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What is the European Trade Union Institute (ETUI)?

The ETUI conducts research in areas of relevance to the trade unions, including the labour market and industrial relations, and produces European comparative studies in these and related areas. It also provides trade union educational and training activities and technical support in the field of occupational health and safety. Through its expertise, scientific publications, specialist journals and training programmes, the ETUI provides European trade unions with the tools to participate in the European debate and to contribute actively to achieving Social Europe. Its current work programme is built around the following five priorities: worker participation, social dialogue, the Lisbon/sustainable development strategies and their follow-up, trade union renewal and the economic and financial crisis.

The European Trade Union Institute is supported by the European Union.

For more detailed information on the ETUI please see the homepage www.etui.org

Aims and objectives of the SEER Journal for Labour and Social Affairs in Eastern Europe

SEER aims to stimulate an exchange of information between researchers, trade unionists and people who have a special interest in the political, social and economic development of the region of eastern Europe.

It seeks to draw attention to new research results and the latest analysis about the ongoing process of political and social changes in the broader eastern European region, and tries to create deeper understanding of the importance of the elaboration of democratic structures within industrial relations.

SEER combines contributions from different disciplines and schools of thought into an information package intended to be of interest to policy-makers, researchers, academics and trade unionists from various backgrounds.

The editors would like to point out that it is the authors who are responsible for the content of their own articles and that neither the editors nor the publisher, the European Trade Union Institute, necessarily share the opinions of the authors whose work is featured in the SEER.

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Editorial

This second issue of the *SEER Journal for Labour and Social Affairs in Eastern Europe* for 2022 focuses on 'Fair taxation and the Euro'. Both issues are critical for the region and have an impact on a number of social and labour concerns that are central to the identity of the *SEER Journal*. The countries of the western Balkans belong to the group of low taxation countries with low progressivity. This undermines social cohesion and makes public investments in areas including education, health and infrastructure, all critical for the future wellbeing of economies and societies, extremely difficult. Two further articles within the focus topic address the most recent development of Croatia having joined the euro area while Bulgaria has been rejected. Eurozone accession is the final stage of EU integration, so the decision making process in this is indicative of the broader context of the EU's enlargement strategy. This is why two articles on why and how Croatia's application was accepted, and Bulgaria's rejected, deliver further lessons for the entire region.

The article by Severine Picard on fair tax policies in the western Balkans examines the structure and scale of taxation in four countries of the region – Bosnia and Herzegovina; Montenegro; North Macedonia; and Serbia. This work is linked to efforts (and to a related project) by the international trade union organisations (both the International Trade Union Confederation and the European Trade Union Confederation) to improve tax fairness and justice in the region. Her review of evidence is based on publications by the major global institutions and drawing in particular on the Staff Working Documents produced by the European Commission. The document review is supplemented by field material gathered first-hand from trade unions active within these countries. The author finds that, while the share of tax revenues in western Balkan budgets is higher than in the OECD and also than the EU average, their tax burden is significantly lower. In 2018, on average, 64.5 per cent of government revenues came from direct taxes, compared to 59.4 per cent for OECD countries and 59.6 per cent for EU Member States. At the same time, the tax burden in the western Balkans (including all forms of direct and indirect taxation as a percentage of GDP) is significantly lower than the averages for the EU and the OECD: total tax revenues account for 30.4 per cent of GDP in the western Balkans, at least 11 percentage points lower than in the EU (41.5 per cent).

The author then sets out the challenges faced by each of the western Balkans countries in coming to terms with squeezed public finances, not least as a result of Covid-19, in the context of sizeable demands for public investment to deliver better public services. She concludes by setting out an agenda which trade unions might adopt in broadening their calls for tax reform and, crucially, in developing the public debate about tax fairness and building alliances for change.

The article by Zsolt Darvas reviews the decisions made in June 2022 to allow Croatia into the euro zone but, in contrast, to make no change in the status of Bulgaria. The author notes that, while the Bulgarian legislation on central bank independence remains an outstanding issue, there are other aspects of the decision to allow Croatia in but to refuse Bulgaria which cause disquiet. In reviewing price stability statistics on the basis of different measures capturing the level of rising prices, the author concludes that these decisions incorporate a level of discretion, creating a grey area in the criterion as well as uncertainty and even a level of dubiety.

Reflecting on the article by Zsolt Darvas, Daniela Bobeva argues that the essence of the case is not about Croatia and Bulgaria: it is about the fundamentals of membership of the euro area (and about the credibility of the accession process). She believes that Darvas is essentially right in his approach; and that, furthermore, the applications of Croatia and Bulgaria for entry to the euro area are a perfect example of why the whole framework needs a thorough re-consideration. The founding fathers of the euro area constructed it on the basis of fundamental principles of macroeconomic stability and the equal treatment of applicants. Consequently, most of the criteria for adopting the euro, the so-called Maastricht criteria, have numerical expressions: clear and transparent criteria do not open any room for interpretations or compromises with macroeconomic stability. However, the author argues that, in the last decade, the flexible interpretation of these criteria has led to changes making the accession process more discretionary and euro area membership less attractive.

The open section of the journal unfolds with the topic of the green transition, not yet an established subject for the *SEER Journal*; and also draws back to issues covered extensively in the past such as the pandemic, the future of Bosnia and corruption.

Ştefan Guga portrays the picture of a two-speed Europe in his article reviewing the state of the automotive industry in Romania and its level of preparedness for the electrification scenarios associated with the drive to reduce CO_2 emissions across Europe arising out of the EU's 'Fit for 55' package. The main features of the industry in Romania include the production of models for export given the low levels of domestic car ownership and amidst strong imports of older, and more polluting, second-hand vehicles from western Europe. Despite healthy relative growth, sales of battery electric cars remain marginal and, critically, there is little competence within the country in the area of electrification, its plants having been geared around the internal combustion engine. The author conclude that this can only imply a delayed electrification, but the chief worry is what that means for jobs and skills within Romania, as well as the broader implications for a two-speed Europe.

Denis Schulze looks at the impact of the Covid-19 pandemic on poverty among Syrian refugees in Turkey. The author ranges widely over the poverty confronting refugees in Turkey who have fled the Syrian civil war, not least against the background of the country's own opaque and inadequate legislation on refugees, which offers only temporary protection and greater precariousness as a result of the lack of formal employment opportunities.

Christophe Solioz scrutinises Sarajevo's urban space in his article, drawing on diverse standpoints inspired by architecture, urbanism, literature, art, anthropology, history, philosophy, social sciences and politics. In the process, he draws expressly on Sarajevo's history allowing people to be one with another, addressing ultimately the permanent metamorphosis of a city bonding its past and its future and, in so doing, healing the tragedies, suffering and failures of humanity of its recent past.

Finally, Fabian Teichmann and Sonia Boticiu provide a review on how corruption in eastern European judicial systems affects proceedings in other countries. The authors address the influence of bribes paid to east European officials on legal procedures in western countries, calling on judicial systems in western countries to advance cautiously in such proceedings and to pay close attention to the paperwork and procedures in the country seeking assistance.

Béla Galgóczi
Calvin Allen

December 2022

Séverine Picard

Fair tax policies in the western Balkans: challenges and recommendations for a trade union agenda[1]

Abstract

This article examines the structure and scale of taxation in four western Balkans countries – Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia – in the context of the work of the international trade union organisations (the ITUC and the ETUC) to improve tax fairness and justice, and in seeking to hold multinational enterprises better to account. Based on a review of evidence from publications in the field authored by the major international organisations and drawing in particular on the Staff Working Documents produced by the European Commission, supplemented by field material gathered first-hand from trade unions active within these countries, the author sets out the challenges facing each of them in coming to terms with squeezed public finances, not least as a result of Covid-19, in the context of sizeable demands for public investment to deliver better public services. She closes by setting out an agenda which trade unions might adopt in broadening their calls for tax reform and, crucially, in developing the public debate about tax fairness and building alliances for change.

Keywords*: tax fairness, multinationals, trade unions, Covid-19, tax distribution, social security contributions, public investment*

Introduction

The objective of this report is to examine the challenges of current tax policies in the western Balkans and, on this basis, to produce recommendations for a trade union agenda for progressive tax reform. Our main finding is that tax policies in the western Balkans present several characteristics of regressive tax systems, i.e. in which the tax burden is borne disproportionately by those in the population with the lowest incomes. This has an impact on inequalities and on poverty which, in turn, feed into political and social instability. Thus, a central recommendation of this report is to increase the shares taken by the top levels of personal income and capital tax revenues within the overall tax distribution.

1 This report was produced for the Pan European Regional Council of the International Trade Union Confederation and published by that organisation on 21 September 2022. It was written for PERC-ITUC by Séverine Picard of Progressive Policies, a consultancy specialised in public policies, industrial relations and labour rights (www.progressivepolicies.eu). It has been specially edited for the *SEER Journal for Labour and Social Affairs in Eastern Europe* and is reproduced here with the kind permission of all parties.

This report is based on desktop research as well as in-depth exchanges with trade unions in four western Balkans countries. These unions highlighted their priority concerns during a workshop organised by the Pan-European Regional Council of the International Trade Union Confederation in November 2021 and subsequently responded to a detailed questionnaire identifying key domestic features. The organisations involved in this study are: KSS (Confederation of Free Trade Unions) and SSM (Federation of Trade Unions of Macedonia) (North Macedonia); SSS (Confederation of Autonomous Trade Unions of Serbia) and UGS 'Nezavisnost' (Trade Union Confederation 'Independence') (Serbia); SSRS (Confederation of Trade Unions of the Republika Srpska (Bosnia and Herzegovina); and SSCG (Confederation of Trade Unions of Montenegro) and USSCG (Union of Free Trade Unions of Montenegro) (Montenegro).

The report is divided into three broad sections of which the first provides an overview of labour's key demands for fair tax policies; the second analyses in-country situations in each of the four countries covered by the report in the light of these general demands; and the third provides a brief outline of a trade union agenda for tax reform. Our conclusion suggests that a major obstacle to tax reform is powerful private lobbies which need to be counterbalanced by a more active tax justice movement within the region.

The labour agenda for fair tax policies

This section first reviews the reasons why trade unions should develop demands for fair and efficient tax policies. It then provides an overview of the main demands developed by the global labour organisations.

Why trade unions should have a tax agenda

Increased fiscal space

Fiscal space is understood as a government's room of manoeuvre to support its public spending choices. In general, governments need revenues to finance social welfare, public services and public investment for sustainable and inclusive growth. In the wake of the Covid-19 pandemic, the need for increased fiscal space has never been so pressing. In December 2020, governments around the world spent over 12 trillion dollars, equivalent to 12 per cent of global GDP. That spending was significantly more pronounced in rich countries with greater fiscal firepower than in emerging economies. In the current context of increased costs of living and an energy crisis, the need for an expanded fiscal space continues to be extremely important. In particular, public investment in social protection to provide support to peoples' incomes and livelihoods is a strong priority for the International Trade Union Confederation (ITUC 2021a).

Fiscal space can be created by raising revenues, through taxes in particular, or by cutting back on public expenditure. In many cases, the International Monetary Fund has advised countries to reduce 'non-priority expenditures'. An ILO Working Paper from December 2021 found that, while the IMF generally supported increased health care expenditure and cash transfers, it also called for fiscal consolidation and the reduction of public debt in a great number of cases. In 40 per cent of the countries investigated, IMF austerity proposals were actually larger than the size of the response to the virus (Razavi et al. 2021).

Austerity measures are generally understood as a reduction in social spending, with an adverse impact on workers and their households in particular those on lower incomes. It is for this reason that the labour movement calls for the harmonisation of fiscal and tax rules. Indeed, trade unions are stepping up their activities in favour of tax policies that raise more and more progressive revenues.

Progressive tax policies

Beyond revenue raising, tax also has a societal role to play in ensuring fairness, inclusiveness and a positive impact on employment. Inequalities can result both from an unequal distribution of wages and from the growing gap between capital and labour shares of global income. Progressive taxes play a key role in reducing these inequalities by increasing tax liability on the wealthy and on capital owners. As listed in Table 1, progressive forms of taxation include personal income tax (to the extent that policies apply progressive rates and not flat taxes), corporate income tax and other taxes on capital and wealth. Regressive forms of taxation include, in particular, value added taxes ('VAT'). VAT is an indirect and unequal tax as those on lower incomes pay a higher share than those on higher incomes. In addition, those who use income to save pay a smaller share of VAT. Another issue with VAT is its cyclicality: in times of economic downturn, revenue collection is lower due to lower consumption but also as a result of firms postponing their VAT payments.

Workers pay a double price for regressive policies. First, the tax burden is being shifted away from the wealthiest incomes towards households and employees. Second, where the tax base is narrow, public budgets are shrinking, leading to insufficient investment in public services and social welfare.

The ITUC advanced its arguments in favour of a stronger social protection regime in times of downturn in a report published in 2022 (ITUC 2022a). The ITUC also looked at various scenarios to finance social protection. A key finding is that financing through progressive direct taxation performs better than more regressive types of indirect taxation. The study concluded that:

> While financing social protection through progressive income tax, corporate tax and capital tax can provide some positive small changes in GDP depending on the structure of the economy, financing social protection through indirect taxes generally perform poorly as they raise consumer prices, reduce real income and result in large crowding out of investments. (ITUC 2022a: 11)

Table 1 – Main types of taxes and the potential efficiency and equity impact

Tax category	Basic features	Equity (progressive or regressive)	Efficiency	Administrative and compliance costs
Personal income tax	Taxes all income or profit	Progressive: people with higher income pay proportionately more	May reduce incentive to save	State should have a good system to fight tax evasion
Corporate tax	Tax on company profit. Affects owners of capital; but can be transferred to consumers via increased prices	Progressive; irrespective of whether it ultimately falls on wage earners or capital owners or a combination of both. It falls disproportionately on wealthy households	Efficient means of collecting revenues particularly on personal income where the system of domestic personal income taxation is weak and easily evaded	Relatively low administrative and compliance costs, especially in comparison to personal income tax
VAT	Applicable to all market consumers. Affects consumers' final price but not production cost	Regressive; but can be made less regressive through a higher threshold, zero rating essential consumer products and higher rating for luxury items	Moderately efficient; a uniform rate makes no distinction between sectors; does not differentiate between domestic and imported goods	High administrative and compliance cost; companies and state require a good accounting system; proportionately more expensive for small business
International trade tax	Import and export tariffs; charged at customs at the time transactions are made	Can be progressive; different rates for essential and luxury imports	Not very efficient; can promote domestic production/ industries and exports; but these may be less efficient and prone to rent seeking	Relatively low administrative and compliance cost; easy to implement/ collect
Excise tax	Levied on specific goods; principally borne by consumers	Generally progressive; allows for differential rates for essentials and luxury goods	Relatively efficient; creates differences between products, but only for few goods; can also correct market flaws and attain social and environmental objectives	Relatively low administrative and compliance cost; but total revenue must be more than the cost

Tax category	Basic features	Equity (progressive or regressive)	Efficiency	Administrative and compliance costs
Property tax (land, wealth, etc.)	A fixed rate for a certain amount of land, based on value, paid by the owner	Progressive; paid more by those who own more or valuable land/ properties	Efficient; does not distort prices; prevents speculative real estate investment; encourages productive use of land	Relatively low administrative and compliance cost; but requires a good system to assess value; can be susceptible to undervaluation

Source: Ortiz et al. (2019)

The role of corporate income tax

The reform of corporate income tax is an important labour demand considering its significant revenue raising prospects as well as the impact on employment and workers' rights.

According to estimates, 312 billion dollars are lost every year due to corporate tax abuse (Tax Justice Network 2021: 6). Aggressive tax avoidance also affects workers in other ways. Corporate profits are extracted from workplaces and sent, through complex mechanisms, to tax havens. When a multinational relies on aggressive tax avoidance schemes, financial accounts are plundered and there is little for trade unions to bargain on. Wages are kept artificially low and working conditions precarious. Effective management is also hidden behind a multitude of shell companies and other letterbox practices (Picard 2020).

Main demands

Global labour organisations have developed the following set of recommendations for tax reforms:

An effective corporate income tax rate of at least 25 per cent

Taking into account that the average effective tax rate in the EU and OECD countries ranges between 20 and 25 per cent, the labour movement is calling for a minimum effective tax rate of 25 per cent. This floor is necessary to stop tax competition between countries. According to estimates, a 25 per cent effective tax rate implemented globally could raise, depending on design, between 580 billion and 650 billion dollars each year (ITUC 2021b).

The introduction of a global minimum tax rate has been actively discussed in the context of G20/OECD negotiations that concluded with a statement published in October 2021. Accordingly, OECD countries will soon implement a 'top-up tax' under which, where the entities of a multinational corporation (e.g. subsidiaries, establishments) are paying corporate income tax below a minimum level, fixed at 15 per cent, other countries will 'tax back' the undertaxed overseas profits up to that minimum (OECD/G20 2021: 4).

For the labour movement, this statement can be considered as only a first step: greater ambition is needed as only a 25 per cent minimum, and on the basis of a broad tax base, would effectively curb tax competition and substantially increase revenues.

Unitary taxation

The taxation of multinational enterprises is very much influenced by the OECD BEPS Action Plan, enacted in 2015 and laying down 15 action items for countries to combat base erosion and profit shifting (OECD/G20 2015). A key area of concern for the labour movement is that Actions 8-11 rely heavily on transfer pricing rules. According to these rules, a multinational corporation has no existence of its own. Each of its subsidiaries and establishments is taxed as if it were an independent and autonomous company. They can trade with each other, and thus transfer capital, as long as they do so by respecting market price (the 'arm's length' principle). This is of course a fiction: a multinational enterprise is a coherent unit, with a consistent tax and business strategy implemented throughout the company group and under the global oversight of the parent company.

The current transfer pricing rules therefore constitute an encouragement for multinationals to set up complex group structures with conduit entities for the purpose of shifting profits from where they have been created to low tax countries.

The trade union movement has long taken a position in favour of the principle of unitary taxation in which the profits of a multinational enterprise are determined at global level and apportioned among countries according to a set of balanced factors. Only then would multinationals be treated as the global companies that they are and made subject to attempts to have a real go at curbing profit shifting activities (Picard 2020).

Unitary taxation is also the most effective way to tax digital companies, which can be highly profitable but pay on average twice less in taxation than their 'bricks and mortar' counterparts. The weaknesses of transfer pricing rules are indeed particularly exacerbated for multinationals with unique and highly mobile assets. Furthermore in a world of digital transactions, taxing rights should no longer be dependent on the existence of a physical establishment but should kick in whenever a series of indices point at a significant economic presence.[2]

Tax transparency

Country-by-country reporting is a vital element in the fight against tax avoidance. Where countries have put in place such frameworks, multinationals are required to report annually and, for each jurisdiction in which they do business, provide essential information on their activities, their structure, their profits and the income tax paid and accrued. Without such reporting, potential risks of profit shifting would be impossible to assess.

2 A proposal to that effect was, unsuccessfully, presented in 2019 by the G24 countries to the G20/OECD Inclusive Framework.

Tax transparency is also an essential element of trade union work. Country-by-country reporting contains crucial data on the financial and economic situation of the company and the scale of its investments in low-tax jurisdictions. This information is precious for workers seeking to engage in collective bargaining over their fair share of corporate wealth.

Higher taxes on capital and wealth

Both corporate income tax rates and top personal income tax rates have been declining in recent decades. In the context of an explosion in the asset values of the wealthy, global labour organisations have called for wealth taxation as well as extra taxes on excess profits. The objective is for individuals and businesses that have gained from the pandemic, and now the energy crisis, to contribute more to the recovery.

The ETUC has issued a call for a net wealth tax, which could initially be implemented as a crisis-fighting tool, with a high threshold tackling very wealthy households with the ambition of lowering the threshold to reach a satisfactory level to enhance tax justice (ETUC 2021). Additionally, the ITUC has called for the introduction of extra taxes on profits that exceed a normal return ('economic rents') (ITUC 2021b: 7).

Taxing financial transactions

Since the 2008 financial crisis, the labour movement has also been campaigning for taxes on financial transactions; that is, small levies on transactions in the financial sector. The objective is to reduce the volume of speculative transactions by making them more costly (ITUC 2021b: 12).

Tax policies in the western Balkans

The EU accession process has been opened for North Macedonia (2005), Montenegro (2012), Serbia (2014), Albania (2014) and, most recently, Bosnia and Herzegovina (2022), while Kosovo remains a potential candidate for accession. This process implies the implementation of complex reforms, fiscal reforms in particular, in order to comply with EU debt and deficit rules but also to level up with EU Member States on welfare and social protection regimes. Tax policies are at the heart of these discussions.

Although the speed and the focus of reforms vary from one country to another, common features are notable throughout the region. The section immediately below reviews the shared challenges especially with regard to inequalities and the insufficient level of tax raising capacities; following that, a country-by-country analysis is provided.

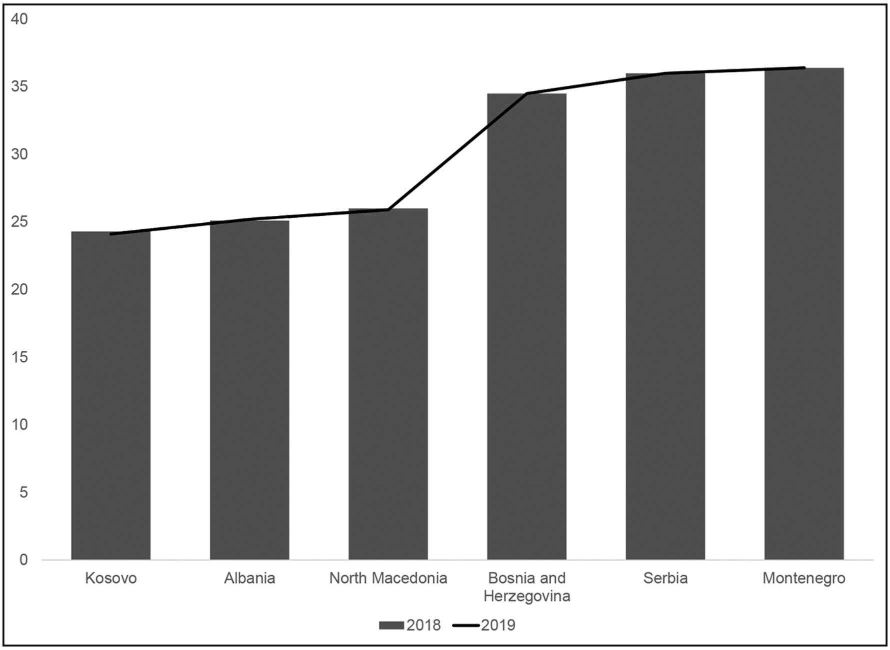
Overview of western Balkans tax policies

Whilst public budgets in the western Balkans are very reliant on taxation, the revenue raising potential is relatively low.

The share of tax revenues in western Balkan budgets is higher than in the OECD and also than the EU average. In 2018, on average, 64.5 per cent of government revenues came from direct taxes, compared to 59.4 per cent for OECD countries and 59.6 per cent for EU Member States (OECD 2020: section 2.4). At the same time, the tax burden in the western Balkans (including all forms of direct and indirect taxation as a percentage of GDP) is significantly lower than the averages for the EU and the OECD: total tax revenues account for 30.4 per cent of GDP in the western Balkans, at least 11 percentage points lower than in the EU (41.5 per cent) (see Figures 1 and 2 below).

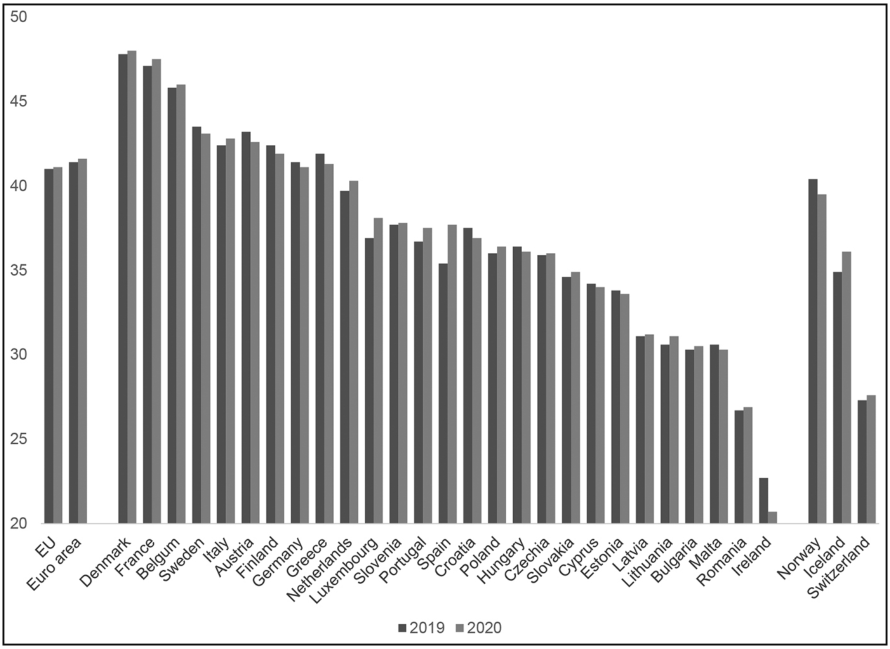
This comparatively low tax burden is explained by low tax policies. The whole region is marked by the low taxation of capital, in particular through the use of tax incentives and low corporate income tax rates, as well as flat tax regimes or personal income tax rates which have little progressivity. As illustrated by Figures 4a to 4d (further below), such low levels of taxation are compensated – at least to some degree – by high social security contributions and an extreme dependence on consumption (valued added) taxes.

Figure 1 – Tax burden in western Balkans, 2018-19



Source: Altax (2020: 42)

Figure 2 – Total tax revenue in EU Member States and EFTA countries, 2019-20, % of GDP



Source: Eurostat 2020 (gov_10a_taxag)
Note: Data for Luxembourg is 2016 and 2017.

Personal income tax: flat taxes and low progressivity

A 'flat tax revolution' was widely implemented in the western Balkans in the early 2000s. A flat tax consists of a uniform tax rate on personal and/or corporate incomes that applies once a threshold or basic allowance is reached (ECB 2007). Flat taxes must be contrasted with progressive income tax rates that increase proportionally to the amount of income.

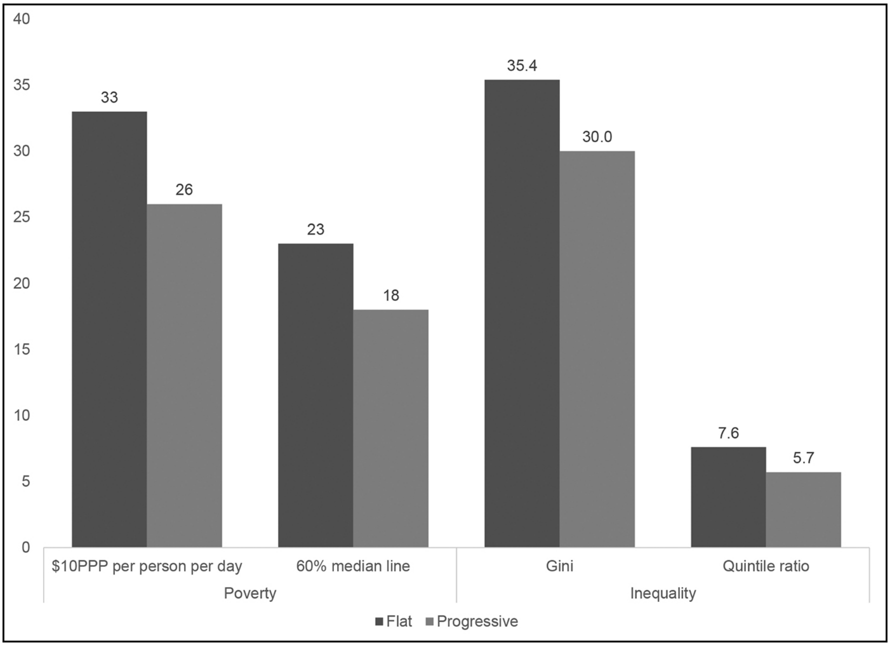
The key argument in favour of flat taxes lies in their simplicity: a simpler tax policy is easier to understand and administer and thus assists with the reduction of tax avoidance. In addition, flat taxes were believed to boost growth since a reduction in the tax burden was seen as contributing to higher investment and, ultimately, in reinforcing incentives to work.

The reality, however, is very different. In a 2022 report, the ITUC collected evidence on the social harm being done by flat taxes, arguing that:

> The reforms have arguably reflected a broader ideological signalling towards a neoliberal market-led model for countries' political economy. (ITUC 2022b: 13)

Case studies provide little evidence of flat taxes having achieved labour market objectives. On the other hand, simulations show that they have significant implications for poverty and inequality as more people are likely to be living in poverty or vulnerable to poverty (ITUC 2022b: 23) (see also Figure 3). The ITUC report also quotes substantial literature pointing at the negative distributional effects at the expense of people on low or middle incomes. In other words, those on lower incomes pay a higher proportion of taxes than their counterparts on higher incomes and this exacerbates inequalities.

Figure 3 – Simulated poverty and inequality measures after hypothetical flat and progressive tax scenarios



Source: ITUC (2022b: 23)

In 2022, out of the four countries covered by this study, two continue to implement a flat tax regime: Bosnia and Herzegovina; and North Macedonia. Montenegro and Serbia have finally abandoned flat tax rates in favour of progressive personal income taxes. Even so, progressivity in the personal income tax rates in these two countries remains low in comparison to the EU average. The top personal income tax rate in the countries of the western Balkans is 23% (see Table 2) – and that is something of an outlier – compared to an average of 35.3% in the EU (see Table 3).

Table 2 – Personal income tax rates in south-east Europe, 2019

Country	Rate
Bosnia and Herzegovina	10%
Croatia	Progressive rates at 24% and 36%, depending on income
Serbia	10% – employment income and business income 15% – income from capital 20% – income from royalties and other income
Montenegro	9% – gross monthly salary up to the amount equivalent to the average salary in the previous year (766 euros) 11% – portion of monthly gross salary exceeding the amount above
Slovenia	16% – income up to 8021.34 euros 27% – income up to 20 400 euros 34% – income up to 48 000 euros 39% – income up to 70 907.20 euros 50% – income exceeding 70 907.20 euros 20% – income from business activities
North Macedonia	10% flat rate
Albania	Exempt – employment income up to ALL 30 000 13% – from ALL 30 001 to ALL 150 000 is taxed at a rate of 13% on the amount exceeding ALL 30 000 tax of ALL 15 600 – income exceeding ALL 150 000 + 23% – income in excess of ALL 150 000 15% – all other income except dividends (8%)
Kosovo	0% – income between 0 and 960 euros 4% – income between 960.01 euros and 3000 euros 8% – income between 3000.01 euros and 5400 euros 10% – income exceeding 5400 euros

Source: Deloitte (2019: 51)

Table 3 – Top personal income tax rates in Europe, 2022

Country	Top statutory personal income tax rate	Country	Top statutory personal income tax rate
Austria	55.0%	Lithuania	32.0%
Belgium	53.5%	Luxembourg	45.8%
Czech Republic	23.0%	Netherlands	49.5%
Denmark	55.9%	Norway	39.4%
Estonia	20.0%	Poland	36.0%

Country	Top statutory personal income tax rate	Country	Top statutory personal income tax rate
Finland	51.2%	Portugal	53.0%
France	55.4%	Slovakia	25.0%
Germany	47.5%	Slovenia	50.0%
Greece	54.0%	Spain (Valencia)	54.0%
Hungary	15.0%	Sweden	52.3%
Iceland	46.2%	Switzerland	44.8%
Ireland	48.0%	Turkey	40.8%
Italy	47.2%	United Kingdom	45.0%
Latvia	31.0%		

Source: PwC Worldwide Tax Summaries

Another legacy of flat tax policy regimes is their implication of reduced revenues for public budgets. In a bid to compensate for such diminished revenues, governments that rely on flat taxes tend to turn to other forms of taxation such as labour taxes and VAT.

High taxation of labour: impact on low wages

A central concern for trade unions in the four countries covered by this report is the heavy tax burden borne by employees. Unions unanimously consider that current labour taxation policies are unfair to workers on lower wages and constitute a strong driver for undeclared work which, in turn, feeds into precarious employment conditions and insufficiently funded social protection regimes. The World Bank has already singled out the taxation of labour as 'one of the most problematic features of institutional labor markets in the Western Balkans' (World Bank 2019: 50). This is due to the high regressivity of the system which incentivises the informalisation of the economy and reduces competitiveness.

The personal income tax components of labour taxation tend to be marginal or modest. Consequently, whilst in most countries social security contributions represent a larger portion of non-wage labour costs than personal income tax, this feature is even more pronounced in the western Balkans (World Bank 2019: 57). In addition, social security contributions are more heavily borne by employees than by employers: in North Macedonia, all social security contributions are paid by employees; in Bosnia and Herzegovina, employees contribute three times more than employers; and in Serbia, the balance of the contribution is almost level (see Table 4).

As a result, labour tax progressivity is lower in the western Balkans than in most EU or OECD countries while the tax burden on workers earning the minimum wage is significantly high. As lower income workers make up two-thirds of employment, the majority of the population is bringing home poor net wages.

The World Bank report underlines two further aggravating factors. One is that the high labour tax burden is not usually compensated by separate tax credits for workers with dependants. Secondly, as labour taxes are high in Montenegro, Bosnia and Herzegovina, and Serbia there is a proportionally higher cost to the employer for minimum wage workers than for average or higher wage workers. Thus, labour intensive industries in these three countries are less competitive than their counterparts in the European Union.

As the country analysis below also describes, there is, as a result, a worryingly high level of undeclared employment in the region.

Table 4 – Social security contributions

Country	From gross salary (cost to employee)	On top of gross salary (cost to employer)
Bosnia and Herzegovina	FBiH: 31% RS: 33% Brčko: 30.5% or 32%	FBiH: 10.5% RS: - Brčko: 0% or 6%
Croatia	20%	16.5%
Serbia	19.9%	17.9%
Montenegro	24%	10.3%
Slovenia	22.1%	16.1%
North Macedonia	27%	0%
Albania	11.2%	16.7%
Kosovo	5%	5%

Source: Deloitte (2019: 52)

Low taxation of capital

Corporate income tax rates in the western Balkans are lower than anywhere else in the EU and also lower than the OECD average. They range between a statutory rate of 9 per cent and one of 15 per cent (see Table 5). These are statutory rates of corporate income tax, meaning that the effective rates (corresponding to the payments actually made by companies) may well turn out to be considerably lower. The research on which this report is based has not been able to find any estimates of effective tax rates, which points at a problem of transparency and a lacking accountability among western Balkans tax authorities. In the EU, the average statutory rate is 23.5 per cent, whilst in OECD countries this ranges between 20 and 25 per cent.

As described in the first main section of this report, a 25 per cent effective tax rate is a strong priority for the labour movement across the globe. This is a necessary reform to increase revenues, stop tax competition and re-establish some fairness between the respective shares of income held by capital and labour.

In addition to the low statutory rates, a characteristic of the western Balkans is the presence of special economic zones. These are geographical areas where business activity is subject to different rules than those prevailing in the rest of the economy. The objective is to have incentives to attract foreign direct investment (FDI), for instance to compensate for risky investment. By increasing FDI, countries expect to foster economic growth through job creation, increased exports and positive spillovers into the domestic economy. Of critical interest for this research are the tax incentives that are deployed in these special economic zones. Broadly, they consist of tax reliefs in the form of tax holidays (exempting firms from corporate income taxation during the initial stage of investment), as well as reduced tax rates and tax credits.

Special economic zones are a substantial part of investment strategies in the western Balkans. According to the OECD, their number quadrupled between 2009 and 2017 and they have become a critical driver in the intensifying regional competition for FDI. Special economic zones in Bosnia and Herzegovina, North Macedonia, Montenegro and Serbia have attracted almost 400 foreign companies, mostly manufacturing investments in the automotive components industry, with a cumulative investment of 2.5 billion euros. In terms of job creation, the report estimates that companies active in special economic zones have generated over 30 000 jobs in the region. Serbia is by far the largest recipient of FDI (OECD 2017).

Table 5 – Corporate income tax rates in the EU and the western Balkans, 2022

Country	CIT rate (%)	Country	CIT rate (%)
Austria	25	Malta	35
Belgium	25	Netherlands	25
Bulgaria	10	Poland	19
Czech Republic	19	Portugal	30
Denmark	22	Romania	16
Estonia	20	Slovak Republic	21
Finland	20	Slovenia	19
France	28.4	Spain	25
Germany	15.8	Sweden	20.6
Greece	24		
Hungary	9	Albania	15
Ireland	12.5	Bosnia and Herzegovina	10
Italy	24	Bulgaria	10
Latvia	20	North Macedonia	10
Lithuania	15	Serbia	15

Country	CIT rate (%)	Country	CIT rate (%)
Luxembourg	18.2		

Source: Data extracted on 20 July 2021 from OECD.stat

Table 6 – Key indicators of special economic zones in the western Balkans

	Albania	Bosnia and Herzegovina	North Macedonia	Kosovo	Montenegro	Serbia
Total no. zones	3	4	15	3	1	14
No. active zones	0	4	6	0	1	10
Size (ha)	494 (planned)	79.5	893	530	130	1615
No. enterprises	0	95	23	0	36	241
Cumulative investment (€m)	0	n/a	207	0	5	2240
No. employees	0	1700	6800	0	398	22 242
Total turnover (2015)	0	303	1475	0	7.6	2431
Zone exports as % of total	0	6.4	36.4	0	n/a	17.6

Source: Data from zone authorities, compiled by the OECD (2017) and OECD calculations based on national statistics.

Notes:

1. Active zones are those with a fully established legal, institutional and management structure, which are broadly investment-ready (basic infrastructure and main services to be offered are in place, etc.) and which have active enterprises operating in them.

2. Cumulative investment is calculated as the simple sum of investments since the zones' establishment (with the exception of North Macedonia, which covers the period from 2011 to 2015) and does not account for capital depreciation.

3. Data for Bosnia and Herzegovina refer to 2014 whereas total turnover for North Macedonia is estimated from the share of total exports for 2015.

However, the reality behind special economic zones is far from ideal. Trade unions have long denounced the adverse effect of the deregulation of investment on workers' rights and the overall insufficient contribution to domestic economies being made by the zones. Foregone revenues through tax holidays and tax credits are a key driver for the unequal level of taxation between labour and capital.

Overall employment levels have to be compared with the quality of the jobs being created. As companies operate in a legal vacuum, the trade union experience with special economic zones is that jobs often consist of precarious forms of employment, poor wages, insufficient health and safety protection and no access to trade unions nor judicial redress.

Several studies have now demonstrated that there is no evidence that reducing corporate income tax has an impact on growth (Gechert and Heimberger 2022). There can indeed be no guarantee that investment would not have been made without the tax incentives: other factors, such as political and economic stability, geographical location, existing infrastructure and the workforce, may be more influential ones on choice of location for real investment.

Further, FDI in special economic zones does not always create positive spillover effects in the domestic economy. The lack of spillover is particularly obvious when foreign multinational companies source their products and services through their own networks rather than through domestic enterprises. On this point, the OECD raises some serious questions as to whether special economic zones in the western Balkans contribute to higher added value activity in global value chains. Foreign investment tends to be in labour intensive industries with limited added value activity and insufficient technological upgrading (OECD 2017: 56-57).

Lastly, tax incentives constitute a clear encouragement for corporate tax avoidance: i.e. multinationals shifting their profits from high tax countries to low tax areas. In the case of profit shifting, FDI does not translate into real investment in the local economy and the benefits of reduced taxes are mainly enjoyed by shareholders.

In addition to low corporate tax rates, the western Balkans rely on transfer pricing rules which the labour movement criticises as inadequate to tackle corporate tax avoidance by multinational enterprises (see above). In parallel, the unions interviewed for this report underlined the lack of capacity in tax administrations to take up the fight against tax avoidance and tax evasion. In a catch-22 situation, poor enforcement further feeds into insufficient resources to strengthen the hands of tax administrations.

Revenues are inevitably lost as a result of these structural weaknesses. Table 7 shows estimated revenue losses in absolute numbers and in terms of the equivalent share of Covid-19 vaccinations during the pandemic. These estimates are based on the current low tax rates.

Table 7 – Estimated revenue losses through corporate tax avoidance

	Serbia	**Montenegro**	**North Macedonia**	**Bosnia and Herzegovina**
Total annual tax loss ($m)	239.6	17.2	38.9	27.1
Total annual tax loss (% GDP)	0.5	0.4	0.3	0.1
Of which: corporate tax abuse ($m)	234.8	16.3	37.1	25.6

	Serbia	Montenegro	North Macedonia	Bosnia and Herzegovina
Of which: offshore wealth ($m)	4.8	0.9	1.8	1.5
Full vaccinations possible (m)	13.9	1.0	2.3	1.6
Full vaccinations possible (% of population)	197.4	161.0	108.7	46.2

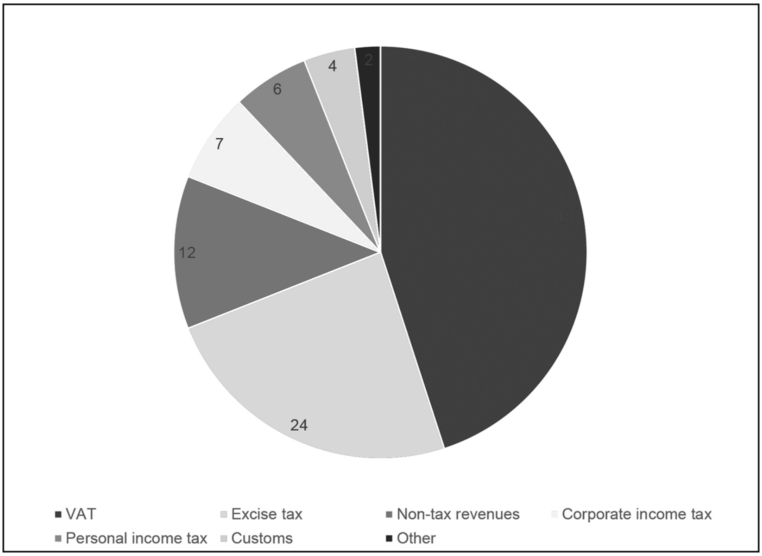
Source: compiled from Table 2 in Tax Justice Network (2021)

Consequences: regressive tax policies, risk of poverty and depleted budgets

Tax policies in the western Balkans present several characteristics of regressive tax systems in which the tax burden is being borne disproportionately by those with the lowest incomes in the population. This has an impact on inequalities and poverty which, in turn, feed into political and social instability.

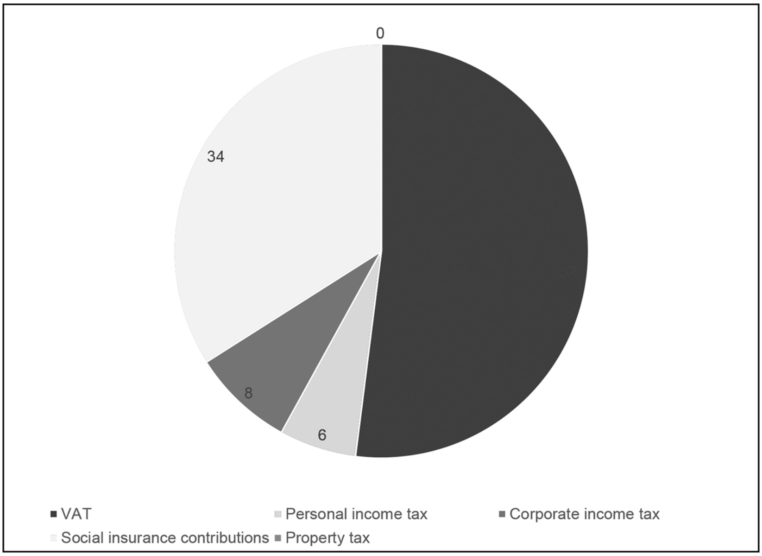
The lack of progressivity in personal income tax regimes as well as foregone corporate revenues have led to massive reliance on workers' social security contributions and consumer-provided VAT. As illustrated by Figures 4a to 4d, western Balkans countries tend to be extremely dependent on VAT, much more so than in the EU or in terms of OECD average.

Figure 4a – Revenue structure in Serbia, 2022



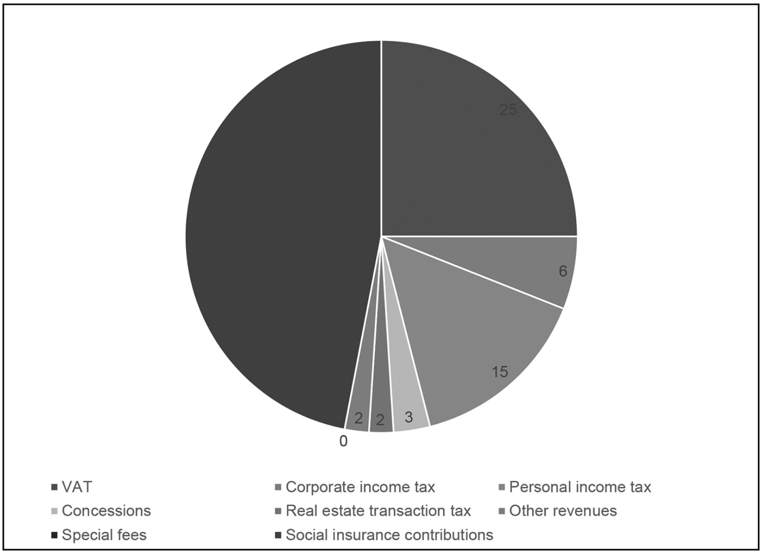
Source: Serbian Finance Ministry website

Figure 4b – Tax distribution in Republika Srpska, 2022



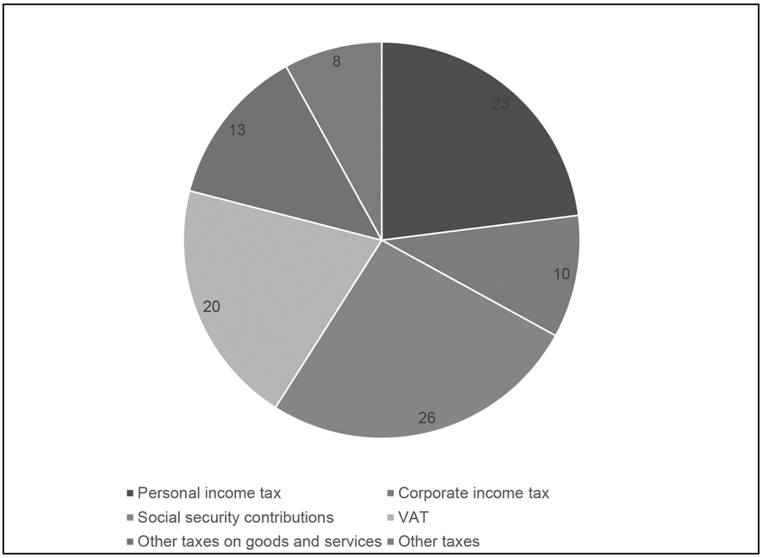
Source: Data compiled by the Confederation of Trade Unions of Republika Srpska

Figure 4c – Tax collection in Montenegro, 2019



Source: Montenegrin Finance Ministry website

Figure 4d – Tax distribution, OECD average (2018)



Source: OECD stats, 2018

The following section shows that, for each country covered by this study, there are fiscal challenges linked to the narrow tax base and the need for public investment. Workers and their communities are, therefore, paying a double price: they carry a heavy tax burden yet are enjoying neither strong public services nor effective social protection regimes.

Lastly, current tax policies are taking a heavy toll on labour market indicators, with high levels of unemployment and undeclared work. The whole region is facing high levels of the population who are at risk of poverty, ranging from 21.9 per cent (North Macedonia) to 30.5 per cent (Montenegro). In comparison, the population at risk of poverty in the EU-27 stands at 20.9 per cent.

Country analysis

North Macedonia

a. Fiscal challenges

Public finances in North Macedonia were hit hard by the pandemic. The share of foregone revenues due to low tax rates and insufficient enforcement was further reinforced by the slowdown in economic activity. In parallel, public spending had to rise to finance Covid-19 related measures: wage subsidies; financial support for households and companies; reduction in the rate of VAT; extension of tax deadlines; etc. The European Commission reports that the total impact of Covid-19 measures in 2021 amounted to an equivalent of 2.9 per cent of GDP (European Commission 2021b: 8).

In parallel, the North Macedonian government has been pursuing an intensive programme of investment. Up to 2025, the government has announced that it will focus on the implementation of infrastructure projects in roads and railways, energy and utilities as well as investments to improve conditions in the health, education and social systems as well as in agriculture and environmental protection. These projects amount to a total of 3.1 billion euros, partly financed with budget funds of 1.16 billion euros.

Thus, there are tensions between, on the one hand, foregone revenues and, on the other, an acute need for fiscal consolidation. According to the trade unions, the IMF and the World Bank are advising the need to increase the progressivity and efficiency of the country's tax policies. In 2021, the European Commission also recommended broadening the tax base in order to improve revenue collection, at the same time expressing concerns about public announcements that would translate into an erosion of tax revenues. For instance, a Tax System Reform Strategy published in 2020 heralded further measures to strengthen revenue collection while also holding out the promise of further tax incentives for companies and households (European Commission 2021: 12).

b. Social indicators

According to 2021 data from MAKSTAT, the national statistical office, the labour force in North Macedonia numbered 937 482 people of whom 795 276 were employed while 142 206 were unemployed, giving an unemployment rate of 15.2 per cent. Trade unions report that the Covid-19 pandemic has aggravated the unemployment situation with collective dismissals, often in violation of workers' rights.

The European Commission estimates that undeclared employment and partially undeclared wages concern almost 44 per cent of employees. A key driver in this situation is the high taxation of wages, in particular for those on lower incomes. Workers appear to prefer to receive a higher net wage in spite of foregoing their right to pension and social protection (European Commission 2021: 21). The high level of undeclared work is an area of particular concern to the North Macedonian trade unions. For instance, SSM reports that the formalisation of the grey economy is a high priority. Undeclared workers are not protected by employment law; they earn less than those in the formal economy, have unstable earnings and do not have access to any form of social protection.

Poverty figures are also high, with 21.9 per cent of people being at risk of poverty in 2019. KSS reports higher risks among lower income earner groups within the population, given that they tend to be employed in vulnerable sectors most affected by the pandemic (such as trade and transport).

Concerning social dialogue, SSM assesses its relationship with the current government as positive, in particular in relation to recent reforms to the minimum wage. That said, the general state of social dialogue remains preoccupying for the European Commission which considers that social dialogue in the private sector remains weak and marked by the absence of engagement with private sector unions. This is confirmed by KSS which raises concerns about unions' lack of influence over the management of the pandemic crisis.

On the business side, it appears from our questionnaire that the Chamber of Commerce of Macedonia has an active policy advocacy agenda on tax-related issues. This agenda appears generally hostile to increases in tax rates, however, including on personal income tax, expressing concerns about the loss of competitiveness.

Aside from the trade unions, there does not seem to be any civil society movement in North Macedonia which is actively engaged in tax justice activities.

c. Personal income tax and labour taxation

North Macedonia applied between 2007 and 2018 a flat rate tax, firstly at a rate of 12 per cent and then at one of 10 per cent. The declared reason was that this would make the business environment more friendly to doing business, while increasing tax revenues due a reduction in the incidence of tax evasion. Although the flat tax was in force for 12 years, a comprehensive analysis of its effects still has never been conducted. In 2019, a higher tax rate of 18 per cent was introduced for incomes above 90 000 denar (approximately 1460 euros). This was a symbolic reform affecting, in the admission of the Finance of Ministry itself, only the highest earning one per cent of the total population (World Bank 2019: 55).

Social security contributions coming from wages are, on the other hand, much more significant, as evidenced by Table 8. Table 9 provides an illustrative calculation of gross and net minimum wages in which, out of a gross wage of 22 146 denars, the worker will take home 15 194. Both tables have been compiled by KSS on the basis of official information.

Table 8 – Rates of social security contributions in North Macedonia, 2022

Contribution to pension fund and disability insurance of Macedonia (PFDIM)	18.80%
Health insurance contribution	7.50%
Additional health contribution	0.50%
Employment contribution	1.20%

Table 9 – Calculation of gross and net minimum wages in North Macedonia, 2022

Gross wage	**22 146**
Contribution to PFDIM	4163
Health insurance contribution	1661
Additional health contribution	111
Employment contribution	266
Total contributions	**6201**
Gross salary reduced for contributions	15 944
Tax exemption	**8438**

Basis for calculation of personal income tax	**7506**
Accrued personal income tax (10%)	751
Net wage	**15 194**

Source: Data compiled by KSS, 2022

d. Corporate income tax and tax incentives for corporations

North Macedonia implements a low corporate income tax rate of 10 per cent. In addition, the country offers foreign investors no less than 15 special economic zones (see Table 10). Table 11 provides a comparison between the tax due by foreign investors established in special economic zones and that due by domestic companies. Foreign investors enjoy considerable tax incentives, including a zero per cent corporate income tax rate for ten years and zero VAT.

Table 10 – Special economic zones

Special economic zone	Area (ha)	No. enterprises	Main operating industry	Cumulative investment (€m)
Skopje 1	140	12	Automotive	208
Skopje 2	97	1	Automotive	25
Skopje 3	44	n/a		
Stip	206	3		12
Tetovo	95	1		
Prilep	67	2	Automotive/ plastics	20
Struga	30	2		
Strumica	25	1		
Kichevo	30	1	Electronics/ cables	15
Gevgelija	50	n/a	Automotive	15
Berovo	17	n/a		
Delchevo	21	n/a		
Radovis	10	n/a		
Rankovce	40	n/a		
Vinica	21	n/a		

Source: OECD (2017: 70)

Table 11 – Comparative tax advantages in special economic zones

	Rate in the zone	Rate outside the zone
Tax duties		
Corporate tax	0% up to 10 years	10%
Personal income tax	0% up to 10 years	10%
VAT	0%	18%
Excise tax	0%	5% – 62%
Customs duties		
Equipment, machines and spare parts	0%	5% – 20%

Source: Data compiled by KSS, 2022

e. Trade union priorities

The priorities of both KSS and SSM are focused on core labour issues, including the increase of wages and reforms to the pension system. Both topics raise questions of public financing and, therefore, tax policies. In addition, whilst the two organisations have not yet developed detailed policy demands for tax reform, they are acutely aware of the synergies between current tax policies and income inequalities.

More broadly, the trade unions emphasise the importance of transparent decision-making. For every reform in the tax system, they demand comprehensive analysis, social dialogue and thorough implementation.

Serbia

a. Fiscal challenges

The global slowdown which resulted from the pandemic did not affect Serbia as substantially as the majority of European countries. This is due to its previous dynamics in terms of growth, financial stability and the structure of the economy.

Nonetheless, like everywhere in the region, the country put in place a sizeable level of support measures which had an impact on the budget. The government issued three successive support packages, with a total amount of eight billion euros. These measures included employment subsidies to SMEs and large companies, tax relief and other public subsidies. In 2020 alone, the support packages amounted to six billion euros, some 12.7 per cent of GDP.

Aside of pandemic-related spending, close to half Serbia's capital expenditure is earmarked for public investment in road and rail transport infrastructure (European Commission 2021c: 12).

b. Social indicators

The unemployment rate in Serbia is 10 per cent of the population. Informal employment remains high, at 16.7per cent, but plays significantly less of a role than in the other three countries covered in this article. Like everywhere in the region, however, high labour taxation is a strong incentive for undeclared work from the perspective both of employers and of workers.

In 2019, 31.7 per cent of the population was at risk of poverty. The European Commission considers that the further increase in non-taxed wage allowances to a level close to, or equal to, the minimum salary would have a significant impact on in-work poverty (European Commission 2021c: 19).

Social dialogue does not appear to be well-functioning, especially in the private sector where few collective agreements are negotiated. In addition, trade unions report a lack of communication with public officials. Although unions have developed a set of clear demands for tax reform, they have mainly been ignored by the government.

On the business side, it appears from our questionnaire that there are several private sector organisations with active policy advocacy on tax reform. These include the Foreign Investors Council, Privredna Komora Serbia (Chamber of Commerce and Industry), the American Chamber of Commerce, the National Alliance for Local Economic Development (NALED), USAID and associations of employers of Serbia.

In contrast, there does not seem to be a civil society movement engaged in tax justice.

c. Personal income tax and labour taxation

Serbia introduced a flat personal income tax rate of 14 per cent in 2001, gradually lowering it to reach 10 per cent in 2013.

Social security contributions exceed 37.05 per cent of the gross wage, more than half of which is borne by employees. The non-taxed allowance is adjusted annually to reflect real wage trends. Furthermore, companies can be completely exempted from labour taxation if they meet one of the following situations:

a) those who employ an unemployed person who has been registered for at least six months with the Employment Bureau are entitled to a 65-75 per cent tax return, depending on the number of newly-employed workers
b) those who employ a person who, in 2019, did not have status as an insured worker are entitled to a reduced tax return for three years, first in the amount of 70 per cent, then 65 per cent in the second year and, finally, 60 per cent.

d. Corporate income tax and tax incentives

The statutory corporate income tax rate is 15%. In addition, Serbia has 14 special economic zones where foreign investors enjoy considerable tax benefits including a zero per cent CIT rate for the first 10 years of investment exceeding 8.5 million euros. Foreign investors also benefit from VAT exemptions.

Table 12 – Special economic zones in Serbia, 2017

Special economic zone	Area (ha)	No. manufacturing enterprises	Main operating industry	No. people employed	Total turnover (€m)
Apatin	415	Zone not fully active	Petroleum	0	0.1
Subotica	44	5	Electrotechnics	3521	622
Zrenjanin	98	5	Plastics	3398	206
Novi Sad	75	6	Petroleum	251	82
Šabac	244	6	Automotive	56	9
Smederovo	143	6	Metal	1363	36
Svilajnac	33	1	Electric works	392	85
Kragujevac	176	7	Automotive	4354	2490
Užice	55	6	Copper	1950	393
Kruševac	64	1	Rubber/ Chemicals	1150	15
Pirot	116	16	Rubber/ Pneumatics	5808	689
Vranje	123	Zone not fully active	Footwear	0	0
Beograd	98	Zone not fully active		0	0

Source: OECD (2017: 75)

Note: The table contains the 12 free economic zones in Serbia except the two in Belgrade and Priboj on which relevant information is not available. The data are relevant as of 2014.

e. Trade union priorities

Both trade unions we interviewed for this research, SSS and UGS 'Nezavisnost', have developed detailed sets of proposals for tax reforms which, to date, are not being considered by the government. These demands are summarised in Box 1.

Box 1 – Trade union demands concerning tax reforms in Serbia

1. Increase the rates of direct taxes

Direct taxes (profit tax, income tax and property tax) should have priority over indirect taxes (VAT, excise duties and customs). A functional state, legal security, a low level of corruption, etc. are more important attraction factors for FDI than low tax rates and low wages.

2. Introduce progressive personal income tax

The flat tax is unfair as it violates the principle that 'those who make more should contribute more'. Income tax should be taxed progressively, with the application of tax relief on the lowest wages.

Contribution rates for social insurance should be maintained or even increased, considering that the applicable rates are low and that the funds (pension and disability fund, healthcare insurance fund) experience difficulties in their operation. Social contributions should be sufficiently high to guarantee the adequacy and sustainability of mandatory social benefits, being mindful of the ageing society.

3. Address tax avoidance and tax evasion

Measures that could help in the improvement of tax collection, stronger discipline and efficient control include:

- improvement and/or capacity building of tax administration;
- Investment in staff, training and modern equipment of tax and social security inspectors;
- mandatory payment of wages, compensation and other earnings (such as bonuses) via a bank account;
- obligation to pay commercial transactions (especially those of higher amounts) via a bank account;
- establishment of a central register of all bank accounts and control of bank accounts safeguarding against indications of tax fraud;
- control of sensitive goods related transactions such as antiquities, pieces of art, gold, jewellery, etc;
- introduction of fiscal cash registers in areas where they are not yet mandatory;
- inclusion of questions about foreign bank accounts or insurance policies in annual tax return forms.

4.Measures aiming at reducing undeclared work

These measures should include:

- the promotion of declared work by way of tax incentives and public campaigns about the long-term advantages of declared employment. This awareness raising should be conducted jointly with employer associations;
- simple and transparent tax laws and simplification of the legislation applicable to bookkeeping, accounting and business records;
- reform of the existing system of social and healthcare insurance and the creation of a stimulating environment for due respect toward the payment of taxes and contributions (extending the tax base and the introduction of progressive taxation);
- more efficient sanctions.

Bosnia and Herzegovina

a. Fiscal challenges

Bosnia and Herzegovina was hit hard by the Covid-19 crisis, with a 4.5 per cent contraction in GDP in 2020, although the crisis accelerated a slowdown that was already present before the pandemic. 2020 saw a reduction in export activities, a major source of the country's economic activity, and public finances experienced a marked drop in revenues.

In parallel, public spending is on the increase. Covid-19 support packages included wage support measures, tax deferrals, the establishment of a solidarity fund and company subsidies. The period was also marked by enhanced public support for the health sector. Independently of the pandemic, Bosnia and Herzegovina is, like all countries in the western Balkans, trying to invest in its infrastructure where there are some noted failings. Even so, the European Commission points out that what investment is being undertaken is driven mainly by the availability of external financing (European Commission 2021a: 2).

The Commission estimates that 2020 tax revenues have been lowered by 1.2 per cent of GDP while expenditure increased by 3.6 per cent (European Commission 2021a: 8). The response has been for the government to reduce public sector spending, including the announcement of measures to cut back on public investment which, expressed as a share of GDP, is set to fall sharply by 2023 (to 2.0 per cent from 2.9 per cent in 2019). The European Commission is particularly concerned that reduced investment would stand in the way of stronger growth in the medium term. Furthermore, it also concerned that, in the context of poor efficiency in tax collection, a reliance on regressive indirect taxes, coupled with a failure to improve contributions from higher income groups, leaves the quality of public finances and budget planning at a rather low ebb (European Commission 2021a: 12).

Overall, analysis and projections are particularly difficult in Bosnia and Herzegovina because of the fractured institutions.

b. Social indicators

The unemployment rate is at 16 per cent and the labour market experiences a strong gender gap (75 per cent of men but only 48 per cent of women are engaged in the labour market). Additionally, informal employment accounts for one-third of employment. This is a strong area of concern for trade unions because of the precarity of workers in such a situation who find themselves outside the protection of labour law.

This report has not been able to find data on the poverty rate.

SSRS, to which confederation we were able to speak in the course of our research, reports an active social dialogue with the government during the Covid-19 pandemic, in particular concerning the safeguarding of employment. At country level, however, the European Commission considers social dialogue to be weak, with consultations limited to labour law but not larger economic and social reforms (European Commission 2021a: 16). In Republika Srpska, collective agreements are largely confined to the public sector although private sector agreements can be found in some industry sectors in the Federation.

On the business side, it appears from our questionnaire that employer organisations have an active tax agenda, calling for a reduction in overall tax burdens. There does not, however, appear to be a civil society movement engaged in tax justice.

c. Personal income tax and labour taxation

The country has a 10 per cent flat tax rate for personal income tax. Social security contributions amount to up to one-third of the gross wage and, here, at best, employees contribute three times more than employers. In Republika Srpska and the District of Brčko, employer contributions are either zero or extremely low. In Republika Srpska, however, recent reforms include a 150 per cent increase in the non-taxed allowance, resulting in an increase of take-home pay. According to the union, this has also led to a decrease in the tax wedge which is usually considered a good sign for employment.

Table 13 – Social security contributions in the Federation of Bosnia and Herzegovina, 2020

Type of contribution	Employee contributions (%)	Employer contributions (%)
Contribution for pension and disability insurance	17.0	6.0
Contribution for health insurance	12.5	4.0
Contribution for unemployment insurance	1.5	0.5

Table 14 – Social security contributions in Republika Srpska, 2020

Type of contribution	% of gross salary – paid only by employees
Contribution for pension and disability insurance	18.5
Contribution for health insurance	12.0
Contribution for unemployment insurance	1.0
Contribution for child protection	1.5

Source: Gjokutaj and Gjokutaj (2020) for each of Tables 13 and 14 (respectively: 2020: 32; 2020: 39)

In the District of Brčko, employees may choose to pay into either the Federation pension and disability fund, in which case there is also an obligation for a six per cent contribution from the employer, or the one in Republika Srpska (zero employer contribution). Health insurance contributions are 12 per cent of gross salary.

d. Corporate income tax and tax incentives

Statutory corporate income tax is fixed at a low rate of 10 per cent. It is also possible to claim tax deductions for the hiring of full-time employees.

Bosnia and Herzegovina has four active special economic zones, fewer than in neighbouring countries. Tax incentives include a 30 per cent reduction in corporate income tax if the foreign investor re-invests 50 per cent of its profits in production and machinery and a 50 per cent reduction for investments of over 20 million Bosnian marks (c. 10 million euros) over five years. Foreign investors established in the zones also benefit from VAT exemptions although the OECD reports that this exemption is not always implemented in practice.

Table 15 – Special economic zones in Bosnia and Herzegovina, 2014

Special economic zone	Area (ha)	No. users	Main operating industry	No. people employed	Total exports (€m)
Hercegovina	43.6	41	Metallurgy	n/a	22
Visoko	17.1	23	Textiles	c. 1000	228
Vogošća	11	30	Automotive	c. 500	24
Lukavac	7.5	1	Wood processing	190	7

Source: OECD (2017)

e. Trade union priorities

Trade unions in Bosnia and Herzegovina have a heavy focus on increasing wages and reducing informal employment. In terms of the position on taxation, SSRS demands that any change in tax policies results in an increase in wages and a reduction in unfairness. SSRS is also calling for the effective taxation of dividends and corporate income at a rate equivalent to that which is applicable in EU Member States.

Montenegro

a. Fiscal challenges

Predictions for recovery in Montenegro are optimistic and the economy is expected to have returned to its pre-crisis level in 2022. The government adopted five Covid-19 packages, consisting of wage subsidies, measures to maintain liquidity in companies and support for vulnerable groups. The European Commission estimates that the fiscal impact of Covid-19 for 2020 was a tax shortfall of 6.2 per cent of GDP whilst support measures increased expenditure by 1 per cent (European Commission 2021d: 8)

According to the trade unions, there was a very limited level of investment in public services at the time of the pandemic. Investments were made only in the field of health services and in order to overcome limited capacities in both equipment and hospital beds and the shortages of other resources necessary in the fight against Covid-19. When it comes to investment in infrastructure, work is continuing on the completion of the Bar-Boljare highway section, expected to be in use this year, but there does not appear to be additional major expenditure after that.

In December 2021, Montenegro adopted a series of laws as part of its 'Europe Now' programme. A set of measures almost doubled the amount of the net minimum wage (from 250 to 450 euros) whilst, at the same time, reducing labour taxation for those on the lowest incomes. A progressive personal income tax regime was also introduced. According to the trade unions, the objective of this ambitious plan is to fight the 'brain drain' and reduce the size of the informal economy.

b. Social indicators

According to official data, the unemployment rate in 2022 was 23.91 per cent. The biggest rate – 32.7 per cent – was registered in July 2000 and the lowest in August 2009 – 10.1 per cent.

Montenegro has a large informal economy with undeclared work estimated at 30 per cent of total employment. According to the European Commission, the scale of phenomenon is diverse but, as regards the labour market, the labour taxation system (prior to the 'Europe Now' reform) was likely to be one driver, having adverse implications for workers, the budget and the country's social security system (European Commission 2021d: 22).

Some 30.5 per cent of the population is at risk of poverty or social exclusion.

The social dialogue is currently stalled. Montenegro is going through a deep political crisis, making it difficult for trade unions to operate, and the improvement of dialogue and its mainstreaming have been specifically identified as a structural reform measure (European Commission 2021d: 35). Nonetheless, SSCG and USSCG report their full participation in the co-ordination body monitoring the implementation of 'Europe Now', which includes representatives of all the relevant institutions and social partners. USSCG reports that the programme reflects about 80 per cent of trade union demands, which were related to the increase of the minimum wage, the introduction of a non-taxable wage allowance, a progressive taxation regime and an increase in the tax on profits above certain threshold.

Although it does not have the status of social partner, the American Chamber of Commerce is active in Montenegro as is the Montenegro Business Alliance and Unija Poslodovaca Crne Gore (Association of Employers of Montenegro).

Unlike the other countries covered by this study, taxation reform can be a visible topic in the media. The increase in the minimum wage and the introduction of anon-taxed wage allowance attracted significant media attention in 2021.

c. Personal income tax and labour taxation

Montenegro introduced in 2007 a 15 per cent flat tax regime, gradually lowering this to 9 per cent in 2010. Following fiscal difficulties during Covid-19, a 2021 reform – a so-called 'crisis tax' – introduced significant changes. First, it increased the non-taxable wage allowance to 700 euros. Gross earnings between 700 and 1000 euro are still taxed at 9 per cent, but gross earnings above 1000 euro are taxed at 15 per cent. The tax wedge is expected to reduce significantly from 39 per cent to 20.6per cent.

However, the 2007 law on contributions for compulsory social insurance revoked the previous healthcare insurance paid jointly by employees and the employer (total 10.8 per cent). The total contributions paid by employees amount to 15.5 per cent and those by employers to 6 per cent.

Table 16 – Social security contributions in Montenegro, 2022

Type of contribution	**Employee contribution (%)**	**Employer contribution (%)**
Pension and disability insurance	15%	5.5%
Unemployment insurance	0.5%	0.5%
Total	15.5%	6%

Source: Data compiled by SSCG, 2022

d. Corporate income tax and tax incentives

Montenegro applies a progressive corporate income tax rate, ranging from 9 per cent to 15 per cent. For profits up to 100 000 euros, the tax rate is 9 per cent while for profits between 100 000 euro and 1.5 million euro there is a fixed amount of 9000 euros plus 12 per cent on profits above 1 million. For profits above 1.5 million euro, there is a fixed charge of 177 000 euros plus 15 per cent.

There is only one special economic zone, in Bar, with a small number of foreign investors mainly offering customs and VAT exemptions.

e. Trade union priorities

Both SSCG and USSCG express overall satisfaction about recent reforms which address long-standing demands for increases in the net minimum wage and a more progressive personal income tax regime. In addition to an improved standard of living, they expect that such reforms will help to address the informal economy.

In addition, USSCG has been calling for a doubling of current corporate income tax rates which it does not believe is a genuine factor in the attraction of FDI. The union is also demanding higher taxation of the wealthy through, for instance, the application of a luxury tax.

Recommendations for a trade union agenda

The previous section has outlined the fiscal challenge faced by the countries of the western Balkans: increased public spending at a time of reduced revenues. The context is therefore highly favourable for tax reforms which are aimed at consolidating tax revenues. This section argues that, to address the recurring issues of inequalities and budgetary resources, more attention needs to be paid to the taxation of capital income, examined immediately below. This is particularly relevant in the light of international developments on a global minimum tax rate. As far as personal income taxation is concerned, a later sub-sections suggests more progressive scales of taxation.

Better taxation of capital income

Western Balkan countries are overly reliant on consumption and labour taxes while sheltering capital income. Many trade unions in the region have focused their policy calls on an increase in minimum wages and the reduction of labour taxation for those on lower incomes. These are natural demands for the labour movement and quite necessary in order to address incentives for undeclared work and to reduce the risk of poverty. However, a narrow focus on labour taxation is unlikely on its own to increase tax revenues to the level that is required for public investment and for adequately funded public services.

The central recommendation of this report is therefore to explore solutions to broaden the base of corporate income tax. In addition to increased revenues, this would go a long way towards reducing the gap between the shares of national income held by capital and labour. An obvious first step is an increase in the statutory rates of corporate income tax, which are significantly lower than the EU and OECD averages. Second, increasing these minimum rates should go hand-in-hand with an in-depth rethinking of transfer pricing rules towards unitary taxation so as to prevent revenue leakage. Third, the capital invested in special economic zones goes virtually untaxed and there are some serious questions as to the contribution of untaxed FDI to sustainable growth and quality jobs. A fourth issue is the need to increase the efficiency of corporate income tax collection.

To address these challenges, trade unions could envisage integrating the following policy demands into their agenda for tax reform.

Increase effective tax rates to at least 25 per cent

We are referring here to the effective tax rate as opposed to the statutory one, which implies a commitment by the tax authorities to enforce the actual payments due. The western Balkans would not be isolated in such a reform: as described above, the momentum for increasing effective tax rates is global as a result of the recent OECD/G20 agreement in which OECD countries are expected to introduce a ‘top-up tax’, or the right to ‘tax back’, designed to compensate the under-taxation of overseas corporate profits.

The OECD model rules give a clear priority to resident countries (i.e. where multinationals are registered) in the application of the right to tax back. The country of residence would come first by imposing the ‘top up’ tax on the parent company to account for the under-taxed profits of its subsidiaries/establishments; it is only where the country of residence does not use this right that source jurisdictions (i.e. countries where subsidiaries/establishments are situated) can, in turn, claim tax adjustments (PSI 2021).

In this context, it makes little sense for low tax countries to maintain their reduced corporate income tax rates. If they persist in doing so, multinational corporations active on their territory would still have to increase their tax payments but the revenues would be collected by other countries in which they are resident. For the western Balkans to get a fair share of the pie, it is therefore essential to increase their effective tax rates to at least the agreed minimum. The OECD/G20 agreement has fixed that minimum at 15 per cent.

However, the global labour movement is urging countries to build on that momentum and to implement a 25 per cent minimum effective rate. This is necessary to curb tax competition effectively and would lead to a substantial increase in revenues.

Switch to unitary taxation with fair allocation features

In parallel to increasing the minimum effective rates, countries can address the risks of revenue leakage through an in-depth reform of transfer pricing rules towards unitary taxation and formulary apportionment. Ensuring that employment becomes an important factor in determining where value is created, and thus where taxes can be raised, is critically important. As a general rule, this substantially increases revenue prospects for labour intensive source countries. A switch to unitary taxation with employment as one of the allocating factors (along with sales and assets) is therefore a perfectly appropriate solution for the western Balkans.

However, great caution is advisable when deciding to join or maintain adherence to the OECD BEPS Action Plan. As illustrated by the recent agreement on a global minimum tax, OECD outcomes tend to reflect bias in the allocation of taxing rights towards developed countries that are home to many multinationals, to the detriment of smaller non-OECD economies. Some of the BEPS actions, including in particular actions 8-10, would make it more difficult for governments in the western Balkans to move away from transfer pricing rules towards unitary taxation. All countries should carry out a careful evaluation of the revenue impact before implementing the recommended actions and, in any case, should adjust some of the OECD model rules to domestic considerations.

Reconsider tax incentives

The rather intensive use of special economic zones needs also to be reconsidered. Since their establishment, such zones in the western Balkans have attracted a cumulative investment of 2.5 billion euros (as at 2017). Exemptions from corporate income tax thus entail sizeable foregone revenues especially as tax incentives may not be a decisive factor in companies' decisions to invest.

Moreover, attracting FDI should not be a blind target in itself. Rather, the incentives that are offered should form part of broader industrial policy strategies that have as their objective green and sustainable development, higher productivity and R&D intensity and, above all, the delivery of quality jobs. Tax incentives, if any, need to be adjusted to reflect that agenda.

Improve tax enforcement

Low tax morale and insufficient enforcement capacities are often cited as a key problem in the western Balkans. Adequate capacities must therefore be devoted to tax administration. This, however, is a catch-22 situation since the availability of technical and human resources is very dependent on state finances. For this reason, the demand for better tax enforcement, whilst fundamental, cannot be a standalone solution. Structural changes, as suggested above, are also necessary to broaden the tax base.

In addition to capacities, transparency and the exchange of information between tax authorities are essential aspects of enforcement. Adopting mandatory country-by-country reporting for multinationals is therefore a crucial step. Companies should be required to report all the information necessary to assess their global operations, where they register their profits and their losses and where they create value, in particular through employment.

Action 13 of the BEPS Action Plan contains a reporting template which can easily be transposed into domestic legislatures. Another source of inspiration is GRI Standard 207 (Global Reporting Initiative 2019); a reporting template relied upon by investors who wish to assess the tax strategy of investee companies. Trade unions favour the GRI standard because it requires public disclosure. As we also note further below in the context of a discussion about public scrutiny, public data is indeed an important trade union demand. Overall, however, the reporting obligation should have a broad scope of application so as to cover all multinational corporations active in the region. The threshold foreseen by Action 13 in the BEPS Action Plan, of consolidated group revenues of 750 million euros, should be lowered to at least 40 million euros. This is in line with EU accounting Directive 2013/34 which considers that, where net turnover is above 40 million euros, a company should be considered as medium-sized and therefore subject to more stringent accounting requirements.

According to the OECD public database, only Serbia and Bosnia and Herzegovina of the countries covered by this study have implemented such a legal framework in their domestic law.[3] Moreover, none seem to have put something in place which is in a format shareable with other tax administrations. All four countries are part of the Global Forum, an OECD hosted body aiming at improving transparency and the exchange of information between tax authorities. Nevertheless, compliance with OECD standards is still under review and, to judge by the demands of the Serbian trade unions concerning the need to carry out operations through bank accounts (see Box 1), the chances are that these standards are not really being complied with elsewhere, too.

Serbian trade unions are also calling for dissuasive penalties. In addition, a powerful enforcement tool can be the exclusion of tax dodging companies from state support and public procurement.

Last but not least, trade unions should include in their demands the creation of beneficial ownership registries that are interlinked with other registries worldwide and which are publicly accessible. Such a tool is indispensable in establishing the ultimate identity of those who ultimately own, control or benefit from any asset.

A more progressive taxation of personal income

The tax wedge in the four countries covered by this study is high. On the one hand, the progressivity of personal income tax is low – this is the legacy of the flat tax revolution; on the other, the need to find revenues in particular to finance pension systems has led to increased labour taxation.

Recent years have seen increases in minimum wages throughout the western Balkans (World Bank 2022). A related trade union demand is to increase the amount of tax-free allowances which has a beneficial impact on low earners and contributes to reducing the tax wedge. The Montenegrin ‘Europe Now’ programme, fully backed

3 And neither does Albania. See: https://www.compareyourcountry.org/tax-cooperation/en/2/630/default (accessed 23 August 2022).

by the trade unions, constitutes an interesting development that may serve as a source of inspiration for other reforms in the region.

Additional solutions can also be explored to ensure greater progressivity in the taxation of personal incomes. The objective is to reduce income inequalities between wage earners. Flat tax rates should be abandoned in Bosnia and Herzegovina and in North Macedonia. In all four countries, personal income tax can be made more progressive, especially with the introduction of top tax brackets of 40 per cent or more. It may be that, due to the small number of individuals with higher earnings, the tax base for higher tax brackets is too narrow to generate a significant revenue effect. It would, however, go a long way towards ensuring more fairness in the tax system, thereby addressing economic resentment which itself feeds into social and political instability. Greater equity can also help with the situation of low tax morale in the region pointed to specifically by the European Commission in the case of North Macedonia (2020e: 123) but also alluded to elsewhere.

The World Bank suggested the need for a readjustment of the shares of social security contributions and personal income tax in its 2019 report on labour market trends in the region, lowering the former and increasing the latter (World Bank 2019: 69). The World Bank correctly indicates that this is potentially a thorny reform but, in principle, it would be revenue neutral with overall positive effects on employment while it could also help with the progressivity of labour taxation since social security contributions are largely borne by employees. Its controversial nature lies in the labour movement being traditionally cautious about calling for reduced social security contributions as this is usually done to the detriment of sustainable pension systems. Therefore, this solution must be carefully explored – taking into account not only the effects in the short term but also the long term impact on social protection regimes.

Finally, the demand of USSCG in Montenegro for a progressive VAT structure with higher rates (of 25 per cent or more) on luxury goods and a minimum rate (of 5 per cent or less) for basic products and services is also worth noting.

Improved public scrutiny

Trade unions in the region report a lack of any impact assessment of past policies on employment, the fiscal space and sustainable growth. There is, therefore, a strong case to improve policymaking via a stronger evaluation of the impact of both past policies and future proposals. Those evaluations absolutely need to be made public.

Trade unions can, to some extent, carry some evaluations themselves. They can, for instance, assess the progressivity of existing policies through the Fair Tax Monitor developed in 2015-16 by Oxfam and the Tax Justice Network Africa that provides a simple methodology for assessing, amongst others, the progressivity of tax systems, the risks of tax leakages and regimes' overall transparency and accountability. Among the indicators to evaluate progressivity, the methodology suggests the identification of different rates for different brackets, types of taxation of capital and the importance of VAT in the tax distribution. With regard to corporate tax, indicators include not only the rate but also loopholes such as loose rules on loss carry forwards, interest deductions and penalties.

Additionally, Action 11 of the BEPS Action Plan provides six indicators to measure and monitor tax avoidance practices at country level, including profit rates in various parts of company groups as well as a comparison between the tax payments of foreign multinationals and those of domestic companies. It may be that the required information is not in the public space. For this reason, public country-by-country reporting is a fundamental labour demand. This will go a long way towards increasing the accountability of tax authorities as well as strengthening collective bargaining strategies for a fairer share of corporate wealth.

Conclusion and strategic considerations

Trade unions in the four countries covered by this report unanimously take issue with the high tax burden on low wages found in each one, which is particularly problematic since the majority of employees are on lower incomes. They also express concerns about the size of the informal economy and the 'brain drain' which they attribute largely to current tax policies.

This research has confirmed that the tax distribution is particularly unfair in the western Balkans, with a heavy reliance on VAT and social security contributions, with the latter themselves being borne more heavily by employees than by businesses. In contrast, revenues from higher incomes and capital are relatively sheltered.

Our main recommendations therefore consist of increasing the effective taxation of corporate profits as well as the progressivity of the taxation of personal incomes. Government accountability should also be improved through higher tax transparency and more open and inclusive policymaking.

These recommendations echo the calls of the global labour movement and several are already part of the union agenda within the region. The key issue, however, may not be lack of technical expertise but rather difficulties in building power for change. This is not a problem specific to the western Balkans. The tax policymaking agenda is captured by business associations and powerful corporations which can go as far as negotiating their tax bills directly with governments. With the exception of Montenegro, where tax was an integral part of a recent reform, all trade unions highlight weak public debate and the absence of a tax justice movement.

A first step therefore is to build a base for action, rooted in public pressure and a coalition of progressive forces. Alliances could be sought with labour organisations and civil society active in the global tax agenda with a view to increasing international attention on the damaging tax policies that are found in the region. Domestically, trade union campaigns targeting multinational corporations should fully integrate the tax avoidance angle: experience has indeed shown that outing corporate tax practices is often effective in raising public attention regarding the relatively low contribution that multinationals make to public budgets. Overall, trade unions need to prepare their arguments carefully on the alleged links between tax hikes and lower business investment and job creation. Finally, a coordinated trade union agenda in the region can deliver a powerful counter-argument.

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Zsolt Darvas

Discretion lets Croatia in the euro area in 2023, but leaves Bulgaria out*

Abstract

This article – written originally as a blog post for the think tank Bruegel – reviews the decisions made in June 2022 to allow Croatia into the euro zone but, in contrast, to make no change in the status of Bulgaria which, nominally, thus remains an EU Member State with a derogation from introducing the euro but one subject to complying with the requirements to allow it to do so. The author notes that, while the Bulgarian legislation on central bank independence remains an outstanding issue, there are other aspects of the decision to allow Croatia in but to refuse Bulgaria which cause disquiet. In reviewing price stability statistics on the basis of different measures, the author concludes that these indicate a level of decision-making discretion, creating a grey area in the criterion, as well as uncertainty over how comparative inflation performance is judged and a level of dubiety. He concludes that a rethink is necessary on how to interpret 'best performers' and that the time is right to fix the flaws in the existing criterion by switching to comparators which are closest to the average for the euro area as a whole.

Keywords: *euro area, Croatia, Bulgaria, European Commission, European Central Bank, price stability*

Introduction

On 17 June 2022, the euro area's finance ministers endorsed Croatia's euro membership, based on assessments by the European Commission (2022) and the European Central Bank (ECB) (2022). Both institutions concluded that Croatia had fulfilled the conditions for the adoption of the euro. They also judged that another candidate, Bulgaria, had not.

To join the euro, countries should meet criteria on price stability, having sound and sustainable public finances, low long-term interest rates and exchange rate stability. Their laws should also provide for central bank independence. While Croatia was considered to have met the necessary conditions, Bulgaria fell short on price stability and incompatible central bank legislation. But Croatia would also have fallen

* This article was written originally for Bruegel.com, a European think tank established in 2005 whose aim is to improve the quality of economic policy with open and fact-based research, analysis and debate. It was published on 22 June 2022 and is re-published here, in slightly re-edited form, with kind permission. We have done so to help inform debate amongst our own readership; for fuller links in support of the author's views, the interested reader is invited to consult the original post, which can be found at: https://www.bruegel.org/blog-post/discretion-lets-croatia-leaves-bulgaria-out-euro-area-2023.

short on price stability without a discretionary adjustment – related to the choice of comparison countries – being made to the assessment.

It should be noted that, from the perspective of macroeconomic development and adjustment capacity under a fixed exchange rate, both countries are ready to enter the euro area.

Bulgaria's performance has been especially stunning: under a fixed exchange rate, the country corrected its current account deficit of close to 22 per cent of GDP in 2008 to a close-to-balance position by 2010. Between then and 2021, a small surplus was maintained on average. The global financial crisis of 2007-08 was followed by robust economic growth and Bulgaria's export performance was similar or even better than floating-rate Czechia, Hungary and Poland, all of which benefited from substantial exchange rate depreciation after 2008. Bulgaria's gross public debt was 25 per cent of GDP in 2021, the third-lowest value in the EU after Estonia and Luxembourg.

Croatia, meanwhile, had a harder time adjusting after the global financial and euro crises but ultimately did so under a tightly managed exchange rate regime. This is encouraging for the country's performance inside the euro area.

Before joining the exchange rate mechanism (ERM II), both Bulgaria and Croatia had to fulfil various requirements, including governance reforms, and both the European Commission and the ECB assessed that Bulgaria and Croatia had properly implemented these reforms. Both countries have integrated into the Single Supervisory Mechanism since their entry in 2020 and their banking systems are strong.

One might welcome the decisions of the European Commission and the ECB to exploit the grey area in the interpretation of the price stability criterion to allow Croatia to join in 2023. But this should not have been done in a way that prevented Bulgaria from joining (conditional on fixing its central bank legislation issues). This episode highlights again the need to re-think the interpretation of the price stability criterion so that it can be applied consistently without the need for discretionary adjustments.

In this article, I review the Commission's and the ECB's justification for excluding two countries from the calculation of the price stability criterion and examine what the consequences of the alternative choices would have been.

How did Croatia benefit and Bulgaria lose out?

Article 140(1) of the Treaty on the Functioning of the EU (TFEU) requires price stability to be measured by comparing the inflation rate in the euro candidate country with that in 'the three best performing Member States in terms of price stability'. For Croatia and Bulgaria, the Commission and ECB dropped two of the comparison countries that would normally be considered best performers, replacing them with countries with higher inflation rates.

TFEU does not define the concept of 'best performing Member States in terms of price stability', leaving room for interpretation. The Commission and the ECB define this concept as those countries with the lowest inflation rates, with occasional discretionary adjustments. Neither the Commission nor the ECB provide any justification for this choice.

For the ECB, considering the lowest inflation countries as the best performers is highly problematic. The ECB defines price stability as an inflation rate of two per cent for its monetary policy framework. It thus uses a different definition of price stability for its monetary policy objective (two per cent) to that used for assessing suitability for euro membership (lowest inflation rates). The ECB only states that:

> The price stability criterion thus takes into account the fact that common shocks (stemming, for example, from global commodity prices) can temporarily drive inflation rates away from central banks' targets. (European Central Bank 2022: 7)

This leaves the definition of price stability for euro membership assessment rather unclear.

Two questions emerge:

- do the lowest inflation rates correspond to 'best' performance?
- on what basis are discretionary adjustments made?

A level of inflation that is too low entails risks. Since price stability is the ECB's primary objective, and the ECB has quantified this concept as an inflation rate of two per cent, it is hard to argue that the countries with the lowest inflation rates are the best performers in terms of price stability. Instead, considering the best performers to be the three countries with inflation closest to the ECB's two per cent target would be an unambiguous definition in line with the provisions of the Treaty.

An alternative would be to measure euro area candidates against the three countries with inflation rates which are closest to the euro area average. The euro area average is what the ECB is able to achieve when pursuing its price stability mandate, under the specific economic circumstances of the time. Euro aspirant countries have close economic ties with the euro area and are influenced by macroeconomic developments in the euro area, including inflation. Again, this definition would be unambiguous, not necessitating any ad hoc adjustment.

Discretionary adjustments to the selection of best performers

The April 2022 inflation data, used for the Commission's and the ECB's assessment, indicated that the three countries with the lowest all-items inflation rates were Malta (2.1 per cent), Portugal (2.6 per cent) and France (3.2 per cent) (Table 1), giving an average of 2.6 per cent.

In assessing price stability, the EU Treaty gives a leeway of 1.5 percentage points by which inflation rates in euro candidate countries can exceed the average rate of the best performers. So the application of the previous practice of the Commission and the ECB would have resulted in an inflation reference value of 4.1 per cent (i.e. 2.6 + 1.5). This would have stopped both Croatia (4.7 per cent) and Bulgaria (5.9 per cent) from joining the euro area in 2023.

But the Commission and ECB chose to exclude Malta and Portugal from the calculation, referring instead to France (3.2 per cent), Finland (3.3 per cent) and Greece (3.6 per cent) as the best performers. This resulted in a reference value of 4.9 per cent (average of 3.4 per cent + 1.5), meaning Croatia squeezed in.

Table 1 – The ten EU countries with the lowest inflation rates, plus Bulgaria, Croatia and the average for the euro area, April 2022 (12-month moving average rate of change, %)

Country	All-items index
Malta	2.1
Portugal	2.6
France	3.2
Finland	3.3
Greece	3.6
Denmark	3.6
Italy	3.7
Sweden	3.7
Austria	4.2
Slovenia	4.2
Euro area	**4.4**
Croatia	**4.7**
Bulgaria	**5.9**

Source (for all tables in this article): Bruegel, based on Eurostat's HCIP monthly data (12-month moving average rate of change) [prc_hicp_mv12r] dataset

Malta and Portugal were excluded because they were considered outliers. The Commission and the ECB used almost the same words for this decision, so I quote the Commission's report. The Commission said that the inflation rates of Malta and Portugal were 'substantially below the euro area average' and there were 'country-specific factors that cannot be seen as representative of the process driving inflation in the euro area' (European Commission 2022: 4). For Malta, the country-specific factor was the absence of energy-price inflation, which was a result of government measures. For Portugal, the country-specific factors were:

> comparatively low energy inflation and the weaker cyclical position of the country compared with most other EU Member States. (European Commission 2022: 4)

The slow recovery from the Covid-19 crisis:

> reflects mainly Portugal's large exposure to tourism and particularly aviation-based tourism, which has been heavily and durably hit by the pandemic. (European Commission 2022: 4)

This raises three issues.

First, the exclusion of any country from the calculation is based on a discretionary decision, because TFEU does not provide any guidance on excluding certain countries.

Second, the Commission's justification refers on multiple occasions to average inflation in the euro area and also refers to a comparison with other Member States. This undermines the rationale for considering the three countries with the lowest inflation rates as the best performers in terms of price stability. Instead, the Commission's justification would actually be consistent with treating as the best performers those three countries in which inflation is closest to the average for the euro area. For the current exercise, that would be Cyprus (4.4 per cent), Ireland (4.5 per cent) and either Austria or Slovenia (both 4.2 per cent), resulting in a reference value of 5.9 per cent, which would have allowed Bulgaria to join the euro area from 2023 (again, provided that central bank law issues had been fixed).

Third, the justifications used to exclude Malta and Portugal could have been used to exclude Finland, France and Greece – the countries that were used – as well (indeed, arguments could also be made for other countries). We explore this issue in detail in the rest of this section, with reference to different measures of price rises.

1. Energy prices grew 13.7 per cent in Portugal, 18.3 per cent in Finland and 18.8 per cent in France, while the euro area average was 24.7 per cent (Table 2). Thus, there was also a sizeable gap between the euro area average and Finland and France. In Croatia, Czechia, Hungary, Malta and Slovakia, energy prices increased less than in Portugal, so the Portuguese energy price increase is not really an outlier.

Table 2 – The ten EU countries with the lowest energy inflation rates, plus the average for the euro area, April 2022 (12-month moving average rate of change, %)

Country	Energy index
Malta	-0.4
Slovakia	6.8
Czechia	12.1
Hungary	13.2
Croatia	**13.5**
Portugal	13.7
Slovenia	17.8
Poland	18.2
Finland	18.3
France	18.8
Bulgaria	**20.4**
Euro area	**24.7**

2. since an important concern was too-low energy price inflation, the overall index excluding energy could have been used (Table 3), leading to Greece and Italy (both 1.3 per cent) and either France or Portugal (both 1.7 per cent) being seen as the three best performers, giving a reference value therefore of 2.9 per cent. In this case, neither Croatia (3.4 per cent) nor Bulgaria (3.9 per cent) would have qualified to enter the euro area.

Table 3 – The ten EU countries with the lowest non-energy inflation rates, plus Bulgaria, Croatia and the average for the euro area, April 2022 (12-month moving average rate of change, %)

Country	All-items index excluding energy
Greece	1.3
Italy	1.3
France	1.7
Portugal	1.7
Denmark	1.9
Finland	1.9
Spain	2.0
Sweden	2.0
Belgium	2.1
Euro area	**2.2**
Luxembourg	2.2
Netherlands	2.2
Croatia	**3.4**
Bulgaria	**3.9**

3. the third lowest increase in food prices among EU countries was France (1.4 per cent) and the fourth lowest increase was in Finland (2.0 per cent) while the euro area average was 2.9 per cent (Table 4). Thus, one could argue here that unusually low growth in food prices could have justified the exclusion of France and Finland.

Table 4 – The ten EU countries with the lowest food price inflation, plus Bulgaria, Croatia and the average for the euro area, April 2022 (12-month moving average rate of change, %)

Country	Food and non-alcoholic beverages index
Belgium	1.0
Ireland	1.2
France	1.4
Finland	2.0
Luxembourg	2.0
Netherlands	2.0
Sweden	2.0
Italy	2.3
Slovenia	2.3
Denmark	2.5
Euro area	**2.9**
Croatia	**5.6**
Bulgaria	**7.7**

4. the price stability criterion could reasonably have been assessed based on the overall index excluding energy, food, alcohol and tobacco – in other words, core inflation (Table 5). By excluding these volatile items, core inflation better reflects underlying price developments. The three countries with the lowest core inflation rates were Greece (0.4 per cent), Italy (1.1 per cent) and Portugal (1.4 per cent), with an average of one per cent, leading to a reference value of 2.5 per cent. Here, Croatia (2.5 per cent) would have just qualified to enter the euro area while Bulgaria (2.6 per cent) would have missed it by a sliver. But, if both Greece and Portugal were excluded because of their weak cyclical positions (see next point), then both Croatia and Bulgaria would have qualified for the euro by a good margin. Moreover, if the three countries with inflation rates closest to the euro area average (2.1 per cent) were the best performers, then both Bulgaria and Croatia would be in, again by a large margin.

Table 5 – The ten EU countries with the lowest non-volatile inflation rates, plus Bulgaria, Croatia and the average for the euro area, April 2022 (12-month moving average rate of change, %)

Country	All-items index excluding energy, food, alcohol and tobacco
Greece	0.4
Italy	1.1
Portugal	1.4
Spain	1.5
Denmark	1.6
Finland	1.6
France	1.8
Belgium	2.0
Malta	2.0
Euro area	**2.1**
Sweden	2.1
Croatia	**2.5**
Bulgaria	**2.6**

5. in terms of the weak recovery argument for Portugal, the latest Commission estimate puts the output gap at -3.3 per cent in 2021 and +0.3 per cent in 2022. But Greek output gap estimates are much lower: -5.3 per cent in 2021 and -2.4 per cent in 2022. Thus, the weak recovery argument would have applied more strongly to Greece than to Portugal yet, while Portugal was excluded from the calculations, Greece was included as among the three best performers on price stability.

Gaming the system?

The inflation criterion is assessed over a one-year period. Euro candidate countries might be tempted to resort to techniques such as freezing administered prices or reducing consumption taxes to squeeze in under the reference value: what has been called 'weighing-in syndrome' (Szapáry 2001: 12ff). This could be followed with a reversal of such measures after a country has joined the euro. Of the first eleven countries that joined the euro area in 1999, all met the inflation criterion in 1997 and 1998, but six failed to meet it in 2000. Similarly large violations occurred in later years.

Whether the intention was to help energy consumers or to foster euro introduction, Croatia has also resorted to such techniques. The ECB noted that:

> The rise in HICP inflation was mitigated by fiscal measures (some temporary), such as reduced VAT rates for gas, electricity and basic groceries, cuts in fuel excise duties and the freezing of margins on petroleum products. (European Central Bank 2022: 103)

However, neither the ECB nor the Commission measured the impact of such techniques. The energy price increase in Croatia (13.5 per cent) was lower than in excluded Portugal (13.7 per cent) (Table 2); while administered energy prices increased by 7.1 per cent in Croatia, the sixth lowest value in the EU and well below the euro area average of 19.5 per cent (Table 6).

Table 6 – The ten EU countries with the lowest rise in administered energy prices, plus the average for the euro area, April 2022 (12-month moving average rate of change, %)

Country	Administered energy prices
Malta	-0.4
Hungary	0.2
Slovakia	1.3
Sweden	1.6
Czechia	4.6
Croatia	**7.1**
Poland	8.2
Finland	9.3
Bulgaria	**9.6**
Romania	10.4
Spain	12.1
France	13.1
Euro area	**19.5**

The assessments could have considered the overall index excluding administered prices for the price stability criterion (Table 7), since government intervention in energy markets was the sole concern over the inclusion of Malta and was also an issue for Portugal. In this case, both Croatia and Bulgaria would have missed the price stability criterion if the countries with the lowest inflation rates are considered as the best performers, irrespective of whether Malta and Portugal were excluded from the calculation or not.

Table 7 – The ten EU countries with the lowest overall inflation excluding administered prices, plus Bulgaria, Croatia and the average for the euro area, April 2022 (12-month moving average rate of change, %)

Country	All-items index excluding administered prices
Malta	2.4
Portugal	2.8
Greece	2.9
France	2.9
Italy	3.0
Finland	3.2
Netherlands	3.8
Denmark	4.0
Cyprus	4.0
Slovenia	4.1
Euro area	**4.3**
Croatia	**5.1**
Bulgaria	**6.4**

Missing convergence report forecast in the first month

The Commission's assessment predicted that inflation in Croatia would remain below the forecast reference value by the end of 2022. This turned out to be already wrong in the first month after it was made. The ECB assessment was more cautious by not presenting a specific forecast for Croatian inflation relative to the reference value, noting instead that:

> Looking ahead, there are concerns about the sustainability of inflation convergence in Croatia over the longer term. (European Central Bank 2022: 67)

The assessments used April 2022 inflation data. On 17 June 2022, one day after the Eurogroup's endorsement of Croatia's euro membership, Eurostat published detailed inflation indicators for May 2022. The countries with the lowest overall inflation rates were (again, on the basis of a 12-month moving average rate of change): Malta (2.6 per cent); Portugal (3.3 per cent); France (3.5 per cent); Finland (3.7 per cent); Sweden (4.1 per cent); Denmark and Italy (both 4.2 per cent); and Greece (4.6 per cent). The euro area average was 4.9 per cent while Croatian inflation was 5.4 per cent and Bulgarian inflation 6.8 per cent. By excluding Malta and Portugal, the reference value would have been 5.3 per cent, preventing Croatia from joining the euro area in 2023.

Croatia would thus have missed the inflation criterion by a mere 0.1 of a percentage point on the basis of the May 2022 data; yet in 2006 Lithuania's entry to the euro was rejected on the basis of the same 0.1 percentage point gap against a reference value of 2.6 per cent, drawn from inflation rates in Sweden, Finland and Poland (European Commission 2006: 8, 12). Then, Lithuania's 2.7 per cent inflation rate was close to the euro area average of 2.2 per cent. In 2006, there was a good reason to exclude Poland and Sweden from the calculation: energy price increases in Poland (6.0 per cent) and Sweden (6.9 per cent) were significantly below the euro area average (11.2 per cent); furthermore, the Polish złoty had appreciated against the euro by 8.5 per cent over the same period, which could have contributed to low inflation in general and to low energy price increases in particular. But no such exclusions were made. Not excluding even non-euro area countries with low energy price increases in 2006, but excluding two countries with low energy price increases in 2022, underlines the arbitrariness of whether a discretionary adjustment is made to the price stability reference value.

Summing up

This all shows that different adjustments – supported by arguments – could have been made to reach any of three outcomes:

1. neither Croatia nor Bulgaria had met the price stability criterion
2. only Croatia had met the criterion
3. both countries had met the criterion.

It is undesirable that the crucial decision of whether a country can join the euro area depends on such dubious discretionary decisions. It is time to rethink the interpretation of best performers as either those countries that are the closest to the ECB's two per cent inflation target or to the euro area average. The latter option would also fix some of the well-known flaws of this criterion (Darvas 2010).

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Daniela Bobeva

It is not about Croatia and Bulgaria: it is about the fundamentals of membership of the euro area

Abstract

This article was invited from the author in response to the June 2022 Bruegel.com blog post by Zsolt Darvas – and see the separate article in this issue – about the decision to let Croatia into the euro area while keeping Bulgaria out; and intended to elicit a view from Bulgaria. The author believes that Darvas is essentially right in his approach; and that, furthermore, the applications of Croatia and Bulgaria for entry to the euro area are a perfect example of why the whole framework needs a thorough re-consideration. The founding fathers of the euro area constructed it on the basis of fundamental principles of macroeconomic stability and the equal treatment of applicants. Consequently, most of the criteria for adopting the euro, the so-called Maastricht criteria, have numerical expressions: clear and transparent criteria do not open any room for interpretations and compromises with macroeconomic stability. In the last decade, however, the author argues that the flexible interpretation of these criteria has led to changes making the accession process more discretionary and euro area membership less attractive.

Keywords*: euro area, ERM II, convergence criteria, TFEU, inflation, public debt, public policy, Stability and Growth Pact*

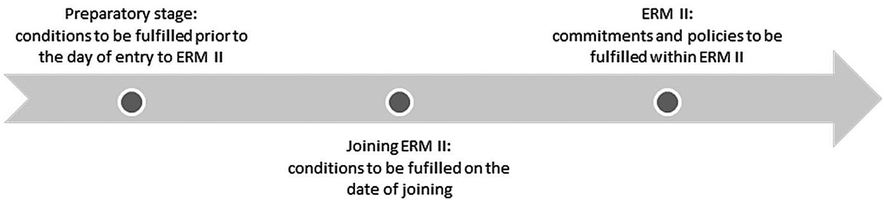
Changing the essence of ERM II

The only non-numerical criterion for euro area admission (namely, participation of the national currency in ERM II for at least two years) has been fundamentally revised in the last three years. Although the European legislation had not so far provided for criteria and restrictions on the access of national currencies to ERM II, in 2020 the two countries with strong aspirations for membership of the euro area – Bulgaria and Croatia – were requested to accept really rather severe conditions in order to fulfil this convergence criterion. The conditions set before the two countries have no precedent in the functioning of the euro area.

It is important to note from the outset that the changes in the conditions and procedures for accession to ERM II are carried out in the form of letters, decisions of the parties responsible for the ERM II process, and others. This creates both legal ambiguity and, therefore, instability. The European Central Bank (ECB) and the European Commission calls these new conditions ‘prior commitments’, although they basically act as restrictions on, or conditions for, access to the mechanism. These new conditions and procedures evidently put the countries that are about to join the euro area at a disadvantage compared to those that are already in it.

Joining the currency mechanism has now become a lengthy process and consists of three stages with various conditions set at each stage (Figure 1).

Figure 1 – Three-stage admission to ERM II



Source: European Central Bank

First stage

The first stage constitutes preparation for the accession of the national currency to ERM II. Unlike prior examples of the accession of national currencies to the mechanism, with requirements set for the policy which needs to be followed after joining, the authorities' new approach sets conditions that need to be fulfilled before joining. The two countries with currencies that joined ERM II in 2020 – the Bulgarian lev and the Croatian kuna – had to fulfil many conditions in various areas – economic, legal and technical.

The fulfilment of these conditions was subject to ongoing reports and a final assessment by the ECB and the Commission. In the cases of Bulgaria and Croatia, the commitments referred to areas such as, among others:

a) supervision of the non-banking sector
b) bankruptcy framework
c) framework for anti-money laundering measures
d) the management of state-owned enterprises.

An essential part of the preliminary stage of preparation is the asset quality review (AQR) of banks selected by the ECB and conducted by it in line with its own methodology. The process itself may put the system at risk insofar as revealing weaknesses in some of the assessed banks may raise doubts about their stability. In the case of Bulgaria, the result of the AQR led to a request for the capitalisation of a private bank with public funds; in the case of Croatia, mergers and acquisitions appeared within the banking system.

Second stage

The second stage represents the actual accession of the national currency to ERM II. Previous practice saw it as sufficient that a country had declared its intention to join the mechanism; refusals and rejections were not foreseen. The discretion of the decision making bodies is limited to determining, at the date of accession and together with the candidate country, the central rate of the national currency against the euro; the rate at which the respective currency enters the mechanism; and the range of deviation from the central rate.

According to the new procedure for ERM II entry, on the date of accession the Commission and the ECB assess whether the preconditions have been met. The second condition, in addition to the fulfilment of the so-called ‘preconditions’, is the mandatory accession of the country to the Banking Union in the form of ‘close cooperation’.

At this stage, ECB selects the banks it will supervise directly. The loss of supervision and control over a country’s own banking system as a condition for joining ERM II is a significant loss of national sovereignty that countries with a derogation have to accept if they wish to enter the euro area.

Third stage

The third and final stage is participation in both ERM II and the Banking Union in the form of close cooperation. Up to now, it has been standard practice that the press release on the admission of the new currency to ERM II includes the setting out of some policy commitments. These are the obligations that countries will honour in the future so as to ensure the stability of the currency alongside its commitments not to erode the stability of its own currency nor that of the mechanism itself. The relevant press releases indicate the new post-entry commitments that each country had agreed to follow after the inclusion of its national currency in the mechanism.

The current impact of change

No matter how one interprets change in the entire process of accession to ERM II, it can be said that it definitely violates the principle of equal treatment. The other problem is that the new conditions, particularly that of participation in ‘close cooperation’, are essentially directly related neither to the currency mechanism itself nor to the maintenance of currency stability within the permitted 15 per cent deviation either side from the exchange rate to the euro. In this sense, the currency mechanism is no longer a pure currency mechanism. On the other hand, data for the last fifteen years on countries with a derogation from membership[1] show that the fluctuation of their currencies is persistently within the ERM II fluctuation band, even though they are not formally included in the mechanism.

The recent changes in ERM II were inspired by the extension of the ECB’s functions to banking supervision within the Banking Union, alongside the ambition to extend those supervisory functions to subsidiaries of banking groups in countries with a derogation. The aim is to test the stability of each country’s banking system before entry to ERM II and before entry to the euro area. For this purpose, the currency mechanism is being used not only as a ‘front door’ to the currency area but also acts as a front door to the banking systems of those countries which have a derogation. Nine years after the establishment of the Banking Union, this ‘close cooperation’

1 It being a requirement that members of the EU join ERM II; those that do not have a derogation but are expected to join where they meet the criteria.

form of participation remains unattractive to countries outside the euro area. The requirement to enter the Banking Union before entering the euro area creates a risk for countries since they do not have access to the European Stability Mechanism – the instrument which provides financial assistance to euro area countries threatened by severe financing problems – as well as that their banks have no access to ECB financing.

Obviously, the Maastricht criteria for ERM II participation have now become completely discretionary even prior to accession itself; and this makes the process of application for membership of the euro area both more risky and less attractive to applicant countries.

The numerical convergence criteria are no longer numerical

We remember with nostalgia the case of Lithuania when, in 2006, the country's request to adopt the euro was rejected because its inflation rate exceeded the reference rate by a mere 0.1 percentage points. At that time, the reference rate for inflation was calculated based on the average of the three best performers; and there was no possibility of excluding so-called 'outliers' from the calculation of the benchmark. If this option had been available then, Lithuania would by now have been in the euro area for more than 15 years.

Things have changed a lot since 2010. As Zsolt Darvas rightly emphasises, the choice of the ECB and the Commission to exclude countries from the inflation reference rate calculation gives them a tool to define different values for that rate. In doing so, the automatism in the assessment of the inflation criteria has already been replaced with discretion. The flexibility inherent in defining the reference rate for the inflation criterion, especially in the most recent assessment carried out in 2022, is subject to serious criticism. The process itself seems to be a manageable one but doubts about what happens in practice have arisen with the 2022 convergence report.

If the principle enshrined in the Treaty and prior practice before the implementation of the new concept, which did not exclude countries regarded as 'statistically atypical in the calculation of the reference value', had been applied in 2022, then Croatia would not have met the inflation criterion. As Darvas (see separate article, this issue) writes:

> The three countries with the lowest all-items inflation rates were Malta (2.1 per cent), Portugal (2.6 per cent) and France (3.3 per cent), giving an average of 2.6 per cent.
>
> …
>
> But the Commission and ECB chose to exclude Malta and Portugal from the calculation, referring instead to France (3.2 per cent), Finland (3.3 per cent) and Greece (3.6 per cent) as the best performers. This resulted in a reference value of 4.9 per cent (average of 3.4 per cent + 1.5 [the leeway]), meaning that Croatia [inflation rate of 4.7 per cent] squeezed in.

The overly vague criteria for excluding low inflation countries from the reference group gives a reason to doubt the appropriateness of the decision of the ECB and the Commission as to whether countries can be excluded from the calculations and, if so, thereafter which ones. This discredits the entire assessment process. Discretion in the inflation criterion can certainly also be exercised by the candidate country: to suppress inflation, short-term measures can be taken – for example, maintaining fixed prices, tax changes and others.

The problem is not so much that some countries could benefit from the concept of outliers and thus enter the euro area. The real problem is that the euro area wants countries with high inflation. The data prove that, following 2010, the inflation reference rate is much higher than that calculated from the three best performers, being higher than the average inflation rate in the EU, and that in only four of the ten convergence reports is inflation below the ECB's target level of two per cent. In the last decade, the euro area has gradually departed from its main benchmark – low inflation.

Although the Treaty states that applicant countries need to fulfil the criteria sustainably, most of the latter are calculated on the basis of a one-year period. This is a very short time in which both random factors and targeted policies can suppress inflation to a level which falls within the reference value. This weakness in the criterion, together with its flexible interpretation, gives access to the euro area to countries with the potential for high inflation.

Greater tolerance for high debt and fiscal deficits among candidate countries

Croatia is a country that has entered the euro area with a large level of public debt and an unsustainable fiscal policy. This has happened due to the flexible interpretation of Maastricht's fiscal and debt criteria. The criterion for the state budget position is fulfilled when there is no excessive deficit, determined not so much by data on the size of the deficit, but by a Council Decision on the presence of an excessive budget deficit or lack thereof.[2] The regulatory framework allows a country's deficit to be assessed as not 'excessive' when:

> … the deficit ratio has declined substantially and continuously and reached a level that comes close to the reference value… [or alternatively] the excess of the deficit ratio over the reference value is only exceptional and temporary and … the ratio remains close to the reference value. (European Commission 2012: 9)

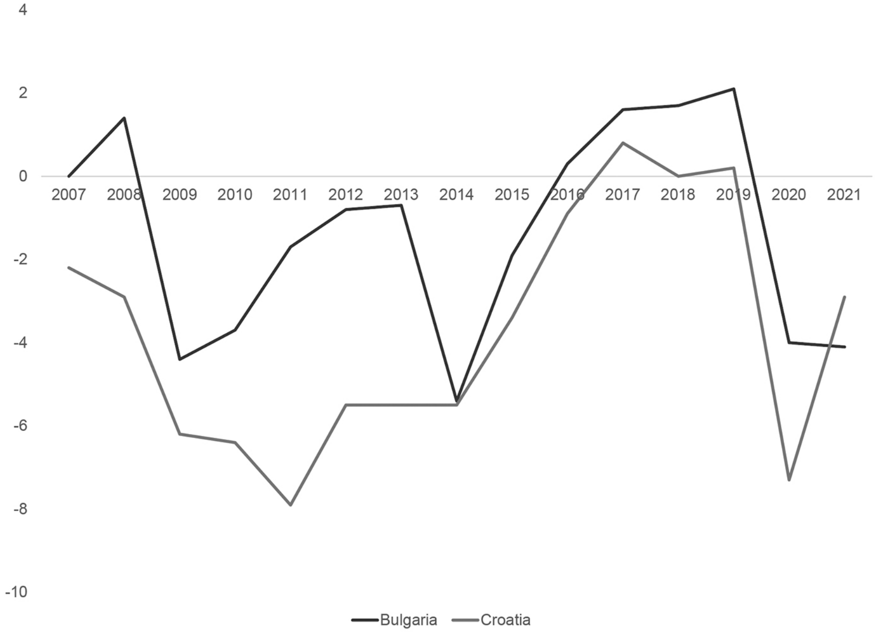
During the financial crisis, in all the countries with a derogation except Sweden, the budget deficit exceeded the reference value of three per cent. Then, however, no relaxations and exemptions from the fiscal criteria were introduced. In 2021 and 2022, the exclusion clause was activated and some countries formally fulfilled the criterion. Its exceptionally high deficit in 2020, amounting to 7.3 per cent of GDP, enabled Croatia to refrain from major public spending in the benchmark year of 2021, thereby achieving fulfilment of the criterion. Sustainability of public finance, however, remains a problem.

2 12008M/PRO/12 'Consolidated text of the Treaty on the Functioning of the European Union – PROTOCOLS – Protocol (№ 12) on the excessive deficit procedure' *Official Gazette* No. 115, 09/05/2008, pp. 0279-0280, accessed 12 December 2022 at: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:12008M/PRO/12&from=EL..

A member state does not fulfil the debt criteria if public debt is above 60 per cent of GDP. But exceptions from the rule can be had when this ratio is decreasing 'at a satisfactory pace'. Croatia's general government debt ratio fell to 79.8 per cent of GDP in 2021 but the ECB and the Commission produced a relatively favourable report (European Commission 2020: 5) on the grounds of the scale of the decline in the ratio from its peak value, of 87.3 per cent of GDP, in 2020. The ECB expects that both the debt ratio and the budget balance will both be below the reference rates in 2022. This remains to be seen.

Bulgaria conducts a prudent fiscal policy and is one of the most fiscally stable countries in the EU. The country has fulfilled the fiscal criterion in two out of three of the last fifteen years. It is also a country with large and durable fiscal surpluses.

Figure 2 – Fiscal balance to GDP, %



Source: Eurostat

Regarding the public debt criterion, Bulgaria has fulfilled the requirement for a figure that is below 60 per cent of GDP, with no exception or interpretation, in the last twenty years. In contrast, Croatia has not kept its public debt below 60 per cent in the last decade.

As these concrete examples show, the debt criterion loses its meaning when there is an excessive number of ways of avoiding it. At the same time, the indicator can be easily managed by candidate countries for euro area membership, including through one-off measures which reduce the value of this indicator.

One of the main arguments of those who advocate against euro area membership is that the euro area tolerates the indebtedness of countries. The ineffectiveness of the Stability and Growth Pact and the entire macroeconomic surveillance mechanism is evident by following the dynamics of debt within the euro area, which has been over 85 per cent of GDP throughout the last fifteen years. This tolerance of high debt levels is expanding to candidate countries.

Sustainability in achieving the nominal convergence criteria is a Treaty requirement. However, since most of the indicators are calculated for a single year they are therefore subject to countries seeking to influence their values by engaging in particular policies. As far as the sustainability of Bulgaria's criteria is concerned, it has:

- the most stable exchange rate between 1997 and late 2022, i.e. without any fluctuation for a period of 25 years
- public debt has always below the reference rate
- prudent fiscal policy (only once, and for a short time, was it in the excessive deficit procedure)
- the inflation criteria has been met six times according to the last ten convergence reports.

Apparently, however, numbers do not matter anymore. And yet this is not about Bulgaria.

The two recent crises in countries with a derogation are a kind of test of the sustainability of their economies and of their macroeconomic stability in the context of nominal convergence criteria. Due to the prevailing level of flexibility in the assessment of the criteria, their achievement largely depends on the intentions of the countries concerned to adopt the euro as well as of those in the euro area to welcome them. Even so, the change in the entire entry mechanism to the euro area creates doubts among countries outside the area who are looking to join. The criteria have been created to ensure the stability of the core of the EU – the euro area – but their loosening at the point of entry and once inside makes it increasingly unstable and a less attractive place to those outside it.

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Stefan Guga

A transition delayed – the Romanian car industry in the slow lane to electromobility

Abstract

This article reviews the state of the automotive industry in Romania and its level of preparedness for electrification scenarios associated with the drive to reduce CO2 emissions across Europe stemming from the EU's 'Fit for 55' package. The author considers the main features of the industry in Romania, which typically revolves around the production of models for export given the low levels of domestic car ownership and amidst strong imports of older, and more polluting, second-hand vehicles from western Europe. Despite healthy relative growth, sales of battery electric cars remain marginal and, critically, there is little competence within the country in the area of electrification, its plants having been geared around the internal combustion engine. On top of that, there is no apparent urgency around developing a compensatory electric battery industry. The author concludes that this can only imply a delayed electrification, but the chief worry is what that means for jobs and skills within Romania, as well as the implications for a two-speed Europe in this area, too, with central and eastern Europe being left further behind.

Keywords: *automotive industry, electrification, value chains, CO2 emissions, public policy, east-west convergence*

Introduction

The accelerating transition to electric vehicles and the rapid shift to a new mobility paradigm imply major challenges for the European car industry and its supply chain. This massive and unprecedented disruption raises legitimate questions about the future role of central and east European countries in the European value chain as fast-track electrification is pushing car manufacturers to rethink their industrial and commercial strategies on their way to carbon neutrality.

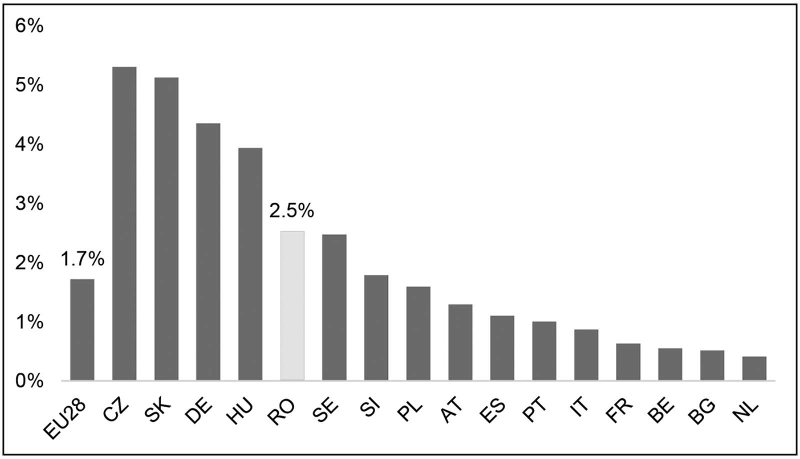
This article looks at the peculiarities of the powertrain transition in the car industries and markets of Romania, one central and east European country in which this industry has played a major role in socioeconomic development in recent decades, being home to two highly successful automotive plants specialised in low-cost vehicles. Specific to the CEE region, the trajectory of car sites in Romania strongly depends on strategic decisions made in companies' headquarters located outside the country. The question today is whether Romania will join the technological transformation early on, or rather be kept as a low-cost manufacturing base for relatively low-end internal combustion engine (ICE) technologies. The answer has deep implications for the country's employment prospects.

The article is organised as follows. In the first section, we present the main features of the Romanian car industry, describing the factors that have sustained its development over the years and discussing the unusually strong weight of suppliers in the ecosystem as well as their strong dependence on Germany. In the second section, we look at the main characteristics of the Romanian car market, chiefly the role of imported second-hand cars, the marginal share of battery electric vehicles (BEV) in new car sales as well as poor networks of charging stations. More generally, we illustrate the already visible risk of a two-track Europe in the race for decarbonisation, with widening east-west inequalities. Here we also look at data on emissions from the perspective of the environment as well as at the market for electric vehicles (EVs) in Romania, together with developments in the charging infrastructure. We next turn to the challenges of electrification based on original equipment manufacturer (OEM) strategies and forecast data that suggest a significant relative delay in the EV transition, before summing up the expected employment effects of electrification. Even if the impact might be limited in vehicle assembly plants, it could be strongly negative in powertrain, transmission and ICE-related component manufacturing plants, putting many thousands of jobs at risk in the medium term.

Industry overview

Similar to other central and east European countries within the EU, the automotive industry in Romania has grown over the past two decades into the country's largest manufacturing industry, creating nearly one-fifth of manufacturing value added before the disruption of Covid-19 (Figure 1). This is significantly higher than most western countries with large automotive industries, with the exception of Germany, although it is considerably lower than other countries in central and eastern Europe, including Czechia, which is an exceptional case, as well as Slovakia and Hungary. Furthermore, the share of the Romanian car industry in total gross value added reaches 2.5 per cent, much higher than the average for the EU as a whole of 1.7 per cent.

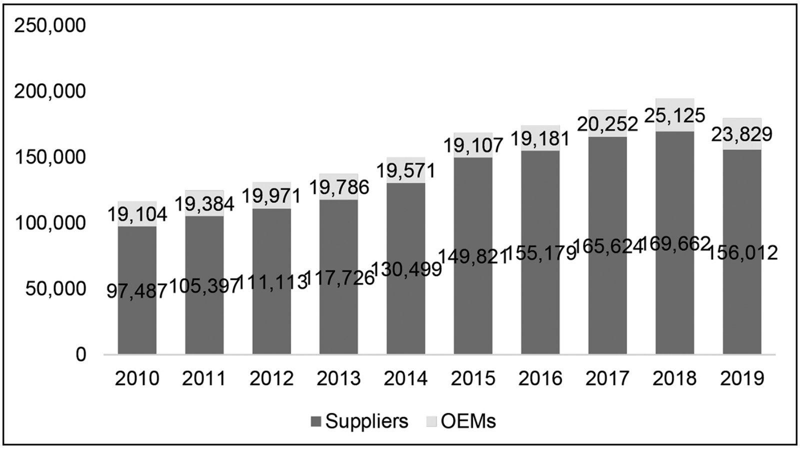
Figure 1 – Gross value added in the EU car industry, as % of total, 2019



Source: Eurostat.

In terms of employment, the picture becomes even more nuanced. With 180 000 people (Figure 2), Romania ranked fifth in the EU before the pandemic when it came to the number of people working in the industry, surpassing Italy and Spain. Furthermore, no less than 15.2 per cent of manufacturing employment was in automotives, second only to the 16.2 per cent registered in Slovakia (ACEA 2022).

Figure 2 – Employment in the Romanian car industry



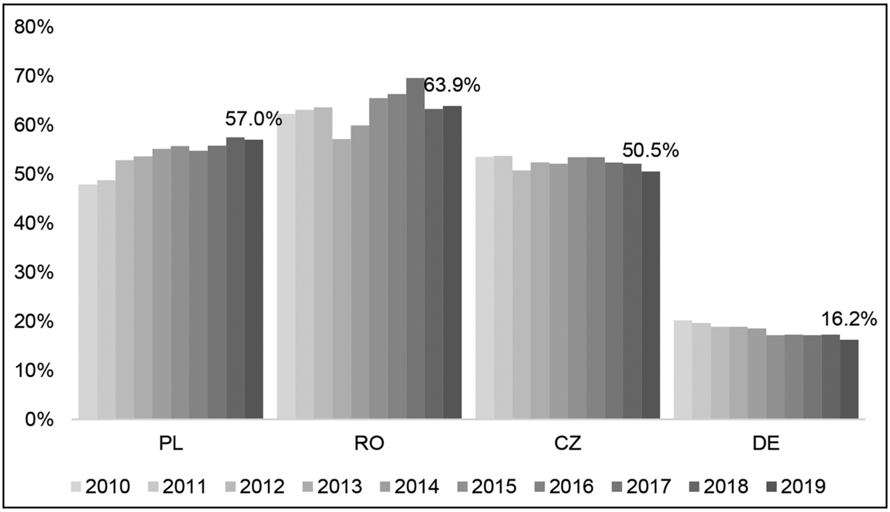
Source: Eurostat.

The importance of the automotive industry for employment grew significantly during the 2010s, growing from 2.1 per cent in 2010 to a peak of three per cent in

2018. In comparison, employment in the German automotive industry remained fairly stable in the context of the overall labour market, despite a 6.5 per cent increase in automotive employment between 2010 and 2019. In other words, the car industry has acted as a major driving force for employment in Romania during the past decade, growing visibly faster than the rest of their economies, beginning to lose some ground only in 2019 when it registered the first decline in employment in a decade.

Overall, the industrial profile is typical of the car industries of other countries of central and eastern Europe, with the supplier industry being much larger than vehicle manufacturing, although in Romania this is more true than of either Poland or the Czechia; and here it is also growing unlike in Czechia (and indeed in Germany, at a much lower level) where it has been extremely stable over the last decade and even slightly declining (Figure 3). In 2019, 64 per cent of turnover in car manufacturing in Romania was attributed to the supplier industry compared to less than 20 per cent in Germany.

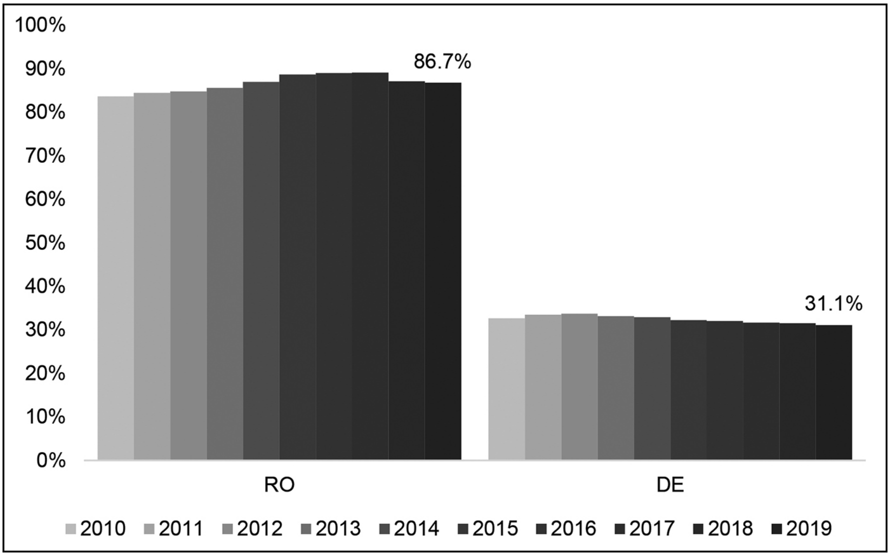
Figure 3 – Share of suppliers in total car industry turnover



Source: Eurostat.

In terms of employment, the asymmetry is even more obvious: suppliers accounted for nearly 87 per cent of total car industry employees in Romania, compared to just 31 per cent in Germany (Figure 4).

Figure 4 – Employment in the car supplier sector (% of total car industry employment)

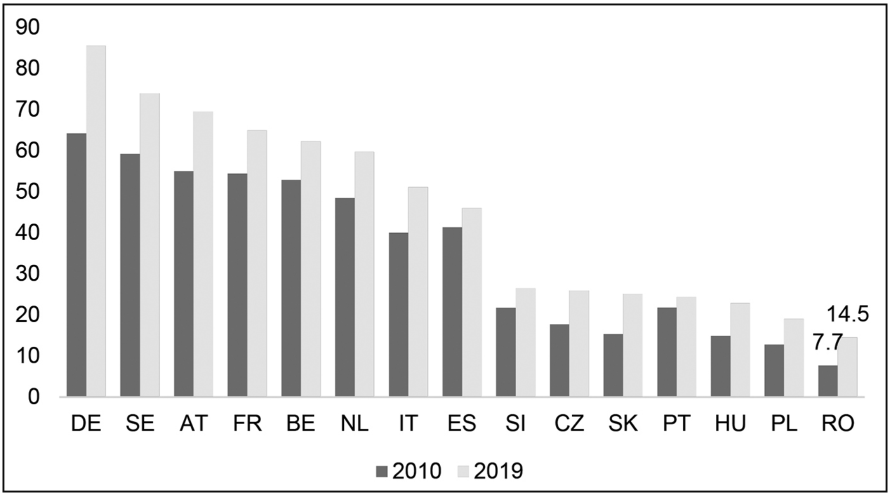


Source: Eurostat.

The Romanian supplier industry is also much larger, even accounting for country size, than that in other central and east European countries. A specific feature in the region's automotive landscape is also that the supplier industry is not just significantly larger than vehicle assembly but that it has also continued to grow faster; this is not the case with Czechia or Slovakia, where the combined share of suppliers began to decrease in the second half of the 2010s (Guzik et al. 2020). In 2019, Romania ranked third in the EU when it came to the number of employees in automotive suppliers; only Germany had more people working in the industry supply chain.

This high share of suppliers, and the contrasting development to countries like Germany, is part of the broader growth of transnational automotive supply chains in Europe and the accompanying east-west differences in specialisation. Differences in labour costs between countries have undoubtedly been the main driver of this, with Romania still having the smallest average labour costs in the EU automotive industry in 2019, as it had been in 2010 (Figure 5).

Figure 5 – Average labour costs in the car industry (000 euros per employee per year)



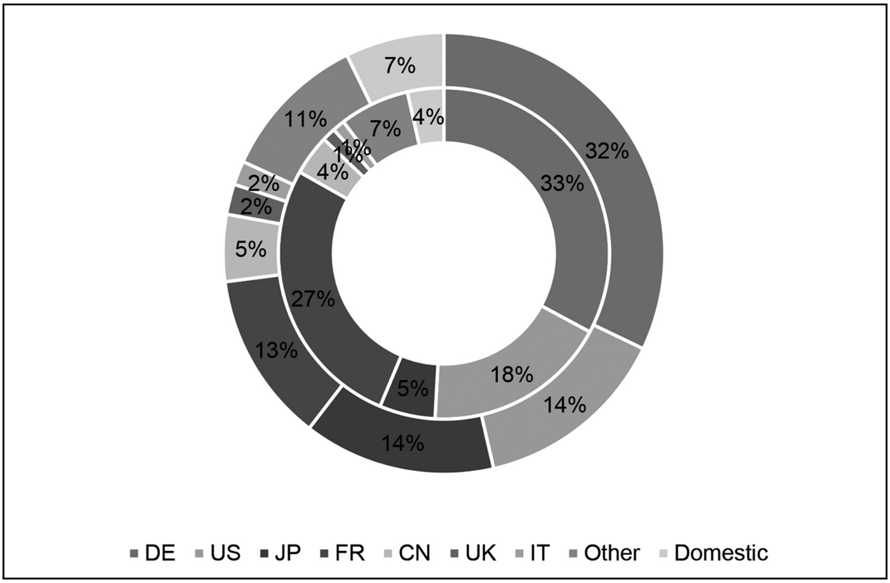
Source: Eurostat.

In policy terms, perhaps the most significant comparison is that, in 2019, an employee in the Romanian automotive industry cost, on average, just 17 per cent of that of a German employee. This difference has become smaller over time (it was 13 per cent in 2010), but there is little reason to speak of genuine wage convergence. In absolute terms, the gap to western Europe has actually increased: if the average automotive employee in Romania was, in 2010, 57 000 euro per year cheaper than in Germany, by 2019 this cost difference had increased to 71 000 euro per year. Roughly speaking, therefore, relocating jobs to central and eastern Europe has, in fact, become more advantageous over time, despite tight labour markets and sustained wage growth right across the region, not less.

Catalysed by low labour costs, the Romanian industry has grown primarily as a result of western foreign direct investment: only seven per cent of automotive employees worked in domestically-owned companies in 2018 (Figure 6). German companies are the most important employers (accounting for 32 per cent), but US, Japanese and French companies (all with roughly equal shares) also have a significant presence. Contrasting the shares of employment by ownership to the shares of turnover, domestic capital shrinks to just four per cent, suggesting that local firms typically have subordinate roles. A significantly higher share of turnover in comparison to employment is registered for OEM-originating countries (the US and, particularly, France), indicating much higher productivity and the impact of such activities compared to suppliers. The huge difference between the shares in employment and in turnover of Japanese companies (14 per cent vs. five per cent) is a stark example of specialisation in low-cost parts and components. Large Japanese suppliers such as

Fujikura, Takata or Yazaki have a substantial presence producing low value added but labour intensive products like wiring and cable harnesses.

Figure 6 – Ownership in the Romanian car industry: by employment (outer circle); and by turnover (inner circle), 2018



Source: Eurostat Foreign Affiliates Statistics.

As regards their foreign trade profiles, wiring (including cable harnesses) is Romania's most important export product from the automotive supplier industry and Romania is by far the most important producer of automotive wiring in the EU (Guga 2019). This is probably the best example of its specialisation in low cost, low value added, labour intensive manufacturing. In contrast to wiring, which hires tens of thousands of people working in a large number of plants across western and central Romania, the production of gearboxes and associated parts is concentrated in just three plants, of which only two are fully export oriented, but the sector has a comparable export significance — gearboxes and associated parts are the second largest group by export value. Importantly, the gap between the two is much larger in favour of wiring if we consider the balance of trade, which is due to gearbox imports by Ford Craiova and, possibly, to the low degree of local integration of the two gearbox plants owned by Daimler. Romania is not an important exporter of internal combustion engines as the two engine plants in the country are captive to local OEMs. It does, nonetheless, export combustion engine parts such as pumps.

Vehicles are, however, the single most important export product. Exports of utility vehicles are negligible, but exports in the passenger car segment have grown continuously during the past two decades, actually surpassing the value of exports from

Poland, where utility vehicle exports are significant, in 2015. In terms of the balance of trade in passenger cars Romania registers an increasingly large trade surplus, partly explained by the significant increase of production in Romania but also by its small market for new vehicles (see next section for more details).

No less than 45 per cent of Romania's automotive parts exports go to Germany. If we include other countries in the region where German OEMs have vehicle assembly operations (Hungary, Czechia, Slovakia and Poland), then the importance of German supply chains becomes even more significant. Integration into German supply chains far outweighs the impact of OEMs' local presence: Romania's exports to Russia, France, North Africa and Turkey are strongly tied to the supply chain of the Renault-Nissan-Mitsubishi Alliance but, even when combined, they pale in comparison to the size of exports to Germany.

Table 1 – Light vehicle assembly plants (000)

Plant	Group	2008	2014	2019	2028 (forecast)
Craiova	Ford	2	68	141	234
Mioveni	Renault-Nissan (Dacia)	243	334	350	366
Total		246	402	490	599

Source: IHS Markit.

Romania has only two OEMs with vehicle assembly operations (Table 1). The IHS Markit forecast assumes both Romanian plants will be working at full capacity in the next years, possibly with a capacity increase at Dacia — total current capacity in Romania is of around 550 000 vehicles (350 000 at Dacia and 200 000 at Ford). The increased volumes forecast for both Ford Craiova and Dacia Mioveni mean that Romania will actually overtake Poland in terms of vehicle production volumes before the end of the decade.

Both Dacia and Ford have their own engine plants on the same sites as vehicle assembly which, in 2019, produced a total of 627 000 units (527 000 in Mioveni, 150 000 in Craiova); Dacia also produced 504 000 gearboxes in its highly integrated plant in Mioveni. The only other powertrain capacities in the country are Daimler's two gearbox plants in Cugir and Sebeș which, combined, produced 777 000 gearboxes in 2019.

Similar to the supplier industry, these plants function primarily as production locations for export, with companies making very limited investments in non-production activities such as R&D. The comparison to Germany is striking: whereas in 2019 Germany produced ten times more light vehicles than Romania, its R&D personnel was 47 times more numerous than in Romania (Table 2). Even though automotive R&D has increased visibly, the growth of German R&D has outmatched this.

Table 2 – Car industry R&D personnel and expenditure

		2011	2012	2013
Total R&D personnel (FTE)	Germany	90 829	108 134	139 331
	Romania	593	2277	2985
Researchers (FTE)	Germany	57 057	68 466	92 837
	Romania	306	632	1316
R&D expenditure (euros/capita)	Germany	203	264	340.3
	Romania	2.6	4.8	8.3

Source: Eurostat, OECD.

As with wages, it is clearly unrealistic to speak of east-west convergence in this respect despite some obvious degree of industrial upgrading in the countries of central and eastern Europe.

Such major differences are also apparent when it comes to the structure of and growth trends in domestic vehicle markets. In the future, these could suggest different implications for Romania when it comes to the transition to electric vehicles.

Market overview

The Romanian automotive market is not substantial, either in volume or in relative terms. With about 162 000 new car sales in 2019, the Romanian passenger car market ranks third among countries in the region behind Poland (556 000) and Czechia (250 000).

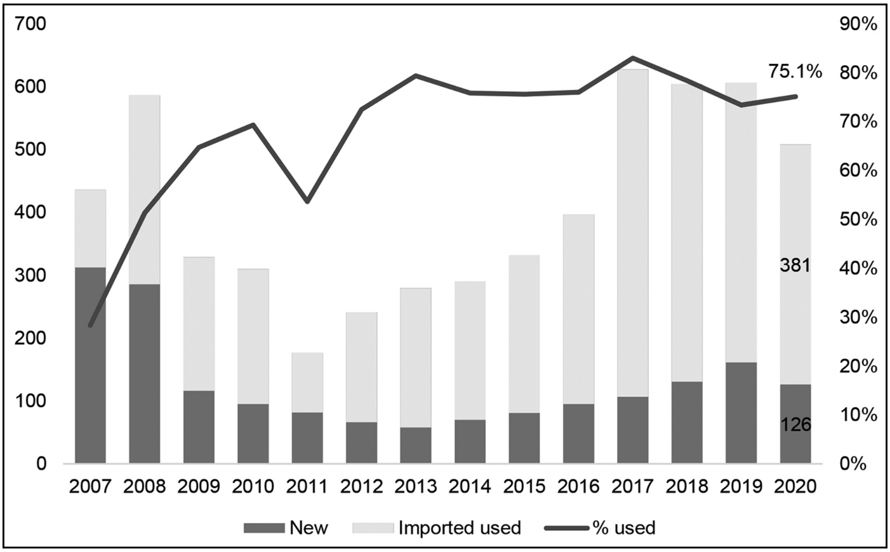
Before the Covid-19 crisis, new car sales had strong momentum: between 2013 and 2019 they almost tripled, showing an impressive compound annual growth rate of 18.7 per cent compared to 4.2 per cent across the EU, the United Kingdom and EFTA combined. Certainly the market was not spared by the Covid-19 crisis, with new car sales dropping by 22 per cent in 2020, highly similar to the decline in the European market (24 per cent). In 2021, in the context of the worsening semiconductor crisis that led to a further decline in sales in Europe (1.5 per cent), the Romanian market fell by 4.1 per cent.

Primarily due to lower disposable incomes in the region of central and eastern Europe compared with western European countries, Romania is at the bottom of the European ranking in terms of new car registrations per 1000 inhabitants (see also Pardi, this volume). In 2019, this ratio was only 8/1000 compared with an average of 30/1000 for Europe with more than half of Romanian households (54 per cent) not owning a vehicle in 2020 compared, for instance, to just 15 per cent in France. Looking at the number of passenger cars in use per 1000 inhabitants, Romania records just about the lowest rate in Europe, at 376/1000 compared to a Europe-wide average of 560/1000, and ahead only of Latvia. It should be noted, however, that Romania recorded the strongest growth in this indicator in 2020, with an increase of 12 per cent against 0.9 per cent for the EU average.

If the limited purchasing power of households is hampering the local growth potential for new car sales, at the same time, and from a socio-cultural perspective, car ownership remains a strong structuring factor of social status for many citizens in the countries of the region. As a combined effect of these factors, the growth of vehicle car fleets remains largely driven by the import of used vehicles, mainly from Germany, while the financial constraint weighing on households naturally works in favour of the second-hand vehicle market.

The significant share of used vehicles imported into Romania (Figure 7) makes its vehicle fleet among the most polluting in Europe. The ratio between the number of imported used vehicles and the number of new car registrations has been over 70 per cent in all of the last decade, with the abolition of the national vehicle tax (the 'environmental stamp') boosting the import of used vehicles in 2017 above 80 per cent and leading to an increase of almost ten per cent in the car fleet (Romania Insider 2022).

Figure 7 – New passenger car registrations vs. imported used cars (000)



Source: Syndex (data: ACEA).

More importantly, in 2017, only a couple of years after the Dieselgate scandal broke, Romania imported 520 000 second-hand cars, of which 370 000 (70 per cent) were old and highly polluting diesels, according to ICCT (see Table 3).

Table 3 – Second-hand cars imported into Romania and their composition (2017)

	Total number of imported cars	Number of diesel cars imported	Average diesel NOx emissions (mg/km)
All imported cars	520 000	369 100	1014
Pre-Euro 1	2900	700	1339
Euro 1	10 300	3900	1339
Euro 2	79 300	38 700	1149
Euro 3	228 700	153 600	1029
Euro 4	132 900	112 200	951
Euro 5	59 900	55 400	1029
Euro 6	5900	4500	415

Source: ICCT.

Romania won't at all be alone in this situation, which perfectly illustrates the way in which an element of car pollution has been exported from western Europe to central and eastern Europe in the context of stricter engine standards in the wake of Dieselgate. It also tends to deepen the already significant inequalities between western European countries and those in central and eastern Europe in the race for decarbonisation; it is already possible to see the risk of a two-track Europe emerging on the horizon in the strategic field of car electrification.

Environmental impact

CO_2 emissions from newly registered cars remain well above the European average. In 2020 average CO_2 emission of new cars registered across the EU/UK/EFTA (excl. Switzerland) region was 107.8g CO_2/km, but this figure reached 115.4g in Romania as a result of the above figures.

Meanwhile, although there has been a strong surge in mild hybrid registrations, sales volumes of BEVs and plug-in hybrid vehicles (PHEVs) are still marginal. As in most CEE countries, electrification started late in Romania in the absence of proactive policies and significant financial resources dedicated to alternative motorisations during the period before Covid-19 compared with those implemented in western and northern Europe. However, we are now seeing a sharp acceleration in the sale of hybrid vehicles: volume remains insignificant but sales in this segment have more than doubled, reaching 30 000 units, or one in four vehicles sold.

Table 4 highlights the significant relative progress made in 2021 in terms of electric car sales as a share of new car sales, accompanied by a significant drop in the sales of internal combustion engine vehicles, in comparison with the average right across the EU/UK/EFTA. The latter is evidently in a different place on the growth curve, but there is, quite clearly, a switch beginning to take place within the Romanian market.

Table 4 – Annual change in new car registrations by fuel type (2021/20), %

	Romania	EU+UK+EFTA
Petrol (ICE)	-28.5	-17.4
Diesel (ICE)	-43.2	-33.1
Mild hybrids	115.2	58.5
PHEV	153.9	68.5
BEV	122.9	63.4
Other	71.9	29.2
Total PCs	-4.1	-1.5
BEV+PHEV	131.2	65.7
Mild hybrids+BEV+PHEV	118.6	61.9

Source: Syndex (data: ACEA).

The combined share of BEVs and PHEVs in new car sales in 2021 in Romania was seven per cent (of which five per cent were BEVs), driven by strong purchasing incentive policies. In comparison, the European average was already close to 20 per cent, due largely to an impressive surge in sales in Germany.

In 2021, the Ministry of Environment doubled the budget for its Rabla Plus programme, which offers subsidies for the purchase of electric and hybrid cars, to around 82 million euros. Under the programme, BEVs are subsidised to the value of 10 000 euros (50 000 lei), PHEVs (≤50g CO_2/km) to one of 4000 euros (20 000 lei) and hybrids to 600 euros (3000 lei). A scrappage bonus of 1300 euros (6500 lei) is also granted for vehicles older than eight years, while electric vehicles are exempt from registration tax. Romania also provides a contribution of a maximum 2500 euros for charging stations (<22kW) and 30 000 euros for fast charging points (>22kW).

In terms of charging infrastructure, however, Romania lags behind with one of the least developed networks in Europe. According to the European Alternative Fuels Observatory (EAFO 2021), at the end of 2020 Romania had around 500 charging points compared to nearly 45 000 in Germany and in France and 66 000 in the Netherlands. Looking at the number of charging points per 100 kilometres of road, Romania had at the end of 2020 the fifth lowest ratio in Europe, at 0.5 compared with 19.4 in Germany and 47.5 in the Netherlands, a country six times smaller. At the end of 2021, the number of publicly accessible EV charging points in Europe increased by 46 per cent, while the current average ratio of 22kW-equivalent publicly accessible charging points installed per 1000 passenger cars on the road was estimated to be 1.9 while Romania stood at 0.3. The leading markets at the end of 2021 were Norway (20), Netherlands (8.3) and Iceland (7.6), which once again illustrates the huge gap between western Europe and central and east European countries in the race for electrification (ACEA 2022).

Electrification prospects and impact on the car industry value chain

Vehicle assembly

The most recent forecast available suggests a significant delay in the EV transition for the automotive industry in Romania in comparison to Europe as a whole (IHS Markit 2022). Such an assessment is far from surprising given the relatively limited market potential for still expensive EVs and the country's specialisation in smaller and cheaper vehicles which are not a priority for electrification (Pavlínek 2022). The share in total production volumes of light vehicles that are full hybrid and pure electric is forecast to remain below 50 per cent by 2028 compared to almost 70 per cent in Europe. According to this forecast, Romania would produce more full hybrid vehicles (BEV: 16 per cent share of production), with the mild hybrid vehicles already in production expected to become the main powertrain option in the second half of this decade. By 2028, light internal combustion engine vehicles (ICEV) would comprise just 11.5 per cent of production in Romania versus less than 3.6 per cent in Europe overall.

Ford has announced it will produce a light commercial vehicle with a pure electric powertrain option starting from 2024, although this is expected to have only limited initial volumes. In the longer run, starting from 2030, Ford has announced the intention of producing only pure electric vehicles in Europe. These plans of course include the Craiova plant and we can assume that the next Puma, coming in the second half of the decade, will have an electric option from the start. For Dacia, management has been explicit about its intentions to delay electrification as long as possible since the still high cost of EV technology poses significant challenges to Dacia's low-cost business model. However, in February 2022 Renault announced it would launch a pure electric Dacia vehicle in 2024, although it remains to be seen whether it will be produced in Romania or elsewhere. For now, the brand's only battery electric vehicle, the Spring, is imported from China. In the absence of high volumes, a scenario in which a pure electric Dacia vehicle is produced elsewhere in Europe is very much a possibility.

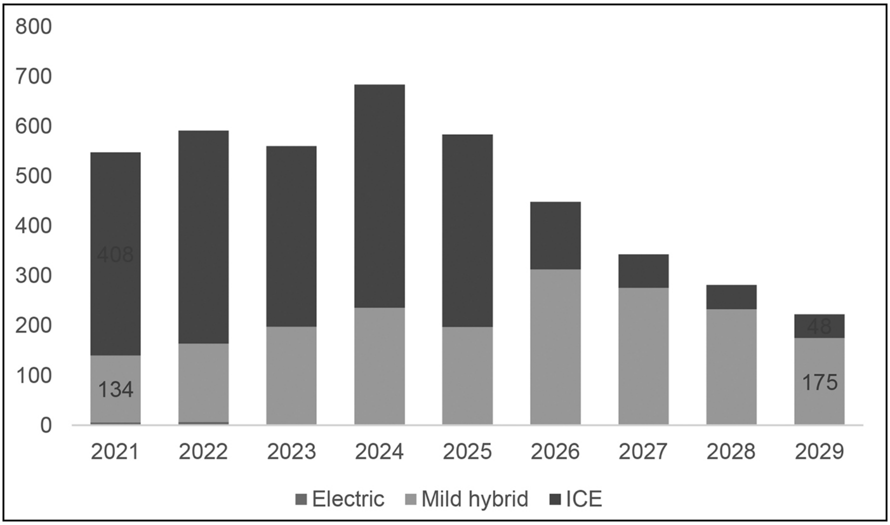
Powertrain and transmission manufacturing

Regardless of the pace of electrification, Romania's vehicle assembly plants should not be affected in the long term; indeed, IHS Markit forecasts show no major decline in volumes which means assembly employment should remain stable or even increase. The same cannot be said for powertrain plants for which the decline is expected to be quite dramatic in Romania, with both of the country's captive engine plants (Ford Craiova and Dacia Mioveni) producing significantly lower volumes by the end of the decade and a strong decline after the 2024 peak (Figure 8).

Behind these forecasts lie several factors. First, the sourcing of EV powertrains from OEMs' core countries: Germany for Ford; France (prospectively) for the Renault-Nissan-Mitsubishi Alliance. Second, those captive engine plants are forecast to convert from ICE to mostly mild hybrid engine production at lower volumes, with OEMs sourcing most of their full hybrid powertrains from other sites. Third, export opportunities would dwindle as pure electric vehicles gain market share in Europe and while the engine plants do not make the transition to pure electric powertrain production.

The situation is yet more complicated for transmission plants. Predominantly, pure electric vehicles have transmissions integrated into their electric drive units, which means that plants specialising in transmission manufacturing face a highly uncertain future. Indeed, forecasts from February 2022 show a significant decline in transmission production volumes during the second half of this decade, with the two Romanian plants especially affected by the shift to electrified powertrains. Dacia transmission volumes are expected to decline with the shift to full hybrids, which is not surprising if local engine manufacturing does not itself transition to full hybrids. For Daimler's transmission production in Romania, the prospects are even worse since the group is likely to make a full EV transition faster than OEMs operating in lower price segments, while its operations in Romania are geographically isolated from the group's vehicle assembly plants. Due to this latter factor, a transition to e-drive manufacturing is difficult to envisage since it is unlikely that bulky and heavy e-drives would be shipped in large volume over long distances. Conversion to smaller parts for EV powertrains might still be an option, but this would in any case be a downgrade for Romania in terms of complexity and value added.

Figure 8 – Engine production volume forecast by type (000)



Battery manufacturing

At least in principle, battery manufacturing offers job creation opportunities for suppliers within the BEV value chain.

However, Romania has not recorded any significant investment in battery cell manufacturing on its territory to date. For example, the future BEV versions of Ford's models assembled in Craiova will apparently source their battery cells from

Hungary, which benefits from the presence of Korean cell manufacturers Samsung SDI (3 GWh) and SK Innovation (7.5 GWh in 2022), as well as the presence of major German OEM assembly lines.

Moreover, the Romanian public authorities have so far shown limited interest in developing local large-scale battery manufacturing operations. Even the National Recovery and Resilience Plan is vague on this subject, aiming to foster the growth of local battery manufacturers but without any clear targets or assessments of viability. At present, the only battery specialist in Romania is Rombat, which has historically produced 12V vehicle batteries and which is now trying to develop its capabilities in the manufacture of battery cells in collaboration with a local start-up. Rombat is, however, a relatively small company with limited financial capacity and it cannot make investments on the scale required. A significant increase in pure electric vehicle volumes at either Mioveni or Craiova is difficult to imagine in the absence of local battery production capabilities, but this is unlikely to happen before the end of this decade.

Expected employment effects

As discussed above, the share of automotive employment in total manufacturing employment in Romania is among the highest in the EU: in absolute terms, before the pandemic the automotive industry directly hired 180 000 people in Romania.

Existing assessments of the employment impact of electrification vary widely. For instance, a recent PwC (2021) study for CLEPA highlights the potential job impact of an EV-only scenario. Here, based on the European Commission's 'Fit for 55' proposals for the reduction of CO_2 emissions, PwC anticipates a 43 per cent net decrease in ICE-related jobs (i.e. 203 000 job losses) between 2020 and 2040 within the EU/UK/EFTA. For Romania, the study predicts that ICEV employment would increase first by 57 per cent (32 000 job gains) between 2020 and 2030 (due to hybrid transition), but then fall sharply with a net loss of 49 per cent of the workforce (28 000 losses) in 2040 compared with 2020.

Electrification should not have a negative impact on employment in vehicle assembly plants. Indeed, since vehicle production volumes are forecasted to increase, we can expect employment also to increase, perhaps less visibly in plants that, today, have a relatively low level of automation, such as Dacia.

If current forecasts prove realistic, however, the impact of electrification should be strongly negative for employment in powertrain plants. In Romania, Daimler's two transmission plants employ around 3000 people, Ford has approximately 1000 people working in engine assembly in Craiova and 4000 people work in Dacia's powertrain plant. Overall, therefore, around 8000 jobs (or 4.4 per cent of total automotive employment) are directly at risk in a full electrification scenario and if no pure electric powertrain capacities are developed in Romania. Such a scenario is actually highly unlikely, since both Ford and Dacia should, in any case, maintain some powertrain employment (in battery pack assembly, for example). Strictly based on volume forecasts, employment in engine manufacturing could decline by as much as 70 per cent by 2028.

The impact on transmission manufacturing employment could be even more severe (a drop of 75 per cent by 2028), with comparatively worse prospects in the longer term. The potential loss of these jobs would have significant negative implications beyond these numbers since these are highly complex activities in comparison to the rest of the Romanian automotive industry.

Beyond engine and transmission plants, the impact of electrification for suppliers is difficult to assess with precision. Looking at Romania's automotive export profile, apart from gearboxes, components which are directly tied to ICE powertrains (ICE pumps, exhaust components, radiators, filters, ignition parts) have a low share in total exports. Wiring and cable harness manufacturing is the most significant export product and is also by far the most important sector in terms of employment. Even if much of the wiring produced today is for ICE powertrains, electric vehicles will require more wiring, and certainly not less, which means there is no automatic risk to these jobs in Romania. Some job losses might happen, however, if companies decide that product changes bring opportunities to relocate production in countries with even lower labour costs, such as Moldova or Serbia, where the automotive wiring industry has been growing in recent years.

The impact of powertrain electrification on direct automotive employment in Romania should be limited from a quantitative point of view, even if some job losses are unavoidable in the light of forecasts showing no substantial investments in EV powertrain manufacturing capacities. The immediate and direct impact would primarily concern engine and gearbox plants. Indirectly, electrification could offer companies an opportunity to reshuffle their investments geographically and some sites in Romania could suffer due to product reallocation.

The impact on the ground could nonetheless be severely felt given the high geographic concentration of automotive employment. In Argeș county, for example, almost 28 000 people (18 per cent of all employees) work in the automotive industry, around half of them being directly employed by Dacia. The two Daimler gearbox plants are in Alba county, which has a relatively low share of automotive employment (4.3 per cent). Other counties in the central and western regions of the country are much more heavily dependent on automotive employment and, even if there is no clearly visible risk for most of them at this time, the lack of a clear approach to the challenges of electrification on the part of both the regional and the central authorities raises some concern. In contrast to OEMs, most suppliers have limited sunk investments and have, so far, focused on pure assembly operations based on labour cost advantages. Moreover, many of the initial investments were generously subsidised via state aid, with the government pursuing purely quantitative employment targets. These companies thus have limited incentives to pursue potentially costly large-scale transformations, while the government would have to consider qualitative industrial transformation goals and possibly make significantly larger funds available. For the moment, such possibilities are entirely theoretical.

Conclusions

The automotive industrial profile of Romania is in many ways typical of central and eastern Europe: high dependency due to foreign ownership; very strong growth over the past decades, resulting in increasing economic and social importance at national level; and export specialisation driven by labour cost advantages versus western Europe. The Romanian automotive industry is nonetheless very different from that of Hungary, Czechia, Slovakia or Poland, the main difference being that vehicle manufacturing is dwarfed by automotive suppliers exporting primarily to Germany. Within this landscape, Romania has become Europe's number one manufacturer of automotive wiring and cable harnesses.

Marketwise, the overall landscape in both countries is likewise typical of CEE: low sales volumes of new vehicles due to low disposable incomes; a very high share of used vehicles imported from western Europe; and aging and relatively more polluting vehicle fleets. Importantly, Romania has become a major destination for diesel vehicles offloaded by western Europeans in the wake of the Dieselgate scandal. At the same time, sales of electric vehicles remain subdued due to low incomes and despite substantial government incentives. The prospects of this situation being reversed are far from positive and the task has thus far proven to be beyond the government. The very weak development of charging infrastructures compared to other EU countries is a good example of these difficulties.

Given these industrial and market features, it is difficult to imagine a scenario in which powertrain electrification (in terms of both manufacturing and sales) would not be delayed. If for vehicle manufacturing per se we are likely to be talking about a delay of a few years, but overall the same trajectory as in western Europe, there is nevertheless much more uncertainty regarding the large supplier industry. In Romania the manufacture of ICE transmissions and components has soared over the past decade but there is little indication of any investments replacing these activities that are bound to disappear as electrification progresses.

There are reasons why a smooth transition to electrified powertrains is bound to face particularly significant headwinds: the country's fiscal weaknesses mean that it could struggle to muster the necessary resources to invest in infrastructure, technology and market stimulus, not least in developing battery manufacturing competences and facilities which could, at least to some extent, compensate for job losses in other areas.

Estimates on the employment impact of electrification range from the insignificant to the dramatic. According to our own assessment, the direct employment impact of the loss of engine and transmission manufacturing would be of less than five per cent of total automotive employment. In the context of low-cost industrial specialisation, however, the loss of these jobs would be much more significant, since these are highly skilled and high value added jobs of which Romania is much in need. The geographical concentration of these jobs also raises important questions concerning the full social and economic impact of job losses in ICE technology manufacturing. So far, sadly, these questions have not sparked major public debates nor stimulated adequate policy responses.

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Denis Schulze

The impact of the Covid-19 pandemic on poverty among Syrian refugees in Turkey

Abstract

It is a global phenomenon that poverty is an everyday experience which can, however, be found universally amongst minorities, refugees and lower class migrants. All of these groups have in common the lack of access to a 'normal life' – an experience which can be even worse in countries where local hostilities are high due to economic scarcity and systemic racism. In this article, the author ranges widely over the poverty confronting refugees in Turkey who have fled the Syrian civil war, not least against the background of the country's own opaque and inadequate legislation on refugees, which offers only temporary protection and greater precariousness as a result of the lack of formal employment opportunities; the continuing inequalities stemming from neoliberalism; the impact of the Covid-19 pandemic; and amidst the country's own extraordinary politics. Focusing in particular on the decline experienced in the pandemic in terms of access to education and the decline in access to healthcare, the article concludes that providing real support for the poor is not realistic under existing political and economic approaches.

***Keywords**: Covid-19, refugees, temporary protection, poverty, precarious work, insecurity, access to education, access to healthcare*

Introduction

As a neighbouring country, the Republic of Turkey is one of the states that has received the highest numbers of refugees following the Syrian civil war. At this same time, the United Nations Development Programme (UNDP) stressed in its annual report that refugees are 'one of the most vulnerable groups hit by this unprecedented crisis' (i.e. the Covid-19 pandemic) (UNDP 2021: 10). As in other parts of the world, Covid-19 has had its deadliest impact (in terms of death toll and serious illness) on the poor. This is undoubtedly a consequence of objective conditions such as systemic racism, the structural inability of neoliberalism to operationalise public spending and the enduring crisis of capitalism which has exacerbated its already existing tendencies towards 'necropolitics': a politics based on defining who matters and who does not; who is disposable and who is not; and who is deserving and who is not.

The outcomes and causes of poverty may differ spatially, temporally and even conceptually between absolute and relative poverty. Regardless of how it is theorised and measured, poverty is an everyday experience dominated by scarcity. In different places in the world, poverty has the greatest impact on minorities, refugees and lower class migrants who can all be identified as having in common a lack of access to a 'normal' life. Therefore, poverty is usually experienced in similar ways: it is manifested in daily living conditions, i.e. with a lack of healthy food, difficulty in finding housing, the absence of healthcare and undoubtedly in barriers to people's mobilisation. These experiences can be even more severe in countries where local hostilities are high due to economic scarcity and systemic racism.

My thesis is that the impact of the Covid-19 pandemic on Syrian refugees can only be understood in the context of Turkey's backsliding from a human rights approach and its own structural deficiencies which are clearly reflected in its labour market.

Within the limits of a single journal article, it is not possible to elaborate all the historical, structural and contemporary perspectives on poverty and its use by the regime. Therefore, this review limits its focus to three aspects. The first section outlines some key information about Syrian refugees and the human rights approach of the country; while the second highlights some information about the structure of the labour market and refugee employment during the pandemic, as well as the primary impact of the pandemic in terms of increasing poverty. Finally, the third section summarises the current situation in Turkey with regard to the political impact being borne by Syrian refugees with specific consequences concerning the decline in access to education and the decline in access to healthcare.

Syrian refugees under the perpetual violation of human rights

According to Juan Somavia, then Director-General of the International Labour Organization, poverty is 'one of the biggest obstacles to peace and social justice' (ILO 2003: 3), meaning that the consequences of poverty are not just a lack of income. Similarly, the United Nations defined poverty as far back as 1997 in the following way:

> The denial of opportunities and choices most basic to human development – to lead a long, healthy, creative life and to enjoy a decent standard of living, freedom, dignity, self-esteem and the respect of others. (UNDP 1997: 5)

In line with the Universal Declaration of Human Rights, there is near-consensus that the eradication of poverty can best be achieved through a human rights framework. However, it would be contradictory to expect such an approach to be sustained by the Turkish state, which had already started to deviate from a rights-based perspective at the point at which refugees from the Syrian civil war started to flee to Turkey (2011-).

The main difficulty in analysing conditions for refugees in Turkey is rooted in structural as well as some historical constraints. Turkey signed the 1951 Geneva Convention and the 1967 Protocol with a geographical limitation, meaning that only those who come from western countries are considered refugees and can claim rights as such. For this reason, millions of people coming mainly from the eastern borders of Turkey are officially considered as 'guests' or 'temporary migrants'.

Since Turkey had not in its history faced such a number of refugees as in the 2011-2016 period, the national laws in place to deal with this situation were insufficient. Indeed, most of the laws and decrees were passed only some years after millions of refugees had entered Turkey, living in the meantime in poorly-constructed camps. The first law on Syrian refugees was passed by the Turkish parliament on 4 April 2013, assuring refugees of temporary protection status. This status was added to Article 91 of the 'Law on Foreigners and International Protection', referring to a security measure for refugees that was:

> Developed to find urgent solutions to ensure the need for international protection of foreigners who have arrived *en masse* at the borders of the Republic of Turkey and whose application for international protection cannot be examined individually. (Ministry of Health 2014)[1]

Under this law, Syrian refugees were officially considered as a single group. In contrast to a biopolitical approach, which would have given individuals rights-based protection by the state, capitalism's necropolitical tendencies does not recognise individualities and associate them with rights. Even the word 'refugee' could have implied international protection. However, since the very beginning of this flow of people, the word has not been used in the mainstream media or by Turkish politicians; refugees are identified as *Syrians* or *Syrian guests*.

The law states that people seeking temporary protection in Turkey who have not attempted to cross the Syrian-Turkish border in a group are obliged to register as soon as possible. It further states that people seeking temporary protection in Turkey will not – note the phrasing – be *punished* if they are identified and can provide 'a valid reason for their irregular (illegal) entry and/or presence in Turkey'.[2]

As a result of the ongoing war, more than 2.5 million people were forced to flee Syria into Turkey between 2011 and 2016. From the right to work to rights to healthcare and education, the laws were (and are still) opaque, leaving millions in an extremely precarious position. In 2013, refugee camps were so overcrowded that the government had to issue a decree allowing refugees to live outside the camps. Undoubtedly, this led to an unforeseen distribution of the population among various metropolitan areas, extending the emergence of precarious working conditions across a wide area.

On 18 March 2016, Turkey finally signed an agreement with the EU. However the Agreement, together with the Turkey-EU Action Programme of 2015 which preceded it, was aimed at the rapid return of all (irregular) migrants who are not considered as 'refugees' or temporary protection seekers. Since there is no universal measurement of the regularity or irregularity of migration from a country which is dominated by extreme deprivation and threats to life, those joint plans and actions offered no more than a simple justification of further displacement and for insecure living conditions, on top of which the threat of 'pushbacks' was added to the dangers facing

1 Editor's own translation of the original Turkish.

2 UNHCR (n.d.) 'Temporary Protection in Turkey' [accessed via the UNHCR website on 11 May 2022 at: https://help.unhcr.org/turkey/information-for-syrians/temporary-protection-in-turkey/].

refugees.[3] The tendency to divide and instrumentalise universal human rights was thus not catalysed only by the authoritarian shift of the Turkish state, but also by the decision makers of the EU.

A short while after the announcement of the EU-Turkey agreement, the Turkish Army began its three-pronged invasion of Syria, mainly targeting the Kurdish Autonomous Administration in northern and eastern Syria known to Kurds as Western Kurdistan (or Rojava). These military offensives were firstly aimed at preventing the activities of Yekîneyên Parastina Gel (YPG), which is officially considered a wing of Partiya Karkerên Kurdistan (PKK; the Kurdistan Workers' Party) in Turkey. Secondly, by destabilising autonomy and suppressing large geographical areas, the Turkish authorities aimed to build a 'safe space' for the militant opposition of the Free Syrian Army (FSA) and some civilian groups. From 2017 onwards, the government started officially to equip a section of the FSA with arms and military uniforms whose designs captured both FSA and Turkish flags. Consequent military offensives were executed largely by FSA groups backed up by the Turkish army. Finally, a compound reason for these offensives was to stop the migration of refugees from within Syrian borders.

The same year the first military operation started, Toplu Konut İdaresi Başkanlığı (TOKİ), which develops mass housing (or social housing) projects, started to build a 837 kilometre wall on the borders with Syria. Furthermore, dozens of so-called removal/detention centres (in Turkish: Geri Gönderme Merkezleri) started to be erected, subsequent to the EU-Turkey Agreement, to facilitate the deportation of irregular migrants. Their capacity has constantly been growing – reaching approximately 20 000 places in 2020.

To summarise in brief, the EU-Turkey Agreement eased the course of Turkey's political shift and also confirmed its military offensive. Indeed, various authoritarian and necropolitical tendencies became interwoven in the field of events following the 15 July 2016 attempted *coup d'état*. Seeking to control people's lives, creating a 'state of insecurity' (Mbembe 2019: 54) and military offensives for strategic displacement were not the direct targets of the Agreement. However, they were one of the by-products of the hypocrisy that is integrated in neoliberal thought. With pushbacks alone not being sufficient to prevent uncontrolled migration and the flight to Europe,[4] thousands of people are thus to be resettled with a little help from the Turkish authorities to places from which they can not easily escape. Even a former general of the Turkish Army (and the current Minister of Defence) tried to justify one of

3 A 'pushback' forces migrants back across the border they have just crossed. In the Aegean, this means that a boat crosses the maritime border, entering Greek territorial waters, and is then pushed back into Turkish waters by the Hellenic Coast Guard. With almost 600 coastguards, Greece has the biggest Frontex input in the whole of Europe (FRONTEX website, accessed 11 May 2022 at: https://frontex.europa.eu/we-support/main-operations/operation-poseidon-greece-/).

4 Since the beginning of the Covid-19 pandemic, more than 40 000 people have been pushed back from EU territorial waters to Turkey (See 'Revealed: 2000 deaths linked to illegal EU pushbacks' *The Guardian* 5 May 2021, accessed 11 May 2022 at: https://www.theguardian.com/global-development/2021/may/05/revealed-2000-refugee-deaths-linked-to-eu-pushbacks).

the longest Turkish military offensives (in Idlib) under the cover of ‘prevent[ing] migration’.[5] The silence of the EU has resulted in nothing less than a refreshment of the Turkish government’s long-sought affirmation of its own sub-imperialism.

Even so, the flow of refugees has continued to increase. Including newborn children, the number of Syrian refugees in Turkey reached 3 723 674 in October 2021, of whom 59 945 are living in refugee camps (Geçici Barınma Merkezleri; ‘temporary accommodation centres’). Compared to a population of Turkey standing at just over 82 million, the Syrian population represents less than five per cent.

Precarisation and insecure living conditions in the time of pandemic

In contemporary Turkey, poverty rates are high not only among the unemployed population but also across the whole of society. The number of people who are without work has long exceeded ten million while a large part of workers are working for wages which put them below the starvation line. Even in the pre-pandemic period, the unemployment rate was about 22 per cent,[6] including as unemployed those who were actively looking for work but who had been unable to find it and those who had simply given up looking, mostly out of desperation. Seventeen million people (other than refugees) were already living below the official poverty line in 2019 (Sonmez 2021). Furthermore, youth unemployment has been at least twice as high as adult unemployment for many years.

When it comes to official data, it is clear that nothing should be taken as reliable, especially when it comes to issues like poverty and unemployment. TURKSTAT (the Turkish Statistical Institute) published its annual statistics in April 2020 with these being immediately questioned by the opposition media and by public opinion. According to its official data, the unemployment rate decreased by 0.2 percentage points year-on-year to 12.8 per cent. In other words, the pandemic had not resulted in job losses. TURKSTAT subsequently faced a massive blowback and even its former president, Birol Aydemir, said he was sure that the institution’s officials ‘had not knowingly’ played with the data although he also said that he had no confidence in the figures either.[7]

The reason for this evasion is simple: in Turkey, TURKSTAT bureaucrats, like many other government officials, are under the influence and pressure of the regime. As proof of the fraudulent appearance of prosperity, Turkish labour minister Zehra Zümrüt Selcuk argued, in late 2020, that ‘poverty, especially extreme poverty, is no longer a problem in Turkey’ (Lıcalı 2021).

5 ‘Turkey launches “fresh” military operation in Idlib as tensions mount’ *Deutsche Welle* 1 March 2020, accessed 11 May 2022 at: https://www.dw.com/en/turkey-launches-fresh-military-operation-in-idlib-as-tensions-mount/a-52595869.

6 The official rate is currently – at the time of publication – around ten per cent.

7 ‘Turkey’s economic data compiled by loyal officials and “detached from reality” says ex stats chief’ *bne IntelliNews* 8 October 2020, accessed 11 May 2022 at: https://intellinews.com/turkey-seconomic-data-compiled-by-loyalofficials-and-detached-from-reality-says-ex-stats-chief-193763/.

Nevertheless, this data was only an indication of the direction of the government's policy. In April 2020, the Turkish government used a temporary article in the Labour Code to prohibit the termination of labour or service contracts by employers for at least three months, with the exception of 'Code 29' dismissals (Karaca 2020). This apparent prohibition was repeatedly extended until April 2021. However, there was no structural mechanism under which such measures could be tracked or at least reported by its victims. In the first year of the pandemic, a total of 176 662 workers were dismissed under the pretext of 'code 29' (Sonmez 2020).

The high level of informal working conditions also facilitated the unauthorised Covid-19 measures used by employers. In the midst of the pandemic, primitive forms of labour discipline were revived. Even at that point, there was no effective social distancing and health measures such as the distribution of masks and medical gloves were simply absent; furthermore, bad working conditions forced hundreds and thousands of workers to work side-by-side with others. There were cases in which workers were locked in a building and shuttled into factories even when there was a Covid-19 outbreak (Demir 2020). Similar to other countries, thousands of agricultural workers were forced to work even though they were living under the constant threat of contagion and were unable to obtain items of personal protective equipment (Hurtas 2020). Yet the Turkish government has covered up this deleterious treatment by falsifying Covid-19 case numbers (cf. Balta and Özel 2020).

When it comes to refugees, the labour market situation is much more dramatic and has deteriorated further during the pandemic. In February 2020, *Tagesschau* published a brief report that nearly half the refugees who had arrived in Germany between 2013 and 2016 had found jobs. Nevertheless, Turkey only officially issued work permits to a total of 140 301 refugees between 2011 and 2019: less than four per cent of the Syrian population in Turkey. The law granting work permits to Syrian refugees living in Turkey came into force in 2016. In consequence, Syrian refugees were also able to claim social security rights. However, developments since that law was passed prove that even seemingly humanitarian arrangements are simply not feasible where the structural and socioeconomic foundations are lacking. Insecurity is a solvable problem. However, it cannot be resolved if the economic system is fundamentally precarious.

To comprehend this unimaginable situation, the dynamics of the labour market of the country need first to be considered. While economic growth and employment growth moved together until 1998, the linear relationship between these two variables thereafter declined in the period up until 2006. In contrast to average annual economic growth of 7.2 per cent between 2002 and 2006, the increase in the employment rate was only 0.8 per cent. Economic growth that does not create jobs or reduce unemployment should be considered a product of an economic model based on speculative growth fed by neoliberal policies. The result was that the narrowly defined unemployment rate, which was 6.5 per cent in 2000, rose to 9.9 per cent nationwide and to 11.1 per cent in urban areas in 2006 (Mütevellioglu and Işık 2009: 179). This model did not last long, however, as can be seen in the GDP growth rates in the ten years between 2006 and 2016. With only a few exceptions, GDP in Turkey has steadily declined, to a growth rate of 3.3 per cent in 2016 before falling further in subsequent years to reach a rate of just 0.92 per cent in 2019 and 1.76 per cent in 2020.[8] Indeed, boosting the short-term sectors of the economy, such as construction, and accelerating financialisation through privatisation have been the main sources of what growth there has been in the Turkish economy. In contrast to economic growth and in the face of rising unemployment, inequalities by income have not changed (Sazak 2018).

Furthermore, it is important to underline that the market is doubly divided. First, it is divided between formal and informal sectors. Second, although agricultural production has declined sharply in the last twenty years, the labour market is also divided into urban and rural dynamics. Informal employment is especially widespread in rural areas.

From the beginning of the flow towards Turkey in 2011, the distribution of refugees has mainly been influenced by opportunities for employment. After the law on temporary protection was passed in 2013, providing an opportunity for refugees from Syria to live outside the camps, this was followed in 2016 by a law on work permits aimed specifically at Syrian refugees with temporary protection. Consequently, a majority of people have been able to look for work – and, of course, this is substantially in parallel sectors to those in which they used to work in Syria. For example, those who have come from Aleppo and who predominantly worked there in the leather and textile industry have settled in Istanbul or Hatay, where job vacancies in those sectors are relatively high. Also, refugees who had been working on the land aimed to find places where the opportunities to work in agriculture are high. A general fact about such sectors as these is that they are predominantly informal. Other sectors which are occupied by refugees in no small numbers are construction, small-scale manufacturing and refuse collection.

In the pre-pandemic period, nearly 92 per cent of Syrian refugees in Turkey were working informally in low-skilled positions where productivity was relatively low. Many companies established by Syrian employers or where Syrians are among the partners operate in agriculture, textiles, bakery, garment, knitwear and leather production (Tarlan 2020), while another sector in which Syrian refugees have gained a foothold in the labour market is construction, where they have met a ready reception from employers, a situation which is a cause of concern for native Turkish workers (Çınar 2018). As Tarlan comments:

> It can be said that, in a country like Turkey, which is eager to expand construction and which is managed by conservative capital, the construction industry has saved the last six or seven years with this new and cheap labour force entering the market. (Tarlan 2020; author's own translation)

The high employment rate among young refugees, working in sectors dominated by informal employment, enhanced the danger of going hungry during the Covid-19 pandemic. Starting from April 2020, as a pandemic measure, young people aged between 18-20 were continuously not allowed to leave home during certain periods,

8 Turkey's GDP growth rate 1961-2021, accessed 2 November 2021 at: https://www.macrotrends.net/countries/TUR/turkey/gdp-growth-rate.

partly including working hours. Exceptions were formally documented employment (i.e. where work permits had been obtained) or for those with health issues. However, tens of thousands of young refugees were thus prevented from going out to work since they were undocumented.

In 2021, it was estimated that about one million Syrian refugees in Turkey are working informally, with neither legal protection nor rights (Ağbaba 2021). The number of Syrians engaged in formal employment in Turkey is therefore worryingly low, both in terms of the size of the Syrian working population and the number of refugees (Danish Refugee Council 2021). All this leads to those Syrian refugees who are working at whatever jobs they can find in the Turkish labour market having a much faster rate of churn: an average of 30.7 per cent of workers quit their jobs each year in Turkey, but this rate rises to nearly 50 per cent for Syrian refugees.

The coronavirus pandemic: a means to an end?

As stated at the outset, the impact of the pandemic on refugees in Turkey ought to be understood in the context of the regime's deviation from a human rights approach as well as Turkey's deficient economic structures. Ever since the pandemic, uncertainty about the future of refugees has been increasing.

World Bank data covering 113 countries show that some 589 billion dollars has been pledged during the pandemic for social protection, i.e. around 0.4 per cent of global GDP. However, according to its expert report, these initiatives will not prevent people from slipping into poverty. For one thing, a large number of people are not in a position to take advantage of this aid; and, as with the unemployment example, deprivation needs to be viewed from the broader perspective. For example, if a household does not have the internet at home, or the family cannot read or write, it is more likely that accessing social support services will be difficult.

At the same time, about four billion people worldwide already lack social protection and those working in precarious conditions, including the 2 billion workers in the informal sector, are often the first to lose their jobs. Job losses during the pandemic could turn out to be permanent in several sectors in many countries and this will inevitably lead to an increase in poverty. Indeed, the pandemic has put 100 million people in this situation worldwide. To identify it precisely: since the outbreak of the pandemic, neoliberal capitalism has sought to use the pandemic as a means rather than an end. At the beginning of the pandemic, various intellectuals emphasised its interruptive character from the perspective of the long-term. However, this tendency gradually retreated into silence – as it did in other parts of the world, including Turkey.

TURKSTAT surveys classify families as 'poor' if their income is less than 60 per cent of median income. This means that 21.5 per cent of families in Turkey are poor. One pre-pandemic report showed that the poverty rate among refugees was at least double the average for the population in Turkey: 45 per cent of Syrian refugees lived in poverty while 14 per cent lived in extreme poverty; furthermore, 25 per cent of children under the age of 5 are malnourished (Tekin-Koru 2020). In 2021, UNHCR estimated that more than 70 per cent of Syrian refugees were living in poverty worldwide.[9] Considering that Turkey hosts over 3.5 million Syrian refugees, this percentage basically reflects what is happening within Turkey.

It should be noted that the lack of structural labour market mechanisms and the sheer indigence experienced by refugees implies that the refugee population constitutes nothing but a cheap productive force for the Turkish labour market which, in turn, facilitates their subjugation and exploitation. Nevertheless, there are also forms of resistance which means that not everyone has to give in to economic need.

The picture presented by these statistics is more dramatic than Naomi Klein's *Disaster Capitalism* because it is not a pessimistic projection of the future or theoretical analysis, but actual lived reality.

Pandemic poverty and its political impact

Limited access to education

Refugees' uncertainty about their future is increasing due to the deteriorating economic situation resulting from the pandemic. In particular because of the economic situation and the structure of the labour market, child labour has also become one aspect of refugee poverty during the pandemic. This is, on the hand, a result of decreasing access to education. On the other, child labour is welcomed by small business owners, especially in the sectors mentioned above. A report released just before the pandemic stated that only 29.4 per cent of Syrian refugee girls under the age of 15 were able to attend school, compared to 86.8 per cent of Turkish girls. The results for refugee boys under 15 were even more striking: in comparison to Turkish boys – among whom 88.4 per cent were estimated as being in attendance – only 12.9 per cent of Syrian boys were able to continue at school (Caro 2020: 11). According to Mültecilerle Dayanışma Derneği (Mülteci-Der; Refugee Solidarity Association), the number of Syrian refugee children under the age of ten is more than one million (approximately 27.9 per cent of the Syrian population). Even though there is no reliable data on the origin of child workers in Turkey:

> The children of the Syrian refugees are at an even higher risk of becoming permanently part of the sector of migrant labor due to lower access to education, discrimination and financial barriers. (Borgen Project 2021)

In June 2021, the education minister, Ziya Selcuk reported that 432 956 Syrian children do not have access to education because of the pandemic. Another report published in 2021 emphasised that increased child labour during lockdowns had made it possible for employers to cut labour costs and save the expenditure on workplace security measures (DTKİD 2021: 8).

Adding on top those child workers who are already in employment, this shows that an absolute majority of refugee children are unable to benefit from the human

9 UNHCR (2021) 'Syria Refugee Crisis – Globally, in Europe and in Cyprus' 18 March, accessed 11 May 2022 at: https://www.unhcr.org/cy/2021/03/18/syria-refugee-crisis-globally-in-europe-and-in-cyprus-meet-some-syrian-refugees-in-cyprus.

right of education with many being compelled to enter the labour market to find work as a means of poverty alleviation.

Restricted access to health services

The Ministry of Health said, in response to the Presidential Decree issued on 13 April 2020 as part of the fight against the pandemic, that personal protective equipment, diagnostic tests and medical treatment would be provided free of charge to anyone coming forward with a suspicion of Covid-19, regardless of their social security status.[10] The items of personal protective equipment included on this list identified that medical facemasks was one of the most important items. The Ministry of Health statement represents a continuation of the other decrees announced to the public on 3 April according to which any person in indoor spaces, such as shopping centres, official buildings or public places (including the streets outside houses and markets), is required to wear a mask. As a result, free masks were distributed, but in a chaotic and insufficient manner, starting from 5 April while, on 6 April, the private sale of masks in supermarkets was prohibited. This order clearly applied to people who were not covered by formal social security arrangements, but refugees have evidently encountered problems in accessing masks (Karakaş 2020).

One indicator of the lack of support received by refugees from the Turkish government during the pandemic is the level of interactions that they have with UNHCR. According to its own report, users of UNHCR social media sites in Turkey increased by more than 60 per cent compared to the same period before Covid-19, while page views also increased by more than 55 per cent (UNHCR 2020: 3). Under temporary protection status, refugees have the right to receive hospital services free of charge. However, a law or decree does not work correctly if it lacks the necessary structural and social foundation.

A compelling example of this is the lack of health support for refugees trying to cross the Turkish-Greek border. In late February 2020, President Erdoğan announced that Turkey would not stop migrants trying to cross the border into Greece immediately following the attack on Idlib (Syria) in which 33 Turkish soldiers were killed. Following this declaration, thousands of refugees made their way to the western city of Edirne, seeking to cross the Turkish-Greek border at Pazarkule. However, things changed with the first case of Covid-19 in Turkey, discovered on 11 March. At the end of the month, the Ministry of Interior (Migration Administration Directorate) published a regulation on measures against coronavirus at Pazarkule. Mülteci-Der summarised this period in the following words:

> After a 30-day wait of 'hope' in an environment where rights such as life, security, shelter, health and nutrition are violated and we watch the most brutal forms of state violence on live broadcasts, the tent areas in Pazarkule were dispersed, burned and the waiting areas de-

10 Response of the General Directorate of Health Services of T.C. Ministry of Health to Presidential Decree No. 2399 on COVID-19 Treatment Expenses, last accessed 11 May 2022 at: https://khgmfinansalanalizdb.saglik.gov.tr/Eklenti/37729/0/covid-19tedavigiderlerive2399-sayilicumhurbaskanikararipdf.pdf.

stroyed, citing the Covid-19 outbreak. Refugees and immigrants were taken away from the border area on buses.[11]

Subsequently, some 5848 refugees were detained in dormitories for at least two weeks after which they were taken to repatriation centres spread across nine different provinces.

At the point when refugees have become the subject of public discussion, it is clear that Erdoğan and his Adalet ve Kalkınma Partisi (AKP; Justice and Development Party) – in contrast to other conservative and right-wing authoritarian figures in Europe – has asserted a positive discourse on refugees. This attitude is fuelled by the claim to be seeking to lead refugees under the flag of the so-called Muslim brotherhood and, where possible, to gain votes from those who have obtained Turkish citizenship. Such an approach has repeatedly been asserted from both right-wing and quasi left-wing nationalists (Kemalists) as Erdoğan's 'secret plan' to retain power.

Due to the deteriorating unemployment rates and rising prices, especially in autumn 2021, tens and thousands of workers and citizens started to protest and mobilise in massive strikes around Turkey. Many of them were not unionised but they were joining demonstrations in the attempt to secure increases in income due to ballooning energy costs and the artificial level of inflation in the costs of rented housing. These protests were an example of the interlinked economic-political agenda relating the basic experiences of class struggle to those in political power. These mobilisations had their peak in the middle of the first quarter of 2022.

However, since the beginning of April 2022 a new public discussion about refugees has politicised large groups of society. Umit Ozdag, an established far-right leader (expelled in 2020 from the centrist nationalist IYI Party) and a former vice president of the fascist Nationalist Movement Party (MHP), has been leading this politicisation. At the end of November 2021, he started a mass petition campaign advocating returning all refugees to their country of origin. This petition was instantly banned by the Ministry of the Interior. Even though only a small group of people knew about the campaign, he received sizable support during a TV show at the beginning of April and, in just one month, membership of his Zafer (Victory) Party rose from 4003 to 10 213. In the days following Ozdag's announcement of a brand new fascist documentary called 'Silent Invasion', some TikTok videos of a few refugees targeting Turkish women in public (on the streets, in shopping malls, etc.) were widely shared on the Twitter social media platform. Those videos were directly boosted by Ozdag's social media account and by other far-right groups, including Turkish nazis. As a result of Ozdag's interventions, almost all political parties have become obliged to announce whether or not they are willing to retain refugees in the country.

In general, AKP uses state repression to tackle criticisms made of it. However, in this case, AKP seems prepared to let happen whatever will happen, without basically

11 Mülteci-Der (2020) Press Release: 'Pazarkule sonrasinda ne yaşaniyor?' ('What happens after Pazarkule?') last accessed 11 May 2022 at: https://multeci.org.tr/2020/04/20/basin-aciklamasi-pazarkule-sonrasinda-ne-yasaniyor/ (author's own translation).

changing its discursive position. Considering all the previous occurrences of human rights violations, there is no good sign as to what will come next.

Conclusion

Even though various social groups in the country are suffering from parallel social problems, their demands are alienated from each other. This method is the well-known 'divide and rule' approach that has been practised in almost every period of history. Starting way before the Covid-19 pandemic, such segmentations have already been instrumentalised by the authoritarian presidential system to maintain ordinary power relations in extraordinary times.

The question of whether the Turkish government was prepared for the pandemic is irrelevant because the country was already on the brink of irreversible poverty and precariousness. Likewise, the implementation of comprehensive support for Syrian refugees could have been a decision made by international organisations (including the EU and its Member States) instead of exporting the crisis to Turkey. However, to expect real support for the poor is not realistic in the neoliberal European Union.

Likewise, many global institutions are also guilty of overlooking the increasing levels of poverty among Syrian refugees. In December 2020, the World Bank published a report on the worsening and the persistence of poverty and its impact on Syrian refugees and host countries (World Bank 2020); however, this report did not mention Turkey, focusing only on Iraq, Jordan and Lebanon. There is no reason for this silence except the adverse explanation of the simple disposability in modern political terms of the poor and the refugee alike.

Ultimately, many of the unjust approaches led by the Turkish Republic are rooted in the 2016 EU-Turkey Agreement since it has paved the way for the instrumentalisation of the refugee situation. Therefore, the existing Agreement between Turkey and the EU needs to be abolished for the sake of universal human rights. Furthermore, both the European and the Turkish economies should be restructured beyond neoliberal economics: refugee labour should not be left to the small business community to exploit and specifically with regard to the opportunistic use of children in a time of poverty as cheap labour.

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Christophe Solioz

Reading Sarajevo City[1]

Abstract

In this essay, introducing a new volume considering Sarajevo as a 'multiplex city' – ceaselessly active and perpetually changing, rooted in the existence of a multidimensional and collaborative system composed of separate projects – the author scrutinises Sarajevo's urban space from diverse standpoints inspired by architecture, urbanism, literature, art, anthropology, history, philosophy, social sciences and politics. In the process, he draws expressly on Sarajevo's history allowing people to be one with another. Here examining graffiti and outdoor wall art, which not only structure the urban space but facilitate the city to speak to and of itself, the author demonstrates how outdoor art, and walls, operates additionally as an agent of power to mediate resistance and to contest, subvert and negate violence. In the process, he addresses how 'being with' – co-existence, exposure to each other and hybridisation – is translated into the permanent metamorphosis of a city bonding its past and its future and, in so doing, healing the tragedies, suffering and failures of humanity of its recent past.

***Keywords**: Siege of Sarajevo, graffiti, outdoor art, urban space, territorialisation, co-existence, identity*

Graffiti as a breadcrumb trail

They still laugh about it in Sarajevo today. Shortly before the Siege (5 April 1992 – 29 February 1996), a piece of nationalist graffiti showed up on the face of the imposing building of the central post office, asserting: 'This is Serbia'. The reply was not long in coming: 'This is the post office, you idiot'.

This reveals a sense of repartee and comic timing that is typical of the 'Sarajevo spirit' (*sarajevski duh*) and is a fine demonstration of the interactive function of graffiti (Zask 2013). It reproduces, word for word, the mechanisms of exclusion and inclusion specific to that wall at the very moment the city was being disassembled and

1 This is the text only – not the accompanying images – of the author's contribution to *Sarajevo Singular Plural. Contributions in honour of Zdravko Grebo*, edited by himself, Jakob Finci and Wolfgang Petritsch, to be published by Nomos in 2023 as No. 14 in the 'South-East European Integration Perspectives' series. The volume offers a collection of contributions – essays as well as art and high-quality photography portfolios – focusing on Sarajevo as a 'multiplex city'. It commemorates Zdravko Grebo, Professor of Law, civic champion, public intellectual and founder of 'Radio Zid' ('Wall'), whose purpose was to preserve the civic, urban and cosmopolitan spirit of Sarajevo during the Siege, and who died at the start of 2019. A trailer for the volume can be found at: https://christophesolioz.exposed/sarajevo-singular-plural-contributions-in-honour-of-zdravko-grebo/.

reassembled by the logic of war, falling within the epistolary register inaugurated by Dondi White, one of the founding fathers of graffiti (Thompson 2013: 212).

The return receipt was to follow on 2 May 1992: the neoclassical building was set aflame, its graffiti with it.

Effacement sealed the fate of the graffiti-trace just as it bore witness to its 'exposure' – a term that obviously takes on an altogether particular significance in times of war. Just as inscription corresponds to the need to exist and to affirm oneself, effacement leads back to the threat and anxiety of irremediable disappearance. The wall still stands; but the memory remains. The wall as mystic writing pad mitigates the city's failures of memory while its operative mode enables everything to be both removed and preserved, while allowing for a fresh layer of writing (Freud 1925 [2001]). A magical screen on the scale of the city, the wall records the successive layers of the city's speech – words of life and death, love and hate, hope and despair. Multiplex transmission and reading.

On Maršala Tita, at the crossing with Slobodana Principa Selje (today's Kulovića), a block of concrete protecting pedestrians from sniper fire hosts one of the multiple graffiti-palimpsests of the Siege. The graffiti wall is a fine illustration of the interaction between graffiti (successive inscriptions); place (a Sarajevo crossroads, but also Berlin and Los Angeles); and temporality (the war, but also 1989). Its integration depends on a spacing that liberates areas which can then take on new paradoxical functionalities (the walled-off crossroads protects and enables movement, but in one direction only) and is apt to welcome disjunctions in the form of assemblages that are not subordinate to place. Somewhat in the manner of a Richard Serra sculpture, the wall is the agent of disturbance and continuity at one and the same time (Zask 2013: 72-74). Here, graffiti plays with, and frees itself from, injunctions of place and time while pluralising the situation, the place into which it is integrated.

Thus, to 'Pink Floyd' (a piece of graffiti from 1992; the reference to 'The Wall' (1979) being clear), there was later added: 'Skid Row – I Remember you – Sebastian' i.e. the name of the Los Angeles rock band, the title of their 1989 song and the name of the group's singer, Sebastian Bach. Skid Row also happens to be the name of an LA neighbourhood, the US capital of homelessness, the city of fallen angels.

A final touch brings about the wall's metamorphosis into 'outdoor art'. Far from pity or seduction, the painter-poet-photographer Louis Jammes added to the composition a silkscreen print from his artistic work made *in situ* (1993). Now, we enter another dimension. An angel spreads its wings. Is the war stopping the angel or is the angel stopping the war? It fell to the photographer Milomir Kovačević, who lives on Maršala Tita, to capture the magic of the juxtaposed messages.[2]

2 We may also mention in this respect a photograph taken early in 1994 by Gérard Rondeau (1994: 70-71).

But where danger is, grows / The saving power also (Friedrich Hölderlin):

that is, it is the prospect of death that renders life and survival possible (Derrida 2020).

When walls speak of the city

Far from conventional clichés, Bojan Stojčić's work *Hotel Bristol – On Walls of Sarajevo 1996-2019* offers an assemblage of graffiti and murals from after the war alongside texts that invite their decoding. It is also, and above all, a book that bears witness to a militant appropriation of urban space by 'the generation that came after', now grouped in the *Črvena* (Red) Association for Culture and Art. This is a generation that makes a point of its difference, calling openly for a re-appropriation of urban space by citizens and proclaiming loud and clear the *Right to the City* – the right also to make the city different (Lefebvre 2000: 147-159).

From the start of the 2010s, the mural 'I Love this City, I defend this City' pays homage to the city in a state of resistance, both during the Second World War (the star on the helmet) and during the recent Siege – with, to boot, a nod to Dondi (the Kangol hat). A 2019 photograph underlines how the enemy is now the neoliberal world (here, the BMW): the Sarajevo that came after, faced with the perils of economism, clientelism and corruption. The right to the city calls upon resistance and for the safeguarding of ordinary civility and democracy, and urges an overhaul of values.

Damir Nikšić's mural poses the question of the sense of resistance in the world that has come after. A future that is nevertheless compromised by the administrative supervision of the Office of the High Representative (OHR) of the United Nations that is still in place and by an unbending Yugo-nostalgia. This Eldorado is magnified in an abandoned barracks by a piece of graffiti showing Marshal Tito (1892-1980) as a supreme leader, looking like Moses dividing the waters of the Red Sea; in this case, the Neretva river. The allusion is to the Battle of Neretva which sealed the victory of the Yugoslav partisans. It is a commemorative fresco that is the symbol of a new generation appropriating for itself the epic narrative of a past long gone and of the unease created by upheavals brought about by metropolitanisation and globalisation. Here, we are far from the graffiti that transgresses and critiques society. This is 'screen', fixated on the Yugoslav past, the 'golden age' of a confiscated present.

In spite of reconstruction, the many bullet-riddled walls still mark out the urban space today and participate in a re-writing of the text of the city. The bullet holes themselves are sometimes integrated into the composition of the graffiti or become the occasion of a magical transfiguration. For example, Edo Vejselović's installation *Star City* (2010) on a wall adjoining the gallery Duplex10m2: at night, the sprayed bullet holes become stars; the wall a magnificent starry sky. The traces of the past can be preserved by giving them an otherworldly dimension.

The wall does not, therefore, have the sole function of structuring the urban space. It becomes a *res politica* because the city is also a shared space of imaginary projection. Through the intercession of the wall, the city speaks of itself, of its history; it draws its own portrait; and it offers its text for deciphering – whether this text is commercial or dissenting like graffiti, the logic is the same (Coccia 2013 [2019]). A screen wall hosting the traces of a collective process of recall, repetition and perlaboration which can also be found on the scale of urban space.

Here, we may recall a dream by Walter Benjamin (1979: 83):

> Sky. – As I stepped from a house in a dream the night sky met my eyes. I shed intense radiance. For in this plenitude of stars the images of the constellations stood sensuously present. A Lion, a Maiden, a Scale and many others shone lividly down, dense clusters of stars, upon the earth. No moon was to be seen.

Frédéric Neyrat picks up this superb text to rethink Benjamin's philosophy from the perspective of his cosmology (Neyrat 2022a); a cosmos which is, however, not only astrophysical:

> Cosmos is, therefore, a term that signifies both a consideration of contemporary sciences and the requirement to show how those sciences are overwhelmed by mythical, artistic and political perspectives obliging us to revisit, from top to bottom, our representations of the universe and the entirety of our perceptions of it. Put in other, more colourful terms: cosmos is what happens to the universe when a dark angel communicates something to it that it is *alien*. (Neyrat 2021: 27)[3]

Reading the city

Jean-Christophe Bailly has underscored the city's relationship with language:

> The city is above all a phrasing, a conjugation, a fluid system of declensions and agreements. It is these phrases and this phrasing that has to be found again: passing from a language that is stocked or stacked to a spoken language, inventing the generative grammar of urban space. (Bailly 2013: 17)

This phrasing is both poetics and politics, and mirrored in the urban fabric.

The 'assemblages' (Deleuze and Guattari 2003: 503) of the urban space and its architecture reflect the syntax of the city as well as its metamorphoses (Grabrijan and Neidhardt 1957). Sarajevo is a 'book city' of history punctuated by four centuries of Ottoman presence (1463-1878), four decades of Habsburg monarchy (1878-1918), a Yugoslav fate that was first royalist (1918-1941) then Titoist (1945-1980), before an independence that became synonymous with a pugnacious transition. From east to west, the full length of the Miljacka river, the phrasing of this city is revealed in an organic network that links together the different neighbourhoods and various temporalities.

This temporal sequence underscores the polysemy of a linear urban grid that is structured in parts that are perfectly identifiable, each characterised by a specific urban form that corresponds to an ideal urban type that tallies with the three ages of urbanism distinguished by Albert Lévy. First, the Ottoman city, Stari Grad, with

3 Author's own translation.

Baščaršija, both a marketplace and a common public space, surrounded by communitarian neighbourhoods (mahala): Vratnik, Muslim; Latinluk, Catholic; Tašlihan, Orthodox; and Bjelave, Jewish (Karahasan 1994). Then, with the first conurbation, the Austro-Hungarian Centar stretched as far as Marijin Dvor, which became the new town centre. Lastly, the outlying town, Novo Sarajevo and Novi Grad, by turns socialist, industrial and Olympic – were boroughs destined to expand and proliferate. Sprawling Sarajevo.

This movement of opening, of extending and thriving, was to evolve much further with trade and the trafficking of humanities, love, money, sport and even gastronomy. Sarajevo spreads, displays itself and exports itself. There is a 'Sarajevo' street in Belgrade, in Baku, in Ferrara, in Forlì, in Milan, in Niš, in Osijek, in Šibenik, in Split, in Tunisia and in Zagreb; 'Sarajevo squares' in Ponte di Piave and in Nantes; and a 'Sarajevo restaurant' in Dieppe, in Düsseldorf, in Berlin, in Frankfurt, in Prishtinë and in Vienna.

It will not be possible here to analyse in detail the diverse registers of urban and architectural forms. For that, we would have to summarise and develop the exceptional work undertaken in the 1950s by Grabrijan and Neidhardt (1957). So, within the framework of this essay, we shall just briefly mention two aspects.

First, the importance of thresholds that signify urban discontinuity and the introduction of a new urban grammar. Alongside the caravanserai, the Hotel Evropa (1881-1882) is characterised by a hybrid architecture – in its construction today as in former times – mixing fin-de-siècle and contemporary architecture. The building lies betwixt and between, on the precise limit between the Ottoman neighbourhood and the Austro-Hungarian neighbourhood. It is a meeting point of two cultures, of two architectures, and is a place of encounter.

Further along, Marijin Dvor deserves special attention. This is the border-crossroads between the Austro-Hungarian architecture and the Sarajevo urbanism of the 1960s to the 1980s, in keeping with the urban plan set out by Juraj Neidhardt, Le Corbusier's collaborator in the 1930s. The work built from the end of the 1970s by Ivan Štraus (Elektropriveda, Unis, Holiday Inn) is not social realism but rather under the influence of Mies van der Rohe and Arne Jacobsen. Additionally, however, Marijin Dvor is the site of a new conurbation. Distancing itself from projects that have been rightly criticised (Daoulas 2017), such as Sarajevo City Centre, the Alta shopping centre (Sanja Galić and Igor Grozdanić, 2010) converses intelligently with the Parliament (Juraj Neidhardt, 1982) just across the street and fits into the area perfectly.

We might also point out, in passing, the approach of Galić and Grozdanić (at Studio Nonstop) who have designed a number of their projects by playing with urban discontinuity: they decompose the urban fabric in order to isolate its characteristic elements which they then juxtapose (Ibelings 2012). This is an original line when it comes to forming a fresh conception of future urban mutations in a city that has been marked by a complex process of re-territorialisation, the main aspects of which it is important to grasp.

Second, we might draw attention to how, while today's urban fabric clearly bears the trace of different periods, each segment has nevertheless incorporated building styles and components that belong to other eras – a tendency that is sure to become stronger. We can mention by way of example the celebrated National Library, the Vijećnica, a splendid building designed by Czech architect Karel Pařík.[4] Constructed in 1891-1896 in a neo-Moorish style during the Austro-Hungarian period, the Vijećnica stands in Baščaršija where it literally forms the figurehead of the old Ottoman Sarajevo. In this context, we may also mention the Papagajka (parrot): an imposing building (27m x 110m x 25m) in bright yellow and green, sited by the Miljacka between the Ashkenazi synagogue and Bakr-Babina mosque; a fine example of brutalist architecture inspired by Le Corbusier (Stierli and Kulić 2018). The building faces, on its right, the Ottoman area and, to its left, the Austro-Hungarian. This last architectural project from the socialist period (begun in 1982 and finished in 1990) is the work of Mladen Goraždena.

A process of (re-)territorialisation

A crossroads between east and west, Sarajevo has always been a cosmopolitan network-city in which Muslim/Bosniak, Orthodox/Serb, Catholic/Croat and Jewish communities live side-by-side; and the alchemy that this produces deserves to be taken in full measure.[5] Here, it is useful to recall Aristotle's approach:

> And yet it is evident that as [the city] becomes increasingly one it will no longer be a city. The city is in its nature a sort of aggregation, and as it becomes more a unity it will be a household instead of a city, and a human being instead of a household (...). So even if one were able to do this, one ought not do it, as it would destroy the city. (Aristotle 1984 [2013]: 26)

Aristotle insists in particular upon the city differing from an alliance and from a nation (in the sense of an 'ethnic people'), as 'those from whom a unity [at city level] should arise differ in kind' and it is this 'reciprocal equality' that preserves the city.

In his essay for Sarajevo, Jean-Luc Nancy refers precisely to Aristotle's viewpoint:

> The common, having-in-common or being-in-common, excludes interior unity, subsistence, and presence in and for itself. Being with, being together and even being 'united' are precisely not a matter of being 'one'. Within unitary community [*communauté une*] there is nothing but death, and not the sort of death found in the cemetery, which is a place of spacing or distinctness (…). (Nancy 2000: 154)

The abundance of religious sites in Sarajevo ought not to mislead us. Their spacing is the sign of a secular 'commonality' whose dual logic is underscored by Benoît Goetz (in a position not far from that of Jean-Luc Nancy):

4 We are indebted to Karel Pařík for a number of further constructions, including the Hotel Evropa. While Pařík developed the Vijećnica project, the plans are by Alexander Wittek and construction was entrusted to Ćiril Ivekovič.

5 It should be noted that, until the end of the 19th century, Bosnian society as a whole remained foreign to national categories, the population identifying itself until then in confessional terms (Bougarel 2017).

> Secularity maintains dispersal; it prevents the commonality from totalising and unifying. (Goetz 2018: 224)

This paradox of secular space is firmly anchored in Sarajevo, where dislocation does not imply any renunciation of politics, quite the contrary:

> It designates that moment when citizens are no longer brought together except by what separates them, and which is the very thing from which they forge the principle of their coming together: free space unceasingly deployed by their coexistence. (Goetz 2018: 225)

Frédéric Neyrat emphasises this complementarity between the close and the distant in similar terms:

> There is no communism other than from a distance, than related to the other-than-oneself, for the infinitely distant only comes close by remaining distant. (Neyrat 2022b: 64)[6]

The city is the architecture of *being-with*. And this applies to Sarajevo in particular (Lovrenović 2001: 9). Even the Sarajevo grid mirrors this through the manifold presence of public spaces and 'multi-technic' buildings; buildings that therefore came to be specifically targeted during the Siege.[7]

Indeed, during the Siege, the city transformed into a panopticon, the space of a biopower that re-territorialised 'a minority as a state' (Deleuze and Guattari 2003: 291) by creating homogenous communitarian enclaves. The common sphere, such spaces as favour movement and flux and inter-communitarian relations, were systematically taken as targets by the snipers and the Bosnian Serb Army with the aim of dividing the city. This result has been enshrined by the Dayton Agreement (1995). The post-war configuration is set to put the finishing touches to this 're-territorialisation' by accentuating a division between Sarajevo and Sarajevo-East which people too often feign to overlook.

The re-territorialisation process can be observed at different levels.

First, with communitarian structuring – to put it briefly:

> Bosnians have ceased to be just Bosnian and become Bosnian Muslims, Bosnian Serbs and Bosnian Croats (Lovrenović 2001: 209),

to which have been added socio-cultural dichotomies: local/newcomer; urban/rural; 'civilised'/'uncivilised'. The figures speak for themselves: half of the pre-war population has left the city, while newcomers (one-third of the population) are displaced persons from the countryside. Certainly they are Bosnian, but they are 'peasants', 'bumpkins', 'outsiders'. Sarajevo is now a virtual city in exile.[8] This dismissal of refugees from rural areas harks back to an imbalance between rural and urban

6 Author's own translation.

7 See the maps produced by Mirjana Ristic (2018), at p. 13 and p. 76.

8 An observation drawn from my presence in the field (between 1994 and 2021); see also Anders Stefansson (2007).

zones: Bosnian society is, by tradition, predominantly rural and provincial, social and cultural modernisation being a recent and urban process, hence the conflictive logic.

Second, the cleavages and stakes of the conflict, including the post-war period, find their re-transcription in the urban space. As Mirjana Ristic pinpoints:

> While the wartime siege was a violent attempt to create a divided and ethnically cleansed city, this was achieved in the post-war period using different spatial regimes and practices of representation. The barricades have been removed and replaced by names, colours and scripts. They function as tools for the territorialization and stabilization of some forms of ethnic identity and exclusion of others. (Ristic 2018: 147)

The post-war renaming of streets, the (re)construction of religious buildings and memorial monuments – clearly tending to eliminate mixing and merging, and to foster the production of 'ethnically' exclusive identities of place – significantly reconstruct the spatial narrative and order.

The spatial praxis of a society – in this instance, a divided one – is revealed by deciphering its space. Space is 'a social product'. It is not neutral; it is political (Lefebvre 1973 [2000]: 53). And it continues to be so, cf. the gradual reinvestment of the 'common sphere' and the return of Bosnian Serbs, albeit with diffidence, to Sarajevo, having initially sought exile in Sarajevo-East. Often a (better paid) job represents the opportunity to go back to Sarajevo. Conversely, some Bosnian Muslims, while working in the Federation, now live in Republika Sprska, especially in Dobrinja, due to the cheaper property market. This has breathed new life into the city and reconnected it to a past characterised by composite integration and permanent cultural interaction, thus bringing together a multiplicity of complementary perspectives open to new aggregations (Lovrenović 2001: 209, 227).

Walls and outdoor art

From the surrounding heights, both the city and its prospect are unobstructed. From here, one can better see what Sarajevo is made of: its spaces. In the meantime, reconstruction has certainly transformed the face of the city, as will future constructions. On each occasion, it is the spacing – the roads, the squares, the places of passage – which is rearranged. The spacing marks the city's degree of openness, its scope, its breathing space and its excesses too; it is what makes it possible to 'be-there-also-with-others'. In the end, architecture is about space (Boudon 2003), more specifically 'a mode of singularisation of space' (Goetz 2018: 92), and thus the city is an arrangement of spaces, a spatial playfulness and a space of play (*Spielraum*), thus a 'spacing activity' (Goetz 2018: 220).

That these spaces are regularly invested in by 'outdoor art' deserves particular attention. Outdoor art, which is not shown within an urban space framework, interacts with and modifies the space it occupies. Our attention here is more especially drawn to the artistic practices that take possession of those very walls that, to say it again, establish spatiality and spacing, playing with an inside and an outside. Here, art resonates with architecture: both of them lay out, set apart, organise and make things possible. This is a proximity that Goetz does not fail to underscore:

> If a sculpture or a painting (in this instance, one thinks of the art of fresco, of course) are conceived of as undetachable from the site of their installation, then one can say, unless they are pieces of architecture, at the least they collaborate in such an intimate manner with the architecture that they create between it and them a zone of indiscernibility. They make a space exist, and not just any space: the space where they stand and to whose existence they contribute. (Goetz 2018: 34)

At this juncture, the work made by Louis Jammes during the Siege of Sarajevo deserves particular attention. Note first of all that Jammes brought together his work made *in situ* under the title 'Sarajevo is in reality the name of nothing that can be represented' (Jammes 1994). Now, this very idea presides over the definition of architecture that Goetz put forward:

> Architecture is what does not allow itself to be represented to the very extent that it presents itself always as something other than itself. (Goetz 2018: 36)

Architecture thus furnishes the 'frame' of representation. Regarding the work of Jammes, it concerns a series of altered photographs that have been silkscreened and pasted on walls around the city.

Far from monumentalisation and the centrality that goes with it – these being characteristic of public art – the work of Jammes is closely knitted to the city, immersed into its urban space (Zask 2013: 20). Places of passage and refuge are particularly favoured, as in the case of the former Red Cross centre in Sarajevo which was adjacent to a particularly dangerous street, not far from 'Sniper Alley'.[9] Executed directly on the walls, the work literally forms one body with the city: it inhabits and clothes the walls of the old tobacco factory in Marijin Dvor, the walls of Hastahana, the walls of Zelenih Beretki (not far from the Hotel Evropa) and the walls of the Vijećnica. The 'angels of Sarajevo' do not interpellate the spectator but rather accompany the passer-by, structuring – and giving meaning to – itinerary and perceptions of space. They are a host of bearings, punctuations, stations of refuge as one moves along. The presence of the angel is a sign of a safe space; one can – as one sees fit – take shelter, pause, discuss, play or go on one's way. It is the exposed angel who comes to the aid of the passer-by exposed to sniper fire.

Unlike certain public artworks, here the passer-by is not caught in a constrictive apparatus. In the context of the Siege, it is the rest of the city that falls within a totalising immersion, the individual being shut into a panoptical device at risk of harm to his or her life.[10]

9 The building, opened on 2 September 1929, was constructed following the plans of architect Helen Baldasar. It is located in Marijin Dvor, at 2 Kranjčevićeva. It formerly housed a famous cinema, the Sutjeska, which was transformed into an art gallery during the Siege.

10 We rely here on Zask's fine-tuned analysis of immersive art (Zask 2013: 130-137).

With the angel, the city finds its space again, restoring to the passer-by subjectivity and freedom of movement.[11] The angel is therefore not only located *on* a site, it *is* the site. This is a site that allows for another perception – of the work, certainly, but also of the space and of displacement across it – whether one moves through it or stays there temporarily or even when it becomes, on occasion, a participatory site, be it celebratory or artistic (we are thinking of the concerts and exhibitions organised during the Siege at the Red Cross centre, Hotel Evropa and even the Vijećnica). One is put in mind of the creation of 'behavioural space' that was so important to Richard Serra:

> My sculptures are not objects for the viewer to stop and stare at. The historical purpose of placing sculpture on a pedestal was to establish a separation between the sculpture and the viewer. I am interested in creating a behavioral space in which the viewer interacts with the sculpture in its context.[12]

The wall effect produces an effect similar to that obtained by the dislocation performed by Gordon Matta-Clark (*Splitting*, 1974): the production of an outside to sites that are generally deprived of it – it is the outside of the inside. The interior is propelled towards the exterior; the wall no longer protects; it explodes and exposes. On closer inspection, it is that exteriority which, in an initial phase, takes possession of the interiority that binds back with its original space, the outside. Hence the relevance of what we might term an 'exology', a science exposed from the outside, as formulated by Frédéric Neyrat to whom we owe the luminescent formula:

> The Outside is the outside-with that transports the inside. (Neyrat 2022b: 81)[13]

The wall no longer being protective, it exposes what architecture usually conceals: a laying bare, therefore, of *being-on-the-outside*.[14] In fact, there is a double laying bare: first, living and being are about being-there, being-in-the-world, among things and thus *outside* (Heidegger 2010: 62 (in the original German edition)); and, second, this world is a shared world, thus: *being-with*. The singular is simultaneously plural, to echo Jean-Luc Nancy:

> The meaning of being [...] can only attest to itself or expose itself in the mode of being-with. (Nancy 2000: 27)

The angel calls to mind how architecture, the city, is a space of coexistence, the site of *being-with*.

11 In Hannah Arendt's view, freedom of movement as well as space is related to politics (Arendt 1961, 2005: 119).
12 From Richard Serra's statement included in the press release of his first American retrospective at the MoMA in 2007; quoted in Yau (2014).
13 Author's own translation.
14 I am borrowing this vocabulary from Benoît Goetz, notably his conception of 'architecturally of existence' (Goetz 2018: 65-66).

The artifices of an apartment that one imagines to have been personalised give way to the angel that exposes another humanity that will ultimately triumph.

> '*Sarajevo će biti, sve drugo će proći* / Sarajevo will be, everything else will pass'.[15]

Outdoor art in its various forms – graffiti, murals, *in situ* art, site-specific art, land art – significantly reframes the narrative of the urban space. Beyond the mere aesthetical values, social and political dimensions are included. Outdoor art thus combines art, politics and urbanism; it also opens a space for new meanings of the existence of the individual and the collective (Dewey 1980).

The examples discussed here illustrate the difference between outdoor art and public art, but they also demonstrate how outdoor art operates additionally as an agent of power to mediate resistance and to contest, subvert and negate violence. Among many others, the artworks presented here are traces of urban facts as well as of the city as an artwork. As recalled by Lewis Mumford, the city fosters art and *is* art:

> The city (...) is also a conscious work of art, and it holds within its communal framework many simpler and more personal forms of art. (Mumford 1938 [1970]: 5)

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15 A well-known song from 1992; words by Đorđe Balašević and Zlatan Fazlić Fazla, set to music by Zlaja Arslanagić. In a telephone interview with Zdravko Grebo, aired at night on Radio Studio 99, the renowned author, composer and poet, Đorđe Balašević (from Novi Sad, Serbia), penned the first two verses of what would later become a hit song.

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Fabian Teichmann and Sonia Boticiu

Corruption in eastern European judicial systems and its effects on proceedings in other countries

Abstract

In the context of the provision of mutual legal assistance, prosecutors, judges and criminal defence lawyers are frequently confronted with criminal proceedings established in east European countries inside or outside the EU. For this reason, coercive measures are regularly requested and often even taken in western countries on the basis of these foreign proceedings. Allegations that proceedings in some east European countries have been manipulated, or even completely fabricated, have become increasingly common. So far, research and teaching have focused on politically motivated procedures, but this article addresses the influence over legal procedures in western countries resulting from bribes paid to east European officials. Referring overtly to 'eastern Europe' in general, the authors use a field report, drawing on their experience and practice in German-speaking countries, to describe the potential for abuse in this area. They call on judicial systems in western countries to advance cautiously in such proceedings and to pay close attention to the paperwork and procedures in the country which is seeking assistance.

Keywords*: mutual legal assistance, eastern Europe, judicial systems, corruption, bribery,*

Introduction

For prosecutors and courts in countries such as Austria, Liechtenstein, Germany and Switzerland – all German-speaking countries but with an experience that is common across western Europe – requests for mutual legal assistance from east European countries, especially in the area of criminal proceedings for white collar crime, are now part of daily work (Wilkitzki 1995). However, questions arise in particular in relation to legal proceedings in east European states with high rates of corruption as to the circumstances under which these investigating authorities and courts have made their decisions. There are often allegations that judges in these countries have been bribed or even that entire proceedings have been fabricated (Mungiu-Pippidi 2018). For defence lawyers, prosecutors and judges throughout the German-speaking world, such things are starting to form a major challenge (Teichmann 2021).

While there is a legitimate interest in providing legal assistance, as western countries should not become a haven for criminals and their criminal assets, it must also be avoided for foreign criminals to have the opportunity indirectly to control proceedings in western countries via bribes paid to their officials in their own countries (Cape and Namoradze 2012). An example of this would be an accusation of embezzlement drawn up in eastern Europe with the seizures, or even independent money laundering proceedings, taking place in German-speaking countries. In a worst case scenario, this could lead to unjustified coercive measures taking place in the latter as a result of corrupt judicial systems in eastern Europe (Schmidt-Pfister and Moroff 2013).

One of the challenges for defence lawyers is to prove that proceedings against their own clients have been influenced by corruption. The prosecution and the court also have a vested interest in not allowing themselves to be instrumentalised in this way. Thus, defence lawyers, prosecutors and judges have an equal interest in questioning how corrupt are judicial systems in eastern Europe and to what extent it is possible for criminals to manipulate proceedings in western Europe. This article takes a look at the circumstances under which it is possible to influence criminal proceedings in east European countries through corruption, or even to have them fabricated entirely, and what effects this could have on judicial systems in western, specifically German-speaking, countries. Conclusions and recommendations for defence lawyers, prosecutors and judges follow.

State of research, the research gap and research objective

The definition of corruption and its causes has been extensively addressed in the existing literature (Shleifer and Vishny 1993; Jain 2001; Treisman 2000). For the purposes of this article, reference is made to the definition of the OECD's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Anti-Bribery Convention) (OECD 1997). The definition, set out in Article 1, paras 1 and 2, should also apply to domestic public officials and has indeed been adopted in criminal law throughout the German-speaking world. There is widespread agreement that large parts of east Europe remain corrupt (see the Corruption Perceptions Index)[1] while, in east European judicial systems, corruption is also widely known (Batory 2012). The negative economic effects and associated limitations on legal certainty have also been well examined (Svensson 2005; Mauro 1995; Glaeser and Saks 2006; Bardhan 1997).

It has been acknowledged in the case law that has been developed so far that proceedings in some east Europe countries may sometimes appear artificial. However, the focus has always been on politically motivated proceedings.[2] Media attention has been increasingly concerned with allegations of politically motivated proceedings, resulting in very little attention being paid to proceedings which are contrived or manipulated for reasons other than political ones.

In the context of European and international arrest warrants in particular, it has been shown that the considerable shortcomings encountered in criminal proceedings in eastern Europe pose a major challenge for the judiciary in German-speaking coun-

1 The 2021 Index, accessed 20 June 2022, is available at: https://www.transparency.org/en/cpi/2021.

2 See the various judgments of the European Court of Human Rights in, for example: Navalnyye v. Russia, no. 101/15 (2017); Merabishvili v. Georgia, no. 72508/13 (2017); and Karácsony and Others v. Hungary, nos. 42461/13 and 44357/13 (2016).

tries.[3] It has also been pointed out in the literature that the judiciary in German-speaking countries can, under certain circumstances, be abused by foreign states or criminals.[4] However, such countries continue, for the most part, willingly to provide legal assistance in criminal proceedings right across eastern Europe.[5]

The effects that the weaknesses of judicial systems in eastern Europe may have on criminal proceedings in other countries have not, however, yet been adequately described in the literature. There has also been insufficient analysis of how criminal proceedings in east European countries can be fabricated or manipulated in practice and the impact that this may achieve in the countries providing legal assistance in the sense of the coercive measures that can be applied there.

There is, therefore, a significant research gap. This gap has practical relevance because defence lawyers need to have adequate bases on which to build their argumentation, while prosecutors and courts need to have a reliable foundation for their own decision-making. It is important that the possible effects of corruption in east European judicial systems on the administration of justice in western countries be critically examined and that this research gap be at least partially eliminated. This article aims consequently to discuss the weaknesses of judicial systems in eastern Europe and their impact on the administration of justice in western countries. It aims to provide a basis for prosecutors, defence lawyers and courts to justify the denial of justice in the context of possibly manipulated or rigged proceedings and is also intended to create a starting point for further investigation.

Methodological approach

Quantitative empirical research methods in which to close the research gap we have identified are out of the question as it seems impossible to test suitable hypotheses. It is highly unlikely that judicial officers in eastern Europe would want to provide honest information about their own (criminal) behaviour, even in the context of anonymised, multi-country surveys. For this reason, qualitative research methods are more likely to be the focus of attention (Creswell 2014: 183ff; Crouch and McKenzie 2006; Bowen 2005; Tewksbury et al. 2010; Buckler 2008), with a 'dark field' (Froschauer and Lueger 2003: 17) forming the basis of investigation. It is not sufficient to evaluate files from previous processes; these would have to be respective national files of origin to which access is generally not possible for reasons of availability as well as for the evident linguistic issues that arise. Moreover, it would not be easy to detect manipulations from the perspective of mere file analysis. Interviews with experts, a proven form of qualitative data collection, should also be excluded because the participants would not only be clients of offenders but also judges, police officers and prosecutors who are usually unwilling to report on their crimes, especially if they have not been convicted.

3 *Kuehne* GA 2018, 121; *Kuehne* StV 2018, 571.

4 *Kuehne,* GA 2020*,* 337.

5 See the legal assistance examples cited at the Swiss Federal Administration Index, accessed 20 June 2022 at: https://www.rhf.admin.ch/rhf/de/home/rechtshilfefuehrer/laenderindex.html.

If one does not want to capitulate in the face of these methodological hurdles, then a report on the practical experience gained in the field seems to make sense, at least as a cautious start. In the course of his work as a lawyer, the lead author has advised various very successful businessmen from eastern Europe – so-called 'UHNW individuals'[6] – who regularly have to struggle with the effects of corruption. Furthermore, in the course of his teaching activities,[7] he has held numerous valuable discussions with prospective and experienced prosecutors, judges, police officers and lawyers from various countries in eastern Europe. Discussions in the professional and academic environment have been held with more than fifty representatives from various countries throughout the east European region. Thus, diverse practical and relevant perspectives can be considered within the scope of a field report.[8]

Field report

In order to understand why it is possible to fabricate or manipulate criminal proceedings, one must first consider the process of selection for important posts as public officials which apply in the systems of some east European countries. It is also important to understand how bribery processes work to prevent discovery. It is also necessary to look at how evidence is constructed at the beginning of trials and, finally, to mention how criminals may be able to coordinate these procedures across several courts.

Staffing in east European judicial systems

According to experts, corruption in east European countries usually starts in university law faculties: in countries such as Moldova, Romania or Ukraine, the main obstacles to creating an effective and independent legal profession are the extremely low standards of legal education in universities (Skoryk 2019).

In the Republic of Moldova, for example, the Soviet legal tradition established more of a dictatorship of the law so that legal education did not even set out to produce judges or lawyers with high standards of integrity, but who were equipped rather to act only according to the will of the executive. As a result of Moldova's educational model, its law graduates are often insufficiently prepared to participate in a modern legal profession (Barrett 2021). This situation also applies to other east European countries.

It is therefore important to understand how to become a high-ranking prosecutor, judge or police officer in order to analyse why the judicial systems in these countries are particularly corrupt (Popova and Post 2018). Although it is possible to pass exams through honest study, many students choose to guarantee exam success by mak-

6 Ultra high net worth individuals are those with more than $30 million in assets.

7 At the National Academy of Legal Sciences in Ukraine and at the International Anti-Corruption Academy (IACA) in Austria.

8 It is expressly stated here that the experiences drawn on in this article stem from the academic and professional networks of the lead author; and that he has purposely refrained from sharing experiences from within his private capacity in order to make it impossible to draw conclusions about individuals.

ing a monetary contribution to the examiner (Heynemann et al. 2008). However, it is important to note that the high level of corruption in universities may also be due to university professors in eastern European countries having much lower incomes than those in western countries (Barrett 2021), contributing to an atmosphere in which monetary benefits from students are simply accepted (Heynemann et al. 2008). Entry into the civil service is usually based on possessing an excellent university degree, but this is by no means easy or transparent: it requires the experience of some kind of practical post depending on the desired position. For future judges, for example, this is a post as an assistant to an experienced judge. These traineeships are comparable to legal internships elsewhere. However, the traineeships usually last much longer and there is no moving around between different ones. Getting hold of a vacancy for such highly sought-after traineeships, eventually paving the way to lucrative jobs, usually takes excellent contacts and not inconsiderable financial means as such posts are often filled on the basis of personal recommendation.

To demonstrate gratitude for gaining a post as an assistant to a judge or as a clerk to a court, amounts such as $50 000 may be paid: an investment which is offset by fairly modest monthly earnings of usually around $1000. Aspiring judges who are still in training thus invest, at the beginning of their career, an amount that they are hardly able to earn legally in their chosen profession: the investment is only worthwhile if they can expect to earn this amount over and above providing for the necessities of life, even with the solicitation of bribes. Thus, experience shows that those who decide to enter public administration are primarily those who have the necessary network and financial means to pave their way.

After several years of practice, becoming a judge requires the passing of an exam allowing an applicant to become qualified for judicial office. This can cost between $50 000 and $150 000, depending on the subsequent position. It is of course possible to pass the exam without paying a bribe, but the chances of doing so are much lower; the safest way is to have a contact on the examination board and express gratitude there in the form of a payment.

The next step is to find a vacancy as a judge. This is extremely difficult as the market for such posts is competitive. The exam qualification is a prerequisite but it is not sufficient to guarantee a position as a judge; on the contrary, there is a lively trade in these posts with prices ranging from $50 000 to several million, the prices being negotiated and dependent on the subsequent earnings possibilities, especially from illegal sources, that the judge may make. Thus, positions in remote district courts are significantly cheaper than those in a large city. Commercial courts are considered particularly lucrative and, as a result, positions as a judge here are usually significantly more expensive.

The path described above shows that, in order to become a judge, a person should have sufficient financial resources and an adequate network. Secondly, such a career is likely to be open primarily to people who are prepared to pay for their education and for their subsequent positions of power. Of course, it is not impossible for an honest student from a poor and unconnected background to be able to follow this path. However, such cases are often exceptions. This has been recognised by the relevant ministries of justice: in Ukraine, for example, attempts have been made via a

Council of Europe programme to introduce judicial reforms that should help to eliminate corruption in the system.[9]

In many eastern European countries, and which is particularly the case in Moldova, there is hierarchical control over the career of each judge, both inside and outside the court. As a rule, judges are pressured by the heads of courts to join the system, sometimes in respect of evaluation or tenure. When a judge has the courage openly to criticise the judicial system, he will not have the support of colleagues and risks the loss of opportunities when applying for promotion or tenure (Anti-Corruption Resource Centre 2021).

Under the considerable pressure of EU accession, reviews of judges have been instituted in several east European countries (Coman 2014) based, in addition to theoretical examinations, on discussions with an expert commission. Such discussions were focused, among other things, on the lifestyle of the judges as well as any previous disciplinary violations. These reforms were supposed to contribute to ensuring professional quality and the personal suitability of the judges but, instead, the reforms brought welcome additional income for all the members of the commission: in order to remain a judge, these assessments had to be passed and, according to reports, commission members were open to judges' gratuities. Thus, many ended up bribing the commission and, although the reform was aimed at eliminating corruption in the judiciary, the opposite was achieved (Mendelski 2015). Furthermore, while judges who had consistently demanded bribes for years were able easily to afford to bribe the members of the commission, honest judges who had, after years of refusing to take bribes, only their regular salaries at their disposal thus did not have the financial means to do so. Therefore, it can be said that these reforms did nothing more than clear the courts of the few judges who were not corrupt since the honest ones left the system because they failed the assessment.

Similar mechanisms to those described above exist as regards police and prosecutors. On the basis of significant investments that should, and must, pay off in order to maintain a certain standard of living on a limited salary, a large proportion of those who have become prosecutors or police officers need to recoup their investment in their careers by accepting bribes. This establishes a deep acceptance of corruption as a part of the system.

Although not yet part of the European Union, Moldova, considered one of the most corrupt countries in eastern Europe, has also adopted strong legislation in the attempt to combat corruption and to try to ensure that judges are independent. As a result of these efforts, salaries have been increased considerably while a performance appraisal system has been introduced. However, outdated structures and the persistence of practices of corruption in Moldova show that real independence among the judiciary is far from guaranteed (Anti-Corruption Resource Centre 2021).

9 See 'Support to the implementation of the judicial reform in Ukraine', accessed 20 June 2022 at: https://www.coe.int/en/web/cdcj/co-operation-projects/judicial-reform-ukraine.

The bribery process

A certain caution is now required when paying bribes; in the past, people openly asked for money for certain services, and this was accepted practice, but it is now the case that much more caution is being exercised. It has come to this point because corruption units have repeatedly laid traps for important officials (Chadee et al. 2021).

This raises the fundamental question of the prosecution of instances of corruption, particularly of individuals. In the cases of the rare examples that exist, this can serve noble purposes: corruption investigations may be used to get rid of disagreeable public officials (Herrera and Rodriguez 2007). However, senior public officials have frequently found their own ways around the problem. These explanations apply similarly to prosecutors and senior police officers but, putting the focus again on judges, it is clear that, as a rule, judges only accept bribes from people they know personally and that, when an unknown person tries to offer them a bribe, they will flatly refuse. This makes it much more difficult for investigators to set a trap for public officials. Judges prefer to accept bribes from people they have known personally for many years, for example, lawyers or, at least, their colleagues.

As a result, anyone who wants to bribe a judge they don’t know personally will try to contact them via another judge and it can happen that a whole series of judges are involved in a single bribe: lawyer A knows judge A, but needs a favour from judge F. This leads him not to approach judge F directly, but to approach judge A first. Unfortunately, judge A does not personally know judge F and so approaches judge B who, in turn, knows judge C. Judge C personally knows judge D, who is a close friend of judge E, who does know judge F. Such long chains naturally increase the price with each of the judges involved receiving their own share of the cake.

It can also be said that the risk of discovery increases considerably because of the large number of people involved in such operations. But there is a common interest in keeping these strictly secret, as everyone involved would lose their jobs if caught. In our experience, knowledge chains naturally operate not only between judges at the same level, but also between courts. These networks would then also be maintained with senior officials in other agencies.

Often, presidents of courts exert pressure (for a fee) on their judges. For this reason, the judges in charge have the choice of acting according to the instructions of the president of the court or risking their expensive paid job.

It can therefore be said that some judicial systems, especially those in eastern Europe, are extremely corrupt (Chadee et al. 2021). The descriptions of the route to becoming a judge or accessing a senior position in the police or in prosecutors’ offices, as well as the procedures for planning bribery, show that corruption is strongly present in these countries. These explanations help understand why a certain degree of caution is necessary when it comes to interpreting decisions in corrupt countries.

The manipulation and fabrication of criminal proceedings

Just because the system is corrupt does not mean that all the decisions made in a country can be questioned: there is the possibility that judges and prosecutors, despite a high level of corruption, may have reached the right decision. However, this article aims to illustrate why, when it comes to decisions in foreign criminal proceedings, great caution is required. In some east European countries it is possible, for personal or economic reasons, to fabricate criminal proceedings against innocent parties and for these to reach a conclusion in which the accused is found guilty (Terziev et al. 2020).

Usually, when a person wants to build a criminal case against another, they first contact the police with a tip-off or an 'anonymous' complaint, leading to the person accused being charged with various offences. The police would begin an ambitious investigation thanks to a generous donation and the first evidence would be built during this investigation. Planting drugs during a seemingly random stop for a traffic violation is one popular approach. The next step is to bring charges against the accused while the prosecutor can also be very ambitious as a result of a financial contribution. Accepting the bribe was not particularly difficult in such a case as the records indicated that the defendant was in possession of narcotics or may even have been distributing them. The bribe to the prosecutor may be useful, however, because the defendant may not as a result be able to buy a way out. The same goes for the judge in charge, who is also grateful for the bribe and finds the defendant's statement that the narcotics were planted in the boot of his car to be an implausible claim. This example shows how easy it is to start a credible criminal case against an innocent person.

For these reasons, the pressure on honest judges in east European countries is growing (Stoyanov et al. 2018). There will always be a risk that they will be replaced by corrupt judges – after all, they are the ones who best serve high-level decision-makers. And honest judges are barely protected from political or other pressures (Terziev et al. 2020). In western countries, a judge who is threatened by a party would usually immediately inform the police and the prosecutor's office, whereas in some cases in eastern Europe we must first ask who has already been bribed by that party. It is common for politicians to try to put pressure on judges.

However, even corrupt judges are not immune to surprises. Not infrequently, anti-corruption investigations seem to serve the purpose of replacing a corrupt judge with one who is even more corrupt: if judge A paid \$100 000 for a position and judge B offers \$300 000 for the same position, judge A may have to leave the post because of suspicions of corruption, leaving judge B to take over.

Discussion

Dealing with foreign criminal proceedings at home

Western countries often face requests for mutual legal assistance in international economic criminal proceedings in eastern Europe. For this reason, it must also be taken into account that there is a wide spectrum of criminal proceedings being handled in these countries (Coman 2014). The effects of these proceedings, both at home and abroad, are far-reaching. They may, however, be brought into question in the context of particular coercive measures asked for within the framework of the provision of mutual legal assistance and requests for custody with a view to extradition on the basis of a judgment in a foreign court.

The question automatically arises as to how criminal proceedings in eastern European countries should be treated in western ones: there are a large number of legitimate requests for mutual assistance but, at the same time, it must be assumed that there are also many requests for mutual assistance based on 'facts' which have been contrived or manipulated. At this point, the debate starts on how to distinguish between rigged and legitimate procedures. In politically motivated proceedings, the distinction may still succeed under certain circumstances. On the one hand, these proceedings have the advantage that the presumed political motivation is usually comprehensible on the basis of objectifiable criteria, which is why prosecutors and judges in western countries view foreign criminal proceedings of politically exposed persons with scepticism; on the other, politically exposed persons often also have the resources to challenge foreign criminal proceedings.

For the defence lawyer, the evidence-base in such cases is extremely precarious, as it is difficult to prove in western countries the acts of corruption being described. As a rule, all that remains is careful analysis of foreign submissions with regard to procedural errors but, in particular also, the unsubstantiated submissions of incriminating facts.

The question may be raised of why anyone would try to attack a wealthy citizen who does not have political office. There is a wide range of possible answers such as competitive business battles, envy or personal dislike. It can be very tempting to remove an unpleasant business partner this way. It can be concluded that there is a not inconsiderable risk that foreign criminals will abuse judicial authorities in western countries to get rid of their competitors. Asset freezing with subsequent money laundering procedures, the confiscation of business documents and extradition warrants can serve this purpose. Thus, competitors are kept busy defending themselves in unjustified criminal proceedings in western countries leaving the criminals who initiated these proceedings free to take over their business.

Particular caution is needed with regard to foreign criminal proceedings, as it is already clear that the judicial system in western countries can be misused for dishonest purposes by foreign criminals. Of course, in justified cases, it is important to provide legal assistance. But the judicial system in western countries ought in principle not to be instrumentalised in this way by foreign criminals.

Fabricated and manipulated foreign proceedings in the everyday life of courts in western countries – a realistic scenario?

The reader might well wonder how common the scenarios described above are in practice. Personal experience suggests that they often correspond to practice and local usage. This can be plausibly explained: the potential benefit to foreign criminals is exorbitantly high: disagreeable business partners can be detained; asset freezes restrict the liquidity of competitors; and, at the same time, criminals can gain access to confidential documents that enable them to conduct advantageous business transactions. At the same time, the risks are extraordinarily low. The probability of criminals being caught red-handed and prosecuted abroad is not particularly high. As noted above, corruption within the judiciary in east European countries ensures that judges, prosecutors and police officers can be bribed. Thus, even if criminals are caught trying to bribe a public official, corruption within the judicial systems of these countries will most likely allow them to buy their way out.

In conclusion, it can be said that the model described herein is extremely attractive to criminals. Judicial systems that are corrupt right from the beginning of training and up to the sale of judge positions struggle with natural adverse selection, attracting corrupt office holders and often eliminating non-corrupt officials. Officials who have made significant investments to gain and keep their positions are always open to further earnings.

However, a precise quantification of prevalence cannot be made on the basis of a field report.

Conclusions and recommendations

Of course there are honest prosecutors, judges and police officers in east European countries. However, one can assume that extraordinarily corrupt judicial systems are still being battled in others. Although these countries have recognised the problems that have developed, their previous efforts to fight corruption in the judiciary have, in many cases, failed. This has to do, among other things, with the route to certain posts already being highly corrupt and, consequently, adverse selection taking place. In the context of the reforms which have been made in this area, it has often been the case that only civil servants who have taken substantial bribes in the past have had the resources to pass assessments. It can therefore be said that judicial systems in some east European countries remain highly corrupt.

The question therefore arises of how to deal with the situation in which the national judicial systems of western countries are misused to imprison innocent people and have their assets and documents confiscated at the request of criminals: one which is clearly not in the interests of legal certainty.

Great caution is thus advised when dealing with foreign criminal proceedings, especially in respect of those established in east European countries. While there is a well-founded interest in providing legal assistance in legitimate criminal proceedings, it is not in the interests of western countries for foreign criminals to be able to store and invest criminal assets without hindrance. Nor is there a desire to create a safe haven for foreign criminals in western countries protecting them from imprisonment in countries with a high risk of corruption.

In theory, the answer to these questions would be to provide legal assistance only in the case of legitimate criminal proceedings. However, how should courts proceed when legitimate criminal proceedings can barely – or not at all – be distinguished from ones that have been contrived? This cannot be dealt with conclusively. If an accused person makes a well-founded claim that criminal proceedings against him or her abroad have been fabricated, this must immediately be examined in greater depth instead of simply granting a request for mutual assistance. Nor must the urgency claimed by the requesting state, for the purpose of avoiding loss of evidence, be taken as a reason to decide positively on a request without a more intensive examination. In particular, the observance of procedural human rights (e.g. with reference to

Articles 5 and 6 of the European Convention on Human Rights), as well as the justification structure in the determination of evidence and its assessment, should be examined in close detail.

In order to fight corruption more effectively, one possible solution would be categorically to refuse mutual legal assistance to highly corrupt countries. This could ensure that judicial systems in western countries are not abused. But this solution is far too intrusive and does not favour political discourse between states. It is also very difficult to find a valid index that convincingly establishes the level of corruption required to substantiate such a level of (non-)intervention. Thus, the only approach to address such problems and keep within the rule of law remains the obligation to examine documentation and procedural processes in the requesting foreign country particularly carefully.

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