

## **1. Background**

The Western Balkans has been badly affected by the global economic crisis. The World Bank estimates that the region will grow more slowly than any other region in the world in the period 2010-2013 and that the drivers of growth in the pre-crisis era (capital inflows and strong growth in export markets) are unlikely to return quickly.

Governments throughout the region have taken measures to tackle the crisis and are now increasingly trying to rebalance budgets. In most cases, restrictive fiscal measures including substantial expenditure cuts are being put in place to tackle the budget deficits.

A number of organisations including International Financial Institutions (IFIs), multilateral development agencies and economic think tanks have considered the impact of the crisis on the economies of the Western Balkans and are examining options available to the countries and to and transition economies in general to stimulate economic growth.

Governments in the region are adapting their economic policies to try to deal with the dynamic environment as are various as are different stakeholders in the international community including the EC and IFIs. In particular, the European Commission (EC) is currently programming the next tranche of IPA assistance to the region (2011-2013) and has begun initial preparations for the new budget cycle (2014 – 2020). As a contribution to the decision making process, the EC-financed project *Support to EC and IFI Coordination in the Western Balkans*<sup>1</sup> has recently carried out a review of studies emanating from, the International Monetary Fund (IMF), the World Bank, the European Bank for Reconstruction and Development (EBRD), the Organisation for Economic Cooperation and Development (OECD) and from think tanks or academic circles on the issue of a new growth model for the Western Balkans.

## **2. Summary Findings from Review**

A number of common themes emerge from the various studies and reports that were reviewed by the IFI Coordination Office:

- The crisis has demonstrated the non sustainability of the growth model pursued by the Western Balkan countries in the past, based on domestic demand and capital inflows;
- Capital inflows should be channelled in the future more in the direction of investment in the tradable and exports sectors; the link between exports and innovation should be stressed;
- As debt sustainability has become a more acute problem, macroeconomic policy must aim at recreating fiscal space through appropriate fiscal reforms and expenditure prioritization in a medium term framework;

---

<sup>1</sup> The EC financed project *Support to IFI Coordination in the Western Balkans and Turkey* aims to ensure that adequate and effective coordination takes place between the EC and the IFIs at policy, technical and operational level, thereby contributing to the overall socio-economic development of the beneficiary countries. The project has three main modules: policy advice and coordination, support to investment and financing initiatives, and enhanced communications. The project is implemented by the IFI Coordination Office and builds on previous activities undertaken in this area, most notably the IFI Advisory Group and complements a range of horizontal and sectoral initiatives such as the Western Balkan Investment Framework (WBIF), the Regional Cooperation Council (RCC), the Energy Community Secretariat (ECS), the Regional Environmental Network for Accession (RENA) and the South Eastern Europe Transport Observatory (SEETO).

- Increasing both public and private domestic savings and developing local currency finance, among others through reform of bank regulation, are essential building blocks;
- The emphasis should be on enhancing the productive use, i.e. the productivity of the domestically available resources: as total factor productivity (TFP) is expected to play a less significant role in future growth, the efforts must concentrate on capital deepening and human capital development;
- There is a shift of emphasis from demand to supply: the key in the future will be to enhance competitiveness in the global context, having in mind the need to diversify exports and to be competitive in relation to the new emerging countries. The link between exports and innovation should be stressed, as the advantage of low labour costs will erode;
- There is a need to invigorate trade, integration and export-led growth: this could be achieved among others through removal of remaining non-tariff barriers to trade and deeper integration within CEFTA countries (for instance new arrangements on preferential liberalization of services);
- There cannot be any more complacency towards needed structural reforms: ***the transition agenda must be completed***, including institution building, strengthening administrative capacities, establishment of a predictable and credible regulatory framework, the fight against crime and corruption. Further progress in taking on board the *acquis communautaire* as part of the EU accession process can provide an essential stimulus in this connection;
- Improving the business environment is the cornerstone of the post-crisis reform agenda; besides, governance, the rule of law and the quality of the regulatory framework, labour reform, the enhancement of skills through education reform and the stimulation of R&D are the most important factors;
- SME development is also a recurring theme with particular concern regarding SME access to finance and technical assistance; in the recent crisis, all too often, the SMEs have been the first to see their access to credit being curtailed. SMEs have a key role to play not only in employment generation but also towards more balanced, innovative and diversified exports;
- Infrastructure is increasingly perceived as one of the most significant constraints to growth through its impact on the business environment. Investing in infrastructure is therefore a key component of any new growth agenda; and
- Given the limitations of public borrowing capacity, encouragement should be given to formulas such as PPPs, which are still difficult but not impossible to implement in the Western Balkan context.

Overall it can be said that to a large extent the new growth agenda is a revised and reinforced version of the old agenda of structural reforms, adding to it an even greater sense of urgency.

This reinforced agenda can also be framed in terms of the *Europe 2020 Agenda* as it also seeks to achieve smart, sustainable and inclusive growth. Thus the EC's request to the Western Balkan countries to emulate as appropriate *Europe 2020 Agenda* is highly relevant.

Many of the issues that need to be addressed as part of the revised agenda lend themselves to regional cooperation among the Western Balkan countries, the most obvious areas being infrastructure and reinvigorating the regional trade agenda.

### 3. **Europe 2020 - The Western Balkan Version?**

#### **Europe 2020**

As a system of governance for reforms, grouped in seven flagship initiatives<sup>2</sup>, Europe 2020 operates in two dimensions. The internal dimension commits member states to prepare a comprehensive set of reform within a national reform programme. The external dimension is built on the importance of engagement with external partners, in areas where cross-border effects can endanger internal policy goals. It therefore calls for strategic dialogue on global imbalances, energy and climate change, access to raw materials, global poverty, education and development. Enlargement policy extends elements of the internal market to accession countries before actual accession and, at the same time, brings other policies (e.g. transport, energy infrastructure) closer to EU norms. The enlargement process contributes to the objectives of the Europe 2020 strategy by extending the area of the *EU's regulatory framework and creating new trading opportunities*.

The *Europe 2020 Communication*<sup>3</sup> encourages beneficiary countries to adapt and adopt relevant headline targets of Europe 2020<sup>4</sup> as critical to achieve the smart, sustainable and inclusive growth<sup>5</sup>. The countries are invited to organise their work on the *Europe 2020* related issues in regional groups.

### 4. **Some Issues for Consideration**

*At the national level, some enlargement countries have developed their own responses to Europe 2020. What are the implications of the findings of the **Report on a new growth model for the Western Balkan countries**' efforts to work towards the Europe 2020 Agenda?*

#### **Regional Initiatives**

The enlargement strategy 2010-11 called upon enlargement countries to pursue some *Europe 2020* initiatives in regional groups/initiatives. Within these groups they can develop targets, which respond to their economic reality and apply forms of governance, which are less demanding than the rules for member states and more appropriate for their level of transition. A number of regional initiatives are already active in areas that are identified as priorities for *Europe 2020*.

*How to bring these and other regional initiatives closer to policy objectives (smart, sustainable and inclusive growth) and working arrangements of the Europe 2020 strategy in terms of their objectives and activities for the next three years?*

*How can the respective initiatives contribute to smart, sustainable and inclusive growth and how can they complement national efforts?*

*How to ensure a regional political commitment that is maintained throughout the process?*

---

<sup>2</sup> Digital agenda for Europe, Innovation Union, Youth of the move, Resource efficient Europe, An industrial policy for the globalisation era, An agenda for new skills and jobs and European platform against poverty.

<sup>3</sup> Europe 2020: A European Strategy for smart, sustainable and inclusive growth - <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:2020:FIN:EN:PDF>.

<sup>4</sup> Employment: 75% of the 20-64 year-olds to be employed; R&D / innovation - 3% of the EU's GDP (public and private combined) to be invested in R&D/innovation; Climate change: energy greenhouse gas emissions 20% (or even 30%, if the conditions are right) lower than 1990, 20% of energy from renewables, 20% increase in energy efficiency; Education: reducing school drop-out rates below 10% at least 40% of 30-34-year-olds completing third level education; and Poverty / social exclusion: at least 20 million fewer people in or at risk of poverty and social exclusion.

<sup>5</sup> Smart growth: developing an economy based on knowledge and innovation; Sustainable growth: promoting a more efficient, greener and more competitive economy; and Inclusive growth: fostering a high-employment economy delivering social and territorial cohesion

*How can progress in the region be monitored and publicised?*

*What role should the RCC play in supporting countries' efforts to work towards tailored Europe 2020 goals?*

***External Support for Regional Initiatives:***

Regional sectoral agreements such as the Energy Community Treaty, the MoU on the Core Transport Network (to be replaced by the Transport Community Treaty) and CEFTA 2006 provide mechanisms for providing assistance and monitoring progress in different sectors. There are also a number of regional programmes funded by the EC, IFIs and bilateral donors that operate across a range of sectors providing technical and financial assistance to improve the overall regulatory and legislative climate and to support specific investments.

The most recent example is the Western Balkan Investment Framework that can expedite major infrastructure investments and ensure that they are in line with overall sectoral policies (where they exist). The WBIF is currently active in the energy, environment, transport and social infrastructure field and will shortly expand to cover energy efficiency and private sector development.

Given the overall objectives of Europe 2020 and the specific needs of the Western Balkans are there particular areas where external assistance can support regional initiatives – politically, technically and/or financially?