

Gent Sejko: Convergence process challenges facing south-east Europe and Albania

Speech by Mr Gent Sejko, Governor of the Bank of Albania, at the 7th ECB conference on central, eastern and south-eastern European (CESEE) countries on "Institutional quality and sustainable economic convergence", Frankfurt am Main, 5 October 2017.

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Accompanying [slides](#)

Honourable Participants,

It is a pleasure for me to participate in this Conference, and discuss about the role of our Institutions in the EU economic convergence process, such a relevant topic nowadays. I believe sharing our knowledge and experience in this area is extremely beneficial to all of us.

My thoughts will be organized along three main dimensions. To begin with, I will highlight some of the challenges that the SEE convergence process is facing, from Bank of Albania' point of view. Next, I will briefly describe how Albania is positioned across these dimensions. Lastly, I will try to emphasise how the convergence process itself can be enhanced to anchor our policymaking.

1. SEE convergence process challenges

The long-term political future and economic prosperity of the SEE region is firmly linked to EU convergence and integration processes. While individual countries have differences, a common specific they all share is the economic and political benefits from the process.

The convergence process is difficult and full of challenges, most importantly, the risk of falling into a 'middle income trap', a feature that is especially relevant given the slowdown in the speed of convergence that the region experienced in the aftermath of the crisis. The main reasons that can entrap an economy in a middle-income level are a low level of innovation, poor quality of institutions and unfavourable demographics.

From a certain point of view, the ability of any country to move up the development ladder depends on the upgrade of its internal economic system, from an efficiency-driven into an innovation-driven economy. Obviously, upgrading the whole economic systems and adopting best practices is easier said than done.

Diminishing marginal returns on labour and capital, as well as a reduced scope for total factor productivity growth, coming mainly from imported technologies, decelerate growth and increase the risks of getting stuck in a 'middle income trap'. Therefore, progression to the next development stage requires improvement of the human capital stock, facilitation and innovation in production processes, advancement of domestically generated technology and expansion of high value added exports. In a nutshell, the SEE countries need to transform themselves into innovation-driven economies.

At this point, the role of institutions broadly determines the rule of law, the investment climate and the protection of intellectual property, the quality of education and infrastructure, as well as access to finance. Upgrading institutions to EU standards is therefore of paramount importance.

2. The convergence process in Albania

Throughout the transition period, Albania has experienced a relatively fast catch-up process, starting from a comparatively low income per capita level. This has, nevertheless, stalled after the financial crisis. While Albania, currently a middle income country, has not fallen yet, in my

opinion, in ‘the middle income trap’, the risks of doing so are present.

Let me briefly examine why.

The institutional setup in Albania has been largely contributory to the convergence process. Macroeconomic policymaking has improved considerably in the past years. The Bank of Albania operates under an inflation targeting regime, modelled closely after the ECB’s framework. The exchange rate is free floating, thereby facilitating the absorption of any adverse shocks. Fiscal policy is on a steady consolidation path to reduce the country’s risk premia and enhance its fiscal space in order to deal with potential future shocks. The authorities have adopted fiscal rules that mandate a steady reduction of public debt. Several policy initiatives have been implemented to strengthen financial stability. A de-euroization strategy has been developed and launched. Legal impediments to collateral execution and NPLs resolution have been overcome. A Bank Resolution Law has been recently passed. In addition, the independence and efficiency of the Financial Supervisory Authority and the Deposit Insurance Agency has been strengthened.

Despite this progress, several deep structural imbalances still exist that prevent the transformation of Albania into an innovation-driven economy. According to the WEF Global Competitiveness Indicators, we are still lagging behind in institutional development, business sophistication, innovation, technological readiness, financial market development, rule of law, and quality of the judiciary. In order to tackle those impediments, various structural reforms have been carried out in the public administration, in education, in the tax system and practices, in the pension system and in the energy sector. Last year a major revise of the justice system was approved to address what is considered one of the main bottlenecks of growth and competitiveness. Although the reform is still being implemented and it is early to assess its effects, it underscores the Albanian authorities’ commitment to address structural weaknesses.

On the other hand, Albania has benefited from a positive demographic position as a result of its young and vibrant labour force, but has suffered from continuous net migration towards more developed countries. While emigration has provided a steady flow of remittances and has eased labour market pressures, it has also drained the country of its highly skilled labour force. The latter might have long-term repercussions on innovation and can have implications on the so-far convergence progress realised.

With that being said, let me now conclude.

3. Towards a steady convergence path

SEE countries are at risk of falling into ‘a middle income trap’. As such the economic systems need to be transformed, through carefully-designed and well-targeted policies that promote domestic innovation, modernise institutions, and cushion the effects of adverse demographics.

It is clear that the load of reforms remains with the SEE countries authorities’ themselves. A domestic ownership of reforms is of utmost importance for the democratic process and the ultimate success of convergence.

However, while these policies need to be carried out regardless of external factors, EU integration has a fundamental importance on economic convergence dynamics.

After the economic and financial crisis, appetite for further EU enlargement declined, due to waning popular support and shifting policy priorities towards reform. As the EU’s mood drifted away from enlargement and from further integration, countries relaxed their drive for reform. These developments coincided, or let me rather say, induced a stall in the convergence process in several SEE countries.

As a final thought, the EU institutions themselves can facilitate this process further through:

- ♦ Providing transparent and objective EU integration guidelines;
- ♦ Emphasising the need of institutional convergence throughout this process;
- ♦ Continued monitoring and reporting on the progress of individual countries.

On one hand, this will enhance the positive leverage of the EU integration process on the development of our countries and societies. On the other, it will increase the cost of non-compliance and possibly induce positive compliance competition amongst the countries in the region.

Thank You!