

The Economic and Investment Plan for the Western Balkans: assessing the possible economic, social and environmental impact of the proposed Flagship projects



Authors:

Will BARTLETT, Matteo BONOMI, Milica UVALIC

European Parliament coordinator:

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STUDY

The Economic and Investment Plan for the Western Balkans: assessing the possible economic, social and environmental impact of the proposed Flagship projects

ABSTRACT

This study provides Members of the European Parliament and other interested stakeholders with an independent evaluation of the likely economic, social and environmental impacts from the 10 Flagship projects of the Economic and Investment Plan for the Western Balkans (EIP), adopted by the European Commission on 6 October 2020. On the basis of a tailor-made methodology, the EIP projects' impact is assessed according to their relevance, effectiveness and efficiency, as well as their synergies and coherence with the wider aims of the EIP and EU enlargement policy. The study identifies the novel aspects of these Flagship projects and considers lessons learned from previous EU and international assistance. Finally, the study evaluates the projects' overall economic, social and environmental impacts as well as their transversal implications in the Western Balkans. In the concluding section, potential obstacles to successful implementation are identified and some recommendations are proposed on ways to improve the EIP's developmental impact, thereby ensuring effective strategic guidance and scrutiny by the European Parliament.

AUTHORS

- Will BARTLETT, Deputy Director, LSE Research on Southeastern Europe (LSEE), United Kingdom;
- Matteo BONOMI, Research Fellow, Istituto Affari Internazionali (IAI), Italy;
- Milica UVALIC, Professor, Department of Political Science, University of Perugia, Italy.

PROJECT COORDINATOR (CONTRACTOR)

- Trans European Policy Studies Association (TEPSA)

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CONTACTS IN THE EUROPEAN PARLIAMENT

Coordination: Amelia PADURARIU, Policy Department for External Relations

Editorial assistant: Daniela ADORNA DIAZ

Feedback is welcome. Please write to amelia.padurariu@europarl.europa.eu

To obtain copies, please send a request to poldep-expo@europarl.europa.eu

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List of abbreviations

BEEPS	Business Environment and Enterprise Performance Survey
CSO	Civil society organisation
DAC	Development Assistance Committee
EBRD	European Bank for Reconstruction and Development
EDIF	Enterprise Development and Innovation Facility
EIB	European Investment Bank
EIP	Economic and Investment Plan (for the Western Balkans)
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Income
ICT	Information and Communication Technology
IFI	International Financial Institution
ILO	International Labour Organisation
IMF	International Monetary Fund
IPA	Instrument of Pre-accession Assistance
KfW	Kreditanstalt für Wiederaufbau
NEET	Not Education, Employment or Training
NGO	Non-governmental organisation
OECD	Organisation for Economic Co-operation and Development
PES	Public Employment Services
PPP	Public private partnership
PPS	Purchasing Power Standards
SME	Small and medium-sized enterprise
SPP	Single Project Pipelines
TEN-T	Trans-European Transport Network
UNFCCC	United Nations Framework Convention on Climate Change
VET	Vocational Education and Training
WBIF	Western Balkans Investment Framework

1 Introduction

1.1 Context and scope

On 6 October 2020, the European Commission adopted the Economic and Investment Plan for the Western Balkans (EIP) (European Commission, 2020a). It aims to boost economic growth and development, support a green and digital transition, promote regional integration among the six Western Balkan countries – Albania, Bosnia and Herzegovina, Kosovo*, Montenegro, North Macedonia and Serbia – and foster their convergence with the European Union's (EU) standards of living. The EIP aims at mobilising up to EUR 9 billion from the Instrument of Pre-Accession Assistance III (IPA) package for the period 2021-2027 and attract additional investments worth EUR 20 billion from the European development banks¹ and other international financial institutions (IFIs)² backed up by the Western Balkans Guarantee Facility. Although the Western Balkans have received substantial EU and international financial assistance during the past 20 years, the scale and ambitions of the EIP and its 10 Flagship projects are unprecedented. They pose unique challenges not only in terms of the EU's ability to coordinate the EIP and ensure political conditionality of the IPA funding, but also the Western Balkan governments' capacity to absorb the funds and implement the proposed Flagships. These tasks are particularly demanding if we consider that the EIP aims to include the Western Balkans within the EU's green and digital transition.

This EIP is an essential component of the programming framework for IPA III, that joins the European Union's pre-existing tools of IPA and the Western Balkan Investment Framework (WBIF)³. It includes two specific lines of budgeting under IPA III, namely *Window 3: Green agenda and sustainable connectivity* and *Window 4: Competitiveness and inclusive growth*, both of which are designed to support economic development in the Western Balkans. These Windows are directly aligned with the EIP. The other three Windows of IPA III are outside the direct scope of the EIP and provide support to the themes: *Window 1: Rule of law, fundamental rights and democracy*⁴; *Window 2: Good governance, EU acquis alignment, good neighbourly relations and strategic communication*; and *Window 5: Territorial and cross-border cooperation*. Of course, this division is not always clear-cut since some policies and actions may relate to more than one theme. In these cases, such issues are placed under the Window most appropriate for the core action⁵. Moreover, cross-cutting themes such as civil society, gender equality and the rights-based approach are to be mainstreamed, hence implemented under all five Windows⁶.

So far, 21 investment projects have been frontloaded as part of the EIP support package. However, the EIP is not just about the Flagships, since it endorses a wider vision and multiple scopes throughout the Western Balkan region, including the creation of a Common Regional Market designed to mimic the EU Single

¹ The European development banks are the European Investment Bank and the European Bank for Reconstruction and Development.

² Principally the World Bank Group and the German development bank KfW.

³ According to the European Commission, the IPA III Programming Framework 'will support the implementation of the Economic and Investment Plan for the Western Balkans'. See: European Commission (2021), Commission Implementing Decision adopting the adopting the Instrument for Pre-Accession Assistance (IPA III) Programming Framework for the period 2021-2027, Brussels, 10.12.2021, (2021) 8914 final.

⁴ Recent assessment of the limited impact on fundamental reforms by EU measures directly supporting rule of law reforms in the Western Balkans under IPA II is provided by a recent report published by the European Court of Auditors (2022). Under IPA III this direct support to rule of law reforms is provided under *Window 1: Rule of law, fundamental rights and democracy* and falls outside the directly cover of EIP umbrella.

⁵ For example, an action relating to the good governance of an infrastructure investment in roads may be placed in Window 2 or 3, while an action related the rule of law in a project concerning small and medium-sized enterprises (SME) competitiveness may be placed in Window 1 or 4.

⁶ See: European Commission (2021) *IPA III Programming Framework for the period 2021-2027*, Brussels, 10.12.2021, C(2021) 8914 final.

Market. This is aimed at bringing the region into closer alignment with EU practices, thereby facilitating eventual EU membership. The EIP has been presented in a number of ways, raising considerable attention and expectations. For instance, it has been deemed to be a post-COVID-19 recovery package for the Western Balkans, a plan for their social and economic development, a driver for the energy, green and digital transitions, and a tool for creating sustainable growth and jobs. At the same time, the EIP also aims at providing the region with a path for its common (Western Balkans) market integration and regulatory alignments with EU standards. It also contributes to advancing reforms on 'EU fundamentals,' which include the rule of law and fundamental rights, economic governance⁷ and the strengthening of democratic institutions alongside public administration reform⁸. Whether or not these and other scopes will be achieved by the EIP has yet to be seen.

1.2 Objectives

Against this background, the current study aims to evaluate these EIP Flagship projects on the basis of an innovative, tailor-made, methodology (see 1.3 below). Evaluation is placed in the context of lessons learned from previous EU and international assistance programmes to the Western Balkans in all key areas covered by the 10 Flagships. This study aims to provide Members of the European Parliament and other interested stakeholders with an objective assessment of the 10 Flagship projects' likely impact, organised within six overarching themes: (i) sustainable transport; (ii) clean energy; (iii) environment and climate; (iv) digital future; (v) private sector; and (vi) human capital. This evaluation will not only assess the Flagships' relevance, effectiveness and efficiency, as well as the EIP's coherence as a whole, but also identify the projects' novel aspects, assessing whether and how they can build on previous EU and international assistance programmes.

The study also evaluates the Flagships' overall economic, social and environmental impacts and their transversal implications in the Western Balkans. The projects' transversal implications include: their impact on the rule of law, good governance, democracy and fundamental rights; their geopolitical impact, namely how implementation might interact with the activities of other geopolitical actors in the region; how visibility actions and communication from EU support can be used to resolve misconceptions about EU funding in the beneficiaries' countries; the benefits that EIP Flagships could bring to people-to-people contacts, regional connectivity and reconciliation; the ways in which the IPA III performance-based approach and conditionality will be enforced in practice; potential mechanisms for ensuring meaningful consultations with local authorities and civil society prior and during project implementation.

1.3 Methodology

The evaluation of the 10 EIP Flagship projects will be undertaken on the basis of an innovative tailor-made methodology, developed on the basis of the principles and criteria identified in the European Commission's *Better Regulation Guidelines* (European Commission, 2021i). 'Better regulation' in the EU relies on a number of key principles, namely compliance with a comprehensive, participative and evidence-based approach, while the impact assessment is to be done on the basis of key criteria: relevance (is the EIP doing the right things?), effectiveness (is the EIP likely to achieve its objectives?), efficiency (how well are the EIP resources likely to be used?) and coherence (how well do the flagship projects fit together and are they coherent with other EU and international interventions?)⁹. The evaluation will take into account existing information, research literature and different stakeholders' opinions gathered through face-to-face interviews, to gauge whether or not EU intervention is:

⁷ Economic governance is defined in relation to a strengthened focus on economic development and improved competitiveness.

⁸ See [IPA III Regulation](#).

⁹ Similar criteria have also been endorsed by the Organisation for Economic Co-operation and Development – Development Assistance Committee (OECD-DAC).

- relevant to current and emerging needs in the Western Balkan region;
- effective in fulfilling expectations and meeting objectives;
- efficient in terms of cost-effectiveness and proportionality of actual costs to benefits;
- coherent with other EU interventions.

These criteria have been used to structure and develop an Evaluation Matrix that sets out the main evaluation questions.

Key sources of evidence collected to inform the study were provided by semi-structured face-to-face interviews with some 30 stakeholders, held from late January until mid-February 2022. These interviews were carried out by the study team with EU officials, representatives of international financial institutions and regional organisations, as well as representatives of civil society organisations (CSOs, both local and international) and national officials from the Western Balkan countries. Separate semi-structured interview sheets were developed for each group of stakeholders, customised to the institution and expected knowledge of different interviewees. This new evidence is also supplemented by an analysis of key documents identified through a comprehensive literature search from relevant sources. A variety of platforms has been used to conduct the literature review, including: Europa website; the website of the Publications Office of the European Union; document depository of the Regional Cooperation Council; the websites of the European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB) and the World Bank; as well as the Library of the London School of Economics.

1.4 Structure

The study is structured as follows. Section 1 here provides a brief introduction to the EIP's scope, the study's key objectives as well as a description of its methodology. In Section 2, the contextual background of the economic, social and environmental situation in the Western Balkans is described so as to point out the main problems of the Western Balkan countries and the need for new interventions in the areas of the EIP Flagships' themes. Section 3 places the EIP in the context of lessons learned from an evaluation of previous EU and international assistance programmes in the Flagship areas. Novel aspects of the EIP Flagship projects will be identified, as well as their ability to build on previous EU and international assistance programmes. The project team provides evaluations of all 10 projects in Section 4, assessing their relevance, effectiveness and efficiency, based on both interviews and desk research. Evaluation of all 10 Flagships is organised in accordance with the EIP's six main thematic areas: (i) Sustainable transport (Flagship 1 - *Connecting East to West*; Flagship 2 - *Connecting North to South*; and Flagship 3 - *Connecting the coastal region*); (ii) Clean energy (Flagship 4 - *Renewable energy*; Flagship 5 - *Transition from coal*; and Flagship 6 - *Renovation wave*); (iii) Environment and climate (Flagship 7 - *Waste and waste water management*); (iv) Digital future (Flagship 8 - *Digital infrastructure*); (v) Private sector (Flagship 9 - *Investing in the competitiveness of the private sector*); and (vi) Human capital (Flagship 10 - *Youth guarantee*). In addition, EIP's coherence as a whole is also addressed. The ensuing Section 5 evaluates the EIP Flagship projects' likely overall direct impacts, their economic, social and environmental impacts, as well as their indirect and transversal implications.

Based on the previous evaluation and impact assessment of the EIP Flagships, in Section 6 the study offers some recommendations on how to ensure successful implementation and maximise the EIP's impact. Potential obstacles to the successful implementation of the EIP will be identified. In addition, the report proposes recommendations on: further implementation of the EIP Flagship projects; strategic guidance and scrutiny powers to ensure the proper use of IPA III/EIP funds; and ensuring even progress in project implementation across the Western Balkan countries.

2 Economic, social and environmental challenges in the Western Balkans

2.1 Integrating the Western Balkans with the European Union

Since the Stabilisation and Association Process was launched in June 1999, the EU has continually supported the Western Balkan countries in their ongoing economic, political and legal reforms through specific financial assistance programmes; privileged access to EU markets through autonomous trade preferences; contractual relations established by the Stabilisation and Association Agreements signed between 2001 and 2008 with all countries in the region; as well as technical and financial assistance to facilitate harmonisation with the *Acquis Communautaire*. The Western Balkans have also been offered the prospect of EU membership, reconfirmed at many high-level EU–Western Balkan summits, from the Thessaloniki summit in June 2003 to the Brdo summit in October 2021. Other specific instruments have been devised in the meantime to assist in integrating the Western Balkans with the EU (see Section 3 below). In order to be considered for EU membership, the Western Balkan countries are expected to fulfil three groups of EU accession criteria: (i) stability of institutions guaranteeing democracy, the rule of law, human rights as well as respect for and protection of minorities; (ii) functioning market economy and capacity to cope with competitive pressures and market forces within the Union; (iii) ability to take on obligations of membership (the *Acquis Communautaire*), including adherence to the aims of economic and monetary as well as political union, which also includes Maastricht Treaty obligations.

The EU's continuous support of the Western Balkans has played a fundamental role in helping their efforts to implement economic, legal and institutional reforms. However, from a twenty-year perspective, overall progress in the EU–Western Balkan integration process has been slow. Economic integration between the EU and the Western Balkans has taken place in goods markets, capital markets and to some extent in labour markets given the large scale of labour migration to the EU, but the Western Balkans' low level of economic development reflects the region's limited convergence towards EU average income levels. Moreover, the political process of EU–Western Balkan integration has been extremely slow: of all the Western Balkan countries, only Croatia was able to fulfil accession criteria and enter the EU in 2013.

In the meantime, most Western Balkan countries have been facing continued political instability, local political crises, corruption scandals, shrinking space for civil society, tendency towards more authoritarian regimes, along with no progress with unresolved bilateral issues (particularly in the Belgrade–Pristina EU facilitated dialogue). Legacies of the 1990s – military conflicts, nationalistic narratives, international sanctions against the Federal Republic of Yugoslavia, the NATO bombing – have left deep scars on Western Balkan societies, political systems and political culture. The democratisation processes have been undermined by: the low level of media freedom; non-transparent policymaking; non-inclusion of the civil society organizations in the consultation process; weak rule of law due to the insufficiently reformed judiciary; inefficient public administration and resulting limited absorptive capacity of EU funds; and ambiguity in politicians' foreign policy stances. Heavy external involvement in the making of states in Bosnia and Herzegovina as well as Kosovo* together with periods of instability that have afflicted the EU during the last decade or so, including the eurozone and the migration crises along with Brexit, have led to growing scepticism about the EU and hence diminished its attractiveness. This, in turn, has led to declining support for the EU in some Western Balkan countries and further reversals in favour of authoritarian regimes.

Renewed interest in EU–Western Balkan integration has recently been stimulated by the Berlin Process, an intergovernmental initiative of engagement with the region's six countries launched by Germany, that since 2014 has promoted stronger connectivity and a Regional Economic Area in the Western Balkans, with the conviction that regional integration can positively influence faster economic development and major political stability. Yet, the connectivity initiatives being promoted with the aim of integrating the Western

Balkans into the main European transport and energy corridors have encountered clear limitations in their implementation and proved to be extremely time-consuming (Bonomi, 2019). A clear sign of EU recommitment in the Western Balkan region was given by the European Commission's new enlargement strategy (February 2018), the Sofia EU-Western Balkan Summit (May 2018) and EU renewed negotiation methodology (February 2020). However, despite these positive signs, there is currently a lack of clarity regarding the 'European perspective' of the Western Balkan countries. Uncertainties regarding future EU enlargement derive not only from different views held within the Council, the European Parliament and the Commission, but also from negative internal developments in the individual Western Balkan countries.

It is against this backdrop that the EIP has been presented with the aim of boosting economic growth and development, supporting a green and digital transition, promoting regional integration among the six Western Balkan countries and fostering convergence of the Western Balkans with EU standards of living. The hope is that a major improvement in the region's economic situation could help the political context and facilitate progress in other fundamental areas of reform. Acceleration of the Western Balkan countries' economic development is considered important in view of the relatively limited economic results achieved to date.

2.2 Some limitations of economic reforms

The Western Balkans have since 2001 implemented major economic reforms, including liberalisation of the economic, trade and financial systems, privatisation of enterprises and banks, gradual improvements in the business environment, together with related legal and institutional reforms. These reforms have contributed to substantial improvements in economic performance and gradual integration of the Western Balkans with the EU. During the 2001-2008 period, the Western Balkans experienced strong economic recovery, with average Gross Domestic Product (GDP) growth rate exceeding 5 %, gradual macroeconomic stabilisation and a rapid increase in foreign trade, particularly with the EU, which has become the region's main trading partner. Economic development has also benefitted from an increased inflow of foreign direct investment (FDI) since 2001, mainly from EU Member States, facilitating the establishment of enterprise networks and links to global value chains. Restructuring of the banking sector and partial privatisation of banks has led to the sale of domestic state-owned banks, or the issuance of greenfield licenses, to foreign banks mainly from the EU, thereby contributing to the inflow of financial capital to local economies. By 2006, from 65 % to 90 % of Western Balkans banking assets were in foreign ownership (EBRD, 2006)¹⁰. The Western Balkan economies are highly 'euroised', as most enterprises and citizens hold their financial assets in the form of euros, partly due to fixed or managed exchange rate arrangements¹¹.

However, strong economic recovery in the Western Balkans was interrupted in the last quarter of 2008 by the global financial and economic crisis. Increasing economic integration of the Western Balkans with the EU through various channels – foreign trade, financial integration, banking sector privatisations, FDI – supported economic growth, but also rendered these economies more vulnerable to external shocks. The global economic crisis brought to the surface several structural weaknesses in their economies, including external imbalances, growing unemployment and rapid structural changes that have caused rapid deindustrialisation.

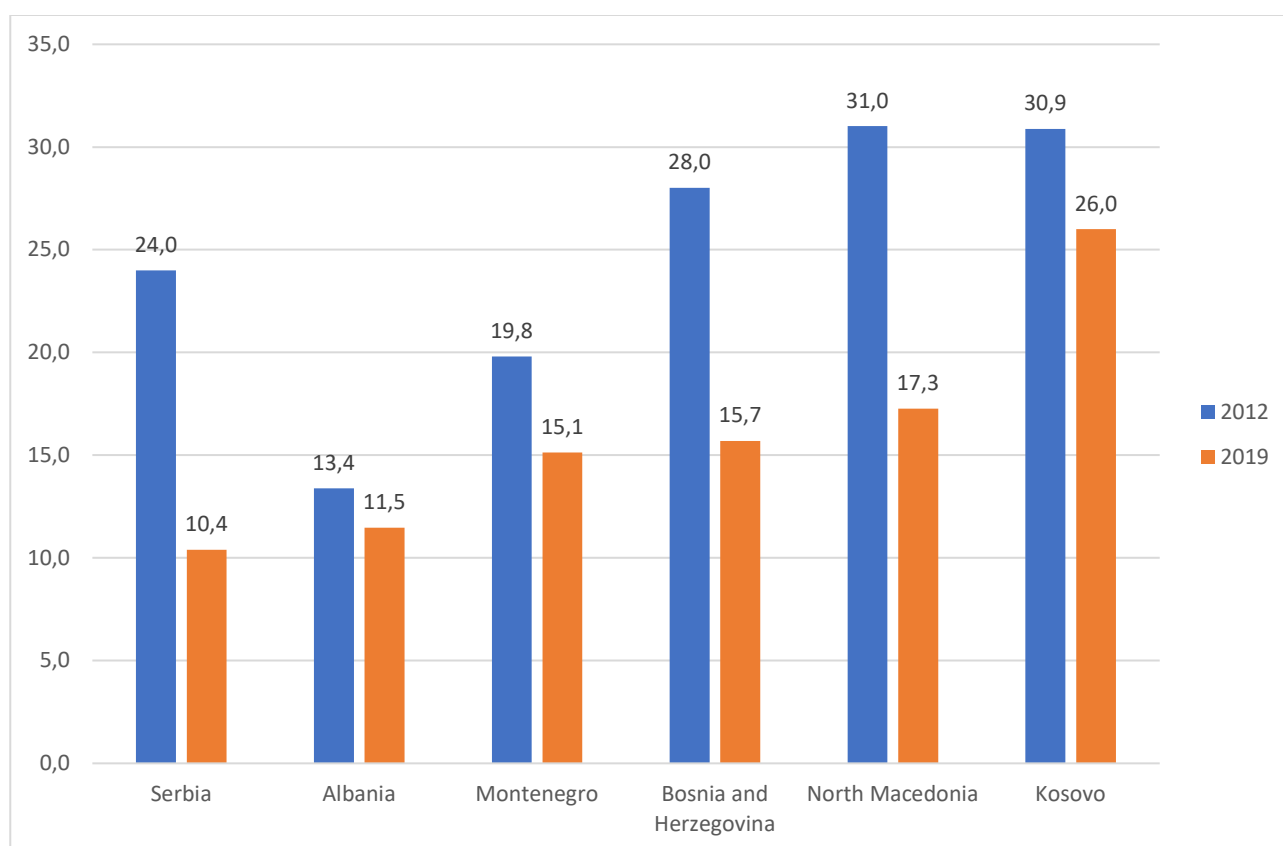
¹⁰ These percentages have not changed much in the meantime. Foreign banks continue to represent between 65 % and 90 % per cent of all banking sector assets, ranging from 65 % in North Macedonia and Montenegro and over 85 % in Bosnia and Herzegovina and Serbia, to about 90 % in Albania and Kosovo* (European Central Bank, 2019).

¹¹ Most countries have adopted exchange rate regimes that officially or unofficially peg their currencies to the euro. Montenegro and Kosovo* already use the euro and have no separate legal tender; Bosnia and Herzegovina has a currency board which ties its convertible mark to the euro; Albania has a floating exchange rate; North Macedonia has a stabilised arrangement that uses the euro as exchange rate anchor; while Serbia has a stabilised arrangement within an inflation-targeting framework, but maintains a de facto exchange rate anchor to the euro (see International Monetary Fund, 2020, pp. 7-8).

The liberalisation of foreign trade regimes since 2001 led to a much faster increase in imports (mainly from the EU) than exports, due to the limited competitiveness of Western Balkan products on external markets. External imbalances reached their peak in 2009, when the Western Balkan countries had some of the highest trade and current account deficits among all countries in Central and Southeast Europe. However, since 2011 external imbalances have improved. In some countries, export-led growth policies, associated with increased inflows of FDI into the manufacturing sector, have led to a substantial reduction in trade deficits in goods and services. Other countries, notably Kosovo* and Montenegro, were less successful and continued to experience large trade deficits in goods and services. Current account balances have also been reduced and remain stable, in part due to the high level of remittances from migrant workers and to external capital inflows associated with growing levels of FDI.

The Western Balkan countries have also had persistent problems with their labour markets. Over recent decades, labour market indicators for the Western Balkans (unemployment, employment, labour force participation, youth, women and long-term unemployment) have continued to diverge significantly from EU averages. Strong economic growth during 2001-2008 has not been accompanied by an equally dynamic process of job creation. Educational institutions have not adapted quickly enough to rapidly changing market needs and consequently the qualifications and skills of university graduates are often at odds with the market demands of potential employers (see Bartlett et al., 2016; Bartlett and Uvalić, 2019). Part of the workforce continues to be engaged in the informal sector, which is estimated to account for 20-50 % of the Western Balkan economies (Milatović and Sanfey, 2020). Although the situation has improved since 2012, unemployment rates remain much higher than those in the EU27, ranging from 10.4 % in Serbia to 26 % in Kosovo* in 2019 (see Figure 2.1). The unemployment rate especially for young people aged 15-29 (NEET - neither in employment, education or training) are much higher than in the EU27. Limited employment opportunities and low living standards are causing a continual brain drain from the region, particularly in the case of young people that have been leaving for higher paid jobs in the EU. The Western Balkan countries have also been facing serious social problems, due to the high level of poverty and income inequality. In 2019, the population shares at risk of poverty or social exclusion were very high: 38.7 % in North Macedonia, 39.8 % in Albania and 24.3 % in Serbia, as compared with the EU27 average of 21.3 % (Eurostat online data).

Figure 2.1 Unemployment rates in the Western Balkans



Source: Compiled on the basis of ILO statistics.

Another group of long-term problems in the Western Balkan economies derives from fast structural changes. All countries faced a strong process of deindustrialisation in the 1990s, that continued into the early 2000s. Financial integration with the EU has proceeded much faster than integration of the real (non-financial) sectors in the Western Balkan economies. During 2011-2019, though, the share of manufacturing value added in total value added has increased in Bosnia and Herzegovina by 2.3 % (from 12.9 % to 15.2 %) and in North Macedonia by 2.1 % (from 13.3 % to 15.4 %) though it has declined in Serbia by 1.5 % (from 18.0 % to 16.5 %) (Eurostat online data). While Albania and Montenegro have the lowest share of manufacturing value added in Europe and are essentially services economies, Bosnia and Herzegovina, North Macedonia and Serbia today roughly equate with the average of EU countries¹². This suggests that EU policies should be nuanced in relation to the different Western Balkan economic structures, with manufacturing-related infrastructure focused on Serbia, North Macedonia and Bosnia and Herzegovina, and services-related infrastructure focused on Albania, Kosovo* and Montenegro, as these infrastructure investments are likely to have different rates of return in different types of economy. The type of environmental mitigations offered to the two distinct types of economies should also be varied accordingly.

Structural changes in the Western Balkans have been strongly influenced by the preferences of foreign investors. The Western Balkans did not attract any major investments until the early 2000s, due to the poor business environment, weak rule of law and continuing political risk (Estrin and Uvalić, 2016). During the 2001-2008 period, foreign investors focussed on the more profitable services sectors, such as retail, banking, telecommunications and real estate, rather than manufacturing (Estrin and Uvalić, 2014).

¹² Thus, while the share of manufacturing value added in total value added was 16.7 % in the EU27, it was 16.5 % in Serbia, 15.4 % in North Macedonia and 15.2 % in Bosnia and Herzegovina.

However, the region has recently become a much more attractive investment destination, especially North Macedonia and Serbia, due to the provision of privileged tax breaks as well as other subsidies to foreign investors along with the establishment of special economic zones in Bosnia and Herzegovina, North Macedonia and Serbia¹³. These economies have attracted large inflows of foreign investment into the manufacturing sectors, especially car components industries which have linked their economies into global supply chains for the first time.

Nevertheless, some studies have shown that the spillover effects expected from FDI have been weak in the Western Balkans (Estrin and Uvalić, 2016; Bartlett, Krasniqi and Ahmetbašić, 2019). Recent FDI into the manufacturing sector has mainly been directed into low and medium-low technology industries, that produce low complexity products (Atanasijević et al., 2021a). The onerous business environment, barriers for the creation and growth of SMEs and ineffective competition policy have contributed to an uncompetitive economic environment (Atanasijević et al., 2021b). Deficiencies in the regulatory environment have impeded a more dynamic process of firm creation and growth, explaining to a large extent why the private sector is still relatively undersized in the Western Balkans in comparison to most EU new Member States. The private sector today contributes the larger part of value added and employment in all the Western Balkan countries, but the state remains an important employer, especially in Bosnia and Herzegovina, Montenegro and Serbia. Some state-owned enterprises have maintained market power due to quasi-monopolistic positions and to insufficiently rigorous application of competition policy. Recent studies on the Western Balkans suggest that there is considerable potential for the further expansion of SMEs and the private sector which could contribute to increased productivity and faster economic growth (Berthomieu et al., 2016; OECD, 2019; OECD et al., 2019; Sanfey and Milatović, 2018; World Bank, 2019a).

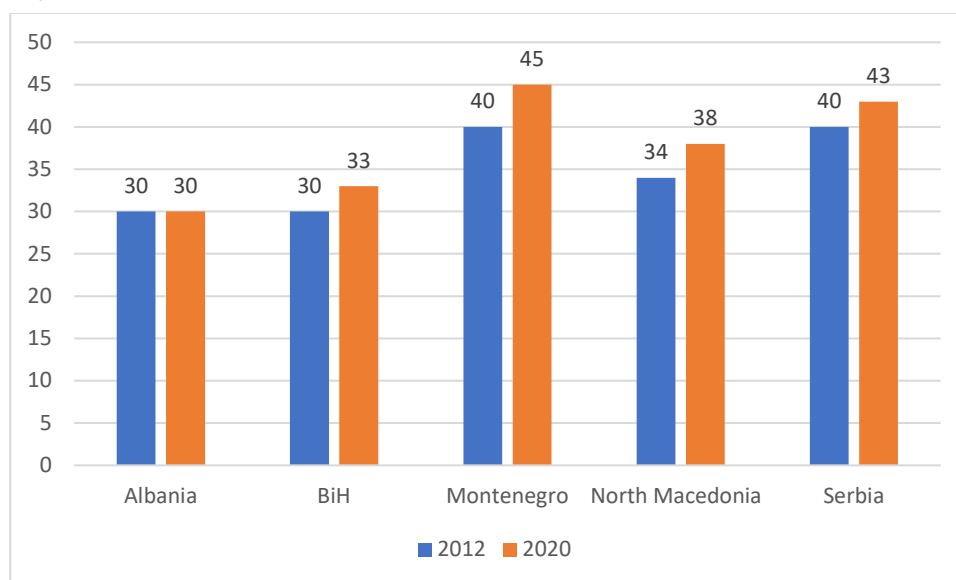
Additional barriers for major investments in the region are the small size of Western Balkan economies, regional fragmentation and no economies of scale (Estrin and Uvalić, 2016). There have been many initiatives that have actively promoted regional cooperation and integration among Western Balkan countries over the past 20 years: the Stability Pact for Southeast Europe that after 2001 initiated numerous projects, including trade liberalisation among the Western Balkans in 2001 that led to the conclusion of Central European Free Trade Agreement in 2006; various joint projects in different areas implemented through the Regional Cooperation Council after 2008; the Connectivity Agenda of the Berlin Process during 2013-2020; and the latest EU initiative to create a Common Regional Market. However, despite all efforts regional connectivity remains poor, particularly regarding transport infrastructure (see Transport Community, 2021c).

2.3 Current economic, social and environmental challenges

Due to strong and lasting effects from the global economic crisis, average economic growth in the Western Balkans during the last 10 years has been substantially lower than during the pre-2009 period. Some countries such as Serbia have had three recessions during this period (Uvalić, Cerović and Atanasijević, 2020). Despite slow recovery, the average GDP growth rates during the 2009-2018 period have been above those achieved in the EU27, permitting some convergence towards average EU income levels in all countries except Albania (see Figure 2). By 2020, GDP per capita (in Purchasing Power Standards – PPS) ranged from an index of 30 in Albania to 45 in Montenegro against the EU27 average. This provides a favourable basis for infrastructure investments through the EIP, suggesting that appropriate investments can yield tangible benefits in the Western Balkans, which could lead to faster catching up processes.

¹³ Special Economic Zones in the Western Balkans have been established as export processing zones within duty-free areas that provide infrastructure and facilities for manufacturing activities aimed at export markets. They have enabled foreign companies to sidestep the difficulties of dealing with poor infrastructure and unwieldy bureaucracies in the domestic markets and have become an important tool for attracting FDI. See: OECD, [Tracking Special Economic Zones in the Western Balkans: Objectives, Features and Key Challenges](#), 2017.

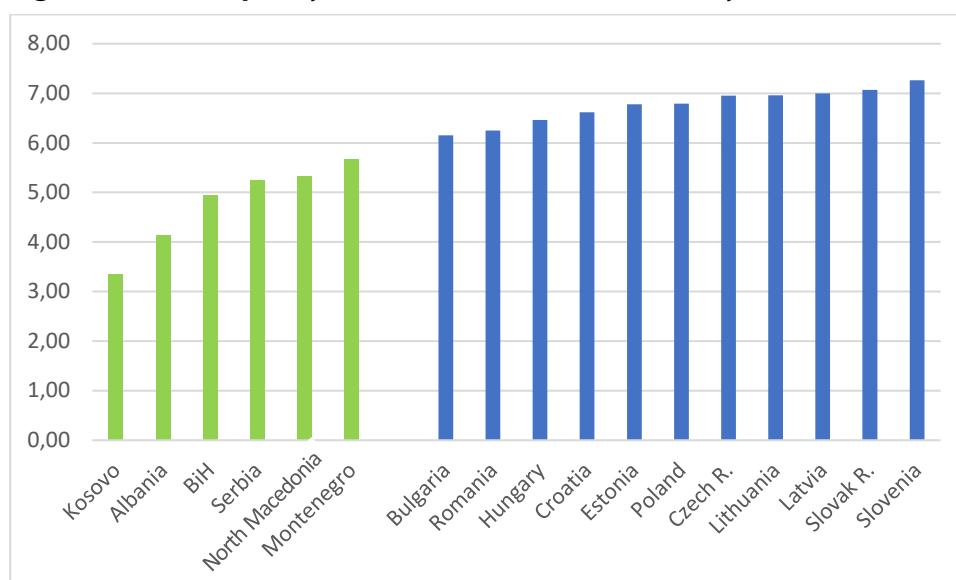
Figure 2.2 Trends in GDP per capita (PPS), 2010–2020 (Index, European Union-27 = 100)



Source: Eurostat online data, February 2022.

In addition to economic and social problems, the Western Balkans' growth potential is currently challenged by increasing environmental problems. Government measures in the areas of air and water pollution, wastewater management and energy efficiency have been limited. All countries except Kosovo* are signatories to the Paris Agreement on climate change (Energy Community, 2021), but reaching the most important objectives within the set deadlines will be demanding and costly for this region. The situation regarding pollution is reported to be one of the worst in Europe, with Sarajevo and Belgrade often being the most polluted cities in the continent (UNEP, 2019). A synthetic indicator provided by the EBRD, the 'green' quality of a sustainable market economy that takes into account various quantitative and qualitative measures of the environment, suggests that in 2021 the Western Balkan countries were ranked worse than the new EU Member States in Central Eastern Europe and the Baltics (see Figure 2.3).

Figure 2.3 Green quality of sustainable market economy, 2021



Source: EBRD online indicators, 2022.

The current economic, social and environmental situation in the Western Balkans is, therefore, not encouraging. The COVID-19 crisis has strongly affected the region's GDP growth, pushing all Western Balkan countries into another recession during 2020, thus diminishing the positive signs from stronger economic growth registered in the last few years (World Bank, 2020a, 2021a, 2021c). An international intervention such as the EIP, based on a major investment package of both public and private resources, may have the potential to facilitate faster economic growth in the Western Balkans (Berthomieu et al., 2017; Atanasijević et al., 2021b). The EIP Flagships could possibly provide the 'big push'¹⁴ that is necessary for the Western Balkans to take off, accelerate economic development and converge faster towards EU income levels.

The objective of spurring long-term economic growth in the Western Balkans is based on the European Union's EIP proposed in October 2020. The 10 Flagship projects organised into six thematic areas have identified a list of priority projects to be financed during the forthcoming period. Poor transport and energy infrastructure, inefficient energy systems, the twin green and digital transition, private sector development and youth unemployment have been selected as key policy priorities. These six areas of priority action have been chosen jointly by the European Union and Western Balkan governments. Although this ambitious Plan for the Western Balkans is only in its initial phase, the present study will try to evaluate some of its possible impacts, the main challenges and critical points.

3 Lessons learned from previous EU/international assistance

Previous EU assistance for the Western Balkans has been delivered through various programmes: PHARE¹⁵; ISPA and SAPARD; CARDS¹⁶; as well as the IPA and IPA II assistance packages¹⁷. In recent years, EU Institutions have provided a large part of region's total grant aid as part of its pre-accession process, supporting institutional reform in the candidate countries (see Table 3.1). The first IPA Programme ran from 2007 to 2013 with a budget of EUR 11.5 billion and contributed 35 % of total official development assistance in the form of grants (while total grant aid from the EU, including bilateral aid from EU member states, amounted to 69 % of total grant aid) (see Table 3.1)¹⁸. IPA II ran from 2014-2020 with a budget of EUR 12.8 billion, which by 2019 accounted for 42 % of the region's total grant aid. Offsetting this increase, grant aid from EU members states fell to 27 % of the total, (thus, total grant aid from the EU stayed at about the same level, namely about 69 % of the total). Grant aid from other bilateral donors who are members of the OECD Development Assistance Committee (DAC)¹⁹ was reduced from 22 % to 20 % of the total, while grant aid from non-DAC donors (principally Kuwait, Turkey and the United Arab Emirates), increased marginally from 4 % to 5.5 % of the total. IPA III, which runs from 2021-2027, has an allocated budget of EUR 14.2 billion.

¹⁴ In his well-known 1943 article, which is at the origin of the Big Push Model theory, Rosenstein-Rodan argued for planned large-scale investment programmes in Eastern and South-Eastern Europe, in order to take advantage of network effects, namely economies of scale and scope, to escape the low-level equilibrium 'trap' (Rosenstein-Rodan, 1943).

¹⁵ PHARE – 'Poland and Hungary: Assistance for Economic Reconstruction' was extended to Albania, North Macedonia and Bosnia and Herzegovina until 2000; it was occasionally extended but for very short periods also to the Federal Republic of Yugoslavia, then consisting of Serbia, Kosovo* and Montenegro. There was a specific technical assistance programme 'Obnova', launched in 1996 and amended in 1998 and 1999, for the war-affected countries in the Western Balkans, providing EUR 400 million for the 1996-2000 period, formally open to Bosnia and Herzegovina, Croatia, Federal Republic of Yugoslavia and the Former Yugoslav Republic of Macedonia.

¹⁶ CARDS – 'Community Assistance for Reconstruction, Development and Stability in the Balkans', covered the whole of the Western Balkans including Croatia from 2000 to 2006, with a total budget of EUR 5.13 billion.

¹⁷ The IPA programme for the period 2007-2013 had a budget of EUR 11.5 billion, while IPA II for the period 2014-2020 had a budget of EUR 12.8 billion. In addition to the Western Balkans, Turkey has also been a beneficiary of the IPA programmes.

¹⁸ The main EU bilateral donors are Germany, which provided 10.2 % of total grant aid from 2014-2019, Sweden (3.9 %) and Austria (3.6 %).

¹⁹ The main donors in this group were the United States, which provided 10.9 % of total grant aid, Switzerland (7.6 %) and Turkey (4.6 %).

Table 3.1 Annual grant aid (disbursements) to the Western Balkans and shares of donor groupings

	2007-2013	2014-2019
EU Institutions	35.62 %	41.52 %
EU Member State bilateral aid	33.03 %	27.16 %
Other bilateral aid (DAC)	21.70 %	19.86 %
Other bilateral aid (non-DAC)	4.09 %	5.53 %
Multilateral agencies	5.56 %	5.93 %
All donors	100.0 %	100.0 %

Source: OECD International Development Statistics database.

Within and alongside IPA II, the EU initiated a Connectivity Agenda through the Berlin Process in 2015 to support the development of public infrastructure projects in the Western Balkans²⁰. It aimed at supporting the development of transport and energy infrastructure in key road and rail routes, inland waterways and ports, electricity and gas transmission and the production of renewable energy. Between 2015 and 2020 it arranged EUR 1 billion in grants to support 37 transport and 8 energy infrastructure projects, of which EUR 124 million was spent on technical assistance and project preparation. The European Commission has claimed that these grants generated a further EUR 3.7 billion investments and created 45 000 jobs (European Commission, 2020c). IPA III, which runs from 2021 to 2027, continues and further deepens this emphasis on public infrastructure projects²¹. However, research studies have shown that public infrastructure investment can have a strong effect on economic growth and competitiveness only under the right conditions (Batini et al., 2014). These conditions include: a strong and effective governance system; robust institutions including the rule of law; as well as effective and transparent public procurement systems, which effectively control high level corruption in public infrastructure spending. These conditions have been absent in the Western Balkans due to a lack of appropriate governance reforms and continuing challenges related to the rule of law²².

The EU accession process is governed by the principle of conditionality, through a 'carrot' and 'stick' approach. The 'carrot' is eventual EU membership backed up by technical and financial assistance, while the 'stick' represents the threat of delay to the accession negotiations or reducing grant aid should basic reforms in areas such as the rule of law and fundamental rights be frustrated, the so-called 'performance for results' approach (European Commission, 2018a). However, in some countries (Bosnia and Herzegovina, Kosovo* and Montenegro), donor allocations have even been increased, despite reductions in corruption controls (Bartlett, 2021a), suggesting that international assistance may have facilitated poor governance and political elites' practice of rent-seeking. Overall, donors have largely chosen to overlook poor governance behaviour among recipients and have provided aid anyway, disregarding the lack of respect for any 'fundamentals', as defined by the EU (Bonomi, 2019). Conditionality was therefore strengthened under IPA II by introducing rewards for performance, with the intention of rewarding compliance from the

²⁰ The Berlin Process was launched in 2014 as a regional cooperation initiative to re-energise the EU enlargement policy by bringing together seven member states (Austria, France, Germany, Italy, Croatia and Slovenia) and the WB6 (Albania, Bosnia and Herzegovina, Kosovo, Former Yugoslav Republic of Macedonia, Montenegro and Serbia) with an interest in the Western Balkans accession to the EU. Through its annual summit meetings, it acts as a driver of new policy initiatives to promote regional cooperation and the progress with the accession agenda. See V. Lilyanova, [The Western Balkans' Berlin process: A new impulse for regional cooperation](#), European Parliament Research Services, European Parliament, 2016.

²¹ See [IPA III Regulation](#).

²² See European Commission, [2021 Communication on EU Enlargement Policy](#), COM(2021) 644 final, 19 October 2021.

region's candidate and potential candidate states that had taken steps to improve their governance performance by controlling corruption and state capture (Džankić et al., 2019, p. 3). Within IPA II, the first performance-reward funding of EUR 78 million was allocated to Albania, Kosovo*, North Macedonia, Montenegro and Serbia in 2017. Albania and North Macedonia received a second performance-reward of EUR 78 million in 2020 for progress with EU-compatible reforms. These relatively small adjustments are unlikely to make much difference to the speed and direction of reforms. Hence, the lesson learnt should be that performance rewards and penalties need to be used more energetically under IPA III. This is especially so given the increasingly assertive presence of 'new actors' in the region, in particular China²³ and Russia²⁴, who are increasingly offering non-concessional loans for infrastructure projects with no strings attached. This threatens to undermine EU soft power in the region and challenges the conditionality approach of EU assistance and enlargement efforts (see more in section 5.2 below on 'geopolitical impact').

The IPA II programme also adopted a 'sector approach' that aimed to promote structural reform in each sector, based on beneficiary-defined 'sector strategies', in place of the rather *ad hoc* project-based approach of the first IPA programme. Sector Planning Documents prepared by the Western Balkans host governments, with backing from the EU, have supported the prioritisation of EU assistance. Sector Working Groups have improved interinstitutional consultation and the participation of civil society in the process of programming EU assistance. Sectoral allocation improved the programming of assistance by facilitating greater dialogue and coherence. However, this strategy was not without its flaws as it depended on the recipient country's degree of political commitment, the potential for bureaucratic resistance and a widespread lack of administrative capacity (DAI Europe, 2015). Despite this lesson learned, IPA III continues with the Sector Approach on the grounds that this assists beneficiaries to design and implement sector reforms and increases coherence between national strategies, sector policies, resource allocation and spending practices²⁵. It remains to be seen whether or not the lack of administrative capacity, bureaucratic resistance and weak political commitment identified in evaluations of IPA II have been sufficiently resolved to permit the effective functioning of IPA III.

All the actions designed in support of a specific sector will be financed under the same window. To achieve this, beneficiaries are expected to demonstrate how their sectoral strategies are in line with the enlargement process in a 'Strategic Response' document, which will include a list of projects for IPA funding and how they link to the thematic priorities of IPA III. The European Commission will select actions based on their policy relevance and only those that are approved will be developed into fully-fledged action documents. Similarly, for infrastructure investments, beneficiaries will be expected to submit a single project pipeline to the WBIF, through Windows 3 and 4, which addresses the host government's priorities, thus ensuring 'local ownership'. These project pipelines are often prepared with the help of EU Delegations and in-country IFI offices, principally those of the EIB and the World Bank. The project pipeline will be screened by the WBIF for the economic and environmental impact of individual projects²⁶. Only mature projects are likely to be selected for approval by the WBIF and hence the preparation of investment projects for inclusion in the single project pipeline is crucial. Once approved, any contractual arrangements between the EU (which provides the grant element), the IFIs (which usually provide the loan element) and the host governments can be concluded. The whole process from conception of an infrastructure project to beginning physical work on the infrastructure investment typically takes several years. Consequently,

²³ See V. Shopov, [Mapping China's rise in the Western Balkans](#), European Council on Foreign Relations, March 2022.

²⁴ See S. Secieru, [Russia in the Western Balkans](#), European Union Institute for Security Studies, 2 July 2019.

²⁵ European Commission, [Commission implementing decision of 10.12.2021 adopting the Instrument for Pre-Accession Assistance \(IPA III\) Programming Framework for the period 2021-2027](#), C(2021) 8914 final, 10 December 2021, p. 7.

²⁶ The European Investment Bank uses its Results Measurement Framework, which is based on three pillars of high-level objectives such as regional integration, the quality of the project and the contribution of the loan to the beneficiary (European Commission, 2018a).

only infrastructure projects that are already at an advanced stage of preparation are likely to be included in the EIP implementation on the ground, at least up to 2024 and probably beyond.

A further lesson learned has been that inadequate coordination between donors can reduce the effectiveness of EU assistance in the region. This is because the interests of bilateral donors are often aimed at stimulating links to trade and commerce, while EU assistance has wider and more general concerns in promoting a candidate country's successful EU accession. Thus, the interests of donors are unlikely to be closely aligned, which may hinder donor coordination efforts. The IPA III Regulation therefore requires that the European Commission and EU Member States should ensure the coherence, consistency and complementarity of their assistance through regular consultations and communications between them. This is particularly important to avoid any duplication of effort and funding. This also extends to consultations with civil society organisations and regional authorities. This was a further lesson learnt from IPA II and hence the IPA III Regulation explicitly states that the role of civil society should be enhanced in all programmes implemented through government bodies. The IPA III Regulation states that the Commission will take steps to coordinate with non-Union donors, bearing in mind the international principles of aid effectiveness. The European Parliament should take steps to monitor the fulfilment of these promised activities of donor coordination and check that consultation with other donors and representatives of civil society are actually carried through and effectively implemented.

For infrastructure investment through the EIP, some of these considerations may be less relevant, because the WBIF, which brings together IPA grant funding and concessional loans from IFIs, is widely perceived as a success story regarding donor cooperation²⁷. The WBIF, established in 2009, brings together the European Commission, six international financial institutions²⁸ and 20 bilateral donors. It provides funding for infrastructure projects and coordinates the finance provided through the EIP. It blends IPA III and other grants with loans and domestic finance through its Joint Grant Facility (JGF) and its Joint Lending Facility (JLF). The grants provide funding for technical assistance (TA) and co-finance infrastructure projects (in this case 'investment grants'). The JGF collects grant resources²⁹ and 'blends' them with loans from participating financial institutions. This blending process provides 'leverage' to grants provided through the IPA III programme (and from other donors). The JLF coordinates loans from the financial institutions and complements the JGF as the second pillar of any blended finance offered by the WBIF. Through donor coordination activities, the WBIF has so far selected, prepared, implemented and monitored a portfolio of 210 infrastructure projects with a total value of EUR 22.4 billion in six sectors: digital infrastructure, energy, environment, social, transport and private sector development³⁰. By May 2021, 187 projects (including TA grants and infrastructure investments) had been completed and 172 projects were active³¹. Transport and energy projects have comprised the largest share of grants by value (67 % and 17 % respectively), environmental and social infrastructures comprise 14 %, while private sector development (1 %) and digital infrastructure (1 %) have been somewhat neglected³². Transport is the most funded sector receiving EUR 10.4 billion of investment grant aid. Social sector investments have financed infrastructure projects in fields such as education (schools), justice (prisons), healthcare and social housing. Technical assistance is provided for project preparation and is a core WBIF activity, comprising 22 % of total grant aid provided. Investment grants are provided to contribute to infrastructure funding and comprise 71 % of total grant

²⁷ Interview, IFI official.

²⁸ These are the European Investment Bank (EIB), European Bank for Reconstruction and Development (EBRD), Council of Europe Bank (CEB), Agence Française de Développement (AFD), the World Bank Group and the KfW, a German development bank.

²⁹ The JGF resources originate from the (i) European Western Balkans Joint Fund (EWBJF), which pools contributions from the EU's IPA programme, bilateral donors and EIB; (ii) IPA grant funding allocated by the EC for IPF technical assistance and 2008 IPF Municipal Window; and (iii) grant funding allocated by IFIs outside the EWBJF.

³⁰ WBIF (2021) *Monitoring Report May 2021*, Brussels: Western Balkan Investment Framework.

³¹ The average amount approved for TA is EUR 1.2m per grant, while that for investment grants is EUR 14.6m per grant.

³² Projects relating to private sector development are channelled through the Western Balkans Enterprise Development and Innovation Facility (EDIF) which was established by the WBIF for this purpose and managed by the European Investment Fund.

aid (other parts of grant aid cover sector studies and interest rate subsidies). The implementation of projects is rather slow, with 19 % of grants needing more than three years to start implementation. This is why, under the EIP, a premium is placed on 'mature' projects as one of the key selection criteria. The financial leverage ratio for IPA and other grants provided through the WBIF is 5x, meaning that each 1 euro of grant attracts an additional 5 euro of loans for infrastructure projects. In the transport sector the leverage ratio is 4, while in the social infrastructure sector it is as high as 24. For investment grants, the leverage ratio falls to 3x since infrastructure projects are more expensive than TA projects (ranging from 3x in transport and energy sectors to 7x in the social sectors).

However, public procurement of infrastructure projects by recipient governments still needs to be strongly monitored and regulated within the beneficiary country to ensure that infrastructure contracts do not permit kick-backs to local officials. If this is done, the WBIF can be expected to provide an effective means of infrastructure financing, thus avoiding the perils of clientelism and state capture. However, although the WBIF may protect against distortions created by its beneficiaries, it may not be free of distortions created by the IFIs themselves, who have a say in both the design and evaluation of individual projects in the project pipeline. To counter this danger, much stronger participation may be needed: (i) from the representative organisations of civil society in the beneficiary countries in the Western Balkans who know the situation on the ground, hence are often in a better position to predict and monitor the environmental and social impact of public infrastructure projects; and (ii) in regard to the European Parliament's political oversight to safeguard the coherence of approved infrastructure projects with the Parliament's political objectives, especially in regard to EU enlargement policies and the Green Agenda. Currently, the European Parliament has an observer status on the WBIF Board. This could be strengthened by membership of the board, along with membership of representatives of CSO organisations.

The remarkable lesson learned from this review of WBIF activities is that social infrastructure investments have a far higher leverage ratio than transport and energy investments. In terms of grant aid, donors receive much greater value for money if they invest in social infrastructure compared to transport and energy. It is therefore surprising that the EIP does not include a Flagship on social infrastructure. This 'missing' Flagship should therefore be developed and included in subsequent evolutions of the EIP.

4 Review and evaluation of the 10 Flagship projects within the six thematic areas of the EIP

This section sets out an overview of the 10 Flagship projects proposed in the Annex to the *Economic and Investment Plan for the Western Balkans*. The evaluation is undertaken in accordance with the European Commission's *Guidelines on Better Regulation* (European Commission, 2021i). These Guidelines rely on a number of key principles, such as: overall comprehensiveness; adoption of a participatory and evidence-based approach; taking into account lessons learnt from experience on the ground; and clear definition of key evaluation criteria. Regarding this final principle, evaluation criteria should be relevant, effective, efficient and coherent (European Commission, 2021i: 23). On this basis, we evaluate the relevance of these specific EIP Flagship projects and make a number of observations on their likely effectiveness, efficiency and overall coherence. The assessment is based on desk research and face-to-face interviews undertaken in February-March 2022 with key stakeholders, who were asked to answer specific evaluation questions. In addition to the initial EIP's Flagship projects proposed in October 2020, this analysis also takes into account the first substantial package of EIP investments worth EUR 3.2 billion for 21 Flagship projects, endorsed by the WBIF on 23 February 2022; the EU and bilateral donors' grant contributions to the package amount to EUR 1.1 billion³³. Expected direct and indirect economic, social and environmental impacts of the EIP Flagship projects are discussed below in Section 5.

³³ See [EIP Factsheet](#), February 2022.

4.1 Sustainable Transport – Flagships 1, 2 and 3

All transport systems in the Western Balkans have suffered from a lack of sufficient investment and poor maintenance for decades. For example, in North Macedonia, weak transport infrastructure and poor transport logistics create barriers to foreign investment (European Commission, 2021e). In Serbia, major improvements are needed in traffic management, maintenance, road safety and the transparency of transport investments (European Commission, 2021f). Railways are heavily dependent on fossil fuels and less than half of the networks are electrified (European Commission, 2020b). Hence, the development of transport infrastructure is far behind that of the EU, with few countries having adequate plans for their roads, including maintenance, safety and general procedures. Even where major infrastructure projects have been undertaken, adequate resources have often not been planned for maintenance.

Any resources that do exist are not always used to best advantage. A number of criticisms about the region's transport infrastructure projects appear in the European Commission's assessments of the Economic Reform Programmes. In the case of Kosovo*, the latest assessment notes that whilst much investment has been committed to prestige projects, there is no clear transportation, environmental or development rationale (European Commission, 2021c). In Montenegro, the poor performance and governance of state-owned transport companies is referred to as a fiscal risk (European Commission, 2021d). Costly transport infrastructure investments based on loans from China and later taken over by the EIB increased Montenegro's ratio of external debt to GNI to 200 % in 2020, and total debt service to 102 % of total exports of goods, services and primary income (World Bank, 2021d). The European Commission in its assessment of the Montenegrin Economic Reform Programme has advised against any further investment on road infrastructure until a cost-benefit analysis had been completed, along with a careful examination of the impact on public debt (European Commission, 2021d: 32).

Figure 4.1 Passenger cars per thousand inhabitants, 2019

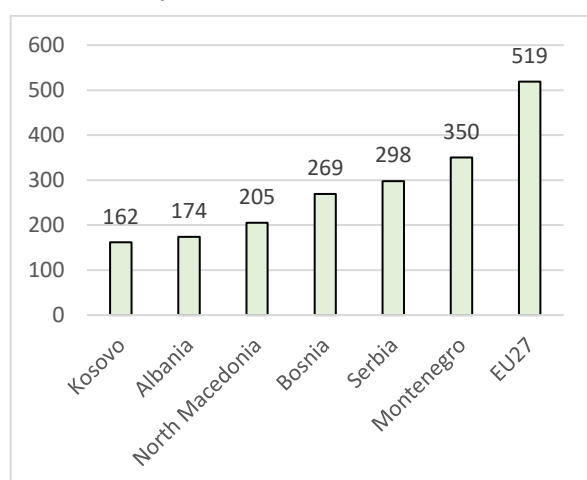
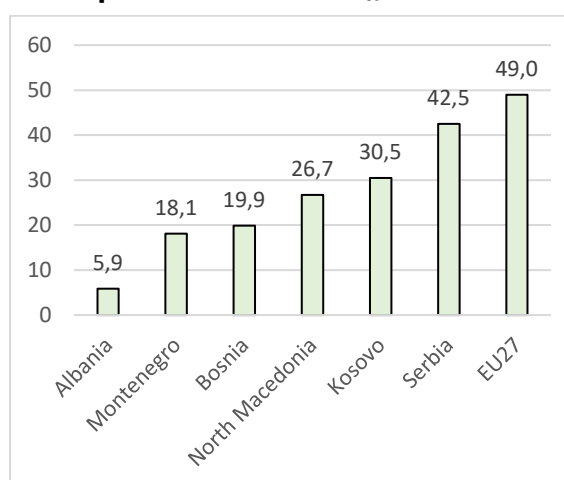


Figure 4.2 Railway network density (metres of line per km² of land area), 2019

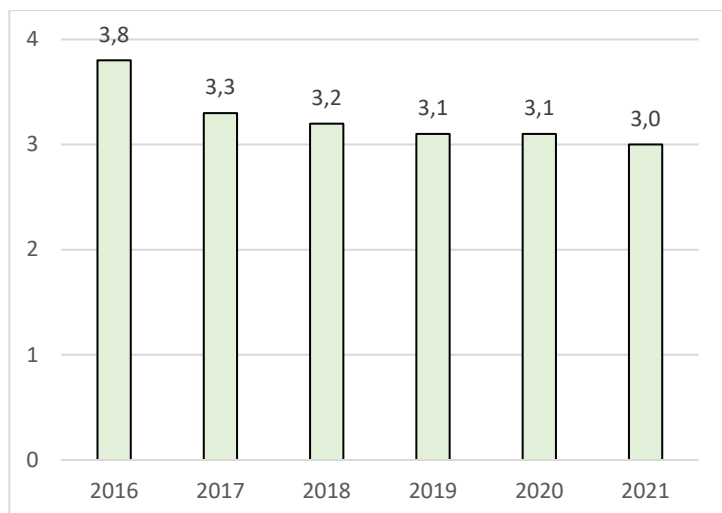


Source: European Commission assessments of country Economic Reform Plans, 2019, Annex A.

Both the population density of passenger cars and the railway network density are far behind that in the EU (see Figures 4.1 and 4.2). Although the number of road deaths per million inhabitants has fallen by one third over the last decade, it is still higher than in the EU27, at 64 per million in 2020 compared to 42 per million in the EU27 (Transport Community, 2021a). The highest level of fatalities occurred in Montenegro at 77, followed by Serbia, ahead of Bosnia and Herzegovina. The rate of fatalities in Kosovo* was similar to that in the EU. Poor infrastructure quality is certainly a barrier for businesses, whose ratings of transport infrastructure quality in the region has been steadily declining over the last decade (see Figure 4.3). Albania is particularly poorly supplied with railway infrastructure. While Serbia is well provided with a railway density approaching that of the EU, it does face problems with maintaining and upgrading its

infrastructure. In general terms, travelling in the Western Balkans, particularly by road, is significantly more difficult and more dangerous than in the EU³⁴.

Figure 4.3 - Business rating of quality of transport 1=very poor to 5= excellent



Source: Balkan Business Barometer, Sarajevo, Regional Cooperation Council 2021. Note: 1 200 businesses were asked: 'For your business purposes, how would you rate the combination of availability, quality and affordability of road, railroad, waterway and air transport in [ECONOMY]?' Answers range from 1= very poor to 5 = excellent.

A major gap in the transport infrastructure is in the development of intermodal transport, although Serbia is constructing an intermodal hub at Belgrade airport. However, Serbia does not apply EU standards in feasibility studies or technical designs, nor does it apply EU procurement procedures to ensure best value for money in many of its transport infrastructure projects (European Commission, 2021g). Western Balkan countries are at various stages in developing transport strategies. For example, Albania does not even have a strategy yet.

The EIP's transport Flagships follow on from the Connectivity Agenda, which ran from 2015 to 2020. Under this arrangement, National Investment Committees define prioritised Single Project Pipelines (SPPs), which facilitate the programming of national financial sources and donor resources. Projects from SPPs have been put forward to the WBIF to be co-financed by the European Commission and loans from IFIs. Almost 50 % of the WBIF portfolio quotes railways and roads as the largest sub-sectors. The WBIF endorsed a further 12 projects in the transport sector on 23 February 2022 with an investment value of EUR 2.7 billion (see more details below) (WBIF, 2022)³⁵.

In 2017, a Transport Community Treaty was signed between EU Member States and the Western Balkan governments with the aim of assisting in the identification of priority transport investments and integrating their transport market systems into the EU³⁶. In 2021, the Transport Community Permanent Secretariat identified 47 road projects for funding (37 on the Core Network and 10 on the Comprehensive Network). The combined length of road sections currently under various forms of upgrading is 915.66 km with an overall value of EUR 8 billion for the entire network (Transport Community, 2021b). In addition, the Secretariat identified 10 fully funded ongoing rail projects under various forms of upgrading, covering

³⁴ Interview, EU official.

³⁵ Across all sectors, the WBIF endorsed projects with an investment value of EUR 3.2 billion at this meeting. Of this, the EU and bilateral donor grants amounted to EUR 1.1 billion.

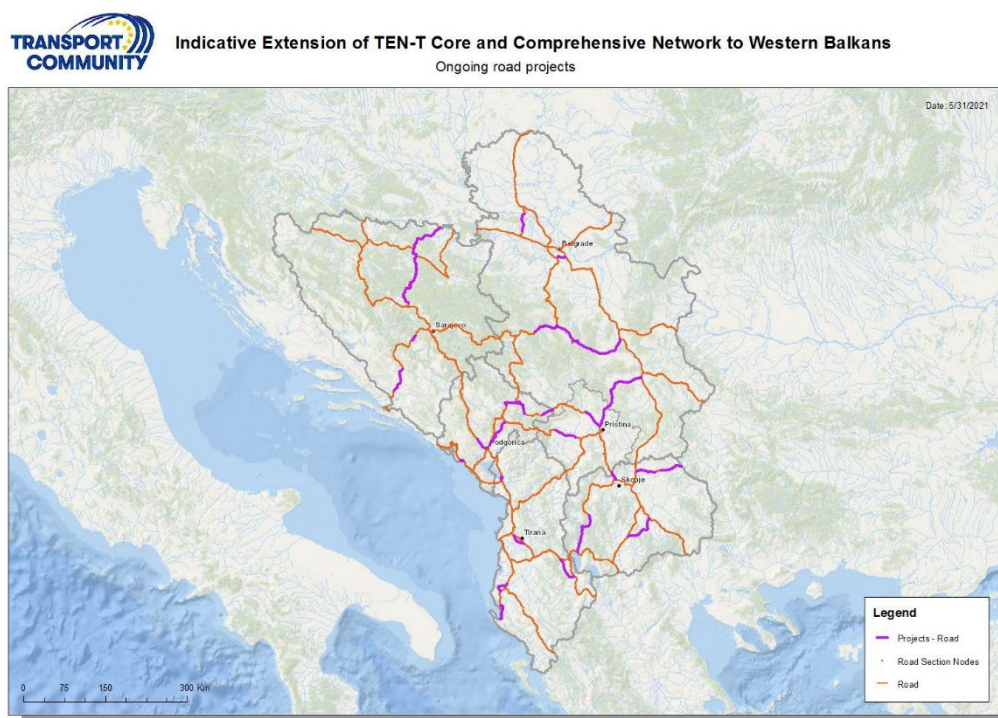
³⁶ The entire extension of the Trans-European Transport Network (TEN-T) (both 'Comprehensive' and 'Core') to the Western Balkans was set out in Commission Delegated Regulation (EU) 2016/758 of 4 February 2016 amending Regulation (EU) No 1315/2013. The extension of TEN-T in Western Balkans includes 5.287 km of TEN-T roads (of which 3 540 km on the Core Network), 3 857 km of TEN-T railways (of which 2 602 km on the Core Network), 1 345 km of TEN-T Core Network Inland Waterways, three seaports, four inland waterways ports and ten airports. See [here](#).

877.8 km of railways on the Core Network with an overall value of EUR 3.7 billion. The EIP will complement and build upon these projects.

The EIP transport investments aim to improve core transport corridors along the Trans-European Transport Network (TEN-T) extensions core networks, to bring them into compliance with EU standards so as to facilitate trade, promote market integration, stimulate cross-border trade and raise economic growth within the region (European Commission, 2020c; 2020a). The Flagships aim to promote multimodal transport solutions and modal shift, reduce transport-related pollution, apply new digital technologies to improve information systems, improve road safety and assist in the design as well as implementation of maintenance schemes. The Flagship projects also aim to promote an integrated regional transport market based on the European Union's legislation and standards in collaboration with the Transport Community in order to simplify border crossing procedures and support reform of the railway systems, eventually integrating the Western Balkans and EU transport systems (2020a: 7).

As far as the economic impact of transport projects is concerned, the fiscal multiplier is expected to be relatively high³⁷. There are opportunities for the private sector to invest in transit for tourism, such as water transport using a ferry rather than travelling along coastal roads by car. These investments will not happen on their own; they require involvement of the EIP and the IFIs³⁸.

Figure 4.4 - Indicative Extension of TEN-T

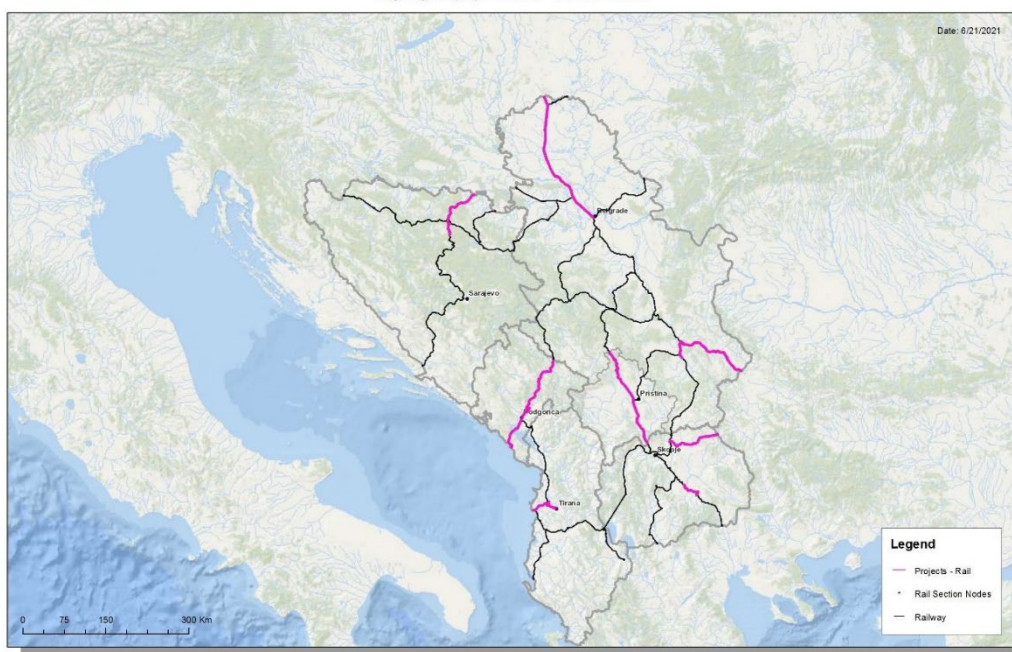


³⁷ Interview, EU official.

³⁸ Interview, IFI official.



Indicative Extension of TEN-T Core and Comprehensive Network to Western Balkans
Ongoing rail projects in the Western Balkan



Flagship 1 - Connecting East to West

This Flagship is expected to be completed or at least well advanced by 2024. It comprises a set of transport infrastructure projects in various stages of completion, as follows:

- (i) The Serbian section of the 'Peace Highway' linking Pristina to Niš in Serbia is expected to be 'substantially advanced'. Work on this project started in 2021 under the Connectivity Agenda with construction of a 32 km section of the highway from Niš in Serbia to Pristina in Kosovo*. All remaining road construction as far as the Kosovo* border will be completed under the EIP. This project is technically challenging, with the construction of 6 tunnels and 12 bridges as well as many overpasses, underpasses and viaducts.
- (ii) The rail corridor parallel to the Corridor X highway is expected to be modernised, the Niš railway bypass is scheduled for completion, rail connection between Serbia and Croatia is due to be upgraded, as is the rail link to North Macedonia.
- (iii) Rail Corridor VIII between Skopje and the Bulgarian border is expected to be substantially advanced to connect Skopje and Sofia.
- (iv) Demining of the river Sava and addressing bottlenecks on the Danube are expected to be completed or advanced as part of the TEN-T network, with further development of intermodal exchanges.

The projects endorsed by 23 February 2022 are shown in Table 4.1.

Table 4.1 - Flagship 1 Connecting East to West: Transport projects endorsed by WBIF in 2022 (EUR million)

Flagship 1	WBIF EU grant	Previous grants	EBRD loan	EIB loan	National input	Total project cost
Serbia: Johovac Interchange–Vukosavlje Interchange Motorway Section	179.8	0.0	0.0	250.2	33.5	463.5
Kosovo*: Orient/East-Med Corridor: Kosovo – Serbia Route 7 Road Interconnection, Pristina – Merdare Section	38.0	43.2	58.0	58.0	7.5	204.7
North Macedonia: Orient/East-Med Corridor: North Macedonia – Bulgaria CVIII Rail Interconnection, Kriva Palanka – Border with Bulgaria Section	149.2	64.1	97.4	97.4	4.2	412.3
Serbia: Orient/East Med Corridor: Niš – Dimitrovgrad Xc Railway Line, Niš Bypass	34.4	78.3	0.0	134.0	29.1	275.8
Serbia: Orient/East-Med Corridor: Belgrade – Mladenovac – Niš X Railway Line, Stalać – Đunis Section	80.2	1.2	0.0	122.1	72.4	275.9
TOTAL	481.6	186.8	155.4	661.7	146.7	1 632.2

Source: [WBIF](#), 2022.

Relevance: is the intervention doing the right things?

The projects in this Flagship aim to build upon and, in some cases, complete, prior investments in East-West road and rail connections. In this sense, they are highly relevant and appropriate, albeit an increase in road traffic should certainly be questioned if the expected increase is reliant on petrol or diesel rather than electricity. Environmental priorities suggest that a greater emphasis should be placed on improving the railway network, with a subsequent shifting of traffic from road to rail and waterways in line with the Green Agenda. Other than completing partly constructed highways, such a shift should be the priority for new transport plans in future regional infrastructure investments. In this respect, the railway and waterway projects under Flagship 1 become extremely relevant. The development of intermodal exchanges in the fourth component of this Flagship is welcomed and should also be extended to other components. However, the EIP also promises to support sustainable urban mobility plans in urban areas, with electric charging stations on new road infrastructure, but there is little evidence of this in the Flagship 1 plans (European Commission, 2020a).

The second and third components of Flagship 1 involve railway upgrading, including electrification. These projects are relevant to the objectives of modal shift and are environmentally friendly, compared with road transport. The Flagship's fourth component is also highly relevant to modal shift and environmental objectives.

Effectiveness: is Flagship 1 likely to achieve its objectives?

The Peace Highway, when completed, is likely to achieve its objective of improving the road connection between Niš and Pristina. However, whether or not it will lead to an increase in traffic and trade between the two countries is questionable. This will depend much more on the demand for travel and trade than on the quality of road connections. In so far as the road provides part of the link between Serbia and the port of Durrës in Albania, an increase in road transport might be expected to facilitate Serbia's connection to a seaport, which may increase trade prospects. The extent of any potential increase in trade is of course unknown but is more likely to depend upon the two countries' trade policies, including non-tariff barriers, than any reduction in travel times. Border procedures are also an important factor. For example, it takes the average Kosovar and Serbian exporters four hours to deal with compliance issues at the border, with six hours and five hours respectively for importers³⁹. Since goods from Durrës to Serbia (and *vice versa*) will cross two borders, these times could be doubled for such trade. In order to benefit fully from trade enhancing possibilities, this infrastructure project would need to rely upon full implementation of the Common Regional Market programme which would reduce border crossing delays related to customs procedures. The upgraded road connection is perhaps more likely to meet its political objectives of providing a visible embodiment of the normalisation of relations between Kosovo* and Serbia, than to meet its economic objectives, although the impact of increased trade on improving political relations may be doubted (see Milošević and Hrnjazi, 2018).

The railway and waterway components of Flagship 1 are likely to be effective in that they will achieve the objectives of improving transport infrastructure and lead to a more environmentally friendly balance of transport infrastructure. For example, the Niš bypass is expected to raise the quality of life in Niš, which is surrounded by a triangular network of railway lines constructed when the city was much smaller. This new road is expected to improve the efficiency of transport, reduce traffic congestion and move freight traffic out of the city centre. In an indication of the length of time needed to complete such infrastructure projects, this particular project began with an environmental impact assessment in 2013, including a feasibility study and general design (Ralev, 2017).

Efficiency: how well are resources likely to be used?

The first section of the Peace Highway funded by the EU and EIB through a grant agreement signed in February 2019 runs from Niš as far as the small village of Pločnik, at a total cost of EUR 255 million, of which the EU is contributing EUR 40.6 million through an investment grant and EUR 7.4 million in technical assistance. These grants complement the EUR 100 million EIB loan and another loan for over EUR 80 million from EBRD, together with EUR 27 million contributed by the Serbian government. The loan agreement took three years of preparatory work to reach signature stage. Under the EIP, the Commission envisages increasing its co-financing rates for road transport projects by up to 40 % (European Commission, 2020a: 8). This is in effect a giant subsidy for road transport and directly contradicts the Green Agenda's ambition to facilitate and support a shift from road to railway and waterway modes of transportation.

The Serbian section of the highway will in total cover 77 km between Niš and the Kosovar border at Merdare, while the extra section beyond Pločnik is expected to cost an additional EUR 605 million to be funded under the EIP⁴⁰, bringing total construction costs to EUR 1.07 billion⁴¹. Other sections of the Peace Highway in Kosovo* will be built using US funding through their International Development Finance Corporation and Export-Import Bank, thereby providing an effective example of donor coordination⁴².

³⁹ See [World Bank – Doing Business Archive – Trading Across Borders](#).

⁴⁰ EU Delegation to the Republic of Serbia, [The Peace Highway: Much More than a Road](#), published on 2 December 2021.

⁴¹ M. J. Woolf, [‘Serbia-Kosovo highway work starting’](#), World Highways, published on 12 October 2021.

⁴² US International Development Corporation, [‘DFC and EXIM Sign LOIs with Serbia and Kosovo to Invest in The Peace Highway’](#), published on 15 September 2020.

When completed, this major road artery may increase travel speed by up to 100 km/h and thus reduce travel times. The European Commission estimates, perhaps optimistically, that traffic will increase from 2 000 vehicles/day to 8 500 vehicles/day within the first two years. It also predicts that 350 jobs will be created in construction, operation and maintenance. Trade between Serbia and Kosovo* may increase, potentially yielding positive economic impacts⁴³. Despite all these benefits, it is still hard to see how the road will bring much in the way of added value to the economies, unless non-tariff barriers to trade are substantially reduced or eliminated.

Flagship 2 - Connecting North to South

This Flagship is expected to be completed or at an advanced stage by 2024. It includes the following projects:

- (i) 75 % of the main North-South road corridor linking Central European capitals through Sarajevo to the port of Ploče (Corridor Vc) is expected to be completed up to motorway standards, while the rail connection along the same corridor will also be upgraded.
- (ii) The Rail Route 4 linking Belgrade to Podgorica and the port of Bar is expected to be fully rehabilitated from the Serbian border to the sea, as is the parallel road corridor and the Podgorica bypass.
- (iii) Sarajevo to Podgorica connection is expected to be enhanced.
- (iv) The railway route from Belgrade to Pristina is expected to be further upgraded in Kosovo* and improved in Serbia by preparing technical documentation for rehabilitation works.

The projects endorsed by March 2022 are shown here in Table 4.2.

Table 4.2 Flagship 2 Connecting North to South: Transport projects endorsed by WBIF in 2022 (EUR million)

Bosnia and Herzegovina Mediterranean corridor Vc	WBIF EU grant	Previous grants	EBRD loan	EIB loan	National input	Total project cost
Šamac – Doboj – Rječica Railway Section	83.1	2.0	37.4	40.0	0.0	162.5
Johovac Interchange – Vukosavlje Interchange Motorway Section	179.8	0.0	0.0	250.2	22.5	463.5
Medakovo – Ozimice Motorway Subsection	79.1	0.0	0.0	109.9	13.1	202.1
Mostar South – Kvanj Tunnel Motorway Subsection	30.3	0.0	40.2	0.0	10.0	80.5
Kvanj Tunnel – Buna Motorway Subsection	23.1	20.7	0.0	58.9	2.0	104.7
TOTAL	395.4	22.7	77.6	459.0	47.6	1 013.3

Source: [WBIF](#), 2022.

⁴³ WBIF, 'EUR 40 Million Investment Grant Agreement Signed for the First Section of the 2018 Connectivity Project the 'Peace Highway' Connecting Serbia and Kosovo*', published on 18 September 2019.

Relevance: is the intervention doing the right things?

As with Flagship 1, the projects in this Flagship aim to build upon and, in some cases, complete, prior investments in North-South road and rail connections. In this sense, they are highly relevant and appropriate. However, as with the previous Flagship, the emphasis on road infrastructure at the expense of railway infrastructure is questionable. Of greater relevance would be a far greater investment in railways, waterways, intermodal connections and urban transit systems.

Effectiveness: is Flagship 2 likely to achieve its objectives?

The infrastructure investments in Flagship 2 are likely to reach their narrow objectives of improving and upgrading some sections of North-South road and rail networks. Providing a direct road connection between Sarajevo and Podgorica is likely to be a particularly effective improvement to transport network in the region. Yet, the infrastructure investments in road building projects proposed are not likely to meet the EIP's wider ambitions, including the objectives set out in the Green Agenda for the Western Balkans. The railway projects are more closely in conformity with the Green Agenda, but there is a lack of detail on the intermodality and road safety features of these projects.

Efficiency: how well are resources likely to be used?

It can be questioned whether or not any benefits from the proposed North-South connectivity projects can justify the costs. The infrastructure projects are at the stage of competitive tender preparation, so little is known about costs, apart from details shown in Table 2, which suggests that for the defined sections a total investment cost of EUR 1 billion will be required. Linking Sarajevo to the coast via road and rail is likely to provide benefits of expanded trade via the port and greater ease of access to the Adriatic for tourists and more generally people from Sarajevo. However, tourists from Europe (Italy, Austria, Hungary) may find it more convenient to drive along the existing motorway from Zagreb, rather than travel via Sarajevo.

Flagship 3 - Connecting the Coastal Regions

This Flagship is expected to be completed or have reached an advanced stage by 2024. It comprises the following projects:

- (i) The Rail Route 2 will link the capitals of Tirana and Podgorica and extend to the port of Durrës; this is a key project for the region and is expected to be enhanced through rehabilitating 120 km of railway line in Albania towards the border with Montenegro.
- (ii) Major steps are expected to be taken in completing the 'Blue Highway' along the coast from Croatia down to Greece, including completion of the Tirana road bypass and two further sections in Albania, while the Budva bypass in Montenegro is expected to be substantially advanced. These projects endorsed by February 2022 are shown in Table 4.3.

Table 4.3 - Flagship 3 Connecting the coastal regions: Transport projects endorsed by WBIF in 2022 (EUR million)

Albania Mediterranean corridor	WBIF EU grant	Previous grants	EBRD loan	EIB loan	National input	Total project cost
Tirana bypass	34.7	34.3	111.7	0.0	9.9	190.6
Vorë - Han i Hotit Route 2 Railway Line	133.4	4.5	62.9	62.9	3.3	267.0
TOTAL	168.1	38.8	174.6	62.9	13.2	457.6

Source: [WBIF](#), 2022.

Relevance: is the intervention doing the right things?

Flagship 3 is highly relevant to linking the port of Durres to Tirana and Podgorica by railway, which should facilitate improved travel and regional trade links between Albania and Montenegro. This is a major contribution to modal shift in creating new rail links, especially in a country (Albania) that is undersupplied with rail infrastructure. The 'Blue highway' is a road infrastructure that goes all the way along the Adriatic coast, from Trieste (Italy) through Slovenia, Croatia, Montenegro and Albania to Greece. It is not relevant to promoting the Green Agenda which aims to shift transport cargo and passengers from road to waterway modes of travel. The Tirana and Budva bypasses are likely to improve the quality of life in these two cities but are not in line with the aim of modal shift and may simply attract more polluting road traffic onto the road network.

Effectiveness: is Flagship 3 likely to achieve its objectives?

Flagship 3 projects are likely to be effective in achieving their narrow objectives of upgrading and creating new transport infrastructure. While the first project of this Flagship is likely to meet the EIP's green objectives, the second component is likely to create a larger amount of road traffic and thus is unlikely to be effective in meeting the EIP's green objectives.

Efficiency: how well are resources likely to be used?

Little information is available about the expected costs and benefits of these infrastructure projects, which are currently at the stage of competitive tender preparation. Hence little is known about their costs, apart from those shown in Table 2; the information presented suggests that for the defined sections a total investment cost of EUR 0.5 billion will be required for the Tirana bypass and a section of railway line. Albania is undersupplied with rail links and this is likely to bring significant added value, especially in terms of green benefits. The Tirana Road bypass may improve the quality of life for residents of Tirana but may also attract large volumes of polluting road traffic to Albania.

4.2 Clean Energy – Flagships 4, 5 and 6

In the area of clean energy, the EIP has suggested three interrelated investment Flagships: Flagship 4 on Renewable Energy; Flagship 5 on Transition from Coal; and Flagship 6 on the Renovation Wave. All Western Balkan economies except Albania rely heavily on highly polluting coal for most of their electricity generation, while the share of oil or gas production is either insignificant or non-existent (Energy Community Secretariat, 2021, p. 5). The amount of coal in the electricity mix of Western Balkan countries ranges from 39 % to 94 % (excluding Albania), while their thermal power plants are outdated and require costly rehabilitation (OECD, 2021). Diversifying energy sources through decarbonisation is particularly important in view of high air pollution created by fossil fuels and the impacts of climate change. Energy consumption is high, which in turn is fuelled by the lack of cost-reflective electricity pricing (OECD, 2021; Energy Community, 2021). Energy productivity remains low when compared with the EU average, which in 2019 ranged from 22 % in Bosnia and Herzegovina to 58 % in Albania (Energy Community Secretariat, 2021, p. 15).

Flagship 4 - Renewable Energy

This Flagship proposes increased use of renewable energy sources, that ought to be in line with the region's potential and national preferences. Its objective is to diversify energy sources in order to increase potential for the country and ultimately the region to produce more energy from renewable sources. Flagship 4 initially (October 2020) proposed the following projects:

- (i) In Albania, both rehabilitation of the Fierza Hydro Power Plant and construction of the Skavica Hydro Power Plant are due to be completed so as to increase potential for the country (and the region) to increase the export of electricity from clean energy.

- (ii) In Montenegro, the Piva Hydro Power System will be expanded with construction of the Komarnica Hydro Power Plant.
- (iii) In Kosovo*, preparations for construction of the Ibër-Lepenc Hydro System Phase II will be accelerated.
- (iv) In North Macedonia, a wind park and solar power plant investment will be substantially advanced, to serve as an example for 'future-proof' investments making use of the region's renewable energy potential.
- (v) Another EIP Flagship project has been added in February 2022, namely a EUR 12 million investment in the first floating Solar Power Plant in Albania, more specifically the installation of a floating solar photovoltaic power plant at the Vau Dejës reservoir. This will be the first application of 'pure-floats' technology in the Western Balkans, with significant potential to replicate it in other reservoirs both in Albania and across the region; the plant is expected to produce over 18 GWh of electricity and displace 8 700 tonnes of CO₂ annually.

Table 4.4 shows the list of projects that have been endorsed at the February 2022 WBIF meeting.

Table 4.4 Flagship 4 Renewable energy projects endorsed by WBIF in 2022 (EUR million)

	WBIF EU grant	Previous grants	EBRD loan	EIB loan	National input	Total project cost
Albania Vau i Dejës Floating Solar Photovoltaic Power Plant	2.6	0.0	7.5	0.0	1.9	12
North Macedonia Oslomej 1 Solar Photovoltaic Power Plant	1.6	0.0	5.9	0.0	1.3	8.8
North Macedonia Oslomej 2 and Bitola Photovoltaic Power Plants	5	0.0	19.8	0.0	0.7	25.5
TOTAL	9.2	0.0	33.2	0.0	3.9	46.3

Source: [WBIF](#), 2022.

Except for these three projects which relate to the construction of solar power plants, all other projects largely follow on from previous projects. In Kosovo*, the Ibër-Lepenc Hydro System Phase II has been co-financed by the World Bank since 2017, aimed at restoring the main water canal in Kosovo* (Ibër Canal) to its original capacity, thereby ensuring more reliable and better quality water⁴⁴. In Albania, the Fierza Hydro Power Plant rehabilitation will effectively modernise one of the country's main hydro power plants⁴⁵. In Montenegro, construction of the Komarnica Hydro Power Plant will expand the country's hydropower system⁴⁶. Some of these projects have already secured financial resources from IFIs or investments by private companies, such as the wind park and solar power plant investment schemes in North Macedonia undertaken by the German renewable energy company WPD that plans to build a EUR 500 million wind farm in the north-eastern part of North Macedonia⁴⁷.

Relevance: is the intervention doing the right things?

⁴⁴ World Bank, [World Bank and Kosovo Sign Project to Support Water Security in Kosovo](#), Press release of 27 January 2017.

⁴⁵ I. Todorović, [Albania's KESH to reconstruct its hydropower plant Fierza](#), Balkan Green Energy News, published on 31 January 2022.

⁴⁶ Hydoreview, [EPCG granted concession to develop 172-MW Komarnica hydro plant in Montenegro](#), published on 9 February 2020.

⁴⁷ Reuters, [Germany's WPD to invest \\$578 mln in North Macedonia wind park](#), published on 12 October 2021.

Flagship 4 is not equally relevant for all countries in the region. For instance, Albania today produces 100 % of its electricity from hydropower (OECD, 2021), although there is potential for better utilisation. By 2010, Albania was already deriving 98 % of its electricity generation from hydropower produced by its three large hydropower plants that provided more than 85 % of total generation, but only 30 % of available sources were actually utilised (Uvalić, 2014). The share of energy from renewable energy sources varies widely across the Western Balkan region, as follows: 45 % in Albania (2020); 44 % in Montenegro (2020); 38 % in Bosnia and Herzegovina (2019); substantially lower in Serbia at 25% (2019); and North Macedonia at 19 % (2019) (Eurostat online database). This is considerably higher than in a number of EU Member States. Kosovo* and Montenegro had already achieved their 2020 target for the use of renewable energy in gross final energy consumption by 2019, while Albania as well as Bosnia and Herzegovina are expected to follow in 2020 (Energy Community Secretariat, 2021).

The Flagship has not taken sufficiently into account the region's potential. Through its initial emphasis on hydropower, other renewable energy sources have been somewhat neglected, including solar and wind sources. Solar and wind power ought to be given major attention as alternatives to the proposed Flagship projects. Less focus on hydropower could ensure a more balanced transition to renewable energy sources⁴⁸. There is huge potential in the region to increase solar and wind energy (OECD, 2021). Although these sources are more expensive, it would still be safer not to put 'all eggs in one basket', but to diversify the future use of renewables⁴⁹. Among the initially proposed WBIF projects, North Macedonia was the only country that proposed wind and solar energy projects. Only one other project on solar energy in Albania was endorsed in February 2022.

Private companies would probably welcome opportunities to invest in alternative sources of energy, other than hydropower. For example, the renewable energy company CWP Global will start building a 50 MW solar power plant ('Kima Solar') near the southwestern Serbian town of Sjenica early in 2023 with a EUR 40 million investment, which will be the first large photovoltaic facility in the country⁵⁰. Similar investments by private companies in solar and wind energy could be amplified by further investments through the WBIF.

Alternative renewable energy sources other than hydropower could also attract wide interest from firms and households, as confirmed by the very positive response to a public call by the Montenegrin power utility company Elektroprivreda Crne Gore, which was offering the subsidised installation of solar photovoltaic panels to produce electricity for self-consumption, to be repaid within six to ten years; from 1 November 2021 until the end of February 2022, 14 000 homes and 800 companies had applied to the public call, well in excess of the targeted 3 000 households and 500 firms⁵¹.

Flagship 4 does not take into account any environmental damage that could result from hydropower projects. Opposition to small hydropower plants has recently increased in the region, as two EIB investment projects allegedly have the potential to cause extreme environmental damage to two rivers⁵². In Bosnia and Herzegovina, the local population has protested because of plans to construct small

⁴⁸ Interview, EU official; Interview, CSO representative.

⁴⁹ Interview, EU official.

⁵⁰ V. Spasić, [CWP Global to build first utility-scale solar power plant in Serbia](#), Balkan Green Energy News, published on 15 June 2021.

⁵¹ V. Spasić, [Great interest of Montenegrin households, firms for solar subsidies](#), Balkan Green Energy News, published on 24 February 2022.

⁵² Interview, EU official.

hydropower plants on two rivers, the Bosna and the Kruščica⁵³. This has led Germany's KfW Development Bank to withdraw from the financing of a 16 MW hydropower plant on the Bosna River, a loan agreement signed with a Bosnian state-owned company in 2014⁵⁴. There is ongoing public debate concerning a total ban on the construction of small hydropower plants in Bosnia and Herzegovina; the Central Bosnia Canton government has terminated 10 concession contracts for small hydropower plants, because their operators failed to pay fees and fulfil obligations⁵⁵.

Effectiveness: is Flagship 4 likely to achieve its objectives?

The hydropower plants proposed by the Flagship are likely to be effective in producing more renewable green energy, but they are nevertheless in conflict with other EIP objectives to do with environmental protection (as indicated earlier). Such projects may not significantly reduce the overall production of electricity from fossil fuels, due to the low contribution of small hydropower plants to electricity production. The Coalition for the Protection of Rivers in Bosnia and Herzegovina has reported that in 2020 all 108 existing small hydropower plants contributed only 341.02 GWh or 2.2 % to total electricity production⁵⁶. According to the same source, it is planned that more than 500 small hydropower plants will be built on 244 rivers in Bosnia and Herzegovina, but implementing such 'ecocide projects' would prevent the development of other potentials, such as tourism, agriculture and fruit growing. Investment projects in hydropower plants may have a negative impact on protected areas, river basins, coastal water and protected species. Hence, any assessments of energy-related projects must include their impact in all these areas⁵⁷. Choices will have to be made among projects that have least environmental impact and greatest energy potential, which often leads to a choice of solar energy projects. If the choice is made to go for hydropower, the best approach is to concentrate efforts on a single plant in a large river, rather than affecting the whole river system⁵⁸.

The construction of a large number of small hydropower plants has provoked intense public debate about their effective contribution to renewable energy sources, negative impact on the environment and sustainable development of rural communities (RERI, 2021). Recent research has shown that small hydropower plants could have serious effects on natural resources in the region (RERI, 2021). Environmental concerns have led to wide protests from the population in the Western Balkans, leading some towns or local communities in Bosnia and Herzegovina, Montenegro and Serbia to limit or prohibit the construction of small hydropower plants (RERI, 2021).

Accordingly, it cannot be concluded that investing in small hydropower plants is likely to be an effective investment. The Flagship has also not addressed the issue of energy security in view of rising energy prices, particularly today after the Russian invasion of Ukraine and increasing uncertainty regarding energy supply.

Efficiency: how well are resources likely to be used?

There are various problems related to the efficient use of resources for investments into renewable energy, particularly respect for environmental norms. Although all potential projects to be considered for financing through the WBIF will be carefully evaluated for their environmental impact, the analytic capacity of local public administration to conduct proper evaluations is weak⁵⁹. Even if a project is assessed as being in line with environmental norms, the capacity of local institutions to monitor the project's implementation may

⁵³ The hydropower plant on the river Bosna would have entailed the construction of a 16-meter-high dam that would flood one of the most beautiful sections of the river with a series of rapids upstream from the city of Zenica. See I. Todorović, [Blue Heart of Europe – hydropower is destroying environment for hardly any energy](#), Balkan Green Energy News, published on 29 January 2020.

⁵⁴ M. Vujasin, [Hydropower projects in Federation of BiH failing. KfW exits](#), Balkan Green Energy News, published on 2 February 2022.

⁵⁵ M. Vujasin, 2022.

⁵⁶ M. Vujasin, 2022.

⁵⁷ Interview, CSO representative.

⁵⁸ Interview, EU official.

⁵⁹ Interview, EU official.

be poor. Non-transparent public procurement procedures may lead to the award of projects to companies motivated by political reasons and clientelism rather than environmental protection, thus not ensuring that the resources are used efficiently.

The Flagship is to be based on national preferences in the Western Balkans. There is political commitment from all countries to implement the Green Agenda. All six leaders adopted the Sofia Declaration on the Green Agenda for the Western Balkans at the Sofia Summit in November 2020; thus, countries have started preparing their National Energy and Climate Plans (Energy Community Secretariat, 2021, p. 3). However, due to Western Balkan governments' limited fiscal capacity, they are likely to find that even transitory measures regarding energy are very expensive. There is no assurance that these objectives will be carried forward by national governments, particularly in those countries that are heavily dependent on coal.

Flagship 5 - Transition from Coal

Flagship 5 proposes ending the use of highly polluting coal by making a transition towards more sustainable and green energy sources. Its objective is to reduce not only carbon dioxide and other emissions, but also air pollution generally, thereby enabling the region to meet its commitments under the Paris Agreement⁶⁰. Decarbonising energy systems is critical for achieving the EU's long-term aim of carbon neutrality by 2050. In 2020, the carbon intensity of electricity production in the Western Balkans exceeded more than three times the average carbon intensity of the EU27 (Energy Community Secretariat, 2021, p. 5).

Under this Flagship, the following projects are planned:

- (i) Construction of the Fier-Vlora gas pipeline in Albania will be completed as part of the Trans Adriatic Pipeline and the Ionian-Adriatic gas pipeline along the coast will be prioritised, facilitating a major diversification of gas supply to the Western Balkans region and beyond.
- (ii) Completion of the gas-interconnector linking Bosnia and Herzegovina with Croatia will complement this diversification of the gas distribution system.
- (iii) Gas links between North Macedonia and Kosovo* will extend the North Macedonia – Greece interconnector.
- (iv) The gas interconnector between North Macedonia and Serbia will be prepared for construction.
- (v) The Trans-Balkan Electricity Transmission Corridor in Serbia will be completed to provide the backbone for electricity distribution throughout the whole region and towards the EU.

Only this last project has received WBIF endorsement by February 2022 (see Table 4.5). The project will provide investment of EUR 40.8 million for constructing 84 km of double overhead transmission line from Bajina Bašta in western Serbia to Bosnia and Herzegovina together with Montenegro, further connecting electricity transmission systems from Western Balkan countries to the EU. Almost 70 % of the total costs of the project is financed through a KfW loan and another 25 % by current and previous EU grants.

⁶⁰ All the Western Balkan countries except Kosovo* are party to the Paris Agreement on Climate Change.

Table 4.5 - Flagship 5 Transition from Coal project endorsed by WBIF in 2022 (EUR million)

	WBIF EU grant	Previous EU grants	KfW loan	EBRD & EIB loans	National input	Total project cost
Serbia Trans-Balkan Electricity Corridor: Serbia - Montenegro - Bosnia and Herzegovina 400 kV Interconnection	8.5	2.1	27.8	0.0	2.4	40.8
TOTAL	8.5	2.1	27.8	0.0	2.4	40.8

Source: [WBIF, 2022](#).*Relevance: is the intervention doing the right things?*

In the transition from coal, this Flagship relies heavily on the use of gas pipelines. Except for one project on the Trans-Balkan Electricity Transmission Corridor, all the other projects propose investments in gas pipelines (fossil fuels), failing to recognise the urgency of the transition to alternative forms of clean energy. The EU's new energy policy is to stop financing fossil fuel projects from 2021 onwards⁶¹. The EIB in early 2022 adopted new guidelines that move in this direction (EIB, 2022)⁶². There are some older projects, such as the gas interconnections between Serbia and Bulgaria as well as between Greece and North Macedonia, that will probably be financed, but the EIB's current priorities with green transition in principle exclude investments in gas pipelines and fossil fuels, encouraging the private sector to use new technologies. Both the EIB and the EBRD are going to finance projects based on gas only as a transitional measure⁶³.

Completion of the Trans-Balkan Electricity Transmission Corridor is a project of significant national and regional relevance because it will provide major electricity connectivity among the countries in the region and with the EU. The Corridor includes the electricity markets of Romania, Serbia, Bosnia and Herzegovina, Montenegro and Italy. The first phase in Serbia was finished in December 2017, while Romania deployed its section of the corridor in May 2018⁶⁴. Regional integration has the potential to improve the performance of electricity markets in these countries and lead to further harmonisation of the economic and technical infrastructure, along with deepening intraregional integration through investment in transmission lines and efficient congestion management (Károva, 2010).

Effectiveness: is Flagship 5 likely to achieve its objectives?

There have been no studies, to the best of our knowledge, providing evidence that the Flagship may succeed in reducing the level of pollution in the region by making a transition from coal to gas. Since gas is a fossil fuel, no investments will be effective in eliminating the production of fossil fuels in the region. Recent estimates for the EU27 show that production from fossil fuels fell by 111 TWh and corresponding carbon emissions dropped by 14 %; conversely, in the Western Balkans fossil-fuel power plants continue to be in operation, with production increasing by 4 % in 2020, resulting in emissions rising when compared with 2019, as follows: carbon dioxide (4 %); nitrogen oxides (6.5 %); sulphur dioxide (8.7 %); and dust (4 %) (Energy Community Secretariat, 2021, p. 5).

These data suggest that decarbonisation has not even started in the Western Balkans and hence objectives will not be realised if Western Balkan governments do not urgently begin preparing and implementing the

⁶¹ Interview, IFI official.⁶² Interview.⁶³ Interview, IFI official.⁶⁴ V. Spasić, [EMS signs EUR 6.5 million contract for second phase of Trans-Balkan corridor](#), Balkan Green Energy News, published on 4 September 2020.

necessary measures. This will also require the elimination of state subsidies to large energy enterprises and other polluting industries that continue to use fossil fuels. The absence of structured energy transition plans raises uncertainty about the direction and speed of this transition in the Western Balkans (Energy Community Secretariat, 2021). To paraphrase one of our interviewees, the train abandoning the use of fossil fuels has left and is a moving target; the Western Balkans must also board that train, as quickly as possible. Being left behind is not an option⁶⁵.

In order for the gas pipelines in the Western Balkans to be effective in ensuring the transition to renewables, the new gas power plants need to be 'hydrogen ready', as suggested for the EU. It is essential that the new gas pipelines are constructed in such a way that they can easily switch to green hydrogen once fossil gas is eliminated and replaced by green hydrogen (in the EU presumably by 2040)⁶⁶.

Efficiency: how well are resources likely to be used?

Decarbonisation is going to be extremely costly for countries that rely heavily on coal for industrial production, electricity generation and heating. The financial resources provided through this Flagship will be able to facilitate investments only into transitional measures, but even these may not be feasible since Western Balkan governments have limited fiscal space within which to increase public investments in alternative energy sources⁶⁷. The low-carbon transition will imply a significant reallocation between activities, sectors, firms, workers and technologies (Tagliapietra et al., 2022). Due to the high cost of transitional measures, local communities will need substantial support to overcome the economic and social costs of decarbonisation. The population will not be eager to implement these proposed measures, without the necessary public campaigns and concrete incentives to be offered by local authorities (RES Foundation, 2021).

The main international financial institutions, including the EIB and the EBRD, may not be ready to support such initiatives on gas pipelines, which form a high priority as a transitory measure. The possibility of using other energy sources to replace coal should be explored for the medium term, options that may be able to avoid relying primarily on gas pipelines. In addition, gas pipelines ought to be 'future-proof', supportive of low carbon transition as well as transit to decarbonised gas and hydrogen. During this transition, the region's potential must be taken into account regarding solar and wind energy, which may become increasingly attractive to private companies.

Flagship 6 - Renovation Wave

Flagship 6 proposes expansion of the EU Renovation Wave to the Western Balkans. Its objective is to refurbish and improve the building stock aimed at assisting transition towards decarbonised and cleaner energy systems. The Flagship's main objectives are:

- (i) Triple the renovation rate of existing buildings.
- (ii) Triple energy savings in existing buildings.
- (iii) Achieve nearly zero energy consumption in new buildings.

The Western Balkans building sector, comprising all public and private buildings, is the largest final energy consumer with approximately 43 % of total energy consumption (Energy Community Secretariat, 2021). Renovating public and private buildings to meet minimal energy performance standards is expected to make a very significant contribution to the reduction of greenhouse gas emissions, boost the living standards of citizens and improve the population's health generally. A building renovation wave

⁶⁵ Interview, EU official.

⁶⁶ M. Vujasin, [Expansion of green hydrogen changing geopolitical relations – IRENA](#), Balkan Green Energy News, published on 18 January 2022.

⁶⁷ Interview, IFI official.

implemented with the help of the Energy Community will assist the Western Balkans in decarbonisation of public and private buildings, with a strong emphasis on digitalisation and taking into account energy poverty.

At the February 2022 WBIF meeting, only one project has been endorsed for this Flagship, namely a EUR 40 million scheme to introduce an advanced remote meter reading system in Serbia (see Table 4.6).

Table 4.6 - Flagship 6 Renovation wave project endorsed by WBIF in 2022 (EUR million)

	WBIF EU grant	Previous EU grants	EBRD loan	EBRD grant	National input	Total project cost
Serbia Advanced System for Remote Meter Reading	7.8	0.0	32.2	0.1	0.0	40.1
TOTAL	7.8	0.0	32.2	0.1	0.0	40.1

Source: [WBIF](#), 2022.

Relevance: is the intervention doing the right things?

The Flagship is very relevant for all Western Balkan countries. Some measures have already been taken: by February 2021, investments in building renovations had increased by some 17 %, although this represents only 39 % of the estimated investment needs for 2011-2020, which are enormous (Energy Community Secretariat, 2021). The overall investment level in all countries remains very low compared with the needs. The Flagship ought to contribute to reducing the investment gap in energy efficiency in all types of buildings. The heating system, mostly based on hydrocarbons and coal/lignite or inefficient use of wood, contributes significantly to air pollution and greenhouse gas emissions. Heating systems in the Western Balkans mainly use fossil fuels (coal/lignite, petroleum products and natural gas), with renewables energy such as biomass and waste heat representing only 3 % of total production, 20 % of which is produced in co-generation plants (Energy Community Secretariat, 2021, p. 17). Belgrade still does not have consumption-based metering of electricity due to communal heating systems, which will require the adoption of a new law on metering of energy consumption and the introduction of new meters⁶⁸. Despite the urgency of addressing these problems, only one project under this Flagship had received WBIF endorsement by February 2022, namely remote meter reading in Serbia (see Table 4.6).

Effectiveness: is Flagship 6 likely to achieve its objectives?

Flagship 6 is likely to be effective in reducing carbon emissions from buildings, but only in the medium-to-long term, since decarbonisation has not yet started in countries which are heavily dependent on coal. Funding planned for the EIP Renovation Wave is going to be provided exclusively for energy efficiency in buildings⁶⁹ but this may not be enough to achieve the desired results. Many people in the Western Balkans are not ready to change their systems of heating, both because they are not aware of the benefits of alternative systems and because they cannot afford it (RES Foundation, 2021). Hence, the measures will not be effective unless there are strong incentives offered to citizens and businesses.

Longer term, this Flagship is likely to contribute to the renovation of buildings across the Western Balkans, but not all its expected benefits are likely to be realised. For instance, living standards will not be improved if people have to pay for insulation, the cost of which may actually reduce their living standards. It is also not clear what the Energy Community's role will be in promoting building renovation investment that aims

⁶⁸ Interview, EU official.

⁶⁹ Interview, EU official.

to decarbonise public and private building stock. It is even less clear in which way the decarbonising of buildings is linked to digitalisation and how energy poverty will be taken into account.

In general terms, the Flagship will be extremely costly, since radical changes are necessary in practically the entire building stock of Western Balkan countries. In the EU Green Deal, spending to increase energy efficiency in buildings takes the largest share, namely EUR 45 billion of the Recovery and Resilience Plan; this is followed by public transport (EUR 34 billion), high-speed trains (EUR 26 billion), renewable energy (EUR 23 billion) and hydrogen (EUR 11 billion) (Tagliapietra et al., 2022).

Efficiency: how well are resources likely to be used?

These projects are likely to be those carrying the highest costs, which raises concern about how they will be financed. It is not entirely clear who will cover the costs of renovating buildings, although some governments have taken the first steps in this direction: for example, in Serbia people have been invited to apply for support to replace their windows and install insulation in their buildings⁷⁰. Moreover, there is a risk that suppliers of the necessary window replacements in existing buildings will be chosen by local municipalities on the basis of arbitrary criteria, which could further contribute to clientelism and corruption. A recent poll in the six Western Balkan countries regarding people's heating practices, profiles of residential buildings and energy consumption illustrate households' unpreparedness to replace their heating devices and low awareness of the negative impact of current heating practices on general health (RES Foundation, 2021).

Public administration capacities remain low in the Western Balkans, especially in sectors such as energy efficiency and climate, which even today are often considered as second-class priorities by respective governments⁷¹. Further attention needs to be given in this area to create an appropriate governance system and support implementation capacities (Energy Community Secretariat, 2018). It is important that this region is not left behind in regard to clean energy transition. Western Balkan countries are surrounded by EU Member States, so existing borders between the EU and non-EU countries have little relevance for environmental and climate-related problems, which today are common challenges.

The three Flagships promoting the clean energy agenda could have been much more ambitious⁷². However, it is not only the European Commission which is to be blamed, but also the Western Balkan governments that have actively participated in the preparation and selection of these projects.

4.3 Environment and Climate – Flagship 7

Western Balkan economies face enormous challenges regarding the environment and climate change, considering that air pollution levels in these countries are the highest in Europe (Regional Cooperation Council, 2018; UNEP, 2019; OECD, 2021; European Fund for the Balkans, 2021). The region's countries have climate policy obligations under both the United Nations Framework Convention on Climate Change (UNFCCC)⁷³ and the EU accession process. Among the main causes of environmental and water pollution are inadequate systems for management of wastewater and solid waste, posing threat to human health and biodiversity (OECD, 2021). The OECD has recently revealed alarming findings regarding wastewater,

⁷⁰ Interview, CSO representative.

⁷¹ Interview, CSO representative.

⁷² Interview, EU official.

⁷³ All countries in the region (except Kosovo*), as UNFCCC Parties, have non-Annex I status, meaning that they are obliged to submit National Communications (NC) and Biannual Updated Reports (BUR). The 2015 Paris Agreement underlines the need for development of National Adaptation Plans (NAPs) and establishment of appropriate and efficient processes for planning and implementation of adaptation measures and actions. The Western Balkan economies have prepared or are in the course of preparing NAPs. The Green Climate Fund provides financial resources (up to USD 3 million) to the UNFCCC Parties for establishment of planning and implementation processes for adaptation measures and actions, including development of NAPs (see more in RCC, 2018).

water and waste management systems in the Western Balkans (OECD, 2021). As an example, only 1 % of Kosovo*’s population is connected to a wastewater treatment plant. Throughout the region illegal, non-compliant landfills and dumpsites are widespread. Again in Kosovo*, only 57.7 % of the population is served by municipal waste collection. Access to drinking water and water scarcity create problems in Bosnia and Herzegovina, Kosovo* and North Macedonia. In Albania, the population share with access to safely managed sources of drinking water has increased from 49.3 % to 70 % since 2000 but remains a challenge particularly in rural areas. Low drinking water quality poses a significant challenge in Serbia: only 56 % of drinking water in urban areas and 37 % in rural areas meets minimum quality requirements (OECD, 2021). Most Western Balkan countries’ high dependence on coal as the main energy generator has a direct impact on ambient and air quality, and climate change (RCC, 2018).

In the environment sector, Flagship 7 proposes investment projects on Waste and Wastewater Management. Its objective is to introduce sustainable and reliable ways of managing water supply as well as wastewater and waste disposal systems, which are crucial for environmental protection. The construction of wastewater treatment plants is essential for the region’s green ambitions and will also help safeguard the health and welfare of its population.

The following projects have been proposed:

- (i) Construction of wastewater treatment plants in Pristina and Skopje is to be completed.
- (ii) Implementation of an environmental investment programme in Serbia, which will also modernise wastewater treatment in large and medium-sized towns.
- (iii) Establishment of integrated regional waste management systems and the closure of non-compliant landfills in Albania, Montenegro and North Macedonia.
- (iv) Support will be given for the establishment of proper air and water monitoring systems as well as pollution prevention measures.
- (v) A new project was added for Montenegro in February 2022, namely a EUR 76 million investment for the construction of a wastewater treatment plant in Podgorica, aimed at ensuring that treated wastewaters are discharged in line with EU standards. This project is looking to safeguard people’s health and bring environmental benefits to surrounding rivers and lakes (European Commission, 2022).

Only two of the proposed Flagship projects have been endorsed by February 2022 (see Table 4.7).

Table 4.7 - Flagship 7 Waste and Wastewater Management projects endorsed by WBIF in 2022 (EUR million)

	WBIF EU grant	Previous bilateral donors or EU grants	EIB grant	EIB loan	KfW grant	KfW loan	EBRD loan	French bilat. grant	National input	Total project cost
Montenegro Podgorica Wastewater Treatment Plant	22.9	9.9	0.0	0.0	0.3	35	0.0	0.0	7.5	75.6
North Macedonia Skopje Wastewater	69.8	0.5	0.5	34.8	0.0	0.0	29.7	0.9	0.5	136.7

Treatment Plant										
TOTAL	92.7	10.4	0.5	34.8	0.3	35	29.7	0.9	8.0	212.3

Source: [WBIF](#), 2022.

Relevance: is the intervention doing the right things?

Since waste and wastewater management are among the main causes of environmental and water pollution in the Western Balkans, Flagship 7 is relevant for all the region's countries. However, because of its strong (almost exclusive) focus on wastewater treatment plants, this Flagship fails to recognise other causes of environmental degradation, including highly inadequate solid waste disposal systems and inappropriate systems for monitoring air and water quality in the Western Balkans⁷⁴.

One of the principle causes of water and air pollution in the Western Balkans is inadequate waste management, yet only one of the proposed Flagship projects focuses on this area and then in reference to only three of the six Western Balkan countries, whereas the problem is common to all countries in the region. In Serbia, the lack of modern waste management systems is significantly contributing to water and air pollution. Recent evidence confirms the extremely harmful effects of domestic waste on pollution in Serbia, with the following citation being particularly revealing: 'Waste isn't dormant. It comes back like a boomerang through our water, land, and air. It enters the food chain and slowly poisons us while we are not even aware of it. The main cause is that a stunning 80 % of municipal waste, 2.4 million tons out of 2.9 million per year, ends up in unsanitary landfills – garbage dumps and illegal landfills – which aren't equipped to prevent the spread of the pollution they generate' (Balkan Green Energy News, 2022)⁷⁵. Measures aimed at introducing waste differentiation have been slow, sporadic and unsystematic, with some communes even in the centre of Belgrade still lacking the necessary facilities⁷⁶.

Under the same heading, Flagship 7 addresses the broad area of Environment and Climate, which has been identified as one of the EIP's six priority areas. However, whilst closely interrelated, the two areas represent separate issues and thus require different policies⁷⁷. Both the Flagship and its projects are too narrowly defined, failing to address many important issues of the Green Agenda for the Western Balkans. Environmental protection policies in the EU are integrated and linked with many other areas of intervention. For instance, the *Acquis Communautaire* comprises over 200 major legal acts covering horizontal legislation, water and air quality, waste management, nature protection, industrial pollution control and risk management, chemicals and genetically modified organisms, as well as noise and forestry. Similarly, from a climate perspective, the Flagship does not reflect a 'true agenda'⁷⁸, since there are a number of important problems which are omitted from consideration. For example, the region's rich biodiversity and abundant forest coverage is threatened by pollution requiring better protection, or issues linked to the circular economy.

Hence, Flagship 7 is relevant for tackling a few of the region's environmental problems, but only as a starting point. It fails to address other equally important causes of environmental degradation and climate change. Only one of the projects is directly related to pollution prevention measures, which is the basis of

⁷⁴ The Western Balkans is marked as a region with continuously excessive air pollution caused by various sources of pollutants – from thermal power plants, heating plants, large and small industrial facilities running on fossil fuels, oil processing, transportation and household heating appliances, to construction, agriculture and landfills (European Fund for the Balkans, 2021).

⁷⁵ Balkan Green Energy News, [Garbage dumps in Serbia are quietly poisoning its citizens](#), published on 21 February 2022.

⁷⁶ Interview, CSO representative.

⁷⁷ Interview, EU official.

⁷⁸ Interview, EU official.

policies in the EU. The Flagship does not consider further policy areas that go beyond the few that have been selected.

Effectiveness: is Flagship 7 likely to achieve its objectives?

This Flagship may lead to fulfilment of some of its explicit goals, such as improvements in wastewater management systems or better systems of monitoring of air and water quality in the Western Balkans. However, this is unlikely to reduce pollution and prevent climate change to any significant extent. Because of the Flagship's narrow focus on only a few among many causes of environmental degradation, these projects are unlikely to help safeguard the health and welfare of the Western Balkan population.

Another critical point regarding the Flagship's effectiveness is that investments in waste and wastewater management (and in other areas related to environment and climate change) require a strategic approach of over 10 or 15 years. Only within such a longer time horizon can the desired results be achieved. Yet, in the Western Balkans, there is a lack of public administration capacity for effective longer-term planning of government budgets even regarding much simpler tasks⁷⁹, despite some progress achieved through the Economic Reform Programmes. However, the ability of Western Balkan administrations to establish longer-term budgetary frameworks has also been constrained by the delays and unpredictability connected with EU funding under IPA III rules and conditionality⁸⁰.

Efficiency: how well are resources likely to be used?

Resources earmarked for the selected projects may not be used efficiently due to both financial and governance constraints. For instance, in 2011-2012, the Serbian Ministry for Environment estimated that the costs of environmental projects necessary to reach EU standards for Serbia would be around EUR 11 billion, which today could be at least 25 % higher⁸¹. Currently, public utility tariffs in the Western Balkans are set below operational costs, which seriously limits the financial resources available for investments in areas such as solid waste and wastewater management, water supply and the energy sector (OECD, 2021). Financing of environmental projects will be further constrained by IPA III rules that require projects to be co-financed from Western Balkan governments' budgets. Compliance with environmental norms included in the *Acquis Communautaire* will require significant investments at local level, which may not be feasible due to local municipalities' limited budgets.

Implementation of the Flagship's projects will require a strong and well-equipped administration not only at national, but also local level, capable of preparing and implementing projects in line with EU environmental norms. There is still a lack of understanding in regard to environmental problems, which calls for a raising of awareness within local authorities about the importance of preventive and other environmental measures. For example, a mayor in one of the Western Balkan countries considered a wastewater treatment plant to be a hostile act, because he would have to explain to his voters why they will have to pay more for their services⁸². Problems tend to be forgotten by policy makers once they become less urgent. During the worst two winter weeks, Sarajevo is the most polluted town in the world, but as soon as the wind starts blowing and the pollution indicators improve, any policy interest for introducing preventive measures evaporates⁸³. The Western Balkans' public administration at all levels ought to be better informed about the importance of green transition and the main areas of intervention.

⁷⁹ Interview, EU official.

⁸⁰ The conclusion of the Financial framework agreement that specifies IPA funding for a beneficiary is sometimes postponed, as currently is the case with some Western Balkan countries (Interview, Western Balkans government official).

⁸¹ Interview, CSO representative.

⁸² Interview, EU official.

⁸³ Interview, EU official.

In the EU, at least 30 % of the 2021-2027 budget and 37 % of EU recovery spending (Next Generation EU) will be devoted to climate-relevant projects (Tagliapietra et al., 2022).

4.4 Digital Future – Flagship 8

The Western Balkans lag behind the EU in the roll-out of digital infrastructure and development of digital skills. In the EU27, 90 % of households had a broadband connection in 2021, compared with only 75 % of households in Bosnia and Herzegovina⁸⁴. Digital connectivity is increasingly important for business success and countries' economic competitiveness, yet throughout this region, whilst service is often good in the main urban centres, there are large gaps in rural areas. During the COVID-19 pandemic, an International Monetary Fund (IMF) study showed that digitalised firms in the Middle East and Central Asia experienced 4 % less downturn in trade than those that were not (Abidi et al., 2022). Digitalisation has also been found to improve businesses export performance and is especially beneficial for SMEs (EBRD, 2022). Business success with digitalisation depends on an adequate level of literacy, numeracy, problem solving and workers' ICT skills, as well as an adequate supply of ICT and data specialists. All this requires a tremendous effort to train workers, university graduates and school children in the use of new digital technologies, including programming skills. In recent years, skills gaps have emerged in the IT industry and among IT specialists throughout many economies (Bartlett et al., 2020).

For the Western Balkans to address these issues, the European Commission launched a Digital Agenda for the Western Balkans in 2018 (European Commission, 2018c). This Agenda set out four key aims: (i) investing EUR 30 million should in the form of grants for broadband connectivity in the region (from this, the first technical assistance package had already been agreed through the WBIF for Albania); (ii) increasing cybersecurity, trust and the digitalisation of industry; (iii) strengthening the digital economy and society by supporting digital skills; (iv) boosting research and innovation by developing new e-infrastructures for integration into the European Research Area (European Commission, 2018b). Flagship 8 builds on this Digital Agenda, envisaging three key projects:

- (i) Continuation of development and roll-out of national broadband infrastructure, with a focus on rural areas;
- (ii) Setting up secure, energy-efficient and trustworthy data centres as well as edge and cloud infrastructures, while ensuring data protection, and linking the Western Balkans to EU initiatives on high performance computers, digital incubators and innovation hubs;
- (iii) Support for synergies with other infrastructure, such as the Balkan Digital Highway, to be explored in the context of infrastructure sharing. Digital education will be supported taking account of access equality, particularly for disadvantaged groups, such as the Roma.

Specific results to be achieved through the Flagship between 2021 and 2027 have been set out by the WBIF as follows: (i) 70 % of households connected to broadband in rural areas in Albania; (ii) 724 healthcare facilities and 2 155 schools connected to broadband in Albania; (iii) 136 500 students and teachers in 500 schools with access to high-speed broadband in Kosovo*; (iv) 48 700 people in Montenegro with access to next-generation networks in 'white zones'; (v) in North Macedonia ultrafast internet for 174 600 people in 'white' and 'grey zones'⁸⁵; and (vi) broadband for 1 500 schools and 225 000 households in Serbian rural areas⁸⁶.

⁸⁴ Eurostat online data [[ISOC CI IT H](#)]. Connection rates elsewhere were: 78 % (Montenegro), 79 % (North Macedonia – 2020), 81 % Serbia, 85 % (Albania – 2019), and 96 % (Kosovo* – 2020).

⁸⁵ 'White zones' are areas in which there is no provider of broadband access services currently operating and where none are expected in the next three years. 'Grey zones' are areas with one provider, where no others are expected in the next three years.

⁸⁶ See [WBIF Digital Future Factsheet](#), November 2021.

Relevance: is the intervention doing the right things?

The European Commission argues that adapting to the rapid transformative technological development is essential for countries to remain prosperous and competitive (European Commission, 2020a). The objectives of Flagship 8 are laudable in the context of rapid technological change which the world economy is experiencing, leaving no region unaffected. Given the large divergence in levels of economic development between urban and rural areas, the roll-out of broadband connectivity to rural areas is a highly relevant objective. Nevertheless, the list of specific objectives provided by the Flagship and the WBIF set out above consider these objectives rather *ad hoc* and lacking in region-wide coherence. A number of countries are focused on rolling out broadband internet to rural areas (within this Flagship) including Albania and Serbia, where there is a high level of ambition to disseminate broadband widely to rural areas. Other countries have chosen different specific investments, with a strong focus on providing internet to schools. This is extremely relevant since many schools in the region (especially in Albania and Kosovo*, together with rural areas in each economy) lack internet access.

Effectiveness: is Flagship 8 likely to achieve its objectives?

Broadband roll-out is progressing well in the Western Balkans and rapidly catching up with the EU. Penetration into rural and mountainous areas, though, remains difficult. Hence, the likelihood of this Flagship achieving its objective of reaching such communities, especially in Bosnia and Herzegovina as well as Montenegro, will probably depend upon success with infrastructure sharing. However, the ability of countries to use infrastructure sharing between public electricity utilities and broadband service providers relies partly on the compatibility of regulations between the region's energy and electronic communications sectors. A feasibility study by the World Bank carried out in 2019 found that there were no major legal or regulatory obstacles that would prevent such infrastructure sharing solutions from being put in place to distribute broadband connectivity to rural areas (World Bank, 2019c). Moreover, alignment with relevant EU legislation in this area is proceeding without difficulty. Successfully increasing broadband services in rural areas will also be driven by the different telecommunication companies' pricing models and various regulations which require these public utilities to provide a public-interest universal service to all communities in each economy.

The absence of internet access for schools in rural areas and more widely in some countries, Albania and Kosovo* in particular, means that basic digital skills such as programming cannot be effectively taught. Hence, the Flagship's objective of raising digital skills may not be met (Bartlett et al., 2020). Since the Balkans Digital Highway is not expected to be completed until 2028 and a EUR 48 million roll-out of digital access to schools in Albania is only at the feasibility study stage⁸⁷, it is hard to envisage that this digital infrastructure Flagship's aims will be met within the EIP's lifetime.

Efficiency: how well are resources likely to be used?

The proposal to develop a Balkan Digital Highway based on sharing the capacity of public companies such as electricity utilities is likely to be a cost-effective way of extending broadband connectivity to rural areas. The World Bank's study found that only 35 % of the fibre optic network capacity of transmission system operators are being used, providing a potential win-win situation in which utility companies optimise the use of their networks and governments enjoy a cost-effective way to distribute broadband services to rural areas in the Western Balkans (World Bank, 2019c). It is estimated that the Digital Highway project will cost EUR 16.6 million, including a WBIF grant of EUR 1 million.

It should be noted that subsidies to internet infrastructure developers in the Western Balkans, often state-owned enterprises, are subject to state aid regulations, other than those in white zones and probably in grey zones. However, in most Western Balkan countries (with the possible exception of Montenegro) state

⁸⁷ See [WBIF Digital Future Factsheet](#), November 2021.

aid is compatible with their underdeveloped status as measured by their relatively low level of GDP compared to the EU average. Thus, subsidies to digital infrastructure developers are unlikely to be held back by state aid rules, albeit they should be managed transparently so as to be compatible with such rules, a condition rarely adhered to in this region (Milenković, 2016).

4.5 Private Sector – Flagship 9

Flagship 9 is titled Investing in the Competitiveness of the Private Sector. Supporting the private sector is one of the EIP's six thematic priorities, which is seen as essential not only for socio-economic development in the Western Balkan countries, but also their regional integration. In order to support investments in SMEs and their capacity to innovate, scale-up and grow, this Flagship identifies three priorities for EU action:

- (i) Increase the grant amount for private sector support under the WBIF; 50 % of EU private sector funding should be dedicated to innovation and green growth.
- (ii) Increase the guarantee capacity supporting investments, primarily to strengthen SMEs' competitiveness and enhance employment creation (particularly for young people), through the Western Balkans Guarantee Facility.
- (iii) Mobilise assistance for the sustainable transformation of agri-food systems and rural development in the Western Balkans.

The Flagship builds on previous EU initiatives aimed at supporting the private sector and SMEs in the region. Within the WBIF, the Enterprise Development and Innovation Facility (EDIF) was created in 2012 in order to support specifically the Western Balkans' SME sector through various financial instruments (equity finance, privileged loans, guarantees) and technical assistance⁸⁸. Until November 2021, support to the private sector through EDIF and other financial instruments has amounted to EUR 4.2 billion (WBIF, 2022).

Relevance: is the intervention doing the right things?

Flagship 9's objectives are only partly relevant for addressing current and future private sector needs in the region. Increasing grant support for private sector, particularly SMEs, will not bring the expected results unless efficient mechanisms exist to ensure good governance and distribution of funds in line with the priority areas of innovation and green growth. Various instruments are envisaged within the EDIF to increase local banks' credit capacity to extend loans to SMEs and municipalities (loans at privileged conditions, equity funds, guarantees). Public private partnerships (PPPs) are expected to facilitate SMEs' access to finance for investments in digital and green transition, sustainable cities (including sustainable transport, energy efficiency, waste management), and human development⁸⁹. These instruments rely on the close cooperation of WBIF stakeholders with local institutions, including the Ministry of Finance and the Central Bank, that are expected to create an enabling environment for local banks to implement investments on the ground in line with established priorities⁹⁰.

Although many recent studies have found that there is considerable potential for further expansion of the region's private sector (Berthomieu et al., 2016; Sanfey and Milatović, 2018; World Bank, 2019a; OECD, 2019), focusing primarily on financial and technical support for SMEs is unlikely to be sufficient to facilitate

⁸⁸ The Western Balkan EDIF is a platform specifically devoted to the private sector and particularly SMEs. EDIF has four pillars. The first pillar is SME equity financing that relies on two equity funds: the Enterprise Innovation Fund (ENIF) for early stage and seed investments; and the Enterprise Expansion Fund (ENEF) for expansion investing. The second pillar is the SME Loan Guarantee Facility: a portion of the risk incurred by banks is covered by EDIF when extending loans to SMEs, enabling banks to provide loans at more beneficial terms. The third pillar is SME lending, providing an EU grant component and EBRD resources for lending to local commercial banks and credit institutions, for on-lending to local SMEs. The fourth pillar offers various technical support mechanisms to create a favourable investment climate.

⁸⁹ Interview, EU official.

⁹⁰ Interview, EU official.

faster private sector development. Experience gained during the past decade suggests that financial instruments offered to SMEs through the EDIF platform have not removed certain obstacles for their expansion (OECD et al., 2019). Whilst trying to grow and develop, SMEs continue to face significant barriers, not only financial but also non-financial, deriving from a weak institutional and business environment, uncompetitive markets and ineffective competition policy (Atanasijević et al., 2021b).

The Flagship's focus on securing funding for the sustainable transformation of agri-food systems and rural development is extremely relevant for the Western Balkans. Agriculture continues to contribute a high share of added value and employment, especially in Albania and Serbia, and represents the only sector where the Western Balkans have enjoyed a trade surplus with the EU. Its importance is also due to the impact of climate change; the predicted increases of temperature in the coming decades bringing uncontrolled floods and droughts are a serious risk to both agricultural production and the rural population's safety (Županić et al., 2021). Sustainable transformation of agri-food systems could lead to increasing exports for the Western Balkan economies, thereby contributing to faster economic growth and development. Rural development could facilitate the creation of new rural jobs outside the main urban centres, thus in healthier environments than the highly polluted capitals (Uvalić and Bartlett, 2021).

Effectiveness: is Flagship 9 likely to achieve its objectives?

This Flagship may not be effective in securing SME growth and private sector expansion generally. Emphasis placed on financial instruments for SMEs is justified, considering that domestic credit to the private sector remains low in comparison with the EU15 average⁹¹, or that interest rates on loans remain relatively high, particularly in Albania and Kosovo* (OECD, 2021). However, SMEs' access to finance may not be the main barrier for their development. Except for Kosovo*, a relatively small percentage of SMEs identifies access to finance as a major constraint (World Bank, World Development Indicators, available online). The banking sector in the Western Balkans is well-capitalised and is generally able to service SMEs, although on micro firms it imposes rather strict requirements regarding collateral, history of operations and profitability (Atanasijević, 2021b; OECD, 2021).

For Flagship 9 to make a significant contribution to the development of a robust, innovative and competitive private sector, fundamental reforms must be undertaken in regard to the business environment, competition policy and education systems. There is ample evidence to suggest that firms in the Western Balkans face administrative barriers that are costly and impose severe constraints for doing business, including difficulties in getting electricity and construction permits, paying taxes, enforcing contracts or resolving insolvency⁹². In part, this is due to slow reforms of the judiciary systems and the resulting poor implementation of the rule of law. These weaknesses in the institutional environment increase the overall cost (and risk) of doing business in the region, so enterprises require a higher expected profit rate to justify investment, compared to economies where the administrative burden is lower (Atanasijević et al., 2021b).

Enterprises in the Western Balkans are also constrained by the highly uncompetitive environment. Strong competition from the large informal sector, according to the recent EBRD-World Business Environment and Enterprise Performance Survey (BEEPS), constitutes the most important constraint for businesses in the Western Balkans (World Bank, 2021b). By avoiding payment of taxes and social security contributions, firms in the informal sector have specific advantages with respect to registered SMEs. The private sector's

⁹¹ Compared to the EU15, where in recent years credit to private sector (in percentage of GDP) has been above 100 %, in the Western Balkans the share is much lower, ranging from under 40 % in Albania to about 60 % in Bosnia and Herzegovina (World Bank Global Financial Indicators). Commercial banks' net interest margins expressed as a percent of total earning assets are still at around 5 % in most Western Balkan countries, which is more than double than in the EU15 (Atanasijević et al., 2021b).

⁹² According to the World Bank's *Ease of Doing Business* indicators, in 2020 North Macedonia was the only Western Balkan country that had an impressive global rank (17th among 190 countries), Serbia, Montenegro and Kosovo* ranked 44th, 50th and 57th, respectively, while Albania and Bosnia and Herzegovina were ranked very poorly (82nd and 90th respectively); see World Bank, 2020c.

competitiveness is further weakened by state-owned companies' privileged position. Particularly in Bosnia and Herzegovina, Kosovo* and Serbia, state-owned enterprises are present in many sectors and benefit from subsidies, indirect government financial support and other advantages (OECD, 2021). Some state-owned businesses have maintained market power due to quasi-monopolistic positions and insufficiently rigorous application of competition policy. In Serbia, it is estimated that 60 % of the distortions in product markets have resulted from government action, especially widespread state ownership and special treatment of state-owned enterprises, through subsidies, preferential access to credit and protectionist regulation (World Bank, 2019b). Similarly, direct or hidden government subsidies offered to foreign companies cause further distortions in market competition which disadvantage SMEs and even well-established larger domestic enterprises⁹³. An inadequately educated workforce creates a further barrier for private sector expansion, since ongoing reforms of the education systems are not sufficiently taking into account the changing skill needs of enterprises (Bartlett et al., 2016). The latest EBRD-World Bank BEEPS survey confirms that in general terms the Western Balkans' poorly skilled workforce is impeding investment growth, job creation, innovation and technology adoption (see also OECD, 2021).

Efficiency: how well are resources likely to be used?

The region's present institutional environment has not always been conducive to the efficient use of financial resources provided by international organisations and external donors⁹⁴. In order to ensure that the Flagship contributes to set objectives, the capacities of both SMEs and local banks have to be strengthened. The increasing supply and demand of green finance requires, on the one hand, that SMEs are capable of preparing innovative green projects; this will require more resources for technical assistance and the provision of general training courses for enterprises so as to build local SMEs' capacities. The fiscal framework will also have to be substantially revised in ways that incentivise SMEs to implement green projects. New priorities will also require, on the other hand, a banking system that can provide not only finance, but also the know-how and capacity to assess green projects. The analytical and technical ability of local commercial banks may currently be too weak for effective evaluation and selection of green projects⁹⁵. With few exceptions, commercial banks operating in Serbia, for example, lack the long-term commitment to finance green investments; have no capacity to assess and implement such projects; and often perceive related investments as unprofitable (Atanasijević et al., 2021b). To benefit fully from the potentials of green transition, commercial banks need to train and invest in dedicated staff who can develop, assess and implement green SME projects on a continual basis.

Among other critical points are current expectations that the Western Balkan Guarantee Facility can attract substantial additional public and private investments. In reality, the precise mechanisms of this Facility have yet to be worked out in detail. It appears that a rather complex procedure is envisaged that will include the development of specific indicators to measure investment impact, including the expected rate of return from investments for different types of firms (such as women- or youth-led businesses); or setting out the eligibility criteria for loans, to be based not only on leverage, but also desired policy objectives⁹⁶. In countries with negligible or inactive capital markets, small activity of other financial intermediaries and very limited equity financing instruments, it will probably be very difficult to glean any meaningful response from private investors, even if guarantees are provided by trusted international institutions. Risk-sharing instruments may not work in highly volatile economic environments, such as those in the Western Balkans. Weaknesses in the institutional environment increase the overall cost (thus also the risk) of doing

⁹³ Interview, CSO representative.

⁹⁴ Interview, IFI official.

⁹⁵ Interview, IFI official.

⁹⁶ Interview, EU official.

business in the region, so potential investors need to be motivated by higher expected profit rates than in case of lower administrative burden (Atanasijević et al., 2021b, p. 25).

Flagship efficiency must also be assessed drawing lessons from past experience and results that have been obtained so far⁹⁷. Partial absorption of EDIF instruments in the previous cycle of SME financing coupled with market failures that are hampering the growth of SMEs suggest that there is much room for improvement (Atanasijević et al., 2021b). The new financial instruments that have been devised to support investment in the private sector are much more complex than those supporting investments in infrastructure⁹⁸. The region's experience with PPPs has so far been limited due to the small size of national markets, inadequate legal and institutional frameworks as well as perceived high regional political risks (IMF, 2018; Estrin and Uvalić, 2014). PPPs have not been effective because of governments' limited capacity to make credible long-term commitments, since they are frequently launched for projects that are not sufficiently mature or have been poorly prepared (IMF, 2018)⁹⁹. Public administration capacity in the Western Balkans is not strong enough to deal with such projects, whereas investors require assurance on contract enforcement and long-term stability¹⁰⁰.

4.6 Human Capital – Flagship 10

With few exceptions, education systems in the Western Balkans could do more to provide a good standard of education for young people, as evidenced by the 2018 OECD Programme for International Student Assessment test results, which show that large proportions of pupils are unable to achieve level 2 in Reading¹⁰¹. The average score places the region above only 13 out of 79 countries in the reading and science test and above only 15 countries in the mathematics test (Bartlett et al., 2020). A large proportion of young people attend secondary vocational schools, where curricula are often outdated. Graduates from such schools often experience a difficult transition into work, as their skills frequently lack relevance to the labour market (Bartlett and Oruč, 2021). Teaching methods in schools and higher education often omit critical thinking and problem-solving approaches that have become vitally important in the digital age. Graduates from higher education regularly experience difficulties in finding jobs due to mismatched skills, a lack of work experience as well as no appropriate career guidance and counselling. Aspiring youth entrepreneurs also face obstacles in setting up their own businesses, due to a lack of support for youth entrepreneurship (Gribben, 2018).

Consequently, Western Balkan economies have high levels of youth unemployment, despite this having improved to some extent in recent years, at least until the outbreak of COVID-19 which hit job prospects especially of young people and young women in particular (Bartlett, 2022). Youth unemployment can have a scarring effect, increasing the risk of future unemployment, reducing future earnings and leading to a high risk of poverty (Petreski et al., 2017; 2021; Council of the EU, 2020). Young people neither in employment nor in education or training run the risk of becoming socially excluded on a long-term basis. In 2020, the NEET rate was 22.4 % among the 15-24 age group compared with 11.1 % in the EU27 (Ramhorst, ed., 2021): it was highest in Kosovo* (37.7 %) and lowest in Serbia (15.9 %). The large number qualifying as NEET is a huge problem that risks deepening social exclusion and thus is an extremely inefficient use of human resources. Youth unemployment for the 15-24 age group fell from 45.4 % in 2018 to 35.6 % in 2019 in North Macedonia following the introduction of a countrywide Youth Guarantee in

⁹⁷ The results of the EDIF platform (value of resources, number of enterprises supported) are published in the WB EDIF Annual Reports; the last EDIF report is available for 2020 at <http://www.wbedif.eu/library/wb-edif-annual-report-2020/>.

⁹⁸ Interview, IFI official.

⁹⁹ Interview, EU official.

¹⁰⁰ Interview, IFI official.

¹⁰¹ This threshold defines pupils who are unable to identify the main idea or reflect on the overall purpose in a text of moderate length. For data on PISA test scores in the Western Balkans, see [here](#).

2018, although it began to rise again in 2020 because of the COVID-19 pandemic (European Commission, 2021e).

The EIP aims to support the development of human capital with an emphasis on youth, in collaboration with the International Labour Organisation and the European Training Foundation¹⁰². In doing this the EU will aim to enable innovative approaches to human capital development by fostering the involvement of civil society and social entrepreneurs (European Commission, 2020a). The EIP also aims to tackle the phenomenon of skill mismatch, which is widespread in the Western Balkans, by backing reforms to education and training systems as well as developing work-based learning approaches in vocational education¹⁰³. In addition, the EIP envisages a wider set of complementary actions to promote human capital. These include support through the Erasmus+ programme to promote academic mobility and capacity building for vocational education and training (VET), improving the labour market inclusion of young people, women, people with disabilities and minorities, particularly the Roma. In addition, social protection and health system reforms as well as creative and cultural sector development are seen as additional ways of developing human capital in the region.

Flagship 10 specifically proposes dealing with these problems by introducing or extending Youth Guarantees to the Western Balkan economies, designed to provide all young people with the offer of good quality employment, continued education, apprenticeship or traineeship within a period of four months of becoming unemployed or leaving formal education. The Flagship builds upon successful experience with the EU Youth Guarantee scheme. Four phases of implementation are proposed, all of which could potentially benefit from EU support:

- Phase 1 consists of developing an Implementation plan in conjunction with key stakeholders.
- Phase 2 features the necessary preparatory work of building commitment and capacity, whilst also ensuring staffing and infrastructure development.
- Phase 3 is designed as a pilot implementation phase.
- Phase 4 is envisaged as full roll-out of the policy.

Relevance: is the intervention doing the right things?

Flagship 10 with its emphasis on developing human capital and extending the EU's Youth Guarantee policies to the Western Balkans is highly relevant to the aim of improving young people's quality of life and avoiding their social exclusion. Intervention is well targeted on the problems of young people in the labour market as well as those in vocational education and training, considering the high rates of youth unemployment and NEETs in the region. It is likely that action being taken will bring about an overall improvement in this situation and support the economic inclusion of young people. Although the EIP provides no details of the Western Balkans' Youth Guarantees, an obvious benefit and synergy with Flagship 8 on digital infrastructure would be to focus vocational training for beneficiaries of the Youth Guarantee on digital skills development.

Effectiveness: is Flagship 10 likely to achieve its objectives?

The total number of NEETs in the Western Balkan region aged 15-24 was estimated to be around 500 000 in 2020¹⁰⁴. Of these, about 350 000 are unregistered (Ramhorst, ed., 2021). Inclusion of even one half of

¹⁰² See ILO, [Introducing a youth guarantee \(YG\) in the Western Balkans - The European Commission and the ILO join forces to support young people](#), News, published on 18 July 2021.

¹⁰³ Skill mismatch has risen due to slow reforms of the education systems in the context of deep structural change in the economies and the resulting changes in the composition of demand for labour (Skikos, ed., 2016; Bartlett and Uvalić, 2019; Bartlett, 2021b; Krasniqi et al., 2022).

¹⁰⁴ Labour Force Survey data for 2020 from ILOSTAT online database (data for Albania are 2019). See: <https://ilostat.ilo.org/data/>

these unregistered NEETs as clients of the public employment services (PES) under the proposed Youth Guarantee schemes would increase the PES workload by about two thirds. This would require a corresponding increase in the PES' staff complement. Currently, the average caseload per staff member in Kosovo*, North Macedonia and Serbia exceeds the average caseload of 140 in the EU27 (Ramhorst, ed., 2021). Limited staff resources in these countries especially may limit the ability of this Flagship to achieve its objectives through the proposed Youth Guarantees. In addition to PES counsellors, the Youth Guarantee would also require an increase in the capacity of VET institutions. Given the low capacity of existing VET institutions to provide appropriate skills, this will in turn require a large improvement in the provision of teacher education and training. It should be noted that existing plans for a Youth Guarantee in the Western Balkans so far have not been promising. However, the Youth Guarantee in North Macedonia has been successful in reducing the youth unemployment rate and shows what can be done (European Commission, 2021e). The proposed Youth Guarantee scheme in Albania, though, does not yet meet EU Youth Guarantee principles (European Commission, 2021a) and needs additional resources to meet the objectives of Flagship 10. Kosovo* has identified donor funds for a feasibility study (European Commission, 2021c), while Bosnia and Herzegovina, Montenegro and Serbia do not yet have any plans for a Youth Guarantee scheme (European Commission, 2021b; 2021d, 2021f).

In the EU, high-quality outreach activities, particularly involving proactive work in schools and the use of mobile teams, are important strategies for increasing the likelihood of achieving objectives (Anghel and McGrath, 2018). Here various difficulties in achieving objectives have been experienced, including: a lack of coordination among stakeholders; the effectiveness of communication to disadvantaged NEETs; the need to improve PES relationships with employers; as well as the need to improve PES capacity in monitoring and tracking Youth Guarantees participants. All of these issues could be especially challenging in the Western Balkans. In East European EU Member States such as Romania and Slovakia, organisers of Youth Guarantee schemes have found it particularly difficult to meet unregistered NEETs, who are often the most in need. Hence, it would be particularly important to reach these groups in the Western Balkans to ensure that objectives are met.

Efficiency: how well are resources likely to be used?

The cost of providing an effective Youth Guarantee scheme in the Western Balkans has not been set out in the EIP. If we assume that the cost of providing such a service, in terms of outreach and providing activation services for job search services, education or training, and in some cases job subsidies, is approximately EUR 1 000 per NEET per annum, the total budget needed in all six economies would be 500 000 x EUR 1 000, equivalent to EUR 500 million, just to clear the existing NEET backlog¹⁰⁵. Additional resources would then be required to cover the annual flow of NEETs from succeeding generations of young people. If these costs were spread out over five years, the annual cost could be as much as EUR 100 million per year, simply for the programme's operational costs. Further costs would be incurred through investments not only in infrastructure for additional training facilities, but also additional teacher training provision in vocational schools and training centres. Detailed organisation would need to feature in Phase 1 of the Youth Guarantee scheme, which is devoted to developing implementation plans. Given these potential difficulties, a degree of flexibility should be built into the Youth Guarantees to take account of differences in the education and training systems, as well as PES capacity in each economy. Moreover, additional costs are likely to arise in achieving the aim of including young people from vulnerable groups and minorities, who have greater difficulties in accessing the labour markets (Selenko and Pils, 2019). Such additional costs should be factored into implementation plans to ensure the efficiency of all youth guarantee programmes.

¹⁰⁵ This is a very modest assumption. In EU countries, the unit cost of delivering the Youth Guarantee scheme has been planned at around EUR 6 000 per person (Escudero and Mourelo, 2017).

4.7 Overall coherence of the EIP Flagship projects

To complete the assessment of the 10 Flagships this section considers the overall coherence of all EIP Flagship projects. They have already been frontloaded for EU and IFIs funding following the European Parliament's adoption of IPA III Regulation for the period 2021-2027, thereby providing financial assistance for the Western Balkans to be channelled through the WBIF. To assess whether the EIP and its Flagships are based on a coherent approach, it is necessary to check for consistency among the EIP's long-term policy objectives, as well as between the EIP and other EU interventions in the region.

The analysis so far has shown that the EIP's six key thematic areas cover an impressive range of public policy priorities, from transport and energy, to private sector and human capital development, including also the green and digital transitions. This broad agenda, though, is reflected only partially in the 10 Flagship projects and often in an uneven way. For instance, of the 21 investment projects that were selected and endorsed with the WBIF's first major package of financial resources on 23 February 2022, over 85 % cover transport infrastructure (13) and energy (5), which largely follow on from the previous Connectivity Agenda (2015-2020) and reflect the specialisation within the WBIF portfolio.

These transport sector projects do reflect the region's needs, given that the transport networks have for decades suffered from insufficient investment and poor maintenance (see Section 4.1). As shown in our previous analysis, under the three Flagships (1, 2, 3) on transport, these investments all appear relevant and appropriate, as they build upon, and in some cases complete, prior investments in road and rail connections. At the same time, the proposed mix between roads and highways, railways and waterways appears to be only partially in line with other EIP objectives, such as the Western Balkans' Green Agenda, which would have benefited from far greater investment in railways, waterways, intermodal connections and urban transit systems. Moreover, whereas the realisation of these projects ought to contribute to achieving their specific objectives of upgrading or creating new transport infrastructure, it is not always obvious that these initiatives will fulfil broader objectives, such as increasing traffic or trade among the Western Balkan countries. Thus, to what extent do connectivity projects fully justify their costs? This is particularly relevant in the Western Balkans where, as noted earlier, few countries have adequate road maintenance plans and where infrastructure resources have not always been used to the best advantage. In this regard, particularly important is full implementation of the Common Regional Market programme as endorsed in the EIP, enhancing potential benefits of these connectivity projects through a reduction of non-tariff barriers, and this is expected, *inter alia*, to reduce border crossing delays related to customs procedures.

Looking at the three EIP Flagships on clean energy (4, 5, 6), project proposals again largely mark a continuation of previous investments. The Renewable Energy Flagship has not taken sufficiently into account the region's potential, by putting emphasis primarily on hydropower, while underestimating other renewable energy sources such as solar and wind sources. The proposed hydropower plants are likely to be effective in producing more renewable green energy, but they could conflict with other EIP objectives, namely environmental protection – a sensitive issue that has sparked intense public debates in several Western Balkan countries. In Flagship 5 on transition from coal, investments proposed rely heavily on the use of gas pipelines, with few exceptions (for instance a project on the Trans-Balkan Electricity Transmission Corridor). Finally, Flagship 6 on the Renovation wave is likely to be effective in reducing carbon emissions from buildings, but only in the medium-to-long run, given that such projects are extremely costly, while it is not clear how they will be financed. Considering rising energy prices, more ambition in looking towards possibly less hydropower and more solar and wind energy projects, thus a more balanced approach between different options, would have been more coherent with the EIP's overall objectives.

At the same time, other priority thematic areas have found only limited space in the EIP Flagship projects so far. For instance, Environment and Climate is highly relevant for all Western Balkan countries since they

are facing enormous challenges regarding environmental problems and climate change. However, the only Flagship in this area is Flagship 7 on Waste and Wastewater Management projects. The Flagship, albeit an emphasis on wastewater treatment plants, fails to recognise sufficiently other causes of environmental degradation in the Western Balkans, including highly inadequate solid waste disposal systems, or inappropriate systems for monitoring air and water quality. Another example is Flagship 9, with its objective of sustaining current and future needs of the private sector in the Western Balkans. It is very unlikely that the expected results will be produced unless mechanisms are introduced to provide good governance and the distribution of funds in line with priority areas (innovation and green growth), along with further economic reforms. Flagship 10 on human capital development based on the Youth Guarantee scheme is highly relevant, considering the high rates of youth unemployment and NEETs in the region. By targeting the youth and vocational education and training it could obviously benefit from synergies with Flagship 8 on the digital future. However, the overall approach to the extension of Youth Guarantees remains at an early stage and needs further specification, including Phase 1 that is devoted to developing implementation plans. As far as digitalisation is concerned, Flagship 8 builds on the Digital Agenda endorsing its key priorities and objectives, aiming at strengthening digital infrastructure and digital skills development. However, specific projects in this domain, set out by WBIF for the 2021-27 period, appear rather limited in their ambitions and lack region-wide coherence.

So far, we have presented some critical observations about the coherence of these Flagship projects which have been proposed for investments by the EIP. However, EIP is not just about the 10 Flagships, since it endorses a wider vision and multiple objectives in the Western Balkans. Going beyond the sectoral projects proposed through these Flagships, the EIP is a political umbrella that joins pre-existing IPA and WBIF tools. The EIP does not introduce new sources of financing: it is based on the financial instruments that the EU has already been using in the region. The EUR 9 billion grants of EIP come from IPA III funding for the 2021-27 period (64.6 % of the planned seven-year allocations to the Western Balkans). The EIP includes IPA III *Window 3: Green agenda and sustainable connectivity* with an allocation of EUR 5.9 billion and *Window 4: Competitiveness and inclusive growth* with another EUR 3.1 billion. Equally important are the other financial assistance packages provided by international financial institutions within the WBIF, that offer additional financial instruments for guarantees and public and private sector blending (e.g. loans from the EIB and other IFIs, as well as large private investors such as pension funds). This is where an additional EUR 20 billion for investment in infrastructure and the various Flagships is expected to come from. The EIP therefore uses a mix of financing instruments including grants, loans and guarantees, that are aimed at lowering risk and investment costs for potential investors. In this respect, the EIP's instruments increase the consistency of EU support to the region.

Another incremental element of the EIP that builds on previous experience is the orientation of EU assistance to the Western Balkans, which is currently moving away from focusing primarily on legal and political reforms, towards giving a clearer focus on supporting economic development. Through the EIP, EU assistance wants 'to think bigger' and 'to do bigger for the longer-term investments'¹⁰⁶. In this sense, the EIP is not only an 'infrastructure pipeline'¹⁰⁷, but includes key priorities along the six thematic areas that aim to reflect the region's most pressing economic and developmental needs, identifying investments that should be prioritised.

At the same time, EIP is based on IPA III and its conditionality. This new Regulation seeks to set much more stringent conditions regarding the amount of financial assistance that the Western Balkan countries can be granted, based on the performance criteria of each country directly linked to fundamentals. The financial resources that each country will receive from the EU are not fixed in advance, as their allocation

¹⁰⁶ Interview, EU official.

¹⁰⁷ Interview, EU official.

requires modulation using performance-based criteria. However, this is balanced by the principal of fair distribution, so that all countries will be equally treated. Thus, the document is a blueprint on how the EU is going to engage with the Western Balkan region through the principal Windows 3 and 4. It does not give clear benchmarks, it merely shows directions and indicates what will be the key EU objectives within IPA¹⁰⁸.

Overall, the EIP provides an opportunity to make progress in the EU-Western Balkan integration process at a difficult political moment. It is a plan to help the political context, facilitate progress in specific areas and bring the region closer to the EU¹⁰⁹. The EIP is an important tool, although it is questionable as to whether its implementation will have the expected impact of accelerating the region's convergence with the EU. The transmission of current EU priorities to the Western Balkans may not necessarily speed up their integration into the EU.

5 Evaluation of the likely direct and indirect impacts of EIP Flagship projects

In line with the European Commission's *Guidelines on Better Regulation* (European Commission, 2021i), evaluation of the EIP Flagship projects in the previous section has been undertaken on the basis of the main principles and criteria that are considered essential for EU policies and actions, namely relevance, effectiveness, efficiency and coherence. Drawing on previous analysis and additional evidence collected through the study's semi-structured interviews, this section draws together and summarises the evaluation of the EIP Flagship projects. It gives a comprehensive view of the economic, social and environmental impacts of the Flagships, including their interactions and trade-offs. It also assesses the indirect and transversal impacts of the EIP Flagships that are likely to have cross-cutting effects in various areas.

5.1 Economic, social and environmental impacts of the EIP Flagships

The EIP Flagships focus on key problems in Western Balkan economies: poor transport infrastructure connectivity; lack of substantial energy reforms; delayed introduction of environmental norms; insufficient digitalisation; slow development of the private sector; and inadequate investments in human capital. These issues act as impediments for faster integration of Western Balkan countries into the EU. The European Commission has proposed a substantial investment package that is expected to spur long-term economic growth by unleashing the region's untapped economic potential. The EIP Flagships are expected to contribute to bridging the income gap between the EU and Western Balkan region through its specific projects, inspired by the EU current priorities and policies in various areas.

The proposed EU interventions follow in principle the EIP's intended objectives in the Western Balkans. As illustrated below, the proposed projects can potentially make a positive impact on economic growth and employment in the medium-to-long term, although their environmental impact remains uncertain. There are various trade-offs among the different impacts that will need to be carefully assessed.

Economic impact

The EIP's positive economic impact could come through various effects of its 10 Flagships. The returns on investment that can be expected from successful implementation of the EIP Flagship projects are, though, difficult to evaluate¹¹⁰. Quantifying the costs and benefits is not feasible, given that most Flagship projects are in their initial phases. As mentioned earlier, only the first EIP package, with EUR 3.2 billion for 21 projects, had been endorsed by February 2022 (WBIF, 2022).

¹⁰⁸ Interview, EU official.

¹⁰⁹ Interview, EU official.

¹¹⁰ The World Bank has done some estimates on the economic impact of CEFTA expansion (see Mulabdic and Ruta, 2018; World Bank, 2019b, p. 27), but not on the impact of the EIP's 10 Flagship projects.

Among the EIP Flagships, there is a strong focus on connectivity through the trans-European transport corridors, vital for integrating the Western Balkans with the EU. Construction of the highways from Bar (Montenegro) to Serbia, from North Macedonia to Pristina or the Adriatic highway down to Greece are very large projects that are likely to have a positive impact on the region's economic development. The Flagships are expected to foster a different way of thinking about public infrastructure investments, since they now form an integrated package, contrary to the previous round of IPA and WBIF finance that funded small investments into relatively small segments¹¹¹.

Public investments in Western Balkans' transport and energy infrastructure could contribute to higher GDP growth. The fiscal multiplier for investments undertaken prevalently through public funds could be high, although the evidence from many countries worldwide is mixed. Some studies have suggested that, in general, fiscal multipliers may have been underestimated before the global economic crisis, particularly in times of recessions (Blanchard and Leigh, 2013). Recent estimates for the 10 Central East European countries have shown that during periods of slow economic growth, the macroeconomic impact of public investment on GDP is large, suggesting that fiscal policy can be effective in boosting aggregate demand in the short run and in enhancing growth in the long run (Petrović et al., 2021). These estimates suggest that public investments have a relatively large effect on overall GDP, employment and private sector activity, since an increase in public spending may stimulate additional private sector investments in the medium term¹¹².

These findings could also be relevant for post-COVID-19 economic recovery in the Western Balkan countries, small open middle-income economies, most of which have adopted fixed exchange rate arrangements that limit the effectiveness of monetary policy, thereby implying a larger fiscal multiplier (with respect to a flexible regime)¹¹³. It is plausible, therefore, that planned large public investments in infrastructure could have a strong impact on GDP growth, employment and private sector investments, under the right conditions. If well designed, this may help to remove critical constraints on growth in the areas of transport, energy, digital communications and human capital. For instance, poor transport connections may impede trade within and between countries, poor energy infrastructure may hinder the productivity of businesses, underdeveloped communications and digital infrastructure may reduce the flow of information and knowledge, while underinvestment in human capital may constrain skills, productivity and competitiveness (IMF, 2018). In the Western Balkans, weak infrastructure has been found to be a key inhibitor of economic growth (IMF, 2018) and thus the EIP is designed to address this constraint by proposing a large investment package in the region's public infrastructure. However, various conditions influence the effectiveness of public infrastructure investment, such as the existence of an effective institutional framework, strong regional connectivity and links to EU supply chains. According to estimates by the IMF, a 1 % increase in regional connectivity infrastructure could lead to a long-term improvement in real GDP per capita of around 3.5 % (the 'fiscal multiplier'). These positive claims have led to the development of a policy agenda favouring investment in public infrastructure, albeit fiscal multipliers for public infrastructure are not always this high. The same study revealed that in emerging market economies multipliers may be as low as 0.3-0.5 %¹¹⁴. Results ultimately depend, *inter alia*, on the institutional

¹¹¹ Interview, EU official.

¹¹² The econometric estimates suggest that in times of slow growth the influence of public investment on overall output is significant and positive. The effect of public investment on GDP is positive over four years with a cumulative effect (multiplier) of 1.46. Public investment also has a positive statistically significant effect on employment and on private spending (Petrović et al, 2021).

¹¹³ Countries with a fixed exchange rate cannot pursue an independent monetary policy, so money supply accommodates government spending, leading to a higher multiplier (relatively to the one under flexible exchange rates). All Western Balkan countries except Albania either use the euro (Kosovo*, Montenegro) or have an exchange rate regime that officially or unofficially pegs the currency to the euro (see Section 2 above).

¹¹⁴ Negative fiscal multipliers have even been found in some emerging economies, where the institutional framework is weak, public procurement is subject to corruption and infrastructure is poorly constructed. This may be the case for the motorway in Montenegro (von der Brelie, 2021). Such investments are sometimes called 'white elephants'.

framework (governance arrangements, the rule of law and public procurement procedures), as well as the economic policy environment (trade openness, labour market flexibility, exchange rate regime and the size of automatic stabilisers) (Batini et al., 2014).

Evidence from a number of countries suggests that the fiscal multiplier's size for public infrastructure investment depends crucially on the quality of institutions. In conditions of weak institutions and poor governance, public infrastructure investment risks being taken hostage by clientelism, state capture and rent-seeking, which all reduce the multiplier effect. Investments in Western Balkans public transport and energy infrastructure risk becoming 'white elephants', unless the institutional environment improves significantly. Thus, the institutional framework is an important determinant of the effectiveness and efficiency of international assistance for infrastructure projects. Investing in a weak or captured state administration to finance public infrastructure may result in the allocation of public funds to politically connected firms (business capture) or to an indirect diversion to informal power networks (state capture) (Bartlett, 2020a; 2021a). It has even been argued that the provision of international assistance related to political conditionality effectively contributes to state capture by 'strengthening clientelist networks and allowing them to consolidate their grip on power' (Richter and Wunsch, 2020).

There are additional impacts from the other Flagships that could have positive economic effects on the region's economies. A number of EIP Flagship projects will probably have an economy-wide impact, supporting the local economy and contributing to regional development. The Flagship projects in transport infrastructure are aimed at providing West Balkan countries not only with improved internal networks, but also better external links to EU Member States. Digitalisation may provide better digital interconnectivity in underdeveloped and rural areas, so digital infrastructure can overcome to some extent the wide regional disparities that currently exist within Western Balkan countries. Improving the wastewater management or waste disposal systems is supposed to be implemented in various parts of these countries. The Youth Guarantee project will target partners at local level to develop their own plans¹¹⁵. Through better transport, digital and other links within countries, the EIP Flagships could work as accelerators of additional measures in various areas, further stimulating regional development¹¹⁶. The support of SMEs and development of the private sector can have a strong developmental effect, perhaps more important than the building of new infrastructure. Even in the case of large infrastructure projects investors may rely on the use of local subcontractors¹¹⁷ (they should indeed be required to do so, through specific clauses in tender documents), contributing to positive spillovers for local economic development.

These positive impacts on regional development could easily be constrained by a lack of local government financial resources or limited capacity of public administrations to prepare and implement projects within their territories. Projects aimed at helping economic development of the Western Balkan region will need careful preparation and management at local level, thus requiring a strengthening of local municipalities' capacities. The Flagships could provide a good opportunity for Western Balkan countries to bring forward reforms regarding decentralisation and regional economic development. In the EU, the dominant part of the EU budget earmarked for regional development through Cohesion policy is planned for EU regions (not countries)¹¹⁸. The Western Balkan countries need to develop expertise and capacity to prepare, manage and implement projects at local level.

All these aspects suggest that there are likely to be positive economic impacts from the EIP Flagships. Nevertheless, expectations that initial investments of EUR 9 billion through EU grants will attract an

¹¹⁵ Interview, EU official.

¹¹⁶ Interview, Western Balkan government official.

¹¹⁷ Interview, EU official.

¹¹⁸ Similarly to the earlier EU Multiannual Financial Perspectives (MFP), in the current MFP for 2021 – 2027 around 80 % of total funding from the EU budget will be allocated to EU regions through the European Regional Development Fund and the European Social Fund+. The minor part is funding allocated to individual countries through the Cohesion Fund (see [here](#)).

additional EUR 20 billion cannot be taken for granted. In the Western Balkans, such investments will probably require higher leverage because of the volatile business environment, non-transparent regulations, lack of enforcement of competition policy, or the relatively high political risks. Regarding green transition, specific laws and regulations need to be adopted offering concrete incentives to enterprises for implementing green projects, to be supported by equally important commercial banks' financial instruments. Further institutional reforms will, therefore, be imperative.

There are many ways that private sector investments can complement the public investments made within the WBIF under the EIP Flagships. Measures that could facilitate a major involvement of the private sector and the transmission of Flagship objectives to local SMEs include: promotion of applied research; cooperation between universities and industry; provision of a supporting environment for the take-up of innovation by the private sector. The support of basic research on climate technologies (and their subsequent application in practice) could also have positive effects on Western Balkan economies, as it could strengthen their competitiveness¹¹⁹. Banking loans available for SMEs will have to include criteria related to innovation and green projects. As for private investments by EU firms, they will have to be motivated to come to the Western Balkans not only by the many opportunities currently available in the region, but also by concrete incentives. Considering that enterprises in the EU Member States are currently being offered specific government incentives to undertake investments, drawing on resources of the Next Generation EU fund, similar measures ought to be introduced also for investing in the Western Balkans.

Social impact

One of the thematic priorities of IPA III is to foster quality employment and access to the labour market¹²⁰. The EIP Flagship projects' effect on employment will in part depend on their overall economic impact (as described in the previous section), but since most interventions are yet to be implemented, the impact is going to be limited in the short run. Only one of the ten Flagships (Flagship 10) is explicitly dedicated to facilitating more employment opportunities. Nevertheless, most other Flagships have the potential of having positive indirect effects on employment, including: (i) infrastructure projects through the creation of additional jobs in various construction-related industries (Flagships 1, 2 & 3); (ii) digitalisation that ought to help young people find jobs (Flagship 9); (iii) transformation of agri-food systems and rural development, that could create more employment opportunities outside urban centres (Flagship 8); and (iv) the renovation of buildings that will create new jobs in the construction sector (Flagship 6). However, other Flagships are likely to have the contrary effect, such as energy sector reforms and decarbonisation (Flagships 4 and 5) that will lead to workers' lay-offs in large parts of the fossil fuel industry. At the same time, the phasing out of coal (Flagship 5) will have many positive effects on energy efficiency, the environment and pollution, hence peoples' health, making the region more attractive for people to stay and seek work in their home countries. These trade-offs will need to be carefully evaluated and managed.

In addition to job creation generally, the new IPA III Regulation aims to stimulate quality employment and support the enforcement of labour rules. This will be extremely important in infrastructure projects to ensure that: the working environment is safe; all health and safety regulations of the beneficiary country are respected; working conditions are set at an acceptable standard; and work contracts are properly drawn up to avoid precarious employment conditions. Labour inspectorates should be strengthened to ensure their capacity to monitor any new infrastructure implementation. Furthermore, thematic priority on quality employment should ensure that EU funded projects within IPA III support the sustainable labour market integration of young people, women, long-term unemployed and all under-represented groups. When screening infrastructure projects proposed within the single project pipeline, the WBIF must confirm that project specifications include clauses that address the integration of these groups. Flagships 9 and 10

¹¹⁹ Interview, CSO representative.

¹²⁰ European Union, [Commission Delegated Regulation \(EU\) 2021/2128](#), Official Journal of the European Union, L 432/8, 3 December 2021, and European Union, [IPA III Regulation - Annex II](#), Official Journal of the European Union L 330/1, 2021.

regarding development of the private sector, especially SMEs, and advancement of human capital, mindful of the Youth Guarantee scheme, should also take these considerations into account, as well as the thematic priority to support gender equality and youth.

A further IPA III thematic priority concerns promoting social protection and inclusion as well as combating poverty. All IPA III projects are required to foster social inclusion, promote equal opportunities and integrate marginalised communities such as the Roma. To ensure that these priorities are met, specific clauses should be built into all infrastructure projects approved by the WBIF. They should also be recognised as requirements for all projects that support SMEs under Flagship 9 and those which are integrated into the Youth Guarantees design under Flagship 10.

More broadly, the new IPA III Regulation requires that all assistance provided should support implementation of the European Pillar of Social Rights, which in addition to the thematic priorities mentioned above emphasises the right to fair working conditions and fair wages. These should be carefully monitored by national labour inspectorates in all EU funded projects. Furthermore, the IPA III Implementing Regulation sets out additional social implications of any project funded through this assistance programme. For example, it states that discrimination against minorities, *inter alia* Roma communities, remains an important challenge which needs to be addressed throughout the region. Hence, it must be ensured that specific attention is given to the integration of these communities in all IPA projects.

Social inclusion and gender equality are listed as key priorities within Window 4 on competitiveness and inclusive growth. Projects should also support low-skilled and poorly qualified people. This could be done by requiring all contracts approved by WBIF to incorporate apprenticeship programmes and training places in all infrastructure projects funded through IPA III, thereby meeting the requirements for developing on-the-job training, reskilling and up-skilling (Implementing Regulation, p. 49). Furthermore, thematic priority 1 under this window requires that equal access should be ensured for financing new start-ups in the social economy, including social enterprises and cooperatives especially among young people furthest away from the labour market.

To assess whether or not IPA III social requirements have been achieved in EU funded infrastructure projects and other initiatives funded under the EIP, Social Impact Assessments must be undertaken. These should be part of standard documentation required for each infrastructure project screened for approval by the WBIF. There is no universally agreed approach to social impact assessment, in part because social impacts are specific to each project, cultural environment and communities involved (Antonson and Levin, 2020). Social impacts can affect, *inter alia*: health and social well-being; the quality of any lived environment; the cultural milieu; the community; and social inequality. Not surprisingly, there is little research evidence on the general social impact of infrastructure investment, since each project has its own specific social effects, bearing in mind also the external effects of such projects over a wide geographic area and long time horizon. In the transport sector for example, a new motorway may have strong positive social impacts in reducing travel time, connecting a wider range of people, but also displacing communities due to construction works, marginalising those less well served by the new transport link, reducing the health and well-being of people who live nearby and so on. Each project will have its own unique spectrum of social impacts, alongside the economic and environmental impacts. Each deserves its own specific Social Impact Assessment.

Environmental impact

Particular challenges are posed by the EIP Flagships' environmental impacts because of the very high costs and sheer complexity of green transition. This part of the EIP has had a slow start and many further issues on the Green Agenda for the Western Balkans will have to be better defined (NGO, 2021; CEE Bankwatch, 2021). All projects submitted by the Western Balkans for EU/WBIF funding will have to pass an

environmental impact assessment to assure that environmental norms are respected; exclusion criteria will be introduced to carry forward the objectives of green transition, financing only those projects that receive a positive environmental assessment¹²¹. By having high environmental standards in the EU, the environmental footprints have been externalised to the Western Balkans¹²². Green transition in the Western Balkans will be assisted by the EU, to support energy efficiency transition in SMEs. The EU has developed policy guidance on how to ensure that trade-offs between environmental protection and economic development can be made in a sustainable way, and this expertise is currently being transmitted to the Western Balkan governments.

Despite these safeguards, the EIP Flagships' environmental impacts will depend on their implementation in practice. Projects in two broad areas – Clean Energy, Environment and Climate – are likely to be the slowest to prepare and implement, and hence it will take some time before any improvement is evident. Although there is an increasing understanding of the Green Agenda along with political commitment (as confirmed in October 2021 by the Sofia Green Agenda Declaration and adoption of the Action Plan at the EU-Western Balkan Summit in Brdo), reaching the intended objectives and minimising the environment risks may be undermined by the limited readiness and administrative capacity of the Western Balkan governments to implement fundamental reforms in sensitive areas, such as energy efficiency, decarbonisation and environmental protection.

The European Commission, the EIB and EBRD are today committed to applying environmental criteria to their funding and investments. However, once a large infrastructure project is put in place, it may remain blocked due to insufficient local public administration capacity, thus postponing progress towards environmental goals. A strategic planning approach will have to be developed and applied by the Western Balkans governments, linking national energy plans to environmental assessments and other issues that are directly relevant for carrying the green transition forward. The current capacity of Western Balkan public administrations is considered too weak to prevent negative environmental impacts¹²³.

Climate change, in particular, is not well understood in the Western Balkans. Serbia had a large drought last year and has had major heatwaves over the past decade. The situation is similar in other Western Balkan countries. Discussions by EU officials with governments on these issues – for example, how to help the agri-food sector adjust to the new climate regime – have not always been fruitful¹²⁴. Although the six countries signed the Green Agenda for the Western Balkans in Sofia and are parties to UNFCCC, this may not preclude the conclusion of agreements with Chinese companies that may not respect EU environmental norms. However, it should be noted that not only Chinese and Asian companies, but also EU businesses, sometimes ignore environmental standards (Uvalić, 2021). In Serbia, one of the latest alarming stories is from Beočin, where a cement factory was sold to the French company Lafarge in 2002; this was at that time considered one of the most successful privatisations. In the meantime, Beočin has become one of the most polluted Serbian towns, since the company decided to substitute natural gas with the cheaper, but highly health-damaging cox petrol, so the town has seen an increasing number of deaths due to cancer (Ivanović, 2021).

An encouraging countervailing element is that environmental issues are becoming more visible to people throughout the Western Balkans. Various problems are contributing to greater awareness of the importance of natural resources, of the environment and of the disastrous effects of pollution. Death rates in the Western Balkans have been increasing due to air pollution (UNEP, 2019; European Fund for the

¹²¹ Interview, IFI official.

¹²² Interview, EU official.

¹²³ Interview, EU official.

¹²⁴ Interview, EU official.

Balkans, 2021). Health concerns and other existential issues of peoples' everyday lives in the Western Balkans are fundamentally changing populations' awareness about the importance of the environment¹²⁵.

Time dimension

Different impacts from the 10 Flagship projects in the Western Balkans are likely to become evident at different times, with costs being incurred early on and benefits emerging only later. The benefits from most EIP Flagships are likely to come only in the medium (five years) or long term (over ten years). The front-loading of infrastructure projects is expected to lead to a good start, since it will show that the EU is serious about supporting the region¹²⁶. Nevertheless, even those projects that are initiated now, or over the next few years, will take time to implement fully. In the area of renewable energy, some projects are a continuation of investments initiated some years ago, but they will still require some time to be completed due to their sheer complexity. Digitalisation may be easier to implement with positive medium-term effects, considering that it is an objective fully taken on by most Western Balkan governments. The expected impact of decarbonisation will require a much longer time, given that energy reforms are just starting in countries heavily dependent on coal. Similarly, transformation of the building stock that continues to rely heavily on polluting energy sources can be achieved only in the long term. The effects of various measures aimed at strengthening the private sector's competitiveness in the Western Balkans are also to be expected only within a longer time horizon, since they depend on further reforms that so far have been slow to progress (improvements in the business environment, competition policy enforcement, or supportive industrial policies that nudge enterprises towards green transition). Proposed EIP interventions in human capital are most likely to have large economic and social impacts, by providing jobs, education and training to young people who are currently excluded from the labour market, though not immediately. Any investment in promoting human capital, developing skills and providing opportunities for inclusion to hundreds of thousands of currently excluded young people should be one of the top EIP priorities, rather than 'vanity' Flagship infrastructure projects, many of which could end up as expensive white elephants, which may facilitate rent-seeking and clientelist practices to entrench current political elites in power and widen existing income inequalities.

Flagships' trade-offs

There are various trade-offs from the EIP Flagships that will need to be carefully assessed. Even in the EU it is difficult to prioritise achieving the so-called 'triple dividend' – economic growth, job creation and emissions reduction (Tagliapietra et al., 2022). There is no guarantee that the transition to carbon neutrality will be good for growth, because climate mitigation can be characterised as a large negative supply shock (Pisani-Ferry, 2021). Investments required by green transition will stimulate demand and employment, but changeover will also affect supply because decarbonisation amounts to, in one way or another, putting a price on a resource – a stable climate – that was previously available for free (Pisani-Ferry, 2022).

There could also be other trade-offs between economic growth and environment-related objectives in the Western Balkan countries promoted through the EIP Flagships. For example, policies to attract foreign investors, considered important for increasing government revenues and for economic development, could conflict with objectives in rural development or respect for environmental norms. As indicated earlier, demonstrations have taken place in Serbia by people who have been asked to sell their land at low

¹²⁵ In Serbia, a number of non-governmental organisations have been focusing on environmental issues recently, including RERI that won the first ruling of the court over a cable car project, since it provided evidence that there were no environmental norms included into the regulatory issues (Interview, CSO representative). The green movement and green protests in Serbia during the past year are playing an important political role, contributing to bringing social and political change; the environmental problems have empowered people to go out and protest and a green political party will compete for the Belgrade Assembly at the April 2022 elections (Interview, CSO representative).

¹²⁶ Interview, EU official.

prices and leave their agricultural activities on family farms, in order to implement agreements with foreign companies on the exploitation of minerals (e.g. Rio Tinto for the extraction of lithium) that could lead to environmental degradation. In Bosnia and Herzegovina, small hydropower plants aimed at increasing the use of renewables has posed serious environmental risks (see Section 4.2 above).

5.2 Indirect and transversal impacts of the EIP Flagship projects

Indirect impacts from the EIP Flagship projects may be equally as important as any direct effects. Many of these impacts are transversal, cross-cutting across different objectives, so they are likely to have effects on various sectors and segments of Western Balkan countries and societies. A few of these indirect effects could be even more important than the direct impacts, considering that they are already becoming visible.

Benefits for people-to-people contacts

One transversal issue concerns the EIP Flagships' likely impact on people-to-people contacts, possibly impacting regional connectivity and reconciliation across the region. Some of the infrastructure projects may lead to closer people-to-people contacts and regional connectivity, since people may travel more for tourism and other reasons. It is still not easy to travel around the Western Balkan region and thus connectivity projects should help. With better transport or railway infrastructure, people may visit and trade more easily with neighbouring countries. Contacts may improve in a country like Albania, where it is almost impossible to travel by rail since large parts of the railways inherited from communist times were literally destroyed in 1997¹²⁷. Travellers are likely to benefit from better roads from North Macedonia to Kosovo* and from Budva to Belgrade¹²⁸, or from the rehabilitation of railways on the Belgrade-Niš-Skopje network. Nowadays, people in the Western Balkans rarely travel by train and hence railway transport is almost exclusively used for cargo (transporting goods). With better rail or waterway connections, it will be easier for people to meet up. A common concern that has also been bringing people together, linked to some of the EIP's main objectives of safeguarding the environment, are recent protests against environmentally damaging infrastructure or small hydro-energy plants (as emphasised earlier).

Good governance and the rule of law principles

The EIP builds upon the IPA III Regulation, which is performance-based and reform-oriented, with 'EU fundamentals' as a basis – the rule of law, economic governance and public administration reform. In line with the broader approach of EU conditionality, respect for the rule of law is necessary to qualify for EU assistance and hence good governance principles should be widely applied by the Western Balkan countries. The *Acquis Communautaire* on public procurement, in particular, should be applied by the countries as a general rule with limited or no exceptions. This ought also to be the case with the EU's support of economic development, so as to avoid market distortions and create a level playing field for all companies.

However, it remains to be seen how in practice the strict IPA III performance-based approach and conditionality can be enforced in the Western Balkans and whether or not additional safeguards should be put in place for mitigating the risks of public funds being misused¹²⁹. Whereas there are very strict controls in place when implementing projects that use EU funds, this is not the case with projects that are directly financed from governments' budgets or that will ultimately be paid directly by governments (e.g. loans or projects implemented on the basis of state-to-state agreements). There is increasing evidence that confirms the non-transparent government practices and non-competitive public contracting when implementing projects not funded through EU programmes (as identified in the latest European Commission country reports). Public procurement practices are of particularly high concern, due to the

¹²⁷ Interview, EU official.

¹²⁸ The drive from Budva to Belgrade is a 10-hours journey, although it is less than 300 Km.

¹²⁹ 'The carrot is not juicy enough... until we reach the time when membership will be approaching, the price of non-compliance is not going to be high' (Interview, CSO representative).

intense use of interstate agreements and tailor-made laws with limited or no availability of related public documents (Transparency Serbia, 2021).

Effective implementation of the EIP projects will also be closely related to whether or not there will be changes in Western Balkan governments' practices regarding the non-transparent and non-competitive public contracting of projects not financed by the EU. Strict use of the EU's 'stick', namely 'negative' conditionality, could be hampered by a number of different factors. These include, for instance, geopolitical considerations and rivalries, the lack of political consensus among EU Member States on why, how and when to modulate EU support, or the simple consideration that the 'carrot' of EU funding might not be big enough to affect cost-benefit calculations of the Western Balkan countries¹³⁰.

Consultations with local authorities and civil society

According to the IPA III Regulation, the European Commission and EU Member States should ensure that local and regional authorities as well as civil society organisations are duly consulted and have timely access to relevant information, to allow their meaningful participation in the different phases of the finance assistance cycle, including those at local level. Despite frequent consultations organised through EU delegations in each of the Western Balkan countries and through national consultations that are taking place according to specific national procedures, the quality of the consultations has been unsatisfactory. Recently, leading CSOs in the six Western Balkan countries have openly requested from EU institutions the formal participation of civil society organisations in national and WBIF programming and implementation cycles, through appropriate mechanisms¹³¹.

There have been no major consultations with civil society especially regarding the four Flagships addressing Green Agenda objectives in the Western Balkans (CEE Bankwatch Network, 2021). Consultations with civil society on draft documents has also not taken place regarding the Commission's Guidelines for the Implementation of the Green Agenda for the Western Balkans adopted in October 2020. This lack of consultations has led 18 civil society organisations from the region¹³², organised under the auspices of the NGO Forum, to write an open letter to the Regional Cooperation Council and the European Commission, in which they have put forward a series of critical remarks¹³³. The letter puts forward a number of complaints about the Action Plan's lack of clarity, including clear indications about how civil society will be consulted about implementation of the Action Plan at national (and not just regional) level, raising doubts about whether the Regional Cooperation Council has the capacity to lead this process. Although the EIP Flagships were supposed to be prepared on the basis of an extensive consultation process with international as well as national stakeholders and developed on the basis of an extensive bottom-up process, to involve not only political authorities from the Western Balkans, but also all relevant civil society

¹³⁰ Interview, CSO representative.

¹³¹ See Cooperation and Development Institute, [WB6 CSO-s to participate in governance mechanism of the Economic and Investment Plan for the WB6](#), Latest News, published on 15 September 2021.

¹³² Association Biom, Croatia; Association of Young Ecologists of Nikšić, Montenegro; Aarhus Centar, Bosnia and Herzegovina; Center for Ecology and Sustainable Development, Serbia; Center for Environment, Bosnia and Herzegovina; CEE Bankwatch Network; Centar za ekologiju i energiju, Bosnia and Herzegovina; Climate Action Network; Europe Coalition for sustainable mining in Serbia (KORS); Serbia EuroNatur; Europe European Environmental Bureau; Eko-Forum Zenica, Bosnia and Herzegovina; Friedrich-Ebert-Stiftung Dialogue Southeast Europe, Bosnia and Herzegovina; Institute for Nature Conservation in Albania, Albania; Kolektiv Z, North Macedonia; LIR Evolution, Bosnia and Herzegovina; The Nature Conservancy in Europe; Young Researchers of Serbia, Serbia.

¹³³ The letter is quite revealing: 'We need to underline our frustration that for 10 months we have received no substantial information on the Action Plan, only to be now given a week to comment on the draft. If the EU and Regional Cooperation Council are serious about encouraging an active civil society and public participation in decision-making in the region, they need to lead by example. As civil society organisations we have much to offer in terms of knowledge about the region, needs for improvement and ways to realise them, and we stand ready to participate. But we need adequate time to read, comment, coordinate and agree on draft documents' (NGO letter, 2021).

organisations and other local partners, the participative principle of consultations does not seem to have been fully respected (see Association Biom, et al., 2021; CEE Bankwatch, 2021).

Geopolitical impact

The launch of the EIP aims at upgrading the EU's stance in the region, offering new ways to bring what once was considered the EU's most successful foreign policy – enlargement – into a new era of geostrategic competition. The Western Balkans have a key role to play in EU supply chains, as stated on the first page of the EIP, that could be further reinforced and so strengthen the quest for EU strategic autonomy (Bonomi, 2021). In addition, the EIP directly contributes to the Global Gateway, the new EU strategy to boost trusted connectivity in partner countries in line with EU interests and values (European Commission, 2021j). The Global Gateway aims at narrowing the global investment gap by mobilising investments of up to EUR 300 billion between 2021 and 2027, of which the EIP is an integral part. The Global Gateway can be seen as a response to China's Belt and Road Initiative, a global infrastructure development programme designed to spread China's commercial and soft power influence around the world with a substantial footprint in the Western Balkans (Vangeli, 2020)¹³⁴.

Yet, the EIP's added value in providing a successful path toward the EU model and standards depends on its ability to use conditionality instruments to ensure fundamental reforms. Unfortunately, the EIP contribution in this regard could be marginal. The Western Balkans remain marred by structural weaknesses, including poor governance, weak rule of law, environmental deterioration, unresolved constitutional disputes and backsliding in democratic standards. For example, within the first financial package from 23 February 2022, the European Commission has made the signing of respective contribution agreements for two investments in Bosnia and Herzegovina, worth EUR 600 million on the territory of Republika Srpska, conditional on the return to the full functioning of state institutions. Whether or not this will be the EU's approach in other West Balkans countries has yet to be seen, especially since geopolitical competition may place limits on a more proactive use of EU conditionality in the region.

Poor governance places the Western Balkans in the 'quicksands' of European and global dynamics, offering inroads to other foreign actors that are also vying for political, economic and cultural influence in this part of Europe (China, Russia, Turkey and some Gulf states). The EU is not the only actor in the region to promote infrastructure connectivity and investments. China, in particular, has been active in a series of investment projects, mainly in the transport and energy sectors (Richet, 2020). The most visible example of Chinese infrastructure investment is the USD 1 billion loan to the Montenegrin government in 2014 to build a motorway using Chinese contractor CRBC, through a non-transparent public procurement procedure, allegedly not meeting EU environmental standards¹³⁵. Montenegro has fallen deeply into debt to China as a result of the loan and the unfinished status of the highway. Russia has been active in the field of energy investments, in particular in the supply of gas to the region (Bechev, 2020a) (see Box 1).

Box 1: Competitive investments in gas pipelines in the Western Balkans

Geopolitical competition in the energy field has been especially fierce. Major infrastructure investments have been made in gas pipelines. For example, the South Stream gas pipeline that would have brought Russian gas to the region through the Black Sea and Bulgaria was under construction before it was suspended in 2014 for failure to meet EU regulations and following Russia's annexation of Crimea. A competitor gas pipeline, the Trans Adriatic Pipeline (TAP), owned by a consortium led by BP and Italy's Snam SpA has been constructed to bring gas from the Shah Deniz oilfield in Azerbaijan through Turkey, Greece and Albania to Italy, with a potential extension to supply Montenegro, Bosnia and Herzegovina

¹³⁴ See V. Shopov, '[Southern discomfort: The West's competition with China in the Balkans](#)', European Council on Foreign Relations, published on 16 March 2022.

¹³⁵ H. von der Brelie, '[The billion-dollar motorway leading Montenegro to nowhere](#)', Euronews, published on 28 May 2021.

and Croatia via the Ionian-Adriatic Gas Pipeline¹³⁶. TAP commenced operation in November 2020¹³⁷. Russia has responded by constructing the TurkStream pipeline, a variant of South Stream, which passes through Turkey to Bulgaria before continuing north to Serbia, Bosnia and Herzegovina and west to North Macedonia. Russia already has major gas investments in the region through the NIS oil company in Serbia, majority owned by Russia's Gazprom Neft and the pipeline began delivering gas supplies to Serbia at the start of 2021¹³⁸. In October 2021, the TurkStream pipeline also began supplying gas to Croatia and Hungary. Its effect has been to substitute for gas from the pipelines that transit Ukraine¹³⁹. These projects directly compete with the clean energy projects proposed under the EIP. Since no conditionality is imposed on them, they are attractive to political decision-makers in Western Balkan countries. Whether they will remain in operation following the potential extension of sanctions on Russia in 2022 remains to be seen.

The United Arab Emirates has also been an active investor in the region, investing in transport (the acquisition of Air Serbia by Etihad), major urban construction infrastructure (the Belgrade Waterfront enabled by a special law to sidestep local planning regulations), agricultural projects and the arms industry (Bartlett et al. 2017; Bartlett and Prelec, 2020). Such investments can be particularly attractive to the region's politicians who are interested in speeding up modernisation of their country's infrastructure, unconstrained by EU political conditionality. This plethora of investors also allows Western Balkan countries to pick and choose between loans from countries with different sets of conditions and business cultures, thus undermining the fundamental principles of EU assistance to the region based on good governance, the rule of law and transparent public procurement procedures.

Unfortunately, increasing geopolitical competition with new actors in the region (such as, China, Russia, Turkey, United Arab Emirates) who do not adhere to EU values, makes this quest for coordination increasingly difficult, especially in relation to infrastructure projects and their financing. The proliferation of assistance from traditional investors as well as new actors has enabled recipient countries in the Western Balkans to play interested parties off against each other, thereby weakening the force of EU conditionality and undermining its 'soft power' in the region. The EIP is an initiative that aims to counter these new actors' geopolitical reach by firmly reorienting EU assistance in the direction of infrastructure investments that can provide tangible evidence of its involvement and contribution to the region's economic development. In this respect it can certainly be seen as well directed. Nevertheless, more could be done, especially considering the relatively low level of overall contribution in terms of investment funds, when compared with noticeably larger structural funding in neighbouring EU member states such as Bulgaria and Croatia. This implies that the funds allocated to the EIP may be insufficient for their purpose and thus consideration should be given to expanding the base of grants that can be 'blended' with IFI loans in order to make a real difference to the region's economic growth prospects on the basis of EU solidarity with its neighbours. This would effectively counter the geopolitical challenge from 'new actors' by demonstrating the EU accession process's real benefits.

EU visibility and communication policy

The EU is currently engaged in securing its visibility and proper communication of its support to the Western Balkan countries in various ways, but this is not preventing misconceptions about its role and its financial assistance to beneficiary countries. More visibility is needed on both sides. There are

¹³⁶ Ž Trkanjec, [Split designated as HQ for the Ionian Adriatic Pipeline](#), Euronews, published on 4 February 2022.

¹³⁷ D. Bechev, [The Trans Adriatic Pipeline: Why it Matters and What Comes Next?](#), MEI@75, published on 2 December 2020.

¹³⁸ Reuters Staff, [Russia's Gazprom begins gas deliveries to Serbia, Bosnia via TurkStream pipeline](#), Reuters, 1 January 2021.

¹³⁹ Hungary suspended imports of gas via Ukraine at this time. A. Tsoneva, [Gazprom starts gas supplies to Hungary, Croatia via Bulgaria, Serbia](#), SEE News, published on 4 October 2021.

misperceptions about how much the EU is doing through financial and other forms of assistance to support the Western Balkans, but also on the part of the EU about progress achieved in specific areas in some countries¹⁴⁰. As noted by an EU official, the EU is investing in the Western Balkans, into an infrastructure that tomorrow will be EU infrastructure, implementing the transport standards that exist in the EU. These projects are benefitting the Western Balkans and by definition are also benefitting the EU. These countries are already in the EU's courtyard. It is hoped that an ambitious programme such as the EIP will give more credibility and visibility to the EU¹⁴¹.

A fundamental factor that is preventing better information about EU policies in the Western Balkans is the poor condition (and often low quality) of the region's news media. Most people in the region have low incomes and correspondingly spend little time and money on media consumption. Most voters rely on state-controlled television broadcasters for news and opinion. The main official public service broadcasters are directly under government control. Neither local advertising budgets nor direct income from market sales ensure sustainable funding for independent media. The heavy involvement of political interests in financing private print and electronic news outlets – for instance through selective allocation of advertising money or state subsidies – means that they control what and how information reaches audiences¹⁴². Some outlets, such as the regional and national N1 TV networks, the Beta News Agency and various investigative journalism web-based news media (such as Krik or weeklies Vreme and Nin in Serbia), are offering high quality information, but they reach only small segments of the population. The quality of Western Balkans media today is affected not only directly, through the censoring of news by editors of local newspapers/TV stations, but also indirectly, since arbitrary editorial decisions can block fundamental changes in this important domain; a journalist who writes an article not fully in conformity with the editorial policy of a newspaper faces the imminent possibility of losing the job. Foreign donations, including grants from the EU, are in most cases essential for the survival of those media which are not under government control.

Most of these aspects limiting objective information, also about the EU, have been analysed in a recent study prepared for the European Parliament on fake news in the Western Balkans that revealed a number of disinformation challenges (Greene et al., 2021). The bulk of disinformation in the Western Balkans is produced and disseminated by domestic actors for domestic purposes, provoking an information disorder which has become the symptom of social and political disorder, rather than the cause. Since this situation has not shown any recent improvement, the EU should indeed further strengthen its efforts to 'bolster the quality of democracy and governance in the Western Balkans, as the most powerful potential bulwark against disinformation' (Greene et al, 2021).

¹⁴⁰ An example are measures to stimulate innovation: the Serbian government has created an Innovation Fund several years ago that funds enterprises innovative projects, but the funding provided so far has been limited (see Uvalić, Cerović and Atanasijević, 2020).

¹⁴¹ Interview, EU official.

¹⁴² Interview, CSO representative.

6 Recommendations for the European Parliament and other stakeholders

The Economic and Investment Plan for the Western Balkans is a EUR 9 billion programme of financial assistance supporting economic development in the six countries, thereby progressing their EU integration and eventual membership. The first substantial package from the EIP investment Flagships, worth EUR 3.2 billion for 21 projects, was endorsed at the WBIF conference on 23 February 2022 (European Commission, 2022). In this section we set out some of the EIP Flagships' critical points that could limit their effective implementation. This is followed by general recommendations to the European Parliament (and other stakeholders) about the EIP projects and specific recommendations regarding each of its 10 Flagships.

6.1 Critical points of the EIP Flagships

The EIP Flagship projects have the potential to make a positive impact on the long-term economic development of the Western Balkan countries. Their successful implementation will contribute to better transport connections, green transition, economic competitiveness, digitalisation and improved employment opportunities for youth. These objectives would all be beneficial for the Western Balkan populations at large and the EU. However, any potential for positive impacts from the EIP Flagships could be limited by a set of inter-related constraints.

Governance and administrative capacity

Implementation of the EIP Flagships may be constrained by weak governance and low administrative capacity of the Western Balkan governments to absorb EU funding¹⁴³. Maturity of project proposals is a key condition for obtaining finance through the WBIF, so countries will get funding only if they prepare mature projects that fully fit the strategy and that are ready to be implemented¹⁴⁴. Given that reforms of the public administration have progressed slowly, especially at sub-national levels and within local municipalities, governments may not be able to prepare and offer mature projects which can be accepted for EIP funding. Hence, limited administrative capacity may reduce the effectiveness and efficiency of many Flagship projects.

This implies that the financial package offered through the EIP will not have its effects, unless there is parallel action by the national authorities to do more regarding the fundamentals: improve economic governance, strengthen administrative capacity, and ensure implementation of the rule of law. Public infrastructure investment may have a strong effect on economic growth and competitiveness, but only under the right conditions: an effective governance system, strong institutions including robust rule of law, as well as effective and transparent public procurement systems which successfully control corruption in public infrastructure spending. In fact, improving governance should also ensure better control in the use of EU funds, since corruption has been facilitated by non-transparent public procurement procedures.

Budgetary constraints

During the post-COVID-19 period, economic policies of Western Balkan governments are likely to prioritise measures for a speedy economic recovery, which may postpone any immediate implementation of some Flagship projects. Despite the apparent 'local ownership' of EIP projects reinforced by the new provisions of the IPA III Regulation, there is little assurance that governments will be able to provide the required co-

¹⁴³ Interview, EU official; interview, CSO representative.

¹⁴⁴ Interview, EU official; interview, IFI official.

financing for those projects approved by the WBIF. In general, investment in infrastructure is costly and requires public support by international financial institutions such as the EIB. The Western Balkans have limited fiscal space¹⁴⁵, and thus it may prove difficult for governments to co-finance EIP projects, alongside blended IPA III and bilateral donors' grants and IFI loans.

Is the EU financial package sufficient to ensure convergence?

The EIP reaffirms that the Western Balkans are an integral part of Europe, a geostrategic priority for the EU. In doing so, it not only identifies the ambitious goal of spurring their long-term growth in the region, but also prescribes how this should be done through a set of highly relevant public policy priorities. Growth in the Western Balkans should be inclusive, based on: improved energy and transport infrastructure; major use of renewables; decarbonisation; stronger economic competitiveness; development of the private sector; as well as sustainable green and digital transition. This is in line with EU interests and values, with the recommended set of priorities being similar to EU ones. Moreover, investment in infrastructure is being carried out for geopolitical reasons to challenge the growing influence of infrastructure projects being undertaken by new actors in the region, including China and the United Arab Emirates. In light of this, it may well be considered that the current level of grant aid is insufficient and hence due for review.

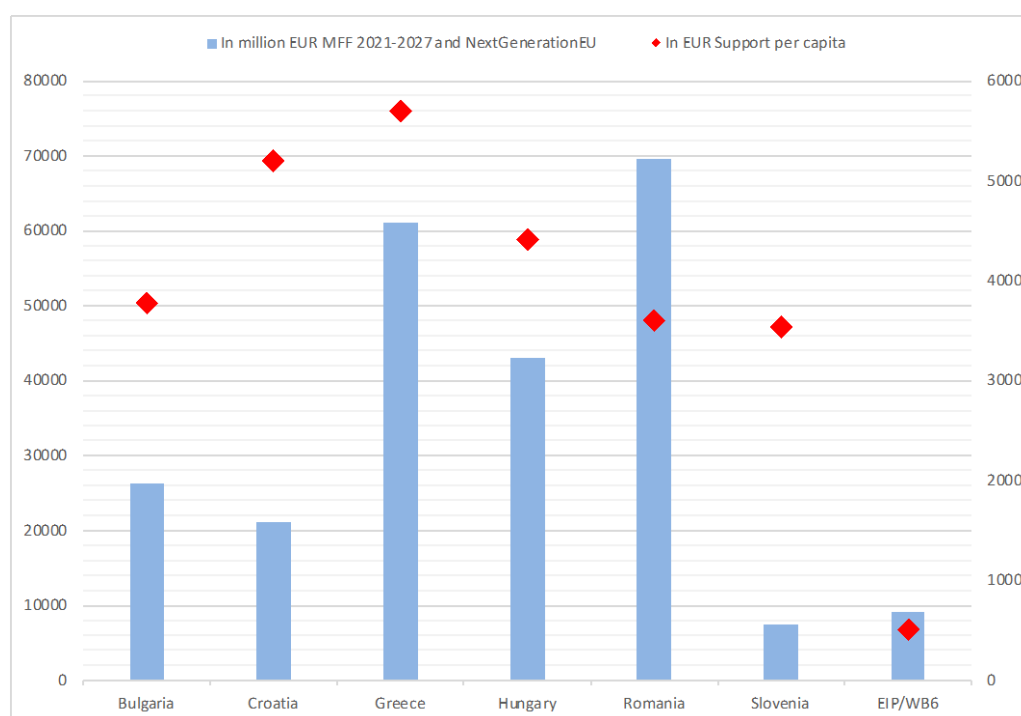
The COVID-19 pandemic has once again demonstrated close relations and interdependencies between the EU and the Western Balkans. Although current EU financial commitments to support economic development in the Western Balkans are likely to be higher than during the previous period, the EU financial package may still prove to be insufficient to achieve the ultimate objective of accelerating the region's economic growth and convergence towards the EU. The proposed financial assistance of EUR 9 billion planned for the Western Balkans through the EIP is actually a very small package, representing less than half percent of the EU budget for the next seven years (0.45 % of the allocations planned within the Multi-annual Financial Framework and the Next Generation EU for 2021-2027).

In order to ensure income convergence of the Western Balkans with the EU, EU financial assistance ought to be much higher (Milatović and Sanfey, 2018; Uvalić, 2020; Reljić, 2021; Tilev, 2021). This argument rests on the fact that financial resources from the EU budget during the next seven years to individual EU Member States in Southeast Europe will be substantially higher (both in absolute values and per capita), than funds going to the whole Western Balkan region through the EIP (see Figure 6.1). It also draws from experience of EU financial assistance to the Western Balkans during the past decades, which has been demonstrated as being insufficient to bring about any significant reduction in the income gap with respect to the EU (as shown earlier). Under such conditions, instead of convergence, there is a risk of further divergence in the levels of economic development between the Western Balkan countries and EU Member States.

Although there is no assurance that providing more EU financial resources to the Western Balkans will actually have the desired impact of accelerating economic development (due to low absorption capacity, weak governance), monitoring mechanisms should ensure that specific forms of EU support (e.g. for rural development, the environment) are used strictly for the specified purposes.

¹⁴⁵ These problems are not unique to the Western Balkans, since the emergency caused by the COVID-19 pandemic has raised serious concerns about fiscal sustainability in the EU and its Member States (see Pisany-Ferry, 2022).

Figure 6.1 EU budgetary allocations planned for Southeast EU MS and WB6 (EIP)



Source: Compiled by the authors on the basis of the basis of EU MFF 2021–2027 and Next Generation EU allocations by country (current prices): https://ec.europa.eu/info/strategy/recovery-plan-europe_en#figures; and Eurostat: DEMO_PJAN.

6.2 General recommendations on EIP Flagships

Based on the main constraints identified in the previous section regarding implementation of the EIP Flagships the following general recommendations are made.

Recommendation 1: Improved governance

While the *EU Guarantee Facility for the Western Balkans* may attract increased public and private investments into the region, these resources may not be spent efficiently unless the national authorities strengthen the fundamentals: improve economic governance, increase administrative capacity, and ensure the implementation of the rule of law. Public infrastructure investment can have a positive impact on economic growth only if it is undertaken under the right conditions: an effective governance system, strong institutions including the rule of law, transparent public procurement systems which effectively control corruption in public infrastructure spending. Improved governance should also be ensured at the sub-national levels of government within local municipalities, since many projects will require their active involvement in order to be effectively implemented on their territories.

Recommendation: Although progress regarding governance is being monitored by the Commission and is built into the IPA III programming process, the European Parliament can make full use of its supervisory and monitoring role, starting with ensuring timely and adequate access to all information.

Recommendation 2: Less stringent budgetary conditions and increase of grant component

Considering their small budgets and limited fiscal space, it will be particularly difficult for Western Balkan governments to co-finance large infrastructure projects or take on loans from international financial institutions co-financed by IPA grants that also require co-financing by national governments. In order to avoid blocking implementation of some EIP Flagship projects, less stringent conditions ought to be set regarding the proportion of co-financing by national governments. The co-financing rates of national

governments could be lowered further for those projects that are considered to be countries' specific national priorities¹⁴⁶.

Recommendation: Consideration could be given to lowering the co-financing rates of national governments and expanding the base of grants that can be 'blended' with IFI loans. This could make a real difference to the region's economic growth prospects on the basis of EU solidarity with its neighbours and effectively counter any geopolitical ambitions of 'new actors' through a demonstration of real benefits from the EU accession process.

Recommendation 3: Financial assistance to local authorities

Although the current IPA III rules envisage financial assistance to countries, rather than local authorities, there are strong reasons to propose a radical change in these regulations so as to introduce more decentralised forms of EU assistance. This would be more in line with the EU's current cohesion policy that is prevalent in helping the economic development of EU regions, rather than countries. This could have a number of beneficial effects on governance issues in the Western Balkans: it would reduce the concentration of power in the hands of central governments regarding the administration of EU financial assistance; responsibilities for the use of EU financial assistance would be transferred to local municipalities; and that could in turn contribute to the necessary strengthening of local administrative capacity. These changes to bring about more decentralised forms of delivery and management of EU financial assistance would also enable better implementation of other EU instruments in the Western Balkans, such as Smart Specialisation Strategies that are designed to contribute to regional development.

Recommendation: Introduce decentralised forms of EU assistance to local municipalities.

Recommendation 4: Social impact analysis

The assessment and screening process for infrastructure investments include environmental impact analysis and assessment of their alignment with the EU accession agenda, but lacks a social impact analysis. All IPA III projects are required to foster social inclusion and promote equal opportunities, to integrate marginalised communities. Specific clauses ensuring the meeting of these priorities should be built into all infrastructure projects approved by the WBIF. This should also be recognised as requirements for all projects that support SMEs under Flagship 9 and integrated into the Youth Guarantees' design under Flagship 10. Furthermore, in line with the European Pillar of Social Rights, fair working conditions and fair wages should be ensured in all EU funded projects. These should be carefully monitored by national labour inspectorates.

Recommendation: A social impact analysis could be included in the WBIF screening process for the acceptance of infrastructure and other project proposals.

Recommendation 5: Better balance of priorities

In implementing the EIP over the years to come, there is a need for more Flagship projects on human capital, the environment and climate, since the first package approved in February 2022 is dominated by transport infrastructure. Areas such as green transition and renewable resources as well as improved education and training for digital skills under the Youth Guarantee scheme ought to receive much wider attention. What is really needed is human capital development. This is captured by individuals, not the state, and can have a much larger developmental effect than a potentially environmentally damaging motorway down the Adriatic coast which will mainly benefit foreign tourists. Digital infrastructure to rural areas can overcome regional disparities to some extent. Furthermore, developing the private sector and offering more effective support of innovative SMEs may produce more progress in the longer term than a

¹⁴⁶ Recent decisions enable 40 % of IPA III grant co-financing of transport projects, and this could be increased. The WBIF public sector blending investments co-financing rates are 70 % for Environment and Climate change, but only 30 % for digital or social infrastructure and even less in case of clean energy (20 – 30 %) (Interview, IFI official).

new road or similar infrastructure. The sustainable transformation of agri-food systems and rural development deserves particular attention. While there is potential for enhancing synergies, different connectivity schemes are not by default mutually reinforcing, but the exploitation of synergies should be based on common rules and a level playfield in place of the lack of transparency that currently characterises public procurement and public-private partnerships in the region.

Recommendation 6: Social infrastructure Flagship

In view of the largely unfulfilled needs in the social sector (education, health, housing), and the success of the WBIF in generating significant leverage effects of IPA grant aid in this sector, additional funding could be provided for the 'missing' Flagship on social infrastructure. Such a Flagship could envisage infrastructure investments in schools, hospitals and social housing.

Recommendation: The European Parliament could request the Commission to add a social infrastructure Flagship to the EIP.

Recommendation 7: Social inclusion

Social inclusion and gender equality are listed as key priorities within Window 4 on competitiveness and inclusive growth. Projects should also support low-skilled and poorly qualified people. This could be done by requiring all contracts approved by WBIF to incorporate apprenticeship programmes and training places in all infrastructure projects funded through IPA III, thereby meeting the requirement for developing on-the-job training, reskilling and up-skilling (Implementing Regulation, p. 49). In addition, thematic priority 1 under this window requires that equal access could be ensured to finance for new start-ups in the social economy, including social enterprises and cooperatives especially among young people furthest away from the labour market.

Recommendation: Require all contracts approved by WBIF to incorporate apprenticeship programmes and training places in all infrastructure projects funded through IPA III.

Recommendation 8: Participatory consultations

Although the WBIF may protect against distortions introduced from the beneficiaries' side, it may not be free of distortions introduced by the IFIs. To counter this danger, stronger participation is needed from representative civil society organisations in the Western Balkans beneficiary countries who are in a better position to predict and monitor key issues regarding the local environmental or social impact of infrastructure investments.

In addition, oversight by the European Parliament ought to ensure political coherence amongst the set of approved infrastructure projects with EU objectives, especially regarding EU enlargement policies and the Green Agenda. Currently, the Parliament has only observer status on the WBIF Board (the 'Strategic Board')¹⁴⁷. This could be upgraded and strengthened by giving the European Parliament a membership place on the Board, along with membership by representatives of CSOs. In addition, the European Parliament could engage directly with parliamentarians in the beneficiary countries and in particular their relevant committees, to strengthen their local oversight on the implementation of EU-funded infrastructure (and other) projects to ensure that all social and environmental impacts are in line with EU standards.

This type of consultation could also be extended to direct relationships between the European Parliament and representatives of relevant civil society organisations in the region who have the capacity to monitor how well projects are being implemented in their countries. This engagement could even be financed through IPA III (in accordance with Annex II, paragraph h of the IPA III Regulation) which calls for

¹⁴⁷ European Commission (2021) IPA III Regulation, Chapter V, Article 12(4).

strengthening not only of the region's capacities, independence and plurality of civil society organisations, but also its networking at all levels among Union-based organisations.

Recommendation: Ensure European Parliament membership of the WBIF Strategic Board, together with CSO representation.

Recommendation 9: European Union visibility

That the EU is not visible enough in the region is openly recognised by both EU officials and CSO representatives¹⁴⁸. Yet little is done to improve the media situation in the region. In order to ensure proper visibility of EU support to the Western Balkan countries, much more attention should be paid to the media's critical role. Under the Stabilisation and Association Agreements, countries are required to align their state aid measures to the *Acquis Communautaire*. Accordingly, each country has established an agency responsible for the monitoring and control of state aid provision. Financial support for media companies comes under horizontal measures for granting state aid to the sector of culture and information. Such horizontal measures should not distort competition or discriminate between media outlets. This should be monitored and controlled by state aid authorities and the provision of such assistance to media companies should be open and transparent. Any lack thereof can lead to limited diversity in media output, hence a potential for bias in providing state aid only to those media outlets that support the government, thereby discriminating against others. EU assistance provided through the EIP could be made directly conditional on full transparency regarding the sources of financing of the most important media and on effective control of the non-discriminatory provision of state aid to media outlets generally.

Recommendation: EU assistance provided through the EIP could be made directly conditional on full transparency regarding the sources of financing of the most important media and on effective control of the non-discriminatory provision of state aid to media outlets.

6.3 Specific recommendations on EIP Flagships

The following specific recommendations regarding each of the EIP themes and Flagship projects ought to be considered.

Transport theme (Flagships 1, 2 and 3)

The transport sector projects are highly relevant since transport networks suffer from insufficient investment and poor maintenance (see Section 4.1). Proposed investments extend or complete prior investments in road and rail connections. However, the proposed mix between roads and highways, railways and waterways are only partially in line with other EIP objectives, such as the Green Agenda. Over-optimistic expectations of increased traffic or trade related to motorway construction risk inefficient investments and the creation of 'white elephants' – prestige projects that serve to bolster the popularity of incumbent political elites rather than making a real contribution to economic development. Moreover, few countries have adequate road maintenance plans and so the long-term sustainability of the investments is also in doubt. In this regard, particularly important is full implementation of the Common Regional Market programme as endorsed in the EIP, enhancing potential benefits of these connectivity projects through a reduction of non-tariff barriers to enhance the trade benefits of connectivity plans.

Recommendation (i): The Transport theme could give greater priority to investment in railways, waterways, intermodal connections and urban transit systems.

Clean energy theme (Flagships 4, 5 and 6)

Projects proposed under the Clean Energy theme mostly extend and complete previous investments. The Renewable Energy Flagship largely emphasises investments in hydropower, rather than solar and wind

¹⁴⁸ This was stressed by several EU officials as well as CSO representatives that were interviewed.

power, and may conflict with other EIP objectives to protect the environment. Flagship 5 on the Transition from Coal relies on the use of gas, a hydrocarbon pollutant. Flagship 6 on the Renovation Wave may succeed in reducing carbon emissions from buildings only in the medium- to long-term.

Recommendation (ii): Considering rising energy prices, more ambition possibly by looking towards less hydropower and more solar and wind energy projects, thus a more balanced approach between different options, would have cohered better with the EIP's overall objectives.

Environment and climate theme (Flagship 7)

Environment and Climate investments are highly relevant in all Western Balkan countries, since air and water pollution are widespread and climate change effects are felt in common with the rest of Europe and the world. However, Flagship 7 focuses mainly on Waste and Wastewater Management with an emphasis on wastewater treatment plants. This neglects other sources of environmental pollution, such as widespread solid waste pollution and the urgent need to introduce more efficient systems for monitoring air and water quality.

Recommendation (iii): Invest more in solid waste disposal and the circular economy; improve systems for monitoring of air and water quality.

Digital infrastructure theme (Flagship 8)

Flagship 8 is highly relevant in regard to the large digital gaps found in Western Balkans rural areas. Some countries focus on roll-out of broadband internet to rural areas, whilst others prioritise schools' connectivity. Both aims are extremely relevant, promising effective and efficient investments. The focus on schools' connectivity should be a major priority in all economies, due to its synergy with Flagship 9 on private sector development, by providing a skilled labour force, and Flagship 10 on the Youth Guarantee scheme, by providing conditions for enabling the provision of digital skills in the education system. The focus on broadband roll-out to rural areas, also highly relevant and likely to be effective, will be efficient only if backed up by a public service requirement on the main providers to ensure no price gauging of households and businesses in rural areas.

Recommendation (iv): Ensure that all households, schools and businesses in the region have access to broadband internet, with no gaps in provision. Ensure that internet provision is properly regulated to enable equal access to broadband internet by households, schools and businesses in rural areas at the same cost as in urban areas. Ensure effective competition between internet providers to drive down costs and user prices by liberalising the market in an appropriate regulatory environment.

Private sector theme (Flagship 9)

Flagship 9 aims to support development of the private sector in the Western Balkans, especially SMEs. It may have little impact unless mechanisms are introduced to ensure good governance and the proper distribution of funds in line with the priority areas of innovation and green growth. Western Balkan governments as well as potential donors ought to pay particular attention to the sustainable transformation of agri-food systems and rural development, since this is a sector where most Western Balkan countries have comparative advantages.

Recommendation (v): Give more priority in this Flagship to supporting investments in innovation and green growth and to sustainable transformation of agri-food systems.

Human capital theme (Flagship 10)

Flagship 10 which proposes that each Western Balkan country develops and implements a Youth Guarantee scheme is highly relevant, considering the high rates of youth unemployment and NEETs in the region. In targeting youth as well as vocational education and training it could create synergies with

Flagship 8 in developing digital skills. Youth Guarantees are likely to be highly effective and efficient if well designed in creating new jobs for socially excluded young people as well as for upgrading their skills in the digital and other areas, thus raising the economic growth and competitiveness of the region's economies. However, the plans have not yet been set out, the public employment services are understaffed in most countries and the sources of finance are not defined. There is a risk that this Flagship could be neglected and underfunded in relation to needs and potential.

Recommendation (vi): Ensure that the Youth Guarantees are fully resourced in relation to need and that public employment services are properly staffed and trained. In part, this will require a major expansion in the scale and scope of these public services. The private sector could also be engaged both in providing appropriate training and in job counselling along with guidance to socially excluded young people.

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