

THE EUROPEAN INTEGRATION OF THE WESTERN BALKANS AND THE EU'S LACK OF COMMITMENT: THE CASE OF THE UNILATERAL EUROIZATION OF MONTENEGRO AND KOSOVO

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Abstract

Saying that the European integration of the Western Balkans is a frustratingly stagnating process is commonplace, given that only Croatia and Slovenia successfully completed the procedure to obtain full EU membership. The reasons why all of the other countries in the region are still lagging behind are multifaceted and complex and, on many occasions, relevant issues are widely unaddressed. The unilateral adoption of the Euro by Montenegro and Kosovo is one of the neglected problems since the fact that Euro is the legal tender in these countries is incompatible with the Maastricht Criteria. There is no intention of denying that Montenegro and Kosovo present other structural problems that hinder their EU accession process. Nevertheless, this research paper aims at pointing out that the European institutions do not seem to be properly tackling the paradoxical situation emerging from the unilateral Euroization of Montenegro and Kosovo. Therefore, lack of regulation is presented as a relevant case in which the lack of commitment of the European Union towards the integration of the Western Balkans is regretfully visible. It can be thus understood that the European Union is largely responsible for the failure of the enlargement process towards the Western Balkans as it has not proven able to provide the countries in the region with the necessary tools for overcoming the obstacles present on the way to European membership. Without a more solid engagement in the Western Balkans' accession process, the European Union clearly fails at establishing itself as a credible international actor.

Keywords: EU integration, Western Balkans, Montenegro, Kosovo, Euroization

1. From Thessaloniki 2003 to Brdo 2021: a neglected aspect of a frustratingly stagnating enlargement process

In June 2003, during the EU-Western Balkan Summit held in Thessaloniki, the EU stated “its unequivocal support to the European perspective of the Western Balkan countries”¹, thus marking the beginning of the path that would have eventually led to the European membership of the countries in the region. Eighteen years later, during the EU-Western Balkan Summit that took place in Brdo in October 2021, the EU reaffirmed “its unequivocal support for the European perspective of the Western Balkans and welcome[d] the commitment of the Western Balkans partners to the

¹ [European Commission. \(2003\) EU-Western Balkans summit – Thessaloniki, 21 June 2003 – declaration.](#)

European perspective”². It is rather striking that on these two occasions the exact same words were used to describe the EU enlargement process towards the Western Balkans, which notably has progressed from 2003 to the present day: while Slovenia and Croatia successfully managed to join the EU in 2004 and 2013 respectively, all of the other countries are still lagging behind. It is thus self-evident that the European integration of the region is not proceeding at the pace it should, even though there is no intention of denying that the EU membership of all the countries in the region would still be desirable and advantageous. It is still true, as it was in 2003, that the EU keeps being the best guarantee for peace, democracy, and prosperity on the continent; a successful process of enlargement would help consolidate democratic institutions and promote better living standards³, and it would be the key driver of transformation in the Western Balkans by acting as an essential tool for fostering reconciliation and stability.⁴

Then why does it not work? What hinders this process of European integration? After the successful enlargement of 2004, the whole process started losing momentum and subsequently entered the phase of enlargement fatigue, led by factors that did not exist at the time of Thessaloniki. From the economic perspective, many countries of the EU were already facing an internal economic crisis when the global financial meltdown hit them. Additionally, the failure of the Constitutional Treaty of 2005 exacerbated the institutional crisis of the EU, which would not recover until the ratification of the Lisbon Treaty in 2009. On that occasion, the general perception was that the EU would start working more efficiently and, having solved the most relevant internal issues, it could actually focus again on the enlargement process⁵. Quite evidently, it did not happen. The most relevant obstacle to overcome is the fact that the EU is showing a serious lack of commitment toward the possible European integration of the Western Balkans: its approach tends to ineffectively transform the need for reform into mere prescriptions that do not demonstrate the right amount of engagement⁶. Another major issue over the last few years has been the influence of bilateral problems among the member states and possible future members: among the many examples that could be mentioned, the recent opposition of Bulgaria to the start of North Macedonia’s EU accession talks stands out⁷. The EU is therefore

² [European Commission. \(2003\) EU-Western Balkans summit – Brdo, 6 October 2021 – declaration.](#)

³ Maas, H., Santos Silva, A., & Logar, A. (2021, June 26). EU Enlargement is a Strategic and Shared Interest. *Balkan Insight*. Retrieved from <https://balkaninsight.com/2021/06/26/eu-enlargement-is-a-strategic-and-shared-interest/>.

⁴ European Commission. (2018) A credible enlargement perspective for and enhanced EU engagement with the Western Balkans, 1-19

⁵ Teokarević, J. (2010). Western Balkans’ EU integration: How to overcome the remaining obstacles? In B., Cerović and M. Uvalić (Ed.). *Western Balkans: Accession to the European Union* (pp. 9-23). Belgrade: Faculty of Economics of the University of Belgrade

⁶ Stratulat, C. (2021, November 8). EU enlargement to the Western Balkans – Three observations. *European Policy Center*. Retrieved from <https://www.epc.eu/en/Publications/EU-enlargement-to-the-Western-Balkans-Three-observations~4392d4>

⁷ *Ibid*,

trapped in a situation in which it keeps claiming the feasibility and desirability of the enlargement process towards the Western Balkans without being able to make actual progress and leaving a relevant amount of crucial aspects unaddressed or unsolved.

This research paper aims at drawing the attention to a widely neglected issue which regards the accession process of Montenegro and Kosovo, namely the fact that their unilateral adoption of the Euro as legal tender in 2002 creates a matter of incompatibility with the Maastricht Criteria for accession and, consequently, an obstacle towards their possible future membership. These criteria (price stability, sound public finances, exchange-rate stability, long-term interest rates) are based on the assumption that a future member of the EU is using its own currency and is then offered the possibility of joining the Eurozone⁸, something that cannot happen in these countries given that they have been using the Euro since its adoption, with the tacit or explicit consent of the European institutions themselves. Although there is no intention of denying that Montenegro and Kosovo present other structural problems that hinder their EU accession process, the following paragraph aims at pointing out that the European institutions do not seem to be properly tackling the paradoxical situation emerging from the unilateral Euroization of Montenegro and Kosovo, thus failing, even in this instance, to support the enlargement process towards the Western Balkans in a credible way.

2. Causes and consequences of the unilateral Euroization of Montenegro and Kosovo

After the disintegration of Yugoslavia, most of the Republics in the Federal system proclaimed their independence from Belgrade, ceased using the Yugoslav Dinar, and adopted a new currency. This scenario did not apply to the former Republic of Montenegro, which remained tied to the former Republic of Serbia and formed the Federal Republic of Yugoslavia (FRY) in 1992. It did not apply to Kosovo either, as it had been a province of Serbia all along and thus naturally became part of the FRY. Within the FRY, the government established a high level of monetary centralization but did not implement sufficient legal boundaries to discipline the financial system. The combination of centralization and lack of regulation created a fertile ground for unbelievable misuses and manipulation and, therefore, the precondition for phenomena like hyperinflation⁹. The situation was additionally affected by the embargos imposed by the UN on the FRY in 1992, as a response to the conflicts that accompanied the dissolution of Yugoslavia. Both the disintegration of the country and the embargo had as an immediate consequence a sharp decline in output, which

⁸ European Commission. Convergence criteria for joining. European Commission - European Commission. Retrieved from https://ec.europa.eu/info/business-economy-euro/euro-area/enlargement-euro-area/convergence-criteria-joining_en.

⁹ Fabris, N. (2015). The History of Money in Montenegro. *Journal Of Central Banking Theory And Practice*, 4(1), 5-1

led to extreme fiscal and monetary expansion, and hyperinflation¹⁰. If one defined hyperinflation in FRY as legendary, that wouldn't be an exaggeration. It lasted for over two years, starting in February 1992, when the level of prices exceeded the 50% increase that conventionally defines hyperinflation, and reached its peak in January 1994, when the monthly inflation rate was 313 million percent. In that same month, the implementation of a stabilization plan finally halted the uncontrolled increase of the inflation rate¹¹. In a situation such as the one depicted above, it becomes easily understandable why both citizens and enterprises started using informally a different currency for daily transactions. As a matter of fact, there is a significant amount of evidence that the German Mark unofficially became both the unit of account and the means of exchange in the entire FRY. The widespread presence of the German Mark in the whole country created the necessary condition that allowed Montenegro and Kosovo to stop using the Yugoslav Dinar and definitively switch to the German Mark¹². It has to be noted though that the hyperinflation was stabilized in 1994, and both countries did not adopt the new currency until 1999. This means that the hyperinflation above described can be considered as the wider, most relevant cause which led to discontent towards the central government and, eventually, to the changeover. In any case, there exist more contextual causes - different for the two countries - which will be brought up in the following sections of this paragraph.

2.1 The case of Montenegro

In the specific case of Montenegro, the centralization of the monetary and financial policies within the FRY had as a consequence the fact that the National Bank of Montenegro lost its autonomy and was downgraded to a regional office of the National Bank of Yugoslavia, whose headquarters were in Belgrade. Given this picture, Podgorica's resentment for having to suffer from the effects of the ineffectiveness of the central decisions becomes comprehensible. Therefore, the Montenegrin government started to look for ways to stop being dependent on the National Bank's decisions. As the German Mark had become throughout the years the most used currency both for transactions and savings, the authorities decided, without the guidance of the IMF, to introduce a dual currency system in which there were two legal tenders, the Mark and the Dinar. In January 2001 it became possible to fully dollarize the economy and adopt the German Mark as the only legal tender because there was a sufficient amount of the currency in the country and no need to use the Dinar anymore. In 2002, when the German Mark ceased existing, Montenegro underwent a process of unilateral Euroization, linking itself to the monetary policy of the European Central Bank¹³.

¹⁰ Petrović, P., Bogetić, Ž., & Vujošević, Z. (1999). The Yugoslav Hyperinflation of 1992–1994: Causes, Dynamics, and Money Supply Process. *Journal Of Comparative Economics*, 27(2), 335-353

¹¹ *Ibid.*

¹² *Ibid.*

¹³ Fabris, N. (2015). The History of Money in Montenegro. *Journal Of Central Banking Theory And Practice*, 4(1), 5-1

It has to be observed that the introduction of the Euro put Montenegro in a delicate position: since monetary policy remained out of the control of the government, it retained only the tool of fiscal policy to boost the country's growth and stabilize the economy. On the one hand, the implementation of an expansive fiscal policy through increased public spending is not very effective in a country such as Montenegro, because as it is a developing country with a public debt fluctuating around 50% of the GDP. Under such circumstances, an increase in public spending would only lead to boosting even more the public debt without producing any visible effect on the economic structure. On the other hand, an intervention in the taxation system could have beneficial effects on income redistribution and structural unemployment. The problem is that it would not be effective as it could, because the country does not have a progressive taxation system that could maximize this type of expansive fiscal policy¹⁴. Nevertheless, the difficulties caused by the impossibility of controlling monetary policies do not change the fact that the adoption of Euro was beneficial to Montenegro: adopting the Euro gave Montenegro the undeniable benefits of having a solid currency and the relief of being freed from Serbia's monetary policies and gaining international credibility.

a. The case of Kosovo

After the war between Kosovo and FRY of 1999, Kosovo established itself as a *de facto* autonomous state, politically and economically separated from the rest of the country. This informal secession happened also in response to the poor way the region was managed when it was fully part of the Republic of Serbia, especially after the dissolution of Socialist Yugoslavia. The level of investment in industry, mining, and infrastructure was unsatisfactory and led to a 50% decrease in Kosovo's GDP between 1989 and 1995. Moreover, little progress was made in the field of privatization and therefore many industries remained under the inefficient control of the state. Nonetheless, Kosovo was in those years a net recipient of state funds and Belgrade was his main trading partner, both indicators of its strong dependence on FRY¹⁵. In any case, the economic conditions of the region represented a solid reason to seek ways not to be subjected to the central administration anymore.

As was the case for Montenegro and the rest of the country, German Marks started circulating and being used in Kosovo during the period of massive inflation and in the following years. Specifically for Kosovo, a factor that influenced significantly the level of German Marks present in the territory was the inflow of remittances coming from the Kosovar diaspora in Germany¹⁶. For this reason and because of the lack of a central authority in Kosovo at the time, the transition to German Marks was more

¹⁴ Šehović, D. (2014). Theoretical Analysis of the Effects of Fiscal Policy in Montenegro. TEM Journal, 3(4)

¹⁵ Korovilas 2. Korovilas, J. (2002). The Economic Sustainability of Post-conflict Kosovo. Post-Communist Economies, 14(1), 109-121

¹⁶ *Ibid.*

spontaneous than in Montenegro. In any case, in June 1999 Kosovo was put under the control of the UN Interim Administration Mission in Kosovo (UNMIK) which almost immediately established the Banking and Payments Authority of Kosovo (BPA), whose main goal was to implement a functioning monetary and financial framework. One of the first decisions of the BPA was to recognize the German Mark as the legal tender in Kosovo. When, in 2002, the transition to Euro had to be operated it happened with the support of the ECB, which decided to frontload around €100 million¹⁷.

In the case of Montenegro, a wider discourse on the implementation of certain fiscal policies after Euroization can be made, as the country already had a solid statal structure at the point, the situation of Kosovo was rather different. As a matter of fact, the introduction of the Euro served to address the more urgent issue of developing the financial sector, with the establishment of 7 banks in 2004, while two years there were no banks in the whole territory of Kosovo. Another urgent matter to tackle was the reduction of cash in circulation, which was obtained by imposing upper limits on the amounts of exchange and encouraging bank transfers¹⁸. Besides these compelling measures, of course, the Euroization of Kosovo's economy was intended to reach the wider objectives of macroeconomic and monetary stability: quite clearly, the Euroization of Kosovo was not simply beneficial but it was a truly necessary step to allow the country to function independently.

b. The position of the European institutions

The process of unilateral adoption of the Euro by Montenegro and Kosovo above described, despite being beneficial in the first instance and even necessary in the second, influences their perspective of joining the EU in the foreseeable future. It is quite evident, indeed, that the fact both countries use Euros as their legal tender conflicts with the regulations regarding EU accession, as mentioned in the first paragraph. It is of crucial importance to underline here that this is clearly not the only economic issue impeding the integration of Montenegro and Kosovo into the EU. Generally speaking, the economies of the countries in the whole region face significant structural weaknesses, as they are characterized by rigid and not competitive markets, limited access to finance, insufficient level of investment, and significant informal economy¹⁹. Furthermore, it is necessary to note that Montenegro and Kosovo are at two significantly different stages toward EU accession. From the analysis of the reports issued by the European Commission in 2021 on both countries, two very different pictures emerge. On the one hand, Montenegro already reached the stage of negotiations in 2012 and is defined as *moderately prepared* on most

¹⁷ Svetchine, M. (2005). Kosovo Experience with Euroization of its Economy. Central Bank of Albania

¹⁸ *Ibid.*

¹⁹ European Commission. (2018) A credible enlargement perspective for and enhanced EU engagement with the Western Balkans, 1-19

relevant issues, concerning the political, economic, and social sphere²⁰. On the other hand, Kosovo signed the Stabilization and Association Agreement in 2016 and has not reached the stage of negotiations yet. Understandably, the political instability that has characterized the region both historically and recently represents a serious obstacle to overcome, not to mention the fact that some of the EU members do not even recognize it as an independent country. The complexity of this political situation has surely conditions the poor performance of Kosovo in all of the relevant fields²¹.

This being said, the core of the issue is that in none of the reports regarding the progress of Kosovo and Montenegro towards EU membership the issue of them having adopted the Euro as legal tender is even mentioned. This uncovers the lack of regulation regarding the specific situation, which creates quite a significant void, especially in the case of Montenegro, given that the country finds itself at quite an advanced stage towards European accession. In all fairness, some information on the reaction of the EU authorities to Montenegro's unilateral adoption of the Euro can be found. The European Central Bank did not object at first to the use of the Euro in the country, recognizing the unusual circumstances in which it happened²², but in a note attached to the Stabilization and Association Agreement signed in 2007, it underlined the incompatibility of the unilateral euroization with the treaties²³. On the other hand, there are no comments from the EU authorities related to the situation of Kosovo. Nevertheless, it has to be mentioned that the transition to Euro was strongly sustained by the EU authorities back in 2002 and in general, the quite fragile economic and political situation of the countries creates a scenario in which the problems related to the adoption of the Euro will be an issue to tackle when the conditions for the EU integration of the country are more favorable.

3. Conclusive remarks: a matter of credibility

The above-discussed issue can be understood as one of the many problems that regard the EU accession process of the Western Balkans. It is functional, though, to underline the lack of commitment of the European Union towards the enlargement, which ended up in a year-long deadlock. Within the seemingly never-ending phase of the enlargement fatigue, the Euroization of Kosovo and Montenegro represents the umpteenth burden and obstacle to overcome in order to get the Western Balkans to join the EU. Subsequently, the lack of credibility of the EU as a strong actor in the region is uncovered. Nevertheless, the European institutions continue to tirelessly reaffirm the European future of the Western Balkans with the same confidence they had in 2003. In a communication issued in 2018 by the European Commission to

²⁰ European Commission. (2021). Kosovo 2021 Report

²¹ European Commission. (2021). Kosovo 2021 Report

²² Kubosova, L. (2007, October 8). EU to question Montenegro's use of euro. Euobserver. Retrieved from <https://euobserver.com/enlargement/24924> on 29-11-2021

²³ BIRN. (2007, October 9). EU warns Montenegro over the Euro. BalkanInsight. Retrieved from <https://balkaninsight.com/2007/10/09/eu-warns-montenegro-over-the-euro/>

the rest of the institution, it was stated that, even though the countries of the region are not ready yet to join the EU, they all have come a long way since the beginning of the century; moreover, it was envisaged the possibility of welcoming the Western Balkan countries in the EU by 2025²⁴. Unfortunately, it is quite clear that such a perspective is not perceived as credible: the Balkan Barometer of 2021 reported that even though 62% of the people who participated in the survey are in favor of EU membership, only 25% remain positive toward the possibility of accession before 2025 and 22% believe that it will never happen²⁵. Additionally, the current deadlock does not manage to inspire politicians to make the effort required to transform their countries: frontrunners - such as Montenegro – and laggards – like Kosovo - and trapped together in a vicious cycle of low expectations. The EU enlargement process towards the Western Balkans still has the potential of bringing a much-needed positive change to the region, but the current state of things confirms this is not happening and it is not likely to happen in the foreseeable future.

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²⁴ European Commission. (2018) A credible enlargement perspective for and enhanced EU engagement with the Western Balkans, 1-19

²⁵ Regional Cooperation Council. (2021). Balkan Barometer 2021

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