OECD Development Pathways

Multi-dimensional Review of the Western Balkans

ASSESSING OPPORTUNITIES AND CONSTRAINTS

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Foreword

Economic growth matters, but is just one facet of development. Policy makers are required to reconcile economic, social and environmental objectives to ensure that their country's development path is sustainable and that the lives of its citizens improve. At the same time, the achievement of economic, social and environmental objectives needs strategies for reform that factor in the complementarities and trade-offs across policies.

The OECD Multidimensional Reviews (MDR) provide governments in the Western Balkans (Albania, Bosnia and Herzegovina, Kosovo[*], North Macedonia and Serbia)[1] with concrete policy advice for their development strategies. They identify the main constraints to more equitable and sustainable growth, and propose priorities for policy intervention. The MDR of the Western Balkans supports the region in identifying key constraints to development and strategic policy priorities for the next decade.

The MDR of the Western Balkans is composed of two parts: Assessing Opportunities and Constraints, and From Analysis to Implementation. The approach aims at the co-creation of reforms that respond to region's specific challenges and opportunities, and comes with guidance on implementation. This report concludes the first part of the project: Assessing Opportunities and Constraints for Albania, Bosnia and Herzegovina, Kosovo, North Macedonia and Serbia. The process conjugates expert policy analysis with participatory approaches including "Visioning" workshops that involved actors from the private and public sectors, civil society, and academia. Analytical work is based on statistics about individual well-being as well as macro- and micro-economic performance at the central, local, sectoral, household and firm levels. Both domestic and international sources are used.

Benchmarking and comparison of results and experiences with other countries is a key element of the OECD method. For each MDR, a set of comparator countries is designed to include regional peers, countries from other regions with similar structural characteristics and OECD members. Depending on data availability, the Western Balkan economies are compared with three groups of benchmark countries: 1) Organisation for Economic Co-operation and Development (OECD) countries (Costa Rica, Czech Republic, Greece, Slovak Republic, Slovenia and Turkey); 2) non-OECD EU countries (Croatia and Romania); and 3) countries in neither the OECD nor the European Union (Kazakhstan, Morocco, Philippines and Uruguay). The report also includes regional averages for the Western Balkans and OECD and EU members. The selection of benchmark economies is based on historical similarities, including their paths towards EU integration, and on economic structures, geographical proximity and mutual partnerships. The selection of non-OECD economies is based on similar economic and social challenges (such as high migration rates), shared history as transition economies and similar development patterns.

[*] This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Opinion of the International Court of Justice on Kosovo's declaration of independence.

[1] In addition to the economies covered by this project, the Western Balkan region also includes Montenegro. Depending on the data availability, Montenegro is included in the benchmarking analysis throughout the report and contained in calculated averages for the region.

The assessment in this report builds on the five pillars of the Sustainable Development Goals: People, Prosperity, Partnerships, Planet and Peace. For each of these dimensions, strengths and constraints, as well as trends that could create opportunities or hamper future progress are identified. The objectives of this report are twofold: first, to identify strategic priorities of relevance for the whole region as the focus for peer learning; and second, to serve as inputs for the development strategies and plans currently under development in the region, as well as for the region's many co-operation partners as they devise their support.

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The review was produced under the guidance of Mario Pezzini, Director of the OECD Development Centre and Special Advisor to the OECD Secretary-General on Development. The review was led and co-ordinated by Jan Rieländer, Head of Country Diagnostics and Strategy, together with Gorazd Režonja, Policy Analyst. The report was drafted by Jan Rieländer, Juan de Laiglesia, Gorazd Režonja, Lara Fleischer (OECD WISE), Diana Hanry-Knop, Kerstin Schopohl and Andrea Colombo (OECD Development Centre), and Marija Kuzmanović (external consultant). The analytical and drafting work for all the economy chapters was co-ordinated by the staff of the OECD Development Centre. Diana Hanry-Knop co-ordinated the work for Albania, Gorazd Režonja the work for Bosnia and Herzegovina, Jan Rieländer the work for Kosovo, Andrea Colombo the work for North Macedonia, and Juan de Laiglesia the work for Serbia. Vararat Atisophon, Kate Chalmers, Lucie Fourel and Nishtha Jain (OECD Development Centre) provided superb statistical and research support. Secretarial assistance was provided by Myriam Andrieux (OECD Development Centre).

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Editorial

The Western Balkans have come a long way over the last two decades, achieving significant economic and social progress, leading to poverty reduction and improved living standards. Geographical proximity to important European markets and production networks, and the ongoing integration with the European Union (EU) have offered additional opportunities for the region to attract international investment, boost competitiveness, develop attractive tourism destinations, and strengthen democratisation processes. In the decade leading up to the global financial crisis in 2008, most regional economies experienced dynamic growth and financial sector expansion. However, the crisis was followed by much more subdued economic performance. Moreover, deep-seated social, institutional and environmental challenges in the region remain pressing. Therefore, the region stands to benefit from more in-depth multilateral engagement and regional collaboration. Innovative solutions will be key to address the challenges ahead and to set the basis for more inclusive and sustainable development.

The first of its kind dedicated to a region, the Multi-dimensional Review of the Western Balkans combines the assessments of five economies, with visions of what may constitute future successes, elaborated through a series of aspirational foresight workshops.

Education and competences for economic transformation emerge as the top priority at the intersection of people’s aspirations for quality of life and the need to address untapped development opportunities for more prosperity in the region. Second comes social cohesion as both an opportunity and a significant challenge for all societies in the region. A lack of jobs leaves many on the side-lines of society and strains citizens’ ability to support each other, while rendering the mostly contribution-based social protection systems unsustainable and under-dimensioned. Third, energy and excessive air pollution must be addressed. A cleaner environment is a top desire among citizens and crucial to making the region an attractive place to live, invest and return to. Given the small size of each economy and the variation in their endowments in terms of natural resources and energy opportunities, a resilient, climate-friendly and high-performing energy mix only seems attainable at the regional level.

As the COVID-19 crisis continues to demand counter cyclical responses, identifying strategic priorities has become more urgent than ever to ensure that resources are well spent. The shared strategic opportunities and challenges presented in the Multi-dimensional Review of the Western Balkans can help deliver solutions and play a part in making recovery spending as strategically effective as possible.

This report is a multidisciplinary effort. It mobilises and combines economic, social, statistical, environmental and institutional expertise from across the OECD. It was prepared in close collaboration with the governments from the Western Balkans and with the financial support of the Swedish International Development Co-operation Agency.

Mario Pezzini
Director of the OECD Development Centre
Special Advisor to the OECD Secretary General on Development

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Abbreviations and acronyms

ACA	Agency for Prevention of Corruption (formerly Anti-Corruption Agency)
AIDS	Acquired immunodeficiency syndrome
ALL	Albanian lek
ALMP	Active labour market programmes
AMMK	Kosovo Environmental Protection Agency
APIK	Agency for the Prevention of Corruption and Coordination of the Fight against Corruption
ATF	Anti-Corruption Task Force
BAM	Bosnia and Herzegovina convertible mark
BEEPS	Business Environment and Enterprise Performance Survey
BHAS	Agency for Statistics of Bosnia Herzegovina
BIRN	Balkan Investigative Reporting Network
BRD	Balanced Regional Development
BTI	Bertelsmann Transformation Index
BTX	Benzene, toluene and xylene
CATI	Computer-assisted telephone interviews
CAW	Computer-assisted web surveys
CBD	Convention on Biological Diversity
CEC	Central Election Commission
CEE	Central and Eastern Europe
CEFTA	Central European Free Trade Agreement
CEO	Chief executive officer
CEPEJ	Council of Europe European Commission for the efficiency of justice
CLRA	Congress of Local and Regional Authorities
CMC	Crisis Management Centre
CoE	Council of Europe
CPI	Transparency International Corruption Perception Index
CSAC	Commission for State Aid Control

DALY	Disability-adjusted life years
DIOC	Database on Immigrants in OECD and non-OECD Countries
DRR	Disaster risk reduction
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
ECE	Early Childhood Education
EEA	European Environment Agency
EFPIA	European Federation of Pharmaceutical Industries and Associations
E-GDDS	Enhanced General Data Dissemination System
EIB	European Investment Bank
EM-DAT	Emergency Events Database
ENTSO-E	European Network of Transmission System Operators for Electricity
EPS	Elektroprivreda Srbije
ERA	LGBTI Equal Rights Association for Western Balkans and Turkey
ERC	Energy and Water Services Regulatory Commission
ERP	Economic Reform Programmes
ESPN	European Social Policy Network
ETF	European Training Foundation
EU	European Union
EUR	Euro
FAO	Food and Agriculture Organization of the United Nations
FBA	Folke Bernadotte Academy
FDI	Foreign direct investment
FIS	Federation of Bosnia and Herzegovina Institute for Statistics
FSA	Financial social assistance
GBV	Gender-based violence
GDP	Gross domestic product
GEF	Global Environment Facility
GHG	Greenhouse gas
GMI	Guaranteed minimum income
GNI	Gross national income
GRB	Gender-responsive budgeting
GSO	General Statistic Office
GVC	Global value chains
HEAL	Health and Environment Alliance

HIF	Health Insurance Fund
HJPC	High Judicial and Prosecutorial Council
IAWD	International Association of Water Supplies Companies in the Danube Rive
ICT	Information and communication technology
IEA	International Energy Agency
IEQE	Institute for Education Quality and Evaluation
IHME	Institute for Health Metrics and Evaluation
ILO	International Labour Organization
IMF	International Monetary Fund
INSTAT	Institute of Statistics
IPA	Instrument for Pre-Accession Assistance
IPU	Inter Parliamentary Union
IREX	International Research & Exchanges Board
ISCED	International Standard Classification of Education
ISO TS	International Organization for Standardization Technical Specification
IT	Information technology
ITU	International Telecommunication Union
IUCN	International Union for Conservation of Nature
JAC	Justice Appointments Council
KAS	Kosovo Agency of Statistics
KCA	Kosovo Cadastral Agency
KLGj	High Judicial Council
KLP	High Prosecutorial Council
KPA	Kosovo Property Agency
KPK	Independent Qualification Commission
LCU	Local currency unit
LFS	Labour Force Survey
LGBTI	Lesbian, gay, bisexual, transgender and intersex
LSG	Local self-governments
MCO	Municipal Cadastral Office
MDR	Multi-dimensional Review
MEI	Ministry of European Integration
MICS	Multiple Indicator Cluster Survey
MP	Member of parliament
MW	Megawatt

NAES	National Agency for Employment and Skills
NAIS	National Agency for Information Society
NALAS	Network of Associations of Local Authorities of South East Europe
NARD	National Agency for Regional Development
NCAC	National Coordinator for Anti-Corruption
NDC	Nationally Determined Contribution
NDP	National Development Plan
NDS	National Development Strategy
NECP	National energy and climate plans
NEET	Not in education, employment or training
NERP	National Emissions Reduction Plan
NPAA	National Programme for the Adoption of the Acquis
NPISH	Non-profit institutions serving households
NPL	Non-performing loan
NSDI	National Strategy for Development and Integration
NSS	National statistical system
ODA	Official development assistance
ODIHR	Office for Democratic Institutions and Human Rights
OECD	Organisation for Economic Co-operation and Development
OHCHR	Office of the High Commissioner for Human Rights
OOP	Out-of-pocket
OPM	Office of the Prime Minister
OSCE	Organization for Security and Co-operation in Europe
PHC	Primary health care
PISA	Programme for International Student Assessment
PM	Particulate matter
PoE	Power over Ethernet
PPP	Public-private partnership
PPP	Purchasing power parity
PPS	Public Policy Secretariat
PRD	Protection and Rescue Directorate
RCC	Regional Cooperation Council
RCP	Representative concentration pathway
RED	Regional Education Directorate
REDA	Regional Economic Development Agency

REK	Mining and Energy Combine
RICYT	Ibero-American and Inter-American Network of Science and Technology Indicators
RSD	Serbian dinar
RSIS	Republika Srpska Institute of Statistics
SAP	Stabilisation and Association Process
SCTM	Standing Conference of Towns and Municipalities
SDG	Sustainable Development Goals
SEA	Strategic Environmental Assessment
SEC	Social and Economic Council
SEPA	Serbian Environmental Protection Agency
SIGMA	Support for Improvement in Governance and Management
SME	Small and medium enterprises
SOE	State-owned enterprises
SORS	Statistical Office of the Republic of Serbia
SSO	State Statistics Office of North Macedonia
STEM	Science, technology, engineering and mathematics
STEP	Skills Toward Employment and Productivity
TAP	Transadriatic pipeline
TB	Tuberculosis
TFP	Total factor productivity
TPES	Total primary energy supply
TVET	Technical and vocational education and training
UCLG	United Cities and Local Governments
UIS	UNESCO Institute for Statistics
UK	United Kingdom
UN	United Nations
UNDP	United Nations Development Programme
UNECE	United Nations Economic Commission for Europe
UNEP	United Nations Environment Programme
UNEP-WCMC	UN Environment Programme World Conservation Monitoring Centre
UNESCO	United Nations Educational, Scientific, and Cultural Organization
UNFPA	United Nations Fund for Population Activities
UNICEF	United Nations International Children's Emergency Fund
UNIDO	United Nations Industrial Development Organization
UN IGME	United Nations Inter-agency Group for Child Mortality Estimation

UNODC	United Nations Office on Drugs and Crime
UNSD	United Nations Statistics Division
UNU-WIDER	United Nations University-World Institute for Development Economics Research
US	United States
USAID	United States Agency for International Development
USD	United States Dollar
VAT	Value-added tax
VET	Vocational education and training
WEF	World Economic Forum
WFD	Westminster Foundation for Democracy
WHO	World Health Organization
WTO	World Trade Organization
WTTC	World Travel & Tourism Council
YLL	Years of life lost

Facts and figures of the Western Balkans

People: Towards better lives for all								
	Albania	Bosnia and Herzegovina	Kosovo	Montenegro	North Macedonia	Serbia	Western Balkans	OECD members
Population (millions)	2 854 191	3 301 000	1 788 878	622 028	2 083 459	6 945 235	17 594 791	1 360 092 863
Aged 0 to 14 (% of population)	17.4	14.7	-	18.2	16.4	15.5	-	17.1
Age 65+ (% of population)	14.2	17.2	-	15.4	14.1	18.7	-	17.8
Life expectancy at birth (years)	78.6	77.4	72.5	76.9	75.8	75.7	76.1	80.7
Income inequality (Gini index: disposable income)	38.4 (2012)	39.2 (2015)	28.2**	29 (2014)	33.6 (2016)	33.6 (2017)	-	-
Unemployment rate (% of total labour force)	11.5	15.7	25.7	15.1	17.3	10.4	15.9	5.8
Labour force participation rate (% of total population aged 15 to 64)	69.6	57.7	38.8	66.3	66.1	67.6	61.0	75.0
NEET rate	30.3	21.2	32.7	15.7	23.1	17.5	23.4	13.1
Vulnerable employment, total (% of total employment)	51.2	19.1	-	13.3	17.2	24.3	-	12.8
Education outcomes: PISA 2018 score (average of reading, mathematics and science)	420	402	361	422	400	442	408	488
Share of women in parliament (% of seats in national parliaments)	29.5	21.4	32.5	28.4	39.2	37.7	31.4	30.5

Prosperity: Boosting productivity								
	Albania	Bosnia and Herzegovina	Kosovo	Montenegro	North Macedonia	Serbia	Western Balkans	OECD members
GDP in current USD billion	15.3	20.0	7.9	5.5	12.7	51.4	112.9	53 581.3
GDP per capita, PPP (constant 2017 international USD)	13 680	14 875	11 402	21 534	16 607	18 292	16 065	46 047
Exports of goods and services (% of GDP)	31.6	40.1	29.2	43.7	62.3	51.0	43.0	54.2
Imports of goods and services (% of GDP)	45.3	55.2	56.3	64.8	76.5	61.0	59.9	50.5
Current account balance (% of GDP)	-8.0	-3.1	-5.6	-15.1	-3.3	-6.9	-7.0	1.3
Net FDI inflows (% of GDP)	7.9	1.9	3.6	7.6	4.4	8.3	5.6	1.8
Personal remittances received (% of GDP)	9.6	11.2	15.8	10.5	2.5	8.2	9.6	0.9
Fixed broadband subscriptions (per 100 people)	15.1	22.6	-	28.5	21.8	18.5	-	33.6
Partnerships and financing: Sustainably financing development								
	Albania	Bosnia and Herzegovina	Kosovo	Montenegro	North Macedonia	Serbia	Western Balkans	OECD members
General government revenue (% of GDP)	27.4	41.8	26.8	42.2	29.6	42.1	35.0	39.6
General government total expenditure (% of GDP)	29.4	40.4	29.6	44.8	31.6	42.1	36.3	40.3
General government gross debt (% of GDP)	66.7	33.3	18.2	81.1	40.7	52.7	48.8	65.8
Domestic credit to the private sector (% of GDP)	34.4	58.1	46.5	49.0	51.5	42.0	46.9	95.1
Tax revenue (% of GDP)	18.3	20.1	23.1*	36.5*	24.1	24.1	30.6*	34.3*
Peace and institutions: Strengthening governance								
	Albania	Bosnia and Herzegovina	Kosovo	Montenegro	North Macedonia	Serbia	Western Balkans	OECD members
Intentional homicides (per 100 000 inhabitants)	2.3*	1.2*	2.4*	2.2*	1.2*	1.2*	1.8*	2.8

	Albania	Bosnia and Herzegovina	Kosovo	Montenegro	North Macedonia	Serbia	Western Balkans	OECD members
Corruption perceptions index[1]	35	36	36	45	35	39	38	67
BTI ranking 2020	28	53	50	21	22	26	33	-
% of population who feel safe walking alone at night	63	70	75	79	68	79	72	73[2]
Planet: Conserving nature								
	Albania	Bosnia and Herzegovina	Kosovo	Montenegro	North Macedonia	Serbia	Western Balkans	OECD members
Land area (1 000 km^2)	27.4*	51.2*	10.9**	13.5*	25.2*	87.5*	215.6*	35 586*
Forest area (% of land area)	28.8*	42.7*	45.0(2012)	61.5*	39.7*	31.1*	41.5	35.3*
CO_2 emissions from fuel combustion per capita (tonnes)	1.5**	6.4**	4.5**	3.5**	-	6.6**	-	8.9**
Fine particulate matter concentration (PM2.5 µg/m^3), mean annual exposure	18.6**	28.6**	24.8***	22.3**	33**	25.1**	25.7**	12.5**

Notes: NEET = not in employment, education or training, PISA = Programme for International Student, FDI = Foreign Direct Investment, BTI = Bertelsmann Transformation Index. Indicators are based on 2019 data. Data are for 2019 or latest available year: in particular, * for 2018, ** for 2017, *** for 2015.

1. Index ranges from 0 (highly corrupt) to 100 (not corrupt).
2. Exclude the Czech Republic (the data are until 2018).

Source: Authors' calculations based on various sources; World Bank (2021), *World Development Indicators* (database), https://www.iea.org/data-and-statistics; IMF (2021), *Fiscal Monitor*, https://data.imf.org/?sk=388dfa60-1d26-4ade-b505-a05a558d9a42; Kosovo Agency of Statistics (2020), *Kosovo Agency of Statistics* website, https://ask.rks-gov.net/en/kosovo-agency-of-statistics; Transparency International (2019), Corruption Perception Index, https://www.transparency.org/en/cpi/2019/index/nzl; BTI (2021), BTI Transformation Index, https://www.bti-project.org/en/home.html?&cb=00000; Norwegian Forestry Group (2012), *Kosovo Forest Inventory*, https://nfg.no/wp-content/uploads/2019/01/Microsoft-Word-NFI-Kosovo_folder_201113_final.docx.pdf; IEA Statistics (2018), *IEA Statistics* (database), https://www.iea.org/data-and-statistics.

Executive summary

The Western Balkans have come a long way over the last two decades. Today, the six economies have a combined gross domestic product (GDP) of close to USD 309 billion (in purchasing power parity [PPP] terms) – up from USD 106 billion (PPP) in 2000. The region's 17.6 million inhabitants enjoy an average GDP per capita of about USD 17 000 (PPP) up from USD 6 000 (PPP) in 2000.

The region's location and deep relationships with Europe and many parts of the world present multiple opportunities. Similar historical development patterns have endowed the region's economies with the relatively solid infrastructure, industrial experience, a skills base and academic tradition that can be levers of future development. EU integration is a central driver of many of the region's opportunities and recent migration flows and centuries of being at the crossroads of South East Europe have bestowed the region with deep relationships with many countries of Europe and the world. As geographical distance seems to shrink with digitalisation, these relationships can be leveraged for further dynamic development. Geographical proximity to important European markets and production networks also offers economic opportunity, if the appropriate skills, infrastructure and business environments can be provided.

Yet, developing the region's potential will require new sources of dynamism and transformation to overcome deep-seated social, institutional and environmental challenges. To this end this report combines multi-dimensional assessments of five economies of the region to distill a regional perspective on shared opportunities, challenges and suggestions for priorities.

Amid a COVID-19 pandemic, learning from and with each other in order to tackle challenges and find innovative and timely solutions is more necessary than ever

The COVID-19 pandemic poses a huge additional challenge for the region. While the region has managed an effective response overall, a return to more stringent measures is possible and the economic fallout has been severe. As the countercyclical imperative will necessitate large-scale public spending, strategic questions become more urgent than ever to ensure that resources are well spent. Because a large amount of resources will be used, missed opportunities will be much more costly than they would be otherwise. The shared strategic opportunities and challenges presented in this report are intended as a contribution to making recovery spending as strategically effective as possible.

Nine shared strategic priorities for the region

The nine strategic priorities suggested here emerge as key levers for future development that are highly relevant for all economies in the region. The potential for peer learning and benefits from regional approaches in these areas is significant.

Further integration into the European Union (EU) is the overarching priority for all economies in the region and a core driver of reforms. The process towards integration with the EU has been an important driver of democratisation, peace and institution building in the Western Balkans and continues to provide the region with large financial and technical support for its development and regional integration. As such it serves as the backdrop and frame for the following development priorities.

Education and competences

Education and competences for economic transformation are the top priorities for all economies in the region. While economic structures vary significantly, finding new sources of productivity growth and engines for future transformation is an urgent task for all. Good jobs are scarce, and young people continue to leave. Boosting youth and workforce competences can unlock new opportunities to overcome these trends. The more unfavourable the economy's current wage-to-productivity ratio is, the more this task becomes urgent; Kosovo tops this table, but the challenges are similar for all economies. Strategies for competences and the future transformation of the economy must combine education with practical training, investment promotion and proactive creation of partnerships with firms, academia and more. Digitalisation, which is currently receiving a boost from the COVID-19 crisis, must be a key element of any competence strategy.

Social cohesion

Social cohesion presents both an opportunity and a significant challenge for all societies in the region. Underperforming labour markets leave many without attractive opportunities and strain citizens' ability to support each other. At the same time, the lack of formal labour market participation renders the mostly contribution-based social protection systems unsustainable and under-dimensioned. Large inequalities between sub-regions and between ethnic groups add to the complexity. Local governments should be on the frontlines in addressing this challenge but, in most places, lack the capabilities in terms of organisation, incentives and funding. Strengthening social cohesion and resilience will require social protection reform, effective service delivery and supportive labour market institutions.

Green recovery – energy and air pollution

Energy and air pollution are complex challenges and significant obstacles to future economic development and well-being. Coal accounts for large to huge shares of energy supply across Western Balkan economies, except for Albania, which relies almost exclusively on hydropower. Many coal power plants are old and need decommissioning or significant investments to ensure reliable electricity supply. At the same time, coal, particularly when burned with old technology, is a driver of climate change and causes significant air pollution, which is the region's foremost environmental burden. Given the current product space of most of the region, attainable opportunities could exist in energy-intensive metals and machines. However, this would only be possible with a more sustainable and reliable energy supply. Meanwhile, a cleaner environment, especially in the major urban centres, is a top desire of residents and would be crucial to making the region an attractive place to live, invest and return to.

Digitalisation

Digitalisation is an unstoppable global trend that can offer the region important opportunities for transforming education, the economy and governments. The COVID-19 pandemic, with its global shift to teleworking and digitalised services, has accelerated digitalisation. At a time when resilience requires the ability to keep an economy going while imposing physical distance between people, digitalisation is essential. Beyond the pandemic, digitalisation has the potential to become a building block of more competitive and productive economies in the region. Given the strong tradition of engineering and mathematics education and young populations eager to connect to the world, a push for digital competences has potential. Done right, bolstering digital skills could also help alleviate unfavourable wage-to-productivity ratios. The biggest potential of digitalisation might be in transforming governments and public service delivery. Inefficient government structures and lack of capacity for service delivery, especially at the local level, have been identified as major constraints to development in all initial assessments. Better governance and services were also among the top dimensions in all future visions.

Migration, brain drain and diaspora engagement

Migration and brain drain present considerable challenges for all societies in the region; making more of diasporas, on the other hand, holds opportunity. Emigration and remittances have been defining features in most of the region over the last decade. They help take the pressure off underperforming labour markets and supply many households with additional income, significantly contributing to poverty reduction and improvements in living standards. They also deprive the region of young talents, potentially contributing to the lack of economic innovation and transformation. Public services, especially medical care, also suffer as qualified people leave. The emotional cost to those who remain is considerable and might fuel resentment towards the European project in the long run. Yet, past migration holds significant potential in the form of a large diaspora in the more advanced economies of Europe and North America. Elsewhere in the world, diasporas have been important sources of investment and know-how, suggesting that more can be made of these links through investment programmes, sponsorships and incentives for return migration.

Creating opportunities for women

Women face particular obstacles to full participation in societies in the region. Across economies, women's low participation in paid work due to full-time household chores, lack of child and elderly care services and cultural norms that encourage traditional division of labour is striking. This is in contrast to many post-communist societies, which traditionally have comparatively high levels of female labour market participation. While the current poor labour market conditions and high unemployment pose challenges for both men and women, and increased female participation could not easily be absorbed, things can change. If economies seize the opportunities laid out in this report and the initial assessments, demand for qualified labour, including female labour, will increase dramatically.

Land management and property rights

Land management and registration of property rights pose significant challenges in most economies, with deleterious consequences for rural development, revenue generation and the environment. The multiple changes in legal and political regimes in the last century have left most economies with significant numbers of overlapping land claims. These stem from both formal regime change and the fact that traditional – from today's perspective informal – means of land transfer have been used where formal channels were not sufficiently present or accessible. In addition to registration problems, cadastres are not complete everywhere and are at times incoherently organised. As a result, often property cannot be used as collateral to access financing, and much of farming is hampered by small plots, as growth through purchase of land is blocked. Yet, sustainable agricultural techniques often require larger plot sizes to generate sufficient returns, and the current small-plot structure incentivises intensive practices with heavy environmental tolls in the form of overuse of water and pesticides.

Local governments

A focus on local governments, their implementation capacities, funding and incentives can help identify important opportunities for future development. Local governments are key in implementation and delivery but often do not play their role. Local governments provide many services, such as education, health care, social assistance and water and waste services. Many municipalities have sizeable staff and spend the large majority of their budgets on salaries. However, benchmarking shows that the services delivered are not in line with what is spent on their delivery. Political patronage often plays an outsized role in hiring at the local level, and in some economies, the incentive structure, set by how local governments receive their funding from the centre, leads to further surplus hiring, as opposed to smart investments in performance. While the structure of multi-level government organisation varies, all economies struggle in some way with delivery at the local level. Learning from each other and from what has been done elsewhere in the world could point the way to new opportunities and solutions.

In the end, progress comes down to implementation and reliability

The high pace of production and the quality of legal texts and strategies across the region are impressive. Yet translation into practice often remains slow. State structures tend to be overly complex. Numerous ministries and agencies and unclear lines of accountability delay decisions and cost time and resources. Frequent political changes and insufficient protection against undue influence are other sources of delay and impediments. At the same time citizens place the rule of law, good governance and effective policy making very high in their visions of a good future. Coming together around the objectives of effective public delivery and implementation in a context of good governance can lead to paths towards new opportunities for development and enable achievements across the strategic priorities listed here.

Part I Assessing opportunities and constraints in the Western Balkans: Regional overview

1 Overview: Identifying strategic opportunities for the Western Balkans

The Western Balkans have come a long way over the last two decades. Similar historical development patterns, have endowed the region's economies with the relatively solid infrastructure, industrial experience and a skills base and academic tradition that can be levers of future development. Developing the region's potential will require new sources of dynamism and transformation to overcome deep-seated social, institutional and environmental challenges. This chapter takes a holistic view of the region's development performance across a range of outcomes, spanning the breadth of the Sustainable Development Goals. It then draws on the remaining chapters in this part to outline strategic priorities to build on the Western Balkans' assets and address the key constraints they face.

The Western Balkans have come a long way over the last two decades. Current population of the Western Balkans is about 17.6 million. Today, the six economies (Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia) have a combined gross domestic product (GDP) of close to USD 309 billion (in purchasing power parity [PPP] terms) – up from 106 billion in 2000, which represents 1.5% of the European Union's GDP. The region's average GDP per capita is about USD 17 000 (PPP) in 2021, having nearly tripled from USD 6 000 (PPP) in 2000 (Figure 1.1 – Panel A).

The region's location and deep relationships with Europe and many parts of the world present multiple opportunities. Similar historical development patterns have endowed the region's economies with the relatively solid infrastructure, industrial experience and a skills base and academic tradition that can be levers of future development. Economies of the region have deep relationships with many parts of Europe and the world as a result of recent migration flows and centuries of being at the crossroads of South East Europe. As geographical distance seems to shrink with digitalisation, these relationships can be leveraged for further dynamic development. At the same time, geographical proximity to important European markets and production networks offers economic opportunity, if the appropriate skills, infrastructure and business environments can be provided. Further EU integration is a central driver of many of the region's opportunities.

Integration into the European Union (EU) is a central strategic objective for the region and an opportunity to accelerate reform processes in the Western Balkans. The process towards integration with the EU has been an important driver of democratisation, peace and institution building in the Western Balkans and has provided the region with large financial and technical support for its development and regional integration. Through the Stabilisation and Association Process (SAP) since 1999, the economies in the region have been involved in a progressive partnership with the European Union. The new Enlargement Package and the adoption of the Economic and Investment Plan have set new directions for EU integration and recovery from COVID-19 (Box 1.1).

Box 1.1. The Western Balkans' integration towards the European Union

The process towards integration with the European Union has been an important driver of democratisation and institution building in the Western Balkans and has provided the region with large financial and technical support for its development and regional integration. As part of the process, the regional economies have worked to bring their legislation in line with the EU acquis. Currently, Albania, Montenegro, North Macedonia and Serbia are candidates for integration, while Bosnia and Herzegovina and Kosovo are potential candidates.

The Stabilisation and Association Process (SAP) rests on the following pillars: bilateral Stabilisation and Association Agreements (SAA); trade relations (wide-ranging trade agreements); financial assistance (the Instrument for Pre-accession Assistance [IPA]); and regional co-operation, such as the Central European Free Trade Agreement (CEFTA).

The first SAA of the region entered into force in North Macedonia (2004), followed by Croatia (2005, which then concluded its process of integration in 2013), Albania (2009), Montenegro (2010), Serbia (2013), Bosnia and Herzegovina (2015) and Kosovo (2016). The agreement offers various benefits to citizens and business (such as visa-free travel), supporting institutional and democratic reforms, and encouraging neighbourly relations and trade (European Commission, 2020[1]).

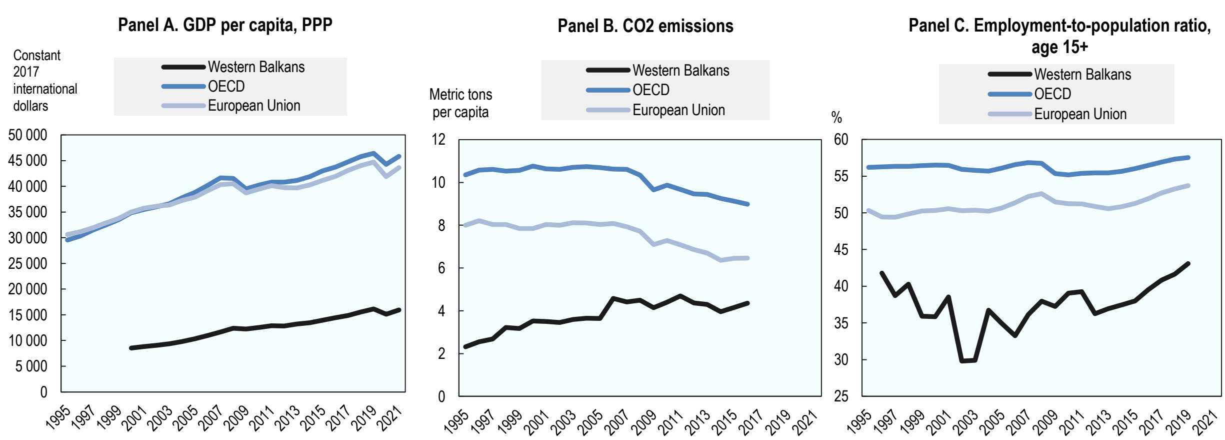
The IPA has been instrumental in providing the region assistance in reforms through financial and technical help. In the period 2014-20 IPA II funding ranged from 3.3% of GDP in Bosnia and Herzegovina to 9.2% of GDP in Kosovo (European Commission, 2020[2]).

The new Enlargement Package and the adoption of the Economic and Investment Plan have set new directions for EU integration and recovery from COVID-19. Building on the Western Balkan strategy from 2018 (European Commission, 2018[3]), the Enlargement Package adopted on 6 October 2020 stresses the need to improve the EU integration process to be better equipped to deal with structural weaknesses in the Western Balkan economies. In parallel, the European Commission adopted the Economic and Investment Plan to spur the long-term economic recovery of the region, support a green and digital transition and foster regional integration into and convergence with the European Union. The support is crucial, especially in light of both the COVID-19 impact and the existing challenges, such as weak competitiveness and high unemployment. The plan will mobilise up to EUR 9 billion of IPA III funding for 2021-27. A large majority of this support will be directed towards key productive investments and sustainable infrastructure in the Western Balkans through the ten flagship initiatives. Through the Western Balkans Guarantee facility, the ambition is to raise additional investments of up to EUR 20 billion (European Commission, 2020[4]; European Commission, 2020[5]).

Note: The ten flagship investment initiatives are: two transport infrastructure projects (connecting east to west and north to south), renewable energy, transition from coal, connecting coastal regions, building renovations, waste and water management, digital infrastructure, supporting the competitiveness of the private sector, and youth support.
Source: European Commission (2020[1]; 2020[2]; 2020[4]; 2020[5]; 2018[3]).

Developing the region's potential will require new sources of dynamism and transformation to overcome deep-seated social, institutional and environmental challenges. In the decade leading up to the global financial crisis in 2008, most regional economies experienced dynamic growth and financial sector expansion. However, the crisis was followed by a much more subdued economic rhythm and the rate of growth has not been sufficient to achieve convergence towards the EU and the OECD averages in per capita terms (Figure 1.1 – Panel A). Labour markets have performed poorly, with among the highest non-participation rates in the world, but have finally found an increasing trend in recent years (Figure 1.1 – Panel C) (IMF, 2021[6]). While emigration eases employment pressures and generates remittances that aid social welfare, it results in brain drain and ageing societies. Inefficient public spending often drives poor education results and insufficient social safety nets. Heavy dependence on coal and other environmentally unstainable practices are the drivers behind high air pollution and increasing CO_2 emissions, both with important negative impact on people's well-being and health (Figure 1.1 – Panel B). Last, formal rules are often at odds with informal practices. The power of networks and weaknesses in governance and institutions must be addressed.

Figure 1.1. While progress in the Western Balkans has been visible across several dimensions, the region needs to identify new drivers of sustainable and inclusive development



Notes: Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.
Source: IMF (2021[6]), World Economic Outlook Databases, https://www.imf.org/en/Publications/SPROLLs/world-economic-outlook-databases#sort=%40imfdate%20descending.

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The COVID-19 pandemic will pose a huge additional challenge for the region for the foreseeable future, making reflection and strategic action urgent. Many economies in the region have experienced economic slowdown, while continued global uncertainty weighs both on the region and on its trading partners and sources of investment and remittances. Overall, the region has managed an effective response. However, a return to more stringent measures resulting from a resurgence in cases and climbing death rates threatens the region's outlook. As the countercyclical imperative will necessitate large-scale public spending, strategic questions become more urgent than ever to ensure that resources are well spent. Given the likely size of the spending, missed opportunities will be much more costly than they would be otherwise.

The Multi-dimensional Review (MDR) of the Western Balkans aims to support the region and its economies to learn with each other and develop strategies for action. The project consists of two reports and multiple peer learning events across the region. This report provides a regional overview and assessments of the five participating economies (Albania, Bosnia and Herzegovina, Kosovo, North Macedonia and Serbia) across the economic, social, finance, governance and environmental pillars of Sustainable Development. The objectives of this report are twofold: first, to identify strategic priorities of relevance for the whole region as the focus for peer learning; and second, to serve as inputs for the national development strategies and plans currently under development in the region, as well as for the region's many co-operation partners as they devise their support.

This overview chapter summarises the main results of the initial assessments and suggests strategic priorities for the region. First, it presents inputs for statements of development visions for 2030 elaborated by participants of strategic visioning workshops conducted in Albania, Kosovo, North Macedonia and Serbia.[1] Second, it presents key trends for the region that any future strategy must take into account. Third, it takes a bird's-eye view to assess the region's development performance on the basis of key statistics on well-being and summarises the major constraints to development identified through multi-dimensional analysis. It concludes by suggesting key strategic directions for the future.

Whenever relevant and subject to data availability, the Western Balkan economies are compared with three groups of benchmark economies: 1) Organisation for Economic Co-operation and Development (OECD) countries (Costa Rica, Czech Republic, Greece, Slovak Republic, Slovenia and Turkey); 2) non-OECD EU countries (Croatia and Romania); and 3) countries in neither the OECD nor the European Union (Kazakhstan, Morocco, Philippines and Uruguay). The selection of benchmark economies is based on historical similarities, including their paths towards EU integration, and on economic structures, geographical proximity and mutual partnerships. The selection of non-OECD economies is based on similar economic and social challenges (such as high migration rates), shared history as transition economies and similar development patterns. Such a broad set of benchmark economies can bring an additional perspective to the Western Balkan economies and create valuable learning opportunities across selected policy dimensions (Table 1.1).

Table 1.1. Benchmark countries

	OECD	European Union	Other regions	Population, total (millions)	GDP (billions)	GDP per capita (current USD [United States dollar])	Relevance for the Western Balkans
Czech Republic	✓	✓		10.7	246.5	23 102	Proximity, industrial base
Greece	✓	✓		10.7	209.9	19 583	Proximity, agro-food sector, tourism
Slovak Republic	✓	✓		5.7	105.4	19 329	Proximity, industrial base
Slovenia	✓	✓		2.1	53.7	25 739	Proximity, industrial base
Turkey	✓			83.4	754.4	9 042	Proximity, agro-food sector, export basket
Croatia		✓		4.1	60.4	14 853	Proximity, agro-food, tourism
Romania		✓		19.4	250.1	12 920	Proximity, industrial base
Costa Rica			✓	5.1	61.8	12 238	Agriculture, IT services, history of FDI attraction
Kazakhstan			✓	18.5	180.2	9 731	Agriculture, mining, SOEs
Morocco			✓	36.5	118.8	3 204	Migration and diaspora in the European Union, labour market challenges, role of FDI
Philippines			✓	108.1	376.8	3 485	Migration as a key feature of the economic model
Uruguay			✓	3.5	56.1	16 190	Agriculture, textiles, mining

Note: IT = information technology, FDI = foreign direct investment, SOEs = state-owned enterprises
Source: World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Subsequent phases of the project focus on peer learning and generating ideas for action on shared opportunities and challenges. Peer-learning events in early 2021 convened representatives of the participating economies and OECD and other international experts to generate knowledge and ideas for solutions. The events focused on shared challenges and opportunities identified on the basis of the present report, the accompanying initial assessments and the discussions in a series of informal meetings of the Mutual Learning Group of members of the OECD Development Centre.

Vision and opportunities

A vision of a desired future is an important input for identifying opportunities and devising strategy. It should provide a description of what citizens hope for in terms of the economy, society, institutions and the environment. Based on the most important desired elements in each domain, vision statements can be formed and obstacles identified. Four Vision and Challenges 2030 workshops were held as part of the MDR (Box 1.2). The workshops gathered a range of participants from various ministries and agencies, the private sector, academia and civil society. Narratives of the lives of future citizens were the basis for vision development.

Despite their anticipated diversity, all future narratives highlighted aspirations for broad economic opportunity and good quality of life, health, education, employment and environmental quality. Most narratives of the lives of future citizens focused on young people, especially women, with higher education – some in high-skilled professions, such as engineering and entrepreneurship. Many have returned with experiences from abroad and are exploring opportunities at home. All have middle-class family lives, decent, stable work, good health and access to quality education. They have houses and enjoy leisure time in green, clean public spaces. Good-quality public services and an economic environment conducive to starting a company and improving skills for career development are also emphasised.

Strong education, good governance and the rule of law, a clean environment and dynamic economies offering opportunities emerge as the main elements of desired futures (Figure 1.2). Following the formulation of narratives and vision statements, workshop participants voted on the most important dimensions of a positive future. With impressive unanimity, quality education ranked topmost in all workshops. Rule of law and quality public services are also very important to citizens, especially in Albania, Kosovo and North Macedonia, indicating the importance of strong institutions. In Kosovo, North Macedonia and Serbia, access to, and quality of, health services rank very high. Reflecting differences in development across geographical areas, decentralisation ranks high for citizens in Serbia. Access to quality jobs and environmental considerations are also important.

Box 1.2. Vision and Challenges 2030: OECD visioning workshops in the Western Balkans

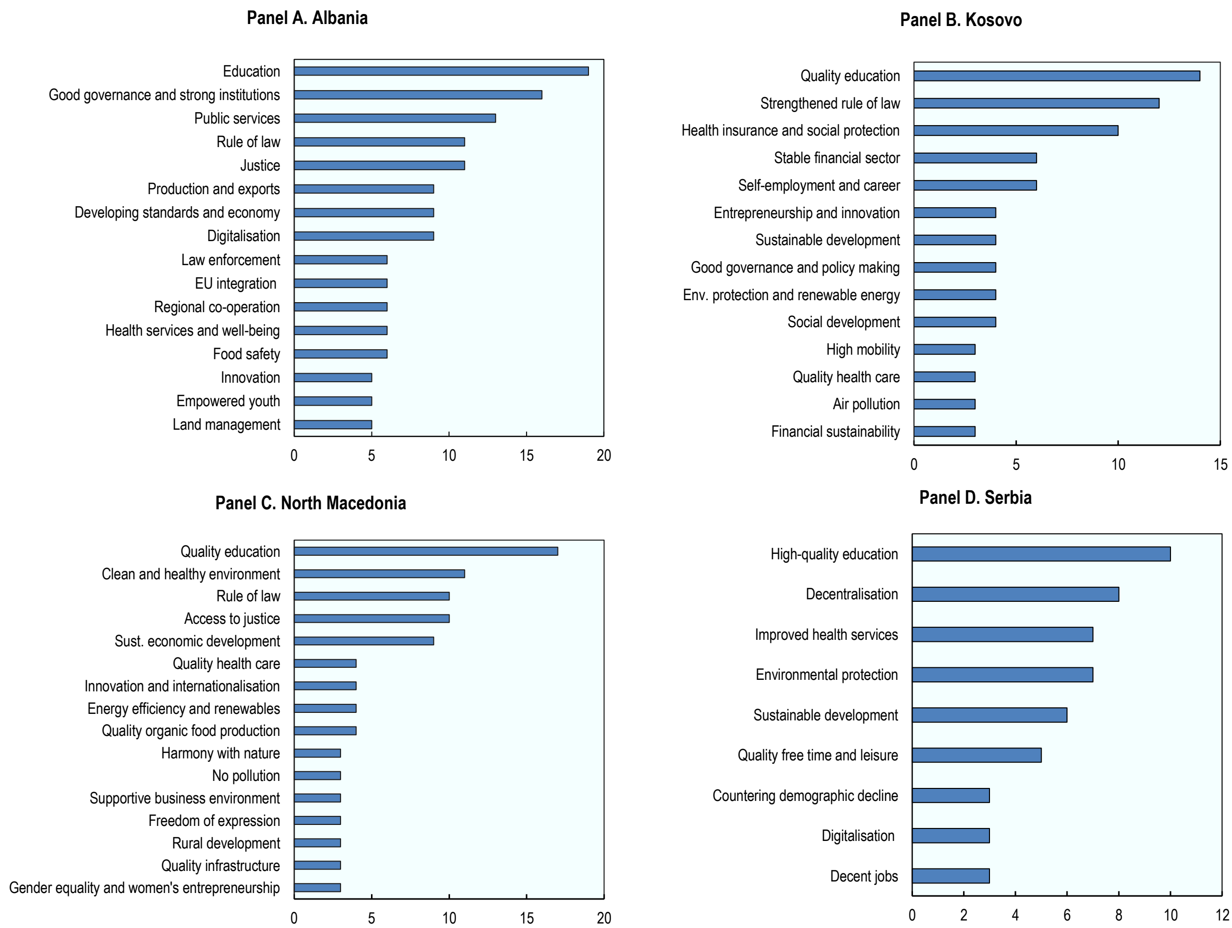
As part of the MDR process, Vision and Challenges 2030 workshops took place in Albania, Kosovo, North Macedonia and Serbia between February and early March 2020. All workshops followed the same methodology and aimed at developing suggestions for a vision 2030, including vision statements, key dimensions of success and challenges. Workshops were jointly organised by the OECD, the Swedish International Development Cooperation Agency and government representatives.

The workshops brought together between 30 and 60 stakeholders representing different perspectives (government, academia, the private sector and civil society) and consisted of four sessions: 1) "Postcards from the future" was a storytelling exercise in which participants developed a fictitious 2030 citizen and described his or her life in a scenario of the economy's successful development. On the basis of these stories, participants identified the key dimensions of future success along the five pillars of sustainable development, then voted to determine the most important dimensions (Figure 1.2). 2) "Vision Statement" was based on the earlier session. Participants developed a vision statement reflecting the desired future and development goals. 3) "Key priorities and challenges for the future" focused on the present with the desired future in mind. Participants discussed and voted on the key challenges a 2030 strategy must address. 4) "Trends and global environment" focused on local, regional and global trends affecting development opportunities and strategy.

As all workshops followed the same methodology, results can be easily compared and help highlight many of the desires and challenges shared across the region.

Figure 1.2. Dimensions for visions in the Western Balkans

Workshop votes



Note: The visioning workshop in Bosnia and Herzegovina was cancelled due to the COVID-19 pandemic.
Sources: OECD visioning workshops held in Albania, Kosovo, North Macedonia and Serbia in 2020.

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Key trends shaping development of the Western Balkans

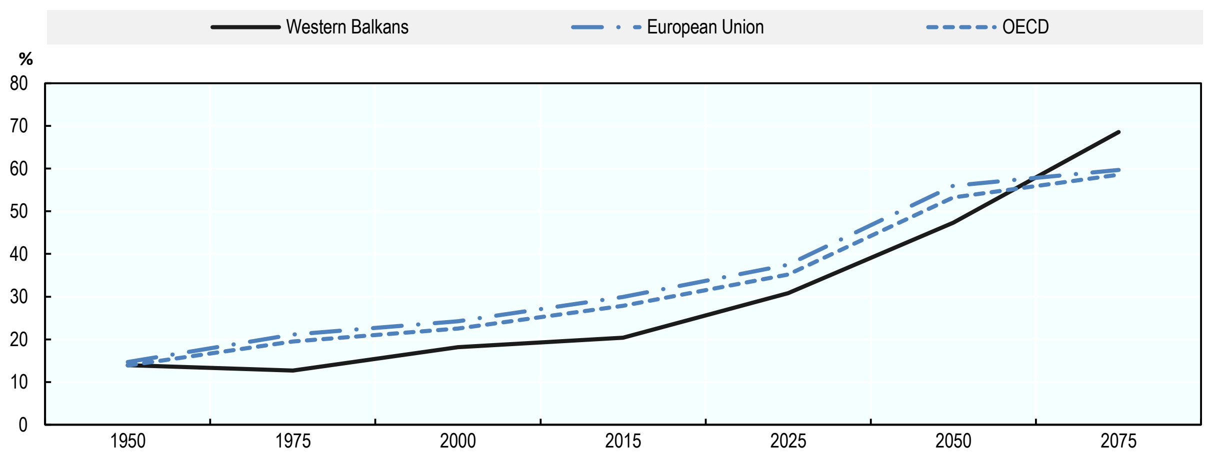
This section presents four important regional and international trends likely to impact the Western Balkans in the near to medium future. These trends have been identified on the basis of horizon-scanning exercises during the visioning workshops and their relevance and potential impact. Together with the visions, these trends will form the foundation for the multidimensional constraints assessment and the identification of strategic opportunities.

Rapid population ageing

The rapid ageing of societies across the region will be a major challenge for achieving further increases in living standards and ensuring the financial sustainability of public social expenditure. Driven by low fertility rates and high migration abroad, the number of those with age 65 or above per those of working age (20-64) is expected to more than double by 2050. Population ageing may lead to the loss of human capital and is already putting considerable pressure on the financial sustainability of social security system in the region, especially on pension expenditures. In addition, medical expenses tend to rise steeply at older ages (Figure 1.3).

Figure 1.3. Old-age support ratio will more than halve in the next 30 years

Old-age dependency ratio projections (ratio of population age 65+ per 100 population aged 20 to 64, %)



Note: Western Balkan average includes Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia. Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.
Source: United Nations (2020[8]), "World Population Prospects 2019", https://population.un.org/wpp/.

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Climate change

The Western Balkans are highly prone to climate change and vulnerable to extreme weather events. According to projections, the region will face rises in temperature and changes in precipitation patterns, leading to increased flood risk, extended periods of drought, soil erosion and forest fires (Table 1.2). Some of the regional economies, especially North Macedonia and Bosnia and Herzegovina have suffered rather significant losses due to extreme weather events in recent years (Figure 1.4). Considering that a high percentage of population is employed in sectors, such as agriculture, tourism and forestry, the Western Balkan region is particularly exposed. The floods in 2014 demonstrated that the region was not prepared nor adequately equipped to deal with the increasing dangers posed by climate-related impacts (ICUN, 2020[9]). In 2017, the region witnessed record temperatures, which caused a drought in Serbia and a drop in agriculture output of nearly 10 %, and forced Albania to spend EUR 200 million on energy imports (World Bank, 2018[10]). Climate change impacts may have a significant impact on society (drinking water deficit, migrations, and heat stress) and economy (disruption of food production, irrigation, and hydropower production).

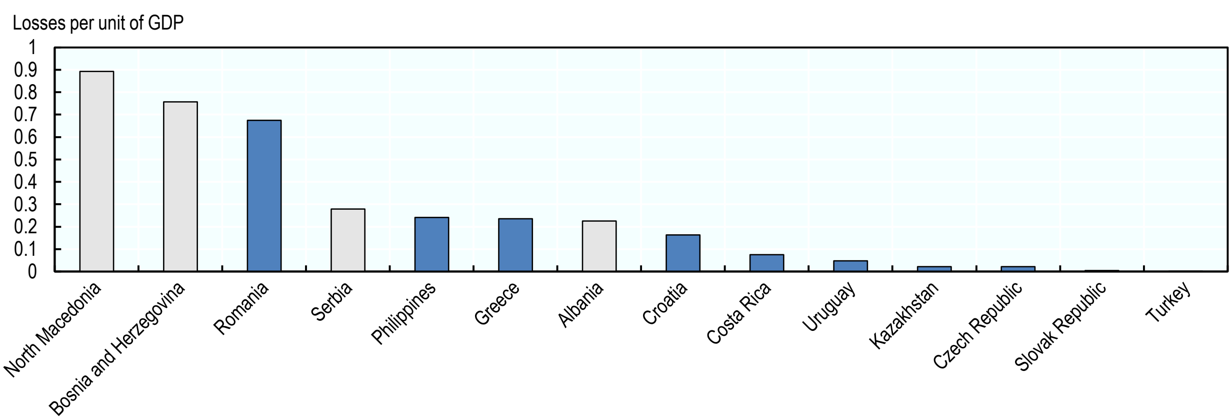
Table 1.2. Western Balkan economies are highly vulnerable to climate change

Change of the mean annual temperature (in °C) with respect to the base period (1986-2005) for the Representative Concentration Pathway (RCP) 4.5 and RCP 8.5 scenarios of GHG emissions

	Albania		Bosnia and Herzegovina		Kosovo		Montenegro		North Macedonia		Serbia	
RCP	4.5	8.5	4.5	8.5	4.5	8.5	4.5	8.5	4.5	8.5	4.5	8.5
2016 - 2035	0.5-1	0.5-1	0.5-1	0.5-1	0.5-1	0.5-1.5	0.5-1	0.5-1.5	0.5-1	0.5-1.5	0.5-1	0.5-1.5
2046 - 2065	1-2	1.5-3	1-2	1.5-3	1.5-2	2-3	1-2	1.5-3	1.5-2	2-3	1-2	1.5-3
2081 - 2100	1.5-2	4-5	1.5-3	4-5	2-3	4-5	1.5-3	4-5	2-3	4-5	1.5-3	4-5

Notes: A Representative Concentration Pathway (RCP) is a greenhouse gas concentration (not emissions) trajectory adopted by the Intergovernmental Panel on Climate Change. The mean annual temperature corresponds to the average of the maximum and minimum temperatures of a year, taking the mean average of the coldest month of the year and averaging it with the mean average of the hottest month of the year. The RCP 4.5 refers to a stabilisation scenario and RCP 8.5 to a continuous rise scenario of GHG emissions.
Source: RCC (2018[11]), *Study on Climate Change in the Western Balkans Region*, www.rcc.int/pubs/62/speech-of-the-secretary-general-majlinda-bregu-at-the-launch-of-rcc-undp-initiative-on-women-empowerment.

Figure 1.4. Economic losses due to extreme weather events in the Western Balkans



Source: Data.World (2021[12]), Climate Risk Index, https://data.world/gpsdd/e1dcef1d-b9ca-4c22-8b78-f7b6703d2274 (accessed on 15 March 2021).

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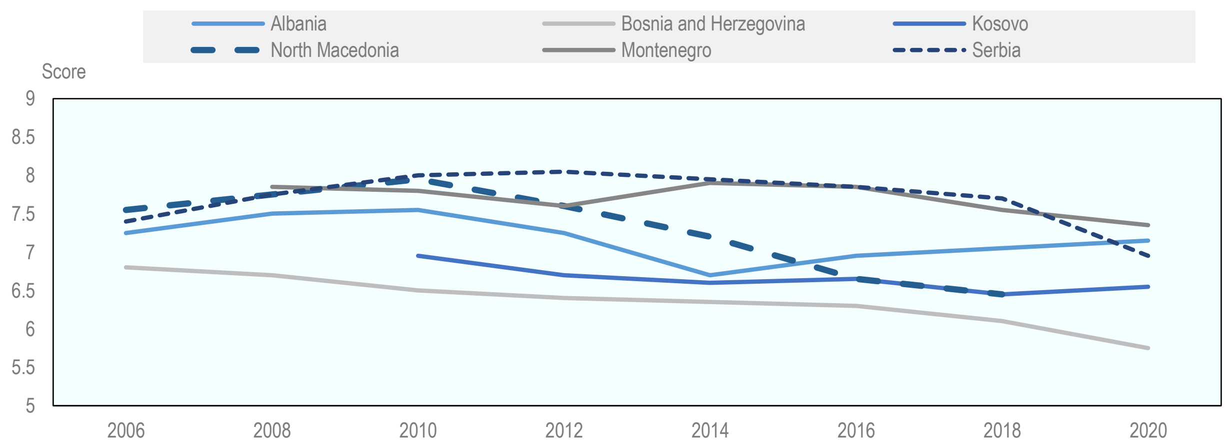
Democratisation process

The halting democratisation process in the Western Balkans in recent years has been eroding people's trust in public institutions. Despite the immense success in democratisation and the build-up of democratic institutions since the start of the political and economic transition in early 1990s, the democratisation process seems to have stalled over the last decade (Figure 1.5). Frequent political changes and political instability, distrust in the electoral processes and their frequency, party fragmentation and other factors have contributed to this trend. If this trends continues, this is likely to further erode citizens trust in institutions, increase migration, affect the EU integration process and the quality of institutions, which in turn may also affect business environment, education and other areas that drive development.

Figure 1.5. Democratic backsliding in Western Balkans over the last years

BTI Democracy status



Source: Bertelsmann Foundation (2020[13]), BTI Transformation Index (database), https://www.bti-project.org/en/data.

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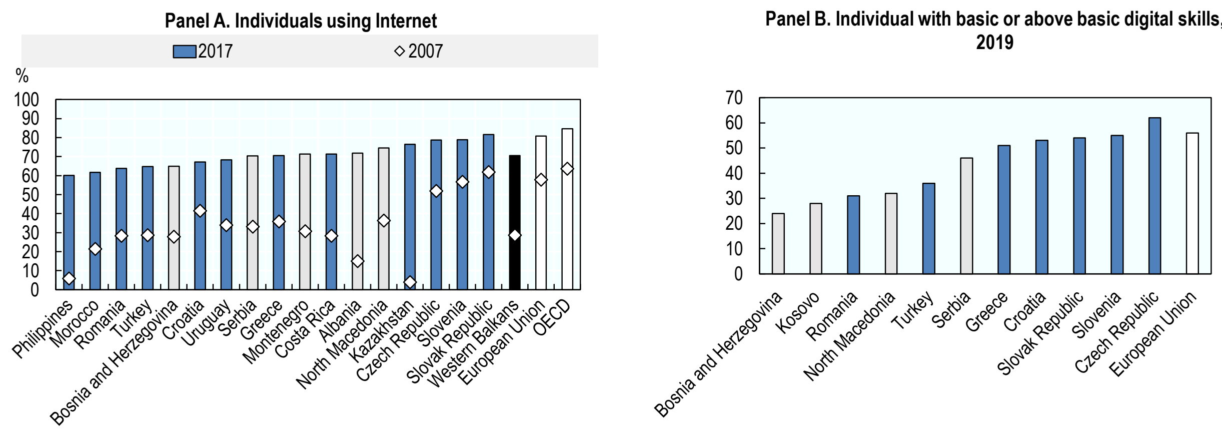
Digital transformation

Digital transformation is an opportunity for the Western Balkans to address some of the structural political, social, economic challenges, and to get ready for the expected changes in the labour market in the near future. The latest OECD research suggests that, should current cutting-edge technology become widespread, 32% of current jobs across the 32 countries analysed are likely to see significant changes in how they are carried out and a further 14% of jobs could be completely automated (OECD, 2019[14]). Although the percentage of individuals using Internet in Western Balkans has increased significantly in the last decade, it still remains below the EU (80.8%) and the OECD average (84.7%) (Figure 1.6 – panel A). At the same time, the Western Balkan region still has a relatively low share of individuals with basic or above basic skills (Figure 1.6 – panel B). The COVID-19 pandemic offers an opportunity to increase the penetration of digital technologies to households and businesses, to increase digital skills of people, to strengthen e-government, to integrate previously marginalised population groups into the economy, and to prepare the citizens for the future changes in the labour market.

Figure 1.6. Use of digital skills in the Western Balkans



Note: Panel A – no data for Kosovo. Panel B – no data for Albania and Montenegro.
Source: ITU (2020[15]), *International Telecommunication Union – Telecommunication Development Sector (ITU-D)* (database), https://www.itu.int/en/ITU-D/Statistics/Pages/default.aspx; Eurostat (2018[16]), *Eurostat* (database), https://ec.europa.eu/eurostat/data/database.

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Assessing well-being performance and constraints to sustainable development in the Western Balkans

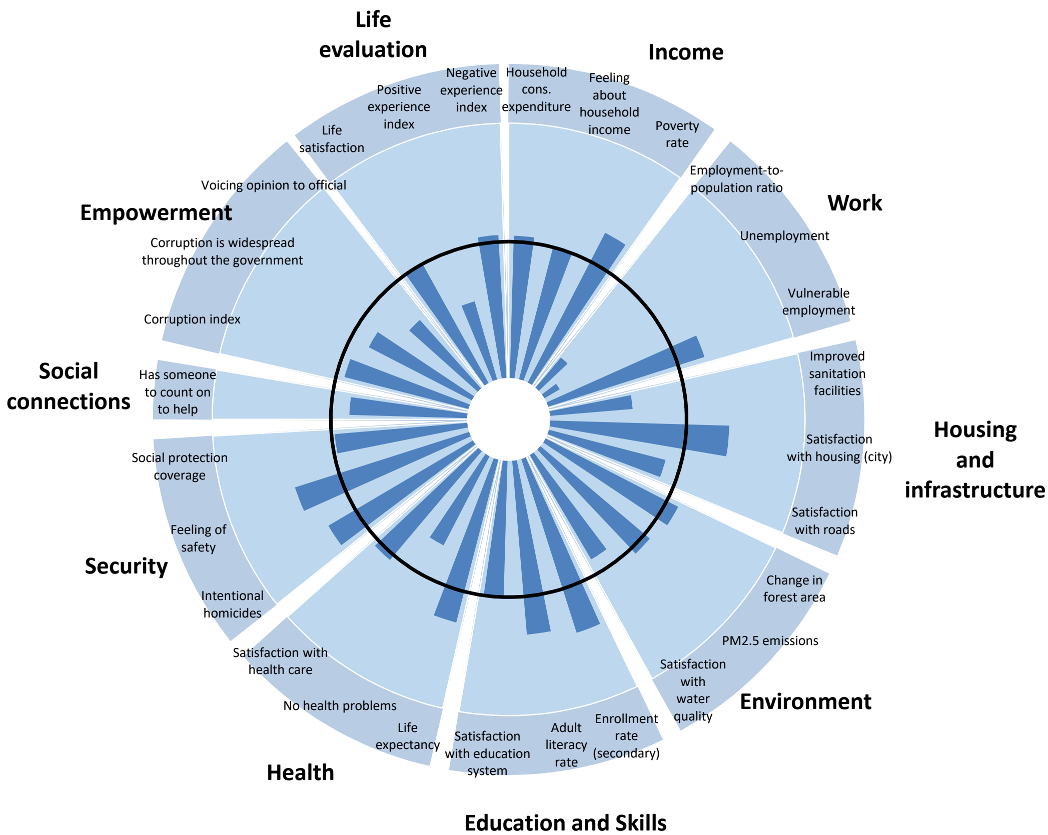
Building on the visions and trends, well-being around the world and sustainable development as benchmarks, this section reviews the development performance of the Western Balkans. The proposed inputs for visions emphasise well-being, strong institutions, access to opportunity, gender equality and sustainable development as the ultimate objectives of development. To assess the well-being of the Western Balkan economies, the OECD's Well-being Framework uses a mix of objective and subjective indicators across a range of dimensions that matter to people (OECD, 2020[17]) (Box 1.3). A version adapted to the realities of emerging economies compares the Western Balkans to the level of well-being outcomes expected, given its level of GDP per capita, in ten dimensions covering material conditions, quality of life and quality of relationships. In a second step, this section assesses the Western Balkans' performance for the five pillars of the sustainable development goals, applying distance-to-target measures across a selection of indicators and building on the analysis in the main body of this report and on other regional assessments, including OECD (OECD, 2018[18]) and European Commission assessments (European Commission, 2019[19]; European Commission, 2019[20]; European Commission, 2020[21]).

Well-being

In terms of well-being, the Western Balkan region's performance reflects its level of development and shows room for improvement. Overall performance is close to what benchmarking suggests for the region's level of GDP per capita (Figure 1.7). Improving well-being will require significant efforts. Citizens across the region feel comparatively safe and are not exposed to violence and crime to the same extent as those in other benchmark economies of similar income status. Poverty rates are relatively low, and life expectancy is high. However, work, empowerment and life satisfaction stand out as underperforming compared to benchmarks. Employment rates (42.7%, on average, in 2019) are very low, and low performance on corruption and on voicing opinions to officials point to a weak link between states and citizens. This is also reflected in the low rates of satisfaction with public services, such as health, roads and education.

Figure 1.7. Current and expected well-being outcomes for the Western Balkans: worldwide comparison

2019 or latest available data; comparison relative to GDP per capita



Notes: The observed values falling inside the black circle indicate areas where the Western Balkans perform poorly in terms of what might be expected from a country with a similar level of GDP per capita. Expected well-being values (the black circle) are calculated using bivariate regressions of various well-being outcomes on GDP, using a cross-country dataset of around 150 economies with a population of over one million. All indicators are normalised in terms of standard deviations across the panel.

Sources: Gallup (2020[22]), "Gallup World Poll", www.gallup.com/analytics/318875/global-research.aspx; ILO (2020[23]), *ILOStat* (database), https://ilostat.ilo.org/data/; OECD (2020[24]), *OECD PISA database*, www.oecd.org/pisa/data/; Transparency International (2019[25]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/; UNESCO (2019[26]), "UNESCO Institute for Statistics", http://uis.unesco.org/; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WHO (2020[27]), *Global Health Observatory* (database), www.who.int/data/gho/data/countries.

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Box 1.3. Measuring what matters to people

As part of its broader Better Life Initiative, the OECD first created its Framework for Measuring Well-being in 2011 with the aim of putting people at the heart of policy making. This represented the culmination of longstanding work both inside and outside the organisation. Important strides to "go beyond GDP" had been made with United Nations Development Programme's Human Development Index and the work on multi-dimensional poverty by the Oxford Poverty and Human Development Initiative. The framework also draws on rich academic literatures in welfare economics and capability theory, the recommendations of the Commission on the Measurement of Economic Performance and Social Progress (Stiglitz, Sen and Fitoussi, 2009[28]) and existing well-being and sustainable development measurement practice in OECD member and non-member countries. Since its launch, the work on well-being has continuously been updated in line with best practice and continues to be published in the OECD's *How's Life?* report series (OECD, 2020[17]). For the purpose of the MDR, the OECD Well-being Framework has been adapted to fit the realities of countries at different stages of development (Boarini, Kolev and McGregor, 2014[29]).

The adapted OECD Well-being Framework used in this report focuses on living conditions at the individual, household and community levels that capture how people experience their lives "here and now". Current well-being here is comprised of ten dimensions related to material conditions that shape people's economic options (Income, Housing and infrastructure, Work and job quality) and quality-of-life factors that encompass how well people are (and how well they feel they are), what they know and can do, and how healthy and safe their places of living are (Health, Education and skills, Environmental quality, Life evaluation, Security). Quality of life also encompasses people's connectedness and engagement (Social connections, Empowerment).

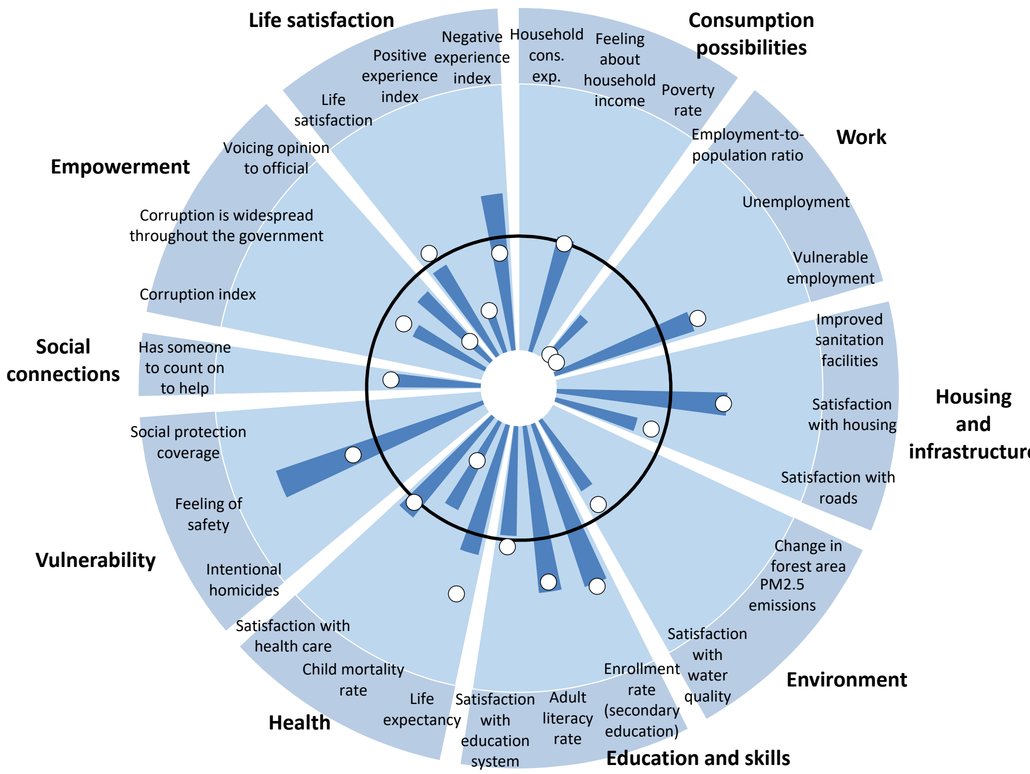
Methodological considerations

To capture the full range of people's actual life experiences, the OECD Well-being Framework uses both objective and subjective indicators. For instance, the Health dimension not only looks at life expectancy estimations but also considers how people feel about their health status and the health services they are receiving. Subjective indicators are sometimes viewed as not being as robust as objective measures; however, there are at least three reasons for considering them alongside the latter to get a holistic picture of well-being. First, there is solid methodological evidence that the subjective measures contained in the well-being framework (e.g. life satisfaction, trust in others and government) are statistically valid and correlate with objective measures of the same construct (OECD, 2017[30]). Second, even in cases where perceptions diverge from objective reality, they capture the reality of survey respondents and can drive real-world outcomes, such as voting and lifestyle behaviours (Murtin, Fleischer and Siegerink, 2018[31]). It can actually be especially insightful for policy makers to zoom in on areas where the gap between citizen perception and objective indicators is largest. Third, many of the measures typically considered objective and routinely used in policy analysis, such as household income, are based on people's self-reports and can equally be affected by response biases and non-response rates (e.g. of very wealthy households).

There are significant differences in well-being between men and women in the Western Balkans, and this report finds that there is scope to improve women's equal participation in society (Figure 1.8). As in most countries around the world, women in the Western Balkans have higher life expectancy and life satisfaction than men (OECD, 2020[17]). Men do much better in terms of work. There are significant differences in labour market participation: 40% of women participated in 2019, one of the lowest rates among benchmark countries. Gender gaps in formal employment are particularly high for women of childbearing age. The lack of early childhood education (ECE) facilities often acts as a burden for women in addition to slow school-to-work transition, full-time household activities and cultural norms that encourage traditional division of labour.

Figure 1.8. Current and expected well-being outcomes for the Western Balkans: gender differences

2019 or latest available data



Note: Well-being outcomes for women are represented by circles; men's outcomes are represented by bars. The observed values falling inside the central black circle indicate areas where the Western Balkans performs poorly in terms of what might be expected from a country with a similar level of GDP per capita. Expected well-being values (the black circle) are calculated using bivariate regressions of various well-being outcomes on GDP per capita, using a cross-country dataset of around 150 economies with a population of over one million. All indicators are normalised in terms of standard deviations across the panel.

Sources: Gallup (2020[22]), "Gallup World Poll", www.gallup.com/analytics/318875/global-research.aspx; ILO (2020[23]), *ILOStat* (database), https://ilostat.ilo.org/data/; OECD (2020[24]), *OECD PISA database*, www.oecd.org/pisa/data/; Transparency International (2019[25]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/; UNESCO (2019[26]), "UNESCO Institute for Statistics", http://uis.unesco.org/; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WHO (2020[27]), *Global Health Observatory* (database), www.who.int/data/gho/data/countries.

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Major constraints to sustainable development

Based on multi-dimensional analysis, this section summarises the major constraints to sustainable development identified along the five pillars of the Agenda for Sustainable Development: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet.

People

Despite the financial crunch COVID-19 will present, Western Balkan societies cannot afford to miss opportunities for investment in their human capital and for generating equal opportunities for all. Although living standards have improved in recent decades, poverty and lack of access to infrastructure continue to affect citizens, especially ethnic minorities and those living in rural areas. There are not enough jobs, particularly in the formal sector, and high youth unemployment rates are pushing the young to migrate. Across countries, women's low participation in paid work due to full-time household chores, lack of child and elderly care services and cultural norms that encourage traditional division of labour is striking. Public services in the region do not live up to their potential: besides the need to develop future-proof education systems in the face of subpar learning outcomes, health and social protection infrastructure needs to be better resourced and modernised, more efficiently organised and made more inclusive of those most in need. Particularly in a context of high informality, the current model of financing social protection largely from social security contributions needs to be revised.

Prosperity

The growth of Western Balkan economies has slowed considerably over the past decade as domestic demand has moderated and export-led growth has been mitigated by weak competitiveness. The period saw a significant decline in productivity growth, as productivity-enhancing labour reallocation between sectors and between firms has been limited and within-sector productivity growth has slowed. A significant share of investment has gone into the non-tradable sectors or sectors with limited productivity-enhancing potential, while in economies that have attracted notable export-oriented foreign direct investment (FDI), limited integration between the FDI sector and the domestic economy has constrained economy-wide productivity gains and structural transformation. Competitiveness is also undermined by weaknesses in human and physical capital. Human capital development is constrained by weak education quality and a mismatch between labour market needs and the qualifications and skills produced by the education system. The underdeveloped physical infrastructure suffers from underinvestment and lack of maintenance by largely inefficient state-owned enterprises (SOEs) and from underutilisation of private-sector investment or operational potential. Unfavourable institutional and business environments hinder the growth and internationalisation of small and medium-sized enterprises (SMEs). Key challenges include pervasive corruption, weak contract enforcement and unfair competition from SEOs or from firms that shirk the rules on taxes and social contributions. Weak access to bank financing and underdeveloped non-bank financing also constrain SMEs, particularly start-ups and microenterprises.

Partnerships and financing

In light of weak domestic savings, most Western Balkan economies rely strongly on external financing for growth. The region benefits from considerably higher inflows of remittances, official development assistance (ODA) and FDI than global peers, even if some of these sources of financing have declined in recent years, compensated for in part by rising external debt. FDI in the financial sector has been an important driver of credit expansion over the past two decades, alongside the rise in domestic deposits. However, credit growth over the past decade in most regional economies has been driven by household and government lending. Enterprise lending has been more subdued, reflecting higher non-performing loans in this sector and tighter lending standards by the bank sector. Bank lending has been particularly constrained for micro and small enterprises and start-ups, which have difficulty meeting banks' stringent collateral and other requirements but have limited alternative financing options due to underdeveloped non-bank financing.

Most regional governments are not highly indebted, but public debt has increased across the region over the past decade, and the COVID-19 crisis has recently taken a big toll on public finances. The rise in public debt was driven by expansionary fiscal policy in the aftermath of the global financial crisis, but it also reflects structural constraints, namely weak revenue performance accompanied by high and rising current expenditures. On the revenue side, the relative underperformance of most regional economies mainly reflects high informality and high tax avoidance through under-reporting of sales, wages, etc. In some economies, it also reflects significant tax incentives for investment and employment, as well as low tax rates. On the expenditure side, high and rising current expenditures have put significant pressure on public finances across the region. They mainly reflect high and rising pension expenditures across the region. In some economies, they also reflect generous subsidies for employment, high benefits for war veterans and high wages for public-sector employees.

Peace and institutions

Throughout the past decade, Western Balkan economies have made institutional improvements. The prospect of EU accession has been pivotal in driving change and pushing governments to align legislative frameworks to the EU acquis. While citizen trust in government remains low, it has increased in some economies. Informal institutions continue to play a key role in settling disputes when court proceedings are lengthy and costly, but overall, the judiciary in the region has strengthened. Through power-sharing arrangements, ethnic groups have a chance to take part in decision-making processes. Old grievances still exist but do not trigger large-scale conflicts like 20 years ago. However, this is not enough; much more has to be achieved to strengthen institutional fundamentals, restore a durable social contract and improve people's well-being.

Reviewing the role of the state in people's lives and the economy can open up opportunities across the region. State structures are often overly complex: numerous ministries and agencies and unclear lines of accountability, for example, delay decisions and cost time and resources. Property rights are not always secure, undermining investments and dampening trust in formal institutions. The balance of power between central and local governments has not yet reached a stable arrangement. Peripheral localities often have few resources to catch up and offer credible alternatives to capitals or outmigration. Public resources are not always allocated efficiently but rather according to political interests. Politics continue to play too great a role in the functioning of the public administration and SOEs, which are sometimes inefficient and capture markets, preventing innovation and productivity gains.

Overall, democratic values need strengthening. Patronage and clientelism (and at times ethnic outbidding) risk undermining democracy. As a result, some parliaments are very fragmented and have difficulty agreeing on policies. Political debates has become so acrimonious that some leaders have boycotted elections and allowed the monopolisation of institutions by one party. Either way, the legislative is often too weak to ensure checks and balances on the executive. A still too-frail judiciary cannot play this role either. Citizens place the rule of law, good governance and effective policy making very high in their visions of a good future. Coming together around this objective can lead to paths towards new opportunities for development.

Planet

The Western Balkans have rich biodiversity. Between 28% (Albania) and 61% (Montenegro) of economies' territory is covered by forests. Across the region, the forest sector makes an important contribution to the economy and could be further exploited. Western Balkan economies should make the most of their rich biodiversity by minimising degradation, better preserving resources and enhancing well-being and quality of life for all.

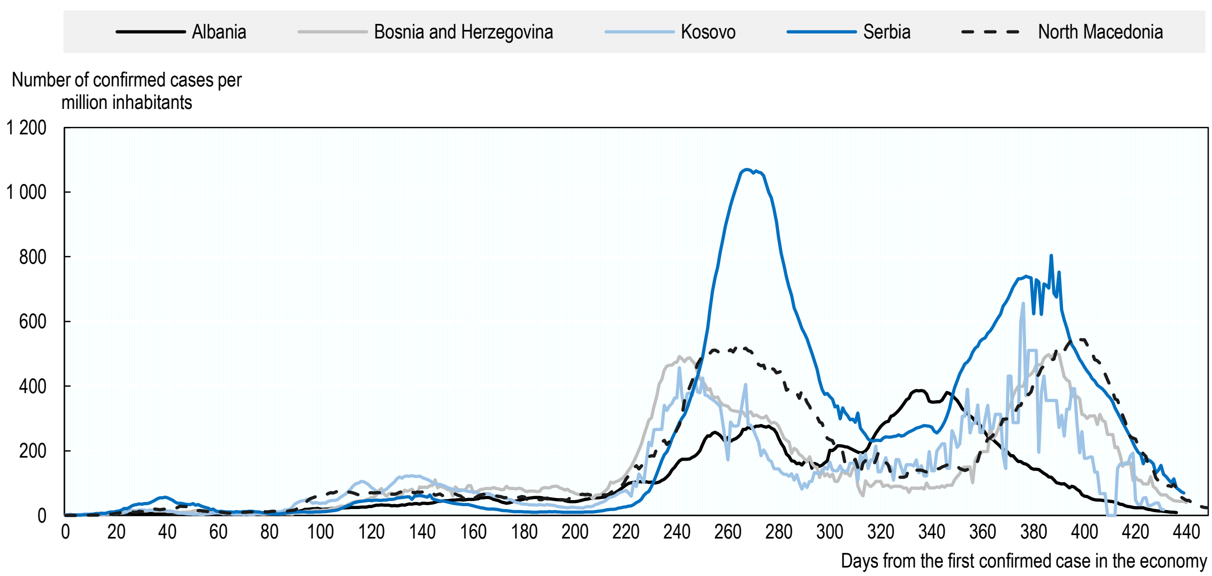
Western Balkan economies have high levels of air, water and ambient pollution and face important challenges in their energy sectors. Levels of air pollution in Western Balkan economies are the highest in Europe, and economic and health costs from air pollution are high. The main sources are the residential sector, poorly insulated buildings, electricity generation from coal and the transport sector. Inadequate management and treatment of solid waste and wastewater cause ambient and water pollution and pose a threat to human health. In the energy sector, except for Albania, Western Balkan economies rely heavily on highly polluting coal for electricity generation. Levels of energy intensity are high, and outdated energy infrastructure and unreliable electricity supply are key challenges. Public utility tariffs set below operational costs limit financial resources available for investments in the energy sector, solid waste and wastewater management and water supply. Water management, water scarcity and natural hazards are challenges in several Western Balkan economies.

COVID-19 in the Western Balkans

Like most of Europe, the Western Balkans experienced two surges of COVID-19 since the onset of the pandemic (Figure 1.9). With 2 789 registered deaths per million inhabitants by 24 May 2021, Bosnia and Herzegovina has been hardest hit in the region. Albania had consistently the lowest number of cases and registered deaths in the region, standing at 850 of registered deaths per million as of end of May 2021 (Figure 1.10). Severe restrictions on movement, business and social life lasted from about mid-March until June 2020. In late 2020, new restrictions emerged in response to a resurgence of infections across most of the region, however, higher public spending and less drastic lockdown restrictions attenuated this wave (World Bank, n.d.[32]) (Figure 1.11).

Figure 1.9. The incidence of COVID-19 in the Western Balkans has followed a double-peak pattern

Daily new confirmed COVID-19 cases per million inhabitants, rolling seven-day average



Source: Authors' calculation based on Our World in Data (2021[33]), *Our World in Data* website, https://ourworldindata.org/.

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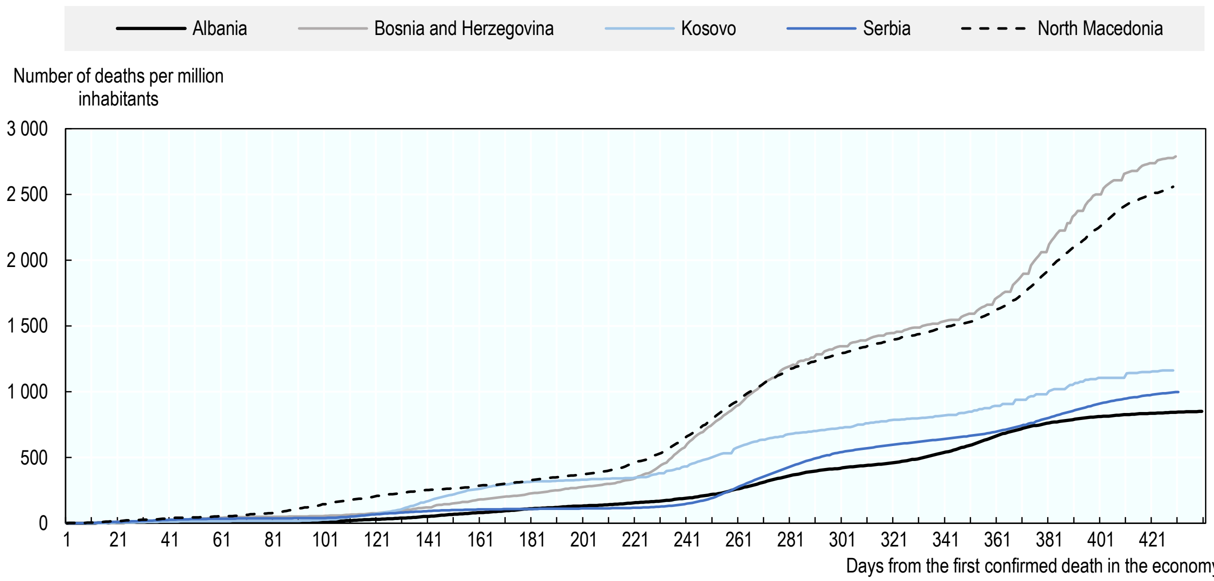
Figure 1.10. Registered deaths per million inhabitants in the Western Balkans varied among the five economies

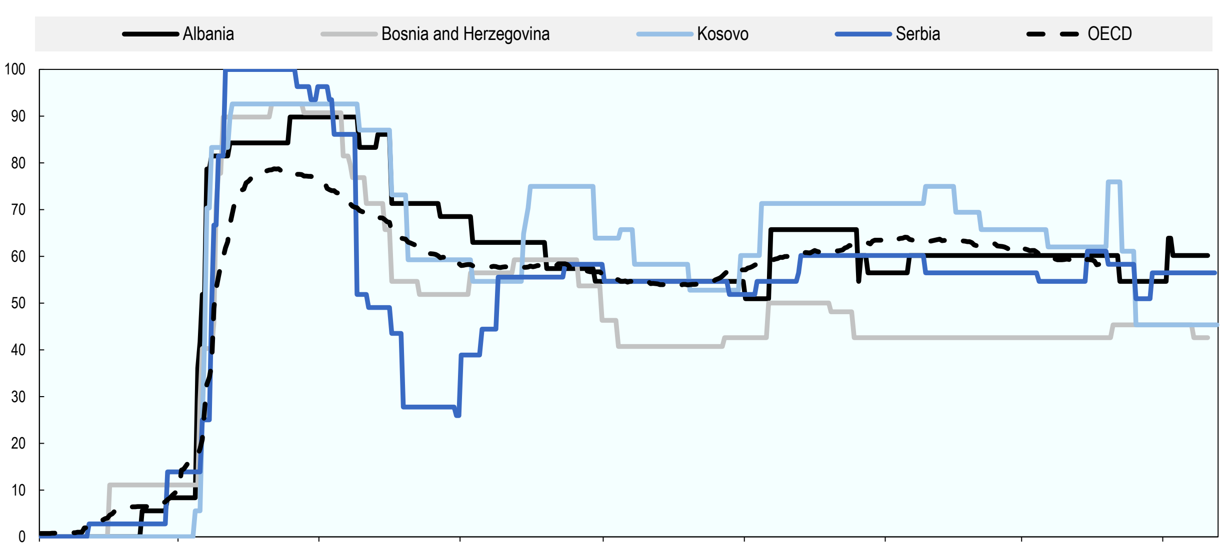


Source: Authors' calculation based on Our World in Data (2021[33]), *Our World in Data* website, https://ourworldindata.org/.

StatLink https://doi.org/10.1787/888934241035

Figure 1.11. Restrictions in the Western Balkans have followed a pattern similar to the rest of the OECD

Stringency index (0 = least stringent; 100 = most stringent)

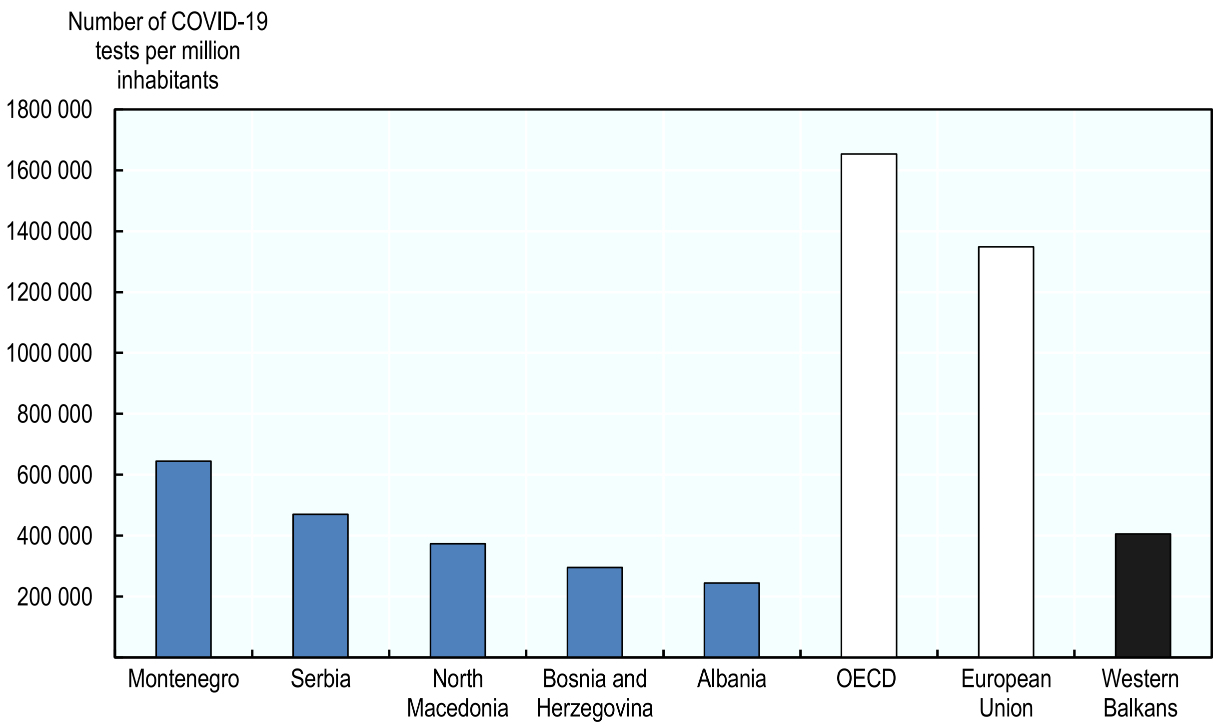


Source: Oxford University (2021[34]), Oxford COVID-19 Government Response Tracker, https://covidtracker.bsg.ox.ac.uk/.

StatLink https://doi.org/10.1787/888934241054

Testing and vaccine capacity vary significantly among the economies in the region. Enhancing the timely detection of new potential cases and hotspots is critical. Montenegro conducted the largest number of tests compared to the rest of the region (644 254 tests per million inhabitants by the latest available data), and was closely followed by Serbia (Figure 1.12). With 28 people fully vaccinated per hundred inhabitants by the latest available data, vaccine capacity in Serbia is by far the highest in the region and also outpaces both the OECD and EU averages (Figure 1.13).

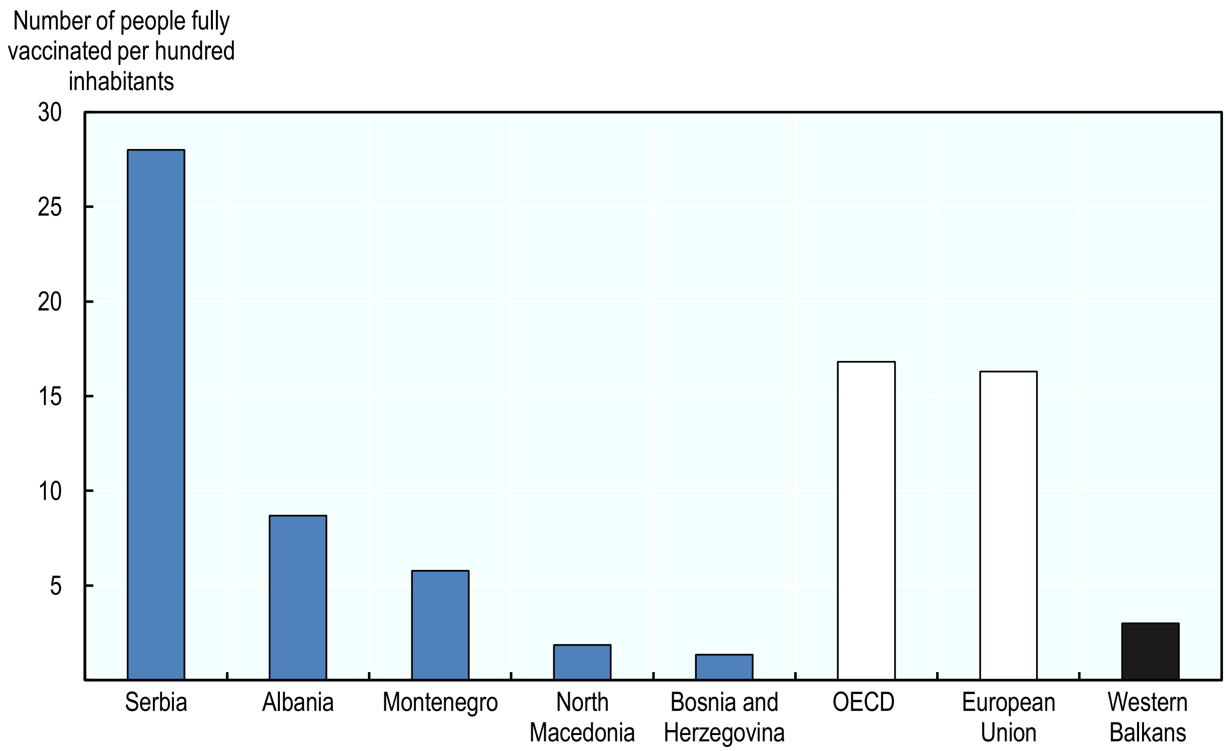
Figure 1.12. Testing capacity in the Western Balkans



Source: Worldometer (2020[35]), "Coronavirus", www.worldometers.info/coronavirus/.

StatLink https://doi.org/10.1787/888934241073

Figure 1.13. Vaccinations in the Western Balkans



Note: Last reported numbers are from May 2021.
Source: Worldometer (2020[35]), "Coronavirus", www.worldometers.info/coronavirus/.

StatLink https://doi.org/10.1787/888934241092

Overall, the region has weathered the pandemic's economic impact better than expected, but some economies have been hit severely. Across the region, real GDP declined by 3.4% in 2020, compared to 6.1% for the EU. However, this average masks significant heterogeneity across the region, due to differences in economic structures and the extent of governments' fiscal responses. Montenegro, heavily dependent on tourism experienced a deep contraction, while Serbia managed to contain the contraction relatively well (Table 1.3).

Table 1.3. COVID-19 has affected the regional economies to varying degrees

GDP, constant prices, percentage change

	Albania	Bosnia and Herzegovina	Kosovo	Montenegro	North Macedonia	Serbia	Western Balkans	European Union
2020	-3.5	-5.5	-6	-15.2	-4.5	-1	-3.4	-6.1
2021	5	3.5	4.5	9	3.8	5	4.7	4

Source: IMF (2021[6]), *World Economic Outlook Databases*, https://www.imf.org/en/Publications/SPROLLs/world-economic-outlook-databases#sort=%40imfdate%20descending.

Governments contributed to this performance with a series of measures to mitigate the negative impact of the crisis on the economy. The various support measures included loan guarantees and tax deferrals for enterprises, cash transfer to citizen, waiwers of wage and social security contributions, price controls and various other measures to support different sectors. In addition, financial assistance came from international donors, including the World Bank and the European Union. Overall, the fiscal stimulus in the region ranged from 2.8% of GDP in Kosovo to 12.7% of GDP in Serbia, which helps explain Serbia's GDP performance.

The pandemic has highlighted the need for effective health and social support services. Before the crisis, the regional economies spent on average 6.8% of GDP on health care, which is lower than the EU and OECD averages – 9.9% and 12.6%, respectively. While, Bosnia and Herzegovina and Serbia spent about 9.2% and 9.1% of GDP on health care, respectively, and have a relatively well equipped health sector in terms of infrastructure, Kosovo spent only 1.6% of GDP, indicating needs for ***substantial investments in infrastructure and equipment***. Relatively high unemployment and widespread informality may also slow down recovery. Moreover, they imply that a significant share of the population risked remaining without adequate health and social assistance.

Women are particularly exposed to the collateral effects of COVID-19. As in other economies, loss of employment and lockdown conditions have raised concerns about increased exposure to the risk of domestic violence during the first wave of the COVID-19 crisis (Bami, 2020[36]; OECD, 2020[37]). Even before the crisis, domestic abuse existed and needed better enforcement of existing legislation, including upping the provision of shelters and issuing emergency protection orders more promptly. Women are affected in other ways too. They make up the majority of the healthcare workforce, which has exposed them to greater risk of infection. At the same time, women shouldered much of the burden at home, given school closures and longstanding gender inequalities in unpaid work.

Shared strategic opportunities and challenges as avenues for peer learning

Combining the visions, trends and multi-dimensional assessments of development, presented in this report, a number of priorities emerge that future strategies must address. This section presents the strategic opportunities and challenges that emerged as shared across the economies of the region. This regional overview and the initial assessments of each Western Balkan economy build the diagnostic basis for the next phases of the MDR of the Western Balkans, which will focus on peer learning to find solutions and ideas for action.

Particularly amid a COVID-19 pandemic, with its huge social and economic implications, learning from and with each other in order to tackle challenges and find innovative and timely solutions is more necessary than ever. The COVID-19 situation continues to change everywhere, and responses must be developed in real time. Simultaneously, the need for recovery spending makes strategic questions more urgent. Because a large amount of resources will be used, missed opportunities will be much more costly than they would be otherwise. Against this backdrop, the following shared strategic opportunities and challenges are presented with the hope that the ensuing peer-learning phase can help deliver solutions and play its part in making recovery spending as strategically effective as possible.

First, education and competences for economic transformation are the top priorities for all economies in the region. While economic structures vary significantly, finding new sources of productivity growth and engines for future transformation is an urgent task for all. Good jobs are scarce, and young people continue to leave. Boosting youth and workforce competences can unlock new opportunities to overcome these trends. This task is the more urgent, the more unfavourable an economy's current wage-to-productivity ratio is. Kosovo tops this table, but the challenges are similar for all economies, and the differences in wage-to-productivity ratios are small.

Strategies for competences and top-notch education will both be needed. Strategies for competences and the future transformation of the economy must combine education with practical training, investment promotion and proactive creation of partnerships with firms, academia and more. Digitalisation, which is currently receiving a boost from the COVID-19 crisis, must be a key element of any competence strategy. Diasporas should be included as core assets in such strategies. Creating top education systems must be the second pillar. Pedagogical and curricular reform are needed, but the most important challenge will be moving from overstaffing to a focus on equity and performance. The region has a comparatively young population and must invest in it, from ECE through tertiary education. Economies learning from each other and from international experiences hold significant potential.

Second, social cohesion presents both an opportunity and a significant challenge for all societies in the region. Underperforming labour markets leave many without attractive opportunities and strain citizens' ability to support each other. At the same time, the lack of formal labour market participation renders the mostly contribution-based social protection systems unsustainable and under-dimensioned. Large inequalities between sub-regions and between ethnic groups add to the complexity. Local governments should be on the frontlines in addressing this challenge but, in most places, lack the capabilities in terms of organisation, incentives and funding.

Strengthening social cohesion and resilience will require social protection reform, effective service delivery and supportive labour market institutions. The pandemic has underlined the importance of effective social protection systems in rendering societies resilient and in acting as automatic stabilisers in times of crisis. Even in normal times, social safety nets are important in creating trust and supporting citizens to participate fully in society. Systems vary across the region, but financial sustainability, lack of social assistance beyond pensions, and expensive regimes for particular groups are common challenges. The size of the informal economy makes it necessary to devise schemes that are universal and not based solely on contributions. Experiences around the world can serve as inputs for solutions. Effective service delivery, particularly at the local level, must be a key element of any social cohesion strategy. Examples of and ideas for stronger local governments that have the resources and capacities to deliver are necessary to overcome the sometimes egregious differences between localities. Labour market institutions must play a role in creating social cohesion. While much of the region's employment performance owes to weak engines of economic growth, labour market institutions, such as matching mechanisms and the employment incentives supplied by labour legislation and social contributions, could play a much more effective role.

Third, energy and air pollution are complex challenges and significant obstacles to future economic development and well-being. Coal accounts for large to huge shares of energy supply across Western Balkan economies, except for Albania, which relies almost exclusively on hydropower. Many coal power plants are old and need decommissioning or significant investments to ensure reliable electricity supply. At the same time, coal, particularly when burned with old technology, is a driver of climate change and causes significant air pollution, which is the region's foremost environmental burden. Given the current product space of most of the region, attainable opportunities could exist in energy-intensive metals and machines. However, this would only be possible with a more sustainable and reliable energy supply. Meanwhile, a cleaner environment, especially in the major urban centres, is a top desire of residents and would be crucial to making the region an attractive place to live, invest and return to.

Solutions to the energy-air pollution nexus will require a regional perspective. Already today, trade in electricity, especially between Albania and its neighbours, is frequent and helps partners achieve a better energy mix. Given the small size of each economy and the variation in their endowments in terms of natural resources and energy opportunities, a resilient, climate-friendly and high-performing energy mix only seems attainable at the regional level. While solar and wind energy can be exploited at small scale, hydropower and conventional energy production can play their role more productively at regional scale. As the energy transition beckons and huge investments must be made, it would now be a good time to engage in peer learning and mutual exchange about opportunities and ways forward, including on the basis of what has been done in other parts of the world. The same holds true for air pollution, which all regional economies must urgently address and for which innovation and inspiration are needed.

Fourth, digitalisation is an unstoppable global trend that can offer the region important opportunities for transforming education, the economy and governments. The COVID-19 pandemic, with its global shift to teleworking and digitalised services, has accelerated digitalisation. At a time when resilience requires the ability to keep an economy going while imposing physical distance between people, digitalisation is essential. Beyond the pandemic, digitalisation has the potential to become a building block of more competitive and productive economies in the region. Given the strong tradition of engineering and mathematics education and young populations eager to connect to the world, a push for digital competences has potential. Done right, bolstering digital skills could also help alleviate unfavourable wage-to-productivity ratios. The biggest potential of digitalisation might be in transforming governments and public service delivery. Inefficient government structures and lack of capacity for service delivery, especially at the local level, have been identified as major constraints to development in all initial assessments. Better governance and services were also among the top dimensions in all future visions. Examples of early-adopting economies, like Estonia, show that digitalisation can help re-engineer structures of the public administration for higher performance at lower cost.

Fifth, migration and brain drain present considerable challenges for all societies in the region; making more of diasporas, on the other hand, holds opportunity. Emigration and remittances have been defining features in most of the region over the last decade. They help take the pressure off underperforming labour markets and supply many households with additional income, significantly contributing to poverty reduction and improvements in living standards. They also deprive the region of young talents, potentially contributing to the lack of economic innovation and transformation. Public services, especially medical care, also suffer as qualified people leave. The emotional cost to those who remain is considerable and might fuel resentment towards the European project in the long run (Krastev and Holmes, 2019[38]). Yet, past migration holds significant potential in the form of a large diaspora in the more advanced economies of Europe and North America. Elsewhere in the world, diasporas have been important sources of investment and know-how, suggesting that more can be made of these links through investment programmes, sponsorships and incentives for return migration.

Sixth, women face particular obstacles to full participation in societies in the region. Across economies, women's low participation in paid work due to full-time household chores, lack of child and elderly care services and cultural norms that encourage traditional division of labour is striking. This is in contrast to many post-communist societies, which traditionally have comparatively high levels of female labour market participation. While the current poor labour market conditions and high unemployment pose challenges for both men and women, and increased female participation could not easily be absorbed, things can change. If economies seize the opportunities laid out in this report and the initial assessments, demand for qualified labour, including female labour, will increase dramatically. Learning from each other about creating opportunities for women and about finding a good balance of opportunity in society can help generate solutions.

Seventh, land management and registration of property rights pose significant challenges in most economies, with deleterious consequences for rural development, revenue generation and the environment. The multiple changes in legal and political regimes in the last century have left most economies with significant numbers of overlapping land claims. These stem from both formal regime change and the fact that traditional – informal, from today's perspective – means of land transfer have been used where formal channels were not sufficiently present or accessible. In addition to registration problems, cadastres are not complete everywhere and are at times incoherently organised. As a result, often property cannot be used as collateral to access financing, and much of farming is hampered by small plots, as growth through purchase of land is blocked. Yet, sustainable agricultural techniques often require larger plot sizes to generate sufficient returns, and the current small-plot structure incentivises intensive practices with heavy environmental tolls in the form of overuse of water and pesticides. Relevant experiences in land management abound internationally; peer learning could help create solutions for Western Balkan economies.

Eighth, a focus on local governments, their implementation capacities, funding and incentives can help identify important opportunities for future development. Local governments are key in implementation and delivery but often do not play their role. Local governments provide many services, such as education, health care, social assistance and water and waste services. Many municipalities have sizeable staff and spend the large majority of their budgets on salaries. However, benchmarking shows that the services delivered are not in line with what is spent on their delivery. Political patronage often plays an outsized role in hiring at the local level, and in some economies, the incentive structure, set by how local governments receive their funding from the centre, leads to further surplus hiring, as opposed to smart investments in performance. While the structure of multi-level government organisation varies, all economies struggle in some way with delivery at the local level. Learning from each other and from what has been done elsewhere in the world could point the way to new opportunities and solutions.

In the end, progress comes down to implementation and reliability. The high pace of production and the quality of legal texts and strategies across the region is impressive. Yet translation into practice oftentimes remains slow. State structures tend to be overly complex. Numerous ministries and agencies and unclear lines of accountability delay decisions and cost time and resources. Frequent political changes and insufficient protection against undue influence are other sources of delay and impediments. At the same time citizens place the rule of law, good governance and effective policy making very high in their visions of a good future. Coming together around the objectives of effective public delivery and implementation in a context of good governance can lead to paths towards new opportunities for development and enable achievements across the strategic priorities listed here.

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Note

[1] Due to the outbreak of COVID-19 and the related travel restrictions, the OECD visioning workshop in Bosnia and Herzegovina was cancelled. This report therefore does not contain inputs for the economy's vision.

2 Multi-dimensional analysis of development in the Western Balkans

Achieving rapid, inclusive and sustainable development requires progress across a range of development domains. This chapter identifies the key capabilities and most pressing constraints in the Western Balkans by linking economic, social, environmental and institutional objectives. The assessment is organised around five thematic sections based on the five pillars of the United Nations 2030 Agenda for Sustainable Development: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet.

People

Despite the financial crunch COVID-19 will present, Western Balkan economies cannot afford to miss opportunities for investment in their human capital. The region needs to improve access to jobs for all and to develop future-proof education systems. The health and social protection infrastructure needs to be better resourced and modernised, more efficiently organised and made more inclusive of those most in need.

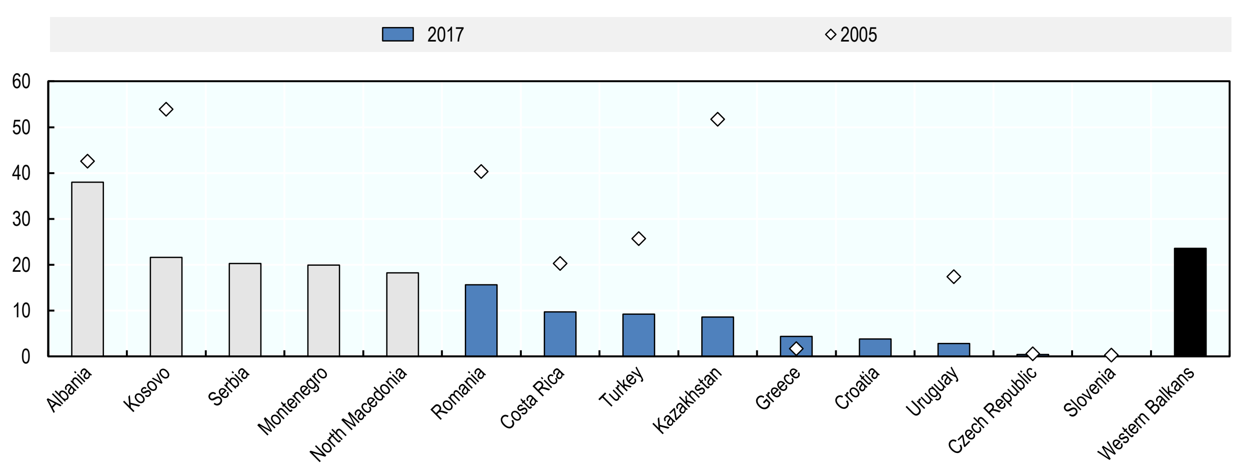
Social cohesion is limited, and many people are left behind

Poverty remains an issue in the region, and regional disparities are significant. Poverty rates of Western Balkan economies vary but remain high compared to benchmark countries in Central and Eastern Europe (Figure 2.1). Subregional inequalities in economic development and well-being exist in all countries. In Albania, Tirana accounts for about 52% of all jobs, while social services, which are the responsibility of local governments, are either underdeveloped or missing in many parts of the country due to poor capacities and local authorities' lack of experience. In Serbia, poverty rates in the Southern and Eastern Serbia (Region Južne i Istočne Srbije) are three times higher than in the Belgrade Region (Beogradski Region). Access to infrastructure, such as public water supply, in rural areas remains an issue in most economies.

Many minority groups, such as Roma and lesbian, gay, bisexual, transgender and intersex (LGBTI) people, are still subject to discrimination. Negative stereotypes, violence or denial of access to public services and jobs leave these groups largely marginalised. In all economies, Roma have very low health coverage, lower employment rates and poor access to education, public services and infrastructure, such as piped water and electricity, particularly in rural areas. Across economies, up to half the population believed homosexuality is a sickness, and LGBTI communities often report personal experiences of harassment. Existing legal provisions to protect LGBTI rights can be strengthened, and data collection on hate crimes should be prioritised.

Figure 2.1. Western Balkan poverty rates remain comparatively high

Poverty headcount ratio at USD 5.50 per person per day (2011 PPP)



Note: The Western Balkan average excludes Bosnia and Herzegovina, for which no data are available.
Source: World Bank (2020[1]), *World Development Indicators* (dataset), https://databank.worldbank.org/source/world-development-indicators.

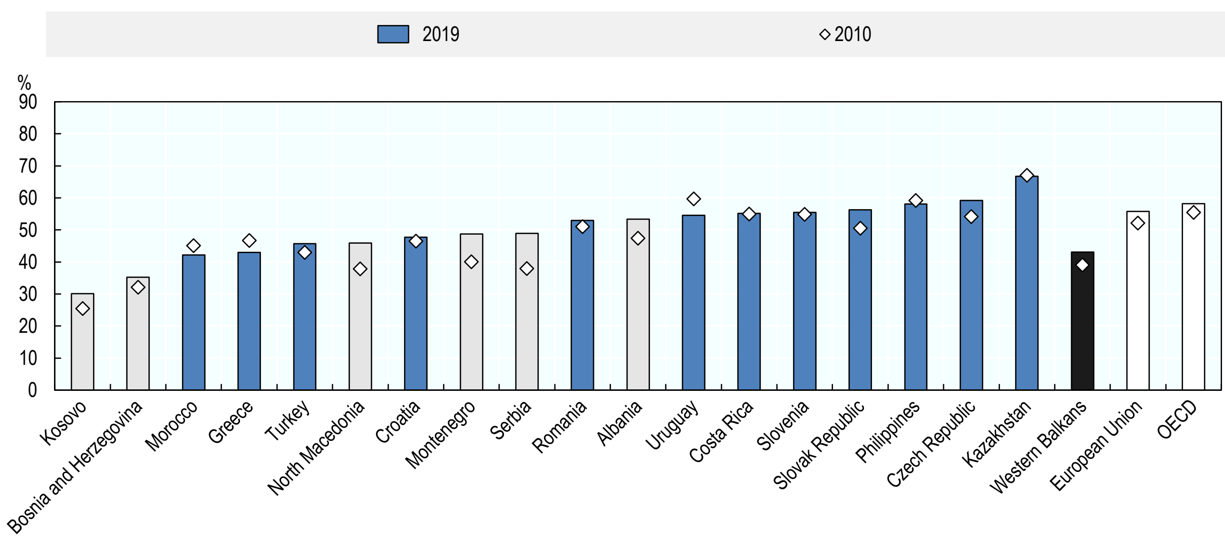
StatLink https://doi.org/10.1787/888934241111

Employment opportunities are inadequate, especially for women and the young

Labour market imbalances leave many in the region without jobs. While employment rates have increased over the past decades in most Western Balkan economies, they still trail behind benchmarks economies (Figure 2.2). On the demand side, a rather slow structural transformation and economic diversification did not lead to job creation. On the supply side, Western Balkan economies struggle with skills gaps and mismatches, inadequate activation policies, inadequately designed labour laws and high labour costs.

Figure 2.2. A large share of the region's population is not employed

Employment-to-population ratio, age 15+, total (%) (national estimate)

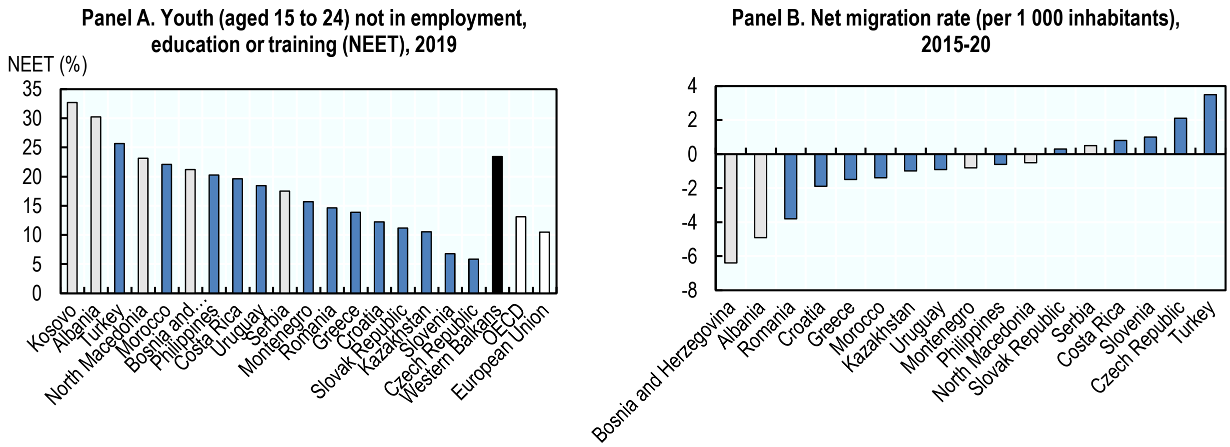


Notes: Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.
Source: World Bank (2020[1]), *World Development Indicators* (dataset), https://databank.worldbank.org/source/world-development-indicators.

StatLink https://doi.org/10.1787/888934241130

The region's youth is not well integrated into labour markets, and looming demographic changes, coupled with high migration, can lead to brain drain and human capital loss. About one in four people aged 15 to 24 does not participate in education, training or employment in the Western Balkans (Figure 2.3 – Panel A). The younger generation migrates abroad primarily due to poor employment opportunities (Figure 2.3 – Panel B) but also to poor public services and environmental concerns, such as air pollution. At the same time, the wage differential with the European Union constitutes a strong pull factor. Low fertility rates throughout the region (World Bank, 2020[1]) are expected to create further demographic pressures.

Figure 2.3. High youth unemployment fuels migration



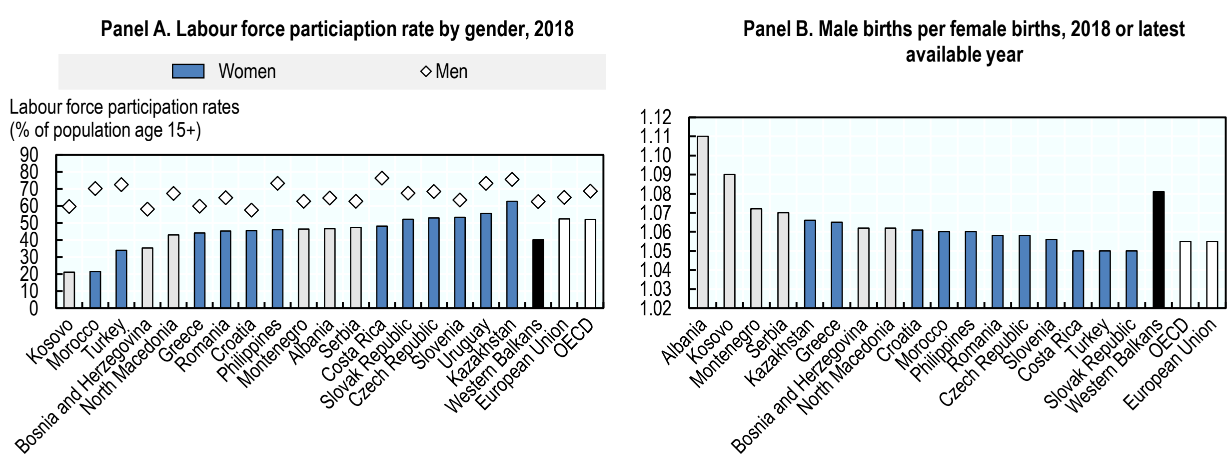
Note: There are no net migration rate data for Kosovo.
Sources: ILO (2020[2]), *ILOStat* (database), https://ilostat.ilo.org/data/; United Nations (2020[3]), "World Population Prospects 2019", https://population.un.org/wpp/.

StatLink https://doi.org/10.1787/888934241149

If managed well, migration can bring significant development opportunities to the region. First, already significant remittances (9.6% of regional GDP in 2019) can be better channelled to finance investments. Second, by promoting circular migration and tapping into their large diasporas, economies can attract more FDI and benefit from new skills and knowledge.

Besides youth unemployment, women's low participation in paid work due to traditional norms and lack of care services is striking. Despite variation across Western Balkan economies, the regional gender gap in labour force participation (22.5 percentage points) is significantly higher than the OECD and EU averages (16.5 and 12.5 percentage points, respectively) (Figure 2.4).

Figure 2.4. Selected indicators of gender equality underscore that women in the Western Balkans are not yet treated equally



Note: Panel B. Data for Kosovo refer to 2014.
Sources: UNFPA/World Vision (2012[4]), *Sex Imbalances at Birth in Albania*, www.unfpa.org/sites/default/files/resource-pdf/UNFPA_report_Albania2012.pdf; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

StatLink https://doi.org/10.1787/888934241168

Across regional economies, women bear the brunt of unpaid work in the household (a main self-reported reason for labour market inactivity), and cultural norms that encourage traditional division of labour are strong. Elderly and child care social services that could free up women's time for paid work are both underdeveloped and not well accepted. Indeed, average preschool enrolment rates in the region are very low, especially among 0- to 3-year-olds.

Women's participation in Western Balkan societies is not yet equal along multiple other dimensions. Although far from parity, female representation in the legislative branch and in private-sector management is generally better than in OECD countries. However, in all regional economies, women's participation in executive branch decision making is lower than men's, and their participation at the local level is significantly lower than at the national level. There are also issues across the region concerning social norms that accept gender-based violence and skewed sex ratios at birth due to strong preferences for male children.

Attending education in the Western Balkans does not yield the skills needed to succeed

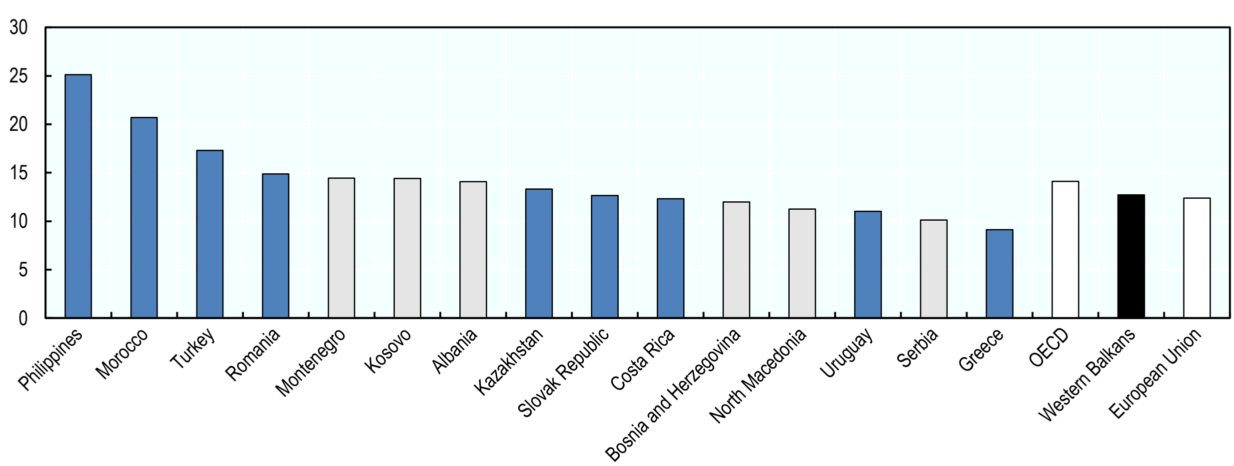
Student skills are generally low in the region, and access to education is not always equal. The OECD Programme for International Student Assessment (PISA) shows most Western Balkan economies trailing behind international benchmarks. Students from rural areas and those from minority groups are less likely to perform well. In Serbia, students attending schools in cities scored, on average, 122.3 points higher in the reading assessment than those enrolled in rural areas (OECD, 2019[5]). Roma children throughout the region are far less likely than their non-Roma peers to participate and progress in school and higher education, especially when living in poverty.

At least half the children in the region do not attend pre-primary education. Gross ECE enrolment rates in 2017 ranged from 30.5% in North Macedonia to 54.1% in Serbia (UNESCO, 2020[6]). Lack of ECE participation means that children are likely to lack foundational skills, which are integral at later stages of education, and keeps women caring for children at home out of the labour market.

Education resources, including teaching staff, are not well utilised. Despite a favourable pupil/teacher ratio overall (Figure 2.5), poor teacher selection criteria and the lack of opportunities for professional development drag down teacher motivation and affect teaching outcomes (Figure 2.6). Limited education funding does not provide adequate opportunity for teachers to take up trainings.

Figure 2.5. Favourable pupil/teacher ratios are not reflected in education outcomes

Pupil/teacher ratios at the primary, secondary and upper secondary education levels

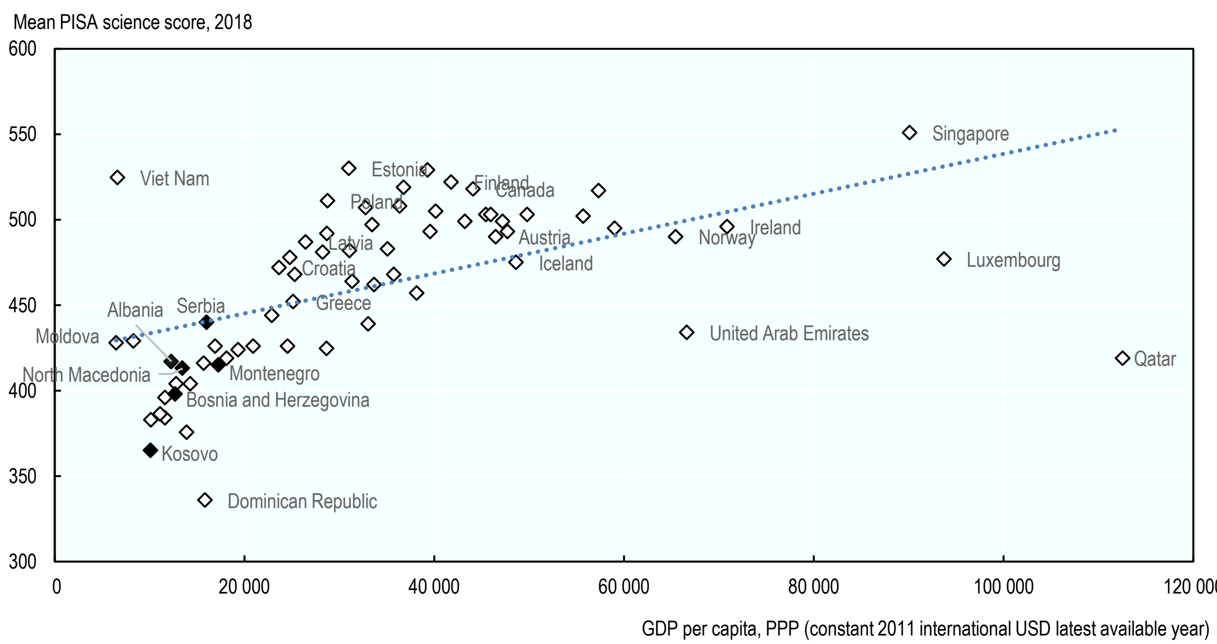


Sources: Kosovo Agency of Statistics (2020[7]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; World Bank (2020[11]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

StatLink https://doi.org/10.1787/888934241187

The potential of vocational education and training (VET) can be further exploited. Western Balkan economies have relatively high secondary education enrolment rates, especially in VET. Effective VET systems can matter a great deal, yet curricula need to be more practical and better adapted to labour market needs. Programmes in most Western Balkan economies are still mainly based on theory, and there is a great need to adapt infrastructure and materials for practical learning (Maghnouj et al., 2019[8]).

Figure 2.6. Education outcomes are comparatively low in the region



Source: OECD (2020[9]), *PISA* (database), www.oecd.org/pisa/data/.

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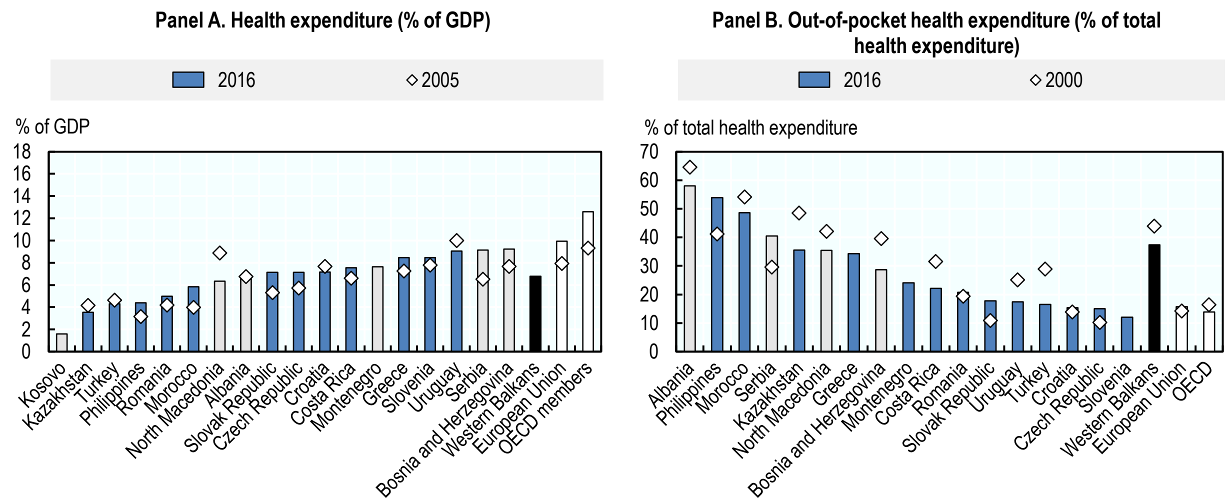
Health systems are ineffective and understaffed, resulting in poor health outcomes

Promotion of healthy lifestyles is a particular challenge in economies that, in common with OECD countries, face ageing populations and a growing share of non-communicable disease burden. Adult obesity rates in the region are higher than the 19% in the average OECD country, as are smoking rates, which range from one in three men in Albania to almost one in two in North Macedonia. While child health outcomes have generally improved in the past decade, they remain a particular concern in Albania, Kosovo and North Macedonia and for children from ethnic minorities throughout the region. All economies will need to improve underdeveloped and fragmented preventative and primary health care.

Healthcare systems in the region are generally under-resourced and financially unsustainable and place high costs on patients. Health expenditure as share of GDP for several economies is much lower than the EU and OECD averages (Figure 2.7). Medication and equipment shortages particularly affect rural areas. While in the efficacy, financial sustainability and set-up of insurance systems vary (ranging from a compulsory health insurance scheme covering almost 98% of the population in Serbia to no public insurance fund in Kosovo), out-of-pocket healthcare expenditures are high throughout the Western Balkans, and a significant share of the population reports unmet medical needs. Informal payments for healthcare services, especially in public hospitals, remain common.

Figure 2.7. Health systems in the region are underfunded and place high financial burdens on patients



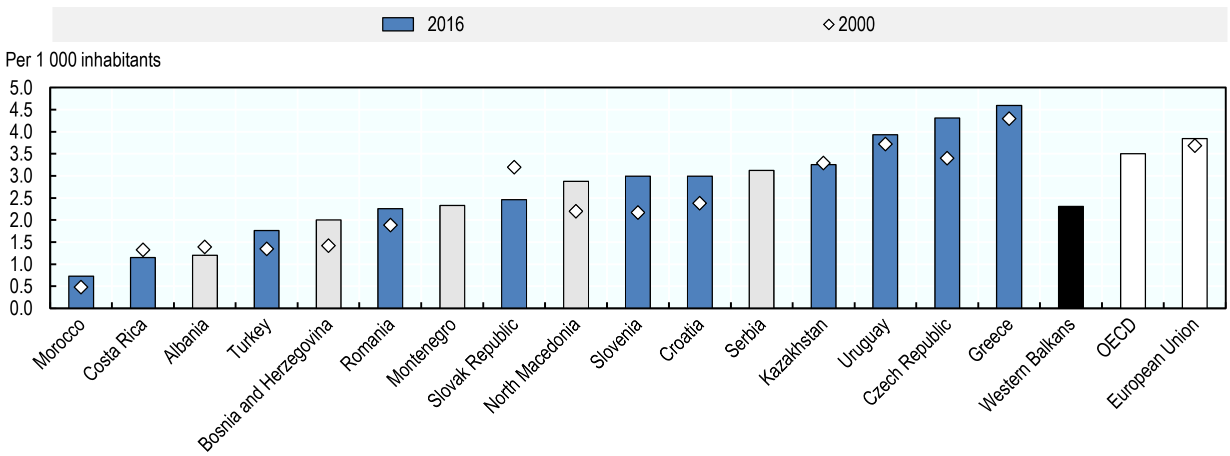
Note: Panel B – the Western Balkan average excludes Kosovo, for which no data are available.
Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

StatLink https://doi.org/10.1787/888934241225

Especially in the face of COVID-19-related strains on health systems, the lack of medical staff throughout the region is problematic. With 2.3 doctors per 1 000 inhabitants on average, the number of doctors per capita in the region is well below the OECD and EU figures (Figure 2.8). Remote hospitals in particular, which already lack specialists, have seen hundreds of physicians and nurses migrate to work in EU countries, mainly Germany, in the last years. Some economies have launched initiatives to retain medical staff, such as a patronage programme that sends doctors to regional districts in Albania or the doubling of doctor and nurse salaries in North Macedonia. Further efforts will be needed, as the overall lack of funds and the lack of transparency in human resource management make working in public health unattractive. Expanding digitalisation and telemedicine to increase access to specialist care in remote regions is an option to consider.

Figure 2.8. Health systems lack qualified medical staff, particularly in Albania and Bosnia and Herzegovina

Practicing physicians (per 1 000 inhabitants)



Notes: The Western Balkan average excludes Kosovo, for which no data are available. The EU average refers to the Eurozone. Latest available data refer to 2017 for Morocco, 2015 for Montenegro and North Macedonia and 2014 for Turkey.
Sources: OECD (2020[10]), *Health care use* (database), https://data.oecd.org/health.htm; WHO (2019[11]), *Global Health Observatory data repository – Burden of disease SDG 3.9.2 Mortality rate attributed to unsafe water, unsafe sanitation and lack of hygiene (exposure to unsafe Water, Sanitation and Hygiene for All (WASH))*, https://apps.who.int/gho/data/view.main.SDGWSHBOD392v.

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Social protection needs a more sustainable financing model and does not always reach those most in need

Western Balkan social insurance systems, particularly pension funds, need to find a more sustainable financing model while fully preventing old-age poverty. Generally, social protection expenditures in the region are low by international comparison, ranging from less than 9% of GDP in Kosovo to 21.5% in Serbia in 2016, and well below the EU28 average of 28%. While it is difficult to generalise the economy-specific set-ups detailed in the assessments, they share several characteristics. Uptake of private old-age insurance is very low, and public pension outlets generally make up the largest and growing share of overall social protection spending. While pension coverage in the region is generally high (and often geared towards special-interest groups, such as war veterans), payments are too low to fully protect against old-age poverty. High informality makes financing from social security contributions difficult. All economies struggle to some degree with financial sustainability, and general government expenditure is used to prop up pension funds. In recent years, various reforms to address pension fund deficits have been implemented. In 2014, Albania removed caps on maximum benefits, linking contributions and payments to incentivise pension uptake. Kosovo is discussing the reintroduction of a pay-as-you-go pension scheme. North Macedonia switched to price indexation of pensions in 2019. Serbia introduced regulations that affected both the retirement age and the pension level from 2008 onwards.

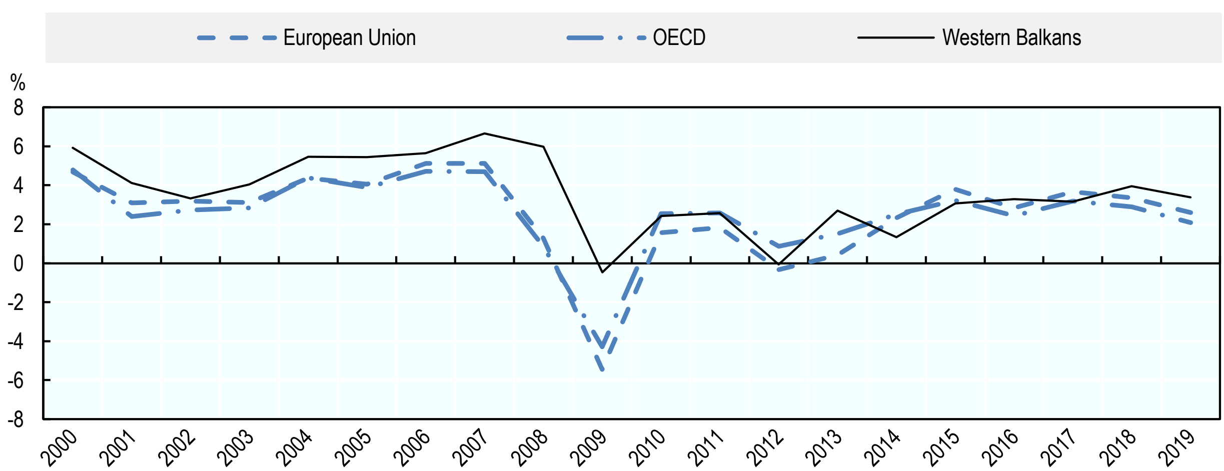
Other social assistance schemes are limited and ineffective. Spending on social assistance makes up a very small share of overall social protection spending, ranging from 1.6% of GDP in North Macedonia to 5% in Serbia, compared to 12.1% in the EU28 in 2016. Last-resort social assistance spending makes up an even smaller share, and benefit levels are inadequate: social assistance programmes across the region only reduced the risk of poverty by 3.9%, half the reduction observed in the European Union (ESPN, 2019[12]). The need to improve the coverage, ease of access and administrative efficiency of social safety nets and to expand nearly non-existent social and labour market reintegration services and link them within the social protection ecosystem is discussed further in the specific parts of the Multi-Dimensional Review of the Western Balkans.

Prosperity

GDP growth is weaker but more balanced

Prior to the global financial crisis, most Western Balkan economies were growing strongly (at an average annual rate of 5.8% between 2001 and 2008) on the back of expanding domestic demand fuelled by credit growth from the newly privatised and largely foreign-owned banking sector and by high and rising remittances. However, in most cases, the largely consumption-driven growth was accompanied by the accumulation of significant macroeconomic imbalances, including high current account deficits (about 7% in all Western Balkan economies), accumulation of significant credit risk in the banking sector, and wage growth that outpaced productivity growth and thus negatively affected competitiveness. The global financial crisis put a wrench in the growth engines of regional economies. In particular, in the context of weak to modest progress on structural reforms and on competitiveness growth, the high credit expansion resulted in a considerable decline in GDP growth (Figure 2.9).

Figure 2.9. Growth declined considerably over the past decade due to moderating domestic demand, in line with global dynamics



Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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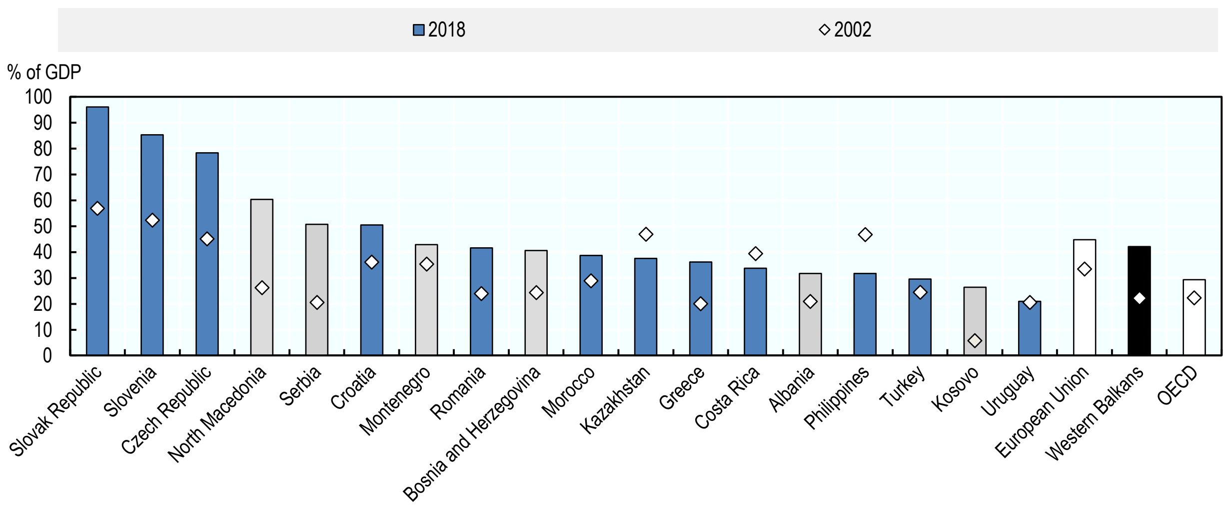
Growth in the post-crisis period has become more broad based, but export performance varies across the region. Over the past decade, GDP growth has become more balanced, with a stronger contribution from external demand (Figure 2.9). This has resulted in more macroeconomic and financial-sector stability. However, exports' contribution to GDP varies considerably across the region, with some economies, such as Albania and Kosovo, lagging significantly behind the others. Even among regional leaders North Macedonia and Serbia, export performance is significantly lower than in aspirational EU peers, whose export-led growth model led to a speedy convergence with EU income levels in the early 2000s (Figure 2.10). Last, the region still relies heavily on the export of raw materials and low-value added products, and there is considerable scope for diversification and upgrading of export baskets.

Figure 2.10. Exports' contribution to GDP has increased across the region, but export performance varies and lags behind aspirational EU peers

Exports as a share of GDP



Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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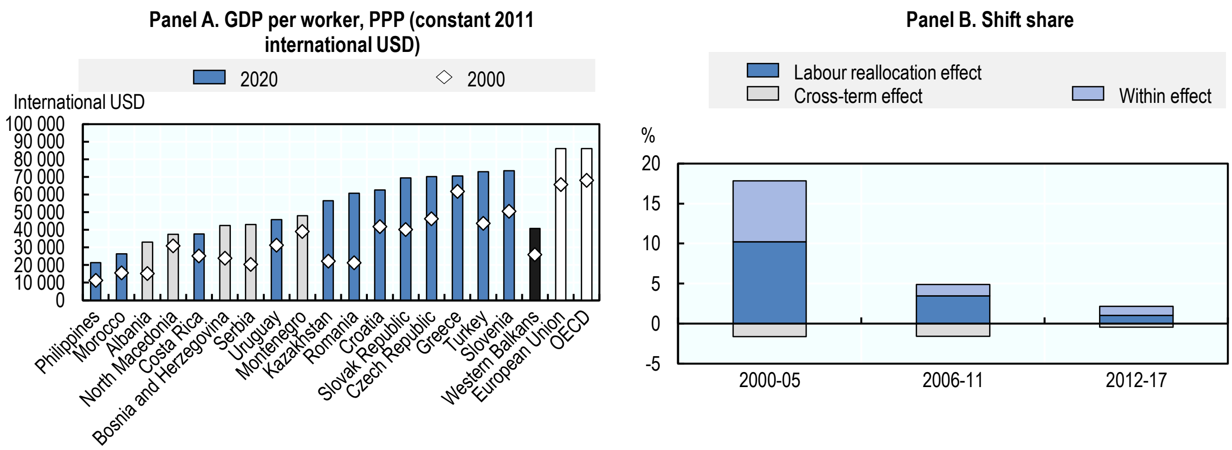
GDP growth and export performance are hampered by weak productivity, low investment in export-oriented sectors and weak linkages between the FDI sectors and the local economy. Labour productivity in the Western Balkans is low compared to global peers and the EU and OECD averages (Figure 2.11 – Panel A). In the post-crisis period, productivity growth weakened considerably across the region due to weak within-sector productivity growth and limited reallocation of labour from less to more productive sectors (Figure 2.11 – Panel B). While investment is moderate or high in most regional economies (Figure 2.12), a significant share goes to the non-tradable sector and/or sectors with weak productivity-enhancing potential (e.g. real estate, wholesale and retail trade). Most economies struggle to attract greenfield FDI in export-oriented sectors, while those that have been more successful (e.g. North Macedonia and Serbia) struggle to reap the productivity-boosting benefits from these investments due to the relatively weak linkages between the FDI sector and the local economy.

Figure 2.11. Labour productivity is low in the region, and productivity growth has weakened over the past decade



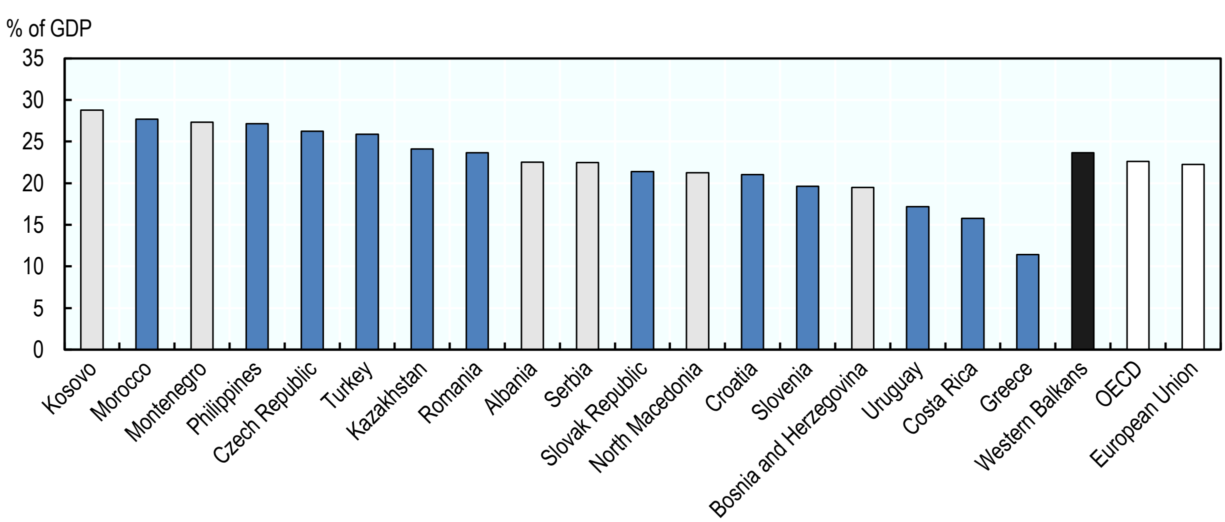
Note: Panel A – no data for Kosovo.
Source: Authors' own work based on ILO (2020[2]), *ILOStat* (database), https://ilostat.ilo.org/data/; United Nations (2020[13]), *Table 2.5 Value added by industries at constant prices (ISIC Rev. 4)* (dataset), http://data.un.org/Default.aspx.

StatLink https://doi.org/10.1787/888934241301

The structural transformation of Western Balkan economies therefore has been relatively slow, and despite some improvements in recent years, labour market outcomes remain relatively weak. Unemployment is high compared to the European Union and the OECD (15.9% vs. 6.5% and 5.8%, respectively), and employment is low (42.7% vs. 55% and 57.7%, respectively). Labour force participation lags considerably behind the EU and OECD averages. Young people are particularly strongly affected by the lack of (quality) job opportunities, a key push factor behind the high emigration from the region, particularly among the young and the highly educated.

Figure 2.12. Investment is moderate or high in most regional economies

Gross fixed capital formation (% of GDP), 2019



Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Looking to the 2030 horizon, Western Balkan economies need to build on their progress by continuing, and in most cases accelerating, structural reforms to increase competitiveness, boost investment and productivity growth and diversify, upgrade and expand export baskets. Reaching these objectives would require addressing common challenges.

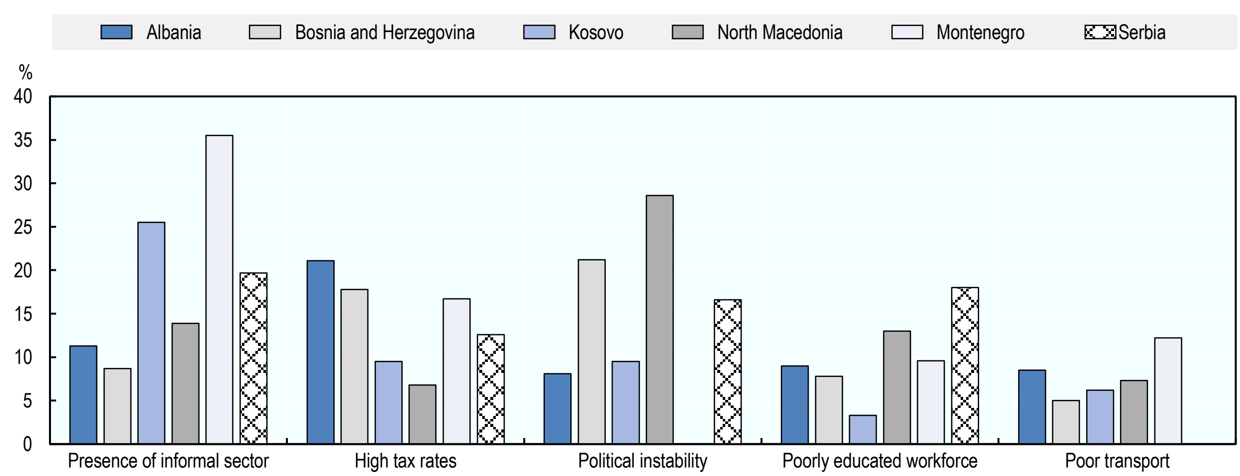
Domestic enterprises, particularly SMEs, face a challenging institutional and business environment

While some regional economies have made more progress than others in reducing the administrative and regulatory burden on businesses and in improving their investment climates, a number of common challenges persist. Corruption remains a pervasive problem that undermines trust in public institutions and is a significant deterrent to investment. Investment is also hampered by lengthy, costly and unpredictable contract enforcement, which in most cases reflects the highly overburdened and insufficiently specialised court systems.

Businesses face an uneven playing field when operating in the region. In all economies, competition from the large informal sector constitutes the most important constraint, as evidenced by the latest Business Environment and Enterprise Performance Survey (BEEPS) results. In some economies (Bosnia and Herzegovina, Kosovo and Serbia), unfair competition also stems from SOEs, which are present in many sectors. These SOEs benefit from direct or indirect government financial support and other advantages not enjoyed by private enterprises.

Figure 2.13. The top five constraints identified by Western Balkan businesses are high informal-sector competition, high taxes, political instability, poorly educated workers and poor transport infrastructure

Share of firms identifying main constraints (%), 2019



Source: WB/EBRD/EIB/EC (2021[14]), *Enterprise Surveys* (database), https://www.enterprisesurveys.org/en/enterprisesurveys.

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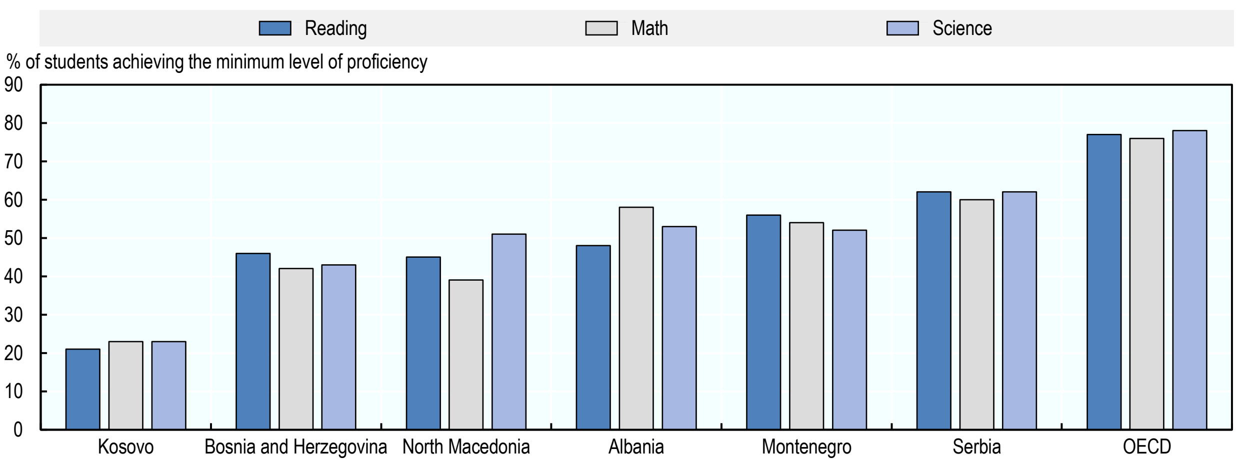
The lack of a skilled workforce impedes the growth of investment, job creation, innovation and technology adoption

An inadequately educated workforce is an important constraint to businesses in the Western Balkans, as evidenced by BEEPS results (Figure 2.13). This constraint reflects not only the quality of the education systems but also the relevance of the education received to the needs of the market.

The quality of education in the Western Balkans lags significantly behind aspirational EU and OECD peers, according to student performance on international assessments and other indicators. In the latest PISA, fewer than 50% of Western Balkan students achieved minimum proficiency across the three subjects, compared to the OECD average of nearly 80%.

Figure 2.14. Western Balkan student performance on the PISA lags considerably behind the OECD

Share of students achieving the minimum level of proficiency (%), 2018



Source: OECD (2020[9]), *PISA* (database), www.oecd.org/pisa/data/.

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The region's education systems do not impart the knowledge and skills needed by the labour markets. In the latest Balkan Barometer survey, nearly 30% of respondents noted that the education they received did not meet the needs of their jobs, and more than one-quarter identified skills they still needed to meet the needs of their jobs. Mismatched or missing skills refer not only to technical skills but also to more general cognitive skills that enable workers to solve problems, adapt, grow and innovate in the workplace (RCC, 2019[15]).

The high emigration from the region, especially of young and highly educated people, exacerbates the skills challenges companies face. Since the 1990s, more than one-third of the region's population has emigrated, and the rate of emigration of high-skilled workers is high: 55% of the population with higher education has emigrated from Bosnia and Herzegovina, and nearly 40% has from Albania and North Macedonia (World Bank, 2020[1]).

Infrastructure gaps impede trade and global value chain integration, and unreliable access to electricity and other utilities deter investment

Deficiencies in the size and quality of infrastructure in the transport, energy and municipal infrastructure sectors vary across economies, with Albania, Bosnia and Herzegovina and Kosovo facing the biggest challenges. However, in all economies, the infrastructure sector suffers from underinvestment and insufficient maintenance by largely inefficient SOEs and from underutilisation of private-sector investment and operational potential. In the transport sector, road and railway density is considerably lower than in aspirational EU and OECD peers. Poor transport infrastructure is one of the top five constraints identified by businesses in the latest BEEPS.

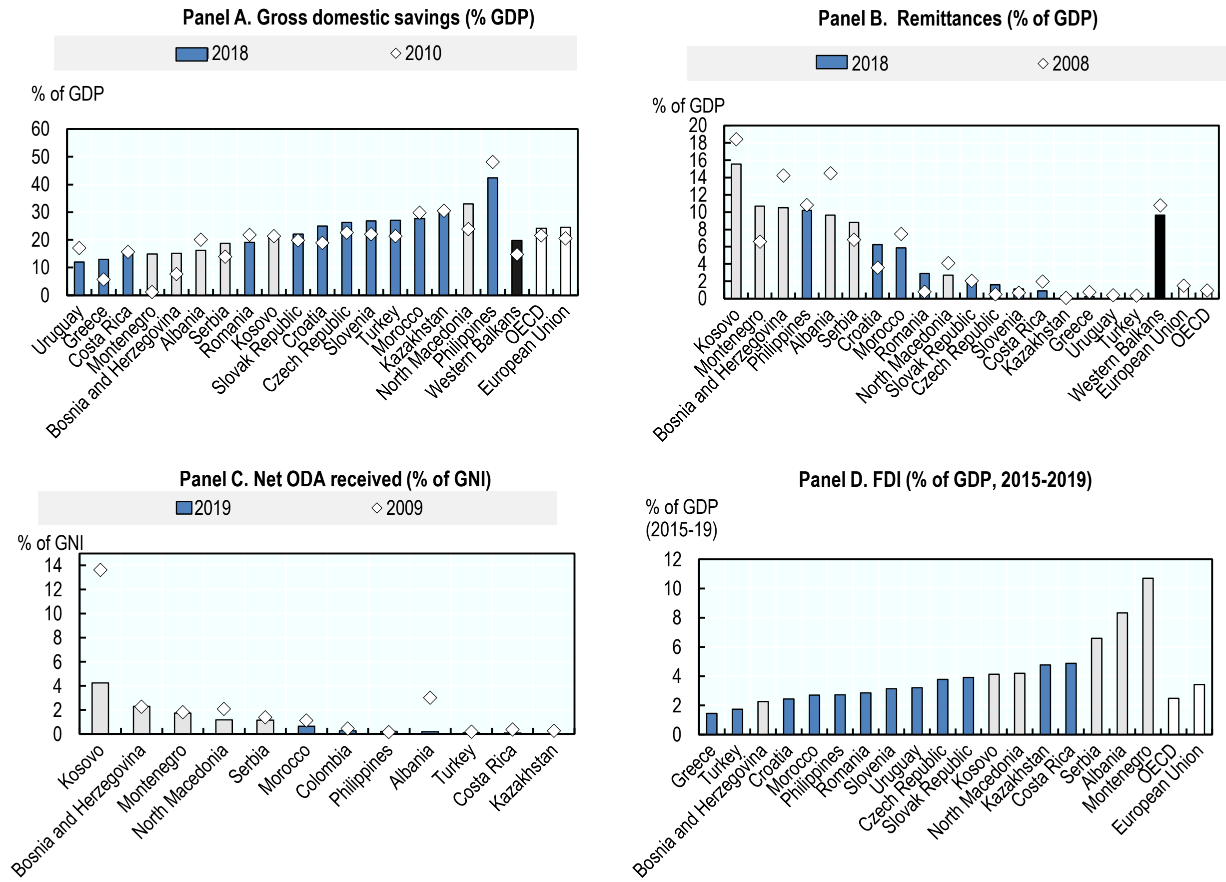
All regional economies face challenges with respect to the sustainability of their energy supply. All except Albania rely on highly polluting lignite coal for most of their electricity generation, but their thermal power plants are outdated and require either costly rehabilitation or decommissioning. This limit on future supply is compounded by the high intensity of energy consumption, which is in turn fuelled by the lack of cost-reflective electricity pricing. Particularly in light of the high air pollution and the impacts of climate change, economies will need to consider diversification into more renewable energy sources.

Partnerships and financing

Western Balkan economies rely heavily on external financing for growth

In light of the weak domestic savings, Western Balkan economies rely strongly on external financing. Even though remittance income and ODA have declined considerably over the past decade, their contribution to GDP in Western Balkan economies is relatively high compared to global peers. The region is also a strong recipient of FDI relative to global peers (Figure 2.15).

Figure 2.15. With low domestic savings, Western Balkan economies rely heavily on external financing, including remittances, net ODA and FDI



Source: OECD (2020[16]), *Aid (ODA) disbursements to countries and regions [DAC2a]* (database), http://stats.oecd.org/; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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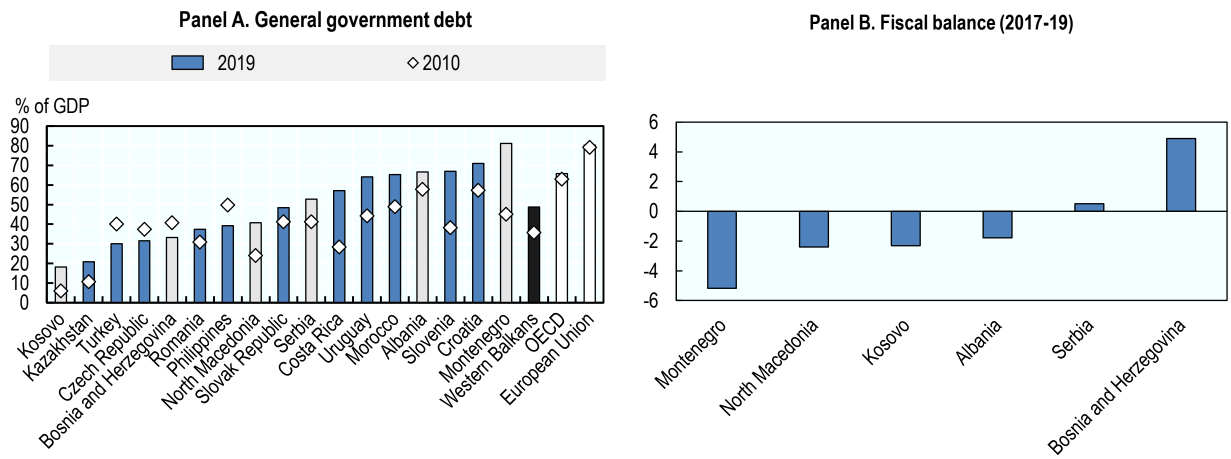
Fiscal performance varies, but the fiscal space in most Western Balkan economies is limited or has narrowed considerably in the post-crisis period

Public debt is low across all economies except Albania and Montenegro but has increased in most over the past decade. Public debt expanded across the region as a result of expansionary fiscal policies in the aftermath of the global financial crisis, including the introduction, in some economies, of various fiscal incentives for investment and employment (Figure 2.16 – Panel A). In recent years, some economies, most notably Serbia, implemented fiscal consolidation to reign in the growth of public debt and to re-establish fiscal sustainability (Figure 2.16 – Panels A and B). Thanks to its strong revenue performance, Bosnia and Herzegovina has been running high fiscal surpluses throughout most of the past decade and is the only regional economy in which public debt declined (Figure 2.16 – Panel A).

Figure 2.16. Public debt is low in most regional economies but has grown in recent years as most economies ran fiscal deficits



Source: IMF (2020[17]), *Government Finance Statistics Yearbook Query – Revenue* (database), https://data.imf.org/?sk=FA66D646-6438-4A65-85E5-C6C4116C4416.

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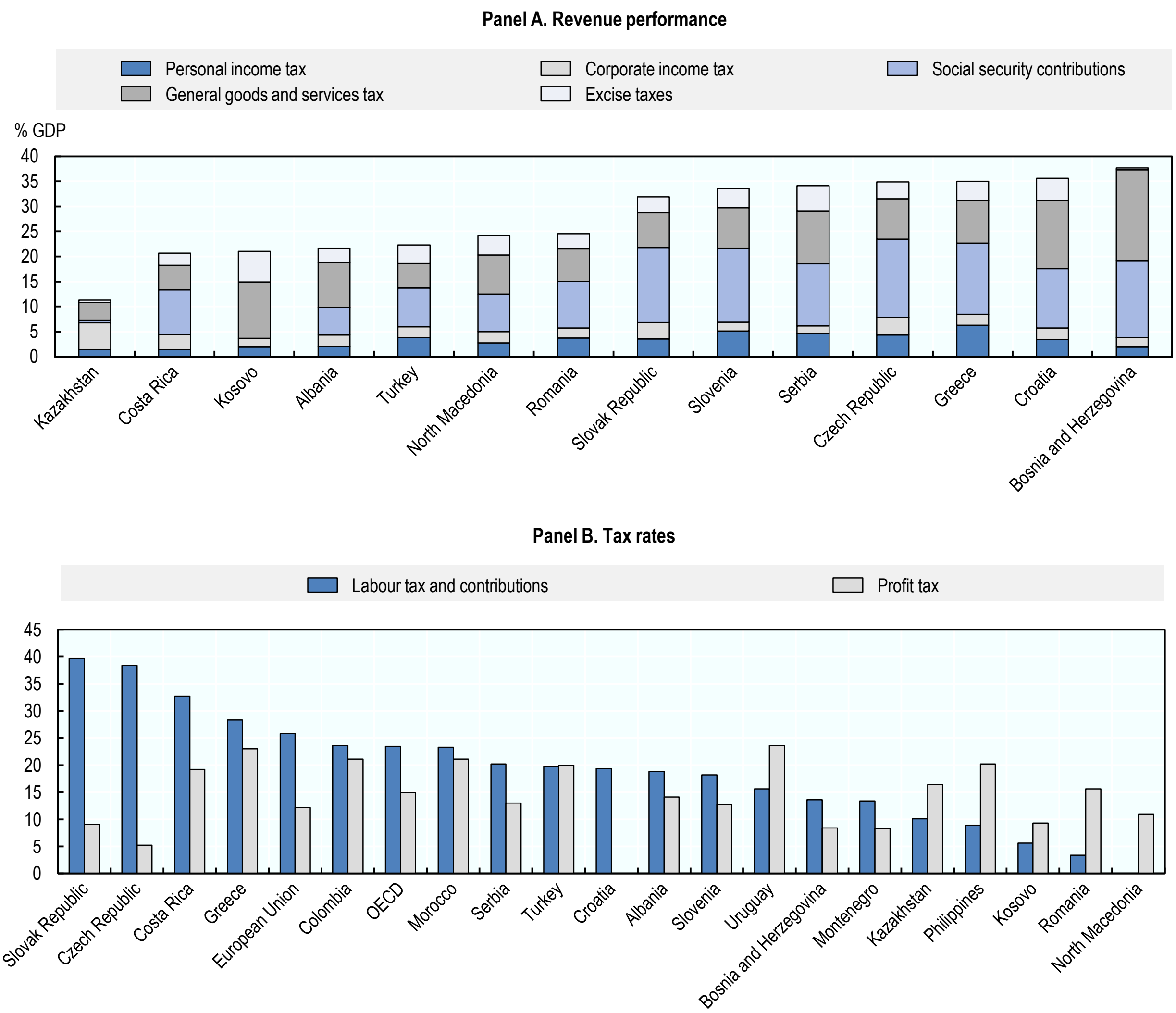
Weak public-sector revenue performance limits the scope for improvement of public services

With the exception of Bosnia and Herzegovina and Serbia, revenue performance in Western Balkan economies lags behind global peers (Figure 2.17 – Panel A). This primarily reflects the low tax bases and the considerable tax avoidance in the large informal sectors (estimated at around 20% to 30% in most economies). All economies are also affected by significant under-reporting of wages and a high share of envelope wages, which affects the revenues from personal income tax and social security contributions. The relative underperformance of revenues also reflects the low tax rates (Figure 2.17 – Panel B) and the significant tax exemptions for investment or employment (e.g. North Macedonia, Serbia).

Figure 2.17. Revenue performance is weak in many regional economies, in part reflecting the low tax rates

2018 or latest available year



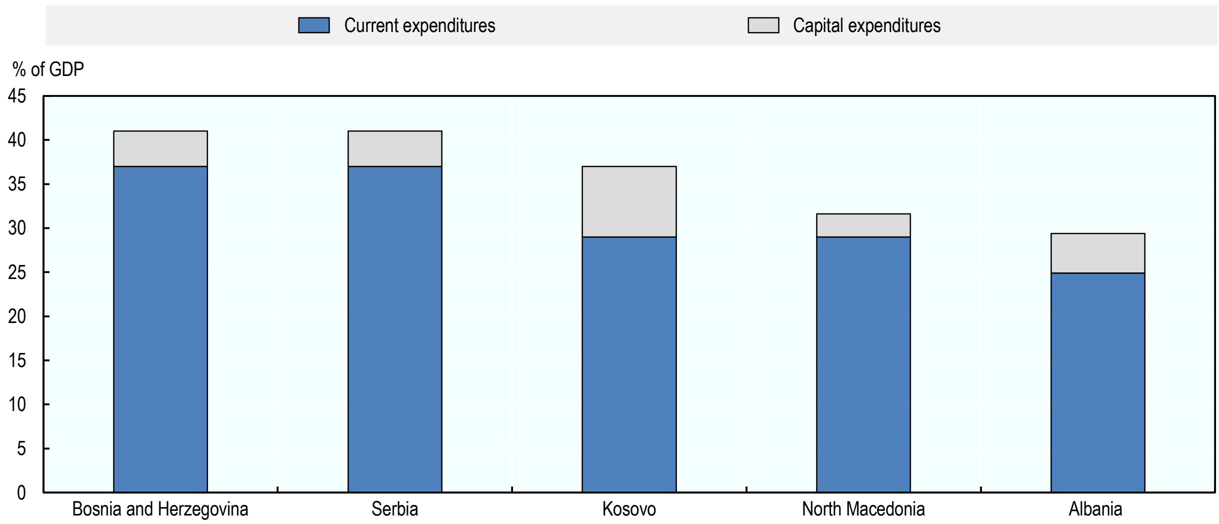
Sources: IMF (2020[17]), *Government Finance Statistics Yearbook Query – Revenue* (database), https://data.imf.org/?sk=FA66D646-6438-4A65-85E5-C6C4116C4416; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

StatLink https://doi.org/10.1787/888934241415

High and rising current expenditures crowd out public investment

Over the past decade, public expenditures in the Western Balkan region have been characterised by high and rising current expenditures (Figure 2.18), driven mainly by public wages and subsidies and transfers. In Bosnia and Herzegovina and Kosovo, rising expenditure pressures reflect generous benefit schemes for war veterans and high wages in oversized public sectors: public-sector wages are 38% higher than private-sector wages in Bosnia and Herzegovina (Agency for Statistics of Bosnia and Herzegovina, 2020[18]) and 43% higher in Kosovo (Kosovo Agency of Statistics, 2020[7]). In North Macedonia and Serbia, the high subsidy and transfer expenditures reflect not only high pension expenditures but also generous subsidies related to private-sector investment and employment. Large, inefficient and loss-making SOEs are an important drain on public finances in Bosnia and Herzegovina, with direct and indirect fiscal support estimated at 5% of GDP annually (Cegar and Parodi, 2019[19]).

Figure 2.18. Current expenditures are high and crowd out capital spending



Source: IMF (2021[20]), *World Economic Outlook Databases*, https://www.imf.org/en/Publications/SPROLLs/world-economic-outlook-databases#sort=%40imfdate%20descending.

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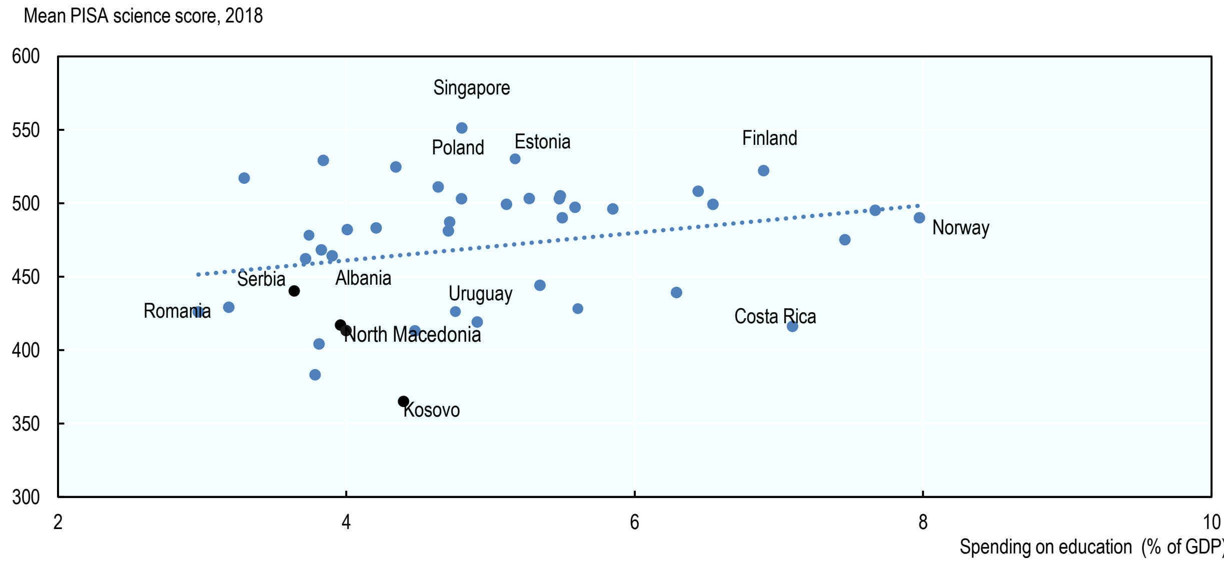
High and growing spending on public-sector wages and transfers limits the space for increased spending on infrastructure, education, health and other areas of development significance. This has had important implications for the quality of infrastructure and public services, with Western Balkan economies lagging significantly behind EU and OECD aspirational peers.

The health, education and other outcomes in the region also reflect the quality of public spending. In most economies, student performance on international student assessments (Figure 2.19) or indicators of infrastructure quality are low relative to the level of public spending. Improved targeting is needed to achieve the right development outcomes.

Figure 2.19. Western Balkan PISA scores are low relative to spending on education



Note: Data on public spending on education were not available for Kosovo in the World Bank World Development Indicators database. The data point for Kosovo was calculated based on data from the Kosovo Agency of Statistics.
Sources: Kosovo Agency of Statistics (2020[7]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; OECD (2020[9]), PISA (database), www.oecd.org/pisa/data/.

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SMEs face considerable difficulties accessing financing

Even though all economies in the region have re-established financial-sector stability over the past decade, and the largely foreign-owned banks are generally well-capitalised, liquid and profitable, access to financing remains a major challenge, especially for micro and small enterprises and start-ups. Banks are generally able to service established SMEs and large enterprises well, but the relatively strict requirements regarding collateral (high value and preference for real estate), history of operations, turnover, profitability, etc. are difficult to meet for many SMEs, especially start-ups. In some economies, high interest rates represent a considerable barrier to financing (e.g. Albania and Kosovo), and high government borrowing from the domestic banking sector crowds out enterprise lending (e.g. Albania, Bosnia and Herzegovina). The challenge is exacerbated by the lack of alternative sources of financing, such as microfinance, capital markets and venture capital.

Peace and institutions

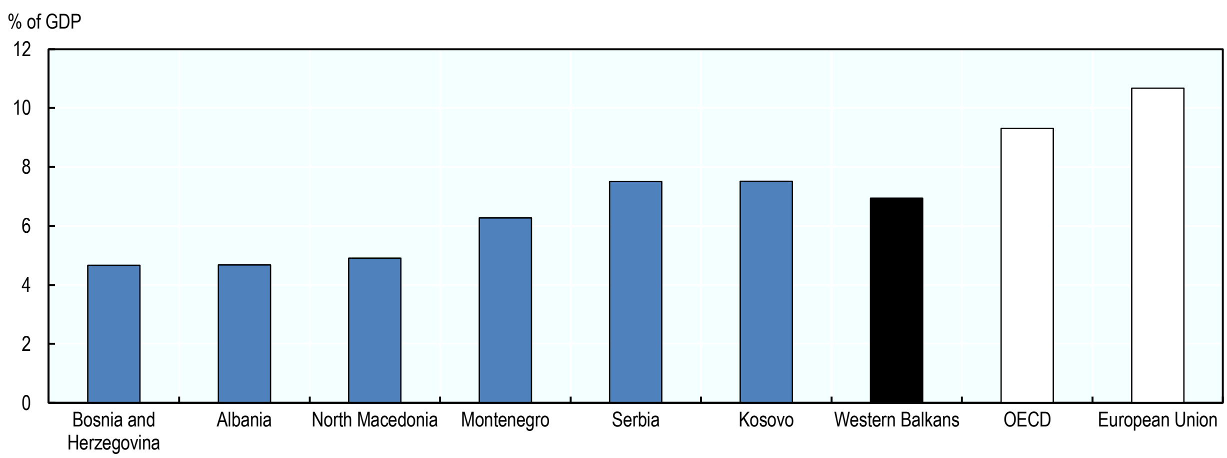
Western Balkan economies have not yet struck the right balance of power between levels of government

Redefining the power of subnational governments has been a crucial pillar of the process of democratisation and economic reform in the Western Balkans. The collapse of previous regimes in the 1990s created pressure for population migration from poorer to richer regions. Capital cities attracted both labour and capital, leading to large and growing regional disparities. In response, governments decentralised power to local governments: given their closer contact with citizens, they seemed better placed to provide the goods and services needed. As opportunities and talent continued amassing in capitals, the resources and fiscal capacity of increasingly autonomous peripheral areas quickly decreased (Bartlett, Kmezić and Đulić, 2018[21]).

The balance of power between central and local governments has not yet stabilised. Local governments often lack the right resources to carry out large responsibilities (Figure 2.20). This is partly due to the Eurozone crisis, which affected the region from 2009 onwards. Local governments had to deliver increasingly significant social protection policies, while tax revenues fell and central governments raided their budgets to pursue fiscal consolidation reforms, for example by squeezing intergovernmental transfers or shared taxes. Some governments have therefore returned to greater fiscal centralisation. Others have used the shrinking resources available for local development to reward local administrators from the same political party, ethnic group or kinship, with little regard to efficiency (Bartlett, Kmezić and Đulić, 2018[21]).

Figure 2.20. In most Western Balkan economies, subnational revenues may be insufficient to provide quality public services and goods

Total subnational revenues (% of GDP)



Source: Authors' elaboration based on OECD/UCLG (2019[22]), *Report of the World Observatory on Subnational Government Finance and Investment – Key Findings*, www.sng-wofi.org/reports/Key_Findings_2019.pdf.

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Far-reaching territorial and administrative reforms are under way in most of the region. They aim at strengthening local governments through increased political and administrative power. This could lead to more balanced territorial development only if local governments have adequate financial tools to deal with the changes, and there is meso-level co-ordination. Co-ordination mechanisms across local governments can enable joint provision of public services and allow economies of scale. By working together, neighbouring administrations are more likely to overcome common obstacles and leverage common opportunities.

Imperfectly defined land rights undermine the functioning of land markets

All Western Balkan economies, albeit to a different extent, face land rights issues. They stem from the position of landowners under socialist or communist regimes and from the liberalisation of markets in the post-socialist era. From the 1950s to the 1980s, private ownership, although heavily regulated, was widespread in the former Yugoslavian republics, while it was completely forbidden in Albania. In the 1990s, land reforms were undertaken everywhere as part of the transition to market economies. These mostly aimed at redistributing land rights based on equity principles and on historical claims from before socialism.

Implementation was not smooth. Authorities could not always verify and register property ownership due to poorly maintained and outdated land registers and cadastres. As a result, individuals claiming ownership rights on the same parcel is a common problem and weighs on courts (Hartvigsen, 2013[23]).

Insufficient property rights regimes have slowed the development of land markets in the Western Balkans. Without clear ownership rights, transactions are either impossible or take place only after long and costly legal proceedings. As an alternative, many transactions take place informally, following local customs and traditions. If not regulated, this type of transaction can further complicate authorities' mapping of land ownership and ultimately undermines the functioning of land markets. Incomplete land markets partly explain the fragmentation of land across the region. Land holdings are often small and do not allow for the large infrastructure investments and economies of scale that would increase agricultural productivity.

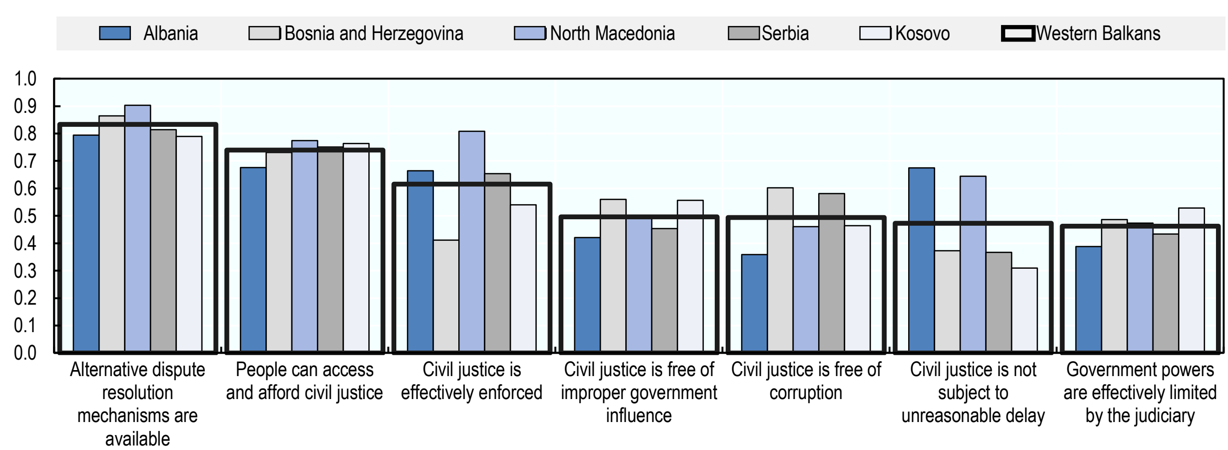
Major reforms have been carried out, with varying results. Success or failure often depend on the organisation (at the national and subnational levels) of the cadastral agencies, the efficiency of the judicial system (which should regulate disputes), the entrenchment and regulation of local customs and traditions, and citizen trust in formal institutions generally.

The judiciary in the Western Balkans is often biased and inefficient

Trust in the judiciary is low in the Western Balkans. Citizens often perceive courts as biased and inefficient (Figure 2.21), and only 35% have confidence in the work of the courts. Bribes, gifts and personal networks are often used to advance special interests, interfere with the normal course of justice or speed up the work of the court. Indeed, the slowness of judicial systems remains a major constraint, particularly in Bosnia and Herzegovina, Kosovo and Serbia. Biased and inefficient courts may discourage investors and push citizens to settle disputes informally, which may create confusion and misunderstandings over time. The judiciary systems seem incapable of providing checks and balances on the executive, which undermines the stability and development of democratic institutions.

Figure 2.21. Judiciary systems in the Western Balkans are perceived as biased and inefficient

Performance of Western Balkan economies along selected dimensions with respect to OECD performance



Note: OECD performance is normalised to 1.0. The lower the bar, the worse the economy's performance with respect to the OECD.
Source: Authors' elaboration based on World Justice Project (2020[24]), *World Justice Project Rule of Law Index 2020*, https://worldjusticeproject.org/our-work/publications/rule-law-index-reports/wjp-rule-law-index-2020.

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Judicial systems in the Western Balkans have three common weaknesses. First, high councils – the highest authorities, which should ensure the independence of the judiciary – are exposed directly or indirectly to external pressures. This affects their ability to select and promote judges and prosecutors based on abilities rather than political affiliations. The way in which judges and prosecutors are recruited, then, is often opaque: standard examinations are rare, and national parliaments often play a significant role in vetting candidates. Some economies also lack codes of ethics.

SOE governance is a source of large inefficiencies

SOEs have a large role in Western Balkan economies. They provide key public goods and services, particularly utilities, transport and telecommunications. SOEs often employ disproportionately large numbers of workers for the economic contribution of the enterprises. Governments, especially at the local level, may distribute jobs in public companies based on ethnic or political principles or kinships rather than skills and merit. SOEs in several Western Balkan economies (especially Bosnia and Herzegovina) offer higher wages than the rest of the public sector or the private sector, thereby distorting the labour market. Costly staffing undermines the efficiency and value of SOEs, causing them to run into debt, which ultimately weighs on taxpayers.

Significant reforms have boosted SOE performance throughout the region, but challenges remain. Governments have introduced stricter rules with respect to the disclosure of financial information and audit practices (OECD, 2018[25]). Yet, ownership remains somewhat opaque, and oversight is insufficient. This creates scope for mismanagement practices, including hiring based on personal networks. More professional boards can improve the quality of management, staff and products, with great benefits for the rest of the economy.

The EU integration process and the role of informal institutions

The prospect of accession at times plays an ambivalent role in the relationship between formal and informal institutions. To signal their commitment to the European Union to voters and the international community, governments sometimes introduce laws that are stricter than requested and hence outpace capacity. According to a regional perception survey, this practice is perceived to be particularly widespread in North Macedonia (54% of respondents), Kosovo (41%) and Bosnia and Herzegovina (39%) (Lavrič, Senjković and Klanjšek, 2019[26]). The incapacity of governments to transpose and implement laws that are too strict and the incapacity of citizens to follow them promote informal practices. In particular, citizens exploit interpersonal relationships that are well rooted in the economy's culture, traditions and history to obtain services they could not otherwise obtain. Informal practices, if not factored into the design of public policy or regulated, may weaken formal institutions and citizen trust in them. This could create a vicious circle that ultimately wears out the social contract necessary for stability.

Planet

Western Balkan economies face high levels of pollution and important challenges in their energy sectors. Air pollution levels in Western Balkan economies are the highest in Europe, and their economic and health costs are high. Inadequate management and treatment of solid waste and wastewater cause ambient and water pollution and pose a threat to human health. In the energy sector, except for Albania, Western Balkan economies rely heavily on highly polluting coal for electricity generation. Pollution, low levels of energy efficiency, an outdated energy infrastructure and an unreliable electricity supply are key challenges. Public utility tariffs set below operational costs limit the financial resources available for investments in solid waste and wastewater management, the water supply and the energy sector. Natural hazards, water management and water scarcity are further challenges in some Western Balkan economies.

Air pollution: high levels of pollution pose a threat to biodiversity, human health and the economy across the Western Balkans

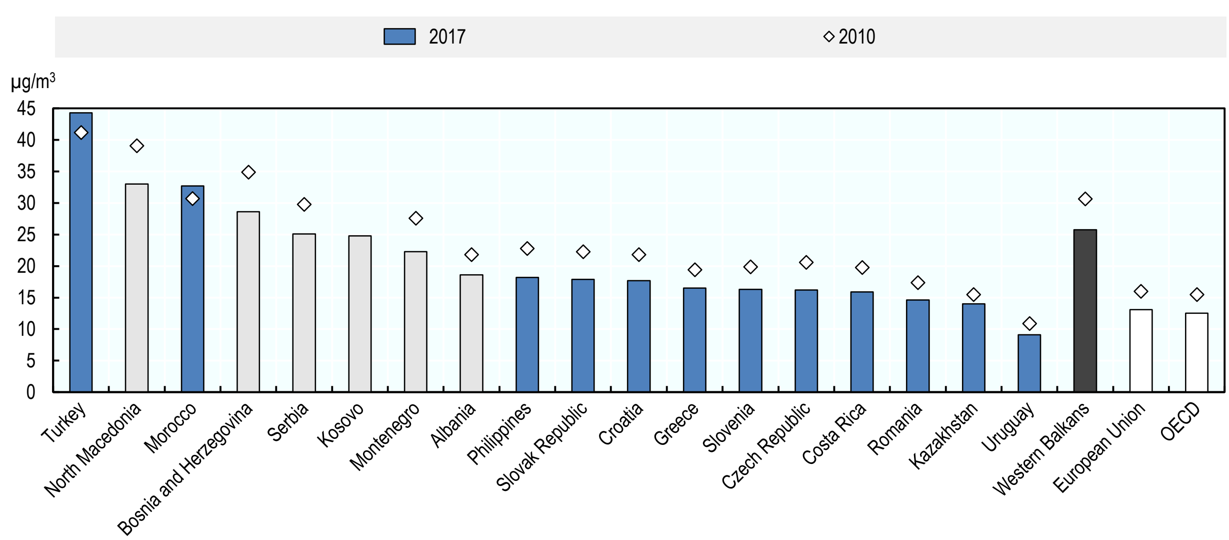
Levels of air pollution are high across regional economies

While high across the region, air pollution levels are highest in Bosnia and Herzegovina and North Macedonia (Figure 2.22). North Macedonia's annual exposure to particulate matter PM2.5 air pollution decreased from 39.1 µg/m³ in 2005 to 33 µg/m³ in 2017 but remains the worst in the region and above the World Health Organization recommended maximum level (annually) of 10 µg/m³. Belgrade, Sarajevo and Skopje are among the most polluted capitals in Europe. Low levels of energy efficiency in the residential sector, poorly insulated buildings, electricity generation from coal and the transport sector (characterised by an outdated vehicle fleet) are the main sources of air pollution in Western Balkan economies.

Air pollution poses a threat to human health, the economy and the environment. Premature deaths attributable to air pollution are high in Western Balkan economies: on average, 130.1 per 100 000 inhabitants died prematurely due to air pollution in 2016 (Figure 2.23). Air pollution negatively affects the economy through healthcare expenses and lost days at work and school.

Figure 2.22. Air pollution levels are high across Western Balkan economies

Mean exposure to PM2.5, 2017 and 2010



Note: Mean population exposure to fine particulate matter is calculated as the mean annual outdoor PM2.5 concentration weighted by population living in the area. It is the concentration level, expressed in µg/m3, to which a typical resident is exposed throughout a year.
Source: OECD (2020[27]), *Green Growth Indicators* (database), https://stats.oecd.org/Index.aspx?DataSetCode=GREEN_GROWTH.

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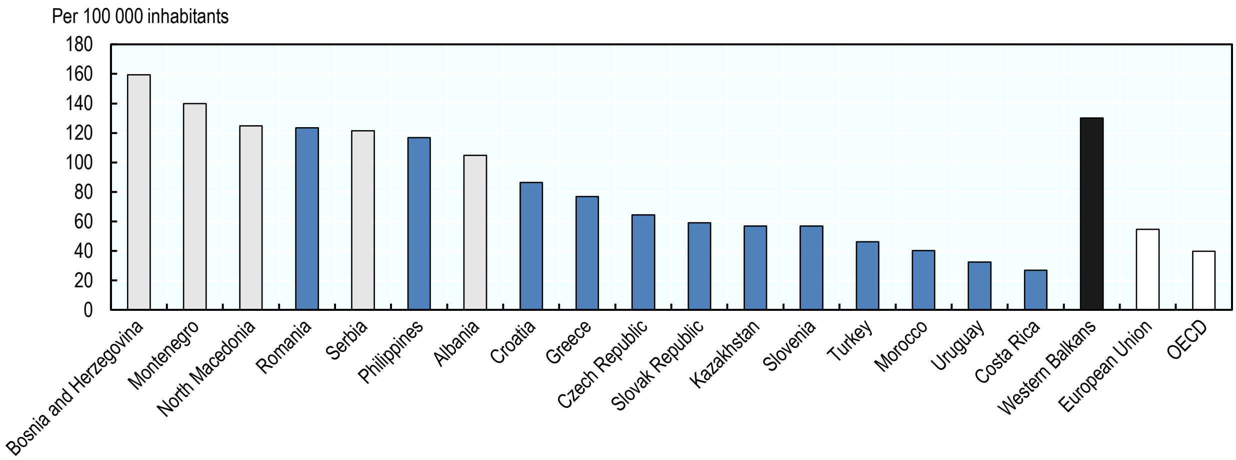
Figure 2.23. The mortality rate due to ambient air pollution is high in Western Balkan economies

Mortality rate attributable to household and ambient air pollution (per 100 000 inhabitants), 2016



Note: There are no data for Kosovo.
Source: WHO (2019[11]), *Global Health Observatory data repository – Burden of disease SDG 3.9.2 Mortality rate attributed to unsafe water, unsafe sanitation and lack of hygiene (exposure to unsafe Water, Sanitation and Hygiene for All (WASH))*, https://apps.who.int/gho/data/view.main.SDGWSHBOD392v.

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Poor waste management and inadequate wastewater treatment are major sources of ambient and water pollution across Western Balkan economies

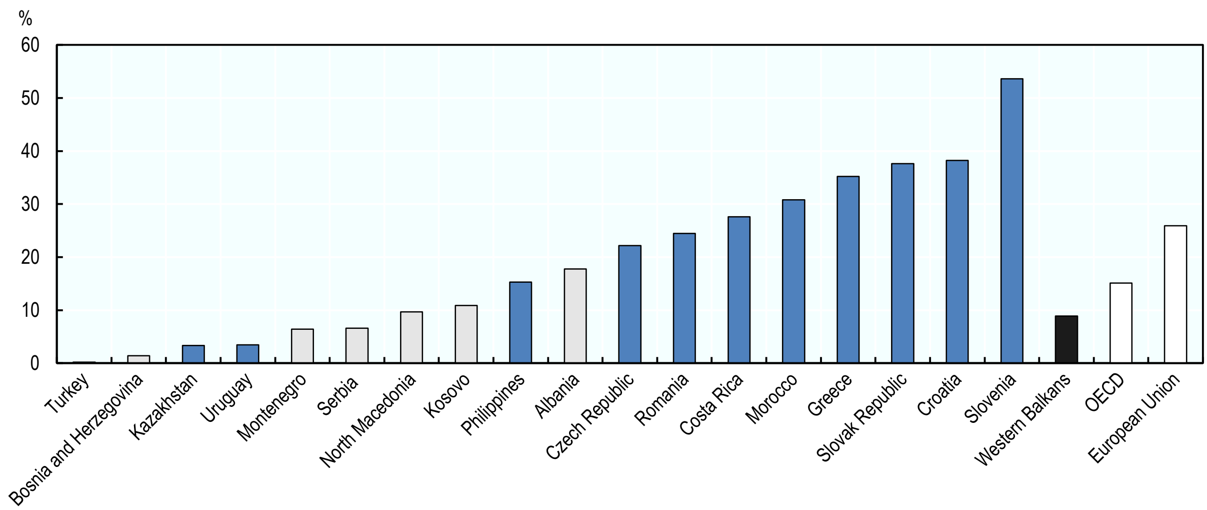
Solid waste and wastewater treatment is limited and a major source of pollution in the region. Waste collection services are not available everywhere, and wastewater treatment plants are scarce: 31% of the population of Bosnia and Herzegovina is connected to the public sewage system, and only 15% of wastewater is treated. Only 1% of Kosovo’s population is connected to a wastewater treatment plant, although three new plants are in development. Illegal and non-compliant landfills and dumpsites are widespread in the region. In Kosovo, 57.7% of the population is served by municipal waste collection. Solid waste and wastewater are a main source of water and ambient pollution and a threat to biodiversity and human health.

Biodiversity: the region’s rich biodiversity and abundant forest coverage is threatened by pollution and not sufficiently protected

Biodiversity in the region is threatened by pollution and needs better protection. Between 28% (Albania) and 61% (Montenegro) of economies’ territory is covered by forests. The forest sector makes an important economic contribution in many Western Balkan economies and could be further exploited. Yet, poor forest management and forest degradation pose challenges. Pollution (most importantly) and solid waste and wastewater also threaten biodiversity. Terrestrial protected areas are scarce in the region, amounting to 8.9% of the territorial area, on average, in 2018, compared to an EU average of 25.9% and an OECD average of 15.1% (Figure 2.24).

Figure 2.24. Terrestrial protected areas are scarce in Western Balkan economies

Terrestrial protected area (% of total territorial area), 2018



Note: There are no data for the Czech Republic, Kosovo, Serbia and the Slovak Republic on marine protected areas (no access to sea). Data for Kosovo are local data for 2019 provided by the Kosovo Environmental Protection Agency.
Sources: UNEP-WCMC (2014[28]), *World Database on Protected Areas (WDPA)* (database), www.unep-wcmc.org/resources-and-data/wdpa; World Bank (2020[1]), *World Development Indicators*, https://databank.worldbank.org/reports.aspx?source=world-development-indicators.

StatLink https://doi.org/10.1787/888934241548

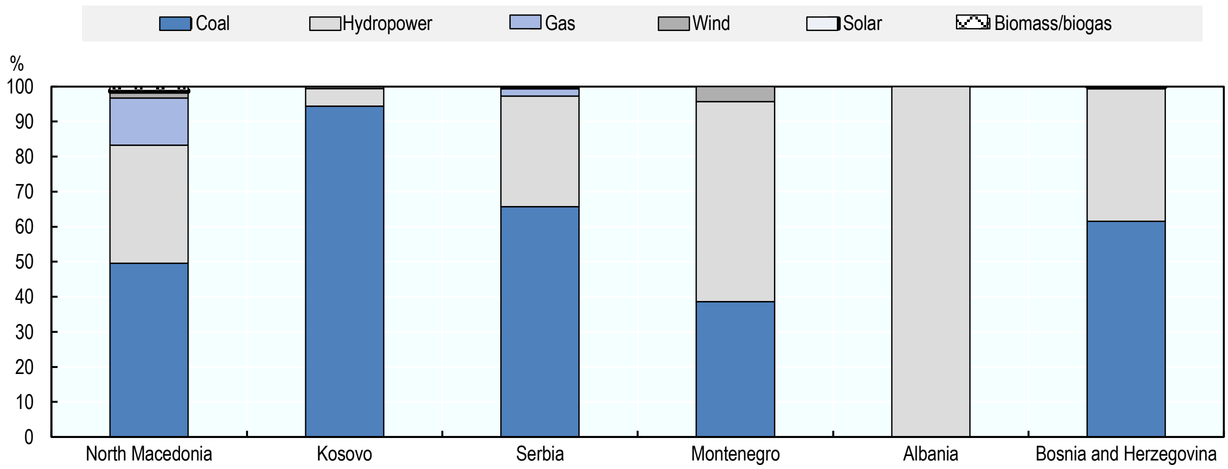
Energy sector: energy efficiency levels are low across Western Balkan economies, and most economies rely heavily on coal for electricity generation

Reliance on coal as the primary source of energy for electricity generation, coupled with low levels of energy efficiency, results in high levels of air pollution and greenhouse gas (GHG) emissions. The share of coal in the electricity mix ranges from 39% to 94% in Western Balkan economies other than Albania, which produces 100% of its electricity from hydropower (Figure 2.25). Except for hydropower, renewable energies are almost non-existent in the energy mix, despite their relative abundance. The high carbon intensity results in high air pollution and GHG emissions: in North Macedonia, carbon dioxide emissions from fossil fuel combustion make up almost 80% of total GHG emissions.

At the same time, energy efficiency is low in most Western Balkan economies. In 2017, the total primary energy supply per USD 1 000 of GDP in Western Balkan economies was, on average, 30% above the EU average; it was 50% above in Bosnia and Herzegovina, the worst-performing economy in the region. Electricity networks are degraded and outdated in many economies, resulting in high transmission and distribution losses (2.5 times the OECD and EU average) (Figure 2.26). Electricity supply tends to be unreliable in the region.

Figure 2.25. Western Balkan economies rely mainly on coal and hydropower for electricity generation

Electricity generation mix (%), 2018

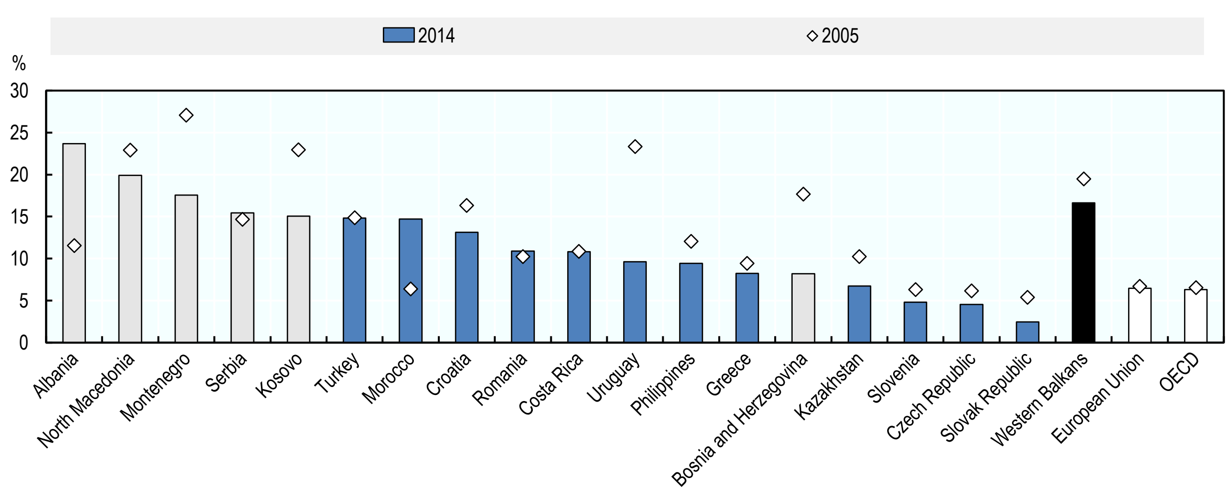


Sources: Energy Community Secretariat (2020[29]), Energy Community Secretariat/NERA annual reports, https://energy-community.org/documents/secretariat.html; Eurostat (2018[30]), *COVID-19 – European Statistical Recovery Dashboard* (database), https://ec.europa.eu/eurostat/data/database.

StatLink https://doi.org/10.1787/888934241567

Figure 2.26. Electric power transmission and distribution losses are high in most Western Balkan economies

Electric power transmission and distribution losses (% of output), 2014 and 2005



Source: IEA (2021[31]), *Data and Statistics* (database), https://www.iea.org/data-and-statistics.

StatLink https://doi.org/10.1787/888934241586

Governance inefficiencies: tariffs set below operational costs threaten the financial sustainability of public utilities

Public utilities are often priced below operational costs in Western Balkan economies, threatening their financial sustainability. Tariffs, including for waste collection, water and electricity, tend to be set below the cost of providing the service and too low to cover operation and maintenance expenses. Local governments are therefore required to support utility companies through transfers and subsidies, leaving insufficient resources for investments to upgrade and build new infrastructure

Water: water management, access to drinking water and water scarcity are challenges in some Western Balkan economies

Water resources are scarce in several economies, including Bosnia and Herzegovina, Kosovo and North Macedonia. With 2 100 m^3 of total renewable water resources per capita per year, Kosovo has only 14% of the regional average of renewable water resources. Access to drinking water is often worse in rural areas than in cities. In Albania, the share of the population using safely managed sources of drinking water has increased from 49.3% to 70% since 2000 but remains a challenge, particularly in rural areas. Low drinking water quality is an important challenge in Serbia: 56% of drinking water in urban areas and 37% in rural areas meets minimum quality requirements.

Natural hazards: most Western Balkan economies are vulnerable to natural hazards

Western Balkan economies are most vulnerable to flooding, earthquakes, droughts, fires and landslides. Flooding poses a particular threat. In Serbia, floods in May 2014 affected 22% of the population (1.6 million people) in two-thirds of municipalities (most located in Central and Western Serbia) and caused EUR 1.5 billion in damage. Several economies, most notably Albania but also Bosnia and Herzegovina and North Macedonia, are also very vulnerable to earthquakes. A magnitude 6.3 earthquake in Albania in November 2019 affected 202 291 people, caused 51 fatalities, injured at least 913, displaced around 17 000 and was estimated to have cost close to EUR 1 billion. Extreme weather events are likely to become more frequent due to climate change.

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Part II Assessing opportunities and constraints in Albania

3 Overview: Identifying strategic opportunities for Albania

Since its independence, Albania has achieved significant success across various social, economic and institutional dimensions. It became a democratic society with a functional open market economy. Productivity growth across all sectors has improved employment, incomes and standards of living. To address its development constraints and embrace a durable, sustainable and inclusive growth path, Albania needs a long-term vision. This chapter takes a holistic view of Albania's development performance across a range of outcomes, spanning the breadth of the Sustainable Development Goals. It then outlines key strategic opportunities to help Albania improve the quality of life for all citizens, strengthen education and skills, find new sources of growth, build local government capabilities, broaden the revenue base, address air pollution, and respect diversity.

Over the last 30 years, Albania has made remarkable progress in becoming a democratic society with a functional open market economy. Productivity growth across all sectors has improved employment, incomes and standards of living. While deprivations remain, extreme poverty is very low and life expectancy is increasing. Institutional development and global integration also progressed. Albania's accession to the European Union is a cornerstone of Albania's foreign policy and a key driver of reforms.

Building on its success, Albania must now create the capabilities for continued strong development. Gross domestic product (GDP) and productivity growth rates have declined since the global crisis of 2008 and have not recovered, indicating that the early gains from the post-communist transition have been achieved, and new engines for a sustainable model of development must be built. Stronger institutions, with the capacity to implement and deliver quality public services to all citizens, will be key, as will be the process towards further integration towards the European Union.

To succeed, Albania is preparing a new Strategy for Development and Integration 2021-2030. This strategy comes at a crucial time, as the accession process with the EU has moved to a new level, while Albania, Europe and the world grapple with the COVID-19 pandemic and its aftermath. Building on the previous National Strategy for Development and Integration 2014-2020 (Republic of Albania Council of Ministers, 2013[1]), the new strategy will have to lay out a vision for Albania in 2030, chart the path and key objectives for achieving this vision and tackle the most important constraints that can hold Albania back.

The Multi-dimensional Review (MDR) of the Western Balkans supports Albania and the region with a strategic perspective and ideas for action on shared challenges. This assessment of Albania is intended to support the new strategy. It provides inputs for a possible vision for Albania's development and identifies the key constraints that must be tackled in order to achieve sustainable and equitable improvements in well-being and economic growth. The next phase of the project will focus on peer learning to find solutions to the challenges that emerge from the initial assessments as shared across the region.

This overview chapter presents the main results of the initial assessment of development in Albania. First, the chapter presents inputs for a development vision for Albania for 2030, elaborated by participants of a strategic foresight workshop. Second, the chapter takes a bird's-eye view to assess Albania's development performance on the basis of key statistics on well-being and the sustainable development goals (SDGs) and summarises the key constraints to development identified in this report. It concludes by suggesting key strategic directions for the future. Given the global impact of COVID-19, this overview is followed by a special chapter on the impact of the pandemic in Albania. Chapter 5 contains the full assessment of Albania along the pillars of sustainable development: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet.

Whenever relevant and subject to data availability, Albania is compared to a set of benchmark economies in the region (Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia), the Organisation for Economic Co-operation and Development (OECD) (Costa Rica, Czech Republic, Greece, Slovak Republic, Slovenia and Turkey), the European Union beyond the OECD (Croatia and Romania) and other countries (Kazakhstan, Morocco, Philippines and Uruguay). It includes regional averages for the Western Balkans and OECD and EU members. The selection of benchmark economies is based on historical similarities (including integration into the European Union), economic structures, geographical proximity and mutual partnerships. The selection of non-OECD economies is based on their similar economic and social challenges (such as high migration rates), shared history as transition economies and the relevance of development trajectories that can bring an additional perspective to Albania and other Western Balkan economies and create valuable learning opportunities across selected areas.[1]

This report benefited from close collaboration with the Government of the Republic of Albania, especially the Department for Development and Good Governance of the Office of the Prime Minister (OPM), and from the collaboration and comments of multiple OECD Directorates and the financial and collaborative support of the Swedish International Development Cooperation Agency, which is gratefully acknowledged.

Towards a vision for Albania in 2030: an attractive society with high quality of life and strong human capital, built on reliable, resilient and efficient institutions, a dynamic economy and integration into Europe and the region

A clear vision of the desired future state of Albania is an important guidepost for a national development and integration strategy. A vision for a strategy should provide a description of what Albanians expect from the economy, society, institutions and the environment and what the most important elements are in each domain. To generate inputs for such a vision, a workshop entitled Albania: Vision and Challenges 2030 was organised in Tirana on 6 February 2020, gathering a broad range of participants from various public-sector ministries and agencies, the private sector, academia and civil society. The vision was built on the basis of simple narratives of the lives of future citizens of Albania and subsequent clustering by the five pillars of sustainable development: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet.

The narratives proposed for the vision highlighted aspirations for good quality of life, health and education, and employment and broad economic opportunity, green spaces and returnees to Albania. The narratives of the workshop evoked young women with high education – some in high-skilled professions, such as engineering and information technology (IT) analysis, others in entrepreneurship, tourism or agro-business. Many have returned with experiences from abroad and are now exploring opportunities in Albania. All fictional citizens enjoy middle-class family lives, with stable, decent work, good health and quality education. Citizens have houses and enjoy leisure time in green, clean public spaces. Digitalised services, quality jobs and an economic environment conducive to starting company and improving skills for career development were also emphasised.

The resulting inputs for the potential vision centre on strong education and governance, the rule of law and a dynamic and regionally integrated economy as the main levers for higher well-being. Box 3.1 presents the vision statements for Albania in 2030 prepared by participants. Anchored in the European Union, Albania of 2030 is envisioned as an economy with stable, reliable and accountable institutions and a functioning system of checks and balances. It has a competitive economy with an attractive framework for business and growth thanks to higher productivity, a skilled labour force and better use of natural resources. Last, Albania of 2030 is a knowledgeable and inclusive society that benefits fully from improved health and education systems and quality jobs and where human capital and well-being are at the heart of the country's development. In terms of the individual dimensions of this vision, education, good governance, strong institutions and public services are considered the most important, as identified through a voting exercise (Figure 3.1).

Box 3.1. A potential development vision for Albania in 2030

Albania of 2030: an attractive society with high quality of life and strong human capital, built on reliable, resilient and efficient institutions, a dynamic economy and integration into Europe and the region.

As part of the OECD strategic foresight workshop organised in Tirana on 6 February 2020, participants developed a vision statement that reflects the desired future for Albania in 2030.

People

- A society with well-being (higher standards of living) through improved health system, enhanced equality and equity of education, better quality jobs, and assured social justice.
- Community integrated social services that optimise human capital.

Prosperity/Partnerships and financing

- Albania is a competitive economy with sustained economic growth and a leading role in the region. Its economy is based on strong and dynamic small and medium-sized enterprises (SMEs) and is attractive to foreign investors. Albania has developed and secured markets (financial, capital and human).
- The economy is characterised by macroeconomic stability and inclusive growth, higher investments and capital, efficient use of natural resources, increased capacity and importance of human resources, attractive climate for foreign investments, digital economy and labour mobility for higher productivity.

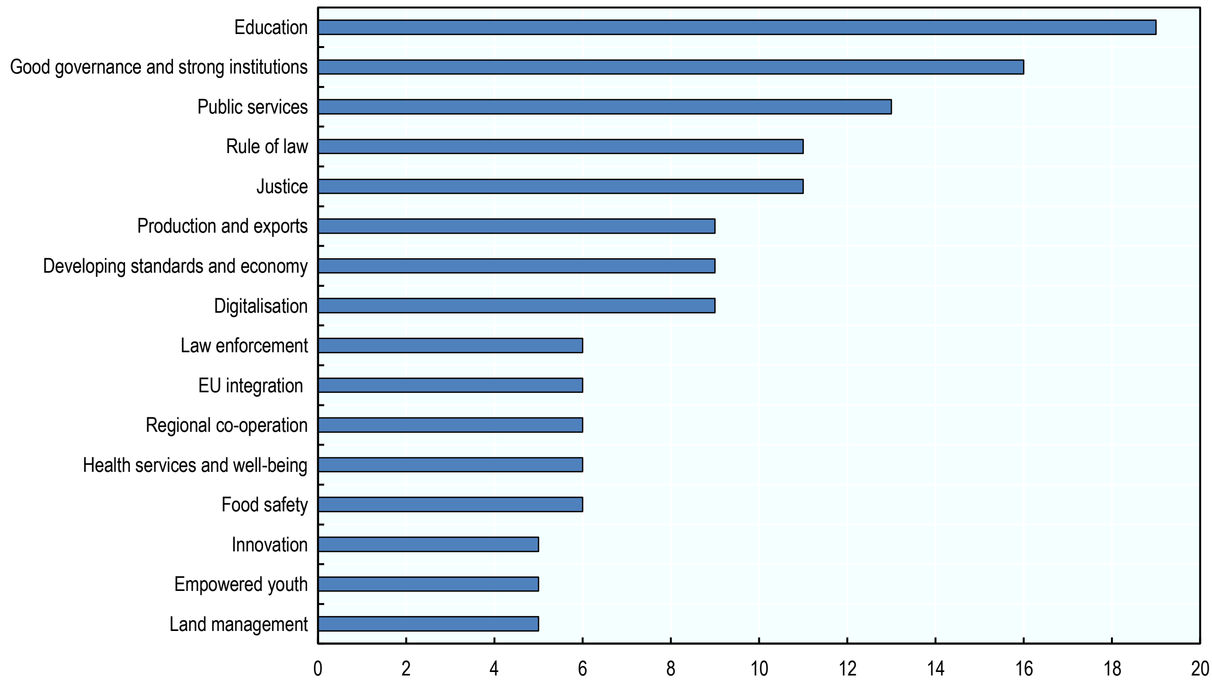
Peace and institutions

- A participatory democracy remains crucial to human rights, social justice and rule of law. Checks and balances mechanisms enable stable, accountable and reliable institutions at all levels, with increased focus on local governments. Effective institutions ensure a merit-based public administration. It is always better to prevent than to punish.
- All citizens enjoy their political, social, economic and cultural rights through accountable, democratic governance.

Planet

- Albania is integrated into the EU economic and infrastructure system. It is a diverse and competitive economy in the Western Balkans. It assures equal access to infrastructure, economy and knowledge, protects cultural, natural and historical heritage and is an attractive destination.

Figure 3.1. The most important dimensions of the vision for Albania: education, good governance and public service provision



Source: Authors' elaboration based on the voting exercise of participants of the OECD strategic foresight workshop organised in Tirana on 6 February 2020.

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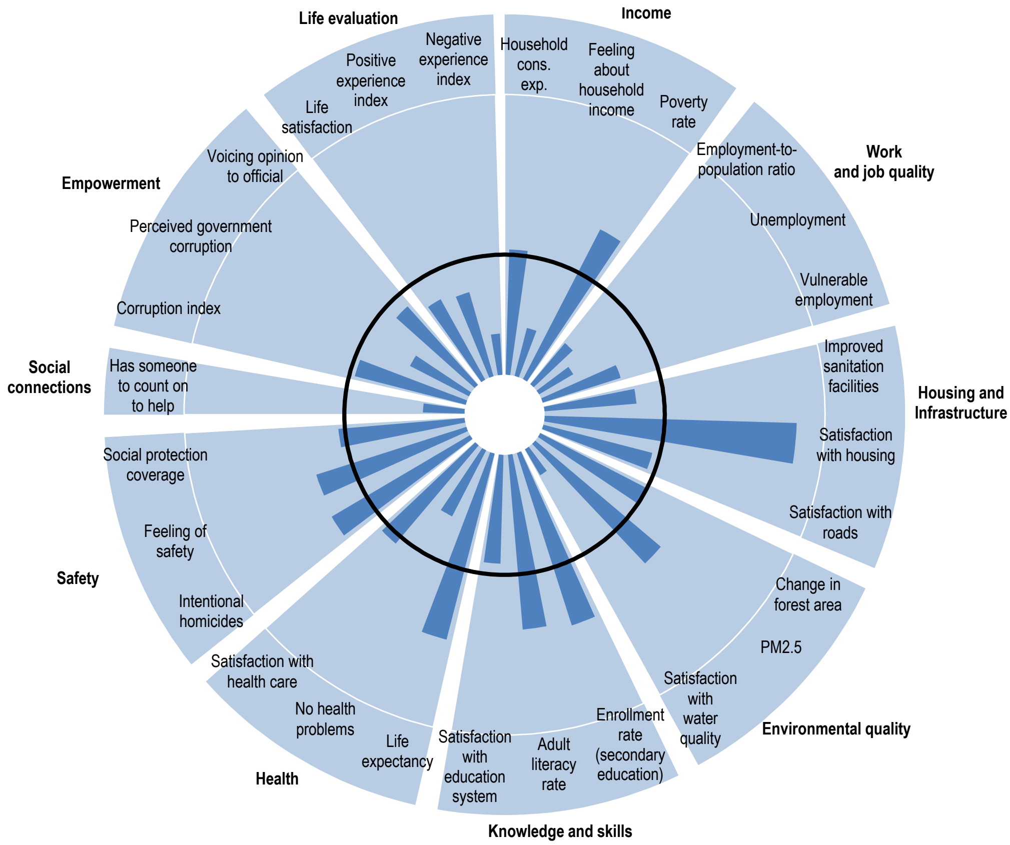
Assessing Albania's development performance

Building on the proposed vision, well-being around the world and sustainable development as benchmarks, this section reviews Albania's development performance. The proposed vision emphasises well-being and sustainable development as the ultimate objectives of development. To assess the well-being of Albanian citizens, the OECD's Well-being Framework uses a mix of objective and subjective indicators across a range of dimensions that matter to people (OECD, 2020[2]) (Box 3.2). A version adapted to the realities of emerging economies compares Albania to the level of well-being outcomes expected given its level of GDP per capita, across ten dimensions covering material conditions, quality of life and relationships. In a second step, this section assesses Albania's performance across the five pillars of the SDGs, applying distance-to-target measures across selected indicators and building on the analysis in the main body of this report.

Albanian citizens are comparatively satisfied with their housing conditions and feel comparatively safe when walking alone at night. The poverty rate is relatively low, and life expectancy at birth is relatively high. However, there are warning signs in other well-being dimensions, such as income, work and job quality, social connections and empowerment (Figure 3.2). For instance, in 2019, three in ten Albanians said that they had no friends or family to count on in times of need, and Albanians rated current life satisfaction at 5, on average, on a scale of 0 (not at all satisfied) to 10 (completely satisfied).

Figure 3.2. Current and expected well-being outcomes for Albania: worldwide comparison

2019 or latest available data; performance shown relative to GDP per capita



Notes: The observed values falling inside the black circle indicate areas where Albania performs poorly in terms of what might be expected from a country with a similar level of GDP per capita. Expected well-being values (the black circle) are calculated using bivariate regressions of various well-being outcomes on GDP, using a cross-country dataset of around 150 countries with a population of over one million. All indicators are normalised in terms of standard deviations across the panel.

Sources: Gallup (2018[3]), "Gallup World Poll", www.gallup.com/analytics/318875/global-research.aspx; ILO (2020[4]), *ILOStat* (database), https://ilostat.ilo.org/data/; OECD (2020[5]), *OECD PISA database*, www.oecd.org/pisa/data/; Transparency International (2019[6]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/; UNESCO (2019[7]), "UNESCO Institute for Statistics", http://uis.unesco.org/; World Bank (2020[8]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WHO (2020[9]), *Global Health Observatory* (database), www.who.int/data/gho/data/countries.

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Box 3.2. Measuring what matters to people

As part of its broader Better Life Initiative, the OECD first created its Framework for Measuring Well-being in 2011 with the aim of putting people at the heart of policy making. This represented the culmination of longstanding work both inside and outside the organisation. Important strides to "go beyond GDP" had been made with the United Nations Development Programme's (UNDP) Human Development Index and the work on multidimensional poverty by the Oxford Poverty and Human Development Initiative. The framework also draws on rich academic literatures in welfare economics and capability theory, the recommendations of the Commission on the Measurement of Economic Performance and Social Progress (Stiglitz, Sen and Fitoussi, 2009[10]), and existing well-being and sustainable development measurement practice in OECD member and non-member countries. Since its launch, the work on well-being has continuously been updated in line with best practice and continues to be published in the OECD's "How's Life?" report series (OECD, 2020[2]). For the purpose of the MDRs, the OECD Well-being Framework has been adapted to fit the realities of countries at different stages of development (Boarini, Kolevi and McGregor, 2014[11]).

The adapted OECD Well-being Framework used in this report focuses on living conditions at the individual, household and community levels that capture how people experience their lives "here and now". Current well-being here is comprised of ten dimensions related to material conditions that shape people's economic options (Income, Housing and infrastructure, Work and job quality) and quality-of-life factors that encompass how well people are (and how well they feel they are), what they know and can do and how healthy and safe their places of living are (Health, Knowledge and skills, Environmental quality, Life evaluation, Safety). Quality of life also encompasses people's connectedness and engagement (Social connections, Empowerment).

Methodological considerations

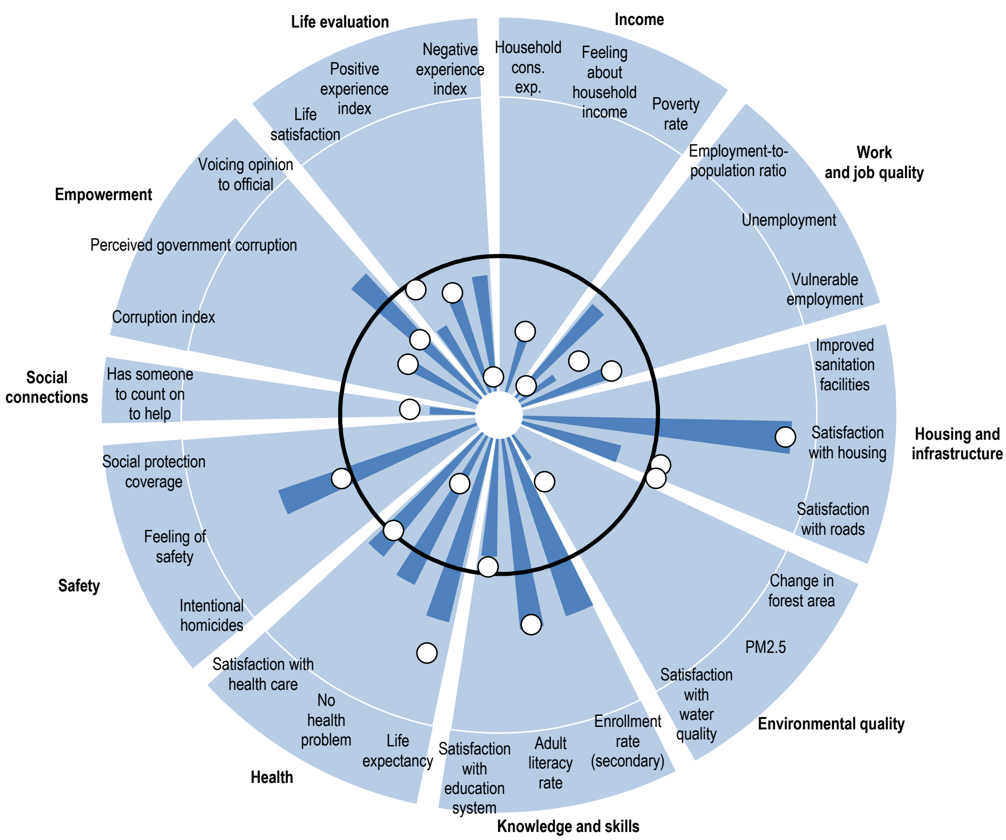
To capture the full range of people's actual life experiences, the OECD Well-being Framework uses both objective and subjective indicators. For instance, the Health dimension not only looks at life expectancy estimations but also considers how people feel about their health status and the health services they are receiving. Subjective indicators are sometimes viewed as not being as robust as objective measures; however, there are at least three reasons for considering them alongside the latter to get a holistic picture of well-being. First, there is solid methodological evidence that the subjective measures contained in the well-being framework (e.g. life satisfaction, trust in others and government) are statistically valid and correlate with objective measures of the same construct (OECD, 2017[12]; OECD, 2013[13]). Second, even in cases where perceptions diverge from objective reality, they capture the reality of survey respondents and can drive real-world outcomes, such as voting and lifestyle behaviours (Murtin, Fleischer and Siegerink, 2018[14]). It can actually be especially illuminating for policy makers to zoom in on areas where the gap between citizen perception and objective indicators is largest. Third, many of the measures typically considered objective and routinely used in policy analysis, such as household income, are based on people's self-reports and can equally be affected by response biases and non-response rates (e.g. of very wealthy households).

There are differences in well-being between men and women in Albania, and this report finds that there is scope to improve women's equal participation in society (Figure 3.3). As in most countries around the world, women in Albania have a higher life expectancy than men and are more socially connected (OECD, 2020[2]). Although women's employment outcomes do not lag significantly behind international benchmarks, Albania is far from achieving gender equality in the labour market. Some 46.9% of the female population over age 15 is in employment, compared to the OECD average of 49.9%. Gender gaps in formal employment are particularly high for women in their childbearing years: in 2018, the employment rate for women aged 25 to 29 was 54.1%, accounting for a gender gap of about 19.3 percentage points. The figures are significantly higher, on average, in OECD countries: 68% and 14.5 percentage points. Family responsibilities, discouragement and lack of access to child care are key reasons for women's lack of participation in the formal labour market. Indeed, Albanian women spend more than six times more time on unpaid household chores than men, compared to around two times more in comparable regional economies, such as Serbia, and the OECD average (see the People section in Chapter 5).

The well-being analysis highlights gender differences in safety and empowerment. Albanian men are more likely to feel safe when walking at night in their neighbourhoods (Gallup, 2020[15]). While this is not surprising (men in every OECD country feel safer than women), there are indications of prevailing gender norms that normalise violence against women: 30% of Albanian women consider a husband to be justified in hitting or beating his wife for trivial reasons, such as burning food, going out without telling him or refusing sex, compared to 8%, on average, in OECD economies. There are gender differences in civic engagement. Male citizens are more likely to voice their opinions to an official, and although one in three parliamentary seats is occupied by a woman, there remains a step to reach parity. A preference for male heirs, rapidly declining fertility rates and sex-selective abortions have skewed the birth sex ratio: 111 boys born for every 100 girls – one of the highest in the region (see the People section in Chapter 5).

Figure 3.3. Current and expected well-being outcomes for Albania: gender differences

2019 or latest available data; comparison relative to GDP per capita



Note: Well-being outcomes for women are represented by circles; men's outcomes are represented by bars. The observed values falling inside the central black circle indicate areas where Albania performs poorly in terms of what might be expected from a country with a similar level of GDP per capita. Expected well-being values (the black circle) are calculated using bivariate regressions of various well-being outcomes on GDP per capita, using a cross-country dataset of around 150 economies with a population of over one million. All indicators are normalised in terms of standard deviations across the panel.

Sources: Gallup (2018[3]), "Gallup World Poll", www.gallup.com/analytics/318875/global-research.aspx; ILO (2020[4]), *ILOStat* (database), https://ilostat.ilo.org/data/; OECD (2020[5]), *OECD PISA database*, www.oecd.org/pisa/data/; Transparency International (2019[6]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/; UNESCO (2019[7]), "UNESCO Institute for Statistics", http://uis.unesco.org/; World Bank (2020[8]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WHO (2020[9]), *Global Health Observatory* (database), www.who.int/data/gho/data/countries.

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Sustainable development: summary of Albania's performance and major constraints

To set the basis for future strategy, this section summarises the constraints analysis of this report for each pillar of sustainable development.

People: Albania is doing well on a number of SDG targets, particularly life expectancy and extreme poverty (Figure 3.4). At 78.6 years, life expectancy at birth is the highest in the Western Balkans and higher than in the United States (75.5 years). Standards of living have improved, and various promising social protection and healthcare reforms have recently been undertaken.

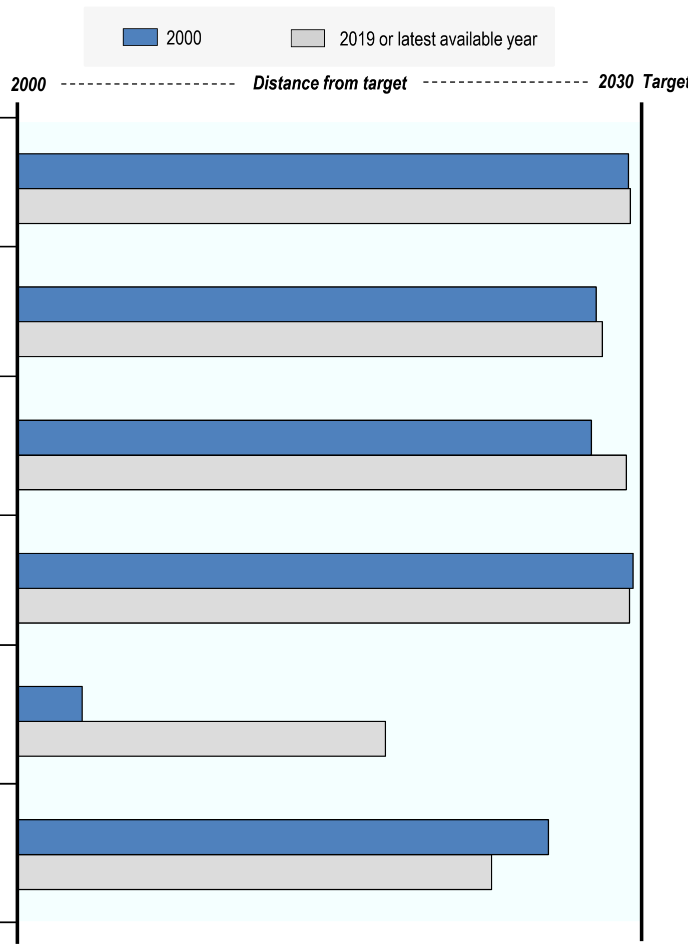
Challenges remain with regards to vulnerability, inequality, skills and social services. Close to 40% of households are materially deprived, and 23.4% of the population is at risk of poverty. Inequality remains higher than in benchmark countries. Many regions and groups, such as Roma and Egyptians, have limited access to infrastructure. Only 58.5% of Albanians living in rural areas have access to drinking water and 15% to sewerage services. Skills gaps affect young people's chances of finding quality jobs, and the Albanian labour market faces structural challenges. Family responsibilities, discouragement and lack of access to child care prevent women's equal participation in the formal labour market. The under-resourced health system places a high cost burden on patients, many of whom have no insurance. While many promising social protection reforms have recently been undertaken, social assistance benefits are too modest and need to be integrated with care services.

Aided by the introduction of a gender quota in 2008, female representation in politics has moved halfway towards the SDG target of equality. There remains room for improvement in the areas of gender discrimination in the family, safety and preference for male children. The People section in Chapter 5 identifies five major bottlenecks to well-being (Table 3.1).

Figure 3.4. People – progress towards the SDGs in Albania

Progress towards 2030 SDG targets, 2000 to 2018 or latest available year

Indicator	SDG	2000	2019 or latest available year	2030 target
Poverty headcount ratio at USD 1.9 per day (2011 PPP) (% of population)	1 NO POVERTY	2% (2002)	1.7% (2017)	0%
Prevalence of undernourishment (% of population)	2 ZERO HUNGER	7.2%	6.2% (2017)	0%
Life expectancy at birth, total (years)	3 GOOD HEALTH AND WELL-BEING	74.0	78.5 (2018)	80 a
Adult literacy rate, population age 15+, both sexes (%)	4 QUALITY EDUCATION	98.7% (2001)	98.1% (2018)	100%
Proportion of seats held by women in national parliaments (%)	5 GENDER EQUALITY	5.2%	29.5%	50%
Income share held by bottom 20%	10 REDUCED INEQUALITIES	8.4 (2002)	7.5 (2017)	9.9 b



Notes:
a. The target is the latest available average performance of OECD countries. Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.al
b. The target is the latest available average performance of top 3 OECD performers. For income share held by bottom 20% the top performers are the Czech Republic (10.2%), Slovenia (10%) and Finland (9.4%). For individuals using the Internet (% of population), the top performers are Iceland (99%), Denmark (97.3%) and Luxembourg (97.1%).
Sources: UNSD (2020[16]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; UNESCO (2019[7]), "UNESCO Institute for Statistics", http://uis.unesco.org/; UN IGME (2020[17]), *Levels and Trends in Child Mortality*, https://childmortality.org/; IPU (2020[18]), *Inter Parliamentary Union (database)*, www.ipu.org/; WHO (2019[19]), *Tracking Universal Health Coverage: 2019 Global Monitoring Report*, www.who.int/healthinfo/universal_health_coverage/report/2019/en; World Bank (2020[8]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Table 3.1. People – five major constraints to leaving no one behind in Albania

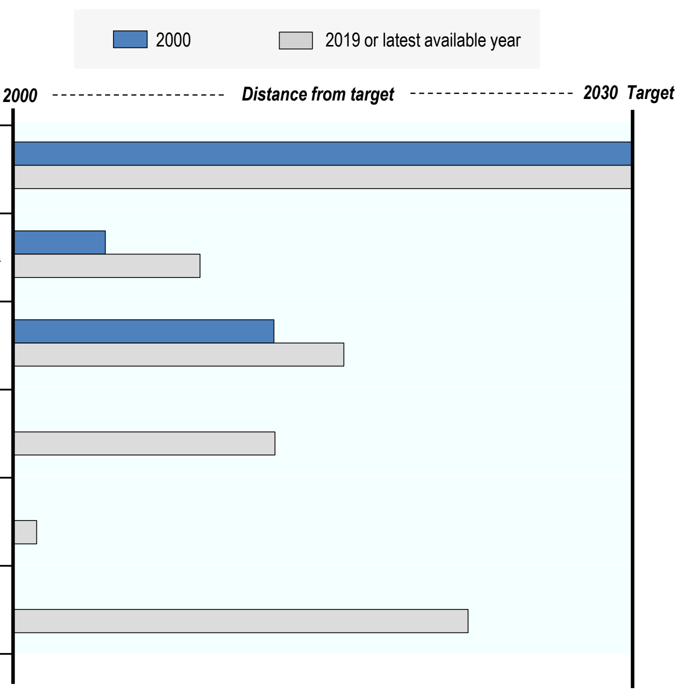
1. Remote Albanian regions are left behind in terms of employment opportunities and access to services, and local authorities' capacity is low.
2. Lack of skills and weak labour market institutions result in low employment inclusiveness, particularly for women and young people.
3. The healthcare sector places a high cost burden on patients, many of whom have no insurance.
4. Healthcare governance needs more resources in terms of medical staff, dynamic management and infrastructure.
5. Many promising social protection reforms have recently been undertaken, but social assistance benefits are too modest and need to be integrated with care services.

Prosperity: economic development has been strong and has translated into higher standards of living; new drivers of transformation and job creation must be developed to continue this dynamic. While the overall labour market remains challenging, Albania has succeeded in increasing employment rates and reducing informal employment. Investments in infrastructure have extended access to electricity to the entire Albanian population, and broadband coverage has increased to 80% of the population (Figure 3.5). To create more jobs, boost productivity and increase investment, Albania would benefit from upgrading its domestic productive capacities, creating a flexible and skilled labour force, removing institutional and administrative barriers to domestic and foreign investment, and addressing the existing infrastructure gaps, especially in the transport and energy sectors. The Prosperity section in Chapter 5 identifies five major bottlenecks to a more dynamic path (Table 3.2).

Figure 3.5. Prosperity – progress towards the SDGs in Albania

Progress towards 2030 SDG targets, 2000 to 2018 or latest available year

	SDG	2000	2019 or latest available year	2030 target
Access to electricity (% of population)	7 Affordable and clean energy	100	100 (2017)	100
Agriculture value added per worker (constant 2010 USD)	8 Decent work and economic growth	2 907	5 897 (2018)	19 537 [a]
Wage and salaried workers, total (% of total employment)	8 Decent work and economic growth	35.2	44.6	83.6 [a]
Account at a financial institution (% of age 15+)	8 Decent work and economic growth	-	40 (2017)	94.7 [a]
Researchers in R&D (per million people)	9 Industry, innovation and infrastructure	-	156 (2008)	4 079 [a]
Individuals using the Internet (% of population)	9 Industry, innovation and infrastructure	0.1	71.8 (2017)	97.8 [a]



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For income share held by bottom 20% the top performers are the Czech Republic (10.2%), Slovenia (10%) and Finland (9.4%). For individuals using the Internet (% of population), the top performers are Iceland (99%), Denmark (97.3%) and Luxembourg (97.1%).
Sources: UNSD (2020[16]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; ILO (2020[4]), *ILOStat* (database), https://ilostat.ilo.org/data/; UNESCO (2019[7]), "UNESCO Institute for Statistics", http://uis.unesco.org/; UN-Habitat (2020[20]), UN-Habitat Data and Analytics, https://unhabitat.org/knowledge/data-and-analytics; RICYT (2020[21]), *RICYT* (database), www.ricyt.org/en/; World Bank (2020[8]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; World Bank (2019[22]), *Sustainable Energy for All* (database), https://databank.worldbank.org/source/sustainable-energy-for-all/preview/on.

Table 3.2. Prosperity – five major constraints to a more dynamic economy of Albania

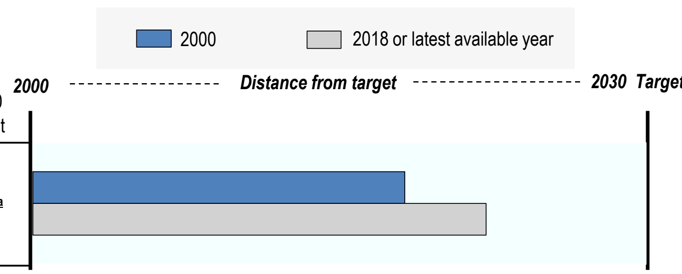
1. Albania needs new growth drivers to accelerate the structural transformation of the economy and to boost productivity.
2. The tradable sector needs more investment, diversification and upgrading.
3. Lack of skills affects growth and productivity.
4. Institutional and administrative barriers limit domestic and foreign investment.
5. The large infrastructure gap deters investment, especially large manufacturing foreign direct investment (FDI).

Partnerships and financing: the double hit of the November 2019 earthquake and the COVID-19 pandemic require considerable fiscal responses that in turn will need a strong fiscal system, with more contributions from all Albanians. The necessarily increasing fiscal burden will put pressure on the already sizeable public debt and require well-targeted and efficient public spending. Albania's current revenue from taxes is too low to support the necessary effort (Figure 3.6). A more dynamic economic path and more willingness by everyone to contribute to the state are necessary. In terms of access to financing, the entry of foreign financial institutions into the Albanian market enabled wider, better and cheaper conditions. However, more is needed. The Partnerships and financing section in Chapter 5 identifies three major bottlenecks to more sustainable financing (Table 3.3).

Figure 3.6. Partnerships and financing – progress towards the SDGs in Albania

Progress towards 2030 SDG targets, 2000 to 2018 or latest available year

		2000	2018 or latest available year	2030 target
Tax revenues (% GDP)	17 PARTNERSHIPS FOR THE GOALS	20.8	25.3	34.3[a]



Note: a. The target is the latest available average performance of OECD countries.
Source: World Bank (2020[8]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Table 3.3. Partnerships and financing – three major constraints to an effective fiscal response to the 2019 earthquake and COVID-19 in Albania

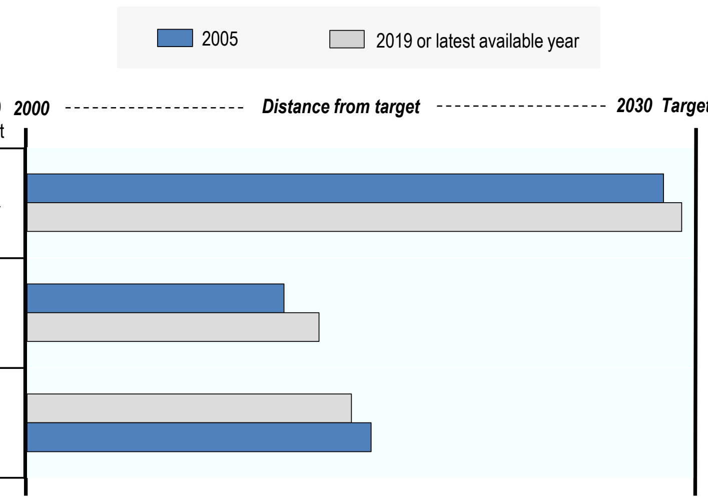
1. The fiscal space is limited.
2. Revenue performance is lagging behind, while expenditures need to increase in key areas.
3. Access to financing is limited.

Peace and institutions: Albania has made remarkable progress in transitioning to democracy and a market economy. Strengthening trust in formal institutions will be key going forward. The country has become safer, and homicide rates have decreased, from 43 to 2 per 100 000 inhabitants between 1997 and 2018 (Figure 3.7). The recent ambitious judicial reforms and the rationalisation of the subnational government structure, if successfully concluded, could lay the foundations for more reliable and efficient services. The government has also improved powers and tools to combat corruption, one of the country's most deeply rooted constraints to development. At the same time, informal practices and networks retain a significant role, often to the detriment of overall efficiency and the rule of law. In the past, patronage has led to the proliferation of ministries, authorities and agencies, each with their own agendas and priorities. Despite recent reforms that have streamlined the structure of the public administration, the multiplicity of actors could make a shared strategic vision and its implementation difficult. Property rights remain a challenge. The Peace and institutions section in Chapter 5 identifies six major constraints to more effective public institutions and services (Table 3.4).

Figure 3.7. Peace and institutions – progress towards the SDGs in Albania

Progress towards 2030 SDG targets, 2000 to 2019 or latest available year

	SDG	2005	2019 or latest available year	2030 target
Intentional homicides (per 100 000 people)	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	5.0	2.3 (2017)	0.4 b
Confidence in the judiciary (% of respondents)	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	22% (2006)	25%	57 a
Corruption perceptions index	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	33 (2012)	35	68 a



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For international homicides rate, the top performers are Japan (0.26), Luxembourg (0.34), and Norway (0.47).
Sources: UN-CTS (2020[23]), *Sustainable Development Goals* (database); World Bank (2020[8]), *World Development Indicators* (database); Transparency International (2019[6]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/results/.

Table 3.4. Peace and institutions – six major constraints to more effective public institutions and services in Albania

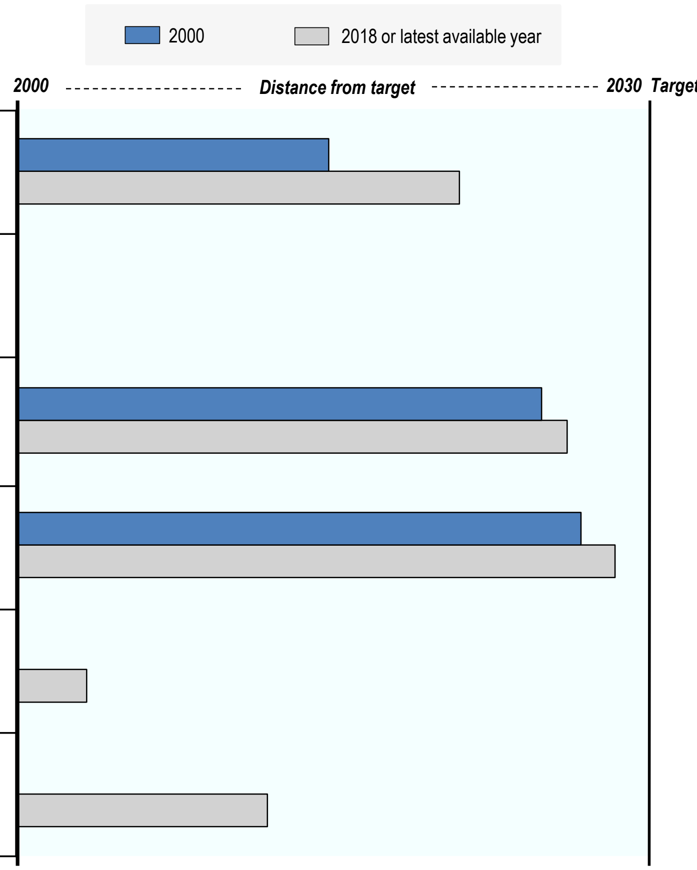
1. The fragmented structure of the public administration can stand in the way of implementation.
2. Courts lack capacity and are exposed to external influence.
3. Land property rights remain complex, affecting land productivity and sustainability.
4. Corruption remains a challenge.
5. Limited local fiscal and administrative capacity and an unclear regional development framework may exacerbate regional inequalities.
6. Statistical capacity is limited, especially in the area of planning and reporting on economic indicators.

Planet: Albania has made progress on improving drinking water and reducing air pollution, but pressures on sustainability and environmental quality of life continue to present challenges (Figure 3.8). The share of the population using safely managed sources of drinking water has increased from 49.3% to 70% since 2000, but many Albanians living in rural areas remain disadvantaged in coverage. The country's annual exposure to particulate matter (PM) 2.5 decreased from 22 μg/m³ in 2005 to 18.2 μg/m³ in 2017, which is the best value in the region, but air pollution continues to pose a significant challenge, especially in Tirana. Albania is a small economy that relies on extensive use of natural resources, especially water, which is relevant for the energy, agriculture and tourism sectors. Minimising environmental degradation and improving resource preservation, as emphasised in the National Strategy for Development and Integration 2014-2020, is needed and will be key for making Albania's growth more sustainable and for enhancing the well-being and the quality of life of all Albanians (Republic of Albania Council of Ministers, 2013[1]). The Planet section in Chapter 5 identifies three major constraints to a more sustainable path (Table 3.5).

Figure 3.8. Planet – progress towards the SDGs in Albania

Progress towards 2030 SDG targets, 2000 to 2018 or latest available year

Indicator	SDG	2000	2018 or latest available year	2030 target
People using safely managed drinking water services (% of population)	6 Clean water and sanitation	49.3	70 (2017)	100
Electricity production from renewables (%, excluding hydro)	7 Affordable and clean energy	0.000	0.004 (2019)	21.5 a
Mean annual concentration of PM2.5 weighted by population (µg/m3)	11 Sustainable cities and communities; 12 Responsible consumption and production	22.0	18.2 (2017)	6.0 b
CO2 intensity of GDP (kg CO2 per unit of GDP in 2017 USD PPP)	13 Climate action	0.17	0.12 (2018)	0.07 b
Marine protected areas (% of territorial waters)	14 Life below water	-	2.7	24.5 a
Terrestrial protected areas (% of total land area)	15 Life on land	-	17.7	44.7 b



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For mean annual concentration of PM2.5 weighted by population, the top performers are Finland (5.9%), New Zealand (6%) and Sweden (6.2%). For CO_2 emissions, the top performers are Sweden (0.062), Switzerland (0.064), and Norway (0.078). For territorial protected areas, the top performers are Slovenia (53.6%), Luxembourg (40.9%) and Poland (39.7%).
Sources: UNEP (2020[24]), *Environment Live/Global Material Flows* (database), www.resourcepanel.org/global-material-flows-database; UNSD (2020[16]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; IEA (2018[25]), *World Energy Balances*, www.iea.org/reports/world-energy-balances-overview; OECD (2020[26]), *Green Growth Indicators* (database), https://stats.oecd.org/Index.aspx?DataSetCode=GREEN_GROWTH; UNEP-WCMC (2018[27]), *World Database on Protected Areas*, https://www.protectedplanet.net/; WHO/UNICEF (2020[28]), *JMP for Water Supply, Sanitation and Hygiene*, http://washdata.org/; World Bank (2020[8]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Table 3.5. Planet – three major constraints to a more sustainable development of Albania

1. Albania is exposed and vulnerable to natural hazards.
2. Deterioration of the environmental quality of life remains a challenge.
3. The expansion of hydropower plants has a detrimental impact on the country's environment and water resources, and other renewable energy sources are underdeveloped.

Suggestions for strategic priorities for Albania

A development strategy for Albania should set the path for achieving a vision for the future, address the most important constraints and build on opportunities. The suggestions for a vision and the major constraints presented above can build the basis for setting strategic priorities. The objectives of the vision statement must be paired with corresponding obstacles and pathways to building implementation capacities and political support. The strategic priorities identified build on other assessments in Albania, including the Voluntary National Review on Sustainable Development Goals of Albania (Republic of Albania Council of Ministers, 2018[29]), the National Strategy for Development and Integration 2019-2020 (NSDI II) (Republic of Albania Council of Ministers, 2013[1]), OECD assessments (OECD, 2018[30]) and the European Commission assessments (European Commission, 2019[31]; European Commission, 2019[32]) and aim to bring the key constraints together in a holistic manner.

The process of integration with the European Union is one of the key assets and strategic opportunities for Albania's development. The process has been an important driver of reforms and institution building in Albania and has provided the country with large financial and technical support for its development and regional integration, as well as market access and economic opportunity (Box 3.3). As part of the integration process, Albania has worked to bring its legislation in line with the existing body of EU laws and standards (known as the acquis), helping set the basis for effective institutions and processes. The strategic importance of EU accession is clearly stated in key policy documents, such as Albania's successive economic reform programmes (ERPs). The recent elevation of the process towards negotiations for membership is a significant step forward and a recognition of Albania's reform progress. The following suggestions for strategic priorities should be considered against the backdrop of EU integration.

The COVID-19 crisis has had an impact on Albania but also offers the opportunity for strategic focus. Albania has dealt well with the health crisis and has been able to limit casualties and the spread of the virus. Like most countries in Europe, however, Albania will suffer a recession in 2020. In response, Albania will have to invest in a swift recovery. These investments and the potential international support present an opportunity for strategic focus on opportunities and on removing identified constraints.

Skills and education emerged as the top strategic priority, constituting both a key constraint and an opportunity. Albanians strongly desire a better education system. Workshop participants converged on a strong education system as the most important dimension of a future vision. At the same time, the analysis of both the people and the prosperity dimensions highlighted the deep insufficiencies in the current skills base and skills system as key constraints. Enabling Albanians to realise their potential should be a strategic objective for both greater well-being and a stronger economy.

Creating dynamic drivers of growth that generate opportunities and revenue must be a second priority. The constraints analysis and the visioning workshop highlight the desire and need for more economic opportunity from new activities that make the most of future opportunities, such as digitalisation, green growth and manufacturing and services more broadly. This requires identifying key opportunities and creating the best conditions for them to emerge. It also requires working with all the subregions and municipalities to identify economic opportunity and ensure that it materialises. The objective must be to stimulate the creation of quality jobs and generate the revenue necessary for solid public services, social protection and environmental quality of life.

Improving the quality of life and the environment for all citizens completes the priorities for Albania. The vision statement emphasises quality of life as an important future expectation. Making Albania an attractive place to live will make it an attractive place to visit and to invest in. To improve well-being, health care and social protection need to be strengthened and better financed. Albania's natural environment is a key resource but must be much better protected. The rapid concentration of the population in urban centres over the last years has left many regions behind. Supporting regions to focus on strengths and ensuring good living conditions will be important. Special attention must be given to allowing women to participate fully as citizens and professionals, with the same opportunities and on an equal footing with men.

Institutional and government shortcomings emerged as the key obstacle that Albania's future strategy should consider. Visioning workshop participants identified the lack of implementation of strategies and plans and the lack of institutional resilience as the most important challenges. The constraints assessment of this report identified as a challenge the somewhat fragmented structure of the public administration (in particular, the multitude of agencies) that often stands in the way of implementation and strategic clarity. Informal practices and networks retain a significant role, often to the detriment of overall efficiency and the rule of law. Local governments play a crucial role in service delivery but have little capacity. Last, land rights and property certainty are not yet fully assured everywhere.

Addressing these governance shortcomings and strengthening the government's capability to deliver will have significant positive effects across Albania's strategic objectives. The government and the public administration must play central roles in driving reforms to realise Albania's development objectives. It will be important to build capacities within the public administration. For skills and education, stronger local governments (the top strategic priority), a more efficient administrative structure and a focus on quality staff will be key. Albania's favourable pupil/teacher ratio could be better leveraged to boost Albanians' skills and competences. For drivers of growth (the second strategic priority), institutional barriers and an unconducive business environment need improvement. Health care and social protection need both stronger local governments and more revenue. Both could be improved by streamlining the public administration, focusing on effectiveness and improving multilevel governance.

Managing regional integration, natural hazards and migration are key requirements for any future strategy. As a small economy with a large share of its population living abroad, Albania must strive for more integration into and collaboration across all policy areas with its regional neighbours and beyond. Stronger integration can boost the emergence of new drivers of growth. It is also necessary for addressing the many environmental challenges, most importantly energy production and diversification but also air pollution and water management. Migration is a key feature of many economies in the region. Albania has put in place the National Strategy for Migration 2019-2022 and National Strategy for Diaspora 2021-2025, which set out important directions to ensure effective migration governance, link migration with development, regulate flows and make the most of remittances, and create links with the diaspora. At the same time, state institutions have started to co-ordinate to manage human and financial resources abroad better. This is an important step forward, and the implementation of this strategy should continue to be part of Albania's overall strategic objectives.

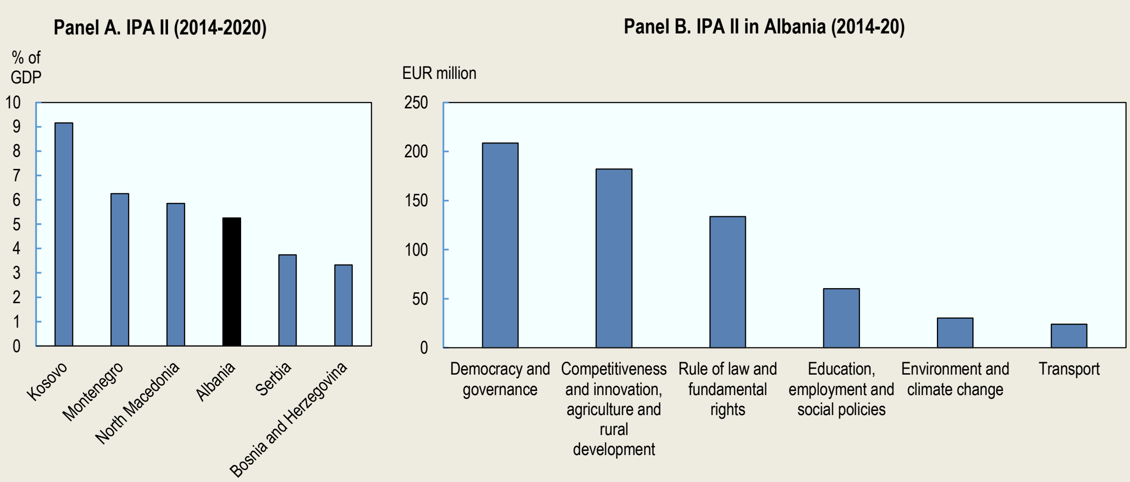
Box 3.3. Albania's integration towards the European Union

The process towards integration with the European Union has been an important driver of democratisation and institution building in Albania and has provided the country with large financial and technical support for its development and regional integration. As part of the process, Albania has worked to bring its legislation in line with the existing body of EU acquis.

Through the Stabilisation and Association Process (SAP) since 1999, Albania and the economies in the region have been involved in a progressive partnership with the European Union. The SAP rests on the following pillars: bilateral Stabilisation and Association Agreements; trade relations (wide-ranging trade agreements); financial assistance (the Instrument for Pre-accession Assistance [IPA]); and regional co-operation, such as the Central European Free Trade Agreement (CEFTA):

- The Stabilisation and Association Agreement with Albania, which entered into force on 1 April 2009, governs the relations between Albania and the European Union. The agreement offers various benefits to citizens and business (such as visa-free travel), supporting institutional and democratic reforms, and encouraging neighbourly relations and trade (European Commission, 2020[33]).
- The IPA has been instrumental in providing Albania assistance in reforms through financial and technical help. IPA II (for 2014-20) accounted for 5.3% of GDP in Albania (EUR 639.5 million) (Figure 3.9 – Panel A), making Albania recipient of the fourth largest IPA in the Western Balkans in terms of share of GDP. Most of the IPA II funds in the period (53.7%, or about EUR 342.5 million) have been allocated towards strengthening democracy and governance, and rule of law and fundamental rights (Figure 3.9 – Panel B).

Figure 3.9. IPA II funding has been concentrated on democracy and governance, and rule of law and fundamental rights



Source: Authors' elaboration based on European Commission (2020[34]), "Albania – financial assistance under IPA II", https://ec.europa.eu/neighbourhood-enlargement/instruments/funding-by-country/albania_en.

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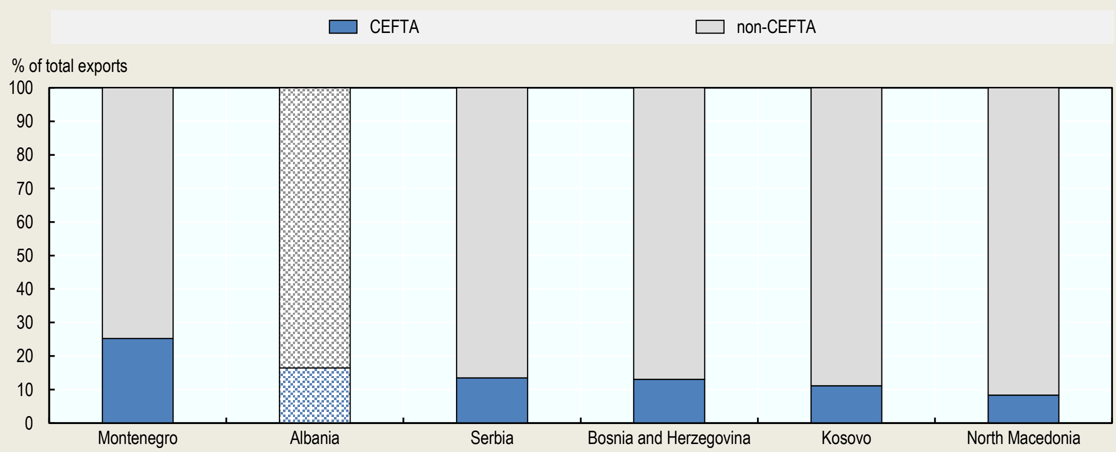
- Regional co-operation has been another important driver in the SAP for developing infrastructure and networks in the region and for establishing a free trade area between Albania and other economies. Key regional initiatives include the CEFTA, the Energy Community, the Western Balkans Investment Framework and the Regional Cooperation Council. The CEFTA, an international trade agreement among economies in South East Europe, was one means of facilitating trade in the region and of harmonising trade-related legislation with the European Union. The share of exports from Albania to CEFTA economies in the Western Balkans increased from 1% in 2012 to 16.5% in 2019. Only Montenegro has a larger share (Figure 3.10). In 2019, 61.5% of Albanian exports went to Kosovo (CEFTA, 2020[35]).

Figure 3.10. The role of the CEFTA in Albania



Source: CEFTA (2020[35]), *Trade in goods* (dataset), https://statistics.cefta.int/goods.

StatLink https://doi.org/10.1787/888934241681

Considering Albania's progress in implementing political and economic reforms, the European Council approved Albania's candidacy status in 2014 (European Parliament, 2019[36]). Good progress was noted in establishing functioning parliamentary procedures, adopting amendments to the electoral code, implementing public administration reform, combating corruption in the judiciary and facilitating business entry into the market, among other areas. Despite the fulfilment of conditions necessary to start accession negotiations by 2019, the process was put on hold, as EU leaders did not reach a decision to open accession negotiations with Albania and North Macedonia at the European Council summit in October 2019.

At the Zagreb EU-Western Balkans Video-Summit of 6 May 2020, EU leaders reaffirmed their support for the European perspective of the Western Balkans. The European Commission presented its proposals for the negotiating framework in July 2020 (European Commission, 2020[37]) and reported on the implementation of reforms in Albania and North Macedonia (European Commission, 2020[38]; European Commission, 2020[39]; European Commission, 2020[40]). For Albania, the European Council listed a number of conditions to be met prior to its first Inter-Governmental Conference, including among others: adopting the electoral reform fully in accordance with the recommendations of the Organization for Security and Co-operation in Europe/Office for Democratic Institutions and Human Rights; ensuring transparent financing of political parties and electoral campaigns; ensuring the continued implementation of the judicial reform; and finalising the establishment of the anti-corruption and organised crime specialised structures (European Commission, 2020[39]).

The new Enlargement Package and the adoption of the Economic and Investment Plan have set new directions for EU integration and recovery from COVID-19. Building on the Western Balkan strategy from 2018 (European Commission, 2018[41]), the Enlargement Package adopted on 6 October 2020 stresses the need to improve the EU integration process to be better equipped to deal with structural weaknesses in Albania and other Western Balkan economies. In parallel, the European Commission adopted the Economic and Investment Plan to spur the long-term economic recovery of Albania and the region, support a green and digital transition and foster regional integration into and convergence with the European Union. The support is crucial, especially in light of both the COVID-19 impact and the existing challenges, such as weak competitiveness and high unemployment. The plan will mobilise up to EUR 9 billion of IPA III funding for 2021-27. A large majority of this support will be directed towards key productive investments and sustainable infrastructure in the Western Balkans through the ten flagship initiatives. Through the Western Balkans Guarantee facility, the ambition is to raise additional investments of up to EUR 20 billion (European Commission, 2020[39]; European Commission, 2020[40]).

Note: The ten flagship investment initiatives are: two transport infrastructure projects (connecting east to west and north to south), renewable energy, transition from coal, connecting coastal regions, building renovations, waste and water management, digital infrastructure, supporting the competitiveness of the private sector, and youth support.
Source: European Commission (2020[33]; 2020[38]; 2020[39]; 2020[40]; 2020[37]); (European Commission, 2018[41]); (CEFTA, 2020[35]).

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Note

[1] See Table 1.1. in the Regional Overview for more detail on the choice of comparable economies.

4 Impact of COVID-19 in Albania

COVID-19 had an impact on Albanian citizens and its economy, but the authorities acted quickly to contain the spread of the virus, and took measures to mitigate the negative effects of restrictions on the economy. Yet, the medium- to long-term economic and social impact of the pandemic will largely depend on pre-existing socio-economic vulnerabilities and policy resilience. This chapter assesses the impact of the pandemic on the Albanian citizens and reviews the most binding channels of socio-economic exposure and policy resilience. In particular, as a small and open economy, Albania is particularly exposed to a reduction in global trade flows and financing, as well as a weakening tourism sector. Building resilience will depend on the strength and capacity of institutions to timely design and implement policy measures, as well as on the citizens' trust in the public decision-making process and the efficiency of the public administration.

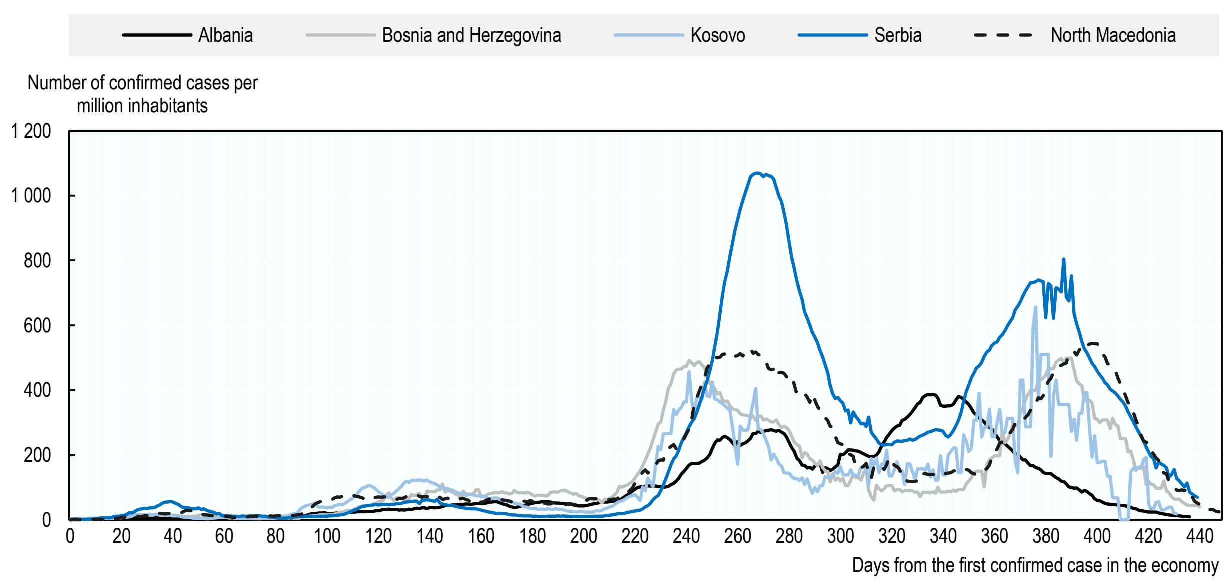
Evolution of the pandemic

Albania has experienced several waves of the pandemic. The economy reported the first case of COVID-19 on 8 March 2020. Two and a half months later, there were around 300 cases and 10 registered deaths per million inhabitants. The latest data show that Albania had the lowest cumulative number of cases in the Western Balkans with 131 517 cases (45 953 cases per million inhabitants). On 26 May 2021, it registered the lowest rate of daily new cases in the region (7 per million inhabitants) (Figure 4.1). Albania has also the lowest number of registered deaths from COVID-19 in the Western Balkans with 2 433 deaths (850 per million inhabitants) (Figure 4.2).

The prime minister declared a state of natural disaster throughout the economy on 25 March 2020. The government then prolonged the state until 23 June 2020 and took a series of measures to control the epidemic (Figure 4.3). Albania had in place policy framework that provided a basis for dealing with the outbreak. It includes the National Civil Emergency Plan of Albania, the Ministry of Health and Social Protection Emergency Operation Plan, the National Pandemic Influenza Preparedness and Response Plan, and the Infectious Diseases Hospital Crisis Prevention Plan, Focused on Pandemic Flu H1N1 (WHO/European Commission/European Observatory on Health Systems and Policies, 2020[1]).

Figure 4.1. Albania registered a relatively high number of new daily cases relative to its population

Daily new confirmed COVID-19 cases per million inhabitants, rolling seven-day average



Source: Authors' calculation based on Our World in Data (2020[2]), Our World in Data website, https://ourworldindata.org/.

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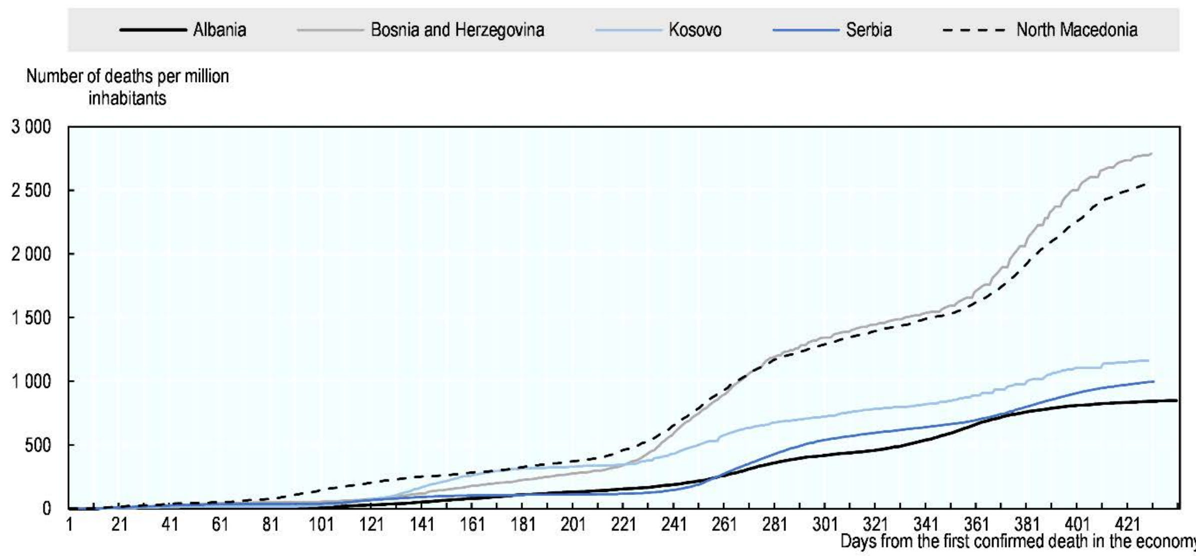
Figure 4.2. Albania has the lowest number of registered deaths per million inhabitants in the Western Balkans

Cumulative number of confirmed COVID-19 deaths per million inhabitants



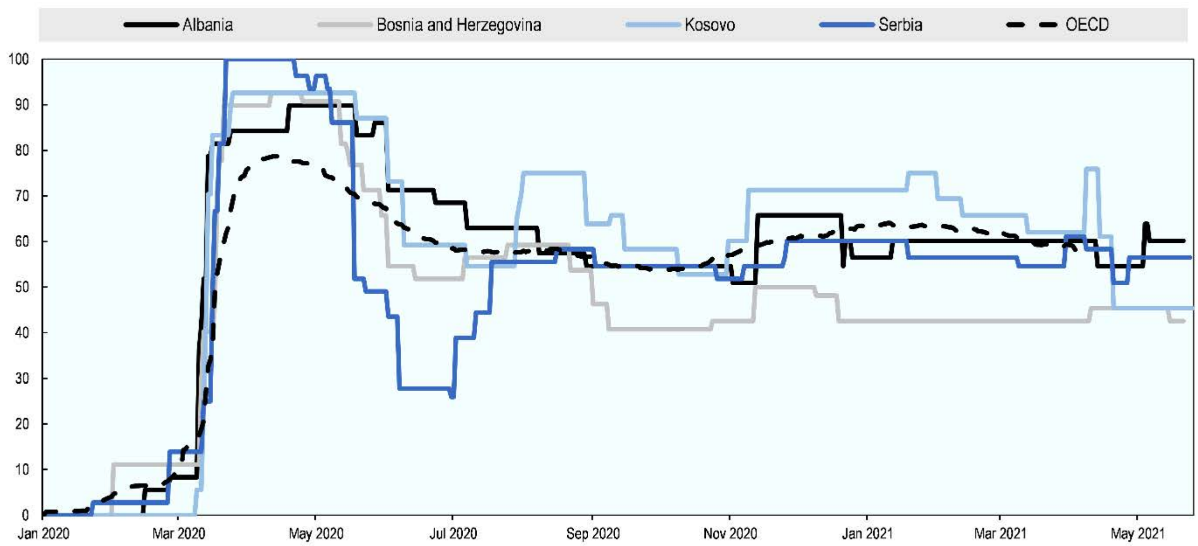
Source: Authors' calculation based on Our World in Data (2020[2]), Our World in Data website, https://ourworldindata.org/.

StatLink https://doi.org/10.1787/888934241719

Albania acted quickly to contain the spread of the virus, but future resilience may be at risk. On 10 March 2020, just two days after the official outbreak, the government announced the first lockdown measures: all private and public transport was banned in 8 out of 12 counties (qarku), and public gatherings were strictly forbidden. These measures were successfully implemented immediately after the announcement. Since 11 March, the government has put in place stringent and timely measures to curb the spread (Figure 4.3). However, Albania has been conducting fewer tests than the rest of the region (around 243 816 per million inhabitants, compared to an average of 405 202 in the Western Balkans) (Figure 4.4). While relaxing confinement, ramping up testing capacity is crucial in order to detect a possible new wave of contagion early. With 9 people fully vaccinated per hundred inhabitants by the latest available data, vaccine capacity in Albania is above the region average but lower than both the OECD and EU averages (Figure 4.5).

Figure 4.3. Albania has put in place timely and stringent measures to curb the spread of the virus

Stringency index (0 = least stringent; 100 = most stringent)



Source: University of Oxford (2021[3]), "Oxford COVID-19 Government Response Tracker", www.covidtracker.bsg.ox.ac.uk/r.

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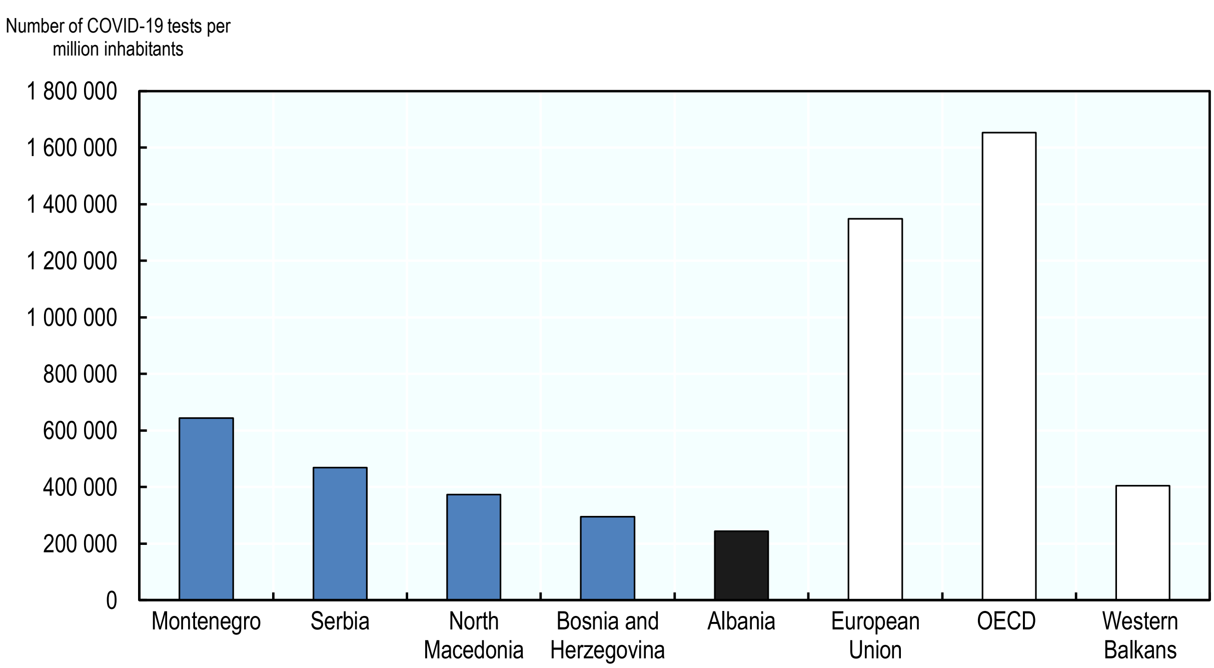
Figure 4.4. Testing capacity in Albania remains limited



Notes: Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.
Source: Worldometer (2020[4]), "Coronavirus", www.worldometers.info/coronavirus/.

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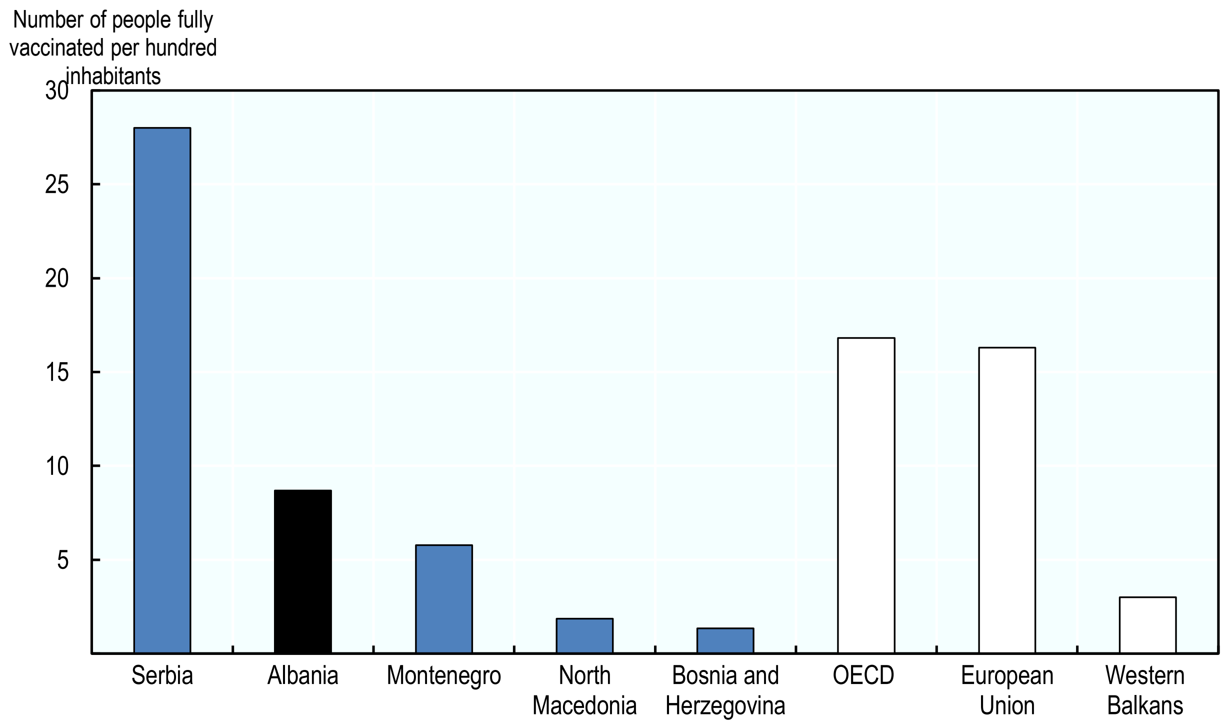
Figure 4.5. Vaccine capacity in Albania outpaces the Western Balkan average



Note: Last reported numbers are from May 2021.
Source: Worldometer (2020[4]), "Coronavirus", www.worldometers.info/coronavirus/.

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Policy responses and economic impact

The government has put in place numerous measures (amounting to 4% of GDP) to support the healthcare system, enterprises and households affected by the confinement measures (Table 4.1). It received emergency financing support from the International Monetary Fund, the European Union and other donors to help assist with the crisis response. Considerable fiscal, monetary and other policy responses will be required to mitigate the impact and to put Albania on a long-term growth trajectory. It will require the careful design and selection of policies and targeting that take into account the domestic context, institutional set-up and government capacities.

Table 4.1. Policy measures in response to the COVID-19 pandemic

	People	Businesses	Health and other measures
First financial plan	• ALL 6.5 billion (Albanian lek) (EUR 52 million) to support disadvantaged populations, small businesses and the unemployed. • Permanent erasure of late payment interest for active debtors who are current energy consumers and for families or small businesses with a financial effect of up to ALL 15 billion (EUR 121 million).	• ALL 10 billion (EUR 80 million) of sovereign guarantee for companies with difficulties paying employee salaries. • Rescheduling of income taxes for all businesses with turnover of up to EUR 118 million that have ceased activities during the COVID-19 period. • Postponement of balance sheet submissions for a period up to 1 June 2020 for businesses submitting balance sheets to the National Business Centre on line or directly.	• ALL 2.5 billion (EUR 20 million) for medical equipment and materials for medical staff. • ALL 2 billion (EUR 16 million) for humanitarian operations. • ALL 1 billion (EUR 8 million) as a reserve fund to the Council of Ministers for any unforeseen emergency.
Second financial plan	• ALL 40 000 (EUR 323) to current employees and laid-off employees under specific conditions.	• State guarantee of EUR 138 million for tourism, the garment industry and manufacturing businesses, provided as a risk-sharing mechanism between the government and banks. • Postponement of due date payment for tax on profits instalments for almost all enterprises.	
Third financial plan	• Provision of minimum wage for public transport workers who resumed work one month later than others totaling ALL 135 million (EUR 1 million).	• Employment promotion programme to cover a part of reemployment costs for businesses.	• Allocation of ALL 14.2 billion (0.8 % of GDP) towards COVID-19 related spending, including treatment, wage increases for healthcare workers and increase in social assistance payments.
Additional measures	• Postponement of rent payment for some groups, including students, individuals with rental contracts, low-income natural/legal persons who have a notarial lease contract.		• Salary reduction of high officials. • Creation of a financial anti-COVID-19 fund.

Sources: OECD (2020[5]), "COVID-19 Policy Tracker", http://oecd.org/coronavirus/en/#economy-policy-tracker.

The pandemic had a significant negative economic impact in Albania, as it was still recovering from the earthquake in late 2019. After growing by 2.2% in 2019, growth contracted by 3.3% in 2020. Despite the sever contraction in the second quarter of 2020, during the summer 2020 economic activity returned as restrictions were lifted. An increased construction in particular contributed to a GDP growth of 3% in the last quarter of 2020. Due to the reduced external demand, exports fell by 6.7% in 2020 (World Bank, 2021[6]).

Coronavirus COVID-19

The analysis of policy responses to the COVID-19 pandemic does not reflect the policy development that occurred since February 2021, with the exception of the figures on testing and vaccination for which the most recent and internationally comparable data were used.

Dimensions of vulnerability to further socio-economic impact from COVID-19

The short-term risk to human life from the COVID-19 has been curtailed thanks to authorities' early response and citizens' respect of confinement orders. Registered case and death numbers in Albania are among the lowest in the Western Balkans region (Figure 4.1 and Figure 4.2). The medium- to long-term impact will largely depend on pre-existing socio-economic vulnerabilities and the resources for resilience that the economy can mobilise. Taking pre-existing vulnerabilities into account can help policy makers to determine who needs support the most and what policies can help restart the economy and create conditions for sustainable and inclusive growth (Table 4.2).

Table 4.2. Albania's socio-economic exposure and policy resilience to COVID-19

	Channels	Level of vulnerability[1]	Signalling indicators (latest available data for 2018 unless otherwise stated)	Albania	OECD
Socio-economic exposure	Health risks	Medium	Adult smoking prevalence (%)	29.2	24.9
			Adult obesity prevalence (%)*	21.7	23.2
			Household debt, loans and debt securities (% of GDP)	11.2	68.3
	Well-being	High	Poverty headcount (measured as USD 5.50 per person per day (2011 PPP) (% of population)**	33.8	2.9
			Personal remittances, received (% of GDP)***	9.6	0.9
			Unemployment rate***	11.5	5.8
			Vulnerable employment (% of total employment)***	51.2	12.8
			Households without high-speed Internet access (%)***	43.3	15
			Life satisfaction (average score on 0-10 scale)***	5.0	6.7
			Lack of social support (% of population)***	32.0	9.4
			Gender norms that normalise domestic violence (% of women)***	29.8	8
	Trade	High	Trade (% of GDP)***	76.9	58
	Investment	High	External balance on goods and services (% of GDP)***	-13.8	0.3
			Microenterprises (1-9 employees) (% among total enterprises)	94.6	78.7
			FDI, net inflows (% of GDP)***	7.9	1.9
	Tertiary sector (tourism/ services)	High	Tourism (% of GDP)	8.8	4.4
			Tourism (% of total exports)	48.2	21.5
			Retail services (% total value added)	12.3	20
	Financial and monetary	Low to medium	Non-performing loans (% total loans)***	8.4	3.7
			Foreign currency reserve (number of months of imports)***	5.9	x
			Capital adequacy ratio (%)***	18.3	18.88
			Main interest rate (%)***	0.5	x
			Spending on health care (% of GDP)	5.2	12.5
Policy resilience	Health sector	Low	Physicians per 1 000 inhabitants	1.2*	2.9**
			Psychiatrists per 100 000 inhabitants	1.8	15
			Gross public debt (% of GDP)	66.7	65.8
			Public deficit (% of GDP)	-1.4	-0.49
			Gross domestic savings (%)***	8.2	22.5
			Short-term debt (% of total external debt)	18.8	9
			Foreign currency debt (% of total debt)	45.0	x
			Average debt maturity (years)	2.2	8
	Social protection	Low	Social protection spending (% of GDP)*	9.4	20.1
	Government effectiveness	Low to medium	Government effectiveness index (-2.5: low effectiveness; 2.5: high effectiveness)	0.1	1.21
			Government performance index (1: low; 10: high)	6.9	7.51
			Rigorous and impartial public administration (0: partial; 4: impartial)***	2.2	3.31

Note: Short-term debt is measured as share of T-bill (www.oecd.org/daf/fin/public-debt/Sovereign-Borrowing-Outlook-in-OECD-Economies-2018.pdf). Data are for 2018 unless otherwise specified. In particular:
*: 2016
**: 2017
***: 2019
1. OECD assessment.

Sources: Authors' elaboration based on national and international data: Coppedge et al. (2020[7]), *V-Dem Dataset -- Version 10* (dataset), www.v-dem.net/en/data/data/v-dem-dataset/; IMF (2020[8]), *International Financial Statistics* (dataset), https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b; IMF (2020[9]), *Financial Soundness Indicators* (dataset), https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA; IMF (2021[10]), *World Economic Outlook Databases* (database), www.imf.org/external/pubs/ft/weo/2020/01/weodata/index.aspx; IMF (2019[11]), *World Economic Outlook, October 2019: Global Manufacturing Downturn, Rising Trade Barrier*, www.imf.org/en/Publications/WEO/Issues/2019/10/01/world-economic-outlook-october-2019; INSTAT (2020[12]), *Statistics by theme* (database), www.instat.gov.al/en; OECD et al. (2019[13]), *SME Policy Index: Western Balkans and Turkey 2019: Assessing the Implementation of the Small Business Act for Europe*, https://doi.org/10.1787/g2g9fa9a-en; WHO (2020[14]), Global Health Observatory, https://www.who.int/data/gho.; World Bank (2020[15]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WTTC (2020[16]), *World Travel & Tourism Council* (database), https://wttc.org/Research/Economic-Impact/Data-Gateway.

Material well-being and social protection

The short- and medium-term impacts of the lockdown could increase the vulnerability of the most disadvantaged and risk compounding socio-economic divides. The unemployment rate, which was at historic low before the crisis at 11.2% in the last quarter of 2019 (INSTAT, 2020[12]), is likely to rise. The current crisis may have a disproportionate effect on those who live in poverty and do not have adequate social security. Close to 40% of households are severely materially deprived (Figure 5.1), and 23.4% of the population was at risk of poverty in 2018.

Informality is a major contributor to individual income risk. Informal employment accounts for about 61% of total employment, and the current crisis may highlight informal workers' vulnerability as their incomes decrease. It could widen the economy's inequality gap and push many people into poverty. Moreover, the many informal workers who cannot afford social distancing are more vulnerable to the pandemic (Gerdin and Kolev, 2020[17]).

A drop in remittances may lead to reduced household consumption and generate significant social strains for many people. A significant share of Albanian households depend on remittances, which accounted for 9.6% of GDP in 2019 and were higher than FDI inflows (7.9% of GDP). Potential further decline in remittances due to migrant workers' loss of employment and wages would be the sharpest in recent history (World Bank, 2020[15]). Given that about 1.4 million Albanians live abroad, the impact might be significant (Government of the Republic of Albania, 2017[18]).

Albania's social protection budget is very modest, and targeting is ineffective, limiting its scope to reach those most in need. Albania spent 9.4% of GDP on social protection in 2016, much lower than the European average of 28% (see the People section in Chapter 5). Spending on social assistance in particular needs to be ramped up, as social transfers, excluding pensions, reduced risk-of-poverty rates by fewer than three percentage points in 2018 and will be an insufficient safety net for the most needy during the pandemic (INSTAT, 2019[19]). As much as 32% of the population lacks sufficient social support.

Health and non-material well-being

Albania's population is young, but there are persistent health risks. Close to one-third of adults in Albania smoke daily, and 21.7% are classified as obese, both of which are risk factors associated with higher COVID-19 mortality rates**.** The Albanian healthcare sector suffers from inefficiency and inequity. These vulnerabilities may be further exposed during the COVID-19 crisis. Albania spent 5.2% of GDP on health expenditure in 2018, less than the majority of comparable economies (World Bank, 2020[15]). Although health coverage has improved moderately compared to a decade ago, over 60% of adults aged 15 to 49 (64% of men and 62% of women) reported having no health insurance in 2018 (INSTAT, 2019[20]; INSTAT/Institute of Public Health/ICF, 2018[21]). The government has made COVID-19-related care available to all residents and waived out-of-pocket payments for such treatments (COVID-19 Health System Response Monitor, 2020[22]). The lack of equipment and staff is an issue. With 1.2 doctors per 1 000 inhabitants – a decline of 14% compared to 2000 – Albania has the lowest number of doctors per capita in the region and is well below the OECD and European figures (see the People section in Chapter 5). In the context of COVID-19, the government ordered the reactivation of retired healthcare staff, mobilisation of workers from various medical fields, engagement of medical students and residents, and additional financial incentives for health workers involved in the pandemic response (Order No. 174 and Order No. 175 of the Minister of Health and Social Protection of 15 March 2020). However, no specific measures are being taken to provide psychosocial or other occupational health support for health workers (COVID-19 Health System Response Monitor, 2020[22]).

Other, non-material, aspects of well-being are affected by the crisis. Living conditions at home, where most people are asked to stay during the crisis, are less than ideal for some: 43.3% of households in Albania lack high-speed Internet, making teleworking and home-schooling difficult. Quality of life is also about people's relationships, which can provide a vital lifeline during crises and social distancing. Yet, one-third of Albanians say that they do not have relatives or friends they can count on for help in times of need. Even before the pandemic, life satisfaction was much lower in Albania than in the average OECD economy. The considerable risks of social isolation and loneliness need to be addressed by policy measures for both physical and mental health, for instance regular check-ins by social services, civil society and volunteers, and promotion of digital technologies that connect people with each other and with public services. In this regard, the World Health Organization is supporting the establishment of a platform for psychosocial and mental health support via a network of community mental health providers. There are also initiatives to home-deliver medicines for older patients with chronic conditions (COVID-19 Health System Response Monitor, 2020[22]).

Women are particularly exposed to the collateral effects of COVID-19. As in other regional economies, loss of employment and lockdown conditions in Albania are likely to have led to increased gender-based violence (Bami, 2020[23]; OECD, 2020[24]). Indeed, reports by civil society organisations (CSOs) and observers indicate that vulnerable groups have been particularly affected by the COVID-19 crisis, especially in remote areas. The government adopted a number of measures to mitigate the effects of the pandemic and lockdown and to ensure outreach to vulnerable people and groups at risk. The effectiveness of actions will depend in part on strengthened collaboration among the central government, local government units and civil society (European Commission, 2020[25]). Prevailing gender norms that normalise violence against women were a concern before the crisis: 30% of women considered a husband justified in hitting or beating his wife for trivial reasons, such as burning food, going out without telling him or refusing sex, compared to 8%, on average, in OECD economies. Women are affected in other ways too. They make up the majority of the healthcare workforce, exposing them to greater risk of infection. At the same time, women are shouldering much of the burden at home, given school closures and longstanding gender inequalities in unpaid work (see the People section in Chapter 5).

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5 Multi-dimensional analysis of development in Albania

Achieving rapid, inclusive and sustainable development requires progress across a range of development domains. This chapter identifies major development constraints in Albania. It builds on multi-dimensional analysis across the five pillars of the Sustainable Development Goals: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet. For each pillar, the analysis highlights key areas where Albania could further realise its full development potential.

This chapter of the MDR of the Western Balkans identifies the key capabilities and most pressing constraints in Albania by linking economic, social, environmental and institutional objectives. The assessment is organised around five thematic sections based on the five pillars of the 2030 Agenda: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet. Whenever relevant, Albania is compared with a set of benchmark economies in the region (Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia), the OECD (Costa Rica, Czech Republic, Greece, Slovak Republic, Slovenia and Turkey), non-OECD economies in the European Union (Croatia and Romania) and non-OECD economies in other regions (Kazakhstan, Morocco, Philippines and Uruguay). It includes regional averages for the Western Balkans and OECD and EU members.

People – towards better lives for all

The People pillar of the 2030 Agenda for Sustainable Development places quality of life at the centre stage, focusing on the international community's commitment to guaranteeing the fulfilment of all human beings' potential in terms of equality, dignity and good health. Albania's economic and political transition has brought several improvements for citizens: standards of living have improved, labour markets are transforming and providing more jobs, and various promising reforms in the social protection and healthcare sectors have recently been undertaken.

However, to improve the long-term prospects of citizens, Albania will need to ensure equal participation of all groups and regions in labour market and education, build the capacity of local authorities and improve the quality and efficiency of public services, including the health and social protection systems. There remains room for improvement in gender equality, particularly in the areas of discrimination in the family, safety and preference for male children. The People section in this chapter identifies five major bottlenecks to well-being (Table 5.1).

Table 5.1. People – five major constraints to leaving no one behind in Albania

1. Remote Albanian regions are left behind in terms of employment opportunities and access to services, and local authorities' capacity is low.
2. Lack of skills and weak labour market institutions result in low employment inclusiveness, particularly for women and young people.
3. The healthcare sector places a high cost burden on patients, many of whom have no insurance.
4. Healthcare governance needs more resources in terms of medical staff, dynamic management and infrastructure.
5. Many promising social protection reforms have recently been undertaken, but social assistance benefits are too modest and need to be integrated with care services.

Improving well-being for all, everywhere

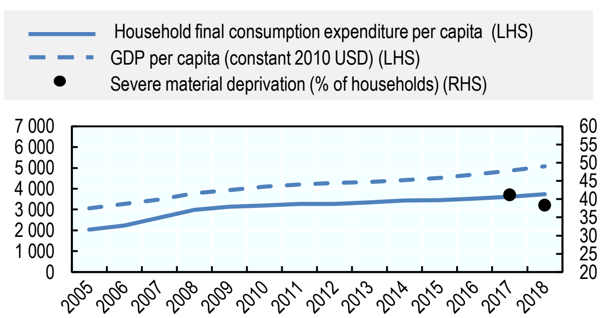
Living standards in Albania have risen modestly in the past decade, but social exclusion and inequality remain issues. After strong growth rates before the 2008 global financial crisis, annual GDP growth dropped from 7.5% in 2008 to 1% in 2013 (World Bank, 2020[1]). Economic growth has started to pick up again, albeit to below pre-crisis rates, while household consumption has risen at a slower pace than GDP per capita. There are no comparable time series on poverty and inequality, but findings from the latest round of the European Union Statistics on Income and Living Conditions survey showed that inequality was above the regional average and that close to 40% of households were severely materially deprived (Figure 5.1). Some 23.4% of the population was at risk of poverty in 2018 (INSTAT, 2019[2]). Poverty particularly affects the unemployed, the low-skilled, people in rural areas, vulnerable women, people with disabilities, and Roma and Egyptian minorities.

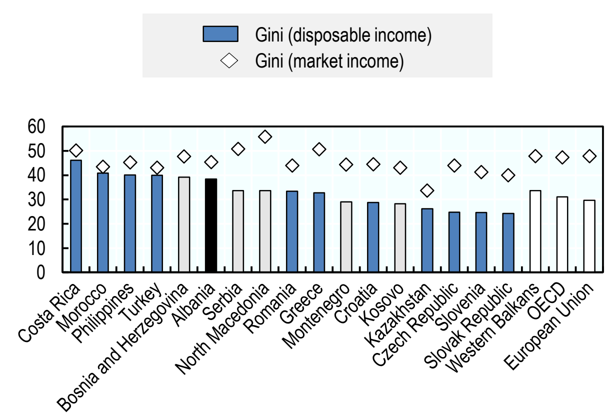
Roma and Egyptians trail behind the rest of the Albanian population in well-being outcomes. They participate marginally in the labour market, have very low health coverage and have poor access to education, public services and infrastructure, such as piped water and electricity, particularly in rural areas

(European Commission, 2019[3]). While Albania has made progress in expanding access to piped water services and sewerage systems in urban areas, only 58.5% and 15% of Albanians in rural areas had access to drinking water and sewerage services, respectively. The former figure drops to 46% for Roma. To address these challenges, the government undertook important initiatives in recent years. The implementation of the 2016-20 national action plan for the integration of Roma and Egyptians is ongoing, and the Ministry of Health and Social Protection is in the process of drafting a follow-up strategy in 2021. The Ministry of Finance and Economy approved a 2018 Law "On social housing" that requires that a quota of 5% of housing be reserved for the most vulnerable members of Roma and Egyptian communities. The Social Housing Strategy 2016-2025 also targets women, victims of violence, orphans and the lesbian, gay, bisexual and transgender (LGBT) community.

Figure 5.1. Household spending has risen, but inequality and material deprivation remain high

Household consumption, GDP per capita and material deprivation (Panel A) and income inequality, 2018 or latest available year (Panel B)





Notes: LHS = left hand side, RHS = right hand side. Severe material deprivation refers to the percentage of households that cannot afford at least four of the following nine items: to pay their rent, mortgage or utility bills; to keep their home adequately warm; to face unexpected expenses; to eat meat or proteins regularly; to go on holiday; a television; a washing machine; a car; a telephone. For income inequality, the latest available year is 2014 for Bosnia and Herzegovina, Montenegro and Morocco, 2015 for the Philippines, 2016 for North Macedonia and Slovak Republic, 2017 for Croatia, Czech Republic, Greece, Kosovo, Romania, Serbia and Slovenia, and 2018 for Albania, Costa Rica, Kazakhstan and Turkey. Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.
Sources: Solt (2019[4]), *The Standardized World Income Inequality Database, Versions 8-9* (dataset), https://doi.org/10.7910/DVN/LM4OWF; INSTAT (2019[2]), *Income and Living Conditions in Albania, 2017-2018*, www.instat.gov.al/media/6544/income-and-living-conditions-in-albania-2017-2018.pdf; World Bank (2020[11]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Regions in Albania (qarku) vary significantly in economic development and well-being outcomes, and gaps continue to widen as people move between regions. GDP per capita in Tirana, which accounts for 52% of all jobs, is more than twice that in Kukës, the poorest province (Table 5.2). There are also large regional inequities in access to social security and health insurance: coverage is up to five times higher in Tirana than in other qarku (INSTAT, 2019[5]). Social services, which are the responsibility of local governments, are either underdeveloped or absent in many parts of Albania due to poor capacities and local authorities' lack of experience. The net pre-primary level enrolment rate has greatly increased since 2000, reaching about 78.9% in 2019, or 80% among male and 76% among female children (INSTAT, 2020[6]; UNESCO, 2020[7]). However, pre-primary enrolment is low in rural areas and among children with disabilities and from minority communities. The quality of teaching staff and the physical condition of preschools remain key challenges (Fuller, 2017[8]; Maghnouj et al., 2020[9]). Unbalanced regional development partly relates to weak implementation of decentralisation policies and to poor overall capacities of municipalities (see the Peace and institutions section in this chapter).

Table 5.2. Regional development varies significantly

Selected indicators, 2018

Region (qarku)	Population (total)	Population (%)	GDP per capita (USD[1])	Net internal migration rate per 1 000 inhabitants	Employment rate	Job distribution (% of total jobs)	Poverty headcount (2012)	Doctors per capita
Tiranë	889 578	31.7	7 065	8.1	48	52	13.9	1.5
Fier	296 446	10.6	5 258	-3.0	58	7	17.1	1.1
Durrës	289 877	10.3	5 069	2.8	48	12	16.5	1.4
Elbasan	276 765	9.9	3 565	-4.6	61	5	11.3	1.1
Korçë	209 034	7.5	3 811	-4.0	63	4	12.4	1.2
Shkodër	203 945	7.3	3 679	-2.3	57	5	15.5	1.1
Vlorë	126 294	4.5	4 294	-7.8	56	5	11.1	2.0
Berat	126 294	4.5	4 265	-7.8	66	3	12.3	1.3
Lezhë	125 998	4.5	3 792	-2.3	42	3	18.4	1.2
Dibër	119 963	4.3	3 830	-13.6	46	2	12.7	0.9
Kukës	76 994	2.7	3 093	-8.8	61	1	22.5	1.3
Gjirokastër	62 188	2.2	5 183	-13.4	63	2	10.6	1.9

Note: 1. At September 2019 exchange rates.
Sources: Honorati et al. (2018[10]), *Job Dynamics in Albania: A Note Profiling Albania's Labour Market*, http://documents.worldbank.org/curated/en/209671528985738916/pdf/Albania-Job-Dynamics-Final.pdf; INSTAT (2019[5]), *Regional Statistics Yearbook, 2019*, www.instat.gov.al/media/6470/rsy_compressed.pdf.

Lesbian, gay, bisexual, transgender and intersex (LGBTI) communities face continued discrimination and harassment. Albanian society remains rather conservative and negative in its attitudes towards LGBTI people. According to a 2015 population survey, 42% of Albanians believed homosexuality is a sickness and would try to help their child find a cure if they found out he or she was not heterosexual. The 2012 European Social Survey asked, "Should gays and lesbians be free to live as they wish?": 23% of Albanian respondents disagreed, and 30% strongly disagreed, demonstrating the greatest antipathy among countries surveyed (no other Western Balkan economy participated) (ERA – LGBTI Equal Rights Association for Western Balkans and Turkey, 2020[11]). Some 65% of LGBTI people in Albania have been personally discriminated against because of their sexual orientation or gender identity (ERA – LGBTI Equal Rights Association for Western Balkans and Turkey, 2020[11]).

Existing legal provisions to protect LGBTI rights can be strengthened. As of 2010, Albania has a Law "On protection from discrimination", which includes protection based on sexual orientation and gender identity. However, it has not yet been fully implemented by state institutions, no data collection on hate crimes exists, and few victims report acts of discrimination out of fear of reprisal or lack of trust in public officials (ERA – LGBTI Equal Rights Association for Western Balkans and Turkey, 2020[11]). In 2015, the parliament passed a resolution recommending the adoption of a national LGBT action plan, diversity training for teachers and greater support for the ombudsman and CSOs. However, the plan has come to an end in 2020 and has not been found to have produced tangible results, partly due to a lack of financial resources (European Commission, 2020[12]).

Strengthening the productive potential and equal participation of all citizens

Albania's overall employment performance has improved in recent years but remains low. Following fluctuations after the 2008 global financial crisis, the employment rate increased from 46.1% in 2015 to 53.6% in 2019 and was above the 2019 Western Balkan average of 43.1% (World Bank/Vienna Institute for International Economic Studies, 2020[13]). Due to increase labour market participation, the unemployment rates in the last quarter of 2019 were at the historical low at 11.2% (INSTAT, 2020[14]), As in all countries, the economic impacts of the COVID-19 crisis in Albania are likely to lead to job losses in the medium term.

Many women and youth are excluded from the labour market and wider society

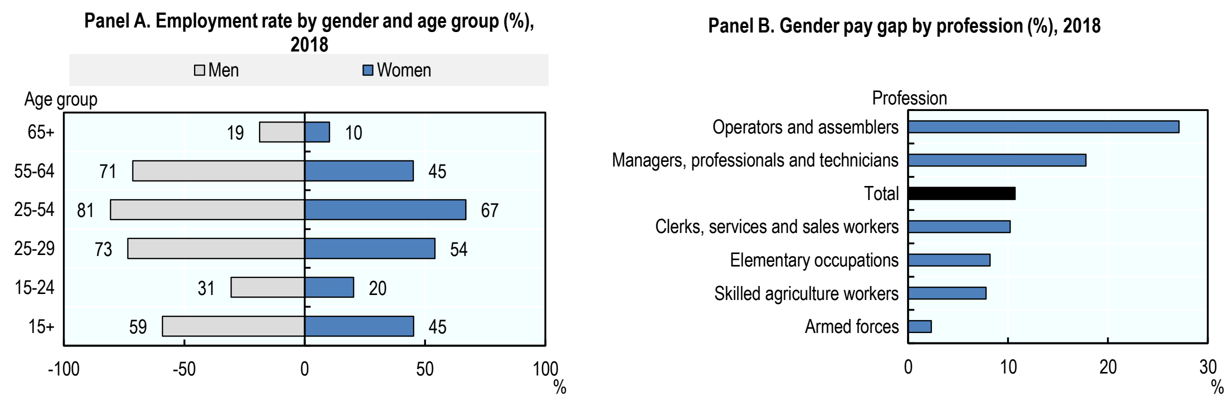
Despite positive recent trends, the Albanian labour market continues to face structural challenges that slow down productivity and growth and are a source of social concern. A substantial proportion of young people find themselves outside education and the labour market, and women's labour market participation is unequal. Albania recently adopted the National Strategy for Employment and Skills 2019-2022, which provides a good strategic basis for increasing the inclusion of women and youth.

Although women's employment outcomes do not lag significantly behind international benchmarks, Albania is far from achieving gender equality, and social norms and limited access to child care continue to keep women at home. The inclusion of women in the labour market has grown steadily over the last five years. In 2019, about 46.9% of the female population over age 15 was in employment, only slightly below the OECD average of 49.9%. However, women in Albania are over-represented in informal employment (66.5% of women vs. 60.1% of men) (ILO/Bureau for Employers' Activities, 2017[15]). Gender gaps in formal employment are particularly high for women in their childbearing years: in 2018, the employment rate for women aged 25 to 29 was 54.1%, accounting for a gender gap of about 19.3 percentage points with men (Figure 5.2), compared to 68% and 14.5 percentage points in OECD countries (World Bank/Vienna Institute for International Economic Studies, 2020[13]).

Family responsibilities, discouragement and lack of access to child care are key reasons for women's lack of participation in the formal labour market (Honorati et al., 2018[10]). Albanian women spend more than six times more time on unpaid household chores than men, compared to around two times more in comparable regional economies, such as Serbia, and the OECD average (OECD, 2019[16]). A 2017 revision to the Law "On social security" recognised fathers' right to paternity leave, after the 63-day mandatory period for mothers (paid parental leave for formal-sector employees can be up to one year, compared to just over 18 weeks for the OECD average) (Ministry of Health and Social Protection/INSTAT, 2020[17]; OECD, 2019[18]) However, according to the recently published Gender Equality Index for the Republic of Albania, half of women but only one-quarter of men report caring for their children or elderly relatives, and close to 90% of women but only 16% of men cook daily (INSTAT, 2020[19]). Not surprisingly, after attending school, unpaid work responsibilities rank as the second-highest reason for women's lack of participation in the labour market (21%) (INSTAT, 2019[20]). Employment gender gaps are also significant for women aged 55 to 64, with many choosing to accept early retirement. As a consequence, this choice lowers the amount of pension benefits and results in an increased pension gender gap (as of 2014, pension reform linked contributions and payments by removing caps on maximum benefits). The gender pay gap (10.7% in 2018) is below the OECD average (12.9%) but has widened by 4.4 percentage points since 2016 and varies across professional sectors: it is much larger for well-paid occupations, such as management (Figure 5.2).

Figure 5.2. Age and occupational choice shape women's employment experience

Employment rate by gender and age group (%), 2018 (Panel A), and gender pay gap by profession (%), 2018 (Panel B)



Sources: INSTAT (2019[20]), *Burrat Dhe Gratë Në Shqipëri: Women and Men in Albania*, www.instat.gov.al/media/6413/burra-dhe-gra_2019.pdf; World Bank (2020[1]), *World Development Indicators – Employment to population ratio, 15+, total (%) (modeled ILO estimate)* (dataset), https://databank.worldbank.org/reports.aspx?source=2&series=SL.EMP.TOTL.SP.ZS&country=; World Bank/Vienna Institute for International Economic Studies (2020[13]) *SEE Jobs Gateway Database* (database), https://data.wiiw.ac.at/seejobsgateway.html.

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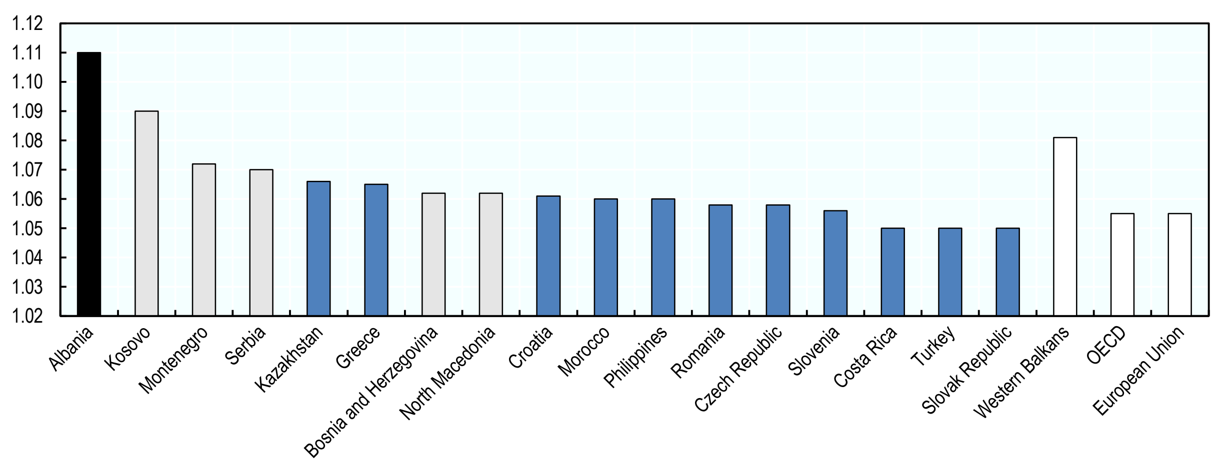
Female representation in politics and private-sector management is far from parity but is on par with the OECD for politics and above the OECD for management. Aided by a 2008 gender quota, one in three parliamentary seats is currently occupied by a female member, and women make up one-third of senior and middle managers, compared to the OECD average of 16% (IPU, 2020[21]; OECD, 2020[22]; World Bank, 2020[1]).

According to the OECD Social Institutions and Gender Index, discrimination against women overall in Albania is "low", but there is room for improvement in the areas of discrimination in the family and safety (OECD, 2019[16]). Some 7% of girls aged 15 to 19 are or have been formally or informally married, many of them Roma and living in rural areas (OECD, 2019[16]). Although the majority of these marriages occurs at age 18 and 19, the share is still higher than in any other Western Balkan economy and almost four times the rate of child marriage of the average OECD country (INSTAT, 2020[6]). Estimates vary by survey, but gender norms that normalise violence against women seem prevalent: according to the OECD Social Institutions and Gender Index, 30% of Albanian women considered a husband justified in hitting or beating his wife for trivial reasons, such as burning food, going out without telling him or refusing sex, compared to 8%, on average, in OECD countries (OECD, 2019[16]). According to the latest Institute of Statistics survey on violence against women, one in two women reported that all or most people in the community believed that violence between a husband and wife was a private matter and that others should not intervene, and 46.5% maintained that all or most people in the community believed a woman should tolerate some violence to keep her family together (INSTAT, 2019[23]). These social norms can contribute to the prevalence of intimate partner domestic violence against women and keep battered women trapped in abusive and violent relationships. Indeed, the same survey found that 8.6% of women aged 18 to 74 currently experience at least one type of sexual harassment, and 38% had been exposed to harassment or sexual assault during their lifetime. In 2019, the European Commission recommended revising the definition of rape; ensuring protection, rehabilitation and reintegration measures for victims of all forms of sexual violence; and ensuring full implementation of Law No. 47/2018 "On Measures against Violence in Family Relations" through the development of by-laws, allocation of sufficient resources and training of relevant staff to ensure adequate support for victims (European Commission, 2020[12]).

Gender-biased sex-selective abortions continue to take place in Albania. Preference for male heirs, rapidly declining fertility rates and sex-selective abortions have skewed the birth sex ratio: 111 boys born for every 100 girls – one of the highest figures in the region (Figure 5.3).[1] Recommended policy actions include monitoring of sex-selective abortions, targeted awareness-raising campaigns (some already undertaken by government) and co-ordination with healthcare providers to prevent abuse of reproductive technologies. Some improvements have been made in the availability and accessibility of contraception, for example by introducing family-planning services as part of general health services and by offering free modern contraceptives (European Commission, 2020[12]).

Figure 5.3. The strong preference for male children in Albania has led to the highest birth sex ratio of all benchmark economies

Male births per female births, 2018 or latest available year



Note: Data for Kosovo are for 2014.
Sources: INSTAT (2020[14]), *Statistics by theme* (database), www.instat.gov.al/en; UNFPA Kosovo (2016[24]), https://eeca.unfpa.org/sites/default/files/pub-pdf/Gender-bias-in-Kosovo-2.pdf; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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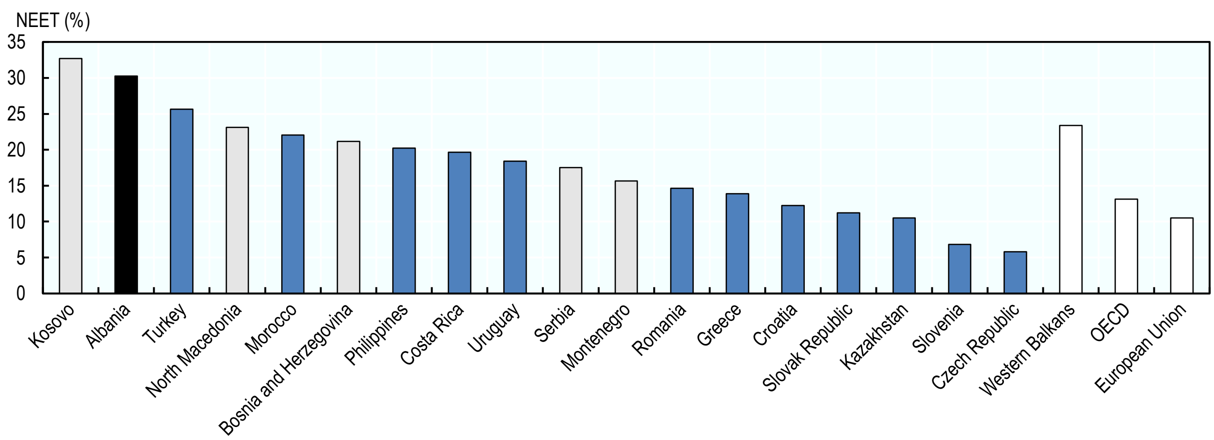
Albania has a significant share of young people who are not in employment, education or training (NEET), putting them at risk of losing skills, self-confidence and motivation (Figure 5.4). The high share of NEET is a source of concern: at 30.3%, the 2019 share of NEET in Albania was more than double the OECD average and almost triple the EU average. While the overall youth unemployment rate in Albania dropped in 2020 and is among the lowest in the Western Balkans,[2] in 2018, the overall unemployment rate among younger members of the labour force was about 28.3% – more than double the OECD average of 12%. Long-term unemployment is another challenge. The share of those who have been without employment for one year or more was about 64.4% in 2019, also significantly higher than the OECD average (25.8%). This affects particularly the young: about 41% of people aged 15 to 24 are long-term unemployed, compared to an OECD average of 14.4% (OECD, 2020[25]; World Bank/Vienna Institute for International Economic Studies, 2020[13]). The young often work without adequate contracts, and an estimated 52.6% of those aged 15 to 24 worked informally in 2019 (World Bank/Vienna Institute for International Economic Studies, 2020[13]). Strengthening pre-university career orientation and providing additional support to young graduates to become entrepreneurs could favour better matching between graduate skills and labour market needs and improve employment prospects. One pillar of the recently approved National Employment and Skills Strategy 2019-2022 seeks to improve the quality vocational education and training (VET) and to provide more training to youth.

Figure 5.4. Young workers need to be better integrated into the labour market

NEET youth (aged 15 to 24), 2019



Source: ILO (2020[26]), *ILOStat* (database), https://ilostat.ilo.org/data/.

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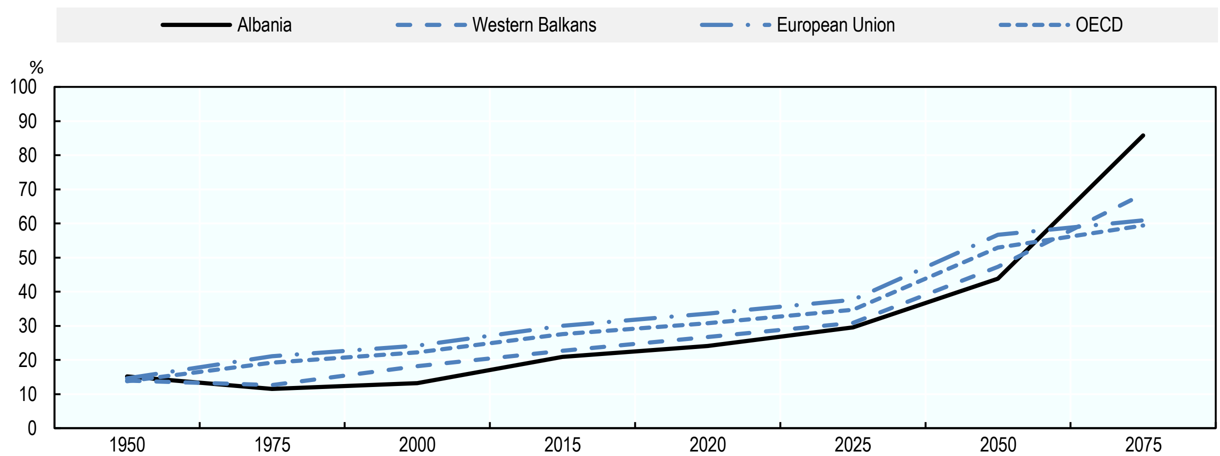
Persistent long-term demographic pressures (Figure 5.5**), poor inclusion of young people and the migration of many (especially young) Albanians in search of better employment opportunities abroad lead to loss and underutilisation of human capital and drag down productivity growth**. Albania is an important origin country of migration, especially to Italy and, to a lesser degree, Greece. There have been a significant number of asylum requests by Albanians, notably in Germany in 2015-16, but they have largely decreased since. More recently, labour migration has increased, in part through a specific scheme that facilitated labour migration to Germany (World Bank, 2017[27]). More than 40% of Albania's population lived abroad in 2017. Albania's role as a transit country has been more limited than the other Western Balkan economies (United Nations, 2019[28]).

Figure 5.5. Albania faces demographic pressures in the future

Old-age dependency ratio projections (ratio of population age 65+ per 100 people aged 20 to 64, %)



Source: United Nations (2020[29]), "World Population Prospects 2019", https://population.un.org/wpp/.

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Labour market institutions do not address job quality and demand-supply imbalances

Albania's labour supply challenges include the widespread incidence of vulnerable and informal employment. The labour market is characterised by significant informality – total informal employment was estimated at about 61% in 2018 (ILO, 2018[30]) – accounting for the large share of unregistered workers, unpaid family workers in the agricultural sector and under-reporting of sales and wages by formal enterprises (Vidovic et al., 2020[31]). Enterprises operating entirely in the grey economy appears to be a significant problem. Data on the extent of informal firm ownership are lacking, but in the latest Business Environment and Enterprise Performance Survey (BEEPS), 45% of surveyed firms listed unfair competition from the informal sector as a major obstacle to business (World Bank/EBRD/EIB, 2019[32]). The government recognises the importance of addressing informal employment and identified it as a priority in the latest ERP (Republic of Albania Council of Ministers, 2019[33]).

Lack of quality formal employment is manifest in poor working conditions in some sectors. *Work accidents are among the top five causes of unnatural deaths in Albania* (ILO, 2019[34])*: in 2015, Albania recorded 2.6 fatal accidents per 100 000 employees, relatively high in comparison to some benchmark economies, including Croatia (1.8), Slovak Republic (1.7) and Greece (1.3).*[3] *Work safety measures need more robust checks and penalties.*

Weak and inadequately enforced labour regulation may increase the likelihood of informality and prevents the creation of quality jobs. The labour inspectorate's capacities are insufficient to monitor adherence to rules: the 154 labour inspectors cover about 7% of active businesses.[4] Regulation is not always well designed. Albania also has a highly regressive tax wedge (ratio between the amount of taxes paid by an average worker and the corresponding total labour cost for the employer), which is particularly high for the lowest-income workers and therefore discourages their formal employment. Part-time employment provisions are lacking: even when salaries are below the minimum wage, employee's social security contributions are still based on this threshold and not on the number of hours worked.[5] In 2017, about 29.6% of the employed population was paid less than minimum wage, which is significant (Jorgoni, 2018[35]).

Activation policies are currently too limited and underfunded to connect jobseekers with quality work or to boost their skills. In 2018, Albania spent only 0.03% of GDP on active labour market policies, compared to the Western Balkan average (0.12%)[6] and Slovenia and Croatia (0.61% and 0.71%, respectively) (European Commission, 2020[36]). The share of unemployed registered with the National Agency for Employment and Skills (NAES) is only about 43% of all unemployed,[7] indicating significant scope to increase coverage. The design of employment promotion programmes, the majority of which are purely wage subsidies, offers limited opportunities for upskilling and sustainable integration into the formal labour market (OECD, 2018[37]). In 2018, 16.6% of jobseekers participated in professional training programmes vs. more than double in OECD countries in 2015 (INSTAT, 2019[20]). Recent restructuring of the NAES, with increased emphasis on skills and collaboration modalities with non-governmental organisations (NGOs) to reach out to vulnerable groups, is encouraging.[8]

Boosting education quality to increase well-being and quality employment

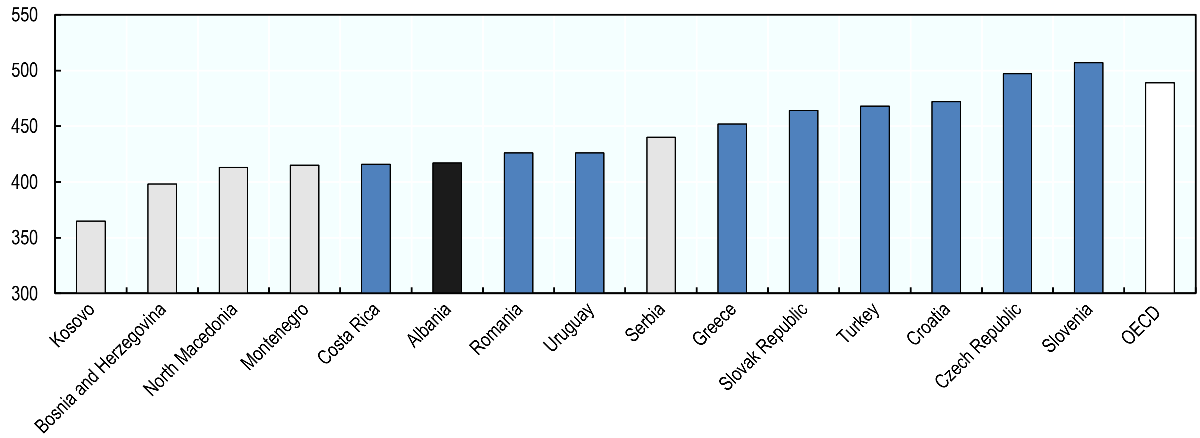
Investment in education in Albania is comparatively low and does not translate into the education outcomes needed to equip people with relevant skills and optimism. In 2018, the government spent 3.2% of GDP on education in 2019 (INSTAT, 2020[14]; Eurostat, 2019[38]), below the OECD average of 4.5% (OECD, 2019[39]). Albania has made good progress in overall education, as reflected by the OECD Programme for International Student Assessment (PISA), yet its progress is well below average (Figure 5.6). Albania struggles with disparities in education opportunities and outcomes by ethnic background and geographical region. Girls outperform boys in most PISA subjects: by 38 points in reading (compared to 30 points, on average, across OECD countries), by 16 points in science (compared to 2 points across the OECD), and similar in mathematics (compared to boys outperforming girls by 5 points across the OECD) (OECD, 2020[40]). Some 66.4% of higher education graduates in 2018/19 were female (INSTAT, 2020[6]). Improving the population's skills to meet labour market needs is a key structural obstacle identified in Albania's 2020-22 ERP (European Commission, 2020[41]).

School closures due to the COVID-19 pandemic and students' lack of adequate information and communications technology (ICT) equipment and connectivity may have a negative impact on education outcomes. Approximately 27% of 15-year-old students in Albania did not have a computer at home. The number without an Internet connection at home is high (14% of 15-year-old students) (OECD, 2020[40]).

Weak job creation is to some degree related to supply-side constraints, in particular weaknesses in education quality and outcomes and the lack of sufficient alignment of education with labour market needs. Companies cannot generate jobs because they cannot find the skilled workforces needed to fill them. In the latest BEEPS, 25% of surveyed firms identified an inadequately educated workforce as a major (the third largest) obstacle to business (World Bank/EBRD/EIB, 2019[32]).

Figure 5.6. Albania's education outcomes leave room for improvement

Mean science score, 2018



Source: OECD (2020[40]), *PISA* (database), www.oecd.org/pisa/data/.

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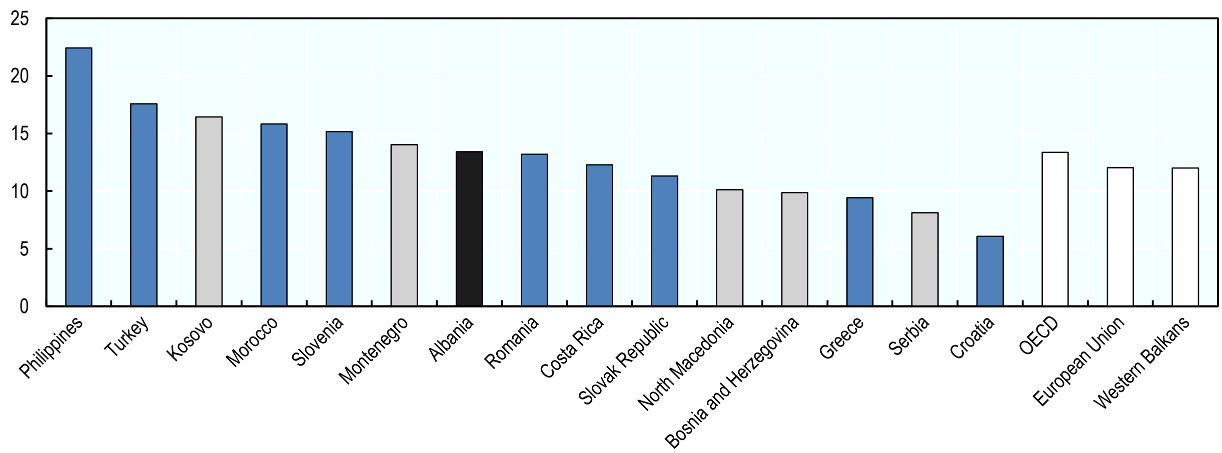
Improving learning outcomes will require further support for teachers. Although the pupil/teacher ratio in primary, secondary and upper secondary education in Albanian is rather favourable (Figure 5.7), the teaching quality remains inadequate. Improving teacher quality is especially important given the recently adopted competence-based curriculum, which emphasises knowledge, skills and attitudes rather than traditionally defined subject content, the requirements to implement it and the increased availability of ICT equipment in classrooms. While the Pre-University Education Strategy 2014-2020 emphasises the need to support teacher professional development, financial support to pre-university education is far behind the strategy's targets and pre- and in-service trainings for teachers are insufficient.[9] University programmes are not yet in line with the Higher Education Law (2018) and the requirements related to the new curriculum (Wort, Pupovci and Ikonomi, 2019[42]). The lack of a progressive career structure for teachers that rewards and promotes individuals based on increasing responsibilities and demonstrated teaching competences (for example through teacher appraisal) also affects teacher quality (Maghnouj et al., 2020[9]).

Figure 5.7. Favourable pupil/teacher ratios are not reflected in education outcomes

Pupil/teacher ratio at the upper secondary level, 2018 or latest available year



Sources: Kosovo Agency of Statistics (2020[43]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Local authorities' and on schools' abilities for effective management and quality control need more support. While the Law "On local self-government" stipulates transfer of full responsibility for the preschool education system to municipalities and management of financial resources to schools, both significantly lack capacities. In particular, the four Regional Education Directorates (REDs) – local authorities co-ordinated by the Ministry of Education – lack staff to undertake effective monitoring, inspection and evaluation of quality. Each RED has only four staff dedicated to this work, and they are responsible for a total of 3 759 schools at the primary and secondary levels. Moreover, the REDs do not have the capacity to evaluate and support schools (Maghnouj et al., 2020[9]; Wort, Pupovci and Ikonomi, 2019[42]).

Improving health and social protection coverage

Health outcomes are comparatively good, but the healthcare sector places a high cost burden on patients and suffers from lack of access and resources

While the health outcomes of the Albanian population are strong by regional standards, changing lifestyle patterns and a mortality profile similar to wealthier countries pose risks for the future. Despite the health system's shortcomings in quality and access, life expectancy at birth is the highest in the Western Balkans at 78.6 years, almost on par with the United States (75.5 years) and outperforming OECD members, such as Slovenia and Turkey (OECD, 2020[44]; World Bank, 2020[1]).

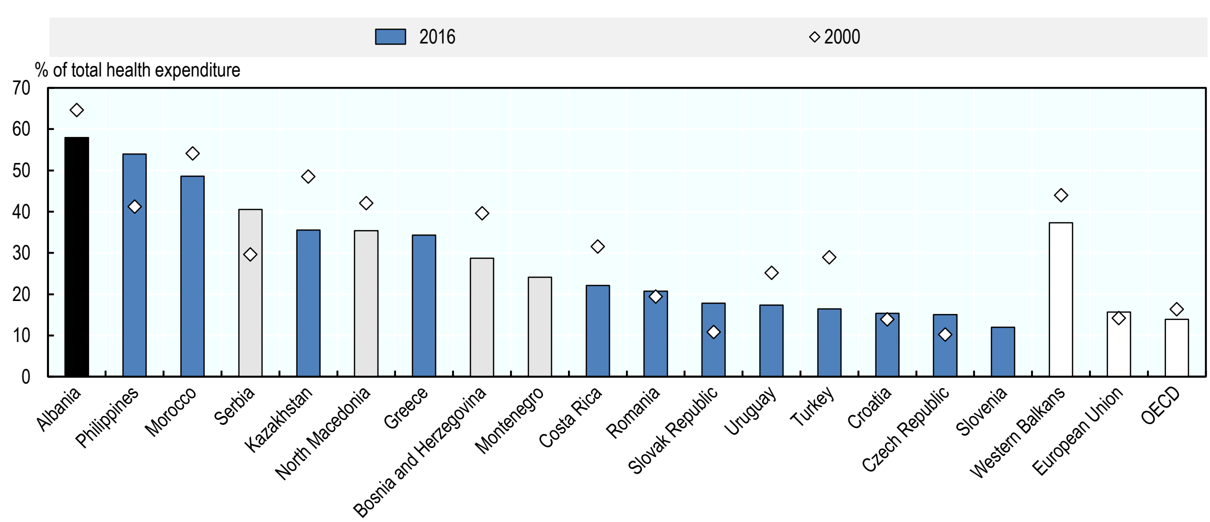
The longevity of Albanians has been credited in part to the economy's Mediterranean diet, but as in most countries, eating habits are changing. Currently, 18% of men and 24% of women aged 15 to 49 are obese, compared to 19% of adults in the average OECD country (INSTAT, 2019[20]; OECD, 2020[22]; World Bank, 2015[45]). Only 6.8% of women and 2.6% of men consume the daily recommended number of vegetables (three or more). In 2018, 36.1% of women and 14% of men consumed the recommended number of fruits (three or more), and only one in ten adults engaged in frequent physical activity (INSTAT, 2020[6]; INSTAT/Institute of Public Health/ICF, 2018[46]). Although male smoking rates declined by eight percentage points compared to a decade ago, more than one in three still smoke daily, which apart from its known impacts on cardiovascular disease and lung cancer, has been associated with more severe COVID-19 cases (Vardavas and Nikitara, 2020[47]).

Child malnutrition remains a challenge. While relevant indicators have improved since 2008, alongside maternal and child mortality rates, almost one in ten children aged 6 to 59 months are stunted, and 16% are overweight (INSTAT/Institute of Public Health/ICF, 2018[46]). The role of local authorities and primary health care (PHC) providers in intersectoral community health interventions, including awareness raising, should be strengthened to tackle these priority risk factors.

The Albanian healthcare sector suffers from inefficiency and inequity and places large financial burdens on patients. The country spent 5.2% of GDP on health expenditure in 2018, less than the majority of comparable countries (World Bank, 2020[1]). The limited public spending on health care until recent years resulted in an extreme reliance on out-of-pocket (OOP) spending for both inpatient and outpatient care. OOP accounts for close to 60% of total health expenditure and is particularly problematic for low-income households (Figure 5.8). Indeed, for the lowest income quintile, OOP spending on inpatient services can represent up to 60% of total monthly household expenditure (Tomini et al., 2015[48]). Patients often bypass lower-cost (and lower-quality) primary care services to seek care in hospitals or the private sector, where they tend to overpay, particularly for medicines. There is scope to improve pharmaceutical regulation to reduce costs. Additional informal payments for healthcare services, especially in public hospitals and including among patients with health insurance cards, remain common; a recent consumer survey placed Albania top among European countries in this regard (Health Consumer Powerhouse, 2018[49]).

Figure 5.8. Albanian patients pay a significant amount for health services

OOP health expenditure (% of total health expenditure)



Note: The Western Balkan average excludes Kosovo, for which no data are available.
Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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The government should continue to assess options to expand insurance coverage within the available fiscal space. Universal health insurance is mandated by law in a model reliant on both mandatory and voluntary contributions, but the contribution base is low due to the large informal sector and relies for almost 30% on subsidies from the state budget. Broadening the tax base will be key to expanding revenue streams, including for social protection and health care (see the Partnerships and financing section in this chapter). Nevertheless, one-third of contributing firms, which are required to pay 16.7% of employee salaries in social security contributions, believe that payroll taxes and social security contributions are a major constraint to doing business (World Bank, 2018[50]). Although coverage has improved moderately compared to a decade ago, over 60% of adults aged 15 to 49 reported having no health insurance in 2018. Beyond regional inequities, there is large socio-economic variation in access: fewer than 20% of those in the lowest wealth quintile have either state health insurance or social security, compared to 81% of women and 62% of men with at least postgraduate education (INSTAT, 2019[20]).

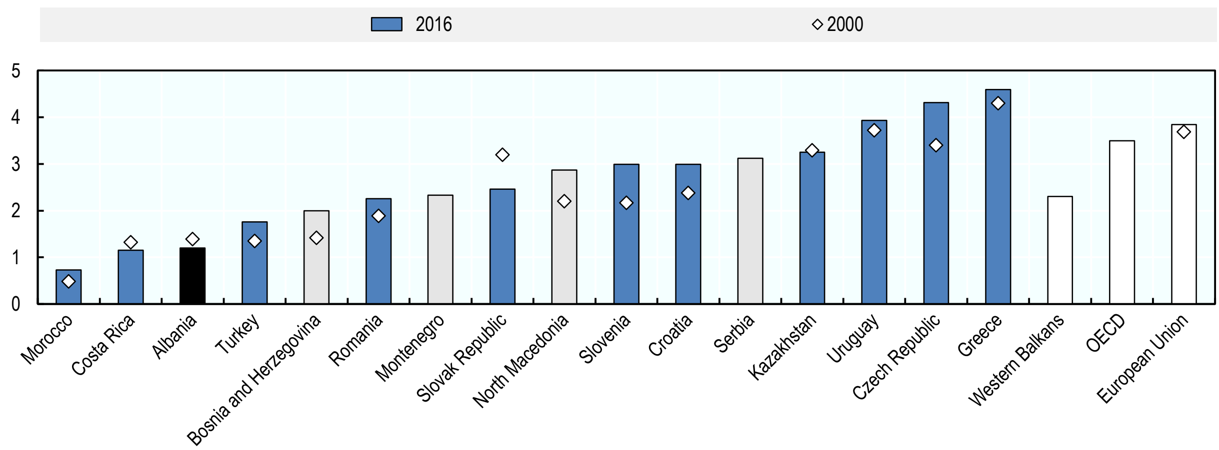
The Ministry of Health and Social Protection has taken important recent steps towards *de facto* universal coverage, but there is scope to reduce inefficiencies, improve quality of care and strengthen management accountability. To reverse over-reliance on hospitals, a national preventive check-up programme and free access to preventive services for the entire population, including uninsured people, were introduced in 2015 and 2017. While these have led to increased use of PHC, a recent review points to long waiting times, the lack of a systematic approach to managing patients with newly detected non-communicable diseases, inefficient co-ordination between PHC and secondary health care, and outdated laboratory and diagnostic equipment (WHO, 2018[51]).

Albania should prioritise personnel PHC management training, selected infrastructure upgrades (including equipment and transport) according to regional needs and an integrated electronic information system that allows for patient follow-up and can stratify by population risk factors. Current policy developments that aim to increase public hospital autonomy to incentivise budget allocation based on performance and cases served rather than static budgets and political appointments of hospital executives should be extended to PHC and could help attract dynamic management (Health Care Insurance Fund of Albania, 2016[52]; WHO, 2018[51]).

Especially in the face of COVID-19-related strains on health systems, the lack of medical staff is problematic. With 1.2 doctors per 1 000 inhabitants – a decline of 14% compared to 2000 – Albania has the lowest number of doctors per capita in the region and is well below OECD and European figures (Figure 5.9). Remote hospitals in particular, which already lack specialists, have seen hundreds of physicians and nurses migrate to work in EU countries, mainly Germany, in the last years (Terziu, 2018[53]). Initiatives recently introduced by the Ministry of Health and Social Protection, such as a patronage programme that gives bonuses to Tiranian doctors practicing in districts and the promotion of specialists to regional and municipal hospitals, are promising but unlikely to suffice in the long term (Curri, 2018[54]). In the context of COVID-19, the government ordered the reactivation of retired healthcare staff, mobilisation of workers from various medical fields, engagement of medical students and residents, and additional financial incentives for the health workers involved in the pandemic response (Order No. 174 and Order No. 175 of the Minister of Health and Social Protection of 15 March 2020). However, no specific measures are being taken to provide psychosocial or other occupational health support for health workers (COVID-19 Health System Response Monitor, 2020[55]). The expansion of telemedicine to increase access to specialist care in remote regions should be considered both during and after COVID-19. A pilot from the International Virtual e-Hospital Foundation NGO has shown promising results in reducing transfers to tertiary centres (Latifi et al., 2020[56]).

Figure 5.9. Albania has comparatively few doctors per capita

Practising physicians (per 1 000 inhabitants), 2016 and 2000



Notes: The Western Balkan average excludes Kosovo, for which no data are available. The European Union average refers to the Eurozone area. Latest available data are for 2017 for Morocco, 2015 for Montenegro and North Macedonia and 2014 for Turkey.
Sources: OECD (2020[44]), *Health Statistics* (database), www.oecd.org/health/health-statistics.htm; WHO (2020[57]), *Global Health Observatory* (database), www.who.int/gho/database/en/.

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Social protection benefits are too modest and need to be integrated with care services

Although Albania's overall social protection spending has more than doubled since 2005, it remains low. According to the European system of integrated social protection statistics, Albania spent 9.4% of GDP on social protection in 2016, which was much lower than the European average of 28% (ESPN, 2019[58]). The social protection system is dominated by both social insurance schemes (pensions, unemployment benefits) and non-contributory cash programmes (proxy means tested social assistance/economic aid, disability transfers) and has undergone various restructuring efforts in recent years. A 2014 pension reform gradually reduced the distributional character of the scheme and created incentives to participate by removing caps on maximum benefits, linking contributions and payments. Although the scheme ran at a deficit of 1.8% of GDP in 2017, the ratio of contributors to beneficiaries increased from 0.98 in 2013 to 1.21 in 2017 and, combined with an increase in the retirement age for both genders to 67 years, led to an overall improvement of the pension system's fiscal sustainability.

Very recent reforms to Albania's non-contributory schemes to improve targeting, efficiency and transparency, such as a National Register of Citizens and efforts to consider broader social and psychological factors associated with disability, still need to be assessed. However, it is clear that spending on social assistance, which has decreased over time and only made up 0.025% of GDP in 2018, needs to be ramped up. Social transfers, excluding pensions, achieved less than a three percentage point reduction in risk-of-poverty rates in 2018 (INSTAT, 2019[2]). The very low amount of benefits should be revised in line with minimum living standards, possibly by redirecting the savings produced by declining pension deficits in the medium term (ESPN, 2019[58]). The government's sensible longer-term plans to replace purely economic aid with reintegration into labour market systems should be fast-tracked and is indeed included in the recent National Strategy for Social Protection 2020-2023.

Improving the outreach and coverage of social care services, such as childcare facilities, orphanages and nursing homes, is a key missing link in the system. Doing so will help boost both labour market participation and poverty alleviation. Efforts to improve social service delivery must be accompanied by significant capacity building among local governments, which are responsible for social care provision (European Commission, 2018[59]). The recent Law No. 121/2016 "On social care services" aims to set up a dedicated fund. The National Action Plan on Ageing 2020-2024 includes the aim of providing the elderly with access to quality social and health services. A two-year joint programme with the United Nations to improve municipal social protection service delivery went into effect in January 2020, but it is too early to assess implementation (Ministry of Finance and Economy, 2018[60]). Albania's 2020-22 ERP highlights the need to improve targeting efficiency and to increase cash support and social care to people with disabilities. The European Commission assessment notes that this will be difficult given the scarcity of social care services (European Commission, 2020[41]).

Prosperity – boosting productivity

The Prosperity pillar of the 2030 Agenda for Sustainable Development calls for broad-based economic growth shared by all people. Albania has made significant progress since 1991. As the fastest-growing European economy prior to the global financial crisis, Albania developed and significantly strengthened its political and economic institutions, attracted considerable external capital, fostered investment and growth, and lifted many people out of poverty. However, the momentum for reforms and growth weakened in the post-crisis period, while the crisis unmasked considerable structural problems, such as weak labour markets, lack of skills, weak governance and inefficient public administration, that constrain Albania's long-term economic potential.

To leverage its strengths and to improve its long-term economic potential, Albania, as a small economy, should seek deeper integration into the global economy. This will require upgrading domestic productive capacities, creating a flexible and skilled labour force, removing institutional and administrative barriers to domestic and foreign investment, and addressing infrastructure gaps (Table 5.3).

Table 5.3. Prosperity – five major constraints to a more dynamic economy of Albania

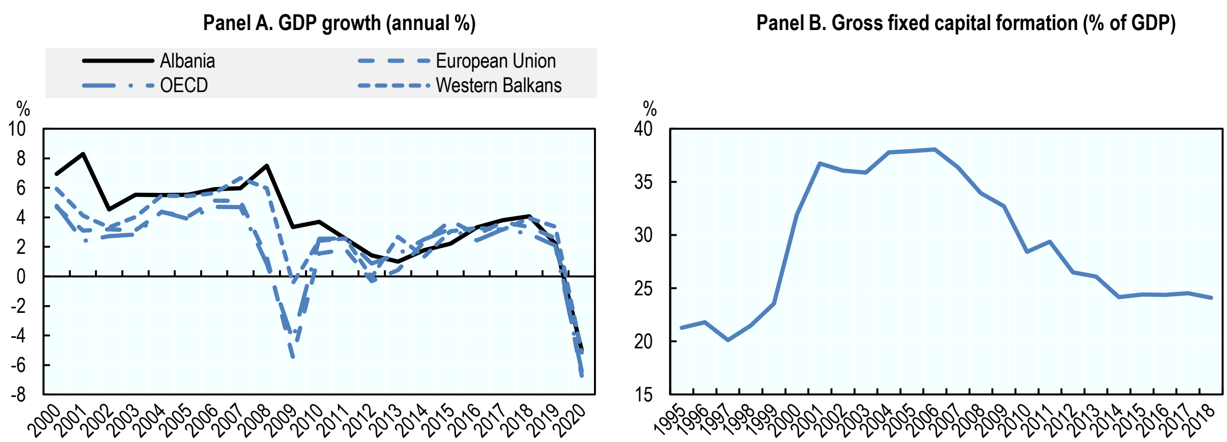
1. Albania needs new growth drivers to accelerate the structural transformation of the economy and to boost productivity.
2. The tradable sector needs more investment, diversification and upgrading.
3. Lack of skills affects growth and productivity.
4. Institutional and administrative barriers limit domestic and foreign investment.
5. The large infrastructure gap deters investment, especially large manufacturing FDI.

Albania's growth model requires new drivers to accelerate structural transformation and boost productivity

The growth of Albania's economy slowed down considerably following the global economic crisis. In the pre-crisis period, strong GDP growth was driven largely by domestic consumption fuelled by strong remittance inflows, high credit growth and lax fiscal policy. As external financing inflows declined, GDP growth fell from a peak of 7.5% in 2008 to 1% in 2013. Despite subsequent recovery, it has not reached pre-crisis levels since (Figure 5.10 – Panel A). Investment also decreased substantially (Figure 5.10 – Panel B). The COVID-19 pandemic will likely have a further negative economic and social impact on Albania, as the economy contracted (IMF, 2020[61]).

Figure 5.10. Albania requires new growth drivers

GDP growth (%) (Panel A) and gross fixed capital formation (% of GDP) (Panel B)



Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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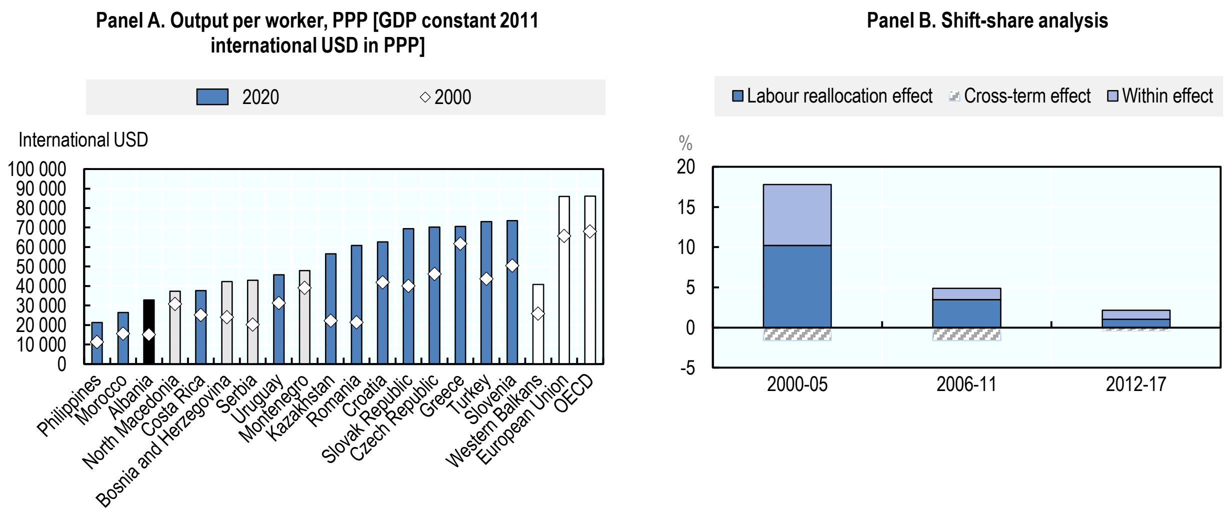
Productivity growth, a key determinant of long-run growth potential, has slowed down. While productivity tripled between 2000 and 2020 (Figure 5.11 – Panel A), most growth occurred during the first decade of the millennium. New productive activities emerged, and workers moved from less productive to more productive sectors. Productivity gains have slowed down considerably since the mid-2000s, affecting both productivity gains within sectors and gains from the movement of labour to more productive sectors. A shift-share analysis reveals a slightly negative cross-term effect, indicating that within-industry and shift effects have been acting as substitutes; that is, productivity growth has been positive in contracting sectors and negative in expanding sectors (Figure 5.11 – Panel B).

Figure 5.11. Productivity has tripled since 2000, but this growth has weakened during the last ten years, as few workers have moved to sectors with higher productivity

Output per worker, PPP [constant 2011 international USD] (Panel A) and shift-share analysis of labour productivity growth (% change in annual growth) (Panel B)



Note: The labour reallocation effect measures the impact on total economy productivity resulting from the movement of labour between sectors. The cross-term effect measures the change in both labour share and productivity in each sector and accounts for the impact of labour reallocation between sectors with varying productivity growth rates. The within effect measures the impact of productivity growth within each sector on total economy productivity growth.

Sources: ILO (2020[26]), ILOStat (database), https://ilostat.ilo.org/data/; UNdata (2020[62]), *UNdata – Value added by industries at constant prices (ISIC Rev. 4)* (dataset), http://data.un.org/Data.aspx?q=Value+added+by+industries&d=SNA&f=group_code%3a205; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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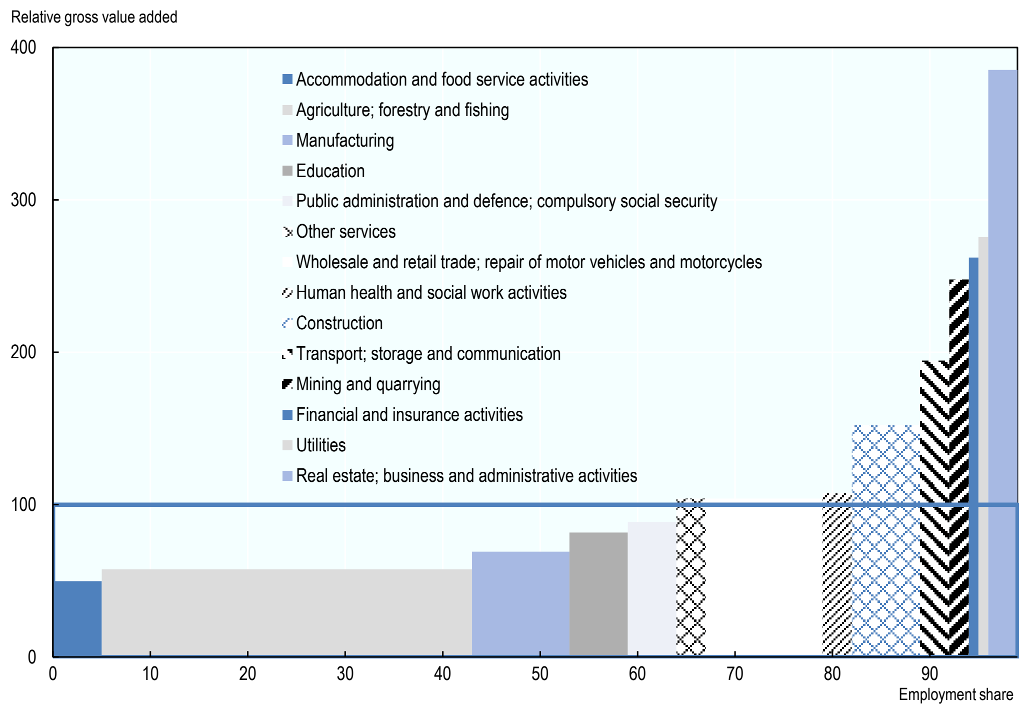
The variation in productivity across sectors remains significant, with most employment found in lower-productivity sectors. The comparative perspective shows the relatively low level of both employment and productivity in manufacturing and the persisting importance of agriculture for employment. New engines of productivity growth will be needed to lift productivity in sectors of broad employment. Sectors currently showing high productivity, such as real estate, finance and mining, have very limited potential for expanding employment (Figure 5.12).

Agriculture needs special attention. The sector is characterised by subsistence farming and is plagued by inefficiencies caused by small land plots and weak consolidation due to inadequately defined property rights (see the Peace and institutions section in this chapter). Consolidation and defragmentation of agricultural land is identified as a reform priority in the latest ERP. Reforms currently under way include improvements in the legal framework and implementation of consolidation projects with a special focus on areas with developed and intensive agriculture (Republic of Albania Council of Ministers, 2019[33]).

Figure 5.12. Lower productivity sectors, particularly agriculture, account for much employment

2019 relative gross value added and employment share by economic sector



Notes: Y-axis: 100 = average national gross value added by sector. X-axis: % of total employment. Weighted average productivity (y-axis) is normalised to 100; a sector with a relative gross value added greater than 100 is more productive than the average. Labour productivity is measured as the annual value added (the value of output less the value of intermediate consumption) per employee.
Sources: ILO (2020[26]), *ILOStat* (database), https://ilostat.ilo.org/data/; UNdata (2020[62]), *UNdata – Value added by industries at constant prices (ISIC Rev. 4)* (dataset), http://data.un.org/Data.aspx?q=Value+added+by+industries&d=SNA&f=group_code%3a205; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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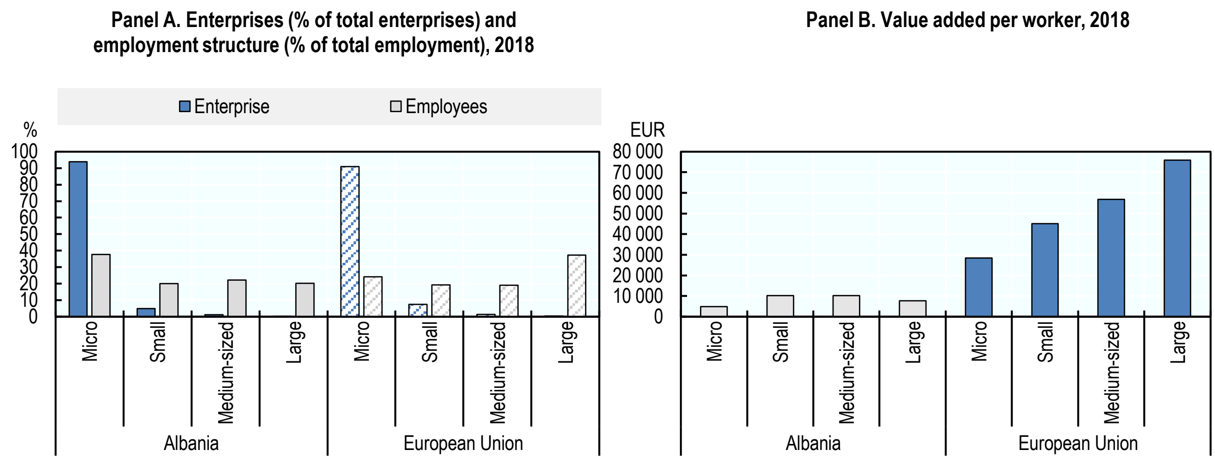
The firm-level perspective provides a similar picture and calls for addressing the constraints that hold firms back. Albanian firms show much lower productivity than their EU counterparts, and large firms have lower average productivity than SMEs (Figure 5.13). This distribution of productivity levels suggests that many factors that limit the potential of economies of scale are at play, i.e. that size confers productivity advantages, as it does in the European Union. Addressing underlying constraints in the business environment that undermine enterprise investment and growth will be key.

Figure 5.13. Firms of all sizes struggle with labour productivity in Albania

Enterprises (% of total enterprises) and employment structure (% of total employment) (Panel A), 2018, and value added per worker (EUR) (Panel B), 2018



Notes: Microenterprises = 1-9 employees; small enterprises = 10-49 employees; medium-sized enterprises = 50-249 employees; large enterprises = 250+ employees. The EU average does not include the construction sector.
Source: INSTAT (2020[63]), *Structural Business Statistics* (dataset), www.instat.gov.al/en/themes/industry-trade-and-services/structural-business-statistics.

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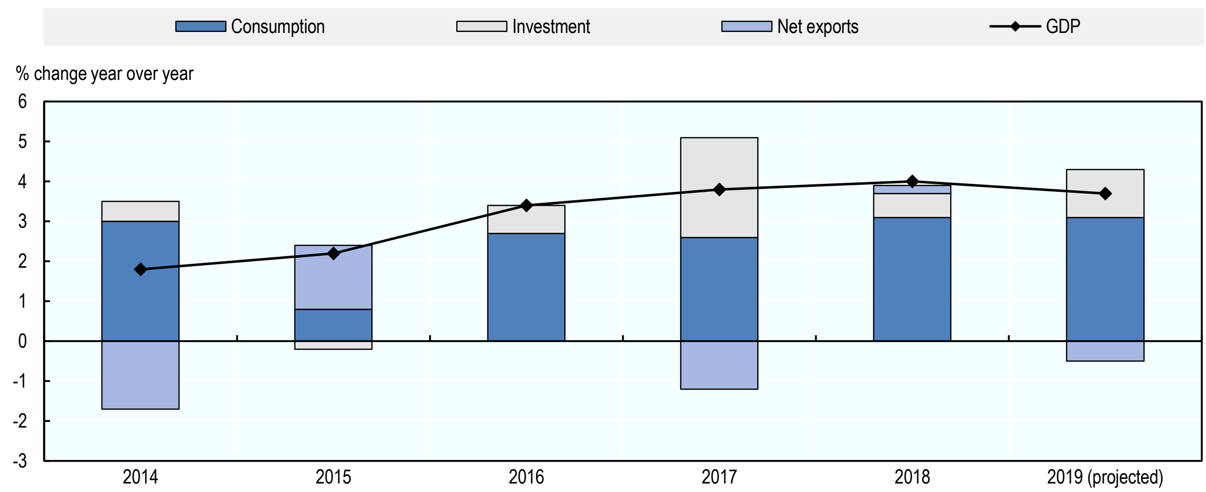
Albania's tradable sector needs more investment, diversification and upgrading

Over the past decade, the contributions of investment and exports to GDP growth have been relatively limited. While exports have grown by over 30% in real terms since 2014, net exports' contribution to real GDP growth has mostly been small or negative, reflecting the limited exports basket (predominantly based on footwear and apparel) and consumption's and investment's high dependence on imports. Investments also had a very limited contribution to real GDP growth (Figure 5.14).

Figure 5.14. Exports and investments do not drive Albanian growth

Contributions to real GDP growth



Source: IMF (2020[64]), *International Financial Statistics* (dataset), https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b.

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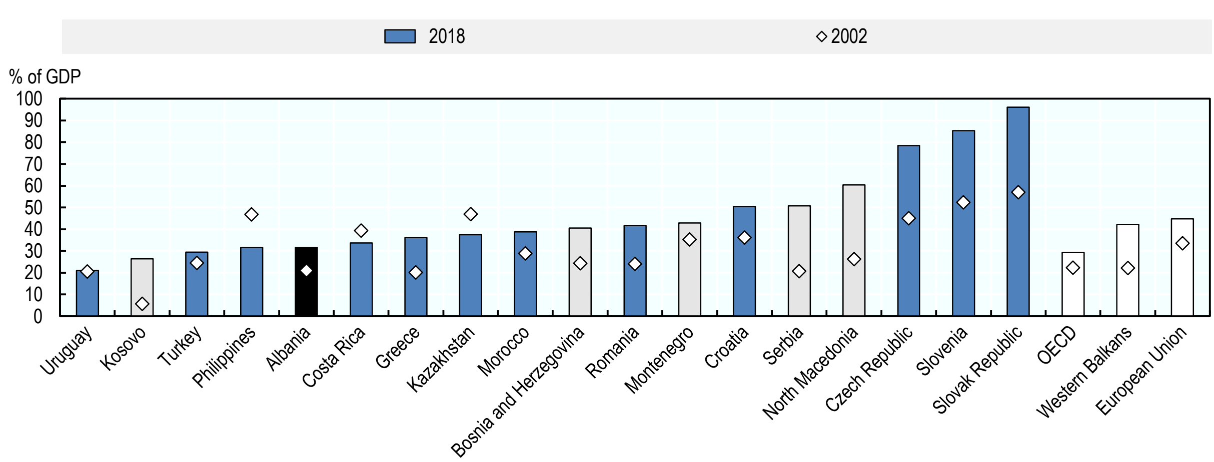
The contribution of exports to GDP has improved but leaves room for progress

In 2018, exports accounted for 32% of GDP in Albania, up from 21% in 2020 but below the regional average of 42% (Figure 5.15). The small contribution is also reflected in a current account deficit of 8% of GDP as of 2019 (World Bank, 2020[1]). Albania has not yet sufficiently leveraged its proximity to EU markets and the CEFTA regional trade agreement. Kosovo, Montenegro and North Macedonia export to the CEFTA at least twice as much in goods as Albania (CEFTA, 2020[65]). This is especially a missed opportunity for domestic enterprises, as regional markets tend to account for a significant share of exports for SMEs in other economies in the region.

Figure 5.15. The contribution of exports to GDP has improved but leaves room for progress

Exports as a share of GDP



Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Exports remain limited to tourism and products with low technological and knowledge content. The exports sector is largely made up of tourism (about 50% of total exports) (WTTC, 2020[66]), labour-intensive manufacturing of footwear and apparel, and raw materials, including minerals, metals and crude oil (INSTAT, 2020[67]). The business process outsourcing sector has grown considerably in recent years and has contributed to the growth of service exports. Albania also exports hydropower-based electricity, but its contribution to exports is relatively volatile, depending on hydrological conditions (Bank of Albania, 2020[68]). Albania ranks 92nd out of 129 economies on the economic complexity index, which measures the level of knowledge or capabilities embedded in an country's export products (OEC, 2019[69]).[10]

Albania has attracted significant amounts of FDI, mostly for energy, extractives and non-tradeable services and less for manufacturing and ICT

Since 2007, Albania has attracted considerable FDI. At an average rate of 8.4% of GDP, annual net FDI inflows over the period have been among the strongest in the region (World Bank, 2020[1]). A significant part of the uptake in investment relates to two large energy projects[11] (35% of all FDI over the past five years), although over the past two years, FDI growth has also been sustained by small-scale investments. The remaining investments have predominantly been in the non-tradable sector, including financial services (9.5%) and real estate (6.5%). Meanwhile, most of the export-oriented FDI went to extractive industries (29%), while sectors like manufacturing and ICT received less than 5% of total FDI over the past five years (Bank of Albania, 2020[70]).

As part of wider efforts to streamline investment attraction and focus on strategic sectors, Albania created Free Economic Zones, which offer a variety of fiscal incentives and employment schemes for foreign investors.[12] The zones also offer speedier issuing of licenses and permits and fast-tracking of other administrative procedures that are otherwise lengthy and burdensome (Albanian Investment Development Agency, 2020[71]). However, neither of the two approved zones (a so-called Technical and Economic Development area and an industrial park) are operational.

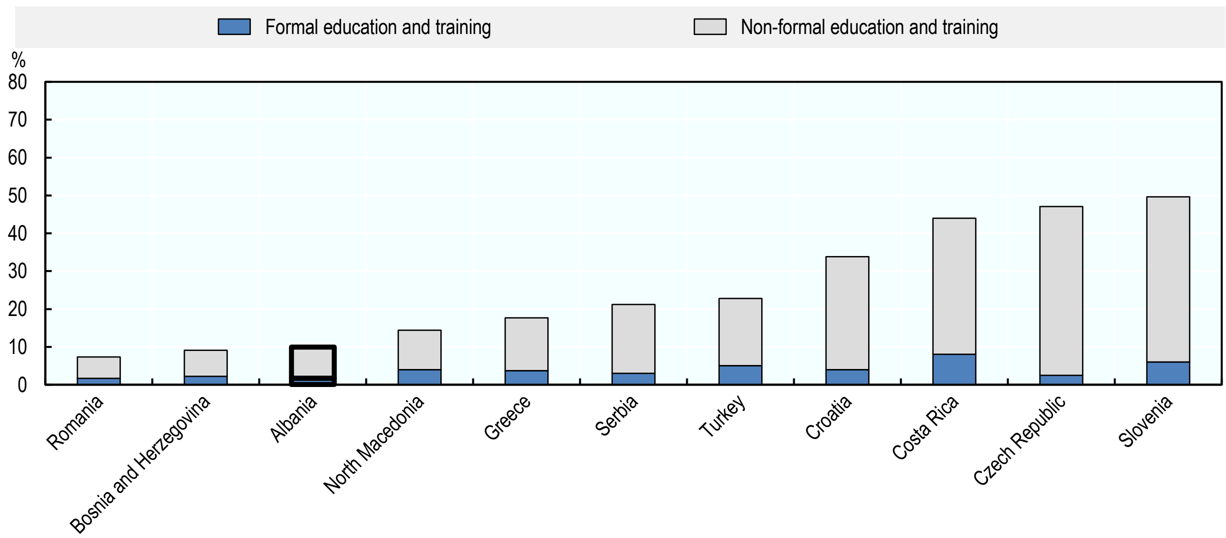
The skills gaps and skills mismatches affect productivity and growth

Albania struggles with relatively poor education outcomes and skills mismatches. The People section in this chapter discusses the education system and outcomes, particularly the low PISA scores and limited investment in the sector. More crucially from a prosperity perspective, nearly 40% of respondents to the 2019 Balkan Barometer survey noted that the skills that they acquired during their education did not meet the needs of their jobs. The most deficient skills included foreign language skills (42% of respondents), communication skills (24%) and other cognitive skills, including ability to learn on the job (27%) and creativity, innovation and risk taking (20%) (RCC, 2019[72]). Career education and better orientation programmes can help guide student choices at the end of upper secondary school based on their skills and potential and on market needs.[13]

Adult professional training can help address Albania's skills gap but remains very limited. About 10% of adults participate in education, compared to 49% in the European Union (Figure 5.16). Many enterprises report that both technical and interpersonal skills are often lacking among applicants (World Bank, 2018[50]).

Figure 5.16. Adult participation in education and training is very low

Adult education and training (aged 25 to 64) (%), 2016



Source: Eurostat (2020[73]), *Skills-related statistics* (database), https://ec.europa.eu/eurostat/web/skills/data/database.

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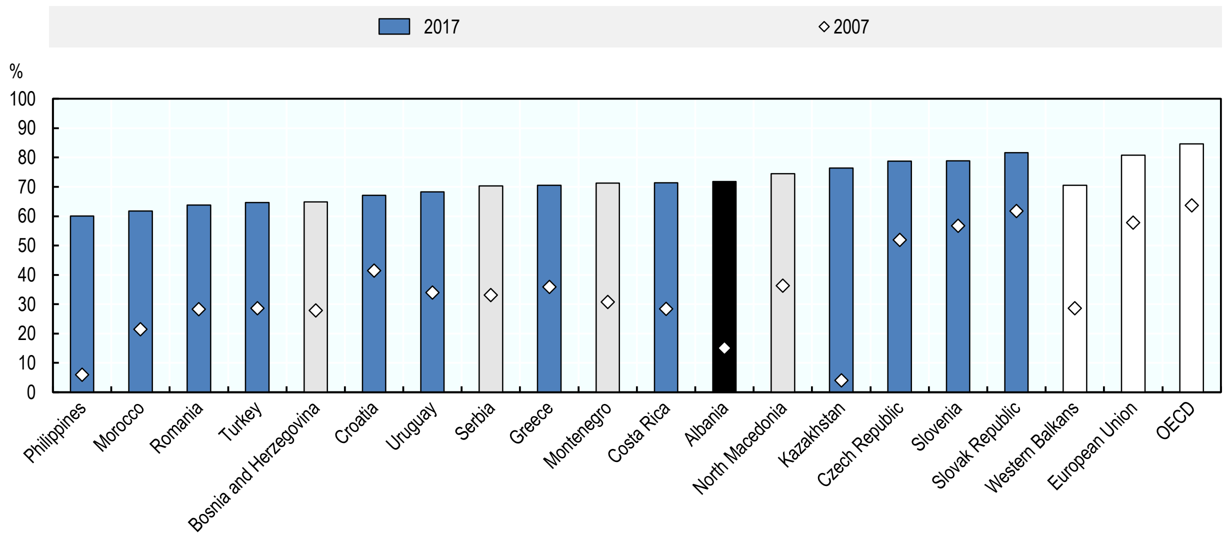
Lack of skills also affects Albania's underdeveloped innovation landscape. Public-sector research and development (R&D) expenditure remains low at less than 0.5% of GDP – lower than most regional peers and the EU average (2%) – and there is significant underutilisation of EU funds for innovation, even compared to other Western Balkan economies. Private-sector R&D expenditure is also low. Fewer than 10% of Albanian firms report having introduced a new product or service in the past year, compared to 25% to 50% of firms in the other Western Balkan economies. Fewer than 5% of Albanian firms report having introduced an innovative process, compared to 15% to 45% in other Western Balkan economies) (OECD et al., 2019[74]).

A skills strategy should aim to make the most of Albania's digital potential. From a low in the 2000s, Internet usage is now the second highest in the region (Figure 5.17).

Figure 5.17. Albania must continue the impressive pace of increasing Internet use

Individuals using the Internet (%), 2007 and 2017



Source: ITU (2020[75]), *International Telecommunication Union – Telecommunication Development Sector (ITU-D)* (database), www.itu.int/en/ITU-D/Statistics/Pages/default.aspx.

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The institutional and administrative constraints limit domestic and foreign investment

The poor business climate and the lack of transparency of business regulations affect investment and productivity growth in Albania. Although the economy undertook significant reforms to create a business environment more conducive to investment and growth, there remain considerable institutional and administrative obstacles. In particular, corruption, slow and unpredictable contract enforcement and difficulties obtaining construction permits negatively affect the quality of the business environment.

Corruption increases the cost of doing business in Albania

Corruption remains a considerable challenge in Albania and is a major constraint for businesses. The BEEPS points to the prevalence of petty corruption: the share of public transactions where a gift or informal payment was requested was 30% in Albania, compared to 13%, on average, for all economies in the survey. About 60% of survey participants in Albania noted that they had received at least one bribe payment request over the past year and that they felt that they were expected to bring gifts to meetings with tax officials, which as noted above, are much more frequent compared to other economies. 43% of surveyed entities identified corruption as a major constraint to business. The bribery value amounted to 30% of the transaction, on average (World Bank/EBRD/EIB, 2019[76]).

Evidence of higher-level corruption in public procurement or public-private partnership (PPP) contracts is mixed. Most of the recent infrastructure-related PPP projects were undertaken with unsolicited bids, which are more susceptible to corruption (IMF, 2018[77]). Yet, only 15% of firms in the BEEPS noted a need to make payments in order to secure government contracts, which is lower than the 24% average for all participating countries (World Bank/EBRD/EIB, 2019[76]).

Reducing corruption has been and should remain a significant priority for the government, as corruption at all levels undermines growth, largely by deterring private investment (see the Peace and institutions section in this chapter).

Contract enforcement is lengthy and political, and regulatory instability is relatively high

Judicial inefficiency and lengthy contract enforcement affect business conflict resolution, which slows down business activities. The overburdened court system, which has a large backlog of unresolved cases and lacks specialisation among judges and a dedicated commercial court, contributes to long and costly contract-enforcement procedures (see the Peace and institutions section in this chapter). On average, contract enforcement takes 525 days, compared to 120 days in global best performers, and costs 43% of the value of the claim (compared to 22% in OECD countries) (World Bank, 2020[78]).

The resulting uncertainty regarding the reliability and length of contract enforcement elevates the risk of investment in Albania and thus negatively affects productivity-enhancing capital generation. This is compounded by perceptions of high political instability and regulatory uncertainty (World Bank, 2019[79]).

Obtaining construction permits is lengthy and expensive

The procedures and costs of obtaining licenses and permits seem to be important obstacles to business. Construction permit procedures in particular require 19 different documents or steps and entail dealing with 10 different national or local government authorities. The procedure takes 324 days, on average, and costs more than twice the average in high-income OECD countries. Two municipal taxes (an infrastructure fee and an examination fee) account for a very large part of the cost. On the Doing Business assessment, Albania ranks 166th out of 191 economies on the indicator of obtaining construction permits (World Bank, 2020[78]).

The government recognises the importance of reducing the regulatory burden on businesses. A priority reform for the coming two years is the systematic assessment and elimination of unnecessary licenses and procedures and the simplification of other procedures in order to minimise the negative impact on businesses. Active efforts in digitalisation of public services will also help reduce bureaucratic red tape and improve the efficiency of the public administration (Republic of Albania Council of Ministers, 2019[33]).

Procedural issues are complicated by frequent disputes over property rights. This problem has deep historical roots dating back to Ottoman times, when an effectively feudal system limited land ownership to a very small group of people. It was subsequently compounded by conflicting ownership allocations of entirely state-owned land under the communist regime, subsequent privatisations, and ownership based on occupation. As a result, there is considerable uncertainty and frequent disputes over property ownership, which in light of the highly overburdened, inefficient and inadequately specialised court system, are difficult to resolve swiftly and adequately in a formal manner. This represents a significant deterrent to investment, particularly FDI. Most potential FDI investors only consider public properties for potential investment due to the high risk associated with ownership of private land (Albanian Investment Development Agency, 2020[71]).

The large infrastructure gap limits investment, particularly manufacturing FDI

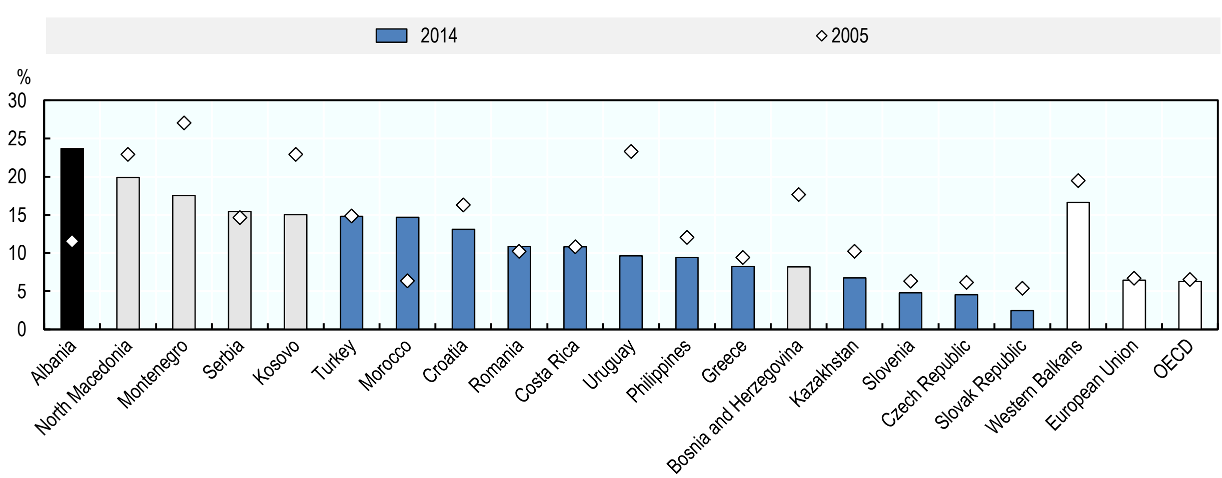
Albania has a sizable transport infrastructure gap compared to most regional peers. Despite some important recent investments in the development of key transport corridors, the road transport network and connectivity with neighbouring economies are still not on par with regional peers, and rail transport is highly underdeveloped and underutilised. Albania ranks 120th out of 141 global economies on the World Economic Forum Global Competitiveness Index with respect to the quality of its transport infrastructure, lagging behind all other European countries (WEF, 2019[80]).[14] Albania is one of few regional countries with a sizable coastline and ports on both the Adriatic and Ionian Seas. However, its key ports need rehabilitation to become more regionally relevant (EBRD, 2018[81]). In recent years, the government has undertaken considerable investments to upgrade infrastructure, mostly executed through PPPs, but as discussed in more detail in the Partnerships and financing section in this chapter, the implementation and risks associated with these liabilities may have negative fiscal implications for the country in the medium to long term (General Directorate of Taxation, 2020[82]).

Electricity supply remains a recognised constraint for businesses. Albanian firms frequently identify electricity supply as a top constraint to business. In 2019, 58.7% of firms experienced electrical outages, which is above the Western Balkan average of 48.9% (World Bank, 2019[79]). Based on latest and international comparable, data and transmission and distribution losses were 23.7% in 2014 [Figure 5.18]) The National Energy Strategy 2018-2030 and the Consolidated National Action Plan on Renewable Energy Resources 2019-2020 recognise and aim to address these challenges. Joining Albania's transmission system operator with the ENTSO-E network in 2017 has helped improve the security of electricity supply (ESC Adriatic, 2017[83]). Encouragingly, the recent reforms since 2014 have led to further reductions in distribution and transmission losses (OST, 2021[84]; OSHEE, 2021[85]).

Albania is advancing in the liberalisation of its energy market thanks to the transposition and implementation of the Third Energy Package (Republic of Albania Council of Ministers, 2019[33]). Albania is the only Western Balkan economy to have completed the requirements to unbundle electricity and gas transmission system operators (Energy Community Secretariat, 2018[86]). New competition in the sector could result in a better quality of service and a more secure energy supply. It will be important complete this process in the national electricity sector distribution system.

Figure 5.18. Electric power transmission and distribution losses are increasingly problematic

Electric power transmission and distribution losses (% of output), 2014 and 2005



Source: IEA (2020[87]), "Data and statistics", www.iea.org/data-and-statistics?country=WORLD&fuel=Energy%20supply&indicator=Total%20primary%20energy%20supply%20(TPES)%20by%20source.

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Partnerships and financing – financing sustainable development

The Partnerships and Financing pillar of the 2030 Agenda for Sustainable Development cuts across all goals focusing on the mobilisation of resources needed to implement the agenda. It emphasises the efficient and effective use of these resources towards achieving the agenda goals.

Albania's economy was recently hit by two major shocks. The November 2019 earthquake caused considerable infrastructural damage, and the ongoing COVID-19 pandemic has already significantly affected economic activity and will require considerable fiscal and other policy responses in the coming months to mitigate the effects.

In light of this increased fiscal burden and its impact on the already sizable public debt, fiscal policy will require careful, well-targeted and efficient public spending in the coming years in order to provide effective public services, finance needed investments and meet debt servicing costs. The Partnerships and financing section in this chapter covers the main fiscal policy and public finance obstacles Albania faces (Table 5.4).

Table 5.4. Partnerships and financing – three major constraints to an effective fiscal response to the 2019 earthquake and COVID-19 in Albania

1. The fiscal space is limited.
2. Revenue performance is lagging behind, while expenditures need to increase in key areas.
3. Access to financing is limited.

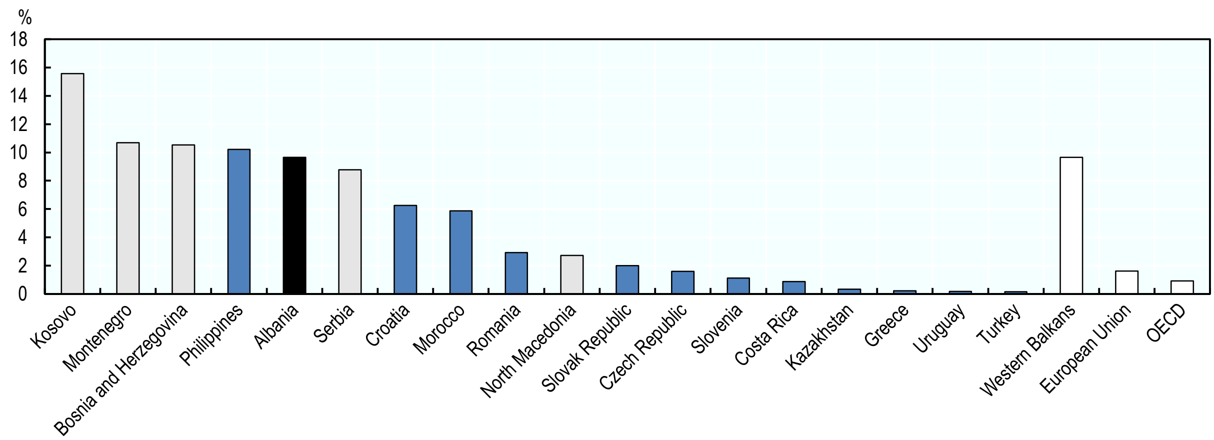
Remittances are an important source of finance in Albania

Albania ranks among Europe's top countries in remittances as a share of GDP. Remittances amounted to around 9.4% of GDP and USD 1 455 billion in 2019. The share has progressively decreased since the transition, from 28% of GDP in 1993 to 14.48% in 2008. Despite their significant share in GDP in Albania and almost all regional economies, remittances are mainly used for household consumption and thus do not constitute an important lever for development (Figure 5.19).

Albania is developing and implementing a state diaspora policy to mobilise and leverage its human and financial resources abroad. Since November 2019, the Albanian Diaspora Business Chamber, an independent non-profit organisation, attracts and supports investors willing to establish or expand their businesses in Albania. The National Strategy for Diaspora 2021-2025, adopted in July 2020 by the Council of Ministers, aims to mobilise professionals abroad and to attract innovative investments from the diaspora.[15] The banking sector will play a crucial role in channelling remittances towards economic sectors in need, and a co-ordinated action plan is under preparation.

Figure 5.19. Remittances play an important role in Albania's economy

Remittances as a share of GDP, 2019



Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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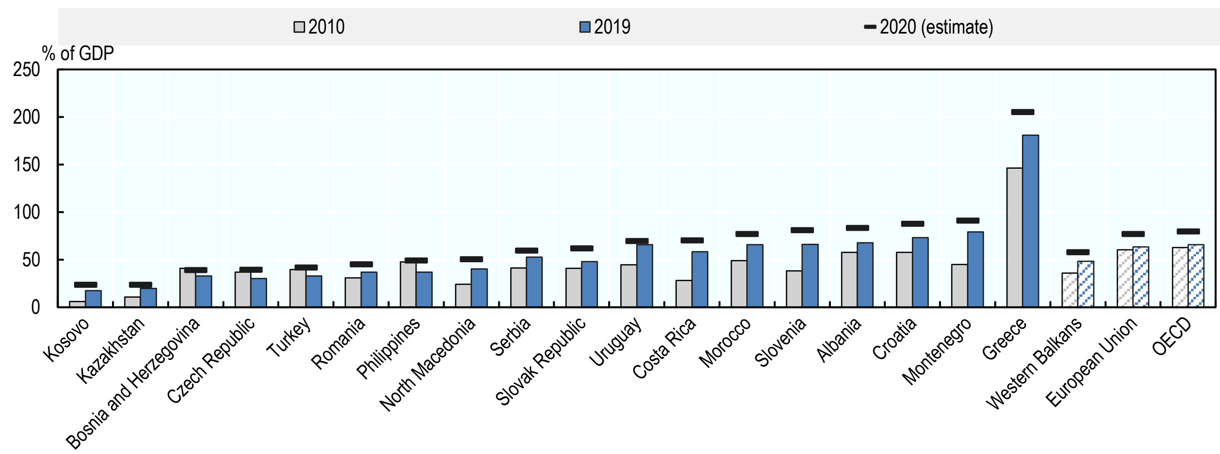
The fiscal space is limited

Albania avoided a major recession in the aftermath of the global financial crisis in large part due to the provision of a considerable fiscal stimulus. This led to a significant and rapid increase in the level of public debt, which rose from 57.7% of GDP in 2010 to 73.3% in 2016. The implementation of consolidation measures have reduced the public debt to 66.7% of GDP as of 2019. Based on estimates, the COVID-19 crisis could increase the public debt to 75,9.3% in 2020 (Figure 5.20), implying significantly reduced fiscal space.

With low domestic savings (9% of GDP as of 2019) and lacking diversified domestic funding sources outside the banking sector, Albania relies strongly on foreign financing sources (World Bank, 2020[1]). Foreign debt, mostly denominated in euros, currently represents 45% of total debt. This exposes Albania to risks related to financing conditions in the Eurozone and to exchange rate-related risks. The exchange rate risks are mitigated by sizable euro reserves, but the increased volatility and depreciation of the lek in relation to the euro since the onset of the COVID-19 crisis, and the uncertainty regarding exchange rate movements as the crisis unfolds, could elevate these risks.

Figure 5.20. Public debt is under significant upward pressure from COVID-19

General government debt (% of GDP)



Source: IMF (2021[88]), *World Economic Outlook Databases* (database), www.imf.org/external/pubs/ft/weo/2019/02/weodata/index.aspx.

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Risk-to-debt sustainability also concerns public-sector contingent liabilities related to infrastructure PPPs. In recent years, the government has undertaken significant new infrastructure investments, most of which are being implemented as PPPs. Many of these (amounting to about 45% of GDP in total) were based on unsolicited bids and lacked proper risk assessments. In the absence of an adequate centralised monitoring framework for PPPs to ensure timely intervention on underperforming projects, there are significant risks that the contingent liabilities associated with this large number of PPPs may be realised, which can threaten the sustainability of government debt (IMF, 2018[77]).

The performance of the energy sector also implies fiscal risks. When hydrological conditions are not good and the electricity sector relies on relatively expensive electricity imports, the additional costs are borne by state-owned enterprises in the sector, with important fiscal implications. Without significant reforms, including among others, electricity pricing that reflects costs, the sector will remain a source of fiscal risk (IMF, 2018[77]).

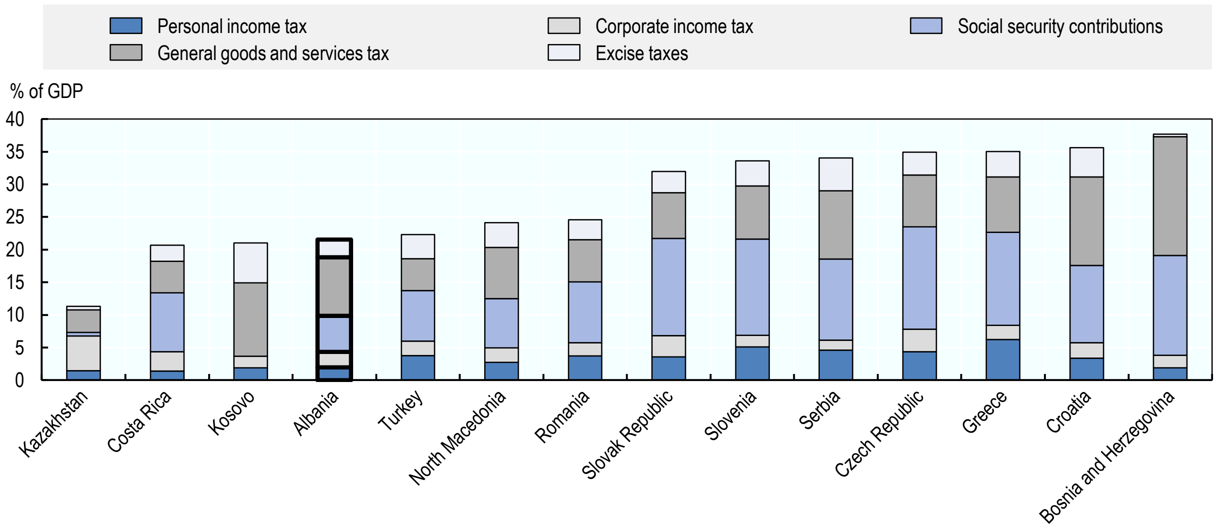
Revenue performance is lagging behind, and expenditures need to increase in key areas

Improved tax collection and a broader tax base are needed to improve revenue performance

Thanks to good economic performance, tax revenues have been steadily growing in recent years, with further room for widening the tax base. Albania's tax-to-GDP ratio was 21.6% in 2018, with taxes on goods and services the most important contributor (Figure 5.21). Most regional countries achieve higher revenues, despite having lower tax and contribution rates, particularly for labour. This points to underlying challenges in the tax system, including the efficiency of tax collection, a need to widen the tax base and the presence of informality and tax avoidance. Tax rates are seen as the biggest obstacle to doing business in Albania, with 50% of surveyed firms noting this as a major constraint (World Bank/EBRD/EIB, 2019[76]).

Figure 5.21. Albania's tax system requires improvement

Revenue by sources (% of GDP), 2018



Note: Data for Croatia, Romania and Slovenia are for 2017. Data for North Macedonia are for 2013. Data for Serbia are for 2012.
Sources: IMF (2020[89]), *Government Finance Statistics Yearbook Query – Revenue* (database), https://data.imf.org/?sk=FA66D646-6438-4A65-85E5-C6C4116C4416; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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The introduction in recent years of various economy-wide or sector-specific tax incentives or tax cuts has reduced potential revenues and complicated the tax regime, creating loopholes for tax avoidance. For example, four- and five-star hotels can be exempt from corporate income tax payments for ten years under certain conditions, and tax rates have been cut from 15% to 5% for entities operating in the IT sector (Invest in SEE, 2020[90]). Many of these interventions come without detailed assessment of the relative gains compared to their fiscal costs, which is especially problematic given Albania's limited fiscal space and high expenditure needs (IMF, 2019[91]).

The government invests in compliance and widening of the tax base, but trust and informality pose tough challenges. The government continues to implement measures to expand the tax base, mainly through better compliance enforcement (European Commission, 2020[12]). However, persistent government debt arrears, value added tax (VAT) refund delays and frequently changing tax regulations create uncertainty for businesses and can undermine trust in government and encourage operation in the grey economy (IMF, 2018[77]). As discussed, informality also reflects lack of trust in institutions, dissatisfaction with public services provision, low ethics of tax payment and other factors that require a wider and longer-term reform effort (ILO, 2011[92]).

The administrative burden of paying taxes is an important obstacle identified by 29% of firms in the BEEPS (World Bank/EBRD/EIB, 2019[76]). Annual tax filing requires 35 procedures and takes, on average, 252 days per year, compared to 3 procedures and 49 days in the global best performers (World Bank, 2020[78]). Some 92% of respondents noted the need to meet with tax officials, compared to 54% for all economies participating in the survey.[16] Moreover, on average, they had to meet five to six times, compared to two to three times for all other economies (World Bank/EBRD/EIB, 2019[76]).

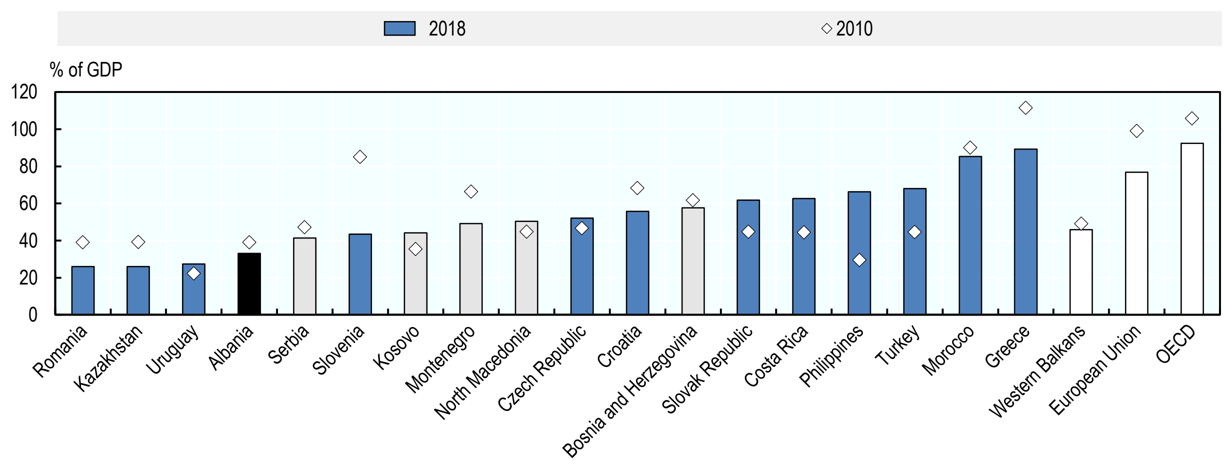
Albania has invested significant effort in building its taxation capacity, and the efforts should continue. Much has been done in recent years to improve the efficiency of tax administration, build the capacity of the tax authority, set up databases and reduce corruption. Further efforts should aim to improve the overall skills and capacities of the tax administration and the profiling and risk assessment of taxpayers, and to speed up reforms enabling entirely electronic filing (IMF, 2019[91]).

Access to financing is constrained by weak property rights and informality

Albania's financial sector is stable, liquid and well capitalised; however, lending to the private sector has declined considerably as a share of GDP in recent years. Between 2010 and 2019, private-sector credit fell from 39.1% to 33% of GDP (Figure 5.22) largely due to the feeble growth in lending to enterprises. The trend is occurring despite the strong and growing deposit base (67% of GDP, which is considerably larger than in regional peers) and despite the decline in lending interest rates (from 9.7% in 2014 to 5.9% in 2019) (IMF, 2020[64]).

Figure 5.22. Bank lending is constrained, especially for enterprises

Domestic credit to the private sector (% of GDP), 2018 and 2010



Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Unclear property rights, widespread informality, weak financial literacy and the high share of NPLs are key constraints to bank lending and access to financing. Illegally constructed buildings, not-yet legalised buildings and un-documented or unregistered property prevent property owners and business from using property as collateral thereby constraining bank lending. Considering the size of the informal economy (about 30% of GDP [(Kelmanson et al., 2019[93])]), banks tend to be additionally risk averse. Low risk tolerance also reflects the share of NPLs, which remains relatively high (11.1% in 2018) (World Bank, 2020[1]). Assessment of credit worthiness is compounded by the lack of a private credit bureau and the limited coverage of the public credit registry (56% of all adults) (World Bank, 2020[78]). The supply of financing is also constrained by the underdeveloped non-bank financing sector, which is especially problematic for start-ups or high-risk innovative investments. The unfolding COVID-19 economic crisis will likely put additional strain on bank lending. Albania's 2020-22 ERP acknowledges access to financing as an important obstacle to business development, particularly for SMEs. While there are various support schemes to improve SMEs' access to financing, information about them reaches a limited number. Increasing the use of the centralised information platform to improve access to financing is one measure proposed in the ERP (European Commission, 2020[41]).

Peace and institutions – strengthening governance

The Peace and Institutions pillar of the 2030 Agenda for Sustainable Development encompasses peace, stability and accountability, as well as effective governance and the performance of the public sector more broadly.

Since 1991, Albania has taken remarkable steps to transition from an autarchic to a market economy and from a repressive regime to a fully-fledged democracy. In the past 20 years, the country held elections on a regular basis, and the political landscape is much less fragmented and unstable today than ten years ago. Albania has become safer, and homicide rates have decreased, from 43 per 100 000 inhabitants in 1997 to 2 per 100 000 inhabitants in 2018. Recent ambitious reforms of the judicial system lay the foundation for more reliable, efficient and independent courts. Tightening for fight against corruption has increased the powers and tools to combat one of the country's most deeply rooted constraints to development. Significant efforts have been made to improve the security of property rights, a problem in many post-communist regimes in the region. The subnational government structure has been rationalised and decentralisation reforms initiated. A modern Competition Authority is well placed to guarantee a quality business environment.

Integration process with the European Union is a strategic priority and has been a driver of institutional development, even where implementation remains challenging. Most Albanians view access to the European Union as an important milestone. The process has been an important driver of reforms and institution building and has provided the country with large financial and technical support for its development and regional integration, as well as market access and economic opportunity (Box 3.3). As part of the process, Albania is striving to bring its legislation and institutional organisation in line with the existing body of EU laws and standards (known as the acquis), helping set the basis for effective institutions and processes. However, implementation of such transcriptions is often challenging (European Commission, 2020[94]).

Frequent election boycotts have hampered representation and institutional development. Opposition parties boycotted national and local elections seven times between 1992 and 2019, partly crippling the capacity of assemblies to guarantee independent oversight of the other state powers. Frequently boycotted national and municipal assemblies cannot represent the entire population, effectively alienating large shares of citizens from the decision-making process: indeed, voter turnout for parliamentary elections fell from 90% in 1992 to 47% in 2017.

Parallel informal institutions remain relevant, solving some problems but creating challenges for development. Closely-knit kinship networks based on traditional norms and customs still regulate relationships between parties in some parts of the country. For instance, village elders in rural areas are a faster, more efficient way to settle land disputes than tribunals. While such solutions can guarantee social peace and help get things done, they can contribute to the dysfunction of formal institutions. Courts cannot keep track of land transactions that occurred on the basis of traditional rules and customs, and cadastral offices often end up with outdated maps and property registers. Still today, formal plot transactions between parties are not the clear and sole owners can easily be contested. Unclear property rights discourage the emergence of functioning real estate and land markets and, consequently, investments (see the Prosperity section and the Partnerships and financing section in this chapter) and undermine the fiscal capacity of municipalities.

Strengthening formal institutions is essential to isolating the decision-making process from interference by special interests. In the past, political patronage has played a role in public hiring and has contributed to the fragmentation of the state apparatus. However, recent reforms have promoted professionalism in the public administration, and some subordinated bodies have been reorganised. Steps have been taken to streamline and co-ordinate the planning process, but their implementation requires time. Last, improving statistical capacity will be key to ensuring that decisions are increasingly based on empirical evidence.

The Peace and institutions section in this chapter identifies six major constraints to the development of solid institutions in Albania, drawing on interviews and a workshop conducted as part of this initial assessment. The country needs to build on its achievements in order to overcome obstacles, including the fragmented structure of the administration, which can stand in the way of implementation; courts' lack of capacity and independence; unsecure property rights; corruption and patronage in the public administration; incomplete decentralisation and regional disparities; and limited statistical capacity, especially in the area of planning and reporting on economic indicators (Table 5.5).

Table 5.5. Peace and institutions – six major constraints to more effective public institutions and services in Albania

1. The fragmented structure of the public administration can stand in the way of implementation.
2. Courts lack capacity and are exposed to external influence.
3. Land property rights remain complex, affecting land productivity and sustainability.
4. Corruption remains a challenge.
5. Limited local fiscal and administrative capacity and an unclear regional development framework may exacerbate regional inequalities.
6. Statistical capacity is limited, especially in the area of planning and reporting on economic indicators.

The fragmented structure of the public administration can stand in the way of implementation

Albania has numerous and sometimes overlapping strategic documents

Currently, Albania has 47 sectoral and cross-sectoral strategies and 33 strategic policy documents, action plans and master plans. In principle, line ministries and subordinate institutions draft their own strategic documents in line with the national priorities set out in the NSDI II. The OPM ensures that all these documents are aligned with the NSDI II. The new Integrated Planning System is supposed to improve the quality of strategies and their consistency with the NSDI II, their link with budget planning and public finance management, and their monitoring.

The OPM is striving to harmonise all strategic documents and to align them with the NSDI II. This is a challenge. There are numerous strategic documents outlining objectives that are contradictory or hard to monitor.[17] Some plans are used by their proponents to carry out their own priorities, rather than align with a common agenda. Others may amend long-term objectives approved during previous legislatures in response to changing political guidelines. The government must also factor in expectations set by international donors, which might be contradictory and add complexity to the planning process. The OPM aims to step up its co-ordination capacity, establish a hierarchy among strategic documents and enhance monitoring capacity (European Commission, 2020[94]; OECD/SIGMA, 2019[95]).

The fragmentation of agencies poses a challenge to implementation capacity

Since the end of the 1990s, responsibility for policy implementation has been gradually transferred from ministries to subordinated authorities and agencies. The rationale for deconcentrating executive power (also known as agencification) is the supposed capacity of these bodies to regulate, inspect and provide services and public goods more effectively, efficiently and, independently from political pressure. Agencies and authorities are usually detached from ministries, enjoy financial and managerial independence, and operate according to business-like principles.

The deconcentration process has yielded efficient and independent institutions but has suffered from the influence of special interests. The Competition Authority stands out as an efficient and independent institution (European Commission, 2020[94]) and a positive example of the agencification drive. Yet, the fragmentation of the political landscape translated into a problematic system. Between 1997 and 2013, small parties multiplied, usually to support the two traditional parties (Partia Demokratike and Partia Socialiste e Shqipërisë) in large coalitions.[18] These parties had narrow electoral bases and limited possibilities to seize a seat in the national assembly. However, in a fragmented political scenario, their contribution was decisive for the coalition's victory and was usually rewarded with a role in the executive, for example with a position in agencies (Mendelski, 2019[96]). These bodies then became vehicles to pursue special interests rather than autonomous branches guaranteeing unbiased and effective implementation of public policies.[19] Moreover, they created steering and co-ordination issues and a larger financial burden for the state budget (OECD/SIGMA, 2019[95]).

Today, Albania has a very high number of agencies and other bodies with sometimes unclear tasks. There are around 190 bodies that are directly accountable to the OPM or various ministries, and several other independent authorities that are accountable to the national assembly (such as the Competition Authority and the Albanian Water Regulatory Authority). Subordinated institutions are the most fragmented: around 100 of them operate under the Law “On civil servants” and are divided into six categories: policy makers, regulators, law enforcers, service providers, inspectorate and trainers (according to data provided by the Department of Public Administration).[20] The rest do not, complicating their categorisation and therefore the definition of their role and type of governance (Table 5.6). The decreasing fragmentation of the political landscape over the years offers an opportunity to reduce the number of agencies and authorities.[21]

Table 5.6. Albania has a very high number of subordinated bodies

Inventory of subordinated institutions as of May 2020

Ministry to which bodies are accountable	Subordinated institutions under the Law “On civil servants”		Subordinated institutions not under the Law “On civil servants”	
	Number of institutions	Number of employees (civil servants)	Number of institutions	Number of employees (not civil servants)
Health and Social Protection	6	1 071	9	3 200
Finance and Economy	19	3 980	3	1 355
Tourism and Environment	5	734		
Office of the Prime Minister	16	707	11	2 546
Internal Affairs	13	456	8	1 822
Agriculture and Rural Development	19	1 416	4	350
Defence	2	201	5	313
Education, Sports and Youth	3	92	10	684
Infrastructure and Energy	13	599	4	397
Justice	7	269	3	308
Culture			29	921
Total	103	9 525	86	11 896

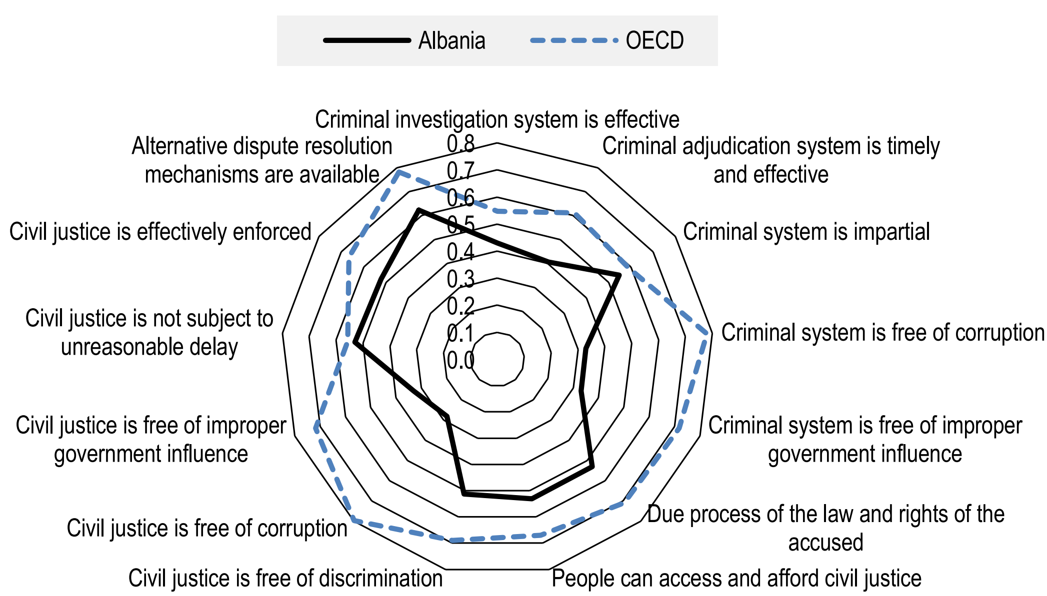
Note: Table does not include figures for civil servants employed in the police and prison system (around 11 000 and 4 500 civil servants, respectively) or staff in ministries (around 2 100). As an example, the State Health Inspectorate (Inspektoriati Shtetëror Shëndetësor) in the Ministry of Health and Social Protection is considered a subordinated institutions operating under the Law “On civil servants”, while hospitals are not.
Source: Authors’ elaboration based on data provided by the Department of Public Administration.

Simplification of the number of agencies and authorities is ongoing but with some limitations. The 2019 Law "On cadastre" established a new State Cadastre Agency that takes over the responsibilities of three previous subordinated bodies: the Immovable Property Registration Office, the Agency of Inventory and Transfer of Public Properties and the Agency for the Legalization and Urbanization of Informal Areas. Moreover, the government is working towards a major reorganisation of subordinated bodies that would simplify their classification and redefine their governance, their degree of operational and administrative autonomy and the applicable supervision and control measures. However, as of May 2020, only six ministries have partly or entirely reorganised their subordinated bodies. Moreover, the restructuring agenda leaves some issues unaddressed. For example, there is still no central guidance on planning and reporting on the performance of these bodies and their boards of directors (OECD/SIGMA, 2019[95]).

The courts are short of capacity and still exposed to unlawful external influence

The judiciary in Albania has long been considered biased, poorly accessible and sometimes inefficient. Civil and criminal justice in Albania is more exposed to the improper influence of the executive power and to corruption than OECD countries (Figure 5.23). Civil justice is neither accessible nor affordable: according to the World Justice Project, 40% of citizens face obstacles while seeking legal assistance. Partiality and inefficiency have undermined people's confidence in the judiciary: according to Gallup data, only 31% of Albanians trust courts, while only 17% believe that judges resolve cases according to the law, which is the lowest share in the region (OECD, 2020[97]).[22] On the positive side, the disposition time for litigious civil and commercial cases is the lowest in the region (159 days). The number of days to resolve civil, commercial and administrative cases has decreased since 2012 (OECD, 2020[97]). Yet, according to the latest Doing Business indicators, some business leaders complain that court fees for commercial cases are high, resolving labour litigation takes over five years and concluding bankruptcy procedures takes two years (at the end of which shareholders recover only 44% of the value of their shares).

Figure 5.23. Civil and criminal justice is more exposed to the improper influence of the executive power and to corruption than in other countries with a similar GDP per capita



Note: The continuous line spider chart represents the perceived dimensions of quality of the judiciary in Albania; the dotted line chart represents the average perceived dimensions of quality of the judiciary in the average OECD country.
Source: Authors' calculation based on World Justice Project (2020[98]), *World Justice Project Rule of Law Index 2020*, https://worldjusticeproject.org/our-work/publications/rule-law-index-reports/wjp-rule-law-index-2020.

StatLink https://doi.org/10.1787/888934242194

To restore efficiency and trust in courts, Albania has profoundly reshuffled its judiciary institutions.

First, the country embarked in a drastic but slow process of vetting members of the judiciary. Since 2016, the Independent Qualification Commission (KPK) – a constitutional body – has been screening the assets, background and proficiency of the 811 judges and prosecutors. An international team of career judges and prosecutors provides support. Between February 2018 and July 2020, the KPK vetted 275 judges and prosecutors; 102 have been dismissed, and 59 resigned before the final verdict. At the current pace (nine judges vetted per month), the KPK's appraisal would end in 2025 (instead of 2022, as expected).[23] At the same time, the Albanian School of Magistrates may have insufficient capacity to resupply the judicial system with qualified jurists.

The vetting process will be beneficial in the long run, but it undermines the capacity of tribunals in the short to medium term. Dismissals and resignations have left some courts dysfunctional. For instance, the Supreme Court has 4 operative judges instead of the 19 envisaged in the constitution and is overburdened: the number of backlogged cases increased from 22 000 in 2017 to 28 863 in 2018 and about 31 000 in 2019. At this pace, the Supreme Court would need an estimated 17.25 years to process all pending files.[24]

Second, the judiciary now has governing bodies that are, in principle, impermeable to clientelistic and informal networks. Law No. 115/2016 "On governance institutions of the judiciary system" established four new institutions: the High Judicial Council (KLGj), the High Prosecutorial Council (KLP), the High Justice Inspector and the Justice Appointments Council (JAC). The KLGj and the KLP deal with the selection, promotion and dismissal of judges and prosecutors. The High Justice Inspector investigates disciplinary misconduct and initiates disciplinary proceedings against judges and prosecutors at all levels. The JAC screens and evaluates candidates for the Constitutional Court and the High Justice Inspector based on professional and moral criteria. Members of all these institutions are either peer judges and prosecutors or lay members elected from among the country's law experts (lawyers, law professors and representatives of civil society). Representatives from the executive or the legislative powers no longer sit on their boards.[25]

The politicisation of the judiciary, however, is deeply rooted in the initial reforms of 1992 to 1996. Following the collapse of the communist regime, the new ruling elite replaced the then-judges with personnel educated through a short three- to six-month course. Participants were often hand-picked from among party militants, enabling the infiltration of political interests into the highest echelons of the judiciary. Subsequent presidential nominees consolidated a system of party patronage (Bertelsmann Stiftung, 2018[99]). The ongoing vetting process and the introduction of new governing bodies of the judiciary will help curb the influence of the politically appointed judges still in the system.

The KLGj is stepping up the capacity of the Supreme Court. Between February and July 2020, it filled 11 new vacancies and is expected to fill the remaining 3 to complete the court. Together with the United States Agency for International Development, the council will provide the Supreme Court with more human resources to reduce the arrears and will introduce IT to make procedures more modern and transparent.

The councils and the Albanian School of Magistrates are putting in place measures to strengthen the long-term capacity of the rest of the judiciary. The KLGj and the KLP are transferring judges and prosecutors to fill vacancies across the country; promoting judges in appellate courts, the Supreme Court and special courts against corruption and organised crime; and screening all recent Albanian School of Magistrates graduates who are ready to be appointed. The Albanian School of Magistrates, in co-operation with the councils, increased the number of candidates attending initial training in 2020.

Property rights are still insecure, affecting land productivity and sustainability

Land rights in Albania remain insecure

Property rights to land are frequently in dispute in Albania. Incomplete cadastral registries fuel disputes over unclear land boundaries, overlapping plots and road access. These disputes are rarely brought to court, where proceedings can be lengthy, expensive and subject to corruption. Rather, they are settled informally through mediation by relatives, village elders or local leaders and are usually based on traditional norms and customs (USAID, 2016[100]). Disputes may involve parties that are both legitimate owners of the same land plot as a result of contradictory legislation (see below). In 2011, this type of dispute constituted about half the cases in civil courts (USAID, 2016[100]). Some have been brought before the European Court of Human Rights, and their settlement was often costly to the state.[26]

Unsecure property rights have delayed the emergence of a functioning land market. In 2007, fewer than 2% of rural households had sold land on the formal market since the beginning of privatisation, and only 3.6% had rented their land. In 2010, 36 000 land transactions involving 830 ha of agricultural land (out of 1 201 300 ha of total agricultural land) were concluded (Cela et al., 2018[101]). In spite of the low number of formal land transactions, average farm size has increased over the past years, indicating that landowners are active in informal markets. Parties might opt not to register transactions if they are unaware of the regulations and their rights, mistrust property registries or do not take formal property rights at face value.

Land consolidation is lagging behind, and landholdings remain small and fragmented, affecting agricultural productivity. As of 2011, there were about 390 000 family farms, with an average size of 1.26 ha divided into 4.7 parcels and with an average parcel size of 0.27 ha.[27] Small farms may have insufficient resources and capacities to mechanise or to experiment with new methods to improve productivity and environmental sustainability. Moreover, the piecemeal management of small parcels has caused soil erosion and degradation. The dysfunctional land market and the lack of consolidation policies exacerbate the fragmentation issue.

Incomplete land titling undermines local fiscal capacity. Since land registries are often incomplete, officers cannot collect property taxes, a main source of own revenues at the subnational level. Indeed, the share of income from property taxes in overall subnational revenues is the lowest in the region (0.3% and 1.7%, respectively) (Figure 5.24).

Path-dependent and incomplete legislative frameworks leave land-related issues unresolved

The land issue in Albania has deep historical roots. In 1912, the newly established state of Albania inherited the Ottoman feudal system, characterised by few landowners controlling large plots. Having resisted attempts in the 1920s and 1930s to redistribute land, the system gradually crumbled under communist rule. The regime first nationalised forests and pastures in 1945, then collectivised agricultural land and formed large co-operatives and state farms and finally abolished private ownership altogether in 1976. When the regime fell 14 years later, restoring property rights became a top national priority in order to realise the transition to a market economy. Land reform in particular was seen as a way to empower the rural population, which was afflicted by poverty and hunger.

Table 5.7. Main legislation defining the regulatory frameworks on land management in Albania

Law	Main provision
Land distribution to new landowners	
Law No. 7501/1991 "On land"	Distribution of land rights (ownership and usage) to members and employees of dissolved co-operatives and state farms through *ad hoc* village commissions. Rights must be registered at the local Office of Immovable Property Registration.
Law No. 7652/1991	Granting urban families ownership of the apartments and houses they occupy.
Law No. 8053/1995 "On the ownership transfer without remuneration of agricultural land"	Conversion of usage rights to ownership rights in line with Law No. 7501/1991 "On land".
Law No. 9948/2008 "On the review of legal validity for the creation of ownership titles on agricultural Land"	Streamlining of criteria defining the validity of titles, as defined by Law No. 7501/1991 "On land" and Law No. 8053/1995 "On the ownership transfer without remuneration of agricultural land".
Law No. 171/2014 "On the completion of legal procedures for the transfer of agricultural land of former agricultural enterprises in ownership of the beneficiaries"	Transference of ownership of agricultural land from former agricultural enterprises (the state) to beneficiaries who fulfil criteria of its possession and use but who do not yet own it.
Law No. 111/2018 "On cadastre"	Creation of the State Cadastre Agency, which replaces the Immovable Property Registration Office, the Agency for the Legalization and Urbanization of Informal Areas and the Agency of Inventory and Transfer of Public Properties.
Law No. 20/2020 "On the treatment of property and finalization of the property compensation process"	Provision of effective legal instruments for resolving remaining problems related to property rights on immovable properties and to registration issues.
Restitution and compensation to former owners	
The Law No. 7698/1993 "On restitution to and compensation of former owners"	Commencement of the process of restitution and compensation to original land owners expropriated during the communist regime.
Law No. 133/2015 "On the treatment of property and finalization of the property compensation process"	Establishment of the Agency for Property Treatment in charge of finalising the recognition and compensation process. The law repealed Law No. 7698/1993 "On restitution to and compensation of former owners" and Law No. 9235/2004 "On restitution and compensation of property".

Source: Authors' own work based on Venice Commission (2019[102]), *Albania – Opinion on the draft law on the finalisation of transitional ownership processes, adopted by the Venice Commission at its 120th Plenary session, Venice, 11-12 October 2019*, www.venice.coe.int/webforms/documents/?pdf=CDL-AD(2019)023-e.

Land redistribution commenced in 1991 and did not immediately consider compensating original owners for land expropriated by the communist regime. Under the guidelines of Law No. 7501/1991 "On land" *ad hoc* village-level commissions distributed ownership and usage titles to members and employees of the dissolved co-operatives and state farms. These certificates had to then be registered in the national cadastre, thus linking the acquired titles to a centralised map of parcels. Implementation of the law, however, was imperfect. Landowners who could not register their certificates due to cadastral maps and distrust of the cadastral offices ended up holding essentially illegal titles (Venice Commission, 2019[102]). Commissions in about half the villages defied the law and distributed plots according to pre-1945 boundaries. Law No. 7698/1993 "On restitution to and compensation of former owners" disrupted the redistribution process and recognised all former ownership of agricultural land that had been nationalised, expropriated or confiscated. By then, however, 700 000 ha of collective and state farmland had already been redistributed to nearly 500 000 family farms (Hartvigsen, 2013[103]).

Since the 1990s, concomitant but separate frameworks have regulated land ownership and the right to compensation, although the two issues are necessarily intertwined (Table 5.7). A 2015 law tried to settle the issue of restitution and compensation, but implementation seems to have been largely defective. For example, two different agencies carry out title registration and the finalisation of restitution (Venice Commission, 2019[102]).

Corruption remains a challenge

Corruption is still perceived as a serious problem in the country. According to the World Bank Enterprise Survey, 43% of firms identified corruption as a major constraint, with the bribery value amounting to 30% of the transaction, on average. Both the incidence and depth of bribery in Albania are the highest among Western Balkan economies. Gifts are usually given to tax officials during inspections or to public officials more generally in order to get things done (Table 5.8). Corruption undermines public services provision. University of Tirana students may be obliged to give gifts in exchange for grades or to purchase their professors' textbooks (Youth Council of the U.S. Embassy in Albania, 2017[104]). Some 68% of respondents in a recent survey reported having bribed doctors or nurses to get treatment in public hospitals (Krasniqi et al., 2019[105]). Corruption may also take the form of vote buying, obscure party financing and patronage in the public administration.

Table 5.8. Gift-giving and bribery are widespread in Albania compared to other Western Balkan economies

Objects of bribery (% of firms giving bribes)

	Albania	Bosnia and Herzegovina	Kosovo	Montenegro	North Macedonia	Serbia	OECD
Tax officials	34.6	14.4	1.8	22.8	3.7	1.2	0.1
Government contract	15.3	8.2	0.9	7	16.8	3.1	6.3
Operating license	8.9	12.7	1.1	20.7	0.7	17.8	3.5
Import license	16.3	1.6	0.9	18.7	7.9	4.5	0
Construction permit	16.8	11.7	6.8	19.5	8	16.7	0.1
Electrical connection	16.8	5.5	10.8	12.6	9.7	8.8	0
Water connection	9.8	1.2	0	0	1.3	0	0
Get things done	31.6	10.6	6.5	17.1	4.3	7.8	2.8

Note: Firm-level survey of a representative sample of an economy's private sector (manufacturing firms only).
Source: WB/EBRD/EIB/EC (2021[106]), *Enterprise Surveys* (database), https://www.enterprisesurveys.org/en/enterprisesurveys.

Albania has taken steps to fight corruption, but more coherence and co-ordination is required

Anti-corruption efforts in Albania are organised through a network of ministries, departments and institutions that prevent, investigate and prosecute cases (Table 5.9). Seven institutions have preventive mandates, which sometimes overlap. The National Coordinator for Anti-Corruption (NCAC), led by the Ministry of Justice, co-ordinates and oversees the implementation of the anti-corruption strategy through focal points in all relevant ministries and institutions. The Anti-Corruption Task Force (ATF) comprises five institutions and directorates inspecting civil servants' operations, dismissing those involved in misdemeanours and referring criminal cases to prosecution. The High Inspectorate of Declaration and Audit of Assets and Conflict of Interests collects public officials' assets declarations, and the State Supreme Audit Institution oversees public tendering. Concerning law enforcement, a new Special Anti-Corruption and Organised Crime Structure investigates criminal corruption and organised crime through a Special Prosecutor's Office and the National Bureau of Investigation. Dossiers are then transferred to a specialised court (first instance and appeal Courts for Serious Crimes) for trial.

Table 5.9. Key actors tackling corruption in Albania

Mandate	Institution in charge
Prevention	• National Coordination for Anti-Corruption • Anti-Corruption Task Force: ○ Central Inspectorate (*Inspektoratin qendror)* ○ Council of Ministers Unit for Transparency and Anti-Corruptionn *(Njësinë e transparencës dhe Antikorrupsionit në Kryeministri)* ○ Public Procurement Agency • High Inspectorate of Declaration and Audit of Assets and Conflict of Interests • State Supreme Audit Institution
Law enforcement (investigation and prosecution)	• Special Anti-Corruption and Organised Crime Structure (*Speciale për Korrupsion dhe Krim të Organizuar – SPAK*): ○ Special Prosecutor's Office ○ National Bureau of Investigation (*Byroja Kombëtare e Hetimit*) • General Directorate of the State Police, Ministry of Internal Affairs (*Policia e Shtetit*) • General Directorate for the Prevention of Money Laundering within the Ministry of Finance and Economy
Specialised courts	• Court for Serious Crimes (*Gjykata e Krimeve të Rënda*)

Source: Authors' work based on interviews with the Ministry of Justice.

Reforms of the anti-corruption framework have produced concrete results, but implementation capacity has yet to improve. In 2019, 2 257 corruption cases were referred for prosecution (2 126 in 2018), and 643 corruption case were sent to court (513 in 2018). Between 2018 and 2019, 192 high-level state officials were prosecuted, 12 people were indicted, and 535 middle- and lower-ranking officials were convicted (European Commission, 2020[107]). Albania may need to streamline the current anti-corruption framework to consolidate its fight against bribery and gift giving. The NCAC and the ATF have partially overlapping mandates, and neither enjoy political or financial autonomy, which undermines their authority and their capacity to co-ordinate and to lead the anti-corruption effort.[28]

Vote buying, obscure party financing and patronage in the public administration are other forms of corruption

Vote buying and improper external influence damage the democratic process. According to a recent survey, 21% of Albanians have been offered money or a favour in exchange for a vote in national or local elections (Popovikj, Gjuzelov and Bliznakovski, 2019[108]).[29] Party financing is also likely to steer the outcome of elections by putting parties on an unequal footing during electoral campaigns. Organised crime groups with political ties seem to have influenced the voting process in past legislative elections. The existence of such allegations demonstrates the system's susceptibility to illegal conduct and thus the need for corruption-proof electoral reform. The Central Election Commission, a permanent agency responsible for managing parliamentary and local elections needs more autonomy and capacity to monitor donations to parties and campaign spending.

Albania has long struggled with political patronage, but recent reforms of the public administration have improved the professionalism of public officials. Fierce ideological conflict accompanied the transition to democracy in the 1990s and facilitated winner-takes-all forms of governance. Changes of government often entailed reshuffling the public administration, dismissing (especially senior) civil servants considered closed to opposition parties and hiring more like-minded civil servants (BTI, 2020[109]; Elbasani, 2008[110]). The high turnover wore out the public administration's collective knowledge and created conditions for continuous changes to the legislative framework and inconsistencies and contradictions. Recent reforms have started breaking this vicious circle. Recruitment has become fairer and more transparent thanks in part to the introduction of a fully digitalised recruitment and selection process for civil service. However, proper and full implementation has yet to be ensured, especially at the local level (European Commission, 2020[94]).

The limited local fiscal and administrative capacity and the unclear regional development framework may exacerbate regional inequalities

Regional development in Albania is unequal, and human and capital resources are concentrated in few areas. Albania has 12 qarku and 61 municipalities (bashkite).[30] Half the population lives in 9 municipalities and 3 qarku. Fier, Gjirokastër and Tirana together account for one-third of the country's GDP. There are also large regional inequities in access to social security and health insurance: coverage is up to five times higher in the Tirana metropolitan area than in other regions (see the People section in this chapter).

Historical and modern approaches to regional development can explain today's territorial imbalances. Between 1945 and 1991, the communist regime tightly controlled the distribution of capital and human resources across the country: it regulated production activities in each municipality, restricted internal migration and established collective and state farms to fulfil autarchic ambitions. The dissolution of co-operatives in 1991 left rural households with few economic opportunities and forced migration abroad or towards cities. Peripheral areas gradually emptied.[31] The decentralisation process accelerated in 2013, and important reforms were implemented in 2014 and 2015.

Today, a regional development agenda exists but is treated separately from the ongoing decentralisation process. This risks undermining the inclusivity of regional development plans (designed at the central level) and their feasibility, since they do not take into account the municipalities' administrative, political and fiscal implementation capacity.

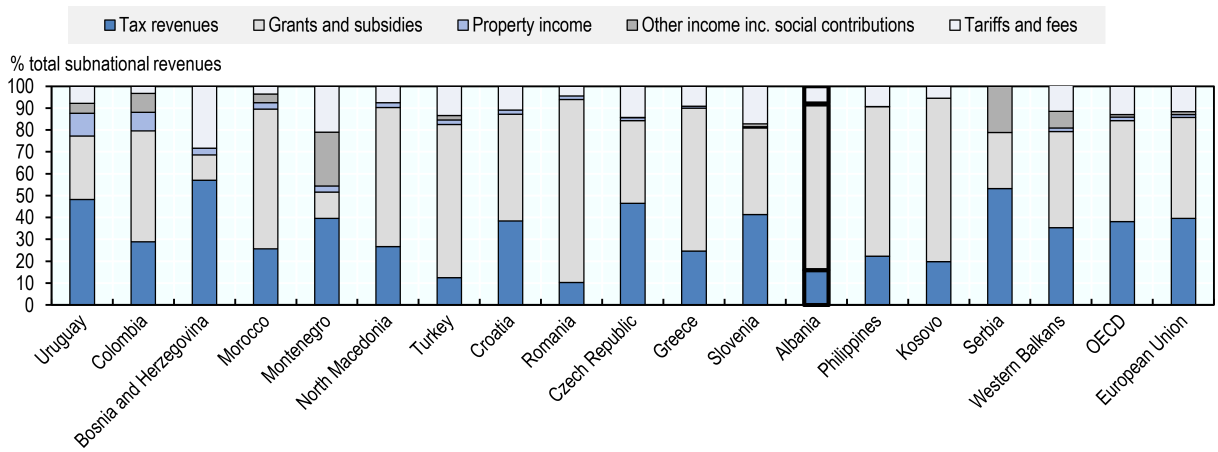
The decentralisation process is ongoing, but local fiscal and administrative capacities remain limited

The National Crosscutting Strategy for Decentralization and Local Governance 2015-2020 guides reforms of the power of local authorities and their relationship with the state. The strategy is part of the framework of public administration reform, together with strategies for anti-corruption, digitalisation and public finance management. Other milestone documents regulating the decentralisation process include Law No. 115/2014 "On administrative-territorial division of local government units in the Republic of Albania" (approved in 2014); the new Law No. 139/2015 "On local self-governance" (approved in 2015); and the new Law No. 68/2017 "On local government finance" (approved in 2017).

In the attempt to narrow territorial inequalities, municipalities have been granted more autonomy and power to provide goods and services.[32] In 2013, the number of municipalities was reduced from more than 300 to 61 to create economies of scale and optimise service delivery. Municipalities have taken on more responsibilities.[33] Since 2013, overall subnational expenditure has slightly increased to 16% of total public expenditure, lower than the OECD average (39%) but in line with the rest of the region. Capital spending has risen at the expense of current expenditure (from 24.3% of total subnational expenditure in 2013 to 27% in 2016) and mostly targets the construction and rehabilitation of local roads and public spaces, as well as sewers and water distribution (OECD/UCLG, 2019[111]). Current expenditure is one of the lowest in the region both in shares (73% of subnational spending) and per capita (USD 387 per person) and is mostly directed towards social spending and staff compensation (30% and 25%, respectively).

Figure 5.24. Own tax revenues are very low compared to the rest of the region and OECD standards

Composition of subnational revenues, latest available year



Source: Authors' calculation based on (OECD/UCLG, 2019[111]), *Report of the World Observatory on Subnational Government Finance and Investment – Key Findings*, www.sng-wofi.org/reports/Key_Findings_2019.pdf.

StatLink https://doi.org/10.1787/888934242213

Local fiscal capacity remains limited, and the allocation of central transfers needs improvement. Own tax revenues amount to 16% of total subnational revenues, compared to 35% in the rest of the Western Balkans. Grants and subsidies represent up to 76%, compared to 44% in the region (Figure 5.24). Most of these transfers are block grants distributed based on demographic parameters that are likely outdated. The number of residents, for instance, is based on 2011 census data and civil registration offices, which might not factor in migration flows within the country and abroad. The current system of resource redistribution may therefore underestimate local service users and exacerbate rather than reduce territorial inequalities (AAM/HSS, 2019[112]). High-frequency demographic data collection could help fine-tune the system. There are also conditional transfers that reward local governments submitting quality projects; yet, distribution seems guided by political criteria rather than merit (Merkaj, Zhllima and Imami, 2017[113]), and disbursement is sometimes hampered by lack of local implementation capacity.

The action plan of the crosscutting strategy seeks to enhance the capacity of local governments. In particular, upcoming reforms will expand the adoption of ICT and the provision of integrated administrative services in all municipalities (Box 5.1), strengthen the dialogue between central and local governments and foster mutual accountability practices. Quality local governance is another strategic goal. Policies will aim to increase transparency and accountability, expand e-governance and strengthen community structures at the local level. Strengthening of EU Integration Network Units across all municipalities will foster the process of integration of subnational governments into the European Union.

Box 5.1. The 2020 digital revolution of public services in Albania

Public service provision in Albania is undergoing a radical transformation. Authorities have been putting an increasing number of services on line. e-Albania acts as a digital one-stop shop, allowing citizens to access more than 750 e-services any time. For each online application, citizens are assigned a unique identifier through which they can interact with the administration by providing documents and can track the status of their request. The portal facilitates interaction among state institutions, which through the exchange of relevant documents, reduces the burden of administrative procedures on citizens and enterprises. The system also accelerates the exchange of documents, which are increasingly certified by the digital signature of the applicant or of the civil servants involved.

The capacity of the public administration has been improving to absorb this ICT innovation. Some 2 000 civic employees have been trained to help citizens access e-Albania services. Some parts of the administration have rationalised and digitalised internal processes, cutting red tape. On average, citizens and businesses have to provide fewer documents per application than before.

The digitisation of public services has led to significant savings and can increase institutions' resilience to emergencies. The National Agency for Information Society (NAIS) estimates that it has cut the waiting time to receive business-related documents by 20 years and eliminated more than 4 million papers originally required for construction permits (it is now a paperless system). e-Albania has helped institutions manage the COVID-19 pandemic: citizens could apply for special permission to leave the house during the emergency, and system's interconnectedness ensured that only one person per family or per authorised business and its employees could apply per day. More than 6 million applications were filed on e-Albania. After real-time validation, citizens received authorisation via email or SMS with a QR code to show authorities upon request.

NAIS has developed a three-phase action plan to digitalise 90% of public services by December 2020.

Source: Information provided by NAIS for this initial assessment in September 2020; presentation by NAIS at the 28th OSCE Economic and Environmental Forum (www.osce.org/files/f/documents/3/d/454948.pdf).

The regional development framework has been separated from the decentralisation process

There is no intermediate government level co-ordinating intermunicipal policy efforts to tackle territorial inequalities. This role was originally assigned to the qarku, which are both "the unit[s] where regional policies are made and implemented" (Constitution, Art. 110) and local government institutions (according to the Law "On the organization and functioning of local government", superseded by Law No. 139/2015 "For local self-governance"). The common interpretation is that the qarku should facilitate co-ordination across municipalities and supervise their activity on behalf of the central government. The creation of the qarku was necessary to channel regional development funds under the EU Instrument for Pre-Accession (IPA) Framework. In practice, the qarku have a vague mandate.[34] They lack legitimacy, since their borders were drawn irrespective of historical heritage or identities. The state and the municipalities have been reticent about sharing or giving up power to a new intermediary subnational level (Shutina, 2019[114]). Because the future of regional development policy is intertwined with that of the qarku and their governance, lawmakers have long refrained from discussing a regional development framework and completing the decentralisation process.

A new regional development framework was recently adopted. In 2015, the government introduced four Regional Management Areas, which have no administrative competences but have regional development agencies that operate under both the National Agency for Regional Development (NARD) and the Regional Economic Development Agency (REDA). By defining a set of regions without self-government, lawmakers unbundled the discussions on regional development policies and the governance of regions. This move has the merit of revamping the regional development agenda but raises issues of subsidiarity and citizen ownership of future regional policies. Through the Decision of the Council of Ministers No. 438 dated 18 July 2018, the government replaced the NARD and the REDA with the Albanian Development Fund, further centralising the management of regional development plans and weakening accountability to citizens in each region. The fund manages all local and infrastructure projects, as well as the "program of 100 villages", which the government launched to reduce disparities between urban and rural areas.

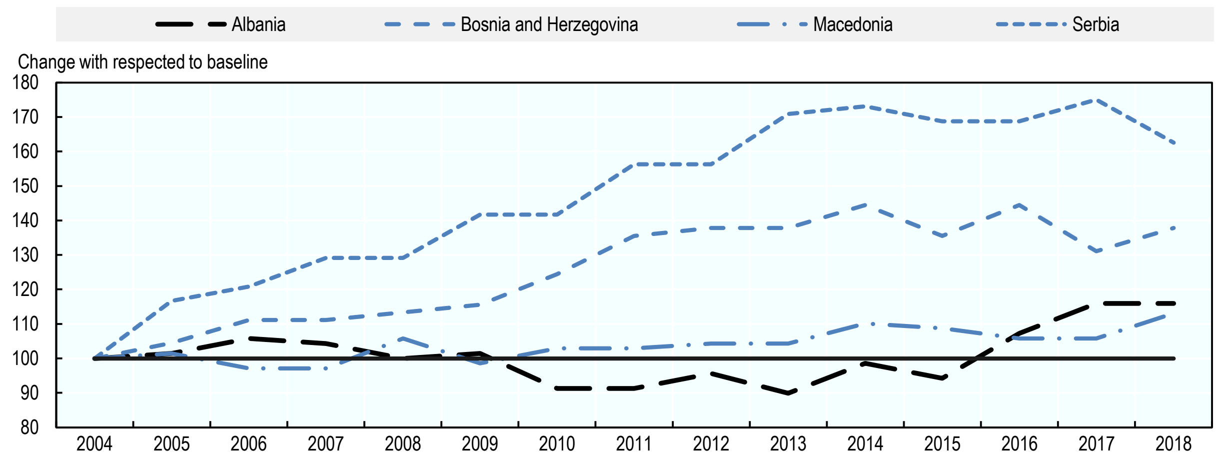
The statistical capacity has improved significantly, but the access to administrative data and sound quality-management frameworks lag behind

The national statistical system (NSS) of the Republic of Albania consists of the Institute of National Statistics (INSTAT), the Bank of Albania and the Ministry of Finance and Economy. Other data producers include local statistics departments, line ministries or other central institutions' statistics departments, such as civil registrar offices.[35] Law No. 17/2018 "On official statistics" strengthens the role of the INSTAT as central co-ordinator of the NSS, and defines it as an independent institution with administrative and financial autonomy, reporting directly to the parliament. The Statistical Council is the body in charge of advising INSTAT in its role implementing statistical activities. It comprises 11 representatives from statistical agencies, academia, civil society, local governments, the media, users of official statistics and private entrepreneurs.

Over the past five years, Albania improved its statistical capacity significantly (Figure 5.25). The country is among the best performers in the region for foundational data, such as vital registration data, population censuses and poverty and health surveys, mainly driven by the improved periodicity of data collection. The country has been collecting and reporting data in a more timely and regular way, especially in areas that used to present large gaps, such as HIV/AIDS rates, gender equality in education and primary school completion rates (World Bank, 2020[115]). Indicators on coverage and data openness confirm these positive trends for the key areas of economic, social and environmental statistics (Open Data Watch, 2018[116]). Albania has subscribed to the Enhanced General Data Dissemination System, a framework for developing a clear roadmap to achieving higher data dissemination standards at a pace consistent with evolving statistical capacity (IMF, 2020[117]). Communication with data users, especially the media, has also improved: for example, in the past two years, the NSS issued press releases on a quarterly basis (PARIS21, 2020[118]).

Figure 5.25. Overall statistical capacity has improved in Albania

Relative changes in the Overall Statistical Capacity Index with respect to the baseline year (2004 = 100)



Source: World Bank (2020[115]), *Statistical Capacity Indicators* (database), https://databank.worldbank.org/reports.aspx?source=Statistical-capacity-indicators.

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Despite overall improvements, capacities in reporting some economic statistics are lacking. Export price indices, which can be used to forecast inflation, are not available monthly or quarterly (while import price indices are) (Table 5.10). While the new statistical law gives INSTAT and the other statistical authorities a strong mandate to collect administrative data from line ministries and governmental agencies, the leading statistical agencies lack the capacities to establish efficient co-ordination mechanisms at the national and subnational levels. To improve the use of administrative data in official reporting, INSTAT could establish a quality management steering committee to discuss areas of improvement and develop data quality guidelines to be followed by all line ministries (Hackl, Redmond and Carlquist, 2018[119]).

Last, Albania is exposed to rapid social changes that require innovative statistical strategies. The large migratory movements and pertinent outward risks make the population census, which usually takes place every ten years, obsolete. Consequently, policy makers have no clear, precise and up-to-date overview of local socio-economic conditions. As discussed, this can also have severe repercussions to resource distribution across regions and municipalities. High-frequency demographic data collection via mobile phone surveys could provide a cost-efficient alternative to traditional household surveys and support the policy-making process. A second option could involve geospatial data integrated into administrative data to create a census, as is currently being explored in Slovak Republic (Gabris, 2019[120]). The infrastructure for such new forms of data collection needs to be established and NSO staff adequately trained to ensure high-quality and reliable data.

Table 5.10. Timely economic statistics are not always available

Availability of selected economic statistics, 2018

Economics statistics	Albania	Bosnia and Herzegovina	North Macedonia	Serbia
Balance of payments manual in use	✓	✓	✓	✓
Consumer price index base year	✓	✓	✓	✓
External debt reporting standard	✓	✓	✓	✓
Government finance accounting			✓	
Import and export price indices				
Industrial production index	✓	✓	✓	✓
National accounts base year	✓	✓	✓	✓
Special Dissemination Standard			✓	

Source: World Bank (2020[115]), *Statistical Capacity Indicators* (database), DataBank, World Bank Group, Washington, D.C., https://databank.worldbank.org/reports.aspx?source=Statistical-capacity-indicators.

Planet – conserving nature

The Planet pillar of the 2030 Agenda for Sustainable Development reflects the need to find the right balance between socio-economic progress and capacity to sustain the planet's resources and ecosystems and to combat climate change. Minimising environmental degradation and improving the preservation of the country's resources, as emphasised in the National Strategy for Development and Integration 2014-2020, is needed and will be key for making Albania's growth more sustainable and for enhancing the well-being and quality of life of all Albanians (Republic of Albania Council of Ministers, 2013[121]).

The Planet section in this chapter identifies three major environmental constraints the country faces in its development path. First, Albania remains highly exposed and vulnerable to earthquakes, floods, droughts and extreme temperatures, with 86% of its territory prone to at least two or multiple natural hazards (Duro, n.d.[122]). The underdeveloped land-use planning and the uncontrolled development of illegal construction increase the risk of physical and property damage. Second, environmental quality is deteriorating due to persistent challenges in managing solid waste and reducing air pollution and inequalities in access to water services. Better enforcement and implementation of the environmental legislation and a more transparent decision-making process will be essential. Third, while Albania does not rely on domestic coal for energy production, the continued expansion of its main energy source, hydropower, comes with serious consequences for the environment and water resources. Overall, environmental concerns seem to remain secondary in Albania, as in other regional economies, but the prospect of EU accession will be a driver of environmental reforms (Table 5.11).

Table 5.11. Planet – three major constraints to a more sustainable development in Albania

1. Albania is exposed and vulnerable to natural hazards.
2. Deterioration of the environmental quality of life remains a challenge.
3. The expansion of hydropower plants has a detrimental impact on the country's environment and water resources, and other renewable energy sources are underdeveloped.

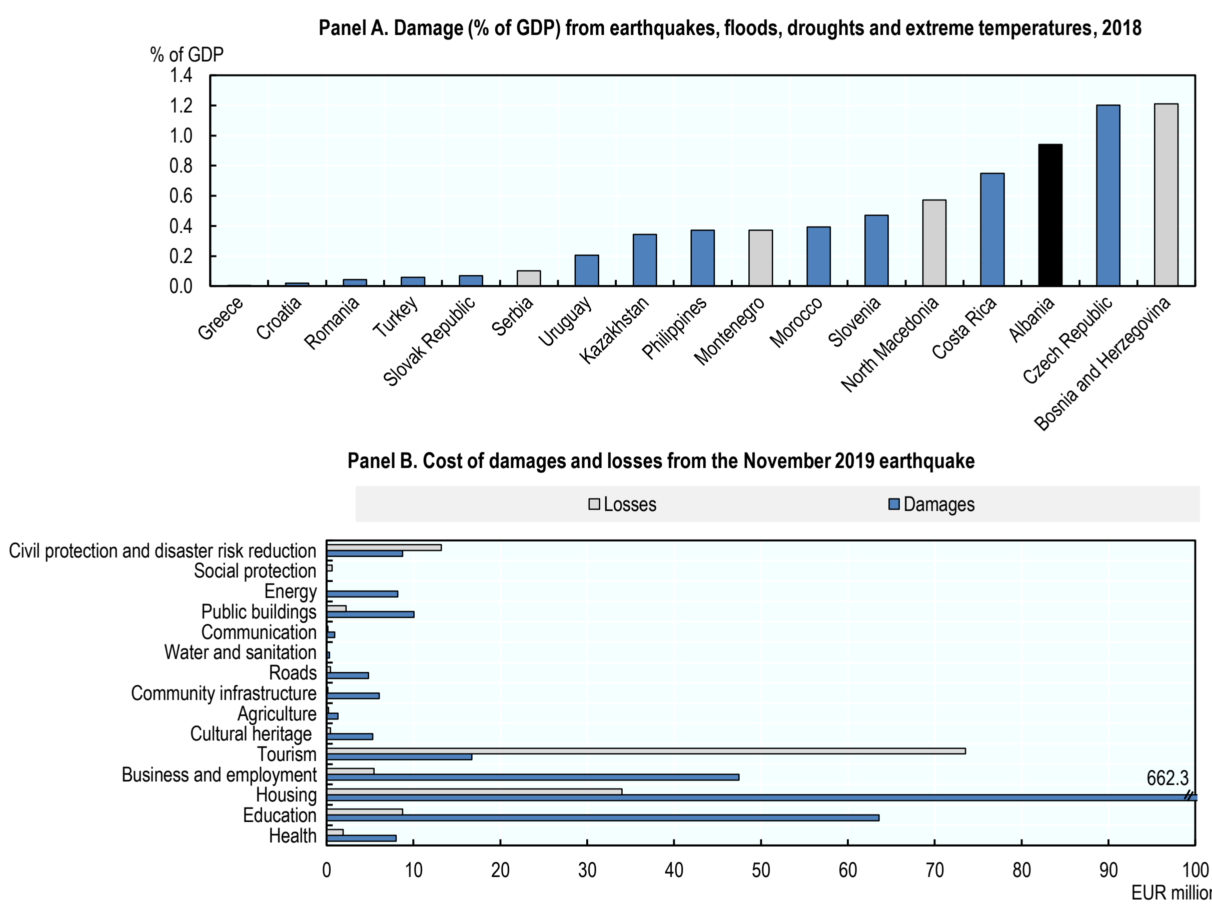
Albania is vulnerable to natural hazards

Albania faces earthquakes, floods, droughts and extreme temperatures

Albania is among the European countries with the highest exposure to hydrometeorological and geophysical hazards (Reliefweb, 2017[123]). Hydrometeorological hazards are frequent in Albania and the Western Balkan region. Floods accounted for the major share of disaster events between 1979 and 2019 (38%), followed by earthquakes (15%) (EM-DAT, 2020[124]). The economic loss caused by floods is estimated at EUR 2.12 billion (FAO, 2018[125]). Albania ranks high for hazard-related damages relative to other economies (Figure 5.26 – Panel A).

The 6.3 magnitude earthquake of 26 November 2019 caused significant destruction. The earthquake was one of the most devastating in the last decades, causing damage in 11 municipalities, including the most populous, Durrës and Tirana. Some 202 291 people were affected, 51 died, at least 913 were injured and around 17 000 were displaced. The earthquake is estimated to have cost around EUR 985.1 million[36] and caused damages equivalent to 6.4% of the 2018 GDP and losses equivalent to 1.1% of GDP (EU/UNDP/World Bank, 2020[126]). Most of the damages were recorded in the housing sector (78.5%), followed by the productive sector (8.4%) and the education sector (7.5%). The productive sector accounts for the highest share of losses (56.4%) (Figure 5.26 – Panel B). Some regions, especially Fier and Tirana, are more vulnerable to earthquakes than others (World Bank/GFDRR, 2017[127]).

Figure 5.26. Albania is vulnerable to earthquakes, floods, droughts and extreme temperatures



Note: Panel B: the assessment focused on estimating the damages and losses caused by the 26 November 2019 earthquake in Albania. Damages are defined as a partial or total destruction of infrastructure of physical assets. Losses are defined as the value of reduced production or income, as well as additional costs of unexpected costs to deliver the same services or functions.
Sources: EM-DAT (2020[124]), *EM-DAT* (database), www.emdat.be; EU/UNDP/World Bank (2020[126]), *Post-Disaster Needs Assessment,* www.undp.org/content/undp/en/home/librarypage/crisis-prevention-and-recovery/pdna.html.

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Climate change is expected to make Albania more arid, with significant social and economic impacts. Albania's Mediterranean climate is characterised by hot, dry summers and mild winters with abundant precipitation. International climate change models predict significant temperature rise and lower precipitation in all scenarios (Ministry of Environment, 2016[128]) (Table 5.12). This will have challenging impacts on agriculture and tourism, which employ a significant share of the workforce. The dominance of rain-fed agriculture makes the sector particularly vulnerable. Precipitation is essential to Albania's electricity production: almost 100% comes from hydropower.

Table 5.12. Like other Western Balkan economies, Albania is highly vulnerable to climate change

Change in mean annual temperature (°C) with respect to the base period (1986-2005) for the RCP 4.5 and RCP 8.5 scenarios of GHG emissions

	Albania		Bosnia and Herzegovina		Kosovo		Montenegro		North Macedonia		Serbia	
RCP	**4.5**	**8.5**	**4.5**	**8.5**	**4.5**	**8.5**	**4.5**	**8.5**	**4.5**	**8.5**	**4.5**	**8.5**
2016-2035	0.5-1	0.5-1	0.5-1	0.5-1	0.5-1	0.5-1.5	0.5-1	0.5-1.5	0.5-1	0.5-1.5	0.5-1	0.5-1.5
2046-2065	1-2	1.5-3	1-2	1.5-3	1.5-2	2-3	1-2	1.5-3	1.5-2	2–3	1-2	1.5-3
2081-2100	1.5-2	4-5	1.5-3	4-5	2-3	4-5	1.5-3	4-5	2-3	4-5	1.5-3	4-5

Notes: GHG = greenhouse gas. RCP = representative concentration pathway. The mean annual temperature corresponds to the average of the maximum and minimum temperatures of a year, taking the mean average of the coldest month of the year and averaging it with the mean average of the hottest month of the year. The RCP 4.5 refers to a stabilisation scenario and RCP 8.5 to a continuous rise of GHG emissions scenario.
Source: RCC (2018[129]), *Study on Climate Change in the Western Balkans Region*, www.rcc.int/pubs/62.

Albania has improved disaster-prevention legislation, but implementation remains a challenge

Albania recently improved natural hazard legislation. It elaborated a comprehensive Strategy on Civil Protection and Disaster Risk Reduction. Law No. 45/2019 "On civil protection", adopted on 18 July 2019 and replacing the Law "On civil emergencies services" from 2001, constitutes the economy's main legal framework and introduces the concept of disaster risk reduction (DRR).[37] The Normative Act "On damage relief from natural disasters" was adopted through Law No. 97/2019 on 16 December 2019, and the Decree No. 887 "Determining the rules and accelerated procedure for drafting and the approval of the compulsory local plan as well as the procedure for the approval of development/construction permits in the case of natural disaster" was adopted on 12 December 2019. Furthermore, 43 municipalities have drafted and approved General Local Plans, which include elements of DRR, identify areas at risk of natural hazards and address risks.[38] In co-operation with the UNDP, Albania is preparing a National Strategy for Disaster Risk Reduction. To deal with the increased incidence of forest fires due to climate change, Albania is modernising and reorganising its firefighting system and forces, including training programmes and upgrading technical rescue and firefighting equipment.

Albania needs to address remaining weaknesses in preventing, reducing and responding to natural hazards. Albania's legislation on civil protection and DDR still needs to be fully implemented. All sub-laws at the national, regional and municipal levels, as well as other sectoral and cross-cutting strategies and plans, need to be harmonised with the new legislation. The integration of DRR into sectoral policies is important. DRR is relevant because it reduces the damage caused by natural hazards *ex ante* through prevention. The Strategy on Civil Protection and Disaster Risk Reduction has not yet been adopted.[39] The impact of the 2019 earthquake demonstrated the lack of modern and homogenous equipment for the operational forces, the lack of skilled human resources and the insufficient training in emergency co-ordination (EU/UNDP/World Bank, 2020[126]). It highlighted the importance of adequate capacities to anticipate, forecast, monitor, warn and inform on the risks linked to multiple hazards, which the economy needs to develop.[40]

The absence of land-use planning based on identified hazards and risks exacerbates the economy's vulnerability. Building codes are outdated, and seismic hazard maps are not regularly updated. Albania needs to adopt a robust regulatory framework, where quality control is enforced and co-ordination between national and local levels is ensured (see the Peace and institutions section in this chapter). Fighting illegal construction remains a challenge. It is estimated that at least six Durrës hotels destroyed by the earthquake were built illegally. Alignment to and compliance with EU construction standards represent an opportunity to improve land-use planning and reduce seismic risks.

Albania is on the right track towards improving DDR budgeting but must improve insurance coverage. The new normative framework on civil protection and DDR, adopted in 2019, establishes that each central ministry should have a separate budget line for DRR and civil protection activities (between 2% and 4% of the annual budget) and that municipalities should allocate at least 4% of their budgets. However, these measures need to be adequately implemented at the national and subnational levels. Market penetration of disaster insurance remains very low in Albania and in the Western Balkan region (OECD, 2015[130]). Only 1-2 houses per 100 are insured (World Bank, 2017[131]). As the housing sector was one of the most affected by the 2019 earthquake, making insurance against catastrophes compulsory for every business and household will be key (see the Partnerships and financing section in this chapter).[41]

Preserving the quality of Albania's environmental resources is crucial for development

The environmental quality and the rich biodiversity are important assets for Albania and its quality of life. The economy is well known for its diversity of ecosystems and habitats; rich and complex hydrographic network of rivers, lakes, wetlands, groundwater and seas; and large number of plant and animal species (CBD, n.d.[132]). Some 28% of Albania's territory is covered by forests (World Bank, 2020[1]), and there are opportunities to develop and exploit the forest sector further. Albania's rich biodiversity also offers opportunities for tourism and agriculture and is an important element of quality of life.

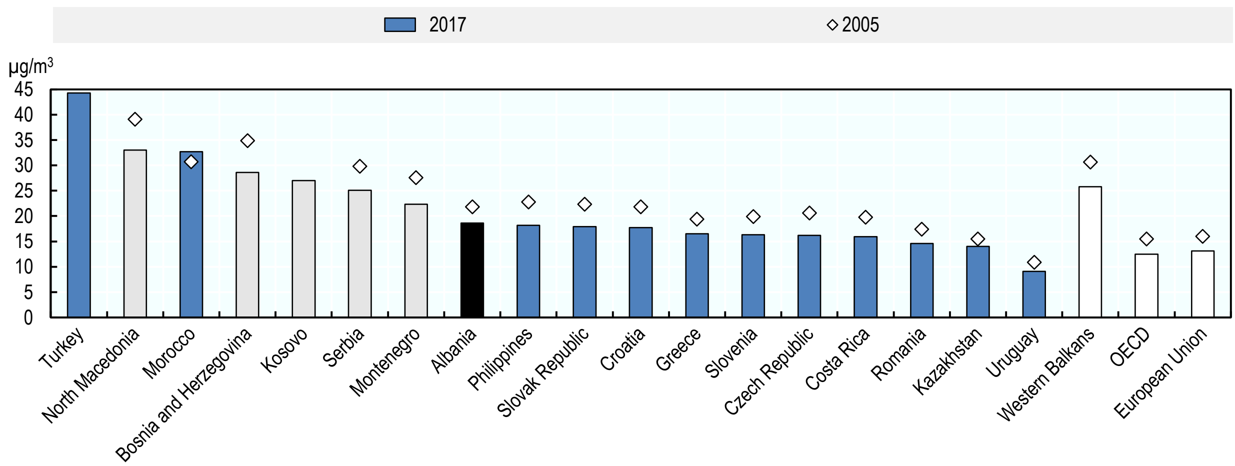
The preservation of biodiversity can contribute to the economy's resilience against natural disasters. Forests protect against flooding, vegetation on steep slopes protects against landslides, wetlands provide overflow reservoirs for rivers, and protected areas stabilise soils, prevent desertification, preserve drought-resistant plants and help maintain natural wildfire patterns (Ministry of Environment of Japan/CEM, 2015[133]). More biodiverse agriculture preserves soil quality and protects against soil erosion while simultaneously being less affected by natural disasters, such as droughts and flooding, compared to monocultures.

Air pollution is a serious concern

Air pollution has declined but remains an important concern, with impacts on health and the economy. The country's annual exposure to PM2.5 is 18.2 μg/m^3, which is the best value in the region and an improvement from 2005 but above the EU and OECD averages (13.1 μg/m^3 and 12.5 μg/m^3, respectively) (Figure 5.27). Three-quarters of Albanians consider pollution a serious problem (Figure 5.28). The mortality rate due to air pollution in Albania is slightly lower than in other Western Balkan economies but remains double the EU average and 2.5 times the OECD average (Figure 5.29).

Figure 5.27. Albania's exposure to PM2.5 is below the regional average but above the OECD and EU averages

Mean exposure to PM2.5, 2017 and 2005



Note: Mean population exposure to fine particulate matter is calculated as the mean annual outdoor PM2.5 concentration weighted by population living in the area. It is the concentration level, expressed in µg/m³, to which a typical resident is exposed throughout a year. Data for Kosovo are for 2015-16 (local data reported to Eurostat. There are no data for Kosovo for 2005). Data for Turkey are for 2017 (World Bank).
Sources: OECD (2020[134]), *Green Growth Indicators* (database), https://stats.oecd.org/Index.aspx?DataSetCode=GREEN_GROWTH; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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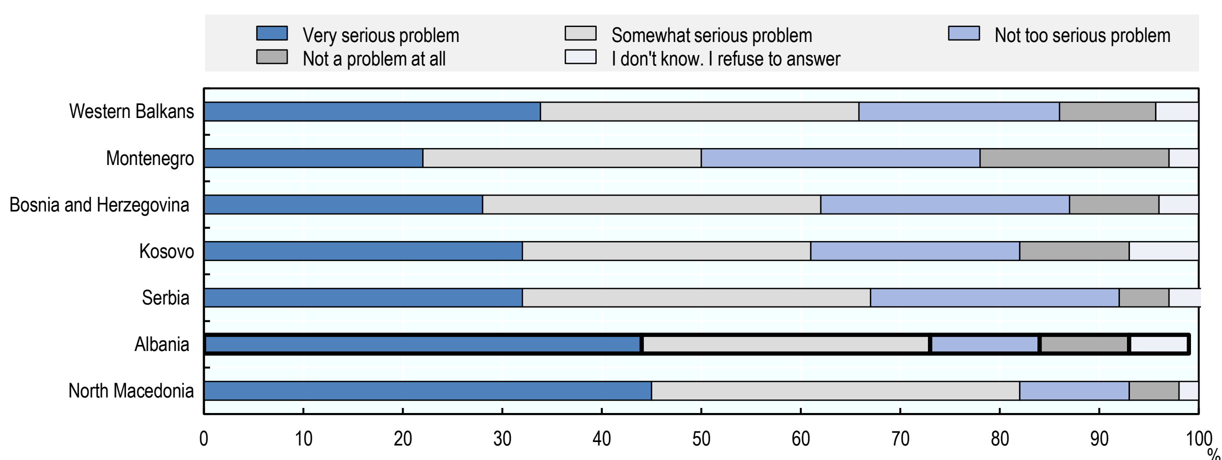
Figure 5.28. In 2019, almost three-quarters of Albanians considered pollution a serious problem



Note: Answers based on the question, "Do you consider pollution to be a problem in your place of living?"
Source: RCC (2019[72]), *Balkan Barometer 2019: Public Opinion Survey*, www.rcc.int/pubs/89/annual-report-of-the-secretary-general-of-the-regional-cooperation-council-2019-2020.

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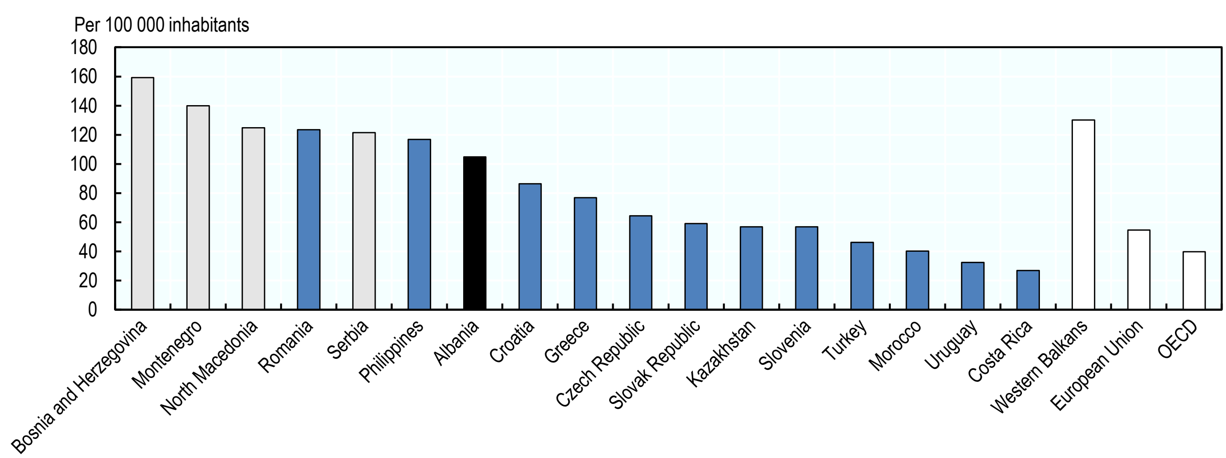
Residential heating and transport represent significant sources of air pollution, especially in Tirana and large urban areas. The transport sector accounts for 45% of overall carbon dioxide (CO_2) emissions,[42] and road transport is by far the largest contributor (Ministry of Environment, 2016[128]). Nearly

87% of all cars owned by Albanians are over 10 years old, and almost 20% are over 20 years old. Some 86% of buses are over 10 years old, and one-third are over 20 years old (INSTAT/Institute of Public Health/ICF, 2018[46]). The number of passenger cars increased by 94% between 2009 and 2014 (UNECE, 2018[135]). Domestic heating also negatively affects air quality. There is no district heating infrastructure, and like in much of the Western Balkan region, a large proportion of Albanians use old stoves and wood-burning fireplaces for residential heating (UNECE, 2018[135]). PM pollution is therefore particularly high in winter. Alignment to and compliance with EU standards on gas heating and vehicle emissions represent an opportunity for Albania to reduce air pollution.

Albania needs to continue improving air quality and start regularly assessing the impact of air pollution on public health. Albania approved the National Plan for the Management of Air Quality in June 2019 to improve air quality management. Currently, the country operates seven automatic stations measuring air pollution: two in Tirana and one in Elbasan, Durrës, Korçe, Shkodër and Vlorë. Moreover, air quality data are inaccurate, as the country has no accredited laboratories for analysis (UNECE, 2018[135]). To inform policy and public health considerations, air quality monitoring should include regular assessment of the impact on health (see the People section in this chapter).

Figure 5.29. The mortality rate due to air pollution in Albania is below the regional average but more than double the EU average and 2.5 times the OECD average

Mortality rate attributable to household and ambient air pollution (per 100 000 inhabitants), 2016



Source: WHO (2016[136]), *Global Health Observatory data repository – Burden of disease SDG 3.9.2 Mortality rate attributed to unsafe water, unsafe sanitation and lack of hygiene (exposure to unsafe Water, Sanitation and Hygiene for All (WASH))*, https://apps.who.int/gho/data/view.main.SDGWSHBOD392v.

StatLink https://doi.org/10.1787/888934242308

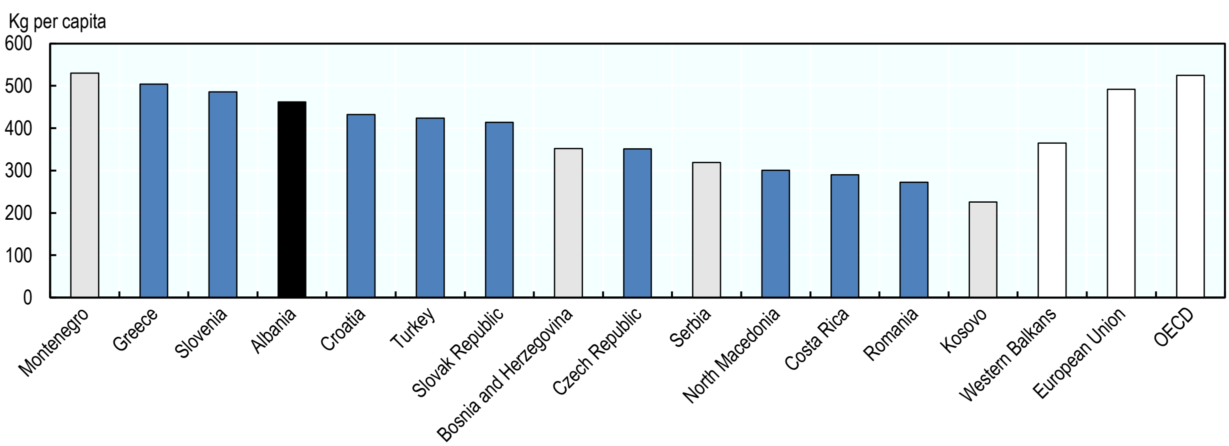
Solid waste management and recycling are lacking

Despite recent steps, solid waste collection and recycling need to be improved and better funded to reduce environmental pollution. Albanians produce, on average, 462 kg of waste per year, which is below the EU and OECD averages but above the Western Balkan average (Figure 5.30). The collection and disposal system was improved in recent years, but it needs further efforts, especially in rural areas. In 2019, 87.9% of Albanians were served by municipal waste collection, an important improvement from 2018 (65.7%) (INSTAT, 2020[137]). However, fees collected by the municipalities are low and cover less than half the cost of operation (UNECE, 2018[135]; UNEP, 2016[138]). Albania has only four sanitary landfills and one waste incinerator. The majority of waste is disposed of in illegal dumpsites, and sometimes waste is illegally burned or dumped in rivers. Untreated waste has an impact not only on air and soil pollution but also on the degradation of rivers and water resources. Recycling rates are difficult to estimate, and no precise data are available. Estimations suggest that recycling stands at 5% to 12% at the national level (UNECE, 2018[135]).

The government has ambitious waste-collection targets and is expanding capacity. The National Waste Strategy and National Waste Management Plan 2010-2025, approved in 2011, set the ambitious recycling rate target of 55% by 2020. A new strategic document and the National Plan for Integrated Waste Management 2020-2035 that promote recycling and a circular economy were approved in May 2020. Two waste incinerators are under construction to improve capacity.

Figure 5.30. Albania's waste generation rate is below the EU and OECD averages but above the Western Balkan average

Municipal waste generation (kg per capita), 2018



Notes: Data for Bosnia and Herzegovina and Greece are for 2017. There are no data for Kazakhstan, Morocco, Philippines or Uruguay.
Sources: Eurostat (2018[139]), *Eurostat* (database), https://ec.europa.eu/eurostat/data/database; OECD (2020[25]), *OECD Statistics* (database), https://stats.oecd.org.

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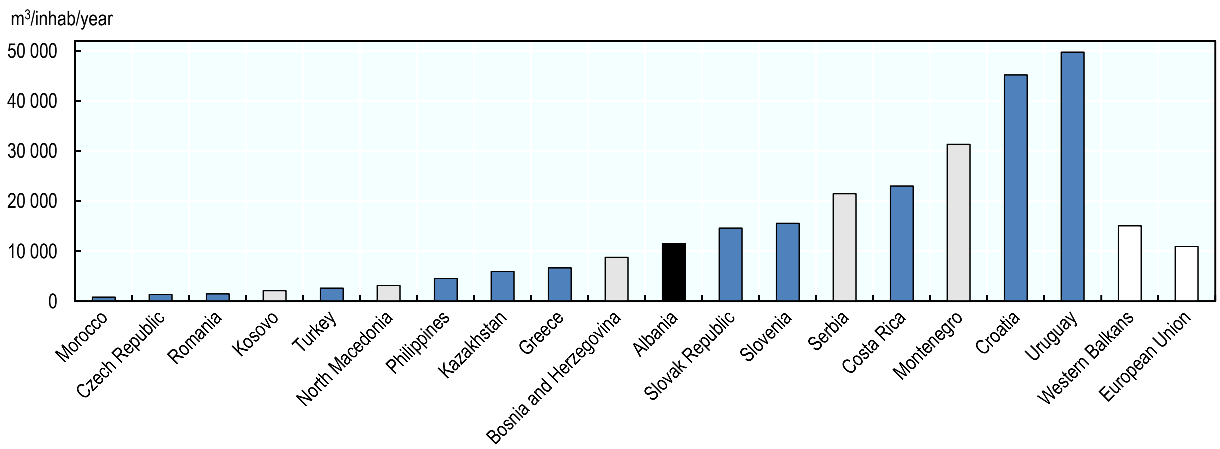
Managing water services is a considerable challenge and will increase in importance

Albania is relatively water rich, with many external inflows, making co-ordination with neighbours crucial for planning, especially in the context of climate change. Albania's 11 559.75 m^3 of water per capita per year is close to the Western Balkan average and above the EU average (Figure 5.31). The share of internal water resources is around 55%, and the remaining shares are external flows from Greece, Kosovo, Montenegro and North Macedonia (Eurostat, 2018[139]). The relatively high dependency on external sources makes co-operation in the management of river basins with neighbouring economies key for current and future water policies. As there is significant variation in water availability across municipalities, Albania will need to emphasise the development of river basin-level planning and transboundary collaboration. In June 2020, Albania approved the Seman Basin Water Management Plan. Transboundary river-basin management collaboration also represents the opportunity of a first step towards regional reconciliation. The need to co-ordinate and proactively manage water will increase with climate change and decreasing precipitation. This particularly affects the agricultural sector, which accounts for more than half of Albania's water extraction (Eurostat, 2018[139]) and depends on precipitation.

Figure 5.31. Albania is relatively water rich compared to the EU average

Total renewable water resources per capita (m3/inhab/year), 2017



Note: Data for Bosnia and Herzegovina, Kosovo and Montenegro are for 2016.
Sources: Eurostat (2018[139]), *Eurostat* (database), https://ec.europa.eu/eurostat/data/database; FAO (2015[140]), *Aquastat* (database), www.fao.org/nr/water/aquastat/data/query/results.html.

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Citizen satisfaction with water quality is low, and access to drinking water and sewerage systems needs to be improved in rural areas. Dissatisfaction with the quality of water services stands out in Albania (Figure 3.2). Access to drinking water and sewage services in 2018 stood at 93% and 80%, respectively, among urban populations and 59% and 15% among rural populations (Water Regulatory Authority of Albania, 2018[141]).

The division of responsibilities between the central and local levels is clearly established by the current normative framework on water, but entities in charge of water management are fragmented at the subnational level. The central government is responsible for strategy setting and implementation in the water sector; municipalities are in charge of service provision. The government has entrusted water tariff-setting responsibilities to the independent water regulator, the Albanian Regulatory Authority of the Water Supply and Waste Water Disposal and Treatment Sector. The sector is highly fragmented at the subnational level, as service provision is organised among 58 water utilities serving all 61 municipalities,[43] 8 of which are not properly licensed.[44] It will be important for Albania to align policies and legislation on water management with key EU water directives and to accelerate the capacity development of agencies in charge of water resource management, water supply, sewerage and waste (European Commission, 2020[12]).

Water infrastructure in Albania suffers from high losses and needs investment. Some 56% of water extracted for water supply networks does not reach end users, compared to 25% in the European Union (Globevnik et al., 2018[142]). Non-revenue water has been estimated at around 63% (Water Regulatory Authority of Albania, 2018[141]), which is slightly below the Western Balkan average (75%).[45] Metering coverage was around 74% in 2018, which remains low but could be much lower for municipal water utilities with a coverage of 20% (Water Regulatory Authority of Albania, 2018[141]). Continuous water supply remains a challenge. In 2018, pressurised water was supplied 12.7 hours per day, on average. Only 10 out of 58 water utilities (Bilisht, Fier, Fushë Arrëz, Konispol, Korçë, Lezhë, Librazhd, Maliq, Pogradec and Tropojë) could provide 24 hours of pressurised water supply throughout the year (World Bank/IAWD, 2015[143]). Even Tirana is unable to provide continuous water supply to all customers.[46]

Current revenues do not cover investment costs, and the central government must subsidise expenditures. In 2018, 37 out of 58 water utilities did not cover their operational costs and continued to rely on subsidies: the central government provided EUR 80 million for investments and EUR 8 million for operating costs. Some utilities also obtained financing from international financial institutions (World Bank, 2019[144]).

Better enforcement and implementation of environmental legislation is key

The Ministry of Tourism and Environment is established but needs more human and financial resources. Law No. 10431/2011 “On environment protection”, adopted in 2013, and the establishment of the Ministry of Tourism and Environment paved the way for the development of a body of environmental protection legislation in Albania.[47] After institutional changes in 2017, tourism activities were added to the ministry’s portfolio. The environmental agenda seems to be a low political priority, subordinated to the development of tourism.[48] In 2020, 52 ministerial staff were working on environmental issues, with an annual budget of about EUR 7.9 million.[49]

Albania made important steps to reform the enforcement and implementation of environmental legislation in the context of approximation with the EU acquis. It needs to continue to increase transparency and effectiveness at the local level. The National Inspectorate for the Protection of the Territory and the National Agency of Environment are responsible for environmental inspections. However, the capacity for adequate environmental inspections remains limited due to the lack of resources, the lack of co-ordination among inspectorial bodies at the national and local levels and the lack of transparency of inspectors’ work (UNECE, 2018[135]). Implementation of new environmental-related tasks resulting from the recent territorial reform is challenging for municipalities. Despite legal requirement, few have adopted local environmental plans. Albania will need to continue efforts to achieve the full alignment of environmental legislation with the EU acquis and the full implementation of existing legislation (European Commission, 2020[12]).

Transparent decision-making processes in environmental matters and an open dialogue with civil society and other stakeholders are important

Despite recent progress, the decision-making process in environmental matters could be improved and further implicate civil society and other stakeholders. The number of requests for environmental information is increasing, and consultations with civil society and other stakeholders have been organised. Albania made important steps to improve access to environmental information at the central level and needs to pursue these efforts at the subnational level. The engagement and integration of environmental NGOs into monitoring and decision making could be improved.

According to legislation, an environmental impact assessment and public consultation are required for hydropower plant construction. In the past, however, the format and procedure of public consultation has not always been respected, as was recognised by the administrative court in the Vjosa wild river case:[50] the impact assessment approved by the Ministry of Tourism and Environment in 2017 was conducted without the *in situ* examination of the project’s impact on groundwater and river species required by legislation. Regulatory impact assessments and public consultations are also mandatory for all new legislative initiatives, and these new management tools could help enhance and improve the environmental impact assessment process. Albania needs to review and improve environmental and strategic impact assessments on existing and planned projects (European Commission, 2020[12]).

The high reliance on hydropower gives Albania the most renewable energy profile in the region, but it cannot be expanded without environmental burden

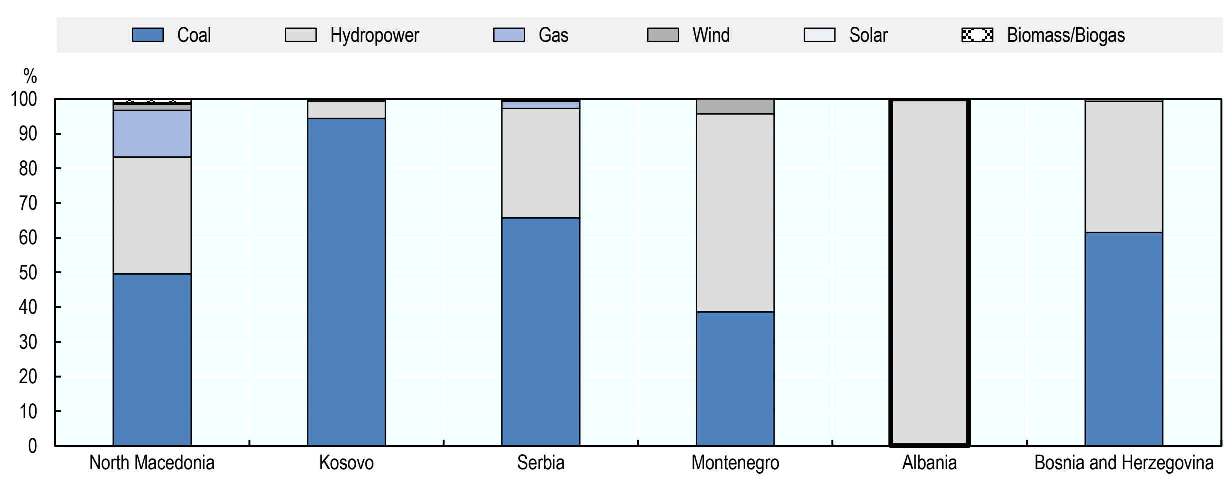
Albania relies on domestic hydropower and carbon-based imports for electricity generation. The country generates almost 100% of its domestic electricity from hydropower (Figure 5.32). The majority of big hydropower plants are situated in the river basins of Drini, Mati and Vjosa. Because of hydropower, the overall share of energy from renewable sources in Albania was 34.9% in 2018, higher than the Western Balkan and EU averages (28.81% and 18.9%, respectively) (Eurostat, 2018[139]). However, the electricity-generation capacity is insufficient for the economy's current needs, particularly when hydrological conditions are unfavourable. In response to variation in hydropower supply, Albania relies on importing carbon-based power from its neighbours. The share of imports ranges from 10% and 40% annually, depending on need.

Albania's energy mix has a higher share of petroleum and oil products than other regional economies. These products accounted for 48.9% of total energy supply and 51% of final energy consumption in 2018, the highest values in the region. This can be explained by the high share of the transport sector in final energy consumption: the sector accounted for 39.3% of final energy consumption in 2018, which is above the Western Balkan average (Eurostat, 2018[139]). To reduce their share in the energy mix, Albania must modernise the outdated vehicle fleet, including private cars and public buses.

Albania's potential for wind and solar energy can help reduce the economy's carbon footprint and prevent the mushrooming of small hydropower plants. Albania has considerable potential for wind and solar energy (European Commission, 2016[145]), but much of it can be better developed. Albania recently introduced feed-in-premium auctions for wind and solar energy, but they are not yet effectively implemented (Energy Community Secretariat, 2018[86]). The mushrooming of small hydropower plants has been problematic and negatively affects water resources and the preservation of biodiversity. In 2015, approximately 94 small hydropower plants were constructed in or near protected areas.[51] The EU integration process could help Albania diversify its electricity production away from hydropower and promote alternative sources of renewable energy, one of the European Union's key recommendations for Albania's energy sector for the coming year (European Commission, 2020[12]).

Figure 5.32. Albania generates almost 100% of its domestic electricity from hydropower

Electricity generation mix (%), 2018



Sources: Energy Community Secretariat (2020[146]), Energy Community Secretariat website, Annual reports, https://energy-community.org; Eurostat (2018[139]), *Eurostat* (database), https://ec.europa.eu/eurostat/data/database.

StatLink https://doi.org/10.1787/888934242365

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Notes

[1] The national estimate of the birth sex ratio in 2019 was 109 boys born for every 100 girls.

[2] Youth unemployment rates (aged 15 to 24) between 2012 and 2019 dropped by about 3.1 percentage points to 26.7%, which is relatively low compared to the Western Balkan average of 30.4% (World Bank/Vienna Institute for International Economic Studies, 2020[13]).

[3] Calculation based on World Health Organization data (WHO, 2018[152]).

[4] Interview with the State Labour Inspectorate in Albania in February 2020.

[5] Interview with the Ministry of Finance and Economy in Albania in February 2020.

[6] Estimated data for the Western Balkans are for 2015 (Bartlett and Oruč, 2018[149]).

[7] OECD calculations based on data from the Albanian Labour Force Survey and Administrative Data on Labour Market (INSTAT, 2020[150]; INSTAT, 2020[151]).

[8] Interview with NAES in Albania in February 2020.

[9] The gap between actual and planned spending was 43.4% of the planned budget in 2019 (Wort, Pupovci and Ikonomi, 2019[42]).

[10] The index does not include Kosovo or Montenegro.

[11] The natural gas Transadriatic Pipeline (TAP), which links Greece with Italy and other Western European countries, and the hydropower plant investments on the Devolli river.

[12] Key incentives in the zones include value added tax (VAT) exemptions on manufacturing-related imports; 50% reduction in profit tax for the first five years; deductible expenses of 20% of the annual capital for the first three years; supply of Albanian goods in the zone considered export supply at zero VAT rate; buildings exempted from immovable property tax for five years; zone developers and users exempted from property transfer tax; expenditures on salaries and contributions recognised at 150% of their value in the first year (same applies but only for salaries in subsequent years); training and research and development costs recognised as expenses at twice the value for ten years. Additional fiscal and non-fiscal incentives are provided for strategic sectors.

[13] A key challenge in this area stems from the underdeveloped VET system. Modernising the system and improving its market relevance is a key priority for the government, and progress has been made. Notably, the VET legal framework has been strengthened with these objectives in mind, and work-based learning has been brought into many vocational schools. More progress is needed to expand these programmes, and more public funding is needed for the VET system, which still relies significantly on donor support (about one-third of VET schools) (European Commission, 2020[41]).

[14] Index does not include Kosovo.

[15] The National Diaspora Strategy 2021-2025 also aims to reorganise the management of migration flows, reform electoral citizens to enfranchise Albanian voters abroad, and promote identity, language, culture and art.

[16] The survey includes 158 000 companies in 144 economies.

[17] There are, for example, five overlapping strategic action plans on energy efficiency: the National Action Plan on Energy Efficiency 2011-2018 (DCoM, No.619/07.09.2011), the National Action Plan for Renewable Energy Sources 2015-2020 (DCoM, No. 27/20.01.2016), the Second Plan and the Third National Energy Efficiency Action for Albania 2016-2020 (DCoM, No. 709/01.12.2017), the National Action Plan for Renewable Energy Sources 2018-2020 (DCoM, No.179/28.03.2018) and the National Consolidated Action Plan on Renewable Energy Sources 2019-2020 (DCoM, No.580/28.08.2019).

[18] Between 1997 and 2013, the number of parties increased from 19 to 68, while the average share of votes obtained by party decreased from 5.3% to 1.5%. Coalitions were usually very large. In 2013, the Aleanca për Shqipërinë Europiane was led by the Partia Socialiste e Shqipërisë (which obtained 41.36% of votes) and was composed of 36 other parties (on average, 0.45% of votes). The Partia Demokratike (30.63% of votes) led the Aleanca për punësim, mirëqenie dhe integrim, which included 24 other parties (on average, 0.37% of votes).

[19] Social and infrastructure spending, usually supervised by agencies, targets specific interest groups rather than the public good more often in Albania than in any other regional economy, according to V-Dem indicators (Coppedge et al., 2020[147]).

[20] Examples of regulators include the National Agency for Territorial Planning under the Ministry of Infrastructure and Energy and the National Agency for Scientific Research and Innovation under the Ministry of Education, Sports and Youth. The General Directorate for the Prevention of Money Laundering under the Ministry of Finance and Economy is considered a law enforcer.

[21] Between 2013 and 2016, the number of parties competing for a seat in the national assembly decreased from 68 to 17.

[22] Low trust in the judiciary is a common issue in the region. On average, 35% of citizens in the Western Balkans have confidence in courts.

[23] This is an optimistic scenario that does not consider the time required to deal with appeals to KPK decisions (which today amount to roughly 30% of verdicts).

[24] The pace of resolution of cases is already high. In 2018, the then-six judges resolved 1 673 cases, or 279 cases each. This means that the Supreme Court took 20 days to complete a trial, whereas other courts took 64 days, on average (Këshilli i Lartë Gjyqësor, 2019[148]).

[25] According to Law No. 115/2016, the KLGj and the KLP are composed of six peer judges (or prosecutors) and five lay members elected by the national assembly. These councils replace the High Council of Justice through which the President of the Republic and the Minister of Justice could steer the career of judges and prosecutors at all levels. In principle, the law ensured the independence of the other two new institutions too. The new JAC, which screens candidates for the Constitutional Court and the High Justice Inspector, is made up of judges and prosecutors from all levels elected annually through a lottery. The High Justice Inspector is elected by the national assembly but from among candidates ranked by the JAC.

[26] In 2005, restitution claims were estimated at around USD 5 billion. The government distributed USD 10 million for financial compensation in 2007 and 2008 and budgeted USD 6.5 million in 2009 (USAID, 2016[100]).

[27] According to Food and Agriculture Organization data, the average farm size increased from 0.73 ha to 1.26 ha between 2005 and 2011, but it remains small compared to other Western Balkan averages: 3.2 ha in Kosovo (2014 data), 4.6 ha in Montenegro (2010) and 5.4 ha in Serbia (2012).

[28] Focal points in all relevant ministries periodically report to the NCAC about the anti-corruption activity of their institutions. According to interviews conducted for this initial assessment, these reports can be delayed, incomplete or badly written.

[29] Clientelist pressure is highest in Montenegro (23%) and lowest in Serbia (8%) and North Macedonia (7%). The share of respondents who reported receiving an offer of money or favours in exchange for a vote was 15% in Bosnia and Herzegovina and 13% in Kosovo.

[30] In every region, a prefect appointed by the central government controls the realisation of the functions and responsibilities delegated to municipalities by the central government. Municipalities are governed by mayors and city councils directly elected by citizens.

[31] Between 1991 and 2018, the share of the population living in rural areas decreased from 64% to 40%.

[32] Local authorities’ own responsibilities include infrastructure, water supply and sewerage, and cleaning and waste removal. They also share responsibilities, for example for social services, health care and education, with the central government.

[33] For instance, municipalities have exclusive responsibility for waste collection and treatment, drinking water and sewerage, PHC, preschool and primary education. The Agency for Support of Local Self-Governance was created to support municipalities with the provision of local services.

[34] As a result, the IPA development funds are allocated directly to local government units without intermediary channels.

[35] Those data producers are not officially designated by the statistics law; however, they produce data at times used as official statistics (WTTC, 2020[66]). In the peer review published in 2018, Eurostat recommended including the data producers in a broader list of official statistics producers inside the NSS (Hackl, Redmond and Carlquist, 2018[119]).

[36] Albania has experienced many earthquakes in the last century. One of the most significant occurred in 1967, causing 18 fatalities and costing EUR 129 million in damages (World Bank/GFDRR, 2017[127]).

[37] Law No. 45/2019 “On civil protection”, adopted on 18 July 2019, also introduces the elaboration of national and local strategies for DRR, the importance of harmonisation of urban planning with DRR at the national and local levels, and risk assessments for development projects and civil emergency plans at all levels.

[38] Law No. 107/2014 "On territorial planning and development" defines the basic principles. A General National Territorial Plan is designed to put into practice the legal framework for territorial planning and development. It provides the mandatory reference framework for all plans drafted in Albania. Furthermore, a considerable number of municipalities have drafted and approved or are in the process of drafting General Local Plans (Planet e Përgjithshme Vendore) for their administrative territories. These plans provide the reference framework for the protection and usage of local governance units’ administrative territories.

[39] There is a draft document (February 2020).

[40] Based on an interview with government counterparts during the OECD mission 2-7 February 2020.

[41] In 2016, the government and the Albanian Financial Supervisory Authority announced an initiative to make catastrophe insurance compulsory for businesses and households. A law is currently under revision.

[42] Emissions from the energy and transport sectors accounted for 97.07% of CO_2 emissions in 2005 (Ministry of Environment, 2016[128]).

[43] Since the adoption of Law No. 115/2014 "On the territorial and administrative division of local government units in the Republic of Albania", which determines the administrative-territorial division of the country into 12 regions and 61 municipalities. Albania was previously divided into 12 regions and 373 local government units (65 municipalities and 308 communes).

[44] Interview with representatives of the water sector in Albania in February 2020.

[45] Reliability and accuracy of data reported by water utilities remain problematic, according to the Water Regulatory Authority of Albania.

[46] Interview with the municipality of Tirana in February 2020.

[47] The country's institutional framework counts, with specific complementary laws linked to the environment: for example, Law No. 10448/2011 "On environmental permits" and Law No. 10440/2011 "On environmental impact assessment", which entered into the force in 2013, as well as more specific sectoral laws on air protection (Law No. 162/2014 "On protection of ambient air quality", entered into force in 2017) and on nature protection (Law No. 9587/2006 "On biodiversity protection" and Law No. 8906/2002 "On protected areas").

[48] Interview with donors and NGOs in February 2020.

[49] Based on information provided by the Ministry of Tourism and Environment and the OPM in April 2020.

[50] In this case, public consultation on the construction of a large dam took place but without the affected local community. Instead, employees of the municipality of Fier, living 80 km away and not located in Vjosa, took part.

[51] Interview with the NGO sector in Albania in February 2020.

Part III Assessing opportunities and constraints in Bosnia and Herzegovina

6 Overview: Identifying strategic opportunities for Bosnia and Herzegovina

Bosnia and Herzegovina has made important progress and significantly improved living standards over the last two decades. Before the global financial crisis of 2008-09, economic growth was strong at over 6% annually. Since 2009, gross domestic product (GDP) growth has declined considerably as pre-crisis growth engines faltered and new growth engines were slow to emerge. Relatively good revenue performance has left some room in fiscal policy to deal with the COVID-19 crisis and to strengthen long-term economic and social resilience. To achieve rapid, inclusive and sustainable development, Bosnia and Herzegovina will need to take decisive policy action on long-term strategic priorities. This chapter takes a holistic view of Bosnia and Herzegovina's development performance across a range of outcomes, spanning the breadth of the Sustainable Development Goals. It then draws on the remaining chapters in this part to outline strategic priorities to build on Bosnia and Herzegovina's assets and address the key constraints it faces.

Bosnia and Herzegovina has made important progress and significantly improved living standards over the last two decades. Following the destruction of its key infrastructure and industrial base during the 1990s, Bosnia and Herzegovina's economy recovered, and living standards improved. Institutional development also progressed. Accession to the European Union became a cornerstone of Bosnia and Herzegovina's foreign policy and a key driver of reforms.

Over the last decade, strong growth was followed by a less dynamic but more balanced growth. Before the global financial crisis of 2008-09, economic growth was strong at over 6% annually. Growth was mainly consumption-driven, fuelled by significant remittances and credit growth from the newly privatised financial sector. Since 2009, gross domestic product (GDP) growth has declined considerably as pre-crisis growth engines faltered and new growth engines were slow to emerge in light of weak progress on structural reforms. Nevertheless, recently growth has become more balanced through increased external demand and moderated domestic demand, which resulted in improvements of the macroeconomic fundamentals.

Relatively good revenue performance has left some room in fiscal policy to deal with the COVID-19 crisis and to strengthen long-term economic and social resilience. Notwithstanding the human cost, the crisis should be seen as an opportunity to address some of the most pressing constraints Bosnia and Herzegovina faces, including those identified in this report.

To ensure sustainable and inclusive development and to strengthen economic and social resilience, a long-term vision should take precedence over short-term politics. Such a strategy can provide a strong basis for policy coherence that supersedes special interests and divisions and can provide a pathway for economic transformation and growth. This multi-dimensional review (MDR) aims to support Bosnia and Herzegovina in charting the path by addressing the most important constraints that can hold development back.

The MDR of the Western Balkans supports Bosnia and Herzegovina and the region with a strategic perspective and ideas for action on shared challenges. This assessment identifies the key constraints that must be tackled in order to achieve sustainable and equitable improvements in well-being and economic growth. The next phase of the project will focus on peer learning to find solutions to the challenges that emerge from the initial assessments as shared across the region.

This overview presents the main results of the initial assessment of development in Bosnia and Herzegovina. First, the chapter takes a bird's-eye view to assess Bosnia and Herzegovina's development performance on the basis of key statistics on well-being and the sustainable development goals (SDGs) and summarises the key constraints to development identified in this report. It concludes by suggesting key strategic directions. Given the global impact of COVID-19, this overview is followed by a special chapter on the impact of the pandemic in Bosnia and Herzegovina. Chapter 8 contains the main body of this initial assessment. It assesses progress and identifies constraints along the five pillars of the United Nations 2030 Agenda for Sustainable Development: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet.

Whenever relevant and subject to data availability, Bosnia and Herzegovina's performance is compared with a set of benchmark economies in the region (Albania, Kosovo, Montenegro, North Macedonia and Serbia), the Organisation for Economic Co-operation and Development (OECD) (Costa Rica, Czech Republic, Greece, Slovak Republic, Slovenia and Turkey), non-OECD countries in the European Union (Croatia and Romania) and non-OECD countries in other regions with relevant development experiences (Kazakhstan, Morocco, Philippines and Uruguay). Comparisons also include regional averages for the Western Balkans and for the OECD and European Union. The selection of benchmark countries is based on historical similarities, including integration into the European Union, economic structures, geographical proximity and mutual partnerships. The selection of non-OECD countries is based on similar economic and social challenges (such as high migration rates), shared history as transition economies and the relevance of development trajectories that can bring an additional perspective to Bosnia and Herzegovina and other Western Balkan economies and create valuable learning opportunities across selected areas.

Due to the outbreak of the of the COVID-19 pandemic, the OECD visioning workshop was cancelled in Bosnia and Herzegovina. This report therefore does not contain inputs for a potential vision. Questionnaires designed by the OECD and filled out by institutions in Bosnia and Herzegovina are a substitute for the cancelled fact-finding mission.

This report benefited from close collaboration with government representatives in Bosnia and Herzegovina, especially the Ministry of Foreign Trade and Economic Relations of Bosnia and Herzegovina, the Federal Institute for Development Programming in the Federation of Bosnia and Herzegovina and the Cabinet of the Prime Minister in Repulika Srpska, and from the collaboration and comments of multiple OECD directorates and the financial and collaborative support of the Swedish International Development Cooperation Agency, which is gratefully acknowledged.

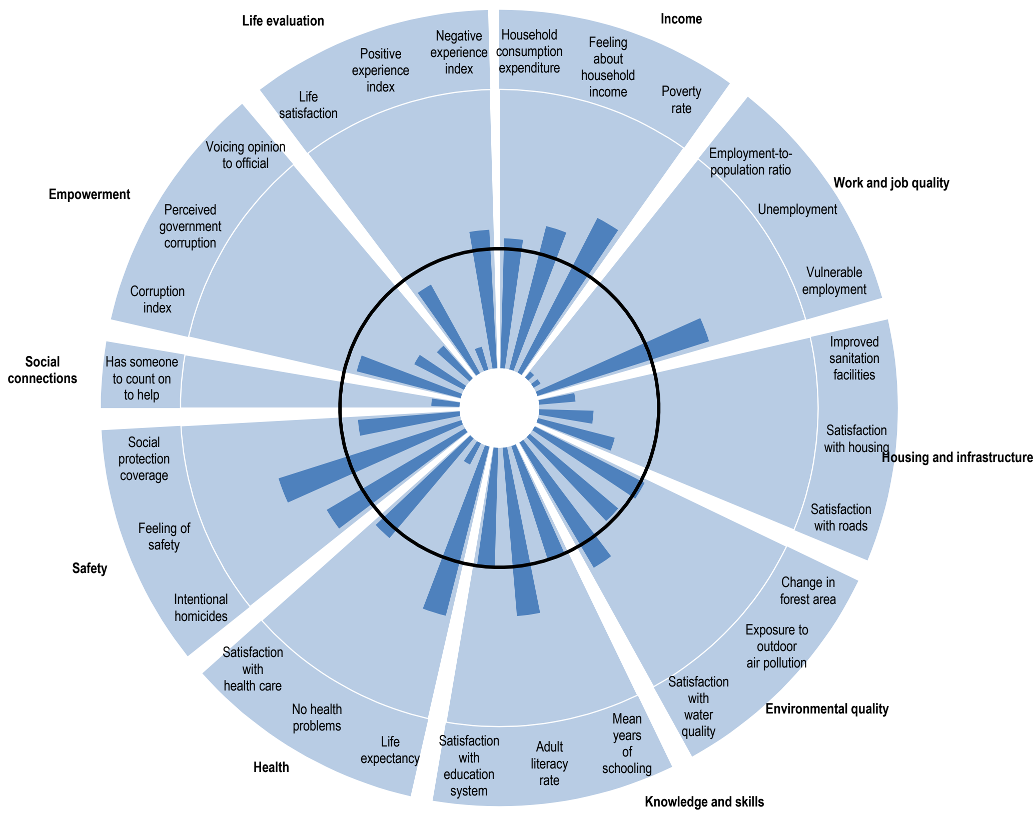
Assessing Bosnia and Herzegovina's development performance

Building on well-being around the world and sustainable development as benchmarks, this section reviews Bosnia and Herzegovina's development performance. To assess the well-being of citizens, the OECD's Well-being Framework uses a mix of objective and subjective indicators across a range of dimensions that matter to people (OECD, 2020[1]) (Box 6.1). A version adapted to the realities of emerging economies compares Bosnia and Herzegovina to the level of well-being outcomes expected given its level of GDP per capita, across ten dimensions covering material conditions, quality of life and quality of relationships. In a second step, this section assesses Bosnia and Herzegovina's performance across the five pillars of the SDGs, applying distance-to-target measures across a selection of indicators and building on the analysis in the main body of this report.

Bosnia and Herzegovina's well-being performance is mixed. Given its level of GDP, Bosnia and Herzegovina performs relatively well in terms of adult literacy, life expectancy and security (Figure 6.1). Adult literacy was 97% in 2013, and average life expectancy was close to 77.4 years in 2019 (World Bank, 2020[2]). The poverty rate and vulnerable employment are relatively low: the poverty headcount ratio at USD 1.90 per day (United States dollar; 2011 PPP) amounted to 0.1% of the population in 2011, and vulnerable employment made up 19.1% of total employment in 2019 (World Bank, 2020[2]). However, corruption and access to quality housing, sanitation services and infrastructure remain important challenges. Health problems are widespread and social capital is low. Close to 38% of the population had a health problem in 2015 (Gallup, 2020[3]), and only 21% had access to improved sanitation services (World Bank, 2020[2]). Some 35.2% of the population did not have someone to count on for help in 2015 (Gallup, 2020[3]).

Figure 6.1. Current and expected well-being outcomes for Bosnia and Herzegovina: worldwide comparison

2019 or latest available data; comparison relative to GDP per capita



Notes: The observed values falling inside the black circle indicate areas where Bosnia and Herzegovina performs poorly in terms of what might be expected from a country with a similar level of GDP per capita. Expected well-being values (the black circle) are calculated using bivariate regressions of various well-being outcomes on GDP, using a cross-country dataset of around 150 countries with a population of over one million. All indicators are normalised in terms of standard deviations across the panel.

Sources: Gallup (2018[4]), "Gallup World Poll", www.gallup.com/analytics/318875/global-research.aspx; ILO (2020[5]), *ILOStat* (database), https://ilostat.ilo.org/data/; OECD (2020[6]), *OECD PISA database*, www.oecd.org/pisa/data/; Transparency International (2019[7]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/; UNESCO (2019[8]), "UNESCO Institute for Statistics", http://uis.unesco.org/; World Bank (2020[9]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WHO (2020[10]), *Global Health Observatory* (database), www.who.int/data/gho/data/countries.

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Box 6.1. Measuring what matters to people

As part of its broader Better Life Initiative, the OECD first created its Framework for Measuring Well-being in 2011 with the aim of putting people at the heart of policy making. This represented the culmination of longstanding work both inside and outside the organisation. Important strides to "go beyond GDP" had been made with United Nations Development Programme's Human Development Index and the work on multi-dimensional poverty by the Oxford Poverty and Human Development Initiative. The framework also draws on rich academic literatures in welfare economics and capability theory, the recommendations of the Commission on the Measurement of Economic Performance and Social Progress (Stiglitz, Sen and Fitoussi, 2009[11]) and existing well-being and sustainable development measurement practice in OECD member and non-member countries. Since its launch, the work on well-being has continuously been updated in line with best practice and continues to be published in the OECD's *How's Life?* report series (Exton and Fleischer, 2020[12]; OECD, 2020[1]). For the purpose of the MDRs, the OECD Well-being Framework has been adapted to fit the realities of countries at various stages of development (Boarini, Kolev and McGregor, 2014[13]).

The adapted OECD Well-being Framework used in this report focuses on living conditions at the individual, household and community levels that capture how people experience their lives "here and now". Current well-being here is comprised of ten dimensions related to material conditions that shape people's economic options (Income, Housing and infrastructure, Work and job quality) and quality-of-life factors that encompass how well people are (and how well they feel they are), what they know and can do, and how healthy and safe their places of living are (Health, Knowledge and skills, Environmental quality, Life evaluation, Safety). Quality of life also encompasses people's connectedness and engagement (Social connections, Empowerment).

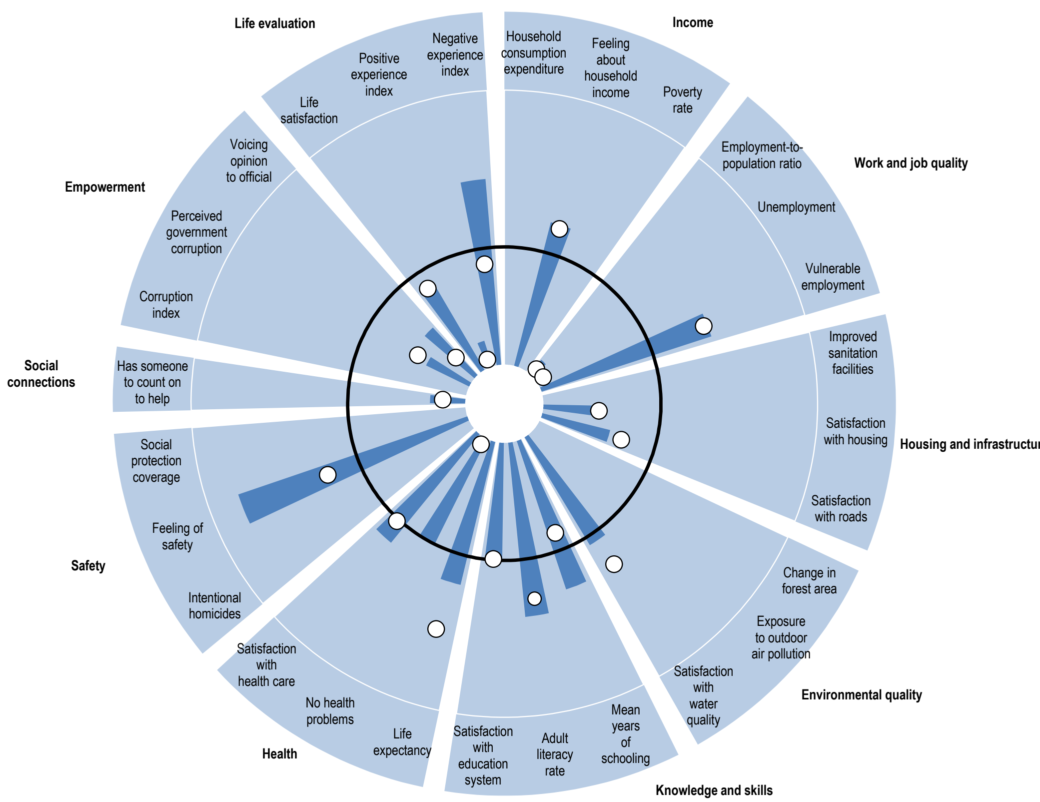
Methodological considerations

To capture the full range of people's actual life experiences, the OECD Well-being Framework uses both objective and subjective indicators. For instance, the Health dimension not only looks at life expectancy estimations but also considers how people feel about their health status and the health services they are receiving. Subjective indicators are sometimes viewed as not being as robust as objective measures; however, there are at least three reasons for considering them alongside the latter to get a holistic picture of well-being. First, there is solid methodological evidence that the subjective measures contained in the well-being framework (e.g. life satisfaction, trust in others and government) are statistically valid and correlate with objective measures of the same construct (OECD, 2017[14]; OECD, 2013[15]). Second, even in cases where perceptions diverge from objective reality, they capture the reality of survey respondents and can drive real-world outcomes, such as voting and lifestyle behaviours (Murtin et al., 2018[16]). It can actually be especially insightful for policy makers to zoom in on areas where the gap between citizen perception and objective indicators is largest. Third, many of the measures typically considered objective and routinely used in policy analysis, such as household income, are based on people's self-reports and can equally be affected by response biases and non-response rates (e.g. of very wealthy households).

There are some differences in well-being between men and women in Bosnia and Herzegovina. Women have a higher life expectancy and are more satisfied with water quality than men. However, women feel considerably less safe (64% of women feel safe, compared to 81% of men) (Gallup, 2020[3]) and have worse education outcomes. Women have 2.3 fewer years of schooling, on average: 7.9 years, compared to 10.2 for men (World Bank, 2020[2]) (Figure 6.2). Women also perform worse in live evaluation than men.

Figure 6.2. Current and expected well-being outcomes for Bosnia and Herzegovina: gender differences

2019 or latest available data; comparison relative to GDP per capita



Note: Well-being outcomes for women are represented by circles; men's outcomes are represented by bars. The observed values falling inside the central black circle indicate areas where Bosnia and Herzegovina performs poorly in terms of what might be expected from a country with a similar level of GDP per capita. Expected well-being values (the black circle) are calculated using bivariate regressions of various well-being outcomes on GDP per capita, using a cross-country dataset of around 150 countries with a population of over one million. All indicators are normalised in terms of standard deviations across the panel.

Sources: Gallup (2018[4]), "Gallup World Poll", www.gallup.com/analytics/318875/global-research.aspx; ILO (2020[5]), *ILOStat* (database), https://ilostat.ilo.org/data/; OECD (2020[6]), *OECD PISA database*, www.oecd.org/pisa/data/ ; Transparency International (2019[7]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/; UNESCO (2019[8]), "UNESCO Institute for Statistics", http://uis.unesco.org/; World Bank (2020[9]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WHO (2020[10]), *Global Health Observatory* (database), www.who.int/data/gho/data/countries.

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People – towards better lives for all

Despite important progress in recent years, Bosnia and Herzegovina has yet to achieve a society that provides opportunities for all. There are not enough formal jobs. With an employment rate of 37.8% in 2019, Bosnia and Herzegovina trails behind Western Balkan peers (World Bank, 2020[2]). Many jobs do not provide enough income to escape poverty. Rural poverty is significant, and many groups, including young people, women, ethnic minorities and those living in rural areas, are left behind. For instance, about one in five young people is without employment or a training activity, and many young people choose to migrate. Women are under-represented in political life, particularly in high-ranking positions and elected offices (Figure 6.3). Despite a 40% gender quota for election lists, only 21% of national parliamentary seats and 22% of ministerial positions in Bosnia and Herzegovina are currently occupied by women (World Bank, 2020[2]).

Bosnia and Herzegovina's economy is fragmented in many ways. First, a large public sector creates a dual labour market. Bosnia and Herzegovina has one of the largest public sectors in the region. In 2013, the government spent over 12% of GDP on public-sector wages (including wages for public administration and elected officials, public education, police and army and excluding wages for state-owned enterprises [SOEs]). Employment in the public sector, including in government administration and SOEs, entails significant benefits, such as higher wages, and acts as a drag on private-sector development.

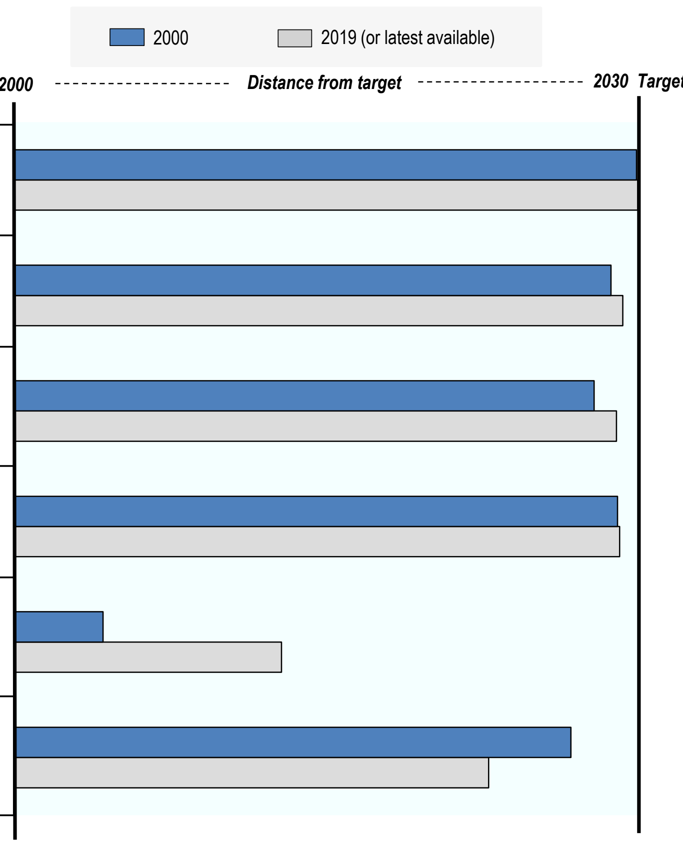
Second, access to pensions, social assistance and health insurance favours the employed and war veterans rather than the least well off. For instance, early retirement for war veterans and exclusion of informal workers from the public pension system have led to a situation where one-third of all pensioners are younger than age 65, while approximately 38% of elderly adults, mostly informal workers, collect no state pension (World Bank, 2020[17]). Further, approximately 60% of social assistance spending allocated to different categories of war veterans, regardless of their needs. On the other hand, fewer than half of the bottom quintile of the rest of the population receives social assistance which reduces poverty by only an estimated 4.6 percentage points – well below the average effect of more than ten percentage points observed in other upper-middle income countries (World Bank, 2020[17]).

Third, complex decentralised education and social protection systems (including health) create inefficiencies and high administrative costs rather than good outcomes for citizens. Health and social insurance funds in Bosnia and Herzegovina are more dependent on social contributions than in any other European country. This makes the system highly dependent on labour market performance, which is characterised by informality, a growing emigration trend and grim prospects resulting from both demographic factors and the likely economic fall-out of the COVID-19 pandemic. Because labour market performance varies across entities and cantons, access to services is highly unequal across the country. Going forward, especially given the financial crunch COVID-19 presents, Bosnia and Herzegovina needs to improve the equity and financial sustainability of social protection. The People section in Chapter 8 identifies six major bottlenecks to well-being (Table 6.1).

Figure 6.3. People – progress towards the SDGs in Bosnia and Herzegovina

Progress towards 2030 SDG targets, 2000 to 2019 or latest available year

Indicator	SDG	2000	2019 or latest available year	2030 target
Poverty headcount ratio at USD 1.9 per day (2011 PPP) (% of population)	1 No poverty	0.3% (2001)	0.1% (2011)	0%
Prevalence of undernourishment (% of population)	2 Zero hunger	4.4%	2.5% (2017)	0%
Life expectancy at birth, total (years)	3 Good health and well-being	74.4	77.3 (2018)	80 [a]
Adult literacy rate, population age 15+, both sexes (%)	4 Quality education	96.7%	97.0% (2013)	100%
Proportion of seats held by women in national parliaments (%)	5 Gender equality	7.1% (2001)	21.4%	50%
Income share held by bottom 20%	10 Reduced inequalities	8.8 (2001)	7.5 (2011)	9.9 [b]



Notes:
a. The target is the latest available average performance of OECD countries. Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.
b. The target is the latest available average performance of top 3 OECD performers. For income share held by bottom 20%, the top performers are the Czech Republic (10.2%), Slovenia (10%) and Finland (9.4%).
Sources: UNSD (2020[18]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; UNESCO (2019[8]), "UNESCO Institute for Statistics", http://uis.unesco.org/; UN IGME (2020[19]), *Levels and Trends in Child Mortality*, https://childmortality.org/; IPU (2020[20]), *Inter Parliamentary Union (database)*, www.ipu.org/; WHO (2019[21]), *Tracking Universal Health Coverage: 2019 Global Monitoring Report*, www.who.int/healthinfo/universal_health_coverage/report/2019/en; World Bank (2020[9]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Table 6.1. People – six major constraints to leaving no one behind in Bosnia and Herzegovina

1. Rural poverty in particular remains high, and discrimination against minority groups, such as Roma and LGBTI people, hampers their well-being.
2. Weak labour market performance excludes women and youth and does not provide a way out of poverty.
3. Education outcomes are low due to institutional deficiencies and inefficient use of resources.
4. Healthcare governance is inefficient and lacks proper planning and accountability processes.
5. Social protection financing (including for health) is over-reliant on social security contributions in a context of high informal employment.
6. Access to social protection (including for health) favours the employed and war veterans and not those most in need.

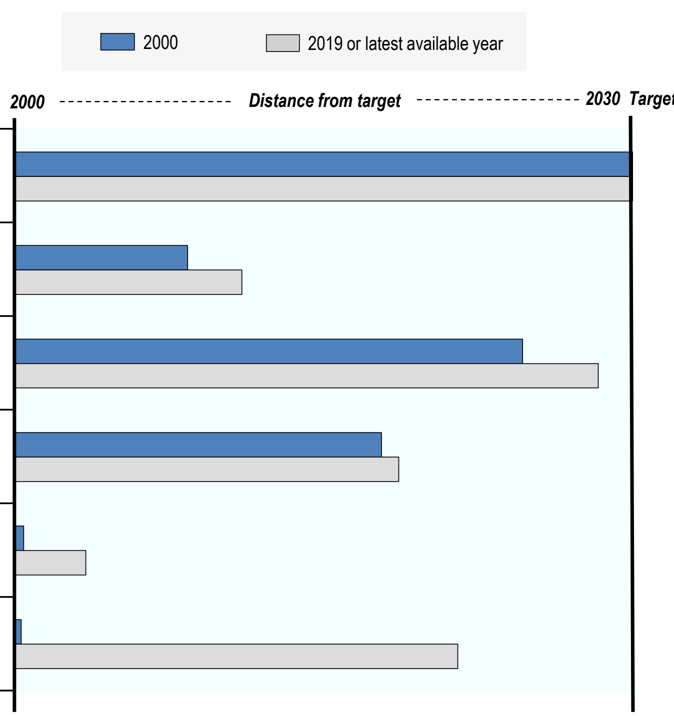
Prosperity – boosting productivity

Over the past decade, Bosnia and Herzegovina's economic growth has become more balanced, and macroeconomic stability has improved considerably, but significant outstanding structural constraints impede private investment, innovation and economic upgrading. Private investment, including foreign direct investment (FDI), is very low, as is productivity growth across all sectors. For example, labour productivity in agriculture remains well below the 2030 SDG target (Figure 6.4). These outcomes primarily reflect the challenging business environment, fragmented internal market and unfair competition from the SOE and informal sectors. They also result from a significant infrastructure gap that undermines connectivity and global value chain (GVC) integration. While Bosnia and Herzegovina has reached the 2030 target when it comes to access to electricity for all (Figure 6.4), it lags behind most global peers across a wide range of other indicators related to infrastructure. Last, diversification and upgrading is undermined by the significant skills gap resulting from the low quality of the education system and weak linkages between the education system and the labour market. The skills deficit is wide and includes digital skills, which in turn reflect Bosnia and Herzegovina's weaker access to the Internet compared to many regional peers. There is still a considerable gap in Internet access vis-à-vis the 2030 target (Figure 6.4). The Prosperity section in Chapter 8 identifies five major bottlenecks to well-being (Table 6.2).

Figure 6.4. Prosperity – progress towards the SDGs in Bosnia and Herzegovina

Progress towards 2030 SDG targets, 2000 to 2019 or latest available year

		2000	2019 or latest available year	2030 target
Access to electricity (% of population)	7 AFFORDABLE AND CLEAN ENERGY	100	100 (2018)	100
Agriculture value added per worker (constant 2010 USD)	8 DECENT WORK AND ECONOMIC GROWTH	5 473 (2005)	7 190	19 537 [a]
Wage and salaried workers, total (% of total employment)	8 DECENT WORK AND ECONOMIC GROWTH	68.7	78.9	83.6 [a]
Account at a financial institution (% age 15+)	8 DECENT WORK AND ECONOMIC GROWTH	56.2 (2011)	58.8 (2017)	94.7 [a]
Researchers in R&D (per million people)	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	61.6 (2003)	471.3 (2018)	4 079 [a]
Individuals using the Internet (% of population)	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	1.1	70.1 (2018)	97.8 [b]



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For individuals using the internet (% of population), the top performers are Iceland (99%), Denmark (97.3%) and Luxembourg (97.1%).
Sources: UNSD (2020[18]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; ILO (2020[5]), *ILOStat* (database), https://ilostat.ilo.org/data/; UNESCO (2019[8]), "UNESCO Institute for Statistics", http://uis.unesco.org/; UN-Habitat (2020[22]), UN-Habitat Data and Analytics, https://unhabitat.org/knowledge/data-and-analytics; RICYT (2020[23]), *RICYT* (database), www.ricyt.org/en/; World Bank (2020[9]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; World Bank (2019[24]), *Sustainable Energy for All* (database), https://databank.worldbank.org/source/sustainable-energy-for-all/preview/on.

Table 6.2. Prosperity – five major constraints to a more dynamic economy of Bosnia and Herzegovina

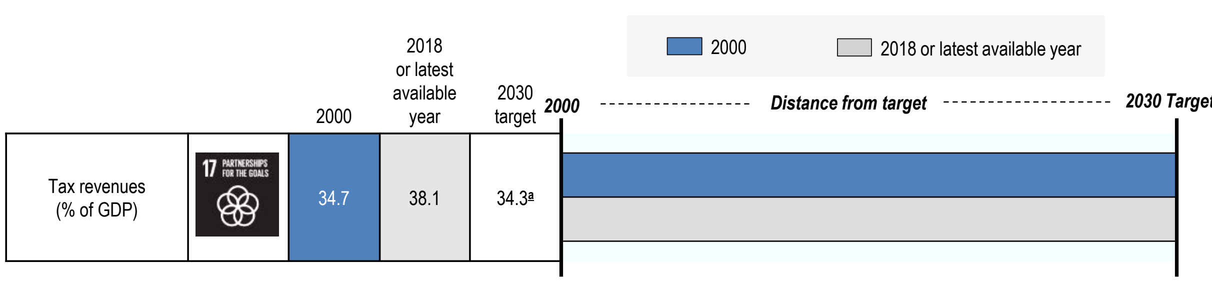
1. Weak investment and productivity have constrained economic growth in the post-crisis period.
2. A fragmented internal market and high bureaucratic burden create a challenging environment for private-sector development.
3. The large and inefficient SOE sector creates unfair competition for private enterprises.
4. Infrastructure gaps impede connectivity with the Western Balkans and beyond.
5. The lack of a skilled workforce limits the potential for economic upgrading and expansion of the tradable sector.

Partnerships and financing – financing sustainable development

Bosnia and Herzegovina's main challenges in the coming decade will be to improve access to finance for small and medium-sized enterprises (SMEs) in order to facilitate private investment, and to direct more public-sector spending towards productivity-enhancing investments and expenditures. Over the past decade, Bosnia and Herzegovina has considerably improved its fiscal performance through strong revenue growth that has almost consistently outpaced the growth in public expenditure. Fiscal revenues amounted to 46% of GDP in 2019, exceeding the 2030 partnership target (Figure 6.5). Thanks to fiscal surpluses throughout most of the past decade, public debt has declined to about 33% of GDP, thereby providing considerable fiscal space for stimulus to deal with the negative impact of the COVID-19 crisis. Despite these positive developments, Bosnia and Herzegovina faces considerable structural challenges in the fiscal sector, including high spending on social transfers and public-sector wages, which are 38% higher than private-sector wages, on average (Agency for Statistics of Bosnia and Herzegovina, 2020[25]), and limited capital expenditures (less than 7% of total public expenditures). The large, loss-making SOE sector is also a considerable burden on public spending, estimated at about 5% of GDP per year. At the same time, private investment remains low, mainly due to the challenging business environment (see the Prosperity section in Chapter 8) but also due to financing constraints for SMEs, particularly start-ups and microenterprises, which are relatively underserved by the banking system and have limited access to or awareness of alternative sources of financing (e.g. microfinance, leasing). The Partnerships and financing section in Chapter 8 identifies three major bottlenecks to well-being (Table 6.3).

Figure 6.5. Partnerships and financing – progress towards the SDGs in Bosnia and Herzegovina

Progress towards 2030 SDG targets, 2000 to 2018 or latest available year



Note: a. The target is the latest available average performance of OECD countries.
Source: World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Table 6.3. Partnerships and financing – three major constraints to financing development in Bosnia and Herzegovina

1. Low domestic savings and limited external financing have constrained investment.
2. Strong revenue performance does not translate into quality public services and infrastructure due to high current expenditures and weak public investment.
3. Access to finance is limited for SMEs, particularly start-ups and microenterprises.

Peace and institutions – strengthening governance

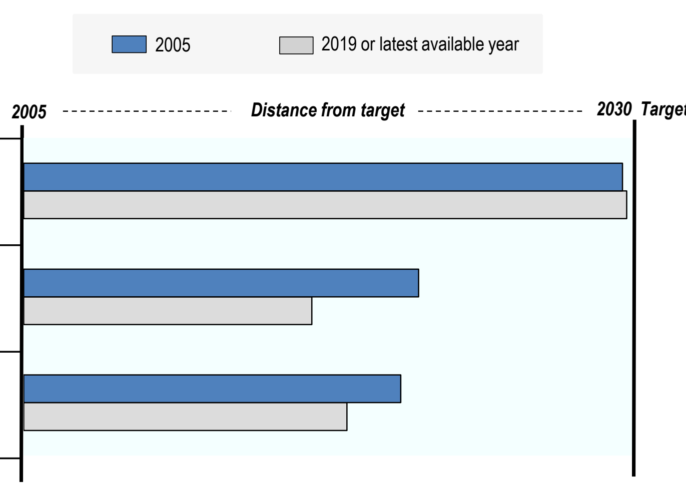
Since 1995, Bosnia and Herzegovina has managed, with the support of the international community, to establish and preserve territorial integrity and has shown progress in some policy areas, but the path towards further reforms is steep. The country has progressively guaranteed peace and safety to its citizens, reformed the judiciary to make it more independent of external pressures and introduced integrity plans for judges and public officials (Figure 6.6). As part of decentralisation, the central state and the two entities went beyond their divisions and adopted the Global Framework for Fiscal Balance and Policies to co-ordinate these at the local level. They also established an institutional, legal and strategic framework to combat corruption.

Bosnia and Herzegovina's complex system of governance helps maintain institutional balance among ethnic groups but may come with a cost. Without adequate co-ordination, it may entrench ethnic polarisation, pose challenges to the proper functioning of the state and create scope for significant inefficiencies. While decentralised governance may advantage local development, subnational governments' fiscal power is limited. Complex institutions may undermine the independence and efficiency of the judiciary and citizen trust in courts. They also create fertile ground for corruption: according to Gallup data, almost 90% of interviewees consider corruption widespread throughout the government, and citizens usually pay bribes to access medical and health services or to avoid police fines (RCC, 2019[26]). The Peace and institutions section in Chapter 8 identifies three major bottlenecks to well-being (Table 6.4).

Figure 6.6. Peace and institutions – progress towards the SDGs in Bosnia and Herzegovina

Progress towards 2030 SDG targets, 2000 to 2019 or latest available year

		2005	2019 or latest available year	2030 target
Intentional homicides (per 100 000 people)	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	1.9	1.2 (2017)	0.4 b
Confidence in the judiciary (% of respondents)	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	37% (2006)	27%	57 a
Corruption perceptions index	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	42 (2012)	36	68 a



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For international homicides rate, the top performers are Japan (0.26), Luxembourg (0.34), and Norway (0.47).
Sources: UN-CTS (2020[27]), *Sustainable Development Goals* (database); World Bank (2020[9]), *World Development Indicators* (database); Transparency International (2019[7]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/results/.

Table 6.4. Peace and institutions – three major constraints to enhanced quality of institutions in Bosnia and Herzegovina

1. The decentralisation framework is asymmetric.
2. Overly complex institutional design addresses ethnic divisions but undermines the independence, efficiency and transparency of the judiciary.
3. Personal connections are inevitable in getting things done but may create social exclusion, distort the labour market and weaken administrative capacity.

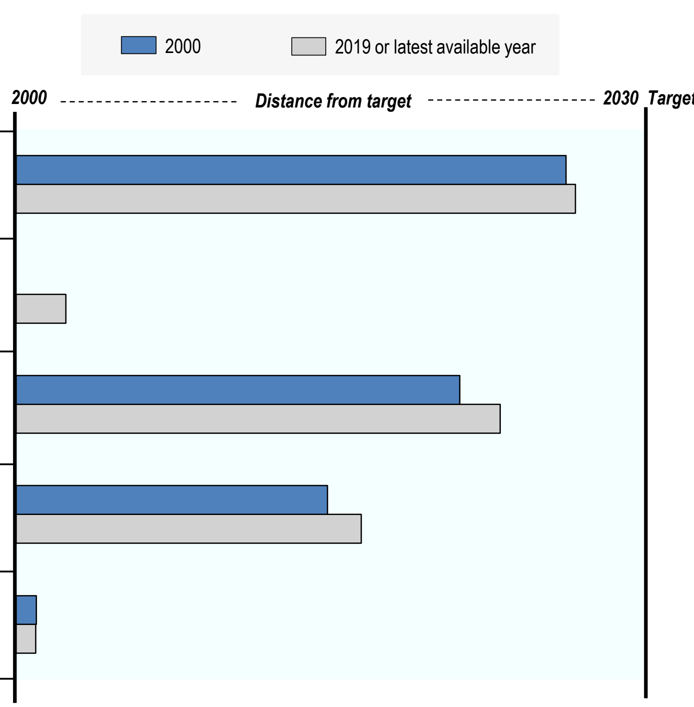
Planet – conserving nature

Bosnia and Herzegovina needs to reduce air, water and ambient pollution and become less reliant on coal for electricity production. Bosnia and Herzegovina's economy is highly reliant on heavily polluting coal, energy efficiency is low, and non-hydropower renewables are almost absent in the country's energy mix. As a result, air pollution and carbon dioxide (CO_2) emissions levels are still far from the SDG targets (Figure 6.7). Air pollution poses a threat not only to the environment but also to human health and the economy. In 2016, the mortality rate attributable to household and ambient air pollution was 159.3 per 100 000 inhabitants, the highest in the Western Balkan region. Pollution from poor waste management is another major concern. Illegal landfills and untreated sewage damage natural resources and pose a risk to biodiversity and well-being. Only 31% of Bosnia and Herzegovina's population is connected to the public sewerage system, and only 15% of wastewater is treated before discharge into rivers. Public utility prices that are set below operational costs undermine the financial sustainability of public utilities and limit the financial resources available for investments in water, waste and wastewater management infrastructure, modern and more efficient energy infrastructure and renewable energies. Natural hazards are another concern: Bosnia and Herzegovina is vulnerable to flooding, earthquakes, droughts, landslides and extreme weather events, which are likely to become more frequent due to climate change. Biodiversity is insufficiently protected, and protected areas are scarce (Figure 6.7). The Planet section in Chapter 8 identifies four major bottlenecks to well-being (Table 6.5).

Figure 6.7. Planet – progress towards the SDGs in Bosnia and Herzegovina

Progress towards 2030 SDG targets, 2000 to 2018 or latest available year

		2000	2019 or latest available year	2030 target
People using safely managed drinking water services (% of population)	6 CLEAN WATER AND SANITATION	87.3	88.8 (2017)	100
Electricity production from renewables (%, excluding hydro	7 AFFORDABLE AND CLEAN ENERGY	0.0	1.7	21.5 [a]
Mean annual concentration of PM2.5 weighted by population (µg/m³)	11, 12	33.2	27.7 (2017)	6.0 [b]
CO2 intensity of GDP (kg CO2 per unit of GDP in 2017 USD PPP)	13 CLIMATE ACTION	0.54	0.49 (2018)	0.07 [b]
Terrestrial protected areas (% of total land area)	15 LIFE ON LAND	1.5 (2016)	1.4	44.7 [b]



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For mean annual concentration of PM2.5 weighted by population, the top performers are Finland (5.9%), New Zealand (6%) and Sweden (6.2%). For CO2 emissions, the top performers are Sweden (0.062), Switzerland (0.064), and Norway (0.078). For territorial protected areas, the top performers are Slovenia (53.6%), Luxembourg (40.9%) and Poland (39.7%).

Sources: UNEP (2020[28]), *Environment Live/Global Material Flows* (database), www.resourcepanel.org/global-material-flows-database; UNSD (2020[18]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; IEA (2018[29]), *World Energy Balances*, www.iea.org/reports/world-energy-balances-overview; OECD (2020[30]), *Green Growth Indicators* (database), https://stats.oecd.org/Index.aspx?DataSetCode=GREEN_GROWTH; UNEP-WCMC (2018[31]), *World Database on Protected Areas*, https://www.protectedplanet.net/ ; WHO/UNICEF (2020[32]), *JMP for Water Supply, Sanitation and Hygiene*, http://washdata.org/; World Bank (2020[9]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Table 6.5. Planet – four major constraints to a more sustainable path in Bosnia and Herzegovina

1. Low energy efficiency and high carbon intensity are reflected in high levels of GHG emissions and air pollution.
2. High levels of air pollution threaten human health, the economy and the environment.
3. Poor waste and wastewater management damages natural resources and poses a risk to the environment and well-being.
4. Public utility prices are set below operational costs and undermine the financial sustainability of public utilities.

Suggestions for strategic priorities for Bosnia and Herzegovina

To achieve rapid, inclusive and sustainable development, Bosnia and Herzegovina will need a development strategy that establishes a vision for the future, building on its assets and opportunities and addressing its most pressing constraints. The key constraints presented in this assessment can serve as a basis for priority setting along these lines.

The COVID-19 crisis has had an impact on Bosnia and Herzegovina but also offers an opportunity for strategic focus and strengthening economic and social resilience. As other economies in the region, Bosnia and Herzegovina was also affected in terms of both health and economic slowdown. In response, Bosnia and Herzegovina will have to invest in a swift recovery. These investments and the potential international support present an opportunity for strategic focus on opportunities and on removing identified constraints. Bosnia and Herzegovina's strong revenue performance in recent years outpaced the growth in expenditures. As a result, it has one of the lowest levels of public debt among comparable economies and should leverage its considerable fiscal space to counter the negative impacts of COVID-19.

Restructuring and improving the performance of SOEs can allow Bosnia and Herzegovina to take advantage of existing assets, create fair competition with the private sector and reduce the environmental footprint. Bosnia and Herzegovina has many SOEs, which are dominant in many sectors. Their costs often significantly outweigh productivity gains, and their dominance stands in the way of private-sector development. Moreover, as public utility companies tend to set public utility prices below operational costs for political reasons, they discourage water and electricity savings, leading to an overexploitation of water resources and high levels of air pollution. Improving SEOs' productivity and profitability and reducing their environmental impact will require defining goals and criteria for ownership of companies, effective performance-based management and hard budget constraints. This includes establishing budgetary and environmental objectives and developing policy options for SOEs with varying profiles and sustainability. To create fair competition with the private sector, it will be important to ensure the competitive neutrality of SOEs.

Bosnia and Herzegovina's export basket shows potential, but roadblocks to investment must be removed to support job creation and the structural transformation of the economy. Bosnia and Herzegovina's export basket shows promise of diversification (the economy ranks 42nd out of 137 economies in Economic Complexity) and industrial potential that can be further developed. However, compared to the Western Balkan region, Bosnia and Herzegovina underperforms in domestic and foreign investments. This likely reflects the more challenging business environment resulting from infrastructure gaps and a fragmented internal market, including a high bureaucratic burden. Appropriately developing key infrastructure, improving regulatory transparency and stability, reducing red tape and effectively tackling corruption to encourage investment through more contestable and competitive markets will be important. Bosnia and Herzegovina should also leverage on migration by creating links with its diaspora and channelling remittances to finance investments.

Optimising the social protection system and improving targeting of social benefits can contribute to financial sustainability, reduce poverty and foster a socially cohesive society. Bosnia and Herzegovina spends significant amounts of resources on social transfers, yet the support often does not reach people in need, rendering the social protection system financially unsustainable and ineffective. Moreover, current social protection is creating disparities among ethnicities, entrenching privileges for some and limiting opportunities for others, especially women, to participate in the labour market. To put in place effective social protection, Bosnia and Herzegovina should focus on needs, coverage and effectiveness, including in terms of the system's adequacy, equity, efficiency, fiscal and financial sustainability and coherence with other polices and among different levels of government.

Bosnia and Herzegovina should use its unique governance structure to foster local development and ensure greater territorial cohesion. Regional disparities remain large; people do not have equal access to opportunities and quality services. Despite decentralisation, subnational governments' fiscal power is limited, and revenues are lower than in the rest of the Western Balkans. This affects municipalities' spending capacity, especially in the long term. Local governments should play a crucial role in service delivery but have little capacity to do so. To ensure better local development, it will be important to develop a clear vision for specific geographic areas, empower regional and municipal authorities with adequate financial and human resources and foster inter-entity collaboration.

Addressing corruption can substantially increase trust in public institutions and increase economic opportunities for citizens. The fight against corruption can become more effective only with stronger political commitment. The recent Anti-Corruption Strategy for 2020-2024 is an important step forward; however, actual implementation depends on political will.

Whatever its strategic direction, Bosnia and Herzegovina will need to maintain macroeconomic stability in the medium and long term. Bosnia and Herzegovina has built a stable macroeconomic environment. The financial sector's health and stability have improved considerably, and private-sector lending is recovering. The profitability of the banking sector has also increased, but the financial sector has to be broadened.

To advance these strategic priorities, Bosnia and Herzegovina must better manage its natural resources and address air pollution. Illegal landfills and untreated sewer damage natural resources and pose a risk to biodiversity and well-being. Bosnia and Herzegovina has valuable natural resources, including some of the most pristine forests in Europe, and very fertile lands. The country can create opportunities for its citizens and enhance environmental sustainability by better utilising its natural resources. High air pollution is a significant burden on the population. Phasing out subsidies for coal mining and coal power plants is key to reducing air pollution and greenhouse gas (GHG) emissions. Bosnia and Herzegovina needs to align energy policy with environmental sustainability objectives and commitments and improve enforcement of existing environmental protection provisions.

Integration into the European Union is a good opportunity to accelerate reform processes in Bosnia and Herzegovina. Bosnia and Herzegovina was identified as a potential candidate for accession in 2003. However, the European Commission recently determined that more work is required in several areas – especially in guaranteeing democracy, the rule of law, the stability of institutions and the reduction of state presence in the economy – before Bosnia and Herzegovina becomes a candidate (Box 6.2).

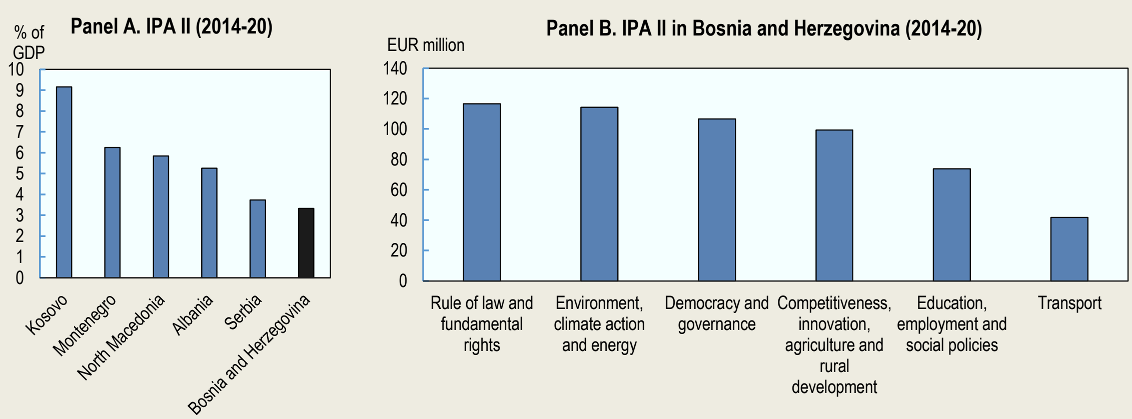
Box 6.2. Bosnia and Herzegovina's integration towards the European Union

The process towards integration with the European Union has been an important driver of democratisation, peace and institution building in Bosnia and Herzegovina and has provided the country with large financial and technical support for its development and regional integration. As part of the integration process, Bosnia and Herzegovina has worked to bring its legislation in line with the existing body of EU laws and standards (known as the acquis).

Through the Stabilisation and Association Process (SAP) since 1999, Bosnia and Herzegovina and the economies in the region have been involved in a progressive partnership with the European Union. The SAP rests on the following pillars: bilateral Stabilisation and Association Agreements; trade relations (wide-ranging trade agreements); financial assistance (the Instrument for Pre-accession Assistance [IPA]); and regional co-operation, such as the Central European Free Trade Agreement (CEFTA):

- The Stabilisation and Association Agreement with Bosnia and Herzegovina, which entered into force on 1 June 2015, governs the relations between Bosnia and Herzegovina and the European Union. The agreement offers various benefits to citizens and businesses (such as visa-free travel), supporting institutional and democratic reforms, and encouraging neighbourly relations and trade (European Commission, 2020[33]).
- The IPA has been important in providing Bosnia and Herzegovina assistance in reforms through financial and technical help. IPA II (for 2014-20) accounted for 3.3% of GDP in Bosnia and Herzegovina (EUR 552.3 million) (Figure 6.8. – Panel A). Most of the IPA II funds (40.4%, or about EUR 223.2 million) have been allocated to strengthening democracy and governance, and the rule of law and fundamental rights (Figure 6.8. – Panel B).

Figure 6.8. IPA II funding has been concentrated on democracy and governance, and the rule of law and fundamental rights



Source: Authors' elaboration based on European Commission (2020[34]), "Bosnia and Herzegovina – financial assistance under IPA II", https://ec.europa.eu/neighbourhood-enlargement/instruments/funding-by-country/bosnia-herzegovina_en.

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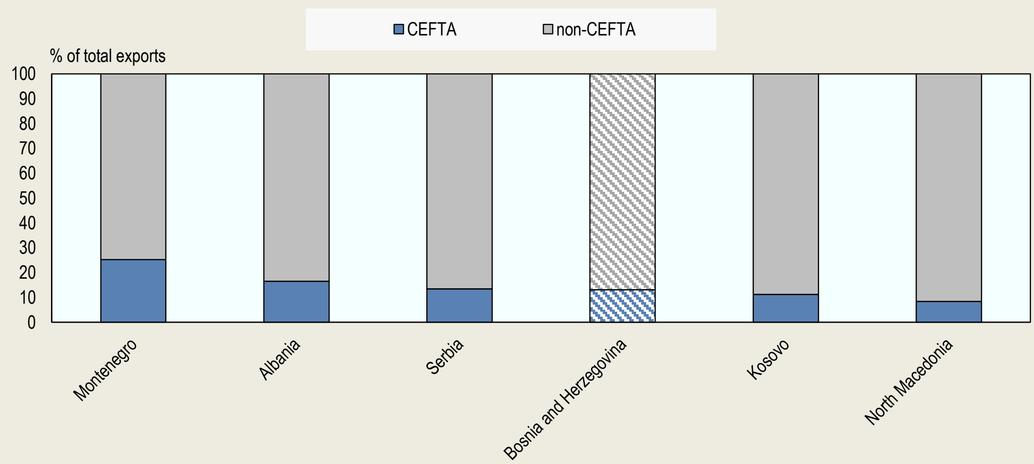
- Regional co-operation has been another important driver in the SAP for developing infrastructure and networks in the region and establishing a free trade area between Bosnia and Herzegovina and other economies. Key regional initiatives include the CEFTA, the Energy Community, the Western Balkans Investment Framework and the Regional Cooperation Council. The CEFTA, an international trade agreement among economies in South East

Europe, was one of the means of facilitating trade in the region and harmonising trade-related legislation with the European Union. The share of exports from Bosnia and Herzegovina to CEFTA economies in the Western Balkans increased from 2.1% in 2012 to 13.1% in 2019 (Figure 6.9). In 2019, 69% of exports went to Serbia (CEFTA, 2020[35]).

Figure 6.9. The role of the CEFTA in Bosnia and Herzegovina



Source: CEFTA (2020[35]), *Trade in goods* (dataset), https://statistics.cefta.int/goods.

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Bosnia and Herzegovina applied for EU membership in February 2016. The European Commission adopted its opinion on the EU membership application in May 2019, identifying 14 key priorities for Bosnia and Herzegovina to fulfil in view of opening EU accession negotiations. The European Council endorsed the opinion and key priorities in December 2019. The opinion constitutes a roadmap for deep reforms in the areas of democracy/functionality, the rule of law, fundamental rights and public administration reform (European Commission, 2020[36]).

The new Enlargement Package and the adoption of the Economic and Investment Plan have set new directions for EU integration and recovery from COVID-19. Building on the Western Balkan strategy from 2018 (European Commission, 2018[37]), the Enlargement Package adopted on 6 October 2020 stresses the need to improve the EU integration process to be better equipped to deal with structural weaknesses in Bosnia and Herzegovina and other Western Balkan economies. In parallel, the European Commission adopted the Economic and Investment Plan to spur the long-term economic recovery of Bosnia and Herzegovina and the region, support a green and digital transition and foster regional integration into and convergence with the European Union. The support is crucial, especially in light of both the COVID-19 impact and the existing challenges, such as weak competitiveness and high unemployment. The plan will mobilise up to EUR 9 billion of IPA III funding for 2021-27. A large majority of this support will be directed towards key productive investments and sustainable infrastructure in the Western Balkans through the ten flagship initiatives. Through the Western Balkans Guarantee facility, the ambition is to raise additional investments of up to EUR 20 billion (European Commission, 2020[38]; European Commission, 2020[39]).

Note: The ten flagship investment initiatives are: two transport infrastructure projects (connecting east to west and north to south), renewable energy, transition from coal, connecting coastal regions, building renovations, waste and water management, digital infrastructure, supporting the competitiveness of the private sector, and youth support.
Source: European Commission (2020[33]; 2020[36]; 2020[38]; 2020[39]; 2018[37]). (CEFTA, 2020[35]).

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7 Impact of COVID-19 in Bosnia and Herzegovina

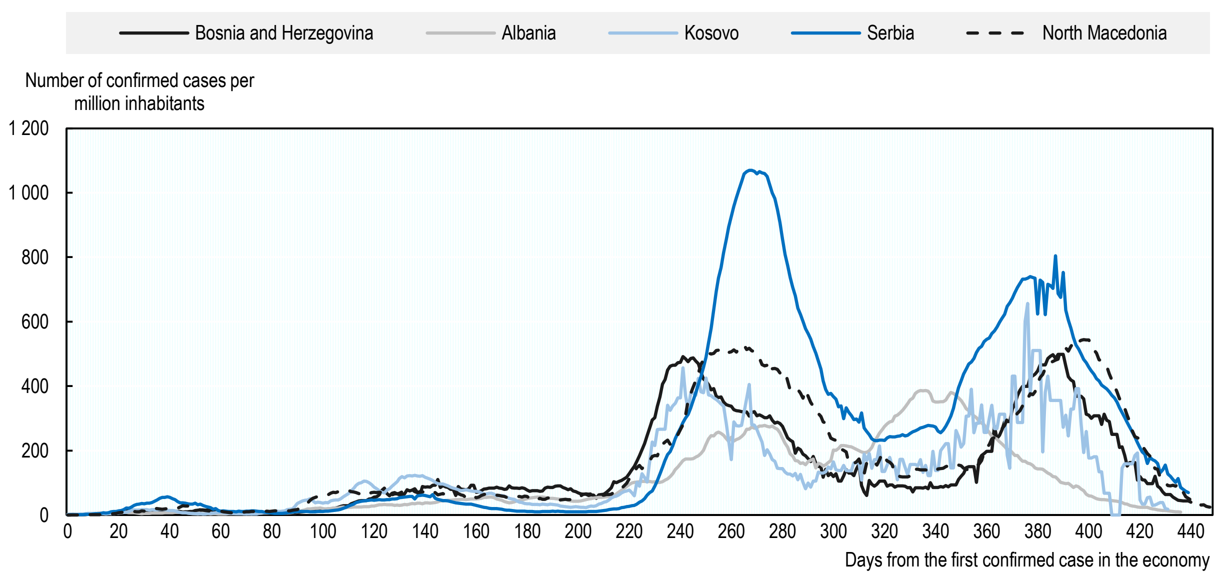
The COVID-19 pandemic and its economic consequences have had a relatively high impact on Bosnia and Herzegovina’s population and economy. The authorities acted quickly to contain the virus during the first wave of the pandemic. They also mobilised sizeable fiscal resources to mitigate the impact of illness and strict confinement measures on people and firms. This chapter reviews the sources of vulnerability and resilience that determined the impact of the crisis and that will condition the path to recovery. While the economy weathered the pandemic better than originally projected, weaknesses in the labour market and the social protection system left parts of the population unprotected. Fiscal room for manoeuvre was pivotal in allowing Bosnia and Herzegovina to respond. The crisis has also put the spotlight on structural sources of vulnerability that should receive attention as the country prepares its development strategy for the future.

Evolution of the pandemic

Bosnia and Herzegovina has experienced several waves of the pandemic. The first case of COVID-19 was reported on 5 March 2020 and the first death on 21 March. By 1 May, there were 1 757 cases (614 cases per million inhabitants) and 68 registered deaths (21 per million inhabitants), compared to 9 registered deaths per million in Albania and 13 per million in both Kosovo and Montenegro. By 24 May 2021, there were 61 994 cases per million inhabitants (Figure 7.1) and 2 789 registered deaths per million inhabitants, which is the highest number in the region (Figure 7.2). On the same date, the economy counted a total number of 203 513 cases and 9 168 registered deaths (Statista, 2021[1]).

Figure 7.1. Bosnia and Herzegovina registered a relatively high number of new daily cases relative to its population

Daily new confirmed COVID-19 cases per million inhabitants, rolling seven-day average



Source: Authors' calculation based on Our World in Data (2020[2]), Our World in Data website, https://ourworldindata.org/.

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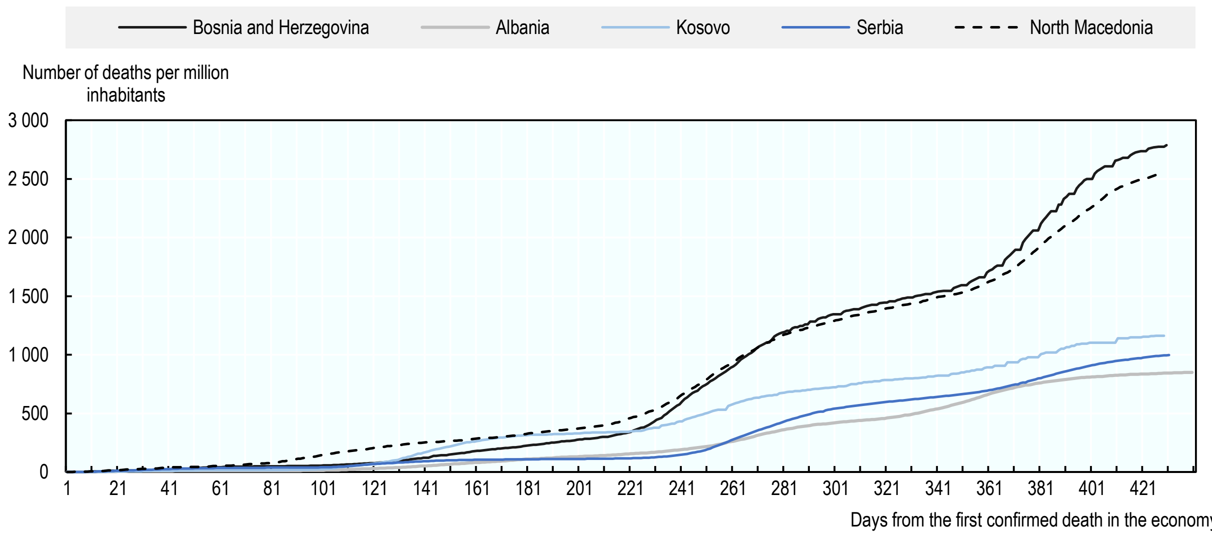
Figure 7.2. Bosnia and Herzegovina has the highest number of registered deaths per million inhabitants in the Western Balkans

Cumulative number of confirmed COVID-19 deaths per million inhabitants



Note: Bosnia and Herzegovina reported its first registered COVID-19 case on 5 March 2020 and its first registered COVID-19 death on 21 March 2020.
Source: Authors' calculation based on Our World in Data (2020[2]), Our World in Data website, https://ourworldindata.org/.

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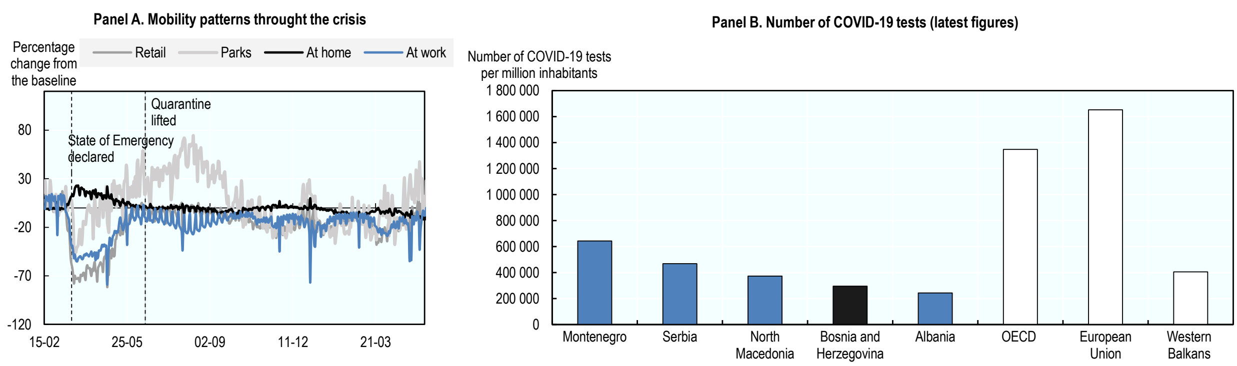
Authorities in Bosnia and Herzegovina acted quickly to contain the spread of the virus, yet future health resilience is not guaranteed. A state of emergency was declared in late March. A lockdown was implemented, and citizen movements were restricted. The borders, public areas, parks and shopping malls were closed; grocery stores and pharmacies remained open. The restrictive measures were effective and led to reduced movements throughout Bosnia and Herzegovina with respect to February (Figure 7.3 – Panel A). While the state of emergency was lifted on 21 May in Republika Srpska and 29 May in the Federation of Bosnia and Herzegovina, the subsequent rising case numbers led to new restrictions. Despite rather effective social distancing measures, Bosnia and Herzegovina has been conducting only 295 030 tests per million inhabitants since the beginning of the pandemic – a relatively low number by regional comparison. Low testing levels raise the risk of an increase in contagion. Increasing testing capacity will be crucial in detecting new cases and strengthening the economy’s health resilience (Figure 7.3– Panel B). With 1 people fully vaccinated per hundred inhabitants by the latest available data, vaccine capacity in Bosnia and Herzegovina is the lowest in the region (Figure 7.4).

Figure 7.3. Efficient restrictions reduced mobility, while testing capacity remains limited

Mobility patterns throughout the crisis (Panel A) and number of COVID-19 test (Panel B)



Note: Panel A shows the relative volume of requests for direction compared to a baseline volume on 15 February 2020, as recorded by Google Maps. Moreover, it shows, in chronological order, the first registered COVID 19 case reported in Bosnia and Herzegovina (5 March 2020), the date of implementation of the curfew (17 March) and the first stage of relaxation of the curfew (21 May in Republika Srpska and 29 May in the Federation of Bosnia and Herzegovina). Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.
Source: Authors' elaboration based on Panel A. Google (2020[3]), "Google Mobility Trends", www.google.com/covid19/mobility/; Panel B. Worldometer (2020[4]), "Coronavirus", www.worldometers.info/coronavirus/.

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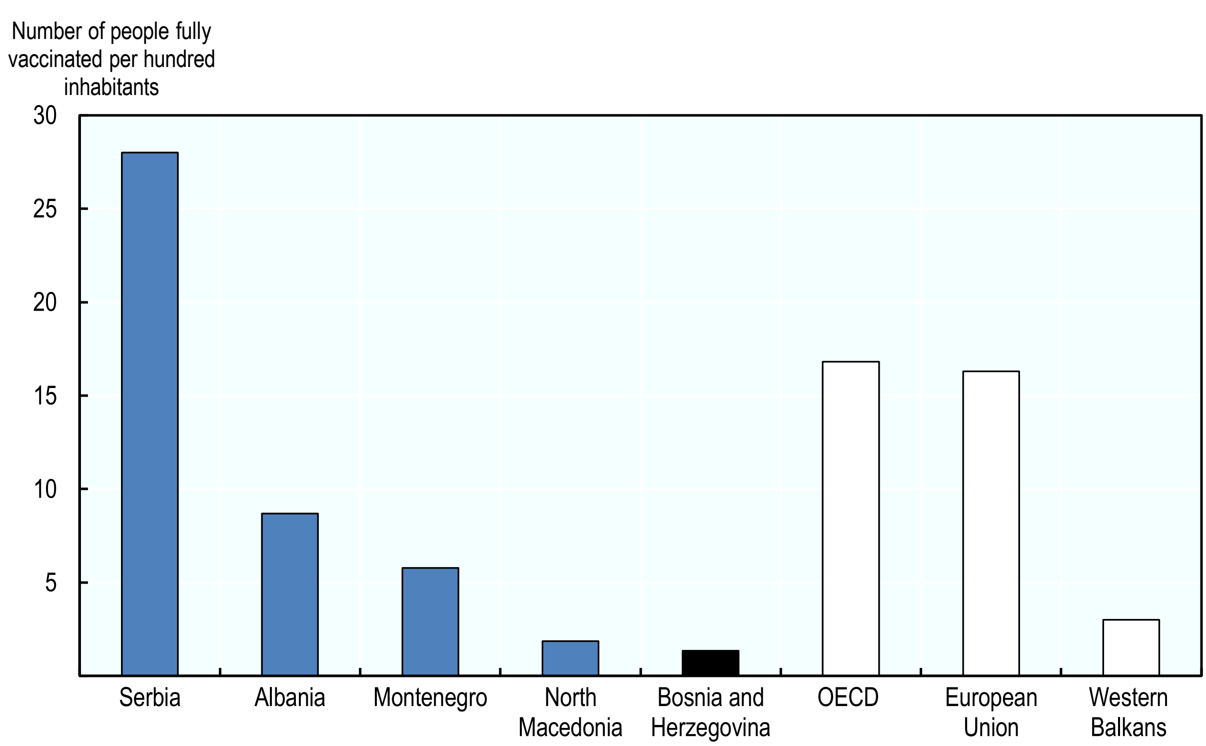
Figure 7.4. Vaccine capacity in Bosnia and Herzegovina remains limited



Note: Last reported numbers are from May 2021.
Source: Worldometer (2020[4]), "Coronavirus", www.worldometers.info/coronavirus/.

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Policy responses and economic impact

Authorities in Bosnia and Herzegovina have taken a series of measures to mitigate the negative impact of the crisis on the economy (Table 7.1). To support affected citizens, the authorities introduced coverage of wage and social security contributions in certain sectors, accommodation vouchers, price controls and other measures. Several measures were introduced for private enterprise, including reduction of rent, easing of loan repayment and preferential treatment of domestic companies in public procurement. Based on the recent available data, the entity governments have allocated BAM 50 million (Bosnia and Herzegovina convertible mark) (0.15% of GDP) to support their health sectors.[1] Bosnia and Herzegovina also received assistance from the International Monetary Fund (IMF) and the European Union.

Table 7.1. Policy measures in response to the COVID-19 pandemic

People	Businesses	Health and other measures
Entity-level (Federation of Bosnia and Herzegovina) • Price controls for specific goods. • Social security contribution subsidies for each employee of BAM 244.9 (EUR 125). • Salary contributions for all employees in the real sector (from March 2020 until one month after the end of the state of emergency) of BAM 245 (EUR 120) per month per employee. **Entity-level (Republika Srpska)** • Price controls for specified goods. • Coverage of full salary contributions in March 2020 and salary contributions in April 2020. Coverage of taxes for citizens most affected by the crisis. BAM 58 million (EUR 29 million) from the Solidarity Fund dedicated to covering the minimum salary, contributions and taxes for around 70 000 employees in April 2020. • Announced by the Steering Committee of the Solidarity Fund: distribution of BAM 30 million (around EUR 15 million) to assist local communities in Republika Srpska. • BAM 100 (around EUR 50) vouchers for citizens that can be used to co-finance accommodations anywhere in Republika Srpska, providing a minimum three-night stay.	**State-level (Bosnia and Herzegovina)** • Preferential treatment of domestic companies in public tenders (from 1 June 2020). Contracting authorities obliged to reduce prices of domestic bids by 30% in all public procurement procedures. • Announced by banking agencies: six-month loan repayment moratorium for restructuring credit arrangements for individuals and legal entities found to have aggravated repayment circumstances due to COVID-19. • Instruction from banking agencies: banks to track clients and exposure portfolios affected by COVID-19 and to consider additional customer relief, including reviewing current service fees and avoiding charging fees to handle exposure modifications. All banks ordered not to pay dividends or bonuses. **Entity-level (Federation of Bosnia and Herzegovina)** • 50% decrease in lease amount (i.e. rent) for business premises managed by authorities of the Office for Joint Affairs of the Federation of Bosnia and Herzegovina. • Announced by the government: first injection of funds (BAM 100 million, or around EUR 50 million) to provide guarantees to commercial banks for loans destined to companies in the strategic development sectors. • Established by the Development Bank of the Federation of Bosnia and Herzegovina: stabilisation fund for stabilising the economy, with initial reserves of up to BAM 80 million (EUR 40 million). • Abolishment of the obligation to make advance payments on corporate income tax for businesses and the self-employed. • Funds totalling BAM 6 million (EUR 3 million) was allocated to major	**State-level (Bosnia and Herzegovina)** • Introduced by the Council of Ministers: tax exemption on equipment and resources granted by both domestic and international entities for the needs of prevention, containment and termination of epidemics caused by COVID-19. • Social distancing measures, limitation on number of people in public gatherings and use of masks wherever social distancing cannot be followed. • A total of BAM 10 million (EUR 5 million) was allocated to public hospitals in November 2020 in reaction to increased strain on the health system caused by the second wave of COVID-19. **Entity-level (Federation of Bosnia and Herzegovina and Republika Srpska)** • Allocated by the two entity governments: around BAM 50 million (0.15% of GDP) for dealing with COVID-19, including for purchasing medical equipment and supplies: 1) the Federation of Bosnia and Herzegovina will transfer BAM 30 million (0.1% of GDP) to hospitals; 2) Republika Srpska's health fund will cover healthcare costs for all patients.

People	Businesses	Health and other measures
	airports in an effort to support liquidity and airport workers in November. **Entity-level (Republika Srpska)** • Three-month repayment moratorium for borrowers from the Investment and Development Bank (IRB)-managed funds. • Allocated by the Ministry of Agriculture: BAM 2.2 million (EUR 1.1 million) in loans to encourage agricultural output. • Postponed corporate income tax liabilities. • Together with the European Bank for Reconstruction and Development (EBRD) and the Guarantee Fund of Republika Srpska, BAM 50 million (around EUR 25 million) provided as a guarantee to enterprises.	

Sources: Deloitte (2020[5]), "COVID-19 – Overview of measures for the stabilization of economy in Bosnia-Herzegovina", www2.deloitte.com/ba/en/pages/about-deloitte/articles/COVID-19-ekonomske-mjere-za-stabilizaciju-privrede.html; IMF (2020[6]) (2020[16]), "Policy Responses to COVID19", www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#S; OECD (2020[7]), "COVID-19 Policy Tracker", http://oecd.org/coronavirus/en/#country-policy-tracker; OECD (2020[8]), *The COVID-19 crisis in Bosnia and Herzegovina*, www.oecd.org/south-east-europe/COVID-19-Crisis-in-Bosnia-and-Herzegovina.pdf.

The severe lockdown that lasted until June 2020 and which was subsequently partially reinstated due to growing case numbers affected economic activity. Despite the GDP growth of 2.7% in 2019 (IMF, 2020[9]), Bosnia and Herzegovina experienced severe contraction in 2020 (-4.3%), driven by reduced cosumption and investment. The services sector was hit hardest by the pandemic, contracting by about -3.1 percentage points. While exports were effected due to reduced external demand, simoultaneous contraction in merchanise imports, improved Bosnia and Herzegovina's overall trade balance (World Bank, 2021[10]).

Coronavirus COVID-19

The analysis of policy responses to the COVID-19 pandemic does not reflect the policy development that occurred since February 2021, with the exception of the figures on testing and vaccination for which the most recent and internationally comparable data were used.

Dimensions of vulnerability to further socio-economic impact from COVID-19

Bosnia and Herzegovina is relatively vulnerable to COVID-19 along a series of economic and social dimensions, while institutional weaknesses undermine the resilience of its policy response (Table 7.2). Considering pre-existing vulnerabilities can help policy makers to determine who will need help the most and to design and target policies accordingly. High unemployment and widespread informality already weaken Bosnia and Herzegovina's economy and can slow down recovery. Moreover, they imply that a significant share of the population risks remaining without adequate health and social assistance. Exposure to foreign investors and trade may be another source of vulnerability, given how severely the virus hit Bosnia and Herzegovina's main trade partners. The relative stability of the financial sector may become an asset for post-COVID-19 recovery. Low government effectiveness and the politicisation of the civil service may weaken the implementation capacity of the state.

Table 7.2. Bosnia and Herzegovina's socio-economic exposure and policy resilience to COVID-19

	Channels	Level of vulnerability[1]	Signalling indicators	Bosnia and Herzegovina	OECD
Socio-economic exposure	Well-being	High	Household debt (% of GDP)	28.3	68.3[2] (2018)
			Poverty headcount (measured as USD 5.50 per person per day, 2011 PPP) (% of population)	4.0 (2017)	3.6 (2016)
			Personal remittances, received (% of GDP)	11.2	0.9
			Unemployment rate	15.7	5.8
			Informal employment (% of total employment)	23.1	x
			Social protection spending (% of GDP)	16 (2016)	20.1 (2018)
			Households without high-speed Internet access (%)	37.1	15.0 (2017)
			Lack of social support (% of population)	12.0	8.6
			Life satisfaction (average score on 0-10 scale)	6.0	6.7
	Health risks	Medium	Adult smoking prevalence (%)	38.9 (2016)	23.1 (2016)
			Adult obesity prevalence (%)	17.8 (2016)	20.8 (2016)
	Trade	High	Merchandise trade (% of GDP)	88.5	42.6
			External balance on goods and services (% of GDP)	-15.2	x
	Investment	Medium	Microenterprises[3] (% among total enterprises)	90.3 (2016)	78.7 (2011)
			FDI, net inflows (% in GDP)	1.9	1.8
	Tertiary sector	Low	Tourism (% in GDP)	10.5	4.4 (2018)
	Financial and monetary	Low	Non-performing loans (% total loans)	7.4	3.7 (2018)
			Foreign currency reserve (number of months of imports)	9.2[4] (2020)	x
			Capital adequacy ratio (%)	18.0	18.88[5] (2018)
			Main interest rate (%)	3.3 (2020)	NA
Policy resilience	Public finances	Low	Gross public debt (%)	33.3/38.5 (Q2 2020)	65.8
			Public surplus (share of GDP)	0.8	-0.4
			Gross domestic savings (% of GDP)	5.0	22.7 (2018)
			Short-term debt (% of total debt)	0.4/2.4 (Q2 2020)	9 (2018)
			Foreign currency debt (% of total debt)	87/83 (Q2 2020)	x
			Debt held by non-residents (% of total debt)	73.9 (2018)	x
			External debt (% of GDP)	23.3 /26 (Q2 2020)	x
	Health sector	Medium	Spending on health care (% of GDP)	8.9 (2017)	12.5 (2017)
			Number of hospital beds per 1 000 inhabitants	3.5 (2014)	4.7 (2017)
			Physicians per 1 000 inhabitants	2.2 (2015)	2.9 (2017)
	Government effectiveness	Low	Government effectiveness index (-2.5: low effectiveness; 2.5: high effectiveness)	-0.6 (2018)	1.2 (2018)
			Rigorous and impartial public administration (0: partial; 4: impartial)	1.1	3.3 (2018)

Notes: Level of vulnerability is the OECD assessment for this report. Data are for 2019 unless otherwise specified.
1: OECD assessment.
2: Average for 25 OECD economies in 2018.
3: 1-9 employees.
4: Computations based on the six months preceding the COVID-19 crisis (i.e. the "normal" period). Yet, the figure (7.2 months) may be an underestimation due to the freeze of international trade as the monthly imports have shrunk, making Bosnia and Herzegovina able to finance more than 7 months of imports.
5: Average for 35 OECD economies in 2018.

Source: Authors' elaboration based on national and international data: Agency for Statistics of Bosnia and Herzegovina (2020[11]), Agency for Statistics of Bosnia and Herzegovina website, www.bhas.ba/?lang=en; Coppedge et al. (2020[12]), *V-Dem Dataset -- Version 10* (dataset), www.v-dem.net/en/data/data/v-dem-dataset/; IMF (2020[13]), *International Financial Statistics* (dataset), https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b; IMF (2020[14]), *Financial Soundness Indicators* (dataset), https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA; IMF (2020[15]), "World Economic Outlook Databases", www.imf.org/external/pubs/ft/weo/2020/01/weodata/index.aspx; IMF (2019[16]), *World Economic Outlook, October 2019: Global Manufacturing Downturn, Rising Trade Barrier*, www.imf.org/en/Publications/WEO/Issues/2019/10/01/world-economic-outlook-october-2019; OECD et al. (2019[17]), *SME Policy Index: Western Balkans and Turkey 2019: Assessing the Implementation of the Small Business Act for Europe*, https://doi.org/10.1787/g2g9fa9a-en; WHO (2020[18]), Global Health Observatory, https://www.who.int/data/gho.; World Bank (2020[13]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WTTC (2020[19]), *World Travel & Tourism Council* (database), https://wttc.org/Research/Economic-Impact/Data-Gateway.

Material well-being

People's material well-being is likely to worsen with the COVID-19 crisis. The poverty headcount ratio (measured as USD 5.50 per person per day, 2011 PPP) was about 4% in 2017, compared to 3.6% in OECD economies. Its incidence varies greatly across the economy and is particularly high in the western parts of Bosnia and Herzegovina (including in some of regions of Republika Srpska and cantons of the Federation of Bosnia and Herzegovina), where opportunities are lacking (Šabanović, 2016[20]).

Labour markets are not solid enough to minimise the effects of the pandemic. Already weak labour market conditions may worsen as the impact of COVID-19 on the economy heightens, thus fuelling future unemployment. At 37.8%, Bosnia and Herzegovina's employment rate is rather low – about 20 percentage points below the OECD average (57.7% in 2019). In line with the low employment rate, the unemployment rate was 15.7% in 2019, about 10 percentage points above the OECD average (5.8% in 2019). The authorities have announced various measures to retain employment, including wage subsidies (Table 7.1). Widespread informality, which accounted for 23.1% of total employment in 2018, may have a significant impact on those that have no access to access to social safety nets.

A drop in personal remittances from Bosnia and Herzegovina's diaspora could lead to income losses for some households. About 2 million citizens from Bosnia and Herzegovina live abroad (Halilovich et al., 2018[21]), and their remittances accounted for about 11.2% of GDP in 2019, compared to 0.9% of GDP in OECD economies in 2018. Potential further drop in remittances, as migrant workers tend to be more vulnerable to loss of employment and wages in the host economy, could erode the income of a significant share of households and lead to a further decrease in consumption (World Bank, 2020[22]).

Health and non-material well-being

Pre-existing risk factors related to the population's health profile and the functioning of the health system affect the country's capacity to deal with COVID-19. Bosnia and Herzegovina's overall key health outcomes are good for its income level, although significantly worse for minority populations. An ageing population and unhealthy lifestyles translate into a growing burden of non-communicable diseases (NCDs), which does not bode well in light of the current crisis. Cardiovascular diseases and lung and colorectal cancers are the leading causes of premature death, and deaths from diabetes grew by over 20% in 2007-17. Level of exposure to harmful outdoor air pollution is among the highest in Europe. Incidence of smoking is also very high (see the People section in Chapter 8) (World Bank, 2020[23]). Spending on health care accounts for 8.9% of GDP – higher than the Western Balkan average (7.5%) but lower than the OECD average (12.5%). The number of physicians and hospital beds relative to the population is in line with the OECD average, but the outlook is grim. The recent migration to Europe of qualified medical staff attracted by higher salaries will undermine Bosnia and Herzegovina's health response to the crisis.

Other, non-material aspects of well-being are affected by the crisis. Living conditions at home, where most people were asked to stay, are less than ideal for some: 37.1% of households in Bosnia and Herzegovina lack high-speed Internet, making teleworking and home-schooling difficult. Quality of life is also about people's relationships, which can provide a vital lifeline during crises and social distancing. Yet, one in ten citizens of Bosnia and Herzegovina say that they have no relatives or friends they can count on for help in times of need. Even before the COVID-19 pandemic, life satisfaction was lower than in the average OECD economy. The considerable risks of social isolation and loneliness need to be addressed by policy measures for both physical and mental health, for instance regular check-ins by social services, civil society and volunteers, and promotion of digital technologies that connect people with each other and with public services (OECD, 2020[24]).

Women are particularly exposed to the collateral effects of COVID-19. As in other economies in the region, loss of employment and lockdown conditions in Bosnia and Herzegovina are likely to have led to increased gender-based violence (Bami, 2020[25]; OECD, 2020[26]). Domestic abuse existed before the crisis: according to a 2013 survey of 3 300 families conducted by the Gender Equality Agency, one in two women had experienced some form of gender-based violence during her adult life (USAID, 2020[27]). Women are affected in other ways too. They make up the majority of the healthcare workforce, exposing them to greater risk of infection. At the same time, women are shouldering much of the burden at home, given school closures and longstanding gender inequalities in unpaid work (see the People section in Chapter 8).

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Note

[1] Bosnia and Herzegovina has three separate health systems: Republika Srpska, the Federation of Bosnia and Herzegovina and Brčko district.

8 Multi-dimensional analysis of development in Bosnia and Herzegovina

Achieving rapid, inclusive and sustainable development requires progress across a range of development domains. This chapter identifies major development constraints in Bosnia and Herzegovina. It builds on multi-dimensional analysis across the five pillars of the Sustainable Development Goals: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet. In each pillar, it highlights key areas where Bosnia and Herzegovina could further realise its full development potential.

This chapter of the MDR of the Western Balkans in Bosnia and Herzegovina identifies the key capabilities and most pressing constraints in Bosnia and Herzegovina by linking economic, social, environmental and institutional objectives. The assessment is organised around five thematic sections based on the five pillars of the 2030 Agenda: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet. Whenever relevant, Bosnia and Herzegovina is compared with a set of benchmark economies in the region (Albania, Kosovo, North Macedonia, Montenegro and Serbia), the OECD (Costa Rica, Czech Republic, Greece, Slovak Republic, Slovenia and Turkey), non-OECD economies in the European Union (Croatia and Romania) and non-OECD economies in other regions (Kazakhstan, Morocco, Philippines and Uruguay). It includes regional averages for the Western Balkans and for the OECD and European Union.

People – towards better lives for all

The People pillar of the 2030 Agenda for Sustainable Development places quality of life centre stage, focusing on the international community's commitment to guaranteeing the fulfilment of all human beings' potential in terms of equality, dignity and health. In the past decades, Bosnia and Herzegovina has improved overall living standards.

However, there is still a long way to go to achieve a society that provides opportunities for all. There are not enough formal jobs, and many do not provide enough income to escape poverty. Many groups, including young people, women, ethnic minorities and those living in rural areas are left behind in terms of economic opportunities and political voice. The country is fragmented in many ways: 1) a large public sector creates a dual labour market, 2) access to pensions, social assistance and health insurance favours the employed and war veterans rather than the least well off; and 3) complex decentralised education and social protection systems (including health) create inefficiencies and high administrative costs rather than good outcomes for citizens. Going forward, especially given the financial crunch COVID-19 will present, Bosnia and Herzegovina needs to improve the equity and financial sustainability of social protection. The People section identifies six major bottlenecks to well-being (Table 8.1).

Table 8.1. People – six major constraints to leaving no one behind in Bosnia and Herzegovina

1. Rural poverty in particular remains high, and discrimination against minority groups, such as Roma and LGBTI people, hampers their well-being.
2. Weak labour market performance excludes women and youth and does not provide a way out of poverty.
3. Education outcomes are low due to institutional deficiencies and inefficient use of resources.
4. Healthcare governance is inefficient and lacks proper planning and accountability processes.
5. Social protection financing (including for health) is over-reliant on social security contributions in a context of high informal employment.
6. Access to social protection (including for health) favours the employed and war veterans and not those most in need.

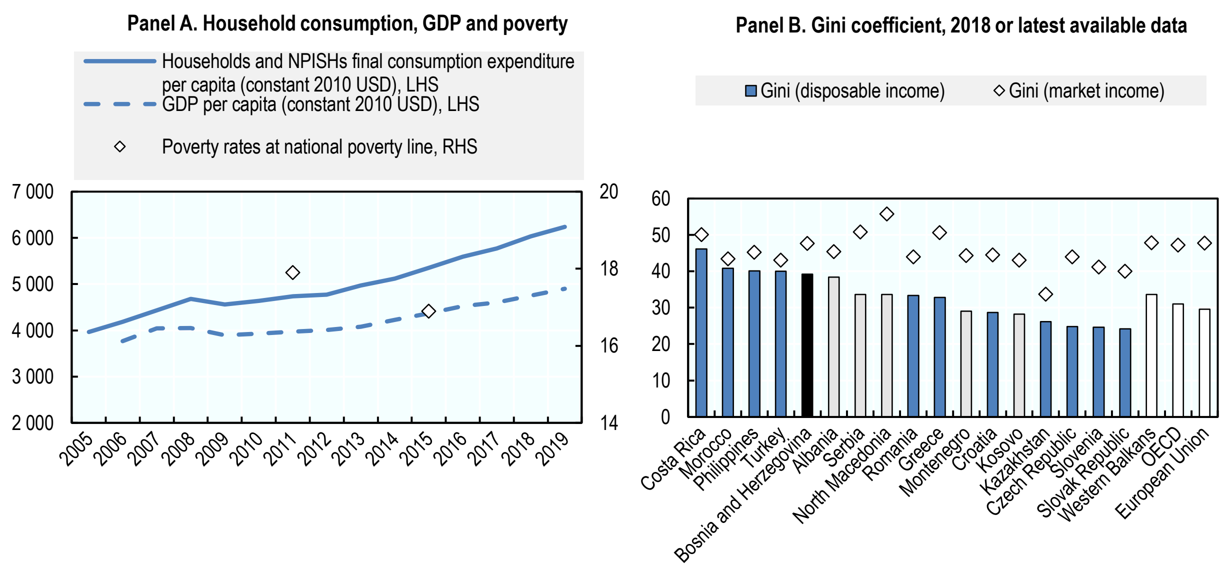
Improving well-being for all

Bosnia and Herzegovina has seen a rise in GDP per capita and household spending over the past decades, yet poverty and inequalities remain relatively high. About 17% of people live in poverty (based on the national poverty line) (Figure 8.1 – Panel A). While this is lower than in North Macedonia (21.9% in 2018), for example, it is relatively high compared to the OECD average (12%) (OECD, 2020[1]). In 2015, 15 in 100 people could not afford basic essentials, such as fuel for heating and cooking, health care or transport. Inequality is also very high (Figure 8.1 – Panel B). Among the key reasons are the political influence in gatekeeping access to stable, well-paid public-sector employment and the political influence along ethnic lines of the social policy administration, which controls access to statuary-based, non-contributory benefits (Obradović and Filic, 2019[2]).

Poverty has a disproportionally large impact on rural populations, the low-educated and children. People living in rural areas are twice as likely as city dwellers to be poor (19% vs. 9%). People with no or only primary education are also twice as likely to be poor as those with secondary education. Considering poverty is higher in large families, there is a significant risk of intergenerational poverty transfer, with rural families more affected (Brookings Institute, 2015[3]). Almost all children aged 0 to 4 (98.1%) are deprived in at least one dimension of multi-dimensional poverty,[1] and children in rural areas are more likely to be deprived in terms of early childhood education (ECE) facilities and access to the Internet and sanitation (UNICEF, 2015[4]).

Figure 8.1. Household spending has risen, and poverty has declined, but inequalities are high

Household consumption, GDP per capita and poverty rate at the national poverty line (Panel A) and income inequality, 2018 or latest available year (Panel B)



Note: NPISH = non-profit institutions serving households, LHS = left hand side, RHS = right hand side. Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.

Sources: Agency for Statistics of Bosnia and Herzegovina (2020[5]), Agency for Statistics of Bosnia and Herzegovina website, www.bhas.ba/?lang=en; Solt (2019[6]), *The Standardized World Income Inequality Database, Versions 8-9* (dataset), https://doi.org/10.7910/DVN/LM4OWF; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Bosnia and Herzegovina's sizeable Roma minority continues to experience worse well-being outcomes than the general population. At between 25 000 and 50 000 people, according to the latest estimates, Roma are the largest minority group in Bosnia and Herzegovina. Key indicators show that Roma children are three times more likely to live in poverty, five times more likely to be malnourished and two times more likely to lag behind in growth than their peers. Their primary school enrolment rate is one-third lower than the non-Roma rate, and their immunisation rate stands at 4%, compared to 68% for the general population. A European Court of Human Rights report found that ethnic discrimination against Roma is evident in the provision of services like housing, health care, education and employment (UNICEF, 2020[8]).

Lesbian, gay, bisexual, transgender and intersex (LGBTI) communities face continued discrimination and harassment. Bosnia and Herzegovina's society remains rather conservative and negative in its attitudes towards LGBTI people. Public opinion polls show that they, along with Roma, are the least-accepted minority group in the country (ERA – LGBTI Equal Rights Association for Western Balkans and Turkey, 2020[9]). According to a 2015 population survey (which did not include intersex people), 44% of citizens believed homosexuality is a sickness and would try to help their child find a cure if they found out he or she was not heterosexual. The next most popular answer was to stop communicating with their child (11%). The study found that 15% of LGBTI people had experienced physical violence because of their sexual orientation and/or gender identity, and that 72% had experienced verbal abuse and harassment (ERA – LGBTI Equal Rights Association for Western Balkans and Turkey, 2020[9]). In September 2019, under tight security, Sarajevo held its first Pride march, the last European capital to do so. While inflammatory reporting has been stopped in all major print, electronic and online media, news about LGBTI people in Bosnia and Herzegovina remains rare compared to stories about LGBTI people from abroad (UNDP/USAID, 2017[10]).

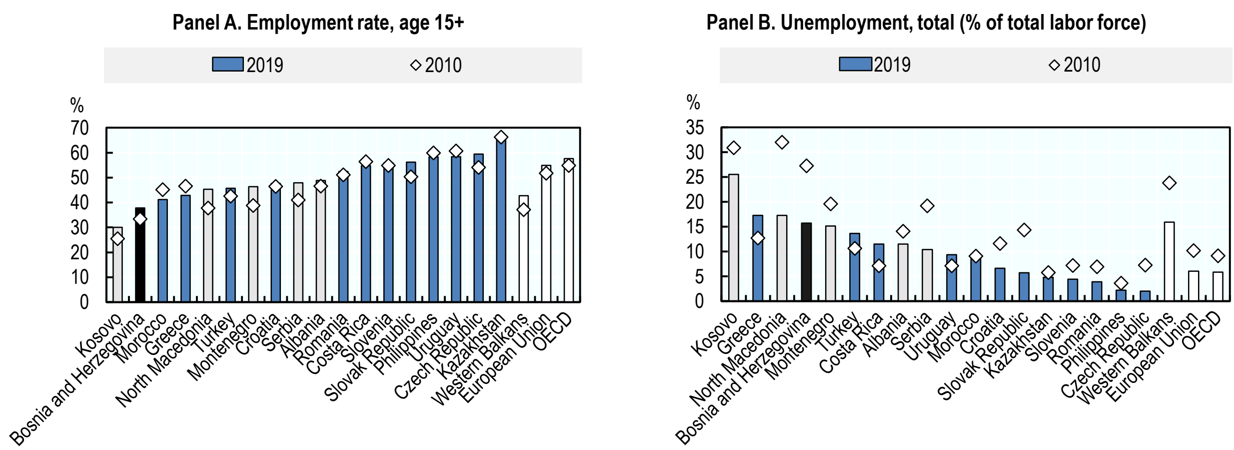
Existing legal provisions to protect LGBTI rights need to be strengthened and implemented. The LGBTI activist movement in Bosnia and Herzegovina began in 2004, making it the youngest activist movement in the Balkans. LGBTI activism over the past few years has resulted in significant improvements in legal frameworks. For instance, a 2015 amendment to the Law on Protection from Discrimination bans discrimination on the basis of sex characteristics, sexual orientation or gender identity. However, information on discrimination and hate speech is not being systematically collected or acted upon: the Ministry of Human Rights and Refugees of Bosnia and Herzegovina has not established a database, a task it was meant to complete within 90 days of the passing of the Law on Prohibition of Discrimination in 2009 (ERA – LGBTI Equal Rights Association for Western Balkans and Turkey, 2020[9]). To date, the number of reported cases of LGBTI human rights violations is extremely low, suggesting widespread under-reporting, and it can take up to three years for a case to be ruled on in the courts. Bosnia and Herzegovina does not currently recognise same-sex marriage or same-sex adoption. The Federation of Bosnia and Herzegovina appointed a working group in early 2020 to draft legislation on same-sex couples' rights, taking the first tentative step towards addressing the issue (Krupalija, 2020[11]).

Strengthening the productive potential and equal participation of all citizens, especially women and youth

Employment performance in Bosnia and Herzegovina remains weak. Bosnia and Herzegovina's employment rate (37.8% in 2019) trails behind the Western Balkans (42.7%) and is about 20 percentage points below the OECD average (57.7%) (Figure 8.2 – Panel A). The unemployment rate (15.7% in 2019) is somewhat higher than the regional average and the second highest among benchmark economies (Figure 8.2 – Panel B). Bosnia and Herzegovina has one of the highest incidences of long-term unemployment. In 2018, 82.4% of the unemployed were without a job for more than a year, which is significantly higher than the Western Balkan average (67.4%) (World Bank/Vienna Institute for International Economic Studies, 2020[12]).

Figure 8.2. Employment performance remains weak

Employment rate (%), age 15+ (Panel A) and unemployment rate, total (% of total labour force) (Panel B), 2019 and 2010



Sources: Kosovo Agency of Statistics (2020[13]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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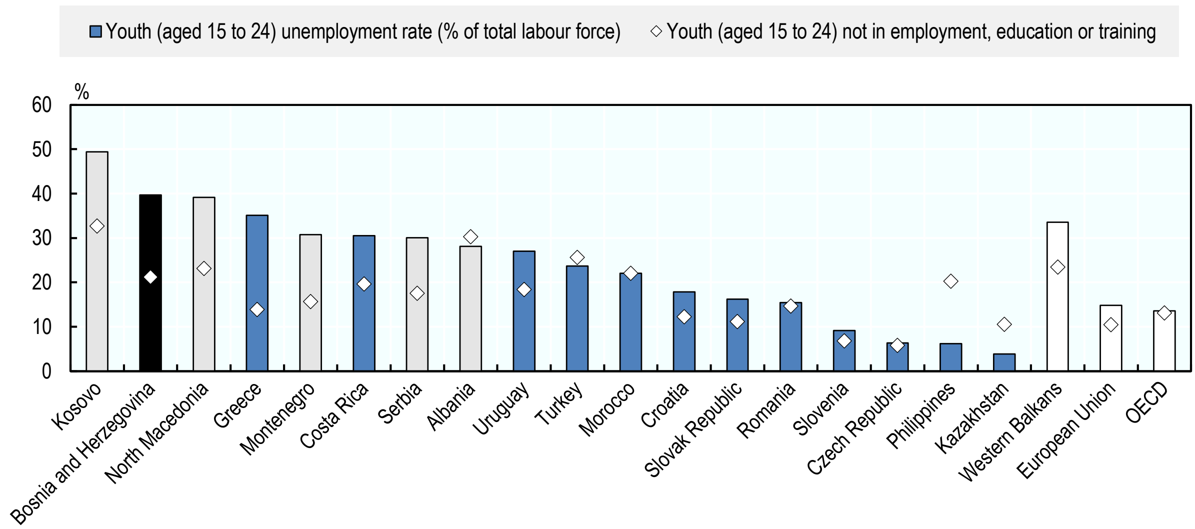
Young people and women find themselves outside the labour market

Youth integration into the labour market remains an important challenge. Youth unemployment rates are among the highest in the Western Balkans and are more than double the OECD average. About one in five people is without employment or a training activity (Figure 8.3). Poor labour market integration can be detrimental to the youth population, as young people risk losing motivation and skills or migrate abroad for better employment opportunities. According to Gallup data, approximately 57% of young people in Bosnia and Herzegovina expressed a desire to emigrate, the highest rate in the region (World Bank, 2020[14]).

Figure 8.3. Young workers need to be included in the labour market according to their potential

Youth (aged 15 to 24) unemployment rate (% of total labour force) and youth not in employment, education or training, 2019



Sources: Kosovo Agency of Statistics (2020[13]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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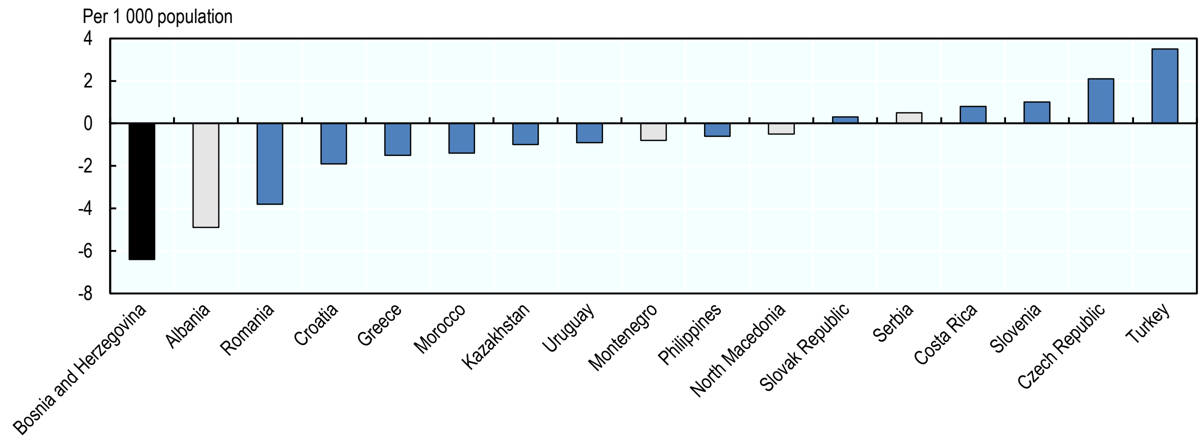
In the medium to long term, Bosnia and Herzegovina is at risk of losing and underutilising its human capital due to migration. Emigration abroad in search of better employment opportunities, especially by the young, may negatively affect the economy's development due to loss of human capital. Bosnia and Herzegovina has the highest outward migration among benchmark economies (Figure 8.4). Some 30% of those who migrated in 2018 were aged 18 to 35. People of all education levels are migrating, creating significant skills shortages, including of technical skills (e.g. construction, mechanical and electrical), which are an important skills asset for any emerging country. Many migrate immediately after university. An estimated one in six doctors trained in Bosnia and Herzegovina is now working in Germany (World Bank, 2020[14]). Reasons to emigrate include unemployment, which is the greatest concern in Bosnia and Herzegovina, overall poor living conditions, weak health care and education, and environmental concerns, particularly air pollution. At the same time, the wage differential with the European Union constitutes a strong pull factor.

Figure 8.4. Migration is very high

Net migration rate (per 1 000 inhabitants), 2015-20



Source: United Nations (2020[15]), "World Population Prospects 2019", https://population.un.org/wpp/.

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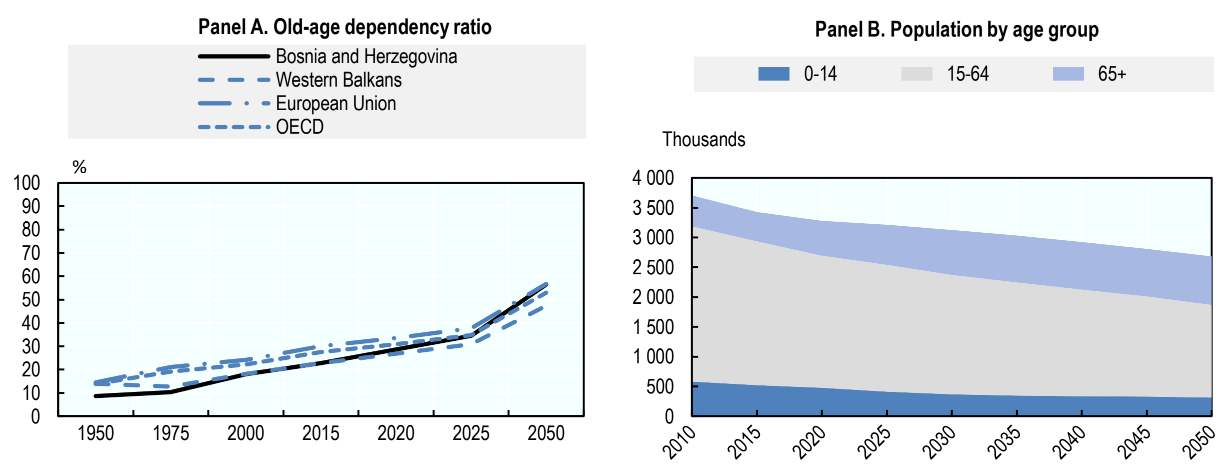
Migration, together with other factors (e.g. low fertility rates), is expected to create significant demographic pressures in Bosnia and Herzegovina. The working-age population is projected to shrink, from 67.6% in 2020 to 57.9% in 2050 (Figure 8.5). Bosnia and Herzegovina has among the lowest fertility rates in the world. The average rate of births per woman in 2018 was 1.3, compared to the OECD average at 1.7 (World Bank, 2020[7]).

Figure 8.5. Demographic pressures are on the horizon

Old-age dependency ratio projections (ratio of population age 65+ per 100 inhabitants aged 20 to 64, %) (Panel A) and population by age group (thousands) (Panel B)



Note: Western Balkan average includes Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia. No data are available for Kosovo.
Source: United Nations (2020[15]), "World Population Prospects 2019", https://population.un.org/wpp/.

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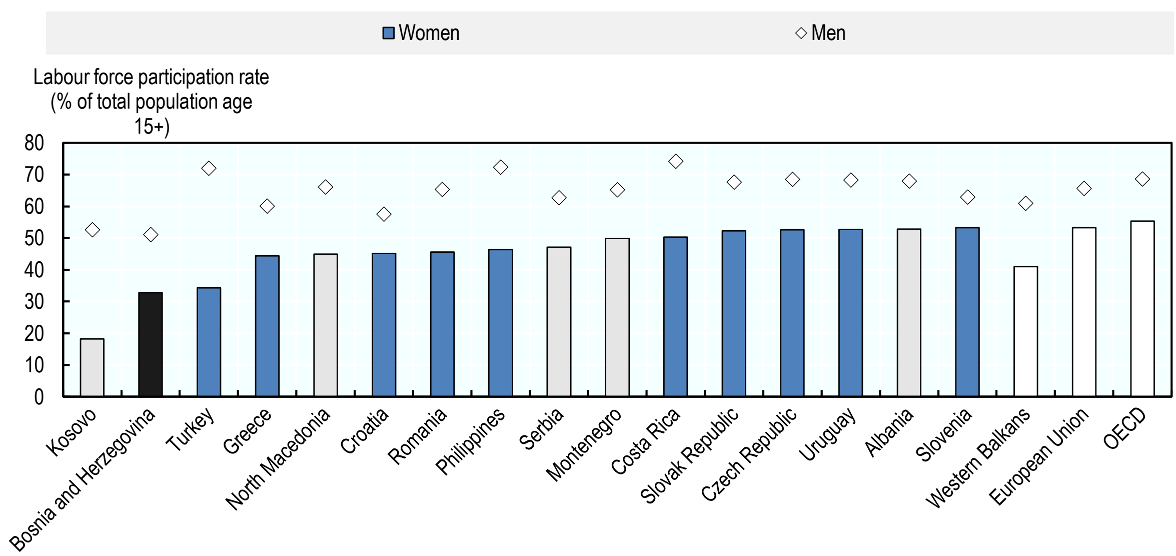
Women continue to be excluded from the labour market. Female labour market participation stood at 35.4% in 2019, 4.6 percentage points below the (also low) Western Balkan average of 40%. Women's participation is about 23 percentage points below that of men (Figure 8.6) and much lower among poor households: 15% of women from the bottom 40% of households engage in formal work, compared to 42% of their male counterparts (Brookings Institute, 2015[3]). It is estimated that women lose approximately 35 years of productive formal employment over their lifetimes. The under-representation of women in the labour market in the context of a social protection system that relies primarily on social insurance linked to employment, as described later in this section, reinforces the male breadwinner model and women's dependent status within the family. Women's wages are approximately 9% lower than men's, although the gap is less than in the average OECD country (13%) (OECD, 2020[1]; World Bank, 2020[14]).

Figure 8.6. Women are not adequately included in the labour market

Labour force participation rate by gender (% of total population age 15+), 2019



Sources: Kosovo Agency of Statistics (2020[13]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Myriad institutional factors and discriminatory social norms explain women's lack of access to economic opportunities. These include women's unpaid work responsibilities, discrimination in the workplace and traditional family relations. Indeed, virtually no men report staying home to take care of their families (Agency for Statistics of Bosnia and Herzegovina, 2017[16]). Lack of access to affordable, quality long-term care arrangements or childcare is a major issue: children attend preschool for up to three hours per day, similar to the first two grades of primary education. At the same time, while costs vary across Bosnia and Herzegovina, childcare and preschool is generally expensive. For example, in the Federation of Bosnia and Herzegovina canton of Sarajevo, public kindergarten costs about EUR 82 per month, which is around 15% of the 2017 average monthly net salary of around EUR 538 (Obradović, Jusić and Oruč, 2019[17]). This is a significant constraint for many people earning below-average wages.

Women's participation in society is not yet equal

Women are under-represented in political life, particularly in high-ranking positions and elected offices. Despite a 40% gender quota for election lists, only 21% of national parliamentary seats and 22% of ministerial positions in Bosnia and Herzegovina are currently occupied by women (World Bank, 2020[7]). This is much lower than in OECD countries, where 30.1% of member of parliament posts and 31% of minister posts are held by women, and out of line with the trend in the rest of the Western Balkans. Albania, Kosovo, North Macedonia and Serbia outperform OECD countries in terms of female representation in national parliament (OECD, 2020[1]). Low female representation is especially prevalent in local government: in the last local elections in 2016, only six women were elected local mayors out of 143 municipalities (WFD, 2019[18]). The only exception is the judiciary, where gender balance is almost attained among judges and attorneys, although women are still under-represented as heads of courts or attorney offices (World Bank et al., 2015[19]).

According to the OECD Social Institutions and Gender Index, discrimination against women in social institutions overall in Bosnia and Herzegovina is "low", but there is room for improvement when it comes to access to productive and financial resources (OECD, 2019[20]). While, from a legal perspective, men and women are equally entitled to owning assets, local customs and traditions often favour male ownership, and men represent over 70% of landowners in the country. There are no customary, religious or traditional laws that discriminate against women's legal right to obtain credit, however, in practice, women rarely own the property or assets required to provide as collateral (World Bank et al., 2015[19]).

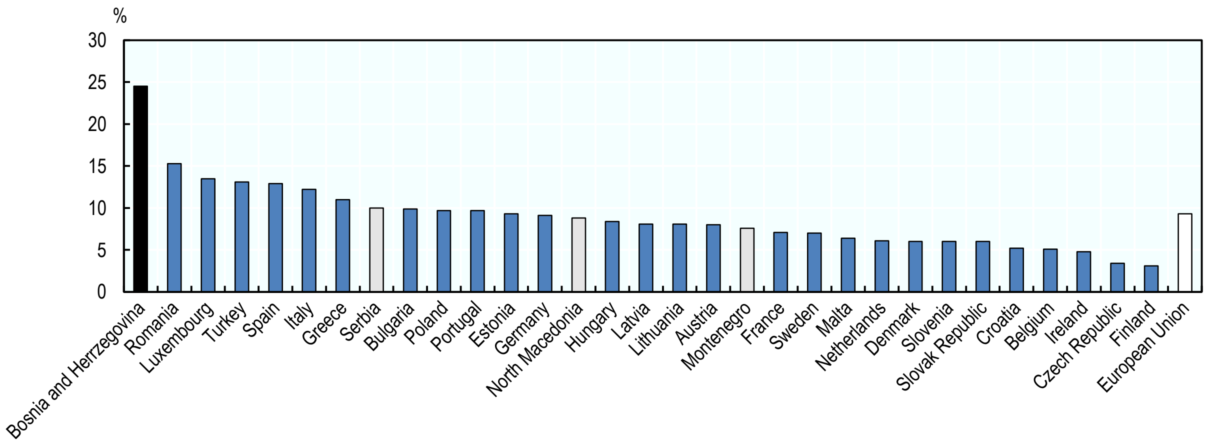
Labour market institutions need to be strengthened and working conditions improved

Informal employment in Bosnia and Herzegovina is high and incentivised by relatively high labour costs. Informal employment rates are estimated at are around 23.1% of total employment in 2019 (ILO, 2020[21]). Informality is particularly high among young workers and those with lower education (Bartlett and Oruč, 2018[22]). Relatively high labour costs, including social insurance contributions and taxes, are partly to blame: social insurance contributions amount to about 41.5% of the gross wages in the Federation of Bosnia and Herzegovina and about 33% in Republika Srpska. The tax burden on labour in Bosnia and Herzegovina is more in line with advanced EU countries than in many emerging economies (IMF, 2015[23]). It is regressive for those earning incomes below 50% of the average gross wage, whereas the effective tax burden falls as incomes increase (Atoyan and Rahman, 2017[24]). Consequently, high labour costs may deter low-wage earners from entering the formal labour market, considering that the majority of private-sector employees work for the minimum salary. In 2014, about 55% of people in Republika Srpska reported earning the minimum monthly salary or below (Đukić and Obradović, 2019[25]). Free health care for anyone registered as unemployed creates additional incentives for informal employment (World Bank, 2020[14]).

Being employed provides no assurance of improved well-being in Bosnia and Herzegovina. The overall in-work poverty rate was 24.5% in 2015, significantly higher than in other benchmark economies (Figure 8.7). Such a high rate suggests that many people work but do not receive a salary.[2] Rates are even worse for the self-employed (36%) and people who work part time (39.9%), significantly higher than for employees and full-time workers (21.5% and 19.4% in 2015, respectively) (Obradović, Jusić and Oruč, 2019[17]).

Figure 8.7. In-work at-risk-of-poverty rate

% of employed people (age 18+)



Notes: Share of people who are employed and have an equivalised disposable income below the at-risk-of-poverty threshold, which is set at 60% of the national median equivalised disposable income (after social transfers). Data for Bosnia and Herzegovina are for 2015. Data for Montenegro are for 2017.
Source: Eurostat (2020[26]), Data Explorer (database), https://ec.europa.eu/eurostat/data/database

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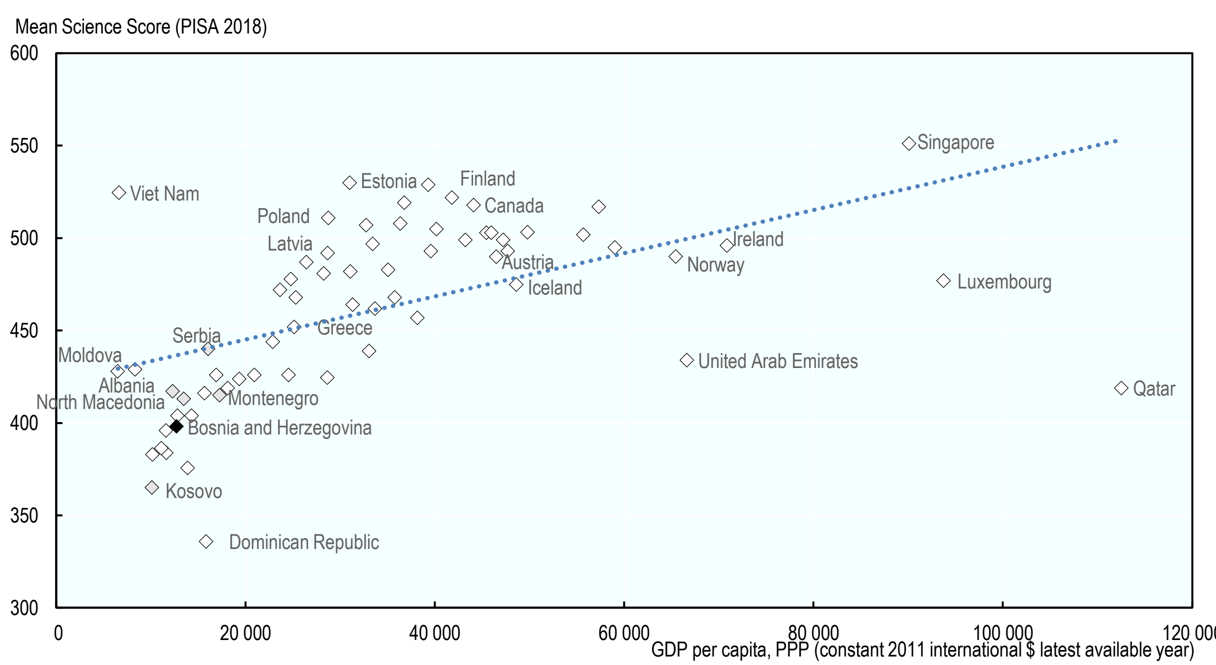
Labour market segmentation is preventing quality job creation and may increase the likelihood of informality. Considering the two major entities' differing constitutional competences for labour and social policy legislation, Bosnia and Herzegovina has in fact two labour markets. There is further labour market segmentation between the public and private sectors. Bosnia and Herzegovina has one of the large public sectors in the region. In 2013, the government spent over 12% of GDP on public-sector wages (including wages for the public administration, elected officials, public education, police and the army and excluding wages for SOEs) (IMF, 2015[23]). Employment in the public sector, including government administration and SOEs, entails significant benefits, such as higher wages, which are rare in the private sector (Obradović, Jusić and Oruč, 2019[17]). In the private sector many work precarious working conditions, including long working hours, small and delayed salaries and fear of job loss. As a result, the public sector has been significantly more attractive than the private sector, which acts as a drag on private-sector development. In a recent survey, about 40% of respondents would prefer to work in the public sector vs. 14% who would prefer to work for private companies (IMF, 2015[23]).

Activation policies are currently too limited and underfunded to connect jobseekers with quality work or to boost their skills. Considering the structural employment challenges, including long-term unemployment and skills mismatches, the absence of adequate and well-targeted activation policies can be an important obstacle to improving people's employability (Obradović, Jusić and Oruč, 2019[17]). Among the active labour market programmes (ALMPs) for unemployed, training programmes represent a very small share (10% in 2015), and the focus is on employment subsidies to companies (71% in 2015). At the same time, the overall coverage of ALMPs is very low: in 2014, an estimated 2.4% of unemployed people participated in an ALMP. Only 18% of ALMP participants undertook training programmes in 2015. Low spending further undermines activation policies. Bosnia and Herzegovina spent about 0.15% of GDP on ALMPs in 2015 (Numanović, 2016[27]). In comparison, benchmark countries such as Slovenia and Croatia spent 0.61% and 0.71% in 2018, respectively (European Commission, 2020[28]).

Boosting education quality

The education system in Bosnia and Herzegovina suffers from low access and poor education outcomes. The country has high structural unemployment, which affects those with low and high education alike. Education enrolment rates are comparatively low. First, ECE enrolment is too low for the future labour force to develop adequate cognitive and socioemotional skills and affects education outcomes at the secondary and tertiary levels. The net ECE enrolment rate in 2018 was 14% (Agency for Statistics of Bosnia and Herzegovina, 2020[5]), compared to the OECD and EU averages of 95.3% (Eurostat, 2020[26]). The ECE enrolment was 18.3% in Republika Srpska and less than 3% in the Federation of Bosnia and Herzegovina in 2015 (OECD, 2018[29]). Net enrolment rates at the primary and secondary levels are also rather low given Bosnia and Herzegovina's income level (83.7.% and 75.1% in 2018, respectively). The tertiary level enrolment rate is also relatively low (23% in 2018) (Agency for Statistics of Bosnia and Herzegovina, 2020[5]). Education outcomes are inadequate. Considering Bosnia and Herzegovina's level of development, student performance in the OECD Programme for International Student Assessment (PISA) shows that Bosnia and Herzegovina is lagging behind regional and other economies (Figure 8.8). The share of students who achieved minimum proficiency ranged from 42% to 46%, depending on the subject. This is considerably below the OECD averages of between 76% and 78%. There is also a lack of equity in education. The achievement gap between students from Bosnia and Herzegovina's top and bottom income groups is equivalent to almost 1.5 years of schooling (OECD, 2019[30]).

Figure 8.8. Education outcomes are low given Bosnia and Herzegovina's level of development



Source: OECD (2020[31]), *PISA* (database), https://www.oecd.org/pisa/data/.

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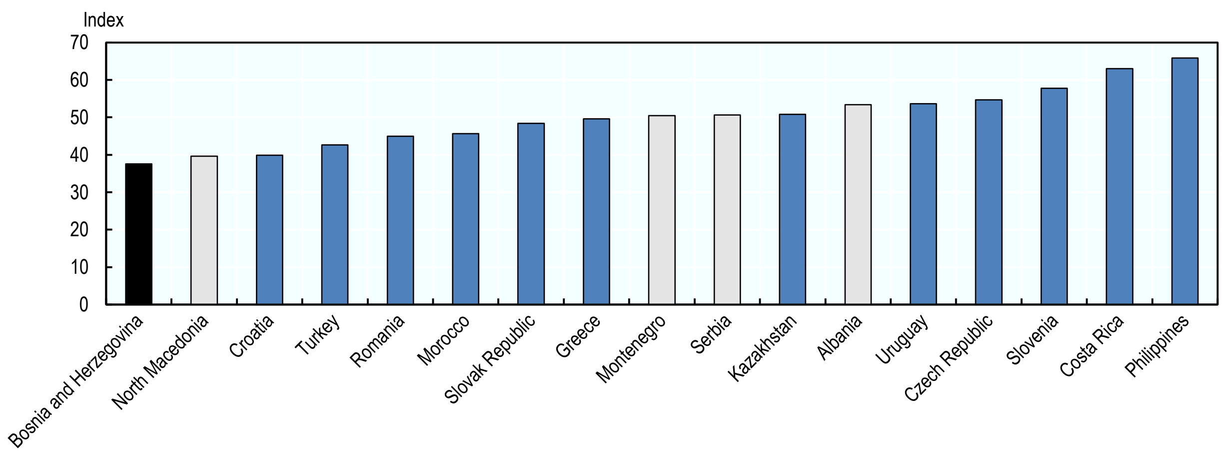
Many citizens lack skills in demand in the labour market. In a recent survey, about 30% of respondents said that the skills they acquired during their education did not meet the needs of their jobs (see the Prosperity section in this chapter). Some 58% of firms believe that the education system does not impart the skills needed in the current labour market (World Bank, 2017[32]). Broader measures of skills in the labour force also show that Bosnia and Herzegovina is lagging behind other economies (Figure 8.9).

Figure 8.9. The skills of Bosnia and Herzegovina's workforce are low

Skills of current workforce Index, 2019



Source: WEF (2019[33]), *Global Competitiveness Index* (dataset), https://tcdata360.worldbank.org/.

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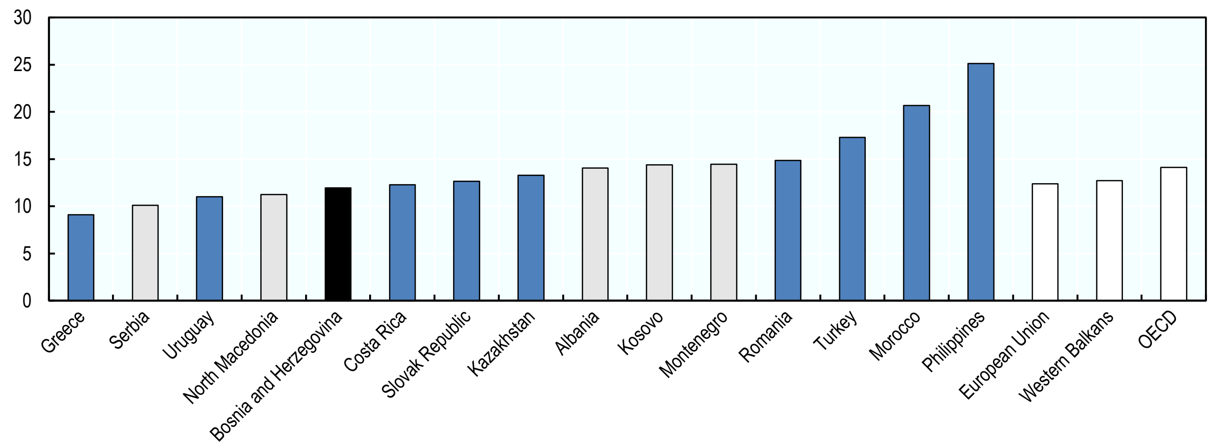
Institutional deficiencies and inadequate use of resources have a major impact on education quality. The complex and decentralised education system in Bosnia and Herzegovina has high administrative costs. While public spending per student in primary and secondary education is high (around 25% to 30% of per capita GDP) compared to peer economies, the outcomes are low given the spending (World Bank, 2020[14]). At the same time, while the number of students has declined in recent years, the number of teachers has increased, indicating a very small and favourable pupil/teacher ratio (Figure 8.10). Because of this oversupply, pre-university teacher salaries account for approximately 90% of education spending, much higher than the 78% to 80% in EU and OECD countries. In addition, a high proportion of salary spending goes to non-teaching staff, who account for one-third of primary school staff, higher than in better-performing education systems. The large salary expenditures mean that there are few resources to invest in quality facilities, teaching materials and teacher training (World Bank, 2020[14]). As an example, Bosnia and Herzegovina has the lowest share of vocational teachers participating in any kind of training, except for continuing professional development at businesses, in which Bosnia and Herzegovina only trails behind Turkey (Table 8.2). Furthermore, the lack of comparable data on learning outcomes and the absence of a state-wide student assessment system to measure these outcomes hinder regular performance monitoring (Obradović, Jusić and Oruč, 2019[17]).

Figure 8.10. Low pupil/teacher ratios are not reflected in education outcomes

Pupil/teacher ratios at the primary, secondary and upper secondary education levels, 2018



Sources: Kosovo Agency of Statistics (2020[13]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Table 8.2. Vocational teachers participating in various forms of professional development (%), 2014/15

	In-service training	Professional development in vocational specialism	Conferences/seminars	Observation visits to schools	Continuing professional development at businesses	No continuing professional development
Albania	56	23	17	31	29	35
Bosnia and Herzegovina	54	32	13	15	32	40
Kosovo	56	36	27	18	16	35
North Macedonia	65	34	35	24	24	27
Montenegro	76	40	37	19	27	21
Serbia	92	54	35	38	31	4
Turkey	47	37	47	30	49	19

Source: ETF (2017[34]), *Torino Process 2016-2017: South Eastern Europe and Turkey*, http://dx.doi.org/10.2816/341582.

Improving health and social protection outcomes

Healthcare governance is fragmented, inefficient and not financially sustainable, leading to subpar and inequitable health outcomes

Bosnia and Herzegovina's overall key health outcomes are good for its income level, although they are significantly worse for minority populations. In 2017, life expectancy at birth (77.4 years) and under age 5 child and maternal mortality rates (5.9 per 1 000 and 10 per 100 000 live births, respectively) were better than regional averages (World Bank, 2020[7]). The latest available data (2012) on child health showed that mortality rates for under age 5 Roma children were much higher (24 per 1 000 live births) and that one-quarter of Roma children were stunted, while 8% were seriously lagging behind the rest of the population in growth (UNICEF, 2020[8]).

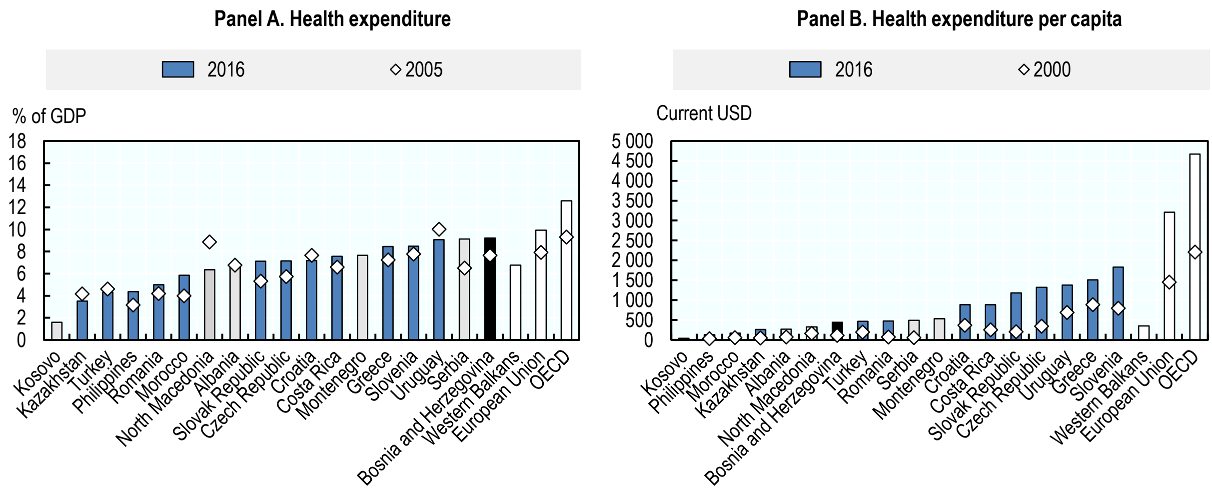
As in other economies in the region and in the OECD, an ageing population and unhealthy lifestyles translate into a growing burden of NCDs. Cardiovascular diseases and lung and colorectal cancers are the leading causes of premature death, and deaths from diabetes grew by over 20% in 2007-17 (IHME, 2020[35]). Lack of exercise, tobacco consumption and a traditional diet based on meat and carbohydrates are the main risk factors. In 2019, 9% of the population had diabetes, and 24% of men and 29% of women were obese, compared to 6.4% and 19%, respectively, in the average OECD country (OECD, 2020[1]; OECD, 2017[36]; WHO, 2013[37]). Over one-third of Bosnia and Herzegovina's adult population is classified as "insufficiently physically active" (WHO, 2013[37]). Levels of exposure to harmful outdoor air pollution are among the highest in Europe (see the Planet section in this chapter), and although tobacco consumption has decreased slightly over the past decade, Bosnia and Herzegovina remains among the world's ten countries with the highest smoking rates: almost 40% of adults smoked regularly in 2016 (World Bank, 2020[7]). The country can do more to discourage tobacco use. Smoking in public places is not currently banned, and retail cigarette prices (EUR 2.66 per pack in 2017) are among the lowest in Europe (Tobbacotaxation, 2018[38]).

The preventative care component of Bosnia and Herzegovina's primary healthcare sector needs to be strengthened. As a first step, a 2013-19 project funded by the Swiss Agency for Development and Cooperation led to the endorsement of two action plans for the prevention and control of NCDs and included a nationwide programme to improve the quality of and access to standardised cardiovascular risk assessment and management services in primary health care and family medicine (WHO, 2019[39]).

The organisation of health care is fragmented and costly and delivers subpar outcomes compared to economies that spend less. The entities have independent health protection systems: while public health care in Republika Srpska is centralised, each canton in the Federation of Bosnia and Herzegovina has its own health insurance fund and corresponding cantonal ministry of health. A total of 13 subsystems at the entity and canton levels leads to duplication and higher co-ordination costs and prevents economies of scale in healthcare management. Partly due to administrative costs, Bosnia and Herzegovina allocates a very high proportion of resources to health care: per capita expenditure is above the regional average, and expenditure in terms of GDP is the highest among neighbouring economies and close to the EU average (10%) (Figure 8.11). Yet, 78% of the population considers the quality of health care to be low or very low. In a 2016 multi-country survey, 48% of respondents were satisfied with the healthcare system, the lowest percentage in the region (World Bank, 2020[14]).

Figure 8.11. Bosnia and Herzegovina spends the largest share of GDP on health in the region

Health expenditure as a share of GDP (Panel A) and per capita, current USD (Panel B)



Source: World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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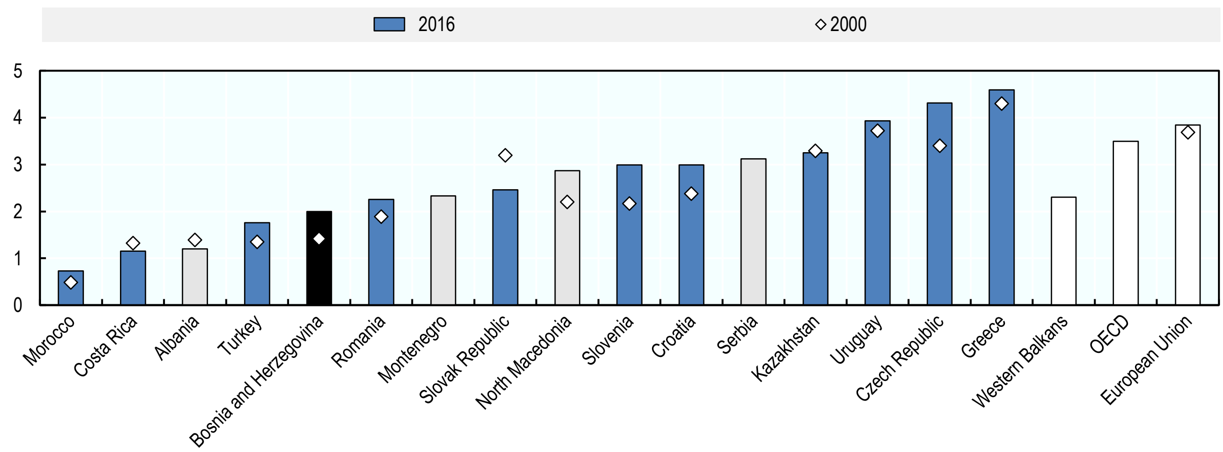
Healthcare governance challenges need to be addressed to increase efficiency and performance. Unclear oversight of expenditures, absence of medical centre performance assessments and accountability, and lack of merit-based hiring and overstaffing in nonmedical functions are some of the key issues in the public health sector (World Bank, 2020[14]). As in neighbouring economies, doctor and nurses are emigrating abroad in search of better working conditions, and even though there are more medical staff now compared to the end of the war, Bosnia and Herzegovina has the lowest number of doctors per capita in the region after Albania (Figure 8.12). There is no special legal framework to purchase medication, which instead falls under general public procurement regulations. This has led to frequent delays in the supply of essential drugs. Informal payments for health care are frequent, as they are in the rest of the Western Balkans (Mejsner and Karlsson, 2017[40]). A small but growing number of patients are turning to comparatively more efficient and available private-sector clinics and pharmacies, especially when it comes to dentistry, diagnostics, over-the-counter medicines and therapeutic and specialist services: 2.7% of health expenditure was spent at private health providers in 2016, higher than the EU average of 2.2% (Friedrich Ebert Stiftung, 2017[41]).

Figure 8.12. The number of doctors per capita in Bosnia and Herzegovina is low

Practising physicians (per 1 000 inhabitants), 2016 and 2000



Notes: The Western Balkan average excludes Kosovo, for which no data are available. The European Union average refers to the Eurozone. Latest available data refer to 2017 for Morocco, 2015 for Montenegro and North Macedonia and 2014 for Turkey.
Sources: OECD (2020[42]), *Health Statistics* (database), www.oecd.org/health/health-statistics.htm; WHO (2020[43]), *The Global Health Observatory* (database), www.who.int/gho/database/en/.

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Reliance on payroll contributions threatens the financial sustainability of Bosnia and Herzegovina's public healthcare system. In general, health care in both the Federation of Bosnia and Herzegovina and Republika Srpska are financed by a comprehensive system of social security contributions (making up 91% and 87% of revenue, respectively), participation fees for certain services and government transfers (see the Partnership and financing section in this chapter). This makes the systems highly dependent on the performance of the labour market, which is characterised by informality, rising emigration and grim prospects from demographic factors and the likely economic fallout of the COVID-19 pandemic. Although the total number of people registered as employed has risen incrementally, health expenditure has consistently exceeded revenues, and debt to suppliers and tax authorities runs into the hundreds of millions (EUR) (Obradović, Jusić and Oruč, 2019[17]). The country's current arrangement with the IMF requires entities to implement a budget allocation ceiling for social expenditure. There is thus limited space for reform towards greater dependence on government budget financing in the medium term, an issue that also applies to social protection, as described below.

Access to health care under the current health insurance system is unequal, costly for patients and disincentivises formal employment. In 2018, an estimated 20% of Republika Srpska inhabitants were without health insurance, either because they were not registered (14% – an issue especially among Roma), or because employers did not pay their health insurance contributions on time (6%) (ESPN, 2019[44]). Some 90% of the population in the Federation of Bosnia and Herzegovina was registered as insured in 2017, but this estimation does not include people with unpaid employer contributions. Coverage varies significantly across cantons in the Federation of Bosnia and Herzegovina, with as few as 63.7% of people registered in Canton 10 (Martić and Đukić, 2017[45]). Since each canton operates its own insurance system, which is in turn dependent on local labour market conditions, services covered also vary widely (Friedrich Ebert Stiftung, 2017[41]; ESPN, 2019[44]). For instance, average total spending per health insurance fund member in the Federation of Bosnia and Herzegovina ranged from EUR 232 in the Central Bosnia canton to EUR 448 in the Sarajevo canton in 2015 (Friedrich Ebert Stiftung, 2017[41]). The rate of out-of-pocket payments (29% of total health expenditure) is lower than the regional average but still double the rate in EU and OECD countries (World Bank, 2020[7]). Private-sector providers are not generally covered under public health insurance and need to be paid in full by patients. Health care is provided free to people registered as unemployed (18.6% of all insured in the Federation of Bosnia and Herzegovina and 22% in Republika Srpska) and their family members but not to the working poor, including people in low paying jobs and people working under temporary contracts. This creates incentives for informal work, and the current practice of stamping insurance cards monthly has public employment bureaux spending unnecessary time processing unemployment benefits rather than connecting jobseekers with employers (World Bank, 2020[14]).

The social protection financing model is unsustainable and does not provide equal access to benefits for the most needy

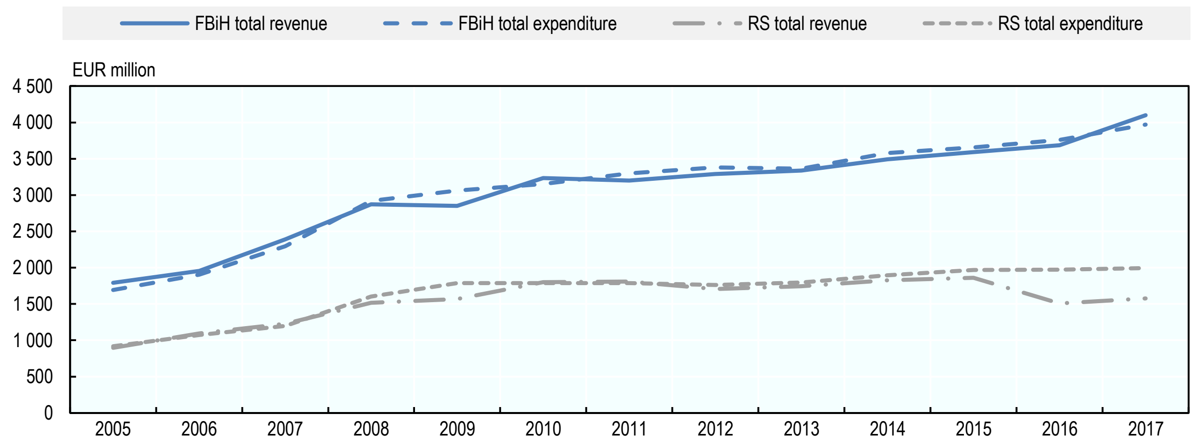
As with health care, social insurance spending is comparatively high, particularly for pensions. In 2017, the country's social protection spending (including health) constituted 17.8% of GDP, the second highest level in the Western Balkans after Serbia, although still lower than the EU average of 26.8% (Eurostat, 2018[46]). More than two-thirds is allocated to social insurance schemes, which spending increased by four percentage points to 76% of total expenditure in 2011-16. Pension and disability insurance constituted approximately 10% of GDP in the two entities in 2017, higher than the OECD average of 8% (ESPN, 2019[44]).

Pensions in Bosnia and Herzegovina are overly reliant on social contributions. Both entities' pension funds function on the pay-as-you-go principle and are largely financed by social security contributions (87% in the Federation of Bosnia and Herzegovina and 99% in Republika Srpska in 2018) (ESPN, 2019[44]). This is unusual: no EU country has such a high share of social security contribution financing, and almost all lowered their relative share of social contribution financing in the last decade in the context of demographic pressures and post-financial crisis economic recovery efforts. Given the low formal labour market participation, which is in turn exacerbated by the relatively high social contributions,[3] each contributor currently supports more than 1.13 pensioners, one of the highest burdens per contributor in Europe (Efendic, Pasovic and Efendic, 2018[47]; World Bank, 2020[14]).

Sustainable pension financing will be a challenge. A steady rise in social insurance fund revenues through more formal jobs in recent years was not sufficient to offset higher expenditure, and both funds were forced to take loans to pay out pensions (Figure 8.13). Given expected negative labour market trends, especially in the context of the COVID-19 pandemic, the entities will need to explore alternative and more sustainable financing models. Both governments have recently transferred or announced the transfer of pension financing to their treasury systems to guarantee payments. In 2018, the government of the Federation of Bosnia and Herzegovina also introduced a decrease of social contributions and a progressive tax rate of 13% (up from 10%) for all salaries above BAM 800 (EUR 410), to be implemented in 2020. It is not yet clear how the resulting drop in social insurance funds will be offset in the short term (ESPN, 2019[48]).

Figure 8.13. Pension funds frequently run a deficit in both entities

Total revenue and expenditure of entity pension and disability insurance funds (excluding transfers to offset benefits) (EUR millions)



Notes: FBiH = the Federation of Bosnia and Herzegovina. Republika Srpska = Republika Srpska.
Source: Calculations based on Federation of Bosnia and Herzegovina Pension and Disability Insurance Fund and Republika Srpska Pension and Disability Insurance Fund cited in (ESPN, 2019[49]), *ESPN Thematic Report on Financing Social Protection – Bosnia and Herzigovina*, https://ec.europa.eu/social/main.jsp?advSearchKey=ESPN_financing2019&mode=advancedSubmit&catId=22&policyArea=0&policyAreaSub=0&country=0&year=0.

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The current pension system cannot be considered fair and excludes informal workers. Although pension benefits are not particularly generous (net replacement rates were just above 40% of net wages, compared to almost 60% in OECD countries), high spending is largely the result of early retirements and war veterans receiving disability or special pensions (OECD, 2017[50]; Bošnjak, 2016[51]). For instance, in 2017, in the Federation of Bosnia and Herzegovina, the government's bill for early retirement of 1992-95 conflict army veterans was BAM 122 million (EUR 65.5 million) (ESPN, 2019[49]), leading to a situation where one-third of all pensioners in Bosnia and Herzegovina are younger than age 65, while approximately 38% of elderly adults, mostly informal workers, collect no state pension at all (World Bank, 2020[14]). Going forward, the entity governments could introduce incentives for later retirement and encourage voluntary pension schemes for informal workers. A relevant pension reform law exists in Republika Srpska, and the first steps towards a voluntary pension fund were taken in 2017.

Social assistance in Bosnia and Herzegovina is dominated by categorical benefits for war veterans rather than targeting the least well off. Overall expenditures for non-contributory social assistance represented 4% of GDP in 2016, but means-tested benefits only accounted for 2.7% of all social protection benefits in 2017, compared to 11.8% in the European Union (Eurostat, 2020[52]; ESPN, 2019[44]). Approximately 60% of social assistance spending is allocated to various categories of war veterans, regardless of need: over 20% of overall assistance for veterans is given to the 40% of beneficiaries with the highest incomes. On the other hand, less than half the bottom quintile of the rest of the population receives social assistance, and social assistance reduces poverty only by an estimated 4.6 percentage points, well below the average effect of more than 10 percentage points in other upper-middle income countries (World Bank, 2020[14]). While a shift towards means-tested universal benefits is needed to cover those most in need, under IMF conditionality, more resources can only be allocated to the needy if war-related benefits are reduced.

Like health care, social assistance is fragmented and poorly co-ordinated. A decentralised system of more than 20 central and local ministries with separate administrative systems in each entity has contributed to extensive regulatory inefficiencies and significant inequalities among entities and cantons (see the Peace and institutions section in this chapter) (World Bank, 2020[14]). For instance, cantons in the Federation of Bosnia and Herzegovina apply different laws when determining eligibility for financial assistance, including diverging treatment of household income components and differing percentage increases in assistance for additional or incapacitated household members (Delalić et al., 2020[53]). Harmonising legislation and standardising qualification criteria at the entity level at least would lead to equal treatment of citizens, regardless of their place of residence.

Prosperity – boosting productivity

The Prosperity pillar of the 2030 Agenda for Sustainable Development calls for broad-based economic growth shared by all people. Over the past decade, Bosnia and Herzegovina has made progress in building a more competitive, export-oriented market economy. The economy's growth has become more balanced, supported by external demand and domestic consumption, and macroeconomic and financial-sector stability have been restored.

Despite this progress, Bosnia and Herzegovina still faces considerable challenges in achieving the prosperity-related goals of the 2030 Agenda. Private-sector investment, including FDI, is very low, productivity growth is weak, and the unemployment rate remains one of the highest in Europe and the world. These outcomes reflect a number of constraints: a challenging business climate, compounded by a fragmented internal market and unfair competition from the sizable SOE and informal sectors; a significant infrastructure gap that undermines trade and GVC integration; and a skills gap and weak innovation and technology adoption that limit the potential for economic upgrading (Table 8.3).

Table 8.3. Prosperity – five major constraints to a more dynamic economy of Bosnia and Herzegovina

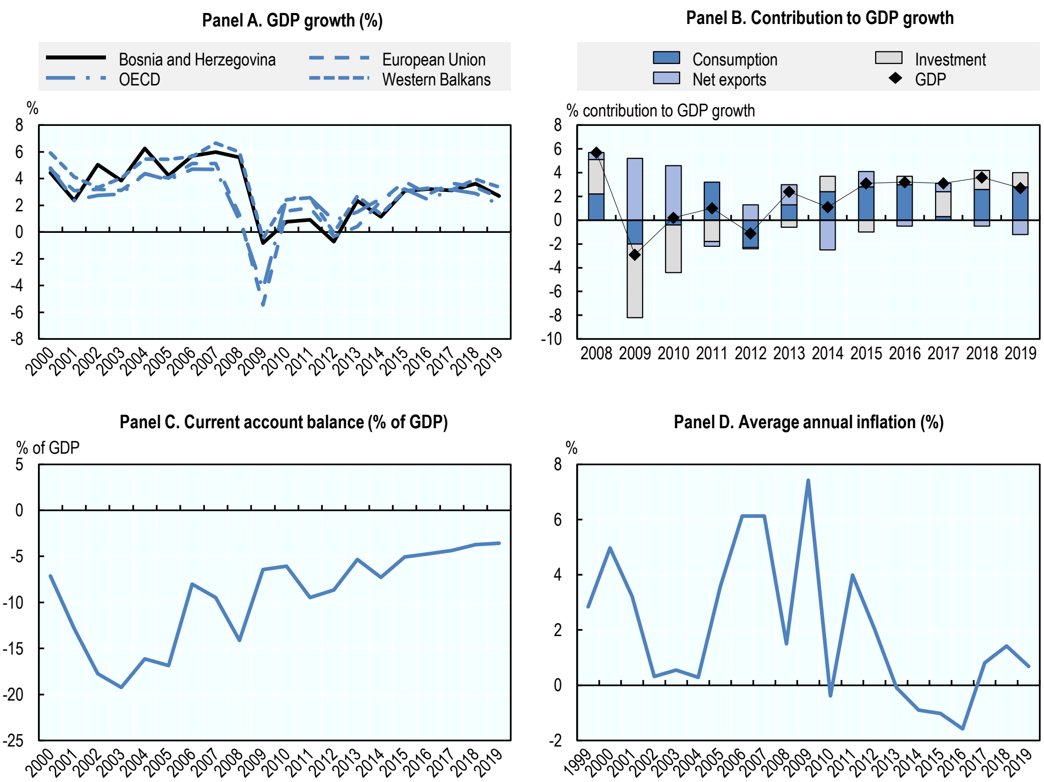
1. Weak investment and productivity have constrained economic growth in the post-crisis period.
2. A fragmented internal market and high bureaucratic burden create a challenging environment for private-sector development.
3. The large and inefficient SOE sector creates unfair competition for private enterprises.
4. Infrastructure gaps impede connectivity with the Western Balkans and beyond.
5. The lack of a skilled workforce limits the potential for economic upgrading and expansion of the tradable sector.

Weak investment and productivity have constrained economic growth in the post-crisis period

Prior to the global financial crisis, the growth of Bosnia and Herzegovina's economy was strong but unbalanced. In the run-up to the crisis, between 2005 and 2008, annual GDP averaged 6% (Figure 8.14 – Panel A). Growth was mainly consumption driven (Figure 8.14 – Panel B), fuelled by credit growth from the newly privatised financial sector (up from 26% to 53% of GDP between 2001 and 2008) (World Bank, 2020[7]) and high and rising remittances (up from USD 1.4 billion in 2002 to USD 2.8 billion in 2008, averaging 18% of GDP over the period) (see the Partnerships and financing section in this chapter) (World Bank, 2020[7]). However, this growth model, accompanied by loose fiscal and monetary policy, resulted in the build-up of significant imbalances, including high current account deficit (Figure 8.14 – Panel C), high inflation (Figure 8.14 – Panel D) and the accumulation of bad credit that led to a high share of NPLs in the crisis aftermath (peaking at 15% in 2013) (see the Partnerships and financing section in this chapter).

Over the past decade, economic growth has become more balanced but is still largely driven by domestic consumption. Since 2009, GDP growth has declined considerably as the pre-crisis growth engines faltered and new growth engines were slow to emerge due to weak progress on structural reforms. Growth also became more balanced through increasing external demand and moderating domestic demand (Figure 8.14 – Panel B). Macroeconomic stability improved considerably as a result (Figure 8.14 – Panels C and D). Nevertheless, the economy remains largely consumption driven (consumption accounts for 96% of GDP) (World Bank, 2020[7]), with a significant contribution from the public sector. General government spending accounts for 20% of GDP, compared to the 15% average for the remaining Western Balkan economies. Bosnia and Herzegovina also has the largest SOE sector in the region, accounting for 10% of value added (World Bank, 2020[7]) (see the Partnerships and financing section in this chapter).

Figure 8.14. Growth performance weakened in the post-crisis period but became more balanced



Sources: IMF (2020[54]), *World Economic Outlook Databases* (database), www.imf.org/external/pubs/ft/weo/2019/02/weodata/index.aspx; IMF (2020[55]), "International Monetary Fund: Bosnia and Herzegovina", www.imf.org/en/Countries/BIH; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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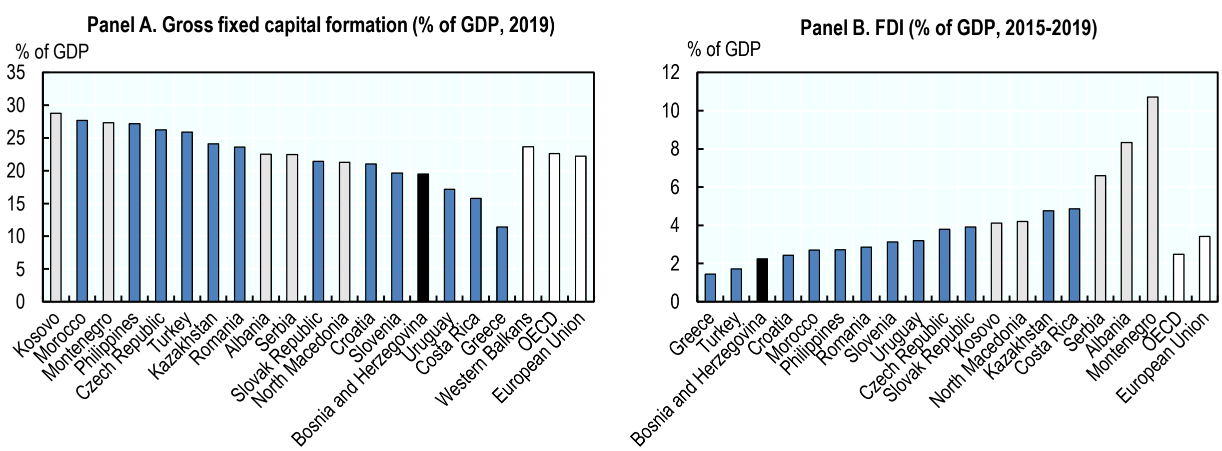
Investment has been low compared to regional peers, having declined considerably in the period following the global financial crisis. Between 2005 and 2008, investment accounted for 24% of annual GDP. Since then, its GDP contribution has declined to below 20% and has remained relatively stagnant. This level of investment is low relative to regional and global peers and to the more advanced EU and OECD economies (Figure 8.15 – Panel A). Private investment has been particularly low, contributing 7% of GDP in 2019 and an estimated 3% of GDP in 2018 (IMF, 2020[56]). Bosnia and Herzegovina has also struggled to attract FDI, despite the introduction of fiscal and other incentives similar to those of regional peers (Foreign Investment Promotion Agency of Bosnia and Herzegovina, 2020[57]). Between 2015 and 2019, FDI inflows accounted for just 2.2% of GDP, well below most regional and global peers (Figure 8.15 – Panel B). This relative underperformance likely reflects the more challenging business environment posed by the country's fragmented internal market, high bureaucratic burden, large state footprint in many sectors and high infrastructure gap.

Figure 8.15. Total investment in the economy is low compared to regional peers, including FDI



Source: World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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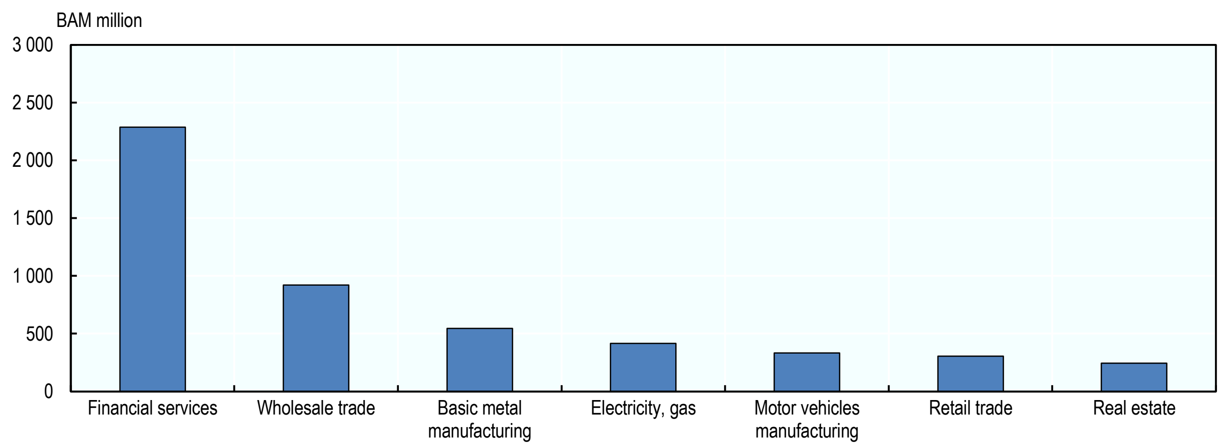
Investment has not gone to export-oriented sectors or sectors that can enhance productivity. The largest share of FDI inflows over the past four years has gone to the non-tradable sector, including financial services, wholesale and retail trade, energy and real estate. Export-oriented FDI has been relatively limited and largely focused on raw materials (Figure 8.16). Moreover, most FDI inflows over the past few years have been earnings reinvested into existing FDI, while greenfield investment has been very low and concentrated mainly in the tourism sector (European Commission, 2019[58]). As a result, the structural transformation of the economy has been limited, and sectoral value added and employment have remained relatively unchanged over the past decade, with the exception of some labour reallocation from the agriculture sector to the services sector (Figure 8.17).

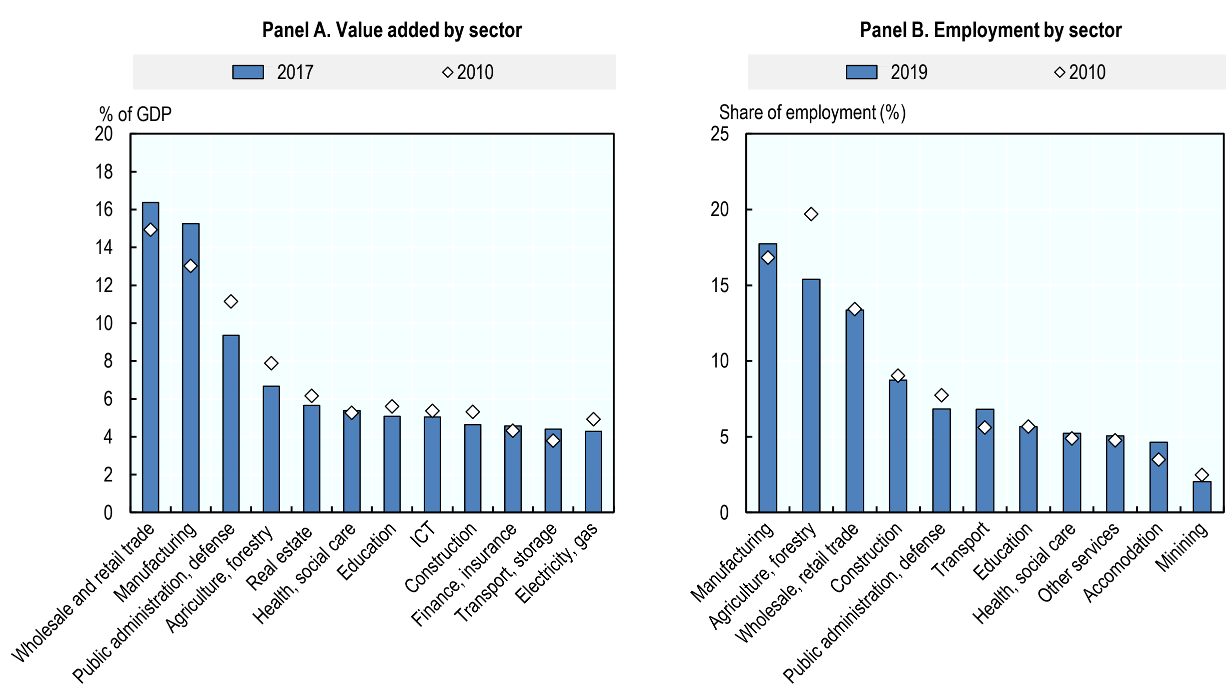
Figure 8.16. FDI (2016-19) has been concentrated in the non-tradable sector



Source: Central Bank of Bosnia and Herzegovina (2020[59]), *Statistical Web Portal – Main Economic Indicators* (database), http://statistics.cbbh.ba/Panorama/novaview/SimpleLogin_en_html.aspx.

StatLink https://doi.org/10.1787/888934242802

Figure 8.17. Value added by sector has not changed much in the post-crisis period, while employment has shifted from agriculture to services



Note: ICT = information and communications technology.
Sources: ILO (2020[21]), *ILOStat* (database), https://ilostat.ilo.org/data/; United Nations (2020[60]), *UNdata SDG Indicators* (database), http://data.un.org/Default.aspx.

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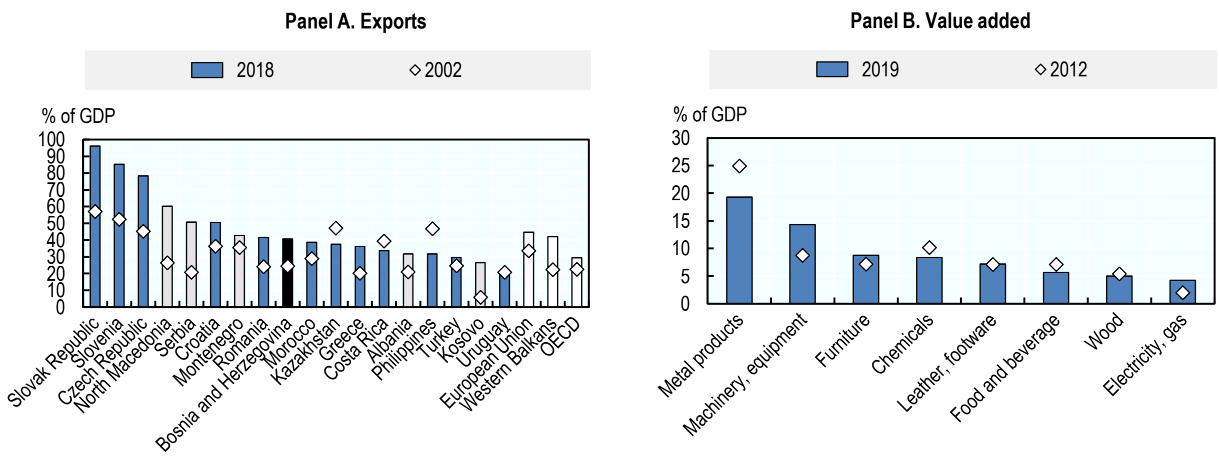
Exports are diverse and have increased considerably in recent years. Bosnia and Herzegovina's exports increased significantly in the post-crisis period: 40% of GDP in 2019, compared to 24% in 2002 (Figure 8.18 – Panel A). The export basket is relatively well-diversified due to the country's strong industrial past. Top goods exports include base metals, machinery, furniture and wood products, chemicals and apparel. The share of base metal exports has declined in recent years, largely in favour of increased machinery and power exports (Figure 8.18 – Panel B). The period also saw growth in export-oriented service sectors, including construction and tourism (European Commission, 2019[58]). However, exports are still dominated by raw materials and low value added manufacturing products, and there is considerable scope for further diversification and upgrading of the export basket.

Figure 8.18. Exports' share in GDP has increased, but they are still dominated by low value added products



Sources: United Nations (2020[60]), *UNdata SDG Indicators* (database), http://data.un.org/Default.aspx; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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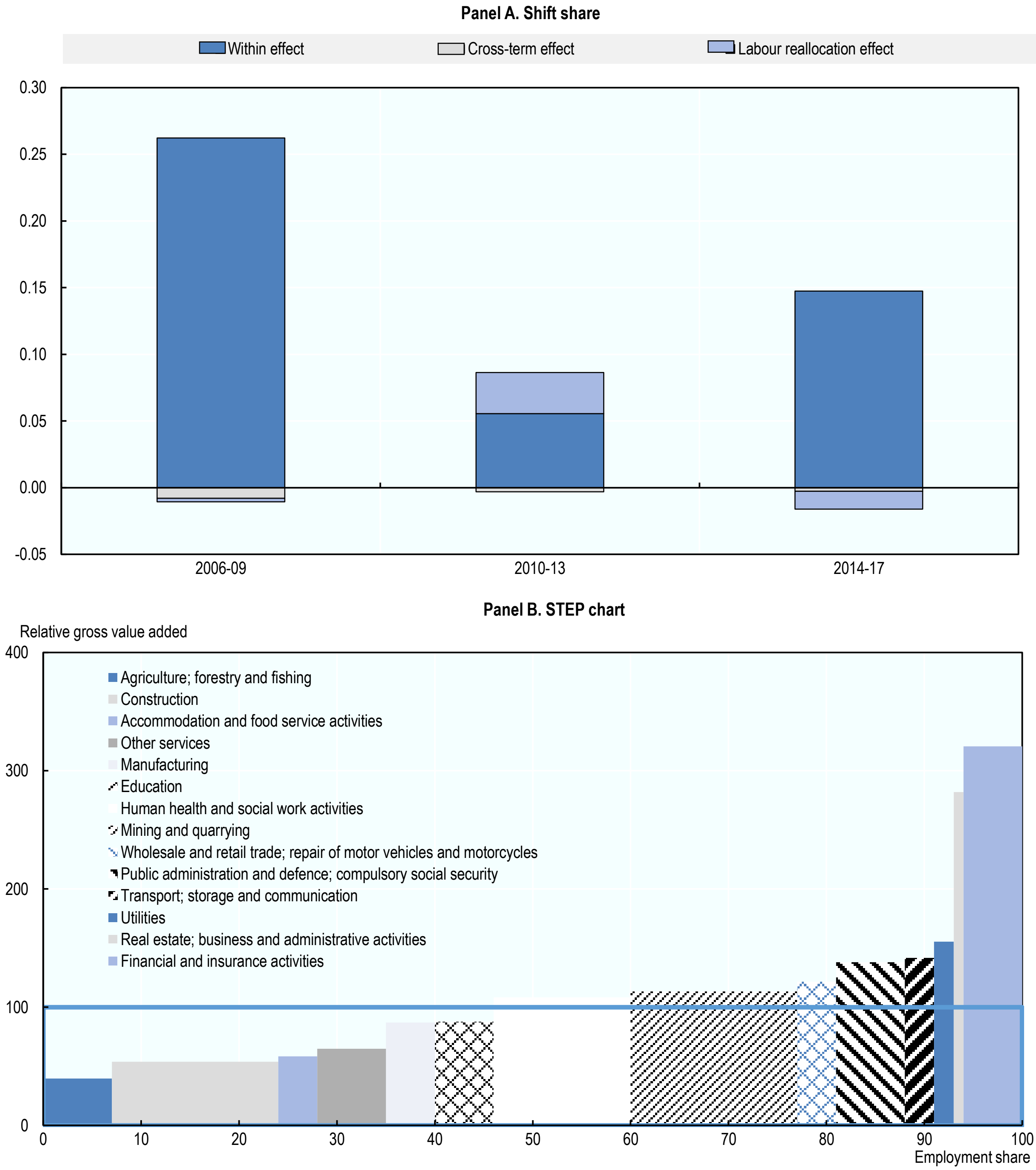
Productivity growth declined significantly in the post-crisis period, and employment remains largely in low value added sectors. The private sector is dominated by SMEs (64% of total value added and 70% of total employment) (Agency for Statistics of Bosnia and Herzegovina, 2020[61]), which face considerable constraints to investment and growth, including a challenging business environment, weak infrastructure, skills gaps and weak access to finance (see the Partnerships and financing section in this chapter). As a result, productivity is weak and remains well below that of EU peers: labour productivity is below 30% of the EU average, with value added per worker in industry being the lowest at 18% of the EU average (World Bank, 2020[7]). Productivity growth declined post crisis due to weaker within-sector productivity growth and limited gains from structural change and labour reallocation (Figure 8.19 – Panel A). In addition, over 90% of employment is in sectors with relatively low productivity (Figure 8.19 – Panel B). Productivity is also dragged down by highly inefficient SOEs that undermine competition in many sectors and underinvest in critical infrastructure for development.

Figure 8.19. Productivity growth declined in the post-crisis period largely due to weaker within-sector productivity growth; most employment remains in sectors with relatively weak productivity



Sources: Authors' work based on ILO (2020[21]), *ILOStat* (database), https://ilostat.ilo.org/data/; United Nations data (2020[60]), *UNdata SDG Indicators* (database), http://data.un.org/Default.aspx.

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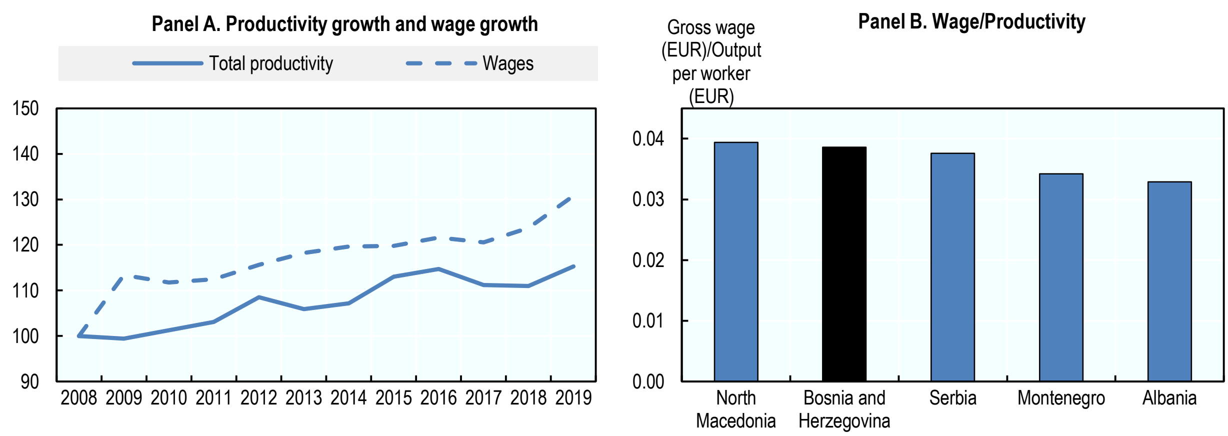
High wage growth and relatively high labour costs undermine competitiveness. Over the past decade, average wages have grown at a faster pace than productivity (Figure 8.20 – Panel A), which has negatively affected external competitiveness. Labour cost adjusted for productivity (Figure 8.20 – Panel B) and the average nominal gross wage in Bosnia and Herzegovina are the second highest in the region after Montenegro (World Bank/Vienna Institute for International Economic Studies, 2020[12]) This has been primarily been boosted by high public-sector wages. The public sector accounts for one-third of all employment and pays, on average, 38% more than the private sector (Agency for Statistics of Bosnia and Herzegovina, 2020[62]). In combination with remittances, which represent 11% of GDP (World Bank, 2020[7]), high public-sector wages have contributed to rising reservation wages and thus to wage and competitiveness pressures for the private sector. The high wages may also contribute to the high unemployment: at 15.7%, the unemployment rate in Bosnia and Herzegovina is one of the highest in the region (World Bank, 2020[7]) (see the People section in this chapter).

Figure 8.20. Wage growth has outpaced productivity growth, contributing to higher labour costs compared to regional peers



Sources: World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; World Bank/Vienna Institute for International Economic Studies (2020[12]), *SEE Jobs Gateway Database* (database), https://data.wiiw.ac.at/seejobsgateway.html.

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Other labour market indicators are among the weakest in the region as well. Despite an increase in employment in recent years, the employment rate remains low at 38% (World Bank, 2020[7]). It is particularly low for women (28% of the total population), which reflects their very low labour force participation rate (33% in 2019) (World Bank, 2020[7]), and young people (over 39%) (World Bank, 2020[7]).

Due to these persistent challenges and the long and devastating war, Bosnia and Herzegovina has among the highest emigration figures in the world. Since 1991, an estimated 1.65 million people, or 37.5% of the 1991 population, have left (WFD, 2020[63]).

A fragmented internal market and high bureaucratic burden create a challenging environment for private-sector development

Bosnia and Herzegovina's complex political structure has resulted in a fragmented internal market, which has negative implications for investment and doing business. If a business wishes to operate across the country, it must be registered in each of the entities and may need to obtain the same type of license, permit or other documentation multiple times to meet the regulatory and legal requirements of each entity. Business laws and regulations can also vary by administrative level. For example, the Federation of Bosnia and Herzegovina's ten cantons have different regulations and administrative procedures (World Bank, 2020[14]).

As a result, it is more difficult to register a business and obtain licenses and permits in Bosnia and Herzegovina than in most countries in the world. According to the latest *Doing Business Report*, compared to peers in Europe and Central Asia (ECA), registering a business in Bosnia and Herzegovina requires, on average, twice as many procedures (13 vs. 5.2), takes nearly eight times as long (80 days vs. 12) and costs more than three times more (14% of income per capita vs. 4% [ECA average]). Bosnia and Herzegovina ranks 184th out of 190 economies globally (World Bank, 2020[64]). Obtaining licenses and permits is also lengthier in Bosnia and Herzegovina compared to regional and global peers (World Bank/EIB/EBRD, 2020[65]). Some recent reforms, such as the establishment of one-stop shops for company registration and an online business registration system, are good steps forward, but more progress is needed to harmonise business licences and permits across the country (European Commission, 2020[66]).

Differing quality control rules and procedures make it difficult to trade externally and internally between the entities. Initial steps had been taken to establish a single economic area and to align the legislative and institutional framework with the free movement of goods acquis. Recently, the government recognised the critical importance of trade and has introduced measures to harmonise the quality infrastructure in order to create a single market and facilitate trade. However, in the absence of cross-cutting entity co-ordination and commitments across levels of government, progress may be slow (European Commission, 2020[66]).

Numerous para-fiscal charges levied at all three levels of government create additional non-tax expenses for business. Due to the inadequate oversight, transparency and consistency in the application of these charges, they have created uncertainty and significant scope for corruption. In recent years, efforts were made to improve the situation by creating registries of parafiscal fees at all levels of government. These registries are also expected to support the elimination of unnecessary or detrimental parafiscal charges, which will in turn improve the business climate across Bosnia and Herzegovina (European Commission, 2020[66]).

Costly and lengthy contract enforcement remains an important impediment to investment in Bosnia and Herzegovina. The court system is weighed down by a large backlog of cases, but alternative methods for dispute resolution are not available. Moreover there are no specialised commercial courts (European Commission, 2019[67]). As a result, it takes longer to enforce a contract in Bosnia and Herzegovina compared to peer ECA and global economies: 595 days vs. 495 (ECA average) and 120 for global leaders. The process is also more costly: 36% of the value of the claim vs. 27% for the ECA region). (World Bank, 2020[64]).

The large and inefficient SOE sector creates unfair competition for private enterprises

The state footprint in the economy remains large, and the SOE sector constitutes an unfair source of competition to the private sector. There are 550 SOEs in Bosnia and Herzegovina (315 in the Federation of Bosnia and Herzegovina and 235 in Republika Srpska), and ownership varies by level of government, including entities, cantons and municipalities. They operate across a wide range of sectors, from utilities to mining, manufacturing, transport and agriculture, and they account for an estimated 10% of value added, 25% of public-sector employment and 11% of total employment. SOEs have significant advantages compared to the private sector. Roughly half receive direct budgetary support or indirect support through tax exemptions in light of their financial difficulties. Most SOEs do not pay any dividends. Last, SOE salaries are, on average, 40% higher than in the private sector, despite lower labour productivity (roughly 8% lower) and lower profitability (SOE salaries are estimated at 31% of total operating expenditures, compared to 12% in the private sector). The higher salaries and more stable employment conditions put unwarranted wage pressures on the private sector and negatively affect its ability to attract talent (Cegar and Parodi, 2019[68]).

Infrastructure gaps impede connectivity with the Western Balkans and beyond

Bosnia and Herzegovina has a comparatively sizable infrastructure gap that stems from significant underinvestment in development and maintenance across all key sectors. To a large extent, this reflects the broader challenge of inefficient SOE operations raised in the previous section in this chapter. SOEs dominate the infrastructure-related sectors (transport, energy, and utilities), but due to their weak governance, inefficient operations, excessive employment, lack of cost-reflective pricing of services, and high indebtedness, they are unable to finance the necessary investments needed to maintain and upgrade the relevant infrastructure. For example, in 2017, SOEs invested EUR 274 million in non-financial assets, which is equivalent to 1.7% of GDP (Cegar and Parodi, 2019[68]). As a result, Bosnia and Herzegovina lags behind most regional and global countries with respect to quality of infrastructure: in the World Economic Forum's Global Competitiveness Index, Bosnia and Herzegovina ranks 89th out of 141 global economies on the composite indicator of infrastructure quality, behind all but one of the regional and global peers (World Economic Forum, 2019[33]).

Bosnia and Herzegovina's road infrastructure needs significant expansion and upgrading. Road density is low compared to regional peers and the European Union (34 km per 100 km^2 of land, compared to the Western Balkan and EU averages of 41 km and 111 km, respectively) (World Bank, 2020[14]) and road infrastructure quality is weak due to considerable underinvestment, inadequate maintenance and poor selection and implementation of road infrastructure projects (Atoyan et al., 2018[69]).

The railway sector suffers from outdated infrastructure, lack of openness and the inefficient operations of the publicly owned railway companies. The rail network density is low compared to most global and aspirational EU peers (Atoyan et al., 2018[69]), as is the share of goods transported by rail (1 177 million tonne-km in Bosnia and Herzegovina, compared to 9 223 million tonne-km EU average) (World Bank, 2020[7]). Underinvestment in expansion and in maintenance and upgrading of the outdated rail infrastructure is in part due to the lack of unbundling: the two highly indebted, overstaffed and inefficient state-owned railway companies (Željeznice Federacije Bosne i Hercegovine and Željeznice Republike Srpske) are in charge of both infrastructure and operations. The poor infrastructure meanwhile prevents the opening of the market to private operators (European Commission, 2019[58]). The restructuring of Željeznice Republike Srpske is currently underway and is expected to be completed by the end of 2021. This includes ownership, financial and organisational restructuring supported by the World Bank (World Bank, 2018[70]).

Deficiencies in energy infrastructure undermine the development and greening of the energy sector. The energy sector contributes to over 4% of GDP and exports, but it has considerable scope for expansion in light of the country's natural endowments (see the Planet section in this chapter). However, weaknesses in energy infrastructure limit the sector's potential growth and pose risks to the sustainability of the energy supply. Namely, Bosnia and Herzegovina relies strongly on thermal power, particularly coal power plants, for its electricity generation; however, most of these plants are old and in need or rehabilitation or closure. In fact, about one-third of all thermal plants are set to be closed over the coming decade (World Bank, 2020[71]). The need to transition to greener energy sources therefore remains an important priority, especially in light of high pollution (see the Planet section in this chapter). Substantial investments (estimated at EUR 3 billion) will be needed to compensate for the loss of coal power production capacity, modernise the power generation sector and ensure the security of the energy supply (Nikolakakis et al., 2019[72]). Elektroprivreda Bosne i Hercegovine (EPBiH) has started by replacing inefficient blocks with new ones, notably in Tuzla. The low energy efficiency, fuelled by lack of cost-reflective pricing, and the weak private-sector participation in the sector contribute to the challenges of upgrading and greening the energy infrastructure (see the Planet section in this chapter).

The lack of a skilled workforce and the lack of technology adoption limit the potential for economic upgrading and expansion of the tradable sector

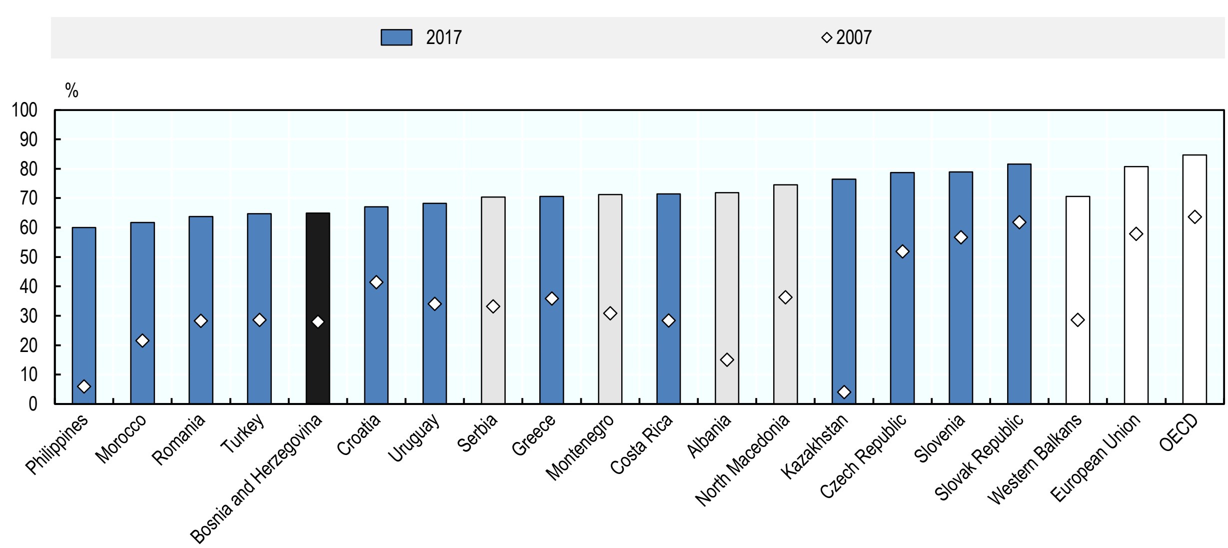
Bosnia and Herzegovina lags behind many regional and global peers on education enrolment and attainment indicators. ECE enrolment is well below that of regional peers and the EU and OECD averages. This is particularly the case in the Federation of Bosnia and Herzegovina, where enrolment in 2015 was less than 5%. In Republika Srpska, it was less than 20%. By comparison, the South East Europe and EU averages were 37% and 92%, respectively. Net enrolment rates are relatively high at the primary and secondary levels (83.7.% and 75.1% in 2018) but relatively low at the tertiary level (23% in 2018) (Agency for Statistics of Bosnia and Herzegovina, 2020[5]). Bosnia and Herzegovina also lags behind regional peers in the share of early leavers from education and training (over 30% among men) and participation in life-long learning (see the People section in this chapter) (OECD, 2018[29]).

Bosnia and Herzegovina needs to make considerable improvements in the quality of its education system. In the latest PISA assessment, students performed well below the OECD average and most EU and regional peers. Across all subjects – reading, mathematics and science – the share of students who achieved minimum proficiency ranged from 42% to 46%, depending on the subject, considerably below the OECD average of between 76% and 78% (OECD, 2019[30]).

The education system does not equip graduates with the skills needed by the labour market. In the 2019 Balkan Barometer survey, 30% of respondents noted that the skills they acquired during their education did not meet the needs of their jobs. The most deficient were digital skills (32% of respondents), communication skills (30%) and other cognitive skills, including ability to learn on the job (27%) and creativity, innovation and risk taking (27%) (RCC, 2019[73]). The lack of digital skills reflects, to some degree, the relatively high share of individuals who still have no regular Internet access (Figure 8.21).

Figure 8.21. The share of individuals without Internet access is high compared to regional and global peers

Percentage of individuals using the Internet in 2007 and 2017



Source: ITU (2020[74]), *International Telecommunication Union – Telecommunication Development Sector (ITU-D)* (database), www.itu.int/en/ITU-D/Statistics/Pages/default.aspx.

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The lack of adequate skills in the labour force may reflect demand-side constraints. Only 19% of people in Bosnia and Herzegovina believe that the right level of education or the right qualifications is necessary to get a job; only 16% believe that previous experience is essential. Some 52% believe that personal contacts are necessary, and 30% believe that a network of family and friends in high places are necessary. The question on what is needed to succeed in life evoked similar answers (RCC, 2019[75]).

The skills challenge is also closely linked to weak innovation and technology adoption, which limit the scope for SME integration into GVCs. Firms in Bosnia and Herzegovina are, on average, less innovative and technologically advanced than those of regional peers. Only 15% of firms have adopted technologies from other countries, and only 38% have introduced new products or services in the past three years (World Bank, 2020[71]). Business investment in research and development is also very small (estimated at below 0.15%, which is less than one-tenth of the 1.5% EU average). There is very limited collaboration between the business sector and research institutions (OECD, 2018[29]), although there have been important initiatives in Republika Srpska in recent years. The Government of Republika Srpska is supporting collaboration between business and science institutions through the Synergy project. In 2019, the Ministry of Scientific and Technological Development, Higher Education and Information Society adopted a strategic document that maps out the research infrastructure of Republika Srpska in order to guide the development of the scientific and research system and to support its closer integration with the private sector.

Partnerships and financing – financing sustainable development

The Partnerships and financing pillar of the 2030 Agenda for Sustainable Development cuts across all goals focused on the mobilisation of resources needed to implement the agenda. It is underpinned by the Addis Ababa Action Agenda, which provides a global framework to align all financing flows and policies with economic, social and environmental priorities.

In Bosnia and Herzegovina, more financing is needed to support investment and growth. Low domestic savings, coupled with low FDI and other external financing, constrain domestic private investment, which at an average of 5% of GDP over the past two years, is among the lowest in the region. Investment is also impeded by weak access to finance, particularly for start-ups and SMEs, due to prohibitively high collateral and other banking-sector requirements, as well as the relative lack of awareness and availability of non-bank financing options. On the public-sector side, high fiscal revenues have not translated into quality public services due to high current expenditures (on wages and social transfers) and weak public investment. The large, inefficient and highly indebted SOE sector imposes a high fiscal burden that limits the funds available for investments in infrastructure, education, health and other areas of development importance (Table 8.4).

Table 8.4. Partnerships and financing – three major constraints to financing development in Bosnia and Herzegovina

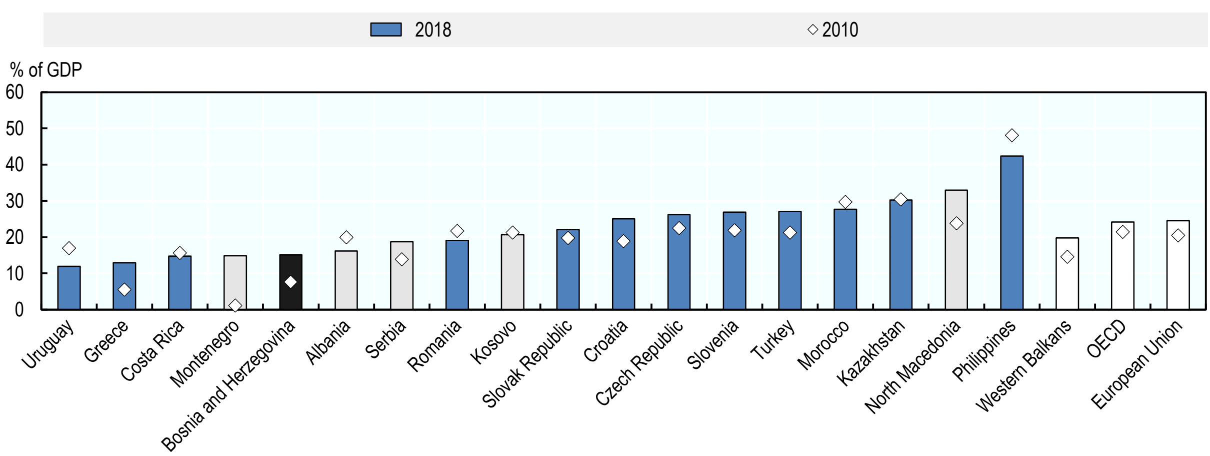
1. Low domestic savings and limited external financing have constrained investment.
2. Strong revenue performance does not translate into quality public services and infrastructure due to high current expenditures and weak public investment.
3. Access to finance is limited for SMEs, particularly start-ups and microenterprises.

Low domestic savings and limited external financing have constrained investment

Domestic savings in Bosnia and Herzegovina are among the lowest in the region and among global peers. In the post-crisis period, domestic savings increased as real consumption expenditure declined from 109% of GDP in 2012 to 96% in 2019. However, at 15% of GDP, domestic savings remain low compared to most peers (Figure 8.22). This represents an important constraint to domestic investment, particularly private investment, whose share in GDP has been less than 6% annually for the past two years (see the Prosperity section in this chapter). This problem has been exacerbated by the decline in or weaker growth of important sources of external financing, including FDI and overseas development assistance (ODA).

FDI declined considerably in the post-crisis period, limited by fewer privatisation opportunities and a challenging business environment for other greenfield investment. In the pre-crisis period, FDI was strongly driven by privatisation and largely market-seeking investments in the financial sector, telecommunications, energy, and other sectors. As privatisation progress has stalled, especially in the Federation of Bosnia and Herzegovina, market-seeking investment has become more limited, with the exception of the power sector. Meanwhile, the lack of progress on many structural reforms, coupled with the complex political structure and the fragmented internal market, creates a uniquely challenging business environment, which limits other investment. As a result, Bosnia and Herzegovina has struggled to attract FDI, despite the introduction of incentives for investors similar to those of neighbouring economies (e.g. customs-free imports of raw materials and equipment, deductions from corporate income tax [CIT] payments subject to investment-related criteria, tax deductions for new employment) (OECD, 2017[76]; Foreign Investment Promotion Agency of Bosnia and Herzegovina, 2020[57]). FDI financing has accounted for less than 2% of GDP for the last five years, which is significantly lower than the regional average of 5.8% (World Bank, 2020[7]) (see the Prosperity section in this chapter).

Figure 8.22. Domestic savings are low compared to regional and global peers



Source: World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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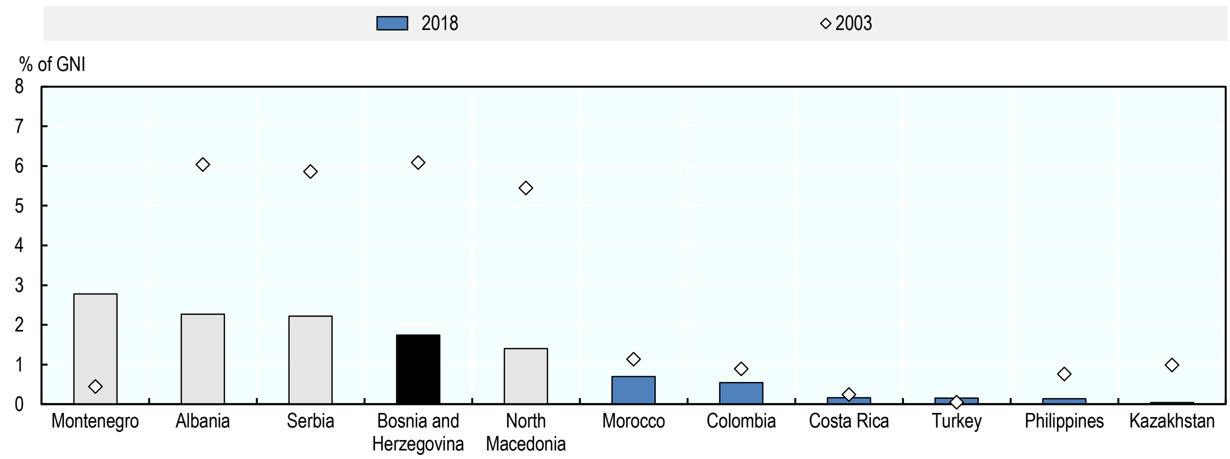
ODA financing is high compared to global peers but has declined since the early 2000s. Bosnia and Herzegovina has benefited considerably from ODA financing, especially in the aftermath of the war, but aid has gradually declined since, from the peak of USD 1.8 billion in 1999 to USD 341 million in 2018. At 1.8% of gross national income (GNI), ODA financing in Bosnia and Herzegovina is still high compared to most global peers (Figure 8.23), but the decline has had an impact, especially on public investment.

Figure 8.23. ODA has declined considerably since the early 2000s but remains high compared to global peers



Source: World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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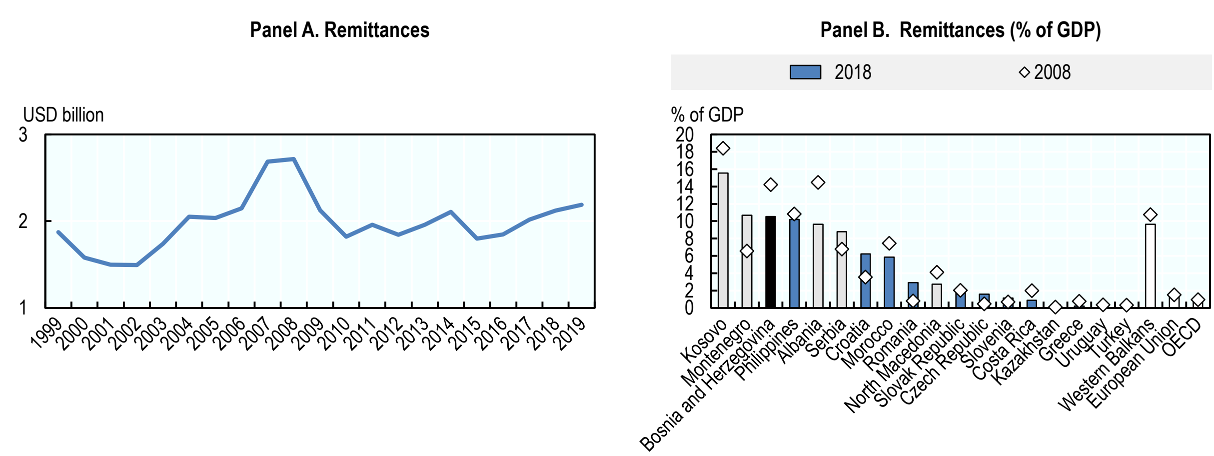
Remittance income has declined from its peak in the run-up to the global financial crisis but has been relatively resilient in recent years and has provided important support for private consumption expenditure. Remittances have declined considerably from their peak in 2007-08 (Figure 8.24 – Panel A). Their contribution to GDP declined from 14% in 2008 to 11.2% in 2018 (Figure 8.24 – Panel B). However, remittance income has been relatively stable over the past decade, despite downturns in the Eurozone, where a considerable share of Bosnia and Herzegovina's diaspora lives. Moreover, remittances have shown some countercyclical tendencies by increasing notably in 2011, when the economy was hit by declining demand due to the Eurozone crisis, and in 2014, when Bosnia and Herzegovina was strongly affected by the floods (see the Prosperity section in this chapter).

Figure 8.24. Remittance income has been relatively resilient over the past decade, and its contribution to GDP remains high compared to global and aspirational peers



Source: World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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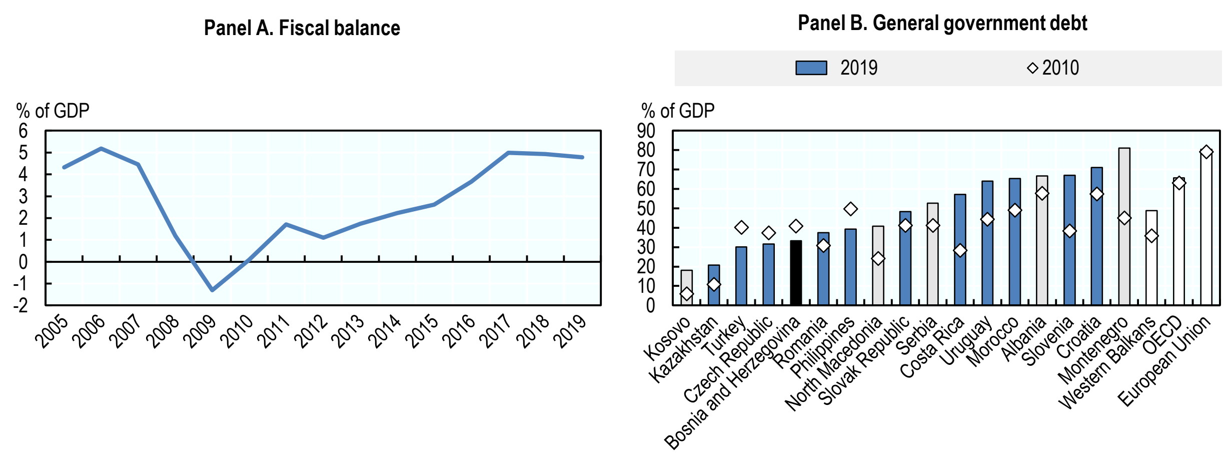
Strong fiscal performance has created ample fiscal space for combatting the COVID-19 crisis

Strong revenue performance and good control of the growth in expenditures have resulted in high fiscal surpluses and declining public debt. Along with the return of growth and the improvements in other macroeconomic indicators, fiscal performance has improved considerably since 2009. Strong revenue performance outpaced the growth in expenditures, giving way to positive fiscal balances that have increased over time (Figure 8.25 – Panel A). As a result, public debt declined from 41% of GDP in 2010 to about 33% in 2019, one of the lowest levels of public debt across comparable global economies (Figure 8.25 – Panel B). As such, there is considerable fiscal space to counter the negative impacts of the COVID-19 crisis.

Figure 8.25. The fiscal balance has improved since 2009 and public debt is low compared to global peers



Sources: Central Bank of Bosnia and Herzegovina (2020[59]), *Statistical Web Portal – Main Economic Indicators* (database), http://statistics.cbbh.ba/Panorama/novaview/SimpleLogin_en_html.aspx; IMF (2020[54]), *World Economic Outlook Databases* (database), www.imf.org/external/pubs/ft/weo/2019/02/weodata/index.aspx.

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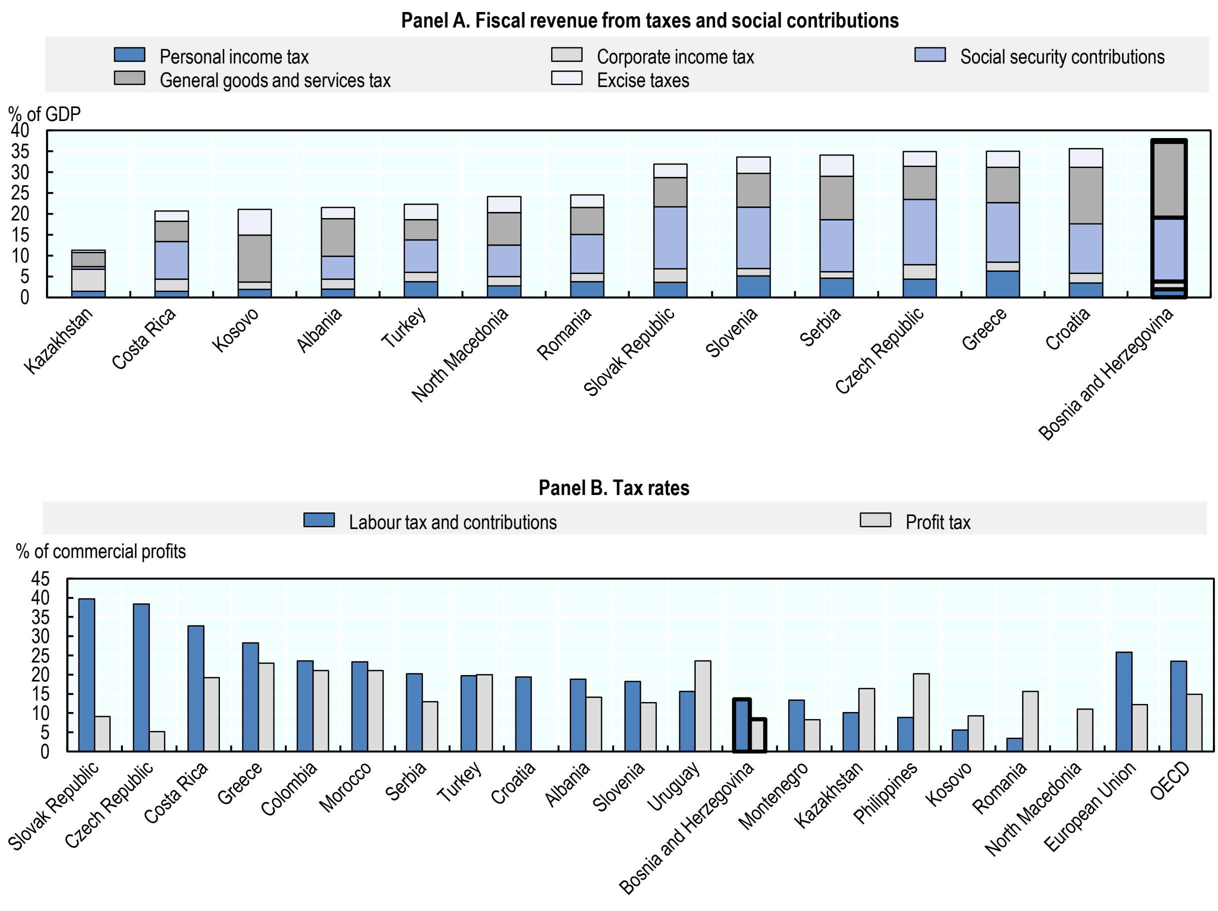
Strong revenue performance has not translated into quality public services and infrastructure due to high expenditures on wages and transfers and low investment

Bosnia and Herzegovina has high fiscal revenues compared to peers, largely on account of high value added tax (VAT) and social security contributions. At 46% of GDP in 2019, revenues as a share of GDP are the highest among all regional and global peers (Figure 8.26 – Panel A). The relative overperformance is mainly due to the high share of VAT income, particularly import VAT contributions, which are significant in light of the high import dependence of the consumption-driven economy (see the Prosperity section in this chapter). At over 15% of GDP, social security revenues are also relatively high compared to regional peers. This is largely due to the high social security contribution rates. At 41.5% in the Federation of Bosnia and Herzegovina and 33% in Republika Srpska, the contribution rates significantly exceed the Western Balkan 6 average of 29.7% (World Bank, 2020[14]).

On the other hand, personal income tax (PIT) and CIT are relatively low, mainly reflecting the low tax base and considerable tax avoidance. Informal employment remains high at 30% of total employment (ILO, 2020[21]). Many employees are registered on a minimum wage while also receiving envelope wages (Obradović, Jusić and Oruč, 2019[17]). Under-reporting of sales and non-issuance of fiscal receipts are also prevalent, and the share of companies operating entirely in the grey economy appears to be high. In the latest Business Environment and Enterprise Performance Survey, 42% of companies stated that they compete against unregistered firms (World Bank/EIB/EBRD, 2020[65]). The relative underperformance on PIT and CIT revenue also reflects the relatively low tax rates (Figure 8.26 – Panel B).

Figure 8.26. Revenue performance is relatively strong, largely thanks to strong indirect taxation, while the underperformance on the PIT, CIT and social contributions in part reflects the relatively low tax rates



Sources: IMF (2020[77]), *International Financial Statistics* (dataset), https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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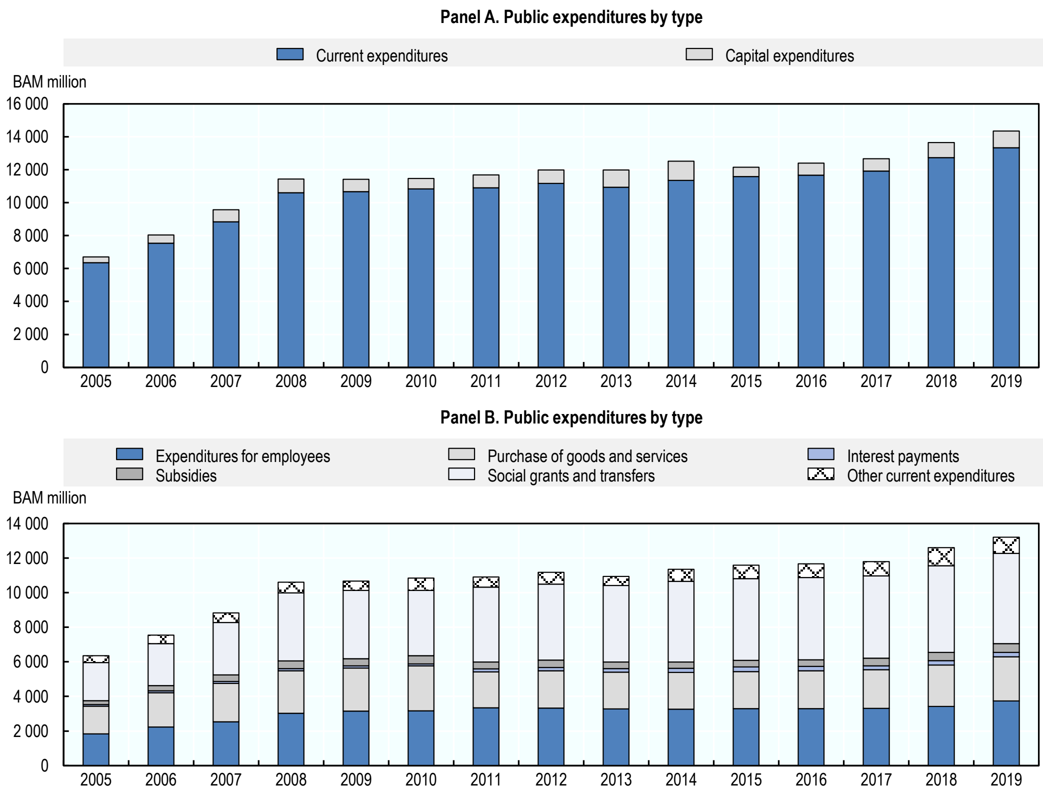
The high revenues, however, do not translate into higher-quality public services or better infrastructure. In fact, public satisfaction with the quality of public services and infrastructure is on par with or lower than that of regional peers. In the latest Balkan Barometer survey, citizens rated the timeliness, quality and cost of obtaining information or services from public institutions at 2.5 out 5.0 points, in line with all other regional peers (RCC, 2019[75]); however, Bosnia and Herzegovina ranks below most peers on indicators concerning infrastructure quality (see the Prosperity section in this chapter). It also lags behind most global peers on education outcomes (see the People section in this chapter).

The relatively weak outcomes mainly reflect the composition of public expenditures, which include high spending on public-sector wages and social transfers but weak investment spending. Since 2005, capital expenditures have represented only 7% of total government spending (Figure 8.27 – Panel A) and 2.8% of GDP. Meanwhile, the high current expenditures have risen considerably, largely on the back of high increases in social transfers and public-sector wages (Figure 8.27 – Panel B).

Figure 8.27. Public investment is limited by high current expenditures, most of which go to social transfers and wages



Source: Central Bank of Bosnia and Herzegovina (2020[59]), *Statistical Web Portal – Main Economic Indicators* (database), http://statistics.cbbh.ba/Panorama/novaview/SimpleLogin_en_html.aspx.

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High spending on social transfers in part reflects the significant inefficiencies in the social protection system. The inefficiencies cut across various areas, including social assistance, unemployment benefits, maternity benefits and health insurance (see the People section in this chapter). They not only increase current fiscal expenditures but also discourage formal employment. Some of the key challenges in this area include the link between unemployment benefits and health insurance, which allows people working informally to get health insurance benefits by registering as unemployed. On the other hand, social benefits discourage labour force participation because low-income households whose members are employed are not eligible for social assistance. Last, the war veterans' scheme is generous, not well targeted and discourages employment because only unemployed veterans are eligible (World Bank, 2020[14]).

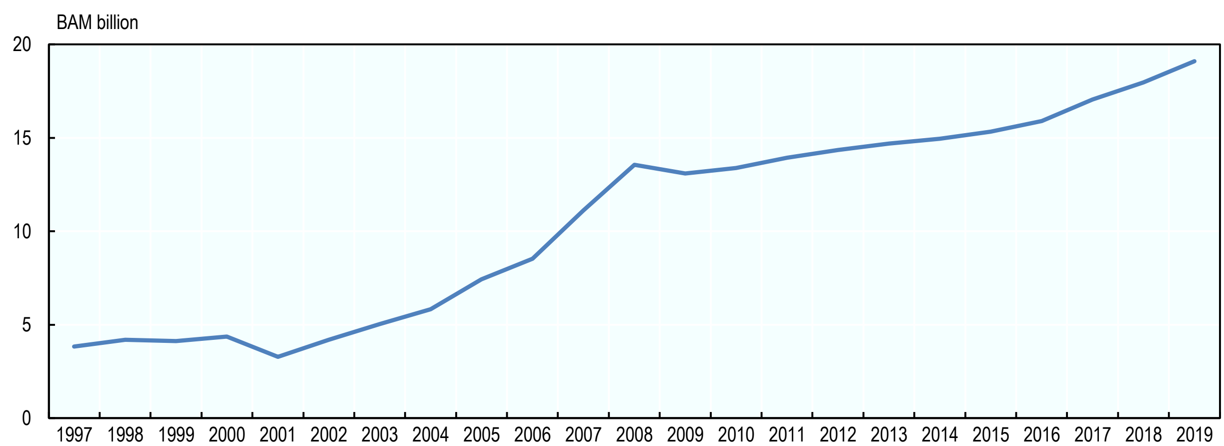
The SOE sector also poses a significant fiscal burden and limits the funding available for infrastructure, education, health and other productivity-enhancing expenditures. SOEs are largely loss making and have incurred considerable as of 2017 debt (estimated at EUR 4 billion, or 26% of GDP).

This includes considerable arrears to suppliers, including other SOEs, such as electricity and water companies (4% of GDP). It also includes tax and social security contribution arrears (4% of GDP), mainly affecting the pension and healthcare funds, which already face considerable sustainability challenges (see the People section in this chapter). About 15% of SOEs are insolvent, with negative equity totalling EUR 290 million, or 2% of GDP, and they require financial and operational restructuring, which may include capital injections. Roughly 50% of the companies are illiquid and require direct or indirect budgetary support, which is estimated at about 5% of GDP annually (Cegar and Parodi, 2019[68]).

Access to finance is limited for SMEs, particularly start-ups and microenterprises

Enterprises' access to bank financing has been relatively limited following the 2008 global financial crisis and the 2011 Eurozone crisis. In the early to mid-2000s, the entry of foreign banks in the market fuelled a credit boom that built up significant imbalances in the banking system, including high credit risk. In the aftermath of the crises, the banking sector was hit hard by high and rising NPLs, which peaked at 16% of total loans in 2015 (Central Bank of Bosnia and Herzegovina, 2020[59]). In this context, private-sector lending suffered significantly as banks tightened credit standards (Figure 8.28).

Figure 8.28. Private-sector credit has been weaker in the post-crisis period



Source: Central Bank of Bosnia and Herzegovina (2020[59]), *Statistical Web Portal - Main Economic Indicators* (database), http://statistics.cbbh.ba/Panorama/novaview/SimpleLogin_en_html.aspx.

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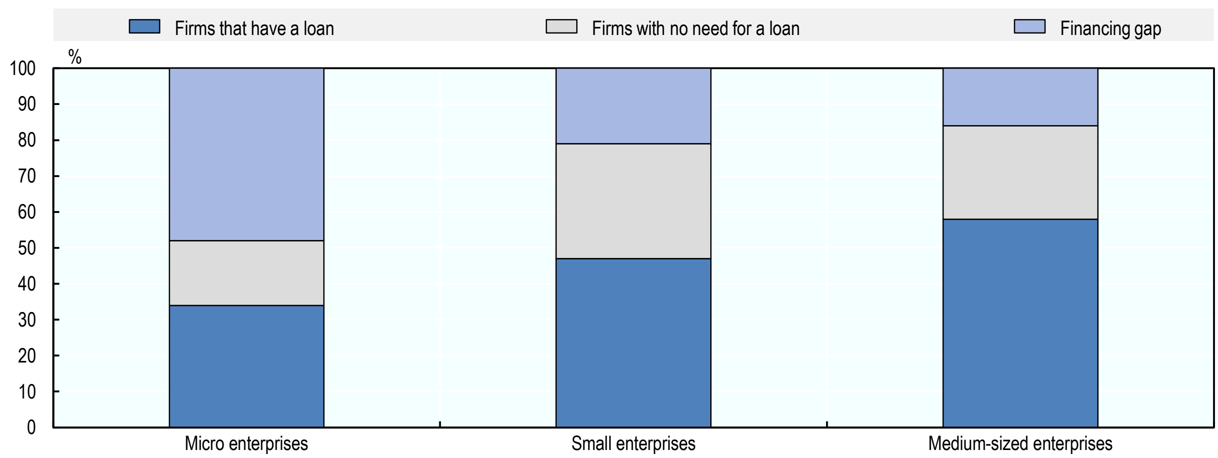
Over the past five years, financial-sector health and stability have improved, and private-sector lending has begun to recover. Since 2015, NPLs have declined (from over 16% to 6% of total loans), capital adequacy has improved (the risk-weighted capital ratio increased from 16.3% in 2008 to 18% in 2019) (IMF, 2020[78]) and the profitability of the banking sector has increased. The improved conditions and overall improvement in the macroeconomic environment have resulted in declining lending interest rates, from an average of 6.6% in 2014 to 3.3% in 2019. All these factors have been conducive to stronger private-sector lending, which has risen by 6.3% annually since 2016, following nearly a decade of very weak growth (Figure 8.28).

Despite this progress, access to finance remains relatively constrained for SMEs, particularly start-ups and microenterprises. Although over 95% of SMEs in Bosnia and Herzegovina have a bank account, about 50% have a bank loan (World Bank/EIB/EBRD, 2020[65]). The financing gap is particularly large for microenterprises, nearly 50% of which need external financing but are unable to get it (Figure 8.29).

Access to bank financing is limited by stringent lending requirements. Often SMEs, particularly start-ups and microenterprises, cannot meet the relatively stringent bank lending requirements, including high-value collateral (over 200% of the loan value), with a strong preference for land and real estate (WB et al., 2021[79]). This also represents an important constraint for women-owned businesses, as women are less likely to own such assets. The financing gap for women-owned businesses (over 60%) is significantly is larger than for male-owned businesses (34%) (World Bank, 2018[80]).

Figure 8.29. The financing gap for SMEs is wide, particularly for micro and small enterprises



Source: World Bank (2018[80]), *Access to Finance for MSMEs in Bosnia and Herzegovina with a Focus on Gender: A Survey Report*, http://documents1.worldbank.org/curated/en/575941521232862413/pdf/124353-REVISED-BiH-Access-to-Finance-Gender-Full-Report-FINAL-formatted.pdf.

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SEOs and ample demand for consumer credit crowd out bank lending to enterprises (World Bank, 2020[14]). This challenge is exacerbated by the relative lack of other financing options. Non-bank financing (equity capital, debt securities, factoring, leasing, credit unions, etc.) remains underdeveloped in part due to weak demand from the SME sector, whose awareness and understanding of alternative sources is relatively weak. Likewise, start-up financing through venture capital funds, business angels, etc. is undersupplied and cannot adequately support the growth of innovation (World Bank, 2018[80]).

Peace and institutions – strengthening governance

The Peace and institutions pillar of the 2030 Agenda for Sustainable Development encompasses peace, stability and accountability, as well as effective governance and the performance of the public sector more broadly.

Since the end of the civil conflict, Bosnia and Herzegovina, with the support of the international community, has established and preserved territorial integrity and shown progress in some policy areas. The country has managed progressively to guarantee peace and safety to its citizens: between 2000 and 2018, the incidence of intentional homicides fell from 2.6 to 1.2 per 100 000 inhabitants, the lowest figure in the Western Balkans and lower than the OECD average (2.8) (UNODC, 2018[81]). Recent reforms have made the judiciary more independent of external pressure, despite serious ongoing limitations. Integrity plans addressing judges and public officials have been introduced, although differently across entities. As part of the decentralisation process, the central state and the two entities went beyond their divisions and adopted the Global Framework for Fiscal Balance and Policies to co-ordinate fiscal balance and policies at the local level (OECD/UCLG, 2019[82]).

Bosnia and Herzegovina's complex system of governance helps maintain institutional balance between communities but, without adequate co-ordination, creates scope for significant inefficiencies. Three separate, autonomous and ethnically characterised subnational governments and a quota system ensure representation of the three "constituent peoples" of the economy (Bosniaks, Croats and Serbs) at all institutional levels and all branches of the administration. However, this system can pose challenges to the proper functioning of the state and may entrench ethnic polarisation. For example, it affects the capacity of the high judicial body that watches over the independence and professionalism of courts. It encourages political leaders to compete for support from ethnically homogeneous groups rather than create incentives for interethnic co-operation and makes it difficult to achieve a shared social contract that could counterbalance divisions (Belloni and Ramovic, 2020[83]).

"If you can't easily walk away from something, then the only way forward is to double down" (Brooks, 2020[84]). As a society with a long history of multiple ethnicities and religions living peacefully side-by-side, Bosnia and Herzegovina can strive to make multi-ethnicity an asset. For most of the past 500 years, coexistence has been peaceful. When violence broke out, its origins were often of a socio-economic rather than an ethnic or religious nature. An effective social contract and performance-oriented government are the cornerstones of institutional, social and economic development.

This institutional assessment identifies three major constraints to the future development of Bosnia and Herzegovina (Table 8.5): (1) the asymmetric decentralisation framework, which fuels inefficiencies and severe territorial disparities; (2) the lack of independence and professionalism in the judiciary; and (3) the widespread reliance on personal relationships, which creates social exclusion, distorts the labour market and undermines the efficiency of the public sector.

Table 8.5. Peace and institutions – three main institutional constraints to enhanced quality of institutions in Bosnia and Herzegovina

1. The decentralisation framework is asymmetric.
2. Overly complex institutional design addresses ethnic divisions but undermines the independence, efficiency and transparency of the judiciary.
3. Personal connections are inevitable in getting things done but may create social exclusion, distort the labour market and weaken administrative capacity.

The decentralisation framework is asymmetric

The Constitution of Bosnia and Herzegovina administratively divides the economy in two entities: the Federation of Bosnia and Herzegovina and Republika Srpska. According to the 2013 Census, the ethnic composition at the national level consists of Bosniaks (50.11% of the total population, or 1 769 592 people), Serbs (30.78%, or 1 086 733) and Croats (15.43%, or 544 780). The rest of the population belongs to other ethnic groups (2.73%) or has not declared an ethnic group. The borders of the entities roughly reflect the distribution of the three constituent peoples. The majority of the citizens of the Federation of Bosnia and Herzegovina are either Bosniaks (70.4%, or 1 562 372 people, according to the latest census) or Croats (22.4%, or 497 883). In Republika Srpska, 81.5%, or 1 001 299 people, are Serbian, followed by Bosniaks (12.69%, or 148 477) and Croats (2.27%, or 26 509).

The administrative division at the sub-entity level is asymmetric. The Federation of Bosnia and Herzegovina is administratively divided into 10 self-governing cantons, 74 municipalities and 6 cities. Republika Srpska has a single level of local government constituted of 56 municipalities and 8 cities. In 1999, Brčko district, a former municipality in the northeast of the country, obtained autonomy. Its population consists of Bosniaks (42.4%), Serbs (34.6%) and Croats (20.7%). The district is officially a condominium over which the Federation of Bosnia and Herzegovina and Republika Srpska jointly exercise their rights. In practice, it is a self-governing unit with the same competences as entities (OECD/UCLG, 2019[82]).

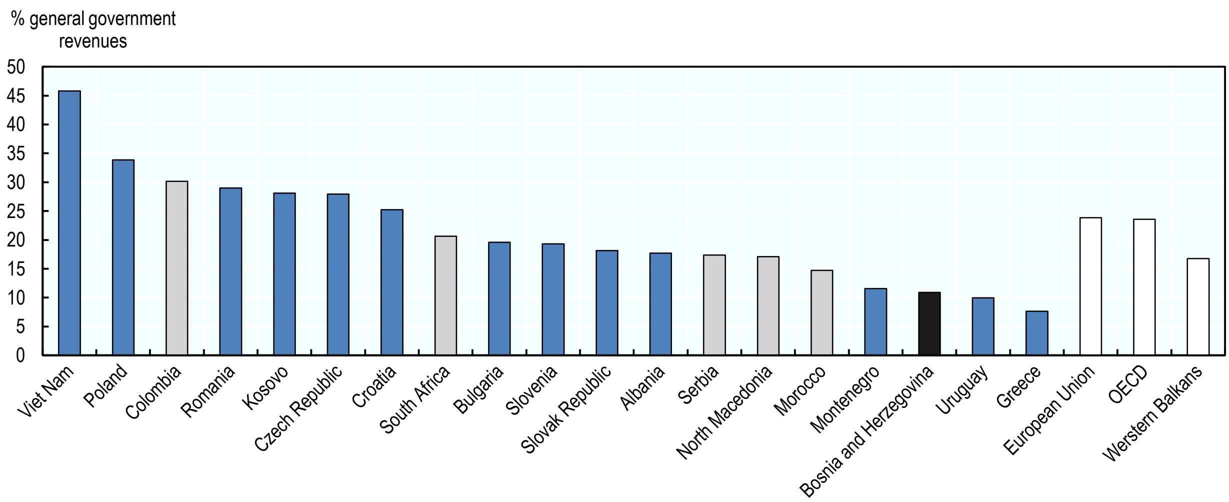
At the state level, the presidency is three-headed and collegial. Two presidents are elected from a joint constituency in the Federation of Bosnia and Herzegovina and one is elected by Republika Srpska, guaranteeing equal representation of the three constituent peoples. Each president serves as chairperson for eight months on a rotating basis. A Council of Ministers functions as the state federal government, while a bicameral parliament is the legislative branch.[4]

At the entity level, the Federation of Bosnia and Herzegovina and Republika Srpska each have a constitution, president, government and parliaments – bicameral in the Federation of Bosnia and Herzegovina and unicameral in Republika Srpska. At the sub-entity level, the cantons in the Federation of Bosnia and Herzegovina cantons have their own constitutions, unicameral parliaments and governments. In Republika Srpska, municipalities have their own assemblies and mayors. The state and the entities share judicial powers.

Most decision-making powers reside at the subnational level. The Constitution of Bosnia and Herzegovina assigns most of the responsibilities to the entities, while the Council of Ministers is responsible for sovereign powers, such as defence, foreign policy, trade policy, customs policy and indirect taxation (Art. III of the Constitution of Bosnia and Herzegovina).[5] The Federation of Bosnia and Herzegovina has competences in, among others, direct taxation, energy, industry and economic policy. Cantons have exclusive and shared powers and can further delegate responsibilities to municipalities (a canton must delegate responsibilities when most of the population in a municipality is from a different ethnicity than that of the canton). In the more unitary Republika Srpska, responsibilities are usually fully or partially delegated to municipalities. Entities regulate their own subnational government finance systems within the three-year Global Framework for Fiscal Balance and Policies (the current framework covers the period 2020-22) under the supervision of the state fiscal council, which sets fiscal targets and debt ceilings (OECD/UCLG, 2019[82]).

In spite of this apparently decentralised setting, subnational governments' fiscal power is limited. Total subnational revenues account for only 10.9% of general government revenues (Figure 8.30) and 4.7% of GDP, which is lower than the average in the rest of the Western Balkans (5.9%), the OECD (9.3%) and the EU27 (10.7%). Some 56.9% of total subnational revenues comes from taxes – the highest share in the region and higher than in other benchmarking economies (Figure 8.31). Nonetheless, tax revenues at the subnational revenue level remain low relative to GDP (2.7%): total tax revenues (excluding social contributions) in 2016 amounted to 23% of GDP (see the Partnerships and financing section in this chapter). This affects municipalities' spending capacity, especially in the long term. Direct investments make up 13% of the total subnational spending but only 0.6% of GDP, the lowest share in the region. Tariffs and fees account for 28% of total subnational revenues – a record high in the region – and for 1.32% of GDP, in line with the EU27 average (1.31%) (OECD/UCLG, 2019[82]; NALAS, 2019[85]).

Figure 8.30. Total subnational revenues are low with respect to general government revenues



Source: Authors' elaboration based on (OECD/UCLG, 2019[82]), *Report of the World Observatory on Subnational Government Finance and Investment – Key Findings*, www.sng-wofi.org/reports/Key_Findings_2019.pdf.

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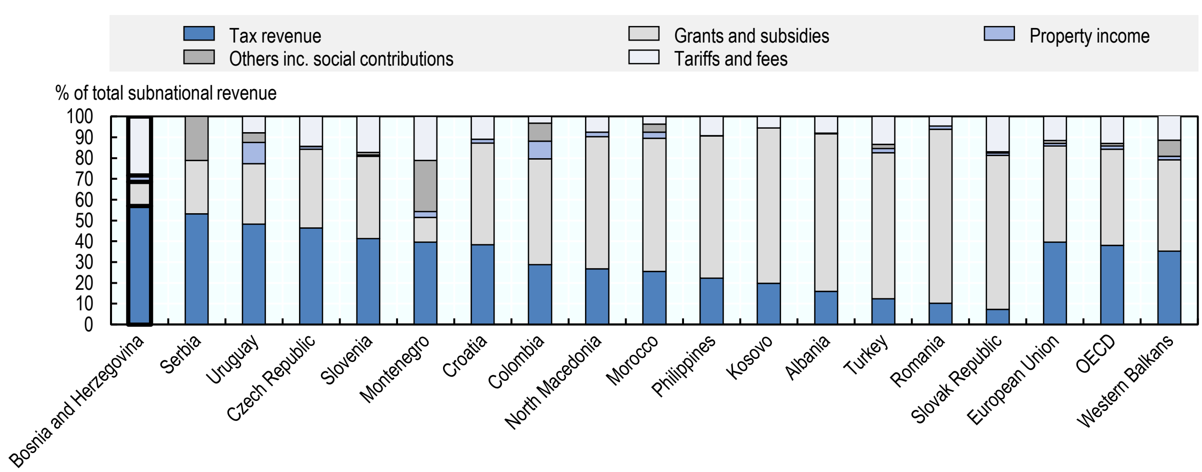
Figure 8.31. Tax revenues and tariffs and fees are the main sources of income of subnational governments



Source: Authors' elaboration based on (OECD/UCLG, 2019[82]), *Report of the World Observatory on Subnational Government Finance and Investment – Key Findings*, www.sng-wofi.org/reports/Key_Findings_2019.pdf.

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Most taxes are collected at the central level and then shared with the entities. In particular, shared revenues from VAT and PIT account for 68.8% and 16.2% of subnational tax revenues, respectively (OECD/UCLG, 2019[82]). These revenues are then then redistributed to the sub-entity levels according to each entity's laws (Table 8.6). For instance, in the Federation of Bosnia and Herzegovina, cantons get the largest share of VAT revenues redistributed from the central government to the subnational level (51.48%).

The rest is shared between the Federation of Bosnia and Herzegovina and the municipalities. In Republika Srpska, the entity level retains 72% of the shared VAT revenues, and the municipalities receive the rest.

Table 8.6. Shared taxes are redistributed across levels of government based on entities' laws

The distribution of taxes between entity and sub-entity levels (% of total subnational revenues)

	Federation of Bosnia and Herzegovina			Republika Srpska	
	Government of the Federation of Bosnia and Herzegovina	Cantons	Municipalities	Government of Republika Srpska	Municipalities
Indirect taxes (VAT, customs and excises)	40.1% (3.9% of which is road excises)	51.5%	8.4%	76% (4% of which is road excises)	24%
Personal income tax		Maximum 65.54% (depending on cantonal law)	Minimum 34.46% (depending on cantonal law)	75%-50% (based on municipalities' development needs)	25%-50% (based on municipalities' development needs)
Corporate income tax	100% of revenues from banks, power insurance and telecommunications companies	100% of revenues from other companies		100%	
Property tax			100%		100%

Note: The property tax base and rate are established by the cantons in the Federation of Bosnia and Herzegovina and by the government in Republika Srpska.
Source: LGI (2018[86]), *Local Government in Bosnia and Herzegovina. Report on Consultations of a Joint Commission on Local Government*, http://europa.ba/wp-content/uploads/2018/06/Master-LGI-report-04062018-web-eng.pdf.

Grants from the central to the subnational government levels are less used than in other Western Balkan and benchmarking economies. Most of them serve to cover subnational current expenditures. Municipalities in the Federation of Bosnia and Herzegovina rely mostly on shared tax revenues and, to a limited extent, on conditional grants transferred from the entity or the cantons. In Republika Srpska, municipalities can access equalisation grants and conditional grants for capital expenditure.

Insufficient funds at the municipal level pose a challenge. In the Federation of Bosnia and Herzegovina, responsibilities are either not transferred to the municipalities, contrary to the stipulations of the Law on Principles of Local Self-Government, or transferred without appropriate funds. In some cases, cantons absorb the competences of municipalities, particularly with respect to the provision of utility services, without necessarily guaranteeing higher quality and performance. While the constitutional court of the entity has ruled in favour of municipalities multiple times, there are no enforcement mechanisms forcing cantons to respect the law or courts' decisions (CoE/CLRA, 2019[87]).

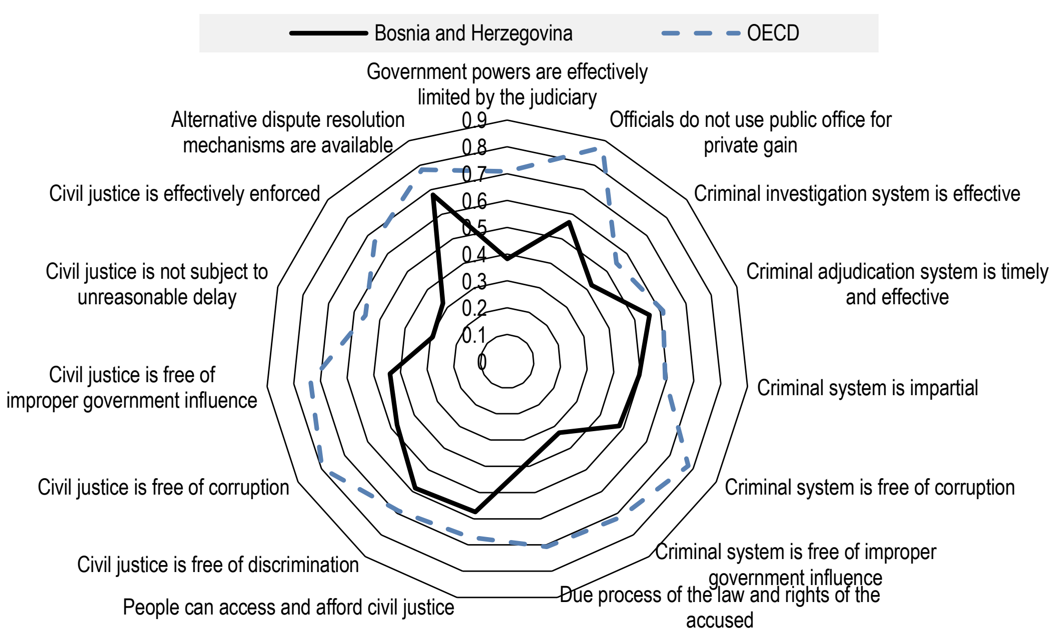
Bosnia and Herzegovina's public debt is roughly evenly distributed between the two entities (50.7% in the Federation of Bosnia and Herzegovina, 48.1% in Republika Srpska and 0.5% in Brčko district) (Ministry of Finance and Treasury, 2019[88]). However, in light of the Federation of Bosnia and Herzegovina's relatively higher contribution to GDP (about two-thirds of total GDP), its contribution to Bosnia and Herzegovina's total public debt is relatively lower than that of Republika Srpska. In entity GDP terms, the Federation of Bosnia and Herzegovina's debt was 27.5% of its GDP in 2018, and Republika Srpska's was 43.8%. In the Federation of Bosnia and Herzegovina, the entity government incurred the largest share of the debt (79.8%), followed by the cantonal governments (15.7%) and the cities and municipalities (4.5%). In Republika Srpska, municipal and city debt accounted for 46.7% of the total public debt in 2018. Municipalities and cities in the Federation of Bosnia and Herzegovina can contract long-term debt if their debt service payment in a given year does not exceed 10% of the previous year's revenues.

Municipalities in Republika Srpska can borrow to finance capital investment expenditures by up to 10% of the actual revenues generated in the previous fiscal year (OECD/UCLG, 2019[82]). Moreover, Republika Srpska's Local Self-Government Development Strategy 2017-2021 identifies the strengthening of local self-government units' financial capacities as a strategic goal for the period.

Overly complex institutional design undermines the independence, efficiency and transparency of the judiciary

Political interference and inefficiencies continue to undermine citizens trust in the judiciary. According to the World Justice Project, both civil and criminal justice in Bosnia and Herzegovina is less free of government influence than in the average OECD country (Figure 8.32). The number of days required to resolve a case has decreased by 13%, or 82 days, since 2012, and the efficiency of first instance courts seems to have increased over the past decade (OECD, 2020[89]). However, the disposition time for litigious civil and commercial cases in Bosnia and Herzegovina (574 days) is longer than in the rest of the Western Balkans (Albanian courts take 159 days, for example). A backlog in the second instance courts may be part of the cause of unreasonable delays (USAID, 2018[90]). As a result, trust in the judiciary is eroding. According to 2018 Gallup data, 30% of Bosnia and Herzegovina citizens trust the judicial system, the lowest percentage of all benchmarking countries used in this report, except for Morocco. Confidence is also down from ten years earlier. Like in Serbia, people in Bosnia and Herzegovina rely more on family and friends than on legal services.

Figure 8.32. The judiciary is exposed to improper government influence and remains inefficient



Note: The dotted line spider chart represents the perceived dimensions of quality of the judiciary in Bosnia and Herzegovina; the continuous line chart represents the average perceived dimensions of quality of the judiciary in the average OECD country.
Source: Authors' calculation based on World Justice Project (2020[91]), *World Justice Project Rule of Law Index 2020*, https://worldjusticeproject.org/our-work/publications/rule-law-index-reports/wjp-rule-law-index-2020.

StatLink https://doi.org/10.1787/888934243106

Three main factors may explain the weakness of the justice system in Bosnia and Herzegovina: 1) the complexity of the judicial system that is not compensated by adequate co-ordination mechanisms; 2) the functioning and composition of the High Judicial Council, the highest judicial self-governing body; and 3) the way judges are selected and kept accountable.

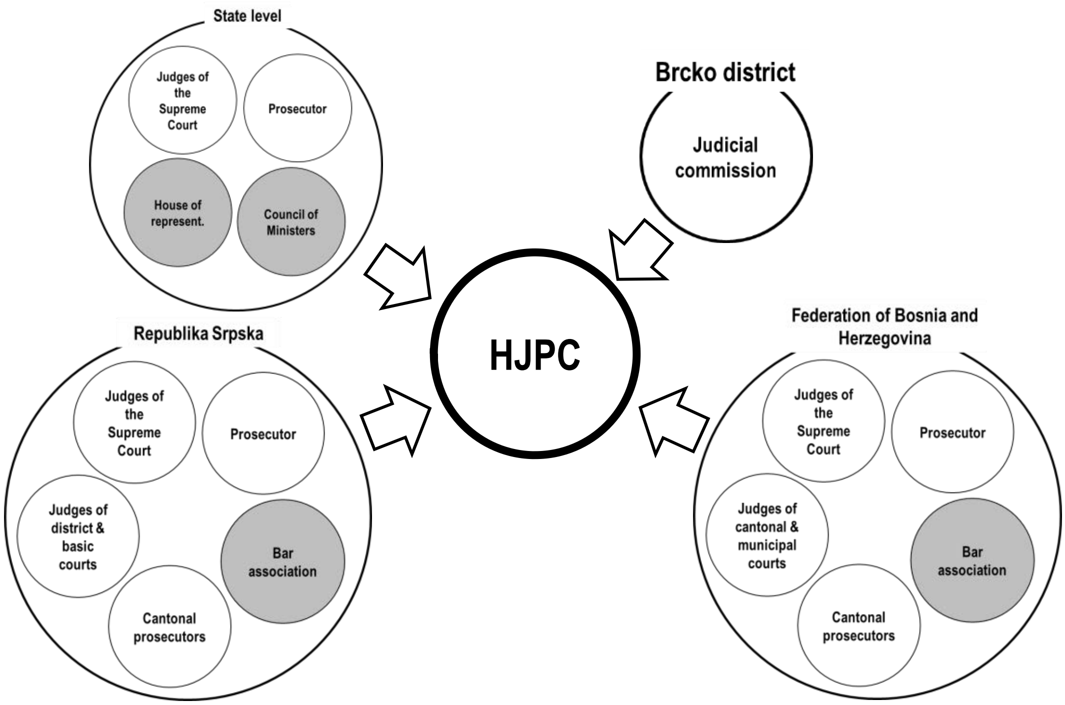
There are four court systems in Bosnia and Herzegovina, including the system of prosecutors' offices: one at the national level, two at the entity level and one for Brčko district. At the state level, there are two courts: the Constitutional Court of Bosnia and Herzegovina and the Court of Bosnia and Herzegovina (Sud Bosne i Hercegovine). The Constitutional Court is the highest judicial body in the country and has jurisdiction over the entire territory of Bosnia and Herzegovina. It settle disputes between bodies of the state and is an appeal body on constitutional issues. The Court of Bosnia and Herzegovina ensures the respect for human rights and the rule of law in the territory of the country (CoE/Venice Commission, 2011[92]).

At the entity level, the judicial system in the Federation of Bosnia and Herzegovina is made up of the Supreme Court, 10 cantonal (appellate) courts and 31 municipal (first instance) courts. The Supreme Court is the highest judicial authority in the Federation of Bosnia and Herzegovina. Prosecutor's offices exist at the entity level and in each canton. A Constitutional Court guarantees for the coherence of laws but has no formal judicial power. The judicial system in Republika Srpska is made up of the Supreme Court, 6 district (appellate) courts and 21 general (first instance) courts. There are also courts with special jurisdiction: the district commercial courts and the Higher Commercial Court. Each district has a Prosecutor's Office, headed by a general prosecutor for the republic. A special department of the Prosecutor's Office at the entity level initiates investigations of corruption, organised crime and serious economic crimes, which are then adjudicated by a special department in the Banja Luka district court (first instance) and by the Supreme Court (second instance). As in the Federation of Bosnia and Herzegovina, the Supreme Court is the highest judicial authority in the entity, while a Constitutional Court exerts normative control. In Brčko district, there is a Court of Appeal, a general (first instance) court and a Prosecutor's Office (CoE/Venice Commission, 2011[92]).

There is no mechanism ensuring the consistency of the law across the country. There is no state-level Supreme Court guaranteeing coherence across the four legislative frameworks and judicial systems. The Court of Bosnia and Herzegovina is in theory well placed to play this role, but as of today, it only rules over administrative acts adopted on the basis of state law, not entity law (CoE/Venice Commission, 2011[92]). As discussed in the next section, the four main prosecutors' offices (at the state and entity levels and in Brčko district) are autonomous and independent, making law enforcement highly fragmented.

Concerning the independence of the judiciary, Bosnia and Herzegovina has made significant progress on paper in the past two decades. In 2004, it established a powerful High Judicial and Prosecutorial Council (HJPC) that is supposed to protect its judges and prosecutors from improper external influences. The council is a self-governing body of 11 professional members of the judicial system elected by their peers, 2 members elected by bar associations and 2 political appointees (Figure 8.33). The council has great powers: among other responsibilities, it appoints the members of the judicial system, supervises their training, creates methodologies to evaluate their performance and conducts disciplinary procedures. Before 2004, all these functions belonged to the executive branch of the government, which created scope for political interference in the judicial process. The establishment of a powerful HJPC, ideally independent of undue external pressures, was therefore a milestone in the creation of a professional judicial system (CoE/Venice Commission, 2014[93]).

Figure 8.33. A multilayered system of quotas regulates the election of HJPC members



Notes: The HJPC has 15 members. The state level and the two entities are represented by the biggest circles. Stakeholders are represented by smaller circles, and each elects one member of the council. Eleven council members are elected by their peers at the entity court level. Four lay members are elected by the stakeholders in grey circles.
Source: Authors' elaboration based on Official Gazette of Bosnia and Herzegovina (2004[94]), Law on Statistics of Bosnia and Herzegovina, No. 25/04, www.bhas.ba/dokumenti/stat.zakon-en.pdf.

The 2004 law might not create the conditions for the emergence of a fully independent and efficient high council. Citizens and members of the judicial community perceive the HJPC as "a centre of unaccountable power in the hands of people serving the interests of a network of political patronage and influence" (Priebe, 2019[95]). The method of selection of members seems to be problematic. Any professional member of the HJPC is elected by peers from her or his entity of origin who serve at the same court level, and not by the entire judicial community (Figure 8.33). The compartmentalisation of the pool of candidates and their voters is rightly respectful of the multi-ethnic nature of the country and of the different branches of the judiciary, but it undermines the competitiveness of the selection process (CoE/Venice Commission, 2014[93]). As the number of peers to win over shrinks, informal networks become a key asset for candidates to win votes – possibly in exchange for leniency during disciplinary proceedings. To surmount the current multilayered system of quotas, authorities could consider a system of proportional representation of judicial members from different entities and court levels whereby any candidate is scrutinised by a broader segment of the judicial community (either across entities or across court levels within an entity) (Priebe, 2019[95]).

Box 8.1. A single transferable vote system could ensure the fair representation of ethnic groups

Single transferable votes are a solution to ensure the representativeness of groups in societies divided along ethnic or religious lines. According to this system, voters rank candidates based on their preferences. To be elected, a candidate must reach a set amount of votes. This quota is usually a function of the number of seats to be filled and the number of ballots. Votes are then counted in stages. First, only first preferences are counted and any candidates who reach the quota with those is elected. Second, votes received by a candidate above the quota are transferred to the next choice on each of those ballots. If no candidate has enough votes to reach the quota, the candidate with the lowest number of votes is eliminated. Third, the votes of the eliminated candidates are passed to the next preference on those ballots. This process is repeated until all seats have been filled.

The single transferable vote system ensures relatively proportional results and encourages co-operation across candidates. Co-operating candidates are indeed more likely to score high in the ranking of preferences cast by voters. Northern Ireland adopted this system at the 1998 parliamentary elections. The electoral reform has produced a significant number of interethnic transfers of preferences and increased the representativeness of the local parliament.

Sources: Mitchell (2014[96]), "The single transferable vote and ethnic conflict: The evidence from Northern Ireland", https://doi.org/10.1016/j.electstud.2013.07.022; Priebe (2019[95]), *Expert Report on Rule of Law issues in Bosnia and Herzegovina*, http://europa.ba/wp-content/uploads/2019/12/ExpertReportonRuleofLawissuesinBosniaandHerzegovina.pdf?utm_source=Klix.ba&utm_medium=Clanak.

Appointment and promotions by the HJPC are based more on ethnic principles than merit, but rules are slowly changing. In particular, the appointment of court presidents and chief prosecutors aims at striking a fair representation of constituent peoples (Priebe, 2019[95]). Ethnic affiliation, which should rightly be taken into account in the formation of courts, should be considered only at the very end of the process, if there is a choice between two equally ranked candidates. Appointment is for life, but all judges and prosecutors need to be subject to performance appraisal, which used to be overly reliant on quantitative criteria and statistics, thus distorting incentives of the appraisee. A recent reform has been introducing better qualitative criteria aimed at evaluating the actual merit of judges and prosecutors (Priebe, 2019[95]).

Last, integrity plans and the assessment of potential conflicts of interests could help enhance citizen trust in the judiciary. Overall, Bosnia and Herzegovina needs a homogeneous, rigorous and credible system of checks of asset declarations of judges and prosecutors that could help unveil misdemeanours. Declarations need to be submitted and processed periodically, and a credible system of sanctions should be in place to punish proven illegal activities (Priebe, 2019[95]). Integrity plans and guidelines for prevention of conflicts of interest have been developed, but implementation is lagging. Courts and prosecutors in Republika Srpska, for instance, face two plans: one developed by the HJPC and one imposed by the Ministry of Justice of the entity. Some prosecutors are also unfamiliar with the steps and activities related to the implementation of the integrity plans (USAID, 2018[90]).

A reform of the judiciary is part of the Justice Sector Reform Strategy 2014-2028 and the Action Plan 2019-2020. The strategy is based on four pillars: 1) independence of the judiciary and harmonisation of laws and court practices; 2) efficiency and effectiveness of judicial institutions; 3) responsibility and professionalism of the members of the judiciary; and 4) transparency of the work of the judiciary. Political deadlock and the resulting slow formation of the Council of Ministers have been delaying implementation of the strategy and the action plan. A new Strategy for Reform of the Justice Sector is under discussion.

Personal connections are inevitable in getting things done but may create social exclusion, distort the labour market and weaken administrative capacity

Formal institutions lack citizen trust because of institutional inefficiencies. While the delivery of public services seems to have improved in the past decade (Fund for Peace, 2020[97]), citizens still find that access often depends on wealth or place of residence. When the state is absent, access to services depends on the work of non-state actors (Belloni and Ramovic, 2020[83]). Bosnia and Herzegovina citizens have the least confidence in their national government (23%) in the region. Trust has been deteriorating since 2007 and is particularly low among young people (aged 15 to 29) (OECD, 2020[89]).

Citizens often rely on informal practices to get a job or overcome government inefficiencies (Efendic and Ledeneva, 2020 (forthcoming)[98]). Around 95% of the population always or occasionally uses personal networks to access basic services, such as employment, education or health care (UNDP, 2009[99]). These informal practices are more common in the Federation of Bosnia and Herzegovina than in Republika Srpska, reflecting different levels of trust in the formal institutions of the respective entities. The Federation of Bosnia and Herzegovina is indeed a very complex entity, with several, often overlapping layers of government. Interactions with the administration are therefore more unpredictable and costly than in Republika Srpska, which is a one-tier entity. Ethnic minorities across Bosnia and Herzegovina are more likely to rely on personal networks compared to citizens belonging to majority communities (Efendic, Pugh and Adnett, 2011[100]).

Informal personal networks may be a blessing or a curse for Bosnia and Herzegovina. Personal networks do not usually involve monetary transactions but rather reciprocity. It is not just a form of material exchange but a practice that reproduces existing and creates new social connections between people (Brkovic and Koutkova, 2018[101]). Therefore, in some cases, it could work across formal divisions, kinships and trauma that separate former neighbours, facilitating interethnic relations (Belloni and Ramovic, 2020[83]). In other cases, these relationships, albeit strong, are primarily family- or locally-based ties. Society is therefore segmented: those without networks have lower access to public services, goods and jobs. In 2009, the United Nations Development Programme estimated that 12% of the population was in this situation (UNDP, 2009[99]). No more recent estimations exist, but the increasing polarisation of the economy along ethnic lines may suggest that network poverty is still an issue.

Informal personal networks can introduce distortions into the labour market and create the wrong incentives. Over 65% of jobseekers report that having the right connections is the most important criterion for getting a job (World Bank, 2019[102]). Leveraging a personal network to navigate the job market is not necessarily bad. However, when networking becomes so predominant, qualified candidates without connections may either be left out or discouraged from applying. In these cases, personal relationships risk becoming more important than investment in skills, contributing to an underqualified labour force and widespread skills mismatches.

Informal networks play a crucial role in getting jobs in the public sector. As recruitment processes remain largely opaque and discretionary, political parties and leaders have often used personal networks to trade public jobs for political support (World Bank, 2019[102]). This practice has contributed to an overly large public sector, which today employs 30% of workers and keeps growing, in spite of numerous hiring freezes.[6] Recruitment of the most connected but not necessarily best candidates, together with a substantial lack of in-depth performance assessment of public employees, weakens the capacity and performance of the public sector, including SOEs. This weakening of state capacity deepens mistrust in formal institutions and dependence on personal relationships, with the potential negative consequences described.

Where personal relationships (and therefore implicit reciprocity) fail to work, citizens pursue administrative action through monetary remuneration. The legislative framework and the distribution of resources across government levels has left room for grand corruption.

Fragmented law enforcement and incoherent legislation frustrate anti-corruption efforts

Corruption in Bosnia and Herzegovina is systemic. According to Gallup data, almost 90% of interviewees consider corruption widespread throughout the government, compared to 70% in the Western Balkans and 50% in the OECD. Citizens usually pay bribes to access medical and health services or to avoid police fines (RCC, 2019[75]). Business leaders often complain about the lack of public integrity, and around 30% of business leaders use bribery to facilitate doing business (compared to 19%, on average, in the region) (RCC, 2019[75]). Several voters report receiving a monetary offer or favour in exchange for political support.

Bosnia and Herzegovina has established an institutional, legal and strategic framework to combat corruption; however, significant gaps remain. Almost 90% of citizens are highly dissatisfied with the government's anti-corruption efforts (RCC, 2019[75]). For instance, the number of officials investigated or indicted is low, and in 2017, no high-level corruption case ended in a conviction.

A centralised anti-corruption body – the Agency for the Prevention of Corruption and Coordination of the Fight against Corruption (APIK) – has a preventive function. It is responsible for the development of the anti-corruption strategy and for the co-ordination and supervision of its implementation. The APIK moreover consults and supervises entities and cantons in the development of their anti-corruption strategies and action plans in line with the principles of the state-level strategy, as prescribed by law. The agency is accountable to the Parliamentary Assembly of Bosnia and Herzegovina, which elects the APIK's director. Corruption-prevention bodies have also been set up at the entity and sub-entity levels. The auditing offices of Bosnia and Herzegovina, the Federation of Bosnia and Herzegovina, Republika Srpska and Brčko district also have a preventive role. They support the development of anti-corruption policies and strategies at all institutional levels and report to the parliaments and the public about the use of public money.

Corruption-prevention institutions are short of capacity. At the state level, the APIK has an appropriate budget, but 20% of 41 positions are vacant. Exchange of information with other bodies that could favour anti-corruption efforts (e.g. ministries of interior, tax authorities, land and vehicle registers) is problematic, making cross-checking data and information arduous if not impossible. The APIK has no power to sanction institutions that refuse to co-operate. Corruption-prevention institutions at the entity level lack professionalism. For example, cantons in the Federation of Bosnia and Herzegovina have set up ad hoc bodies without full-time professional members. Their mandate is usually linked to the duration of cantonal government, and they need to be reappointed when new cantonal governments are put in place (European Commission, 2019[103]).

Law enforcement is fragmented. At the state level, the State Investigation and Protection Agency and the Special Department for Organized Crime, Economic Crime and Corruption within the Prosecutor's Office investigate and prosecute corruption cases and criminal offences that fall under the jurisdiction of the Court of Bosnia and Herzegovina. Each entity has a Prosecutor's Office, but a department dedicated to anti-corruption activities exists only in Republika Srpska. In the Federation of Bosnia and Herzegovina, specialised departments do not exist, although the relevant legislation has been adopted. All three prosecutor's offices (one at the state level and two at the entity level) are independent of each other and competent within their area of jurisdiction only. Without an overarching body, co-ordination across offices is often difficult. The Central Election Commission (CEC) investigates violations of political party and election financing regulations (European Commission, 2019[103]).

The CEC has a "very limited mandate when it comes to audit and control of party financing, particularly in the field of expenditure auditing" (Bosso, 2014[104]). The CEC has no obligation to control the accuracy of asset declarations of candidates, which are not made public.

The anti-corruption legislative framework may lack coherence. The four coexisting criminal codes – one for each administrative unit: the state, two entities and Brčko district – are not always consistent with each other. For example, third-party beneficiaries of active bribery are covered in the criminal code of Bosnia and Herzegovina only. Lack of harmonisation may raise issues of jurisdiction too, especially during the investigation and prosecution phases (Lee-Jones, 2018[105]). The legal framework regulating party financing is dispersed across multiple laws, including the election law (for elected officials), the law on government service (for public servants and all government employees) and the law on high judicial and prosecutorial council (for judges and prosecutors). Whistle-blower protection is scarce. Reporters of misdemeanours are protected against retaliation by state law and at the entity level in Republika Srpska; there is no such legislation in the Federation of Bosnia and Herzegovina (Lee-Jones, 2018[105]).

The fight against corruption can become more effective only with stronger political commitment. The recent effort of 13 anti-corruption bodies led to the definition of the new Anti-Corruption Strategy 2020-2024 and an action plan for implementation. The AKIP has prepared an Action Plan for Prevention of Corruption of Bosnia and Herzegovina's Institutions during the COVID-19 to guide the preparation by all levels of government of specific anti-corruption activities during the pandemic. Actual implementation depends on the political will to overcome entrenched patronage and vested interests and to co-ordinate anti-corruption efforts beyond ethnic divisions.

Poor governance can explain poor SEO performance

SOEs are a large part of Bosnia and Herzegovina's economy. They own 40% of all fixed assets and account for about 11% of total employment. Most SOEs are small and medium-sized municipal utilities, but entity-owned SOEs have the largest operations and account for most of the sector's employment. Municipalities own 279 SOEs, mainly in the water supply, heating and sewerage sectors but also in communications and recreation. Entity-owned SOEs generate about 85% of SOE revenues (EUR 2.9 billion), employ 58 000 workers and mostly operate in the electricity, mining, manufacturing, agriculture and transport sectors (Cegar and Parodi, 2019[68]). SOEs in the electricity, gas, steam and air conditioning supply sector generate almost half (46%) the total revenues from SOEs and employ 27% of total SOE employees (Table 8.7).

SOE performance is poor, but the wage premium is high. SOEs contribute only 10% of total value added generated in the economy, and the estimated average revenue per worker is 8% lower than in the private sector. Yet, salaries are, on average, 40% higher than in private firms.[7] Wages account for 30.5% of total operating expenditures in SOEs, compared to 12% in the private sector. SOE debt accounts for roughly 26% of GDP, including 4% of GDP in tax and social contributions arrears. This dampens tax revenues and jeopardises the functioning of the social security system (Cegar and Parodi, 2019[68]).

Table 8.7. SOEs in the electricity and gas sector generate almost half the revenues from SOEs and employ 27% of SOE employees

SOE sectoral distribution, 2017

Industry	Number of SEOs	Revenues (EUR million)	Assets (EUR million)	Number of employees
Electricity, gas, steam and air conditioning supply	32	1 526.8	5 702.4	17 306
Information and communications	38	414.7	852.0	6 452
Transport and storage	19	390.3	5 536.0	12 337
Mining and quarrying	12	263.8	744.8	11 500
Water supply; sewerage, waste management and remediation	168	208.5	950.5	10 703
Agriculture, forestry and fishing	17	193.3	636.9	9 126
Manufacturing	31	151.2	597.7	4 527
Professional, scientific and technical activities	38	77.1	122.7	1 024
Wholesale and retail trade; repair of motor vehicles	10	39.1	101.0	658
Arts, entertainment and recreation	15	37.7	88.8	1 364
Construction	14	28.8	60.4	620
Other services	6	7.1	13.2	358
Accommodation and food service	3	4.9	35.1	212
Real estate	7	4.3	42.2	181
Financial and insurance	1	1.2	1.3	28
Human health and social work	1	0.6	2.3	51
Administrative and support service	1	0.2	0.1	15
Education	1	0.0	0.8	6
Public administration and defence; compulsory social security	0	0.0	0.0	0
Total	414	3 350	15 488	62 2815

Source: Cegar and Parodi (2019[68]), "State-Owned Enterprises in Bosnia and Herzegovina: Assessing Performance and Oversight", www.imf.org/en/Publications/WP/Issues/2019/09/20/State-Owned-Enterprises-in-Bosnia-and-Herzegovina-Assessing-Performance-and-Oversight-48621.

Poor governance can explain the underperformance of SOEs, which may at times become a drag on productivity growth (see the Prosperity section in this chapter).

SOE registers and ownership strategies are either incomplete or partly missing. In the Federation of Bosnia and Herzegovina, the list is impartial and does not include canton- and municipality-owned enterprises. In Republika Srpska, a comprehensive list exists and is publicly available but has not been updated since 2004. Neither entity has a SEO ownership strategy that would justify entity intervention in SOE sectors (Cegar and Parodi, 2019[68]).

Government oversight and performance management are inadequate. In the Federation of Bosnia and Herzegovina, line ministries oversee both SOE operation and financial performance. Authorities have been establishing a separate unit in the Office of the Prime Minister that should centralise oversight. In Republika Srpska, the Investment and Development Bank of Republika Srpska (IDB Republika Srpska) is the only owner on behalf of the entity government. However, no government agency is tasked with overseeing the IDB Republika Srpska. In practice, there is scarce financial and operational performance oversight, and there is no fiscal risk assessment framework for systematic performance assessments. In principle, SOEs have to publish externally-audited financial statements, but compliance is uneven. Moreover, the entity governments have never produced a sector-wide SOE annual report summarising performance and outlining fiscal risks (Cegar and Parodi, 2019[68]).

Opaque ownership and insufficient oversight create space for mismanagement practices, including the hiring of personnel based on personal networking instead of skills or on political motivations. Line ministries in both entities usually nominate supervisory and board members. Professional competence requirements guide the selection of board members but are weakly defined. There are moreover no provisions requiring independence from political parties nor regulations for conflicts of interest (Cegar and Parodi, 2019[68]). By controlling SEO management, political parties have often abused SOEs, for example by distributing jobs in exchange for political support.

Bosnia and Herzegovina's statistical capacity requires improvement

Statistical capacity has been improving over the past years, yet co-ordination is a challenge, and important data gaps remain, particularly in social policy design. The statistical system of Bosnia and Herzegovina is characterised by a high degree of regional decentralisation, reflecting the administrative and political organisation of the country. The statistical law designates the Agency for Statistics of Bosnia Herzegovina (BHAS) and the Central Bank as official producers of statistics at the state level. The Federation of Bosnia and Herzegovina Institute for Statistics (FIS) and the Republika Srpska Institute of Statistics (RSIS) are obliged to collect data and statistics at the entity level (Official Gazette of Bosnia and Herzegovina, 2004[94]). The BHAS approves and endorses the data collected and processed by the FIS and the RSIS.

Statistical capacity has been increasing over the past two decades, although slowly (World Bank, 2020[106]). In particular, data accessibility at both the state and entity levels has improved (Ardeni and Kveder, 2014[107]; Misic and Richter, 2015[108]; European Commission, 2019[58]). In 2014-17, thanks to EU support, the amount of macroeconomic, employment, business and other statistical data that comply with EU standards increased (European Commission, 2018[109]). This will support evidence-based policy making for socio-economic reforms. For instance, the Labour Force Survey (LFS) has been upgraded to the Eurostat standards set for yearly LFS surveys, supported by the Swedish International Development Cooperation Agency and Statistics Sweden, among others (Ardeni and Kveder, 2014[107]). Environmental statistics were standardised and environmental accounts introduced in 2016 (European Commission, 2019[58]).

Nevertheless, important data gaps remain, particularly in health, agriculture and the disaggregation of social data. Health statistics have not been available for the past five years (World Bank, 2020[106]). The last agricultural census was conducted in 1960, which impedes reliable policy design for agriculture and rural development. Moreover, policies targeted to vulnerable groups require disaggregated data. However, the 2013 Census did not provide data on the civil, political and socio-economic status of national minorities (European Commission, 2019[58]). The statistical classification of subnational data does not follow international standards, making comparability difficult (European Commission, 2019[58]). Data and information collected are not fully disaggregated by gender, as the Law on Gender Equality requires.

Better co-ordination could help improve data quality. Poor co-operation across statistical bodies hampers data provision and transparency. For instance, the statistical agencies of the entities do not always provide the BHAS with the full set of data they collect, as required by law. Moreover, entity-level agencies contest some of the statistical activities carried out by the BHAS (European Commission, 2019[58]). The next census, planned for 2021, is key to improving the data quality of other statistical products. The BHAS needs to develop a new master sample frame not only for the household survey but also for upcoming surveys, such as the LFS, a full-scale Survey of Income and Living Conditions and the Multiple Indicator Cluster Survey (MICS) (European Commission, 2019[58]).

Planet – conserving nature

The Planet pillar of the 2030 Agenda for Sustainable Development reflects the need to find the right balance between socio-economic progress and capacity to sustain the planet's resources and ecosystems and to combat climate change.

The Planet section in this chapter identifies several major constraints Bosnia and Herzegovina faces in its development path (Table 8.8). Bosnia and Herzegovina's economy is highly reliant on heavily polluting coal, and energy efficiency is low. Hydropower accounts for more than one-third of electricity generation, but other renewables, such as solar and wind energy, are almost absent in the country's energy mix. This results in high levels of GHG emissions and air pollution. Air pollution poses a threat not only to the environment but also to human health and Bosnia and Herzegovina's economy. Pollution from poor waste management is another major concern. Illegal landfills and untreated sewage damage natural resources and pose a risk to biodiversity and well-being. Public utility prices set below operational costs undermine the financial sustainability of public utilities and limit financial resources available for investment in water, waste and wastewater management infrastructure, modern and more efficient energy infrastructure and renewable energies.

Table 8.8. Planet – four major constraints to a more sustainable path in Bosnia and Herzegovina

1. Low energy efficiency and high carbon intensity are reflected in high levels of GHG emissions and air pollution.
2. High levels of air pollution threaten human health, the economy and the environment.
3. Poor waste and wastewater management damages natural resources and poses a risk to the environment and well-being.
4. Prices set below operational costs undermine the financial sustainability of public utilities.

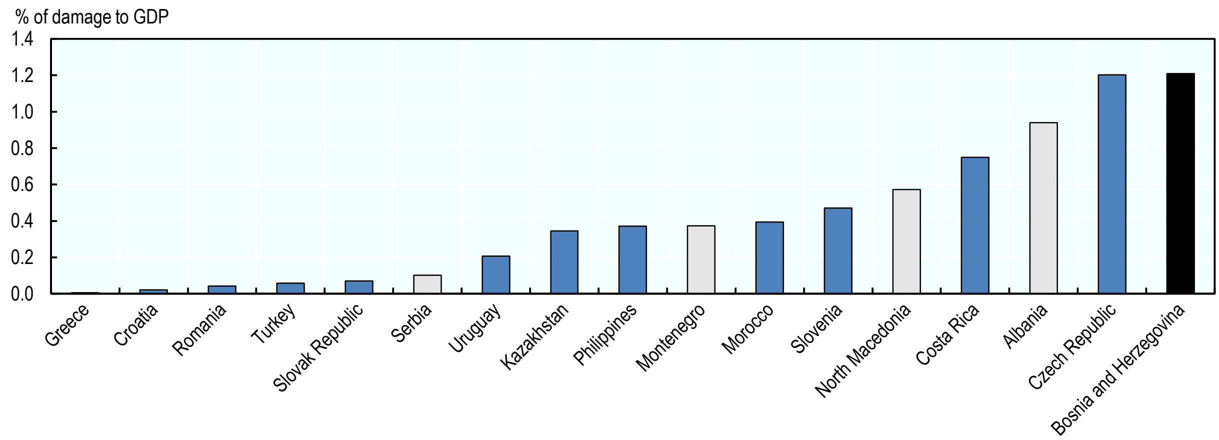
Bosnia and Herzegovina is vulnerable to natural hazards and climate change

Bosnia and Herzegovina is vulnerable to natural hazards, particularly floods, earthquakes, droughts and landslides. Natural hazards are estimated to cost 1.4% of GDP annually, the highest toll in the region (Figure 8.34). The greatest recent disaster was the floods of 2014, causing USD 450 million in damages. Over the last 20 years, Bosnia and Herzegovina experienced a drought, on average, every four years, resulting in reduced harvests, higher food prices and lower river levels, which affects hydropower generation (World Bank, 2020[110]).

Bosnia and Herzegovina faces particular challenges in geographic exposure to natural hazards, capabilities to cope with natural disasters and adaptive capabilities for climate change. According to the World Risk Index, the population's exposure and susceptibility to natural hazards, which depend on infrastructure, nutrition, income and the general economic framework, are low. Yet, the economy's geographic exposure to natural hazards is classified as high, and its adaptive capacities for climate change and its coping capabilities for natural hazards – based on governance, medical care and material security – are evaluated as medium (Bündnis Entwicklungshilfe, 2017[111]).

Figure 8.34. Bosnia and Herzegovina is very vulnerable to natural hazards

Damage to GDP through droughts, floods and extreme temperatures, 2018



Notes: The economic impact of a disaster usually consists of direct consequences to the local economy (e.g. damage to infrastructure, crops, housing) and indirect consequences (e.g. loss of revenues, unemployment, market destabilisation). Figures correspond to the estimated value of direct damage caused by droughts, floods and extreme temperatures in 2018, expressed as a percentage of GDP.
Source: CRED (2020[112]), *EMDAT – The International Disaster Database*, www.emdat.be/.

StatLink https://doi.org/10.1787/888934243125

Table 8.9. Like other Western Balkan economies, Bosnia and Herzegovina is highly vulnerable to climate change

Change of the mean annual temperature (°C) with respect to the base period (1986-2005) for the RCP 4.5 and the RCP 8.5 scenarios of GHG emissions

	Albania		Bosnia and Herzegovina		Kosovo		Montenegro		North Macedonia		Serbia	
RCP	4.5	8.5	4.5	8.5	4.5	8.5	4.5	8.5	4.5	8.5	4.5	8.5
2016 - 2035	0.5-1	0.5-1	0.5-1	0.5-1	0.5-1	0.5-1.5	0.5-1	0.5-1.5	0.5-1	0.5-1.5	0.5-1	0.5-1.5
2046 - 2065	1-2	1.5-3	1-2	1.5-3	1.5-2	2-3	1-2	1.5-3	1.5-2	2-3	1-2	1.5-3
2081 - 2100	1.5-2	4-5	1.5-3	4-5	2-3	4-5	1.5-3	4-5	2-3	4-5	1.5-3	4-5

Notes: The mean annual temperature corresponds to the average of the maximum and minimum temperatures of a year, taking the mean average of the coldest month of the year and averaging it with the mean average of the hottest month of the year. RCP = representative concentration pathway. RCP 4.5 refers to a stabilisation scenario and RCP 8.5 to a continuous rise of GHG emissions scenario.
Source: RCC (2018[113]), *Expert Report on Rule of Law issues in Bosnia and Herzegovina*, http://europa.ba/wp-content/uploads/2019/12/ExpertReportonRuleofLawissuesinBosniaandHerzegovina.pdf?utm_source=Klix.ba&utm_medium=Clanak.

Bosnia and Herzegovina's vulnerability to natural hazards is likely to increase through climate change. Bosnia and Herzegovina ranked 129th out of 181 countries on Germanwatch's Climate Risk Index in 2018 (Germanwatch, 2019[114]). Since 1961, the average annual air temperature has increased 0.4°C to – 0.8°C in Bosnia and Herzegovina (USAID, 2016[115]) and climate models predict an additional increase in average temperatures of up to 1°C in the country by 2030 - 2035 (Table 8.9) and less regular rainfall patterns. This will result in more extreme weather events, including droughts and floods, leading to loss of lives, property and infrastructure. Since the early 2000s, there have been more droughts and floods than in previous decades. The agriculture sector, water resources, biodiversity and hydropower will be particularly affected by climate change (World Bank, 2020[110]).

Bosnia and Herzegovina's rich biodiversity and forest coverage is not sufficiently protected

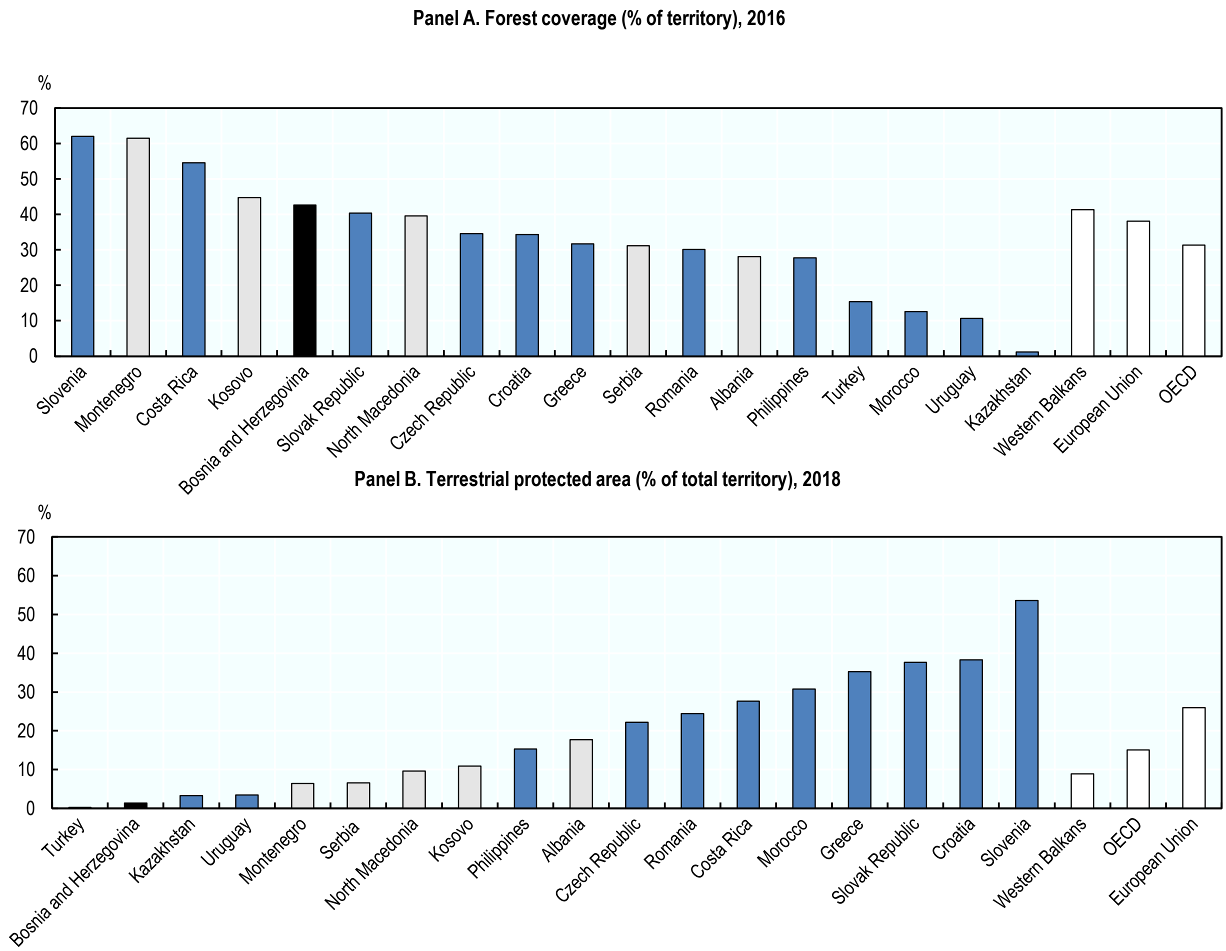
Bosnia and Herzegovina is one of the most biodiverse countries of Europe. Some 30% of flora endemic to the Balkans is found in Bosnia and Herzegovina (around 1 800 species) (CBD, n.d.[116]). There are more than 5 000 species and subspecies of vascular plants, more than 100 species of fish and more than 320 species of birds in Bosnia and Herzegovina (GEF/UNEP/Government of Bosnia and Herzegovina, n.d.[117]).

Bosnia and Herzegovina's rich biodiversity is threatened and not sufficiently monitored or protected. Coal mining and the disposal of its waste have resulted in the degradation of meadows, arable land and forests. Opencast mining or opencast exploitation of mineral ores has damaged approximately 15 000 ha of land in Bosnia and Herzegovina (UNEP, 2012[118]). Untreated wastewater and illegally dumped solid waste cause pollution and negatively affect biodiversity. Other important pressures come from habitat conversion, over-exploitation of natural resources, unsustainable use of land and forests, pollution, climate change, invasive alien species, fires and inadequate fire protection, agriculture, energy, the industrial sector and illegal hunting and mining. Bosnia and Herzegovina has no biodiversity monitoring system, and data on biodiversity is scarce, fragmented and often outdated. Budgetary allocations to nature conservation and biodiversity monitoring are too low (UNECE, 2018[119]). Only 1.4% of Bosnia and Herzegovina's land area was designed protected as of 2018 (Figure 8.35) (World Bank, 2020[7]) the lowest area in a Western Balkan economy. Bosnia and Herzegovina's alignment with the EU acquis on nature protection is very limited (European Commission, 2020[120]).

Legislation for biodiversity protection is in place but its enforcement remains a challenge. The Law on Environmental Protection for the Federation of Bosnia and Herzegovina was adopted in 2013 and the Law on Nature Protection for Republika Srpska in 2014, both of which are harmonised with the EU Directives on Habitats and Birds. Bosnia and Herzegovina has had a Strategy and Action Plan for Protection of Biological Diversity in Bosnia and Herzegovina (2015-2020) since 2016, but financial resources and expert knowledge for its implementation are lacking. Although both entities have red lists of species at risk of extinction, there is no unified list for Bosnia and Herzegovina. There has been progress in biodiversity protection through the establishment of gene banks and a national Biodiversity Clearing House Mechanism, and through public awareness raising (CBD, n.d.[116]).

The large forest areas that house this rich biodiversity are an important economic factor in Bosnia and Herzegovina. In 2016, 42.7% of the land area was covered by forests (World Bank, 2020[7]) above the Western Balkan and EU averages (Figure 8.35). In total, 5.7 million m^3 of timber, corresponding to about 331 km^2 of forest area, is harvested annually for wood production (UNECE, 2018[119]). According to local data, the forest sector accounted for 2.7% of GDP in 2018: forestry and logging contributed 0.7% in 2018, and manufacturing of wood, cork, furniture and paper contributed 2%. Timber is also an important export product: Bosnia exports about 1.5 million m^3 of wood annually (UNECE, 2018[119]). Forests also provide protection against floods and natural cooling in urban areas.

Figure 8.35. Bosnia and Herzegovina's large forest area houses its rich biodiversity, but biodiversity is not sufficiently protected



Notes: Panel A: data for Kosovo are local data for 2018 provided by the Ministry of Agriculture, Forestry and Rural Development of Kosovo: www.mbpzhr-ks.net/repository/docs/ENG_Raporti_i_Gjelber_2019.pdf. Panel B: there are no data for the Czech Republic, Kosovo, Serbia and Slovak Republic on marine protected areas (no access to sea). Data for Kosovo are local data for 2019 provided by the Kosovo Environmental Protection Agency.

Sources: World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; UNEP-WCMC (2014[121]), *World Database on Protected Areas (WDPA)* (database), www.unep-wcmc.org/resources-and-data/wdpa.

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Important challenges persist in forest management. Entities are responsible for forest management legislation, but there is currently no such legislation in the Federation of Bosnia and Herzegovina. A new framework has been elaborated but not approved by parliament. Establishing comprehensive forest legislation in the Federation of Bosnia and Herzegovina is important to ensure adequate forest management. There is a lack of co-ordination in forest management in Bosnia and Herzegovina, and institutional and inspection capacities are underdeveloped. Public forest management enterprises are not profitable since the price of wood is set by law at a very low level. This results in insufficient financial resources for investments in forest management and encourages the use of wood as a source of energy, for example for residential heating and cooking, which in turn contributes to high air pollution levels. The low price of wood also discourages private investment in the sector. These challenges result in poor forest management and a lack of organised reforestation. Illegal logging and forest fires are additional threats.

As a consequence, the country's forests are degrading, threatening biodiversity and the development of economic activities in the forest sector (UNECE, 2018[119]).

Soil degradation and loss of agricultural land are increasing in Bosnia and Herzegovina. Soil degradation and loss of agricultural land are mainly caused by sudden urbanisation, industrialisation and changes in commercial development. Inadequately managed solid waste is also a challenge. Bosnia and Herzegovina lacks specific laws at the state or entity level that address soil protection and monitoring, a systematic soil monitoring and soil and land information system, and information on soil contamination. Data on soil use and quality are limited and of poor quality (UNECE, 2018[119]).

High levels of air pollution threaten human health, the economy and the environment

Bosnia and Herzegovina has high levels of air pollution, mainly due to the economy's high carbon intensity. Bosnia and Herzegovina has the second highest level of air pollution of Western Balkan economies after North Macedonia (Figure 8.36). Both particulate matter (PM) 2.5 and PM10 air pollution are high in Bosnia and Herzegovina. Banja Luka, Sarajevo and other urban areas are most affected.

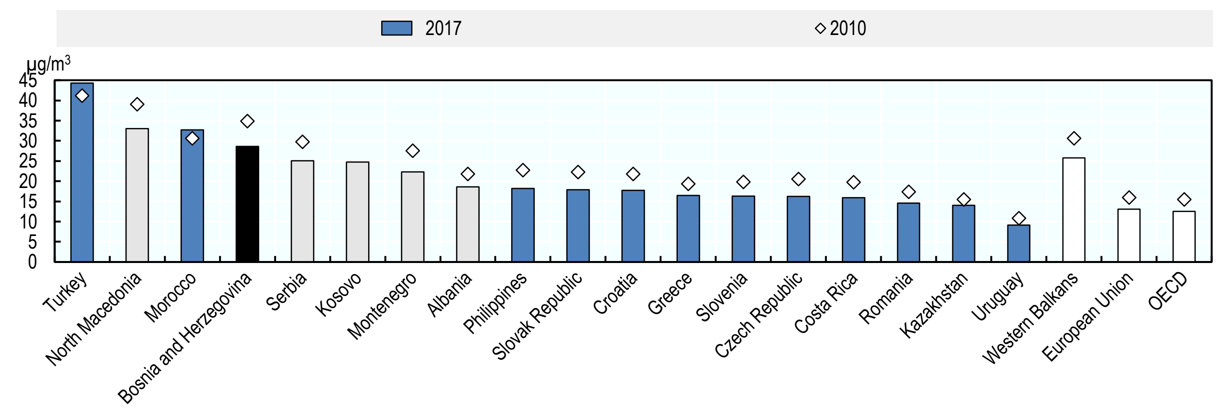
The main sources of PM2.5 are residential combustion and the heating, industry, coal power plant and transport (through an aging vehicle fleet) sectors. Energy efficiency is very low across residential and economic sectors. Heating of buildings accounts for more than 50% of primary energy consumption. Some 70% of houses are heated with low-grade wood, lignite or coal in inefficient stoves and boilers, and buildings are often badly insulated. This causes a lot of air pollution, particularly in urban areas. It is estimated that energy demand from residential, public and commercial buildings could be reduced by 60% through energy-efficient and cost-effective refurbishments (World Bank, 2020[110]). Electricity production contributes to air pollution through a high reliance on coal. The average age of the private car fleet is 17 years, and more than 75% use diesel fuel (UNECE, 2018[119]). Waste and agriculture are further sources of air pollution (World Bank, 2020[110]).

The high levels of air pollution threaten well-being and Bosnia and Herzegovina's economy. Some 62% of the population considers pollution a serious or somewhat serious problem (RCC, 2018[113]). In 2016, the mortality rate attributable to household and ambient air pollution in Bosnia and Herzegovina was 159.3 per 100 000 inhabitants, the highest rate in the Western Balkan region (Figure 8.37): approximately 5 300 citizens die prematurely due to air pollution every year. According to the World Bank, 9% of annual mortality in Bosnia and Herzegovina is attributable to air pollution (World Bank, 2020[110]). The Federation of Bosnia and Herzegovina is more affected by premature deaths due to air pollution than Republika Srpska (World Bank, 2019[122]). According to the United Nations Environment Programme, the overall loss of GDP due to air pollution amounts to 21.5% of GDP when taking into account not only premature deaths but also lost work and school days and healthcare and fuel costs (UNEP, 2018[123]). However, there is a lack of local data on the impact of air pollution. Public data on the health impact of air pollution, including the number of premature deaths, are not currently being collected by national authorities (United Nations in Bosnia and Herzegovina, 2020[124]).

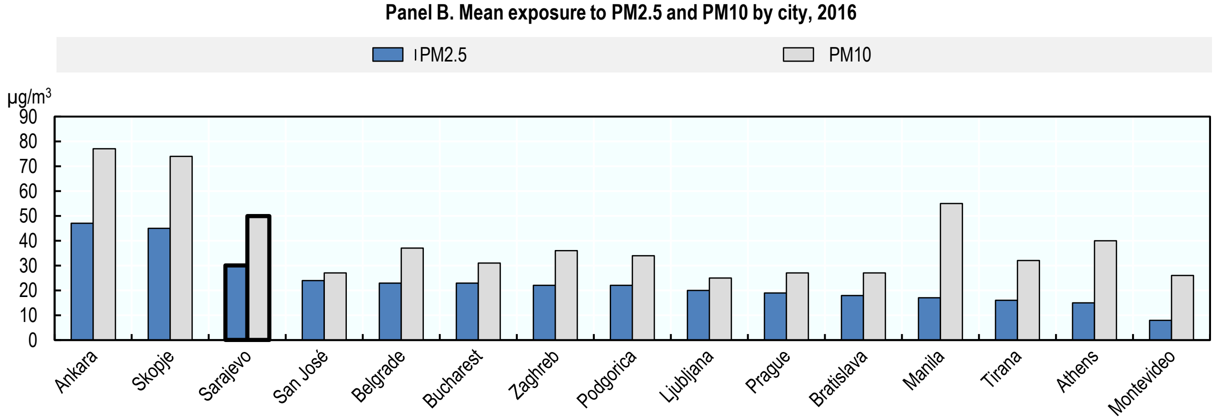
Bosnia and Herzegovina is making efforts to reduce air pollution, but policies and enforcement need to be improved. Currently, enterprises must pay a tax on emissions that is progressive and increasing with the level of pollution. Environmental permits issued at entity and canton levels include emission limits for the leading air-polluting substances that are mainly based on EU standards. A special environmental fee, dependent on the type of engine and fuel and vehicle age, must be paid at the time of motor vehicle registration, although the fee's linkage with actual pollution is weak (UNECE, 2018[119]). The legal framework to tackle air pollution is largely in place, but implementation and enforcement are inadequate (United Nations in Bosnia and Herzegovina, 2020[124]). For example, Bosnia and Herzegovina adopted a National Emission Reduction Plan for Large Combustion Plants in 2015, but financing has not yet been secured for the estimated implementation cost of over EUR 300 million (UNECE, 2018[119]). Air quality monitoring efforts in Bosnia and Herzegovina focus mainly on PM10 and less on PM2.5, and the quality of monitoring data is a challenge. The division of competences and lack of co-ordination across municipalities, cantons, entities and the state are further impediments to tackling air pollution (World Bank, 2019[122]). Bosnia and Herzegovina's alignment with the EU acquis on air quality, most importantly, air quality monitoring, remains limited (European Commission, 2020[120]).

Figure 8.36. Bosnia and Herzegovina has among the highest levels of air pollution of Western Balkan and European economies

Panel A. Mean exposure to PM2.5 by economy, 2017 and 2010



Panel B. Mean exposure to PM2.5 and PM10 by city, 2016



Notes: Mean population exposure to fine particulate matter is calculated as the mean annual outdoor PM2.5 concentration weighted by population living in the area. It is the concentration level, expressed in µg/m^3, to which a typical resident is exposed throughout a year. Data for Kosovo are for 2016 (local data reported to the European Environment Agency). Data for Turkey are from the World Bank.
Sources: EEA (2020[125]), *Air pollutant concentrations at station level (statistics)* (dataset), www.eea.europa.eu/data-and-maps/data/air-pollutant-concentrations-at-station; OECD (2020[126]), *Green Growth Indicators* (database), https://stats.oecd.org/Index.aspx?DataSetCode=GREEN_GROWTH.

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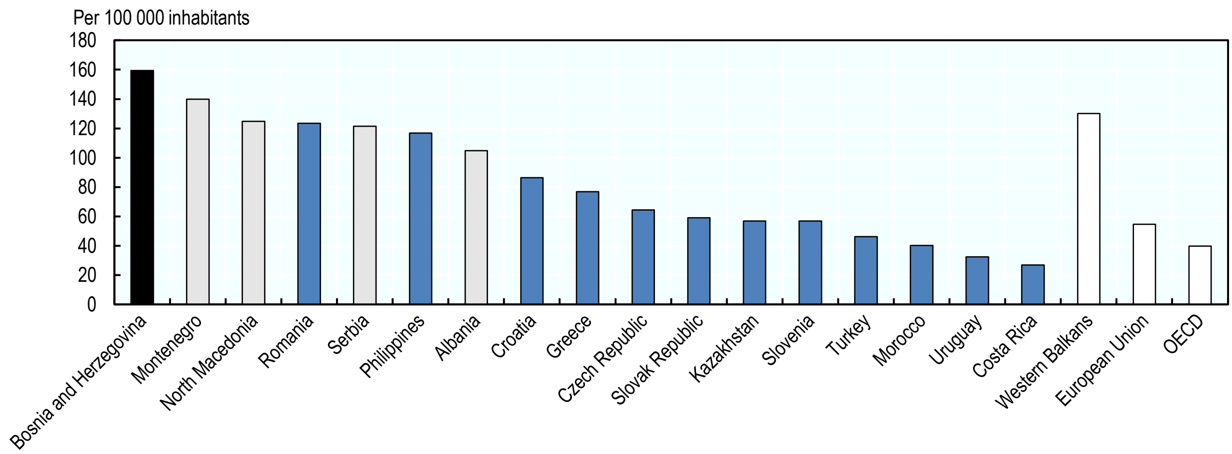
Figure 8.37. The mortality rate due to ambient air pollution in Bosnia and Herzegovina is the highest among Western Balkan economies and almost three times the EU average

Mortality rate attributable to household and ambient air pollution (per 100 000 inhabitants), 2016



Note: There are no data for Kosovo.
Source: WHO (2020[43]), *Global Health Observatory data repository – Burden of disease SDG 3.9.2 Mortality rate attributed to unsafe water, unsafe sanitation and lack of hygiene (exposure to unsafe Water, Sanitation and Hygiene for All (WASH))*, https://apps.who.int/gho/data/view.main.SDGWSHBOD392v.

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Inadequate waste management poses a risk to the environment and damages natural resources

The development and implementation of waste management policies in Bosnia and Herzegovina is at the entity level, and responsibilities are shared among entities, cantons and municipalities (Cero, Silajdžic and Kurtagic, 2018[127]). Municipalities are responsible for the organisation of the collection and disposal of municipal waste in co-ordination with cantons. Waste management services are mainly provided by communal enterprises, which are wholly or partly owned by the state or, less frequently, by private entities contracted by municipalities. Public communal enterprises are financially responsible for their businesses: they collect fees from households and pay fees to landfill operators. Municipalities in the Sarajevo canton are an exception: the communal enterprise in Sarajevo both collects waste and manages the cantonal landfill (World Bank, 2020[110]). The Federal Ministry of Environment and Tourism of the Federation of Bosnia and Herzegovina's, the Ministry of Physical Planning, Civil Engineering and Ecology of Republika Srpska, and the Department for Physical Planning and Proprietary Affairs of the Government of Brčko district are responsible for cross-border movements of waste and the development of legislation in the field of waste management (Cero, Silajdžic and Kurtagic, 2018[127]).

Inadequate waste management poses risks to the population, contributes to pollution and damages natural resources and the environment. Municipal waste generation is in line with other Western Balkan economies: Bosnia and Herzegovina produced 352 kg of municipal waste per capita in 2018, compared to a Western Balkan average of 365 kg (Eurostat, 2018[128]). However, only approximately 66% of Bosnia and Herzegovina's population had access to municipal solid waste collection and disposal services in 2015, and only 74% of solid waste generated was collected through waste-collection services in 2016 (Cero, Silajdžic and Kurtagic, 2018[127]).

The limited capacity of the waste disposal system and poor management have contributed to a large number of illegal landfills and dumpsites. Illegal dumping and burning of solid waste is widespread in Bosnia and Herzegovina and results in soil, air and water pollution (World Bank, 2020[110]). In 2015, only 33% of municipal waste collected was disposed of in sanitary landfills; 67% was disposed of in non-compliant and uncontrolled municipal landfills (Cero, Silajdžic and Kurtagic, 2018[127]). There are an estimated 1 200 illegal dumpsites in the country (Cero, Silajdžic and Kurtagic, 2018[127]). Even where regional sanitary landfills exist, enforcement is often lacking, in part due to high transport costs (World Bank, 2020[110]).

Low levels of recycling and treatment of special categories of waste are further challenges. As Bosnia and Herzegovina lacks recycling facilities, recycling of solid waste is very limited (World Bank, 2020[110]): recyclables separated from mixed municipal waste amounted to less than 5% of total municipal waste in 2010 (EEA, 2010[129]). Despite recent improvements, particularly with regards to electrical and electronic waste, Bosnia and Herzegovina lacks facilities to treat and dispose of special categories of waste, such as medical and hazardous waste (Cero, Silajdžic and Kurtagic, 2018[127]).

Water management must be improved in Bosnia and Herzegovina to ensure a stable drinking water supply in the long run

Competence for water regulation and management in Bosnia and Herzegovina is shared among entities, cantons, towns and municipalities. Entities are responsible for managing and regulating wastewater; creating the strategic framework and legislation for water management; overseeing implementation of the water legislation; monitoring and supervising local and communal public services; controlling water quality; granting and controlling water extraction and discharge rights; setting fees for water extraction and discharge; and managing category I surface waters. Cantons are responsible for managing category II surface waters. Towns and municipalities are responsible for managing water supply and sanitation systems, treating urban wastewater and setting water tariffs (World Bank/IAWD, 2015[130]). Bosnia and Herzegovina lacks a national water policy and water management plan and does not comply with most water-related provisions of the EU acquis (European Commission, 2020[120]).

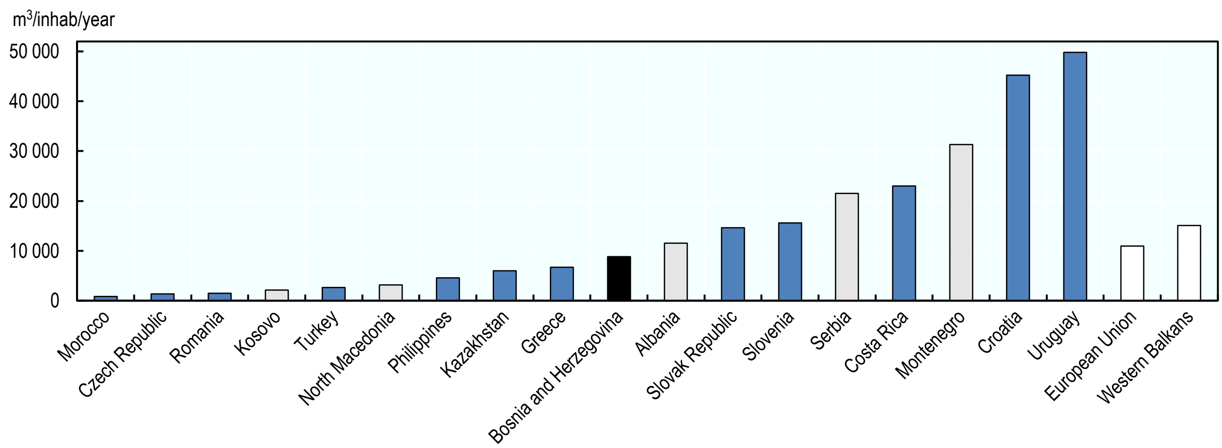
Bosnia and Herzegovina's total renewable water resources per capita (8 790 m^3 per inhabitant annually in 2017) are 20% below the EU average and rather low by international comparison (Figure 8.38). Most drinking water is extracted from groundwater (81%) (World Bank/IAWD, 2015[130]). About 82% goes to domestic use, 16% to industry and the remainder to agriculture and other applications (UNECE, 2018[119]).

Water resources are unevenly distributed across the country and over seasons. Water resources are split between the Danube River Basin District and the Adriatic Sea and are therefore scarce in some areas, such as the Bosna River sub-basin, which is densely populated and contains a large concentration of industries. Highly seasonal rainfall leads to flooding in the wet season and water shortages in the dry season. Climate change is likely to reinforce these patterns. Bosnia and Herzegovina has not yet developed specific strategies for dealing with the impact of climate change on water availability (World Bank/IAWD, 2015[130]).

Water pollution is a challenge. Water quality in Bosnia and Herzegovina is negatively affected by untreated wastewater and improperly disposed of solid waste. Other sources of pollution are uncontrolled animal manure, silage leaching and surplus fertilizer. Due to pollution, 21% of drinking water samples fail microbiological tests (UNECE, 2018[119]). Surface water pollution is a particular concern, most importantly, nutrient pollution in the Danube Basin. The entire Danube Basin and limited parts of the Adriatic Basin are "sensitive areas", as defined by the EU Water Framework Directive. Of the country's 22 groundwater bodies, 6 are considered at risk because of quality concerns to do with pollution or because of decreased water availability due to overexploitation (World Bank/IAWD, 2015[130]).

Figure 8.38. Bosnia and Herzegovina's freshwater resources are moderate compared to other regional economies and the EU average

Total renewable water resources per capita (m3/inhab/year), 2017



Note: Data for Bosnia and Herzegovina, Kosovo and Montenegro are for 2016.
Sources: Eurostat (2018[128]), *COVID-19 – European Statistical Recovery Dashboard* (database), https://ec.europa.eu/eurostat/data/database; FAO (2015[131]), *Aquastat* (database), www.fao.org/nr/water/aquastat/data/query/results.html.

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Despite good access to drinking water, there is scope for improving public water services. In 2017, 96% of the population was using at least basic drinking water services, and 89% was using safely managed drinking water services. Good access to quality drinking water is reflected in a low mortality rate attributable to unsafe water (only 0.08 per 100 000 inhabitants in 2016 (WHO, 2020[43]). However, only 58% of the population is connected to the public water supply network (UNECE, 2018[119]). Furthermore, Roma are marginalised and mainly live in informal settlements that lack basic sanitary facilities, including access to potable water. Water quality and water pollution are also much bigger challenges in rural areas than in urban areas (World Bank/IAWD, 2015[130]).

The water supply and sewerage infrastructure is outdated, and there are quality concerns. Water leakages are frequent in Bosnia and Herzegovina's public water supply system: 59% of water is lost through leaks in the network (UNECE, 2018[119]). In some areas, water supply infrastructure destroyed by the war has not yet been fully rebuilt and repaired. The World Bank estimates that the water and wastewater sector will require EUR 3.66 billion of investment over the next 20 years (38% for water management; 62% for wastewater management) to comply with EU environmental standards (World Bank/IAWD, 2015[130]).

An incomplete sewerage system and a lack of wastewater treatment threaten water quality and human health. Bosnia and Herzegovina lacks sewerage systems and wastewater treatment plants. Only 31% of Bosnia and Herzegovina's population is connected to the public sewerage network (World Bank, 2020[110]) (33% of the population in the Federation of Bosnia and Herzegovina and 36% in Republika Srpska in 2015). Only about 3% in the Federation of Bosnia and Herzegovina (excluding Sarajevo) and less than 5% in Republika Srpska was connected to a wastewater treatment plant in 2015. Brčko district has no urban wastewater treatment facility at all (UNECE, 2018[119]). As a result, only 15% of Bosnia and Herzegovina's wastewater is treated before reaching the rivers (World Bank, 2020[110]). Untreated wastewater poses an important threat to water quality.

Access to basic sanitation services is good; however, limited access to the sewerage network and wastewater treatment results in poor access to safely managed sanitation services. In 2016, 97.2% of the population had access to basic handwashing facilities, and in 2017, 95.4% was using at least basic sanitation services (World Bank, 2020[7]). Some 91% of the population had access to a flushing toilet in 2012 (World Bank/IAWD, 2015[130]). However, in 2017, only 21.6% was using safely managed sanitation services (World Bank, 2020[110]).[8] Improving access to safely managed sanitation services is important to protect the environment and human health, especially in light of the COVID-19 pandemic.

Insufficient water quality monitoring and a shortage of qualified staff and financial resources are key challenges for public water management. Water quality monitoring is not comprehensive, and monitoring infrastructure is lacking. Water and wastewater utilities also lack sufficient qualified staff (World Bank/IAWD, 2015[130]) and expertise for the preparation and implementation of projects to adapt water management to EU water supply and sanitation directives.

Management of public utility services is too fragmented, and prices are set below operational costs

Responsibilities for environmental governance are divided among the state, entities, cantons and municipalities. In general, entities are responsible for most environmental regulation and legislation. Bosnia and Herzegovina's Ministry of Foreign Trade and Economic Relations has a role in co-ordinating entity and Brčko district environmental policies and is responsible for international agreements and projects. An inter-entity environmental body deals with all environmental issues that require a harmonised approach by entities.

The provision of public utilities is too fragmented. According to the constitution, it is the responsibility of municipal authorities to provide public services. Therefore, a multiplicity of public utility companies operate in the country (e.g. 119 water utility companies). A public utility system that is too fragmented is inefficient and fails to take advantage of economies of scale. Furthermore, few of the municipal utility companies have the ability to ensure adequate operation of their facilities (World Bank, 2020[110]).

Tariffs are set below operational costs and threaten the financial sustainability of public utility services. Due to political considerations, tariffs for public utility services, including for waste collection, water and electricity, tend to be below the cost of service provision and too low to cover operation and maintenance expenses, undermining financial sustainability. Local governments are required to support utility companies through transfers and subsidies, while the government lacks financial resources for investments to upgrade and build new waste and water management and electricity infrastructure.

Low tariffs do not encourage water and electricity conservation and lead to overexploitation of water resources and high levels of air pollution and GHG emissions through electricity generation from coal (World Bank/IAWD, 2015[130]). Tariffs charged for waste collection amount to 0.5% of disposable income in Bosnia and Herzegovina, compared to 1% to 1.5% in most EU countries (Cero, Silajdžic and Kurtagic, 2018[127]). Electricity prices charged to users are below the cost of supply, producing a revenue shortfall amounting to 3-4% of GDP from 2011 to 2014. In 2017, households paid less than half the average electricity price of residential customers in the European Union, and business tariffs were the second lowest of all EU and Western Balkan economies. Authorities need to align tariffs with the cost of services (World Bank, 2020[110]).

Bosnia and Herzegovina's environmental legislation is improving, but enforcement remains a challenge

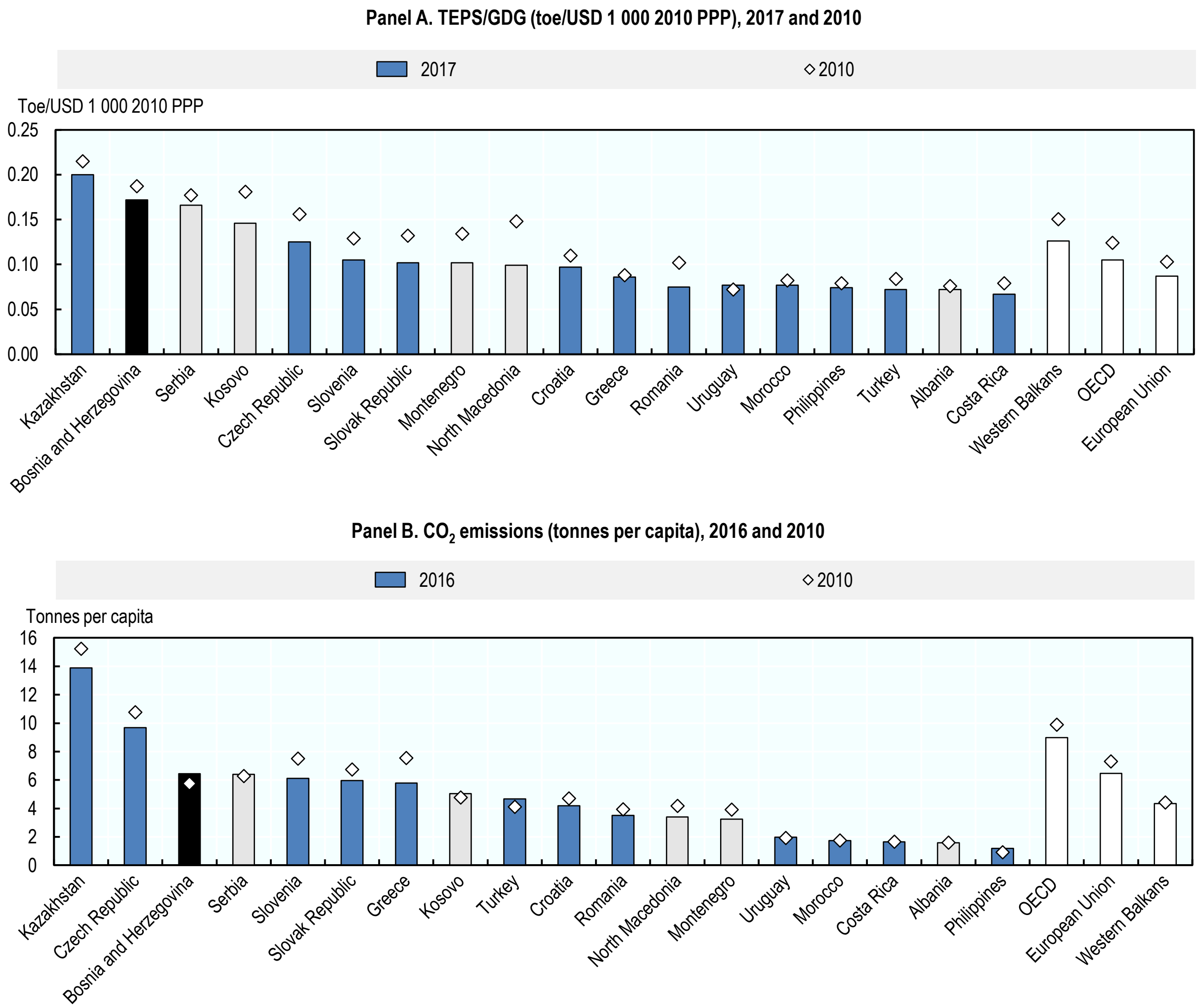
Environmental legislation and regulation is continuously being improved in Bosnia and Herzegovina, but challenges remain. New laws on environmental protection and on air protection are currently being discussed in parliament in the Federation of Bosnia and Herzegovina. The entity-level laws on environmental protection stipulate the requirement for environmental impact assessments (EIA) and strategic environmental assessments (SEA) as prerequisites for the granting of operating permits to large-scale projects with significant environmental impact. However, integrated permits, for example for air and water pollution, are not yet issued in Bosnia and Herzegovina.[9] Bosnia and Herzegovina is taking steps to harmonise environmental legislation with EU standards: since 2017, Bosnia and Herzegovina has had an official Environmental Approximation Strategy to align its environmental legislation, regulations, policies and infrastructure (Ministry of Foreign Trade and Economic Relations, 2017[132]). Republika Srpska has had such a strategy since 2016 (Government of Republika Srpska, 2016[133]). The criminal codes of the Federation of Bosnia and Herzegovina, Republika Srpska and Brčko district include articles on environmental crimes, which however do not cover the spectrum of offenses as provided in EU Directive 2008/99/EC on the protection of the environment through criminal law. Moreover, the legal provisions are incomplete and insufficiently specific, precise and clear (UNECE, 2018[119]).

Challenges remain in terms of law enforcement and implementation and public participation. Since 2011, the Federation of Bosnia and Herzegovina has taken steps to make the environmental permitting system work. All new industrial installations require EIAs and receive environmental permits. Nevertheless, not all existing installations have yet received environmental permits. Republika Srpska also faces challenges in implementing the provisions on SEAs, environmental permits and eco-labelling. Although SEAs exist in Bosnia and Herzegovina (since 2003 in the Federation of Bosnia and Herzegovina), only three were conducted in the Federation of Bosnia and Herzegovina and eight in Republika Srpska in 2015-16, and none has ever been done in Brčko district. The EU provisions for EIAs and SEAs have not been fully transposed to entity-level legislation (European Commission, 2020[120]). Furthermore, the current, relatively low level of financial sanctions for violating permit conditions (EUR 500 to EUR 5 000) does not incentivise permit holders to change their behaviours: paying the fine is, in many cases, cheaper than investing in the technological upgrades required to meet environmental standards (UNECE, 2018[119]). Progress on the implementation of the Environmental Approximation Strategy is slow (European Commission, 2020[120]). It is also important to improve public awareness of environmental protection and challenges and to involve environmental civil society organisations and the private sector in environmental decision-making processes.

Bosnia and Herzegovina's high carbon intensity and low energy efficiency are reflected in high GHG emissions

CO_2 emissions and energy intensity are quite high by international comparison. Bosnia and Herzegovina's CO_2 emissions per capita (6.4 tonnes) are the highest among Western Balkan economies and in line with EU countries (Figure 8.39). This largely owes to the economy's reliance on coal and its high carbon intensity. The carbon-intensive energy sector is the main source of GHG emissions (61% to 70%) (UNECE, 2018[119]). Bosnia and Herzegovina's energy intensity is also the highest in the region and is twice as high as in the European Union (Figure 8.39). Progress in aligning regulation with EU standards on energy efficiency is limited. Bosnia and Herzegovina still needs to align its legislation with the EU Energy Efficiency Directive and the new Framework Energy Labelling Regulation (European Commission, 2020[120]).

Figure 8.39. Bosnia and Herzegovina's high energy and carbon intensities result in high CO_2 emissions



Note: TPES = total primary energy supply. toe = tonne of oil equivalent. Panel A: data for the Czech Republic, Greece, the Slovak Republic and Turkey are for 2018.
Sources: IEA (2018[134]), *IEA Statistics* (database), https://www.iea.org/data-and-statistics; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Bosnia and Herzegovina has ambitious renewable energy and energy-efficiency targets but may not be able to meet them. Bosnia and Herzegovina ratified the Paris Agreement 2017, and through the Energy Community Treaty, committed to limit the emissions of existing and new large combustion plants (World Bank, 2020[110]). Bosnia and Herzegovina is currently working on a national adaptation plan and an integrated national energy and climate plan in line with the 2018 Energy Community recommendation (European Commission, 2020[120]). Bosnia and Herzegovina also adopted a Climate Change Adaptation and Low-Emission Development Strategy in 2013, which is currently being revised, to increase resilience to climate change and reach a peak in GHG emissions in 2025 from which they will decline (UNECE, 2018[119]). However, Bosnia and Herzegovina recently announced investments in new coal plants to replace existing ones, which may jeopardize its ability to meet these targets (World Bank, 2020[110]). Yet, replacement with new coal plants will contribute to reducing GHG emissions and air pollution.

Bosnia and Herzegovina is heavily reliant on subsidised coal and does not sufficiently incentivise renewable energies

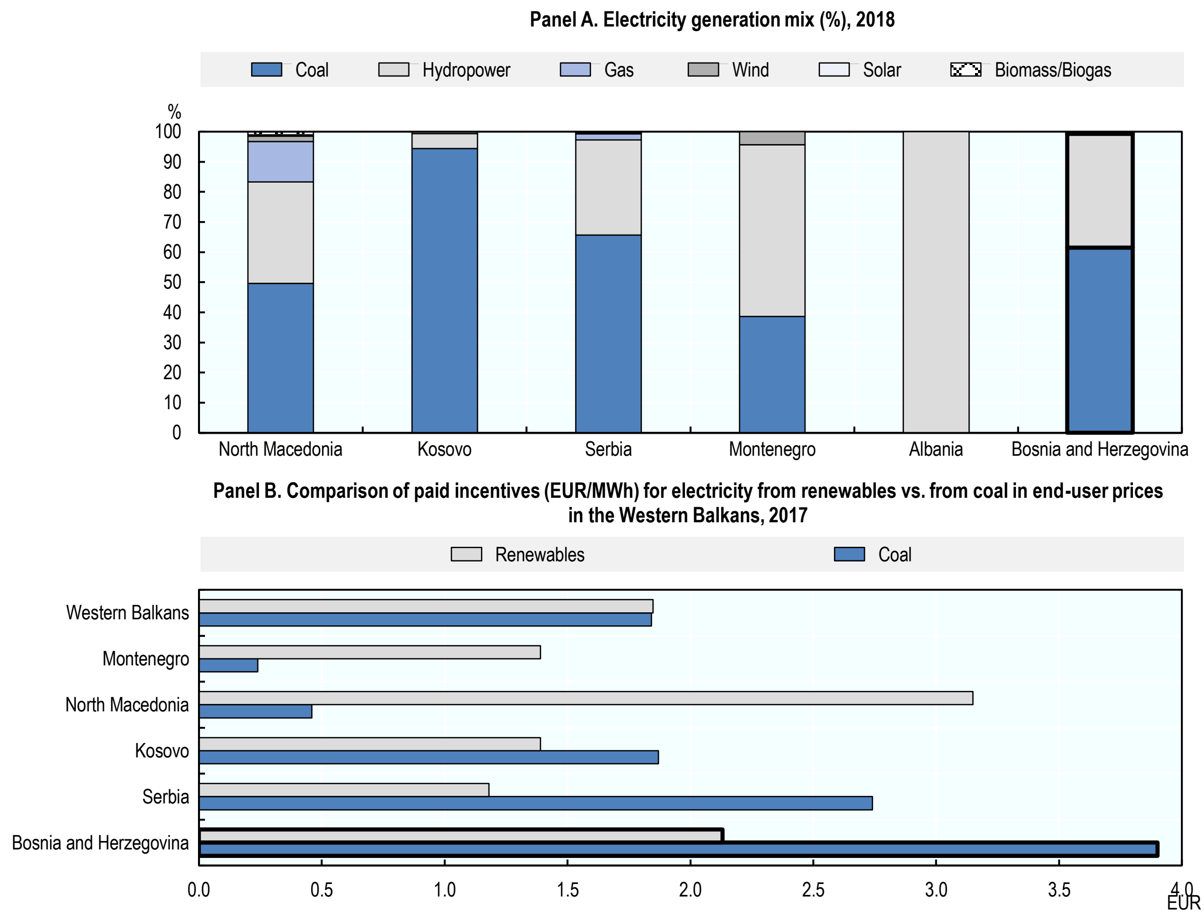
Bosnia and Herzegovina remains very dependent on highly polluting and inefficient coal. In 2018, 61.5% of electricity was generated from coal and 37.8% from hydropower (Eurostat, 2018[128]) (Figure 8.40). Coal is relatively cheap and seen as increasing energy security in Bosnia and Herzegovina.

Extensive subsidies promote electricity production from coal. Bosnia and Herzegovina's two main energy producers received an estimated EUR 23.3 million in direct coal subsidies and a further EUR 177.6 million in indirect subsidies in 2017. Coal mines are profitable only thanks to these large public subsidies: mine productivity is low due to outdated methods and high labour costs (World Bank, 2020[110]).

Despite coal's disadvantages, Bosnia and Herzegovina is currently stepping up exploration of coal reserves and starting to explore local oil and gas reserves. There are plans to replace obsolete lignite plants with new, more efficient ones and to meet the growth in electricity demand with four to six new coal power plants (World Bank, 2020[110]), including the Block 7 Tuzla thermal power plant investment project (European Commission, 2020[120]). Even though the new coal power plants will be less polluting, they increase the country's strong dependence on coal as a source of energy. Through its reliance on coal, Bosnia and Herzegovina's energy sector is a leading source of GHG emissions and an important contributor to air pollution. Phasing out subsidies for coal mining and coal power stations is key to reducing these threats (UNECE, 2018[119]).

Despite recent progress, Bosnia and Herzegovina does not sufficiently incentivise investments in renewable energies. Renewable energies, such as hydro, solar and wind, are relatively abundant in Bosnia and Herzegovina, and more than one-third of electricity production is from hydropower. However, the share of other renewables in the energy mix is very low. The Federation of Bosnia and Herzegovina has set up a new incentive scheme for electricity production from renewable energies and bond schemes for the implementation of energy-efficiency measures. The entity also plans to establish an emissions trading system and an emissions monitoring system. Despite these efforts, the government still subsidises coal mining and electricity production from coal too much for renewables to be competitive: in 2017, paid incentives for energy production from coal in Bosnia and Herzegovina were almost twice as high as those for energy from renewables (Figure 8.40). In Republika Srpska, incentives for wind energy projects were recently removed, and the growth of incentives to generate electricity from renewable energies was reduced in the context of an amendment to the Law on Renewable Energy and Efficient Co-generation. Moreover, Bosnia and Herzegovina has not yet transposed recent amendments by the Energy Community Secretariat on renewable energies to entity-level laws, and its legislative framework on renewable energies needs to be further aligned with the EU acquis (European Commission, 2020[120]).

Figure 8.40. Large subsidies for coal result in a high share of coal in the electricity generation mix



Sources: Eurostat (2020[26]), "Data Explorer (database)", European Statistical Office, Luxembourg City, https://ec.europa.eu/eurostat/data/database; Energy Community Secretariat (2020[135]), Energy Community Secretariat website, Annual reports, https://energy-community.org; Miljević (2019[136]), *Analysis of Direct and Selected Hidden Subsidies to Coal Electricity Production*, www.energy-community.org/documents/studies.html; Miljević (2019[137]), *Rocking the Boat: What is keeping the Energy Community's Coal Sector Afloat? Analysis of Direct and Selected Hidden Subsidies to Coal Electricity Production in the Energy Community Contracting Parties*, www.energy-community.org/documents/studies.html.

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Outdated energy infrastructure, SOE monopolies and lengthy procedures are key challenges in the energy sector

The outdated energy infrastructure contributes to the low levels of energy efficiency. Electricity tariffs set below operational costs have resulted in a lack of financial resources for investments in the outdated energy infrastructure. More than half the country's thermal power plants date from the 1960s and 1970s, and at least 30% of thermal capacity will need to be shut down over the next decade. Approximately EUR 3 billion will be required to modernise power generation plants and to build new capacity in the next 20 years, and a further EUR 350 million will be needed to upgrade the electricity transmission network. Without these investments, the country's energy security is effectively threatened. Investments in energy infrastructure are also required in order to comply with obligations under the EU Stabilisation and Association Agreement and the Energy Community Treaty (European Commission, 2020[120]). Outdated electricity infrastructure contributes to the country's low levels of energy efficiency (World Bank, 2020[110]).

Bosnia and Herzegovina has started making some of the investments required to upgrade its energy infrastructure. In the Federation of Bosnia and Herzegovina, EPBiH, one of the SOEs in charge of electricity production and distribution, has started replacing old and inefficient coal power plants with new ones, most importantly in Tuzla. Although less polluting, this plant reinforces Bosnia and Herzegovina's dependence on highly polluting coal. Republika Srpska recently invested EUR 80 billion in the construction of a desulphurisation plant at the Ugljevik thermal power plant that complies with EU standards.

Bosnia and Herzegovina's electricity sector is dominated by a few SOEs. Electricity production and distribution are regulated by entity law. Within each entity, electricity generation and distribution is performed by one or two SOEs. These enterprises are in fact public monopolies in their exclusive service areas, and there is no competition between them (Enerdata, 2020[138]). EPBiH and Elektroprivreda Hrvatske Zajednice Herceg-Bosne are in charge of electricity distribution and the largest share of electricity generation in the Federation of Bosnia and Herzegovina. In Republika Srpska, Elektroprivreda Republike Srpske owns five subsidiary companies for electricity generation and five companies for electricity distribution and supply. Komunalno Brčko operates the Brčko district's electricity distribution network (USAID-EIA, n.d.[139]). Bosnia and Herzegovina has not yet unbundled the transmission system operator or the electricity distribution, supply and generation operators in entities, thereby failing to comply with the Energy Community Secretariat's Third Energy Package (European Commission, 2020[120]). There are few private enterprises in Bosnia and Herzegovina's electricity sector, and SOEs have few incentives to increase electricity generation from renewable energies.

Bosnia and Herzegovina's energy sector is also affected by lengthy procedures, red tape and a shortage of qualified professionals. Procedures for the construction of energy infrastructure, such as power stations, and permitting processes are complicated and lengthy. The regulatory framework for renewable energies is incomplete. A chronic lack of professional and qualified staff and lack of expertise, particularly in renewable energies, are further concerns. These challenges are obstacles to the implementation of energy-sector reforms and energy-efficiency measures.

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Notes

[1] Dimensions of multi-dimensional child poverty covered in this UNICEF study are nutrition, health, child development, violent discipline, information access and housing.

[2] High in-work poverty often occurs in countries with large insolvent SOEs and in unsuccessfully privatised enterprises whose new owners are under a contractual obligation to keep people in employment but cannot pay wages due to insolvency (Obradović, Jusić and Oruč, 2019[17]).

[3] The total social contribution rate is 41.5% (23% for pensions) of gross wages in the Federation of Bosnia and Herzegovina and 33% (18.5% for pensions) in RS.

[4] The Parliamentary Assembly of Bosnia and Herzegovina is composed of the House of Representatives and the House of Peoples. The former has 42 members directly elected on a proportional basis; the latter counts 15 members appointed by the parliaments of the entities.

[5] The Central Bank of Bosnia and Herzegovina is the sole authority for issuing currency and for monetary policy throughout Bosnia and Herzegovina (Art. VII of the Constitution of Bosnia and Herzegovina).

[6] Following the latest attempt, as part of the European Union-led Reform Agenda for Bosnia and Herzegovina 2015-2018, at least two-thirds of public institutions at state and entity levels continued hiring, and the net number of civil servants rose by between 5% and 10%. At the entity level, Republika Srpska has implemented a legal framework to regulate hiring in the public sector tightly. The Law on Civil Servants and the law on administrative inspection, for example, provide legal protections for those who contend that their rights were violated during the employment process.

[7] In 2017, the SOE average gross monthly salary was EUR 756, compared to EUR 540 in the general government and EUR 535 in the private sector (Cegar and Parodi, 2019[68]).

[8] Safely managed sanitation services are improved sanitation facilities that are not shared with other households and where excreta are safely disposed of in situ or transported and treated off site. Improved sanitation facilities include flush/pour-flush-to-piped sewer systems, septic tanks or pit latrines (ventilated improved pit latrines, compositing toilets or pit latrines with slabs) (World Bank, 2020[7]).

[9] Thus, an operator of an installation having multiple environmental impacts, for example on air, water and generation of waste, would need to apply for multiple permits from various ministries.

Part IV Assessing opportunities and constraints in Kosovo

9 Overview: Identifying strategic opportunities for Kosovo

Kosovo has generated continuous economic growth, improved living standards and made important steps in institution building. Living standards have improved, and life satisfaction is the highest in the region. However, Kosovo’s robust growth performance has not been accompanied by an increase in employment, and Kosovo’s economy needs upgrading from the current consumption-driven, remittance-fuelled model to a more productive and innovative one. This overview presents Kosovo’s strengths and constraints to development and outlines strategic priorities to help Kosovo improve the quality of life of all citizens. These strategic priorities include strengthening education and skills, shifting from the consumption-driven model to a more creative and dynamic economy, building a strong healthcare system and a fair and adequate social protection system, ensuring an adequate and sustainable energy supply and addressing institutional shortcomings.

Kosovo has generated continuous economic growth, improved living standards and made important steps in institution building. Kosovo's economic growth has been the highest in the Western Balkans, despite a narrow productive base. The creation of formal institutions has been significant, despite remaining challenges. Living standards have improved, and life satisfaction is the highest in the region. Accession to the European Union has become a cornerstone of Kosovo's foreign policy and a key driver of reforms.

Kosovo must now create the capabilities for continued strong development. The robust growth performance has not been accompanied by an increase in employment, and Kosovo's economy needs upgrading from the current consumption-driven, remittance-fuelled model to a more productive and innovative one. A strong focus on delivering quality public services will be necessary and require that informal norms and formal institutions coalesce around this objective.

Kosovo is preparing a new National Development Strategy (NDS) for the coming decade. This strategy comes at a crucial time, as the accession process with the EU may be moving to a new level just as Kosovo, Europe and the world grapple with the COVID-19 pandemic and its aftermath. Building on the NDS for 2016-21 (Republic of Kosovo, 2014[1]), the new strategy will have to lay out a vision for Kosovo in 2030, chart the path and key objectives for achieving this vision and tackle the most important constraints that can hold Kosovo back.

The Multi-dimensional Review (MDR) of the Western Balkans supports Kosovo and the region with a strategic perspective and ideas for action on shared challenges. This initial assessment of Kosovo is intended to support the new NDS. It provides a possible vision for Kosovo's development and identifies the key constraints that must be tackled in order to achieve sustainable and equitable improvements in well-being and economic growth. The next phase of the project will focus on peer learning to find solutions for the challenges that emerge from the initial assessments as shared across the region.

This overview chapter presents the main results. First, the chapter presents inputs for a development vision for Kosovo for 2030, elaborated by participants of a strategic foresight workshop. Second, the chapter takes a bird's-eye view to assess Kosovo's development performance on the basis of key statistics on well-being and the Sustainable Development Goals (SDGs) and summarises the key constraints to development identified in this report. It concludes by suggesting key strategic directions for the future. Given the global impact of COVID-19, this overview is followed by a special chapter on the impact of the pandemic in Kosovo. Chapter 11 contains the full assessment of Kosovo along the pillars of sustainable development: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet.

Whenever relevant and subject to data availability, Kosovo is compared with a set of benchmark economies in the region (Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia), the Organisation for Economic Co-operation and Development (OECD) (Costa Rica, Czech Republic, Greece, Slovak Republic, Slovenia and Turkey), the European Union beyond the OECD (Croatia and Romania) and other regions (Kazakhstan, Morocco, Philippines and Uruguay). Regional averages for the Western Balkans and averages for OECD and EU members serve as additional benchmarks. The selection of benchmark economies is based on historical similarities (including integration into the European Union), economic structures, geographic proximity and mutual partnerships. The selection of non-OECD economies is based on their similar economic and social challenges (such as high migration rates), shared history as transition economies and the relevance of development trajectories that can bring additional perspectives to Kosovo and other Western Balkan economies and provide valuable learning opportunities across selected areas.

This report benefited from close collaboration with the Government of Kosovo, especially the Office for Strategic Planning under the Office of the Prime Minister, and from the collaboration and comments of multiple OECD directorates and the financial and collaborative support of the Swedish International Development Cooperation Agency, which is gratefully acknowledged.

Towards a vision for Kosovo in 2030: strong economic growth and rising living standards contributing to healthier and longer lives built on equal access to quality education, strong human capital, respect for the environment and democratic and effective institutions

A clear vision of the desired future state of Kosovo is an important guidepost for a NDS. A vision for a strategy should provide a description of what Kosovars expect from the economy, society, institutions and the environment, and what the most important elements are in each domain. To generate inputs for such a vision, a workshop entitled Kosovo: Vision and Challenges 2030 was organised in Pristina on 11 March 2020, gathering a broad range of participants from various public-sector ministries and agencies, the private sector, academia and civil society. The vision was built on the basis of simple narratives of the lives of future citizens of Kosovo and subsequent clustering by the five pillars: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet.

The narratives proposed for the vision highlighted aspirations for good quality of life built on access to social protection, decent pensions and health insurance, quality jobs, broad economic opportunity, green growth and strong social capital and cohesion. The narratives of the workshop evoked mainly young and middle-aged women who either are entrepreneurs or have stable quality jobs in tourism and banking. All fictional citizens enjoy middle-class family lives with decent work, financial stability and a rich social life. Citizens travel regularly and have access to a good health system and quality education. Businesses are flourishing and green, and social business models and citizen initiatives are gaining popularity. Other important issues were innovation, jobs for women and youth, Kosovo's rich environment and integration into the European Union.

The resulting vision centres on equal access to high-quality education, strong gross domestic product (GDP) growth, democratic and effective institutions and respect for the environment through sustainable development. Box 9.1 presents the vision statements for Kosovo in 2030 prepared by participants. Kosovo is envisioned as an economy with strong GDP growth based on improvements in the business environment and the transformation of the economy. Equal access to high-quality education contributes to strong human capital, resulting in higher living standards for Kosovo's citizens. Effective institutions based on participatory democracy are committed to peace, respect for human rights and socio-economic development. Sustainable development, building on the increased use of renewable energies, the transformation of the urban transport system, a modern waste management system and sustainable water management results in healthier, longer lives. In terms of the individual dimensions of this vision, quality education, strengthened rule of law, health insurance and social protection were considered the most important areas for improvement and levers of sustainable economic development, as identified through a voting exercise (Figure 9.1).

Box 9.1. A development vision for Kosovo in 2030

Kosovo of 2030: strong economic growth and rising living standards contributing to healthier and longer lives built on equal access to quality education, strong human capital, respect for the environment and democratic and effective institutions

As part of the OECD strategic foresight workshop organised in Pristina on 11 March 2020, participants developed a vision statement that reflects the desired future for Kosovo in 2030.

People

- Living standards have been enhanced.
- Equal access to high-quality education, which promotes equality and respect for diversity, has unlocked human potential and contributed to sustainable development, including improved access to quality health care, insurance, social welfare and protection.

Prosperity, and Partnerships and financing

- By 2030, Kosovo has doubled its wealth and reached 50% of the EU average GDP per capita (PPP adjusted) through an average annual GDP growth of 5% to 6%.
- This has been achieved by: 1) reducing barriers for businesses and people; 2) improving the business climate through reliable infrastructure, rule of law, healthy competition and European Union-compatible incentives for local and international investment; 3) building partnerships and linkages between economic actors in Kosovo and abroad; and 4) transforming the economy.
- As a result, the size of the informal economy has declined from about 26% to 15% of GDP, and unemployment has dropped to 15%.

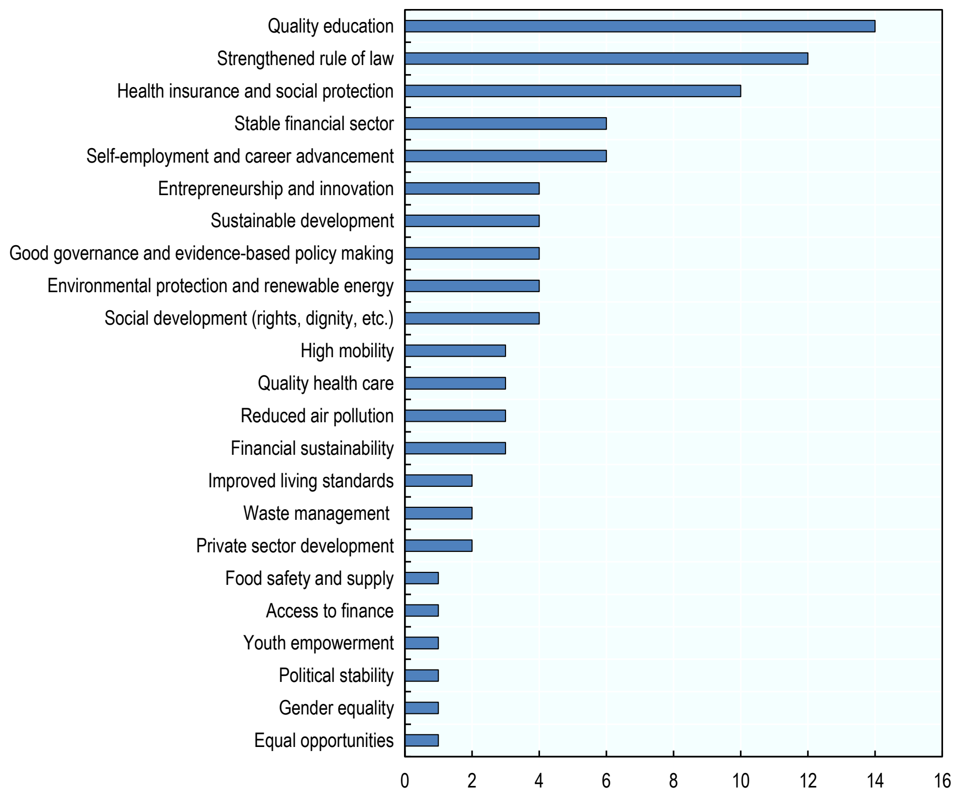
Peace and institutions

- Kosovo has developed democratic and effective institutions to provide equal opportunities to its diverse population and citizens. This reflects a commitment to peace, respect for human rights and socio-economic development.
- People and communities have a voice in policy making and support the EU agenda.
- A focus on effective design, implementation and monitoring of public policy has created opportunities for growth and greater social integration, which are key conditions for sustainable development.

Planet

- Citizens live healthier, longer lives.
- Kosovo has significantly reduced coal usage and successfully switched to renewable resources.
- Due to sustainable policies and urban mobility plans, citizens use bicycles, public transport and electric vehicles. As a result, there are stricter technical controls for vehicles and improved fuel quality.
- Kosovo has attracted recycling companies to invest and create partnerships with municipalities. This has created significant new job opportunities. Citizens have recycling bins near their residences. Illegal landfills have been reduced.
- Artificial lakes have been created to reduce water scarcity, and adequate metering has been put in place. Penalties for water misuse are enforced.

Figure 9.1. The most important dimensions of the vision for Kosovo: quality education, strengthened rule of law and the provision of health insurance and social protection



Source: Authors' elaboration based on the voting exercise of participants of the OECD strategic foresight workshop organised in Pristina on 11 March 2020.

StatLink https://doi.org/10.1787/888934243258

Assessing Kosovo's development performance

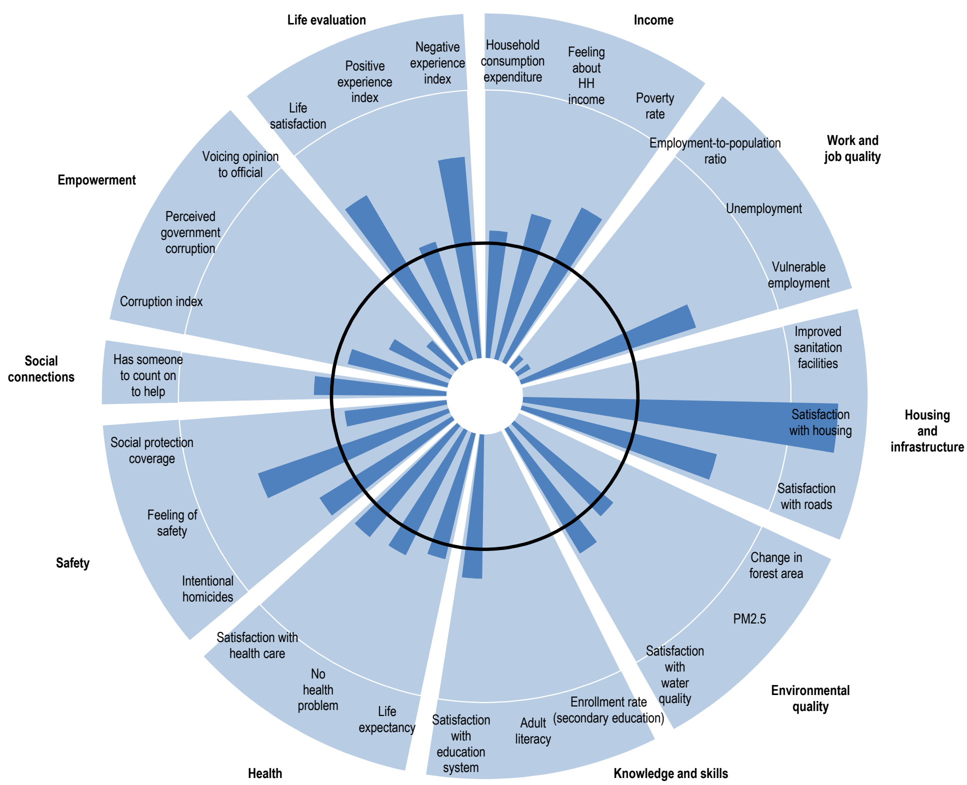
Building on the vision, well-being around the world and sustainable development as benchmarks, this section reviews Kosovo's development performance. The proposed vision emphasises well-being and sustainable development as the ultimate objectives of development. To assess the well-being of the citizens of Kosovo, the OECD's Well-being Framework uses a mix of objective and subjective indicators across a range of dimensions that matter to people (OECD, 2020[2]) (Box 9.2). A version adapted to the realities of emerging economies compares Kosovo to the level of well-being outcomes expected, given its level of GDP per capita, across ten dimensions covering material conditions, quality of life and relationships. In a second step, this section assesses Kosovo's performance across the five pillars of the SDGs, applying distance-to-target measures across selected indicators and building on the analysis in the main body of this report.

Kosovo's well-being performance is mixed. Citizens of Kosovo feel comparatively safe when walking alone at night and are satisfied with their housing and the road infrastructure. Poverty levels are relatively low and life satisfaction is high, compared to benchmark economies. However, social protection coverage is comparatively low, and social protection expenditure falls short of international comparisons and is not well targeted to those most in need, leaving many poor families unassisted. There are weaknesses in other dimensions of well-being, such as work and job quality, and empowerment vis-à-vis public institutions: the

2019 unemployment rate was 25.7%, and the employment-to-population ratio amounted to 30.1%, one of the lowest in the word. About one in ten Kosovars reported voicing their opinion to a public official in the preceding month in 2019, and 81% perceived government corruption as widespread (Figure 9.2) (Gallup, 2020[3]).

Figure 9.2. Current and expected well-being outcomes for Kosovo: worldwide comparison

2019 or latest available year; performance shown relative to GDP per capita



Notes: The observed values falling inside the black circle indicate areas where Kosovo performs poorly in terms of what might be expected from an economy with a similar level of GDP per capita. Expected well-being values (the black circle) are calculated using bivariate regressions of various well-being outcomes on GDP, using a cross-section dataset of around 150 economies with a population of over one million. All indicators are normalised in terms of standard deviations across the panel. Data are missing for adult literacy rates and the enrolment rate (secondary education).

Sources: Gallup (2018[4]), "Gallup World Poll", www.gallup.com/analytics/318875/global-research.aspx; ILO (2020[5]), *ILOStat* (database), https://ilostat.ilo.org/data/; OECD (2020[6]), *OECD PISA database*, www.oecd.org/pisa/data/; Transparency International (2019[7]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/; UNESCO (2019[8]), "UNESCO Institute for Statistics", http://uis.unesco.org/; World Bank (2020[9]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WHO (2020[10]), *Global Health Observatory* (database), www.who.int/data/gho/data/countries.

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Box 9.2. Measuring what matters to people

As part of its broader Better Life Initiative, the OECD first created its Framework for Measuring Well-being in 2011 with the aim of putting people at the heart of policy making. This represented the culmination of longstanding work both inside and outside the organisation. Important strides to "go beyond GDP" had been made with the United Nations Development Programme's Human Development Index and the work on multi-dimensional poverty by the Oxford Poverty and Human Development Initiative. The framework also draws on rich academic literatures in welfare economics and capability theory, the recommendations of the Commission on the Measurement of Economic Performance and Social Progress (Stiglitz, Sen and Fitoussi, 2009[11]) and existing well-being and sustainable development measurement practice in OECD member and non-member economies. Since its launch, the work on well-being has continuously been updated in line with best practice and continues to be published in the OECD's *How's Life?* report series (OECD, 2020[2]). For the purpose of the MDRs, the OECD Well-being Framework has been adapted to fit the realities of economies at various stages of development (Boarini, Kolev and McGregor, 2014[12]).

The adapted OECD Well-being Framework used in this report focuses on living conditions at the individual, household and community levels that capture how people experience their lives "here and now". Current well-being here is comprised of ten dimensions related to material conditions that shape people's economic options (Income, Housing and infrastructure, Work and job quality) and quality-of-life factors that encompass how well people are (and how well they feel they are), what they know and can do and how healthy and safe their places of living are (Health, Knowledge and skills, Environmental quality, Life evaluation, Safety). Quality of life also encompasses people's connectedness and engagement (Social connections, Empowerment).

Methodological considerations

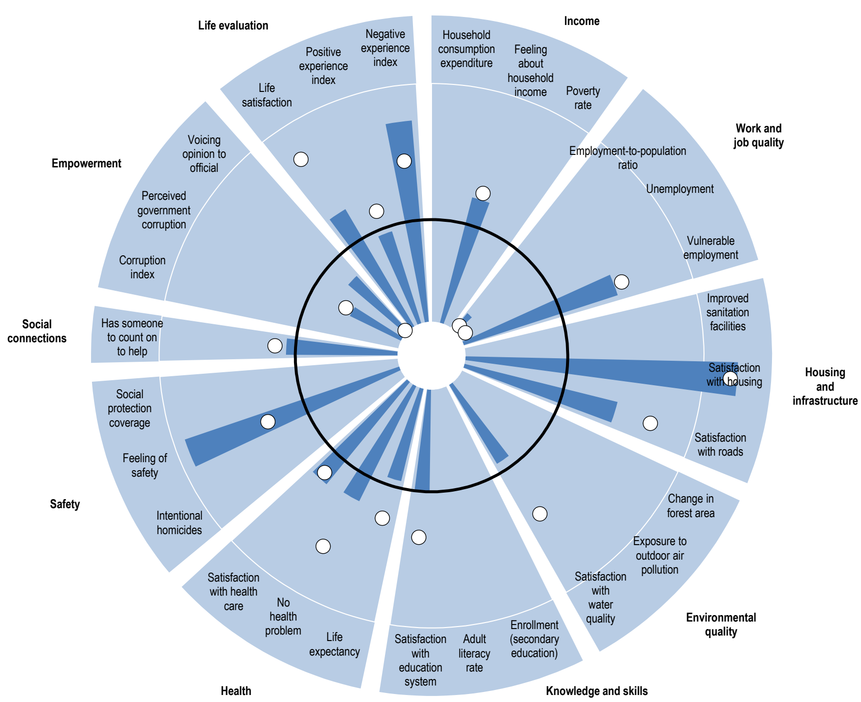
To capture the full range of people's actual life experiences, the OECD Well-being Framework uses both objective and subjective indicators. For instance, the Health dimension not only looks at life expectancy estimations but also considers how people feel about their health status and the health services they are receiving. Subjective indicators are sometimes viewed as not being as robust as objective measures; however, there are at least three reasons for considering them alongside the latter to get a holistic picture of well-being. First, there is solid methodological evidence that the subjective measures contained in the well-being framework (e.g. life satisfaction, trust in others and government) are statistically valid and correlate with objective measures of the same construct (OECD, 2013[13]; OECD, 2017[14]). Second, even in cases where perceptions diverge from objective reality, they capture the reality of survey respondents and can drive real-world outcomes, such as voting and lifestyle behaviours (Murtin, Fleischer and Siegerink, 2018[15]). It can actually be especially illuminating for policy makers to zoom in on areas where the gap between citizen perception and objective indicators is largest. Third, many of the measures typically considered objective and routinely used in policy analysis, such as household income, are based on people's self-reports and can equally be affected by response biases and non-response rates (e.g. of very wealthy households).

There are significant differences in well-being between men and women in Kosovo, and this report finds that there is scope to improve women's equal participation in society. Women have higher life expectancy, social connections and life satisfaction than men (OECD, 2020[2]) (Figure 9.3). Men do much better in terms of work. There are significant differences in labour market participation between women and men: almost 80% of women were inactive in 2019, one of the highest rates in the world (see the People section in Chapter 11). Despite a solid legal framework for women's right (Law on Protection from Discrimination) and a dedicated Agency for Gender Equality, discrimination against women in the workplace and poorly developed maternity and parental leave policies financed by employers rather than the public sector remain issues (Jose et al., 2017[16]; European Commission, 2019[17]). Over half of inactive women cite family reasons as the main cause of inactivity, although rates are lower for women with tertiary education, who also show higher overall employment rates (Figure 11.3). The current lack of care leave, flexible working arrangements and limited elderly and childcare facilities act as additional barriers. For example, in 2017/18, only 4% of children aged 0 to 5 attended public preschool education, including kindergartens and nurseries (World Bank, 2017[18]; Thaçi, Rraci and Bajrami, 2018[19]).

The well-being analysis highlights gender differences in terms of safety and empowerment. Men in Kosovo are more likely to feel safe when walking at night in their neighbourhoods (Gallup, 2020[3]). They are also more likely to participate in civic engagement, and they continue to dominate decision making in politics and the private sector: male citizens are much more likely to voice their opinion to an official (Figure 9.3), and only 9% of firms in Kosovo have a female top manager, compared to 17% in the OECD (2020[9]). Although at least one-third of seats in national and municipal assemblies are filled by female MPs, as required by a gender quota (putting Kosovo on par with the OECD average), all national parliamentary groups in the previous legislature were chaired by men, and no local council is currently run by a woman (Halini, 2019[20]).

Figure 9.3. Current and expected well-being outcomes for Kosovo: gender differences

2019 or latest available year; performance shown relative to GDP per capita



Notes: Well-being outcomes for women are represented by circles; men's outcomes are represented by bars. The observed values falling inside the black circle indicate areas where Kosovo performs poorly in terms of what might be expected from an economy with a similar level of GDP per capita. Expected well-being values (the black circle) are calculated using bivariate regressions of various well-being outcomes on GDP, using a cross-section dataset of around 150 economies with a population of over one million. All indicators are normalised in terms of standard deviations across the panel.

Sources: Gallup (2018[4]), "Gallup World Poll", www.gallup.com/analytics/318875/global-research.aspx; ILO (2020[5]), *ILOStat* (database), https://ilostat.ilo.org/data/; OECD (2020[6]), *OECD PISA database*, www.oecd.org/pisa/data/; Transparency International (2019[7]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/; UNESCO (2019[8]), "UNESCO Institute for Statistics", http://uis.unesco.org/; World Bank (2020[9]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WHO (2020[10]), *Global Health Observatory* (database), www.who.int/data/gho/data/countries.

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Sustainable development: summary of Kosovo's performance and key constraints

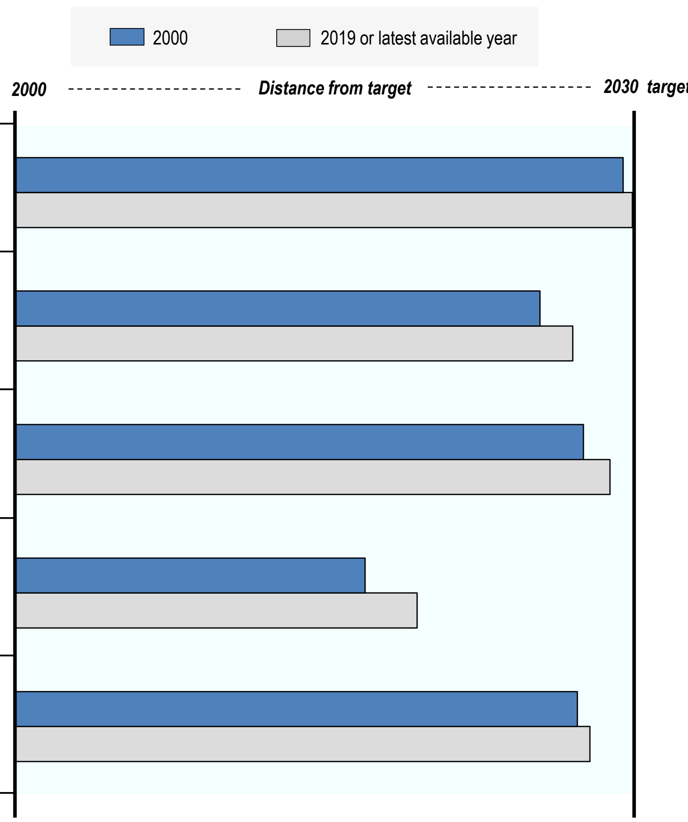
To serve as guiding tools for action, strategies must identify the problems that stand in the way of the envisaged objectives. Weak implementation has been identified as a key challenge for Kosovo by strategic foresight workshop participants. This is likely due to a strong emphasis in strategies and plans on objectives but a lack of focus on problems to overcome. Strategic objectives not impeded by problems would likely have been achieved already and hence no longer be objectives. At the same time, without defining the problem, it is not possible to evaluate the impact of actions and thereby improve or adjust them during implementation (Rumelt, 2011[21]). To set the basis for future strategy, this section summarises the constraints analysis of this report and presents the key constraints identified for each pillar of sustainable development.

People: Kosovo has been able to raise living standards somewhat over the last decade; however, an extremely low employment rate, regional differences in quality of life and the poor quality of public services related to health, education and social protection remain key challenges. Despite important improvements in poverty reduction, poverty rates in Kosovo remain high and could rise in the aftermath of COVID-19. Large regional differences in income inequality, access to basic infrastructure and quality of life need to be reduced. Minority groups, such as Roma, Ashkali and Egyptians, risk being left behind. At 25.7%, Kosovo's employment rate remains among the lowest in the world. Unemployment rates are high, particularly for youth and women. Weak labour market institutions and a large supply of workers have resulted in high rates of informality and poor working conditions. The performance of both Kosovo's health and education systems can be improved. The education system fails to equip people with job-ready skills. Public health expenditure is low, and shortages of medication, health equipment and staff, as well as corruption in the health sector, are major challenges. Kosovo's social protection expenditure remains low by international comparison, and social protection schemes are not well targeted to those most in need, leaving many poor families unassisted. Gender inequality and persistent societal divisions along ethnic lines remain bottlenecks (Figure 9.4). The People section in Chapter 11 identifies five major challenges to the well-being of Kosovo's population and a more inclusive development path (Table 9.1).

Figure 9.4. People – progress towards the SDGs in Kosovo

Progress towards 2030 SDG targets, 2000 to 2018 or latest available year

		2000	2019 or latest available year	2030 target
Poverty headcount ratio at USD 1.90 per day (2011 PPP) (% of population)	1 NO POVERTY	1.7% (2003)	0.2% (2017)	0%
Life expectancy at birth, total (years)	3 GOOD HEALTH AND WELL-BEING	68.0	72.2 (2018)	80 a
Adult literacy rate, population age 15+, both sexes (%)	4 QUALITY EDUCATION	91.9% (2003)	96.2% (2011)	100%
Proportion of seats held by women in national parliaments (%)	5 GENDER EQUALITY	28.3% (2016)	32.5%	50%
Income share held by bottom 20%	10 REDUCED INEQUALITIES	9 (2003)	9.2 (2017)	9.9 b



Notes:
a. The target is the latest available average performance of OECD countries. Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.
b. The target is the latest available average performance of top 3 OECD performers. For income share held by bottom 20%, the top performers are the Czech Republic (10.2%), Slovenia (10%) and Finland (9.4%).
Sources: UNSD (2020[22]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; UNESCO (2019[8]), "UNESCO Institute for Statistics", http://uis.unesco.org/; UN IGME (2020[23]), *Levels and Trends in Child Mortality*, https://childmortality.org/; IPU (2020[24]), *Inter Parliamentary Union (database),* www.ipu.org/; WHO (2019[25]), *Tracking Universal Health Coverage: 2019 Global Monitoring Report*, www.who.int/healthinfo/universal_health_coverage/report/2019/en; World Bank (2020[9]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Table 9.1. People – five major constraints to leaving no one behind in Kosovo

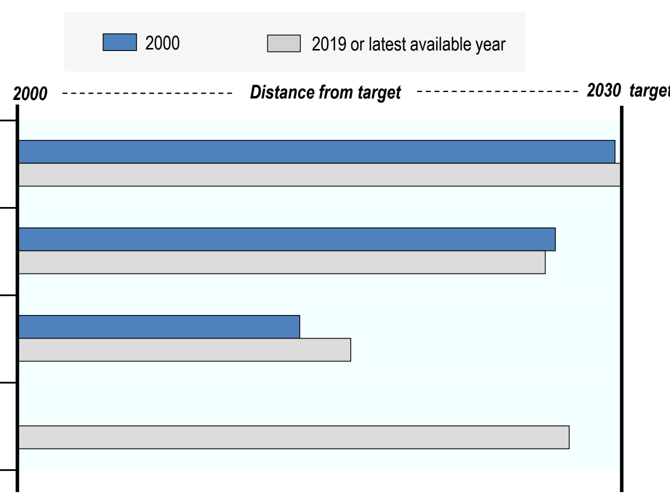
1. Regional development is extremely uneven, and many municipalities lack basic infrastructure.
2. Kosovo has one of the highest unemployment rates in the world, including for youth and women, partly fuelled by poor education outcomes and skills mismatches, lack of social care services and difficult regulations to operate businesses.
3. Kosovo's health system is underfunded and fails to deliver quality results and access to care, and capacity to implement overdue reforms is low.
4. Targeting of social protection does not adequately focus on the most needy and currently disincentivises labour participation.
5. Given the limited integration of ethnic communities, Kosovo's youth in particular need to be sensitised to issues of transitional justice and dealing with the past.

Prosperity: Kosovo's economic growth performance has been relatively strong, but a more sustainable economic growth model is needed. Over the past decade, Kosovo has been the fastest growing economy in the Western Balkan region, with average annual GDP growth exceeding 3.5%. However, the relatively robust growth performance has been too dependent on consumption and import growth fuelled by high remittance inflows (amounting to 16% to 20% of Kosovo's GDP) and has not been supported by investment in production-oriented activities in the tradable sector. While remittances have supported the welfare and living standards of many, they present a major challenge for managing economic transformation. In small open economies similar to Kosovo's, high levels of remittances tend to drive financial-sector development and push up prices in non-tradeable sectors, including wages and property prices, increasing the costs for producing tradeables (Acosta, Lartey and Mandelman, 2009[26]; Basnet, Donou-Adonsou and Upadhyaya, 2019[27]; Gammage, 2006[28]). This has caused weak export and productivity growth and the stagnation of Kosovo's narrow productive base. High levels of unemployment and widespread informality persist, encouraging further emigration. Kosovo has significantly improved its business environment, especially the process of starting a business (on this indicator, Kosovo ranks 12th out of 192 economies in the World Bank's Doing Business ranking). However, the unreliable and insufficient electricity supply remains a significant deterrent for private investment, especially in the manufacturing sector, and a cause of low investment in productive activities. Widespread corruption, lengthy and costly contract enforcement and excessive and costly administrative procedures remain important impediments to private investment as well. The Prosperity section in Chapter 11 identifies three major constraints to a more dynamic economic development path (Table 9.2).

Figure 9.5. Prosperity – progress towards the SDGs in Kosovo

Progress towards 2030 SDG targets, 2000 to 2018 or latest available year

		2000	2019 or latest available year	2030 target
Access to electricity (% of population)	7 AFFORDABLE AND CLEAN ENERGY	99 (2010)	100 (2018)	100
Wage and salaried workers, total (% of total employment) 1	8 DECENT WORK AND ECONOMIC GROWTH	74.5 (2012)	73.1	83.6 a
Account at a financial institution (% age 15+)	8 DECENT WORK AND ECONOMIC GROWTH	44.3 (2011)	52.3 (2017)	94.7 a
Individuals using the Internet (% of population)	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	-	89.4 (2018)	97.8 b



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For individuals using the Internet (% of population), the top performers are Iceland (99%), Denmark (97.3%) and Luxembourg (97.1%).
Sources: UNSD (2020[22]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; ILO (2020[5]), *ILOStat* (database), https://ilostat.ilo.org/data/; UNESCO (2019[8]), "UNESCO Institute for Statistics", http://uis.unesco.org/; UN-Habitat (2020[29]), UN-Habitat Data and Analytics, https://unhabitat.org/knowledge/data-and-analytics; RICYT (2020[30]), *RICYT* (database), www.ricyt.org/en/; World Bank (2020[9]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; World Bank (2019[31]), *Sustainable Energy for All* (database), https://databank.worldbank.org/source/sustainable-energy-for-all/preview/on.

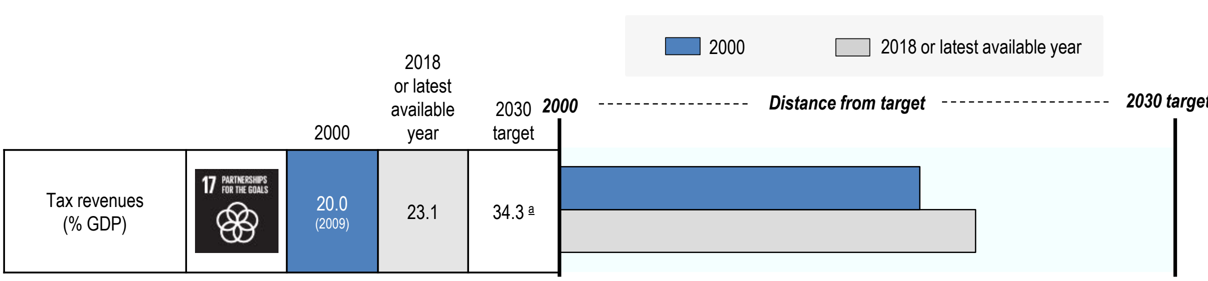
Table 9.2. Prosperity – three major constraints to a more dynamic economy of Kosovo

1. Remittances and redistribution through public-sector employment drive consumption and high reservation wages that outpace productivity growth and inhibit job creation.
2. An unreliable electricity supply discourages investment, particularly in the manufacturing sector.
3. A challenging business environment and weak governance increase the costs of investment and operation in Kosovo.

Partnerships and financing: Kosovo needs to diversify its sources of financing and improve tax revenue mobilisation in order to meet the partnerships-related targets of the United Nations 2030 Agenda for Sustainable Development. Over the past decade, Kosovo's economy has strongly relied on external financing from the diaspora (remittances and foreign direct investment [FDI]) and relatively high foreign aid inflows. However, these inflows have been declining, and the long-term prospects are weak as a result of migrants' integration into host countries and falling fertility rates, which translate into a shrinking pool of potential future migrants. Domestic financing and domestic private investment, particularly in production- and export-oriented activities, need to be mobilised. Kosovo's tax revenues are low by international comparison due to low tax rates, tax exemptions, a large informal sector and significant tax evasion (Figure 9.6). Increased government current spending, most importantly on wages and social security benefits, has crowded out public investment. Spending on education, health and social protection remains low. Kosovo needs to increase tax revenues and to redirect expenditures towards productivity and growth-enhancing public investments. Despite the economy's sound and well-developed financial sector and strong credit growth over the past decade, supported by declining interest rates and non-performing loans (NPLs), access to financing remains an important constraint to private investment, especially for small and medium-sized enterprises (SMEs). The Partnerships and financing section in Chapter 11 identifies four major challenges to more sustainable financing of Kosovo's development (Figure 9.6).

Figure 9.6. Partnerships and financing – progress towards the SDGs in Kosovo

Progress towards 2030 SDG targets, 2000 to 2018 or latest available year



Note: a. The target is the latest available average performance of OECD countries.
Source: World Bank (2020[9]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Table 9.3. Partnerships and financing – four major constraints to financing development in Kosovo

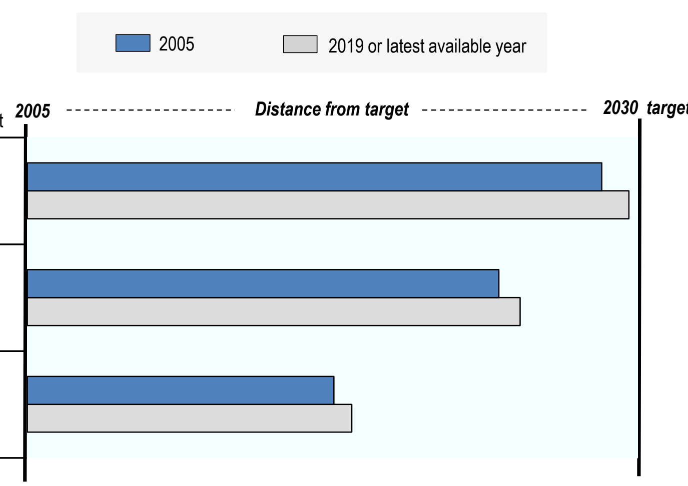
1. Kosovo's economy lacks diversified financing for investment and growth.
2. Revenue performance has been weak on account of the low tax rates, limited tax base and inefficient tax collection.
3. Government current expenditures have crowded out investment in priority areas for development.
4. Access to finance is constrained, particularly for SMEs.

Peace and institutions: Kosovo has made remarkable advancements by successfully building a new state from scratch and designing its own executive, legislative and judiciary powers. However, the prevalence of informal institutions, low trust in formal institutions and ethnic tensions remain important challenges. The large size of Kosovo's public administration fragments the central government and reduces accountability and effectiveness in executing public policy. The low fiscal capacity of local governments, in combination with intergovernmental grants to municipalities, create incentives for patronage, raising public-sector employment at the local level. This results in high levels of local public spending on employee compensation but low levels of investment in local public goods. The judicial system is biased and inefficient, since financial and human resources are lacking, judges lack impartiality and, bribery and gift giving are widespread. Citizens therefore often resort to informal mechanisms to resolve disputes (Figure 9.7). Publicly owned enterprises (POEs) play a significant role in Kosovo's economy, but despite several reforms and privatisation initiatives, their performance remains poor. Land and property ownership is still largely ruled by ancient social customs and norms rather than formal legislation. Complete land registries and secure land rights could boost agricultural productivity, facilitate law enforcement and anti-corruption efforts and improve access to credit, thereby encouraging long-term investments. Despite improvements in statistical capacity since 2013, a lack of human and financial resources and institutional and organisational inefficiencies impede the Kosovo Agency of Statistics (KAS) from producing high-quality statistical products. The Peace and institutions section in Chapter 11 identifies six key priorities to improve the institutional setting in Kosovo (Table 9.4).

Figure 9.7. Peace and institutions – progress towards the SDGs in Kosovo

Progress towards 2030 SDG targets, 2000 to 2019 or latest available year

		2005	2019 or latest available year	2030 target
Intentional homicides (per 100 000 people)	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	6.5 (2008)	2.1 (2016)	0.4 b
Confidence in the judiciary (% of respondents)	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	44% (2006)	46%	57 a
Corruption perceptions index	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	34 (2012)	36	68 a



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For international homicides rate, the top performers are Japan (0.26), Luxembourg (0.34), and Norway (0.47).
Sources: UN-CTS (2020[32]), *Sustainable Development Goals* (database); World Bank (2020[9]), *World Development Indicators* (database); Transparency International (2019[7]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/results/.

Table 9.4. Peace and institutions – six major constraints to enhancing the quality of institutions in Kosovo

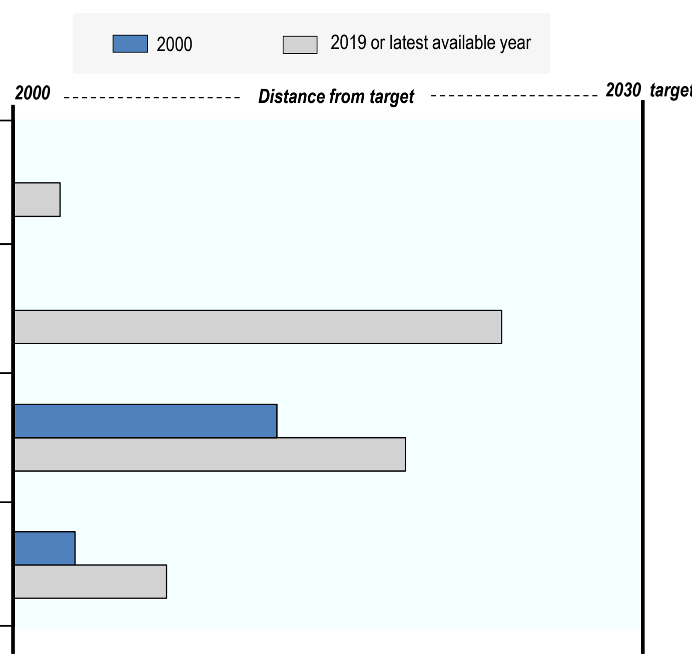
1. An overly complicated structure and political interference may undermine the effectiveness of the public administration.
2. The current form of decentralisation creates incentives for patronage instead of spending on public goods.
3. The judicial system is formally strong but remains inefficient and too exposed to interference.
4. Lack of accountability and financial mismanagement in POEs may undermine macroeconomic stability.
5. Property rights remain insecure, mainly due to faulty registration procedures and lack of awareness about existing laws.
6. Shortage of human resources and insufficient methodological standards impede the quality of statistical products.

Planet: Kosovo needs to improve the management of natural resources, step up environmental protection, diversify its energy supply and raise energy efficiency in order to make its economic development more sustainable. Kosovo's rich ecosystem and biodiversity are threatened. Forest covered 45% of the total land area in 2012, but forest degradation is a major challenge. Kosovo's rich mineral resources are not sustainably managed, and mining sites cause environmental and social problems. Water is scarce in Kosovo by regional and international standards. Kosovo does not have wastewater treatment, and access to water is not universal in rural areas. The annual cost of environmental degradation is high, and high levels of air pollution, limited solid waste collection and mismanagement of the scarce water resources are major hindrances to the population's well-being and Kosovo's economic development. Environmental protection needs to be stepped up in Kosovo. At present, the enforcement and implementation of environmental legislation is weak. Kosovo's energy supply is unreliable in some parts of the economy, the energy market lacks competition, and energy production is inefficient and lacking diversification: Kosovo is highly dependent on coal as the primary source of electricity. Except for hydropower, renewable sources are very low in Kosovo's energy mix (Figure 9.8). Kosovo's energy intensity is high. Due to old electricity distribution networks, electric power transmission and distribution losses are high. These energy-sector challenges make access to electricity a major obstacle to private investment. The Planet section in Chapter 11 identifies three key constraints to a more sustainable development path (Table 9.5).

Figure 9.8. Planet – progress towards the SDGs in Kosovo

Progress towards 2030 SDG targets, 2000 to 2019 or latest available year

	2000	2019 or latest available year	2030 target
Electricity production from renewables (%, excluding hydro)	0.0	1.6	21.5 [a]
Mean annual concentration of PM2.5 weighted by population (µg/m3)	-	27.0 (2016)	6.0 [b]
CO2 intensity of GDP (kg CO2 per unit of GDP in 2017 USD PPP)	0.61	0.42 (2018)	0.07 [b]
Terrestrial protected areas (% of total land area)	4.4	10.9 (2018)	44.7 [b]



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For mean annual concentration of PM2.5 weighted by population, the top performers are Finland (5.9%), New Zealand (6%) and Sweden (6.2%). For CO2 emissions, the top performers are Sweden (0.062), Switzerland (0.064), and Norway (0.078). For territorial protected areas, the top performers are Slovenia (53.6%), Luxembourg (40.9%) and Poland (39.7%).

Sources: UNEP (2020[33]), *Environment Live/Global Material Flows* (database), www.resourcepanel.org/global-material-flows-database; UNSD (2020[22]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; IEA (2018[34]), *World Energy Balances*, www.iea.org/reports/world-energy-balances-overview; OECD (2020[35]), *Green Growth Indicators* (database), https://stats.oecd.org/Index.aspx?DataSetCode=GREEN_GROWTH; UNEP-WCMC (2018[36]), *World Database on Protected Areas*, https://www.protectedplanet.net/; WHO/UNICEF (2020[37]), *JMP for Water Supply, Sanitation and Hygiene*, http://washdata.org/; World Bank (2020[9]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Table 9.5. Planet – three major constraints to a more sustainable path in Kosovo

1. Mismanagement of natural resources is a challenge for sustainable development.
2. Poor environmental quality affects people's well-being.
3. The energy supply is unsustainable, insufficiently diverse and inefficient.

Suggestions for strategic priorities for Kosovo

A development strategy for Kosovo should set the path for achieving a vision for Kosovo's future, address the most important constraints and build on opportunities. The inputs for a vision and the key constraints presented above can serve as a basis for setting strategic priorities. The objectives of the vision statement must be paired with corresponding obstacles and pathways to building implementation capacities and political support. The strategic priorities identified build on other assessments in Kosovo, including the 2016-21 NDS of Kosovo (Government of Kosovo, 2016[38]), OECD assessments (OECD, 2018[39]) and European Commission assessments (European Commission, 2019[40]; European Commission, 2019[41]), and aim to bring the key constraints together in a holistic manner.

The COVID-19 crisis hit Kosovo hard but also offers the opportunity for strategic focus. Kosovo has dealt well with the health crisis so far and been able to limit casualties and spread. Like most economies in Europe, however, Kosovo will suffer a recession in 2020. In response to the crisis, Kosovo will have to invest in a swift recovery. Investments and possible international support present an opportunity for strategic focus on structural reforms and removing identified constraints.

Skills and education emerged as the top strategic priority, constituting both a key constraint and an opportunity. According to the vision proposals developed in the strategic foresight workshop, citizens desire equal access to high-quality education that promotes equality and respect for diversity and can unlock people's potential. The constraints analysis of the people and prosperity dimensions highlighted as key constraints deep insufficiencies in the current skills base and skills system. Enabling Kosovars to make the most of their potential should be a strategic objective for both greater well-being and a stronger economy.

Shifting from a consumption-driven model to a more creative and dynamic economy driven by capabilities offers huge opportunities and must be a strategic priority. The constraints analysis and the visioning workshop highlighted citizens' desire for economic growth based on the development of innovative, green and social businesses and on a reduction of informality. Kosovo's current economic model relies heavily on remittances, which have allowed for significant improvements in living standards, poverty alleviation and financial, construction and travel services. They have also created imbalances, such as high reservation wages that contribute to uncompetitive export sectors. The future strategy must focus on capabilities, effective public services and rapid upskilling of the workforce to make up for these imbalances, generate more home-grown opportunities and create jobs. Several niches in metal-based manufacturing and information services look promising but need a more conducive environment. Capabilities will require strategic attraction of FDI and development of competences.

Building a strong healthcare system and a fair and adequate social protection system is an opportunity to boost quality of life and resilience in Kosovo, especially in light of the current COVID-19 crisis. During the visioning workshop, citizens expressed a strong desire for higher living standards, including inclusive, quality and affordable health care and adequate and accessible social protection. Strengthening Kosovo's healthcare system is an opportunity to improve the health of Kosovo's population, raise life expectancy and reduce infant mortality. Better and fairer access to social protection will reduce poverty and inequalities. Kosovo's healthcare system will require substantial investments in infrastructure and equipment and must continue progressing towards universal access. Kosovo should improve the coverage, benefit levels and design of social assistance to ensure equity and social cohesion. Last, special attention must be given to allowing women to participate fully as citizens and professionals in the labour market on an equal footing and with the same opportunities as men.

Ensuring an adequate and sustainable energy supply is an opportunity to attract more investment in productive activities and to improve quality of life. The vision highlighted Kosovars' desire for sustainable development, in particular through a reliable and clean energy supply, which also results in healthier, longer lives. The constraints analysis of the planet and prosperity dimensions showed that Kosovo's unreliable and inadequate energy supply is a key obstacle to private investment in manufacturing and a major source of pollution and carbon dioxide (CO_2) emissions. Building a reliable and adequate energy system is key to attracting more private investment in productive activities and to enhancing environmental quality. Improving energy efficiency, phasing out highly polluting coal power plants, increasing the share of renewables in the electricity mix and modernising electricity transmission and distribution networks should be among the government's strategic priorities.

Institution and government shortcomings emerged as a transversal constraint and key obstacle that Kosovo's future strategy must tackle. Citizens express a strong desire for effective institutions based on participatory democracy, a commitment to peace, respect for human rights, and socio-economic development. However, the constraints analysis of the peace and institutions dimension showed that the prevalence of informal institutions, low trust in formal institutions and ethnic tensions remain important challenges. Widespread corruption and patronage in the public administration needs to be addressed, and the judicial system, the land and property ownership system and statistical capacity need to be improved. Developing efficient and impartial institutions must be at the core of Kosovo's strategic objectives in order to strengthen citizens' and businesses' trust in the government. Effective and well-functioning institutions are the basis for sustainable economic development and are a transversal challenge across all five dimensions of the constraints analysis.

The process of integration with the European Union is one of the key assets and strategic opportunities for Kosovo's development. The importance of EU accession for Kosovo is clearly stated in key policy documents, such as Kosovo's successive economic reform programmes (ERPs). Over the last decades, the EU integration process provided Kosovo with large financial and technical support for its development (Box 9.3). It continues to be an important lever to address some of the identified constraints and to foster regional co-operation.

Addressing institutional shortcomings and strengthening the government's implementation capability will have significant positive effects across Kosovo's strategic objectives. For example, stronger and more effective local governments are key to establishing and improving quality assurance processes at the school level and improving curricula and teaching skills, thereby strengthening the education system and human capital, Kosovo's top strategic priority. An improved business environment and higher levels of trust in the government based on effective quality institutions are key for the second strategic priority: transitioning to a more sustainable model of economic growth based on private investment in local production and innovation. Health care and social protection need both stronger local governments and more revenue. To address these key strategic priorities, it is essential to streamline the administration, focus on effectiveness and improve multilevel governance.

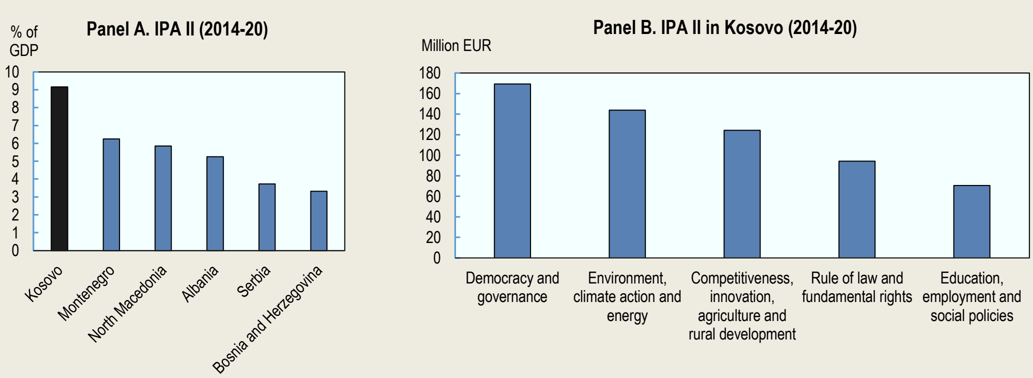
Box 9.3. Kosovo's integration towards the European Union

The process towards integration towards the European Union has been an important driver of democratisation and institution building in Kosovo and has provided the economy with large financial and technical support for its development and regional integration. As part of the process, Kosovo has worked to bring its legislation in line with the existing body of EU laws and standards (known as the acquis). The Kosovo authorities continue to demonstrate publicly their commitment to advancing on the economy's European path (European Commission, 2020[42]).

Through the Stabilisation and Association Process (SAP) since 1999, Kosovo and the economies in the region have been involved in a progressive partnership with the European Union. The SAP rests on the following pillars: bilateral Stabilisation and Association Agreements; trade relations (wide-ranging trade agreements); financial assistance (the Instrument for Pre-accession Assistance [IPA]); and regional co-operation, such as the Central European Free Trade Agreement (CEFTA):

- The Stabilisation and Association Agreement with Kosovo, which entered into force on 1 April 2016, governs the relations between Kosovo and the European Union. In July 2018, the European Commission confirmed that Kosovo has fulfilled all visa liberalisation benchmarks. While the European Parliament confirmed its support for the Commission's proposal for visa liberalisation, the proposal is currently pending in the European Council (European Commission, 2020[42]).
- The IPA has been instrumental in providing Kosovo with assistance in reforms through financial and technical help. IPA II (for 2014-20) accounted for 9.2% of GDP in Kosovo (EUR 602.2 million) (Figure 9.9 – Panel A), making Kosovo recipient of the fourth largest IPA in the Western Balkans in terms of share of GDP. Most of the IPA II funds in the period (28.1%, or about EUR 169.4 million) have been allocated to strengthening democracy and governance. A significant share went to environment, climate action and energy (Figure 9.9 – Panel B).

Figure 9.9. IPA II funding has been concentrated on democracy and governance, and environment, climate action and energy



Source: Authors' elaboration based on European Commission (2020[43]), "Kosovo – financial assistance under IPA II", https://ec.europa.eu/neighbourhood-enlargement/instruments/funding-by-country/kosovo_en.

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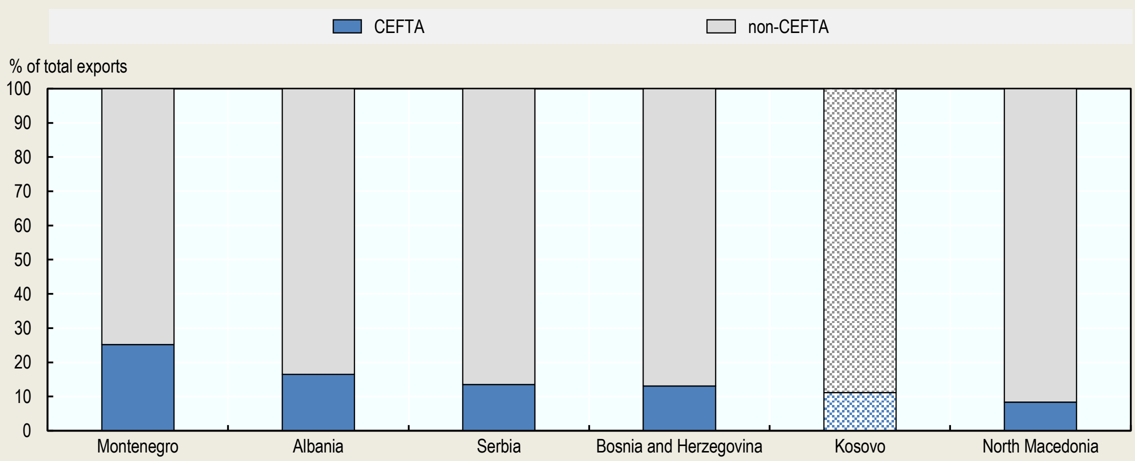
- Regional co-operation has been another important driver in the SAP for developing infrastructure and networks in the region and establishing a free trade area between Kosovo and other economies. Key regional initiatives include the CEFTA, the Energy Community, the Western Balkans Investment Framework and the Regional Cooperation Council. The CEFTA, an international trade agreement among economies in South East Europe, was one of the means of facilitating trade in the region and harmonising trade-related legislation with the European Union. The share of exports of goods and services from Kosovo to CEFTA economies in the Western Balkans increased from 1.4% in 2012 to 11.2% in 2019. About 50% of Kosovo's overall exports went to Albania (Figure 9.10) (CEFTA, 2020[44]).

Figure 9.10. The role of the CEFTA in Kosovo



Source: CEFTA (2020[44]), *Trade in goods* (dataset), https://statistics.cefta.int/goods.

StatLink https://doi.org/10.1787/888934243334

The new Enlargement Package and the adoption of the Economic and Investment Plan have set new directions for EU integration and recovery from COVID-19. Building on the Western Balkan strategy from 2018 (European Commission, 2018[45]), the Enlargement Package adopted on 6 October 2020 stresses the need to improve the EU integration process to be better equipped to deal with structural weaknesses in Kosovo and other Western Balkan economies. In parallel, the European Commission adopted the Economic and Investment Plan to spur the long-term economic recovery of Kosovo and the region, support a green and digital transition, and foster regional integration and convergence with the European Union. The support is crucial, especially in light of both the COVID-19 impact and the existing challenges, such as weak competitiveness and high unemployment. The plan will mobilise up to EUR 9 billion of IPA III funding for 2021-27. A large majority of this support will be directed towards key productive investments and sustainable infrastructure in the Western Balkans through ten flagship initiatives. Through the Western Balkans Guarantee facility, the ambition is to raise additional investments of up to EUR 20 billion (European Commission, 2020[46]; European Commission, 2020[47]).

Note: A first set of projects is articulated around ten flagship investment initiatives, including investments in transport infrastructure projects (connecting east to west and north to south), renewable energy, transition from coal, connecting coastal regions, building renovations, waste and water management, digital infrastructure, supporting the competitiveness of the private sector, and youth support.
Source: European Commission (2020[42]; 2020[46]; 2020[47]; 2018[45]); (CEFTA, 2020[44]).

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10 Impact of COVID-19 in Kosovo

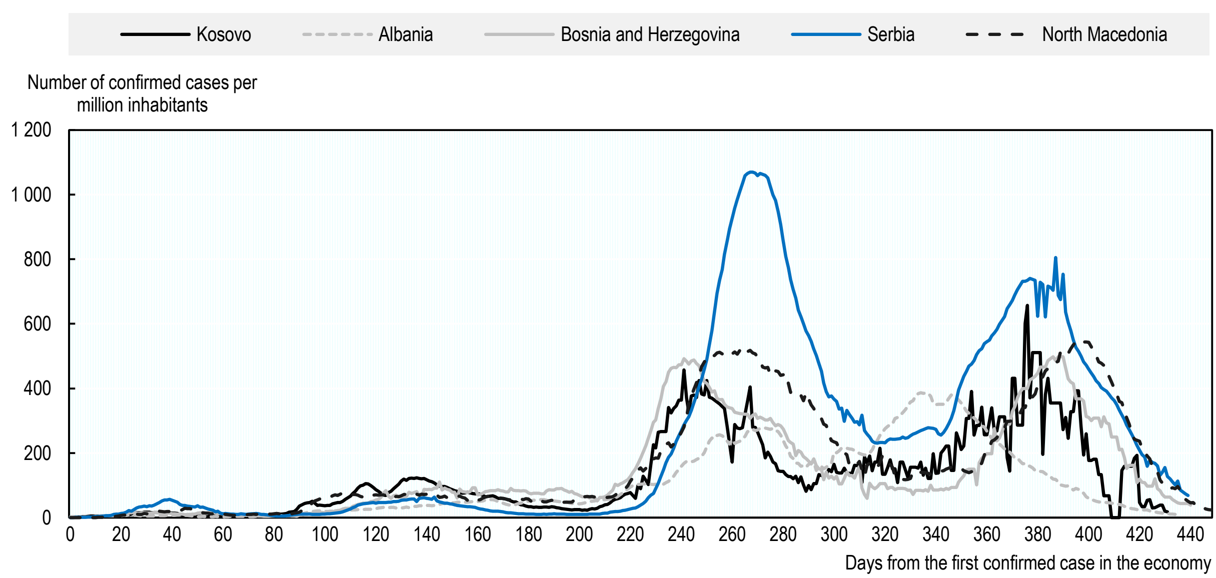
The health impact of COVID-19 in Kosovo was moderate. Authorities acted quickly to contain the spread of the virus, and took measures to mitigate the negative effects of restrictions on the economy. Yet, the medium- to long-term impact of the pandemic will largely depend on pre-existing socio-economic vulnerabilities. This chapter reviews the most binding of them. In particular, weaknesses in Kosovo's health and social protection systems and high levels of unemployment and informality expose the economy strongly to the COVID-19 crisis. The COVID-19 pandemic increases the vulnerability of the unemployed, informal workers and people without social protection. Kosovo's relatively sound public finances can help taking measures to attenuate the impact of the pandemic.

Evolution of the pandemic

Kosovo has experienced four waves of the pandemic. Kosovo reported the first case of COVID-19 on 13 March 2020. On 17 March 2020, the president signed a decree to call a state of emergency. About three months later, there were around 1 500 cases (500 cases per million inhabitants) (Figure 10.1) and about 30 registered deaths (16 per million inhabitants) (Figure 10.2). Like most of the region, Kosovo has hitherto experienced four waves of the pandemic. On 26 May 2021, Kosovo counts an accumulated 103 599 cases and 2 176 registered deaths (55 312 cases per million inhabitants and 1 162 registered deaths per million inhabitants, on average). The fatality rate in Kosovo (around 2.6 registered deaths per 100 cases) is, however, higher than in other economies that have been more affected by the virus, namely Serbia (around 1.0 registered deaths per 100 cases).

Figure 10.1. Evolution of COVID-19 cases in the Western Balkans

Daily new confirmed COVID-19 cases per million inhabitants, rolling seven-day average



Note: Kosovo reported its first registered COVID-19 case on 13 March 2020.
Source: Authors' calculation based on Our World in Data (2020[1]), Our World in Data website, https://ourworldindata.org/.

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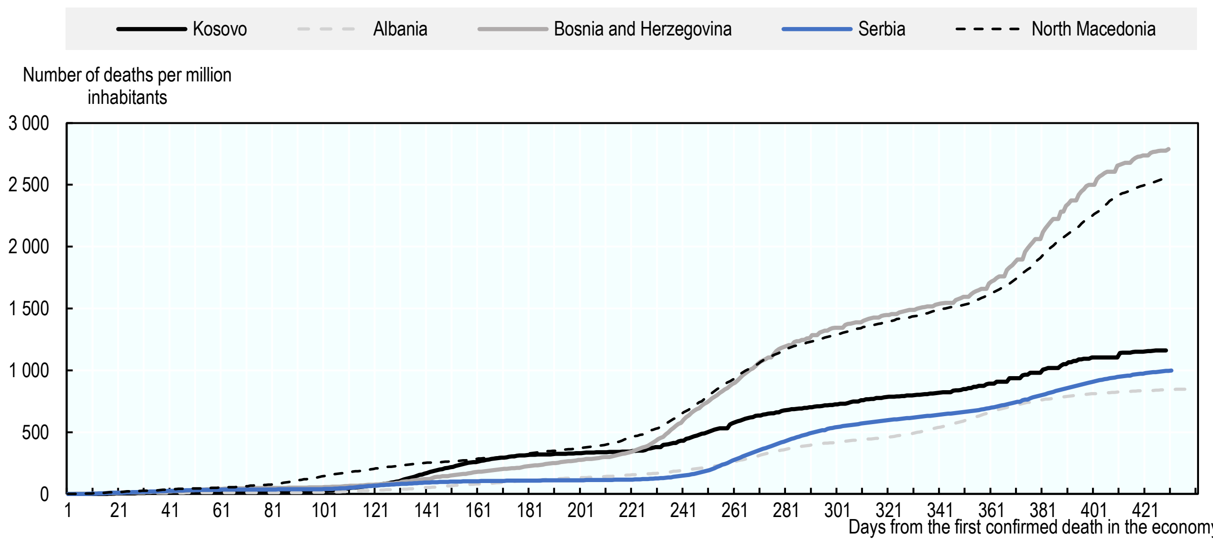
Figure 10.2. Registered deaths per million inhabitants in the Western Balkans

Cumulative number of confirmed COVID-19 deaths per million inhabitants



Note: Kosovo registered the first COVID-19 death on 22 March.
Source: Authors' calculation based on Our World in Data (2020[1]), Our World in Data website, https://ourworldindata.org/.

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Policy responses and economic impact

The government announced a range of stimulus measures amounting to 2.8% of GDP to support affected citizens and businesses. Government transfers to households went up by 38% (World Bank, 2021[2]).

Table 10.1. Policy measures in response to the COVID-19 pandemic

People	Businesses	Other measures
• Cover pension contributions for the next two months for those who benefit from the minimum wage of EUR 170. • Suspend all verification requirements for pensions. Those with a pension of less than EUR 100 will receive a temporary EUR 30 top-up. • Cover monthly wages in April and May by an amount equivalent to the minimum wage. • Extension of the deadline to fill and pay tax liabilities and pension contributions. • Payments of up to EUR 130 for April, May and June to citizens who lost their jobs due to the public health emergency.	• Financial support for companies in financial difficulties because of a decrease in activities: 1) cover monthly wage expenses up to EUR 170 for April and May (EUR 41 000 000); 2) subsidise leases up to 50% of the value of the lease for SMEs for April and May (EUR 12 000 000); 3) cover the value of pension contributions for wages for April and May (EUR 8 000 000). • Interest-free loans to public enterprises in financial difficulties due to the public health emergency to ensure their temporary liquidity (EUR 20 000 000) • Support to exporters (EUR 10 000 000). • Financial support for commercial companies that hire employees with an employment contract of at least one year during the public health emergency, covering EUR 130 of employees' salary for the two months after the employment	• Increase the budget for grants and subsidies for the Ministry of Agriculture, Forestry and Rural Development to increase agricultural production (EUR 5 000 000). • Provide extra financial support to affected municipalities (EUR 10 000 000). • Increase the budget for grants and subsidies to the Ministry of Culture, Youth and Sports due to the impact on sports and cultural activities (EUR 5 000 000)

People	Businesses	Other measures
	registration (EUR 6 000 000). • Loan guarantees by the state benefiting private borrowers. • Financial liquidity ensured for: 1) microenterprises and the self-employed through financing by the Kosovo Credit Guarantee Fund, amounting to up to EUR 10 000 for 24 months (EUR 15 000 000); 2) commercial/authorised companies that provide basic services (similar to those of public enterprises).	

Source: OECD (2020[3]), "Covid-19 Policy Tracker", webpage, http://oecd.org/coronavirus/en/#country-policy-tracker.

Kosovo's economy was heavily affected by the COVID-19 crisis. In 2020 Kosovo's economy recorded a contraction of 6.9%, mainly due to declines in consumption, especially diaspora-related exports of travel services and investments. Government support, mainly surprising surges in both remittance receipts and exports (the latter among other causes due to higher demand for Kosovo's nickel), helped avoid a deeper recession (World Bank, 2021[2]).

Kosovo's relatively sound public finances can help in taking measures that attenuate the impact of COVID-19. Kosovo entered the crisis with some fiscal buffers and has considerable fiscal space to mitigate the effects of the crisis. Gross public debt accounts for around 18% of GDP, compared to an OECD average of 66.4% (Table 10.2). The government announced a range of measures in response to the crisis. In addition to the deferral of tax payments, it set up an emergency response package worth 2.8% of GDP. Despite sound public finances, the likely large revenue shortfall, combined with this fiscal stimulus, is expected to widen the budget deficit in 2020 (World Bank, 2020[4]).

Coronavirus COVID-19

The analysis of policy responses to the COVID-19 pandemic does not reflect the policy development that occurred since February 2021, with the exception of the figures on testing and vaccination for which the most recent and internationally comparable data were used.

Dimensions of vulnerability to further socio-economic impact from COVID-19

The medium- to long-term impact of the COVID-19 pandemic on Kosovo will largely depend on pre-existing socio-economic vulnerabilities. Taking pre-existing vulnerabilities into account can help policy makers to determine who will need help the most and to design and target policies accordingly (Table 10.2). Kosovo is strongly exposed to the COVID-19 crisis through weaknesses in its health and social protection systems and high levels of unemployment and informality.

Table 10.2. Kosovo's socio-economic exposure and policy resilience to COVID-19

	Channels	Level of vulnerability	Signalling indicators (Latest year: 2019 unless otherwise specified)		
				Kosovo	OECD
Socio-economic exposure	Well-being	High	Household debt, loans and debt securities (% of GDP)	15.6	68.3*
			Poverty headcount (measured as USD 5.50 per person per day, 2011 PPP) (% of population)	24.4**	2.9*
			Personal remittances, received (% of GDP)	15.8	0.9
			Unemployment rate	25.7	5.8
			Social protection spending (% of GDP)	6.5*	20.1*
			Life satisfaction (average score on 0-10 scale)	6.4	6.7
			Lack of social support (% of population)	17.0	8.6
	Health sector	Medium	Adult smoking prevalence (%)	36.4(2020)	24.9*
	Trade	High	Trade (% of GDP)	85.4	60.6
			External balance on goods and services (% of GDP)	-27.0	0.5
	Investment	High	Microenterprises (1-9 employees) (% among total enterprises)	93.1***	78.7*
			FDI, net inflows (% in GDP)	3.6	1.8
	Tertiary sector	High	Tourism (% in GDP)	6.0–7.0	4.4*
			Services (% of total exports)	80.9	28.0
			Retail services (% total value added)	13.0*	20.0*
	Financial and monetary	Low	Non-performing loans (% total loans)	1.9	2.9
			Foreign currency reserves (number of importing months)	2.5	9.5
			Capital adequacy ratio (%)	15.9	18.9*
			Main interest rate (%)	0.0	x
Policy resilience	Public finances	Low	Gross public debt (% of GDP)	18.2	65.8
			Public deficit (% of GDP)	2.8	0.8
			Gross domestic savings (%)	3.0	22.5*
			Foreign currency debt (% of total debt)	0.13	x
	Health sector	Low	Spending on health care (% of GDP)	2.5*	12.6**
	Government effectiveness	Low	Government performance index (1: low; 10: high)	5.2	7.5*
			Rigorous and impartial public administration (0: partial; 4: impartial)	2.4	3.3*

Notes: Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report. Household debt is defined as loans to households in Q4 2018 (EUR 998.5 million) divided by Kosovo's GDP in 2018 (EUR 6 725.9 million). The level of vulnerability has been assessed by the OECD. 2019 is the latest year available unless otherwise specified. In particular:

*: 2018

**: 2017

***: 2016

Sources: Authors' elaboration based on national and international data: Central Bank of the Republic of Kosovo (2019[5]), *Quaterly Assessment of Financial System*, https://bqk-kos.org/repository/docs/2015/CBK_Financial%20System_Q4_2018.pdf; Coppedge et al. (2020[6]), *V-Dem Dataset -- Version 10* (dataset), www.v-dem.net/en/data/data/v-dem-dataset/; Hasanaj and Nimani (2019[7]), "Tourism development of Kosovo as a tourist destination", http://dx.doi.org/10.33807/monte.1.201904248; IMF (2020[8]), *International Financial Statistics* (dataset), https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b; IMF (2020[9]), *Financial Soundness Indicators* (dataset), https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA; IMF (2021[10]), "World Economic Outlook Databases", www.imf.org/external/pubs/ft/weo/2020/01/weodata/index.aspx; IMF (2019[11]), *World Economic Outlook, October 2019: Global Manufacturing Downturn, Rising Trade Barrier*, www.imf.org/en/Publications/WEO/Issues/2019/10/01/world-economic-outlook-october-2019; Kosovo Agency of Statistics (2020[12]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; OECD et al. (2019[13]), *SME Policy Index: Western Balkans and Turkey 2019: Assessing the Implementation of the Small Business Act for Europe*, https://doi.org/10.1787/g2g9fa9a-en; WHO (2020[14]), Global Health Observatory, https://www.who.int/data/gho; World Bank (2020[15]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WTTC (2020[16]), *World Travel & Tourism Council* (database), https://wttc.org/Research/Economic-Impact/Data-Gateway.

Material well-being and social protection

The short- and medium-term impact of COVID-19 increases the vulnerability of the most disadvantaged and risks compounding socio-economic divides. The unemployment rate was very high before COVID-19 (25.7%) and will likely increase due to the current economic and health crises (Table 10.2). Informal employment accounts for about 35% of total employment, and the current crisis may exacerbate the vulnerability of informal workers as their incomes decrease. This could widen the inequality gap and push many people below the poverty line. As many informal workers cannot afford to adhere to social distancing, they are more vulnerable to the pandemic (Gerdin and Kolev, 2020[17]).

The current crisis may disproportionately affect the many Kosovars without social protection coverage. Kosovo's social protection spending (about 6.5% of GDP) is low compared to the OECD average (20.1%). The social protection system's stringent eligibility criteria should be relaxed in light of the crisis, for example by covering near-poor households in the medium term and streamlining admission procedures for social assistance. Kosovo has no functioning unemployment, workplace disability or sick leave social insurance systems, although the government has announced that monthly wages will be covered for April and May by an amount equivalent to the minimum wage. The government needs to provide not only an emergency response to the pandemic but also a longer-term response to support households in coping with a very likely long-term economic crisis.

Health and non-material well-being

Kosovo's healthcare system would require substantial investments in infrastructure, equipment and staff. It will be imperative to secure more funding for health care, despite the immediate pressure to cut health funds due to the economic downturn. ***Healthcare expenditures amounted to 1.6% of GDP in 2016 – the lowest among comparable economies – and represented 40% of the total annual needs for public health care*** (European Commission, 2018[18])***. By 2018 total spending on healthcare had increased to 2.5% of GDP, but overall health expenditure remained the lowest in the region. Without publicly available health insurance, citizens were bearing an estimated 40% of total health care costs out of pocket (OOP) before the crisis, compared to an average of 13% in the OECD. Since many doctors and nurses migrated to work in Western Europe, medical staff shortages are a key challenge, as they are elsewhere in the region.*** Telemedicine is one way to deal with staff shortages in remote areas and might be particularly useful for easing increased pressure on the healthcare system due to COVID-19.

Other, non-material aspects of well-being are affected by the crisis. Quality of life is also about people's relationships, which can provide a vital lifeline during crises and social distancing. Yet, 17% of Kosovars say that they have no relatives or friends they can count on for help in times of need. The considerable risks of social isolation and loneliness need to be addressed by policy measures for both physical and mental health, for instance regular check-ins by social services, civil society and volunteers, and promotion of digital technologies that connect people with each other and with public services (OECD, 2020[19]). Some 37.4% of men and 19.7% of women in Kosovo smoke daily, a risk factor associated with higher rates of mortality from COVID-19.

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11 Multi-dimensional analysis of development in Kosovo

Achieving rapid, inclusive and sustainable development requires progress across a range of development domains. This chapter identifies major development constraints in Kosovo. It builds on multi-dimensional analysis across the five pillars of the Sustainable Development Goals: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet. For each pillar, the analysis highlights key areas where Kosovo could further realise its full development potential.

This chapter of the MDR of the Western Balkans identifies the key capabilities and most pressing constraints in Kosovo by linking economic, social, environmental and institutional objectives. The assessment is organised around five thematic sections based on the five pillars of the 2030 Agenda: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet. Whenever relevant, Kosovo is compared with a set of benchmark economies in the region (Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia), the OECD (Costa Rica, Czech Republic, Greece, Slovak Republic, Slovenia and Turkey), non-OECD economies in the European Union (Croatia and Romania) and non-OECD economies in other regions (Kazakhstan, Morocco, Philippines and Uruguay). It includes regional averages for the Western Balkans and OECD and EU members.

People – towards better lives for all

The People pillar of the 2030 Agenda for Sustainable Development places quality of life centre stage, focusing on the international community's commitment to guaranteeing the fulfilment of all human beings' potential in terms of equality, dignity and health. After the war, Kosovo achieved tangible improvements for its citizens: household consumption rose, poverty declined and important healthcare, gender equality and employment legislation was put in place.

However, there is a long way to go. Capacity to move forward on implementation of reforms and enforcement of legislation is low. The striking regional inequalities in basic infrastructure and well-being between minority communities and the general population need to be reduced. Kosovo's formal employment rate is among the lowest in the world, with the large young labour force and women especially affected by a lack of opportunities. There remains room for improvement in terms of building up effective education, health and social protection systems. The People section in this chapter identifies five major bottlenecks to the well-being of Kosovo's population (Table 11.1).

Table 11.1. People – five major constraints to leaving no one behind in Kosovo

1. Regional development is extremely uneven, and many municipalities lack basic infrastructure.
2. Kosovo has one of the highest unemployment rates in the world, including for youth and women, partly fuelled by poor education outcomes and skills mismatches, lack of social care services and difficult regulations to operate businesses.
3. Kosovo's health system is underfunded and fails to deliver quality results and access to care, and capacity to implement overdue reforms is low.
4. Targeting of social protection does not adequately focus on the most needy and currently disincentivises labour participation.
5. Given the limited integration of ethnic communities, Kosovo's youth in particular need to be sensitised to issues of transitional justice and dealing with the past.

Improving well-being for all

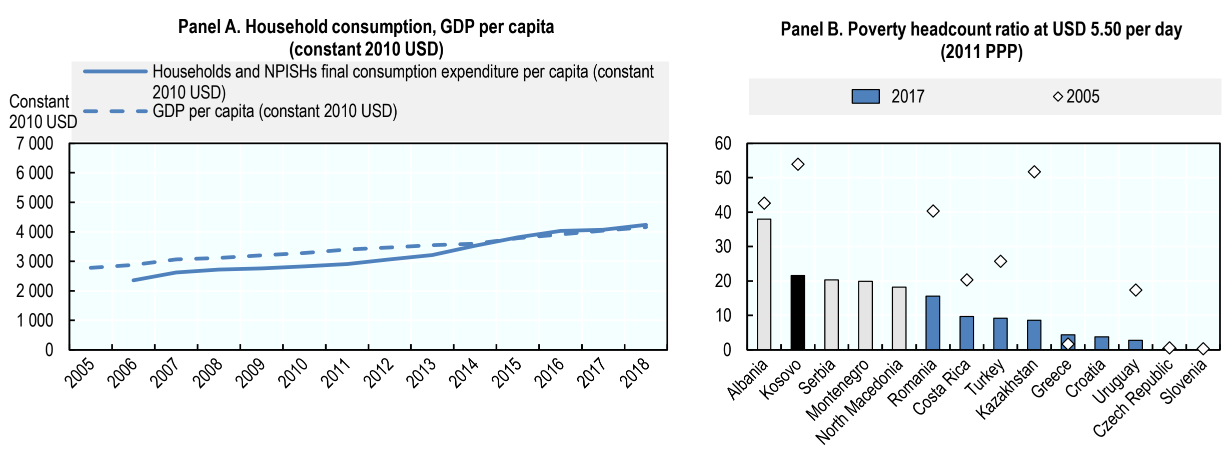
Household consumption has almost doubled alongside GDP growth since 2006, and poverty rates (USD 5.50 [United States dollar] per day) have more than halved since 2005. Nevertheless, poverty, mainly driven by high unemployment and low wages, remains very high compared to benchmark economies, with 18% to 21% of the population living under the national poverty line (according to national and international estimates, respectively). Some 5% of the population experienced extreme poverty in 2017 (Figure 11.1) (Kosovo Agency of Statistics, 2019[1]). The impacts of COVID-19 on poverty are likely to be substantial, as economic activity in Kosovo has been brought to a standstill and remittances have plummeted. Recent simulations suggest that the poverty rate will rise by between four and ten percentage points going forward (World Bank, 2020[2]).

Regional inequalities are evident in access to basic infrastructure, and minority groups risk being left behind

Quality of life depends on a household's location among Kosovo's seven regions. Income inequality, as measured by the disposable income Gini coefficient, is slightly below the OECD average of 31.1, although it has increased since 2016, according to national estimates (Kosovo Agency of Statistics, 2019[1]; Solt, 2019[3]). Regional differences, particularly regarding access to water, sewerage systems and power supply, are striking (Table 11.2): about 42% of villages are connected to piped water in Mitrovica, compared to more than 85% in Priština or Peć. Mitrovica also has poor access to sewerage and relatively unreliable power: six out of nine municipalities have issues with access to electricity. Apart from Priština, the four regions with the poorest connections to the water and sewerage systems (Gnjilane, Gjakova, Peć and Mitrovica) also show higher infant mortality. Since 2009, social welfare funds have been allocated through a general grant without any clear earmarking in relation to the local budget available for social services, which has led to considerable variation in social services delivery across municipalities (European Commission, 2018[4]).

Figure 11.1. Household spending has risen, but poverty remains high

Household consumption, GDP per capita (Panel A) and poverty headcount ratio at USD 5.50 per day (2011 PPP) (Panel B)



Note: Poverty data for Romania refer to 2006. NPISH = non-profit institutions serving households. Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.
Sources: Kosovo Agency of Statistics (2020[5]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; Solt (2019[3]), *The Standardized World Income Inequality Database, Version 8-9* (dataset), https://doi.org/10.7910/DVN/LM4OWF; World Bank (2020[6]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Ethnic communities in Kosovo continue to face social and political exclusion and worse well-being outcomes than the rest of the population. Kosovo is a multi-ethnic society, which apart from Albanians and Serbians, includes Roma, Ashkali, Egyptians, Bosniaks, Turks and Gorani. The 2011 Census, which excluded North Kosovo, estimated a total of 8 824 Roma, although 2010 Organization for Security and Co-operation in Europe (OSCE) estimates suggested that there were around 34 000. Unemployment rates among Roma, Ashkali and Egyptian communities are about 90% (European Commission, 2019[7]). Personal documents of many community members were destroyed during the conflict or are not recognised by local authorities, since Kosovar and Serbian administrations both require their own documents before allowing access to public services. Children living in rural areas are less likely to have access to good health care; and access is even worse for ethnic minorities. Only three in ten Roma, Ashkali and Egyptian children are fully immunised against measles, and more than 60.0% lived in absolute poverty and over 30.0% in extreme poverty in 2014 (compared to the average statistics of 48.6% and 18.9%, respectively) (UNICEF Kosovo Office, 2014[8]). The government approved the Strategy on Children's Rights 2019-2023 in January 2019 and recently developed a child and maternal indicators framework to monitor children's rights, but child labour remains prevalent: about 10.7% of children, many from ethnic minorities, are involved in work, including in agriculture, mining, construction and manufacturing but also in commercial sexual exploitation – sometimes as a result of human trafficking – and street work (European Commission, 2019[7]; Refworld, 2017[9]). A systemic solution and an institutional response to child begging and child marriage, especially among Roma and Ashkali children, is lacking. Although Roma, Ashkali and Egyptians have a total of four reserved seats in the Kosovo Assembly, they remain excluded from real participation in political life and discussions on the future of Kosovo (Minority Rights Group International, 2018[10]).

Table 11.2. Regional differences extend across most sectors

Selected indicators, 2018 or latest available year

Region	Population	Villages connected to a water system (%)	Villages connected to a sewerage system (%)	Unreliable power supply (% of municipalities)	Pupil/teacher ratio (primary and secondary education)	Medical staff (per 1 000 population)	Infant mortality rate (per 1 000 live births)
Prizren	407 414	78.6	76.9	50	13.2	4.4	6.5
Priština	369 548	86.8	90.7	17	13.3	4.1	13.4
Mitrovica	368 692	41.6	40.6	66	11.5	4.9	7.5
Peć	228 537	88.6	60.7	40	14.3	3.3	5.3
Gnjilane	222 323	63.7	68.8	60	10.6	7.0	8.3
Uroševac	104 312	83.7	88.4	0	16.5	3.0	5.0
Gjakova	94 840	47.3	0.0	0	11.9	3.6	5.8

Note: Medical staff includes doctors, nurses and other staff.
Sources: Calculations based on data from the Kosovo Agency of Statistics; Kosovo Agency of Statistics (2020[5]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; OSCE (2019[11]), *Municipal Profiles 2018*, www.osce.org/mission-in-kosovo/410279?download=true.

Despite relatively progressive legal frameworks, lesbian, gay, bisexual, transgender and intersex (LGBTI) communities face continued discrimination and harassment. Kosovo's constitution is one of only ten in the world that ban discrimination on the grounds of sexual orientation (Art. 24). The definition of marriage remains liberal, making no reference to gender and thus allowing for cases to be brought forward in the constitutional court. In 2013, the Law on Protection from Discrimination was updated to include discrimination based on gender identity. Nevertheless, society overall remains conservative, and LGBTI communities are largely invisible in public life (e.g. there are no public gay bars) and face high levels of verbal abuse and harassment. According to a 2015 population survey, 41% of the population believed homosexuality is a sickness and would try to help their child find a cure if they found out he or she was not heterosexual (Kosovo Agency of Statistics, 2020[5]).

Prioritising quality jobs for all

The employment rate in Kosovo is among the lowest in the world. While it increased from 25.5% in 2012 to 30.1% in 2019, it is below Yemen, which has the lowest employment rate among all economies with available data in the ILOStat database, and well below the Western Balkan and OECD averages (42.7% and 57%, respectively) (World Bank, 2020[6]). Unemployment rates in Kosovo are among the highest in the region, and almost six in ten unemployed have been without work for a year or longer (European Commission, 2019[7]). The COVID-19 crisis will likely have an additional negative impact on jobs, with those on fixed-term contracts, seasonal workers and workers in the informal economy and the construction sector particularly at risk.

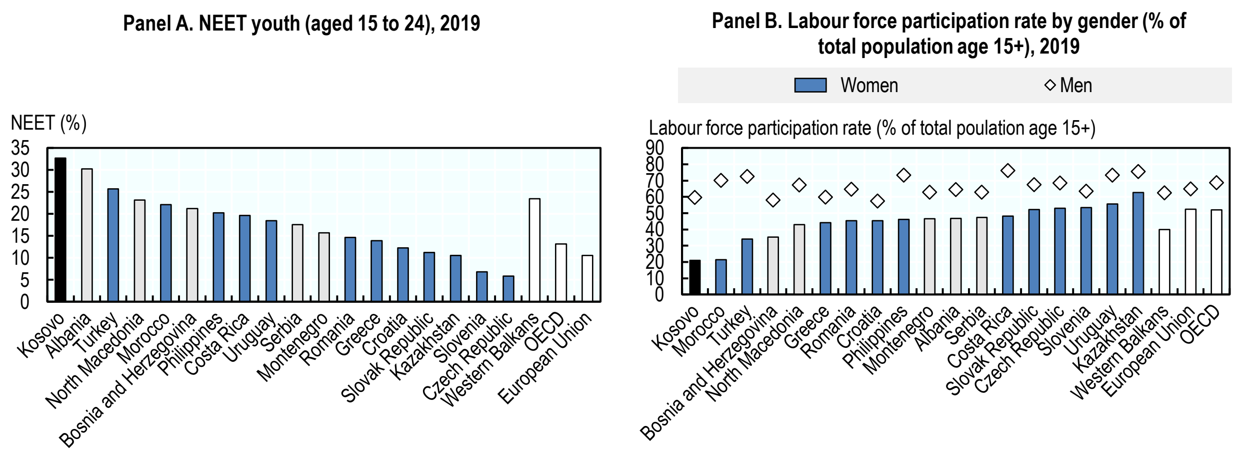
Young people and women find themselves outside the labour market

Youth integration in the labour market is a strategic objective but remains a significant challenge in practice. In 2019, more than one-third of young workers were not in employment, education and training (NEET), the highest share among Western Balkan economies and almost triple that of the average OECD economy (Figure 11.2). Indeed, youth disenfranchisement is a key driver of fragility in Kosovo today. Poor integration into the labour market can be detrimental to young people, as they risk losing motivation and skills and migrate abroad for better employment opportunities. Alongside Bosnia and Herzegovina, North Macedonia and Serbia, Kosovo is an important place both of origin and of transit for migration. Transit migration was particularly important in the 2015-16 surge of asylum seekers to European OECD countries. It has since declined significantly but continues on a more modest scale. Austria, Germany, Slovenia and Switzerland are the main destination countries of emigration from Kosovo, although the nature of migration has changed over time. Managed labour migration to Germany in particular has increased in recent years through a scheme that facilitates labour migrants from the Western Balkans. In total, around one-third of Kosovo's national population lived abroad in 2017 (World Bank, 2017[12]).

The government has placed women's integration in the labour market high on the economy's agenda, both as part of its Strategy on Employment and Social Welfare 2018-2022 and as a priority area for the recently established Employment Agency. It remains to be seen how much will be implemented. There are significant differences in labour market participation between women and men. Almost 80% of women in Kosovo were inactive in 2019, one of the highest rates in the world (Figure 11.2). Despite a solid legal framework for women's right (Law on Protection from Discrimination) and a dedicated Agency for Gender Equality, discrimination against women at the workplace and poorly developed maternity and parental leave policies financed by employers rather than the public sector remain issues (Jose et al., 2017[13]; European Commission, 2019[7]). Over half of inactive women cite family reasons as the main cause of inactivity, although rates are lower for women with tertiary education, who also show higher overall employment rates (Figure 11.3). The current lack of care leave, flexible working arrangements and limited elderly and childcare facilities act as additional barriers. For example, in 2017/18, only 4% of children aged 0 to 5 attended public preschool education, including kindergartens and nurseries (World Bank, 2017[14]; Thaçi, Rraci and Bajrami, 2018[15]). Given Kosovo's poor performance in the recent OECD Programme for International Student Assessment (PISA), investing in early childhood education would enhance longer-term human capital development.

Figure 11.2. Young workers and women need to be better integrated into the labour market

NEET youth (aged 15 to 24) (Panel A) and labour force participation rate by gender (% of total population age 15+) (Panel B), 2019



Sources: ILO (2020[16]), *Share of youth not in employment, education or training (NEET) by sex – ILO modelled estimates, Nov. 2019 (%) – Annual* (dataset), www.ilo.org/shinyapps/bulkexplorer45/?lang=en&segment=indicator&id=EIP_2EET_SEX_RT_A; Kosovo Agency of Statistics (2020[5]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; World Bank (2020[6]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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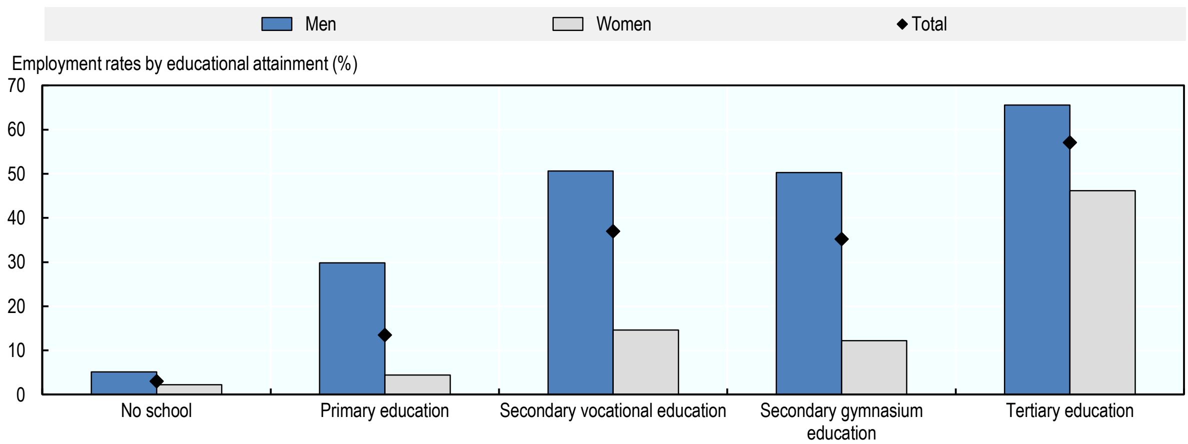
Labour market institutions need to be strengthened and working conditions improved

Besides tackling Kosovo's general lack of employment opportunities (see the Prosperity section in this chapter), effective labour market institutions and policies focused on closing skills gaps can be important levers to address the demand side of the labour market.

Labour market activation policies in Kosovo are underdeveloped and underfunded. Although the recent establishment of Kosovo's Employment Agency is an important step, poor coverage, lack of resources and weak collaboration with other institutions limit its activation potential. Public funds for active labour market programmes account for about EUR 2 million per year, or 0.03% of GDP, compared to an OECD average of 0.42% (World Bank, 2019[17]). Only 56.5% of all unemployed had registered at the agency in 2019, and there remains a gender gap in service provision, with only 34% of participants in active labour market measures being women (World Bank, 2018[18]). Almost half of job seekers have no formal education or only primary education and could benefit from well-targeted upskilling and reskilling, a pattern seen across the labour force overall (Kosovo Agency of Statistics, 2020[5]) (Figure 11.3).

Figure 11.3. Kosovars with lower education attainment, particularly women, have a harder time finding employment

Employment rates by educational attainment (%)



Source: Kosovo Agency of Statistics (2017[19]), *Series 5: Social Statistics Labour Force Survey 2017*, https://ask.rks-gov.net/media/3989/labour-force-survey-2017.pdf.

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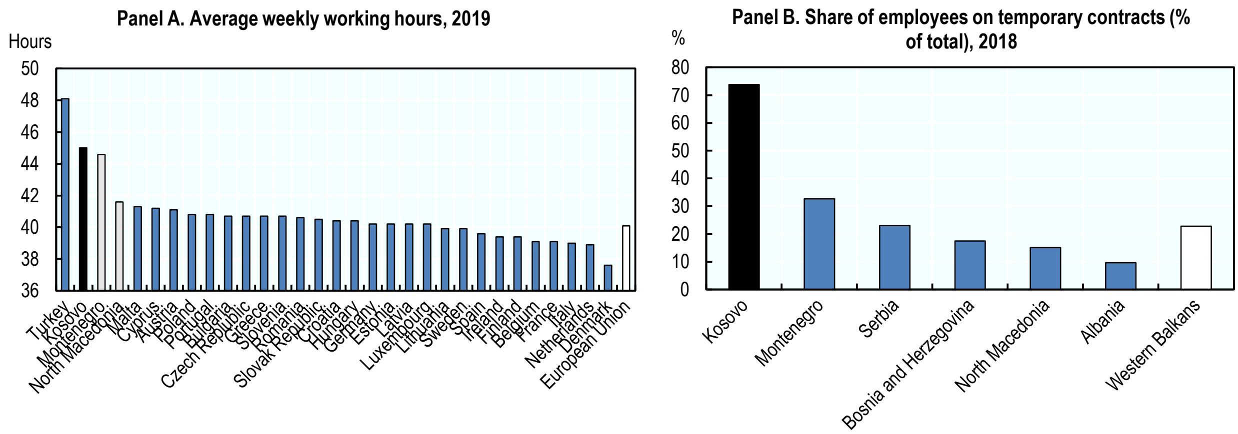
Weak labour market institutions, skills mismatches and a large supply of workers have resulted in high rates of informality, hiring reliant on personal contacts (see Prosperity section in this chapter) and poor working conditions for many. Average weekly working hours in formal work are well above the regional and EU averages, the likelihood of which is increased by the fact that the majority of workers hold temporary contracts (Figure 11.4). About 18.1% of all formal employees work more than 50 hours per week, more than double the OECD average of 7% in 2018 (OECD, 2020[20]). In many sectors, workers do not receive financial compensation for long working hours, due to either lack of employer adherence to working contracts or lack of work contracts all together. While low labour demand and high labour supply provide scope for such abuses, inadequately designed labour law, the weak capacity and efficiency of labour inspectorates and non-existent trade unions intensify the issue (Jakurti, 2020[21]). *Labour inspectorates lack human and financial resources and technical equipment (inspectorates still use paper documentation for internal processes), and limited collaboration with other relevant institutions, such as tax authorities, leads to uncoordinated and extensive visits to businesses, which encourages informality* (World Bank, 2017[14]). Work safety should also be monitored. With six fatal accidents *per 100 000 employees in 2019,*[1] *Kosovo outnumbers some other benchmark economies in terms of occupational safety: Croatia recorded 1.8 fatalities per 100 000 employees in 2015, the Slovak Republic 1.7 in 2014 and Greece 1.3 in 2014.*[2]

Figure 11.4. Employment conditions in Kosovo can be straining and precarious

Average weekly working hours (Panel A), 2019, and share of employees on temporary contracts (% of total) (Panel B), 2018



Sources: Eurostat (2020[22]), *Data Explorer – Average number of usual weekly hours of work in main job* (dataset), https://ec.europa.eu/eurostat/web/products-eurostat-news/-/DDN-20180125-1; Kosovo Agency of Statistics (2020[5]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; World Bank/Vienna Institute for International Economic Studies (2020[23]), *SEE Jobs Gateway Database* (database), https://data.wiiw.ac.at/seejobsgateway.html.

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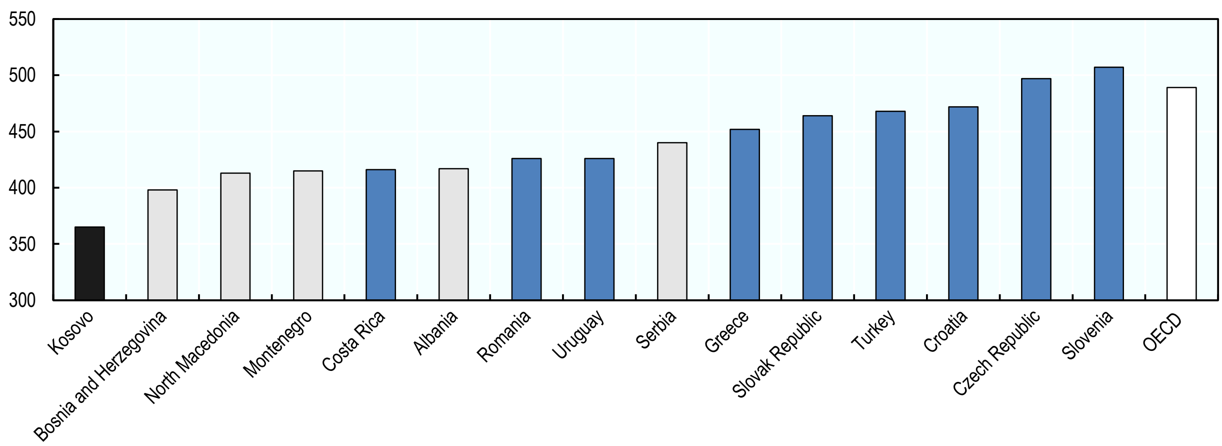
Boosting education quality

Kosovo's education system fails to equip people with job-ready skills. The economy's performance in PISA is very low (Figure 11.5). An employer survey suggests that lack of appropriate skills and experience are primary constraints to recruitment at all skill levels.[3] Skills gaps and mismatches are accentuated by limited training provided by firms and missing links between companies and the education system. In 2017, Kosovo spent 4.4% of GDP on education, up from 3.4% in 2008 (Kosovo Agency of Statistics, 2020[5]) which is not significantly lower that than the OECD average (5.1%), indicating potentially inefficient use of funds (World Bank, 2020[6]). Kosovo's education system tends to focus on top performers and neglect others, affecting equity, which in turn influences the participation in the education system of various groups, including women and ethnic minorities.

Figure 11.5. Education outcomes are low given Kosovo's level of development

Mean science scores, 2018



Source: OECD (2020[24]), *PISA* (database), www.oecd.org/pisa/data/.

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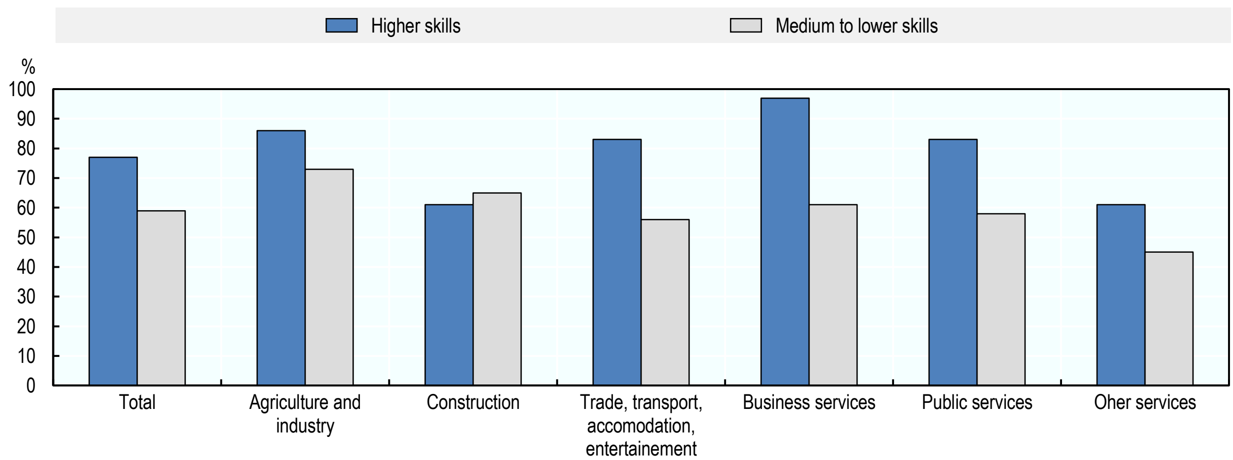
Poor education outcomes reflect the low quality of primary and lower secondary education, which owes to a lack of local capacities, including quality assurance and a mismatch between the requirements of the new competence-based curriculum and teaching skills. Directorates for Municipal Education, to which responsibility was decentralised a decade ago, and schools need more capacities and resources to implement quality assurance processes, such as school self-evaluation, teacher and school leader evaluation and student assessments (Aliu, 2019[25]). Many school-level quality co-ordinators reportedly lack a clear understanding of their roles, and not all carry out their responsibilities (Thaçi, Rraci and Bajrami, 2018[15]). A competence-based curriculum was adopted about ten years ago and became mandatory as of 2018, but implementation is lacking, and teachers have been resistant. This relates to insufficient training (only about 40% of teachers were trained to implement the new curriculum), lack of up-to-date textbooks and insufficient science staff, despite salaries that exceed average incomes (Aliu, 2019[25]).

Skills gaps and mismatches are also attributable to the weak vocational education and training (VET) system. Although more than half of upper secondary students are enrolled in VET (about 53% in 2018) (Kosovo Agency of Statistics, 2020[5]), the system is characterised by an education offer not aligned with labour market needs, poor collaboration with the private sector and weak quality assurance mechanisms (World Bank, 2019[17]). VET students have the option of enrolling in academic tertiary programmes. The VET system must therefore prepare students for both tertiary education and the labour market, likely resulting in students underequipped for either. About 77% of hiring firms encountered difficulties due to skill gaps (Figure 11.6), compared to 55% in Albania, demonstrating the poor quality of VET in Kosovo. Lack of higher and medium to lower skills is particularly pronounced in agriculture and industry, and business services.

Figure 11.6. Recruitment difficulties due to skills gaps

% of hiring firms encountering difficulties due to skills gaps, by skills level



Source: World Bank (2019[17]) *Kosovo Country Report: Findings from the Skills towards Employment and Productivity Survey*, http://documents.worldbank.org/curated/en/209751557432399449/pdf/Kosovo-Country-Report-Findings-from-the-Skills-towards-Employment-and-Productivity-Survey.pdf.

StatLink https://doi.org/10.1787/888934243486

Improving health and social protection coverage

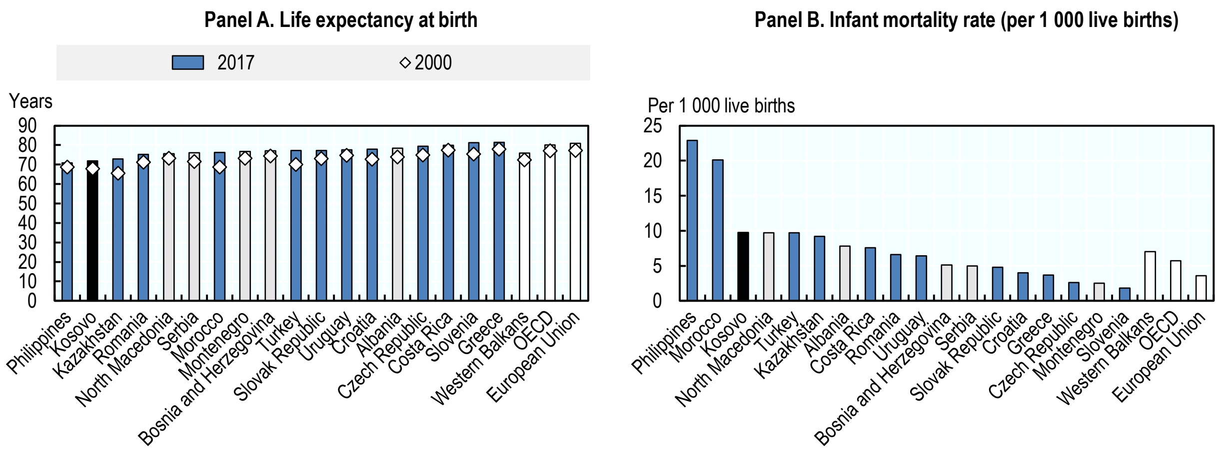
Kosovo's health system fails to deliver quality results and access to care

Despite improvements in health outcomes in recent years, Kosovo has a long way to go. Many health and nutrition indicators, particularly those related to maternal and child health, lag behind regional and international benchmarks. At 72.5 years, life expectancy in Kosovo is the lowest in the Western Balkans, and infant mortality, mostly caused by perinatal conditions, respiratory diseases and diarrhoea, is the highest in Europe (Figure 11.7). Data from 2010 showed that 15.7% of school-aged children and 23.0% of pregnant women had mild anaemia, and one-sixth of children were stunted (UNICEF, 2010[26]). A more recent study found that the diets of a small sample of kindergarten children were deficient in several micronutrients (Rysha, Gjergji and Ploeger, 2019[27]). Improvements in primary health care – a Ministry of Health stated priority in the 2017-21 health sector strategy – should include educating families and communities about adequate homecare management, nutrition, child physical and cognitive development and general reproductive health. There is currently no legislation on nutrition and physical activity.

Although tuberculosis (TB) cases declined by 3.5% annually in 2002-17 (mainly due to large grants by the Global Fund to Fight AIDS, TB and Malaria), Kosovo has one of the highest TB rates in Europe, with almost 40 new cases per 100 000 population per year (WHO, 2013[28]; Bajrami et al., 2019[29]; European Centre for Disease Prevention and Control/WHO, 2019[30]). High rates of tobacco use – 37.4% of men and 19.7% of women in Kosovo smoke daily – are contributing factors and, apart from their known implications for cardiovascular disease and lung cancer, have been associated with more severe COVID-19 cases (Vardavas and Nikitara, 2020[31]; Gashi, Berisha and Ramadani, 2017[32]). Kosovo has a comprehensive Law on Tobacco Control; however, enforcement has been weak due to lack of political will and the poor performance of implementing authorities (European Commission, 2019[7]).

Figure 11.7. General population and child health outcomes need to be improved

Life expectancy at birth (Panel A) and infant mortality (per 1 000 live births) (Panel B), 2017



Note: Infant mortality refers to deaths under 12 months old.
Sources: Kosovo Agency of Statistics (2020[5]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; World Bank (2020[6]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Kosovo's healthcare system needs substantial investments for infrastructure, equipment and urgent staff costs; it is imperative to increase funding, despite the immediate pressure to cut health funds due to the economic downturn. At 1.6% of GDP in 2016, Kosovo's healthcare expenditures are the lowest of all benchmark economies and represent only 40% of the total annual needs for public health care. More than two-thirds of expenditures are allocated to fixed costs (European Commission, 2018[4]; World Bank, 2020[6]). In many public municipal health centres, healthcare workers list basic resources (e.g. space, heating, water, beds, medical equipment, computers) as missing, and drugs, even those on the essential list compiled by the government, are often unavailable, particularly in rural areas. The shortage of essential medication includes modern contraceptives, which only 11% of women report using (Kosovo Women's Network, 2016[33]). In terms of specialised services, there are only two magnetic resonance imaging machines in the entire public health system, leading to long waiting lists. In a recent population survey, three-quarters of patients said that they were forced to seek treatment in private clinics because interventions, such as computerised tomography scans, were unavailable (Kosovo 2.0, 2018[34]). As in all economies in the region, many doctors and nurses in Kosovo migrated to work in Western Europe. In a recent poll, 73% of medical students said that they would leave if they were given the opportunity (Elton, 2018[35]). Telemedicine is one way to deal with staff shortages in remote areas and might be especially appropriate for easing pressure on the healthcare system during the COVID-19 pandemic.

Access to health care in Kosovo depends on how much a patient can afford to pay or wait for a procedure. Many end up forgoing preventative checks and treatment altogether. Without publicly available health insurance, citizens bear an estimated 40% of total healthcare costs OOP, compared to an average of 13% in the OECD (Kosovo Women's Network, 2016[33]; World Bank, 2020[6]). In a recent population survey, 54% of respondents had never had a general health examination, and only 26% had a doctor when needed in the previous year, citing financial barriers (Kosovo Women's Network, 2016[33]). Corruption is also widespread. Doctors often illegally refer patients from public health to the private clinics in which they work. In 2015, close to one-third of the population admitted having used personal connections or given money or goods to healthcare staff for better services (payments average EUR 63 but can go as high as EUR 600) (FOLIëvizja, 2016[36]). Although legally prohibited, collusion between doctors and pharmaceutical companies is common. Existing drug regulations need to be better enforced, for example via inspections, given a high prevalence of pharmacies selling medication without prescription (Kosovo Women's Network, 2016[33]).

The highly anticipated Health Insurance Fund announced in 2014 needs to be implemented and sustainably financed as important steps towards universal access. The law foresees mandatory enrolment, paid for by up to 3.5% of salaries by both companies and workers. So far, very few details, including information for trade unions and business, have been made public. Transparent communication with all stakeholders will be essential for an eventual launch (Jaha, 2019[37]; Fazliu, 2017[38]). As health costs can affect poverty, the reform should consider financial risk protection. While there seems to be consensus on developing an outpatient drug benefit scheme and on exemptions from premium contributions relying on a combination of means testing and proxy means testing, relevant parameters need to be finalised (World Bank, 2018[39]).

The equity and targeting of Kosovo's social protection schemes can be improved

Kosovo's social protection expenditure is growing but remains low by international comparison. Total social protection expenditure, almost entirely financed by government revenues, grew by four percentage points in 2005-16 but remained below 9% of GDP, compared to the European average of 28%. There are no typical social insurance institutions, apart from the not-yet implemented Health Insurance Fund, or other insurance schemes providing protection against typical social risks, such as unemployment, workplace disability or sick leave. The two programmes with the largest scope are the universal old-age pension and the social assistance scheme that targets households (the only programme targeted at poverty reduction in Kosovo).

Kosovo's tiered pension has recently been extended beyond a basic pension via special schemes for multiple beneficiary groups, many of which constitute powerful interest groups (e.g. former socialist workers, war veterans). This has reduced the equity of social protection and driven up costs. Now, 95% of pensions are financed by general taxes. Some 5% of Pillar I pensioners were unlawfully working or receiving double tax-financed pensions in 2017, and many war veterans exit work to become eligible for benefits. Interest in reform of the insurance model is growing. In November 2018, the Ministry of Labour and Social Welfare proposed a substantial pension reform that would add a pay-as-you-go insurance model whereby current worker contributions pay for current pensions (ESPN, 2018[40]). The proposal would end layering of pensions by establishing universal rules and increasing the income of (average) pensioners. Coverage of the old-age population would remain at 100%, but the basic pension would only be issued to those with incomes under 60% of the median. If accepted, this reform would substantially reduce the short-term burden on the national budget and contribute to decreasing inequality among pensioners. It will be important to prioritise the new model to avoid the implementation delays affecting other reforms (e.g. health insurance).

There is substantial scope to improve the coverage, benefit levels and design of social assistance, especially during the COVID-10 pandemic. The above-mentioned expansion of programmes targeting population groups has crowded out social assistance spending aimed at the poor, which is low and declining. In 2016, spending on the last-resort social assistance scheme (SAS) amounted to 0.48% of GDP, down from 0.69% in 2009. The number of beneficiaries also declined, from over 40 000 households in 2005 to 26 000 in 2017. SAS coverage in 2016 stood at 35.5% for the lowest income quintile, leaving many poor families unassisted, while transfers resulted in only a 1.7 percentage point reduction in poverty, which is less than the regional average reduction of 3.9% and half the reduction observed in the European Union (World Bank, 2019[41]; ESPN, 2019[42]). The government should consider expanding coverage by eliminating categorical eligibility criteria (e.g. exclusion of poor families without children under age 5 or orphans under age 15, or those with more than one individual able to work), which are inexact proxies and disincentives to labour participation. Such criteria should be relaxed and admission procedures for social assistance streamlined, especially during the COVID-19 pandemic. Options for universal means testing and in-work benefits are currently being explored in collaboration with donors, such as the World Bank. Investments in functioning social registries will make targeting easier and save resources in the long term for any social protection scheme.

Ensuring social inclusion of women beyond the labour market

Kosovo has a progressive and advanced Law on Gender Equality codifying equal opportunities for men and women in political, cultural and social life, but men continue to dominate decision making in politics and the private sector. Only 9% of firms in Kosovo have a female top manager, compared to 17% in the OECD (World Bank, 2020[6]). Although at least one-third of seats in national and municipal assemblies are filled by female MPs, as required by a gender quota (putting Kosovo on par with the OECD average), all national parliamentary groups in the previous legislature were chaired by men, and no local council is currently run by a woman (Halini, 2019[43]).There are encouraging signs for change: under the government formed in early 2020, six women were elected to leadership posts – the highest share since the end of the war – including the first female speaker of the assembly (Plesch, 2020[44]). At the time of writing, the gender composition of the new government remains to be determined.

Institutional governance to improve gender mainstreaming in all policies could be further improved. Once developed by ministries, newly proposed laws are shared with the Agency for Gender Equality to ensure gender sensitivity. However, comments are rarely taken on board. The agency's earlier involvement in the development of legislation or greater gender mainstreaming capabilities in government agencies themselves would be preferable.[4]

Achieving social cohesion

Social cohesion in Kosovo has come a long way over the past two decades, moving from violent conflict to international intervention and a transatlantic military presence (North Atlantic Treaty Organization Kosovo Force), a unilateral declaration of independence accepted by the International Court of Justice in The Hague and the signing of the Brussels Agreement in 2013. Yet, divisions along ethnic lines remain in Kosovo, in common with the rest of the Western Balkans. Although apparent elsewhere, tensions between Kosovo Albanians and Kosovo Serbs (the largest ethnic minority at around 8% of the population, according to 2013 data) are most manifest in northern Kosovo, where the influence of Serbia is strong. While Kosovo has achieved some degree of political integration, social, cultural and economic integration is minimal, and communities effectively live side by side (UNDP/FBA, 2019[45]).

Apart from needed political leadership to overcome tensions and initiate a general reconciliation process, Kosovo's youth in particular need to be sensitised to issues of transitional justice and dealing with the past. According to a recent workshop series on social cohesion, Kosovo's youth perceived themselves to be excluded from political processes and how the future is shaped (UNDP/FBA, 2019[45]). Kosovo's education system is characterised by poor inclusiveness and a design that limits contact among ethnic groups. Serbian and Albanian ethnic groups have much higher levels of education than other communities (World Bank, 2019[17]). Textbooks in Serbian and Albanian schools differ in their narratives about the war. The government should invest in developing uniform materials or presenting the interpretations of both sides to illustrate the subjectivity of history (Haxhibeqiri, 2020[46]).

Prosperity – boosting productivity

The Prosperity pillar of the 2030 Agenda for Sustainable Development calls for more broad-based growth that can be shared by all people. The relevance and importance of this goal for Kosovo cannot be understated in light of the strong growth performance and very weak employment and productivity growth in the past decade.

As a relatively young economy, Kosovo is in the process of building the foundations for sustainable economic development. With a narrow productive base, low employment, widespread informality, high emigration and strong reliance on remittances, Kosovo has faced a challenging reform agenda over the past decade. Policies aimed at improving the business environment, strengthening domestic institutions, improving governance and narrowing the infrastructure gap have provided a much-needed boost to investment and exports in recent years. However, progress is needed on all fronts to ensure sustainable and job-creating economic growth.

Kosovo needs to accelerate the transition to a more sustainable economic model driven by productivity-enhancing investment and exports. The economy must continue to implement reforms aimed at improving the business environment, reducing corruption and strengthening contract enforcement. It needs to improve the sustainability and reliability of its energy supply through increased generation capacity, connectivity, energy efficiency and pricing more reflective of costs (Table 11.3).

Table 11.3. Prosperity – three major constraints to a more dynamic economy of Kosovo

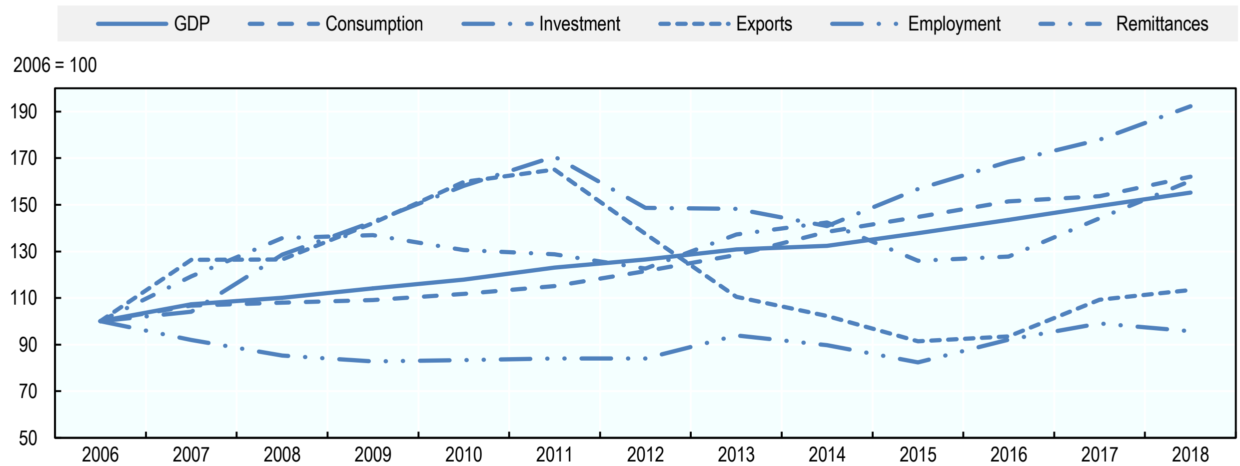
1. Remittances and redistribution through public-sector employment drive consumption and high reservation wages that outpace productivity growth and inhibit job creation.
2. An unreliable electricity supply discourages investment, particularly in the manufacturing sector.
3. A challenging business environment and weak governance increase the costs of investment and operation in Kosovo.

Kosovo's growth model over the past decade has undermined competitiveness and discouraged productivity-enhancing investment and job creation

Over the past decade, Kosovo's economy has grown at an average annual GDP growth rate exceeding 3.5%. The economy grew largely on the back of rising domestic consumption demand, even though the global financial crisis of 2008/09 and Eurozone debt crisis of 2011-12, during which Kosovo saw a slump in exports and investment (Figure 11.8). This performance was largely due to resilient remittance inflows from Kosovo's large diaspora in Germany and Switzerland, strong wage and pension growth and the economy's relative insulation from other critical channels of impact due to its weak trade and financial linkages with the European Union (World Bank, 2020[6]).

Robust growth performance has not been accompanied by an increase in employment (Figure 11.8), nor has it supported the expansion and upgrading of Kosovo's narrow productive base. In fact, Kosovo's remittance-fuelled, consumption-driven economy has contributed to increased reservation wages, which, alongside weak productivity growth, have undermined the economy's competitiveness and discouraged productivity-enhancing investments and much-needed job creation in the private sector. With most of Kosovo's youth either unemployed, inactive or seeking better opportunities abroad, Kosovo has been unable to take advantage of its potential demographic dividend.

Figure 11.8. Kosovo's GDP growth has been resilient to external shocks thanks to strong growth in consumption demand



Note: The index is based on GDP and components in constant LCU, employment in percentage of population age 15+, and remittance inflows in current USD.
Source: World Bank (2020[6]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Domestic demand has largely driven economic growth over the past decade

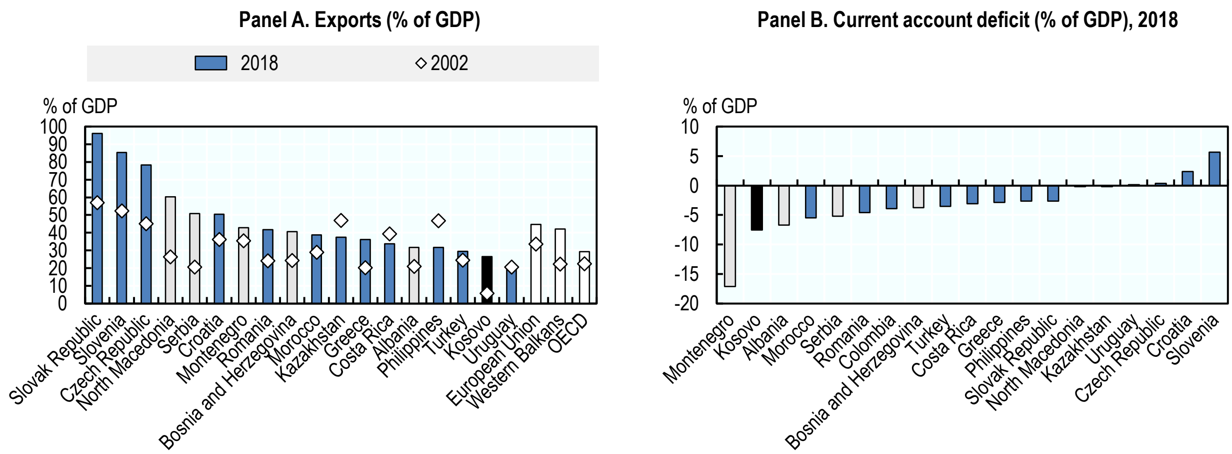
Consumption accounts for the largest share of GDP and has been the main growth driver over the past decade. Between 2008 and 2018, private consumption increased by a cumulative 70% and currently accounts for 86% of GDP. It has been supported by: 1) robust remittance inflows, which contributed 16% to 20% of GDP annually over the period; 2) strong credit growth, which more than doubled over the last decade; and 3) increasing wages, especially those in the public sector, which nearly tripled over the period (Kosovo Agency of Statistics, 2020[5]; World Bank, 2020[6]).

Investment contributed strongly to GDP growth, increasing by over 50% cumulatively between 2008 and 2018. Most of this growth came from private investment (which accounted for about 70% of total investment), particularly domestic private investment, whose growth more than compensated for the decline in FDI, which has nearly halved from the 2008 peak of 9.5% of GDP (World Bank, 2020[6]).

Real exports have declined over the past decade, largely on account of declining global demand and the loss of base metals market share, Kosovo's main export. Total exports nearly halved between 2011 and 2015 and have still not recovered to pre-2011 levels (Figure 11.8). They represent 23% of GDP, considerably lower than observed in most regional and global peers.

Import growth remained strong throughout the past decade and outpaced the growth of exports, as evidenced by net exports' mostly negative contribution to GDP (Figure 11.9). Imports accounted for 56.3% of GDP in 2019 and have been strongly driven by consumption demand due to Kosovo's very limited domestic production base (IMF, 2020[47]). High import dependence and weak export performance have resulted in large trade and current account deficits (30% and 7.6% of GDP in 2018, respectively) – higher than in most regional and global peers (Figure 11.9).

Figure 11.9. The low share of exports in GDP and the high import dependence of consumption have resulted in a high current account deficit



Source: World Bank (2020[6]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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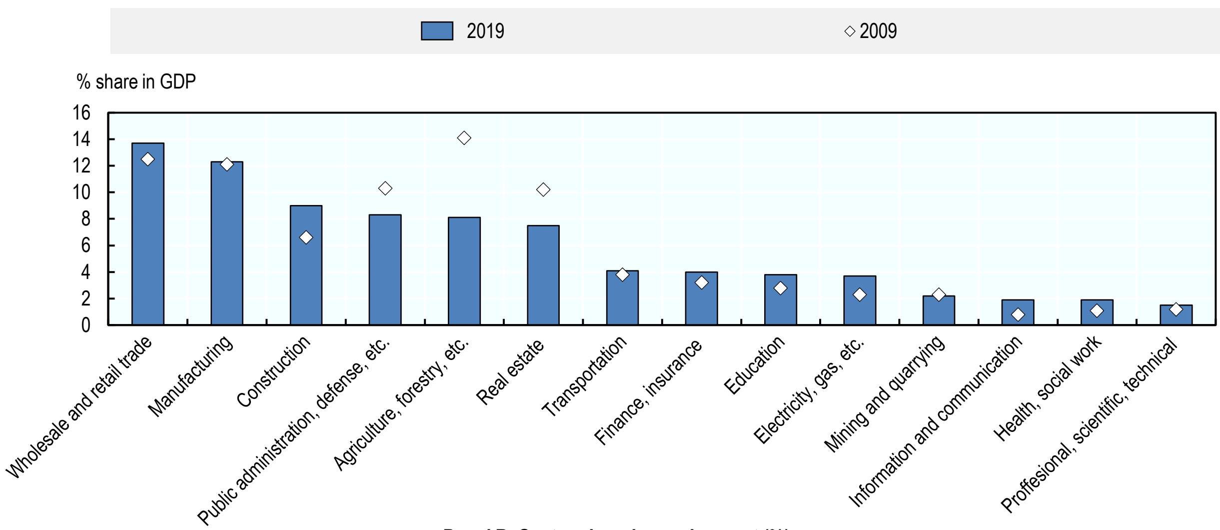
Investment has supported the growth of non-tradable services and real estate

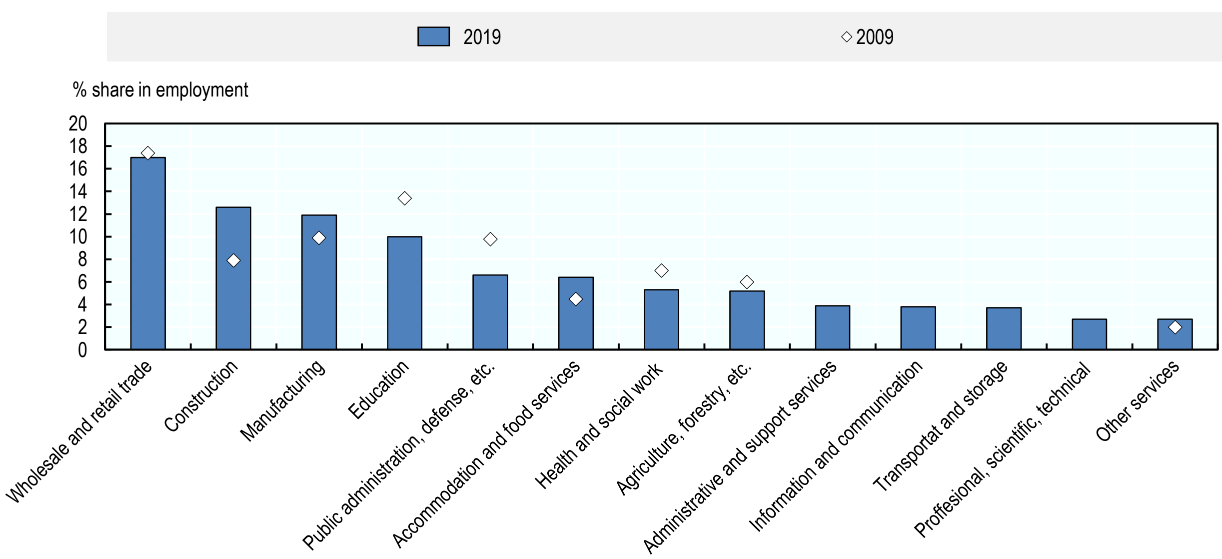
Over the past decade, domestic investment has largely supported the growth of services (Figure 11.10). In line with the economy's high consumption and import dependence, the transport, storage, and trade sectors have grown considerably, increasing their share in GDP and, in most cases, employment. The healthcare and information and communications technology (ICT) sectors have also seen significant growth in terms of value added and employment in the past decade. The construction sector's contribution to GDP has grown marginally, but its employment share has jumped, from less than 1% in 2008 to nearly 12% in 2019 (Kosovo Agency of Statistics, 2020[5]).

Figure 11.10. In the past decade, services accounted for the largest increase in value added, while construction accounted for the largest increase in employment

Panel A. Sector share in GDP (%)



Panel B. Sector share in employment (%)



Sources: Kosovo Agency of Statistics (2020[5]) *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; Kosovo Agency of Statistics (2017[19]), *Series 5: Social Statistics Labour Force Survey 2017*, https://ask.rks-gov.net/media/3989/labour-force-survey-2017.pdf; Kosovo Agency of Statistics (2019[48]), *Labour Force Survey 2018*, https://ask.rks-gov.net/media/5026/labour-force-survey-2018.pdf; Kosovo Agency of Statistics (2010[49]), *Results of the Labour Force Survey 2009*, https://ask.rks-gov.net/media/1691/results-of-the-labour-force-survey-2009.pdf.

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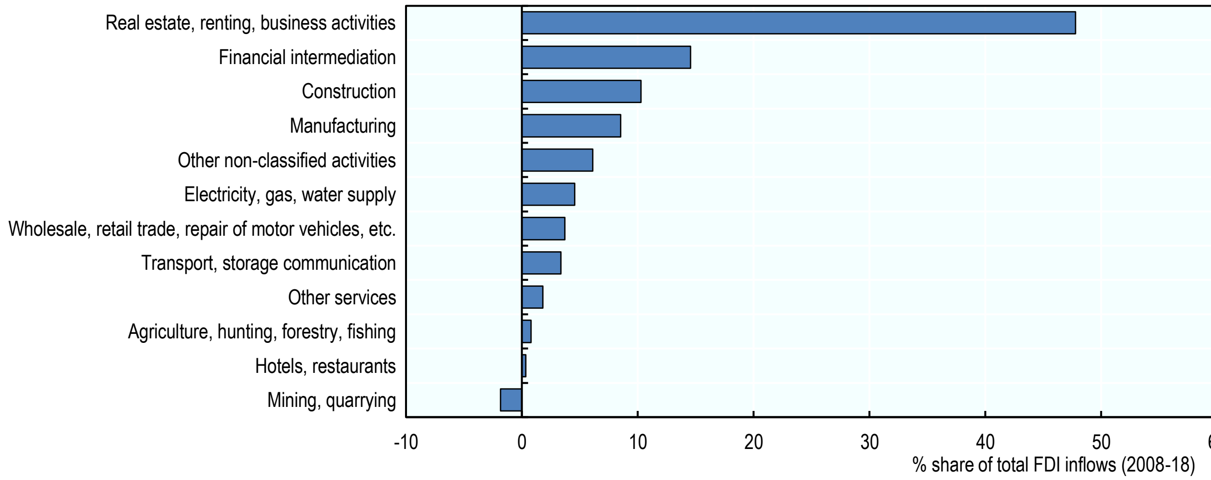
FDI, mostly diaspora-funded, accounts for 4% of GDP and has largely financed real estate and construction activities. Between 2008 and 2018 nearly 60% of FDI went to real estate and construction, and 18% went to the financial sector (Figure 11.11). In 2019, 87% of FDI went to real estate (Kosovo Agency of Statistics, 2020[5]). Housing has also been the dominant investment sector for remittance income, accounting for roughly 20% of remittance spending (Kosovo Agency of Statistics, 2013[50]).

Figure 11.11. FDI has financed non-tradable activities



Source: Kosovo Agency of Statistics (2020[5]) *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312.

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Limited investment in production-oriented activities has translated into stagnation or decline in their contribution to GDP and employment. The manufacturing share in GDP (11%) and employment (10%) have not risen since 2008. Agriculture's contribution to GDP has halved since 2008 (to 7%) and accounts for just 3.5% of formal employment (Kosovo Agency of Statistics, 2020[5]).

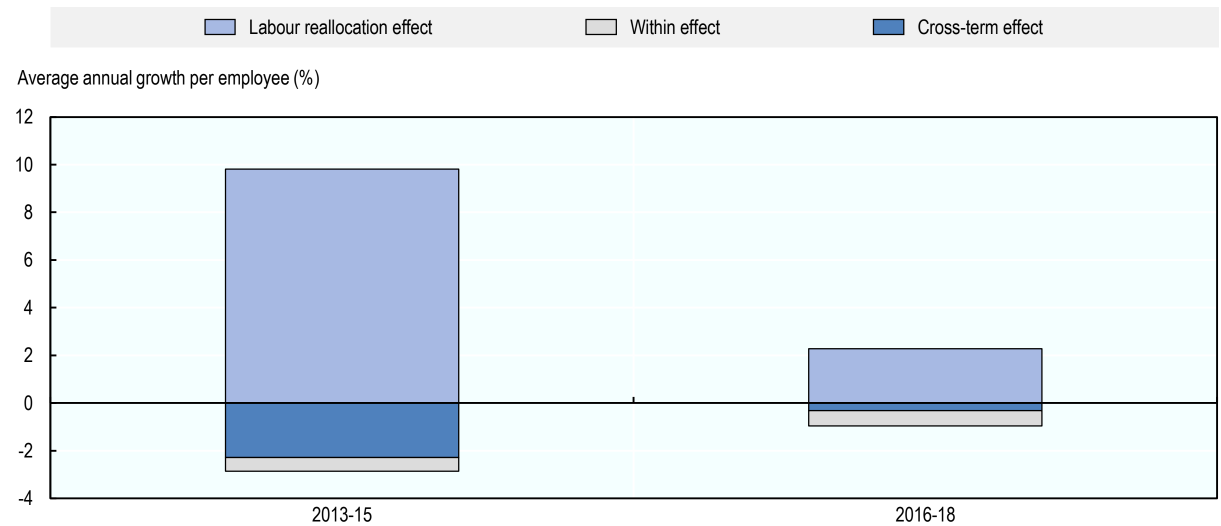
Limited investment in the tradable sector has resulted in weak export growth and limited diversification and upgrading of Kosovo's narrow export base. Exports accounted for just 23% of GDP in 2018, less than half the contributions of regional best performers (Figure 11.9 – Panel A). Kosovo's exports continue to be dominated by base metals, particularly ferro-nickel, which accounted for nearly 50% of total exports. Other exports include mostly low value added products, such as plastics and rubber (13%), processed foods (10%), vegetables (6%) and textiles (3%) (Kosovo Agency of Statistics, 2020[5]).

Low productivity and high wage growth have limited job creation and weakened competitiveness

Kosovo's strong GDP and investment growth over the past decade have not been accompanied by strong job creation. Kosovo's labour market is still characterised by very high unemployment (25.7%) – especially among the young (55%) – feeble employment growth (1.6% over the past ten years) and widespread informality (estimated at 35%). Kosovo also has the lowest labour force participation rate in the world (38.8% in 2019) (World Bank, 2020[6]). Given the young and expanding workforce, emigration has been a release valve from labour market pressures (see the People section in this chapter).

Productivity growth has been very modest and has even declined in recent years. It has largely been driven by within-sector growth, with limited contribution from labour reallocation to more productive sectors (Figure 11.12). The negative cross-term effect indicates that within-industry and shift effects have been acting as substitutes; that is, productivity growth has been positive in contracting sectors and negative in expanding sectors. The largest share of the workforce is still employed in low-productivity sectors (Figure 11.13).

Figure 11.12. Productivity growth has declined in recent years on account of weaker within-sector productivity growth



Note: The labour reallocation shift effect measures the impact on total economy productivity resulting from the movement of labour between sectors. The within-sector effect measures the impact of productivity growth within each sector on total economy productivity growth. The cross-term effect measures the extent to which the former two effects act as substitutes.

Source: Authors' calculation based on Kosovo Agency of Statistics (2020[5]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312.

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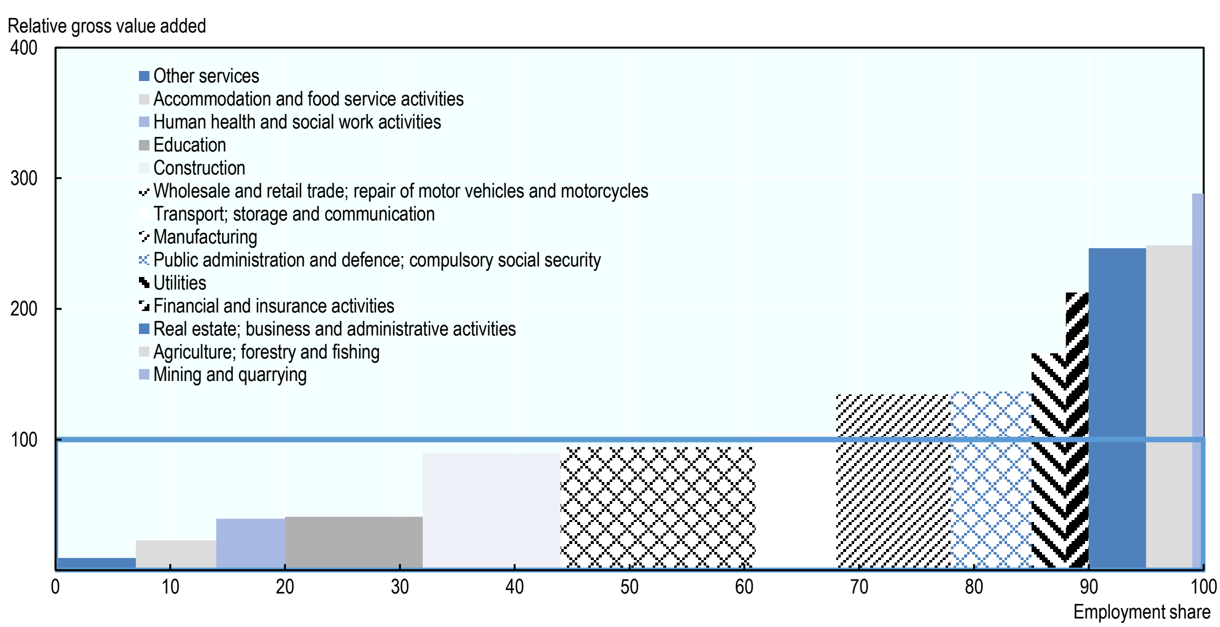
Figure 11.13. Most of the workforce is employed in low-productivity sectors



Source: Authors' calculation based on Kosovo Agency of Statistics (2020[5]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312.

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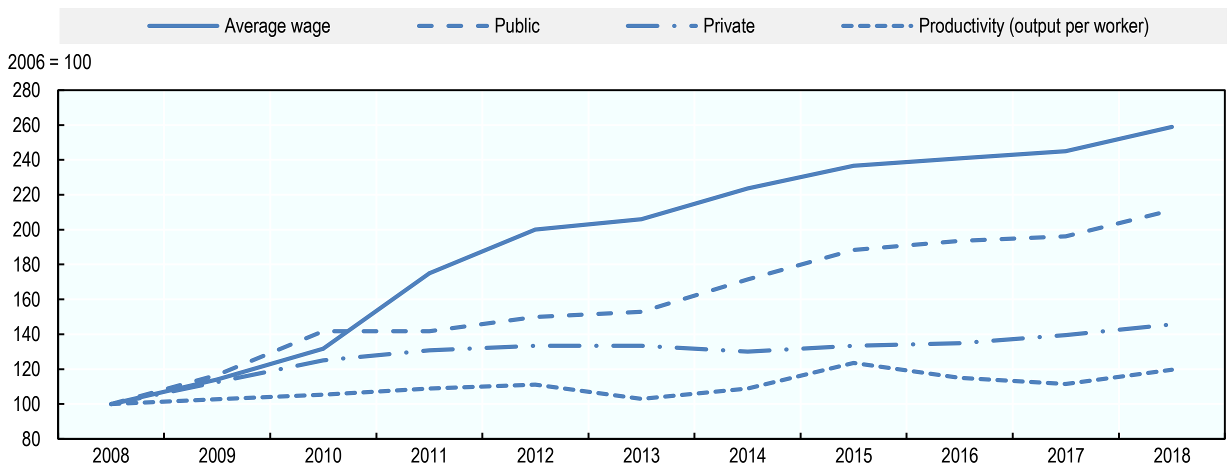
The challenge of job creation in the private sector has been amplified by wage pressures stemming from higher reservation wages.[5] These in turn reflect a strong rise in public-sector wages, which nearly tripled between 2008 and 2018 (Kosovo Agency of Statistics, 2020[5]), and high remittance income, which has reached an estimated 25% of Kosovo households and has contributed to over one-third of their total monthly expenditures (Kosovo Agency of Statistics, 2013[50]; Rudi, 2014[51]).

Figure 11.14. Labour cost competitiveness has weakened on account of high wage growth and very limited productivity growth



Source: Kosovo Agency of Statistics (2020[5]) *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312.

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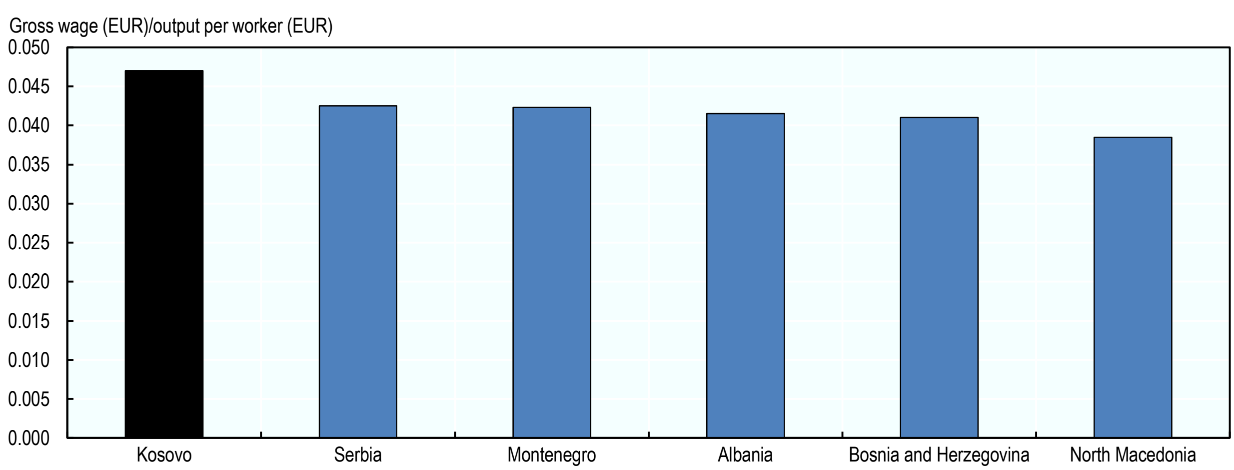
Higher wages have also contributed to weakening labour cost competitiveness, as they have not reflected productivity growth (Figure 11.14). As a result, even though in nominal terms Kosovo's average wage is lower than that of other Western Balkan economies, it has the highest labour costs per unit of output in the region (Figure 11.15).

Figure 11.15. Kosovo has the highest wage-to-productivity ratio in the region



Sources: Kosovo Agency of Statistics (2020[5]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; World Bank/Vienna Institute for International Economic Studies (2020[23]), *SEE Jobs Gateway Database* (database), https://data.wiiw.ac.at/seejobsgateway.html.

StatLink https://doi.org/10.1787/888934243657

In light of Kosovo's unilateral adoption of the euro and the resulting inability to access monetary policy instruments, regaining labour cost competitiveness without painful adjustments in wages would require faster growth in productivity compared to wages. This will be more challenging if the reservation wage continues to increase, elevating the importance and urgency of addressing obstacles to productivity-enhancing investment and reigning in public-sector wage growth.

Towards more sustainable growth

Kosovo's current economic model is overly dependent on consumption and remittances, supporting poverty alleviation but making transformation challenging. The current model has provided for continued economic growth, and remittances have played an important welfare function by increasing the living standards of many families and alleviating poverty. At the same time, emigration provides a release valve for a labour force with limited domestic job prospects. However, like in other economies with similar characteristics, high remittance inflows in Kosovo have also pushed up relative prices in the non-tradeable sectors, including wages and property prices, which in turn increases the costs of domestic productive activities that are in competition with imports and global markets (Gammage, 2006[52]; Acosta, Lartey and Mandelman, 2009[53]; Basnet, Donou-Adonsou and Upadhyaya, 2019[54]). While this has likely supported the development of financial-sector activities and other non-tradeable services to the domestic economy, it has stood on the way of transforming the economy towards broad-based inclusiveness and job creation.

At the same time, the long-term outlook for remittances is declining. Kosovo's demographics are declining as fertility rates decrease. Experiences in other economies point to a likely gradual decline in remittances as emigrants become more integrated into host countries (see the Partnerships and financing section in this chapter) and ties with Kosovo loosen, especially among second-generation Kosovars abroad.

Kosovo's objective must be to maintain the benefits of the current model while building a more dynamic and productive economy focused on capabilities to make up for high costs. Strengthening linkages with the diaspora will become increasingly important, particularly as family linkages tend to weaken. Initiatives can serve to channel remittances towards economically and socially beneficial investments, as practiced in El Salvador, for example (Gammage, 2006[52]). Yet, the bulk of the economic strategy must focus on strengthening Kosovo's potential, first and foremost by creating targeted capabilities and competences among firms and the workforce but also by a concerted drive for better business conditions. As Kosovo does not have its own currency, it must make up for the disequilibrium between tradeable-sector and non-tradeable-sector wages through increased capability and productivity in the latter. This will require a focus on strategy, education and training and an acceleration of reforms.

With a capability strategy, Kosovo can unlock potential in several export areas. Analyses of Kosovo's current goods exports basket and other endowments indicate considerable long-term export potential for the automotive industry (vehicle and engine parts), various other machinery and metal products. Significant short-term gains can be achieved through increased exports of car seats, chemical products (e.g. cleaning products), metals and metal-based products (e.g. aluminium bars), wood-based products (e.g. toilet paper) and agro-processing products (e.g. cheese, animal food) (OECD, 2019[55]). Services exports have grown strongly over the past few years, and revealed comparative advantage data points to strong potential in ICT, finance and insurance, transport and travel services (World Bank, 2017[56]).

A more reliable electricity supply can improve investment prospects

Unreliable electricity supply is a considerable obstacle to doing business in Kosovo and a significant deterrent to investment, especially for the manufacturing sector. In the 2019 Business Environment and Enterprise Performance Survey (BEEPS), 63% of firms identified electricity as a major constraint to their businesses – nearly three times as many as in Europe and Central Asia (ECA). The proportion was even higher among manufacturing firms: 78%, compared to 28% in ECA.

Some 60% of firms noted that they had experienced electrical outages over the past year, twice the average share in ECA, and the average cost of outages (in percentage of annual sales) was about 3.5 times higher in Kosovo compared to ECA. These problems were more pronounced for manufacturing firms, which recorded losses of about 4%, of total annual sales compared to a 1.3% ECA average (World Bank/EBRD/EIB, 2019[57]).

Challenges in the electricity sector reflect a coalescence of factors, including insufficient and unreliable supply from old and outdated coal power plants, inefficient energy consumption, limited scope for importing electricity and underdeveloped alternative sources of domestic electricity generation or energy supply (e.g. natural gas) (World Bank, 2018[58]).

If the government decides not to continue to pursue building a new lignite power plant, as indicated during interviews conducted for this report, and if one of the two existing lignite plants, which currently supplies one-third of Kosovo's electricity, is decommissioned as planned, supply will become even more constrained. In the absence of significant new power generation capacity and better integration in regional power markets, this constraint will likely intensify.

Power generation capacity will likely need to come from alternative (mostly renewable) sources, given the limited scope for financing from international financial institutions for lignite power plant projects. A recent study noted that Kosovo's significant potential in wind and solar power and its improved connectivity with hydropower-rich Albania could provide for a feasible energy transition path away from dependence on highly polluting lignite thermal power (Buck et al., 2018[59]).

In the context of further, especially near-term constraints on supply, improving the efficiency of electricity consumption will also be critical, particularly in light of the high intensity of consumption supported by low electricity tariffs. More cost-reflective pricing will improve funding for rehabilitation or new investments in the power sector and is an important consideration for fiscal sustainability (see the Partnerships and financing section in this chapter). As outlined in the ERP, the government is engaged in efforts to promote energy efficiency, but activities are largely focused on public-sector infrastructure, with limited incentives for efficiency improvements in the residential and private sectors. While Kosovo has made some progress in phasing out cross subsidies among categories of customers, the retail market is only partly deregulated (European Commission, 2020[60]).

Balancing this benefit against the government's objective of maintaining affordable electricity for households will require careful consideration. Targeted support for the most vulnerable families could be among the most cost-effective and sustainable solutions to Kosovo's energy problem (IMF, 2018[61]).

Strengthening governance and improving the business environment will reduce the cost of doing business in Kosovo and enhance trust in institutions

Improving governance and resolving outstanding obstacles in the business environment is essential for boosting productivity, investment and job creation, as well as reducing informality. Kosovo has made significant improvements in this area, especially in facilitating the process of starting a business (Kosovo ranks 12th out of 192 economies on this indicator in the Doing Business ranking) (World Bank, 2020[62]). However, operating and growing a business in Kosovo appears to be challenging on a number of fronts.

Corruption and weak contract enforcement

Widespread corruption undermines trust in institutions and increases the risk premium for investment in Kosovo. In the latest BEEPS, 56% of firms identified corruption as a major obstacle, compared to the 20% ECA and 33% global averages (World Bank/EBRD/EIB, 2019[57]). Analyses of corruption in Kosovo point to a considerable lack of transparency and accountability in the public administration, which leaves room for corruption and lack of prosecution and sanctioning of corruption. The judiciary, customs, public utilities and procurement are identified as the sectors with the highest incidence of corruption (GAN Business Anti-Corruption Portal, 2020[63]).

The inefficient and corrupt court system contributes to unpredictable, lengthy and costly contract enforcement, which is an important constraint for Kosovar businesses and an important deterrent for investment in Kosovo. Some 43% of respondents in the BEEPS identified the court system as a major obstacle – three times higher than in ECA.

The administrative and bureaucratic burden remains high

Despite some progress in this area, businesses operating in Kosovo deal with an excessive and costly administrative burden. Firms surveyed in the latest BEEPS related that senior management spends, on average, 10% of the time dealing with requirements related to government regulations, which is considerably higher than regional best performers Montenegro (1.5%) and North Macedonia (2.5%). The areas of tax administration and obtaining licenses and permits were noted as particularly burdensome (World Bank/EBRD/EIB, 2019[57]).

Kosovo does not stand out in the Doing Business ranking as having a particularly problematic tax administration system in terms of time, cost and number of procedures to file taxes. In fact, Kosovo scores better on most of these indicators than the ECA and OECD on average, although it lags behind global top performers. However, the BEEPS points to a significantly higher burden in terms of the requirement to meet with tax officials (83% of businesses) and the number of times such meetings occur (about three times). This also gives scope for corrupt behaviour, which might help explain the much higher share of Kosovar businesses that identified tax administration as a major constraint (39% in Kosovo vs. 20% in ECA) (World Bank/EBRD/EIB, 2019[57]).

Some 44% of surveyed firms identified obtaining licenses and permits as a major obstacle, which is comparably higher than the ECA and global averages of around 33% (World Bank/EBRD/EIB, 2019[57]). Construction permits appear to be most problematic, requiring 18 procedures, involving at least 7 institutions or companies, taking 237 days (compared to 170 in ECA on average) and costing roughly 25% more than the ECA average (World Bank, 2020[62]). This problem may reflect weak capacities at the local administration level, where the longest delays take place. Likewise, the high costs may relate to the broader challenge of insufficient funding at the municipal government level.

Partnerships and financing – financing sustainable development

The Partnerships and financing pillar of the 2030 Agenda for Sustainable Development cuts across all goals focused on the mobilisation of resources needed to implement the agenda. It is underpinned by the Addis Ababa Action Agenda, which provides a global framework to align all financing flows and policies with economic, social and environmental priorities.

Kosovo faces a few critical financing challenges. On the private-sector side, the consumption-driven economy has strongly relied on external financing from the diaspora, but these inflows have been declining and cannot be sustained over the long term in light of demographic trends. Even though credit growth has been strong and access to finance has expanded over the past decade, enterprises, especially SMEs, face considerable obstacles to obtaining credit. On the public-sector side, revenue performance needs to be improved considerably, especially with respect to the collection of personal and corporate income tax revenues, and expenditures need to be directed more towards productivity-enhancing investments and away from growing current expenditures on wages and transfers.

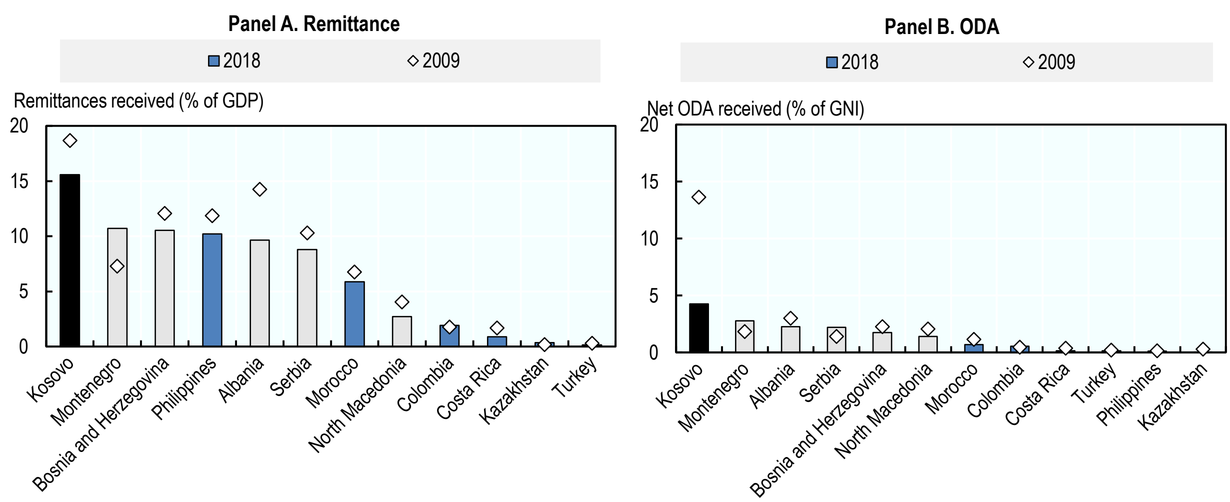
Table 11.4. Partnerships and financing – four major constraints to financing development in Kosovo

1. Kosovo's economy lacks diversified financing for investment and growth.
2. Revenue performance has been weak on account of low tax rates, a limited tax base and inefficient tax collection.
3. Government current expenditures have crowded out investment in priority areas for development.
4. Access to finance is constrained, particularly for SMEs.

Kosovo's economy needs more diversified financing for investment and growth

Over the past decade, Kosovo's largely demand-driven economy has relied strongly on external financing from its diaspora and relatively high foreign aid inflows. In the period following the declaration of independence, remittances amounted to 18% of GDP on an annual basis, diaspora-financed FDI reached a high of nearly 10% of GDP and overseas development assistance accounted for nearly 14% of GDP and 30% of investment. This income was considerably higher than in other regional and global economies (Figure 11.16).

Figure 11.16. Remittance and overseas development assistance financing contributions to GDP have declined considerably over the past decade but remain high compared to peers



Notes: GNI = gross national income. ODA = overseas development assistance.
Source: World Bank (2020[6]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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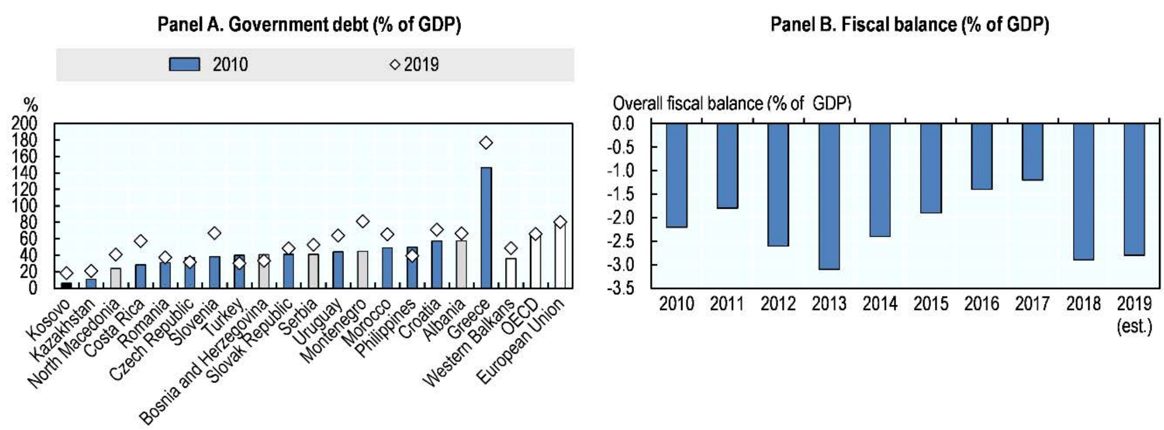
The remittance and ODA contribution to GDP has declined considerably over the past ten years, and the long-term prospects are weak, especially in light of demographic trends. Due to declining fertility rates (World Bank, 2020[6]), Kosovo's population growth has slowed down notably over the past decades, and the population size is projected to fall below the current 1.8 million people by 2040 (Kosovo Agency of Statistics, 2020[5]), effectively reducing the pool of potential emigrants. Likewise, as current and future emigrants become more integrated into host countries, their relatively weaker connection to their home country further reduces the long-term prospect of diaspora financing for the Kosovo economy (Havolli, 2009[64]).

Although domestic savings (21% of GDP) are relatively high compared to most peers (World Bank, 2020[6])**, domestic private investment is modest, and attracting investment in production- and**

export-oriented activities has been challenging. As elaborated in the Prosperity section in this chapter, considerable institutional and administrative barriers, infrastructure deficiencies and weaker labour cost competitiveness compared to regional peers have hampered domestic private investment and deterred attraction of non-diaspora-financed foreign capital, especially in the tradable sector.

Public debt has increased considerably since 2010. The fiscal balance has been consistently negative and, in most years, has surpassed the fiscal rule deficit limit of 2% of GDP (Figure 11.17). The deficits have largely reflected higher current spending, which has exceeded revenue performance. Even though, at around 18% of GDP, public debt is low compared to regional peers, the rapid increase over the past seven years (from 5.9% in 2010) has contributed to higher financing risks and more limited fiscal space to address urgent economic needs, like the ongoing COVID-19 crisis (IMF, 2020[65]).

Figure 11.17. Public debt (% of GDP) is relatively low but has risen significantly since 2010 on account of negative fiscal balances



Source: IMF (2021[66]), "World Economic Outlook Databases", webpage, https://www.imf.org/en/Publications/SPROLLs/world-economic-outlook-databases#sort=%40imfdate%20descending.

StatLink https://doi.org/10.1787/888934243695

Rollover risks have increased due to the prevalence of short-term debt and the low diversification of financing sources. Due to its unresolved status, Kosovo does not have a sovereign rating, which effectively limits the government's access to financing from international financial markets. As a result, most of deficit is financed locally through borrowing from banks operating in Kosovo (those with EU parent banks have a 100% risk weighting on Kosovo government bonds), the Central Bank of Kosovo and the pension fund (IMF, 2018[61]). However, scope for additional borrowing from these entities is relatively limited: bank exposures to domestic government debt are assessed to be at their limit, and the Kosovo pension fund has surpassed the exposure limit of 30% of total government securities holdings (IMF, 2020[67]), which will likely worsen as a consequence of the ongoing COVID-19 crisis. The scope for diversification of public-sector financing sources (e.g. more domestic institutional investors, individuals, enterprises) remains high.

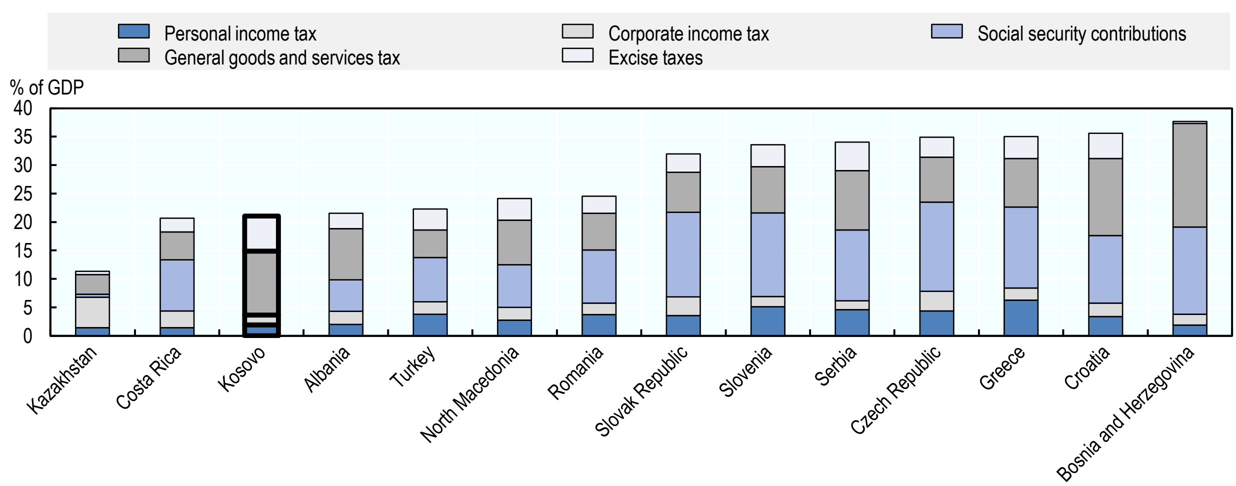
International financing has mainly come from the International Monetary Fund (IMF) and other donors. Kosovo is also eligible for overseas development assistance (ODA) financing on blend terms, which can help mitigate the limitations stemming from the lack of access to international markets for the time being (IMF, 2020[67]).

Revenue performance has been weak on account of the low tax rates, limited tax base and inefficient tax collection

Taxes account for 93% of government revenue. Weaknesses in tax revenue performance therefore have strong implications for the government's capacity to provide quality public services and to invest in education, health, infrastructure and other areas that are key for Kosovo's sustainable economic development (IMF, 2020[65]).

Tax revenues increased somewhat over the past decade (from 21% to 23% of GDP) but are considerably less than in most regional and global peers (Figure 11.18). Kosovo relies significantly more on indirect taxes (value added tax [VAT] and excise taxes) and less on personal and corporate income tax revenues and social security contributions compared to most peers, which makes its tax revenues more susceptible to consumption and import fluctuations. This reflects, to a large degree, the economic structure: a consumption-driven economy highly reliant on imports with weak domestic productive capacities (see the Prosperity section in this chapter). In fact, border VAT is currently by far the largest contributor to tax revenues in Kosovo currently (IMF, 2020[65]).

Figure 11.18. Tax revenues are low and rely more on indirect tax income compared to most peers



Source: IMF (2020[65]), *Government Finance Statistics Yearbook Query – Revenue* (database), https://data.imf.org/?sk=FA66D646-6438-4A65-85E5-C6C4116C4416.

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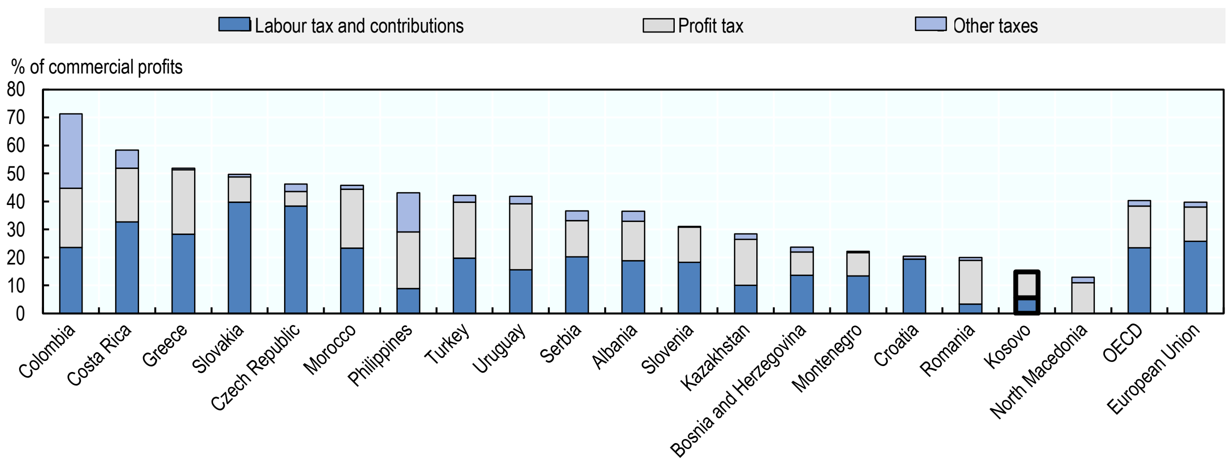
Kosovo's lagging revenue performance with respect to peers and more advanced economies reflects low tax rates (Figure 11.19), tax exemptions (especially regarding corporate income tax), a low tax base due to the large informal economy, and significant tax evasion resulting from the tax authority's weak enforcement capacities. Tax gaps due to these factors are estimated to be high across all tax types. Personal and corporate income tax gaps are estimated at about 75% and 17% of potential revenues, respectively, while the VAT tax gap is estimated at 34% of the potential revenue (World Bank, 2014[68]).

Formalisation is a key strategic government priority. A new strategy to tackle informality, adopted in May 2019, sets clear targets for reducing the size of the informal economy and informal employment and confiscating assets in key sectors of criminal activity. It envisages progress in the development of the business registry, reduction of cash-based payments, improved co-operation between the tax authority and law enforcement, and more effective labour inspections. However, these efforts need to be complemented by measures to improve the business environment and incentives for formal employment (European Commission, 2020[60]).

Figure 11.19. Tax rates are low compared to most peers



Source: World Bank (2020[6]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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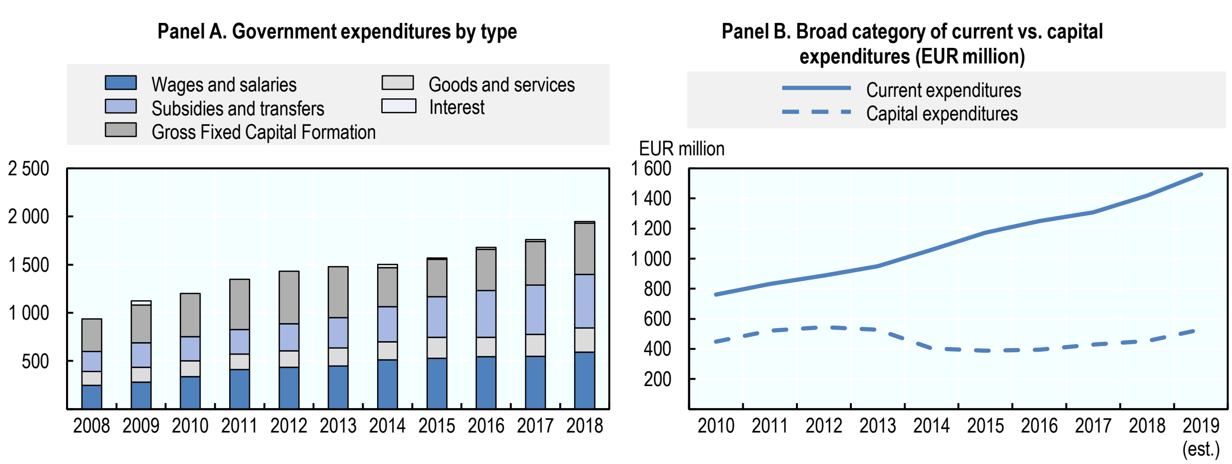
Government current expenditures have crowded out investment in priority areas for development

Over the past decade, the share of current spending in total government expenditures increased from 65% to 73%, largely due to increased spending on wages and social security benefits for war veterans (Figure 11.20). The higher wage bill reflects an increase in public-sector employment, which rose from 7% in 2008 to 9% in 2018, and an increase in wages (see the Prosperity section in this chapter). Public-sector wages nearly tripled over this period and are now, on average, 50% higher than private-sector wages. Social security benefits, most of which go to war veterans, have also increased significantly, from 14% of total expenditures in 2008 to 25% in 2018 (Kosovo Agency of Statistics, 2020[5]; IMF, 2020[67]).

Figure 11.20. Current expenditures have increased significantly, largely at the expense of capital expenditures



Note: Kosovo statistics data were used until 2015; IMF data were used for 2016-18.

Sources: Kosovo Agency of Statistics (2020[5]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; IMF (2020[69]), *Government Finance Statistics* (database), https://data.imf.org/?sk=89418059-d5c0-4330-8c41-dbc2d8f90f46.

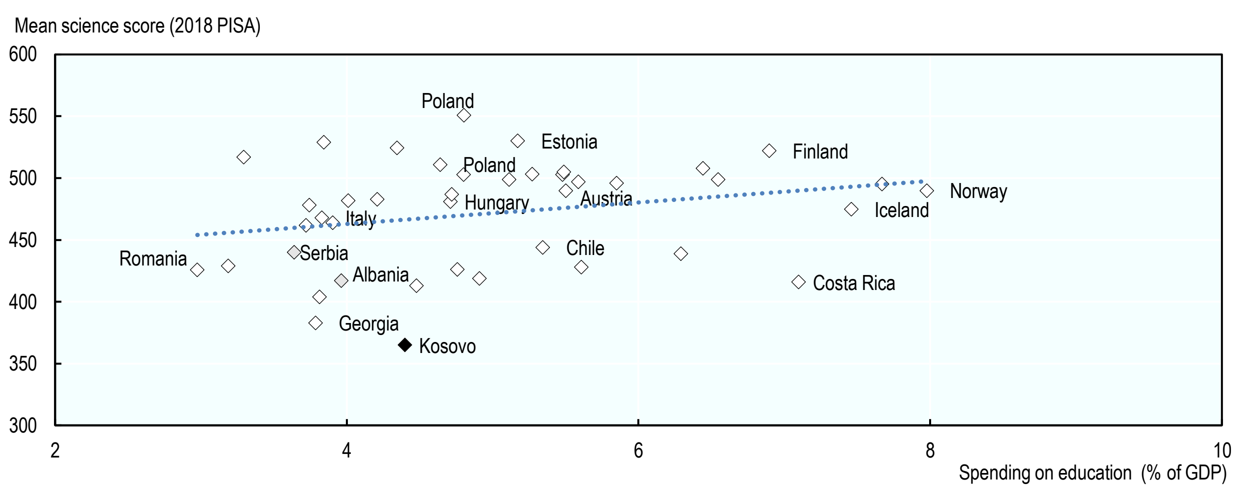
StatLink https://doi.org/10.1787/888934243752

Increases in public spending have come at the expense of capital expenditures. The share of capital expenditures in total government expenditure, while high by regional standards, has declined in recent years, from 37% in 2010 to 27% in 2018 (12% to 7% of GDP). Government capital expenditures barely increased in nominal terms over this period, while current expenditures almost doubled (Figure 11.20 – Panel B) (IMF, 2020[69]; Kosovo Agency of Statistics, 2020[5]). The increase in veterans' benefits has crowded out spending on other social programmes aimed at the poor (e.g. SAS) (World Bank, 2019[41]).

These trends, particularly the introduction of war veteran benefits in 2014, have long-term fiscal and economic implications. Not only have very generous benefits (guaranteed pension, healthcare benefits, free public transport, etc.) been granted to a large number of beneficiaries, but benefits can be inherited by family members of war veterans. They also create significant disincentives for labour market participation, as veterans or their family members cannot receive or inherit the pension income if they are employed. This has implications for both economic development and tax revenues (Republic of Kosovo, 2014[70]).

Spending on education, health and social protection has increased over the past decade, but at 4.4% 2.5% and 6.5% of GDP, respectively, it is relatively low (see the People section in this chapter). The weak progress in outcomes suggests that the efficiency of this spending needs to be improved, particularly for education (Figure 11.21).

Figure 11.21. Public-sector spending on education does not translate into strong education outcomes



Note: Data on public spending on education were not available for Kosovo in the World Bank World Development Indicators database. The data point for Kosovo was calculated based on data from the KAS.

Sources: Kosovo Agency of Statistics (2020[5]), *Askdata* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; OECD (2020[24]), *PISA* (database, www.oecd.org/pisa/data/; World Bank (2020[6]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

StatLink https://doi.org/10.1787/888934243771

Access to finance is particularly constrained for SMEs

Kosovo's financial sector is well developed, and strong credit growth (from 4% of GDP in 2002 to 44% in 2018) has supported the robust consumption and investment growth that has driven Kosovo's economy over the past decade. Most of the financing (93% of total loans) comes from Kosovo's largely foreign-owned banking system, supported by financial deepening, declining interest rates (from 11.0% in 2014 to 6.5% in 2019 (IMF, 2020[71]) and low and declining NPLs (currently 2.5% from a high of 8.5% in 2013) (Central Bank of the Republic of Kosovo, 2020[72]).

Most of the financing has gone to the private sector, but the share of lending to the government has increased significantly over the past decade, in line with the sharp increase in public debt. Lending to the government increased from 2% of total loans from the banking sector in 2010 to 22% in 2019 (Central Bank of the Republic of Kosovo, 2020[72]).

Enterprises still account for the majority of private-sector lending (66% of total private-sector loans), even though their share has declined somewhat over the past decade in favour of higher credit to households, which increased from 29% to 34% of total private-sector lending (Central Bank of the Republic of Kosovo, 2020[72]). Unsurprisingly, most of the lending to enterprises has gone to the most dynamic retail and wholesale trade sectors (32% of total loans) and other services (12% of total loans), while the manufacturing sector received 10% of total loans (IMF, 2018[61]). SMEs account for 23% of total loans (IMF, 2020[73]).

Despite the relatively strong performance of the banking sector and robust credit growth over the past decade, access to financing remains a key constraint to investment and growth. In the latest BEEPS, 47% of surveyed firms in Kosovo identified this issue as a major obstacle (compared to a 17% ECA average). The proportion was higher among SMEs, which need more bank financing and have more limited scope for internal financing of investments (World Bank/EBRD/EIB, 2019[57]).

Collateral requirements appear to be a key obstacles to obtaining credit. Firms noted that over 90% of loans require collateral (compared to 73% in ECA), and the collateral value is 269% of the total loan (compared to 178% in ECA) (World Bank/EBRD/EIB, 2019[57]). The high collateral requirements reflect outstanding problems with property rights, as considerable post-war construction was completed speedily by largely unlicensed developers without relevant documentation. As a result, many apartments have been sold and occupied without official titles (see the Peace and institutions section in this chapter). In smaller towns, collateral values are highly discounted due to difficulty reselling properties on account of the stigma associated with buying neighbouring properties (EIB, 2016[74]).

Peace and institutions – strengthening governance

The Peace and institutions pillar of the 2030 Agenda for Sustainable Development encompasses peace, stability and accountability, as well as effective governance and the performance of the public sector more broadly.

As an economy, Kosovo is one of the most ambitious and recent institution-building projects. At the end of the war and following the declaration of independence in 2008, many expected the former Yugoslav province to implode under the multiple pressures. However, apart from the 2004 riots, internal and regional conflicts have been avoided, and Serbian-majority municipalities in North Kosovo have gradually been integrated into the formal institutional framework. The national assembly and the government function, albeit struggling with political instability and the constitution explicitly provides legal safeguards to the independence and impartiality of judges.

In spite of remarkable progress, ethnic tensions weigh on Kosovo, and trust in formal institutions remains low. Since 2018, Kosovo has registered the highest number of attacks – mostly in Mitrovica, Peć (on the border with Montenegro) and Priština – targeting minority groups and their property among Western Balkan economies (Raleigh et al., 1010[75]). Newly established formal institutions are not always able to answer the needs of Kosovars. As a result, citizen trust in the national government, although in line with the regional average, is decreasing. Only 32% trust courts.

Informal institutions are stronger in Kosovo than elsewhere in the Western Balkans. Close-knit communities, often based on kinship and with strong expectations of solidarity among members, often work as a parallel social safety net (Efendic and Ledeneva, 2020[76]).[6] Their secular or religious leaders are often called on to mediate disputes for which formal institutions do not have capacity. Looking ahead, informal institutions can complement formal ones, benefiting citizens and the efficiency of the public administration. For example, they can improve the working of the judiciary and the regulation of property rights. Doing so depends on Kosovo's ability to regulate and integrate informal mechanisms into formal ones and on the capacity of formal institutions to implement policies efficiently and transparently – premises not entirely satisfied today.

Capacity gaps hinder the functioning of formal institutions and make informal practices more appealing. Human and financial capacity is sometimes insufficient for the appropriate implementation of laws. For example, the judiciary lacks trained members of the court. Co-ordination among administrative units is also problematic: multiple accountability lines may undermine the effectiveness of the cadastre, for instance. Hasty and approximate drafting of laws may create ambiguities and leave room for contradictory by-laws issued by the executive, contradictory interpretations by the courts and incomplete implementation by agencies. Administrative and legislative hiccups trickle down to citizens, who may rely on the more efficient and familiar informal institutions to get things done.

The prospect of access to the European Union can play an ambivalent role in the relationship between formal and informal institutions. To signal their commitment to the European Union, voters and the international community, past governments have introduced stricter laws than originally requested and which outpaced capacity. This contributed to the adoption of laws that could not be implemented due to lack of administrative capacity to monitor compliance or citizen capacity to comply. These laws thus became “empty shells” to circumvent, often via informal practices (Lavrič, Senjković and Klanjšek, 2019[77]).

Informal networks can be a burden. They can facilitate access to services or jobs, but in exchange for favours, money or gifts, weighing significantly on household or enterprise budgets. According to the World Enterprise Survey, 56% of firms identify corruption as a major constraint, far higher than the regional average (28%). Political parties have used informal networks to gain electoral support in exchange for transfers of resources or jobs in the public sector. Political patronage has inflated the state apparatus, further hampering implementation capacity at the local and central levels and undermining the competitiveness of POEs.

Addressing informal institutions and their integration into formal ones is a key priority that could unblock Kosovo’s development along six dimensions (Table 11.5).

Table 11.5. Peace and institutions – six major constraints to improving the institutional setting in Kosovo

1. An overly complicated structure and political interference may undermine the effectiveness of the public administration.
2. The current form of decentralisation creates incentives for patronage instead of spending on public goods.
3. The judicial system is formally strong but remains inefficient and too exposed to interference.
4. Lack of accountability and financial mismanagement in POEs may undermine macroeconomic stability.
5. Property rights remain insecure, mainly due to faulty registration procedures and lack of awareness about existing laws.
6. Shortage of human resources and insufficient methodological standards impede the quality of statistical products.

An overly complicated structure and political interference may undermine the effectiveness of the public administration

The public administration in Kosovo has become overly complex. The number of ministries, for example, increased from 12 in 2002 to 22 (and 70 deputy ministers) in 2017, often to iron out political tensions that could have threatened the stability of the executive. Similarly, agencies have been established on a case-by-case basis, leading to their rapid proliferation: today, Kosovo has 80 agencies employing around 27 000 employees or one-third of total public employees. Principles guiding agency establishment, organisation and oversight seem to be missing (OECD/SIGMA, 2019[78]).

The inflation of the public administration has resulted in a fragmented organisation of the central government, loss of accountability and reduced effectiveness in executing public policy. Some bodies face duplication or confused reporting lines (OECD/SIGMA, 2017[79]), which favours inaction and creates obstacles to the smooth flow of information among administrative bodies. According to Article 142 of the constitution, many agencies report to the national assembly, which undermines both the separation of powers and adequate control over their performance of these bodies (Government of Kosovo, 2016[80]).

In the past years, there have been remarkable efforts to enhance the effectiveness of the public administration, but reforms need stronger commitment. The government that took office in June 2020 reduced the number of ministers to 16, which could help streamline the decision-making process and improve co-ordination among departments within so-called "super ministries". An extensive review of the structure and organisation of agencies was initiated in 2018 (Government of Kosovo, 2018[81]), but has halted. A progress assessment is therefore not available. Reforms of the decentralisation framework may be needed to halt the inflation of the public administration at the subnational level, as discussed in the next section.

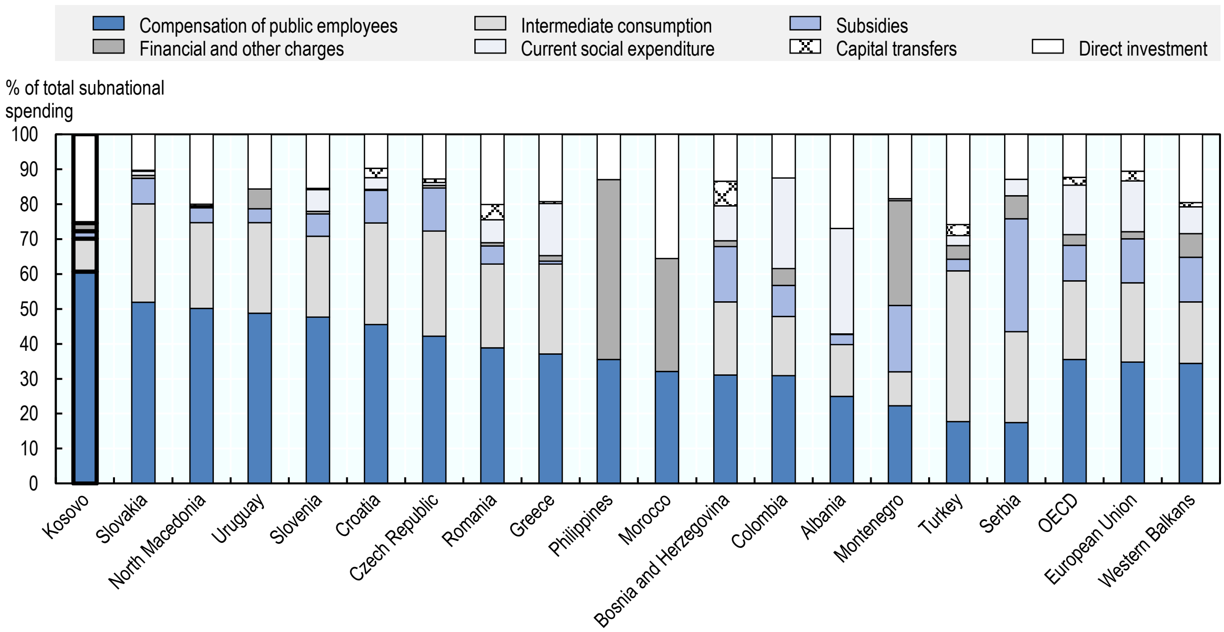
There has been some progress in the reform of the public administration, but implementation remains weak. A new Law on Salaries introduces a more transparent salary system for public officials; however, an unfavourable ruling by the constitutional court and recent government changes have slowed its implementation. More political commitment is needed to adopt all necessary secondary legislation and ensure implementation. Procedures for recruitment to senior management positions in the civil service have improved. However, some senior civil servants might still be appointed or dismissed based on politics rather than skills (OECD/SIGMA, 2017[79]; European Commission, 2020[82]).

The current form of decentralisation creates incentives for patronage instead of spending on public goods

Municipalities are the only level of subnational government in Kosovo. There are 38 municipalities, and their borders largely reflect the distribution of ethnic groups. The 14 municipalities – 4 in northern Kosovo and the rest in enclaves – host 60% of Kosovo's Serb population. Mayors hold executive power for a four-year term and are directly accountable to voters. Municipal assemblies are the legislative bodies. Municipalities are further subdivided into villages and urban areas, which have no formal power but can still influence the decision-making process.

Kosovo is transitioning to a highly decentralised system of government. Since 2008, an increasing number of responsibilities have been transferred from the central to the local level. Today, municipalities manage the education system (from pre-primary to secondary education), primary health care and land, water and wastewater. They also manage cadastral records, business licensing and forestry protection on behalf of the central government. Serb-majority municipalities have enhanced competences in the areas of health, education and cultural affairs.[7] In 2016, the government adopted a strategy and action plan for local self-government for 2016-26 to enhance effective decentralisation (OECD/UCLG, 2019[83]).

Figure 11.22. Local public spending is relatively high but mostly goes to the compensation of public employees



Source: Authors' calculation based on OECD/UCLG (2019[83]), *Report of the World Observatory on Subnational Government Finance and Investment – Key Findings*, www.sng-wofi.org/reports/Key_Findings_2019.pdf.

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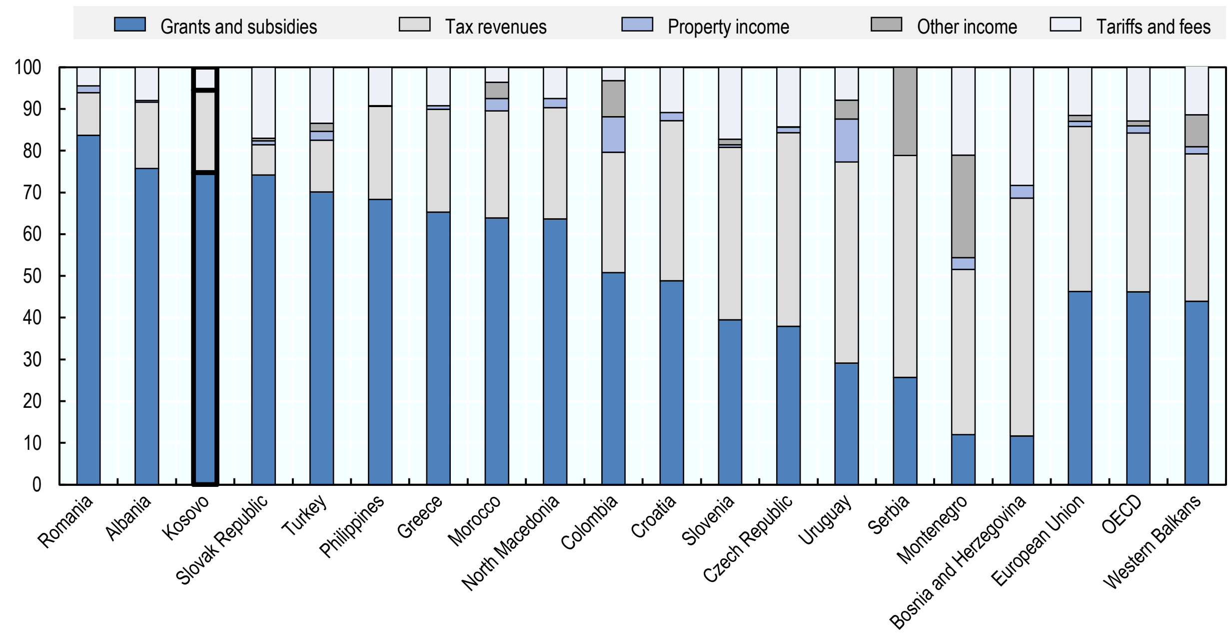
Certain Serb-majority municipalities in the north of Kosovo remain at the centre of a controversy with Serbia. In 2008, these municipalities refused to acknowledge the unilateral declaration of independence of Kosovo and established their own administrative structures (in particular, the parallel police force and courts) under the aegis of Serbia. The 2013 EU-brokered Brussels Agreement, a first step towards the normalisation of the relationship between Kosovo and Serbia, envisaged the dismantling of these parallel administrations and the integration of their staff into Kosovo's formal institutions. In return, Serb majority municipalities would have obtained greater autonomy and the right of self-organising into an "Association/Community of Serb Majority Municipalities in Kosovo". The association would have co-ordinated the economic development, urban and rural planning and provision of education, health and social care services in Serb-majority municipalities. The actual powers of the association, however, were left vague and became a source of unsolved controversy. As a result, negotiations ended in a stalemate, the association still formally does not exist and parallel structures remain in place in the north of Kosovo.

Subnational public expenditure is high (24% of total public expenditure), but 61% of it is spent on compensating public employees. This is unique among Western Balkan and selected benchmark economies (Figure 11.22) and is partly a legacy of the recent past. When teachers, students and medical personnel were expelled from the education and health systems of the former Yugoslavia in the 1990s, a parallel system of schools and clinics emerged (Pula, 2004[84]).[8] These merged with Kosovo's education and health systems in the 2000s. As a consequence, Kosovo now has the lowest pupil/teacher ratio in the region – exceptionally lower than the ratios of many OECD members that attain far higher education outcomes (see the People section in this chapter).

Figure 11.23. Local own fiscal capacity is poor, and municipalities mostly rely on intergovernmental grants



Source: Authors' calculation based on OECD/UCLG (2019[83]), *Report of the World Observatory on Subnational Government Finance and Investment – Key Findings*, www.sng-wofi.org/reports/Key_Findings_2019.pdf.

StatLink https://doi.org/10.1787/888934243809

Local own resources are not enough to cover the large expenses. Tax revenues and tariffs and user fees represent 19.8% and 5.5% of total subnational revenues, respectively.[9] Municipalities mostly rely on intergovernmental transfers, which constitute 75% of subnational income – by far the largest share in the region (Figure 11.23). Half these grants are distributed based on municipal population, size and ethnic composition. Allocation of the Education Grant, for example, is based on a formula that considers teacher, administrator and support staff wages, goods and services, building maintenance and specific education policies (OECD/UCLG, 2019[83]).

Under these conditions, the decentralisation framework in Kosovo is weak and creates the wrong incentives. On the one hand, local governments do not seem to have enough resources (own or unconditionally distributed from the central level) to finance bottom-up projects and grassroots initiatives. On the other hand, mayors can pander to kin members and voters by offering positions in the local education and health system while passing the fiscal buck to the central level (Kosovo Local Government Institute, 2014[85]; USAID, 2017[86]).

Reform of intergovernmental transfers could enhance decentralisation in Kosovo. The weight of general grants could be increased and made dependent on demographic and tax-raising capacities and services needs. The distribution of block grants (targeting local education and health systems, for example) could be more results based and conditional on the achievement of socio-economic targets or on competitiveness scores (e.g. in the Municipal Competitiveness Index, supported by the Millennium Foundation Kosovo). Data used to measure results should be accessible to encourage public scrutiny.

Measures have been taken to limit patronage and its consequences to the size of the local public sector. Concerning education specifically, the hiring of teachers has been decentralised to school boards rather than municipal education directorates in an attempt to de-politicise the process (USAID, 2017[86]).

Yet, interviews conducted as part of this MDR revealed that the governance and political affiliation of school boards can bias the selection of candidates. More generally, an annual ceiling of 0.5% on current local expenditure growth was introduced in 2009, and according to the Law on Public Finance Management and Accountability, municipalities have to publish annual financial reports. However, most lack internal auditors and auditing mechanisms, thus broadly obscuring the actual use of local budgets (OECD/SIGMA, 2019[78]).

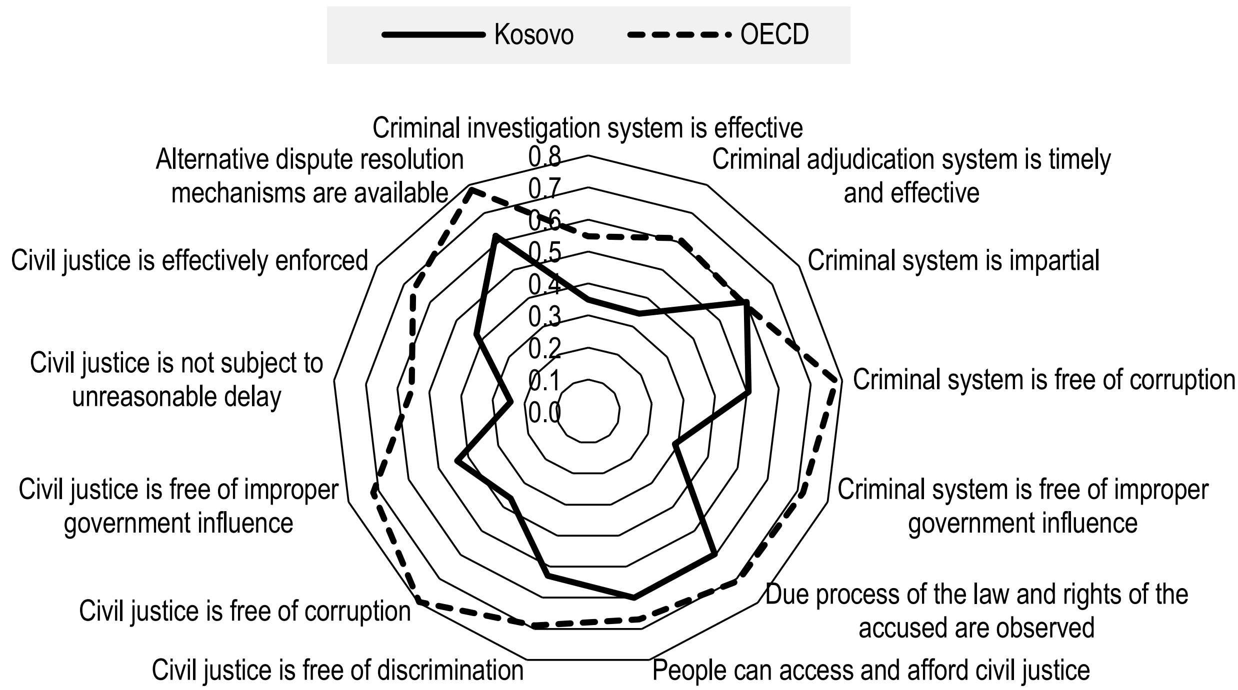
The internal structure of political parties also shapes the accountability and behaviour of local politicians. Political parties in Kosovo are very hierarchical: leaders at the top set the party strategy and manage the internal flow of resources, especially for national and local electoral campaigns. There is neither middle management nor spaces for party members and municipal leaders to challenge party leadership. Lack of internal accountability weakens external accountability. Locally elected representatives end up owing their careers to the respective party leaders rather than to voters. To reciprocate, mayors (but also members of the national assembly) necessarily prioritise managing the interests and patronage requests of party leaders and possibly of their networks over the provision of public services to the rest of the population.[10] The lack of internal accountability may also create space for the infiltration into leadership of informal networks and their particular interests, which can affect the control of the decision-making process.

The judicial system is formally strong but remains inefficient and too exposed to interference

Formally, Kosovo has an exemplary justice system. The constitution and the legal framework provide legal safeguards for the independence and impartiality of judges. Cases are supposed to be allocated randomly throughout the courts, and judges cannot be transferred without their consent. The recruitment process of judges and prosecutors is based on entry examinations and seems transparent. The Kosovo Judicial Council and the Kosovo Prosecutorial Council (the highest self-governing bodies of the judiciary) carry out performance evaluations of judges and prosecutors every three years (European Commission, 2019[7]). This might have helped restore, at least partly, citizen satisfaction with the judiciary (UNDP, 2019[87]). However, the quality of performance evaluations remains an issue, and the positive ratings of virtually all judges and prosecutors in 2019 were at odds with citizen perceptions of their professionalism (European Commission, 2020[82]).

The judicial system is considered biased and inefficient. Informal networks and relationships may steer the activity of judges and prosecutors, in spite of council oversight. The economic resources allocated to the functioning of the judiciary amount to 2.4% of the general budget and are deemed insufficient. Political will to increase them seems to be lacking (Tika, 2017[88]). Both criminal and civil justice are subject to significant delays compared to OECD countries (Figure 11.24). Courts face a high number of criminal cases, most of which are for minor offenses (European Commission, 2019[7]): In 2016, there were 440 627 pending cases, and the basic court in Pristina struggles with a large backlog of administrative cases, as well as many minor offence cases (European Commission, 2020[82]). Bribing and gift giving are sometimes used to speed up procedures (and influence their outcomes), further inflating the overall cost of justice and discouraging its use, especially among the poor.

Figure 11.24. Civil and criminal justice in Kosovo is more exposed to corruption and the improper influence of the executive than in other economies with a similar GDP per capita



Note: The continuous line spider chart represents the perceived dimensions of quality of the judiciary in Kosovo; the dotted line chart represents the average perceived dimensions of quality of the judiciary in OECD countries.
Source: Authors' calculation based on World Justice Project (2020[89]), *World Justice Project Rule of Law Index 2020*, https://worldjusticeproject.org/our-work/publications/rule-law-index-reports/wjp-rule-law-index-2020.

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A mediation system has been operational since 2008, and a Chamber of Mediators was established in September 2018. However, citizens are unfamiliar with these mechanisms and seem to prefer informal mediation outside the courts. These combine modern and traditional techniques and involve independent third parties, such as village elders or Imams (Pasamitros, 2017[90]). The inclusion and regulation of these measures in the formal court system could speed up the settlement of quarrels before they are brought in front of judges, thereby reducing backlogs.

A vetting process, coupled with an empowered Academy of Justice, could improve the quality and integrity of judges and prosecutors. Decision makers have been considering the vetting of all or most members of the judiciary. The experience of Albania, which has embarked on one of the most radical vetting processes in the region, could provide insights into the dos and don'ts of the process. For example, Kosovo must ensure that the Academy of Justice has the required capacity to train sufficient new judges to fill the voids the vetting process will produce. Vetting aside, the academy is an asset, and its role has been increasingly valued.[11] It provides initial and in-service training for judges and prosecutors and their legal and administrative staff (courses focuses, for example, on public procurement and combating corruption, money laundering and cybercrime) and maintains an online library of applicable legislation, commentaries and other legal materials open to all members of the judiciary (European Commission, 2020[82]).

Lack of accountability and financial mismanagement in POEs may undermine macroeconomic stability

POEs play a significant role in the economy, but their performance has been disappointing. Kosovo has 17 POEs managed at the central level and in the energy, waste and water management, telecommunications and transport sectors.[12] POEs account for 17% of GDP and employ around 10 000 people (3% of total employment). The average monthly salary in POEs has been the highest among institutions in Kosovo: in 2018, it amounted to EUR 620 after taxes, compared to EUR 573 in the rest of the public sector and EUR 401 in the private sector. Yet, POE performance has long been disappointing: 10 out of 16 POEs run losses, and overall POE debt amounts to approximately 8% of GDP. Figures are particularly problematic in the telecommunication sector. Telekomi i Kosovës, the second largest employer among national POEs, was the largest loss-maker in 2016 (EUR 31 million loss). Its liabilities alone accounted for 5% of GDP (Table 11.6).[13] Significant underinvestment in capital (0.2% of GDP in 2017) raises concerns about POEs' medium-term viability (IMF, 2018[61]).

To alleviate the burden of POEs on the national budget and development outlook, governments have conducted mass privatisation since 2002. Kosovo Electricity Distribution and Supply was privatised as part of the comprehensive energy strategy for 2009-18. Several concession contracts have also been signed off. In 2019, the government requested European Bank for Reconstruction and Development assistance for the restructuring and repositioning of Kosovo Telecom to improve its performance and practices. This could lead to the privatisation of the company. In the same year, the Trepça mining complex, which has Europe's largest lead-zinc and silver ore mine, was officially transformed into a joint stock company. The government kept control of 80% of the shares employees own the remaining 20% (EBRD, 2019[91]). Kosovo has also put in place a series of laws to reform the corporate governance of POEs.

A number of laws issued between 2008 and 2015 have been improving the transparency of the management of POEs and have adopted the OECD corporate governance principles (OECD, 2015[92]). The Law on Publicly Owned Enterprise (Law No. 03/L-087, issued in 2008) and its complements (Law No. 04/L-111, issued in 2012, and Law No. 05/L-009, issued in 2015) define the government's role in POE ownership and oversight and the duties of their boards. A government decision signed in 2008, moreover, defines the rationale for public ownership: 1) to support economic and strategic interests; 2) to ensure continued national ownership of enterprises; and 3) to supply specific public goods and services when private suppliers do not exist (OECD, 2018[93]). The government exercises shareholder rights in centrally managed POEs.

Table 11.6. Structure of POEs managed by the central government

	Number of companies	Staff	Return on equity (average)	Return on assets (average)	Value (EUR million)
Energy	4	4 420	10.8%	-0.5%	542.8
Waste and water management	9	1 886	-0.8%	-5.2%	287.7
ITC	2	3 276	-25.5%	-16.8%	142.9
Transport	3	570	-10.4%	-5.7%	42.1
Total	18	10 152	-5.2%	-6.1%	1 015.5

Note: Values refer only to POEs managed by the central government. Kosovo has 42 other locally managed POEs in the transport (23), water and waste management (12), public housing (3), energy (2) and wholesale trade (2) sectors.
Source: Authors elaboration based on Government of Kosovo (2017[94]), *Raporti i Performancës së Ndërmarrjeve Publike për vitin 2016*, www.mzhe-ks.net/npmnp/repository/docs/RaportiiPerformancesseNdermarrjevePublikepervitin2016.pdf; Office of the President of Kosovo/National Council for European Integration (2013[95]), *Tryeza Tematike Për Ekonomi Financa Dhe Statistika Kosova 2020*, https://president-ksgov.net/repository/docs/TRT_3_ALB.pdf.

POE boards need more autonomy from the shareholder to enhance performance. The government selects POE board members from candidates shortlisted by an independent ad hoc Recommendation Commission of experts. In practice, a number of POE directors are recognised as political persons (GAP, 2015[96]). The composition of the commission itself could be a potential source of political capture, since the Office of the Prime Minister appoints its members. Board independence from political interests is necessary to weaken political patronage. Boards have a number of competences in relation to POE officials: they recruit them, determine their salaries and terminate their contracts. In a context of pervasive political patronage, boards that are too politicised could increase the number of employees to reward party loyalties and hurt the interests of the company (GAP, 2015[96]).

The financial oversight of POEs needs significant improvement. By law, the POE Monitoring Unit under the Ministry of Economy and Environment reports to the assembly on the performance of central POEs on an annual basis. According to the auditor general, however, reports are published with large delays and are sometimes incomplete (IMF, 2018[61]), making the timely identification of potential fiscal risk difficult. Debt issuance by POEs requires no government approval, nor is it monitored at the central level. To increase the quality and timeliness of reports, their information (e.g. financial plans, financial statements, requests for financial support) can become part of the budget process. The Ministry of Finance, which does not currently collaborate with the unit, should be given a clear legal mandate to analyse the data, propose limits on and approve issuance of POE debt and guarantees, and disclose related fiscal risks in annual budget documents.

A working group of representatives from various ministries recently worked on a draft Law on Publicly Owned Enterprises. Its purpose is to align the functioning of POEs with OECD standards. The new government is supposed to hold a new round of discussions and public consultations before the release of the final draft.

Property rights need to be strengthened through better registration procedures and greater awareness about existing laws

The legislative framework regulating land management is relatively complete and formally in line with international standards. The 2008 Constitution of Kosovo explicitly guarantees the right to own property (Art. 46). Use is regulated by eight main laws (Table 11.7). The Kosovo Cadastral Agency (KCA) and Municipal Cadastral Offices (MCOs) are responsible for the implementation of this legislative framework. MCOs run the day-to-day operations of the cadastre. The KCA is responsible for the overall co-ordination and training of staff. Two other independent agencies play a complementary role for the proper functioning of the land market. The Privatisation Agency of Kosovo supervises the privatisation of agricultural land owned by POEs. The Kosovo Property Agency (KPA) facilitates the resolution of property claims resulting from the armed conflict between the Federal Republic of Yugoslavia and Kosovo with respect to private immovable property.

Table 11.7. Main components of the legislative framework for land management

Law	Scope
Law on Basic Property Relations – SFRY No. 6/80 (1980)	Governs urban land to the extent not superseded by Law No. 03/L-154.
Law on Establishment of an Immovable Property Rights Register – Law No. 2002/5 (2002)	Introduces basic concepts and procedures for an immovable property rights register.
Law on Inheritance – Law No. 2004/26 (2004)	Gives women and men equal rights to inherit from their predecessors.
Law on Agriculture Land – Law No. 02/L-26 (2006)	Determines the use, protection, regulation and lease of agricultural land for the purpose of permanent preservation and protection of agricultural potential.
Constitution of Kosovo (2008)	Explicitly guarantees the right to own property.
Law on Property and Other Real Rights – Law No. 03/L-154 (2009)	Regulates the creation, transfer, protection and termination of land rights.
Law on Cadastre – Law No. 04/L-013 (2011)	Regulates the cadastre of immovable property, national and cadastral surveys, geodesic and cadastral works, as well as the acquisition, registration, keeping, maintenance and use of cadastral data.
Law on Land Regulation – Law No. 04/L-040 (2011)	Enables voluntary land consolidation for the creation of parcels of regular geometrical shape and improvement of infrastructure.
Law on Obligation Relationships – Law No. 04/L-077 (2012)	Regulates leases.

Source: USAID (2016[97]), *USAID Country Profile: Property Rights and Resource Governance – Kosovo*, www.usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID_Land_Tenure_Dominican_Republic_Profile.pdf.

Well-rooted social customs and norms function alongside formal legislation. Since the 15th century and throughout Ottoman domination, a set of unwritten laws – the *Kanun of Lekë Dukagjini* – has regulated land management in Kosovo. Because of its longevity, the Kanun still influences Kosovo society but often clashes with formal institutions. For example, the fact that the old Ottoman legislation recognised males as sole heirs of real property is one reasons women are rarely registered as landowners (USAID, 2019[98]). The Kanun also regulated land transactions: before being public, any sale had to be approved by relatives, neighbours and other villagers. These customs still condition the functioning of the land market in certain areas of Kosovo (and Northern Albania, as discussed in the ongoing Albania MDR).

Informality is partly the result of long-lasting ethnic tensions and the resulting conflict. Already in the 1990s, informal contracts, imposed by the then Federal Republic of Yugoslavia and Kosovo, were concluded to circumvent restrictions on transactions between Kosovo Albanians and Kosovo Serbs. Most property records and archives were either destroyed or removed by retreating Yugoslavian troops during the 1998-99 conflict. The war, moreover, resulted in around 245 000 displaced people who, upon their return, found their former properties occupied. Claims were filed, and the KPA processed virtually all of them. However, enforcement of decisions has been problematic due to illegal buildings on former claimants' properties and public land. The KPA also struggles to regulate the settlement of displaced Kosovo Roma, Ashkali and Egyptians who lived in informal settlements before the war and thus have no formal legal title to claim properties (Todorovski, Zevenbergen and van der Molen, 2016[99]; USAID, 2016[97]).

Faster procedures, better institutional design and awareness campaigns about land rights can enhance property registration

Faster and cheaper forms of registration, together with the recognition of alternative forms of mediation, could help enhance formal registration. According to a recent survey conducted by the United States Agency for International Development, 60% of landowners have not registered their properties (USAID, 2019[98]). Most consider registration time consuming and expensive, despite recent improvements.[14] Some owners regulate ownership informally, for example by orally concluding property transfers in the presence of witnesses. Others inherited land plots tacitly, without going through formal procedures. Some parties prefer to settle disputes without resorting to legislative and court proceedings.

While Kosovo has put a lot of effort into making property registration accessible, it could consider the formalisation of other forms of mediation, possibly via village heads or municipal officials rather than lawyers and judges.

Redesigning the institutional relationship between the KCA and MCOs could help enhance the implementation of land laws. These bodies have complementary tasks, but the KCA is accountable to the Ministry of Environment and Spatial Planning, while MCOs are subordinate to the relevant local government. Multiple accountability lines may undermine the effectiveness of the cadastre: co-ordination problems among ministries may lead to inefficiencies, high monitoring costs or capture (Hammond and Knott, 1996[100]; Estache and Martimort, 1999[101]; Voorn, van Genugten and van Thiel, 2019[102]). MCOs may leverage potentially diverging agendas between the agency, which co-ordinates them, and the Ministry of Local Government Administration, which holds them accountable, in order to pursue their own interests or favour external actors interested in altering local property registers. Kosovo could consider an institutional reorganisation giving the agency greater financial and administrative autonomy from the Ministry of Environment and Spatial Planning, and full control of MCO activities.

Raising awareness about land rights can strengthen the legislative framework. Public knowledge about property rights issues and procedures, particularly among minorities, remains spotty, making informal options appear more accessible. Moreover, when it comes to upholding their rights in court or cadastral offices, minority groups encounter language barriers and prohibitive costs. These outcomes point to a need to educate citizens on these matters (USAID, 2019[98]).

Securing property rights is paramount to future development

Complete land registries may boost agricultural productivity. Kosovo has a large number of small and fragmented family farms and a small number of large-scale corporate farms. The average size of agricultural holdings in 2014 was 3.2 ha (up from 2.5 ha in 2009), with 35% of holdings having less than 0.5 ha of arable land (Hartvigsen, 2013[103]; Bedrač et al., 2019[104]). Because agricultural productivity usually increases with farm size, there have been efforts to consolidate separate parcels of land, reallocating them among landowners. However, reallocation is often difficult because it involves parcels not formally registered (USAID, 2016[97]). Enhancing registration is therefore crucial to make transactions secure and to favour consolidation.

Secured land rights could contribute to long-term sustainable growth. Owners with legal titles may have better access to loans, since financial institutions often only use properties with legal titles as collateral. Access to credit would encourage long-term investments and a more efficient and sustainable use of land resources. Property rights also facilitate law enforcement and anti-corruption efforts. For example, the confiscation of assets is only possible with an updated property registry.

Lack of human resources and harmonised methodological standards impede the quality of statistical products

The KAS has been the main producer of statistics since 1999. According to the Law on Official Statistics, adopted in 2011, the KAS co-ordinates the National Statistical System, which includes the Central Bank of Kosovo, the Ministry of Finance and other national authorities (ONAs) (Government of Kosovo, 2011[105]). The Statistical Council advises the KAS on the preparation of statistical work programmes, annual plans and the overall functioning of the agency. The council consists of 13 members, including the CEO of the KAS and representatives from public user and data provider institutions, ONAs, academia, civil society and the business community. Because it is a young institution, the KAS' co-ordination role is evolving. For instance, administrative data exchanges with line ministries take place within specified working groups (Duerr, Hackl and Andersen, 2017[106]).

Statistical capacity has been improving since 2013. The KAS is currently implementing its second five-year plan, the Programme of Official Statistics 2018-2022 (Kosovo Agency of Statistics, 2017[107]). Broadly, the KAS' products cover economic, social, agriculture and environmental statistics (Open Data Watch, 2018[108]). Cross-domain publications, such as the statistical yearbook and the quarterly bulletin, combine various areas of data. Economic data are collected relatively frequently; Kosovo has some of the most complete subnational budget execution data (Kosovo BOOST) in ECA. The KAS also stands out in its extensive use of administrative data, having signed more than 15 memoranda of understanding with data providers (Duerr, Hackl and Andersen, 2017[106]). Data dissemination has improved. With support from the Swedish International Development Agency, the KAS set up a new website accessible in English, Serbian and Albanian.

Despite these positive trends, the KAS needs to strengthen institutional, organisational and individual capabilities. According to the 2011 Statistics Law, the head of the KAS does not have the sole responsibility for deciding on statistical methods, standards and procedures, and his or her three-year term does not cover the five-year planning cycle. These legal caveats may affect statistical planning and quality. Although Kosovo participates in the IMF Enhanced General Data Dissemination System programme, supporting members to improve statistical quality (IMF, 2020[109]), frequent changes in methodology and instruments have severely compromised comparability over time, especially with regards to labour force and household surveys. For instance, surveys conducted from 2000 to 2008 were based on the 1989 Census, while surveys after 2012 use the 2011 Census as base year (World Bank, 2017[56]).

Overall, more financial resources are needed. According to the Creditor Reporting System, the KAS received around USD 10 million from development co-operation providers in 2010-15 (OECD, 2020[110]). Further domestic and external funding will be needed to scale up human resources and improve statistical production and quality management. As of 2020, the KAS does not dispose over enough statisticians to fulfil its programme of work, and many employees lack specialised skills. Next to external training supported by Eurostat and Sida, internal workshops on quality management and metadata provision are necessary to adhere to international standards (Duerr, Hackl and Andersen, 2017[106]). For instance, the KAS could offer access to e-learning resources to upskill staff cost effectively. In the long term, collaboration with academia and research institutes could help train the next generation of statisticians.

Planet – conserving nature

The Planet pillar of the 2030 Agenda for Sustainable Development reflects the need to find the right balance between socio-economic progress and capacity to sustain the planet's resources and ecosystems and to combat climate change.

Environmental concerns are not a political priority in Kosovo. The 2016-21 NDS has no environmental pillar at this stage (Government of Kosovo, 2016[111]) and Kosovo has not adopted a strategy or long-term action plan to reduce CO_2 emissions. The economy is rich in biodiversity and natural resources, and their preservation and sustainable use could pave the way for more environmentally friendly growth and enhanced well-being and quality of life.

The Planet section in this chapter identifies three major environmental constraints to sustainable development in Kosovo. First, mismanagement of natural resources could hamper Kosovo's future development path. Second, ongoing challenges in waste management, air pollution and limited and unequally distributed water resources threaten the environmental quality of life of all Kosovars. Better implementation and enforcement of environmental legislation is essential. Third, the energy supply is unsustainable and insufficiently diverse, secure and efficient. Although environmental concerns remain secondary in Kosovo, in common with other economies in the region, the EU approximation process could help raise environmental awareness and drive environmental reforms (Table 11.8).

Table 11.8. Planet – three major constraints to a more sustainable path in Kosovo

1. Mismanagement of natural resources is a challenge for sustainable development.
2. Poor environmental quality affects people's well-being.
3. The energy supply is unsustainable, insufficiently diverse and inefficient.

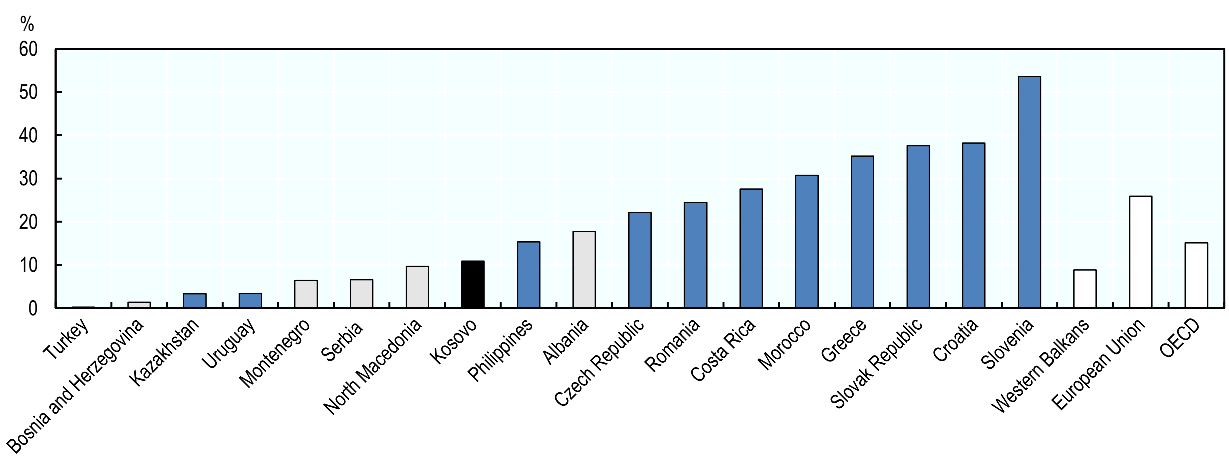
Mismanagement of natural resources could hamper Kosovo's future development path

Kosovo's rich ecosystem and biodiversity are threatened

Kosovo is home to a rich ecosystem and rich biodiversity, but their protection remains challenging. Kosovo doubled its protected area from about 4.36% of the territory in 2002 to approximately 10.9% (126 119 ha) in 2019. This is slightly higher than the regional average (8.88%) but below the OECD and EU averages (15.1% and 25.94%, respectively) (Figure 11.25). Most of the protected area falls within the two main national parks (10.6%), Bjeshkët e Nemuna (62 000 ha) and Sharri (39 000 ha) and Bjeshkët e Nemuna (62 000 ha) (AMMK, 2018[112]). Kosovo is also very rich in flora, a large percentage being endemic (AMMK, 2019[113]; AMMK, 2018[112]). However, illegal construction, infrastructure development, logging, hunting and fires are frequent in protected area. The lack of spatial and regulatory plans and irregular monitoring of biodiversity make the efficient management of Kosovo's protected area an issue.

Figure 11.25. Kosovo has slightly more protected area than the regional average but less than the EU and OECD averages

Terrestrial protected area (% of total territory), 2018



Note: Data for Kosovo are local data from 2019 provided by the Kosovo Environmental Protection Agency.
Sources: AMMK (2019[113]), *Red Book of Fauna of the Republic of Kosovo*, http://ammk-rks.net/repository/docs/v2Red_Book_-_6_Shtator_1_(1).pdf; AMMK (2018[112]), *Annual Report of the State of the Environment in Kosovo in 2017*, www.ammk-rks.net/repository/docs/Raporti_M_2017_english.pdf; World Bank (2020[6]), *World Development Indicators* (database), http://datatopics.worldbank.org/world-development-indicators.

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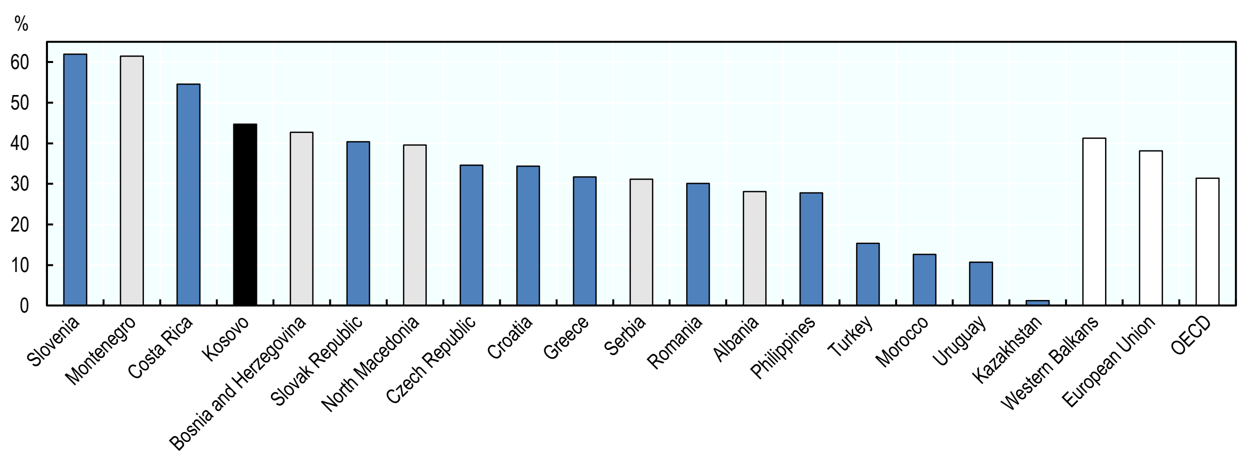
Forests cover a large part of the territory, but little is done to fight their degradation. Kosovo has considerable forest coverage (around 44.7% of total land area in 2018, or 481 000 ha), as do other Western Balkan economies (41.27%), which is greater than the EU and OECD averages (38.09% and 31.37%, respectively) (Figure 11.26). Approximately 62% of forests (295 200 ha) are public, and 38% (180 800 ha) are privately owned (Ministry of Agriculture, Forestry and Rural Development of the Republic of Kosovo, 2019[114]). This is an estimation, as there are no official statistics on the size or value of forests due to lack of regular monitoring by public authorities. Based on the latest Forest Inventory, realised in 2012, 59% of public and 34% of private forests have been subject to illegal felling and uncontrolled harvesting activities (Ministry of Agriculture, Forestry and Rural Development of the Republic of Kosovo, 2013[115]). Most illegally harvested timber was initially used to rebuild houses after the war; now, it is used for firewood during winter, which affects air pollution (Ministry of Agriculture, Forestry and Rural Development of the Republic of Kosovo, 2009[116]). Forest fires are another major challenge. The number and affected area increase each year. In 2018, the Forest Agency of Kosovo identified 83 fires in public and private forests, affecting about 949 ha (Ministry of Agriculture, Forestry and Rural Development of the Republic of Kosovo, 2019[114]). Forestry legislation and the planning and management of forest policies, remain in the early stages. Limited implementation and insufficient enforcement of normative and regulatory frameworks constitute an additional constraint to the sustainable use of natural resources.

Figure 11.26. Kosovo's forest coverage is greater than the EU and OECD averages

Forest coverage (% of territory), 2016



Note: Data for Kosovo are local data from 2018 provided by the Ministry of Agriculture, Forestry and Rural Development of the Republic of Kosovo (2019[114]), *Green Report 2019*, www.mbpzhr-ks.net/repository/docs/ENG_Raporti_i_Gjelber_2019.pdf.
Sources: Ministry of Agriculture, Forestry and Rural Development of the Republic of Kosovo (2019[114]), *Kosovo Green Report 2019*, www.mbpzhr-ks.net/repository/docs/ENG_Raporti_i_Gjelber_2019.pdf; World Bank (2020[6]), *World Development Indicators* (database), http://datatopics.worldbank.org/world-development-indicators.

StatLink https://doi.org/10.1787/888934243866

Serious gaps exist in the sustainable management of minerals

Kosovo is rich in natural resources and has large reserves of lignite, lead, zinc, silver, nickel, cobalt, copper, iron and bauxite, but serious gaps exist in their sustainable management. Kosovo, like the whole of former Yugoslavia, has a long history of mineral extraction and exploitation. Mining and quarrying currently accounts for 2.1% of GDP, compared to 1.2% of GDP in the Western Balkans (see the Prosperity section in this chapter). Kosovo has the world's fifth largest lignite reserves (around 11 billion tonnes), which are distributed across the territory (mainly in the Drenica and Dukagjin basins) and primarily serve power generation in Kosovo (World Bank, 2017[56]). Nickel exploitation is concentrated in the Dushkaja, Gllavica and Suka mines. Lead, zinc and silver are present in the Trepča complex (Ministry of Economic Development of the Republic of Kosovo, 2012[117]). Most mining sites have huge environmental and social problems (e.g. water and soil pollution from heavy metals) and do not meet the standards for sustainable mine management (UNEP Vienna, 2009[118]).

Environmental quality of life must be improved

Box 11.1. Better environmental quality of life is at the heart of the vision statement for Kosovo

The strategic foresight workshop organised on 11 March 2020 in Pristina with representatives from various public-sector ministries and agencies, the private sector, academia and civil society aimed to capture citizen aspirations for the future of Kosovo and the major obstacles to realising progress. In one session, participants developed a vision statement reflecting the desired future for Kosovo and its development goals. The vision statement developed for the planet pillar highlighted the importance of a better, healthier environmental life for all Kosovars based on improved air quality and waste and water management and a successful transition to sustainable energy.

Planet: vision statement for Kosovo

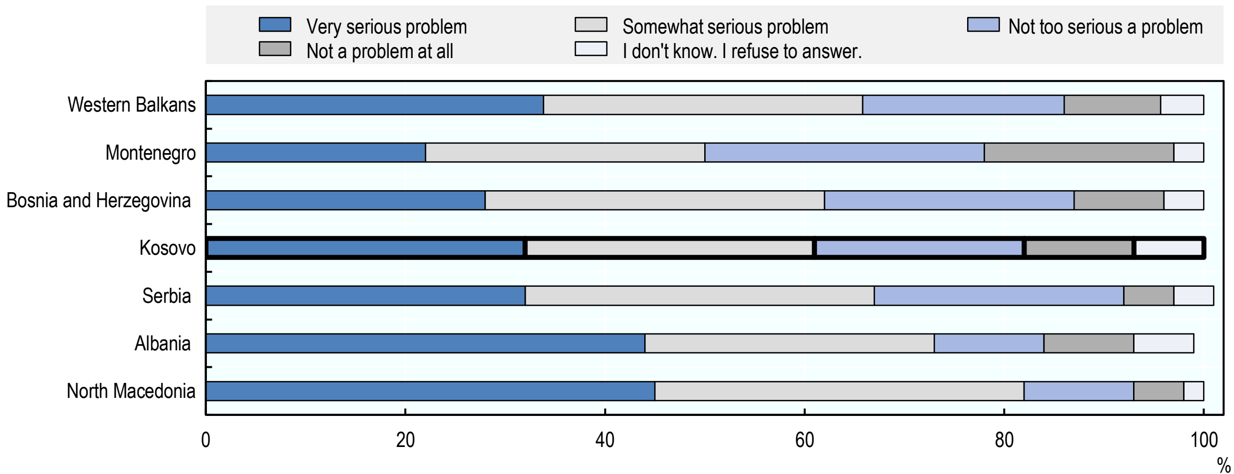
"*Citizens live healthier and longer lives. Kosovo has significantly reduced coal usage and has successfully switched to the use of renewable resources. Due to sustainable policies and urban mobility plans, citizens use bicycles, public transportation and electric vehicles. As a result, there are stricter technical controls for vehicles and improved fuel quality. Kosovo has attracted recycling companies to invest and create partnerships between municipalities and companies and this has created significant new job opportunities. Citizens now have dedicated recycling bins in proximity to their residences. Illegal landfills have been reduced. Artificial lakes have been created to reduce water scarcity and adequate metering has been put in place. Penalties for water misuse are being enforced*."

Source: OECD (2020), Kosovo: Vision and Challenges 2030, Foresight Workshop held in Pristina on 11 March 2020, organised jointly by the Government of Kosovo and the OECD.

Air pollution is a serious threat

Kosovars, in common with other Western Balkan populations, are exposed to the highest concentration of air pollution in Europe. Annual exposure to particulate matter (PM) 2.5 is 27.0 μg/m^3, which is higher than the regional average (25.8 μg/m^3), more than double the EU and OECD averages (13.1 μg/m^3 and 12.5 μg/m^3, respectively) (Figure 11.28) and above the maximum 10 μg/m^3 recommended by the World Health Organization. Beyond PM, the principal sources of contaminants are carbon monoxide and CO_2, nitrogen oxides (NO and NO_2), ozone (O_3) and sulphur dioxide (SO_2). The World Bank estimates the annual cost of environmental degradation in Kosovo at between 2.9% and 7.5% of GDP (midpoint 5.3% of GDP) (Worldometer, 2020[119]). Pollution was considered a serious threat by almost two-thirds of Kosovars and a very serious threat by one-third in 2019, in line with the regional average (Figure 11.27) (Box 11.1). This shows encouraging public concern but has not translated into long-term government commitments.

Figure 11.27. Almost two-thirds of Kosovars considered pollution a serious problem in 2019



Note: Answers based on the question, "Do you consider pollution to be a problem in your place of living?".
Source: Regional Cooperation Council (2019[120]), *Balkan Barometer 2019: Public Opinion Survey*, www.rcc.int/pubs/89/annual-report-of-the-secretary-general-of-the-regional-cooperation-council-2019-2020.

StatLink https://doi.org/10.1787/888934243885

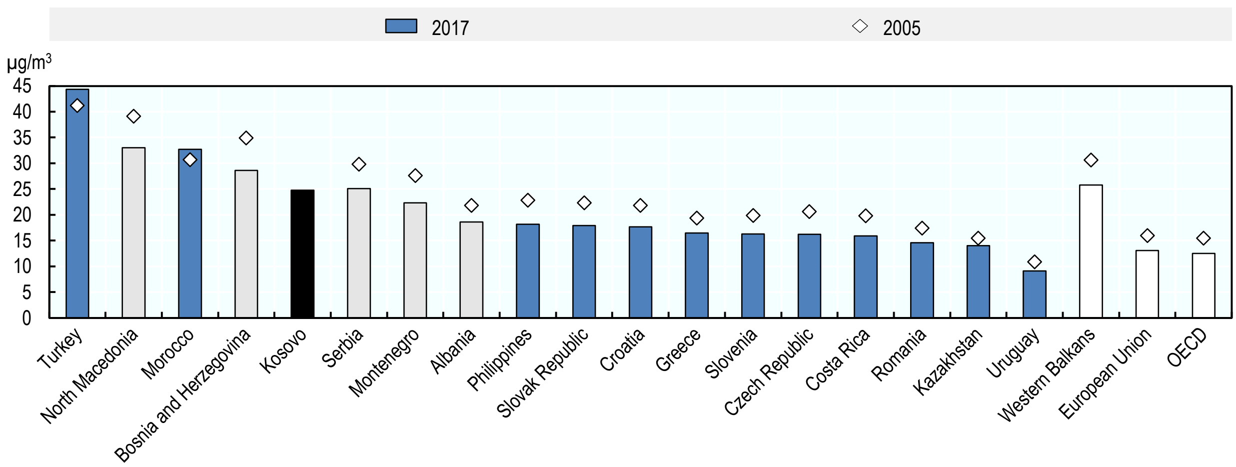
Air pollution has a considerable impact on health and poses a serious threat to the economy. The health costs of air pollution in Kosovo were estimated at 3.6% of GDP in 2016 (around USD 240 million), 1.3 percentage points higher than in 2010 (2.3% of GDP) (World Bank, 2019[121]; World Bank, 2017[56]). PM2.5, NO_2 and O_3 were estimated to cause 3 920 premature deaths in 2016, the large majority attributable to PM2.5 (3 800 deaths, the equivalent of 97% of premature deaths). PM2.5 is also estimated to have caused 37 200 years of life lost (YLL) annually, which corresponds to 2 100 YLL per 10 000 inhabitants (EEA, 2019[122]).

Power generation, heating and transport are the main sources of air pollution. Poor air quality particularly affects areas in and around Drenas, Mitrovica, Obiliq and Priština (AMMK, 2018[112]). The two main power plants (Kosovo A and Kosovo B) are among the ten most toxic in Europe.[15] They are considered the main sources of PM in Obiliq and Priština (Faberi, 2014[123]; HEAL, 2016[124]) and their health cost is estimated at between EUR 70 million and EUR 169 million per year (HEAL, 2016[124]). It is important to bring the gaseous emission levels of these power plants in line with the EU acquis. Works to enhance the environmental performance of Kosovo B have started (European Commission, 2020[82]). The exceedance of the daily PM limit is particularly high in winter. As public transit is poorly developed, cars are the main means of transport, and the number of cars increased by around 60.7% in the past seven years, from 170 321 in 2011 to 280 422 in 2018 (Ministry of Infrastructure and Environment of the Republic of Kosovo, 2020[125]; Kosovo Agency of Statistics, 2020[5]). The average age of cars in Kosovo is 19 years. The ecological tax is fixed at EUR 10 for all vehicles, without differentiation by age of vehicles.[16] The power sector and road transport contribute 75% and 12% of total greenhouse gas (GHG) emissions from energy production, respectively (AMMK, 2015[126]).

Kosovo recently improved air quality monitoring but needs to assess the impact of air pollution on public health regularly and increase the number of monitoring stations. Through a European Union-funded project, Kosovo's air quality monitoring system has been fully operationalised, and the monitoring of air quality has been improved. However, the coverage of air quality monitoring is limited to 12 monitoring stations: 2 in Priština, 3 in the Kosovo Energy Corporation area and the rest in Brezovica, Drenas, Gjilan, Hani i Elezit, Mitrovica, Peć and Prizren (AMMK, 2018[112]). Going forward, monitoring should include regular assessment of impacts on health towards reducing death and illness caused by air pollution (see the People section in this chapter).

Figure 11.28. Kosovo's PM2.5 exposure is much higher than the OECD and EU averages

Mean exposure to PM2.5



Notes: The mean population exposure to fine PM is calculated as the mean annual outdoor PM2.5 concentration weighted by the population living in the area. It is the concentration level, expressed in µg/m3, to which a typical resident is exposed throughout a year. Data for Kosovo are from 2016 (local data reported to EEA). There are no 2005 data for Kosovo. Data for Turkey are from the World Bank.
Sources: EEA (2020[127]), *Air pollutant concentrations at station level (statistics)* (dataset), www.eea.europa.eu/data-and-maps/data/air-pollutant-concentrations-at-station; OECD (2020[128]), *Green Growth Indicators* (database), https://stats.oecd.org/Index.aspx?DataSetCode=GREEN_GROWTH.

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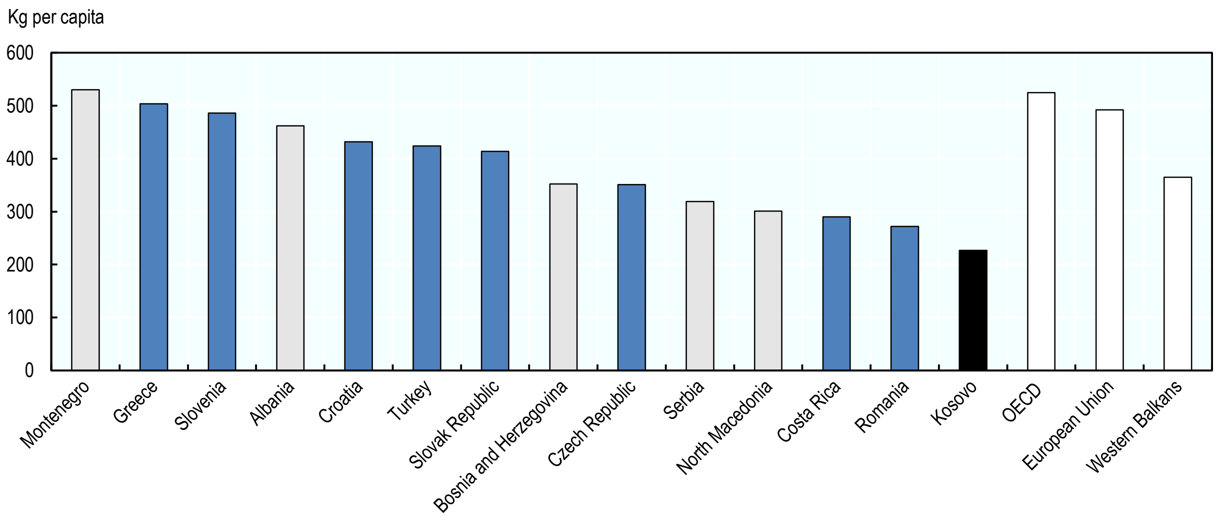
Waste management remains a challenge

Kosovo has low waste production, but solid waste management remains limited. Improvement in coverage of municipal waste collection will be essential to reducing Kosovars' exposure to pollution. Each citizen produces, on average, 227 kg of waste per year, which is below the EU and OECD averages (492 kg and 525 kg per capita per year, respectively) and below the Western Balkan average (Figure 11.29). Waste collection and disposal are poor, especially in rural areas. Municipal waste collection regularly serves approximately 75% of the urban population but only 41% of the rural areas (AMMK, 2018[129]). Nationally, municipal waste collection covers 57.7% of the population, which is much lower than in other regional economies, except Albania (Kosovo Agency of Statistics, 2020[130]).

Figure 11.29. Kosovo's waste generation rate is below the EU, OECD and Western Balkan averages

Municipal waste generation (kg per capita and per year), 2018



Notes: Data for Bosnia and Herzegovina and Greece are from 2017. There are no data for Kazakhstan, Morocco, Philippines or Uruguay.
Sources: Eurostat (2018[131]), *Eurostat* (database), https://ec.europa.eu/eurostat/data/database; OECD (2020[132]), *OECD.Stat* (database), https://stats.oecd.org.

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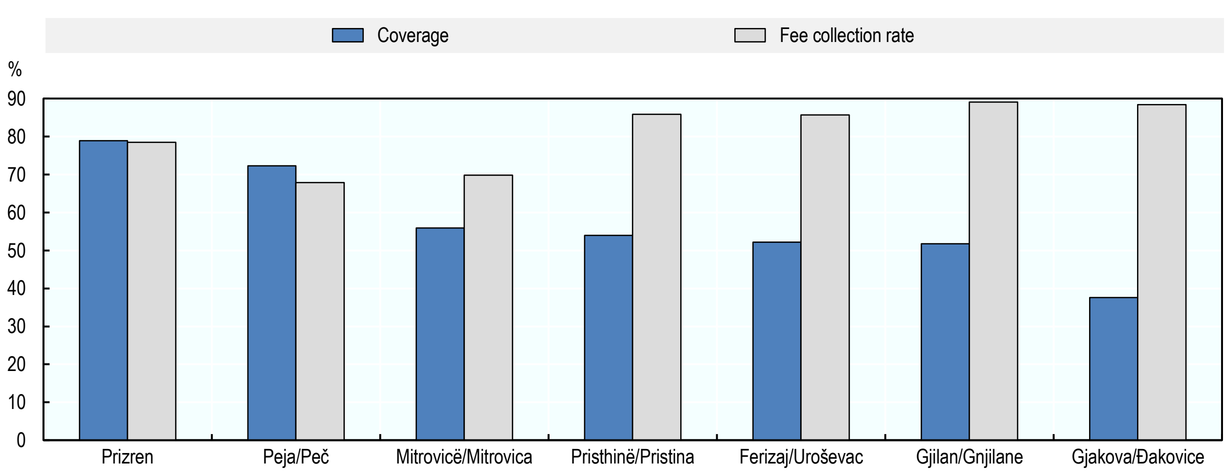
Figure 11.30. Waste collection coverage is low but fee collection rates are promising in selected Kosovo regions

Waste collection coverage and fee collection rate (%) by regions, 2016



Source: AMMK (2018[129]), *Municipal Waste Management in Kosovo: Status Report*, www.ammk-rks.net/repository/docs/Municipal_Waste_Managment_in_Kosovo_Status_Report_2018.pdf; Kosovo Environmental Protection Agency/AMMK (2018), *Municipal Waste Management in Kosovo*, www.ammk-rks.net/?page=2,1.

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Kosovo's national normative framework and strategies for solid waste management are not systematically fulfilled. Kosovo recycles slightly below 5% of waste, which is similar to other regional economies (Eurostat, 2018[131]). Nationally, the waste collection rate is 77%, but it varies across Kosovo's regions (Figure 11.30). Less than 40% of solid waste is disposed of in managed facilities (European Commission, 2020[82]) and illegal dumping remains a serious problem in all municipalities (urban and rural). There were 2 529 illegal landfills and dumpsites in Kosovo in 2019, a large increase over 2017 (1 572) (European Commission, 2020[82]; KEPA, 2019[133]). Untreated waste is frequently burned or discarded and, consequently, not only negatively affects air and soil pollution but also degrades Kosovo's rivers and scarce water resources. Around 15 municipalities have local waste management plans. Going forward, the complete implementation of Kosovo's Waste Management Strategy 2013-2022 and its new Integrated Waste Management Strategy (2020-2029) and Action Plan (2020-2022) (Ministry of Economy and Environment of the Republic of Kosovo, 2020[134]) will be key, along with better co-ordination between waste management companies and central and local governments. Kosovo should also fully align its legislation with the EU acquis on solid waste management and make further efforts to reduce waste and increase recycling (European Commission, 2020[82]).

Water mismanagement could hurt Kosovo's development

Universal access to drinking water is only provided in urban areas. Kosovo's urban population is almost 100% covered with drinking water supply, on average, compared to 69.7% of the rural population (Inter-Ministerial Water Council of the Office of the Prime Minister, 2014[135]). In some regions, less than half the villages are connected to a functioning water system: 47.3% in Gjakova and 41.6% in Mitrovica (OSCE, 2019[11])(see the People section in this chapter). Roma are disadvantaged in terms of coverage and access to water and public sewerage, as they are in other Western Balkan economies (Robayo-Abril, 2019[136]; World Bank/UNDP/European Commission, 2017[137]) (see the People section in this chapter).

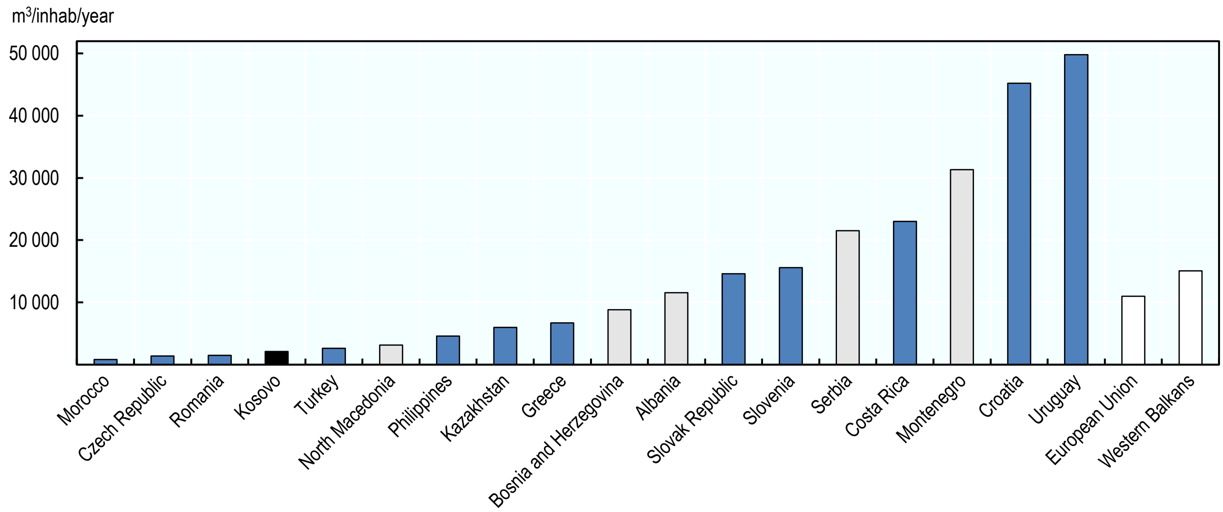
Kosovo has limited water resources compared to other Western Balkan economies, with unequal distribution from among the five main river basins. Kosovo has just 2 100 m^3 of total renewable water resources per capita per year, which is around 13.95% of the regional average (Figure 11.31). It is the only economy in the region close to water stress levels (1 700 m^3/capita/year), particularly affecting three river basins: Iber Basin (1 092 m^3/capita/year), Lepenci Basin (1 320 m^3/capita/year) and Morava e Binçës Basin (1 380 m^3/capita/year) (Government of Kosovo, 2016[138])). Due to increasing economic, environmental and demographic pressures, all river basins in Kosovo are expected to be water stressed in 20 years (World Bank, 2018[139]). The share of internal water resources is around 96.4% (Eurostat, 2018[131]). Consequently, the dependency ratio is very low (FAO, 2017[140]).

The normalisation of political relations with Serbia regarding the management of water resources is crucial for Kosovo. The Ibër Lepenc canal and the Pridvorica Dam, located in the northern part of Kosovo, are relevant for the economy, as they supply water to one-third of the population. Both Kosovo A and Kosovo B power plants depend on their waters for cooling. Without an agreement with Serbia on the management of these water resources, Kosovo will remain vulnerable in the future.

Kosovo will have to prioritise competing water uses. Households and agriculture are the largest users: households consume around 52% of the abstracted water and agriculture around 41% (Government of Kosovo, 2016[138]). Around 62% of citizens live in rural areas and depend on agriculture for their livelihoods. With warmer temperatures and a projected decline in annual precipitation, water use for agriculture will remain important, and demand for irrigation will increase. Demand from industry (representing around 8%), particularly the energy sector, is also growing. The energy sector uses water for hydropower and, mainly, for cooling thermal power plants. Reconciling competing uses of limited water resources (for drinking, agriculture, energy and industry) will be key for Kosovo's future development.

Figure 11.31. Kosovo has limited water resources compared to other Western Balkan economies

Total renewable water resources per capita (m³/inhab/year), 2017



Note: Data for Bosnia and Herzegovina, Kosovo and Montenegro are from 2016.
Sources: Eurostat (2018[131]), *Eurostat* (database), https://ec.europa.eu/eurostat/data/database; FAO (2017[140]), *AQUASTAT* (database), www.fao.org/nr/water/aquastat/data/query/results.html.

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Kosovo has advanced considerably in establishing a normative and regulatory framework on water, but significant gaps exist in implementation, especially at the local level. The central government is responsible for strategies and implementation of policies in the water sector and river basin co-ordination. Regional water companies are in charge of service provision. The government has entrusted water tariff-setting responsibilities to the independent Water Services Regulatory Authority. However, complete implementation and enforcement of the current framework is lacking. Moreover, at subnational levels, water use planning remains limited, as river basin management plans have not yet been adopted. Furthermore, Kosovo has not yet aligned its water legislation with the EU acquis (European Commission, 2020[82]).

The efficiency of water service providers could be improved. The continuity of water supply services is almost guaranteed: in 2018, it averaged 22 hours per day (Water Services Regulatory Authority of the Republic of Kosovo, 2018[141]). Service reliability is an issue in some Uroševac municipalities, with a water continuity less than 18 hours per day (Water Services Regulatory Authority of the Republic of Kosovo, 2018[141]). Non-revenue water was estimated at around 58% (Water Services Regulatory Authority of the Republic of Kosovo, 2018[141]), below the Western Balkan average of 75% (World Bank, 2017[56]). Operational costs are covered by tariffs (World Bank/IAWD, 2015[142]), however, capital investments in the water sector are mainly financed by the international donor community.[17] Collection rates were 87% for households and 95% for commercial and industrial consumers in 2018, but rates vary significantly across regions, with the lowest rates in Mitrovica (60% and 83%, respectively) (Water Services Regulatory Authority of the Republic of Kosovo, 2018[141]). Water tariff setting should better integrate sustainability and consumption criteria to discourage excessive consumption, e.g. for irrigation, for which non-volumetric pricing is widely used.[18]

Kosovo has no wastewater treatment, and discharges wastewater directly into rivers. Around 1.0% of the population is connected to wastewater treatment plants, less than the Western Balkan average (6.5%) and far less than the EU average (86.0%) (Eurostat, 2018[131]; World Bank, 2018[139]). Three wastewater plants are currently under development. Water pollution due to untreated sewage, waste dumping and agricultural and industrial polluters affects the health of Kosovars. Water contamination costs more than EUR 30 million per year, according to World Bank estimations, and leads to various diseases particularly dangerous to children, such as diarrhoeal disease (Worldometer, 2020[119]).

Implementation and enforcement of environmental legislation remains weak

Responsibility for environmental matters was recently transferred from the Ministry of Infrastructure (formerly Ministry of Infrastructure and Environment) to the Ministry of Economy and Environment. The Ministry of Economy and Environment (formerly the Ministry of Economic Development) has the main regulatory responsibilities related to the creation and implementation of legislation in the areas of environment, water and spatial planning.

Kosovo must continue to progress in the implementation of environmental legislation in the context of approximation with the EU acquis in order to increase compliance and effectiveness at the national and subnational levels. Capacities for adequate environmental inspections remain limited due to lack of resources and co-ordination among national and local inspecting bodies. Despite some progress in strengthening the criminal code, Kosovo has not yet fully aligned legislation with the European Union's Environmental Liability Directive (European Commission, 2020[82]).

The energy supply is unsustainable, insufficiently diverse and inefficient

Like other Western Balkan economies, Kosovo is characterised by high energy intensity, low energy efficiency and widespread energy poverty (see the Prosperity section in this chapter).

A high dependency on domestic and heavily polluting coal production

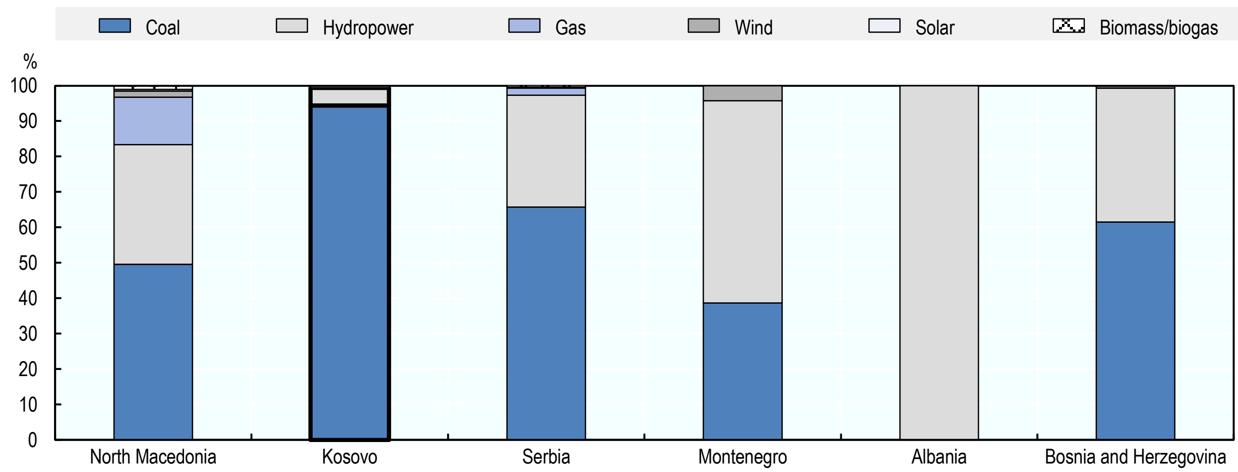
Kosovo relies heavily on domestic coal production, as do many other economies in the region, except Albania. Kosovo generates approximately 94.4% of its domestic electricity from coal (lignite) and around 5.0% from hydropower (Figure 11.32). At 0.146 toe/USD 1 000, energy intensity in Kosovo is substantially higher than the regional average (0.126 toe/USD 1 000) and almost double the EU average (0.087 toe/USD 1 000) (Figure 11.33). The EU integration process could be an important driver of the diversification of Kosovo's energy sector, since shifting from coal to renewables and increasing energy efficiency are priorities set by the European Union for Kosovo's energy sector (European Commission, 2020[82]).

Kosovo's gas market is not developed at this stage. Kosovo has no domestic production of natural gas, and it is not linked to any operational natural gas supply networks (Energy Regulatory Office of the Republic of Kosovo, 2019[143]). However, the Kosovo Economic Reform Programme 2020-2022 aims to prepare a Gas Master Plan for the distribution and supply of natural gas (reform measure two). The Ministry of Economy and Environment is responsible for preparing the technical documentation for the plan's elaboration. Developing the gas market would promote the decarbonisation of Kosovo's economy by reducing dependence on coal and by improving the diversification of the energy sector.

There is no diversification of renewable energy sources in Kosovo, and investments are low compared to those dedicated to coal. Thanks to hydropower and the recent inclusion of biomass in the definition of renewable energy sources, the overall share of renewable energy in gross final consumption was 24.9% in 2018, slightly below the regional average (28.8%) but higher than the EU average (18.9%) (Eurostat, 2018[131]). However, other sources of renewable energy – solar and wind energy – are insufficiently developed, even with the recent implementation of new solar energy plants (3.4 MW) and wind energy plants (137.4 MW) (Energy Community Secretariat, 2019[144]). Renewable incentives continue to be modest compared to coal subsidies (Figure 11.35). A working group established by the Ministry of Economy and Environment is currently drafting a concept document to promote renewable energies further. Kosovo should fully align its energy regulation with the EU acquis to facilitate the integration of renewables into its energy market (European Commission, 2020[82]). To raise the share of renewables like solar and wind in Kosovo's energy mix, it is important to integrate Kosovo's energy market regionally by connecting its transmission network with neighbouring economies.

Figure 11.32. Kosovo generates 94.4% of its domestic electricity from coal

Electricity generation mix (%), 2018



Sources: Eurostat (2018[131]), *Eurostat* (database), https://ec.europa.eu/eurostat/data/database; Energy Community Secretariat (2020[145]), Energy Community Secretariat/NERA annual reports, https://energy-community.org/documents/secretariat.html.

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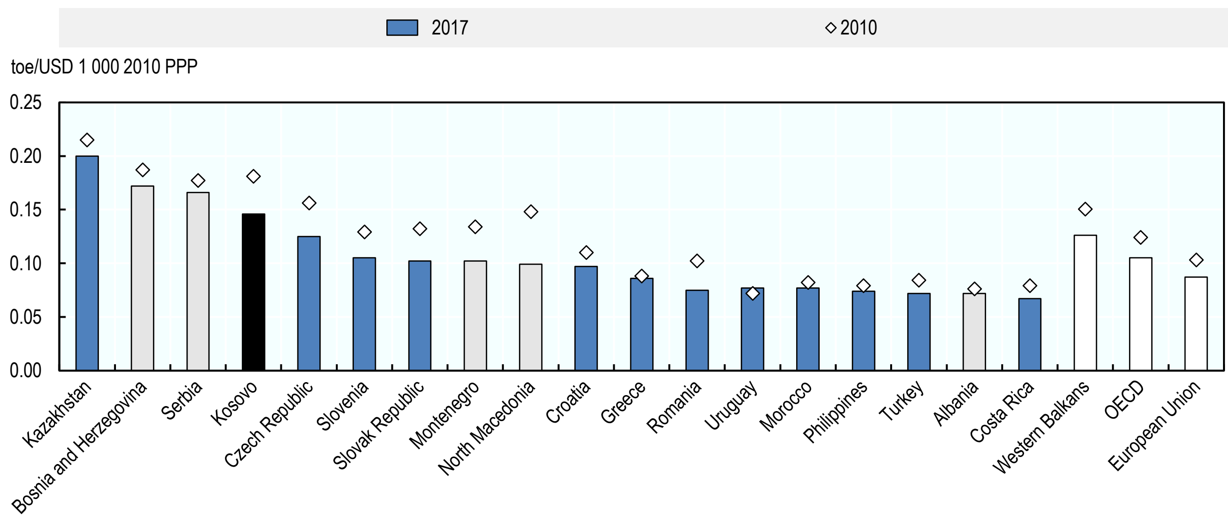
Energy supply is unreliable

Access to electricity is a main concern in Kosovo. The economy ranks 90th in the world for ease of getting electricity (World Bank, 2020[62]). Due to degraded and old electricity transmission and distribution networks, secure, reliable and constant supply is a challenge. Firms frequently identify electricity supply as the second greatest business constraint, along with informal sector practices. Electricity is the top constraint among enterprises with more than 100 employees (World Bank/EBRD/EIB, 2019[57]) (see the Prosperity, and Peace and institutions sections in this chapter). In 2019, 59.9% of firms in Kosovo experienced electrical outages, more than the Western Balkan average (48.9%) (World Bank/EBRD/EIB, 2019[57]). Although electric power transmission and distribution losses decreased from 22.94% in 2005 to 15.05% in 2014, Kosovo is regularly affected by important distribution losses. According to Kosovo's Energy Regulatory Office, in 2018, losses accounted for 14.6 % of electricity supply (of which 1.4% were transmission losses and 13.2% were distribution losses) (Energy Regulatory Office of the Republic of Kosovo, 2019[146]). Power transmission and distribution losses thus remain considerable, as they do in other Western Balkan economies (Figure 11.34). Theft remains important as well.

Figure 11.33. Energy intensity in Kosovo is higher than the regional average and almost double the EU average

TPES/GDP (toe/USD 1 000 2010 PPP), 2017 and 2010



Note: Data for the Czech Republic, Greece, the Slovak Republic, Slovenia and Turkey are from 2018.
Source: IEA Statistics (2018[147]), *IEA Statistics* (database), https://www.iea.org/data-and-statistics.

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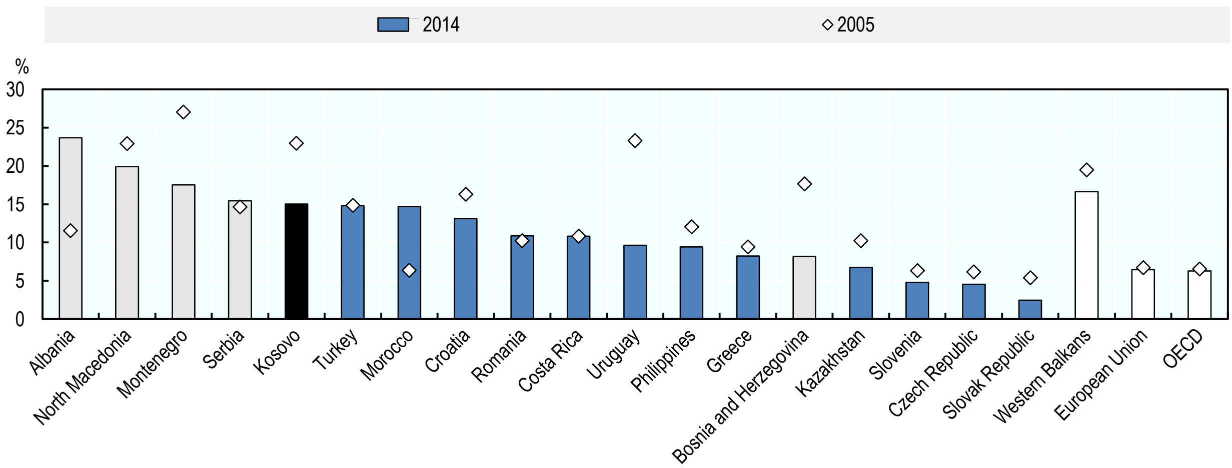
Kosovo needs to open and liberalise its energy market to implement the Third Energy Package fully.[19] There has been some progress: the certification of Kosovo's transmission system operator, KOSTT, is complete. The process to complete the requirements to unbundle electricity transmission systems operators is ongoing in Kosovo (Energy Community Secretariat, 2018[148]); however, the development of competition is stagnant (Energy Community Secretariat, 2019[144]). Moreover, the recent contract the government signed with ContourGlobal to build a 450 MW thermal power plant (Kosova e Re) substantially impairs the aim of an open and competitive electricity market in Kosovo, as it is at odds with European laws on competition and state aid (Energy Community Secretariat, 2019[149])(see the Prosperity, and Peace and institutions sections in this chapter).[20] The development of competition in the sector could result in a better quality of service and a more secure energy supply.

Despite recent progress, energy market integration in the Western Balkan region is not achieved and seriously affects Kosovo. At the time of writing, the connection agreement between KOSTT and the European Network of Transmission System Operators for Electricity (ENTSO-E) was expected to be enforced starting in autumn 2020. Technical preparations, through ENTSO-E and the Swiss transmission system operator, Swissgrid Coordinator, are ongoing. However, Kosovo's energy sector remains highly politicised, and due to the absence of a stabilisation of relations with Serbia, the energy supply will continue to suffer from unsolved issues between the transmission systems operators in both economies. As a result, the technical agreements between operators are signed but not fully implemented.

Figure 11.34. Electric power transmission and distribution losses have decreased but remain high compared to the EU and OECD averages

Electric power transmission and distribution losses (% of output), 2014 and 2005



Source: IEA Statistics (2018[147]), *IEA Statistics* (database), https://www.iea.org/data-and-statistics.

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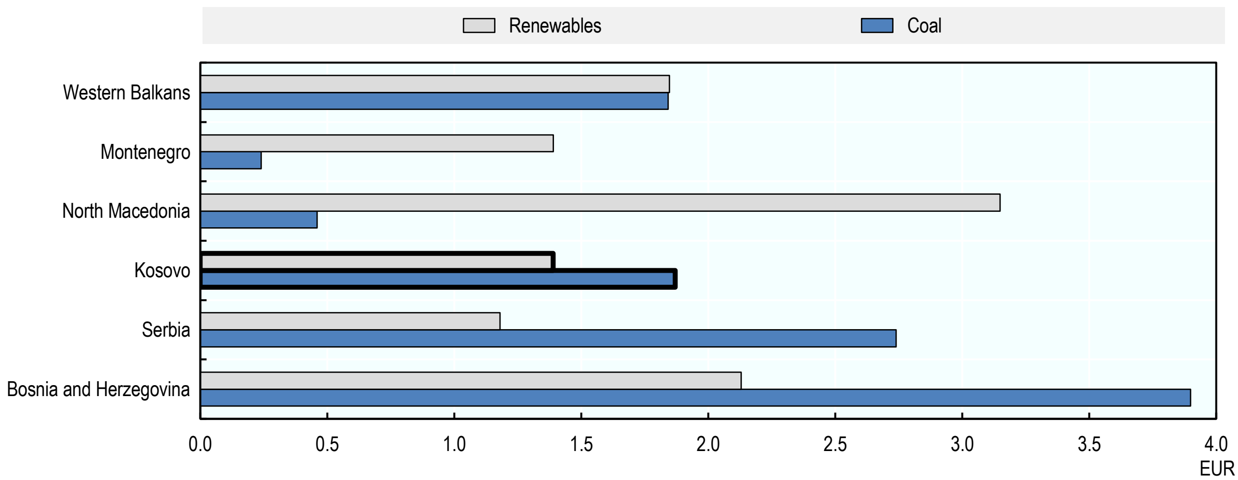
Energy efficiency needs to be improved and the social and environmental impact of energy production reduced

Kosovo has taken several steps to improve energy efficiency but needs to accelerate and prioritise the implementation of energy-efficiency policies. Energy-efficiency policies could reduce energy and carbon intensities and energy poverty. Kosovo adopted a law on energy efficiency in November 2018, but it has yet to be properly implemented. The Energy Efficiency Fund, established in 2019, is an independent and autonomous entity with its own governing body. This board of directors includes non-voting representatives from the World Bank and the European Union's office in Kosovo who monitor the fund's work and operations. The fund recently published calls for tenders for the implementation of energy-efficiency measures. It is important to accelerate these projects (European Commission, 2020[82]).

Along with transport (27%), the residential sector (38%) has the highest final energy consumption in Kosovo due to poor insulation of buildings, and many people cannot afford to pay their energy bills. About 29% of household costs are spent on housing, with the energy bill a main component. On average, 43% of Kosovars are unable to pay their utility bills and similar payments on time at least twice per year (Kosovo Agency of Statistics, 2016[150]) (see the People section in this chapter). Energy poverty is not defined and not monitored in Kosovo (Robić, 2016[151]).

Figure 11.35. Coal continues to benefit from higher incentives than renewables

Comparison of paid incentives (EUR/MWh) for electricity from renewables and from coal in end-user prices in the Western Balkans, 2017



Sources: Miljević (2019[152]), *Analysis of Direct and Selected Hidden Subsidies to Coal Electricity Production*, www.energy-community.org/documents/studies.html; Miljević (2019[153]), *Rocking the Boat: What is keeping the Energy Community's Coal Sector Afloat? Analysis of Direct and Selected Hidden Subsidies to Coal Electricity Production in the Energy Community Contracting Parties*, www.energy-community.org/documents/studies.html.

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Energy production based on brown coal and the development of small hydropower plants have a detrimental impact on Kosovo's environment and water resources. The planned new Kosova e Re coal plant close to Priština, estimated at EUR 1.3 billion (see Partnerships and financing section in this chapter), will not significantly reduce the existing negative impact of electricity production on air pollution and health in the capital and its surroundings. The number of hydropower plants increased between 2009 and 2018, and their capacities increased from 45.8 MW to 83 MW. This is despite Kosovo having limited hydropower potential and being water poor compared to its neighbours. However, the planned capacity is fixed at 120 MW by 2020 (initially 240 MW) by the National Renewable Energy Action Plan (Government of Kosovo, 2013[154]). New small hydropower plants have an impact on water resources and on the preservation of biodiversity. Several built and planned plants are in national parks (Gallop, Vejnovic and Pehchevski, 2019[155]). Kosovo should ensure that new hydropower projects comply with the EU acquis on concessions and the environment (European Commission, 2020[82]).

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Notes

[1] Calculation based on European Commission fatal accidents data (European Commission, 2019[7]) and SEE Jobs Gateway employment data (World Bank/Vienna Institute for International Economic Studies, 2020[23]).

[2] Calculation based on World Health Organization data (WHO, 2018[159]).

[3] Three in four firms attempting to fill a higher-skilled position and three in five attempting to fill a medium- to lower-skilled position encountered difficulties related to applicants' lack of skills and/or experience (World Bank, 2019[17]).

[4] Information obtained from interviews at the OECD fact-finding missions in Pristina.

[5] The reservation wage is the lowest wage that a person is willing to accept in order to become employed. An increase in the reservation wage can contribute to higher inactivity rates and can incentivise wage growth, especially if labour supply is constrained or if skilled labour is in short supply, as has been the case in Kosovo.

[6] As in most of the Western Balkans, kinships have a long historic tradition. In Kosovo, the centuries-old social and political village structure based on kinships became crucial to the provision of education and health services to the local population during the struggle for greater autonomy in the 1990s. Today, kin-based networks are in decline but seem still to explain part of relationships among individuals (Efendic and Ledeneva, 2020[76]).

[7] According to the Law on Local Self-Government (Law No. 03/L-40), the municipalities of Gracanica, Mitrovica North and Štrpce have enhanced competences for the provision of secondary health care, including registration and licensing of healthcare institutions, recruitment, payment of salaries and training of healthcare personnel and administrators. Mitrovica North has similarly enhanced competences for the provision of higher education. All municipalities in which the Kosovo Serb community is in the majority have enhanced competences for the management of cultural affairs.

[8] Kosovo Albanian teachers and university staff organised classes in alternative makeshift facilities, such as private houses, basements and garages, under the co-ordination of the Democratic League of Kosovo and with the financial support of informal municipality-level tax collection and remittances; 20 000 teachers and non-teaching staff supported around 300 000 students in 400 primary schools, 50 000 students in 65 secondary schools and approximately 10 000 university students in 20 faculties (Selenica, 2017[156]).

[9] In 2017, property taxes represented 34% of own revenues, followed by land development fees (28%), communal fees and charges (31%) and education and health fees (6%) (NALAS, 2018[158]).

[10] Central parties can steer the local hiring of public employees even at relatively low hierarchical levels. In 2012, for example, a minister forced through the employment of a security guard in a Kamenica school that was initially opposed by the local mayor (Jackson, 2018[157]).

[11] The budget allocated to the academy increased by more than 20% from 2017 to 2018.

[12] There are also 44 locally managed POEs in the transport (23), water and waste management (12), public housing (3), energy (2) and wholesale trade (2) sectors. Hereafter, subnational POEs are excluded from analysis, since consolidated information about their financial situation and employment is not available.

[13] With 4 000 employees, Korporata Energjetike e Kosoves in the energy sector is the largest POE by number of staff. It is the only POE to have registered profits in 2016 (EUR 11 million) and a positive return on equity in both 2015 and 2016 (7.4% and 10.8%, respectively).

[14] Registration costs have been decreasing. Still, it can take a company 6 procedures, 32 days and up to EUR 500 (including notary fees) to register a property (Worldometer, 2020[119]).

[15] Kosovo A and Kosovo B are on the top ten polluter lists for PM2.5, SO_2 and NO_2 (HEAL, 2016[124]).

[16] The ecological tax is collected as part of the annual vehicle registration.

[17] Kosovo's water and wastewater sectors rely heavily on financial support from the international donor community (see the Prosperity, and Partnerships and financing sections in this chapter). For example, between 1999 and 2011, the government allocated EUR 66 million from the budget for capital investment in the water sector, while the international donor community allocated around EUR 190 million (Government of Kosovo, 2016[138]).

[18] Non-volumetric pricing for irrigation in Kosovo is based on units of land (ha).

[19] The EU Third Energy Package aims at liberalising gas and electricity markets and empowering energy consumers.

[20] "On 20 December 2019, the Energy Community Secretariat sent an Opening Letter to Kosovo in Case ECS-4/19, addressing its concerns with regard to the illegality and existence of State aid in relation to the Kosovo e Re project. In particular, the Secretariat preliminarily found that certain measures, such as energy and availability payments over 20 years under the power purchase agreement, the sale and transfer of the plant site under market value, a state guarantee, a VAT exemption, and taking over several charges and costs constitute state aid. These measures have not been notified to the competent State aid authority and therefore constitute *per se* illegal state aid" (Energy Community Secretariat, 2019[149]).

Part V Assessing opportunities and constraints in North Macedonia

12 Overview: Identifying strategic opportunities for North Macedonia

Since its independence, North Macedonia has achieved significant success in the social, economic and institutional dimensions. It emerged as a manufacturing hub in the region, moved from lower middle-income to upper middle-income status, and doubled income per capita. Living standards of its citizens have improved, extreme poverty declined and social protection expanded. To face the next challenges and embrace a durable, sustainable and inclusive growth path, North Macedonia needs a long-term vision. This overview presents North Macedonia's strengths and constraints to development, as well as global and domestic trends that could catalyse or endanger future development. It then outlines strategic priorities to help North Macedonia improve the quality of life for all citizens, strengthen education and skills, aim for the high end of international value chains, build local government capabilities, broaden the revenue base, diversify the energy mix, and appreciate diversity.

Since its independence, the Republic of North Macedonia has achieved significant success in the social, economic and institutional dimensions. Income per capita doubled, and the economy moved from lower middle-income to upper middle-income status. Thanks to a strategic geographic location at the heart of the Western Balkan Peninsula, a relatively cheap labour force and generous tax credits, North Macedonia has appealed to foreign investors and emerged as a manufacturing hub in the region. On the social side, North Macedonia has improved the standard of living for its citizens, reduced extreme poverty overall and undertaken important social protection reforms. Since its identification as a potential candidate for European Union (EU) membership in 2003, North Macedonia has been aligning its legislative framework to the EU acquis relatively quickly. It was the first economy in the region to adopt the Stabilisation and Association Agreement in 2004. It earned the status of "candidate country" for accession to the European Union in 2005 and entered into formal negotiations for accession in March 2020.

To sustain this pace of development and ensure sustainable and inclusive growth in the long term, North Macedonia must tackle a set of important challenges. Foreign investors have had few incentives to create high-skilled jobs and to establish solid linkages with local firms. This makes North Macedonia vulnerable to competition from other economies with relatively cheaper labour forces, and to automation, which may push some multinationals to bring parts of the production chain back into their home economies. The young are seeking opportunities abroad, contributing to the ageing of the population, for which the health and social security systems are not ready. Political instability has become increasingly challenging, and informal behaviours and networks at times interfere with the proper functioning of institutions. Moreover, economic development has taken a heavy toll on the environment; Skopje is one of the most polluted capitals in Europe.

To ensure sustainable and inclusive development and to strengthen North Macedonia's economic and social resilience, a long-term vision should take precedence over short-term politics. A long-term strategy can provide a strong basis for policy coherence that goes beyond special interests and divisions and can provide a pathway for economic transformation and growth. This Multi-dimensional Review (MDR) aims at supporting North Macedonia to define a shared vision for the economy in 2030, charting the path and key objectives for achieving this vision and tackling the most important constraints that can hold back development. The next phase of the project will focus on peer learning to find solutions for the challenges that emerge from the initial assessments as shared across the region.

This overview chapter presents the main results of the initial assessment of development in North Macedonia. First, the chapter presents inputs for a development vision for North Macedonia for 2030, elaborated by participants of a strategic foresight workshop. Second, the chapter takes a bird's-eye view to assess North Macedonia's development performance on the basis of key statistics on well-being and the Sustainable Development Goals (SDGs) and summarises the key constraints to development identified in this report. It concludes by suggesting key strategic directions for the future. Given the global impact of COVID-19, this overview is followed by a special chapter on the impact of the pandemic in North Macedonia. Chapter 14 contains the full assessment of North Macedonia along the pillars of Sustainable Development: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet.

Whenever relevant and subject to data availability, North Macedonia is compared with four groups of benchmark economies. These groups are: 1) Western Balkan economies (Albania, Bosnia and Herzegovina, Kosovo, Montenegro and Serbia); 2) Organisation for Economic Co-operation and Development (OECD) economies (Costa Rica, Czech Republic, Greece, Slovak Republic, Slovenia and Turkey); 3) EU economies that are not part of the OECD (Croatia and Romania); and 4) economies that are neither in the OECD nor in the European Union (Kazakhstan, Morocco, the Philippines and Uruguay). The selection of benchmark economies is based on historical similarities (including their paths towards EU integration), economic structures, geographic proximity and mutual partnerships. The selection of non-OECD economies is based on similar economic and social challenges (such as high migration rates), shared history as transition economies, and similar development patterns. Such a broad set of benchmark economies can bring an additional perspective to North Macedonia and other Western Balkan economies and create valuable learning opportunities across selected policy dimensions.

This report benefited from close collaboration with the Government of the Republic of North Macedonia, especially the Cabinet of the Deputy President of the Government in charge of economic affairs and co-ordination of economic departments, and its Sustainable Development Unit. Moreover, it benefited from collaboration with and comments from multiple Directorates of the OECD and the financial and collaborative support of the Swedish International Development Cooperation Agency, which is gratefully acknowledged.

Towards a vision for North Macedonia in 2030: high quality of life, including access to quality education and health care for all citizens, built on sustainable economic development through an innovative local industry in combination with environmental protection

A clear vision of the desired future state of North Macedonia is an important guidepost for a national development strategy. A vision for a strategy should provide a description of what Macedonians expect from the economy, society, institutions and the environment, and what the most important elements are in each domain. To establish such a vision, a workshop entitled "North Macedonia: Vision and Challenges 2030" was organised in Skopje on 13 February 2020, gathering a broad range of participants from various public-sector ministries and agencies, the private sector, academia and civil society. The vision was built on the basis of simple narratives of the lives of future citizens of North Macedonia and subsequent clustering by the five pillars of Sustainable Development and this report: People, Prosperity, Partnerships and financing, Peace and institutions and Planet.

The narratives proposed for the vision highlighted aspirations for high quality of life, environmental sustainability and innovation. The narratives of the workshop evoked young and middle-age women with high levels of education. Most of them were successful entrepreneurs with innovative business models based on organic farming and agribusiness. All fictional citizens enjoyed middle-class lives, financial stability and access to quality health care. Citizens were involved in environmental activism and enjoyed high environmental quality based on organic agriculture, increased energy efficiency and renewable energies. In the narratives, North Macedonia is becoming an immigration rather than an emigration economy due to its high environmental quality and quality of life. The business environment is encouraging local production of innovative, high-quality goods, and these are exported all over the world. Emphasis was also placed on quality infrastructure and good connectivity within North Macedonia, support for and integration of ethnic minorities, eco-tourism, a decline in corruption and freedom of speech.

The resulting vision centres on innovation and local production, environmental quality and access to quality health care and education as the main levers for greater well-being. Box 12.1 presents the vision statements for North Macedonia in 2030 prepared by participants. North Macedonia of 2030 is envisioned as an economy with a business environment that encourages local production and entrepreneurship built on innovation and technological progress. The environmental quality is high, and energy efficiency and the transformation of the energy sector towards renewable energies are policy priorities. Citizens enjoy access to quality education, health care and public services, including an independent judiciary. Vulnerable groups are supported and integrated into society. In terms of the individual dimensions of this vision, quality education, a clean and healthy environment, rule of law and access to justice were considered most important, identified through a voting exercise (Figure 12.1).

Box 12.1. A development vision for North Macedonia in 2030

North Macedonia of 2030: high quality of life, including access to quality education and health care for all citizens, built on sustainable economic development through an innovative local industry in combination with environmental protection.

As part of the OECD strategic foresight workshop organised in Skopje on 13 February 2020, participants developed a vision statement that reflects the desired future for North Macedonia in 2030.

People

- The education system enables the development of competencies for life-long learning and innovation by providing formative and summative support. The school is an open, quality unit, which is a part of broader systems with better teachers, better school facilities and improved student performance.
- A reformed education system prepares children to become active contributors to society through applied skills, inclusivity (lack of discrimination) and a curriculum that is in line with modern life and science, adapted to the age and aligned with the needs of the labour market.
- The national health system is accessible and provides high-quality services thanks to significant investments in human capital and infrastructure, and to the mobilisation of financial resources.
- Measures for the inclusion of vulnerable groups are developed to ensure access to employment without discrimination.

Prosperity/Partnerships and financing

- A conducive and inclusive business environment allows continuous innovation and technological development. Innovation and technological development, smart specialisation and internationalisation increase the competitiveness and productivity of the economy. Productivity is also enhanced through better skills, decent jobs and a more predictable legislative framework. Renewable energies secure a sustainable use of resources.

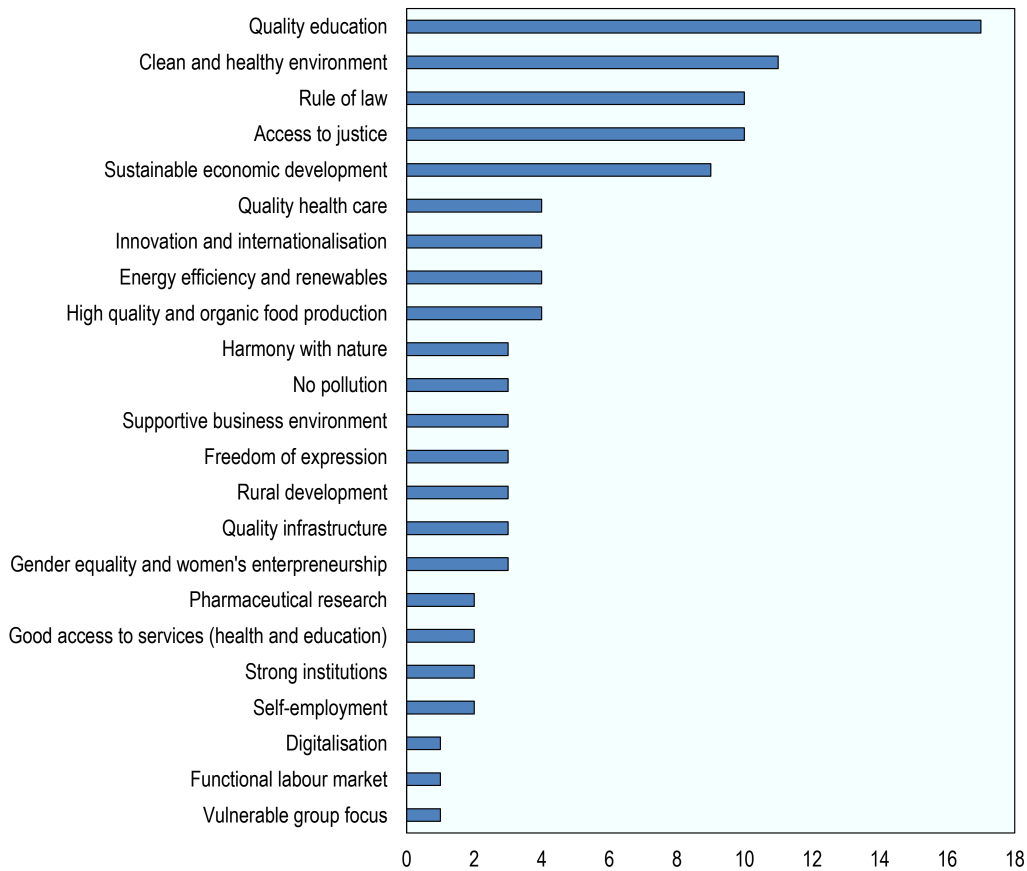
Peace and institutions

- By 2030, North Macedonia has an independent judiciary system, an optimised, functional and digitalised public administration through merit-based recruitment of public servants, easy access for citizens to quality public services, and a transparent and independent selection process for judges and prosecutors.

Planet

- By 2030, citizens of North Macedonia enjoy a clean and healthy environment with reduced air pollution, an energy-efficient industry, high-quality organic production, an increased capacity for renewable energies, and a circular economy. North Macedonia will have reached the targets set by the Paris Agreement through the development of a clear strategy, a transparent action plan that sets clear priorities and co-financing.

Figure 12.1. The most important dimensions of the vision for North Macedonia: education, a clean and healthy environment, rule of law and access to justice



Source: Authors' elaboration based on the voting exercise of the participants of the OECD strategic foresight workshop organised in Skopje on 13 February 2020.

StatLink https://doi.org/10.1787/888934244056

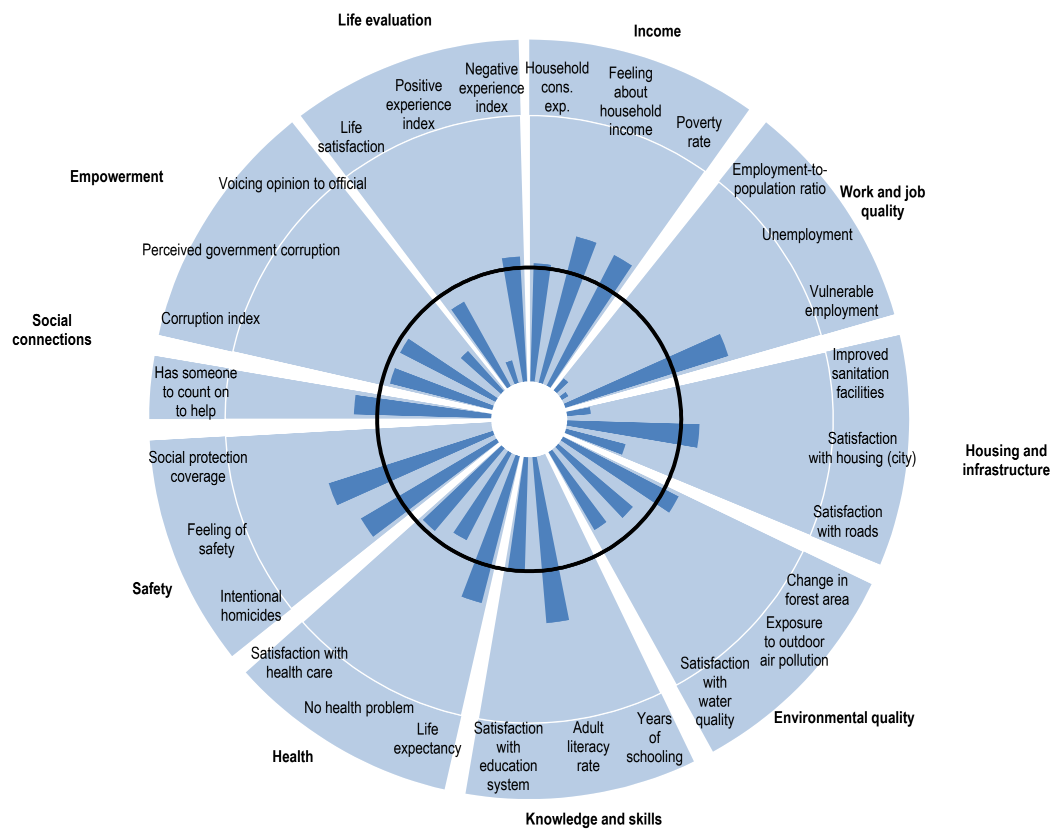
Assessing North Macedonia's development performance

Building on the vision, well-being around the world and sustainable development as benchmarks, this section reviews North Macedonia's development performance. The proposed vision emphasises well-being and sustainable development as the ultimate objectives of development. To assess the well-being of Macedonians, the OECD's Well-being Framework uses a mix of objective and subjective indicators across a range of dimensions that matter to people (OECD, 2020[1]) (Box 12.2). A version adapted to the realities of emerging economies compares North Macedonia to the level of well-being outcomes expected given its level of gross domestic product (GDP) per capita in a range of ten dimensions covering material conditions, quality of life and quality of relationships. In a second step, this section assesses North Macedonia's performance across the five pillars of the SDGs, applying distance-to-target measures across a selection of indicators and building on the analysis in the main body of this report.

North Macedonia's well-being performance is mixed. Macedonians feel comparatively safe and experience comparatively few homicides given the economy's level of GDP. The poverty rate is comparatively low, and people's satisfaction with their incomes and housing is comparatively high. However, there are weaknesses in other aspects of well-being: employment rates are low (in 2019, the employment-to-working-age population ratio was 47.3%) as are access to improved sanitation and satisfaction with water quality. Macedonians are comparatively dissatisfied with other parts of public infrastructure, such as roads and health care, and in 2019, comparatively few Macedonians (12%) reported having voiced their opinions to a public official in the month preceding the interview (Figure 12.2).

Figure 12.2. Current and expected well-being outcomes for North Macedonia: worldwide comparison

2019 or latest available data



Notes: The observed values falling inside the black circle indicate areas where North Macedonia performs poorly in terms of what might be expected from an economy with a similar level of GDP per capita. Expected well-being values (the black circle) are calculated using bivariate regressions of various well-being outcomes on GDP, using a cross-economy dataset of around 150 economies with a population of over 1 million. All indicators are normalised in terms of standard deviations across the panel. Data on social protection coverage and (mean) years of education are not available.

Sources: Gallup (2018[2]), "Gallup World Poll", www.gallup.com/analytics/318875/global-research.aspx; ILO (2020[3]), *ILOStat* (database), https://ilostat.ilo.org/data/; OECD (2020[4]), *OECD PISA database*, www.oecd.org/pisa/data/; Transparency International (2019[5]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/; UNESCO (2019[6]), "UNESCO Institute for Statistics", http://uis.unesco.org/; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WHO (2020[8]), *Global Health Observatory* (database), www.who.int/data/gho/data/countries.

StatLink https://doi.org/10.1787/888934244075

Box 12.2. Measuring what matters to people

As part of its broader Better Life Initiative, the OECD first created its Framework for Measuring Well-being in 2011 with the aim of putting people at the heart of policy making. This represented the culmination of longstanding work both inside and outside the organisation. Important strides to “go beyond GDP” had been made with the United Nations Development Programme’s Human Development Index and the work on multi-dimensional poverty by the Oxford Poverty and Human Development Initiative. The Framework also draws on rich academic literatures in welfare economics and capability theory, the recommendations of the Commission on the Measurement of Economic Performance and Social Progress (Stiglitz, Sen and Fitoussi, 2009[9]) and existing well-being and sustainable development measurement practice in OECD member and non-member economies. Since its launch, the work on well-being has continuously been updated in line with best practice and continues to be published in the OECD’s *How’s Life?* report series (OECD, 2020[1]). For the purpose of the MDRs, the OECD Well-being Framework has been adapted to fit the realities of economies at different stages of development (Boarini, Kolev and McGregor, 2014[10]).

The adapted OECD Well-being Framework used in this report focuses on living conditions at the individual, household and community levels that capture how people experience their lives “here and now”. Current well-being here is comprised of ten dimensions related to material conditions that shape people’s economic options (Income, Housing and infrastructure, Work and job quality) and quality-of-life factors that encompass how well people are (and how well they feel they are), what they know and can do and how healthy and safe their places of living are (Health, Knowledge and skills, Environmental quality, Life evaluation, Safety). Quality of life also encompasses people’s connectedness and engagement (Social connections, Empowerment).

Methodological considerations

To capture the full range of people’s actual life experiences, the OECD Well-being Framework uses both objective and subjective indicators. For instance, the Health dimension not only looks at life expectancy estimations but also considers how people feel about their health status and the health services they are receiving. Subjective indicators are sometimes viewed as not being as robust as objective measures; however, there are at least three reasons for considering them alongside the latter to get a holistic picture of well-being. First, there is solid methodological evidence that the subjective measures contained in the well-being framework (e.g. life satisfaction, trust in others and government) are statistically valid and correlate with objective measures of the same construct (OECD, 2013[11]; OECD, 2017[12]). Second, even in cases where perceptions diverge from objective reality, they capture the reality of survey respondents and can drive real-world outcomes, such as voting and lifestyle behaviours (Murtin, Fleischer and Siegerink, 2018[13]). It can actually be especially illuminating for policy makers to zoom in on areas where the gap between citizen perception and objective indicators is largest. Third, many of the measures typically considered objective and routinely used in policy analysis, such as household income, are based on people’s self-reports and can equally be affected by response biases and non-response rates (e.g. of very wealthy households).

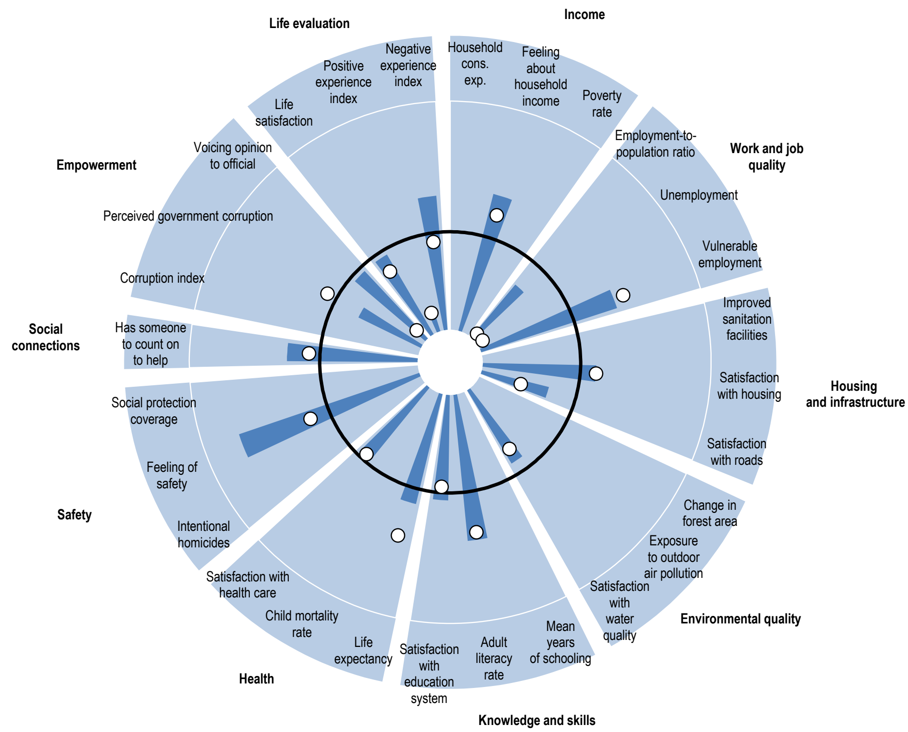
There are significant differences in well-being between men and women in North Macedonia, and this report finds that there is scope to improve women's equal participation in society (Figure 12.3). As in most economies around the world, women in North Macedonia have a higher life expectancy and are more socially connected than men (OECD, 2020[1]). However, as in other economies in the region, the low participation of women in paid work in North Macedonia is striking. After Kosovo, North Macedonia's gender gap in labour force participation is the highest in the Western Balkans at more than 24%. Women are also more likely to work in low-income jobs than men, and the estimated ratio of female-to-male earned income in North Macedonia is 0.49, which represents the highest regional pay gap (USAID, 2019[14]; Nikoloski, 2019[15]). This is partly why the contribution base for social insurance payments discussed in this report is so meagre. Gender differences in paid work are due to slow school-to-work transition, full-time household activities and cultural norms that encourage traditional division of labour. Indeed, about 41% of women but just 1.3% of men who are not in the labour force cite "personal and family obligations" as their primary reason for not looking for a job. While the economy has seen improvements in preschool enrolment, from 22% in 2012 to 35% in 2017, it is far behind the EU target of 95% (UNICEF, 2020[16]), and quality ratings for childcare services were the lowest of all surveyed economies in the European Quality of Life Survey in 2016 (Eurofund, 2018[17]). Policy options to encourage female labour force participation include expanding the availability and affordability of child care, in addition to promoting their acceptance; expanding barely existent institutional care for the elderly; reforming parental leave rules; and gender-sensitive public education (see the People section in Chapter 14).

The well-being analysis highlights gender differences in terms of safety. Men in North Macedonia are more likely than women to feel safe when walking at night in their neighbourhoods (Gallup, 2020[18]) (Figure 12.3). While this is not a surprising finding (men in every OECD economy feel safer than women), there are indications of prevailing gender norms that normalise violence against women. Some 14.5% of women, compared to 8% in OECD economies, justify husbands hitting or beating their wives for trivial reasons. North Macedonia ratified the Istanbul Convention, which requires the criminalisation of all forms of gender-based violence (GBV), as well as effective prevention and protection measures. However, the economy's criminal code only criminalises rape. Public policy should focus on implementing legislation for domestic violence prevention and improving data collection, since representative data on the extent of GBV in North Macedonia are currently not available (Tozija, 2020[19])

Gender differences in civic engagement and access to productive resources are apparent. Male citizens are more likely to voice their opinions to an official, and although 39% of parliamentary seats in North Macedonia are occupied by women, there remains a step from reaching parity. The gender quota for the national parliament does not include Roma or Turkish women, and overall female participation is much lower at the local level, where few women hold leadership positions. Only 8.5% of women in rural areas are members of a political party (USAID, 2019[14]). Furthermore, only 28% of women own property, which is traditionally registered in a man's name, and the share is even lower in rural areas.

Figure 12.3. Current and expected well-being outcomes for North Macedonia: gender differences

2019 or latest available data



Notes: Well-being outcomes for women are represented by circles; men's outcomes are represented by bars. The observed values falling inside the central black circle indicate areas where North Macedonia performs poorly in terms of what might be expected from an economy with a similar level of GDP per capita. Expected well-being values (the black circle) are calculated using bivariate regressions of various well-being outcomes on GDP per capita, using a cross-economy dataset of around 150 economies with a population of over 1 million. All indicators are normalised in terms of standard deviations across the panel.

Sources: Gallup (2018[2]), "Gallup World Poll", www.gallup.com/analytics/318875/global-research.aspx; ILO (2020[3]), *ILOStat* (database), https://ilostat.ilo.org/data/; OECD (2020[4]), *OECD PISA database*, www.oecd.org/pisa/data/; Transparency International (2019[5]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/; UNESCO (2019[6]), "UNESCO Institute for Statistics", http://uis.unesco.org/; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WHO (2020[8]), *Global Health Observatory* (database), www.who.int/data/gho/data/countries.

StatLink https://doi.org/10.1787/888934244094

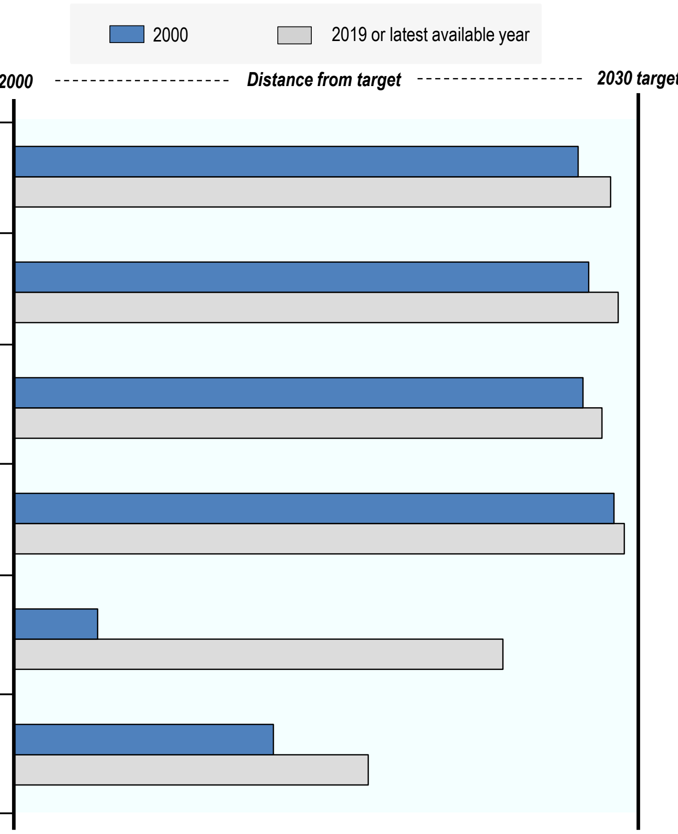
People – towards better lives for all

Despite progress in recent years, North Macedonia should increase its efforts to provide better opportunities for all its citizens and to improve their productive potential (Figure 12.4). North Macedonia has the highest market income inequality among all benchmark economies and is very far from attaining the SDG by 2030. Almost 25% of the population continues to live on less than USD 5.5 per day, and less than 50% of the working-age population held a formal job in 2019. In 2019, less than 50% of the working-age population held a job. These rates vary significantly across regions in North Macedonia. In 2019, the economy's youth unemployment rate of about 39% was the second highest in the Western Balkans. The exclusion of women from the labour market is discussed above. Although the literacy rate is very close to the SDG target, the current education system fails to equip people with job-ready skills.

Figure 12.4. People – progress towards the SDGs in North Macedonia

Progress towards 2030 SDG targets, 2000 to 2018 or latest available year

	2000	2019 or latest available year	2030 target
Poverty headcount ratio at USD 1.9 a day (2011 PPP) (% of population)	9.6% (2009)	4.4% (2017)	0%
Prevalence of undernourishment (% of population)	7.9%	3.2% (2017)	0%
Life expectancy at birth, total (years)	73	76 (2018)	80 a
Adult literacy rate, population 15+, both sexes (%)	96.1% (2002)	97.8% (2014)	100%
Proportion of seats held by women in national parliaments (%)	6.7%	39.2%	50%
Income share held by bottom 20%	4.1 (2009)	5.6 (2017)	9.9 b



Notes:
a. The target is the latest available average performance of OECD countries. Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.
b. The target is the latest available average performance of top 3 OECD performers. For income share held by bottom 20%, the top performers are the Czech Republic (10.2%), Slovenia (10%) and Finland (9.4%).
Sources: UNSD (2020[20]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; UNESCO (2019[6]), "UNESCO Institute for Statistics", http://uis.unesco.org/; UN IGME (2020[21]), *Levels and Trends in Child Mortality*, https://childmortality.org/; IPU (2020[22]), *Inter Parliamentary Union (database)*, www.ipu.org/; WHO (2019[23]), *Tracking Universal Health Coverage: 2019 Global Monitoring Report*, www.who.int/healthinfo/universal_health_coverage/report/2019/en; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

As in other Western Balkan economies, ethnic inequality in North Macedonia is stark, and minority groups are in many ways excluded from economic growth and society as a whole. Over 40% of the poorest quintile are estimated to belong to households of ethnic Albanian origins, with disposable incomes two-thirds those of households of ethnic Macedonian origins (World Bank, 2018[24]).[1] Roma communities, which constitute 2.7% of the population according to the 2002 Census, are left behind in multiple ways. For instance, Roma women have worse health indicators (e.g. fewer prenatal visits, lower quality of care), and their children suffer from stunting more than the rest of the population (World Bank, 2018[24]). In 2017, about 20% of Roma aged 15 to 64 were employed, compared to 40% of non-Roma in neighbouring communities – a slight improvement since 2011 but a widening of the gap with non-Roma. The situation is particularly hard on young Roma women, 80% of whom were not in employment, education or training (NEET) in 2017, compared to 60% of young Roma men (World Bank, 2018[24]). Lesbian, gay, bisexual, transgender and intersex (LGBTI) communities face continued discrimination and little acceptance in a rather conservative society. In late 2020, the Parliament voted and passed the new Law on Prevention and Protection against Discrimination, which is in important step in addressing issues related to discrimination.

North Macedonia needs better health care to tackle rising burdens of lifestyle diseases, a more inclusive social protection system and a financially viable pension system. There is room to restructure underused hospital services and boost underdeveloped and fragmented preventative and primary health care (PHC). Furthermore, the current social protection system can do more to target poor families with social assistance and remove disincentives to labour participation. Pensions in North Macedonia face challenges of sustainable financing given relatively generous benefits, low contribution rates and low labour force participation. The 2019 Law on Social Protection introduced price indexation of pension incomes in order to reduce the pension fund deficit in the short run. It envisaged the consolidation of existing social assistance programmes, introduced an improved equivalence scale, simplified administrative procedures and increased benefit eligibility thresholds and amounts. The People section in Chapter 14 identifies five major bottlenecks to the well-being of North Macedonia's population (Table 12.1).

Table 12.1. People – five major constraints to well-being in North Macedonia

1. People's well-being varies significantly across regions, and poverty disproportionally affects numerous ethnicities in North Macedonia.
2. Weak labour market institutions and lack of skills due to an inadequately developed education system result in low employment inclusiveness, particularly for young people.
3. Lack of child and elderly care services, restrictive parental leave policies and traditional cultural norms prevent many women from seeking paid employment.
4. The rising burden of lifestyle diseases needs to be addressed through increased healthcare funding and more efficient organisation, especially in public PHC.
5. Despite recent reforms, the current social protection system is not fully financially sustainable in the face of a low formal worker contribution base.

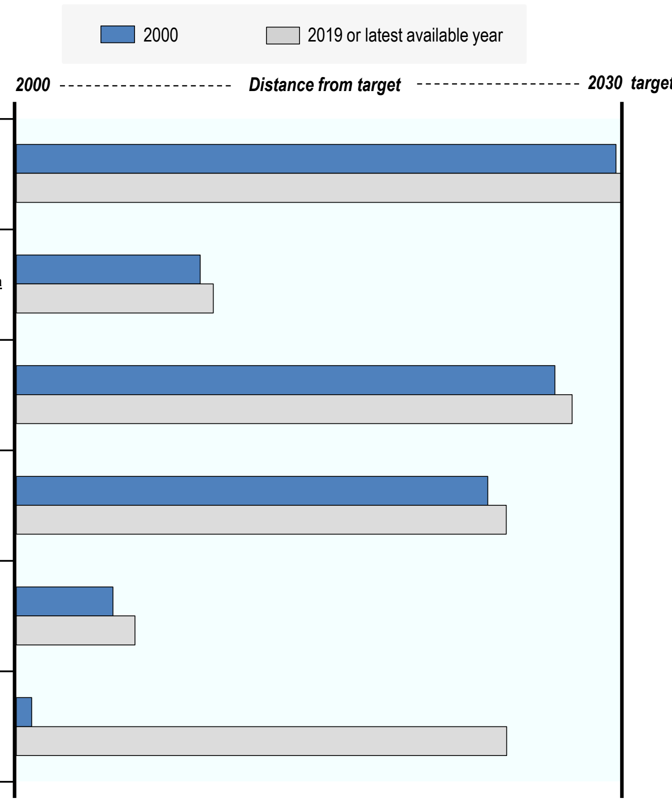
Prosperity – boosting productivity

Over the past decade, North Macedonia's economy has become more broad based, but spillovers have been limited. Since the 2008 global financial crisis, North Macedonia has been able to attract significant export-processing foreign direct investment (FDI) in its special economic zones. This has revived the automotive manufacturing sector and strongly contributed to the growth, diversification and upgrading of the export sector. However, with a high share of imported inputs and few supplier linkages with the domestic economy, the creation of spillovers throughout the economy and the contribution to higher GDP growth by the FDI sector has been limited. Looking forward, the conditions to create better linkages and specialise in high-end segments of regional and global value chains (GVCs) are slowly forming. For example, the sharp rise in Internet access among citizens over the years hints at the economy's increasing readiness to digitalise. The amount of resources dedicated to research and development (R&D), although low, is increasing (Figure 12.5).

Figure 12.5. Prosperity – progress towards the SDGs in North Macedonia

Progress towards 2030 SDG targets, 2000 to 2018 or latest available year

		2000	2019 or latest available year	2030 target
Access to electricity (% of population)	7 AFFORDABLE AND CLEAN ENERGY	99 (2006)	100 (2018)	100
Agriculture value added per worker (constant 2010 USD)	8 DECENT WORK AND ECONOMIC GROWTH	5 932	6 357 (2018)	19 537 a
Wage and salaried workers, total (% of total employment)	8 DECENT WORK AND ECONOMIC GROWTH	74.3	76.7	83.6 a
Account at a financial institution (% age 15+)	8 DECENT WORK AND ECONOMIC GROWTH	73.7 (2011)	76.6 (2017)	94.7 a
Researchers in R&D (per million people)	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	651	799 (2018)	4 079 a
Individuals using the Internet (% of population)	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	2.5	79.2 (2018)	97.8 b



Notes:

a. The target is the latest available average performance of OECD countries.

b. The target is the latest available average performance of top 3 OECD performers. For individuals using the internet (% of population), the top performers are Iceland (99%), Denmark (97.3%) and Luxembourg (97.1%).

Sources: UNSD (2020[20]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; ILO (2020[3]), *ILOStat* (database), https://ilostat.ilo.org/data/; UNESCO (2019[6]), "UNESCO Institute for Statistics", http://uis.unesco.org/; UN-Habitat (2020[25]), UN-Habitat Data and Analytics, https://unhabitat.org/knowledge/data-and-analytics; RICYT (2020[26]), *RICYT* (database), www.ricyt.org/en/; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; World Bank (2019[27]), *Sustainable Energy for All* (database), https://databank.worldbank.org/source/sustainable-energy-for-all/preview/on.

Three major obstacles undermine the creation of strong linkages between domestic small and medium-sized enterprises (SMEs) and the FDI sector. First, firms lack the capacities to innovate, adopt new technologies and meet the quality standards required by GVCs. Second, human capital is weak, and the skills that the market needs do not match those that Macedonian students can offer. Third, the political and regulatory environment is unstable, creating uncertainties that are often overcome through informal means. A biased playing field penalises the growth and development of SMEs. By addressing these underlying constraints, North Macedonia could not only foster the development of the SME sector but also strongly improve labour market outcomes and strengthen employment in higher-wage and higher-productivity jobs, thereby reducing unemployment and the brain drain. The Prosperity section in Chapter 14 identifies three major bottlenecks to a more dynamic development path (Table 12.2).

Table 12.2. Prosperity – three major constraints to a more dynamic economy of North Macedonia

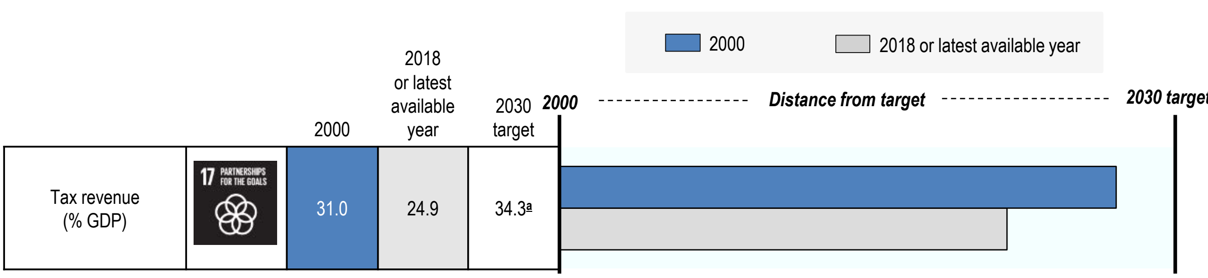
1. Linkages between the export-oriented FDI sector and the domestic economy have been limited.
2. Most domestic SMEs lack the capacities and skilled workforce to innovate, adopt technologies and meet quality standards to join GVCs.
3. Political instability, regulatory uncertainty and corruption undermine the growth and development of the private sector.

Partnerships and financing – financing sustainable development

North Macedonia needs to make considerable progress in improving the public sector revenue performance and increasing productivity-enhancing public investment. Over the past two decades, tax revenue as a share of GDP has increased marginally and is still well below the 2030 SDG target (Figure 12.6). Revenue performance is constrained by a low tax base, significant tax evasion, low tax rates and fiscal subsidies and exemptions aimed at promoting investment and employment. On the expenditures side, high and rising current expenditures, particularly pension-related transfers, have been constraining the growth of much-needed capital expenditures.

Figure 12.6. Partnerships and financing – progress towards the SDGs in North Macedonia

Progress towards 2030 SDG targets, 2000 to 2018 or latest available year



Notes:
a. The target is the latest available average performance of OECD countries.
Source: World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Financing for the private sector remains a considerable constraint. Recently, the offer of financing instruments for innovation, start-ups and SMEs has been expanding and diversifying. However, bank financing for enterprises is still limited by high collateral requirements and lack of good-quality projects. The limited non-bank financing and capital markets further limit the financing options, particularly for risky innovative projects. The Partnerships and financing section in Chapter 14 identifies three major bottlenecks to a more dynamic development path (Table 12.3).

Table 12.3. Partnerships and financing – four major constraints to the financing of sustainable development in North Macedonia

1. The fiscal space has narrowed, limiting the scope for further provision of economic stimulus.
2. Revenue performance is constrained by high informality, low taxes and high exemptions.
3. High current expenditures have been crowding out capital spending.
4. Access to finance is constrained, particularly for the SME sector.

Peace and institutions – strengthening governance

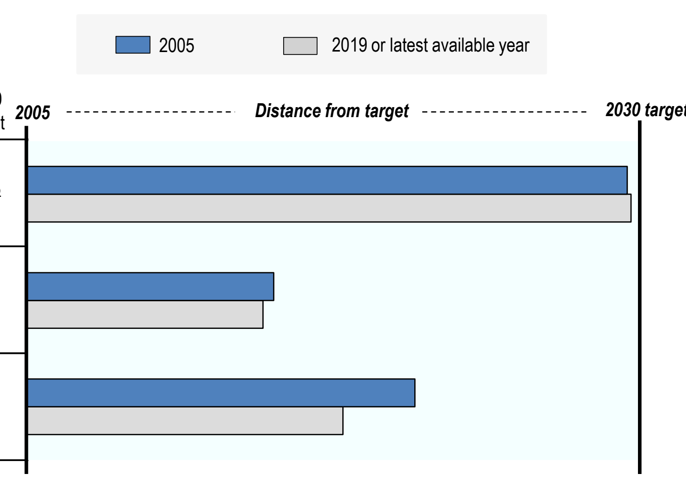
Since its independence, North Macedonia has made concrete institutional progress amid political instability and uncertainty. As part of the Stabilisation and Association Process (SAP), the economy has been aligning its legislative framework to the EU acquis relatively quickly and partly successfully and adopted a Stabilisation and Association Agreement in 2004. Moreover, North Macedonia has signed multilateral agreements (such as the Central European Free Trade Agreement [CEFTA]) and bilateral free trade agreements with Turkey and Ukraine, opening up access to markets with more than 650 million consumers. Property rights are not as salient a problem as in neighbouring economies, although private agricultural land remains fragmented. The economy is relatively more peaceful than other economies in the region and is increasingly safer (the intentional homicide rate has been decreasing over the past 20 years). These results are even more impressive considering the economy is highly politically unstable and has been hit by serious scandals; indeed, perceived corruption is mounting (Figure 12.7).

Undue use of institutions, multi-level governance and pending ethnic grievances are three major obstacles that still prevent the economy from reaching its true potential (Table 12.4). Politicians and representatives of special interests have been using the tight interpersonal relationships that characterise the economy to distribute public jobs in exchange for support. This has had consequences for citizen trust in institutions, especially for trust in the judiciary (Figure 12.7) and has undermined the effectiveness of public administration. A complicated regional development framework, together with poorly implemented decentralisation laws, hinders the distribution of resources across the economy, leaving places (especially outside of Skopje) behind. The mechanisms to safeguard power sharing among ethnic groups have sometimes impeded the basic functioning of the state, such as the appointment of judges, as well as its statistical capacity. Partly because of ethnic tensions, the economy has not had a census in the past 20 years, which in turn hampers evidence-based policy making.

Figure 12.7. Peace and institutions – progress towards the SDGs in North Macedonia

Progress towards 2030 SDG targets, 2000 to 2019 or latest available year

	SDG	2005	2019 or latest available year	2030 target
Intentional homicides (per 100 000 people)	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	2.1	1.5 (2017)	0.4 b
Confidence in judiciary (% of respondents)	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	23% (2006)	22%	57 a
Corruption perception index	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	43 (2012)	35	68 a



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For international homicides rate, the top performers are Japan (0.26), Luxembourg (0.34), and Norway (0.47)..
Sources: UN-CTS (2020[28]), *Sustainable Development Goals* (database); World Bank (2020[7]), *World Development Indicators* (database); Transparency International (2019[5]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/results/.

Table 12.4. Peace and institutions – five major constraints to more effective public institutions and services in North Macedonia

1. Lagging fiscal capacity, a complex system of transfers and inefficient organisation of the territory jeopardise the implementation of decentralisation reforms.
2. The approach to regional development is confusing and creates inefficiencies.
3. The judicial system suffers from undue external interference.
4. Agricultural land is still very fragmented, undermining productivity and sustainability.
5. The lack of a census presents huge challenges to inclusive and accurate policy design.

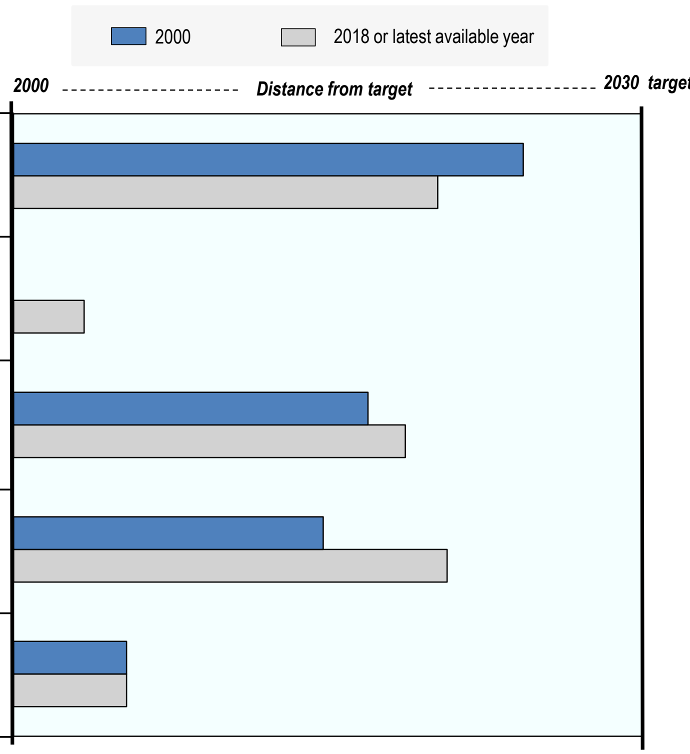
Planet – conserving nature

North Macedonia must do much more to reduce persistently high levels of air pollution and carbon dioxide (CO_2) emissions (Figure 12.8). Air pollution continues to pose a significant challenge. The economy's annual exposure to particulate matter (PM) 2.5 decreased from 39.1 µg/m^3 in 2005 to 33 µg/m^3 in 2017 but remains the worst value in the region and above the World Health Organization (WHO) recommended maximum (annually) of 10 µg/m^3. Skopje remains one of the most polluted capitals in Europe. The CO_2 emissions from fossil fuel combustion cover almost 80% of the total greenhouse gas (GHG) emissions in the economy, with a dominant share from the energy supply, buildings and transport sectors (Government of the Republic of North Macedonia, 2015[29]). North Macedonia has committed to reducing CO_2 emissions from fossil fuel combustion by up to 72.8% in 2040, compared to business as usual (Government of the Republic of North Macedonia, 2019[30]). To meet this objective and the SDG targets for air pollution and CO_2 emissions for 2030, energy efficiency policies must be strengthened significantly, and North Macedonia's supply of renewable energies must be stepped up. Except for hydro, the share of renewables in North Macedonia's energy mix remains low and considerably below both the 2030 SDG target of 10.3% and the 2040 target of 35%-45% (including hydro) in North Macedonia's new energy strategy 2040 (Government of the Republic of North Macedonia, 2019[30]).

Figure 12.8. Planet – progress towards the SDGs in North Macedonia

Progress towards 2030 SDG targets, 2000 to 2018 or latest available year

Indicator	2000	2018 or latest available year	2030 target
People using safely managed drinking water services (% of population)	97.3	81 (2017)	100
Electricity production from renewables (%, excluding hydro)	0.0	2.9 (2019)	21.5 a
Mean annual concentration of PM2.5 weighted by population (μg/m^3)	36.4	29.7 (2017)	6.0 b
CO2 intensity of GDP (kg CO2 per unit of GDP in 2017 USD PPP)	0.45	0.23	0.07 b
Terrestrial protected areas (% of total land area)	9.7 (2016)	9.7	44.7 b



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For mean annual concentration of PM2.5 weighted by population, the top performers are Finland (5.9%), New Zealand (6%) and Sweden (6.2%). For CO2 emissions, the top performers are Sweden (0.062), Switzerland (0.064), and Norway (0.078). For territorial protected areas, the top performers are Slovenia (53.6%), Luxembourg (40.9%) and Poland (39.7%). TPES = total primary energy supply.
Sources: UNEP (2020[31]), *Environment Live/Global Material Flows* (database), www.resourcepanel.org/global-material-flows-database; UNSD (2020[20]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; IEA (2018[32]), *World Energy Balances*, www.iea.org/reports/world-energy-balances-overview; OECD (2020[33]), *Green Growth Indicators* (database), https://stats.oecd.org/Index.aspx?DataSetCode=GREEN_GROWTH; UNEP-WCMC (2018[34]), *World Database on Protected Areas*, https://www.protectedplanet.net/; WHO/UNICEF (2020[35]), *JMP for Water Supply, Sanitation and Hygiene*, http://washdata.org/; World Bank (2020[7]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

North Macedonia needs to protect its rich environment better. When it comes to biological diversity, the economy is located in one of the richest European regions, with a high degree of endemism, and has 86 protected areas covering 10% of the territory, which is similar to the regional average but very low compared to the 2030 target of 44.7% (Ministry of Environment and Physical Planning, 2018[36]). The Planet section in Chapter 14 identifies three key challenges to a more sustainable path (Table 12.5).

Table 12.5. Planet – three major constraints to environmental quality and energy sustainability in North Macedonia

1. Exposure and vulnerability to natural hazards.
2. The deterioration of the environmental quality of life of all Macedonians.
3. High dependence on coal and the energy supply is not sufficiently efficient and secure.

Suggestions for strategic priorities for North Macedonia

The combination of visioning and multi-dimensional constraints analysis in this report points to seven strategic priorities for North Macedonia. Achieving them will require a strong focus on evidence-based action and addressing the problems that hold back opportunity. Clear problem definitions and implementation mechanisms are key to evaluating the immediate impact of actions and improving or adjusting actions during implementation (Rumelt, 2011[37]). The six priorities are: 1) quality of life for all citizens; 2) stronger education and skills (including for digitalisation); 3) aiming for the high end of international value chains; 4) capable local governments and service delivery; 5) a more sustainable revenue base and willingness to contribute; 6) a better energy mix for a better environment; and 7) appreciation for diversity.

Improving the quality of life of Macedonians should be the overarching goal of a development strategy. The visioning workshop revealed the value citizens attach to good health care, clean air and economic and job opportunities. The rule of law is another important element of quality of life. Providing the best quality of life possible in all regions and for all citizens (i.e. women and men, citizens of different ethnic backgrounds) and leaving no one and no places behind should form the guiding principle of future strategies. It will entail a strong focus on effective service delivery, and on creating a high-performing economy that generates opportunities and revenue.

Good education must be a top priority, both as a core element of a vision of well-being and an informed citizenry and to drive innovation and economic development. The participants of the foresight workshop placed quality education as the most important element of a positive future for North Macedonia. At the same time, skills mismatches and deficiencies are important obstacles to job creation and economic success. Education in North Macedonia should focus on delivering more practical skills and hands-on experience while empowering students to engage in the democratic process through civic education, regardless of their gender or their ethnic or socio-economic background. Putting schools in the driver's seat – equipping them with effective power and good governance – would be an important step. Many workers in North Macedonia have obtained skills and competencies without formal education. They should have the opportunity to have them validated.

The high-end segments of regional and global supply chains hold potential for North Macedonia; domestic micro-, small- and medium-sized enterprises (MSMEs) can play an important role. Around 70% of companies in North Macedonia operate with fewer than ten people. Because of their size, MSMEs could become ideal providers of the types of services GVCs are increasingly asking for. For instance, logistic and business services could boost exporting firms' capacity, optimise their production systems and improve the quality of their products. Most of these services are highly human-capital intense and require the mastery of digital tools, big data and other transferable skills. The mobilisation of MSMEs require reforms that level the playing field, remove administrative barriers to doing business and eradicate corruption.

Empowering local governments and effective regional development present major strategic opportunities. North Macedonia has the institutional framework in place for a strong bottom-up process of economic development. However, too many channels of resource distribution from the centre to local governments create inefficiencies and open the door to special interests. This needs streamlining, with a strong role for the regional fund, which gives voice to local communities in setting local development objectives. Future strategies must focus on making local governments more capable of delivering quality services and local development. This will require a genuine reform of multi-level governance, introducing the right incentives and budget framework.

Insufficient tax revenues and contributions to social protection systems pose a significant constraint to North Macedonia's ambitions. In the face of significant investment needs, fiscal space is limited, and low labour force participation and generous benefits undermine the financial sustainability of pensions. Envelop wages are common, and undeclared income has been recorded among 44% of employees. Under-reporting of sales and non-issuance of fiscal receipts are also highly prevalent, and the share of companies operating entirely in the grey economy appears to be high. New reforms are on their way and need timely monitoring and assessment of their impact on informality and tax elusion. A new tax regime that was able to broaden the tax base would increase the resources that central and subnational governments could invest in public goods and services. It would moreover improve the viability of the health and social security systems, which is of utmost importance given the ageing population and the outmigration of the young.

The transition towards a new development model must be respectful of the economy's natural resources. Authorities have acknowledged the negative externalities that growth has imposed on the environment, particularly in terms of air quality. North Macedonia has committed to reducing the CO_2 emissions from fossil fuel combustion by up to 72.8% until 2040 (Government of the Republic of North Macedonia, 2019[30]). This creates momentum for a radical restructuring of the energy mix and further diversification of renewables away from hydroelectric power.

The success of North Macedonia's development will depend on its ability to ensure social cohesion and to respect diversity. Reforms work best with a shared social fabric, where individuals feel part of the same long-term project. This can happen if authorities and citizens were accepting of the economy's historically multi-ethnic nature. Ethnic divisions are still a challenge and the reason for some complications in the institutional set-up. Ethnic diversity should become a strategic resource for long-term sustainable growth, as the juxtaposition of various cultural inheritances could contribute to the economy's unique trademark. In practice, this means going beyond the existing framework and finding a new balance with a stronger emphasis on the effectiveness of institutions and policy, rather than quotas.

The process of integration into the European Union is one of the drivers of North Macedonia's development. The strategic importance of EU accession for North Macedonia is clearly stated in key policy documents. North Macedonia was the first economy in the region to adopt the Stabilisation and Association Agreement in 2004, and the European Union officially opened negotiations for accession in March 2020 (Box 12.3).[2] This process offers North Macedonia new opportunities to address the constraints identified in this report.

Box 12.3. North Macedonia's integration towards the European Union

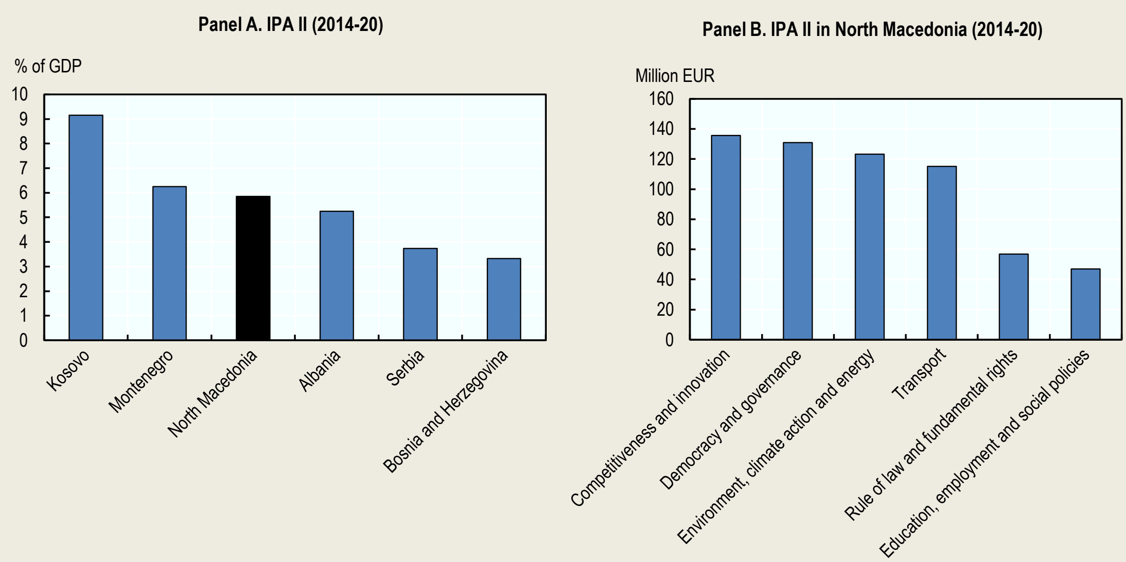
The process towards integration towards the European Union has been an important driver of democratisation and institution building in North Macedonia and has provided the economy with large financial and technical support for its development and regional integration. As part of the process, North Macedonia has worked to bring its legislation into line with the existing body of EU laws and standards (known as the acquis).

Through the SAP, since 1999, North Macedonia and the economies in the region have been involved in a progressive partnership with the European Union. The SAP rests on the following pillars: bilateral Stabilisation and Association Agreements, trade relations (broad ranging trade agreements), financial assistance (the Instrument for Pre-accession Assistance [IPA]) and regional co-operation, such as the CEFTA.

The Stabilisation and Association Agreement with North Macedonia, which entered into force in 2004, governs relations between North Macedonia and the European Union. The Agreement offers various benefits to citizens and businesses in North Macedonia (such as visa-free travel), supporting institutional and democratic reforms and encouraging neighbourly relations and trade (European Commission, 2018[38]).

The IPA has been instrumental in providing North Macedonia with technical and financial assistance for reforms. North Macedonia is the third largest IPA II recipient in the Western Balkans for 2014-20 in both absolute and relative terms: IPA II amounted to EUR 608.8 million and accounted for 5.8% of GDP (Figure 12.9 – Panel A). Around 65% of the funds received (EUR 389.8 million) has been allocated to projects that improve economic competitiveness and innovation capacity, strengthen democracy and governance, and create a cleaner environment and support the transition towards a low-carbon economy (Figure 12.9 – Panel B).

Figure 12.9. IPA II in North Macedonia (2014-20) funding has been concentrated on democracy and governance, and rule of law and fundamental rights

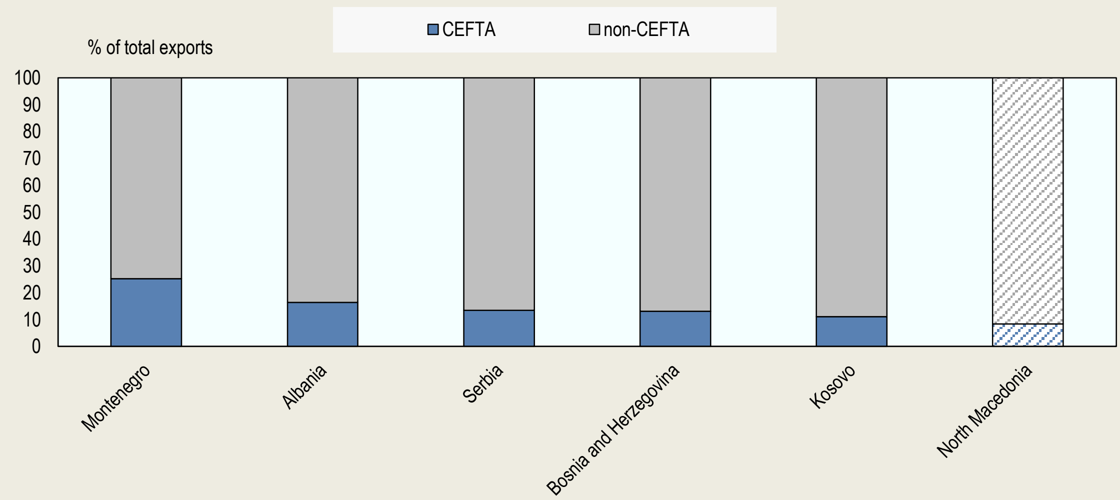


Source: Authors' elaboration based on European Commission (2020[39]), "North Macedonia – financial assistance under IPA II", https://ec.europa.eu/neighbourhood-enlargement/instruments/funding-by-country/north-macedonia_en.

StatLink https://doi.org/10.1787/888934244113

The SAP has promoted regional co-operation by establishing a number of initiatives, such as the Energy Community, the Western Balkans Investment Framework and the Regional Cooperation Council, and the CEFTA. The CEFTA in particular aims to facilitate trade in the region and harmonise trade-related legislation with the European Union. North Macedonia's volume of exports towards CEFTA economies is the third largest in the region in absolute terms (USD 763 million in 2018) but the lowest in relative terms (Figure 12.10). The share of North Macedonia's exports towards the CEFTA economies has been increasing, from 2.6% in 2012 to 8.4% in 2019. Within the Western Balkans, North Macedonia directs exports towards Kosovo (40.5%), Serbia (33.8%), Bosnia and Herzegovina (11.5%), Albania (9.9%) and Montenegro (4.3%).

Figure 12.10. The role of the CEFTA in North Macedonia



Source: CEFTA (2020[40]), *Trade in goods* (dataset), https://statistics.cefta.int/goods.

StatLink https://doi.org/10.1787/888934244132

The General Affairs Council decided to open accession negotiations with North Macedonia in March 2020 in view of its progress in implementing key institutional reforms. In particular, the Council acknowledged the significant legislative steps taken to strengthen the independence of the judiciary, reform intelligence and security services and enhance the quality and transparency of public administration (European Commission, 2020[41]). Since then, the European Commission has moved forward, and in July 2020, it presented a draft negotiating framework, which lays out new guidelines and principles needed to start accession talks (European Commission, 2020[42]). As of November 2020, the Council had not yet adopted the framework.

On 6 October 2020, the European Commission adopted a new Enlargement Package and a comprehensive Economic and Investment Plan for the Western Balkans. These two sets of documents aim to spur the long-term recovery of the region, enhance structural reforms, overcome structural weaknesses, strengthen innovation potential and accelerate the green and digital transitions in the region (European Commission, 2020[43]). In particular, the Plan is set to mobilise up to EUR 9 billion of IPA III funding for 2021-27. The large majority of this support will be directed towards key productive investments and sustainable infrastructure in the Western Balkans through ten flagship initiatives. Furthermore, a new Western Balkans Guarantee facility aims to raise investments of up to EUR 20 billion in the region. This financial support is particularly crucial in light of COVID-19's disruptive effects on Western Balkan economies (European Commission, 2020[43]).

Note: The ten flagship initiatives include investments in transport infrastructure projects connecting east to west (flagship 1), north to south (flagship 2) and the coastal regions (flagship 3), renewable energy (flagship 4), transition from coal (flagship 5), renovation of buildings (flagship 6), waste and water management (flagship 7), digital infrastructure (flagship 8), competitiveness of the private sector (flagship 9), and youth support (flagship 10).
Source: European Commission (2020[41]; 2020[42]; 2020[43]; 2018[38]); (CEFTA, 2020[40]).

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Notes

[1] Estimations are based on the nationally representative 2017 Quality of Life population survey carried out by the Finance Think research institute. Official poverty breakdowns by ethnicity can only be confirmed in the next census round, planned for 2021.

[2] At the time of the OECD's fact-finding mission and the visioning workshop in Skopje 2-7 February 2020, the decision to start negotiations was still on hold, which affected elaboration of challenges and the inputs for the vision.

13 Impact of COVID-19 in North Macedonia

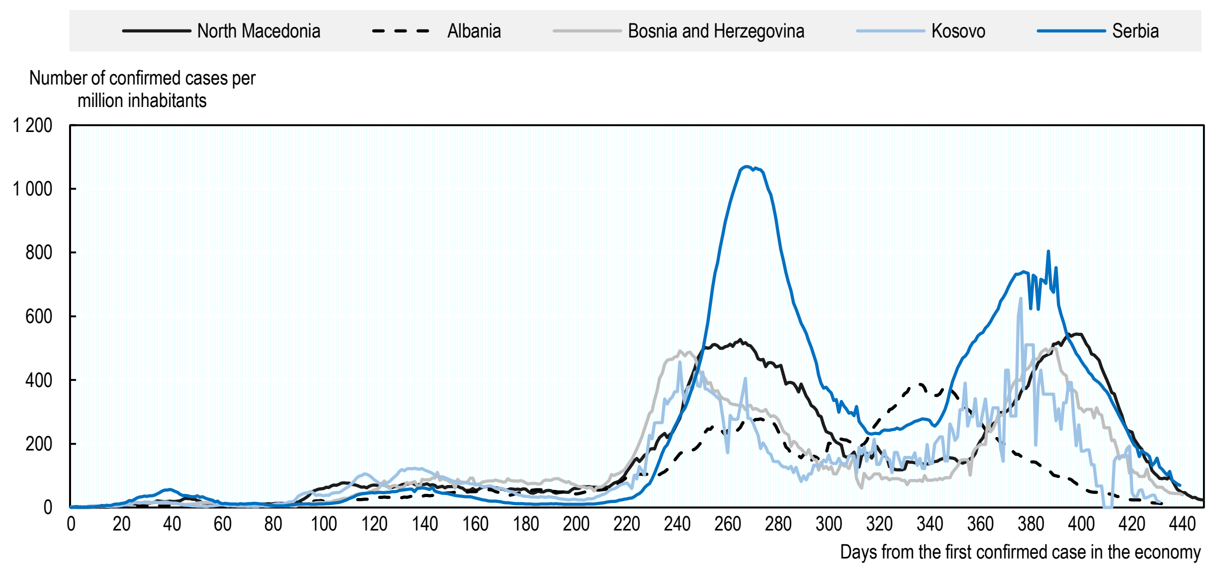
COVID-19 took a relatively high toll on North Macedonia's citizens and economy. Authorities acted quickly to contain the spread of the virus, and took measures to mitigate the negative effects of restrictions on the economy. Yet, the medium- to long-term impact of the pandemic will largely depend on pre-existing socio-economic vulnerabilities. This chapter reviews the most binding of them. In particular, as a small and open economy, North Macedonia is particularly exposed to a reduction in global trade flows and financing, as well as a weakening tourism sector. The pandemic hit the hardest already vulnerable groups, the poor and the unemployed, who accounts for a large share of the population. Building resilience will depend on the strength and capacity of institutions to timely design and implement policy measures, as well as on the citizens' trust in the public decision-making process and the efficiency of the public administration.

Evolution of the pandemic

COVID-19 has had a relatively high health impact in North Macedonia. The first case of COVID-19 was reported on 26 February 2020. Three and a half months later (on 29 June), the economy registered 6 092 cases (2 933 cases per million inhabitants) and 286 registered deaths (138 per million inhabitants). Importantly, the situation worsened as of the end of May: the number of cases increased sharply, resulting in a new wave of contagion. As of 26 May 2021, the economy counts an accumulated 154 640 cases (or 74 454 per million inhabitants) (Figure 13.1) and the second highest number of COVID-19 deaths in the region with 5 337 registered deaths (or 2 570 per million inhabitants) (Figure 13.2).

Figure 13.1. North Macedonia reported the highest number of new daily cases in the Western Balkans

Daily new confirmed COVID-19 cases per million inhabitants, rolling seven-day average



Note: North Macedonia reported its first COVID-19 case on 26 February 2020.
Source: Authors' own calculations based Our World in Data (2020[1]), Our World in Data website, https://ourworldindata.org/coronavirus.

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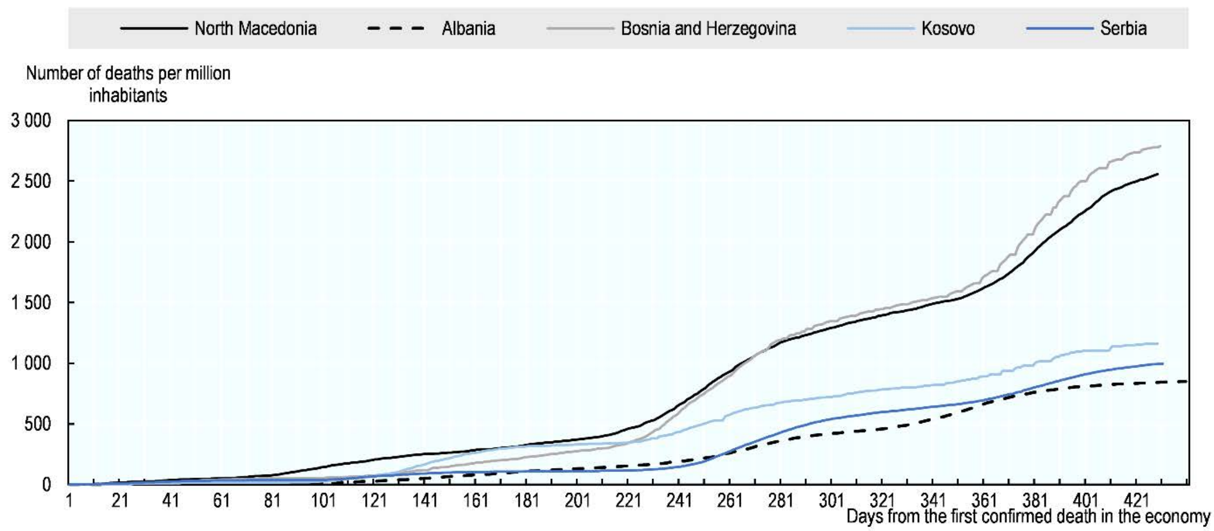
Figure 13.2. North Macedonia reported the second-highest number of COVID-19 registered deaths per million inhabitants in the Western Balkans

Cumulative number of confirmed COVID-19 deaths per million inhabitants

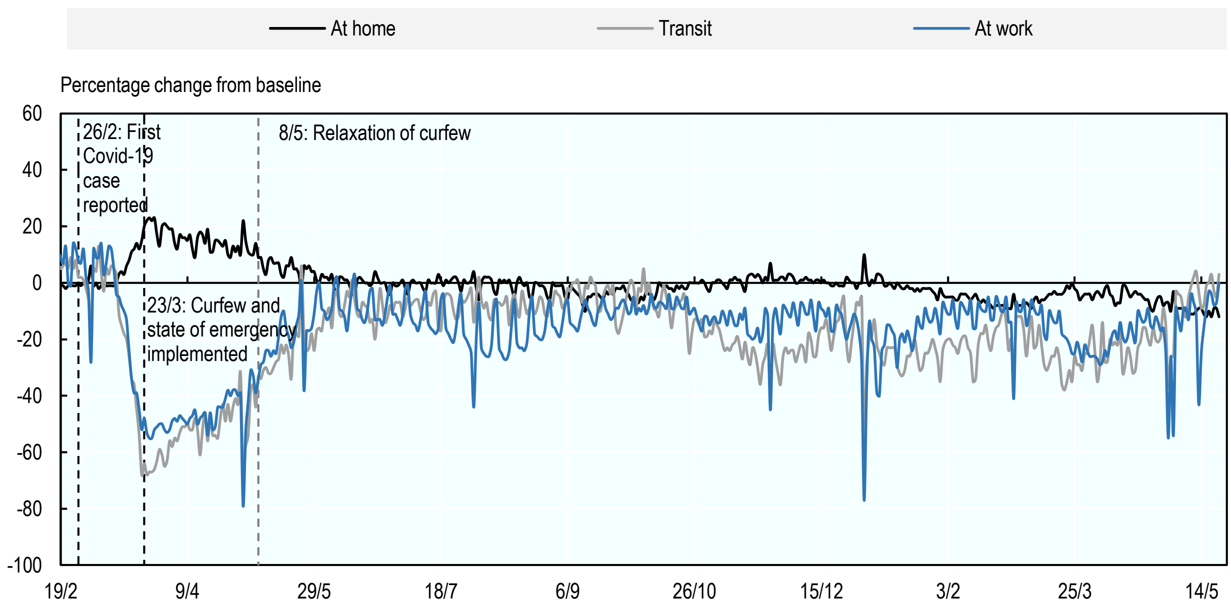


Note: North Macedonia reported its first COVID-19 death on 22 February 2020.
Source: Authors' own calculations based Our World in Data (2020[1]), Our World in Data website, https://ourworldindata.org/coronavirus.

StatLink https://doi.org/10.1787/888934244170

Authorities in North Macedonia acted quickly to contain the spread of the virus, yet future health resilience is not guaranteed. On 18 March 2020, three weeks after the first case was announced, a 30-day nationwide state of emergency was declared, restricting public gatherings and the movement of people. As of 22 March, a curfew was put in place. The government closed all schools, cultural premises, restaurants, non-critical stores and borders. Only essential businesses, such as food stores and pharmacies, remained open. The parliamentary elections scheduled for April were postponed to 15 July. The measures led to about a 95% decrease in movements throughout the economy (Figure 13.3). As of the latest available data, North Macedonia has conducted 373 491 tests per million inhabitants since the beginning of the pandemic (Figure 13.4). Increasing testing capacity will be crucial in detecting new cases and in strengthening the economy's health resilience. With 2 people fully vaccinated per hundred inhabitants by the latest available data, vaccine capacity in North Macedonia is the second lowest in the region (Figure 13.5).

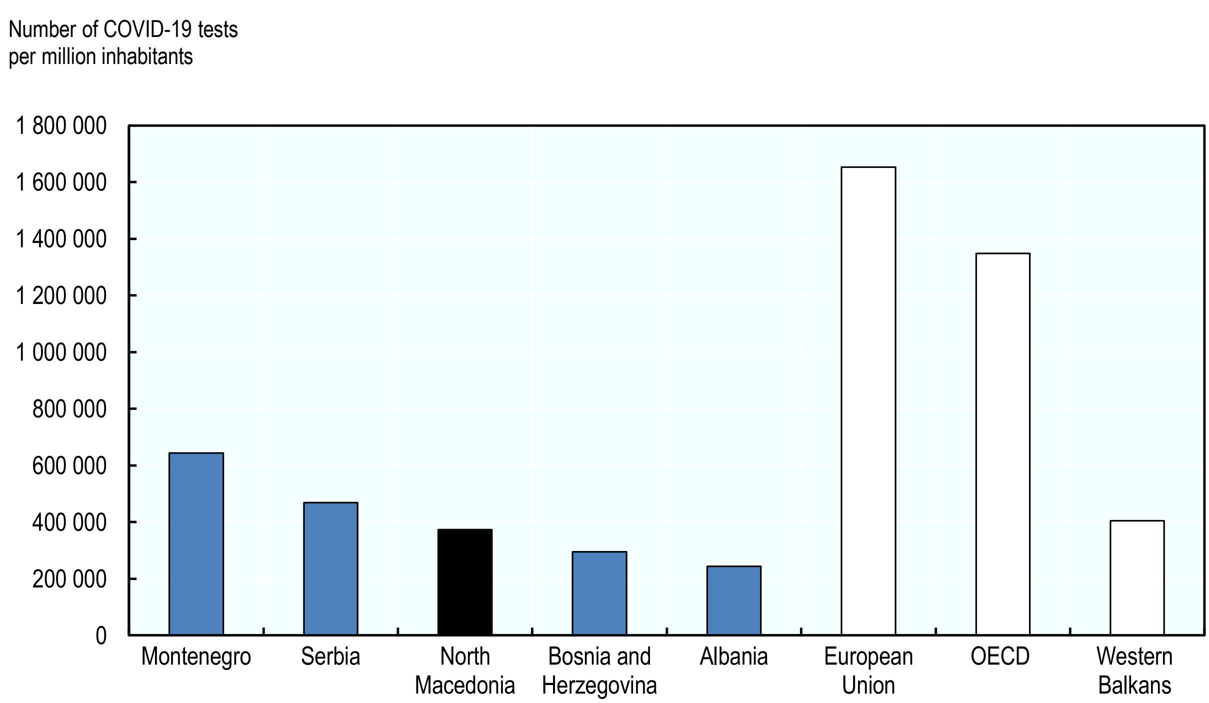
Figure 13.3. Restrictive measures to tackle COVID-19 have reduced mobility of people



Notes: The chart shows the relative volume of requests for directions compared to a baseline volume on 15 February 2020, as recorded by Google Maps.
Source: Authors' elaboration based on Google (2020[2]), "Google Mobility Trends", www.google.com/covid19/mobility/.

StatLink https://doi.org/10.1787/888934244189

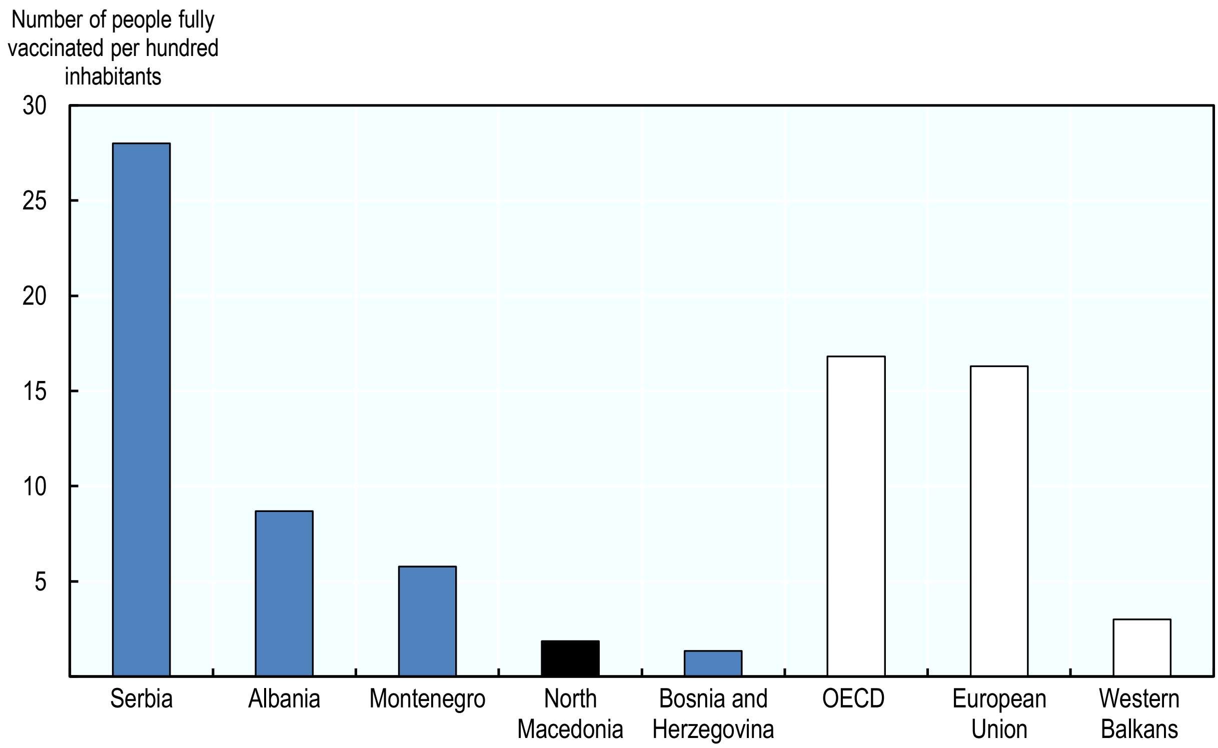
Figure 13.4. Testing capacity in North Macedonia remains relatively low



Source: Worldometer (2020[3]), *Worldometer* (database), www.worldometers.info/coronavirus/. Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.

StatLink https://doi.org/10.1787/888934244208

Figure 13.5. Covid-19 vaccination rates in North Macedonia are low



Note: Last reported numbers are from May 2021.
Source: Worldometer (2020[3]), *Worldometer* (database), www.worldometers.info/coronavirus/.

StatLink https://doi.org/10.1787/888934246925

Policy responses and economic impact

The government has taken measures to mitigate the negative effects of restrictions on the economy. In May 2020, the government retroactively classified the measures into four packages. The first two were implemented between March and May 2020 and were intended to provide life support to the economy and to the health sector. On 17 May, the government introduced a third package, worth EUR 335 million, to boost economic recovery and stimulate consumption further. The three packages together are worth EUR 550 million or 5.5% of GDP. The fourth package, adopted on 24 September, is worth about EUR 470 million and is a direct extension of the three previous ones.

Table 13.1. Policy measures in response to the COVID-19 pandemic

	People	Businesses	Other measures
1st and 2nd package, implemented from March to May 2020	• Setting up an unemployment insurance system for employees who lost their jobs due to the health crisis. The state paid a monthly allowance of 50% of the average monthly net salary. • For citizens who lost their jobs or were part of the informal economy, providing accelerated access to the social protection system for April and May. • Postponing rent payments on social housing.	• A three-month fiscal package (0.2% of GDP) to help address firms' liquidity problems and protect jobs, targeted at transport, tourism and catering, starting in April. • A salaries support programme subsidising contributions for employees in the tourism, transport and catering sectors up to a maximum of MKD 14 500 (EUR 235) per month and per employee for April, May and June. • Credit support measures: new credit risk methodology introduced by the National Bank to promote more favourable credit standards for companies affected by the COVID-19 crisis and to ease the standards for household and corporate loan restructuring. • The Development Bank of North Macedonia issued a first set of interest-free loans for MSMEs worth EUR 13.7 million (EUR 5.7 million + EUR 8.0 million) – up to EUR 90 000 per enterprise, depending on the number of employees.	• Scaling up of public health measures, adopting protocols for the treatment of COVID-19 cases and mobilising the necessary medical and health staff and equipment (e.g. mechanical respirators) from public and private health facilities. • Public call for the procurement of respirators. • On 16 March 2020, the National Bank of North Macedonia cut its policy rate by 0.25% to 1.75%. On 13 May 2020, the policy rate was cut further to 1.50%. The National Bank reduced the offer of the Central Bank Bills by MKD 15 billion and increased the liquidity of the banking sector. It also revised its credit risk regulation to encourage banks to restructure loans temporarily and relaxed the loan classification standards for non-performing loans. In addition, it reduced the base for the reserve requirement for firms in affected sectors. • The government signed a decree that facilitates procedures in banks.
3rd package	• Distributing payment cards credited with MKD 3 000 for low-paid employees to stimulate consumption of domestic goods and services. • Providing support to students: up to MKD 6 000 to cover tuition fees, a payment card of MKD 3 000 and co-financing vouchers of up to MKD 30 000 for IT and digital skills training. The measure is estimated to affect 100 000 students and is worth about EUR 12 million. • Vouchers for home tourism of MKD 6 000. • 40% of base wage reward for medical staff.	• Support for the agriculture sector: package of measures supporting agriculture amounting to EUR 76.1 million. Measures include support to micro enterprises and SMEs and direct support to green oil farmers and grape processors. • The Development Bank of North Macedonia will unblock interest-free loans worth EUR 31 million. This credit line will be available to all micro and small companies. The Development Bank will also offer a non-refundable 30% grant for companies that are run or founded by women or employ young people, are export-oriented or introduce innovation and digitalisation in their operations. • State guarantees for commercial loans and customs debt: a support for start-ups and small and micro companies through commercial banks; EUR 10 million of initial capital for easier access to funds will be granted, mainly by taking part in the credit risk.	
4th package	• Continued dispersal of payment vouchers for vulnerable households, including the unemployed, students and pensioners, in amounts up to	• Support programme for salary payments extended until the end of 2020, adjusted for the decline in revenue for companies covered by this measure.	• Refund of the tourist tax collected in 2019 to 5 000 businesses. • Decrease in VAT for goods and services purchased from artisans in amounts from 5 to 18%.

	People	Businesses	Other measures
	MKD 6 000, package totalling EUR 27.6 million. • Domestic payment card for single parents, low-income pensioners, passive job seekers. • Reduction and/or abolishment of parafiscal charges.	• 3-month extension of the grace period on interest-free loans for existing lines of credit. • A package totalling EUR 100 million will be made available to domestic companies through the provision of favourable loans at low interest rates. • A state credit guarantee was activated, offering EUR 10 million in financial resources to support companies through taking partial responsibility of their credit risk. • Deferred payment of VAT for companies.	

Sources: OECD (2020[4]), "COVID-19 Policy Tracker", http://oecd.org/coronavirus/en/#country-policy-tracker; OECD (2020[5]), *The COVID-19 Crisis in North Macedonia*, www.oecd.org/south-east-europe/COVID-19-Crisis-in-North-Macedonia.pdf.

COVID-19 had significant negative effects on North Macedonia's economy. While North Macedonia experienced a robust GDP growth of 3.6% in 2019, GDP declined by 4.5% in 2020. Private consumption declined by 5.6% and investments by more than 10%, even though they rebounded in the third quarter due to public investments in infrastructure. Government consumption increased by more than 10%. Manufacturing, construction, trade, transportation and tourism experienced were particularly affected by the reduced economic activity, while information and communication, and real estate grew. Reduced external demand, saw a fall in exports by 10.9% in 2020, but was followed by a decline in imports (World Bank, 2021[6]).

Coronavirus COVID-19

The analysis of policy responses to the COVID-19 pandemic does not reflect the policy development that occurred since February 2021, with the exception of the figures on testing and vaccination for which the most recent and internationally comparable data were used.

Dimensions of vulnerability to further socio-economic impact from COVID-19

The medium- to long-term impact of the COVID-19 pandemic on North Macedonia will largely depend on pre-existing socio-economic vulnerabilities and the strength of the policy-setting institutions and their ability to implement the envisaged policy measures. Taking pre-existing vulnerabilities into account can help policy makers to determine who will need help the most and to design and target policies accordingly (Table 13.2).

Table 13.2. North Macedonia's socio-economic exposure and policy resilience to COVID-19

	Channels	Level of vulnerability	Signalling indicators (Latest available year is 2019 unless otherwise specified)		
				North Macedonia	OECD
Socio-economic exposure	Well-being	High	Household debt, loans and debt securities (% GDP)	26.8	68.3
			Poverty headcount (USD 5.5 per person per day, 2011 PPP) (% population)	19.5*	2.9
			Personal remittances, received (% of GDP)	2.5	0.9
			Unemployment rate	17.3	5.8
			Informal employment (% of total employment)	13.8	x
			Social protection spending (% of GDP)[1]	15.3	20.1
			Life satisfaction (average score on 0-10 scale)	5	6.7
			Lack of social support (% of population)	18	8.6
			Gender norms that normalise violence against women (% of adult women who consider a husband justified in hitting or beating his wife for trivial reasons)	14.5	8(2012)
	Health risks	Medium	Adult smoking prevalence (%)	48.4	24.9
			Adult obesity prevalence (%)	22,4**	20.8
	Trade	High	Trade (% of GDP)	138.8	60.6
			External balance on goods and services (% of GDP)	-14.2	0.46
	Investment	High	Micro enterprises (1-9 employees) (% among total enterprises)	68	78.7
			FDI, net inflows (% in GDP)	4.4	1.8
	Tertiary sector	Medium	Total contribution of the tourism sector to GDP (% GDP)	7.4	8.8
	Financial and monetary	Low	Non-performing loans (% total loans)	4.6	2.9
			Total reserves in months of imports	4.3	9.5
			Capital adequacy ratio (%)	16.3	18.9
			Main interest rate (%)	1.5 (May 2020)	x
Policy resilience	Public finances	Low	Gross general government debt (%)	40.7	65.8
			Budget deficit (% GDP)	1.95	0.76
			Gross domestic savings (%)	20.3	22.5
			Foreign currency debt (% of total debt)	73.7	x
	Health sector	Medium	Spending on health care (% of GDP)	6.6*	12.6
			Hospital beds per 1 000 inhabitants	4.3*	4.7
			Physicians per 1 000 inhabitants	2.9†	3.5
	Government effectiveness	Medium	Government performance index (1: low; 10: high)	6.0	7.5
			Rigorous and impartial public administration (0: partial; 4: impartial)	1.9	3.3

Notes: Level of vulnerability is an OECD assessment for this report. Data are from 2019 unless otherwise specified. In particular: *: 2017; **: 2016; †: 2015; 1: The figure for social spending in North Macedonia includes healthcare spending.

Source: Authors' elaboration based on national and international data: Coppedge et al. (2020[7]), *V-Dem Dataset -- Version 10* (dataset), www.v-dem.net/en/data/data/v-dem-dataset/; IMF (2020[8]), *International Financial Statistics* (dataset), https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b; IMF (2020[9]), *Financial Soundness Indicators* (dataset), https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA; IMF (2020[10]), "World Economic Outlook Databases", www.imf.org/external/pubs/ft/weo/2020/01/weodata/index.aspx; IMF (2020[11]), "Republic of North Macedonia: Request for purchase under the rapid financing instrument", www.imf.org/en/Publications/CR/Issues/2020/04/16/Republic-of-North-Macedonia-Request-for-Purchase-Under-the-Rapid-Financing-Instrument-Press-49340; IMF (2020[12]), "Republic of North Macedonia: 2019 Article IV Consultation", www.imf.org/en/Publications/CR/Issues/2020/01/24/Republic-of-North-Macedonia-2019-Article-IV-Consultation-Press-Release-Staff-Report-and-48982; IMF (2019[13]), *World Economic Outlook, October 2019: Global Manufacturing Downturn, Rising Trade Barrier*, www.imf.org/en/Publications/WEO/Issues/2019/10/01/world-economic-outlook-october-2019; OECD et al. (2019[14]), *SME Policy Index: Western Balkans and Turkey 2019: Assessing the Implementation of the Small Business Act for Europe*, https://doi.org/10.1787/g2g9fa9a-en; WHO (2020[15]), Global Health Observatory, https://www.who.int/data/gho.; World Bank (2020[8]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WTTC (2020[16]), *World Travel & Tourism Council* (database), https://wttc.org/Research/Economic-Impact/Data-Gateway.

Material well-being and social protection

The short-term impact of the lockdown could harm the most vulnerable, including the unemployed and people living in poverty. Despite a progressive decrease in the unemployment rate since 2015, North Macedonia entered the crisis with a relatively high unemployment rate of about 17.3%. While North Macedonia has taken measures to mitigate the negative effect of the crisis on employment (Table 13.1), unemployment is likely to increase due to business closures. Poverty remains a major challenge, and households will need adequate support in the coming months, especially those faced with loss of income.

Inadequate social assistance limits its ability to act as an automatic stabiliser. Prior to the crisis, social assistance programmes were small in scale, poorly targeted and only reduced the risk of poverty by 3.7% in 2016, half the reduction observed in the European Union. In response, the government mandated a Guaranteed Minimum Income (GMI) in 2019. However, this does not cover 75% of those likely to fall into poverty during the pandemic (World Bank, 2020[17]). Furthermore, the decline in remittance inflows may jeopardise the revenue of many households.

Health and non-material well-being

The pre-existing, comparatively poor health outcomes and inefficiencies of North Macedonia's health system render the economy vulnerable to the current pandemic and potential new outbreaks. According to the Ministry of Health, the economy has around 1 000 hospital beds for COVID-19 cases and 4.3 beds per 1 000 inhabitants, which is a decent capacity to respond to the crisis by international comparison. The economy has 2.9 physicians per 1 000 inhabitants, slightly below the OECD average. The low healthcare spending of about 6.6% of GDP in 2017 (OECD, 2020[5]), compared to 12.6% in 2017 in OECD economies, is likely to affect North Macedonia's capability to respond adequately to the crisis. Furthermore, health-sector revenues are very sensitive to employment and economic downturns, such as the predicted repercussions of COVID-19, since they heavily depend on payroll contributions from the population in formal employment.

Other, non-material aspects of well-being are affected by the crisis. Quality of life is also about people's relationships, which can provide a vital lifeline during crises and social distancing. Yet, 18% of people in North Macedonia say they have no relatives or friends they can count on for help in times of need. Even before the COVID-19 pandemic, life satisfaction was much lower in North Macedonia than in the average OECD country. The considerable risks of social isolation and loneliness need to be addressed, for both physical and mental health, by policy measures (for instance, through regular check-ins by social services, civil society and volunteers) and the promotion of digital technologies for connecting people with each other and with public services (World Bank, 2018[18]).

Women and children are particularly exposed to the collateral effects of COVID-19. As in other economies, loss of employment and lockdown conditions in North Macedonia are likely to have led to increased GBV, while services and shelters for victims of violence are not operational after curfew (OECD, 2020[19]; Bami, 2020[20]). Even before the pandemic, prevailing gender norms that normalised violence against women were concerning. Some 14.5% of women in North Macedonia justified husbands hitting or beating their wives, compared to 8.0% in OECD economies (OECD, 2019[21]), while 61% of 850 women surveyed in 2005 stated that they had suffered domestic violence (World Bank, 2018[18]). Women are affected in other ways too. They make up the majority of the healthcare workforce, exposing them to greater risk of infection. At the same time, women are shouldering much of the burden at home given school closures and longstanding gender inequalities in unpaid work (see the People section in Chapter 14). The government has recently taken measures to relieve the burden. For example, on 8 April 2020, the government teamed up with local providers to expand mobile Internet access for distance learning purposes. This measure will affect 30 000 primary and secondary school students (OECD, 2020[5]).

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14 Multi-dimensional analysis of development in North Macedonia

Achieving rapid, inclusive and sustainable development requires progress across a range of development domains. This chapter identifies major development constraints in North Macedonia. It builds on multi-dimensional analysis across the five pillars of the Sustainable Development Goals: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet. For each pillar, the analysis highlights key areas where North Macedonia could further realise its full development potential.

This chapter of the MDR of the Western Balkans identifies the key capabilities and most pressing constraints in North Macedonia by linking economic, social, environmental and institutional objectives. The assessment is organised around five thematic sections based on the five pillars of the 2030 Agenda: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet. Whenever relevant, North Macedonia is compared with a set of benchmark economies in the region (Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia), the OECD (Costa Rica, Czech Republic, Greece, Slovak Republic, Slovenia and Turkey), non-OECD economies in the European Union (Croatia and Romania) and non-OECD economies in other regions (Kazakhstan, Morocco, Philippines and Uruguay). It includes regional aaverages for the Western Balkans and OECD and EU members.

People – towards better lives for all

The People pillar of the 2030 Agenda for Sustainable Development places quality of life centre stage, focusing on the international community's commitment to guaranteeing the fulfilment of all human beings' potential in terms of equality, dignity and health. In the past decade, North Macedonia has improved the standard of living for its citizens, reduced poverty and undertaken important social protection reforms.

However, there is still a long way to go to achieve a thriving society that provides opportunities for all. More and better jobs are needed, and the economy's full human capital needs to be utilised. This will involve equipping people with better skills and supporting people, especially women, young people and ethnic minorities, to participate equally in the formal economy. Citizens will need better health care, especially preventative and primary care, to tackle the rising burden of lifestyle diseases that the economy has been seeing. The current social protection system can do more to target poor families and is not fully financially sustainable going forward. There remains room for improvement in gender equality, namely in the area of access to assets and safety. The People section in this chapter identifies five major bottlenecks to the well-being of North Macedonia's population (Table 14.1).

Table 14.1. People – five major constraints to well-being in North Macedonia

1. People's well-being varies significantly across regions and poverty disproportionally affects numerous ethnicities in North Macedonia.
2. Weak labour market institutions and lack of skills due to an inadequately developed education system result in low employment inclusiveness, particularly for young people.
3. Lack of child and elderly care services, restrictive parental leave policies and traditional cultural norms prevent many women from seeking paid employment.
4. The rising burden of lifestyle diseases needs to be addressed through increased healthcare funding and more efficient organisation, especially in public PHC.
5. Despite recent reforms, the current social protection system is not fully financially sustainable in the face of a low formal worker contribution base.

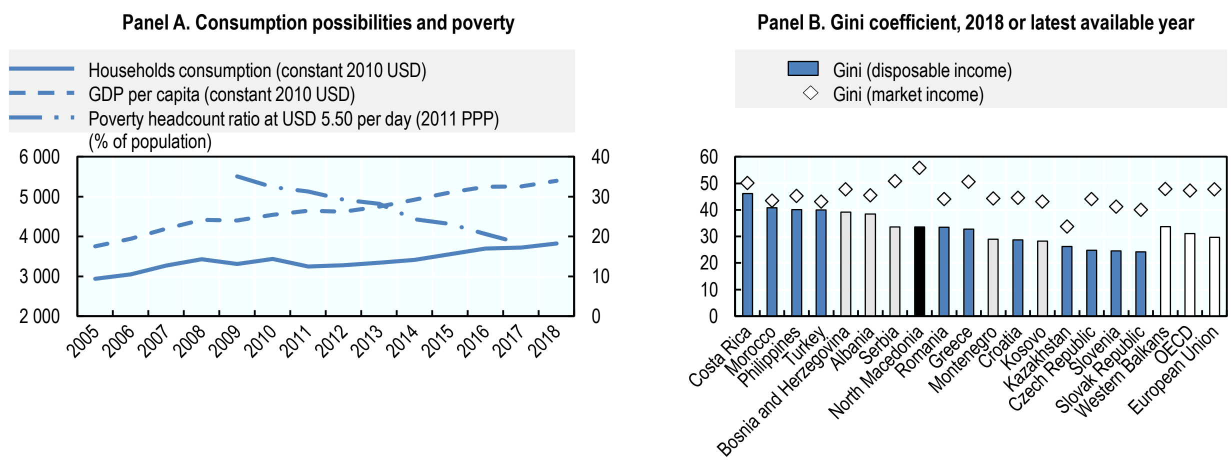
Improving well-being for all

Living standards, exemplified by rising GDP per capita and household consumption over the past 15 years, have improved for Macedonians, but poverty and inequality remain issues. Poverty rates have significantly dropped since 2008 but are still very high, with 18% of the population living on less than USD 5.5 a day (Figure 14.1 – Panel A) (World Bank, 2020[1]). While disposable income inequality is in line with regional peers, North Macedonia has the highest market income inequality among all benchmark economies (Figure 14.1 – Panel B). This points to the relatively high redistributive effects of the tax-benefit system and also indicates that there is a large number of households on low-market income, which can be related to age, emigration or unemployment. Both measures of inequality have changed little since 2008 (Solt, 2019[2]).

Citizen perceptions confirm the stagnant pattern in living standards. The 2016 Life in Transition Survey found that only 8% of Macedonians believed that their position on the income distribution had improved since 2010, pointing to the continued economic vulnerability of many households and the failure to consolidate a middle-class society (World Bank, 2018[3]). In addition, while the overall life satisfaction has markedly improved since 2010, the average response on a scale of 0-10 was 5 in 2019, compared to 7.4 in OECD economies (OECD, 2020[4]; Gallup, 2020[5]). Nevertheless, 65% of people felt optimistic about their children's or grandchildren's future in 2016, significantly higher than the EU28 average of 57% (Eurofund, 2018[6]). On a scale of 1-10, average trust in other people was 3 in 2016, significantly lower than the European Union average of 5.2 (Eurofund, 2018[6]). There is significant research showing that inequality can lead to lower levels of trust in other people and that economies where ties within known groups, such as families, are strong tend to show lower trust in people outside these circles (OECD, 2017[7]).

Figure 14.1. Household spending has risen, and poverty has declined

Household consumption, GDP per capita and poverty headcount ratio at USD 5.50 per day (Panel A) and income inequality, 2018 or latest available year (Panel B)



Notes: Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.
Sources: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; Solt (2019[2]), *The Standardized World Income Inequality Database, Versions 8-9* (dataset), https://doi.org/10.7910/DVN/LM4OWF.

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The well-being of Macedonians greatly depends on their place of residence. Regions affected by high poverty are mainly located in the north (which hosts more than half the economy's population), including the Polog, Skopje and Northeast regions, with poverty rates as high as 42.8% in the latter. The north is largely dependent on agriculture, and almost 33% of the working poor are active in this sector, compared to 13% of the working non-poor (World Bank, 2018[3]). Employment rates range from 37% in the Northeast region to 63.3% in the Southeast region. Labour force rates are also very low in some regions, indicating that a significant share of people are not economically active anymore. Labour force participation rates were lowest in the Polog and Northeast regions (51.9% and 55.2% in 2019, respectively) and were the highest in the Southeast region (67.6% in 2019). Infant mortality rates, which are a concern for the economy as a whole, as described in the health section below, also vary significantly, ranging from 4% in the Vardar region to 8.7% in the Polog region, according to national estimates (Table 14.2). To boost regional development in North Macedonia, the European Union has created several programmes in the three least developed administrative regions.

Table 14.2. Well-being varies significantly across regions

Selected indicators, 2019 or latest available year

Regions	Population	Population (%)	Employment rate (%)	Labour force participation rate	GDP per capita (USD)	Annual gross earnings (USD)	Poverty	Infant mortality rate (per 1 000 live births)
Skopje	630 873	30.4	45.6	53.5	7 724	9 496	23.8%	5.1
Polog	322 338	15.5	37.1	51.9	2 572	6 804	38.1%	8.7
Pelagonia	227 919	11.0	56	64.5	5 285	7 282	10.7%	4.1
Southwest	219 580	10.6	43.1	57	4 367	6 446	13.2%	4.8
Northeast	176 196	8.5	37	55.2	3 187	5 850	42.8%	5.3
East	174 877	8.4	54.3	58.9	5 308	6 589	14.0%	7.2
Southeast	173 327	8.3	63.3	67.6	6 396	6 605	23.5%	6.5
Vardar	152 022	7.3	55.2	61.8	5 639	6 523	14.0%	4
Total	2 077 132		47.3	57.2	5 446	8 114		

Sources: MAKStat (2020[8]), *MAKStat* (database), http://makstat.stat.gov.mk/PXWeb/pxweb/en/MakStat/MakStat__NadvoresnaTrgovija__KumulativniPod/?rxid=e70e8868-e6a5-4557-87cc-fc8b565e5da3); World Bank (2018[3]), *Former Yugsolav Republic of Macedonia – Systematic Country Diagnostic: Seizing a Brighter Future for All*, http://documents.worldbank.org/curated/en/113581543719676213/Former-Yugoslav-Republic-of-Macedonia-Systematic-Country-Diagnostic-Seizing-a-Brighter-Future-for-All.

As in other Western Balkan economies, ethnic inequality in North Macedonia is stark, and minority groups are in many ways excluded from economic growth and society as a whole. Over 40% of the poorest quintile are estimated to belong to households of ethnic Albanian origins, with disposable incomes two-thirds those of households of ethnic Macedonian origins (World Bank, 2018[3]).[1] Roma communities, which constitute 2.7% of the population according to the 2002 Census, are left behind in multiple ways. For instance, Roma women have worse health indicators (e.g. fewer prenatal visits, lower quality of care), and their children suffer from stunting more than the rest of the population (World Bank, 2018[3]). Moreover, about 33% of ethnic Roma children complete upper secondary school by age 25, compared to 87% of non-Roma youth, and virtually no Roma are enrolled in tertiary education (World Bank, 2018[3]). In 2017, about 20% of Roma aged 15 to 64 were employed, compared to 40% of non-Roma in neighbouring communities – a slight improvement since 2011 but a widening of the gap with non-Roma. The situation is particularly hard on young Roma women, 80% of whom were NEET in 2017, compared to 60% of young Roma men (World Bank, 2018[3]).

LGBTI communities face continued discrimination and little acceptance in a rather conservative society

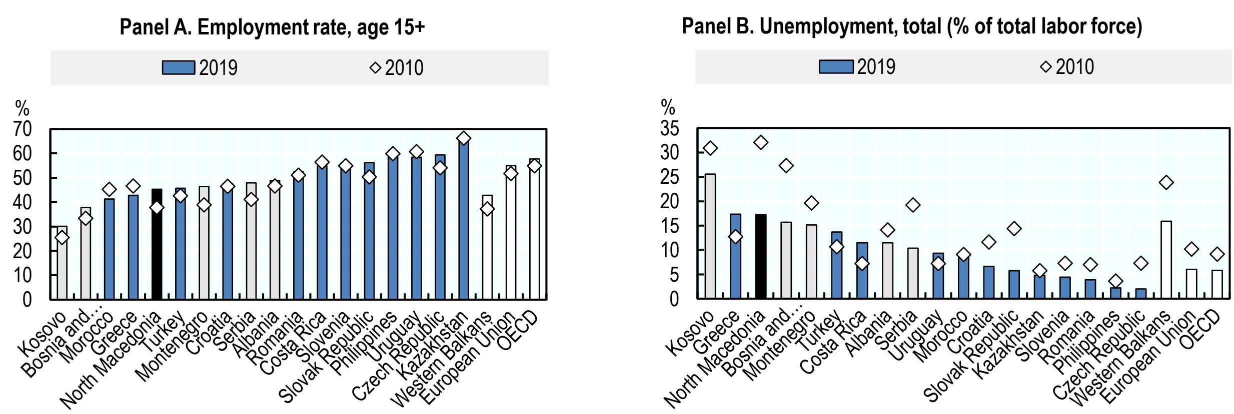
According to a 2015 population survey, only one in ten people personally knew a member of the LGBTI community, and 35% believed that paedophiles were part of that group (LGBTI Equal Rights Association for Western Balkans and Turkey, 2020[9]). Some 41% of people believed homosexuality is a sickness and would try to help their son or daughter find a cure for if they found out their child was not heterosexual. Some 89% did not support equal marriage (LGBTI Equal Rights Association for Western Balkans and Turkey, 2020[9]). In late 2020, the Parliament voted and passed the new Law on Prevention and Protection against Discrimination, which is in important step in addressing issues related to discrimination.

Prioritising quality jobs and equal participation for all

While the employment rate has improved in recent years in North Macedonia, it remains very low – less than 50% of the working-age population held a job in 2019 – and opportunities have not necessarily been created in a sustainable manner (Figure 14.2 – Panel A). In the years following the global financial crisis, jobs were mainly created through construction of very expensive, large-scale public projects, public-sector jobs, active labour market programmes (including subsidies for the self-employed and wage subsidies) and increased demand for labour in foreign-owned companies in the special economic zones (Vidovic et al., 2020[10]; World Bank, 2018[3]). New public jobs in public administration, health, education and water supply constituted more than 20% of net employment growth in 2009-13 (World Bank, 2019[11]). Considering the fiscal cost of some of these interventions, it is questionable whether these gains can be sustainable (World Bank, 2018[12]). Relatedly, unemployment rates dropped somewhat in recent years but remain among the highest in the Western Balkans and above the international benchmarks (Figure 14.2 – Panel B).

Figure 14.2. Employment performance has been improving but remains weak

Employment rate (%), age 15+ (Panel A) and unemployment rate, total (% of total labour force) (Panel B), 2019 and 2010



Note: Data for Kosovo are from the Kosovo Agency of Statistics.
Sources: Kosovo Agency of Statistics (2020[13]), *ASK Data* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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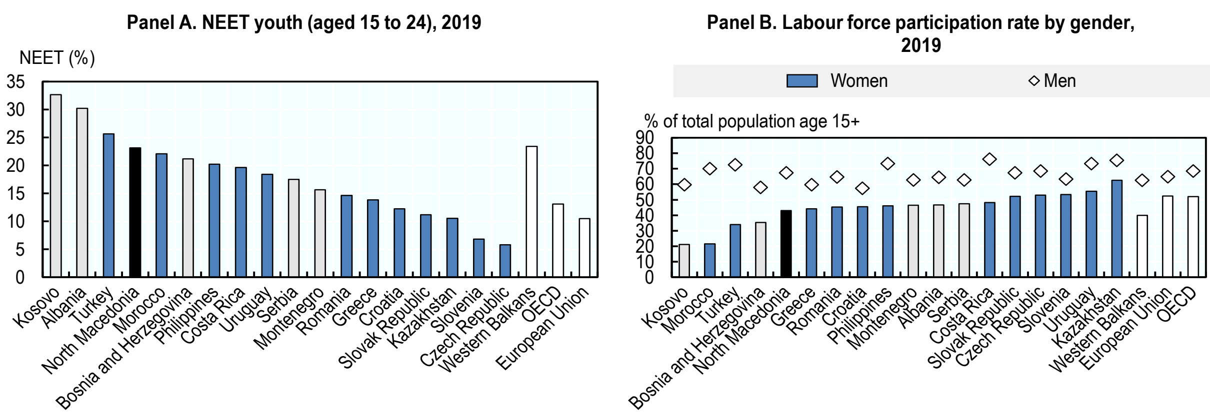
Young people and women are excluded from the labour market and society as a whole

Productive human capital is underutilised, and many young people are not active in the labour market. In 2019, more than half (about 53%) the population aged 15 to 64 were either unemployed or inactive (MAKStat, 2020[8]). The economy's youth unemployment rate of about 39% in 2019 was the third highest in the Western Balkans, just after Kosovo and Bosnia and Herzegovina (49.4% and 39.7%, respectively) (Kosovo Agency of Statistics, 2020[13]; World Bank, 2020[1]). Likewise, the share of NEET youth was about 23%, double the OECD and EU averages (Figure 14.3 – Panel A). As many as 30% of young people work informally (Studies, 2020[14]).

Young talent is driven to migrate abroad. Poor inclusion of young people and migration of the high-skilled abroad (Figure 14.3 – Panel A), together with persistent long-term demographic pressures (Figure 14.4), pose a threat to the development potential of North Macedonia. The migration abroad of especially high-skilled young people and women in search of better employment opportunities drags down productivity growth and increases the speed of population ageing, making social protection more challenging. The working-age population will shrink from 71% in 2015 to 57% in 2050, and the share of elderly will expand from 12.5% to 24.5% (Figure 14.3 – Panel B). About 25% of the population lives abroad, a number that has been rising for ten years, while migrants constitute an estimated 32% of the economy's high-skilled workers (World Bank, 2018[3]). Austria, Germany, Slovenia, Switzerland and Turkey are the main destination economies, although the nature of migration has changed over time. Germany, in particular, has set up a scheme that facilitates labour migration from the Western Balkan region, including North Macedonia. Despite these challenges, some recent efforts in North Macedonia, such as the implementation of the Youth Guarantee with the support of the Swiss Government,[2] are a strong response to support NEET youth (European Commission, 2021[15]).

Figure 14.3. Young workers and women need to be activated according to their potential

NEET youth (aged 15 to 24) (Panel A) and labour force participation rate by gender (% of total population age 15+) (Panel B), 2019

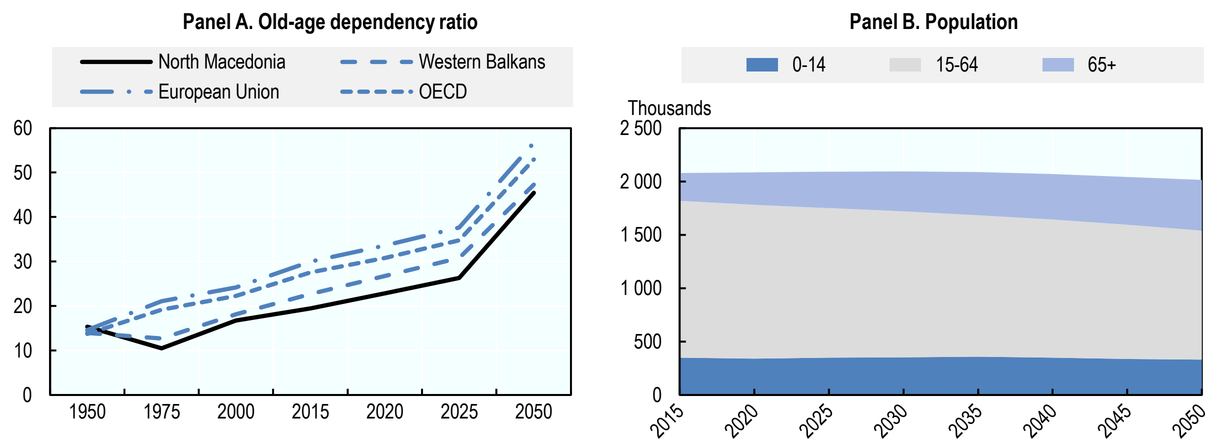


Note: Data for Kosovo are from the Kosovo Agency of Statistics.
Sources: ILO (2020[16]), "Share of youth not in employment, education or training (NEET) by sex -- ILO modelled estimates, Nov.2019 (%) - Annual", www.ilo.org/shinyapps/bulkexplorer45/?lang=en&segment=indicator&id=EIP_2EET_SEX_RT_A; (Kosovo Agency of Statistics, 2020[13]), *ASK Data* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

StatLink https://doi.org/10.1787/888934244265

Figure 14.4. Demographic pressures are on the horizon

Old-age dependency ratio projections (ratio of population age 65+ per 100 population aged 20 to 64, %) (Panel A), population projections (thousands) (Panel B)



Note: The Western Balkan average includes Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia. No data are available for Kosovo.
Source: United Nations (2020[17]), *2019 Revision of World Population Prospects*, https://population.un.org/wpp/.

StatLink https://doi.org/10.1787/888934244284

Like in other economies in the region, the low participation of women in paid work in North Macedonia is striking. It is one of the reasons the contribution base for social insurance payments is meagre (discussed below). After Kosovo, North Macedonia's gender gap in labour force participation is the highest in the Western Balkans (Figure 14.3 – Panel B). This is at odds with female educational attainment, especially among cohorts younger than age 40, of whom 25% of women have post-secondary education, compared to 17% of men (World Bank, 2018[3]). Women are more likely to work in low-income jobs than men, and the estimated ratio of female-to-male earned income is 0.49, which represents the highest regional pay gap (USAID, 2019[18]; Nikoloski, 2019[19]).[3] Gender differences in paid work are due to slow school-to-work transition, full-time household activities and cultural norms that encourage traditional division of labour. Indeed, about 41% of women but just 1.3% of men who are not in the labour force cite "personal and family obligations" as their primary reason for not looking for a job. Furthermore, one-third of Macedonian women reported believing that their primary role is not to work but to give birth and take care of the home (USAID, 2019[18]; Nikoloski, 2019[19]). While the economy has seen improvements in preschool enrolment, from 22% in 2012 to 35% in 2017, it is far behind the EU target rate of 95% (UNICEF, 2020[20]), and quality ratings for childcare services were the lowest of all economies surveyed in the European Quality of Life Survey in 2016 (Eurofund, 2018[6]).

There are various policy options to encourage female labour force participation. First, expanding the availability and affordability of childcare, in addition to promoting their acceptance (for example, by raising awareness about the well-documented benefits for early childhood development and by deregulating services to encourage private provision) will be key. Recent estimations predict that female labour force participation in North Macedonia would increase by 6.6 percentage points with universal childcare, which would more than pay for its cost with increased tax revenues (UN Women, 2019[21]). Similarly, expanding barely existent institutional care for the elderly can help free up time for family members with care responsibilities who wish to engage in paid work. Second, reforming parental leave rules, which currently grant nine months of paid maternity leave to women but only seven days to men (and only if the mother does not take up her leave entitlement), would encourage the participation of fathers in the care of newborns (Globalization Partners, 2020[22]). Third, gender-sensitive public education, including creation of role models and support for female entrepreneurship, can help change women's professional aspirations (World Bank, 2018[3]).

Although far from reaching parity, female representation in national politics and private sector management is better than in the average OECD country. Following a gender quota introduced 17 years ago, 39% of parliamentary seats in North Macedonia are currently occupied by a female MP, compared to 29% in the OECD. Some 16% of ministerial positions are held by women, who also make up almost 33% of senior and middle managers, compared to the OECD average of 16% (OECD, 2020[23]; IPU, 2020[24]; World Bank, 2020[1]). However, the gender quota for Parliament does not include Roma or Turkish women, and overall female participation is much lower at the local level, where few women hold leadership positions. Only 8.5% of women in rural areas are members of a political party (USAID, 2019[18]).

According to the OECD Social Institutions and Gender Index, discrimination against women overall in North Macedonia is "very low", but there is room for improvement in the areas of financial independence and safety (OECD, 2019[25]). Only 28% of women own property, which is traditionally registered in man's name, and the share is even lower in rural areas (OECD, 2019[25]). Half the women who do own land are not active in decision making about activities related to their property (USAID, 2019[18]). Prevailing gender norms that normalise violence against women are also concerning: 14.5% of women in North Macedonia, compared to 8% in OECD economies, consider a husband justified in hitting or beating his wife for reasons such as burning food, going out without telling him or refusing sex (OECD, 2019[25]). While the government ratified the Istanbul Convention, which requires the criminalisation of all forms of GBV, as well as effective prevention and protection measures, North Macedonia's criminal code only criminalises rape. Public policy should focus on implementing legislation for domestic violence prevention and improving data collection, since representative data on the extent of GBV in North Macedonia are currently not available (Tozija, 2020[26]). Evidence from small-scale surveys suggests that the issue is pervasive: 61% of 850 women surveyed in 2005 stated that they had suffered domestic violence (World Bank, 2018[3]).

While gender-responsive budgeting (GRB) will be compulsory with the new Organic Law on Budgeting, the capacity to carry out GRB in policy and budgets still needs to be built, and staff will need to be trained and sensitised accordingly (USAID, 2019[18]).

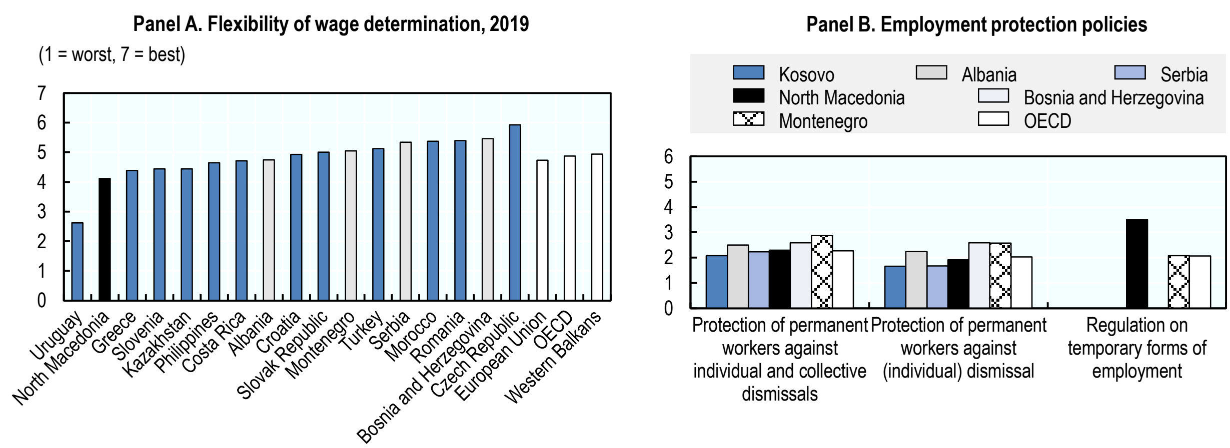
Labour market institutions need to be strengthened

The extent and duration of unemployment suggest that activation policies are ineffective. While unemployment has decreased over the last decade (Figure 14.2 – Panel B), about three-quarters (74.7%) of Macedonians stay unemployed more than one year. This is well above the Western Balkan average of 67.4% and the OECD and EU averages of 29% and 43%, respectively. Moreover, the length of time spent unemployed increases significantly with age: among those aged 45 to 64, the period of unemployment averages about 11 years. The average worker aged 15 to 64 is estimated to lose about 25 years of productive employment during the work lifecycle (30 years for women) (World Bank, 2018[3]). This leads to loss of skills and motivation, and overall discouragement among peer groups. Long-term unemployment also affects earnings through degradation of skills: earnings of those who find employment after a longer period of unemployment are up to 20% lower than earnings of those who find employment sooner (World Bank, 2016[27]). Activation policies are currently too limited and underfunded to connect job seekers with quality work or to boost their skills. In 2018, North Macedonia spent 0.16% of GDP on active labour market policies, which is higher than the Western Balkan average of 0.12% of GDP[4] but lower than international benchmarks, such as Croatia (0.71%) and Slovenia (0.61%) (European Commission, 2020[28]). Nevertheless, this is too low to upskill and connect jobseekers with jobs sufficiently. Currently, active labour market policies cover about 11% of all jobseekers, many of whom are categorised as hard to employ. Despite low coverage and lack of funding, the recent creation of a specific unit for youth employment in the Employment Agency is good step towards better co-ordination and monitoring of activities related to the transition from school to work (European Commission, 2020[29]).

North Macedonia's labour market needs more flexibility. The economy has a rather low score on flexibility of wage determination, indicating that the wage bargaining process is very centralised and rigid, which in turn means that wages cannot adequately respond to changes in supply and demand (Figure 14.5 – Panel A). While the regulation on permanent employees is in line with OECD economies, the regulations governing temporary employment seem very restrictive (Figure 14.5 – Panel B). In the absence of adequate flexibility, firms are likely to seek other forms of employment, including choosing to operate informally.

Figure 14.5. North Macedonia's labour market is relatively inflexible

Flexibility of wage determinations, 2019 (Panel A) and employment protection legislation, 2015 or latest available year (Panel B)



Notes: Flexibility of wage determination ranges from 1 to 7, where 1 indicates that the bargaining process is very centralised, and 7 indicates that the bargaining process takes place mainly at the company level. OECD indicators of employment protection legislation measure the procedures and costs involved in dismissing individuals or groups of workers and the procedures involved in hiring workers on fixed-term or temporary work agency contracts. The indicators range from 0 to 6, where 6 indicates least restrictive policies, and 6 indicates most restrictive policies. Data are available for Kosovo for 2014 and for Montenegro for 2013.
Source: World Economic Forum (2020[30]), *Competitiveness Index - Global Competitiveness Index*, https://tcdata360.worldbank.org/indicators/flex.wage; OECD (2020[31]), *OECD Indicators of Employment Protection*, https://www.oecd.org/employment/emp/oecdindicatorsofemploymentprotection.htm.

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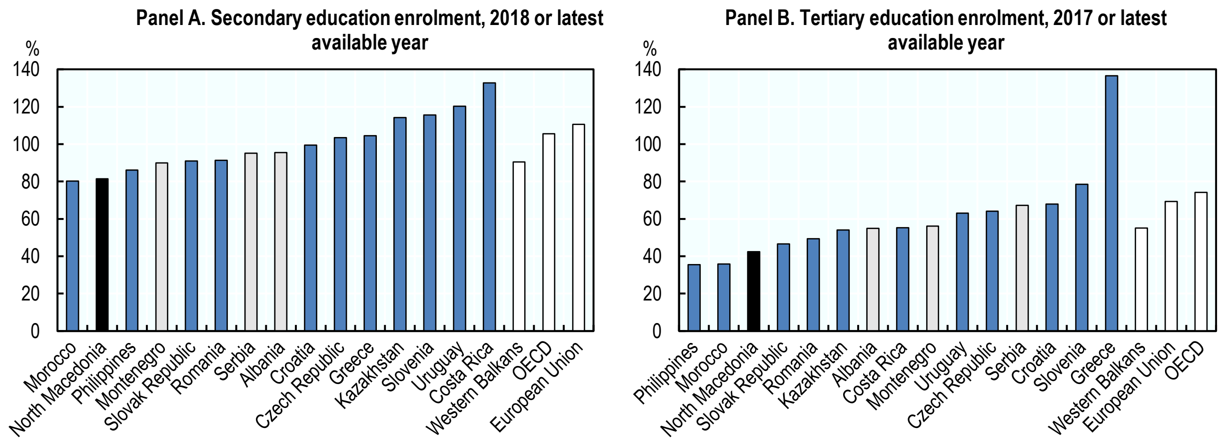
Boosting education quality at all levels

Low job creation is, to some degree, related to supply-side constraints, particularly the weaknesses in education quality and insufficient alignment with labour market needs. Indeed, an inadequately educated workforce is the third greatest obstacle to doing business identified by North Macedonian firms, indicating that a better understanding of skills needs is required (World Bank, 2020[32]). While primary education enrolment rates are high, North Macedonia has one the lowest secondary and tertiary education enrolment rates compared to international benchmarks (Figure 14.6). The current education system also fails to equip people with job-ready skills. North Macedonia's performance in the OECD Programme for International Student Assessment (PISA) is very low in terms of test scores (Figure 14.7), and ethnic Albanian students have lower results than ethnic Macedonian students (OECD, 2019[33]). North Macedonia's education system tends to focus on top performers and neglect others, affecting equity in the education system. This in turn influences the participation of various groups, including women, people living in rural areas and ethnic minorities (OECD, 2019[33]). The education system lacks adequate funding to respond to the challenges. Between 2011 and 2016, public spending on education as a share of GDP fell from 4.6% to 3.8%. The adoption of the 2018-25 education strategy and related action plan, laws and by-laws clearly signals that education is the top priority for authorities. However, financial resources of EUR 8 million indicated under the proposed measure in the recent Economic Reform Programme (2020-22) are rather modest (European Commission, 2020[29]).

Figure 14.6. Enrolment rates in North Macedonia are very low

Secondary school enrolment (% gross), 2018 (Panel A) and tertiary school enrolment (% gross), 2017 (Panel B)



Notes: Gross enrolment ratios indicate the capacity of each level of the education system. A ratio above 100% may reflect a substantial number of over-age children enrolled in each grade due to repetition or late entry, rather than a successful education system. The net enrolment rate excludes over-age and under-age students and more accurately captures the system's coverage and internal efficiency. Differences between the gross enrolment ratio and the net enrolment rate show the incidence of over-age and under-age enrolments.
Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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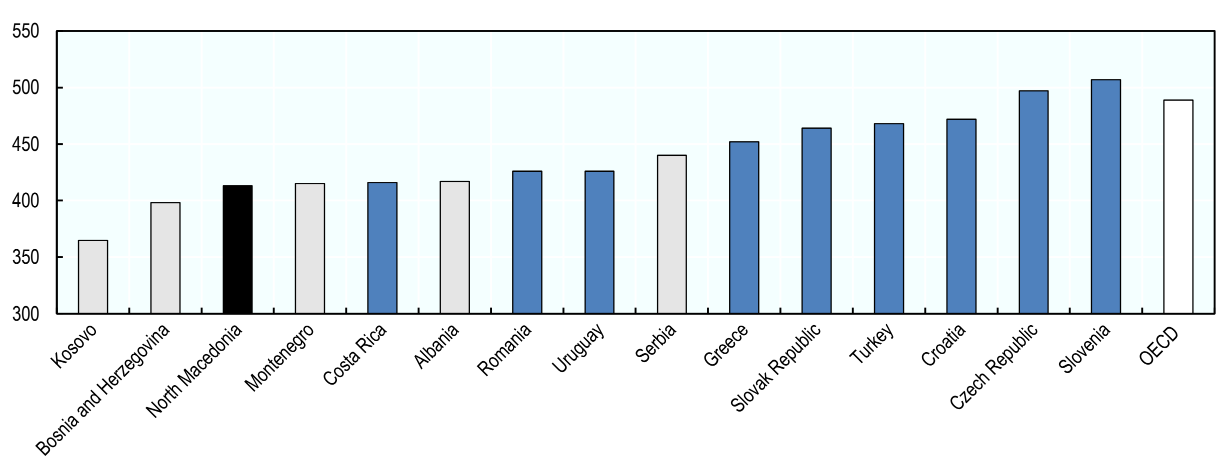
Figure 14.7. Education outcomes are low given North Macedonia's level of development

Mean science scores, 2018



Source: OECD (2020[23]), *PISA* (database), www.oecd.org/pisa/data/.

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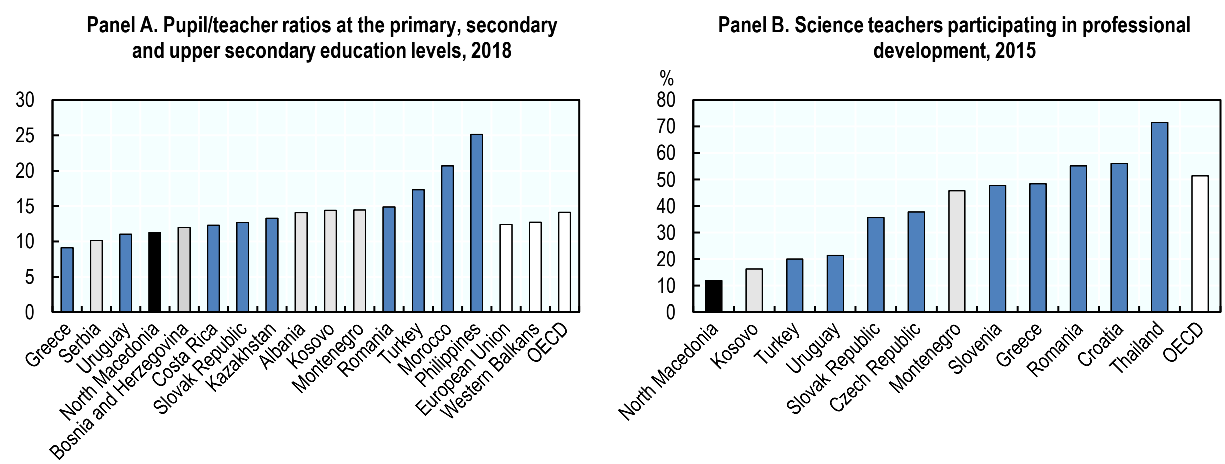
Education resources in North Macedonia are not efficiently allocated, and teachers lack sufficient quality to equip students with relevant skills. Although the pupil-teacher ratios at the primary, secondary and upper secondary education levels are among the lowest in the region and in comparison to international benchmarks, teaching quality is inadequate (Figure 14.8 – Panel A). Relatively small pupil/teacher ratios relate to the fact that North Macedonia has essentially two parallel education systems within its national system, as ethnic Albanian students attend separate schools, and their classes are taught in Albanian. Moreover, the system creates inefficiencies, as resources are duplicated. Teachers lack incentives and access to opportunities to develop their knowledge and teaching skills. The salary scale is largely flat and not linked to performance and opportunities for high-quality professional development organised by the government. Initial teacher education lacks selectivity: a vast majority of candidates who apply receive a place. Mechanisms in place are limited, including a lack of rigorous accreditation and teacher certification that would ensure that training programmes sufficiently prepare aspiring teachers, especially regarding practical demands (OECD, 2019[33]). Although teachers are expected to participate in at least 60 hours of professional development over three years, they rarely participate compared to other economies. Last, rather than boosting teaching quality, already very limited municipal education budgets were used on teacher recruitment (see the Peace and institutions section in this chapter), although the number of teachers in North Macedonia is adequate, except in upper-level mathematics and science classes (Figure 14.8 – Panel B).

Figure 14.8. Low pupil/teach ratios are not reflected in education outcomes, and teachers lack adequate training

Pupil/teacher ratios at the primary, secondary and upper secondary education levels, 2018 (Panel A) and science teachers participating in professional development, 2015 (Panel B)



Note: Data for Kosovo are from the Kosovo Agency of Statistics.

Sources: Kosovo Agency of Statistics (2020[13]), *ASK Data* (database), https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/?rxid=4ccfde40-c9b5-47f9-9ad1-2f5370488312; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; OECD (2020[23]), *PISA* (database), www.oecd.org/pisa/data/.

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Lack of skills is reflected at both the secondary and tertiary education levels. Insufficient general competencies, such as reading and writing, and technical skills characterise vocational school graduates in North Macedonia. One of the issues relates to the governance of the vocational education and training (VET) system at the municipal level. In the past, municipalities often introduced new classes that did not reflect a local need for such professions, or teachers lacked skills to provide adequate training in those areas. The result was a proliferation of classes across the economy. The Education Strategy for 2018-2025 defines challenges related to the VET system, including insufficient attractiveness of VET, especially of the two- and three-year vocational education; lack of modern post-secondary education; and not ensuring efficiency of VET reforms through centralisation of investments and concentration of results. With ongoing plans to introduce three major regional vocational and education centres, the government aims to improve the quality of the VET system (World Bank, 2018[3]).[5]

Although about 20% of university graduates are unemployed, employers complain that they cannot find people with the necessary skills (ETF, 2017[34]). One-third of tertiary graduates who do find employment have an official qualification that does not match their current job, while a further one-third are over-educated for their job. This can be attributed to a large number of programmes that are too theoretical, with little practical relevance; asymmetry of information, as many students enrol in programmes with little market value; and outdated curricula in many university programmes (World Bank, 2018[3]).

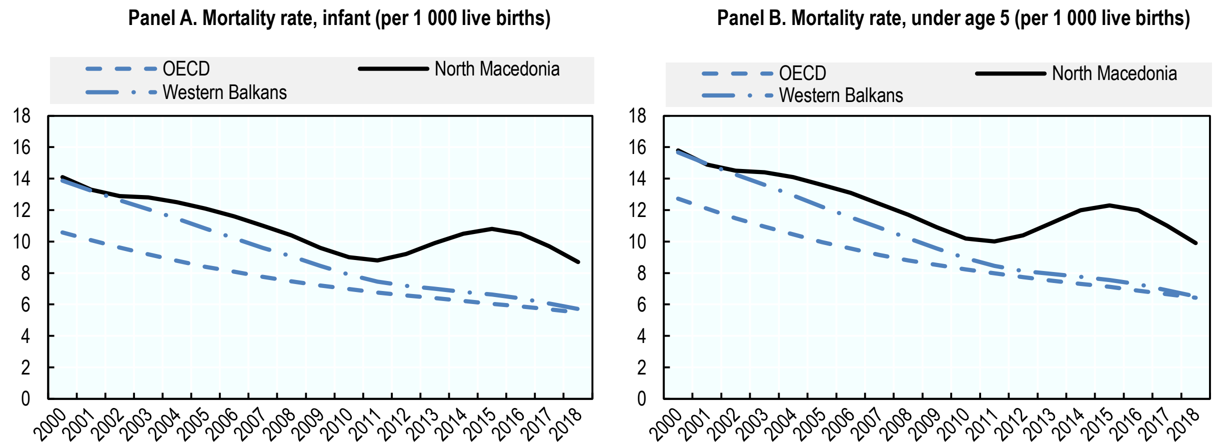
Improving health and social protection coverage for all

The rising burden of lifestyle diseases and adverse child health outcomes need to be addressed by increased healthcare funding and more efficient organisation, especially in public PHC

Health outcomes in North Macedonia are a source of concern. In 2013, over 46% of adult men smoked daily, and more than 2 700 cigarettes were smoked in a year – the third highest figure in the world after Belarus and Lebanon – while the tobacco taxation of 58.8% is low compared to neighbouring economies. Adult alcohol consumption (8.1 litres of pure alcohol per capita annually)[6] is lower than OECD and regional averages, but it has increased by almost 30% since 2010 (World Bank, 2020[1]). More than 60% of adults are overweight, and 21.1% are obese, compared to 19% of adults in the average OECD country (WHO, 2013[35]). Around 33% children are overweight or obese. Nutrition in schools could be improved, quality physical education is missing and access to school recreational facilities and opportunities for extracurricular physical activities is limited (WHO, 2019[36]). Infant and under age 5 mortality rates rose between 2010 and 2016, partly because many doctors left the public health system (Figure 14.9). Child mortality dropped in recent years after the development of new protocols and standards for perinatal and neonatal health and the introduction of quality standards in newborn facilities. It remains, however, an area to watch. Maternal mortality stands at 8 per 100 000 live births, which is close to the EU average (World Bank, 2018[3]).

Figure 14.9. Child mortality recovered after a spike in recent years but remains high

Infant mortality rate (Panel A) and under age 5 mortality rate (Panel B), per 1 000 live births, 2000-18



Note: The Western Balkan average excludes Kosovo, for which no data are available.
Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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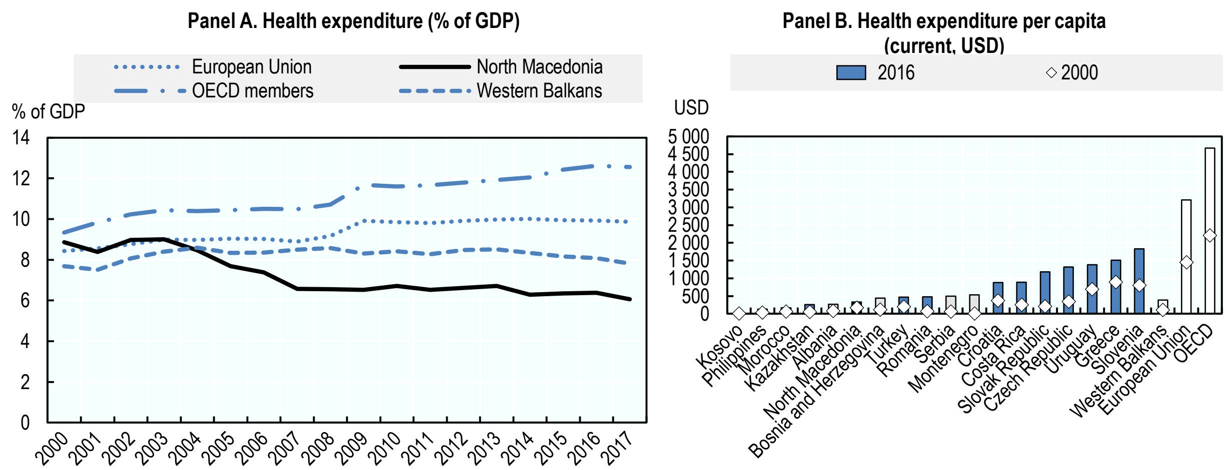
Healthcare system needs increased funding and more efficient organisation, especially in preventative and public PHC. After independence, the economy capitalised on existing, well-distributed health service coverage and built a social health insurance system with a relatively broad benefits package, covering citizens with universal access. Reforms in recent years include integration of public and private providers and a health information system that reduced waiting times and has led to better co-ordination of care (Kostova et al., 2017[37]). However, since the early 2000s, healthcare spending as a share of GDP has fallen and, up to 2017 (the year with the latest available data), remains low in per capita terms by international comparison (Figure 14.10). Health-sector revenues are very sensitive to employment and economic downturns, such as the predicted repercussions of COVID-19, since they depend heavily on payroll contributions from the population in formal employment, which represent 33% of the insured population but provide 84% of contributions (ESPN, 2019[38]).

The current allocation of funds points to inefficiencies. The share of Health Insurance Fund spending on PHC dropped from 30.1% to 29.3% in 2012-16, whereas the share of specialist consultative services increased from 28.6% to 31.3%. At the same time, allocations to hospital care decreased from 38.1% to 35.1% (World Bank, 2018[3]). Given the rise in non-communicable diseases, particularly diabetes and lung cancer, it is necessary to restructure underused and overstaffed hospital services and to boost underdeveloped and fragmented preventative and primary care. At 22% in 2015, the mortality rate from cardiovascular diseases, cancer and chronic respiratory diseases for those aged 30 to 70 in North Macedonia was significantly higher than the EU average of 13% and slightly above the 18% to 20% rates in the Western Balkans (World Bank, 2018[3]). The government recognises the need for PHC reform and recently launched two pilot websites with the support of WHO and announced plans for a diabetes centre (WHO, 2020[39]; Apostolova, 2018[40]).

Figure 14.10. North Macedonia needs to reverse the decline in healthcare investment

Health expenditures as a share of GDP (Panel A) and per capita, current USD (Panel B)



Note: The Western Balkan average for health expenditures as a share of GDP excludes Albania and Kosovo, for which no data are available.
Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Other challenges include cost effectiveness, corruption and retention of healthcare staff. Pharmaceutical-sector reforms to decrease medicine unit prices and increase access to innovative and cost-effective therapies (e.g. telemedicine) should be prioritised to curb the 35.4% out-of-pocket (OOP) expenditures in total health spending, which is below the regional average but more than double the EU and OECD levels of 15% and 13% (World Bank, 2020[1]). In addition, corruption in the healthcare sector will need to be addressed, since the majority of OOP expenditures go to direct payments for privately purchased healthcare services and informal payments (ESPN, 2019[38]). The government doubled salaries for medical staff between 2017 and 2020[7] to prevent the migration of specialists to private practices and to Western Europe, but further efforts will be needed to retain human capital. The Medical Chamber of the Republic of Macedonia recently listed the overall lack of funds, old equipment and lack of transparency in human resource management as critical factors that render working in the public health system unattractive (Apostolova, 2018[40]). While a pay-for-performance scheme for physicians in secondary and tertiary care has existed since 2012, it currently does not measure any quality aspects or outcomes (WHO, 2017[41]).

Despite recent reforms, the current social protection system is not fully financially sustainable due to a low formal worker contribution base

Pensions in North Macedonia face challenges of sustainable financing given the relatively generous benefits, low contribution rates and low labour force participation. In 2018, North Macedonia's social protection spending (including health) constituted 15.3% of GDP, slightly higher than the Western Balkan average (14.6%) but about half the share in European economies (28.2%) (ESPN, 2019[38]). More than 60% of spending, or 9.3% of GDP, goes to the mixed pension system, which includes unfunded and two-funded pillars. This represents an increase of 1.1 percentage points since 2008 due to a range of policy measures, including abolishment of formal indexation mechanisms in favour of ad hoc supplementary pension increases between 2014 and 2017 (ESPN, 2019[38]). Furthermore, in an attempt to promote employment, North Macedonia reduced pension contributions from 21.2% to 19% in 2009 and introduced contribution exemptions. This came at the cost of fiscal sustainability – the pension system currently runs at a sizable deficit of 4.5% of GDP, which is projected to more than double by 2030 – but did not increase labour force participation (IMF, 2016[42]).[8] Currently, general government budget constitutes 43.5% of pension funding.

Recent reforms under the 2019 Law on Social Protection saw a switch to price indexation of pensions, which is likely to reduce the deficit in the short run (European Commission, 2020[29]). There will still be a need to generate more savings, particularly considering the introduction of a new social pension under the same reform package (World Bank, 2018[43]). Specifically, the incremental introduction of social contributions from temporary incomes (currently only subject to personal income tax) and increased support for female labour market participation are policy options to consider.

Previous social assistance programmes, small in scale and poorly targeted, have not substantially alleviated poverty and have shifted focus to supporting families with children. Spending on social and unemployment assistance represents only 10.5% of all social transfers, or 1.6% of GDP, the lowest in the region (ESPN, 2019[38]). Social assistance expenditures increased by 0.3 percentage points in the past decade due to the introduction of categorical benefits, such as a relatively generous parental allowance for a third child until age 10, which has done little to increase birth rates. Meanwhile, the number of households receiving the two previous anti-poverty programmes has more than halved due to a fixed income and low-income threshold, and expenditures on these schemes dropped from 0.6% of GDP in 2005 to 0.2% of GDP in 2016. This is only half the 0.4% of GDP spent on parental allowance (ESPN, 2019[38]). Indeed, social assistance programmes reached fewer than 25% of poor households in 2016 and only reduced the risk of poverty by 3.7%, slightly less than the average of 3.9% achieved in the region and half the reduction observed in the European Union (ESPN, 2019[38]). At the same time, various rules, such as regressive tax wedges and immediate withdrawal from social transfers when earning income above the benefit amount, have discouraged employment (World Bank, 2018[44]).

The GMI, under the 2019 Law on Social Protection, tackled some of these social protection issues. It consolidated existing social assistance programmes, introduced an improved equivalence scale, simplified administrative procedures and increased benefit eligibility thresholds and amounts. Currently, about 27 000 households receive social benefits under the new legislation. In the face of COVID-19, the GMI's three-month rule for income assessment has been further relaxed to take into account households' sudden drop in income (World Bank, 2020[45]). In addition, an unemployment insurance fund has been set up, social housing rents have been postponed and additional consumption vouchers have been distributed to the poorest households. These measures, aimed at supporting vulnerable populations, are likely at least to buffer the crisis in the short term (OECD, 2020[46]). In the medium to long term, especially if the recovery takes time, it will be important to look at the fiscal implications of financing a long-term spike in unemployment benefits and consumption support schemes and to gauge them against other measures to support the recovery process.

Prosperity – boosting productivity

The Prosperity pillar of the 2030 Agenda for Sustainable Development calls for broad-based economic growth shared by all people. Over the past decade, North Macedonia has made notable progress in building a more competitive, export-oriented market economy. The economy's growth has become broader based, supported by robust private investment and exports, in addition to consumption. Exports have become more diversified and sophisticated, largely on the back of manufacturing FDI inflows in the economy's special economic zones. The external trade and current account deficits have improved significantly. Last but not least, this period has seen a significant increase in employment (from 34% in 2005 to 45% in 2019) and a rapid decline in unemployment, which halved between 2005 and 2019 (from 37% to 17.3%) (World Bank, 2020[1]).

Despite these positive developments, North Macedonia's economy still faces significant challenges in achieving the prosperity-related goals of the 2030 Agenda. Linkages and spillovers from the FDI sector have been very limited, and non-FDI private investment has largely gone to the construction and trade sectors, with limited productivity gains. The past decade saw a significant decline in productivity growth caused by a decrease in within-sector productivity growth and limited gains from labour reallocation to more productive sectors. While employment has increased considerably, a significant share of this growth can be attributed to public investment projects or fiscal incentives for employment in the private sector, which may not be sustainable as the fiscal space narrows further, especially in light of the COVID-19 crisis.

North Macedonia needs to foster deeper integration between the FDI-dominated tradable sector and the domestic economy. Deeper integration would facilitate stronger transfer of technology and know-how and support productivity growth and more robust creation of high-productivity jobs in domestic SMEs. The capacities of local firms to meet the quality and technical standards required by the relevant industries in the FDI sector have to improve. The skills of the workforce need to match labour market needs better. Political stability and regulatory certainty are necessary to enhance the business environment (Table 14.3).

Table 14.3. Prosperity – three major constraints to a more dynamic economy of North Macedonia

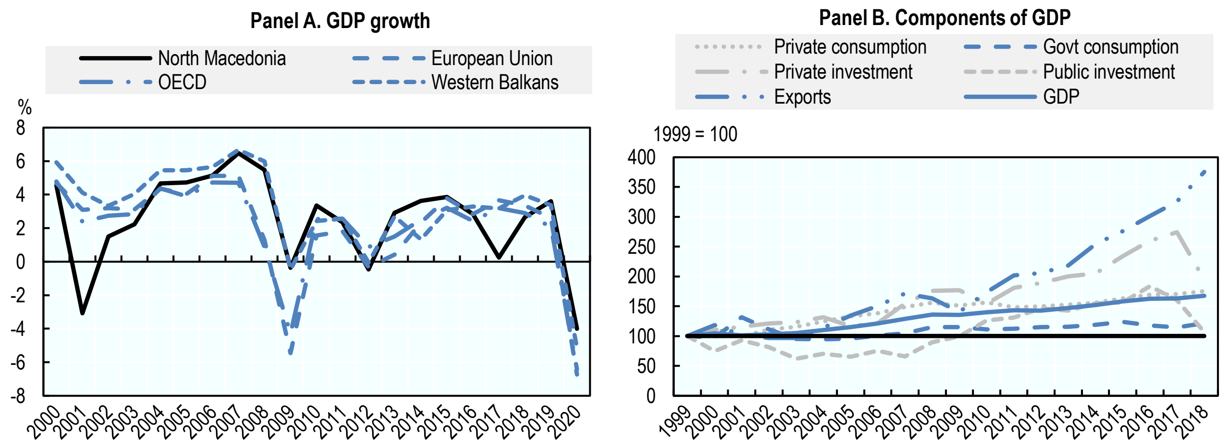
1. Linkages between the export-oriented FDI sector and the domestic economy have been limited.
2. Most domestic SMEs lack the capacities and skilled workforce to innovate, adopt technologies and meet quality standards to join GVCs.
3. Political instability, regulatory uncertainty and corruption undermine the growth and development of the private sector.

Weak linkages between the FDI sector and the rest of the economy have mitigated the structural transformation of the economy

Over the past two decades, the economy of North Macedonia has grown at a relatively moderate pace, averaging 2.9% per year. In the period preceding the global financial crisis, growth was relatively stronger (Figure 14.11 – Panel A), driven by private consumption and investment (Figure 14.11 – Panel B), which were in turn fuelled by private transfers and strong credit growth financed by deposits and complemented by FDI inflows in the financial sector. Between 2003 and 2008, annual credit growth averaged 28%, annual remittance growth was 26% and private consumption and investment increased by a cumulative 35% and 49%, respectively (World Bank, 2020[1]).

In the post-crisis period, growth has been more volatile and has weakened considerably (Figure 14.11 – Panel A), **but it has also become more broad based, with a stronger contribution from exports and private investment** (Figure 14.11 – Panel B). Between 2008 and 2018, exports of goods and services increased by 2.3 times in real terms (Figure 14.11 – Panel B), and their share of GDP nearly doubled, from 33% to 60% (Figure 14.12 – Panel A). Investment rose by 66% from 2009 to 2017, (Figure 14.11 – Panel B), led by private-sector investment, which currently accounts for 80% of total investment. Public investment also grew considerably, providing significant stimulus to the economy during and in the aftermath of the global financial and Eurozone crises (Figure 14.11 – Panel B) (World Bank, 2020[1]).

Figure 14.11. Growth in the aftermath of the global financial crisis has slowed down considerably, but has become more broad based, with a higher contribution from exports and investment, 2000-18



Note: Projections for 2020 GDP growth in Panel A are based on International Monetary Fund estimates.
Sources: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; IMF (2020[47]), *World Economic Outlook, April 2020: The Great Lockdown*, www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020.

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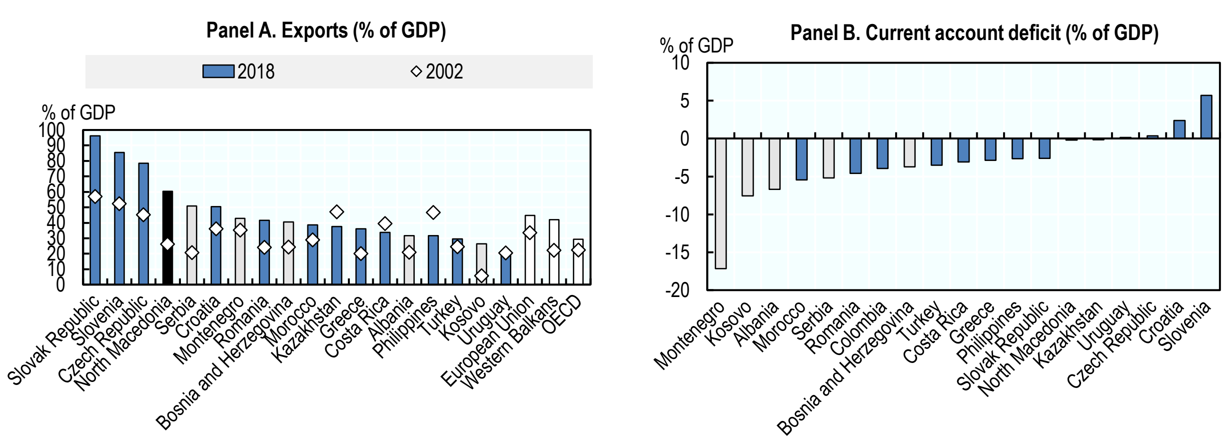
The strong growth in exports has significantly improved North Macedonia's external balance. The trade deficit has declined from a high of 25% of GDP in 2008 to 13% in 2018, and the current account deficit declined to a historical low of 0.2% of GDP in 2018 (down from 12.7% in 2008) (Figure 14.12 – Panel B) (World Bank, 2020[1]). With exports comprising over 60% of GDP (Figure 14.12 – Panel A), North Macedonia is highly integrated, particularly with the EU market, which accounts for nearly 80% of the economy's exports (MAKStat, 2020[8]).

Figure 14.12. High export growth has resulted in a significant decline in the current account deficit



Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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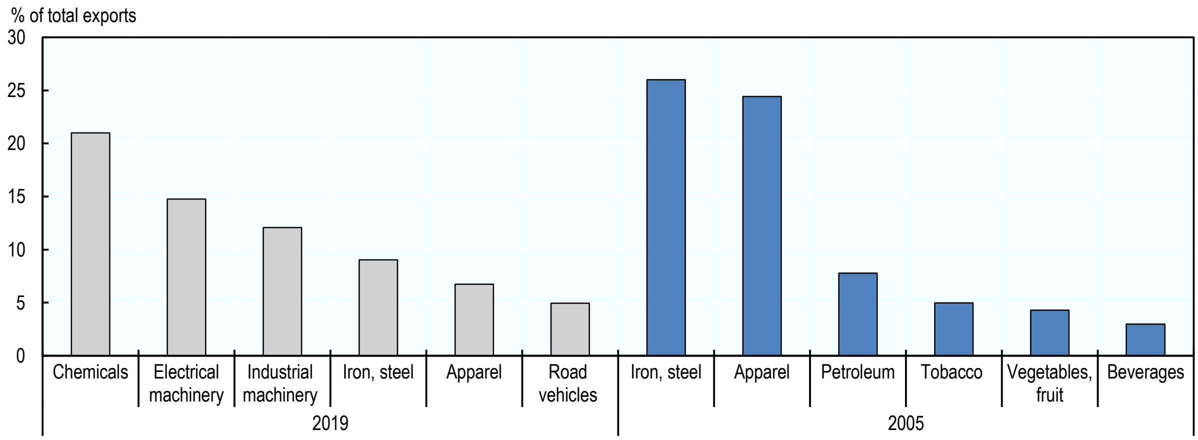
Figure 14.13. The export basket has diversified and upgraded to products largely related to the automotive sector, which have a higher technological content



Source: MAKStat (2020[8]), *MAKStat* (database), http://makstat.stat.gov.mk/PXWeb/pxweb/en/MakStat/MakStat__NadvoresnaTrgovija__KumulativniPod/?rxid=e70e8868-e6a5-4557-87cc-fc8b565e5da3.

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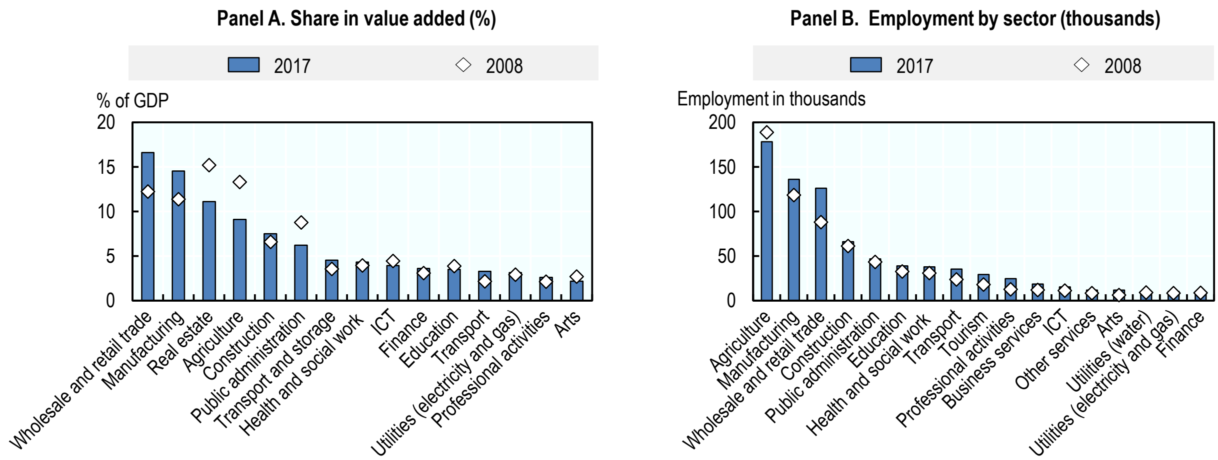
Exports have largely been driven by FDI in the automotive and associated industries, which has contributed to significant diversification and upgrading of the tradable sector and to deeper integration into GVCs. In 2005, only two product categories, iron/steel and apparel, accounted for over 50% of all North Macedonia's exports, while the remaining top exports included products with low technological content, including commodities (petroleum products, minerals), footwear, tobacco, fruits and vegetables and beverages. Since then, exports have continued to grow across all of these product categories except petroleum, but the export basket has become more diversified and sophisticated with the introduction of automotive sector-related exports. The automotive industry now accounts for most of the top exports, including chemicals (reaction and catalytic products), electrical machinery, industrial machinery and vehicles (Figure 14.13).

Automotive sector FDI has been one of the main drivers of the structural transformation of the economy. Over the past decade, most of the growth in value added in the manufacturing sector came from the automotive sector, along with the food processing industry (Figure 14.14 – Panel A). Automotive contributed significantly to manufacturing sector employment growth over this period (Figure 14.14 – Panel B). It also accounted for the largest share of manufacturing investment, which in turn accounted for 25% of total investment in the economy over the past decade.

Figure 14.14. The automotive and food processing sectors have contributed the most to the growth of manufacturing value added, while most of the employment growth has been in the service sectors



Source: MAKStat (2020[8]), *MAKStat* (database), http://makstat.stat.gov.mk/PXWeb/pxweb/en/MakStat/MakStat__NadvoresnaTrgovija__KumulativniPod/?rxid=e70e8868-e6a5-4557-87cc-fc8b565e5da3.

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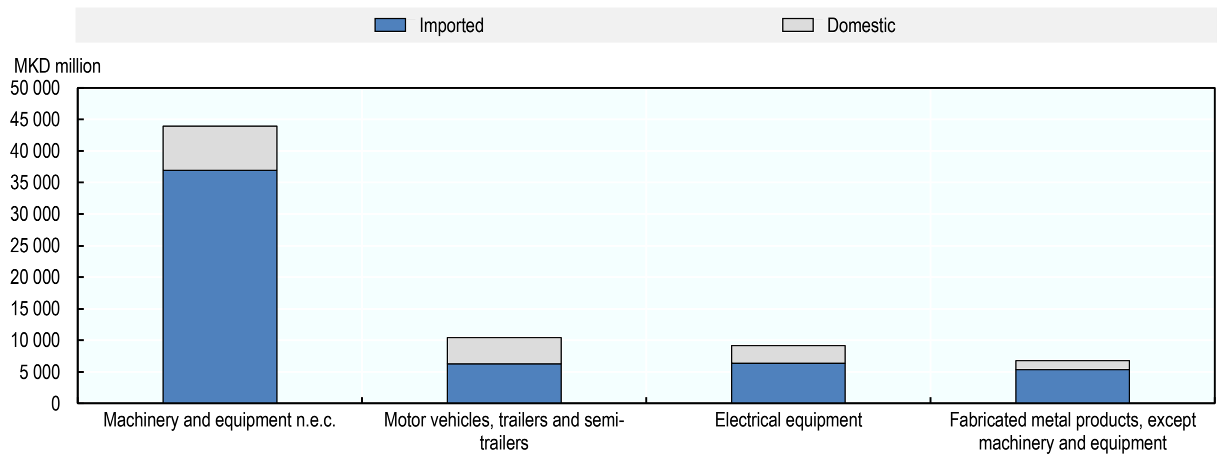
Weak FDI spillovers and productivity growth have negatively affected economic growth and job creation

Weak linkages with the rest of the economy have mitigated the impact of the tradable sector on GDP growth and structural transformation. FDI enterprises have sourced most of their inputs, other than labour, from abroad (Figure 14.15), and very few supplier relationships have been established over the past decade beyond auxiliary services provided locally. Anecdotal evidence points to limited spillovers in terms of education, training, etc. (OECD, 2017[48]). The limited growth impact of these sectors reflects the largely low value added activities in North Macedonia's manufacturing plants, including labour-intensive assembly and cabling. (OECD, 2017[48]).

Figure 14.15. The automotive and associated sectors source most of their inputs from abroad



Source: MAKStat (2020[8]), *MAKStat* (database), http://makstat.stat.gov.mk/PXWeb/pxweb/en/MakStat/MakStat__NadvoresnaTrgovija__KumulativniPod/?rxid=e70e8868-e6a5-4557-87cc-fc8b565e5da3.

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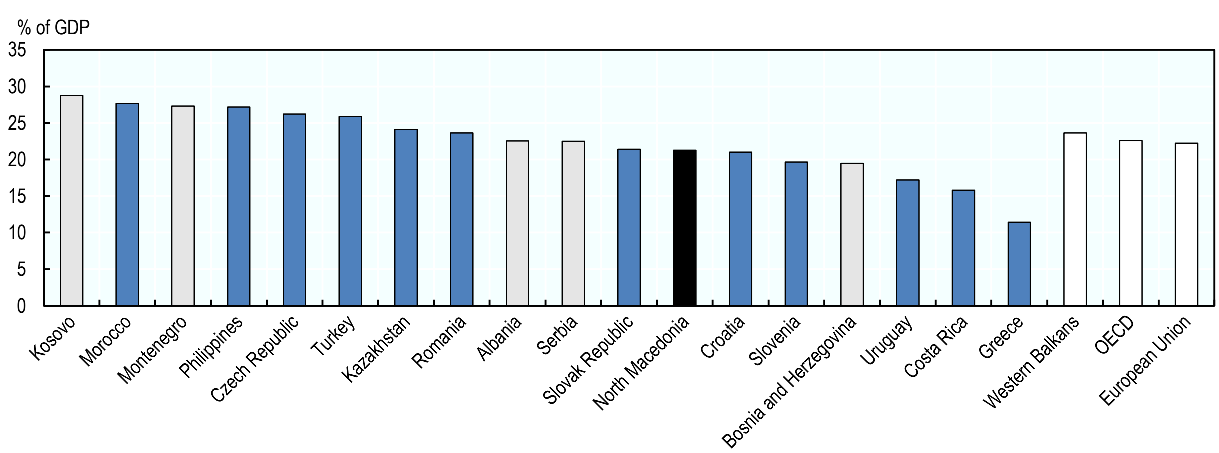
Even though investment growth has been strong, its impact on GDP growth has been relatively limited. Investments increased more than fourfold between 2008 and 2017, but the incremental capital output ratio for this period was 10. Investments targeted sectors with relatively weak productivity and weak potential for productivity-enhancing spillovers (Figure 14.16). The construction, wholesale and retail trade sectors accounted for 50% of total investment (MAKStat, 2020[8]). A significant share of public investments was allocated to civil construction projects, such as Skopje 2014, which included the construction of numerous monuments and administrative buildings in the nation's capital (USAID/BIRN, 2018[49]).

Figure 14.16. Investment as a share of GDP is relatively high



Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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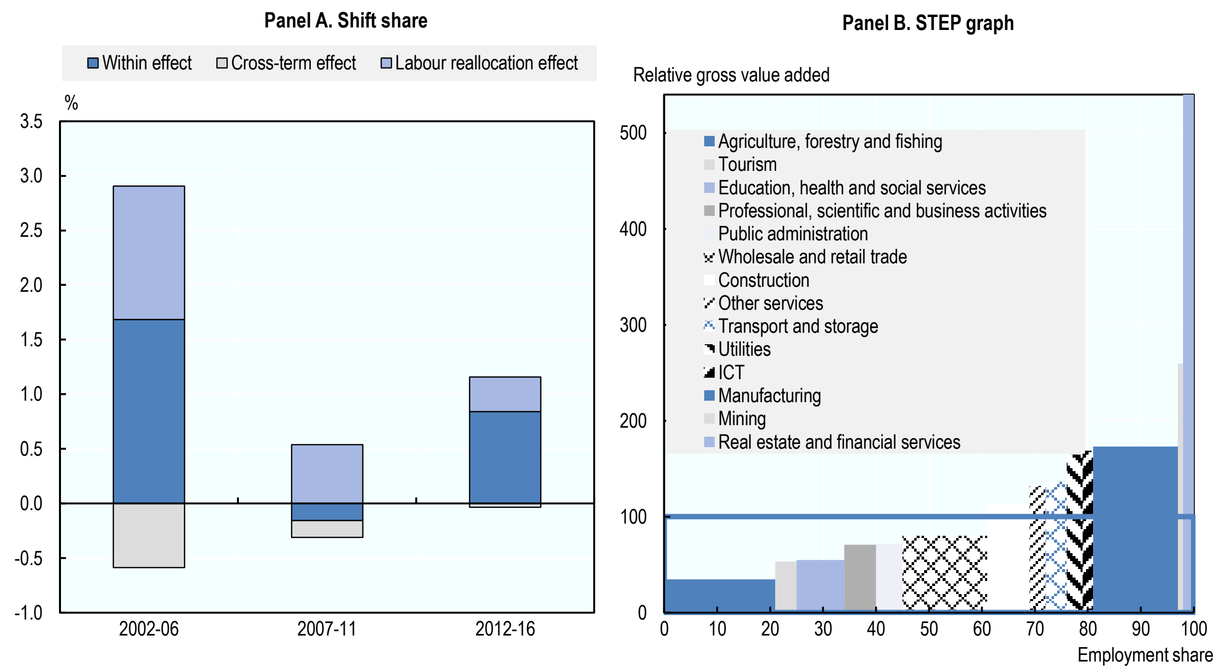
The post-crisis period has seen a significant decline in productivity growth. In the pre-crisis period, productivity growth was driven by significant within-sector productivity growth and labour reallocation to more productive sectors (Figure 14.17 – Panel A). (MAKStat, 2020[50]). However, over the past decade, productivity growth has declined considerably due to weak reallocation and weak within-sector productivity growth (Figure 14.17 – Panel B).

Figure 14.17. Productivity growth has declined significantly due to weaker within-sector growth and weaker gains from productivity-enhancing labour reallocation; most of the employment remains in relatively low-productivity sectors



Notes: Panel A: the labour reallocation shift effect measures the impact on total economy productivity resulting from the movement of labour between sectors. The within-sector effect measures the impact of productivity growth within each sector on total economy productivity growth. The cross-term effect measures the extent to which the former two effects act as substitutes. Panel B: the productivity of each sector is normalised with respect to the average productivity in the economy, which has been set equal to 100 and is represented by the blue horizontal line.

Source: Authors' work based on ILO (2020[51]), *ILOStat* (database), https://ilostat.ilo.org/data/; United Nations data (2020[52]), *UNdata SDG Indicators* (database), http://data.un.org/Default.aspx.

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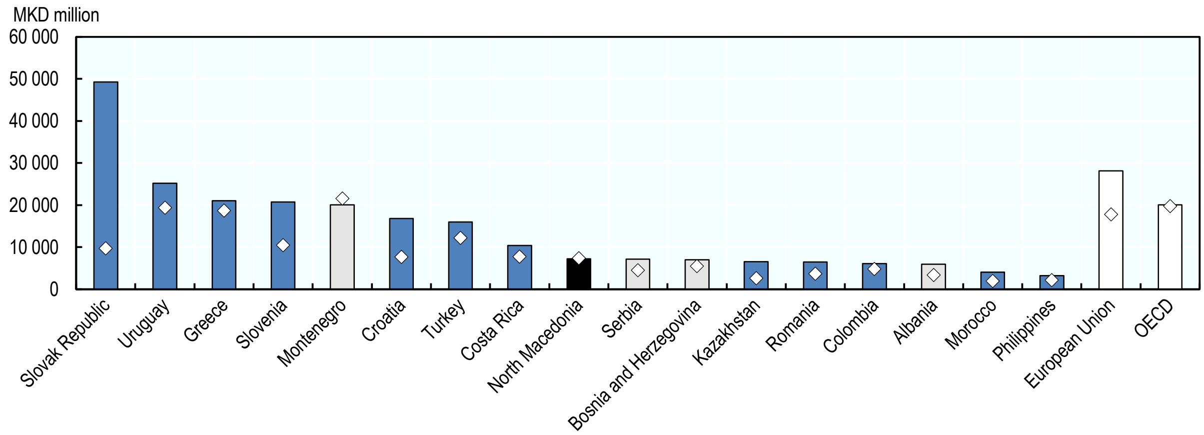
Today, a large share of the workforce is still employed in low-productivity and low-wage sectors, most notably agriculture, which still accounts for the largest share of employment at 20% (Figure 14.17 – Panel B). Agricultural productivity, measured as value added per worker, has not improved notably over the past decade and remains low compared to regional peers and the EU and OECD averages (Figure 14.18). Analyses point to significant inefficiencies: a farm in North Macedonia can produce, on average, the same level of output with 55% less inputs (World Bank, 2019[53]). High agricultural subsidies do not create incentives for productivity growth in this sector or for the reallocation of labour to more productive activities (e.g. agribusiness, manufacturing, services). In fact, non-subsidised farms are more efficient than subsidised ones. Moreover, subsidies have had a negligible impact on poverty reduction: a 100% increase in market support and direct payments for agriculture between 2013 and 2016 led to only a 0.5% reduction in poverty (World Bank, 2019[53]).

Figure 14.18. Productivity in the agriculture sector (value added per worker) has not increased over the past decade and remains low compared to aspirational peers



Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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The misallocation of resources has been noted at the firm level, as capital and labour have not moved from less productive to more productive firms. This problem has been exacerbated by SMEs' limited capacities, access to finance and propensity to innovate and adopt new technology. The shortage of skills is further contributing to the challenge of boosting productivity growth and high-productivity job creation (World Bank, 2018[3]).

In this context, significant labour market challenges persist. Even though North Macedonia has achieved considerable progress in reducing unemployment, which fell from the peak of 37% in 2005 to 17.3% in 2019, the decline has been accompanied by high levels of emigration (World Bank, 2020[1]). Moreover, the unemployment rate remains high, and 68% of the unemployed consists of the long-term unemployed (Studies, 2020[14]). Youth unemployment stands at 39% (World Bank, 2020[1]). Labour force participation remains a challenge, especially among youth and women, for whom it represents 31% and 43%, respectively (World Bank, 2020[1]).

Despite its robust growth over the past decade, employment remains relatively low at 45%. The drivers of employment growth have been numerous: 1) public funds/public investment projects; 2) increases in public-sector employment; 3) labour-related fiscal incentives for employees in the special economic zones (which encompass almost all employment in the automotive and related sectors); and 4) recent employment subsidy programmes aimed in part at formalising informal labour and which currently represent 17% of total employment.

Strengthening human capital can help turning FDI into stronger economic growth and quality jobs

Looking to the 2030 horizon, North Macedonia can build on progress made over the past decade, but if FDI continues to be the driving force behind the structural transformation of the economy, wider and deeper linkages with the local economy need to be developed. This can entail focusing on attracting FDI that can source more content locally. The example of Belgian bus manufacturer Van Hool's strong and expanding supplier relationship with the local company Aktiva might suggest that attracting smaller and more niche manufacturers could facilitate the development of more local supplier relationships compared to larger manufacturers with more established and complex supply chains. More importantly, strengthening the capacities of local companies to innovate, adopt new technologies and meet quality standards can support the development of more supplier relationships and enable the internationalisation of SMEs even outside of the FDI channel (e.g. in information and communications technology, agriculture).

Strengthening human capital can significantly contribute to these development objectives. A better educated and skilled workforce can also support the attraction of higher value added activities, such as R&D, among existing FDI investors. Removing outstanding barriers to enterprises' investment and growth is also needed to facilitate the growth and development of local SMEs. This primarily entails fostering a more stable political environment, strengthening regulatory quality and implementation, reducing corruption and promoting more fair competition.

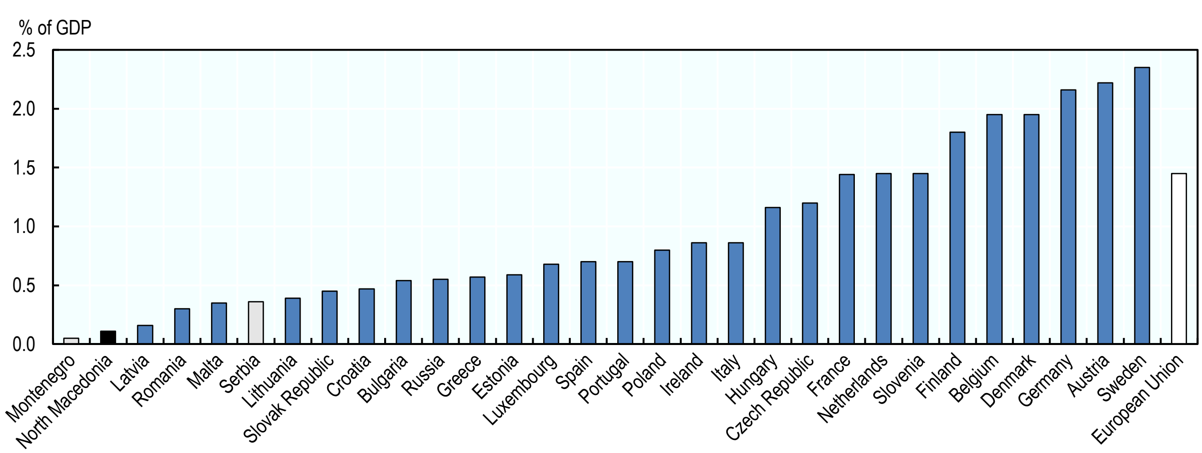
Firms face significant skills gaps and weak capacities for innovation and technology adoption

Linkages between the FDI sector and local enterprises have been thus far very limited, largely because local firms cannot meet the technical, safety, delivery and other requirements of the automotive industry (OECD, 2017[48]). This reflects many underlying constraints, including firms' limited capacities to innovate and to adopt new technologies, weak management and workforce knowledge and skills, and weak access to finance for investments in training and certifications.

North Macedonian firms do not invest sufficiently in innovation or meet quality standards necessary for GVC integration

At 0.1% of GDP, firm investment in R&D is low compared to many regional peers and well below the EU benchmark of 1.5% (Figure 14.19). North Macedonia also ranks well below most aspirational peers in key innovation capability-related indicators on the World Economic Forum Global Competitiveness Index, including multi-stakeholder collaboration within companies (ranked 125 out of 140 economies), university-company collaboration (116) and number of patent applications (74, above only Albania relative to regional and aspirational peers).

Figure 14.19. Firm investment in R&D is much lower than observed in EU member states and other aspirational peers



Source: Eurostat (2020[54]), *Eurostat COVID-19: Statistics serving Europe* (database), https://ec.europa.eu/eurostat/data/database.

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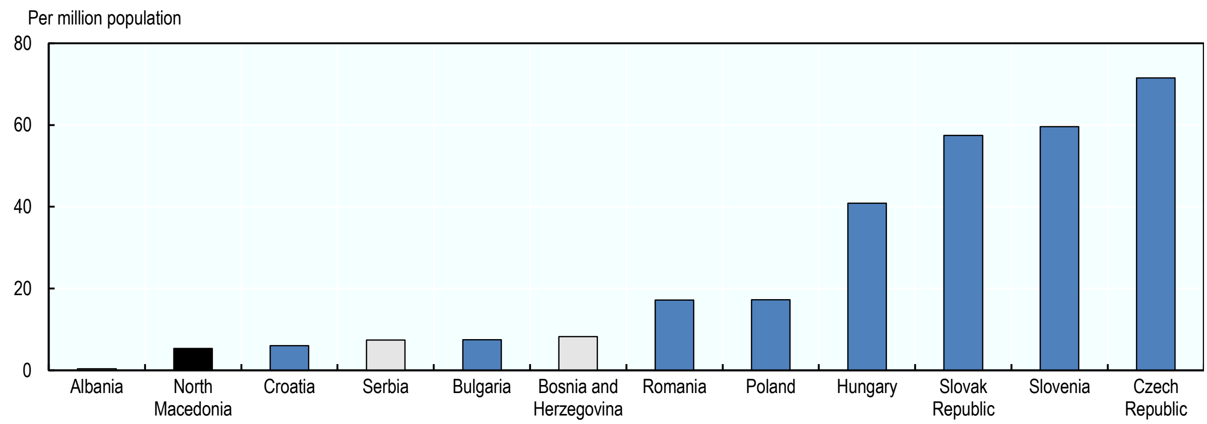
North Macedonian firms also lag behind in achieving quality standards. This represents a critical barrier for GVC integration for many industries, including the automotive sector (Figure 14.20).

Figure 14.20. Low adoption of quality standards impedes integration into automotive GVC

Presence of International Organization for Standardization Technical Specification (ISO TS) 16949 quality management systems for automotive production and relevant service part organisations



Source: Authors' elaboration based on ISO (2020[55]), Survey Data, https://isotc.iso.org/livelink/livelink?func=ll&objId=18808772&objAction=browse&viewType=1; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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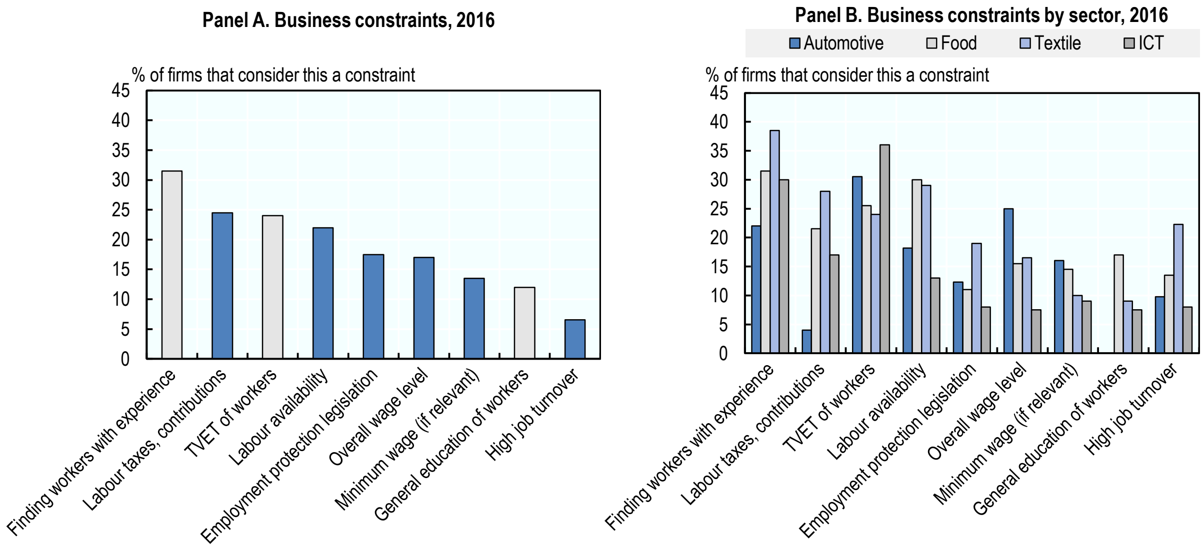
In recent years, the government has made considerable effort to improve firms' access to finance, information and training and other needed support to boost innovation. The Fund for Innovation has indeed significantly expanded its funding instruments and available funds for SMEs and start-ups. However, as the data indicate, more progress is needed to catch up to the levels of innovation and technology adoption of aspirational peers.

Boosting skills is essential for productivity growth and GVC integration

Skills represent an important challenge for firms in North Macedonia, ranking higher than any other labour-related constraint, including wages and labour regulations, for firms across all major sectors (Figure 14.21) (World Bank, 2017[56]).

Figure 14.21. Skills are an important constraint for productivity growth and job creation across all key sectors



Source: World Bank (2017[56]), *Looking for Skills in the former Yugoslav Republic Macedonia*, http://documents.worldbank.org/curated/en/914541498623380214/pdf/112196-WP-P133003-PUBLIC-27-6-2017-13-40-18-MKDReportLookingforSkillsFinal.pdf.

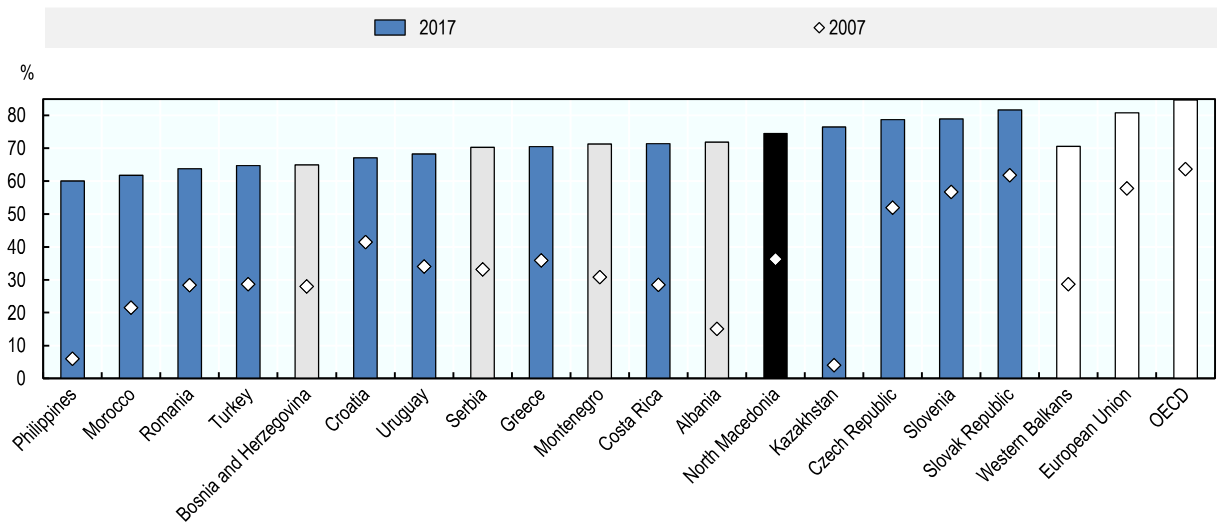
StatLink https://doi.org/10.1787/888934244607

Skills have been an important constraint for job creation and productivity growth. About 33% of firms that have tried to hire workers report experiencing difficulties; in most cases, lack of skills was the primary impediment. About 50% of firms consider that their employees do not have sufficient skills for the jobs they currently occupy. This is particularly a problem in the automotive industry, where nearly three-quarters of firms report a significant employee skills gap. There is also frequently a mismatch between employees' education and the jobs they occupy. This is a particular challenge for VET and university graduates, most of whom consider themselves overeducated for their jobs and claim that they do not use the knowledge they obtained during their schooling at all (World Bank, 2017[56]).

The skills gap refers not only to technical skills but also to general skills, such as communication, people skills and time management (World Bank, 2017[56]). In the latest Balkan Barometer survey, 29% of respondents noted deficiencies in their foreign language skills, 25% identified a need to improve their skills for effectively managing their own learning on the job, and 23% identified a need to improve their creativity, innovation and risk-taking on the job. Although North Macedonia is among the regional leaders in Internet access and use (Figure 14.22), there is still progress to be made in the population's digital competencies. Nearly one-quarter of respondents identified deficiencies in their digital skills (RCC, 2019[57]). These underlying constraints reflect: 1) problems in the general quality of the education system; 2) the inadequate provision of technical skills needed by the labour market; and 3) the mismatch between professional qualifications acquired and the skills actually needed in the labour market.

Figure 14.22. The share of individuals with Internet access is high compared to regional peers but lags behind aspirational peers in the European Union and the OECD

Percentage of individuals using the Internet in 2007 and 2017



Source: ITU (2020[58]), *International Telecommunication Union – Telecommunication Development Sector (ITU-D)* (database), www.itu.int/en/ITU-D/Statistics/Pages/default.aspx.

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The skills problem reflects demand-side constraints as well. Many labour market outcomes suggest that education does not have a strong pay-off in North Macedonia, which discourages the acquisition of higher levels of education and skills. Unemployment levels are high even for people with high levels of educational attainment (20% of the unemployed have completed tertiary education). A large share of people work in fields that do not match their qualifications and consider themselves overeducated. Consequently, tertiary education enrolment in North Macedonia is low and trails behind most regional and aspirational peers.

Incentives for skills acquisition are further weakened by the importance of other factors (e.g. political or family connections, bribes, prizing diplomas themselves over skills acquired) that determine hiring or salary outcomes, especially in the case of public sector employment. According to the Balkan Barometer survey, the top two assets for finding a job identified by respondents included a network of family and friends in high places (39%) and personal contacts (38%). By comparison, only 19% of respondents identified the level of education or qualifications as one of the top two assets for getting a job (RCC, 2019[57]). This discourages demand for quality education and skills acquisition even among those enrolled in higher education (World Bank, 2017[56]).

Political and regulatory uncertainty and corruption discourage investment and enterprise growth

Political instability is a major constraint to investment and growth in North Macedonia. The highly polarised and fragmented political climate has resulted in frequent elections – 6 parliamentary elections over 15 years – with frequently contested results, obstructive opposition behaviour and a general climate of high political uncertainty. The best example of the large impact this uncertainty has had on the economy is the recent political crisis of 2016-17. The protracted crisis and ambiguity over the economy's leadership resulted in a significant contraction in domestic demand, mainly private and public investment (gross fixed capital formation), which declined by 6% in 2017, and a decline in GDP growth to 1.1% (from 2.8% the previous year). In the latest Business Environment and Enterprise Performance Survey (BEEPS), political instability was identified as the main constraint by nearly one-third of all surveyed firms, making it the top constraint to doing business in North Macedonia (World Bank, 2020[32])

Political uncertainty has been coupled with high regulatory uncertainty, which stems from frequent changes in legislation and uncertain and uneven implementation of legislation. Frequent changing of legislation has been an important impediment for firms, making it difficult for them to keep up and comply with regulations. Coupled with uneven and discretionary enforcement of regulations, reflecting weak governance and weak capacities of inspection bodies, frequent legislative changes add to the perception of uncertainty and discourage investment (World Bank, 2017[56]).

Unfair competition, especially from the informal sector, is cited as a major challenge for businesses in North Macedonia. In the latest BEEPS, more than 50% of surveyed firms noted that they competed against informal or unregistered firms, and 40% of all firms identified this as a major constraint. This particularly affects SMEs but is also an obstacle for manufacturing firms (World Bank, 2020[32]).

Corruption remains an important impediment to investment and growth. Even though considerable progress has been made in some aspects (e.g. government transparency vis-à-vis the media, participation of civil society in the policy-making process), there has been significant regression in other areas. Most importantly, the uncovering of corrupt behaviour in the very institutions tasked with preventing and fighting corruption, including the Special Prosecutor's Office and the Public Prosecutor's Office, has significantly undermined trust in institutions and further raised awareness about the persistence of high-level corruption in the economy. North Macedonia's score and ranking in Transparency International Corruption Perception Index (CPI) has declined considerably in the last six years. It currently ranks 106 out of 198 economies globally and below most regional peers.

Partnerships and financing – financing sustainable development

The Partnerships and financing pillar of the 2030 Agenda for Sustainable Development cuts across all goals focusing on the mobilisation of resources needed to implement the Agenda. It is underpinned by the Addis Ababa Action Agenda, which provides a global framework to align all financing flows and policies with economic, social and environmental priorities.

In the area of financing, North Macedonia faces considerable challenges in improving the public-sector revenue performance, increasing public capital expenditures and improving access to finance for the SME sector (Table 14.4). On the public-sector side, rising public debt over the past decade has limited the fiscal space, which represents an important constraint in light of the economy's currency peg to the euro and related lack of monetary policy options. Public finance is also affected by structural constraints. Revenue performance remains weak due to high informality and tax evasion, significant fiscal subsidies and exemptions, and low tax levels, while inefficient current expenditures limit the scope for growth of productivity-enhancing capital expenditures. On the private-sector side, non-bank financing remains limited, and access to finance for SMEs, start-ups and innovative projects remains constrained. Rising public debt is exacerbating this challenge, as higher domestic financing for the government is likely to crowd out bank lending to the private sector further.

Table 14.4. Partnerships and financing – four major constraints to the financing of sustainable development in North Macedonia

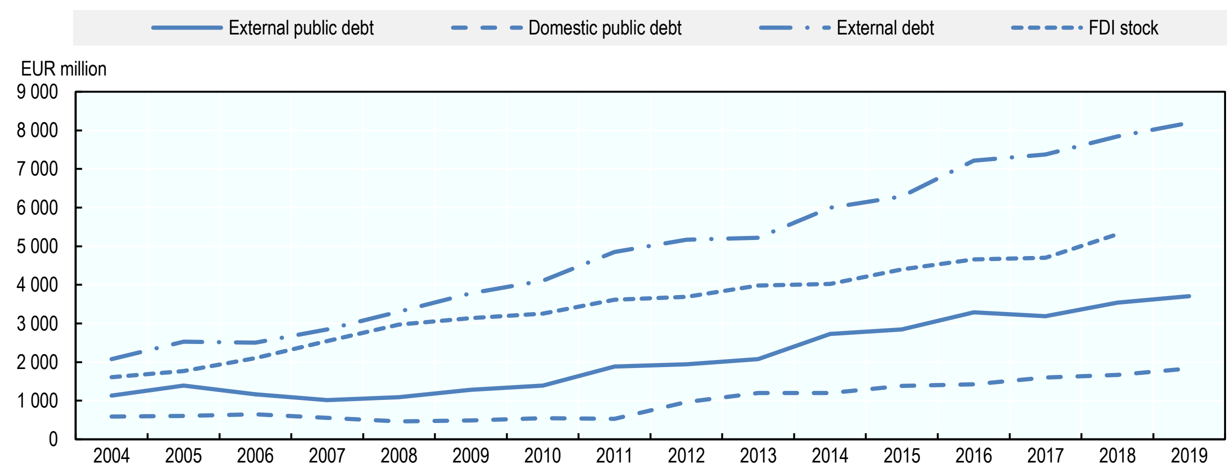
1. The fiscal space has narrowed, limiting the scope for further provision of economic stimulus.
2. Revenue performance is constrained by high informality, low taxes and high exemptions.
3. High current expenditures have been crowding out capital spending.
4. Access to finance is constrained, particularly for the SME sector.

The fiscal space has narrowed, limiting the scope for further provision of economic stimulus

Over the past decade, the economy of North Macedonia has relied heavily on external financing. Since 2008, external debt has quadrupled to 73.3% of GDP on the back of rising public and private debt (Figure 14.23), which currently account for 45% and 55% of total external debt, respectively.

This period saw a significant increase in FDI inflows. In the pre-crisis period, FDI in the financial, retail and other sectors significantly fuelled the consumption-driven growth. In the post-crisis period, strong growth in the predominantly manufacturing FDI has been one of the main drivers of the structural transformation of the economy (Figure 14.23).

Figure 14.23. External financing of the public and private sectors has increased over the past decade, 2004-19



Source: Authors' own work based on data provided by the Ministry of Finance and the National Bank of the Republic of North Macedonia.

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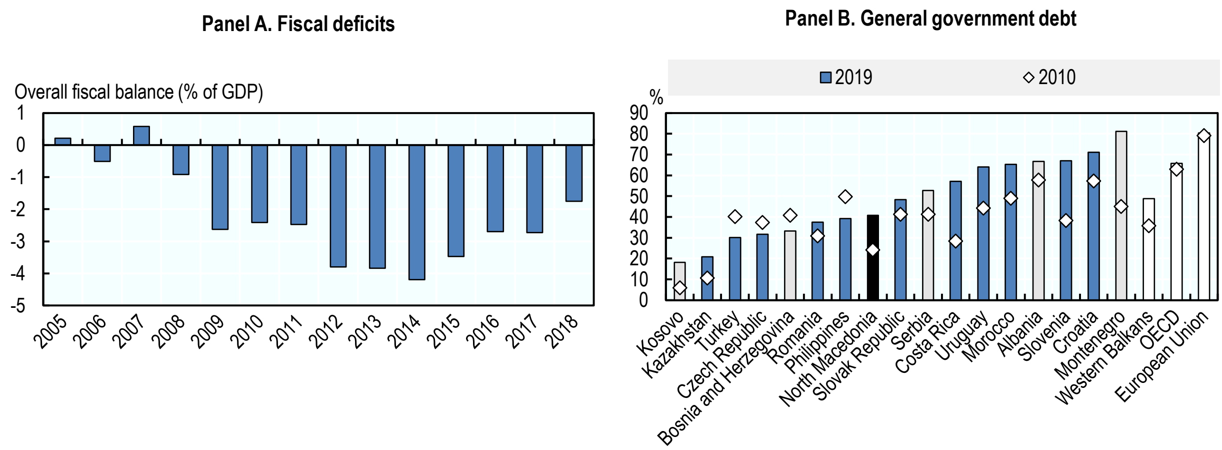
The past decade saw a significant increase in public debt as the government relied more heavily on fiscal stimulus measures to support economic growth and job creation in the aftermath of the global financial and Eurozone crises. These measures included public investment in infrastructure and civil construction projects, fiscal incentives for FDI in the special economic zones, employment-related subsidies and higher employment in the public sector (World Bank, 2018[3]). Coupled with weaker revenue performance due to a slowdown in economic growth in the post-crisis period, these measures resulted in a significant increase in the fiscal deficits (Figure 14.24 – Panel A) and the doubling of public debt between 2008 and 2019 (Figure 14.24 – Panel B).

Even though, at around 41% of GDP, general government debt is not high by regional standards (Figure 14.24 – Panel B), **the narrowing of the fiscal space over the past few years has important implications.** Since the MKD is pegged to the euro, the National Bank has limited options on the monetary policy side to stimulate the economy in times of crisis. Moreover, with roughly 80% of government expenditures going to public wages, social transfers and subsidies, which are difficult to cut, the government's ability to adjust expenditures in response to declining revenues or to redirect spending towards other pressing needs, such as the ongoing economic crisis, has become much more limited.

The high reliance on external financing of the public debt has elevated fiscal risks, as has the high share of foreign currency-denominated public debt (more than 67% of total debt). On the other hand, the maturity of public debt has increased substantially over this period, contributing to reduced rollover risks (Ministry of Finance, 2018[59]).

Figure 14.24. Fiscal deficits increased in the post-crisis period and general government debt rose significantly as a result



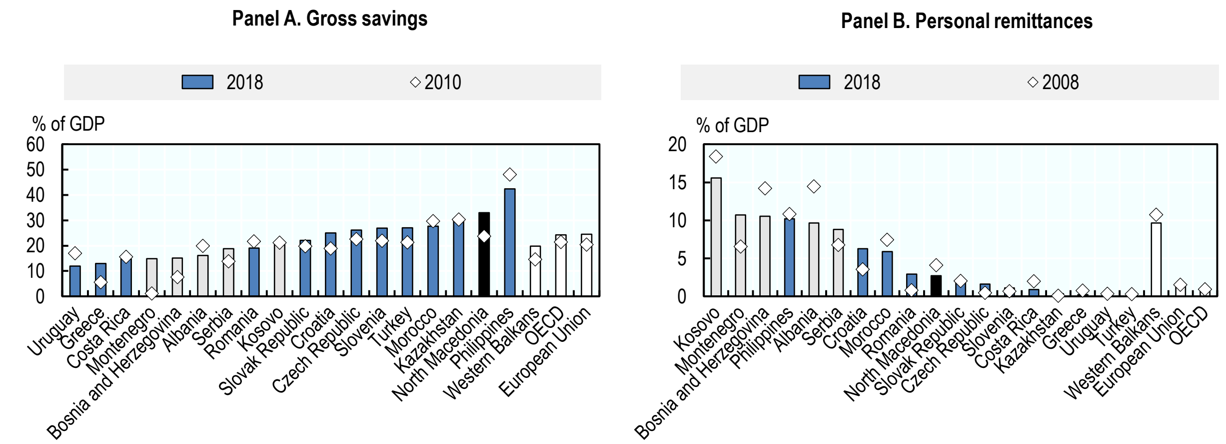
Sources: Ministry of Finance (2018[59]), Ministry of Finance website, https://www.finance.gov.mk/en; IMF (2019[60]), *World Economic Outlook, October 2019: Global Manufacturing Downturn, Rising Trade Barrier*, www.imf.org/en/Publications/WEO/Issues/2019/10/01/world-economic-outlook-october-2019.

StatLink https://doi.org/10.1787/888934244664

On the private-sector side, the past decade saw a significant increase domestic savings. Consumption as a share of GDP declined from 97% to 80% in this period (World Bank, 2020[1]), and domestic savings rose from 3% of GDP in 2008 to 20% in 2019 (Figure 14.25 – Panel A). However, as noted in the Prosperity section in this chapter, the high share of domestic investment in the construction and real estate sectors has mitigated the impact on economic growth and development. Structural challenges in financial intermediation and underdeveloped financial markets have also limited the impact of increased savings on domestic investment and growth.

In the post-crisis period, remittance income declined considerably. Even though remittances have not contributed as significantly to the economy in North Macedonia as they have in most regional peers (at the 2011 peak, they amounted to 4% of GDP), their strong growth supported consumption in the pre-crisis period, and their decline of over 25% since 2011 is notable (Figure 14.25 – Panel B).

Figure 14.25. Gross savings have increased in the post-crisis period, while remittance income has declined significantly



Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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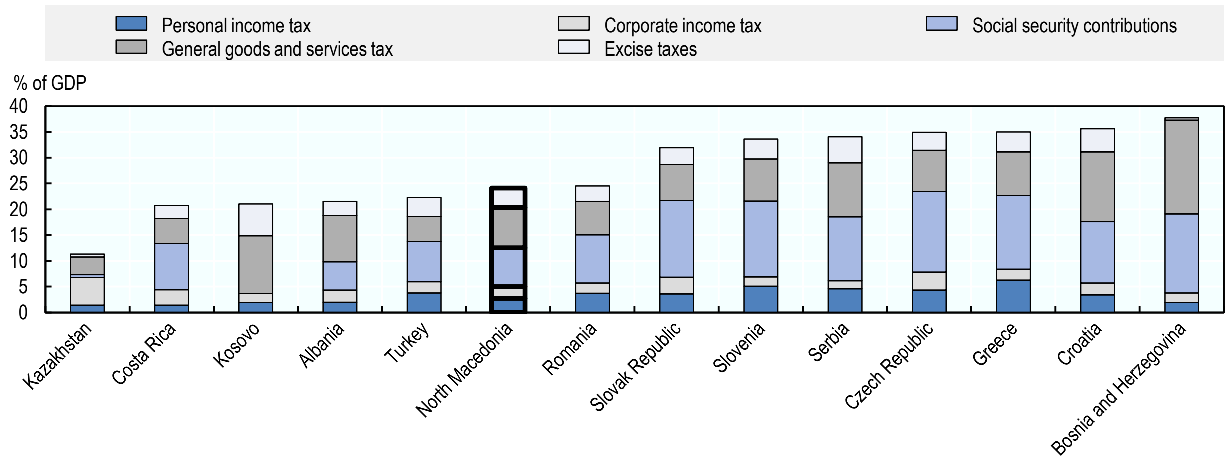
Revenue performance is constrained by high informality, low tax rates and high exemptions

In the aftermath of the global financial crisis, revenue performance weakened considerably. Revenues as a share of GDP have declined, from 32.9% of GDP in 2008 to 28.6% in 2018, largely due to weaker performance in the collection of Value Added Tax (VAT) and import duties. Revenues are considerably lower compared to most aspirational peers, especially with respect to the collection of personal income tax and social contributions (Figure 14.26). Over this period, North Macedonia also experienced the largest changes in the revenue mix compared to other Western Balkan economies, with an increase in the share of tax revenues (by 6% between 2011 and 2018) and a decline in the share of grants and other non-tax revenues (by 5.3% between 2011 and 2018). Likewise, there was a change in the tax mix: the share of excise and profit taxes revenues increased while the contribution from VAT revenues declined, reflecting exemptions, including road tolls (OECD, 2020[61]).

The relative underperformance reflects a low tax base and significant tax avoidance. Informal employment remains high at 18% of total employment. Under-reporting of wages and envelope wages are widespread: partially or fully undeclared income has been recorded among 44% of employees (European Commission, 2019[62]). Under-reporting of sales and non-issuance of fiscal receipts are also highly prevalent, and the share of companies operating entirely in the grey economy appears to be high. In the latest BEEPS, more than 50% of companies stated that they competed against unregistered firms (World Bank, 2020[32]).

Recently, the government undertook a few reform initiatives to reduce informal practices and improve revenue outcomes. A VAT refund scheme sought to incentivise consumers to demand fiscal receipts for the purchase of goods and services, as they are then able to receive a 20% refund on the VAT paid for domestic goods and services and a 10% refund on the VAT paid for foreign goods and services. Another initiative aimed at reducing envelope wages introduced subsidies on social security contributions paid by employers for wage increases (Government of the Republic of North Macedonia, 2020[63]). Since these are relatively new reforms, it remains to be seen if the revenue costs entailed will pay off through higher revenues and reduced informality.

Figure 14.26. Revenue performance lags behind aspirational peers



Source: Authors' own work based on IMF (2020[64]), *International Financial Statistics* (dataset), https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b.

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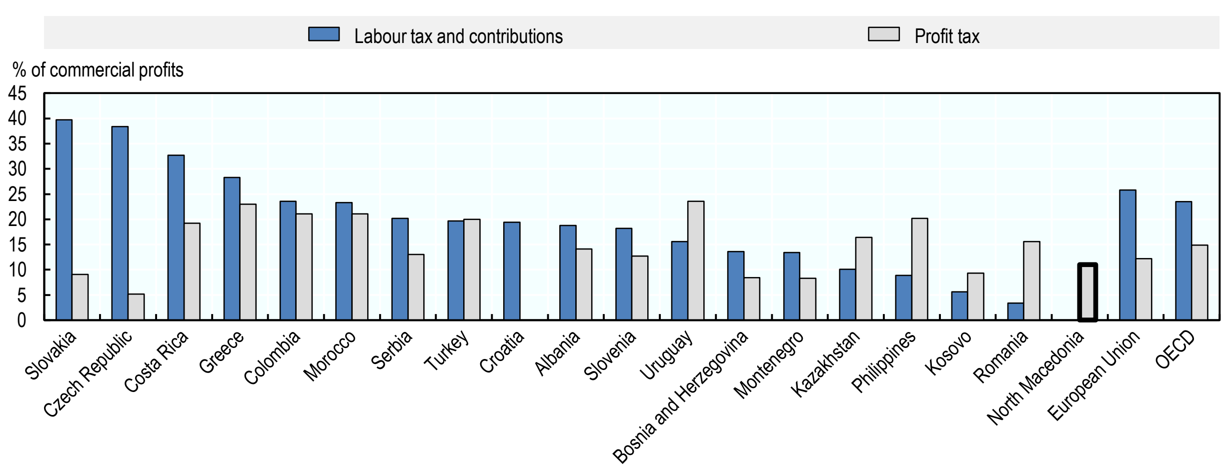
The relatively weaker revenue performance also reflects low tax rates. North Macedonia has the lowest rates compared to global peers (Figure 14.27), with flat personal income, corporate income and capital gains tax rates of 10%. At the beginning of 2020, the government postponed the introduction of a progressive personal income tax and increase of the capital gains tax to 15% on account of unfavourable findings from the public revenue office's analysis, which included weak expected impact on income inequality and high expected increase in tax evasion (European Commission, 2019[65]).

Figure 14.27. North Macedonia has the lowest tax rates of all global peers



Source: World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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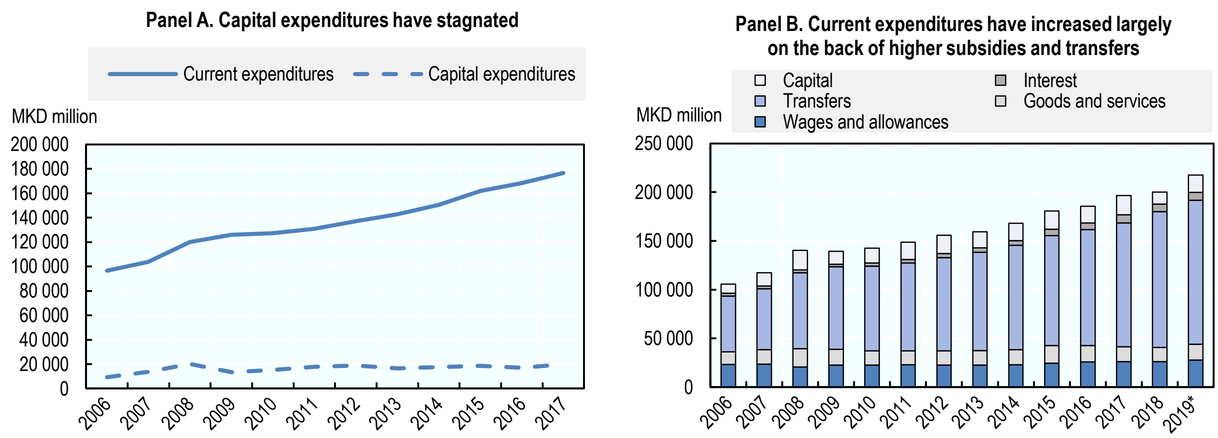
Weak revenue growth reflects significant fiscal incentives offered primarily in the special economic zones. This includes a special regime for corporate income tax, personal income tax on the salaries of all employees in the zones and VAT on traded goods and services in the zones. These special conditions are applied for a period of ten years (Public Revenue Office, 2020[66]).

Current expenditures are high and crowd out capital spending

Over the past decade, current expenditures have increased significantly (Figure 14.28 – Panel B), **while capital expenditures have remained stagnant** (Figure 14.28 – Panel A). Most of the growth in expenditures has come from subsidies and transfers, particularly pensions, healthcare spending and other subsidies (Figure 14.29). The latter includes agricultural subsidies, which are higher than those of regional peers and the EU average.

Figure 14.28. Current expenditures have increased largely on the back of higher subsidies and transfers, while capital expenditures have stagnated



Note: * Data for 2019 is an estimate.
Source: Authors' own work based on IMF (2020[64]), *International Financial Statistics* (dataset), https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b.

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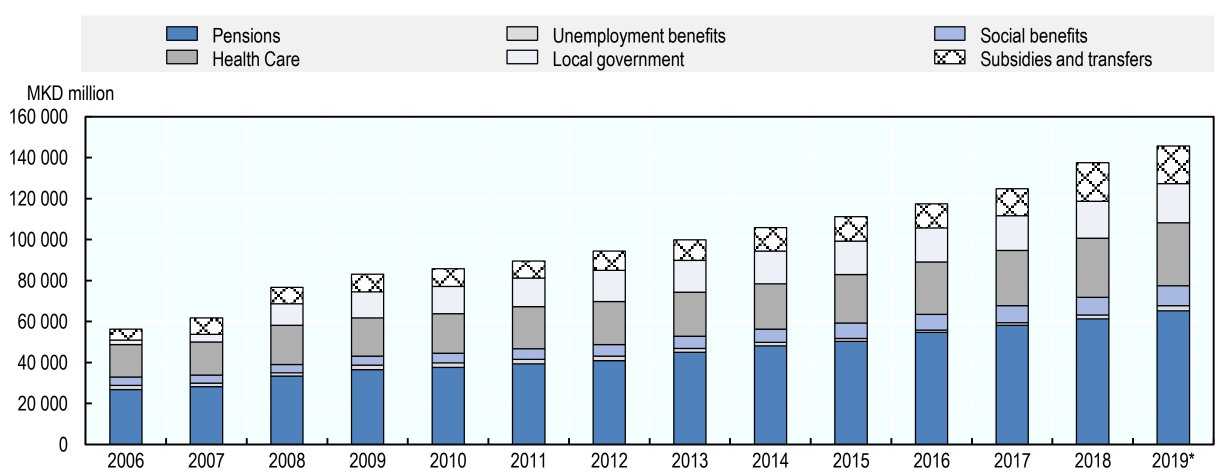
Figure 14.29. Higher expenditures on pensions, health care and subsidies account for the largest share in public expenditures



Note: Subsidies and transfers include transfers to local governments.
* Data for 2019 is an estimate.
Source: Authors' own work based on IMF (2020[64]), *International Financial Statistics* (dataset), https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b.

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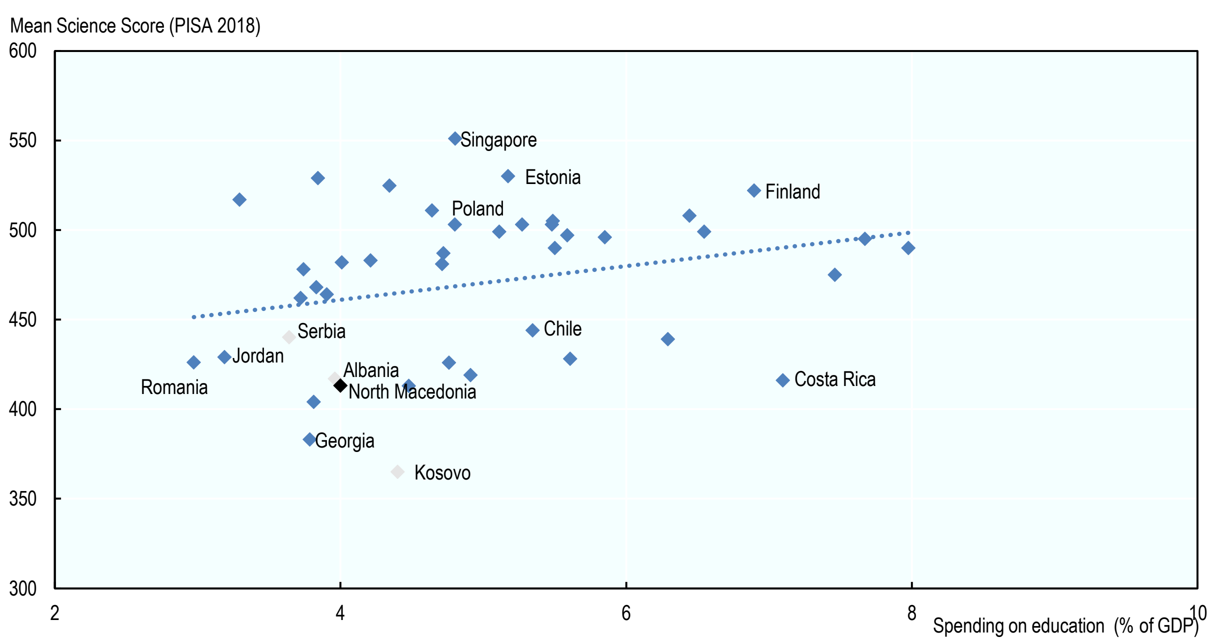
Despite significant pension reforms undertaken in the early 2000s to strengthen the sustainability of the North Macedonia pension system, over the past decade, the pension system situation has worsened. Rising pension expenditures due to ad hoc increases in pension levels have been coupled with decreased contribution rates and the introduction of exemptions of the payment of social contributions in order to support employment growth. At 9.3% of GDP, pension expenditures are high by international standards and are projected to continue to rise in the absence of proper implementation of the pension reforms started in 2019 (World Bank, 2018[44]). The new reforms include, among other things, a new indexation formula that further restricts the growth of pension expenditures, but as noted over the past decade, the success of the reforms will strongly depend on restraint with respect to ad hoc changes to this indexation. In light of the high public investment needs, to provide more space for higher capital spending, assessments of North Macedonia's public finances point to the need for pension reform and reduced and better targeted agricultural subsidies (World Bank, 2015[67]).

Significant gains can be made through improvement in the efficiency of government spending. Benchmarking against peer economies indicates that, given the current spending on education, health and infrastructure, outcomes should be much better than they currently are. For example, student performance in the 2018 PISA was much lower than economies with similar levels of spending on education (Figure 14.30).

Figure 14.30. The mean science PISA score is low compared to economies with similar levels of education expenditures



Note: Data for North Macedonia are from 2013.
Source: Authors' own work based on OECD (2020[23]), *PISA* (database), www.oecd.org/pisa/data/; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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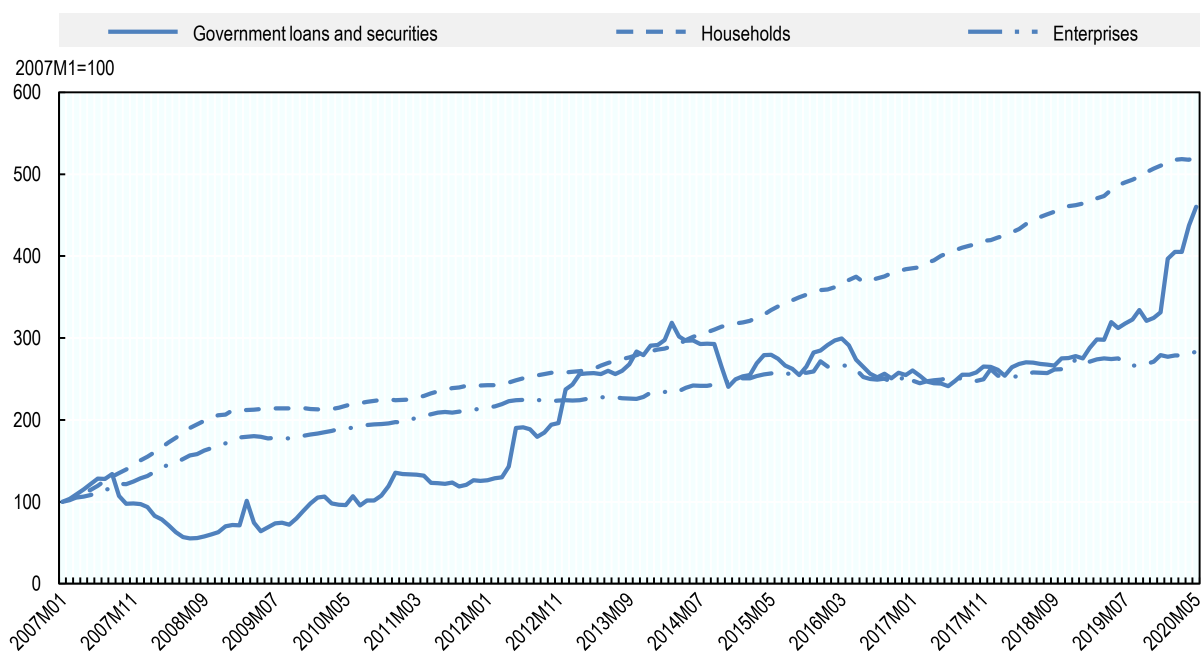
Financing is constrained, particularly for SMEs

Financing for enterprises in North Macedonia comes mainly from commercial banks. Even though the banking sector share in total financial sector assets has been declining, it remains high at over 81%, with most of the remaining share belonging to pension funds. Banks account for 98% of all SME financing (European Investment Bank, 2016[68]).

The largely foreign-owned banking sector is liquid, well capitalised and profitable, and non-performing loans are relatively small at 4.6% of total loans (World Bank, 2020[1]). However, even though credit growth has been relatively robust at an annual growth rate of 7% between 2012 and 2019, it has been mostly driven by lending to households, which has increased fourfold since 2007 and currently accounts for 50% of total loans (Figure 14.31). Financing for the government increased significantly, especially in the aftermath of the global financial and Eurozone crises. It has accelerated recently in the face of the global crisis caused by the COVID-19 pandemic. Meanwhile, enterprise lending has remained relatively stagnant, despite strong and growing demand for loans from the private sector (National Bank of the Republic of North Macedonia, 2020[69]), especially in light of declining interest rates, which are low by regional standards. Indeed, over the past five years, the denar lending rate fell, from 7.5% at the end of 2014 to 5.4% at end of 2019. Enterprise loans currently account for 48% of total loans. This reflects, in part, the mandatory write-offs of non-performing loans that banks have had to make from June 2016 to today (National Bank of the Republic of North Macedonia, 2018[70]).

Figure 14.31. Lending to households and the government is crowding out lending to enterprises



Source: National Bank of the Republic of North Macedonia (2020[71]), *Statistical Web Portal* (database), http://nbstat.nbrm.mk/pxweb/en/.

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In the post-crisis economic context, lending has been particularly constrained for SMEs. Banks has been able to achieve good profitability thanks to strong expansion in the mortgage and consumer-lending sector and to a steady supply of high-yielding government securities. They have therefore been reluctant to expand significantly the lending portfolio to SMEs, which are considered riskier investments (World Bank, 2018[3]).

SME lending is constrained by high collateral requirements. Almost all lending to this sector requires some kind of securitisation and mostly immovable assets, which many SMEs do not have. Collateral requirements are high at 180% of the total value of the loan (World Bank, 2020[32]). This reflects, to a large degree, the difficulties of executing collateral, as it takes 1.5 years to resolve insolvency, and the recovery rate is just 48%, compared to 70% for OECD high-income economies (World Bank, 2020[72])

Non-bank financing remains to be fully developed. The law on financial companies and law on leasing provide the framework for loans and factoring by financial companies. Regarding equity, as a key type of non-bank finance, a number of economy-specific or regional investment funds operate in North Macedonia. However, so far they finance few projects, and their overall portfolio is relatively small. As a result, most non-bank financing for SMEs comes from the government.

Capital markets remain relatively shallow. On the one hand, there is a weak supply due to high-performing companies' preference for internal or debt financing through banks. Weak fundamentals and low corporate governance also limit the quality of supply on the market. This results in weak demand and preference for investment abroad or in lower risk government securities (Shteriev, 2018[73]).

Peace and institutions – strengthening governance

The Peace and institutions pillar of the 2030 Agenda for Sustainable Development encompasses peace, stability and trust, as well as effective governance and the performance of the public sector more broadly.

Since its independence, North Macedonia has been increasingly integrating with its neighbours and the rest of the world. As part of the SAP, the economy has been aligning its legislative framework to the EU acquis relatively quickly and partly successfully, and a Stabilisation and Association Agreement was adopted in 2004. It has signed multilateral agreements, such as the CEFTA and bilateral free trade agreements with Turkey and Ukraine, opening up access to markets with more than 650 million consumers. In 2020, it became part of the North Atlantic Treaty Organization.

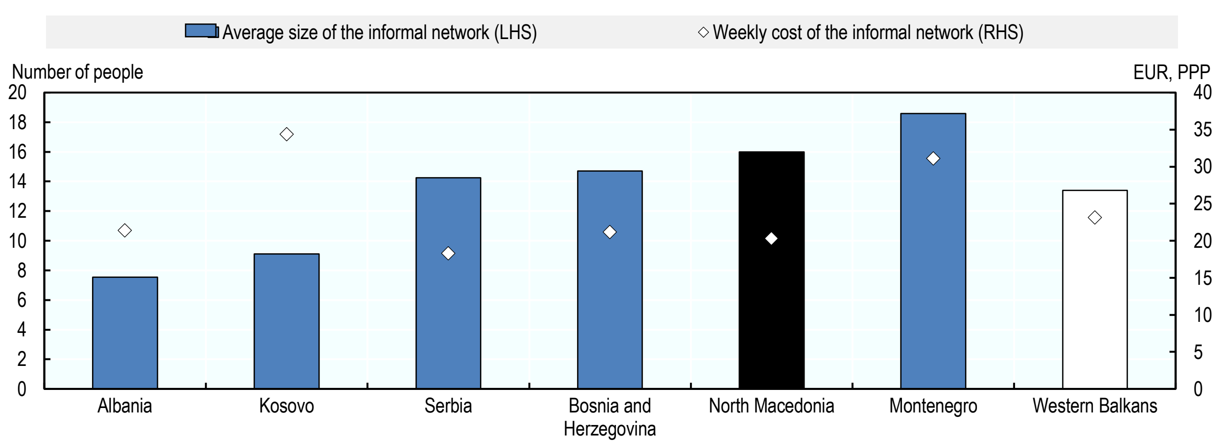
The economy has made concrete institutional progress amid political instability and uncertainty. North Macedonia has suffered relatively fewer property rights issues than other economies in the region (such as Albania and Kosovo), in part because of a careful sequencing of the land liberalisation process in the 1990s. The judiciary has gained independence and has been proactively undertaking investigations, prosecutions and final convictions in corruption cases, including those at a high level. Major reforms of the public administration are ongoing and aim to increase the transparency of public institutions (European Commission, 2020[74]). These results are all the more impressive considering the economy is highly politically unstable (6 parliamentary elections over 15 years) and its political leaders have been hit several times by serious scandals.

Two structural obstacles continue to prevent the economy from unleashing its true potential.

First, power-sharing mechanisms have contributed to easing interethnic tensions over the past 20 years but have complicated the functioning of the state. In spite of significant progress since 2001, ethnic divisions and consequences have at times undermined the functioning of the state. Grievances between citizens of North Macedonia of Macedonian ethnic origin and those of Albanian ethnic origin always existed (although in minor forms), but they significantly deteriorated after the economy declared independence from Yugoslavia in 1991. At the beginning of the 2000s, tensions turned into an eight-month armed conflict between Albanian rebels and government forces. The conflict resulted in a series of political and constitutional reforms that introduced some power-sharing features (known as the Ohrid Framework Agreement). Since then, ethnic minorities have significant political power and must be equitably represented in the public administration. The mechanisms to safeguard the power sharing have nonetheless sometimes hindered the basic functioning of the state, such as the appointment of judges.

Second, North Macedonia's commitment to fighting corruption is strong, but informal practices persist and create market inefficiencies. Citizens in North Macedonia can rely on the second largest informal network in the Western Balkans (after Montenegro) and the most expansive one (together with Kosovo) (Figure 14.32) (Efendic and Ledeneva, 2020[75]). This could be an indicator of strong social capital; however, the connections a family has – the *vrski* – can help its members get a job, gain access to services or overcome administrative obstacles (Otten, 2018[76]). *S*ome politicians rely on them to distribute public jobs in exchange for support. Teachers, for example, are sometimes hired on political grounds rather than merit or because of loopholes in the decentralisation framework. The politicisation of the public sector can, in turn, distort democratic institutions – for example, public administration employees may be subjected to pressures during election periods (OSCE/ODIHR, 2017[77]) – and the activity of some judges. Bureaucrats may use *vrski* to steer tenders for public-private partnerships (Otten, 2018[76]).

Figure 14.32. Informal networks in North Macedonia are large and expansive



Notes: The figure is based on Efendic and Ledeneva (2020[75]), which analyses data specifically gathered as part of the INFORM project. INFORM is an EU Horizon 2020 project that aims to conduct multidisciplinary research on formal and informal institutions in the Balkans. Data were collected in Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia over March-June 2017. A multi-stage random (probability) sampling methodology ensured representative samples in the data collection. The dataset comprises 6 040 respondents with over 1 000 observations per economy. Respondents were asked about: the average size of their network (outside of their own household); the number of hours spent in a typical week with relatives (outside of the household), friends, neighbours, professional and business colleagues and acquaintances through face-to-face meetings and other means of communication; and the approximate amount of money spent with these people (e.g. gifts, coffees, meals, parties, Internet, phone, transport, hosting people at home, preparing meals).
Source: Authors' elaboration based on Efendic and Ledeneva (2020[75]), "The importance of being networked: The costs of informal networking in the Western Balkans region", https://doi.org/10.1016/j.ecosys.2020.100784.

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Besides these two structural obstacles, the rest of this section discusses five key priority constraints to North Macedonia's development that authorities are encouraged to tackle swiftly: 1) poor implementation of decentralisation reforms and distribution between central and local governments; 2) confusing and inefficient approach to regional development; 3) politicisation of the judiciary; 4) fragmentation of private agricultural land; and 5) lack of a census (Table 14.5).

Table 14.5. Peace and institutions – five major constraints to more effective public institutions and services in North Macedonia

1. Lagging fiscal capacity, a complex system of transfers and an inefficient territorial organisation may hamper decentralisation reforms.
2. The approach to regional development is confusing and creates inefficiencies.
3. The judicial system suffers from undue external interference.
4. Agricultural land is still very fragmented, undermining productivity and sustainability.
5. The lack of a census presents huge challenges to inclusive and accurate policy design.

Lagging fiscal capacity, a complex system of transfers and inefficient territorial organisation may hamper decentralisation reforms

North Macedonia has a long tradition of decentralisation. Municipalities were granted wide-ranging autonomy under the Yugoslav Federation, and their power was further enhanced after the economy's independence through the Law on Local Self-Government (1995) and the ratification of the European Charter for Local Self-Government (1997). The new Law on Local Self-Government (2002) adopted under the Ohrid Framework Agreement aimed at redistributing administrative responsibilities at the subnational level. Between 2004 and 2005, significant reforms further reorganised local administrative units' scope and consolidated the local public finance system.

Municipalities are the only layer of subnational government in North Macedonia. Since 1996, the number of municipalities has decreased from 123 to 81. Municipality borders largely reflect the distribution of ethnic groups in the territory. Around 80% of the citizens of North Macedonia of non-Macedonian ethnic origin live in municipalities in the Northwest and the Southwest.[9] In 11 of these municipalities, they represent more than 90% of the local population.

Many functions have been delegated to municipalities, but adequate fiscal decentralisation has not followed. Municipalities play an important role in supporting local economic development and mobility, more than in most other Wester Balkan economies (Table 14.6). They provide education services (from preschool to secondary school), basic utilities and social welfare (such as elderly care) and environment protection (such as fire protection) and are at the forefront of public health (OECD/UCLG, 2019[78]). In spite of the broad portfolio of responsibilities, subnational expenditures amount to 4.9% of GDP, which is relatively low compared to neighbouring economies, such as Bosnia and Herzegovina (6.9% of GDP), Serbia (6%) and Montenegro (5.4%).

Table 14.6. North Macedonia is one of the most decentralised economies in the Western Balkans

Selected responsibilities decentralised to the subnational level

		Kosovo	North Macedonia	Serbia	Albania	Bosnia and Herzegovina		Montenegro
						Federation	Republika Srpska	
Preschools	Buildings	✓	✓	✓	✓	✓	✓	
	Wages	✓	✓	✓				
Primary schools	Buildings	✓	✓	✓	✓	✓		
	Wages	✓	✓					
Secondary schools	Buildings	✓	✓	✓	✓		✓	
	Wages	✓	✓					
Primary and secondary health	Buildings	✓		✓	✓		✓	
	Wages	✓						
Social welfare	Buildings	✓	✓		✓		✓	✓
	Wages	✓	✓		✓		✓	✓
Culture and sport	Buildings	✓	✓		✓		✓	✓
	Wages	✓	✓		✓		✓	✓

Source: NALAS (2018[79]), *Fiscal Decentralization Indicators for South-East Europe*, http://nalas.eu/Home/Download/FD_rep2018x.

To finance public spending, local fiscal autonomy has been increased. Since 2004, municipalities administer the property transfer tax, the inheritance and gift tax, and the recurrent property tax. Municipalities can determine the base and rate of these taxes within the limits set by law. The recurrent property tax represents 15% of the total subnational revenues and is levied on land and buildings owned by legal entities and individuals. It is based on the market value of the property as estimated through a methodology defined by the central government and approved by the association of municipal councils. Municipalities can set the tax rates, which usually range from 0.1% and 0.2%, according to the type of property.

Yet, municipal fiscal capacity remains limited, as municipal revenue still relies heavily on grants. Subnational tax revenues represent only 7.2% of the overall national tax revenues, which is low compared to other Western Balkan economies, such as Serbia (16%), Bosnia and Herzegovina (12%) and Montenegro (11%). The income from the recurrent property tax (14.9% of subnational tax revenues) remains low with respect to other economies in the region, such as Montenegro (61%) and Albania (43%). This is partly because of outdated registers and cadastres that prevent local authorities from identifying and charging landowners. In these circumstances, municipalities are forced to draw most of their resources from intergovernmental transfers: in 2016, these accounted for 64% of local revenues (OECD/UCLG, 2019[78]).

The system of transfers is complex and may create the wrong incentives. There are five transfers: block grants, earmarked grants, VAT revenue, capital grants and grants for a delegated competency (OECD/UCLG, 2019[78]). Block grants are mostly distributed to finance primary and secondary education based on historical allocation and number of pupils. Most of them end up paying for teachers' salaries because municipalities are barred from using their own resources for this purpose. This spares mayors from any potentially unpopular optimisation of their school network or a reduction in the number of teachers (Herczyński, 2019[80]). In fact, over the past decade, the number of teachers has been increasing, in spite of a declining number of students (World Bank, 2018[81]).[10]

The system of allocation of capital grants is fragmented and opaque. Municipalities can apply to 18 different programmes by submitting project proposals to various line ministries. As a result of the compartmentalised management of these programmes, resources may be channelled towards projects with overlapping scopes or opposing objectives. This can jeopardise a balanced regional development process, as argued below. Moreover, funding is awarded according to criteria that are not always transparent (World Bank, 2018[81]).

Limited fiscal autonomy affects the capacity of municipalities to provide quality services to citizens, undermines their fiscal viability and sustainability and leads to an accountability issue.

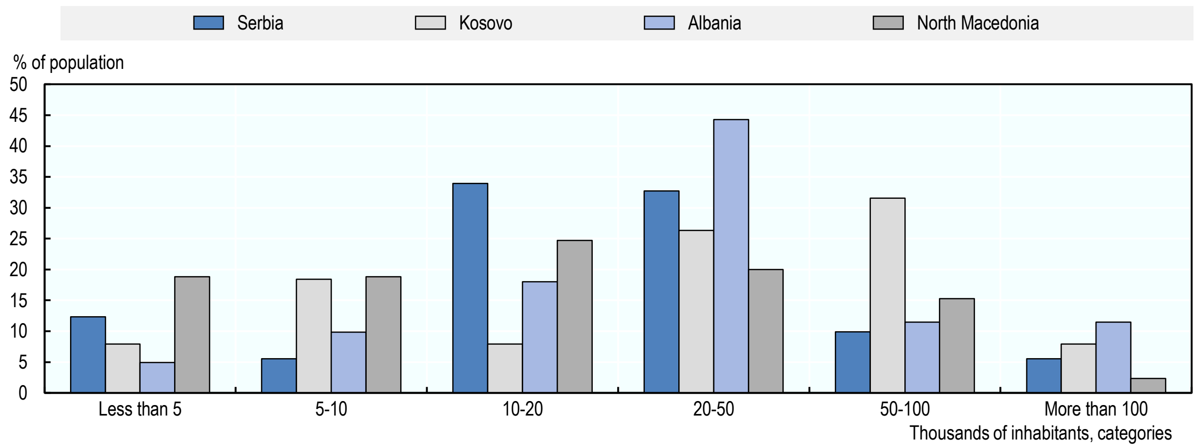
First, the provision of decentralised public services is underfunded. The education sector particularly suffers (World Bank, 2018[81]). With limited own-source revenue and high vertical imbalance, municipalities are left with few resources for long-term investment, which remains low at 20% of subnational expenditures, in line with other economies in the region where the relationship between levels of government is not always clear (namely Albania and Kosovo).

Second, North Macedonia's decentralisation process has undermined the fiscal sustainability of several municipalities. The arrears reported by local governments account for 1.2% of GDP and around 30% of all arrears in the public sector. Most of them (MKD 4.6 billion) arise from municipal budgets, while MKD 2.5 billion are on the books of municipal utility companies (World Bank, 2018[81]). This undermines the credibility of local institutions among investors and lenders and could become a problem for the central state in the long term.

Third, fiscal considerations aside, limited fiscal decentralisation may undermine the transparency of the decision-making process. Local politicians are more accountable to those disbursing grants (the central government) than to their citizens, and spending decisions may ignore the actual needs of local communities. Faulty mechanisms to monitor local spending may exacerbate the transparency issue. Between 2017 and 2018, the central government adopted a Public Financial Management Reform Programme 2018-2021 and specific legislation to improve the transparency of and accountability for the use of public funds. Their implementation depends on co-ordination between the Ministry of Local Self-Government and the Ministry of Finance, which is limited. In principle, these ministries should jointly monitor the operations of municipalities; in reality, they do not co-ordinate. Moreover, line ministries should normally keep local municipal departments accountable for budget execution, but in practice, few of them have put in place tools to monitor and promote performance on a systematic basis.

Fourth, municipalities in North Macedonia might be too small to exploit economies of scale in the delivery of local public services. In spite of past reforms, their average size is still much smaller than in the rest of the Balkans (28 050 inhabitants, compared to 37 500 inhabitants). Around 38% of municipalities in North Macedonia have fewer than 10 000 inhabitants (Figure 14.33) and host 7% of the economy's population. In neighbouring Albania and Kosovo, small municipalities are rarer (15% and 26% of all local administrative units, respectively), and they host only 2% and 3% of the total population. In Serbia, 18% of the total municipalities have fewer than 10 000 inhabitants, and they host around 1% of the population. North Macedonia has only two municipalities with more than 100 000 inhabitants (Skopje and Kumanovo, in the Northeast region), while Albania and Serbia have seven and nine, respectively. To enhance service provision, the Law on Local Self-Government envisages the establishment of intermunicipal mechanisms for the joint provision of public services and goods. These mechanisms are, however, underused. To ensure better co-ordination among local administrative units, North Macedonia might need to rethink the role of regions.

Figure 14.33. Municipalities in North Macedonia might be too small to exploit economies of scale in the delivery of local public services



Notes: There are 162 municipalities in Serbia (including those that are organised into cities), 81 municipalities in North Macedonia, 61 in Albania and 38 in Kosovo. The elaboration is based on 2011 Census data for Albania, Kosovo and Serbia and on 2002 Census data for North Macedonia.
Source: Authors' elaboration based on census data from Albania, Kosovo, North Macedonia and Serbia.

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The approach to regional development is confusing and creates inefficiencies

North Macedonia is divided into eight "planning regions", which have no administrative power. The regions of Skopje and Pelagonia account for 54% of GDP and 45% of the population (around 860 000 inhabitants) and continue to attract people. The poorest regions in the economy, Polog and the Northeast, have not caught up for the past 20 years. Their real GDP per capita has increased by only 2% annually since 2000 and remains three times lower than that of Skopje (which is the highest, amounting to approximately MKD 300 000). Overall, regional disparities seems higher than in other economies in the region (see the People section in this chapter).

To narrow regional gaps, the central government allocates funds amounting to at least 1% of GDP from the yearly state budget. The way funds are allocated depends first on the region's level of development, then on the quality of development plans and projects that regions periodically submit to central authorities. The level of development is defined according to a series of socio-economic indicators (GDP per capita, subnational revenues per capita, growth of total value added and unemployment rate) and demographic indicators (natural growth rate of population, an aging coefficient, net migration rate per 1 000 people and number of graduates per 1 000 people). The projects that receive funding have a proven potential to stimulate local development and can be realistically delivered given the implementation capacity of local authorities.

The 2007 Law on Balanced Regional Development (BRD) set the framework that regulates the planning process. On paper, this is bottom-up and involves six policy stakeholders at various government levels (Table 14.7). Each planning region has a dedicated centre for its development. With the support of the Bureau for Regional Development, the centres draft a ten-year Strategy for Regional Development – which includes objectives and a list of projects to fulfil them – and five-year action plans. The Strategy is then formally approved by a regional Council for Development of the Planning Regions (hereafter the regional council) and then by the Council for Balanced Regional Development (hereafter, the national council).

Table 14.7. The regional development process in North Macedonia involves numerous stakeholders

	Stakeholder	Members	Tasks
Policy	Council for Balanced Regional Development (Советот за рамномерен регионален развој)	• Deputy Prime Minister, responsible for economic affairs. • Eight ministries with a regional development portfolio (Local Self-Government; Finance; Economy; Transport and Communications; Labour and Social Policy; Culture; Environment and Physical Planning; Agriculture, Forestry and Water Management). • Eight Presidents of the Councils for Development of the Planning Regions. • President of the Macedonian Association of Municipalities.	Harmonisation of regional policies with sectoral and macroeconomic policies.
Policy	Ministry of Local Self-Government		Definition of the national Policy for Balanced Regional Development.
Policy	Councils for Development of the Planning Regions (Советот за развој на планскиот регион)	Mayors of the municipalities from the respective regions. The president is elected from among council members for a two-year mandate with the right to be re-elected.	Adoption of regional development documents; co-ordination of regional stakeholders; identification of areas with special development needs, promotion of cross-border co-operation with regions from other economies.
Operation	Bureau for Regional Development (Бирото за регионален развој)	Entity within the Ministry of Local Self-Government.	Implementation of the national Policy for Regional Development; distribution of funds and support to the Centres for Development of the Planning Regions.
Operation	Centres for Development of the Planning Regions (Центрите за развој на планските региони)	The head of a regional centre is appointed by the respective Council for Development of the Planning Regions for a four-year mandate.	Preparation of regional development documents; implementation of development projects targeted by regional funds.
Operation	Units of the Local Self-Government		Contribute to the planning process and keep the centres accountable for implementation.

The national council sits at the apex of the planning process. It gathers all ministries whose portfolios touch wholly or partly on regional development issues and ensures harmonisation among regional plans, sectoral strategies and the national strategy. The Ministry of Local Self-Government, as part of the national council, defines the national strategy for balanced regional development and, through the Bureau for Regional Development, watches over the local allocation of funds and follows up on implementation. Regional councils and municipalities contribute to the drafting of the regional plans and keep the respective centres accountable for implementation – the former by selecting their heads, the latter by financing their operation. Councils and municipalities then report back to the national council about the activity of the centres.

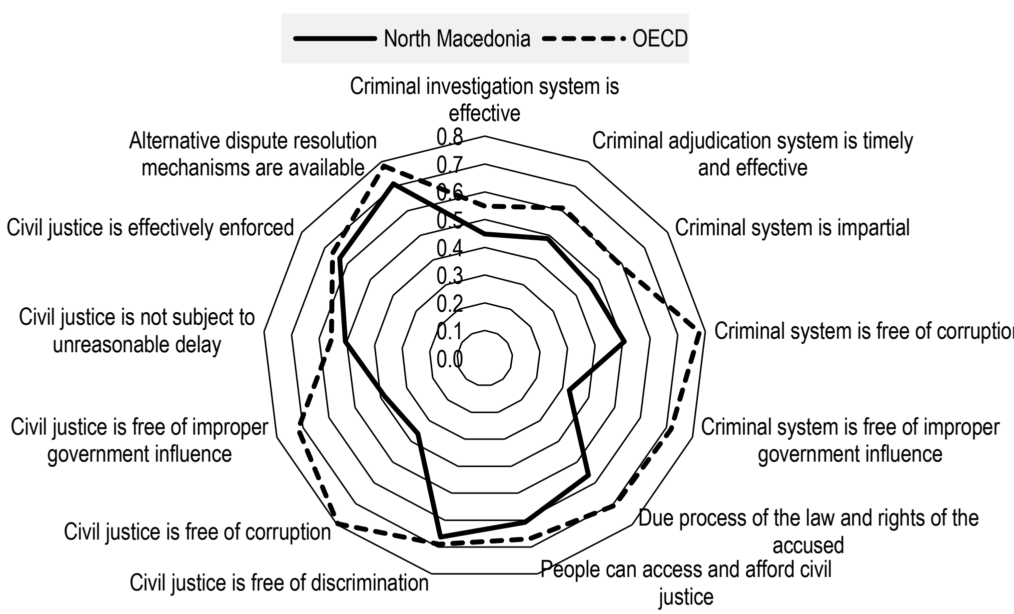
Institutional weaknesses, lack of local capability and opaque decision making undermine the efficacy of this system of allocation of funds for regional development. Interinstitutional co-ordination during the planning and implementation of the regional plans seems to be lacking. Mechanisms to monitor and evaluate the projects financed by the funds are missing or not systematically used (Karaeva, Ashtalkoski and Chungurski, 2018[82]). The functioning of the centres, at the heart of the planning and implementation process, can also be significantly affected by municipalities' poor fiscal capacity and scarcity of resources, especially in strained regions. Last, planning regions are only functional territorial units characterised by common social and economic features, strengths and challenges. While their transformation into fully-fledged political units may be premature, it is not clear how the current legislative framework can provide citizens with enough leverage to contribute to the planning process.

The management of funds targeting regional development is fragmented. Since 2007, the regional funds allocated through the planning regions have been falling short of the minimum target of 1% of GDP set by law. As of December 2018, they amounted to only 0.2% of GDP. Most of the funds targeting projects with a regional component are instead distributed by line ministries through capital grants (see above) outside of the BRD framework. This parallel system of allocation does not involve the regional centres or regional councils in the planning and implementation phase and hence does not necessarily match the needs and priorities identified in the regional development plans. The Ministry of Local Self-Government needs more power to supervise and steer the distribution of regional funds, which potentially crowd each out or pursue overlapping or contradicting objectives. Moving forward, authorities are introducing an electronic system that will help the Ministry of Local Self-Government better monitor the distribution of grants from the central budget to the planning regions.

The judicial system suffers from undue external interference

While judiciary independence is enshrined in the Constitution, courts are still perceived as biased and prone to political interference. The Venice Commission recently praised the constant efforts of North Macedonia's authorities to align the legislative framework with international standards and best practices. Notably, the economy stepped up implementation of the Strategy for Reform of the Judiciary 2017-2022 and revised its action plan. Still, a large share of judges and legal experts believe that political parties, ethnic groups and nepotistic networks fundamentally steer the selection and dismissal of judges to favour private interests in decision making (Figure 14.34) (European Commission, 2019[83]). The crux of the matter seems to be the functioning of the Judicial Council, which is responsible for the whole careers of judges, watching over their autonomy and independence (Stojkova-Zafirovska, Aleksov and Godzo, 2019[84]).

Figure 14.34. Justice is not free from improper external influence



Note: The continuous line spider chart represents the perceived dimensions of quality of the judiciary in North Macedonia; the dotted line chart represents the average perceived dimensions of quality of the judiciary in the average OECD country.
Source: Authors' own calculations based on World Justice Project (2020[85]), *World Justice Project Rule of Law Index 2020*, https://worldjusticeproject.org/our-work/research-and-data/wjp-rule-law-index-2020.

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The independence of the Judicial Council has increased, but its composition still raises concerns over its possible bias. According to the Law on the Judicial Council, the Council is composed of: the President of the Supreme Court and the Ministry of Justice (*ex officio*), eight judges elected by their peers, three lay members elected by the Assembly of the Republic of North Macedonia from among reputable and experienced law specialists, and two members elected by the Assembly upon proposal by the President of the Republic. *Ex officio* members participate without the right to vote and do not take part in discussions on the careers of judges. Yet, the presence of candidates indicated by the President of the Republic may be enough to steer some decisions. This is especially true considering the President of the Council is elected by only a simple majority (Art. 8). An election by qualified majority instead would force members of the Council to overcome political divisions and agree on a common candidate, possibly on the basis of their competences and not their political allegiances.

The method of appointment of judges by the Judicial Council leaves space for undue interference. According to the Law, the Council selects a judge on the basis of an applicant's performance at the examinations organised by the Academy for Judges and Public Prosecutors. However, the Council still has the possibility of influencing the final ranking by interviewing candidates and then voting for the favourite. After the election, each Council member has to elaborate and justify her or his decision orally. While this obligation may seem to increase the transparency of the selection process, it exposes Council members to pressures and threats that could undermine their independence. Following the recommendations of the Venice Commission, the results of the selection process may instead be accompanied by a collectively reasoned decision on appointment. A collective rather than an individual decision would thus reflect the position of the majority of the Council and could be accompanied by potentially dissenting opinions (Venice Commission, 2019[86]).

The Law creates the conditions for ethnic groups potentially to block the election of judges too easily. The Council elects judges with a two-thirds majority of all the members, as well as a majority of attending members from ethnic minorities. This measure helps enforce the Ohrid Framework Agreement, but it could also lead to deadlocks. By law, the Council consists of at least four members from ethnic minorities: at least two (out of four) elected by the National Assembly and at least one (out of two) proposed by the President of the Republic. It is sufficient that only two of these members (13% of the Council's members) vote against a candidate judge to stall the selection process (Venice Commission, 2019[86]).

Lay judges are another weak link in the North Macedonia judicial system. They wield power equal to that of professional judges, and their resignation may be enough to reboot trials in which they participate.[11] In spite of their importance, they do not face the same public scrutiny as professional judges. According to the Law on Courts (Law No. 08-1577/2), appointed lay judges are not required to pass any specific examination (only to attend a legal training course), do not need to take psychological and "integrity" tests (to which professional judges are subjected) and are not explicitly prohibited from engaging in any political activities. Their salaries have been increasing but are still relatively low (MKD 600 per day spent in court and a compensation for travel expenses). Sketchy selection, low salary and considerable power make lay judges susceptible to bribery and undue pressure (Magleshov, 2020[87]).

Agricultural land is still very fragmented, undermining productivity and sustainability

Unlike other economies in the region, North Macedonia has not encountered particular issues related to land ownership. This is because, as the economy became independent in 1991, 78% of the agricultural land was already privately owned. Furthermore, the process of restitution of the nationalised land after the Second World War involved only 5% of the total agricultural land and proceeded in a more orderly way than in neighbouring economies (namely Albania). Reforms were indeed well sequenced, and the interests of state farms were initially protected. Thus, the original owners (and their heirs) of land where large state-owned enterprises had arisen had to accept either another plot as compensation or a form of co-ownership of the state farm. In March 2012, the government announced that the restitution process had been finalised. Since then, North Macedonia has been leasing the remaining 17% of state land, often to large farm corporations. The land reforms, however, have not yet solved land fragmentation, which is an inheritance of the farm structure under Ottoman rule (Hartvigsen, 2013[88]).

Private agricultural land is still highly fragmented. The average size of a family farm is 1.62 ha, slightly higher than in Albania but lower than in the rest of the Western Balkans (MAKStat, 2020[8]).[12] Around 60% of farm holders own less than 1 ha. Smallholding is particularly common in the Skopje and Vardar regions, where more than half the family farms are under 0.5 ha. Moreover, landholdings are fragmented into five or more land parcels, with a parcel size ranging from 0.25 ha to 0.6 ha. Fragmentation and irregular shapes often complicate agricultural land cultivation and limit the use of modern mechanisation. Inadequate agricultural infrastructure, such as roads passing through arable land and obsolete or non-existent irrigation and drainage systems, make agricultural activities even more difficult. This severely curbs land productivity and forces farmers to face high transport and production costs.

North Macedonia recently embarked on land consolidation processes with the support of the international community. Through the European Union-funded Mainstreaming of the National Land Consolidation Programme (MAINLAND), the Food and Agriculture Organization assists the Ministry of Agriculture, Forestry and Water Economy to manage and implement the National Land Consolidation Programme by developing the expertise and strengthening the technical and administrative capacities of the ministry and key local stakeholders. Among other objectives, the programme aims to raise awareness among farmers about the advantage of land consolidation (FAO, 2019[89]). This arguably first major obstacle to any attempt at reform can be successfully overcome only by involving (formal and informal) village institutions in the process. Under MAINLAND, land consolidation assemblies were established at the village level to allow land owners to discuss and vote on plans for reallotment of agricultural land. In January 2020, the village of Egri (Bitola municipality, Pelagonia region) became the first in North Macedonia to adopt a local consolidation plan through majority-based voting by its dedicated assembly.

North Macedonia has made significant progress in strengthening statistical capacity, but the lack of a census and prevailing gaps in social statistics prevent accurate policy design

The State Statistics Office of North Macedonia (SSO) is the main national producer of official statistics in the economy. The National Bank, Ministry of Finance, Ministry of Interior, Ministry of Justice, Hydrometeorological Service, Institute of Public Health, Pension and Disability Insurance Fund and Employment Agency belong to the national statistical system, according to the Statistics Law (adopted in 1997 and last updated in 2018). According to the Peer Review conducted by Eurostat in 2017, the SSO is described in the legislation as an independent, professional administrative organisation with legal personality and powers (Alldritt, de Pourbaix and Carlquist, 2017[90]). In 2018, the government signed the Commitment on Confidence to ensure the professional independence of the SSO (European Commission, 2019[83]). The Statistical Council consists of 15 members appointed by a parliamentary body whose membership and role are regulated by legislation. Since a modernisation of its organisational structure in 2015, the SSO employs around 300 full-time staff operating in seven departments (MAKstat, 2020[91]).

In the past three years, North Macedonia has engaged in adequate statistical planning and coherent data dissemination practices. The SSO published a five-year programme of statistical surveys (2018-22) and a strategic plan (2019-21). In terms of data openness, at 64.2 out of 100 points, North Macedonia scores almost on par with European economies (average 67) (Open Data Watch, 2015[92]). The SSO is good at communicating data via quarterly press releases and social media, and its website is fully accessible in English (PARIS21, 2020[93]). The SSO also carries out biannual user satisfaction surveys to assess demand and feedback (MAKstat, 2019[94]).

The SSO has made significant progress in complying with international and European statistical standards. North Macedonia adheres to the Special Data Dissemination Standard Plus, the highest statistical data dissemination standard of the International Monetary Fund (IMF, 2020[95]). Eurostat and European Commission recommendations conclude that official statistics are broadly aligned with the European Union acquis. The SSO is currently fostering further alignment with these standards (Alldritt, de Pourbaix and Carlquist, 2017[90]).

Despite positive developments, the quality of social statistics requires improvement. While the SSO successfully concluded a survey on living standards and provided complete labour market statistics in 2019, migration statistics need to be expanded, and statistics on crime, education and public health need improvement (European Commission, 2019[83]). This is confirmed by a drop in available data on education and infrequent reporting of health data in the World Bank's Statistical Capacity Indicator.[13] For instance, data on child malnutrition have only been reported once over the past decade (World Bank, 2020[96]). However, internal documents provided by the SSO show that North Macedonia is currently working towards improved data collection and dissemination of social statistics in the domains of education and crime statistics (European Union/Republic of North Macedonia, 2019[97]).

The SSO has technical and financial capacity for a 2021 Census, but a parliamentary approval process is wanting. North Macedonia's latest census dates back to 2002. The census round in 2011 was stopped because of disputes about its methodology among parties in the ruling coalition (Daskalovski, 2013[98]). The census planned for 2019 was postponed, first to 2020 because of snap elections, then to 2021 following the outbreak of the COVID-19 pandemic. Despite these circumstances, the SSO has advanced the methodology in an attempt to move to a combined census, which complements census data with administrative data. It extended its capacity to use administrative data and successfully concluded a pilot census in July 2019 (UNECE, 2019[99]). The combined method allows for a cost-effective and time-efficient headcount while expanding the overall statistical capacity of the SSO (UNECE, 2015[100]). The SSO has engaged in preparations for the 2021 census amid the COVID-19 pandemic. It secured funds to start the census process, the information technology infrastructure necessary for the enumeration is set up and the Agency for Real Estate Cadastre is in the process of preparing the census cartography. However, the Census Law, a necessary precondition for carrying out the census, is under parliamentary review.

Further delaying a population headcount might have long-term consequences on evidence-based policy making. North Macedonia still uses the 2002 population figure as a baseline for all other data, estimations and projections. This has consequences for the size of the public administration (which should grant a minimum representation of minority ethnic groups) and the policy-making process, since the demographic characteristics of the population partly affect the way resources are redistributed across the economy. For example, census data are normally used to build the sampling frame for household surveys (World Bank, 2018[3]). Missing census data might have implications for designing gender-sensitive and inclusive social and economic policies, especially during COVID-19 recovery.

Funding to data and statistics should be increased. Compared to other economies in the region, the SSO received relatively high external financial support for statistical capacity development (USD 12.6 million) in 2017 (PARIS21, 2019[101]). Yet, given North Macedonia's plans to advance the methodology for a new census round and improve the scope and quality of certain statistical sectors, more resources are needed (European Commission, 2019[83]).

Planet – conserving nature

The Planet pillar of the 2030 Agenda for Sustainable Development reflects the need to find the right balance between socio-economic progress and capacity to sustain the planet's resources and ecosystems and to combat climate change.

North Macedonia is located in one of the richest European regions when it comes to biological diversity, with a high degree of endemism, and the Ohrid region is an example of natural heritage. North Macedonia has 86 protected areas, covering 10% of the territory, and around 39.7% of the territory is covered by forests (Ministry of Environment and Physical Planning, 2018[102]). North Macedonia could build on its rich biodiversity by minimising environmental degradation, improving the preservation of its resources and enhancing the well-being and quality of life of all citizens. Taking advantage of regional fora and dialogues for environmental protection represents an opportunity for North Macedonia.

The Planet section in this chapter identifies three major constraints North Macedonia faces in its development path. First, North Macedonia is highly exposed and vulnerable to earthquakes, floods, droughts and extreme temperatures. Climate change is likely to increase North Macedonia's vulnerability to natural hazards. Second, unsolved challenges in managing waste, high levels of air pollution and significant water losses threaten the environmental quality of life of all Macedonians. Better enforcement and implementation of environmental legislation will be essential. Third, North Macedonia needs to create a lower carbon energy sector. The economy is still highly dependent on coal, and energy supply is not sufficiently efficient and secure. Overall, as in other Western Balkan economies, environmental concerns remain a secondary concern in North Macedonia, but the EU approximation process could help raise environmental awareness and be a driver of environmental reforms (Table 14.8).

Table 14.8. Planet – three major constraints to environmental quality and energy sustainability in North Macedonia

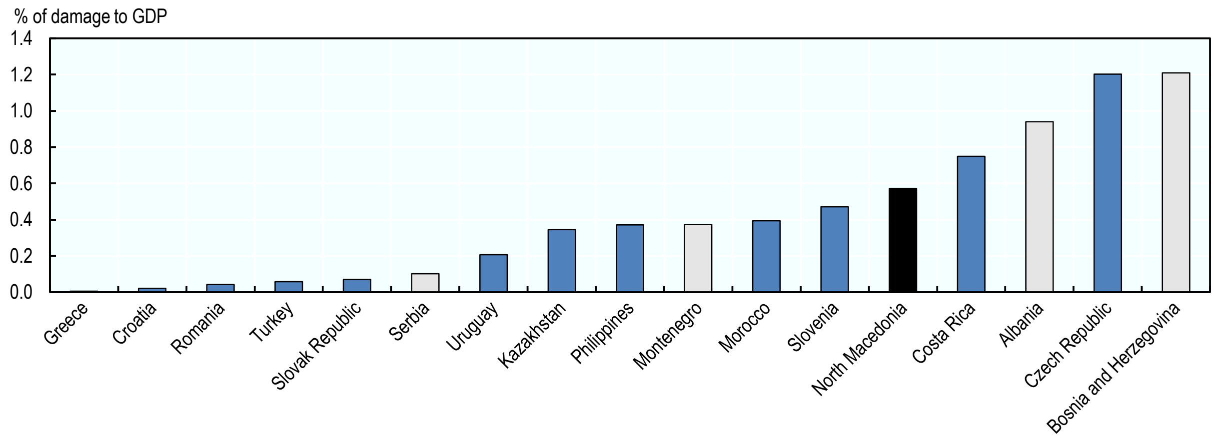
1. Exposure and vulnerability to natural hazards.
2. The deterioration of the environmental quality of life of all Macedonians.
3. High dependence on coal, and the energy supply is not sufficiently efficient and secure.

North Macedonia is highly exposed and vulnerable to multiple hazards

North Macedonia is vulnerable to earthquakes, floods and extreme temperatures

Situated in a seismically active region and in territory prone to floods, North Macedonia needs to improve its resilience to hydro-meteorological and geophysical hazards (World Risk Report, 2017[103]). In the last 30 years, more than 20 severe disaster events were recorded in the economy, resulting in around USD 409 million in direct damages (EM-DAT, 2020[104]). North Macedonia is highly susceptible to the floods, droughts and extreme temperatures in the region and among benchmark economies (Figure 14.35). The two most recent floods in 2015 and 2016 caused the death of 31 people and affected more than 133 500 (EM-DAT, 2020[104]). North Macedonia is considered one of the most arid areas in Europe. Regions around the Crna, Bregalnica and Vardar rivers are particularly vulnerable, but it is very difficult to estimate damages and losses, for example, in agriculture due to lack of consistent data (FAO, 2018[105]). Due to its location at the intersection of the African and Eurasian tectonic plates, North Macedonia has suffered numerous destructive earthquakes. One of the most significant was the 1963 earthquake in Skopje, which killed more 1 000 people, left around 200 000 without a home and caused direct losses estimated at around USD 8 billion, corresponding to 15% of the economy's then gross national income (World Bank, 2018[3]).

Figure 14.35. North Macedonia is highly susceptible to floods, droughts and extreme temperatures



Source: EM-DAT (2020[104]), *EM-DAT* (database), www.emdat.be.

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Like the whole Western Balkan region, North Macedonia is expected to be warmer and drier due to the scarce precipitation projected as a consequence of climate change. North Macedonia's climate ranges from Mediterranean to continental, with hot, dry summers and mild winters. Average annual precipitation ranges from 500 mm in the eastern part of the economy to 1 700 mm in the more mountainous western part. North Macedonia is vulnerable to climate change, with observed temperature increase for all representative concentration pathway (RCP) scenarios. The variation depends on the global efforts in GHG emissions reduction (Table 14.9). Climate change is likely to affect agriculture, tourism and hydropower, three important sectors for North Macedonia, strongly. Through its negative impact on the environment and increased risk of natural hazards, climate change will also have a negative impact on human health and quality of life in North Macedonia.

Table 14.9. Like other Western Balkan economies, North Macedonia is highly vulnerable to climate change

Change of the mean annual temperature (in °C) with respect to the base period (1986-2005) for the RCP 4.5 and RCP 8.5 scenarios of GHG emissions

	Albania		Bosnia and Herzegovina		Kosovo		Montenegro		North Macedonia		Serbia	
RCP	4.5	8.5	4.5	8.5	4.5	8.5	4.5	8.5	4.5	8.5	4.5	8.5
2016 - 2035	0.5-1	0.5-1	0.5-1	0.5-1	0.5-1	0.5-1.5	0.5-1	0.5-1.5	0.5-1	0.5-1.5	0.5-1	0.5-1.5
2046 - 2065	1-2	1.5-3	1-2	1.5-3	1.5-2	2-3	1-2	1.5-3	1.5-2	2-3	1-2	1.5-3
2081 - 2100	1.5-2	4-5	1.5-3	4-5	2-3	4-5	1.5-3	4-5	2-3	4-5	1.5-3	4-5

Notes: The mean annual temperature corresponds to the average of the maximum and minimum temperatures of a year, taking the mean average of the coldest month of the year and averaging it with the mean average of the hottest month of the year. The RCP 4.5 refers to a stabilisation scenario and RCP 8.5 to a continuous rise scenario of GHG emissions.
Source: RCC (2018[106]), *Study on Climate Change in the Western Balkans Region*, www.rcc.int/pubs/62/speech-of-the-secretary-general-majlinda-bregu-at-the-launch-of-rcc-undp-initiative-on-women-empowerment.

Complex institutional organisation for disaster management and lack of disaster risk reduction (DRR) integration into sectoral planning produce inefficiencies in practice

The current legislative framework regulating disaster risk management (Table 14.10) **creates complexities and uncertainties.** Various institutions (e.g. the Protection and Rescue Directorate [PRD], the Crisis Management Centre [CMC]) collect data and provide risk assessments but based on different methodologies. Duplications at the national level have had an impact at the subnational level.[14] Subnational offices of the CMC (8 main and 27 smaller) and of the PRD (35) rarely co-ordinate or communicate (European Commission, 2018[107]). Furthermore, DRR is not integrated into long-term strategies or sectoral plans, especially for those sectors particularly exposed to disasters, such as agriculture (FAO, 2018[105]).

Table 14.10. The legislative framework regulating disaster risk management is based on two laws

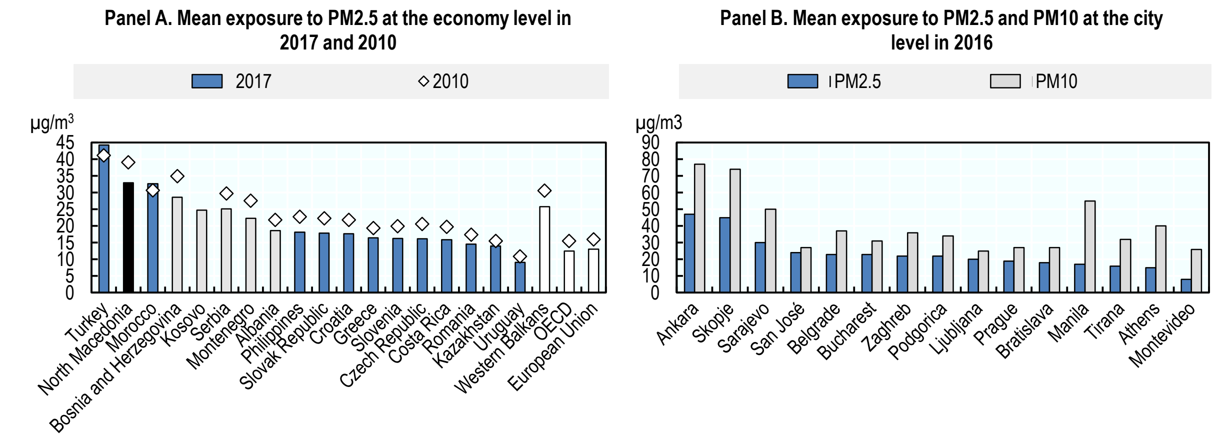
Law	Scope
Law on Crisis Management (2004)	Sets the organisation, functioning, planning, co-ordination and financing of the economy's response, as well as the security risk management for natural hazards. It also establishes the PRD and CMC.
Law on Protection and Rescue (2005)	Clarifies the roles and responsibilities among the main actors at the national and local levels and defines natural hazard prevention, preparedness and recovery.

The environmental quality of life of all Macedonians is deteriorating

Air pollution is a serious threat

Macedonians and other Western Balkan populations are exposed to the highest concentration of air pollution in Europe. North Macedonia's annual exposure to PM2.5 air pollution decreased from 39.1 μg/m^3 in 2005 to 33 μg/m^3 in 2017.[15] However, it remains the highest level in the Western Balkans (25.77 μg/m^3), more than double the EU and OECD averages (13.1 μg/m^3 and 12.5 μg/m^3, respectively) (Figure 14.36 – Panel A) and far above the WHO recommended maximum (annually) of 10 μg/m^3. The number of pollutants exceedances in North Macedonia is considerably above EU limits (European Commission, 2020[108]). Skopje is one of the capitals most exposed to particulate matter in Europe (Figure 14.36 – Panel B). Pollution is considered a serious problem by 82% of citizens and a very serious problem by 45%, which were the highest percentages in the Western Balkans in 2019 (Figure 14.37). The level of environmental public awareness is encouraging and forces authorities to tackle pollution more systematically.

Figure 14.36. North Macedonia's exposure to PM2.5 air pollution is the highest in the Western Balkans, while its capital is one of the most polluted in the region



Notes: Mean population exposure to fine particulate matter is calculated as the mean annual outdoor PM2.5 concentration weighted by population living in the area. It is the concentration level, expressed in µg/m³, to which a typical resident is exposed throughout a year. Data for Kosovo are from 2016 (local data reported to the European Environment Agency). There are no 2005 data for Kosovo. Data for Turkey are from the World Bank.

Sources: EEA (2020[109]), *Air pollutant concentrations at station level (statistics)* (dataset), www.eea.europa.eu/data-and-maps/data/air-pollutant-concentrations-at-station; OECD (2020[110]), *Green Growth Indicators* (database), https://stats.oecd.org/Index.aspx?DataSetCode=GREEN_GROWTH; UNECE (2019[111]), *3rd Environmental Performance Review of North Macedonia*; World Bank (2020[1]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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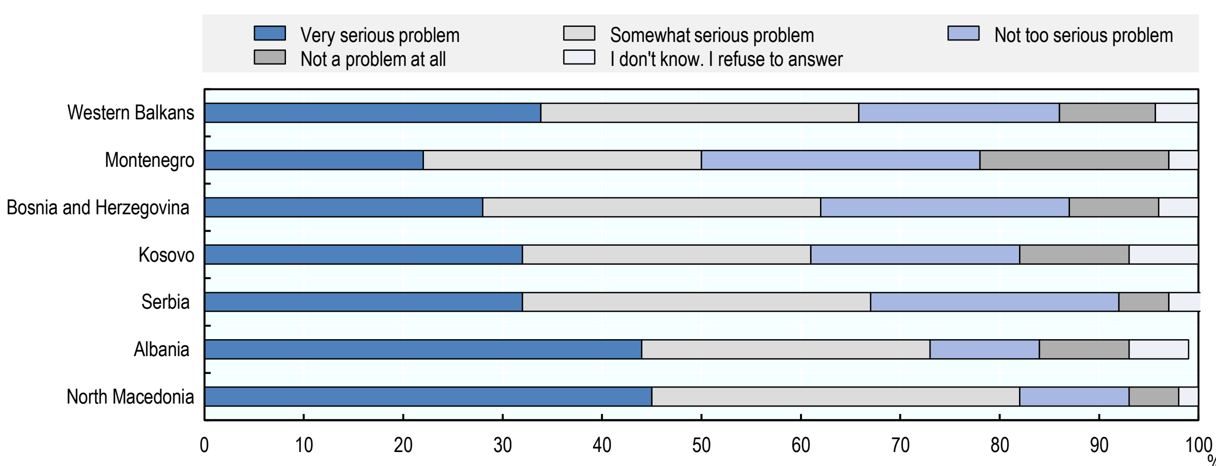
Figure 14.37. More than 80% of Macedonians consider pollution a serious problem



Note: Data are based on answers to the following question: Do you consider pollution to be a problem in your place of living?
Source: RCC (2019[57]), *Balkan Barometer 2019 -- Public Opinion* (database), www.rcc.int/balkanbarometer/results/2/public.

StatLink https://doi.org/10.1787/888934244911

Air pollution has a considerable impact on the health of Macedonians and constitutes a serious threat to the economy. The estimated economic cost associated with mortality from exposure to air pollution in North Macedonia is between USD 500 million and USD 900 million annually, which was between around 5.2% and 8.5% of GDP in 2016 (World Bank, 2019[112]). Air pollution is estimated to cause 1 600 premature deaths per year, approximately 21% of which are in Skopje.

Residential heating, transport and road traffic, power generation, industry, and agriculture are the main sources of air pollution in North Macedonia. The main emissions sources for PM2.5 in 2016 were residential heating (63%), industrial processes (mainly ferroalloys production [20%]) and energy (6%). Regarding PM10, residential heating (46%), industrial processes (19.6%), energy (11%) and agriculture (12%) were the main contributors in 2016 (Ministry of Environment and Physical Planning, 2017[113]). Exceedance of the daily limit for particulate matter is particularly high during winter due to increased emissions from the burning of solid fuels for home heating. Transport and road traffic are significant contributors to air pollution, especially in urban areas, due to the low share of public transport[16] and the significant use of old cars (average age of around 19.1 years) (MAKStat, 2020[114]). To tackle pollution through transport, since January 2020, all motor vehicles in North Macedonia are subject to taxation based on their level of CO_2 emissions.[17]

The government recently adopted emergency measures, which apply when air pollution exceeds certain alert thresholds, but a more systematic approach is needed. When levels of air pollution are high, access to public transport is free, heavy vehicles are banned from entering in city centres and pregnant women and people over age 60 may be excused from work (Associated Press, 2018[115]). Medium-term and long-term measures to tackle air pollution have been included in national and local planning documents, and their implementation is in progress. However, authorities need to adopt a more systematic and integrated approach to tackle and reduce significantly the impact of air pollution in main city areas (Skopje and Tetovo) and in the economy more broadly. Most importantly, enforcement of regulations needs to be improved, and air quality inspectorates at the central and local levels need to become more effective. Measures to tackle air pollution should be enforced not only in winter months when pollution levels are highest but throughout the year.

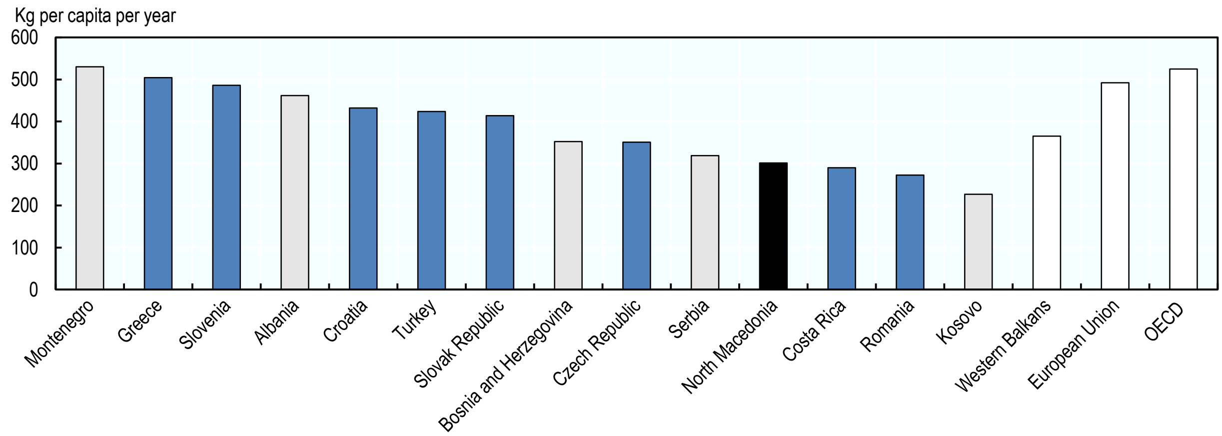
North Macedonia has developed a national inventory of pollutants but has to enhance air quality monitoring. There are 17 permanent air quality monitoring stations across the economy (Ministry of Environment and Physical Planning, 2017[113]), which are subject to regular maintenance and monitoring. However, continuous monitoring of PM2.5 is not established in all monitoring stations, especially those outside of Skopje.[18] The frequency of monitoring of other pollutants, such as sulphur dioxide, nitrogen oxides, ammonia, and benzene, toluene and xylene (BTX), varies across the monitoring stations (World Bank, 2019[112]).[19] Monitoring of air quality should include a regular assessment of the impact on health.

Waste management remains a challenge in North Macedonia

Waste production in North Macedonia is relatively low, but its collection is not always effective. On average, the waste production rate amounts to 301 kg of waste per capita per year, lower than the EU and OECD averages of 492 kg and 525 kg, respectively, and lower than the rest of the region (Figure 14.38). The collection rate ranged between 73.98% in 2011 and 80.81% in 2017 (State Statistical Office, 2018[116]); however, populations living in rural areas are not always adequately served.

Figure 14.38. North Macedonia's waste rate is below the European Union, OECD and Western Balkan averages

Municipal waste generated in 2018 (in kg per capita and per year)



Note: Data for Greece and Bosnia and Herzegovina are from 2017. There are no data for Kazakhstan, Morocco, the Philippines and Uruguay.
Sources: Eurostat (2020[54]), *Eurostat COVID-19: Statistics serving Europe* (database), https://ec.europa.eu/eurostat/data/database; OECD.Stat (2019[117]), *OECD.Stat* (database), https://stats-2.oecd.org/index.aspx?DatasetCode=DACSECTOR.

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Waste collection fees are very low and do not cover operational costs. The tariff applied for waste collection is fixed by the municipal council based on size of household or living space and on volume of waste collected on companies' premises (UNECE, 2019[111]).[20] Fees are often evaded: at the national level, it is estimated that only 50% of the potential revenues are collected. The rate is higher in Skopje (80%), where fees collected are enough to cover the costs of collection.

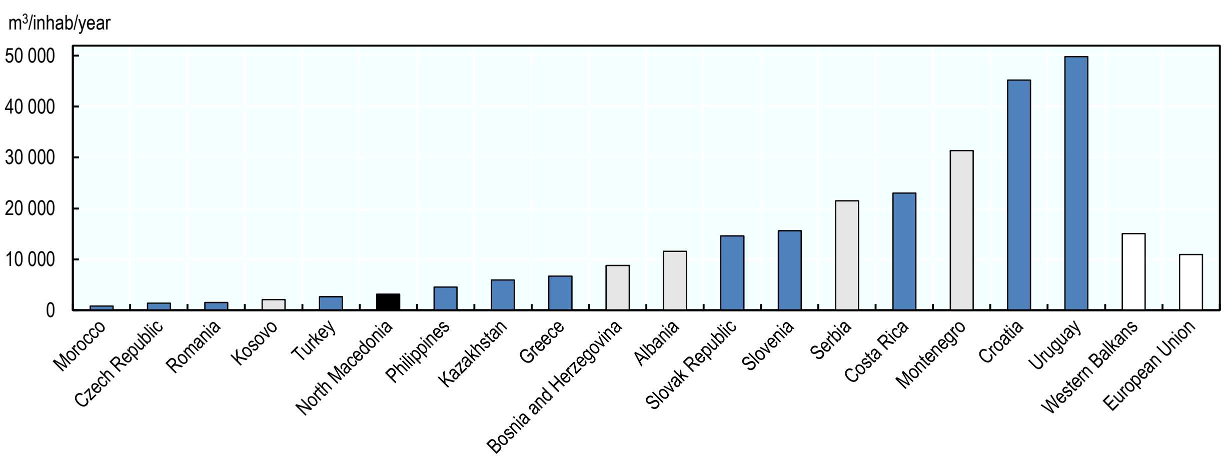
The part of waste that is recycled in North Macedonia remains low (Eurostat, 2020[54]). Based on available data (which cover only ten municipalities: Bitola, Brod, Kriva, Ohrid, Palanka, Prilep, Resen, Skopje, Veles and Vinica), the recycling rate is 13.16% for metal, 18.86% for glasses, 33.1% for plastic and 85.18% for paper (Ministry of Environment and Physical Planning, 2019[118]). Only one landfill, Drisla, complies with national requirements; 54 others are not safe and operate without permits (UNECE, 2019[111]). Moreover, there are around 1 000 dump sites in North Macedonia, mainly in rural areas. Many landfills are located close to rivers and risk polluting surface and ground water. According to estimations, North Macedonia would need to invest around EUR 82 million to modernise the public waste management infrastructure (Ministry of Environment and Physical Planning, 2008[119]).

The efficiency of water management needs to be improved

Access to quality drinking water is almost universal in North Macedonia, but monitoring in rural areas needs to be improved. The entire urban population and 97% of the rural population have access to drinking water (Government of the Republic of North Macedonia, 2020[120]); coverage difficulties exist only in some remote locations in rural areas. The quality of drinking water in urban areas is 94.4% compliant with EU standards, and the level of satisfaction with water quality is comparable to benchmark economies (Institute of Public Health of North Macedonia, 2018[121]; State Statistical Office, 2019[122]). The majority of households, especially in dense settlements, are connected to a sewerage system; in rural areas, the population uses septic tanks (UNECE, 2019[111]). The monitoring of water quality by the Institute of Public Health is not systematic in rural and vulnerable areas. Water quality remains a significant problem for many Roma households in rural areas (Government of the Republic of North Macedonia, 2020[120]).

North Macedonia has lower renewable water resources than other Western Balkan economies, but levels of water withdrawal are relatively low. There are four river basins (Crn Drim, Juzna Morava, Strumica and Vardar), and the total renewable water resources per capita per year amounts to 3 150 m^3, which is below the regional and EU averages (Figure 14.39). However, North Macedonia's water exploitation index is relatively low at between 8.3% (FAO, 2020[123]) and 11.2% in 2017 (EEA, 2020[124]). With the support of international donors, North Macedonia is working on the assessment and management of water at the river basin level. The river basin management plans for the Strumica River Watershed and the Vardar River Watershed have been prepared, the Crn Drim River Basin Management Plan is being finalised (Ministry of Environment and Physical Planning, 2020[125]), and river basin management councils are being established.

Figure 14.39. North Macedonia has lower renewable water resources than other Western Balkan economies, but levels of water withdrawal are relatively low



Note: Data are from 2017, except for Bosnia and Herzegovina, Kosovo and Montenegro, which are from 2016.
Sources: Eurostat (2020[54]), *Eurostat COVID-19: Statistics serving Europe* (database), https://ec.europa.eu/eurostat/data/database; FAO (2020[123]), *Aquastat* (database), http://www.fao.org/nr/water/aquastat/data/query/results.html.

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North Macedonia will have to prioritise among competing uses of water and significantly reducing water losses. Households and agriculture are the largest users of water in North Macedonia: 47.3% and 39.68% of the resources available, respectively. Demand from industry represents around 13.01% and is growing in the energy sector but remains low compared to other sectors (Ministry of Environment and Physical Planning, 2020[125]). Demand for irrigation is expected to increase, mostly as a result of warmer temperatures and a projected decline in precipitation, but the irrigation system may not be ready to accommodate it. The system is old and obsolete, lacks measuring devices on irrigation intakes and is the cause of significant water losses (Ministry of Environment and Physical Planning, 2020[125]; UNECE, 2019[111]).

North Macedonia has advanced considerably in establishing a normative framework to regulate the use of water, but significant gaps exist. The water sector is controlled at the national level, and municipalities have some regulatory duties; there are 75 water service providers in total in North Macedonia, almost 1 per municipality. Co-ordination among various ministerial bodies in charge could be improved, and the recently created National Water Council needs more political leadership in order to set a longer term and strategy-oriented vision for water in North Macedonia. The economy still needs to make significant efforts to implement the EU acquis in the area of water management (European Commission, 2020[108]).

Tariffs are affordable but do not discourage excessive water consumption and are often evaded. Municipalities can set their own tariffs based on a reference value and a range determined by the Energy Regulatory Commission. On average, tariffs amount to 1.7% of household income (UNECE, 2019[111]) but do not take into account actual water consumption. Non-volumetric pricing is still widely used, especially for irrigation water. In spite of their affordability, in 2018, water service providers collected between 32% and 78% of potential revenues (ERC, 2019[126]). However, information about revenues are partial, and it is not clear whether they are enough to cover the costs faced by water suppliers.

Undue interference may also undermine the efficient functioning of local public utilities, which are often used to allocate jobs in exchange for political support (World Bank/IAWD, 2015[127]).

The enforcement and implementation of environmental legislation remains weak

The Ministry of Environment and Physical Planning in North Macedonia lacks resources and capacity. In 2018, the budget of the ministry amounted to MKD 671.3 million (around EUR 10 939 560), which corresponds to 0.35% of total central government expenditures (Ministry of Finance, 2018[59]). The state environmental inspectorate is an autonomous entity with its own budget. It is understaffed with only 17 inspectors at the central level and rarely co-ordinates with other environmental inspectorates, such as the forestry and hunting inspectorate. Unlike Albania or Kosovo, North Macedonia does not have a separate environmental protection agency.

Capacity is even more limited at the subnational level. The state environmental inspectorate does not supervise the appointment of local inspectors, who are instead appointed by mayors. This may create space for local patronage and therefore inefficiencies. Compared to inspectors at the central level, the mandate of local inspectors is too broad and covers several environmental dimensions (waste, soil, air and water) (UNECE, 2019[111]). Municipalities have no incentives to strengthen inspecting efforts, since by law, they collect most of the fees only on behalf of the central government.

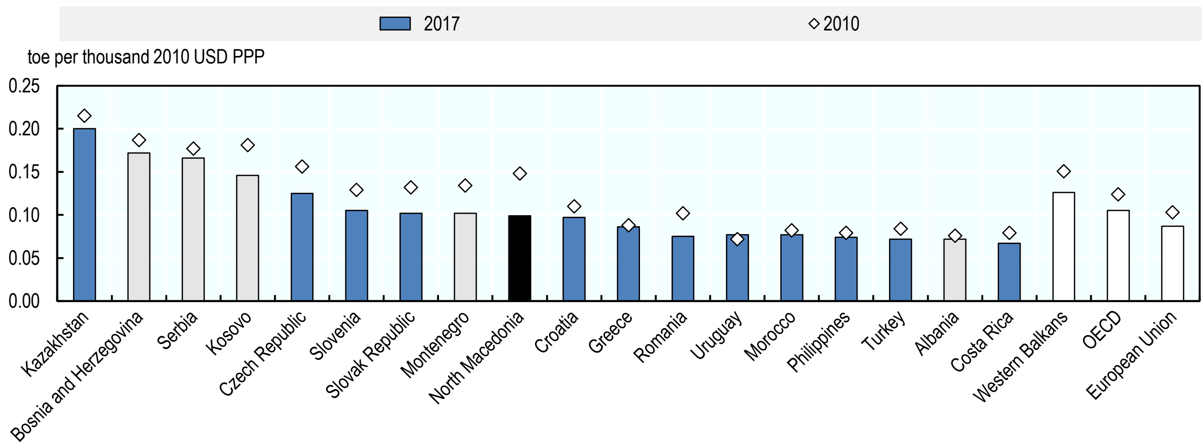
North Macedonia is highly dependent on coal, and energy supply is not sufficiently secure and efficient

North Macedonia highly depends on domestic and heavily polluting coal production, and energy imports

Despite recent improvements, energy intensity in North Macedonia needs to be reduced, and the legislation on energy efficiency must be enforced. Energy intensity in North Macedonia is decreasing and, at 0.099 toe (tonne of oil equivalent)/USD 1 000, is below the Western Balkan regional average of 0.126 toe/USD 1 000 but remains high compared to the European Union (Figure 14.40). North Macedonia adopted a new law on energy efficiency that aims to align North Macedonia's legislation with the EU energy efficiency and energy performance directives. However, the economy has not yet adopted the fourth action plan on energy efficiency, and the new legislation still needs to be fully enforced (European Commission, 2020[108]).

Figure 14.40. Energy intensity is decreasing in North Macedonia and is below the regional average but remains high compared to the EU average

TPES/GDP (toe/USD 1000 in 2010 USD PPP), 2017 and 2010



Note: Data for the Czech Republic, Greece, the Slovak Republic, Slovenia and Turkey are for 2018.
Source: IEA (2020[128]), *Data and Statistics* (database), http://iea.org/stats/index.asp.

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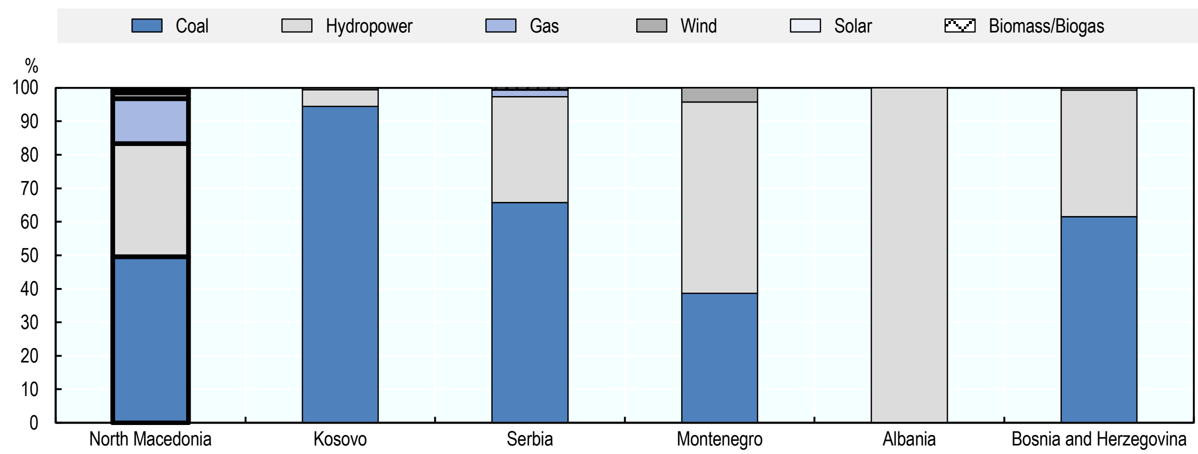
North Macedonia relies on domestic coal production provided by outdated power plants and on significant energy imports. Almost 60% of the final energy consumption was imported and the rest was covered by domestic production in 2017 (ERC, 2019[126]). Regarding final electricity consumption, around 26% is covered by imports and 74% by domestic electricity production (European Commission, 2019[62]). Some 50% of the domestic electricity production comes from coal (lignite), 33% from hydropower, 13.4% from gas and around 3% from wind, biomass and solar together (Figure 14.41). Electricity from coal is generated in two thermal power plants built in the 1980s, REK Bitola and REK Oslomej, managed by the state-owned company *Elektrani na Severna Makedonija*, with a total installed capacity of around 800 MW (ERC, 2019[126]). Construction of a new thermal power plant (Mariovo), with 300 MW power, appears in the government's main long-term strategic energy documents but has not been included in the new strategy adopted in December 2019.[21]

Despite recent efforts, the production of renewable energy lacks diversification. The overall share of renewable energy in gross final energy consumption (including hydroelectric power) was 18.1% in 2018, which was below the Western Balkan regional average of 28.8% and slightly lower than the EU average of 18.9% (Eurostat, 2020[54]). Without hydroelectric sources, the share of renewable energy is only 2.9%. North Macedonia's energy law is fully aligned with the EU Renewable Energy Directive (European Commission, 2020[108]). Since 2012, North Macedonia has introduced feed-in tariffs for small hydropower plants, wind farms, photovoltaic installations and power plants using biogas and biomass and has set limits of total installed new capacities for all renewable technologies except small hydropower plants. Moreover, in 2018, the new Law on Energy reinforced the support given to renewable energies by keeping feed-in tariffs for hydropower, biomass and biogas and introducing feed-in premiums for wind and solar. Even though feed-in tariffs for small hydropower are below the level of those for other types of renewable energy, the largest share of public funds spent on renewable energy subsidies is dedicated to small hydropower: operators of small hydropower plants received almost 42% of all resources spent on feed-in tariffs and premiums for renewable energies in 2018 (Gallop, Vejnovic and Pehchevski, 2019[129]).

Figure 14.41. North Macedonia generates half its domestic electricity from coal and one-third from hydropower

Electricity generation mix (in %), 2018



Sources: Eurostat (2020[54]), *Eurostat COVID-19: Statistics serving Europe* (database), https://ec.europa.eu/eurostat/data/database; Energy Community Secretariat (2020[130]), *Annual Implementation Report 2018/2019*, www.energy-community.org/implementation/IR2020/IR2019.html.

StatLink https://doi.org/10.1787/888934244987

Energy supply is unreliable in North Macedonia

Despite recent improvements, due to old electricity transmission and distribution networks, secure, reliable and constant electricity supply remains an issue in North Macedonia. Almost one-quarter of firms considered electricity a major constraint in 2019, along with political instability, practices of the informal sector and access to finance (WB/EBRD/EIB, 2020[131]). Electric power distribution losses decreased from 15.5% in 2014 to 13.4% today, and electric power transmission losses are in line with EU levels (1.8% in 2019). Despite these positive developments, electric power transmission and distribution losses and an outdated energy infrastructure remain issues. North Macedonia needs to adopt a more systematic approach to upgrading its energy infrastructure and to reducing transmission and distribution losses. The European Union is currently drafting a Green Agenda for Western Balkan economies with a focus on energy efficiency, which could play an important role in improving energy efficiency and in upgrading North Macedonia's energy infrastructure.

The liberalisation of energy markets has been progressing quickly. The electricity and gas markets are currently open to competition. The liberalisation of the electricity market started in 2018, and the adoption of the 2018 Law on Energy and of the corresponding secondary legislation was a milestone (Energy Community Secretariat, 2019[132]). Electricity transmission operators have been unbundled and certified in line with the European Union's Third Energy Package. Competition in the sector has been increasing. A continuation of this trend could result in better quality service and a more secure energy supply. It is important that North Macedonia unbundles its gas transmission operator in line with the European Union's Third Energy Package (European Commission, 2020[108]) and continues to depoliticise its energy sector.

Energy production is not efficient and has an environmental impact

North Macedonia's energy production based on lignite and the development of small hydropower plants risks having a negative impact on the environment and water resources. The mushrooming of hydropower plants has had an impact on water resources and on the preservation of biodiversity. Several of the already-built and planned plants are in protected areas. For example, some hydropower plants are in national parks (Mavrovo National Park [Tresonce hydropower plant on Tresonecka reka] and Pelister National Park [Brajcinska reka 1 and 2]) and directly threaten both the drinking water sources of local communities and the endemic species living in these protected areas (Gallop, Vejnovic and Pehchevski, 2019[129]). North Macedonia should align investments in hydropower with the relevant environmental EU acquis.

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Notes

[1] Estimations are based on the nationally representative 2017 Quality of Life population survey carried out by the Finance Think research institute. Official poverty breakdowns by ethnicity can only be confirmed in the next census round, planned for 2021.

[2] As a result of the Youth Guarantee programme, there were more than 650 young people employed or self-employed, 233 internships and 202 young people entering training in 2018 (Swiss Federal Department of Foreign Affairs, 2020[135]).

[3] Women have particularly low salaries in textile and wearing apparel sectors, which together accounted for 5.2% of total employment and employed 85.2% of women in 2019 (MAKStat, 2020[8]). While the average gross salary in February 2020 was EUR 659 per month, in the textile sector, it was EUR 534, and in the wearing apparel sector, it was EUR 423 (Invest North Macedonia, 2020[134]). Considering the high share of women in both sectors, low wages are affecting many women.

[4] Estimated data are for 2015 (Bartlett and Oruč, 2018[136]).

[5] Based on analysis conducted in the three regions (Northeast, Polog and Southwest), the Concept for Regional VET Centres is in preparation. The objective is to build VET centres of excellence aimed at deepening student involvement in the labour market and to co-operate with various skills providers. Building a comprehensive network of participating institutions is expected to improve access to various technologies and to provide new skills-development opportunities (input from the Ministry of Education).

[6] It should be noted that this is a crude measure of prevalence of alcohol abuse and does not allow determining whether consumption is concentrated among specific population groups.

[7] Any impact of this reform on health expenditures is not reflected in this report, as the latest available year for internationally comparative data is 2017.

[8] The change in regulation coincided with the aftermath of the global financial crisis, which also negatively affected non-public-sector-driven employment creation.

[9] There are at least six ethnic groups in North Macedonia, representing 36% of the population. According to the 2002 Census, these are the ethnic Albanians (25.2% of the population), Turks (3.9%), Roma, Ashkali and Egyptians (2.7%), Serbs (1.8%), Bosniaks (0.8%) and Vlachs (0.5%). Other groups represent 1% of the population.

[10] The pupil/teacher ratio decreased from 15 in 2007 to 11.3 in 2018, and the average class size decreased from 20.9 to 17.4.

[11] For instance, the resignation of a lay judge in January 2020 sent a high-profile trial involving former Prime Minister Nikola Gruevski back to the beginning.

[12] The average farm size is 3.2 ha in Kosovo (2014 data), 4.6 ha in Montenegro (2010) and 5.4 ha in Serbia (2012).

[13] North Macedonia's overall statistical capacity declined from 86 out of 100 points to 82.2 points in 2019 (World Bank, 2020[96])

[14] Municipalities have specific duties in the DRR system (Law on Local Self-Government, 2002 and Law on Rescue and Protection, 2004) in terms of undertaking protection and rescue activities during natural hazards and fires. At the municipal level, the responsibilities of municipal councils and mayors differ as well.

[15] The reduction of PM emissions is associated mainly with the decrease in industrial emissions due to the closure and reduced operating hours of ferroalloys facilities.

[16] The average age of buses is around 18.7 years (MAKStat, 2020[114]).

[17] The calculation of the motor vehicle tax consists of two components: an ad valorem component based on the value of the vehicle and a specific component based on the vehicle's level of CO_2 emissions and fuel type. The law on the motor vehicle tax adopted in January 2020 aims to raise citizens' environmental awareness and incentivise them to use greener, less polluting vehicles in order to reduce air pollution and improve the environmental quality of life. This new law is in line with the EU's recommendation to introduce an environmental component in the taxation of motor vehicles to reduce pollution.

[18] Over the last decade, PM2.5 was regularly measured in only two fixed monitoring stations located in the agglomeration of Skopje (Ministry of Environment and Physical Planning, 2020[125]; UNECE, 2019[111]).

[19] For example, BTX is measured in only four fixed monitoring stations (Ministry of Environment and Physical Planning, 2020[125]).

[20] The municipality of Skopje applied two tariffs: MKD 5.5 (EUR 0.09) per m^2 for companies and MKD 3.59 (EUR 0.06) per m^2 per household per month in 2018. These tariffs do not include VAT. Interview with the representative from the municipality of Skopje in February 2020.

[21] A new Strategy for Energy Development of the Republic of North Macedonia until 2040 was adopted in December 2019 (Government of the Republic of North Macedonia, 2019[133]).

Part VI Assessing opportunities and constraints in Serbia

15 Overview: Identifying strategic opportunities for Serbia

Serbia's development has accelerated notably since the year 2000. Income per capita has more than doubled, poverty has fallen rapidly and the country has established itself as a competitive, export-led market economy despite successive crises. A steady recovery of macroeconomic stability in recent years has increased resilience and created room for manoeuvre in the face of the COVID-19 pandemic. To achieve rapid, inclusive and sustainable development, Serbia will need to take decisive policy action on long-term strategic priorities. This chapter takes a holistic view of Serbia's development performance across a range of outcomes, spanning the breadth of the Sustainable Development Goals. It then draws on the remaining chapters in this part to outline strategic priorities building on Serbia's assets and address the key constraints it faces.

Serbia's development has accelerated notably since the significant political and economic changes that have taken place since 2000. Real gross domestic product (GDP) per capita more than doubled between 2000 and 2019. Poverty fell rapidly, especially during the first decade of the 2000s. Serbia also achieved progress in institutional development and global integration, including through a number of reforms to align Serbian institutions with a view to accession to the European Union (EU). The EU accession negotiations, which started in 2014 after the entry into force of the Stabilisation and Association Agreement and the receipt of candidate status in March 2012, and the broader EU integration process have contributed to the reform momentum in the country.

In the past ten years, Serbia has established itself as a competitive, export-led market economy, despite successive crises. Economic growth averaged 6.5% per year between 2001 and 2008, and trade grew from 57% to 79% of GDP. However, growth in this period was unbalanced; the employment rate fell during the decade as external imbalances mounted. Serbia was highly exposed to the 2008-09 global financial crisis and suffered recessions not only in 2009, but also in 2012 – due to severe weather conditions and contagion from the 2011 Eurozone crisis – and in 2014 due to particularly severe floods. Following fiscal consolidation since 2014 and a steady recovery of foreign direct investment (FDI) flows, the economy was on track to recover economic dynamism by 2019, with growth reaching 4.2%. Despite the turmoil, trade grew from 77% to 113% of GDP between 2010 and 2019. By the end of 2019, unemployment had fallen below 10% for the first time since the 1990s.

The COVID-19 crisis hit Serbia as the economy was gathering momentum, but it also finds the country better prepared than for some past crises. Annual economic growth has been modest since 2014, averaging 3%, but it exceeded 4% in real terms in 2018 and 2019, with four quarters exceeding 5% growth (year on year) for the first time since the 2008 financial crisis (National Bank of Serbia, 2020[1]). Fiscal consolidation between 2014 and 2017 drove public debt down to about 52% of GDP, leaving room for manoeuver in fiscal policy. Low and stable inflation also means that there is scope for monetary policy to be effective in stimulating the economy. Notwithstanding the human cost of the COVID-19 crisis, the implementation of a sizeable fiscal stimulus package is an opportunity to steer the economy towards more productive, higher value added and knowledge-intensive activities.

Progress in development dimensions beyond the economy has been more mixed and will require a holistic development strategy. While the pattern of growth since 2014 has created good-quality jobs in numbers, women, the young, some ethnic minorities and those living in lagging regions face significant, often overlapping, deprivations. Moving towards a more inclusive development pattern will require taking well-being considerations into account in setting the direction of economic policy. A holistic development strategy should also consider the toll the current economic development model is taking on the environment, largely through the heavy reliance on coal-fired electricity generation, which also has deleterious effects on health outcomes (Health and Environment Alliance/Climate Action Network, 2017[2]). Achieving this will require accelerating reforms to address a number of governance challenges.

The Multi-dimensional Review (MDR) of the Western Balkans supports Serbia and the region with a strategic perspective and ideas for action on shared challenges. This assessment of Serbia is intended to support the new strategy. It provides inputs for a possible vision for Serbia's development and identifies the key constraints that must be tackled in order to achieve sustainable and equitable improvements in well-being and economic growth. The next phase of the project will focus on peer learning to find solutions to the challenges that emerge from the initial assessments as shared across the region.

This overview chapter presents the main results of the initial assessment of development in Serbia. First, the chapter presents inputs for a development vision for Serbia in 2030, elaborated by participants of a strategic foresight workshop as a means of identifying key elements of success for the future of Serbia. Second, the chapter takes a bird's-eye view to assess Serbia's development performance on the basis of key statistics on well-being and the Sustainable Development Goals (SDGs) and summarises the key constraints to development identified in this report. It concludes by suggesting key strategic directions for the future.

The main body of this initial assessment is contained in Chapter 17, which assesses progress and identifies constraints along the five pillars of the 2030 Agenda for Sustainable Development: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet. Whenever relevant and subject to data availability, Serbia's performance is compared with a set of benchmarks in the region (Albania, Bosnia and Herzegovina, Kosovo, Montenegro and North Macedonia), in Organisation for Co-operation and Development (OECD) economies (Costa Rica, Czech Republic, Greece, Slovak Republic, Slovenia and Turkey), non-OECD economies in the European Union (Croatia and Romania) and non-OECD economies in other regions with relevant development experiences (Kazakhstan, Morocco, Philippines and Uruguay). Comparisons also include regional averages for the Western Balkans and OECD and EU members. Given the global impact of COVID-19, this Overview is followed by a special chapter on the impact of the pandemic in Serbia.

Towards a vision for Serbia in 2030: a healthy, cohesive, more inclusive and equal society and a clean environment built on economic and social development through education, skills and digitalisation in combination with good governance, democracy, decentralisation and respect for human rights

A clear vision of the desired future for Serbia is an important guidepost for Serbia's National Development Plan (NDP). The Law on the Planning System of the Republic of Serbia establishes the NDP as the highest level long-term development strategic planning instrument, setting out the vision and goals of the country and guidelines for their fulfilment (Republic of Serbia, 2018[3]). Such a vision should provide a description of what citizens of Serbia expect from the economy, society, institutions and the environment and identify the most important elements in each domain. To establish elements of such a vision, a workshop entitled Serbia: Vision and Challenges 2030 was organised in Belgrade on 27 February 2020, gathering 23 participants from a range of public-sector ministries and agencies, the private sector, academia and civil society. The vision was built on the basis of simple narratives of the lives of future citizens of Serbia and subsequent clustering by the five pillars of Sustainable Development of Agenda 2030 and this report: People, Prosperity, Partnerships and financing, Peace and institutions, and Planet.

The narratives proposed for the vision highlighted aspirations for high quality of life, equal opportunities for all and equal development of all regions. The narratives of the workshop evoked mainly middle-aged women with high levels of education. All fictional citizens enjoyed middle-age family lives and had quality jobs with a good work-life balance. Citizens lived in a healthy environment and enjoyed equal access to education, easy access to credit, a good social safety net, life-long learning and a variety of leisure activities. Economic development benefited all regions, and quality infrastructure facilitated movements across the country. The narratives also placed particular emphasis on gender equality, women's empowerment, integration of minority groups and the vulnerable, and digitalisation.

The resulting vision centres on a cohesive, inclusive and equal society, education, digitalisation, democracy, decentralisation, respect for human rights and environmental quality as the main levers for greater well-being. Box 15.1 presents the vision statements for Serbia in 2030 prepared by participants. Serbia in 2030 is envisioned as a country with an inclusive and equal society built on quality employment, access to quality health care and the preservation of cultural heritage. Knowledge, skills, digitalisation and quality infrastructure are the main drivers of economic growth. Citizens enjoy good governance, democracy, respect for human rights, high levels of decentralisation and quality public services. All citizens of Serbia live in a clean and healthy environment that is resilient to climate change. In terms of the individual dimensions of this vision, education, decentralisation, improved health services, and environmental protection were considered most important, identified through a voting exercise (Figure 15.1).

Box 15.1. A development vision for Serbia in 2030

Serbia in 2030: a healthy, cohesive, more inclusive and equal society and a clean environment built on economic and social development through education, skills and digitalisation in combination with good governance, democracy, decentralisation and respect for human rights.

As part of the OECD strategic foresight workshop organised in Belgrade on 27 February 2020, participants from the public administration and civil society developed a vision statement that reflects the desired future for Serbia in 2030.

People

- Serbia has become a more cohesive society. All available data demonstrate sustained and marked progress towards a healthier, more inclusive and equal society for all people, regardless of their personal or social features.
- The strategic framework and planning documents haven been upgraded and hierarchically linked in order to improve all the crucially important aspects of social cohesion. The upgrading of systems and practices of life-long learning helps boost the quality of employment. People of all gender identities enjoy a better work-life balance.
- Social services are better integrated with public health services, and awareness of these has been adequately raised.
- All citizens of Serbia have equal and easy access to a wide range of cultural activities. Serbia safeguards all individual cultures and people within its borders and enables effective intercultural exchange. Serbia preserves and protects its cultural heritage.

Prosperity/Partnerships and financing

- Economic and social development is based on knowledge and skills. The education system is aligned with labour market needs and society is digitally transformed (better general knowledge of information technology among citizens and enterprises, e-governance, etc.).
- Economic and social development is equal across all regions and built on equal opportunities for all, easier access to finance and good governance. Infrastructure is developed through projects financed by the state and local communities, as well as external sources. Serbia has built a climate-resilient society.

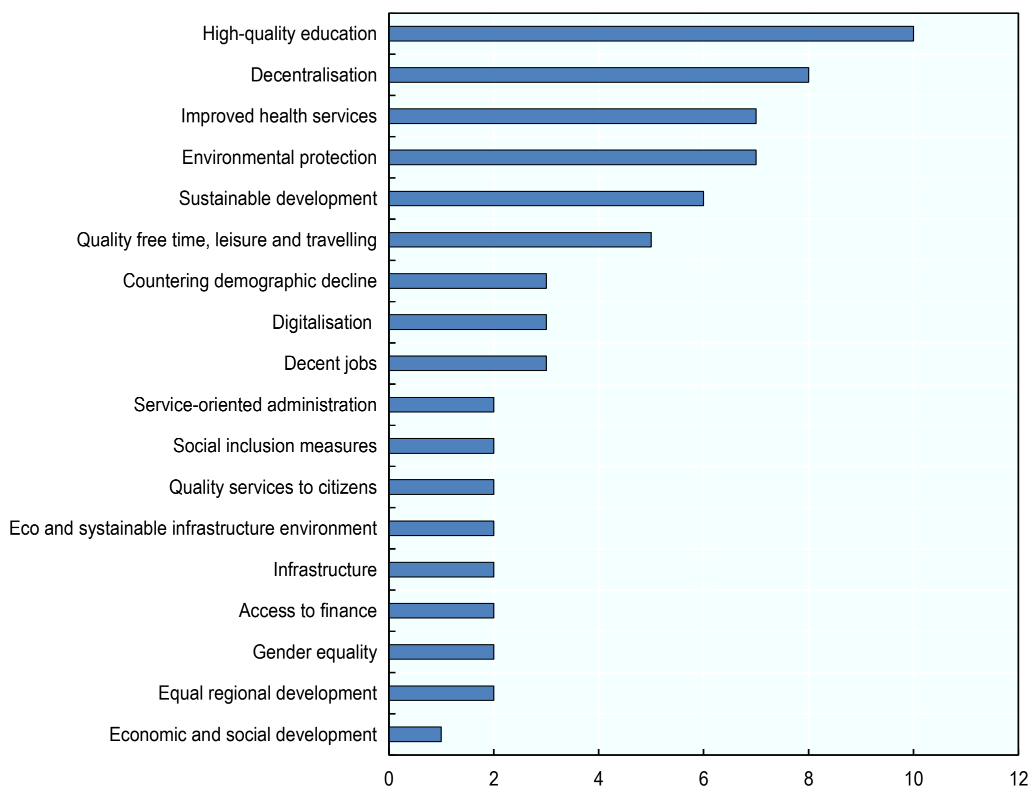
Peace and institutions

- In 2030, Serbia is an EU member state with separation of powers between the executive, legislative and judicial branches. Serbia has strong independent institutions and free media as effective guardians of a democratic society, and human rights are fully respected and protected.
- Public policies and decisions are inclusive and based on the needs of society and its various groups. Serbia is a decentralised country built on the logic of subsidiarity, which empowers local communities.
- Public services and the administration at all levels are impartial, professional, transparent, ethical and citizen oriented. This results in cheap, fast and high-quality public services.
- Serbia is a society with low levels of corruption. The government undertakes all actions based on good governance principles.

Planet

- Serbia has established good governance and efficient planning at all levels. EU environmental legislation is in place and is being implemented. Serbia is contributing to global environmental initiatives.
- Education for sustainable development is integrated into the education system. Citizens, the public administration, civil society and the business sector are informed, educated and engaged in sustainable development. The joint activities of all stakeholders have led to the sustainable use of natural resources with environmental and biodiversity safeguards in place.
- Citizens are living in healthy places with blue-green infrastructure, energy-efficient buildings, clean air, water and healthy food, surrounded by climate-resilient landscapes.

Figure 15.1. The most important dimensions of the vision for Serbia: education, decentralisation, improved health services and environmental protection



Source: Authors' elaboration based on the voting exercise of the participants of the OECD strategic foresight workshop organised in Belgrade on 27 February 2020.

StatLink https://doi.org/10.1787/888934245006

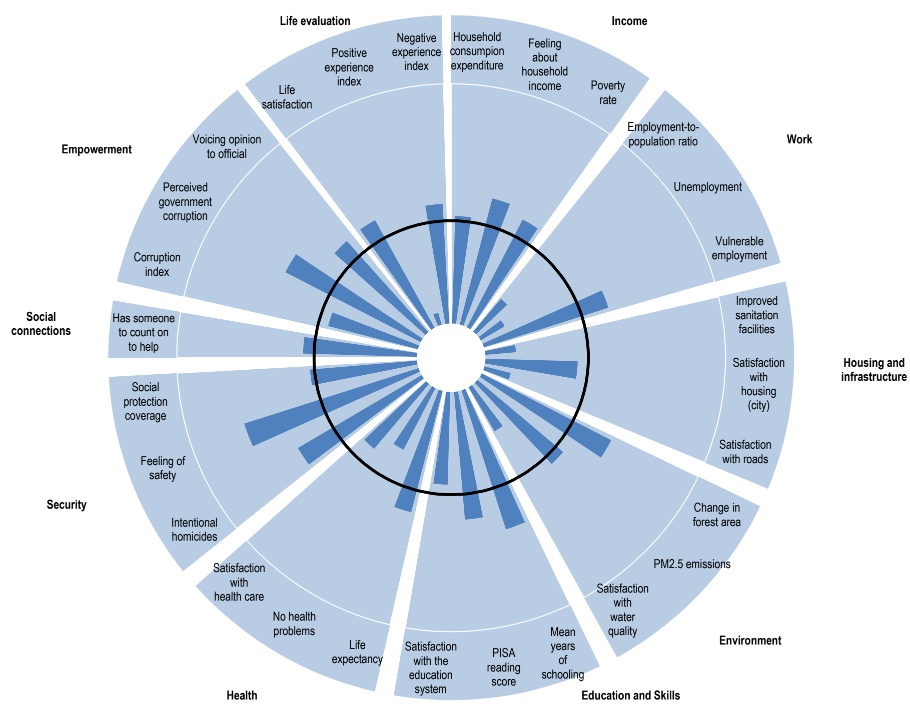
Assessing Serbia's development performance

Building on the vision, well-being around the world and sustainable development as benchmarks, this section reviews Serbia's development performance. The proposed vision emphasises well-being and sustainable development as the ultimate objectives of development. To assess the well-being of the citizens of Serbia, the OECD's Well-being Framework uses a mix of objective and subjective indicators across a range of dimensions that matter to people (OECD, 2020[4]) (Box 15.2). A version adapted to the realities of emerging economies compares Serbia to the level of well-being outcomes expected given its level of GDP per capita in ten dimensions covering material conditions, quality of life and quality of relationships. In a second step, this section assesses Serbia's performance across the five pillars of the SDGs, applying distance-to-target measures across a selection of indicators and building on the analysis in the main body of this report.

Serbia's well-being performance is mixed. Serbian citizens feel comparatively safe and are exposed to comparatively few homicides given the country's level of GDP. They also attain better than expected education outcomes in terms of completion rates and test scores on the OECD Programme for International Student Assessment (PISA).[1] The country also performs comparatively well in some facets of environmental quality, such as forest protection. However, there are weaknesses in other aspects of well-being: employment rates are low (49.0% in 2019), as are access to improved sanitation and satisfaction with water quality. Citizens of Serbia are comparatively dissatisfied with other parts of public infrastructure, such as roads and health care, and relatively few people report having "no health problems" (Figure 15.2).

Figure 15.2. Current and expected well-being outcomes for Serbia: worldwide comparison

2019 or latest available data



Notes: The observed values falling inside the black circle indicate areas where Serbia performs poorly in terms of what would be expected from an economy with a similar level of GDP per capita. Expected well-being values (the black circle) are calculated using bivariate regressions of various well-being outcomes on GDP, using a cross-country dataset of around 150 economies with a population of over 1 million. All indicators are normalised in terms of standard deviations across the panel.

Sources: Gallup (2018[5]), "Gallup World Poll", www.gallup.com/analytics/318875/global-research.aspx; ILO (2020[6]), *ILOStat* (database), https://ilostat.ilo.org/data/; OECD (2020[7]), *OECD PISA database*, www.oecd.org/pisa/data/; Transparency International (2019[8]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/; UNESCO (2019[9]), "UNESCO Institute for Statistics", http://uis.unesco.org/; World Bank (2020[10]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WHO (2020[11]), *Global Health Observatory* (database), www.who.int/data/gho/data/countries.

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Box 15.2. Measuring what matters to people

As part of its broader Better Life Initiative, the OECD first created its Framework for Measuring Well-being in 2011 with the aim of putting people at the heart of policy making. This represented the culmination of longstanding work both inside and outside the OECD. Important strides to "go beyond GDP" had been made with the United Nations Development Programme's Human Development Index and the work on multi-dimensional poverty by the Oxford Poverty and Human Development Initiative. The Framework also draws on rich academic literatures in welfare economics and capability theory, the recommendations of the Commission on the Measurement of Economic Performance and Social Progress (Stiglitz, Sen and Fitoussi, 2009[12]), and existing well-being and sustainable development measurement practice in OECD member and non-member countries. Since its launch, the work on well-being has continuously been updated in line with best practice and continues to be published in the OECD's *How's Life?* report series (Exton and Fleischer, 2020[13]; OECD, 2020[4]). For the purpose of the MDRs, the OECD Well-being Framework has been adapted to fit the realities of countries at various stages of development (Boarini, Kolev and McGregor, 2014[14]).

The adapted OECD Well-being Framework used in this report focuses on living conditions at the individual, household and community levels that capture how people experience their lives "here and now". Current well-being here is comprised of ten dimensions related to material conditions that shape people's economic options (Income, Housing and infrastructure, Work and job quality) and quality-of-life factors that encompass how well people are (and how well they feel they are), what they know and can do and how healthy and safe their places of living are (Health, Education and skills, Environmental quality, Life evaluation, Security). Quality of life also encompasses people's connectedness and engagement (Social connections, Empowerment).

Methodological considerations

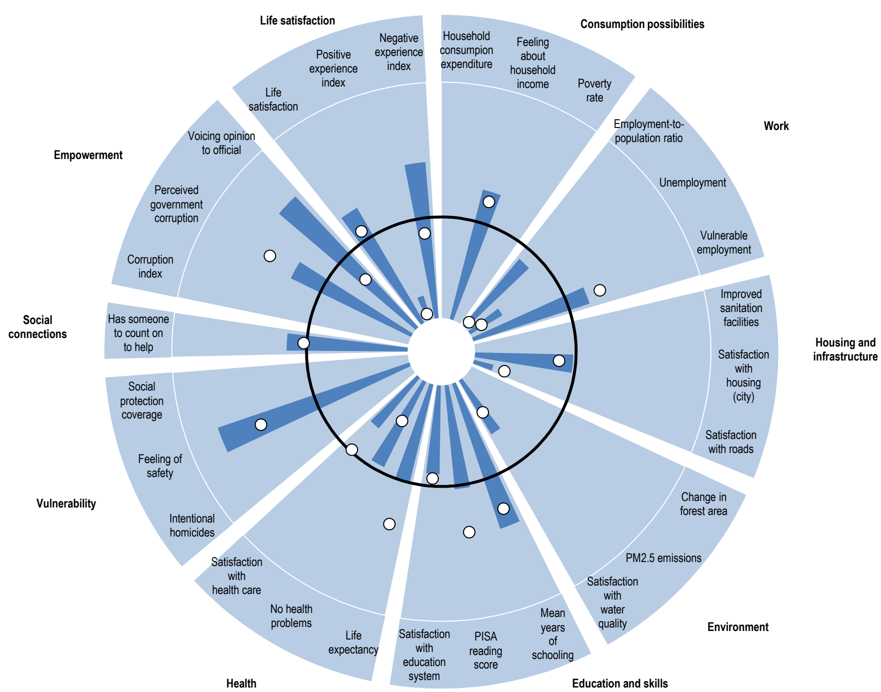
To capture the full range of people's actual life experiences, the OECD Well-being Framework uses both objective and subjective indicators. For instance, the Health dimension not only looks at life expectancy estimations but also considers how people feel about their health status and the health services they are receiving. Subjective indicators are sometimes viewed as not being as robust as objective measures; however, there are at least three reasons for considering them alongside the latter to get a holistic picture of well-being. First, there is solid methodological evidence that the subjective measures contained in the well-being framework (e.g. life satisfaction, trust in others and government) are statistically valid and correlate with objective measures of the same construct (OECD, 2017[15]; OECD, 2013[16]). Second, even in cases where perceptions diverge from objective reality, they capture the reality of survey respondents and can drive real-world outcomes, such as voting and lifestyle behaviours (Murtin, Fleischer and Siegerink, 2018[17]). It can actually be especially insightful for policy makers to zoom in on areas where the gap between citizen perception and objective indicators is largest. Third, many of the measures typically considered objective and routinely used in policy analysis, such as household income, are based on people's self-reports and can equally be affected by response biases and non-response rates (e.g. of very wealthy households).

There are significant differences in well-being between men and women in Serbia, and there is scope to improve women's participation in Serbian society on an equal footing with men (Figure 15.3). As in most countries around the world, women in Serbia have a higher life expectancy than men, and 15-year-old girls perform better in reading tests (OECD, 2020[4]). While gender differences in employment rates in Serbia are lower than those in the region and in OECD countries, they remain far from equality at about a 14.5 percentage point gap in 2018 (55.4% for men and 40.9% for women) (ILO, 2020[18]). This is mainly due to high inactivity rates among women (13.5 percentage points higher than inactivity among men) and the gender unemployment gap (1.3 percentage points) (World Bank, 2020[10]). Women have less access to productive and financial resources, such as credit and land (which is traditionally registered in the man's name). Women are traditionally expected to take care of unpaid work in the household, lack adequate support to reconcile work and family responsibilities (e.g. via child and elderly care facilities) and are systematically discriminated against by employers (see the People section in Chapter 17).

Although discrimination against women seems to be "very low", according to the OECD Social Institutions and Gender Index, the well-being analysis highlights gender differences in terms of safety and empowerment in Serbia. Men are more likely than women to feel safe when walking at night in their neighbourhoods (Gallup, 2020[19]; OECD, 2019[20]). While this is not a surprising finding (men in every OECD country feel safer than women), there are indications that gender-based violence remains high in Serbia and that existing legislation needs to be better enforced. Furthermore, there are gender differences in civic engagement and political representation: men are more likely than women to voice their opinion to an official. Women are relatively well represented in the legislative (38% of seats in the national parliament are occupied by a female MP) and in the executive (the government is led by a female prime minister since 2017, and 10 out of 23 minister posts are held by women compared to 4 out of 21 in the previous government) The share of men and women in senior civil service positions is nearly equal (OECD/SIGMA, 2019[21]) (see the People section in Chapter 17).

Figure 15.3. Current and expected well-being outcomes for Serbia: gender differences

2019 or latest available data



Notes: Well-being outcomes for women are represented by circles; men's outcomes are represented by bars. The observed values falling inside the central black circle indicate areas where Serbia performs poorly in terms of what might be expected from a country with a similar level of GDP per capita. Expected well-being values (the black circle) are calculated using bivariate regressions of various well-being outcomes on GDP per capita, using a cross-country dataset of around 150 economies with a population of over one million. All indicators are normalised in terms of standard deviations across the panel.

Sources: Gallup (2018[5]), "Gallup World Poll", www.gallup.com/analytics/318875/global-research.aspx; ILO (2020[6]), *ILOStat* (database), https://ilostat.ilo.org/data/; OECD (2020[7]), *OECD PISA database*, www.oecd.org/pisa/data/; Transparency International (2019[8]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/; UNESCO (2019[9]), "UNESCO Institute for Statistics", http://uis.unesco.org/; World Bank (2020[10]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WHO (2020[11]), *Global Health Observatory* (database), www.who.int/data/gho/data/countries.

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People – towards better lives for all

Not everyone is taking equal part in Serbia's development (Figure 15.4**).** In past decades, Serbia managed to ensure more jobs for its population (2019 employment rates were close to the OECD and EU averages), and it is about to undertake reforms in the labour market and social protection systems to align with EU standards. Yet, many groups, including young people, women, some ethnic minorities and those living in non-urban areas, are left behind. Unemployment rates for people under age 25 are about three times higher than for the overall labour force, gender inequalities in the labour market persist, and one-third of Bosniaks[2] living in non-urban areas are vulnerable in terms of multi-dimensional poverty. Regardless of whether they live in urban or non-urban areas, about one-quarter of Roma are also vulnerable in this way. Roma constitute 2% of the population, according to the 2011 Census (SORS, 2015[22]), but Roma are generally undercounted and, according to other estimates, could constitute up to 8% of the total population – one of the largest shares in the Western Balkan region (CoE, 2012[23]). In addition, only one in five Roma students are enrolled in upper secondary education (compared to 87% for the country average), their labour force participation rate is half that of the total population, and only 65% of Roma households have access to the public sewage system (World Bank, 2018[24]).

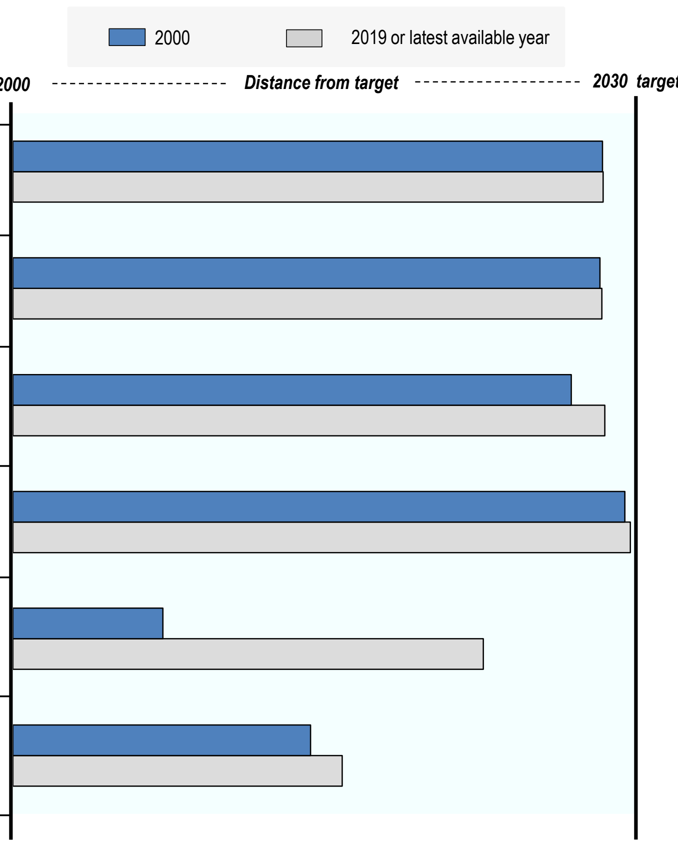
Serbia has a solid base to build its human capital and foster the inclusive structural transformation of the economy but needs to face the challenge of underutilisation. Nearly all children participate in compulsory education, and participation rates at other levels is also high. The share of technical upper-secondary students (74%) is also high, which can promote better school-to-work transitions. However, young people need better labour market integration. They face three times the unemployment rate of adults over age 30, and 23% of them are in low-wage occupations. The lack of better employment prospects acts as a push factor in decisions to migrate abroad. Although migration can be mobilised to foster development at home, it risks compounding the demographic pressures of population ageing.

Despite the financial crunch COVID-19 will present, Serbia cannot afford to miss opportunities for investing in its human capital. Fiscal consolidation was necessary after the 2008 financial crisis and the recession that followed the 2014 floods. The pattern of consolidation has already prevented the expansion of social spending and led to poor outcomes, especially in the health sector. Many public services do not yet operate at their full potential: the education system achieves better test scores for high school students than neighbouring economies but fails to equip students with sufficient job-relevant skills. The social protection system is relatively good in terms of coverage, but transfers (e.g. pensions, social assistance) are generally too low to prevent material deprivation for all. At the same time, the financial sustainability of social protection and the ease of accessing services need to be reviewed. The People section in Chapter 17 identifies five major bottlenecks to the well-being of Serbia's population (Table 15.1).

Figure 15.4. People – progress towards the SDGs in Serbia

Progress towards 2030 SDG targets, 2000 to 2019 or latest available year

	SDG	2000	2019 or latest available year	2030 target
Poverty headcount ratio at USD 1.9 per day (2011 PPP) (% of population)	1 NO POVERTY	5.6% (2012)	5.5% (2017)	0%
Prevalence of undernourishment (% of population)	2 ZERO HUNGER	6.0% (2006)	5.7% (2017)	0%
Life expectancy at birth, total (years)	3 GOOD HEALTH AND WELL-BEING	71.6	75.9 (2018)	80.1 [a]
Adult literacy rate, population age 15+ years, both sexes (%)	4 QUALITY EDUCATION	98.0% (2011)	98.8% (2016)	100%
Proportion of seats held by women in national parliaments (%)	5 GENDER EQUALITY	12.0% (2006)	37.7%	50%
Income share held by bottom 20%	10 REDUCED INEQUALITIES	4.7 (2012)	5.2 (2017)	9.9 [b]



Notes:

a. The target is the latest available average performance of OECD countries. Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.

b. The target is the latest available average performance of top 3 OECD performers. For income share held by bottom 20%, the top performers are the Czech Republic (10.2%), Slovenia (10%) and Finland (9.4%).

Sources: UNSD (2020[25]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; UNESCO (2019[9]), “UNESCO Institute for Statistics”, http://uis.unesco.org/; UN IGME (2020[26]), *Levels and Trends in Child Mortality*, https://childmortality.org/; IPU (2020[27]), *Inter Parliamentary Union (database)*, www.ipu.org/; WHO (2019[28]), *Tracking Universal Health Coverage: 2019 Global Monitoring Report*, www.who.int/healthinfo/universal_health_coverage/report/2019/en; World Bank (2020[10]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Table 15.1. People – five major constraints to leaving no one behind in Serbia

1. Young people, women and some ethnic minorities often lack opportunities to participate in the labour market.
2. More investment in teachers’ capacities, a curriculum update and better co-ordination with the productive sectors are needed to equip students with job-relevant skills.
3. Pension and social assistance transfers are too low to prevent poverty.
4. Social protection financing is inadequate and over-reliant on (frequently evaded) social security contributions.
5. Complicated administrative procedures and strict eligibility designs prevent easy access to social safety nets.

Prosperity – boosting productivity

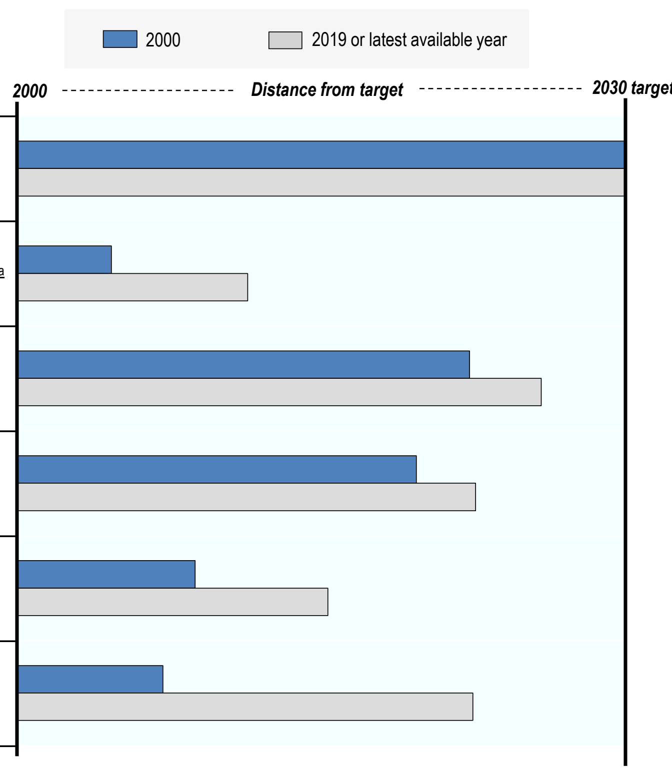
Over the past decade, Serbia has made considerable progress in building a more competitive market economy. Thanks to the return of macroeconomic stability, advancements in the structural reform agenda and strengthening of the institutional framework, Serbia is now better placed to seek out a higher and more sustainable growth trajectory based on economic upgrading and smart specialisation. The strong improvements in access to digital services and investment in research and development (R&D) in line with the 2030 Agenda over the past decade (Figure 15.5) support this growth prospect.

A number of outstanding structural constraints need to be addressed to accelerate economic convergence with aspirational peers in the European Union. These include creating a more enabling business environment for investment, in particular through public administration reform: improving the quality and transparency of the regulatory process, reducing the adminsitrative burden on business and reducing corruption. Increasing the capacity of the judiciary to deliver greater legal certaininty without unreasonable delay is also important. Serbia can also make more progress on leveling the playing field for all actors by reducing market dominance in key sectors and reducing the size and distortiveness of state aid. Economic upgrading and smart growth will also require strengthening the skills of its workforce and strengthening the capacities of businesses to innovate and adopt new technologies.

Figure 15.5. Prosperity – progress towards the SDGs in Serbia

Progress towards 2030 SDG targets, 2000 to 2019 or latest available year

Indicator	SDG	2000	2019 or latest available year	2030 target
Access to electricity (% of population)	7 AFFORDABLE AND CLEAN ENERGY	100 (2002)	100 (2018)	100
Agriculture value added per worker (constant 2010 USD)	8 DECENT WORK AND ECONOMIC GROWTH	3 035	7 419	19 537 a
Wage and salaried workers, total (% of total employment)	8 DECENT WORK AND ECONOMIC GROWTH	62.2	72.1	83.6 a
Account at a financial institution (% age 15+)	8 DECENT WORK AND ECONOMIC GROWTH	62.2 (2011)	71.4 (2017)	94.7 a
Researchers in R&D (per million people)	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	1 196 (2007)	2 087 (2018)	4 079 a
Individuals using the Internet (% of population)	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	23.5 (2004)	73.4 (2018)	97.8 b



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For individuals using the nternet (% of population), the top performers are Iceland (99%), Denmark (97.3%) and Luxembourg (97.1%).
Sources: UNSD (2020[25]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; ILO (2020[6]), *ILOStat* (database), https://ilostat.ilo.org/data/; UNESCO (2019[9]), “UNESCO Institute for Statistics”, http://uis.unesco.org/; UN-Habitat (2020[29]), UN-Habitat Data and Analytics, https://unhabitat.org/knowledge/data-and-analytics; RICYT (2020[30]), *RICYT* (database), www.ricyt.org/en/; World Bank (2020[10]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; World Bank (2019[31]), *Sustainable Energy for All* (database), https://databank.worldbank.org/source/sustainable-energy-for-all/preview/on.

Table 15.2. Prosperity – three major constraints to a more dynamic economy of Serbia

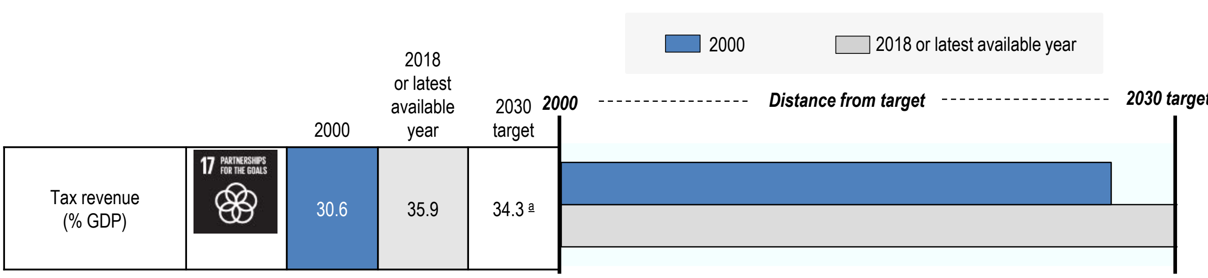
1. Weak investment and productivity growth impede income convergence with the European Union.
2. Investment is hampered by weaknesses in the administrative and regulatory environment, corruption and weak competition.
3. Economic upgrading and smart specialisation are constrained by weaknesses in the skills profile of the workforce.

Partnerships and financing – financing sustainable development

To improve financing for development, Serbia needs to improve the composition and quality of public spending and diversify the financing options for small and medium-sized enterprises (SMEs), especially start-ups and microenterprises. In light of recent achievements in fiscal consolidation, which include stemming the growth of current expenditures and improving revenue performance (Figure 15.6), there is scope for higher capital expenditures and their deployment towards priority needs that can increase investment, productivity and long-term growth prospects. These efforts need to be complemented by reforms and support instruments to diversify financing options for SMEs, particularly small enterprises and start-ups, which are currently underserved by the banking sector. Measures in this regard have been implemented as a response to the COVID-19 pandemic, including the creation of a portfolio guarantee scheme for SMEs and regulatory reform to ease corporate bond emissions. Other necessary measures include supporting the development of capital markets, microfinance institutions, venture capital, business angels and other alternative funding mechamisms to offer adapted modes of finance for SMEs and innovative new firms, buildling on recent legislation on open-ended funds with a public offering and alternative investment funds.

Figure 15.6. Partnerships and financing – progress towards the SDGs in Serbia

Progress towards 2030 SDG targets, 2000 to 2019 or latest available year



Note: a. The target is the latest available average performance of OECD countries.
Sources: Ministry of Finance of the Republic of Serbia (2020[32]), *Macroeconomic and fiscal data, December 2020* (database), www.mfin.gov.rs/en/documents/macroeconomic-and-fiscal-data/; World Bank (2020[10]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Table 15.3. Partnerships and financing – three major constraints to financing development in Serbia

1. Low domestic savings have constrained investment, an impact only partially offset by external financing inflows.
2. Stronger growth in capital expenditures is needed, alongside more binding limits on current spending.
3. More diversified financing options are needed to support start-ups and SME innovation and growth.

Peace and institutions – strengthening governance

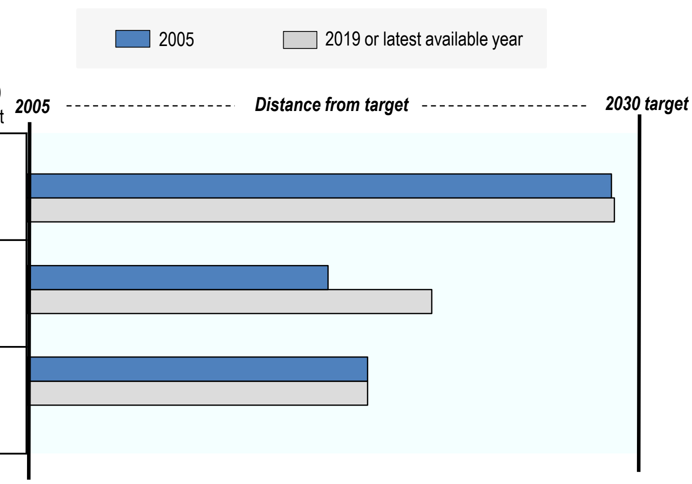
Serbia's institutions have made progress since the beginning of the democratic transition. The country has engaged in a comprehensive reform that aims at increasing the efficiency of the civil service.

Service delivery and human resource management has been improving since 2017 (OECD, 2020[33]) Serbia's appeal to investors has been increasing thanks to an improving business regulatory environment. Trust in government has increased since 2007: 48% of the citizens of Serbia reported that they had confidence in the national government. Confidence in the judiciary, although still low, has been increasing with respect to 18 years ago (Figure 15.7). Moreover, Serbia is perceived as a very safe country. The intentional homicide rate (1.2 victims per 10 000 population) is declining and among the lowest in the region (together with Bosnia and Herzegovina and North Macedonia).

Figure 15.7. Peace and institutions – progress towards the SDGs in Serbia

Progress towards 2030 SDG targets, 2000 to 2019 or latest available year

		2005	2019 or latest available year	2030 target
Intentional homicides (per 100 000 people)	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	1.6	1.1 (2017)	0.4 b
Confidence in the judiciary (% of respondents)	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	29% (2006)	39%	57 a
Corruption perception index	16 PEACE, JUSTICE AND STRONG INSTITUTIONS	39 (2012)	39	68 a



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For international homicides rate, the top performers are Japan (0.26), Luxembourg (0.34), and Norway (0.47).
Sources: UN-CTS (2020[34]), *Sustainable Development Goals* (database); World Bank (2020[10]), *World Development Indicators* (database); Transparency International (2019[8]), *Corruption Perceptions Index 2019* (database), www.transparency.org/en/cpi/2019/results/.

Moving forward, Serbia's capacity to promote durable and inclusive development depends on achieving three main strategic goals (Table 15.4). First, the independence of the judiciary needs to be further protected to ensure that it plays its role as a control on the executive and legislative powers and thus contribute to strengthening democratic institutions. Moreover, judges need more skills to better enforce laws that uphold competition in markets. Second, Serbia needs a harmonised regional development and decentralisation framework to reverse the "Belgradization process", promote balanced regional development and leave no one behind, anywhere. Third, Serbia has to pursue the professionalisation of its public sector. This could help discourage patronage and corruption and enhance civil servants' incentives to plan long term.

Table 15.4. Peace and institutions – three major constraints to enhancing the quality of institutions in Serbia

1. The judiciary lacks independence and has limited capacity.
2. Fragmented decentralisation and regional development frameworks undermine the balanced development of local communities.
3. The public administration continues to be politicised.

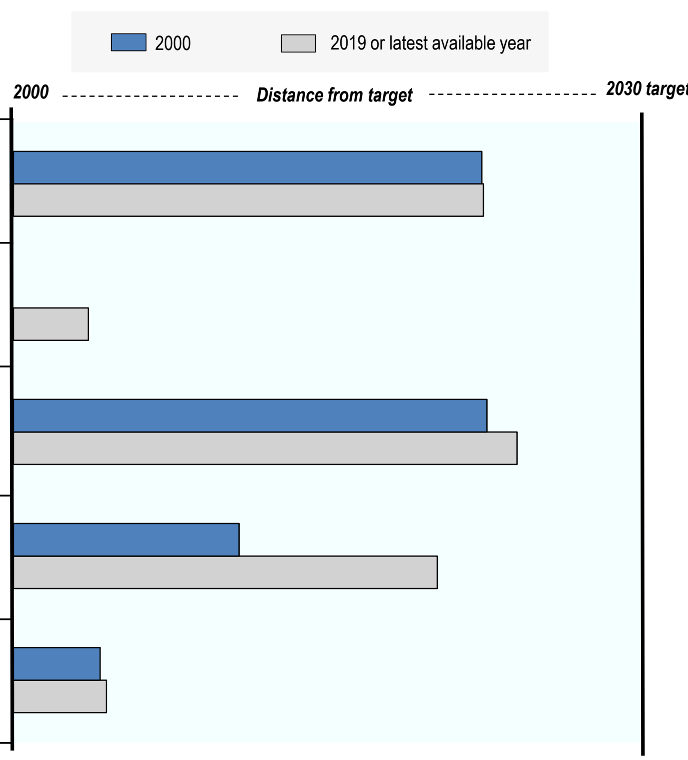
Planet – conserving nature

Environmental quality is a major source of concern in Serbia (Figure 15.8**).** While a large share of the population has access to drinking water, water quality is low and poses a threat to the health of citizens. Improvements in water governance and the establishment of an independent environmental agency are key to improving water quality. Air pollution is particularly high; Belgrade is one of the most polluted capitals in Europe. In 2009, Serbia adopted a normative framework on air protection, but implementation is lagging. Serbian authorities need to adopt a more systematic and integrated approach to tackle and reduce significantly the impact of air pollution in the country. Climate change and natural hazards may exacerbate negative environmental outcomes, urging the country to diversify its energy mix. Serbia remains highly dependent on coal and lacks a coherent long-term strategy that combines energy and climate targets. Serbia has set targets to increase the share of renewable energy sources in final energy consumption to 27% by 2020 and to reduce greenhouse gas emissions by 9.8% with respect to the 1990 baseline by 2030. The preparation of the National Energy and Climate Plan should remedy the lack of long-term objectives and planning for emissions and the energy sector.

Figure 15.8. Planet – progress towards the SDGs in Serbia

Progress towards 2030 SDG targets, 2000 to 2019 or latest available year

	2000	2019 or latest available	2030 target
People using safely managed drinking water services (% of population)	74.5	74.7 (2017)	100
Electricity production from renewables (%, excluding hydro)	0.0	2.6	21.5 [a]
Mean annual concentration of PM2.5 weighted by population (µg/m3)	29.2	24.7 (2017)	6.0 [b]
CO_2 intensity of GDP (kg CO2 per unit of GDP in 2017 USD PPP)	0.69	0.38 (2018)	0.07 [b]
Terrestrial protected areas (% of total land area)	6.2 (2016)	6.6 (2018)	44.7 [b]



Notes:
a. The target is the latest available average performance of OECD countries.
b. The target is the latest available average performance of top 3 OECD performers. For mean annual concentration of PM2.5 weighted by population, the top performers are Finland (5.9%), New Zealand (6%) and Sweden (6.2%). For CO2 emissions, the top performers are Sweden (0.062), Switzerland (0.064), and Norway (0.078). For territorial protected areas, the top performers are Slovenia (53.6%), Luxembourg (40.9%) and Poland (39.7%).
Sources: UNEP (2020[35]), *Environment Live/Global Material Flows* (database), www.resourcepanel.org/global-material-flows-database; UNSD (2020[25]), *Sustainable Development Goals* (database), https://unstats.un.org/sdgs/indicators/database/; IEA (2018[36]), *World Energy Balances*, www.iea.org/reports/world-energy-balances-overview; OECD (2020[37]), *Green Growth Indicators* (database), https://stats.oecd.org/Index.aspx?DataSetCode=GREEN_GROWTH; UNEP-WCMC (2018[38]), *World Database on Protected Areas*, https://www.protectedplanet.net/; WHO/UNICEF (2020[39]), *JMP for Water Supply, Sanitation and Hygiene*, http://washdata.org/; World Bank (2020[10]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

Table 15.5. Planet – three major constraints to a more sustainable path in Serbia

1. Serbia is exposed and vulnerable to natural hazards.
2. Poor environmental quality affects the lives of all citizens of Serbia
3. High dependence on coal is holding back sustainable development.

Strategic priorities for development in Serbia

To achieve rapid, inclusive and sustainable development, Serbia will need a development strategy that establishes a vision for the future of Serbia, builds on the country's assets and opportunities and addresses its most pressing constraints. The preparation of Serbia's development plan, to be drawn up for the first time in application of the Law on the Planning System of the Republic of Serbia, is an opportunity to establish such a development strategy and to materialise it in the highest level long-term planning instrument in the country. The vision and key constraints presented in this assessment can serve as a basis for a process of priority setting along these lines.

The necessary concerted action to recover from the COVID-19 crisis is an opportunity to set a clear course for a brighter future for the country. Following the period of rapid growth in the first decade of the 2000s, Serbia had to overcome three recessions linked to the 2008 global financial crisis, a second dip linked to public financial distress in Europe in 2012 and very significant flooding in 2014. Having recovered from the 2014 recession with a stabilised macroeconomic and public finance situation, the country today retains some margin for intervening to lead a new recovery. In implementing a sizeable fiscal stimulus package, the country has an opportunity to steer the pace and direction of structural transformation in a way that best contributes to achieving its vision for the future.

The process of integration into the European Union is a key strategic objective for Serbia and a key asset in its development. The strategic importance of EU accession is clearly stated in key planning and policy documents, including the National Programme for the adoption of the EU acquis, Serbia's successive economic reform programmes (ERPs) (Government of the Republic of Serbia, 2019[40]) and successive needs assessment documents to orient international development assistance (Government of the Republic of Serbia, 2014[41]) but also in declarations of Serbian officials at the highest level. This process grants mutual market access, provided under the Stabilisation and Association Agreement and the special preferences granted by the European Union to Western Balkan economies. The integration process started formally in 2014 and had led to opening 18 of the 35 negotiation chapters by mid-2019, two of which (Science and Research, and Education) are closed. This process has brought momentum to key areas of policy reform on top of the impetus provided by internal considerations in Serbia. The centrality of EU accession in Serbia's development policy has not prevented the country from building solid partnerships with other players, including the People's Republic of China (hereafter 'China'), Russia and the United Arab Emirates.

For EU integration to drive Serbia's development policy, public support and the progressive normalisation of relations with Kosovo are critical. Public support for EU membership has waned over the years. The share of citizens supporting EU accession has fallen from a high of 73% in 2009 to 53% in June 2019 while remaining well above the share of those opposing accession (Ministry of European Integration, 2019[42]). Normalisation of relations with Kosovo remains a highly contentious issue in Serbia, and differences within EU member states do not help clarify what will be required should an accession decision be tabled. While technical agreements have been reached among the parties, the dialogue process, held under the auspices of the European Union and some of its member states, has often stalled. In this respect, the prospect of EU integration is an important factor in ensuring normalisation can happen (Huszka, 2020[43]).

A second key strategic axis for Serbia's development is fostering structural transformation towards a knowledge economy competitive in higher value added sectors. Serbia can build on the foundations laid over the past two decades, including improved macroeconomic stability and considerable FDI attraction, to strengthen investment and productivity growth. Upgrading the economy can be achieved through a combination of attracting FDI in higher value added activities, where current FDI incentives favour labour-intensive industries (see the Prosperity section in Chapter 17), and supporting deeper and wider integration of domestic SMEs with the FDI sector and global value chains (GVCs).

A key line of action to achieve industrial upgrading is to strengthen Serbia's human capital and skills system. The country has a solid base for upgrading its human capital: participation in compulsory education is almost universal, and the country performs better than its neighbours on tests of learning outcomes, such as PISA (see the People section in Chapter 17). However, the system does not equip the majority of students for the labour market, as long and difficult school-to-work transitions and enterprise surveys suggest. Strengthening human capital and the capacity of domestic firms to innovate and adopt new technologies is critically important for the development of sectors with higher technological content and higher value added.

Focusing support on the conditions necessary for the emergence of key transformational industries can foster economic upgrading and structural transformation. To this end, Serbia needs to overcome key obstacles in the business environment in order to make markets contestable and attractive. This will require strengthening recent reforms in the competition and state support domain, as well as further decided action on corruption. Serbia can also build on recent successes to ensure that sectors with productive and export potential, such as information and communications technology (ICT), agriculture and food processing, machinery, electronics, etc., thrive. This will require support for innovation and its framework conditions, including the links between universities and productive sectors and the development of appropriate financing instruments for start-ups and innovation. The recently adopted Smart Specialisation Strategy, which identifies high-potential sectors for development across all the regions of Serbia, is an important step in setting out the vision and path for economic development and upgrading in Serbia.

A third key strategic axis is to develop further the policy instruments that can make the development process more inclusive of all citizens, fostering social cohesion. Incomes before taxes and transfers are very unequal in Serbia, reflecting overlapping inequality in access to economic opportunities along gender, geographic, age and ethnic lines. Young people's and women's labour market outcomes are worrisome, as they also reflect an underutilisation of key productive assets. Certain groups, especially Roma and Bosniaks living in non-urban areas, face overlapping deprivations, including in access to education, labour market opportunities and public services.

Territorialised economic development policies and improved skills development policies can contribute to creating opportunities for all. Regional disparities remain large in Serbia, and the lack of a harmonised regional development framework makes it difficult to ensure that territories can make the most of their comparative advantages. Appropriate development of key infrastructure, for example, can help ensure that, while more developed regions follow a higher value added development strategy, regions with comparatively abundant labour can exploit their cost advantage in labour-intensive manufacturing sectors for a period of time. Likewise, the necessary improvement in skills development policies (through education, training and active labour market policies) is critical to ensure equality of opportunities for all.

Resourcing social policies is a key condition of improving their effectiveness. The fiscal consolidation process has taken its toll on social sectors, lowering expenditure on health, education and social transfers as a share of GDP. While transfers contribute to significantly lowering income inequality to levels common in EU countries, the limited coverage rate of social assistance and the relatively small size of social assistance transfers do not suffice to curtail poverty significantly. Social protection relies in large part on payroll tax funding, which is challenging in an economy with relatively high informality and payroll tax evasion rates.

Whatever its strategic direction, Serbia will need to ensure it maintains macroeconomic stability. Following a period of rapid but unbalanced growth up to the 2008 financial crisis and the recessions that followed, Serbia has managed to build a stable macroeconomic environment. Macroeconomic stability has contributed to stronger investment and export growth. The fiscal consolidation process put a limit on public capital investment and put social sectors under strain. At the same time, it generated fiscal room to manoeuvre at a critical juncture. The country could benefit from rules-based fiscal policy to ensure an appropriate balance between current and capital expenditure, ensure that public investment encourages private domestic investment and allow for countercyclical policy when it is needed.

To implement its forthcoming National Development Plan, Serbia will also need to tackle outstanding issues in public governance and administration. As documented in the Peace and institutions section in Chapter 17, Serbia has made progress in public administration reform, recently reformed its planning architecture and has set up a legal framework to fight corruption and abuse of power. However, capacity building is needed for effective implementation. Serbia still needs to improve regulatory transparency and stability, reduce red tape and effectively tackle corruption to encourage investment through more contestable and competitive markets. Strengthening the effectiveness and independence of the judiciary is not only important to improve investment prospects but also a key item in an agenda to strengthen the rule of law in Serbia. Increased administrative efficiency and rules-based policy would also reduce the burden of accessing social benefits, making them more effective in fighting poverty and exclusion.

Last, progress in all three strategic priorities will require that the next stage of development in Serbia be greener and more climate resilient. High air and water pollution lead to Serbia having a sizeable death burden due to air pollution and particularly low citizen satisfaction with the quality of water for its income level. In a knowledge-based economy, agglomeration effects are particularly important, with access to talent pools driving the location of knowledge activities and talented professionals. Establishing adequate environmental quality of life is necessary for Serbia's would-be high-tech cities to become truly cosmopolitan centres. Given Serbia's mineral wealth and its reliance on coal-fired thermal power plants, addressing the environmental sustainability of Serbia's development requires first and foremost aligning energy policy with environmental sustainability objectives and commitments. The development of an integrated energy and climate plan can contribute. Addressing environmental sustainability will also require improvements in the enforcement of existing environmental protection provisions.

Box 15.3. Serbia's integration towards the European Union

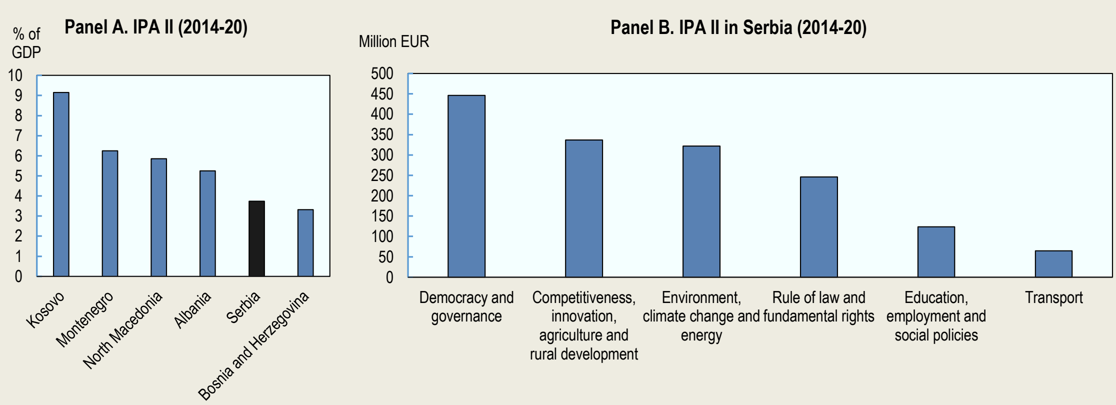
The process towards integration with the European Union has been an important driver of democratisation and institution building in Serbia and has provided the country with large financial and technical support for its development and for regional integration. As part of the process, Serbia has worked to bring its legislation in line with the existing body of EU laws and standards (known as the acquis), in particular through the National Programme for the Adoption of the Acquis (NPAA), a comprehensive work plan for the harmonisation of Serbian laws and regulations to ensure alignment with EU standards. The NPAA is currently in its third revision, adopted in 2018, with a horizon to ensure full alignment by 2021.

Considering Serbia's progress in implementing political and economic reforms, the European Council approved Serbia's candidacy status in March 2012. In line with the decision of the European Council in June 2013 to open accession negotiations with Serbia, the Council adopted in December 2013 the negotiating framework and agreed to hold the first Intergovernmental Conference with Serbia in January 2014 (European Commission, 2020[44]). Since the opening of Serbia's accession negotiations in January 2014, 18 out of 35 chapters have been opened, two of which are provisionally closed. The overall pace of negotiations will continue to depend in particular on a more intense pace of rule of law reforms and on progress in Belgrade-Pristina dialogue. More specifically, the European Commission recently underlined several areas where progress is required, including improving effectiveness and independence of parliament, addressing the overall environment for freedom of expression, speeding up structural reforms of state-owned enterprises (SOEs), increasing the quality and relevance of education and training and aligning public procurement with EU rules and standards (European Commission, 2020[45]).

Through the Stabilisation and Association Process (SAP) since 1999, Serbia and the economies in the region have been involved in a progressive partnership with the European Union. The SAP rests on the following pillars: bilateral Stabilisation and Association Agreements; trade relations (wide-ranging trade agreements); financial assistance (the Instrument for Pre-accession Assistance [IPA]); and regional co-operation such as the Central European Free Trade Agreement (CEFTA):

- The Stabilisation and Association Agreement with Serbia, which entered into force in September 2013, governs relations between Serbia and the European Union. The Agreement offers various benefits to citizens and businesses in Serbia (such as visa-free travel), supporting institutional and democratic reforms and encouraging good neighbourly relations and trade (European Commission, 2020[46]).
- The IPA has been instrumental in providing Serbia assistance in reforms through financial and technical help. IPA II (for 2014-20) accounted for 3.7% of GDP in Serbia (EUR 1 539.3 million [euro]) (Figure 15.9 – Panel A). Serbia is the largest recipient of IPA funds in the Western Balkans in absolute terms, while it is the second smallest recipient in relative terms. Most of the IPA II funds (28.9% or about EUR 446.4 million) have been allocated to strengthening democracy and governance (Figure 15.9 – Panel B).

Figure 15.9. Most of IPA II funding went to areas supporting democracy and governance



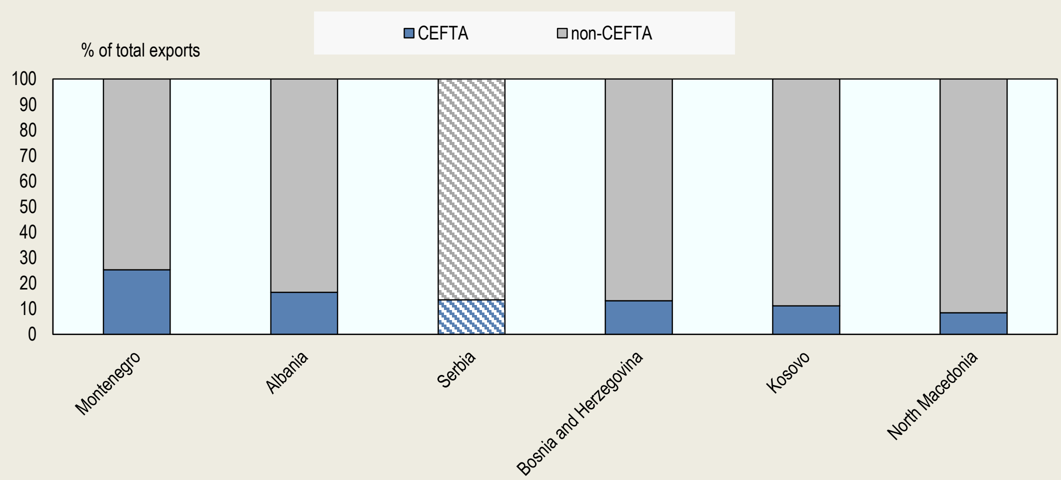
Source: Authors' elaboration based on European Commission (2020[47]), "Serbia – financial assistance under IPA II", https://ec.europa.eu/neighbourhood-enlargement/instruments/funding-by-country/serbia_en.

StatLink https://doi.org/10.1787/888934245063

- Regional co-operation has been another important driver in the SAP for developing infrastructure and networks in the region and establishing a free trade area between Serbia and other economies. Key regional initiatives include the CEFTA, the Energy Community, the Western Balkans Investment Framework and the Regional Cooperation Council. The CEFTA, an international trade agreement among economies in South East Europe, was one of the means of facilitating trade in the region and harmonising trade-related legislation with the European Union. The share of exports from Serbia to CEFTA economies in the Western Balkans increased from 6.5% in 2012 to 13.5% in 2018 (Figure 15.10). In 2019, 45.5% of Serbian exports to CEFTA economies went to Bosnia and Herzegovina (CEFTA, 2020[48]).

Figure 15.10. The role of the CEFTA in Serbia

Shares of exports to CEFTA and non-CEFTA countries, 2019



Source: CEFTA (2020[48]), *Trade in goods* (dataset), https://statistics.cefta.int/goods.

StatLink https://doi.org/10.1787/888934245082

The New Enlargement Package and the adoption of the Economic and Investment Plan have set new directions for EU integration and recovery from COVID-19. Building on the Western Balkan strategy from 2018 (European Commission, 2018[49]), the new Enlargement Package, adopted on 6 October 2020, stresses the need to improve the EU integration process to be better equipped to deal with structural weaknesses in Serbia and other Western Balkan economies. In parallel, the European Commission adopted the Economic and Investment Plan to spur the long-term economic recovery of Serbia and the region, support a green and digital transition and foster regional integration and convergence with the European Union. The support is crucial, especially in light of both the COVID-19 impact and existing challenges, such as weak competitiveness and high unemployment. The Plan will mobilise up to EUR 9 billion of IPA III funding for 2021-27. A large majority of this support would be directed towards key productive investments and sustainable infrastructure in the Western Balkans through the ten flagship initiatives. Through the Western Balkans Guarantee facility, the ambition is to raise additional investments of up to EUR 20 billion (European Commission, 2020[50]; European Commission, 2020[51]).

Note: A first set of projects is articulated around ten flagship investment initiatives, including investments in transport infrastructure projects connecting east to west, infrastructure projects connecting north to south, renewable energy, transition from coal, connecting coastal regions, building renovations, waste and water management, digital infrastructure, supporting the competitiveness of the private sector, and youth support.
Source: European Commission (2020[44]; 2020[45]; 2020[46]; 2020[50]; 2020[51]); (European Commission, 2018[49]); (CEFTA, 2020[48]).

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Notes

[1] PISA measures 15-year-olds' ability to use their reading, mathematics and science knowledge and skills to meet real-life challenges (OECD, 2020[7]).

[2] The Multiple Indicator Cluster Survey survey asks household heads about their ethnic origin. This group corresponds to households whose heads identify as Bosniak (Bošnjak) in their responses to the survey.

16 Impact of COVID-19 in Serbia

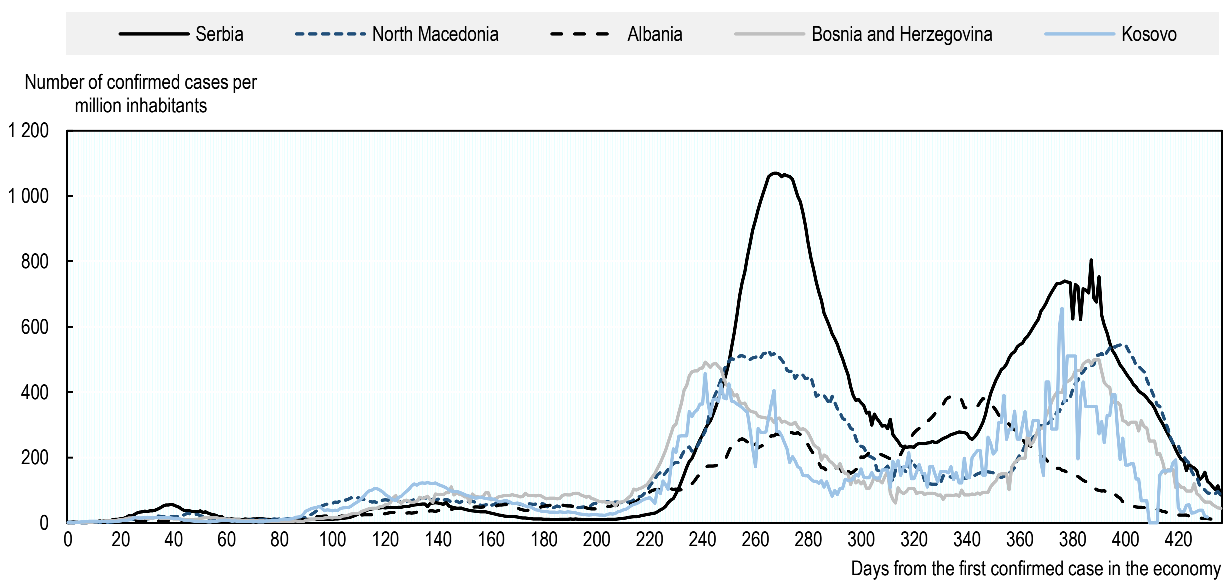
The COVID-19 pandemic and its economic consequences have had a relatively moderate impact on Serbia’s population and economy so far. The authorities acted quickly to contain the virus during the first wave of the pandemic. They also mobilised sizeable fiscal resources to mitigate the impact of illness and strict confinement measures on people and firms. This chapter reviews the sources of vulnerability and resilience that determined the impact of the crisis and that will condition the path to recovery. While the economy weathered the pandemic better than originally projected, weaknesses in the labour market and the social protection system left parts of the population unprotected. Fiscal room for manoeuvre was pivotal in allowing Serbia to respond. The crisis has also put the spotlight on structural sources of vulnerability that should receive attention as the country prepares its development strategy for the future.

Evolution of the pandemic

Serbia has experienced four waves of the pandemic. The first case of COVID-19 was reported on 6 March 2020 and the first death on 20 March. The virus progressed rapidly in Serbia: 60 days after the first registered case, there were more than 10 000 – the highest number in the region – and 38 registered deaths from COVID-19 per million inhabitants, compared to 13 in Albania, 53 in Bosnia and Herzegovina, 20 in Kosovo and 137 in North Macedonia. The economy suffered a second wave from early June to mid-September, a third wave from October to December 2020 with significantly higher incidence rates and a fourth wave from mid-February to end of April 2021 (Figure 16.1). As of 21 May 2021, the economy counts an accumulated 900 233 cases (or 103 254 per million inhabitants) and 8 649 registered deaths (or 992 per million inhabitants), which is the second-lowest mortality rate in the region (Figure 16.2). The fatality rate (0.99%) is the lowest compared to other Western Balkan economies. The official figures might underestimate the real human cost of the pandemic insofar as positive tests are required to classify a death as due to COVID-19.

Figure 16.1. Serbia suffered several waves of infections

Number of confirmed daily cases per million inhabitants, rolling seven-day average

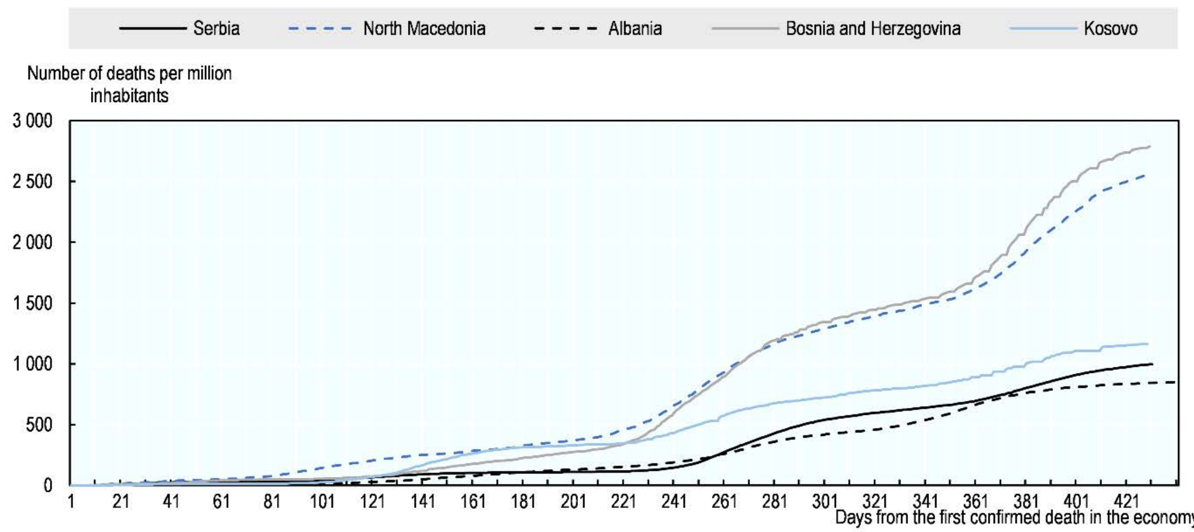


Note: Serbia reported its first COVID-19-related case on 6 March 2020.
Source: Authors' calculation based on Our World in Data (2020[1]), Our World in Data website, https://ourworldindata.org/.

StatLink https://doi.org/10.1787/888934245101

Figure 16.2. Serbia has the second-lowest mortality rate attributed to COVID-19 in the region

Cumulative number of registered deaths per million inhabitants



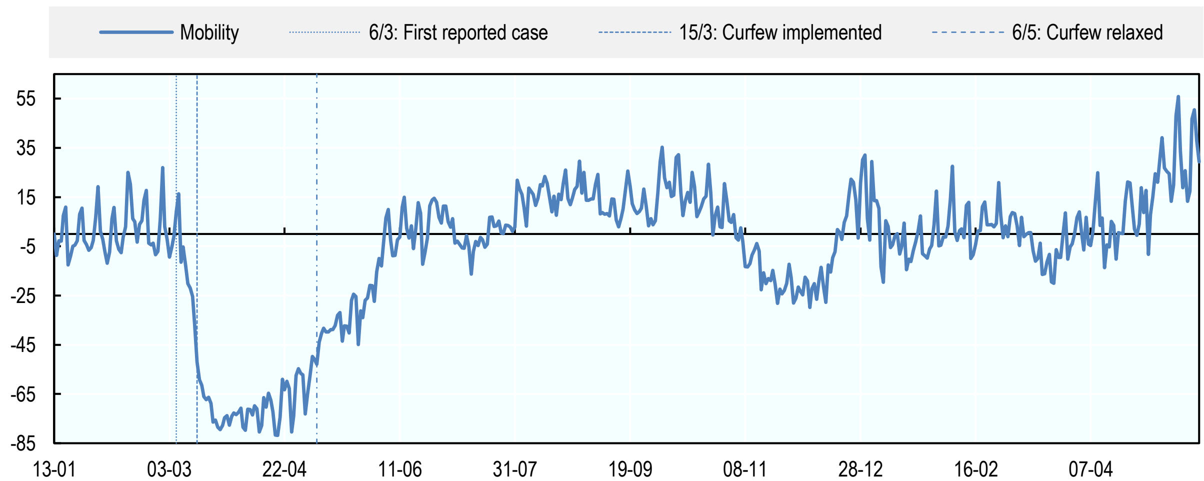
Note: Serbia reported its first COVID-19-related death on 20 March.
Source: Authors' calculation based on Our World in Data (2020[1]), Our World in Data website, https://ourworldindata.org/.

StatLink https://doi.org/10.1787/888934245120

Serbia acted quickly to prevent the spread of the virus, but some measures triggered social tensions. The government declared a national state of emergency on 15 March 2020 and implemented a lockdown, prohibiting movement of citizens during the weekends and between 5:00 pm and 5:00 am on weekdays, with a total ban for senior citizens. Borders, public areas, parks and shopping malls were closed; grocery stores and pharmacies remained open. The measures were effective and led to about an 80% decrease in movements throughout Serbia with respect to February, before the first case was registered (Figure 16.3). The government lifted the curfew on 6 May but announced weekend curfews on 7 July because of the new wave of contagion. The new measures, however, triggered social tensions and were ultimately repealed. With the third wave, the government introduced a series of new measures limiting opening hours for certain businesses and implementing online classes for schoolchildren in grades 5 and above.

Figure 16.3. Policies: efficient restrictions reduced mobility of people

Mobility patterns throughout the crisis



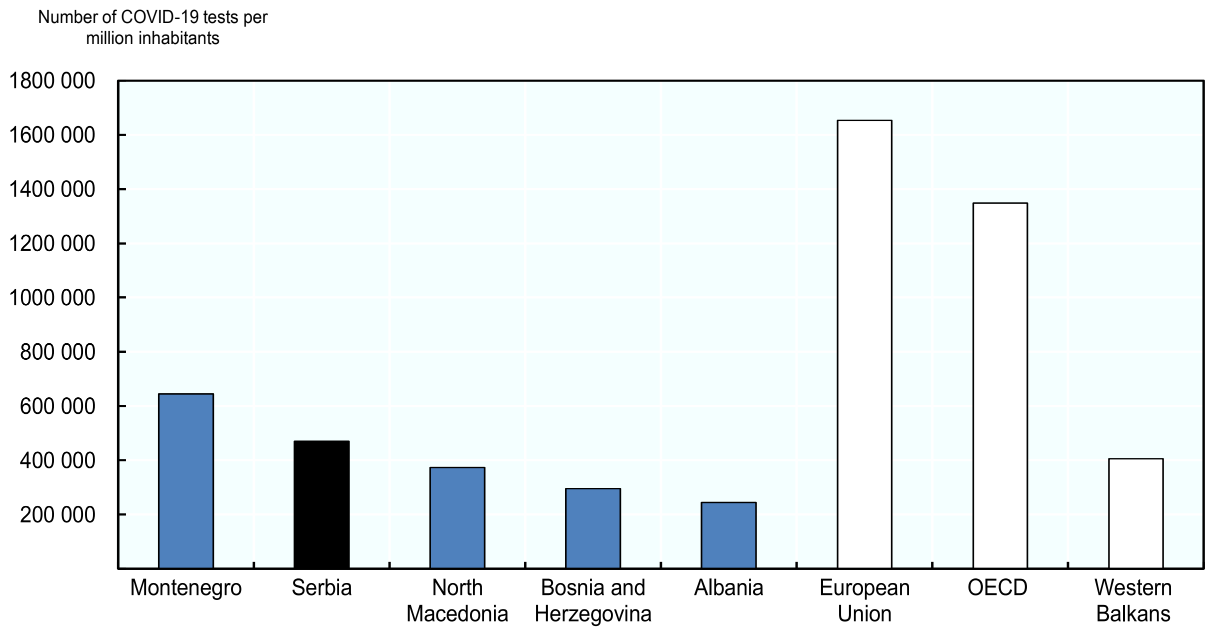
Notes: The chart shows the relative volume of requests for directions compared to a baseline volume on 13 January 2020, as recorded by Apple. Moreover, it shows, in chronological order, the first COVID-19-related case reported in Serbia (6 March), the date of implementation of the curfew (15 March), and the first stage of relaxation of the curfew (6 May).
Source: Authors' elaboration based on Apple (2020[2]), *Mobility Trends* (dataset), www.apple.com/covid19/mobility.

StatLink https://doi.org/10.1787/888934245139

Serbia has also stepped up its testing and vaccine capacity. It was conducting the second largest number of tests compared to the rest of the region (469 421 tests per million inhabitants by the latest available data) and was carrying out over 20 000 tests per day for most of early December 2020 (Figure 16.4). Enhancing the timely detection of new potential cases and hotspots is critical in order to strengthen the economy's health resilience. With 28 people fully vaccinated per hundred inhabitants by the latest available data, vaccine capacity in Serbia by far the highest in the region and also strongly outpaces both the OECD and EU averages (Figure 16.5).

Figure 16.4. Policies: strengthened testing capacity

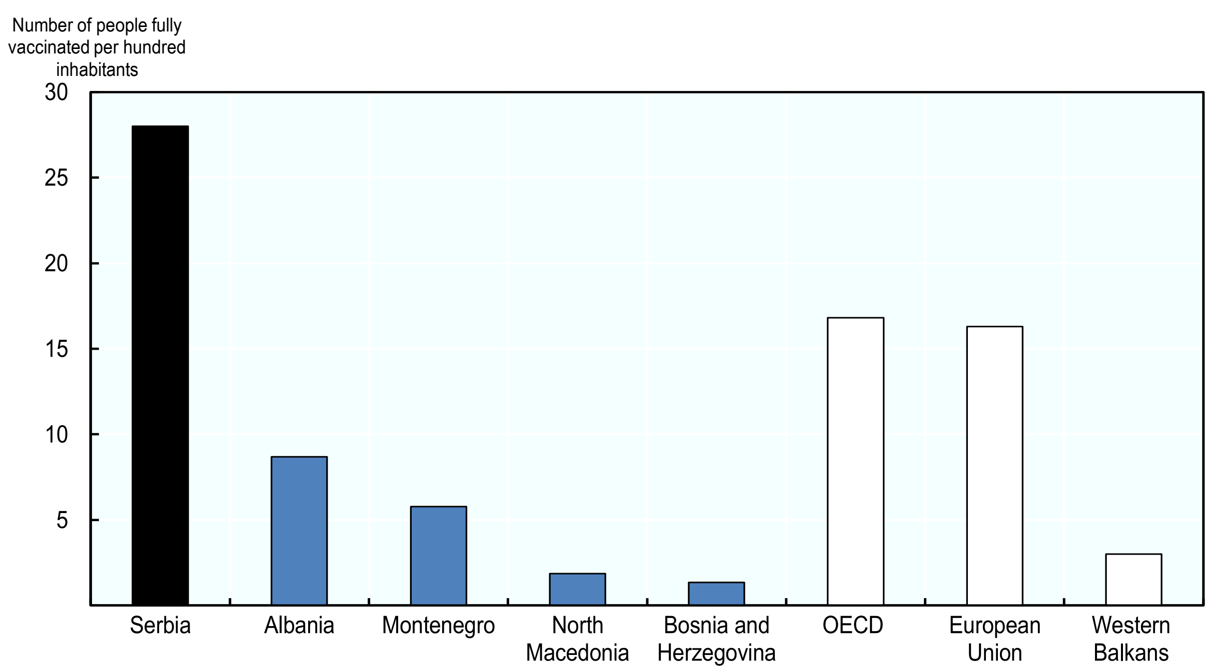
Number of COVID-19 tests per million inhabitants



Notes: Data as of 7 January 2021. Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.
Source: Worldometer (2020[3]), "Coronavirus", www.worldometers.info/coronavirus/.

StatLink https://doi.org/10.1787/888934245158

Figure 16.5. Vaccine capacity in Serbia strongly outpaces both the OECD and EU average



Note: Last reported numbers are from May 2021.
Source: Worldometer (2020[3]), "Coronavirus", www.worldometers.info/coronavirus/.

StatLink https://doi.org/10.1787/888934246944

Policy responses and economic impact

The government has taken a series of measures to mitigate the negative impact of the crisis on the economy (Table 16.1**).** The government provided private enterprises with loan guarantees and tax deferrals and distributed a special universal cash transfer of EUR 100 to each citizen. The total value of the fiscal package amounted to EUR 6 billion (12.7% of GDP) with EUR 4.0 billion in direct fiscal support and expenditures and EUR 2 billion in credit guarantees and grants. Further assistance came from the Council of Europe Development Bank (EUR 200 million loan), the World Bank (EUR 100 million loan) and the European Union (EUR 93 million financial support package).

Table 16.1. Policy measures in response to the COVID-19 pandemic

People	Businesses	Health and other measures
• One-off financial assistance for all pensioners (RSD 7 billion [Serbian dinar]) and temporary benefit to beneficiaries who have exercised their rights (RSD 4 000). • Universal cash transfer of EUR 100 to each citizen older than age 18 (RSD 70 billion). • Assistance in hygiene packages and essential food products for 14 000 vulnerable women. • Programme (My first salary) to support youth employment through wage subsidies and training (RSD 2 billion). The programme target was to benefit 10 000 young graduates from November 2020. • Public-sector health workers were given a one-off assistance of RSD 10 000 (estimated total of 0.02 percent of GDP) in December 2020.	• Support to private-sector activity and employment through government payment of a net minimum wage to every employee of micro, small and medium-sized enterprises (MSMEs) for three months and two months of 60% of the net minimum wage for the same group. For larger enterprises, government payment of 50% of the minimum wage for each employee on involuntary leave for five months. • Loan guarantee schemes for the maintenance of liquidity and working capital for small business owners, SMEs and agricultural enterprises worth EUR 2 billion. • Deferral of payroll taxes and contributions over a period of four months. • Deferral of advance payments of corporate income tax for the March, April and May 2020 until the submission of final returns for fiscal year 2020. • Special call by the Serbian Innovation Fund for innovative proposals by MSMEs to respond to the pandemic. • Support to the tourism sector: 160 000 holiday vouchers distributed by the government, as well as direct aid to the hotel and leisure sector amounting to approximately RSD 1.4 billion. • Working capital loans provided by the Development Fund for SMEs to companies in the medical supplies and tourism and hospitality sectors. • The City of Belgrade decided not to charge rent for business/office space during the state of emergency. • Facilitation of eligibility criteria for loans and financial assistance provided to farmers. • The Development Fund provided loans with longer repayment periods (up to five years) to the most vulnerable sectors (hoteliers, travel agencies, etc.) to improve their liquidity and working capital.	• 10% wage increase for the public healthcare sector (RSD 13 billion) and increased healthcare spending to about RSD 12 billion. • Employment of 2 500 additional health workers (doctors and nurses). • EU package of EUR 93 million (EUR 15 million for immediate purchase and transport of medical equipment and EUR 78 million for economic recovery). • Bilateral support from Hungary and the United States for medical supplies.

Sources: OECD (2020[4]), "COVID-19 Policy Tracker", http://oecd.org/coronavirus/en/#economy-policy-tracker; OECD (2020[5]), The COVID-19 Crisis in Serbia, www.oecd.org/south-east-europe/COVID-19-Crisis-in-Serbia.pdf. IMF (2020[6]), "Policy Responses to COVID-19", www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19/.

Following a heavy recession during the first wave and lockdown, Serbia's economy weathered the crisis relatively well with significant government support. After growing by 4.2% in 2019, GDP fell by 1% in real terms in 2020, according to estimates of the Statistical Office of the Republic of Serbia (SORS, 2021[7]). After falling by 0.6% in the first quarter of 2020, GDP contracted by 9.2% in the second quarter (in seasonally adjusted terms) after lockdown and containment measures were introduced, but recovered in the third and fourth quarters (by 7.2% and 2.2% respectively). Services sectors have been the most affected during the pandemic: leisure services fell by 14.6% in real terms during 2020, professional services and administration by 9%, and wholesale and retail trade, the second largest contributor to GDP, declined by 5.2%. Despite strong quarter-on-quarter recoveries, these services sectors could not make up for lost business during the first half of the year. Manufacturing production was expected to decline due to the disruption in supply chains (World Bank, 2020[8]). While industrial sectors, excluding construction, fell by 12% between the first and second quarter, they rebounded strongly and closed the year with a 0.4% growth over 2019. Construction, on the other hand, closed the year with a 5.1% fall in value added. The recovery of certain key sectors shows their resilience in the face of sizeable disruption: exports and imports both decreased by around 20% and consumption dropped by 7.2% in the second quarter of 2020 (World Bank, 2021[9]; SORS, 2020[10]).

Coronavirus COVID-19

The analysis of policy responses to the COVID-19 pandemic does not reflect the policy development that occurred since February 2021, with the exception of the figures on testing and vaccination for which the most recent and internationally comparable data were used.

Dimensions of vulnerability to further socio-economic impact from COVID-19

A series of economic and social dimensions have made Serbia relatively vulnerable to COVID-19, while institutional weaknesses undermined the resilience of its policy response (Table 16.2). Considering pre-existing vulnerabilities can help policy makers to determine who will need help the most and to design and target policies accordingly as well as plan for the next crisis. Serbia’s health sector was relatively well equipped in terms of infrastructure to deal with the health impact of the pandemic. High unemployment and widespread informality already weaken Serbia’s economy and can slow down recovery. Moreover, they imply that a significant share of the population risked remaining without adequate health and social assistance. Exposure to foreign investors and trade could be another source of vulnerability, given how severely the virus hit Serbia’s main trade partners. The relative stability of the financial sector may become an asset for post-COVID-19 recovery. Low government effectiveness and the politicisation of the civil service may weaken the implementation capacity of the state.

Table 16.2. Serbia's socio-economic exposure and policy resilience to COVID-19

	Channels	Level of vulnerability	Signalling indicators (Latest available year is 2019 unless otherwise specified)		
				Serbia	OECD
Socio-economic exposure	Well-being	High	Household debt, loans and debt securities (% GDP)	20.6	68.3
			Poverty headcount (measured as USD 5.5 (United States dollar) per person per day, 2011 PPP) (% population)	19.3**	2.9
			Personal remittances, received (% of GDP)	8.2	0.9
			Unemployment rate	10.4	5.8
			Informal employment (% of total employment)	18.7	..
			Social protection spending (% of GDP)	19.5**	20.1
			Households without high-speed Internet access (%)	30.4	15.0
			Lack of social support (% of population)	10.0	8.6
			Life satisfaction (average score on 0-10 scale)	6.2	6.7
	Health risks	Medium	Adult smoking prevalence (%)	40.7*	24.9
			Adult obesity prevalence (%)	21.5***	20.8
	Trade	High	Merchandise trade (% of GDP)	89.1	58.3
			External balance on goods and services (% of GDP)	-10.0	0.46
	Investment	Medium	Microenterprises (1-9 employees) (% among total enterprises)	75.0**	78.7
			FDI, net inflows (% in GDP)	8.3	1.8
	Tertiary sector	Low	Tourism (% in GDP)	6.9	8.8
	Financial and monetary	Low	Non-performing loans (% total loans)	4.1	2.9
			Foreign currency reserve (number of months of imports)	5.0	..
			Capital adequacy ratio (%)	22.3	18.9
			Main interest rate (%)	1.25† (June 2020)	..
Policy resilience	Public finances	Low	Gross general government debt (% GDP)	57.6†	65.8
			Budget deficit (% GDP)	-0.2	0.8
			Gross domestic savings (%)	15.1	22.5
			Short-term debt (T-bill as % total debt)	0.9	9
			Foreign currency debt (% total debt)	72.4	..
			Debt held by non-residents (% total debt)	58.0	..
			External debt (% GNI)	73.8	..
	Health sector	Medium	Spending on health care (% of GDP)	8.5*	12.6
			Hospital beds per 1 000 inhabitants	5.6**	4.7
			Physicians per 1 000 inhabitants	3.1***	3.5
	Government effectiveness	Low	Government effectiveness index (-2.5: low effectiveness; 2.5: high effectiveness)	0.1*	1.2
			Rigorous and impartial public administration (0: partial; 4: impartial)	1.8	3.3

Notes: Level of vulnerability is an OECD assessment for this report. Data are from 2019 unless otherwise specified. In particular: *: 2018.; **: 2017; ***: 2016; †: 2020; ..: not available.

Source: Authors' elaboration based on national and international data: Coppedge et al. (2020[11]), *V-Dem Dataset -- Version 10* (dataset), www.v-dem.net/en/data/data/v-dem-dataset/; IMF (2020[12]), *International Financial Statistics* (dataset), https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b; IMF (2020[13]), *Financial Soundness Indicators* (dataset), https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA; IMF (2020[14]), "World Economic Outlook Databases", www.imf.org/external/pubs/ft/weo/2020/01/weodata/index.aspx; IMF (2019[15]), *Republic of Serbia: 2019 Article IV Consultation and Second Review under the Policy Coordination Instrument-Press* Release, www.imf.org/en/Publications/CR/Issues/2019/07/22/Republic-of-Serbia-Staff-Report-for-the-2019-Article-IV-Consultation-and-Second-Review-under-48511; IMF (2019[16]), *World Economic Outlook, October 2019: Global Manufacturing Downturn, Rising Trade Barriers*, www.imf.org/en/Publications/WEO/Issues/2019/10/01/world-economic-outlook-october-2019; OECD et al. (2019[17]), *SME Policy Index: Western Balkans and Turkey 2019: Assessing the Implementation of the Small Business Act for Europe*, https://doi.org/10.1787/g2g9fa9a-en; WHO (2020[18]), Global Health Observatory, https://www.who.int/data/gho.; World Bank (2020[19]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; WTTC (2020[20]), *World Travel & Tourism Council* (database), https://wttc.org/Research/Economic-Impact/Data-Gateway.

Material well-being and social protection

People's material well-being was expected to worsen with the COVID-19 crisis. The poverty headcount ratio (measured as USD 5.5 per person per day, 2011 PPP) was about 19.3% in 2019, compared to 2.9% in OECD economies. Its incidence varies greatly across the economy and is particularly high in Southern municipalities, where opportunities are lacking. Differences range between 4.8% in Novi Beograd in the Belgrade Region (Beogradski Region) to 66.1% in Tutin in the Šumadija and Western Serbia Region (Region Šumadije i Zapadne Srbije) (see the People section in Chapter 17).

While the overall labour market proved resilient to the first shock, the crisis could have an impact on some groups, especially young. The unemployment rate declined to 10.4% of the labour force in 2019 – the lowest level in the last decade – and employment increased to 49% of the working age population. The unemployment rate for people under age 25 was about three times higher than for the overall labour force and amounted to 27.5% of the young population that is active in the labour market. Labour market conditions may worsen as COVID-19 impacts on the economy, fuelling future unemployment. On 13 August, the government adopted a regulation to implement a youth employment programme, "My first salary", which includes new measures (worth RSD 2 billion, or EUR 16 million, and 0.04% of GDP) to stimulate youth employment through wage subsidies, recruitment support and additional training programmes for those seeking employment.

A drop in personal remittances could lead to income losses for some households. About 10% of the workforce lives abroad, and their remittances accounted for about 8.2% of GDP in 2019, compared to 0.3% of GDP in OECD economies in 2018. Potential further drop in remittances, could erode the income of a significant share of households and lead to a further decrease in consumption (World Bank, 2020[8]). From January to May 2020, remittances fell by 24% compared to the same period in 2019 (OECD, 2020[5]).

Inadequate social assistance limits its ability to act as an automatic stabiliser. Social protection expenditure in Serbia is concentrated in pensions, while means-tested social assistance has very limited coverage among the poor: Financial Social Assistance (FSA), the main income support programme, covers less than 6% of the poor population. At the same time, relatively high levels of labour informality (around 20%) and low labour market participation hinder the impact of unemployment insurance and extraordinary support to businesses as stabilising mechanisms. Social insurance measures were introduced as a response, including a one-off cash payment to pensioners and extensions in unemployment insurance coverage. However, the largest measure was a EUR 100 grant distributed to all adult citizens. The universal nature of the grant ensured that it circumvented the lack of adequate targeting mechanisms for reaching those in need and that it could do so quickly. However, this came at the significant cost of about 1.3% of GDP. Future income support programmes will need to be better targeted so as to more efficiently utilise Serbia's shrinking fiscal space (UN/UNDP, 2020[21]).

Health and non-material well-being

The health sector is relatively resilient to COVID-19, but the outlook is uncertain. Spending on health care accounts for 8.5% of GDP, higher than the average in the rest of the region (7.5%) but lower than the OECD average (12.6%). The number of physicians and hospital beds relative to the population is in line with the OECD average and above that of most regional peers. However, staffing remains a concern. Qualified medical staff have migrated to Europe in the recent past, attracted by higher salaries. According to some estimations, over 10 000 doctors left Serbia in the past 20 years, and the health system is lacking 3 500 doctors and 8 000 nurses (Harris and AFP, 2020[22]; N1 News, 2018[23]). While access to health care is relatively equal, people in sparsely populated areas and those with lower incomes report higher unmet medical needs, and frequent evasion of health insurance contributions by employers prevent affected workers from exercising their right to health care (see the People section in Chapter 17). This deficit undermines Serbia's health response to the COVID-19 crisis.

Other, non-material aspects of well-being are affected by the crisis. Living conditions at home, where most people were asked to stay, are less than ideal for some: one-third of households in Serbia lack high-speed Internet, making teleworking and home-schooling difficult. Quality of life is also about people's relationships, which can provide a vital lifeline during crises and social distancing. Yet, one in ten citizens of Serbia say that they have no relatives or friends they can count on for help in times of need. Even before the COVID-19 pandemic, life satisfaction was lower than in the average OECD economy. The considerable risks of social isolation and loneliness need to be addressed, for both physical and mental health, by policy measures (for instance, through regular check-ins by social services, civil society and volunteers) and the promotion of digital technologies for connecting people with each other and with public services (OECD, 2020[24]).

Women are particularly exposed to the collateral effects of COVID-19. As in other economies, loss of employment and lockdown conditions in Serbia raised concerns about increased exposure to the risk of domestic violence during the first wave of the COVID-19 crisis (Bami, 2020[25]; OECD, 2020[26]). This led to calls from the Commissioner for the Protection of Equality and civil society organisations to ensure that protective measures were in place (Autonomous Women's Center, 2020[27]; Commissionner for the Protection of Equality, 2020[28]). Even before the crisis, domestic abuse existed and needed better enforcement of existing legislation, including upping the provision of shelters and issuing emergency protection orders more promptly (see the People section in Chapter 17). Comparable surveys suggest a 24% lifetime prevalence of domestic violence against women pre-COVID, which is in line with the OECD average, but other studies have found that up to 45% of women who have or have had an intimate partner experienced intimate partner violence (including psychological violence) (OECD, 2019[29]; OSCE, 2019[30]). Women are affected in other ways too. They make up the majority of the healthcare workforce, which has exposed them to greater risk of infection. At the same time, women shouldered much of the burden at home, given school closures and longstanding gender inequalities in unpaid work (see the People section in Chapter 17).

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17 Multi-dimensional analysis of development in Serbia

Achieving rapid, inclusive and sustainable development requires progress across a range of development domains. This chapter identifies major development constraints in Serbia. It builds on multi-dimensional analysis across the five pillars of the Sustainable Development Goals: people, prosperity, partnerships and financing, peace and institutions, and planet. In each pillar, the analysis highlights key areas where Serbia could further realise its full development potential.

This chapter of the MDR of the Western Balkans identifies the key capabilities and most pressing constraints in Serbia by linking economic, social, environmental and institutional objectives. The assessment is organised around five thematic sections based on the five pillars of the 2030 Agenda: People, Prosperity, Partnerships and Financing, Peace and Institutions, and Planet. Whenever relevant, Serbia is compared with a set of benchmark economies in the region (Albania, Bosnia and Herzegovina, Kosovo, Montenegro and North Macedonia), the OECD (Costa Rica, Czech Republic, Greece, Slovak Republic, Slovenia and Turkey), non-OECD economies in the European Union (Croatia and Romania) and non-OECD economies in other regions (Kazakhstan, Morocco, Philippines and Uruguay). It includes regional averages for the Western Balkans and OECD and EU members.

People – towards better lives for all

The People pillar of the 2030 Agenda for Sustainable Development places quality of life at the centre stage, focusing on the international community's commitment to guaranteeing the fulfilment of all human beings' potential in terms of equality, dignity and good health. In the past decades, Serbia has managed to generate more jobs for its population and is about to undertake reforms in the labour market and social protection systems to align with EU standards.

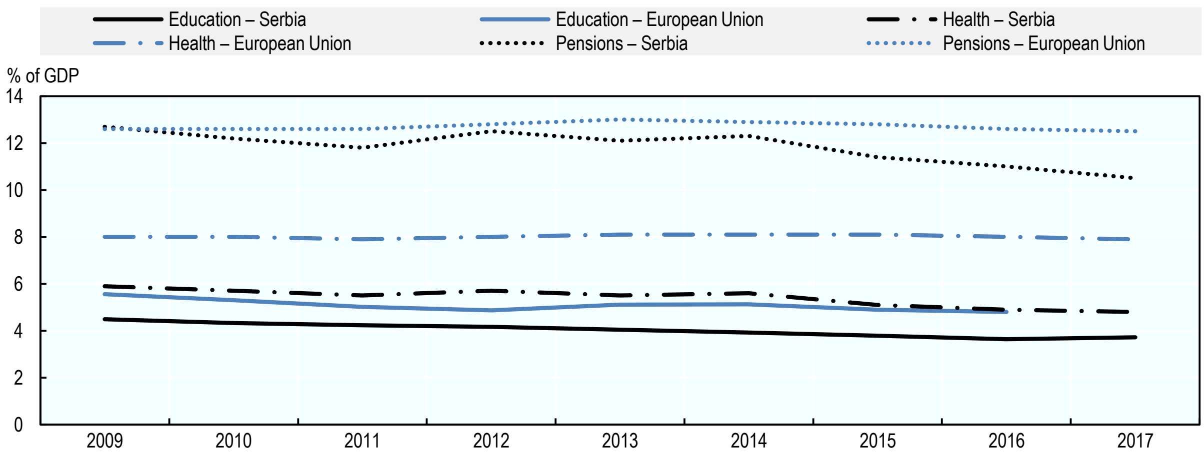
However, there is still a long way to go to achieve a society that provides opportunities for all. Many groups, including young people, women, some ethnic minorities and those living in non-urban areas, are left behind in Serbia's development, especially in terms of labour market outcomes. Necessary fiscal consolidation measures in the years after the 2008 financial crisis and the crisis that hit the country after the 2014 flooding have prevented the expansion of social spending and investment in human capital (Figure 17.1). Many public services do not yet operate at their full potential: the education system does not equip students with relevant skills to thrive after graduating, and social transfers, while generally achieving good coverage, are too low to prevent material deprivation for all. The social protection system needs to be reviewed in terms of financial sustainability and ease of accessing services. Going forward, and despite the financial crunch COVID-19 will present, Serbia cannot afford to miss opportunities for investing in its human capital. The People section in this chapter identifies five major constraints to the well-being of the population of Serbia (Table 17.1).

Table 17.1. People – five major constraints to leaving no one behind in Serbia

1. Young people, women and some ethnic minorities often lack opportunities to participate in the labour market.
2. More investment in teachers' capacities, a curriculum update and better co-ordination with the productive sectors are needed to equip students with job-relevant skills.
3. Pension and social assistance transfers are too low to prevent poverty.
4. Social protection financing is inadequate and over-reliant on (frequently evaded) social security contributions.
5. Complicated administrative procedures and strict eligibility designs prevent easy access to social safety nets.

Figure 17.1. Fiscal consolidation has prevented the expansion of social spending

Government expenditure on education, health and pensions (% of GDP)



Note: General government expenditure on education includes expenditure funded by transfers from international sources to the government. Government pension expenditure includes old-age, partial and disability pensions.
Sources: For pensions and health: Eurostat (2018[1]), *Social protection statistics - pension expenditure and pension beneficiaries*, https://ec.europa.eu/eurostat/statistics-explained/index.php/Social_protection_statistics_-_pension_expenditure_and_pension_beneficiaries; for education: World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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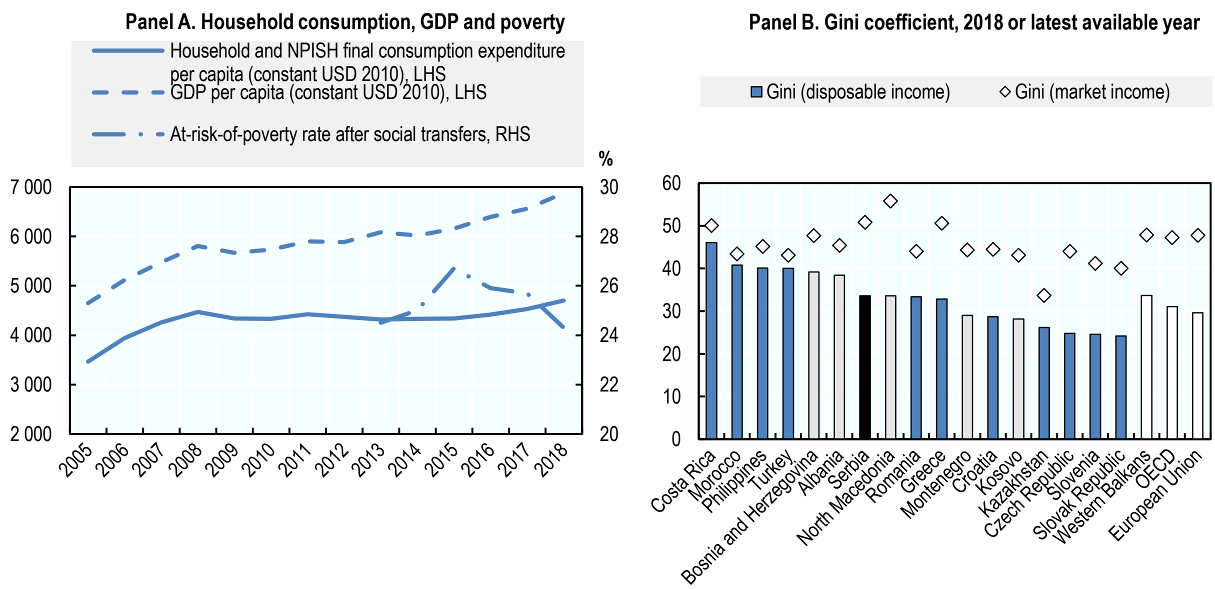
Improving well-being for all, everywhere

Serbia has seen GDP per capita grow over the past 15 years, but amidst the economic downturn after the 2008 financial crisis, household consumption has remained largely flat. Poverty and inequality persist. After a spike following the 2014 floods, one-quarter of the population was at risk of poverty, after accounting for social transfers, in 2018 (Figure 17.2 – Panel A). Poverty also affects those in employment: some 10% of employed people are at risk of poverty, meaning they cannot fulfil their basic needs, despite working (European Commission, 2020[3]). While disposable income inequality is in line with regional peers, Serbia has very high market inequality (Figure 17.2 – Panel B). This is partly due to high overall unemployment and the fact that agricultural and other subsistence income is not well captured in some household surveys (UNDP, 2018[4]). Both measures of inequality have changed little since 2008 (Solt, 2019[5]).

Inequalities among Serbia's four major regions persist along various aspects of well-being. About one-quarter of the population live in each region: Belgrade Region (*Beogradski Region*), Southern and Eastern Serbia (*Region Južne i Istočne Srbije*), Šumadija and Western Serbia (*Region Šumadije i Zapadne Srbije*) and Vojvodina Region (*Region Vojvodine*). Belgrade Region, with the capital city of Belgrade, hosts most economic activities and generates about 40.4% of the country's GDP, whereas Southern and Eastern Serbia generates about 13.8%, and its GDP per capita is one-third that of Belgrade Region. Regions also vary in terms of poverty and access to services. Southern and Eastern Serbia's poverty rates are three times higher than in Belgrade Region, and only about two-thirds of households are connected to the water supply system (Table 17.2). Poverty rates within regions vary significantly. The southern parts of Serbia especially have significant municipal pockets of poverty: differences range from 4.8% in Novi Beograd in Belgrade Region to 66.1% in Tutin in Šumadija and Western Serbia (SORS/World Bank, 2016[6]). The lack of harmonised decentralisation and regional development frameworks partly explains persistent regional inequalities (see the Peace and institutions section in this chapter).

Figure 17.2. Household spending has risen, and poverty has declined

Household consumption, GDP per capita and at-risk-of-poverty rate after social transfers (Panel A) and income inequality, 2018 or latest available year (Panel B)



Notes: LHS = left hand side, RHS – right hand side, NPISH = non-profit institutions serving households. The threshold for at-risk-of-poverty is set at 60% of the national median equivalised disposable income (after social transfers). Solt's SWIID (Standardized World Income Inequality Database Version 8) income inequality estimates are based on different published Gini indices, including the World Bank's PovcalNet, national statistical offices and the Luxembourg Income Study. For Serbia, these sources include both the Household Budget Survey and EU Statistics on Income and Living Conditions. Costa Rica officially became an OECD Member on 25 May 2021, therefore it is not included in the OECD averages in the current report.

Sources: Eurostat (2018[7]), Eurostat (database), https://ec.europa.eu/eurostat/data/database; Solt, F. (2019[5]), *The Standardized World Income Inequality Database, Versions 8-9* (dataset), https://doi.org/10.7910/DVN/LM4OWF; World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

StatLink https://doi.org/10.1787/888934245196

Table 17.2. Well-being depends on where citizens of Serbia live

Selected indicators, 2019 or latest available year

Regions	Population (%)	Employment rate (%)	People with incomplete primary education (%)	GDP share (%)	GDP per capita (USD)	Annual gross earnings (USD)	Poverty	Crude mortality rate (per 1 000 people)	Inhabitants per physician	Household connected to water supply system (%)
Belgrade Region	24.4	64.9	3.4	40.4	9 688.3	579.6	10.5	12.8	288	94.3
Vojvodina Region	26.7	60.7	9.5	26.5	5 733.0	442.0	25.8	14.6	397	96.0
Šumadija and Western Serbia	27.5	59.8	12.6	19.2	3 997.8	398.3	32.3	14.9	389	78.3
Southern and Eastern Serbia	21.5	56.9	13.5	13.8	3 664.7	410.5	33.0	16.2	335	67.3

Sources: SORS (2020[8]), *STAT database*, https://data.stat.gov.rs/?caller=SDDB&languageCode=en-US; SORS (2020[9]), *Statistical Pocketbook of the Republic of Serbia 2020*, https://publikacije.stat.gov.rs/G2020/PdfE/G202017013.pdf; SORS/World Bank (2016[6]), *Poverty Map of Serbia – Method and Key Findings*, http://pubdocs.worldbank.org/en/859541477472336209/Poverty-Map-of-Serbia.pdf.

Some minorities, especially Roma and Bosniaks[1] living in non-urban areas, continue to be left behind. This is true along several dimensions of well-being, including access to education, labour market and public services. According to data from the 2014 Multiple Indicator Cluster Survey, one-third of Bosniaks living in non-urban areas are vulnerable in terms of multi-dimensional poverty. Regardless of their location, about one-quarter of Roma are also vulnerable in this way. Roma could constitute up to 8% of the total population by some estimates – one of the largest shares in the Western Balkans region (Maghnouj et al., 2019[10]). In addition, only one in five Roma students are enrolled in upper secondary education (UNICEF, 2015[11]), compared to 87% for the country average. The percentage of those completing tertiary education remains extremely low at 1%, compared to 16% of the non-Roma population and low levels of education remain a key barrier to their employment prospects (European Commission, 2020[3]). While the average labour force participation rate is 66% in Serbia, it is 33% for Roma. Likewise, as much as 62% of the Roma population aged 15 to 24 are not in education, employment or training (NEET), more than three times the average for Serbia. Only 65% of Roma have access to the public sewage system, and health outcomes for Roma children, as described elsewhere in this chapter, are poor (World Bank, 2018[12]).

Lesbian, gay, bisexual, transgender and intersex (LGBTI) communities face continued discrimination and harassment. Serbian society, which is largely Orthodox Christian, remains rather conservative and negative in its attitudes towards LGBTI people. Serbia elected an openly gay prime minister in 2017. However, according to a 2015 population survey, almost half the citizens of Serbia believed homosexuality is a sickness and would try to help their son or daughter find a cure if they found out their child was not heterosexual (ERA, 2020[13]). There have been numerous instances of violent gay-bashing in the past, the most extreme occurring during the first Belgrade Pride in 2001.

Existing legal provisions to protect LGBTI rights can be strengthened. The 2009 Anti-Discrimination Law explicitly prohibits discrimination on the grounds of sexual orientation and gender identity, and Serbia is bound by almost all UN human rights treaties, the European Convention on Human Rights[2] and numerous conventions of the Council of Europe. In practice, the protection of rights is weak and inconsistent: LGBTI people continue to face harassment ranging from violence and hate speech to being denied access to healthcare services.[3] A 2015 opinion poll revealed that 51% of LGBTI people in Serbia had been personally discriminated against because of their sexual orientation or gender identity (ERA, 2020[13]). Serbia also does not currently recognise same-sex marriage or same-sex adoption, and there are no standardised procedures for recognising gender where this differs from the sex assigned at birth, which leaves people undergoing transition in a legal vacuum (UNDP/USAID, 2017[14]). Beyond strengthening legal protections and investigating hate crimes, the government should promote a culture of respect for the rights of LGBTI people. It could be taught to citizens of Serbia from a young age by removing current discriminatory content from school textbooks and curricula.

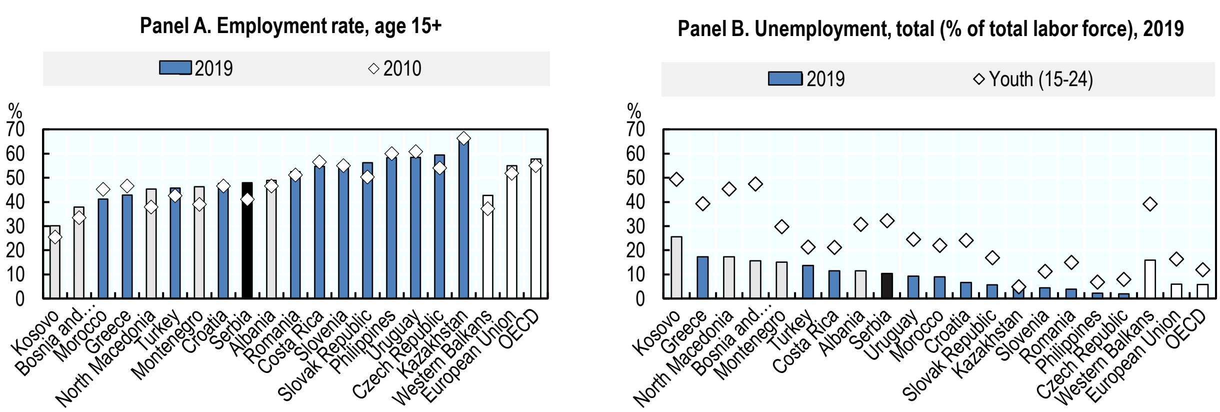
Strengthening the productive potential and equal participation of all citizens of Serbia

Young people and women need better labour market integration

Serbia's employment performance improved over the last decade, but young people are left out. In 2019, employment rates were close to the OECD and EU averages and were among the highest in the Western Balkans (Figure 17.3 – Panel A). However, unemployment rates for people under age 25 are about three times higher than for the overall labour force (Figure 17.3 – Panel B).

Figure 17.3. Despite overall solid labour market performance, youth outcomes are not encouraging

Employment rates, age 15+ (Panel A) and unemployment rates (Panel B)



Source: World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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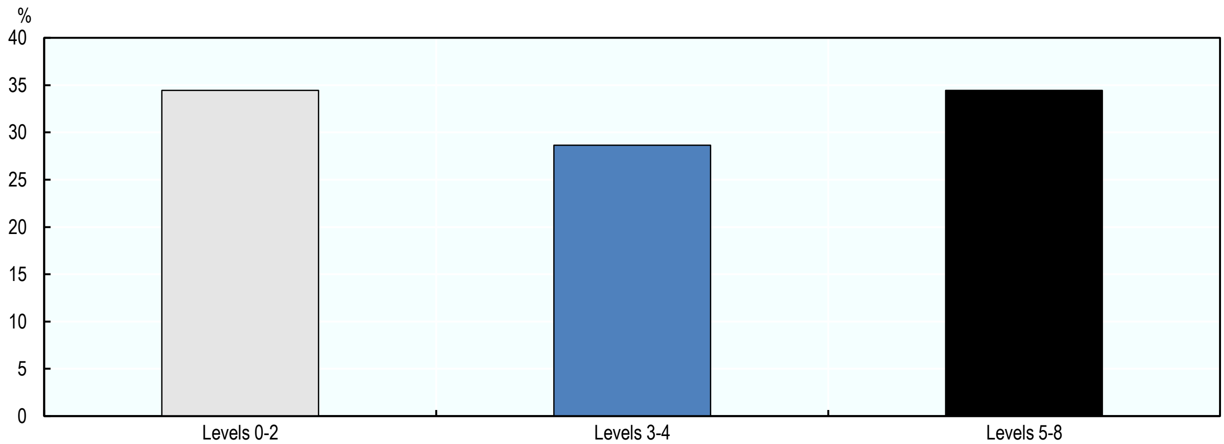
Youth unemployment is highest among those with higher education, suggesting significant skills mismatches (Figure 17.4). A large share of young workers are engaged in low-wage occupations: 22.9%, compared to the EU average of 17.2%. Young workers are more likely to be low-wage earners (21.4%) than those over age 30 (13.9%) (Vidovic et al., 2019[15]). The exclusion of young people not only affects them directly and encourages migration abroad but is a constraint to Serbia's overall growth potential.

Figure 17.4. Highly-educated young workers in particular are affected by unemployment

Unemployment, youth aged 15 to 24, total (% of total labour force) by education level



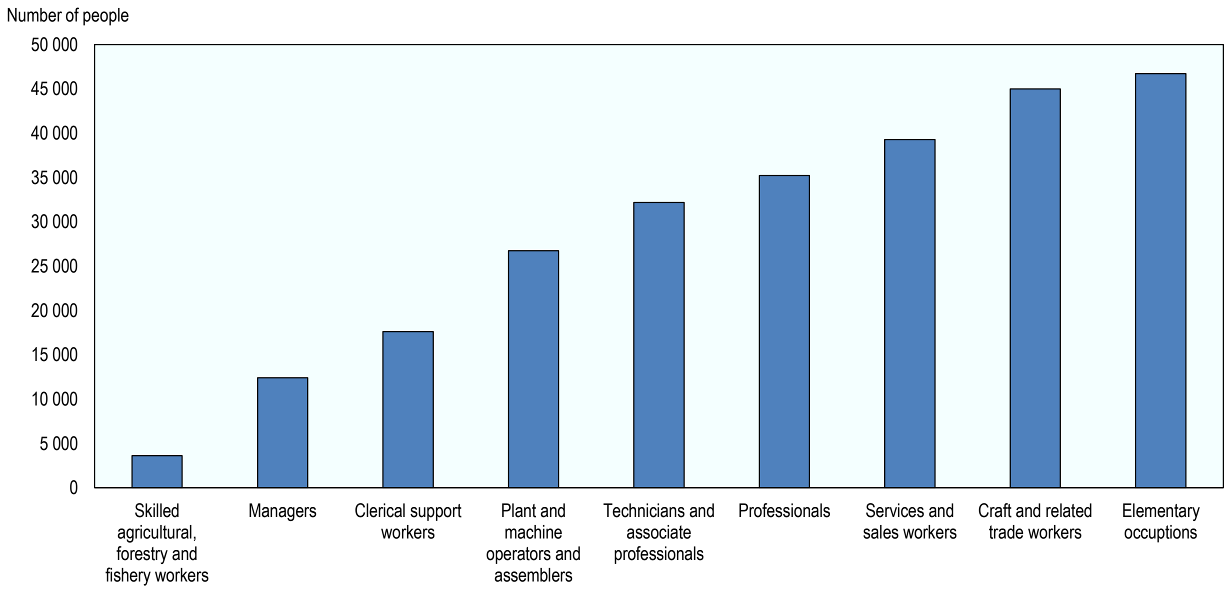
Note: According to the International Standard Classification of Education, levels 0-2 correspond to early childhood, primary and lower secondary education; levels 3-4 correspond to upper secondary, post-secondary and short-cycle tertiary education; levels 5-8 correspond to tertiary education and above.
Source: World Bank/Vienna Institute for International Economic Studies (2020[16]), *SEE Jobs Gateway Database* (database), https://data.wiiw.ac.at/seejobsgateway.html.

StatLink https://doi.org/10.1787/888934245234

In the medium to long term, Serbia is at risk of losing and underutilising its human capital. Poor inclusion of young people and migration of the high-skilled abroad, together with persistent long-term demographic pressures (Figure 17.6), pose a threat to Serbia's development potential. The migration abroad of especially high-skilled young people in search of better employment opportunities drags down productivity growth and increases the speed of population ageing, making social protection more challenging. Austria, Germany, Slovenia, Switzerland and Turkey are the main destination countries for emigration from Serbia, although the nature of migration has changed over time. Managed labour migration to Germany in particular has increased in recent years through a labour migration facilitation scheme. On average, around 30 000 to 60 000 people per year left Serbia in recent years, one-quarter of whom had completed higher education (Radonjić and Bobić, 2020[17]). Most of the citizens of Serbia currently living in OECD countries are highly qualified: almost 70% are plant and machine operators and assemblers; technicians and associate professionals; professionals; services and sales workers; and craft and related trades workers (Figure 17.5). About 73% had medium or higher education (OECD, 2016[18]). According to a recent state-financed survey conducted on a sample of 11 000 students from Serbia, one-third would like to leave the country due to their inability to find work in their profession, low salaries and poor living standards. For 94.3% of those surveyed, the main reasons to emigrate were economic, including lack of employment opportunities and low living standards. Loss of funds spent on education, decrease in GDP due to lower consumption and loss of human capital are some of the major consequences of youth emigration. Recent estimations show that the total education costs in one year of people leaving Serbia range from EUR 960 million to a little over EUR 1.2 billion (Western Balkans Democracy Initiative, 2019[19]). While emigration may bring benefits in the form of remittances or new skills, returns are complex, often triggering subsequent emigration due to misplaced expectations, disappointments, problems with pursuing entrepreneurial, research or scientific ideas, diploma recognition issues and non-acceptance by wider social and professional communities, among other reasons (Anđelković Vesković and Bobić, 2019[20]).

Figure 17.5. High-skilled people represent the majority of Serbian people living in OECD countries

Number of Serbian people living in OECD economies, 2015/16



Source: OECD (2016[18]), *Database on Immigrants in OECD and non-OECD Countries: DIOC* (database), www.oecd.org/els/mig/dioc.htm.

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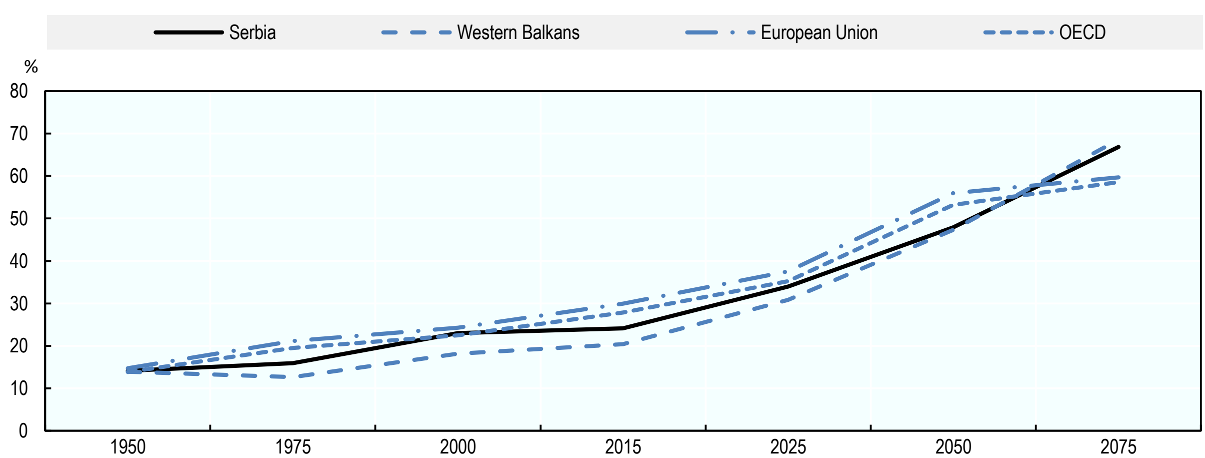
Figure 17.6. Demographic pressures are on the horizon

Old-age dependency ratio projections (ratio of population age 65+ per 100 population aged 20 to 64, %)



Note: Western Balkan average includes Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia.
Source: United Nations (2020[21]), "World Population Prospects 2019", https://population.un.org/wpp/.

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Gender inequalities in the labour market persist. The employment gap between men and women is lower in Serbia than in the region and in OECD countries but nevertheless far from equality at about 14.5% in 2018 (employment rates are 55.4% for men and 40.9% for women, compared to 57.3% for women in

OECD economies) (ILO, 2020[22]; OECD, 2020[23]). The difference in employment rates is mainly due to women's markedly higher inactivity in the labour market: in 2019, labour force survey data showed a 13.5 percentage point difference between men and women aged 15 to 64, while the gender unemployment gap was 1.3 percentage points (World Bank, 2020[2]). Similarly, 27.0% of women compared to 18.5% of men aged 20 to 34 were neither in employment, education or training, a slightly higher gap than the EU averages (Eurostat, 2020[24]). While women are more likely to work part-time (23% of female employees vs. 18% of male), this gap is much lower than in OECD countries (25.4% of women and 9.6% of men), largely reflecting the high prevalence of part-time employment in Serbia overall (OECD, 2019[25]; World Bank, 2020[2]).

Women's lower labour market participation reflects unpaid work in the household, including taking care of children and sick or elderly people, inadequate support to women in reconciling work and family responsibilities, and employers' discriminatory treatment of young women. Only one in two children has access to preschool education in Serbia, and access to early education in Serbia remains inequitable: more than 80% of children from the households in the better-off quintile are enrolled in early childhood education and care programmes, compared to less than 10% of children from the poorest families. Access for Roma children averages only 6% (World Bank, 2017[26]). Serbia has a generous maternity leave scheme of 52 weeks, well above the EU average of 23 weeks. However, with the 2017 amendments to the Law on Financial Support for Families with Children, future mothers will be able to receive the maximum benefits only if they were employed during the previous 12 months. Women with less than six months of employment will no longer be entitled to the guaranteed minimum (ESPN, 2018[27]). Serbian law mandates equal remuneration for work of equal value, but its application is difficult, for instance due to the fact that employees rarely know the salaries of their co-workers (World Bank, 2017[28]).Nevertheless, the gender wage gap (11%) is lower than the OECD average of 13%, partly reflecting the higher education qualifications of women who work compared to men (OECD, 2020[29]; Vladisavljeviü et al., 2013[30]).

Women's participation in Serbian society is not yet equal

Although far from reaching parity, female representation in the legislative and private-sector management is higher than in OECD countries. Female MPs currently occupy 38% of national parliamentary seats in Serbia, and women make up more than one-third of senior and middle managers, compared to the OECD averages of 28% and 16%, respectively average (OECD, 2020[29]; IPU, 2020[31]; World Bank, 2020[2]). Women are relatively well represented in the executive. Currently, 10 out of 23 ministerial posts are held by women (compared to 4 out of 21 in the previous administration despite the election of a female prime minister since 2017) but women's participation in decision making at the local level is significantly lower. However, the share of men and women in senior civil service positions is close to equality (OECD/SIGMA, 2019[32]). As in neighbouring economies, a significant share of the population in Serbia (39%) believes that men make better political leaders than women (OECD, 2019[33]). The National Strategy for Gender Equality 2016-20 aims to achieve no less than 30% female participation in all levels of advisory and expertise bodies responsible for planning and drafting public policies, and a 2015 budget system introduced gender-responsive budgeting as mandatory for all budget users (OECD, 2019[33]). In early 2020, parliament announced an amendment to electoral laws with a new minimum quota of 40% of candidates from the less-represented gender on electoral lists for parliamentary and local elections from the less-represented gender (IPU, 2020[34]).

According to the OECD Social Institutions and Gender Index, discrimination against women in social institutions overall in Serbia is categorised as "very low". However, there is room for improvement when it comes to access to productive and financial resources (OECD, 2019[33]). Men own most land and property in Serbia, and in some non-urban areas, women do not have *de facto* access to land, as it is traditionally registered in the name of their husbands or other close male relatives. Once married, any land or property a woman owns is signed over to her male relatives so that it remains in the family. The situation is more acute among Roma: only 0.2% of property is registered in a woman's name. Lack of property to act as collateral translates into women often experiencing difficulty obtaining credit, including for starting businesses. Moreover, many banks that view women primarily as mothers and housewives remain sceptical of financing female entrepreneurship.

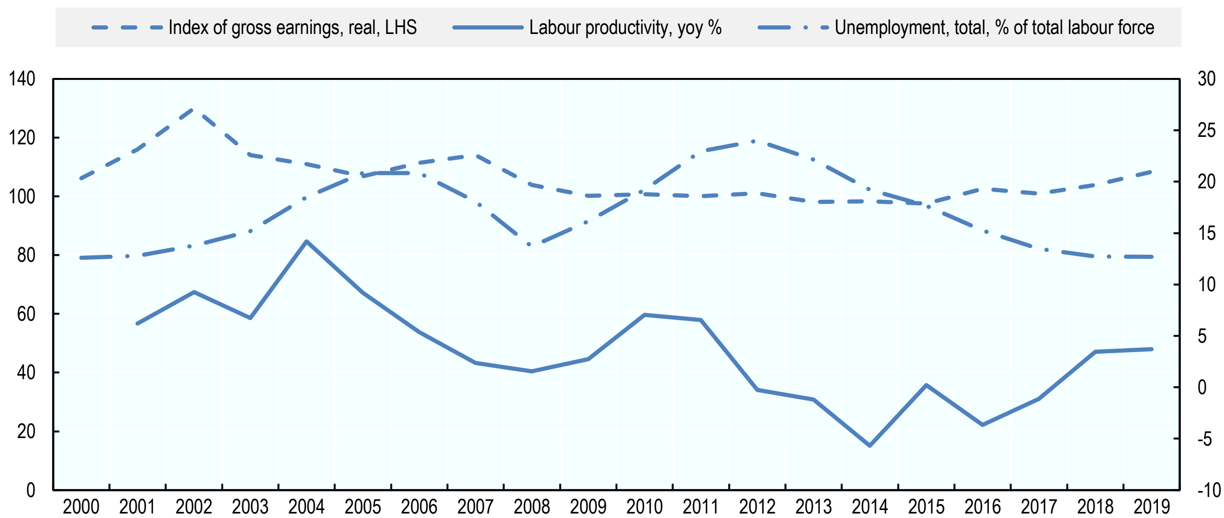
Gender-based violence remains high in Serbia, and existing legislation needs to be better enforced. Comparable surveys suggest a 24% lifetime prevalence of domestic violence against women in Serbia, which is in line with the OECD average, other studies have found that up to 45% of women who have or have had an intimate partner experienced intimate partner violence (including psychological violence) (OECD, 2019[33]; OSCE, 2019[35]). As of 2016, a specialised department to prevent and fight domestic violence had been created in the Criminal Investigations Directorate in 2016, but it needs to be reinforced (European Commission, 2016[36]). Emergency protection orders are not issued promptly, and the number of shelters is insufficient. There is often an informal acceptance of domestic violence by police whereby violence against women is considered a private matter, and little assistance is provided to women seeking help.

Labour market institutions need to be strengthened

Declining productivity and other factors hampered wage growth. Since 2015, wages have increased only slightly: the share of salaried workers earning less than RSD 25 000 has declined, while the share of workers earning between RSD 25 000 and RSD 45 000 has increased (Reyes and Nguyen, 2020[37]). In part, the steady decline in labour productivity since 2004 has not justified more significant gains (Figure 17.7). Moreover, under the 2014 fiscal consolidation programme, in co-operation with the International Monetary Fund (IMF), all public-sector wages above the minimum wage were cut by 10%. Amendments to labour laws also led to a reduction in labour costs of about 3% for employers. Recently, the minimum wage was allowed to increase and reached slightly above 50% of the average wage (Eurofound, 2020[38]). In September 2020, the Government of the Republic of Serbia passed the Decision on the amount of the minimum labour wage for the period January-December 2021, raising the hourly minimum wage by 7% to RSD 183.9 (net) per working hour from 1 January 2021.[4] In 2016-21, the minimum wage increased, on average by 6.8% in real terms, in contrast with the 2.0% depreciation of the fiscal consolidation period (2013-15).

The Serbian labour market is characterised by significant informality, and labour market insecurity is high. This manifests itself in a large share of unregistered workers, as well as under-reporting of sales and wages by formal enterprises (Vidovic et al., 2019[15]). The share of informal employment in total employment was estimated at about 20% in 2018 (World Bank/Vienna Institute for International Economic Studies, 2020[16]). Workers with official contracts do not necessarily enjoy quality employment: one in five employees age 15 and above had a temporary contract (SORS, 2020[8]). About one-third of all workers are self-employed, many of them working informally (SORS, 2020[8]). Once again, the young are particularly vulnerable, with higher overall shares of workers under age 24 working informally (28%) or on temporary contracts (55%). This highlights high economic and social vulnerabilities, which may be exacerbated by the COVID-19 pandemic.

Figure 17.7. Wages have stayed flat in light of declining productivity growth



Sources: ILO (ILO, 2020[39]), *ILOStat* (database), https://ilostat.ilo.org/data/; SORS (2020[8]), *STAT* (database), https://data.stat.gov.rs/?caller=SDDB&languageCode=en-US.

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A high tax burden on minimum wages and loss of benefits discourage formalisation and prevent access to social security. The net income change from formalisation is negative for wage levels of 25% of the average wage (Koettl, 2013[40]). First, the minimum social security contribution base is set at 35% of the average monthly salary, which makes formal part-time low-wage work costly for both employers and employees. Second, workers with earnings above a certain (very low) threshold become ineligible for means-tested social assistance benefits (see section on social protection) (Vidovic et al., 2019[15]; ESPN, 2017[41]).[5] Hence, the lack of economic viability effectively excludes a substantial share of the working-age population from formal employment and social security coverage. In this sense, informality and inactivity are predominantly a matter of exclusion rather than voluntary exit. Considering the limited capacities of the labour inspectorate (242 inspectors to cover about 440 000 businesses), the capability to monitor formalisation is low.

Activation measures are too limited and underfunded to connect job seekers with quality work or to boost their skills. In 2019, Serbia spent about 0.08% of GDP on active labour market policies, compared to the Western Balkan average of 0.12%, to Croatia (0.71%), and to Slovenia (0.61%) (European Commission, 2020[42]).[6] Active labour market policies also have very low coverage in Serbia: in 2017, less than 25 000 beneficiaries (around 3.7% of all registered unemployed) were included in measures such as training, employment or self-employment subsidies or public works.

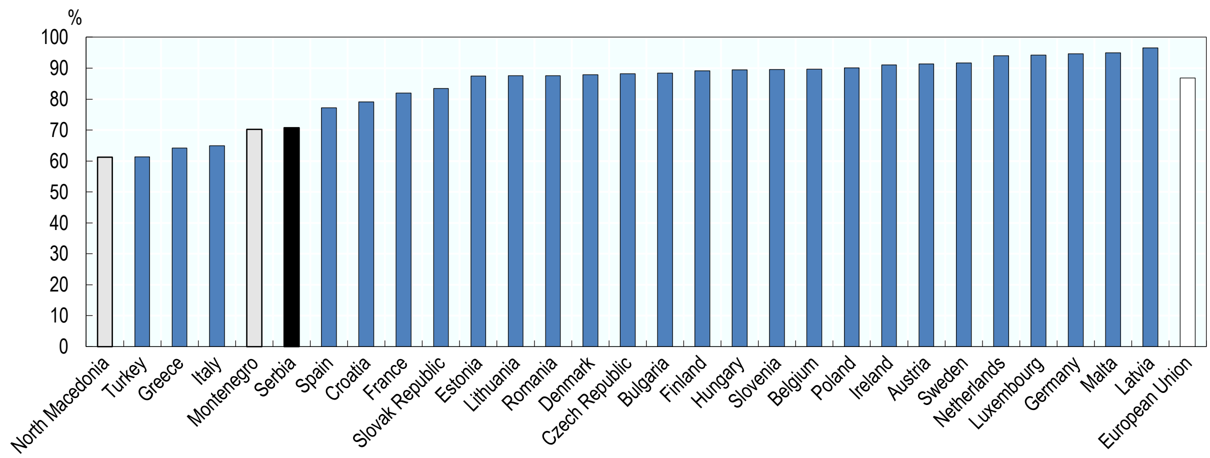
The institutional framework underpinning social dialogue remains weak. Trade union density remains high in the public sector (over 60%) but is much lower in the private sector (below 20%), limited by loss in confidence and by legal provisions preventing workers in new forms of employment from joining unions (Petkovic Gajic, 2018[43]). The Serbian Association of Employers, the representative employers' organisation, also has limited representativity at the branch and sectoral levels, as it does not include the largest employers. After the lapse of all collective agreements following the reform of the Labour Law in 2015, a number of collective agreements have been signed in the public sector, with coverage estimated at around 60%. However, they remain the exception in the private sector. The Social and Economic Council (SEC), set up by a dedicated law in 2004, is Serbia's key forum for social dialogue on policy issues and sets the annual increase in the minimum wage. However, a number of laws in relevant fields have not been discussed in the SEC, which has weakened trust in the process and capacity of the SEC (ILO, 2017[44]). Recently, the SEC has not achieved consensus on minimum wages, which were increased by government decision in 2019, for example (European Commission, 2020[3]).

Boosting education quality

The education system has a solid base. Nearly all children participate in compulsory education, and participation rates at other levels, including technical training, are also very high.[7] Participation at the upper secondary level has increased significantly over the past years and is now about 87%, higher than the Western Balkan, OECD and EU averages. Serbia also has a very high proportion of students who stream into upper secondary vocational education and training (VET): about 74% of students enter VET rather than general education, compared to an OECD average of 47%. Socio-economic family background plays an important role in deciding whether students go to general or vocational programmes; students from more favourable backgrounds are more likely to attend general schools. There are two VET tracks in Serbia: three-year and four-year. The latter offers the opportunity to transition to tertiary education later on. Student demand for four-year VET profiles has increased in recent years. Vocational programmes have multiplied and been updated, some becoming very reputable, whereas gymnasium curricula were not updated for two decades (Reyes and Nguyen, 2020[37]). At 67.2%, participation in tertiary education is close to the OECD average.

Yet, the education system is not adequately adapted to meet labour market needs. In terms of employment rates for recent graduates aged 20 to 34 who are not in education and training, Serbia trails behind EU economies (Figure 17.8). Close to 30% (28% in 2019) of all recent tertiary education graduates studied science, technology, engineering and mathematics (STEM) subjects, compared to 15%, on average, in OECD countries in 2015 (UNESCO, 2020[45]; OECD, 2018[46]).[8] However, higher education institutions adopt traditional methods of teaching that do not necessarily encourage interactive thinking or collaboration, and employers rarely collaborate with higher education institutions (Maghnouj et al., 2019[10]). In 2017, 29.3% of companies indicated problems with finding new workers, mostly due to skills shortages. Skills shortages extend across most sectors of the economy, with significant shares of companies citing the problem across sectors: manufacturing (38.6%), construction (37.7%), mining (33.3%), accommodation and food production (32.2%), information and communications (32.1%) and transport and storage (29.4%) (Reyes and Nguyen, 2020[37]). Interestingly, apart from the information and communications sector, which values technical skills of employees the most, all sectors interviewed in Serbia's Skills Toward Employment and Productivity (STEP) Skills Measurement Employer Survey, placed a higher value on socio-emotional skills, such as reliability and resilience. In general, employers report that the skills of VET graduates are slightly more relevant than those of general education graduates. The establishment of the Agency for Qualifications and Sector Skills Councils in 2018 was a positive step towards reducing the mismatch between skills required in the labour market and education outcomes (European Commission, 2020[3]).

Figure 17.8. Employment rates of recent tertiary education graduates aged 20 to 34 not in education and training, 2019



Source: Eurostat (2020[47]), *Eurostat (database)*, https://ec.europa.eu/eurostat/data/database.

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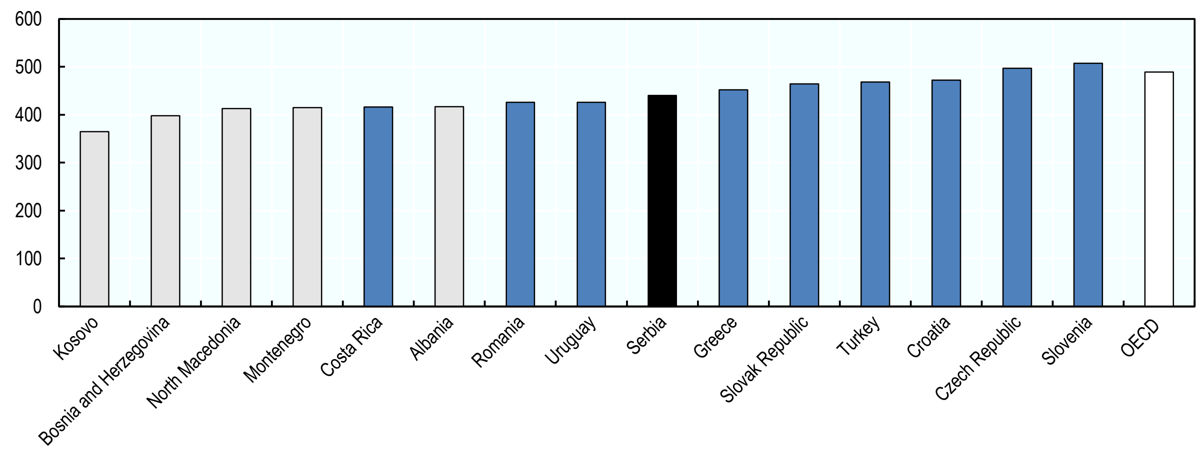
While Serbia is the best PISA performer in the Western Balkans, it trails behind many more developed economies in terms of test scores and inequalities in student outcomes. Although its PISA scores for 15-year-olds have improved in comparison to the 2006 and 2012 PISA cycles, Serbia still lags behind many benchmark economies from Central and Eastern Europe and the OECD (Figure 17.9). While it is promising that Serbia's share of overall high performers[9] increased by nearly 2% since 2009, the share continues to be much lower than the OECD average in all three test subjects: in 2018, 3% of students in Serbia were top performers in reading (OECD average: 9%), 2% were top performers in science (OECD average: 7%) and 5% were top performers in mathematics (OECD average: 11%). Moreover, the performance gap has widened, and the simultaneous increase in low performers (4.9%) means that fewer students are achieving moderate outcomes (Maghnouj et al., 2019[10]). Lack of equity remains an issue, with low-quality schools tending to be in more disadvantaged areas. Variation in socio-economic background among schools explains about 40% of the variation in low performance in mathematics, suggesting significant concentrations of low performers in particular schools (OECD, 2016[48]).

Girls have somewhat better PISA test scores than boys, while as in most participating economies, 15-year-old boys in Serbia show higher career ambitions in computer-related fields than the girls. In PISA 2018, girls significantly outperformed boys in reading (by 30 score points, on average, across OECD countries) and somewhat outperformed boys in science (by 2 score points). Boys outperformed girls in mathematics (by 5 score points). In Serbia, girls scored better than boys in reading and similarly to boys in mathematics and science. Some 16% of boys and 3% of girls in Serbia expect to work in ICT-related professions (OECD, 2020[49]).

Figure 17.9. Education outcomes in Serbia are higher than in neighbouring economies but could be better

Mean PISA science score, 2018



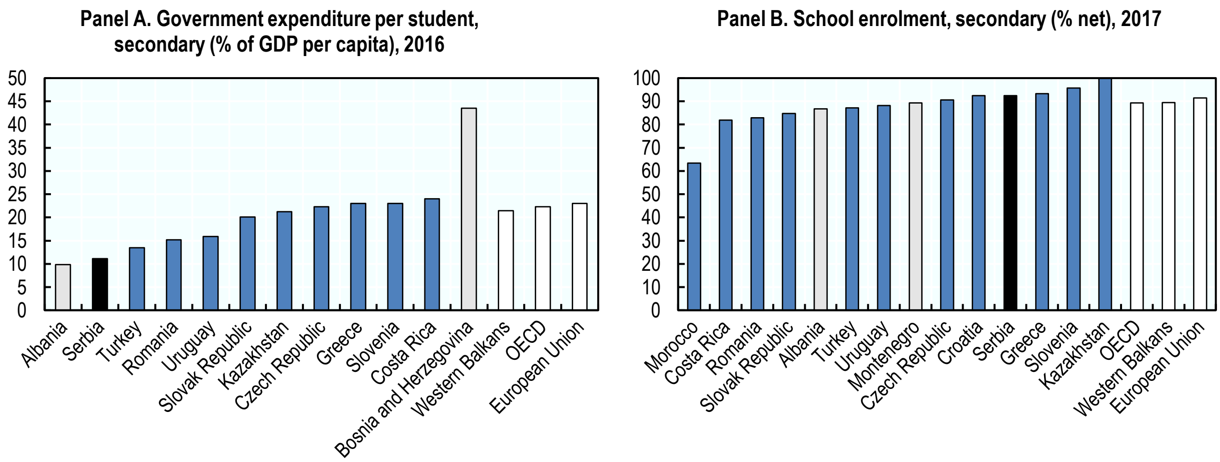
Source: OECD (2020[50]), *PISA* (database), www.oecd.org/pisa/data/.

StatLink https://doi.org/10.1787/888934245329

A recent OECD review of evaluation and assessment in the education system points to chronic underfunding of the school system, which limits the capacity of schools to enact meaningful changes in their policies and practices. Serbia's level of public expenditure on education, especially at the secondary level, has an important impact on education outcomes. At 3.6% of GDP in 2016, public education spending remains lower than the OECD average (5.3%) (World Bank, 2020[2]). While Serbia increased per-student funding at the pre-primary and tertiary levels between 2007 and 2015, per-student funding decreased for primary and secondary education (Maghnouj et al., 2019[10]). Overall public expenditure on secondary education is relatively low compared to neighbouring and European economies, despite similarly high enrolment rates at the secondary level (Figure 17.10). Low secondary education spending might reflect the fact that these programmes are still based mainly on theory, representing another gap at the secondary level: these programmes tend to be more costly across OECD countries due to the need to adapt infrastructure and materials for practical learning (Maghnouj et al., 2019[10]). Local governments are responsible for funding professional development for teachers and other school staff but lack funds. This among other factors affects teacher quality and makes the teaching profession unattractive.[10]

Figure 17.10. Despite its importance, secondary education is underfunded in Serbia

Government expenditure per student, secondary education (% of GDP per capita), 2016 (Panel A) and net school enrolment, secondary education (%), 2017



Note: The Western Balkan average includes Albania, Bosnia and Herzegovina and Serbia. Data for Serbia are for 2016.
Source: World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

StatLink https://doi.org/10.1787/888934245348

Lack of quality teachers and little teacher training are main constraints at all levels of education. Despite a small pupil/teacher ratio overall, which may act favourably to improve teaching, poor selection criteria for teachers and lack of opportunities for professional development drag down teacher motivation and education outcomes (Maghnouj et al., 2019[10]). Criteria for entry into initial teacher education in Serbia are not selective, and almost all applicants to teaching faculties are admitted: acceptance rates are almost 100%, and many universities struggle to fill available positions with graduates (Maghnouj et al., 2019[10]). The take-up of professional development programmes remains low, especially in some areas.[11] In Serbia, teachers are required to complete 100 credit points of professional development (one hour of training equals 1 point) over five years. In 2017, less than half of teachers had achieved 80 credit points over the reference period (Politika, 2016[51]). Main reported reasons related to lack of financial support; often, teachers pay out of their own pocket to attend training.

Teachers need greater support to implement the new curriculum. While a new learning standard with a competency-based approach was introduced in 2013, the curriculum was not rolled out until 2018. At the same time, the new curriculum is overloaded and very prescriptive, compared to practices in OECD countries. This severely limits teachers' room to adapt their practices to the specific learning needs of students (Maghnouj et al., 2019[10]). In addition, there are no guidelines that describe students' learning progression in a cycle. Based on external school evaluation results, the use of assessment to inform learning and adapt teaching to student needs is weak in almost half of basic education schools and two-thirds of upper secondary schools (IEQE, 2017[52]). While the Ministry of Education, Science and Technological Development (MoESTD) identified student assessment as a priority for teachers' professional development in Serbia for 2017-20, the take-up rate for professional development remains low, as previously described.

Considering the relevance of the VET system, the government is working to make VET more relevant to Serbia's labour market needs. In 2016, the MoESTD and the Chamber of Commerce began to work together to institutionalise dual education in Serbia (only 2% of the total student population attended dual education in 2018/19). As a result, several VET profiles were terminated, and others are being modernised. The Chamber of Commerce, representing companies, supports the MoESTD and the Institute for the Improvement of Education in designing VET curricula to meet current labour market needs for the professions (Reyes and Nguyen, 2020[37]). Because, as mentioned, a large proportion of students get to higher education through vocational schools, making VET schools more relevant to skills the labour market demands may yield efficiency gains, as well as improve student skills.

Improving health and social protection outcomes

Quality of health care has deteriorated amid austerity measures and reliance on frequently evaded social contributions

Serbia's overall key health outcomes are good for its income level but significantly worse for low-income and minority groups. In 2017, life expectancy at birth (76 years) and under age 5 child and maternal mortality rates (5.9 per 1 000 and 12 per 100 000 live births, respectively) were in line with regional averages (World Bank, 2020[2]). Yet, the latest available data on child health show that mortality rates for under age 5 Roma children are twice as high as for the general population (SORS/UNICEF, 2014[53]). Children in Roma settlements are also five times more likely to be underweight and three times more likely to be stunted. With the involvement of Roma mediators, the government newly registered 131 495 Roma for health insurance between 2009 and 2014, and 30 018 children and 2 719 adults were immunised. The 2016-25 strategy for the social inclusion of Roma for the period also lists improvements in the health status of Roma and their access to health care as a priority goal (ESPN, 2018[54]).

As elsewhere in the Western Balkans and the OECD, the ageing population and unhealthy lifestyles in Serbia mean that non-communicable diseases pose a growing risk to health, productivity and well-being. In 2018, Serbia's top causes of premature death were cardiovascular diseases (51%) and cancer (22%). Although smoking rates have decreased slightly over the past decade, Serbia remains among the ten economies with the highest smoking rates in the world: 40% of adult men and 37% of adult women (the highest rate for women in Europe) regularly consumed tobacco in 2016 (World Bank, 2020[2]). In 2019, 9% of the population had diabetes (one of the top five causes of death and disability in Serbia),[12] compared to 6.4% in the average OECD country (Institute for Health Metrics and Evaluation, 2020[55]; OECD, 2017[56]; World Bank, 2020[2]).

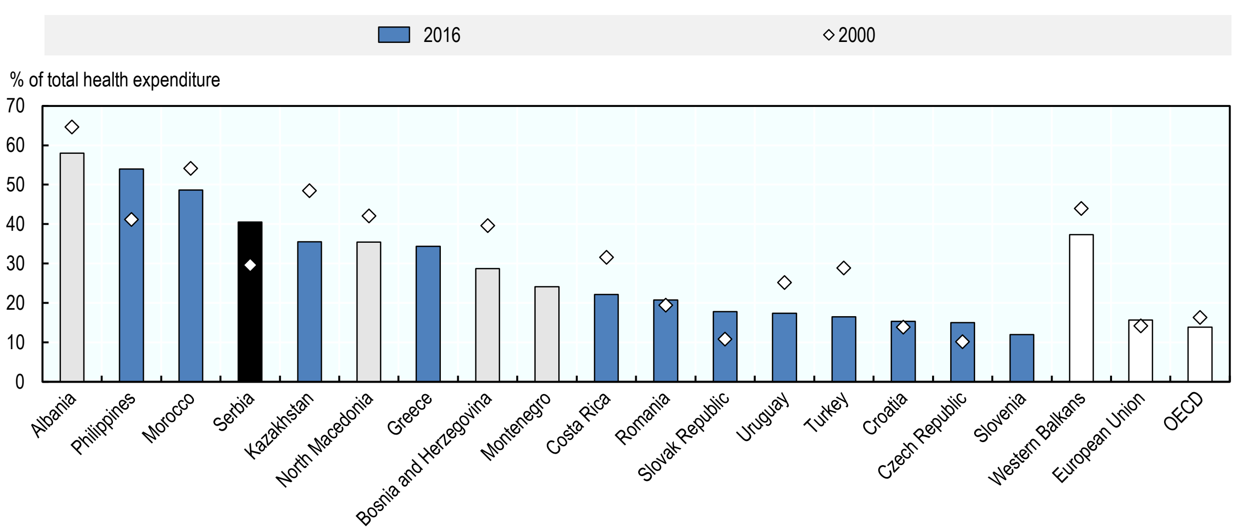
The preventative care component in Serbia's primary healthcare sector will need to be strengthened and regulation to discourage unhealthy behaviours sharpened. Tobacco taxes (at EUR 70 per 1 000 cigarettes) are two-thirds the EU standards and could be gradually increased in co-ordination with non-EU neighbouring economies to prevent smuggling (Institute of Economic Sciences Belgrade, 2018[57]). Authorities are currently discussing an amendment to the Law on Protecting the Population from Exposure to Tobacco Smoke that would introduce a full ban on indoor smoking. In addition, the current Law on Excise Duties prescribes a gradual increase in the total excise burden on cigarettes, in order to reach the level prescribed by EU directives. A medium-term plan for a gradual increase in the excise burden in the period 2021-2025 has been adopted.[13]

Access to health care in Serbia is relatively equitable, but complicated administrative processes should be streamlined. A compulsory healthcare insurance scheme covered 97.5% of the population in 2016. The state provides insurance contributions for vulnerable groups, such as registered beneficiaries of social assistance and registered unemployed, who are also exempt from co-payments. One-fifth of all insured people were covered by this provision in 2016. There is also a cap on annual co-payments for the remainder of the insured, but the present procedure requires the collection of all receipts and a complicated calculation of the limit. This could be streamlined by monitoring payments through existing patient e-health cards. The proportion of citizens who reported unmet medical care needs has been decreasing since 2013, reaching 11.8% in 2018, while health care comprised 3% of household spending (ESPN, 2018[54]; Eurostat, 2020[47]). Nevertheless, unmet needs are higher for people in sparsely populated areas and those with lower incomes, one-sixth and one-quarter of whom reported unmet medical needs in 2014, respectively (Popovic et al., 2017[58]).

Evasion of health insurance contributions and corruption pose further challenges. Out-of-pocket (OOP) expenditure is a high and growing share of total health expenditure (Figure 17.11). Evasion of contributions by employers, including public companies, is one reason: in 2016, 47 000 employees in Belgrade, representing 7% of its employed labour force, were unable to exercise their right to health care as their firms did not pay health insurance contributions (ESPN, 2018[59]).[14] There is also evidence that government financing for vulnerable groups in 2010 and 2015 was consistently lower than specified in the statutory obligation, leading to shortfalls in Health Insurance Fund (HIF) financing (ESPN, 2019[60]). A significant share of OOP health expenditure is spent on informal payments for better quality care or to reduce the waiting time for medical tests or surgery (see the Peace and institutions section in this chapter).[15] The recent 2019 Law on Healthcare Protection includes provisions regulating conflicts of interest and thresholds for healthcare providers receiving gifts but does not stipulate the period of time for accounting for such gifts or forbid side payments for "bought and brought goods" (Radošević and Milica, 2019[61]). The HIF and the Ministry of Health should take a more active approach to reaching out and educating patients, the majority of whom, according to a recent survey, tend not to be well informed about their rights or how to report potential violations (European Policy Centre/European Movement in Serbia, 2018[62]).

Figure 17.11. Citizens of Serbia have to pay a significant and rising share of health expenditure out of pocket

Out-of-pocket health expenditure (% of total health expenditure)



Note: The Western Balkan average includes Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia.
Source: World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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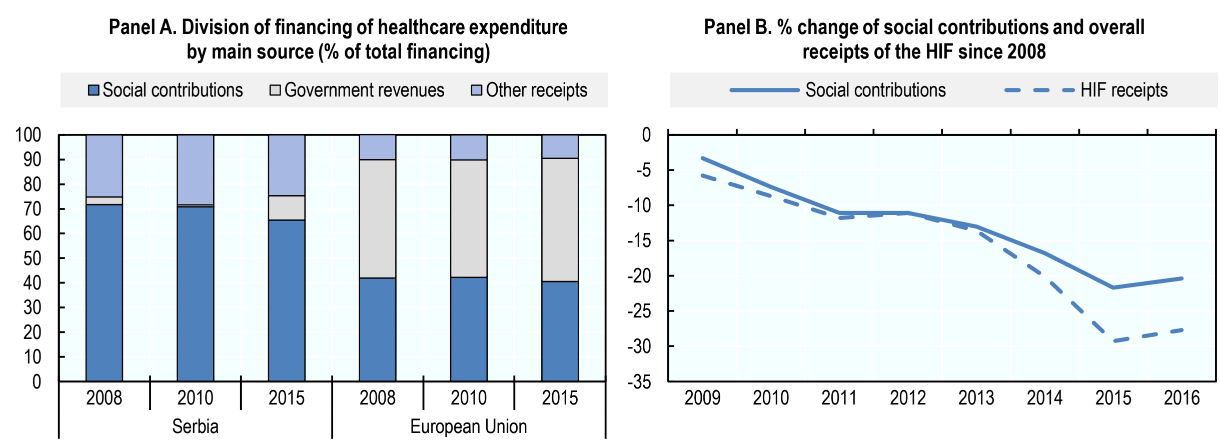
In the past decade, the supply of health services was not driven by actual need and demand but was kept in check by fiscal considerations. Like Western Balkan neighbours but in contrast to other European economies, the health insurance model in Serbia largely depends on social security contributions. The government general budget covers the remaining costs as needed (Figure 17.12). In real terms, HIF revenues in 2017 were equal to half those in 2008, mainly due to declining contributions. A variety of factors contribute: the accumulation of debt for unpaid contributions (the HIF paid them off in

2012 with disastrous consequences for fund finances), a two percentage point cut in the social contribution rate in 2014, continued evasion of contribution payments by firms, low employment rates and minimal wage growth after the 2008 financial crisis. Overall health spending is in line with the Western Balkan average, but compared to 2008, dropped by close to one percentage point to 7.8% of GDP in 2017. It has also fallen relative to other social protection functions (World Bank, 2020[2]).

Inefficient health spending and a growing gap between the very broad basic package of health benefits and available resources have resulted in poor health system outcomes. These include rationing of services, deterioration of health infrastructure and longer waiting lists. Austerity measures included a stop on hiring public-sector employees in 2014. Coupled with the migration of qualified staff abroad, the number of healthcare personnel fell by almost 10% between 2008 and 2015. For a while, the government added no new or more innovative drugs to the Positive Drug List. Insured people in Serbia wait an average of 812 days for an innovative drug – the worst result in the Western Balkan region. By comparison, it takes 585 days in Albania and 127 days in Germany for a new drug to be made available to the general population (EFPIA, 2020[63]). Waiting times for all major surgical procedures continuously increased in 2012-16, despite the introduction of an online system for direct specialist bookings in some hospitals and e-prescriptions (ESPN, 2018[54]). Since 2017, some surgical procedures may be conducted in the private sector, but without wider inclusion of the private sector in managing waiting lists, the situation will remain problematic.

Figure 17.12. Social contributions make up a high share of Health Insurance Fund finances and have been falling in line with overall revenues

Division of financing of healthcare expenditure by main source (% of total financing) (Panel A) and % change of social contributions and overall HIF receipts since 2008 (Panel B)



Note: Other receipts refers to transfers from other social security schemes (e.g. Pension Fund, National Employment Service).
Source: ESPN (2019[60]), *Financing Social Protection: Serbia*, https://ec.europa.eu/social/BlobServlet?docId=21843&langId=en&.

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To improve the sustainability of the healthcare system, medical staff and investments in equipment maintenance need to increase. On the back of slightly more favourable public finances from 2017 on, the government announced a raise in public-sector wages, including for medical staff, at the end of 2019 (Reuters, 2019[64]). However, given the likely negative impact of COVID-19 on public finances, some of the necessary savings will need to come from spending existing health funds more efficiently. Potential reform options include directing more people to primary care (costs for providing services vary significantly between primary care facilities and hospitals), output-based financing (reimbursement based on a

Diagnostic Related Groups System is being piloted), enhanced facility autonomy, and accountability and reform of pharmaceutical spending. In addition, the widespread evasion of social security contributions in terms of under-reporting wages needs to be more stringently penalised, and current official exemptions for public companies need to be phased out.

Pensions and social assistance schemes fail to prevent poverty

Funding for other social protection measures has also been on a downward trend. In 2016, gross expenditure on social protection as a share of GDP was 21.5%, almost 6.7 percentage points lower than the EU28 average and 1.4 percentage points lower than in 2008 (ESPN, 2019[60]). Pensions, the majority of which are old-age benefits, make up the largest social protection function (46.2% of total expenditure in 2015) and, at 10.3% of GDP in 2018, are in line with the EU average (Eurostat, 2018[1]; SORS/Ministry of Finance, 2020[65]). Serbia has a public statutory pension system that is compulsory for all persons engaged in standard or non-standard forms of employment and is based on a pay-as-you-go scheme. The number of individuals enrolled in voluntary private pension funds is very low: around 2.9% in 2019 (National Bank of Serbia, 2020[66]).

Like health care, pensions were affected by fiscal consolidation and austerity measures. Given the high deficit of the Pension Fund for several decades, the government introduced various reforms that affected both the retirement age and the level of pensions from 2008 onwards: pensions were frozen in 2009-10, the pension indexation was adjusted below the inflation rate between 2011 and 2014, higher-than-average pensions (over EUR 208) were temporarily cut between 2014 and 2018 and penalties for early retirement were introduced (ESPN, 2019[60]). In combination with a four percentage point increase in the pension insurance contribution rate (in contrast to the reduction in contributions for health), these changes resulted in a decrease in the Pension Fund deficit, even though the number of old-age pensioners increased by almost one-quarter in 2008-16. While pension levels were raised again in 2020 by 5.4%, it is unclear whether necessary public funding will be available, given the negative economic impacts of COVID-19 (Reuters, 2019[64]).

Pensions in Serbia do not fully protect against old-age poverty. While coverage is high – 95.9% of men and 85.6% of women age 65 and over received a pension payment in 2019 – the adequacy of pensions is low. According to the latest available data in June 2020, about one-quarter of pensioners received less than EUR 128.50 per month, approximately one-third the cost of the average minimum consumer basket for a three-person household (ESPN, 2017[41]; Pension and Disability Insurance Fund for the Republic of Serbia, 2019[67]).[16] In 2019, the at-risk-of-poverty rate for a household with two adults households and at least one person over the age of 65 was 18.4%, compared to an EU28 average of 11.9% (Eurostat, 2018[68]). The gender gap in pension income for those aged 65 to 79 is high at 25.5% (the retirement age for women is 61.5 years compared to 65 years for men) but less than the EU28 average of 36.5% and smaller when disability and survivor pensioners are excluded from the calculation (in which case it is only 17% for employees and 5.4% for farmers) (ESPN, 2017[41]).

In common with the region, social assistance in Serbia is inadequate. The overall expenditure on means-tested schemes, which include family, social exclusion and housing benefits, is low by European standards: it represented 0.9% of GDP in 2018 compared to 3.1% in the EU28 (corresponding to 4.7% of gross social protection expenditure for Serbia compared to 11.7% for the EU28) (ESPN, 2019[60]). FSA is the main financial support for all families with low incomes. Although the number of FSA beneficiaries increased by 67% and related budget outlays doubled to 0.34% of GDP between 2010 and 2014, transfers have low adequacy, especially for families with children and single parents. Families with three or more children have the highest at-risk-of-poverty rate at 44.4%, 19.8 percentage points more than the national average. It is estimated that FSA benefits for two-parent families should be increased by more than one-third to reach the poverty threshold (ESPN, 2015[69]).

In addition to benefit levels, coverage of social safety nets is an issue. While FSA targets the poor (75% of benefits go to the poorest quintile), the scheme covers only 5.7% of this population (World Bank, 2020[70]). There are huge gaps in coverage among municipalities: in Priboj, one of the poorest municipalities, 0.7% of poor households are covered by FSA, compared to 8.4% in Apatin, one of the richest. The main obstacles in take-up relate to complicated administrative procedures, the significant power of social workers and strict exclusion criteria. Applicants must submit a large set of supporting documentation, including birth certificates (which Roma in particular are less likely to have) and official proof that persons legally responsible to support the applicant are not doing so. Social workers have discretionary power to estimate unrecorded revenues and potential revenues[17] and decide on applications. In addition, individuals who own more than the basic living area (one room per member) or agricultural land of 0.5 ha or more are not entitled to FSA unless they agree to mortgage their property for valorisation of cash benefit costs (European Minimum Income Network, 2014[71]).[18] Very low income eligibility thresholds (EUR 68.9 for a single-person household and EUR 103.3 for two adults in 2017) also leave out beneficiaries on the minimum pension scheme (ESPN, 2017[41]). Given that this group is less likely to remain active in the labour market, a more relaxed FSA threshold could be defined for people over age 75.

Prosperity – boosting productivity

The Prosperity pillar of the 2030 Agenda for Sustainable Development calls for broad-based economic growth shared by all people. Over the past decade, Serbia has made notable progress in building a more competitive, export-oriented market economy. Thanks to advancements in the structural reform agenda, strengthening of the institutional framework and return of macroeconomic stability in recent years, Serbia is now better placed to pursue a higher growth trajectory and faster convergence with EU income levels.

Over the coming decade, continued commitment to macroeconomic stability will be crucial in strengthening and sustaining GDP growth, as will be reforms that create a more stable and predictable institutional, regulatory and business environment that is conducive to robust investment and productivity growth. This would entail increasing the transparency and predictability of regulations that affect business, reducing red tape and corruption and levelling the playing field for all actors in the economy. In line with its aspirations to foster faster and more sustainable growth through smart specialisation, Serbia also needs to improve the skills of its workforce and strengthen the capacities of its SMEs to innovate and adopt new technologies. These reforms are also critical for developing deeper linkages with the economy's growing and increasingly diverse FDI sector and GVCs.

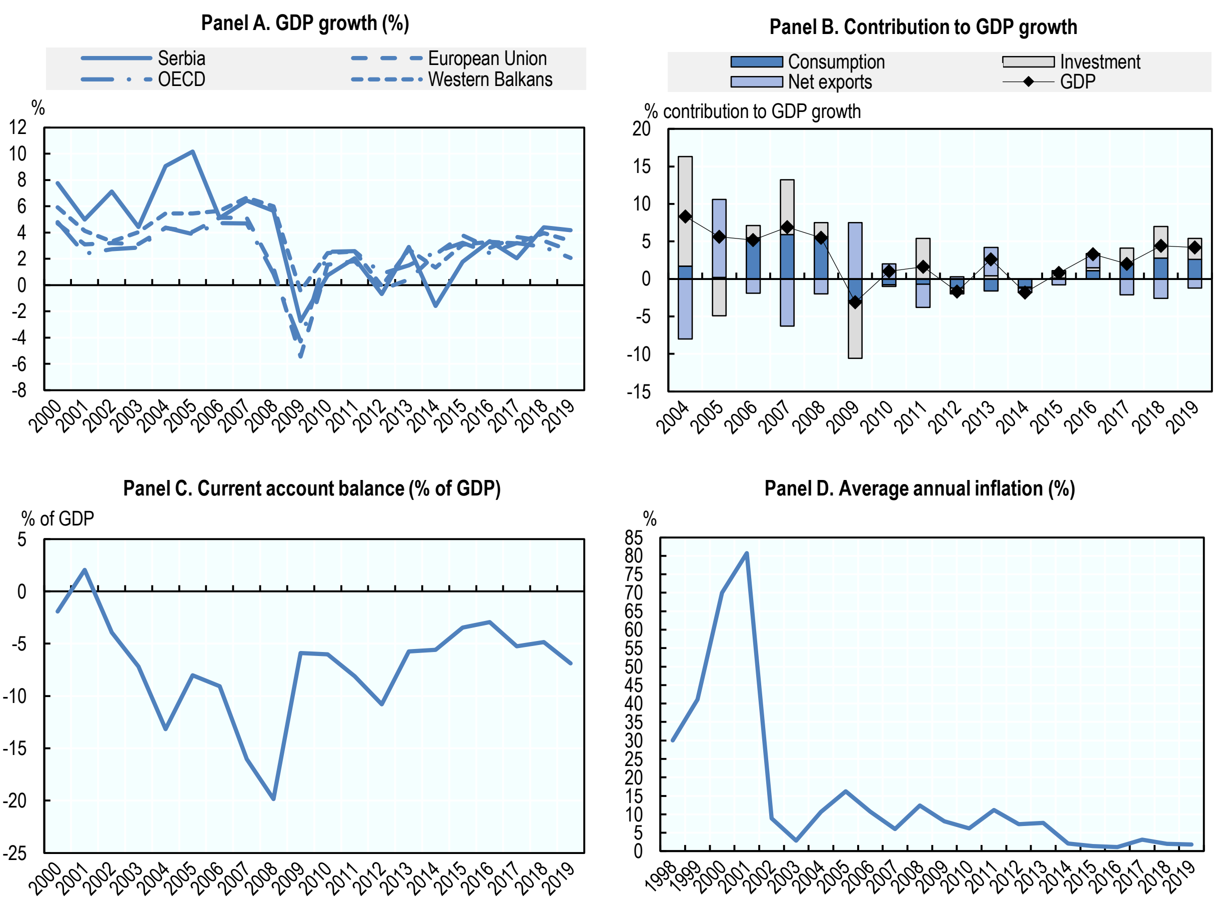
Table 17.3. Prosperity – three major constraints to a more dynamic economy of Serbia

1. Weak investment and productivity growth impede income convergence with the European Union.
2. Investment is hampered by weaknesses in the administrative and regulatory environment, corruption and weaknesses in competition.
3. Economic upgrading and smart specialisation are constrained by weaknesses in the skills profile of the workforce.

Stronger investment, productivity growth and income convergence

Prior to the 2008 global financial crisis, the growth of the Serbian economy was high but unbalanced. Between 2000 and 2008, GDP grew by an average of 6.5% on the back of high domestic demand fuelled by strong credit growth from the newly foreign-owned banks, as well as expansionary fiscal policy (Figure 17.13 – Panels A and B). However, the high growth was not accompanied by strong investment growth or improvements in labour market outcomes, and this period saw a decline in employment, from 49% in 2000 to 43% in 2006. In the face of high inflation, which averaged 9.7% between 2002 and 2008, monetary policy remained tight and could not mitigate the currency appreciation pressures, which further dampened the weak export performance (Figure 17.13 – Panel B). The current account deficit rose significantly, from 4% to 20% of GDP between 2000 and 2008 (Figure 17.13 – Panel C), and external debt rose from 14% of GDP in 2004 to 77% in 2009. The high inflation and weak confidence in the local currency, the dinar, following the hyperinflation of the mid-1990s and the high and volatile inflation thereafter (Figure 17.13 – Panel D) resulted in high demand for foreign currency loans (80% of loans were denominated or indexed in foreign currency in 2007) and high exposure to currency risk. In the context of the credit boom, these risks materialised during the global 2008 financial crisis and thereafter, with the NPL portfolio reaching 21.6% of total loans by 2015 (National Bank of Serbia, 2020[72]).

Figure 17.13. GDP growth has weakened in the post-crisis period (%) on account of weaker domestic demand, but external balances and internal balances have improved



Sources: IMF (2020[73]), "Republic of Serbia and the IMF", www.imf.org/en/Countries/SRB; World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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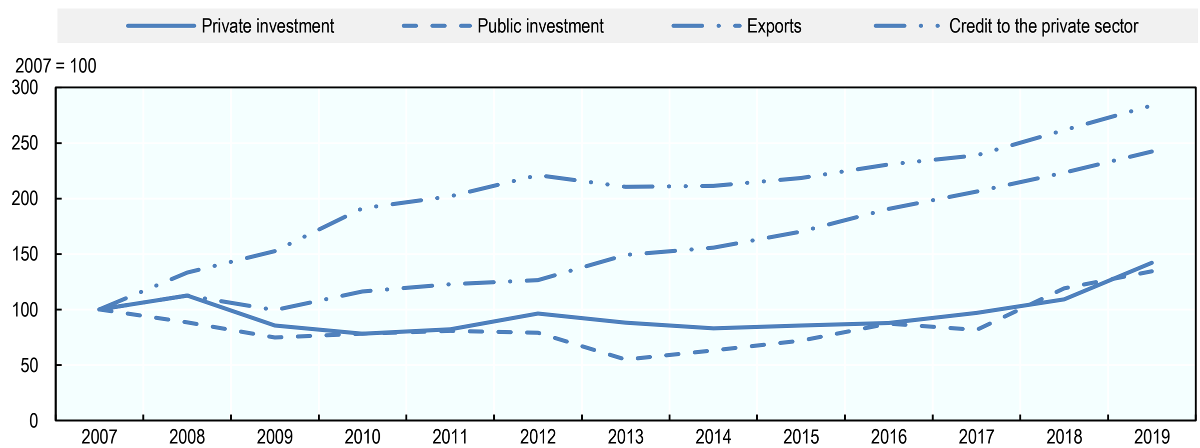
Growth in the post-crisis period has been relatively weak and quite volatile, especially in the immediate aftermath of the crisis. Serbia experienced a double-dip recession caused by the Eurozone crisis of 2011 and the devastating 2014 floods (Figure 17.13 – Panel A). These shocks amplified other challenges, including high and rising NPLs and weakening credit growth (Figure 17.14). They also dampened the gains in productivity (Figure 17.18 – Panel A) and exports coming from FDI, as Serbia began to attract investment in the tradable sector in the newly established free zones, leveraging the relatively cheap qualified labour and offering attractive incentives to export-oriented investors. This period also saw productivity gains from the reallocation of labour from agriculture into more productive manufacturing and services (Figure 17.18 – Panel A).

Figure 17.14. Export growth has been strong in the post-crisis period, but the increase in domestic private investment has been modest, despite high credit growth

Index of investment, exports and credit to the private sector (100 in 2007)



Sources: World Bank (2020[2]) *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators; National Bank of Serbia (2020[72]), *Statistics* (database), www.nbs.rs/internet/english/80/index.html.

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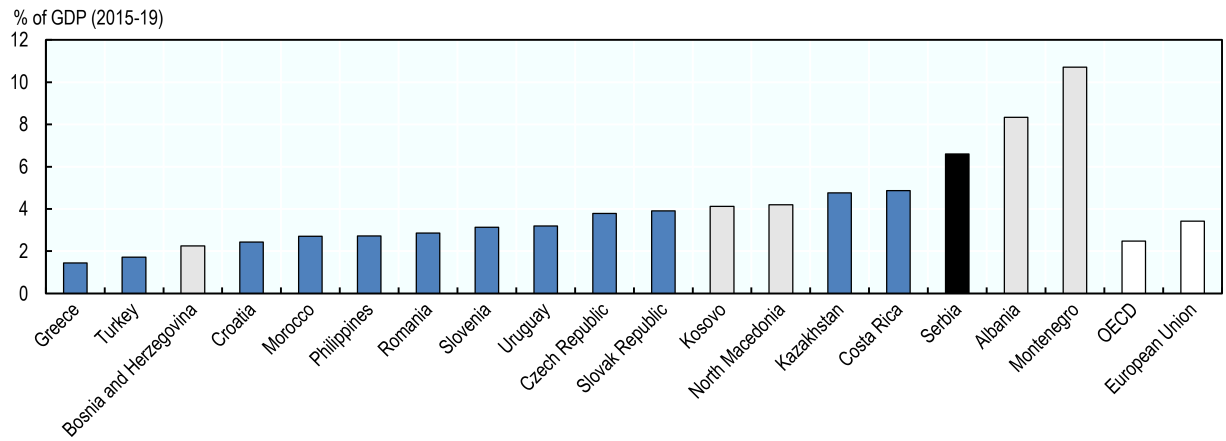
Over the past five years, economic performance has improved significantly, underpinned primarily by strengthened macroeconomic stability. Inflation has declined and stabilised, with an annual average of 1.9% (Figure 17.13 – Panel D). Strong fiscal consolidation (from a 6.4% deficit in 2012 to a 0.6% surplus in 2018) has reduced the public debt from 70% of GDP in 2015 to about 53% in 2019 (see the Partnerships and financing section in this chapter). Over this period, financial stability improved as well, with NPLs declining to 4% of total loans and dinar-denominated lending increasing from less than 20% in 2007 to 33% in 2019 (National Bank of Serbia, 2020[72]).

The improved macroeconomic environment has been conducive to stronger investment and export growth. Private investment has increased by more than 30% since 2014. This includes strong growth in FDI investment (Figure 17.15) – Serbia has been a global leader in greenfield FDI attraction in recent years – most of which went into export-oriented manufacturing, including the automotive industry, food and beverage processing, textiles and electronics (Development Agency of Serbia, 2020[74]). Exports growth also increased significantly (Figure 17.14, Figure 17.16). Manufacturing exports rose by nearly 52% since 2015 and currently account for 65% of total exports, while service exports, driven by the ICT sector, grew by 16% annually over the past three years and, in 2019, accounted for 30% of total exports (SORS, 2020[8]).

Figure 17.15. Serbia has attracted significant FDI over the past five years



Source: World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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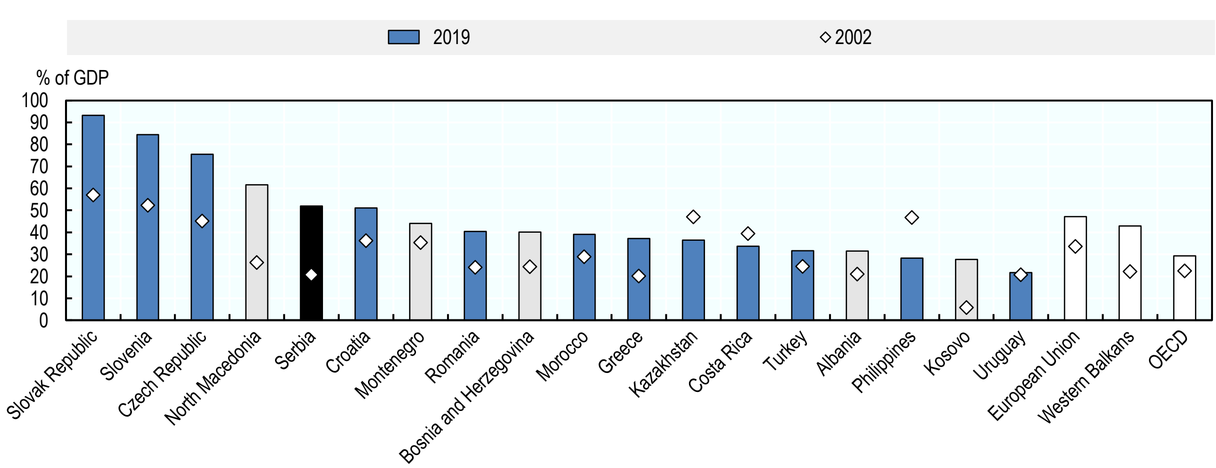
Despite these positive developments, growth remains modest and income convergence with aspirational peers in the European Union is slow. Annual average GDP growth has been 3% since 2014. Given that Serbia's current GDP per capita is less than a half the EU average, it would take Serbia more than 20 years to catch up to current EU income levels at this pace (World Bank, 2020[2]). The modest growth reflects a confluence of factors including low investment and its allocation to low value added sectors, weak productivity growth and slow structural transformation of the economy.

Figure 17.16. Exports' contribution to GDP has increased considerably

Exports as a share of GDP



Source: World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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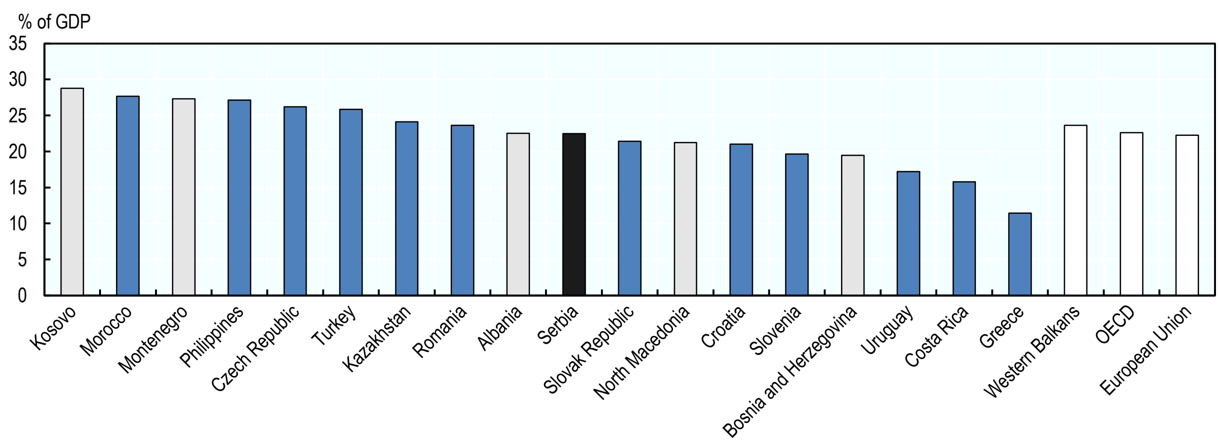
Domestic private and public investment remains relatively weak compared to regional peers (Figure 17.17). Private investment is constrained by weaknesses in the business environment and weak access to finance for SMEs, particularly start-ups and microenterprises, while public investment has been constrained by fiscal consolidation and structural weaknesses, including an insufficiently developed public finance management framework and the high share of current expenditures mainly going towards subsidies and transfers (see the Partnerships and financing section in this chapter). Weak investment is also reflected in the relatively weak contribution of the capital stock towards productivity over the past decade (World Bank, 2019[75]).

Figure 17.17. Gross capital formation in Serbia has been relatively weak compared to regional and global peers

Gross fixed capital formation (% of GDP), 2019



Source: World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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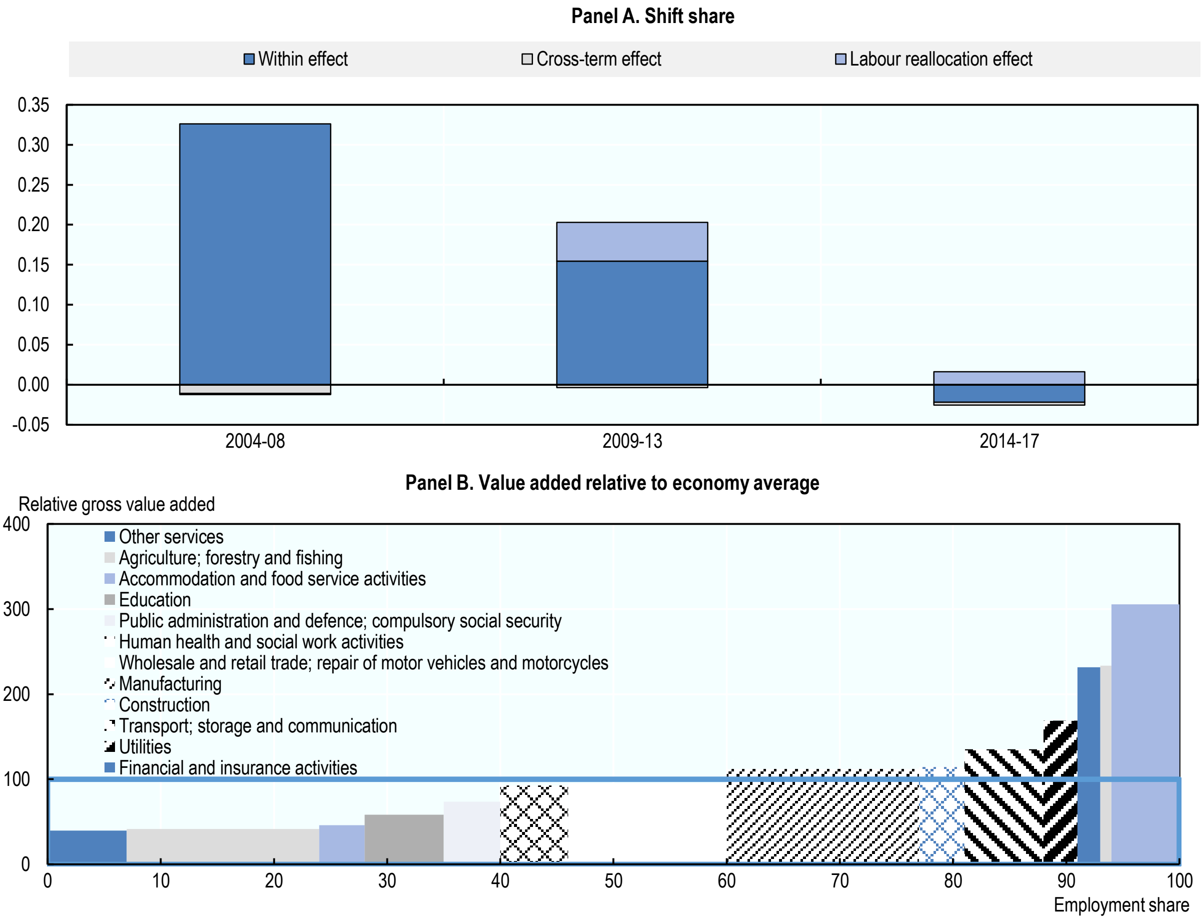
Productivity growth has declined considerably, and most employment is still in low-productivity sectors. Within-sector productivity growth has declined significantly in the post-crisis period, and Serbian labour productivity significantly lags behind that of aspirational EU peers. In 2019, value added per worker in industry (including construction) and agriculture was roughly one-quarter the EU average, while it was even weaker in services at 20% of the EU average (World Bank, 2020[2]). Productivity gains from labour reallocation to more productive sectors have also been relatively limited (Figure 17.18 – Panel A).

Figure 17.18. Productivity growth has declined considerably in the post-crisis period, and most current employment is in low-productivity sectors

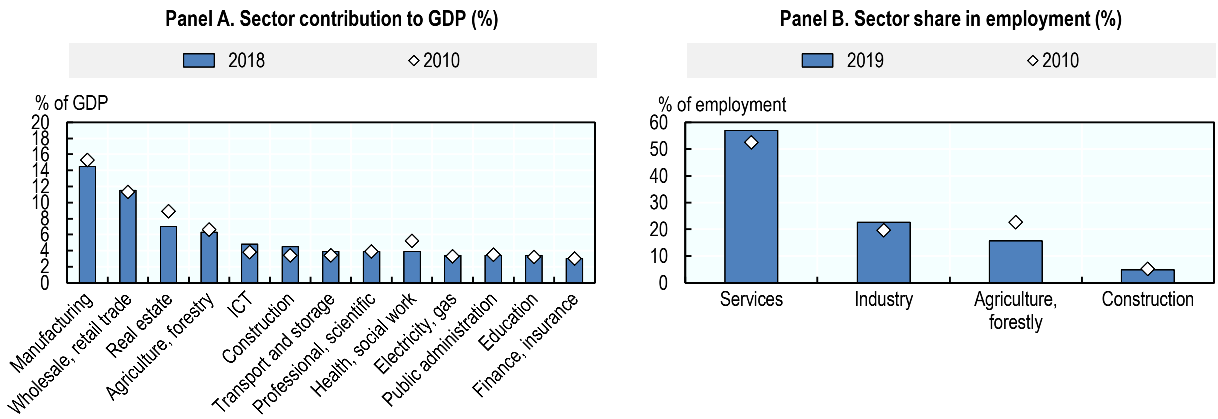


Source: Authors' own work based on ILO (2020[22]), *Data on employment by sector* (dataset), www.ilo.org/shinyapps/bulkexplorer46/?lang=en&segment=indicator&id=EMP_2EMP_SEX_AGE_NB_A; UNdata (2020[76]), *Value added by industries at constant prices (ISIC Rev. 4)* (dataset), http://data.un.org/Data.aspx?d=SNA&f=group_code%3A204.

StatLink https://doi.org/10.1787/888934245500

The weak productivity growth from labour reallocation between sectors also reflects the relatively limited structural transformation of the economy. Sector contribution to GDP has not changed significantly over the past decade (Figure 17.19 – Panel A). Labour has moved from agriculture to manufacturing and services, but agriculture still accounts for nearly one-fifth of all employment (Figure 17.19 – Panel B) and productivity gains have been limited. Even though Serbia has been a regional leader in FDI attraction, these investments have not strongly contributed to structural transformation because the linkages with the domestic economy and other spillovers have been fairly limited. FDI has also been largely concentrated in labour-intensive manufacturing activities (automotive, food processing, textiles) with relatively low value added (OECD, 2017[77]).

Figure 17.19. Sector contribution to GDP (%) and sector share in employment (%)



Source: SORS (2020[8]), *STAT* (database), https://data.stat.gov.rs/?caller=SDDB&languageCode=en-US.

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Investment is hampered by weaknesses in the administrative and regulatory environment, corruption and weak competition

Regulatory and administrative burden

Over the past five years, Serbia has made notable progress in reducing the regulatory and administrative burden on businesses, but many challenges remain. Thanks to reforms that streamlined the process of issuing construction permits, introduction of an e-permitting system, introduction of filing VAT returns in electronic form and social security contributions, Serbia has facilitated doing business. This is reflected in its World Bank Ease of Doing Business rankings: from 2015 to 2020, Serbia rose from 186th to 9th on the indicator for dealing with construction permits and from 165th to 85th on the indicator for paying taxes (World Bank, 2020[78]).

More progress is needed to reduce bureaucratic red tape and improve regulatory transparency and certainty. In the latest Business Environment and Enterprise Performance Survey (BEEPS), Serbian firms cited considerable challenges in dealing with the administration. The management of Serbian firms spends, on average, more time dealing with government regulation requirements than management in peer economies. It also takes, on average, much longer (98 days) to obtain an operating license relative to comparable economies (24 days in Europe and Central Asia [ECA]; 28 days globally) (World Bank/EIB/EBRD, 2019[79]). Tax administration remains relatively cumbersome, as firms in Serbia have to make 33 tax payments per year – twice as many as in regional peers. Nearly half the firms surveyed in the BEEPS noted that they had to meet with tax officials, on average, two times per year (World Bank/EIB/EBRD, 2019[79]). The response to the COVID-19 pandemic has shown the capacity of Serbia to mobilise digital tools, building on the priority given by the Government of Serbia to digitalization and e-government. Serbia put in place distance learning, as did many other countries around the world, but also put in place innovative tools such as a volunteering platform (Be a volunteer) and a COVID-19 National integrated information system to aggregate and report data (OECD, 2020[80]). Digitalization of previously optimised procedures can contribute greatly to a more efficient, accountable and user-oriented public administration.

Increasing the transparency and predictability of regulations affecting businesses is an area where Serbia can make significant progress. Serbia has set up a regulatory and institutional framework for effective, inclusive, evidence-based policy making. When it comes to implementation, however, there is still room for improvement. Data collection and use in the process of policy making are not comprehensive and consistent across the administration. Since 2019, the Public Policy Secretariat (PPS) requires lawmakers to conduct impact assessments of draft laws and regulations. However, these assessments are not systematically submitted to the Parliament together with the legislative process (European Commission, 2020[3]). A policy planning legislative framework is well in place, and the Law on the Planning System of the Republic of Serbia (Republic of Serbia, 2018[81]) sets the framework for consultation with stakeholders throughout the process. Further efforts are warranted to ensure that its implementation leads to significant improvements in the inclusiveness of policy making.[19] Domestic and foreign businesses, for instance, complain about the lack of timely consultation and regular dialogues with the business community when it comes to drafting legislation or regulations affecting their operations. Overall, businesses also complain about a lack of clear instructions on the implementation of regulations, which adversely affects their operations (Foreign Investors Council, 2019[82]).

The Public Policy Secretariat (PPS) has undertaken important initiatives to improve interministerial co-ordination at the national level and to strengthen the stakeholder consultation process. This includes the preparation and implementation of the Action Plan for the Implementation of the Government Programme. In that regard, four implementation groups have been set up, and meetings with relevant authorities are being held regularly and include the preparation of follow-up reports and their submission to the prime minister.[20] Preparation is also underway for an e-participation platform, an IT solution for the consultation process and public debate, which should help improve the ongoing consultation process in Serbia.

Corruption

Corruption remains an important challenge in Serbia. In the latest Transparency International Corruption Perceptions Index, Serbia ranked 91st out of 191 economies, well below most aspirational peers in Central and Eastern Europe (CEE) (Transparency International, 2019[83]). The prevalence of bribery is higher in Serbia compared to peers. In the latest BEEPS survey, a higher share of businesses in Serbia reported having to provide gifts to obtain licenses compared to regional and global peers. For example, the bribery incidence while obtaining operational licenses in Serbia was 18%, compared to 9% in the ECA region (World Bank/EIB/EBRD, 2019[79]).

Prosecution and sanctioning of corruption lags behind (see the Peace and institutions section in this chapter). In its latest assessment, the European Union noted that law enforcement and the judiciary have yet to establish a credible track record of prosecuting high-level corruption cases (European Commission, 2019[84]). Serbia's ranking also declined on the latest Transparency International Corruption Perceptions Index on account of weak progress in anti-corruption efforts (Transparency International, 2019[83]).

Competition

Serbia lags behind many peers on indicators related to market competition and state participation in markets. In the latest World Economic Forum Global Competitiveness Index, Serbia ranked 110th out of 141 economies on the indicator for market dominance, which measures the extent to which corporate activity is dominated by a few business groups or is spread across many firms. It also ranked lower compared to most aspirational peers on the indicators for distortedness of taxes and subsidies (81st) and competition in services (85th) (WEF, 2020[85]).

The role of the state in the economy is decreasing but remains large; if not regulated, it may threaten competition. In 2018, state aid in Serbia accounted for 1.9% of GDP, decreasing from 2.2% in 2017. It still remains higher than in the rest of the region and the EU average (0.76% in 2018). State aid can promote growth, create jobs and trigger spillovers throughout the economy, but if mistargeted, it can provide incumbent unprofitable companies an unfair advantage over more innovative and competitive outsiders. In Serbia, sector-specific aid sometimes supports ailing industries. Some 60% of corporate subsidies target SOEs, which play a shrinking but still large role in the economy: they account for 19% of value added and formal employment (European Commission, 2019[84]; World Bank, 2019[75]). SOEs are present in many sectors, including utilities, telecommunications, transport, banking and insurance, construction and agriculture. The high presence of SOEs in network industries also affects the productivity of other sectors, especially manufacturing (World Bank, 2020[70]). In general, SOEs have enjoyed preferential treatment in terms of regulatory enforcement too (World Bank, 2020[70]).

The legal frameworks for the protection of competition, the regulation of state aid and SOE governance have been improving, but implementation needs to be strengthened. The country has long had an independent and empowered anti-trust agency (the Commission for Protection of Competition) and, since January 2020, an independent Commission for State Aid Control (CSAC) (in application of the Law on State Aid Control adopted in 2019). The actual empowerment of the CSAC will therefore be crucial to regulate the role of the state in the economy and prevent potential distortion of the market. State subsidies and guarantees for SOEs have been decreasing (World Bank, 2020[70]). The Law on Public Enterprises adopted in 2016 aims to reform the governance of SOEs, making a clear distinction between the ownership and the regulator (World Bank, 2020[70]).

Economic upgrading and smart specialisation are constrained by weaknesses in the skills profile of the workforce

Looking to the 2030 horizon, Serbia can seek further economic upgrading in order to boost the dynamism of the economy and increase its growth potential. Sectors with high export and growth potential in Serbia include ICT, agriculture and food processing, machinery, electronics, mining, etc. The growth and upgrading of these sectors can be supported through the attraction of FDI in higher value added activities but also through supporting the deeper and wider integration of domestic SMEs in GVCs, either through the FDI channel or independently. Serbia’s recently developed smart specialisation strategy, which identifies sectoral priorities for development across all regions, is an important step in setting out the vision and path for advancement.

Two key necessary conditions for the implementation of the smart specialisation agenda are the creation of a skilled and adaptable workforce and an SME sector that can innovate and adopt new technologies. On both fronts, Serbia can make progress to reach the benchmarks of aspirational peers in the European Union.

Skills

When it comes to education outcomes, Serbia performs well compared to regional peers, as evidenced by its relatively strong performance on international student assessments, such as PISA, and its comparatively high enrolment and completion rates across all levels of education. Yet, Serbia lags behind the EU and OECD averages on most of these indicators (see the People section in this chapter).

Despite the strong outcomes, enterprises still have difficulties in finding a workforce with the right skills. In the latest STEP survey, skills were identified as the most significant constraint for hiring followed by lack of experience. Skills were also cited as a constraint by about 50% of surveyed firms. Firms note the lack of both technical and cognitive skills, which are increasingly important as the economy upgrades to higher value added activities but which are not well integrated into education curricula of educational institutions in Serbia (World Bank, 2018[86]).

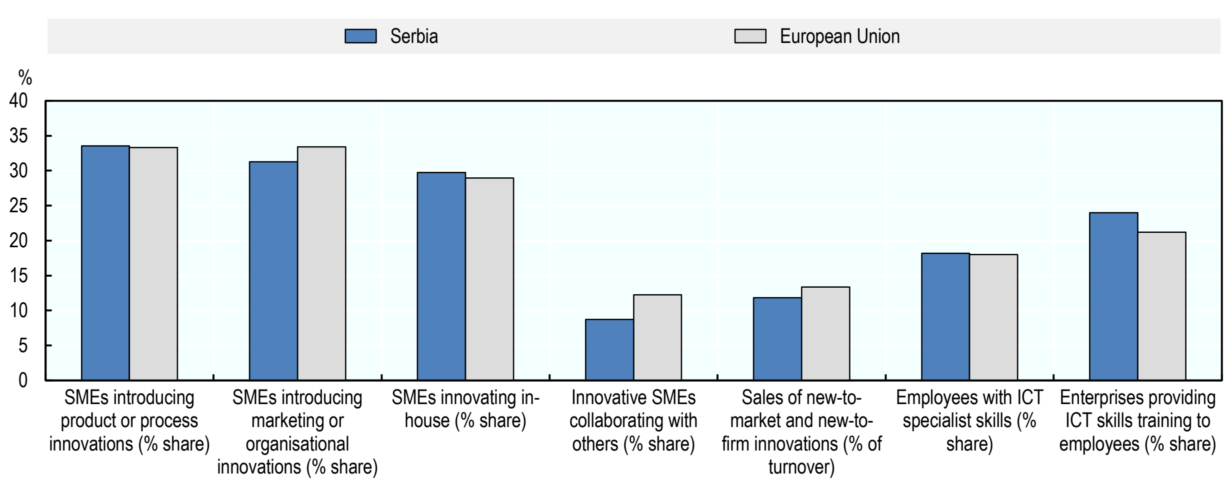
This skills gap reflects outstanding weaknesses in the education system and labour markets. There is significant scope to improve the quality and relevance of higher education by updating the curricula and fostering stronger linkages and co-operation between business and academia (World Bank, 2019[87]). The introduction of the dual education model following the experiences of Austria, Germany and Switzerland should enable smoother school-to-work transitions for VET students (Government of the Republic of Serbia, 2020[88]). Improvements in the access to and quality of life-long learning can help address skills mismatches after the completion of formal education, including addressing the challenges faced by the long-term unemployed (60% of the unemployed population) (World Bank/Vienna Institute for International Economic Studies, 2020[16]). Serbia's ERP also envisages the introduction of relevant measures to encourage innovation in the education system through digitalisation. These include the introduction of an Education Management Information System that will be linked to the Central Registry of Statutory Social Insurance and thus enable the monitoring of graduates' performance in the labour market and in turn help design better education policies to meet labour market needs (Government of the Republic of Serbia, 2020[88]).

Serbia faces considerable emigration of high-skilled people, which exacerbates the challenge of developing a skilled workforce that can support the economic upgrading envisioned in the smart specialisation agenda. Serbia's ERP recognises this structural issue and addresses it in part through reforms aimed at supporting circular migration, particularly targeting the ICT sector. According to this measure, Serbian nationals returning to the country can receive a tax deduction of up to 70% for several years. This is an important first step, but it should be complemented by labour market and business environment reforms to provide incentives for people not to leave in the first place (European Commission, 2020[89]).

Innovation and technology adoption

Enhancing the capacities of companies to innovate and adopt new technologies is critical for fostering stronger linkages between the FDI sector and domestic SMEs and for supporting the upgrading and internationalisation of domestic SMEs. Serbian firms are, on average, more innovative than regional peers, and their performance on a number of innovation indicators is in line with EU peers. In the latest Small Business Act for Europe Assessment, the share of Serbian firms that had introduced product or process innovations, introduced marketing or organisation innovations and that innovate in-house are in line with the EU averages. Serbian firms also have a high share of employees with ICT skills, and they offer more ICT skills training to their employees compared to the EU average (Figure 17.20).

Figure 17.20. Serbian firms' innovation performance is in line with the EU average on many indicators



Note: Data on the first five indicators are from 2016; data for the last two indicators are from 2018.
Source: European Commission (2019[90]), *2019 SBA Fact Sheet: Serbia*, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/sba-fs-2019_serbia.pdf.

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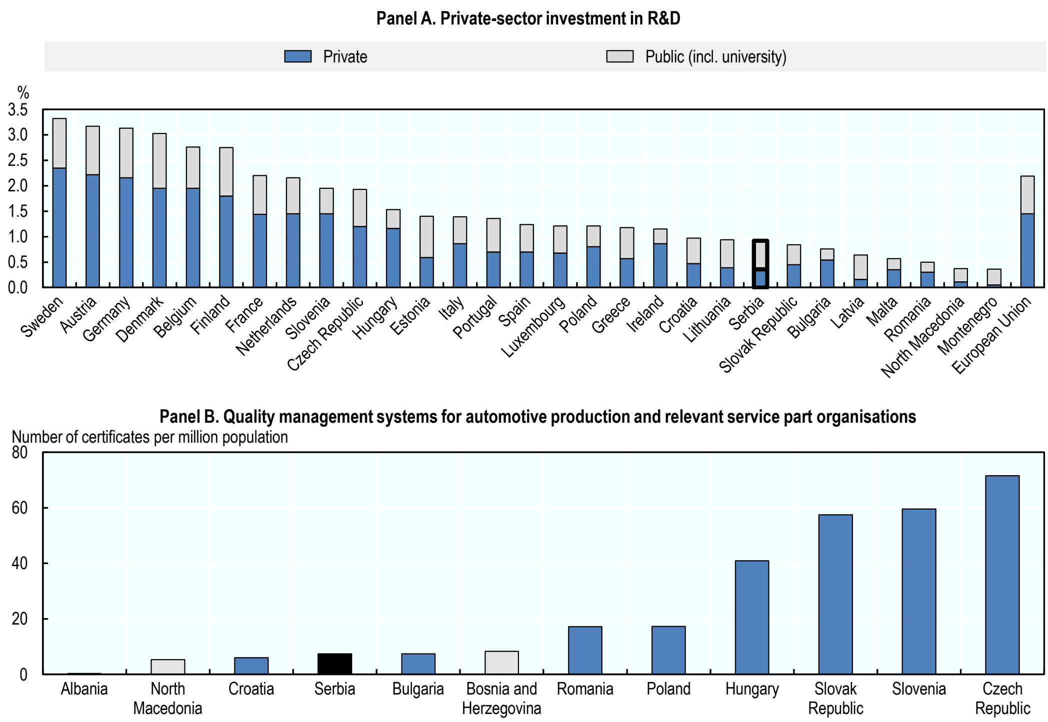
Serbian firms lag behind on other critical innovation-related indicators. The share of innovative SMEs collaborating with other companies is weak (Figure 17.20), and the linkages between business and academia are tenuous (OECD, 2018[91]). Serbia also lags behind most EU countries with respect public- and private-sector R&D investment (Figure 17.21 – Panel A) and the adoption of quality standards necessary to meet industry standards and boost exports (Figure 17.21 – Panel B). Innovation is also constrained by weak access to finance, particularly to the underdeveloped non-bank financing for start-ups and innovative projects (see the Partnerships and financing section in this chapter).

Figure 17.21. Private-sector investment in R&D is low compared to the EU average, and adoption of quality standards lags behind aspirational peers



Sources: Eurostat (2020[47]), *Eurostat* (database), https://ec.europa.eu/eurostat/data/database; ISO (2018[92]), *ISO Survey of certifications to management system standards – Full results* (dataset), https://isotc.iso.org/livelink/livelink?func=ll&objId=18808772&objAction=browse&viewType=1; World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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Partnerships and financing – financing sustainable development

The Partnerships and Financing pillar of the 2030 Agenda for Sustainable Development cuts across all goals focused on the mobilisation of resources needed to implement the agenda. It is underpinned by the Addis Ababa Action Agenda, which provides a global framework to align all financing flows and policies with economic, social and environmental priorities.

In the area of financing, Serbia faces challenges in improving the composition of public expenditures and the access to finance for start-ups and microenterprises (Table 17.4). On the public-sector side, even though Serbia has achieved impressive fiscal consolidation over the past five years, which primarily stemmed from the growth of current expenditures, there is still a need to increase capital spending in order to boost economic growth. In the absence of binding fiscal rules and in light of high discretionary spending, the risks of fiscal slippages remain non-negligible. On the private-sector side, access to finance is particularly constrained for start-ups and microenterprises, which cannot meet the financing requirements of banks but have little other financing recourse due to the relatively underdeveloped alternative sources of financing.

Table 17.4. Partnerships and financing – three major constraints to financing development in Serbia

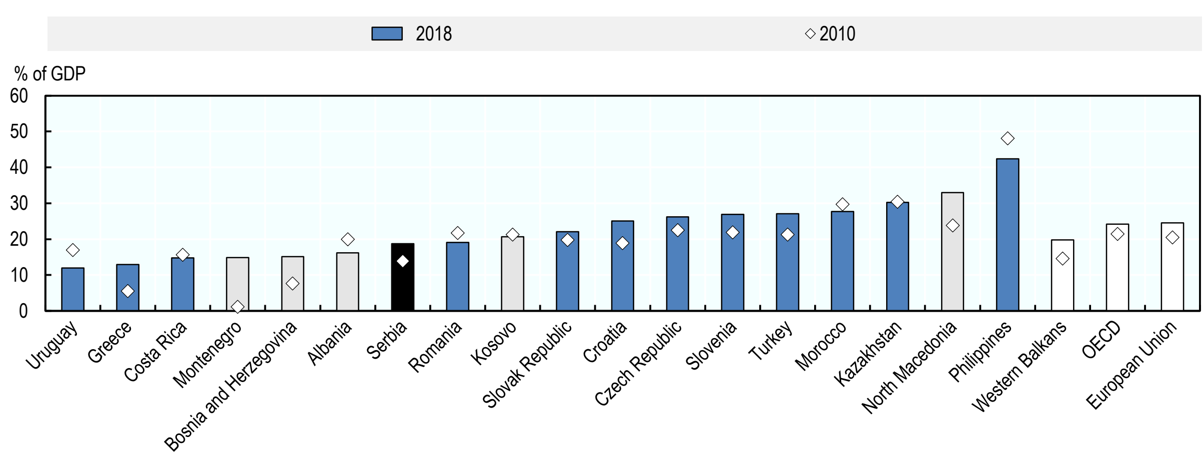
1. Low domestic savings have constrained investment, an impact only partially offset by external financing inflows.
2. Stronger growth in capital expenditures is needed, alongside more binding limits on current spending.
3. More diversified financing options are needed to support start-ups and SME innovation and growth.

Low domestic savings have constrained domestic investment, an impact only partially offset by external financing inflows

Weak domestic savings have constrained domestic private investment in Serbia. Domestic savings increased in the post-crisis period as a result of a decline in real consumption expenditure (from 95% of GDP in 2010 to 85% in 2019). However, despite their recent growth, at 18% of GDP, domestic savings remain low compared to most peers (Figure 17.22) and represent an important constraint to domestic private investment, which has contributed, on average, less than 5% to annual GDP over the past two years (World Bank, 2020[2]).

As a result, the Serbian economy has strongly relied on external financing. This includes debt financing, which has accounted for roughly 9% of GDP on an annual basis over the past five years (IMF, 2019[93]); foreign direct investment inflows, with an average annual GDP contribution of 7% over the same period; remittances, with an annual average contribution of 8.3% over the five-year period; and overseas development assistance (ODA), contributing 2% of gross national income (GNI) annually over the last five years (World Bank, 2020[2]).

Figure 17.22. Domestic savings (% of GDP) are low compared to regional and global peers



Source: World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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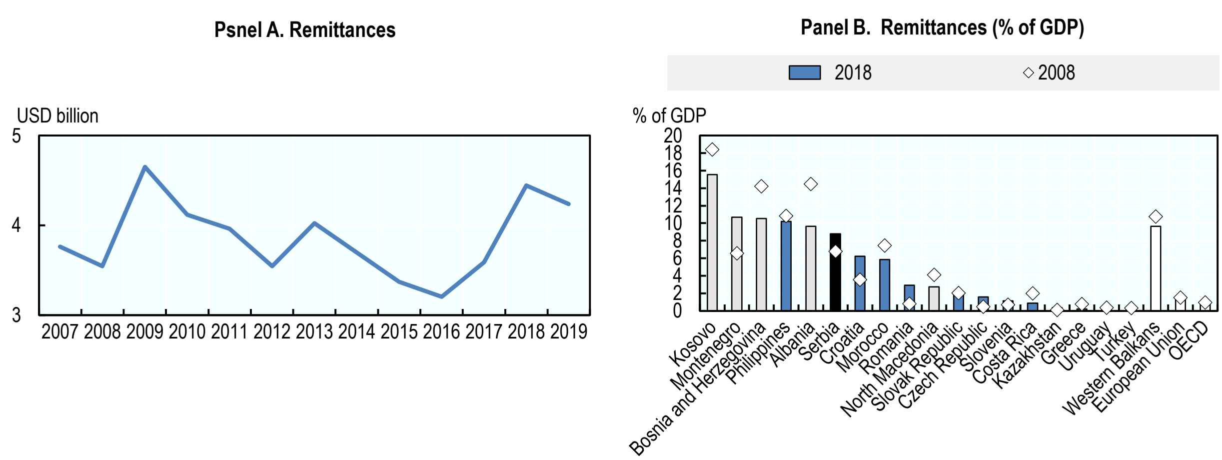
External debt has been an important source of financing for the Serbian economy for both the public and private sectors. In the pre-crisis period, growth in external debt was strongly driven by government borrowing to finance the expansionary fiscal policy (see the Prosperity section in this chapter). As a result, the share of public debt rose from 25% of total external debt in 2004 to 68.7% in 2008. However, public debt, including external debt obligations (see below), declined due to fiscal consolidation in the post-crisis period, while private-sector borrowing continued to increase (IMF, 2019[93]). Currently, roughly half the external debt is owed by the government and about 40% by private enterprises (National Bank of Serbia, 2020[72]).

The contribution of FDI to the Serbian economy has also increased substantially over the last seven years. Net FDI inflows rose continuously, from USD 1.75 billion in 2012 to USD 4.3 billion in 2019 (World Bank, 2020[2]), as Serbia established free economic zones and introduced various incentives to attract export-oriented FDI. Serbia has become one of the leaders in FDI attraction in the region and among peer economies: net FDI inflows accounted for over 8% of GDP in 2019 (see the Prosperity section in this chapter).

In the pre-crisis period, remittances strongly contributed to the growth in consumption, and their contribution to GDP remains high compared to most peers. Remittances rose considerably in 2009, helping smooth consumption during the crisis period, but they have otherwise not shown strong countercyclical tendencies. This likely reflects the high share of the diaspora living in Eurozone economies also strongly affected by the same downturns (Figure 17.23 – Panel A). In recent years, there has been a pickup in remittance inflows. In 2018, they represented 8.2% of GDP, which is high relative to most global peers (Figure 17.23 – Panel B).

Figure 17.23. Remittances have bounced back in recent years and remain relatively high compared to global and aspirational peers



Source: World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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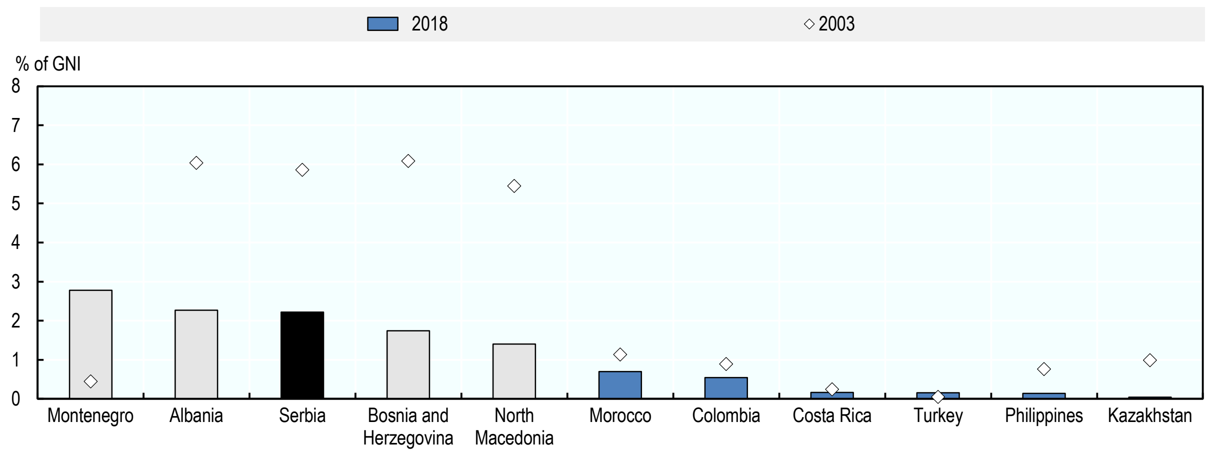
While ODA to Serbia has declined since the early 2000s, it remains sizable compared to most peers. In the early 2000s, Serbia benefited significantly from ODA aimed at supporting the country in the post-conflict recovery and the economic transition. Between 2000 and 2005, average annual ODA amounted to 10.6% of GNI, well above most regional peers. Since then, ODA has declined considerably, but at 2.2% of GNI, it is notably higher than in aspirational peer economies (Figure 17.24). Most ODA still comes from the European Union. EU institutions have been the largest donor since 2010, providing USD 1.42 billion in

ODA between 2014 and 2018, mostly through the Instrument for Pre-Accession Assistance (IPA II). Individual EU countries (Austria, France, Germany and Sweden) are also among the ten largest donors, as are Japan and Switzerland (OECD, 2020[94]). In 2014 and 2016, Serbia also benefitted from significant financing from the United Arab Emirates in the form of two large soft loans for budgetary support. It has also received considerable financing from China, Russia and Turkey (MEI, 2020[95]).

Figure 17.24. ODA to Serbia remains high compared to global peers



Sources: OECD (2020[94]), *Aid (ODA) disbursements to countries and regions [DAC2a]* (database), http://stats.oecd.org/; World Bank (2020[2]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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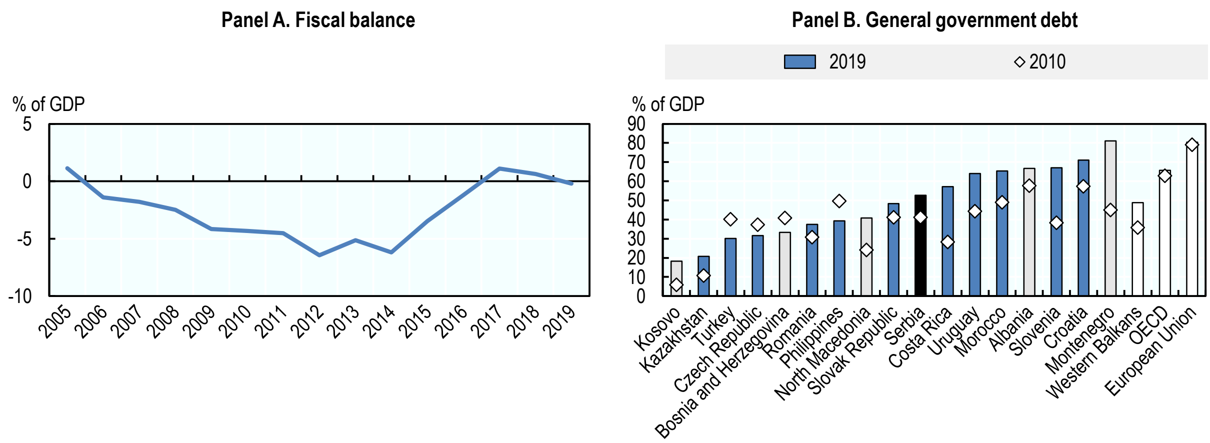
In light of weak domestic savings, the contribution of these external sources of financing has been important in supporting investment growth. Nevertheless, as noted in the Prosperity section of this chapter, investment remains modest compared to global and aspirational peers, and stronger growth in both private and public investment is needed to accelerate convergence with EU income levels.

Public debt dynamics have improved, but risks persist

Public debt increased considerably in the post-crisis period. The government strongly relied on fiscal stimulus measures to support economic growth and job creation in the aftermath of the global financial crisis of 2008 and subsequent crises. Coupled with weaker revenue performance due to a significant slowdown in economic growth in the post-crisis period (see the Prosperity section in this chapter), the higher expenditures resulted in higher fiscal deficits (Figure 17.25 – Panel A) and an increase in public debt, from 31% in 2009 to 70% in 2015 (Figure 17.25 – Panel B).

Over the past five years, Serbia has implemented a successful fiscal consolidation programme. As part of the programme supported by an IMF Stand-By Agreement, Serbia reduced current public expenditures by lowering the public-sector wage and pension bills and the budgetary support for public enterprises, which had reached 5% in previous years. Serbia implemented additional reforms, including improving revenue collection and public financial management (IMF, 2019[93]). Serbia significantly improved its fiscal position thanks to the programme. The overall fiscal deficit declined from 6.2% of GDP in 2014 to a surplus of 1.1% in 2017 (Figure 17.25 – Panel A), while in the last three years of the programme (2016-18), the primary surplus averaged 2.7% of GDP. General government debt also declined, from 71.2% in 2015 to 52.7% in 2019. Contingent liabilities related to the SOE sector declined by more than 50% between 2013 and 2019 (Ministry of Finance of the Republic of Serbia, 2020[96]).

Figure 17.25. The fiscal balance has improved considerably since 2014 and general government debt is now at a moderate level relative to global peers



Sources: IMF (2020[97]), "World Economic Outlook Databases", www.imf.org/external/pubs/ft/weo/2020/01/weodata/index.aspx; Ministry of Finance of the Republic of Serbia (2020[96]), *Macroeconomic and fiscal data, December 2020* (database), www.mfin.gov.rs/en/documents/macroeconomic-and-fiscal-data/.

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Despite the recent progress, fiscal risks remain high. Serbia does not have binding fiscal rules, leaving considerable space for discretionary increases in spending and potential deterioration of the fiscal position. Likewise, many reforms remain incomplete, including reforms of the wage and employment system in the public sector and improvement of the governance and performance of SOEs (European Commission, 2018[98]). The adoption of the Swiss formula for pension indexation at the end of 2019 is a step in the right direction. Consultations have also begun on the creation of new fiscal rules. It remains to be seen how they will be implemented and to what extent they will be binding.

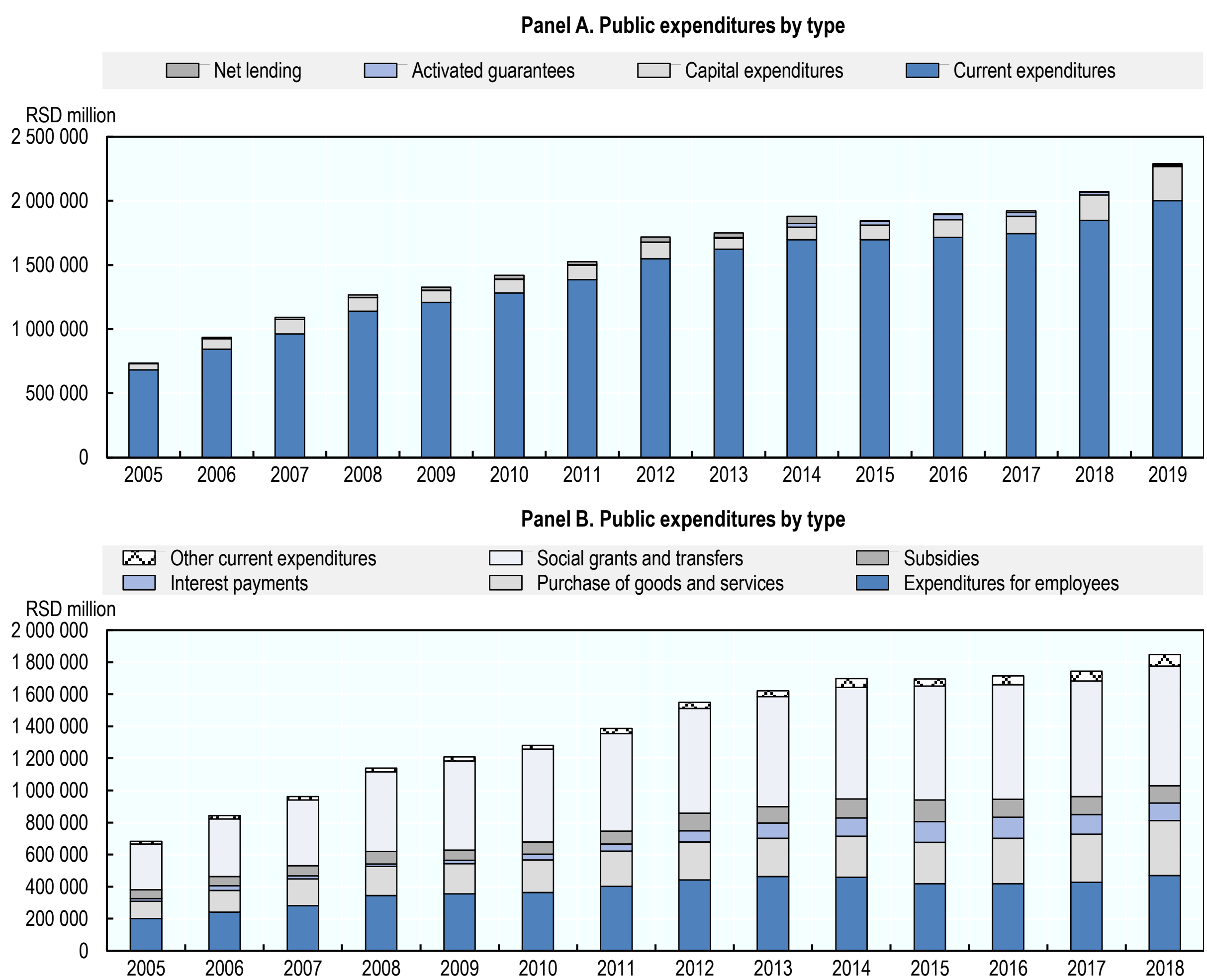
The COVID-19 crisis poses further challenges to Serbia's fiscal policy, and the post-crisis period will test the government's resolve to maintain fiscal discipline and stability. Serbia has implemented the largest fiscal stimulus programme in the Western Balkan region to limit the impact of the COVID-19 crisis. It is estimated at 8.3% of (2020) GDP in public expenditure and includes a credit guarantee scheme worth 4.4% of GDP and a lending scheme through the Serbian Development Fund worth 0.4% of GDP. Measures have included: 1) higher fiscal expenditures for the public healthcare system; 2) aid to households and enterprises (universal cash transfer, wage subsidies); 3) deferment of private-sector business entities' obligations towards the state (four-month deferment of labour taxes and contributions, deferment of advance payments of the corporate income tax for March, April and May 2020 until the submission of tax returns for the year 2020); and 4) a credit guarantee scheme to support enterprise liquidity (OECD, 2020[99]). These measures, alongside the impact on revenues from lower economic activity, will result in a significant increase in the fiscal deficit, which is projected to exceed 8.9% of GDP. Public debt is expected to increase to close to 60% of GDP mark and had increased to 58.1% of GDP as of September 2020 (IMF, 2020[100]).

The COVID-19 crisis also revealed the notable fiscal implications of the structural and operational problems of Serbia's large SOEs, most notably those of the state airline operator, Air Serbia, and the state-owned energy utility, Electroprivreda Srbije (EPS, Power Industry of Serbia). Fiscal aid to these companies amounted to 0.4% to 0.5% of GDP over the past year, but as the Fiscal Council has noted, the full extent of the financing, its structure and its use is not well elaborated in the rebalancing of the budget. The Council postulates that financing goes well beyond the liquidity shortfalls caused by the crisis and aims to compensate for financial losses due to structural and operational weaknesses (Fiscal Council of the Republic of Serbia, 2020[101]).

Stronger growth in capital expenditures is needed, alongside more binding limits on current spending

After a decade of increasing current expenditures, the consolidation programme has created space for higher capital expenditures. Current expenditures, which accounted for over 90% of total government expenditures for most of this period, nearly tripled between 2005 and 2014 (Figure 17.26 – Panel A), significantly outpacing GDP and revenue growth and driving the rise in deficits and public debt. Since the start of the consolidation programme, current expenditures have, however, largely stabilised, providing scope for higher capital expenditures, whose share has increased to 11% of total expenditures (Figure 17.26 – Panel A).

Figure 17.26. Most growth of public expenditures has been due to current expenditures, particularly high subsidies and transfers



Source: Ministry of Finance of the Republic of Serbia (2020[96]), *Macroeconomic and fiscal data, December 2020* (database), www.mfin.gov.rs/en/documents/macroeconomic-and-fiscal-data/.

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In spite of this progress, government spending composition can still be improved. Capital expenditure is low compared to the needs of the economy. An analysis that benchmarks Serbia's current growth rate against the growth rate implied by convergence theory and based on EU countries points to the need for a significant increase in public and private investment if Serbia is to converge with the European Union at the optimal rate. Specifically, it finds that infrastructure investment should be increased by 1% of GDP per year and that central and local SOE investment should also increase by 1% of GDP (Petrović, Brčerević and Gligorić, 2019[102]). Investment needs are particularly high in the area of environmental infrastructure, where Serbia's investments are considerably lower than those of its CEE aspirational peers and the EU average (Fiscal Council of the Republic of Serbia, 2019[103]) and its environmental outcomes are considerably worse (see the Planet section in this chapter).

Even though the growth of current spending has declined thanks to the fiscal consolidation, there is scope to address underlying structural issues. On the wage bill side, there is room for discretionary increases in wages, given the lack of binding fiscal rules that define the parameters for such increases (Fiscal Council of the Republic of Serbia, 2018[104]). In general, discretionary spending is high and has been increasing (European Commission, 2019[84]).

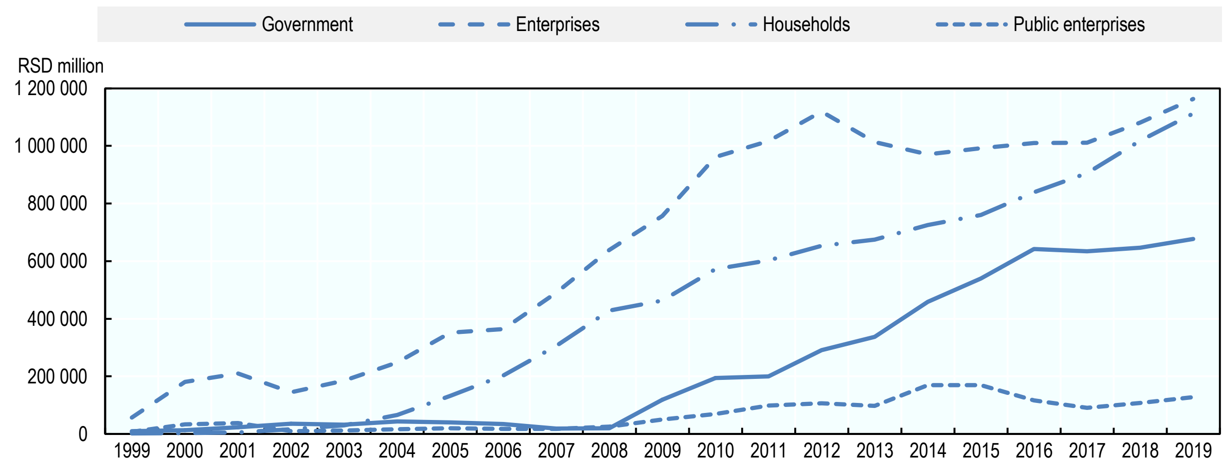
More diversified financing options are needed to support SME innovation and growth

Enterprises' access to bank financing has been relatively limited in the period following the 2008 global financial crisis and the 2011 Eurozone crisis. In the early to mid-2000s, the entry of foreign banks in the Serbian market fuelled a credit boom that built up significant imbalances in the Serbian banking system, including a high share of foreign currency-denominated and foreign currency-indexed loans (80% of total loans) and an already high share of non-performing loans (11% of total loans in 2008). In the aftermath of the crises, the banking sector was hit hard by high and rising NPLs, which peaked at 21.6% of total loans in 2015 but remained in the double digits until 2017 (National Bank of Serbia, 2019[105]). Enterprise lending suffered significantly as banks tightened credit standards and was further crowded out by high government borrowing needs and growing mortgage and consumer lending (Figure 17.27).

Over the past five years, financial-sector health and stability have improved, and enterprise lending has begun to recover. Since 2015, NPLs have declined from over 20% to 4% of total loans, capital adequacy has improved (the risk-weighted capital ratio increased from 19 to 23) and the profitability of the banking sector has increased significantly (return on assets rose from an average of 0.3% in 2011-16 to 2% in 2017-20; return on equity increased from an average of 1.2% to 10.5% over the same time interval). The improved conditions and the overall improvement in the macroeconomic environment have been conducive to enterprise lending, which has risen by 15% since 2017 following a five-year stagnation (Figure 17.27).

On most banking sector indicators, Serbia performs better than regional and global peers. A higher share of Serbian enterprises (54%) have bank financing compared to the ECA and the all-country averages (37% and 33%, respectively). Serbian firms also reported a lower share of loans requiring collateral (41% vs. 73% for ECA and 78% for the world), a lower proportion of investments financed internally and a higher share of working capital financed by the banks. Last, at 101%, the value of collateral required to obtain a loan in Serbia is much lower than in regional peers (over 170%) and other global peers (176% for ECA and 199% for the world) (World Bank/EIB/EBRD, 2019[79]).

Figure 17.27. Enterprise lending has begun to recover after years of stagnation



Source: National Bank of Serbia (2020[72]), *Statistics* (database), www.nbs.rs/internet/english/80/index.html.

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Nevertheless, SMEs, particularly start-ups and microenterprises, face considerable challenges in obtaining financing. Analyses of the banking sector indicate that large enterprises and larger and more established SMEs are well-served by the banking sector because interest rates are low and these enterprises can meet the banks' relatively stringent lending requirements, including credit history, turnover and collateral. By contrast, start-ups or microenterprises, which do not have sufficient years of operational history and turnover, face significant difficulty getting access to bank capital (World Bank, 2019[106]).

This challenge is exacerbated by the relative lack of other financing options. Non-bank financing remains underdeveloped. Microfinance is limited by a weak legal and regulatory framework. While factoring and leasing exist, they are significantly underutilised by small enterprises. Start-up financing through venture capital funds, business angels, etc. is undersupplied and cannot adequately support the growth of innovation in Serbia (World Bank, 2019[106]).

Last, capital markets remain relatively shallow. While the government bond market has grown, the private bond and stock markets are underdeveloped, as companies prefer other means of obtaining financing. Enterprises cite the highly restrictive Law on Financial Transactions, which significantly limits the types of financial transactions that can be made between enterprises, as a significant barrier to the development of capital markets in Serbia, according to mission interviews with the European Bank for Reconstruction and Development and AmCham Serbia.

The government has recently undertaken notable regulatory and policy initiatives to facilitate SME access to financing. It established a EUR 2 billion guarantee scheme for SMEs and drafted and approved two new laws: the Law on Open-Ended Investment Funds with Public Offering ("Official Gazette of the Republic of Serbia", No. 73/2019) and the Law on Alternative Investment Funds. These laws establish a stable legal framework in line with international standards to better attract domestic and foreign investors. The Securities Commission has enacted by-laws that regulate the application of these laws in more detail. The government also continues its work on strategies for development finance and capital markets development that should promote alternative sources of financing, such as crowd funding, venture capital and angel investors.

Peace and institutions – strengthening governance

The Peace and Institutions pillar of the 2030 Agenda for Sustainable Development encompasses peace, stability and trust, as well as effective governance and the performance of the public sector more broadly.

Serbia's institutions have made progress in the past years. The European accession process has created momentum for significant reforms of the business regulatory environment and of the public sector. In particular, the country has an independent and empowered anti-trust Commission for Protection of Competition and, since January 2020, an independent body controlling state aid, the CSAC. Appeal to investors has increased has a result. Moreover, Serbia has engaged in a comprehensive reform to increase the efficiency of the civil service. Over the past few years, it has improved the capacity to deliver services and manage public-sector human resources (OECD, 2020[107]). Serbia is perceived as a very safe country, and the intentional homicide rate (1.2 victims per 10 000 people) is among the lowest in the region (together with Bosnia and Herzegovina and North Macedonia).

Yet, Serbia faces shortcomings in the institutional guarantee of the separation of powers. Checks on the power of the executive have weakened in recent years, and perceived corruption is high, in spite of recent progress. Political patronage risks undermining the independence of the judiciary, the efficiency of the public administration and the capacity of the state to deliver quality services to all. It also jeopardises the efforts of the executive to put forward a harmonised and monitorable strategy for development. Some civil servants may face incentives to pursue short-term, fragmented agendas rather than a common and prioritised one. The politicisation of institutions weakens the independence and reliability of data collection for evidence-based policy making.

Moving forward, the capacity of Serbia to capitalise on a promising macroeconomic framework and promote durable and inclusive development depends on the achievement of three main strategic goals (Table 17.5). First, courts need stronger institutional guarantees of their independence to serve justice better and to control the executive and legislative powers and thus strengthen quality democratic institutions. Judges need more skills to better enforce laws that uphold the competitiveness and contestability of markets. Second, Serbia needs a harmonised regional development and decentralisation framework to reverse the "Belgradization process", promote balanced regional development and leave no places behind. Third, Serbia has to pursue reform of its public sector, discouraging all practices that could lead to further politicisation of the state apparatus.

Table 17.5. Peace and institutions – three major constraints to enhancing the quality of institutions in Serbia

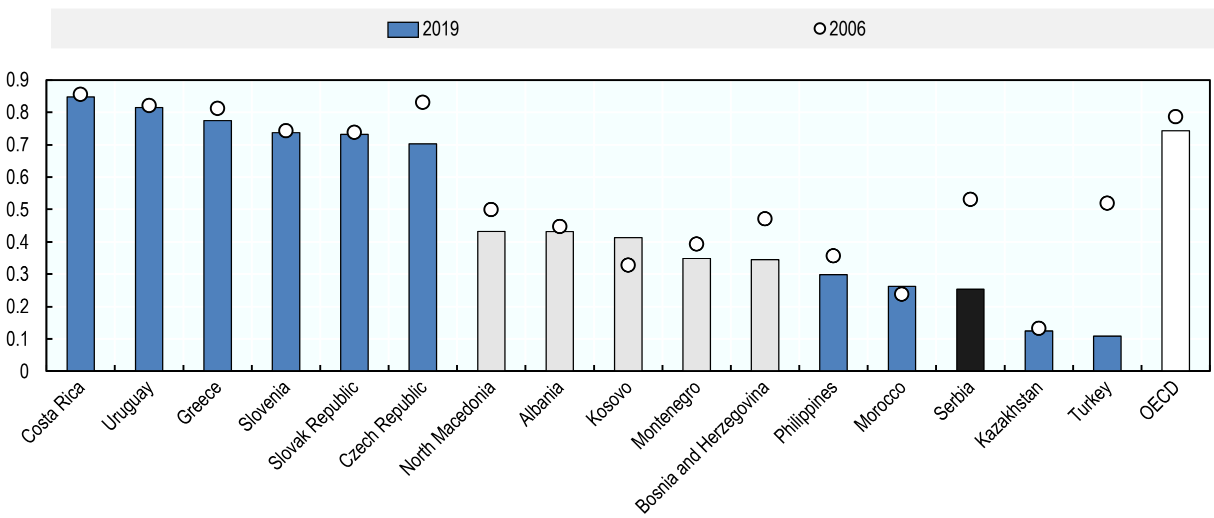
1. The judiciary lacks sufficient guarantees of independence and has limited capacity.
2. Fragmented decentralisation and regional development frameworks undermine the balanced development of local communities.
3. The public administration continues to be politicised.

Checks and balances on the executive are weakening

Checks and balances on the executive are weakening, increasing the scope for discretionary policy making. According to the 2006 constitution (Art. 3), the separation of powers and the independence of the judiciary are cornerstones of the rule of law in Serbia. However, according to participants of the visioning workshop and expert assessments, the executive, legislative and judicial branches are poorly separated, and the limits to the executive have been eroded since the entry into force of the constitution (Figure 17.28). The judiciary is not afforded sufficient guarantees of independence and accountability and is the least trusted of the branches of government (Gallup, 2020[108]). Political parties often control media directly or indirectly. Journalists seem to be regularly denied access to public information (IREX, 2019[109]), changes in power may trigger the dismissal of entire public broadcast editorial teams, and marketing agencies with close political ties put pressure on the media (Kmezić, 2019[110]). Journalists, activists and certain party militants become the target of violence more frequently in Serbia than in the rest of the Western Balkans.

Figure 17.28. Checks and balances on the executive are weakening

Relative change in the Varieties of Democracy (V-Dem) Liberal Democracy Index (2006-19)



Note: The V-DEM Liberal Democracy Index measures the capacity of an economy's institutions to check the government through constitutionally protected civil liberties, strong rule of law, an independent judiciary and effective checks and balances. The index scores the strength of liberal democratic institutions from weak (0) to strong (1). Changes are measured with respect to 2006, when the first Constitution of the Republic of Serbia was adopted.
Source: Coppedge, M. et al. (2020[111]), *V-Dem Codebook v10*, www.v-dem.net/en/data/data-version-10/.

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Any reform or policy aimed at improving social, economic, environmental or institutional standards has to take into account the traditional importance of informal networks and connections (*veza*). In particular, during the monarchy and the socialist regime, political connections within the ruling elite provided advantages, such as access to information, personal promotion and privileges, which in turn benefited their families, friends and associates. The transition to a market economy and democracy has not weakened political connections (*političke veze*), which are still perceived as a social lift for the few but hinder overall equality and inclusive development (Stanojevic and Stokanic, 2018[112]). In fact, it has led parties to compete for the monopoly of state resources, which they redistribute in exchange for political support. According to World Values Survey data, party affiliations relative to population (12.2%) are higher in Serbia than in any other benchmark economy and in all but two EU countries (Inglehart et al., 2014[113]). Based on interviews with the Organization for Security and Co-operation in Europe (OSCE), the ruling Serbian Progressive Party is one of the largest in Europe with 730 000 members. At the same time, employment in the public sector (including SOEs) accounts for 26.8% of total employment and, between 2011 and 2018, grew faster than in the rest of the region (1% annually vs. 0.1%).[21]

A widespread use of connections can limit access to public goods and services. Connections rather than merit and skills are seen as the most effective routes for social mobility, especially among young graduates (Tomanović et al., 2012[114]) – more so than anywhere else in the region. Often, households can only access quality health and education services with good connections, and connections and gifts are often used with the aim of influencing the judiciary (Krasniqi, 2019[115]).[22]

In the economic sphere, personal connections can help get business done. Interviews revealed that these patron-client relationships have attracted foreign investors, who have been driving the economy and structural transformation so far. The right connections can help enterprises circumvent or avoid state regulations and formal procedures. In other cases, they are the fastest and most profitable way to secure legal verdicts and gain access to workers, raw materials and machinery at below-market prices.

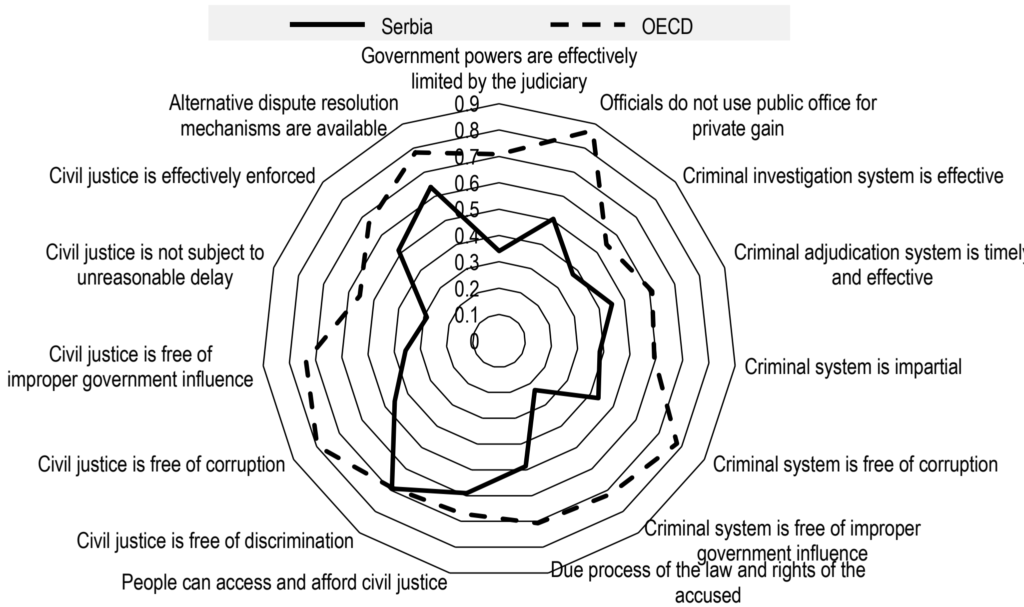
Connections therefore represent a trade-off. On the one hand, they could grease the wheels of a large and not always efficient state apparatus. On the other hand, they create inequalities between those with and without connections and could become a source of instability. As politics and the economy get increasingly intertwined, changes of government can scare off investors and expose the economy to major economic shocks. This risk could lead incumbent politicians to tighten their monopoly on state resources, thus further weakening the quality of institutions.

The judiciary lacks institutional guarantees of independence and has limited capacity

The court system consists of general courts and specialised courts. General courts are basic courts, higher courts, appeal courts and the Supreme Cassation Court. Specialised courts are the commercial courts (together with their appeal court), misdemeanour courts (together with their appeal court) and the administrative court. The judiciary is, in principle, self-governed by the High Judicial Council, which decides over the career of judges.

The judiciary remains exposed to undue political interference. A "fully objective, transparent and merit-based system for appointing, transferring and promoting judges and prosecutors in line with European standards" is still missing (European Commission, 2020[3]). Pressure on the judiciary remains high (European Commission, 2020[3])and improper government influence is higher in Serbia than in the average upper middle-income and high-income country (Figure 17.29). Separation of powers, although constitutionally granted, is generally at risk. Part of the problem lies in the composition and functioning of the high judicial bodies: most of the members of the High Judicial Council, for example, are elected by the national assembly. To improve independence, the ongoing constitutional reform provides that the majority of the Council members are judges elected by their peers, thus incorporating the recommendations of the international community (CoE/Venice Commission, 2018[116]; CoE/Venice Commission, 2018[117]). A clear constitutional prohibition on judges belonging to political parties, however, remains absent and is delegated to secondary law (CoE/Venice Commission, 2018[117]).

Figure 17.29. The judiciary remains exposed to undue political interference and is ineffective



Note: The solid black line spider chart represents the perceived dimensions of quality of the judiciary in Serbia; the black dotted line represents the average perceived dimensions of quality of the judiciary in the average OECD country.
Source: Authors' calculation based on World Justice Project (2020[118]), *World Justice Project Rule of Law Index 2020*, https://worldjusticeproject.org/our-work/publications/rule-law-index-reports/wjp-rule-law-index-2020.

StatLink https://doi.org/10.1787/888934245709

The process of selection of judges and prosecutors does not isolate judges from political influence. According to Article 147 of the constitution, the national assembly elects first-time judges for a three-year probationary period from a list of candidates vetted by the High Judicial Council.[23] The assembly does not simply rubber-stamp the council's decision. According to the Law on Judges (Art. 50), the council proposes to the assembly one or more candidates for each position. It is not clear upon what criteria the assembly bases a final choice. This selection process is likely to expose judges to political pressure and interference, which could ultimately jeopardise the capacity of courts to deliver impartially (BTI, 2020[119]). Similarly, public prosecutors are elected by the national assembly upon proposal by the government. The ongoing constitutional reform will create the conditions for the introduction of a more merit-based recruitment, evaluation and appointment of judges and prosecutors (European Commission, 2020[3]).

The judiciary lacks capacity to deliver effectively, and there are significant delays in disposition times for cases. Civil justice in particular is subject to unreasonable delay more often than occurs in the average OECD country (Figure 17.29). The overall backlog of pending cases is large, especially in basic courts (European Commission, 2020[3]). In particular, the average number of days to resolve litigious civil and commercial cases in first-instance courts decreased from 316 days in 2010 to 224 in 2018; however it remains higher than in Albania (171) and North Macedonia (178) (CEPEJ, 2020[120]). The efficiency of the administrative court is relatively low, and there is evidence of regression over recent years: the average time to resolve a case increased from 235 days in 2010 to 745 days in 2018 (CEPEJ, 2020[120]). Part of the problem is the lack of specialisation of judges, who need to acquire better knowledge of competition law and economics. This is particularly true for judges in the administrative court, which is at the receiving end of all competition-related disputes (Rakić, 2017[121]). Alternative arbitration mechanisms exist to settle commercial-related disputes (the Permanent Arbitration at the Serbian Chamber of Commerce in Belgrade and Belgrade Arbitration Centre) and labour disputes (Agency for Peaceful Settlement of Labour Disputes).

Fragmented decentralisation and regional development frameworks undermine the balanced development of local communities

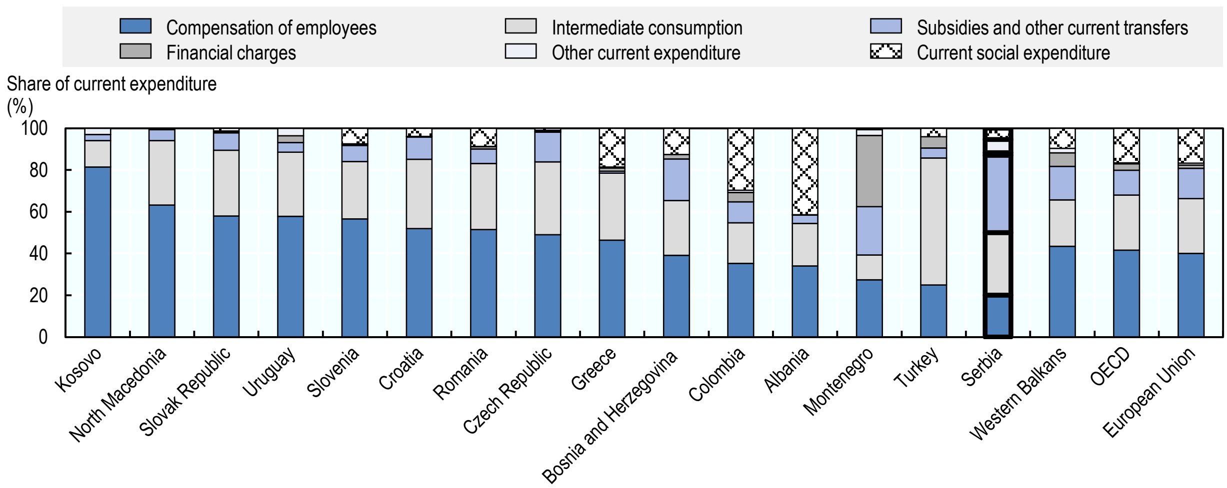
The Republic of Serbia has an asymmetric organisation of subnational levels of government. The greater part of its territory has only two levels of government: central government and local self-governments (LSGs). The constitution (Art. 188) identifies three types of LSGs: cities (*grad*), towns (*opstina*) and the City of Belgrade. The latter has a special status, as regulated by its Statute and the Law on the Capital City. In some cities, public authority is further decentralised to city municipalities (*gradske opštine*). In most LSG units, local communities (*mesne zajednice*) contribute to the decision-making process around selected local issues. The other part of the territory has three levels of government: central government, provincial government and LSG. Throughout Serbia, LSGs are organised into districts (*okruzi*), which are not levels of government but a form of de-concentration of the central government and a way for line ministries to co-ordinate their activities at the local level. There are also statistical regions (*statistički regioni*), which have no power but are necessary statistical units for planning and implementing regional policy and channelling future EU cohesion funds (Kmezić and Đulić, 2018[122]).

The competences of LSGs are numerous. They are listed in the constitution (Article 190) and in various acts. According to the Law on Local Self-Government ("Official Gazette of the Republic of Serbia", Law No. 47/2018), competences include the construction and maintenance of local roads and the provision of all utility services (*komunalne usluge*) (except for electricity and telecommunications), health and social protection. LSGs are responsible for the stimulation of local economic development, environmental protection and disaster risk management. Special sectoral laws entrust LSGs with further responsibilities, some of which are shared with the central government, such as primary and secondary education are shared with the central state (OECD/UCLG, 2019[123]).[24] Responsibilities "still continue to be borne at local level without proper analysis of the capacity and human/financial resources required" (European Commission, 2020[3]).

Current subnational expenditure is higher in Serbia than in the rest of the region, and capital investments remain low. In 2018, subnational expenditure accounted for 6.1% of GDP, which was more than in the Western Balkans (5.3%) but less than the OECD average (15.5%). They amount to 14.9% of total public expenditure, which is in line with the regional average (15.1%) but much lower than the OECD average (40.4%). Current expenditure amounts to 87% of total subnational spending, which is much higher than in other Western Balkan economies and is mostly made up of subsidies and current transfers (37% of total current expenditure), purchase of intermediary goods and services (30%) and compensation of employees (20%) (Figure 17.30). As a consequence, capital investments are particularly low in comparison (12.9% of total subnational expenditure) (Figure 17.31).

Figure 17.30. Subsidies, intermediate consumption and wages make up most of the subnational current expenditure

Composition of current subnational public expenditure, 2017 or nearest available year



Source: Authors' calculation based on OECD/UCLG (2019[123]), *Report of the World Observatory on Subnational Government Finance and Investment – Key Findings*, www.sng-wofi.org/reports/Key_Findings_2019.pdf.

StatLink https://doi.org/10.1787/888934245728

Figure 17.31. Capital expenditure is low

Capital expenditure by local self-government entities, 2017 or nearest available year

Source: Authors' calculation based on OECD/UCLG (2019[123]), *Report of the World Observatory on Subnational Government Finance and Investment – Key Findings*, www.sng-wofi.org/reports/Key_Findings_2019.pdf.

StatLink https://doi.org/10.1787/888934245747

Subnational revenues are in line with the rest of the regions but low compared to the competences of municipalities. In 2019, municipal total revenues amounted to 6.0% of GDP, in line with the rest of the region (5.6%) but much lower than the OECD average (15.9%) (NALAS, 2019[124]). Shared taxes (mainly the Wage Personal Income Tax, which the central government collects and redistributes to LSGs) accounted for 39% of total subnational revenues (NALAS, 2019[124]).[25] A shrinking Wage Personal Income Tax base and rate have forced municipalities to improve the share of own resources, which represented 42% of total subnational revenues in 2019, up from 37% in 2006. Half own revenues come from local fees and charges. Revenues from property tax accounted for 38% of local own revenues, an increase of 26 percentage points since 2006 (NALAS, 2018[125]).

The framework regulating the distribution of intergovernmental transfers is arguably clearer in Serbia than in the rest of the region. In 2018, transfers accounted for 19.9% of LSGs' revenues, out of which unconditional transfers accounted for 11%. According to the law on LSG finances, cities and municipalities have access to unconditional transfers (general transfer, equalisation transfer and compensational [*kompenzacioni*] transfer) and conditional transfers (functional transfers and dedicated transfers [*namenski transfer u užem smislu*]). Unconditional transfers are distributed according to the level of development of LSGs; the general transfers are based on population, area, number of children attending primary and secondary school, number of primary and secondary schools and number of children under social protection. Moreover, municipalities (except for the City of Belgrade) can access a Solidarity Fund, the distribution of which is based on coefficients for development.

LSG debt is low and tightly regulated, but limitations exist. In 2016, local government debt amounted to 1.7% of GDP, the lowest in the region (OECD/UCLG, 2019[123]). Liquidity borrowing should not exceed 5% of recurring revenues from the previous year. The total amount borrowed has to be repaid before the end of the budget year and cannot be refinanced or renewed. Local governments can borrow long term only to finance capital investments that are part of the local government budget. In this case, the amount borrowed cannot be higher than 50% of the recurring revenues from the previous year. The amount of principal and interest on long-term debt due in a fiscal year cannot exceed 15% of revenues generated by local governments in the previous year. Last, LSGs cannot borrow without the consent of the Ministry of Finance. Nonetheless, the current legislative and institutional framework may not be sufficiently transparent to guarantee a clear distinction between liabilities of municipalities and of local SOE debt (Živanović, Đulić and Jolović, 2020[126]), as discussed below.

After initial dynamism, the decentralisation process in Serbia lost momentum

Decentralisation has accompanied Serbia's transition towards democracy and a market-oriented economy. Between 2000 and 2008, local authorities received new responsibilities for providing public goods and services to citizens and a new role in implementing social, economic and environmental policy. More competences were accompanied with more effective political, administrative and fiscal power, and between 2000 and 2004, local government revenues increased by over 220%. Since 2009, the 2008 global financial crisis forced the central government to raid local budgets to pursue fiscal consolidation reforms (Kmezić and Đulić, 2018[122]). Intergovernmental transfers to local governments were reduced, while municipal fees and charges were cut to reduce the fiscal burden on enterprises and improve the business environment (Bartlett, Đulić and Kmezić, 2020[127]). Since 2011, local revenues as a share of public revenues have stabilised at around 14% (16.3% in the Western Balkans, 23.5% in EU28 and 42.4% in OECD) (NALAS, 2019[124]).

Frequent regulatory changes in local public finance have made local revenues unstable and unpredictable. Moreover, the sources and amounts of local revenues changed every six months between 2009 and 2016 (Kmezić and Đulić, 2018[122]). This was also because amendments often happened through government decrees, decisions and rulebooks, which, as opposed to laws, guarantee the central policy maker enough room for frequent and ad hoc changes (Kmezić and Đulić, 2018[122]). The lack of co-ordination among line ministries, which delegate functions, and the Ministry of Finance, which allocates resources, has exacerbated the problem, curbing the capacity of local administrations to deliver quality goods and services to citizens (Kmezić and Đulić, 2018[122]).

Local long-term investments, although needed, are missing, and the use of local resources is not always efficient. Local infrastructure, such as water pipes, sewers, landfills and local roads, requires an increase in LSG investments of at least EUR 300 million per year, compared to their current level (Fiscal Council of the Republic of Serbia, 2019[128]). Instead, with the introduction of the first Law on Local Government Finance in 2007, subnational capital investments fell from EUR 112 per capita to EUR 47 per capita in 2014, and from 1.5% of GDP in 2011 to 0.9% in 2018, which is lower than the Western Balkan average (1.3% of GDP) and the OECD average (1.7%) (OECD/UCLG, 2019[123]; NALAS, 2019[124]). At the same time, resources that could be used for long-term investments are used to cover the losses of locally owned public enterprises, which get "enormous subsidies of over EUR 200 million per year" (Fiscal Council of the Republic of Serbia, 2019[128]).

Improving the transparency of LSG finances could improve the efficiency of local spending. The Standing Conference of Towns and Municipalities (SCTM), the association of LSGs, helps municipalities frame and standardise local budget plans by linking them to national and local strategic plans and assigning expected results and indicators for monitoring. According to the SCTM, around 80% of LSGs disclose information about their performance (by presenting annual plans in the context of program budgeting), although quality still needs to improve.

Serbia is rethinking the needs and scope of decentralisation. As part of the Public Administration Reform Strategy 2018-2020, the Public Administration Reform Strategy 2021-2030 and their respective Action Plans, the Ministry of Public Administration and Local Self-Government and the STCM are preparing a Program for the Reform of the Local Self-Government System. The Program aims at: 1) analysing the state of LSG; 2) assessing costs and benefits of two possible models of decentralisation; 3) taking stock of all competences and tasks devolved at the local level; and 4) guiding the next decentralisation reforms in Serbia. As of March 2021, the drafts of the Program and of the Public Administration Reform Strategy 2021-2030 have undergone public consultation.

Serbia lacks a harmonised regional development framework

Macroregions in Serbia have very limited roles. The 2007 strategy for regional development and the 2009 Law on Regional Development (together with its subsequent amendments) introduced four regions but assigned them no administrative, political or fiscal power. Regional Development Councils exist but have a consultative role with respect to ongoing or much-needed local development projects. Regions were created, rather, to channel future regional cohesion funds in view of EU accession and to play a very small role in enhancing territorial development. It is therefore hard to identify a clear framework that regulates the multi-dimensional development of local communities.

The development of regions has a purely economic dimension. Since 2015, the Agency for Foreign Investments and Promotion of Exports and the National Agency for Regional Development merged into the Development Agency of Serbia. The agency exerts its mandate through 16 accredited regional development agencies – limited liability companies established by at least three municipalities in a statistical region. Agencies aim to "boost and implement direct investments, promoting and increasing exports, developing and improving the competitiveness of companies" (Law on Investments, Art. 27). They do not co-ordinate social, environmental or institutional development among municipalities as regional governments would normally do. Moreover, their activities are not directly accountable to citizens.

Co-ordination across LSGs is on specific issues and on a voluntary basis. According to the Law on Local Self-Government, municipalities can decide to collaborate with their neighbours to address specific issues and common development issues. The SCTM and the Ministry of Public Administration and Local Self-Government have prepared a set of models for such intermunicipal co-operation agreements. The ministry has, moreover, set up a new fund (the Fund for the Establishment and Improvement of Inter-Municipal Cooperation) to support the establishment and the improvement of intermunicipal co-operation. As a result, between 2019 and 2020, four intermunicipal partnerships were established within 33 LSG units. The existing forms of co-operation include the management of regional landfills within and across *okruzi*, joint social welfare centres serving two or three municipalities, joint environmental inspectorates, joint utility companies and joint public prosecutor offices (SCTM, 2017[129]). At the end of 2020, a new public call for inter-municipal partnerships was announced, and support was provided also for 2021.

A more holistic and accountable approach to regional development is needed. In the long term, the competitiveness of local communities not only depends on their attractiveness to foreign investors or capacity to export but also on the quality of local education, health and social services, high environmental standards and solid institutions. Tighter collaboration among the development agency, its regional subsidiaries and municipalities (through the SCTM, for instance) could help broaden the scope of the regional development process. Intermunicipal co-operation has to be systematised. In terms of the accountability of the regional development process, there are no institutional mechanisms to keep decisions taken above the municipal level accountable. The newly established Smart Specialisation Strategy framework (adopted in February 2020) will facilitate the bottom-up identification of local comparative advantages and obstacles to development, but it is not yet clear how agencies and municipalities will operationalise it. The country is working on the action plan to this strategy to guide the implementation phase (European Commission, 2020[3]).

There has been progress regarding the preparation of LSG Development Plans. In December 2019, five Serbian LSG (Bački Petrovac, Kuršumlija, Mali Zvornik, Petrovac na Mlavi and Sjenica), with the support of UNDP, STCM and the Government of the Slovak Republic, released their first Development Plans, prepared in line with the Law on the Planning System of Serbia and adopted in January 2020. The Development Plan of the Autonomous Province of Vojvodina was finalised at the end of 2020. In May 2020, the Public Policy Secretariat published the Guidelines on preparation of the LSG Development Plans, which are partly binding after the adoption of a specific regulation in August 2020 ("Regulation on obligatory elements of the development plan of the autonomous province and local self-government unit", Official Gazette of the Republic of Serbia, No. 107/2020).

The public administration continues to be exposed to political influence

Serbia has adapted the legislative framework to move towards a more meritocratic and professional civil service. Amendments to the Law on Civil Servants adopted in December 2018 and new secondary legislation adopted in 2019 introduced a competency framework for the civil service. The new regime will introduce compulsory written entrance tests for all civil servants (Meyer-Sahling et al., 2019[130]). Ministries and agencies in Serbia have more autonomy in recruiting staff than in the rest of the region, which can ensure adequate administrative capacity. The general management of the pay system and the setting up of the performance appraisal system are completely centralised. Centralised and therefore even, pay scales could, in principle, trigger competition among entities, broaden opportunities for government-wide strategic human resources planning, minimise barriers to mobility inside the civil service and shield staffing decisions from political interference (OECD, 2020[107]). Following adoption of these amendments, changes in the recruitment and selection practices in the civil service have not yet been observed yet (OECD/SIGMA, 2019[32]).

The method of appointing senior civil servants creates scope for the politicisation of the administration. According to the Law on Civil Servants, senior officials are appointed for a five-year period after passing internal or public competitions. While the selection process unfolds, one or more civil servants are often called to fill vacant positions as "acting heads" for the total duration of maximum 6 months without an internal or public competition (Art. 64 of the Law on Civil Servants). In 2019, "acting heads" represented 55% of the total number of 377 senior civil service positions. "Acting heads" can be extended for an additional 3 months if the process of selection process is unsuccessful. This would seem to leave the door open for additional delays in appointment of senior management (OECD/SIGMA, 2019[32]). Moreover, appointment decisions for management positions can be overthrown by a government personnel committee after the selection process is finalised at the institutional level (European Commission, 2020[3]). The abuse of “acting position” and the opaque methods of appointing senior civil servants have two main shortcomings. First, they favour patronage and careers based on political loyalty more than merit (Meyer-Sahling et al., 2019[130]). Second, they are a major source of staff turnover and thus loss of institutional memory (European Commission, 2020[3]).

The recruitment of temporary employees and personnel “under contract” is widespread in the rest of the public sector too. According to data provided by the SORS, temporary public-sector employment increased by 2.5% per year between 2005 and 2019. In 2019, it accounted for around 4% of total public-sector employment. This practice is a significant obstacle to merit-based recruitment and creates further scope for patronage and the politicisation of the public sector. On the positive side, temporary positions of up to six months are now publicly advertised and open to competition (OECD/SIGMA, 2019[32]). Contracted personnel, moreover, are directly hired to fill positions that do not formally exist in the Rulebook on Internal Organisation and Job Systematisation, even though they can perform public service tasks (OECD/SIGMA, 2015[131]).

These practices can undermine the capacity of the state in the long term. The selection of acting senior civil servants and personnel under contract is not based on merit. Moreover, their temporary assignment may slow down the building up of institutional memory that usually drives the efficiency of the civil service in the long-term. Phasing out these types of positions and effectively implementing a merit-based civil servant recruitment system (especially at the senior level) are therefore crucial steps to enhance the capacity of the state to plan long term.

The state has not yet developed the capacity to plan and prioritise strategically

The planning process in Serbia is patchy and with a limited time horizon, but changes are ahead. As of 2021, the current national strategy is based on 67 Strategies and programs – 2 of which will expire by the end of 2021. According to interviews, these documents do not seem to be strategic per se but are rather a long list of intentions, only 60% of which are accompanied by monitorable action plans. At least four entities are in charge of the design of strategic planning and the definition and harmonisation of policy priorities (OECD, 2020[107]).[26] The Law on the Planning System of the Republic of Serbia, adopted in 2018, set out clear rules for developing, monitoring and reporting on sector strategies (European Commission, 2020[3]). There is still room for significantly improving the capacity to oversee and monitor implementation and meaningfully report priorities and recommendations to top decision makers.

Serbia is optimising its strategic planning, but more effort is needed to prioritise policy action. The PPS, under the Office of the Prime Minister, is leading the implementation of the Law on the Planning System of the Republic of Serbia, in force since 2018, the Regulation on the methodology of public policy management, impact assessment of public policies and regulations and the Regulation on the methodology of drafting mid-term plans. The PPS has adopted tools to control the quality of the planning process better. A unified system for planning and monitoring the implementation of public policies has been operational since January 2019, and a hierarchy of strategic public policy documents is under development (European Commission, 2019[84]). Yet, effective quality control by the PPS remains a challenge. The comments on draft laws and planning documents that the PPS provides to institutions are not legally binding. Moreover, there is no mechanism to verify that they are effectively incorporated (European Commission, 2020[3]).

The implementation of anti-corruption strategies has been slow

Serbia has created a legal framework to fight corruption and abuse of power. The normative framework for the fight against corruption in the Republic of Serbia consists of almost 26 laws, one strategy with its operational plan and the Action Plan for Chapter 23 – Subchapter “Fight Against Corruption”

(Table 17.6). The Action Plan for Chapter 23 (firstly adopted in 2016 and then revised in 2020 and its subsequent revision) is the main comprehensive strategic document. The implementation of the subchapter “Fight Against Corruption” of the Action Plan is monitored by the Agency for Prevention of Corruption (ACA - formerly Anti-Corruption Agency).[27] At the political level, a new Coordinating Body for the implementation of the Operational Plan will ensure the implementation of anti-corruption activities across ministries, agencies and institutions, issue guidelines and resolve possible conflicts between institutions. It will be chaired by the Minister of Justice, and composed by the Minister of the Interior, the Minister of Finance, the Minister of Education, the Minister of Public Administration and Local Self-Government and the Minister of Health.

Table 17.6. Serbia has created a solid legal framework to fight corruption and abuse of power

Laws, strategies and actions plans put in place since 2010

National Anti-Corruption Strategy for the period 2013-2018 (“Official Gazette of RS“, No. 57/13)
Revised Action plan for the implementation of the National Anti-Corruption Strategy for the period 2013-2018 (“Official Gazette of RS“, No. 61/2016)
Action Plan for Chapter 23
Law on Financing of Political Activities (“Official Gazette of RS”, No. 43/11, 123/14 and 88/19)
Law on Prevention of Corruption - in force since September 1, 2020 ("Official Gazette of RS", No. 35/2019 and 88/19)
Law on Lobbying ("Official Gazette of RS", No. 87/2018)
Criminal Code ("Official Gazette of RS", No. 85/05 88/05, 107/05, 72/09, 111 / 09,121 / 12, 104/13, 108/14, 94/16 and 35/19)
Law on Free Access to Information of Public Importance ("Official Gazette of RS", No. 120/04, 54/07, 104/09 and 36/10)
Law on Public Procurement - in force since July 1, 2020 ("Official Gazette of RS", No. 91/19)
Law on Privatization ("Official Gazette of RS" No. 83/14, 46/15, 112/15 and 20/16 - authentic interpretation)
Criminal Procedure Code (“Official Gazette of RS”, No. 72/11, 101/11, 121/12, 32/13, 45/13, 55/14 and 35/19)
Law on State Audit Institution (“Official Gazette of RS”, No. 101/2005, 54/2007, 36/2010 and 44/2018 - other law)
Law on Seizure and Confiscation of the Proceeds from Crime (“Official Gazette of RS“, No 32/13, 94/16 and 35/19)
Law on Liability of Legal Persons for Criminal Offenses (“Official Gazette of RS“, No. 97/2008)
Law on International Legal Assistance in Criminal Matters ("Official Gazette of RS", No. 20/2009)
Law on the Program for the Protection of Participants in Criminal Proceedings ("Official Gazette of the RS", No. 85/2005)
Law on the Organization of State Bodies in the Suppression of Organized Crime, Terrorism and Corruption ("Official Gazette of the RS" No. 94/16 and 87/18)
Law on Public Prosecutor's Office ("Official Gazette of RS" No. 116/08, 104/09, 101/10, 78/11, 101/11, 38/12 - Decision of the Constitutional Court 121/12 and 101/13, 111/14 - Decision of the US RS, 117/14, 106/15 and 63/16 - Decision of the US RS)
Law on the State Prosecutors' Council ("Official Gazette of RS", No. 116/08, 101/10 and 88/11 and 106/15)
Law on Police ("Official Gazette of RS", No. 6/2016, 24/18 and 87/18)
Law on Property Origin and Special Tax - in force since March 11, 2021 ("Official Gazette of RS", No. 18/2020)
Law on Tax Procedure and Tax Administration ("Official Gazette of RS", Nos. 80/02, 84/02 - corr., 23/03 - corr., 70/03, 55/04, 61/05, 85/05 - dr. law, 62/06 -. law, 63/06 - corr. dr. law, 61/07, 20/09, 72/09 - dr. law, 53/10, 101/11, 2/12 - corrected, 93/12, 47/13, 108/13, 68/14, 105/14, 91/15, 112/15, 15/16 108/16, 30/18, 95/18 and 86/19)
Law on Protection of Whistleblowers ("Official Gazette of RS" No. 128/2014)
Law on Ratification of the United Nations Convention against Corruption ("Official Gazette of Serbia and Montenegro - International Agreements, No. 12/2005)
Law on Ratification of the Criminal Law Convention on Corruption (“Official Gazette of the FRY - International Agreements”, No. 2/2002 and “Official Gazette of Serbia and Montenegro - International Agreements”, No. 18/2005)
Law on Ratification of the Additional Protocol to the Criminal Law Convention on Corruption ("Official Gazette of RS - International Agreements", No. 102/2007)
Law on Ratification of the Civil Law Convention on Corruption (“Official Gazette of RS - International Agreements”, No. 102/2007)
Law on Ratification of the United Nations Convention against Transnational Organized Crime and Additional Protocols ("Official Gazette of the FRY - International Agreements", No. 6/2001)

Source: Republic of Serbia, Negotiating Group for Chapter 23. *Action Plan for Chapter 23* (June 2020), www.mpravde.gov.rs/files/Revised%20AP23.docx.

Prevention and repression of corruption involves a number of actors. The most important bodies in charge of preventing corruption are the Anti-Corruption Council, the Anti-Corruption Agency (ACA), the Commissioner for Information of Public Importance and Personal Data Protection and the State Audit Institution. The ACA is an independent state authority that reports to the National Assembly and has, among others, the following roles: (i) it resolves the incompatibility of public offices and conflict of interest; (ii) controls the assets of public officials; (iii) investigates the financing of political subjects; (iv) performs tasks in accordance with the law governing lobbying; (v) supervises the adoption and implementation of integrity plans; (vi) supervises the implementation of strategic documents; (vii) addresses the complaints of citizens and raises awareness about corruption practices; and (viii) adopts the training programme and instructions in the field of prevention of corruption and monitors the implementation of training in public authorities. The 2019 Law on the Prevention of Corruption (in force since September 2020) requires the ACA to carry out corruption risk analyses of public authorities and laws and to recommend solutions for risk management. Police, public prosecutors and courts handle the repression of criminal activities.

In spite of these efforts, corruption is still a major constraint to development in the country. Perceptions of corruption in Serbia are higher than in economies with a similar GDP per capita (Figure 15.2) and have been increasing over the past five years. According to Transparency International's 2019 Corruption Perceptions Index, Serbia ranks 91st out of 180 economies.

The normative framework has not always been followed up by concrete actions, but implementation of the National Anti-Corruption Strategy has been slowly improving. The strategy set 53 goals and identified 177 measures for their fulfilment. The ACA, however, reports that only 26% of the measures had been implemented by the end of 2017 (European Commission, 2019[84]). A Revised Action Plan for the period 2016-18 envisaged 113 measures and 250 activities: 37% were realised as expected; 60% were not (assessment for the remaining activities was not possible) (ACA, 2019[132]). The prevention arm of the anti-corruption framework is weak. The ACA has neither inspection nor investigation powers and is short of financial and human resources. The State Audit Institution prepared reports, which the national assembly has not discussed since 2013 (BTI, 2020[119]; OHCHR, 2019[133]). The lack of a harmonised database and record of criminal offenses with elements of corruption undermines repression (ACA, 2018[134]).

Public procurement is one of the most critical areas of corruption. The level of competition in the public procurement process remains limited: the average number of bids per tender fell from 3.0 in 2017 to 2.5 in 2018, the lowest level in the last five years. At the local level, the average is even lower (2.1 bids per tender) (World Bank, 2020[70]). A new procurement law was adopted in 2019 to strengthen the transparency of public procurement processes and their resilience to corruption. However, the institutions supervising the process (the Public Procurement Office and the Commission for the Protection of Rights in Public Procurement Procedures) lack human capacity and do not always co-ordinate (ACA, 2018[134]). Moreover, a new law adopted in February 2020 allows the government to exempt linear infrastructure projects of "special importance for the Republic of Serbia" from the application of public procurement rules, undermining the implementation of the 2019 law with regards to oversight and to the contestability of public procurement opportunities (European Commission, 2020[3]).

Serbia has seen stark improvement in statistical capacity but can still strengthen statistical independence and processes to ensure confidentiality

In addition to the Statistical Office of the Republic of Serbia (SORS), the system of official statistics in Serbia includes the National Bank of Serbia, the city administration of the City of Belgrade and a list of over 30 authorised producers of official statistics. According to the Statistical Law adopted in 2009, the SORS is the main producer and disseminator of official statistics, as well as the authorised professional agent, organiser and co-ordinator of the statistical system of the Republic of Serbia (SORS, 2009[135]). The SORS performs statistical activities according to the five-year programme and annual plans.

Serbia's statistical council consists of 17 members, including the director of the SORS and representatives from various government ministries, the National Bank of Serbia, scientific and education institutions, the Chamber of Commerce and the Statistical Society of Serbia.

Over the past decade, Serbia has seen a stark improvement of its statistical capacity. The World Bank measured an increase in statistical capacity from 75.6 out of 100 in 2010 to 88.9 in 2019 (World Bank, 2020[136]). The SORS implemented a range of innovative organisational reforms. For instance, it modernised its data production processes by establishing an integrated system for data entry and data processing. The system facilitates computer-assisted telephone interviews (CATI), computer-assisted personal interviews and computer-assisted web surveys (CAW). Today, around 90% of surveys are collected via the system (Gerziunaite, Hackl and Redmond, 2017[137]).

The SORS improved data quality standards. Serbia is a member of the IMF's Enhanced General Data Dissemination System (e-GDDS), expressing its voluntary commitment to act on upgrading the quality of data collected and distributed through statistical systems (IMF, 2020[138]). The SORS also adopted transparent data dissemination and communication practices. It publishes a release calendar and quarterly press releases and is active on social media (PARIS21, 2020[139]). Its website is highly accessible in English and Serbian and provides a database that allows users to generate tables interactively. Since 2013, the SORS has conducted biannual user satisfaction surveys. The SORS receives the highest external funding to statistical capacity development in the region, amounting to USD 991 436 in 2017 (PARIS21, 2019[140]).

Despite this progress, Serbia has room for improvement in social statistics. World Bank data show that there has been no health survey available for the past five years (World Justice Project, 2020[118]). The European Health Interview Survey, conducted in 2019 under IPA funding will rectify this particular gap. Preliminary results of this survey were published in December 2020. Serbia lags behind in tracking progress towards the SDGs. Only 31% of the indicators (75 out of 244) are reported on line (SORS, 2020[8]).

Serbia needs to improve its practices to ensure confidentiality in data collection. According to Eurostat, penalty provisions for confidentiality breaches are quite weak. For instance, there is no provision in the case a staff member breaches the confidentiality of official statistics, and provisions in existing policies state that enterprise employment and production data are not confidential (Gerziunaite, Hackl and Redmond, 2017[137]) which can affect the quality of the primary data collected.

Planet – conserving nature

The Planet pillar of the 2030 Agenda for Sustainable Development reflects the need to find the right balance between socio-economic progress and capacity to sustain the planet's resources and ecosystems and to combat climate change. The Planet section in this chapter identifies three major constraints Serbia faces in its development path. First, Serbia is prone to natural hazards, such as droughts, floods and extreme temperatures. Second, the environmental quality of life of all citizens of Serbia is threatened due to unsolved challenges in waste management, high levels of air and water pollution and poor-quality drinking water. Third, Serbia needs to create a lower carbon energy sector. Serbia is highly dependent on coal and continues to prioritise the development of coal power plants, despite the environmental and climate challenges the country is facing. Defining a coherent long-term strategy that combines energy and climate targets will be key for Serbia's development path; the country is currently already working on a strategic document.[28] Overall, environmental concerns have yet to be become an integral part the growth agenda. The process of accession to the European Union could help raise environmental awareness and be a driver of environmental reforms (Table 17.7).

Table 17.7. Planet – three major constraints to a more sustainable path in Serbia

1. Serbia is exposed and vulnerable to natural hazards.
2. Poor environmental quality affects the lives of all citizens of Serbia.
3. High dependence on coal is holding back sustainable development.

Serbia is exposed and vulnerable to multiple natural hazards

Serbia is prone to natural hazards, such as droughts, floods, earthquakes, landslides and fires. Over the past two decades, droughts, floods and weather-related extreme events have caused major damages and losses to the country's infrastructure and economic sectors, especially agriculture, and have affected many people's lives.

Flooding in particular poses a threat to livelihoods. From 2006 to 2019, there were ten natural hazards, eight of them floods: 2007, 2009, twice in 2010, twice in 2013, 2014 and 2019. The floods in May 2014 were particularly severe, affecting 22% of the population (1.6 million people) in two-thirds of municipalities (most located in Central and Western Serbia). Damage amounted to EUR 1.5 billion, based on Post-Disaster Needs Assessment methodology (EU Serbia/United Nations/World Bank, 2014[141]). The 2014 floods had a significant impact on the energy and mining sectors, causing EUR 494 million in damages. Around 90% of the damages were in the coal and power generation sectors (for example, the Kolubara coal mining basin was flooded), followed by the power distribution sector (EU Serbia/United Nations/World Bank, 2014[141]).

Climate change may intensify the frequency and impact of floods and other natural hazards. The cost of extreme weather events in Serbia since 2000 exceeds EUR 5 billion. More than 70% of the losses are associated with droughts and extreme temperatures (Government of the Republic of Serbia, 2015[142]). Serbia, like the whole Western Balkans, is expected to become warmer and drier due to projected scarce precipitation. Serbia's climate is moderate-continental. A continental climate dominates in the mountainous regions, and Mediterranean, subtropical and continental climates prevail in the southwestern part of the country. Serbia is vulnerable to climate change, with observed temperature increase for all representative concentration pathway (RCP) scenarios. The variation depends on the global efforts in greenhouse gas (GHG) emissions reduction (Table 17.8).

Table 17.8. Like other Western Balkan economies, Serbia is highly vulnerable to climate change

Change of the mean annual temperature (in °C) with respect to the base period (1986-2005) for the RCP 4.5 and RCP 8.5 scenarios of GHG emissions

	Albania		Bosnia and Herzegovina		Kosovo		Montenegro		North Macedonia		Serbia	
RCP	4.5	8.5	4.5	8.5	4.5	8.5	4.5	8.5	4.5	8.5	4.5	8.5
2016 - 2035	0.5-1.0	0.5-1.0	0.5-1.0	0.5-1.0	0.5-1.0	0.5-1.5	0.5-1.0	0.5-1.5	0.5-1.0	0.5-1.5	0.5-1.0	0.5-1.5
2046 - 2065	1.0-2.0	1.5-3.0	1.0-2.0	1.5-3.0	1.5-2.0	2.0-3.0	1.0-2.0	1.5-3.0	1.5-2.0	2.0-3.0	1.0-2.0	1.5-3.0
2081 - 2100	1.5-2.0	4.0-5.0	1.5-3.0	4.0-5.0	2.0-3.0	4.0-5.0	1.5-3.0	4.0-5.0	2.0-3.0	4.0-5.0	1.5-3.0	4.0-5.0

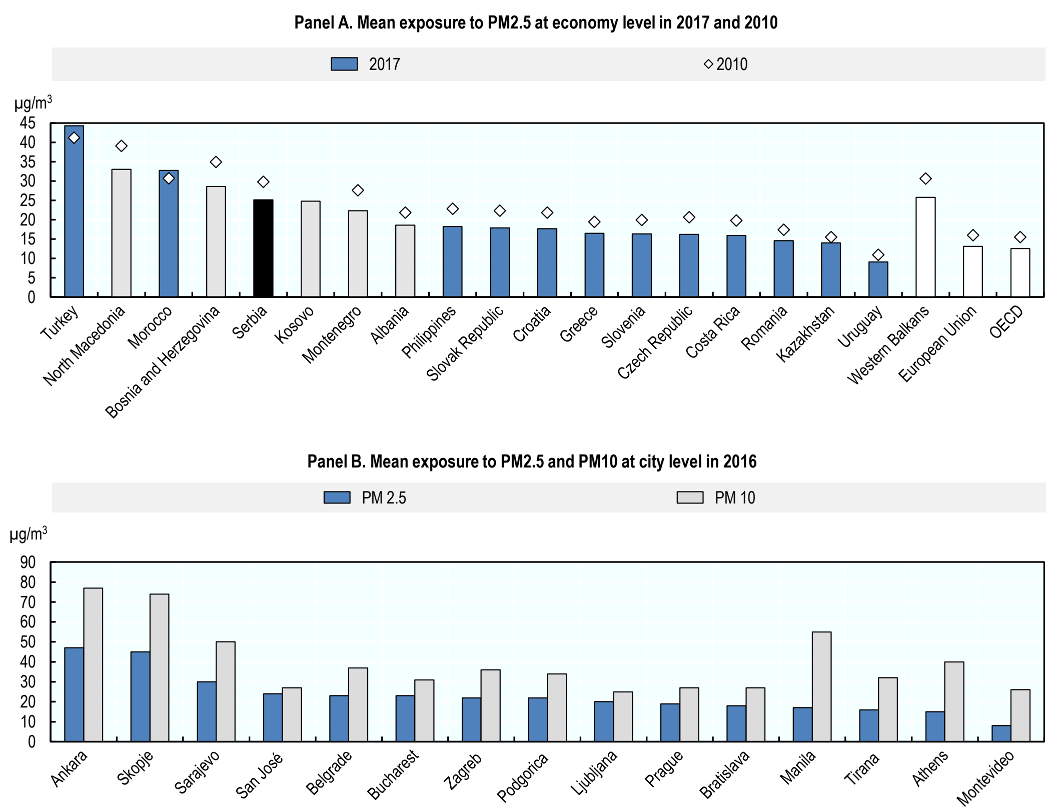
Notes: The mean annual temperature corresponds to the average of the maximum and minimum temperatures of a year, taking the mean average of the coldest month of the year and averaging it with the mean average of the hottest month of the year. The RCP 4.5 refers to a stabilisation scenario and RCP 8.5 to a continuous rise scenario of GHG emissions.
Source: RCC (2018[143]), *Study on Climate Change in the Western Balkans Region*, www.rcc.int/pubs/62.

The deterioration of the environmental quality of life of all citizens of Serbia

Air pollution is a serious threat, and the level of some pollutants, especially acidifying gases, remains unchanged since 1990

The population of Serbia is exposed to the highest concentration of air pollution in Europe. The annual exposure to particulate matter (PM 2.5) air pollution decreased from 29.8 µg/m³ in 2005 to 25.1 µg/m³ 2017, but it remains almost double the EU average (13.1 µg/m³) and the OECD average (12.5 µg/m³) and more than double the World Health Organization (WHO) recommended maximum (10 µg/m³) (Figure 17.32 – Panel A). Belgrade and Niš are more exposed than other European cities (Figure 17.32 – Panel B). Based on the country's inventory, provided by the Serbian Environmental Protection Agency (SEPA), there were no significant changes in nitrogen oxides (NO_x) or ammonia (NH_3) emissions between 1990 and 2017 and only a slight decrease in sulphur oxides (SO_x, SO_2) emissions (SEPA, 2019[144]).[29] Pollution is considered a serious problem by 67% of people in Serbia and a very serious problem by 32%, which are in line with regional averages (RCC, 2019[145]).

Figure 17.32. The population in Serbia is exposed to high concentrations of air pollution compared to Europe and other benchmarks



Notes: Panel A: mean exposure to PM2.5 by economy in 2017 and 2010. Panel B: mean exposure to PM2.5 and PM10 at the city level in 2016. Mean population exposure to fine particulate matter is calculated as the mean annual outdoor PM2.5 concentration weighted by population living in the area. It is the concentration level, expressed in µg/m³, to which a typical resident is exposed throughout a year. Data for Kosovo are from 2016 (local data reported to the European Environment Agency) (EEA, 2020[146]). Data for Turkey are from the World Bank.
Source: OECD (2020[147]), *Green Growth Indicators* (database), https://stats.oecd.org/Index.aspx?DataSetCode=GREEN_GROWTH.

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Air pollution poses a significant threat to the health of the population and has significant costs. Air pollution is estimated to cause 6 592 deaths per year, the highest rate in the Western Balkans and among the highest in Europe. Exposure to PM2.5 accounts for 3 585 premature deaths per year, approximately 50.1% of which are in Belgrade. The estimated health costs based on annual emissions from the country's coal power plants alone is between EUR 0.89 billion and EUR 1.682 billion, the highest in the Western Balkans (Health and Environment Alliance/Climate Action Network, 2017[148]).

The energy sector and traffic are the main sources of air pollution in Serbia. Heating plants and individual heating account for 57% of total PM10 emissions and 77% of total PM2.5 emissions. Energy generation and distribution is also the most significant contributor to acidifying gases (53% of all NO_x emissions and 90% of all SO_2 emissions) (SEPA, 2020[149]). Several of the most polluting coal power plants in Europe are located in Serbia: Nikola Tesla A (97 557 tonnes of SO_2 emissions in 2019), Nikola Tesla B (78 839 tonnes), Kostolac B (79 112 tonnes) and Kostolac A (52 710 tonnes), were the four largest emitters of SO_2 in 2019 (EPS, 2020[150]; EEA, 2020[151]). To reduce pollution from power plants and extend their lifetime under improved environmental standards, desulphurisation systems are currently being installed at Kostolac B[30] and Nikola Tesla A, and the plants are being modernised with sizeable investments (reaching approximately EUR 300 million for desulphurisation alone in the two power plants) (Serbia Energy, 2020[152]). However, the deadline for the finalisation of the desulphurisation systems in Nikola Tesla A was recently pushed back to 2022 from 2020/21 (Balkan Green Energy News, 2020[153]). Other polluting sectors are the mineral industry (13% of total PM10 emissions and 9% of total PM2.5 emissions) (SEPA, 2019[144]) and the transport sector. Road transport accounts for around 6% of total PM10 emissions. The age of privately owned vehicles and the ageing of the vehicle fleet of public transport companies in the largest cities contribute to the deterioration of air quality. Agriculture is responsible for almost 83% of total gaseous ammonia emissions and 10% of total PM10 emissions (SEPA, 2019[144]).

In 2009, Serbia adopted a normative framework on air protection, but implementation is lacking. Serbia's legislation on air pollution has a high degree of alignment with the EU acquis (European Commission, 2020[3]). The Law on Air Protection and its subsequent amendments define measures for the protection and improvement of air quality, set responsibilities regarding air quality monitoring and require the adoption of local air quality plans for areas where the air is excessively polluted. However, this legislation needs to be fully implemented, and the monitoring of air quality needs to be strengthened (European Commission, 2020[3]). The network of stations detecting pollution in Serbia provides better coverage than in the rest of the Western Balkans,[31] but not all monitoring stations are regularly maintained, and the annual measurement of some pollutants remains limited, undermining the capacity to produce complete health assessments throughout the country (WHO, 2019[154]).[32] So far, only Belgrade, Bor, Novi Sad, Smederevo, Pančevo, and Užice have adopted local air quality plans, although a number of others are in preparation (UNECE, 2015[155]).

Waste management is a challenge in Serbia in terms of collection, treatment and reporting

Serbia has been improving its legislation on waste management, but implementation must be strengthened. Serbia's legislation on waste management is largely aligned with the EU acquis. In 2019, Serbia adopted a number of new regulations on waste management. A national waste management strategy and a national sludge management strategy are currently in the adoption process. A by-law on the treatment of equipment and waste containing polychlorinated biphenyl is also in the adoption process and will fully transpose the EU directive on waste management once adopted. Serbia must improve the implementation of waste management legislation (European Commission, 2020[3]).

Waste production is relatively low, but data reliability is questionable. Each citizen of Serbia produces, on average, 319 kg of waste per year, which is below the OECD (525 kg), EU (492 kg) and Western Balkan (365 kg) averages (Eurostat, 2018[1]). However, local data on municipal waste generation are provided by Serbian local self-government units, and both the Ministry of Environment and the Fiscal Council of the Republic of Serbia consider them unreliable (Ministry of Environmental Protection, 2010[156]).

Waste collection rate and fees are low. While the figures are outdated, organised collection of municipal solid waste covered about 80% of generated waste in 2013 (UNECE, 2015[155]) with particularly limited collection in non-urban areas (Ministry of Environmental Protection, 2010[156]). The collection rate is notably low among households. In general, municipal waste collection fees are based on the amount of waste collected (in m^2), the number of household members or the number of families in a building, and they only partially cover operating costs.

Much of solid waste is not disposed of correctly. According to the National Waste Management Strategy for the period 2010-2019, there are 164 registered landfills (Ministry of Environmental Protection, 2010[156]). Around 70% do not meet basic operational standards and are functioning without previous environmental impact assessment studies or the required permits. Some present high environmental and human health risks due to their location: 12 are located less than 100 m from a human settlement and 25 are located less than 50 m from a lake or river bank (Ministry of Environmental Protection, 2010[156]). Last, not all municipal waste collected is disposed of correctly, and part of it ends up in illegal dumpsites. There are around 4 481 such dumpsites, located mainly in non-urban areas, which receive about 40% of municipal waste and are located mainly in non-urban areas (Ministry of Environmental Protection, 2010[156]).

Separate collecting, sorting and recycling of waste is not systematically organised. The share of waste recycled in Serbia (2.59%) is lower than in the rest of the region and the EU average (36.2%) (Eurostat, 2020[47]). Separate waste collection occurs sporadically in Bajina Bašta, Belgrade, Čačak, Leskovac, Mitrovica and Sremska Leskovac (Fiscal Council of the Republic of Serbia, 2019[103]).

Poor-quality drinking water and water pollution affect public health in Serbia

Serbia has abundant water resources and shares most of them with neighbouring economies. The country has 21 493 m^3 of total renewable water resources per capita per year, which is higher than the regional and EU averages (Figure 17.34). Approximately 90% of the Serbian territory lies in the Danube River Basin (International Commission for the Protection of the Danube River, 2020[157]), the second largest river basin in Europe and the most international in the world, flowing through the territories of 19 economies. Serbia shares other transboundary basins, such as the Drina, Sava and Tisza. Transboundary river-basin management is therefore crucial for sustainable water policy development.[33]

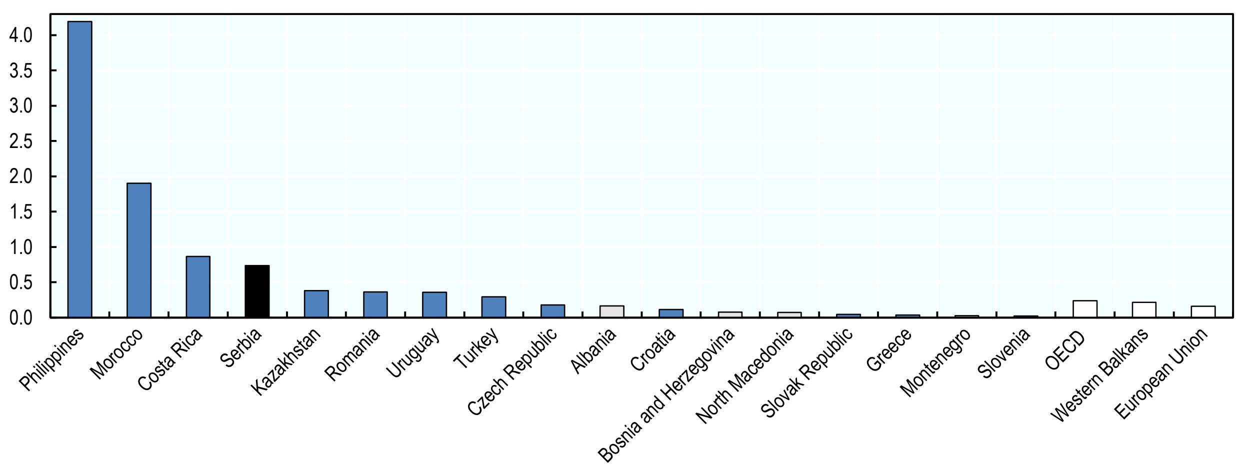
Serbia has good access to drinking water, with proven water service continuity. The relatively good coverage is mainly due to the infrastructure and investments inherited from the former Yugoslavia (Fiscal Council of the Republic of Serbia, 2019[103]). Municipal public utilities are responsible for water distribution. They propose tariffs, which are approved by local government competent bodies, (municipal assemblies in most cases).

Water quality is low, especially in non-urban areas. The quality of drinking water has been slightly improving (SEPA, 2019[144]), but remains low compared to the rest of the region and the European Union. The level of satisfaction with water quality in Serbia is, moreover, much lower than in other economies with a similar income per capita (Figure 15.2). According to annual evaluations by the Institute of Public Health, under the Ministry of Health, 56% of drinking water met minimum quality requirements in urban areas vs. 37% in non-urban areas. Since monitoring is discontinuous, the situation might further deteriorate (WHO et al., 2017[158]; Fiscal Council of the Republic of Serbia, 2019[103]).[34] Drinking water quality seems to be particularly poor in the Autonomous Province of Vojvodina due to high concentration of arsenic in the groundwater – the main source of abstracted drinking water.[35] Around half the population of the province is potentially affected.

Securing safe water and sanitation remains problematic in Serbia. The large number of illegal dumpsites, uncontrolled waste deposit, continuous discharges of urban and industrial wastewater into rivers and pollution from agriculture have significantly contributed to water pollution. As a result, only 7% of surface water in Serbia is classified as at least decent, compared to 50% in Europe (Fiscal Council of the Republic of Serbia, 2019[103]). For example, the 118 km Great Bačka Canal, which runs from Bezdan (Danube River) to Bečej (Tisza River), is one of the most polluted watercourses in Europe. Around industrial towns like Kula and Vrbas Crvenka, the river is no longer navigable because of its pollution levels.[36] Moreover, Serbia suffers from waterborne diseases more than other economies in the region (Figure 17.33). Water pollution may also expose the population to higher cancerogenic risks and may affect cognitive development among children.

Figure 17.33. Securing safe water and sanitation in Serbia remains an issue compared to other regional and benchmark economies

Mortality rate attributed to unsafe water, unsafe sanitation and lack of hygiene (exposure to unsafe WASH services) per 100 000 population in 2016



Source: WHO (2020[159]), "Burden of disease SDG 3.9.2 - Mortality rate attributed to unsafe water, unsafe sanitation and lack of hygiene (exposure to unsafe Water, Sanitation and Hygiene for All (WASH))", https://apps.who.int/gho/data/view.main.SDGWSHBOD392v.

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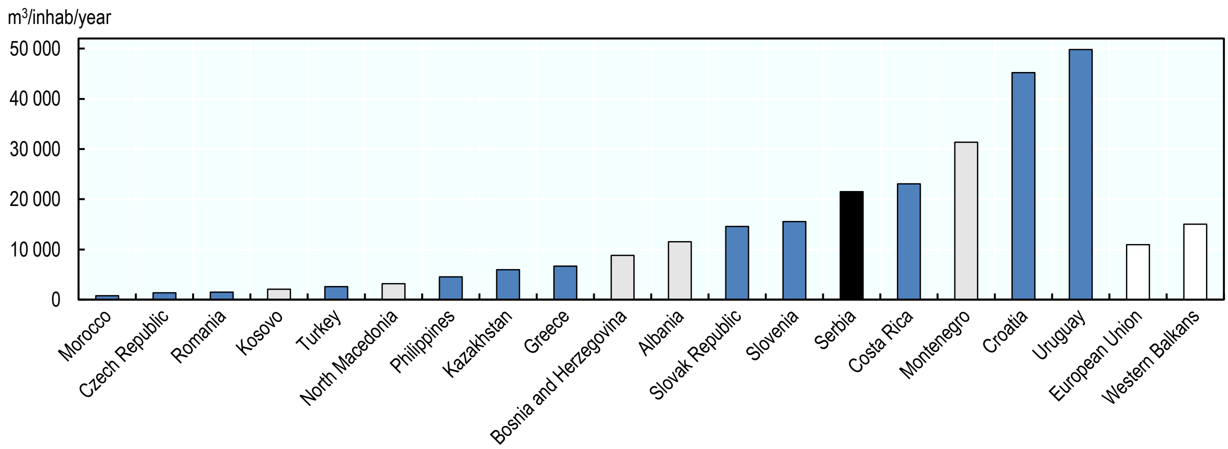
Wastewater treatment plants are sporadic and rarely operational. Around 58% of the population is connected to public sewerage systems, but only 10.5% is connected to public sewerage served by a wastewater treatment plant. This percentage is higher than the Western Balkan average (6.5%) but lower than the EU average (86%). In 2018, only 16.8% of the 400 million m³ discharged wastewater was treated (SEPA, 2019[144]). Households accounted for 71.4% of the wastewater discharged, followed by industry (14.6%) and other sectors (14%). According to SEPA, 42 municipal wastewater treatment plants were operational in 2018, but they worked at a lower efficiency level than designed, and 18 were still under construction or reconstruction (SEPA, 2019[144]). Unlike other Western Balkan economies, the country's capital does not have a wastewater treatment plant (World Bank, 2020[70]). Based on the estimation of the Fiscal Council, the construction of new wastewater treatment facilities with supporting infrastructure, such as the main wastewater collection infrastructure, will cost about EUR 600 million (Fiscal Council of the Republic of Serbia, 2019[103]).

Figure 17.34. Serbia has relatively abundant freshwater resources compared to other regional economies and the EU average

Total renewable water resources per capita (m3/inhab/year), 2017



Note: Data for Bosnia and Herzegovina, Kosovo and Montenegro are from 2016.
Sources: Eurostat (2018[1]), "Social protection statistics - pension expenditure and pension beneficiaries", https://ec.europa.eu/eurostat/statistics-explained/index.php/Social_protection_statistics_-_pension_expenditure_and_pension_beneficiaries; FAO (2020[160]), *Aquastat* (database), www.fao.org/nr/water/aquastat/data/query/results.html.

StatLink https://doi.org/10.1787/888934245804

Governance issues and inefficiencies undermine the quality of the water supply

Governance of the water sector in Serbia remains very fragmented, and the legislation for water management must be strengthened. There are 152 municipal public utilities and 6 ministries in charge of the water sector (Government of the Republic of Serbia, 2017[161]).[37] Unlike other economies in the region, Serbia has no autonomous regulatory authority in the water sector. Water management legislation needs to be better enforced and fully aligned with the EU acquis (European Commission, 2020[3]).

The efficiency of water service providers could be improved. Due to infrastructural gaps and administrative issues, non-revenue water amounts to around 38% of the water provided. Based on the estimation of the Fiscal Council, over EUR 800 million are needed for the expansion and rehabilitation of the water supply network (Fiscal Council of the Republic of Serbia, 2019[103]). The billing collection rate remains low (Salvetti, 2015[162]), although tariffs for water services remain affordable (0.9% to 1.1% of monthly household income in 2018, depending on the region) (Table 17.9) (SORS, 2019[163]). The tariffs do not allow the recovery of cost for water supply services. Around 40% of public water utilities were unable to generate tariff revenues to ensure the maintenance of the water infrastructure and network (UNECE, 2015[155]).

Table 17.9. Expenditures on communal services in Serbia per region

Structure of individual consumption of households (in %) for housing and communal services, 2018

	Belgrade Region	Vojvodina Region	Šumadija and Western Serbia Region	Southern and Eastern Serbia	Serbia
Housing, water, electricity and gas	17.3	16.7	16.4	16.3	16.7
Water supply	0.9	1.1	0.9	1.1	1.0
Waste collection	0.4	0.5	0.4	0.5	0.4
Sewage collection	0.3	0.1	0.0	0.0	0.1
Electricity	5.3	5.6	5.8	6.0	5.6
Gas	0.2	1.3	0.2	0.0	0.5
Central heating	3.9	1.4	0.8	1.0	1.9
Total	**11.0**	**10.0**	**8.1**	**8.6**	**9.5**

Note: "Housing, water, electricity and gas" includes rentals, fuels and dwelling. "Total" includes only the part corresponding to communal services, except fuels and dwelling.
Source: SORS (2019[163]), *Bulletin: Household Budget Survey, 2018*, https://publikacije.stat.gov.rs/G2019/PdfE/G20195652.pdf.

Enforcement and implementation of environmental legislation remains weak, and the decision-making process and funding for environmental matters lack transparency

The Ministry of Environmental Protection was established in 2017 but plays a secondary role within the government in terms of size and budget. The Ministry of Environmental Protection has existed since the 1990s, but its area of work has been moved several times to other ministries (including the Ministry of Science and the Ministry of Energy). In 2014, it was abolished. The latest institutional change was the separation of the Ministry of Agriculture and the Ministry of Environmental Protection in 2017. Funding for environmental protection and climate change was identified as a main concern.[38] The Green Fund was formally established in 2016 (Government of the Republic of Serbia, 2016[164]) and became operational in 2018 with the adoption of the by-laws on its operation and management.[39] Since 2018, the Green Fund has financed several environmental protection projects, but improvement of its institutional and legislative framework are necessary in order to establish a sustainable environmental financing system. An efficient and transparent system for financing environmental protection is an issue at both the national and local levels (Koalicija 27, 2019[165]).

Lack of regular and systematic monitoring hampers the enforcement of environmental legislation at both the national and subnational levels. Monitoring of landfills is almost non-existent, and only 20% of surface and ground water are regularly monitored. The capacity of inspectors is also problematic. According to the Fiscal Council, there are fewer inspectors than what efficient monitoring and supervision require (Fiscal Council of the Republic of Serbia, 2019[103]). International donors are active in reinforcing the capacities and competences of environmental inspectors, especially at the local level. The lack of reporting on inspection and permitting activities at the local level undermines the effectiveness of the environmental inspectorate (UNECE, 2015[155]).

The administrative and penal liability for damage to the environment is underdeveloped in Serbia and makes the polluter-pays principle ineffective. Due to lack of knowledge and information, environmental inspectors do not use administrative fines at the local level in practice, although the corresponding legislative framework is in place. Moreover, judges are not sufficiently familiarised and trained in environmental law (see the Peace and institutions section in this chapter). Increasing their awareness about environmental issues and the corresponding challenges regarding the enforcement of environmental legislation is essential. Last, the absence of data on concluded administrative, civil and penal cases related to environmental issues at country level undermines adequate monitoring of environmental legislation.

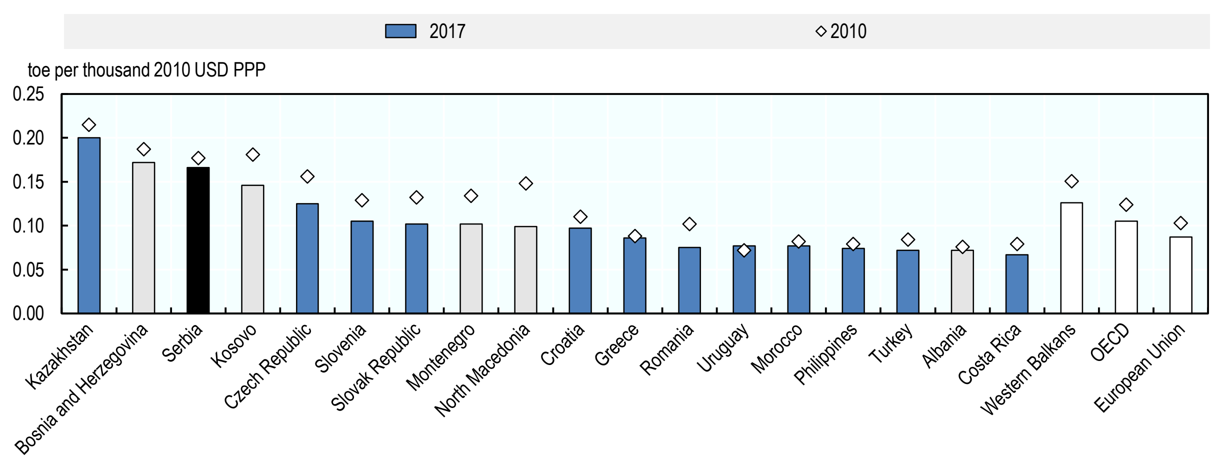
Greater transparency would help support effective compliance with environmental legislation at both the national and subnational levels. The decision-making process in environmental matters is not participatory. Given the need to diversify its energy mix, Serbia has incentivised the construction of small hydropower plants, about which environmental concerns can arise. Failures in the concession and permitting process, for example, led to some plants being built without the appropriate clearance from nature conservation authorities. The concentration of recipients of the associated concessions has raised concerns among some observers, which more participatory and publicised processes could help address. The main recipient of feed-in tariff payments was EPS, but 80% of other payments went to a single group of companies (Gallop, Vejnovic and Pehchevski, 2019[166]).

Serbia is highly dependent on coal and lacks a coherent long-term strategy that combines energy and climate targets

The Serbian economy remains very energy intensive. The energy intensity has been decreasing slightly over the last decade, but at 0.166 toe/USD 1 000, it is higher than the Western Balkan average (0.126 toe/USD 1 000) and remains very high compared to the EU and OECD averages (Figure 17.35).

Figure 17.35. Serbia's economy is very energy intensive compared to the EU and OECD averages

TPES/GDP (toe/USD 1 000 in 2010 USD PPP), 2017 and 2010



Note: Data for the Czech Republic, Greece, the Slovak Republic, Slovenia and Turkey are for 2018.
Source: IEA Statistics (2018[167]) (database), http://iea.org/stats/index.asp.

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High dependency on domestic and heavily polluting coal production continues to be prioritised, despite existing environmental and climate challenges

The primary energy production in Serbia was 10 025 million toe in 2018, by far the largest in the region. In 2018, 65.9% of the primary energy production was from solid fuels, around 9.7% was from crude oil, 3.6% was from gas and around 20.8% was from renewables (hydro, wind, geothermal, biomass, solar and biogas) (Eurostat, 2018[7]). Like other economies in the region, Serbia is a net importer of energy. Net imports supplied, on average, one-third of gross inland energy consumption of Serbia (Eurostat, 2018[7]).

In common with many other economies in the region, Serbia relies on domestic coal-fired electricity production provided by outdated power plants. In 2019, some 70.4% of domestic electricity production came from thermal power plans (using coal (lignite) and gas), 27.0% from hydropower, and around 2.6% from other renewable sources (wind, biomass and solar together) (Elektromreža Srbije, 2020[168]). Electricity from coal is generated in old thermal power plants (located in two main coal basins: Kolubara and Kostolac)[40] that are owned and managed by subsidiaries of EPS.

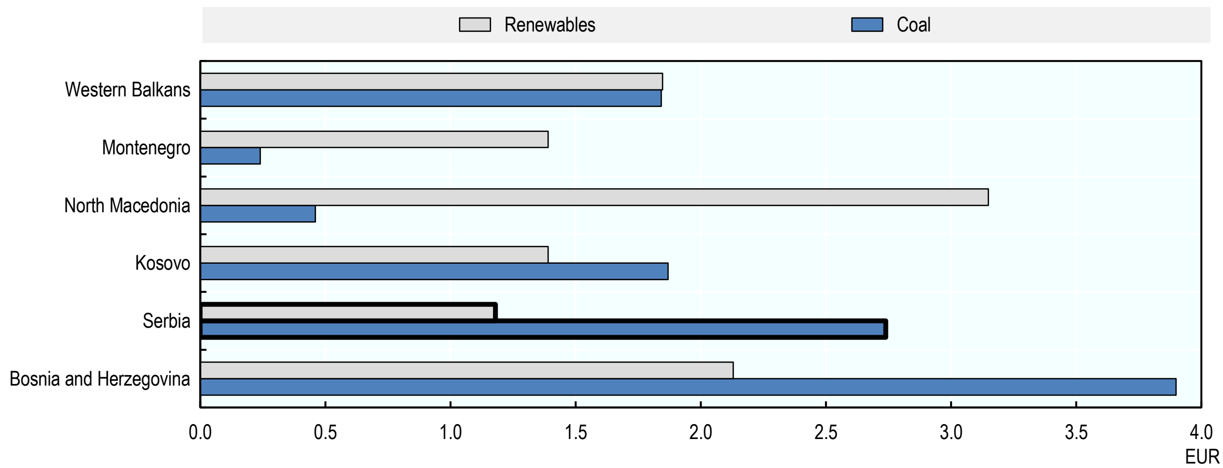
Despite existing climate and environmental challenges, Serbia continues to prioritise investments in the replacement of existing coal power plants and the construction of new ones. A new lignite power plant (Kostolac B3) located close to Pozarevac with 350 MW of power was approved by the government to be built before 2025 (Gallop and Cluta, 2017[169]). Serbia's 2016 Energy Sector Development Strategy and the Implementation Programme for the period 2017-2023 define three main priorities for the energy sector: improvement of energy security, development of the energy market and sustainable development (Government of the Republic of Serbia, 2017[170]; Ministry of Mining and Energy, 2016[171]).

Serbia has moved to diversify its energy mix through hydropower, wind, solar, biomass and biogas, but electricity production still takes a toll on the environment

Serbia adopted some measures to support the development of renewable energy sources, but except for hydro, power generation from renewables is marginal in the country. Thanks to hydro, the overall share of renewable energy in gross final consumption of energy in Serbia was 20.3% in 2018, below the Western Balkan average (28.81%), slightly higher than the EU average (18.9%) (Eurostat, 2018[1]), but well below the renewables target of 27% by 2020 set by Serbia and even lower than the renewable energy share (21%) in the 2009 baseline year.[41] Other sources of renewable energy – solar and wind energy – are insufficiently developed, even with the recent connections to the grid of 264 MW of wind power in 2018 and 398 MW in 2019 (Energy Community Secretariat, 2019[172]).[42] To improve the take-up of renewable energies, the system of support schemes for wind and solar would need to be revised, including, for example, by introducing auctions[43] and by reviewing capacity caps initially set in Serbia's National Renewable Energy Action Plan (Government of the Republic of Serbia, 2013[173]). For this purpose, the European Bank for Reconstruction and Development (EBRD) is currently advising the government on policies for the competitive procurement of renewable energies in order to increase the share of renewables in Serbia's energy mix (EBRD, 2020[174]). Fully transposing the EU acquis on energy in Serbia's energy legislation could play an important role in raising the share of renewables in Serbia's energy mix (European Commission, 2020[3]). Work on a draft Law on Renewable Energy has begun as of January 2021. Support schemes for renewables are in place, but the part of renewable incentives continues to be modest compared to coal subsidies (Figure 17.36). Incentives for coal were extended in January 2020, while stimulus measures for renewables expired in December 2019 (Balkan Green Energy News, 2020[175]).[44] Corresponding regulation to promote prosumers in Serbia is missing, although the Energy Law includes the possibility for households to produce electricity from renewable sources (Government of the Republic of Serbia, 2014[176]).

Figure 17.36. Coal continues to benefit from higher incentives than renewables in Serbia

Comparison of paid incentives (in EUR/MWh) for electricity from renewables and from coal in end-user prices in the Western Balkans, 2017



Sources: Miljević (2019[177]), *Analysis of Direct and Selected Hidden Subsidies to Coal Electricity Production*, www.energy-community.org/documents/studies.html; Miljević (2019[178]), *Rocking the Boat: What is keeping the Energy Community's Coal Sector Afloat? Analysis of Direct and Selected Hidden Subsidies to Coal Electricity Production in the Energy Community Contracting Parties*, www.energy-community.org/documents/studies.html.

StatLink https://doi.org/10.1787/888934245842

Serbia's energy production based on lignite and the development of small hydropower plants have a detrimental impact on the environment and water resources. The mushrooming of hydropower plants has an impact on water resources and on the preservation of biodiversity. Several of the already-built and planned plants are in protected areas (Gallop, Vejnovic and Pehchevski, 2019[166]). For example, in the Kopaonik National Park, Josanicka Banka and Stara Planina Nature Park (close to Bulgaria). The Knesevici plant near the Kopaonik National Park has an impact on available water resources and on their deterioration (Vejnović, 2018[179]). Amendments to the Law on Nature Protection were under discussion in 2019 and should ban the construction of small hydropower plants in protected areas, but those already built will not be demolished (Government of the Republic of Serbia, 2010[180]). The alignment of Serbian legislation with the EU environmental acquis could play an important role in limiting the negative impact of new hydropower plants on the environment (European Commission, 2020[3]).

The construction of new coal power plants sidesteps required environmental impact assessments. For example, in the case of the Drmno mine's 30% increase in annual production, the government decided not to realise a new environmental impact assessment.[45] In the case of Kostolac B3, the assessment realised in 2013 suffered numerous deficiencies, such as the absence of transboundary impact, although the new plant is located 15 km from the Romanian border.[46] A new environmental impact assessment for the construction of Kostolac B3, which included consultations with the Serbian and Romanian public, was conducted in June 2017.

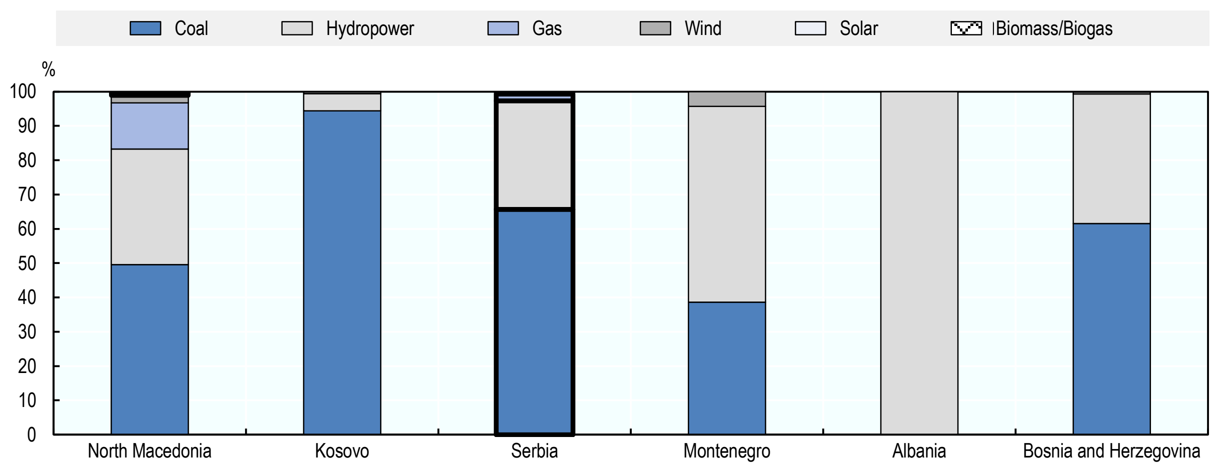
Serbia should aim to make its energy supply more reliable

Access to electricity is a significant concern for businesses in Serbia. The country ranks 94th in the world for ease of getting electricity, with an average time of 125 days (World Bank, 2019[181]). Due to degraded and old electricity transmission and distribution networks, secure, reliable and constant supply is a challenge. More than 15% of firms in Serbia considered electricity a major constraint in 2019 (World

Bank/EBRD/EIB, 2019[182]) (see the Prosperity and Peace and Institutions sections in this chapter). In 2019, 49.5% of firms experienced electrical outages, more than the Western Balkan average of 48.9% (World Bank/EBRD/EIB, 2019[182]). To tackle these challenges, new electricity distribution networks are currently under construction. Power transmission and distribution losses fell from 14% in 2016 to 11.91% in 2019 (Republic of Serbia, 2019[183]; Republic of Serbia, 2016[184]) below the regional average (16.63%) but higher than the EU and OECD averages (around 6.44% and 6.29%, respectively).

Figure 17.37. Serbia generates more than two-thirds of its domestic electricity from coal and almost one-third from hydropower

Electricity generation mix (in %), 2018



Sources: Energy Community Secretariat (2020[185]), Energy Community Secretariat website, https://energy-community.org; Eurostat (2020[47]), https://ec.europa.eu/eurostat/data/database.

StatLink https://doi.org/10.1787/888934245861

Serbia's electricity market is fully liberalised, in line with the Third Energy Package,[47] and the liberalisation of the gas sector is ongoing. The process to finalise unbundling in electricity is making good progress in Serbia (Energy Community Secretariat, 2018[186]). In the gas sector, Srbijagas, the state-owned natural gas provider, has been working on the creation of the business, financial and technical preconditions for the sustainable functioning of unbundled energy entities in open market conditions, including through the procurement of a telemetry system and the creation in October 2019 of an independent transport system operator, Transportgas Serbia. The development of competition in the sector could result in better quality service and more secure energy supply.

Energy efficiency policies, including in electricity generation, should complement shifts in the energy mix

Energy efficiency policies can do a lot more to reduce the environmental impact of growth in Serbia. The transposition of the relevant EU acquis on energy efficiency in the Law on Efficient Use of Energy and secondary legislation has already allowed the implementation of energy efficiency projects, such as increasing the efficiency of street lighting in Belgrade. Full implementation of the Energy Efficiency Directive and appropriate financial and human resources to encourage the implementation of energy efficiency projects will be necessary to achieve the Energy Community energy efficiency targets (Energy Community Secretariat, 2018[186]; European Commission, 2019[84]; Government of the Republlic of Serbia, 2013[187]). In particular, it is important to align Serbian legislation and regulations with the EU Directive on

Energy Performance of Buildings and to implement consumption-based metering and billing in district heating on a large scale as a prerequisite for implementing energy efficiency measures in residential buildings (European Commission, 2020[3]).

As the energy sector is responsible for almost 80% of GHG emissions, the sector will be crucial for mitigation. As of today, the government does not possess a long-term strategy that combines energy and climate targets and is in line with the EU 2030 framework for climate and energy policies and the EU climate acquis. The legislation on monitoring, reporting and verifying GHG emissions has not yet been aligned with the EU emissions trading system and EU Effort Sharing Regulation (European Commission, 2020[3]). However, a strategic document, which will include GHG emissions targets, is currently under preparation. In 2018, the Energy Community adopted a recommendation on the preparation of National Energy and Climate Plans (NECPs) by the members of the Energy Community. In line with this recommendation, the Ministry of Mining and Energy is currently working on a NECP for Serbia, which is planned to be a key document in defining Serbia's climate policies.[48] The creation of a Department on Climate Change within the Ministry of Environmental Protection is encouraging and will be key in designing a more ambitious update of the Nationally Determined Contribution (NDC) for the period 2021-2030, with mitigation measures that better target the energy sector. Serbia ratified the Paris Agreement in May 2017 and submitted a National Communication on climate change in 2010 (Government of the Republic of Serbia, 2010[188]) and in 2017 (Government of the Republic of Serbia, 2017[189]). In its NDC, Serbia committed to reducing its GHG emissions by 9.8% compared to 1990 levels by 2030 (Government of the Republic of Serbia, 2015[142]) and has already started.

Serbia adopted a National Emissions Reduction Plan (NERP) in January 2020, but its enforcement remains a challenge. The National Plan for the Reduction of the Main Pollutant Emissions from Old Large Combustion Plants aims to harmonise these emissions from Serbia's large old combustion plants with the limits set out in the European Union's Industrial Emissions Directive by 2027 (Government of the Republic of Serbia, 2020[190]). The NERP had been on hold since 2016, and Serbia only proceeded to its adoption shortly after the Energy Community launched a dispute procedure against the country. The document lacks an enforcement framework and sanction mechanisms should Serbia not honour its commitments (Balkan Green Energy News, 2020[153]).

Serbia has the opportunity to reduce energy consumption and, consequently, carbon emissions. Relatively low electricity prices in Serbia do not provide incentives for investing in energy efficiency or for saving energy. Serbia's electricity prices (approximately EUR 0.05/kWh for households)[49] are considered among the lowest in Europe (Fiscal Council of the Republic of Serbia, 2019[103]). Electricity tariffs remain affordable and corresponded, on average, to between 5.3% and 6.0% of monthly household income in 2018, depending on the region (SORS, 2019[163]).The current electricity tariffs for households do not reflect real costs needed, for example, to invest in infrastructure and thus guarantee security of supply.[50] Moreover, they do not include charges that would lead consumers to internalise the environmental impact of coal power plants. However, in contrast to other economies in the region, bill collection rates in Serbia are significant for households (95%) and lower for companies (89%) (UNECE, 2015[155]). Regarding heating, bills are based on m^2 rather than real-time consumption and do not encourage energy savings. Like electricity tariffs, heating tariffs do not reflect real costs and corresponded, on average, to between 0.8% and 3.9% of monthly household income in 2018, depending on the region (SORS, 2019[163]).

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Notes

[1] The Multiple Indicator Cluster Survey survey asks household heads about their ethnic origin. This group corresponds to households whose heads identify as Bosniak (Bošnjak) in their responses to the survey.

[2] A complaint relating to the banning of the 2009 Belgrade Pride Parade by the Government of Serbia (due to police being unable to ensure the right to peaceful assembly) was submitted to the European Court of Human Rights (ECtHR). The 2017 ruling of the ECtHR did not decide on whether the ban breached the European Convention on Human Rights when it came to Freedom of Peaceful Assembly and Freedom of Expression as the government had granted permission for subsequent Pride parades to take place from 2014 to 2016, thus citing positive developments.

[3] Official data on hate crimes based on sexual orientation and gender identity do not exist. Police, courts and prosecutor’s offices should actively collate information relating to such crimes.

[4] Information provided by the Ministry of Labour, Employment, Veteran and Social Affairs of the Republic of Serbia.

[5] EUR 68.90 for a single-person household and EUR 103.30 for two adults in 2017.

[6] Estimated data are for 2015 (Bartlett and Oruč, 2018[193]).

[7] The total duration of compulsory education in Serbia is nine years. Children enter compulsory education at age 5.5 and leave it at age 14.5 (European Commission, 2018[192]).

[8] Some 43% of Serbian STEM graduates are women.

[9] Defined as students who scored at or above Level 5 in the PISA.

[10] A teacher's maximum annual basic gross statutory salary in Serbia in 2014 was 149.3% of the GDP per capita in primary education, compared to 225.3% in North Macedonia and 193.8% in Montenegro in 2015 (European Commission/EACEA/Eurydice, 2016[200]).

[11] Continuous training of teachers must be organised by municipalities, which do not always have enough resources to implement this requirement (see the Peace and institutions section in this chapter).

[12] Measured by DALYs or the number of years lost due to ill-health, disability or early death.

[13] Information provided by the American Chamber of Commerce in Serbia.

[14] Employees who lose healthcare insurance due to such evasions of the law are obliged to pay full price for healthcare services. The situation is more complex for farmers, who have accumulated high arrears of all social insurance contributions. The government is currently looking into ways to write off farmers' debts for healthcare insurance.

[15] Exact figures on informal payments for medical care are hard to come by. A systematic review of corruption in the healthcare sector in the Western Balkan region estimates that, in the entire Serbian healthcare system, patients pay informally 7% to 23% of the time, compared to 4% to 13% in North Macedonia at the lower end and 19% to 91% in Albania at the higher end. In some studies, reported payments can be as high as EUR 500 (Mejsner and Karlsson, 2017[191]). In addition, 61% of Serbian healthcare users reported being requested to bring (and pay for) their own goods (e.g. pharmaceuticals, materials, equipment, bed linen, meals), even though these should be free and provided at the point of care. These "brought and bought good" payments are estimated to constitute up to 10% of total healthcare expenditure for close to 60% of users (Arsenijevic, Pavlova and Groot, 2015[195]).

[16] The cost of the average minimum consumer basket (for a three-person household) varies significantly among municipalities, ranging from EUR 268 per month in Leskovac to EUR 541 per month in the City of Belgrade in 2017.

[17] Data on lost earnings are determined on the basis of the possibility of employment of an individual, the frequency of employment, the wage levels for a particular job, and the possibility of leasing real estate (Information provided by the Ministry of Labour, Employment, Veteran and Social Affairs of the Republic of Serbia).

[18] Many of the administrative obstacles are expected to be eliminated with the Law on Social Card, which was passed in February 2021 and with the establishment of the Social Card Register. The application of the register or law will begin on 1 March 2022, when all the records, necessary for determining the socio-economic status of a person, will be connected (Information provided by the Ministry of Labour, Employment, Veteran and Social Affairs of the Republic of Serbia).

[19] The PPS has prepared a Consultation Manual to guide policy making bodies in consulting with the public and relevant stakeholders, as mandated by the Law on the Planning System of the Republic of Serbia.

[20] The Action Plan for the Implementation of the Government Programme 2020-22 was adopted by the Government of Serbia on 28 January 2021.

[21] The average annual growth of public-sector employees between 2011 and 2018 was positive, in spite of the freeze on public-sector hiring introduced in 2014. According to interviews with OECD/SIGMA and the IMF, this could be explained by a spike in hiring before the introduction of the embargo and by a relatively slow implementation of the freeze. The embargo, moreover, does not concern temporary employees, whose numbers have been increasing lately, with consequences to the politicisation of the public sector.

[22] According to the European Union-funded INFORM survey, 40% of interviewees in Serbia have relied on gifts and connections to get employment, as much as in North Macedonia, and 45% of them used gifts to get treatment in public hospitals. Almost 45% provided gifts to obtain services from the courts, the second highest share in the region after Bosnia and Herzegovina (47%) (Krasniqi, 2019[115]).

[23] The High Judicial Council appoints first-time judges to permanent office depending on the candidate's performance assessment (Law on Judges, Art. 52).

[24] The central government pays the salaries of school principals and teachers and funds capital investments. Municipalities cover costs related to the maintenance of school facilities and utility bills, early childhood education and additional support programmes for students with special education needs. Municipalities are also responsible for funding the professional development of teachers and other school staff (Maghnouj et al., 2019[10]). Concerning social services, the central government finances residential care for people with disabilities, orphans and other vulnerable groups; municipalities are in charge of day care centres and other non-residential types of services (Avlijaš and Bartlett, 2011[194])

[25] According to the 2007 Law on Local Government Finance (amended in 2016), municipalities receive 74% of the Wage Personal Income Tax levied by the central government. The City of Belgrade and cities receive 66% and 77% of the Wage Personal Income, respectively (OECD/UCLG, 2019[123]).

[26] These are the Office of Prime Minister, the General Secretariat of the Government, the Republic Secretariat for Legislation and the PPS. By contrast, in Albania, the Office of Prime Minister co-ordinates and supervises the planning process. The head of the Office of Prime Minister has the status of a civil servant (OECD, 2020[107]).

[27] Chapter 23 includes sub-chapters on the judiciary, fight against corruption, and fundamental rights. A Coordination Body for implementation oversees the Action Plan as a whole, while the Agency for Prevention of Corruption supervises only the implementation of the Subchapter Fight against Corruption of the Action Plan for Chapter 23.

[28] The Ministry of Mining and Energy is currently working on a National Energy and Climate Plan (NECP) for Serbia. However, the government has not yet fixed targets or objectives (based on an interview in February 2020).

[29] In 1990-2017, there was a decrease in carbon monoxide and a very slight decrease in non-methane volatile organic compounds (NMVOC) (SEPA, 2019[144]).

[30] The installation of a flue-gas desulphurization (FGD) system in Kostolac B is completed but its operation is still only on a trial basis.

[31] There are 47 stations; 33 stations are part of the national SEPA network, and 14 are part of local networks (SEPA, 2020[196]). The air quality monitoring network in Serbia is distributed across three zones and eight agglomerations: Beočin, Beograd, Bor, Čačak, Kikinda, Kopaonik, Kosjerić, Kostolac, Kragujevac, Kraljevo, Kruševac, Loznica, Mitrovica, Niš, Novi Sad, Obrenovac, Pančevo, Paraćin, Šabac, Smederevo, Sombor, Subotica, Uzice, Valjevo, Vranje and Zaječar.

[32] In 2016, exposure to PM2.5 was measured in only three stations: two in Belgrade and one in Novi Sad (WHO, 2019[154]).

[33] Serbia is a member of the International Commission for the Protection of the Danube River and participates in the preparation of the Update of the Danube River Basin Management Plan (International Commission for the Protection of the Danube River, 2020[157]). It is also a member of the International Sava River Basin, participating in the preparation of the Sava River Basin Management Plan, and of the Tisza River Basin Forum.

[34] Based on the recent assessment provided by the WHO, water is not controlled in various small-scale water supply networks in non-urban areas due to unsolved issues of competences and unknown ownership (WHO et al., 2017[158]). This is the case for 88% of non-urban water supply networks (Fiscal Council of the Republic of Serbia, 2018[198]).

[35] In the rest of the country, groundwater is the source of two-thirds of abstracted water; the rest is taken from surface water (SEPA, 2019[144]; UNECE, 2015[155]).

[36] In 2008, the Ministry of Environmental Protection of Serbia declared the Great Bačka Canal one of the three black spots of the Serbian environment. A project of remediation was adopted but never completed (Fiscal Council of the Republic of Serbia, 2018[198]). Information on the project is available at www.ppf.rs/en/projects/ppf8-vbk-en.

[37] The Ministry of Agriculture designs water resource policies; the Ministry of Finance revises tariffs set by public water utilities; the Ministry of Health monitors water quality; the Ministry of Construction, Transport and Infrastructure inspects and supervises public water utilities; the Ministry of Public Administration and Local Self-Government supervises LSGs and their management of public water utilities; the Ministry of Mining and Energy manages groundwater resources and oversees the Geological Survey of the Republic of Serbia, which conducts basic hydrological groundwater exploration and maintains the groundwater cadastre.

[38] Interview with the Environmental Working Group in February 2020.

[39] The Decree on the conditions that must be met by users of funds of the Green Fund of the Republic of Serbia, conditions of the distribution of funds, criteria for assessing requests for funds, monitoring of the use of funds and rights and obligations of users of funds (“Official Gazette of the Republic of Serbia”, No. 25/18); and Rulebook on detailed conditions for the allocation and use of funds of the Green Fund of the Republic of Serbia (“Official Gazette of the Republic of Serbia”, No. 31/18).

[40] The Kolubara Mining Basin produces between 29 million tonnes and 31 million tonnes of lignite annually, which is supplied to the Kolubara A, Morava and Nicola Tesla power plants. It provides approximately 75% of the lignite used for EPS thermal generation. The Drmno Mining Basin close to Kostalac produces around 9 million tonnes of lignite annually, which is supplied to Kostalac A and Kostalac B plants. It represents the rest of the 25% (https://bankwatch.org/beyond-coal/the-energy-sector-in-serbia).

[41] EU target of 20% share of renewable energy in gross final consumption of energy as fixed by the 2009 Renewable Energy Directive (299/28/EC).

[42] The measured share of renewable energy in gross final consumption would be greater if it could account for the use of geothermal energy for heating and cooling. However, there is no cadaster of the heat pumps installed in Serbia that would allow accounting for the energy so produced.

[43] Renewable energy auctions are a type of support mechanism for renewable energy technologies and generally opened by the government of a country. They generally specify the capacity (kW) or the electricity generation (kWh) that is up for auction, as well as the generation technology (e.g. wind, solar) and sometimes the generation location. Project developers then submit a bid to the auction, outlining their project proposal and stating the price per unit of electricity at which they will be able to realise it. The government evaluates the bids based on price and other criteria and selects the best offer (IRENA, 2013[197]).

[44] In January 2020, the decree on the special fee to incentivise preferential electricity producers was extended. Consumers keep paying a surcharge of RSD 0.093 per kWh or EUR 0.79/MWh (Balkan Green Energy News, 2020[175]).

[45] Registered complaint to the Energy Community Secretariat: www.energy-community.org/legal/cases/2018/case0918RS.html. An environmental impact assessment study for the Drmno mine was conducted in 2009 (Decision of the Ministry of Environmental Protection, No. 353-02-0360/2008-02 of 10 April 2009 approving the environmental impact assessment). However, when the mine's annual production was later increased, the Ministry of Environmental Protection decided it was not necessary to prepare a new environmental impact assessment, given that the borders of the mine were unchanged.

[46] In June 2016, the administrative court decided that the environmental impact assessment realised in 2013 should be revoked.

[47] The European Union's Third Energy Package aimed at liberalisation of the gas and electricity markets and empowering energy consumers.

[48] The government has not yet fixed targets or objectives (based on an interview in February 2020). The Ministry of Mining and Energy set up a project, Further Development of Energy Planning Capacity Project (follow up IPA 2013), to define targets for 2030 and 2050 to contribute to the EU targets for 2030, support the preparation of the NECP and to further develop and improve Serbia's energy policy.

[49] There is a bill discount for vulnerable customers (Decree on Energy Vulnerable Customer, January 2016, amended in 2018, https://www.paragraf.rs/propisi/uredba-o-energetski-ugrozenom-kupcu-republike-srbije.html). In 2019, 76 888 customers were granted bill discounts but takeup is low: between 300 000 and 400 000 households would probably be eligible for the bill discount (AERS, 2020[199]).

[50] The electricity tariff for households and small customers exercising their right to remain under regulated tariffs are not deemed to reflect costs, while in the remaining segment of the market (around 50% of total consumption) price-setting is subject to competition.

OECD Development Pathways

Multi-dimensional Review of the Western Balkans

ASSESSING OPPORTUNITIES AND CONSTRAINTS

The Western Balkans region has come a long way over the last two decades in achieving economic and social progress. With a population of 17.6 million, the region today boasts a combined gross domestic product (GDP) of close to EUR 100 billion, an average GDP per capita of about EUR 5 400 and a comprehensive process of integration with the European Union.

This report provides multi-dimensional assessments across the economic, social, finance, governance and environmental pillars of sustainable development for five economies of the region. The region's location, its deep relationships with Europe and its academic tradition present many opportunities for future development, especially at a time when distances are shrinking further with digitalisation. Making the most of this potential will require collaboration in tackling challenges, which have been further exposed during the COVID-19 pandemic. Boosting competences and education, strengthening social cohesion and ensuring a green transformation towards clean energy and the valuation of the region's natural wealth, emerge as strategic priorities. Beyond practical and financial constraints, future solutions must address considerable institutional and governance challenges that remain across the region.

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