

Alvarez Orviz, Roberto; Savelin, Li

Research Report

Benchmarking institutional and structural indicators in EU candidate and potential candidate countries

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Occasional Paper Series

Roberto Alvarez Orviz, Li Savelin

Benchmarking institutional and structural indicators in EU candidate and potential candidate countries

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Abstract

This paper reviews institutional and structural challenges in countries preparing for EU membership, i.e. Albania, Bosnia and Herzegovina, Kosovo¹, the former Yugoslav Republic of Macedonia, Montenegro, Serbia and Turkey. Sound institutions and solid economic structures are not only the cornerstones of EU accession (as defined by the Copenhagen political and economic criteria), but are also crucial for achieving higher income levels and sustainable long-term growth. This paper finds that the EU candidate and potential candidate countries (EU CC/PCC) fare worse than the majority of EU Member States in a number of institutional and structural metrics, such as business environment, access to finance, judicial system, trade and competitiveness, labour market and education and institutional governance. When comparing EU CC/PCC among themselves, large intra-group disparities emerge. Countries such as the former Yugoslav Republic of Macedonia, Montenegro and, to a certain extent, Serbia and Turkey, tend to score on average higher than Albania, Bosnia and Herzegovina and Kosovo. While many EU CC/PCC have improved the quality of their institutions and economic governance over the past decade, it is crucial that they preserve the reform momentum to enable a sustainable convergence with the EU.

Keywords: institutions, economic growth, EU accession, Western Balkans, business environment, access to finance, trade integration, governance.

JEL codes: F13, F15, G21, O11, O43

¹ This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo Declaration of Independence.

Executive summary

This paper reviews structural and institutional indicators in EU candidate and potential candidate countries (EU CC/PCC) and benchmarks these against developments in current EU Member States, including those that have joined the EU since 2004 (“new Member States”) and the 19 euro area countries. A selection of structural and institutional indicators have been divided into the six main policy areas in the surveillance process of these countries in preparation for EU accession (business environment, access to finance, judicial system, trade and competitiveness, labour market and education, and institutional governance). The aim is to depict the relative strengths and main weaknesses of EU CC/PCC, both as an aggregate compared with EU Member States, as well as among themselves. Sound institutions and competitiveness-enhancing structural policies are crucial not only for EU accession (as outlined in the Copenhagen criteria), but also for achieving increases in income per capita and sustainable economic growth.

This paper strongly relies on survey-based data and qualitative indicators from the World Bank, the World Economic Forum and the International Monetary Fund (IMF), among others. Even though survey-based data reflect overall conditions in a country, they remain a subjective source of information and only partially illustrate the actual situation. However, the advantage of using survey-based data is that, while they may not reveal the quality of laws in a society, they mirror individuals’ perceptions of their effect on the economy.

EU CC/PCC have been improving rapidly in terms of ease of doing business, and the gap between them and EU countries has narrowed. The case of the former Yugoslav Republic of Macedonia is particularly striking – the country ranked 10th worldwide in 2016 for this metric. There are, however, areas for improvement in EU CC/PCC, such as control of corruption, contract enforcement and resolving insolvency.

Access to finance is a major obstacle to many businesses in EU CC/PCC, particularly for the Western Balkans. Low development of capital markets makes it difficult for businesses to obtain financing from sources other than local banks. Moreover, banks’ elevated credit risk perception, coupled with extensive collateral requirements, leads to high lending costs.

Concerning trade and competitiveness, several EU CC/PCC have, to varying degrees, experienced an increase in their trade openness and export market shares over the past decade. Nevertheless, overall competitiveness, as measured by the Global Competitiveness Index, remains below the level of the majority of EU Member States.

Unemployment is one of the main structural problems in EU CC/PCC. Their unemployment rates are more than double that of the EU as a whole, and there is a strong structural component behind these persistently high rates. This can partially be explained by the relatively low scores of the Western Balkans in labour market

efficiency and innovation. Long-term unemployment and youth unemployment are particularly high, also in comparison with new EU Member States.

As regards governance and the judicial system, EU CC/PCC are still far from EU-28 average, especially concerning indicators such as voice and accountability, government effectiveness, political stability and the rule of law. They still have a long way to go before meeting the Copenhagen political criterion for stability of institutions guaranteeing democracy and the rule of law, and their shadow economies are far larger than in EU countries. Central bank independence and transparency levels in EU CC/PCC come close to the EU-11 average, which is itself influenced by relatively lower scores for Poland (independence) and Croatia (transparency). The gap to the European Central Bank has also closed (notwithstanding the fact that, at this stage of their accession processes, it could be argued that the ECB score is not the most appropriate benchmark for EU CC/PCC). However, the available data, which evaluate central banks from a legal perspective, do not capture all EU CC/PCC or all events in these countries (e.g. a central bank governor's mandate coming to an end before the statutory term was reached), and cannot capture intense political pressure by a government on central bank decision-making.

Overall, in spite of the positive efforts and the (partial) progress shown over recent years, it is clear that, in many respects, EU CC/PCC still are far from EU-28 averages. Weaknesses in business and institutional environments are putting a strain on economic growth as well as on competitiveness, and are hampering their convergence with the EU. This is mirrored by their low GDP-per-capita levels (less than half of the EU-28 average), imbalanced growth models and stubbornly high current account deficits. In a framework of mostly de facto fixed exchange rates vis-à-vis the euro, the importance of sound structural policies appears even more crucial. It is therefore important to further accelerate the pace of reforms in order to provide sufficient leverage to converge towards EU levels.

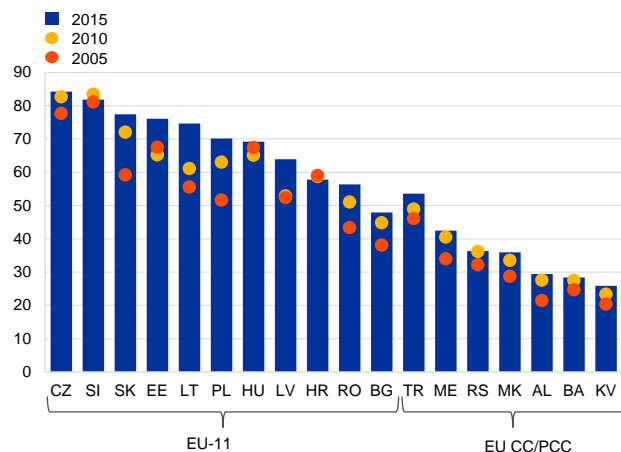
1 Key institutional and structural challenges in EU candidate and potential candidate countries

1.1 Income levels and institutional quality

Evidence points to a positive relation between income levels in a country and the quality of its institutions. While other historical, cultural and geographical factors may also play a role, a major determinant for cross-country differences in income per capita appears to be “differences in institutional quality” (Acemoglu and Robinson (2008); IMF (2003)). In Acemoglu et al. (2005), institutions are defined as the rules of the game in a society, i.e. the set of rules and policies that shape individuals’ incentives and influence the economic outcome in a society. One important pillar for economic institutions and well-functioning markets is the enforceability of property rights, without which individuals have no incentives to invest or innovate.

Chart 1
Real GDP per capita

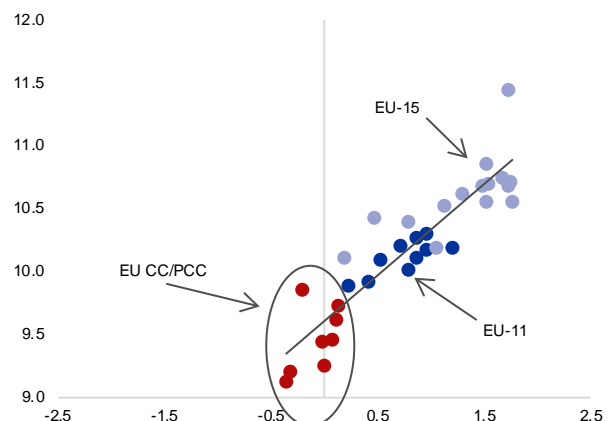
(percentages of EU-28 average, GDP per capita at PPP, 2011 international dollars)



Refer to the Abbreviations section for details regarding regional aggregates.
Sources: Haver Analytics, World Bank and ECB staff calculations.

Chart 2
Income levels and institutional quality in 2015

y-axis: log of real GDP per capita at PPP, 2011 international dollars
x-axis: World Bank Worldwide Governance Indicators average scores – higher score indicates better governance quality



Notes: EU CC/PCC are highlighted in red, EU-11 in dark blue and EU-15 in light blue.
Sources: Haver Analytics, World Bank Worldwide Governance Indicators (see Kaufman et al. (2010) for methodology) and ECB staff calculations.

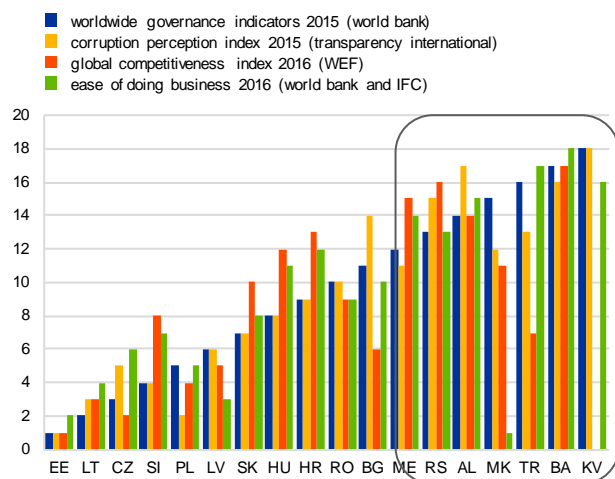
The Copenhagen criteria (established in 1993 and strengthened in 1995) outline the political and economic conditions that need to be fulfilled before EU accession, including “the stability of institutions guaranteeing democracy and the rule of law” as well as a “functioning market economy”. Taking into account the Western Balkans’ and Turkey’s status as prospective candidates to join the European Union, using the institutional quality in current EU Member States as a benchmark seems justified, given that it is the benchmark that EU candidate and potential candidate countries

(EU CC/PCC) will be measured against.² As illustrated in **Chart 1** and **Chart 2**, EU CC/PCC lag significantly behind current EU Member States in terms of real GDP per capita and institutional quality, with Turkey being the only exception as it is close to new EU Member States in many categories.

The EU CC/PCC tend to exhibit a much lower income per capita level than their average institutional development score would suggest. While real GDP per capita in purchasing power parity (PPP) increased over the past decade in absolute terms, it still lagged significantly behind relative income increases in EU-11 countries over the same period, and fared poorly in comparison with the EU-28 average. In relative terms, the highest income gains among EU CC/PCC since 2005 have been achieved in Albania, Montenegro and Turkey.

Chart 3
Institutional quality and competitiveness in new EU Member States and prospective Member States

(ranking from 1 (best) to 18 (worst))



Notes: Countries are ranked according to their performance in each category and sorted according to their average performance in the World Bank Worldwide Governance Indicators. Kosovo is not included in the World Economic Forum's Global Competitiveness Index. EU CC/PCC are circled in red.
Sources: Haver Analytics, International Finance Corporation, Transparency International, World Economic Forum, World Bank and ECB staff calculations.

This being said, **Chart 2** clearly highlights not only the gap in institutional quality that exists between EU CC/PCC (red squares) and the EU, but also the heterogeneity among EU Member States (dark and light blue squares). While the EU and the euro area are natural benchmarks for this report in view of EU CC/PCC's accession prospects, these intra-EU differences underline that other benchmarks may be called for. A recent study published by the ECB (2016) finds that almost all euro area countries have weaker institutions than the best performers in the OECD.³

Furthermore, when broadening the range of institutional and governance quality indicators, it is clear that EU CC/PCC exhibit comparatively lower scores (as a group) than current EU Member States, though sizeable cross-country differences are apparent in a few cases (see **Chart 3**).

Albania, Bosnia and Herzegovina and Kosovo⁴ have the lowest scores among new EU Member States and EU CC/PCC across most metrics in **Chart 3**. In contrast, the former Yugoslav Republic of Macedonia

and Montenegro have institutional quality scores which are, to a large extent, comparable to those of central and eastern European countries. Bulgaria, Croatia and Romania, however, appear to exhibit institutional quality scores that are, for the most part, closer to those of EU CC/PCC in the Western Balkans than those of other EU-11 peer countries.

² See the Appendix for full lists of country groupings.

³ The study looks at a selection of the World Bank Worldwide Governance Indicators (namely government effectiveness, regulatory quality, rule of law and control of corruption) and compares the average euro area scores with the best-performing countries in the OECD – Finland, New Zealand and Switzerland.

⁴ This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo Declaration of Independence.

The close association between institutional quality and income levels suggests that some countries may be subject to mutually-reinforcing negative feedback loops which might be difficult to break, effectively halting the transition process.⁵ For example, ex ante negative perceptions or experiences of countries' institutional quality and the underlying business environment may condition investment patterns (both foreign and domestic), likely leading to poor growth outcomes and hence hampering increases in average income levels. Poor growth prospects would, in turn, justify the sluggish level of investment and thereby contribute towards the continuation of this trend. Moreover, existing structural weaknesses might exacerbate the situation by weighing down on institutional quality indicators ex ante, and on domestic authorities' relative appetite to take remedial measures in this domain ex post. However, by the same token, this suggests that virtuous circles between improvements in institutional quality, the business environment and overall growth outcomes via the investment channel are also possible, leading to sustained increases in average income levels and thereby altering authorities' relative incentives to undertake policy reforms.

Box 1

Impact of EU accession on economic development and institutions

The European Council declared in 1993 at the Copenhagen Summit that “the associated countries in Central and Eastern Europe that so desire shall become members of the European Union”. The majority of these countries' EU applications were submitted two years later and 11 central, eastern and south-eastern European countries joined in 2004, 2007 and 2013 respectively.

The Stabilisation and Association Process between the EU and south-eastern European countries was launched in 1999 with the aim of eventual EU membership once the Copenhagen political and economic criteria were fulfilled, entailing developments in trade relations as well as cooperation in fields such as justice and home affairs. During the EU-Western Balkans summit in Thessaloniki in 2003, the EU reiterated “its unequivocal support to the European perspective of the Western Balkan countries”.⁶

Despite being at different stages of transition, to what extent are income levels and institutional quality in these two regions comparable at the time when their EU accession plans were initiated, and how far have they come since then? The two charts depict the average situation in EU-11 countries and EU CC/PCC in 1995/1996 and 2003 respectively.⁷ All of the Western Balkan countries' real per capita income in 2003 (as well as in 1995) was lower than that in the EU-11 in 1995, pointing to their worse initial conditions. Although income growth in absolute terms has been strong in the Western Balkans, its relative increase was much weaker than in new EU Member States, indicating a possible additional boost to economic activity from EU membership. Chart B

⁵ See also the European Bank for Reconstruction and Development's Transition Report 2014 (“Innovation in transition”), which argues that economic reforms have stagnated in the transition region since the mid-2000s, thus hampering its economic growth prospects.

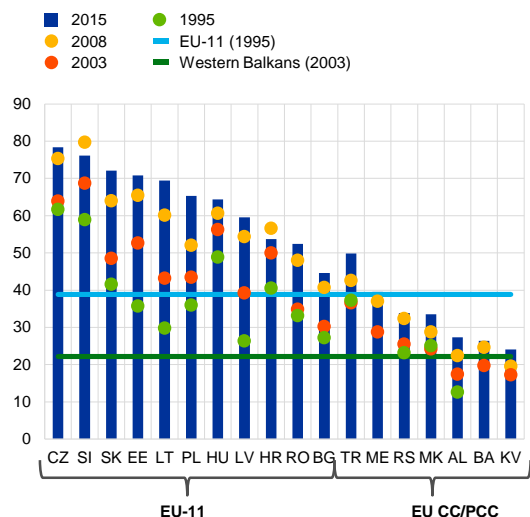
⁶ Although the situation is slightly different in Turkey (with the Association Agreement signed in 1963 and accession negotiations started in 2005), here we adopt the same year as for the remaining EU CC/PCC, i.e. 2003.

⁷ To simplify the comparison, the same date of EU membership application is assumed for the EU-11. Country-specific dates can be found here: http://ec.europa.eu/enlargement/archives/pdf/press_corner/publications/corpus_en.pdf.

depicts changes in institutional quality over the same period, proxied by the average country score of the Worldwide Governance Indicators.⁸ It is clear that, on average, the institutional gap between new EU Member States and the Western Balkans also persisted in 2015.

Chart A
Real GDP before and after EU accession prospects were initiated

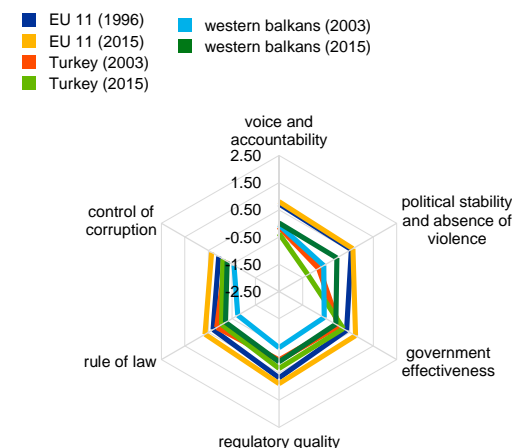
(in percentage of euro area 12 average, GDP per capita at PPP, 2011 international dollars)



Note: The euro area 12 comprises Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain.
Sources: World Bank and ECB staff calculations.

Chart B
Worldwide Governance Indicators

(higher score indicates better governance quality)



Notes: Western Balkans cover comprises Albania, Bosnia and Herzegovina, Kosovo, the former Yugoslav Republic of Macedonia, Montenegro and Serbia. EU-11 comprises new EU Member States that joined in and after 2004, except Cyprus and Malta.
Sources: World Bank Worldwide Governance Indicators and ECB staff aggregation of data.

Several previous studies have underlined the effects of EU (pre-) accession on economic growth and incentives to undertake institutional reforms. Böwer and Turrini (2009) find that countries with initial lower income levels and weaker institutional quality benefitted more strongly from EU accession in terms of economic growth. Moreover, they argue that much of the accession-related growth effects in fact took place prior to joining the EU, given the economic and institutional adjustments needed to meet the *acquis communautaire*, as well as EU transfers related to accession and capital inflows. The length of EU membership is found by Crespo, Cuaresma et al. (2008) to have a significant positive effect on economic growth. This effect is relatively higher for poorer countries. The positive impact of the EU accession process on institutional quality is echoed by Belke et al. (2009), whose study finds that pre-accession incentives provided by the EU (and NATO) clearly matter for institutional development in transition economies. Despite different preconditions, it is clear that the income convergence process has been much more pronounced in new EU Member States than in the Western Balkans over the past 20 years, and that the latter still have several institutional obstacles to overcome until they can benefit from the positive effects of the accession process.

⁸ See Kaufmann et al. (2010) for further description of the methodology used for the Worldwide Governance Indicators.

For this reason, it is important to understand which gaps exist in the EU CC/PCC's institutional governance and structural domains that would warrant the attention of domestic policymakers. In order to shed light on this question, this paper takes a closer look at six different areas: business environment (Chapter 3), access to finance (Chapter 4), judicial system (Chapter 5), trade and competitiveness (Chapter 6), labour market and education (Chapter 1), and governance (Chapter 8). Comparisons are made with both a benchmark level of "old" (EU-15) and "new" (EU-11) peer country groupings as well as among EU CC/PCC themselves. The remainder of this section provides an overview of the main findings of the paper. Summary findings by country (rather than by thematic chapter) are provided in Section 10.1. Unless otherwise specified, this paper strongly relies on survey-based and qualitative data from the World Bank, the World Economic Forum and the IMF, among others. Even though survey-based data provide an overview of general conditions in a country, they remain a subjective source of information and this may ultimately be reflected in the overall country assessments.

1.2 Business environment

EU CC/PCC have substantially improved their perceived business environment in recent years, edging closer to the levels characteristic of EU Member States. The World Bank's "Ease of doing business – distance to frontier (DTF)" ranking shows the distance of each economy to the "frontier", which represents the best performance observed for each of the indicators across all economies in the "Doing Business" sample since 2005.⁹ On average, EU CC/PCC's DTF improved by 15% in the last six years, from 59.68 to 68.58 (on a scale from 0 to 100), growing faster than the EU-11 (improvement of 13% over the same period) and EU-15 (improvement of 3%), yet starting from lower initial levels. There is still a gap of around eight points between EU and non-EU countries, but it is gradually closing. It is noteworthy that EU-11 countries are, on average, almost at the EU-15 level according to this metric, as the average score for the latter group of countries has remained broadly unchanged since 2009 (see [Chart 4](#)).

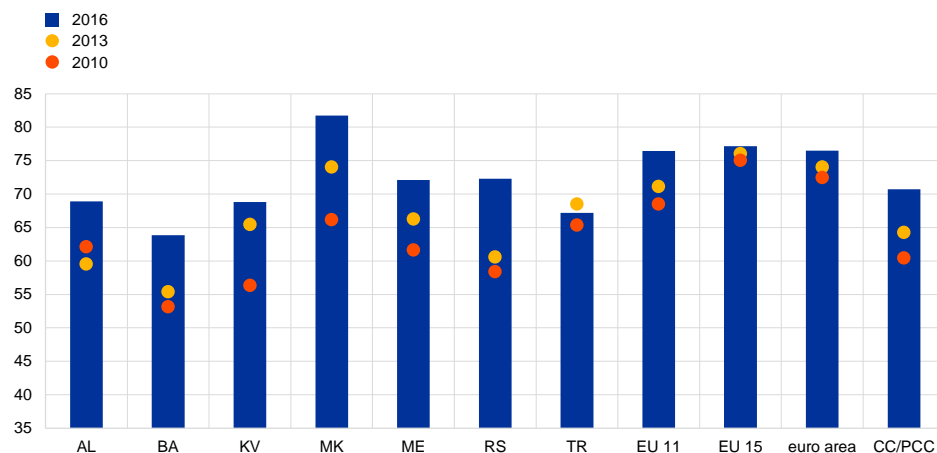
Taking a look at EU CC/PCC, the former Yugoslav Republic of Macedonia is the country that experienced the highest growth, and it is among the best in the global ranking, with a higher DTF than many EU-11 countries and even some EU-15 countries. On the other hand, Bosnia and Herzegovina is slightly behind the other EU CC/PCC in 2016. While some sub-indicators in Bosnia and Herzegovina are below the region average (e.g. registering property, paying taxes and enforcing contracts), the worst score concerns starting a business, where the country ranks 174th in the world, despite having introduced reforms in 2011 and in 2016. Starting a business in Bosnia and Herzegovina takes 65 days, costs 13.5% of income per capita, and requires 12 procedures.

⁹ For more information about the World Bank's ease of doing business – distance to frontier (DTF) ranking, see Section 10.2 of the Appendix.

Chart 4

Overall Ease of doing business – distance to frontier (DTF)

(higher score indicates better performance)



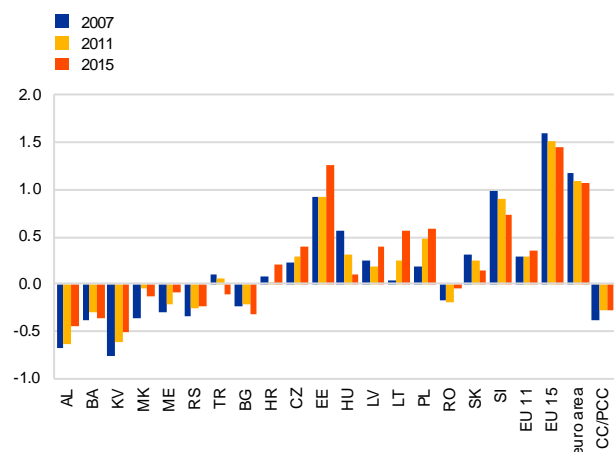
Note: Regional aggregates are calculated as the simple average of individual country scores.
Source: World Bank's ease of doing business – distance to frontier (DTF).

Contract enforcement in EU CC/PCC is perceived to be close to the levels characteristic of current EU peers, although this could be partially explained by methodology changes in 2014 in the “Ease of doing business” survey (see Appendix). Kosovo and Montenegro have experienced a major improvement in this indicator since 2010; the other EU CC/PCC were already close to the EU-11. In the case of other “Doing Business” indicators, such as paying taxes, resolving insolvency, or getting electricity, EU CC/PCC are, on average, behind the EU-11 and even further behind the EU-15 (see Section 3).

Chart 5

Control of corruption

(higher score indicates better governance quality)

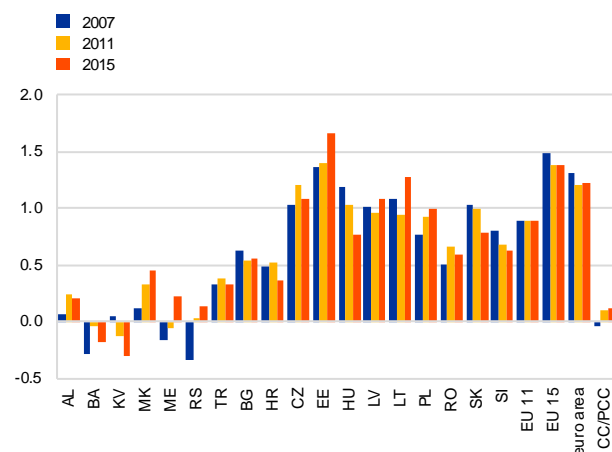


Note: Regional aggregates are calculated as the simple average of individual country scores.
Source: World Bank Worldwide Governance Indicators.

Chart 6

Regulatory quality

(higher score indicates better governance quality)



Note: Regional aggregates are calculated as the simple average of individual country scores.
Source: World Bank Worldwide Governance Indicators.

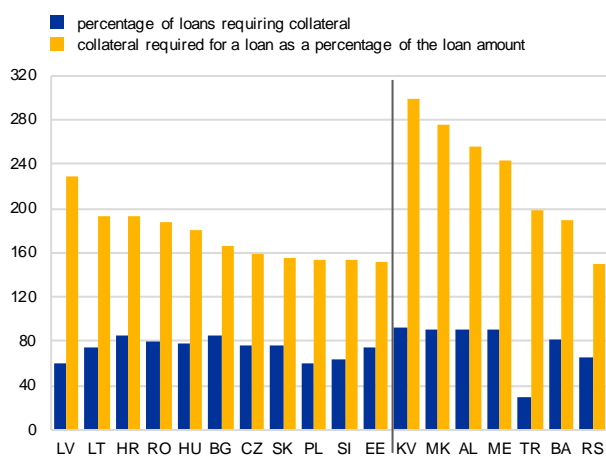
In contrast, survey measures suggest that perceptions of control of corruption and regulatory quality, though significantly improved, are still far from the levels

characteristic of peer countries in the EU. Control of corruption and regulatory quality are part of the World Bank's Worldwide Governance Indicators, but they have been included in the analysis of the factors affecting the business environment for the purposes of this paper. Despite improvements during recent years, EU CC/PCC are still significantly far from most EU-11 countries (Bulgaria, Romania and Croatia are the exceptions to this, although they still score better than EU CC/PCC in some of the cases). The former Yugoslav Republic of Macedonia, Montenegro and Turkey are the best-performing countries among the EU CC/PCC aggregate in both indicators in 2015, while Bosnia and Herzegovina and Kosovo have a negative score for both categories in 2015. Albania performs well relative to its neighbours in terms of regulatory quality, though not in terms of control of corruption. Serbia is in an intermediate position, and has experienced an increase in both scores in recent years (see [Chart 5](#) and [Chart 6](#)).

1.3 Access to finance

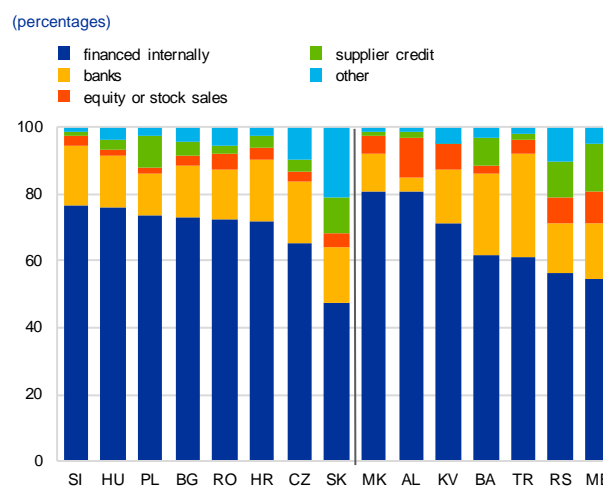
Access to finance remains problematic in EU CC/PCC, even when compared with the worst-performing new EU Member States. Although contract enforcement (in number of years and cost) and resolving insolvency (in number of years) measures seem fairly similar in the EU-11 and EU CC/PCC on average, businesses in the Western Balkans report comparatively more difficulties as regards both access to finance and ease of getting a loan relative to most new EU Member States.

Chart 7
Collateral requirements for borrowing in 2013



Sources: World Bank Enterprise Surveys and ECB staff aggregation of data.

Chart 8
Investments financed by the respective category in 2013



Sources: World Bank Enterprise Surveys and ECB staff aggregation of data.

Over-collateralisation is a distinctive hurdle in access to finance for EU CC/PCC relative to peers already in the EU. While secured lending as a percentage of total lending appears roughly similar across central and south-eastern European countries, the value of collateral needed to obtain a loan is much higher in EU CC/PCC than in the remainder of the region (see [Chart 7](#)). Albania, Kosovo and the

former Yugoslav Republic of Macedonia stand out compared with the other EU CC/PCC, with required collateral corresponding to almost three times the value of the loan itself. In turn, the trend of over-collateralising lending appears largely to stem from impediments to collateral execution and weak property rights systems, leading banks to compensate by requiring higher collateral for lending. These legal and judicial bottlenecks also impact the persistently high non-performing loan ratios, which in turn are dampening commercial banks' lending supply. The 2016 European Investment Bank lending survey finds that high collateral requirements continue to be an obstacle to external financing for corporates. In the case of Turkey, the proportion of loans requiring collateral (29%) is considerably lower than for the other EU CC/PCC.

In contrast, relative reliance on retained earnings is similar across all EU CC/PCC. Financing through own funds remains the main source of funding for many firms in the EU-11 and EU CC/PCC, with Albania, Kosovo and the former Yugoslav Republic of Macedonia above the peer average (see [Chart 8](#)). Bank funding accounts for a small fraction of financing of new investment, especially in Albania and the former Yugoslav Republic of Macedonia. Moreover, in 2013 only 11% of firms in Albania and 21% in the former Yugoslav Republic of Macedonia used banks to finance investments according to the World Bank Enterprise Surveys, corresponding to the lowest ratios for the EU-11 and EU CC/PCC. In Turkey and Bosnia and Herzegovina, bank loans financed, on average, 31% and 24%, respectively, of all new investments in 2013 – the highest proportion of bank funding across the two regions. The limited access to capital markets leads Western Balkan corporates to strongly depend on more traditional channels for financing. Firms with foreign ownership of more than 10% in EU CC/PCC appear, however, to be less dependent on bank loans to finance their investments than domestically owned firms. They have a higher proportion of investments financed internally, and fewer define access to finance as a major constraint on business activity, according to the World Bank 2013 Enterprise Surveys.

1.4 Judicial system

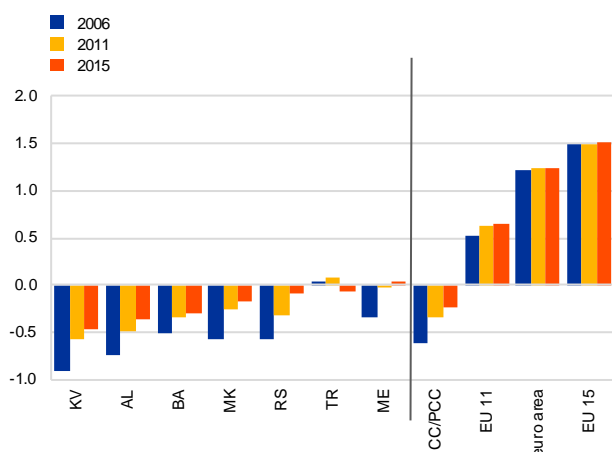
Perceptions in EU CC/PCC about the rule of law, quality of contract enforcement, property rights, the police and the courts are significantly below the levels typically found in EU Member States (see [Chart 9](#)). Albania, Bosnia and Herzegovina and Kosovo stand out with particularly low scores in 2015, although there has been an improvement for all EU CC/PCC over the past decade. The reverse developments in the former Yugoslav Republic of Macedonia are noteworthy, where the rule of law score fell back into negative territory in 2015, having improved from -0.2 in 2013 to 0.0 in 2014. This is largely attributable to political tensions over the past year.

Overall, developments in the rule of law and the independence of the judicial system in EU CC/PCC appear moderate, also in the light of the Copenhagen political criteria for joining the EU requiring stable institutions that can guarantee democracy and the rule of law. It is worth highlighting, however, that Bulgaria has been hovering around the same rule of law score for the past decade, while Croatia and Romania have

scores just above zero. Turkey's judicial independence score has been on a downward trend since 2007 (see [Chart 10](#)). Moreover, in its 2016 Nations in Transit report, Freedom House deems that institutional reforms in the Western Balkans have slowed (and even retreated), putting the region's average democracy score back at 2004 levels¹⁰, an assessment that further dampens the region's outlook.

Chart 9
Rule of law

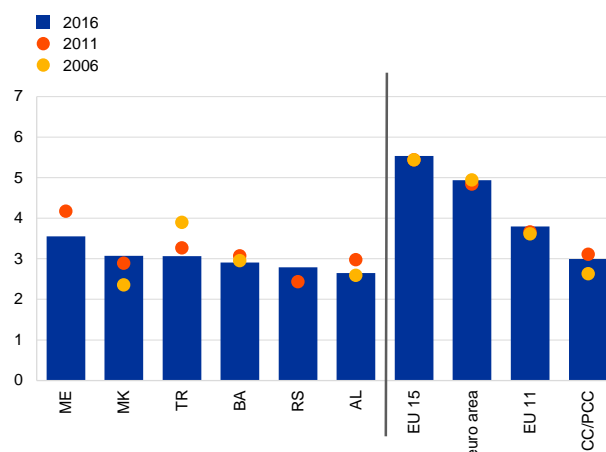
(higher score indicates better governance quality)



Sources: Haver Analytics and World Bank Worldwide Governance Indicators.

Chart 10
Independence of judicial systems from influences of the government, individuals or companies

(1 = not independent at all; 7 = entirely independent; higher score indicates better performance)



Sources: World Economic Forum (Global Competitiveness Report) and ECB staff aggregation of data.

1.5 Trade and competitiveness

Improvements in EU CC/PCC's overall competitiveness have ground to a halt in recent years, though individual country results are close to peers within the EU in some cases. External imbalances have remained at stubbornly high levels, in part owing to the strong import component of domestic consumption. As shown in [Chart 11](#), while there have been some improvements in the overall competitiveness of EU CC/PCC, it remains far from EU averages. The quality of the business environment (high levels of corruption, the size of the informal sector, administrative, legal and judicial impediments and political instability) is dampening economic activity and foreign investors' appetite for investing (mirrored by the relatively low stock of inward foreign direct investment, see [Chart 43](#)). The time and costs linked to exporting tend to be higher in EU CC/PCC compared with the EU, on average. High borrowing costs are restricting SMEs' investment and expansion, in many cases limiting them to relying on retained earnings (see [Chart 8](#)).

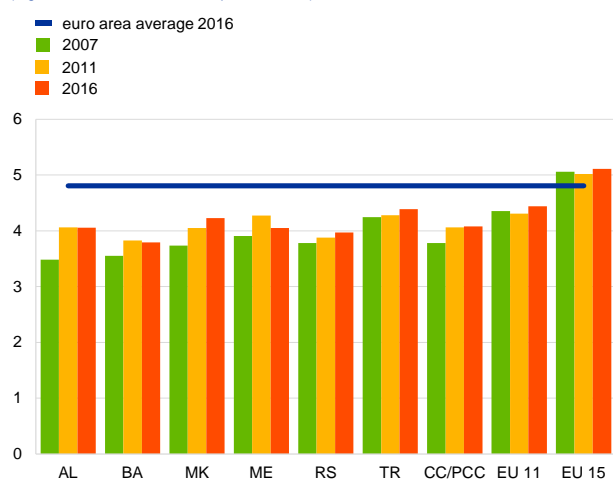
Turning to price and cost competitiveness indicators, labour productivity (measured as real GDP in PPP per person employed) is far below EU averages, both in the

¹⁰ See Freedom House's "Nations in Transit 2016" report

Western Balkans and in new EU Member States, with ratios close to 55% and 68% of the EU-28 average in 2015 for the Western Balkans and EU-11 respectively (see [Chart 42](#)). Among the Western Balkans, individual country performances vary extensively, with the lowest productivity ratio in Albania (39%) and the highest in Montenegro and Serbia (close to 66%). Overall, however, the Western Balkans have been slow to catch up with the EU over the past eight years (see [Chart 42](#)).

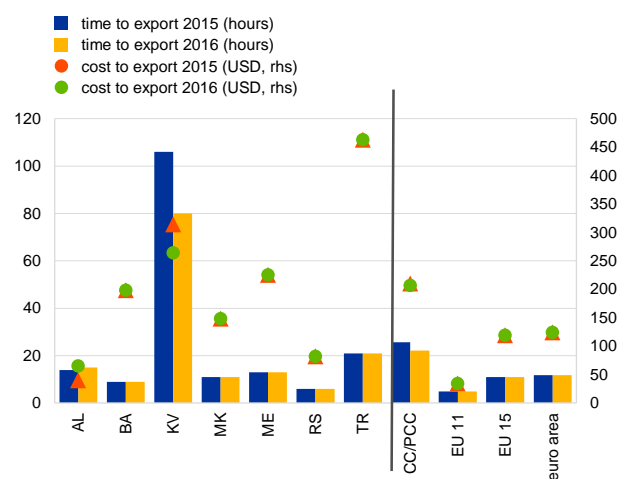
Chart 11
Overall competitiveness score

(higher score indicates better performance)



Note: Kosovo is excluded due to lack of data.
Sources: World Economic Forum (Global Competitiveness Report) and ECB staff aggregation of data.

Chart 12
Time and costs to export, 2015 and 2016



Note: Chart shows the time and costs resulting from compliance with border and documentation requirements. Sources: World Bank's ease of doing business ranking and ECB staff aggregation of data.

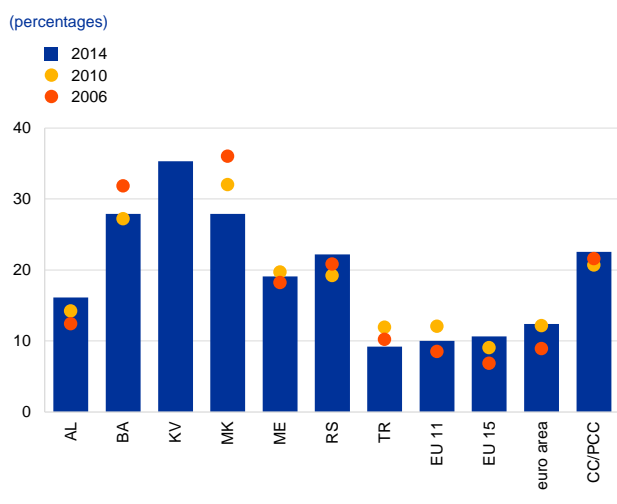
Strong wage increases (especially in the public sector) over recent years in several EU CC/PCC (in many cases attributable to national elections) are putting an additional strain on price competitiveness. Moreover, the Western Balkans' low external competitiveness points to the structural obstacles many of these countries still have to overcome before achieving a well-functioning market economy capable of coping with competition and market forces within the EU, as defined in the Copenhagen economic criteria as one of the key conditions for EU accession.

1.6 Labour market and education

Average unemployment rates in EU CC/PCC (as a group) are more than twice as high as those in new EU Member States (see [Chart 13](#)). Part of the problem may be related to the shadow economy (see [Chart 16](#)), as some of the employment may not be registered in the official records. It may also be the case that data are not fully reliable due to measurement problems in some countries' surveys. The average unemployment rate has increased by 55% and 18% in EU-15 and EU-11 countries respectively compared with pre-crisis levels. In EU CC/PCC, it remained more or less at the same levels between 2006 and 2014, and in 2014 was more than double the EU-11 and EU-15 rates. Bosnia and Herzegovina, Kosovo and the former Yugoslav Republic of Macedonia have the highest unemployment rates, close to or

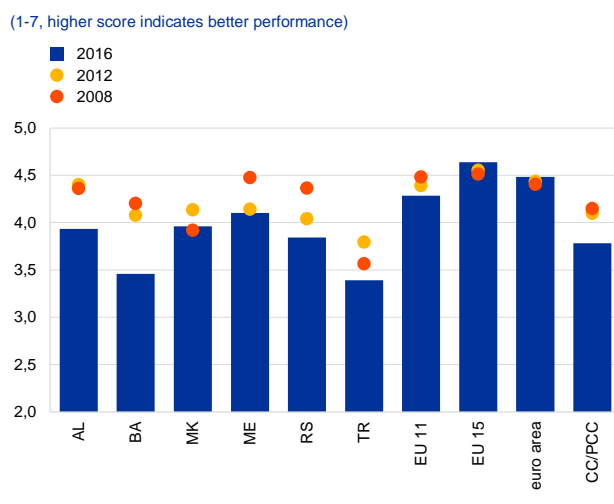
just above 30%, while the unemployment rate in Turkey is close to 10%. Nearly 70% of unemployment in EU CC/PCC is classified as long term, and youth unemployment reaches up to 40%. Most of the unemployment in EU CC/PCC is of a structural nature (see Sections 7.1 and 7.2 for more information about long-term, youth and structural unemployment).

Chart 13
Unemployment rate



Note: Regional aggregates are calculated as the simple average of individual country scores.
Sources: Haver Analytics, World Bank Development Indicators, Kosovo Agency of Statistics and ECB staff aggregation of data.

Chart 14
Labour market efficiency



Notes: Regional aggregates are calculated as the simple average of individual country scores. Kosovo is excluded due to lack of data.
Source: World Economic Forum (Global Competitiveness Report).

Indicators for labour market efficiency¹¹ show that EU CC/PCC are lagging behind new EU Member States, albeit to a lesser extent than the difference in overall unemployment rates would suggest. **Chart 14** depicts how EU CC/PCC tend to be below EU-11 and EU-15 average levels, although not by much despite a decrease over the past years. EU-11 and EU-15 average scores have remained relatively steady on this indicator since 2012. Bosnia and Herzegovina and Turkey are the countries with the lowest scores, largely stemming from a low capacity to attract and retain talent (both countries), high redundancy costs (Bosnia and Herzegovina) and a low labour participation rate for women (Turkey). As regards other labour market indicators, such as higher education and training, as well as innovation, EU CC/PCC are relatively far from EU-15 and EU-11 averages. Finally, related to the situation of the labour market in EU CC/PCC, there is a substantial stock of emigrants living and working abroad, and personal remittances represent a non-negligible portion of the GDP of these countries (see Section 6 for further details).

1.7 Governance

EU CC/PCC are still far from EU Member States in terms of governance, according to the World Bank Worldwide Governance Indicators (see **Chart 15**). Large intra-

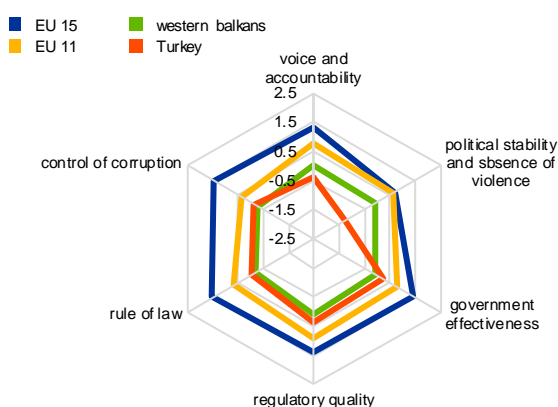
¹¹ See Section 10.3 of the Appendix for a definition of the labour market efficiency indicator.

group disparities exist, however, which impact the regional aggregate. Each of the indicators are individually analysed in Sections 2.4 and 8 (except control of corruption and regulatory quality, already covered in this Section).

In 2007, the shadow economy in EU CC/PCC accounted, on average, for 32.76% of GDP (see **Chart 16**). In the same year, the numbers for the EU-15 and EU-11 were 26% and 19% respectively. There are no data available for EU CC/PCC after 2007. However, the averages for the EU-11, EU-15 and the euro area have decreased by around 10% since 2007, so it may be possible that the shadow economy in EU CC/PCC has also experienced a decrease in recent years. According to these metrics, the former Yugoslav Republic of Macedonia had the largest shadow economy in 2007 (close to 36% of GDP). Other indicators, such as public finances, government expenditure, and large and small scale privatisation, can be found in Section 8.

Chart 15
Worldwide Governance Indicators 2015

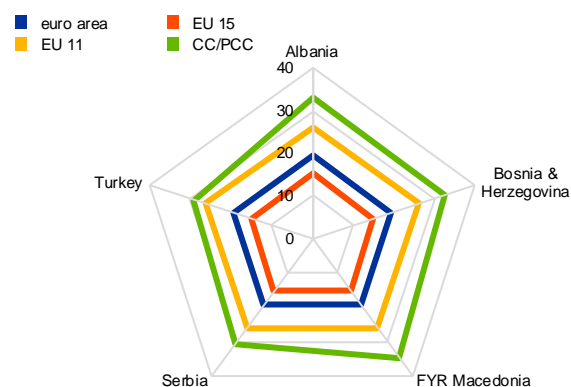
(average scores between -2.5 and 2.5, higher score indicates better governance performance)



Note: Regional aggregates are calculated as the simple average of individual country scores.
Sources: Haver Analytics, World Bank Worldwide Governance Indicators and ECB staff aggregation of data.

Chart 16
Shadow economy in 2007

(percentage of GDP)



Notes: Regional aggregates are calculated as the simple average of individual country scores. Kosovo and Montenegro are excluded due to lack of data.
Sources: Schneider (2015), Krstić et al. (2013) and ECB staff aggregation of data.

Regarding central bank independence and transparency, the countries for which data are available (Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia and Turkey) exhibit scores which come close to those of new EU Member States. However, two caveats have to be made. First, the data do not cover all EU CC/PCC; no data are available for Kosovo, Montenegro and Serbia. Second, due to the way the indicator is constructed, it is not possible to accurately capture all events in the four countries (e.g. where a central bank governor's mandate came to an end before the statutory term was reached), nor is it possible to capture intense political pressure by a government on central bank decision-making. Regarding bank regulation and supervision, in 2011 EU CC/PCC had more stringent definitions of capital, more restrictions to engage in non-banking activities, more loan provision requirements, more empowered regulators and weaker information disclosure requirements (see Box 3 at the end of Section 8).

1.8 Summary table of individual country performances

The heat map below depicts how the individual EU CC/PCC perform in a number of categories with respect to the other EU CC/PCC on the one hand, and with respect to their own performance over the past five years on the other.

Heat map – performance compared with other EU CC/PCC

Country	Ease of doing business	Access to finance	Judicial system	Trade and competitiveness	Labour market and education	Governance
Albania	↑	↓	↓	→	↑	→
Bosnia and Herzegovina	↑	→	→	↑	↑	↓
Kosovo	↑	↓	↑	↓	n.a.	↑
FYR Macedonia	↑	→	↑	↑	↑	→
Montenegro	↑	→	↓	→	↑	→
Serbia	↑	↑	↑	↑	↑	↑
Turkey	→	→	→	→	↑	↓

Notes: Each category has been constructed using the average of a set of sub-indicators. The colour of the cell depicts the individual country score with respect to the EU CC/PCC average performance for the last available year. Red = below EU CC/PCC average. Yellow = in line with EU CC/PCC average. Green = above EU CC/PCC average. The arrows show the country-specific change in the indicator between 2010-2015/2016.

Albania compares negatively to its peers, particularly as regards access to finance and trade and competitiveness, areas in which it has also not improved in absolute terms (according to its own record) during recent years. Bosnia and Herzegovina and Kosovo perform, on average, worse than the other EU CC/PCC in more or less all categories, but with signs of improvement with respect to their own scores in 2010. For the remaining EU CC/PCC, the results are more varied, with stronger performances in some categories and worse in others. Serbia and Turkey score highly in access to finance, mainly as a result of their relatively low collateralisation of lending, and the amount required for borrowing (see also Section 2.3).

It is worth bearing in mind, however, that while green colours indicate a good result compared with other EU CC/PCC, the picture is more nuanced when benchmarking against EU Member States, as described throughout Section 2 (and in the more descriptive sections below). Additional country-specific results are listed in Section 10.1 of the Appendix.

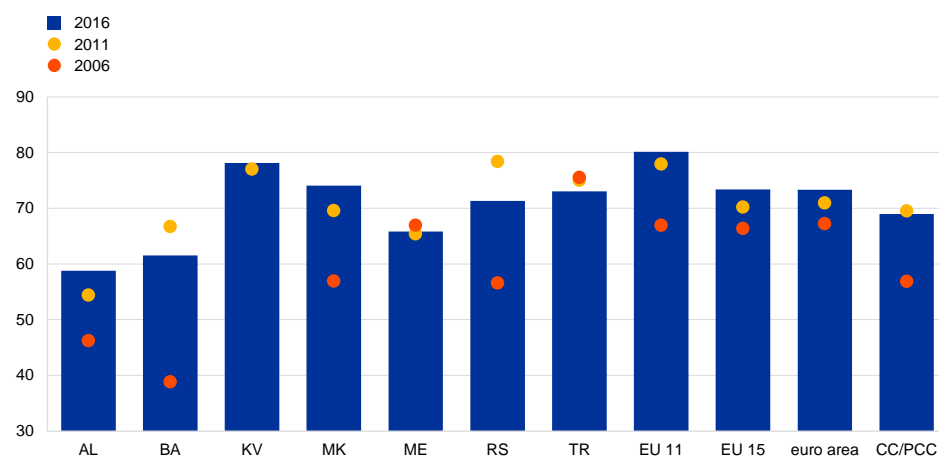
2 Business environment

2.1 Registering property

While significant improvements have been made as regards indicators for registering property in EU CC/PCC during recent years, a sizeable gap still remains relative to the standards characteristic of new EU Member States (see [Chart 17](#)). Kosovo, the former Yugoslav Republic of Macedonia and Turkey's distance to frontier (DTF) scores are in line with EU-15 and euro area averages (and, in the case of Kosovo, even close to the EU-11). Serbia, the former Yugoslav Republic of Macedonia and Bosnia and Herzegovina have experienced the strongest increases. Albania has also improved its score, but it still lags behind the other EU CC/PCC.

Chart 17
Registering property

(distance to Frontier, higher score indicates better performance)



Note: Regional aggregates are calculated as the simple average of individual country scores
Source: World Bank's ease of doing business – distance to frontier (DTF)

Albania and Bosnia and Herzegovina are the countries with the lowest scores among EU CC/PCC. Despite reforms made in 2011 and 2014 to improve the process, it takes 19 days, 6 procedures and a cost of 9.9% of the property value to register a property in Albania, putting the country near the bottom of the ranking and far from the other EU CC/PCC (except for Bosnia and Herzegovina, where it takes 24 days, 7 procedures and 5.2% of the property costs).

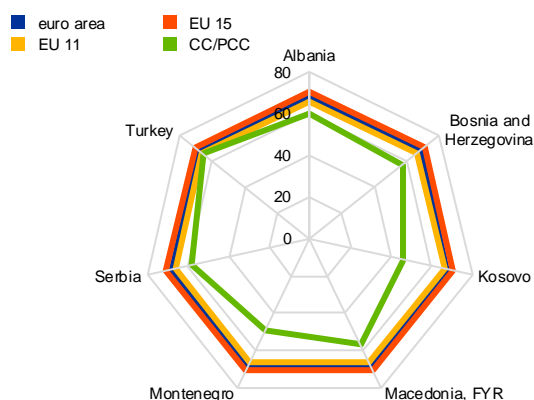
2.2 Enforcing contracts

Progress in contract enforcement in EU CC/PCC has been significant in recent years, such that in a few cases individual scores are comparable to those which new EU Member States tend to exhibit. [Chart 18](#) shows how, in 2011, Turkey, Albania, Serbia, the former Yugoslav Republic of Macedonia and Bosnia and Herzegovina

had DTFs relatively close to the EU-11 average and not far from the EU-15 average, while Kosovo and Montenegro lagged behind. In 2016 (see [Chart 19](#)) the situation changed, and both Montenegro and Kosovo are now closer to EU-15 and EU-11 averages, which are very close to each other, while Albania and Serbia have the worst scores. The main reason behind the bad performance in these two countries seems to be the cost of enforcing contracts, at close to 35% of the value of the claim in Albania, and to 40% in Serbia.

Chart 18
Contract enforcement, 2011

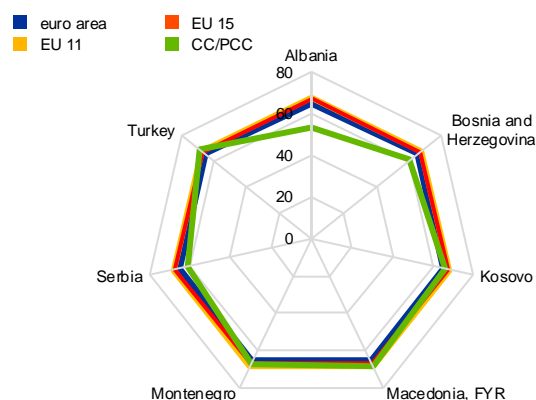
(distance to frontier, higher score indicates better performance)



Note: Regional aggregates are calculated as the simple average of individual country scores
Source: World Bank's ease of doing business – distance to frontier (DTF).

Chart 19
Contract enforcement, 2016

(distance to frontier, higher score indicates better performance)



Note: Regional aggregates are calculated as the simple average of individual country scores
Source: World Bank's ease of doing business – distance to frontier (DTF).

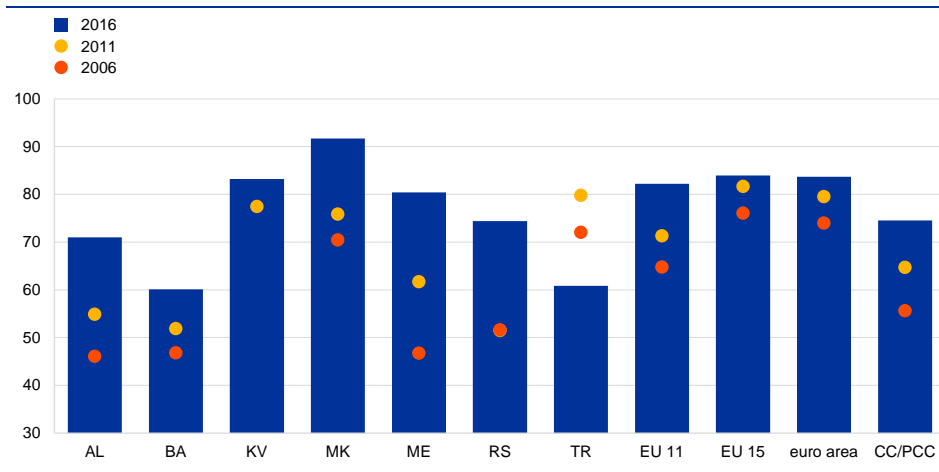
2.3 Paying taxes

EU CC/PCC tend to exhibit mixed scores for paying taxes relative to new EU Member States. [Chart 20](#) shows how the former Yugoslav Republic of Macedonia stands out in terms of paying taxes, being among the best in the overall Doing Business ranking. In the EU, only Ireland and Denmark have a higher DTF. The introduction in recent years of reforms to encourage electronic tax filing and lower tax costs may partially explain such a good position. Kosovo has also a high DTF, as does Montenegro in 2016, after a 30% increase compared to 2011. The scores in these countries are comparable to the EU-15 and EU-11 averages. On the other hand, Serbia, Albania and Bosnia and Herzegovina and Turkey are still far from scores of EU Member States.

Chart 20

Paying taxes

(distance to frontier, higher score indicates better performance)



Note: Regional aggregates are calculated as the simple average of individual country scores
Source: World Bank's ease of doing business – distance to frontier (DTF).

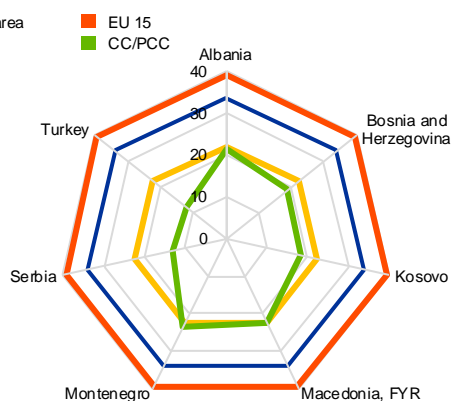
2.4 Resolving insolvency

Resolving insolvency indicators show that EU CC/PCC (with the exception of Kosovo and Turkey) are close to the countries who joined the EU in the 2000s. It is noteworthy that the EU-11 average score has increased substantially between 2011 and 2016, reducing the gap with EU-15. Kosovo and Turkey are markedly below the rest of the candidate and potential candidate countries, as [Chart 22](#) depicts.

Chart 21

Resolving insolvency, 2011

(distance to frontier, higher score indicates better performance)

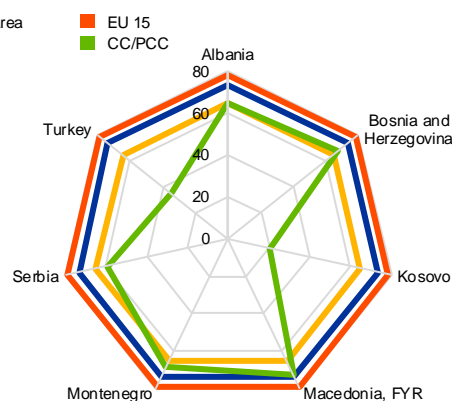


Note: Regional aggregates are calculated as the simple average of individual country scores
Source: World Bank's ease of doing business – distance to frontier (DTF).

Chart 22

Resolving insolvency, 2016

(distance to frontier, higher score indicates better performance)



Note: Regional aggregates are calculated as the simple average of individual country scores
Source: World Bank's ease of doing business – distance to frontier (DTF).

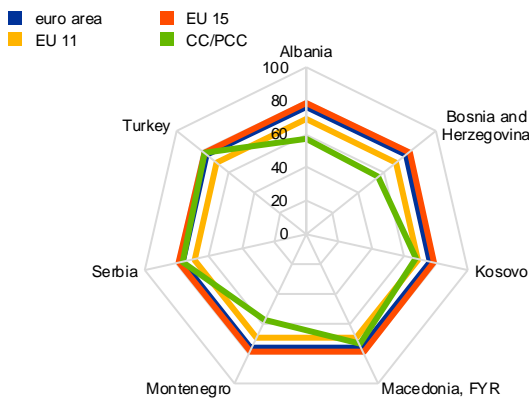
In the case of Kosovo, the score is especially low due to the fact that, according to the World Bank's "Ease of doing business" survey, there is no insolvency procedure, only foreclosure. In Turkey, the recovery rate for investors is rather low (18.5 cents on the dollar), and the time required is longer than in many other countries (4.5 years).

2.5 Getting electricity

EU CC/PCC tend to exhibit lower average scores as regards getting electricity relative to current EU Member States (see [Chart 24](#)). The former Yugoslav Republic of Macedonia, Serbia and Turkey are the exception to this in 2016, with scores that above the ones of some EU-15 countries, such as Spain and Belgium.

Chart 23
Getting electricity, 2011

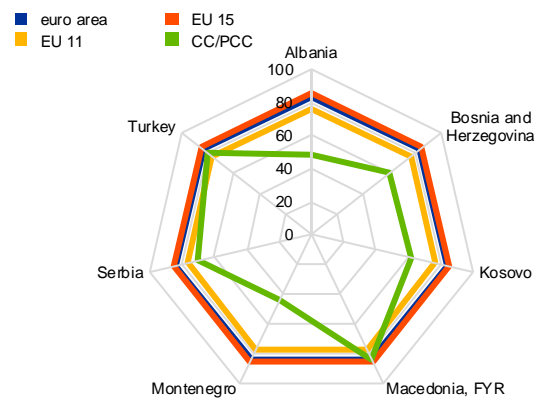
(distance to frontier ranking, higher score indicates better performance)



Note: Regional aggregates are calculated as the simple average of individual country scores
Source: World Bank's ease of doing business – distance to frontier (DTF).

Chart 24
Getting electricity, 2016

(distance to frontier ranking, higher score indicates better performance)



Note: Regional aggregates are calculated as the simple average of individual country scores
Source: World Bank's ease of doing business – distance to frontier (DTF).

Moreover, survey data suggest that getting electricity is becoming more problematic (rather than less) in some EU CC/PCC. This is the case in Albania and Montenegro, which are among the worst countries in the whole ranking for this indicator. In the case of Albania, getting electricity requires six procedures, takes 134 days and costs 515.5% of the country's income per capita. For Montenegro, those figures are seven procedures, 142 days and 440.5% of the country's income per capita. Neither country has introduced reforms related to this indicator in recent years.

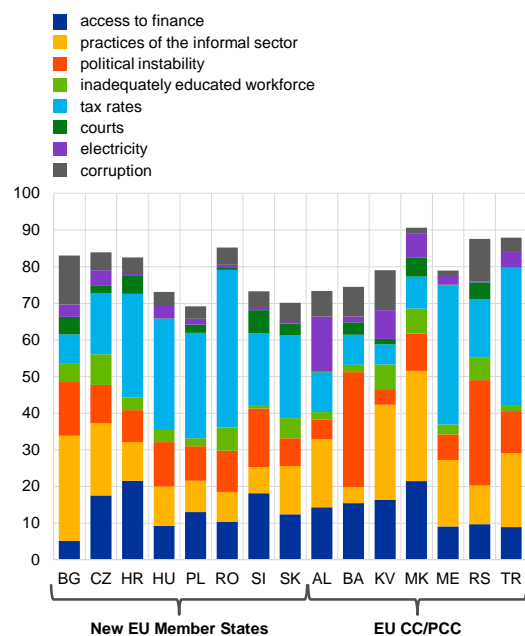
Box 2

Main obstacles for businesses

Chart C

Main business environment obstacles in 2013

(percentage of firms reporting obstacle)



Sources: World Bank Enterprise Surveys and ECB staff aggregation of data.
Note: Eight obstacles selected out of a total of 15.

Yugoslav Republic of Macedonia and Serbia), political instability (Bosnia and Herzegovina and Serbia), and high tax rates (Albania, Bosnia and Herzegovina and Serbia). The former Yugoslav Republic of Macedonia stands out, with more foreign-owned firms (27.3%) perceiving access to finance as the main obstacle to business than domestically owned firms (21%), compared with an average of 3% of foreign firms for several of the other Western Balkans countries.

Informal sector practices, access to finance and political instability are perceived to be among the largest obstacles to business activity in the Western Balkans (but also in new EU Member States) according to firm-level surveys conducted in 2013. Business owners and top managers of close to 360 private sector firms in each Western Balkan country (202 in Kosovo and 150 in Montenegro) were presented with a list of 15 business environment obstacles, and were asked to choose the biggest obstacle to their business. The results appear strongly to depend on the characteristics of the firms surveyed (domestic or foreign, exporter or non-exporter) and their geographical location within the country. **Chart C** depicts the average score for major obstacles in EU CC/PCC and in a selection of new EU Member States.

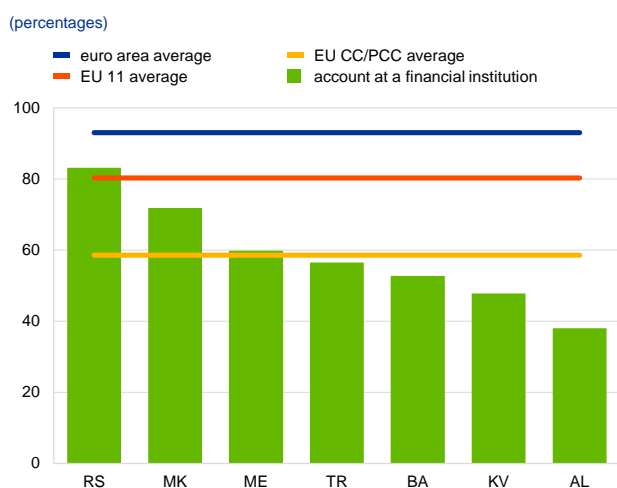
On a more granular level, foreign businesses appear to be less subject to credit constraints than local firms, but more concerned by the skill mismatch on the labour market (the former

3 Access to finance

Access to finance and the use of financial services are more limited in the Western Balkans and Turkey than in most EU Member States. While about 80% of citizens in new EU Member States have a bank account, financial intermediation is considerably lower in EU CC/PCC (with the exception of the former Yugoslav Republic of Macedonia and Serbia), with an average of 58% of all adults (see [Chart 25](#)). Most striking are Albania and Kosovo, where less than 50% of adults have a bank account. This can be explained by several factors, including lack of trust in financial institutions, high fees and limited network making physical access difficult. In addition, a much lower proportion of EU CC/PCC reported that they saved money during the past year compared with EU countries (see [Chart 26](#)).

Chart 25

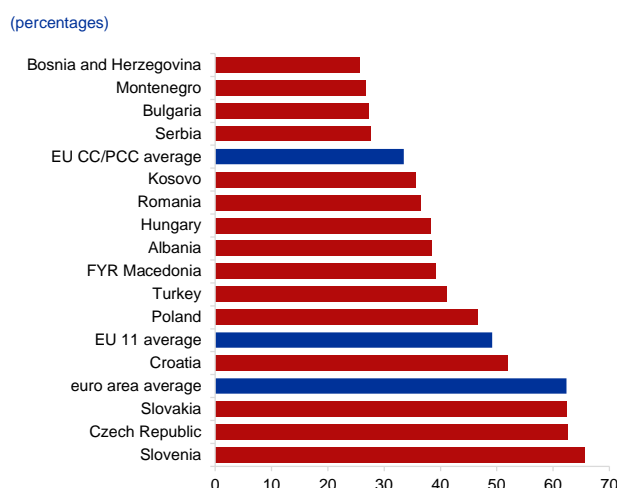
Citizens with an account at a financial institution in 2014



Notes: Regional aggregates are calculated as the simple average of individual country scores. Data for citizens aged 15+.
Sources: World Bank (Global Financial Inclusion Database) and ECB staff aggregation of data.

Chart 26

Citizens who saved money in 2014



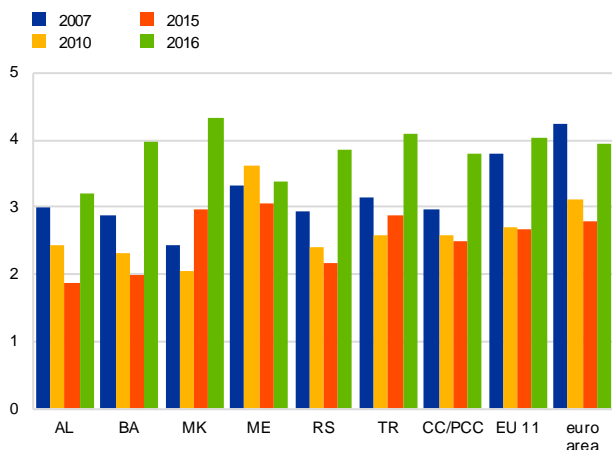
Notes: Regional aggregates are calculated as the simple average of individual country scores. Data for citizens aged 15+.
Sources: World Bank (Global Financial Inclusion Database) and ECB staff aggregation of data.

With a few exceptions, the overall environment for getting a bank loan seems to have become more difficult over the past decade, not only in EU CC/PCC but also within the EU (see [Chart 27](#)), although the trend seems to be reversing in 2016. Lending tends to be more costly in EU CC/PCC (compared with in new EU Member States) and is more likely to require collateral that well exceeds the value of the loan itself (see [Chart 7](#)).

Chart 27

Ease of access to loans

(How easy it is to obtain a bank loan with only a good business plan and no collateral (1 = extremely difficult; 7 = extremely easy; higher score indicates easier access))

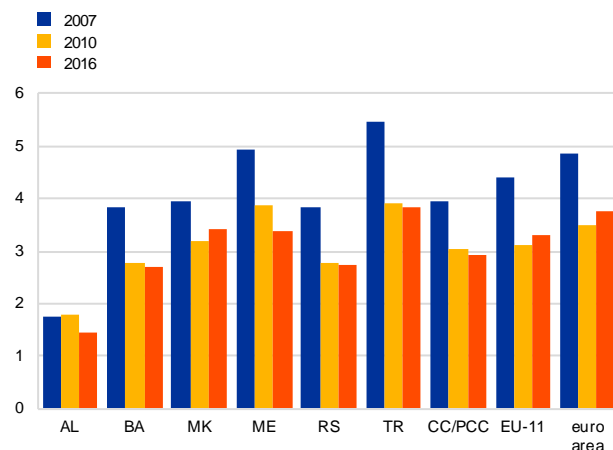


Note: Regional aggregates are calculated as the simple average of individual country scores.
Sources: World Economic Forum (Global Competitiveness Report) and ECB staff aggregation of data.

Chart 28

Financing through local equity market

(To what extent companies can raise money by issuing shares and/or bonds on the capital market (1 = not at all; 7 = to a great extent; higher score indicates increased possibility))



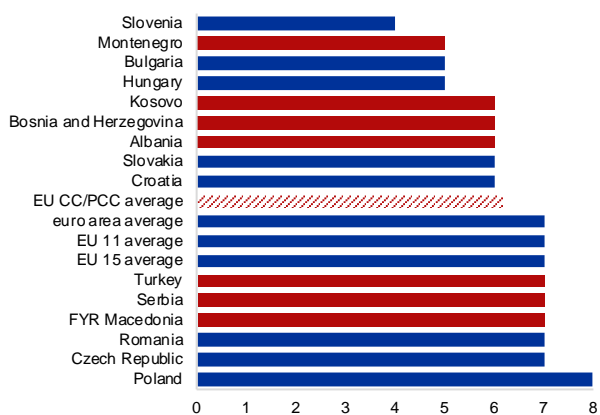
Note: Regional aggregates are calculated as the simple average of individual country scores.
Sources: World Economic Forum (Global Competitiveness Report) and ECB staff aggregation of data.

Although already limited, the possibility for firms to finance their activity through local equity markets seems to have decreased over the past decade (see **Chart 28**). In the case of Albania, the absence of a functioning national stock exchange is also reflected in the country's low score (1.5), since domestic firms are constrained in their access to external (non-bank) funding. Moreover, local bond markets in EU CC/PCC are dominated by sovereign bonds, with corporate bonds representing less than 6% of the total local bond market (where existing).

Chart 29

Depth of credit registries, 2016

(higher score indicates better quality, accessibility and scope of credit information)



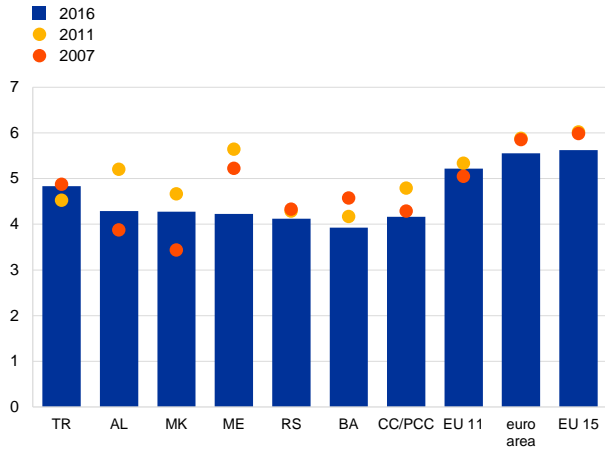
Notes: Regional aggregates are calculated as the simple average of individual country scores.
Sources: World Bank's ease of doing business ranking, Haver Analytics and ECB staff aggregation of data.

Credit registries (public or private systems that provide credit information about firms and individuals) have improved over the past decade in EU CC/PCC (and is even more present than in some cases than in EU Member States). In particular, the former Yugoslav Republic of Macedonia, Serbia and Turkey score well and the quality of credit information services seems to be close to EU-15 standards, with well-developed databases available for banks and financial institutions, both with positive and negative credit data about borrowers. It is worth keeping in mind, however, that the indicator presented in **Chart 29** is calculated using the number of affirmative answers to a short survey and therefore does not necessarily reflect the full complexity of a national legal system, nor the de facto practices.

4 Judicial system

Chart 30
Costs imposed on businesses by organised crime

(To what extent organized crime (mafia-oriented racketeering, extortion) imposes costs on businesses (1 = to a great extent; 7 = not at all))



Note: Kosovo is excluded due to lack of data.
Sources: World Economic Forum (Global Competitiveness Report) and ECB staff aggregation of data.

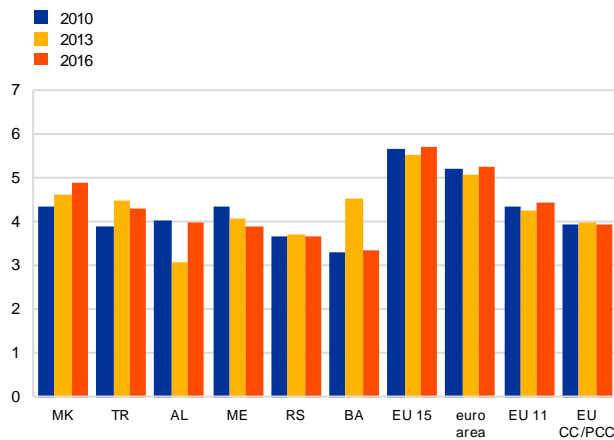
Survey indicators for the rule of law, corruption and the cost of organised crime in EU CC/PCC suggest that strong weaknesses persist relative to current EU Member States. Organised crime seems to impose higher costs on businesses in EU CC/PCC than in new EU Member States (see **Chart 30**) with the former Yugoslav Republic of Macedonia and, to a lesser extent, Albania being the only countries among the EU CC/PCC to improve their score between 2007 and 2016 (although 2016 performances are below those in 2011). The costs of organised crime appear to be higher in Bosnia and Herzegovina in 2016 compared with the remaining EU CC/PCC, and have been on a seemingly upward trend.

Moreover, the occurrence of extra payments and bribes to officials in many EU candidate and potential candidate countries highlights the long journey ahead towards fulfilling Chapter 23 of the *acquis*

communautaire (see **Chart 31**). While bribes in the former Yugoslav Republic of Macedonia and Turkey occur, on average, even less frequently than in several new EU Member States, they tend to be more common in Albania, Bosnia and Herzegovina, Montenegro and Serbia.

Chart 31
Frequency of undocumented extra payments or bribes

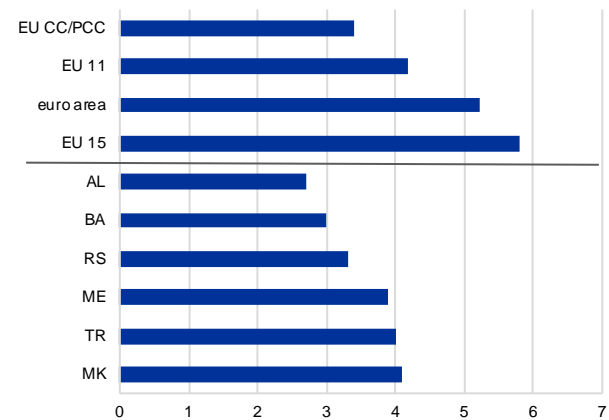
(the score ranges from 1 (very common) to 7 (never occurs))



Notes: The scores are an average across five sectors (imports and exports, public utilities, annual tax payments, awarding of public contracts and licenses, and obtaining favourable judicial decisions). Kosovo was excluded due to lack of data.
Sources: World Economic Forum (Global Competitiveness Report) and ECB staff aggregation of data.

Chart 32
Likelihood of companies making irregular payments and bribes to obtain favourable judicial decisions (2016)

(higher score indicates lower likelihood)



Note: Kosovo was excluded due to lack of data.
Sources: World Economic Forum (Global Competitiveness Report) and ECB staff aggregation of data.

Breaking it down further, extra payments and bribes for awarding public contracts and licences, or obtaining favourable judicial decisions, seem to occur more frequently than other forms of bribes. According to the World Bank Enterprise Surveys, in 2013 40% of firms in Kosovo and Serbia, 34% in Albania and 28% in Bosnia and Herzegovina expected to give gifts to secure a government contract (on average). Another telling example is the extent of bribery (the share of public transactions where a gift or informal payment was requested), which in Albania reached 17% in 2013 according to the same survey data, the highest among all EU-11 and EU CC/PCC results. The low degree of judicial independence in EU CC/PCC is also reflected in [Chart 32](#).

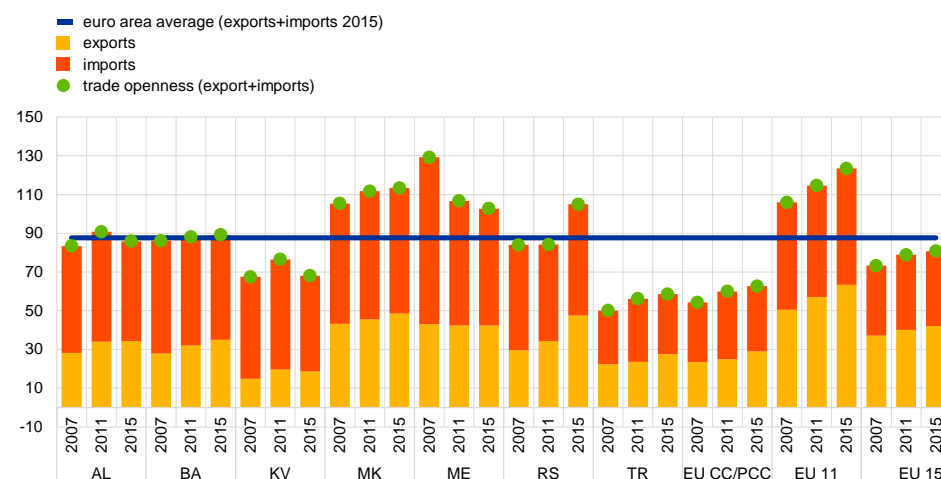
5 Trade and competitiveness

5.1 Trade openness and export market shares

On average, and despite their strong dependence on imports, EU CC/PCC demonstrate lower trade openness than EU Member States and, more specifically, than new EU Member States. Exports to GDP remain subdued compared with new EU Member States, largely attributable to low external competitiveness and a narrow production base (particularly in Kosovo and Montenegro, see [Chart 33](#)). The EU is the main trading partner for the Western Balkans, accounting for between 60% and 80% of total merchandise exports in 2015, depending on the exporting country, with Germany, Italy, Slovenia and Croatia being among the principle markets. Turkey, on the other hand, depends less on the EU market for its merchandise exports, in part due to its location between eastern Europe and western Asia.

Chart 33
Trade openness

(goods and services traded with the rest of the world as a percentage of nominal GDP)



Note: Regional aggregates are calculated as total exports (or imports) of the region divided by the aggregated (nominal) GDP of the countries in that region.

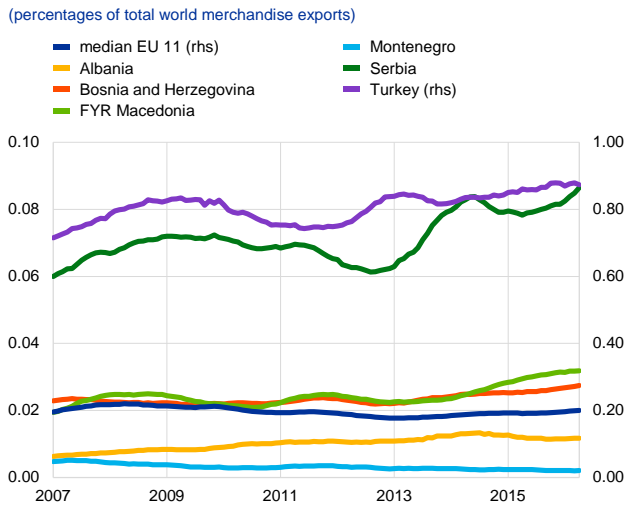
Sources: IMF/WEO and ECB staff aggregation of data.

Although starting from very low levels, most EU CC/PCC have managed to increase their presence in the global and euro area merchandise export markets since 2008 (see [Chart 34](#) and [Chart 35](#)). Only Montenegro experienced a noticeable drop in its export market share during the period, possibly influenced by barriers to exporting (including high border costs and documentary compliance costs, see also [Chart 12](#)), despite the administrative burden being less cumbersome than in some of the other EU CC/PCC, such as Kosovo and Turkey.

In addition, Montenegro (together with other smaller economies in the Western Balkans, such as Kosovo) is exposed to fluctuations in external demand and global commodity prices given its narrow production base and the fact that its merchandise

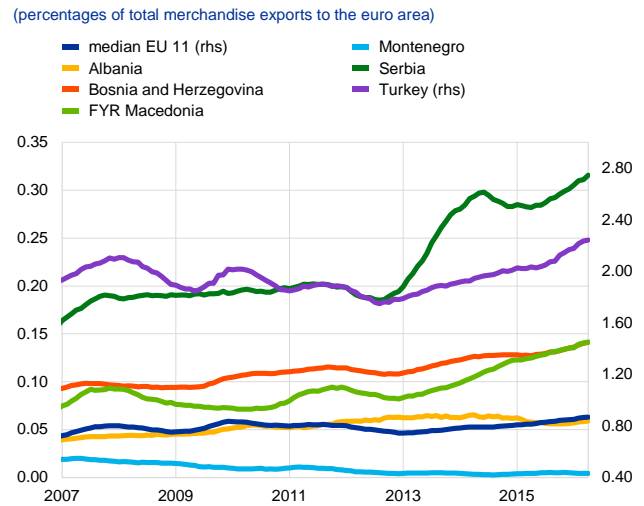
exports are concentrated in a few sectors (aluminium in the case of Montenegro, although production is declining, and base metals in Kosovo).

Chart 34
World export market shares



Notes: Moving sum of the past 12 months. Kosovo was excluded due to lack of data.
Sources: IMF Direction of Trade and ECB staff aggregation of data.

Chart 35
Euro area export market shares



Notes: Moving sum of the past 12 months. Intra-euro area exports are excluded. Kosovo was excluded due to lack of data.
Sources: IMF Direction of Trade and ECB staff aggregation of data.

5.2 Goods market efficiency

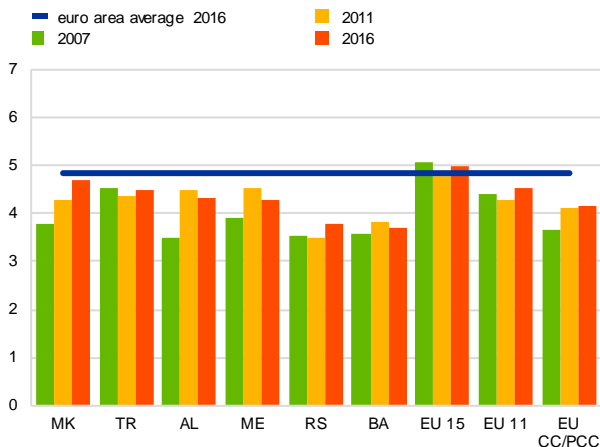
Goods market efficiency in EU CC/PCC is close to new EU Member States' levels, although large inter-country differences exist.¹² The former Yugoslav Republic of Macedonia and Turkey demonstrate scores close to or above those of new EU Member States (see [Chart 36](#)), while Bosnia and Herzegovina, Serbia and, to a certain extent, Albania, score much lower, largely due to long procedures for starting a business (especially in Bosnia and Herzegovina), low effectiveness of anti-monopoly policies, low buyer sophistication and strong market dominance.

¹² Goods market efficiency is defined by the World Economic Forum as the capacity of an economy to produce the right mix of products and services given its particular supply-and-demand conditions, as well as to ensure that these goods can be the most effectively traded in the economy.

Chart 36

Goods market efficiency – overall score

(higher score indicates better performance)

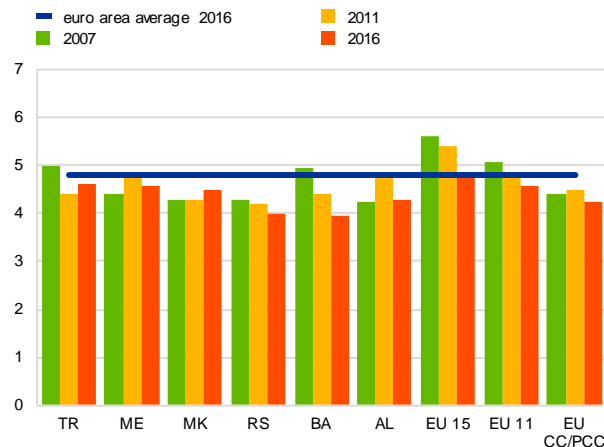


Notes: Regional aggregates are calculated as simple averages of individual country scores. Kosovo is excluded due to lack of data.
Sources: World Economic Forum (Global Competitiveness Report) and ECB staff aggregation of data.

Chart 37

Prevalence of non-tariff trade barriers

(higher score indicates lower prevalence)



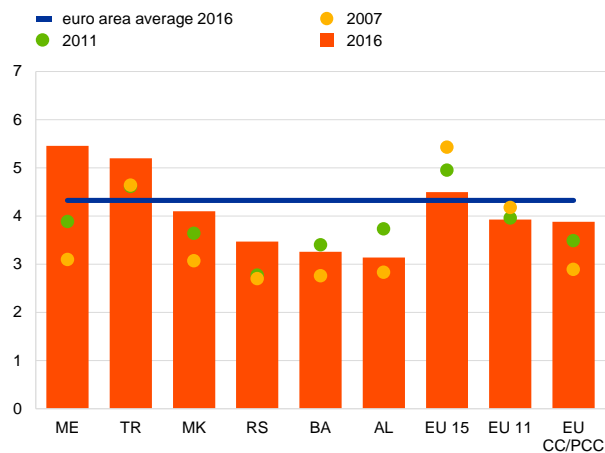
Notes: Regional aggregates are calculated as simple averages of individual country scores. Kosovo is excluded due to lack of data.
Sources: World Economic Forum (Global Competitiveness Report) and ECB staff aggregation of data.

Non-tariff barriers put a larger strain on goods market efficiency in EU CC/PCC than in the EU-11, even though non-tariff barriers seem to have increased in many EU Member States over the past five years, according to the Global Competitiveness Report (see [Chart 37](#)). Market competition creates incentives for firms to reduce costs and allows more efficient firms to enter the market. The presence of dominant players, on the other hand, drives up prices and could decrease firms' incentives to innovate and retain high productivity. Anti-monopoly policies seem to have had limited success in ensuring fair competition in most EU CC/PCC, and market dominance is strong relative to new EU Member States. Albania, Bosnia and Herzegovina and Serbia are the Western Balkan economies where anti-monopoly measures tend to have the lowest impact. What is particularly noticeable is that the situation seems to have gradually worsened in Albania and Bosnia and Herzegovina over the past three to five years. The strong market concentration in the Western Balkans is illustrated in [Chart 39](#). Albania, Bosnia and Herzegovina and Serbia stand out with relatively concentrated corporate activity.

Chart 38

Effectiveness of anti-monopoly policy

(higher score indicates increased effectiveness)

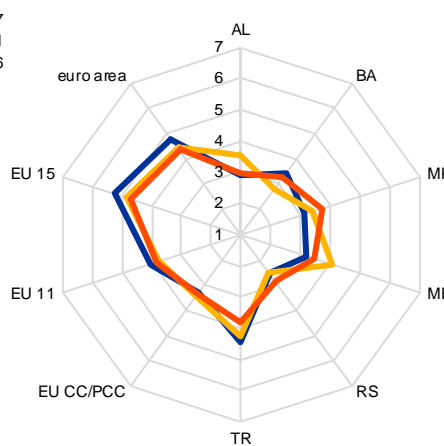


Notes: Regional aggregates are calculated as simple averages of individual country scores. Kosovo is excluded due to lack of data.
Sources: World Economic Forum (Global Competitiveness Report) and ECB staff aggregation of data.

Chart 39

Extent of market dominance

How firms characterize corporate activity (higher score indicates higher spread of activity among many firms)



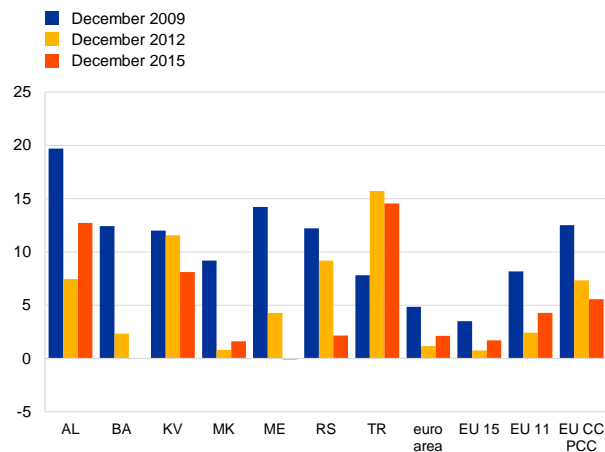
Notes: Regional aggregates are calculated as simple averages of individual country scores. Kosovo is excluded due to lack of data.
Sources: World Economic Forum (Global Competitiveness Report) and ECB staff aggregation of data.

5.3 Price and cost competitiveness

Chart 40

Wage increases

(annual average nominal growth rate, three-year average)



Note: Regional aggregates are calculated as simple averages of individual country scores.
Sources: AMECO, Haver Analytics, national authorities and ECB staff aggregation of data.

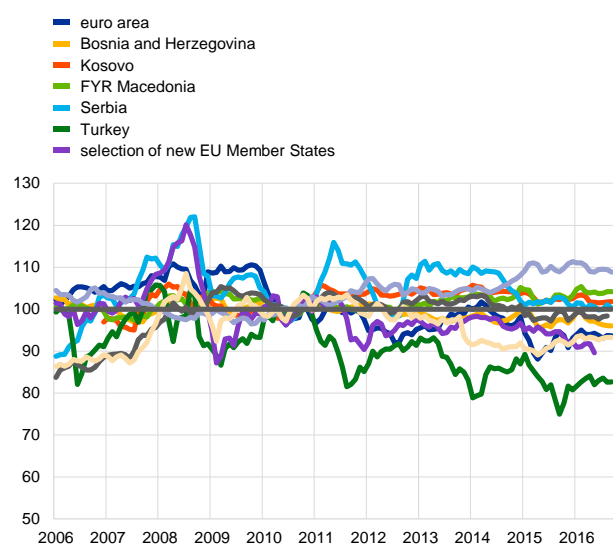
All EU CC/PCC have experienced increasing labour costs since 2010, although to different extents. Albania, Kosovo and Turkey stand out with close to double-digit nominal annual average growth rates (see **Chart 40**). Overall wage growth is, however, lower when looking at increases in real terms, bringing the total economy wage growth between 2014 and 2015 to around 9% in Kosovo, 6.5% in Albania and 6% in Turkey. Turkey's minimum wage increase of 30% in January 2016 also had an impact on overall labour costs in the country. In Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia and Montenegro, the rise in nominal wages has been tempered since the onset of the global financial crisis in late 2008 and 2009 (and has even been negative or close to zero in the first two cases). Serbia is situated somewhere between the two categories, with an average annual (nominal) wage increase of 5.7% between 2010 and 2015, and a slight decline from 2014 to 2015 for the economy as a whole.

Excessive wage rises pose a particular challenge to EU CC/PCC with a fixed exchange rate regime (or that do not have their own currency), since they can only rely on internal devaluation through price and wage adjustments to improve their competitiveness.

Several EU CC/PCC experienced depreciation in their CPI-based real effective exchange rate in 2015 (see [Chart 41](#)). Serbia and Turkey, the only two of the EU CC/PCC depicted in the chart with floating exchange rates vis-à-vis the euro and the US dollar, registered a depreciation of their currencies in the second half of 2014 (Serbia) and in 2015 (Turkey), suggesting that the flexible exchange rate mechanism absorbs or at least mitigates external shocks. This may also have impacted the increased export market shares of both countries (see [Chart 34](#) and [Chart 35](#)). Labour productivity is lower in the Western Balkans compared with EU levels (see [Chart 42](#)). Growth in labour productivity¹³ in EU CC/PCC has been low over the past decade, with the exception of Albania and Serbia. For the former, the increase largely stems from an increase in real GDP in PPP terms (which is also reflected in the strong growth in income levels in absolute terms, see [Chart 1](#)). In the case of Serbia, it is a combined effect of lower employment figures and higher real GDP in PPP terms. Still, overall growth rates in labour costs have outpaced labour productivity growth rates in most EU CC/PCC, putting a strain on competitiveness. Moreover, low levels of labour force participation (around 51% in 2014 on average for the Western Balkans) and a high degree of informal employment reinforce the notion of rigidities of the labour market (see also Section 1).

Chart 41
Real effective exchange rate

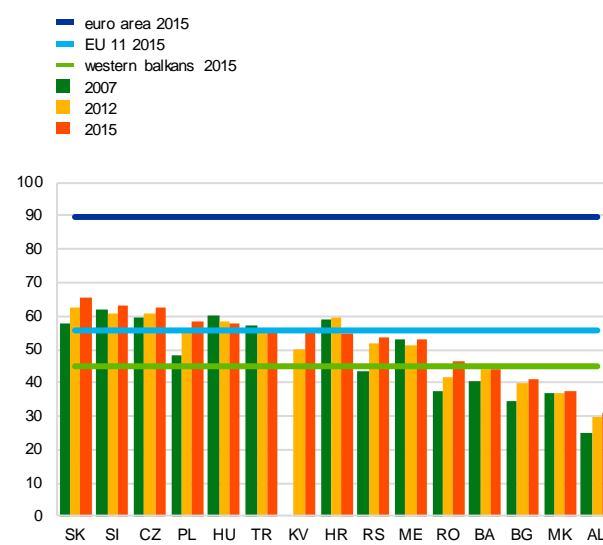
(index, average 2010=100, CPI-based)



Note: New EU Member States cover Bulgaria, Croatia, the Czech Republic and Poland.
Sources: Thomson Reuters, national central banks and ECB staff aggregation of data.

Chart 42
Labour productivity

(billions of 2011 international dollars at PPP)



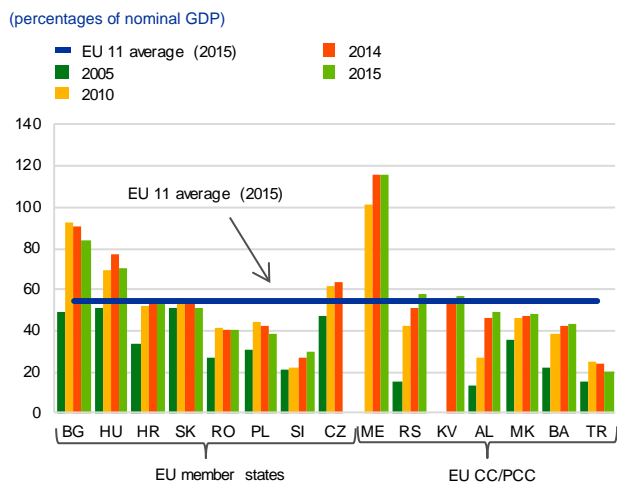
Notes: Real GDP at PPP divided by total number of persons (officially) employed. Regional aggregates are calculated using the sum of the individual countries. Employment figures come from the WEO and omit the informal sector, which may have an influence on overall labour productivity estimates. Malta is excluded from the euro area aggregate due to lack of data on employment.
Sources: Haver Analytics, IMF/WEO, national authorities, World Bank and ECB staff calculations.

¹³ Labour productivity is measured here as real GDP in PPP per person employed, which by definition omits informal employment.

5.4 Foreign direct investment

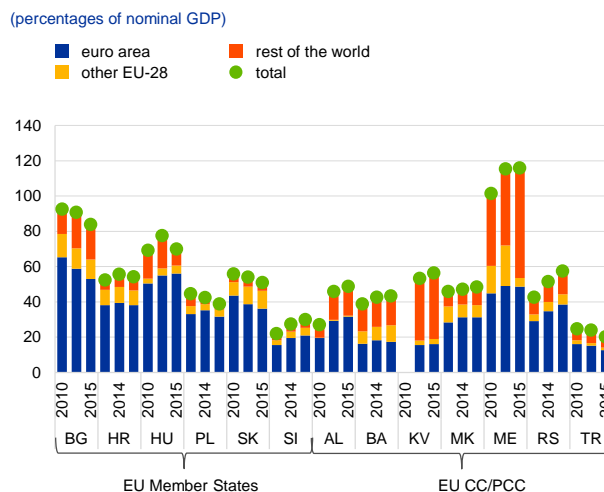
All of the EU CC/PCC have attracted considerable foreign direct investment (FDI) over the past decade. In spite of this, the influx of foreign investment tends to be lower in several EU CC/PCC than in new EU Member States (see [Chart 43](#)).

Chart 43
Inward FDI stock



Notes: Average for EU-11 based on countries with data available for 2015.
Sources: AMECO, IMF/WEO, WIIW, national authorities and ECB staff aggregation of data.

Chart 44
Share of EU-28 and euro area in total FDI stock



Notes: Regional aggregates are the sum of available countries. Missing data for certain euro area countries may influence the overall FDI stock in 2015.
Sources: AMECO, IMF/WEO, WIIW, national authorities and ECB staff aggregation of data.

Albania and Serbia are the Western Balkan countries that experienced the strongest increase over the past ten years, although both started from low levels. The EU is the main investor in the region (see [Chart 44](#)), accounting for close to 64%, on average, of all FDI in the Western Balkans in 2014 (compared with 82%, on average, for the selected EU-11 countries). Kosovo stands out with respect to the other Western Balkans, since only 34% of its FDI inward stock originates from EU Member States, with Turkey and Switzerland among other important investors.

6 Labour market and education

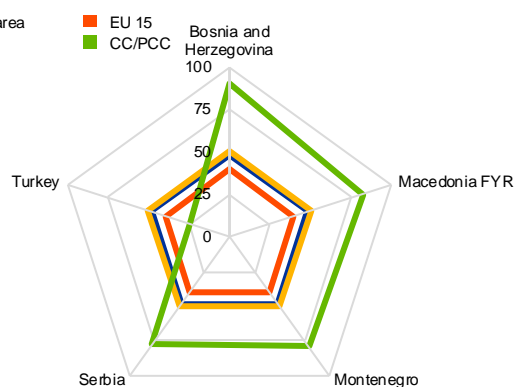
6.1 Long-term and youth unemployment

An average of 70% of the total unemployment in EU CC/PCC is classified as long-term unemployment (defined as people with continuous periods of unemployment extending for a year or longer). This figure is much higher than the one for the EU-11 (50%) and the EU-15 (less than 40%, see [Chart 45](#)). Among EU CC/PCC, Turkey is the exception with a very low long-term unemployment rate, 24.9%, and Bosnia and Herzegovina has the worst figure, 90.5%, both figures in year 2012.

Chart 45

Long-term unemployment, 2012

(percentages)

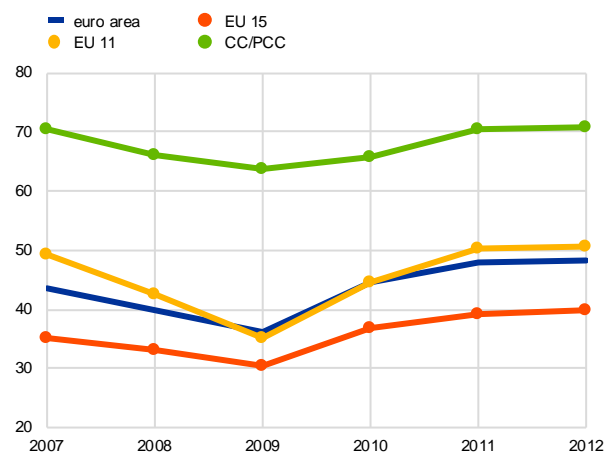


Notes: Regional aggregates are calculated as the simple average of individual country scores. Kosovo is excluded due to lack of data.
Source: World Bank Development Indicators.

Chart 46

Long-term unemployment, 2007-2012

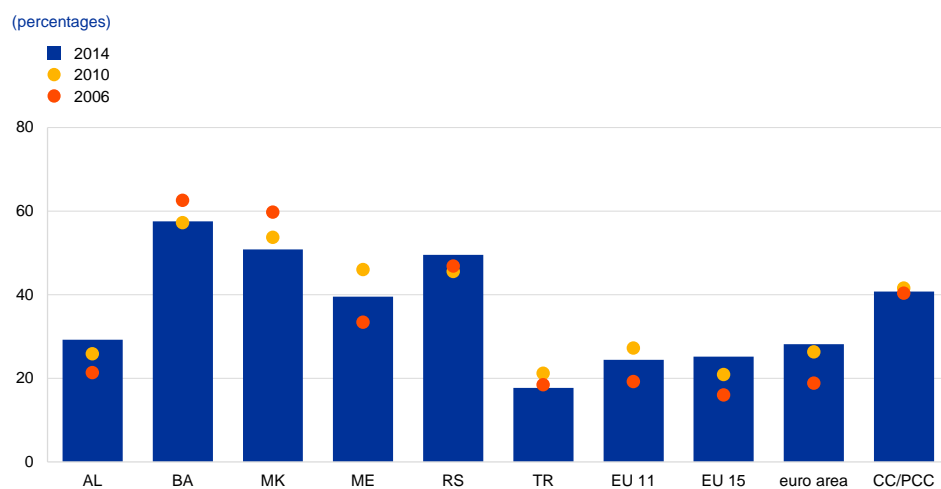
(percentages of total unemployment)



Notes: Regional aggregates are calculated as the simple average of individual country scores. Kosovo and Albania are excluded due to lack of data. Data for Montenegro only covering 2011 and 2012.
Source: World Bank Development Indicators.

When looking at youth unemployment (covering people aged between 15 and 24, see [Chart 47](#)) the situation is similar, with very high rates in EU CC/PCC relative to the EU-15 and the EU-11. In the case of Bosnia and Herzegovina, youth unemployment is about 60%, and in the former Yugoslav Republic of Macedonia and Serbia the figure is above 50%. Turkey is again the exception, with a rate of 17.7% in 2014 – even lower than many of the EU-15 countries.

Chart 47
Youth unemployment



Notes: Regional aggregates are calculated as the simple average of individual country scores. "Youth" refers to people aged between 15 and 24. Kosovo is excluded due to lack of data.
Source: World Bank Development Indicators.

6.2 Structural unemployment

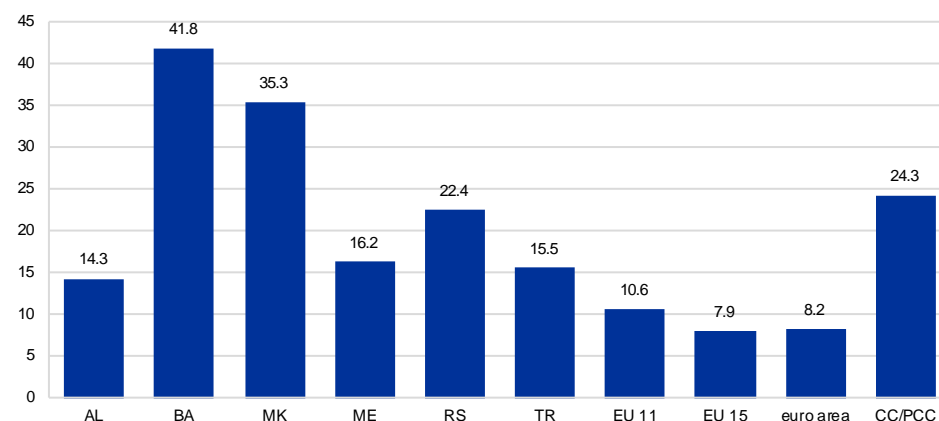
Structural unemployment is defined as a longer-lasting form of unemployment caused by inefficiencies in the economy, such as a mismatch between available jobs and employees' skills, geographical unavailability, a lack of incentives for workers to find a job, etc. One of the indicators used to measure structural unemployment is the non-accelerating inflation rate of unemployment (NAIRU), which measures how much unemployment there would be if inflation remained constant over a given period of time (that is, the amount of unemployment non-dependent on inflation).¹⁴

¹⁴ NAIRU is calculated as proposed by Ball and Mankiw (2002) and averaged for the period 2001-2015.

Chart 48

Average structural unemployment (2001-2015)

(percentages)



Notes: Regional aggregates are calculated as the simple average of individual country scores. Structural unemployment measured using NAIRU. Kosovo is excluded due to lack of data. 2015 data are estimates.

Sources: IMF World Economic Outlook, World Bank World Development Indicators and ECB staff calculations.

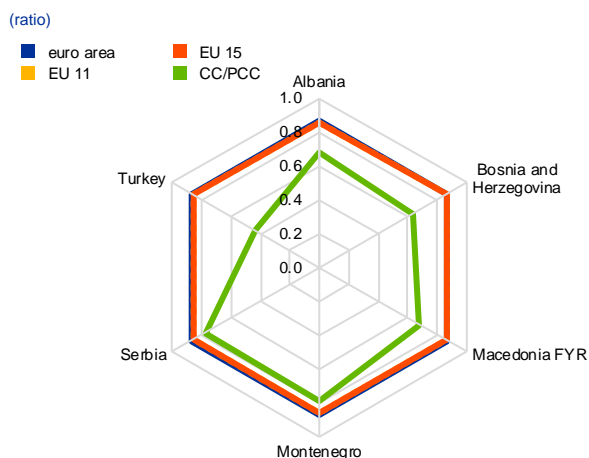
Chart 48 shows that practically all of today's unemployment in EU CC/PCC is of a structural nature (see **Chart 13** for comparison). In the EU-11 and the EU-15, the structural component represents around 80% of the unemployment rate. Bosnia and Herzegovina and the former Yugoslav Republic of Macedonia have the highest structural unemployment rates.

6.3 Female participation in the labour force

As regards indicators for female participation in the labour force, EU CC/PCC have worse scores than the ones EU Member States tend to exhibit. Turkey scores especially low in female participation in the labour force, one of the sub-indicators of labour market efficiency in the World Economic Forum Global Competitiveness Report, with a ratio in 2016 of 0.44 women to every man (**Chart 49**), and drags down the EU CC/PCC average. The other EU CC/PCC have higher ratios (the average excluding Turkey is 0.71), but are still below EU-11 and EU-15 averages, both of which are 0.86. Moreover, since 2008 this ratio has been continuously decreasing in EU CC/PCC (**Chart 50**). There are no data for Kosovo for this indicator, but based on data from the Kosovo Agency of Statistics, the ratio for Kosovo in 2013 was around 0.25 – also very low.

Chart 49

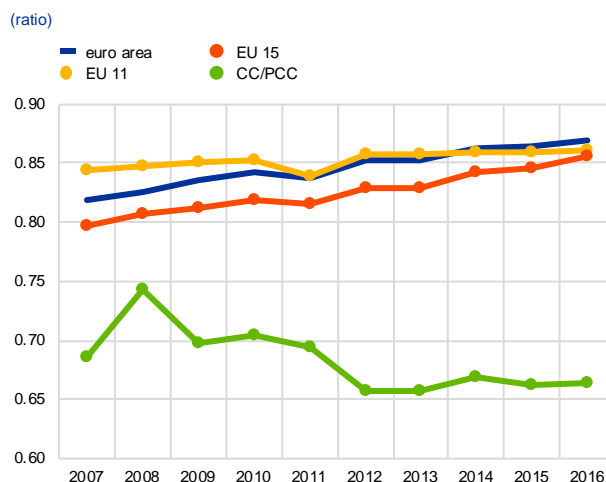
Female participation in the labour force, 2016



Notes: Regional aggregates are calculated as the simple average of individual country scores. Kosovo is excluded due to lack of data. Sources: World Economic Forum (Global Competitiveness Report) and ECB staff aggregation of data.

Chart 50

Female participation in the labour force, 2008-2016



Notes: Regional aggregates are calculated as the simple average of individual country scores. Kosovo is excluded due to lack of data. Source: World Economic Forum (Global Competitiveness Report).

6.4 Higher education and training

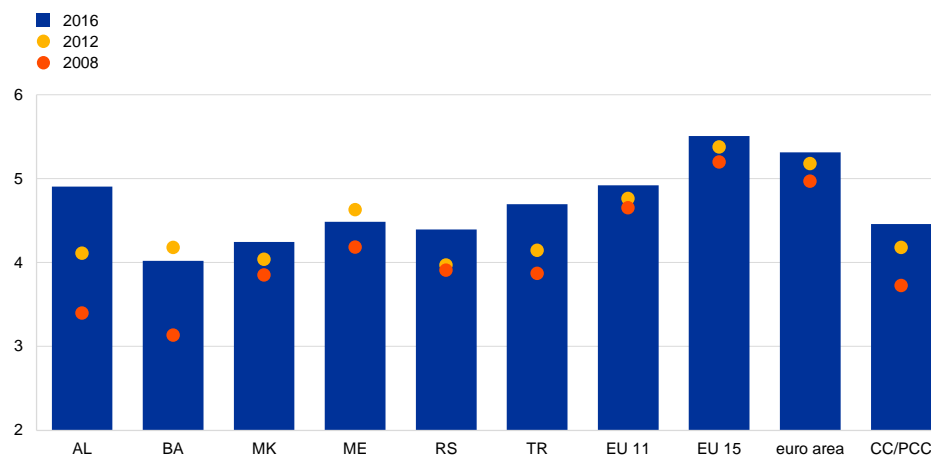
As expected, the higher education and training pillar is inversely correlated with the structural unemployment rate. On average, EU CC/PCC are still behind the EU-11 and the EU-15, despite their continuous growth.

The low score for Bosnia and Herzegovina (**Chart 51**) seems to be driven by the quality of its education system and lack of training for staff. Serbia's score is also lower than the average for the same reasons.

Chart 51

Higher education and training

(1-7, higher score indicates better performance)



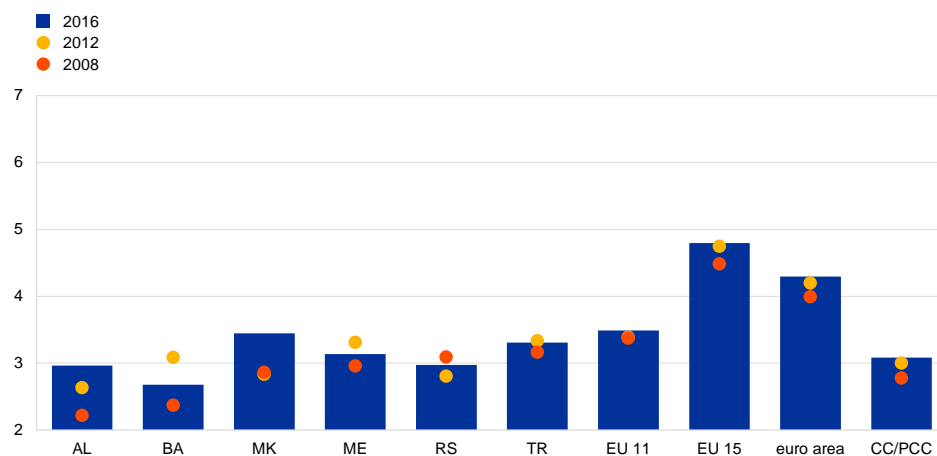
Notes: Regional aggregates are calculated as the simple average of individual country scores. Kosovo is excluded due to lack of data. Source: World Economic Forum (Global Competitiveness Report).

6.5 Innovation

In spite of having much lower average scores for innovation than older EU Member States, EU CC/PCC are relatively close to the scores new EU countries tend to exhibit. The best-performing countries are the former Yugoslav Republic of Macedonia (with a big improvement over the last four years), Turkey and Montenegro. Albania and Bosnia and Herzegovina have the lowest scores. The main issues in Albania are the quality of research and the lack of university-industry collaboration; for Bosnia and Herzegovina the problems are a lack of capacity for innovation and low government procurement of advanced products.

Chart 52
Innovation

(1-7, higher score indicates better performance)



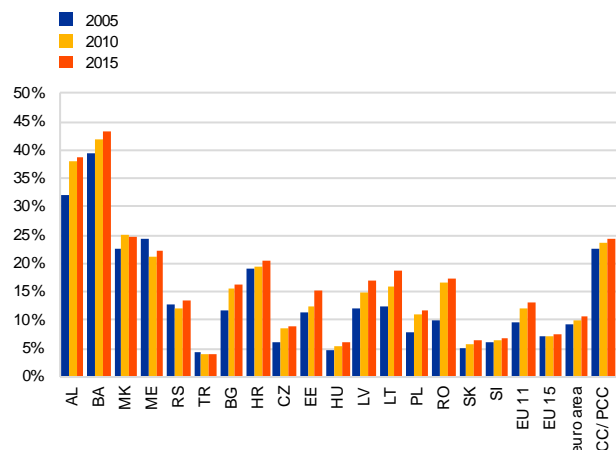
Notes: Regional aggregates are calculated as the simple average of individual country scores. Kosovo is excluded due to lack of data.
Source: World Economic Forum (Global Competitiveness Report).

6.6 Diaspora and personal remittances

In order to complement labour market information in EU CC/PCC, it is interesting to analyse the diaspora of nationals living abroad and the remittances they send back to their countries of origin (see [Chart 53](#) and [Chart 54](#)). With the exception of Turkey, both diaspora (as a percentage of the country population) and personal remittances (as a percentage of the country GDP) are generally higher in EU CC/PCC than in the EU-11 countries. Nevertheless, large intra-group disparities exist in the latter group. For example, countries such as the Czech Republic and Slovenia have levels of emigration and personal remittances below the group averages, whereas other countries, such as Lithuania, Latvia and Croatia, are at the other end of the spectrum. The data for the EU-15 countries show that, on average, this group of countries tends to have less emigration and a lower amount of personal remittances than the other two groups.

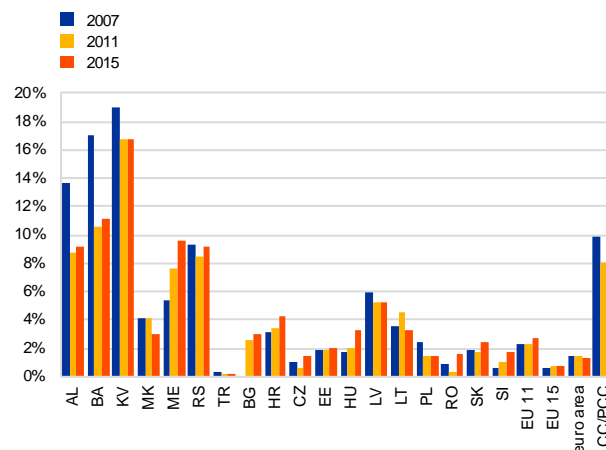
Chart 53
Diaspora

(percentages of the country population)



Note: No data for Bulgaria in 2007.
Source: World Bank.

Chart 54
Remittances



Sources: United Nations Global Migration Database and World Bank.
Note: Kosovo not included due to lack of data.

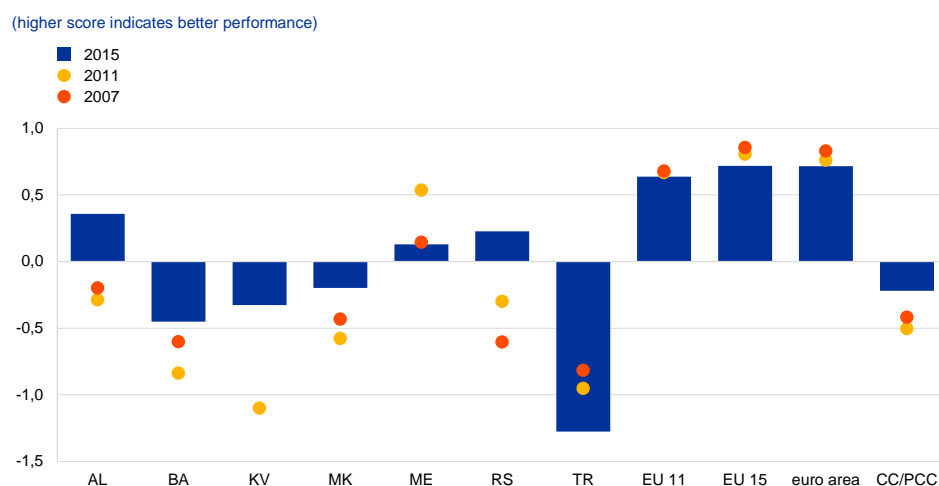
Taking a look at the EU CC/PCC, two groups can be identified. The first one includes Albania, Bosnia and Herzegovina and Kosovo, with a very large diaspora (around 40% relative to population in 2015) and high amounts of personal remittances relative to GDP (over 10% in 2007 for the three countries). There are no diaspora data for Kosovo, although in 2012 it was estimated by the International Organization for Migration to be around 47% of the country population. The second group includes the former Yugoslav Republic of Macedonia, Montenegro and Serbia, which have levels of emigration lower than the first group but above the EU-11 average, and remittances ranging from 3% to 10% over the last few years. As mentioned before, Turkey would be an exception in both groups, with very low numbers for these indicators. For the first group, the remittances as a percentage of GDP reduced significantly in 2015 compared to 2007. For Albania and Bosnia and Herzegovina, this was due to a decrease in the value of the personal remittances. In Kosovo the remittances did not decrease, but they grew at a slower pace than GDP.

7 Governance

7.1 Political stability

While the average political stability score for EU Member States has been more or less stable over the past few years, EU CC/PCC's performance has fluctuated, experiencing a decrease after 2008 and slowly improving again from 2011 onwards, though still far from EU levels (**Chart 55**). On average, the EU-11's score is behind, but close to, that of the EU-15. Turkey, which has seen a decreasing trend since 2007, has the lowest score, followed by Bosnia and Herzegovina and Kosovo (which had the lowest in 2011 but has improved since). However, the level of political stability is higher in Albania, although still relatively low compared to EU Member States.

Chart 55
Political stability



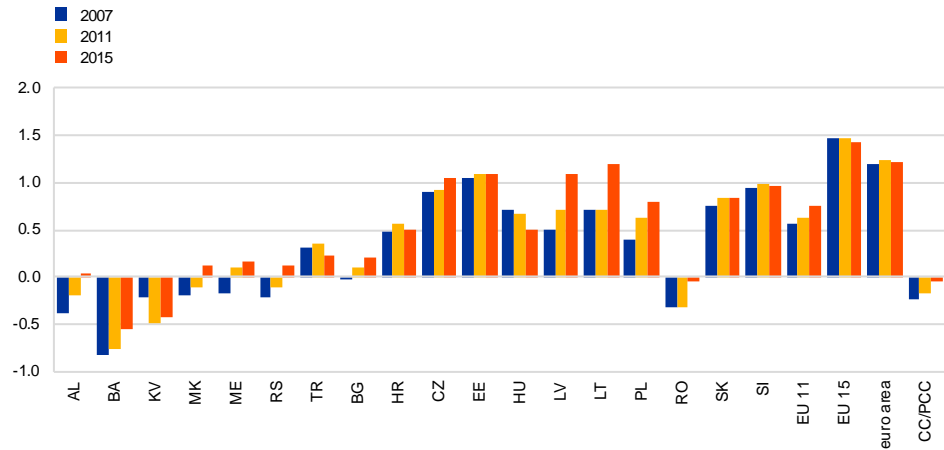
Notes: Regional aggregates are calculated as the simple average of individual country scores. No data for Kosovo in 2007.
Source: World Bank Worldwide Governance Indicators.

7.2 Government effectiveness

Chart 56 highlights how the scores in government effectiveness for EU CC/PCC are generally far from the EU-11's performance (with the exception of Romania and Bulgaria), and further still from EU-15 averages. Turkey is the best-performing EU CC/PCC in this indicator, while Kosovo and Bosnia and Herzegovina have the worst scores. However, almost all EU CC/PCC have improved their scores in the past years.

Chart 56
Government effectiveness

(higher score indicates better performance)



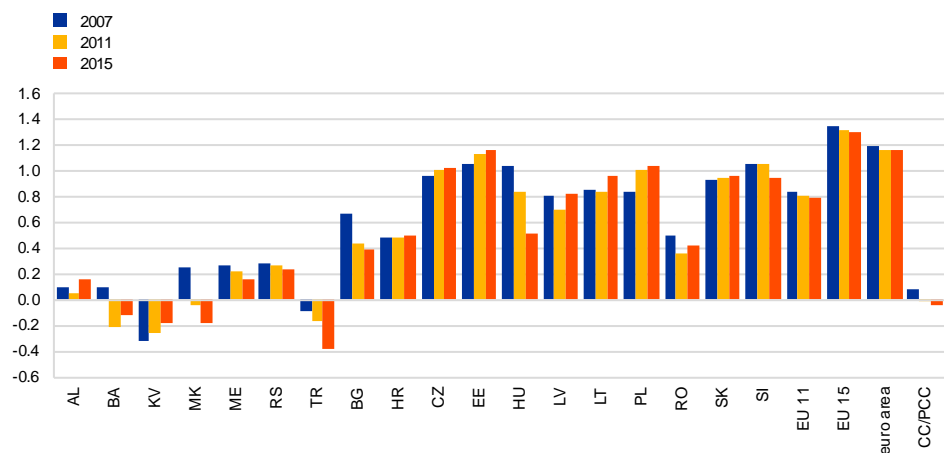
Note: Regional aggregates are calculated as the simple average of individual country scores.
Source: World Bank Worldwide Governance Indicators.

7.3 Voice and accountability

EU CC/PCC perform worse than the EU-11 and far worse than the EU-15 in terms of voice and accountability. There is, however, a noticeable difference between Bulgaria, Romania and Croatia and the rest of the EU-11 countries (with the possible exception of Hungary in 2015). Turkey, which has seen a downwards trend, is the country with the lowest score, followed by Kosovo and Bosnia and Herzegovina.

Chart 57
Voice and accountability

(higher score indicates better performance)



Note: Regional aggregates are calculated as the simple average of individual country scores.
Source: World Bank Worldwide Governance Indicators.

7.4 General government final consumption expenditure

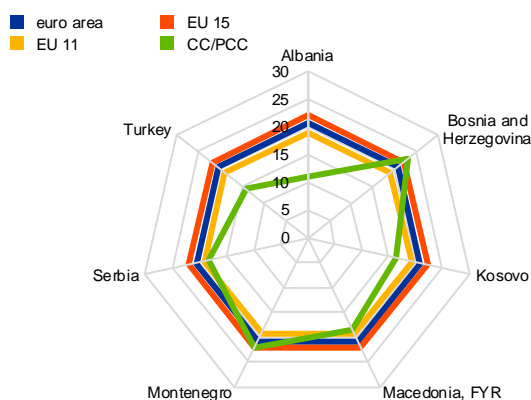
Chart 58 illustrates how, on average, EU CC/PCC devote less funds to general government final consumption expenditure as a percentage of GDP than EU Member States. All three averages (EU CC/PCC, EU-11 and EU-15) have remained more or less stable during the last few years.

Bosnia and Herzegovina is the country with the highest general government final consumption expenditure (22.5% in 2014, see **Chart 59**); higher than the EU-15 average. Albania, on the other hand, is the country with the lowest expenditure, only 11.2%, followed by Turkey with 15.3%. Kosovo, the former Yugoslav Republic of Macedonia and Serbia have similar levels of expenditure to the EU-11.

Chart 58

General government final consumption expenditure, 2010

(percentages of GDP)

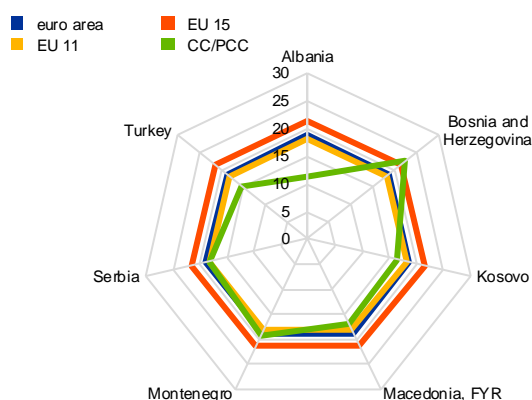


Note: Regional aggregates are calculated as the simple average of individual country scores.
Source: World Bank.

Chart 59

General government final consumption expenditure, 2014

(percentages of GDP)



Note: Regional aggregates are calculated as the simple average of individual country scores.
Source: World Bank.

Here, general government final consumption expenditure is used as a proxy for the size of the government and as a structural indicator that provides an interesting benchmark for EU CC/PCC against EU Member States regarding government expenditure. However, conclusions must be drawn carefully from this indicator. A higher final consumption expenditure figure does not necessarily mean better institutional quality (there may even be a threshold beyond which higher government consumption could actually mean the opposite), and other factors such as country revenues, demography, etc. should also be taken into account.

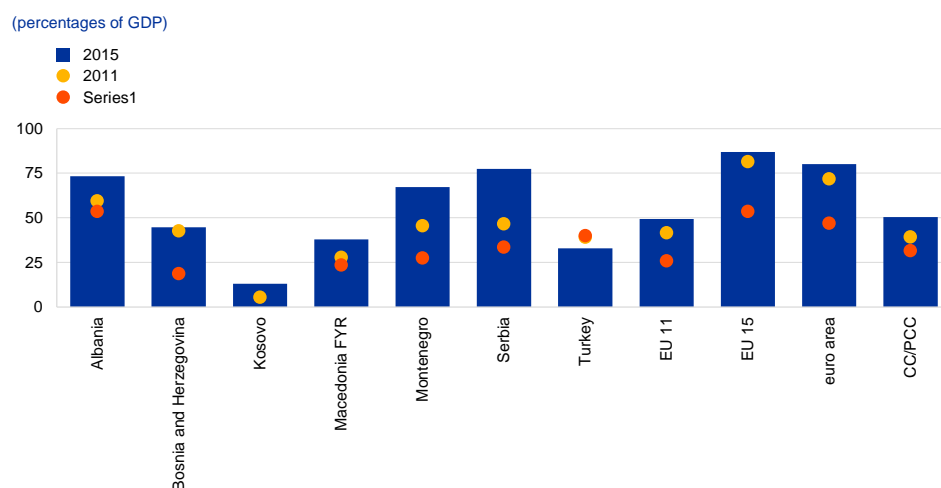
7.5 Public finances

Another relevant area when looking into institutional governance is public finances. Sound public finances are not only an indicator of economic stability; they are also part of the convergence criteria for the Economic and Monetary Union, and therefore

important for EU CC/PCC. EU Member States have been deeply impacted by the financial crisis of 2008 and the debt crises of 2009; as a consequence, their public finances have weakened substantially in recent years. For this reason, we find it more useful to look at intragroup scores when drawing conclusions from these indicators. Notwithstanding this fact, for informative purposes we also provide a description of how each group of countries fares when compared to the others.

When looking at the general government gross debt for the groups of countries analysed (**Chart 60**), it is easy to identify a progressive increase in its average value from 2007 to 2015. The EU CC/PCC and the EU-11 were at a similar level in 2015, with average gross debt to GDP of around 50%. However, the EU-11 countries saw a steeper increase as the group had an average value of around 25% in 2007 (compared to 31% for EU CC/PCC in the same year). The EU-15 countries' average gross debt to GDP is substantially higher (close to 87%), and since 2007 (when it was around 53%) it has also sharply increased.

Chart 60
General government gross debt



Notes: Regional aggregates are calculated as the simple average of individual country scores. No data for Kosovo in 2007.
Source: IMF World Economic Outlook.

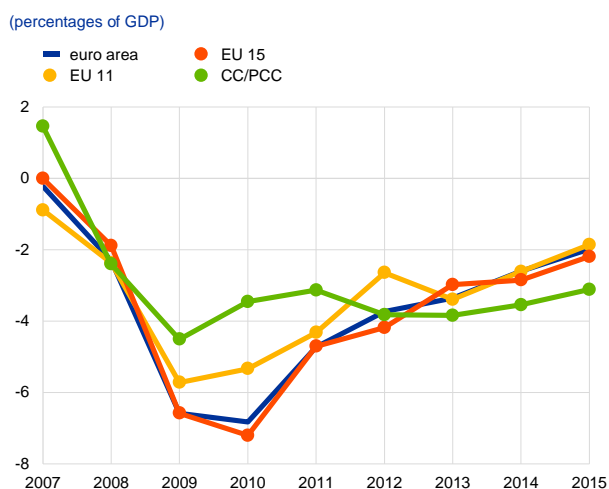
At country level large intra-group disparities are found in EU CC/PCC. On the one hand, countries such as Kosovo (the country with the lowest gross debt to GDP, lower than 20% in 2015), Turkey, Bosnia and Herzegovina and the former Yugoslav Republic of Macedonia keep their gross debt values below 50%, while on the other hand Serbia, Albania and Montenegro have higher levels of gross debt to GDP, ranging from 67% to 80%, close to the EU-15 average.

Chart 61 shows how the picture is somewhat different when it comes to general government deficit/surplus (measured as the general government net borrowing/lending). On average, EU CC/PCC had a surplus of around 1.5% in 2007, while the EU-15 and the EU-11 showed average deficits relatively close to zero (0.5% and 1.77% respectively). However, all groups' general government deficit/surplus was hit considerably during the financial crisis of 2008 and 2009 (even 2010 for the EU-15). Then, each of the groups began to recover at different rates. By

2015 EU CC/PCC, despite being the group of countries least affected by the crisis, showed the highest deficit figures on average (3.12%), whereas the EU-15 countries recovered from a deficit average of 7.2% in 2010 to 2.2% in 2015. The EU-11 countries returned, on average, to levels close to those of 2007, with a deficit of 1.86%.

Chart 61

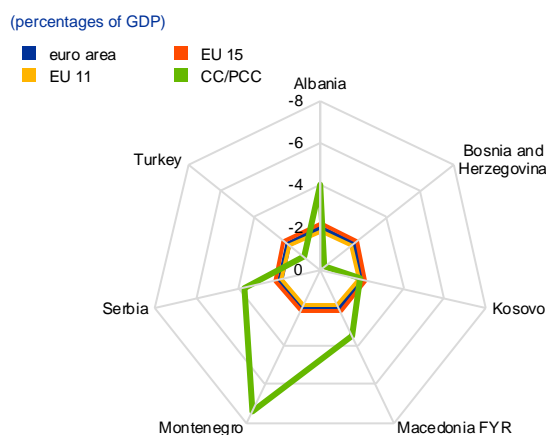
Net borrowing/lending, 2007-2015



Note: Regional aggregates are calculated as the simple average of individual country scores.
Source: IMF World Economic Outlook

Chart 62

Net borrowing/lending, 2015



Note: Regional aggregates are calculated as the simple average of individual country scores.
Source: IMF World Economic Outlook

Chart 62 shows that Montenegro is the country driving down the EU CC/PCC average, with a general government deficit of 7.5%. Other EU CC/PCC, such as Serbia, Albania and the former Yugoslav Republic of Macedonia, show figures close to 4%. Finally, Turkey and Bosnia and Herzegovina have the lowest general government deficits (1% and 0.2% respectively), well below EU-11 and EU-15 averages.

7.6 Large and small-scale privatisation

The scores for EU CC/PCC are close to the new EU Member States' average in terms of large-scale privatisation,¹⁵ except for Serbia and Kosovo. The EU-11 countries' average is 3.74; Montenegro, Albania, Turkey and the former Yugoslav Republic of Macedonia score between 3 and 4; Bosnia and Herzegovina 3; Serbia 2.67; and Kosovo 1.67 (see **Chart 63**).

The case of small-scale privatisation is similar, with all EU CC/PCC close to the new EU Member States' average, in this case with the exception of Bosnia and Herzegovina and Kosovo. **Chart 64** shows that EU CC/PCC score between 3 and 4+ ("+" rating is treated by adding 0.33 to the full value), and the EU-11 average is 4.22.

¹⁵ For further explanations on the EBRD transition indicators for privatisation and the meaning of the scores, see Section 10.4 of the Appendix.

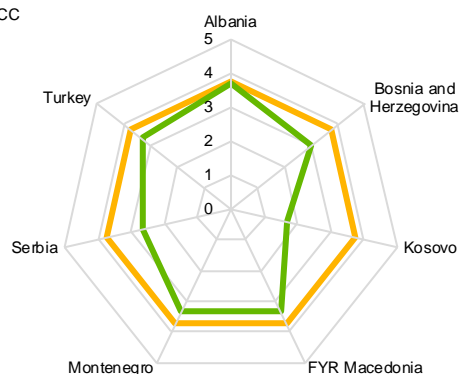
Kosovo (3.33) and Bosnia and Herzegovina (3) have the lowest scores. Similar to the previous indicator, the amount of public companies that should be privatised and how this amount relates to the structural and institutional situation of the country is a matter of debate. However, large and small-scale privatisation is among the transitional indicators used by the European Bank for Reconstruction and Development (EBRD) to measure structural policies undertaken by transition economies. The progress in this field is in line with the Copenhagen criterion of being a functioning market economy and, more specifically, having a free interplay of market forces (including liberalised prices and trade). For the purposes of this paper, comparisons with new EU Member States can be a useful indicator of the structural situation of EU CC/PCC in terms of having a functioning market economy.

Chart 63

Large-scale privatisation, 2014

(higher score indicates more privatisations)

■ EU 11
■ CC/PCC



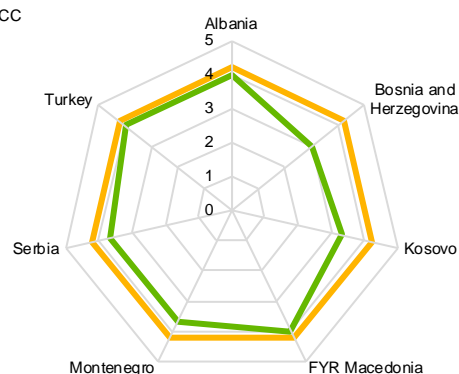
Note: Regional aggregates are calculated as the simple average of individual country scores.
Source: EBRD transition indicators.

Chart 64

Small-scale privatisation, 2014

(higher score indicates more privatisations)

■ EU 11
■ CC/PCC



Note: Regional aggregates are calculated as the simple average of individual country scores.
Source: EBRD transition indicators.

Box 3

Central bank governance and banking supervision

Central bank independence and transparency

It is not straightforward to find official data about central bank transparency and independence, especially for EU CC/PCC, although several models have been proposed by different authors. The data on central bank independence in this box are taken from Dincer and Eichengreen's (2013) dataset, following a similar approach to the one taken by Crowe and Meade (2008), and include data until 2010. The data for central bank transparency come from an update of the same dataset in 2015 and include data until 2014.

Central bank independence is measured following the approach taken by Cukierman, Webb and Neyapti (1992), while adding some additional criteria to create an index that goes from 0 to 1. The index includes elements such as the independence of the governor, the independence of policy formulation, limits on lending to the public sector and the appointment of board members. The data

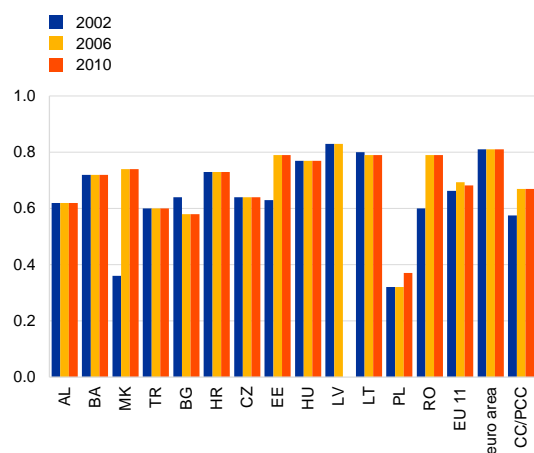
are fairly static and no large changes can be seen in the last 10 years. The central bank transparency measure is survey based.

Not all of the countries are represented in the available data. For example, the data on central bank independence for EU CC/PCC only represent Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia and Turkey, while for the EU-11, Slovakia and Slovenia are missing.

Chart D shows that Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia and Turkey exhibit central bank independence scores close to, but below, the ones of the non-euro area EU-11 countries in 2010. One reason for that is that Poland's score drags down the average of those countries. The former Yugoslav Republic of Macedonia and Bosnia and Herzegovina are the countries with the strongest scores. The European Central Bank scores 0.8, while Poland and the United Kingdom are the European countries with the lowest scores (0.37 and 0.23 respectively).

Chart D
Central bank independence

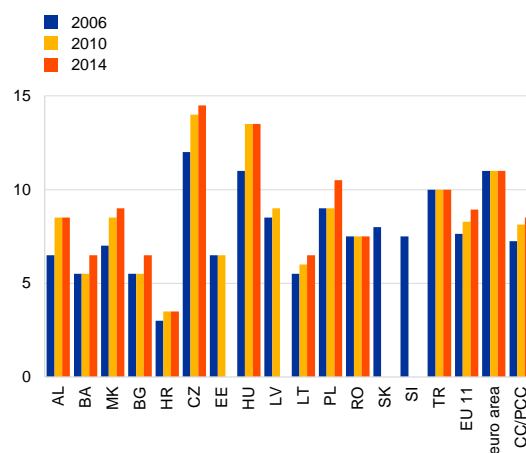
(higher score indicates better performance)



Notes: Regional aggregates are calculated as the simple average of individual country scores. Data available only for the countries in the chart. Source: Dincer and Eichengreen (2013).

Chart E
Central bank transparency

(higher score indicates better performance)



Notes: Regional aggregates are calculated as the simple average of individual country scores. Data available only for the countries in the chart. Source: Dincer and Eichengreen (2015).

Regarding transparency, **Chart E** shows that Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia and Turkey are again close to the non-euro area EU-11 average, although large inter-country disparities exist within the regional aggregates. While the Czech Republic and Hungary score close to 15, Croatia, Bulgaria and the Baltic countries score less than 7. Turkey has the highest score within the EU CC/PCC group, followed by the former Yugoslav Republic of Macedonia and Albania. Bosnia and Herzegovina has the worst score (6.5).

Bank regulation and supervision

Čihák et al. (2012) present five main findings when comparing what they define as “crisis” vs “non-crisis” countries (all EU CC/PCC for which data are available, i.e. Bosnia and Herzegovina, Kosovo, Montenegro, Serbia and Turkey, are included in the non-crisis group). This box summarises each of those pillars from the EU CC/PCC’s perspective, compared to the EU-11, the EU-15 and euro area countries. No data was available for the Czech Republic and Sweden, and Cyprus and Malta were excluded from the analysis. See appendix 10.4 for more detailed information on the topic.

1. Capital regime and actual capital levels: EU CC/PCC have more stringent definitions of capital, less discretion in how banks calculate capital requirements and exhibit a higher capital ratio. Serbia was the only EU CC/PCC to allow capital injections with assets other than cash or government securities. The EU-11 countries have tighter restrictions than the EU-15.
 2. Restrictions on bank activities: EU CC/PCC face more restrictions than the EU-11 and the EU-15 countries when engaging in non-bank activities such as insurance, investment banking or real estate.
 3. Asset classification mechanism: EU CC/PCC have more non-performing loans and provisioning requirements in place and are stricter when dealing with bad loans and loan losses. For example, among the EU CC/PCC analysed in 2011, Montenegro was the only country that allowed banks to upgrade the classification of a loan immediately after it had been restructured, while that was the case for 43% of the EU-15 countries.
 4. Supervisory powers in cases of bank losses: regulators in EU CC/PCC were more able to demand that banks increase equity, constitute greater provisions or suspend bonus and management fee cases (100% of the countries analysed, compared with an average of 83% in the EU-11, 64% in the EU-15 and 71% in the euro area).
 5. Information for markets to monitor banks: EU CC/PCC had weaker disclosure requirements. Almost all EU countries were required to disclose capital ratios, transactions with related parties and the scope of consolidation, while Bosnia and Herzegovina and Montenegro do not have any such requirements. According to the survey, Bosnia and Herzegovina is the only country among the ones analysed that does not require banks to prepare consolidated accounts for accounting purposes.
-

8 Conclusions

This paper provides an overview of current institutional and structural challenges in EU CC/PCC, compared with the benchmark set by average levels in the EU. For successful EU accession, EU CC/PCC need to fulfil, ahead of time, the Copenhagen political and economic criteria, requiring the safeguard of democracy, the rule of law and human rights, but also the existence of a functioning market economy, as well as the capacity to cope with competitive pressure from other Member States. Moreover, in countries with de facto fixed exchange rate regimes or that lack their own currency (which is the case for four of the seven EU CC/PCC), sound structural reforms appear particularly important. Starting from the assumption that sound institutions and economic structures allow for a stronger and more sustainable growth path, we consider six policy areas (doing business, access to finance, judicial system, trade and competitiveness, labour market and governance) with the aim of depicting the relative strengths, as well as the main weakness, of EU CC/PCC as an aggregate compared with the EU, as well as with each other.

We find that, despite some progress since the mid-2000s, EU CC/PCC still perform below EU averages in many respects. Weaknesses in the business and institutional environments are having an impact on economic growth and competitiveness, with income gains further below the EU-28 average than most new EU Member States. Control of corruption, the rule of law and regulatory quality tend to be considerably lower than in EU peer countries, with only Bulgaria and Romania displaying scores close to those of the Western Balkans. Impediments to collateral execution and weak property rights systems lead banks to compensate by requiring more collateral and higher interest rates for lending, which in turn limits (in particular domestically owned) small and medium-sized firms' access to finance, reducing them to reliance on retained earnings and possibly also hampering their capacity to expand their business activity. Competitiveness is low in EU CC/PCC compared with EU Member States; labour productivity is lower than in most EU countries and appears to have been outpaced by growth in wages in several EU CC/PCC. Other non-price barriers, such as relatively high administrative costs for exporting or market concentration, also tend to weigh on the external competitiveness of EU CC/PCC. Unemployment is high in the Western Balkans, even when compared with new EU Member States, affecting almost one third of the (official) labour force in some countries. The high unemployment rates have a strong structural component, partially due to a skill-mismatch in the labour market. It remains crucial for EU CC/PCC not to let the reform momentum slow down, even more so given that several IMF programmes currently running in the Western Balkans will come to an end in the near future. Further structural reforms will not only allow for more balanced and sustainable economic growth models – and consequently continuous increases in income levels – but also enhanced resilience to future adverse shocks and a more sustainable convergence process towards EU standards.

Appendix

Country summaries

Albania

Albania is the country with the lowest performance among the Western Balkans in the 2016-2017 vintage of the ease of doing business report. It is worth noting however that the country's ranking jumped from 90th in 2015-2016 to the 58th in 2016-2017 (with 1 being the best performer). This was largely due to reforms made in dealing with construction permits. Albania also has the worst score in enforcing contracts and the second worst score in control of corruption (after Kosovo), and it has a mid-range score (compared to EU CC/PCC) in paying taxes and in regulatory quality. On the other hand, it is close to EU-11 averages as regards resolving insolvency.

The degree of financial intermediation in Albania is low, even compared with other EU CC/PCC. Together with Kosovo, Albania is perceived to be the Western Balkan country where it is the most difficult to get a bank loan, and close to 91% of all loans to companies required collateral in 2013 (82% in the case of foreign-owned firms). The amount of collateral required for borrowing has risen sharply over the past four years, and reached (on average) 250% of the value of the loan in 2013 (although the size and location of the firm have a large impact on the outcome). The absence of a domestic stock exchange reflects how difficult it is for firms to refinance themselves on local capital markets, and almost 81% of new investments in 2013 were financed internally.

Albania is the country in the Western Balkans (together with Kosovo) where confidence in the rule of law is the lowest. In addition, the likelihood of bribery incidents for firms (particularly to secure a government contract, a construction permit or a favourable judicial decision) appears greater than in many other Western Balkan countries.

Turning to governance, Albania is close to or slightly above the average of EU CC/PCC in government effectiveness, as well as voice and accountability, and it has the highest score among EU CC/PCC in political stability. Albania's general government gross debt (close to 73% in 2015) is higher than the EU CC/PCC average.

Despite starting from low levels and having experienced a considerable increase over the past seven to eight years, inward FDI stock in Albania remains rather low (close to 49% of GDP). Labour productivity (real GDP per person employed adjusted for PPP) is the lowest among EU CC/PCC and has remained virtually flat since 2010 (with a few minor inter-year changes). This contrasts with the strong (nominal) wage increases during the same period, in particular in the industrial

sector, mining (although the trend seemed to turn with an annual wage decrease in 2015), manufacturing and services.

For labour market and education, Albania's situation is in line with other EU CC/PCC as a result of its mid-range scores in the analysed indicators and its unemployment rate (17.1% in 2015), which was the second lowest after Turkey. Albania has one of the highest diasporas as percentage of the country's population when compared with the rest of EU CC/PCC.

Bosnia and Herzegovina

Bosnia and Herzegovina's ease of doing business ranking is the worst among EU CC/PCC. The country's performance is particularly poor in starting a business, paying taxes, dealing with construction permits and getting electricity.

Concerning labour market and education, Bosnia and Herzegovina has the lowest score in labour market efficiency (next to Turkey), one of the highest unemployment rates (43.2% in 2015, of which a considerable proportion is long-term) and low scores in higher education and training, as well as in innovation. Youth unemployment is also high, at 57.5% in 2015. Bosnia and Herzegovina's diaspora is the highest among EU CC/PCC for the countries where data is available (i.e. all EU CC/PCC except Kosovo).

Financial intermediation remains low, but is close to EU CC/PCC averages. Only 50% of adults have a bank account, only 25% saved any money in 2014 (although this was up from 15% three years earlier) and close to 82% of all loans to corporates require collateral amounting to about 190% of the value of the loan (large disparities exist, depending on the location and the size of the firm). Accessing a loan is perceived by firms to have become more difficult since 2010, although there seems to have been a considerable easing in access to finance in 2016. About 24% of firms financed their investments through banks in 2013, a relatively high share compared with the other Western Balkans (see Chart 8).

Political instability and corruption are perceived to be among the main obstacles to business activity in Bosnia and Herzegovina. It is also the Western Balkan country with the highest costs imposed on business by organised crime.

Bosnia and Herzegovina has the lowest Global Competitiveness Index ranking among the Western Balkans, a less developed transport infrastructure network than the other EU CC/PCC and a stubbornly low inward FDI stock of around 44% of GDP, with little change since 2011.

Concerning institutional governance, Bosnia and Herzegovina is lagging behind most of its neighbours, although it is not the worst performing country among the Western Balkans. Its score is especially low in government effectiveness and small-scale privatisation, and generally mid-range in the other indicators. As regards bank supervision, Bosnia and Herzegovina seems to have loose public disclosure

requirements. It also scores below the EU CC/PCC average in central bank transparency.

Kosovo

Kosovo has improved its business environment in recent years. Its ease of doing business ranking is in line with the EU CC/PCC average, and it has good results in registering property, paying taxes, as well as mid-range results in enforcing contracts. On the other hand, Kosovo has poor scores in control of corruption and, in particular, resolving insolvency, due to its lack of insolvency procedures. The country's low score in controlling corruption is reflected in the 2016 Corruption Perceptions Index (published by Transparency International), in which Kosovo scores the worst among all prospective Member States, although there was a slight improvement compared with 2015. In addition, close to 50% of the 202 private sector firms in Kosovo surveyed by the World Bank in 2013 identified corruption as a major constraint on business, and 39% of the surveyed firms expect to give gifts to secure government contracts. Kosovo also has the worst score among the Western Balkans for rule of law.

Financial intermediation in Kosovo is low, even compared with levels in other EU CC/PCC. Close to 92% of all loans to companies require collateral (up to 100% for certain regions, according to the 2013 World Bank Enterprise Surveys). The amount of collateral required for borrowing has risen considerably over the past four years, and reached (on average) 300% of the value of the loan in 2013 (although the size and location of the firm seem to play a major role in firms' access to finance). The Kosovo Credit Guarantee Fund (which entered into force in December 2015) targets micro, small and medium-sized enterprises (SMEs) that are having difficulties accessing finance due to a lack of appropriate collateral. The aim of the initiative is to ease the access to finance of SMEs by reducing the amount of collateral required for borrowing. Regulatory reforms implemented in 2015 and in 2016, together with the introduction of bailiffs in 2013, appear to have led to a slight reduction in banks' risk perception premium and hence in borrowing costs for smaller loans with shorter maturities. Bank funding for investing remains low, with close to 70% of new investments in 2013 financed internally.

After Turkey, Kosovo has the lowest level of trade openness in central, eastern and south-eastern European countries, which is largely attributable to its narrow export base and overall low export performance. In addition, exports from Kosovo seem to be subject to lengthy and costly administrative procedures, also with respect to other EU CC/PCC.

Unfortunately, Kosovo is omitted from many databases and surveys, which limits the overall assessment of its business environment (notably labour market efficiency). Its unemployment rates are among the highest in the region, reaching 32.9% in 2015, with youth unemployment of 57.7%, according to the National Labour Force Survey. There is not data regarding the country's diaspora in the United Nations Global

Migration Database, but regarding remittances, Kosovo has the largest amount as percentage of GDP when compared with the other EUCC/PCC.

Kosovo is one of the worst performers among EU CC/PCC as regards institutional governance. It has low scores in political stability and government effectiveness, small-scale privatisation and voice and accountability. However, regarding public finances, Kosovo has the lowest general government gross debt when among EU CC/PCC (close to 13% in 2015 according to the national Ministry of Finance). Turning to bank supervision, Kosovo is the exception among EU CC/PCC and the EU-11, with a broader enforcement and resolution legal framework than the EU-15 and euro area countries.

The former Yugoslav Republic of Macedonia

The former Yugoslav Republic of Macedonia has one of the highest scores in the ease of doing business rankings, not only among EU CC/PCC but also compared with the EU-11 and to a certain extent the EU-15. According to the ranking, it is among the best performers worldwide in paying taxes (with a DTF of over 90), and is consistently among the best EU CC/PCC in all of the other ease of doing business indicators.

The amount of collateral required from firms for borrowing is among the highest in the Western Balkans (close to 276% of the value of the loan in 2013, compared with 176% in 2009).

Trade openness in the former Yugoslav Republic of Macedonia is the highest among EU CC/PCC (close to 113% of GDP in 2015), with imports worth around 65% of GDP. It is considered the most competitive country among the Western Balkans by the World Economic Forum, and its world (as well as euro area) merchandise export market share has been growing since 2013.

Labour productivity, however, (measured as real GDP at PPP per person employed) remains a concern. Together with that of Albania, it is the lowest in the region and has been virtually flat over the past decade.

The country performs well in labour market and education metrics. In spite of high unemployment figures (26% in 2015, down from 28% in 2014), notably its high long-term and youth unemployment rates, the former Yugoslav Republic of Macedonia is the best performer among EU CC/PCC in technological innovation, according to the Global Competitiveness Report 2016-2017. Despite a ratio of the diaspora to total population close to the EU CC/PCC average, remittances as a percentage of GDP are lower in the former Yugoslav Republic of Macedonia than in the neighbouring countries,

Turning to institutional governance, the former Yugoslav Republic of Macedonia is in a good position, generally above the EU CC/PCC average. It has the second highest scores in government effectiveness among the EU CC/PCC and central bank

independence. Nevertheless, it has a low score in voice and accountability, also following recent period's political turmoil.

Montenegro

Montenegro is the third best performer among EU CC/PCC in the 2016-2017 ease of doing business ranking. The country's scores are consistently aligned with or above the EU CC/PCC average in most of the analysed ease of doing business indicators and specially in resolving insolvency, where its score is actually above the EU-11 average. The only exception is getting electricity, where it has the lowest score among EU CC/PCC.

Montenegro has experienced a noticeable drop in its world export market share (both from a goods only and from a goods and services point of view) since 2008, possibly due in part to non-price barriers for exports (including high border and documentary compliance costs). However, the country has been successful in attracting foreign direct investment, with an inward FDI stock of 115% of GDP in 2015 (the highest among EU CC/PCC), with the EU-28 accounting for close to 55% of all FDI in 2015 (based on available country-specific data, see [Chart 43](#) and [Chart 44](#)).

The country's performance is slightly above the average for EU CC/PCC when it comes to labour market and education. Montenegro has the highest score for labour market efficiency, has scores close to (but above) the average in higher education, training and innovation, and had an unemployment rate of around 17.6% in 2015 (down from 18% in 2014).

Montenegro also performs above the EU CC/PCC average in institutional governance in 2015. It has the second-best score in government effectiveness among the seven countries, the highest in control of corruption, and is in line with EU CC/PCC averages in large and small-scale privatisation.

This being said, costs related to organised crime have increased for businesses over the past five years and judicial independence is perceived by firms to be deteriorating. On average, 18% of all firms in 2013 saw informal sector practices as the main impediment to their activity, which is a notable increase on 13% in 2009. High tax rates as well as customs and trade regulations are other areas in which Montenegrin corporates experience considerable obstacles to their business. Close to 19% of the 150 Montenegrin firms surveyed by the World Bank in 2013 had experienced at least one bribery payment request, most frequently to get a construction permit, an electrical connection or in meetings with tax officials.

As regards bank regulation and supervision, Montenegro has loose public disclosure requirements and no public disclosure of the ultimate owner.

Serbia

Serbia's performance is close to the EU CC/PCC average in business environment indicators such as registering property, enforcing contracts, paying taxes and resolving insolvency, getting electricity, control of corruption and regulatory quality. This being said, 25% of the 360 private sector firms in Serbia surveyed by the World Bank in 2013 identified corruption as a major constraint on business activity, and 40% of the firms expected to give gifts to secure government contracts.

Turning to labour market and education, Serbia's performance is also close to the average for EU CC/PCC in all of the analysed indicators, although the Serbian diaspora as percentage of GDP is the lowest in the Western Balkans.

The country performs relatively well as regards institutional governance, in which, despite not being the best in most of the indicators, it is consistently above the EU CC/PCC average. However, close to 30% of Serbian firms listed political instability as the main impediment to their activity in 2013, which is an increase on 2009. Serbia's gross debt as percentage of GDP was the highest among EU CC/PCC in 2015.

Access to finance seems less restricted than in other Western Balkan countries, with a lower share of all loans granted to corporates requiring collateral (on average 66%), and the value of the collateral required being less than half what is necessary in Kosovo (the Western Balkan country with the highest lending costs in 2013, according to the World Bank Enterprise Surveys). Also, more individuals held a bank account in 2014 than in 2009 (83% compared with 62%). In spite of this, getting a loan is perceived by many businesses in Serbia as being rather difficult (according to the Global Competitiveness Index) and as having worsened since 2010, although a credit easing seem to have taken place over the past year, as judged by the uptick in the score for the 2016-2017 Report (see [Chart 27](#)).

Moreover, as in Albania, judicial independence in Serbia is perceived to be among the worst in EU CC/PCC. Contract enforcement is longer (in number of days required) than in other EU CC/PCC, and related costs are also the highest on average (41% of claims, according to the 2016-2017 ease of doing business report).

The country's world (and euro area) merchandise export market share has been growing over the past two years and it has experienced a considerable increase in its trade openness, following both stronger imports and exports. This being said, there is still room for improvement given that Serbia's Global Competitiveness Index ranking is below the EU CC/PCC average and its score has been hovering below but close to 4 (out of 7) for the past decade. Similar to other EU CC/PCC, average annual (nominal) wage growth has outpaced gains in labour productivity, although the disparity is less pronounced than in other Western Balkan countries.

Turkey

In general, Turkey has good ease of doing business scores and performs well in regulatory quality. It has, however, the second lowest score in resolving insolvency among EU CC/PCC, mainly due to a low recovery rate for investors.

Financial intermediation is more developed in Turkey than in the Western Balkans, with private sector loans at close to 76% of GDP in 2015. The proportion of corporate loans requiring collateral decreased between 2009 and 2013, but, on the other hand, the amount of collateral needed rose significantly over the same period. In 2013, 9% of Turkish firms cited access to finance as the main obstacle to their activity, compared with 26% in 2008.

Turkey experienced a drop in its Global Competitiveness Index ranking between 2015 and 2016 (i.e. in the 2016-2017 edition), falling four places to 55th, though it is noteworthy that the data were collected before the attempted coup in July 2016. Main fields for improvement remain the quality of education, labour market flexibility, domestic competition, as well as efficiency and transparency of its public institutions.

Trade openness and inward FDI as shares of GDP are low (60% and 20% respectively in 2015) compared with the other EU CC/PCC, but also in comparison with the EU-28. Wage growth has significantly outpaced growth in labour productivity (measured as real GDP per person employed adjusted for PPP), which risks putting a strain on the country's price competitiveness.

High tax rates were perceived by 37% of firms in 2013 as the main impediment to their business. According to the World Bank's ease of doing business data, the total tax rate (as percentage of profit) amounted to 41% in 2015, which is among the highest for EU CC/PCC and the EU-11.

Unemployment rates in Turkey are the lowest in the EU CC/PCC, even below EU-11 and EU-15 averages. The scores in higher education and training as well as education are above average, although labour market efficiency is low, possibly in part due to the low ratio of women to men in the labour force.

Turning to institutional governance, Turkey's performance is rather mixed. The country has the lowest score in political stability and one of the lowest in voice and accountability, in which its score has been decreasing since 2008. Its rule of law score has been declining since 2013 although in absolute terms it is among the highest of the EU CC/PCC. Moreover, judicial independence appears to be deteriorating in recent years. On the other hand, Turkey has good results in government effectiveness and in central bank transparency compared with other EU CC/PCC, and a higher score in big and small-scale privatisation compared with the other EU CC/PCC. It also performs well in bank governance (within bank supervision) and in supervision of staff appointment and remuneration, and participation in its deposit insurance system is compulsory.

Indicators explained: Business environment¹⁶

Ease of doing business – distance to frontier (DTF): “The distance to frontier score helps assess the absolute level of regulatory performance over time. It measures the distance of each economy to the ‘frontier,’ which represents the best performance observed on each of the indicators across all economies in the Doing Business sample since 2005. One can both see the gap between a particular economy’s performance and the best performance at any point in time and assess the absolute change in the economy’s regulatory environment over time as measured by Doing Business. An economy’s distance to frontier is reflected on a scale from 0 to 100, where 0 represents the lowest performance and 100 represents the frontier. For example, a score of 75 in 2016 means an economy was 25 percentage points away from the frontier constructed from the best performances across all economies and across time. A score of 80 in 2017 would indicate the economy is improving.”

Registering property: This indicator examines “the steps, time and cost involved in registering property [...]. It assumes a standardized case of an entrepreneur who wants to purchase land and a building that is already registered and free of title dispute.”

Enforcing contracts: The enforcing contracts indicator “measures the time and cost for resolving a commercial dispute through a local first-instance court and the quality of the judicial processes index”.

Paying taxes: This indicator measures “the taxes and mandatory contributions that a medium-size company must pay in a given year as well as the administrative burden of paying taxes and contributions”.

Resolving insolvency: This indicator “studies the time, cost and outcome of insolvency proceedings involving domestic legal entities as well as the strength of the legal framework applicable to judicial liquidation and reorganization proceedings”.

Getting electricity: This topic tracks the “procedures, time and cost required for a business to obtain a permanent electricity connection and supply for a standardized warehouse”, in addition to assessing the efficiency of the connection process.

Control of corruption: Control of corruption, one of the World Bank’s Worldwide Governance Indicators, “captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as ‘capture’ of the state by elites and private interests”. It combines data from several sources and normalises it to a range between -2.5 (weak) and 2.5 (strong).

Regulatory quality: Regulatory quality, another of the World Bank’s Worldwide Governance Indicators, “captures perceptions of the ability of the government to

¹⁶ All business environment definitions are from the World Bank’s Ease of Doing Business Index unless otherwise specified.

formulate and implement sound policies and regulations that permit and promote private sector development”. Some of the indicators used to capture these perceptions are competition policy, tariffs, price controls and burden of regulations.

Indicators explained: Labour market and education

Labour market efficiency: The labour market efficiency pillar of the World Economic Forum’s Global Competitiveness Report measures the efficiency and flexibility of the labour market on a scale of 1 to 7 through a series of sub-indicators, such as the flexibility of wage determination, how easy it is to find skilled employees, labour market policies, productivity and taxation, among others.

Higher education and training: The higher education and training pillar measures several education parameters on a scale from 1 to 7, including the attainment rate, the number of years a person is expected to remain in education, the quality of the system, the quality of the vocational training and encouragement of creativity.

Innovation: The innovation pillar evaluates, among other things, the quality of research institutions, the number of researchers per capita, the availability of scientists and engineers and patent applications. Like the rest of the Global Competitiveness Pillars, the scale goes from 1 to 7.

Diaspora and remittances: The diaspora data are estimates from the United Nations Global Migration Database, more specifically from *International migrant stock: The 2015 revision*. These migration stocks are then divided by the country’s total population using figures from the World Bank. According to the World Bank, “total population is based on the de facto definition of population, which counts all residents regardless of legal status or citizenship.” The data on remittances and GDP also come from the World Bank database. The World Bank’s remittances data are retrieved from the IMF Balance of Payments statistics. The IMF offers the following definition of remittances: “Personal remittances consist of current and capital transfers in cash or in kind, made or received, by resident households to or from non-resident households and net compensation of employee from persons working abroad for short periods of time (less than one year)”.

Indicators explained: Governance

Political stability: The political stability sub-indicator from the World Bank’s Worldwide Governance Indicators “measures perceptions of the likelihood of political instability and/or politically-motivated violence, including terrorism.” It includes data from several sources about topics like social unrest, violent demonstrations, ethnic tension, government stability and internal conflicts. The scale goes from -2.5 to 2.5.

Government effectiveness: “Government effectiveness captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and

implementation, and the credibility of the government's commitment to such policies." Some of its sources include data like quality of bureaucracy, quality of primary education, infrastructure, risk of state failure and policy instability. This is another of the World Bank's Worldwide Governance Indicators.

Voice and accountability: This Worldwide Governance Indicator "captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media." Some of its variables are about topics like political rights, civil liberties, freedom of association, democracy and electoral processes.

General government final consumption expenditure (percentage of GDP): According to the World Bank, this "includes all government current expenditures for purchases of goods and services (including compensation of employees). It also includes most expenditures on national defence and security, but excludes government military expenditures that are part of government capital formation".

Public finances: These data come from the IMF World Economic Outlook. General government gross debt is defined as: "all liabilities that require payment or payments of interest and/or principal by the debtor to the creditor at a date or dates in the future", and general government net lending/borrowing (percentage of GDP) is defined as: "revenue minus total expenditure. This [...] measures the extent to which general government is either putting financial resources at the disposal of other sectors in the economy and non-residents (net lending), or utilizing the financial resources generated by other sectors and non-residents (net borrowing). This balance may be viewed as an indicator of the financial impact of general government activity on the rest of the economy and non-residents".

Shadow economy: Schneider et al. (2010) define the shadow economy as "all market-based legal production of goods and services that are deliberately concealed from public authorities" for a number of reasons, and have developed an econometric methodology to estimate the size of the shadow economy in 162 countries up to 2007. The calculations are updated for OECD countries by Schneider (2015). The shadow economy estimation for Serbia was taken from Krstić et al. (2013).

Large and small-scale privatisation: The large and small-scale privatisation scores are taken from the European Bank for Reconstruction and Development (EBRD) transition indicators to evaluate the status of privatisation in EU CC/PCC. The scale goes from 1 to 4+ and, on average, has not changed substantially over the last ten years. The numbers on the scale represent the following:

"Large-scale privatisation

- 1:** Little private ownership.
- 2:** Comprehensive scheme almost ready for implementation; some sales completed.
- 3:** More than 25 per cent of large-scale enterprise assets in private hands or in the process of being privatised (with the process having reached a stage at which the

state has effectively ceded its ownership rights), but possibly with major unresolved issues regarding corporate governance.

4: More than 50 per cent of state-owned enterprise and farm assets in private ownership and significant progress with corporate governance of these enterprises.

4+: Standards and performance typical of advanced industrial economies: more than 75 per cent of enterprise assets in private ownership with effective corporate governance.

Small-scale privatisation

1: Little progress.

2: Substantial share privatised.

3: Comprehensive programme almost ready for implementation, complete privatisation of small companies with tradable ownership rights.

4+: Standards and performance typical of advanced industrial economies: no state ownership of small enterprises; effective tradability of land.”

Central bank transparency and independence: The data for central bank transparency are from Dincer and Eichengreen (2015), who use central banks’ websites and statutes, annual reports and other published documents to build an indicator with a scale that goes from 0 to 15. The transparency data show more variation between countries than the independence data and are more up to date, with the most recent data point being 2014.

Regarding independence, the data come from Dincer and Eichengreen (2013), where a description on the methodology can be found. The indicator constructed goes from 0 to 1. However, there are two caveats regarding the data on central bank independence. First, the data do not cover all EU CC/PCC; no data are available for Kosovo, Montenegro or Serbia. Second, due to the way the indicator is constructed, it is not possible to give a full representation of the conditions in which an event in one of the four countries, such as the central bank governor not reaching the end of their statutory term, takes place, nor can the indicator capture intense political pressure by a government on central bank decision-making.

Bank regulation and supervision: The data come from the World Bank’s Bank Regulation and Supervision Survey (BRSS), and a similar approach has been taken to that taken in Čihák et al. (2012).

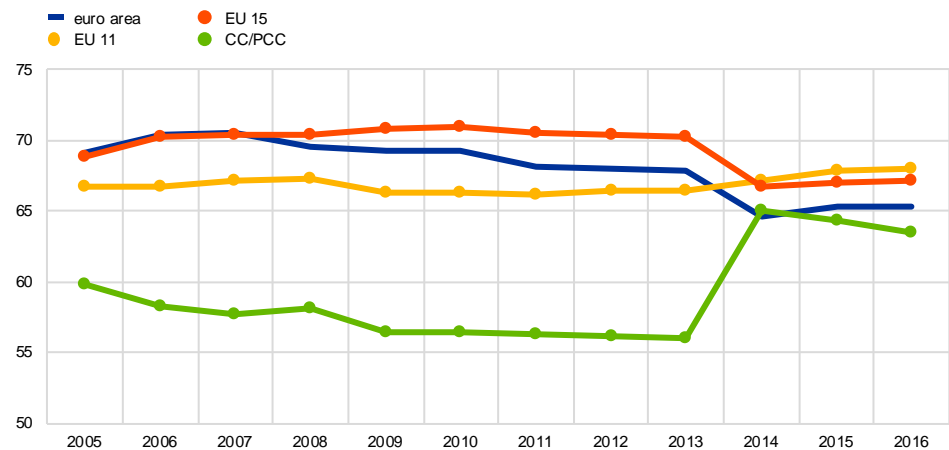
Čihák et al. analyse and compare data from the 2007 and 2011 BRSS. We have kept some of their comparative analysis, although the countries evaluated each year are slightly different (Kosovo, Montenegro, Serbia and Turkey in 2011, but Bosnia and Herzegovina, Kosovo and the former Yugoslav Republic of Macedonia in 2007), which makes comparing the results difficult. On top of this, many of the questions in 2011 were new. This is why we have made limited use of 2007 data.

Description of changes in the World Bank’s “ease of doing business” methodology over the past three years

Changes in methodology have altered the trend of the enforcing contracts indicator over the last three years. From 2005 to 2013, the enforcing contracts score remained more or less stable in all country groups, with a small decrease in EU CC/PCC. In 2014, 2015 and 2016, probably due to the aforementioned changes in methodology, the ease of doing business – distance to frontier (DTF) value for this indicator changed abruptly, decreasing for the EU-15 and the euro area and increasing in EU CC/PCC until both all three of countries practically converged. This can be seen in the chart below.

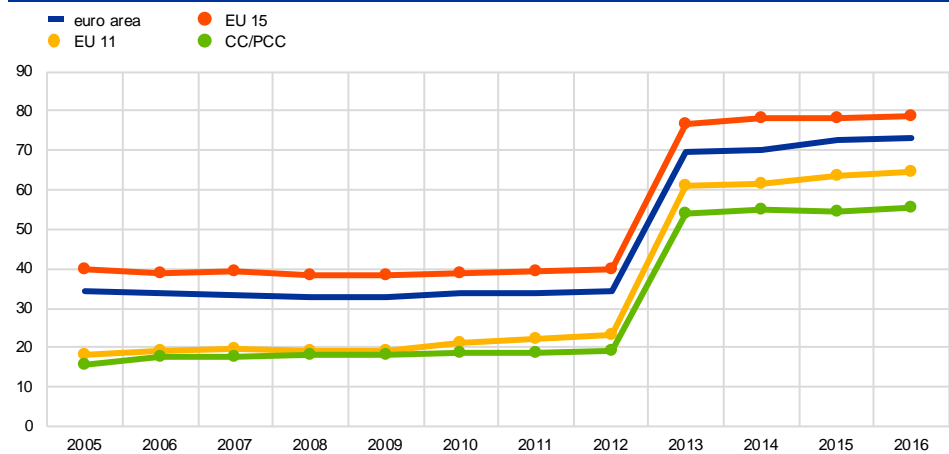
In the case of resolving insolvency, all the scores increased sharply in 2014 and have remained at a similar level since then.

Enforcing contracts: changes in 2014 due to the new methodology



Source: World Bank – ease of doing business.

Resolving insolvency: changes in 2014 due to the new methodology



Source: World Bank – ease of doing business.

Bank supervision – other findings of the BRSS

Čihák et al. (2012) analyse the World Bank's Bank Regulation and Supervision Survey (BRSS) section by section, highlighting what they consider to be some of the most relevant questions. We cannot do the same in this paper due to space limitations, but some of the findings for EU CC/PCC are highlighted in the following table:

Section	Highlights
Entry into banking	EU CC/PCC countries only require one license for all banking activities Rejection rates for entry applications: 8% in EU CC/PCC, 17% in EU-11 and 6% in EU-15
Ownership	Public disclosure of the ultimate owner and controller of a bank compulsory in all EU CC/PCC except Montenegro (60% EU-11, 36% EU-15) Tighter requirements for approval of significant shareholders in EU CC/PCC
Capital	Only Montenegro requires banks to perform internal assessments of their capital adequacy (100% EU-11 and 93% EU-15) Tier 3 capital not allowed in EU CC/PCC (70% EU-11, 79% EU-15 and 88% euro area) Minimum regulatory, risk-based and tier 1 capital ratios higher in EU CC/PCC
External auditing requirements	Auditors are required to inform banking supervisors when they intend to issue qualified opinions on the accounts only in Bosnia and Herzegovina and Kosovo (90% EU-11 and 86% EU-15) Legal action taken by the supervisor within last five years (2006-2010) in Turkey (21 times), Montenegro and Serbia
Bank governance	Supervisor approval of board members and senior managers higher in EU CC/PCC than in EU-11, EU-15 and euro area Supervision of remuneration of board directors in line with EU-11 and EU-15, supervision of senior management slightly less strict, and only Turkey supervises other staff
Liquidity and diversification	60% of the EU CC/PCC have supervisory guidelines regarding asset diversification, in line with the EU-15 and better than the EU-11 (Serbia and Turkey do not) Requirements for liquidity management on foreign currencies, minimum ratio on liquid assets and maturity mismatch limits present in most EU CC/PCC Kosovo banks prohibited from making loans abroad
Deposit (saving) protection schemes	All EU CC/PCC analysed have a legally separate insurance agency Participation in the deposit insurance system only compulsory in Turkey Deposit insurance coverage less strict in EU CC/PCC, especially for foreign banks
Asset classification, provisioning and write-offs	EU CC/PCC have a more comprehensive asset classification, provision and write-off framework than the EU-11 and EU-15 (100% of countries, while 60% EU-11 and 64% EU-15) Coverage is also more extensive in EU CC/PCC, the minimum levels of specific provisions are better and the time limit until write-off is stricter
Accounting / information disclosure	EU CC/PCC have tighter public disclosure practices for statements and other items than the EU-11 and EU-15
Discipline / enforcement	EU CC/PCC and EU-11 countries have a broader enforcement and resolution framework than EU-15 and euro area countries; Kosovo is the exception Supervisory agencies in EU CC/PCC also enjoy more enforcement powers
Supervision	All EU CC/PCC banks are under the supervision of the relevant supervisory agency The supervisory agencies in EU CC/PCC are fairly independent All EU CC/PCC countries except Bosnia and Herzegovina have a specialised department for financial stability and systemic supervision The head of the supervisory agency has a fixed term in all EU CC/PCC and a maximum number of terms (except Serbia and Bosnia and Herzegovina) Bank supervisors have less experience on average in EU CC/PCC
Banking sector characteristics	Bank concentration is lower in EU CC/PCC than in the EU-11, EU-15 and euro area Government and foreign controlled banks hold most of the sector's assets
Consumer protection	Around 50% of EU CC/PCC, have consumer protection requirements, similar to EU-15 and EU-11 figures

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Abbreviations

Countries

AL	Albania	LV	Latvia
BA	Bosnia and Herzegovina	ME	Montenegro
BG	Bulgaria	MK	The former Yugoslav Republic of Macedonia
CZ	Czech Republic	PL	Poland
EE	Estonia	RO	Romania
HR	Croatia	RS	Serbia
HU	Hungary	SI	Slovenia
KV	Kosovo ¹⁷	SK	Slovakia
LT	Lithuania	TR	Turkey

In accordance with EU practice, the EU Member States are listed in this report using the alphabetical order of the country names in the national languages.

Regional groupings of countries

EU candidate countries	Countries that in 2015 held EU candidate status, i.e. Albania, the former Yugoslav Republic of Macedonia, Montenegro, Serbia and Turkey.
EU potential candidate countries	Countries that in 2015 held EU potential candidate status, i.e. Bosnia and Herzegovina and Kosovo
EU CC/PCC	EU candidate and potential candidate countries
EU-11	Countries that joined the EU between 2004 and 2013, except Cyprus and Malta, i.e. Bulgaria, the Czech Republic, Croatia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia
EU-15	Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom
EU-28	Countries that were members of the European Union in 2015
Euro area	Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, Spain
Western Balkans	Albania, Bosnia and Herzegovina, Kosovo, the former Yugoslav Republic of Macedonia, Montenegro and Serbia

Conventions used in the tables

“-” data do not exist/data are not applicable

“.” data are not yet available

¹⁷ This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo Declaration of Independence.

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Roberto Alvarez Orviz

European Central Bank, Frankfurt am Main, Germany; email: roberto.alvarez@ecb.europa.eu

Li Savelin

European Central Bank, Frankfurt am Main, Germany;

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Postal address 60640 Frankfurt am Main, Germany
Telephone +49 69 1344 0
Website www.ecb.europa.eu

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