the EU. Since corruption, organised crime and judicial inefficiency remain serious problems in Bulgaria and Romania, there is a strong perception that in the 2007 enlargement the EU did not apply the accession criteria correctly; moreover, once a member, a country has little incentive to change.

The negative perceptions of the region due to the experiences with Bulgaria, Romania, and Greece, serve to compound the very real problems of corruption and organised crime in most of the candidate countries. The road towards integration into the EU will definitely be longer if fragile and unreformed institutional structures, a weak rule of law, and largely corruption-based economies and organised crime flourish. Corruption not only harms economic growth and development, it distorts markets and fair competition, undermines the rule of law, damages government legitimacy, erodes the private sector and contributes to greater income inequality. In the context of the Western Balkans’ accession path, it would appear that the current difficult economic conditions make these necessary reforms and changes even more difficult to implement.

Table 5 presents the Corruption Perception Index for the Western Balkans, as calculated by Transparency International (out of a total of 183 countries worldwide). The Table shows that Croatia was the best placed in 2011, while Albania was ranked the lowest of all the Western Balkan countries. Compared to 2004, all countries except Bosnia have improved their standing over the past few years. It is also interesting to compare the Corruption Perception Index of the Western Balkan countries to those of other EU countries, members that joined in 2004, in 2007, or even Greece. It is worth pointing out that many countries experienced a drop in their ranks between 2009 and 2011, a fact that supports the premise that pursuing and implementing the necessary measures against corruption and in favour of transparency is more difficult during times of economic crisis.

Table 5: Corruption Perception Index

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<tr>
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<th>Rank</th>
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<tr>
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<td>86</td>
<td>49</td>
<td>71</td>
<td>80</td>
<td>49</td>
</tr>
</tbody>
</table>

Source: 2011 Transparency International Corruption Perception Index (www.transparency.org)

34 B. Sergi and Q. Qerimi, The political economy of Southeast Europe from 1990 to the present, Continuum, New York and London, 2008, pp. 112-120.
Thus, although fighting corruption and organised crime in the Western Balkan countries is a prerequisite for EU accession, the already challenging task of eradicating organised crime networks, establishing the rule of law, creating an independent judiciary, and ensuring transparency, is being made all the more difficult by the unfavourable economic environment.

**Loss of an ally**

Finally, the Greek crisis may affect the Western Balkans’ accession prospects on another level as well. For several years, Greece was the Western Balkans “enlargement ambassador” to the EU; since 2003 Greece had made enlargement towards the Balkans a cornerstone of its foreign policy and had promoted it actively with the EU institutions. Its “Agenda 2014” aimed at achieving accession of all Western Balkan countries to the EU by 2014, as part of a plan to promote peace, security and democracy in the region. Now, hugely indebted, discredited and facing years of austerity, Greece’s days as a regional champion are well and truly over. Greece no longer has the clout, the prestige or the capacity to play the role of the “champion” of Balkan enlargement, or to be a bridge between Brussels and the Balkans. This void leaves the candidate countries without an enthusiastic ally in less-than-enthusiastic Brussels, adding yet another negative dimension to the enlargement picture.

**Conclusions and Future Outlook**

There is no doubt that the timeline of the EU’s Western Balkan enlargement is unfolding under extremely unfavourable conditions. As far as the EU is concerned, accession of the Western Balkan countries continues to be its official regional policy. EU officials have repeatedly stated that they remain committed to the integration of the Western Balkans into the bloc, dismissing fears of “enlargement fatigue” in the wake of the Greek financial crisis. In practice, however, and under growing pressure as a result of the financial crisis, Europeans seem to be increasingly divided about what to do with the Balkans, and have adopted a “wait-and-see” policy. Some policymakers increasingly view the prospect of enlargement into the Balkans with alarm, with potentially destabilising political, social and economic repercussions. Other policymakers, however, see postponing the accession of the Western Balkans indefinitely as an even greater risk that could undermine the fragile progress that has been made in the region. They posit that the promise of EU integration has not only been the catalyst for reforms, but also the political glue that has held the Balkans together this past decade.

However, as was discussed above, the current crisis has challenged some strongly held convictions concerning the nature of Europeanisation and the transformative power of the EU. The shocking impact of the crisis on the entire Southern flank of the EU has also raised the question of whether the EU is still willing and able to be an engine for convergence between core Europe and its peripheries. Divided between the fear of a hasty enlargement and the fear of a slow one, the EU has been losing influence across the Balkans, as the region’s leaders and population start to doubt the sincerity of the EU’s commitment – and the need to pursue EU-mandated reforms. If the enlargement process is to be kept on track, the European Union must reclaim its “soft power” in the region, and build on its

position of creating incentives for reform and progress, rather than risk sowing disillusionment and the possibility of regression.\textsuperscript{38}

These are difficult times for Western Balkan politics. The economic crisis in Greece and other EU member states has deeply affected the already weak economies of the region and deepened the mood of uncertainty. The fact remains that despite the danger of delaying enlargement indefinitely, it is difficult to interest EU leaders in the Balkans at the moment. Nonetheless, Croatia’s accession in July 2013, the decision to start negotiation talks with Montenegro and the granting of candidate status to Serbia are a step in the right direction. In the midst of the Greek crisis, Commission President Barroso declared that “we see the countries of the region as members of the European family of nations, we see them all as part of Europe. Their roots, their present and their future are in Europe”.\textsuperscript{39} The Western Balkans are indeed the European Union’s final frontier, but there is a long way to go before these words become reality.


\textsuperscript{39} Associated Press, 5 May, 2011.
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