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Economic Issues in the Western Balkans

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Quick Summary

- The Western Balkan countries are lagging behind EU countries in digitalization. Individual usage of digital technology is deemed high, paving the way for its supply. The lack of infrastructure is the main deficiency in the WB and on individual country level it ranges from inadequate legal frameworks to unsatisfactory long license times for providers. Digital Integration becoming part of the MAP REA is a landmark, however at this stage it is impossible to evaluate its outcomes.
- The Western Balkans has among the highest youth unemployment rates in the world standing at 35%. Youth that are neither in education, training, or employment (NET) comprise a staggering 20%. Labour market measures do not make distinctions between youth in rural and urban areas, or young men and women's needs, without which policies fail to clearly and effectively address unemployment. The demand side for labour expresses dissatisfaction with the supply of skilled individuals.
- Women's activity rate in the WB countries, on average, stands at less than 50%. Increasing the activity rate of women in the labour market not only contributes to gender equality and sustainable growth but also has a direct effect on the economic growth of the individual countries. Lack of part-time initiatives, childcare and elderly care services, and challenging patriarchal mindsets are key issues that need to be tackled.
- Projects in infrastructure and energy, stemming from the Berlin Process, are showing great progress in the preparatory phase as all the countries are meeting the deadlines, however, they exhibit hindrance once the implementation commences. In the implementation phase, countries exhibited technical difficulties such as land expropriation, insufficient fiscal capacities, and lack of administrative capability.
- The Western Balkan's diaspora counts around six million people, yet the WB countries have not made concrete strategies on utilizing diaspora's potential for becoming one of the region's engines of growth. Concretely, countries must gather data on their respective diaspora, their profiles, following with exchanges, creating incentives (e.g. fiscal policies) for investment, and building long-lasting networks.
- Failure to attract foreign direct investment remains one of the leading obstacles to sustainable economic growth in the Western Balkans. Key issues include political instability, weak rule of law, protection of property rights, and inadequate tax policies. The Multi-Annual Action Plan for a Regional Economic Area in WB6 provides concrete steps as the online investment platform which need to be utilized by the WB6 countries as a way of promoting it as a single-market for investment.

Relevance to Regional Reconciliation:

Youth unemployment, combined with a high migration rate of skilled individuals, a digital economy that has potential but is lagging behind in infrastructure, and foreign direct investment which could boost the region's economy, are just some of the myriad of fields where greater cooperation among the Western Balkan countries could ensure the region's prosperity. Identifying common issues, jointly developing action plans, and agreeing on monitoring mechanisms, are the first steps towards cooperation, which then affects reconciliation. Tackling the aforementioned problems without a regional approach would not suffice – because problems, especially in connectivity are dependent on a regional approach, but more importantly are beneficial for all. Further, WB countries have more in common than differences, and tackling common problems, as youth unemployment, and women's inactivity rate, without a regional approach, given their similar context in all countries, would be time deficient. Regional cooperation is not just a mere prerequisite but a win-win situation for all WB countries, as it would allow for utilizing their common potentials.

List of think-tanks and organisations whose research and/or field reports were used for the preparation of this document:

1. Democracy for Development, Prishtina, Kosovo
2. Kosovo Center for Security Studies, Prishtina, Kosovo
3. Group for Legal and Political Studies, Prishtina, Kosovo
4. GAP Institute, Prishtina, Kosovo
5. Riinvest Institute, Prishtina, Kosovo
6. Institute for Development Policy, Prishtina, Kosovo
7. Cooperation and Development Institute, Tirana, Albania
8. European Movement Albania, Tirana, Albania
9. Albanian Center for Economic Research, Tirana, Albania
10. Albanian Socio Economic Think Tank, Tirana, Albania
11. Belgrade Fund for Political Excellence, Belgrade, Serbia
12. Center Public Policy Research, Belgrade, Serbia
13. European Movement Serbia, Belgrade, Serbia
14. European Policy Centre, Belgrade, Serbia
15. Economics Institute, Belgrade, Serbia
16. Institute of International Politics and Economics, Belgrade, Serbia
17. Center for Research and Policy Monitoring, Skopje, North Macedonia
18. European Policy Institute, Skopje, North Macedonia
19. Reactor, Skopje, North Macedonia
20. Analytica, Skopje, North Macedonia
21. Center for Monitoring and Research, Podgorica, Montenegro
22. Tehnopolis, Niksic, Montenegro
23. Institute for Strategic Studies and Prognoses, Podgorica, Montenegro
24. Analitika, Sarajevo, Bosnia & Hercegovina
25. Center for Investigative Reporting, Sarajevo, Bosnia & Hercegovina
26. Western Balkan Civil Society Organizations for Youth Employment Support (consortium)
27. Friedrich Ebert Stiftung

Background to the Topic:

The region currently stands at a critical point, as WB countries can either pursue the momentum ignited by the Berlin Process, halt their progress, or at worst reverse the achievements made thus far. The decision on the way forward and responsibility on the consequences remain within the countries.

Economic growth, creation of new jobs, digitalization, and easier mobility, contribute to the general welfare of the society. The Western Balkans, with economic growth rate reaching 3.8% in 2018, and a projection of 3.7% for 2019–2020, enjoys a growth rate faster than the EU's. However, this has not been reflected in job creation; job creation in WB countries has halved from around 171 thousand jobs created in 2017 to 96 thousand in 2018. Therefore, unemployment rates ought to be taken with a grain of salt considering that their decrease can be attributed to higher emigration and lower activity rate. While, foreign direct investment has been vital for transforming and establishing export-oriented industries, the rate of high growth firms is considered low in comparison to EU countries, where only 1 in 33 exist in North Macedonia, 1 in 20 in Serbia, and 1 in 17 in Albania. Regulatory barriers are the main culprit in this negative trend. Coupled with human capital challenges, such as mismatch between labour skills and market demand, the Western Balkan countries share more similarities than they display differences.

The Berlin Process offers a tangible and vital opportunity for the WB countries to utilize their potential. Advancing their progress on the connectivity agenda, addressing key issues in youth employability and women's inactivity, rebranding as a single market to attract investment, and utilizing its vast diaspora, would make WB not just a potential partner for the EU but rather an integral part of it.

Key Issues

Issue 1:

Lack of Digital Infrastructure for Propelling the Digital Economy

The WB countries have the opportunity to tackle several issues, most importantly lack economic growth, through one vital step – digital transformation. The WB countries, with variation among countries, are severely lagging behind the EU countries. Infrastructure for the digital economy is one of the WB countries' deficiencies, whilst individual usage of digital technology is deemed as positive. The relation between investments in infrastructure and households with internet access is negative. Some of the most notable impediments hindering digital infrastructure development are inadequate legal frameworks, long license times for 4G, building permits, permits for optical cable laying, and the lack of digital payment systems. Combining all the aforementioned issues with low levels of connectivity, fragmented telecommunications infrastructure, and lack of investments due to political uncertainty and instability are making it difficult for the WB countries to catch up. Albania, Bosnia and Hercegovina, and Kosovo are the region's biggest laggards. The larger the share of the population with mobile network access, the more it affects economic growth, and more specifically job creation. Digital transformation affects the economy, governance, and social dimensions. An investment of 100 million euro in broadband infrastructure could induce an increase of gross value added (GVA) ranging from 0.3 to 2.1 percent depending on the country.

Digital Agenda (DA) became part of the Multiannual Action Plan for a Regional Economic Area (MAP). Following DA's inclusion as a pillar of the BP, a meeting of WB countries' high-level representatives was held in Sofia where they reaffirmed their commitment. Afterward, the World Bank produced a feasibility study on developing a broadband connection, where the key recommendation is developing regional broadbands. The Digital Agenda identifies common objectives, derived from a common problem, for WB countries, notably on boosting digital infrastructure, policy harmonization, roaming policies for roaming-free economic areas, cyber security and data protection, and increasing supply of digital skills. The second Digital Summit saw WB countries sign an agreement to remove roaming costs by 2021 which is of great economic as well as political significance. The DA, although hard to tell at this stage, has faced slow implementation where timeframes for 2018 have already been moved to 2019 (e.g. roaming charges).

Issue 2:

Youth Unemployment and Women's Inactivity Impeding Economic Growth

Youth unemployment rates in the Western Balkan countries are among the highest in the world. On a positive note, this trend is declining throughout the years but still stands at alarming rates. Unemployment rates of young people, on average for WB countries, in 2018 were at 35%, which is twice as high as the EU average. More alarmingly, 20% of young people are neither in employment nor attending any education or training (NEET). The data varies from 24% youth unemployment in Montenegro to 55% in Kosovo. Despite the active labour market measures existing in each country, they have not been vital in addressing youth unemployment as the measures do not tackle youth as a separate category, and are hardly measurable due to lack of monitoring and evaluation. Companies on the other hand report lack of skilled individuals. The most vulnerable groups are youth from rural areas where national strategies and mechanisms have failed to reach them. Low labour costs do not constitute Western Balkans' comparative advantage anymore as when productivity is taken into account the level of wages is on par with those of EU member states.

Women's participation rate in the labour market in all Western Balkan countries stands below 50%. Kosovo is the worst case where only 18% of women are active in the labour market. Legal frameworks not recognizing household work as work further diminish the position of women from rural areas. Low activity rates are strongly linked to family obligations. Higher activity rates for women are linked positively with the GDP. The WB countries, in general, lack labour market measures directly targeting inactive women, particularly those from rural areas. Expanding the availability of part-time jobs and childcare services are two avenues for increasing the activity rate. Part-time jobs, childcare services, and measures related to each country's field evidence contribute to enabling higher activity rate among women.

Countries have already established employment agencies; however, lack of visibility, limited regional cooperation between agencies, and absence of information on employment profiles leaves the agencies limited in developing policies (training, courses, grants) to utilize their respective labour force.

Issue 3:

Slow Implementation of Connectivity Projects

One billion euro was allocated in 2015 by the EC until 2020 from the EU IPA funds, for the Connectivity Agenda in the WB. The countries had also adhered to a list of soft-measures, however, they had little progress, where the quarterly monitoring assessment of soft-measure implementation in energy projects shows that, in late 2018, the average implementation score for all WB countries stands at 58%. There is no proper review of soft-measure implementation in infrastructure related projects. The connectivity agenda's aim is deemed as highly incompatible when compared to the actual implementation: whilst there are around ten projects that the WB6 countries have actively undertaken, only a handful have been meeting the estimated timelines, mostly due to lack of administrative capacities, complexities in technical preparations, issues in spatial planning, permits, and to some cases also lack of political will. Despite the issues presented above and specifically the low percentage soft measure application, there is ongoing funding for other projects, whilst a majority of the previous projects are still lagging behind the estimated timelines. Projects hit the bottleneck usually in the technical phase where main problems are associated with spatial and urban plans, the lack of public administration capacities to adhere to the EU standards in regards to the technicalities and functionality of the projects.

On a positive note, given that projects are deemed positive in the preparatory phase, and also with high-level political representatives endorsing the projects, there is certain political will for cooperation. The cooperation is prerequisite for projects, though in practice the lack of cooperation contributes directly to slow implementation. Second, countries show difficulties pertaining to their fiscal capacities and that is also one of the main reasons for delays inland expropriation which adversely affects implementation of projects. Specifically, countries are noted to fail on direct contributions

to the project implementation, compensation to land owners, and loan repayments, which prove to be essential in implementation. Lack of a procedure for data-sharing between the National Investment Committees results in regionally-dependent projects either failing to be selected or when selected failing to have smooth implementation.

Issue 4:

Diaspora and Labour Mobility: Unleashing the Potential

The Western Balkan's diaspora consists of around six million people. The topic of migration is seen as negative by the countries as most of them are struggling to reverse the emigration trend rather than seeking to utilize its potential. Around 10% of the entire population of WB has migrated in the last 30 years. Combining the data on ageing population with the emigrant profile being mostly youth, if the diaspora is not utilized, the countries will face severe problems with unmet labour force demands. The data on WB's diaspora is scarce and unreliable; there are no specifics on the diaspora's education level, training, skillsets, gender, and other variables. Having the data contributes to establishing fruitful networks which then could be used for targeted policies. Targeted policies in these cases would be looking at how can WB countries utilize the potential of highly skilled and talented individuals. Current labour market and development strategies in each of the countries do not consider tapping the potential of the diaspora.

While independent initiatives aimed at encouraging brain gain have cropped up, governments have not formulated concrete plans for attracting skilled workers from abroad. Brain gain and diaspora investments particularly require additional efforts related to conditions (legal and infrastructural), labour supply, and market demand. Remittances represent a significant portion of WB countries' GDP where they range from 3.1% in Macedonia to 15% in Kosovo, relative to the GDP. Heavy reliance on remittances constitutes a potential source of vulnerability for the Balkan economies, particularly should the expectations of gradually decreasing remittances prove true over time. WB countries ought to therefore initiate serious discussions on migration and its implications for their economies, rather than shying away from an open debate, as has mostly been the case to date. Easing labour mobility is more beneficial rather than trying to treat migration as a taboo. EU countries, especially those that benefit from skilled labour, should invest in promoting circular migration (engagement of workers both in country of origin and destination country). The WB countries ought to devise strategies with EU countries that focus on circular migration thereby allowing for a win-win situation.

The dominant political discourse operates with statistics of decreasing unemployment rate. However, the latter can mostly be attributed to high levels of emigration and inactivity, not to a significantly improving economic climate. As emigration continues, the lack of a regional debate on the subject, absence of challenges to the dominant discourse and lack of communication with the diaspora are likely to have dire consequences for the region's economic vitality.

Issue 5:

The Downside of Foreign Direct Investments

The largest investors in the WB region are EU companies, having invested over €10 billion in 2013–2018 alone. The Western Balkans, with its market of 18 million customers, can be considered a viable trading partner. Boosting foreign direct investment (FDI) is, at least on paper, the aim of all WB countries. The FDI could be attracted more efficiently if the WB acts as a single-market thus enforcing coalitionary discipline of modern economics game-theory. The WB faces numerous obstacles to attracting foreign investors, including political instability, weak rule of law, protection of property rights, and inadequate tax policies. Although, at first glance these issues may seem internal, they are quite linked with their level of cooperation and unsolved bilateral issues. Even the dire need for the FDI has failed to bring together key actors to tackle the common issues, despite having a very high potential gain for all.

The average FDI stock per capita in the Western Balkans (€2,600) is quite low compared to the EU level (€6,000). There was a positive trend for all the countries up until 2008. However, the financial crisis had a major effect on losing the momentum. For individual countries, the net FDI to GDP ratio differs, whereas the change from 2017 to 2018, in percentage, is positive for all except Montenegro, whilst North Macedonia leads in percentage. The FDIs are not only dependent on the internal policies but also the region as a whole. Issues as connectivity through transport and energy, disputes, and time consuming, arbitrary customs decisions create disincentives for foreign investors.

Thus far, little has been done to utilize the potential of the Western Balkans to become a single market for investment. Notable progress has been seen on the MAP REA, where there were agreements on developing online investment platforms, and promotion of such platforms, but still there is no joint action plan which comes as a derivative of WB countries themselves. The WB should identify common areas of interest, where cooperation is a prerequisite, and then follow up with concrete policy convergence, followed with a monitoring mechanism to ensure the implementation of said agreements. The WB needs to remove all the barriers to trade in the region, prioritize rule of law, including legal certainty as one of the prerequisites, and refrain from seeing FDI only as a competition between the countries in the region.

Recommendations:

To Decision-makers in the Western Balkans:

1. Accelerate the implementation of the MAP objectives on digital integration. Establish communication between line ministries responsible for implementing the digital agenda, and produce quarterly reports that highlight the progress. Concretely, countries should focus on harmonizing their policies to ensure the deployment of standardized 5G networks, boost digital infrastructure, enhance cyber security and data protection, and develop and strengthen digital skills.
2. Increase the visibility of Employment Agencies as a key institution to linking youth with employment opportunities, and redraft policies to address young men and women, and also youth in urban and rural areas. Invest in childcare and elderly service, and develop nation-wide campaigns to combat deep-rooted patriarchal views in the labour market, as ways of promoting women's labour activity.
3. Establish tracking mechanisms for the projects related to connectivity, where the indicators and data will be shared with the wider public. Develop action plans that analyse the countries lacking administrative capabilities, and develop monitoring mechanisms to ensure that IPA funds are absorbed and used effectively to increase those capacities.
4. Initiate the debate on internal migration by using different communication channels, including information sessions, social media, TV and radio, to better inform the population on circular migration. Develop (voluntary) mechanisms for diaspora collecting professional profiles of its members. Based on the profiles collected, devise action plans on pursuing diaspora investments, brain gain through offering incentives through fiscal policies, rule of law promotion, and competitive skilled labour force, and link with private sector companies for staff exchanges.
5. Create a joint action plan within the region that focuses on branding the Western Balkans as a single market investment. Formal and informal networks between key institutions as Ministries (Economic Development specifically), Employment Agencies, and Statistical Agencies in the regional scale ought to be formed in order to contribute towards developing action plans that direct foreign investment in the region. Accelerate the implementation of MAP REA objectives, namely using appropriate instruments to formalize the regional investment reform agenda, and promote WB6 region as a single-market.

To the EU:

1. Follow up on the Digital Agenda by developing tracking mechanisms that measure each country's respective progress. The tracking mechanisms should be available to the wider public and use data visualization tools to provide for enhanced accessibility, thus also instilling healthy competition between countries.
2. Provide (or update the existing) employability constraints analysis of youth in WB countries, which is thorough in terms of understanding the differences in gender, and settlement type (urban or rural). Throughout the course of the analysis, increase the internal capabilities of WB institutions to conduct such analysis themselves. Use the constraint analysis in designing the twinning and capability enhancement projects under the IPA funds.
3. Develop a formal communication channel that must be transparent to the wider public, to enhance the communication among the National Investment Committees for higher collaboration on developing National Single Project Pipelines. Set floor requirements for soft measure implementation prior to applying to projects related to the area of connectivity, and in cases of infrastructure develop transparent measuring mechanisms for evaluating the soft-measures implementation.
4. Provide assistance on linking diaspora with their respective countries by allocating IPA funds that promote regional cooperation with diaspora, most preferably on enterprise development and innovation. Introduce programmes on circular migration, enabling utilizing WB's high skilled individuals in EU countries, and providing the WB countries with more skilled individuals upon their return.
5. Promote foreign direct investment in WB6 through region-branding as a single market. Utilize the IPA funds directed at regional investment support to include also a dimension of regional promotion for the WB as a single-market investment. Focus on enhancing the rule of law and promote legal certainty to create a business and investment-friendly environment in the Western Balkans.

To member-states:

1. Initiate developing joint strategies with WB countries on promoting circular migration, easing the process of abroad training and courses, aligning labour supply and demands, and developing tailored action plans on utilizing the WB's labour to bring back investment to the countries.
2. Intensify collaboration with the Western Balkans on building training programs, tailored capacity building of young men and women especially in the ICT sector given its growth and demand. Provide funding for childcare and elderly services in order to contribute to increasing women's labour activity rates in the WB.
3. Establish specialized institutions that cooperate with the Western Balkan countries on developing joint strategies on utilizing member states training courses, and seasonal job placements, to enhance the WB's labour force capacities and employability.

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