Institutional Quality and Sustainable Economic Convergence

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The economic convergence has slowed down...

- Economic convergence firmly tied to the EU integration process in the SEE region.
- SEE countries benefited from rapid efficiency gains due to large-scale liberalization reforms during the transition period.
- The economic and financial crisis induced a stall in convergence dynamics for the region.

Source: Eurostat
1. SEE Convergence Process - Challenges

- Convergence slowdown due to diminishing returns from capital and labour, as well as fading efficiency gains.

- Risks of falling into a ‘middle-income trap’ because of low level of innovation, poor quality of institutions and unfavourable demographics in the future.

- Imperative to prepare our economies for a gradual transition, from efficiency-gains-driven systems onto innovation-driven ones.

- Quality of institutions paramount in facilitating the move to the next development stage.

- Necessity for intelligent and targeted structural reforms:
  - Objectives: to promote business environment, rule of law, innovation capacity and overall competitiveness.
  - Targeted policy outcomes: improvement of the human capital stock, facilitation of innovation in production processes, advancement of domestically-generated technology and expansion of high value-added exports.
2. Convergence Process in Albania

• Institutional setup in Albania has been largely contributory to the convergence process, and macroeconomic policymaking has improved considerably in the past years.

• Independent central bank with an inflation targeting regime and a free floating exchange rate.

• Fiscal policy is on a steady consolidation path and a debt-reducing fiscal rule adopted.

• Range of structural policy initiatives to strengthen financial stability:
  – A banking sector de-euroization strategy
  – Removal of legal impediments to collateral execution and NPL resolution
  – Bank Resolution Law recently passed
  – Independence and efficiency of the FSA and the DIA strengthened further

• However, certain structural imbalances remain.
For a steadfast economic convergence to EU countries, Albanian needs to engage in continuous structural reforms aiming at improving:

- institutional development
- business sophistication
- innovation capacity
- technological readiness
- financial market development
- rule of law and quality of the judiciary.

Various have been carried out:

- Growth enhancing reforms:
  a) Education reform, aimed at reducing skills mismatch in the labour market
  b) Active labour market policies, aimed at increasing labor participation
  c) Judicial system reform, aimed at improving law enforcement and increasing contract compliance
  d) Energy sector reform, aimed at increasing efficiency and alleviating bottlenecks in supply

- Sustainability enhancing reforms:
  a) Pension system reform, aimed at ensuring sustainability of public finances
  b) Administrative and territorial reform, aimed at reducing waste and increasing efficiency

However, more is needed to smooth Albania’s EU integration process and ensure that convergence is successfully achieved.
3. Concluding Remarks

• Economic systems in the SEE countries need to be transformed to avoid falling into ‘a middle-income trap’.

• Domestic ownership of structural reforms is crucial for the advancement of institutional quality and for achieving a sustainable long-term and inclusive economic growth.

• Targeted policy needs to promote innovation, cushion the effects of adverse demographics and facilitate the overall convergence process.

• The EU institutions can contribute further by:
  – providing transparent and objective EU integration guidelines;
  – emphasising the need of institutional convergence throughout the process;
  – continuing to monitoring and reporting on the progress of individual countries.
THANK YOU!

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