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Western Balkans Regular Economic Report
No. 26 - Fall 2024

WORLD BANK GROUP

Retaining the Growth Momentum

Western Balkans
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Retaining the Growth Momentum

Acknowledgements

This Regular Economic Report (RER) covers economic developments, prospects, and economic policies in the Western Balkans region: Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia.

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This Western Balkans RER and previous issues may be found at: www.worldbank.org/eca/wbrer/.

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Abbreviations

AE	Advanced Economies
BCR	Benefit-to-Cost Ratio
BLAs	Bilateral Labor Agreements
BOP	Balance of Payments
BSSA	Bilateral Labor and Social Security Agreements
CAD	Current Account Deficit
CAPEX	Capital Expenditure
CBAM	Carbon Border Adjustment Mechanism
CCDR	Country Climate and Development Report
CESEE	Central, Eastern, and Southeastern Europe
CEB	Council of Europe Development Bank
CPI	Consumer Price Index
CR	Coverage Ratio
DI	Diaspora Invest
DPL	Development Policy Loan
EC	European Commission
ECA	Europe and Central Asia
EFTA	European Free Trade Association
EIB	European Investment Bank
EMDEs	Emerging Markets and Developing Economies
E&S	Environmental and Social
ESI	Economic Sentiment Indicator
EU	European Union
FDI	Foreign Direct Investment
FY	Fiscal Year
GEGI	Gender Employment Gaps Index
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GSI	Green, Social, and Impact
GSPs	Global Skills Partnerships
H1	First Half
H2	Second Half
HBS	Household Budget Survey
HEWS	Heat Early Warning Systems
HIC	High-Income Country
ICT	Information and Communications Technology
IFRS	International Financial Reporting Standard
ILO	International Labour Organization
IMF	International Monetary Fund
K/Y	Capital-Output Ratio
KNOMAD	Global Knowledge Partnership on Migration and Development
LCU	Local Currency Unit
LFS	Labor Force Survey
LIC	Low-Income Country
LP	Labor Participation
LTGM	Long-Term Growth Model
lhs	left-hand scale
MIC	Middle-Income Country
MIPEX	Migrant Integration Policy Index
MTBF	Medium-Term Budgetary Framework
NMS	New Member States
NPLs	Non-Performing Loans
NZ	Net Zero
OECD	Organisation for Economic Co-operation and Development
PES	Public Employment Services
PISA	Programme for International Student Assessment
PMI	Purchasing Managers' Index
PM2.5	Particulate matter 2.5 micrometers or less in diameter
PM10	Particulate matter 10 micrometers or less in diameter
pp	Percentage Points
ppb	parts per billion
PPP	Purchasing Power Parity
PPG	Public and Publicly Guaranteed (Debt)
Q1	First Quarter
Q2	Second Quarter
Q3	Third Quarter
Q4	Fourth Quarter
RCP	Representative Concentration Pathway
RER	Regional Economic Report
rhs	right-hand scale
RS	Republika Srpska
SDG	Sustainable Development Goals
SEPA	Single Euro Payment Area
SILC	Survey of Income and Living Conditions
SMEs	Small and Medium Enterprises
SOEs	State-Owned Enterprises
TIPS	TARGET Instant Payment Settlement
TP	Talent Partnership
TTL	Task Team Leader
UHCI	Utilization-adjusted Human Capital Index
UN	United Nations
UN DESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme
US	United States
WB6	Western Balkans Six
WBR	Western Balkan Regulation
WDI	World Development Indicators
WDR	World Development Report
WHO	World Health Organization
y/y	year-on-year

WB6 Country Abbreviations:

ALB	Albania
BiH	Bosnia and Herzegovina
KOS	Kosovo
MKD	North Macedonia
MNE	Montenegro
SRB	Serbia

Note: All comparisons are year-on-year unless otherwise stated.

Retaining the Growth Momentum

1. Overview

The economies of the Western Balkans (WB6) continue to navigate a complex operating environment, and despite experiencing a moderate acceleration in growth, uncertainty remains high. This year, the region is expected to rely more on domestic than foreign demand. Economic growth in 2024 has been supported by expansionary fiscal policies, rising credit availability, and easing of price pressures, which have resulted in increased consumption and investment on the demand side, together with growth in the construction and services sectors on the supply side. However, sluggish performance across key European trading and investment partners has limited external demand, and previous rapid growth in demand for services (particularly tourism) has plateaued. As a result, unlike in 2023, neither trade in goods nor services is expected to contribute to growth in 2024. During the year, the slowdown in inflation and increase in wages has also contributed to growth by supporting higher disposable incomes. Uncertainty related to the strength of demand in the EU and its impact on the region remains high, and retaining the growth momentum will require a combination of structural reforms and closer economic integration.

Economic growth in the Western Balkans as a whole is expected to accelerate to 3.3 percent in 2024, up from 2.6 percent in 2023. Serbia—the largest economy in the region—is projected to reach 3.8 percent GDP growth in 2024, up from 2.5 percent a year ago, driven by a recovery in private consumption and investment. In Bosnia and Herzegovina (BiH), growth is expected to quicken to 2.8 percent from 1.7 percent in 2023, largely due to a recovery in private consumption fueled by an increase in minimum wages and a tightening labor market. Growth in Kosovo is also projected to accelerate to 3.8 percent in 2024, supported by consumption underpinned by rising incomes, credit, and public spending. In contrast, North Macedonia is struggling to recover, with growth projected to increase to 1.8 percent in 2024, up from a mere 1.0 percent in 2023, driven by stronger consumption growth and supported by expansionary wage policies. In Albania, growth in 2024 is forecast to be close to last year's performance of 3.3 percent, supported by household consumption, which has benefited from higher wages and moderating inflation. In Montenegro, growth for the year is forecast to slow to 3.4 percent, down from 6.3 percent in 2023, owing to a weaker tourism season.

The region's labor market saw further improvement in 2024, with employment reaching a historical high of 48.5 percent in June 2024. Although still lower than the rate of 54.4 percent of the EU27, a 6-percentage point increase since mid-2021 means that the gap is narrowing. In Albania and Montenegro, the employment rate (15+) is above the EU27. In Kosovo, despite recent gains, only 37.1 percent of the working-age population is employed. Between mid-2023 and mid-2024, an additional 114,000 jobs were created in the region, of which Serbia saw the largest nominal gains (48,400), followed by Bosnia and Herzegovina (39,000). However, a tightening labor market has led to increased concerns among businesses citing labor shortages and skills mismatches.

Poverty reduction in the Western Balkans has continued its downward trend but at a slower pace than in the pre-pandemic period. On current trends, poverty is estimated to fall by roughly 1 percentage point annually. This slower reduction is primarily attributed to a combination of slower economic growth and food and price shocks during 2022-2023. Recent wage increases in the region may not necessarily translate into significant increases in the welfare of households below the poverty line, as a significant share of these households are characterized by long-term unemployment or high levels of inactivity.

After three years of consolidation, WB6 countries are set to experience widening fiscal deficits during 2024 as spending pressures

build. Revenue performance remains robust across the region, but expenditures are increasing at a fast clip. Nominally, tax revenue growth for the first half of the year remained strong across all six countries, helped by compliance gains. Spending increases are broad based, but spending pressures on social benefits, pensions and wages are particularly acute. Most of the countries are also experiencing a rebound in capital spending. The average fiscal deficit level for the WB6 economies is expected to increase by 1 percentage points of GDP, reaching 2.5 percent of GDP in 2024. Serbia is the only country in the region expected to maintain the same level of deficit from the previous year, while Montenegro is expected to experience the highest increase after closing 2023 with a fiscal surplus. North Macedonia is expected to continue running a large deficit.

After three years of consistent decline, public and publicly guaranteed debt in the region is estimated to increase only slightly in 2024. Public debt for the Western Balkans as a whole is expected to experience an increase as a share of GDP, from 46.8 percent in 2023 to 47.2 percent in 2024. Montenegro and North Macedonia are driving this regional increase, with public debt as a share of GDP rising by 2.8 and 1.5 percentage points in 2024, respectively. Montenegro's increase is primarily due to the issuance of a Eurobond to cover 2024 financing needs and create a buffer for 2025. North Macedonia's increase is driven by a persistently high fiscal deficit and the greater issuance of domestic securities for liquidity purposes. Both Serbia and Montenegro saw positive sovereign ratings actions during the year. Given that global interest rates remain elevated and economic conditions continue to be volatile, fiscal prudence is essential to prevent unsustainable debt levels, particularly given uncertainty surrounding external borrowing costs.

In line with international trends, in 2024 the WB6 countries experienced a reduction in inflation, though the pace of this decrease has slowed. At the regional level, consumer price inflation eased from 4.4 percent at the outset of the year to 3.2 percent by July. By July 2024, Serbia and Montenegro recorded the highest headline inflation rates, at 4.3 and 3.5 percent, respectively, above the regional average. Conversely, North Macedonia (3 percent), Kosovo (2.2 percent), Albania (2.0 percent), and Bosnia and Herzegovina (1.8 percent) reported inflation rates below the regional mean. The continued downward inflationary trend is partially attributable to the normalization of international commodity prices. Recent weather events, however, may lead to renewed pressure on food prices during the remainder of 2024. Energy prices have also decreased, mirroring the general trend of headline inflation, albeit exhibiting some volatility during the first half of 2024.

Credit growth has picked up in 2024, after slowing in 2023. Average credit growth steadily increased in the first half (H1) of 2024, following the deceleration observed in 2023, with growth reaching 9.4 percent in June 2024 (from 6.5 percent in December 2023). In particular, credit growth increased in Albania (13 percent as of June 2024), driven by an overall pick-up in business activity and an easing of credit conditions, and also in Montenegro. Kosovo continued to post the highest level of loan growth among the Western Balkan economies (13.6 percent as of June 2024). Despite an uncertain economic environment, asset quality has remained mostly stable in the financial sector and capital buffers remain sufficient, broadly stable non-performing loans and an average capital adequacy ratio of 19.1 percent.

WB6 countries are navigating increasing pressures on their external sectors amid a challenging external environment. The widening regional current account deficit (CAD) is partly driven by sluggish growth in the EU, particularly in Germany, a key trading partner. Therefore, weakened foreign demand for exports, coupled with still-elevated energy costs and sluggish labor markets in the EU impacting remittance inflows, has led to a deterioration in the current account. Across most of the region, both merchandise exports and imports are expected to exhibit a downward adjustment this year in GDP terms. Similarly in 2024, the sharp rise in net services export inflows seen since 2021 is expected to come to an end. Remittances are also expected to stagnate over 2024, in GDP terms. Overall, the current account deficit is expected to deteriorate from 4.1 percent of GDP in 2023 to an estimated 5.6 percent in 2024, although this is still significantly below the average over the past five years. Three countries in particular—Albania, North Macedonia and Serbia—are projected to experience a more pronounced current account widening in 2024, in the order of 3.0, 2.5 and 1.5 percent of GDP, respectively. Nevertheless, at the regional level, 95 percent of these deficits are financed through net FDI inflows, and most countries in the region experienced an increase in foreign exchange reserves in the past year.

Growth in the WB6 is expected to increase moderately over the projection period, with a change in the drivers of growth. Compared with projections in the Spring edition of the Western Balkans Regular Economic Report, in 2024, the expected increase in growth for the region will be higher by 0.1 percentage points. This revision is driven primarily by an increase in projected growth for Serbia (+0.3 pp), Bosnia and Herzegovina (+0.2 pp), and Kosovo (+0.1 pp). On the other hand, there was a decrease in expected growth in North Macedonia in 2024 (-0.7 pp compared with the Spring projection). Consumption and investment are expected to play a more significant role in supporting growth during the coming years, as export demand remains muted with import growth outpacing exports growth. Within the region there is noticeable division between those countries which are seeing a faster recovery of consumption and investment (namely Albania, Kosovo, Montenegro and Serbia), and those (such as Bosnia and Herzegovina and North Macedonia) where lower external demand and domestic fiscal pressures are acting as a drag on growth.

The structural reform agenda remains critical in order to retain the growth momentum in the Western Balkans toward more sustainable improvements in living standards and closer economic integration. The EU's New Growth Plan for the Western Balkans offers a combination of new financing opportunities as well as early access to selected aspects of the single market. An expansion of the geographic scope of the Single Euro Payments Area (SEPA) to some of the WB6 countries as early as 2025 would help support market integration and remove barriers to financial flows. The opening up of "green lanes" to allow for faster trade facilitation could accelerate value chain integration between the Western Balkans and the EU. Similarly, domestic market reforms to boost competition, upscale innovation and attract higher quality foreign investments could accelerate growth and job creation. Meanwhile, there are continued risks to the outlook, mainly stemming from sluggish global growth, higher financing costs, political uncertainty and an increasing frequency of extreme weather events. In all six economies, labor market and social protection reforms would help increase labor force participation, particularly for women. And expanding childcare services would not only improve labor market opportunities for women but also enhance children's school readiness through better early childhood education.

The transition to net zero will require substantial investments in the Western Balkans, predominantly to be made by the private sector, with governments playing a complementary role. New analysis as part of the 2024 Western Balkans Country Climate and Development Report finds that the largest investments would need to be channeled into decarbonizing transport and scaling up solar, wind, and hydro generation capacities across the region. Investments will also need to be accompanied by regulatory reforms, including but not limited to: (i) adoption of carbon prices; (ii) harmonization of the power sector's legal and regulatory frameworks for integration into the pan-European electricity market; (iii) investing in training and reskilling of existing labor; (iv) structural changes in the education system over the longer term; and (v) increased coverage and adequacy of social protection and health systems.

The Spotlight in this edition of the Western Balkans Regular Economic Report focuses on migration, a fact of life for many people from the WB6. Today, close to one in four people from the Western Balkans resides abroad, making the region one of the largest origin of migrants relative to its population around the world. Bosnia and Herzegovina, and Albania are the main sending countries, both in terms of stocks (1.7 million and 1.4 million, respectively) and as a share of their populations (34 and 32 percent, respectively). WB6 emigrants are concentrated among the prime age population compared to both natives in host countries and the non-migrant population at origin, consistent with employment being a primary driver of emigration. Educational levels among WB6 migrants have traditionally been low. However, while only one in six WB6 migrants in 2015 had tertiary education, more recent data suggest that WB6 emigrants' education levels have been increasing over the past decade. As large number of Western Balkan citizens leave the region, foreign workers have increasingly arrived to fill emerging labor shortages.

TABLE 1.1.

Western Balkans outlook, 2021–26

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth (percent)						
Albania	8.9	4.9	3.4	3.3	3.4	3.4
Bosnia and Herzegovina	7.4	4.2	1.7	2.8	3.2	3.9
Kosovo	10.7	4.3	3.3	3.8	3.9	4
North Macedonia	4.5	2.2	1	1.8	2.5	3
Montenegro	13	6.4	6.3	3.4	3.5	3.2
Serbia	7.7	2.5	2.5	3.8	4.2	4
WB6	7.9	3.4	2.6	3.3	3.7	3.7
Real GDP components growth (percent)						
Consumption	4.8	3	1	3.2	2.9	3.1
Investment	2.2	1.3	-0.8	2.2	1.6	1.2
Net exports	-0.4	-1.6	2.1	-2.1	-0.8	-0.5
Exports	9.9	6.6	1.6	2.4	3.3	3.2
Imports (-)	10.3	8.2	-0.5	4.5	4.1	3.7
Consumer price inflation (percent, period average)	3.2	11.8	9	3.4	2.6	2.3
External sector (percent of GDP)						
Goods exports	25.2	28.5	25.6	24.9	25	25.2
Trade balance	-16.7	-18.7	-14.3	-14.9	-15	-14.8
Current account balance	-5.7	-7.7	-4.1	-5.6	-5.9	-5.8
Foreign direct investment	5.9	6.9	5.3	5.3	5.2	5.2
External debt	83.1	75.3	70.7	70.2	69.3	69.3
Public sector (percent of GDP)						
Public revenues	35.9	34.8	36.4	37.1	36.8	36.9
Public expenditures	38.8	37.5	37.8	39.6	39.2	39.1
Fiscal balance	-3	-2.7	-1.5	-2.5	-2.5	-2.3
Public and publicly guaranteed debt	56.5	50.4	46.8	47.2	46.9	46.8

Sources: National statistical offices; Ministries of Finance; central banks; World Bank staff estimates.

Note: e = estimate; f = forecast.

Migration shapes lives, livelihoods and aspirations of the Western Balkans population via multiple and interrelated channels. By moving abroad, migrants experience significant income gains, with benefits for their families back home, as well. In fact, remittances are a key source of income for WB6 recipient households and support poverty reduction among vulnerable groups in the region. Beyond remittances, the benefits of an internationally mobile population can be significant. The diaspora can channel international savings, transfer know-how and new technologies, and link the economy to global business networks. All of this can spur productivity, exports, entrepreneurship and job creation. However, emigration has reduced the supply of labor in all Western Balkan countries. Between 2000 and 2020, the population fell by 8 percent, equivalent to 1.2 million people. While these emigration outflows initially alleviated labor market pressures, they may have also increasingly fueled labor shortages across the skills spectrum.

The Spotlight suggests that emigration does not always lead to human capital losses if the right incentives are in place. Emigration can be a source of human capital accumulation in the WB6 through different channels. First, remittances sent by emigrants increase the availability of financial resources in emigrant households, which can spend part of them on the education of family members who do not migrate. Second, the return of high-skilled migrants may also represent a "brain gain" opportunity for the country. Emigrants themselves often acquire new educational degrees and skills overseas, which positively revert to the country when they return. Third, the prospects of higher wages abroad in specific sectors can further incentivize human capital accumulation in origin countries. In the Philippines, evidence shows that more migration pathways for nurses in the United States led to an even faster increase in enrolment and graduation of nurses in the country. Some promising initiatives in the Western Balkans show that these effects may also materialize in the region, when suitable programs are implemented.

Both emigration of WB6 nationals and immigration of foreigners are expected to continue in the coming years, drawing the attention on the importance of well-designed and carefully implemented policies. Despite a progressive convergence of incomes in recent years, differentials in economic opportunities and quality of services with Western European countries remain large, fueling intentions to emigrate. As such, a critical question is how to make migration yield positive impacts for the Western Balkans economies while at the same time ensuring the safety and prosperity of both migrants and their communities left behind. In recent years, WB6 countries have made significant efforts to improve the management of migration flows and strengthen their developmental impacts.

Overall, Western Balkan countries are at an important juncture, with a unique opportunity to better leverage the role of migration to enhance economic development. With some of the largest diasporas around the world as a share of the population, migration has been part of the region's identity for decades. Countries have made substantial progress in developing their migration systems. Despite these efforts, relevant gaps remain. The Spotlight provides several options for policies that can support a more holistic and development-centric approach to support the Western Balkan mobile population for the benefit of migrants and local economies alike. Time is of the essence in addressing the existing challenges. From the perspective of the emigrant population, the large diasporas can still be engaged and supported via multiple channels to participate in countries' economic development. From the perspective of foreign-born workers, recent trends have shown that immigration will continue growing to fill important workforce gaps. As such, the WB6 countries can take action to further develop their systems to select, train, and integrate foreign workers in their economies and, more broadly, in their societies.

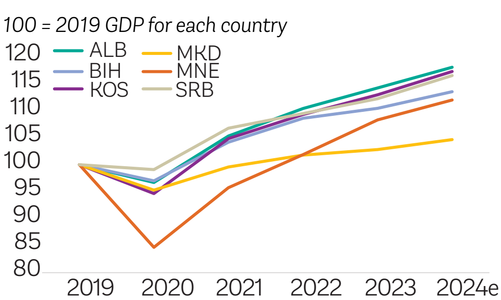
2. Growth is accelerating supported by strong domestic demand

The WB6 countries continue to navigate a complex economic landscape, relying more on domestic demand and less on foreign trade. Economic growth in the WB6 region is supported by expansionary fiscal policies, rising credit availability, and strong income and transfers from abroad, which have boosted consumption and investment on the demand side, together with growth in the construction and services sectors on the supply side. Unlike in 2023, neither trade in goods nor services is expected to contribute to growth in 2024. For this year, the slowdown in inflation has further supported growth by increasing disposable incomes. Sluggish growth in the EU, particularly in Germany—a key trading partner—and weakened foreign demand for exports are weighing negatively on growth potential through the trade channel and remittances. The new Reform and Growth Plan for the Western Balkans, adopted by the European Commission in November 2023, offers opportunities to advance economic integration, and more fundamentally to boost investment and productivity. It provides budgetary and investment support in the form of grants and concessional loans aimed at fostering economic development and facilitating the integration of the WB6 countries into the EU by promoting growth and structural transformation.

Economic growth is expected to accelerate to 3.3 percent in 2024, up from 2.6 percent in 2023. Growth is projected to accelerate, primarily supported by domestic demand amidst sluggish growth in the EU. By year-end, Serbia—the largest economy in the region—is projected to reach 3.8 percent GDP growth, up from 2.5 percent in 2023, driven by a recovery in private consumption and investment (Figures 2.1 and 2.2). In Bosnia and Herzegovina, growth is forecasted to rise to 2.8 percent from 1.7 percent in 2023, largely due to a recovery in private consumption fueled by rising minimum wages and a tightening labor market. Growth in Kosovo is also projected to accelerate to 3.8 percent in 2024, supported by consumption driven by rising incomes, credit, and public spending. North Macedonia, is expected to see growth increase to 1.8 percent, up from a mere 1 percent in 2023, driven by stronger consumption growth and supported by expansionary wage policies. In Albania, growth for 2024 is expeted to be similar to last year's performance of 3.3 percent, supported by increased household consumption, resulting from higher wages and moderating inflation. In Montenegro, growth slowed after a strongQ1 performance of 4.4 percent, declining to 2.7 percent in Q2 due to

FIGURE 2.1.

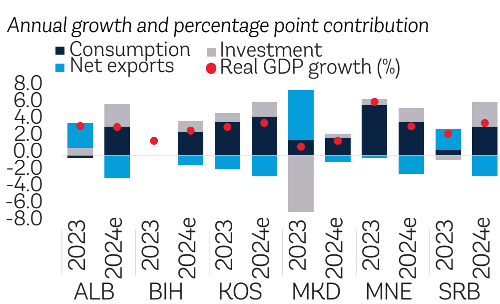
GDP is accelerating amid a complex external environment



Source: National statistical offices and World Bank staff estimate

FIGURE 2.2.

Domestic demand is the main driver of economic growth



Source: National statistical offices and World Bank staff estimate a drop in tourist overnight stays and industrial production. Growth for the year is forecast to slow to 3.4 percent, down from 6.3 percent in 2023.

Economic growth in the WB6 region is diverging, with Albania, Serbia, Montenegro, and Kosovo enjoying strong growth driven by consumption and investment, while Bosnia and Herzegovina and North Macedonia face slower growth. At the regional level, consumption is expected to be the main driver of economic growth in 2024, supported by rising real incomes, easing inflation and an increased employment. Higher wages are playing a key role in boosting consumption activity across the WB6 region, as moderating inflation supports real disposable incomes. As part of governments' plans to address the cost-of-living crisis, in 2024 several countries (Kosovo, Bosnia and Herzegovina, and North Macedonia) saw an increase in minimum wages. In other countries, improving labor market indicators are also contributing to robust consumption activity. For example, in Albania, Montenegro, and Serbia, improving labor market indicators—such as increasing employment and declining unemployment rates—are expected to fuel consumption activity. Consumption is projected to contribute 3.4 percentage points (pp) to economic growth in Albania and Serbia and 3.9 pp in Montenegro, while in Kosovo consumption is estimated to contribute 4.6 pp to growth, the largest increase in the WB6 region. In Bosnia and Herzegovina, while total employment increased, unemployment rate went up as well as more people entered labor market. In North Macedonia, total employment remained almost unchanged, and youth unemployment stayed stubbornly high, suggesting the need for further job growth. Such trends are partially explaining the lower impact of consumption on growth compared with the rest of the region, with consumption contributing an estimated at 2.7 pp and 2.0 pp in Bosnia and Herzegovina, and North Macedonia, respectively. All WB6 countries recorded increased levels of public spending on wages, placing additional pressure on public finances and raising the issue of the sustainability of consumption-driven growth. One challenge with wage increases is that the WB6 region is lagging in productivity growth (as discussed in the RER Spring 2025). The Box 2.1 discusses human capital's contribution to productivity growth and options to improving it.

Investment is recovering in 2024 after its negative contribution to growth in the previous year. Unlike 2023, investment is projected to contribute positively to growth adding 2.2 pp in 2024 reversing a negative contribution of 0.8 pp in 2023. Serbia and Albania stand out for their investment growth. In Serbia and Albania, investment growth is expected to accelerate significantly, contributing 2.9 pp and 2.6 pp to growth, respectively (up from -0.6 and 0.8 pp, respectively, in 2023). In Serbia, this improvement is driven by a strong performance in net FDI and by government spending on capital projects, including preparations for EXPO 2027. In Albania, investment growth is supported by increased construction activity and rising credit growth and is also reflected in positive business sentiment indicators. In Bosnia and Herzegovina, Kosovo, and Montenegro higher public investment is also driving growth. However, in North Macedonia the contribution of investment is expected to remain muted (0.5 pp) due to delays in highway construction and tight monetary conditions.

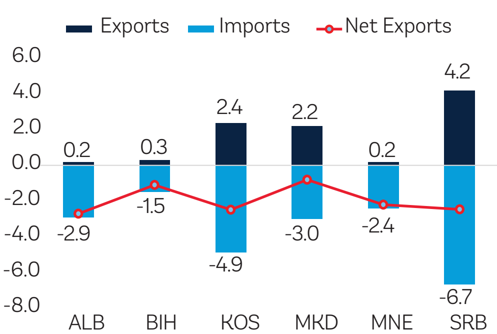
Trade (net exports of goods and services) is projected to detract from growth in 2024, with a negative contribution of 2.1 pp. In all six WB6 countries trade is expected to weigh on growth, Albania, Kosovo and Serbia facing the largest negative impacts (of 2.5 pp or more) (Figure 2.3). This marks a shift from 2023, when trade contributed positively to regional growth, though this was driven by three countries, North Macedonia, Albania, and Serbia; Montenegro had nearly zero contribution of trade to growth, and Kosovo a negative contribution. The projected negative contribution of trade to growth in 2024 reflects the anticipated sluggish performance of the EU, and especially Germany, for the year. Looking at changes in trade for the WB6 region, Albania, Kosovo and Bosnia and Herzegovina are expecting improvements in merchandise trade relative to GDP in 2024, while all countries except North Macedonia are expecting a deterioration in services trade relative to GDP in 2024 (Figure 2.4).

On the production side, the service sector remains the main driver of growth across the WB6, while manufacturing continues to struggle in the context of weak Eurozone growth, particularly in Germany. Strong retail sales and catering are key drivers of services growth in Bosnia and Herzegovina, North Macedonia, Montenegro, and Kosovo. In Montenegro, where tourism is a vital part of the economy, overnight stays fell by 4 percent in due to a weaker winter season. Construction is also a major growth driver in Albania, Kosovo, and Serbia, supported by increased public capital expenditures and funds from the EU's New Reform and Growth Facility. Following a decline in 2023, Serbia's industrial production has shown resilience to external challenges and recorded growth in H1 2024, contributing an estimated 0.7 pp to Serbia's annual growth. The contribution of agriculture to growth remains limited across all WB6 countries. In Serbia, a drought during the summer of 2024 may significantly impact agriculture, the food industry, and exports, ultimately having a negative effect on annual growth.

FIGURE 2.3.

Trade is expected to be a drag on growth in 2024 in all WB6 countries...

Net exports of goods and services, percentage point contribution to GDP growth

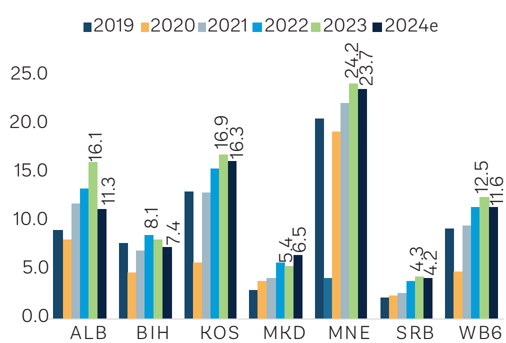


Source: National statistical offices and World Bank staff estimate

FIGURE 2.4.

...driven largely by a reduction in services

Net services exports as share of GDP



Source: National statistical offices and World Bank staff estimate

Box 2.1: How can the WB6 countries improve their human capital outcomes? Recent evidence from an extension of the Human Capital Index

If current growth projections hold, it will take many years for WB6 countries to graduate from middle-income status. Despite recent gains, most of the WB6 countries lag behind EU countries in human capital outcomes. Development economists have long emphasized that the development of countries is closely tied to its stock of human capital, understood as the productive capacity of individuals.. But this capacity is conditional on the environment in which individuals live. In the WB6 region, the nature of labor demand is such that full basic education is no longer enough to ensure a productive employment. Moreover, in aging societies such as those in the WB6 region, adult health plays a key part the long-term productivity of workers. To assess the productivity of human capital in middle-income countries, an extension of the World Bank's Human Capital Index, called the Europe and Central Asia Human Capital Index (ECA-HCI), has been proposed. [1] This index encompasses quality-adjusted years of higher education and the prevalence of three adult health risk factors (smoking, drinking, and obesity, all of them risk factors for noncommunicable diseases such as heart diseases, cancer, and diabetes, among others). This extension can help countries in assessing their readiness to avoid the middle-income trap and transition to high-income status, where productivity, more than pure investment, and innovation, rather than simple technological adoption, are the engines of growth.

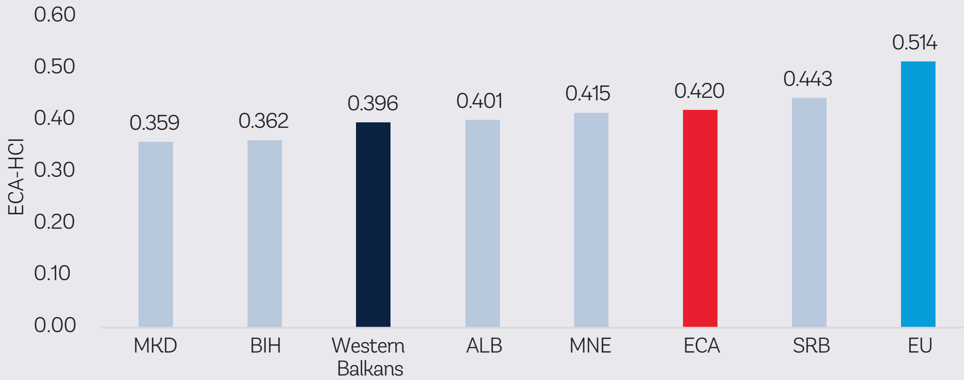
The citizens of the WB6 countries could see their productivity increase by 48 percent if they achieved the education and health indicators of the best performer in the EU. The average WB6 ECA-HCI value is at 0.396 (Figure 2.5), which implies that its citizens have a productivity that is only 39.6 percent of the productivity achieved in a best education and best health scenario (i.e., 3.5 years of higher education and zero prevalence of adult health risk factors). If WB6 countries were to close the gap with the EU's best performer (Ireland, with an ECA-HCI value of 0.587), their citizens' productivity would increase by 48 percent. The average WB6 value is behind the average for ECA[2] (0.42) and the average for the EU (0.514). Within the WB6, North Macedonia has the lowest value at 0.359, which is also the second-lowest value in the whole ECA region, only behind Tajikistan. The highest value in the sub-region is found in Serbia, at 0.443, ahead of Bulgaria and Romania, but behind the rest of the EU countries.

1 Demirgüc-Kunt and Torre (2022). Measuring Human Capital in Middle Income Countries. Journal of Comparative Economics. Vol. 50, n.4: 1036-1067

2 ECA (Europe and Central Asia) corresponds to the following countries: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Kazakhstan, Kosovo, Kyrgyz Republic, Moldova, Montenegro, North Macedonia, Poland, Romania, the Russian Federation, Serbia, Tajikistan, Türkiye, Turkmenistan, Ukraine, and Uzbekistan.

FIGURE 2.5.

ECA-HCI - Western Balkans, ECA and EU



Source: Demirgüc-Kunt and Torre (2022).

Note: Data correspond to 2020. The value for Kosovo is not available due to data limitations. The values for the WB6, ECA, and the EU correspond to the simple average of the countries they include.

TABLE 2.1.

Prevalence of adult health risk factors and indicators of higher education

	Albania	Bosnia and Herzegovina	Kosovo	Montenegro	North Macedonia	Serbia	Western Balkans	ECA	EU
	Adult health risk factors (prevalence among adult population, in %)								
Obesity	22.3	19.4	21.5	24.9	23.9	23.5	22.6	20.0	16.6
Smoking	28.9	38.1	36.4	35.4	35.0	36.0	35.0	27.8	25.5
Heavy Episodic Drinking	22.9	22.7	8	26.9	26.5	32.9	23.3	19.9	20.9
	Higher education indicators								
Attainment (% of pop age 30-34 with tertiary degree)	23.5	21.0	32.3	34.0	29.9	33.3	29.0	33.2	42.9
University quality score (0-100)	6.9	5.5	n.a.	1.5	7.3	22.6	8.7	12.5	28.8

Source: Data on obesity, smoking, and heavy episodic drinking are from the European Health Interview Survey, Health Equity and Financial Protection Indicators, the World Health Organization, Morina and Brestovci (2022), and Hlbell et al. (2012). Attainment data were calculated from the European Union Statistics on Income and Living Conditions and household surveys. University quality score from Demirgüc-Kunt and Torre (2022).

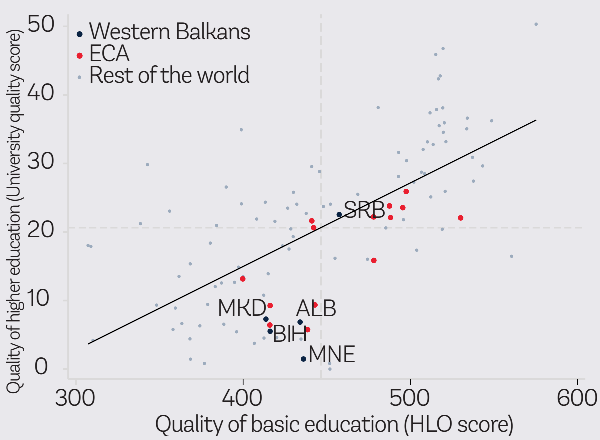
Note: Data correspond to 2022 or latest available year. The value for the university quality of score is not available due to data limitations. The values for the WB6, ECA, and the EU correspond to the simple average of the countries they include. The university quality score measures, in a scale from 0 to 100, the average quality of universities in each country. The value of 100 corresponds to the notionally highest ranked university of the world. The score is calculated using data from six university rankings (Times Higher Education, QS, US News, ARWU “Shanghai” index, CWUR, and U-Multirank).

On the health side, the relatively lower productivity of the WB6 citizens is explained by a high prevalence of adult health risk factors, above ECA and EU averages (Table 2.1)**.** The average incidence of obesity among the adult population in the WB6 is 23 percent, compared with 20 percent in ECA and 17 percent in the EU. The average share of adult smokers in the WB6 is 35 percent, compared with 28 percent in ECA and 26 percent in the EU, while the prevalence of heavy episodic drinking among adults in the WB6 is at 26 percent, compared with 20 percent in ECA and 21 percent in the EU. Across the WB6 region, the prevalence of smoking and heavy drinking is substantially higher among men than women, while the prevalence of obesity is slightly higher among women.

The largest gaps in the productivity of human capital are observed in education. International student tests[3] have shown that scores in Albania, Kosovo, and North Macedonia were among the lowest in the region. Beyond the low basic education outcomes, the same weak performance is equally observed in higher education, where quality is low. The average university quality score in the WB6 countries is 8.7 (on a scale from 0 to 100, where 100 corresponds to the notionally highest ranked university in the world[4]), while the average for ECA is 12.5, the average for the EU is 28.8, and the world's leader (Singapore) has a score of 50.3. The region's performance in this indicator is only buoyed by Serbia, which has an average university quality score of 22.6, while the remaining countries in the WB6 seeing considerably lower scores. Notably, the quality of higher education is well below other countries with similar quality of basic education. Higher education attainment is also low in the WB6 countries: on average, 29 percent of the adults aged 30–34 have a university degree, compared with 33 percent in ECA and 43 percent in the EU. Improving the quality of higher education is fundamental for countries to transition to an innovation-led growth model, which will lead them to achieve high income status.

FIGURE 2.6.

Higher education is underperforming in the WB6 and ECA



Note: This graph plots, for every country with available data, the quality of higher education (vertical axis) and the quality of basic education (horizontal axis). The black line indicates the linear fit between both variables. The dashed horizontal line indicates the average quality of basic education in the country sample, while the dashed vertical line indicates the average quality of higher education. The quality of basic education is proxied by the average harmonized test score by country as published in the latest version of the World Bank Human Capital Database. The quality of higher education is proxied by the aggregate university quality score as calculated by Demirgüç-Kunt and Torre (2022). Light orange points indicate countries in ECA, while dark orange points indicate countries in the Western Balkans.

Sources: Demirgüç-Kunt and Torre (2022); Human Capital Database of the World Bank (2022).

3 Such as the Program for International Student Assessment (PISA), the Progress in International Reading Literacy Study (PIRLS), and the Trends in International Mathematics and Science Study (TIMMS).

4 No single university tops all the rankings -each of the six rankings has a different top university-, so the maximum score corresponds to a notional university.

The productivity of human capital is also affected by migration (see RER Spotlight**).** In the past 30 years, the stock of migrants from the WB6 countries has more than doubled, reaching almost 5 million. While emigration reduces the stock of human capital in a country, it can also affect its productivity, both in a positive and in a negative sense. On the one hand, emigration of the most talented and healthy workers raises the concern of a brain drain and an overall decrease in the productivity of the workforce that remains in the country. While highly educated individuals are increasingly leaving the region, the average educational profile of the WB6 emigrants shows generally low levels of education: only one in six WB6 migrants has tertiary education, below the rates of the non-migrant population. On the other hand, emigration of talented and healthy workers results in a higher flow of remittances and in potential investments in human capital in the origin country. Multiple channels are behind these mechanisms. The prospects of high wages abroad drive individuals to invest in their own education even if they do not end up migrating.[5] There is also evidence that households that receive remittances tend to invest more in education of the children than households that do not receive them.[6] Some migrants also accumulate human capital while abroad.[7] However, well designed migration policies need to be in place to allow all actors to fully benefit from international mobility and limit its potential risks to the human capital of origin countries. In this regard, higher education institutions play an important role in ensuring that the benefits of migration accrue to both origin and destination countries.

What should countries do to improve the productivity of their human capital?

- **Get the basics right**: according to a recent World Bank analysis[8], some of the most cost-effective interventions can deliver the equivalent of three years of high-quality education for as little as $100 per child. The three most cost-effective approaches are: targeted information campaigns on benefits, costs, and quality, together with a reinforcement of education management information systems; interventions to target teaching instruction by learning level rather than by grade (like individual tutoring and digital personalized learning[9]); and improved pedagogy in the form of structured lesson plans with linked student materials, teacher professional development (emphasizing pre-service training, as well as a competitive teacher recruitment process)and monitoring.
- **Invest in prevention and primary health care while soliciting good behaviors and healthy practices**. These could comprise incentivizing targeted performances at the primary care level - e.g., early identification of risk factors, counseling on how to reduce and control these risks, proper treatment, and monitoring of the conditions that lead to acute cases (diabetes, hypertension, etc.). Governments could also introduce policies that prevent unhealthy behaviors, like excise taxes on cigarettes, sugar-sweetened beverages, alcohol, bans on smoking in public places, and similar measures[10].

5 Abarcar and Thehoarides, 2024.
6 USAID, 2010; Oruc, Jackson and Pugh, 2018.
7 Eurostat, 2024.
8 Angrist et al., 2020. "How to Improve Education Outcomes Most Efficiently? A Comparison of 150 Interventions Using the New Learning-Adjusted Years of Schooling Metric." Policy Research Working Paper 9450. World Bank: Washington, DC.
9 World Bank 2024b. *Investing in People and Enhancing Innovation and Growth through Education in Europe and Central Asia*. Washington, DC.
10 World Bank 2020. *Fall 2020 ECA Economic Update: COVID-19 and Human Capital*. World Bank: Washington, DC

- **Reform curricula aligned with regional quality assurance standards and accreditation**. WeBa countries are encouraged to align their quality assurance systems with EU standards to ensure quality and relevance of their higher education programs. This includes internal quality assurance processes within institutions and external quality assurance mechanisms conducted by independent agencies.

- **Factor in re-skilling and skills upgrading due to the changing nature of work**. There is an urgency to upgrade higher order skills training in Science, Technology, Engineering and Mathematics (STEM), and research and innovation. Across the 6 countries, the green transition and the changing nature of work play a key role in determining the new sets of skills demanded in the labor market. WeBa countries need to invest in making sure that workers can adapt to frequent changes in skill requirements – an important skill in itself. This will be particularly important as brown jobs give way to green jobs in the region, and also to ensure that an aging workforce remains healthy and productive.

- **Consider regional engagements/projects**. In many fields and interdisciplinary areas, regional endeavors and projects help to achieve economies of scale and conduct leading-edge scientific research that many countries would be unable to do on their own for lack of adequate financial and scientific resources. Regional collaboration in higher education can take two basic forms[11]: coordinated regional activities -like enhancing the external quality assurance of universities and supporting the establishment of internationally recognized indicators of quality- and integrated regional activities -like the establishment of regional centers of excellence for research and graduate education and joint degree programs. International examples include the establishment of a resilient and sustainable ASEAN (Association of Southeast Asian Nations) Higher Education Space[12] by East Asian countries. The Western Balkans can explore such a model of cooperation and connect with other countries within the EU and beyond.

11 Linden, Arnhold, and Vasiliev 2008. "From Fragmentation to Cooperation: Tertiary Education, Research, and Development in South Eastern Europe

12 https://asean.org/asean-roadmap-2025-to-realise-a-common-higher-education-space-in-southeast-asia/

3. Solid growth is driving employment in 2024[13]

The WB6 region's labor markets further improved in 2024, with employment levels reaching historical highs across WB6 countries, although the employment growth is decelerating. The growth recovery that began in 2021, led by demand for transport, trade, tourism, and a booming ICT industry, brought employment to new highs, far surpassing pre-pandemic levels and adding over 390,000 jobs since end-2019. Between mid-2023 and mid-2024 alone, an additional 114,000 jobs were created in the region, of which Serbia showed the largest nominal gains (48,400), followed by Bosnia and Herzegovina (39,000). Average annual employment growth for the region has been 1.8 percent in 2024 (Figure 3.1), declining from 2 percent in 2023.

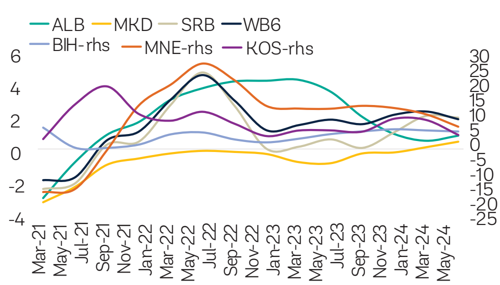
Employment rates have increased in most WB6 countries, with the average reaching a historical high of 48.5 percent in June 2024.[14] Although still lower compared with 54.4 percent in the EU27, the gap in employment rates is narrowing, given the increase in the WB6 countries of 6 pp since mid-2021, underscoring the magnitude of the region's recovery. In Albania and Montenegro, the employment rate (15+) is above the EU27, and the employment rate increased most in Montenegro in the first half of 2024 (Figure 3.2). In Kosovo, despite recent gains, only an estimated 37.1 percent of the working-age population is employed.

Labor shortages continue being among the key concerns for businesses (Box 3.2)**.** These shortages have fueled an increase in imported foreign workers (see *Spotlight*) and a widening of the skills mismatches that firms in the region have been reporting for some time. To enable cross-border labor mobility, Albania, North Macedonia, and Serbia launched a single labor market on March 1, 2024, as part of the Open Balkans initiative. The joint labor market aims to simplify the procedures for free access to these countries' labor markets. The joint protocols allow citizens from the three countries to travel freely to any of these countries with a valid biometric ID for work, eliminating the need for work permits. Furthermore, electronic

FIGURE 3.1.

Continued employment growth in 2024...

Two-quarter averages, yoy employment growth, percent

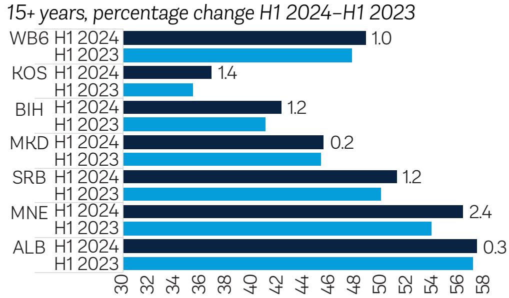


Source: National statistics offices and World Bank staff estimates.

FIGURE 3.2.

...has led to historically high employment rates

15+ years, percentage change H1 2024–H1 2023



13 This analysis was affected by (1) delayed publishing of Labor Force Survey (LFS) data in Kosovo and Albania, and by (2) a sampling revision in Bosnia and Herzegovina, and Montenegro in 2021-22 that reduced comparability with previous LFS data. Using administrative employment and unemployment in Albania, and tax administration data for Kosovo helped provide an approximate picture of the labor market in H1 2024.

14 The employment rate is the WB6 region's simple average.

services to businesses for registering workers will be available, and the e-government portals of the three countries will be inter-connected. Permits can be obtained for up to two years, with the possibility of further extensions.

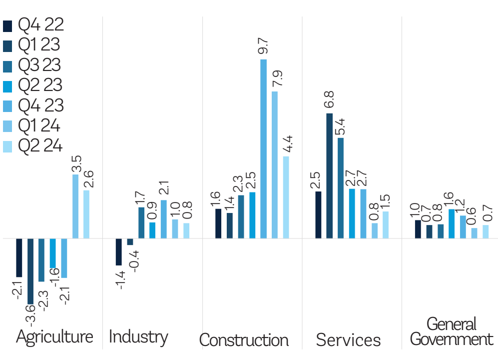
All sectors have contributed to the labor market recovery (Figure 3.3). A rebounding tourism sector has boosted employment, followed by a rise in the trade and ICT sectors, as well as in transport in mid-2024. The construction sector has also seen an increase in employment across WB6 countries, with the exception of North Macedonia. Apart from Serbia and Montenegro, employment growth in the agriculture sector was positive, potentially responding to increased agricultural subsidies aimed at containing the impact of food inflation and helping to boost import substitution. In June 2024, the strongest employment growth in the region was in the construction (4.4 percent, yoy and agriculture (2.6 percent) sectors, with the slowest growth in industrial employment and public administration. The energy sector in Montenegro increased employment by double digits compared with 2023, similar to employment in the construction and ICT sectors in Kosovo.

The labor force participation rate has slightly improved over the past year on a regional level (Figure 3.4). The participation rate (for 15+ age groups) averaged 54.4 percent in H1 2024, an increase of 0.9 pp since H1 2023. Gains in labor force participation have been observed in Bosnia and Herzegovina, Kosovo, Montenegro, and Serbia. In June 2024, female participation rate for the WB6 region improved to 45.3 percent, respectively, which is a historical high. The labor force participation rate in Montenegro of 63.8 percent is the highest among the WB6 countries, with men participating at a rate of 71.4 percent. The lowest ratio of population participating in the labor market is seen in Kosovo, at only 42.7 percent, which is nonetheless an improvement of 2.5 pp from 2023. The participation rate dynamics partly reflects a decline in the working age population of around 45,200 for the WB6 region as a whole, with most of the decline observed in Kosovo and Serbia, by 23,700 and 26,700, respectively. This reflects both population aging and migration outflows (in Kosovo this was led by visa liberalization and more relaxed work permitting in some EU countries, in particular Germany).

FIGURE 3.3.

Construction and services created new jobs

Employment level, 15+ years, percent, annual change



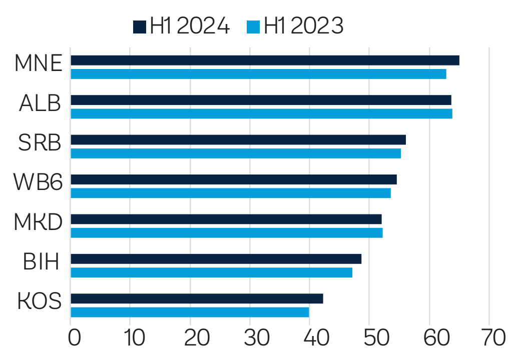
Source: National statistics offices and World Bank staff estimates.

Note: Employment growth is weighted average.

FIGURE 3.4.

More people joined the WB6 labor force

Participation rate, percent of population aged 15+

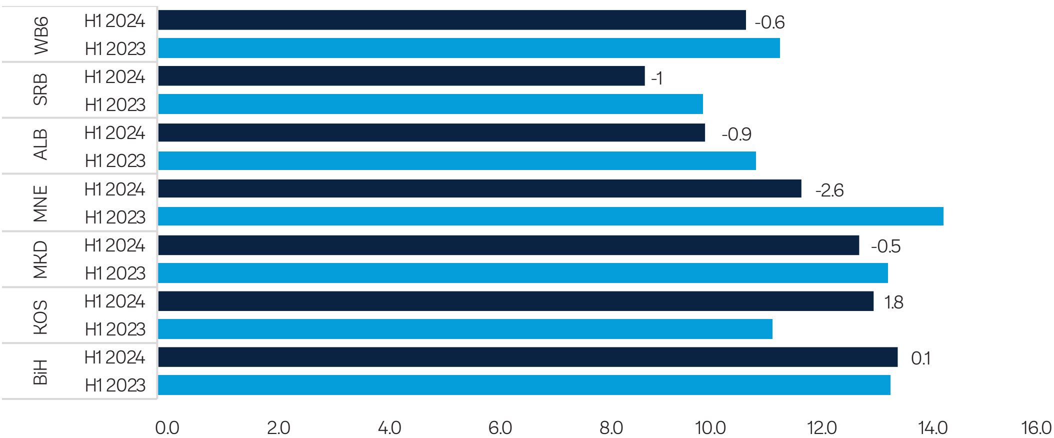


Source: National statistics offices and World Bank staff estimates.

FIGURE 3.5.

Unemployment rates have declined further in the WB6 in 2024

Unemployment rate, 15+ years, percent, and H1 2024–H1 2023, percentage change



Source: National statistics offices and World Bank staff estimates.

Unemployment has declined across all WB6 countries, with the exception of Kosovo, and the unemployment rate for the WB6 region reached 11.3 percent in June 2024. There were 783,000 people unemployed in the region, or 52,900 people less than a year ago. Serbia and Albania recorded the largest nominal declines on an annual basis, partly explained by the rise in employment, but also a rise in inactivity in the case of Albania. While Montenegro observed the largest decline in the unemployment rate (by 1.6 pp), Serbia attained the lowest rate of 8.2 percent in June 2024 (Figure 3.5).

The broad-based recovery in employment has also benefited vulnerable groups over the past two years, but some of these gains are reversing. By mid-2024, youth unemployment (15–24 years old) increased to 25.6 percent, up by 2.7 pp yoy. There are over 147,000 young people without jobs in the WB6 region, a cohort that is in the prime working age (Box 3.1). For example, despite improvements, the youth unemployment rate in Bosnia and Herzegovina—a country with one of the largest diasporas (see Spotlight)—is the highest in the WB6 region, at above 30 percent. In Montenegro, North Macedonia, and Kosovo, the number of young jobseekers has increased, in the latter as eligibility to participate in the Youth Guarantee Program that subsidizes wages for 6 months requires a registration at the employment bureau.

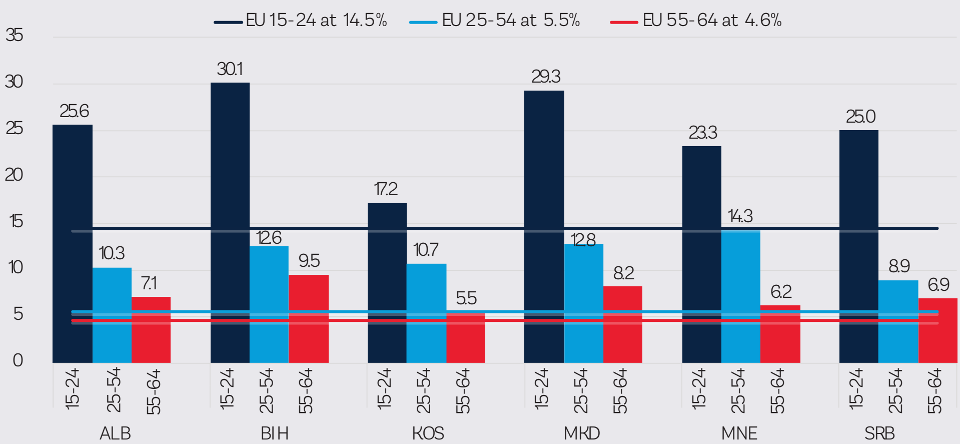
Box 3.1: Who are the unemployed in the Western Balkans?

In 2023, youth unemployment and unemployment rates among prime-age workers (25–54 years old) in the WB6 countries were double the average unemployment rate of the EU27 for same age categories, a significant missed opportunity for human capital to contribute to growth. All countries had youth unemployment rates (15–24 years old) far exceeding 20 percent, except for Kosovo (17.2 percent) where it was slightly above the EU27 average. The unemployment rate for people in the prime working age (25–54 years old) was also double the EU27 average (with Montenegro having the widest gap). For the oldest age category (55–64 years old), the gap was not that wide, except in Bosnia and Herzegovina, and North Macedonia (Figure 3.6).

FIGURE 3.6.

Unemployment rates still compare poorly with the EU27, especially for the youngest and prime age workforce

Unemployment rates by age cohorts, percent

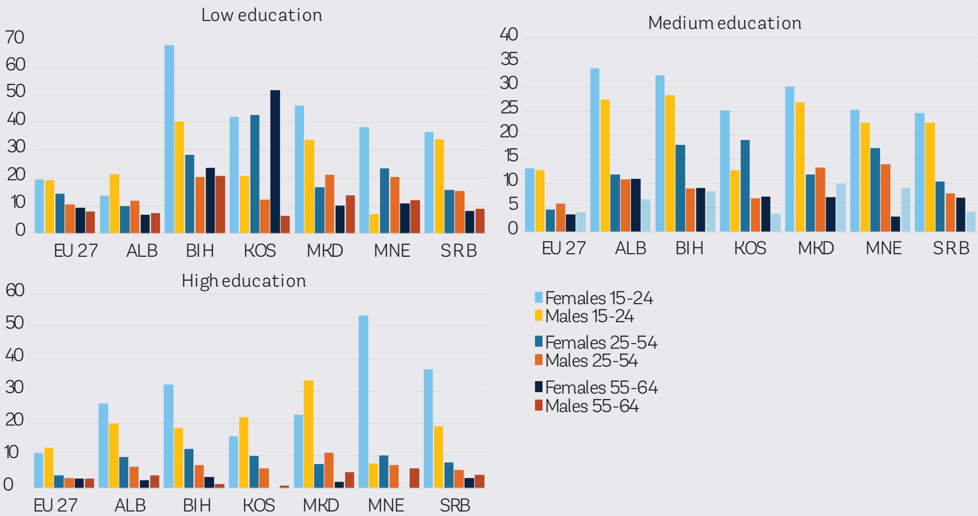


Source: National state statistical offices and the World Bank staff estimations.

Age, educational attainment, and gender played an important role in shaping the differences in unemployment rates between the Western Balkans and the EU27 in 2023 (Figure 3.7). In the lowest educated workforce group, Albania had the lowest unemployment rates both by age and gender, even outperforming the EU27 outcomes. At the other extreme, Bosnia and Herzegovina had the worst employment prospects, especially for younger women with low education. In Kosovo, women in the 55–64 age cohort were particularly affected by unemployment, in contrast to the rest of the WB6 countries. Serbia, on the other hand, had the greatest homogeneity in terms of gender. Looking at those with secondary school education, the WB6 region appears more uniform, with generally higher unemployment rates than for the EU27, and with younger workers of both genders most affected. For the group with tertiary education, the youth unemployment rate was again the main issue, especially for females in Montenegro, Serbia, and Bosnia and Herzegovina, and males in North Macedonia and Kosovo.

FIGURE 3.7.

The highest unemployment rates are found among younger women with only primary educational attainment

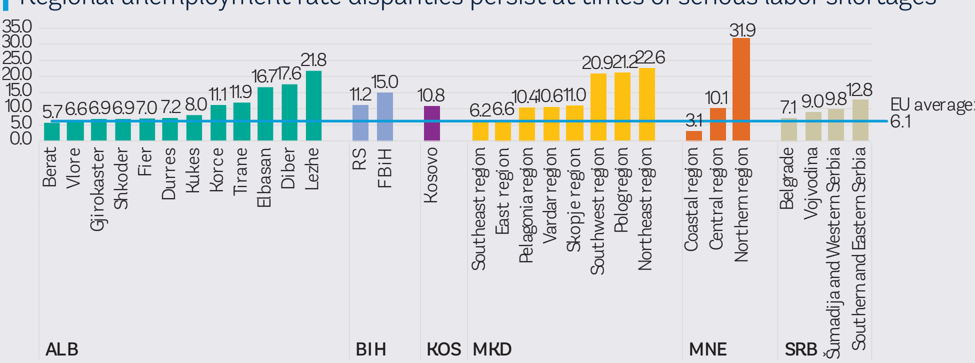


Note: Low educational attainment comprises less than primary and primary education; medium educational attainment includes vocational after primary and secondary education; high educational attainment stands for tertiary education. The estimates for females in the 15–24 age group with low educational attainments and for males in the 15–24 age group with high educational attainments for Montenegro were estimated using the working age (15–64) population structure.
Sources: National statistical offices and Eurostat.

There are persistent unemployment hotspots within countries. While the unemployment gap—the difference between the highest and lowest unemployment rates—within WB6 countries has decreased, the disparities remain striking. The most prominent example is seen in Montenegro which, in 2023, had regions with both the highest (northern region) and the lowest (coastal region) unemployment rates among the WB6 countries, suggesting very low labor mobility. Albania and North Macedonia present wide unemployment gaps, both around 16 pp in 2023. The lagging regions deserve a deeper analysis of the factors behind being unemployment hotspots at times of serious labor shortages.

FIGURE 3.8.

Regional unemployment rate disparities persist at times of serious labor shortages

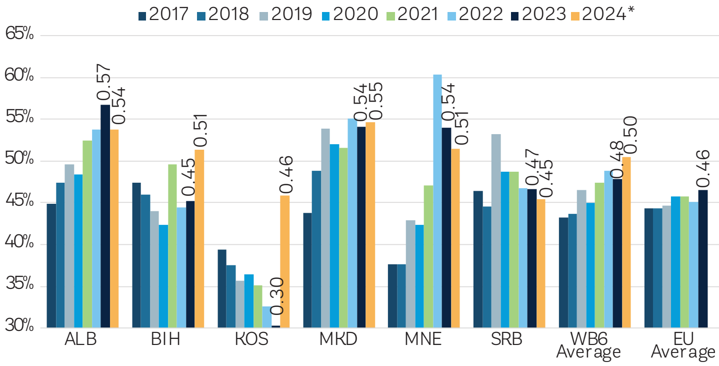


Source: National statistical offices and Eurostat.

FIGURE 3.9.

Replacement rates are higher than in the EU27

Minimum to average wage ratio, percent



Note: For 2024, the average wage refers to H1 for Albania, Bosnia and Herzegovina, North Macedonia, Montenegro, and Serbia. The average wage for 2023 and 2024 for Kosovo were estimated from the administrative tax data.

Source: National statistics offices and World Bank staff estimates.

Real wages have increased in the WB6 countries in the period 2023–24, as inflation has declined, and minimum and public sector wages have increased, while labor markets have remained tight (Box 3.2.). In 2023, real wages increased by 8.4 percent, on average, across the WB6 countries, far surpassing productivity growth of just 0.2 percent. This increase continued in H1 2024, with real wages increasing on average by 8.3 percent in H1, ranging from 2.7 percent (Montenegro) to 11.6 percent in North Macedonia and Serbia. The WB6 region's average replacement rate—calculated as the minimum wage to nominal average wage ratio—is increasing at a higher pace than in the EU27 due to a sharp rise in minimum wages (Figure 3.9). This reduces income inequality, as low-wage workers' earnings increase more compared with the average worker. From 2017 to the beginning of 2024, this rate increased in most WB6 countries. In H1 2024, most WB6 countries increased their minimum wages significantly, while Kosovo doubled its minimum wage in August 2024 to €340, and Montenegro raised its minimum wage to €670 from October 2024. An increasing replacement ratio can be viewed positively if it reflects a deliberate policy to improve the livelihoods of the lowest-paid workers. However, it could also signal underlying economic challenges if it reflects stagnant or slow growth in average wages, potentially due to high informality, low productivity, or demand for lower-quality lower-paid jobs.

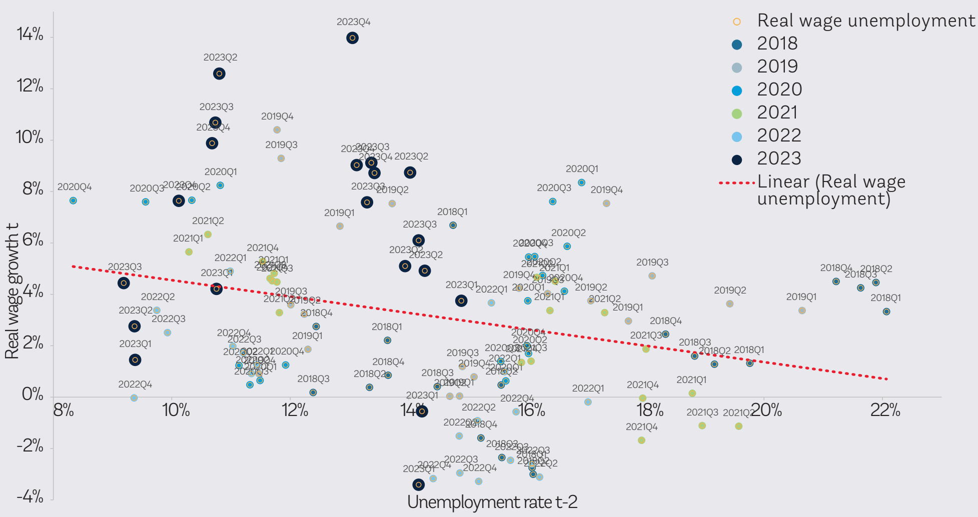
Box 3.2: Does the Phillips Curve hold true in the Western Balkans?

The Phillips curve entails a negative correlation between nominal wage growth and the unemployment rate,[15] meaning that low unemployment relates to accelerated nominal wage growth. In simpler terms, wages tend to increase more quickly when the labor market is tight, and they rise more slowly when the labor market is slack. Understanding the drivers of unemployment and wages is important not only for macroeconomic policy, but also for prospects of reducing income inequality and enhancing workers' security.

Examining the relationship between wages and unemployment in the WB6 region suggests that the Phillips curve holds for most WB6 countries. Figure 3.10 plots the unemployment rate and the growth rate of real wages for each country in the region between 2017 and 2023. In the analysis, real wages were used instead of nominal wages to analyze the relationship between unemployment and wage dynamics as real wages account for inflation and provide a clearer picture of workers' purchasing power. For the period 2017–2023, real wage growth and two-quarter lagged unemployment rates are negatively correlated,[16] with the resulting regression line exhibiting a negative slope (with statistically significant 0.32 coefficient), supporting the applicability of a downward sloping Phillips curve. This is the case for all of the WB6 countries, with the exception of North Macedonia.

FIGURE 3.10.

Real wage growth and unemployment in the Western Balkans (2017–2023)



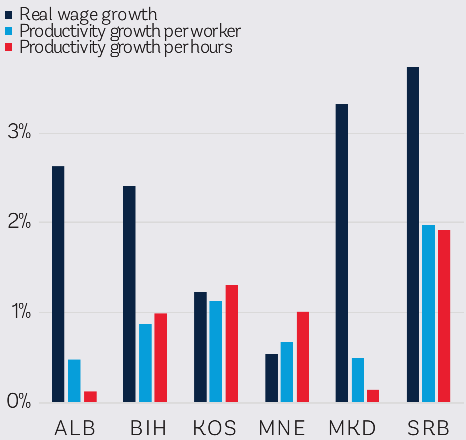
Note: Kosovo is not presented on the figure given no quarterly wage data are available.
Source: National state statistical offices and the Bank staff estimations.

15 https://www.jstor.org/stable/2550759
16 The lags chosen are based on the comparison of the resulting from the regressions of real wage growth on unemployment rate with different lags. The highest is associated with two lags.

Is such real wage growth sustainable given that it has surpassed productivity growth since 2015? In the WB6 region, wage growth has not reflected productivity growth since 2015, and recent wage increases have widened the wage-productivity gap. This gap is most notable in Albania and North Macedonia (Figure 3.11). Key factors that have contributed to this are automatic increases of minimum wages in several countries, strong public sector wage bargaining, and a record shortage of workers, as indicated by the Balkan Business Barometer in 2024. For the period 2019–2024, the Balkan Business Barometer suggests that labor shortages are trending from being a minor toward being a moderate business obstacle (Figure 3.12).

FIGURE 3.11.

Average real wage and productivity growth, 2015–2023



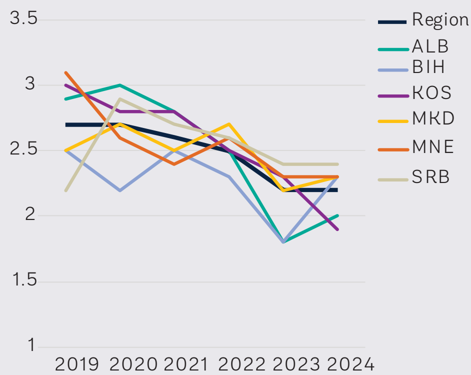
Note: Productivity growth per worker and per hour estimates are obtained using number of employees and average hours worked per week, respectively, from Labor Force Survey (LFS) and real GDP.

Source: National state statistical offices and the World Bank staff estimations.

FIGURE 3.12.

Labor shortages as business obstacles in the WB6 countries, 2019–2023

Scale: 1 - major obstacle, 2 - moderate obstacle, 3 - minor obstacle, 4 - no obstacle.



Source: Regional Cooperation Council's Balkan Business Barometer 2023.

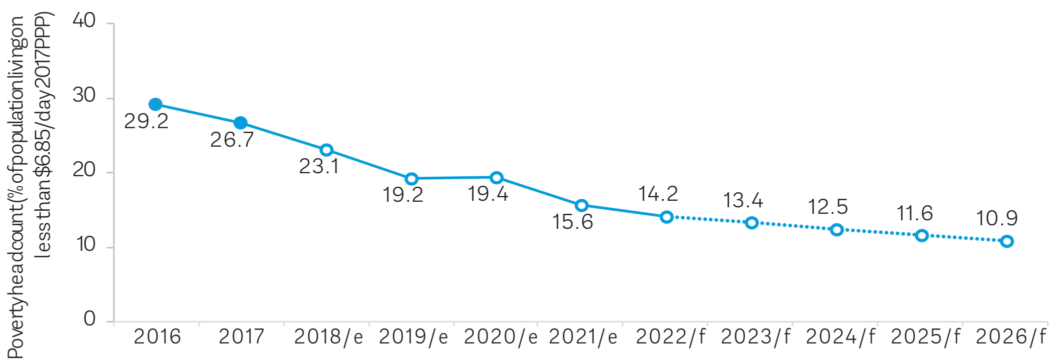
4. Closing gender disparities can support stronger poverty reduction in the region

Poverty reduction in the Western Balkans has continued its downward trend but at a slower pace than in the pre-pandemic period. Up to 2019, poverty decreased by over 3 percentage points annually, but between 2022 and 2025, this rate is estimated to fall to roughly 1 percentage point annually. This slower reduction is attributed to a combination of slower economic growth in the region and significant increases in food and energy prices during 2022–23, which strained households' purchasing power. In 2022, real wages declined in all six countries in the Western Balkans. As inflation started to decrease in 2023, with projections indicating a continued slowdown throughout the forecast period, this trend is expected to benefit lower-income households significantly. As labor markets continue to display positive signals across the region and wages have risen during the 2023–24 period, it is expected that these developments could further contribute to reducing poverty.

The World Bank's new global prosperity gap[17] measure—an indicator of inclusive growth—also highlights the significant challenges of boosting inclusive growth. Poverty reduction is not the only indicator of societal progress. To capture the progress and equity aspects of economic growth, the World Bank has recently introduced the Global Prosperity Gap, which captures how far people's incomes are from a global prosperity standard, which is set at US$25 per person per day. This benchmark represents the average income when countries transition from upper middle-income to high-income country status (World Bank, 2024).[18] Specifically, the Global Prosperity Gap is defined as the average factor by which incomes need to be multiplied to bring everyone in a given group (for example, the Western Balkans region) to the prosperity standard.[19] In 2023, the incomes of the WB6 countries population would need to be multiplied by a factor of 2.1 to fully close the

FIGURE 4.1.

Poverty reduction has de-escalated in recent years



Source: World Bank estimates and forecasts based on 2021 income data from the Survey of Income and Living Conditions (SILC) for Montenegro; 2019 for Albania and North Macedonia, 2021 for Serbia; and 2017 Household Budget Survey (HBS) for Kosovo.

Note: Income and consumption measures from the SILC and the HBS, respectively, are not strictly comparable. Welfare is estimated in US dollars using 2017 PPPs. Due to a lack of comparable data, the regional estimate excludes Bosnia and Herzegovina (BiH). Forecasts are based on GDP per capita in constant LCU, e = estimate, f = forecast.

17 Find out more about the new prosperity gap indicator in this series of blogs (https://blogs.worldbank.org/en/developmenttalk/prosperity-gap-proposed-new-indicator-monitor-shared-prosperity , https://blogs.worldbank.org/en/impactevaluations/can-we-have-welfare-index-easy-understand-also-distribution-sensitive)

18 World Bank. 2024. *Poverty, Prosperity and Planet Report 2024.* Washington, DC: The World Bank.

19 In other words, the Prosperity Gap measure is thus the average, across all people, of the ratio of individual incomes to the prosperity standard.

regional prosperity gap. Within the region, North Macedonia had the largest Prosperity Gap at 2.9, while Bosnia and Herzegovina had the lowest at 1.4. Albania and Serbia matched the regional average, whereas Montenegro and Kosovo reported above-average gaps, at 2.4 and 2.7, respectively (Figure 4.2). The Prosperity Gap in the WB6 countries, while smaller than the average for the ECA region of 2.6 and considerably lower than the global average of 5.1, remains much higher than EU and high-income countries such as Croatia (1.2) or Slovenia (0.7).

The WB6 countries have shown limited improvement in the prosperity gap in the post-COVID-19 pandemic years. In 2019, before the onset of the COVID-19 pandemic, the average Prosperity Gap for the Western Balkans stood at 2.3. However, its latest estimate is largely unchanged, with none of the six countries in the region registering significant gains. This is a concern for inclusive growth because the Prosperity Gap gives greater weight to the incomes of the poor, such that poorer households contribute significantly more to the gap than their better-off counterparts (Kraay et al., 2023[20]). Figure 4.3 shows each country's contribution to the regional Prosperity Gap in 2023. Although Kosovo and Montenegro experienced the largest improvement in the gap, the impact on the regional trend was limited by their small, combined contribution to the overall index.

Boosting economic growth, increasing labor market participation of both men and women, and reducing gender disparities in labor market outcomes will be essential to further increase incomes at the lower end of the income distribution. Poverty reduction will likely remain muted during the forecast period, primarily due to structural labor market constraints related to low participation. This means that recent wage increases in the region may not necessarily translate into significant increases in the welfare of households below the poverty line, because a significant share of these households are characterized by long-term unemployment or high levels of inactivity. In the short run, supporting labor market participation and closing gender employment gaps can help address the high degree of vulnerability to economic shocks of households in the WB6 countries that was highlighted in the previous edition of the Regional Economic Report. Over the long term, the WB6 countries can potentially reap significant gains from closing gender employment gaps alone (see Box 4.1).

FIGURE 4.2.

Regional and country-specific Prosperity Gap, 2019 and 2023

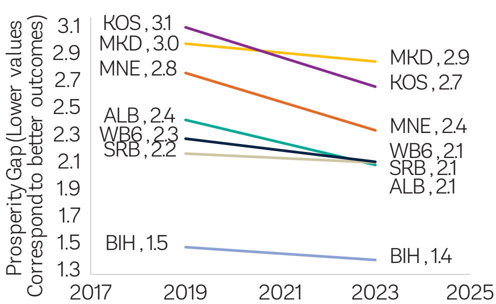
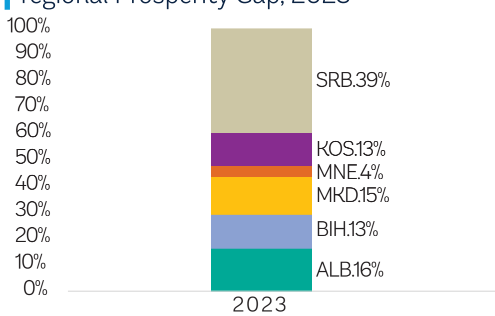


FIGURE 4.3.

Contribution of each country to the regional Prosperity Gap, 2023



Note: The plots show the regional and national Prosperity Gaps in 2019 and 2023 and their contribution in 2023. Source: using data from Kraay (2023) and Yonzan, Mahler, Lakner (2023).

20 Kraay,Aart C.; Lakner,Christoph; Ozler,Berk; Decerf,Benoit Marie A; Jolliffe,Dean Mitchell; Sterck,Olivier Christian Brigitte; Yonzan,Nishant. A New Distribution Sensitive Index for Measuring Welfare, Poverty, and Inequality (English). Policy Research working paper ; no. WPS 10470; RRR Washington, D.C. : World Bank Group. http://documents.worldbank.org/curated/en/099934305302318791/IDU0325015fc0a4d6046420afe405cb6b6a87b0b

Box 4.1: Gender Employment Gaps Index (GEGI)

The Gender Employment Gaps Index (GEGI) quantifies the potential economic benefits of equalizing employment rates between men and women in terms of the percentage increase in long-run GDP per capita (Pennings, 2022). The basic GEGI is defined as the gap between male and female employment, as a share of total employment:

$$\text{Basic GEGI} = (l_M - l_F) / (l_M + l_F) * 100$$

where (*l*) the employment-to-population ratio of 15–64 year olds by gender.

This quantification of disparities in employment between males and females can provide insights into the economic impacts of these gaps because, in simple neoclassical growth models, the increase in long-run GDP is proportional to the change in the number of workers as the capital-to-output ratio is constant in the long run. Thus, for example, moving from no female employment to achieving gender parity in employment by doubling the number of workers would lead roughly to a doubling of long-run GDP (see Pennings, 2022, for a detailed discussion).

In addition to the basic GEGI, it is also possible to compute a Full GEGI, which disaggregates total gender employment gaps into a "better employment" gender gap and an "other employment" gender gap, where "other employment" is defined as employment that is not "better employment":

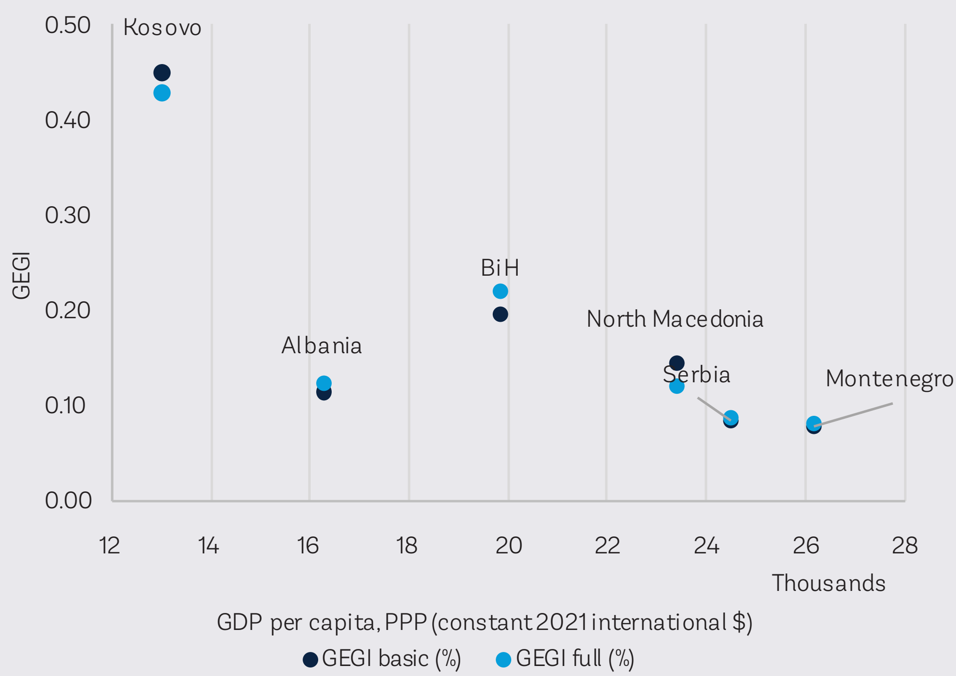
$$\text{Full GEGI} = \omega \text{ Better Employment gender gap} + (1\text{-}\ \omega) \text{ Other employment gender gap}$$

The Full GEGI is defined as a weighted average of the "better employment" gender gap and the "other employment" gender gap. Following Pennings (2020), better employment is defined as non-agricultural employees plus employers, to capture employment categories where people may be better able to use human capital and skills to increase their productivity. The weights $\omega = hL^{be}/(hL^{be} + L^{oe})$, measure the relative contribution of better employment and other employment to GDP, where $h = h_f = h_m$ is human capital per worker and Lbe and Loe are the number of workers in better employment and other employment respectively.

Figure 4.4, which plots the GEGI index for the WB6 countries, illustrates the implications of achieving gender equality in employment. Kosovo, for example, could boost its long-term GDP per capita by between 43 and 45 percent if it closed its gender employment gap. In contrast, Albania could see improvements in long-term GDP per capita of around 12 percent. This difference may be related to differences in female labor force participation between the two countries. In 2023, Albana and Kosovo had the lowest and highest female labor force participation rates in the WB6 countries, respectively, with Albania's rate being three times higher than Kosovo's 22 percent. Bosnia and Herzegovina could see improvements in long-term GPD per capita between 20 and 22 percent, while North Macedonia is estimated to gain between 12 and 14 percent by eliminating its gender employment gaps. Although higher-income countries have lower potential gains from reducing employment gaps, all the countries in the region would benefit from improving labor market outcomes for women.

FIGURE 4.4.

Gender Employment Gaps Index



Note: The figure plot the Basic and Full GEGI against GDP per capita (constant 2021 international $). Data in the figure have been updated with the most recent data from ILOSTAT. Source: ILO series "Employment-to-population by sex and age (%) – Annual (age 15-64)". GDP per capita retrieved from WDI.

References

Pennings, S. 2020. "The Utilization-adjusted Human Capital Index (UHCI)" Policy Research Working Paper 9375. © Washington, DC: World Bank

Pennings, S. 2022. "A Gender Employment Gap Index (GEGI): A Simple Measure of the Economic Gains from Closing Gender Employment Gaps, with an Application to the Pacific Islands." Policy Research Working Paper 9942. © Washington, DC: World Bank.

5. Maintaining fiscal prudence is needed to preserve past consolidation gains

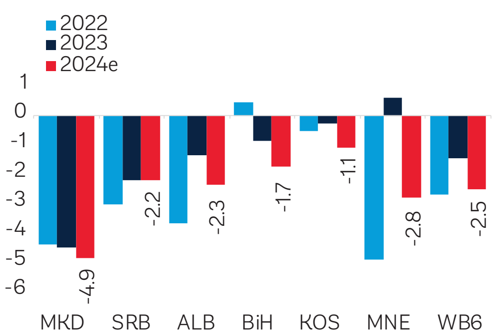
After three years of consolidation, the WB6 countries are set to experience widening fiscal deficits during 2024. Revenue performance remains robust across the region, but expenditures are increasing faster. The average[21] fiscal deficit level for the WB6 countries is expected to increase by 1 percentage point (pp) of GDP, reaching 2.5 percent of GDP (Figure 5.1). Serbia is the only country in the WB6 expected to maintain the same level of deficit from the previous year, while Montenegro is expected to experience the highest increase after closing 2023 with a fiscal surplus. North Macedonia is expected to continue running the highest level of deficit, almost double the regional average in 2024. Strong growth and inflation coupled with the withdrawal of pandemic and inflationary crisis measures led to a solid post-pandemic consolidation until 2023; however, a wave of electoral cycles across the region, heavily impacted by the recent inflationary episode, poses risks for hard-won gains in fiscal consolidation.

Despite the fading inflationary impetus, public revenues continue to increase, albeit at a slower pace than in 2023. Nominally, tax revenue growth for the first half of the year remains strong across all WB6 countries, ranging from 7.2 percent in Albania and 8.6 percent in Montenegro, to between 13 and 14 percent in Kosovo, Serbia, and North Macedonia. Bosnia and Herzegovina is also experiencing strong nominal indirect tax growth. This momentum is partially driven by compliance gains, including from formalization, and strong domestic activity , with minor benefits from tax policy changes from one year before. Increases in minimum wages are boosting direct taxation, except for Kosovo where minimum wage increases were associated with a full tax exemption. Total revenues are also expected to increase as a share of GDP in four out of the six WB6 countries, with North Macedonia and Albania expected to gain most by 2.4 and 1.4 pp of GDP in revenue, respectively. Nonetheless, growth in revenue is slower than in 2023. On the other hand, Montenegro is expected to see a drop in revenues

FIGURE 5.1.

Fiscal deficits are widening in 2024…

Fiscal balance, percent of GDP

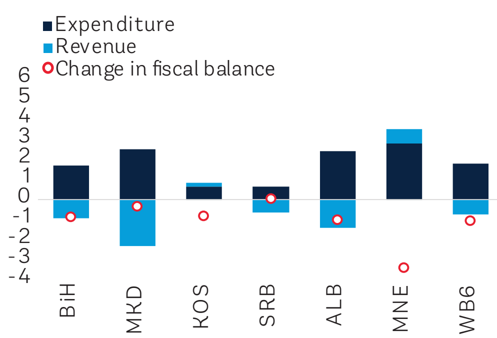


Sources: National statistical offices, ministries of finance and World Bank staff estimates.

FIGURE 5.2.

…against broad based expenditure growth

Contribution to change in the fiscal balance, percent of GDP, 2024e



Sources: National statistical offices, ministries of finance and World Bank staff estimates.

21 From here on, the regional average refers to the regional unweighted arithmetic average.

as a share of GDP because of the significant impact of one-off revenues in 2023. Kosovo will also see a slight drop because of the sizable impact of EU on-budget grants in 2023. In fact, one-off EU budget grants averaged 0.5 percent of GDP in 2023 for all WB6 countries except Bosnia and Herzegovina, and tax revenue growth is expected to largely compensate for their absence in 2024.

Increased public expenditures are driving the deficit expansion across the WB6 countries in 2024 (Figure 5.2)**.** Revenues as share of GDP are projected to experience only a minor increase and deficits are mostly driven by expenditure growth. For the first part of the 2024, expenditures across the WB6 region experienced double-digit nominal growth. As a share of GDP, expenditures are expected to increase by more than 2 pp of GDP in Albania, North Macedonia, and Montenegro, followed by an increase of 1.7 pp of GDP in Bosnia and Herzegovina. Primary fiscal balances will be negative in all WB6 countries except for Albania where primary balance is expected to be zero. . Interest expenditures remain sizable at about 2 percent of GDP for the WB6 countries with access to international debt markets. Kosovo and Bosnia and Herzegovina represent an exception and have low levels of interest payments due to lower debt shares compared to the rest of the countries.

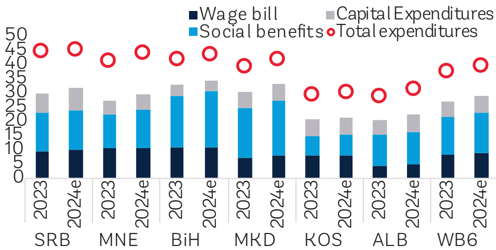
Increases in expenditure are broad-based, but spending on social benefits is leading the way (Figure 5.3)**.** While the entire WB6 region is experiencing population aging, accelerated by outmigration of younger cohorts, social benefits spending—predominated in the form of pensions—is expected to increase in every WB6 country, with the WB6 average increasing from 13.2 percent in 2023 to 14.1 percent of GDP in 2024. After Bosnia and Herzegovina, North Macedonia is also seeing high levels of social spending, with both countries expected to spend almost one-fifth of their GDP on social benefits in 2024 (Figure 5.4). Montenegro is set to experience the highest increase in social spending (1.7 pp of GDP) following a significant rise in the minimum pension from January 2024. The long-term sustainability of state pension systems in the face of not only rising pressures for more spending, but also informality and aging populations, remains a significant challenge. On the other hand, except for Bosnia and Herzegovina and Montenegro, spending on public wages has also continued to increase as a share of GDP, albeit at a slower rate than in 2023. North Macedonia is expected to experience an increase of 0.9 pp of GDP in its wage bill, while Serbia and Albania are both expected to see wage-bill increases of 0.6 pp of GDP. Kosovo will see a slight increase of 0.2 pp of GDP in wage spending.

Most countries of the region are also experiencing a rebound in capital spending. Capital spending will, on average, expand by 0.5 pp of GDP for the region, reaching a record level of 5.9 percent of GDP. Serbia, the region's largest country, is expected to end 2024 with capital investments amounting to close to 8 percent of GDP, the highest level recorded since 2006. With the exception of Bosnia and Herzegovina, public investments—predominated by transport infrastructure investment—will rise by about 1 pp of GDP in Serbia and Albania, and by 0.5 pp of GDP or slightly lower in Montenegro, Kosovo, and North Macedonia. Bosnia and Herzegovina is expected to maintain the same—and the lowest—level of capital spending, at just 3.8 percent of GDP. Despite the increase, capital budget under-execution remains endemic for most WB6 countries. The EU Growth Plan, with a significant portion of financing dedicated to projects under the Western Balkans Investment Framework, could further bolster medium-term public investment spending in the WB6 region, but addressing public investment management bottlenecks requires immediate attention.

FIGURE 5.3.

Capital spending has rebounded…

Composition of estimated public spending, 2023 and 2024e, percent of GDP

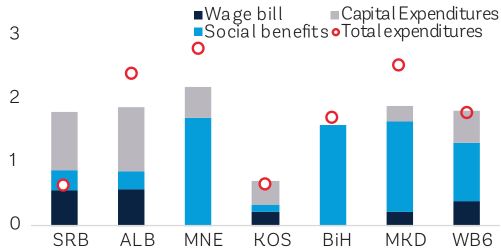


Source: National statistical offices, ministries of finance and World Bank staff estimates.

FIGURE 5.4.

…while all WB6 countries have turned to higher spending on social benefits

Contribution to change, 2024e, in percent of GDP



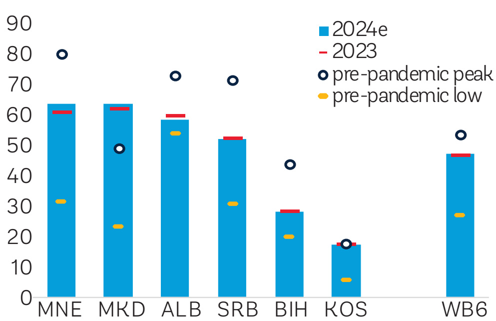
Source: National statistical offices, ministries of finance and World Bank estimates.

After three years of consistent decline, public and publicly guaranteed (PPG) debt in the region is estimated to increase only slightly in 2024. For the first time since the pandemic, PPG debt is expected to experience a minor increase as a share of GDP, from 46.8 percent in 2023 to 47.2 percent in 2024 (Figure 5.5). Montenegro and North Macedonia are driving this regional increase, with PPG debt as a share of GDP rising by 2.8 and 1.5 percentage points in 2024, respectively. Montenegro's increase is primarily due to the issuance of a Eurobond to cover 2024 financing needs and create a buffer for 2025. North Macedonia's increase is driven by a persistently high fiscal deficit and the greater issuance of domestic securities for liquidity purposes. North Macedonia is also the only WB6 country in which PPG debt as a percentage of GDP has surpassed its pre-pandemic peak. In Albania, in line with the fiscal rule, the public debt ratio is estimated to decline by 1.5 pp—the largest decline in the region—driven by a mix of fiscal consolidation, higher growth, and the appreciation of the Albanian lek. Serbia is expected to see a reduction of 0.4 pp in its PPG debt-to-GDP ratio. In Bosnia and Herzegovina, the combination of a denominator effect, negative net borrowing, and slow project disbursement and implementation is estimated to cause a 0.3-pp decrease in PPG debt as a share of GDP, while Kosovo's PPG debt-to-GDP ratio is estimated to remain at 17.4 percent, the lowest among the WB6 countries.

FIGURE 5.5.

Public and publicly guaranteed debt as a share of GDP has declined to its lowest in a decade…

Public and publicly guaranteed debt, percent of GDP

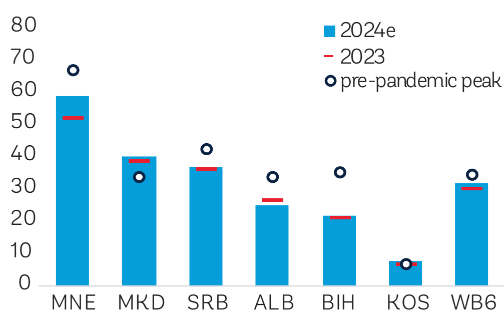


Sources: National statistics offices; World Bank staff estimates.

FIGURE 5.6.

…as has external public and publicly guaranteed debt

External public and publicly guaranteed debt, percent of GDP



Sources: National statistics offices; World Bank staff estimates.

External PPG debt is estimated to grow more sharply than overall PPG debt. The external PPG debt-to-GDP ratio for the WB6 countries is projected to increase from 30.6 to 31.8 percent, with all WB6 countries except Albania seeing an increase in external PPG debt (Figure 5.6). Montenegro's external PPG debt is expected to remain the highest among the WB6, reaching 58.8 percent of GDP in 2024—an increase of 6.5 pp from 2023—due to its large Eurobond issuance and planned borrowing from international financial institutions later in the year to create fiscal buffers for 2025. Other countries are estimated to see modest increases in their external PPG debt-to-GDP ratios, ranging from 0.4 pp in Bosnia and Herzegovina to 0.9 pp in North Macedonia. Kosovo continues to have the lowest share of external PPG debt, at 7.8 percent of GDP, further constrained by the requirement of a two-thirds parliamentary vote to authorize new external debt. Serbia and Kosovo maintain active engagement with the IMF, which has conducted reviews and made available a total of €63 million for Kosovo, €200 million for North Macedonia, and €400 million for Serbia, with the latter treated as precautionary.

The WB6 countries continue to face elevated borrowing costs despite some improvement in global market conditions, driven by persistent economic uncertainties and rising interest rates. After pausing their market activity in 2022, most WB6 countries resumed accessing international markets in 2023, albeit under significantly different and more challenging conditions. This return came amid a new landscape of higher interest rates and cautious investor sentiment, reflecting the ongoing global economic uncertainties. In 2023, several WB6 countries reentered the Eurobond market at significantly higher costs, with Serbia issuing two Eurobonds totaling US$1.75 billion at coupon rates of 6.25 and 6.5 percent, respectively, North Macedonia issuing a €500 million bond at 6.96 percent, and Albania raising €600 million at 5.9 percent, all reflecting a sharp rise in borrowing costs compared with previous years when coupon rates were as low as 1 percent. In 2024, the trend of elevated borrowing costs for WB6 countries continued, though with a slight decline, as Montenegro issued a seven-year US$750 million Eurobond at a 7.25[22] percent coupon rate in March, reflecting a modest reduction compared with 2023 yield levels. Similarly, Serbia issued a 10-year €1 billion Eurobond in June 2024 at a 6 percent coupon rate. Even though they have decreased by an average of around 60 basis points compared with six months ago, yields on the existing Eurobonds of WB6 countries remain elevated (Table 5.1). Notwithstanding this, the credit rating agencies have either confirmed or upgraded the ratings of all WB6 countries (Table 5.2). The latest S&P ratings upgraded the outlook from stable to positive in Serbia, signaling improving economic conditions and fiscal management, while Montenegro received a credit rating upgrade from B to B+, reflecting financial resilience and economic growth. These upgrades highlight positive developments in the region despite global economic challenges.

Given that global interest rates remain elevated and economic conditions continue to be volatile, fiscal prudence is essential to prevent unsustainable debt levels. Establishing independent fiscal councils (e.g., in North Macedonia and Montenegro) or strengthening existing ones (e.g., in Serbia) would play a critical role in ensuring fiscal discipline by providing unbiased assessments of government budgets, enhancing transparency, and promoting long-term economic stability (see Box 5.1). These institutions can guide prudent decision-making, mitigate risks, and foster confidence among international investors—factors that are crucial for the WB6 region's economic resilience. Also, the WB6 countries should avoid increasing current spending, particularly during election years, and focus on optimizing public spending, especially in areas such as public sector wages and social programs, to improve cost efficiency. Finally, aligning fiscal legislation and statistics with EU methodologies such as the European System of Accounts 2010 will be vital for improving fiscal governance, meeting EU accession criteria, and enhancing the region's overall economic stability and integration into the broader European market.

22 In March 2024, Montenegro hedged its US$750 million Eurobond by converting it into euros through a cross-currency swap, reducing the effective interest rate to 5.88 percent.

TABLE 5.1.

Yields on WB6 countries outstanding Eurobonds

	Coupon	Maturity	Yield in % (28 Mar 2023)	Yield in % (26 Sep 2023)	Yield in % (5 Mar 2024)	Yield in % (18 Sep 2024)	Spreads (basis points)
Albania	3.5	16/06/2027	6.5	5.5	4.5	4.4	235.8
	3.5	09/10/2025	6.1	5.5	4.4	4.3	119.9
Montenegro	2.785	16/12/2027	8.4	6.8	6.2	5.2	305.0
	3.375	21/04/2025	7.3	5.9	5.1	4.3	105.6
North Macedonia	6.96	13/03/2027	-	6.0	5.2	5.1	296.1
	2.75	18/01/2025	6.4	6.0	5.6	5.1	190.6
Serbia	3.125	15/05/2027	5.8	6.2	4.5	4.2	208.4
	6.25	26/05/2028	-	6.8	5.9	5.3	310.3
Bosnia & Herzegovina, Republic of Srpska	4.75	01/01/2026	7.0	7.1	7.9	6.6	341.9

Source: Source: https://www.boerse-frankfurt.de/en, accessed on 11 September 2024

Note: Spreads refer to spreads with yields on German bonds with the same or similar residual maturity

TABLE 5.2.

Credit ratings of the WB6 countries

	Moody's	Standard & Poor's	Fitch
Albania	B1 (stable)	BB- (stable)	—
Kosovo	—	—	BB-(stable)
BiH	B3 (stable)	B+ (stable)	—
Montenegro	B1 (stable)	B+ (stable)	—
North Macedonia	—	BB- (stable)	BB+ (stable)
Serbia	Ba2 (positive)	BB+ (positive)	BB+ (stable)

Box 5.1: Fiscal governance in the WB6 countries: Ensuring fiscal sustainability

Debt sustainability is crucial for economic stability, particularly in economies where fiscal policy has been more volatile and the options for monetary policy are limited. In the WB6 countries, maintaining sustainable debt levels is essential in preserving fiscal space for fostering growth and green transition, as well as for the capacity to respond to future shocks. The WB6 region has been grappling with the aftermath of multiple crises, which have increased volatility, public debt, and borrowing costs. Public debt for the WB6 countries reached its peak of 60.2 percent of GDP in 2020, with the average deficit close to 8 percent of GDP, which triggered action by the authorities to bring debt levels down. Fiscal rules and fiscal councils have since emerged as crucial tools to address challenges related to fiscal sustainability, and the volatility of discretionary fiscal policy. These instruments are designed to strengthen fiscal frameworks, promote debt sustainability, and increase the credibility of fiscal policy. In the WB6 countries, where government spending has fluctuated between procyclical and countercyclical patterns, these rules and councils should help promote a more stable and less discretionary fiscal policy.

As of summer 2024, all WB6 countries have introduced some form of fiscal rules, but only Serbia and North Macedonia have operational independent fiscal councils. The Serbian fiscal council has been in place for more than a decade, and is similar to the fiscal council in Bosnia and Herzegovina's entity of Republika Srpska, covering about 30 percent of the country's government finances. North Macedonia established a fiscal council in 2023, although the fiscal rules are only to be implemented from 2025. Montenegro has started setting up a fiscal council, though its members have not yet been appointed. Meanwhile, Albania has started considering establishing such a body.

A public perception survey conducted by the World Bank in 2023 revealed that public finance sustainability is the top concern among stakeholders in the WB6 countries.[23] Awareness of fiscal rules has improved since 2018, but only half of the respondents could correctly identify their country's fiscal rules. The trust in compliance with these rules has increased, with more than half of the participants expressing confidence in adherence. Most respondents find the authorities' reports on compliance with fiscal rules to be credible, and around two-thirds believe that they are effective. However, the survey also highlighted the need for greater transparency and the availability of public reports, with strong support for strengthening the independence of fiscal councils or establishing them where they do not yet exist.

Analysis using the European Commission's Fiscal Governance Compliance Methodology[24] shows that fiscal rules and councils in the WB6 countries could be further strengthened to support fiscal policy credibility and better comply with the acquis directive on budgetary frameworks. The qualitative comparisons of fiscal rules, councils, and medium-term fiscal frameworks of the WB6 countries to those in Central, Eastern, and Southeastern European (CESEE) EU member states reveal that fiscal rules

23 The online questionnaire by country disseminated via social media and through email communication in November 2023 had 109 respondents. A similar survey was carried out in December 2018.

24 Available at: https://economy-finance.ec.europa.eu/economic-research-and-databases/economic-databases/fiscal-governance-database_en

in the WB6 countries lack prudent fiscal accounting (due to cash accounting and off-budget spending that is not reported as part of the general government), strong monitoring systems for rule adherence, budgetary safety margins, automatic correction mechanisms, and proper economic cycle adjustments. While *de jure* WB6 fiscal councils are comparable in scope with those of CESEE, they underperform in actively promoting transparency, macroeconomic forecasting, and long-term sustainability assessments. Furthermore, they scarcely offer any normative recommendations on fiscal policy direction. In addition, WB6 medium-term budgetary frameworks score worse than those in CESEE. The primary shortcomings include weak links to annual budgets, the absence of correction mechanisms for discrepancies between the two, and the fact that the fiscal council does not prepare the macroeconomic and fiscal forecasts used in the medium-term plans but only reviews them. Overall, medium-term fiscal frameworks are merely indicative, can be easily altered, and fail to offer genuine guidance on fiscal policy behavior over the medium term.

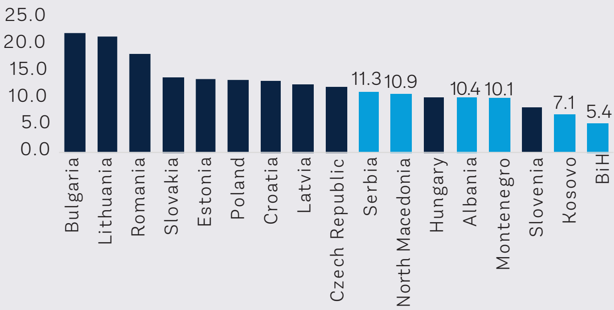
The current fiscal frameworks in the WB6 countries raise concerns about their adequacy in ensuring medium-term debt sustainability. Using deterministic and stochastic debt sustainability analysis, the assessment reveals that debt sustainability in the WB6 countries is at risk under scenarios such as unfavorable interest rate-growth differentials, lower structural primary balances, and financial stress. Only Serbia's debt-to-GDP ratio is projected to decline under all three scenarios, albeit remaining at higher levels. Economic shocks pose the greatest risk to complying with fiscal rules. These findings underscore the need for more effective fiscal instruments to guide the WB6 countries toward a more resilient and sustainable economic path.

The recent changes to the EU Fiscal Governance Framework, which entered into force in 2024, aim to strengthen debt sustainability and promote inclusive growth in member states. This highlights further the need for improved technical and analytical capabilities within the WB6 fiscal institutions in light of their EU accession ambitions. The WB6 economies generally have lower public debt levels and fiscal rules aligned with, or more stringent than, the EU's benchmarks. Thus, regarding overall public debt and budget deficit levels, adaptation to the new EU fiscal rules should present no significant challenge for these economies. However, the WB6 countries may face challenges in meeting multi-annual budgetary objectives due to insufficient infrastructure for long-term planning and projections. In addition, the updated EU Fiscal Governance Framework could negatively impact public investment in the WB6 countries, given their extensive investment needs. To secure fiscal space for a green agenda, the WB6 countries might consider reforming their tax systems to increase progressivity and revenue collection, ensuring that they meet fiscal targets without compromising essential public investments.

The WB6 countries should ideally have fiscal rules that do not restrict investment and growth to better accommodate economic convergence, accompanied by further institutional reforms. Strategic investment clauses and adherence to a 'golden rule' are current strategies to address investment needs. However, the efficacy of large investments hinges on improved institutional frameworks that guarantee competitive public procurement and transparency. Fiscal rules should also encourage counter-cyclical spending to manage macroeconomic imbalances, especially where monetary policy options are limited.

FIGURE 5.7.

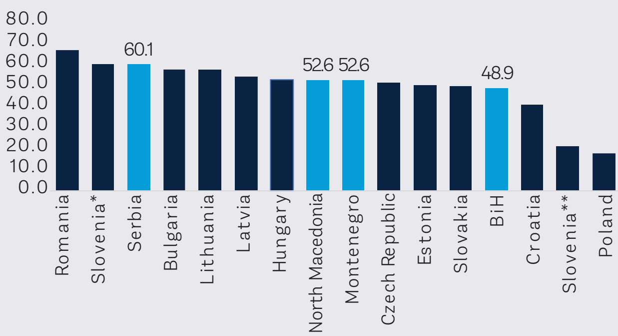
The Country Fiscal Rule Strength Index for the WB6 countries and the EU member states from CESEE



Note: The Fiscal Rule Strength Index measures the strength of fiscal rules based on the following variables: Statutory/legal base of the rule; room for setting or revising objectives; nature of the body in charge of rule monitoring and the correction mechanism; real-time monitoring; nature of the body in charge of monitoring the correction mechanism in case of deviation from the rule; independent body providing/endorsing macro/budgetary forecasts; correction mechanisms in case of deviation from the rule; resilience to shocks or events outside the control of the government. The fiscal rule in North Macedonia will become operational only in 2025 and in Serbia it has been delayed until 2029. The other fiscal rules refer to 2022.

FIGURE 5.8.

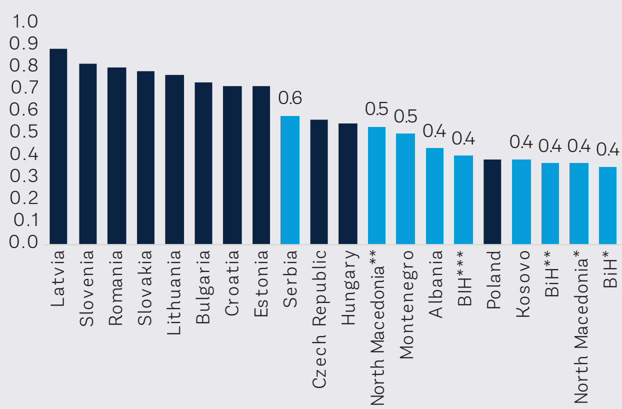
Scope Index for Independent Fiscal Institutions, in the WB6 countries and the EU member states from CESEE



Note: The Scope Index for Independent Fiscal Institutions measures the breadth of tasks covered by independent fiscal institutions based on the following variables: monitoring compliance with fiscal rules; macroeconomic forecasting; budgetary forecasting and policy costing; analysis of long-run sustainability of public finances; active promotion of fiscal transparency; and normative recommendations on fiscal policy. For Slovenia: * refers to the fiscal council, whereas ** refers to the Institute of Macroeconomic Analysis and Development. Fiscal councils in Montenegro and North Macedonia will become operational only in 2024. Other fiscal institutions refer to 2022. The fiscal council in BiH covers only Republika Srpska. Albania and Kosovo do not have fiscal councils.

FIGURE 5.9.

Medium-term budgetary framework index, in the WB6 countries and the EU member states from CESEE



Note: The MTBF index measures the quality of medium-term budgetary frameworks (MTBF) along five dimensions: coverage of the targets/ceilings included in the national medium-term fiscal plans; connectedness between targets/ceilings included in the national medium-term fiscal plans and the annual budgets; involvement of national parliament or use of coalition agreement in the preparations of national medium-term plans; involvement of independent fiscal institutions in the preparation of national medium-term fiscal plans; and the level of detail included in the national medium-term fiscal plans. For BiH: * refers to the MTBF that refers to the whole of Bosnia and Herzegovina, ** to the MTBF that refers to Federation BiH, and *** to the MTBF for Republika Srpska. For North Macedonia: * refers to the existing MTBF in North Macedonia, ** to the new MTBF, that will enter into force in 2025. Other MTBF's rules refer to 2022.

Source: DC-ECFIN for EU member states, World Bank staff calculations for WB6. World Bank and The Vienna Institute of International Economic Studies

6. Inflation is continuing to decelerate, but at a slower pace

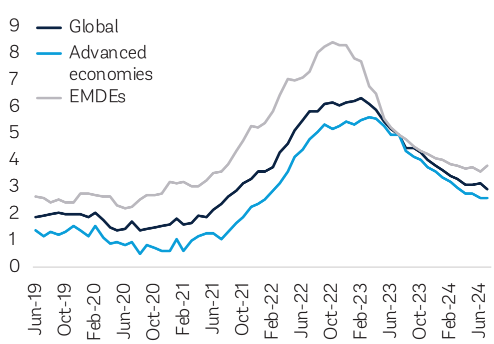
During 2024, global inflation has continued to decline, although it remains above target in many countries worldwide. Recent data suggest that the pace of the decline in inflation has slowed, indicating that post-pandemic disinflationary pressures—previously underpinned by declining commodity prices and the normalization of supply chains—are finally easing. Key drivers of the slowdown in the pace of consumer price disinflation include a partial rebound in energy prices, together with a notable deceleration in the rate of decline in core inflation[25] (Figure 6.1). During the first months of 2024, inflation declined more prominently in advanced economies than in EMDEs), where on average price pressures remained more elevated. As of July 2024, the global median headline inflation rate stood at 3 percent, down from its peak of 9.4 percent two years earlier. There are, however, disparities between advanced economies and EMDEs, with median headline inflation rates reaching 2.5 and 4.0 percent, respectively, by July.

The momentum of disinflation is slowing, reflecting different country and sectoral dynamics. In major advanced economies, including in the Euro area, disinflation in consumer goods prices appears to have bottomed out, while inflation in consumer services prices remains more elevated (Figure 6.2). Wage growth remains robust in many countries worldwide. Aggregate commodity prices have partially rebounded in the first months of 2024 after declining, on average, in 2023, partly reflecting heightened geopolitical tensions. The World Bank commodity price index was 4.1 percent higher in July 2024 than in the previous year.

FIGURE 6.1.

The pace of decline in core inflation has slowed this year

Median global core inflation (percent, yoy)

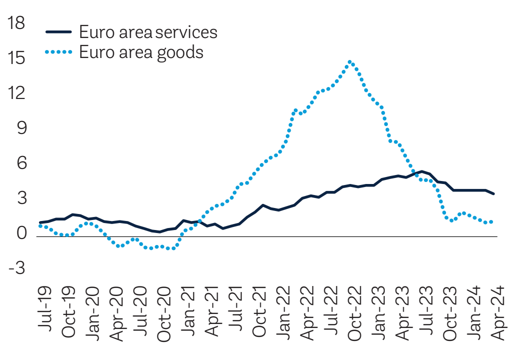


Source: World Bank Global Economic Prospects.

FIGURE 6.2.

In the Euro area service inflation remains elevated

Goods and services inflation (yoy, percent)



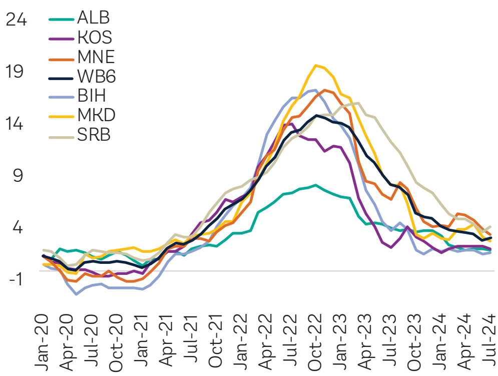
Source: Eurostat; World Bank Global Economic Prospects.

25 Core inflation focuses on the underlying and persistent trends in inflation by excluding transitory price changes such as prices that are more volatile, including food and energy, most affected by seasonal factors or temporary supply conditions.

FIGURE 6.3.

Inflation heterogeneity among countries persists

WB6 CPI inflation, in percent

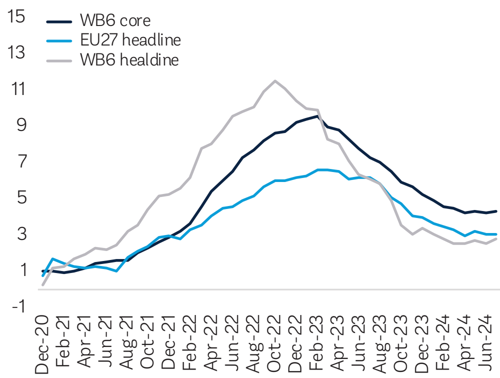


Source: Statistical offices and World Bank staff calculations.

FIGURE 6.4.

WB6 core inflation remains high

Core inflation, in percent



Source: Statistical offices and World Bank staff calculations.

In line with international trends, in 2024 WB6 countries have experienced a reduction in inflation, though the pace of this decrease has been more gradual than in the preceding year (Figure 6.3)**.** At the regional level, consumer price inflation eased from 4.4 percent at the outset of the year to 3.2 percent by July. By July 2024, Serbia and Montenegro recorded the highest headline inflation rates, at 4.3 and 3.5 percent, respectively, above the regional average. Conversely, North Macedonia (3 percent), Kosovo (2.2 percent), Albania (2.0 percent), and Bosnia and Herzegovina (1.8 percent) reported inflation rates below the regional mean (Figure 6.3). The continued downward inflationary trend is partially attributable to the normalization of international commodity prices. Given that food prices account for a large share of the consumption basket in WB6 countries, the deceleration in food prices has been a key factor in the overall decline of inflation rates. Recent extreme weather events, however, may lead to renewed pressure on food prices during the remainder of 2024. Energy prices have also decreased, mirroring the general trend of headline inflation, albeit exhibiting greater volatility during the first half of 2024.

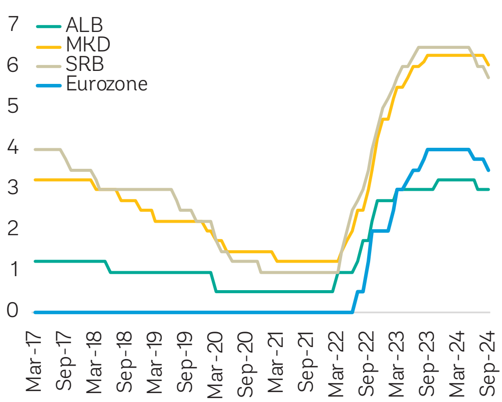
Core inflation continues to outpace headline inflation, underscoring the impact of price pressures from domestic factors. Although core inflation declined from 5.0 to 4.4 percent between January and July (Figure 6.4), it remains high in several countries in the region. As of July 2024, North Macedonia recorded the highest core inflation rate at 5.7 percent, followed by Serbia (5.1 percent) and Montenegro (5 percent). These data indicate that domestic price pressures remain strong, and inflation remains persistent. Pressures arising from wage and production costs are high. Moving forward, monitoring and containing excessive wage growth and ensuring that it moves in line with productivity will be central to managing inflation pressures and expectations. In previous years, rising minimum wages and tight labor markets led to rapid wage increases, which then spilled over into economy-wide wage increases. To avoid the risk of further inflation persistency and tame inflation expectations it will be important for policy makers to contain excessive wage growth and ensure that revisions to minimum and public sector wages is informed by adequate analysis of the labor markets.

Declining inflation rates led central banks in countries with independent monetary policies to embark on gradual monetary policy easing (Figure 6.5). In September, the National Bank of Serbia observed that yoy inflation has been hovering within the target tolerance band (3 ± 1.5 percent) since May, with forecasts suggesting a steady convergence to the target midpoint. As a result, it decided to reduce the policy rate by 25 basis points in both July and September. Likewise, in July the Bank of Albania, recognizing that price pressures were easing, reduced its policy rate by 25 basis points to the level of 3 percent. Meanwhile, in early September the National Bank of North Macedonia decided to reduce its policy rate by 25 basis points to the level of 6.05 percent, noting that the latest conditions in the economy enable the start of gradual prudent normalization of the monetary policy. Moving forward, central banks will need to carefully calibrate their monetary policy actions to take into account evolving price dynamics and risks to the financial sector. The central banks of Serbia and North Macedonia have (de facto) continued to stabilize their exchange rates, while the Bank of Albania has opted for greater flexibility. The appreciation of the Albanian lek against the US dollar in 2024 has persisted, albeit at a slower pace (Figure 6.6).

FIGURE 6.5.

Central banks have cautiously initiated an easing of monetary policy...

Policy rates, in percent

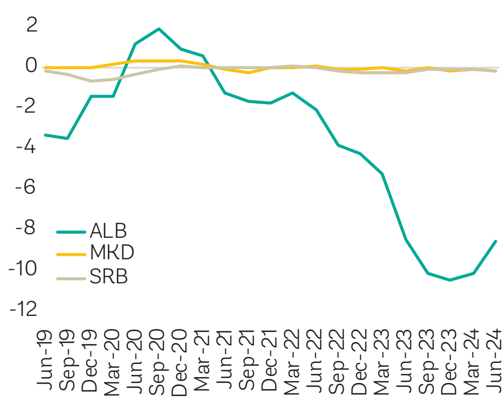


Source: National central banks and World Bank staff calculations.

FIGURE 6.6.

...continuing to allow for different degrees of exchange rate flexibility

Exchange rate changes, in percent



Source: National central banks and World Bank staff calculations

7. Financial stability remains resilient amid uncertainty, helping to support credit growth

The financial system across the WB6 countries have remained stable and resilient, despite a weak external environment. During 2023 and up to March 2024, asset quality was mostly stable, with the exception of Albania, and Bosnia and Herzegovina, where non-performing loans (NPLs) continued a slow downward trend; average NPLs represented 3.7 percent of total loans as of March 2024. While capital buffers strengthened during 2023, by March 2024 they were at the same comfortable levels as in December 2023, with an average capital adequacy ratio of 19.1 percent.

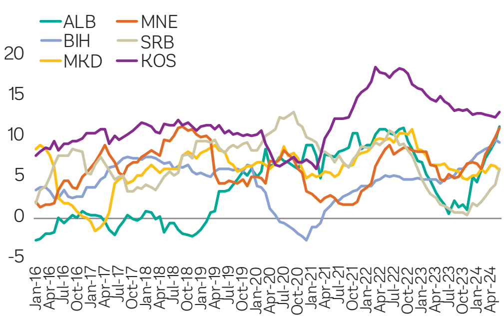
After slowing in 2023, credit growth regained momentum in the first half of 2024 (Figure 7.1). Average credit growth steadily increased in H1 2024, following the deceleration observed in 2023, with growth reaching 9.4 percent in June 2024 (from 6.5 percent in December 2023). In particular, credit growth increased in Albania (13 percent as of July 2024),[26] driven by an overall pick-up in business activity and an easing of credit conditions, and Montenegro.. Kosovo continued to post the highest level of loan growth among the WB6 countries (13.6 percent as of July 2024).

Corporate credit growth accelerated, narrowing the gap with household loan growth recorded in 2023. The average corporate loan growth increased steadily back toward 2022 levels, rising from an average of 4.3 percent in 2023 to 5.6 percent between January and June 2024 (Figure 7.2). By June, corporate credit growth in WB6 reached 7.9 percent. Albania, followed by Kosovo, Bosnia and Herzegovina and Montenegro, led the acceleration. Household loan growth, which suffered a less pronounced deceleration, also recovered, rising to 9.7 percent between January and June 2024, and reaching 10.9 percent by June 2024, led in most cases by real estate exposures.

FIGURE 7.1.

Credit growth rebounded in H1 2024

Change in nonfinancial private sector credit outstanding, percent, yoy

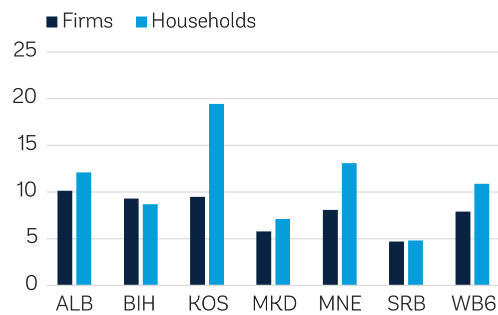


Sources: IMF International Financial Statistics; central banks.

FIGURE 7.2.

Corporate credit growth resumed its pace narrowing the gap with household growth

Change in credit outstanding June 2024, percent, yoy



Source: Central banks.

26 Credit growth rates were affected by the appreciation of the Albanian lek that occurred during 2023.

The credit supply and demand gap in WB6 countries, persistent over the past couple of years, is diminishing with the tightening in credit supply expected to gradually ease. According to the results of the latest Central, Eastern and Southeastern Europe (CESEE) Bank Lending Survey,[27] between September 2023 and March 2024, credit supply improved slightly, albeit remaining tight, while credit demand remained resilient, driven by inventories, working capital, and also consumer credit. Going forward, the tightening of credit supply, triggered by the macroeconomic and financial environment, appears to be ending, boosted by a more benign outlook, while demand is expected to remain positive. Fixed investments, inventory and working capital on the corporate side, as well as real estate and consumer credit, are expected to drive credit demand. Overall, foreign banks operating in the WB6 region see the market potential as mostly strong, although exposures are not expected to expand over the next six months.

With only marginal increments during early 2024, NPLs reached 3.7 percent of total loans by March 2024 (Figure 7.3). Asset quality improvements mostly stabilized in 2024, after decelerating in 2023, particularly in jurisdictions with limited credit growth (on average, NPLs decreased by 0.2 pp between December 2022 and 2023). Albeit at higher levels than the pre-global financial crisis period, NPLs have decreased significantly over the years, with Albania, and Bosnia and Herzegovina at the lowest level recorded since 2011 (4.6 and 3.6 percent, respectively, as of March 2024). When looking at comparisons with the WB6 average by March, NPLs remain higher than the regional average in Albania and Montenegro as of March 2024 (4.6 and 5.8 percent, respectively). Moreover, while the volume of stage 2[28] loans slightly declined in the region (CEE), it is still higher than the pre-pandemic levels, and a sizable gap between stage 2 and stage 3 volume of loans is still present, the slight downward trend notwithstanding.[29] The CESEE Bank Lending Survey also indicates that banks expect NPLs to remain stable throughout the remaining of 2024.[30]

FIGURE 7.3.

Asset quality showed limited movement

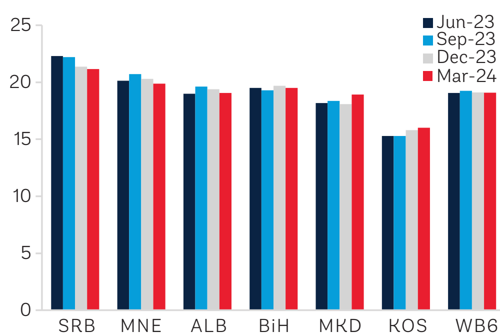
NPLs as a percentage of total loans

Sources: IMF Financial Soundness Indicators; central banks.

FIGURE 7.4.

Capital levels remained relatively stable

Capital adequacy ratios



Sources: IMF Financial Soundness Indicators; central banks.

27 EIB Central, Eastern and Southeastern Europe Bank Lending Survey, H12024.
28 Stage 2 assets, in the context of International Financial Reporting Standard (IFRS 9), are financial instruments that have deteriorated significantly in credit quality since initial recognition but that offer no objective evidence of a credit loss event. Assets are classified stage 3 if the loan's credit risk increases to the point where it is considered credit impaired. The IFRS is published by the International Accounting Standards Board. IFRS 9 specifies how an entity should classify and measure financial assets, financial liabilities, and some contracts to buy and sell nonfinancial items.
29 NPL Monitor H1 2024.
30 EIB Central, Eastern and Southeastern Europe (CESEE) Bank Lending Survey, H1 2024.

Capital adequacy remained at comfortable levels in the WB6 countries supported by sustained profitability, while liquidity remained broadly stable. As of March 2024, the regional banks' capital adequacy ratio averaged 19.1 percent, far above the regulatory minimum. Average capital levels have been relatively stable since June 2023 (19.1 percent) and are mostly comprised of Tier 1 capital. At 16 percent as of March 2024, Kosovo holds the lowest capital levels in the region, although still well above the regulatory minimum of 9 percent. The ratio of liquid assets to total assets averaged 26.8 percent in March 2024, with the lowest liquidity ratio seen in North Macedonia (18.4 percent) and the highest in Serbia (41.7 percent).

High interest rates continued to boost banks' lending margins and profitability. Profitability, as measured by return on assets, has remained above 2 percent since March 2023 (2.5 percent as of March 2024), supported by the still high interest rates, which can boost net interest margins. Recent downward movements in lending rates may put some pressure on interest margins. As of March 2024, Serbian banks presented the highest profitability (3.1 percent) in the region, followed by Montenegro at 2.6 percent. Albania, despite a steady increase since September 2022, continued to have the lowest return on assets (2.2 percent as of March 2024).

While financial systems remain resilient, continuous surveillance is required. With current economic growth expectations, still high interest rates, and a positive credit growth trend, overall, banks' balance sheets are not expected to suffer significant additional pressures over the next few months. This situation notwithstanding, the persistent geopolitical tensions, and sluggish growth and labor markets in the EU, coupled with the pressures of high interest rates faced by borrowers, underscore the need for continuous monitoring of financial vulnerabilities and risks, including through stress testing. Moreover, authorities should remain alert to potential deteriorations in asset quality. In view of this, the effective use of macroprudential tools, including countercyclical capital buffers, loan-to-value and debt-to-income ratios, can help mitigate the impact of economic shocks and downturns.

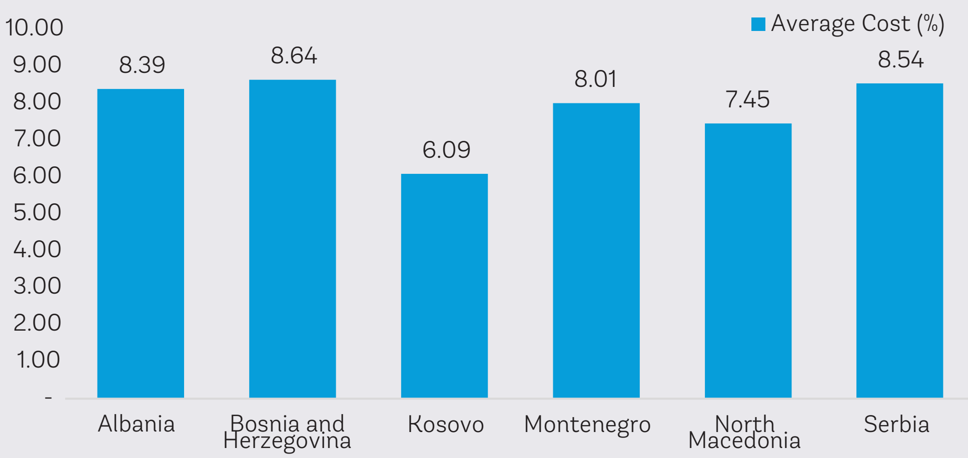
Financial stability will be critical to ensure sustainable growth in the WB6. Several countries have embarked on reforms to harmonize their frameworks and legislations with EU standards, including in the area of digital payments and transactions. A more digitalized and modern payment system could play a key role in supporting financial inclusion, trade and business activity more broadly. Moreover, it could play a critical role in reducing informal transaction and facilitating remittances flow (see Box 7.1).

Box 7.1: Migration and digitalization: How payment systems act as a lever

For the WB6 countries, aspiring to intertwine more closely with each other and with the EU, reducing the cost of cross-border payment services is crucial for economic development. One key aspect of such integration is the membership of the WB6 countries in the Single European Payments Area (SEPA). SEPA is an initiative that facilitates bank transfers denominated in euro by treating all euro payments within its geographic scope equally, regardless of whether they are domestic or cross-border. Digital payments can reduce the informal economy by making transactions traceable and transparent, aiding tax collection, and reducing corruption and crime. Digitalizing payments can help provide access to financial services for underserved populations, and close gender and urban-rural gaps. In the WB6 countries, digital payments could help to provide financial access to an additional 1.9 million people.[31]

FIGURE 7.5.

Average cost of sending US$200 in remittances to WB6 countries (Q2, 2024) - percent



Source: World Bank staff calculations.

Modern systems facilitate remittances, offering low-cost solutions for migrants to send money home, potentially saving the WB6 countries about €500 million in remittance costs annually. According to data on remittances collected by the World Bank, the average cost of sending remittances to WB6 countries is 7.9 percent of the transaction value, ranging from 6.1 percent in Kosovo to 8.6 percent in Bosnia and Herzegovina. This is more than twice the SDG target of 3 percent,[32] despite being on average 7 percent cheaper than non-digital services. SEPA membership can bring significant reduction in costs of cross-border transfers. Currently, based on the costs and number of transfers observed with the EU, the WB6 countries could see between a 9- and 15-fold decrease in fees when receiving a €200 transfer.

31 World Bank staff calculations based on the World Bank Global Findex 2021 data.

32 The STG target is to reduce to less than 3 percent the transaction costs of migrant remittances and eliminate remittance corridors with costs higher than 5 percent.

Modernizing payment systems is also critical to lowering business-to-business cross-border transfer costs. Digital payments can reduce transaction fees for businesses, making them more competitive and simplifying reconciliation processes and cashflow management. The World Bank has been monitoring business-to-business cross-border transfer costs in euros for micro, small and medium enterprises (MSMEs) in the WB6 countries and in selected EU countries to set benchmarks and inform program actions. The data collected so far reveal significant cost disparities between WB6 countries and the EU. For €5,000 transfers, costs within the WB6 are, on average, 10 times higher than within the EU, while for €20,000 transfers they are 17 times higher. Transfers from the EU to the WB6 are also more expensive, costing about 12 times more for €5,000 transfers and 15 times more for €20,000 transfers compared with intra-EU transfers. Similarly, sending €5,000 from the WB6 to the EU costs 10 times more than within the EU, and sending €20,000 costs 17 times more. After joining SEPA, based on the costs observed currently within the EU, WB6 firms could see between an 8- and 15-fold decrease in fees when sending a €5,000 transfer.

Thus far, the WB6 countries have made significant progress by adopting EU-consistent legislation and developing retail payment infrastructures to enhance cross-border payments and become part of the SEPA. To become eligible for SEPA membership, the WB6 countries have been working to ensure that their payment systems, and laws and regulations governing payment services, banking, anti-money laundering and counter-terrorism financing (AML/CFT), are compliant with the EU legislation. This also involves ensuring that there are no legal, competition, tax, regulatory or other significant obstacles or impediments to ensuring an appropriate level playing field for all payment service providers in the SEPA area. Albania, Montenegro, and North Macedonia have already finalized the transposition efforts and have thus submitted their formal applications for SEPA membership (extension of the geographical scope) with the rest of the countries in the region soon to follow suit. Serbia and Kosovo are expected to submit their applications soon, while Bosnia and Herzegovina is still working on the necessary legal framework. Once the WB6 countries have been accepted into SEPA, individual payment service providers can apply to join the individual European Payments Council payment schemes and start processing SEPA payments. Alignment with these requirements, paired with the modernization of infrastructure, will facilitate the participation of WB6 countries in SEPA, thus improving market access and fostering economic integration within the WB6 region and with the EU.

8. The external deficit has been widening amid continued external pressures

Western Balkan countries are navigating increasing pressures on their external sectors amid a challenging external environment. The widening regional CAD is partly driven by sluggish growth in the EU, particularly in Germany, a key trading partner. Therefore, weakened foreign demand for exports, coupled with elevated energy costs and sluggish labor markets in the EU impacting remittance inflows, has led to a deterioration in the WB6 current account. Moreover, global uncertainties, such as continued geopolitical tensions, keep risks elevated. Although oil prices have moderated slightly compared with their peak in 2023 due to weaker demand from China, they remain high, keeping import costs elevated and maintaining pressure on the external accounts. Nevertheless, at the regional level, 95 percent of these deficits are financed through net FDI inflows, and most countries in the region experienced an increase in foreign exchange reserves in the period June–July 2024.

Following an improvement in 2023, the external position of the WB6 countries deteriorated in 2024. This correction occurred after a significant narrowing of the CAD in 2023 by 3.6 percentage points compared to the year before.[33] Specifically, the CAD is expected to deteriorate from 4.1 percent of GDP in 2023 to an estimated 5.6 percent in 2024, which is still significantly below the average over the past five years (Figure 8.1). Four countries—Albania, North Macedonia, Serbia, and Montenegro—are projected to experience a more pronounced current account widening in 2024, on the order of 3.0, 2.5, 1.5 and 1.2 percent of GDP, respectively (Figure 8.2). In Albania, net services exports (in GDP terms) rather than movements in the merchandise balance account for the deterioration of the external position. In Serbia, this development is being driven by a pick-up in private consumption due to real wage growth, tightening labor markets, and credit growth, which caused stronger import growth and a decline in merchandise exports (in GDP terms) due to weaker foreign demand. In both countries, however, the correction in the external account represents a partial reversal, as it comes on the back of an impressive narrowing of the current account in 2023.

Across most WB6 countries, both merchandise exports and imports are expected to exhibit a downward adjustment in GDP terms. As a result, the WB6 merchandise trade deficit is expected to narrow at the margin, by 0.3 percentage points compared with 2023, to 26.5 percent of GDP in 2024 (Figure 8.3). With the region witnessing a difficult landscape considering that EU growth is expected to remain below 1 percent in 2024, this has led to weaker exports (in GDP terms) and a simultaneous decline in the region's demand for imports of intermediate inputs. The import of consumption goods, however, remains robust due to private consumption contributing most to real GDP growth in most WB6 countries.

In 2024, the sharp rise in net services export inflows seen since 2021 is expected to come to an end. These inflows represent predominantly net tourism inflows and diaspora travel home, although signs of diversification are also taking place, particularly into Information Technology (IT) services. Overall, WB6 countries appear to have reached a ceiling of between 11.5 and 12.5 percent of GDP over the past three years, which represents more than a doubling of net service exports

33 These are simple averages across the six countries.

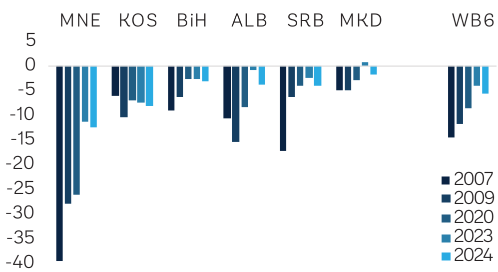
compared with roughly 15 years ago. Specifically, net services exports are set to stabilize in 2024 at 11.6 percent of GDP compared to 11.5 percent of GDP in 2022 (Figure 8.4). In Albania, Montenegro, and Kosovo, which have the highest double-digit net services exports in GDP terms, there have been sizable gains in tourism inflows and diaspora travel home since the pandemic, overshooting peaks from pre-pandemic years. All three countries show signs of stabilization at around 24 percent of GDP in Montenegro, 16 percent in Kosovo, and 11-12 percent in Albania. At the same time, services exports are experiencing a diversification, with IT and other business services gaining more prominence in countries such as Kosovo, North Macedonia, and Serbia.

Similar to net services exports, remittances are also expected to stagnate in 2024, in GDP terms. This may be the result of some signs of reverse migration combined with a softening of labor markets across the Euro area. As a result, almost all WB6 countries are set to experience a mild deterioration in remittances from a peak of close to 7 percent of GDP in 2022 to 6.1 percent in 2024. The largest decline in remittances, amounting to 0.6 and 0.3 percentage points, is expected in Kosovo and Serbia, respectively. In Kosovo, smaller scale sources of primary income—from temporary workers abroad—increased significantly, reflecting the impact of visa liberalization that started in 2024.

FIGURE 8.1.

The regional current account deficit has been widening in 2024...

Percentage of GDP



Source: Regional central banks, World Bank staff calculations

FIGURE 8.2.

...with Albania, North Macedonia and Serbia accounting for the bulk of the external adjustment in 2024

Percentage of GDP

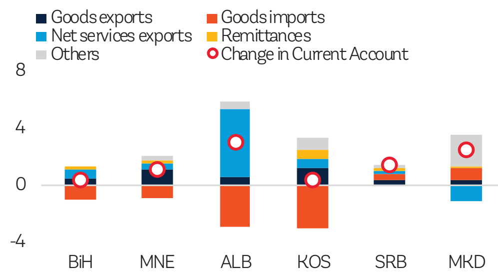
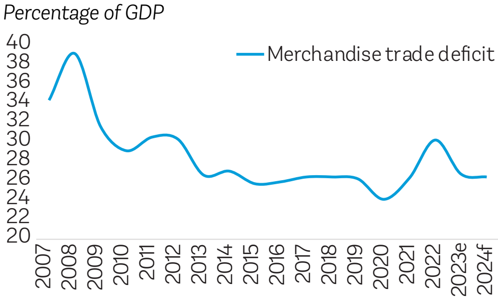


FIGURE 8.3.

The merchandise trade deficit has returned to the five-year average seen prior to the pandemic, after the deterioration in 2022...

Percentage of GDP

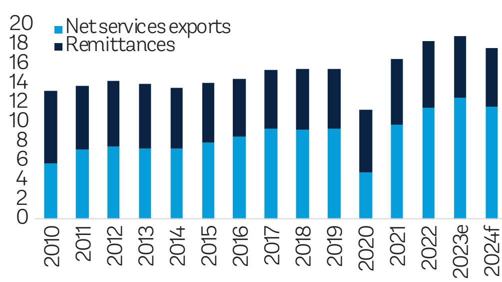


Source: Regional central banks, World Bank staff calculations.

FIGURE 8.4.

...while remittances and net services exports have stagnated

Percentage of GDP



At the regional level the CAD is projected to be 95 percent financed by net FDI inflows in 2024 (Figure 8.5)**.** Net FDI inflows are projected to total 5.3 percent of GDP in 2024, falling short of the external deficit by 0.3 percent of GDP. However, this masks more heterogeneous developments at the country level. In countries such as Albania, Bosnia and Herzegovina, North Macedonia, and Serbia net FDI inflows fully finance, and in some cases exceed, the external deficit. In other countries, such as Kosovo and Montenegro, FDI is only expected to finance between 65 and 69 percent of their external deficits in 2024. These inflows are predominantly in the form of equity investments and reinvestments, with a smaller proportion in inter-company loans (Figure 8.5).

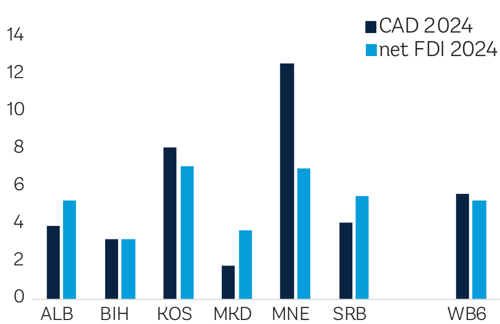
Total external debt appears to have continued to decline in 2024 to around 70.2 percent of GDP. This outcome is the result of smaller total external debt in Albania, Bosnia and Herzegovina, and Serbia, while Kosovo and North Macedonia are expected to see a rise in total external debt. In Montenegro, external public debt (Figure 8.6) is likely to rise by 6.5 percentage points in 2024 to close to 59 percent of GDP as the fiscal balance is expected to shift to a deficit of around 3 percent of GDP in 2024, from a surplus of 0.6 percent of GDP, and as refinancing shifts to external sources. In Kosovo, higher external public debt is projected to increase by 0.6 percentage point to 7.8 percent of GDP to finance the higher fiscal deficit. In North Macedonia, meanwhile, higher private external debt accounts predominantly for the rise in total external debt. In Bosnia and Herzegovina, Montenegro, and Serbia expected higher external public and publicly guaranteed debt levels in 2024 are projected to be offset by a decline in private external debt.

Most countries in the region have been witnessing a build-up in foreign exchange reserves over 2024. In Serbia, foreign exchange (FX) reserves reached 7.2 months of imports of goods and services by Q2 of 2024. Other countries experiencing a rise in foreign exchange reserves include Bosnia and Herzegovina, Kosovo and Montenegro. Meanwhile, Albania and North Macedonia saw falling foreign exchange reserves. Nevertheless, in Albania FX reserves still totaled 5.6 months of imports in May 2024, whereas in North Macedonia FX reserves amounted to 4.3 months of imports, with both countries exceeding the standard metric of 3 months of imports.

FIGURE 8.5.

At the regional level, FDI inflows almost fully finance the current account deficit in 2024, although country differences are significant...

Current account deficit and net FDI, Percentage of GDP

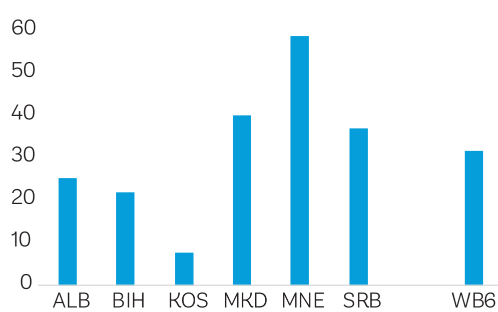


Source: Source: Regional central banks, World Bank staff calculations.

FIGURE 8.6.

...with the regional PPG external debt level projected to remain largely unchanged in 2024

PPG external debt, Percentage of GDP



9. The growth outlook: diverging growth drivers

Following a slow start in 2024, gradual growth recovery in the euro area is projected to continue through 2025-2026, supporting economic activity in the WB6 region. Euro area growth expanded by 0.6 percent year-over-year in the second quarter, up from 0.5 percent in the first quarter, driven by exports and, to a lesser extent, consumption expenditures. While manufacturing PMIs have remained in contractionary territory for two consecutive years, services PMIs have consistently stayed above 50 since February 2024. The European Central Bank cut the deposit interest rate for the second time this year by 25 basis points to 3.5 percent, as inflation eased to 2.2 percent in August. Growth in the euro area is anticipated to gradually strengthen in 2025-2026, driven by increasing momentum in export and investment activities, supported by more accommodative monetary policy and the effective deployment of EU funds.

Growth in the WB6 region is expected to increase slightly over the projection period. Compared with the Spring RER projections, in 2024, the expected increase in growth for the WB6 region will be 0.1 pp. This revision is driven primarily by an increase in projected growth for Serbia (+0.3 pp), Bosnia and Herzegovina (+0.2 pp), and Kosovo (+0.1 pp). On the other hand, there was a significant decrease in expected growth in North Macedonia in 2024 (-0.7 pp compared with Spring RER projections). Similarly, in 2025, growth is expected to be 0.2 pp higher compared with previous Spring RER projections, driven by an improved outlook for Montenegro and Serbia. Bosnia and Herzegovina, and North Macedonia will have somewhat lower growth in 2025 than previously projected (Table 9.1).

There is also a change in the drivers of growth. Investment and exports of goods and services will make a more significant contribution to growth in 2024, while in outer years (2025–26) consumption will contribute more to WB6 growth than was previously projected. Part of this higher consumption (and, to a lesser extent, investment) is expected to be reflected in higher imports. Therefore, the negative contribution to growth from imports will be higher by 1.2 pp and 0.3 pp in 2024 and 2025, respectively (Figure 9.1).

TABLE 9.1.

Real GDP growth in WB6 countries, percent

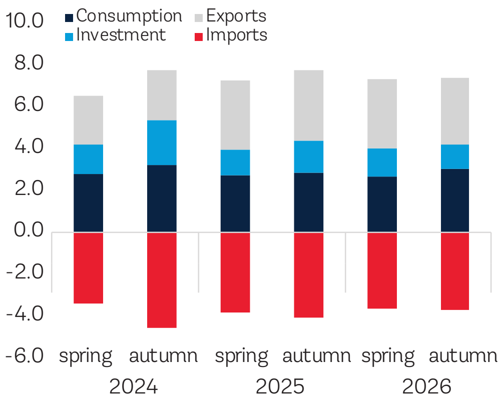
	2024		2025		2026	
	Spring edition	Autumn edition	Spring edition	Autumn edition	Spring edition	Autumn edition
Albania	3.3	3.3	3.4	3.4	3.5	3.4
Bosnia and Herzegovina	2.6	2.8	3.3	3.2	4.0	3.9
Kosovo	3.7	3.8	3.9	3.9	3.9	4.0
North Macedonia	2.5	1.8	2.9	2.5	3.0	3.0
Montenegro	3.4	3.4	2.8	3.5	3.0	3.2
Serbia	3.5	3.8	3.8	4.2	4.0	4.0
WB6	**3.2**	**3.3**	**3.5**	**3.7**	**3.8**	**3.7**

Source: World Bank staff estimates.

Within the WB6 region there is also a more pronounced division between countries where faster recovery of consumption and investment supports growth, namely Kosovo, Montenegro and Serbia, and those such as Bosnia and Herzegovina and North Macedonia, where lower external demand and domestic fiscal pressures cause slower growth.

FIGURE 9.1.

Contribution to growth, spring vs. autumn projections



Source: National statistical offices and World Bank staff calculations

The Economic Sentiment Indicator (ESI) remains strong in the WB6 countries.[34] The ESI has increased since February and remains well above its historical averages (Figure 9.2). This has been driven by mounting confidence in services and retail trade and, to a lesser extent, in industry. Confidence in construction has been recovering only since July, while consumer confidence has continued to decline. Among the surveyed WB6 countries, ESI performance is particularly strong in Montenegro and Albania, and slightly less so in Serbia, while in North Macedonia is has started to decline since August.

There are some additional factors that could both increase or decrease projected growth. First, there are additional opportunities for financing infrastructure (i.e., the new Growth Plan for the Western Balkans), as well as to promote private sector growth (such as through the payments initiative related to the Single Euro Payment Area). Second, growth in some WB6 countries could benefit from increases in FDI (such as, for example, investments in the Serbian automotive sector). Meanwhile, there are further risks to the outlook, mainly stemming from: (i) weak EU growth and trade impacting trade and remittances; (ii) domestic factors, including continued outmigration, national elections, etc.; and (iii) the impact of the recent drought.

Inflation is expected to continue its downward path, in line with international trends. The latest projections indicate that in 2024 inflation will reach 3.4 percent instead of previously projected 3.9 percent. Lower expected inflation of imported goods is the main contributor to this slowdown, given that domestic demand will increase even faster than previously projected. However, as previously mentioned, the recent drought may have an inflationary impact on food prices (both in 2024 and 2025), and on the overall CPI thereafter.

The structural reform agenda remains critical in order to retain the growth momentum toward more sustainable improvements in living standards and closer economic integration. Priority reforms are those that: (i) capitalize and build on WB6 countries' human capital potential; (ii) support firm to grow and increase their productivity; (iii) leverage higher connectivity through increased competition and high quality foreign investment. In Kosovo and Bosnia and Herzegovina, the focus should be on labor market and social protection reforms that would help increase labor force participation, including higher participation of women in labor markets. Expanding childcare services would not only improve labor market opportunities for women but also enhance children's school readiness through better early childhood education. In

34 The Economic Sentiment Indicator (ESI) is a composite indicator combining judgements and attitudes of businesses (in industry, construction, retail trade, and services) and consumers by means of a weighted aggregation of standardized input series. It is published monthly by DG EFIN: https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/business-and-consumer-surveys_en

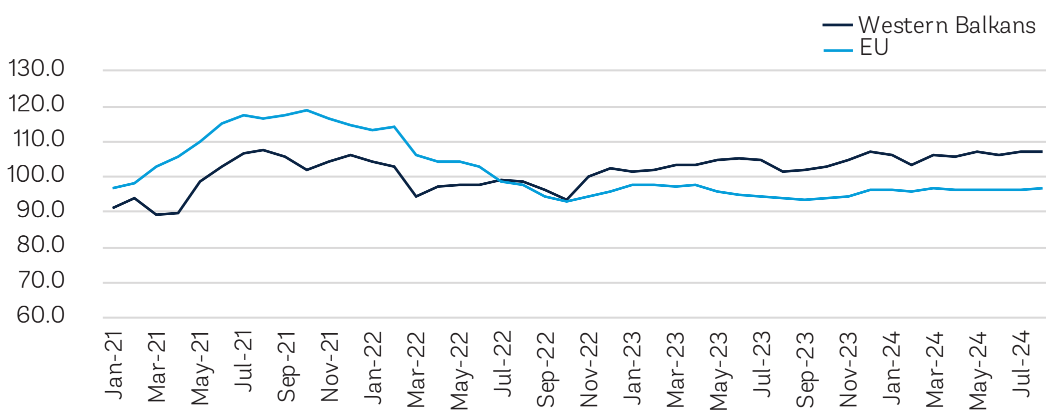
Bosnia and Herzegovina, efforts are needed to advance with digitalization and unification of the main databases relevant for businesses. In this context, sound macro-fiscal management is a key prerequisite for WB6 countries' macroeconomic stability and growth over the medium and longer term. While Montenegro and Albania need to proceed with proposed revenue mobilization measures, Serbia needs to contain the growth of the fiscal deficit by carefully managing the pressures deriving from the capital budget.

Transition to net zero will require substantial investments, predominantly to be made by the private sector, with governments playing a complementary role (see Box 9.2). Most of the investments would be channeled into decarbonizing transport and scaling up solar, wind, and hydro generation capacities. The EU pre-accession funds can supplement the limited public resources in the WB6 countries, but these funds can cover only a part of the total investment needs described. The rest should come from the private sector through different mechanisms. Investments will need to be accompanied by regulatory reforms, including but not limited to: (i) adoption of the carbon price; (ii) harmonization of the power sector's legal and regulatory frameworks for the integration into the pan-European electricity market; (iii) investing in training and reskilling of existing labor; (iv) structural changes in the education system over the longer term; and (v) increased coverage and adequacy of social protection and health systems.

FIGURE 9.2.

Economic Sentiment Index 2021–2024

Average 2000–2023=100



Source: European Commission. Note: Simple average for the WB6 countries.

Box 9.1: Escaping the middle-income trap: Insights for the Western Balkans from the new World Development Report

Since the term "middle-income trap" was first coined 20 years ago, there has been concern that the shift to the policies needed to enable growth in a middle-income country (MIC) from those needed to enable growth as a low-income country (LIC), is not easy.[35] Globally, 27 countries have transitioned from middle- to high-income since 1990. Of these, 13 have been EU member states, including 11 countries that were World Bank clients in the 1990s. What has become known as the EU "convergence machine"—through institutional change, trade, investment, and flow of capital and managerial expertise from richer to poorer countries—has helped all its member states to overcome the middle-income trap.[36] The remaining countries include economies with very substantial natural resource endowments, large dependence on tourism, and the economies of the Republic of Korea and Uruguay. Countries that neither have large natural resource endowments nor implemented significant structural reforms have seen a slower pace of convergence to high income status.

Having undergone three decades of transition from a planned to a market economy, Europe and Central Asia (ECA) is a solidly middle-income region, with ambitions to escape the middle-income trap and converge to high income. In ECA, MICs account for 75 percent of regional economic activity, 85 percent of the region's population, nearly 90 percent of the people living in poverty, and nearly 90 percent of CO_2 emissions. All the WB6 economies are classified as MICs.

The median ECA MIC has an income per capita of about one-third that of the United States, up from one-fifth for the average MIC around the world. The chances of their transitioning to high income status have deteriorated in the context of slower global growth and weaker growth potential, fragmented global value chains, increased geopolitical tensions, and rising populism. Even without these headwinds, MICs face long odds with respect to becoming HICs and escaping the middle-income trap. The need to achieve growth while also decarbonizing adds new challenges to today's MIC policy makers compared with those that went before them.

A new World Development Report (WDR) focusing on how countries can escape the middle-income trap offers new insights, including a "Schumpeterian lens" to development, with an emphasis on the extent to which institutions encourage (or discourage) creative destruction.[37] Modern Schumpeterian growth theory brings new ideas about the role of creative destruction in driving economic growth. A key stylized fact of this theory is that technological progress must continue through new innovations. But innovation does not take place in a vacuum, as firms or individuals incur costs and take risks to innovate. So, to fully understand the underlying drivers of economic development, it is necessary to connect the macroeconomic structure of growth with microeconomic determinants such as the incentives, policies, and organizations that interact with the

35 Gill, I. and H. Kharas. 2007. *An East Asian Renaissance: Ideas for Economic Growth,* Washington, DC: World Bank.
36 Gill, I., and M. Raiser. 2012. *Golden Growth: Restoring the Lustre of the European Economic Model*. Europe and Central Asia Studies, Washington, DC: World Bank.
37 https://www.worldbank.org/en/publication/wdr2024.

growth process—including how winners, losers, and rents associated with innovations are allocated and awarded.

The Schumpeterian process of creative destruction can be viewed through three overlapping dimensions, as follows:

- **Creation**. The key extent to which governments facilitate or blunt the natural force of *creation* in the entry of new businesses, new innovations, and innovative ideas both at home and from abroad.
- **Preservation**. The extent to which governments allow for the *preservation* of existing players to function as a blocking force either by protecting incumbents or allowing incumbents to impede market competition.
- **Destruction**. The necessary process that allows for scarce resources to be reallocated to their most efficient use, and often takes place the most during economic crises, yet (for myriad reasons) governments often limit the extent to which they allow the process of destruction to take place.

Empirical work on the economics of creative destruction has highlighted the economy-wide risks associated with a lack of Schumpeterian institutions. These risks include increased market concentration, higher markups and profit margins, lower labor shares of output, a large productivity gap between industry leaders and other competitors, declining firm entry rates, weak survival of young firms, and weakening job reallocation and churn. This critique seems particularly relevant for the WB6 economies that are exhibiting slowing convergence. Hence, the fears of a middle-income trap in the WB6 region amid a struggle to effectively make the leap to an innovation-based growth model.

The 2024 WDR offers a roadmap, termed as a 3I approach**, implying that MICs need to navigate two important and sequential development transitions to successfully become high income.** The LIC-to-MIC transition shifts from accelerating **investment** (a *1I strategy)* to focusing on both investment and **infusion** (*2Is*), which brings ideas, practices, and technologies from abroad and diffuses them domestically. The MIC-to-HIC transition then necessitates a shift to increased **innovation** (*3Is*), not only borrowing ideas from abroad but also pushing out the technology frontier at home.

- **Investment, the first I.** Foundational reforms are necessary to maximize the *fundamental drivers of economic growth*, including investing in and maximizing the returns associated with scarce physical and human capital. Foundational investments, policies, and institutions facilitate sustainable increases in public and private investment. They also unlock the full potential of human capital in both quantity (to ensure full labor force participation) and quality (education and skills formation). And they efficiently allocate and productively use physical and human capital.
- **Infusion, the second I.** Structural reforms—to enable the transition from 1I to 2Is—are more complex institutional arrangements needed to sustain *Schumpeterian creative destruction* in a new and more challenging external environment. This requires a policy framework that allows for the creative destruction process to freely take place. This

framework will vary depending on the relative stage of an individual country's level and stage of development. In its simplest form, countries at the earlier stage of their transitions from MIC to HIC status need to focus primarily on reforms that level the playing field to attract new private investments, particularly from abroad, to enable the infusion of ideas, practices, and technologies across the economy.

- **Innovation, the third I.** Transformative reforms—to enable the transition from 2Is to 3Is—would come as countries approach the HIC threshold, with a particular focus on *managing the incumbency advantage* associated with the behavior of existing firms in the market. Countries seeking to sustain growth beyond the HIC threshold need policies and institutions that allow for growth at the frontier, reducing the risk premium associated with innovation by firms.

FIGURE 9.3.

To achieve high-income status, countries will need to recalibrate their mix of investment, infusion and innovation policies

Income Classification	Investment	Infusion	Innovation
Low-income	Higher priority	Lower priority	Lower priority
Low-middle-income	Higher priority	Higher priority	Lower priority
Upper-middle-income	Higher priority	Higher priority	Higher priority

Source: World Development Report 2024.

Tellingly, experience from past high-income transitions in the region points to the need for higher ambitions and a deeper commitment to reform efforts among ECA's current set of middle-income economies, including those in the Western Balkans.

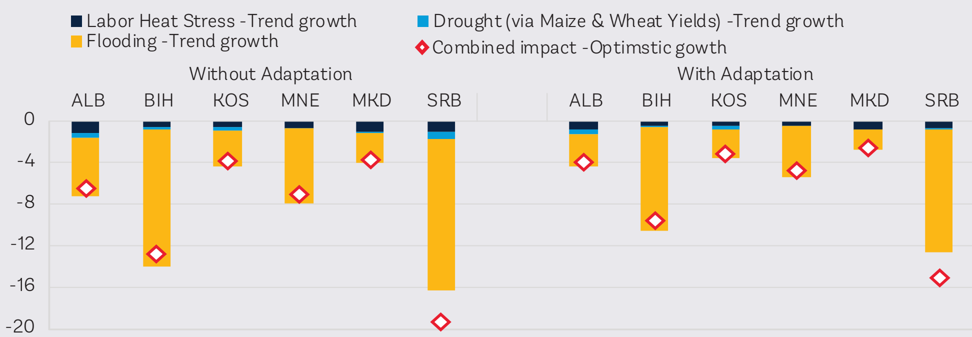
Box 9.2: Responding to climate change in the Western Balkans[38]

The WB6 region will be subject to varying degrees of economy-wide damage from climate hazards. In recent years, the WB6 region has seen a surge in heat-related stressors—mainly heightened temperatures and intensified droughts—that threaten to undermine regional stability and productivity. The average temperature for the region increased by 1.2°C compared with 1961–80, while precipitation decreased by 0.2 percent but at the same time showed higher volatility. A model[39] analyzing the impacts of three climate hazards—riverine floods, droughts (via the impact on maize and wheat), and labor heat stress—indicates that Serbia is expected to experience the most significant damage under RCP 4.5[40] and trend growth, followed by Bosnia and Herzegovina (Figure 19). Floods are expected to cause the most significant damage to GDP in all WB6 countries, ranging from about 15 percent loss in 2050 GDP for Serbia and about 3 percent of GDP loss for North Macedonia under the trend growth.

FIGURE 9.4.

Percent reduction in 2050 GDP from selected climate hazards under RCP 4.5

Trend growth (breakdown) and optimistic growth (combined impact)



Source: 2024 Western Balkans 6: Country Climate and Development Report (CCDR).

However, damage from climate risks can be alleviated through adaptation investments and early interventions. The costs of these investments are high—with a regional annual average of 1.5 percent of GDP in 2025–2030, 1.3 percent in 2031–2040, and 1.2 percent in 2041–2050.[41] Yet, the benefits are even higher and could lead to transformation through avoided losses, accelerated economic potential, and amplified social and environmental spillovers. Looking at investment costs and benefits, annual investments averaging 1.3 percent of GDP across the region for 2025–2050 could yield an average annual benefit of 1.7 percent of GDP and a benefit to cost (BCR) ratio of 1.6. The estimated initial, comprehensive multi-sectoral adaptation investment package[42] comes to a total for the region of US$37.2 billion (in 2020 US$) undiscounted (Table 9.2).

38 Based on the 2024 Western Balkans 6: Country Climate and Development Report (CCDR) available at: https://www.worldbank.org/en/region/eca/publication/western-balkans-6-ccdr

39 Climate-enhanced macro-structural model of the World Bank, MFMOD.

40 RCPs (Representative Concentration Pathways) are scenarios describing GHG-trajectories and their climate impacts. The most stringent pathway is RCP 1.9, which limits global warming to below 1.5 °C. RCP 4.5 is an intermediate scenario with emissions peaking by 2040. The high-emission scenario is RCP 8.5, where emissions continue to rise throughout the 21st century.

41 The assessment accounts only for direct impacts on GDP.

42 This analysis was completed based on data gathered from local documents, literature, and expert knowledge.

TABLE 9.2.

Undiscounted costs of proposed policy actions and investments for an initial detailed adaptation package (in 2020 US$ billion, US$ undiscounted)

	WB6	Albania	Bosnia and Herzegovina	Kosovo	Montenegro	North Macedonia	Serbia
Adaptation	32.7	6	6.8	2.8	5.7	6.4	9.5

Source: Source: 2024 Western Balkans 6: Country Climate and Development Report (CCDR).

While decarbonization is required to meet emissions commitments and achieve economy-wide net zero emissions by 2050, this can be achieved without compromising WB6 economic growth potential. The economic costs of the transition to a net zero emission scenario vary by country, according to the modeling done for the Country Climate and Development Report (CCDR), in terms of GDP per capita growth: half of the countries will have higher growth rate in the net zero (NZ) than the reference scenario (RS)[43] for 2030 and 2040, although most will have a small negative difference in 2050. Under trend growth, the levels of GDP per capita (in 2020 US$) are expected to be smaller under NZ than under RS by less than 1 percent of GDP in 2050 in all countries, except Bosnia and Herzegovina (-1.17 percent lower GDP per capita level). These results include the positive offsetting impact that externalities have on GDP through investments, the impact of lower air pollution, lower road accidents, and lower road maintenance.

TABLE 9.3.

Estimated CAPEX[44] of mitigation measures under trend growth by 2050 (US$ billion, US$ discounted at 6 percent)

	WB6	Albania	Bosnia and Herzegovina	Kosovo	Montenegro	North Macedonia	Serbia
Mitigation CAPEX	32.0	5.3	5.8	4.7	0.2	5.6	10.4

Source: Source: 2024 WB6: Country Climate and Development Report (CCDR).

Transition to net zero will require substantial investments, predominantly made by the private sector, with governments playing a complementary role. The average annual gross incremental adaptation and mitigation investment (without considering benefits) through 2050 come to 1.3 percentage points of GDP and 1.9 percentage points of GDP, respectively. The estimates are sizable, given that the 20-year average total investment rate for the WB6 region is about 27 percent of GDP and the public investment rate is about 7 percent of GDP. Considering mitigation costs, compared with RS, the WB6 would need to invest an additional US$32.0 billion discounted at 6 percent[45] to achieve NZ (Table 9.3). Most of the investments would be channeled into decarbonizing transport and scaling up solar, wind, and hydro generation capacities. The transition will necessitate attracting private sector financing beyond current levels while advancing sectoral reforms to entice private capital and bridge the climate mitigation investment gap. It is estimated that about 85 percent of the total investment required to achieve the net zero goal by 2050 could be made by the private sector under adequate enabling conditions (Figure 20 and Figure 21).

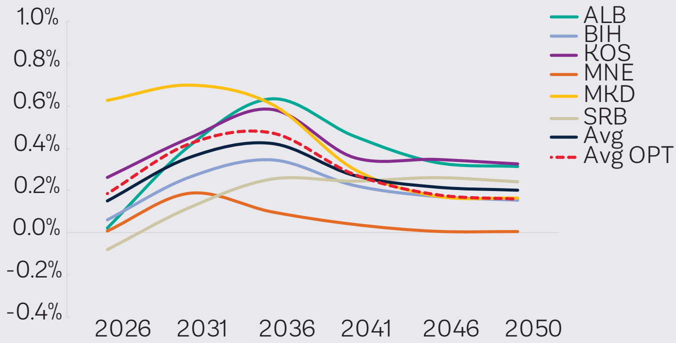
43 Net zero scenario assumes reaching zero greenhouse gas (GHG) emissions by 2050, while the reference scenario assumes the business-as-usual scenario.

44 Capital Expenditure.

45 In this summary, the costs of the initial adaptation investment package are presented as undiscounted lupsusms due to their immediate or short-term benefits (5-10 years); mitigation costs are discounted because they involve long-term investments with benefits accruing over time (25 years).

FIGURE 9.5.

Incremental public investment under trend growth, percent of GDP

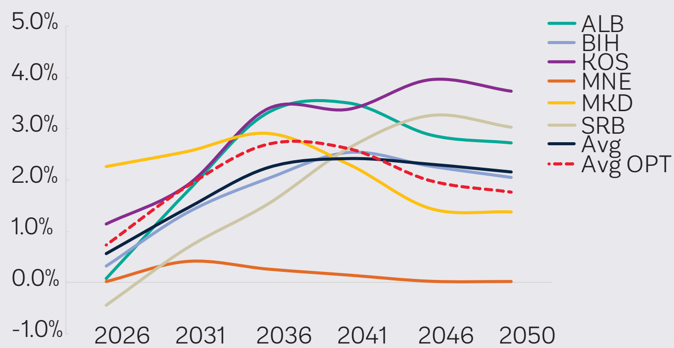


Note: For Serbia, for both public and private investment, the level of investment under net zero is less than the level of investment in the RS. However, the composition of investment differs under the two scenarios. For Montenegro, the level of investment under the net zero and the RS are about equal after 2041.

Source: 2024 WB66: Country Climate and Development Report (CCDR).

FIGURE 9.6.

Incremental private investment under trend growth, percent of GDP



Note: For Serbia, for both public and private investment, the level of investment under net zero is less than the level of investment in the RS. However, the composition of investment differs under the two scenarios. For Montenegro, the level of investment under the net zero and the RS are about equal after 2041.

Source: 2024 WB6: Country Climate and Development Report (CCDR).

Financing needs mandate access to EU and partner funding, and also developing new in-country financial products and services. The EU pre-accession funds[46] can supplement the limited public resources in the WB6 countries but they can cover only a part of the total investment needs described. The rest should come from the private sector through different mechanisms. Domestically, the WB6 region's low savings rate (19 percent in 2022) requires encouraging savings activity in the long term. Also, banks and non-bank financial institutions, including institutional investors, can play a critical role in providing long-term green financing through equity and debt channels.

46 The European Commission's 2020 Economic and Investment Plan allocates up to €9 billion in EU funds for 10 investment flagships, addressing various needs such as transport, renewable energy, and youth employment. The EU Western Balkan Guarantee Facility aims to mobilize up to €20 billion in investments, thereby reducing financing risks.

Investments will need to be accompanied by regulatory reforms, as well as incentives to change behaviors: adoption of the carbon price is one example. Creating an enabling environment for green finance is a necessary but insufficient measure to attract low-carbon investment at scale. Aspects such as the adoption of carbon pricing, to also limit the impact of the Carbon Border Adjustment Mechanism (CBAM),[47] and harmonization of the power sector's legal and regulatory frameworks for the integration into the pan-European electricity market are critical. Consequently, having a clear, coordinated, and consistent financial and energy markets reform plan will be crucial for boosting confidence among investors to scale up renewable energy investment in the WB6 region.

Enabling just transition—based on effective and adequate social protection, education, and health systems—is a prerequisite for the green transition. Investing in retraining and upskilling is essential to avoid unemployment risks and ensure that firms have an adequately skilled workforce. Already about 417,000 people across the WB6 countries (excluding Montenegro) are in occupations with a high risk of being impacted by the green transition and this will likely double. Estimates show that the cost of retraining and reskilling those workers most at risk may reach €700 million if they were to be retrained into alternative occupations that are not likely to be impacted by the green transition, and €2.4 billion if they were to be retrained into alternative green jobs. In the longer term, more structural changes in the education system will be needed. To reduce the risks and uncertainty of the green transition on people's incomes, consumption, and health, increased coverage and adequacy of social protection and health systems are needed across the WB6 region.

47 From October 2023, the EU's CBAM imposes fees on imported goods, initially targeting the iron and steel, cement, fertilizers, aluminum, electricity, and hydrogen sectors. Importers of these goods are obligated to purchase CBAM certificates, the price of which is linked to the average price of EU ETS allowances and the required number of certificates is based on the carbon content of the goods, including both direct and indirect emissions. From October 2026, the CBAM certificates will be gradually phased in and the allocation of free allowances to EU ETS entities will be phased out.

10. *Spotlight:* Reaping the Benefits of a Global Workforce

Migration has been a characterizing feature of the Western Balkans for decades, shaping the lives, livelihoods and aspirations of its population. While Western Balkans (WB6) countries have some of the largest emigration rates in the world, foreign workers are increasingly present in the region to fill emerging labor shortages. Both emigration of WB6 nationals and immigration of foreigners are expected to continue in the coming years, drawing the attention on the importance of well-designed and carefully implemented policies to unlock the benefits of international mobility in the region. In fact, despite a progressive convergence of incomes in recent years, differentials in economic opportunities and quality of services with Western European countries remain large, fueling intentions to emigrate. As such, a critical question is how to make migration yield positive impacts for the Western Balkans economies while at the same time ensuring the safety and prosperity of both migrants and their communities left behind. In recent years, WB6 countries have made significant efforts to improve the management of migration flows and strengthen their developmental impacts. However, gaps still remain. By shedding light on trends, characteristics, impacts and current policy efforts in the area of migration in the WB6, this Spotlight aims to inform actions that can help Western Balkans economies leverage migration for their development.

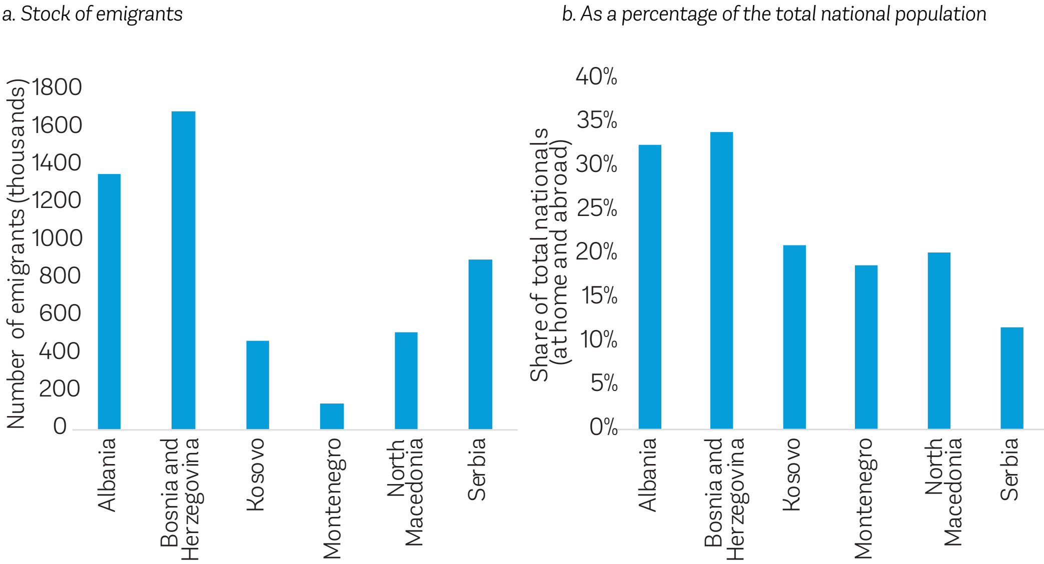
On the Move: Unpacking Western Balkans Migration Dynamics

Close to one in four people from the WB6 resides abroad. Today, around 5 million people who were born in the WB6 countries live abroad (Figure 10.1a). The disintegration of the former Yugoslavia and the subsequent conflict led to rapid migration outflows, with the number of emigrants doubling from 2 to 4 million between 1990 and 2000. Since then, the stock of emigrants has continued to grow, although at a slower pace. Bosnia and Herzegovina, and Albania are the main sending countries in the region, both in terms of stocks (1.7 million and 1.4 million, respectively) and as a share of their populations (34 and 32 percent, respectively).[48] Around one in five citizens from Kosovo and North Macedonia are also living abroad (Figure 10.1b). Emigration rates are lower in Serbia (12 percent), although emigration is still sizable in absolute numbers. Intentions to emigrate from the region remain high and have been rising over the past five years, with 44 percent of adults in 2023 considering living and working abroad.[49]

48 World Bank KNOMAD Bilateral Remittance Matrix 2021, December 2022.
49 Balkan Barometer Public Opinion survey (2023).

FIGURE 10.1.

Stock of emigrants from Western Balkan countries in 2021



Source: World Bank KNOMAD (2022).

Box 10.1: Data source and challenges to estimate migration numbers

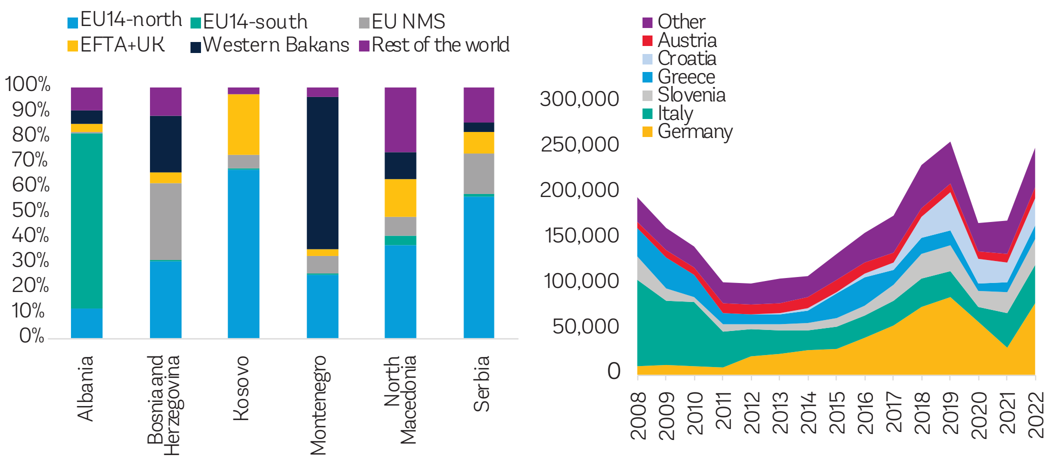
Migrant origin and destination countries around the world face challenges in collecting data on the stocks and flows of migrants, leading to conflicting—and generally undercounted—numbers. In destination countries, census data, as well as administrative data and surveys, capture immigration based on the country of birth and, in some cases, citizenship. Census data are the most accurate, however, they do not capture rapid changes in migration patterns, given that they are collected every 5-10 years. They also tend to undercount certain groups such as undocumented migrants or hard-to-reach refugees. Estimates of migrants also vary depending on the definition, which is usually based on either the country of birth or on citizenship. For example, Germany, which reports statistics of migrants based on citizenship, does not provide information on those migrants that were born abroad but obtained German citizenship. In general, data sources from sending countries suffer from more identification problems in capturing the whole extent of emigration. This is particularly the case for those migrating informally or when entire households leave a country.

Throughout this spotlight, migrants are considered to be those who reside in a country that is different from their place of birth, irrespective of their citizenship. The main data source for the stock of Western Balkan emigrants comes from the World Bank's Global Knowledge Partnership on Migration and Development (KNOMAD) database, which compiles information from censuses and other administrative and survey data in destination countries. These data are complemented with information on work permits issued by EU destination countries from Eurostat.

FIGURE 10.2.

Main destination countries and regions of Western Balkan emigrants

a. Share by destination region (2021) *b. Trends in first permits for WB6 migrants in Europe*



Source: World Bank KNOMAD (2022) and Eurostat.

Note: Note: EU14 North = Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Luxembourg, the Netherlands, and Sweden; EU14 South = Greece, Italy, Portugal and Spain; EU NMS (EU New Member States) = Bulgaria, Croatia, Cyprus, Czechia, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, and Slovenia; EFTA + UK = Iceland, Lichtenstein, Norway, and the United Kingdom; Western Balkans = Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia.

WB6 emigrants are highly concentrated in European countries, although important variations exist by country of origin. The vast majority of Albanian emigrants go to either Greece or Italy. Montenegrin emigrants mostly reside in Serbia. In turn, emigrants from Bosnia and Herzegovina, Kosovo, North Macedonia or Serbia tend to move to Western European countries such as Germany, Austria or Switzerland, although there are also flows driven by ethnic ties. In the case of North Macedonia, one fourth of its emigrants reside in Türkiye, mostly ethnic Turks. Recent trends in the issuance of new permits to WB6 emigrants in Europe show that neighboring countries such as Croatia and Slovenia have become increasingly more prevalent as a destination since they joined the European Union (EU) in 2004 and 2013, respectively.

Historically, people from the Western Balkans have moved for different reasons, but the search for better economic opportunities has been a common thread throughout the years. While the decision to move is rooted in a diverse set of economic, political, social, or humanitarian reasons, all migrants move in search of a better life for themselves and their families. The redrawing of the borders of the former Yugoslavia and the subsequent conflict in the region in the 1990s led to strong waves of forcibly displaced populations, both internally and internationally.[50] In recent years, economic motives have been the main driver for emigration. Most migrants move in search of better employment opportunities and higher wages. Employment rates in the WB6 countries are significantly below those observed in destination countries (60.3 percent in 2023, compared with 70.4 percent in the EU).[51] Moreover, wages in more advanced EU economies are as high as three times those of countries in the WB6, even after taking into consideration differences in the cost of living (Figure 10.3a). These wage

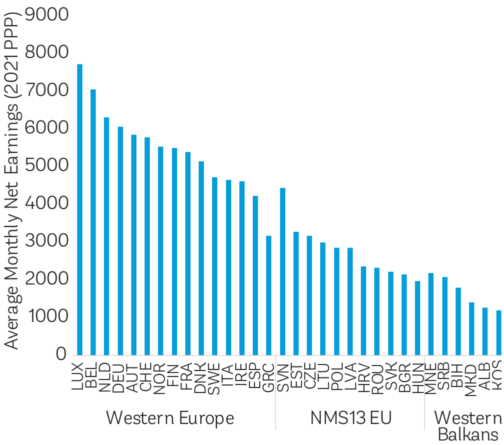
50 By 1995, there were 770,000 Bosnian refugees displaced in third countries, which represented more than half of the total Bosnian migrants at that time. Conflict also displaced more than 850,000 Kosovars in third countries by the end of 1998/99 (OECD, 2022).

51 These figures refer to the working age population in each region (Eurostat and ILOSTAT 2024).

FIGURE 10.3.

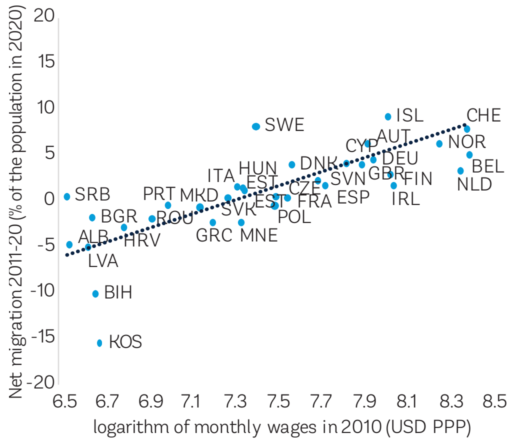
Wage differentials across Europe and net migration

a. Average Annual Earnings by country in 2022 (2021 Purchasing Power Parity adjusted)



Source: Ilostat (2023).

b. Wages in 2010 and net migration (2011–20)



Source: Adjusted from *Bossavie, Garrote-Sanchez and Makovec (2024)*. "The Journey Ahead: Supporting Successful Migration in Europe and Central Asia," Europe and Central Asia Studies Series, Washington, DC: World Bank, based on Eurostat, Ilostat and World Bank World Development Indicators.

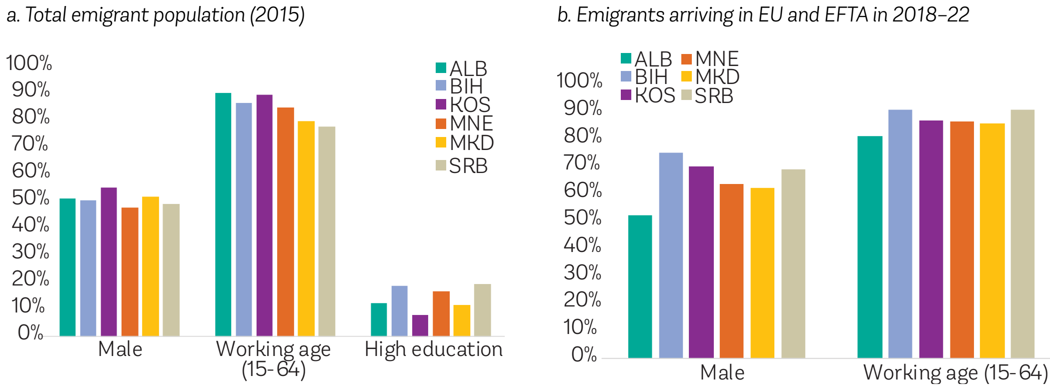
differentials are not just driven by differences in workers' productivity but also by what is called the "place premium". In Europe, countries with lower wages are associated with higher emigration (Figure 10.3b). More lenient migration policies in destination countries in Europe have also been a main pull factor in attracting migrants from the WB6 countries. For example, the passing of the Western Balkan regulation in Germany in 2015 increased formal labor migration pathways for both high- and low-skilled migrants. Given the size of the WB6 diaspora, family reunification is another key factor for migration, with 45 percent of new permits issued to WB6 emigrants by the EU between 2013 and 2022 being granted for this purpose.[52] Dissatisfaction with the quality of the education and health systems has also been found to be a relevant push factor to emigrate.[53] Beyond economic factors, research also finds that perceived corruption and nepotism also influence the decision to emigrate from the WB6.[54,55]

The profile of emigrants from different Western Balkan countries is diverse but with some commonalities. WB6 emigrants are concentrated among the prime age population compared to both natives in host countries and the non-migrant population at origin, consistent with employment being a primary driver of emigration. Eighty-five percent of the WB6 emigrant population are of working age compared to 66 percent of non-migrants (Figure 10.4a). This rate is particularly high in Albania, Bosnia and Herzegovina, and Kosovo. Intentions to migrate are also consistently higher for the youth than the general adult population.[56] With respect to gender, the stock of WB6 emigrants tends to be neutral, with 51 percent being males (Figure 10.4a). However, the predominance of male emigration has surged in recent years, especially in Bosnia and Herzegovina (75 percent) and Kosovo (70 percent) (Figure 10.4b). The gender profile of emigrants varies across countries of

52 Eurostat (2024).
53 European Training Foundation (2022).
54 López García, A.I., and B. Maydom (2023): "Frontline corruption and emigration in the Western Balkans," Migration Studies, 11(4): 694–720.
55 Malaj and Firza (2023): "The Impact of Corruption on Migration: Evidence from the Western Balkans," Migration Letters, 20(8): 896–907.
56 Seventy-one percent of the population aged 18 to 24 in the Western Balkans intend to migrate abroad, compared with 44 percent of the general adult population (Balkan Public Barometer Survey, 2023).

FIGURE 10.4.

Profile of emigrants from the Western Balkans in OECD countries



Source: OECD-DIOC (2015/16) and Eurostat (2018–2022).

origin and types of migration. While migration of forcibly displaced groups is gender neutral or with a higher share of women, migration for economic purposes—especially seasonal or temporary—is more male-dominated. Survey data of migrant households in WB6 that better capture short-term migration episodes show that around 75–80 percent of household members abroad in Albania, Bosnia and Herzegovina, Kosovo, Montenegro, and North Macedonia are male.[57] The educational profile has traditionally shown low levels of education: only one in six WB6 migrants in 2015 had tertiary education, below the rates of the non-migrant population at that time (Figure 10.4a).This rate is slightly lower than that of the non-migrant population in the Western Balkans for the same year.[58] The prevalence of highly educated emigrants is the lowest in Kosovo (8 percent), North Macedonia (12 percent), and Albania (13 percent). More recent data suggest that WB6 emigrants' education levels have been increasing over the past decade, with more than 20 percent having tertiary education.[59]

Western Balkans emigrants tend to have better employment outcomes than non-migrants, although gaps remain with respect to the population in host OECD countries, with occupational downgrade representing a major challenge. Employment rates among WB6 adult migrants in OECD countries ranged between 61 and 71 percent for men, and between 37 and 57 percent for women, according to OECD statistics for 2015 (Figure 10.5a). In each of the six countries, these rates were significantly higher than those of non-migrants during the same period (43–53 percent for men and 25–39 percent for women). The positive employment gaps for migration is particularly large for women and lower-skilled workers, and it is not fully explained by differences in demographic characteristics. Nonetheless, WB6 emigrants in OECD countries face challenges in the labor market, with high rates of occupational downgrade. Among emigrants with tertiary education, 46 percent of men and 41 percent of women are overqualified for their jobs, an issue particularly prevalent for those originating from Kosovo and Albania (Figure 10.5b). These rates are higher than those of natives in main destination countries such as Germany (16%), or Austria (27%).

The emigration of citizens of WB6 countries is not only a one-way story, as a portion of them, especially in some of the countries, do return at some point in their

57 Life in Transition Survey (LiTS 2024).
58 18% according to the World Development Indicators of the World Bank.
59 Ibid.

lives. Available statistics from the cohorts of displaced populations from war and conflict show a large volume of returns. In Kosovo, the vast majority of refugees returned in the years following the 1999 Peace Accords.[60] In Bosnia and Herzegovina, the return of refugees was slower, with 60 percent of them still residing abroad 10 years after the end of the war.[61] Statistics of the return of economic migrants are scarcer and usually limited to assisted returns or forced repatriation, which is an undercount of the total return flows. In the past decade (2013–22), close to 120,000 WB6 emigrants left their host countries in Europe. Less than two-thirds of them were forced to return due to their irregular status abroad, while the other one-third did so voluntarily.[62] In Bosnia and Herzegovina and Kosovo, the number of returnees tend to be low compared with the size of their emigrant population. However, ad-hoc surveys in origin countries such as Albania and Kosovo suggest that return migration might be a more prevalent phenomenon.[63] In Albania, flows of return migrants have been consistently sizable. Between 2001 and 2011 around 140,000 migrants returned to the country, and another 108,000 returned between 2011 and 2023.[64]

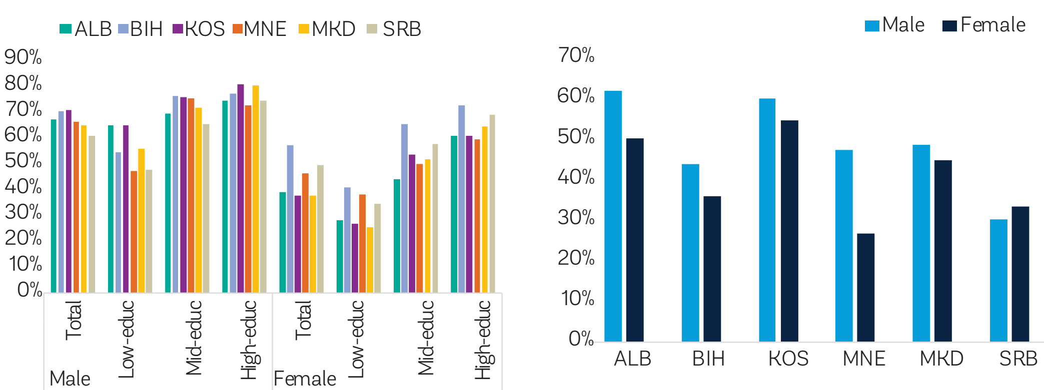
The Ripple Effect: Migration's Role in Shaping WB6's economic development

Moving across borders often results in significant welfare gains for migrants and their families. The large wage and employment differentials observed between the WB6 and other European countries provide a unique opportunity for potential emigrants and their families to increase their incomes. While part of these wage differentials is due to different workers' productivity across countries, it has been shown that the same individuals can

FIGURE 10.5.

Labor market outcomes of Western Balkan emigrants in OECD destination countries

a. Employment rates of WB6 emigrants in OECD countries *b. Share of overqualified tertiary educated emigrants*



Source: OECD DIOC database 2015/16 and EU-LFS 2015.

Note: The share of over-qualified tertiary educated migrants shows the proportion of tertiary-educated migrant workers employed in a low- or medium-skilled occupation in their destination country (international standard classification of occupations (ISCO) major groups 4–9).

60 Around 600,000 of the 850,000 forcibly displaced (OECD, 2022).
61 Ministry of Human Rights and Refugees of Bosnia and Herzegovina (2006).
62 Eurostat (2024): "Third-country nationals who have left the territory by type of return and citizenship [migr_eirt_vol__custom_11968055]".
63 For example, a recent survey conducted in 2022 by Kantar found that 17 percent of the population 18 to 65 had worked abroad, which would suggest a total population of returned migrants of around 200,000.
64 Albanian Census of 2011 and 2023 (Instat and IOM, 2013, 2020, and Instat, 2024).

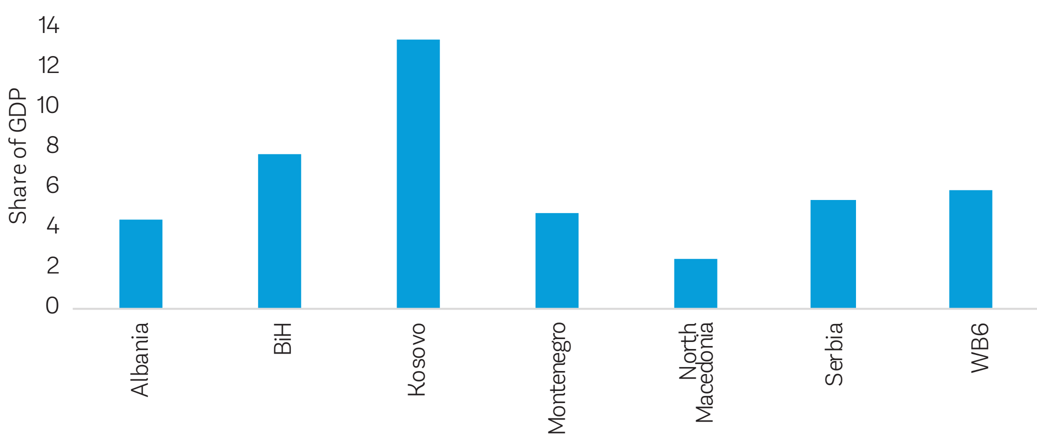
earn significantly more just by moving.[65] One key motivation behind the decision to migrate, particularly among labor migrants, is the ability to send remittances to relatives and acquaintances back home. Close to 70 percent of WB6 emigrants send remittances home.[66] Remittances are a key source of income for WB6 recipient households and support poverty reduction among vulnerable households in the region.[67] Remittance-recipient households mostly use this additional income for consumption, especially consumer goods and, to a lesser extent, in real estate. For example, consumption represents 60 percent of those transfers in Bosnia and Herzegovina, compared with 15 percent on investments in education.[68]

At the macro level, remittances represent an important and stable source of funding for countries in the Western Balkans. For origin countries, the mobility of a part of their populations can serve to increase the inflows of international remittances. In WB6 countries, remittances amounted to US$13.8 billion, equivalent to an average of 6 percent of GDP in 2023 (Figure 10.6). They range from 2.5 percent of GDP in North Macedonia to 13.4 percent in Kosovo.[69] Moreover, remittances tend to be more stable than capital flows, and are more countercyclical in nature.[70]

Beyond remittances, the benefits of an internationally mobile population can be significant. Countries of origin can benefit from having a mobile population, both from those that remain abroad and those who return to the country. The diaspora can channel international savings, transfer know-how and new technologies, and link the economy

FIGURE 10.6.

Remittances in WB6 countries as a share of GDP (2023)



Source: World Bank staff calculations based on country statistical offices and central banks data.

65 Clemens, Montenegro, and Pritchett (2019).
66 World Bank Life in Transition Survey IV (2024).
67 Petreski and Jovanović (2013) for North Macedonia; Dushku (2019) for Albania; and Möllers and Meyer (2014) for Kosovo.
68 IOM (2020).
69 Official statistics tend to underestimate the total volume of remittances, which partly come through informal channels. In North Macedonia a larger share of remittances is recorded as cash exchange on FX markets in the balance of payments, and the Central Bank of North Macedonia incorporates the two categories for a more accurate overview of remittances.
70 Frankel (2011).

to global business networks.[71] All of this can spur productivity, exports, entrepreneurship and job creation.[72] Globally, a higher presence of the diaspora in a destination country is associated with larger inflows of FDI from that country to the origin country, pointing to the fundamental role of the diaspora in attracting international capital.[73] Some of these positive effects may be occurring in the WB6 countries. FDI inflows in 2022 ranged from 3.0 percent in Bosnia and Herzegovina to 13.2 percent of GDP in Montenegro, but overall the WB6 countries are well above the average for peer upper middle-income countries (1.3 percent), a pattern observed for more than two decades.[74] Studies have also found that the return of refugees back to the Western Balkans after the 1990s war led to increases in firms' exports.[75] Ad-hoc surveys in Kosovo reveal that the vast majority of returnee entrepreneurs gained valuable experience, knowledge, skills, and global business networks during their migration experience.[76] Positive spillovers from the return of part of the diaspora have also been observed in Albania, improving employment rates and wages of non-migrants, and boosting GDP (see Box 10.2).[77]

Box 10.2: The impact of Albanian returnees after the crisis in Greece

The sovereign debt crisis in Europe at the end of the 2000s hit Greece particularly hard. As a result, employment drastically fell, reducing the opportunities for Albanian emigrants to obtain sustainable incomes. Many emigrants decided to return to Albania, which led to an increase in the labor force in the country of 5 percent between 2011 and 2014. This sudden shock of return migrants, who mostly located back in their localities of origin, led to positive spillovers in the local economy. Evidence shows that many returnees were engaged in entrepreneurial activities, creating jobs not just for themselves but also for the non-migrant population.[78] For every 1-percentage-point increase in returnees in a given district, employment rates of non-migrant Albanians increased by 0.6 percent. Strong positive effects were also found on wages of non-migrants, especially for low-skilled workers (between 2.5 and 5.9 percent increase).[79] The job creation capacity of return migrants also generated significant GDP gains (between 0.8 and 1.3 percent of 2009 GDP). This mostly offset the negative effect caused by the reduction in remittances coming from Greece (1.5 percent of GDP).

71 Valette (2018), in a cross-country study of 20 OECD countries, shows that migrants transfer technology to their origin countries in the next five years after they have left their origin country, measured by increases in the economic complexity of their production. Fackler, Giesing and Laurentsyeva (2020) also find increases in patenting in 32 European origin countries due to emigration.
72 For example, Bahar and Rapoport (2018) find that a 10 percent increase in the migrant stock at destination is associated with a 2–3 percent increase in the likelihood that the host country starts exporting that good in the following decade. Docquier and Lodigiani (2010) find a long-run elasticity of the FDI to skilled migration of 50–75 percent.
73 OECD (2022).
74 World Bank World Development Indicators (2024).
75 Industries with 10 percent more returning refugees had larger exports between the pre- and postwar periods by 1.0 to 1.6 percent (Bahar et al. 2024).
76 Haxhikadrija (2009) and Möllers et al. (2017).
77 Hausmann and Nedelkoska (2018).
78 Hausmann and Nedelkoska (2018).
79 Ibid.

Emigration has reduced the supply of labor in all Western Balkans countries. During the past two decades, rapid population outflows, combined with weak trends in the natural change of the population due to declining fertility rates, have reduced the population in the WB6 countries. Between 2000 and 2020, the population fell by 8 percent (10.7a), equivalent to 1.2 million people. During this period, Bosnia and Herzegovina saw the largest population drop due to emigration (21 percent of the population).[80] As emigrants are disproportionately of prime working age, their departure has significantly decreased the labor supply in the WB6 countries, amplifying the impact of emigration on the local workforce. Emigration also reduces the supply of labor through another indirect channel. The increase in remittances leads to an income effect that increases reservation wages[81] of household members in the countries of origin, particularly women, dampening activity rates. These patterns have been consistently observed in the Western Balkan countries.[82]

While these emigration outflows initially alleviated labor market pressures, they have increasingly resulted in shortages across the skills spectrum. In the past two decades, sizable emigration outflows from the WB6 countries have coincided with significant reductions in unemployment rates. In 2023, unemployment rate stood at 10.9 percent in the region, compared with above 20 percent of the active labor force during most part of the 2000s, with rates higher than 30 percent in Bosnia and Herzegovina, Kosovo, and North Macedonia. This trend has been accompanied by improvements in the labor force participation rate –from around 55% in the 2000s to close to 66% in 2023–, and a sizable increase in wages.[83] While there is no strong causal evidence, the emigration of part of the working-age population, particularly of those with less employment opportunities, has helped reduce the excess supply in the WB6 countries. However, emigration can also lead to losses of human capital, particularly in the short term. Although emigrants tend to have similar or lower levels of education than the non-migrant population, the emigration of workers of all skill levels reduces the availability of skills in the countries of origin. In recent years skill shortages have become more apparent in certain sectors. According to the 2021 Balkan Business Opinion Barometer, 44 percent of firms were unable to fill their vacancies with the needed skills, and 37 percent considered that these shortages were due to the emigration of part of the workforce (Figure 10.7b). This is commonly observed across all countries in the region. Skill shortages are found in sectors such as ICT, engineering services, manufacturing, and construction[84]. Skill shortages can generate distortions in firms' composition of resources, and limit productivity and growth. For the countries of origin, it results in foregone consumption and lower tax revenues.

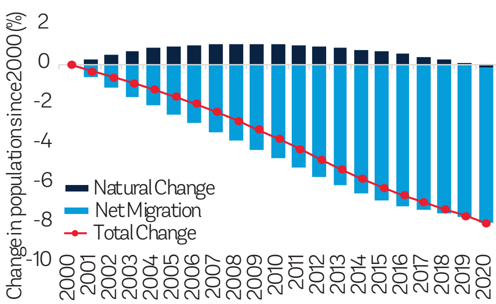
Of particular concern are shortages in some key occupations, especially medical-related jobs. While emigration of part of the workforce occurs across different fields and education levels, concerns of a potential "brain drain" have been particularly salient in specific sectors such as health care. During the past decade, the emigration of WB6 doctors has gained momentum, with the stock residing in other European countries more than quadrupling from 1,368 in 2010 to 5,752 in 2021.[85] This represents 15 percent of the available medical workforce in the Western Balkans, and more than 20 percent in countries such as Albania and Kosovo.[86] At the same time, available data of graduates in medicine remains relatively stable in Montenegro, North Macedonia or Serbia.[87] These patterns have led to

80 Population growth is calculated by the change between 2000 and 2020 divided by the population at the beginning of that period (2020).
81 The reservation wage is defined as the lowest level of wage at which a worker would be willing to accept a particular type of job.
82 Dermendzhieva (2009); Kalaj (2009); Rudi (2014) and Petreski (2019).
83 Around 105% in nominal terms between 2009 and 2022, and close to 35% in real terms according to ILOSTAT data.
84 OECD (2022)
85 OECD health workforce migration dataset.
86 Hashani et al. (2024).
87 Eurostat (2024) Health Graduates Database (hlth_rs_grd2).

FIGURE 10.7.

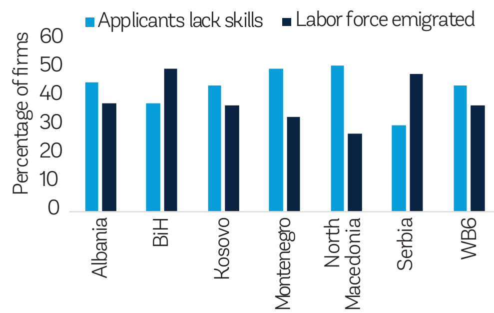
Impact of emigration on the supply of labor and skills in Western Balkan countries

a. Cumulative change in the WB6 population since 2000



Source: Bossavie, Garrote-Sanchez and Makovec (2024) "The Journey Ahead: Supporting Successful Migration in Europe and Central Asia," Europe and Central Asia Studies Series, Washington, DC: World Bank, based on UN DESA Population Division database.

b. Share of firms citing the following reasons for skills shortages



Source: Western Balkans Business Opinion Barometer (2021).

a more moderate increase in the rate of doctors per capita in the last decade, which remains significantly below that in the EU –ranging from around 300 doctors per 100,000 inhabitants in North Macedonia, Serbia and Montenegro, to 170 in Kosovo, compared to 400 in the EU–.[88] Two-thirds of WB6 migrant doctors reside in Germany alone. More broadly, Germany has attracted more than 18,000 WB6 health-care workers since the implementation of the Western Balkan regulation in 2015.[89] From the perspective of Western Balkan countries, this represents a loss of human capital, although it also coincides with still significant although declining unemployment rates of health-care professionals. Given the low supply of doctors in the region and the increasing demand in the coming years due to aging, more investments in the health-care system would require additional workforce in the medical sector.[90]

In this context, foreign workers have increasingly been recruited to address labor shortages. Although WB6 countries are historically emigration countries, there has been a rapid increase in the inflows of immigrants in the past decade. In 2020, more than 1.1 million foreign-born individuals resided in the Western Balkans (6 percent of the population), 0.8 million in Serbia alone. However, close to 90 percent are from other former Yugoslavian countries with long-term residency since the redrawing of borders and subsequent wars. In the past decade, inflows of immigrants have accelerated, mostly driven by economic reasons due to the increasing demand in the Western Balkans to fill labor shortages. In Serbia, 155,000 immigrants have arrived since 2011, and two-thirds are from non-Balkan countries. The annual issuance of work visas rose from 2,512 in 2010 to 13,475 in 2021, with the largest nationality groups being China, Türkiye and India.[91] Similar trends are observed in other countries. In Montenegro, the number of immigrants

88 Healthcare personnel statistics for 2021, Eurostat (2024).
89 Mara (2023) "Health Professionals Wanted: The Case of Health Professionals from Western Balkan Countries to Europe." and Schmitz-Pranghe Oruč, Mielke and Ibričević (2020).
90 European Training Foundation (2021).
91 Ministry of Interior of the Republic of Serbia (2022): https://kirs.gov.rs/media/uploads/Migracije/Publikacije/Eng/Migration%20Profile%20of%20the%20Republic%20of%20Serbia%20for%202021.pdf

has tripled, from 1,741 in 2015 to 15,989 in 2022.[92] In Bosnia and Herzegovina, annual work permits for immigrants increased from 2,593 in 2017 to 3,780 in 2022, driven by increases of immigrants from South Asia and Türkiye.[93] In Albania, Kosovo and North Macedonia, inflows of immigrants have remained more limited although they are also growing.[94] Additionally, recent developments since Russia's invasion of Ukraine have led to a significant increase in the number of Ukrainian refugees in the Western Balkans (around 92,000 in 2023, of which two-thirds of them are in Montenegro).

In the longer term, there is increasing evidence that emigration does not necessarily lead to human capital losses if the right incentives are in place. Emigration can become a source of human capital accumulation through different channels. First, remittances sent by emigrants increase the availability of financial resources in emigrant households, which can spend part of them on the education of family members who do not migrate. Second, the return of high-skilled migrants may also represent a "brain gain" opportunity for the country. Emigrants themselves often acquire new educational degrees and skills overseas, which positively revert to the country when they return. Third, the prospects of higher wages abroad in specific sectors can further incentivize human capital accumulation in origin countries. In the Philippines, evidence shows that more migration pathways for nurses in the United States led to an even faster increase in enrolment and graduation of nurses in the country. For each nurse that emigrated, nine new nurses were licensed, leading to more human capital accumulation in the country.[95]

In some Western Balkans countries, initial evidence suggests that this positive effect might also be at play. Households receiving remittances spend part of them on education, which in some cases can support better education outcomes for children.[96] There is also evidence of human capital accumulation of migrants themselves during their migration experience, with close to 9,000 WB6 emigrant students in Europe in 2022.[97] Surveys of return migrants in Albania also find that skills acquisition while abroad leads to upward occupational mobility and productivity enhancements in the country.[98] In Kosovo, the Heimerer College aims to improve the availability of skills in the country's health-care sector with curricula and qualifications aligned with and recognized by the German labor market[99]. While Heimerer College's graduates have skills and qualifications that could help them find jobs in Germany, data show that only 20 percent of those who are employed have moved abroad (see Box 10.3).

92 In Albania, the stock of immigrants with work permits increased by more than 2,000 between 2015 and 2022 (Instat, 2024), while in Kosovo and North Macedonia it increased by more than 700 workers during the same period (Eurostat, 2024 and Kosovo Government Authority for Migration, 2024).

93 Bosnia and Herzegovina's Ministry of Security (2022).

94 Eurostat statistics on immigration [migr_imm1ctz] and Kosovo Government Authority on Migration (2024).

95 Abarcar and Theoharides (2024).

96 For example, studies in Kosovo (USAID 2010) or Bosnia and Herzegovina (Oruc, Jackson and Pugh 2018) find that migrant households not only allocate part of remittances to education, but they also spend more overall on education than non-migrant households. In Bosnia and Herzegovina, it translates into better educational enrolment in certain low to middle quintiles of the population.

97 Eurostat (2024).

98 Bucheli and Fontenla (2022); Bahar et al. (2019); Kilic and Carletto (2009).

99 OECD (2022).

Box 10.3: The Heimerer College in Kosovo

The Heimerer College is a private university in Kosovo that provides training opportunities in the health-care sector following the curricula and the qualification system adopted in Germany. The college offers a variety of undergraduate and postgraduate degree programs, including in fields and specializations not commonly offered in the Western Balkans. These programs also include on-the-job training opportunity in Germany. The college was founded by a diaspora investor and is privately funded through student tuition fees.[100] The program has been successful at providing opportunities for 1,802 students between 2013 and 2023, with 93 percent of students graduating between 2013 and 2023 being employed, 80 percent of them in Kosovo[101].

Through its programs, this model of bilateral labor and training agreement with Germany has increased human capital in the health sector in Kosovo,[102] and built health-care vocational training capacity, aligning it with international standards. It has also created both supply and demand for new health specialties such as autism services that previously did not exist in Kosovo[103]. Overall, it is a successful example of how bilateral agreements can facilitate formal migration pathways while expanding the availability and variety of human capital in the country.

100 German employers fund language courses for those who access the migration track.
101 Beqiri (2024).
102 According to health statistics from the Kosovo Agency of Statistics, the number of nurses certified by the Chamber of Nurses has increased from around 12,000 in 2018 to over 30,000 in 2022.
103 OECD (2022).

However, migration still has an untapped potential in the Western Balkan region, as some beneficial channels are still not fully active. Remittances, while providing a vital income to migrant households, still have limited developmental impact. The cost of remittances through formal channels in the Western Balkans remains high, ranging from 4.3 to 10 percent depending on the migration corridor; and this cost exceeds the SDG target of 3 percent.[104] Notably, remittances sent between WB6 countries are 32 percent costlier than those sent from other parts of the world to the region. These costs reduce the incentives of immigrants to send money back. Furthermore, remittances are rarely channeled toward productive investments and entrepreneurship.[105] Western Balkan countries can also expand their outreach efforts to engage their diaspora for developmental purposes. Even in countries with more active diaspora engagement programs such as Bosnia and Herzegovina, there is a large untapped potential for the economy, as only a small fraction of those interested in investing in the country end up doing so.[106] There is also significant room for maximizing the earnings potentials of migrants throughout the whole migration journey. The large prevalence of occupational downgrade of WB6 migrants in Europe reduces the potential gains from the migration experience and limits the diversity of skills acquired. This skill waste reduces the beneficial impact of migration for migrants, origin and destination countries alike, and hampers productivity. The limited recognition of education credentials and certificates in many of the main destination countries is usually the

104 World Bank Remittance Prices Worldwide database https://remittanceprices.worldbank.org/.
105 World Bank (2022).
106 One in three migrants want to invest in the country, but only 6 percent do so (Efendic, 2021; Williams, 2019).

reason why migrants do not work in the field or level of occupation that they are trained in.[107]

In addition, some emigrants are still exposed to different types of vulnerabilities while embarking on their journeys and during their stay abroad. While migration can boost lifelong earnings of emigrants and their households, this journey is not exempted from risks. Evidence shows that migrants are more responsive to labor demand conditions than non-migrants, showing higher rates of job destruction during downturns.[108] That was the case of WB6 emigrants in the EU during the COVID-19 pandemic, who suffered higher job losses than the average population.[109] This pattern is due to factors such as the higher concentration of immigrants in a few sectors or lower tenure and formality of employment contracts. Moreover, immigrants are less likely to have access to social insurance mechanisms—either in the host country or at home—reducing their ability to cope with income shocks. Unless specific bilateral social security agreements are in place, the portability of pensions is also limited. The migration decision is based on a perceived cost-benefit analysis of the journey. Some emigrants, particularly low-skilled ones, have unrealistic expectations regarding the employment opportunities abroad, and the availability of formal migration channels. An example of this was seen by the rapid spike in asylum applications to the EU of West Balkans migrants, from 53,000 in 2013 to 170,000 in 2015, led by misinformation on asylum requirements. This resulted in massive rejections of asylum applicants, who were forced to return unexpectedly to the Western Balkans. More broadly, return migrants, mainly those whose migration journey was unexpectedly interrupted, face additional barriers to reintegrating in the domestic labor market,[110] ranging from bureaucratic hurdles, loss of local networks and knowledge, cultural adaptation or, in some cases, stigma or discrimination.

Migration systems and policies in the WB6 countries: the status quo

Recognizing the importance of migration, WB6 countries have developed strategies, laws, regulations, and institutions to harness the benefits of migration. All countries have adopted migration strategies. These documents tend to focus on improving the management of migration flows and support the integration of return migrants. All WB6 countries with the exception of Bosnia and Herzegovina also have strategies to engage their diaspora.[111] In line with the different goals and objectives, governments in the region have strengthened the legal framework on migration, progressively aligning it with EU standards. All countries have competent institutions in charge of different aspects of the migration system and have created specific inter-ministerial bodies to facilitate coordination. In recent years, WB6 countries have also taken important steps to develop a common intra-regional market and increased the regional coordination on migration with the EU.[112]

Agreements with some destination countries were introduced over the years to ensure the safe migration and employment of workers. One of the most comprehensive bilateral labor agreements was signed between Bosnia and Herzegovina and Slovenia in 2011 to limit informal migration flows. Annual quotas of migrants were established, and employment agencies were set up to cooperate throughout

107 Western Balkan countries are making efforts to align their national qualification frameworks to the European Qualifications Framework (EQF) to facilitate the interpretation of a qualification and its level in EU destination countries.

108 Azlor et al. (2020).

109 Bossavie et al. (2021).

110 Migrants who are forced to return unexpectedly tend to accumulate lower levels of savings or international experience compared to what they had planned, which then hinder their ability to successfully access job opportunities or start their own businesses in their home country. For example, the Albania Return Migration Survey (2013) shows that those that planned their return were 20pp more likely to be employed than those that were forced to return (65.7% vs 45%).

111 Bosnia and Herzegovina has passed the Policy for Cooperation with the Diaspora that aimed to pave the way to a diaspora strategy yet to be approved. However, both the Federation of Bosnia and Herzegovina and the Republika Srpska have in place their own diaspora strategies.

112 Through the Migration, Asylum, Refugees Regional Initiative (MARRI).

the migration process, from the selection stage to the return. Both countries also exchange data to ensure insurance payments to migrants are made depending on where they work and reside.[113] Several WB6 countries also have bilateral cooperation with Germany on skills training and migration agreements in specific sectors.[114] Migration regulations in destination countries have also shaped migration flows. In particular, the Western Balkan Regulation (WBR) in Germany has opened legal pathways for WB6 migrants with all skill levels to emigrate if they have a job offer.[115]

With a certain degree of variation, some services have also been introduced to help WB6 emigrants throughout their migration journey. Cognizant of the fundamental role of migration, WB6 countries have increased service provision to migrants in recent years. These range from information on migration opportunities for prospective migrants, to support services targeted to the diaspora, to repatriation and reintegration support for returning migrants. The availability of services varies across WB6 countries and is shaped by the degree of collaboration and development of bilateral agreements with third countries. Before departure, the bilateral labor agreement between Bosnia and Herzegovina, and Slovenia offers an example of how public employment services (PES) in both countries can cooperate to make employment opportunities in Slovenia accessible for workers in Bosnia and Herzegovina. The employment agencies of Albania and Kosovo support prospective migrants to prepare for their migration journeys by providing information on in-demand occupations and requirements, and regulations in key destination countries.[116] While abroad, emigrants from all WB6 countries can access consular services, and benefit from the portability of social security in countries where bilateral agreements are in place. WB6 countries have also developed different initiatives to map and engage the diaspora and increase its developmental impact. These include online platforms and registries,[117] knowledge-sharing events,[118] and services and incentives to spur diaspora investments in the country (See Box 10.4 for an example of a diaspora project in Bosnia and Herzegovina).[119] WB6 countries have also expanded services for returned migrants under readmission agreements to support their repatriation and reintegration. In recent years, some initiatives have emerged to incentivize the return of highly skilled migrants.[120]

However, challenges in six main areas remain with implications on the effectiveness of the initiatives introduced by Western Balkan governments. These challenges include: (i) limited cohesiveness of policy frameworks and imperfect coordination between stakeholders; (ii) inadequate provision of tailored services to emigrants; (iii) underdeveloped systems to manage inflow of foreign workers; (iv) capacity constraints (including financial, IT, and human resources); (v) complex bureaucratic processes, including the issuance of relevant migration-related documents for emigrants and returnees; and (vi) data gaps.

113 Ministry of Civil Affairs of Bosnia and Herzegovina and Ministry of Labor, Family and Social Affairs of the Republic of Slovenia (2011); https://www.ess.gov.si/en/jobseekers/employment-of-non-eu-migrant-workers/work-in-slovenia/employment-of-nationals-of-bih

114 For example, the “Triple Win” program between Germany and Bosnia and Herzegovina in the nursing sector.

115 In its initial phase (2016–20), the WBR provided 244,000 preliminary approvals of employment, and was extended indefinitely in 2023 (Brücker et al., 2020).

116 https://akpa.gov.al/informacione-rreth-emigracionit/. In Kosovo, the EARK is also working on the certification of prior learning in specific occupations like welding to be recognized in Germany (ETF, 2021).

117 Most countries have developed online platforms and registries of individuals, associations, and businesses to map and engage their diasporas worldwide, with initiatives led by the government (e.g., ediaspora.rks-gov.net from the Kosovo Government) and private sector (e.g., “i-dijaspora” in Bosnia and Herzegovina).

118 The Ulpiana forum in Kosovo or Macedonia 2025 in North Macedonia are examples of diaspora fora. The Serbian Science Fund provides financial incentives for diaspora members to develop research projects in the country in collaboration with domestic research centers, incentivizing cross-national research and innovation.

119 Other examples of support for diaspora investors include the MARDI project in Kosovo, or the initiative by the chamber of commerce in North Macedonia to create business centers for the diaspora. The government of Kosovo also issued diaspora bonds in 2021 to attract more capital to the economy, raising EUR 10 million out of the targeted EUR 20 million.

120 For example, the project Returning Point in Serbia identifies key barriers migrants face, promotes successful return stories, and assists returnees by providing relevant information and creating networks.

Box 10.4: The Diaspora Invest Project in Bosnia and Herzegovina

The Diaspora Invest Project in Bosnia and Herzegovina is one of the largest projects in the Western Balkans to leverage diaspora investments for economic development. It was launched in 2017 with a budget of US$6.6 million funded by the United States Agency for International Development (USAID). The project provided a complete package of support to diaspora investors including: (i) grants to diaspora firms to incentivize investment; (ii) technical assistance to firms to start or expand a business; and (iii) an information exchange platform to facilitate international networks. The project focused on strengthening links between the diaspora and local communities of origin and the capacity of municipalities. Municipalities provided further incentives to invest, such as local tax exemptions, free land in economic zones, financial support, or one-stop shops for businesses.

Over four years of the first phase, US$2 million in grants were distributed to 164 beneficiary companies, which invested more than US$22 million of their own funds. Beneficiary firms increased their sales by over 70 percent, mostly toward exports in countries where diaspora owners resided. In the labor market, diaspora firms generated 1,571 new jobs in the local economy. Beneficiary firms were spread out across the country, as diaspora investors prioritized investing in their localities of origin rather than main economic centers. In 2022, the program started a second five-year phase, with a budget of US$15.7 million.

Despite substantial improvements in the governance framework, migration systems in the Western Balkans have room to expand their cohesiveness and coordination across actors. Most WB6 countries can enhance the developmental aspects of migration in their long-term vision and strengthen the intertemporal migration policy cohesiveness. In some cases, countries could further clarify objectives in their migration agenda, set concrete action plans, and develop monitoring and evaluation systems to assess their progress. While all countries have institutions in place to support the different aspects of migration, in some cases they would benefit from more clarity on their different roles and responsibilities. Coordination mechanisms exist, but their implementation is ad hoc. Coordination is particularly challenging between institutions at different administrative levels. This is important as, while migration policy is decided at the central level, most migrants and returnees interact and receive services from local institutions. Few WB6 countries have created diaspora councils to better set adequate policies and serve them and, when they do, they are not always embedded and consulted in the policy process.

Migration systems in all WB6 countries have gaps in the service provision to emigrants throughout their migration journey. Prior to departure, only a few countries offer information on employment opportunities abroad. Access to skill training programs for migrants is also limited. While residing abroad, WB6 emigrants still do not have adequate access to social insurance or full portability of pensions in many destination countries. In emergency situations, as during the COVID-19 pandemic, rapid support services remain limited. Services provided by WB6 countries to engage their diaspora also tend to be fragmented and donor-driven. In many cases, insufficient outreach of diaspora programs and a lack of trust in institutions have limited the usage of these services by most migrants. Most WB6 countries also lack incentive packages to promote and facilitate the return of migrants, including tax incentives, information on job opportunities in the home country, or other forms of financial assistance. For return migrants, services are more developed, although important gaps remain. First, they focus on migrants under readmission agreements, while voluntary returnees do not usually access any of these services. Second, there are limited outreach efforts, leading to low utilization. WB6 countries are in different stages of development of the case management system for returnees but, generally, services are still fragmented and need to be strengthened.[121]

The management of foreign worker inflows in WB6 countries is also becoming a topic of important attention. Most WB6 countries have included objectives and specific interventions in their migration strategies to manage immigration inflows and curb irregular migration into the country. These countries also have measures to support the integration of immigrants, although implementation budgets tend to be limited. Albania, Kosovo, North Macedonia and Serbia also aim to attract skilled immigrants to address labor shortages in their migration strategies. One key issue throughout all WB6 countries is the lengthy process to obtain work permits and visas, which involves many actors and raises coordination challenges[122].This pushes employers to seek private recruitment and employment agencies to help navigate the system, putting at the forefront the need to better regulate these agencies and the recruitment process. WB6 countries have not signed bilateral labor agreements (BLA) with potential countries of origin of foreign workers to facilitate formal migration flows. WB6 countries also have limited linkages between their immigration policies and their labor market needs. For example, the selection process lacks accurate information and verification about the skills of foreign workers, leading to potential skill mismatches. There are also limited pre-departure support and integration measures for foreign workers in WB6 countries. Overall, WB6 countries rank among the lowest in terms of integration policy measures across Europe[123].

Complexities in bureaucratic processes also generate barriers that hamper emigrants' access to services. Countries have room to improve and streamline bureaucratic procedures that have an impact on emigrants. For example, banking regulations can limit the capacity of emigrants to have bank accounts in different currencies and delay transfers of money across countries. This can disincentivize the diaspora to invest in the country, or the return of some of them. Recently, Albania has made efforts to facilitate the transferability of financial assets and ease the burden of bureaucratic requirements.[124] Migrants also face bureaucratic challenges in transferring and translating personal records across countries, which can be costly and lengthy. Also, additional administrative requirements such as historical medical records can de-facto limit their registration and access to certain services back in their country of origin. Recognition of skill credentials obtained in third countries is another key barrier that return migrants face in re-integrating into the labor market. WB6 countries are also at different stages in implementing their national qualifications frameworks and aligning them with the EU Directive 2005/36/EC on recognition of professional qualifications.[125]

Capacity constraints hinder the ability of government institutions to implement migration policies and support migrants throughout their journey. In all WB6 countries, governments have mobilized sizable budgets for implementing their migration

121 As shown by satisfaction surveys to return migrant beneficiaries (World Bank, 2024).
122 IOM (2024)
123 MIPEX Index (2024)
124 Gedeshi, I. (2021): "How migration, human capital and the labour market interact in Albania," ETF, Turin.
125 Mara, I., and M. Landesmann (2022): "'Use It or Lose It!' How Do Migration, Human Capital and the Labour Market Interact in the Western Balkans." ETF.

strategies[126]. However, some of them rely heavily on donor funding, which can be more volatile. Moreover, resources—both financial and human—are mostly concentrated on border control. On the other hand, the capacity to support the developmental potential of the diaspora is more limited. Institutions in charge of diaspora engagement tend to be understaffed, hindering their capacity to connect and provide valuable services to their citizens residing abroad. Despite recent investments, authorities supporting returnees under readmission agreements, particularly those at the local level, have limited human resources and have training needs. Resources are even more limited to support the reintegration of migrants who voluntarily return. At the municipal level, insufficient human resources for monitoring and evaluation can also compound the data and coordination challenges previously mentioned. There is also limited interoperability of systems across institutions, hindering service delivery to migrants.

Data gaps limit the capacity of WB6 countries to implement evidence-based migration policies. As in other origin countries, current data availability on migration is incomplete and fragmented. Registration of emigrants and return migrants is mostly limited to self-reporting, except for migrants who are forced to return under readmission agreements. Diaspora registries and censuses have so far achieved only limited success, hindered by limited outreach and incentives for the diaspora to participate. Periodic surveys in WB6 countries also have insufficient coverage of current emigrants and returnees and ad-hoc migration surveys are scarce.[127] As a result, there is imperfect knowledge of the size of the WB6 mobile population, its profile and migration patterns, or of outcomes both in destination countries and upon return. Significant data gaps also exist on the profile and skills of the foreign-born population, given the limited depth of information collected in administrative sources and the challenges of regular surveys to capture this still relatively small and mobile population. Beyond data collection, there are also challenges in the standardization of data and the interoperability of systems. This limits the exchange of information and collaboration between institutions with responsibilities on migration. These data gaps hamper the ability of WB6 governments to understand the linkages between migration and local skills and labor markets, to implement well-informed evidence-based policies, and to test what interventions work best and have the potential to be scaled up and what interventions are not effective or even harmful.

The way forward: reaping the benefits from a global workforce

Reaping the benefits from migration in the Western Balkans requires a change in mindset. The existing efforts in the WB6 are not sufficient to fully unlock the benefits of migration. The human capital and the workforce available to the WB6 countries are not only that of the people who currently live within their borders but also includes their global workforce. A portion of this population eventually returns to their home countries while others remain abroad. Even when they remain physically outside the country, this global workforce can significantly contribute to the country's development in various ways, such as bringing essential flows of capital and expertise to the local economies or building economic linkages with other countries (e.g., trade and business networks). Additionally, with lower barriers to mobility due to changes in regulations in some EU member states, stronger cooperation between the WB6 and migrant-destination countries is needed. The

126 OECD (2022)

127 The 2019 National Household Migration Survey in Albania is the latest survey collected in the region.

following paragraphs, summarized in Table 10.1, present a snapshot of interventions that could enhance the benefits of migration for the development of the Western Balkan economies.

TABLE 10.1.

Recommendations

Policy recommendation	Responsible institution(s)
I. Strengthening the migration governance framework	
Applying a migration lens to different national strategic documents	Ministry of Finance, Ministry of Economy, Ministry of Labor, Ministry of Education and other line ministries
Developing skills training and mobility programs (e.g., Global Skills Partnerships)	Ministry of Labor, Ministry of External Affairs
Expanding the depth and breadth of Bilateral Labor and Social Security Agreements (BSSA)	Ministry of External Affairs, Ministry of Labor, Public Employment Agency
II. Expanding protection and service provision to emigrants throughout their migration journey	
Improving social protection to emigrants	Diaspora Agency, Ministry of Labor, Ministry of Social Welfare
Providing pre-departure information and training for prospective emigrants	Public Employment Agency,Ministry of Education, Ministry of Labor
Strengthening consular services for emigrants	Ministry of External Affairs, Embassies
Reducing the cost of remittances	Central banks, Ministry of Finance
Expanding outreach efforts to map the diaspora	Diaspora Agency, Ministry of External Affairs, Embassies
Strengthening and scaling up diaspora investments and knowledge-sharing programs	Diaspora Agency, Ministry of External Affairs, Embassies
Providing information and tax incentives to support the return of migrants	Ministry of External Affairs, Embassies, Ministry of Finance, Public Employment Agency
Expanding support services to return migrants in need to facilitate their reintegration	Public Employment Agency, Ministry of Interior, Ministry of Labor, Ministry of Social Welfare
III. Developing a fit-for-purpose immigration system	
Investing in labor skills monitoring systems and linkages to migration policy	Ministry of Labor, Public Employment Agency, Ministry of Interior
Providing services to foreign workers to facilitate their integration in the labor market	Public Employment Agency, local governments, Ministry of Social Welfare
IV. Leveraging technology and data to increase the effectiveness of services	
Digitalization to support an integrated migration management and service delivery systems	Ministry of Interior, Public Employment Agency, municipalities
Strengthening data collection by establishing a comprehensive registry covering short- and long-term migration	National Statistics Agency, Diaspora Agency, Public Employment Agency, different ministries with roles on migration

I. Strengthening the migration governance framework

To implement this shift in mindset, the first step is to apply a migration lens to WB6's national development strategies. This entails connecting migration policies throughout the migration cycle to the development objectives of the country and consolidating its different elements into a singular legislation. Initial steps in this direction have been made in several WB6 countries. For example, Albania has included key components of the migration agenda under the country's main strategy, the "National Strategy on Development and Integration".

Global Skills Partnerships (GSPs) are examples of programs that can increase the development impacts of migration for Western Balkan countries. These programs are bilateral labor and training agreements between two countries. Through these arrangements, workers in the country of origin are trained in skills that are in demand in both countries, with the destination country participating in the funding and development of the curriculum. After the training, some trainees emigrate to work in the destination country ("abroad" track), while others remain and work in their country of origin ("domestic" track). The two tracks ensure that both countries are able to benefit from the development of skills. These programs also address concerns of human capital losses in sending countries due to emigration, while providing additional formal migration pathways for migrants in specific sectors. Furthermore, GSPs strengthen the capacity of education and training systems in the origin countries, and align them to international standards.[128] GSPs provide a holistic skill and migration package that includes tailored services and support to prospective migrants, and ease coordination challenges across actors in both countries. Pilots have already been developed across the world, including in the region.[129] EU countries are increasingly interested in these types of models that fit within the Talent Partnership (TP) framework announced in the recent EU Pact on Migration and Asylum. The final goal is to explore mutually beneficial labor mobility and skills arrangements between the EU and partner countries. TPs incorporate capacity building in partner countries, including in vocational education and training, and support for nationals of those countries to be trained and work in the EU.[130]

WB6 countries could also explore further expanding and developing the depth of bilateral and multilateral labor and social security agreements with main destination countries. These are essential for enhancing coordination across countries in the matter, strengthening formal labor migration corridors and reducing irregular migration, and better protecting and serving mobile workers throughout their migration journey. Western Balkan countries can build on existing examples, such as the Bosnia and Herzegovina and Slovenia bilateral labor agreement (BLA), to expand the coordination with third countries. Data-sharing of relevant information for migrants is a key element that needs to be included in agreements with the main destination countries.

128 Adhikari et al. (2021).
129 Center for Global Development (2021).
130 European Commission (n.d.).

II. Expanding protection and service provision to emigrants throughout their migration journey

An internationally mobile workforce also requires the development and adaptation of social protection instruments to mitigate the risks that they may face. Many migrants from the Western Balkans are still not fully covered by social protection systems, neither in origin nor in destination countries. The proposed expansion of BLAs and BSSAs can better cover migrants against risks and facilitate the portability of pensions and unemployment benefits. International evidence shows that this not only increases migrants' welfare but also incentivizes some of them to return to their home country.[131] A particular focus should also be given to increasing the protection of migrants with informal employment contracts. WB6 countries can consider developing welfare funds to provide financial assistance to migrants facing adverse economic situations, similar to the situation that many faced during the COVID-19 pandemic. For example, the Overseas Welfare Fund of the Philippines provides support to migrant workers irrespective of their working status.[132] Welfare funds can be financed by personal contributions and/or through the engagement of private employers.

Government agencies can also expand their services to their mobile population across borders. As workers move between countries, their demand for services evolves. Before departure, Western Balkan public employment agencies can expand migration information services and skills training provision to increase the readiness of prospective migrants and to ensure more equitable access to migration opportunities. For example, employment agencies can share job offers so migrants can have better information at home on opportunities in destination countries. While abroad, emigrants can benefit from stronger consular sections that provide counseling and support. WB6 countries could also consider measures to reduce the cost of remittances, such as exempting remittance flows from fees, improving the competitive environment in the remittance market, and supporting technology adoption in payment and settlement systems.[133] Evidence from other regions shows that the reduction in the cost of remittances promotes their transfer through the formal financial system.[134] To incentivize return migration, governments have room to ease the repatriation of funds, including reducing the tax burden, especially that of double taxation. The current system of service delivery for return migrants under readmission agreements could be expanded to provide tailored services to more successful returnees, such as access to networks and support for entrepreneurial activities.

More broadly, WB6 countries have a unique opportunity to strengthen the engagement with the diaspora through a more holistic approach to expand their development impact. In previous decades, individual diaspora programs in the Western Balkans have shown promising results and the potential the diaspora has to support the local economies, even without returning. Moving forward, expanding the role of the diaspora requires institutionalizing current engagements under a long-term comprehensive approach that addresses the main challenges that the diaspora faces to give back to the local economy. This starts with investing in extensive outreach efforts to map the diaspora, strengthening trust in public institutions, and enhancing migrants' connection to their home country through service provision and cultural identity

131 Avato, Koettl, and Sabates-Wheeler (2010).
132 ILO (2023): "Using Migrant Welfare Funds as a social protection instrument – potential and limitations?" Social Protection Spotlight.
133 World Bank (2006): "Reducing Remittances Fees", Global Economic Prospects.
134 Ambler et al. (2014); Aycinena et al. (2010).

events, or promotion of political rights. Ireland is a successful example of a country that developed a comprehensive system to leverage its diaspora's resources to support its economic growth (see Box 10.5). Best practices include consolidating support services (e.g., information, financial support, training) into one-stop shops that are easily accessible to diaspora investors. Furthermore, more efforts can be made to expand the matching between the diaspora and the local economy, be they entrepreneurs or research centers.

Box 10.5: Diaspora engagement in Ireland

Similar to many Western Balkan countries today, Ireland is a small country that faced sizable waves of emigration throughout the 1900s and 2000s.[135] However, robust economic growth in the final decades of the twentieth century led to a reversal of trends, and the country now attracts more inflows of migrants, including the return of Irish emigrants. The dynamism in the economy supported growth in wages over a prolonged period of time, reducing earning gaps with main destination countries (e.g., the United States or the United Kingdom). As the economic growth increased employment opportunities, Ireland took purposeful steps to connect and attract its sizable diaspora.

Ireland's diaspora engagement is based on a vision of the 'Global Irish' workforce where the diaspora can contribute in different ways whether they return or not. All the engagement is guided by the overarching diaspora strategy ('Global Ireland' 2020–25) that connects individual programs and links all the main objectives to the development strategy. The Government of Ireland offers a wide range of services, from providing assistance while abroad, to maintaining connections to the country through cultural events, to promoting return and entrepreneurship back home. To improve the success of these programs, the Government has invested in building trust and a common Irish identity through philanthropic and cultural events. These efforts have led to larger flows of diaspora resources in the economy, such as FDI, tourism, and global networks.

Another important lesson from the Irish case is that the continued investment in the education system, even if it initially meant that more high-skilled individuals were emigrating, had positive payoffs decades later. As a powerful example, the return of high-skilled migrants that accumulated wealth, knowledge and global networks while abroad was a key engine in the development of the IT industry in Ireland, which proved to be vital for growth.

135 Barrett (2005).

III. Developing a fit-for-purpose immigration system

WB6 countries can strengthen their immigration systems to better select, train, and integrate foreign workers to ensure the availability of needed skills in the labor market. Bilateral employment and social security agreements need to be developed with potential countries of origin of foreign workers to better regulate entry paths and enhance the protection of immigrants (including portability of benefits and regulating recruitment agencies at origin and destination). Linking immigration to labor market needs will also require better forward-looking skills monitoring, including what skills will be more in demand and what are the main skill gaps and in what sectors so they can be addressed, either through educational investments, inflows of return migrants, or import of immigrant workers. More efforts to streamline the selection process of foreign workers are needed to be more reactive to labor market needs, including reducing timelines for visa and permit applications, and eliminating duplicate steps required by different agencies. In order to facilitate the social inclusion and integration of foreign workers, WB6 countries can also expand services to this population, including language training, better access to active labor market programs, and enhancing rights for family members.

IV. Leveraging technology and data to improve the effectiveness of services

Digitalization can support the streamlining of bureaucratic procedures and facilitate coordination across multiple stakeholders. Digitalization of different procedures can ease some capacity constraints, and support more effective and integrated migration management and service delivery systems. This, in turn, facilitates the coordination of migration policy across different agencies. It also allows the implementation of the electronic Case Management System that can support migrants in a holistic way throughout their migration journey. In the region, Kosovo has developed a good example of electronic case management for return migrants that covers the entire process of reintegration, from the return to the settlement in different municipalities.[136] The electronic system can be accessed by all relevant public agencies and contains relevant information on services provided to migrants and different outcomes of interest. Services provided include temporary shelter, transportation, medical services, or information. Needs assessments and referrals are done both in reception centers at border crossing points and in their home municipalities through the Municipal Office for Communities and Return.[137] This model can be expanded beyond return migrants under readmission agreements to cover a broader group of emigrants and throughout the different phases of migration, as well as foreign workers arriving to the country.

Strengthening data is imperative to better inform migration policymaking. A comprehensive registry of migrants that covers short- and long-term migrants, and also captures their return to the country, is needed as a base for building effective policies and service delivery. To do this, incentives should be created for migrants to register, including the provision of valuable services. Key information on migrants for sound policymaking includes their migration patterns, education, skills, and work experience. Censuses and periodic nationally representative surveys can also incorporate questions to capture both current migrants and return migrants to be able to assess their socio-economic outcomes. In

136 Republic of Kosovo (2017).
137 Republic of Kosovo (2020).

addition, the WB6 countries can consider developing ad-hoc migration surveys with detailed questions on the migration history, skills, constraints and vulnerabilities, and outcomes in the education and labor markets throughout the migration cycle, before migration, while abroad, and after returning to the home country. Recent examples of such surveys include the 2023 Kyrgyz Migration Survey or the 2019 Bangladesh Return Migrant Survey. As data collection efforts increase, it is important to use an evidence-based approach in migration policymaking. This includes developing rigorous evaluations of different migration programs. Given the uncertainty about the effectiveness of many ongoing interventions, learning is critical to calibrate and adjust, scaling up the more successful ones while discontinuing those showing worse results to avoid misguided policies.

Conclusions

Overall, Western Balkan countries are at an important juncture, with a unique opportunity to better leverage the role of migration to enhance economic development. With some of the largest diasporas around the world as a share of the population, migration has been part of the region's identity for decades. Reflecting on this, the WB6 countries have made substantial progress in developing their migration systems. Despite these efforts, relevant gaps remain. This spotlight provides several options for policies that can support a more holistic and development-centric approach to support the Western Balkans mobile population for the benefit of migrants and local economies alike. Time is of the essence in addressing the existing challenges. From the perspective of the emigrant population, the large diasporas can still be engaged and supported via multiple channels to participate in countries' economic development. From the perspective of foreign-born workers, recent trends have shown that immigration will continue growing to fill important workforce gaps. As such, the WB6 countries can take action to further develop their systems to select, train, and integrate foreign workers in their economies and, more broadly, in their societies.

Country Notes

Albania

- Growth in 2024 is expected to remain robust at 3.3 percent, on the back of private consumption, tourism, and construction. Price pressures have continued to ease.
- Poverty is expected to continue to decline as labor income increases.
- Medium-term prospects hinge on the recovery of the global economy and on the pace of structural reforms. The EU accession aspirations provide an anchor to speed up convergence.

Key conditions and challenges

The Albanian economy has shown considerable resilience as prudent macroeconomic policies supported a strong economic rebound, with real GDP growth averaging 4.2 percent in 2022 and 2023. A key factor in Albania's resilience has been the proximity to the EU, a key source of investment and remittances, and a main destination for exports. Tourism remains a key growth driver, helping to improve external imbalances and partially contributing to a steady appreciation of the LEK in recent years. The availability of hydropower, which meets 85 percent of domestic energy demand in years with average precipitation, has contributed to containing the country's greenhouse gas emissions. Albania's key development challenges are its declining population, partially due to outmigration; the poor quality of the labor force and the low quality of jobs created; the moderate pace of structural reforms, especially in the areas of private sector environment and governance; and rising fiscal pressures, due to climate risks, contingent liabilities and debt refinancing at a time of the high cost of external financing. To create the needed fiscal space and address these challenges, Albania will need to implement a Medium-Term Revenue Strategy to strengthen domestic revenues. Unlocking further growth is conditional on the swift implementation of the government's program, anchored in the EU accession aspiration, and built on reforms tackling productivity, including improving the business environment, and expanding Albania's integration into foreign markets.

Recent developments

Following a 3.4 percent real growth rate in 2023, Albania's economy grew at a higher pace of 3.6 percent in Q1 of 2024. On the supply side, growth was primarily driven by services and construction. Private consumption and investment were the main drivers on the demand side. In the coming quarters, investment and services exports are expected to strengthen. Economic sentiment remains positive, though showing signs of moderation. At the end-2023, the employment rate reached 66.7 percent with variation across demographics, with a 0.7 percentage point increase for men and 0.3 percentage point decrease for women. Overall, poverty declined by 1.9 percentage points to reach 21.7 percent. Based on administrative data for Q1 2024, employment grew by 1.1 percent y-o-y, driven by the private sector. The average private sector wage increased by 12.7 percent, reflecting growth across all economic activities. Annual inflation rate continued its declining trend, averaging around 2.7 percent in Q1 of 2024, as a result of downward pressures from lower import prices, domestic currency appreciation and monetary policy normalization. In the subsequent months up to July 2024, inflation has remained stable at around 2.1 percent, mainly driven by wage increases in the private sector, while food and non-alcoholic beverages, which constitute close to 35 percent of the consumption basket, had a deflationary trend.

As of July 2024, the government reported a fiscal surplus, on account of robust revenue collection and sluggish execution of capital investment. Budget revenues increased by over 8 percent y-o-y as of July 2024, with growth observed in all categories, except grants and profits, which were mostly affected by the base effect (as they had picked up in the previous year). Overall credit increased by 13% y-o-y through July 2024. Both private businesses and household loans registered double digit growth, at approximately 12.0% and 14.5%. Gross non-performing loans reached the level of 4.7% in July 2024. The current account deficit (CAD) widened in H1, primarily driven by the rapid growth of imports and the decrease in exports of goods. Net FDI continued to perform strongly, increasing by 8.5%. Foreign currency reserves reached the level of 5.7 billion Euros as of July 2024.

Outlook

Growth is expected to remain robust at 3.3 percent in 2024, with increased tourism and construction expected to drive exports, and consumption and investment growth at rates similar as in the pre-pandemic period. The inflation rate is projected to remain below the 3 percent target in the medium term, despite the increase in wages, which has partially been offset by the appreciation of the LEK. The current account deficit is expected to hover at 3.8 percent of GDP in the medium term. With higher growth expected, poverty is also projected to decrease. A tighter labor market could further boost wages. Albania's primary balance is projected to improve and reach zero percent of GDP from 2024 onwards. Government plans to continue improving tax administration, as envisioned in the Medium-Term Revenue Strategy. Public debt is expected to decline further in the medium term. Leading indicators are pointing upwards: there is strong tourism data and increased construction activity, rising credit growth, positive business and consumer sentiment indicators, and strong tax revenues. Given Albania's growing reliance on external financing, risks related to the exchange rate, interest rate, and refinancing remain elevated. As a small, open economy, Albania is highly exposed to external shocks, such as a recession in the EU or further tightening of financing conditions in international capital markets. Risks to growth emanate from natural disasters and unfavorable global conditions (including geopolitical developments). Fiscal risks emanate from public-private partnerships and SOEs, in addition to the country's hydropower-based energy sector, due to variation in hydrology.

ALBANIA - Selected Economic Indicators

ALBANIA	2021	2022	2023	2024e	2025f	2026f
Real GDP growth (percent)	8.9	4.9	3.4	3.3	3.4	3.4
Composition (percentage points):						
Consumption	3.7	6.4	-0.3	3.4	2.2	2.3
Investment	4.4	2.1	0.8	2.6	1	0.9
Net exports	0.7	-3.6	3	-2.7	0.2	0.2
Exports	13	2.6	3.6	0.2	2,4	2.5
Imports (-)	12.3	6.2	0.7	2.9	2,2	2.3
Consumer price inflation (percent, period average)	2	6.7	4.8	2.2	2.7	2.9
Public revenues (percent of GDP)	27.5	26.8	27.8	29.2	28.4	28.5
Public expenditures (percent of GDP)	32.1	30.4	29.2	31.6	30.7	30.3
Of which:						
Wage bill (percent of GDP)	4.5	4	4.3	4.9	4.9	4.8
Social benefits (percent of GDP)	12.3	11.5	11.1	11.4	11.3	11.2
Capital expenditures (percent of GDP)	6.9	5.2	5.1	6.2	5.6	5.5
Fiscal balance (percent of GDP)	-4.6	-3.7	-1.3	-2.3	-2.3	-1.8
Primary fiscal balance (percent of GDP)	-2.7	-1.8	0.7	0	0	0.5
Public debt (percent of GDP)	71.5	62.1	57.2	55.4	54.4	53.2
Public and publicly guaranteed debt (percent of GDP)	75.4	65.3	59.8	58.3	57.6	56.3
Of which: External (percent of GDP)	36.8	30.2	26.9	25.3	24	22.7
Goods exports (percent of GDP)	8.3	10.8	8.6	8	7.5	7.5
Goods imports (percent of GDP)	33.6	34.6	30	27.1	27.1	27
Net services exports (percent of GDP)	11.8	13.4	16.1	11.3	11.8	11.8
Trade balance (percent of GDP)	-13.4	-10.4	-5.2	-7.8	-7.8	-7.7
Net remittance inflows (percent of GDP)	5	4.6	4.4	4.4	4.5	4.5
Current account balance (percent of GDP)	-7.7	-5.9	-0.9	-3.9	-3.8	-3.7
Net foreign direct investment inflows (percent of GDP)	6.5	6.6	5.9	5.3	5.3	5.4
External debt (percent of GDP)	62.7	54.3	51.8	50	49	48.5
Real private credit growth (percent, period average)	5.5	2.9	-1.8	-	-	-
Nonperforming loans (percent of gross loans, end of period)	5.7	5	5.2	-	-	-
Unemployment rate (percent, period average)	11.5	10.9	10.7	-	-	-
Youth unemployment rate (percent, period average)	20.9	20.7	22.2	-	-	-
Labor force participation rate (percent, period average)	59.8	62.4	64.1	-	-	-
GDP per capita, PPP (current international $)	16,302	16,782	17,151	17,758	18,408	19,071
Poverty rate (percent of population)	27.1	23.6	21.7	20.1	18.5	17.1

Sources: Country authorities, World Bank estimates and projections.

Bosnia and Herzegovina

- Real GDP growth rose 2.7 percent in Q1 2024, from 1.7 percent in 2023 due to the modest economic expansion in the EU and a deceleration in investment growth.
- Upcoming municipal elections are expected to lead to a widening fiscal deficit to 1.7 percent of GDP in 2024, yet public debt remains around 27.4 percent of GDP.
- Living standards are stagnant, in part due to an anemic labor market.

Key conditions and challenges

BiH has been granted permission by the European Council to begin accession talks in March 2024, pending the implementation of necessary reforms. To meet the economic criteria for EU membership, BiH must tackle internal market fragmentation by bolstering nationwide regulatory and supervisory bodies, improving the transparency and efficiency of the large public sector, and reducing the footprint of state-owned enterprises. BiH's economy has shown macroeconomic stability and resilience over the past, including during the COVID-19 pandemic. This resilience is attributed to three economic anchors: the currency board (which ties the BiH mark to the euro), the statewide collection of indirect taxes through ITA, and the prospects of EU membership. Despite macro stability and resilience, real income growth has averaged only 2 percent per annum from 2009 to 2023, leading to stagnant living standards, with real per capita consumption remaining at just 40 percent of the EU27 average. Achieving faster convergence with the EU27 remains difficult due to low investment rates and a growth model that depends on private consumption. The need for structural reforms is even more critical given the challenges of a declining population and the likely slowdown in total factor productivity over the long term. In addition, the introduction of the EU Carbon Border Adjustment Mechanism in 2026 is expected to further challenge BiH's export competitiveness by 2030. To achieve sustained long-term growth of 3-4 percent, reforming the economy and the energy system is crucial. However, the pace of reform remains slow due to lack of consensus on country level policies that would bring BiH closer to EU membership; furthermore, frequent elections, widespread corruption, and the fragmented division of responsibilities between the two entities and cantons also contribute to the slow pace of reforms. Overcoming these obstacles is vital for BiH to move towards a more prosperous future.

Recent developments

In Q1 2024, real GDP growth rose 2.7 percent, discontinuing the sharp slowdown in 2023. The pick-up in output growth is largely due to a recovery in private consumption fueled by an increase in minimum wages and a tightening labor market. Stronger retail sales volumes in the first half of 2024 suggest robust private consumption outcomes during this period. Inflation reached 1.8 percent in July 2024 y/y, compared to 4.0 percent the year before, marking a drop in transport prices and a slowdown in utility prices. The labor market showed mixed signals. The employment rate rose to 41.9 percent in Q1 2024, up from 41.5 percent in 2023, whereas the unemployment rate increased to 13.5 percent, a 0.3 percentage point increase compared to the previous year. Economic vulnerability to shocks in BiH remains high – according to the 2023 Life in Transition Survey, 40 percent of the population report being unable to save, running into debt, or not being able to cover basic household expenses for longer than 1 month in case of loss of their main income source. Higher government spending and smaller revenues (in GDP terms) contributed to a consolidated fiscal deficit of 0.9 percent of GDP in 2023, which followed a surplus of 0.5 percent of GDP the year before. The deficit in 2023 was driven by an estimated 16 percent increase in subsidies, social benefits and transfers in FBiH, and an 11 percent increase in RS. Nevertheless, public debt remains relatively low at around 27.4percent of GDP. Meanwhile, the current account deficit improved to 2.8 percent in 2023. It was almost fully financed by net FDI inflows, and other investments, mainly foreign loans.

Outlook

An improvement in the EU economic landscape, coupled with higher private consumption and investment driven by construction activities, is set to raise real GDP growth in BiH to 2.8 percent in 2024, and 3.2 percent in 2025. Inflation is expected to decelerate to half a percent by 2026 barring any further external shocks. By 2026, real output growth is projected to rise to 3.9 percent fueled by strengthened exports and private consumption stemming from improved economic conditions in the EU and tightening labor markets in BiH. The current account deficit is expected to widen to around 3.6 percent of GDP due to higher imports of consumer goods. In the last quarter of 2024, policy makers are focused on the municipal elections leaving little space for economic reforms. Several structural challenges hinder stronger output growth. Productivity is affected by the large footprint of state-owned enterprises, which employ a sizable portion of the educated labor force. Population ageing, driven by outmigration, also dampens productivity and burdens public service delivery, particularly in health. The economic activity rate remains low at around 48 percent compared to the EU average of 75 percent, with women's participation at roughly 37 percent. Gender discrepancies in employment remain particularly stark at the lower levels of education. Thus, creating conditions to activate the female labor force would benefit economic growth. Furthermore, the sharp rise in minimum wages, in January of 2023 and 2024, may impact external competitiveness, which could also be affected by the EU's Carbon Border Adjustment Mechanism, considering that two-thirds of BiH's electricity production comes from coalfired thermal power plants. In addition, a lack of digitalization and unified databases and registries hampers regulatory compliance and business operations. Finally, geopolitical risks pose a threat of exacerbating domestic political frictions, undermining the much-needed push for structural reforms.

BOSNIA AND HERZEGOVINA - Selected Economic Indicators

BOSNIA AND HERZEGOVINA	2021	2022	2023	2024e	2025f	2026f
Real GDP growth (percent)	7.4	4.2	1.7	2.8	3.2	3.9
Composition (percentage points):						
Consumption	-	-	-	2.7	2.3	3,0
Investment	-	-	-	1.3	1.8	0.5
Net exports	-	-	-	-1.1	-0.9	0.3
Exports	-	-	-	0.3	1	1.4
Imports (-)	-	-	-	1.5	1.9	1
Consumer price inflation (percent, period average)	2	14	6.1	2	0.9	0.4
Public revenues (percent of GDP)	41	40.2	41.3	42.2	42.6	43.2
Public expenditures (percent of GDP)	41.3	39.7	42.2	43.9	42.8	43.6
Of which:						
Wage bill (percent of GDP)	10.3	10.3	10.9	10.9	10.5	10.1
Social benefits (percent of GDP)	14.6	17.4	18.2	19.8	19.9	20.7
Capital expenditures (percent of GDP)	3.5	3.5	3.8	3.8	3.3	3.6
Fiscal balance (percent of GDP)	-0.3	0.5	-0.9	-1.7	-0.2	-0.4
Primary fiscal balance (percent of GDP)	0.3	1.1	-0.1	-0.8	0.8	0.6
Public debt (percent of GDP)	33.9	29.3	26.9	27.4	27.2	26.7
Public and publicly guaranteed debt (percent of GDP)	37.6	31.5	28.5	28.2	28.9	28.4
Of which: External (percent of GDP)	29.5	24.9	21.4	21.8	21.5	21.1
Goods exports (percent of GDP)	32.5	35.9	32	31.5	31.4	31.3
Goods imports (percent of GDP)	50.8	58.2	52.8	51.8	51.9	51.3
Net services exports (percent of GDP)	7	8.6	8.1	7.4	7	6.7
Trade balance (percent of GDP)	-11.3	-13.8	-12.7	-12.9	-13.5	-13.3
Net remittance inflows (percent of GDP)	7.8	7.9	7.7	7.5	7.4	7.3
Current account balance (percent of GDP)	-1.8	-4.3	-2.8	-3.2	-3.8	-3.6
Net foreign direct investment inflows (percent of GDP)	3.3	3	3.2	3.2	3.1	3.1
External debt (percent of GDP)	57.2	48.7	54.4	52.3	50.5	48.5
Real private credit growth (percent, period average)	-0.3	-8.1	-0.7	-	-	-
Nonperforming loans (percent of gross loans, end of period)	5.8	5.4	5.2	-	-	-
Unemployment rate (percent, period average)	17.4	15.4	13.2	-	-	-
Youth unemployment rate (percent, period average)	38.3	35.1	30.1	-	-	-
Labor force participation rate (percent, period average)	48	47.6	47.8	-	-	-
GDP per capita, PPP (current international $)	17,377	17,898	18,202	18,712	19,311	20,064

Sources: Country authorities, World Bank estimates and projections.

Kosovo

- Economic activity picked up during the first quarter of 2024, on the back of robust consumption growth as prices stabilized.
- Over the medium term, growth is projected to strengthen further, fueled by consumption, rising real incomes, credit expansion, and increased public wages and transfers.
- A strengthened EU accession process, backed by the EU growth plan, has the potential to improve trade integration, attract more FDI and bolster economic growth.

Key conditions and challenges

After a slowdown in 2023, Kosovo's growth accelerated in the first part of 2024, yet within the bounds of its structural constraints. The fiscal performance remained robust, with revenue growth continuing to be strong. However, the country is confronted with the need to undertake reforms that demand substantial fiscal resources. Key among these is the implementation of a new energy strategy, improvement of water security, and the acceleration of reforms aimed at bolstering human capital and connectivity. Kosovo's growth model relies mainly on consumption and construction investment, financed significantly by the country's diaspora. Recent growth trends in exports of ICT and other business services are encouraging. Foreign direct investments in 2024 continue to increase but remain primarily focused on real estate. In 2023, labor force participation inched up to 40.7 percent. However, the working-age population has shrunk, partly due to ongoing outmigration. Visa liberalization with the EU has reduced costs and spurred an increase in international travel and higher service imports. The country lags peers in human capital development. To transition to a growth model that favors more and better-quality jobs, Kosovo should continue to maintain macroeconomic stability and accelerate reforms that target the closing of regulatory, human capital, and vital infrastructure gaps. The positive trend in the national average for poverty reduction may obscure regional disparities. Poverty is more prevalent among people with lower education and children, so it is essential to emphasize human capital accumulation. A significant portion of Kosovo's workforce comprises the working poor, who face low wages and limited human capital. This situation is exacerbated by low labor force participation, especially among women, influenced by high reservation wages and attractive outside options, including migration.

Recent developments

GDP growth accelerated in the first quarter of 2024, with provisional estimates indicating a 5.6 percent increase. Private consumption growth (9.7 percent y/y) provided the highest contribution. On the supply side, net taxes on products contributed most to the growth. Consumer inflation decelerated, averaging 2.1 percent between January and August 2024. Core inflation, however, remains elevated (3.6 percent by August). Labor market formalization continued in 2023, reflected in a 4.5 percent increase in formal employment. The current account deficit (CAD) for the first half of the year increased by ¼ from the same period of last year, driven by a higher deficit in the goods balance. Cumulative remittances' growth by July slowed down to 0.5 percent, compared to 11.3 percent during the same period of last year. By August 2024, the government ran a fiscal surplus and tax revenues grew by 11 percent, reflecting increased compliance and formalization gains. Meanwhile, expenditures increased by 14 percent, driven by increases in wage spending. In the first quarter of 2024, public and publicly guaranteed debt (PPG) fell to 15.8 percent of GDP, down from 17.5 percent in 2023. The financial sector remains robust. By July 2024, credit increased by 13.6 percent (y/y) and non-performing loans remaining stable at 2 percent. Poverty reduction is projected to continue, with a decline of 2.2 percentage points in 2024 (from 21.4 percent in 2023) due to slightly higher growth. However, growth has been skewed towards urban centers, leading to increased inequality. Another important dimension is susceptibility to shocks and its welfare consequences. In 2022, price increases reached levels not seen in decades, and energy price shocks posed concerns for the most vulnerable groups. Similarly, geopolitical tensions and subsequent supply-chain disruptions have heightened worries about their effects on those at the lower end of the economic distribution.

Outlook

GDP growth is projected to accelerate to 3.8 percent in 2024 and gradually converge towards 4 percent over the medium-term. Growth is likely to be spurred by consumption, underpinned by rising incomes, credit, and public spending. Public infrastructure and private real estate investments, along with post-2025 renewable energy investments, are also expected to contribute to growth. On the production side, services and construction will provide the highest contribution. Merchandise exports will remain subdued in 2024, gradually recovering by 2026. International price stabilization is expected to slow domestic consumer price inflation to 2 percent in 2024. However, upward pressure on wages could keep core inflation higher. Outmigration and increased travel spending abroad, associated with visa liberalization, represent a drag on growth. The CAD is expected to deteriorate in 2024 but improve starting in 2025. Real estate FDI is projected to increase, but more greenfield and productive FDI is needed. Driven by higher current and capital expenditures, the fiscal deficit is expected to edge up to 1.1 percent of GDP in 2024 and remain in line with fiscal rules over the medium-term. An increase in spending pressures associated to the upcoming electoral cycle represents a risk. Continued geopolitical uncertainty, including that associated with the domestic political context, also entails risk. A reinforced EU accession process could enhance growth prospects. With growth expected to accelerate, poverty is also projected to decrease. A tighter labor market is anticipated to boost wages. While outmigration has sparked concerns about human capital losses, migration can also incentivize the optimal use of domestic human capital. The declining population could be offset by increasing female labor force participation, constrained by lack of childcare services. Expanding childcare services would not only improve labor market opportunities for women but also enhance children's school readiness through better early childhood education (ECE).

KOSOVO - Selected Economic Indicators

KOSOVO	2021	2022	2023	2024e	2025f	2026f
Real GDP growth (percent)	10.7	4.3	3.3	3.8	3.9	4
Composition (percentage points):						
Consumption	8.3	2.7	3.9	4.6	3.8	4.1
Investment	4.8	-1.1	1	1.7	1.7	1.5
Net exports	-2.4	2.7	-1.6	-2.5	-1.5	-1.5
Exports	16.3	6.4	2.4	2.4	1.7	2
Imports (-)	18.7	3.7	4.1	4.9	3.2	3.4
Consumer price inflation (percent, period average)	3.3	11.6	4.9	2	1.9	1.8
Public revenues (percent of GDP)	27.4	27.9	29.4	29.2	29.4	29.6
Public expenditures (percent of GDP)	28.8	28.4	29.7	30.3	31.1	31.4
Of which:						
Wage bill (percent of GDP)	8.4	7.3	7.9	8.2	8.2	8.3
Social benefits (percent of GDP)	7.8	8.1	7	7.1	7,1	7
Capital expenditures (percent of GDP)	5.3	4.7	5.7	6.1	6.7	7.2
Fiscal balance (percent of GDP)	-1.3	-0.5	-0.3	-1.1	-1.7	-1.9
Primary fiscal balance (percent of GDP)	-0.9	-0.1	0.2	-0.7	-1.3	-1.4
Public debt (percent of GDP)	21.1	19.7	17.2	17.2	18.1	18.9
Public and publicly guaranteed debt (percent of GDP)	21.6	20	17.5	17.4	18.3	19.1
Of which: External (percent of GDP)	7.2	7.2	7.2	7.8	8.4	8.5
Goods exports (percent of GDP)	9.5	10.5	9	7.7	8.1	8.3
Goods imports (percent of GDP)	54.3	58.7	56.6	53.6	54.1	53.9
Net services exports (percent of GDP)	13	15.4	16.9	16.3	16.4	15.8
Trade balance (percent of GDP)	-31.8	-32.8	-30.8	-29.7	-29.6	-29.8
Net remittance inflows (percent of GDP)	14.1	13.4	13.4	12.8	12.8	12.8
Current account balance (percent of GDP)	-8.7	-10.3	-7.6	-8.1	-7.6	-7.5
Net foreign direct investment inflows (percent of GDP)	4	6.3	6.8	7.1	7	6.9
External debt (percent of GDP)	37.6	38.6	38.6	39.5	39.8	40.2
Real private credit growth (percent, period average)	7.6	5.2	8.7	-	-	-
Nonperforming loans (percent of gross loans, end of period)	2.3	2	2	-	-	-
Unemployment rate (percent, period average)	20.7	12.6	10.9	-	-	-
Youth unemployment rate (percent, period average)	38	21.4	17.3	-	-	-
Labor force participation rate (percent, period average)	39.3	38.6	40.7	-	-	-
GDP per capita (US$)	5,405	5,445	6,142	6,676	7,119	7,577
Poverty rate (percent of population)	25.5	22.8	21.4	19.2	17.1	15.5

Sources: Country authorities, World Bank estimates and projections.

Montenegro

- Montenegro's economy is expected to grow by 3.4 percent in 2024. Growth is projected to moderate but remain solid at 3.5 percent in 2025, boosted by wage increases.
- However, fiscal challenges persist as the Fiscal Strategy 2024-27 reduces pension contributions, likely increasing the deficit to 4.1 percent of GDP in 2025.
- Public debt is expected to rise to an estimated 64.5 percent of GDP by 2026.
- Maintaining fiscal sustainability will require disciplined policies amid high external financing costs and geopolitical uncertainties.

Key conditions and challenges

Montenegro, characterized by its small open economy, rich biodiversity, and EU ambitions, has shown resilience despite vulnerabilities to external and domestic demand shocks. As a euroized economy, it relies heavily on fiscal policy for macroeconomic stability. Given its reliance on tourism and the challenges of environmental degradation and climate change, the country would benefit from more sustainable development strategies. After a 15.3 percent contraction in 2020, the economy rebounded swiftly in 2021-23, averaging 8.6 percent growth per annum. Growth is estimated to remain robust in 2024 at 3.4 percent, driven by private consumption, still supported by foreign residents, primarily Russian and Ukrainian citizens. Montenegro successfully reduced its public debt from 103.5 percent of GDP in 2020 to 59.3 percent in 2023, but a lumpy debt repayment profile represents a vulnerability. While one-off revenues resulted in a fiscal surplus of 0.6 percent of GDP in 2023, a return to fiscal deficits is expected in the medium term. Tax revenues remain below 2021 levels following the 2022 reform, which removed healthcare contributions and introduced the PIT allowance (Europe Now 1). Under the government's Fiscal Strategy 2024-27 (Europe Now 2), revenues are projected to decline further with the proposed reduction in pension contributions. After years of political instability following the 2020 elections and the first power shift in 30 years, Montenegro's government, formed in October 2023 and reshuffled in July 2024, has made EU accession its priority. By March 2024, key judiciary and prosecution appointments were made, and in June 2024, a positive Interim Benchmark Assessment Report marked a crucial step, enabling the country to begin closing chapters and move closer to EU membership.

Recent developments

The solid growth from 2023 continued into 2024, although GDP growth moderated from 4.4 percent in Q1 to 2.7 percent in Q2. While increased private consumption and investment supported growth, their high import dependence led to higher imports, weighing on overall growth. By July, real retail trade had grown by 6.4 percent, and the value of construction works by 3.1 percent. However, tourist overnight stays fell by 4 percent, and industrial production by 6.5 percent. Strong employment gains across all sectors continued into 2024. In Q2, LFS data (15-89) showed employment and activity rates of 56.7 percent and 64 percent, respectively, while the unemployment rate dropped to 11.4 percent. By July, annual inflation averaged 4.6 percent, and real wages increased by 1.2 percent y/y. Poverty (income below $6.85/day in 2017 PPP) is projected to have declined to 8.8 percent in 2023. The financial sector is well capitalized and liquid, and credit growth remains strong. In June, the average capital adequacy ratio was at 19.5 percent, while non-performing loans declined to 5 percent from 6.1 percent of total loans a year ago. By June 2024, banking sector lending and deposits increased by 12.5 and 2.1 percent y/y respectively. In H1, the current account deficit (CAD) widened due to lower service exports and a decline in net income accounts, driven by higher dividend and interest payments. Net FDI fell by 5 percent, covering a third of the CAD, with the remainder financed through new debt. External debt stays high at 130 percent. In the first seven months of 2024, the central government achieved a fiscal surplus of 0.4 percent of GDP. Revenues rose by 8.6 percent, despite one-off revenues in 2023, supported mainly by stronger VAT and CIT collection. Expenditures grew by 17.9 percent, mainly due to increased social transfers following the minimum pension increase to €450 in January 2024. In June, public debt stood at 60.8 percent of GDP, and in September, S&P upgraded Montenegro's credit rating from 'B' to 'B+'.

Outlook

The growth outlook is positive albeit challenged by an unfavorable global environment. Coming from a very high base, growth is expected to moderate to 3.4 percent in 2024, still led by private consumption, but also investments. Considering the anticipated increase in the minimum and net wages from October 2024 as reflected in the Fiscal Strategy, personal consumption is expected to boost growth in 2025 to 3.5 percent, despite a closure of the thermal power plant in 2025 for reconstruction that will require greater energy imports. Medium-term growth is expected to be sustained and stimulated by Montenegro's progress towards EU membership. The CAD is projected to widen to 12.6 percent of GDP in 2024 and further to 13.7 percent in 2025 due to higher energy imports, with much of it financed by net FDI. Inflation is expected to soften only slightly to 3.7 percent in 2025 and further to 2.7 percent in 2026. Poverty is projected to decline by 1.8 percentage points from 2023 to 7 percent in 2026. Most of the poor are chronically unemployed, students, or out of the labor force, often living in the northern region. Thus, reducing poverty further requires targeted government policies alongside sustained economic growth. The fiscal deficit is expected to increase in 2025 to an estimated 4.1 percent of GDP before gradually declining to 3.7 percent in 2026. The announced reduction in pension contributions is expected to create a revenue shortfall despite the government's planned compensatory measures. Implementing additional fiscal consolidation measures would improve fiscal performance and help ensure sustainability. Public debt is expected to rise to an estimated 64.5 percent of GDP by 2026. Maintaining debt sustainability will require strong fiscal discipline, especially amid challenging global financial conditions and significant financing needs over 2025-27. The outlook is clouded by potential downside risks. Heightened geopolitical uncertainties may weaken growth prospects for Montenegro's trading partners, while the high cost of external financing poses a risk given the country's substantial financing needs. Domestic political developments also pose a risk.

MONTENEGRO - Selected Economic Indicators

MONTENEGRO	**2021**	**2022**	**2023**	**2024e**	**2025f**	**2026f**
Real GDP growth (percent)	13	6.4	6.3	3.4	3.5	3.2
Composition (percentage points):						
Consumption	3.6	8.1	5.9	3.9	4.5	3.2
Investment	-2.4	3.3	0.7	1.7	1.2	0.8
Net exports	11.8	-5	-0.3	-2.2	-2.2	-0.8
Exports	21	9.4	4.3	0.2	1.8	1.9
Imports (-)	9.1	14.3	4.5	2.4	4.1	2.7
Consumer price inflation (percent, period average)	2.4	13	8.6	4.2	3.7	2.7
Public revenues (percent of GDP)	44	38.6	42.2	41.5	39.7	39.7
Public expenditures (percent of GDP)	46.1	43.4	41.6	44.4	43.8	43.3
Of which:						
Wage bill (percent of GDP)	12.2	10.5	10.5	10.5	10.3	10
Social benefits (percent of GDP)	11.5	11.3	11.9	13.6	13.3	13.1
Capital expenditures (percent of GDP)	5.7	6	5	5.5	5.4	5.4
Fiscal balance (percent of GDP)	-2.1	-4.9	0.6	-2.8	-4.1	-3.7
Primary fiscal balance (percent of GDP)	0.2	-3.3	2.4	-0.8	-1.8	-1.3
Public debt (percent of GDP)	84	69.2	59.3	62.2	61.6	64.5
Public and publicly guaranteed debt (percent of GDP)	86.8	70.9	60.8	63.6	62.9	65.7
Of which: External (percent of GDP)	77.6	61.8	52.3	58.8	57.9	60.9
Goods exports (percent of GDP)	10.6	12.9	10.3	9.2	9	9.2
Goods imports (percent of GDP)	49.3	58	53.2	52.3	52.9	52.4
Net services exports (percent of GDP)	19.3	22.2	24.2	23.7	23.9	24
Trade balance (percent of GDP)	-19.4	-22.9	-18.7	-19.4	-20	-19.2
Net remittance inflows (percent of GDP)	6.1	6.5	4.8	4.6	4.5	4.5
Current account balance (percent of GDP)	-9.2	-12.9	-11.4	-12.6	-13.7	-13.2
Net foreign direct investment inflows (percent of GDP)	11.7	13.2	6.2	7	7	7
External debt (percent of GDP)	191.7	158.4	129.9	130.2	128.8	134.1
Real private credit growth (percent, period average)	-0.2	-4.9	-2.3	-	-	-
Nonperforming loans (percent of gross loans, end of period)	6.8	6.3	6.4	-	-	-
Unemployment rate (percent, period average)	16.6	14.7	13.1	-	-	-
Youth unemployment rate (percent, period average)	37.1	29.4	23.3	-	-	-
Labor force participation rate (percent, period average)	50.9	58.9	63.9	-	-	-
GDP per capita, PPP (current international $)	23,318	27,027	30,880	33,148	34,814	36,638
Poverty rate (percent of population)	12.2	10.1	8.8	8.1	7.5	7

Sources: Country authorities, World Bank estimates and projections.

North Macedonia

- Real growth remained constrained in H1 2024 amidst lingering inflationary pressures, weak external demand, and delayed highway construction.
- Fiscal consolidation targets are likely to be missed for 2024 following election promises. The fiscal deficit and public debt remain elevated over the medium term with higher mandatory spending and build-up of fiscal risks related to arrears, pensions, and spending pressures ahead of local elections.
- The growth outlook is positive, but downside risks prevail.

Key conditions and challenges

North Macedonia is struggling to recover after crises. Real GDP growth has remained muted in 2024, after mere 1 percent in 2023, reflecting delays in the take-off of highway construction works, weaker external demand, and lingering price pressures. Poverty reduction, having stalled in 2023, is estimated to have resumed in 2024 due to rising wages and employment growth vis-à-vis 2023. Fiscal challenges remain persistent. While some reforms have been made to boost domestic revenues, spending efficiency remains low, and fiscal discipline weak. The fiscal deficit remains at around 5 percent post-pandemic, pushing the debt-to-GDP ratio close to 62 percent of GDP. Both the fiscal deficit and public debt remain above the newly introduced fiscal rules, further challenged by pre-election spending commitments related to pensions, public sector wages, and transfers to municipalities. Monetary tightening has helped contain the surge in prices but persistent inflationary pressures risk prolonging the tightening cycle and further dampening economic activity. Rising wages and pensions risk keeping inflation higher for longer and cause a slower return to the long-term average. Crisis induced scars to the economy have significantly slowed potential growth and income convergence with the EU. The country's rebound after the pandemic has not kept pace with that of peers. Ensuring sustainability, rising productivity, and undertaking necessary labor and regulatory structural reforms are essential for EU accession to progress and to enable sustainable growth.

Recent developments

Output growth averaged 1.8 percent in H1 2024 with strong domestic demand while exports and imports dropped. Services led growth, while construction picked up and agriculture had a negative contribution. Relative to end-2023, labor market indicators in Q2 2024 improved slightly, with the employment rate rising by a notch to 45.6 percent, while the participation rate remained almost unchanged at 52.1 percent. The unemployment rate dropped slightly to 12.5 percent, and the youth unemployment rate (15-24) remained high at 26.9 percent. Nominal net wage growth, driven by public sector and minimum wage increases, spiraled up to 14.8 percent in June 2024, outpacing inflation by close to 12 pp. While headline inflation eased from double-digit growth in 2022 to 3 percent in July 2024, core inflation remains high—at above 5 percent, led by wage pressures and services. At the same time, the Central Bank initiated the first policy rate cut of 25 basis points to 6.05 percent in September 2023. The fiscal deficit (with the state roads finances included) is projected to reach 5.1 percent of

GDP in 2024 after a July budget revision that increased spending on wages, pensions and transfers, and lowered capital spending. Public debt went up to 61.5 percent of GDP in Q2 2024, mostly on account of higher issuance of domestic securities. Expenditure arrears have surged to 4.7 percent of GDP in Q2 2024 on account of poor fiscal discipline of local utility companies, public health institutions, and state-owned enterprises. Banking sector stability has been maintained in line with an increase in the capital adequacy ratio to 18.9 percent in Q1 2024, while the liquidity rate (without government securities) settled around 20 percent. At the same time, the NPL ratio increased, but solely as a result of methodological changes. The CAB returned to negative territory at 1.2 percent of GDP in H1 2024 owing to a worsening of the goods trade balance, while services exports held up and remittances eased. External debt slightly declined to 81.8 percent of GDP in Q1 2024, but roughly half of the total is private and mostly intercompany lending.

Outlook

The medium-term outlook remains positive, but risks are tilted strongly to the downside. Growth is expected to step up in the medium term to an average of 2.7 percent during 2025-2026. This projection assumes a rebound of public investments and a gradual recovery of consumption and exports. Headline inflation is projected to remain above or close to 3 percent in 2024-25, but to slow thereafter to a long-term average of 2 percent. Poverty rates are projected to maintain a slow declining pathway, helped by real wage and employment growth, falling by a further 1.2 percentage points over the forecast period. The baseline scenario is built on the assumption that the focus on the EU accession agenda remains a priority for the new administration that won general elections in May 2024. At the same time, low productivity, inefficient capital deployment, and weak external demand, compounded by limited fiscal space and rising fiscal risks amidst high interest rates, continue to impede growth prospects and further slow the pace of income convergence with EU peers. Additional delays of decarbonization targets, along with carbon pricing, risk a loss in domestic public revenues and international competitiveness given the start of the EU Carbon Border Adjustment Mechanism. In this context, following up on the Growth Plan pledges is critical to carve out a growth-conducive economic environment.

NORTH MACEDONIA - Selected Economic Indicators

NORTH MACEDONIA	2021	2022	2023	2024e	2025f	2026f
Real GDP growth (percent)	4.5	2.2	1	1.8	2.5	3
Composition (percentage points):						
Consumption	6.7	2.2	1.8	2	1.4	2.1
Investment	1.4	3.7	-6.7	0.5	1.1	1.2
Net exports	-3.6	-3.8	5.9	-0.8	0	-0.2
Exports	9.1	7.9	-0.1	2.2	3.9	4.4
Imports (-)	12.7	11.7	-6	3	3.9	4.6
Consumer price inflation (percent, period average)	3.2	14.2	9.4	3.5	2.8	2
Public revenues (percent of GDP)	32.1	32.1	34.9	37.3	37.1	37.1
Public expenditures (percent of GDP)	37.4	36.6	39.6	42.1	41.2	40.8
Of which:						
Wage bill (percent of GDP)	6.8	6.5	7.2	8.1	8.1	7.9
Social benefits (percent of GDP)	16.7	16.4	17.7	19.1	18.3	17.7
Capital expenditures (percent of GDP)	4.2	4.2	5.7	6	5,8	5,9
Fiscal balance (percent of GDP)	-5.3	-4.5	-4.7	-4.9	-4	-3.7
Overall fiscal balance with the Public Enterprise for State Roads included (percent of GDP)	-5.7	-4.8	-4.9	-5.1	-4.3	-3.9
Primary fiscal balance (percent of GDP)	-4.1	-3.4	-3.1	-2.9	-2	-1.3
Public debt (percent of GDP)	51.4	50.4	54.1	56.3	57.8	58.8
Public and publicly guaranteed debt (percent of GDP)	60.3	59	62	63.5	63.1	62.8
Of which: External (percent of GDP)	39.4	38.7	39.1	40	39.8	39.6
Goods exports (percent of GDP)	51	56.2	53.5	53.1	53.7	53.8
Goods imports (percent of GDP)	70.8	82.9	72.3	73.2	74.5	75.3
Net services exports (percent of GDP)	4.2	5.8	5.4	6.5	7.9	9.2
Trade balance (percent of GDP)	-15.6	-20.9	-13.5	-13.6	-13	-12.3
Net remittance inflows (percent of GDP)	2.9	2.7	2.5	2.4	2.3	2.3
Current account balance (percent of GDP)	-2.8	-6.1	0.7	-1.8	-2	-2
Net foreign direct investment inflows (percent of GDP)	3.3	5	3.8	3.7	3.5	3.4
External debt (percent of GDP)	80.9	82.8	82	84.7	84.8	84
	-2.9	-5.3	7.4	-0.1	0.7	0.7
Real private credit growth (percent, period average)	2.8	-4	-2.9	-	-	-
Nonperforming loans (percent of gross loans, end of period)	3.1	2.8	2.8	-	-	-
Unemployment rate (percent, period average)	15.4	14.4	13.1	-	-	-
Youth unemployment rate (percent, period average)	36.1	32.5	29.3	-	-	-
Labor force participation rate (percent, period average)	55.8	55.2	52.3	-	-	-
GDP per capita, PPP (current international $)	18,934	20,329	20,532	20,902	21,424	22,067
Poverty rate (percent of population)	18.7	17.8	17.6	16.9	16.1	15.8

Sources: Country authorities, World Bank estimates and projections.

Serbia

- The growth of the Serbian economy accelerated in the first half of 2024 leading to an increase in projected GDP growth for the year as whole to 3.8 percent.
- The incidence of poverty declined to an estimated 6.9 percent. However, there is a possibility of revising down the projected growth considering the severe drought that hit Serbia in 2024.
- Poverty reduction is projected to continue at a much slower pace, as the remaining poor are often characterized by chronic unemployment and thus not benefiting from positive market trends.

Key conditions and challenges

Growth in 2024 is projected at 3.8 percent, y/y, higher than the previously projected figure of 3.5 percent thanks to a better-than-expected performance of the construction and services sectors in the first half of the year. However, a severe drought that hit Serbia this summer had a significant negative impact on agriculture, which may still cause a downwards revision of 2024 GDP projections. On the expenditure side, consumption and investment were the main drivers of growth in the first half of 2024 while net exports had a negative contribution. Consumption started to recover because of the continued increase in incomes as well as a steady decline in inflation. In order to reduce the high degree of volatility associated with the agriculture (and related food industry) output, Serbia needs to introduce policy and investment measures to mitigate the negative impact of increasing climate shocks and to promote private sector participation in these measures. Over the medium term, under the baseline scenario, the Serbian economy is expected to grow at around 4 percent. With limited space for future stimulus packages, structural reforms are needed to accelerate private sector led growth.

Recent developments

Strong GDP growth in Q1 and Q2 2024 (4.6 and 4 percent, y/y) was driven by a recovery of private sector consumption and investment. On the other hand, net exports made a negative contribution to growth in the first half of the year due to lower-than-expected exports growth, as external demand weakened, and imports remained at a high level (in part explained by increased investment). Manufacturing remained resilient to external developments. Its output was 3.6 percent higher over the first seven months (y/y) thanks to a good performance of the food, tobacco, metals, electronics and automotive sectors. Labor market indicators improved slightly in the first half of 2024. The unemployment rate reached 8.2 percent in Q2 2024 (a record low since Q2 2020) and the employment rate continued to increase (to reach a record high level of 51.4 percent) even though informal employment declined marginally. Wages increased by 14.7 percent in nominal terms (9.2 percent, in real terms) in H1 2024 compared to the same period of 2023. Poverty (based on the upper-middle income line of $6.85/day in 2017 PPP) is estimated to have declined from 7.5 percent in 2021 to 6.9 percent in 2022. In 2023, poverty levels are likely to have stayed the same, as private consumption growth was modest, affected by the high inflation and the phasing out of government support programs, which had fueled the strong post-COVID-19 recovery of 2021. Inflation continued to gradually decline in the first half of 2024, mainly due to a significant decline in food related inflation. However, the headline inflation index edged up again in July, due to an increase in food prices, most likely because of the drought. The NBS kept unchanged the key policy rate at 6.5 percent from July 2023 through June 2024 when it was lowered for the first time. Currently the key policy rate is 6 percent. Budgetary revenues overperformed significantly in H1 2024 (up 14.1 percent in nominal terms, y/y), primarily thanks to a higher-than-planned collection of contributions for social insurance, VAT, and excises. Over the same period, expenditures increased by 15.2 percent in nominal terms. As a result, the consolidated fiscal surplus was lower than in the same period of 2023, while still reaching 0.4 percent of annual GDP. After a continued decline over 15 months (February 2023-May 2024) public debt increased significantly in June 2024 (by 2.1pp) to reach 52.6 percent of GDP. The current account deficit is expected to increase to 4.1 percent of GDP in 2024. Over the first half of the year the CAD already more than doubled compared to the same period of 2023. The trade balance keeps widening as well as the primary income deficit. At the same time net transfers declined marginally, although still reporting a major surplus. Net FDI has continued to perform strongly, remaining broadly unchanged in euro terms (at EUR 2 billion in H1). Foreign currency reserves increased to a record high level of EUR 27.5 billion by June. Overall credit decreased by 1.2 percent (y/y) through June 2024. However, loans to private businesses and households were up by 7.3 percent and 4.8 percent respectively. Gross nonperforming loans declined to 2.9 percent in June 2024.

Outlook

The Serbian economy is expected to grow at around 4 percent over the medium-term, driven primarily by consumption and to some extent by investment. There are both up and downside risks. Downside risks relate to the impact of climate change on agriculture and infrastructure. On a positive side, there could be a more significant impact of exports on growth, including but not limited to the recent private sector investment in the automotive sector. Inflation is expected to decline gradually and to stay within the NBS target band. The fiscal deficit is now projected at a higher level than before since the government decided to de facto suspend fiscal rules until 2029, in the context of largescale infrastructure public spending plans. Continued economic growth will keep bringing more Serbians out of poverty. However, the remaining poor are increasingly concentrated among pensioners, the long-term unemployed or those completely out of the labor force. Thus, targeted social assistance or other direct channels will become essential to continue poverty reduction.

SERBIA - Selected Economic Indicators

SERBIA	2021	2022	2023	2024e	2025f	2026f
Real GDP growth (percent)	7.7	2.5	2.5	3.8	4.2	4
Composition (percentage points):						
Consumption	6.1	2.8	0.6	3.4	3.4	3.4
Investment	2.5	1.2	-0.6	2.9	1.8	1.5
Net exports	-0.9	-1.5	2.5	-2.5		-0.9
Exports	10.9	9.9	1.6	4.2	4.7	4
Imports (-)	11.8	11.4	-0.9	6.7	5.7	5
Consumer price inflation (percent, period average)	4	11.9	12.1	4.5	3.1	3
Public revenues (percent of GDP)	43.2	43.4	42.6	43.3	43.4	43.2
Public expenditures (percent of GDP)	47.4	46.4	44.8	45.5	45.9	45.5
Of which:						
Wage bill (percent of GDP)	10	9.6	9.5	10.1	10,1	10,1
Social benefits (percent of GDP)	13.6	13.1	13.5	13.8	14,2	14,0
Capital expenditures (percent of GDP)	7.4	7.2	7	7.9	8,0	8,0
Fiscal balance (percent of GDP)	-4.1	-3	-2.2	-2.2	-2.5	-2.3
Primary fiscal balance (percent of GDP)	-2.4	-1.5	-0.4	-0.2	-0.5	-0.5
Public debt (percent of GDP)	54.5	53	49.7	49.6	48	46
Public and publicly guaranteed debt (percent of GDP)	57.1	55.6	52.6	52	50.4	48.4
Of which: External (percent of GDP)	34.7	35.7	36.5	37	36.5	36
Goods exports (percent of GDP)	39.4	44.6	40.2	39.8	40.6	40.9
Goods imports (percent of GDP)	50.7	60.1	49.7	50.1	51	51.5
Net services exports (percent of GDP)	2.6	3.8	4.3	4.2	4	4.2
Trade balance (percent of GDP)	-8.7	-11.7	-5.2	-6.1	-6.4	-6.5
Net remittance inflows (percent of GDP)	4.7	6.2	5.4	5	4.8	4.7
Current account balance (percent of GDP)	-4.3	-6.9	-2.6	-4.1	-4.7	-5
Net foreign direct investment inflows (percent of GDP)	6.9	7.2	5.5	5.5	5.5	5.5
External debt (percent of GDP)	68.4	69.3	67.2	64.5	62.9	60.4
Real private credit growth (percent, period average)	3.7	-2.7	-9.2	-	-	-
Nonperforming loans (percent of gross loans, end of period)	3.6	3	4	-	-	-
Unemployment rate (percent, period average)	11.1	9.5	9.4	-	-	-
Youth unemployment rate (percent, period average)	26	24.3	25	-	-	-
Labor force participation rate (percent, period average)	53.8	54.7	55.4	-	-	-
GDP per capita, PPP (current international $)	21,902	24,655	26,305	27,985	29,866	31,776
Poverty rate (percent of population)	7.5	6.9	6.7	6.2	5.8	5.4

Source: Country authorities, World Bank estimates and projections.

Retaining the Growth Momentum

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