

Bod, Péter Ákos; Neszmély, György Iván

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Péter Ákos Bod and György Iván Neszmélyi*

Benign Neglect or Institutionalisation? Dealing with de facto Euroisation in Candidate Countries

EU enlargement rounds have always been driven by political will of the parties concerned and administered through a comprehensive legal-bureaucratic procedure. There is strong political determination to carry on the accession process involving Western Balkan countries as well as Ukraine, Georgia and Moldova, but the standard enlargement procedures have proven time-inconsistent for recent applicants. This article scrutinises the specific historical, geopolitical and domestic characteristics of the Western Balkans and focuses on the unique currency situation of the region. Widespread spontaneous use of the euro in everyday life, and unilateral euroisation in two cases, should justify a non-standard monetary policy arrangement; not a shortcut to the euro area but providing an institutional framework and clear perspective for the parties concerned. These proposals align with recent accession practices and would strengthen political momentum.

The enlargement of the European Union is a par excellence *political act*: granting full membership to a candidate country must be approved by all incumbents, and the successful conclusion of negotiations ends with member state ratifications. At the same time, the accession process is a complex and time-consuming *bureaucratic procedure*, designed deliberately to be gradual and controllable, and it consists of numerous stages granting any incumbent the right to exercise politically motivated checks, if deemed necessary (European Commission, 2024a).

The long and demanding process thus has a dual logic: political and bureaucratic. This duality has been put to the test in various enlargement events in recent decades.

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* Note: the designation “Kosovo” is used without prejudice to positions on status and in line with UNSC 1244 and the opinion on the Kosovo Declaration of Independence.

None has been simple; not even those involving economically advanced applicants who are potential net contributors to the common budget, as in the case of Austria, Finland and Sweden (accession accomplished in 1995). That round reminds us that enlargement has always been geopolitical: applications were submitted between 1989 (Austria) and 1992 (Finland), in a political window of opportunity, when global constellations and inner dynamics of Russian politics allowed the hitherto neutral states to apply for EU membership. The subsequent enlargement round was a “big bang” of ten new members in 2004, followed by Romania, Bulgaria and most recently Croatia.

Recent events highlight the primacy of politics: immediately after Russia’s attack, Ukraine applied for EU membership on 28 February 2022. Days later, Georgia and Moldova submitted their applications. The European Council decided in less than four months to grant Ukraine and Moldova candidate status, and it recognised Georgia’s “European perspective” – one notch short of formal candidacy. Their outlook is beyond the scope of the present study, which revisits the ongoing accession procedure of the West Balkans and highlights a somewhat neglected aspect: money.

Balkan countries have their own unique baggage of complicated history and nontrivial political conditions. They are also less advanced in economic terms than incumbents that entered EU between 2004 and 2013. The combination of complex politics and relative underdevelopment is a tough challenge in the bureaucratic merit-

Péter Ákos Bod, Corvinus University of Budapest, Hungary.

György Iván Neszmélyi, Milton Friedman University, Budapest, Hungary.

based accession process. Still, EU institutions and member states have made binding promises to the applicants. Thus, unprecedented tension has evolved between the (geo)political will to enlarge, and the readiness of the applicants as well as incumbents to accomplish the customary legal-bureaucratic accession process.

This is the context in which the customary enlargement procedure is being scrutinised. The same European leaders who support the speedy eastern enlargement under the new geopolitical situation that emerged after Russia's aggression are also keen not to leave behind the six countries in the Western Balkans that aspire to membership: Serbia, Bosnia-Herzegovina, Montenegro, North Macedonia, Kosovo and Albania (also known as the WB6) have spent considerable time in the complex bureaucratic accession procedures. The authorities and peoples of the region worry now about being left behind and leapfrogged by eastern applicants.

It is logical, in such a situation, to search for some policy space, hitherto unused or non-existent, to further the WB6 accession procedure knowing, however, that the applicants are still far from meeting crucial entry conditions. That idea resonates in academic and political circles. One line of argument is that the accession process should be restructured so that some applicants may become partial or associate members, before acquiring full membership at a much later stage (Kribbe & van Middelaar, 2023). However, the concept of a new classification is controversial among key stakeholders who do not want to depart from the existing framework and main administrative rules of enlargement. Below, we argue for another possible direction of change: a non-standard sequencing of the existing process, involving a currency and payment affairs.

That changes should be made in the customary legal-institutional enlargement framework is not a novel concept, nor is it directly related to applicants in the EU's southern and eastern periphery. EU membership is strictly conditional on full acceptance of the four freedoms (free movement of goods, services, capital and labour) and core values (democracy and rule of law); but beyond that, it is imaginable that EU members could belong to "one or several clubs or partnerships, like the European monetary union or a future European defence union" (Sapir, 2022, p. 215). The concept of a flexible "club membership" is particularly justified by political realism: the EU may offer "visible and tangible benefits early on and immediate return for reform progress" (Kribbe & van Middelaar, 2023, p. 13).

Flexibility, far from being academic advice only, is present practice. Tailor-made bilateral agreements and pro-

grammes already exist, beyond the classical enlargement policy framework, as in the case of the Deep and Comprehensive Free Trade Agreements (DCFTAs) with Ukraine, Moldova and Georgia, or the Stabilisation and Association Agreements (SAAs) for the WB6.

A general policy dilemma for the EU in recent cases is still valid: how to incentivise candidates and strengthen their morale – without making political exceptions to the rules. There is no easy answer in the present situation. Domestic support for the needed reform measures will wane if the general mood is that the EU institutions only play for time by setting unattainable targets. It would be politically and managerially beneficial to identify specific areas where a candidate is well prepared to meet EU standards, allowing good performers to be accepted into a "club" based on real merits.

Going ahead in one area, not waiting for definite progress in other aspects, is already reality in the case of free trade agreements in manufacturing goods under DGFTAs: a sufficiently mature candidate is accepted for a specific agreement without becoming a member of the EU customs union yet. Full harmonisation with the EU's internal market regulations is, as history has shown, a long and hard process. Still, important progress in trade matters can be achieved when local conditions allow, to mutual benefit, at a time when the contours of full EU accession are vague. Similarly, an enhanced status or "club membership" could be established for certain services and the labour market for the people of the West Balkans.¹

Could what is true for product markets and the labour market be true in a monetary aspect? Understandably, monetary issues are sensitive in the EU as they involve considerations of sovereignty and raise questions about whether applicants are really prepared in fiscal and monetary aspects, i.e. the Maastricht criteria. Still, the present research acknowledges the particular socio-economic conditions of this region, exploring whether the customary sequencing of the accession process could be modified and suitable administrative arrangements could be created for the legal use of the euro to the mutual benefit of well-prepared candidates and the euro area itself.

The issue of monetary preparedness is country specific and context dependent. Therefore, it is important to con-

1 The opening of labour markets of EU member states was not offered automatically for the entrants. Central and Eastern European countries learned in 2004 that key employment targets, primarily Germany and Austria, requested a seven-year derogation in order to protect domestic jobs in the face of an assumed inflow of low-pay workers from the East. The historical antecedents were different in ex-Yugoslavian countries, resulting in rather intensive cross-border flows of former Yugoslav nationals throughout the transition period until the very present.

sider the particularities of the given region before outlining the design of the recommended changes in the accession procedure.

Idiosyncrasies of the WB6 – History, legacies and options

Five of the WB6 countries – all but Albania – share common legacies as former republics of Yugoslavia until its dissolution. Socialist Yugoslavia maintained particular economic, labour and financial relations with Western states during the East-West political separation of Europe from the 1960s onwards, and this has consequences for the present.

Under the special relationship, large numbers of Yugoslavs found employment in the West as guest workers. As a result, use of parallel currencies became an everyday reality. Remittances in “hard currencies”, especially in the West German mark, flowed to Yugoslavia legally. The West German mark gradually assumed currency functions alongside the Yugoslav dinar, the rather inflationary domestic legal tender. Yugoslav authorities did not hinder economic migration knowing that guest workers would repatriate their savings for consumption or real estate or small business investment purposes (Vidovic & Mara, 2015). Mass economic migration and remittances were negligible in other European socialist countries at that time.

The collapse and fragmentation of the Yugoslav state in the early 1990s led to suffering, years of hostility, wars and political instability. The new, emerging entities experienced severe economic and financial troubles, to varying degrees, but managed to remain economically connected with Western Europe.

In the turmoil, quite specific currency relations emerged. Take the case of Bosnia and Herzegovina: at the time of the establishment of its central bank (CBBH) in 1997, market transactions were settled in four currencies (Bosnian dinar, Yugoslav dinar, Croatian kuna, German mark). Given the antecedents and complex local conditions, the unilateral introduction of the so-called convertible mark was logical, however peculiar such a decision sounded at that time when Germany and other EU states were busy creating the common European currency. At the outset, the convertible mark was fixed at a 1:1 ratio to the value of the German mark. With the introduction of the euro in January 1999, the ratio was adjusted according to the Deutschmark/euro exchange rate (1.95583), and maintained permanently (BIS, 2003).

Economic and financial processes of the region have always been influenced by regional tensions and conflicts, as the fragile case of Kosovo indicates. Similarly, there

are issues with North Macedonia, causing complications in the accession process: the country's aspirations had been blocked by Greece until a bilateral agreement was signed in 2018 concerning the official country name.² As for Bosnia and Herzegovina, it was constructed as a quasi-federal state consisting of two parts under the Dayton Agreement (1995), yet one entity called Republika Srpska seems to be oriented politically more towards Serbia than the Federation of Bosnia and Herzegovina, with its majority of Croats and Bosniaks.

Under these peculiar conditions, the emerging new entities needed instant solutions for vital issues including the currency regime. The case of Montenegro and Kosovo is unique: in their efforts to distance themselves from Serbia, and consequently from the Serbian dinar, authorities decided to institutionalise the de facto use of the euro. The de jure euroisation was, importantly, a unilateral decision without officially involving the ECB or other EU bodies. At present, this is the status quo. There is no incentive whatsoever for these countries to create their own currency, only to give it up in the final phase of the EU accession process for the euro.

All six countries strive to obtain EU membership. The degree of preparedness and their respective “maturity for the union”, however, differ greatly. The speed of the progress hardly substantiates the hopes that these countries will fulfil all membership preconditions in the foreseeable future (Bourguignon et al., 2022). Strong political will might accelerate the process; still, under the dual logic of the enlargement process, as defined above, full EU integration of the WB6 is conceivable in the long term only.

This conclusion stems from area studies and comprehensive reports prepared by the European Commission on the level of integration maturity and preparedness of the countries concerned (Emerson & Blockmans, 2023). On a five-point scale of the average value of the qualifying aspects, Montenegro is in first place (3.11), followed by Serbia and North Macedonia (3.06; 3.04 respectively); the scores of the other applicants are lower (Mihajlović & Macek, 2024). In certain aspects, some countries perform far below average, especially with political issues (jurisdiction, basic rights, justice, freedom, security) while in other clusters, including economic criteria like competitiveness and the domestic market, the results are relatively good.

² Previously, the country was referred to as the Former Yugoslav Republic of Macedonia in international documents. At present, the official reference is Republic of North Macedonia. Still, historical and ethnic problems with Bulgaria and Albania persist even after the conclusion of the denomination dispute.

Such a variability in preparedness has been recognised in academic circles as well as by policy-makers who are unsatisfied with the accepted accession process. The customary bureaucratic procedure – including the fulfilment of all criteria along the 35 *acquis* chapters – may only be attainable in the very long run in the Balkans case, or with Eastern candidates for that matter. What if, in the meantime, a particular applicant has achieved significant progress in a specific field? In this case, alternative concepts have emerged such as “Staged Accession”, as a break with the present binary procedure of being either “in” or “out”, recommending instead distinct stages defined by two criteria: applicant’s readiness and incumbent’s preparedness (Emerson et al., 2021).³

New definitions and unused phrasing, however, can elicit political objections and justified concerns about procedural aspects, and those in the waiting line for membership may find any new definition suspicious and take “intermediate membership” as a substitution for the real thing. Maintaining a supportive political climate is key for the success of such a protracted process as defined by the conventional accession procedure. Further progress in the process, driven by the intentions of both the EU and the candidates, is assumed here, but the political mood may change.

The EU is the largest trading partner of the region as a whole (Vulović, 2023), although political actors and stakeholders are not limited to Europe. While all Western Balkan countries have a free trade agreement with the European Union, Serbia also has such an agreement with the United States and, more importantly, with Russia, and plans to conclude one with China. All WB6 countries have free trade agreements with Turkey.

A distinctive feature of the region is a high unemployment rate, especially among the youth, who tend to seek temporary or longer-term employment abroad – a continuation of the economic migration process that has characterised the region for a long time. Reverse labour force movements are also common. Cross-border money transfers, repatriation of wages and other incomes have become structural parts of economic life.

These are critical characteristics that set apart the WB6 from other nations that have accomplished accession in previous EU enlargement rounds. The idiosyncrasies raise an obvious question: why should this particular set

3 Four stages are proposed: initial, intermediate, new member state, and conventional membership. Second: retaining safeguards in relation to existing member states’ concerns over further enlargement for which the EU’s institutional structure is not yet adapted (Emerson et al., 2021).

of countries follow exactly the same path as others – free trade area, customs union, single market, full EU membership, and, once members, the fulfilment of the Maastricht criteria and the transition to the euro.

That pattern, tested in several recent accession events, assumes the existence of a national monetary system and a domestic currency. Then the member, with all conditions met, including a minimum of 24 months in the European Exchange Rate Mechanism, may apply for euro area membership. In contrast, the Balkans region has a critical feature: high level of *de facto* euroisation, with two countries having undergone a unilateral transition to the euro. This is a situation benignly neglected or tolerated by European institutions.

The above review of the region substantiates the claim made in this article that such a substantive feature would justify hitherto unused paths to the monetary union.

Currency considerations

The daily use of a parallel currency is not a unique Balkan phenomenon; hard currency in circulation has been a case in many emerging and developing markets. To give up volatile local currency for a strong anchor currency is justifiable under the logic of “institutions substitution” (Mendoza, 2002).

Similarly, for transition countries in Central and Eastern Europe (CEE), strong monetary policy arguments have been made to peg the local currency to the euro (currency board) or give it up altogether via unilateral euroisation (Buiter & Grafe, 2002). CEE candidates were, however, strongly discouraged by EU institutions in the membership preparatory phase and did not deviate from the textbook procedure: accession to the EU first, followed by preparation for entering the euro area.

The Balkans case is very different: secondary position or total lack of a local legal tender is, as we have seen it, an important peculiarity.⁴ Currency and banking affairs therefore differ significantly from those of CEE countries that operated a sovereign monetary system with a domestic currency during the long preparatory period before EU

4 The Austrian National Bank regularly monitors the use of euro in certain states outside the euro area. The euro substitution ratio in 2023 (i.e. the ratio of euro cash to national cash in circulation) is limited in present EU member states that have not yet joined the euro area (Bulgaria: 3.05%, Czechia 4.47%, Hungary 4.39%, Poland 3.63%, Romania 12.27%); the ratio is remarkably high in the Western Balkan countries (Bosnia and Herzegovina: 9.35%, North Macedonia 50.7%, Serbia 47.82). Data are not collected in Western Balkan countries with the euro as legal tender (Kosovo, Montenegro). For more information, see the OeNB Euro Survey.

accession. Once in the EU, some of them embarked on euro adoption immediately, while others had managed their own currency and monetary system for some time before authorities decided to make serious efforts to enter the euro area; again, some other governments retain derogation that allows them to stay out of the euro area.⁵

Country cases do not substantiate claims in favour of maintaining independent monetary policy regimes as an assumed crisis management tool (Bod et al., 2021a). What is more: whatever the monetary track records of CEE member states, they would have limited relevance for the WB6 group because of its particular financial conditions, as mentioned above.

The high level of de facto euroisation has been the reality for some time, thus one may claim that there is no need for immediate action, and the Balkans case does not demand material changes in the customary accession procedure. The above review of the economic and social aspects, as well as the geopolitical conditions of the region, however, will not justify an easy acceptance of the status quo. Until EU accession takes place, the European Central Bank (ECB) has only limited influence on the monetary and macro-prudential policy of the countries concerned within present legal frameworks. The ECB and other regulatory bodies would be particularly important, however, in shaping longer-term processes, typically neglected by local politicians with short time horizons (Benczes, 2022).

There are strong monetary policy arguments for the general use of a strong anchor currency in an otherwise volatile business environment. Banking and finance are conducted in euro, thus prudential regulation is of utmost importance even if the entities concerned are far from passing all the tests needed for full EU membership.

What would, then, the alternative paths look like in the monetary respect? It is pointless to expect the government without national legal tender to retreat to where CEE candidates were at the time of their application and establish a floating national currency. No one expects these governments to go in reverse: the EU institutions have acknowledged the status quo with an attitude of benign neglect. Acceptance of the present situation may seem rational for both sides: the authorities of countries with legal or spontaneous use of euro are aware of the customary enlargement process; as for the EU institution, they

have many more urgent issues to tackle. Still, the status quo does not serve the interests of either party.

Given the region's modest level of economic advancement, high unemployment and related social problems, along with the negative social consequences of the enhanced outflow of the working-age population, trade promotion and job creation/retention is a must. In order to serve the above goals, a Western Balkans Growth Plan was published by the European Commission in November 2023 aiming for, among other things, the creation of a common regional market (Jovanović, 2024). The issue of currency and banking is one of the priority areas, in particular, access to the single euro payment area (SEPA). The other aspects cover free movement of goods, services and workers, the promotion of road transport, the integration and decarbonisation of the digital single market, and integration into the industrial supply chain (European Commission, 2024b).

A large body of monetary literature underlines the fact that regional use of a stable common currency contributes to trade creation. Such currency is there for the WB6; what is needed is a clear framework and adequate monetary arrangements, under a modified sequencing of the accession process.

Modification, obviously, raises the feasibility issue, given the dual (political and bureaucratic) nature of the accession process. As for politics, aspirants and EU incumbents alike know all too well that a process with its numerous chapters is going to take a long time – longer than in the 2004, 2007 and 2013 enlargement cases – for two main reasons. One of them is the relative underdevelopment of the candidates, coupled with weaknesses in preparatory work.

The other – and more pertinent to the present research – reason is the time-inconsistency of the customary enlargement procedure. This is not surprising: the whole accession process had been designed for certain types of countries – not for those that had lived for decades, during the East/West separation, under political, economic, legal and social systems so different from those in the core EU. Such procedural time-inconsistency was felt profoundly by CEE states eventually admitted to the EU between 2004 and 2013. They somehow coped with the less-suited procedures – but at some unnecessarily high costs. At present, two decades after the largest enlargement round, the original enlargement rules seem to be less and less appropriate.

Yet, there does not seem to be an appetite among the incumbents for a watered-down version of the legal-administrative procedure for either WB6 or Eastern candi-

⁵ Bod et al. (2021a, 2021b) have discussed the euro introduction process of Slovakia, Hungary, Poland, Czechia, Croatia, Slovenia and the Baltic countries, pointing out that those that adopted the euro did that only after becoming EU members and subsequently fulfilling the Maastricht criteria. They also experienced spontaneous euroisation but to a lesser degree than in the WB6.

dates. Still, the political momentum for the promised enlargement process has to be maintained in order to retain supporters within the countries concerned and in the EU itself. Given that the traditional path seems to be excessively long, efforts have to be made to come up with alternatives. As recent special arrangements for product markets and (some) services indicate, new modalities can be found in areas where the candidate countries are prepared enough – and the EU is also ready to institutionalise the rules, conditions and framework. Based on the above analysis, monetary and currency issues should be tackled in the same fashion.

Concluding recommendations

Given the political and economic importance of the currency regime, it is understandable that the EU institutions and major actors are sensitive to any proposal concerning the legalisation of the status quo that had been created by the unilateral introduction of the euro. In reality, institutions always acknowledge non-customary cases as well. Interfaces between EU institutions and regional monetary and fiscal authorities are active. Experts from candidate countries participate regularly in technical as well as high-level events at the European Central Bank. Professional collaborations between monetary authorities cover important aspects of financial technology, anti-money laundering and payment settlements. These efforts are supported through events organised by the International Monetary Fund, the World Bank and, importantly, by the EU via the Western Balkans Payment System Modernization Project, under the administration of the Council for Regional Cooperation.⁶

It is thus important to realise that a kind of quasi-membership in expert teams already exists. Collaboration is all the more important between the EU and the WB6 as further financial convergence of the Western Balkans region would stimulate trade-creation effects and increase the region's ability to attract foreign direct investment.

A compelling geopolitical argument can also be put forward. Major non-European players, foremost China, entertain intentions to gain further influence in the region.⁷ WB6 governments will consider geopolitical gains and immediate economic benefits. The mere fact of conducting

accession negotiation is an asset of the EU in this competition for influence – but this should be underpinned by tangible progress. An ordered legalisation of the status quo for the two euroised country cases, and convenient framework for those using euro intensively as parallel currency, would replace the current attitude of benevolent indifference with a pragmatic business-like future.

What is not proposed here is immediate entry into the euro area with full membership rights. Incumbents have passed a complex and demanding, albeit somewhat arbitrary, process to earn entry. Those still staying out with derogation would have to go through the same or very similar procedures. From their perspective, it would be unfair to offer easier entry for others. But it is about more than fairness: it is logical that to have a seat at the ECB, the country must be member of the EU, and pass “Maastricht” or its potential upgrade by that time.

Also, a party to the proposed agreement will have no claim on the ECB's seigniorage (income from issue of euro currency) before EU membership and euro area membership. Still, what the recommended currency agreement offers to applicants and the EU, is important and useful. It will imply membership of the country's monetary authorities in all working groups of the ECB and the Eurosystem, and (non-voting) representation in policymaking forums. Being present in monetary workshops and decision-making bodies is justified in the case of countries where the euro is the legal tender, banks and financial enterprises conduct business in euro, and the common European currency is an organic factor in the economy and society.

Whether such a status promotion in the concerned two country cases would encourage a further step towards a full-fledged euroisation is not certain. Any important economic policy issue should be debated and agreed upon jointly during structured policy negotiations, and based on country-specific recommendations from EU institutions. Arguably, a currency regime of hard peg to euro is reason enough for the country's monetary institutions to be represented (obviously without voting power) in professional, regulatory and policy forums where issues of business and social consequences are debated. A structured policy dialogue between candidates and EU institutions would ease the transition to the euro, and the whole accession process, rather than perpetuating substandard monetary conditions.

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⁶ EU-supported digitalisation has been progressing in the region, and national institutions have embarked on drafting EU-compatible regulations on cash operations as one of the basic criteria towards membership in the SEPA Payments Scheme and access to the EUs fast payments system (Target Instant Payment Settlement), as declared by the governor of Kosovo's central bank (Ismaili, 2024).

⁷ This appeal will increase unless the EU convincingly promises rapid progress within the accession framework (Steinbach, 2024).

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