



## **Editorial**

*The European Commission's latest monitoring report on the preparedness of Bulgaria and Romania for accession gives the clearest possible warning to both countries that immediate action is necessary over the problem of corruption and related weaknesses in their administrative and judicial systems. To give these warnings maximum credibility the Commission details the procedures that would have to be taken by the Council and Commission to defer accession from 1<sup>st</sup> January 2007 to one year later. All survey data (for example those published by Transparency International and Freedom House) show that these two countries are a further category worse than the new member states on corruption, which in turn are a category worse than the average of the old member states. The Commission's report describes quite vividly the type of problems for the functioning of EU policies that are here at risk.*

*An important event for Southeast Europe in October was the signing of the region's energy treaty with the EU, which will integrate the region itself and with the EU virtually as if there was a single energy area. This theme of Southeast European regionalism is taken further in a short paper by Michael Emerson, arguing that the European Commission and Stability Pact for South East Europe should together propose two further radical steps: (i) to bring the whole of the region, member states or not, into the customs union that is already shared by the EU and Turkey, thus moving much ahead of the present intra-regional free trade arrangements; and (ii) to devise a regional Schengen arrangement, whereby the whole of Southeast Europe, member states or not, would become a visa-free area, and that the existing hard Schengen frontier (as between Hungary and Austria) would be where visa requirements would for some countries remain. This initiative would cut out the imminent and dangerous absurdity of the EU forcing its new member and candidate states of the region (such as Croatia) to introduce visa requirements for their neighbours.*

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[Extracts]

## **2.2. Summary of the findings**

### *2.2.1. Political criteria*

The Commission concluded last year that both countries fulfilled the political criteria. This assessment remains valid.

In 2004 the Commission suggested a number of areas for each country where further improvements could still be made. The 2005 reports show that progress has been made in some of these areas, such as freedom of expression in both countries, the fight against petty corruption in Bulgaria, and the reform of the justice system, the integration of minorities, child protection and property restitution in Romania.

However, further improvements are still needed in a number of areas. These concern, for both countries, the public administration reform, the functioning of the justice system, the prosecution of high-level corruption, the fight against trafficking in human beings, illtreatment in custody, the mental healthcare system and the integration of the Roma minority.

The existence of efficient public administrations and justice systems, and the fight against corruption are essential for the effective implementation of the *acquis*. Both countries need to vigorously pursue their current efforts in these areas. They still need to reinforce their public administrations at all levels, including regional and local levels, in terms of improving their accountability, reliability, coordination among and within institutions, staffing and financial resources. The reforms aimed at modernising both countries' justice systems should continue, so as to ensure the effective enforcement of the *acquis*. This concerns in particular the pre-trial phase and the need to improve the accountability of the justice system in Bulgaria. In Romania, justice reform is broadly on track but implementation will need to continue in strict accordance with the deadlines laid down in the action plan.

In both countries corruption is still a problem which affects confidence in the public administration and the judiciary, thereby also affecting the proper implementation of the *acquis*. The fight against corruption should therefore continue to be high priority. The countries' authorities should not spare efforts to enforce anti-corruption legislation, to investigate and prosecute high-level corruption cases, and to take preventive measures. The Commission will also pay particular attention in the coming years to protecting EU funds from being diverted from their rightful beneficiaries as a result of fraud and corruption.

### *2.2.2. Economic criteria*

The Commission concluded last year that both countries complied with the criterion of being a functioning market economy. As regards compliance with the criterion of being able to cope with competitive pressure and market forces within the Union, it concluded that, for Bulgaria, 'the continuation of its current reform path' and that, for Romania, 'vigorous implementation of its structural reform programme' should allow them to do so. This assessment remains valid.

Both countries continued to show relatively favourable economic developments. Real GDP growth, 5.6% for Bulgaria and 8.3% for Romania, was strong in 2004 and this trend broadly continued in the first half of 2005. Inflation remained fairly low in Bulgaria and fell further in Romania. Employment has also started to rise, leading to slight reductions in unemployment rates in both the countries. Financial intermediation deepened further, driven by the strong growth in domestic lending in both countries. Despite being uneven across the various areas, structural reforms continued in both countries, thereby strengthening the medium-term competitiveness of their economies.

In 2004 the Commission suggested a number of areas where further improvements could particularly still be made. The 2005 reports show that considerable progress has been made in several

of these areas, such as privatisation of state-owned enterprises or the liberalisation of telecommunications in Bulgaria, and the restructuring of key sectors and the improvement of financial discipline in Romania.

However, in a number of areas progress has clearly been less pronounced. In particular, in Bulgaria the current account deficit has further widened and labour market reforms have been very limited. In Romania, the expansionary policy mix has widened macroeconomic imbalances. Privatisation has continued but at a slower pace than envisaged in the Government's programme. These issues call for continued attention.

### *2.2.3. Legislative and administrative preparations*

Last year the Commission expected both countries to fulfil the *acquis* criteria and to be ready for membership by January 2007, bearing in mind the progress achieved, the track record in implementing their commitments, and taking into account their preparatory work in progress. This Report shows that both countries have, since then, made further progress in adopting and implementing the *acquis*.

However, developments have been insufficient in a number of areas. Overall, it is important that the *acquis* is not only adopted, but also implemented on the ground. Both countries need to step up their efforts to complete preparations and in particular to Develop a sufficient administrative and judicial capacity to implement and enforce the *acquis*.

### *Progress made in adopting and implementing the acquis*

In most areas of the *acquis*, preparations for membership are quite well advanced in **both countries**. Relatively few problems still exist in the *acquis* chapters relating to capital movements, company law, transport, energy, statistics, economic and monetary union, industrial policy, small and medium-sized enterprises, science and research, education and training, external relations, common foreign and security policy and EU budgetary provisions. In addition, in **Bulgaria**, competition rules and the *acquis* on culture and audiovisual policy are well respected. In the case of **Romania**, the situation is

encouraging in relation to most areas concerning the free movement of persons, telecommunications and consumer protection. In all these chapters, if the current pace of progress is maintained, Bulgaria and Romania should be able to integrate smoothly into the EU.

### *Issues requiring increased efforts*

Bulgaria and Romania have thus reached a considerable degree of alignment with the *acquis* by the cut-off date of 30 September 2005, which is 15 months away from the envisaged date of accession. Nevertheless, at this stage the Commission has also identified a number of areas where increased efforts are required.

In **both countries** the fight against money laundering must be given more attention. In the area of *agriculture*, Bulgaria and Romania need to speed up preparations for their integration into the Common Market Organisations and for putting in place the mechanisms for external trade. Both countries must give greater priority to the completion of preparations in *fisheries*. The horizontal *environmental* legislation is not yet completed in either country and increased efforts are needed. In the *social policy* field, both acceding countries must step up efforts in the areas of labour law and social dialogue and must improve public health, social inclusion and conditions in care institutions and to combat discrimination. Increased efforts are required in both Bulgaria and Romania to prepare for the implementation of the *Structural and Cohesion Funds*, including timely accreditation for Extended Decentralisation (EDIS) in the context of the pre-accession funds. The legislative framework is not yet complete and work on preparing the pipeline, with adequate co-financing mechanisms, needs to continue. In the field of *justice and home affairs*, Bulgaria and Romania must accelerate preparations to apply EU visa and anti-drugs policies and the judicial cooperation mechanisms between Member States. Important weaknesses still exist in the area of *financial control*, which may affect the countries' ability to implement EU-funded programmes in a sound and efficient way.

In addition, in **Bulgaria**, particular efforts will still be required in the field of public procurement; financial services; minimum training requirements and mutual recognition rules for a number of professions; freedom to provide non-

financial services; and the principle of mutual recognition of product specifications, although in general much has been done as regards the *internal market acquis*. Increased efforts are needed to ensure adherence to the national restructuring programme for the steel *industry*, in particular the commitment not to grant restructuring aid to the steel sector after 2005. Among the other sectoral policies, Bulgaria needs to accelerate efforts in relation to *transport* by air and over sea and in relation to *energy* and *telecommunications* market liberalisation. In the area of *social policy*, increased efforts are needed as regards anti-discrimination policy. In relation to *taxation*, Bulgaria needs to accelerate alignment with both indirect and direct taxation rules and to rapidly complete the setting up of implementing structures. Shortcomings still exist in Bulgaria in the *environmental policy* fields of integrated pollution prevention and control, implementation of waste management legislation and nuclear safety, and in relation to all aspects of the *consumer protection acquis*. In Bulgaria, the implementation of the *acquis* on *asylum* needs to be speeded up. In the field of *customs*, efforts will be required to ensure the computerisation and interconnectivity with EU customs IT systems.

**Romania** has also achieved a good level of alignment in many areas related to the *internal market*, but increased efforts are needed in the field of industrial product requirements, the freedom to establish companies, and the protection of personal data. Although good progress has been made in state aid control, efforts are still needed to attain a satisfactory enforcement record. Romania needs to increase efforts in the *audiovisual* sector and in relation to the implementation of the *customs union acquis*. The *fight against organised crime* must be stepped up in Romania.

Corrective action is at this moment feasible and expected in all these areas, but both countries are warned that greater efforts are required to solve them in time for accession. If such efforts are not undertaken as expected, there is a real risk of delays in transposing and applying the *acquis* by accession. For example, there is a serious risk that Bulgaria and Romania will not have the enforcement capacity to implement rules on the protection of personal data unless efforts are speeded up. Also, Romania must reduce the proportion of motor vehicles which are unin-

sured against third party liability with a view to joining and implementing the 'green card' Multilateral Guarantee Agreement before accession.. If such cases are not resolved in time, they would be subject to remedial action by the Union as described in Point 3.2 below.

### *Areas of serious concern*

The Commission has identified a number of gaps in the preparation for membership which are of serious concern and where, unless immediate and decisive action is taken, the country in question will not be in a position to implement the *acquis* or to benefit from EU funds by accession in 2007.

**Both countries** suffer from high levels of piracy and counterfeiting. Enforcement must be strengthened, especially border control and the effective prosecution of *intellectual property violations*.

Bulgaria and Romania must reinforce efforts to set up the necessary institutions and administrative capacity to apply direct support schemes for farmers, to realize market-related expenditure and to disburse rural development funds in the context of the Common Agricultural Policy. There are serious concerns that the *paying agencies* and the *integrated administration and control system* will not be fully functional by accession. Unless this situation is remedied, new Member States run the risk that their farmers will not have access to payments under the Common Agriculture Policy.

The adoption and implementation of the necessary veterinary legislation is urgently required in both countries. Problems in this area compromise the integration of both countries' animal sector into the internal market because if they are unresolved they would undermine the veterinary system and the safety of the food chain in the EU. Insufficient progress has been made to date notably in organising the *identification and registration of animals* and *checks on third country imports* within the framework of the overall veterinary control system. The implementation of the *acquis* in respect of *transmissible spongiform encephalopathies (TSEs)* such as BSE is a cause of serious concern for both countries. *Animal disease control* is flawed in Bulgaria and Romania as serious diseases appear to be endemic. Measures may be needed to protect

the rest of the EU from disease. In both countries, the current pace of upgrading their *agri-food establishments* will not permit all of them to meet the obligations agreed in the accession negotiations. In the interest of public health, specific measures will be taken to deal with non-compliant producers, for example by imposing restrictions on the production and marketing of their products.

Bulgaria and Romania do not possess sufficient border infrastructure and lack sufficient numbers of well-trained staff to ensure full compliance with *EU external border* requirements and procedures. Specific restrictive measures may need to be imposed to prevent the internal security of the EU from being compromised.

Corruption remains a serious problem in both Bulgaria and Romania. If it remains at current levels, *corruption* threatens the internal market, the proper functioning of EU policies and EU-funded programmes. Urgent and forceful action is needed to demonstrate the ability of Bulgaria and Romania to combat corruption effectively and to set in motion an irreversible decline in the levels of corruption. The unambiguous enforcement of the rule of law is a precondition for any country aspiring to EU membership.

Both Bulgaria and Romania face substantial difficulties with regard to the administrative capacity of the *institutional framework* and in ensuring adequate *financial management and control* for the implementation of EU-funded *Structural Funds* programmes and *Cohesion Fund* measures. If the required bodies are not in place or if their administrative capacity remains weak, Bulgaria and Romania will not be in a position to absorb all funding allocated to them.

In addition, serious concerns remain regarding the enforcement by **Bulgaria** of the rules on *motor vehicle insurance*, with high levels of vehicles uninsured against third party liability. If Bulgaria does not join and implement the 'green card' Multilateral Guarantee Agreement border controls may need to be maintained for compulsory insurance against third party liability after accession. In the field of agriculture, Bulgaria is insufficiently advanced in setting up the *milk market organisation*, which will impede EU market interventions in that sector if not remedied in time. In the field of veterinary control, the capacity to treat *animal waste* is insufficient

in Bulgaria. Bulgaria has also not transposed the *acquis on trade in live animals and animal products* and the enforcement of *animal welfare* rules at farm level, during transport and at slaughter is deficient. In the field of justice and home affairs, in addition to the problems mentioned above, Bulgaria has failed to curb *organised crime*. Here too, the rule of law must be made to prevail.

In addition, **Romania** has not completed alignment with EU *public procurement* rules, and the implementation and enforcement of these are seriously flawed. If not corrected, this would create unfair conditions for operators from other Member States and affect Romania's ability to implement EU-funded programmes in a sound way. Disbursement of EU funds, notably under the Structural and Cohesion Funds, may not be possible as long as this situation persists. There are serious delays in Romania in *computerization and interconnectivity* with EU tax IT systems. Unless immediate and sustained efforts are made, appropriate remedial measures will be required to safeguard the smooth operation of EU taxation systems. In the environmental field, Romania does not have sufficient administrative capacity to complete the issuing of permits to industrial operators in compliance with the EU rules on *integrated pollution prevention and control* and to ensure rules are enforced. This would have adverse cross-border environmental effects and would create unfair operating conditions for industries. Remedial measures might need to be imposed as long as this situation persists.

#### *Translation of the acquis*

The two countries must also ensure the *acquis* is translated into Bulgarian and Romanian respectively. Of the nearly 90 000 pages of *acquis*, Bulgaria has already translated more than 95%. However, around 60% of these have still to be revised by the national authorities before they can be submitted to the EU institutions. Romania has translated almost 60% but more than 50% of this volume still has to be revised.

The translation and revision capacity in both countries has not yet reached the necessary throughput level of some 6 000 pages per month, largely due to difficulties with recruiting and retaining staff. The Bulgarian and Romanian

governments have been urged to give this matter the necessary attention.

### 3. NEXT STEPS

#### 3.1. Actions to be taken by Bulgaria and Romania

It is the responsibility of the authorities of both countries to take all necessary corrective measures to address the shortcomings identified in this Report, so as to ensure that they will be fully prepared for membership in 2007. All energy and efforts should now be geared towards that goal.

This will involve, at all government levels, precise activity planning, setting priorities, adopting measures and ensuring an adequate allocation of the necessary financial and human resources. Both countries will need to pay attention to reinforcing their administrative and judicial capacity in order to adequately implement and enforce the required legislation. Vigorous steps will need to be taken in the fight against corruption and in the reforms of the justice system and the public administration in order to ensure the proper functioning of the rule of law.

#### 3.2. Monitoring and safeguards

In view of the shortcomings that still need to be addressed, the Commission will continue its intensive monitoring of the countries' preparations, focusing on the findings of this Report. Monitoring will be aimed at guiding Bulgaria and Romania in completing their preparations for membership, and at keeping the Council and the Parliament duly informed of the progress made by both countries. It will also serve as a basis for deciding on any measures that may be required to prevent or to remedy possible problems that could affect the functioning of the EU if the countries were insufficiently prepared.

The Commission will continue its various monitoring activities until accession. It intends to make full use of all available instruments, such as warning letters, peer reviews, monitoring missions carried out by the Commission services and the structures of the association agreements.

Immediately after the adoption of this Report, the Commission will send substantiated **warning letters** at a political level to the Bulgarian

and Romanian authorities, drawing their attention to the main shortcomings identified and inviting them to undertake the necessary remedial action.

The Commission will then launch a series of **peer reviews** covering the most problematic issues identified in this Report. These reviews, carried out by Member States' and Commission experts, will aim to assist both countries and assess real progress on the ground in the various areas concerned. The Commission intends to have these reviews completed before spring 2006. In March/April 2006 the Commission will then organize **high level meetings** with each country focusing on the outstanding issues.

The results of these follow-up meetings and all information gathered until then will feed into a **monitoring report** which the Commission intends to present to the Council and Parliament in April/May 2006. On the basis and in the context of this report, the Commission may recommend that the Council postpone the accession of one or both countries until 1 January 2008, if the conditions for such a postponement set out in the Treaty of Accession are met. In accordance with the Treaty, the Council may decide to 11 postpone the accession of one or both countries by one year if there is a serious risk of any of those states being manifestly unprepared to meet the requirements of membership by January 2007 in a number of important areas or, in the case of Romania, if specific requirements in the areas of competition policy and justice and home affairs are not met.<sup>1</sup>

The Commission expects Bulgaria and Romania to take all necessary corrective action until then so as to avoid having to issue such a recommendation.

In the event of a Commission recommendation to postpone accession, the Council would have to decide on postponing the accession of any of the two countries until 1 January 2008. Immediately thereafter, the Commission would propose to the Council the necessary **adjustments to the Treaty of Accession**, in particular regarding the institutional and budgetary provisions. The budgetary adjustments would have to fit within

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<sup>1</sup> The precise details of the postponement clause and of the safeguard clauses can be found in Articles 36-39 of the Protocol and Act of Accession, as published in OJ L 157, 21.6.2005.

the process for deciding on the EU budget for 2007.

Independently of whether a postponement decision has been taken or not, in autumn 2006 the Commission will present a second series of **comprehensive monitoring reports** on Bulgaria and Romania's preparedness for membership to the Council and Parliament. For accession in 2007, these reports will serve as a basis to decide on any possible remedial measure to be taken by the Commission in its role as guardian of the Treaties. Such measures include safeguards, infringement proceedings or financial management measures. The Commission will not hesitate to take them when required.

Failure to implement parts of the *acquis* after accession would affect not only the citizens and companies of the country concerned, but also of other Member States. Therefore, the Commission may, in certain cases, need to take measures to prevent or remedy such negative cross-border effects. The basis for such action is found in a number of specific provisions of the Treaty of Accession. These include **three safeguard clauses** which allow measures to be taken by the Commission until three years after accession<sup>1</sup>:

- a general economic safeguard to remedy serious and persisting difficulties in one or other economic sector in present or new Member States;
- an internal market safeguard to prevent or deal with serious breaches by Bulgaria or Romania of the functioning of the internal market. They relate to the four freedoms, but also to competition, energy, transport, environment, telecommunication, agriculture and consumer and health protection (e.g. food safety) insofar as they have cross-border effects. Safeguard measures may result in temporarily excluding the new Member State or its citizens and companies from the benefits of membership in specific areas in order to protect the integrity of the internal market and prevent damage to others;
- a justice and home affairs safeguard to deal with serious shortcomings in the field of co-operation in civil and criminal matters, in

particular to temporarily suspend related rights and obligations under the EU *acquis*.

In addition to these three safeguards, **specific safeguards** existing in the *acquis* (e.g. to prevent the sale of unsafe food) and other procedures (notably **infringements** and decisions on **competition matters**) will become applicable as from accession in order to deal with shortcomings in Bulgaria and Romania.

Shortcomings may also automatically incur penalties, such as when the Commission is not able to disburse **EU funds**. The Commission, in its capacity to execute the budget, will not release funds from the EU budget if, for example, a new Member State does not offer the necessary guarantees on proper spending of EU funds as required under the Common Agricultural Policy or under the Structural Funds.

Although the safeguard or management measures which are taken must be proportional to the extent of the problem and must be designed to cause the least disruption, in most cases their inevitable effect will be temporarily to deny the new Member States and their citizens the full benefits of membership. It is therefore in the interest of all parties to do their utmost to avoid such a situation by tackling the remaining gaps quickly and effectively.

### 3.3. EU support measures

The EU is providing a substantial financial assistance to both countries in order to help them prepare for membership. In 2006 approximately EUR 1 155 million will be reserved for Romania and approximately EUR 545 million for Bulgaria.

The Commission intends to support both countries in their efforts by focusing this assistance on measures to tackle the remaining gaps. Depending on the nature of the problem, EU support could take the form of peer assistance, training seminars, advice missions, twinning (light) projects or similar instruments, which can be mobilized quickly and can be focused on well-targeted issues. Equally, a number of existing EU programmes (such as Customs 2007, Fiscalis, and other programmes) can be used to address gaps in both countries.

Such specific support measures may help to improve or accelerate alignment and implementation of the *acquis*. The Commission will actively pursue this task. Much will depend, however, on the capacity of both countries to absorb and make good use of the EU funds. Further efforts to improve the management and control capacity are needed in particular to ensure the move to Extended Decentralisation (EDIS) in 2006.

#### 4. CONCLUSIONS

In the light of the above, the Commission's conclusions and recommendations are the following:

- The Commission confirms its earlier assessment that Bulgaria and Romania meet the political criteria for membership. Nevertheless, further efforts are needed in particular to strengthen the rule of law, by improving public administration and the justice system and by fighting corruption effectively. As regards the economic criteria, Bulgaria and Romania fulfil the requirement of being a functioning market economy. Bulgaria's continuation of the current pace of its reform path and Romania's vigorous implementation of its structural reform programme should enable them to withstand competitive pressure and market forces within the Union.
- Both Bulgaria and Romania have continued to make progress in adopting and implementing EU legislation and have reached a considerable degree of alignment 15 months before their envisaged accession on 1 January 2007. At this stage the Commission has also identified a number of areas where increased efforts are required. The authorities in both countries should vigorously pursue their preparations in order to ensure the full benefit of membership for their citizens and economic operators. They need in particular to step up their efforts to develop a sufficient administrative and judicial capacity to implement and enforce the *acquis*. The Commission will continue to monitor progress intensively up to accession. Particular attention should be paid to actual implementation and enforcement of the legislation.
- There are a limited number of specific gaps in both countries' preparations which give cause for serious concern. Without immediate action Bulgaria and Romania will most likely not be able to fulfil their obligations in those specific areas by 1 January 2007. Bulgaria and Romania hold the key to their accession on time; even more than in the past years, they need to take firm and decisive steps to tackle these issues.
- The main remaining problems will be followed up in warning letters. On-site peer reviews and specific consultations will be held to ascertain the steps taken by Bulgaria and Romania; where needed, the Union will rapidly mobilise targeted assistance. The results of this follow-up will feed into a monitoring report which the Commission intends to present to the Council and Parliament in April/May 2006. At that moment, the Commission may recommend that the Council postpone the accession of Bulgaria or Romania until 1 January 2008 if there is a serious risk of any of those states being manifestly unprepared to meet the requirements of membership by January 2007 in a number of important areas. The Commission expects Bulgaria and Romania to take all necessary corrective actions until then so as to avoid having to issue such a recommendation.

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## **An Interim Plan for South-Eastern Europe: Customs Union with the EU and a Regional Schengen for the Free Movement of People**

Michael Emerson

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The Amato report of April 2005<sup>2</sup> took as its central recommendation setting the year 2014 as target accession date for the whole of the Western Balkans, which would take the EU from the 27 (in 2007 or 2008) to 32 member states minimally, 33 with Turkey, and 35 in the event of independence for Montenegro and Kosovo. This scenario is in contradiction with the present mood of the EU after the French and Dutch referenda, which rejected the Constitution that was itself designed to pave the way institutionally for further enlargement. The EU has now officially entered a period of profound reflection on its future, a process which cannot be hurried.

While the Amato group had bad luck in its timing, a mood of pessimism in the region is not necessary. Recent developments in relations between the EU and South-East Europe have on the contrary been really quite promising. In October it was decided that accession negotiations could now begin with both Turkey and Croatia, and negotiations with Serbia-Montenegro and with Bosnia for Stabilisation and Association Agreements (SAA) are to be launched. This package of agreements needed a dose of cliff-hanging political dramas to get adopted, but such is invariably the case for all important decisions taken by the EU and its member states. The Commission still highlights problems to be resolved by Bulgaria and Romania, but only 12 months separate the most positive versus negative outcomes: 1 January 2007 or 2008.

Two regional economic initiatives that have emerged in the course of 2004 are also notable: the signing of the Energy Community between the EU and the whole of South East Europe, and the opening of Single European Sky negotiations between the EU and states of the region. The civil aviation agreements would encourage new regional airline networks, so badly needed. With ongoing work to upgrade the Trans-European Network of transport corridors through the region, three strategic economic networks (energy, land and air transport) will be progressing

for the region as a whole, irrespective of who accedes to the EU earlier or later.

Since the process of enlargement cannot be hurried, there is every reason to consolidate the positive recent developments with further initiatives of strategic importance to the region. There are two outstanding candidates for this purpose: (1) enlargement of the existing Customs Union of the EU and Turkey to include the whole of the Western Balkans, and (2) a South-East European Schengen Agreement.

Together these could be at the heart of a new interim plan for the region, pending clarification of further enlargement prospects.

### **1. Customs Union for the EU and the whole of South-East Europe**

Trade policy in the region has made important progress since 2001, when it was agreed to negotiate a matrix of bilateral free trade agreements among the states of the South East European Cooperative Initiative. This has largely been put into effect, although there are many product-specific exceptions to the general principle of tariff and quota free trade (see Annex A).

It was further agreed in June 2005 to explore the possibility of multilateralising these bilateral agreements with a single agreement. This could improve the system, yet it would still be far from the goal of complete integration into the EU internal market.

The next step should therefore be for the whole of the Western Balkans to join the customs union of the EU (soon to be 27 with Bulgaria and Romania) and Turkey, thus embracing the whole of the territory between the EU and Turkey. This initiative becomes urgent since with the EU's enlargement to Bulgaria and Romania, and with the opening of negotiations with Turkey and Croatia, the states of the Western Balkans will be hit by an increasing comparative disadvantage. Mobile businesses will be looking more actively at investment opportunities in the new member states and new candidate states, and therefore less at the Western Balkans.

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<sup>2</sup> International Commission for the Balkans, "The Balkans In Europe's Future", Giuliano Amato (Chairman), published by the Centre for Liberal Strategies, Sofia, April 2005.

Business lobbies in the Western Balkans may protest that they cannot withstand this competition. Their concerns can be to some degree by offering an asymmetric adjustment period, with the EU offering immediate tariff and quota free trade deals for the exports of the Western Balkans, whereas these states might have a transition period of 5 years to phase out their own tariffs towards the EU and introduce the EU's common external tariff regime for imports from third countries.

A technical advantage of the customs union regime will be the scrapping of the burdensome rules of origin requirements for exports to the EU that contain inputs imported from third countries. This would in turn greatly facilitate the growth of direct investment from the EU in the Western Balkans, especially for intra-industry trade integration, which has to be the future of the region's prosperity.

Those protesting that the competitive pressures would be excessive have to say whether they really want to accede to the EU or not, or to reflect on what the prospects will be for attracting investment in an ever decreasing ghetto of excluded Western Balkan states. Of course these states would prefer to have the political status of full EU membership, but even if they did they would hardly be able to determine the EU's external trade policies, or escape the disciplines of the internal market. On the other hand early accession to the customs union would avoid the very serious hazard of losing every conceivable competitive advantage they may have to the new member states that surround them. They would also be gaining a fresh argument for sustained adjustment aid, rather than see their allocations under pressure for reduction. For Serbia in the middle of the Western Balkans the choice would be between that of regaining a regional economic hub role versus becoming the centre of a black hole.

## **2. A South-East European Schengen**

With the EU's recent enlargement Hungary and Slovenia have already had to comply with the EU's visa policies, which meant introducing visa requirements for Bosnia, Serbia and Montenegro, Macedonia and Albania. With the accession of Bulgaria and Romania these countries too will have to do the same, and so on with

Croatia as and when its negotiations with the EU advance.

It is bad enough for decent law-abiding citizens of South East Europe to face the visa queue at EU embassies, but now there is the prospect of the Western Balkans being driven back into an inner ghetto space. This applies of course only to the law-abiding citizens, since criminals can walk or bribe their way across these frontiers with little difficulty. The introduction of visa requirements between South East European states is a stimulus for corruption and criminality, since the borders are unenforceable, yet the attempts to install them create incentives for illegal activity, including the trafficking of goods and people.

To avoid creating this ghetto hazard the EU itself needs to reshape its Schengen doctrine, which presently requires the new member states to become Schengen-compliant with visa requirements before they have themselves full accede to the Schengen system (i.e. with suppression of frontier checks). Thus, for example, frontier checks still take place on the Slovenian or Hungarian frontiers with Austria.

The reshaping of present Schengen policy could be very simple in essence: all of South East Europe could for the time being become a visa free zone, including the new member states. The hard Schengen frontier, as at the Slovenian or Hungarian frontier with Austria, would remain for the time being. However the EU would cease to require the new member states or new candidate states such as Croatia to adopt the Schengen visa list for other Western Balkan states. This interim policy could last for a period of years while the Western Balkan states worked on their qualifications to gain visa-free status for the EU as a whole. The new member states would still retain frontier checks at their borders with the non-member Western Balkan states, and passports would be checked against computerized black lists of criminals and wanted persons with the aid of the Schengen Information System.

## **Conclusions**

It is thus proposed that the European Commission and the Stability Pact for South Eastern Europe should join together without delay to prepare plans for:

(1) Enlargement of the customs union of the EU and Turkey to include the whole of the South East European space in between.

(2) A South East European Schengen Agreement to cover the whole of the region including Turkey, permitting visa-free travel through all states of the region, whether EU member states and non-member states.

These two initiatives, on top of the recent decisions to open accession or SAA negotiations

with much of the region and the ongoing developments in regional energy and transport network initiatives, could be core economic components of a new interim plan for the region – sufficient for several years to mobilise political energies and business interests.

In the meantime outstanding constitutional issues would be worked upon and resolved: independence or not for Montenegro, final status for Kosovo, and phasing out of the protectorate in Bosnia.

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## The EU and South East Europe sign a historic treaty to boost energy integration

<http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/05/1346&format=HTML&aged=0&language=EN&guiLanguage=en>

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*Today the first ever multilateral treaty in South East Europe was signed in Athens. Signing the Energy Community Treaty, the European Union and nine partners of South East Europe – Croatia, Bosnia and Herzegovina, Serbia, Montenegro, the Former Yugoslav Republic of Macedonia, Albania, Romania, Bulgaria and UNMIK on behalf of Kosovo – will create the legal framework for an integrated energy market. Negotiations with Turkey are ongoing for joining the treaty at a later stage. European Commission President Jose Manuel Barroso hailed the Treaty as “a major achievement for peace and stability in Europe”. Commissioner Andris Piebalgs in charge of energy, who signed the treaty on behalf of the European Union, commented that “the Energy Community Treaty will enhance security of supply and give support to a strategically vital sector”.*

As a result of the Energy Community Treaty, the Internal Market for Energy will be extended into the Balkan Peninsula as a whole. This means that the relevant *acquis communautaire* on energy, environment and competition will be implemented there. Market opening, investment guarantees and firm regulatory control of the energy sectors will be enhanced.

This is the first time in history that all of these states and territories have signed a legally binding treaty and is a milestone in reconciliation after the wars of the 1990s. The Energy Community Treaty is consciously modelled on the European Steel and Coal Community that was the genesis for the European Union.

The treaty will also create, firstly, an agreed policy framework for the World Bank and the EBRD support to infrastructure investments – which are estimated at \$ 30 billion in the electricity sector to reach EU standards by 2015 – and, secondly, the expansion of the natural gas system to create an intermediate gas market between the Caspian Sea and the European Union.

From the strategic point of view, the treaty creates a supply route for gas into the European Union from the Middle East and the Caspian region and this will eventually increase compete-

tion in the core EU markets and reduce dependency on single sources of gas. European Union companies that have invested at the far end of the supply chain will be able to better export to the EU.

The treaty will address the very local and specific energy and environment concerns of South East Europe, such as increased mortality rates from winter cold and environmental degradation from emissions in old power stations, the use of wood for domestic heating that results in deforestation and the unsustainable development of wetlands and watercourses for hydroelectric power.

Significant new investments in the mining and metallurgy sectors are expected as short term results from this initiative, but in the longer term, the stabilisation of the energy sector will considerably assist the macro-economic regeneration of the region, contributing to lower emigration rates, economic growth and peace. For Further information :

[http://europa.eu.int/comm/energy/index\\_fr.html](http://europa.eu.int/comm/energy/index_fr.html).

## ANNEX

### Energy and Poverty

Having access and connection to reliable and safe sources of energy is not universal in South East Europe. Energy sources can be directly dangerous – using combustible material in apartments without fireplaces, poisoning from sub-standard appliances – or indirectly so, by poisoning the local air and water. Connection is often capricious and electricity, gas and district heating can all be cut off for many reasons. Chief amongst these reasons is the ability to pay. In South East Europe, energy is generally underpriced; nevertheless, substantial portions of the population cannot pay. Reform of the energy sector will lead to rebalancing of prices: for those who can pay, prices will rise. The challenge is for those who cannot, where targeted support systems will be needed.

Take a look at the impact of poverty on one country. In its Study *Stuck in the Past, Energy, Environment and Poverty in Serbia and Monte-*

*negro*<sup>3</sup>, the UNDP came to the following conclusions:

- Average energy consumption per square metre of living space is about 2.5 times greater than in Northern Europe, yet in more than one in four households the amount of heated space per person is below minimum health standards.
- Mortality is 30% or more higher in winter months than the monthly average, with poor households disproportionately affected. Child mortality, which is high comparatively, is directly related to energy poverty.
- More than half the population uses wood and lignite coal as the major source of energy for heating and cooking, creating high levels of indoor air pollution and leading to chronic illnesses.
- Substandard heating devices and high emissions from thermal power plants, district heating plants and industrial energy use expose poor people to severe air and water pollution.
- Carbon dioxide emissions per unit of GDP are more than twice the world average.
- To improve energy efficiency and reduce poverty new energy policy should remedy the uneven distribution of welfare benefits, especially the sizeable cross-subsidy from poor to rich (implicit in the generally low retail tariff and the fact that the energy sector is subsidized out of taxation).
- Implementing energy efficiency measures could contribute to a boost in the GDP growth rate to 5%-7% a year, a leap that no other policy change could achieve.

### Energy and the Balkan Wars

At the start of the wars (1992) that tore apart the ex-Yugoslavia, the strategic cutting of energy

<sup>3</sup>

[http://www2.undp.org.yu/energy\\_environment/stuckinthepast/stuckinthepast.html](http://www2.undp.org.yu/energy_environment/stuckinthepast/stuckinthepast.html)

supplies was very evident. Take the example of Bosnia and Herzegovina. The cutting of energy supply for citizens was one of the main war targets in BiH. The besieging forces in Sarajevo destroyed all the infrastructures under their control. Sarajevo did not have any of its own power resources. All high voltage transmission lines supplying Sarajevo with electricity were cut, although the nearest power plant at Jablanica could produce some electricity.

Sarajevo was without electricity for three years and for some of that time without water because the water supply system could not work without electricity. In 1995, a partial re-supply by underground cable connection was achieved.

The gas supply (from Russia through Serbia) was also cut.

The result was several cold winters in Sarajevo, and the loss – in this once forested town - of all its trees. Similar situations arose across the region.

These two witnesses, a journalist and a young child, give some indication of why energy is now considered so important.

*"Do whatever you can to stop the killing, to bring about peace, and then bring us trees. There aren't any left in Sarajevo. All city trees, all parks, have been cut for wood to give some warmth to people freezing in a city with no windows, no gas, no electricity."*

Kemal Kurspahic<sup>4</sup>

*"Toward the end of summer (1992) and the beginning of fall, around September, we no longer had electricity, and there were problems with water. The winter was approaching but we had no supply of firewood. We made a stove shaped like a box out of tin. The end of November and the beginning of December I remember from the cold and the shortage of food."*

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<sup>4</sup> Kemal Kurspahic is former editor-in-chief for the Bosnian independent daily "Oslobodjenje" in Sarajevo. The World Press Review named him International Editor of the Year in 1993 for publishing under fire in wartime Sarajevo. His memoirs, "As Long as Sarajevo Exists," were published in 1997 by Pamphleteer's Press. This extract is reprinted from "American Forests" magazine, Spring 1998. <http://www.rec.org/REC/Bulletin/Bull81/Sarajevo.html>

*People were cutting the trees everywhere; in the parks, around homes and anyplace where it was possible. I would spend all day outside collecting wood. Evenings were spent in darkness, and there was by then no electricity for several months.”*

Dejan Ljavric<sup>5</sup>

### **Energy, Investment and Mutual Assistance**

The basis for investment decisions in the Energy Community will move from national/state level approaches to regional approaches. This latter approach is far cheaper. The aim is to save money. However, regional approaches imply regional co-operation and trust. And to avoid that each country is put at risk, the European Union has guaranteed – under Articles 44-46 (Mutual Assistance obligation) – to help the regional states in the event of supply disruption by their neighbours.

### **Electricity**

The World Bank, the United States and the European Commission have co-operated to establish an investment needs assessment in South East Europe. To bring the region up to EU levels of security of supply in electricity will need investments in the region estimated at being up to \$ 25 billion (rehabilitation, new construction and interconnections).

For example, the rehabilitation of existing generation facilities and the building of new, in a reference scenario, will amount to a cost of \$ 15.4 billion.<sup>6</sup> This cost is a regional cost; if reconstruction was done on a country by country basis, the cost would be about \$18 billion. So working at regional level is cheaper.

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<http://safekids.survivorsartfoundation.org/kfeatured.html>

6

[http://siteresources.worldbank.org/INTECAREGTOP/POWER/Home/20551044/Volume%201%20-%20Exec%20sum\\_final.pdf](http://siteresources.worldbank.org/INTECAREGTOP/POWER/Home/20551044/Volume%201%20-%20Exec%20sum_final.pdf); On the World Bank Strategy see, [http://iris37.worldbank.org/domdoc/PRD/Other/PRD/DCon-tainer.nsf/All+Documents/85256D2400766CC785256FFC00738B1B/\\$File/Energy\\_TradeStrategy.pdf](http://iris37.worldbank.org/domdoc/PRD/Other/PRD/DCon-tainer.nsf/All+Documents/85256D2400766CC785256FFC00738B1B/$File/Energy_TradeStrategy.pdf)

EU levels of security of supply means near perfect system stability and the application of EU environmental and technical norms.

### **Gas**

The region is relatively undeveloped from a gas perspective. Gas is used extensively in Romania, but in Albania there is none. The region is a potential if small market, especially for Caspian and Middle Eastern gas. Delivered prices on gas from these sources are expected to be competitive. As a result there are various pipeline projects in the region, though all of them expect to connect the EU to the gas, and develop the local market as an add-on.

The World Bank is leading efforts on the economics of gas expansion with a study.

The Energy Community Treaty is expected to adopt legislation that will make the regulatory framework for the long-distance transmission of gas much easier and will facilitate the investments of European Union companies in the Caspian and the Middle Eastern region. The aim is to have a substantial proportion of EU gas consumption coming from this region from 2010 onwards.

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*Edited by Michael Emerson*

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- To develop these proposals in-depth and in policy-operational terms;
- To combine in-house research capacity with networks of individuals from leading research institutes in the EU and the neighbourhood, and to disseminate and advocate proposals throughout the region;
- To work independently from the EU institutions but in close interaction with them; and
- To decide on the sequencing and selection of priority topics with core stakeholders.

Over the last five years, CEPS has developed an exceptional expertise in European Union policies in the area often called the Wider Europe. This has been reflected in publications that have been both regional and thematic: *CEPS Plan for the Balkans* (1999), *Stability Pact for the Caucasus* (2000), *The Elephant and the Bear – EU, Russia and their Near Abroads* (2001), *Cyprus as Lighthouse of the East Mediterranean* (2002), *Norway, the European Economic Area and the European Union* (2002), *Europe's Black Sea Dimension* (2002), *The Rubic Cube of the Greater Middle East* (2003), *The Wider Europe Matrix* (2004), *Economic Transition in Central and Eastern Europe* (2004), *Europeanization and Conflict Resolution* (2004), *Readings in European Security*, Vols. I (2002) and II (2004). These publications and related working papers are available from the CEPS' on-line bookshop, at <http://shop.ceps.be>

CEPS has decided to build on and strengthen its work in this broad area through the StrataGen programme over the five-year period 2005-2010. The rationale for this initiative follows from both the EU's historic enlargement on 1 May 2004, which now leads the EU to define a new neighbourhood policy, and the unprecedented turmoil in the Middle East in the aftermath of September 11th and the Iraq war, with its consequences for transatlantic relations.

The StrataGen programme will be organised under the following broad geographic areas:

- Northern neighbourhood policy, covering CIS states targeted by EU neighbourhood policy
- EU-Russian relations
- Southern neighbourhood policy, covering Mediterranean states, but reaching also into what is now officially called the Broader Middle East and North Africa (BMENA)
- Implications for transatlantic relations will be considered for all three regions above.

The analytical methodology will be multi-disciplinary: political science, international relations and European studies, economics and law.

The programme is led by Michael Emerson, CEPS Senior Research Fellow, together with Daniel Gros, CEPS Director. CEPS gratefully acknowledges financial support for the StrataGen programme from the Open Society Institute and the Compagnia di San Paolo.

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