



CONNECTIVITY AND CONVERGENCE IN SEE6 A BLUEPRINT FOR AN EU MEMBERSHIP-BASED DEVELOPMENT MODEL



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CONNECTIVITY IN PANDEMIC TIMES: THREATS AND OPPORTUNITIES**

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**CONNECTIVITY AND CONVERGENCE IN SEE6
A Blueprint for an EU Membership-Based Development Model**

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LIST OF ACRONYMS

| | |
|----------------|--|
| BP | Berlin Process |
| CA | Connectivity Agenda |
| CSOs | Civil Society Organizations |
| DG NEAR | Directorate-General for Neighbourhood and Enlargement Negotiations |
| EIP | Economic and Investment Plan |
| EU | European Union |
| FDI | Foreign Direct Investment |
| GDP | Gross Domestic Product |
| GVC | Global Value Chains |
| IMF | International Monetary Fund |
| LIPS | Large infrastructure projects |
| LIPs | Large Infrastructure Projects |
| P2P | People-to-people connectivity |
| SEE6 | South East Europe Six |
| SMEs | Small-Medium Enterprises |
| SOEs | State-Owned enterprises |
| TCF20 | Tirana Connectivity Forum 2020 |
| UN | United Nations |

Foreword from the Authors

In October 2019, the 5th Tirana Connectivity Forum ended with a roundtable where a dozen participants gathered to discuss what we had learned from two intensive days of talk. The debate focused on connectivity's contribution to SEE6 growth and on the hindering factors. Infrastructure financing, quality of institutional framework, political will, short-term vs. long-term perspective and availability of human resources were among the factors identified as conditioning the impact of connectivity on growth.

The introduction of p2p (people-to-people) connectivity and the role of institutional governance brought into our debate the long-term development angle. Predictability, sustainability, pace of reforms, role of EU support and, the overarching importance of human capital appeared as systemic factors that condition the success of investment in connectivity infrastructure and its contribution to overall development of SEE6 countries. The participants noted that to be sustainable in the long term, growth indicators should be complemented with benchmarks on institutional good governance and human development capital.

The interaction of the EU connectivity agenda with SEE6 institutional governance was the main topic of the subsequent 2020 monitoring report: "Connectivity Agenda and Structural Weaknesses of EU Candidate Countries". The goal was to understand and explain the interactions between Connectivity Agenda (CA) and SEE6 institutional reforms.

The current paper aims to place the connectivity concept into the larger development dynamics of the Balkans peninsula. This has been made possible by applying the concept of multi-layered connectivity and extending its scope to include p2p and institutional connectivity. This development allows growth and development actors to identify optimal entry points for their actions, design the appropriate delivery mechanisms, allocate the right resources and devise development strategies that are sustainable and resilient.

The creation of a methodological framework that links the local infrastructure, domestic institutions and the people, allows us to understand the dynamics and complexity of sustainable and resilient development paths, as well as identifying entry points for SEE6 and EU policy-makers. The 2020 publication builds on the previous findings and tries to group them into three nodes – space, institutions and people – and put them into a unique and connected framework.

Since 2016, our Berlin Process (BP) publications have contributed to the creation of a critical mass of knowledge on BP structure, mechanisms and impact; have provided insights into its two pillars – regional cooperation and connectivity; have produced regular monitoring reports on the Connectivity Agenda and on its impact on the ground; have laid out the interrelations and synergies between the CA and Enlargement; and have brought into focus the role of good governance and political will, in both implementation of connectivity infrastructure and SEE6 domestic reforms. We have prepared this report as a direct contribution to the planning of the next phase of the Berlin Process.

As announced in the last edition, wherever possible we continue to use the term South East European Six instead of the Western Balkans Six.

In the best tradition of Tirana Connectivity Forum, this edition contains the contributions from policy-makers, Enlargement practitioners and SEE6 Connectivity stakeholders who provide a much-needed vantage point on the practical implications of whatever analysis and concepts we develop. Due to the online format of TCF20, all panels and keynote addresses can be consulted in video format at: <https://cdinstitute.eu/tcf/>, while the contributions have been edited and published in event report format at: <https://cdinstitute.eu/>.

Finally, and most importantly, the authors would like to express their gratitude to Dušan Reljić, Florent Marciacq, Jelica Minic and Ioannis Armakolas for their constructive critiques and deep insights provided during the preparation of this paper.

Executive Summary

Pitching endurance and constancy vs. cleverness and speed¹

International financial institutions and other organizations have identified as main impediments to growth in the SEE6 the endowment of the region in human capital, the quality of its infrastructure, the structure of the economy and the quality of local institutions.² The size of the gap between the SEE6 and their EU partners in each of the above-mentioned factors conditions the SEE6 growth rate – and the growth differential – between two blocs. The speed of SEE6 convergence towards the EU defines the pace of enlargement progress.

But to be sustainable in the long term, de-linking growth objectives from institutional good governance benchmarks and/or from human development capital indicators, opens the development trajectory to both system entropy and external shocks; both premises for a vicious circle. For example, democratic backsliding lowers the efficiency of institutions and increases transaction costs, while brain drain depletes the country of its best and most productive citizens. Both directly lower the domestic growth rate, which causes a diminishing of the resources available for the development of institutions and increases the push factors that further favour emigration.

The subsequent COVID-19 shock provided a life-test of the resilience of the SEE6 development model. Beyond its direct impact on economic growth, it tested the solidity of health systems and educational institutions, as well as local production networks and their participation in global value chains. COVID-19 made visible and measurable the system's capacity to sustain such a shock and eventually grow again.

During the pandemic it became evident that to make available to their population the needed medical equipment and supplies, SEE6 national institutions needed to closely and quickly coordinate with each other. To contain the spread of the virus and respect quarantine measures, citizens had to respect the decisions of their governments. To be respected, such decisions needed to be perceived as legitimate (i.e., as protecting the interests of citizen and as being the best available options under the circumstances).

Thus, while studying the interaction between connectivity and the development of a territory, three systemic elements started to attract our attention. First was “space”, as defined by the endowment of the territory in production capability and in connective infrastructure (transport, energy and data). Second was the local “institutions” which in a simplified definition would be the “structures and mechanisms of social order and cooperation governing the behaviour of a set of individuals” materialized in the array of both public and privately owned organizations. The way domestic institutions are set up, function and deliver defines the efficiency of policymaking, and increases or hampers any endowment that a country has in infrastructure or production capability. The third element is the local “people”. As workforce they are a key factor to growth while as citizens, they keep local institutions accountable and efficient.

In a schematic presentation we group those three elements in a triangle where space, people and institutions permanently interact and impact each other. Once seen as integral parts of

¹ Concept taken from Branko Milanovic's blog, “Impatience: A Deep Cause of Western Failure in Handling the Pandemic?”, published on Dec. 14 2020, extracted at: <https://glineq.blogspot.com/2020/12/impatience-deep-cause-of-westerns.html>

² See for instance “Lifting Growth in the Western Balkans”, by N. Ilahi et al., IMF 2019; “How the Western Balkans can catch up”, by P. Sanfey et al., EBRD 2016; “Government at a Glance – Western Balkans”, OECD 2020; “An Economic and Investment Plan for the Western Balkans”, European Commission 2020.

a system, the inter-connectedness between roads, global value chains, institutional good governance and level of education become evident.

The next challenge was to identify actions that induce a “Pareto improvement” in the space-institutions-people system in the long term: i.e., a positive improvement in one node without negatively impacting the rest of the triangle. To be realistic, the impact assessment of any intervention should include the three nodes even if the planned action happens only in one of them. For the change to be durable, we need to factor in the induced change, resilience and sustainability in each node and at the same time the resilience of the whole triangle.

At this stage we can introduce the problematic of the “entry point” and of the “availability of resources”. In our subsequent analysis we have considered the Enlargement dynamic as an optimal entry point and the EU political and financial support for the SEE6 as a main external resource. Together with the SEE6 citizens they can set in motion a virtuous development dynamic.

The next element we bring to our triangle system is the multitude of actors. Very often by using the term “country” or “EU” we convey the meaning of the Balkan country or the EU as a unique and monolithic entity. But latest data on the capture of SEE6 institutions, or debates within the EU between member states on Enlargement, have exposed a multitude of actors, each of them following their own goals and interests. Applied to our triangle, this means that it has been the most powerful actors that have decided what infrastructure to invest in; what migration policies to design and implement with regard to the SEE6; or which form and intensity of institutional cooperation to follow between the EU and the Balkans.

In this picture, we also bring in “other triangles” in the form of third actors such as China, Russia or Turkey to illustrate other forms of interaction and impact with SEE6 space, people and institutions.

By deconstructing space, people and institutions in the SEE6 and putting them in one system, we underline their inherent interconnectedness. By analysing their links and the multitude of actors involved, we shed light on the complexity of each decision-making process aiming to impact them. By bringing in an analysis of availability and suitability of resources we point out the efficiency and sustainability of any change dynamics.

Our aim is to argue that to be sustainable, virtuous and resilient, the development scenario chosen to sustain the convergence dynamic towards the EU must happen in all three nodes of the SEE6 triangle.

Introduction

COVID-19 has shown that top-notch connectivity infrastructure without well-governed institutions can be of little use. Long border controls write off any advantage painfully gained through huge investments in infrastructure improvement. Massive efforts to attract FDI fall flat if qualified people migrate in other directions. No country can efficiently design and develop its productive tissue, infrastructure network or human capital without well-governed domestic institutions.

While SEE6 politicians keep claiming their attachment to EU values, latest reports point out a serious backslide in democratic institutions. The phenomenon of state capture and corruption is on the rise.³ Although with growth prospects and FDI indicators similar to some member states, SEE6 citizens massively keep leaving the region. The presence of third actors has grown visible, supported by the COVID-19 pandemic and by the many ongoing connectivity projects in the region. Institutional reforms are in full swing but the pace of the enlargement process has slowed.

Do growth rate, infrastructure development, institutional reform and migration interact – and if so, how? How do state capture, corruption, low Pisa scores or high electoral apathy affect the pace of SEE6 convergence with the EU? Where to intervene, how and at what cost? Who are the potential allies?

The current paper acknowledges this permanent connection between growth, quality of domestic institutions and the people within a country. Its methodological novelty lies in analysis of the SEE6 as a simplified system composed of the *space* where the growth indicators are rooted (defined as endowment in infrastructure and production system); *institutions* which form the backbone of a chosen development path (defined as "historically rooted stable, values-based, regulated and recurring patterns of behaviour" in both state- and privately-owned structures); and *people*, who are the final growth and development beneficiaries and also the ultimate controllers of the institutions (focused on citizens' knowledge, skills and civic engagement).

Because space, people and institutions permanently interact and impact each other, we consider them as nodes connected in a virtual triangle. The deconstruction of their interaction allows us to identify entry points for policy-makers dealing not only with sustainable growth, but also with the endurance and resilience of the whole system.

In the *first part* we identify, describe and define the concepts of space, institutions and people as nodes. We posit that a territory is defined by its endowment in infrastructure and in production facilities (services included). To mobilize and efficiently use this endowment, legitimate and well-governed institutions are required, both in state and private sector. Finally, it is the people who by acting as human resources operate the institutions and use the space, and while behaving as citizens keep those institutions accountable.

In the *second part*, we explain the main ways that space, institutions and people connect and interact with each other. The objective here is to identify mechanisms and the most appropriate entry points that policy-makers can use to initiate positive change and improve the triangle. Availability and use of resources are also summarily treated with special focus on EU and enlargement dynamics.

SEE6 space, institutions and people are open to interaction with third actors, where the most important by far is the European Union. The EU and enlargement dynamics impact the SEE6

³ See 2021 Transparency Reports: "Deconstructing State Capture in Albania: An Examination of Grand Corruption Cases and Tailor-Made Laws from 2008 to 2020", by Gj. Vurmo et al., Transparency International, 2021; and, "Grand Corruption and Tailor-Made laws in Serbia", Transparency Serbia, March 2021.

economy, infrastructure, institution building as well as the everyday lives of SEE6 citizens. At the same time, other dynamics and third actors' influence are being felt in this region.

We *conclude* with a set of lessons learned and recommendations on the functioning of this complex web of nodes and interconnections. Here we try to bring an empirical view on the currently underestimated role of institutional connectivity in institutional resilience and knowledge transfer, the need for the EU to go beyond an inter-governmental approach and work with new pro-reform and pro-Europe actors, the need for a bigger and better designed SEE6 support budget, better capitalization projections, and the better identification and valorisation of endogenous SEE6 resources.

The 2020 Sofia Western Balkans Summit consolidated the importance of connectivity for growth and development of the SEE6 region. By identifying the main bottlenecks in connectivity infrastructure and human capital, it acknowledged the multidimensional and multi-layered nature of the challenges ahead. By including "integrity compliance" in the Chair Conclusions, and by pairing any progress in this area with the reforms and advancement on enlargement fundamentals, the EU partners brought in as systemic additional challenges the institutional good governance and political will of SEE6 elites. Magnified by the response to the COVID-19 pandemic, endurance and constancy became constitutive benchmarks of the SEE6 transformative processes.

In the end, a "*slow and patient effort to build things*" is needed. The Berlin Process with its high impact and politically charged dynamics may make the difference. Multi-layered connectivity and multi-actor regional cooperation may provide the much-needed impetus where top-down and inter-governmental efforts have stalled. A systemic approach involving the SEE6 territory and its people, all by acknowledging the situation of domestic institutions, will increase the resilience of achievements.

In summary, to be sustainable in the long term, growth indicators should be complemented with benchmarks on institutional good governance and human development capital. Describing those mechanisms and proposing innovative and applicable policies and actions is the objective of this research paper.

PART 1. THREE NODES: SPACE, HUMAN CAPITAL AND INSTITUTIONS

According to UN, the differences in socio-economic development across countries are a consequence of gaps in their productive capacities⁴. Identifying and acting on those gaps contributes to the convergence of the laggards with the most advanced countries.

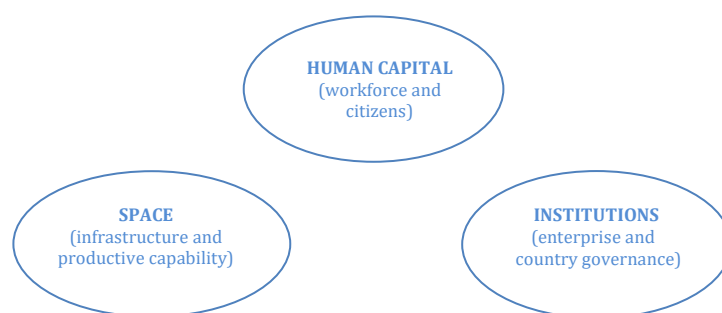
In our simplified model each SEE6 country is endowed with human capital, with domestic institutions and with its own specific productive resources that are permanently linked and interact with each other. We call them nodes. Reforms and enlargement processes aim to develop the countries and speed up their convergence with EU in each of those nodes.

Schematically they be described as follows:

- *SEE6 space* can be schematically described by: i) the state of its infrastructure (with focus on transport, energy and digital); and ii) productive capability as defined by its manufacturing, services and agriculture sectors, by sector specialization of the country, by the intensity of fixed capital, and by the place its local businesses hold in the global value chains and supply chains;
- *SEE6 human capital* is represented by a country's population and measured by their contribution to the economy as the workforce, and to the democratic system as citizens. The most relevant features are: i) workforce profile as in size, age, skills, education, health, etc. and ii) the citizens' values and their engagement in the functioning of the country's institutions;
- *SEE6 institutions* are defined as stable, values-based, regulated and recurring patterns of behaviour in both state structures and privately owned organizations. But more than the structures and organizations per se, the institutions are the embodiment of societal values together with the way that individuals relate to each other and to the organization, as manifested in institutions' legitimacy⁵ and governance mechanisms.

The three nodes can be represented in a simplified way as a triangle. Each of them is permanently connected and interacts in real time with the two others. Any change in one node will immediately be reflected – positively or negatively – in the two others.

Figure 1. Three Nodes



Endowments in human capital, space and institutions are specific to each country. As the result of centuries of social, cultural, economic and political evolution they are permanently connected, interact with and impact each other, and define the country's development path.

⁴ "UNCTAD Productive Capacity Index. Methodological Approach and Results", United Nations 2021.

⁵ More on the institutional "good governance" and legitimacy concept can be found in "EU Enlargement in SEE6 and Country Reforms: The Justice Reforms in Albania as a Case Study", by A. Hackaj, CDI 2020.

To simplify our explanations, in this paper the SEE6 will be the territory of reference for our triangle, unless specified otherwise. In the following sections we endeavour to describe and conceptualize each node. The description is by no means exhaustive but serves as an illustration to better convey as complete an understanding as possible of the concept.

1.1. Space node: endowment in infrastructure and in productive capability

Endowment in infrastructure, in technology and the positioning in the global value chain (together with the geographical position in space) are key factors that determine the growth pace of a territory. Investment in infrastructure sets up links between nodes around which the production chains, trade flows and p2p exchanges develop. This environment attracts FDI, which further develops production capability of the territory and increases the amounts and variety of exchanges.

i) Infrastructure. On top of its location on the map, each territory is endowed with and defined by its infrastructure. Optimal transportation infrastructure shortens travel time, lowers transport costs, opens up new possibilities that were previously unavailable for the production sector, and connects communities (or connects them better). It transforms that space by improving exchanges amongst economic and social hubs, and bringing new ones into the exchange networks. Better energy links lower production costs and increase system resilience, while high digital connectivity allows for high productivity.⁶

ii) Productive capability comprises physical or virtual sites where human transformation adds value to a product or a service. In our triangle model we have decided to focus on endowment in natural capital and in technology (keeping them separated from human capital and from infrastructure). In a globalized world, endowment in productive capability makes sense only if domestic production hubs are interconnected and actively participate in value and global supply chains. The next most important determinant is sector specialization (as in agriculture, manufacturing and services) and country position in the global value chains (GVC).

Box 1. GVC in the SEE6

By increasing their GVC links, Western Balkan countries could raise the GDP level by 3–10%. But currently SEE6 links with Germany – the GVC hub in Europe – are not very strong, while especially Albania has strong GVC links with neighbouring Italy. Intra-regional GVC links in the Western Balkans are generally limited, except in the case of Montenegro (and that in relation mostly with Serbia).

SEE6 GVC profiles are insufficiently taken into account in the design of SEE6 Connectivity Agenda infrastructure. Assessments on eventual reinforcement dynamics between connectivity infrastructure and support to GVC are absent during the infrastructure project identification phase.

During the CA project-financing phase, infrastructure project maturity takes precedence over the contribution of this infrastructure in the territory. Moreover, while the SEE6 CA is promoted as a prolongation of the Trans-European Transport and Energy Networks, the SEE6 Economic and Reform Programmes are not harmonized with the EU Industrial Policy blueprint.

⁶ To keep it simple, in this analysis we do not include the “criticality of destination” – i.e., a country’s place on the map and the way it is linked with other territories.

1.2. Human capital node: endowment in knowledge and skills, and civic engagement

Endowment in high quality human capital is key for enterprise growth as well as for well-governed domestic institutions. But human capital in the SEE6 has been heavily affected by emigration resulting in brain drain, and a hollowing out of the middle class. While the most discussed consequence of emigration is the impact on local workforce numbers and skill levels, the exodus-like migration has direct political outcomes for SEE6 democracies. When dissatisfied and disenfranchised citizens leave their countries instead of being active in their communities and willing to change the system from inside, democracy and its institutions suffer.

1.2.1. *The workforce*

Human capital is one of the most important factors of economic growth. At a macro level the quantity and quality of labour that individuals supply is an important factor in determining the economy's level of production and rate of growth. At a micro level, quality and availability of workforce determine the productivity of an enterprise, as well as the efficiency of public administration.

At the company level, intangible assets such as employee education and skill level, in-company research and development, number of patents, or intellectual capital have a direct influence on the market value of companies and also on their growth, leading ultimately to economic growth at the national level. Public administration quality of services depends on the education and skills of the civil servants.

At the country level it is the health-care systems, social protection, cultural development and other policies focused on people's welfare and development, that contribute to the advancement of the country's pace of development.

1.2.2. *The citizens*

Besides their contribution as members of the workforce, through their participation in democratic processes citizens also contribute to the quality of a country's governance. Citizen engagement makes sure that the country political system represents the interests of its people; that it works efficiently; with integrity; is resilient; and that it produces the required deliverables.

Accountability to citizens is key to the good governance of state institutions in a democratic system. Accountability means that any state institution, or any other authority in charge of public duties, take action to inform citizens, to explain and to justify their decisions and actions. Citizens have the right and the responsibility to access information, get explanations, to check and to pass judgement on the conduct of those with public responsibilities.

Alongside the regular monitoring of institutions' activity, the most important judgement function is voting in elections. Educated, informed and engaged citizens directly impact the legitimacy and good governance of domestic institutions through their vote.

Box 2. Migration and human capital in the SEE6

The massive migration of youth and the middle class has altered voting dynamics by radically modifying the social structure of SEE6 populations. The relative proportion of the very poor and of the very rich in the dwindling total population of SEE6 countries has been increasing.

The existence of a middle class is not a guarantee for a full-fledged and functioning democracy, but undoubtedly is a precondition. Combined with an ever-increasing inequality inherent in the neo-liberal economic system applied to the SEE6 region, the high international p2p mobility of the most educated and active citizens is directly damaging the exercise of liberal democracy in already fragile Balkan countries.

This heavy trend of losing its most educated and active citizens is damaging the potential of the region to grow quickly as well as the exercise of local democracy.

1.3. Institution's node: legitimacy and good governance

Each country is endowed with its own institutions. In our model we describe them as local structures or mechanisms of social order and cooperation that govern the behaviour of a group of individuals. As such they are "stable, values-based, regulated and recurring patterns of behaviour" in both state- and privately-owned structures⁷.

As patterns of behaviour, institutions are embedded in the specific socio-cultural context of the country and operate within a regulatory framework. Materialized as structures and mechanisms with their own governance that produce goods or are involved in policy-making, domestic institutions are the result of centuries of social, cultural, economic and political evolution.

In our model, the enterprise – private or state-owned – is the institution that brings together space and people to make the production process happen. Enterprises connect through the market where they exchange goods and/or services, and through the value chains where the inter-enterprise exchanges encompass also company values, knowledge transmission and technology.

State institutions formulate and carry out public policies enabling and steering the social and economic development of a country. They condition the growth rate, the development model and the overall efficiency level of endowment in infrastructure and production capabilities, as well as the welfare of the people of a country.

So defined, the institutions – state or privately owned – and their functioning constitute the third node in our triangle development model. While firms – again private and state-owned – are the main production actors that generate added value, state institutions condition the space through the identification and support of infrastructure projects, and the promotion of selected production capability. As well, they decide its future development by promoting certain policies. They provide political stability and guarantee the market functioning.

⁷ We also consider well-functioning markets as intricate webs of institutions and social arrangements that have evolved so that transactions can take place at minimum cost.

Key to successful institutions is the quality of their governance. Good corporate governance conditions the growth of enterprises and their profit rate, while “*the quality of a country’s governance and public administration is a key factor in its economic performance and the wellbeing of its citizens*”.⁸

Box 3. State capture and country development

Bringing in the institution’s node allows us to complete the tableau of challenges that our triangle model faces, and observe how malfunctioning in one node impacts the other two. For example, the state capture phenomenon and/or the insufficient administrative capacity of SEE6 institutions increases the risks that may affect infrastructure projects in the space node. As a matter of fact, the IMF has pointed to the management of public investment in the SEE6 region as exhibiting significant weaknesses. This has also been recognized by the DG NEAR and regularly mentioned as a potential risk.

By re-arranging the productive capacity factors of a country into the nodes of space, human capital and local institutions we propose a simplified system that describes the starting situation of any development scenario in the SEE6. Presented in this simplified mode, the triangle development model introduces two novelties from the point of view of policy-making.

First, because of inter-connectedness the model makes it obligatory for any policy-maker during the planning phase to take into account the connectedness factor: the impact of any intended policy action simultaneously affects the three nodes – space, people and institutions – notwithstanding the selected policy sector or area.

Second, the model allows for the design of policy actions that improve the resilience of the system by aiming not only to maximize outcomes in the initially targeted policy area, but to bring the system into a higher equilibrium position (or at least to not diminish it). The actions in one node should be a Pareto improvement with regard to the two other nodes.

Finally, while we have chosen to apply the triangle model at a country level, the research has shown that the profile and interaction of people, space and institutions define growth and development also at sub-national levels. In selected cases, the sub-national level analysis is preferable to bypass the hurdles that national stereotypes may present in the workings of connectivity vectors, and/or to find more efficient and resilient ways to deal with the development of cross-border areas.⁹

⁸ “Governance and public administration”, DG for Structural Reform Support, EU Commission, July 2020, PDF ISBN 978-92-76-18594-9.

⁹ “Broadening Multilevel Connectivity between Greece and North Macedonia in the Post-Prespa Environment”, by I. Armakolas et al., ELIAMEP, accessed at: <https://www.eliamep.gr/en/publication/διευρύνοντας-την-πολυεπίπεδη-διασυν/>

PART 2. INTERACTIONS SIMPLIFIED

Policy-making through centred on a single node – be it infrastructure, institution building or people issues – is built on two assumptions: i) that the intended focussed positive impact in the targeted node will be sustainable; and ii) that – eventually – it will contribute positively to the current existing situation in the other remaining nodes. But while focusing on one isolated node helps policy-makers deal with the complexity of cause-and-effect during the planning phase, it does not take into account the system connectedness. Moreover, any short-term improvement in one node may mask adverse consequences in the two other triangle components, and fragilize the long-term resilience of the system.

In our triangle system, because of permanent and multi-layered connectivity what happens in space reverberates in the people and institutions nodes, and vice versa. The mutual inter-dependence between change actors, the intended policy impact and the final beneficiaries may very easily result in unforeseen outcomes or in Catch22 situations.

By putting the permanent connectivity at the base of our model, we acknowledge the importance of their inter-dependence during policy-making. This allows us to identify and plan actions that create a Pareto improvement. In the long term, these dynamics makes it possible to initiate and maintain a virtuous cycle of positive outcomes in all the nodes of the triangle.

EU indicators in infrastructure and growth rate, education level of citizens and good governance practices can be considered as the equivalent of a Pareto-optimality target for the SEE6. In that case, an SEE6 virtuous cycle would be translated into a resilient and speedy convergence with the EU, and progress in all the enlargement chapters, all by avoiding democratic backsliding. This dynamic is a long-term endeavour, which requires interventions in the three nodes, carefully planned domestic reforms, backed by necessary resources, and implemented by actors who have the political will to do this.

2.1. Connecting the nodes

In this section we present a schematized and simplified interaction dynamics between the nodes. This list is by no means exhaustive, as we have given priority to interactions that are relatively easy to illustrate and relevant to the SEE6 context. The goal is to start a discussion on the permanent interconnectedness between space, institutions and people nodes, and identify potential entry points for policy-makers.

To stay in the simplified mode, we have chosen to illustrate the interactions only with examples that contribute to a virtuous circle – i.e., that contribute to a Pareto improvement.

2.1.1. Interaction between space and institutions

While the attention is mainly on how domestic institutions impact infrastructure and economic activity, we have proven that large infrastructure projects can change the way domestic institutions operate. FDI has a direct impact on corporate governance of domestic enterprises as well.

The vectors through which space impacts the institutions are investment in infrastructure projects, FDI and development of GVC, as illustrated below:

- i) Large infrastructure projects (LIPs) and FDI help expose the quality of governance of domestic institutions, be they public or private.¹⁰ LIP implementation serves as

¹⁰ For a detailed description of how private investment exposes the quality and impacts governance of central and local state institutions, please see “Implementing Large Infrastructure Projects in the “Implementing Large Infrastructure Connectivity Projects in the Western Balkans - The Case of Trans Adriatic Pipeline (TAP) in Albania”, Study Report by A. Hackaj, Tirana, May 2020.

a litmus test of domestic institutions by exposing their capacity to plan, implement and operate LIPs and/or attract and support FDIs. Success or failure in attracting and nurturing FDI is an indicator of the health of local institutional framework;

- ii) LIPs, FDI and participation of domestic firms in GVC impact the functioning of domestic enterprises and of state institutions by obliging the domestic actors to develop and adapt in order to keep pace with the international regulatory context and best management practices.

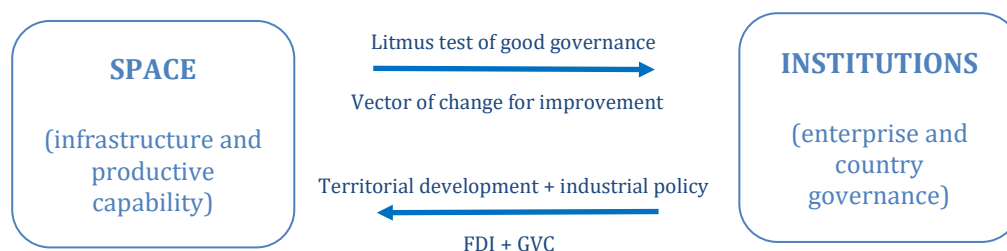
Box 4. Trans Adriatic Pipeline and the Albanian institutional framework

For example, involvement in the implementation of the Trans Adriatic Pipeline obliged the Ministry of Energy in Albania to draft and adopt new legislation, and improve internal institutional governance at central and local levels. The foreign investor and its partners also obliged Albanian private sub-contractors to modernize their business processes and adopt world-standard good governance practices.

State institutions impact the *space* through policy-making and the regulatory context. Through investment, enterprises develop the productive tissue of a territory, and/or adopt new technology, as illustrated below:

- i) State institutions impact the space through infrastructure project identification, design, territory planning, etc. Through industrial policy they identify and support the priority sectors; decide on the ways to encourage infrastructure development and/or certain strategic businesses or sectors; make available support measures; create and enforce the regulatory framework; identify and adopt selected technical parameters, norms and standards, etc.
- ii) Enterprises impact the space by investing in new production and services facilities or improving existing ones. Adoption of new technologies, establishment of new production units, sub-contracting, etc., change the economic profile of the territory.

Figure 2. Interaction between Space and Institutions



2.1.2. Interaction between human capital and space

We have chosen improvement of infrastructure, economic growth and knowledge transfer as the main vectors through which space impacts domestic human capital:

- i) Better infrastructure improves citizens' livelihood and quality of life, intensifies people-to-people contacts and reinforces communities, lowers displacement costs

and increases people’s mobility. Better digital connections, broader broadband coverage and 5G infrastructure impact education and improve daily life through better digital services.

- ii) More and well-run companies increase employment, personal income and other work-related workforce benefits. High added-value GVCs improve knowledge transfer, increase the transmission of best work practices, of advanced skills and of modern industrial relations.

A highly qualified workforce and educated and engaged local citizens impact space, as illustrated below:

- i) A highly educated and skilled workforce is a key attractive factor for incoming FDI. It conditions the participation of domestic enterprises in high added-value GVCs. Top quality workforce increases the efficiency and territorial impact of infrastructure during planning, implementation and operation (i.e., digital infrastructure can boost the local economy only if used by qualified programmers);
- ii) educated, responsible and engaged local citizens keep infrastructure promoters and business owners accountable on development of the territory. Currently, this is visible mostly in avoiding negative impacts of infrastructure and of FDI on the environment, climate change, workers’ rights, ethical FDI, etc. Informed, engaged and organized workforce contributes to higher productivity and competitiveness of enterprises.

Figure 3. Interaction between Human Capital and Space



2.1.3. Interaction between institutions and human capital

Both public institutions and private enterprises affect the way the individual relates to work, grows, develops and contributes to the community. As policy-makers, the decisions of public institutions impact every aspect of the daily life of the citizen.

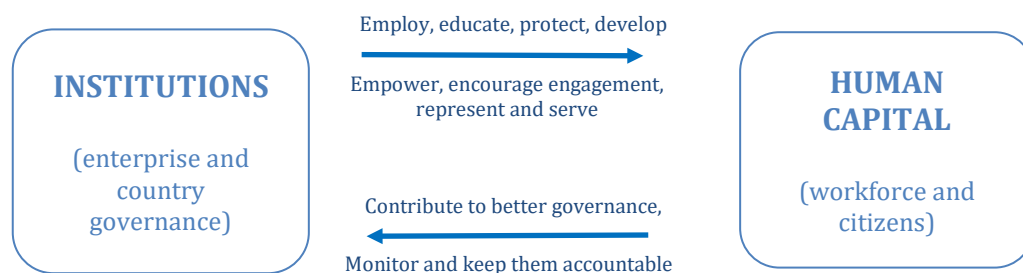
Well-governed institutions – be they public or private – educate, protect and develop the human capital as illustrated below:

- i) As employers, socially engaged firms and well-administered public institutions benefit from and contribute to the development of a highly skilled workforce. Through human resource development efforts, they invest in the improvement of their employees hence increase their overall efficiency;
- ii) Well-governed public institutions empower and encourage citizens to engage, represent, be represented and serve the community. As policy-makers they improve the general welfare of citizens through different sector policies – education, health, employment, social protection, etc.

Human capital to institutions. Educated, skilled, engaged and enlightened individuals contribute to improve the functioning of enterprises, as well as the governance of public institutions by holding them accountable:

- i) As members of the workforce people contribute to better managed (and profit-generating) enterprises, as well as better governed and efficient public institutions;
- ii) As citizen they keep in check the legitimacy of public institutions. Through democratic engagement they monitor public institutions, and through trade unions and civil society movements they keep private enterprises accountable.

Figure 4. Interaction between Institutions and Human Capital



* * *

Well-governed institutions and a professional workforce are required to develop a country's infrastructure. Top educational institutions, functioning health systems, social protection schemes as well as enterprises that invest in their employees are pre-conditions for having high-quality human resources. To keep its institutions accountable a country needs engaged and educated citizens; while to grow and be profitable domestic companies require a highly qualified workforce.

Each node is connected and interacts with the other two – change in one directly impacts the two others, positively or negatively. It is this interdependence that makes relevant the identification of entry-points for any policy-maker.

2.2. Identifying entry points and actors

While permanently linked with each other, each node is in contact and interacts with other triangles. In a highly globalized world, interaction with the exterior is one of the most common ways of inducing change in a selected triangle, be it in space, human resources or institutions.

Below we present some illustrative cases of how different SEE6 nodes interact with selected third actors. The selected examples are not representative and serve only for didactic purposes.

2.2.1. The EU membership drive

Due to the firm commitment of SEE6 countries to their full EU membership, the EU is currently the only third actor that, through the enlargement process, has an official permanent linking mechanism with all three nodes of the SEE6 triangle. In the following presentation we will stay at the EU level and not focus on the interaction of SEE6 countries with specific EU member states, EU regions or other EU-linked actors such as big companies of International Finance Institutions.

In the **space** node, two examples illustrate the systemic connections with the EU: the extension of the EU Trans-European Transport and Energy Networks in the SEE6 and participation of the SEE6 economy in EU value chains. By design, the SEE6 Connectivity Agenda is an “indicative extension” of the EU’s,¹¹ while the Peninsula’s economy is de-facto part of the EU’s. In 2017, the SEE6 had “73% of their total goods trade with the EU within an almost completely liberalized trade regime. Between 75-90% of their banking systems are foreign-owned (mainly by German, Italian, French, Austrian and Greek banks)”.¹²

In support of a speedier convergence, the EU Commission has adopted an Economic and Investment Plan worth EUR 9 bn in grants (and up to EUR 20 bn in loans). EIP also contains a list of 10 flagship projects designed to cover the main sectors and all the SEE6 countries.

To better channel EU aid in the region, different proposals include the reinstatement of an EU Agency for Reconstruction and Development in the SEE6 region, the establishment of a joint regional Western Balkan Investment Committee equipped with supra-national powers or the set-up of a regional Western Balkan Regional Infrastructure Fund.¹³

The next target of EU intervention in SEE6 is capacity building of public **institutions**.

However, EU institution-building actions do not deliver the intended outcomes because domestic South-East European state institutions have poor governance quality, are captured or their leaders lack the political will for reform. “Funds from the EU’s Instrument for Pre-accession Assistance range from around 40 million euro a year for Montenegro to 200 million euro for Serbia and are directed almost entirely to supporting administrative and other institutional reforms without sufficiently taking account of the enormous development gap between the Western Balkans and the EU.”¹⁴ The EU-supported public administration reforms have only partially addressed elements of institutional good governance, mostly focusing on capacity-building projects that assist them to improve their deliverables (or on output legitimacy elements).

Further, we estimate that the role of European enterprises as vectors of change capable to improve SEE6 corporate management practices and governance models has not been used in full. EU companies are key in the development of SEE6 productive capacities, for the inclusion of the peninsula in the European GVCs, and for the adoption of new technologies. Innovative supporting schemes should be devised and adopted to encourage EU companies to be more active in the SEE6, beyond market access. Given the embeddedness of the SEE6 economy in that of the EU, Union industrial policy should contain at least a chapter on the SEE6 and adapted policy measures should be foreseen and budgeted.

Until now EU infrastructure support has been designed separately from SEE6 institutional reforms. The dependency of CA implementation on the quality of SEE6 institutions, on their legitimacy and good governance mechanisms, as well as the infrastructure’s own impact on local institutions, has not been strategically assessed.¹⁵ IFIs do not vet the good governance mechanisms, skills or competences of SEE6 public institutions in charge of infrastructure before allocating EU grants or approving loans. On the other side, the contribution of

¹¹ International relations – Western Balkans, Mobility and Transport, European Commission at: https://ec.europa.eu/transport/themes/international/enlargement/westernbalkans_en

¹² “The EU and the Western Balkans: So Near and Yet So Far”, by M. Bonomi and D. Reljić, SWP Comments 53, December 2017.

¹³ See “Investment in the Western Balkans. New Directions and Financial Constraints in Infrastructure Investment”, by R. Grieveson and M. Holzner, WIIW November 2018.

¹⁴ “The EU and the Western Balkans: So Near and Yet So Far”, *op cit*.

¹⁵ For more details on interaction between Connectivity Agenda and governance, see “The Berlin Process: Implementation of Connectivity and Institutional Governance”, by A. Hackaj and K. Hackaj, CDI March 2019.

domestic non-state actors – CSOs, SMEs, academia or other interest groups – has been limited to their consultative and “watchdog” role.

With regard to the **people** node, a very visible interaction EU-SEE6 is between education and emigration. In education there are different Europe programmes available for SEE6 students and researchers such as Erasmus or Horizon 2020. Regarding emigration, on the positive side emigrating to the EU allows SEE6 citizens to realize their life aspiration and through remittances contributes to the SEE6 balance of payments. On the negative side it deprives SEE6 economies of their best and most productive elements and the society of its middle class, i.e., the most educated and engaged citizens.

In Enlargement, the EU uses the intergovernmental model of interacting with the SEE6 countries. This explains the preponderant role of the institution node in EU-SEE6 interactions, and especially of state institutions. But when domestic state institutions are captured, or are incompetent, they distort all the intended EU impact in the SEE6 triangle.

The EU is a systemic actor supporting the SEE6 in its reforms and development path. It supports the SEE6 in **space**, in **people** or in **institutions** (through institution building), but those interventions are not comprehensively harmonized with the EU’s own growth policies, or interconnected amongst themselves.

2.2.2. Interacting with other triangles

In a globalized and interconnected world, our three nodes are in permanent contact and interact with a multitude of third actors.

a) China

Assessment of China’s interaction with SEE6 nodes sheds light on the role of different actors in the triangle model. According to mainstream theories, Chinese state institutions, State Owned Enterprises, provincial governments, privately-owned companies and China investment banks form a monolithic body. They all follow one strategy and implement the same action plan which in this case is the Belt and Road initiative. But recent research has put to doubt this thesis by pointing out the contradicting and uncoordinated approach amongst Belt and Road actors.¹⁶

Chinese actors – state (different ministries and state agencies), provincial governments, development banks, SOEs, private companies – are already present in the SEE6 space, people and institutions nodes, especially in Serbia. With reference to **space** Chinese companies have invested billions of EUR in heavy industry (mining, smelter, tire production, etc.) all situated in under-developed regions (Smederevo or Bor in Serbia, etc.). But the positive impact on the local economy and employment has been dented by the negative consequences of high pollution (Smederevo, Bor; Bankers, Albania, etc.).¹⁷ on the health of citizens.¹⁸ Chinese IT companies have been providing high tech equipment to almost all SEE6 telecom companies

¹⁶ See “China Challenges Global Governance? Chinese International Development Finance and the AIIB”, by Sh. Hamairi and L. Jones, *International Affairs* 94, 2018. Published by Oxford University Press on behalf of The Royal Institute of International Affairs; and the: “The Chinese ‘Debt Trap’ Is a Myth”, by D. Brautigam and M. Rithmire, in *The Atlantic*, Feb. 6, 2021.

¹⁷ “The Long Shadow of an Oil Legacy: Fact Finding Mission Report from the Bankers Petroleum Oil Fields at Patos Marinza, Albania”, CEE Bankwatch Network 2014.

¹⁸ “Eco-Monsters & Eco-Fighters: China's Investments in Serbia's Heavy Manufacturing Industry as Seen Through an Environmental Lens”, by T. Prelec, Jan. 2021.

as subcontractors mostly in 4G.¹⁹ Further on in the space node, Chinese companies have been in the lead in implementing the concept of smart cities and safe cities in Serbia.

Regarding people, while there is no data on the impact of China in the development of local workforce it is worth mentioning Chinese engagement through education and cultural exchanges. To be noted are the newly established IT research centres (Huawei in SER) contributing to the quality of local human resources in the IT sector, and the Confucius Institutes specialized mostly in cultural aspects as well as Chinese language classes in primary and secondary schools. Lastly it is worth mentioning the health contribution of China to Serbia in the fight against COVID-19. This assistance has taken the form of supplies in medical equipment in the emergency phase during 2020, and provision of Chinese vaccines in early 2021 to Serbia and later to North Macedonia and Albania.

The impact of China in the governance of SEE6 **institutions** remains invisible for the moment. On face view it can be illustrated by the 17+1 Cooperation initiatives and the many secretariats that have been set up in SEE6 capitals.²⁰ However there is little information on the governance mechanism or policy-making routines of those joint structures. Moreover, in marked contrast with Western partners of the SEE6, there are no Chinese consultants embedded in or assisting different branches of the executive in SEE6 institution building, or during the domestic policy-making cycle.

Regarding Chinese corporate governance practice in SEE6, a serious concern is transparency and difficulty of access to information. Recent publications have noted a general absence of BRI governance rules that is translated into un-regulated SOE behaviour.²¹

b) Turkey

In the SEE6 Turkey has been active in space, people and institutions. In **space** the North Macedonian airports of Skopje and Ohrid are run by Turkish TAV Airports Holding. In Pristina the Kosovo national airport is managed by Turkish-French consortium Limak & Lyon under a concession agreement, while in Albania the national airline and the new Vlora airport are being developed in partnership with Turkish Airlines. In the road sector, the US-Turkish joint venture Bechtel-Enka built the motorway connecting Kosovo and Albania while Tasyapi is currently building two sections of the Belgrade-Sarajevo motorway.

In Albania Turkish companies own banks, smelters, mines and Hydro Power Plants, while in North Macedonia they are heavily involved in real estate. Cevahir Holding developed the Cevahir Sky City. Limak is building the Limak Skopje Luxury Hotel and the multipurpose Diamond Skopje complex in downtown Skopje. Migros Ticaret opened the first mall in Skopje as well as Ramstore supermarkets across the country. In both infrastructure and productive capacity Turkish endeavours in general observe the local laws and regulations regarding industrial relations, contracting or the general business-making environment.

Regarding their involvement with the **people** node, Turkish action is mostly focused on education and poverty relief in rural and socially distant areas in the SEE6, as well as in direct assistance in emergency situations or natural disasters.²² The close relationships

¹⁹ "Infrastructure Investment in the Western Balkans: A First Analysis", by M. Holzner and M. Schwarzhappel, Sept. 2018, Vienna Institute for International Economic Studies.

²⁰ See the list in page 45 in Table 5, "16+1" Coordinating Mechanism / Platforms of Cooperation, in "The Berlin Process 2014-2018", by A. Hackaj and K. Hackaj, CDI eds. 2018.

²¹ China challenges global governance? Chinese international development finance and the AIIB, by Sh. Hameiri and L. Jones, International Affairs 94, 2018. Published by Oxford University Press on behalf of The Royal Institute of International Affairs.

²² In Albania Turkey has also financed the construction of the largest mosque in the Balkans which can host 5,000 people, as well as 20 new mosques in Kosovo during the last years, as stated by Top

between Turkey and most of the Balkan countries, especially those with large Muslim populations, stem not only from Turkish economic clout but also from their long shared history as these countries were part of the Ottoman empire for five centuries. This left an enduring legacy of Turkish minorities in several countries and a majority Muslim population in Albania, Bosnia & Herzegovina and Kosovo, as well as Turkish influences on local culture, architecture and cuisine.

In education, Turkish-owned schools have a very good reputation regarding the quality of teaching, however during the last five years they have been transitioning reflecting the political power struggle between their original owner (Gülenist Movement) and President Erdogan. Since 2018 Maarif Foundation – created in June 2016 by the Turkish Parliament as the sole official provider of Turkish-backed education abroad – has established an extensive presence in Albania from kindergarten to the university level.²³

The specificity of Turkish aid is its unique feature of bypassing external consultants and national authorities during implementation, and delivering the aid directly to the final beneficiaries. In Albania, Laci reconstruction efforts and Fieri Memorial hospital are designed and implemented directly by Turkish companies. This largely explains the high impact of Turkish action when compared with the aid amount engaged.²⁴

With regard to **institutional** governance node, an illustration is the long-term cooperation in the sector of defence where a Turkish team has been working together with Albanians for 15 years building up capacity and training civil servants in the Ministry of Defence.²⁵ It also is worth mentioning the latest development in joint policy-making: the creation of the Council for High Level Cooperation between Albania and Turkey signed on 6 January 2021. This unique structure will “*facilitate and deepen cooperation in key areas such as security, defence, energy, tourism, infrastructure, education and culture*”.²⁶

c) Russia and the UAE

Russia, Arab countries and other third-party investors are present mostly in the **space** node of the SEE6 development triangle. Russians are building the command-and-control centre of Serbian railways while the UAE has heavily invested in real estate in Belgrade and Sarajevo, and recently Albania has attracted its attention for a multi-billion-euro seafront development. No comprehensive assessment exists about the involvement and impact of Russian and UAE development, especially on SEE6 institutional governance.

In the **people** node, the Orthodox Church links between Russia and orthodox Balkan countries should be mentioned as well.

Channel, see: <https://top-channel.tv/2019/01/23/xhamia-turke-ne-shqiperi-rruga-e-erdoganit-per-te-hyre-ne-ballkan/>

²³ “Schools: A New Tool of Turkish Influence in Albania”, by F. Mejdini, BIRM, Sept. 2019, accessed at: <https://balkaninsight.com/2019/09/04/schools-a-new-tool-of-turkish-influence-in-albania/>

²⁴ Popular song dedicated to Erdogan thanking him for Turkey’s assistance to Albania for the rebuilding of Laci public dwellings damaged by November 2019 earthquake, and the Fieri Hospital, extracted from https://www.youtube.com/watch?v=cKUsmAwLhdM&feature=emb_logo

²⁵ “Albania – Turkey sign the Cooperation Plan in the field of Defense”, <https://www.mod.gov.al/index.php/newsroom-2/4224-shqiperi-turqi-nenshkruset-plani-i-bashkepunimit-ne-fushen-e-mbrojtjes>; “Europeanization Process and Bilateral Relations in the Balkans: Turkey and Albania”, by D. Ekinci, Department of Political Science and International Relations, Çankaya University

²⁶ “Albania and Turkey sign agreements to strengthen co-operation”, *Euronews Albania*, at: <https://euronews.al/al/aktualitet/2021/01/06/live-rama-dhe-erdogan-nenshkruajne-marreveshje-bashkepunimi>

CONCLUSIONS: THE BERLIN PROCESS 2.0

All SEE6 countries are fully engaged in deep-cutting reforms that are transforming their institutions, developing their economy and improving the quality of life of their citizens. The European Union through its Enlargement mechanism is supporting them. But on their way to membership, SEE6 economies must grow quickly to catch up with their EU peers, and local infrastructure must be upgraded and extended. Domestic institutions should complete the reforms and also deliver on the rule of law, justice reform, the fight against corruption and organized crime, as well as in security and fundamental rights. SEE6 citizens should enjoy employment, good health services, education and social services, and must keep their institutions accountable.

But can all this be done at the same time? Can we have privileged entry points for policy-makers? Who are the good change actors? What should the change mechanisms be? What are the pitfalls to be avoided? How to make the outcomes irreversible? By putting space, people and institutions in one system we have tried to present all these challenges in one plan, underline their interconnectedness and complexity and provide elements of reflection useful for policy-makers. By looking at it as one system, we have drawn some preliminary conclusions.

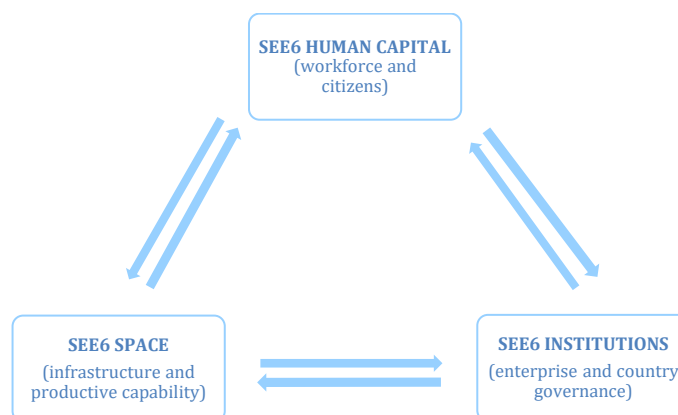
First, to be virtuous and resilient, any change affecting the SEE6 reforms and convergence dynamic towards the EU must be designed by taking into account all three nodes of the triangle. The resulting policies should be spread out in the long-term perspective and include sustainability and resilience factors on top of efficiency.

Second, the Enlargement dynamics and in-built connectivity with the EU provide the rails along which SEE6 countries will develop. However, in an ever-changing and hyper-connected world we must be aware of competing models of development that interact with each node of our SEE6 triangle.

Finally, we are conscious that this is only a first modest step in adopting a comprehensive development approach adapted to the very specific SEE6 situation. As such its goal is to set up some – useful – reference points that can hopefully serve to initiate a broad and inclusive reflection on the development in this part of Europe in the years to come.

Given its contribution to Enlargement dynamics, this model can provide a blueprint for an EU membership-based development model. Its strong focus on connectivity provides elements of reflection for the design of the second phase of the Berlin Process.

Figure 5. Berlin Process 2.0



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