

BTI 2020 | Trouble at the Top

Regional Report East-Central and Southeast Europe

By *Allan Sikk**

Overview of transition processes in *Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Kosovo, Latvia, Lithuania, Montenegro, North Macedonia, Poland, Romania, Serbia, Slovakia and Slovenia*



This regional report analyzes the results of the Transformation Index BTI 2020 in the review period from 1 February 2017 to 31 January 2019. For more information visit www.bti-project.org.

Suggested citation: Allan Sikk, Trouble at the Top – BTI 2020 Regional Report East-Central and Southeast Europe, Gütersloh: Bertelsmann Stiftung 2020.

This work is licensed under a Creative Commons Attribution 4.0 International License (CC BY 4.0).

* *Allan Sikk is Associate Professor of Comparative Politics at the University College London School of Slavonic and East European Studies and BTI Regional Coordinator for East-Central and Southeast Europe.*

Introduction

East-Central and Southeast Europe has consistently ranked highest on all three dimensions among all the BTI regions. Overall, the political and economic reforms after the fall of communism were successful, establishing liberal democracies, efficient governance structures and, perhaps most unmistakably, market economies that have experienced impressive economic development and raised living standards. However, despite its small size, the region is also very diverse. Eleven countries – from Central Europe and the Baltic States – have joined the European Union and eight of them are now members of the Organisation of Economic Co-operation and Development (OECD). In these countries, historical and cultural ties to Western Europe, the proximity of European markets, financial and political support and promise of EU membership, followed by accession, have all provided a major boost to development. The remaining six countries in the Western Balkans faced a much more turbulent exit from socialism and from the Yugoslav federation and currently merely aspire to join the EU. Some of them are dangerously close to a break-up (Bosnia) or lack universal recognition as an independent state (Kosovo). However, even within the two sub-regions there are important differences – for example, the Baltic states, the Czech Republic and Slovenia have clearly outperformed some other new EU member states. Intra-regional differences have increased rather than decreased over time – in recent years, Hungary has fallen behind some non-EU member states in terms of democracy and governance. Democratic backsliding may have gained growing media and scholarly attention only in recent years, but the trend has been consistent since the BTI 2010.

Hence, instead of maintaining the lead over other regions, East-Central and Southeast Europe has experienced a clear downturn in democratic quality and governance in the last decade, with some degree of backsliding in nearly all countries. This trend is similar to that in Latin America, the other region performing well above the global average – both are creeping closer to the global average for democracy and governance; both continue to strongly outperform global averages for market economy. It is hard to point to any significant recent improvements apart from North Macedonia that in 2017 witnessed a dramatic change of government and turned its back on the issues that had plagued the country under the decade of strongman rule by Nikola Gruevski. Perhaps of greatest symbolic importance was the referendum and treaty with Greece that broke a several decades long stalemate obstructing development and European integration; it also allowed the Former Yugoslav Republic of Macedonia to escape the shackles of history – dropping from its name a reference to a country that disappeared a quarter of a century ago. However, Northern Macedonia offered a rare glimmer of light in the region – while all countries remain classified as democracies, nearly all saw the quality of democracy deteriorate.

In the 1990s and early 2000s, instability was often seen as a main obstacle to political and economic development in the region. In recent years, stability has increasingly come to signify stagnation. Stability often reinforces authoritarian tendencies – Viktor Orbán's return to parliamentary supermajority for a third time in Hungary, Prime Minister Aleksandar Vučić's ascent to presidency in Serbia, the well-established but corrupt Social Democratic Party regaining power in Romania, the veteran Prime Minister Boyko Borisov returning in Bulgaria or Miloš Zeman continuing as the President of the Czech Republic. Remarkably, the last two come across as only mildly controversial on this list.

In contrast, the recently appointed new Prime Ministers in North Macedonia, Slovenia or Latvia much more represent progress and positive change. This applies perhaps even more for Zuzana Čaputová, the new Slovak president elected in 2019, riding the tide of huge anti-corruption protests.

Emerging from communism, one of the main conflict lines throughout the region was a communist/anti-communist cleavage – with a partial exception of the former Yugoslavia where ethnic and nationalist divisions dominated. Slowly but surely, this has been overshadowed by other divides – the socio-economic cleavage and, increasingly, liberal/illiberal cleavage that partly maps onto positions on corruption that is perhaps the most relevant political issue in many countries. It is the conflict between liberal and traditional values and between good governance and corruption where the biggest challenges in the region lie. The predominant media narrative is right in emphasizing the rise of illiberalism in many of the countries. However, focusing on authoritarian tendencies among governments often overlooks the support for democratic principles among citizens and wide segments of political opposition – that is, however, often weak and fragmented. Most of the countries have in recent years seen mass anti-government protests – while the focus of these is often corruption, it often overlaps for demands for greater government accountability and liberalism.

Despite the political challenges, the region has steadily been making economic progress. While most of the fundamentals of market economy are in place throughout the region, there are issues with sustainability of economic development. Several countries may have recently become members in OECD but even they lag behind the most developed economies in many ways. Social exclusion remains a problem throughout the region – especially that of women and minorities (e.g. the Roma) who can suffer from high levels of poverty even if the overall levels of poverty are low. Most countries have suffered from extensive outmigration (and general population decline) in the last couple of decades that undermines labor supply and economic activities. Finally, research and development as well as education policies and environmental sustainability remain challenges, preventing a qualitative leap in economic development in most countries of the region.

Political Transformation

East-Central and Southeast Europe is the most democratic of all BTI regions. It outperforms the others in terms of both the share of consolidating democracies (41%) and the average democracy index (7.93). At the same time, it is also the only region that has suffered from continuous democratic backsliding since the BTI 2010. In recent years, the decline has been deepest among all regions bar Latin America – another region with high but dwindling democratic performance. Notably, in East-Central Europe, diversity has increased – the three Baltic states have made progress compared to BTI 2006 while several others have suffered considerable backsliding – including Hungary, Poland and Croatia that once were democratic frontrunners. However, by global standards, the region remains the bastion on democracy – even the worst performing countries have a democracy index above the global average.

Table 1: Status of political transformation

Consolidating democracies Score 10 to 8	Defective democracies Score < 8 to 6	Highly defective democracies Score < 6	Moderate autocracies Score ≥ 4	Hard-line autocracies Score < 4
Estonia	Bulgaria ▼	Bosnia and Herzegovina ▼		
Lithuania	Poland ▼			
Czech Republic	Romania ▼			
Slovenia	Montenegro			
Latvia	North Macedonia			
Slovakia	Albania			
Croatia	Serbia			
	Hungary			
	Kosovo			

The table follows the BTI 2020 index scores. The countries are ranked according to their respective score in the Democracy Status. Arrows mark a change of category compared with the BTI 2018, dots mark failing states.

Compared to the BTI 2018, Bulgaria, Poland and Romania have dropped to the group of defective democracies. Bosnia maintained the lowest score in the region and is now classified as a highly defective democracy. Both Serbia and North Macedonia remain defective democracies but show opposite trends – while Serbia experienced the biggest overall decrease in the democracy index (-0.75), North Macedonia clearly bucked the negative regional trend (+0.75).

In North Macedonia, curtains fell on the rule by the nationalist VMRO-DPMNE and Prime Minister Nikola Gruevski. After losing his parliamentary majority in the 2016 elections, Gruevski incited a movement against political change (supposedly orchestrated by Albania), culminating, in April 2017, in a forcible entry of demonstrators to the parliament aided by VMRO-DRMNE politicians. The mob injured around 70 people, including many MPs and the later Prime Minister Zoran Zaev (Social Democratic Union). After assuming office in May 2017, the Zaev's government reached an agreement with Greece resolving a long-standing dispute over the country's name that had kept North Macedonia out of international institutions. Following that, the NATO Accession Protocol was signed in February 2019. Domestically, there are signs of reduced government control over the media and civil society that had mobilized during the tumultuous events. However, political polarization remains high as VMRO-DPMNE has boycotted key votes in the parliament and initially threatened to boycott the referendum on the treaty with Greece. Boycotts are an important tool in the arsenal of political opposition in the Western Balkans – in recent times, it has also been used in Albania, Bulgaria, Montenegro and Serbia.

The neighboring Serbia witnessed increasing authoritarian tendencies after Prime Minister Aleksandar Vučić was elected the President in May 2017, following the footsteps of a fellow member of the Progressive Party. Backed by an absolute parliamentary majority, the government has controlled the legislative process and sidelines the opposition by frequent use of disciplinary measures, fast-track legislation and sudden changes to the parliamentary agenda; media pluralism around recent elections

has declined as biased coverage increasingly advantages incumbents. The judiciary suffers from political interference and is also plagued by inefficiency, nepotism and corruption. Anti-corruption policies are inconsistent and not fully implemented; few verdicts have been reached in cases involving high state officials.

Democratic backsliding continued in Hungary as the Viktor Orbán government further curtailed checks and balances and increased its grip over the media. In September 2018, the EU triggered Article 7 procedure against Hungary, condemning attacks on media, academics, the judiciary, migrants and refugees and the rights of minorities as violations of EU's founding principles. The procedure could, in principle, lead to the suspension of Hungary's voting rights. Democracy in Hungary has abated steadily since BTI 2006 – it has transformed from the region's third most democratic country to the third least democratic one. Backsliding has been helped by the weakness and fragmentation of the opposition in the 2018 elections as Fidesz was handed another supermajority in the parliament. However, in the end of 2018 cooperation between opposition parties improved as they united in mobilizing the largest anti-government protests since Orbán took office in 2010.

Throughout the region, the rule of law has been challenged. The regional average scores for separation of powers and the prosecution of office abuse both decreased by 0.47 compared to the BTI 2018. Alleged cases involving ties with leading politicians often escape investigation and even when cases reach the courts, defendants are often acquitted. The judicial system is often used as an instrument against political opponents. For example, in Poland, the Central Anti-Corruption Bureau (CBA) is staffed by officials loyal to the governing Law and Justice (PiS) party who are focused less on tackling corruption than exerting control over the judiciary and targeting opposition politicians. In Croatia, it was established that during a massive state bailout of food conglomerate Agrokor, an Economy Minister and a Finance Minister (a former top executive of Agrokor) violated conflict of interest disclosure rules but later did not face any penalties. Milan Bandić, the Mayor of Zagreb who was elected for the sixth term in 2017, has faced constant accusations of corruption and office abuse and has once been arrested has always been acquitted of charges.

The separation of powers has deteriorated in seven countries. In Poland, nearly complete political control has been achieved over the judiciary, crippling government accountability. Civil society has organized protests and the EU, referring to the justice system being brought “under the political control of the ruling majority,” started an Article 7 procedure against Poland in December 2017. However, this failed to herald a return of judicial independence. Romania reverted the pre-EU accession reforms that had given the power to appoint prosecutors from the Ministry of Justice to the President (who has an independent popular mandate). The Social Democrat-led coalition has intimidated the judiciary – for example, by introducing special prosecutors, allegedly controlled by the government, for investigating magistrates. Tackling corruption and sustaining judicial independence is hard if top judiciary and law enforcement officials are themselves involved in corruption. Notoriously, Adriatik Llalla, the Albanian Prosecutor General, was in 2017 harshly criticized by the US ambassador for suspected involvement in corruption and later banned from entering the United States.

Even though in many countries of the region the media enjoys levels of freedom similar to Western Europe, there are significant challenges in others. These range from excessive litigation in Croatia and insufficient ownership transparency in Bulgaria to allegedly enforced consolidation of media into businesses loyal to the governing parties in Hungary and Serbia. In Poland, the outright politicization of the National Broadcasting Council was followed by a dismissal of outspoken journalists and others leaving in protest. Journalists also continue to face threats of firing by nationalist politicians (for example, in Bulgaria) or direct intimidation, threats and attacks (in Bosnia and Serbia). In Slovakia, Ján Kuciak, an investigative journalist who had investigated murky links between oligarchs and top politicians was murdered alongside his fiancée in the beginning of 2018. The double murder triggered a series of mass protests, drawing the biggest crowds since the 1989 Velvet Revolution. Protesters and opposition demanded the resignation of the Interior Minister and the Police President. However, eventually Prime Minister Robert Fico (Smer-SD) was forced to resign in March 2018 as Most-Híd, a junior coalition partner, started to side with his critics after Fico had ignored the magnitude of public frustration and lectured opposition leaders over “exploiting” the situation when Smer-SD appeared to be (indirectly) linked to the murder.

Finally, at least by global standards, stateness is firmly established throughout the region and has recently been reinforced in North Macedonia, following the resolution of the country name issue, and in Kosovo where Serbian-populated areas have become more integrated. However, centrifugal tendencies persisted in Bosnia and Herzegovina as ethnonational strife stymied the functioning of political institutions and the introduction of reforms necessary for achieving the EU membership candidate status. The country’s complex constitutional set-up has been routinely challenged, particularly by the leaders of Republika Srpska (RS) and main Croat parties. The Croatian Democratic Union advocates the creation of a Croat federal unit, following the election of the Croat member of the tripartite Presidency with support from the Bosniak community. Bosniak politicians question the legitimacy of RS institutions because of the ethnic reference in the unit’s name; in turn, RS leadership continues to advocate independence.

Economic Transformation

East Central and South Eastern Europe has the highest level of GDP per capita (26,600 USD on average in 2017) among the BTI regions bar Middle-East and North Africa (a region that includes extremely rich and extremely poor countries). Economic recovery after the Great Recession of 2008 has been consistent and robust (4.6% on average in 2017), and poverty levels are very low or moderate by global standards – only in Albania, North Macedonia and Romania does more than 5% of the population live on less than \$3.20 a day. Inflation is generally moderate or low (2.2% on average in 2017) and in many countries, the share of non-performing loans has decreased in recent years – from around 12% on average in 2011 to 7% in 2017. The region has high research and development expenditure by global standards – around or above 1% of GDP in half of the countries, with Slovenia consistently reaching 2% or more. However, most countries – including the high performers – have recently experienced clear decreases.

Table 2: Status of economic transformation

Highly advanced	Advanced	Limited	Highly limited	Rudimentary
Score 10 to 8	Score < 8 to 7	Score < 7 to 5	Score < 5 to 3	Score < 3
Czech Republic	Croatia	Serbia ▼		
Slovenia	Romania	Albania		
Estonia	Bulgaria	Bosnia and Herzegovina		
Lithuania	Hungary	Kosovo		
Slovakia	North Macedonia			
Latvia	Montenegro			
Poland				

The table follows the BTI 2020 index scores. The countries are ranked according to their respective score in the Economy Status. Arrows mark a change of category compared with the BTI 2018.

In the BTI 2020, the state of economic transformation suffered a more moderate downturn than political transformation and governance, deteriorating in eight countries and improving in six. Also, in contrast to the Democracy Status, the region maintained a lead over others, rather than edging closer to the global average. Serbia's economic transformation status has been downgraded from highly advanced to advanced, but the country has oscillated around the threshold between the two since the BTI 2010. One particular issue facing the country is the dominance of state-owned enterprises (SOE) among network and utility companies (e.g. rail, gas and electricity transmission) and their inefficiency, helped by the fact that many of them enjoy a privileged market status or even outright monopoly. Their poor performance often prompts state support and, as a result, Serbia has the second highest level of state subsidies in Europe. State aid often lacks transparency and many privatization contracts are classified even when disclosure is mandated by the public information commissioner. As a result, corruption allegations are rife but litigation uncommon and charges rare.

Even though Serbia has been downgraded to a lower category, the decline in scores was considerably higher in Poland, Romania and, in particular, Hungary (-0.54). On the one hand, the Hungarian government does prioritize fiscal rigor as economic progress is used to secure regime support. On the other hand, in recent years, it has become more difficult to conduct business independently as the government increasingly colludes with the business circles it has itself forged. In sectors important for strategic political purposes, competition is inhibited so that the government can implement popular measures (e.g. utility price cuts), control the public discourse through pro-government media conglomerates and enrich allied entrepreneurs.

Romanian economic policies have been hectic and, like in Hungary, discriminatory. The center-left government in power since early 2017 inflated the budget deficit in 2018 by cutting taxes and significantly increasing expenditures (mostly on public salaries and pensions). The increased deficit and the resulting spike in inflation (4.6% in 2018) both exceeded the Maastricht target necessary for introduction the Euro. A devaluation of the Leu (about 2.5%) followed in early 2019. Financial markets have also been concerned about the government's attacks against foreign companies and the leadership of the Central Bank. In 2018, the government introduced a "greed tax" (so dubbed by the

Finance Minister himself) on banks and other sectors dominated by foreign companies. It sparked complaints from business associations and the European Central Bank about not being consulted and, ironically, hurt the stock prices of native banks.

While many market economy indicators are struggling, the sheer economic output in the region has a strikingly positive trend – no country suffered setbacks in the indicator and in a global comparison, the average change only lags behind the Post-Soviet Eurasia (+0.35 and +0.38, respectively). Lithuania, Slovakia and Slovenia, boosted by foreign direct investments, experienced some of the most robust improvements while Bosnia recovered from the setback suffered after the 2014 floods. Slovenia, already with a very low level of state subsidies, completed the privatization of the largest bank in the country and beefed up its competition authority. However, fast development created upwards pressure on public sector salaries, which caused trade unions to push for the same in the private sector.

The greatest declines in regional average scores compared with the BTI 2018 were recorded with regard to the banking system and sustainability in the areas of education and environmental policy although East-Central and Southeast Europe still performs well compared to global standards. Montenegro saw the worst deterioration in banking because of severe problems with supervision. A former vice-governor of the Central Bank was arrested, suspected of involvement in organized corruption while the Central Bank suspended payments by two banks that did not comply with the minimum capital risk requirements; the owner of the banks later accused President Milo Đukanović of corruption. In Poland, the government pursued a controversial “repolonization” of the banking system and in 2018, the formally independent chair of the National Bank defended the head of the Financial Supervision Authority who faced bribery allegations (both close to the leading party of the government), rejecting them as attempts to destabilize Polish financial system.

Several countries in the region have been struggling with sustainability of economic development both in terms of environmental policies as well as education and R&D policies. Environmental initiatives are often underfunded, subject to administrative fragmentation or counterproductive re-organization of government agencies. Environmental sustainability is often simply not a priority for governments – as shown by slow reductions in greenhouse gas emissions or uptake of renewable energy, and disregard for planning new factories, mines or tourist resorts in environmentally sensitive areas. While North Macedonia bucked the overall negative trend as the new government annulled a controversial mining plan, air pollution in its cities remains among the worst in Europe. Even though high levels of economic development can provide more resources for environmental investments, the correlation between economic development and prioritization of environmental concerns is not necessarily high. For example, despite relatively high levels of economic development, the BTI scores for environmental policy for Hungary and Poland remain below the regional average. The reason for this is that all too often environmental concerns are subordinated to growth efforts. Furthermore, together with two other economically advanced countries (the Czech Republic and Estonia), they vetoed in 2019 the EU Decarbonization Plan For 2050.

Finally, education and R&D policies are increasingly worrisome for the long-term sustainability of economic development. Curriculum reforms have been controversial as they are either insubstantial

(in Croatia) or politically motivated, pretending to fix a system that already works well (e.g. in Poland with excellent results in international comparative tests). In several countries, students, teachers, or both, have organized protests (Albania) or strikes (Lithuania). Bulgaria, Hungary, North Macedonia and Romania are among the countries suffering from excessive early school drop-outs while in many countries the declining number of school-aged children is causing problems for the education systems – particularly for the universities where the competition is often abroad. Research and development policy is often not a priority for governments – there are few votes in it and returns on investments do not materialize quickly. Even in the more economically advanced countries, there has been a consistent decline in R&D funding in recent years. This is partly linked to the lack of private funding but even that has roots in ineffective policies – like the pervasive problems with vocational education that suffers from poor status, partly because the skills and qualifications offered are out of touch with labor market requirements. Nepotism, political interference and corruption play a role in the problems facing education and research. For example, in Hungary, gender studies were banned, the Central European University – the country’s flagship graduate school – forced into exile in Vienna, and much of research funding was brought under direct control of the government. In Romania, the sought-after R&D funds often benefit old-school insider institutions rather than acting as a catalyst for new ideas and innovation. The plagiarism rows that have hit several senior politicians throughout the region (e.g. Hungary, Romania, Serbia, Slovakia) are symbolic of the attitude towards education – valued on paper but not worthy of proper investment. The region is still doing reasonably well in a global comparison but the gap between what the relatively affluent countries could afford and what they actually do is striking.

Governance

Trends in governance have been as negative as those in democracy and the region has been slipping slightly closer to the global average. The only country with considerable improvements was North Macedonia (+0.97), which led to its governance performance as being categorized as “good” in the BTI 2020). The new government has set a much more consensual tone in politics – politics remains polarized but ethnic tensions have been assuaged, witnessed by increases in cross-ethnic voting. The civil society is becoming more involved in policy-making in marked contrast to the hostile calls of former Prime Minister Gruevski for “desorosozation”. The government has increased transparency and accountability and started to involve stakeholders properly in policy-making. International credibility and cooperation considerably improved as the government set upon developing friendly relations with the EU and its immediate neighbors. However, numerous economic and political challenges remain – for example, gaps in investment (e.g. in infrastructure), and bloated and non-transparent public administration.

Table 3: Quality of Governance

Very good	Good	Moderate	Weak	Failed
Score 10 to 7	Score < 7 to 5.6	Score < 5.6 to 4.3	Score < 4.3 to 3	Score < 3
Estonia	Slovenia	Serbia ▼	Hungary ▼	
Lithuania	Montenegro	Kosovo	Bosnia and Herzegovina	
Czech Republic	Slovakia	Romania ▼		
Latvia	North Macedonia ▲			
	Bulgaria			
	Poland			
	Croatia			
	Albania			

The table follows the BTI 2020 index scores. The countries are ranked according to their respective score in the Governance Index. Arrows mark a change of category compared with the BTI 2018.

Serbia (-0.68) and Romania (-1.04) recorded the biggest score declines in the Governance Index compared to the BTI 2018. In Serbia, this negative trend is mainly due to poorer assessments in the BTI criteria of consensus-building and resource efficiency. Democracy is challenged from the very highest echelons of power with the president breaching constitutionally ascribed limits to his power by constantly taking initiative in decision-making, undermining the rule of law and the system of checks and balances. While the government tried to alleviate ethnic and religious tensions domestically, it has at the same time exacerbated political and social conflicts domestically and tensions with neighboring countries (e.g. with Croatia and Kosovo). The full potential of civil society is not being utilized in policy making as political leaders launch verbal attacks against civil society organizations (CSOs) critical of the current government. Meanwhile, NGOs created by the government serve to legitimize the ruling coalition and are used to launch attacks on other CSOs. Resource efficiency in the public sector is low as budgets are stifled by the bloated public sector wage bill (despite restrictions on new hiring) and subsidies to inefficient state-owned enterprises. Strategic plans are often poorly linked to fiscal planning and some important documents are not easily available to the public, negatively affecting the public scrutiny; they have also been undermined by frequent parliamentary elections.

Romania, like several other countries in the region, suffers from ineffective anti-corruption policies and deteriorating regional cooperation, but it also faced many additional challenges to good governance. Civil society involvement in public policy making has been severely undermined by government hostility towards CSOs. NGOs face threats and ridicule in the politically controlled mass media; “Anti-Soros” laws have been initiated, copying the notions of “foreign agent” and constraints on independent civil society familiar from Russia or Hungary. EU directives on data protection and money laundering are used to burden NGOs and independent media with bureaucratic obligations. Anti-democratic actors have been getting stronger while the governing (mainstream) PSD is the main source of nationalist and occasionally xenophobic rhetoric, fake news and conspiracy theories. In 2018, a referendum on prohibiting same-sex marriage in the constitution was organized following

pressure from conservative groups and supported by the government, though it failed due to low turnout.

The lack of effective anti-corruption policy has been one of the most pressing issues – the indicator saw one of the biggest declines on average (-0.35), even if most of the countries maintain an overall high ranking in a global comparison (led by Estonia, Lithuania and Slovenia). The problems have been most visible in Romania. When the Romanian government led by Social Democrats (PSD) came to power in early 2017, it hastily attempted to decriminalize the abuse of public office if the damage was under 45,000 Euros – allegedly to allow Liviu Dragnea, the party leader, to clear his criminal record and become the Prime Minister. Following waves of mass protests (that did not subside until 2019), the government backtracked, but tried to weaken anti-corruption policies through the back door. The protests led President Klaus Iohannis, a critic of the government, to call a referendum that in May 2019 proposed prohibiting amnesties and pardons for corruption offences. Andrej Babiš, the Czech Prime Minister since December 2017 (Finance Minister in the preceding government), has faced allegations of the misuse of EU funds by his companies. Babiš's government, although elected on the pledges to fight corruption and to run the state efficiently, does not list corruption among the priorities in its program. Although he has dismissed the accusations as witch hunt, a preliminary report by the European Anti-Fraud Office, leaked before the 2017 parliamentary elections, corroborated the findings of the Czech police.

Conflict intensity remained high – even by global standards – in Bosnia, Kosovo and North Macedonia due to intensified political polarization and challenges to core institutions of the state. In recent years, socio-political conflicts also intensified in Poland, Hungary and Serbia. In Serbia and Hungary, the repression of political opposition and the governments' lack of accountability mobilized tens of thousands to protest at the end of 2018 while the political leadership showed no intention of taking the challenges seriously. In Poland, the extremely hostile environment against liberal ideas and politicians created by the governing Law and Justice party (PiS) primed a mentally ill young man to assassinate Paweł Adamowicz, the liberal Mayor of Gdansk, in early 2019.

Regional cooperation deteriorated both in East-Central and in Southeast Europe. Because of the democratic backsliding and issues with the rule of law, Article 7 process has been triggered against Poland and Hungary by the European Union. However, while the leading parties in the two countries share grievances over the EU and a chunk of their ideological outlooks, their bilateral cooperation and Visegrad 4 cooperation (also involving the Czech Republic and Slovakia) is hindered by various disagreements, including over Russia and European politics. While Poland remains deeply suspicious of Russia, the Hungarian Prime Minister Viktor Orbán is an open admirer of President Vladimir Putin and a nuclear power plant is currently being constructed in the country by the Russian State Atomic Energy Corporation. On the European front, the Visegrad 4 agreed in their opposition to the EU refugee quotas, but Hungary voted in favor of reelection of the EU Council's President Donald Tusk in March 2017 (in contrast to his native Poland).

Relationships between Croatia, Serbia and Bosnia have deteriorated in recent years. Croatia and Serbia have clashed over disputes related to the conflicts in 1990s. For instance, Vojislav Šešelj, the leader of oppositional Serbian Radical Party, refused to resign from parliament after being convicted

of war crimes in 2018 and controversial statements by the Defense Ministers of the two countries led to mutual travel bans. Croatia and Serbia have even become involved in a minor mutually hostile spending spree on arms, in addition to frequently overheating rhetorical battles. Bosniak war victims have accused the Croatian President of inappropriate claims that Bosnia is turning into a hub for Islamic terrorists and for criticizing the outcome of the elections of the Croat member of the collective presidency (a moderate was elected aided by support from Bosniak voters). Bosnia's relations with neighboring Serbia deteriorated as Serbian President Vučić aligned with the RS leadership that argues for RS's independence. Finally, the 2013 Brussels Agreement between Serbia and Kosovo improved relations and cooperation but especially after the election of a more nationalist Kosovan government in 2017 the agreement has come under heavy fire. In 2018, after Serbia blocked Kosovo's membership in Interpol, Kosovo imposed 100% customs tariffs on its Northern neighbor. President Vučić proposed a land swap deal to open a path for the countries to EU membership talks that did not only create a schism between Kosovo's President and Prime Minister but also in the international community. Some (including EU High Commissioner Federica Mogherini and President Trump) see it as a path to compromise and stability while many others are deeply skeptical. The redrawing of borders following ethnic lines could set a precedent which explosive potential extends well beyond the Western Balkans.

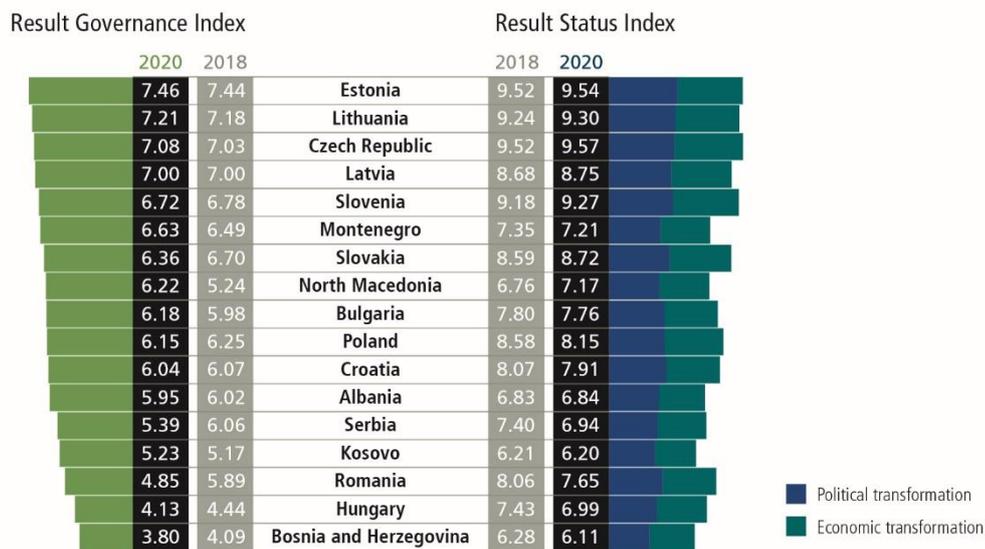
Outlook

East-Central and Southeast Europe remains on average the best performing region in the BTI but is experiencing backsliding in democracy and governance. It is slowly edging closer to the global averages but, more importantly, the differences within the region are becoming more pronounced. Overall, the rule of law and separation of powers (especially judicial independence), and, relatedly, anti-corruption policies, remain some of the most troubled areas. These are not easy to tackle as in most cases, the issues stem from the very top of the political system, where is little appetite for changes – one does not bite the hand that feeds you. Failing checks and balances and inconsistent prosecution of office abuse undermine trust in politics and commitment to democratic practices. This can play to the hands of illiberal populists, but in many cases, the illiberal populists are already in power. There are increasing signs that citizens' patience with corrupt, but also illiberal, practices is wearing thin. In recent years, people have taken to the streets in significant numbers, sometimes ushering in tangible political changes (in North Macedonia, Romania, Slovakia). Despite disappointingly low overall engagement in civil society organizations, this suggests that the spirit of 1989 could be alive and could impose some checks on power.

During the EU enlargement to the region, it was often mooted that many positive developments can be attributed to the EU conditionality. There are very clear signs that at least among the new member states, the EU no longer yields much impact on reforms. In principle, all member states are supposed to subscribe to the founding values of the EU, including rule of law and democracy. However, as the belated triggering and ineffectiveness of Article 7 procedures against Hungary and Poland shows, it is easy for member states to get away with violating these values. The two countries, while not always in perfect agreement, can mutually block the suspension of voting rights. It is also remarkable how

belatedly the European People’s Party suspended Fidesz’s membership for the fear of losing clout in the Council and the European Parliament. These limits to EU’s influence are heightened by the recently increased fragmentation in the European Parliament, uncertainties over post-Brexit balance of power and the rise to power of parties sympathetic to the cause of the Hungarian and Polish governments (in particular, in Italy).

The flexibility with which countries operate within the EU is also illustrated by Eurozone enlargement. According to accession treaties, all new member states are obliged to introduce the Euro, as five countries did between 2007 and 2015. The current governing parties in the Czech Republic, Hungary and Poland are opposed to the introduction of Euro in the foreseeable future even if they did comply with all the convergence criteria. In contrast, the governments of Bulgaria, Romania, and Croatia are committed to joining the Eurozone by 2022 or 2023. The latter three comply with the Maastricht inflation criteria and exchange rate stability but Croatia is struggling with a high debt-to GDP ratio and Romania unacceptably high long-term interest rates; the legislation is not fully compatible in none of the countries. On the one hand, fulfilling the convergence criteria is not easy for countries that are still economically lagging behind; on the other hand, some policies are blatantly counterproductive to achieving these aims (see the discussion on Romanian economic policies above).



The economic growth in the EU member states has been boosted by access to the single market but also by generous EU structural funds. These have helped to make much needed but costly investments in infrastructure (and beyond) but there have also been many accusations of misappropriation, most recently over the business of the Czech Prime Minister Andrei Babiš. The start of the new budget cycle in the EU in 2021 will bring about a decrease of funds, and a need to substitute funding for various investments will create new fiscal challenges. In addition to that, Hungary and Poland

are fighting a proposal to link budget outlays with recipient countries' respect for the rule of law. This comes at a time when even in the best performing countries the sustainability of economic development in the region is already weakening both in environmental, and education and R&D terms. Robust growth cannot be taken for granted in the medium and longer run without increasing investments in these areas while the outlays from the EU fall.

For six Western Balkan countries, the EU membership is yet an aspiration. It is obvious that even the four with a candidate country status (Montenegro, Serbia, North Macedonia and Albania) are not fully prepared to join. As exemplified by the French-led decision to block Albania and North Macedonia from entering the next stage with starting membership talks in the fall of 2019, the EU's appetite for further enlargements might have faded even if any of the countries were to make brilliant progress. Expansion could be politically toxic in some old member states, would move the center of power firmly Eastward and could further fragment the EU political scene. For Serbia, getting closer to the EU is also a balancing act because of its strong historic ties to Russia that sees the EU as an expansionary competing power in the region. The former direct or indirect overlord in much of the region (excluding Western Balkans and Romania) has recently partnered up on its mission against liberalism with Hungary and some governing parties or prominent politicians elsewhere. Putin's regime has been accused in meddling in the North Macedonian referendum of 2018 and orchestrating a coup to overthrow the Montenegrin government in 2016. Several other countries have been alarmed of Russia's growing assertiveness in its "near-abroad" (in particular, the Baltics and Poland). For this reason, NATO membership has been an important objective for most countries in the region – Montenegro joined most recently in 2017 and North Macedonia is on course to joining the alliance soon. This leaves only Bosnia with a candidate status as Serbia prefers to remain neutral and Kosovo cannot even be considered for membership because it is not a member of the United Nations.

The Western Balkan countries still outside of the EU are facing up to a potentially combustible cocktail of circumstances. On the one hand, regional tensions have unmistakably increased – Bosnia, Croatia and Serbia are linked up in a three-way bone of contention. On the other hand, the glimmer of EU membership has dimmed for most of the aspiring future members – the prospect of which has always been one of the key arguments in favor of (relatively) moderate pro-European political forces. Reinforced with increased Russia's assertiveness, the combination could embolden radical political forces, and lead to further increases in mutual animosities and ethnic tensions. The positive developments in North Macedonia point towards a more optimistic path but the future remains fragile even there.