



Perspectives on Western Balkans Economic Integration

ICG Research Policy Paper
December 2021

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Introduction

Western Balkans economies find themselves in a prolonged process of negotiations for accession in the European Union. Amidst the commitment to progress and fulfill enlargement criteria, governments face challenges from a mounting pressure in public finances resulting from post-pandemic recovery packages and an increasing sovereign debt for the last decade. Undertaking fiscal discipline and consolidating economic governance frameworks could be the place to start a set of reforms.

In parallel, the regional economic integration Agenda being pushed also from semi-spontaneous initiatives such as the Open Balkans should be boosted from an organic economic integration of the real productive sectors that contribute to grow and in the same time allow creation of synergies across the region. Integration of key industries of the Western Balkans through respective top successful firms into European Value Chains could be a realistic approach to work towards regional economic integration and prepare the case for EU membership.

Implementing Economic Governance Framework in Western Balkans Six

Sound public finances remain a precondition to be met by the Western Balkans Six (WB6) countries, in order to seriously engage in the Enlargement agenda by actively contributing into a national and regional context. In this light, success in implementing economic governance agenda of Economic Reform Programs (ERPs)¹, as a proactive integrated framework of rules aimed to ensure macroeconomic stability and economic policies convergence in the Western Balkans economies is of a paramount importance. From the European Commission's Progress Reports² perspective seen under the loupe of Economic Convergence Criteria, countries of the Balkans neighborhood face similar economic challenges. These consist in: (i) developing a functioning market economy, (ii) reducing budgetary deficit and sovereign debt, (iii) smooth

¹"Assessments of 2021-2023 Economic Reform Programmes of Albania, the former Yugoslav Republic of Macedonia, Montenegro, Serbia, Turkey, Bosnia and Herzegovina and Kosovo", EC 2021

https://ec.europa.eu/neighbourhood-enlargement/enlargement-policy/policy-highlights/economic-governance_en

²latest of October 2021. Please refer to EC Staff Progress Reports.

https://ec.europa.eu/neighbourhood-enlargement/enlargement-policy/strategy-and-reports_en

present fiscal imbalances and, (iv) enhance macroeconomic stability through implementing effective macro-fiscal economic reforms. Lowering sovereign debt under 60 percent of GDP, increase in public revenues and decrease of budgetary deficit to meet the 3 percent criteria are necessary steps towards further fiscal consolidation. This would enable WB6 Governments to have room for maneuvers in support of concrete Enlargement Agenda joint actions aiming to build closer infrastructural ties in the Region.

Table: Public Finances Indicators (as % of GDP)

	Albania	Bosnia and Herzegovina	Kosovo	FYR Macedonia	Montenegro	Serbia
Total Revenues	27.3	41.5	27.3	43.3	29.6	41.4
Total Expenditures	34.0	44.8	32.1	48.3	35.6	47.9
Sovereign Debt	81.4	38.9	25.7	93.4	52.9	59.8
Current Deficit	8.6	3.8	7.8	20.9	2.0	4.0

Source: IMF World Economic Outlook Database October 2021

Economic governance framework adoption strategy should be considered the opportunity of Western Balkans Six countries to accelerate the pace of convergence in the European integration process by enhancing prudent designation of budgetary and economic policies. Sound public finances are at the forefront of macroeconomic fundamentals needed to create conditions for solid and sustainable development, faster economic growth, boost employment, develop an enabling environment for innovation and enterprise in the private sector as well as increase confidence in foreign investors to start considering Western Balkans a safe vibrant growing emerging market³. Regional integration contributes to an equalization of fundamentals: i.e. costs of production throughout WB6. Completing this by policy coordination makes the WB6 area a homogenous market.

The economic integration agenda as a joint commitment to grow regional cooperation beyond joint coordination of economic and budgetary reforms serves to pave the way towards the creation of a regional common market through closer infrastructural ties, energy connectivity,

³ "Economic Governance in the Region: How does it affect Western Balkans and the EU Integration Process?" *Arlind Rama, Center of Excellence MFA Policy Papers Series, May 2016*

http://www.excellence.al/sites/default/files/Policy_Paper_Arlind_Rama_Final_11maj.pdf
http://www.excellence.al/sites/default/files/Policy_Paper_Arlind_RamaFinal.pdf

labor mobility, further trade facility and experience sharing in the Western Balkans. In this line, success in implementing the Economic Governance framework in the Western Balkans Six countries would provide the much-needed macro-fiscal stability for strategically projecting the Balkans of the future.

Value Chains as an economic dimension of Regional integration

European integration process in itself, more than a saga of legal-economic reforms and approximations, should be perceived as a socio-economic evolution of WB6 countries within an inter-correlated system of EU value creation standards. In this outlook, Enlargement Agenda should seek to explore new dimensions of Region's economic integration into the EU through designing mechanisms for recognizing present WB6 economic potential and develop by exploring it in compliance with EU's mid-to-long term demands.

A potential alternative worth elaborating in an EU economic integration perspective would be the embedding of WB6 economies into European Value Chains. By definition, Value Chains represent a full range of activities that are required to bring a product from its conception, through its design, its sourced raw materials and intermediate inputs, its marketing, its distribution and its support to the final consumer. Value chain goes much further than the buyer-seller relationship based on and managed by market institutions. It involves shared development plans, long term relationship, heavier investments, regular and meaningful technology transfer, trust, strict quality controls & safeguards, and in general a more committed partnership. In this regard, European value chains represent a safe path for sustainable growth and development of WB6 SMEs and large producers that aim to expand their business activity through orienting their production capacities in line with EU markets demand. Moreover more important than the market, is the long-term relationship that WB6 SME are expected to establish with EU companies. We expect a trickle down effect from EU companies to WB6 ones in terms of quality, technology transfer, continuity of production, development of workforce and industrial relationship.

The concept foresees specialized development of key economic production sectors in WB6 and making them competitive in terms of cost and quality standards in compliance with EU quality standards. A certain growth path would guarantee local producers long-term trade contracts in

response to European Value Chains needs. As it takes two to tango, local producers' investments in capacity building and production technology upgrading processes ought to be competitively projected in compliance with price-quality equilibrium standards demanded by European contractors. This means that WB6 economies would engage in a "catching up" process seeking to meet quality standards of production and services that would gain producers eligibility and eventually access into European and Global Value Chains.

Benefits of WB6 economies "in" the European Value Chains

Depicting potential benefits of Western Balkans' economies inclusion in European Value Chains is possible to envisage growth horizons for local producers and the Region as one. Under specific demands from European and Global value Chains operators, WB6 producers would expand and diversify existing production base in order to increase their offer. They will invest in human resources and technology to increase the value added conduct of their production activity. This would develop closer business ties with EU giving a boost to EU-Western Balkans Six trade exchange but also provide prolific grounds for increasing intraregional trade volumes. A regional network of sub-subcontractors will profit from the trickle down effect. By producing for the same market, the WB6 companies will tend to move towards inclusion same chain values, hence using same standards and quality benchmarks. Hence, these countries would benefit from aggregate growth of exports and the positive spillover effects in developing domestic production capacities by building dynamic capabilities to serve to the integration into European Value Chains and putting domestic industry into a growing trajectory of profitability

Inclusion of WB6 Small Medium Enterprises and local producers into European Value Chains means forging access to large international and global markets by allowing them to develop proper conditions for economy of scale that would be reflected in minimizing costs and significantly improving efficiency in delivering value. Inward Foreign Direct Investments flows in the Region are expected to heighten⁴ if this vision is followed by long-term agreements to

⁴ "Global Value Chains and Development, Investment and value added trade in the global economy" – UNCTAD Report 2013

http://unctad.org/en/PublicationsLibrary/diae2013d1_en.pdf

export value through large value chains participation. An enabling business environment in support of embedding WB6 producers in international value chains would enhance regional cooperation and essentially contribute in upgrading welfare and social cohesion in the Balkans neighborhood by increasing productivity and in finale fostering structural transformations and sustainable economic growth.

Challenges

In point of fact, integration into value chains does not depend only from the “willingness” of global firms to cooperate with local producers aiming to export value to larger markets, more it is an issue of readiness and capability to compete through quality standards and price. At present, numerous challenges lay ahead Western Balkans Six suppliers hampering their progress in the Value Chains integration roadmap:

- Lack of highly skilled workforce that gets reflected in inefficient production operations chains with weaknesses resulting in low levels of productivity, scarce use of their human resources and waste of materials and inputs that prevent firms from supplying intermediate inputs at world-competitive prices.
- Missing technology and innovation trends. Firms have much to gain by adopting new technologies in response to latest innovation trends but knowledge absorption is always an issue when capacity building is still not a priority for WB6 producers. Small production scales and narrow profit margins of firms prolong the recovery period of any fixed costs of investment and make it difficult to focus on processes and organizational innovation that would increase firms’ productivity by reducing production costs.
- Quality and product certification based on international standards. Certification of quality and products and compliance with international standards are another relevant challenge for WB6 suppliers to participate in Value Chains. Competitive pressures in global markets require firms to produce at world-class standards of quality in order to gain the ‘Carte blanche’ to enter.

- Trade-infrastructure and Enlargement obstacles. It is known the paramount importance of good Enlargement and efficient trade infrastructure in defining the ability of countries to join and empower participation in Value Chains. Key factors in determining the costs of sourcing from and supplying to European markets. In this concern, the Enlargement Agenda is seen as a remedy in over-passing Enlargement barriers and playing a vital role in bringing WB6 closer to the EU common market.

If the abovementioned challenges are to be addressed effectively from the side of Western Balkans firms and policy-makers, then necessity of demand by growing global operators would simply be a determinant to integrate these economies 'in' the European Value Chains.

Aligning the policy approach

With EU as main trading partner, prime origin of foreign direct investments and with determinants of success ranging from productive capacity to infrastructure and services, to the business environment, to the assurance of efficient trade and good Enlargement overall, Western Balkans economies ambition to further tighten linkages with EU market and Value Chains can be considered a rationale. Coordination and harmonization of policies under the Commission's directives is crucial for improving cross-border cooperation and further integration of the Region's economies into Value Chains.

By design, economic policies in the Western Balkans Six should aim to create an enabling environment for EU companies to find local firms and establish long-term relations. This may take the form of public aid covering the "sunk costs" that an EU company incurs when investing in a local value chain.

Second, local firms must be exposed to and supported to go beyond market-bound contracts and establish long-term relationship. This kind of business behavior change is very difficult especially for SME that need to adopt modern management rules. They need to conceive viable opportunities to help them exploit production growth potential.

Third, SMEs should encourage capacity building of workforce in line with technical skills needed to make use of latest production technologies, create funding schemes that would allow SMEs to increase significantly production capacities benefiting from higher availability of financing and lower costs and in parallel set regulatory frameworks that would standardize quality of production in full compliance with EU requirements.

Fourth, public authorities should continue the trade-facilitation agreements both intra-regional among WB countries and with EU in order to minimize trading costs and enable incremental efficiency in trade exchanges under the strategic aim of reaching access into European Value Chains.