



■ **University American College Skopje**
Seventh Annual Conference on European Integration

EUROPE 2020:
TOWARDS INNOVATIVE
AND INCLUSIVE UNION

■ **Skopje, 2012**

University American College Skopje

Treta makedonska brigada br. 60, 1000 Skopje, Macedonia
www.uacs.edu.mk/conference

Europe 2020: Towards Innovative and Inclusive Union



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For the publisher. Dr. Marjan Bojadziev, Rector
UACS Publishing Editor-in-Chief. Dr. Kokan Grcev

Partner institution:

Friedrich-Ebert-Stiftung, office Macedonia, www.fes.org.mk
Dr. Heinz Bongartz, Resident representative of FES Macedonia

**Seventh annual international conference on European integration
EUROPE 2020: TOWARDS INNOVATIVE AND INCLUSIVE UNION
Skopje, 17 May 2012**

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Proof reading:

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Design & Layout:

Dr. Kokan Grcev

Print: V. I - Biblo, dooel, Skopje

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EUROPE 2020: TOWARDS INNOVATIVE AND INCLUSIVE UNION

<i>Preface</i> Heinz Bongartz	7
<i>Opening speech</i> Matthias Kollatz-Ahnen: <i>The EU Fiscal Compact and Discussions about EU Growth Initiatives</i>	11
 <u>Inclusive Union: Political, Social and Cultural Aspects</u>	
Zlat Milovanovic: <i>European Citizenship at the Time of Crisis</i>	23
Stevo Pendarovski: <i>Replacing the European Union: Eastern Alternatives Awaiting?</i>	35
Mihail Stojanovski: <i>Permanent Structured Cooperation as an Institute of the Common Foreign and Security Policy of the European Union and its Significance for Membership Candidate - Countries</i>	52
Katharina Crepaz: <i>Accession Conditionality as a Tool for Achieving Compliance Regarding Minority Protection Policy – A Rationalist Bargaining Approach</i>	63
Maja Gerovska Mitev: <i>Implications of EU2020 Targets and Indicators on Social Inclusion and Poverty in Macedonia</i>	84
Oliver Treidler: <i>Why Europe 2020 is Likely to Be as Unsuccessful as the Lisbon Strategy?</i>	103
Sonja Stojmenska-Elzeser: <i>Teaching European Literature(s)</i>	124
Olimpija Hristova: <i>Impetus for Parliament's Change: Comparative Approach- Macedonia and Switzerland</i>	133
Dragana Beljanski, Dragan Janjušić, Saša Raletić: <i>Comparative Analysis of Applications to Erasmus Mundus and Tempus Programs in Slovenia, Croatia and Serbia</i>	152
David C. McGaffey: <i>Neostates: Old Problems</i>	168

Economy, Business and Innovation in Time of Crisis

David Ramiro Troitiño: <i>The Current Economic Crisis of the EU and the European Economic Government</i>	192
Tome Nenovski: <i>The Balkan Economic Community as a Prospective Integral Part of the European Union</i>	217
Jeremy Cripps, Kevin Feeney: <i>Consequences of Sovereign Debt Default</i>	236
Elena Makrevska: <i>Preserving EU Competitiveness</i>	252
Zoran Sapurik, Ninko Kostovski, Elena Klisarovska: <i>The Transformation of Institutions of the European Union towards a Stronger Common Economic Policy</i>	272
Jadranka Mrsik, Dimce Lazarevski: <i>Reformed Pensions Systems in Central and Eastern Europe: Challenges to Future Safe Pension Benefits</i>	288
Evica Delova Jolevska, Tome Nenovski, Ilija Andovski: <i>The Impact of the Accession of Macedonia to the EU on the Banking System</i>	311
Marjan Bojadziev, Ilijana Petrovska, Ana Tomovska-Misoska: <i>Understanding Factors of Innovative Thinking in Advertising Agencies: The Cases of Macedonian, Slovenian and Serbian Advertising Agencies</i>	331
<i>About the Authors</i>	347

Preface

This volume includes a selection of papers presented at the 7th International Conference on European integration entitled “Europe 2020: Towards Innovative and Inclusive Union” which was held on May 17, 2012 in Skopje. The volume seeks to analyse the key threats to the political and institutional architecture of the Union and to consider sustainable solutions for Europe at the crossroad. Major issues addressed at the conference included:

- Federal Europe based on deeper political integration and common economic governance as a solution to the debt and Euro crises vs. revival of economic nationalisms on the continent;
- EU innovation policy, capital market development and stimulating business excellence as a strategic response to globalizing pressures;
- Creation of a society of knowledge as a developmental priority;
- Improving higher education policies in order to cope with the new challenges and global competition;
- Sustaining an information society and reducing the digital gap within Europe as a prerequisite for wider integration;
- Making multicultural practices an asset, not an obstacle towards building more inclusive communities;
- Euro-skepticism as a by-product of political (un)accountability and poor delivery of EU institutions, enlargement fatigue of EU members and transitional fatigue of would be members;
- Western Balkan countries caught between domestic reform inertia and a distracted EU;
- Social cohesion, marginalized human resources and gender aspects in the time of crisis.

These and other relevant questions formed the theme for the conference which was attended by a number of distinguished scholars from USA, Germany, Belgium, France, Austria, Montenegro, Serbia, Albania, and Slovenia and participants drawn from universities, government departments, research institutions and civil society.

The papers presented at the conference were grouped under the subthemes “Inclusive Union: Political, Social and Cultural Aspects” and “Economy, Business and Innovation in Time of Crisis”.

As the global downturn has demonstrated, the EU's growth is linked closely to the performance of other countries and regions. Consequently, whether the 2020 Strategy is able to deliver results depends not only on regional policies and measures, but also on how it deals with the global context.

The Europe 2020 Strategy is an important milestone on the European path towards an integrated economic and sustainable growth, reflecting the European commitment to work together for a better future. Nonetheless, many challenges remain. On the one hand, it is important to ensure that the Strategy has sufficient popular and financial support. On the other hand, the EU needs to take the necessary steps to overcome existing internal tensions and problems.

One of the major strengths of the EU 2020 Strategy is that it is a single common strategy for all member states. The Strategy is based on the idea of a truly sustainable economy and, as such, it puts forward a comprehensive approach to development, addressing three key dimensions: the economy, the environment and social policy. Accordingly its targets focus on key social, environmental and investment outcomes. In practice, this means measuring progress in areas such as poverty, carbon emissions, education and employment levels, rather than relying merely on economic indicators. This is perceived as an important improvement vis-a-vis previous market-based benchmarks.

The global economic crisis has triggered a severe debt crisis which is rocking the European Union and could jeopardize implementation of the Europe 2020 Strategy. Underlying the crisis, however, is an issue which intensifies instability and poses an even more serious risk in the years to come. Despite all integration efforts, extreme asymmetries remain between EU member states in areas such as employment and income. At the same time, external observers have pointed out that several countries are putting the brakes on further unification and convergence and are pursuing independent policies on issues such as immigration. In this context, there are widespread doubts among other global actors concerning whether a common European development strategy would have enough support to deliver on its objectives.

At the international level, the European crisis is having an impact on how the European Union is perceived. Some international observers argue that the EU has failed to provide alternative and innovative approaches to political and economic development. The areas of climate change and trade agreements, among others, are policy fields in which the EU was expected to be a leading actor but is now no longer making much progress. From a non-European perspective, this has resulted in a loss of political clout at the international level.

Despite the strengths of the strategy, international experts consider that it lacks ambition and a clear strategic vision. When defining its medium-term goals the EU could have taken the opportunity to put Europe back at the forefront of social, political and economic change by putting forward bold and innovative approaches to development. Instead, it seems that the Strategy has neither managed to go beyond existing agreements nor considered alternative growth models or trade policies.

The worldwide economic and financial crisis has, to a significant extent, been aggravated by the deregulation of international markets and financial sectors. Not only does the EU 2020 Strategy fall short of offering an alternative to the existing system, but more importantly, it does not pay sufficient attention to the role and regulation of the financial sector in general. This could prove a major flaw and undermine implementation. Many people believe that financial stability has been brought about with public money, while the financial sector has not contributed its fair share to the process. It is likely that European citizens are expecting some of these issues to be addressed within the Strategy - otherwise, popular support for the strategy might be eroded.

Civil society and trade unions from inside and outside Europe have heavily criticized the fact that social objectives are not adequately addressed in the strategy. This is a sensitive issue in itself, but it becomes an important problem when considered within the framework of the current trend towards a less social Europe. Trade unions and other social actors are essential in order to ensure the social objectives of the strategy. However, since the Lisbon Treaty, and even though the crisis is putting pressure on wages and labor conditions, they have seen their participation reduced. This trend could jeopardize the strategy as it undermines the development of inclusive and cohesive policies.

At the regional level, the Europe 2020 Strategy is an important milestone on the European path towards integrated economic and sustainable growth as it reflects the European commitment to work together for a better future. Nonetheless, many challenges remain. On the one hand, it is important to ensure that the Strategy has enough popular and financial support. Without these two key elements, the Strategy is unlikely to achieve its aims. On the other hand, the EU needs to take the necessary steps to overcome the existing internal tensions and problems. It is essential to ensure that Europe works together in the same direction through common and cohesive policies, developed within the framework of multi-stakeholder dialogue at all levels.

The EU has shown in the past that a crisis can be turned into a catalyst for positive change, by means of leadership and commitment. Making it happen, however, will require a set of common and coordinated efforts in the coming years.

This volume contains a selection of conference papers which were further revised by the authors. It is expected that the volume will provide a new look at some of the controversial issues of Europe integration. We are grateful to all colleagues who have helped in various ways in organizing the conference and preparation of this volume, in particular to all the contributors who have not only invested time in preparing and presenting their papers, but also for undertaking revisions in the light of deliberations at the conference. Our regrets and apologies go to those participants whose papers, although highly valuable, could not be included in the volume because of the constraint of space and exigencies of the publication. The conference and this volume were realized in cooperation between the University American College Skopje and the Friedrich Ebert Foundation Skopje. We are grateful to all our colleagues who supported this project right from the beginning until the publication, for their valuable support and advice in the successful completion of the project.

Heinz Bongartz

The EU Fiscal Compact and Discussions about EU Growth Initiatives

Matthias Kollatz-Ahnen

The EU Fiscal Compact

The official name of the fiscal compact is 'The treaty on stability, coordination and governance in the Economic and Monetary Union.' It was negotiated on Dec 9, 2011, and signed on March 2, 2012, by all the EU Member States, but the Czech Republic and the United Kingdom. The Czech Prime Minister stated that the Czech Republic might join later, whereas the British Prime Minister stated that UK will remain out of this treaty. Against this background the British Chair vetoed the EU making this treaty a part of the Lisbon Treaty inside the EU. However, the countries signing the fiscal compact sign their intention, too, to merge the fiscal compact in due course with the Treaty of the Union (and / or the Treaty of the Functioning of the Union).

If we look back, the so-called Maastricht Treaty started as the stability-treaty. After the French elections the then newly elected Prime Minister Jospin fought for a growth component. So the Maastricht Treaty was re-named as the treaty for stability and growth (1997) and the Amsterdam summit decided on a program for growth. But the treaty itself remained unchanged and the growth component remained a one-off effort; ultimately, the growth vision was not embedded in the treaties. Today, we see again a discussion starting about an amendment to the fiscal compact about growth, because a compact without taking care of growth seems to be missing one necessary leg.

If we look back to an even more distant past, during the first half of the seventies the big European debate was (i) between the French view, first to have the single currency and afterwards to go for the Political Union and (ii) on the other side the German view, first to achieve the Political Union and based on this system establish the single currency. There was no view at all that a monetary union makes sense or could be sustainably achieved based on a kind of autopilot system without a real Political Union.

The new treaty, the fiscal compact, is again about state budgets only. This is one of the reasons why it's criticized so heavily. The difficulties in Ireland and Spain didn't come along with indebted budgets. On the contrary, both countries were regularly 'best in class' with the Maastricht criteria. A building up of bubbles, a development of the society into a vulnerable and less diversified mix of sectors and finally a tax base which is too small and works only in boom-times is not reflected by budget figures and will not be reflected in the future.

How Does the Fiscal Compact Work?

Participating countries have to commit to go for balanced budgets or surplus budgets, and they have to establish the respective laws in their national system with an automatism driven by those laws, when and if the goals are not met. This approach reflects the situation where in the past, the national rules didn't really comply with the Maastricht rules and based on this discrepancy, countries like France and Germany asked for temporary waivers of the Maastricht rules. When their domestic national budget rules were stretched, but kept; however the 3 % new debt was not achieved and a higher new indebtedness took place.

With the new treaty the rules are planned to be tougher: up to 0.5 % new deficit is accepted and only up to 1 %, when the overall state indebtedness is significantly lower than the 60 % of the national GDP, well known from Maastricht. If one year after the treaty has entered into force - according to the plans this would be January 1st, 2014, the national laws are not approved by the Parliaments, the European Court of Justice can fix fines up to 0.1 % of the respective GDP. For the largest country of the Union (Germany) this maximum fine would be around 2.5 bn €. Only those countries who have ratified the fiscal compact and created the respective legal code will be eligible to apply for bail-out money from the permanent ESM (European Stability Mechanism).

This last part of the treaty was the point of sale in countries like France and Germany. The acting conservative governments in both countries had to face a growing opposition mainly in their own governing parties against any kind of new bail-out for EU countries. The broad picture in the political debate was about that the likelihood that support without control would not be acceptable for the ruling parties, because the countries receiving the bail-out

could remain permanent bail-out candidates and only tough control mechanisms can bring them to observe better behavior.

At this moment in time, there was no, or at least less, discussion about what is needed to move a country out of a bail-out situation: and it's evident that budget consolidation is only one necessary part of it. But in my view it's not a sufficient concept. Increase of productivity is needed, investments in sustainable growth and the respective infrastructure are needed as well. And competitive corporates need also the products or services to be exported, which have to be invested in and financed beforehand. There is nothing to find in the fiscal compact about these types of questions. And if you ask for any theoretical justification behind it, sometimes you receive the answer that growth will come automatically with a fast recovery after the cut in the budget and the structural reforms to make the labor markets more flexible are completed.

The belief in this promise is fading or gone. Partly, because the fast recovery didn't happen, and doesn't happen, and there is a growing understanding in the respective countries that is enhanced by delayed results despite implementation of the adjustment program. In Spain, for example, for more than two years the ideas of the fiscal compact have already been implemented. But the recovery doesn't come, it is late, postponed now for the second time. Instead of recovery Spain has gone again into recession in the first quarter of 2012. The recent downgrading of Spain was explicitly justified by Standard and Poors by the lack of growth. The belief is also fading, because it's challenged from a theoretical point of view as a generalization of micro-economy or micro-management to a macro-level, which is simply considered wrong. This theoretical opinion is supported by empirical studies stating that there is no proof at all that austerity as a common approach in a big economic zone at the same time can work, and the forecast of this theory is more about a downward spiral, where one round of austerity is followed by the next, because the second round effects result in shrinking the economy even more. This is where the discussion of growth initiatives come onto the scene and that's why the goal of these debates was to change the fiscal compact, or to add a kind of protocol which would be a part of the treaty itself and therefore kept permanently as an annex to the treaty and does not evaporate like the growth component of the Maastricht Treaty.

EU Growth Initiatives

When the big financial crisis started in the second half of 2007 and emerged eventually after the failure of Lehmann Brothers dramatically in autumn 2008; the need and the usefulness of coordinated action and anti-crisis programs to restore growth was widely accepted.

However, this acceptance didn't remain at the same level for several reasons, different countries developed different strategies, the crisis pattern developed differently, but in my opinion the most important items were (i) the feeling in some of the countries of a rather fast recovery, i.e. that the crisis is more or less over and (ii) the discussion to do something about the 'exit' of the anti-crisis-modus to go back to 'normal', which means as much as possible to a pre crisis world.

In the situation of a crisis which lasts longer, of a recovery which will not come like an autopilot, and of growth which will not result out of budget-consolidation automatically, it's very important to decide on an immediate action program on growth and to prepare a more long-term oriented perspective in parallel.

Immediate Action Program for Growth

Looking at this very moment on two of the core countries of the EU, France and Germany, the fiscal-pact was in the first round presented in Germany as a success of the Merkozy cooperation, which for the first time brought together financial support via the European Stability Mechanism ESM and 'more Europe' with tighter controls represented by the fiscal compact. The German government seemed to realize only at a very late stage of the negotiations that it might need a majority for a change of the constitution and thus the support of the opposition or the major part of the opposition; the recommendation given by a part of the German government was, at that moment in time, to start another attempt to introduce a tax on financial transactions (Finanztransaktionssteuer) and ask for endorsement of the whole package in the Parliament.

The more recent developments could be followed in the press: the government in Germany itself is split about the support of the transaction tax, the German Liberals as part of the government are closer to the standpoint of the UK, the Social Democrats in the opposition stated that endorsement will

not be possible without a growth initiative, notably an initiative to restart and modernize real-sector industries across Europe. After a blunt refusal of such ideas about a growth initiative the German Chancellor Merkel, during the last weekend before the final round of the French Presidential elections, leaked deliberately a lot on 'how' to do it, if needed; to keep it as a separate initiative from the fiscal pact as such.

In France the Socialist Candidate Hollande asked to re-negotiate the fiscal pact, which was refused by the incumbent President. But after the first round of elections Sarkozy warmed himself up, too, for a growth initiative and didn't refuse it anymore as dangerous for France.

The main elements of Hollande's proposals are:

- (i) Introduction of a tax on financial transactions,
- (ii) To do more investments with the European Investment Bank, which are mainly loans to viable and economically sound projects,
- (iii) To use in a better way the Structural Funds of the EU, and for a quick start the remainders of the ongoing financial perspective until the end of 2013, and finally
- (iv) To create Euro Bonds for European Projects (this last topic changed somehow during the Presidential campaign, but let's assume that it is close to the old proposal of Jacques Delors)

The second and the third element are able to deliver as parts of an immediate action program for growth, whereas the first and the last element are important for a long term growth program, in combination with those to be implemented for the immediate action-program.

The first (transaction tax) is helpful to finance the activities for growth. The projected income of the transaction tax will cover more than twice as much as needed for the growth initiative. As shown below if the growth initiative exploits the existing budget resources and combines budget and EIB activities in an efficient way, out the projected income of the transaction tax of some 57 bn € p.a. only 11 % might be needed for the growth package. A growth impulse may need something close to 2,5 % of the GDP (which we can extract from the experiences of the past, where the so-called Marshall Plan after the Second World War injected some 2,5 % GDP distributed over 5 years to the European Economies). If a program of 60 bn € p.a. could be achieved in five or six years this would cumulate into an impact of the same size as the historical Marshall Plan executed by the USA.

Pragmatic Elements of the Immediate Action Program on a European Level

To start with, let us look at the volume and the financial instruments: I see three main components that could be decided on a European level:

(i) To use existing budget out of the ongoing financial perspective for new growth projects. This will be possible, because the budgets for the Regional Funds, the Social Funds and the Innovation budget are implemented with delays. A very flexible approach will be needed for reprogramming, it will not work inside the old programs which were basically designed before the crisis and are sometimes dealing with oversized projects and not enough geared to economic viability. Thus, these additional projects should include a high share of SME (small and medium sized enterprises) projects, be geared very much to projects with rapid implementation, like energy efficiency projects, and go for a first come first serve approach to support mature projects in the sake of rapid implementation. About 15 bn € p.a. in 2012 and 2013 could be collected, together with some co financing of the respective member states from public and private sources, this could result in an annual investment of 20 bn €.

(ii) To use additional 5 bn € p.a. from the existing budget for risk covering of EIB loans, so additional reprogramming might be needed. Experience exists in the field of innovation financing, SME financing and urban development. The experience is positive and has shown that loan instruments have some advantages in respect to the former grants. The implementation is faster, because they follow a demand driven approach, the project selection follows a better viability approach without neglecting, due to the rather long tenors of the loans, the long-term productivity boost of the innovation. About 5 bn € p.a. risk buffer brings forward investments between 20 and 30 bn € p.a., perhaps more likely 20 during the crisis, where multipliers tend to be lower.

(iii) To inject capital to the EIB from those member states who want and are able to do it in a selective and specific capital fund, which will be paid back after some 15 years via dividends to the states. The former mechanism of capital increase without cash injection is not anymore likely to work, because after the crisis the whole discussion about supervision and robustness of banks emerged. The robustness of the EIB in the past was delivered by a 20 fold guarantee beyond the paid in capital, which comes

mainly from accrued profits of the past. This guarantee boosts the so-called leverage ratio and therefore rating-agencies will ask to bring the leverage back from 9 to 8. However such a multiplier of 8 is good. With a specific injection of 10 bn € of a group of member states which are willing to do so an additional lending volume can be created out of 10 bn € each year from 2013 to 2020, altogether the eightfold of the injection. As EIB loans are co financed by other players (like commercial banks or national promotional banks), 20 bn € p.a. is the result of investment in projects. Adding things together the result is 60 bn € on investment across Europe - which is about 0.5 % of the EU GDP. A certain focus to the countries which have higher needs than others seems logical and is doable. The projects could be geared in the direction of 0.25% of GDP in the less stressed ones and up to 0.75% in the more stressed ones.

Three Suggestions for the Budget

It can't be emphasized enough that a change in the budgetary approach is needed. The plans have to be changed a great deal for flexible utilization, and the economical viability has to become paramount, which is not the case now. If you listen, you often hear or always hear that the money is allocated to projects and can't be re-used elsewhere. But having an allocation idea and having a running project is not the same and in the crisis even less likely to be the same. According to the recent data of DG Regio some 25 % of the Structural Funds are not allocated yet, this counts to 82 bn € across the EU. As the financial perspective is not over it can be expected that more money will be allocated, but not all, until 2013.

Even more important in my view is the room of maneuver for reprogramming and the need to do so, because projects turn out to develop slower during the crisis and down-sizing could help as well. So if the political will is there, reprogramming of some 20 bn € per year is possible. (Just one small example from the past: during the 2009 anti-crisis program called ERP the Commission and the Member States decided on a project list to be supported by this program. Because of the strategic importance it was decided to give a visible grant to the Nabucco pipeline. No investment is done, nothing has reached the real economy and this money was simply unutilized, because the project is not mature.)

The third important change in my opinion is the incentive for down-sizing. The first reaction during the crisis of the Commission and the Member

States was to support the Member States with a reduction of the co financing requirements. The requirement was set down from one third in several steps to 5% or even less. The much better approach is to go down to zero co financing for loans (but not for grants!) and other financial instruments. For those projects a repayment is planned and takes place, the money to be reinvested again in a kind of revolving fund. This will strengthen the investment capacity in the long run as well beyond a short boost of investment and help very much with long-term growth.

Pragmatic Elements of Long-Term Growth Contributions with Investments

Long-term growth depends on a multiplicity of input factors. Perhaps the most important ones are linked to the development of the educational sector. This is not our topic here, but one should bear this in mind for the general debate. For the topic at hand (i) sustainable investments, (ii) investments in innovation and (iii) development of competitive small and medium sized enterprises are relevant.

I. Sustainable Investments in Infrastructure

Sustainable investments in infrastructure will show a very distinct pattern in the future. Some of it like, public transport are very important, but unlikely to be financed without long lasting public support. Some, like new energy grids or broadband are needed fast and don't find enough investors at all, or at least not enough patient investors at the moment, but will pay off in the future with the related tariff system or fee system. For the first group, we can rely on the mechanisms mentioned above. The intensity of subsidy can be geared by an adaption of a grant/loan mix, the more subsidy element needed the higher the grant element (and vice versa).

For the second, group a stronger involvement of the private sector may be useful and necessary. Patient private capital is out of the market for the time being, because technically the mono line insurances have disappeared. These mono-liners mapped loans: against the payment of an insurance premium, a not very highly rated investment project was moved into the sphere of AAA and made it therefore eligible for the pension funds or re-insurers or insurance companies.

To bring those investors back, two ideas are to my best knowledge prepared and partly under implementation:

(i) To go with hybrid infrastructure funds (like Marguerite, backed notably by Italy in the past) supported by public money in this group of infrastructure projects, add additional equity to the equity of the project promoter, commit to stay in the project for 15 years, or so, and achieve with such a high equity piece that private investors can take the risk of the more senior tranches of debt or mezzanine financing, which are after this intervention closer to investment rating degrees.

(ii) If a rating degree for the senior parts is mandatory, one could create project-bonds with the support of the EIB. This is often confused with the EURO Bonds, but is somehow different. It is based on the risk-buffer idea. The project promoter brings 25% equity; the EIB brings another 25% mezzanine piece, which would be junior by comparison to all senior tranches beyond. For this 25% EIB receives a risk buffer of the Commission's budget.

To interconnect the world of budget and the world of long term project finance this risk buffer, let's say 12.5% is put upfront from the budget into an escrow account of the EIB. If it's needed, it's lost for the Commission. If it's not needed, it can be re-used again later. With a larger group of projects a kind of portfolio consideration is possible, which should help to stabilize the instrument even better. The most senior 50% of the project finance are mapped with this mechanism to an Investment Grade world, not to a AAA, but rather to the low end of the Investment Grades. However, such an approach could bring in private Investors, which could help a lot for long term growth investments in infrastructure

II. Investments in Innovation

In respect to the innovation finance I already touched on the good experience with a risk buffer system in the past, this approach was successful and could be continued and be expanded.

III. Investments in SME Projects

As a last topic I want to touch on the innovation in corporate, including SMEs. A recovery and a significant boost in productivity in countries like Portugal or Italy, will not come without investments in SMEs, without

modernization of production, without development of new products and services, without looking for international competitors and eventually overtaking some of them. Given the scarcity of funds it's reasonable to start from the group of growing companies, where jobs are created and further market penetration is addressed.

Experience in my professional life shows that it's wise to go with a wide understanding of innovation, and not to close it too much down to research related things only. Certainly the grey-zone is larger with this approach, but the classical European weakness lies in the bridging of the gap from knowledge, from research to technical or commercial products and less in the creation of knowledge as such. Revolving funds are for those objectives a fine instrument, they should have a built in flexibility to move resources from one instrument to the other. Depending on the stages of crisis, development and economic cycles higher shares of guarantee instruments might move to higher shares of high risk junior loans without classical securities. Promotional banks are experienced in doing such administrations.

New Debt Needed for such a Program of Growth?

The financing of such innovation instruments should use a part of the income of the financial transaction tax. Why a part only? Because the major part should be used by the countries to contribute to repayment of state debt accrued to the financial crisis. The part used could be transformed to the European level and I advise to bring it into the form of a revolving fund. The financing of in-structure instruments could be done by the Project Bonds having the advantage that no new public level of state indebtedness will be needed, which was always the point of refusal for the Delors idea by many member states of the EU. But even the modest proposal of the project bonds requires a sufficient European Budget. The existing position of the UK, Germany and other countries to reduce the EC budget by 10 percent or even more the next financial perspective would not allow financing it. So this position has to be changed.

Conclusion

To sum up, finally, the volume of such a long-term investment program: in addition to the 60 bn € p.a. of financial injection for investment with the immediate action program in 2012 and 2013, I think another 60 bn € p.a. after this immediate action program for the long-term program until 2020 is the right dimension and a pragmatic one as well. Most of it can be done by already existing budget until 2013 or the budget plan provided by the Commission for 2014 to 2020, if the budget is not cut and geared in the direction described. The EIB capital injection and the co financing of some of the activities at a national level needs a new budget. The budgetary space in the existing and the new EU budget needed is about 20 bn € p.a., which could be done without extension of the existing and the proposed new budget. The EIB capital injection and the national co financing are about 6.5 bn € p.a. and this is doable. If in addition, new debt should be avoided, the introduction of the financial transaction tax would create according to the Commission some 57 bn € p.a. revenues for the states and the EU together, so a multiple of the 6.5 bn € needed.

The above speech was given in Skopje by the author Dr. Matthias Kollatz-Ahnen who has published several articles about an EU program for growth, including: 'Ein Wachstumsprogramm für Europa', available at: <http://library.fes.de/pdf-files/id/ipa/09201.pdf> and: 'Stimulating European Growth' together with Prof. Dr. Stephany Griffith-Jones, available at: <http://blogs.ft.com/economistsforum/2012/06/stimulating-european-growth/#axzz1yJcrkK76>

EUROPE 2020: TOWARDS INNOVATIVE
AND INCLUSIVE UNION

Inclusive Union: Political, Social and Cultural Aspects

European Citizenship at the Time of Crisis

Zlat Milovanovic

Abstract

*The Charter of Fundamental Rights of the European Union states that the European Union (E.U). "places the individual at the heart of its activities, by establishing the citizenship of the Union and by creating an area of freedom, security and justice...To this end, it is necessary to strengthen the protection of fundamental rights..."The Charter, together with the Treaty of Lisbon is today a part of the *acquis communautaire*. On the other hand, the economic, financial and political crisis threatens not only the Euro but also the very existence of the E.U. The crisis of the common currency has brought itself to the center of the E.U. attention, while the individual, the citizen of the E.U. remains more or less on the periphery.*

*This paper is about citizenship, its importance and its future. The Euro has to be saved, definitely, but E.U. citizenship as well. There are several building blocks of citizenship, on national, regional and international level. They are: legal in their character, either as a part of international or constitutional law or – European, they are also psychological, i.e. linked to personal or national identity, social, cultural, philosophical... To be able to protect the citizens, E.U. citizenship has to be protected and, expanded in the future. It should become a real citizenship within a new, federal context. The question is: how can the E.U. or another form of integration become a model for the world, a model attractive globally? What answer is to be given to the American challenge or the challenge of other major powers?An interdisciplinary methodology is used here, first of all in the domain of *de lege lata et de lege ferenda*. The new needs will require new solutions and projection to the future remains a part of futurology.*

Keywords: Human rights, fundamental freedoms, European citizenship, nationality, dual nationality, ethnic groups, change of identity, European integration, American challenge

The Charter of Fundamental Rights of the European Union states that the European Union (E.U.) “places the individual at the heart of its activities, by establishing the citizenship of the Union and by creating an area of freedom, security and justice... To this end, it is necessary to strengthen the protection of fundamental right...” (Charter of Fundamental Rights of the E.U., 2007). On the other hand, the present economic, financial and political crisis threatens not only the Euro but also the very existence of the E.U. as we know it. This crisis has brought itself to the center of the world’s attention; while the individual, the citizen of the E.U. remains more or less on its periphery - which was not the original idea of the E.U. member states. If the E.U. is ever dissolved, as some eurosceptics stand for, would E.U. citizenship also disappear? If a member state, with or without consulting its own citizens, decides to leave the E.U., would that mean that its citizens would also cease to be European citizens? The Euro can be replaced by a national “denarius” but no matter the name, citizens of the country leaving the E.U. would all lose their acquired rights.

The Question of Citizenship

The Treaty on the European Union, signed on February 7, 1992 – did establish among other things European citizenship (TEU).

According to Art. 20:

Para.1 - Citizenship of the Union is hereby established. Every person holding the nationality of a member-state shall be a citizen of the Union. Citizenship of the Union shall be additional and not replace national citizenship.

Para. 2- Citizens of the Union shall enjoy the rights and be subject to the duties provided for in the Treaties. They shall have, inter alia:

a) the right to move and reside freely within the territory of the member-states;

b) the right to vote and stand as candidate in elections to the European Parliament and in municipal elections in their member-state of residence, under the same conditions as nationals of the state;

c) the right to enjoy, in the territory of a third country in which the member-state of which they are nationals is not represented, the protection of

the diplomatic and consular authorities of any member-state on the same conditions as the nationals of that state;

d) the right to petition the European Parliament, to apply to the European Ombudsman and to address the institutions and advisory bodies of the Union in any of the Treaty languages and to obtain a reply in the same language.

These rights shall be exercised in accordance with the conditions and limits defined by the Treaties and by the means adopted thereunder. (TEU, 1992).

* * *

The term nationals / nationality is used in this article: It amounts to the same concept as that of citizenship. The first is a concept of international law, the second of constitutional (i.e. municipal law). Citizenship is a link between a citizen and his/her state, while nationality also implies a link between a person and his/her nation (Skaric, 2004). Vojin Dimitrijevic, in his piece on ethno-nationalism, divides national constitutions into two groups: those that are based on "demos" (i.e. the totality of citizens irrespective of their origin), and those based on "ethnos" (i.e. the ethnic origin of a majority of citizens). (Dimitrijevic, 2012; Hudson & Bowman. 2012) Looking back at the Treaty of Maastricht, there is primary and secondary citizenship, the second one is based on "demos" while the first could be defined either way, depending on the nation's constitution.

One should remember here that Aristotle envisioned the best state as the one in which all citizens have the same rights, the same education, the same capacity (ethical, political, cultural and rational) and the same goal: a good life! In Aristotle's "politeia ariste", every citizen would know how to govern and how to be governed. Ultimately, all the highest positions would be accessible to every citizen (Djuric, 1997).

The ideal state, however, has never been achievable. Present day states have lower expectations. The E.U. may be too big for an ideal state but this does not preclude the existence of real European citizenship in the interest of European citizens and their "good life" or at least a "better life". Being an additional citizenship, European citizenship may be too dependent on the national "ethnos". It may also be considered "pseudo-citizenship" – for instance by Jean Marc Favret – as E.U. citizens do not have the constitutive power i.e. "le pouvoir constituant" (2008). Not being a nation, Europe cannot have full European citizenship under the present conditions. But, if the

concept of "demos" is used, citizenship could become all- inclusive, almost like world citizenship.

The United States, within its federal system is based on "dual citizenship" as a fundamental part of its system (Stephens & Scheb, 1993). In the U.S., two levels of government, federal and state, exercise direct authority simultaneously over persons within their jurisdictions (Ibid.). Many rights, privileges and immunities derive from both federal and state citizenship. This happens in many federations. Why not in a European federation if it is created one day?

As the E.U. grows in different areas, its citizens can acquire new rights. The united citizens and their interests should indeed have precedence over purely economic or monetary considerations. If, for instance, country A decides to leave the E.U., its citizens cannot just be stripped of their European citizenship. Why? There are several reasons.

- a) There is no provision in the Treaties that would allow such a change.
- b) Those citizens of country A who are legally residents in E.U. member states M and N do have the same rights as the citizens of those countries and would be discriminated against if denied the acquired rights;
- c) If the citizens of country A vote in a referendum and reject the government's policy, they should not be sanctioned by other states;
- d) It is impossible to think of long term economic integration without political integration (Schuman, 2009);
- e) The system of human rights and fundamental freedoms having been already established, the E.U. values of respect for human dignity, democracy, solidarity etc. are there to protect the European citizens;
- f) The European Court of Justice ruled in the case of Van Gend en Loos that the Community constituted a new legal order, the subjects of which consisted not only of states but of their nationals. (ECJ, 1963).

European law protects citizens too, in a great number of cases.

European Identity

European citizenship is a legal category and at the same time, an expression of European identity. The identity may be defined as the quality of being the same as others within a group, small or large and remaining the same. It is a sense of self, providing sameness and continuing one's

personality over time. Nations also have their identity as communities of generations, past, present and future. For some authors, national identities may have developed recently and are not permanent (Thiesse, 1999).

The European identity is obviously older than European citizenship. Already Philip II of Macedonia was considered the greatest European of his time. Dante Alighieri in his work "De Monarchia" spoke of European culture and the need to create a European unified state. J.J. Rousseau wrote that "We have no more Frenchmen, Englishmen, Germans or Spaniards, we are all Europeans!" The Roman Empire was the first to unify all of known Europe of that time. The *Constitutio Antoniana de Civitate* enacted by Emperor Caracala in 212 AD, made all free men of the Empire Roman Citizens, from Iraq to England and from North Africa to Northern Europe. A common currency was already used in the whole Empire and beyond.

The empires, states, identities and the concepts of nationality, have changed many times and are likely to keep changing. Identities can develop before a corresponding citizenship, or after that citizenship or instead of citizenship. As an example, a German nation existed before the unification of the twenty-four sovereign states. Today, there is no citizenship of the Duchy of Oldenburg, for instance, but the Oldenburgers' identity remains in part of the population. The idea of a united Yugoslavia goes back to Napoleon's time and its strong identity resulted in a common state. That state has disappeared but the identity has not as there are yet Yugoslavs and in addition, that is a common name of the Southern Slavs (Dodovski, 2011).

There are only about twenty-six surviving Livonians in Europe, yet they have their own identity. What about Mandeans, an Iraqi minority of about 50,000, with their language and gnostic religion (recognized since at least the 4th century AD); thrown out of Iraq by militants' violence and accepted in Sweden as refugees? The Livonians are disappearing old Europeans and the Mandeans are present and prospective new Europeans, potentially new European citizens.

In a recent interview, Umberto Eco said that European identity, in 2012, was widespread but shallow (in Italian "superficiale"). It is culture, he said, not war that cements our (European) identity. The United States needed a civil war while culture and a common market will do it for us (Eco, 2012). Europeans should spend more time with other Europeans, all over Europe. Exchanges of professors and students are wonderful, of lawyers, architects, etc. but there is still lacking an exchange of taxi drivers, workers, artisans, etc.

On one hand, there is European literature, education and film, the Eurovision song contest, European sports' championships, European Railway Systems, and European organizations including IGO's and NGO's. There is the Theatre de l'Europe in Paris.

Not only do the French, Germans, Swedes, and Hungarians feel European, but also many Turks, Icelanders, Americans, and Russians. And of course, the Macedonians! The question of feelings is personal and cannot be imposed by laws. Many citizens of the Commonwealth feel European too, and others such as Francophones, Iberophones, Lusophones from all around the world. According to Eurobarometer (in 1999), European citizens (over the age of fifteen) feeling attached to Europe (very or fairly) was 78% for Luxemburgers, 71% for Swedes and Danes, on the top of the list, with 49% for Dutch, 41% for Greeks, 37% for English, among the last on the list. As for European versus national identities, the highest scores were reached by Luxemburgers, 49%; Italians 45% and Spaniards 32%. Here, the British go with -37%, the Portuguese with -22% and Finns with -19% (European Commission, 2001).

In 2006, in Macedonia, answering the question of how important is the integration of Macedonia into the E.U., 86% answered: important or very important, with 11% opposing it. At the same time, 87.8% said that in a referendum for the entry of Macedonia into the E.U. they would vote YES! While 5.2% were opposed (Government of Macedonia Secretariat for European Affairs, 2008).

For a large part of Europeans and world citizens, the European identity is quite real. For many, it is not, and the question arises on how to strengthen individual national identities. In many parts of Europe, nationalism is on the rise too. "The recent upsurge of nationalism in Europe reflects above all a failure of politics and difficulty of forging new collective identity based on a genuine political project" (Thiesse, 1999).

Looking Ahead

European citizenship is now confronted by crisis - as is the E.U. itself and in a wider European architecture. The future, we assume, is in an innovative and inclusive Europe, as the title of this Conference suggests. Whatever the solutions to the crisis are worked out to be, emphasis should be on individuals, citizens, people. As we have seen earlier, European law and

the existing European identity are clearly opposed to the abolition of European citizenship, for one country, for a few or for all. There are, however, no clues on how to stay on the right path, i.e. on the path of European integration as defined by the founding fathers of Europe.

*The first change needed is to make European citizenship primary or full citizenship. Present "additional" citizenship should become a citizenship *proprio sensu*.

*The link with nationality will remain but as citizenship of federal units within a European federation. To be European will eventually mean to belong to a state.

*European identity, irrespective of nationality, will entitle individuals to acquire European citizenship directly. Those who chose to be citizens – even when and if their countries withdraw from the E.U. will be able to remain European citizens. It is a matter of choice and an innovative approach.

*This should apply to the citizens of candidate countries, and also of non candidate countries. In these cases, European institutions with an expanded federal authority, will make individuals or groups of people European citizens by their decisions (the European Parliament, for instance). Federal authorities in the U.S., Brazil, Argentina, Switzerland, Austria etc. already make such decisions. The conditions are to be worked out.

*Citizens of any country will be able to apply and obtain European citizenship based on their links with Europe, material and spiritual. *Ius soli* and *ius sanguinis* will be relevant, as well as knowledge of Europe, of European languages and of European values. Those working for their countries and Europe will also qualify, those contributing to mutual understanding, peace and progress.

*Europe will act as a protector of minorities, ethnic, religious, racial, cultural and others. The descendants of Francois I, Maria Theresa and Catherine the Great will protect the Christian minorities and at the same time the Muslim, Jewish, Hindi, Buddhist and all other minorities world over. Europe will be an area of accepting refugees and asylum seekers.

*Europe can grow by more states joining in the areas of Euro-Atlantic, Euro-Asia and Euro-Africa, and also with citizens of those areas coming to Europe and opting for Europe. Those belonging to other European configurations can also become European citizens.

*A democratic model of any state or organization is based on the concept of government of the people, by the people and for the people. To

paraphrase Aristotle, if Europeans can learn to live in peace with each other (without wars and conflicts), they will become the center of the world.

*The protection of human rights and fundamental freedoms is already a proclaimed goal of the E.U., of the Council of Europe and of the U.N. The goals to be found in their basic documents, and are the long term commitment of the European and the International community. For instance, the goals proclaimed by the E.U. Charter in 2007 could not possibly be declared void in a ten year period.

*Europe, as suggested here, is to become a universal Europe, the most successful model of international integration at the level of states and citizens. The E.U area of freedom, security and justice will also become an area of: tolerance, solidarity, non-discrimination, human dignity, social rights, minority rights etc. As such, Europe is also to become a world unifying factor, unique and distinctive in all its aspects.

The American Challenge

Back in 1967, Jean-Jacques Servan Schreiber (JJSS), a French journalist, politician, university teacher, and fighter-pilot, published a book called "The American Challenge" (JJSS, 1967), which received tremendous publicity on both sides of the Atlantic. The author pointed out American leadership in management techniques, technology and research capacity, challenging Europeans to become more modern and more competitive. About fifty percent of U.S. high school graduates went on to universities whereas about ten percent of Europeans (of that period) did so. In forty-five years, the gap has diminished greatly, in part due to the efforts of the E.U. and, of course, of national governments of many nations.

Yet, U.S. population has increased by more than 100 million, i.e. from 198 to 313 million, while Europe grew from 450 to about 505 million. The U.S. called "the first new nation" has attracted a large number of Europeans from Europe or people of European extraction in countries in Latin America and other parts of the world. Most Europeans, no matter how divided they may be in Europe, become tolerant Americans in the U.S., demonstrating their capacity to live in peace with each other. That is probably the largest challenge today which is likely to continue as a challenge unless Europeans develop a new approach, e.g. by building the European federation and the European identity.

The other important challenge is the fact that U.S. Government and society recognize and readily accept foreign students, professors, researchers, scientists and professionals of all kinds. In general, European actors, artists and sportsmen integrate relatively easily into American society; but also workers, artisans, taxi drivers, shepherds, barbers, etc. Workers of all possible: nationalities, creeds, races, genders, ages, origins, languages, sexual orientations, etc should be welcome in Europe too. American values are the same, or very close, to those proclaimed in the E.U. Charter.

The U.S. can go a little further. The U.S. Constitution in its Amendment XIV, proposed in 1868, contains the norm of "equal protection of the laws". It reads: "All persons born or naturalized in the United States and subject to the jurisdiction thereof, are the citizens of the U.S. and of the state wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of the citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."(U.S. Constitution, Amend. XIV, Section 1).

I would like to draw the reader's attention here to a case decided by the Supreme Court, *In Re Griffiths* (1973). In this case, *Fre Le Poole Griffiths*, a citizen of the Netherlands, challenged the decision of the Connecticut bar to deny her membership due to her citizenship. Ms. Griffiths came to the U.S. as a visitor in 1965, married a U.S. citizen in 1967 and became a resident of Connecticut. After graduating from Law School in 1970, she applied for permission to take the Connecticut bar examination. The County Bar Association found her qualified in all respects except that she was not a U.S. citizen. She sought judicial relief, asserting that the regulation was unconstitutional, but her claim was rejected. Ultimately, her case made it to the Supreme Court (Fletcher & Sheppard, 2005). The Supreme Court held that the rule unconstitutionally discriminated against resident aliens, under the equal protection clause. Here, the Connecticut State Bar Examination Commission attempted to justify the total exclusion of aliens from the practice of the law. In fact, the Supreme Court ruled in 1873 the admission to the practice of law did not depend on citizenship at all (in *Bradwell v. State*, 16 Wall. 130, 139). Later, the State of Connecticut established the rule which was in question. In the *Yik Wo* case, equal protection was found applicable to a Chinese resident against an ordinance regulating laundries. A resident was found to be a person under the XIVth amendment. The legal history is long.

At some point, even a fishing license was made beyond reach of a person ineligible for citizenship (in California). In *Graham v. Richardson* (1971) the Court concluded that "classifications based on alienage, like those based on nationality or race, are inherently suspect and subject to close judicial scrutiny" (Fletcher & Sheppard, 2005).

"Resident aliens, like citizens, pay taxes, support the economy, serve in the Armed Forces and contribute in myriad other ways to our society" (*McLaughlin v. Florida*, 1964). Without going into more details, it is important to understand that Mrs. Griffiths was allowed to take the exam and become a lawyer. This is where the E.U., the ECJ and other institutions and national governments should see the challenge for the future. Fletcher and Sheppard, comparing the U.S. situation to the European one, point to rather liberal anti-discrimination provisions of both the Council of Europe Convention and the E.U. Charter. They have asked a number of questions: How serious are Europeans about their criteria? Discrimination based on wealth appears to be permissible, they say. Or the rule of obligatory retirement of teachers of certain age, which does not exist in the U.S. (The age is mentioned in the E.U. Charter as a cause for discrimination). Language discrimination is also mentioned as an existing practice in Europe, "la nationalité" as well. The E.U. has introduced the use of Catalan, Galician and Andalusian as languages of communication, which leaves at least some 30 minority languages out, including Russian, for instance. The U.S. does not have a similar linguistic policy. Nationality (as "the ethnos") remains a criterion in various constitutions of the E.U. countries and may be used for discrimination purposes (Fletcher & Shappard, 2005). Getting back to *In Re Griffith*, one has to admit that it was a bold liberal decision of the Burger court which could be considered almost a revolutionary one in Europe.

Conclusion

The present crisis is developing within the context of growing nationalism within the E.U. and other parts of Europe. The crisis feeds nationalism and nationalism augments the crisis. The world needs a stable and globally oriented Europe in the situation where global problems require common action of all in solving them, as well as stronger international homogeneity and solidarity. To be innovative and inclusive, Europe will have to follow the road so far determined and create a model for the world, not just

for itself. The founding fathers have already called for a United Europe. "To serve mankind is a duty equal to our dedication to our nation" wrote Schuman (2009). Political integration is a condition sine qua non of the economic integration, as witnessed in the summer of 2011 by all of us. Our proposal calls for a new category of European citizens and the engagement of all citizens of Europe in solving European problems and contributing to the solution of global problems of mankind. By bringing the citizens to the center stage, all will progress faster.

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Replacing European Union: Eastern Alternatives Awaiting?

Stevo Pendarovski

Abstract

Protracted crisis in the European Union has substantially augmented lingering euro-skepticism on the continent. Member-countries are desperate to restore the legitimacy of the organization, while descending perceptions about values of the EU integration model among candidates and would be members are real. Inward-looking EU is less engaged in imposing conditionality which has been for more than a decade a main instrument in exporting democracy. With the EU gravitational effects largely absent, nationalistic and populist sentiments are gaining ground in some parts of the Western Balkans, advocating alternatives to European integration as a regional gate to globalization. What does the past record of several Eurasian regional organizations imply about their potential to serve as sustainable alternatives to the European Union? Can the regional trends in the wider Euro-Asian area eventually open up alternative perspectives for some of the Western Balkan countries trailing back on their European path? In this article, the performances of a few regional organizations in Eurasia in several domains will be analyzed applying the comparative method. The aim of the paper is to depict a different genesis and civilizational background and emphasize structural flaws and comparative weaknesses of these organizations to the European Union, especially in the area of political and cultural values underpinning their engagement.

Keywords: Crisis, euroscepticism, alternative regional organizations, political values

Introduction

What began in 2008 as a sovereign debt crisis three years later translated itself into the profound crisis of public confidence in economy, in politicians and in the European project as a whole (Stokes, 2012). What is making the overall setting even more complicated is that the mid-term euro-crisis coincides with the structural, longer term tendencies of Europe's relative decline and these two sides of the coin are only reinforcing each other. Especially worrying is skepticism signifying partial "emotional detachment" stemming not so much by the meager economic benefits of integration, but, more by the lack of "fit" between the Union and a person's identity (Sorensen, 2006).

Although in some parts of Europe there are expectations that in due time the organization will restore its legitimacy, the underlying contradictions of the European enterprise will likely prevent deeper political integrations and making the Union as envisaged in Maastricht or Lisbon (Friedman, 2012). Beyond doubt, the European Union still counts in global affairs, but, its downward trajectories in the military domain, economy, energy dependence and demographics are unlikely to be dramatically reversed in the foreseeable future (Youngs, 2011). However, an important bright spot does exist in the otherwise gloomy scenery: deep financial and economic distresses in the EU have not undermined belief of EU citizens in political and cultural pillars of their organization. A sound majority of them still remain committed to the market economy and democratic norms (Stokes, 2012). In terms of legitimacy, the amount of support for EU institutions is low across the member countries, but, the Union anyhow fares much better than some other models of regional governance when judged against the respective national discourses (Schneider & Hurelmann, 2011).

In the same period in the Western Balkans European integrations have been pressurized by at least two processes approaching from opposite directions: infighting in Brussels has undermined attractiveness of the project and increased enlargement fatigue among the members, while bilateral disputes between the local nations, such as the Greek blockade of Macedonia's bid for NATO membership due to a dispute over the latter's name, are holding some of them back for years. It is reasonable to expect that after the integration of Croatia no country from the region will enter the European Union until 2020. In an atmosphere of rising mutual suspicion

between Brussels and Balkans it has not been a surprise to hear political proposals going outside of the parameters of the traditional integration rhetoric. In Macedonia formal and informal advisors to the politicians in power have publicly hinted on leaving Euro-Atlantic integrations, while in Serbia the Interior Minister on several occasions has suggested the same in the context of their dispute with Kosovo. Local experts and politicians have been publicly juggling with two options: political neutrality and more often, rapprochement towards allegedly more functional and vibrant regional organizations in Eurasia.

Therefore, in the next chapters some of the current forms of Eurasian regionalism will be examined with special focus on China and Russia as the most powerful entities able to initiate, participate and navigate almost all relevant undertakings in that part of the world. Within our subject of analyses answers to two outstanding questions will mostly shape the debate and conclusions at the end: first, what does the inner political logic of the most influential regional players suggest about the forms and substance of the regional organizations they are a part of and second, what does the comparative regionalism have to say about the past achievements and future prospects of regional cooperation in Eurasia? Before that, a brief paragraph about the potentials of Euroscepticism as a playing field for all debates on the European future that will ensue.

Endurance of Euroscepticism

Recent records of almost all European post-communist countries confirms that the level of enthusiasm for EU integration was at its highest in the first years after the political and ideological changes of 1989. Rather strange at the time, but, the public in the former communist countries had overwhelmingly been supportive of the processes of integration despite the substantial lack of knowledge about the basics of the phenomenon and practical absence of debates about benefits and pitfalls stemming from it. In this regard accurate accounts have been offered by Riishoj who writes about the uninformed enthusiasm (2004), and Drulak on the consensus-making without debate (2001). However, as the candidate-countries have been nearing the Union awareness among the citizens and politicians alike about the complexity and challenges of the overall endeavor have been gradually emerging on the surface.

Ten years ago Taggart и Szczerbiak published relevant research on Euroscepticism (2002), analyzing party politics on the subject in the EU member countries and candidates for membership. Their proposed dichotomy of hard and soft Euroscepticism still holds despite notorious methodological difficulties in defining the term and specific influence over it of more than twenty different political contexts on the continent. Within their framework, hard Euroscepticism is principled opposition to the project of a United Europe, as such, exercised by the parties who urge their countries to withdraw from membership, while soft Euroscepticism is rejection of specific EU policies wherever the perception persists that national interest and trajectory of integrations are passing each other. Key findings from the Taggart and Szczerbiak study confirmed that in virtually all EU members and candidates political manifestations of Euroscepticism were alive well before Eastern enlargement. Although a decade ago most of them had been only randomly present and classified within the group of soft Eurosceptics, they had already been established as part of the European political discourse. However, political decision-making in the states in the aforementioned period was relatively relaxed due to the fact that the amount of citizens' Euroscepticism had not been substantially transferred into the support for the Eurosceptic political parties.

For a long stint, one central feature of Euroscepticism had been its informal affiliation with the populist and anti-elitist platforms on the continent. Rationale behind their position was easily observable: since its inception European integrations were widely conceived as a project of the European elites, so the ensuing populist criticism of it and the "anti-establishment" mobilization was a logical outcome (Taggart, 1995). However, a decade later in the unexpected twist of history citizens and elites find themselves on the same side of politics. A sequence of polls conducted by Eurobarometer in the period 1981-1999 found that on average between 8% and 17% of EU citizens have been firm that EU membership is not a "good thing" for their country. In mid-2007, 57% of EU citizens thought that the EU membership had been beneficial for their country, but, in mid-2011 only 47% supported the same view in a Eurobarometer poll (Stokes: 5). In the meantime, the European political elites have not indicated at all that they are ready to challenge the popular tide.

Russia and Eurasian Regionalism

In the last two decades there have been various efforts to institutionalize regional groupings on the Eurasian continent from the Commonwealth of Independent States (CIS) up to the latest attempts to reinvigorate the Eurasian Economic Community and behind many of them stood Russia. A Commonwealth of Independent States from Moscow's perspective has two rationales for emerging: maintaining the energy complex as unified as it was in the fallen federation and preserving "interstate community of belonging" with the new democracies many of which had never existed before the USSR. However, because of the political disagreements between Russia and other members, CIS has remained, in the words of Molchanov, in the zone of "rhetorical regionalism". By the end of 2004, more than a decade after its inception CIS had adopted more than 1400 documents in total, but, virtually none had been implemented in its entirety (Molchanov; 2011). Instead of politico-military union with at least coordinated trade, monetary and economic policies, the CIS of today is nothing more than a consultative forum. The announced common ruble zone never materialized, the status of Russian troops deployed abroad is negotiated on a bilateral basis instead of being agreed upon within the multilateral framework.

The most ambitious grouping in Euro-Asia, Shanghai Cooperation Organization (SCO) established in 2001 is a successor of the so-called "Shanghai 5" brought into being five years earlier for mainly managing border security. The organization has linked two Eurasian giants - Russia and China with a group of secularized Central Asian nations - Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan and officially proclaimed peace, security, stability and economic development as its chief objectives. Today its activities span from countering terrorism, drugs and trafficking in persons, to joint military exercises and cooperation in education, economy, trade and finance with energy cooperation at the top of the agenda (Molchanov, 2011). Regarding the nature and real ambitions of the SCO, at least two schools of thought exists in the West: the first is classifying it as essentially an anti-western alliance and gathering of semi-authoritarian regimes additionally confirmed by the fact that they have rejected USA's bid to be an observer in the organization. And the second group of authors argue that despite holding serious objections about the features of the globally dominant neoliberal-type of globalization, members of SCO are equally interested in "mutually

beneficial" cooperation with the leading Western nations (Molchanov; 2009). For both Moscow and Beijing apart from other arguments the organization is important for being the platform for harmonizing Sino-Russian relations without the presence of Western powers (Balcer & Petrov; 2012). Motives of other local nations for engagement in SCO though not stated are visible: neither Moscow nor Beijing are using conditionality which is the key instrument regularly applied by the EU for democratic transformation of the applicants before accession. Until now, no meaningful level of cooperation had been recorded between SCO and any of the European countries for obvious reasons: disparate political and cultural matrices and a lack of a common denominator which should be respected by both sides as a basis for durable partnership.

The Eurasian Economic Community (EurAsEC) is an old project whose facilitation was not possible in the early 1990-ties since its economic logic was pushed back by the regional security threats after the collapse of the communist empire. The EurAsEC was planned to be a tightly connected economic organization that would eventually lead to a single economic space (Molchanov, n.d.). However, the idea which initially envisaged covering nearly 40% of the total area of the Eurasian continent never penetrated outside of the former Soviet space and has not even been endorsed by two thirds of the former Soviets republics, suspicious of the eventual political components of the concept. In essence, Kremlin's vision for EurAsEC was (and still is) just another attempt for post-Soviet reintegration centered on the Customs Union between Russia, Belarus and Kazakhstan. It seems that the undeclared target of the organization is more to clash than to be complementary with the EU's foreign relations instrument - European Neighborhood Policy (Judah, Kobzova, & Popesku).

Moscow's vs. Brussels's Regionalism: Alternative or Modified Western Model

In the past decade the regime in Moscow started to increasingly define itself against the West; by overemphasizing the concept of "sovereign democracy" Russia is firmly pursuing autonomous development (Judah, Kobzova, & Popesku, 2011, p. 17). Pragmatic political reasons, but, historic experience as well, has contributed significantly to the Russian ambivalence towards the Western Alliances. Although influences of modernization have

been coming for centuries from the West perceptions of the ordinary people and the political elite in Moscow is that exactly the same side of the world is producing the biggest threats for the Russian state. According to the recent polls more than a half of the Russians believe that their country's relations with the leading European states will never be truly friendly (Balcer & Petrov; 2012). According to some observers, the Joint Statement on the Partnership for Modernization, issued at the end of the EU-Russia Summit two years ago is the most recent evidence of different political templates supported by both sides. While the main goal for Brussels through this document is to change, if possible, the Russian "discourse on modernization", for Moscow it means only importing Western technology and investments without executing meaningful institutional and structural reforms (Ibid).

The European Union during the last 20 years has been intermittently stabilizing or transforming the former communist states by exporting its norms and principles of good governance. From the Velvet Revolutions in 1989-1991 to the Color Revolutions a decade and a half later it appeared that the neighboring countries (including Russia) have been attracted by the democratic practices of the European Union (Johansson-Nogues; 2011). But, what is happening nowadays with the so called "automatic attraction" of the EU in the light of its latest deep financial and economic challenges, especially concerning the Russian Federation? Since the official opening of the bilateral relations between Moscow and Brussels, Russian people have been mostly supportive of political models coming from the West. At its peak in 1991 approximately 70% of Russians supported liberal democracy and market economy, but, the Russian favorable view of the EU persisted well into the 2000s (Shevtsova, 2011). However, in the period after the Kosovo War and coming to power of the new political leadership, the Kremlin has started to outline new political frameworks with the so-called "Russia-first" argument on the top. If 35% of Russians surveyed in 2000 declared that Western values and culture are destructive for their country, ten years later 57% were firm that the West/EU seeks to undermine Russia. Approximately in the same span of time the number of Russians who do not regard themselves as Europeans and sharing the same liberal values rose from 48% to 71%. And the most intriguing fact exposed by the recent surveys: 72% of the citizens replied that they "prefer order to democracy" (Johansson-Nogues, 2011, p. 15).

Having said that, an objective observer cannot ameliorate or justify mistakes done by the "other side". It is true that in the meantime instead of

being a defender and promoter of norms and values the EU has often produced dissonant views or maintained double track behavior which has ultimately undermined its moral authority and legitimacy. Nevertheless, it is a fact that since the fall of communism Russia has never risen above its own transitional problems and produced attractive political and economic models to be followed by its neighbors or the rest of the world. It is safe to say that in the long run Moscow will make a strategic mistake if it drifts apart from Europe since the western part of the continent beyond a doubt can offer valuable instances of modernization and successful transition from communism to democracy. Former communist states, now in the EU according to the relevant economic and democratic benchmarks are faring much better measures against all the others who have not been through the processes of conditionality and Europeanization. The western Balkan countries and Turkey, also, have made substantial progress since the EU recognized them as the potential candidates in 1999 and 2000 according to the various indicators on democratic credentials of the institutions from Freedom House to the World Bank (Borzel & Van Hullen, 2011). Instead of marching in step with the most advanced countries in the world Russia in the meantime has declined on indexes that project corruption, property rights and competitiveness. Experts consider that problems had been augmented by the huge capital flight from Russia, while the national authorities estimated that 1.25 million people have left the country in the last few years only (Judah, Kobzova & Popesku). Flexing muscles internationally has not helped Moscow even in the area of economy since the EU in the last decade has overtaken Russia as the main trading partner of the countries covered by the so-called "Eastern Partnership" (Belarus, Ukraine, Moldova, Azerbaijan, Armenia and Georgia) with the exception of Belarus.

At the same time despite Moscow's declarations of allegedly keeping equal distance to other poles of global power, an important political rapprochement between the Russian Federation and the People's Republic of China has taken place. When analyzing mutual support of Russia and China in the last decade clear strategic rationale from the arsenal of real politics is appearing on the surface. At the threshold of the century the crucial document, the Beijing Declaration, paved the way for an emerging strategic alliance structured on the platform of "defying hegemonism" (Beijing Declaration, 1999). Since that period, two countries established forums that have routinely excluded the West, such as the BRIC and Shanghai

Cooperation Organization, while in the meantime an unofficial “veto coalition” performed almost uninterrupted in the United Nations (Judah, Kobzova & Popescu; 2011). However, regardless of the political rhetoric, overall it looks like an uneasy partnership in which both sides strictly pursue their own national interests. The fact is that the economic relations are growing, but, they are increasingly imbalanced in China’s favor: in 2010 Russia counts for only 2% of China’s imports and bought only 1.9% of its exports. China has penetrated into the traditional Russian gas monopoly in Central Asia, while Russian arms exports to Beijing have been slashed down from 60% of the Moscow’s total export in 2005 to meager 6.7% in 2010.

Moscow, but Beijing and other regional capitals as well, have found one common denominator and several distinctive motives for their positioning towards the regional organizations. Defensive reaction against western-style globalization was the common ground for collective efforts, but China’s economic penetration in the region, Eastern enlargement of the European Union and Russia’s attempts to reassert itself in its “near abroad” figured prominently on the national list of priorities (Molchanov; 2009).

Asian Integration Paradigm

A sizable amount of literature on Asian regional cooperation has been predominantly focused on East Asia, and much less on other Asian regions, but there is still no consensus on the definition or features of Asian regionalism (Soderbaum; 2008). Regional institution-building in Asia according to some views is a clear example of tensions between western-centric and autonomous regional models of cooperation. Even the early proposals for global multilateralism which envisaged connecting most of the vast Eurasian land, such as the model initiated by the Conference on Security and Cooperation in Europe (CSCE) in the 1970-ties and later met with considerable opposition by China and other influential Asian nations (Acharya, 1997). To a certain extent, the Asia-Pacific region after the Second World War has not been explicitly open to multilateral institutions because of the undisputed hegemony of the United States of America over much of the bipolar world and after. Nevertheless, a much stronger reason has been the intention of regional nations to adapt and internalize universal principles of multilateralism in line with their specific political systems, cultural heritage and historical experience.

Asian Development Bank (ADB) study suggests that it is highly unlikely for the Asian countries to cope effectively with the challenges of globalization relying on the market forces and national undertakings alone. According to the ADB's findings, future transformations will ask for norms, rules, common vision and regional organizations to coordinate governments' actions. This huge region hardly needs new regional institutions since at present there is a total of 40 (Asian Development Bank, 2010). Some of them are overarching, umbrella organizations, others are geographically or functionally oriented for dealing with specific issues and areas. However, the prime goal for the existing organizations to be more effective is more power and competences to be assigned to them by the governments in the region. Precisely at this point lays the crucial Asian dilemma: it does not seem that local elites are ready to surrender parts of their national sovereignty to regional bodies.

Since its foundation in 1967 the preeminent Asian regional institution ASEAN (Association of Southeast Asian Nations) has been the bearer of all the essential trademarks of the so-called "ASEAN way" of regional cooperation. Four principles employed by the organization, deserve particular attention because they are giving distinctive character to this regional model of institution-building: open regionalism, cooperative security, "soft" regionalism and consensus (Acharya; 1997). ASEAN has not accepted the idea of centralized bureaucracy with decision-making authority. Since its beginnings the organization has developed a flexible framework of coordination undertaken by the national Governments without delegating sovereignty to a regional authority. "Soft" regionalism in the Asian context means "preference for evolutionary, non-legalistic methods and non-binding commitments". In Acharya's words virtually all Asian nations insist on a non-threatening atmosphere as more prone for problem-solving. Even China's "peaceful rise" preoccupying the world in the past two decades has never been described by them as a threat. In a similar discourse the nation of "confidence building" as allegedly more appropriate for describing "relationship among adversaries" not among the partners is dismissed (Ibid, pp. 334 - 336). Regional political arrangements always tend to center on negotiations among governments framed in a manner that does not endanger sovereign prerogatives in any way (ADP, 2010).

Establishment of multilateral institutions in the Asia-Pacific is an interest-driven process, but, identity-driven as well, involving ideas, regional cultural norms and a quest for a collective regional identity. This identity-

building is conditioned as much by historical, cultural and political self-perceptions as by the neo-liberal logic of the market-led integrations. On the continent ASEAN is widely considered an organization which is leading the way towards more institutionalized regional integration. Its members in 1992 committed themselves to the creation of a free trade area, adopted a Charter in 2008 and publicly endorsed the objective for creating the ASEAN Economic Community by 2015. The Charter established regional human rights and envisaged a rule-based community, especially in trade, finance and environmental areas. Nevertheless, the traditional "ASEAN way" involving cooperation through informal understanding is still firmly dominated by the principle of non-interference in the internal affairs of the members. The whole project is weakly institutionalized even including the "ASEAN plus 3" format where ten ASEAN members cooperate with the global economic powerhouses like China, Japan and South Korea.

Asian regional organizations have always been inclined toward adopting the so-called "convoy membership practices" – inclusive institutions open to a large membership virtually without preconditions. Such practices are generally contrary to the process of adopting the EU' *acquis communautaire* by the EU candidates (ADB; 2010). Decades long ASEAN gradual enlargement from 5 to 10 members was not based on previously declared objective criteria. However, deeper regional integration might require more standing organs and a secretariat with proportions similar to the one facilitating the activities of the European Commission in Brussels with an operating budget of 3 billion Euros annually. Therefore, the next big dilemma about the ways to improve efficiency of regional architecture will be how to define membership and compliance rules which is unusual in a region attached to the traditional notions on sovereignty.

ASEAN Way vs. European Way

One explanation of rationalists on the logic of regional cooperation concentrates on the economy and expected material gains from such transactions. However, their discourse is less convincing when explaining the lack of regional institutions in the parts of the world where the countries are engaged in the intense mutual economic cooperation like China, Japan and South Korea. In this regard, helpful contribution is coming from the constructivists' camp who argue that basic prerequisites for successful

integration are “sense of community” and higher “cultural affinity” among the respective nations (Borzel, 2011, pp. 4-21). Some authors are going even further by stressing significance of the shared political values among the participating states (Behr & Jokela, 2011). Although a complex and multidimensional phenomenon is able to single out four key elements in most of the regional projects: common geography, regular interactions on political and economic levels, shared regional perception, and outside recognition. Among the drivers of regional cooperation and integration, the socio-cultural values are the critical ones that could lead towards “cognitive regionalism” based on “shared linguistic, religious, historical and emotional affiliations” (Ibid., p. 14).

Eurasian regionalism has at least three areas in common: economy, security and opposition to the Western ideas of democracy-promotion and is developing quite differently from the European integrations - without foundational treaties or supra-territorial institutions or regimes. These are likely the prime reasons for the absence of substance and direction of regionalization processes in Eurasia (Molchanov; 2011) where local nations are unable to share common strategic vision and understanding of what makes their region distinct from its wider neighborhood. Different and at times competing national interests and concerns about Russian or Chinese domination in the region have produced uneven patterns of cooperation. In fact, the mode of Eurasian regionalism reflects key difference between Moscow security-driven and Beijing economy-driven models of integration. For some authors, the slow pace of regionalization in Eurasia is due to the lack of the local “engine”, a state or states that would be able and willing to navigate integrations politically. Practically all members revolve around the concept that models of political and social development should not be exported to other countries nor imported from the outside.

More generally speaking among the new and old regional powers with global ambitions no country is willing to support promotion of democracy outside of their borders in line with the long-standing Western practices. Virtually all of them, including Russia and China in the first place remain leading exponents of the pro-sovereignty, anti-interventionist approach to international politics (Carothers & Youngs; 2011).

Within the field of comparative regionalism two tendencies are remarkable about the relations between European and other regionalisms in the world. First, the perspective dubbed as Europe-centered, strongly

emphasizes values of the EU model and consider it as a reference point of each comparison in the field. The second approach reject the European experience as a general point of departure and instead emphasizes regional specifics and positions that each regionalism is a sui generis case (Soderbaum, 2011).

Many Asian policymakers dislike the notion that Asian regionalism is inferior compared to the European one. Some of them would eventually accept that the EU might be an inspiration, but, reject the thesis that Europe should provide a model for Asian cooperation (Acharya, 2008). One author opines that differences between Asia and Europe in this regard are shaped by four groups of reasons: history, foundational objectives, domestic political structures and security relations with external powers. First of all, Europeans are connected by a common religious and cultural traditions and collective problem-solving mechanisms which dated back as far as the early 19th century. To the contrary, Asia is much more culturally diverse with a poorer record in multilateral practices. Second, United Europe was made and transfer of sovereignty agreed in order to prevent another world war, while in Asia by promoting regionalism national elites of post-colonial countries have been eager to fully preserve sovereignty not to transfer it. Third, Western European states are politically and economically stabilized and it looks practically irreversible while Asian states have visible shortcomings in achieving political and social cohesion and the rule of law which prevent them from making more credible commitments to international cooperation. Finally, a pattern of regional security arrangements is different in two regions: in Europe despite the military preeminence of the United States *de jure* there exists multilateral military alliance, while in Asia is established the so-called "hub and spoke" system within which the US is bilaterally connected with several regional allies. As notified by Acharya, there is no presence of NATO in Asia and no regional organization is aspiring to assume either the role of the EU or the OSCE in election monitoring and democracy promotion. Despite the provisions in the ASEAN Charter there is still no effective regional human rights mechanism in place with a capacity to enforce its own decisions.

Despite occasional denials by the Asian politicians several EU ventures have already been emulated by them as a useful guide for internal organization and practical cooperation among the ASEAN members. For example, the organization has adopted a Constitution-like Charter in 2007, introduced an ASEAN Troika consisted of the former, current and future Head

of the Council of Ministers and recently established a dispute settlement mechanism. Members are commonly referring to the “three pillars” of the organization and have publicly announced their goal of establishing an Economic Community (Jetschke; 2010).

Conclusion

Beyond doubt, the current EU crisis is widening the political gap between its members and some authors are even alleging the “European clash of civilizations”. Within the suggested framework, the so-called Germanic bloc insists on austerity and rules, Latin bloc wants growth, while an Anglo-Saxon nations would like to relax connections with the Union (Leonard, 2011). However, no one among the relevant political subjects within the EU is mentioning alternative regional organizations or extra-European models of cooperation as a way out of the depressing situation. Even among the Nordic countries traditionally known as “reluctant Europeans” (Smoor; 2006, p. 43) no country has been looking for alternatives, including Norway which is not an EU member, but, for decades, de facto is behaving as one.

According to the latest Ernst and Young European survey the EU remains the world's largest regional destination for FDI with a quarter of all global investment landing within its borders (2011). Within the polycentric world the EU share of global FDI is slightly decreasing, but its attractiveness as a business destination remains strong. An important fact for the Balkan countries is that Central and Eastern Europe are positioned in the third place as the world's most attractive investment regions behind China and Western Europe. Last, but not the least important, Gallup's Potential Migration Index predicts that populations in some wealthy nations could see substantial growth due to the migration from the poorest countries and regions in the world. The very fact that on the chart of twenty of the most desired destinations by the migrants worldwide ten are members of the European Union (Esipova, 2010) speaks volumes about its preserved level of attractiveness despite the unprecedented scope of economic and financial turmoil on the continent.

As presented by some authors (Warleigh & Rosamond, 2011) studies of comparative regionalism should not condone bypassing the “most advanced instance” of regionalism in world politics – European regionalism. According to Borzel in virtually all vital areas: economy, political and security

cooperation, common administration and adjudication, decision-making and policy implementation, the European Union is far ahead compared to any other regional organization in Asia, Africa, South and North America (Borzel, 2011).

According to some comparative analyses, despite visible dynamism in recent years rigid focus on intergovernmental cooperation and principles of non-interference in the internal affairs has largely diminished prospects for deeper integration in Asia. Important contemporary issues such as human rights, environmental protection or labor standards are rarely or never tackled by regional organizations all of which lack supranational mandate. Security cooperation is mainly in the initial stages, complex border disputes and regional rivalries persist, a single market for goods and services does not exist. Described specifics of Asian regionalism leave extremely narrow maneuvering space for any European country to be eventually involved in the non-economic dimensions of Asian regionalism, let alone embraced by the organizations born and managed in a very different socio-cultural milieu.

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Permanent Structured Cooperation as an Institute of the Common Foreign and Security Policy of the European Union and its Significance for Candidate Countries

Mihail Stojanoski

Abstract

Permanent Structured Cooperation is a revolutionary new institute introduced in the European Union framework with the Lisbon reform treaty. It provides member states with a tool to improve the long standing problem of foreign and defence policy passivity and irresponsiveness. Though sounding quite progressive, it yet awaits to be implemented, and the road ahead seems full of obstacles. This paper first explains the essence of the institute, than deals with the problems of implementation of Permanent Structured Cooperation, its rewards and would-be hazards, as well as problems to be expected before and during implementation. Emphasis is being put on the special relation with the NATO alliance that will come to light as soon as Permanent Structured Cooperation comes into existence. The last part consists of an analysis of the impact that Permanent Structured Cooperation will have on candidate countries, especially the Republic of Macedonia, both as a potential reform and a soon - to - be reality.

Keywords: EU Common Foreign and Security Policy, Permanent structured cooperation, EU candidate countries, Macedonia

Introduction

At the dawn of the twenty first century the European Union yet remains a structure difficult to define in legal terms. *Stricto sensu*, the Union is not an international organization, even less a federation. It can only be defined through its founding treaties, as a *sui generis* entity. Using the words of John Ruggie (1993), "the European Union may be the first post - modern political formation." The one thing that makes the European Union differ from any

other political form in existence is the institutions that are endowed with supranational authority. They possess very real power to make very real calls that have a very real impact on the lives of everyday people. The agricultural, monetary, visa and asylum policies leading the way (although not being the only ones) are today led by the Union's institutions instead of those of the member states. The process described here is referred to as 'European integration'.

The process mentioned, being re-emphasized and re-explained over and over again, is a pioneer effort, and that very fact exonerates most of the mistakes made along the way. The Lisbon reform treaty introduced several novelties in the field of CFSP. Three new bodies were introduced; High representative for Foreign Affairs and Security Policy, Permanent president of the European Council and the European Foreign Affairs service. The decision - making process was thoroughly reformed as well as the defense policy, but bearing most symbolism, the Union was given legal subjectivity.

This paper will attempt to argue that:

1) The only way the European Union can assert itself as a worldwide defense factor is through capacity pooling and strengthening of the European Defense Agency;

2) Permanent Structured Cooperation (further on - PSC) is an excellent action plan to achieve the aforementioned and

3) PSC can be a double-edged blade for accession candidate countries, while making the Union to appear more attractive (and thereby, at least in theory, increasing their integration momentum) it makes the Union integration appear a never ending process (through forming a 'Union inside the Union'). The Permanent Structured Cooperation is a CFSP reform that is yet to come, if at all. None the less, its potential is huge, and it is only prudent to go into it in some detail.

What Exactly is PSC?

The efficiency problem of the European armed forces is well known: From around two million men and women in uniform all together, only ten to fifteen percent can effectively be fielded (Biscop, 2008). The reasons for such ineffectiveness are multiple: Unnecessary piling of institutions with overlapping authorities inside the Union, the existence of many small, ineffective capacities rotting in the barracks of member states, lack of

logistical unification and interconnection and so on and so forth. Although the reasons are clear, little is done on the field to correct such issues.

With the introduction of PSC, first introduced in the Lisbon treaty and restated in the Treaty of the European Union, a possibility is left open for a new level of integration of member states that decided they need deepening of cooperation in the field of defense. The beauty of PSC is that it operates from inside existing Union institutions and adds to them, rather than doubling them or minimizing their significance. The member states that choose to participate are given a certain functional autonomy on defense issues, which does not endanger the existence of the Union as a whole.

The PSC protocol to the Lisbon treaty contains two obligations for PSC participant states: One general, incalculable position formulated "To intensify the development of their defense mechanisms" though as proven so far by Union precedent, little hope can be laid in such declarations unless they serve another more explicit goal. Another more precise obligation "by 2010 all participating states must be prepared to take part in e.g. battle groups", following exact plans, deadlines and tasks. The tasks amount to "deployability" and "sustainability" of military units. Such a battle group needs to be able to deploy in thirty days at the latest and to perform its duties for a period of thirty to one hundred and twenty days initially.

The states that intend to participate have an obligation to notify the High representative and the Council, which at the end of a three month period of consultation decides by *qualified majority* whether to allow the formation of PSC, while at the same time confirms the list of participant states. Further on, there is a mechanism to leave PSC or be suspended from PSC without it bearing any consequence on the state of the Union as a whole. This gives PSC the appearance of an 'open club' that is founded on common interest rather than on obligation to participate. Any decisions in PSC are made inside the Council, where all member states of the Union sit and discuss, but only those participating can vote. We believe that this is the key factor that makes PSC a cohesive factor for the Union rather than a destructive force.

What Makes Permanent Structured Cooperation so Significant?

The *prima facie* advantage of PSC, when compared to similar, current and past proposals such as European Political Cooperation, the Western European Union, the Fouchet plan, and the Closer cooperation institute

among others, is that it can actually solve the problem of dichotomous ideas on further integration. Although some criticize the proposal as being opposed to the "general idea of European Integration" (Biscop, 2008; Santopinto, 2007), most agree that progress for some is still better than stagnation for all (Lellouche, 2001).

Launching such a partial integrationist project could create rifts between member states, and herein lies the main reason why PSC hasn't been launched yet. Therefore, the implementation of PSC has to represent a careful balance between effectiveness and inclusiveness - a problem which will be the biggest thorn in the foot for European leaders if one day PSC is to be brought forward.

Another significant advantage of PSC is its flexibility. The list of participating member states is not closed, states can opt in or out, and there is no minimum threshold for creation. PSC leaves the option for every member to choose how exactly it will participate. So, it can be said that the case present is a case of 'partial participation in a partial project' - essentially, everyone does what they want. The significance of this possibility is that it solves the problem of diverse views inside the Union on how defense integration should proceed.

The task of conducting PSC is to be taken by the European Defense Agency. Its mission is to coordinate all efforts and to oversee reform progress. Let's not forget that the European defense agency is *prima facie* a supranational body, and although participating states have the last say in PSC matters, empowering a supranational agency in such a way at least symbolically gives a direction in which European defense is to develop in the future.

Perhaps the one feature of PSC that will make most difference is the possibility for resource and capacity pooling. Today, all of the Union's member states strive to maintain a huge pallet of diverse military and defense capacities without really taking into consideration the needs or advantages of the European Union or NATO, for that matter. One could say that when we are talking about defense, essentially it is still 'every man for himself'. Such maintenance of "mini mass armies" (Pilegaard, 2004) results in resource fragmentation, having multiple institutions doing the same things and huge expenses while at the same time limited efficiency.

PSC offers the possibility of institutional pooling, thereby cutting down on expenses made on behalf of inefficient national armies. Pooling

possibilities are virtually endless: common requisitions, joined research projects, joined training facilities etc. Such experiences already exist, and they can be used as a foundation which PSC can expand on. Namely, France and Belgium already have a joint program for the training of pilots and a European airlift command center is already in function in which Belgium, France, Germany and the Netherlands take part. Such programs under PSC are expected to develop further and gain in significance. We also expect a strong spillover effect on other defense projects such as intelligence or airspace monitoring. Furthermore, considering the fact that many European countries already have their troops serving together on away missions, the creation of joint training programs is only a step away. Such pooling projects do not necessarily have to include all PSC participant states. Projects can be partial, and participation will be decided according to interest or capability. PSC will serve as a framework under whose coordination such projects will take place under supervision of the European Defense Agency (See Appendix 1).

Pros and Cons - What PSC Lacks

One obstacle standing in the way of PSC, at the same time being the common obstacle in European Integration is the fear of losing sovereignty. This fear is a generational problem and is slowly dissipating, but will remain a factor to be considered in years to come. We consider such a fear to be irrational for several reasons (regardless of its irrationality, however, the fear is no less real): First, due to enormous costs of defense technology research, many small countries are simply unable to follow technological development. By pooling together, even such small countries will be able to participate in larger research projects which will in time allow them access to new technology, which will consequentially, through implementing defense technology advancements grant them an advantage in the field of defense, thus providing more, instead of less sovereignty. Second, as things stand right now, for those states who are unsatisfied there is always a way out of PSC.

A problem which really stands in the way of PSC is the improbability for European leaders holding office for a limited time span to see a broader picture for European stability, or put better, their hesitancy. As a theoretical concept, the PSC project won the heart of Great Britain and its Prime Minister, as well as from several other European leaders. However, since the

Lisbon treaty is in force, PSC, notably, is being kept under the carpet. As an explanation, we believe that the Union suffers from reform fatigue as well as from expansion fatigue. Put simply, this generation of European citizens simply has had enough change.

Another truism is the fact that right now, the Union is preoccupied with the economical crisis as well as a very real bankruptcy of a few member states lurking in the dark, shaking the very foundations of the alliance. Common interests are fading away, and it remains questionable whether present mechanisms for crisis remedy are satisfactory.

Although the abovementioned is undoubtedly a fact, it is also true that integrationist efforts, seen through the prism of history are never easy. So, it can be subsumed that although now is not the right moment to talk about deepening of defense integration, for such a reform there might never be a right moment. So why wait? At the least, the PSC concept should be kept alive. This can be done through statements, non-obligatory declarations of the European Parliament and the High Representative. Otherwise, a brilliant idea might be forgotten, as though it never happened.

A serious flaw of the PSC concept is the lack of measurable criteria by which progress will be measured. Still, it is reasonable to predict that measures in this context will be developed if the proposal becomes active. Still, initial deadlines are necessary at this point if the PSC proposal is ever to become a reality.

Another reasonable fear in context of PSC is the dissatisfaction that will ensue inside the wider European Union. The division between 'those inside' and 'those unwilling to be inside' might result in fatal negotiations on other European Union issues where leverage for support for PSC decisions will be taken into account. A proposal to remedy a part of this problem is to launch the PSC initiative at the level of the European Council and to maintain involvement of non-participating member states to discuss PSC issues without the right to vote (Biscop & Coelmont, 2010).

Permanent Structured Cooperation and the NATO Alliance

An issue that is fearfully being addressed in the Lisbon treaty is the relation between a potential PSC in existence and NATO. PSC is a project that is intended to be independent and which can be used to the benefit of both NATO and the United Nations. If the specific goals of PSC are examined

it is obvious that their major parts overlap with the goals of NATO. Furthermore, any NATO member state that also participates in PSC could only benefit from it by increasing its military preparedness and technological advancement, thus contributing to overall NATO prestige and capacity. Essentially, the United States and Western European countries share much of the same values, such as free market economy, democracy and human rights. So, in the foreseeable future the relative increase in power of a European Union represented by a core of PSC states does not present a threat for the interests of NATO worldwide. Furthermore, a joint NATO mission where PSC states would participate actively would have an increased degree of legitimacy to take charge of missions that fall inside the scope of the United Nations, or even outside of it.

The only change that is anticipated inside the North-Atlantic alliance as a result of PSC is a possible creation of a two-pillar NATO where both parties share the same values and most of the same interests. Still, this would result in a relative drop in influence on the side of the United States, but from what is obvious so far, the US seems to approve the creation of a unified Europe on every level, defense included. This position is explained by the US needing someone to share the burden of responsibility for worldwide military action, now more than ever (Smith, 2003).

Impact of Permanent Structured Cooperation on Candidate Countries

PSC primarily is an institute of the Common Foreign and Defense Policy of the European Union, and as such, it is deemed to have a very small, if any at all, impact on accession countries and the expansion process of the European Union as a whole. Two separate models need to be examined: one where PSC is up and running, and one where PSC is a plan for the future or is *in statu nascendi*. Assuming that PSC is a reform that is yet to come, its impact comes down to being merely symbolic. In this scenario accession countries would focus on immediate general and country specific accession criteria, while taking a stand on PSC would only potentially complicate the accession process, most likely in the shape of being forced to make a choice between a group of member states that support the creation of PSC and those against.

Furthermore, the very fact of taking a stand might be looked upon as 'dealing with issues that are way over your head', and even as going into insider issues of the Union.

Looking ahead, it would be best if accession countries, the Republic of Macedonia included, would lead their defense policy independently, or as part of NATO or the partnership for peace. The possibility for an existing PSC at the moment of accession of a candidate country (a realistic scenario for the Republic of Macedonia) entails several different opportunities. One possibility is that candidate countries would lose their integrationist momentum due to the existence of another level of integration once they accede to the Union. The existence of PSC can even be seen as added criteria for membership, something that can only have a negative impact on the integrationist process.

An added problem is the perceived collision of PSC interests with those of NATO. Candidate countries might seek to balance, or believe that a choice has to be made between the two. Although at a global scale the interests of both organizations do not collide, at a micro level the whole ordeal might be seen as a 'zero sum game'. Considering the aforementioned, the stand taken by NATO (or the United States) regarding the accession of a single country might play a crucial role. None the less, initial signals seem encouraging (Nuland, 2008).

Another scenario is the one where a functional PSC makes the Union appear even more attractive for candidate countries. This scenario is way more likely for countries that do not look keenly on NATO, or represent a factor in regional security themselves and have enough leverage not to depend on NATO integrationist processes for the near future, i.e. Turkey and Serbia.

We need to stress that choosing PSC as an alternative to NATO might prove a hazardous political move. Firstly, we believe this because at this point, there is no clear reason for making a choice between the two integrationist processes. Furthermore, the European defense system, however promising, remains untested. Another alternative needs to be examined: that PSC will make the Union appear more attractive for all candidate countries. Those with greater defense ambitions will see it as a forum for development, while those with lesser ambitions as added security. However optimistic, we choose to give this scenario less probability.

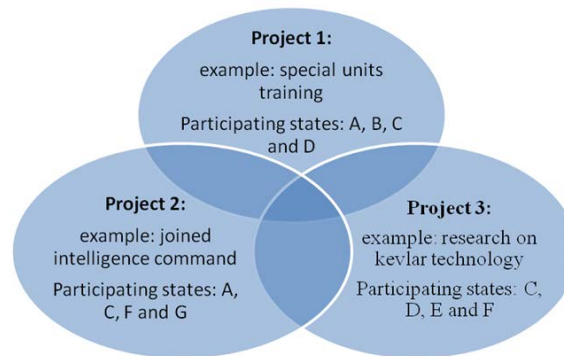
Conclusion

The issue at hand is not whether the European Union in the future will act together with NATO, the United Nations or unilaterally. That is a decision that will always be made in context. The issue is how far do European military ambitions go? So far the Union has proven an invaluable partner when it came to post-conflict reconstruction, conflict prevention (somewhat) and peace building, but it is nowhere to be seen when it comes to using brute force. Apparently, the Union has big ambitions when it comes to defense (bearing in mind the Petersbourg tasks), but the appropriate strength or willingness to act seems to be lacking. However ambitious, PSC does not offer an answer to all the questions. It is merely a project to improve military capacity inside the Union (De Flers, 2008), but it does not necessarily reform the process of defense decision-making. The rule remains consensus. Even now through consensus it can be decided that consensus is needed no more. So, no improvement there.

Whether the willingness for reform shown in the Lisbon treaty continues, remains a question unanswered. So far, it seems that the momentum has come to a halt, even though reduced expenses through pooling are more than wanted.

When it comes to relations with the NATO alliance, the initial appearance of interest collision seems faulty. Both blocks have overlapping interests and it seems that collision is highly unlikely. When it comes to accession and candidate countries, first of all the Republic of Macedonia, the issue seems clear. Wait and see. If nothing happens, keep quiet. If, however, something does happen (e.g. PSC is put into motion) the Republic of Macedonia should none the less focus on its accession criteria. Defense reforms are already being carried out under supervision of NATO, and it seems adequate that such reforms will also prove sufficient to fulfill any PSC requirements. If the day comes to make a clear choice on whether to enter a commitment such as PSC, we do not see any reasons why the Republic of Macedonia should pass. PSC would give the Republic of Macedonia a seat which brings a lot of leverage, influence and prestige.

Graph 1 - An example of PSC where different participating states take part in different projects



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Accession Conditionality as a Tool for Achieving Compliance Regarding Minority Protection Policy – A Rationalist Bargaining Approach

Katharina Crepaz

Abstract

After a relatively long period of neglect, the EU finally put minority protection policy on its agenda in the early 1990s, as the CEECs were now making their way towards accession and minority issues could therefore have posed a destabilizing threat to the Union as a whole. The importance of ethnic conflicts and their devastating potential for violence became all the more clear during the years of the Balkan Wars, making a commitment to protection and non-discrimination of minorities a vital security interest. The EU therefore made the protection of minorities part of its Copenhagen accession criteria, creating a gap between "old" member states (who often had very neglectful minority policies, e.g. France and Greece), and new members and candidates, who were now under pressure to change their approach in order not to endanger their accession. This paper therefore argues – in accordance with Schimmelfennig & Sedelmeier's (2002) External Incentives Model – that accession conditionality and the promised advantages are what entices states to comply, and that candidates make a rational cost-benefit calculation, in which they often decide to accept the EU's desired policies to profit from the assets of membership. Social learning processes offer much less explanatory capacity – if the adoption of the most appropriate rules was the case, the neglectful "old" member states would have adapted their policies to those publicly endorsed by the EU by now. In order to illustrate these hypotheses, a comparison between Greece as a long-time member and Croatia as a candidate and their respective policy development will be drawn.

Keywords: EU accession conditionality, minority protection policy, rational approach, Greece, Croatia, Macedonia

Introduction: EU and its Approach to Minority Issues – Past and Present

The EU has played a prominent role in advocating minority rights over the past few years, but this strong commitment has only been made recently. In its early years, the EU steered clear of going into the touchy subject of minorities, which in an ethnically very fragmented Europe could also always represent threats to state-sovereignty. Instead, the Council of Europe stepped up to the role of human rights champion in post-war Europe, presenting its *Convention for the Protection of Human Rights and Fundamental Freedoms* as the first European document on human rights in 1950. A general non-discrimination article was already present in this version, amended in 2000 by Protocol No. 12:

1 The enjoyment of any right set forth by law shall be secured without discrimination on any ground such as sex, race, color, language, religion, political or other opinion, national or social origin, *association with a national minority*, property, birth or other status.

2 No one shall be discriminated against by any public authority on any ground such as those mentioned in paragraph 1. (Council of Europe, Protocol No. 12 to the *Convention for the Protection of Human Rights and Fundamental Freedoms*; emphasis mine).

Besides this general prohibition of discrimination, no international commitments to minority protection were made in Europe, and the matter remained a purely internal state affair. A prominent case of a minority problem being internationalized was the German- and Ladin-speaking minorities in the province of Bolzano (South Tyrol), Italy. They had been granted certain rights (education in their mother tongue, e.g.) in the Treaty of Paris signed by Italy and Austria in 1946, but Italy was disregarding the commitments made. Due to the promised minority rights having been recorded in an international treaty and with the help of Austria acting as a kin-state, the case was brought to the U.N. in 1960. However, no solution was found, and the U.N. General Assembly told Italy and Austria to find an acceptable compromise on their own. This again shows that no international body was willing to get involved in

issues that could possibly pose imminent threats to state sovereignty. Therefore, having minority protection policies was also not an issue the EU took interest in when rating a possible new member's application. The matter was left completely to member states' decency, and if a country chose to opt for neglectful or even hostile minority policies, there was not much more than possible criticism from the Council of Europe to be expected as a consequence. This explains how one of the "engines" of the EU, France, could get away with very neglectful behavior, even denying the existence of minorities on its territory. To this day, France still has not ratified some of the most important international documents on the matter (see below); the same is valid for Greece, which will be investigated in more detail later on in my paper. In 1981, when the country of Greece joined the Union, no demands were made regarding minority protection standards.

Commitments to minority protection on the European level only really began to be made at a much later date: after the downfall of communism in the CEECs and the Baltic States, and especially after the Balkan Wars and their horrible instances of genocide that had sprung from ethnic conflict. In 1995, the Council of Europe drafted a specific document for minority policy, namely the *Framework Convention for the Protection of National Minorities*. Along with key documents by the OSCE, the *Framework Convention* is also nowadays used by the EU as a benchmark to rate applicants regarding their minority protection policies. The *European Charter for Regional or Minority Languages* was drafted in 1992, giving the Council of Europe a tool to protect minority languages but not minorities as such, as the Charter does not offer any kind of group rights.

As can be noted by the dates on which these new documents were made, progress in minority protection began to advance at a much faster pace after the downfall of communism in the CEECs and after the Balkan Wars. Strong ethnic tensions had led to these conflicts, and it became clear that issues relevant to ethnic groups and minorities could lead to a significant destabilization of the Union as a whole. From a security-policy point of view, action needed to be taken to prevent such outbursts in the future, and reducing conflict potential could only be achieved by dealing with ethnic questions, such as minority issues. In 1993, the OSCE created the High Commissioner for National Minorities' mandate. This new position was installed to enable direct involvement in conflict areas, using an approach of "quiet diplomacy": before publicly putting pressure on countries and maybe

even creating resentment or a backlash against the minorities present, the High Commissioner aims to find compromises and solutions through discrete talks with the parties concerned. The High Commissioner co-operates closely with the European Commission, especially with the DG Enlargement, and provides evaluation of minority situations in applicant and candidate states.

The EU itself has not established any kind of protection regime giving group rights, as this would fall beyond its competences. However, minorities can expect protection through various pieces of EU legislation that prohibit discrimination. Article 13 of the Treaty Establishing the European Community (TEC) establishes the Commission's right to "take appropriate action to combat discrimination based on sex, racial or ethnic origin, religion or belief disability, age or sexual orientation. This article constitutes the basis for the "Racial Equality Directive", adopted in 2000, and demanding equal treatment for people irrespective of racial or ethnic origin. "Membership of a national minority" was also included in Article 21 of the *Charter of Fundamental Rights*. The EU's approach therefore remains focused on human rights based on outlawing discriminatory behavior; this is underlined by the fact that out of the four Copenhagen accession criteria, only minority protection still remains merely a political and not a legal prerequisite for accession.

Membership requires that the candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights, respect for and protection of minorities, the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union (Copenhagen Presidency Conclusions, 1993).

All other demands made in this statement are now part of the *acquis*, while minority protection was too sensitive a topic to be included. This of course reduces the EU's leverage on the matter (Schwellnus 2004). However, accession conditionality has still proven to be a valuable tool for achieving compliance on the minority protection policy sector, and norm adoption or rule transfer without the use of conditionality is much less likely.

This paper therefore argues that before the EU had access to the tool of accession conditionality, applicants had no incentive to adjust neglectful minority policies to official EU standards and still to this day lack this kind of stimulus. Where conditionality is absent, rule adoption is less likely to occur

and develops at a much slower pace, if at all. A rationalist bargaining approach, like the one presented by Schimmelfennig and Sedelmeier in their *External Incentives Model* (2004) thus offers a more comprehensive explanation for this problem than social learning or lesson drawing models (Schwellnus, 2004). Without the often quoted “carrot and stick”, a change in policies is very difficult to achieve. As the case of Greece shows: a member for over 30 years, the country still preserves a hostile approach to the minorities present on its territory, denying their existence in most cases. Comparatively, I will shortly investigate the case of Croatia, where changes on the field of minority protection policies have gradually been made since the accession perspective for the Western Balkans was given. However, there are also internal factors that may hinder compliance, such as national identity functioning as a bias.

Divergences in Minority Protection Policies: A New Field for Research?

The gap between some of the “old” and “new” member states regarding minority protection has not been very thoroughly investigated yet; research has been carried out by Sasse (2008) regarding differences between the EU's “internal” and “external” approach to minority protection. The main focus regarding European Integration and minorities has been on minority situations in the CEECs over the last few years, e.g. research on minority protection in Romania, Hungary and Poland (Schwellnus, 2004), a single case study on the effectiveness and limits of EU conditionality in Slovakia (Fedorová, 2011) and a theoretical analysis of Europeanization in the CEECs (Grabbe, 2006), or comparisons of political conditionality in Slovakia and Latvia (Pridham, 2008). Latvia and Slovakia have been the most investigated cases in recent literature, as they offer two prominent examples of conditionality: Slovakia's change from the neglectful Meciar government to a more minority friendly executive was arguably influenced by EU conditionality, and Latvia faced considerable problems with its russophone community. The EU intervened using conditionality, but it also turned a blind eye to the shortcomings still present.

In a paper that has been very influential for accession conditionality research, Schimmelfennig and Sedelmeier (2004) provide two different accounts for how rule adoption occurs regarding the EU and new member

states: the External Incentives Model and the Social Learning Model. *The External Incentives Model* takes up a rationalist bargaining approach, arguing that states will adopt EU rules if the benefit of EU rewards will exceed the domestic adoption costs. If this is the case or not depends on the determinacy of the conditions and on the size and speed of the rewards that can be expected – the strongest reward possible is obviously being granted membership. Other important factors include the credibility of threats and promises, meaning that if accession could occur in the near future, the EU's leverage again increases; as well as the size of domestic adoption costs, and if they go against the preferences of the applicant states' government or other significant internal veto-players.

The second explanation is referred to as the *Social Learning Model*, taking a more constructivist approach. According to the *Social Learning Model*, countries are motivated by internalized values and norms, and when faced with alternative courses of action choose the most appropriate or legitimate one. The process of rule transfer is therefore not characterized by bargaining, but by persuasion, and by complex learning instead of behavioral adaptation. Rules are more likely to be adopted if a state identifies with the EU, and if the state's internal norms and preferences do not differ significantly from those of the EU. The EU is seen as a community of shared values and norms, and the adoption of these rules ensues because countries realize that the provided norms are the most appropriate ways of handling issues (Schimmelfennig & Sedelmeier, 2004).

As this paper was written in 2004, the theories present have mostly been applied to the CEECs until now. I would like to test if the *External Incentives Model* also offers explanatory capacity for the Western Balkans, Croatia in this case, and if external incentives and conditionality are indeed the strongest methods for achieving compliance. If, contrary to my assumptions, Greece presented signs of rule adoption, this would function as a case in point for social learning models, since conditionality and external incentives have been absent in this case.

In a comparative paper dating back to 2003, Schimmelfennig, Engert and Knobel introduce the notion of "reinforcement by reward" regarding conditionality. This refers to "the expectation that, after a certain time, the actors subjected to reinforcement will stick to a pro-social behavior in order to avoid punishment and continue to be rewarded" (Schimmelfennig, Engert and Knobel, 2003, p. 496). Also noting the strong leverage that conditionality

possesses, Schimmelfennig and Lavenex (2009) carried out a study on rule adoption and found that norm transfer is more likely when a hierarchical mode of governance is chosen.

Freyburg & Richter (2010) make an important contribution to research on the limits of conditionality, saying that national identity needs to be taken into account as a constructivist factor in rationalist bargaining models. National identity acts like a filter through which governments look at EU policy guidelines: “it biases choices so that certain behavior is discounted as inappropriate for national identity” (Freyburg & Richter, 2010, p. 266). As national identity plays an important role in the Western Balkans, as well as in my cases of Croatia and Greece, an in-depth analysis of how this may have impeded compliance and rule transfer represents an interesting field for future research.

The Western Balkans will provide the future main area of interest for conditionality research, as they are the next countries who will join the Union. Croatia has already been given an accession date (July, 2013) and in December 2011, the accession treaty was signed by the EU member states. A referendum was held on January 22, 2012, with the result of 66% of voters being in favor of joining the Union. Croatia has ratified the treaty in March 2012. Serbia has been granted candidate status on March 2, 2012, and as the Serbs constitute the largest ethnic minority in Croatia, it will be especially interesting to witness the impact of EU accession on this situation. The Republics of Macedonia and Montenegro also hold candidate status. Macedonia's road to EU accession will also offer many possibilities for research on the minority sector, because of the country's ethnic diversity and because of the ongoing conflict about names and national symbols with Greece. The predominant prediction in literature so far (e.g. Sedelmeier, 2008) is that compliance with EU norms will be more difficult to achieve in the Western Balkans than in the CEECs, due to higher adoption costs and because more salient issues such as state sovereignty and national identity are at stake.

Case Studies

Croatia

Croatia became an independent country in 1991, after being part of the Socialist Federal Republic of Yugoslavia. The first democratic elections were held in 1990, and saw the predominant Communist Party replaced by the Croatian Democratic Union (HDZ), who endorsed Croatian sovereignty. The Serb population, to the day this the strongest national minority in Croatia, did not benefit from the country's independence: its status was reduced from a constituent nation to a national minority, and many Serbs working in the public service sector were forced to leave their posts in the shadow of the Yugoslav Wars in the early 1990s. Under-representation and discrimination were especially high in the police force, the judiciary and in education (Petričušić, 2004, p. 6). According to the 2001 census, the Serbs are still the largest minority in the country, even though the ethnic conflicts have reduced its population by a large margin and refugee return is only occurring slowly. They are at one third of their 1991 strength, numbering 201,631 ethnic Serbs and making up 4.25% of the country's total population. The downfall of Yugoslavia and the nationalist policies that ensued in Croatia have in fact seen a very significant decrease in minority population overall: it went from 22% in 1991 to 8% in 2001, rendering it very interesting to see which direction this development has taken in the last 5 years. The second largest minority are the Bosniaks with a population of 20,755, followed by the Italians in Istria (19,636), Hungarians (16,595), Albanians (15,082), Slovenes (13,171), Czechs (10,510) and Roma (9,463). The Italian minority is very active and well-protected, as it had already been under the Yugoslavian rule – having a Western European kin-state surely helped in achieving protective measures (Minority Rights Group International 2008: Croatia).

Croatia had already installed minority protection legislation shortly after its independence, but most measures lacked actual implementation. The first law on minority protection was the Constitutional Law on Rights and Freedoms and the Rights of Ethnic and National Communities or Minorities in the Republic of Croatia. The passing of this law was mentioned by the international community as a prerequisite for the recognition of Croatia as an independent state (Petričušić, 2004, p. 8). This provides a first instance of conditionality and the country complying with the demands made. As non-

compliance would have led to unacceptable consequences, e.g. the country becoming marginalized as a state not even existent in the eyes of the Western world, Croatia complied and implemented the Constitutional Law. Despite this step in the right direction, discrimination especially against the Serb population continued in the country, fueled by the Tudjman government and its strong focus on ethnic identity.

The parliamentary elections of 2000 marked a turning point in the country's approach to minority protection policy, new laws regarding education in minority languages were implemented and compliance with the ICTY started to take place. In 2002, Croatia drafted the *Constitutional Law on National Minorities*, which granted minority language education, non-discrimination and participatory rights. The OSCE High Commissioner on National Minorities positively commented on this law, saying it was in line with the *Lund Recommendations* the organization had issued (Minority Rights Group International, 2008: Croatia).

In the meantime, the EU had made progress towards the future rounds of enlargement. The 1993 Copenhagen Presidency Conclusions mentioned the protection of minorities as a prerequisite for joining the EU, and the Santa Maria da Feira Council in 2000 opened the membership perspective for the Western Balkans: "The European Council confirms that its objective remains the fullest possible integration of the countries of the region into the political and economic mainstream of Europe through the Stabilization and Association process, political dialogue, liberalization of trade and cooperation in Justice and Home Affairs. All the countries concerned are potential candidates for EU membership" (Presidency Conclusions, Santa Maria da Feira, 2000). Croatia therefore knew that compliance was necessary to achieve its goal of joining the Union, and in October 2001 a Stabilization and Association Agreement was signed. However, the EU retained the right to suspend the agreement if demands made on the human rights sector were not fulfilled (Miller, 2004). Besides granting incentives, the main one of course being future membership, the EU also made arrangements to be able to withdraw already granted perks based on non-compliance, using both "carrot" and "stick".

In 2003, Croatia applied for EU membership, and was granted candidate status in June 2004. In its Opinion on Croatia's application for membership, the Commission honored the commitments made so far, but also noted that improvement still needs to be made, especially regarding

representation of ethnic minorities in the judiciary and in administrative bodies. It also criticized the lack of minority media, and ongoing societal discrimination particularly against the Serb and Roma minorities (European Commission: Opinion on Croatia's Application for Membership of the European Union, 2005).

Croatia therefore seemed to be on a stable road towards membership, but the 2005 Progress Report issued by the Commission slowed the present enthusiasm down. The Commission criticized the slow implementation of the 2002 *Constitutional Law on the Rights of National Minorities*, especially regarding minority representation in local bodies. It also noted that minorities were still under-represented in the public sector, and that no numbers were available regarding how many civil servants and judiciary workers belonged to national minorities (Progress Report on Croatia, 2005, p. 20-21). Progress was made in the sector of Roma inclusion, where the country signed an action plan. This supports the findings of Rechel, who carried out his analysis for the CEECs: "One of the main concerns for the EU was the potentially destabilizing role the large Roma population could play for the enlarged EU and it aimed to put their integration onto the agendas of candidate countries" (2012, p. 11). However, the main shortcoming was lack of compliance with the ICTY regarding the arrest of war criminal Ante Gotovina, leading the Chief Prosecutor to note that Croatia was no longer fully cooperating. The EU reacted to this development, and on March 16, 2005 the Council decided to postpone the start of accession negotiations (Progress Report on Croatia, p. 24).

Faced with the EU's strongest possible leverage, the withdrawal of potential membership, Croatia implemented an Action Plan to hasten progress on the matter. ICTY compliance is not directly related to the minority sector, but it is closely connected to the problems of national identity and ethnic conflict, making it a comparably delicate issue. Willingness to comply on the ICTY sector might indicate that if a credible threat regarding possible loss of membership perspective is made, Croatia will consider responding with compliance even on highly salient issues. Cooperating on the arrest of a war criminal that was still considered to be a hero by a considerable proportion of the population was certainly an endeavor with high costs, especially on the internal level, but the benefits of EU membership being at stake prompted the country to comply. In October 2005, the Chief Prosecutor noted that cooperation was now making sufficient progress, and in December 2005 Ante Gotovina was arrested in Spain.

In 2010, Croatia amended prior laws made with the *Constitutional Act on the Rights of National Minorities*. The main target area was the political representation of minorities, especially regarding seats in local-self government entities. As this had been one of the EU's main points of criticism, and therefore represented a possible hindrance on the way to EU accession, it seems logical that Croatia would take action on the matter. Political representation particularly concerns the Serb minority groups, who tend to be under-represented and discriminated against in local ethnically Croatian-dominated entities. Serbia was granted candidate status on March 2, 2012; it is therefore now officially on its way towards membership, and minority situations need to be settled between the two countries in order to avoid possible conflicts during the accession process.

It is important to note the big part conditionality has played in inducing Croatia to establish changes regarding minority protection policies. Without the goal of EU membership and the obligations that came with it, Croatia would not have implemented minority protection measures like the ones present today. The credibility of both threats and promises was high: the EU would deny membership in case of non-compliance, and as the membership perspective for the Western Balkans was open since Santa Maria da Feira in 2000, it was likely that the Union would honor compliant behavior with further steps towards membership. Croatia's progress on the minority policy sector clearly coincides with its rapprochement towards the EU, as the country was given an incentive to correct its neglectful course and to adopt a more minority-friendly approach. The Union also reprimanded Croatia for non-compliance, making it clear that this was an important topic regarding its progress towards accession. It can therefore be concluded that without the EU membership perspective, the advancement of minority protection in Croatia would have happened at a slower pace; arguably, it would not have ranked high on the political agenda to implement minority protection measures, as issues of high salience such as national identity are affected by this topic. However, when EU accession is at stake, even high internal adoption costs are often overcome by the foreseen benefits of future membership.

It can therefore be concluded that accession conditionality is a very powerful tool to achieve policy adoption. But as the case of France and its recent neglectful or even hostile treatment of the Roma population shows, once a country has entered the Union, there is not much to be done to force a

member state to change its minority policies, even if they are quite openly discriminatory. Even in fields that are part of the *acquis*, such as general anti-discrimination regulations, countries may find a way to circumvent the law: in France, financial benefits were promised to Roma who would return to their home countries – rendering it a repatriation based on “free will”. It will be very interesting to witness the unfolding of Croatia's way into the EU, and particularly to track if the way towards favorable minority policies continues or if progress slows down once membership is reached. The Western Balkans will probably prove to be a very fruitful area for future research on ethnic and minority issues; as EU membership is also seen as a means to stabilize the region and prevent further conflict, minority issues will need to be put on the agenda and settled in a European context.

Greece

Greece has been a member of the European Union since 1981. Due to the country having been part of the Ottoman empire until 1827, a Turkish minority population is present; it mostly resides in the area of Western Thrace. In 1923, a population exchange was established in the Treaty of Lausanne, making for the exchange of almost 2 million people between their respective kin-states Greece and Turkey. The Treaty also to this day remains the most important document for minority protection, as it establishes the presence of a largely Turkish Muslim minority in the country. The Muslim minority is the only officially recognized minority in Greece. It must also be noted that Greece only accepts a religious minority – ethnic diversities are not acknowledged or even denied. This becomes apparent in the official stance on the Macedonian question: speakers of Slavonic languages are seen as ethnic Greeks speaking a different language (Minority Rights Group International, 2011: Greece).

Like Spain and Portugal, Greece also has a history of dictatorship. In 1967, the Colonels tempted a first coup d'état, forcing king Constantine to flee the country. In 1973, kingship was abolished and dictator Papadopoulos declared himself president. The junta subsequently wanted to invade Cyprus, then run by Archbishop Makarios. The Greek invasion prompted Turkey's reaction, who in turn occupied the North of the island. The Greek-Turkish conflict in Cyprus has not been settled to this day, and will prove to be a major obstacle on Turkey's way into the EU. In 1974, the dictatorship was

overthrown, and Greece became a republic in 1975. Accession negotiations to the then EEC began in 1976, and the adhesion treaty was signed in 1979.

A report compiled in 1982 as an official EU document shows that minority policies were not on the agenda during negotiation and accession. Greece was promised help and special measures on agricultural policy and industrialization, as the EU noted that it lagged behind on these instances. There was also a section on human rights present; however, it only evaluated general constitutional human rights, and did not comment on the minority situation at all. The report strongly focuses on agricultural and economical evaluation, providing detailed lists of the country's produce and monetary outcomes. Social policy only plays a minor role, and it is not scrutinized in the domestic context, but more regarding possible large workforce movements from Greece to EEC countries that the Community wanted to prevent.

As the Greek census does not ask about belonging to an ethnic minority, the minority populations present in the country can only be estimated, and the sources cited differ significantly according to the political side they are used by (the Greek government tries to downplay the number, while minority organizations are likely to overestimate it, especially regarding those speakers who actually identify themselves as ethnic Macedonians and not just as speakers of another language). The biggest minority present in Greece today are the Albanians (4.28 % of the population – counting those who are not yet Greek citizens), a group who has largely come into the country because of economic immigration (Minority Rights Group International, 2011: Greece).

Discrimination is reported as being a frequent phenomenon in Greece, especially regarding the Roma and Albanian minorities, who are not seen as ethnic Greeks. Besides the above mentioned Turks in Western Thrace, none of the other minorities present in the country receive publicly funded education in their mother tongue (Minority Rights Group International, 2011: Greece). The neglect of specific policies for ethnic minorities seems to be defining the official policy line; by simply disregarding the existence of minorities on its territory, Greece is free from constraints to take action in any kind of way. The EU does not possess any kind of leverage regarding the minority question if the country is already a member. As minority protection is not part of the *acquis*, no treaty infringement procedure can be run against the country, and besides general non-discrimination rules, protecting minorities remains in the discretion of the member state alone. However, other

international organizations such as the Council of Europe and the OSCE expressed their concerns on the situation of minorities in Greece.

In 1999, there was considerable discussion in Greece about the government's recent adherence to the Copenhagen Document, drafted by the OSCE in 1990. The Copenhagen Document provides extensive articles about the protection of minorities, noting that "to belong to a national minority is a matter of a person's individual choice" and that "persons belonging to national minorities have the right freely to express, preserve and develop their ethnic, cultural, linguistic or religious identity and to maintain and develop their culture in all its aspects, free of any attempts at assimilation against their will" (OSCE Copenhagen Document, 1990). The Document also specifically underlines the group rights dimension by stating that "Persons belonging to national minorities can exercise their rights individually as well as in community with other members of their group". Discussions in Greece revolved mainly around this granting of group rights, seen by many as paving the way for minorities to demand their right to self-determination and maybe cause losses of territory.

The second point that caused arguments was the fact that each person was free to decide if they belonged to an ethnic minority or not. This rendered state recognition unnecessary; a minority was present if people declared themselves to belong to it. The OSCE High Commissioner for National Minorities, Max van der Stoep, explicitly stressed this in a statement issued after the polemics in Greece: "A second misunderstanding is that in order to acquire or enjoy the rights mentioned in the Copenhagen Document a minority will have to be formally recognized by the State. The Copenhagen Document makes it clear that this is not necessary" (Statement by the HCNM on minorities in Greece, 1999).

The question on minorities in Greece had been brought to the forefront by 13 members of Parliament belonging to minorities, who had raised a Parliamentary Question to the Greek minister of foreign affairs regarding the ratification of the *Framework Convention for the Protection of National Minorities*. Greece had signed the Convention in 1997, but has to this day not ratified it. The Minister's response was that the ratification was a matter of time, and that:

All Council of Europe states that have to this date ratified the Framework Convention, among which Germany, have made interpretative 'declarations', on the basis of which they either limit the Convention's application to specific minority groups, which they name in the text of their declaration; or determine particular criteria on the basis of which they will identify the national minorities present on their territory and to which, as a result, this Convention will apply. (Parliamentary Question, 1999).

In regard of more than 10 years having passed since this statement was issued, a commitment to ratifying the Convention in the near future seems unlikely. Also, the assumption about the declarations made by other states is incorrect: only 11 states have issued such statements or made reservations regarding the minorities the Convention applied to in their territory. However, even the small concession made by the Minister that ratification of the Convention was under way created outrage among the Greek media. This indicates that social learning processes have not been present or at least have not had much impact on the way public opinion in Greece sees the minority question. Even though the country had already been an EU member for almost 20 years when this discussion took place, no signs of rule adoption or adhering to norms promoted by the EU can be noted. The *Framework Convention* functions as the main benchmark that applicants are measured by before joining the EU; Greece not ratifying the Convention therefore means that it refuses to implement minority standards that the Union demands from its new members.

Among the minorities most strongly demanding recognition is the Macedonian group, represented by the Rainbow coalition in the Greek parliament. However, the relations with this minority remain very frail, as do the general relations between Greece and Macedonia. Macedonia declared independence in 1991, and its official name is Republic of Macedonia. Greece saw this choice of name as a threat for its territorial integrity, because of the Northern Greek provinces that also run by the name of Macedonia. It argued that the Former Yugoslav Republic of Macedonia, by choosing the name Macedonia, was making demands to include these provinces in its territory. After Macedonia's independence, Greece prevented the country from joining the U.N., and it imposed an embargo that brought Macedonia close to economic breakdown. In 1995, a truce was reached under the leadership of

Cyrus Vance: Greece forced Macedonia to change its name to Former Yugoslav Republic of Macedonia, to write an article in its constitution that it would not threaten Greek territorial integrity or interfere in Greek internal affairs, and to change its flag. The Macedonian flag had been displaying the sun symbol used by Alexander the Great, showing its nation as descending from a statesman claimed by Greece as one of its main national symbols. The constitution article prohibiting any interference in inner-Greek politics also makes it very difficult for Macedonia to act as a champion and kin-state for the Macedonian minority in Greece. Macedonia holds candidate status, but it is likely that Greece will try to counteract accession, as it is still doing regarding Macedonia's accession to NATO. Regarding this case, hearings for the lawsuit filed by Macedonia against Greece took place before the International Court of Justice in 2011. Macedonia accuses Greece of violating the 1995 agreement, which stated that Macedonia can enter international organization as long as it goes by the name of Former Yugoslav Republic of Macedonia. Greece's refusal of Macedonian NATO accession in 2008 stands against this principle (SETimes, 2011). In December 2011, the ICJ ruled that Greece had indeed violated the principle present in the treaty, and warned the country not to repeat this action. As long as this hostile background between the two countries is present, any kind of recognition for the Macedonians in Greece remains unlikely. Social learning processes would have led to a more favorable climate for minorities. If the country accepted the EU's norms as most appropriate and chose to follow suit, the door would be open for at least a gradual process towards recognition of ethnic and not only religious minorities. However, with a conflict so salient for national identity taking place, rule adoption processes will not occur. It will be very interesting to witness how this situation evolves as Macedonia makes its way towards the EU.

These recent developments show that if social learning processes are present in Greece, they are certainly not strong enough to bring about change in society and rule adoption. Greece has signed the benchmark document, the *Framework Convention for the Protection of National Minorities*, but as long as it is not ratified this commitment remains an empty shell. International organizations like the Council of Europe and the OSCE, along with NGOs like Human Rights Watch, have spoken out about the minority situation in the country, noting that improvements need to be made. However, none of these organization possess any leverage to provide consequences in case of non-compliance; the credibility of threats is not maintained. Greece has no reason

to change its policy on minorities, as continued neglect will not lead to any worsening of the country's stand in the EU. Demands made by the EU mainly concern the financial situation and the aid given during the financial crisis, and minority protection is not ranked among the provisions the country has to fulfill.

Conclusions

In the present paper, I have tried to show that without EU conditionality, compliance with official EU norms regarding minority protection policy is very difficult to achieve. This accounts for the large discrepancies still present between some of the "old" and the "new" member states who joined in more recent rounds of enlargement. Since it has made the protection of minorities part of the accession criteria, the Union demands that applicants fulfill certain standards before achieving membership; one of the benchmarks used to evaluate candidates' performance is the Framework Convention for the Protection of National Minorities, drafted by the Council of Europe. If a candidate does not comply on certain measures, the EU can withhold the membership perspective or at least slow down or suspend the accession process, giving it a tool with high credibility of threat that in most cases successfully reaches compliance. Faced with the threat of not being accepted into the Union, countries will make a rational cost-benefit calculation and consider their options (Schimmelfennig & Sedelmeier, 2004); in most cases, the benefits of EU membership will outweigh the domestic costs of complying on a particular matter. The EU has made a credible promise by opening an accession perspective, and it is therefore likely that the country will indeed be granted its promised reward if it acts according to EU norms. Depending on what the consequences of non-compliance could be, accession conditionality may also force countries to change their policy on issues of high salience, such as subjects concerned with national identity. The case of Croatia and the ICTY shows that as the EU delivered a credible threat (the suspension of accession negotiations), the country considerably increased its efforts to cooperate, despite the fact that the treatment of General Gotovina as a war criminal was a very contested issue among the Croatian public. Denying accession is the strongest leverage the EU possesses, and it represents a very useful tool when dealing with issues that are strongly connected to national identity and ethnic conflicts. Even though the protection of minorities

remains a purely political criterion, the EU is able to force considerable progress by the use of conditionality during the accession phase. Laws and concessions made regarding minority protection in Croatia would have happened at a slower pace, if at all, without EU involvement. EU membership functions as a very strong pull-factor, and it is able to overcome domestic concerns even on issues of high salience such as national identity. Croatia represents a very interesting field for research on this problem, as identity and sovereignty issues rank highly among the internal political priorities, and any further developments now that the accession date has been given will also prove to be a fruitful field for ongoing investigation. Once the new member state has entered the Union, achieving compliance on the matter could be a considerably harder task, as minority protection is not part of the *acquis* and no legal measures can be taken to enforce it. However, it has to be noted that even though conditionality has proven to be a viable measure, it does have its limitations. The main concern is that while legislation may be installed on paper, the implementation may not be sufficient.

When a country has already joined the Union, compliance regarding minority protection is much less likely. As the case of Greece shows, a country that is already a member state does not have many incentives to comply, because no credible threats can be made. Without the possibility to deny accession, the EU's leverage decreases considerably, and since minority protection is not part of the *acquis*, no other consequences can arise for the member state. International organizations such as the OSCE, the Council of Europe and NGOs may express their evaluation of the matter, but they also do not possess the capability to make a credible threat. The only possibility is to attempt a procedure of "shaming", e.g. inducing the country to comply by publicly noting its non-compliance with recognized protection standards. However, this is only viable when the country desires to adhere to a community of values and norms and wants to be seen as a member of said community. If this is not the case, "shaming" loses its power, as the country does not care about its reputation on this particular matter, framing it as one of only internal importance. Looking at Greece, it is unlikely that social learning processes have occurred at a larger level: the reactions regarding the Macedonian minority's demands prove that rule transfer has not taken place, and that EU-promoted measures are not seen as the most appropriate way to handle the minority issue. When dealing with an issue so important for national identity, countries are very reluctant to make any commitments that

could weaken their position, or even pose a threat to territorial identity. Without an incentive from the EU, both in form of “carrot” and “stick”, and the following cost-benefit calculation that usually favors the adoption of EU norms, compliance regarding minority protection policies is unlikely and very difficult to achieve.

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Implications of EU2020 Targets and Indicators on Social Inclusion and Poverty in Macedonia

Maja Gerovska Mitev

Abstract

As a European Union (EU) candidate country, Macedonia is formally obliged to comply and adjust its social policies with the new Europe 2020 targets. In the social domain, this implies increase in employment and tertiary education rates, combined with the reduction of poverty and social exclusion. In addition to the targets, the Europe 2020 proposes new indicators according to which progress should be measured. Taking into consideration the negative structural conditions, such as high unemployment and poverty rates in Macedonia, it is expected that the new EU framework will have major implications on the national social policy agenda.

The aim of this paper is two fold. First, by providing comparative data on poverty and social exclusion in the EU member and candidate countries based on Europe 2020 indicators, it strives to show the differences in poverty rates measured according to a variety of indicators. Secondly, by applying the Europe 2020 estimations of poverty and social exclusion in Macedonia, it attempts to show the differences in poverty rate as well as categories at risk with those generated from the current official data in the country. Apart from these two general aims, this paper also assesses possible implications from the Europe 2020 in relation to strategic redefinitions of the national social policy. In addition to the literature review and comparative statistical analysis, the work in this paper is also based on quantitative research, involving a representative sample of 1602 households, whose responses formed a basis for calculating poverty and social exclusion in Macedonia, according to the Europe 2020 indicators.ⁱ

Keywords: EU2020, material deprivation, poverty, jobless households, social exclusion

Poverty and social exclusion have been two interconnected phenomena which have preoccupied social policy agendas on a global level. Their effective tackling has been to some extent hindered due to lack of coherent, comprehensive and comparatively acceptable ways of defining and measuring these social phenomena. The European Union, along with other international agents, has contributed in the past decade towards a clarification of indicators and targets which represents an important step forward in combating poverty and social exclusion. First, EU indicators for poverty and social exclusion were agreed upon at the European Council meeting in Laeken, in December 2001, and then amended in June 2006. The portfolio for measuring social protection and social inclusion process included 14 overarching indicators (+11 context indicators) in the three policy strands - social inclusion, pensions, health and long term care. The most recent EU approach in relation to social indicators has been adopted at the June 2010 European Council, through the Europe 2020 agenda, with its aim of achieving smart, sustainable and inclusive growth.

While such indicators provide a chance for a more progressive and inclusive social model both on a national and supranational level, we should be aware that they only "tell us about the aggregate situation of people, but little or nothing about the quality of their experiences" (Stubbs & Gerovska-Mitev, 2008, p.23). On the other hand, not having or utilizing these social indicators also hinders the possibility of effective social policies that can potentially improve the quality of life of the most vulnerable populations. Such social indicators are particularly important for Macedonia, as a country which on the one hand experiences higher rates of poverty and on the other lacks harmonized, comparative and disaggregated data on poverty and social exclusion.

Targets and Indicators on Poverty and Social Exclusion in Europe 2020

Since June, 2010, the European Union (EU) has replaced its Lisbon Strategy with the Europe 2020 Strategy. The focus on poverty and social exclusion in this new Strategy may be seen through its headline targets, flagship initiatives as well as the integrated guidelines. Their achievement and operationalization is set through:

- a) Five reinforcing EU-wide headline targets, one of which is primarily focused on poverty and social exclusion: “promoting social inclusion, in particular through the reduction of poverty, by aiming to lift at least 20 million people out of poverty and exclusion. The anti-poverty target is based on a combination of three indicators: the number of people at risk of poverty (whose total income is below 60% of the median national equivalised household income), the number of people suffering severe material deprivation (the number of people living in households who can not afford at least four items out of a list of nine: 1. to face unexpected expenses; 2. one week annual holiday away from home; 3. to pay for arrears; 4. a meal with meat, chicken or fish every second day; 5. to keep home adequately warm; 6. to have a washing machine; 7. to have a colour TV; 8. to have a telephone; 9. to have a personal car), and the number of people aged 0-59 who live in jobless households;
- b) Seven flagship initiatives, including one with the particular theme of poverty - “A European Platform against poverty”; and
- c) Ten Integrated Guidelines, the last of which focuses on promoting social inclusion and combating poverty (European Commission, 2010).

Despite welcoming the “stronger legal base” (Daly, 2010), improvements in the “ideational and operational components” (Ferrera, 2010) and a “strengthened social dimension” (Zeitlin, 2010), the new Europe 2020 framework and particularly the potential of its poverty and social exclusion targets and indicators, have been widely criticized in the academic literature. Reflecting the French experience, Walker outlines challenges with all three measures (at risk of poverty, material deprivation and jobless households) emphasizing their unstableness, i.e. when incomes are clustered around the poverty threshold; their vulnerability to technological change, i.e. the phone as an element of deprivation; and the trade-off between competing targets, i.e. reducing the number of jobless households by low wage employment could increase income poverty (2010, p.214-215). Similarly, in the Synthesis report based on the reports of the EU Network of Independent Experts on Social Inclusion, Fraser and Marlier identify key issues, in relation to poverty and social exclusion targets, outlining that “there is a risk of focussing on just one aspect of poverty and social exclusion, and in effect of moving people from one aspect of poverty and social exclusion to another” (2011, p. 8).

Concerned with the other aspects in the economic and social protection system, Pochet has questioned the potential of attaining the poverty reduction target “without any changes in the distribution of income and the mechanisms for redistribution” (2010, p.143).

Notwithstanding these important challenges, Stubbs and Gerovska-Mitev have emphasized the importance of the new EU 2020 indicators and targets in the field of poverty and social exclusion for the EU candidate countries, particularly because they “provide an incentive for candidate countries to update and amend their previously adopted National Strategies as well as Action Plans in the field of poverty and social exclusion” but also “to move statistical assessments from consumption to income, from different national thresholds (i.e. on poverty) to more harmonized EU thresholds, as well as towards use of new statistical methods which can become a national standard” (2012, p.70).

Taking into consideration all the different arguments and shortcomings of the targets and indicators for poverty and social exclusion in the new Europe 2020 Strategy, it is still not possible to object to their significance, particularly in the period following the global economic crisis. Aware of the fact that their relevance varies upon each country's commitment to targets as well as factors such as economic growth and the tradition in governance of the social inclusion agenda, they may still be used as an additional tool to compare and assess performance against other existing national targets and indicators.

Comparative Trends on Poverty and Social Exclusion in the EU Member States and Candidate Countries

The social map of the European Union according to EU2020 indicators changes significantly, taking into consideration that poverty and social exclusion are measured by a combination of three indicators, including both monetary and non-monetary assessments. As argued by Nolan and Whelan the combination of a national income poverty line with an EU common deprivation threshold can be seen as seeking to capture “exclusion from customary EU living patterns due to lack of resources at the national level” (2011, p.7). Analysis of the rates of vulnerable population according to each of the three indicators suggests that newer member states (BG, LV, HU and ROM) are more affected with income poverty rather than with material

deprivation (in LT and SK the difference is negligibly in favour of income poverty). Accordingly, we can assume that countries experiencing higher material deprivation rates are countries in which the value of disposable income is lower compared with the costs of living in that respective countries, or that disposable income does not provide for a decent living standard. As also noted by Nolan and Whelan, “the addition of the deprivation criterion produces much sharper variation across countries than seen with relative income poverty alone, but this mainly involves a much sharper contrast between a sub-set of New Member States and the remaining countries” (2011, p.9). The EU member states in which there is a high material deprivation also are countries with relative income poverty higher than the EU average (BG, LV, LT and RO). The best performing EU member states in relation to poverty and social exclusion are found among the following: one of the new member states (CZ), the Scandinavian group of countries (SE, FI), as well as those who in the welfare state literature (Esping- Andersen, 1990) are defined as corporative-conservative countries (NL, AT).

Table 1: People at risk of poverty or social exclusion in EU member and candidate countries, 2010 (% of the total population)

	Severely materially deprived people	At risk of poverty (after social transfers)	People living in households with very low work intensity	People at risk of poverty and social exclusion
EU 27	8.1	16.4	10.0	23.5
Belgium (BE)	5.9	14.6	12.6	20.8
Bulgaria (BG)	35.0	20.7	7.9	41.6
Czech Republic (CZ)	6.2	9.0	6.4	14.4
Denmark (DK)	2.7	13.3	10.3	18.3
Germany (DE)	4.5	15.6	11.1	19.7
Estonia (EE)	9.0	15.8	8.9	21.7
Ireland (IE)	7.5	16.1	22.9	29.9
Greece (EL)	11.6	20.1	7.5	27.7
Spain (ES)	4.0	20.7	9.8	25.5
France (FR)	5.8	13.5	9.8	19.3
Italy (IT)	6.9	18.2	10.2	24.5
Cyprus (CY)	9.1	17.0	4.0	24.0
Latvia (LV)	27.4	21.3	12.2	38.1
Lithuania (LT)	19.5	20.2	9.2	33.4
Luxembourg (LU)	0.5	14.5	5.5	17.1

Hungary (HU)	21.6	12.3	11.8	29.9
Malta (MT)	5.7	15.5	8.4	20.6
Netherlands (NL)	2.2	10.3	8.2	15.1
Austria (AT)	4.3	12.1	7.7	16.6
Poland (PL)	14.2	17.6	7.3	27.8
Portugal (PT)	9.0	17.9	8.6	25.3
Romania (RO)	31.0	21.1	6.8	41.4
Slovenia (SI)	5.9	12.7	6.9	18.3
Slovakia (SK)	11.4	12.0	7.9	20.6
Finland (FI)	2.8	13.1	9.1	16.9
Sweden (SE)	1.3	12.9	5.9	15.0
United Kingdom (UK)	4.8	17.1	13.1	23.1
Iceland (IS)	1.8	9.8	5.6	13.7
Croatia (HR)	14.5	20.5	15.4	31.3

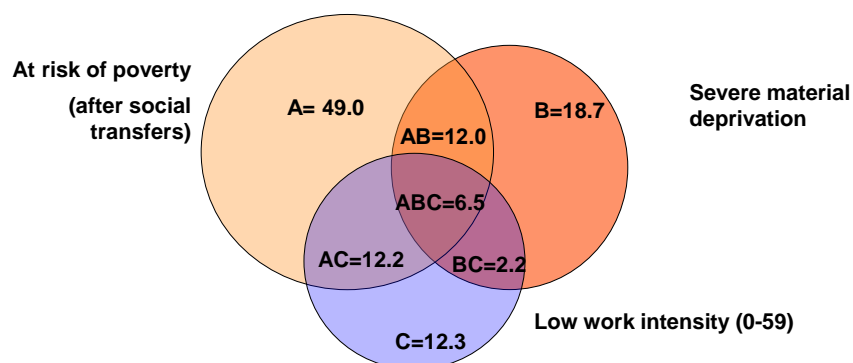
Source: Eurostat, 2012

http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=t2020_50

Conditions of poverty and social exclusion among the EU candidate countries can be analyzed only for Iceland and Croatia, as comparative Eurostat data are available only for these countries. Accordingly, it may be seen that Iceland can be grouped in the best performing countries in relation to poverty and social exclusion, while Croatia experiences much higher rates of poverty and social exclusion. According to each of the indicators, material deprivation in Croatia is lower than in some EU member states (BG, LV, LT, HU and RO), while income poverty is much higher and close to poverty rates in the Southern EU member states and in some of the newer EU member states (BG, EL, ES, LV, LT and RO). Overall, Croatia's rate of poverty and social exclusion is quite high (31.3%), however lower than in some member states (BG, LT and RO).

People at risk of poverty or social exclusion in the EU 27 (experiencing one, two or all of the risks) represent 23.5% of all the population. The largest group is represented by people living at risk of poverty (16.4%), followed by those living in households with low work intensity (10.0%), while those living in material deprivation are fewest (8.1%). Those suffering severe cumulative disadvantage (experience all of the three risks) represent 6% of the total population in EU, or approximately 6.5 million people (Lelkes and Gasior, 2012, p.3).

Diagram 1: Overlap of those at risk of poverty, material deprivation and low work intensity in EU



AC = at risk of poverty + low work intensity

AB = at risk of poverty + materially deprived

BC = materially deprived + low work intensity

ABC= low work intensity or at risk of poverty or materially deprived

Source: Lelkes and Gasior, 2012

Reading note: 49 million people in EU are faced with risk of poverty, while 6.5 million people are faced with risk of poverty and social exclusion.

It may be concluded that the new EU 2020 indicator for poverty and social exclusion produces much higher rates of a vulnerable population. However, for the purpose of reaching the EU 2020 target of lifting more than 20 million people out of poverty and social exclusion, member states can choose target indicators on the basis of which this aim will be measured. According to an analysis by Lelie (2011) of the draft National Reform Programs produced by EU member states in November 2010, it may be seen that countries with higher material deprivation rates have opted only for "at risk of poverty rate" as a benchmark indicator (BG, EE, LV, RO). From the point of feasibility of achieving the national targets, choosing to avoid a non-monetary indicator may seem obvious, as political action can not intervene at

the level of material deprivation. However, if countries want to genuinely tackle poverty and social exclusion, then a combination of monetary and non-monetary indicators may provide greater chances for reaching those most at risk.

Poverty and Social Exclusion in Macedonia according to EU2020 Indicators

Since 2000, the debate on poverty and social exclusion in Macedonia has been on the rise. A body of research literature appeared related to the measurement of inequality (Eftimovski, 2002), poverty and fragmentation (Jakimovski, 2003) as well as analysis of problems related to defining the social exclusion (Donevska, 2003). The academic literature focusing on poverty measurement provided additional analysis and arguments confronting the official measurements based on expenditure and 70% median as threshold. In the following years, the literature and research concerning these topics continued to grow, analyzing different dimensions, such as: poverty assessment (World Bank, 2005), social inclusion of vulnerable groups (Donevska, M., Kirandjiska, S. & Lazarevska, S., 2005; Polio Plus, 2005; Novkovska, 2008; Bornarova, S. & Gerovska Mitev, M., 2009), as well as policy governance and priorities in these domains (Gerovska Mitev, M., Gjorgjev, D. & Miovska-Spaseva, S., 2007; UNDP., 2008). Unfortunately, it may be said that these critical debates had no impact on political actions and policies aimed at poverty and social exclusion. National programs targeting socially excluded groups (2004) as well as the National Strategy for tackling poverty and social exclusion (2010) were primarily developed on the basis of data from the State Statistical Office and other administrative sources (Ministry of Labour and Social Policy, Ministry of Education, Agency for Employment, etc.). Notwithstanding the representativeness of these data, still they did not provide a complete picture of the problems of poverty and social exclusion.

Current official data on EU2020 indicators in Macedonia are partially available through the State Statistical Office. The only available official indicator focused on social exclusion is the number of people who are severely materially deprived, although its calculation is not based on the full list of 9 items. According to these data, the number of people who are severely materially deprived is slowly decreasing since 2005, from 55.9% to

41% in 2010. Other official data on poverty and jobless households (not based on the EU2020 calculation) indicate that 30.9% of the population is poor (State Statistical Office, 2010), while the rate of jobless households (by age group) is 21.4% (0-17) and 16.6% (18-59).

Table 2: Official data on poverty, material deprivation and joblessness in Macedonia

	2006	2010
At risk of poverty	29.8	30.9
Severe materially deprived	51.0	41.0
People living in jobless households	29.4 (0-17)	21.4 (0-17)
	24.7 (18-59)	16.6 (18-59)

Source: State Statistical Office from various releases – Poverty line (2006 and 2010), Republic of Macedonia 2020, Labour Force Survey (2010)

With the purpose of complementing the official data, but also to provide a more complete and comparable view with those at risk of poverty and social exclusion in the European Union, this paper will use the data gathered for the purposes of the Friedrich Ebert Study on material deprivation, poverty and social exclusion among households in Macedonia (forthcoming), based on the representative sample of 1600 households in the country.

According to these data, 30.8% of the households in Macedonia are faced with material deprivation, measured by the number of households lacking at least four out of list of nine basic items. This rate is lower by almost 10% than the currently available official data for Macedonia. The reasons for such a difference may arise due to the fact that the official data were not based on a complete list of nine items (only 8), but also a dissimilarity may arise due to time differences. Namely, the official data are based on assessments in 2010 (a year when the effects of the global economic crisis were severely experienced in Macedonia), while the study from which these data are taken was conducted at the end of 2011.

In comparative terms, the rate of materially deprived in the country (30.8%) indicates that Macedonia has similarly high rates of material deprivation as Bulgaria (35.0%) and Romania (31.1%), but almost three times higher than the EU average rate (8.1%).

Table 3: Poverty, material deprivation and joblessness in selected EU member states and EU candidate countries, 2010

	At risk of poverty (after social transfers)	Severe materially deprived	People living in jobless households	People at risk of poverty and social exclusion
EU 27	16.4	8.1	10.0	23.5
Slovenia	12.7	5.9	6.9	18.3
Bulgaria	20.7	35.0	7.9	41.6
Romania	21.1	31.0	6.8	41.4
Croatia	20.5	14.5	15.4	31.3
Macedonia	22.9	30.8	17.2	44.5

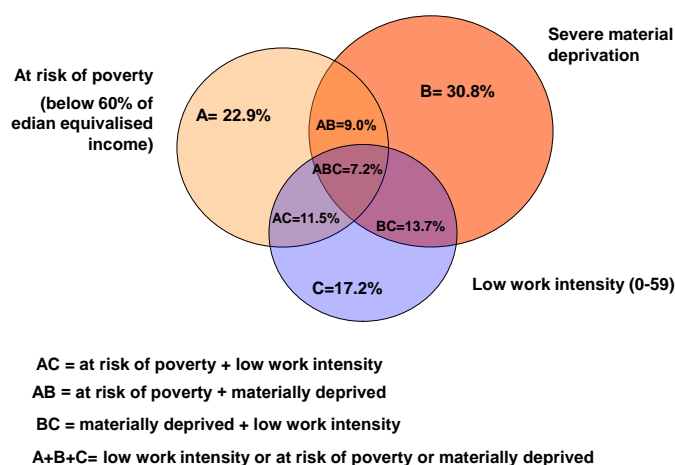
Source: Eurostat, 2012 and own calculation based on the data from the FES study (forthcoming)

Analysis of households at risk of poverty, measured according to the EU approach (below 60% of the median equalised income) indicates that 22.9% of the households in Macedonia are faced with poverty. This rate implies that when a method of incomes and lower threshold is applied (60% of the median income rather than 70%), the result is a lower poverty rate. However, due to the specific socio-economic characteristic of Macedonia, such as a high level of undeclared work as well as lack of disclosure of the actual amount of incomes, measuring poverty according to the expenditure approach will remain relevant. Having said that, one also must be aware that the relative income measure also has its limitations, and as argued by Bradshaw and Mayhew any median threshold is arbitrary and not related to an understanding of need, but merely a line drawn on income distribution (2010, p.173).

Jobless households or people living in households with very low work intensity, according to the Europe 2020, are people aged 0-59 living in households where the adults work less than 20% of their total work potential during the past year. Data from the FES study suggest that 17% of the households (where the household head is 0-59) were jobless in 2011. When compared with other EU member and candidate countries, Macedonia's rate of joblessness is highest (with the exception of Ireland - 22.9%). This is not surprising, taking into consideration the high official rate of unemployment in Macedonia (31.2% in the third trimester of 2011). In addition, the problem of precise estimation of joblessness in Macedonia is accumulated due to the high level of the grey economy and undeclared work.

As definitions and measurements of social exclusion are scarce both at the national and international level, the Europe 2020 provides significant contributions towards this end. Namely, the cumulative sum of all three indicators - at risk of poverty rate, material deprivation and low work intensity provide assessment of those at risk of poverty or social exclusion. This may be measured in two ways, i.e. either as a cumulative sum of all three indicators, where persons are counted only once even if they appear in more than one category, or as a total number of people who are represented in all three categories. The latter category provides data about those experiencing multiple social exclusion. Analysis of the households at risk of social exclusion in Macedonia (belonging to at least one of the three categories) signals that 44.5% of all households in the country are affected with this problem. If assessment is based on households affected by all three indicators than we see that 7.2% of the households are those mostly disadvantaged, or those experiencing multiple social exclusion. Both rates are comparatively higher than rates of poverty risk and social exclusion in all EU member and candidate countries.

Diagram 2: Households at risk of poverty or social exclusion in Macedonia



Source: FES study on material deprivation, poverty and social exclusion among households in Macedonia (forthcoming)

Policy Implications for Tackling Poverty and Social Exclusion in Macedonia

Available data on poverty and social exclusion estimated according to the Europe 2020 indicators provide important information for adapting national social policy agenda. In addition, they enable more targeted and quantified insight into trends of poverty and social exclusion according to which national targets and actions should be framed.

Currently, national targets in relation to the Europe 2020 indicators can be seen from the Employment Strategy – 2015. While the new National Strategy can be praised in terms of aligning new targets in the domains comparable to those with Europe 2020, still the stipulated national targets particularly in the domain of poverty give little hope for improvement. The national target for population living at risk of poverty until 2015 is set for 29%, which represents a decrease of only 1.9 percentage points for a period of four years. In addition, setting national targets in relation to EU 2020 goals seems to have been realized without any prior analysis and research, as well without an integrated 3 pillar approach.

Table 4: Comparison of national targets 2015 and EU 2020 targets

	Status in 2010	National targets 2015	EU 2020 targets
Employment rate (20-64)	48,1%	55%	75%
Employment rate of young people (15-29)	26,5%	29%	/
Employment rate of young people (15-24)	15,4%	17%	/
Employment rate among women	34%	42%	/
Employment rate of older workers (55-64)	34,2%	41%	/
Early school-leavers	16,2%	14%	10%

Share of 30-34 with completed tertiary or equivalent education	14,2%	19%	40%
People below poverty line	30,9%	29%	Lifting 20 million people out poverty and social exclusion

Source: Ministry of Labor and Social Policy, National Strategy for Employment-2015

In this respect, data provided in this paper enable a disaggregated view of those living at risk of poverty and social exclusion. A comparison between categories of people faced with the risks of material deprivation, poverty and joblessness suggest that in Macedonia the problem of material deprivation is much higher than that of income poverty and joblessness. In this respect, a possible redefinition of national targets and strategies, which currently tackles only those at risk of poverty, should also take into consideration people faced with material deprivation and those with low work intensity. In addition, these data provide a chance for policy measures which can be focused at the larger population faced with poverty and social exclusion (44.5%), but also a more targeted approach towards those experiencing multiple social exclusion (7.2%).

Use of the different statistical indicators which are comparable to that in the European Union can also serve as an important tool for comparison and extrapolation of different categories of risk. The applied EU estimation of at risk of poverty according to 60% of median income does not only provide a different rate of poverty, but can also serve as a method to analyze differences between the profile of people faced with income poverty and those faced with poverty according to the expenditure method.

As already noted by Gerovska-Mitev and Stubbs (2012), Europe 2020 indicators and targets contribute towards a number of challenges, which for the candidate countries may mainly be seen in the need to: "widen official indicators for measuring poverty and social exclusion, widen the focus of social policies and measures towards larger target groups and integrate social

policies targets with that of other public policies, such as employment, education, housing, and so on, to overcome the current lack of horizontal coordination of policies for social inclusion" (p. 70).

However, these challenges also provide an opportunity for a more coordinated and focused social inclusion policy, which reflects its multidimensional character. By combining policy measures targeted towards different vulnerable populations instead of only at those currently defined in Macedonia as poor, the chances for reducing poverty and social exclusion in the country are much greater.

Conclusions and Recommendations

This paper has provided quantitative and qualitative analysis of data related to poverty and social exclusion according to Europe 2020 Strategy. It enabled an identification of the scale of the population affected with risks of poverty, material deprivation and low work intensity, as well as the population faced with all three risks, defined as people at risk of poverty and social exclusion. The analysis in the paper indicates that the country is not only faced with poverty based on average expenditure (according to official data), but also with a high scale of material deprivation (30.8%). In addition, the paper identifies 44.5% of people living at risk of poverty and social exclusion, which is a worrying signal not only for the policy makers, but also for the future socio-economic development of the country. In this respect, it is of immanent importance that social policy measures and particularly social inclusion policy focus on multiple categories associated with any of the mentioned risk, in order to prevent further escalation of the problem.

When stipulating national targets regarding reduction of poverty and social exclusion, the country should avoid opting for only one of the three indicators according to which it will assess and reform its policy programs. In doing so, it will undermine the complexity and multidimensionality of the problem and will not contribute towards effective tackling of poverty and social exclusion in the long run. Hence, a comprehensive approach towards future redefinitions of policies and strategies in the field of poverty and social exclusion should incorporate the following important aspects:

- Assessment of poverty and social exclusion on the basis of national and international statistical indicators. This should ideally be based on

both income and non-income measures of poverty and social exclusion.

- Targeting policy measures and providing access to social protection to all categories of vulnerable population, namely: those at risk of poverty, materially deprived and jobless. This would imply that beside those “traditionally vulnerable categories”, such as unemployed, long-term unemployed, others such as people experiencing in-work poverty should also be part of the governmental measures and programs.
- Differentiation of measures between those experiencing poverty and social exclusion and those experiencing multiple social exclusion. The latter should be targeted with a long-term strategy which should include all aspects of public support: social welfare, education, housing etc.
- Use of all three EU 2020 indicators when stipulating national targets in the field of poverty and social exclusion.

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ⁱ The quantitative research is part of the Friedrich Ebert Foundation's study on "Material deprivation, poverty and social exclusion among households in Macedonia", forthcoming, and the author of this paper is also the author of the forthcoming study.

Why Europe 2020 is Likely to Be as Unsuccessful as the Lisbon Strategy

Oliver Treidler

Abstract

In March 2010, the European Commission (2010, preface) introduced Europe 2020 as marking “a new beginning” and having “new tools and [...] new ambition”. The research questions guiding my paper are the following: Does Europe 2020 constitute a new beginning? Does Europe 2020 address the shortcomings of the Lisbon Strategy? Is Europe 2020 likely to succeed? The recent crisis illustrates that the EU needs to decide on how to address multiple and pressing challenges. As the member states are faced by similar challenges, adopting a common economic strategy appears to be sensible. However, in 2000 the Lisbon Strategy was also launched as an ambitious common strategy. Despite the substantial effort and resources which were invested, the Lisbon Strategy was a failure. The success of Europe 2020 will in large part depend on whether the lessons have been learned.

I conducted a comparative analysis of two strategies. The analysis of key-documents and publications showed that policy content and implementation mechanism of Europe 2020 closely resemble those of the Lisbon Strategy. Further, I identified the main shortcomings of the Lisbon Strategy and analyzed whether Europe 2020 constitutes an adequate remedy. Here, I particularly focused on the open method of coordination (OMC) and found that many shortcomings of the Lisbon Strategy are likely to persist. Based on my findings, I argue that Europe 2020 is unlikely to succeed, unless significant amendments are made. The paper is of relevance for everyone who is interested in engaging in a critical and informed dialogue regarding European economic strategy.

Keywords: Lisbon Strategy, Community Lisbon Programme, Europe 2020, Open method of coordination, benchmarking

Introduction

Stating that the Lisbon Strategy was a failure is unlikely to raise many eyebrows. In order to support this statement, one can refer to prominent evaluations (CER, 2010; World Economic Forum, 2010; ECB, 2008). There is conclusive evidence for the fact that the targets stipulated for the Lisbon Strategy have been missed. Unfortunately, as I have demonstrated elsewhere (Treidler, 2011), these evaluations suffer from a variety of shortcomings. Aside from several methodological inconsistencies, they exhibit an inadequately narrow scope; not accounting for the implementation mechanism and the so-called Community Lisbon Programme (CLP). In sum, these evaluations do not suffice to refute the evaluation presented by the European Commission (2010b).

Despite acknowledging that the targets have been missed, the Commission concludes that the Lisbon Strategy has not failed, but rather that it resembles a mixed picture. According to the Commission, the strategy has focused on the right structural reforms and yielded a positive impact. The substantial gap, by which the targets were missed, is downplayed. A central argument underlying the Commission's conclusion is that most of the shortcomings of the Lisbon Strategy are attributable to an implementation deficit. While it is relatively easy to expose the weaknesses of the evaluation document presented by the Commission, it has received surprisingly little attention and criticism. As a consequence, the extent of the failure of the Lisbon Strategy is generally underestimated (Treidler, 2011).

Even though the true extent of the failure was not recognized, it should have been evident that a successor strategy would require a meticulous overhaul. All stakeholders should have made it a priority to learn from past mistakes. In other words, it would have been prudent to adopt a distinctly critical mindset. In this context, it is revealing to note that the initial proposal for Europe 2020, the so-called consultation paper "on the Future 'EU 2020' strategy" (European Commission, 2009), was actually published prior to the evaluation document of the Lisbon Strategy. In other words, the conception of Europe 2020 was hastened, hardly reflecting a critical mindset. The subsequent consultation process, in which all interested parties were invited to submit comments and suggestions, had little effect. In total, the Commission received 1.400 contributions, of which it published a representa-

tive overview (European Commission, 2010c). While recognizing some nuances and critical points, the Commission stressed the existence of a broad consensus. Unsurprisingly, the thrust of Europe 2020 remained unaltered from the outline of the consultation paper. To be sure, some stakeholders voiced concerns. As acknowledged by the Commission, there were “calls for postponing adoption of Europe 2020 until early 2011 to allow for a full consultation exercise” (2010c, p.22). Similar concerns were voiced in the respective debates in the European Parliament (European Parliament, 2010; European Parliament, 2010b). However, most of the concerns were rather timid. The important point is that the rationale of pursuing a comprehensive common economic strategy was never seriously questioned. Thus, continuing with the Lisbon Strategy was essentially a foregone conclusion.

Does Europe 2020 Constitute a New Beginning?

Europe 2020 was introduced as marking “a new beginning” and having “new tools and [...] new ambition” (European Commission, 2010). My introductory observations suggest that this is mere rhetoric. I have basically claimed that Europe 2020 does not differ significantly from the Lisbon Strategy, but that it is rather just a new label applied to an old strategy. Am I being unduly sarcastic, or is there substance to my claim?

Comparing the ultimate objectives (mission statements) of the strategies reveals only minor differences. While the objective of the Lisbon Strategy was to turn the EU into “the most dynamic and competitive knowledge economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion and respect for the environment” (Kok et al., 2004, p.6), the objective of Europe 2020 is to realize the vision of Europe’s social market economy by “turning the EU into a smart, sustainable and inclusive economy delivering high levels of employment, productivity and social cohesion” (European Commission, 2010, p.8). The only significant difference is to be seen in the fact that Europe 2020 is not immediately focused on competitiveness. Aside from this initial indication of a shift in prioritization, the objectives are strikingly similar; sharing two main features, namely being vague and comprehensive.

Comparing the policy framework of Europe 2020 (for an illustration see Figure 1), with that of the Lisbon Strategy also reveals only minor differences. The headline targets of Europe 2020 can be grouped into five broad policy

areas: Knowledge, Education, Employment, Social Cohesion and Environment. The headline targets of the Lisbon Strategy were grouped into almost identical policy areas (compare Kok et al., 2004, p.48ff). The only difference is that Europe 2020 does not contain the policy area Economic Reform (which contained policies for enhancing the functioning of the internal market). Instead, the policy area Education is now stipulated as a headline target, while for the Lisbon Strategy it had merely been a sub-target within the policy area Knowledge. Consequently, the bulk of the quantitative targets and indicators, including many of the so-called 14 key-indicators, also remained unchanged or were only slightly modified. To name an example, one of the most prominent quantitative targets of the Lisbon Strategy, increasing gross domestic expenditure on R&D to 3%, was adopted as a headline target for Europe 2020 without any modification. Some scholars have argued that the Lisbon Strategy was almost exclusively focused on jobs and growth, particularly after the Kok Report (Büchs, 2009; Kröger, 2009). I consider this argument to be an exaggeration. It underestimates two aspects, namely the comprehensive nature of agenda and that the priority attached to other policy areas (notably Environment) increased significantly during the lifetime of the strategy. However, there is some merit in the argument, as evidenced by the methodology applied by some of the aforementioned evaluations. In conducting their benchmark analysis, both the CER (2010) as well as the World Economic Forum (2010), allocated (significantly) higher weight to the policy areas of Employment, Knowledge and Economic Reform. Similar evidence can be found in the Commissions evaluation document (2010b, pp.7-8) as well as in the annual progress reports (APRs), in which only two indicators (the employment rate and gross domestic expenditure on R&D) were benchmarked against the specified targets (European Commission, 2006, country chapters). The explanation for allocating a (somewhat) higher priority to jobs and growth is to be seen as reflecting the ultimate objective of the Lisbon Strategy, that is enhancing competitiveness. For Europe 2020 it is no longer feasible to allocate different weights to the headline targets, thus the initial indication of a shift in prioritization is confirmed.

While finding hard evidence for a shift in prioritization, let alone quantifying it, is difficult, there are strong indications for a rather nuanced character of the shift. In this context, the integrated guidelines (IGs) are particularly noteworthy. The IGs are a vital component of the implementation mechanism, on the basis of which member states are expected to translate

the headline targets into national targets and policies. In an effort to streamline the agenda, which had repeatedly been criticized as being overloaded, the Commission reduced the number of IGs from 24 to 10. However, comparing the Europe 2020 IGs (European Commission, 2010d) with those of the Lisbon Strategy (European Commission, 2007), shows that neither the content nor the scope has been significantly changed (see Table 1). Thus, the numerical reduction is to be seen as reflecting a minor architectural adjustment rather than a pronounced shift in prioritization. Further indication for the fact that Europe 2020 is to be seen as a continuation of the Lisbon Strategy rather than marking a new beginning, can be found in the flagship initiatives. In contrast to the Lisbon Strategy, Europe 2020 does not utilize the CLP for implementing reforms at the EU level. Instead of deriving the CLP on the basis of the IGs, Europe 2020 focuses on directly translating the seven flagship initiatives into EU level policy actions. While, the introduction of the flagship initiative ostensibly seems to constitute a significant modification, closer examination (again) reveals the change to be of rather minor significance. In fact, the bulk of objectives contained in the flagship initiatives were focal points of the earlier CLPs (compare European Commission, 2006b). Many flagship initiatives can be traced back to 2005. Two prominent cases are the "Innovation Union" and the "Youth on the Move" initiatives which have their predecessors in the "European Technology Initiative" and the "European Youth Initiative" (compare European Commission, 2005, pp.23ff). The "Innovation Union", is a particularly illustrative example. It contains the sub-objectives of improving framework conditions for innovation by improving the IPR system (e.g. creating the single EU Patent) as well as promoting knowledge partnerships (e.g. the EIT), both of which had been focal points of the CLP. In sum, the introduction of the flagship initiatives mainly constitutes an architectural adjustment.

Despite having identified the "implementation deficit" as one of the most serious shortcomings of the Lisbon Strategy, the Commission refrained from introducing new instruments for implementing Europe 2020 (for a concise evaluation of the instruments, see European Commission, 2010b, pp.18-21). As shown above, the IGs were only subjected to minor adjustments. Analogous to the Lisbon Strategy, the member states will still have to compile and implement their respective national reform programs (NRPs) based on the IGs, which in turn will be subjected to the APRs. However, the most intriguing component of the implementation mechanism is

the so-called open method of coordination (OMC). The introduction of the OMC was one of the most characteristic features of the Lisbon Strategy. The defining trait of the OMC is that the corresponding instruments such as 'objectives', 'guidelines' and 'targets' are not legally binding. The ultimate decisions and implementation are reserved for the member states (hence the OMC is regarded as "soft law"). The idea of the OMC is to rely on benchmarking, best practices and peer pressure in order to facilitate mutual learning (for an illustration of an ideal-typical OMC process, see Figure 2). This basic idea continues to be applied for Europe 2020. The Commission stated that "Europe 2020 strategy will need more focus and transparent benchmarks for assessing progress" and that the "Commission will monitor annually the situation on the basis of a set of indicators showing overall progress" (European Commission, 2010, p.25 and p.27). The most substantial change in the implementation mechanism can arguably be seen in the Commission's aim to sharpening the policy recommendations by increasing their precision and level of detail of (e.g. by outlining specific measures and stipulating timeframes). Most notably, the Commission intends to issue a "policy warning" in case a member state should fail to adequately respond to a recommendation (European Commission, 2010, p.26). Without addressing the legal background, it is evident that this adjustment is designed to equip the Commission with additional power. The introduction of policy warnings may be interpreted as a shift away from a coordination based strictly on voluntary ("soft") implementation towards a coordination based on more compulsory ("hard") means. In general, however, the Commission remained unspecific and devoted surprisingly little attention to the nuts and bolts of the implementation mechanism.

In sum, our initial question can be answered in the negative. Some adjustments have been made, but the changes can be characterized as reflecting minor structural adjustments. As a consequence, Europe 2020 does not constitute a new beginning, but is more or less a continuation of the Lisbon Strategy. Due to its high relevance for the later discussion, it should be emphasized that irrespective of the shift in prioritization, the basic rationale of Europe 2020 remained unchanged. As correctly observed by Vilpisauskas (2011, p.5), "Europe 2020 represents a continuation of a paradigm which tries to combine different economic and social visions of Europe and different 'models of capitalism'".

Does Europe 2020 Address the Shortcomings of the Lisbon Strategy?

While casting doubts on its chances for success, the single fact that Europe 2020 does not mark a new beginning must not necessarily condemn it to fail. In case the adjustments address the most important shortcomings of the Lisbon Strategy and provide adequate remedies, success could be possible.

I consider it to be one of the most vital lessons to be learned from the Lisbon Strategy, that failing to stipulate a clear objective diminishes the quality of a strategy and constitutes the root cause of many subsequent deficiencies. A vague ultimate objective precludes a consistent target-setting process, which translates into severe obstacles in the implementation and evaluation of the strategy (Treidler, 2011). The overloaded agenda and the corresponding lack of prioritization can be interpreted as manifestations of the vague ultimate objective. In order to avoid repeating past mistakes, considerable attention should have been devoted to defining a clear objective, setting consistent targets and establishing a sensible measuring rod. As seen above, the vision of Europe's social market economy outlined by Europe 2020 is extremely vague. While the Lisbon Strategy was focused on enhancing competitiveness, thus arguably prioritizing jobs and growth, it is not feasible to allocate different weights to the Europe 2020 headline targets. Furthermore, the notion of a European social market economy can be seen as problematic, since it neglects the considerable heterogeneity of social models existing within the EU. The typology in the relevant literature distinguishes between four distinct regimes, which differ significantly in the role assigned to the government in providing social security (Berthold & Brunner, 2009). According to Sapir (2005, p.1), the difference between the respective regimes is significant and "the notion of 'European social model' is misleading [...] in reality [there are] different European social models, with different features and different performance in terms of efficiency and equity". Considering that the differences have strong historical and cultural roots, it is questionable whether a common European vision of a social market economy can ever be established. In addition to failing to stipulate a clear ultimate objective, I consider it problematic that the prioritization shifted away from competitiveness. The evaluation of the Lisbon Strategy illustrates that the competitive position of the EU developed unfavorably. The EU was unable to

significantly close the gap on the USA and lost further ground to the more dynamic East Asian economies. Hence, it would have been sensible to renew and even strengthen the focus on enhancing competitiveness.

According to the Commission, the CLP should have reflected EU-level partnership, fostering a collective sense of ownership. However, it acknowledged that the attempt failed, "since the CLP failed to generate momentum and ownership in Council and Parliament, as well as in member states" (European Commission, 2010b, p.20). As seen above, the introduction of the flagship initiatives mainly constitutes an architectural adjustment. Substituting the flagship initiatives for the complementary but separate CLP agenda appears sensible, as it streamlines the agenda. A further positive aspect is that the responsibility is now explicitly assigned to the Commission. However, irrespective of these structural changes, at least four important shortcomings in the implementation of Community-Level reforms remain unsolved. First, the flagship initiatives are extremely complex, including a multitude of separate sub-objectives. Second, success is neither defined for the flagship initiatives as a whole nor for the sub-objectives. Corresponding impotence to evaluate the progress of flagship initiatives will likely contribute to a poor and slow implementation. Third, the monitoring process is not sufficiently specified. While the CLP was subjected to a detailed assessment in the context of the "Technical Implementation Report", no equivalent process is established for the flagship initiatives. Fourth, the flagship initiatives include a national level for which the member states are responsible. Inclusion of the national level blurs the ownership of the flagship initiatives. Furthermore, many actions outlined for the national level are already stipulated in the IGs (word-by-word) and are thus redundant.

Considering that the "implementation deficit" was identified as one of the most serious shortcomings by the Commission, improving the implementation mechanism and particularly the OMC should have been a priority in designing Europe 2020. However, as briefly illustrated above, the attention devoted to this issue was not impressive. According to the Commission, the implementation deficit was mainly attributable to a lack of commitment by the member states. The Commission (2010b) found that the member states have utilized the OMC as a low level reporting tool rather than one of policy development. The introduction of policy warnings must be seen as an attempt to strengthen the OMC. As this adjustment is conceived as a remedy for a main shortcoming of the Lisbon Strategy, it ostensibly constitutes

an example of a lesson that has been learned. However, I would like to argue that the diagnosis of the Commission is inaccurate and that the proposed changes constitute a perversion of the OMC.

My argument is based on *four* (non-exclusive) points. *First*, the fact that the OMC was not efficiently utilized is neither the fault of the member states nor is it attributable to the “soft” character of the OMC. Despite the vehement recommendations of the Kok Report to focus on more adequate benchmarking processes and to publish corresponding results, ideally in the form of rankings (Kok et al., 2004, pp.42ff), the Commission shied away from designing and applying a rigorous benchmarking process. In respect to the APR country chapter, the ECB (2008, p.20) criticized the Commission for “[...] toning down somewhat the cross-country comparison element and arguably reducing the already limited role of quantitative benchmarking in its assessments”. Neglect to act upon the recommendations of the Kok Report was criticized by Pisani-Ferry and Sapir (2006, p.6), who emphasized that “the Commission strongly rejected the proposal to ‘name and shame’ and nearly abandoned benchmarking altogether”.

Second, the Commission failed to address the lack of participation and transparency which plagued the OMC. Failure to involve sub-national actors constitutes an obstacle for adapting reforms to specific regional conditions (downloading) and limits the opportunity to learn from regional expertise (uploading). Further, limited transparency will inevitably diminish political ownership and inhibit mutual learning. In this context, Zeitlin (2005, p.8) concluded his extensive analysis of the OMC by stating that the OMC “is widely regarded as a narrow, opaque, and technocratic process involving high domestic civil servants and EU officials in a closed policy network, rather than a broad, transparent process of public deliberation and decision-making, open to the participation of all those with a stake in the outcome”. Similar conclusions were drawn by Kröger (2009) as well as by Pisani-Ferry and Sapir (2006).

Third, the Commission failed to acknowledge the limits inherent in the logic of the OMC. Zeitlin (2005, pp.4ff.) identified various manifestations of ideational convergence which have been facilitated by the OMC. One example is the prolific dissemination of various key concepts included in the Lisbon Strategy which moved to prominent positions of national policy agendas, notably ‘lifelong learning’, ‘active ageing’, ‘gender mainstreaming’, ‘flexicurity’ and ‘inclusive labor markets’. The Commissions fails to appreciate

that neither the quantity nor the selectivity exercised by member states in downloading policies constitutes an acceptable yardstick for assessing the performance of the OMC. Whether Member States decide to engage in downloading must be a strictly voluntary decision, as variations in interpretation and implementation are an inherent part of the logic on which the OMC is based. As pointed out by Zeitlin (2005, p.7), the OMC processes "should be viewed less than as mechanisms for producing 'cognitive harmonization' [...] than for a creation of a common language and categorical framework to discuss and evaluate different solutions to similar problems".

Fourth, and most importantly, the Commission failed either to diagnose (or to acknowledge) that the implementation deficit was rooted in a persistent consensus deficit. To understand this argument, one must be aware of the reasons why the OMC was introduced as a vital part of the Lisbon Strategy. Throughout the 1990s, the main obstacle to designing and implementing a common EU strategy for enhancing competitiveness was "the lack of shared beliefs on what the European model of capitalism should be" (Radaelli, 2003, p.19). It was precisely the soft character of the OMC, that is relying on benchmarking and peer pressure (or information rather than authority), which appeared to offer a feasible compromise by promising "progress in politically sensitive areas by 'avoiding' politicization" (Radaelli, 2003, pp.20ff; Arrowsmith et al., 2004, pp.10ff.). During the course of the Lisbon Strategy it should have become evident, that avoiding politicization became increasingly difficult, as the lack of shared beliefs proved to be persistent. One particularly vivid example is to be seen in the so-called "LIME assessment framework (LAF)". The LAF constitutes a complex GDP accounting approach (relying on over 200 indicators), designed to provide "[...] an analytical framework for identifying policy priorities for Member States" (DG ECFIN, 2008, p.6; for a concise analysis of the LAF see Treidler, 2011). However, despite investing considerable effort into establishing the LAF as an evaluation framework, the Commission refrained from utilizing it. One explanation for the fact that the LAF was not utilized is the lack of consensus among member states. While some member states regarded the LAF as a sensible evaluation framework, others remained opposed to the idea of publishing rankings based on the LAF. The argument of those opposing the LAF was based on the fact that it did not include the policy areas of Environment and Social Cohesion. Instead of adopting a GDP accounting approach, they favored a "beyond GDP" approach which would focus more on these policy areas (EU, 2011).

Interestingly, these opposing views were also expressed in the consultation process for Europe 2020 (European Commission, 2010c, pp.10ff). Another example for the lack of consensus is to be seen in the fact that in their NRPs for 2011 Denmark, Germany, Luxemburg, Sweden and the UK did not apply "reduction of population at risk of poverty" as an indicator (for the policy area of Social Cohesion) and refrained from stipulating a corresponding target (European Commission, 2011). The respective comment of the Commission (2011) suggests this to be a mere technical issue, namely that a "result cannot be calculated because of differences in national methodologies". However, it would be a serious mistake to dismiss the differences among the member states as mere technicalities. Only when the existence of a consensus deficit is acknowledged, it will be possible to address it. Even if the technical obstacles could be overcome, the fundamental problem remains that "[...] political consensus is still required to identify and implement benchmarking projects" (Arrowsmith et al., 2004, p.2). Hence, addressing the consensus deficit should be the starting-point of any strategy intending to rely on benchmarking, such as Europe 2020. The brief consultation process and the generally hastened conception of Europe 2020 did not allow for the intense public debate required to address the consensus deficit. Introducing policy warnings in order to enforce compliance with the benchmarking process is merely addressing the symptoms of the implementation deficit and constitutes a perversion rather than an improvement of the OMC.

In sum, I have to conclude that Europe 2020 does not address the main shortcomings of the Lisbon Strategy. Most of the adjustments are of merely architectural nature. Particularly in the context of the implementation mechanism many lessons remained unlearned.

Is Europe 2020 Likely to Succeed?

An answer to this question must necessarily be speculative. However, the preceding analysis, despite being extremely concise, should have illustrated that failure is more likely than success. Despite all the rhetoric, introducing Europe 2020 as marking a new beginning, not much has changed. I find myself agreeing with Vilpisauskas (2011, p.28), who concluded that "(a)lthough Europe 2020 represents elements of instrumental learning which could be attributed to changes in environment as well as

previous experience, there is little basis to claim that the main elements of the strategy, its goals and core values underpinning them have been altered as a result of the experience of the last decade. Nor there is evidence to maintain that the economic downturn [...] led to a paradigm shift with regards to the main goals of the EU as presented in Europe 2020”.

Considering that the Lisbon Strategy was a failure and that vital lessons remained unlearned, I want to make *four* cautious statements relating to the likely success of Europe 2020. *First*, the ‘vision’ of a European social market economy is extremely vague, failing to provide a clear objective. *Second*, the competitive position of the EU may deteriorate. By increasing the priority of Environment and Social Cohesion, Europe 2020 potentially shifts resources away from competitiveness enhancing policies. *Third*, the implementation deficit is likely to persist. Insufficient transparency and participation will continue to constitute severe obstacles, inhibiting bottom-up learning and corresponding exchange and adoption of best practices. *Fourth*, the Community-Level reforms will continue to be inefficient, as the flagship initiatives are poorly defined, overly complex and not subject to a stringent monitoring process. These brief assumptions should be sufficient at this point. They are derived from the preceding analysis, and thus somewhat limit the degree of speculation. Furthermore, each assumption would potentially have a severe impact on the likelihood of success. When the cumulative impact is considered, Europe 2020 appears unlikely to succeed.

Considering the pessimistic outlook, it appears prudent to ask whether it would make sense to abandon Europe 2020. Ideally, the question should have been carefully addressed when evaluating the Lisbon Strategy, prior to designing and implementing Europe 2020. Instead, the transition from the Lisbon Strategy to Europe 2020 can be characterized as a process of “muddling through”. To be sure, my advocacy of abandoning Europe 2020 is not to be misinterpreted as generally opposing any European economic strategy. It is rather to be understood as a plea to politicians and citizens to deliberately think about the rationale to be applied in EU policymaking. The agenda remains overloaded and the notion of a European social model is misleading. Does Europe really need a comprehensive economic strategy? Would it be more promising to focus the strategy on those policy areas where there is consensus, where preferences among Europeans are relatively homogeneous?

The failure of the Lisbon Strategy and the pessimistic prospects of Europe 2020 should provide sufficient impetus to address these questions. It is my belief, that Europe deserves better than Europe 2020. We must go back to the drawing board.

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Table 1

Comparison of the Integrated Guidelines of Europe 2020 and the Lisbon Strategy

Europe 2020 Integrated Guideline	Europe 2020 Headline Target	2005-2008 and 2008-2010 IGs
1.) Ensuring the quality and sustainability of public finances		1, 2
2.) Addressing macroeconomic imbalances		3, 4, 5
3.) Reducing imbalances in the euro area		6
4.) Optimizing support for R&D and innovation, strengthening the knowledge triangle and unleashing the potential of the digital economy	Innovation	7, 8, 9
5.) Improving resource efficiency and reducing greenhouse gases emissions	Environment	11
6.) Improving the business and consumer environment and modernizing the industrial base		14, 15
7.) Increasing labor market participation and reducing structural unemployment	Employment	17, 21
8.) Developing a skilled workforce responding to labor market needs, promoting job quality and lifelong learning	Employment	18, 20
9.) Improving the performance of education and training systems at all levels and increasing participation in tertiary education	Education	23, 24
10.) Promoting social inclusion and combating poverty	Social Cohesion	

Note: The right column is based on a comparison of the documents European Commission, 2010d and European Commission, 2007; it shows which of the 2008-2010 IGs correspond to the new IGs. While the cross referenced IGs are not identical, a significant overlap in policy objectives was found to exist.

Table 2

Lessons learned from the Lisbon Strategy

Lesson	Extent of Learning (0-4)
Avoiding an overloaded agenda	1
Stipulating a clear goal (prioritizing)	0
Establishing a measuring-rod (monitoring and evaluation process)	0
Accounting for differing starting positions of the Member States	3
EU-Level reforms (address shortcomings of CLP)	2
Policy Recommendations (sharpening the soft instruments)	4
OMC (establishing benchmarking process, political consensus)	0
OMC (improve mutual learning process, transparency and participation)	0
Ownership (overcome bureaucratic character, incentives for participation)	0
Communication (explain rationale to shareholders, facilitate support)	1

Note: The scale applied for evaluating the extent of learning is the following: 0 = 'lesson not learned', 1 = 'minor structural adjustments', 2 = 'significant structural adjustments', 3 = 'corrective measures', 4 = 'lesson learned (significant corrective measures)'

Figure 1

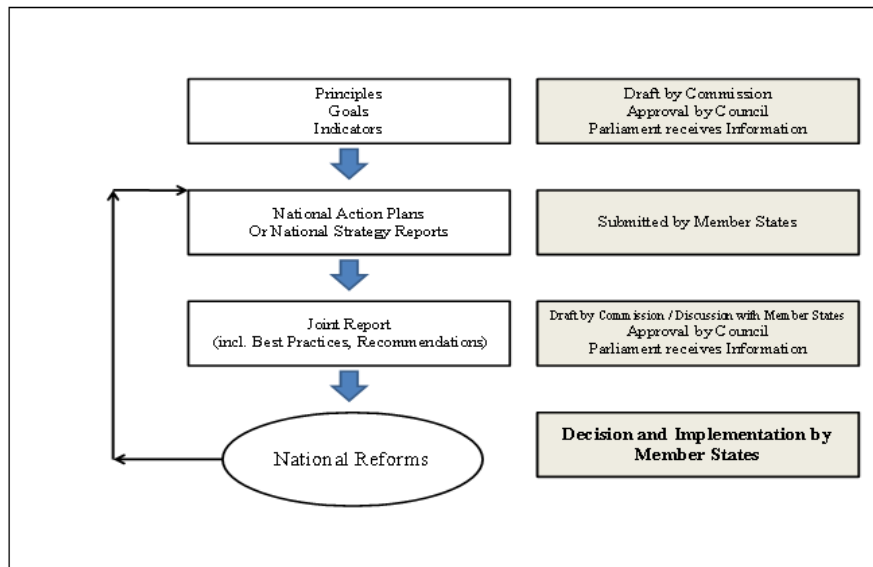
Europe 2020 policy framework – headline targets and flagship initiatives
(European Commission, 2010, p.30)

Headline Targets		
<ul style="list-style-type: none"> • Raise the employment rate of the population aged 20-64 from current 69% to at least 75% • Achieve the target of investing 3% of GDP in R&D in particular by improving conditions for R&D investment by the private sector, and develop a new indicator to track innovation. • Reduce greenhouse gas emissions by at least 20% compared to 1990 levels or by 30% if the conditions are right, increase the share of renewable energy in our final energy consumption to 20% and achieve a 20% increase in energy efficiency. • Reduce the share of early school leavers to 10% from the current 15% and increase the share of the population aged 30-34 having completed tertiary education from 31% to at least 40%. • Reduce the number of Europeans living below national poverty lines by 25%, lifting 20 million people out of poverty 		
Smart Growth	Sustainable Growth	Inclusive Growth
INNOVATION – EU flagship initiative “Innovation Union” to improve framework conditions and access to finance for research and innovation so as to strengthen the innovation chain and boost levels of investment throughout the Union.	CLIMATE, ENERGY AND MOBILITY – EU flagship initiative “Resource efficient Europe” to help decouple economic growth from the use of resources, by decarbonising our economy, increasing the use of renewable sources, modernizing our transport sector and promoting energy efficiency.	EMPLOYMENT AND SKILLS – EU flagship initiative “An agenda for new skills and jobs” to modernize labor markets by facilitating labor mobility and the development of skills throughout the lifecycle with a view to increase labor participation and better match labor supply and demand.

<p>EDUCATION – EU flagship initiative “Youth on the move” to enhance the performance of education systems and reinforce the international attractiveness of Europe’s higher education</p>	<p>COMPETITIVENES – EU flagship initiative “An industrial policy for the globalization era” to improve the business environment especially for SMEs, and to support the development of a strong and sustainable industrial base able to compete globally.</p>	<p>FIGHTING POVERTY – EU flagship initiative “European platform against poverty” to ensure social and territorial cohesion such that the benefits of growth and jobs are widely shared and people experiencing poverty and social exclusion are enabled to live in dignity and take an active part in society.</p>
<p>DIGITAL SOCIETY – EU flagship initiative “A digital agenda for Europe” to speed up the roll-out of high-speed internet and reap the benefits of a digital single market for households and firms.</p>		

Figure 2

Ideal-typical OMC process



Note: The figure is a translated and slightly modified version derived from Eckardt and Kerber, 2004, p.125. It must be noted that such a figure constitutes a "rather abstract template" by providing an illustration of the "ideal-typical sequence of 'guidelines-indicators-national plans-evaluation'", which in reality does not emerge in all relevant policy areas (as emphasized by Radaelli, 2003, p.2., p.9. and p.15).

Teaching European Literature(s)

Sonja Stojmenska-Elzeser

Abstract

This paper questions the possibility of teaching European Literature in the academy. Can we speak about European Literature as one coherent and cumulative teaching field? Evidently, there are problems with defining European identity itself, so the question of European literature is even more complicated and uncertain. Which and whose literary works could be incorporated in the common European literary canon, if such a canon exists at all? The building of such a canon must take into consideration many different, mainly unliterary aspects: the pragmatic aspects of literary phenomena, the literary field, market, economy, literary awards, etc. Also, postcolonial aspects are very influential, especially regarding the minor cultures and the hybrid cultures born as a result of migrations. From the other side, there are some moments in literary history that are very appropriate for European contextualization, and others which are not. For example, the period of Renaissance, or medieval culture, or the culture of 20th century, can be easily researched on a transnational level. But, there are also movements that are local and it is difficult to observe in what respect these fit into the wider European context. Theoretical and practical problems of observing European literature as a whole, based on the principles of inclusion, transculturality and overcoming eurocentricity are main points in this discussion.

Keywords: European literary canon, European identity, European cultural context, eurocentricity, transculturality

Teaching European Literature(s)

The present-day academy faces many challenges on theoretical and practical levels. To teach literature nowadays is a very uncertain and provocative task because of the questionable position of literature in the contemporary world. The problematic approach to the classical concept of literary history makes all the efforts for encyclopedic knowledge meaningless. Also, the new media and growing dominance of information technologies have a serious impact on literature's existence. Political, economical and other unliterary movements are responsible for the axiological gap between art and literature, and for their enormous production, re-production and commercialization. What can be the main goal in teaching literature in academies today, except to make the students capable of keeping a relationship with literature, to enjoy literature and to think about it and comment on its values in a wider cultural contexts?

Starting from that point I would like to examine the possibilities of teaching literature in a European context instead of teaching one monolithic compendium of European literature(s). In fact, the speculations on this issue are a kind of proposal for a postgraduate course in cultural studies which uses an interdisciplinary approach to literature and arts from the point of view of European identity. Evidently, there are problems with defining European identity itself, so the question of European literature is even more complicated. Which and whose literary works could be incorporated into the common European literary canon, if such a canon exists at all? The building of such a canon can no longer be based on principles of classical literary history, but it must take into consideration many different, mainly unliterary aspects: the pragmatic aspects of literary phenomena, the literary field, market, economy, literary awards, etc. Also, postcolonial aspects are very influential, especially regarding the minor cultures and the hybrid cultures born as a result of migrations. Transculturality as a dominant form of reality in the world has serious consequences on the humanities. For all these reasons I dare to ask: Does the academy need a canonical approach at all? Does the student need to have encyclopedic knowledge about the sum of the national literary canons that are included in the European integration process? I prefer to answer this question negatively and I would rather mention that students need to have a proper orientation and basic skills in navigating the map of Europe's "republic of letters" (let me use the term from the title of the

influential book by Pascale Casanova), but, on the other hand, to have developed a strong sense of the specificities of the European cultural context.

What do I mean when I say specificities of a European cultural context? First of all, I think of the constant redefinition of the European identity as one unstable and ever changing concept. Europe as "Fenix", as "unfinished adventure" (according to Zygmund Bauman, 2004), as something that is still in expectation, as identity that is in process of being built, or "under reconstruction"... Europe is an enigma: geographically it is "a little promontory on the continent of Asia" (Paul Valery), in mythology it is a raped princess who is happy to be kidnapped, for politicians it is an "unidentified political object" (Jacques Delors), for economists – one common market "without soul", for philosophers very different things, for example for Immanuel Kant it is the "perpetual peace" project, for George Steiner (2004) "a map of cafés", for H.G. Gadamer it is "fusion of horizons".

The question of European identity is very often treated in literary works, so it helps to include the voices of poets and writers in this endless discussion. The orientation of a student in this "intellectual cartography" of the idea of, about and for European culture is most important for further understanding of its phenomena as inclusive, transcultural, post-national and post-Eurocentric. Intercultural communication, multiple identities, pluralism and diversity should be widely accepted as principles of the rethinking of a European context. Europe should be always accepted as a mission, as a task, according to the Italian philosopher Massimo Cacciari, who says: "We must always be building Europe. And it can't be built with hegemonic intentions, as we have seen throughout European history: Charlemagne, Charles V, Napoleon, Hitler – they all attempted to exercise hegemonic power over Europe. But every time someone has tried it, Europe has got rid of them, she has not wanted anyone who wanted *one* Europe. Europe is not one, they are many" (Interview with Massimo Cacciari) "I am many", says Europe. We have to be capable of being many.. In this multiple and polycentric vision of European culture the literature can't be observed as *grand narrative* - it can exist just in partial networks, localized narratives, nexuses of researchers made from a European, but not Eurocentric perspective.

Such researchers can have a vertical or horizontal direction, or with other words, they can cross time or space, to be historic or geographic in a postmodern sense. The first ones refer to the different stylistic formations in the classic literary history that can be commented on from the European

perspective. Some of the best books of ComLit de facto are such types of research. The problem is that there are some moments in literary history that are very appropriate for European contextualization, and others which are not. For example, the period of the Renaissance, or medieval culture, romanticism, modernism or the culture of the 20th century, can be very easily put in frames and can be researched on a transnational European level. But, also there are movements that are local and it is difficult to observe to what extent these movements fit into the wider European context. Depending on the affiliations of the students and on the teacher's main fields of interest, one can choose various aspects to be researched in a European context. In such an approach of great help are new electronic archives that provide access to materials from visual arts and literature in enormous quantity, so that they become an important and necessary educational tool.

From a horizontal perspective the multiple European identity can be researched from the starting point of cultural geography mainly oriented to the uniqueness of the European regions, and the dominant characteristic of the literature written within them. For example, I would mention the research of the Mediterranean cultural sphere (as it is done in Fernan Braudel's work for example) or of the phenomena of Mitteleurop or/and Central Europe (although literally these concepts seem to be synonyms, they are not, as seen through the lens of Milan Kundera, Vaclav Havel, Danilo Kish etc.), the West and East, or Occident-Orient implications in culture and literature, the specificity of the Balkan region (Maria Todorova), of the Black Sea (Neil Asherson), of the Danube river (Claudio Magris), reflections on Nordic, Alps-Adriatic, Iberian and others cultural regions and other similar research.

Especially provocative and still enigmatic and strongly politically colored is the problem of the East European and South-East European cultural region (as an example in these frames I will mention the project *History of the Literary Cultures of East-Central Europe* by Marcel Cornis-Pope and John Neubauer, 2004). This approach in classic ComLit was strongly expressed in the theory of interliterary communities advocated by Dionis Djuřishin and afterwards they came into the focus of studies worldwide, introducing the consciousness of common characteristics of wider, mainly geographical or geopolitical regions. One of the highlights of such a type of ComLit research which is now combining literary histories and Zeitgeist-history with geopolitical implications is the project *Comparative History of Literatures in European Languages* coordinated by Margaret R. Higonnet in

volumes that are devoted to avant-garde, renaissance, romanticism (as stylistic formations in European context) and Caribbean, East-Central European and Iberian regions (as geo-cultural regions of Europe). It is a pity that this kind of research hasn't yet been sufficiently introduced into the educational process.

On this level Europe is observed as "Europe of regions", of nexuses, of intercultural connections. Another level of observation could be "Europe of urban settlements, of cities". European cities as a backstage for many narratives, give an opportunity to comment on the characteristics of plurivocal and intercultural European realities. There are so many literary works connected or devoted to particular cities, and through that there is so much material for discussions, which can combine the literary facts with architecture, film, tourism, urban sociology and other aspects of cultural studies. For example, cities like Dublin, Sankt Petersburg, Paris, Prague, Barcelona can be seen through the eyes/discourses of their writers James Joyce, Alexander Pushkin, Charles Baudelaire, Franz Kafka and many architects, filmmakers, painters... Most provocative on this level are border cities and cities with strong multi- and intercultural background, so called "liminal cities" or "marginocentric cities", such as the cities of Odessa, Vilnius, Trieste, Sarajevo, Skopje... The modern concept of *flâneury* and the postmodern concept of "imagined cities", as well as the influence of art and literature on a city's formation of its own identity are some of the questions to be discussed in these frames.

Cities are the surroundings for transcultural transformations provoked by the migrations, exiles, travelling, etc., and any new elaboration of European culture has to count on that. "Transnational and transcultural streams are not exceptions anymore, we can say that they became norm or very soon will be norm. They are the material from which the European culture and identity should be carefully built" (Meinhof & Triandafyllidou, 2008). The literary studies have to take care of writers whose profiles and literary works are "on the borders" and who express the cultural dialog in their works. Exiled and diasporic authors make the special issue of teaching literature in a European context.

The matter of cultural mediation focuses our attention on the most important aspect of supranational cultural and literary research. That is the translation issue. Students must be aware of the importance of the literary translation as a highly creative work, but also of the non-literary impacts on its

development. It is always a result of many cultural streams, connected with ideology, politics, fashion, marketing, literary awards and other segments of cultural industry. For literary works coming from so called "minor cultures", to be recognized and accepted by the readers of other European environments, is one of the main goals. Successful translation in several languages is the first step to it. Also the system of translating literature in minor cultures has a much more complex role in the literary polysystem (to use the terminology of Itamar Even Zohar, 1979) than in the cultures with great influence. That's why the theory and practice of literary translation is a very important part of education and of cultural policy in general today. Here comes the rhetorical question posed by Zygmunt Bauman on this matter : " ...how much wisdom we would have all gained, how would our co-existence have benefited, had part of the Union's funds been devoted to the translation of members' writings... Personally I am convinced that it would have been perhaps the best investment into the future of Europe and the success of its mission" (Bauman, Z.). With the new technologies the policies of "better knowing each other" (or the vision of a possibility for "everyone to know everyone") become more and more optimistic, so the numerous projects of electronic sources or libraries, archives and digitalized museums provide us with access to a really wide quantum of information.

It is obvious that the proposed educational practice is rather eclectic from the point of view of the methodology. In fact, it is the teaching program on the crossroad of ComLit and cultural studies, which combines various disciplines (philosophy, history, sociology) and different approaches (area studies, postcolonial critics, translation studies etc.). Somebody could ask: Where is the literature here? This program addresses postgraduate students who have surpassed the phase of "literarische Bildung" and who read literature not just in their mother language, but also in at least one foreign language. They are supposed to be acquainted with the most important readings from world literature before taking an adventure of European contextualization of literature. With this proposed type of literary education we could contribute to the building of "European citizenship" and to the forming of a European public sphere, which is one of the main necessities of present European integration processes.

Literature is a phenomenon of cultural dialogue and a specific mode of communication. If we agree that "Europe exists only in the modes of communication about it" and that the "EU has become more like a network

than a traditional state" (Delanty, 2006) than researching literature in a European context is one of the most interesting fields to examine the basic ideas of EU, the dominant European discourses and concepts and the European autopoietic self-definition. Such an approach to literature studies is appropriate to the human situation in "liquid modernity" (Bauman) and is strongly future-oriented.

Conclusion

Modern knowledge does not consist just of information. It is much more about moving through information, systematizing and applying facts according to some premises. That's why my advocating for teaching literature in a European context rather than teaching the history of literatures written in Europe in a classic sense is a kind of orientation, preparation and general framework for various research projects chosen by the students themselves. In contact with literature written in the countries located on the European continent they learn how to recognize and to overcome the Eurocentric position, not just in the imperial history but also today, in the policies, discourses and movements of our time. They learn to appreciate the main value of the EU concept of *unity in diversity* and to respect the plurality. They get acquainted with many different understandings of the concept of Europeaness through history, in politics, philosophy, literature and in common life, and receive some basic directions for perception of the cultural heritage of Europe, participate in the redefinition of European imagination and enrich the polyglossia of discourses on Europe.

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Impetus for Parliament's Change: Comparative Approach - Macedonia and Switzerland

Olimpija Hristova

Abstract

Can the work of parliaments improve and become what it is meant to be: a place of genuine representation of citizens in the modern democracies? It is of vital importance that political scientists address this question, since many indicators point to the democratic deficit in the European countries. The decline in electoral turnouts, lack of participation in public deliberation and party membership all the more pronouncedly challenge the future legitimacy of the democratic institutions of the political system. However, if one carefully follows the current trends in democratic research, namely, quality of democracies and democratic deliberation; Switzerland remains a prime example of a small European consensual democratic state, where states with similar configuration of the political system could look for ideas. In this paper I look at the growing relevance of the Swiss Parliament apparent in its increased quality of deliberation, due to greater research activities and professionalized knowledge backing of the Swiss Parliament's activities on one hand, and the direct democratic practices on the other as the backbone of its political system. The paper presents a comparative study of particular findings in the work of the Swiss and the Macedonian Parliament regarding their increased importance as democratic institutions, calling attention to the lessons that Macedonia can draw from the Swiss practices for improvement of its institutional capacities. The tentative conclusion is that Macedonia has to invest more in research activity concerning the parliamentary deliberation and legislative procedures in order to increase its relevance as a representative institution, reinforced by revitalizing the direct democratic practices.

Keywords: *research, direct democracy, deliberation, Parliament, Switzerland, Macedonia, quality of democracy, institutional design*

Introduction

Parliaments are often times perceived as symbolic institutions merely confirming policy decisions and representing a décor underneath the shadows of the executive governments, while loosing their impetus for real change. Therefore, parliaments that infuse a dose of uncertainty especially in consensual democracies are a worthwhile subject of evaluation for getting insight into how their work can be improved. Correspondingly, the concept of democracy at this point of political system development may sound quite tedious and myopic if one does not really approach it with the hope to make it sanguine. Numerous criticisms and attempts to remedy parliaments as a stronghold of democracy are present in the literature and the political scene, which to me only proves that this concept is alive and gives boundless chances for change! As Philippe Schmitter asserts: "We are dealing with a moving target" (2012). Believing that democracy actually goes much beyond elections, government formation and the power of the executive increases the significance of the lively institution a parliament could be. Why? Simply because of its nature - to represent the citizens in a process of decision-making and the creation of the rules they are further required to abide by. Gerardo Munck put it nicely: "democracy is all about guaranteeing a political process in which no outcomes are placed beyond the reach of the people" (2009, p. 124).

Fortunately the work of parliament is gaining greater interest, especially among academic institutions in Switzerland, constructing Discourse Quality indexes (Steiner et.al, 2005), evaluation of deliberation in parliaments, particularly in the committees etc. Hence the broader question of this essay is how can parliament become a more relevant and influential institution in consensual democracies? For this reason, and because of already available data for deliberation in the Swiss Federal Assembly, I look at developments concerning parliamentary work in the last decade, when Tretchel and Kreisi argue the parliament is both changing and strengthening its position in the political system (2008, p. 75). The hypothesis is that the Swiss Parliament gains greater relevance and becomes more influential because of two features of the Swiss political system combined: parliament deliberation based increasingly on research activities and constant use of direct democratic practices. Looking at institutions separately may bring skewed conclusions and emphasize characteristics that are not really that influential if

put into a broader context of institutional design. Therefore, my argument is that Macedonian Parliament has to pursue the deliberative practices reinforced with quality research and more robust direct democracy, in order to gain greater legitimacy as a key representative institution of the political system.

From a comparative point of view, it is important to notice at the very beginning that the differences between the countries are pronounced, both in terms of history and economic development. Switzerland is one of the richest and most highly developed democracies and Macedonia - a developing, semi-consolidated democratic country (Nation in Transit, 2011, p. 21). Another major difference is the way in which the countries have gained their statehood. Macedonia got its independence after the dissolution of Yugoslavia in 1991, whereas Switzerland on the contrary, is a federation built from below - with a consensus of the cantons to become a modern federal state in 1848. Switzerland is a federation, while Macedonia is a unitary state with a consociational complex power sharing model (Weller, 2011). Furthermore, Switzerland has crosscutting cleavages: linguistic, religious and ethnic, whereas in Macedonia there are overlapping ethnic and religious cleavages, but also to some extent political party cleavages that generally overlap with the ethnic. Still, they are both small European states, more or less consensual democracies in Lijphart's sense, both divided in cleavages, sharing similar direct democratic mechanisms.

Theoretical Underpinnings

"Consensus politics" describes the ongoing effort to achieve a balanced compromise among key political factors and among the different cultural, linguistic and social communities (Dryzek, 2008, p. 12), while Cohen defines deliberation as reasonableness in the decision making process where those governed by the decision, are treated as equals (2009, p. 250). The main issue is to what extent does legislation really matter in a liberal democracy, since the legislations as Jean Blondel argues are "still docile to the executives and play rather symbolic roles because of party discipline" (1995, p. 253). For setting up the scene and going deeper into the Swiss and Macedonian case, I start with Blondel's emphasize on the importance of research activities in the legislation for the quality of deliberation and Vatter's empirical findings for this argument in the Swiss Parliament. Research in this context refers to

academic and scientific constant support that is at disposal to the MPs in parliaments. To this I add the concept of deliberation in parliament developed by Steiner and other scholars, grounded in Habermases idea of deliberation in the public sphere, and finally embrace the importance of practicing direct democracy in Switzerland for the high quality deliberation in parliament though the mechanism such as citizen's initiatives, citizen's assemblies and referenda. I approach these conditions as reinforcing one another and adding to the greater legitimacy of the Swiss Parliament. Across my comparison, I also use Kreisi and Trechsel's broad account on the Swiss political system and Florin Bieber's accounts on Macedonia after the ethnical conflict in 2001. I additionally present survey data in order to present citizens' confidence and expectations from the Macedonian Parliament.

Legislation - Participation, Research Quality and Agenda Setting

The main formal tasks of parliaments are the legislative or making laws, discussions on financial provisions, voting the budget and setting up an agenda for a debate (Blondel, 1995, p. 256). Redundant parliamentary debates wherein everyone knows the outcomes, are not new to the public in liberal democracies. Since citizens at large are represented in national parliaments, those by default should be as diverse as possible. Another important task of the legislation is the choice to initiate "great debates" and set an agenda for a broader discussion, rather than merely "follow" (Blondel, 1995, p. 264). This influence "depends on the research support members enjoy, the size of government's majority and on the standing of the executive in the country" (Blondel, 1995, p. 263). In combination with this, the role of Parliamentary committees is becoming more influential in the crafting of the legislative acts as well. In a state where the legislatures are limited in their participation in policymaking, their involvement is growing once members of parliament become more specialized and gain greater research support. Current findings of Swiss Parliamentary research are confirmed by international comparative studies. In his studies on the relationship between the executive and the legislature in eighteen Western European states, Döring (Vatter, 2008) allocates Switzerland in most cases to the group of countries characterized by the lowest level of governmental control on parliament and simultaneously the most developed powers of parliamentary committees and individual MPs (Vatter, 2008). Therefore, Switzerland is a case where we find

how the *good research* establishment creates fertile ground for greater professionalization and expertise of the MPs, and hence contribute to the smooth functioning of the legislation.

What we see on the other hand in the case of Macedonia is that the research support for policymaking in the Macedonian Parliament is just becoming realized as essential for the quality of legislation, and for the first time a Parliamentary Research Institute is in its initial phases of being established in the Macedonian Parliament (NDI, 2011). The absence of such a research center until now poses immense challenges to the parliament as well as the other state institutions with regards to evaluation and setting a quality basis for policymaking and informed legislative processes.

The Swiss Political System

Switzerland represents a unique case of a consensual federal democracy, with many of its practices based in a tradition that is to some extent still resistant to greater changes. Namely, since it became a modern federal state in 1848, Switzerland has a pluralistic party system without a single dominant party but four major parties: Swiss Social Democratic Party (SP), The Liberals (FDP) and the Christian Democrat Party (CVP). Even the Swiss People's Party (SVP), a far right wing, is a system party and it is in Swiss Parliament. Since 1959 these parties formed a grand coalition for the Federal Council, which is the executive, by the authentic Swiss "magic formula" that creates grand coalitions including representatives from the major political parties (The Swiss Confederation Guide, 2011, p. 43). However since 2007, the SVP is not part of the Federal Council, despite being the country's party with the greatest number of votes. The system is also characterized by the dispersion of the political power in the 26 cantons with a hybrid parliamentary-presidential system and their popularly elected executives. Being the least populace federation, federalism in Switzerland is acquired because of the plurality of the society with four official languages; twenty-two cantons are unilingual, three are bilingual (Bern, Fribourg and Valais), and just one (Graubunden) has three official languages. Cross cutting cleavages stabilize the country and represent polarized pluralism, which is why the country is not considered a consociational model in its strict sense. Nevertheless, today classic religious and ethnic divides show up only on a few issues like EU integration. It could be argued, however, that because of

the vanishing of the religious cleavage, Switzerland is getting closer to the classical model of competitive democracy. Since the classic divisions Catholic vs. Protestant, French vs. German speaking are vanishing, a possible vacuum is in sight, which will present a challenge for the new generations to maintain a common identity. However, both historically and presently, Switzerland is a country of the “willing” (Pelinka, 2011) where the will of the people keeps the country together.

Swiss Legislation

The government of liberal democratic countries lets legislatures debate major issues, yet Blondel continues, “they also generally succeed in ensuring that the policymaking process is not markedly affected as a result” (1995, p. 251). This is not the case with Switzerland, since it has a stronger Parliament than executive. The Swiss legislature is undergoing changes and is gaining greater relevance in the last decade besides the great power vested in the cantons. Both chambers in the Federal Assembly: the National Council and the Council of States are directly elected, reflecting the horizontal control and balance of power. According to Lijphart’s classification of legislatures, “Switzerland is one of the rare examples of bicameral legislatures with formally equal powers” (in Blondel, 1995). Furthermore, the functioning of the Swiss Parliament is semi-professional and among the cheapest in the OECD countries; the MPs besides their professional engagements, dedicate about half of their time to the Federal Parliament. In line with Blondel’s aforementioned arguments on the importance of legislature, he also claims that “since the activities on the floor do not always give the legislators marked opportunities to exercise influence, committee work has an impact in boosting the morale of the legislators who can see that they are not reduced to supporting” (Blondel, 1995, p. 263). Each chamber in the Federal Assembly has ten legislative and two supervisory committees. In the case of Switzerland, new research on the role of legislature grant the credit of greater legislative influence to the work of the committees.

The Federal Assembly not only strengthened its legal influence, but also made sure, by way of structural adjustments (*reform of the commission system, streamlining council debates, strengthening council committees*), that it is also able to exercise its rights in a more effective manner. For instance, the Parliamentary Administration Control was created as an exclusive unit to

conduct evaluations for the oversight committees that were responsible to evaluate the effectiveness as a new important criterion to control the administration (Rist & Sandahl, 2002, p. 378). But mere evaluation and checking of legality and bookkeeping was not enough for the Swiss institutions, realizing that the social sciences can develop more sophisticated perceptions of social problems, and the institutions should embrace this knowledge. The process of introducing scientific knowledge from the social sciences research was started in the 1960's and increased in the 1990's when methodological approaches were brought to the administration and there was a proliferation of research and development within the state institutions (Rist & Sandahl, 2002, p. 380). These processes were overseen by the Swiss Development Corporation, The Federal Office of Justice, and The Swiss National Fund of Scientific Research, providing numerous studies on policy creation and implementation. More specifically, the Swiss Association for Political Science, Swiss Association for Administrative Science, the Swiss Evaluation Society (SEVAL), and the National Center of Competence in Research Challenges to Democracy in the 21st Century have contributed greatly to the research. The universities and the cantonal institution that themselves set up research departments in order to improve their policies and effectiveness also play important roles.

Besides the fact that until recently the Parliament in Switzerland was still slow in terms of considering scientific and strategic long-term perspectives for the policies by the Parliament (Rist & Sandahl 2002, p. 384), the studies I here refer to show that the last decade drastically changed the approach towards the research at disposal to the MPs. One study by Vatter concludes that in the years 1996-2004 the Parliament amended around 39 % of government drafts (Schwarz et al. in Vatter, 2008). Thus, in recent times, Lüthi (in Vatter, 2008) concludes that, overall, the Parliament has at its disposal a range of differentiated legal instruments that enables it to effectively participate in the legislative process and exercise its supervisory function.

Swiss Direct Democracy as an Impetus for Efficient Federal Legislature

Besides the improvement of legislative procedures backed by research activity, which boosts the efficiency of the Swiss Parliament, this I argue is also due to the robust direct democratic system. Its represents not only Swiss pride where 41 % of the population is very proud and 45.7 % are proud it (Trechsel & Kriesi, 2008, p. 66), but also I argue key to a functioning parliament, which is always under latent constraints of the sovereignty of the citizens. A key idea is that there is no opposition in the Swiss Parliament, but the opposition is the citizen through the practice of direct democracy. Several times a year the citizens of the Swiss cantons go out and vote either for issues in their communes, cantons or on a federal level. Through a petition, any canton at any time can raise a legislative initiative to the Federal Council, or eight cantons can launch a referendum against a Federal law. The cantons can become strong veto players if they coordinate their action (Trechsel & Kriesi, 2008, p. 40). After the last revision of the Constitution in 2003, there is an incremental pattern of extension of direct democracy on the federal level, taking the experience on the cantonal level (Trechsel & Kriesi, 2008, p. 51). More empirical support is required to show correlation between greater practice of direct democracy on the federal level and improvement of the parliamentary performance. Still, by the practice of direct democracy, Switzerland is an open political system, where interaction between MPs and citizens influences deliberation in parliament (Lutz, 2008, p. 7).

The anecdotal nature of the argument that parliament should be the place for civilized deliberative discussions, moves scholars like Jürg Steiner to search for empirical grounds for the normative judgments on how important deliberation is in democracies, particularly in parliaments (Steiner *et.al*, 2005). Tschentscher *et. al.* found that "in the Swiss case, a more deliberative political system is coupled with direct democracy" (2008, p. 18). In this institutional scenario, deliberating politicians are more directly accountable to citizens, who can scrutinize deliberatively achieved political decisions via direct democratic votes. The possible drawback of this conclusion is that the deliberative behavior of parties strongly varies within the same institutional setting, showing that deliberative willingness is a potent driver of the quality of political discourse (Steiner *et.al*, 2008, p. 21). Also, the high quality deliberation in Parliament does not explain much of the outcomes, but most

certainly sets an example for a case such as Macedonia where the quality of deliberation has rudimentary if any research; and the heuristic conclusions so far show that it conveys a meager perception of the institution itself.

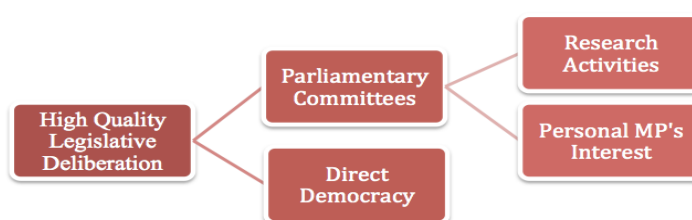


Diagram 1. High Quality of Deliberative Legislation

Based on the conclusions of Tschentscher, Axel, André Bächtiger, Jürg Steiner and Marco Steenbergen and personal conclusions from these researches. Both the research activities and the personal interest of MPs to engage in their parliamentary work professionally, positively influence the work in the committees, which also affects higher quality of parliamentary deliberation. Also, direct democracy itself positively affects higher quality deliberation in Parliament (Tschentscher et al, 2008).

The shortcomings of the Swiss model are generally located in the lower turnouts on referendums, but they are still significant (Pelinka, 2011). The referendum in many cases has a conservative structured bias where direct democracy practices are structurally conservative and status quo oriented" (Pelinka, 2011). This explains why we cannot observe anti system parties of a new type since the last new Swiss People's Party emerged in the 1920's. Switzerland has especially low turnouts in elections, and the level of participation in direct democracy is between 45 and 55 % (Trechsel & Kreisi 2008, p. 62). Regardless, the complaints that direct democracy also slows down the legislative processes and poses an obstacle for greater international integration, it still works very well as an efficient control or rather impetus to improving the work of the Federal Assembly. Concerning Parliament itself, Swiss MPs work 70 % of their time in the committees, but until recently, the MPs were not paid. Even though citizens trust Parliament, they were not ready to support greater funding for MPs greater specialization. These perceptions of citizens' for a while were making them permeable to social group interests and lobbying. But the important fact is that Swiss MPs are moderate, injecting uncertainty between government and Parliament

(Trechsel & Kreisi, 2008, p. 74). This was seen in the last Federal Election in October, 2011, when again the center was strengthened and hindered some trends of greater polarization. This I argue is not uncertainty, but rather the way the parliament should work if there is high discourse quality and real interest for the broader society. All in all, Swiss pride is more concerned with the direct democracy but it certainly has a positive effect on the Federal Legislature, which has been noted empirically.

What Lessons Can be Drawn?

The relatively new democracies in consolidation are looking at the example of the Western democracies, figuring out how to apply the principles, where the assembly, the legislation, or the house of representation is an inevitable feature. Still, the fatigue for its vital democratic role seems to expire. Should the role of parliament remain purely symbolic or do efforts in the direction of infusing life to this institution make sense at all, especially after some backsliding examples from developed democratic parliaments? But we do find examples that are not perfect, yet moving towards improvement such as the Swiss one presented herein. Of course, the suggestion is not to apply practices as they are in Switzerland, but my approach is meant to display some possible directions for contemplation that I believe would thrive in the Macedonian context and solidify in time. Even more, some initiatives between the two countries regarding parliaments are in progress and it will be noteworthy to see their provisions and evaluate the progress they bring. Therefore, in the next section, I will briefly lay out the important features of the Macedonian political system for comparison with the Swiss one.

Macedonian Political System

Macedonia consists of several main cleavages: ethnical, religious and political. Ethnical minority groups contain 35% of the population, with the Albanian as the largest one. The country pursues consensual institutional practices in order to integrate the society and offer stability. To its credit, the Ohrid Framework Agreement (OFA) that came into power after a short ethnical conflict between Macedonians and Albanians in 2001, "did incorporate key aspects of complex power-sharing and the consociationalism encouraged collaborative decision-making by the parties" (Ilievski, 2008, p.

29). The process of decentralization, double majority in Parliament and greater inclusion of the minorities was a major outcome from the OFA. Bieber argues that the OFA transformed Macedonia into a "self-defining nation state with informal grand coalition" (2008, p. 24), where the parties are required to cooperate on an ethnical basis since they need a majority in parliament. The double majority is necessary for questions on culture, use of languages, education, personal documentation, use of symbols and local-self government. In this sense, the minorities cannot really affect the economic policies, which present a kind of compromise for smoother legislative processes. This actually forces the parties to form coalitions more out of a sense of pragmatism than actually moving towards greater integration. On the basis of Blondel's accounts of parliament's character, I argue that generally the Macedonian Parliament even though very diverse ethnically and politically, is more a symbolic institution that merely confirms already drawn legislation. The reason for this problem is sometimes given as the proportional electoral system, which is still in favor of the larger parties, or the non-use of direct democratic initiatives (referendum and national initiative guaranteed by the Constitution). But one of the biggest factors is, I argue, the weak consideration of research support on parliamentary legislation. Hence I find Switzerland a good comparative case for Macedonia.

Lack of Research Backing in Parliament

In Macedonia the Parliamentary Committees are gaining greater attention; especially the one introduced with the Ohrid Framework Agreement. This is the Committee for Inter Ethnical issues which has seven Macedonians, seven Albanians, and one representative from each other minority. This Committee in the absence of a second parliamentary chamber is supposed to balance the debate in the Macedonian Parliament. In praxis so far, this Committee has only marginal significance. Instead, the greatest emphasis goes to the grand coalition and the informal leadership meetings, which overshadow the transparent power-sharing institution that should be closer to the citizens. The Macedonian Parliament therefore is far from being a body for deliberation, but a reference point of political power. The former is not a surprising observation, since the grand coalition has a double majority in Parliament, which does not give incentives for greater deliberation or uncertainty. Taleski argues, "if you control greater majority in Parliament, you

will cooperate less with the opposition and vice versa" (2009, p. 4). Such ill quality deliberation creates more pressure and degrades the institutions itself, since as Talevski continues, "it serves as mere procedure and political revanchist through very inappropriate behavior." Regardless of how pessimistic this conclusion may sound, I see greater research backing within the Macedonian Parliament as one of the key goals to be pursued in the Macedonian case that will have its positive implication on the parliamentary discourse quality.

In ethnically and religiously divided societies, this gets greater weight since it would slowly shift the debate to better-grounded and informed discussions in plenary and committee sessions, which can have an integrating effect in regard to the diverse ethnical composition of the Parliament. It will also lead to professionalization of MPs, since profound knowledge would make MPs debates better augmented, and concentrate the debates on the substance of the particular policy. For instance, it can focus on new findings in how parliaments improve their communication with citizens or use researches and surveys from comparative politics to improve accountability mechanisms of MPs or government representatives.

The debilitating experience of research quality in the Macedonian Parliament infers an urgent need of supporting such endeavors since social scientific research is not generally appreciated as a policy tool or good background for policymaking. One indicator is the fact that there are hardly any research methodology courses for familiarizing the students of social sciences with scientific research in their disciplines during their undergraduate studies. The motions of MPs on the floor are very speculative and often times the debate simply turns into offences not founded in argumentative debate and deliberation based on empirical findings. Even the analysis on how satisfied citizens are with the work of the Parliament are scarce, and without noticeable domestic interest for research on improving the quality of the Parliament as a democratic institution. Again foreign funding like Westminster Foundation for Democracy in Macedonia and the US National Democratic Institute, NDI supports the researches that have happened twice to analyze the perceptions of citizens on Parliament more comprehensively (IDSCS, 2010 and 2012). One of the most important finding in their analysis is that the citizens expect greater initiative from MP's (Figure 1, appendix). Furthermore, the citizens characterize the deliberation on the plenary sessions in Parliament and the committees as predominantly negative (Figure 2,

appendix). Lastly, they still do not have the habit to follow the deliberation in the committees (Figure 3, appendix). Comparing the surveys from 2010 and 2012, there is a constant trend of increase with the response – “I don't know” which can modestly be interpreted as vesting hopes in the representative function of Parliament, yet the citizens are confused on the role of the Macedonian Parliament in the overall political system (IDSCS, 2012). From these results, the citizens still recognize it as an institution with great democratic potential. Hence my argument that Parliament can play a crucial role in the Macedonian society in conjunction with increased direct democratic practices and increased research backing.

More Research, More Direct Democracy

In two ways Swiss accumulated knowledge is currently present in Macedonia, through the Swiss Agency for Development and Cooperation (SDC), which reflects the two courses of action regarding greater relevance and policy influence of parliament I previously elaborated on. First comes support for the creation of a Parliamentary Institute for independent analytical and comparative research and training, and second the support for improving the process of decentralization. These subdomains of Swiss assistance through the SDC allow Switzerland to additionally contribute to the democratization process and through these initiatives raises its stake in Macedonia's democracy by “stepping up the lawmaking capacity and resources of MPs, as well as by consolidating opportunities for citizens to communicate their concerns and interests to the legislators” (SDC, 2009, p. 13). By following my previous accounts on what makes Swiss Parliament gaining more relevant, these pledges of the SDC are a pure reflection of the positive experiences Switzerland has acquired in the last decade.

The substantial initiative in the direction of improvement of research hopefully will surpass the theoretical and speculative debates in Parliament lacking empirical grounding. Expanding the quality of deliberation research in parliaments in developing countries is one of the major recommendations of Steiner et. al in their research on *Deliberative Politics in Action* (2005). The new Parliamentary Institute I argue should follow these recommendations, and by this improve and provide data for further comparative researches. Namely, the initiative for a new Parliamentary Institute is driven by the conclusion that “the presence of an independent research center is crucial for

the Constitutional role the Parliament should play and for impartial preparation of laws and effective control of the work of the government " (NDI Webpage). Bearing in mind that the "the policymaking capacity of Macedonia is poor, and rank and file have little opportunity to participate in decisions" (Crisis Group Report, p. 9), the politicians and government should take a responsible and mature approach to these new institutes and profit as much as possible from its research.

The Swiss development implementation projects also subscribe to the country's ongoing decentralization process, which I find relevant to the second major point of my argument, namely, the direct democratic practices. In line with the 2001 Ohrid Framework Agreement, this process was aimed to balance the interests of the various communities. The decentralization process presumably should strengthen the democratic capacities and practice of direct democracy on a local level. Those in the Macedonian case are citizen's initiative for a certain legislative act, compulsory and facultative referendum, citizens' forums and citizens letter of appeal (Siljanovska, 2004, p. 220). The improvement of the direct democratic practices as shown in Tschentscher et. al should be accompanied by greater quality deliberation in parliament. This is quite obvious knowing that the MPs always have in mind the possibility of citizens initiating new law, or calling a referendum.

Conclusion

A key feature of democracies is effective legislation. The trends in the last decade in Switzerland and the efforts for a Parliamentary Research Institute in Macedonia are moving in that direction. In this essay I elaborated on the factors that influence and increase the importance of the Swiss Federal Parliament accompanied with the direct democratic practices. The analysis on the specific Swiss political system in recent empirical studies come to the conclusion that the Parliament is changing its role in policymaking and gaining greater influence because of greater support of research activity and professionalization articulated in the improvement of the intermediate functions of parliamentary committees. Direct democracy also serves as a mechanism that sets latent control on the Swiss Parliament since citizens use their legislative instruments at their disposal to legislate themselves. These factors make the urge for greater quality deliberation more easily achievable and significant; of course in combination with other factors like political culture, party system, citizens interest in the decision making process etc.

As a model of complex- power sharing, the Swiss model is a good place for drawing lessons and practices for countries such as Macedonia. Given that the political system remained flexible in many regards, such as not formalizing rules for grand coalition (Bieber, 2008, p. 57), it makes it vulnerable but moreover gives an alibi to the politicians to behave opportunistically and speculatively. However, increased research activity and giving impetus to citizens for more direct democracy I consider crucially valuable for making parliament a more influential institution in policymaking. In time, if Macedonia is moving in this direction one could hope for improving deliberation within the Macedonian Parliament and the democratic system as a whole. The greatest challenge for both countries is to constantly maintain a feeling of community among its citizens and keep the state together. Swiss willingness might evaporate in time or Macedonians still fragile consensus has a potential to radicalize again. Still the democratic institutions should strive for creating favorable conditions and balance for the ethnical, linguistic and religious divisions. However, even the institutional capacities as Schneider argues, "exert their impact only in combination with other institutions and the societal context in which they are inserted" (Schneider 2009, p. 113). Hence, the conclusions of this short study and the current events on the ground in Macedonia, give ample material and direction for further research on how the work of parliament can be improved combined with other institutional and social factors.

Appendix

Figure 1.

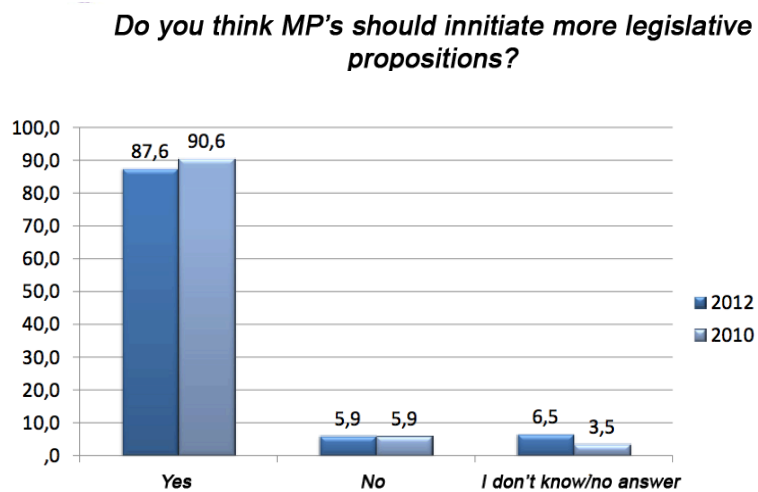


Figure 2

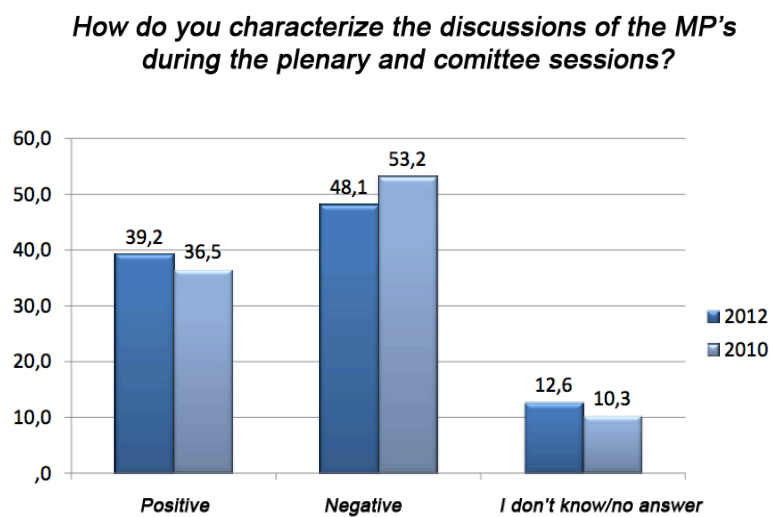
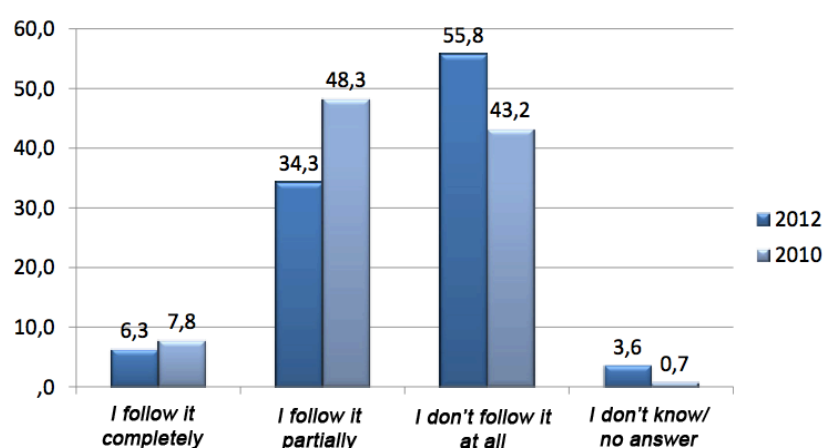


Figure 3.

How often do you follow the work of the committees?**References**

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Comparative Analysis of Applications to Erasmus Mundus and Tempus Programs in Slovenia, Croatia and Serbia

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Abstract

Lagging, in an economic sense, behind USA and Asia, rising unemployment, high costs of pensions in the national framework of member states, are some of the reasons why the European Union developed a strategy for economic development which is based on knowledge and scientific research. Namely, the European Union saw a way out of the recent crisis in improving the higher education system and in increasing the number of educated people. In this paper, the authors emphasise the relevance of higher education and its role in raising productivity not only in the national framework of each country, but also on the level of the EU. The paper discusses the main issues of the Bologna Declaration, the Lisbon Strategy, Europe 2020 Strategy, and the programs implemented by the European Union to raise the level of the higher education system, to recognise foreign diplomas and to increase the mobility of students and lecturers. In a comparative approach the paper shows how Erasmus Mundus and Tempus programs are used in Serbia, Croatia and Slovenia. The authors chose to compare these three countries considering that Croatia recently gained the status of candidate for EU, that Serbia still has not gained the candidate status, while Slovenia has been in the EU since 2004. The research was done on the basis of the old status of countries because more recent data was not available to the authors. The research problem is set in the form of the question: "Which country, Serbia, Croatia or Slovenia, makes more use of European educational programs?" The conclusion of this work, as well as the empirical part, contains suggestions for the improvement of higher education and the Lifelong Learning Program, i.e. their application.

Keywords: Higher Education Policy, Lisbon Strategy, Europe 2020, Bologna Declaration, Lifelong Learning Programme

The Importance of Education for the European Union

Lagging, in an economic sense, behind USA and Asia, rising unemployment, high costs of pensions in the national framework of member states, are some of the reasons why the European Union developed a strategy for economic development which is based on knowledge and scientific research, which was called the Lisbon Strategy. Knowledge is the basic moving force of every society and the main prerequisite of progress. An important premise for the functioning and the development of the EU economy is the improvement of higher education systems and policies in each member state. By definition, every investment demands certain start up costs, and this is also true for investing in education. Thus, economically speaking, the costs of investing in pedagogics, education and the health of people are investments in human capital. Increasing the number of people with higher education, as well as improving higher education systems and policies, are conditions for the development of the EU. Education is one of the key elements in the Europe 2020 Strategy, with the aim to encourage development and improve international competitiveness, economic growth, social cohesion and democracy.

In order for the European Union to gain the status of the strongest competitor in the economy, and in order to get closer to the USA and the continuously growing countries of Asia, the EU developed programs and strategies for managing education policy. Namely, the objectives of the EU education policy are: enhancing the quality of general and vocational education, advancing the comprehensive approach to education and the maximum level of knowledge through constant professional improvement, writing up a program of lifelong learning, promoting equality, promoting creativity and innovation. EU member states could not fulfill all these goals on their own, i.e. without mutual cooperation, which is exactly why a need for cooperation between the member states is emphasised, through equalising the value of diplomas and duration of studies, through an exchange of information and experiences, as well as through an exchange of students and teachers.

The objective of our paper is to present the existing higher education policies in the European Union, as well as the existing programs which aim to fulfill the objectives of the Lisbon Strategy, and to offer suggestions for improving them, which would contribute to the status of the EU as a competitive player in the global market.

Theoretical Framework: Higher Education Strategies of the European Union

The Lisbon Strategy

The Lisbon Strategy, 2000, is the main strategic framework for increasing the economic growth of the European Union. It was revised in 2005, since it did not achieve the expected results with its original contents. With the Revised Lisbon Strategy, or, as it is also called, "Renewed strategy for growth and jobs", the European Union, in order to accomplish the set objectives, put emphasis on knowledge, new ideas and human capital. The instruments which were to accomplish these objectives and which were foreseen by the Strategy, are the highest quality of general, as well as vocational, education, legal recognition of diplomas, compatibility of educational systems in Europe and their development, greater investments in research, etc. As one of the main points in raising education to a higher level in Europe there is a need for an international exchange of students and teachers, in order for them to meet the cultures, languages and systems of other countries, as well as for other countries to get acquainted with their country. Furthermore, this point is important for the exchange and the gain of experiences among young educated people. The Strategy should be implemented on the level of the European Union, but also on the national level of each member state in order to ensure that the strongest weapons in the fight against economic instability in the European Union are knowledge and innovation (Council of Europe, 2012).

As a response to the global crisis that has been affecting the EU in recent years, the European Commission has adopted a number of measures and programs, most importantly the so-called fifth freedom, i.e. the freedom of mobility of knowledge, which has complemented the existing four freedoms: free mobility of goods, services, people and capital (European Commission, 2010). In addition, a new strategy has been formed – Strategy Europe 2020, which was begun in 2011, and which sees knowledge as one of three key pillars of the development of competitiveness and productivity (European Commission, 2010).

The Strategy of Europe 2020

In March 2010, the European Commission adopted a new strategy “Europe 2020: A strategy for smart, sustainable and inclusive growth”, which contains the most important elements of the new program. The three most important goals given are: smart growth – developing the economy on the basis of knowledge and innovation, sustainable growth – promoting a more resource-efficient, green and competitive economy, and inclusive growth – ensuring high employment with social and territorial cohesion. Five main objectives of this strategy are (European Commission, 2010):

- increasing the employment rate of the population aged 20-64 to 75% through various programs and activities, including a greater participation of youth, the elderly and the lower qualified workers, as well as a better integration of legal migrants;
- improving the conditions for development and research, especially bearing in mind the aim of increasing the joint public and private investment in this sector to 3% GDP;
- reducing gas emissions which cause the greenhouse effect by 20% in relation to the levels noted during the 1990s; increasing the share of recyclable energy sources in the overall energy consumption to 20%; increasing the efficiency of energy by 20%;
- improving the quality of education, with a special emphasis on reducing the rate of school drop outs to less than 10% and increasing the share of 30-34 year olds in tertiary or an equivalent level of education to at least 40%;
- improving social inclusion, especially through reducing poverty, in order for at least 20 million people to rise from poverty and exclusion.

These objectives are mutually linked. For instance, improving the quality of education will result in increasing the employment rate. Each state should attempt to achieve the objectives proclaimed in the Strategy, and this can be done by implementing them in national legislature. Smart growth, as has already been said, should be accomplished by improving the system of higher education, through lifelong learning programs, financing research and improving information and communication technologies. The emphasis is also on the need to increase mobility of students and lecturers through various programs and grants. Each state is obligated to invest in its educational system, to monitor achieved results, to enable its professionals to enter the work market through apprenticeships, internships, etc.

Bologna Declaration

The main aim of the Bologna process is to create the European Higher Education Area which is supposed to improve employment and mobility of citizens, as well as the international competitiveness of European higher education. The Bologna process encompasses over forty countries, which decided on this plan due to facing the growing problem of uncompetitiveness of higher education. The countries voluntarily opted to reform their higher education systems in keeping with the priorities agreed upon in the Bologna Declaration. The priorities of the Bologna process are (Ministry of Education and Science, 2012):

- adopting a joint framework for comparing diplomas,
- introducing joint undergraduate and graduate levels in all countries,
- introducing a European system of credit transfer,
- introducing European standards for providing quality higher education,
- improving the free movement of students, teachers and researchers.

Instruments of Implementing Education Policy in the European Union

Instruments which the European Union employs in order to improve its education policies are directives and numerous action programs. Through directives the EU coordinates the legal and administrative regulations of member states in the field of education, and defines the field of recognition of vocational and higher education diplomas. All action programs were consolidated in the Lifelong Learning Programme in 2007. Their objectives are: increasing student mobility, exchange of experiences and innovation, improving linguistic and cultural skills, and many others. Aside from the action programs and directives, educational-political activities include other instruments of support to the national policies of member states. It is especially important to mention the founding of a European Centre for the Development of Vocational Training and European Training Foundation (Foundakon Konrad Adenauer, 2010).

Lisbon Recognition Convention, 1997

Recognition of qualifications and diplomas is a goal which most European governments and international organizations strive towards. It is a necessary condition for increasing the mobility of students and teaching staff. The objective of the Lisbon Recognition Convention was to enable students of all countries equal access to all levels of higher education, including doctoral studies, under the same conditions that exist for candidates from the country where the degree is sought, and the use of academic titles, in keeping with the laws and regulations of the country where the title is sought. Upon filing an application to the appropriate body in a country that has signed this Convention, the holder of qualifications should have adequate access to the assessment of their qualifications, without any discrimination. Each country that has ratified the Lisbon Recognition Convention should recognize higher education qualifications acquired in another country that has signed the Convention, unless there are important, essential differences between qualifications of those two countries.

The Committee of the Lisbon Recognition Convention also adopted four additional documents: Recommendation on International Access Qualifications, Recommendation on Criteria and Procedures for the Assessment on Foreign Qualifications, Code of Good Practice in the Provision of Trans-national Education, and Recommendation on the Recognition of Joint Degrees. These additional texts further define and supplement certain points of the Convention and through them the Convention is implemented.

Other important conventions that have been adopted in this field by the Council of Europe and UNESCO are: European Convention on the Equivalence of Diplomas leading to Admission to Universities, European Convention on the General Equivalence of Periods of University Study, European Convention on the Academic Recognition of University Qualifications, Convention on the Recognition of Qualifications concerning Higher Education in the European Region (Council of Europe, 2009).

Action Programs

All action programs of the education policy in the European Union have been over time consolidated in the framework of the Life long Learning Program (LLP), which aims to increase the employment rate and to strengthen the competitiveness of the European economy in the global game, which makes this program a key element of the Lisbon Strategy. The Program also encourages social inclusion, active citizenship and personal growth (Council of Europe, 2009). The following subsections discuss those programs which are the most important, which are being implemented in our country and which are generally well-known in the public.

Erasmus Mundus

Erasmus Mundus enables the exchange of students and university professors, as well as the cooperation of higher education institutions throughout Europe. Through this program every student from a country that participates in the realization of the program is able to spend one semester at a university in an EU member state. Achieved results from this semester are then recognized as part of the regular studies in the student's own country.

The main aim of Erasmus Mundus is the creation of the program "European Union Master Courses" which would provide grants, researchers and lecturers for students at European universities. Erasmus Mundus was established in the framework of the Lisbon Strategy. Objectives of this program are (European Commission):

1. increasing cooperation of international universities of Third Countries,
2. promoting cooperation of sending and receiving institutions,
3. enabling students to gain new experiences by studying in other countries, meeting new languages, cultures, and promoting EU values,
4. improving the recognition and transparency of studies, qualifications gained in Bologna process,
5. developing educational, cultural, political and economic ties between member states of the EU and Third Countries,
6. expanding the knowledge and qualifications of teaching staff, in order to improve the quality of education,

7. building the private and public sector, developing capacities of administration by having their staff participate through doctorates of higher education.

Erasmus Mundus is implemented through the following actions (European Commission):

- One action applies to master studies and is called the “European Union Master Courses”. This action should be implemented through linking at least three different universities from different countries through exchange, and getting a joint final degree at the end of studies.
- Second action includes scholarships and fellowships that are granted to qualified individuals who participate in masters and doctoral studies of Erasmus Mundus.
- Next action is called Partnership. Its goal is to improve the exchange of students and activities.
- Final action is conceived with the goal of furthering activities that would lead to enhancing the profile, the visibility and the availability of European higher education.

Tempus

The Tempus program is the oldest program conducted by the European Union in the field of international cooperation in higher education. Through this program the EU develops and promotes higher education in the countries of Eastern Europe and Central Asia, North Africa and Middle East, and Western Balkans. The European Union attempts through Tempus by an analogue of the existing educational programs to meet the specific needs of Middle and East-European countries. The Tempus Program was established in 1990. It provides financing and encourages cooperation between universities in said countries and the European Union (European Commission). The Tempus program should contribute to the reform of higher education structures, to the development of teaching programs in priority fields, to the development of expert training for the advanced, to strengthening regional connections through the participation of multiple partner countries, especially among the countries of South-East Europe (European Commission).

Methodological Approach to the Problem

The aim of the research is to compare the presence of European educational programs in Serbia, a country that does not have the status of candidate for the European Union when the authors wrote this paper, Croatia, a country with the status of candidate for membership into the EU, Slovenia, a country which has been a member of the EU since 2004. The research was done on the basis of the old status of countries because more recent data were not available to the authors. These countries were chosen because they are all countries of former Yugoslavia, which allows for a closer comparative approach.

The research problem is set in the form of the question: "Which country, Serbia, Croatia, or Slovenia, makes more use of European educational programs?" In other words, the problem points to establishing differences in the distribution of European educational programs in the afore-mentioned countries.

The research has been conducted on a *sample* that is comprised of two parts: the first part of the sample are students of master and doctoral studies that have applied to some of the Erasmus Mundus programs, while the second part of the sample are countries, or their institutions, that have applied to some of the Tempus projects. The sample, that is formed from the above-mentioned subjects, applies to the *period* from 2007 to 2011, and is distributed by year. This period was taken as relevant by the authors considering the fact that the Republic of Serbia as a country exists from 2006, when Montenegro became an independent country, separating from the country Serbia and Montenegro, whose legal successor is the Republic of Serbia.

The research has been conducted by comparing secondary data, statistical data of the European Commission on Erasmus Mundus programs and Tempus projects, which can be considered as instruments of research. The authors used descriptive statistics in this research, as well as the method of statistic data analysis.

Results and Discussion

Table 1. - Descriptive representation of students of masters and doctoral studies who applied and were accepted to some of the Erasmus Mundus programmes from Serbia, Slovenia and Croatia

Slovenia		Croatia		Serbia			
Doctoral courses	Masters courses	Doctoral courses	Masters courses	Doctoral courses	Masters courses		
-	0	-	7	-	30	Accepted	2007
-	-	-	-	-	-	Total	
-	0	-	10	-	46	Accepted	2008
-	-	-	-	-	-	Total	
-	0	-	13	-	65	Accepted	2009
-	0	-	41	-	174	Total	
1	3	1	20	0	61	Accepted	2010
5	16	10	60	36	216	Total	
0	7	4	14	9	55	Accepted	2011
2	14	21	66	34	365	Total	

*data for doctoral studies for 2007, 2008, 2009 are missing in the table because doctoral studies in this form did not exist through Erasmus Mundus until 2010.

*total number of students who applied in 2007 and 2008 to some of the programs of Erasmus Mundus has not been statistically processed

Source: European Commission (2011).

By comparing the data in Table 1, we obtain the results that the Republic of Serbia, in the period from 2007 to 2011, had the highest number of students in masters and doctoral studies who applied to some of the European educational programs of Erasmus Mundus, and that it had the highest number of students that were accepted and attended those programs, in comparison with Slovenia and Croatia. The exception is the year 2010 if we only look at doctoral students, where Slovenia had one doctoral student who was accepted in one of the programs of Erasmus Mundus, while the other two countries had none. As suppositions for these results we may give the following reforms of educational systems and satisfaction or dissatisfaction of students with the offer and the past experiences of older colleagues of masters and doctoral studies. The reform of educational systems was the primary presupposition which explains the obtained result. Slovenia has been a member of the EU for eight years and its educational system is completely modernised, i.e. fully conformed to the Bologna process, while Croatia is in greater compliance with the Bologna process because it is a country with the status of candidate for membership in the EU from 2004. year, while in Serbia the Bologna process is still being developed and has lasted for five years. In the opinion of the author, and given the data, that Serbia from the total population 10% of people are highly educated (Statistic Office of Republic of Serbia, 2012) 12% in Croatia (Statistic Office of Republic of Croatia, 2012) and in Slovenia the percentage of 20 (Statistic Office of Republic of Slovenia, 2012), that the achieved level of implementation of the Bologna declaration in these countries does have an impact on students' commitment to higher education. This fact pertaining to the levels of development of educational systems could have influenced students in Serbia to be dissatisfied with the existing programs of masters and doctoral studies, which is the third supposition, and that is why they chose to attend Erasmus Mundus programs. Given the above percentages of highly educated people in Strbiji, Slovenia and Croatia the authors conclude that there is a causal link between the level of development in the application of the Bologne Declaration and the young leave because of the demand upon international programs for high-quality education, and offering Erasmus Mundus and Tempus. In addition, the results show that in all three countries from 2010 the tendency of applying to programs of Erasmus Mundus is in decline, which could be attributed to the global economic crisis.

Table 2. Descriptive representation of accepted projects for Serbia, Slovenia and Croatia for Tempus IV

			2008	2009	2010	2011
Serbia	coordinators	JP	1	5	5	4
		SM	6	1	3	2
	co-beneficiaries	JP	7	49	70	50
		SM	44	14	21	36
		<i>Total</i>	58	69	99	92
Croatia	Coordinators	JP	1	0	0	1
		SM	1	0	0	1
	co-beneficiaries	JP	3	14	9	14
		SM	14	30	29	21
		<i>Total</i>	<i>19</i>	<i>44</i>	<i>38</i>	<i>37</i>
Slovenia	Coordinators	JP	0	0	0	1
		SM	0	0	0	0
	co-beneficiaries	JP	0	5	6	5
		SM	16	5	3	1
		<i>Total</i>	<i>16</i>	<i>10</i>	<i>9</i>	<i>7</i>

*JP is short for type of project Joint Projects

*SM is short for type of project Structural Measure

Source: European Commission (2011).

By comparing the data from Table 2, we obtain the result that Serbia has the highest number of accepted projects in the cycle Tempus IV, regardless of whether they are coordinator or partnership projects, in comparison with Slovenia and Croatia. The suppositions for this result could be given as the following: the financial situation in the country; having or not having the knowledge relating to the projects; access to funds. The financial situation in these three countries is the primary supposition which might explain it. Slovenia is the country which in this comparison has the highest revenue per capita, and it is the most developed of the three, which is why Slovenia could have had the least need to apply for funds to finance projects, including Tempus IV. Slovenia has more opportunity for individual financing of both national and international educational projects than Serbia or Croatia,

which is confirmed by the obtained result. However, it is important to note that Serbia and Croatia are in a similar financial situation, but that Serbia considerably dominates in the number of approved projects in comparison with Croatia, which could be explained with a higher awareness of the importance of projects in Serbia and more skilled staff, which is the second supposition. Skilled staff as a supposition relates to defining the relationship between Serbia and Croatia, considering that the authors believe that Slovenia has the staff skilled for writing, applying with and realizing projects and that this cannot be an obstacle, or a reason for such a small number of approved Tempus IV projects in Slovenia. The final supposition relates to the number of accessible funds which countries or institutions have the opportunity to apply for. Slovenia as an EU member has the opportunity to apply to numerous funds for projects, while Serbia and Croatia have a decidedly lower number of accessible funds at their disposal, and so they turn to applying for Tempus IV, as the above given results illustrate. As in the previous descriptive analysis of Erasmus Mundus programs, the results here also show that in all three countries from 2010 the tendency of approved Tempus projects is in decline, which can also be explained due to the global economic crisis.

Limitations of the Research

- Disadvantages of the used method - descriptive statistics. For instance, this method does not allow for establishing a correlation or connection between certain variables.
- The time period of the research. This research was conducted in the time period when Serbia received the status of candidate for membership in the European Union while the data applies to the period when Serbia was still not a candidate.

Conclusion

The results obtained in the empirical research are not surprising, considering the economic, legal, political, social and cultural circumstances of Serbia, Croatia and Slovenia, which form the sample of the research. The obtained results show that Serbia, even though it is not a member of the European Union, had the highest number of masters and doctoral students

who used the program Erasmus Mundus in the period from 2007 to 2011, and that the highest number of Tempus IV projects was realized in Serbia for the period from 2008 to 2011. Based on the above stated, the initial hypothesis, which says that the European policy of higher education and the action programs through which it is implemented are equally applicable and accessible to all European countries, regardless of their status within the European Union, has been confirmed. In other words, the authors' conclusion is that the status of countries regarding membership in the European Union is not of importance for making use of accessible funds, or for implementing European higher education policies.

The results of this research into action programs ErasmusMundus and TempusIV show great potentials for Serbia, which may imply that Serbia is a country where young people have a high awareness of the importance of education, and that education represents the key to success not only of the individual but of the society as a whole.

The authors would suggest the following subjects of research in this field for some future time:

- A research which would deal with comparing the number of realized projects in Serbia while it did not have the status of a candidate for membership in the EU and the number of projects which it realized after gaining that status.
- A research which would deal with comparing the number of masters and doctoral students from Serbia who used the action programs of the higher education policy while Serbia did not have the status of a candidate for membership in the EU and the number of students who will use them after gaining that status.
- A research through correlation which would allow to reach a conclusion on which factors are related, or which factors mutually influence each other – for instance, to establish whether and to what extent skilled staff influences the number of approved projects.

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Neostates: Old Problems

David C. McGaffey

Abstract

Newstate or neostate is proposed as the designation of a class of new political-geographic entities which, while having some of the attributes of states, have not yet (and may never) solidified into fully functioning states. This class is distinct from 'failed states', which had been fully functioning. All neostates, whether built up from an amalgamation of existing states, like the European Union, or as successors to a vanished old state, like the Republic of Macedonia, face similar issues which must be resolved if the neostate is to survive. This paper will examine three primary issues, all of which are identity issues - Consolidating Stable Borders, Crafting a National Economy, and Creating a National Identity - which are both critical and difficult. The paper will define these issues; examine how and why they arise; argue why it is critical for the neostate to resolve them; and then examine these issues in the specific cases of the European Union and the Republic of Macedonia, with examples from other neostates for contrast. The paper will argue that neither the EU nor Macedonia has, as yet, satisfactorily resolved any of those issues, and that this failure threatens their futures as states.

Keywords: European Union, Macedonia, state, neostate, borders, national identity, national economy, survival issues, international relations, political science

This paper is an essay which proposes a new model of issues which affect the survival of certain new states. It is neither a research study nor a review of the literature nor an historical analysis. The paper will outline and attempt to define this new model, and do a preliminary test of its validity by examining primarily the author's personal observations about two states which appear to fit the definition of neostates: The European Union and the

Republic of Macedonia. If the model appears to be valid, this paper could be the beginning point of a number of much deeper and more thorough studies, but the purpose of this essay is to ask the readers to examine and test, in their own minds, whether this model is both valid and useful in the study of the survival of neostates.

In this paper, I propose that, as a category separate from mature, established states, there are "*neostates*"ⁱ, which are uncertain of long-term survival. These *neostates*, whether built up from an amalgamation of existing states (such as the European Union) or as successors to a vanished old state (such as the Republic of Macedonia) whether large or small, face essentially identical issues of perception which must be resolved if the new state is to survive. I must make clear that these issues exist in the minds and perceptions of the inhabitants of the territory, and are neither political nor legal issues. For example, there are recognized lines on a map which meet all political and legal definitions of the borders of both Macedonia and the EU. It is the contention of this paper that, regardless of the legal status of the border, if the people who live inside and the near neighborhood of those borders do not consider them valid, the state has problems which must be satisfied to ensure its survival.

These perception issues are:

- Securing their borders (defining the state geographically in the minds of the people);
- Restructuring a national economy (defining the state economically in the minds of the people); *and, perhaps most important,*
- Creating a national identity (defining the state in the minds and hearts of its people.)

These problems exist for all neostates because of the nature of modern statehood and current demographics. In ancient times, a wandering tribe or fragment of a tribe could move to a new (empty) valley and continue its traditional life without difficulty. City-states or countries could fragment, establishing new colonies in (empty) locations or expand frontiers without difficulty. Today, however, we live in a world which is to a large extent fully populated and interdependent. Essentially all land, people and most natural economic resources, are owned (or at least claimed). Therefore, all neostates, large and small are emerging into an existing structure, and must compete to survive.

What is a State?

But first, we must establish some definitions. What is a 'state'? There is no agreed legal definition, which follows naturally from the fact that all laws are national and end at state borders. Everything else – everything that we call 'international law' – is a series of bilateral and multilateral agreements between specific states. The political science definition of a state consists of three parts: It must have "defined" boundaries; it must have "effective" governance (the legitimate use of force) within those boundaries; and it must be recognized as a state by a "sufficient" number of other states (Weber, 1918). Each element is deliberately fuzzy: boundaries can change, or can endure for generations with undefined patches; governance is 'effective' if an observer agrees it is, but no state has complete and perfect governance; and as for recognition – what number is 'sufficient'? Currently, we have a useful shorthand for the last element – if a political entity is accepted for membership in the United Nations, it is clearly sufficiently recognized. But then, what is Taiwan which was, for a long period, recognized as *the* state of China, but was de-recognized in favor of Beijing? What is South Sudan, which was apparently pre-emptively recognized by the U.N., but seems to be having difficulty getting organized as a state?

Let us accept, then, that 'state' is a fuzzy concept, organized around the idea of a political entity with some form of government deemed legitimate by its population, generally definable political boundaries and generally governed population, which deals independently with other states. Under that definition, it is clear that both the European Union and Macedonia are states, as are such other quasi-states as Taiwan, Palestine, and South Sudan as well as mature states such as France, Germany, the U.K., China, and the U.S. Within that broad category, I propose we consider a sub-category of 'neostates' which fit the broad definition, but have not matured sufficiently to allow us confidence in their endurance – in which sub-category I include both Macedonia and the European Union. My thesis then is that such 'neostates' must master these three national definition issues if they are to have a good chance of survival and growth into mature statesⁱⁱ.

And survival is a real issue. States are fragile entities. According to Euratlas (2011), there were 79 independent states in Europe in 1800, only 28 in 1900, and 58 in 2000. According to Rosenberg (2011) there are currently 195 countries in the world (196 if you include South Sudan) but the maximum

number recorded was 294. According to official U.S. State Department lists(2011) (other lists may vary slightly for political reasons), there were 194 independent states in the world in 2009. We all know that ancient states and empires (such as Rome and Alexander's Empire) vanished, but in modern times, the independent states of the Germanies, the Austro-Hungarian Empire, the Ottoman Empire, Czechoslovakia and Yugoslavia, for example, while appearing solid and permanent to their inhabitants at the time, have vanished. New states have appeared, but some did not survive (Rosenberg, 2011). States, in general, are fragile and may be short-lived. Nations – collections of peoples with a shared language, history and culture and identity – are long-lasting, but are not always associated with states (for example, the Kurds and the Roma are nations without states). Napoleon Bonaparte, while not the originator, was critical in building the concept of the 'nation-state.'

"Napoleon Bonaparte was a key figure in the development of the nation-state. Amid the chaos of the French Revolution in the late eighteenth century, most remaining medieval and feudal laws were overturned and a truly national law code was established. Similarly, a national military was created. Although not the only reason, France's status as a nation-state was a key factor in its ability to dominate feudal neighbors in Italy and Germany. Napoleon's military victories also paved the way for the emergence of nation-states in the rest of Europe: In many places, the people rallied together as a nation in order to defeat Napoleon." (Anonymous, 2011)

Napoleon attempted to marry the two concepts to give his *state* the endurance of a *nation*, and to give every citizen the identity of a Frenchman, while making the government the embodiment of the people of France. This has become the (at least, stated) goal of every government of a modern state, but it is, in most instances, a goal rather than a current reality.

A true nation-state gets its identity from its people, and its people take their identity from the state. I know of no entity today which is a true nation-state, except perhaps a few South Pacific island-states with homogeneous populations, but striving for that goal may be the best means of survival for a state. And building a nation-state requires adequate fulfillment of these three basic requirements. Let us now examine these three issues more closely.

THE THREE ISSUES

Defining the State Geographically in the Minds of its People

Securing borders has physical, psychological, political, legal and social meanings, and must be considered in each of those meanings in two ways: in relation to neighboring states and in relation to distant states.

Every new state, by definition, has a new set of boundaries—larger or smaller than the predecessor state. Boundaries – borders – serve multiple functions. The primary function, of course, is to differentiate between ‘us’ and ‘not-us’, with the important corollaries of setting the limits for the legitimate use of force by the government, and the allowable limits for any necessary defense of territory. One element of this issue is resolved by the formal recognition by other states. But unless those recognizing states include bordering states, the border is not and cannot be secure. As we see with the status of Palestine, Israel, Afghanistan and Kosovo, no distant formal recognition or legal ruling affects the relationship between the neighbors, and the acceptance of the border by the state on the other side of the border is essential for a secure border.

Even more important is the acceptance of the ‘us/not-us’ definition in the minds of the people who live on each side of the border. As the Berlin Wall taught us, no extreme of state border control can constrain the perception, or even the movement of people if they do not see that line as a legitimate border between ‘us’ and ‘not-us’. East Berliners were visiting (or moving to join) relatives (i.e., ‘us’). The greater the effort the East German government put into stopping physical movement across what was seen as an illegitimate border, the more that government itself was seen, in the minds of its people and in the world, as an illegitimate government. A different problem is seen in South Sudan.

After difficult and lengthy negotiations, the governments of Sudan and South Sudan agreed on a border between the two states – based primarily on the location of economic resources and definable and defensible landmarks. Unfortunately, the population of some of the border areas allocated to Sudan, largely comprised of people who had been part of the decades-long insurgency against Sudan, do not see themselves as part of Sudan, and so do not recognize the border. The continued conflict since the declaration of independence results from this difference in perception from the legal border definition, and threatens the survival of South Sudan.

Defining the State Economically in the Minds of the People

The creation of a new state, by whatever means, draws a line – a border – across existing economic patterns. People are used to dealing with certain suppliers and customers as either foreigners or neighbors, and they deal with each class differently. This is true for the village lady selling her onions and garlicks and equally true for the CEO of a multi-national firm headquartered in the state. When a new state is created, the new borders mean that some old foreigners become neighbors, and some old neighbors become foreigners. Everyone engaged in economic activity must now re-draw their mental map and plan their activities according to the new rules, if the new state is ever to have an integrated economic system.

This is difficult and disruptive. The alternative is to have people follow their old habits – ignoring the old borders. For any individual, old habits are both easier and more comfortable. For the new state government, old habits are defined as smuggling and disloyalty. These are both perceptions, but relating to concrete economic actions. Unless the two perceptions become integrated, the neostate will have problems. Just as we saw with the geographic border above, however, new rules on 'domestic' vs. 'foreign' economic relations must be established, not by force, but in the minds of the residents. When a housewife 'knows' that the best ingredients for her famous *ajvar* sauce comes from that village down the road (now across a border) or an industrialist finds that new 'domestic' sources for his raw materials provide a different quality than his traditional suppliers, both will be tempted to follow old habits.

The government is then faced with a choice of enforcing economic regulations against the will of its people – thus being considered illegitimate – or of making no effort to enforce its laws and borders – thus raising questions of its effective control, or of acting capriciously, enforcing them sometimes and not others, thus raising questions of its competence. All three choices challenge the basic definition of a state. The only real resolution is to change the perceptions of the population, so that they actively differentiate – economically as well as politically – between themselves as a national population and foreigners. Some few will always cheat; some may grumble that 'things were easier under Tito'ⁱⁱⁱ, but will cooperate; some will enthusiastically adopt the 'new order'. It is the task of the government to increase the number in the last two pools until the first pool is small enough that it can be subject to sanctions which most citizens will see as legitimate.

Defining the State in the Hearts and Minds of its People

When a new state comes into being, it never represents the will of all of its population. Sometimes there are many groups advocating the new state, but each group has a different idea of what the new state will look like. The majority of the population will tend to be largely ignorant and often indifferent. Some percentage of the population will be actively opposed. In the goal of a nation-state, a new state must obtain its identity from its population, and the population must take its group identity from the state. This means that the government is seen as representing and taking care of the needs of the entire population, while the entire population comes to see themselves as a unity (different from 'those foreigners') who are represented by the government. This does *not* mean that everyone agrees with each other or that everyone likes the government: it means that fights become 'family' fights, with everyone seen as having a legitimate role in the internal fight. Until this begins to happen, people residing in the new state will retain identities and ties with a former state or a now-foreign state or an alternative idea of a new state, and therefore they will not have loyalty to or even recognition of the validity of the new state.

A new government tends to win power through its own core-group— a political party, an ethnic group, or residents of a core locality — and will therefore initially tend to assert its identity with that core-group. The result may be that it is seen as defining anyone outside the core-group as outsiders in the new state. Thus the Israeli government tends to assert its identity with Jews, leaving the large population of Israelis of Palestinian origin and of Christians in an anomalous position. Can they really consider themselves Israelis? Do Jewish Israelis consider them Israelis? In any country, this can only result in instability, and can lead to violence, civil war and the eventual break-up of the new state.

Afghanistan represents another response. Most people in Afghanistan identify primarily with their tribe, region or as followers of a specific leader. Thus, while Afghanistan is recognized as a state and is a member of the U.N., it does not function as a state, but rather as a loose coalition of confederated tribes. This includes the assumption of integration with all 'Afghan' tribes, many of whom live in the Affiliate Territories legally recognized as part of Pakistan, but not effectively controlled by Pakistan. One effect of this is the anomalous border between Afghanistan and Pakistan. The

efforts of NATO and the government in Kabul to establish borders, create a central government with effective control, and craft an "Afghan" identity appear futile. (Note: Even the word 'Afghan' is in fact the name of a tribe which has furnished almost all the kings/presidents/rulers, including the current President. Members of other tribes will rigorously object to being identified as 'Afghans'.) Unless and until Afghanistan can solve this problem, it cannot become a nation-state – though it has survived for centuries and may well continue to survive as a loose confederation.

I believe that this issue is the most critical one for any new state to resolve. Unless and until the governments sees itself as serving essentially every citizen of the state, regardless of ethnic, religious, historical or other ties, and unless and until essentially every citizen of the new state identifies primarily as a member of that new state, in addition to many other sub-identities, there is a high risk of non-survival of the new state. No state ever has or perhaps ever will achieve 100% mutual identification, but the need and effort must persist until the 'outsider' fraction is minimal if the new state expects to survive -- and this is the area where both the European Union and Macedonia have made the least progress.

The National Myth

One among many methods governments of neostates use to create a national identity is to create a National Myth – a set of stories, images, sayings, songs, expressions which, ideally, begin to give their population the essential elements of a nation: a shared history, culture, language, values and finally- identity. The fact that an individual citizen was not, in fact, connected to the elements of the myth is irrelevant. Americans whose parents immigrated in the 1900s speak proudly of the conquering of the great Western frontier, of the battle at the Alamo (even if they don't remember that it was a defeat), and of shivering in Valley Forge in the Revolutionary War. Their own ancestors might even have been on the other side in one of those battles, but they are all proud of 'what we Americans have accomplished.' Thus France inundates its population with the image of bare-breasted Victory at the barricades, with 'La Marseillaise', with "Liberté, Fraternité, Égalité," with the public faith in and expression of French Secularism. Recently, France has begun to insist that all its citizens, of whatever origin, eschew public expressions of faith (e.g. by banning crosses, yarmulkes, and headscarves from public schools) because

that clashes with French Secularism. When successful, such political myths can unite a disparate population into a feeling of unity, with each other and with the state. If done improperly, as in Nazi Germany's myth of the Aryan Nation which excluded large portions of its own population, it serves to divide the people, and decreases the chances of the new state's survival. We will now examine the efforts and accomplishments of Macedonia and the European Union in terms of these three issues.

THE EUROPEAN UNION AND THE ISSUES

First, let us ask the question "Is the European Union a State?"

Politically and legally, the European Union does not call itself a state. Like Afghanistan, or like the original form of the United States, it appears to function as a collective of separate 'sovereign' states. However, it clearly meets the political science definition: it has clearly defined and acknowledged borders, it is recognized (at least as a political entity) by essentially the entire world (governments meet with, negotiate with, and deal with its representatives), and (within limits) it has effective governance within its territories (European Union Laws and Treaties have priority over local and national laws; European Union Government, court and commission rulings are binding within member countries.) The men generally considered the 'Fathers of the European Union' – such as Churchill, Monet, Schuman, Spaak, and Spinelli – all spoke of a united and unified Europe (a 'United States of Europe') as their goal. Therefore, for all practical purposes, we may consider it a state, and its current inability to claim 'state' political/legal status makes it clear that it falls in the sub-category of 'neostate' for the purposes of this paper.

A. The Border Issue

The European Union originated as a loose collective with primarily economic objectives which found its expression in such institutions as the European Coal and Steel Community (ECSC) and the European Atomic Energy Community (EURATOM) in the 1950s. It quickly grew beyond its original six members and in its objectives. These came to include both expanded economic unification as well as a growing demand for political and

geo-political objectives, in an attempt to make Europe a major player vis-a-vis the U.S. and the U.S.S.R. It has expanded in numbers, goals, and attributes, becoming the EEC, the EC, the Euro-Zone, the Schengen area. It has created a European Parliament, European courts, a European bureaucracy and senior political offices. Within Schengen, it has abolished internal borders; within the Euro-zone, it has replaced national currencies with a European currency. It currently (since 2007) has 27 full members, three candidate Members (Turkey, Croatia and Macedonia), and the majority of the Western Balkans are seeking formal candidate status (EU, 2010). It associates with numerous other states in Central Europe, former U.S.S.R. and the Mediterranean basin on an 'association' or 'neighbor' basis. It states that its final shape will include and be limited to "Europe", but is generally reticent about defining that term.

Thus, at any one time, its official borders are fixed, well-defined, and generally secure. However, the relatively rapid expansion – from 6 to 27 member states in less than 60 years, with on-going discussions to include more, means that these borders are somewhat nebulous in the minds of both its own people and in the perception of the world. The core is certain, but the periphery is unclear. Moreover, since each element of expansion has been by separate treaty, and some member countries have failed to accede to several of these treaties, some elements of unity are unclear even in the core. The U.K., for example, has rejected both the Euro as a currency and the Schengen treaty abolishing borders. Does that mean it is fully a part of the European Union or not? A recent attempt to adopt a Constitution, a critical step in making the European Union a state, was rejected (largely by the Irish) and has been replaced by the "Lisbon Treaty", which has only some of the attributes of a state detailed in it. Current efforts to deal with the Euro-crisis by increasing EU-wide monetary controls have gotten entangled in sovereignty issues. Also important and costly in terms of defining a European identity, the European Union member countries have been adamant about promoting their separate nationalisms and national identities within their borders, and it is only among the younger generation that the concept of a European Identity (with sub-identities as Greek-, French-, Portuguese- "hyphenated" identities) has strongly taken hold.

This becomes a problem - especially among neighboring states. Whether these states are currently official candidate states or not, the people of neighboring states, as well as the current population of the European

Union, must think about the possibility of eventual accession. Thus, the perception of 'us' and 'not-us' must be blurred, on both sides. They deal with each other like guests at a party bringing together the families of prospective brides and grooms – currently strangers, but probably future family members. How do you treat them? The uncertainty about expansion, with more than a decade of 'will he, won't he' on the accession of Turkey leaves the European Union with insecure borders. Until the European Union as a whole firmly decides at minimum on a clear statement of the limits of its expansion, and wins a unified expression of cohesion among all its members on issues such as the Euro-zone and Schengen, the uncertainty of its borders will remain, and will decrease its chances of long-term survival and full expression as a mature state.

B. The National Economy Issue

Because the European Union began with economic integration in the ECSC, and has maintained its focus on economic integration, it has been most successful in achieving this goal. The substitution of the Euro for most national currencies, plus the Schengen elimination of internal borders (and customs, and duties, and tariffs) has served to largely equalize prices for European products throughout the European Union, has greatly expanded intra-European Trade, and has allowed the development of coordinated trade policies with non-European trade partners. The European Union can speak (usually) with one voice at WTO meetings, and the European Union examines foreign competitors (e.g. Microsoft on questions of restraint of trade) through a single organization. Perhaps most important, the European Union has formed a labor market which largely functions as a single market for all its member states. An individual from any member state can (and does) seek and find employment anywhere in the European Union without hindrance. (Important in this regard was a European Court decision that any citizen of the European Union, resident in and working in any state of the European Union, has the right to vote in local elections. This largely eliminated the perception that, for, example a Portuguese working in Frankfurt was a 'foreigner'.) While far from perfect integration, this comes closest to it, and this economic integration remains the strongest force in favor of the European Union's survival.

C. The National Identity Issue

My personal observations at universities in Portugal, France, the U.K., and Italy show a strong and growing sense of European Identity among current university students, but a much weaker sense of European identity among their parents – bankers, professionals, politicians and the like. A generational change (30 years?) may be necessary before a new identity becomes established, and if so, the European Union may be on the right track. The students clearly see themselves as ‘also’ Portuguese or British or whatever, but increasingly, they identify themselves as European. When they talk of their career hopes, they talk of cities, not countries, and do not limit themselves in choosing among European cities. Similarly, a number of industries – especially food, retail clothing, and automobile – have adopted European-wide sales pitches, and are opening stores or branches regardless of traditional borders. There are a growing number of city centers – Barcelona and Milano chief among them – which are developing integrated economic structures which cross national borders, such that many towns in France, for example, see themselves as dependencies, suburbs, of these ‘Spanish’ or ‘Italian’ cities. Even governments have gotten into it. In at least two instances, separate European states have opened joint Embassies (e.g. FRG and France in Guyana) sharing buildings, staff and responsibilities. In numerous instances, separate European Embassies engage in joint efforts (e.g. 10 European Embassies sponsored a campaign to attract Korean students to European universities.) The European Union has created a National Anthem (which nobody seems to know), a national flag/logo which has been widely adopted and is popular (e.g. on automobile license plates) and other national symbols of varying degrees of significance (EU, 2011).

On the other hand, in almost every country politicians and parties have gained influence by being ‘Euro-skeptics’; the financial crisis in Greece, Ireland and Portugal has raised doubts about the value of the Euro-zone, the defeat of the Constitution has raised deep doubts about the future direction of the European Union, and criticism of Eurocrats is becoming widespread. (This last is a mixed message. People in every country complain about their government, so the pervasive spread of complaints about Eurocrats could mean that people are beginning to think of them as ‘their government.’)

Finally, the right of veto by each member country on essential issues seems likely to contribute to increasing deadlock as the European Union

moves toward becoming a state. On the issue of European identity, the European Union seems to be teetering on a tipping point. Perhaps like the U.S. Articles of Confederation, or the original League of Nations, the European Union will fail only to become the basis of a later more successful union. On the other hand, if they can hang on until today's students move into positions of influence, the next generation can move them forward into true union and they will become what Churchill called for – "The United States of Europe."

THE REPUBLIC OF MACEDONIA AND THE ISSUES

A. The Border Issue

The Republic of Macedonia has done an excellent job of physically delineating its borders – primarily because it adopted pre-existing foreign and internal borders – and has achieved broad recognition, admission to the United Nations, and candidate status with both NATO and the European Union. These accomplishments, however, are undermined by Macedonia's failure, so far, to reach real acceptance and accommodation with its neighbors, especially Greece, and further undermined by cross-border ethnic affiliations among its population, to some extent encouraged by the government itself. Moreover, while officials at police stations and official border crossing points seem to apply regulations rigorously, the borders in reality seem fairly porous. It may not show significant weakness in terms of identity, but I have found in personal conversations with citizens of Macedonia who live in border regions that the local inhabitants routinely cross the borders – for shopping, visiting relatives, attending weddings or other festivities, for trade or other purposes, generally without bothering to pass through the official border stations or registering their passage with the government.

In a fish restaurant on Lake Ohrid, I was offered a trip 'to the other side' to see a shrine, and only later learned that the shrine was in Albania. Similarly, at Sveti Naum Monastery, I was offered a guide to a walk to an island castle which turned out to be in Greece. In a restaurant on Lake Dojran, which is bisected by the border with Greece, the proprietor informed me that his sons caught the fish "on the other (Greek) side" while buying some items for the restaurant. In Kumanovo, restaurants and shops had numerous items from Serbia lacking the Macedonian sticker, and similarly in

Kriva Palanka the items were Bulgarian, also lacking the MK sticker. I cannot, of course, know that these items were all transported unofficially across an essentially unguarded border, but it seems the likeliest explanation.

In contrast, however, I (white-bearded and an obvious foreigner) was stopped and questioned for some time by border patrollers while driving near the Megalithic Observatory Kokino above Kriva Palanka. Finally, in the Ministry of the Interior, the department which deals with applications for asylum spoke to me of a sudden upsurge of applicants from Afghanistan, who had appeared at the office in Skopje (in the center of the country) without passports and lacking any evidence of official admission into Macedonia. It is clear that these individuals, at least, found it both easy and expedient to bypass border controls. This is not a problem unless and until it impacts either the national economic system (through rampant smuggling) or reinforces divided loyalties by emphasizing family/ethnic ties in competing states.

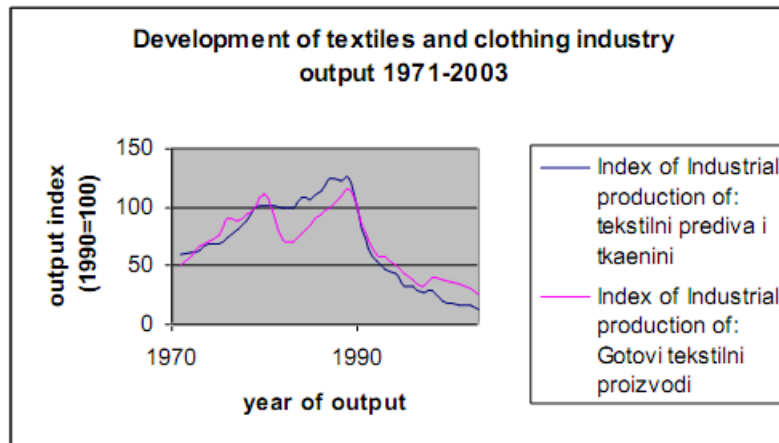
As an aside, another question is why Macedonia insists on (formally) stringent border controls while in reality giving evidence of porous borders? Porous borders are not necessarily a bad thing. The U.S. and Canada have had a porous borders almost since the two states came into existence, but these were matched (at least until the 9-11 attack on the World Trade Towers and subsequent U.S. paranoia) by almost equally porous controls at the official border crossing points. When I was growing up near the border, people in farms in the border region routinely shopped in the nearest towns, regardless of what country the town was in, and the border officials at the bridge between Detroit, Michigan, and Windsor, Ontario, just asked, "Are you American or Canadian?" and then waved you through. The existing relatively stringent border controls in Macedonia may merely be a remnant hanging over as a habit from the former Yugoslavia – which had very stringent controls – but it might be worth the government asking itself what useful function they serve. Note that, if Macedonia successfully joins the European Union, it will have to adapt to European Union rules – including (assuming adherence to Schengen) the abolition of borders between Macedonia and Greece and eventually any other Western Balkan state which successfully becomes a member.

B. The National Economy Issue

This issue may be the Republic of Macedonia's weakest area. While a part of Yugoslavia, Macedonia was a part of a fully-integrated Yugoslavian National Economy. Perhaps the best example is the textile and garment industry, which was a major part of Macedonia's economy under Yugoslavia, and remains a major (but sharply diminished) part of the Republic of Macedonia's economy. Cotton and silk were grown in Macedonia; sheep raised in Macedonia produced wool. The raw fibers were often processed elsewhere in Yugoslavia, shipped back to Macedonia as finished fiber, and transformed into yarn and fabric in Macedonia. The fabric, in turn, was processed into clothing in numerous small facilities, often in Macedonia (especially around Shtip) but also elsewhere in Yugoslavia, before being finished and sold, domestically and internationally.

Following independence, Macedonia found it had lost its integration and connections. The numerous individual sheep-herders, spinners and weavers and cutters and garment manufacturers were not directly affected, but were no longer part of an integrated whole. Sheep-herding and the textile industry sharply declined. Macedonia was left with a significant infrastructure investment in fabric manufacture, without the necessary integrated system to take advantage of it. In 1985, Macedonia accounted for 15% of the total Yugoslavian production of cloth- bigger than either Bosnia or Herzegovina. The contribution to Macedonia's GDP dropped sharply from 1990 to 2000 – apparel went from 10.5% to 6%, while textiles fell from 6.3% to 2.3%. While overall GDP also dropped, the fall of this sector was disproportionate.

"With the year 1990, the sharp decline of this industry began. The decrease was small in the production of apparel... but more significant in the textile sector... The decline in the sector apparel production lasted until 1996, stabilizing [at a lower level] in the following years, until 2000. In the same time, the decline in the production of textiles and fabrics was continuous." (Macedonian Ministry of Economy, 2005)



(Macedonian Ministry of Economy, 2005)

Similar integrated processes fed the steel production, power supply and other economic sectors, including, especially the consumer sector, which had been supplied largely either by Yugoslavian producers or by import through Yugoslavian importers and distributors. The transport sector similarly went into sharp decline, as the owners of the usual trucks suddenly became 'foreigners', or the links between producers and consumers were snapped.

As you can see, the Republic of Macedonia can serve as a prime case study of the economic disruptions associated with an abrupt change to a new state, with new borders, new alliances, and the sudden need for new links to be established. Interestingly, in 2010, Andrew Jobling of WGSN - a textiles trade research service, outlined a textile industry strategy, suggesting that the Macedonian Industry expand from 'cut, make and trim (CMT)' to 'full package production,' in order to capitalize on its relatively inexpensive production, quick turn-around times and short shipping distances to appeal to the European market. Jobling was careful to note concerns from a number of Macedonian Industry figures, who stated that it would be necessary to move slowly and cautiously in this direction. This reflects an attempt to develop a National Economy model for this sector, and appears appropriate – but was written in 2010, twenty years after independence (Jobling, 2011)! This long delay may help explain why there was such a steep decline in this sector in Macedonia and reinforces the need for and importance of an early and priority focus on developing a National Economy Strategy for any new state.

I would also like to point out that the Republic of Macedonia's public planning for economic development as well as the general expectation of Macedonians about things getting better both center around the Republic's hope of joining the European Union. Whenever that might occur, the planners for the Republic of Macedonia should realize that this event, like independence, will abruptly change Macedonia's economic borders, cutting off established linkages and opening the economy to new ones. While it appears likely to improve Macedonia's economy in the long run, it is almost certain to be at least as disruptive in the short term as independence was. How will new Macedonian enterprises, created by the absence of traditional Yugoslavian suppliers, survive the onslaught of competition from every supplier in the European Union? How long will it take Macedonian enterprises to learn how to compete in the new economic environment of the European Union? The Government of Macedonia should assume accession will involve severe, if short-term, economic disruption, and plan for it.

C. The National Identity Issue

This is another area where the Republic of Macedonia shows significant weakness, and illustrates a typical pitfall for neostates which are formed from sub-regions of larger states. Very similar problems exist currently, for example, in the Newly Independent States formed from the dissolution of the Soviet Union. Historically, we see the same issue repeatedly in the countries formed with the dissolution of the British Empire. I will call this "affiliate politics."^{ivv}

When a new state is formed from a sub-region, it typically has few or no people who are familiar with and experienced in national politics, much less international relations. The leaders of the independence movement are, in almost all cases, local leaders and local politicians. They have had no need to develop expertise in national or international affairs, because all such issues were handled in the old capital. They do, however, have both experience and expertise in local politics.

Local (affiliate) politics consists primarily of gathering a tightly-knit interest group and using the group's collective weight to campaign for allocation of resources from the central government. It is highly competitive, and in most countries, tends to be a zero-sum game. That is to say, the politics begins after the central authorities have completed a budget, and

assigned a fixed sum to each region, sector, or area. Local politics consists of getting as much of that sum for your group as possible, thereby denying it to other, and competing, groups. In local politics, especially in diverse societies, groups tend to be formed around tight identifications - ethnic groups, religious groups, age groups, and job-related groups – in which all the members are very similar, and define anyone not a member as a competitor. This system works as a way of giving each interest group a voice, because the resource allocator, the central government, is outside of all the groups, and can allocate resources according to non-group criteria.

When the sub-region suddenly becomes a state, however, these local politicians - trained to operate under local conditions - are the likeliest to be seen as the natural leaders of the new state, and need to suddenly shift to becoming national politicians, trying to do their best for every citizen of the new state. Unfortunately, it is difficult to break out of all prior experience and training, and it seldom happens. Instead, these politicians carry on as they have always done in the past, fighting to get the maximum for their own group – their affiliates - and there is no outside balance to ensure equity for people who are not members of their affiliation group.

Macedonia's Name Problem

An example of this is the Republic of Macedonia's 'name problem', which has little to do with Greece. According to the CIA's World Fact Book, the population of Macedonia (as of 2002) was 64.2% 'Macedonian', 25.2% 'Albanian', 3.9% 'Turkish', 2.7% Roma, 1.8% Serbian and 2.2% Other. According to that same publication, the name for the nationality of all citizens of the country is 'Macedonian' (CIA, 2011). Those two facts constitute the name problem. If the citizens of the country are Macedonians, and Macedonians account for only 64.2% of the population, who are or what is the rest of the population?

As outlined above, at independence Macedonia fell into affiliate politics. The largest, most powerful, and best organized ethnic group – a clear majority – naturally assumed control of the government and the country. Operating under the rules of local politics, they tried to get as big a piece of the pie for their affiliates as possible. They named the country after their affiliates; they tried to create a National Myth based on the myths of their affiliates; they made their affiliate religion (Macedonian Orthodox Christianity)

the national religion; and they tried to make anyone outside of their affiliates losers. For example, they tried to ban higher education in any language except Macedonian, and erected (Macedonian Orthodox) Christian crosses above most towns (including most 'Albanian' Muslim villages).

The authorities forgot that they were supposed to be national politicians, working for the good of every citizen of the nation, working for national equity. As a result, they faced ten years of growing discontent and finally an outbreak of real violence. With the help of and at the insistence of NATO members, who were determined that there would be no spread of post-Yugoslavian violence, the Government and major political parties representing the various players signed the Ohrid Framework Agreement which ended the most egregious elements of discrimination against minorities, but at the cost of firming up ethnic divisions and calling for future issues to be settled on the basis of ethnic proportionality. That seems to be working, despite continuing resentment on all sides, but the basic name problem persists.

Their concept of the National Myth was to make Macedonia the inheritor of the mantle of Alexander of Macedon – Alexander the Great. The main airport is named after him, massive public statues of Alexander have been and are still being erected. Some politicians even spoke of reaching out to Macedonians in neighboring countries (Greece, Bulgaria) and forging a 'Greater Macedonia.' This had two problems: it ignored the feeling of those neighboring countries (one of which, Greece, had already adopted Alexander as its own mythic hero) and it ignored the feelings of those citizens who did not (were not permitted to) call themselves Macedonians and who felt no identification with Alexander.

In fact, since Slavic Macedonians reserved that name for themselves, the authorities effectively denied 1/3 of the country's citizens any participation in the proposed National Myth. 'Macedonians' and the 'Macedonian' language are Slavic, but the authorities tended to minimize their Slavic heritage. The Ottoman Empire may have originated this myth, naming its Balkan province (and the population there) "Macedonia" because it contained the presumptive birthplace of Alexander. From whatever origination, it is of long enough standing that it is ingrained in the 'Macedonian' consciousness. This is part of what makes Greece so nervous about the Republic of Macedonia, since the same affiliate myth exists in the 'Macedonian' population of Greece (as well as, presumably, the same population in Bulgaria) because the territory, with its affiliate population, was taken from the Ottomans and split between the three

countries when the Ottoman Empire lost WW1. Unfortunately, it has no place in the affiliate myths of the remaining 35% of the population of the Republic of Macedonia. When the 'Macedonians', in power in the independent Republic of Macedonia, tried to adopt this affiliate myth as their National Myth, they only succeeded in reinforcing the sense of exclusion on the part of one-third of their population (as well as making Greece nervous).

The non-'Macedonian' population has contributed equally to this problem. The largest minority calls itself 'Albanian', uses the Albanian national flag as the symbol for its largest political party, and acts as if it was a foreign presence in the Republic, despite the fact that the large majority of Republic of Macedonia 'Albanians' have no connection with the neighboring country of Albania. Their links relate not to political or national identity, but to language – 'Albanians' in Macedonia and Albania speak largely the same language, to ethnicity – the 'Albanian' affiliate myth derives them from the semi-historic Illyrians; religion – 'Albanians' in Macedonia tend to be either Muslim or Roman Catholic, rather than Orthodox, similar to religion in Albania; or even home town – certain towns and regions are seen as 'Albanian.' (Curiously enough, when I travelled in Albania, people there tended to identify themselves by regional or affiliate affiliations. I seldom heard people call themselves "Albanians" inside Albania.) So we have the curious fact that 1/3 of the population of Macedonia do not (cannot?) call themselves Macedonians, despite what the CIA World Fact book says.

This kind of problem is not unique to Macedonia. Afghanistan (Land of the Afghans) uses the name of its largest tribe, for example. It should be noted, however, that Afghanistan has never successfully coalesced into a modern state, and its internal history has been characterized by violence. Through migration, many countries named after a particular ethnic group (e.g. Germany) now have significant populations who are citizens but not of the named ethnicity. It appears to me, however, that in-migration to an established country with an established name is of a different order of problem than the establishment and survival of a new state whose name excludes a large percentage of its founding population. Political parties inside Macedonia are essentially all affiliate (ethnic-based) at this time; all are engaged in a struggle for a bigger piece of the pie for their affiliates, and there appears to be few who are concerned about the welfare of the entire population of Macedonia. Politics continues to be local rather than national.

Because of this name problem, there appears to be little or no concern with national problems. I suggest that, to resolve this name problem, the Republic of Macedonia has at least two options: either it finds a way that essentially all its population becomes comfortable identifying themselves nationally as Macedonians with no sense of ethnic separations; or it keeps Macedonians as an affiliate/ethnic identifier for its Slavic population and finds a new name for the state which all its citizens can identify with. The former might be possible through, for example, the widespread use of hyphenation (Slavic-Macedonians, Illyrian-Macedonians, Roma-Macedonians, etc.)

The latter might be faster, might also resolve certain problems with neighbors, but appears much more difficult politically. There is certainly little or nothing being done to create a sense of national identity which encompasses the entire population of Macedonia. This lack of national identity, in turn, creates real risks for the success and even the long term survival of the Republic of Macedonia.

Conclusion

While this essay about the nature of neostates and the common problems they face in their struggle for survival is not definitive, it appears from examining the European Union and the Republic of Macedonia, that the model contains at least some validity. Further research needs to be undertaken to determine whether the three identified issues are the most important of the issues facing neostates, or merely among the most important. Further research in neostates would determine how much resolution of those three issues contributes to long term survival. Obviously, each new state faces problems that are unique – due to geographic, historical, resource, population and other issues – but as this paper makes clear, these three issues are ones that must be dealt with in all neostates. This paper has not attempted to perform that research, nor has it proposed worked-out policy options for those two neostates to adopt to resolve these issues. If this paper has succeeded in stimulating thought among students of international relations, and perhaps policy discussion among those interested in the survival of those two exemplar neostates – the European Union and Macedonia – it has succeeded in its purpose.

Notes

ⁱNote well that this term – neostates – is used only in international relations terms. It has nothing to do with geo-political legal status (i.e. the two examples cited have different legal status: the EU is legally not a state; Macedonia is legally a state, but I cite both as neostates), nor does it relate to recognition by others. The term *neostates*, as defined in this paper, refers to the *perception* of the “state” on the part of the inhabitants of the territory of the state and of its near neighbors. The term is taken, deliberately, from the medical term ‘neonatal.’ Technically, neonatal means nothing more than ‘newborn’, but most newborn babies are sent to the nursery, while any newborn infant sent to the neonatal ward can be assumed to have issues which threaten its survival. Similarly, some newborn states (e.g. Canada or the Philippines, emerging from colonial status, are lusty new states, while others may be considered neostates and considered with some concern.)

ⁱⁱ Note that this issue is sharply distinct from the issue of “failed states.” The literature on failed states is voluminous, but in every instance assumes a mature state which, because of changed circumstances, can *no longer* function as a state. Scholars in each case search for the cause of failure, and it tends to be unique to each case. These include cases of foreign conquest, civil war, and – at least historically – cases of disease, drought, or other disasters which undercut the state. If the model of *neostates* becomes accepted, some of those case histories may need to be re-written, because some so-called *failed states* may in fact be *neostates* which never matured.

ⁱⁱⁱ McGaffey, David. This is perhaps the most common grumble this author has heard in the Republic of Macedonia among citizens old enough to have been adults under Tito. They typically hasten to explain that Yugoslavia after Tito was the worst possible alternative and that Macedonia is better off independent, but still “(certain) things were easier under Tito.”

^{iv} This is, in the international relations literature, generally termed “tribal politics”, but I prefer the term ‘affiliate’ because of certain specific negative connotations in Macedonia. The following footnote provides further definition. The phenomenon is found in every country and in every political system. It appears to function well and thrive in centralized, authoritarian systems, but is arguably always disruptive (though common) in democratic representative systems. An ‘affiliate’ politician believes his occupational purpose is to *solely* benefit his affiliate group (whether ethnic, regional, occupational, religious or other) regardless of the effect on the state as a whole. Unless there is at minimum a substantial percentage of politicians working to ensure the benefit of the whole state, affiliate politicians will tend to tear the state apart.

^vThe phenomenon of tribal politics in the United States, while often considered as a term that relates only to Native Americans, is actually a concept that applies to a number of political groups within the country. Here are some basic facts about tribal politics and how this idea is found in many different parts of United States culture. At its roots, tribal politics is about the identity of a given group that is based on common ethnic or cultural factors that are thought to coalesce the group into a functioning political unit. While there may be some disagreement within the group, ultimately all those concerned rally behind a common purpose, even if there is some difference of opinion on how to express that common purpose. The concept is based on the model of Indian tribes, and the way that an Indian tribe would be governed by tribal leaders, even in the setting of a contained society, such as on Indian reservations today. The model goes on to make use of the decision making process that is developed among those on the reservation, what powers are given to central tribal councils, and how order is maintained within the group. It has been noted that many groups within our wider culture employ a similar model in order to

function as a subset of our society. As an example, people of the same religion may form a group in which tribal politics will be employed to give direction and a common sense of purpose to like-minded persons. Individuals will emerge within the group who are empowered to make statements that are considered to represent the entire body. In turn, the group will establish mechanisms that allow for the confirmation of orthodoxy among all group members, as a way to ensure that order is maintained. This will of course require the employment of skills to gain the support of the majority, as well as talents to keep the support once it is given. Thus, tribal politics come into play within this religion-based subgroup. Factors other than religion can also be the basis for tribal unity and thus employ tribal politics in order to maintain the status quo. Political party affiliations may be used as a means of identifying with a given group, and may demand strong adherence to basic rules and codes of conduct, just as in the religion model. Ethnic background can also be a powerful foundation for the formation of a tribe, with tribal politics providing the motivation to function as a unified front. While the formation of groups or tribes has many advantages, such as clear communication and the establishment of traditions that are expected to be observed, tribal politics can also have a negative side as well. At times, tribal politics may work well for the subgroup, but act as a barrier between the various subgroups. Without the ability to communicate and learn from one another, a subgroup will continue to grow inward and eventually stagnate. The ideal balance is when tribal politics can allow persons of like mind or background to have a unified voice, but not one that is heard to the exclusion of the voices of other tribes. When the concerns of all can be heard, the opportunity for equality exists, even if it remains a goal rather than a reality.

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EUROPE 2020: TOWARDS INNOVATIVE
AND INCLUSIVE UNION

Economy, Business and Innovation in Time of Crisis

The Current Economic Crisis of the EU and the European Economic Government

David Ramiro Troitño

Abstract

The article presents the current economic crisis from an historical perspective, analyzing the building of the monetary integration and the common currency. The process is explained pointing out its effects on the European integration and outlining the positive and negative consequences of the introduction of a common currency in the European Union. The investigation continues with a general outlook of the current situation of the countries more affected by the current crisis, Greece, Ireland, Portugal, Spain and Italy. All of them have in common the necessity of extra funding in a context of austerity, plus some national particularities. The author proposes an expansion in the public spending as the only reliable way to stimulate the European economies in crisis. As the Euro meant the end of the monetary independence of the member states it is suggested an innovative solution, the creation of an Economic government in the Union in order to transfer funds from the wealthier states to the countries in troubles. Deeper integration is presented as a necessity for the states in crisis, a necessity for the wealthier states and a must for the European Union.

Keywords: Euro crisis, common currency, austerity, public spending; crisis in Greece, Ireland, Portugal, Spain, Italy; European economic government

The current crisis of some members of the European Union is influencing the Union itself, generating a European crisis. The integration of the European states has not yet been finished and hence creates tensions between the member states and spreads to the whole system. The individual actions to improve the economy in each member state are not effective because the lack of financial instruments of the monetary union, and hence deeper integration is needed in order to solve the current tensions of the system.

Genesis

To understand the difficult times that the EU is going through, we have to go back to the origins of the organization and pioneering ideas in the process of European integration. For centuries there have been thinkers who have proposed different forms of integration in Europe to avoid wars, what was considered the main problem in Europe. Most of them, like the German philosopher Kant and his work *Perpetual Peace*, identified this problem with nationalism and the confrontation between nations at the European level, given Europe's international influence, worldwide. The armed conflicts in Europe were the result of an exacerbated nationalist propaganda and of the need for internal cohesion in the European states and to establish a strong foreign policy abroad. Building a national image based on the differentiation from the outside (Kant, 2009).

Thus, the process of European integration since its inception is based on the abolition of the political powers of the nation, relegating it to a cultural role. All these thinkers and politicians did not want to end the concept of nation, they just wanted to undress their political forms while retaining their cultural and emotional values. Kant, Aristide Briand, Count Codenhove Kalergi, Altiero Spinelli and Jean Monnet sought to develop a system of peace in Europe based on the integration of the various political entities of the European continent in a merger that would result in a higher political community that came to power in order to manage the common good, encompassing all structures of power in a political institution at a European level that would prevent conflicts between European states. The biggest difference between all these ideas and proposals was, and still is, the different path to reach the desired content of the European state. In this regard there are various theories related to the process of European construction. These theories are important to study what happened in the past, explain what is happening today and what drives the process forward. However, there are three theories that prevail over the rest because of their popularity and influence during the whole process of European integration. They are Federalism, Neofunctionalism and Cooperation (Rosamond, 2002).

Federalism is based on the construction of Europe based on two main premises, the legal and policy framework on the one hand, and citizens and democratic legitimacy on the other. Thus, federalism advocated the creation of a European executive, a strong common parliament and a constitution, with

the idea of creating the United States of Europe revolving around a principal axis, the European citizen, which would have the same rights and obligations irrespective of the nationality.

Another important theory is the Neofunctionalism, based on the integration of areas of low political profile, mainly economic, to prevent resistance from various social and political regimes in Europe. The fields of integration should be chosen by their potential for deeper integration, covering more aspects, which would lead to a spiral effect where the integration in a given field generates benefits for society, but in turn creates new problems that can be solved only with more integration, reaching the European state as the final result of the integration process.

Finally, cooperation between states has a great influence on the development of the European Union. It is based on agreements between states and depends on the ability of political, social and economic aspects of each state to understand and reach agreement without resorting to extreme decisions as the use of violence or blocking of the relations between states. Today the ability to reach agreements that determines the jumps of integration caused by other reasons, and has its highest expression in the Council policy requiring unanimity for approval.

The European Union today is the result of an amalgamation of Federalism, Cooperation and Neofunctionalism, and other minor influences. It gives a special character to the process of European construction, being unique in the world (McCormick, 2008). The importance resides on understanding that the current EU is only one stage in the process of European construction whose ultimate goal is the attainment of a European state. As we are not at the end of the process, or in a static situation, in the long term more reforms will be included in the European building process and hence more reforms will surely happen affecting the common currency. Thus, the problems that EU faces today are short term, and are included in another process even bigger, which ultimately will lead to the creation of a European state, whose form and powers are still to be defined.

The word crisis in Latin means change, and in this sense the EU has been in constant crisis since the creation of the first community, the Coal and Steel Community, back in the 50's, until today, constantly changing its shape, policies and powers. And this state of crisis will last until the achievement of the common goal, the European state. In this sense it is important to note that the process never had a regression in the integration, perhaps stoppages in

the process but never steps back. The integration model could be explained widely with different stages that are repeated over the time as a cycle, part of the overall process of European construction. It is integration, deepening, stabilization and stagnation, which again after witnessing a new cycle would begin again with integration following the same pattern.

The first stage is the creation of new policies at a European level that include different aspects that are integrated in a common management. Following the integration there is a period of deepening following the paths opened by enhancing integration of the Community status of those policies to absorb the different prerogatives of member states and managed in a European or supranational level. This progress in integration is slowing down to a state where the process of stabilization takes hold and the different problems raised during the previous stages are treated. After that there is a high integration, a result of the process of stagnation, as the fields or integrated policies begin to show problems that can only be resolved by integrating them further, and including other new aspects, but in some way related, with the original policies. As the output of the deadlock there can be only one possibility, more integration. The intention to keep the European Union static, without further movement forward, without further integration, would mean the collapse of the organization because it would not be able to meet the new challenges created by the previous integration. Obviously, this would lead to the demise of the organization, which would have devastating consequences for Europe, so that member states would not take that path lightly and finally would have to accept greater integration albeit as a lesser evil (Naurin & Rasmussen, 2012).

According to this model of integration in Europe, the European organization always take member states' policies and manages the common way, but never returns the same policies to the states, the EU always takes, never returns. The EU absorbs above all policies that have been under the power of the member states to manage them jointly, but it never nationalizes, or reverses the Community policies already in the European sphere to the member states.

Currently the process of European construction is in a delicate stage of stagnation that will be followed by another phase of integration. The EU's current problems will be solved with more integration. Of course, after overcoming the reluctance of national governments of the various current EU member states, which is given by the gravity of the crisis itself that Europe is facing right now (Glencross, 2009).

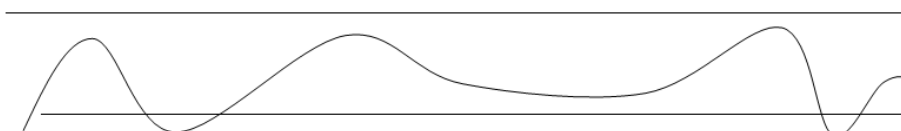
Analysis

Currently there is a serious economic and financial crisis in Europe. It will be a national problem of the member states if they will still have their national currencies, without the common currency, and thus would be resolved at the national level without significantly affecting the rest of the members of the Union, as it happened in the 80's when economies of Spain, Italia or Great Britain responded to their domestic crisis by devaluing their currencies.

Monetary integration has its most remote roots in the decision of U.S. President Richard Nixon to abandon the gold standard, which led to worldwide monetary instability. European states reacted to the Breton Woods conference with the creation of various financial mechanisms to ensure stability, especially the creation of the ECU, a basket of European currencies in which the central banks of each state were responsible for maintaining the value of their currencies within certain limits, 2.5% of the mean. So if a currency was revalued above that limit, it was a consequence of demand of the international financial markets being higher than the supply. That is, most traders had wanted more of this currency than they could acquire. As the demand was higher than the offer the value rose, and the Central Bank of that state had to supply the market with more of its currency, which traded for dollars, the international currency of reference, matching demand and supply. In the case of a devaluation of its currency value, it meant that the offer was greater than the demand: more national currency in the international market than could be absorbed. The way to stabilize the currency was using the national Central Bank for buying national currency in the international market with dollars, and hence equalizing the demand and the offer.

Currency Stability: 2.5% +/-

+ 2, 5% Central Bank sells National currency for dollars $O < D$



- 2, 5% Central Bank buys National currency with dollars $O > D$

$O = D$ Full stability, the value do not change

The main problem was when the National Central Bank lacked enough dollars for stabilizing the value of its currency. The system worked properly for a few years, but the financial crisis of 80 and great movements of financial capital markets led to the extreme situation when some Central Banks lacked enough dollars or national currencies to stabilize their currencies, to match the offer and demand. Then it was decided to extend the limit to +/- 15% fluctuation, which in reality meant the end of the system because it allowed the value of the currencies a fluctuation of 30% of their value, a very big gap in terms of stability.

To avoid these fluctuations and maintain a stable financial situation, apart from other political reasons as the predominance of the German Mark in Europe or the process of European integration, it was decided to create a single currency for the European Union, the Euro (De Grauwe & Peeters, 1998).

Positive Aspects of the Common Currency

1. Decrease the costs associated with foreign currency exchange for trade. The development of the Common Market and later the Single Market in Europe meant a significant increase in intra-Community trade so that a common currency meant the stabilization of trade. It reduced costs related to intra-Community trade, and meant less than 1% of EU GDP, since all companies involved in foreign currency exchange had a substantial reduction in their business activity.

2. End of uncertainty. When trading between countries with different currencies and with different periods of payments and delivery, the final price may be altered depending on the fluctuations of the exchange rate. This creates some uncertainty and has a restrictive effect on international trade. The common currency ends the uncertainty and increases trade between Eurozone countries.

3. Euro International Importance. As the world's largest trading bloc, the common currency of the European Union could become a competitor of the U.S. dollar as international currency. This means that many Central Banks of other countries will have financial reserves in Euros, with the consequent benefits for Europe and its economic system.

4. The introduction of the Euro led to a decline in interest rates, which meant a period of expansion in some European economies because they had

a cheaper access to loans. Anyway this positive aspect is relative because some EU members already had low interest rates. It could be also included in the negative effects of the Euro, as it led to an increase in debt of the weaker economies, a worrying problem nowadays.

5. European Identity. The introduction of common currency has led to an increase in the sense of European identity: as EU citizens can use their own currency in other member states, they may feel a sense of belonging to a common area, to a common territory, to Europe.

6. Control of German economic power. The reunification of Germany created a state of panic in Europe because there was a fear about the repetition of the German economic miracle after the WWII in rebuilding the communist East. It could have led to a stronger Germany than the rest of the communitarian partners and the obvious dominance of a united Germany over the other European states. So the best way to prevent it was suppressing the independent monetary policy of Germany, and including it in the community entity, the European Union. For this reason Germany lost monetary sovereignty, but shared it with the rest of its partners.

7. The introduction of the Euro must also be understood within the prism of European integration, whose long-term goal is the creation of the European state. And one of the strongholds of the states is its monetary policy, and one of its major symbols is the common currency, so from that point of view, the Euro is a step nearer the final goal of integration.

Negative Aspects of the Common Currency

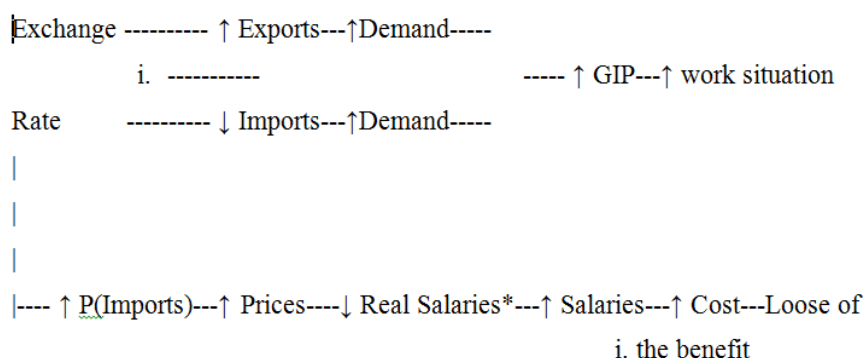
The negative aspects of adopting the common currency are primarily related to loss of independence of member states squandering the possibility to use financial instruments independently to revive their economies in times of crisis.

1. Loss of ability using the interest rate. When a state experiences an economic crisis, it can reduce the interest rate, which means that private investors have a lower return on their investments in the public sector. Therefore they prefer to invest in the private sector. This leads to an increase in the economic activity that eventually translates into higher inflation. But the important thing is that it will increase economic activity in a time of economic recession. On the other hand, if a state has overheating problems in its economy, it may raise the interest rates, so that investors allocate their capital

to the public sector because of the highest return, which will reduce investment in the private sector and shrink the economy and consequently reduce the rate of inflation. Currently the interest rate depends on the European Central Bank, so member states of the Eurozone cannot use it to their own devices, and the European agency will only act in case of a global crisis (a European crisis affecting the majority of the market common) not in crisis affecting just some countries of the Eurozone. The reason is obvious; helping some states needs of higher economic activity will mean overheating the economy of the rest of the member states with the negative effect of a high inflation. It means harming the healthy to treat the unhealthy.

↓ I-----↑ Private Investment-----↑ Economical expansion-----↑ inflation
↑ I-----↓ Private Investment-----↓ Inflation

2. Loss of the possibility of devaluing the currency. A state faced with a crisis situation may decide to reduce the value of its currency. The consequence is that the economy of this state produces cheaper goods for the international market, increasing foreign demand for the production of that state, so exports grow, economic activity increases and it also increases the occupation rate. In turn, what is produced abroad becomes more expensive in the domestic market. Thereby there is a reduction of the imports and an increase of the domestic demand for those products produced within the state. It increases the domestic economic activity. Thus, an economy can be reactivated using this financial instrument, but its effects are limited in time and have long-term harmful consequences, since a devaluation means that the price of imports rises. Some of these imported products are replaced by domestic production, but not all can be. So prices rise as a result of more expensive imports and the domestic economic growth, causing real wages to decrease. As the salaries are maintained in a pre-devaluation level and then the products are more expensive, the possibility of employees to purchase goods is reduced. This situation leads to social unrest resulting in increases in wages, which increases the cost of production. It means that the domestic production becomes more expensive and the loss of the initial benefits of the devaluation. Anyway, it can be a useful tool to revitalize the economy in a timely manner at a particular time of a crisis.



3. Fiscal Policy. According to the Stability Pact countries that joined the common currency have borrowing limits which reduces the possibilities of increasing the deficit. In a crisis situation, a state may resort to international markets to raise capital later used to revive the economy, following the example of Roosevelt's New Deal in the crisis of 29. If the state increases its public investment in a time of recession it becomes the engine of the economy at a time when the private sector lacks the capacity to lead the economic recovery. Obviously, in a time of economic downturn, state revenues are reduced because there is less economic activity and therefore it is less able to fundraise, so the only way is to spend more is by borrowing abroad. Once revived the economy of the state revenues increase again and used the surplus to pay the debt. This is another element that is lost at the national level, although the controls that were established have been insufficient, so that the debt crisis of the states has increased dramatically causing huge tensions in the system and among member countries of the monetary union (Wickham, 2008).

Crisis----↑ **Public deficit**-----Improvement of the economic situation

All negative aspects of the Euro are related to the loss of independence of national economies in a crisis situation, because these instruments go under control of the community, the European Central Bank, which is only used to benefit the whole community. So the problem lies in cases of asymmetric shocks, crises that affect only part of the community (but not the whole). The more integrated an economy is the less likely is a crisis of this nature, as a crisis that happens in one part of the common market will quickly spread to the rest of the market and the European Central Bank will act

accordingly. But now the European market is not as tightly integrated, certain persisting blocks with less integration and less access to the rest of the system, leading to local crises that do not expand to the rest of the system which prevents the European Central Bank to act effectively solving problems without harming healthy economies. Today we have four different cases related to this issue, Greece, Ireland, Portugal, Spain and Italy.

The Case of Greece

The country has spent more than they received, and financed their spending by borrowing with debt. This model can only be maintained in a long term with a future increase of the state revenues to meet the rising payments that have to be performed, basically the common obligations of the Greek State and the payment of the debt and its interest. Normally it is achieved by the growth of economic activity and the consequent increase in government revenue, in other words, the state spends today what it will earn tomorrow. The problem is that you cannot keep this model in a scenario where economic recession lowers the state revenues and spending power is diminished. If expenditures are maintained or even increased, the state has to borrow more money, and it means more debt, increasing future costs (Manolopoulos, 2011). If the crisis persists and future revenues are not increasing the state's ability to repay these loans will decrease, until you reach a situation where lenders doubt of the state's ability to repay loans and fear for their investments. Under these circumstances of mistrust, the international investors will not lend more money to the state, which may not meet its obligations and would lead to the bankruptcy of the state. Part of the problem is that expenditures are constant in the states or even progressive, they are obligations of the state, unless a reform to reduce state spending is done. Thus, the state must reduce its spending and increase its incomes, which in practice means socially painful reforms very unpopular among voters, as increasing the tax burden on its citizens and economic agents, an effective fight against fraud and reducing the salaries. The costs should be reduced in the less productive sectors of the system, especially on those whose influence on the future economic growth is lower, normally the public workers and public institutions. Thus, those most affected by cost containment reforms are salaries of civil servants, social spending, pensions, public enterprises, etc. Revenues increased by raising taxes, combating tax fraud and investing in economic sectors with potential to

create growth. These investments are not only monetary, but also may be legal, creating a legal framework that encourages development, which often leads to loss of privileges obtained by different social agents. In the case of Greece there has been a social and institutional fraud, the state deceived the international markets making up their accounts, with greater economic activity than it actually had, thus artificially increasing their ability to generate revenues and meet its obligations, making believe that the international market was a bigger national economic capacity. This institutionalized fraud was discovered by the economic weakness of Greece following the global crisis after the country had problems to pay its debts.

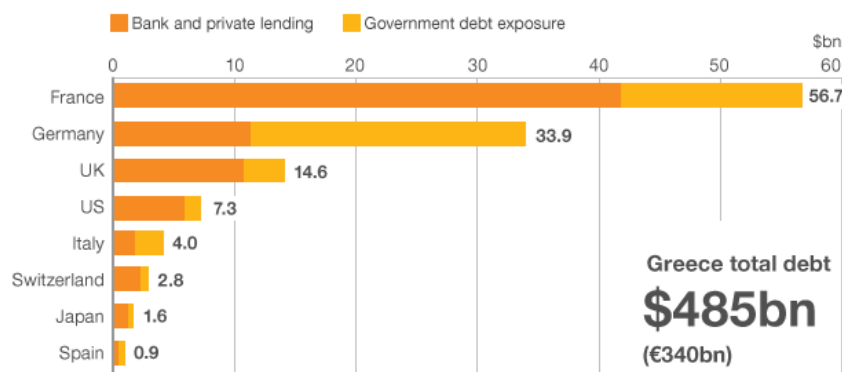
In turn, there is a great fraud of social agents in tax matters. The level of tax evasion in Greece is huge compared with other community partners. Tax evasion between private fortunes and companies is common, even among the middle class Greeks. For example, it was recently discovered that 4000 pensioners were still getting their pensions when they were dead: it was money that was pocketed by their families. All these problems considerably reduce the state tax capacity. Furthermore, the Greek public enterprises have become employment agencies for politicians and their followers, so they are not managed professionally and are economically inefficient, so their losses are substantial. In Greece there is an important social rejection to the reduction of the welfare state, pensions, salaries and other benefits limiting the ability of the Greek state to reduce the public spending (Mitsopoulos & Pelagidis, 2011).

Another Greek problem was the lack of investment in productive sectors with growth of potential that would serve to increase economic activity. The state revenues were spent on ineffective policies from the economic point of view, as artificially high public salaries, or artificially minimum wage in the country.

Thus, as the Greek state spending increases and revenue fell as a result of the economic crisis it cannot meet their payments and responsibilities. As a member of the common currency cannot devalue its currency, they are not able to lower the interest rate and simply increase its deficit against the provisions of the Stability Pact. By the time the markets decided they did not trust Greece's ability to repay loans, funding became more expensive while the collapse of the Greek economy comes closer. The result is a bailout led by the strongest economies in the EU, as well as some international financial institutions like the International Monetary Fund, and the loss of independence

of the Greek government from having to comply with the requirements of the rescue plan reforms to reduce costs and increase revenue. Even if the public debt was reduced by half the Greek state cannot repay the other half unless it gets another loan from the International Monetary Fund and the other members of the Eurozone. The problem is very basic; Greece cannot keep its high standards of living under the current circumstances because it has no money to pay for it. The country was paying its social system with borrowed money and now cannot repay it. The country has the option of reforming the economy, cutting the expenditures, decreasing the incomes of the Greek citizens and the loss of the financial wealth of its citizens or leaving the Euro adopting back the Drachma devaluating its value, not paying its debt with the international investors and isolating itself from the international world, both options seen hard to accept and will have catastrophic consequences for Greece, its European partners and the holders of the Greek public debt. The Greek government has been playing with their European partners because of the consequences for the Euro if the country leaves the common currency, because it could be seen as the first country forced to abandon it, creating a crisis that could lead to similar situations in other member states of the Eurozone, as Ireland, Portugal, Spain, Belgium or Italy, in order to get more money from Europe. At the same time the Greek government did not reform its economy because of the social resistance, so it still depends on external money to keep the country running. Unless the Greek government starts a serious reform program cutting expenditures and increasing incomes the international aid will stop and the country will be bankrupt (Brown, 2012).

Countries most exposed to Greek debt



Source: BIS Quarterly Review

The Case of Ireland

In the case of Ireland there is not a level of fraud as high as in Greece, so the situation is radically different. The Irish economic system was based mainly on tax breaks for big corporations who came to Ireland because there were paying fewer taxes and in turn had access to the entire European Common Market. These world-class companies settled on Irish soil, such as Microsoft, with only one goal - work in the European common market within a location where taxation was lower. The second point of importance in the Irish economy was the construction sector, real estate, which was the main driver of the Irish economy in the years before the global crisis. With the fall of this economic sector there was a great reduction of the state revenues. In turn, the Irish state did not raise taxes in order to keep the international companies in Irish soil. The Irish government did not generate much newer revenue, and even increased its expenses because the Irish financial sector was in deep trouble for the debts owed to the property developers. Its situation was critical, close to insolvency. The Irish State decided to save its banking system by supporting financially the main banks with the State monetary muscle, but as huge amounts of money were spent to save the banks and the Irish state revenues decreased due to lower economic activity, the country was unable to meet its obligations, and a bailout was needed from its community partners. It meant a loss of independence of Ireland by having to accept the reform plan developed by participants in the bailout. Among the reforms were included higher taxes on large corporations by decision of Germany that saw it as an unfair competition.

The case of Ireland is also special, because of its strong links with the United Kingdom. The British do not have the common currency, and hence they keep independence on their financial decisions, but were involved in the crisis of the Euro because of their implications in the Irish economy, which is integrated into the British economy. So, the bankruptcy of the Irish economy would have affected strongly the British economy and the British financial sector. That's why the British government participated actively in the bailout developed by the Eurozone countries for Ireland. Anyway right now the British government does not want to get involved in the Euro crisis, and it could have important consequences for Ireland.

The Case of Portugal

This case is simpler because the problems in Portugal are generated by an economy poorly productive that was financed through borrowing. Revenue did not evolve in the same way as expenses. It led to a situation where the Portuguese state has been unable to meet its obligations. The need for reform in the Portuguese economic system was therefore an obligation, but such reforms were not carried out because of electoral reasons. Nobody wanted to assume the political cost of the reform or face the rejection that arose between important social actors, such as the Trade Unions, a very important social actor in the country. It clearly points out the difference between politicians, who rely more on short-term thinking and statesmen who are concerned about the situation in the long term. The lack of agreement among the ruling classes of Portugal has meant the need to request a bailout from its EU partners and the imposition of reforms from the outside with the consequent loss of independence. The Portuguese state is currently cutting expenditures and raising taxes to balance the national accounting, and these actions are presented as a European requirement reducing the electoral cost of these measures and giving them more respectability avoiding the lack of credibility of the national politicians among the Portuguese population (Ferreira-Pereira, 2011).

The Case of Spain

It's a complicated case because of the size of the Spanish economy and its possible knock-on effect to the whole Community as a country too big to fall. Spain had a period of unparalleled economic boom based on real state. During certain periods of time the country built more houses than Germany and France combined, although the Spanish population is 46 million and the Germans and French have more than 140 million people. The crisis in this sector represented a sharp drop in earnings for the State. For example, the sale of flats in the first quarter of the year 2011 was 11,000 million euros, while during the same period four years ago was 38,900 million euros. Despite lower incomes, Spain increased its public expenditures in order to activate its economy. This action was financed by borrowing in the international market through public debt. The money was invested in an artificial way to maintain the welfare state without investing in wealth-generating sectors that would be

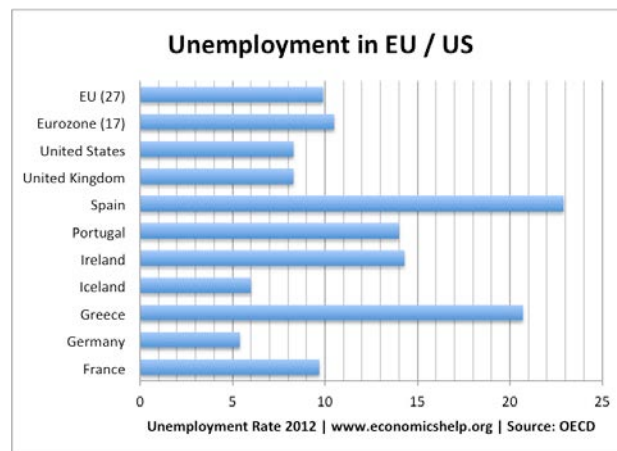
more productive, as administrative expenses of the State that are duplicated as a result of the regional autonomy status, or social benefits, pensions and public unemployment payments. Other problems of the Spanish economy are corruption, crisis in the public banking sector and its privatization, lack of innovation and lack of external presence of the Spanish companies and a high unemployment rate.

The bank system is still in trouble by its exposure to the real state. As many real state developers could not pay their loans, the banks seized their real state possessions and included them in their balances with the economic value if the times of economic expansion. It means that their value is not real, but if the banks reduce the prices of the real state in order to get rid of their stock, their losses will be great. The Spanish government has supported it for avoiding the collapse of the banking sector, as a minor harm. The current stock of new houses in Spain is around 700,000, plus the second hand houses in the market. The real estate market with the current prices will need many years to absorb this stock without any new building activity. But during the year 2011 more than 250,000 houses have been built in Spain increasing the problems of stock but avoiding the collapse of the real estate sector that currently employs more than 1 million workers. On the other hand, the incomes of the Spanish citizens have been reduced by government cutbacks, the effects of the crisis and the reduction of bank loans for real estate purchases, increasing the problem of the real estate stock.

The other main problem of Spain is the high unemployment rate, 4,998,225 people. It means a huge reduction in the state revenues from the taxes of the people who was working before and now are not, plus an important increase in the expenditures of the state via social policies as unemployment payments and other economic and social aid for those without work, and finally the impossibility of reforming the real estate sector reducing the current rate of construction because it will mean an even higher unemployment.

Thus the hope of the Spanish state is reducing expenses and increase revenues. Some reforms have been done, such as reducing the salaries of public employees, reducing subsidies, in addition to reducing other unnecessary expenses. But reforms are insufficient and will need to be deeper in order to escape the ghost of the bailout that could have tremendous consequences on the whole Union. Discussions are ongoing about the need for a more flexible labor market, reducing the regional institutions expenditures

- totaling more than central government spending - and investments in productive sectors with a potential capacity to generate wealth. In turn, the Spanish state has increased its revenue capacity increasing taxes and combating tax fraud. Also, the Spanish state revenues have been increased by the activity in the current motor of the Spanish economy - tourism.



But this is a temporary solution that must be managed cautiously because the current tourist growth is a consequence of the crisis in Arab countries. Tourists, that are looking for sun and sand, mainly come from Northern European states. Although Spain is comparatively more expensive than countries like Tunisia or Egypt, recent changes of government in these countries and the consequent political instability has caused fear among European tourists who preferred the security offered by Spain as a place to spend their holidays, despite being more expensive. Another importance sector, agriculture, has not been affected by the crisis, as it is one of the few sectors of the Spanish economy orientated to the external market (Rosell & Trigo, 2011).

However, deeper reforms are needed to solve the problem in the medium and long term, a process that the current government is undertaking with an important program of expenditure cuts provoking a reduction in the living standards of the Spanish citizens and with a negative impact in the economic growth.

The Case of Italy

Italy is one of the biggest economies of the European Union and the 7th largest economy of the world. The situation of Italy is in many cases similar to the Spanish one, but more serious because of its bigger size. Corruption is wider than in other European States, the subsidies are numerous but ineffective from an economical point of view, the unemployment rate is high, but the tourism industry is also big in Italy and also has benefited from the recent disturbances in the Arab countries increasing the revenues of the Italian state and benefiting its economy. Also Italy has a problem with the regional governments and the overdeveloped national, regional and local institutions. These regional institutions have more employment agencies for politicians and its supporters than effective or needed public institutions. Its agriculture has been also less affected than other economic sectors because of its orientation to the European market. But there are also differences. Firstly, the real estate, less developed in Italy than in Spain, and secondly, the historical division in two areas of Italy, north and south. The northern part of Italy, more industrialized and strongly linked with the European markets is in a better position to overtake the crisis, but the southern part, continuously being heavily subsidized by the Italian State needs to change its patron of growth and public expenditure. The political situation is also different in Italy. The previous government opted to avoid the crisis by hiding it, without any effective action, just with some dramatic reforms that seemed to be effective just on paper but with small implication in the real problems of the Italian economy. Anyway the changes in the Italian government and the strict program of reforms of the technocrat Monti can help to reverse the situation. The Italian state cannot afford financing its expenditures with public debt anymore because it is already huge, much bigger than in the other cases explained here, so it needs to reform the economy in two possible ways: expending more in order to increase the economic activity and its revenues in the future or reducing its expenditures in these cases where the economic benefits for the whole country are small or nonexistent. But as Italian politicians are trusting the size of the economy to avoid a bailout, and hence are trying to win time to have the economic growth back in the close future without doing any important reform; their support to their new technocratic government could evaporate leading to the ruin of the country. This strategy could work because the European Union will obviously collapse if Italy goes into bankruptcy because it won't have the

financial muscle to help such a big economy and could mean the end of the Eurozone as we know it today and destroy the future possibilities of the area. But it also depends on a fast world recovery from the crisis, if this world economic recovery will not happen soon, Italy will not be able to last without important and real reforms.

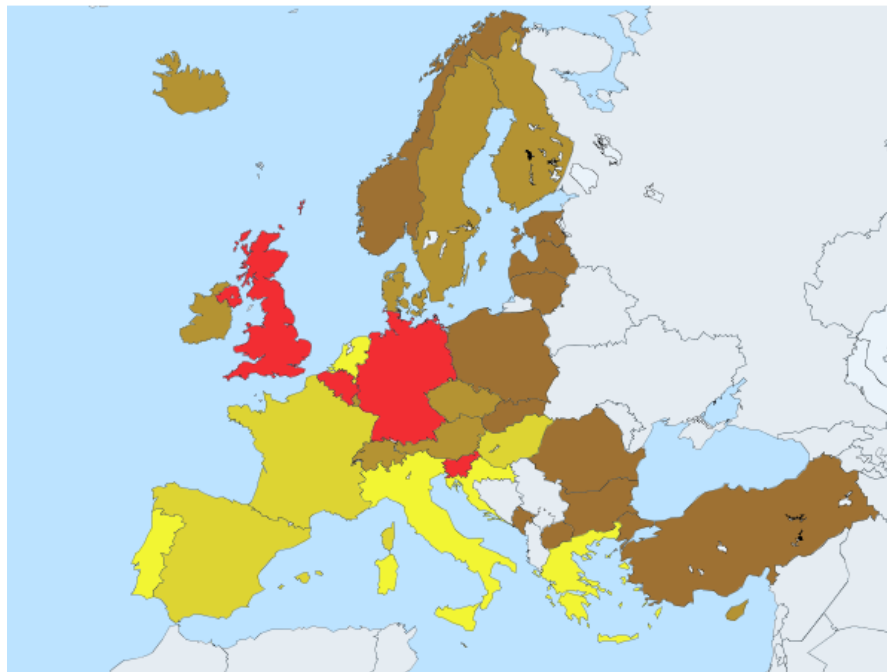
Solutions

As these five countries are member of the Eurozone, their problems become problems in Europe because their bankruptcy would create tensions that could lead to the end of the common currency and a major European crisis. But the crisis in the economies of these five countries has not spread to the rest of the Community, i.e. the core economies of France and Germany are growing and overcoming the crisis. It makes it impossible for the European Central Bank to use any financial instruments available to help countries in crisis without harming healthy economies in Europe. The solution to current problems at the community level depends largely on the following factors:

1. The historical evolution of European construction process teaches us that the EU will never return policies to the member states, because it always adds and never subtracts. As the dissolution of the common currency, or abandonment of the group of countries with problems, is not feasible within the historical development of the EU, this option could be used just in the case of Greece, as a minor partner of the Union. Anyway it is not likely to happen as Europe is in a process that began in the 50's and is still developing; the member states will try by any mean to avoid this solution.

Real GDP growth rate - volume**Percentage change on previous year - 2013**

Based on a comparison with: EU (27 countries)

**Legend**

0.4667 - 0.8667

0.8667 - 0.9999

1.0000

1.0001 - 1.8

1.8 - 2.7333

N/A

Minimum value:0.467 Maximum value:2.733 eu25:1.5 eu15:1.4

Source of Data:: Eurostat

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Last update: 14.04.2012

Date of extraction: 16 Apr 2012 12:37:04 MEST

Hyperlink to the map: <http://epp.eurostat.ec.europa.eu/tgm/mapToolClosed.do?tab=map&init=1&plugin=1&language=en&pcode=tsieb020&toolbox=legend>

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Short Description: Gross domestic product (GDP) is a measure of the economic activity, defined as the value of all goods and services produced less the value of any goods or services used in their creation. The calculation of the annual growth rate of GDP volume is intended to allow comparisons of the dynamics of economic development both over time and between economies of different sizes. For measuring the growth rate of GDP in terms of volumes, the GDP at current prices are valued in the prices of the previous year and the thus computed volume changes are imposed on the level of a reference year; this is called a chain-linked series. Accordingly, price movements will not inflate the growth rate.

Code: tsieb020

2. Germany is the largest economic power in Europe and its economy is based on exports, so an important part of the debt owed by the countries in crisis has been devoted to buying German products. Two thirds of German companies' exports are destined to other EU countries, so the Teutonic country has enjoyed a big economic growth and higher tax revenues from the economic activity of the German companies. So, there is no sense that Germany's refusal to help these countries is against its own economic interests. Here the problem is the management of the benefits generated by German companies because of their exports to the rest of Europe. They are under the control of the German state and under the European Union. Therefore, it is radically false that the Germans paid with their own money to save the struggling economies of the Eurozone. Germany is the main beneficiary of a common policy, internal market, but there is not a common policy in the European Union to manage periods of crisis as the current one. Germany benefits from the European Union, but its contribution to help the countries with problems can be seen as a national generosity.

3. The current bailout is temporary and unstable, depending on the willingness of the richest states, read Germany and France, although France is showing itself much more flexible. The rules of the rescue are not decided within the EU but by the strongest states. It breaks the principle of Communitarian solidarity and the spirit of coexistence and common management. On the other hand it also lacks any efficient tools to introduce reforms in countries receiving financial aid, because it is based primarily on good faith without coercive legislation. It leads us to a situation of dictatorship of the rich countries to determine unilaterally the conditions of redemption, and to the fraud of the weak countries that do not meet their commitments (Blanchard, Giavazzi, & Amighini, 2010).

The Impossibility of Ending the Crisis Cutting the Public Expenditure

The main problem of the economies in recession is finding money to invest in their economies to push the economy towards a higher activity. Following the teaching of Keynes, still updated even when the main economies of Europe are presently preaching state prudence. Keynes already spoke about fiscal austerity during periods of expansion in the economy but during recessions a cut in the public expenditure will lead to a deeper

depression of the economy. According to Paul Krugman the European leaders reacted against the crisis focusing on public debt instead of employment, and it has been a great mistake. The Europeans based their reaction to the crisis on the trust of the economic agents on the general accounts of the national governments as the best way to increase consumption in an environment of global recession and activate their economies. The so called expansionary austerity is not working, as the crisis is deepening in the economically weaker European states. The case of Ireland has been used as an example when in 2010 it seemed that the economy of the Irish tiger would recover thanks to the austerity measures, but it was just a mirage, as later it was checked with the national accounts at the end of the year. Anyway, as the member states of the Eurozone do not yet have the possibilities of devaluating the currency, or using the interest rate or increasing the public debt in the short term without paying outstanding types of interest, obviously they cannot find the money to shake their economy and hence accelerate their economies in order to overtake the crisis. Austerity measures are needed in order to avoid national bankruptcy, but it should be focused on nonproductive sectors, eliminating all the superfluous expenditures. But if the austerity depresses the economy even more, as the unemployment rate will grow and the state revenues will decrease and the expenditures will grow. Hence, the main problems are where to find the money to activate the economy via public expenditure and how to design and apply credible economic plans in countries that already showed an obvious incapacity in this task (Krugman, 2008).

Conclusions

The only acceptable solution to the current economic problem is more EU integration, the common management of the problem through the creation of a European Economic Government to manage the costs and revenues on a common ground based on communitarian legislation and new communitarian institutions. This does not mean the end of the economic management of the states, which would continue managing their respective budgets, albeit reduced, to develop national policies and influence the European Economic government via the European Council. It will be the creation of a European entity, funded with European taxes paid by the European citizens and the companies operating in the common market. The European taxes will provide the European Economic government with enough financial muscle to address

the economic problems of the European states alleviating the effects of asymmetric shocks in the European Union with a common management of expenses and incomes.

The idea is feasible and could function as in the case of the federal government of the United States and the crisis in California in the 80's, where after the Cold War the U.S. federal government cut its defense spending, with the resulting crisis in the weapons industry. Most companies in this sector were located in California, so there was a crisis focused in this state and it did not spread to the rest of the country. Thus, the Federal Reserve of the United States could not use financial instruments such as interest rate or devaluation to solve the problem of California because it would hurt the economies of other U.S. areas whose economic performance was good. The California state revenues declined, so that reduced its transfers to the federal state, but at the same time, the federal state, despite receiving less money from California, increased funding for the state to alleviate the crisis. It helped to increase the economic activity of California and solved the crisis.

The members of the Eurozone have lost their monetary independence, and currently are in a big need of funds to activate their economies. As the European Union holds nowadays the monetary power via the European Central Bank, it is logical that the European Union will provide these needed funds to these member states. On the other hand, these countries have shown a lack of credible economic governance, and the European Economic government could also solve this situation, being the institution in charge to develop credible plans and oversee its right application. The member states should adopt in their national systems the communitarian rules. There will be resistance for the inclusion of a new tax in Europe, but first of all it should replace existing taxes in order to avoid a tax increases with negative effects on the economy. The tax should be paid according to the economic activity, and hence the areas with more economic activity and hence have benefited more by the European common market will contribute to keep this market in particular, in Europe in general.

Finally, a European Economic Government will avoid the current situation of domination of the strongest economies over the weakest. The rules of the financial help given to countries as Greece, Ireland or Portugal are decided by the main donors, mainly by Germany. In a common Economic government decisions will be taken by all its members by a system of qualified majority where countries with stronger economies will have more votes and it

will avoid any single state to veto any decision. It will create a more democratic and equal system where all the members share the benefits and losses of the European integration.

Currently the European Union is working in the direction of reform but still much is needed. The presidential elections of France and the pressure of Monti, prime minister of Italy are focusing the solution of the crisis in measures focused on activating the economy of the member states rather than in cutting the public debt, but the European Commission lacks a clear plan on the European level. It means that the creation of a Common Economic government is even more needed in order to increase the economic activity and solve the current crisis. Germany has become the main supporter of fiscal austerity, and the German Minister of Economy has become a key figure in European politics. But the social consequences of these actions are high in many states of the Union, and the German political cost is becoming very high, with a growing rejection among Europeans of the growing German influence in the national affairs of the other member states of the Union. Again, this problem could be solved with a common management of the crisis by a European Economic Government. All the fiscal measures of the Union will be empty in the middle term if they do not lead to more integration and a common management of their fiscal affairs, but such a concept is strongly rejected by the nationalist forces in the member states of the EU.

This current crisis can only be understood in the context of the European integration process, as a stage of change and which most likely effect will lead to a deepening of the integration. Currently there have been some movements in the right direction, but still they are very weak and mild, just temporal solutions for a long term problem that could be reproduced again and again until a final solution is reached.

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The Balkan Economic Union as a Prospective Integral Part of the European Union

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Abstract

Together with the IMF and the World Bank, the EMU is the biggest monetary project in the history of mankind. Its goals are reduction of trade costs between its member-states, increase in the convergence in their relations and their economic growth. The main pillars of the monetary institutions were set up for its normal operation. However, the member-countries kept their fiscal sovereignty. The EMU was not a part of a larger political integration of the member-countries. It enabled them to make political decisions on a national level which were not in line with the so-called Maastricht criteria. The outcome of the lack of a political union is: growing budget deficits and continuing growth of the public debt of most of the member-states of the EMU. A debt crisis was created which shakes the basis not only of the EMU but also of the EU. For the first time in its six and a half decade existence, the EU faces an existential crisis. The exit of this condition lies in redesigning the basic structures on which it stands. This process might be fatal, as well as painful for the EU. In such a situation, the Balkan aspiring member-states will have to wait longer to enter the union. In the meantime, to protect their national economic and political tissue, as well as to prepare for the accession in the EU, a regional cooperation and union is a necessity. A Balkan Economic Union in which Serbia, Bosnia and Herzegovina, Albania, Kosovo, Montenegro, Turkey and Macedonia will be a part will help in achieving the goal of entering the EU less painfully. The Balkans can finally cease being the "gunpowder barrel". With application of a quality, historic, comparative and descriptive method, this paper presents the possibilities and opportunities of this model of designing a political and economic picture of the Balkans. The aim of this paper is to show that with such a union, the Balkan

countries have a serious chance to overcome, still, the prevalent antagonisms and thus clear the way to their final destination – the EU.

Keywords: European Union, European Monetary Union, debt crisis, Balkan Economic Union, regional cooperation, European integration

Introduction

A basic idea for the integration of Europe was born after World War II. The leading ideologists of the time estimated that the piled nationalisms, which in the past had turned Europe into an arena for various wars, should be eliminated so as to establish some sort of integration between different European nations and peoples. Over time, this noble idea grew into an idea of establishing multiculturalism as a foundation for future establishments of Europe.

The conclusion of the Second World War, the division of Germany, the economic and political crisis in Western Europe and the beginning of the cold war in the early 1950's presented the European integration as a manifestation of economic and political reconstruction of western Europe. That was the true beginning of the process of European integration, which has lasted for nearly six and a half decades, during which the process itself altered and adjusted to the changes in the globalized world.

The strongest change occurred in the early 1990s with the establishment of the pillars of the European Monetary Union (EMU). But then, the European Union (EU) perhaps made the only major mistake that threatens to ruin the idea of a united Europe today. Despite the deviation in monetary unity, member states of EMU have kept their fiscal unity. Monetary political integration was established. It created an opportunity for Member States at a national level to adopt measures that do not match the Maastricht criteria, i.e. the pillars of the EMU. The result of this was the growing budget deficits and the public debts of most members of the EMU. In this respect, their self-mindedness conditioned that the EU face an existential crisis for the first time in its 6.5 decades of existence.

There is a definite way out of this crisis, but it will be neither easy nor fast. This means that the joining of aspiring EU member candidates (including the Republic of Macedonia) will continue to be left on hold without a clear perspective about when the door will be opened again. Hence the question

arises: whether the Western Balkans will patiently await for the moment of opening the EU gate at some time in the future, near or distant, or whether they should be organized in a manner that will provide protection from adverse trends in the EMU, as well as foster their economic prosperity and higher-quality preparation for entering the EU.

If the events in different parts of Europe where there are intensive separate groupings of countries (Visegrad, Nordic, Baltic, Eurasian, etc.) were to be analyzed, the positive response should be located in the second part of that question. Following the example of those groups, the Western Balkans (Serbia, Montenegro, Bosnia and Herzegovina, Kosovo, Macedonia, Albania, with an option of the joining of Turkey) should proceed to their economic integration in such a way that it will not only enable economic prosperity and protection from possible future adverse movement in the EMU, but also contribute to replacement of the politics in the region with economy, thus preventing the association of the Western Balkans with the term "gunpowder barrel".

By presenting the general ideas, goals, development, crisis and prospects of the EU, the objective of this paper is to present the needs and possibilities of forming a Balkan Economic Union as the predecessor of the membership of other countries of the Western Balkans into the EU. Using a qualitative, historical, comparative and descriptive method, the paper will present opportunities for the design and implementation of a future economic community of the Western Balkans. The final conclusion of the analysis will be that those countries have a serious chance to overcome their mutual antagonisms and thus, economically stronger, to clean up the way to their final destination - the EU!

Idea, Goals, Development, Problems and Prospects of the EU

The foundations of the EU that we know today were set in the 1950's. It was the period when six developed European countries (Germany, France, Italy, Netherlands, Belgium and Luxembourg) decided to establish a European community, which in some way would be the counterpart to the USA and would assume the obligation to establish an international political and economic balance.

In fact, the basic idea of a European integration is much older. Immediately after the First World War an idea (Pushkaric, 2012) was born,

according to which the crowded nationalisms, which in the past had turned Europe into an arena for running various wars, should be eliminated so as to establish some sort of integration between different European nations and peoples. Moreover, building upon the basic developments of that idea politicians from certain Western European countries, as well as leading political institutions of the West, were increasingly developing the idea of establishing multiculturalism as a foundation for future European unity, which after the Second World War the English Prime Minister Winston Churchill called "United States of Europe" (Pushkaric, 2012). Hence, we can say that there is a centennial inspiration, tendency and desire to pave the way to the creation of European integrity, and thus of European identity.

This idea was developed throughout the second half of the 20th century. The European integration evolved over the years, gaining new forms that were supposed to act towards the removal of all emerging problems and realization of the envisioned perspectives. Since it was becoming more and more obvious that without economic integration, the ideas for achieving multiculturalism, economic prosperity and a single European identity were not possible, in the early 1990s the EU implemented the second largest monetary project in human history - the establishment of the EMU.

The EMU rests on three main pillars (also called Maastricht criteria): a) the budget deficit of a Member State of the EMU must not be greater than 3 percent of its gross domestic product (GDP), b) the rate of inflation in the Euro-zone is not greater than 2 percent annually, and c) the public debt of a member-country of EMU is not greater than 60 percent of its GDP. Following these criteria, the EMU should be a vanguard of the future overall unification of Europe.

The EMU: Economic Prosperity and European Integrity and Identity

The establishment of the EMU and the introduction of the Euro as common currency (along with the establishment of the Bretton Woods institutions - the International Monetary Fund and World Bank) are the largest monetary projects in the history of mankind (Nenovski, 2002). At first it united about 300 million people from the wealthy Western European countries, with a tendency to expand with other member states, which meant a market of more than 500 million people. It was conceived as the vanguard of the future, not

only economic, but political integration of Europe. In fact, it represents the counterpart of the US economic and political federation, as well as the relevant economic associations, such as the North American Free Trade Area - NAFTA. It combines different economies and their currencies, which are at the top of the world rankings. Therefore, there are a lot of high expectations of the common West European currency - the Euro.

Benefits of the EMU: Cost Reduction, Trade Increase

In order to ease the financial life, at the beginning the 12, and today 17 Western European countries (Germany, France, Italy, Greece, Luxembourg, Spain, Portugal, Belgium, Netherlands, Austria, Ireland, Finland, Slovakia, Malta, Cyprus, Slovenia and Estonia) have joined the EMU, which has only one currency - the Euro. Using a common currency was projected to save money and time, and simultaneously increase trade between those countries.

The greatest advantage of the introduction of the Euro was lowering the cost of trading. These are costs that importers must pay while exchanging domestic for foreign currency in banks, for payment of obligations to foreign partners. During the introduction of the Euro (1 January 1999), the European Commission (EC) estimated that those transaction costs amounted to about 0.5 percent of the gross domestic product of Member States of the EMU.

The one-for-all currency has contributed to reducing uncertainty about future exchange rates of the currencies of the member states. Although, major adjustments to their exchange rates were not common even before, the previous system allowed some daily exchange rates variability. It gave rise to the uncertainty about the future value of a particular currency, and thus risk for importers and exporters. Therefore the risk of exchange rate trade depleted to a certain degree because of the introduction of the hidden transaction costs. The single currency eliminated that risk and thereby increased trade and the positive results that stem from it. These results revealed an increase in the range of products traded and the decline in prices due to increased competition by market expansion.

The following advantage of the introduction of the Euro was preventing member countries from devaluing their currencies in order to increase exports. Previously, a country could devalue its currency to boost exports. For its own protection, its trading partners could devalue their currencies. This phenomenon, which was common in the past, according to Nenovski (2002)

is known as *competitive devaluation*. Any reduction in the value of a currency has inflationary tendencies, which means that competitive devaluations could trigger *inflation spiral* (Nenovski, 2002). Although the former regime of exchange rates in the EU were designed in order to eliminate the competitive devaluations, nevertheless such devaluations were possible given the large number of currencies whose rates have often been set more by policy makers than the market itself.

Thus, competitive devaluations bring profits for some, and loss for other countries. However, the cumulative economic impact of competitive devaluations of the Member States of the EMU would be negative, even catastrophic, if it comes to the so-called devaluation spiral (devaluation of a currency in response to a previously performed devaluation in another currency). The single currency within the EMU eliminates the danger of such a mutual competition of the Member States of the Union.

Besides these primary advantages, the introduction of the euro has a secondary, but very important advantage - preventing speculative attacks. Since the former European mechanism of exchange rates allowed large, though not frequent adjustments, it could be vulnerable to speculative attacks. If speculators believe that the value of a currency will decrease (to depreciate relatively to other European currencies), they will sell the values that they have in that currency. If it was believed by a large number of speculators, confidence in the value of that currency could collapse and cause even the appropriate government to devalue its currency, though there was no intention or need.

Indeed, in this case the government may have played speculators by raising interest rates and thereby causing the return of values denominated in that currency on the money markets and capital markets. However, there is a lower limit to which it can be done, because higher interest rates cause enterprises to face large interest costs, which would make them borrow less and less and consequently invest less and less, which in turn basically means slowing down economic growth. The introduction of the Euro completely eliminated opportunities for such speculative activities.

Weaknesses of the EMU: No Autonomous Monetary Policy

Since the introduction of the Euro eliminated uncertainty about exchange rates, interest rates declined. It impacted on encouraging

investment and on economic growth within the EMU. That, in turn, encouraged excessive borrowing by individual member states, which led to the emergence of a debt crisis because the fall in interest rates in Southern Europe has encouraged countries such as Italy and Greece to create an excessive debt (Biznis, 2011). Anyway, this is one reason why in the current discussions more commonly the Euro is determined as one of the causes of the current debt crisis and contributes to its enhancement.

By accepting the Euro, member states of the EMU gave up the use of their own monetary policy and exchange rate policy of their national currency as a tool for their own economy and for overcoming potential problems in improving the national economy. They gave control over monetary policy to the European Central Bank, which sets out the general interest rates. Considering the previously eliminated barriers to international transfer of capital and highly developed and competitive financial markets among the member states of the EMU, interest rates, even before the introduction of the Euro, do not differ much from country to country. However, it is important that no uniform (in a way) European interest rates were determined by the major European countries. This implies that smaller member states would have neither the opportunity nor the power to influence the reduction of interest rates in the periods of their economic slump. Finally, no member state can adjust its exchange rate against the exchange rates of currencies of other member states. In other words, the European agreement almost completely eliminates the possibility of smaller member countries to conduct an independent monetary policy in the future (Nenovski, 2002).

The ultimate victim of a cancellation of independent monetary policy and exchange rate policy depends on the types of macroeconomic "shocks" that the national economy will eventually be exposed to, and also on how good the mechanisms for their cushioning or compensation are.

At the start of the introduction of the euro the question was raised: what will happen if any of the member states of Euroland slides into recession? Until then there was the opportunity for the respective central bank to influence the recession by increasing the money supply, thus reducing interest rates and increased investment, with the final effect of healing the economy. The grounds on which the European Central Bank is set do (did) not allow it to lead expansionary monetary policy for helping a member state, because such an action would cause inflation in other member countries which are not in recession.

In such a situation, in order to reduce interest rates, the member state in recession could use its fiscal policy to boost the economy. However, larger and lasting fiscal borrowings which may be used by one or more member states, will cause increased costs for all other members of the EMU by increasing repression against the general interest rates or by forcing the European Central Bank to increase money supply in order to avoid a rise in interest rates, which ultimately will increase the risk of inflation. To prevent this, the member states of the EMU agreed to limit the use of their own fiscal policies. Under such an agreement (not solid, binding contract) any member state of the EMU must keep its annual budget deficit from exceeding 3 percent of its GDP. Otherwise, the member state had to pay substantial penalties to other states. It is considered an EMU policy that each member state is denied the chance to use supportive fiscal policy during recessions.

Antirecession Solutions and Opportunities

Then what would be the exit if the country fell into recession?

The rate of release of any country out of recession depends mostly on the flexibility of European labor market. If workers are highly mobile, unemployed and with low incomes in the country which went into recession they will work in another country - a member of the EMU. Such mobility would balance the effects across the EMU and establish greater symmetry in the objectives of its overall economic policy. However, in western Europe there are strong cultural and linguistic differences that restrict the international movement of labor, so that the so-called flexibility in the movement of labor (at least in the near future) may not be the salvation for the member country in recession.

The second saving solution for the member country in recession would be the adjustment of wages. If during the recession, workers are willing to accept lower wages, employers will not only retain the same number of employees, but through reduced expenditure on wages they will decrease prices. Lower prices will encourage exports and consumption of domestic products, which all together would lead to economic prosperity of the country concerned. However, worldwide experience confirms that despite the rise during the economic crisis, wages do not fall during the economic recession. Moreover, economic and social analysis shows that Western workers are more willing to remain unemployed rather than accept lower wages!?

The third solution would be competitive devaluation of the domestic currency. However, the single currency does not exclude the method that Italy and other countries have used during the Second World War when faced with huge debt: permitting inflation and devaluation of domestic currencies. Despite this, now another solution is possible, but the price is high. It is conducting "internal devaluation", known as a reduction of wages and mass unemployment, as are now required for Italy, Greece and other European countries in debt (Biznis, 2011).

Despite problems and limitations that lots of EMU member states face in times of recession (Greece, Portugal, Italy, Ireland, Spain), the current Euro crises brought significant advantages to some of the more resistant and more developed countries (Germany, Austria, Luxemburg...). Their economies, especially in Germany, are based on export. They produce more than they can spend at home, because of that they are forced to export a substantial part of domestic production. In that way, the fall of the Euro value towards the US dollar was in their interest. The greatest benefit from that ratio has had been seen in the German economy. For the first time in its history, the German economy realized an export of goods and services bigger than 1.000 billion Euros in 2011. After retaining it at a level of 8-8.5% for many years, the rate of unemployment in Germany decreased to around 6.5%. Therefore, while a bigger share of EMU member states face debt and recession problems, economies of a few members of EMU member states, especially Germany, used the weakness of the Euro to acquire the highest positive achievements.

Obviously there are serious reasons that could confirm the estimation that the introduction of the single currency increased asymmetry between the member countries of the EMU. Because of the many differences between their economies, the appearance of certain asymmetric shocks, particularly in the area of demand or in production of some individual products is a common phenomenon. Faced with such shocks, some of the countries - members of the EMU (Ireland, Portugal, Greece, Spain, Italy ...) have begun to rely more on fiscal policy to compensate for the lack of independence in conducting monetary policy. Practice has shown that the perceived fiscal discipline within the EMU does not exist and that some members have used their growing budget deficit and public debt over the so-called Maastricht criteria as a means to address not only their economic problems, but also to sate the untamed appetites of the ruling structures.

This confirms the conclusion that at the beginning of the functioning of the EMU a possible solution to overcome the problems of a member country fallen into recession was much needed. The analysis according to Nenovski (2002) shows that even then an international tax policy and the policy of distribution of shared revenues through the growth of the EU budget, which would be used to overcome regional differences by conducting a policy of encouraging or limiting, was to be established. This will have satisfied the requirements of the member countries of the EMU and/or will have prevented the occurrence of high budget deficits and public debt which drew the European economy in 2010 into a so-called debt crisis with serious threats to the future of the global economy.

A Political Monetary Union is not Possible without a Political Union: Fiscal Union or Deterioration of the European Union

True and complete confidence in the EMU depends on the confidence in the various markets (goods, labor, and capital). And it is obvious that the member countries of the EMU can not react in different ways to economic shocks that come from inside or outside the EMU. The reasons for this are seen in different levels of economic development of the member countries, diversity in their tradition, culture, language, etc. The enlargement of the European Union with countries from Central and Eastern Europe make the EMU more heterogeneous and complex. That, in turn, raises the question of the need for a political rapprochement between the member countries of the Union and what kind of political structure in the future will be created in Europe.

Given the different traditions, divergent economic standards and the different political approaches to supranational political and economic structures in Western Europe, it is very difficult to find identical solutions for all the member countries. Problems that some countries increasingly have faced in the last 3-4 years point to the conclusion that it is impossible for the European integration to become a composition in which all coaches (countries - members) will move with the same speed. "Striking disparities in the development of certain regions of the EU is one of the key current issues that the EU should resolve as quickly as possible" (Arangelovik et al., 2007).

Since the early efforts for European monetary integration some controversies were present about the impact of national and supranational

levels of political decision-making. In this respect, the discussions in some countries for (non) membership in the EMU (UK, Sweden, Denmark), have a long tradition. To overcome this problem the principle of subsidiarity in decision making might be a solution, but not sufficiently (Nenovski, 2002).

Therefore, to be sustainable, the EMU must be part of a wider political integration of the member countries. In the first ten years of the functioning of the EMU attention had not been paid to that fact. That issue is becoming increasingly pressing in recent years, after it has become clear to all that devolution and fiscal sovereignty of member states in the structures of the EMU will determine its future perspective.

The EU needs a strong common constitution that will specify the responsibilities of the different political levels: regional, national and supranational. It would be one of the possible ways of preventing a possible collapse of the EMU in the future, as has happened with some other similar integration in the past.

Namely, in the late 19th century, during the validity of the so-called gold standard, there were several currency unions. Among them was the Nordic or Scandinavian Union, which was without political unification, however, for some time it functioned very well. Economic and political performance in the countries - members of the Union were virtually identical for a longer period. However, in the early years of the last century the member countries of the union turned to implementing various economic policies, which was the reason for the dissolution of that union (Nenovski, 2010).

Politically speaking, a long-term solution for the weak EMU would be the creation of a fiscal union or a genuine political federation. In this regard are the measures as proposed by the leading countries of the Union (Germany and France). They insist on changing the Lisbon treaty (some sort of EU constitution) in order to reduce the fiscal sovereignty of members of the EMU and to introduce a tax on financial transactions.

The first would mean that the member state in the EMU needs to strictly respect the Maastricht rules of conduct in relation to the size of its budget deficit, and thus gradually restore the public debt level up to 60 percent of its GDP. Otherwise, the Commission and any member state of the EMU could bring a complaint before the international courts and the EC to introduce a kind of "forced administration" on the specific disobeying country to control its fiscal finances.

The latter would mean imposing a tax on financial transactions which in the early 1970s was advocated by the American Nobel laureate James Tobin (so-called "Robin Hood tax"). Under the proposal, trading in stocks and bonds would be taxed at a rate of 0.1 percent and transactions with so called financial derivatives will be taxed at a rate of 0.01 percent. It is estimated that the tax that would be collected annually would be about 74 billion dollars that would be instilled in the fund for interventions to EC countries facing debt crisis.

Regional Groupings for Protection against Bad Scenarios for the Future of the EU and the EMU

Once ignited the so-called debt crisis in the EU, imposed the following frequently asked questions: 1) Will the EU survive, and 2) whether and to what it will be transformed?

In order to answer these questions, the European dignitaries in late 2011 began to lead (finally) a political battle, basically, for saving the Union. The proposed measures previously discussed, should lead in that direction. However, even to ratify the amendments to the Lisbon treaty, it will mean an easy and quick solution to political problems of countries - members of the EU. "Politically speaking, a long-term solution to the weak euro is creating a fiscal union or a genuine political federation. But it would be a solution for which the application of the same takes decades, a crisis that escalates each week" (Biznis, 2011). It is a long time, in which there may be new challenges and uncertainties. That means a guarantee of reliability, stability and durability of the EU, will still not exist.

It is well known by most of the existing member states. Moreover, they know that coming a long way is a possibility for new adverse scenarios whose realization would jeopardize their overall national interests and strategic objectives. Therefore, even now some of them are beginning to prepare the ground for their own protection against possible new adverse trends in the EU. Thus the Baltic and Vishegrad group appeared and the Nordic Union was formed.

The Baltic group includes Letonia, Lithuania and Estonia. Those three countries are among the most recent EU members. Of them, only Estonia is a member of the EMU. It shows satisfactory overall political and economic performance. Its public debt was only 4.5 percent of its GDP, the lowest level

of public debt among all countries in Europe. Because on the whole they are not getting what they expected from the EU and EMU, these countries have developed strategies for joint action aimed at their protection from any new turbulence in the EMU.

The Vishegrad group consists of Hungary, Czech Republic, Poland and Slovakia, out of which only Slovakia is an EMU member. Since the beginning of the debt problems, officials increasingly emphasize that entering, or, remaining in the Euro zone has negative consequences for the Slovak economy. Although Poland is not a Euro skeptic, it postpones its EMU membership with a great deal of caution, though, it may be said that Poland functions in such a way that anticipated the whole EMU to function. The Czech President very often states his attitude against the euro-concept, and Hungary faces many other serious economic problems which drag her away from the EMU. All in all, due to tradition and self-protection from eventual future negative events in the Eurozone these countries tend to turn to their political and economic relations established by the Agreement of Vishegrad in 1991.

If we take the Scandinavian countries (Denmark, Sweden, Norway and Finland), only Finland is a member of the EMU. Occasional referendums in Denmark and Sweden confirm the animosity of the majority of their population toward the euro. Norway is not a member of the EU. In such conditions, and recalling the experience of their monetary union which was previously discussed, these countries are distancing themselves from the EMU, organizing a loose alliance which should protect them from any new adverse events in the EMU.

Great Britain saw a perfect opportunity in the crisis to weaken the Franco-German pillar of euro domination and took an aggressive stand to position itself as a carrier of an alternative European project based on euro scepticism.

Although unofficially, the idea of a so-called Eurasian Union as a new and very broad and superior economic region is being advocated. The concept of Eurasia is based on trade relations, and not on ideology. It is imagined to be an economic union that would allow free movement of goods and capital across the borders of its Member States. It would include Russia, Belarus, Ukraine, Armenia, Turkmenistan, Tajikistan, Uzbekistan, Kyrgyzstan, Kazakhstan, Turkmenistan and Moldova, with an ample opportunity later to be joined by Turkey, Syria and Azerbaijan. Obviously it would be a huge market

composed of countries that have proven to be more resistant in times of crisis. No wonder that this market each day is becoming more and more attractive to all western economies. It is particularly noticeable in Germany and France who, in difficult circumstances when faced with the economic crisis in the Union, all increasingly turning to the states that Russia, as a carrier of the idea, originally imagined them as members of a future Eurasian Union (Neshkova, 2012).

Needs, Opportunities and Advantages of Forming a Balkan Economic Union as a Future Member of the European Union

It is obvious that the Balkans are absent from all political and economic events, and groupings in Europe. This is probably the reason for the more frequent and louder mentioning of the so-called Balkan Union in the world public, even in the administration of the leading countries in the world. Because the term union could mean a political union, which in this period is neither possible nor desirable (it reminds one of the former Yugoslav federation), and due to the goals we want to achieve with its formation, probably a more suitable name for such association would be Balkan Economic Union (BEU). All Balkan non-EU countries would participate in it: Bosnia and Herzegovina, Serbia, Macedonia, Montenegro, Kosovo and Albania. It is possible for the Republic of Turkey to join it as well unless it joins the Eurasian Union. The BEU would be created as a kind of protection from the global economic crisis, and from the shocks and misunderstandings inside the EU. It is estimated that: "none of the mentioned Balkan countries has the capacity to independently realize prosperity for its citizens. They all have small and barely competitive economies, weak and underdeveloped labour market; have out-dated educational systems, etc" (Velinovska, 2011).

With the current economic (non)development, these countries cannot expect to become EU members soon. Further efforts are needed to raise their level of economic development which will lead to achieving the ultimate goal - admission to the EU. The frequent messages from Brussels point of the need to: "create an economic union based on a Balkan free characterized by a close "cross-border "cooperation and loose political ties" (The Washington Times, 2003).

Western Balkan countries should increase mutual trade, which will increase their economic growth, thereby increasing the amount of foreign

investment in their economies. To achieve this goal, they need to establish a framework for trade cooperation. In fact, it means establishing a free trade zone in which these countries will trade without any restrictions. By applying the so-called diagonal accumulation which now operates under the CEFTA, those countries of the European market will export goods with a regional prefix that will export goods that originate not from a particular country, but the free trade zone. Thus, the competitiveness of their products to European, and thus the global market will significantly increase.

There are several reasons why the formation of a BEU would be acceptable to the Western countries, and thus to the Republic of Macedonia.

First, all these countries that would have entered the commercial zone, except for Albania and Turkey, emerged from the breakup of the Yugoslav economic integration where, before beginning the process of transition, they had based their development. With the dissolution of that federation, the market where these countries placed most of their products disappeared as well.

Secondly, the western Balkan countries are not optimal economic zones. Their own market capacity (excluding Turkey) is very small. By connecting the common trade area, a market of 100 million people will be created. Given the closeness to other countries in southeastern Europe, that market could increase to about 250 million people. This fact is especially important for significantly reducing the high unemployment rate in these countries, especially in Macedonia, Bosnia and Herzegovina, and Kosovo.

Thirdly, the process of European integration of these countries is very complex. Several factors can confirm that most of these countries are still not ready to accept the challenges of EU membership, especially in the realization of significant economic performance. Their average level of economic development is far behind the level of the economic development of the EU countries. This data can significantly slow down their European integration if positive things do not happen in their development. In that sense, linking the regional economic community is a complement to their integration into the global conglomerate - the EU. Indeed, the successful functioning of the BEU would be the best recommendation for acceptance of all its members in the EU in 5 to 6 years' time.

Fourthly, without a strong recognition sign (brand), the products of most of these countries show difficult competing schemes on the European market. The establishment of a regional regime of free trade will allow a reduction of such weaknesses.

Fifthly, after the disintegration of the former Yugoslav federation and after the various wars on its territory, countries of the western Balkans feel alienated from one another. Most of them have significantly higher trade with other countries than with their neighboring countries.

Accordingly, there is a strong economic interest in unification and economic integration of the Balkan countries. An initial mutual free trade agreement should gradually become a customs union. Members of the regional economic community should have a common customs policy towards third countries.

Economic cooperation could be further promoted by: forming a Balkan Exchange, concluding contracts for joint appearance on third markets, as well as conducting joint energy, tourism, agricultural and transport policy (Jovanovski, 2009), a joint organization of sports events on regional, European and global levels, "forming a fund for economic assistance to Member States" (Domljan, 2008) more efficient use of the EU IPA fund, etc.

Besides economic factors, which seem to be major, the BEU would have other benefits for its members. Thus, Bosnia and Herzegovina, would finally become a functional state, political tensions in the region would be reduced and any possibility of secession of the Republic of Srpska will be prevented; Serbia would solve its internal affairs and relations with Kosovo; Montenegro would solve the still open Serbian question, Macedonia would improve its quality of life; Albania would create major economic opportunities; Kosovo would finally be stabilized in the Balkan framework. Finally, the BEU would create conditions for establishing a common security, social and educational policy, as well as a policy of protection of human rights. However, to make this come to life, we need someone's initiative. Will any of those countries, the western Balkan countries, dare to take the first step?

Conclusions

In the early 1950s the process of European integration began as a means of gradual economic and political reconstruction of western Europe. It is a process which took 6.5 decades, constantly changing and adapting to the demands of the globalized world. In his new idea lies the need to establish multiculturalism in order to overcome the various nationalisms and reach economic prosperity and political harmony of the united countries. Fashioned in this manner, the EU should be the third equal partner of the global

economic and political map – right in the middle between the U.S. in the West and the former USSR, now Russia to the East.

The wider European identity was deliberately based on a series of principles and above all, the idea of a single European economy that will connect all nations. It was considered that if the EU provided a basis for European prosperity, the continued existence of nations in Europe will be a threat for the EU and, perhaps, over time some nationalism will “reduce” their intensity and the European identity will be strengthened. It was assumed that economic prosperity will lead to a reduction of national tensions. In this capacity the EMU formed, which in the long run displayed more advantages than disadvantages. However, over time, it is becoming increasingly clear that Europe is a lot more than just an integrated trade zone and its economies are far from homogeneous. Debt crisis revealed some more cracks in the European construction. It became clear to everyone that without political integration there can not possibly be a monetary one, or an overall economic union.

Therefore, for the sake of its longevity, the EMU must be part of a wider political integration of the countries - members. In other words, a long-term solution for the now weak Euro is the creating of a fiscal union or a genuine political federation. However, this solution can take years, given its daily growing size and the strength of the Euro crisis. That means that a guarantee for the reliability, stability and durability of the EU will be impossible to provide.

In response to such uncertainties, some countries in Europe suit their own grouping in formal and informal alliances, which are supposed to represent some kind of preventive measures against possible future serious consequences of the (non) functioning of the EMU. The Visegrad, Baltic and Scandinavian group of alliances were renewed. More and more frequently the establishment of a so-called Eurasian Union is mentioned, which should be led by Russia. From these events, the Balkan countries seem to be missing. Do they need to come together in a Balkan economic union?

If we follow the example of others, wealthier and more experienced, then the answer to that question should be affirmative. With the formation of the BEU there would exist some kind of protection against the global economic crisis, as well as the economic shocks and incongruities within the EU. In addition to that idea is the fact that along with the ongoing economic (non)development, the Balkan countries should not hope for EU membership soon. Further efforts are needed to raise their level of economic development, which will bring about the ultimate goal - admission to the EU.

The BEU would be an economic union following the example of Benelux. It means absolute cooperation of the member states, primarily in the field of economics. Thus, the western Balkans would become an economical and not only a geographical name, what it is at the moment. Indeed, the process of disintegration in the Balkans ended. A period begins when the economy will conquer politics. The possible formation of a BEU as the vanguard of the integration of the western Balkan countries into the EU could be persuasive evidence.

Finally, it can be concluded that the successful functioning of the BEU would be the best recommendation for admission to all its member countries in the next 5 to 6 years. And with integration of the Balkan countries into the EU, the process of European unification can be considered completed.

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Consequences of Eurozone Sovereign Debt Default

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Abstract

After the Second World War in connection with the potential for a national Euro sovereign debt crisis and sovereign debt default, we identify potential and positive consequences of such sovereign debt crises and sovereign debt defaults. This history reveals that four principle consequences have resulted from prior sovereign debt crises and defaults. These are generally seen to be: first, lost national reputation and reduced national borrowing capacity; second, the exclusion of some national companies from trading in certain markets; third, the impact on the domestic economy relating in particular to the cost of imports; and lastly, the impact on political activity and socio-economic policy.

Reviewing the consequences of sovereign debt crisis and default post 1980, this paper considers the consequences of the current Euro-zone sovereign debt crisis, the potential for default and its likely short and long-term significance, as well as the potential for unexpected consequences. The paper considers the likely magnitude of the output losses and the human costs that will inevitably follow on the current Euro-zone crisis. The Euro-zone has unique peculiarity because it is an economy within the European Union economy so the possibility of devaluation within the zone does not exist. The paper finds that there is potential for both positive and negative impacts on the citizens of Europe.

Keywords: *Sovereign Debt Crisis, Sovereign Debt Default, Bond Agreement clauses.*

"Nous devons eriger quelque chose comme les Etats-Unis d'Europe"
("We must build a kind of United States of Europe")
(Sir Winston Churchill, Zurich, 19, septembre 1949)

The ongoing sovereign debt crisis in Europe has led to the recent default on euro-denominated bonds held by banks and other investors. "Many experts continue to worry about the sovereign debt of European governments" (Pollock, 2012). History "is littered with sovereign debt defaults" and the purpose of this paper is to identify potential and positive consequences of our current debt crises and the potential consequences of further debt default.

An examination of the nature and recent history of sovereign debt is followed by the identification of four principle consequences that have resulted from prior sovereign debt crises. These four principle consequences are described in some detail. Based on the analysis of the four principle consequences, the paper then considers the concerns, the likely consequences, and the potential sovereign debt default outcomes of the present Eurozone crisis.

Nature and Recent History of Sovereign Debt

For the purposes of considering the consequences of a potential 21st century euro default, we may agree "that national debt is one of the few important economic phenomena without roots in the ancient world" (Hamilton, 2005). This is because the nature of modern sovereign debt provides a variety of resorts to the legal process, which developed after the several sovereign debt defaults in the 19th and 20th centuries. Similarly, it is unquestionable that the "single most important factor in the financial revolution had been the increasing reliance on debt to finance personal, business, and government activities" (Veseth, 1990). In fact, the Bank of England was managing British sovereign debt since its foundation in 1694 and in the 18th century borrowed more and more money which became known as "the National Debt." When its charter was renewed in 1781, the Bank of England was described as the "Public Exchequer." The bank continued to a great extent to manage the debt with the care and conservative nature associated with traditional banking and, with the nightly support of a piquet from the Guards regiments, had set the mark for sovereign debt assurance being "as safe as the Bank of England" (Historic UK, 2012).

At about the same time, 1719, Sweden also founded a National Debt office (Wheeler, 2004). Throughout the 18th and 19th centuries, government debt was essentially just national government debt, as only a small proportion of sovereign debt was denominated in currencies other than the country's own currency. After the Second World War, the inclusion of foreign currency denominated debt in the national debt of many developing countries accelerated. The starting point for this effect was the denomination of government debt in foreign currency under the Marshall Fund (1948). This U.S. sponsored aid program was denominated in US dollars and made grants and loans to 17 war-torn countries and was a key factor in reviving their economies and stabilizing their political structures (Dulles, 1993). Similar dollar-denominated funds were invested to encourage post-war recovery in Japan, which also received grants and loans during the Korean conflict of 1950-1953. The growth of dollar-denominated debt was recognition that the developing countries did not have full and free access to the international capital market. Because these markets are seen to be "inherently unstable" (Vos, 1994), grants and loans denominated in the donor country currency, rather than the domestic country currency, were an essential factor in the achievement of the capitalist goal of economic growth. The very success of the post-war aid meant that the volume of the aid debt grew and often included export guarantee funding for U.S. companies to grow not only at home, but also abroad. As a result, there was established a strong "link between public debt and democracy" (McDonald, 2003). The link was well established in the growth of national debt and private sector debt during this period and the growth of both was intermingled and complex. This was not exactly the theoretical zero sum game on which much of current international financial theory has been and still is to some extent based (Gordon, 2012). However, the idea that capital flows are operating in an internationally competitive market where buyers and sellers operate as if rational portfolio managers, either intentionally or unintentionally, were no longer sustainable. The potential for unethical interference with capital flows has been hopelessly exposed in particular in the provision of aid in the government sector and in the number of private sector variations of non-competitive market practice which have come to light in the private sector. The post-Perestroika evolution of government debt in the CIS countries has also brought new complexities into the market. The size of their debt seems to parallel U.S. growth in public debt. The problem for a new democracy was well expressed in a 1980 U.S.

congressional hearing on the crisis in the bond market. Certainty for bond market holders is dependent upon voters only voting for public expenditures within the limits of the funds actually available from the public treasury. Inevitably excess borrowing takes place and the interest cost of borrowing these funds provides the perception or actually exceeds the ability of a government to finance the debt. When government is able to print money there is the potential, at least for a time, to expand the debt, which will provide insurance to pay bond interest, thereby supplying some cover. The process most likely leads to currency devaluation comparable to an appropriate world market level.

The euro is a multi-national currency. Unlike a national currency, the decision to print more money (risking devaluation in the currency market) is not a matter on which all 17 Eurozone nations can at present agree. Similar disagreement exists on the issue of additional euro-denominated bonds. Thus, the question of exchange depreciation or economic readjustment (Balogh, 1948) is complicated because of the lack of consensus within the multi-national governing structure. This is the present situation for the euro and the current context for likely sovereign debt default by one or more of the Eurozone member countries. The public interaction of the European governments whose sovereign debt is denominated in euro, and the public and government reaction from those who trade and interact with the Eurozone, is focused on "avoiding sovereign debt default" which is generally considered to be "an important objective of debt management in all countries, given the magnitude of the output losses and the human costs that can accompany default" (Wheeler, 2004).

Four Principle Consequences of Sovereign Debt Default

Observing the outcomes of other sovereign debt defaults since the end of the Second World War, it is possible to identify four principal consequences of such a default. These are:

- Lost national reputation and reduced national borrowing capacity
- Exclusion of some national companies from trading in certain international markets
- Impact on the domestic economy relating in particular to the cost of imports
- Impact on political activity

These consequences have been noted (Riley, 2010) and particularly

with reference to borrowing capacity, capital flight, and the domestic economy (Allen, 2002). The impact on trading (Brooks, 2007) and on domestic politics (Bowen, 2012) has also been widely noted in newspapers and media commentaries on the upcoming elections in Greece, France, and Germany.

These potential consequences may be further subdivided by consideration of their short and long-term significance and potential for unexpected consequences. One might ask, what then is the likely magnitude of the output losses and the human costs that are likely to accompany a Eurozone sovereign debt default? We now proceed to answer the question by examining each of these issues in detail.

Lost National Reputation and Reduced National Borrowing Capacity

The loss of a triple AAA credit rating in the case of the “Sarkozy Debt” (Carnegy, 2012) was much rumored and expected, but nonetheless when the downgrade took place the impact was a significant negative. Even a reduced credit rating can contribute to lost national reputation and therefore a wider risk aversion to both private sector and public sector debt (Wright, 2011). The risk aversion impacts government bond interest rates as lender confidence ebbs and so an additional risk premium is required to market the bonds. There was therefore an inevitable loss of reputation for the French public sector euro bonds and so this has, to some extent, reduced the ability of France to finance its own debt, and in turn impacted upon the rescue packages proposed to salvage other countries euro bond debt. It has been said that the French “sense of self is closely bound-up in the prestige of the State” (Waghorne, 2012) and, as a result, the downgrade has certainly impacted the reputation of the French domestically and possibly internationally, so that a national downgrade from a ratings agency may be considered a first step towards an actual sovereign debt default. Such downgrades led eventually to Argentina’s sovereign debt default.

The most recent significant sovereign debt default was that of Argentina in 2001. Much rumored before the event, the sovereign debt default was expected, at least by realists, in the context of Sarkozy like debt expansion following years of reduced growth coupled with not insignificant social unrest. Eventually Argentina’s government collapsed and ceased all sovereign debt payments. Technically, the Argentine default and subsequent

restructuring (still in progress) represented the largest sovereign default in history with a need to restructure over \$100 billion owed to domestic and foreign bondholders. There was an immediate loss of national reputation as Argentina was downgraded. However, by building partnerships and negotiating with the bondholders, Argentina was able to develop "a congruence of interests and participation" (Woodrow Wilson School, 2003). Congruence with creditors and focus on the potential for a new government then opened the possibility of foreign participation in future growth and development.

Other recent sovereign debt defaults [Mexico, 1995, Russia 1998, Turkey 2001, etc.] featured the same early warning by rumor and realist expectation. Similar patterns of debt expansion with reduced growth and some social unrest were also present. Indeed there are significant parallels in the process and in the immediate loss of reputation and after an appropriate change of government and financial policy a new focus on growth and participation. The new policy is, as one might expect, one which emphasizes a reduced need for borrowing. In practice, after recognizing the sovereign debt default, there has usually been a quick turnaround in national fortunes so that the embarrassment of sovereign debt default has led to an improved financial foundation, improved growth, and the successful restructuring of debt.

Thus on the basis of past experience, any defaulted Eurozone country can expect to encounter a period of reputation loss (possibly prolonged by refusal to recognize reality) followed by a sharp change of government financial policy. In the present case of the embattled Eurozone economies, the customary preludes of rumor and realism and the gradual and growing awareness of endangered countries' dire predicaments may have been so prolonged that the expected change of government has already taken place. The only phase in the drama not already acted out is the formal act of sovereign default itself. Remarkably, some satisfactory changes in debt structure are likely to lead, after a period of some austerity, to a more satisfactory and for a time at least an amelioration of the living standards for the citizens of the country that finally defaults.

Exclusion of Some National Companies from Trading in Certain Markets

From a purely practical perspective, national companies with a close relationship to the sovereign debt defaulting government will likely avoid trading in markets where they may be subject to punitive action against them, especially if the link between the company and its government may be seen to be too close. For example, investors who have lost assets at the time of default may attempt to obtain legal orders to acquire the company assets to offset losses caused by the defaulting government of the country in which they are registered. This is an increasing feature of the changes in the terms, which sovereign governments are required to provide in the bond issues made to the international market.

Historically, the evidence is that there will always be repeated sovereign debt crises coupled with a continuous concern over the lack of a universally binding legal mechanism for resolving them. Whilst the default may be accompanied by an acceptance of a reduced repayment of the bond by the bond holders, there is a risk that some bond holders may not accept the terms offered, which then leads to a long-term and potentially expensive exercise in the debt-restructuring and repayment post-default. An ongoing example of this feature is still a live issue, a decade after Argentinean sovereign debt default as two “vulture” hedge funds continue to chase their unpaid debt. They are seeking to get a court order over the U.S. assets of the Banco Central de La Republic d’Argentina (BCRA) the central bank of Argentina. The case holds that under the “alter-ego” theory BCRA lacks separateness from its government and so BCRA assets in the US may be taken to meet the outstanding liabilities (Economist, 2011). Not surprisingly, there exist a number of international companies ready to provide services for the recovery of sovereign debt through the courts.

Since the U.S. Foreign Sovereign Immunity Act of 1976, sovereign bond issues in the United States are considered commercial activities. As a result, the old assumption of sovereign debt immunity no longer applies. A subsequent series of successful lawsuits “made it extremely difficult for a defaulting country to issue new credit without paying off old creditors” (Ahmed et al, 2010). In 1995, as part of the solution to the Mexican debt crisis, the International Monetary Fund (IMF) put together a rescue package which included the idea of collective action clauses (CACs), which were designed to

make sure that “reckless private lenders” (Gelpern & Gulati, 2010) took an appropriate level of responsibility when a sovereign debt crisis arose in the future. In modern parlance, bonds would include CACs or “haircuts” (Foxman, 2011). But, CACs were initially avoided since they were seen to be likely to raise interest costs. There is indeed a history of attempts to provide for “a universally acceptable procedure for restructuring debt” (Masoodi, 2011). CACs now appear to be the one instrument that has been accepted (Bradley and Gulati, 2011).

While there are 5 standard elements in all international loan agreements (Klein, 1994) and proposals for an internationally binding Sovereign Debt Restructuring Mechanism (SDRM) (Kreuger, 2002) contain an array of clauses designed to make failure to agree to a bond rescheduling less attractive, there are still opportunities for creditors to refuse to exchange bonds and to pursue companies seen to be related to the sovereign nation. The effect of this fear is to limit trading in certain, often the most profitable, markets.

Impact on the Domestic Economy Relating in Particular to the Cost of Imports

At least for an immediate post sovereign euro default, the domestic economy of the defaulting country is likely to find the cost of imports will go up (as the new currency loses value against the euro). This will be particularly relevant with regard to energy resources in Europe since the energy resource planning has been to a great extent integrated under the European Commission. An increase in the cost of imports inevitably impacts the domestic economy. However, while some businesses will be hurt and unable to pass on the additional costs, others will have an opportunity to take advantage of the devaluation effect on their prices and they may see significant increases in exports.

In the particular case of the tourism industry, the cost of holidays for foreign visitors will likely be reduced making tourism more attractive and the rising cost of importing food may provide a shot in the arm for agricultural production which will be released from the constraints of the Common Agricultural Policy. Nevertheless, a sovereign debt default will lead to interesting times in the domestic economy with much opportunity and recognition of the need for change in economic policy.

The historic experience of sovereign debt defaults is generally recognized to provide signals which lead to higher costs (Hatchondo, 2007). If haircuts are negotiated there is an indication that policymakers are not prone to respect property rights. A default amidst bad economic decisions will reveal incompetent management of the economy which usually leads to a change of government (but not necessarily a fundamental change of policy). Signals of poor strategy may then extend to the private sector, especially when there is evidence of corruption and the acceptance of uneven policing of tax policy.

In this context, Argentina's experience provides important insights. "Although other countries may look to Argentina as a model for reneging on sovereign debt, the cost of Argentina's financial collapse in long-term social and economic terms has been devastating" (Hornbeck, 2004). Finance houses and investment companies suffered huge losses on investments, not just their ownership of sovereign debt, but also from the post default impact on the value of non-sovereign assets in the domestic economy. This is a significant reason why a wide variety of workouts are being implemented and considered and dreamed about. This may be an important factor in the present EU negotiations with euro bond holders and why there is so much insistence on haircuts, and any other possible way there might be to avoid an actual default. All manner of plans are being considered simply because the impact of a euro bond sovereign debt default can not accurately be determined, except to say that its effects will be severe and widespread. Certainly investment houses and banks and holders of market debt will face huge losses. The same may not be said for the ordinary citizen who may not be affected negatively and, as a player in the restructured post sovereign debt default nations, the ordinary citizen may actually find their prospects turn out to be less austere than at present.

Impact on Political Activity

As recently seen in Greece, Italy, Spain, and Ireland, the threat of sovereign debt default has a notable impact upon national (and even international) politics. Clearly the limited Federal approach which has been taken for Europe has failed and failed conclusively and recognition of the failure is hard to accept. The outstanding features of the European system have illustrated one of the major negative tendencies of government. There has been a destructive tendency to come up with "one size fits all" policy. As with the International Monetary Fund "one size fits few" (Mathaison, 2004).

The bureaucracy in Brussels and the leaders of Europe need to recognize that the resistance to IMF style fiscal policies of austerity and cutbacks are justified simply because these policies have had such poor results, especially as seen in the case of Argentina. The all-powerful EU officials in Brussels are notoriously unconstrained by the need to answer any electorate. They are seen to be "tyrannical" and simply out-of-touch with democratic reality (Moravcsik, 2001). Many of their programs, particularly Europe's Common Agricultural Policy, have "stifled innovation by protecting the industry from the realities of the market" (Flynn, 2005). Creativity and the growth of entrepreneurship get bogged down in "a network of small, complicated, painstaking, uniform rules" many of which lack common-sense (Kimball, 2003).

This has neutered the idea of political leadership and, in effect, abandoned the middle classes and the lower income groups, a fact established so clearly in the growing gap between rich and poor in Europe (Beckford, 2009). Government in Europe has not learned essential management lessons from successful multi-national companies. Multi-national companies operate a corporate strategy that measures performance constantly and takes appropriate actions whenever the monthly (or more frequent) reports indicate departures from its corporate strategy. One policy does not fit all. One strategic vision (a series of specific strategies) is implemented where and when that strategy can be achieved. This leads to a complex of meaningful and significant differences from location to location in response to local conditions. Government, because they are out of touch with the reality of the every day world stifle local initiative and (particularly in the case of the Common Agricultural Policy) require no purposeful production performance. Major multi-national manufacturing companies like Ford have adopted extraordinarily complicated optimization systems (Cisco, 2012) which can link customers with assembly, maintenance and supply so that the main focus of concern is on customers. European leaders need to focus more on constituents in their actual location and not constituents in the nebulous world of virtual Europe.

If Eurozone countries in crisis had had the stable economies that macro-economic theorists supposed them to have, then the market might have worked. But, like the concept of a free market, the stable macro-economic environment in which a government would like to hope, simply does not exist. So the euro began with some strict guidelines on deficits (the

Maastricht Treaty convergence criteria) and then over a decade or so saw the strict guidelines become inconvenient. As a result government grew rapidly, not to finance real long-term investment (factories, infrastructure, and education), but rather a series of short-term investments like the real estate bubble. Simply put, the performance measures necessary to achieve a long-term strategic vision were not the right measures and once in place there was a reluctance to change them.

Convincing bureaucrats in Brussels appears to be virtually impossible. It is maddening to hear from officials facing sovereign defaults that “the European economy is strong and there is no reason to change the direction of economic policy” (Alogoskoufis, 2008). This complacency and inertia is hard to pull out of because, just like the IMF “everything (is) going on behind closed doors” in a Brussels bureaucracy which “likes to go about its business without outsiders asking too many questions” (Stiglitz, 2000). Like many of the domestic Eurozone governments strategic targets are undermined by imposing one fits all policies, albeit unintentionally. Healthcare across Europe is an example. No country is trying a variety of approaches in different locations to offer the sort of adjustment to local conditions that is required for success. Officially, of course, Brussels negotiates Commission policy, but the powers in the negotiation are top-down when a multi-national would be seeking a bottom-up approach. This concept, so long established in the corporate world, is too difficult for many European bureaucrats to understand, since so many of them have never had a real, full-time, non-government job.

Concerns, Consequences, and Sovereign Debt Default Outcomes

The EU has “an extremely complex decision-making system with multiple institutional actors and a dizzying array of governance processes” (Schmidt, 2010), which is why there are so many obstacles to decisions on how to prevent euro-denominated sovereign debt. Proposals put forward have usually lacked leadership and EU-wide consensus and have yet to produce a lasting solution in spite of the feeling that we are already near to a Eurozone end-game. The remaining options for leaders are limited.

Some format for continuing official euro support for as long as the market will continue to support existing euro denominated sovereign debt may be found. Absent significant changes in economic policy this option looks increasingly unsustainable. Major changes to the existing restrictions on economic activity are being sought (Watt, 2012).

A sovereign debt default with some form of continued official lending to permit significant face value deduction (in effect a devaluation into a new currency) is a second possibility. This can be well-prepared or messy and the obstacles to decision-making suggest that any such default will not be well-managed. Already we have reports of individuals taking preventative action in Eurozone countries where a sovereign debt default is considered more than a possibility. Banks have naturally limited lending and this is contributing to the IMF's forecast of negative growth in Europe (Euronews, 2011).

Once a sovereign debt default has been accepted, the defaulting country will have the opportunity to derive a trade surplus without too much depression in economic activity and employment. Simply put, the market will be free of the Eurozone restrictions and will have the opportunity, albeit in emergency, to adopt policies which free the market from present EU restrictions and enable the country to become internationally competitive again. That in turn may provide the EU with the leadership and example which prompts a long overdue revision of existing constraints on productivity such as Commission rules and the Common Agricultural Policy to be revised. Then the prospect of a federal Europe with focus on citizens will have a better chance of being realized.

"En vue de cette tache imperieuse, ... doivent etre les protecteurs de la nouvelle Europe et defendre son droit a la vie et a la prosperite."

("In all this urgent work ... (we) must be the sponsors of the new Europe and champion its right to live and shine.")

(Sir Winston Churchill, Zurich, 19 septembre 1949)

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Preserving EU Competitiveness

Elena Makrevska

Abstract

The competitiveness of the European Union (EU), as a global trade actor is achieved through a combination of three elements: investments into research and development, technology based industry and functioning of the Internal Market. But the recent economic crisis, revealed a number of structural weaknesses of the Union which caused a lowering of the competitiveness on the global markets. This paper has the aim to identify the underlying reasons for decreased competitiveness and point out potential future challenges for the EU. Even though the EU has a sizeable advantage in higher value added economic activities as a result of a high level of innovations and research and development, in the recent years USA is gaining competitiveness over primary innovations. Also, EU technology based industry which uses a highly educated workforce creates disadvantages for the EU in commoditized markets where price plays the most important role. That creates emerging opportunities for low costs productions. China has become the global leader in labor intensive manufacturing based on a comparative advantage in cheap labor, and it is increasing the quality and the share in the sectors which have traditionally been important to the European economy such as industrial machinery, automobiles, computer equipment and certain chemicals. As a result of that, the EU is losing the dominant position in emerging markets such as ASEAN, South America, the Middle East and Africa. Finally, the third element, the Internal market is fragmented between national manufacturers who lacked economies of scale, still not harmonized national policies and increased usage of barriers to trade (especially during the economic crisis), which again has an influence on the lower EU competitiveness on the world market.

Keywords: Internal market, EU competitiveness, Economic crisis

Theoretical Concept of Competitiveness

Under the term “competitiveness” in the literature can be found many different definitions. Generally, an economy is competitive if it does things that are likely to encourage economic growth. The simple measure of economic growth is the value of the gross domestic product (GDP). But, if a country is increasing its GDP that would not mean that the country's competitiveness has improved. For instance, if the growth is based on natural resources and their favorable price developments, the GDP will grow ($GDP = \text{quantity} \times \text{prices}$), but the economy will not have significant improvements in competitiveness. In the case where the reason for the dynamics and the quality of economic growth is determined from the level of labor productivity, then we can make a difference. In the macro economy it is widely accepted that the difference in labor productivity is the reason for the great differences in the level of economic growth in the countries in the world economy (Mankiw, 2010).

Krugman (1996) has also declared that the real essence of competitiveness is reflected in the productivity. Still, many economists (particularly in Europe) do not agree with this kind of simplification about competitiveness. They believe that not only the quantity of economic production is important, but also the quality of living of the people (Aiginger, 2004). That would mean, greater opportunities for education, healthy life, rich cultural life, etc. That can be measured by the second indicator of economic growth, GDP per capita. A higher GDP per capita means higher living standards for the population. Still, GDP per capita does not take into account the country's ability to distribute the gained wealth in a fair manner (it is calculated on an average level). Another weakness is that we can get a wrong conclusion. For example, if we have the same value of the GDP, but decreasing growth rates of population, we will get higher GDP per capita.

Some authors (Haiman & Alena, 2006) find the linkages between competitiveness and trade (traditional theories). Popular discussion often views ‘competitiveness’ as a way to narrow the current account deficit of the balance of payments. That can be measured by the growth of the export of the market share (participation of the total value of the export in the total world export). The essence of this theory is compounded by openness to trade tending to be associated with openness to ideas. Especially for small economies, openness to trade should boost economic growth by increasing

domestic competitive pressures (from imports) and allowing domestic producers access to wider markets and so economies of scale (from exports). Still these theories do not take into account the quality of the product or the service or the branding of the products. In the long run, non pricing factors (structural and technological aspects) such as: research and development, regulatory regimes and others have a significant influence on the competitiveness of the products and of the economy.

Finally, if we summarized all the above mentioned views, the competitiveness of one country can be defined as the ability of the country to compete on the world market, with final goal to increase the wealth of the country and the living standards (Ottaviano et al, 2009).

In this paper, we focused on the EU competitiveness and its sustainability/trends in the future. We will analyse the indicators of competitiveness, that we already mentioned by using time series. Mainly, we will focus on the factors that determine EU productivity as the main drivers of competitiveness. The main trumps of the EU productivity are: investments into research and development, technology based industry and functioning of the Internal Market (economies of scale, lower costs, etc.). Therefore, we will make an historical overview of the main indicators of productivity and a comparison between the EU and its most important competitors USA, Japan and in the last decade China. The underlying reason for analyzing the competitiveness of the EU is the influence of the world economic crisis on the EU that revealed some of the weaknesses of the EU that makes its sustainability nowadays doubtful.

Dynamics of EU Competitiveness in the World Economy

In the previous section we discuss about the different understanding of the term competitiveness. In order to compare and measure the level of competitiveness, we will use the real rate of GDP growth and indicators of productivity (labor productivity and total factor productivity).

Since the mid 1990s the average growth rates of real GDP, labor productivity and total factor productivity in the European Union have fallen behind those in the United States of America – USA (table 2, 3 and 4). What makes this remarkable is that, this is the first time since World War II that these performance measures have shown lower growth rates for the EU for several years in a row. The recent economic slowdown (as a result of the world economic crisis) in the USA and the EU has not changed this trend.

During the early 1990s the GDP growth slowed in all three regions, but both the USA and the EU saw a substantial recovery during the second half of the 1990s. However, the recovery was much faster in the USA than in the EU. More importantly, the USA recovery was accompanied by a large upswing in labor input and productivity growth. In contrast, the EU realized a substantial expansion in labor input but productivity growth slowed down to a rate that was substantially lower than that achieved during the 1980s. It created a labor productivity gap between the USA and the EU.

Back in the 80s and first half of the 90s, the EU had a substantially higher rate of labor productivity (2.6% compared with 1,1 % in USA, table 1), but afterwards the convergence process was replaced with stagnation. During 2005-2010 the EU labor productivity was 0,7% compared with 1,2% for USA (table 1). The labor productivity gap in the EU relative to the US has widened by 0.2 percentage points in 2000, to 2.7 percentage points in 2009 (table 3).

This might suggest that the EU has entered onto a low productivity growth track. Or, it might not be the case. First, many EU countries are still in the midst of an adjustment process towards a new arrangement of their economies, with less emphasis on capital intensive manufacturing, and a greater emphasis on technology use and diffusion in services. Secondly, there is still a much greater potential in terms of underutilized resources to be employed in the EU. This latter view is consistent with the notion that the EU is merely lagging behind the USA in the adoption of new technology and that the EU will see the benefits within the next decade. The key issue for the EU is whether these resources can be mobilized in a productive way (Mahony & Ark, 2003).

But, it seems that implications of a deeper integration in the EU are still not achieved and the expected benefit within the next decade might not be realized. The world economic crisis (2008-2010) revealed the EU weaknesses. The internal balance was impaired as a result of intensive fiscal spending that the countries were using in order to compensate for the decline of domestic consumption. Supplemented with intensive credit growth in the period before the crisis, this resulted in unproductive spending. That makes the amount of discrepancy with the real wages of labor productivity in favor of higher wages, which led to high budget deficits without a development component.

Simultaneously, the external balance deteriorated, reflected by disturbed relations in international trade and economic growth. The rate of

economic growth has the lowest level in 2009 (-4,3%, table 2). Even before the crisis, huge macro-economic imbalances existed inside the Euro zone (surplus versus deficit countries; divergence in competitiveness; etc.). This points out the inadequate decision making procedures and lack of leadership in the EU/eurozone. Also, fast-growing economies, such as China, base its economic growth on a high level of net exports. In contrast, developed countries, such as the EU rely on import oriented domestic demand that creates a problem of high trade deficits. Such positions in foreign trade had a direct impact on the international value of the currencies and the competitiveness of the EU as a whole.

EU as a Global Actor

As we mentioned in section 1, in general, three important factors contribute to enhancing EU competitiveness: investments into research and development, technology based industry and functioning of the Internal Market (economies of scale, lower costs, etc.). We can first start with focusing on the advantages and disadvantages of the internal market.

The EU is the biggest economy in the world according to the number of population. The EU population in 2010 (Eurostat, 2012) creates 7, 3% of the total world population (501.105 million people). Second largest economy is USA with 4, 5% of the world population (307.007 million people). We can associate higher population growth with higher growth in real GDP, but probably a little less than proportionately (Haijman & Altena, 2007). But, in case of the EU, even though it is the largest economy by number of population, still, the rates of population growth in Europe are the smallest compared to other continents. Europe has a 0.8% population growth in the period 2000-2010. That creates a disadvantage in labor intensive manufacturing. Having in mind that the EU has the competitive disadvantages of not being a producer of raw materials (we already mentioned that the productivity is achieved through technological factors) and having a relatively expensive work force makes a huge disadvantage in the price competitiveness.

Regarding trade, the EU is a global leader. In the whole period of existence of the EU, with the exception of 1958-1960, EEC/EU has the biggest part in the value of the world export. The second largest world exporter is USA, whose global participation decreases continuously from 2000. China as a fast-growing economy succeeds and from 2005 onwards is the third largest exporter in the world, pushing Japan into fourth place.

The strength as a trade leader comes from the high integration effects of the Union (monetary and economic union). The EU is functioning as a single market (free movement of goods, services, capital and labor) and has a single currency. But even though it reached a high level of integration (monetary union) internal trade is hampered by a long list of trade barriers such as: different technical standards and industry regulations, controls on capital, preferential procurement, administrative and border formalities, different VAT and excise rates and different transport regulations.

Although most of these policies seemed to be insignificant, their joint effect significantly determines the intra-Community trade (Baldwin & Wyplosz, 2003).

That makes the Union less competitive on the world markets. Aiginger (2005) claims that the reason why the EU is lagging behind the USA in productivity is high welfare cost, rigid labor market rules and higher environmental standards in the EU compared with the USA. The EU single market is still far away from an area of free movement of the four freedoms. The existing trade barriers are constantly supported by new ones introduced by the countries that want to protect domestic economy.

The second and third factors that contribute to EU productivity is the technological knowledge and investments into R&D. Since the 1957 in the EEC Treaty, a certain amount of money for R&D for the private sector was defined that would contribute to improving the manufacturing and distribution process of the products or promote technical or economic progress (Article 107.3).

In 1968, the Commission permits contracts between firms (even large firms) for the exclusive opportunity to develop joint R&D projects. In 1984, it expanded its responsibilities. A Single European Act in 1987, aimed to strengthen scientific research and the technological base of the Community in order to become competitive globally. In 1996 the Commission issued a new guide to R&D in order to comply with the rules of WTO. Hence, it makes the difference between R&D that are according to the rules of WTO and illegal R&D activities (like marketing new products).

Hence, the main instrument to increase the innovative activity of the Union is investing into R&D. According to the objectives set by the European Commission in the strategy "Europe 2020" the cost for R&D should be 3% of GDP for each Member State (same as in the Lisbon strategy). In the period of 1995-2010, the costs for R&D calculated as a percentage of GDP within the

EU and the euro zone were relatively fixed and moving with an average of 1.8% of GDP (table 5). With regard to other regions, the EU and euro zone have higher costs for R&D only compared with China. Thus, the cost of R&D in 2008 as a percentage of GDP in the EU (27) amounted to 1.92%, which is below the level of 3% (the target rate). Within the EU, Sweden (3.7) and Finland (3.7) exceed the target. Among other countries that have a higher rate than the average EU are Germany (2.69%) and Denmark (2.85%). In 2008, Japan has the highest percentage of R&D cost of 3.45%, followed by South Korea (3.36%) and USA (2.76%). Significant growth of the costs for R&D were seen in South Korea during the reporting period and it is expected to grow in the future.

What are the dominant industries in which most of the R&D cost are invested into and industries that create the EU competitiveness? Regarding the industries, there are also some similarities in the time pattern in 'traditional' industries such as food, drink and tobacco, leather, fabricated metals, hotels, and other services with declining growth rates through time in both regions, EU and USA. But on the whole productivity growth rates in EU manufacturing industries remain somewhat above that of the USA counterparts (Inkalaar, O'Mahony, et al., 2003). Manufacturing goods are very important for the EU, since the trade in 2009 consist of 85% exports of manufactured goods 85%, and import of about 75%.

According to the Balassa index of comparative advantage, the euro zone is specializing in the export of medium and high technological productions (especially products that are difficult to copy). USA has a high comparative advantage in producing high tech products (especially in the technology sector of IT), while Japan has the highest value of the index in high technological products. As regards the utilization of the factors of production, the euro zone is specialized in capital intensive, research-intensive and labor-intensive production (Tables 6 and 7).

Developments in the global economy, suggests that the decade before the crisis was characterized by integration of countries in large and dynamic markets such as BRIC. Their export structure is very different from industrialized economies, but over time their export structure is approaching that of the developed economies. Such a change is very visible in China, where export structure changes aimed at increasing exports of products with the research base and IT equipment. Thus, the participation of Japan and the United States reduces as a result of the increasing share of these countries.

However, according to Table 6, China has the largest percentage of high-tech manufacturing, it is not true. The rapid growth of communication technologies and falling transport costs has enabled multinational companies to perform allocations of separate stages of production in different countries. Thus, the analysis of the export structure must be correlated with the analysis of the trade balance, suggesting that the weakened position of the USA and Japan is due to the process of outsourcing (Baldwin, 2006). However, there are some countries in the EU like Portugal, Italy and Greece that have low technological specialization of production, which gradually lose their export positions as a result of increased competition of low-price products.

Generally, if we observe the export performance of the euro zone we can reveal some weaknesses. Specialization in medium and high tech products going before the crisis when the value of exports of these categories (at a time when demand for these products is high such as machinery and equipment, motor machinery and transport equipment). The share of low technology products (textiles and furniture) in exports decreases. It is noticeable that instead of specialization in fast growing high tech, the euro zone retreats from these sectors, with certain exceptions for medical and optical equipment.

The main export products, machinery and the transport services (which include industrial machinery, computers, electrical and electronic parts and equipment, vehicles and parts for cars, ships, aircraft and parts for trains) tend to decline in favor of China. China is becoming the global leader in labor intensive industries based on comparable advantage in cheap labor force, which is likely to be maintained in the foreseeable future. The labor productivity growth in China (table 4) was highest in 2003 when it amounted to 13,1%, while the EU had 1.1% growth. Low prices together with aggressive export created high rates of economic growth. China is reaching high rates of economic growth from 2000 onwards (table 2). For example, the EU economy in the middle of the world financial crisis in 2009 fell with -4,3%, USA with -3,5% while in the same year China grew with 8,8%.

China has become the global leader in labor intensive manufacturing based on a comparative advantage in cheap labor, and it is increasing the quality and the share in the sectors which have traditionally been important to the European economy such as industrial machinery, automotives, ICT equipment and certain chemicals. As a result of that, the EU is losing the dominant position in emerging markets such as ASEAN, South America, the Middle East and Africa (Schultmann & Sunke, 2010). Also, direct policy

towards a low Yuan rate makes unfair competition on the world market in favour of China. Artificial depreciation of the Chinese Yuan, makes the Chinese export cheaper and lead to distortions of competition and thus to decreased competitiveness of the EU. In this context we can mention also the exchange rate policy of the USA that keeps the dollar depreciated and puts the EU in an unsatisfactory position.

Finally, in order to remain competitive and to face the challenges on the global market, the EU must enhance its position as a knowledge economy through innovation by facilitating technology transfer, creating a sustainable economy, and improving standards policies as well as better functioning of the Internal market.

Future Opportunities and Challenges of EU Competitiveness

In order to improve the competitiveness and research based activity, the Lisbon strategy set a goal to establish the European Research Area (ERA). Such a zone would create an internal market "for researching where researchers, technology and knowledge would circulate freely through the effective coordination of national and regional research activities, programs and policies." This concept was initiated in 2000 through the initiative of the European Commission to the European research area and gets more pronounced in 2007 by the Green Paper Commission, the European Research Area new perspectives (Delanghe et al., 2009).

The Lisbon Strategy adopted in March 2000, aimed to turn Europe into the most competitive economy and knowledge-based economy by 2010. There were several challenges that the Union faced in the first decade of 21st century that prevent the Union to reach this goal (world economic crisis being the most significant reason). That is why this goal was revised by the European Commission with a new European strategy ", *European strategy for development of Europe by 2020*", adopted by the European Council in 2010. The establishment of the European area of research remained one of the main priorities of the Union.

There are also other programs that outline the need for future innovations and improving competitiveness in the fields. In 2006, it was "*Putting knowledge into practice: A broad based innovation strategy for the EU*". The main priorities of this program are: support of education, establishing a European institute of technology, enhances of labor market for researchers, and

so on. In addition, a 2007 communication entitled “*Lead market Initiative for Europe*” outlines the EU plan to lift obstacles to innovation in six markets: eHealth, sustainable construction, bio-based products, protective textiles, recycling and renewable energy. According to the Commission, as these markets are already highly innovative, supporting their growth and international expansion could give European producers a competitive advantage as lead producers (i.e. first mover advantage).

Beginning from 2007, the EU has adopted a “*Competitiveness and innovation program for 2007-2013 (CIP) mainly for small and medium enterprises-SMEs*”. (Luxemburg, 12 October 2006, 13855/06, Presse 284). Each program has its specific objectives, aimed at contributing to the competitiveness of enterprises and their innovative capacity in their own areas, such as ICT or sustainable energy:

- The Entrepreneurship and Innovation Program (EIP)
- The Information Communication Technologies Policy Support Program (ICT-PSP)
- The Intelligent Energy Europe Program (IEE).

Also, The Seventh Framework Program (2007-2013) is the Union's main instrument for the funding of research in Europe. It contributes to the creation of a European Research Area (ERA) as a vision for the future of research in Europe. It aims at scientific excellence, improved competitiveness and innovation through the promotion of increased cooperation, greater complementarity and improved coordination between the relevant actors at all levels.

Many programs are already in force within the EU and the main goal is to promote two-way knowledge transfer between enterprises and academic science-based institutions. They seek to encourage enterprises to build up collaborative R&D networks with supply-chain partners as well as universities and research institutes. The main focus is high-tech industry, in which large proportions of PhD students in engineering and science subjects have access to industrial training during their studies.

Despite these negative trends within and outside the EU, the European Union needs to make an effort to implement these programs. The competitive strength in this area is comprehensive. European operators are consolidating their strengths in services by offering new ‘integrated solutions’ which go far beyond the traditional selling of commoditized goods. There are some advantages in which the EU can straighten its own competitiveness (Schultmann & Sunke, 2010).

- Innovation and R&D
- Design
- Marketing and Branding
- Servicing (after-sales, customized solutions)
- Management operating systems
- Overall superior quality of goods and services
- Financial strength (applies mainly to multinationals)

These strategies suggest that these programs aimed at promoting knowledge transfer and fostering innovation try to build on institutional strengths within each country. By fostering the education and training that would make improvement of the mobility of labor market. Together with the technological factors, they are the main resources on which the EU should continue to build its competitive strength.

But, there are threats to the accomplishment of these goals. The main threat for the Union is China. Not only that China became a factory for middle and high tech products, but it is expected to boost growth by creating new innovations. Although reforms in the EU were implemented, reduced taxes, regulations simplified and liberalized labor markets; however the effects are not so significant. This policy had many flaws and because it was revised by the European Commission with a new strategy, Europe 2020 for smart, sustainable and comprehensive development, which is accepted by the European Council (2010).

Another challenge for accomplishing the planned objectives of the Union is the financial crisis. The financial crisis not only that created challenges for the Union, but also point out the inefficient spending of the public finances. The budget deficit reached levels above 3% of the GDP, and public debt above 60% of GDP, which is an upper limit regulated by the Maastricht Treaty. The average rate of the budget deficit for the EU27 in 2009 was -6,9% of GDP and in 2010 it was -6,6% of the GDP (Eurostat, 2012a). Public debt has a value of 74,4 % of GDP in 2009 and 80,1% in 2010 (Eurostat, 2012b). In this regard during 2012, the EU introduced a new financial agreement in order to strengthen the coordination of the European policies.

This agreement was ratified by 23 member states, with the exception of Great Britain and the Czech Republic. The Member States have to include these budgetary rules in their national legislation in a period of one year. The agreement provides strict fiscal constraints, i.e. budget deficit to be in the

amount of 0.5% -1% of GDP and financial penalties for those who will violate it. The penalty is 0.1% of GDP. The responsible body for implementing the reforms should be the European Court of Justice that gives legal framework to the agreement (Walker, 2012).

These strict rules in the spending are a serious challenge for achievement of the proposed measures for increasing the EU competitiveness. Also, the investors are pessimistic about the future economic development, and they restrain from investing. Even this is a serious constrain for further investing, it can be reason for rational spending of the public and private finances of the member states of the EU. That is why we believe that the fiscal rules will be implied in order to make the distinction between productive and unproductive spending and that the Union will continue to support productive and innovative projects that will boost economic growth.

Conclusion

The European Union is struggling to keep up with the United States and Japan in the economic competitiveness race and is feeling the heat from emerging powers such as India, Brazil and China. Low prices together with aggressive exports created high rates of economic growth. Since the mid 1990s the average growth rates of real GDP, labor productivity and total factor productivity in the European Union have fallen behind those in the United States of America – USA. The growing evidence of the recent fall of the EU competitiveness is suggesting that the EU is losing track.

The main trumps of the EU productivity are: investments into research and development, technology based industry and functioning of the Internal Market (economies of scale, lower costs, etc.). But, it is noticeable that instead of specialization in fast growing high tech, euro zone retreats from these sectors, with certain exceptions for medical and optical equipment. At the same time investment into research and development are not on an adequate level, lagging behind USA and Japan. Above all, the internal market it is securing the four freedoms (free movement of labor, goods, services and capital) that make the functioning of the Internal market less effective. What needs to be done is a combined set of strategies from three fields, designed:

- to reduce or remove unnecessary administrative burdens and barriers to competition.

- to reform institutions, and to make labour and product markets more competitive, but not by means of a simple deregulation strategy, rather by targeted reforms such as training, education, and increasing geographical mobility and incentives to work.
- to boost long-run growth and productivity by supporting and encouraging innovation, education and the diffusion of new technologies.

The European Union needs to make an effort to implement these programs. The competitive strength in this area is comprehensive. The new proposed measures for fiscal constraints, should not present a barrier for new investments. The objectives of the EU reform should not only be to sustain economic growth, but also to strengthen the competitiveness on the global level.

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Tables

Table 1.

Aggregate Annual Growth Rates of Real GDP,
Labor Input and Labor Productivity (1980-2010)

	Real GDP				Total hours worked (labor input)				GDP/hours (labor productivity)			
	1980-90	1990-95	1995-05	2005-10	1980-90	1990-95	1995-05	2005-10	1980-90	1990-95	1995-05	2005-10
EU	2.4	1.6	2.4	0.9	0.1	-1.0	0.6	0.2	2.3	2.6	1.8	0.7
USA	3.2	2.4	3.3	0.7	1.7	1.2	1.0	-0.5	1.4	1.1	2.3	1.2
Japan	4.0	1.4	1.1	0.1	1.0	-0.4	-0.9	-1.0	3.0	1.8	2.0	1.1

Note. Growth rates are based on the difference in the log of the levels of each variable
Source: The Conference Board total economy database, September 2011.

Table 2.

Real GDP Growth for Regions (annual average, percent)

	US	EU-27	Japan	China	India	Euro Area
1990	1.7	2.5	5.0	3.5	5.1	2.9
1991	-0.3	1.9	3.3	6.4	1.4	2.4
1992	3.3	1.2	0.8	9.3	5.2	1.3
1993	2.8	-0.3	0.2	9.2	5.5	-0.7
1994	4.0	2.8	0.9	9.5	6.2	2.5
1995	2.5	3.0	1.9	14.1	7.0	2.7
1996	3.7	2.0	2.6	2.0	7.7	1.6
1997	4.4	2.7	1.6	5.1	4.2	2.6
1998	4.3	2.9	-2.1	0.3	6.5	2.8
1999	4.7	3.0	-0.1	6.4	6.2	2.9
2000	4.1	3.8	2.8	8.6	4.3	3.8
2001	1.1	2.0	0.2	10.2	5.6	1.9
2002	1.8	1.3	0.3	11.7	3.7	1.0
2003	2.5	1.5	1.4	14.1	8.2	0.9
2004	3.4	2.6	2.7	9.6	7.2	2.2
2005	3.0	2.1	1.9	9.9	9.1	1.7
2006	2.6	3.4	2.0	12.0	9.1	3.1
2007	1.9	3.1	2.3	13.3	8.9	2.8
2008	-0.3	0.6	-1.2	9.2	6.5	0.4
2009	-3.5	-4.3	-6.5	8.8	7.7	-4.2
2010	3.0	1.8	3.9	9.9	8.2	1.7
2011	1.5	1.7	0.5	8.6	7.2	1.6

Source: The Conference Board Total Economy Database™, September 2011,
<http://www.conference-board.org/data/economydatabase/>

Table 3.

*Labor Productivity Growth for Regions
(GDP per person, annual average, percent)*

	US	EU-27	Japan	China	India	Euro Area
1990	0.6	1.4	3.3	1.5	2.7	1.7
1991	0.6	1.1	1.3	4.9	-0.9	1.0
1992	2.7	3.6	-0.3	8.2	2.9	2.5
1993	1.4	1.3	-0.2	8.2	3.2	0.9
1994	1.7	2.9	0.7	8.6	4.5	2.8
1995	1.0	2.8	1.7	13.1	5.6	2.0
1996	2.2	1.4	2.2	0.9	6.2	1.0
1997	2.1	2.1	0.9	3.9	2.7	1.8
1998	2.7	1.7	-0.9	-0.9	5.0	1.0
1999	3.1	2.3	1.2	5.2	4.8	1.1
2000	2.6	2.4	3.4	7.6	2.1	1.5
2001	1.0	1.2	0.9	9.0	3.2	0.5
2002	2.1	1.4	1.8	10.6	1.3	0.3
2003	1.7	1.1	1.7	13.1	5.7	0.4
2004	2.3	2.0	2.5	8.6	4.8	1.4
2005	1.3	1.1	1.5	9.0	6.6	0.8
2006	0.8	1.7	1.6	11.2	6.7	1.5
2007	0.8	1.3	2.0	12.5	6.5	1.0
2008	0.1	-0.3	-0.8	8.5	4.8	-0.3
2009	0.2	-2.5	-4.9	8.1	6.0	-2.3
2010	3.6	2.3	4.3	9.1	6.1	2.2
2011	1.1	1.0	0.5	7.9	5.1	0.8

Source: The Conference Board Total Economy Database™, September 2011,
<http://www.conference-board.org/data/economydatabase/>

Table 4.

TFP Growth for Regions (annual average, percent)

	US	EU-27	Japan	China	India	Euro Area
1990	-0.1	0.0	2.3	-0.7	1.1	0.3
1991	-0.8	0.3	0.3	2.1	-2.4	0.3
1992	1.8	0.6	-1.4	4.3	1.6	0.4
1993	0.1	0.0	-0.2	3.1	1.8	-0.4
1994	0.9	1.9	-0.6	3.0	2.6	1.9
1995	-0.1	2.5	0.7	7.5	2.8	1.6
1996	1.3	0.5	0.5	-4.8	3.6	0.3
1997	0.7	0.9	0.1	-1.4	0.4	1.1
1998	0.4	0.4	-2.4	-5.9	2.6	0.3
1999	1.5	0.4	-0.1	0.5	2.2	0.3
2000	1.3	1.4	1.4	3.3	-0.2	1.4
2001	-0.2	-0.2	-0.2	4.7	1.3	-0.1
2002	0.5	0.2	0.6	5.9	-0.6	-0.2
2003	0.9	0.1	0.6	7.7	3.7	-0.4
2004	1.7	0.6	1.7	2.5	2.3	0.2
2005	0.8	0.4	1.2	2.4	3.6	0.3
2006	0.0	1.3	0.8	4.5	3.4	1.1
2007	-0.1	0.5	1.6	5.9	2.9	0.3
2008	-1.1	-1.2	-1.1	2.2	0.9	-1.4
2009	-1.0	-3.3	-4.5			-3.1

Source: The Conference Board Total Economy Database™, September 2011,
<http://www.conference-board.org/data/economydatabase/>

Table 5.

Cost for R&D Calculated as % of GDP

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
EU 27	1,8	1,75	1,78	1,79	1,84	1,86	1,87	1,88	1,87	1,83	1,83	1,85	1,85	1,92	2,01	2
EU 15	1,85	1,8	1,83	1,84	1,89	1,92	1,93	1,94	1,93	1,89	1,89	1,92	1,93	2,01	2,1	2,09
Euro zone 17	:	:	:	:	:	1,84	1,86	1,88	1,87	1,85	1,84	1,87	1,88	1,96	2,06	2,06
USA	2,48	2,52	2,55	2,58	2,63	2,69	2,71	2,6	2,6	2,53	2,56	2,6	2,66	2,79	:	:
China	:	:	:	:	:	:	0,95	1,07	1,13	1,23	1,32	1,39	1,4	1,47	:	:
Japan	2,91	2,8	2,87	3	3,02	3,04	3,12	3,17	3,2	3,17	3,32	3,4	3,44	3,45	:	:
South Korea	:	:	:	2,26	2,17	2,3	2,47	2,4	2,49	2,68	2,79	3,01	3,21	3,36	:	:

Source: Eurostat database, Available at:
<http://appsso.eurostat.ec.europa.eu/hui/submitViewTableAction.do>

Table 6.

Comparative Advantage of Technological Aspect (2005/2008), Balassa index of competitive advantage

	EU	USA	Japan	Great Britain	China
High technology industries	0,9	1,3	1,0	1,2	1,5
Medium technology industries	1,2	1,1	1,5	1,0	0,7
Medium-Low technology industries	0,8	0,8	0,9	0,7	0,6
Low technology industries	0,9	0,8	0,4	0,9	1,2

Source: CHELEM data, Mauro, di F., Forster, K., Lima, A. (2010). *The global downturn and its impact on euro area exports and competitiveness*. Frankfurt: European Central bank.

Table 7.

Competitive Advantage in Productions According to the Intensity of Factor of Production

	EU	USA	Japan	Great Britain	China
Raw material	0,5	0,7	0,1	0,6	0,4
Labor intensive productions	1,1	0,8	0,5	1,0	2,3
Capital intensive productions	1,2	0,9	1,6	1,1	0,3
Research intensive production	1,1	1,4	1,4	1,2	1,0

Source: CHELEM data, Mauro, di F., Forster, K., Lima, A. (2010). *The global downturn and its impact on euro area exports and competitiveness*. Frankfurt: European Central bank.

The Transformation of Institutions of the European Union towards a Stronger Common Economic Policy

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Abstract

Recent developments in the European Union in the field of economic policy show the need for redefinition of certain aspects of the common activities. The consequences of uncoordinated government spending and fiscal and monetary activities in the member states are evident. It led to large budget deficits in some member states which have caused a range of threats to their macroeconomic stability and to the overall macroeconomic stability of the entire Union. This requires urgent harmonization of the national economic policies if further endangering of the value of the common currency, the euro, is to be avoided. The European Council meeting, in December 2011 and in March 2011, recognized the deterioration of the economic and the financial situation in the EU and called for full implementation of the European Union's New Economic Governance; aiming for further confidence in the European economy. The reforms of the EU institutions are expected to yield stronger competencies to influence the implementation of common policies and legislation.

The main aim of this paper is to put in the limelight the needs for reforms of the EU institutions towards a higher coherence of the common policy, and to offer recommendations for further actions. The Republic of Macedonia, as a state with aspirations for full membership in the EU, has to continually and carefully follow the developments in the area of the prospective reforms of the EU, and whenever it is viable to meet the relevant national targets for the government spending, the public sector and the overall national debt. We surveyed the history of the EU, as well as other monetary unions such as that of the USA, and it seems that both suffer certain volatility. However, it also seems that more recent and/or less economically integrated monetary unions are more prone to it.

Keywords: economic policy, common policy, EU institutions

Introduction

Monetary unions are agreements between two or more states with the aim to share their currencies or to issue new common currencies. The term covers only agreements between fully sovereign states. However, monetary unions do not apply to the common currencies of the national federations such as the United States, the old Austro-Hungarian Empire, former Yugoslavia, Czechoslovakia or the USSR. Based on the level of concession of the national sovereignty to some form of central monetary power they can have two basic forms, with (1) independent or with (2) pooled monetary authority. There are also examples of informal monetary unions, when one country, usually a smaller one uses the currency of some other state as legal tender on its own territory. This can be an interim model until establishment of monetary authority or a permanent solution with the idea of making transaction costs smaller. For example Montenegro and Kosovo, use the euro although that is not fully recognized by the European Central Bank.

Some other countries like Turkey use world currencies like the euro and the dollar in parallel with its own, thus having full internal convertibility of its national currency. The Republic of Macedonia, in fact, inherited a similar system from Yugoslavia, in which the state allowed its citizens and businesses to save in hard currencies and keep a blind eye toward the actual ways of how they obtained them. This was an asymmetric, dual in fact, currency system, with many virtues of the real monetary union was the hedging for the currency risk in the era of high inflation in former Yugoslavia. Despite the strict adherence to the policy of attaching the Denar to the Euro, ever since its political and monetary independence, people in Macedonia still prefer saving in Euros and the majority of transactions in the country, particularly in the regions with higher rates of economic emigration, are in fact in Euros. This implies that the people and the businesses would easily and eagerly accept the Euro as the only legal currency in the country. Ironically, it appears that Macedonia, in the terms of formal requirements related to the budget deficit and the level of public debt, performs much better than some of the Euro countries and is very close to the formal requirements. The EU on the other hand, has institutions that regulate these issues and this paper argues the transformation of the same for a better union.

The Treaty on Stability

Latest developments in the European Union show the need for strengthening the cohesion of the Union in many spheres, especially in the sphere of the economic and monetary policies. Only by strengthening the competencies of the Union's institutions is this considered a possibility. The Statement by the Euro area heads of state or government from December 9, 2011, on reinforced architecture for economic and monetary union ("Statement by", 2011), clearly shows the determination of the European Union for redefinition of many aspects of common activities. As a result of the intensity the European Council adopted the Treaty on Stability, Coordination and Governance in the Economy and Monetary Union known as the Treaty on Stability and as the Treaty on Fiscal Stability. The expectations are that the Treaty will come into force in the beginning of 2013, after its ratification in the national parliaments of twelve member states. Despite some skepticism from the Euro skeptics, the Treaty on stability was signed by 25 member states. It was not signed by the United Kingdom and the Czech Republic. The Czech Republic might sign the Treaty, after consultation with the national parliament. The British position, for now, is not to sign The Treaty on Fiscal Stability. But, with or without all member states, the European Council, as an EU institution, which has the power to adopt the most important strategic, legal and political acts, has a strong determination to tackle the big problems in the economy and monetary spheres. Right at the beginning, the Treaty on stability opens some legal, political and other dilemmas, which will be elaborated in this paper.

Reforms and redesign in the sphere of the economy with a strengthening of the competencies and the powers on the European Union's level are needed. It means stronger power and competencies in the EU institutions. One of the most important questions in the context of strengthening common activities on the Union's level is: "Could the EU institutions receive stronger power in the sphere of the economy, without amending the basic EU treaties: The Treaty of the European Union (Treaty on the EU, 2010) and the Treaty of the functioning of the European Union (Treaty of the Functioning, 2010). To better understand the issues elaborated here, it is crucial to have a look at the monetary unions in the past and identify their strong and weak points.

A History of Monetary Unions

Surprisingly, the European history is rich with several examples of successful or unsuccessful monetary unions. The first functional union was that between Great Britain, France and the United States, and originated in 1867. The idea was that all three countries standardize and then mint equally and thus have fully interchangeable gold money. The attempt proved not viable. Another concept started simultaneously and was called the Latin Monetary Union, which proved quite viable and sustainable. It encompassed Belgium, Italy, Switzerland, and France, and in its latter phase Greece. The Scandinavian Monetary Union was established in 1873 between Sweden and Denmark and later Norway. It lasted an impressive 58 years and was finally dissolved with the great depression in the thirties. In the area of the former German states there were two separate unions: on the North it was the union of states that used the Florin and in the South the union between the states that used the Gulden. Austria was also a member of the Southern union between 1857 and 1866 when the Austro-Prussian War erupted. In 1922 Belgium and Luxembourg established their own union. The concept proved successful since it finally was transferred into the union of the Euro in 1999. The Belgian and the Luxembourg francs existed in parallel, but only in the case of Luxembourg were they fully in use. Despite what was declared, the Luxembourg monetary authority was mainly a big lame duck institution and its Frank was not in use in Belgium at all. This fact today pours additional oil on the fire in the camp of those concerned about the surrounded sovereignty and suppression of the small nations in a large agglomeration such as the Euro zone. Nevertheless, the Euro zone, ever since its beginnings in 1999, continuously drives astonishing interest among academics and business people all over the World. It was a unique case in which established states and big economies engaged in a gigantic experiment of unprecedented proportions. The idea is brave, while retaining political sovereignty; member governments have formally delegated their monetary sovereignty to the European Central Bank. Despite the failure of many past initiatives, the future could see yet more joint currency ventures among sovereign states (Cohen, 2012). Monetary unions are considered in many parts of the world, like in Latin America. However, to develop the Mercosur integration into a common currency area, the member countries should further improve their economic performances and act in such a way that shows they are unified under a single goal (Numa, 2011).

The Advantages of Monetary Unions

One thing is definitely clear. The idea of a monetary union is much older and with a considerable track record than the history of the Euro, and the perils that this common currency is facing are much more related with the (lack) of fiscal and monetary discipline of the member states than the disappointment of the advantages of the common currency area. The Euro zone has proven to have a sustainable currency union. However, there must be a fiscal integration to absorb and smooth economic shocks. If the ultimate goal is a monetary union, then an economic union should also be taken into consideration (Numa, 2011).

The main virtues of a stabile monetary union are the same that can be attributed to any prudent national monetary and economic policy: the maintenance of the public spending on a "short leash" and the preference to long term stability over short term spending binges. However, the fact that the mandate of any political option in a normal democracy is put on a test every fourth year, the temptation to take the advantage of the shortsighted spending sprees in order to acquire another mandate will always be very high, particularly if we have in mind that the painful reimbursement always lags at least several years and is transferred to the succeeding political option. The budget deficit, in the strategic political games, acts as a political poison pill for any successor. That is way, in any economic crises it is not a problem to provoke the government to demise, and it is much more difficult to find an alternative political candidate keen to take charge of the helm! That is why Rose (2006) argues for a strict no deficit carry-over rule in order to preempt the pre-election spending and the post-election restraint patterns that typify political business cycles.

For the sake of the truth it must be stressed that even among the economists there is a lack of consensus over what is to be considered a prudent monetary policy and what is a stable or balanced budget. For some schools (particularly more conservative ones) a balanced budget has neither a deficit nor a surplus and the total revenues equal total expenditure. According to the Modern Monetary Theory the level of taxation relative to the government spending is a policy tool that regulates inflation and unemployment, and not a means of funding the government's activities per se. Most economists today agree that a balanced budget would decrease interest rates, increase savings and investment, shrink the trade deficit and

help the economy grow faster over a longer period of time. The budget is seen as a control rod that when released heats the “chain reaction” of the economic activity and when fully deployed in a surplus, cools it down. Some others advocate for cumulative budgeting in which case the budget deficit can be offset with the consecutive budget surplus. This budget is cyclically balanced over the entire economic cycle and runs in a surplus in boom years and a deficit in lean years. However, there are economists which claim that the balanced budget can be economically destabilizing. Daniel Smith and Yilin Hou refer to the work of Schmitt-Grohe and Uribe (1997) and that of Levinson (1998) that the balanced budget requirements effectively exacerbate business cycle fluctuations.

Comparative Study of the Economy of USA, Countries in the EU and Macedonia

Over the Atlantic, in the USA, the budget issue is a subject of overheated political debates. Virtually all states have balanced budget amendments and some even ban large budget surplus (more than 2%). Oregon and Colorado refund their taxpayers if that happens. It seems that in Europe, in general, the public was not so sensitive when the budget deficit was on the agenda. However, when over-borrowing in both the public and private sector leads to a banking crisis, like in the case of Sweden at the beginning of the 90s, the case of Iceland, almost a decade later and ultimately with the massive debt crisis of Greece, but also that of the Spain, Italy and Portugal, the wide political consensus developed on fiscal prudence that asks for maintenance of the goal of 1 % over the business cycle, for the sake of the truth, with the pensions no longer considered a government expenditure.

A short desk study of the current situation in some of the EU countries reveals rather interesting facts. In France the budget is almost entirely a domain of the executive power. The Constitution stops the national assembly and the senate from making any amendments to the budget proposed by the government. Once approved by the parliament, the government may make adjustments of up to 2% without having to seek any further parliamentary approval. Since 2011 the French government introduced a bill to amend the Constitution in order to ensure an entirely balanced budget. The latest data show that the French budget deficit fell to approximately 91 billion euros at the end of 2011, from a record of approximately 149 billion euros in 2010. This

was understood as a clear step forward for the second-biggest EU economy towards getting its finances in order according to *The Economic Times* (2012). Similarly, after years in which Germany also failed to meet the EU imposed budget deficit rule, the biggest Euro economy budget in 2011 fell from 4.3 in 2010 to 1% percent of the GDP, or well below the 3% current EU target. The expectations for 2012 are that the trend will, despite the election, be sustained. This impressive result is primarily due to the strong economic growth of 3% in 2011 which boosted the tax revenues (German Budget Deficit Plunges to 1 Percent of GDP, 2012). The current deficit of just 25.8 billion in the case of such a big economy looks rather impressive, particularly from the viewpoint of its counterpart over the Atlantic, the Federal administration of the USA and its deficit between 8 and 11% of the USA gross domestic product, mainly thanks to the "socialist" flavor of Obama's plans and the previous gratuity in the tax cuts of the Bush's administration (US Federal Deficits in the 20th Century, 2012).

Greece failed to meet the EU budget deficit target (3% of GDP) in the early 2000s and then met it shortly in 2007 and 2008. The country budget deficit skyrocketed again in 2009 to a record 15%. Unpopular austerity measures managed to reduce it to a one digit figure (approximately 9%) in 2011, but the outlook is rather gloomy (Greece, 2012). Nevertheless, while the notorious "Mediterranean easygoing Four: Greece, Portugal, Italy and Spain dominate most of the negative press when it comes to debt in Europe, some other economies like that of the UK are also big underachievers when it comes to the overspending discipline. The UK budget deficit is approximately 168 billion pounds, settled between the 13% in 2010 and the 10% of the 2011, or well above the old EU target and not to mention the new. This partly can explain why David Cameron pulls the "patriotism" and "sovereignty issue" cards from his sleeve. There is no chance that the UK will meet the EU target of 1% budget deficit in due time, at least not without violent street riots like that of the August 2011 (The UK's budget deficit, 2012).

After the impressive descent of the Croatian budget deficit from 10% in 2004 to the lean 1% in 2008, it seems that buying the wide public acceptance of the EU accession was paid with 3% budget deficit in 2009 according to the Ministry of Finance of Croatia (2009). A similar situation, although due to reasons other than EU accession, can be seen in the case of the Republic of Macedonia. From a surplus of 0.6% of the GDP in 2008 the country budget deficit first jumped to 0.9% and then to 2.7% in 2010, according to the IMF (2012). Many economists suggest, even those close to the government,

restraining the spending enthusiasm, particularly in the case on non-productive buildings and monuments. The argument of the other side is that the government simply follows Keynesian doctrine and uses it, it must be admitted, still mild deficit, for bustling the rather stalled and skeptical business sector, particularly in the situation when the country is very strict regarding the low level of its external debt, fixed currency rate and restrictive credit policy and control. Under these circumstances, 2 percent points of budget deficit above the new EU target are the only excess money in the economy.

	Annual change in		Budget deficit as a pct		Public debt as a pct.	
	GDP		of GDP		of GDP	
	2009	2010	2009	2010	2009	2010
Greece	-2.0%	-4.0%	13.6%	8.1%	115.1%	131.0%
Ireland	-7.1%	-0.6%	14.3%	12.0%	64.0%	88.2%
Portugal	-2.6%	1.1%	9.4%	8.2%	76.8%	82.4%
Spain	-3.7%	-0.5%	11.2%	9.3%	53.2%	63.5%
Germany	-4.7%	3.3%	3.3%	4.1%	73.2%	72.5%
Euro zone	-4.1%	1.6%	6.3%	6.0%	78.7%	84.7%

Source: Wall Street Journal

The Future Perspectives of the New Treaty on Fiscal Stability

The European Council meeting held in Brussels on December 9, 2011 adopted the conclusions relating to the current economic and financing situation. The European Council, as an EU institution which has competencies for adoption of strategic decisions, documents and legal acts, recognized the worsening economic and financial situation and underlined the need for establishing the new measures against the economic crisis in the conclusions. The Council shows strong determination for structural reforms and fiscal consolidation in the Union. It is a very important step toward signing the Treaty on Fiscal Stability. The heads of the EU member states agreed that stronger monitoring of the fiscal, financial and economic activities in the member states is very important for the future perspectives of the Union's macroeconomic stability. The Council also stressed that economic and financial instability in the last two years produced a serious increase of unemployment.

In the same session of the European Council another Statement (Statement Euro area, 2010) was adopted, by the Euro area heads of state or government (France and Finland are represented in the EU Council by the president of the state, the other twenty five members, according to their national legislation, are represented by their prime ministers), which presents a strong will for moving towards a solid economic union, together with strengthening the activities in the sphere of economy and finance on the EU level. In the future, the Commission must be granted stronger competencies in the economic, financial, fiscal and many other spheres, possibilities for stronger monitoring of the member states' activities and a power to sanction the member states, which is not in the common policies and common legislation. Only with more coordinated fiscal cooperation and strengthened economic policy coordination is this possible.

It is clear that Germany and France have the main role in adopting the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. Germany and France have been pushing the new Treaty on Stability since the end of 2010, when the situation in the field of economy in almost all member states started to have stronger negative effects. The Treaty was signed by 25 member states, excluding Britain and the Czech Republic. Britain for now, as we have mentioned, refuses to sign the new Treaty, while the Czech Republic will probably sign the Treaty after a debate in the national parliament. The expectations are that the Treaty will come into force after its ratification from the national parliaments in at least twelve member states, which should be done by the beginning of 2013. Only in Ireland, the Treaty will be ratified after the referendum. In the case of rejecting the Treaty on Fiscal Stability in the referendum, Ireland in the future will not have the right to use financial support from the new EU stabilization fund. Adopting the Treaty from the 24 states without a referendum, or other types of consolation, shows a great determination of the political leaders, and also their readiness to take urgent actions for solving serious economic problems. They also show readiness to undertake full responsibility for adoption and enforcement of the Treaty on Stability.

For the time being, the idea of changing the Lisbon Treaty in the short future period, which was the primary goal of Germany and France, will suffice. The position of France and Germany is that the Treaty on Stability can be successfully enforced without changing the Lisbon Treaty. It seems that it is the most controversial issue related to the Treaty on Stability. But, despite

numerous Euro skeptics, the Treaty opens completely new future perspectives for the Union's economic, monetary and fiscal policies with firmer cohesion. But, the Treaty also will have a strong influence on the whole EU perspective and it is a big step toward redesigning the EU. From the long term perspectives, it will result with the changing of the Treaty of Lisbon, which means changing the Treaty on the European Union and the Treaty of the functioning of the European Union, as basic EU treaties. The Fiscal Stability Treaty opens clear perspectives toward stronger cohesion of the Union. It is an important phase toward a fiscal Union, which is one of the main goals on the way for building stronger economic cohesion of the EU. It is not only important for the 17 member states but it has an importance for the whole Union.

According to the Treaty on Stability, the budgetary position of the general government of a contracting member state shall be balanced or in surplus. The member states which signed the Treaty agreed to strengthen the economic pillars of the Union by adopting a set of rules intended to foster budgetary discipline through a fiscal compact and to strengthen the coordination of their economy, thereby supporting the objectives for sustainable growth, employment, competitiveness and social cohesion. The Treaty produces the obligations that general budgets shall be balanced or in surplus and annually structural deficit shall not exceed 1 % of nominal GDP. The public debts of the member states should not exceed 60% of GDP. In those strict conditions, the aims of building a much stronger fiscal discipline are visible. It is important to underline that the strengthening of the cohesion in the Euro zone is one of the key preconditions for the economic and financial stability in the whole Union. The stabilization of the Euro will have positive impacts on the economy of the EU, and all of Europe, taking into account the influence of the EU economy on Europe.

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, opens a question: "Are the changes in the basic EU Treaty necessary for the enforcement of the Treaty on Fiscal Stability, or the enforcement is possible only with the changes in the secondary EU legislation?" In Article 3, paragraph 2 of the Treaty and Fiscal Stability, there is a provision that the rules relating to the stability, coordination and governance in the economic and monetary Union, will take effect in the national law of the contracting states at the latest one year after the Treaty on Stability enters into force. It means that the full implementation of the

obligations of fiscal discipline and other measures will happen after transposition of the fiscal obligation from the Treaty on Stability into the national legislation. But there are some opposing arguments. For complete implementation of the goals coming from the Treaty on Stability, changes in the EU primary legislation (the EU treaties) are necessary. That means that a sufficient legal framework for complete enforcement of the Treaty on Stability would not be satisfied only with the adoption of secondary legislation of the EU. This is an important point because according Article 48 of the Treaty on the EU, changing of the basic EU law (basic treaties) must be agreed unanimously with consensus of all member states and ratified by all member states.

But it is important to consider that there are many arguments in favor of the enforcement of the Fiscal Stability Treaty without changes in the primary EU treaties. It can be supported with the argument that in Article 4, paragraphs 3 of the Treaty on the European Union, it is stipulated that the member states shall take any appropriate measure, general or particular, to ensure fulfillment of the obligation of the treaties or resulting from the acts of the institutions of the Union, and the members-states shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardize the attainment of the Union's objectives. Article 20 of the Treaty on the EU gives a legal framework for enhanced cooperation between the member states. Furthermore, Article 121 of the Treaty of the functioning of the European Union defines measures for closer cooperation of the member states in the field of economic policy and monitoring of the economic development in each of the member states. Article 126 of that Treaty confirms that member states shall avoid excessive government deficits. Article 136 of the same Treaty regulates undertaking specific measures on the EU level for member states such as strengthening the coordination and surveillance of their budgetary discipline, setting out economic policy guidelines for them, while ensuring that they are compatible with those adopted for the whole Union. According to the Treaty for the Functioning of the European Union, member states that use the euro may establish a stability mechanism to be activated if it is indispensable to safeguard the stability of the euro area as a whole. These legal provisions and also the fact that the Fiscal Treaty on Stability will be implemented into the legal systems of 25 members states which signed the Treaty, has disappointed some viewers, especially in the United Kingdom, (which refused to sign the Treaty), that the new Fiscal

Stability Treaty is outside the domain of the primary EU law. The UK refuses to sign the Treaty because of the assessment that the Treaty does not cover their national interests. It confirms that the comments about the collision between the new Stability Treaty and primary EU law in fact are more politically, than legally supported. But also, it is good to note that from the long-term perspective of the process of strengthening the cohesion of the EU in the economy and fiscal areas, it will be useful to make changes in the primary treaties, which will enhance the powers on the EU level, especially the power of the Union's institutions.

The Position of EU Institutions versus the New Stability Treaty

Since 2007, when the drafting of the Lisbon Treaty was compiled, it is evident that the reinforcement of an extensive discussion about the character of the structure and of EU cohesion is much needed and an answer to the question: "Does the Union function as a community federation or confederation?" But it is not possible, according to current Union construction, to give a simple answer. The EU has elements of a confederation and also elements of a federation and exists as a community which is between a federation and confederation. That construction, despite many other considerations, is a result of the position of the common institutions. Some of them, like the European Parliament and European Commission act like federal institutions and some like the Council of Ministers and European Council act like confederative institutions. Also, in the field of a single market, the Union has a number of federal elements but for example in fields of defense and foreign policy the Union has more elements of a confederative construction than a federal construction.

The strengthening of the concept of European integration has been going on for more than fifty years. That process in some periods goes faster, slower but obviously it shows the continuation of the integration process. The growing membership of the Community/Union demonstrates the extraordinary attractiveness of the multinational integration process (Mouses, 2006). The institutions of the European Union are the moving power of the Union, they are very often named as the vehicles of the European Union. The member states, building common activities, give up some aspects of their sovereignty and transfer a part of the sovereignty to the European Union and its institutions. The institutions formulate, adopt and effect the common policies

and common legislation. Regardless of how the institutions are formed, elected on the EU level, like the European Parliament, European Commission, or they are composed by nomination by the member states, like the European Council, Council of ministers, Court of Justice of the European Union and others, the EU institutions have been working on building European identity permanently. The EU institutions have numerous advantages compared to the institutions of the member states. They concentrate financial, human, technical, technological, expertise and other common resources on the EU level, which makes it much easier, more efficient and effective to achieve the common goals. The institutions of the EU directly reflect the Union's most fundamental goals (Peterson & Shackleton, 2005). The needs for strengthening the power do not only come from the current financial and fiscal problems. They also come from the permanent process of the enlargement of the EU, from 15 member states before 2004 and 27 member states now, and expecting further enlargement. There is almost a universal agreement in the EU that fundamental institutional reforms are needed to ensure that an enlarged Union can function effectively (Odenaren, 2005). The position of the EU institutions depends on the level of the common integration because the Construction of the European Union is a question of organization (Cini, 2005).

The Treaty on Stability promotes further strengthening of the role and of the position of the European Commission. The Commission, according to the Treaty on Stability, has a right to monitor the enforcement of obligation for fiscal stability. Building stronger economic cohesion is not possible without a strong position for the European Commission, and it is realistic that the Commission will develop in the future to a real EU government. The viewpoints that the Treaty on Stability and especially the functions of the EU institutions, which are stipulated in the Treaty, are outside EU law are incorrect because the above-mentioned legal framework shows the opposite. The biggest discussion is related to the right of the Court of Justice of the European Union to impose fines for breaching the stipulated fiscal rules.

Conclusions and Recommendations

The greatest advantage of monetary unions is that they lower the transaction costs and the costs of hedging the export arrangements for the exchange rate risk. However, while the advantages on the side of the

individual economic entities are clear there are some important disadvantages for the national governments engaged in some sort of a monetary union. They lose effective control of the money supply and the exchange rate, the two main monetary policy instruments to cope with domestic or external disturbances. Against a monetary union's efficiency gains at the microeconomic level, governments must compare the cost of sacrificing the autonomy of the monetary policy at the macroeconomic level. These governments cannot even take the advantages of deliberate depreciation of its national currencies to offset some of the social pressures while paying more but less valued money (Cohen, 2010). A monetary union among autonomous countries cannot simultaneously maintain an independent monetary policy, national fiscal sovereignty and a no-bail out clause. These three features make up an impossible trinity, and attempts to preserve all three concurrently will ultimately end in failure. In order to save the EMU, one of these three must be abandoned (Hanno & Aloys, 2012).

It is evident, besides the numerous political and legal dilemmas, that the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union opens an opportunity for fiscal consolidation of the 25 member states which adopted the Treaty and the European Union as a whole. It is an important step toward financial stability. This Treaty does not replace the basic EU treaties, but it opens an opportunity for stronger cohesion of the Union, besides the fact that two member states still haven't signed the treaty. From the optimistic point of view it is realistic that the Czech Republic and United Kingdom in the future will accept the Treaty and after that the basic EU treaties will be changed. However even without adoption from all member states the Treaty produces fiscal responsibility for the 25 member states. The Treaty is an important step toward stronger economic and financial cohesion of the EU. It will have a stronger influence in building the cohesion in other spheres. In the process of further building a stronger position the European Union's institutions, especially of the European Commission, the determination of the UK not to sign the Treaty on Stability for now seems very firm. But also it will be very positive for EU cohesion to make further negotiations between the EU and the UK and Czech Republic about the future process of fiscal discipline and fiscal equalization.

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Reformed Pensions Systems in Central and Eastern Europe: Challenges to Future Safe Pension Benefits

Jadranka Mrsik, Dimce Lazarevski

Abstract

The objective of this paper is to examine and analyze empirically whether the Central and Eastern European countries' reformed pension systems are providing adequate and safe pensions. Starting in the 1990s, most Central and Eastern European countries radically reformed their pension systems. The rising optimism initiates many studies where the advantages of the reforms were in the focus. The global financial crisis negatively affects the reformed pension systems. As a response, the policy makers in a few of those countries decided to set up different measures: increasing or reducing the pension contribution for alleviating the fiscal deficit or encouraging the employment, adapting the contribution rate and allowing individuals to switch back to the old system. These last changes in the pension systems have triggered the following question: How much and in which way the implementation and experiences gained with the functioning of the reform pension system will have impact in the future pension adequacy and sustainability of the pension system?

Keywords: reformed pension systems, financial crisis, sustainability of pension systems, pension contributions, pension benefits

Introduction

In Central and Eastern Europe (CEE), almost all countries have reformed their pension systems in the past two decades as a response to the population aging and fiscal pressures. Many of them have implemented the Chilean model; defined-contribution schemes based on individual pension savings accounts and adopted the multi-pillar pension structure. In the new system the first pillar that is mandatory and managed by the government

represents a pay-as-you-go scheme. The second pillar is mandatory also but based on a funded scheme, and the last pillar, a funded one, is voluntary.

Most of the studies are exploring the reasons for the pension system reform, the design of the reformed system, the investment activities and its performance, and only a few are paying attention to the capacity of the reformed system to provide its sustainability and adequate pensions to the population. However, those studies that examine the impact of the reformed pension systems to the amount of future pension have not included the Macedonian pension system in their research. This is because the Macedonian pension system is among the last reformed and the pension funds assets are still insignificant: in 2010, 2.9% from GDP compared with 15.8% in Poland and 14.6% in Hungary, the leading pension reform countries among the CEE countries (Pension Markets in Focus, 2011).

In many EU countries, especially in the CEE countries, which have adopted the second pillar later than Latin American countries, the global financial crisis has raised questions concerning the benefit of switching to a mixed pension system, in comparison with the former one which relied exclusively on public pay-as-you-go schemes. The shocks to pension systems caused by the financial near meltdowns in 2008/2009 balanced, but the question remains how its effects are likely to linger with us in the decades to come, because of the long run character of the pension savings. Therefore, the beliefs in the future reliable pensions within the reformed pension systems in CEE countries are becoming questionable.

The aim of this paper is to assess the adequacy of prospective retiring income of Macedonia's current generations of workers next to the retiring income of current retirees, and compare those results with those in the selected CEE countries (Poland, Hungary, Slovakia and Bulgaria). Pension system sustainability will also be in the focus of our analysis.

Literature Review: The Impact of the Pension Reforms on the Future Pension Benefit

Defining pension adequacy is clearly more controversial than defining pension sustainability. Whereas the definition of sustainability exposes the perception of actuarial fairness, there is a different conception for the adequate pension systems. Some are concentrating on alleviation of poverty while others will say adequacy should cover both this poverty objective as well as the guarantee that pensioners can maintain a decent living standard or even a broader condition on the income distribution to pensioners (Draxler

& Mortensen, 2009). Various definitions also explain why there is a more long-standing tradition to focus on the sustainability of pension systems in the median and long term. Fornero and Vanriet (2005) recapitulate some definitions related to adequate pensions. The adequacy concept of a pension is defined as: "securely financed, adequate income that does not destabilize public finances or impose an excessive burden on future generations, while maintaining fairness and solidarity, and responding to the changing needs of individuals and society" (Social Protection Committee, 2000). "Public earnings-related schemes (first pillar), private occupational schemes (second pillar) and individual retirement provision (third pillar), provide good opportunities for most Europeans to maintain their living standards after retirement" provide adequacy (European Commission, 2002). Pension systems should "ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living" and "enable people to maintain, to a reasonable degree, their living standards after retirement" (Laeken summit, 2001). At the Laeken summit (2001), the members of the EU-15 have fixed eleven objectives for pension systems with particular emphasis on three general targets: adequacy, financial sustainability and modernization. Three of the eleven objectives specially referred to the adequacy of pension systems: poverty among the elderly population, living standard smoothing after retirement and (intra and inter-generational) solidarity (EC, 2003). In this study, we are focusing on the definition of indexes for living standard smoothing after retirement.

As the number of pensioners in Europe rises in relation to the number of people in employment, ensuring adequate pensions on a sustainable basis has become a major challenge. The wave of "pension privatization" was expanding during the last three decades (Brooks, 2005; Clark & Whiteside, 2005; Ervik, 2005; Guardiancich, 2008; Kay & Sinha, 2008; Madrid, 2003; Müller, 2001; Orenstein, 2008; Weyland, 2005), started as a regional trend in Latin America and Central and Eastern Europe in the 1990s, later spread to Africa and Asia. Pension reform cut the state provision for old-age retirement and increased individuals' responsibility (Hacker, 2006; Munnell & Sass, 2007).

The global financial crisis of 2008-2010 seems to have ceased, at least temporarily, so there is a trend towards mandating savings in individual funded pension accounts worldwide, the core reform of the pension privatization trend. Since the crisis, not a single country has adopted mandatory individual accounts and several of them only have considered but not implemented it.

Some of them have even taken some few specific actions in this respect (World Bank, 2009; Velculescu, 2011): some countries have modified the overall contribution rate, and some of them increased it in order to alleviate the fiscal deficit (e.g. Romania). Others have reduced it, with the aim of fostering the employment and incomes (e.g. Macedonia and Bulgaria). Several have frozen or adjusted differently in comparison with the prior calendar of the second pillar contribution rate (e.g. Estonia, Lithuania, Latvia, Romania, and Estonia). Moreover, more radical measures have been taken by some CEE countries, allowing individuals to switch back to the old system, getting out of the second Pillar (e.g. Hungary, Slovakia) or making the second pillar voluntary to new entrants on the labor market (e.g. Slovakia). Finally, they have taken some measures in order to prevent early retirement (e.g. Hungary, Poland, and Latvia) or they increased the retirement age limit (e.g. Hungary, Romania, and Poland).

Milos and Milos (2011) believe that all these actions taken by the authorities in order to alleviate the budget tensions are short-term solutions, thus the reform of the pension system must continue. Jarrett (2011) pointed out that trying to solve the problem of public finance sustainability by radically shrinking the second tier of the pension system has obvious costs in terms of poverty among old-age pensioners. Their benefits will be considerably lower than the ones of working age, and it will strongly affect their confidence in the multi-pillar system.

The current economic crisis is the first one since the pension reform implementation in the CEE countries. Earlier, the researchers focused mainly on the reformed pension systems' structures and pension funds' investment activities in the newly established second pillars. Since 2008, several works have been published that examine the impact of the economic crisis on the pension systems financing in the CEE countries.

Future levels of pensions in relation to earnings (income replacement levels) will depend on different factors, notably the pace of accrual of pension entitlements (linked to evolutions in the labor market), the maturation of pension schemes and the effect of enacted reforms (European Commission, 2009).

To explore the impact of the institutional setting and policy distance on pension implementation on the amount of the future pension benefits, we have studied four Central and East European countries that reformed their pension systems in the 1990s and early 2000s: Poland, Slovakia, Hungary and Bulgaria.

The two main official studies dealing with the calculation of replacement rates at retirement are those by the ISG (2006) and OECD (2007). In the report *Current and Prospective Theoretical Pension Replacement Rates* by the ISG (2004 and 2006), replacement rates are calculated for sample individuals to allow a comparison of similar work histories among different European countries. The sample individuals have a career pattern lasting 40 years, from the age of 25 to 65, a full-time job and a salary steadily equal to 100% of the national average wage. Other common assumptions include the inflation rate and the formula to calculate pension and survivor's benefits.

In *Pensions at a Glance 2007* (OECD, 2007), gross and net replacement rates are calculated for sample individuals entering the labor market at the age of 20 and working until retirement. Calculation of the gross replacement rate is for workers with incomes equal to the median and to 0.5, 0.75, 1, 1.5 and 2 times the national wage. Net replacement rates take into account the individual's taxation and paid contributions. The calculation of supplementary pension benefits assumes an annual actual return rate of 3.5%, net of administrative costs. To compare replacement rates calculated by the ISG using a representative individual with sample-based replacement rates, the authors calculate replacement rates based on the first and the second pillars, net of taxes, and for men only.

Macedonia reformed its pension system in 2006, among the latest CEE countries that have made structural pension reform. The impact of the reformed pension system especially on the future retirees' incomes, we cannot precisely see for at least next 20 years. The first pensioners from the multi pillar pension system are expected in 2030, since the average age of members of the second pillar is 32 (Agency for supervision of fully funded pension insurance, 2010). However, by using the calculations for the replacement ratios in this paper we will try to answer approximately the previously touched dilemmas.

Model and Data

The issue of pension income adequacy (Zaidi, 2010) has not been a priority in pension reforms. During the initiation of the Macedonian pension reform, we have no evidence of a study that measure the expectations for obtaining higher pension benefit from the reformed pension system. Thus, this paper focuses on the current and future pensions for three groups of workers

(low, average and above average earners), for those who stayed in the pay-as-you-go system and those who entered the reformed (three pillar) system.

We will use different ratios to evaluate how Macedonian and selected CEE Countries' reformed pension systems will affect pension levels in the future. To analyze the aggregate impact of pension reforms we will use the indicator 'Benefit Ratio', as calculated by the Working Group on Ageing of the EU's Economic Policy Committee. The Benefit ratio calculation:

$$\frac{GAPB}{EGAW} = BR$$

Where GAPB is the gross average pension benefit and EGAW is the economy wide gross average wage. GAPB calculation is:

$$OAP + EP + SP + DP = GAPB$$

Where OAP is the old-age pension, EP is the early pensions, SP is the survivor's pension, and DP is the disability pensions. Private pensions, statutory or occupational, are not included.

We will compare the calculated benefit ratio for Macedonia for 2007 and 2060, with the results for the selected CEE countries.

Then we will elaborate the pension income adequacy by examining how pension reforms have changed the structure of pension systems across EU countries. This impact of pension reforms results are derived from the simulations of pension income entitlements for future retirees, undertaken by OECD in 2009. For these calculations, we use the APEX (Analysis of Pension Entitlements across Countries) model infrastructure of the Organization for Economic Co-operation and Development (OECD). Axia Economics originally developed the APEX (Analysis of Pension Entitlements across countries) model, with the help of funding from the OECD and the World Bank. The model codes detailed eligibility and benefit rules for mandatory pension schemes based on available public information that has been verified by country contacts. It provides most of the results reviewed in OECD's biennial Pensions at a Glance publication (OECD, 2005; OECD, 2007; OECD, 2009; and Whitehouse, 2007). To analyze the impact of the pension reforms on the structure of future pension systems, we will calculate the changes in the 'Net Replacement Rate' before and after the pension reform for low, average (basic scenario) and above average workers' wage.

Calculation of Net Replacement Rate is:

$$\frac{NP}{NARW} = NRR$$

Where NP is the Net Pension (gross pension, tax deducted), and NAW is the Net Average Real Wage calculated for 40 years.

NRR will be calculated using the case of a male worker who entered into employment during 2006 and will retire in 2046 and spent his full career working (40 years) in Macedonia, and then will be compared with those for the selected CEE countries.

Last but not the least; we will focus on the changes in the entitlement of public pension income during the period 2006-2046. The indicator in use is the 'Theoretical Replacement Rate' (TRR), as provided by the Indicators Sub-Group of the EU's Social Protection Committee (an ISG indicator). The Indicator Sub-Group (ISG) of the Social Protection Committee (SPC) has defined a set of common adequacy indicators within the realm of the Open Method of Coordination in order to monitor the progress towards the agreed streamlined objectives in the field of pensions. Theoretical Replacement Rate calculation in the base scenario is meant for a hypothetical person (male) employed in 2006, with a full working life (40 contribution years), retiring at 64, and accumulating pension rights under the new mandatory pension scheme and divided by the projected wage in the immediate previous period (2045). We will compare this ratio with the theoretical ratio in 2006 for someone employed for the first time in 1966 and accumulating pension rights only under the PAYG system. It measures how reformed pension systems change future pension entitlements and it covers mandatory public and private pension schemes. We will compare the obtained TRR results with those of the selected CEE Countries.

Theoretical replacement rates, as stated in the EU Report for 2009, provide the possibility to look at individual case studies and evaluate to what extent current and future pension systems ensure adequate pensioners living standards. Furthermore, theoretical replacement rates provide different information than those obtained through the projection exercise of the Ageing Working Group (AWG) Economic Policy Committee. Their calculations of benefit ratios and replacement rates, project future benefits using assumptions such as the increases in women's participation, whereas

theoretical replacement rates allow the possibility to study the singular effect of reformed pension rules on the adequacy of pension income (ISG Report, 2009). Borella and Fornero (2009) propose the use of a comprehensive replacement rate (CORE) for comparing the ability of different pension systems to enable individuals to maintain their living standards when retired, using the (CeRP) SAM simulation model (Ferraresi & Monticone, 2009).

For the performance of the tasks defined within this model, several government institutions' data will be used: Bureau of Statistics for the gross and net wage, nominal and real growth rate; Agency for Pension and Disability Insurance that administrates the Pay-as-you-go pillar for the replacement rates actuarial calculation and formulas for calculating the gross wage; Agency for Supervision of Fully Funded Pension Insurance that supervises the mandatory and voluntary fully funded (second and third) pillar for the data regarding the contribution percentage, entry fee, management fee and the rate of return for the two private pension funds.

The data for the Benefit ratios, Net and Theoretical Replacement Rates for the period/years previously stated in the model for the selected CEE Countries in this paper are taken from the 2009 OECD Report. In calculation, they use the following assumptions: inflation rate (2%), annuity interest rate (1.7%), real rate of return (2.5%) net of administrative charges and taxes, and real earnings growth ranging from 1.2% to 2.8% for different OECD Countries.

Different models of the main schemes for private-sector employees exist for each country. It is assumed that all income during retirement that comes from the pension schemes are included in the calculations. Statutory pensions include classical pay-as-you-go schemes (Defined-benefit (DB) or Notional defined contribution (NDC)), and the mandatory Defined-contribution (DC) funded tier of the statutory scheme are existing in some Member States (e.g. BU, EE, LT, LV, HU, PL, RO, SK and SE).

Methodology

We only take the PAYG system into consideration when calculating the pension benefits for employees remaining in the first pillar and for those entering the reformed pension system both mandatory pension schemes (PAYG and fully funded pension system) are used. In this research, we neglected the voluntary pension system for the insignificant role in providing retirement incomes in Macedonia.

- a) In order to calculate the Benefit ratio for 2060 the actuarial projection for the old-age, early pensions, survivors, and disability pensions will be used (FPID Report, 2010), and then this ratio will be compared with the one for 2007 which is the first year of the reformed pension system in Macedonia. We will also conduct a comparative analysis with the available data for the Benefit Ratios already calculated in the OECD 2009 Report for the selected CEE countries.
- b) In order to compare those employees who stayed in the pay-as-you-go system and those who enter the reformed pension system for the period 2006-2046, we use the calculations for the Net Replacement Rate. Net Replacement Rate will be calculated as:

$$NRR = \frac{NP}{NW}$$

Where, NP is the net pension (pension, tax deducted), and NW is the net wage (gross wage minus contributions, tax deductions and taxes).

For those who stayed in the PAYG system, according to the current legislated policy solutions – the Law on Pension Insurance and Disability, pension replacement rate is 72% in 2046 (we use only this scenario in the comparative analysis because the same replacement rate is valid for different levels of earnings). We will adjust this replacement rate by the tax rate of 10% (the flat tax rate in Macedonia). For those who enter the reformed pension system NRR will be calculated as a sum of the replacement rate in the first pillar (maximum 30% for contributing 40 years minus tax rate of 10%), and the replacement rate in the second pillar (mandatory pension schemes). Calculation of the replacement rate for the second pillar is according to the following methodology:

We use wage real growth rate of 2.01% for the period 2006-2046 calculated as an average rate for the period 2000 – 2006. The real rate of return of 2.25% in the second pillar we calculate as an average nominal rate of return gained by the two private pension funds, for the entire operating period (2006 – 2011), and adjusted for the average inflation rate of 2.15% in Macedonia for the period 2002 – 2011. The pension funds during this period have been investing mainly in the local government bonds and bank deposits. Appendix No. 1 shows the detailed structure of the pension funds investments. For the calculations of the contribution fee, entry fee, management fee and tax rate, we use

currently legislated reforms policy solutions. The total pension contribution fee is 18% of the gross wage, where 65% remains in the first pillar and 35% goes to the second pillar (or 6.3% from the gross wage). The entry fee is 4% and the management fee calculated on yearly basis for the accumulated assets is 0.6%. We use monthly data when computing in our model. Macedonian pension funds' fees are among the highest in the selected CEE countries: Poland 7% (3.5% by 2014), Hungary 4.5%, Slovakia 1% and Bulgaria 5%. Taking into consideration that the entry fee is 4% and the real rate of return is only 2.25% for the operating period, the main concern of all involved parties should be to decrease the entry fee and increase the rate of return.

For the basic scenario (average earnings), we use the official published average gross and net wage for 2006. For the calculations of the gross wage in the low and above average wage scenario, we will use 2006 policy solutions:

$$NW - TD = PTW$$

Where the NW is the average Net wage for 2006 of 13.490 MKD, TD is the tax deduction and for 2006 is a constant of 2.966 MKD, and PTW is the Pre Tax Wage.

$$NW + PTW * PTI / (100\% - PTI) = GW I$$

Where PTI is Personal Tax Income for 2006 of 15%, and GW I is Gross Wage I.

$$GW I * 100 / (100\% - PI - HI - E) = GW II$$

Where PI is the percentage contribution for pension insurance of 21.2% for 2006, HI is the percentage contribution for Health Insurance of 9.2% for 2006, E is the percentage contribution for Employment of 1.6% for 2006, and GW II is the Gross Wage that according to the calculation is 22.950 MKD.

For a Net Wage of 6.745 MKD (50% of the average net wage) calculated Gross Wage is 10.900 MKD, and for the Net wage of 20.235 MKD (150% of the average net wage) calculated Gross Wage is 34.239 MKD.

From the collected contribution of 6.3% from the monthly gross wage, private pension funds charge 4% entry fee, as stated before. For capitalization of the accumulated assets, we use the monthly real rate of return of 0.1875% (2.25% annually), and 0.05% (0.6% annually) - the charge of monthly management fee. The calculations are made on a monthly basis for the period of 40 years, and the accumulated assets are transformed into monthly pension annuities using the monthly interest rate of 0.14167% (1.7% annually) and 191 month (15.91 years - the life expectancy of a man at the age of retirement). The Net Replacement Rate is calculated as a ratio between the monthly net pension (monthly pension annuity minus the tax of 10%) and the monthly average net wage for the period 2006-2046 (as given in the formula above).

We will then perform comparative analysis on the available data for the Net Replacement Rates already calculated in 2009 OECD Report for the selected CEE countries.

- c) For the current Theoretical Replacement Rate i.e. TRR for the period 1966-2006, we will use legislated policy solutions for the period before 2006. According to article 33 from the Law on Pension Insurance and Disability, for the current employees/pensioners in the first pillar of the Pension system, the replacement rate is 80%, and will be reducing in the next forty years to 72%. For the prospective TRR for the period 2006 - 2046, we will use calculations performed for the NRR for the same period.

We will complete the comparative analysis, using data for the TRR in 2009 OECD Report for the selected CEE countries.

Discussion of Results

As previously mentioned in the Model and Data section, the issue of pension system sustainability and pension income adequacy in Macedonian has not been the subject of foreign, nor domestic research studies. Thus, this paper focuses on the current and future pensions and the replacement rates, analyzing different scenarios: workers who remain in the pay-as-you-go system and workers who enter the reformed system, with low, average and above average earnings. The results from the calculated and compared indexes are as follows:

1. Benefit Ratio, that measures the evolution of pension expenditures per pensioner in relation to the wage per worker in Macedonia:

Table No. 1 Macedonian Pension System Benefit Ratios (2007 – 2060)

Year	Benefit Ratio (In %)	Change to base scenario (In %)
2007	50,50	/
2060	41,08	-19 %

Source: Report on Macedonian Pension System with actuarial projections
p. 38

Changes in the Benefit Ratio for the selected CEE countries:

Table No. 2 Selected CEE Countries Benefit Ratios (2007 - 2060)

Country	Benefit Ratio (in %)		
	2007	2060	Change
Poland	56,2	25,8	-54%
Hungary	38,9	35,8	-8%
Slovakia	45,2	33,1	-27%
Bulgaria	44,4	35,6	-20%

Source: 2009 Ageing Report p. 289 by EU Commission

The Benefit Ratio is declining in all examined countries showing a decrease of the public pensions in relation to the wages. It is a result of reformed measures for providing long-term financial sustainability of a public system. These results will lead to relatively increased poverty of older people in the future, which will require government help in a form of a social assistance. In the reformed pension systems in all countries elaborated in this paper, expenditures from the public pillar will be lower in the future. This is quite strong in Poland (-54%) and Slovakia (-27%), moderate in Macedonia (-19%) and Bulgaria (-20%), and low in Hungary (only -8%). The question that arises is will the mandatory private pillar balance the decline in the public pillar. According to the findings in this

paper, mandatory private pension schemes except for Poland should offset the shortfall in the public pillar. If Poland does not take policy measures to improve the adequacy future retirees will be poorer.

2. Net Replacement Rate as previously stated, measures the impact of pension reforms to the structure of future pension system, for low, average and above average workers wage. As a ratio between the net pension (pension, tax deducted), and the net average wage calculated for 40 years, this paper provides the following results:

Table No. 3 Macedonian Pension System Net Replacement Rates (2006 - 2046)

Scenario	Net Replacement Rate (in %)	Change in %
Only Pay-as-you-go	64.8 (100% from PAYG)	/
Reformed system 50% net average wage	61.2 (max 30% points from PAYG)	-5.6%
Reformed system net average wage	63.0 (max 30% points from PAYG)	-2.7%
Reformed system 150% net average wage	62.8 (max 30% points from PAYG)	-3.1%

Source: Law on pension insurance and disability (for the PAYG) and Authors own calculations (for the other three scenarios)

We compare the results for the Macedonian Pension System NRR's with those of the selected CEE countries:

Table No. 4 Selected CEE Countries Net Replacement Rates (2006 - 2046)

Scenario	Only Pay-as-you-go			Reformed system			Change (in %)		
	50%	Aver. Wage	150%	50%	Aver. Wage	150%	50%	Aver. Wage	150%
Poland	97.1	76.9	69.7	74.4	74.9	75	-23	-3	8
Hungary	85.9	83.2	79.1	94.3	105.5	99.2	10	27	25
Slovakia	76.4	75.9	52.2	66.3	72.7	74.9	-13	-4	43

Source: Pension at a glance 2009 OECD Report p. 80

Net Replacement Rates can be helpful when analyzing the redistributive aspects of the pension system. Elaborated countries in this paper, according to the calculated results, are countries that strengthening links between contribution and benefits, i.e. pensions in retirement and earnings during employment (OECD, 2009). This means that in those countries the system is rather fair than redistributive, which make concerns regarding the adequacy of future pensions, especially for low earners. In other words, the system is stimulating the employers and employees to declare and pay maximum contributions according to the job position, sector and industry. In Poland, there is a big decline in the pensions for low earners of -23%, fall of only 3% for average earners and 8% rise for high earners. For Slovakia and Hungary, the change is even more significant. Low earners assume a difference of -13% and +10% respectively, while the above average earners expect +43% and +25% respectively. Macedonia tends to make across-the-board cuts in pensions, highest for the low earners -5.6%, -3.1% for above the average earners and only -2.8% for average earners. This system solution, of close NRR's, and small but still decreasing NRR's can be anticipated as a policy for providing future equality between different earners (at least in rational numbers) and providing system financial sustainability.

3. The changes expected in the average first pension as a proportion of the average wage or so called Theoretical Replacement Rate, are given in the table below:

Table No. 5 Macedonian Pension System Theoretical Replacement Rates (2006–2046)

Scenario	Period	Theoretical Replacement Rates	Δ (in % points)
Pay-as-you-go	1966 – 2006	72.0 (max)	/
Reformed system	2006 – 2046	51.8	-19,2 % points

Source: Authors own calculations

We compare the results for the Macedonian Pension System TRR's with those for the selected CEE countries:

Table No. 6 Selected CEE Countries Theoretical Replacement Rates (2006 – 2046)

Scenario	Change in TRR in % point (2006 – 2046)
Poland	-19 % points
Hungary	+5 % points
Slovakia	+2 % points
Bulgaria	+15 % points

Source: The 2009 Indicator Sub-Group (ISG) of the Social Protection Committee (SPC) Report p. 17.

This is another indicator used in the analysis of the adequacy of pension benefits to future retirees – expected changes in the average first pension received as a proportion of the average wage. Results indicate that for Poland and Macedonia the TRR is projected to decline over the coming period almost the same (-19% points), Hungary and Slovakia will not changed significantly (+5% points; -5% points), while the TRR in Bulgaria suggest immense increase of 15% points.

Conclusions and Recommendations

In the past several years as a response to the global financial crisis, the CEE countries started remodeling the previously reformed private pension systems with an effort to decrease the fiscal deficits.

The initial pension reform implementation made expectations for significant benefits such as increased labor participation, higher saving rates and faster capital market development. However, these benefits are not visible for the time being. The long-term projections show that the reduced relative levels of public pensions will affect the future sustainability of the pension system. The current analysis of the adequacy of the pension benefits shows that the ratio between the average public pension benefits and the wages in the selected CEE countries is higher than it will be in the future. This

implies that the future pensioners will experience a relative deterioration in living standards vis-à-vis the working force, unless their average working life is prolonged.

All these assumptions lead to one general conclusion that the pension system structure needs reevaluation in order to find the optimal structure, taking into account demographics, labor market and socio-economic developments. Calculated reduction in the replacement rates in this paper shows that the reform is not going to create adequate pension benefits. The actual situation of the labor market is changed (temporary and part-time jobs, self-employment) and makes it difficult to complete the lifetime employment that needs to be fulfilled for adequate retirement incomes. Not to forget that calculations for the replacement rates are for a full career employee and still they are not adequate. Therefore, there is a need for additional savings funds apart from the state pensions in order to sustain the current quality level of living when people retire. The government and the regulatory bodies should work together to improve financial education and change behavior towards longer working life and savings to generate greater retirement income.

The comparative analysis indicates relative variation within the selected CEE countries in providing adequate pension benefits and pension system sustainability. Moreover, the similar pension systems' history and the ongoing global financial crises consequences make it difficult to find proper solutions for the problems within the pension systems in each country. In order to avoid any social imbalance and fiscal distortions policy makers should maintain balance between the adequacy of the future pension benefits and the pension system sustainability. According to its pension system characteristics, each country should use the best of the scientific and empirical experience to continue with the reforms towards the realization of the previously mentioned goals.

Since 2006 (the beginning of the three pillars pension system) Macedonia started facing fiscal problems in terms of covering the public pension expenses, due to the decreased level of total pension contributions collected in the state pension fund. Even though these measures endanger the fiscal stability in the short term, it seems the only reasonable path towards long-term pension system sustainability. The changes in the economic and demographic factors in the future will provoke extended fiscal problems, if none of the reforms are implemented.

Policy makers' main concern in the future should be to increase the employment. In doing so, policy makers should not motivate early retirement. Although it creates opportunities for new employment, higher expenses will burden the pension system even more.

Despite the previous increase of the retirement age limits, any further extensions will not favor towards decreasing unemployment. However, following the other European countries' experience, where the retirement age is increasing taking into account the extended life expectancy, we recommend the same for Macedonia in the near future.

The final asset balance for the pension benefit depends on the contributions flow, the administrative fees and the rate of return. Therefore increased contributions, reduced pension funds administrative fees, and an increased rate of return will lead towards lower costs and pensions that are more adequate.

We used different variables for determining the ratios, such as the inflation rate, contribution fee, entry fee, management fee and the rate of return. However, different results may occur in a scenario where other estimated values are used. It is important to say that we used real data to determine the variables, although they refer only to a short time period of the private pension fund's operation.

This research can be extended and updated, and used for measuring the specific implication in the future pension system's modification, or can be used as an useful guidance to pension related issues for the policy makers.

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Tables

Table No. 1 Macedonian Pension System Benefit Ratios (2007 – 2060)

Table No. 2 Selected CEE Countries Benefit Ratios (2007 – 2060)

Table No. 3 Macedonian Pension System Net Replacement Rates (2006 – 2046)

Table No. 4 Selected CEE Countries Net Replacement Rates (2006-2046)

Table No. 5 Macedonian Pension System Theoretical Replacement Rates

Table No. 6 Selected CEE Countries Theoretical Replacement Rates

Appendix No. 1

Year	2006	2007	2008	2009	2010	2011
ASSET CLASS*						
Shares of domestic issuers	3.8	18.9	7.1	4.8	3.2	3.5
Bonds of domestic issuers	72.4	59.8	44.2	57.5	53.7	61.7
Short term domestic assets	6.9	0.0	3.8	0.0	0.2	0.0
Bank deposits (domestic)	16.9	18.5	41.9	35.1	31.6	18.6
Cash	0.0	0.0	0.5	0.8	0.3	0.3
Shares of foreign issuers	0.0	2.7	1.7	1.1	2.1	2.6
Bonds of foreign issuers	0.0	0.0	0.0	0.0	3.0	0.0
Foreign investment funds	0.0	0.2	0.4	0.3	5.9	13.3

The Impact of the Accession of Macedonia in the EU on the Banking System

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Abstract

The aim of this paper is to examine the impact of the accession of Macedonia in the EU on the banking system. EU enlargement is a complex process with enormous impact on the economy of the new member countries. The financial system of the new member country, and the banking system as part of it, faces the challenge of integration in the EU financial system. The best evidence of the EU accession impact on the banking system is the analysis of the basic characteristics of banking systems of the countries that have become members in the last 20 years. The future banking development in the new EU member countries will very likely follow some main patterns known from the old EU members. In a way, banks from candidate countries can see their own future by observing the current developments in the Western European banking. The process of restructuring in the banking system through consolidation which has led to increased concentration has been one of the main drivers of changes. The existence of this process in new EU countries will be examined together with the structure of the Macedonian banking system. It is important to examine whether significant efficiency improvements have been achieved in the banking systems of the new EU countries and if they are a result of the bigger market power or some other factor. Also, there have been changes in the funding sources of the banks from the new EU countries with a lot of potentials for alternative funding. The financial crises has made these potentials evaporate, but on the long-term horizon, those opportunities will appear again. The low level of financial intermediation in new EU countries leaves space for increasing the range of financial services and their scope.

Keywords: European Union, banking sector, financial system, new member countries, funding, financial intermediation

Introduction

The process of enlargement of the European Union (hereinafter: EU) is a complex one with a strong impact on the economy of the country that will access it. Stable financial markets are key to successful and sound economic development. Their development depends on a stable economic environment and vice versa, financial stability is, in turn, a precondition for sustained economic growth and an efficient monetary policy. Therefore, the role of the financial markets in the process of convergence is of great importance. Only a solid financial sector can create stable framework conditions for economic growth.

One way of predicting the impact of EU accession on a banking system of a country is the idea that possible forthcoming developments in the banking system are to a large extent determined by the developments in banking sectors of the "old" EU members (Ribnikar & Kosak, 2006, p.2). In a way, the banks from candidate countries can predict their future transformation by observing the current developments in Western European banking. This paper will analyze the impact of the accession to the EU of the new EU countries on the banking system according to the process of consolidation of the EU banking system, the level of concentration and the level of financial intermediation. Then, based on the characteristics of the Macedonian banking system the possible effects could occur to the Macedonian banks are analyzed and there will be given the answer to the question if the Macedonian accession to the EU will improve the efficiency of the banking system.

Concentration in the Banking Sector in EU

The European banking system is in a continuous process of consolidation. The consolidation in the banking industry starting from the nineties was a global phenomenon (Ribnikar & Kosak, 2006, p.2). The number of financial institutions was decreased through mergers and acquisitions. Prior to the establishment of the euro, both the suppliers and users of financial services undertaking cross border activities faced risks and costs associated with national currencies (Ekkayokkaya, Holmes, & Paudyal, 2005, p 17). As such, competition in the bank M&A market was limited. The introduction of the euro saw the withdrawal of national currencies and, hence,

the removal of this key element of risks and costs. Thus, with the introduction of the single currency, cross-border activity became more attractive and competition within national markets was expected to increase. The key efficiency that determines the M&A in the financial sector lies in the achievement of economy of scales and the opportunity to cut costs by overlapping operations and consolidating back office operations. Despite the enlargement of the euro area through the accession of Greece (2001), Slovenia (2007), Cyprus and Malta (both 2008), Slovakia (2009) and Estonia (2011), the number of monetary financial institutions (MFIs, 2011) in the euro area has decreased by 20.2% or 1,991 institutions since January 1, 1999 (Figure 1). On January 1, 2011 Germany and France accounted for 40.8% of all euro area MFIs, a share similar to that recorded on January 1, 2010. On January 1, 2011 there were 9,921 MFIs resident in the EU, a net decrease of 271 units (-2.7%) since January 1, 2010. Compared with the situation on January 1, 1999 (10,909 MFIs in the EU), there has been a net decrease of 988 units (-9.1%), despite the addition of 1,608 MFIs on May 1, 2004, when ten new Member States acceded, and of a further 72 MFIs on 1 January 2007, when Bulgaria and Romania joined the EU.

Figure 1

Number of MFIs in EU / Euro area in the Period 1999-2011

Source: European Central Bank. (2011), MFI statistics 2011, ECB, Frankfurt

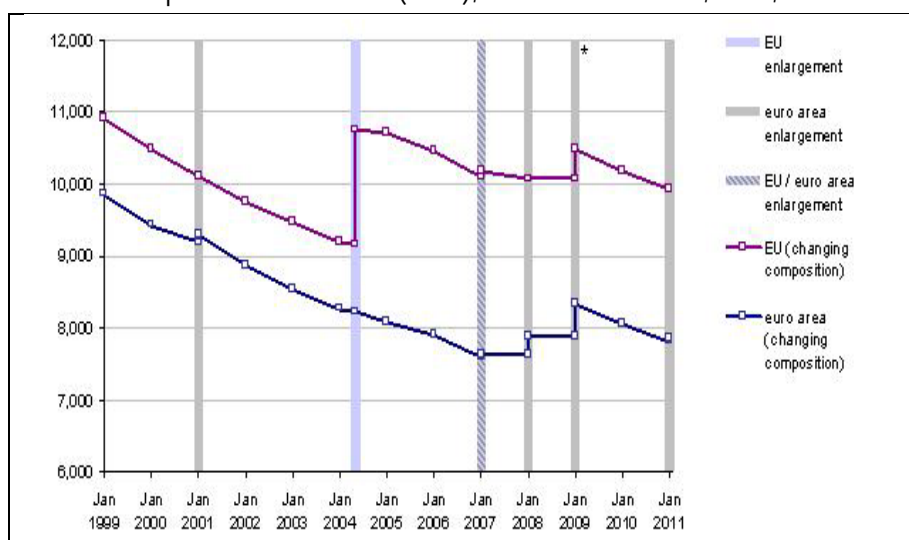
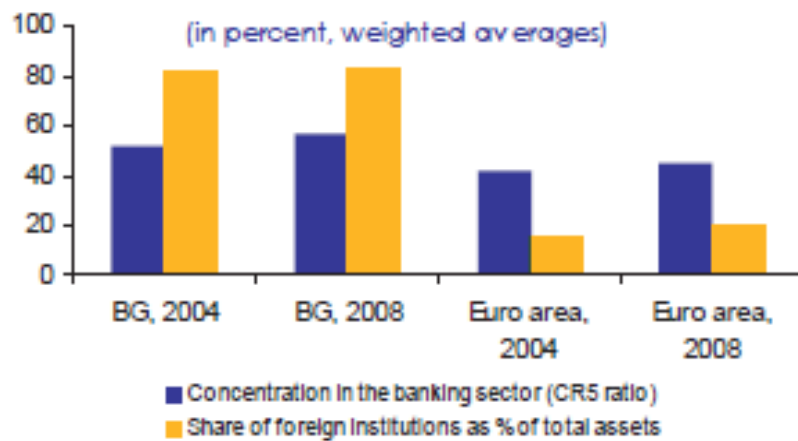


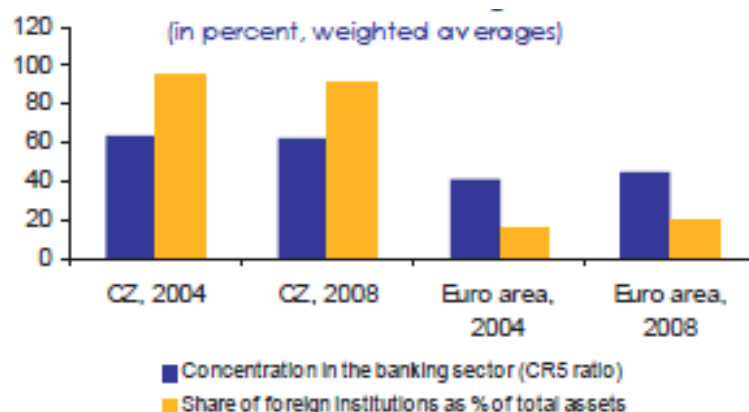
Figure 2

Concentration and Share of Foreign Institutions in the Banking Sector of Bulgaria, Romania and Czech Republic

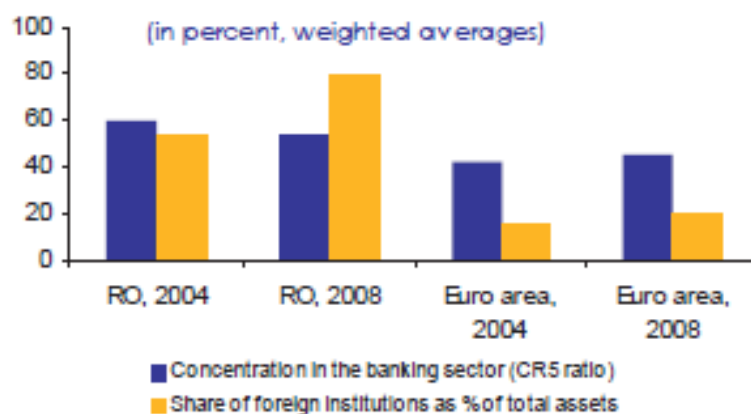


Source: ECB, Structural indicators for the EU banking sector, January 2010.

What is important is that 78% of the total M&A are done by institutions from the same country (Campa & Hernando, 2005, p.9). Over the last decade there has been no evidence of significant cross border deals in the EU suggesting that banks have preferred to consolidate their market position within the national borders. Certainly, this tendency has had its implications on the concentration in the banking sector. From 1997 to 2003 the banking sector experienced a 23% reduction in the number of banks operating in the EU which led to a moderate increase of the concentration on the European level. In Spain the level of concentration (C5) increased from 32% to 44%, in France from 40% to 47%, in Germany from 17 to 22%, and in Italy from 25% to 27% (Campa & Hernando, 2005, p.12).



Source: ECB, Structural indicators for the EU banking sector, January 2010.



Source: ECB, Structural indicators for the EU banking sector, January 2010.

According to Charles Movit the concentration in "new" EU countries (countries that became members in 2004) before their accession to the EU was higher than in the above-mentioned EU countries. (CR5 in Czech, Bulgaria and Romania in 2004 was higher than 60%) This is why accession to the EU didn't have a great impact on the concentration level. The other reason is that in the process of privatization European banks have already bought significant parts of their banking systems. So with their accession they already had a significant market share. The comparison between CR5 in 2004, when these countries became member states, and 2010 shows almost

the same level of concentration (Figure 2). The level of concentration can only be changed by the consolidation at a global and European level. Because a dominant part of the banking sector is owned by foreign institutions, possible changes in consolidation of the parent company can have an influence on the concentration in these countries.

Level of Financial Intermediation in EU

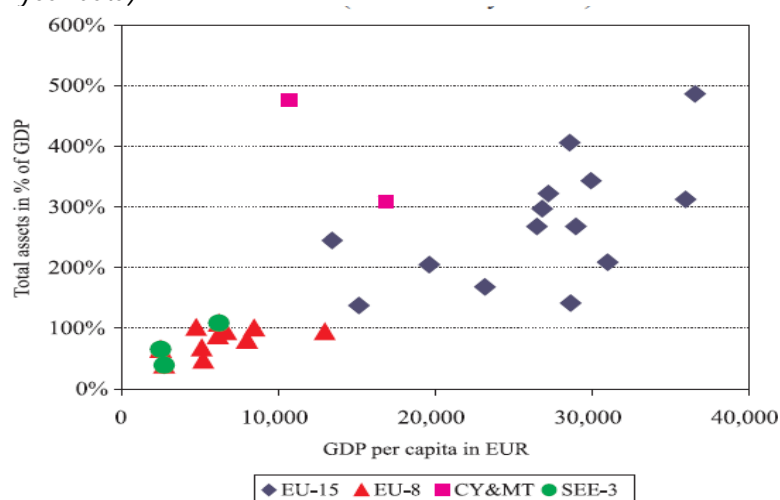
Financial intermediaries have an important role in spurring growth (Bagehot, p.873; Schumpeter, 1912). The empirical studies show that "there is positive relationship between financial intermediation and growth, which show that financial development is a good predictor of future growth" (King & Levine, 1993, p.20). These studies confirm the existence of a strong, positive contribution of the exogenous component of financial development to economic growth.

The level of financial intermediation can be measured with different indicators, and the proportion of total banking assets in GDP is considered the basic indicator. There is significant variation of this indicator in the 27 EU countries (Ribnikar & Kosak, 2006, p.3). Banking systems in the "old" EU countries with average total assets to GDP value of 272% clearly dominate new member states with 84%. According to Ribnikar and Kosak the explanation of these differences lies in the differences of the degree of economic development. Comparison between the degree of financial intermediation (total assets to GDP) and the degree of economic development (GDP per capita) of individual countries can confirm this relationship. On average, countries with higher GDP per capita experience higher total assets to GDP ratios. So major movements can not be expected in the level of financial intermediation because GDP per capita can't change overnight, on the contrary these changes can happen only in medium or long term prospects (Figure 3).

The dependence between the level of development and financial intermediation can be confirmed if we analyze this ratio five years after the accession of the new EU countries in the Union. As can be seen from Figure 4 the level of financial intermediation is almost on the same level as from five years ago.

Figure 3

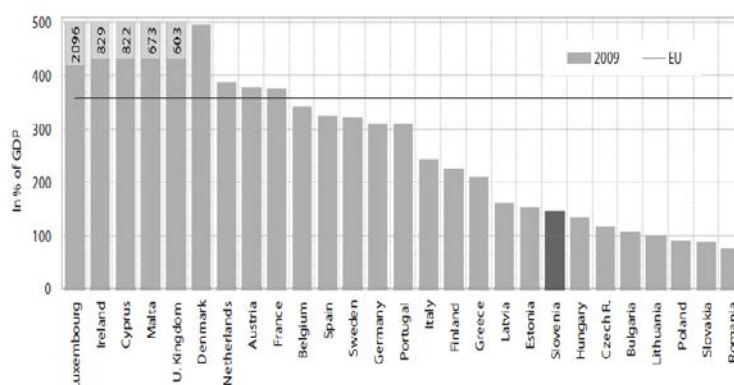
Total Banking Assets in % of GDP (vertical) vs. GDP per capita in EUR (horizontal) for Selected pool of EU member and Candidate Countries (2004 end of year data)



Source: Ribnikar, I. and Kosak, M. (2006). Development prospects of the banking industry in the new EU member countries and forthcoming member countries, Faculty of economics, Rijeka.

Figure 4

Total Assets of Banks in EU member States in 2009, as a % of GDP



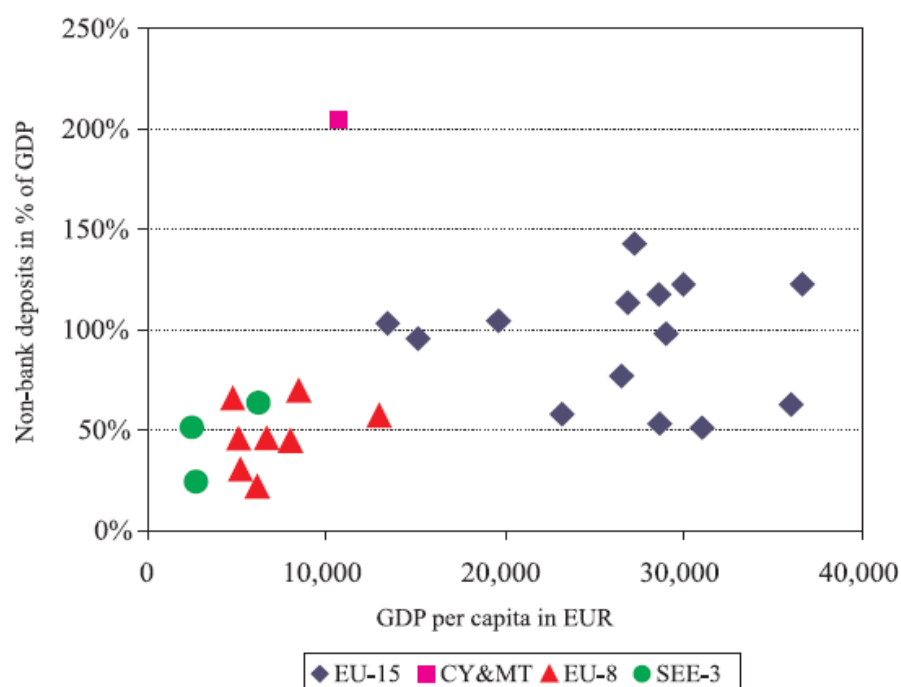
Source: European Central Bank. (2010). Financial stability report. ECB, Frankfurt.

Also higher deposit correlation is associated with higher economic and financial development as measured by GDP per capita, the amount of electricity use, the availability of explicit deposit insurance and better credit environment (World Bank, 2011, p.3). There are smaller differences between the “old” and “new” EU member states in the share of non-bank deposits in the GDP indicator compared to assets/GDP ratio (Figure 5). A pretty much straightforward explanation for the differences between the total assets/GDP indicator and non financial deposits/GDP indicator lies in the development characteristic of the modern financial systems. The market share of the non banking sector is increasingly rising, and those alternative ways of saving are the main force to decrease the share of deposits in total liabilities in the banking sector. Accordingly banks will be forced to switch gradually from predominantly deposit based funding to different types of market based funding, which means that they will need to compete for funds in the market. Low levels of deposits by non-banks (as a percentage of GDP) in the candidate countries for EU accession is “attributable to the low income level and, subsequently, the population’s low disposition to save there are various factors that might explain the low ratio of loans to non-banks to GDP” (Kager, 2002, p. 103):

- Bad loans. The yet unresolved problem of bad loans has inhibited loan expansion and/ or increased the risk aversion of banks.
- Legal and institutional factors. Inadequate collateral/mortgage provisions, insufficient law enforcement and/or slow enforcement of legal titles might also have played a role.
- Structural reasons on the demand side. Additional factors are foreign direct investment (FDI) and multinational enterprises direct financing.

Figure 5

Deposits from Non-bank Depositors in % of GDP (vertical) vs. GDP per capita in EUR (horizontal) for Selected Pool of EU Member and Candidate Countries (2004 data)



Source: Ribnikar, I. and Kosak, M. (2006). Development prospects of the banking industry in the new EU member countries and forthcoming member countries, Faculty of economics, Rijeka

Efficiency of the EU Banking System

In order to see if the accession to the EU has an impact on the efficiency of the banking system, using indicators, a comparison will be made of the efficiency of the banking system before and after entering the EU. For the efficiency of the banking system after entrance into the EU data for 2001 and 2008 will be used (Table 1 and Table 2) to abstract the impact of financial crisis.

According to Kager (2002, p.107) a comparison of the balance sheets of the 25 largest banks in Eastern Europe and of 18 large Western European banks produces a similar picture: Eastern banks profits, expenses and net income are significantly higher than those of comparable Western banks. Eastern European banks lower return on equity (ROE) is chiefly attributable to the fact that their balance sheet equity is many times higher than that of Western banks, i.e. Eastern European banks are less leveraged. Banking sector productivity (as measured by assets per employee) was relatively low in the new EU countries, with Poland reporting the lowest result at EUR 0.65 million. On average, banking sector productivity in the new EU countries in 2001 was EUR 0.93 million compared to an EU- average of EUR 8 million.

Table 1
Bank Profitability in Eastern Europe in 2001

	Return on equity	Interest income	Loan loss provisions	Cost/Income ratio	Net income	Equity	Total assets per employee
	% of average total assets						EUR million
Poland	13.3	4.27	-1.09	63	1.11	8.2	0.653
Hungary	11.6	4.09	-0.58	66.1	1.04	9.4	1.194
Slovak Republic	6.6	3.74	0.66	107.7	0.56	7	1.814
Czech Republic	6.8	2.02	1.43	99.4	0.57	9.5	0.863
Slovenia	6.7	4.19	-1.27	55.3	0.68	9.9	1.413
18 Western European banks	18.6	1.6	0.2	69.5	0.7	3.9	8

Source: Marianne, K. (2002). *The Banking System in the Accession Countries on the Eve of EU Entry*, Bank Austria AG, Bank Austria AG, Vienna

Table 2
Bank Profitability in Eastern Europe in 2008

	Return on equity	Interest income	Cost/Income ratio	Net income	Equity	Total assets per employee
	% of average total assets					EUR million
	% of net assets					
Poland	22.94%	3.21%	60%	1.90%	7.77%	3.88
Hungary	19%	4.60%	42.60%	1.50%	7.68%	2.96
Slovak Republic	13.90%	4.50%	56.10%	0.90%	8.50%	2.95
Czech Republic	21.60%	4.70%	40%	1.16%	7.20%	2.6
Slovenia	16.28%	3.79%	52.72%	1.36%	8.60%	2.86
Macedonia	12.50%	8.10%	62.20%	1.40%	11.50%	0.67

Source: Central banks for sample countries

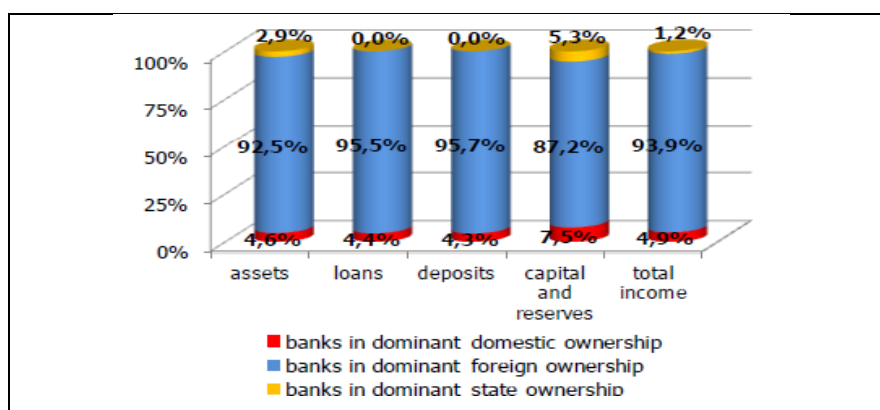
Five years after the accession to EU (Table 2), banking systems of the new EU countries have improved their efficiency. The return on assets has increased and as a result of the increased leverage, the return on equity records multiplying. Banking operations are more efficient and the ratio of assets per employee increased for several times. Certainly, this is tightly connected with the increased lending activity after EU accession. Also the operational efficiency of the analyzed banking sectors has increase and the cost to income ratio in some countries is two times smaller.

Structure of the Banking System in the Republic of Macedonia

The banking system in the Republic of Macedonia at the end of 2011 is comprised of eighteen banks and eight savings houses (National Bank of The Republic of Macedonia, Report, 2011, p. 10) Thirteen of the total numbers of banks have foreign shareholders as dominant owners. Banks with a dominant foreign ownership have above an 87% share in the total capital of the Macedonian banking system and above 92% share in total assets (Figure 6). From the foreign owners, 78% are from EU member countries. This composition of the banking sector has been stable as of 2006.

Figure 6.

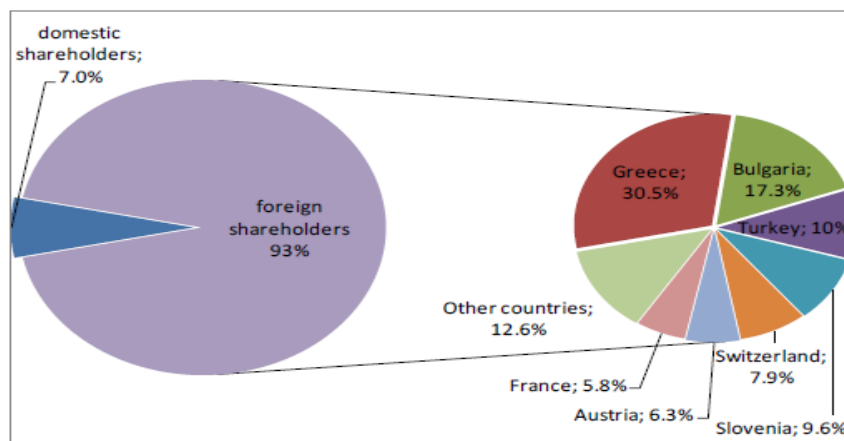
The Structure of the Balance Sheet Positions According the Banks' Ownership on 30.06.2011



Source: National Bank of The Republic of Macedonia, (2011) Report on Banking System of the Republic of Macedonia in the second quarter of 2011, NBRM, Skopje

The analysis of the structure of the banking system by dominant shareholder points to Greece and Slovenia as well as foreign portfolio-investors as owners with a dominant share in the total assets of the banking system in the Republic of Macedonia. Thus EU countries are already dominant owners of the Macedonian banking system (Figure 7).

Figure 7.
Structure of Banks' Capital by Countries on 30.06.2011



Source: National Bank of The Republic of Macedonia, (2011) Report on Banking System of the Republic of Macedonia in the second quarter of 2011, NBRM, Skopje

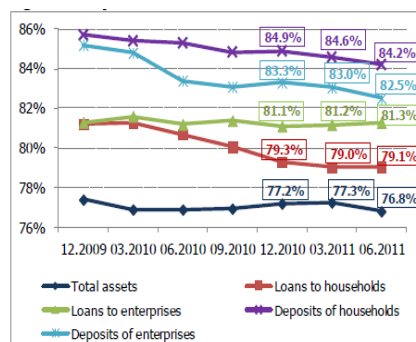
Although Greek banks own more than 30% of the Macedonian banking system, the obligatory limit is exposure to the parent Greek banks to be maximum 10% of the bank capital. Also Macedonian banks don't have investments in Greek securities and the deposits are invested in Macedonian companies and citizens (Bogov, 2011, p.1) which make Macedonian banks resilient from the developments in Greece. The structure of the Banks' assets and liabilities indicates that the Macedonian banks' business model is traditional. The dominant banking activities are collecting deposits and granting loans. On the liabilities side as of December 31, 2011 the deposits of non-financial entities with 70% are a dominant source of financing (NBRM, 2012, p.23). The assets side is dominated by loans on non-financial entities whose share in the total assets is 55%. This kind of structure makes the

Macedonian banking sector resistant to direct influence of the world financial markets that was confirmed during the global financial crisis.

Concentration according to the CR5 ratio is high in all segments of banking activities, being highest in household deposits, and lowest in total assets. There aren't any big movements in the concentration level. The five largest banks as of June 30, 2011 occupy over 75% of all segments of banks' operations. The market share of individual banks is stable. However, in thirteen out of seventeen banks the individual share in the total assets of the banking system is less than 5%, whereas in eleven of them it is below 3%. In contrast, only in three banks the individual share in the total assets of the banking system is greater than 19%.

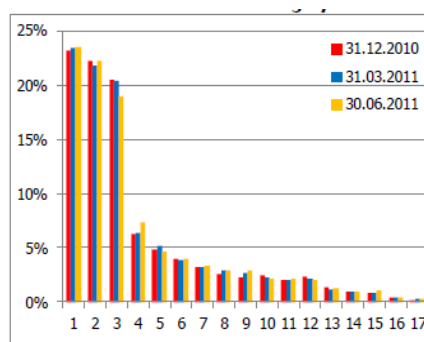
The analysis of the capital adequacy ratio by individual banks (Figure 10) shows that big banks are constrained in their credit growth from their capital. The market distress leads to circumstances where it is difficult to ensure their recapitalization which leaves space for credit growth amidst the smaller banks.

Figure 8.

Dynamics of the CR5 Ratio

Source: NBRM, on the basis of data submitted by banks.

Figure 9.

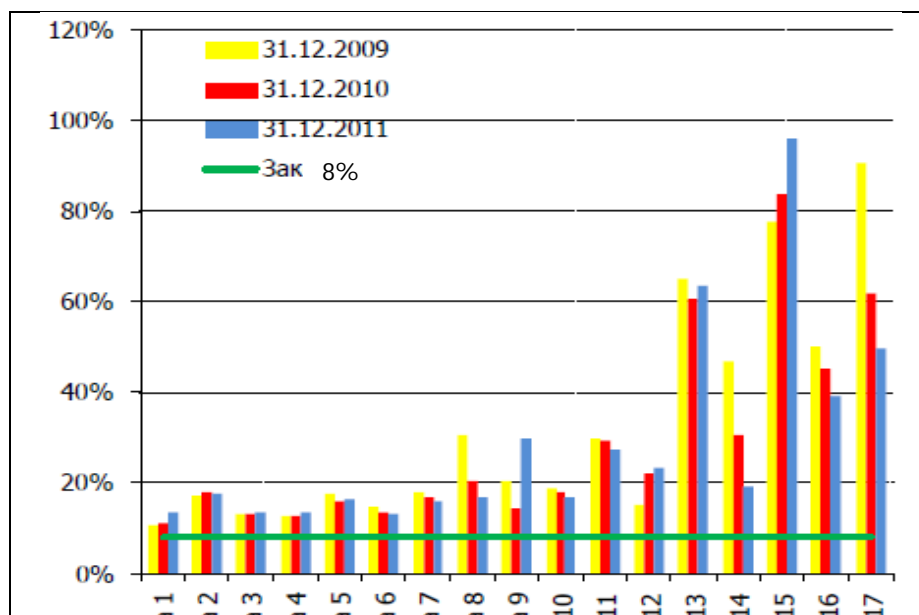
Market Share of Individual Banks in the Total Assets of the Banking System

Source: NBRM, on the basis of data submitted by banks.

Considering the current concentration in the banking system, the EU accession, like in the other east European countries probably won't have an impact on the structure of the banking system. With three main competitors

that hold more than 65% of the market, the biggest three banks are market leaders and there isn't a place for further increase of the concentration. This practically oligopoly structure has a strong influence on the pricing of the banking activities. Considering the current structure of the banking system, a relatively high concentration and relatively large number of banks, there is need for consolidation of the banking system through acquisitions and /or mergers in the segment to other banks and thereby creating larger banks, which will increase the level of competition and contribute to reducing interest rates and spreads.

Figure 10
Capital adequacy ratio by individual bank



Source: National Bank of The Republic of Macedonia, (2012) Report on Banking System of the Republic of Macedonia for 2011, NBRM, Skopje

Level of Financial Intermediation in Macedonia

The banking system has a dominant role in the financial system of the Republic of Macedonia. This is why the impact from accession of the country in the EU on the financial system will be most felt in the banking system. With a 90% share in the total assets of the whole financial system, the banking system has a dominant role in financial intermediation. Until 2008, when the Macedonian economy and the banking sector were influenced by the world financial crises, there was a continual trend of strengthening the role on the banking sector as a financial intermediary.

Table 3

*Structure of Total Assets of the Financial System
of the Republic of Macedonia*

Structure of total assets of the financial system of the Republic of Macedonia						
	2005	2006	2007	2008	2009	2010
Depository financial institutions	90%	90%	91%	90%	90%	90%
Banks	88%	88%	90%	89%	88%	89%
Saving houses	2%	2%	1%	1%	2%	1%
Non depository financial institutions	10%	10%	9%	10%	10%	10%

Source: National Bank of The Republic of Macedonia, (2011) Report on Banking System of the Republic of Macedonia in the second quarter of 2011, NBRM, Skopje

Despite the positive movements, the financial intermediation in the Republic of Macedonia is still on the lowest level relative to some countries from the European Union, the EU average and the Euro zone average (Table 4). This is another confirmation that the level of financial intermediation is

determined by the level of development. According to GDP per capita and the level of financial intermediation, on Figure 10 Macedonia is placed on the bottom. The accession to the EU in medium term won't change the level of financial intermediation, like it didn't have impact on financial intermediation in "new" EU countries.

Table 4

Level of financial intermediation in the banking system of R.M.

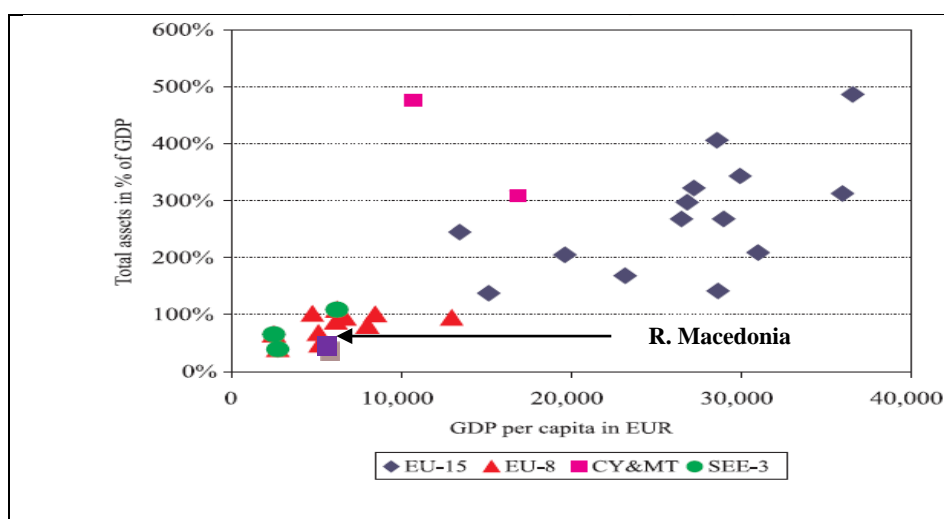
Country	Assets/GDP	Loans/GDP
Romania	75%	43%
Poland	88%	57%
Lithuania	98%	72%
Slovakia	86%	49%
Hungary	136%	79%
Bulgaria	112%	78%
Czech rep.	117%	58%
Slovenia	153%	102%
Estonia	155%	114%
Latvia	161%	70%
Cyprus	822%	341%
Malta	721%	373%
EU	334%	141%
R.Macedonia	72%	44%

Source: National Bank of The Republic of Macedonia, (2011) Report on Banking System of the Republic of Macedonia in the second quarter of 2011, NBRM, Skopje

That trend continued in 2009 and 2010 but with smaller speed. The banking sector has a crucial role in the financial system through channelling on the financial resources to the deficient economic agents.

Figure 10

Total Banking Assets in % of GDP (vertical) vs. GDP per capita in EUR (Horizontal) for Selected Pool of EU Member, Candidate Countries and R.Macedonia



Source: Ribnikar, I. and Kosak, M. (2006). Development prospects of the banking industry in the new EU member countries and forthcoming member countries, Faculty of economics, Rijeka

Efficiency of the Macedonian Banking System

As can be seen in table 2, the efficiency of Macedonian banks is smaller than in new EU countries and far smaller than the EU average. The return on equity is smaller than the EU average which is due to the small leverage and the high adequacy ratio. Also the Macedonian banking sector although it has a higher interest margin, yet the operating efficiency is poorer. The asset per employee ratio is on a 2000 level in Poland or Czech Republic and there is still room for enhancement of the operational efficiency through improvement of this ratio. The operational efficiency can be further improved which will result in a decline of the cost to income ratio.

The banking system is a mirror to the real economy and every recession is imperceptible in the financial world with a certain time lag. Best evidence for the condition in the economy is the level of non performing loans. As can be seen from table 5, if we analyze the NPL to total loans ratio until 2008, accession to EU had an influence on the decrease of this ratio. There are three main reasons: high credit growth, GDP growth and restructured banking system with EU owners. This trend further increased the efficiency of the banking system in "new" EU countries.

If we compare the NPL level in 2008, before the financial crises, the Macedonian banking system has the biggest NPL share from all selected countries. This implies that on that point the Macedonian banking system was less efficient than the banking system of the "new" EU countries. Stated otherwise, from a 1 euro loan the loss on the Macedonian banks was bigger. But, the financial crises also showed that although EU accession of the "new" EU countries had a positive impact on the non performing portfolio, i.e. their banking system is more vulnerable to financial crises. The non performing ratio in almost all "new" EU countries is above the EU average. The conclusion that follows is that as a result of the new funding sources and GDP growth the accession to the EU has an effect on increasing the efficiency of the banking system.

Table 5
Bank Non- Performing Loans to Total Loans

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Euro area	2.6	2.6	3	2.8	2.45	2.25	2.1	1.8	2.5	3.6	5.55
European Union	3.8	2.8	2.9	2.6	2.25	2.1	1.95	1.8	2.7	5.15	6.8
Austria	2.4	2.3	3	3	2.7	2.6	2.7	2.2	2	2.3	
Bulgaria	17.3	3.3	2.6	3.2	2	2.2	2.2	2.1	2.5	6.4	7.8
Czech Republic	29.3	13.7	8.1	4.9	4	3.9	3.7	2.8	2.8	4.6	4.9
Estonia	1	1.3	0.8	0.4	0.3	0.2	0.2	0.4	1.9	5.2	5.6
France	5	5	4.2	4.8	4.2	3.5	3	2.7	2.8	3.6	
Germany	4.7	4.6	5	5.2	4.9	4	3.4	2.6	2.8	3.3	
Greece	12.3	5.6	5.5	7	7	6.3	5.4	4.5	5	7.7	9
Hungary	3	2.7	2.9	2.6	2.7	2.3	2.6	2.3	3	6.7	7.8
Italy	7.8	6.7	6.5	6.7	6.6	5.3	4.9	4.6	4.9	7	
Latvia	4.6	2.8	2	1.4	1.1	0.7	0.5	0.8	3.6	16.4	17.9
Lithuania	11.3	6.7	5.3	2.4	2.2	0.6	1	1	4.6	19.3	19.2
Luxembourg	0.5	0.4	0.4	0.5	0.3	0.2	0.1	0.2	1	1.3	0.5
Macedonia			23.1	22.4	17	15	11.2	7.5	6.8	8.9	9.9
Poland	15.5		21.1	21.2	14.9	11	7.4	5.2	4.5	7.6	
Portugal	2.2	2.1	2.3	2.4	2	1.5	1.3	1.5	2	3.2	3.3
Romania		3.3		8.3	8.1	2.6	2.8	4	6.5	15.3	17.5
Slovak Republic	13.7	11.1	7.9	3.7	2.6	5	3.2	2.5	2.5	5.3	5.8
Slovenia	6.5	7	7	3.7	3	2.5	2.5	1.8	1.8	2.3	2.5
Spain	1.2	0.9	1.1	1	0.8	0.8	0.7	0.9	3.4	5.1	5.5
United Kingdom	2.5	2.6	2.6	2.5	1.9	1	0.9	0.9	1.6	3.5	

Source: World Bank data,
<http://data.worldbank.org/indicator/FB.AST.NPER.ZS>.

As it was mentioned earlier the financial intermediation in the Republic of Macedonia is still on the lowest level relative to EU members if we use Loans to GDP ratio. This also has effects on the efficiency of the whole financial system and the banking system as a part of it. If we use the Deposit/GDP as an indicator for financial intermediation the Macedonian banking sector has a better position than the comparison with Loans to GDP ratio. This is due to more developed other parts of the financial system apart from the banking system which creates possibilities for further development of the non banking financial activities in Macedonia.

Conclusion

The banking system in Macedonia will face many new conditions, requirements and challenges of the EU-market. The competition from banking and non banking financial institutions is expected to increase. This will emphasize the need for innovations among the traditional banking products that banks offer now and creation of new banking products will gradually replace a part of traditional products.

Regarding the process of consolidation that is present in the EU, the level of concentration in the Macedonian banking sector is high. With three main competitors that hold more than 65% of the market, the biggest three banks are market leaders and there isn't place for further increase of the concentration. However, consolidation can be expected of the small and medium banks in order to survive the domestic oligopoly structure and the new foreign competition.

Dramatic changes in the level of financial intermediation can not be expected. This variable depends on the level of economic development and the empirical examples show that the accession to the EU hasn't had an impact on financial intermediation in "new" EU countries. Further improvement can be expected in the efficiency of the banking systems. These two trends will decrease the interest margin and interest rates. Finally, the accession to the EU will require restructuring and reorganization of the economy as a whole, and the banks will be part of that process.

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Understanding Factors of Innovative Thinking in Advertising Agencies: Case of Macedonian, Slovenian and Serbian Advertising Agencies

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Abstract

Increasing pressure for innovations is present in modern business, coping with financial crises, which places higher importance on creativity. Innovation is at the center of the Europe 2020 strategy for growth, and the European Council has recognized the need for urgent action in the field of innovation. And it is not just innovation in production, but especially innovative thinking seen as creativity, that is a priority for each company, institution or at a personal level. Creativity contributes towards higher competitiveness in the globalized market. This paper explores creativity as a fuel for innovativeness in advertising agencies in three countries in the Balkan region. The advertising agencies are tightly connected to creativity since they do not produce creative ideas for themselves, but focus on creative outputs for companies and institutions as their clients. In an attempt to understand the determinant of creativity this paper employs the methodology developed by Grant and Berry (2011). The paper uses a sample of employees from Macedonian, Serbian and Slovenian advertising agencies and explores the creativity and the determinants of creativity as any intrinsic and prosocial motivation. The research results show the level of creativity as judged by the supervisors as well as the employees' thinking about what motivates them. By drawing upon existing literature and the survey results, this paper contributes to understanding of innovative thinking and enhancement of innovative ideas at advertising agencies and companies as their clients.

Keywords: innovative thinking, creativity, advertising theory, intrinsic and prosocial motivation

Introduction

Ever since Schumpeter (1934) presented a very convincing argument, it has been accepted that innovation is a basic ingredient of a dynamic economy. Both experience and research have made it clear that the objectives of the Europe 2020 strategy (2010) will not be achieved if Europe does not become more innovative, not only in its market activities but also in its institutions and public administrations. The Europe 2020 strategy strongly reflects this view and is correspondingly ambitious.

Creativity and innovativeness are very important for companies in today's world with intensive global competition (Cummings & Oldham, 1997). Customers are changed, empowered, much more knowledgeable and ready to search for more information, but at the same time they are bombarded with many different advertising messages. In such a situation the creativity of the advertising message serve as a first and a last frontier for providing a competitive advantage of the brands (Collister, 2007). Namely, creativity in advertising is a very powerful tool for innovative marketing communications. This means that instead of spending a lot of money on bigger advertising campaigns or longer and more frequent campaigns, the results can be achieved by increased creativity in advertising (Dahlen, Rosengren & Torn, 2008). As such it is of great importance for advertising agencies to provide their clients with creative and innovative ideas to help the brands' survival and the growth of the brand and the company itself (Collister, 2007).

The significance of creativity and innovation is recognized in advertising (Dahlen, Rosengren & Torn, 2008; Collister, 2007; Smith & Yang, 2004; White & Smith, 2001). It is accentuated that the creativity has four different aspects: the product or the outcome of creative behavior, the process, the personality and the environmental and cultural influences on behavior (White & Smith, 2001). Smith and Yang (2004) point out that the ad creativity is different than the personal creativity of the members of the creative team. Therefore it is important to study the creativity of team members, and the variables connected with the personal creativity. Much of the research was focused on understanding the creative process and on uncovering how different groups of people, namely advertising professionals and the consumers judge the creative ideas, and very little attention was paid to the individual factors that can contribute to the production of creative and innovative ideas (Collister, 2007; White & Smith, 2001). It is also noted that

creativity is connected to cultural factors and the judgment of the creative ideas is culturally bound (Smith & Yang, 2004). Therefore it might prove beneficial to study creativity in various cultural settings. Since very little research is done in the field of advertising creativity, innovation and understanding the factors of advertising agencies' team members' creativity in South-Eastern Europe, this paper will try to cover these topics using data from advertising agencies operating in three Balkan countries: Macedonia and Serbia, as non EU member countries and Slovenia as an EU member country.

Considering the fact that creativity of the team members is very important for the work and success of advertising agencies, understanding the factors that can promote it and develop it is crucial. Creativity is presented as a designer of innovations (Cummings & Oldham, 1997; Oldham & Cummings, 1996; Scott & Bruce, 1994) and therefore it is important to be researched and defined how to be supported. Several research studies in different fields point to the value of creativity in achieving competitive advantage and also look at different factors that are linked to creativity (Cummings & Oldham, 1997; Oldham & Cummings, 1996). Among the factors studied are personal factors such as problem-solving style and employee personality (Cumming & Oldham, 1997) as well as the job design, organizational and work context including job complexity, supportive and non-controlling supervisors and stimulating co-workers. As a result of the analysis the studies also pointed to the importance of motivation as a factor of creativity although they did not study it directly (Cummings & Oldham, 1997; Oldham & Cummings, 1996). More direct support for the role of motivation in creativity comes from research that examined leadership and employee creativity and leadership styles in different industries (Tierney, Farmer & Graen, 1999) and pointed to the need for appropriate motivation and appropriate job placement to enhance creativity. Further studies in quite different settings found direct support for the link between two types of motivation, namely intrinsic and prosocial motivation in enhancing employees' creativity (Grant & Berry, 2011).

Having in mind the importance of creativity towards innovative advertising communication, we research the motivational factors that influence personal creativity, but are rarely researched. The aim of this paper is to provide understanding of intrinsic and prosocial motivation and different aspects of creativity of advertising professionals in one country from the European Union and in two non-European member countries. The paper will

start by examining the different definitions and aspects of the importance of innovation in the European Union, then it will explore creativity as an important aspect of innovativeness, and we will then move on to uncovering the theoretical connection between the two motivations and creativity which is the aim of the paper. We will then present the results of the current research and provide a conclusion and recommendations at the end of this paper.

Innovativeness, Motivation, and Creativity – An Important Link Need for Innovativeness in Europe

An innovation is defined as an idea or an object that is perceived as new by an individual or an agency (Rogers, 1995). The innovativeness of a new product and firm innovation capability is important for several reasons. Innovative products present opportunities for firms in terms of growth and expansion into new areas as well as allow firms to gain competitive advantage (Ihinmoyan & Akinyele, 2011). Firm innovativeness by definition includes successful implementation of creative ideas, whereas innovation performance is related to entry and penetration into markets with innovative products and gaining market share (Ihinmoyan & Akinyele, 2011; Schumpeter, 1934) that should improve the performance of those companies, which leverage the innovations and, contrarily, will destroy firms with old products and processes. Innovations are ranging from minor changes to existing products, processes, or services to introduction of new breakthrough technologies that introduce first-time features, offer exceptional performance, or change the rules of the game (Dibrell, Craig, & Hansen, 2011).

There was a great interest regarding innovativeness in the last years in the European Agenda. According to the Europe 2020 Flagship Initiative Innovation Union research results (COM, 2010), the United States and Japan continue to lead the EU in innovation performance. The innovation gap of the European Union compared with the USA is -43, and compared with Japan is -41. Meanwhile, countries like China and South Korea are moving from being imitators to leaders in innovation. Their development creates huge market opportunities and new cooperation potential, but also considerable pressure on companies in the European Union. The European Union needs to use these challenges and exploit its huge scientific and innovation potential. Innovation is at the core of the Europe 2020 Strategy agreed by Member States at the June 2010 European Council.

Constant innovation in the paper of de Waal and Morais (2010, p. 333) is presented as "a cushion and defense against a more uncertain world, where an advantage of one brand over another is only temporary", which is stressing the need for innovation, and placing greater importance on creativity at all times. Stressing the creativity and diversity of European people and the strength of European creative industries, European 2020 Flagship Initiative is presenting creativity that offers huge potential for new growth and jobs through innovation (COM, 2010). All of this is presenting the interconnection between innovations and creativity.

Understanding Creativity

Creativity is an originator for innovations and innovative working (Cummings & Oldham, 1997; Oldham & Cummings, 1996; Scott & Bruce, 1994). There are many different definitions and explanations of creativity. However, it is a concept connected to organizational performance and it is perceived as a major aspect enabling organizational success. When looking at creativity in a business context it is quite often used interchangeably with innovativeness (Scott & Bruce, 1994). However, many authors (Collister, 2007; Amabile, 1997; Scott & Bruce, 1994) point out that creativity is linked with the production of novel ideas and innovativeness is linked with the successful implementation of those creative ideas. This paper will therefore focus on the aspect of organizational functioning linked with production of novel ideas, creativity and innovative working in advertising agencies, as a main supportive partner for innovative work of any company. In the definition for creativity from Amabile (1997, p.2) creativity is "focused on appropriate and usable ideas and solutions to problems". In that sense creative behavior is related to a business need to focus on another characteristic idea, implementation and influencing the business workflow (Amabile, 1998). Having original, usable and easy implementable ideas is quite important in advertising as it enables creation of good noticeable advertising campaigns and client satisfaction (Stuhlfaut, 2010; Dahlen, Rosengren & Torn, 2008; Collister, 2007). This is important as in advertising companies creativity is a part of a dynamic process involving a number of people and it is a structured and collaborative team effort guided by organizational culture and the implicit theories about how to produce a creative product (Stuhlfaut, 2011; de Waal & Morais, 2010; Smith & Yang, 2004). Although the appraisal of creativity differs

it was noted that supervisors and managers can serve as a valuable source when judging employees' work creativity because they are monitoring employees work on a daily basis (Tierney, Farmer & Graen, 1999).

The model of the general theory of creativity in advertising developed by Smith and Yang (2004) covers five different perspectives regarding the advertising divergence. It considers the communications process, the management process, the societal process, creativity as a group process and creativity as a personal process. As creativity is a complex process, we are taking into consideration only two perspectives, the societal and the group process from the Smith and Yang theory, in order to research the influential factors of the Balkan creative advertising people, behavior, and creativity. The group process is not much researched, especially for this market, therefore we assess how creative ideas are generated in different team settings, taking into consideration the role of personal and social identity factors. The paper focuses on exploring the personal views on what motivates the employees working in advertising agencies, as well as how their creativity is judged by their supervisors. By doing so it takes into consideration the personal and the social factors.

Amabile (1997) accentuates three aspects that lead to creativity. The first aspect of creativity is expertise which is the cognitive aspect of creativity seen through the pathways used to solve a problem or perform a task. The second aspect are the creative thinking skills linked to cognitive styles that enable taking new perspectives when it comes to looking at problems and having a working style favorable to pursuit of one's work. The third aspect is intrinsic motivation which determines what the person will actually do unlike the previous two that determine the capabilities (Amabile, 1997). The motivation aspect of creativity could be influenced by social and work environment, and therefore it should be deeply understood as it is highly connected to supporting creativity in organizations (Amabile, 1998). This presents the need for deeper understanding of work-related motivation factors.

Intrinsic and Prosocial Motivation and Creativity

Intrinsic motivation expands the individuals desire to learn, explore and engage their creativity (Grant & Berry, 2011). Studying intrinsic motivation in relation to creativity is quite important in advertising agencies where creativity

is a precondition to innovation and success, and motivation is a precondition to creativity (Stuhlfaut, 2011). In essence intrinsic motivation is based on people's need to feel competent and self-determined. As such intrinsic motivation arises in the active engagement with tasks that individuals find interesting and that satisfy the needs for competence and independence (Deci & Ryan, 2000). This is in contrast to extrinsic motivation where the extra-personal factors such as money, rewards, recognition or external threats serve as an initiator of performance (Stuhlfaut, 2010), so it comes from the outside and is far less conducive to creativity but it can serve as a starting point for developing intrinsic motivation (Amabile, 1998). Although intrinsic motivation is a powerful motivator and driver of performance, people need to feel the usefulness of their ideas and focus on how the ideas will benefit others (Grant & Berry, 2011).

The aspect of motivation connected to focusing on others perspective is prosocial motivation. Prosocial motivation can be defined as "a desire to expend effort to benefit other people" (Grant, 2008, p. 49). The prosocial motivation is based on the desire to benefit others unlike the intrinsic motivation that is concerned with enjoyment and interest on a personal level. The prosocial motivation is outcome focused and intrinsic motivation is process focused and prosocial motivation is future focused, whereas the intrinsic motivation has a present focus. As such intrinsic and prosocial motivation work coherently to produce positive organizational outcomes (Grant, 2008). Having in mind that the advertising professionals need to take into consideration the wishes and needs of their clients (Collister, 2007) taking the prosocial motivation into consideration when studying the effects of motivation on creativity is especially important.

Therefore this study applies the model developed by Grant and Berry (2011) in studying the effects of motivation on creativity. The model points to the importance of intrinsic motivation for creativity, but also accentuates the role of prosocial motivation. It states that when the employees are focused on others they will produce ideas that are useful to others. This means that prosocial motivation acts to channel the intrinsic motivation towards producing innovative, novel and useful ideas for others. Therefore the study is aimed at gaining a better insight into the level of intrinsic and prosocial motivation and different creative behaviors of advertising professionals.

Methodology

The current study was conducted with the employees of three different advertising agencies that have offices in a number of countries. For the study the branches in Macedonia, Serbia and Slovenia were used. The total number of employees participating was 31 of which 14 were males and 17 females. In addition their immediate supervisors participated in the appraisal of employee creativity as they are deemed an appropriate source of employees' work creativity. The total number of supervisors that took part in the research was 4. Most of the participants, 48%, worked between 1 and 5 years for the company.

The research was conducted in January and February 2012, using web-based questionnaires. The first step of the research was the employee survey where the employees filled a questionnaire for appraising their intrinsic and prosocial motivation. The second step involved the supervisors and started after the employees finished with their questionnaires, since it has been pointed out that managers and supervisors can judge employee creativity (Tierney, Farmer & Graen, 1999). The supervisors also filled a questionnaire. The questionnaires were administered using the names and surnames of employees to enable matching of the employees' answers and the supervisors' appraisal of their creativity. The questionnaires included an explanation of how the anonymity of the answers was ensured.

The employees filled the intrinsic and prosocial motivation scales developed by Grant (2008). The scale on intrinsic motivation contained four items with a Cronbach Alpha of .90 and the prosocial motivation scale also contained four items with a Cronbach Alpha of .71. Both scales were administered in the same questionnaire with the same opening question: "Why are you motivated to do your work". The intrinsic motivation scale contained items such as: "Because I enjoy the work itself" and the prosocial motivation scale contained items such as: "Because I want to help others through my work". The items were given on a 7 point Likert-type scale ranging from "disagree strongly" to "agree strongly". Higher scores meant higher levels of motivation.

The supervisors filled a creativity appraisal scale developed by Tierney, Farmer and Graen (1999) with a wording adapted to fit the context of advertising agencies. The scale contains nine items on a 7 point scale ranging from "disagree strongly" to "agree strongly" with a Cronbach Alpha of .95.

Supervisors were instructed to appraise how often a certain employee exhibits certain behavior such as: "Found new uses for existing methods and strategies". Higher scores meant a higher degree of creativity.

Results

To begin with we appraised the overall scores on the three scales. The means and standard deviations are given in Table 1. As it can be seen the mean for both intrinsic and prosocial motivation are quite high. However, the intrinsic motivation scores slightly higher than the prosocial motivation. To further explore the two different types of motivation, the results for each question that was asked to employees of advertising agencies in Macedonia, Serbia and Slovenia, trying to define which kind of motivation has a biggest influence on employees' creativity will be presented as well.

Table 1. Means and standard deviation for intrinsic and prosocial motivation.

	Mean	Standard deviation
Intrinsic motivation	5.9113	1.05
Prosocial motivation	5.1371	1.61

Summarizing the answers from thirty one employees working in advertising agencies in three different countries, presented in Table 2 we could notice that employees are evaluating each of these factor on a high level with values above 4.9 in the scale from 1 to 7. It should be noted that a higher mean value has the answer that they "enjoy" with 6.13 and lowest value has that they "care about others" with 4.94, presenting the lower level of prosocial motivation factors compared to intrinsic motivation factors. This is shown also with the fact that the first four questions that are presenting the prosocial motivational factors have a lower mean value from 4.9 to 5.3, and the last four questions have a higher mean values from 5.6 to 6.1 presenting higher influence of intrinsic motivation toward agency employees.

Regarding the answer that they "care about the others"; there are 45 percentages of answers with values 4 and 5, meaning they have average

agreement with this statement. Hence, 29% of employees agree strongly that they “care about others”, showing that there is certain percentage of people with stronger prosocial motivational factors, but less than others with stronger intrinsic motivation.

Table 2. Employees answers on eight questions about different motivational factors

	Mean	Standard deviation
Care about others	4.9	1.7
Help others	5	1.7
Positive impact on others	5.3	1.6
Do good for others	5.2	1.7
Enjoy the work	6.1	1.1
It's fun	5.6	1.3
Work engaging	5.7	1.3
I enjoy	6.1	1.2

Regarding the overall factors for creativity, perceived by supervisors in advertising agencies in three different countries, there is an average perception about the creativity of their employees, presented in table 3, with a mean value of 4.54.

Table 3 Means and standard deviation for creativity

	Mean	Standard deviation
Creativity	4.5412	1.47

According to the answers from the supervisors for their employees (31 employees in advertising agencies from three different countries), summarized in Table 4 with mean and standard deviations for all nine questions, we could conclude that most of the answers are positive with strong agreement of different forms of creativity above 3,97. The highest mean value has the opinion that their employees are generating novel and effective ideas with a mean value of 5, and the lowest opinion that their

employees generate revolutionary ideas with lowest mean value of 3.97. Overall evaluation is that supervisors are having average satisfaction from their employees' creativity. It is interesting to mention that the "role model of creativity" has the highest evaluation, at 22% with respect to the employees, which means that some employees are the best role model of creativity in their agencies or abroad.

Table 4. Supervisors answers on nine questions for their employees

	Mean	Standard deviation
Originality in work	4.8	1.5
Took risk in producing new ideas	4.8	1.6
New uses	4.5	1.8
Solved problems	4.1	1.8
Tried new ideas and approaches	4.8	1.3
Opportunities for new products/ services	4.1	1.8
Novel effective ideas	5	1.4
Role model for creativity	4.5	1.8
Generated revolutionary ideas	3.9	1.8

Conclusion and Recommendations

The aim of this paper was to explore the creativity and intrinsic and prosocial motivation of employees in advertising agencies in the Balkan region. The research is focused on exploring personal creativity of the employees, taking into consideration how the creativity is judged by the supervisors and how employees perceive motivating factors. The research was based on the premises that intrinsic and prosocial motivations are important factors in employee creativity. Since there is a lack of research in the factors determining creativity in the advertising agencies on the Balkans the research utilized three different instruments to understand the levels of intrinsic and prosocial motivation levels of creativity judged by supervisors in three countries from the Balkan peninsula, Macedonia, Serbia and Slovenia. The research is also one of the first in the field of marketing and advertising to

utilize specific instruments in researching creativity and motivation among advertising professionals. The search results do not suggest presence of a specific motivation of advertising agencies' employees. They suggest that the motivation of the employees is quite complex. The results show higher levels of intrinsic motivation dominates those motivated by prosocial motivation. This might suggest that advertising agency managers should try to utilize the intrinsic motivation of their employees for more creative work. It must also be noted that the supervisors need to sustain high levels of intrinsic motivation by allowing freedom, supervisory encouragement and support as well as access to resources to sustain the flow of creative ideas (Amabile, 1998). Although the values of prosocial motivation are slightly lower, it does not mean that this former should be forgotten. On the contrary it is an important motivational factor that should be even more accentuated having in mind that advertising professionals produce creative ideas for the clients.

The sample used in this research was quite small and it was based on convenient sampling. If a different sampling technique was utilized and a bigger sample was used the results might have been different. The second reason for the obtained results might lie in the instrument used in the research. The proposed instruments were never previously used in the field of advertising. This means that the instruments used need more testing to see whether they are appropriate to be used in the field of advertising. Most importantly it needs to be considered how creativity of an advertising professional is measured and whether the supervisor can be used as the only source for the creativity of the employees in advertising agencies. More appropriate measures might include ratings from various sources such as clients and consumers as it can be shown that different people judge creativity differently (Collister, 2007; White & Smith, 2001).

This research shows that more work is needed to understand the factors that influence creativity in advertising agencies. The lessons learnt from such research might prove to be very valuable for managers in advertising agencies since they can help motivate the employees in a manner which will lead to greater creativity and productivity of the employees in advertising agencies and provide benefits for their clients. Continuation of this research, taking into account other important factors, will improve the perception and will be a step towards developing a model for motivation and creativity specially designed for advertising agencies, that will be a novelty in this research field. It is important to understand different motivational factors

towards better creativity of advertising professionals, as creativity is an important factor of innovativeness and innovativeness is a driver of prosperity, business growth and an important issue in the European 2020 Strategy.

Acknowledgment

The authors would like to express their deepest gratitude to the employees of the three advertising agencies that took part in the research and to the intern, who assisted in literature search and data collection.

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EUROPE 2020: TOWARDS INNOVATIVE
AND INCLUSIVE UNION

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