

# Economic drivers of conflict in the Western Balkans

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13. 03. 2017

## Question

*To what extent do economic factors drive instability and conflict in the Western Balkans? - Albania, Bosnia-Herzegovina, Kosovo, Macedonia, Montenegro and Serbia.*

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## 1. Overview

This report looks at each of the six Western Balkans countries listed above, identifies the key economic challenges they face and assesses whether any of these are, or have the potential to become, drivers of conflict. The literature reviewed largely comprised reports from international development/finance organisations, notably the World Bank, IMF and European Commission, as well as journal/newspaper articles.

The key conclusion is that, while all countries in the region face serious economic challenges, these are not *per se* drivers of conflict. To date the main effect of these - particularly of high unemployment - seems to be to drive outward migration from the Western Balkans to more advanced economies in Europe. But, as economic stresses grow, and at a time when the European Union is itself facing economic crisis, it is questionable whether this situation –

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economic factors not leading to social unrest - is sustainable (Economist, 2012); particularly given the presence of significant other (non-economic) conflict drivers in most countries.

The main findings of the report are as follows:

- **Impact on growth of global economic crisis of 2008 and of Eurozone crisis:** All six countries have shown progress in moving from closed, centrally planned economies to open, market-based ones. Post-communist growth in all was generally strong, often helped by international aid, but dropped following the 2008 global economic crisis (World Bank and Bertelsmann Stiftung country reports). Drop in demand from the Eurozone has hit their economies hard (Economist, 2012). The Greek economic crisis, in particular, is causing negative ripple effects, most notably in Albania which depends heavily on Greek foreign direct investment (FDI) and remittances from workers there (USAID, 2012; CIA, 2017a).
- **Structural issues hampering investment and job creation:** While the specific issues and importance of these varies from country to country, consumption-based economies, lack of production, weak competitiveness, a weak business environment, oversized and inefficient public sectors, high levels of public debt, organised crime and corruption are common factors deterring investment and limiting growth and job creation (World Bank, IMF, CIA and Bertelsmann Stiftung country reports).
- **High unemployment, especially youth unemployment:** The Western Balkans as a region is characterised by high levels of unemployment, particularly among young people and women. Unemployment across the region in 2015 stood at 21.6 percent, with youth unemployment at 45 percent (Lange, 2016: 2). Individual country youth unemployment rates range from 38.8 percent in Montenegro to 54.3 percent in Bosnia and Herzegovina (World Bank, 2016a: 7). Nearly 25 percent of youth in the six countries are inactive – not in employment, education or training (ibid).
- **Migration from Western Balkans countries:** All the factors listed above have contributed to high levels of migration out of these six countries to the rest of Europe. They accounted for 177,925 asylum applications in the EU in the first three quarters of 2015 alone (Lange, 2016: 1). Expat numbers for Western Balkan countries range from 10-30 percent of the population, compared to 2-4.5 percent in most western European countries – the bulk of these are economic migrants (Lange, 2016: 2).
- **Migration through Western Balkans:** The Western Balkans have become a key migration route for refugees from Syria, Afghanistan, Iraq and other countries, seeking asylum/a new life in the EU (European Parliament, 2016). To date, assistance from the European Commission to cope with the refugee crisis, coupled with the fact that most migrants are keen to move on from the Western Balkans, mean the refugee crisis – while serious – has not been a conflict driver. Indeed, the migrant crisis has led to increased regional cooperation (Lange, 2016).
- **EU accession:** All six countries are at various stages along the road towards EU accession. While the literature points to ambiguity about the perceived benefits of joining (Lange, 2016), for many countries this is a goal and could prove a stimulus for urgently needed but challenging reforms. IMF financing agreements serve a similar purpose, pushing countries to undertake vital reforms.
- **Regional factors promoting resilience:** The Economist Intelligence Unit identifies three factors contributing to stability. The first, ironically, is the backwardness (e.g. large

agricultural sectors, important role of extended families) of the region's economies (compared to western and northern Europe) that has helped cushion populations from the effects of the economic downturn. A second factor is the decline of trade unions and the left, meaning there are few social and political forces that can organise large, non-spontaneous demonstrations. Thirdly, opinion surveys point to widespread apathy, not conducive to social activism (Economist, 2012).

## 2. Albania

### Economic performance

Albania has made progress in moving from a closed, centrally planned economy to a modern, open market economy (Export.gov, 2016). In the decade following the collapse of communism in 1992, it showed strong economic growth, helped by international aid and other strategic assistance (World Bank, 2017a). The average growth rate between 2000 and 2008 was 6 percent (Export.gov, 2016). From being the poorest country in Europe in the early 1990s, Albania had reached middle income status by 2008; poverty dropped by half during this period (World Bank, 2017a). The country also initially weathered the global economic crisis of 2008, mainly because of close supervision of the banking sector and fiscal stimulus policies (BTI, 2016a).

But by 2013 growth had fallen to just 1.4 percent (BTI, 2016a: 16). 'The global financial crisis exposed the weaknesses of its growth model and highlighted the need to shift from consumption-fuelled to investment- and export-led growth' (World Bank, 2017a). Economic growth rebounded to 2.7 percent in 2015 (Export.gov, 2016) and 3 percent in the first quarter of 2016, projected to reach 3.2 percent for the full year, 3.5 percent in 2017 and 3.8 percent in 2018 (World Bank, 2017a). The World Bank predicts short-term growth on the back of recovery in consumption and robust investments, as well as gradually rising net exports (ibid). But it says the medium-term outlook depends on the pace and depth of reforms (see below) and on external developments associated with slow growth in the European Union (ibid).

### Impact of Greek economic crisis

Albania has already been negatively affected by the knock-on effects of the economic crisis on Greece and, to a lesser extent, Italy. 'Close trade, remittance and banking sector ties with Greece and Italy make Albania vulnerable to spill-over effects of debt crises and weak growth in the euro zone' (CIA, 2017a). Remittances accounted for 12-15 percent of GDP before the 2008 financial crisis, mostly from Albanians living and working in Greece and Italy. By 2014 these had fallen to 5.7 percent of GDP (CIA, 2017a). Greek foreign direct investment (FDI) in Albania fell from 53 percent of total FDI in 2006 to 27 percent in 2011 (USIAD, 2012). At the same time Albanian exports to Greece fell from 8.2 percent of total exports in 2007 to 4.9 percent in 2011 (ibid).

As of 2015 an estimated 180,000 Albanian migrants had returned to Albania from Greece (Barber, 2015). A further several hundred thousand remain in Greece, mostly thought to be there illegally. Should these people lose their jobs and return to Albania 'this would push up unemployment...in the short term, strain the over-stretched social security system and pose the challenge of how to integrate migrants' children educated in Greek into Albanian schools and society' (Barber, 2015).

## **Labour market issues and migration**

Unemployment is a chronic major problem in Albania. The unemployment rate rose from 12.5 percent in 2005 to 16 percent in 2013; some 75 percent of this is considered to be long-term unemployment (BTI, 2016a: 16). There are also significant gender differences, and youth unemployment is even higher at 30 percent (BTI, 2016a: 16). This helps explain the massive exodus of people from the country in recent years, seeking work and a better life in other countries of Europe. In 2014 and 2015 over 75,000 Albanians left the country for Germany and other EU countries; in 2015 Albanian citizens were the second-largest asylum seeking group in Germany (after Syrians) (Balkananalysis, 2016).

## **Structural issues**

The negative effects of slow growth in the Eurozone are exacerbated by a challenging fiscal and budgetary environment within Albania, structural problems in the economy and a sharp decline in oil and mineral prices (Albania's primary exports) (Export.gov, 2016). 'Complex tax codes and licensing requirements, a weak judicial system, endemic corruption, poor enforcement of contracts and property issues, and antiquated infrastructure contribute to Albania's poor business environment making attracting foreign investment difficult' (CIA, 2017a). In February 2014, faced with rising public debt – up from 57.4 percent of GDP in 2005 to 70.1 percent in 2013 (BTI, 2016a: 17), the country entered into a financing arrangement with the IMF. The three-year USD 457 million IMF arrangement aims to help Albania pay back government arrears, pursue fiscal consolidation and improve debt sustainability (CIA, 2017a). However, that programme has been at risk because of a persistent failure to collect sufficient tax revenue, rising budget deficits (up to 6.5 percent in 2014 - BTI, 2016a: 20) and still rising public debt - up to 73 percent of GDP in 2015 (BTI, 2016a: 17).

## **Corruption**

In a 2011 UN Office of Drugs and Crime (UNODC) survey, respondents ranked corruption as the second most pressing problem they faced after unemployment (cited in Bloomer, 2015). Albania has long had a culture of bribery, with corruption a part of everyday life. Even accessing basic services like healthcare depended on payment of bribes. The government has introduced measures to tackle corruption, including a citizen feedback system that asks users of public services if they had to pay a bribe (ibid) and a law on whistleblower protection (EC, 2016a). But the European Commission reports that 'corruption remains prevalent in many areas and continues to be a serious problem', and calls in particular for greater efforts to tackle high level corruption (EC, 2016a: 4). Similarly, while some progress has been made in tackling organised crime, much more needs to be done (ibid).

## **Reform efforts**

Since 2014 the government has been undertaking an ambitious reform programme to improve the business climate, through fiscal and legislative reforms focused on simplification of licensing requirements and tax codes (CIA, 2017a; BTI, 2016a). Efforts are also being made to upgrade the electricity distribution grid, and improve the national road and rail network – all long-standing barriers to sustained economic growth (CIA, 2017a). To offset the reduction in remittances, the government has focused on increasing FDI as well as promoting domestic production (BTI,

2016a). FDI inflows into Albania have increased in recent years, but largely because of Albanians living in Greece bringing their savings home (USAID, 2012).

Former Deputy Foreign Affairs Minister Edith Harxhi criticises the failure to implement necessary reforms. She points to the lack of a 'stable policy on tax collection and no oversight, massive corruption in customs and other areas in administration...the emergence of a political oligarchy, as well as lack of accountability from government and politicians' as contributing to an increased crime rate and drugs trafficking, as well as overall economic decline (Balkanalysis, 2016).

In terms of factors promoting resilience, despite the criticisms, there has been progress on economic reforms (BTI, 2016a). In June 2014 Albania signed the Stabilisation and Association Agreement becoming a candidate for EU accession. In November 2016 it received a European Commission recommendation to open EU accession negotiations, though this is conditional upon implementation of a judicial reform package passed in the same year.

### **Regional linkages**

Albania has very good relations with Kosovo. In 2016 the two countries signed a number of agreements for cooperation in the fields of customs and taxation, energy, public administration, transport and the environment (EC, 2016a: 23-24). It has good relations Bosnia and Herzegovina and Macedonia, while relations with Montenegro are stable and with Serbia continue to normalise (EC, 2016a: 24). Economic cooperation with Italy has intensified, and in April 2016 a 'Facility for feasibility studies and final level-projecting in infrastructure sector' project was signed by the two countries (EC, 2016a: 24).

### **Conflict potential**

While Albania faces serious economic challenges, particularly high unemployment and the negative fallout of the economic crisis in Greece, the literature does not identify these issues as potential drivers of conflict. In the context of the Greek crisis, however, it does refer to a further danger that this could set back 'recent Albanian-Greek efforts to ease tensions in a relationship dogged by territorial, ethnic minority and other disputes, some of which go back to the second world war' (Barber, 2015). 'In times of deep economic and financial crisis, these problems are much more difficult to address. Nationalistic rhetoric comes into fashion, and this doesn't create an environment conducive to dealing with bilateral issues' (Ditmir Bushati, Albanian Foreign Minister, cited in Barber, 2015).

## **3. Bosnia and Herzegovina**

### **Economic performance**

Post-communism, economic growth in Bosnia and Herzegovina has been less rapid than in Albania, and fell sharply after the 2008 global economic crisis, from 5.0 percent in 2005 to 0.7 percent in 2010 (BTI, 2016b: 19) and -1.2 percent in 2012 (UN, 2015: 16). There was a slow economic recovery up to 2013, with a GDP growth rate of 2.5 percent that year. But heavy floods in May 2014, causing damage estimated at between 5-10 percent of GDP (BTI, 2016b: 24), contributed to an overall slowdown of economic activity: the economic growth rate that year was just 1.2 percent (BTI, 2016b: 19).

According to the World Bank 'the key economic challenge faced by Bosnia and Herzegovina is the imbalance of the country's economic model: public policies and incentives are skewed towards the public sector rather than the private sector; consumption rather than investment; and imports rather than exports' (World Bank, 2017b). The public sector is discussed below. With regard to the second imbalance, during the post-war economic recovery, Bosnia and Herzegovina did not create new foundations for sustainable economic growth: this was consumption-based and, as of 2015, consumption remained at over 100 percent of GDP (Goldstein et al, 2015). Exports account for just 30 percent of GDP. A strong indicator of the country's weak competitiveness, this low figure stems from the poor business climate, poor infrastructure (especially transport) and high cost of employment (ibid; UN, 2015). The World Bank's 2015 Doing Business survey ranked Bosnia and Herzegovina 170<sup>th</sup> out of 189 countries on the ease of starting a business (cited in BTI, 2016b: 22).

### **Public sector and labour market issues**

The literature identifies the country's massive public sector as one of the major impediments to growth: 'an oversized public sector, with one of the highest levels of public employment in Eastern Europe, has elbowed out productive public infrastructure spending' (IMF, 2016). A Brookings blog (Goldstein et al, 2015) claims that 'public expenditures amount to nearly half of GDP and, if state-owned enterprises and costs from corruption are added in, the public sector may be as large as 70 percent of GDP'. The public sector accounts for about 30 percent of employment in Bosnia and Herzegovina, around 220,000 jobs (UN, 2015: 18).

The labour market in Bosnia and Herzegovina (certainly in the public sector) is marked by corruption and political party patronage (SEESOX, 2015: 12). Despite mechanisms to ensure transparent, impartial recruitment – particularly for managerial positions – these are easily circumvented. When focus groups in a survey were asked the most important factors in finding a job, the overwhelming majority responded: connections, party membership and bribery (UN, 2015: 16). Indeed, 'public sector jobs represent an important power base for political leaders, as many of these positions are within their gift'. Moreover 'a vast network of overlapping, at times clashing, lines of patron-client relations runs the sector' (ibid: 18). Coupled with the lack of merit-based recruitment, these clashes result in highly inefficient provision of services. Not surprisingly, efforts at reform have met strong resistance. One politician complained that the bureaucracy had grown so large that it was essentially impossible to cut down to size (cited in UN, 2015: 18).

Slow economic growth and lack of investment – private investment is low and foreign investors have generally stayed away - has contributed to high and rising unemployment: up from 25.6 percent in 2005 to 28.4 percent in 2013, of whom 90 percent are considered long-term unemployed (BTI, 2016b: 19). According to the UN, the country has the lowest employment rate in the world after the West Bank and Gaza, at 33 percent of the population over 15 (UN, 2015: 18). It highlights that fact that the female employment rate is even lower at 24 percent, and notes that women are subject to illegal discrimination: 'You work at a private firm, you get pregnant, and automatically you're out of a job' (ibid). According to the IMF, youth unemployment is significantly higher, exceeding 62 percent (IMF, 2016b). This is three times higher than the average youth unemployment rate in the EU, which was 23.5 percent in 2012 (UN, 2015: 19).

## Poverty and migration

Poverty levels in Bosnia and Herzegovina are also high and rising. In 2007, 18.6 percent of the population was below the poverty line; by 2011 this had increased to 23.4 percent (UN, 2015: 21). Targeting of social protection is ineffective, meaning that the poorest and most vulnerable do not get the help they need (UN, 2015; Goldstein et al, 2015). Groups at high risk of poverty and social exclusion include the elderly, youth, people with disabilities, the Roma population and women (BTI, 2016b: 18).

'Not surprisingly, a large number of educated young people have left for Western Europe over the past two decades, further affecting the potential for future growth' (IMF, 2016b). This is confirmed by the findings of UN surveys: 'young people report by far the highest readiness to emigrate, with an outright majority of 53.6 percent "completely ready" to leave and only 16.9 percent firmly committed to staying' (UN, 2015: 20). Referring to radicalisation, Lange reports that the highest numbers of foreign fighters of European origin per capita are estimated to come from Bosnia and Herzegovina as well as Kosovo. She acknowledges that the root causes of this are complex, but adds that the 'bleak economic situation, in particular for the youth, is a significant factor' (Lange, 2016: 2).

## Decentralised governance system

The literature identifies Bosnia and Herzegovina's decentralised institutional frameworks established under the Dayton Agreement, as inimical both to service delivery and economic growth (World Bank, 2017b). The IMF notes that the heavily decentralised system of government in the country has made policy-making difficult and 'has made preserving a single economic space an ongoing challenge' (IMF, 2016b). Critically, the decentralised governance structure makes introduction and implementation of reforms extremely difficult (WB, 2016b; CIA, 2017b). Warning that Bosnia and Herzegovina 'is slowly spiralling towards disintegration', and pointing to the governance set-up under the Dayton Agreement as primarily responsible for this, a 2014 ICG report calls for the country to search for a new constitutional foundation.

## Reform efforts

In July 2015 the Council of Ministers of Bosnia and Herzegovina, Government of Republika Srpska and Government of the Federation of Bosnia and Herzegovina adopted the Reform Agenda, a joint programme of structural reforms. The World Bank predicts that implementation of the Reform Agenda will lead to improvements in the business environment and thus to increased investment. However, it adds that limited progress in implementing reforms, coupled with adverse shocks to external trade and financial conditions, could put this outlook at risk (World Bank, 2017b). In September 2016 the IMF approved a three-year USD 608 million loan to Bosnia and Herzegovina to help the government implement reforms (IMF, 2016b). The main goals of the programme are private sector growth, higher public investment and financial sector reform. The IMF's mission chief in the country warned that, 'successful implementation (*of the Reform Agenda*) will depend on tackling entrenched interest groups that often operate along ethnic lines. It will also require improved coordination and cooperation among governments within the decentralized administrative structure' (Nadeem Ilahi cited in IMF, 2016b).

The desire to join the European Union could serve as a strong stimulus to reform. In 2015, after years of stalled negotiations, Bosnia and Herzegovina concluded a Framework Participation

Agreement (Lange, 2016: 4), and in mid-February 2016 formally submitted its application for EU membership (World Bank, 2017b).

### **Regional linkages**

Bosnia and Herzegovina has good relations with Albania and Croatia. It does not recognize Kosovo as an independent state, and there are no official relations between the two countries. An agreement on the border between Bosnia and Herzegovina and Montenegro came into force in April 2016 (EC, 2016b: 29). Overall, relations with Serbia are good: in 2016 the two countries signed a number of bilateral agreements, including on the environment and telecommunications, construction of the inter-state bridge across the River Drina, international road transport of passengers and cargo, and in the field of radiation and nuclear safety (EC, 2016b: 29). The Serbian Prime Minister took part in an investment forum in Srebrenica in November 2016 (ibid). Bosnia and Herzegovina has good relations with Turkey; bilateral agreements were ratified recently on cooperation in the areas of veterinary medicine, science and technology, and on international carriage of passengers and goods by roads (EC, 2016b: 30).

### **Conflict potential**

Bosnia and Herzegovina faces serious – and in some cases, growing – economic challenges: high levels of unemployment and poverty, and weak growth. However, these challenges are a symptom rather than a cause of tension and, potentially, of conflict. The fundamental issue hampering Bosnia and Herzegovina is the need to accommodate the interests of three diverse and still highly divided ethnic communities. The inability to work together and carry out vital reforms to promote growth is in large part a legacy of conflict. While the literature does not specifically identify economic factors as driving the country to renewed conflict, they clearly are not helping in what is already a tense situation.

## **4. Kosovo**

Kosovo was the last of the former Yugoslav territories to gain independence, declared by the Kosovo Assembly on 17 February 2008. While over 100 countries have recognised its independence, and it has joined international organisations such as the World Bank, IMF and European Bank for Reconstruction and Development, Serbia still rejects Kosovo's independence. However, EU-facilitated talks led to an agreement in 2013 to normalise relations between Serbia and Kosovo; this has led to some improvements. In April 2016 a Stabilisation and Association Agreement (SSA) with the EU went into effect.

### **Economic performance**

Economic growth in Kosovo has remained steady in recent years, even outpacing its neighbours: 2.5 percent in 2014, 3.9 percent in 2015, 3.8 percent in the first quarter of 2016, and predictions of 3.9 percent in 2017 (World Bank, 2017c). However, growth is dependent on international aid and on remittances from the Kosovo-Albanian diaspora, mainly in Germany, Switzerland and the Scandinavian countries (BTI, 2016c). Aid is estimated to account for 10 percent of GDP, and remittances 15 percent (CIA, 2017b). This dependency on aid and remittances, coupled with a weak business environment, lack of infrastructure, poor natural resources and lack of investment, mean that growth has not led to job creation. A further economic challenge in Kosovo is that rich

natural resources and most industry are located in the Serbian-dominated north of the country (Visoka & Beha, 2013). It is unclear who owns those assets, making their exploitation and development difficult (CIA, 2017b; BTI, 2016c).

### **Labour market issues and poverty**

Unemployment in Kosovo is very high: between 2001 and 2013 it averaged 44.1 percent, the highest in the Western Balkans, and was 31 percent in 2012 (BTI, 2016c). Youth unemployment is almost double that at nearly 60 percent (CIA, 2017b). Given that the average age of the population is 26 years, the latter is a particularly serious problem (ibid). It fuels a significant informal economy, thought to account for 30-35 percent of GDP (BTI, 2016c: 18). Women and ethnic minorities are particularly disadvantaged in the job market (BTI, 2016c). Kosovo is also among the poorest countries in Europe: in 2014 per capita GDP was USD 4,000 (ibid). All these factors are driving outmigration: Kosovars were the third largest group of arrivals in Germany in 2015 (after Syria and Bosnia and Herzegovina) (Lange, 2016: 1).

### **Impact of global economic crisis**

High levels of corruption, little contract enforcement and unreliable electricity supply discourage investors (CIA, 2017b). The global economic crisis has made things worse. The slowdown in China brought down the price of base metals, Kosovo's main commodity export, and led to a 5.6 percent drop in exports of goods in the first half of 2016, while imports went up by 8.3 percent, driven by increased domestic demand (World Bank, 2017c). FDI in the same period fell by 36 percent (ibid). The protracted economic crisis in Europe has led to a reduction in remittances from migrant workers (BTI, 2016c: 18).

### **Regional linkage**

Kosovo has very good relations with Albania. In May 2016 the two signed a bilateral agreement on enhancing and protecting investment, to intensify economic cooperation and create favourable conditions for investment (EC, 2016c: 31). In June 2016, the two governments signed cooperation agreements on environment, energy, transport, public administration reform, customs, taxation and joint training (ibid). There are no official relations between Kosovo and Bosnia and Herzegovina as the latter does not recognise Kosovo's independence. Relations with Macedonia continue to develop, while relations with Montenegro are good. Relations with Serbia continue to be strained, though some progress has been made on implementation of agreements for normalization of relations, reached through EU-facilitated dialogue (EC, 2016c).

### **Conflict potential**

Despite diverse and serious economic challenges, the literature does not identify economic factors as drivers of conflict in Kosovo. Far more significant is the country's relationship with Serbia as well as the position of Serb minorities within Kosovo.

## 5. Macedonia

### Economic performance

In 2015, GDP growth stood at 3.7 percent (European Commission, 2016d: 23). However, Macedonia's external debt and public debt levels are increasing rapidly (European Commission, 2016d: 25-26). Moreover, the significant size of Macedonia's shadow economy, which accounts for between 20 percent and 40 percent of total output, has a negative impact on the competitiveness of the private sector (European Commission, 2016d: 27).

There is consensus in the literature that the ongoing political crisis in Macedonia is having a negative impact on the country's economy (see for example IMF, 2016c: 4). According to a report published by the Clingendael Institute, in Macedonia, as well as in Albania, Bosnia and Herzegovina, and Kosovo, 'uncompromising political elites and ethno-nationalist parties are part of the establishment, and have consolidated their economic and political power' (van Ham, 2014: 9). They argue that the result has been 'a process of "state-capture," characterised by governance through clientelism and patronage networks accompanied by large-scale, high-level corruption' (van Ham, 2014: 9).

### Labour market issues and poverty

Unemployment in Macedonia stands at 24 percent (IMF, 2016c: 17). According to the IMF, unemployment is largely structural, due to skills shortage and qualifications mismatch. This is the result of the emigration of skilled workers and low education levels. Unemployment is particularly high among people with low education levels (Blazevski et al, 2016: 469). Whereas, unemployment rates are lower among workers with vocational training and tertiary education (IMF, 2016c: 17). Female labour market participation in Macedonia is low. This is attributed to the traditional role of women in Macedonia as taking care of the home, and of children and the elderly (Blazevski et al, 2016: 469). Youth unemployment is also an issue. Only a third of young people are active in the labour market (Blazevski et al, 2016: 469). Moreover, informal workers, women, young people, and the low skilled are more likely to receive low wages (Blazevski et al, 2016: 470). Despite these challenges, annual employment growth stands at an average of 2.5 percent. This is the result of job creation in the public sector, in construction and manufacturing, and through government measures to improve the labour market (European Commission, 2016d: 28).

The poverty rate in Macedonia stands at 27.3 percent (Blazevski et al, 2016: 469). Unemployment is a strong predictor of poverty in the country (Blazevski et al, 2016: 469). Moreover, households with dependent children have a higher poverty rate than the national average, at 29.6 percent (Blazevski et al, 2016: 469).

### Migration

Twenty-five percent of the total population of Macedonia lives abroad. Moreover, the country has a net emigration rate of 0.5 percent per year (Petreski et al, 2016: 4). One peer-reviewed journal article states that remittances account for between 4 percent and 10 percent of GDP per year (Petreski et al, 2016: 4). However, another article by the same author states that remittances account for 3.1 percent of GDP in Macedonia (Petreski et al, 2017: 2). One paper forecasts a

reduction in outward migration from Macedonia by 3 percent in the next five years (Petreski et al, 2017: 13). It also projects a 9 percent increase in remittances in the same period (Petreski et al, 2017: 13). Macedonians typically emigrate to Western European countries, the US, Canada and Australia (Petreski et al, 2016: 3). Remittances reportedly continue to be a major source of financing of Macedonia's trade deficit, and help to alleviate development constraints, by reducing poverty and inequality (Petreski et al, 2016: 4).

Recent migrants include a significant number of young people who leave Macedonia to find jobs or who travel abroad to study but then find a job and do not return (Petreski et al, 2016: 4). This has resulted in concerns about 'brain drain' (Petreski et al, 2016: 4). Moreover, ethnic Albanians are reportedly more inclined to emigrate because they become dissatisfied with the political and economic environment in Macedonia. However, there is no evidence to suggest that they are motivated by gender and/or ethnic inequalities (Petreski et al, 2016: 4). In keeping with this trend, remittances received by ethnic Albanians are larger, especially for the poorest households (Petreski et al, 2016: 4).

While Macedonia was at the forefront of 2015/2016 migration crisis, due to its geostrategic location, inward migration appears to have had little economic impact on the country. This is largely due to the fact that migrants were transiting through Macedonia *en route* to other European countries.

### **Organised crime and corruption**

Macedonia has made some progress in combatting organised crime. A number of criminal networks and routes have been dismantled, in particular relating to people smuggling, human trafficking and drug trafficking (European Commission, 2016d: 17). There are relatively few cases of money laundering in Macedonia, however, according to the European Commission, all relevant institutions still need to ensure proper implementation of anti-money laundering legislation (ibid). Moreover, law enforcement and prosecution bodies need more expertise and greater capacity and authority to conduct serious financial investigations. Precautionary freezing of assets is rarely applied, leading to poor confiscation rates (ibid). In combatting corruption, financial investigations and asset confiscation are still used very rarely. Moreover, the capacities of law enforcement and judicial institutions remain weak (European Commission, 2016d: 15).

### **Regional linkages**

According to the European Commission, Macedonia has generally good relations with Albania, and its relationship with Bosnia Herzegovina, Montenegro, and Turkey continue to develop (European Commission, 2016d: 22). Relations with Kosovo are also developing, but there have been some tensions due to politicians' statements alleging participation of people from Kosovo in the Kumanovo incident in 2015<sup>1</sup> (European Commission, 2016d: 22). While Bulgaria and Macedonia cooperate on cross-border issues such as trade relations and infrastructural priorities, relations are marred by their different interpretations of history (European Commission, 2016d: 22). Relations with Greece continue to be affected by the issue of Macedonia's name, but economic and trade relations between the two countries remain normal (European Commission,

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<sup>1</sup> In May 2015, there was a shootout in the northern Macedonian town of Kumanovo involving Macedonian police and a group calling itself the National Liberation Army (NLA).

2016d: 22-23). However, in contrast, a report published by the Friedrich Ebert Stiftung states that Macedonia's relations with almost all of its neighbours remain 'complex and very poor,' arguing that this situation will persist (Dukanovic, 2016: 34).

There are limited transport infrastructure linkages to regional neighbours. Limited progress has been made in implementing connectivity reform measures agreed in the context of the Western Balkans Investment Framework (European Commission, 2016d: 30). The Macedonian Corridor X<sup>2</sup> motorway section is expected to be completed by May 2017 (ibid). While the electricity transmission connection with Serbia has been completed, interconnection with Albania, which would link the country to the wider Corridor VIII network, is still in the planning phase (ibid).

### **Conflict potential**

While Macedonia faces some economic challenges, the literature does not identify these as potential drivers of conflict. There is consensus in the literature that the principal drivers of conflict in Macedonia relate to the on-going political crisis in the country. In March 2017, the Economist warned that Macedonia is at risk of armed conflict due to tensions between the country's minority ethnic Albanian politicians and the current regime (Economist, 2017).

## **6. Montenegro**

### **Economic performance**

In April 2016, four European banks, Citigroup, Deutsche Bank, Erste Group and Societe Generale, stated that corruption, money laundering, organised crime and Montenegro's ability to repay its debts were the main risks to its economy (Tomovic, 2016). They also argued that the economy remains vulnerable to external shocks (Tomovic, 2016). Investment in infrastructure and tourism has reportedly resulted in a 3.4 percent increase in GDP in 2015 (European Commission, 2016e: 24).

### **Labour market issues**

Unemployment in Montenegro is high for both men and women, standing at 17.6 percent (World Bank, 2017d). It also tends to be long-term - 80 per cent of the unemployed have been looking for a job for more than a year (World Bank, 2017d). New entrants constitute 40 percent of those unemployed (World Bank, 2017d). The inactivity rate in Montenegro is also high, especially among women (World Bank, 2017d). Moreover, people with low education levels find it particularly difficult to find employment (World Bank, 2017d). Unemployment is lower in the coastal zone than in the poorer northern regions (World Bank, 2017d). Montenegro has a large informal sector - one in three jobs in Montenegro are informal (World Bank, 2017d). However, seasonal jobs are largely filled by migrants from abroad (World Bank, 2017d).

Unemployment and labour market participation rates of women, standing at 17.3 percent and 56.6 percent, remain lower than for men, which stand at 18 percent and 70.6 percent (European

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<sup>2</sup> The Corridor X motorway runs between Salzburg in Austria and Thessaloniki in Greece. The corridor passes through Austria, Croatia, Serbia, Macedonia and Greece.

Commission, 2016e: 27). The gender imbalance recently increased due to changes in the social care system. Initiatives like the introduction of life-long benefits for mothers of at least three children, reportedly provided disincentives for women's participation in the labour market (European Commission, 2016e: 27).

According to the World Bank, young people in Montenegro lack soft skills such as language, leadership, initiative, and critical thinking. They also lack advanced hard skills like technical knowledge (2017). However, the ILO reports that Montenegrin youth are highly educated, which is reflected in lower unemployment rates and faster school-to-work transitions for young men and women (Djuric, 2016: 2). However, the unemployment rate for tertiary graduates still stands at 32 percent (Djuric, 2016: 2). Informal employment among youth stands at 59.5 percent. Young people living in rural areas are more likely to be engaged in informal employment than young people in urban areas (67.5 and 56.0 percent, respectively) and male workers are more likely to be in informal employment than female workers (61.7 and 56.8 percent, respectively) (Djuric, 2016: 4). 11.4 percent of young workers are overqualified for the jobs that they are doing (Djuric, 2016: 4). This is low compared to other countries in the region, which is reportedly a positive sign of the economy's capacity to absorb most of its highly educated youth, albeit following extended periods of unemployment (Djuric, 2016: 4).

### **Poverty and migration**

8.6 percent of the Montenegrin population lived below the absolute poverty line in 2013 (Djuric, 2016: 8). The rate of poverty is significantly higher in the northern region. Poverty in Montenegro is closely linked with employment status (Djuric, 2016: 8). The poverty rate is highest among people who are self-employed or unemployed. Education levels also have a significant impact on poverty status, with the highest poverty rate found among people that are only educated to the primary level, standing at 17.1 percent (Djuric, 2016: 8).

According to a report published by the ILO, the employment issues facing many young people in Montenegro foster a desire to work overseas. This is described as 'a potential waste of the educated productive potential of young graduates' (Djuric, 2016: 52). In 2013, 45.3 percent of the Montenegrin population lived abroad (Petreski et al, 2017: 2). Remittances account for 8 percent of GDP (Atoyan et al, 2016: 14). According to a report published by the IMF, outward migration has reduced annual GDP growth in Montenegro by between 0.6 and 0.9 percentage points (Atoyan et al, 2016: 17).

### **Demographics**

According to a report published by the ILO, based on an analysis of the last two censuses, the share of the population aged 65 and over increased from 12 percent in 2003 to 12.8 percent in 2011 (Djuric, 2016: 7). This is expected to increase to 15.4 percent by 2021. Moreover, the share of the population aged 14 years or under decreased from 22.6 percent in 2003 to 19.2 percent in 2011. It is expected to reduce to 16.8 percent by 2021 (Djuric, 2016: 7). The expected consequence of Montenegro's aging population is that the cost of pensions, and disability and health services will grow, while there will be increasing constraints on the availability of public funds for young people and their education. Demographic changes reportedly affect economic growth through their impact on the labour market, and youth in Montenegro are expected suffer the consequences of this (Djuric, 2016: 7).

## **Regional linkages**

Relations between Montenegro and Serbia remain complex. However, since 2012 Serbia has not interfered with internal Montenegrin affairs. Moreover, the two countries are cooperating in the context of European integration. There have also been announcements of more significant Serbian investments in Montenegro (Dukanovic, 2016: 33). Montenegro has good relations with Albania and Kosovo. Moreover, it held a business forum on investment opportunities in Macedonia, and on strengthening economic cooperation between the two countries, in October 2015 (European Commission, 2016e: 22). The demarcation of borders between Montenegro and Croatia is an ongoing issue between the two countries. However, a border demarcation agreement between Montenegro and Bosnia Herzegovina came into force in April 2016 (European Commission, 2016e: 22).

Montenegro has taken steps in constructing the Smokovac-Mateševo section of the Bar-Boljare highway project, the extension of the Orient East-Med core corridor in the Western Balkans (European Commission, 2016e: 52). In terms of Trans-European Energy networks, the construction of an undersea interconnection cable with Italy continues (European Commission, 2016e: 52).

## **Conflict potential**

There is a consensus in the literature that Montenegro is relatively stable at present. While the country faces some economic challenges, the literature does not identify any of these as potential drivers of conflict.

# **7. Serbia**

## **Economic performance**

According to the European Commission, economic reforms in Serbia have improved growth prospects and resulted in a reduction in domestic and external imbalances (2016f: 5). GDP growth stood at 0.8 percent in 2015 (European Commission, 2016f: 25). However, government debt remains high (European Commission, 2016f: 5). Both public and private investments have reportedly increased, although investment levels are still too low to meet the economy's needs (European Commission, 2016f: 5). Moreover, Serbia has experienced a significant increase in exports in recent years, which has helped to reduce internal imbalances (European Commission, 2016f: 26). However, the state's role in the economy remains high, and the state continues to provide aid to unprofitable public companies or in a non-transparent manner (European Commission, 2016f: 26).

## **Labour market issues**

Unemployment in Serbia stands at 17.7 percent. Forty percent of young people are unemployed (European Commission, 2016f: 29). Moreover, according to the European Commission, women are less active in the labour market than men (2016f: 30). In addition to women, Roma, people with disabilities and people with low qualifications are the most discriminated against in the labour market (European Commission, 2016f: 51). However, according to one peer-reviewed journal article, there is an equal proportion of women and men at all levels of education in Serbia,

except for among Roma women (Ignjatović & Bošković, 2013: 426). Moreover, the article states that female employment stands at 44 percent, and the gender pay gap stands at 61 percent (Ignjatović & Bošković, 2013: 426).

## **Migration**

In 2013, 18.2 percent of the Serbian population lived abroad (Petreski et al, 2017: 2). One article forecasts a 13.5 percent increase in outward migration from Serbia in the next five years (Petreski et al, 2017: 13). It also projects a 17.4 percent increase in remittances in the same period (Petreski et al, 2017: 13).

With regard to inward migration, according to a report published by the Friedrich Ebert Stiftung, based on a survey of a sample of the general population, the majority of respondents believed that the permanent settlement of the migrant population would have a negative impact on employment rates in Serbia (2016: 17). The majority of respondents also believed that integration of migrants puts a lot of pressure on public finances. Three key issues identified in the report relating to migrant integration and employment opportunities in municipalities are:

- The municipalities do not have enough jobs for the local population, let alone for migrants.
- Employment of migrants depends on their individual skills and competencies.
- The possibility of migrants undertaking agricultural and temporary/seasonal jobs.

The above reportedly suggest that there is a very low chance of migrant inclusion in the labour market without 'special preparation and focused aid' (Friedrich Ebert Stiftung, 2016: 21).

## **Organised crime**

In Serbia, financial investigation is limited to the seizure and confiscation of criminal assets of individuals. It rarely focuses on tracing money flows (European Commission, 2016f: 17). Moreover, precautionary freezing of assets is rarely undertaken during investigations. This means that assets often disappear, which results in a poor track record of confiscating criminal assets on final conviction (European Commission, 2016f: 17). Sanctions applied by judges reportedly do not serve as a deterrent to organised crime (European Commission, 2016f: 17). Serbia has made some progress in combatting money laundering, with the Administration for Prevention of Money Laundering identifying and acting upon some suspicious transactions. However, the institution lacks adequate resources (European Commission, 2016f: 17).

## **Regional linkages**

Serbia has good relations with most of its neighbours, including Bosnia Herzegovina, Macedonia, Montenegro (see also section on Montenegro), Bulgaria, Hungary and Romania (European Commission, 2016f: 23). However, relations with Kosovo continued to be strained (European Commission, 2016f: 24). According to the European Commission, relations between Serbia and Albania and Turkey remain 'stable,' but relations with Croatia are 'mixed' (European Commission, 2016f: 23).

In 2015, Serbia, together with Austria, Bulgaria, Croatia and Slovenia, initiated the founding of the Alpine-Western Balkans freight corridor, which will extend from Salzburg to the Bulgarian-Turkish border (European Commission, 2016f: 53). In terms of road infrastructure for the Orient

East-Med corridor South and East branches, several sections have been completed (European Commission, 2016f: 53).

### Conflict potential

There is a consensus in the literature that Serbia is relatively stable at present. While the country faces some economic challenges, the literature does not identify any of these as potential drivers of conflict.

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## Key websites

- Balkan Insight: <http://www.balkaninsight.com/en/page/all-balkans-home>
- World Bank: <http://www.worldbank.org/en/region/eca>
- Central Intelligence Agency, World Factbook: <https://www.cia.gov/library/publications/the-world-factbook/>

## Acknowledgements

We thank the following experts who voluntarily provided suggestions for relevant literature or other advice to the author to support the preparation of this report. The content of the report is the sole responsibility of the author and does not necessarily reflect the opinions of any of the experts consulted.

- Gallina Vincelette, Macroeconomics and Fiscal Management Global Practice, Europe and Central Asia Region, The World Bank

## Suggested citation

Idris, I., & Strachan, A. (2017). *Economic Drivers of Conflict in the Western Balkans*. K4D Helpdesk Report. Brighton, UK: Institute of Development Studies.

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