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ECONOMIC COOPERATION BETWEEN ALBANIA AND SERBIA

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I. Background: *The importance of regional economic cooperation in the Balkans*

The economic dimension of regional cooperation is a key pillar for achieving an interconnected and developed Western Balkan region. Due to the prolonged economic transition, the high unemployment, especially among the youngsters, and the consideration of WB6 countries as non-functioning market economies, the economic cooperation and integration pillar has in fact topped the agenda of the ‘Berlin Process’ and has consequently received the largest allocation of funds, when compared with the other two –diplomatic and soft- pillars¹.

The regional economic cooperation in the Western Balkans is based on two central goals:

1. Economic Cooperation aiming to overcome nationalism and political imbalances;
2. Economic Cooperation as a way to foster national economic growth and development

There are several reasons that make Regional Economic Cooperation a prerogative for increasing prosperity, for creating more jobs and for boosting economic growth. Firstly, regional economic cooperation will enable participating countries to overcome the small size of their domestic markets, to achieve economies of scale and greater specialization in the production process; thus increasing the competitiveness of their products. Secondly, it will expand existing industries and will set up new export industries, diversifying exports and reducing their vulnerability to setbacks in a specific product market. Thirdly, regional cooperation can enhance the capacity of participating countries to meet emerging challenges, including the application of new technologies. Fourthly, it is increasingly clear that regional economic cooperation increases trade volumes by reducing the costs of transactions across international borders and removing non-border obstacles.

In addition, the creation of regional market with 26 million customers in the Balkans is key element for attracting foreign direct investments (FDI). FDI are not only an important source of increasing trade and financing current account deficits, but are recognized as a source of positive spillover effects, ranging from the transfer of technology and knowhow to increased

¹ Final Remarks. Western Balkan Summit, Vinna 2015. http://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/policy-highlights/regional-cooperation/20150828_chairmans_conclusions_western_balkans_summit.pdf

local competition, creation of employment opportunities and provision of access to international markets for foreign producers².

Apart from being a basic requirement for economic advancements of each country, closer economic cooperation in the Balkans is of a strategic importance to further consolidate political stability at national and cross-border level, an important requirement towards the EU accession. The long term view is to restructure relationships so that Western Balkan countries would have an incentive to see each other prospering, this because the wellbeing of “the other” has a direct impact on the wellbeing of “the self”.

Albania and Serbia are the two largest countries of the Western Balkans and in the same time they exert a major political influence in the region. As such, the cooperation between these two countries is instrumental for the economic and political stability of the region and its future integration into the EU. With regard to the EU integration, Serbia has granted EU candidate status since March 2012 and in January 2014 has taken place the formal start of accession negotiations, while Albania awarded candidate status only in June 2014 and has not started yet the negotiation process.

As previous socialist countries, both countries have undergone major economic transformations over the past 25 years. They have opened up to global trade and have become export-oriented, have expanded the role of the private sector, have dismantled regulations that stifled business development, and have begun to build institutions needed to support a market system. The result of these efforts have been a significant rise in incomes, living standards, and enhanced macroeconomic stability.

However, the process of structural transformation has begun gradually to stall after the 2000s, in the face of vested interests and structural obstacles. The de-industrialization, the development of internationally non-marketable services, and the development of low added-value manufacturing activities are some of the few distortions of the economic tissue in both countries. Clear evidence of the weaknesses in the region’s economic model can be found in the high unemployment rates, a continuing brain drain and in the poverty rates. Despite some economic structure and activity differences (ex. Serbian economy is approximately three times bigger than that of Albania and its GDP per capita is only at around 1.3 times bigger; the Serbia

² OECD. (2002). Foreign Direct Investments for Development.
<https://www.oecd.org/investment/investmentfordevelopment/1959815.pdf>

economy is much more industrialized, while in Albania agriculture sector weights 23% of the total value added in the economy), both countries face common challenges and with this regard, economic regional cooperation is expected to make both countries better off³.

Regional economic cooperation involves collaborative efforts and common interests that do not stop at the country border and which are often facilitated by the creation of an economically integrated area, such as a free trade area. Therefore, the success of regional cooperative efforts is to some degree dependent on the institutionalized unification in terms of integration. That is why the economic pillar prioritizes joint economic governance - which constitutes the heart of the new approach of the European Commission – and connectivity. In the spirit of economic governance and under the technical support of the European Commission, the WB6 countries agreed to prepare every year credible National Economic Reform Programmes (NERPs), including both a macroeconomic and fiscal programme along with a structural reforms and competitiveness programme. In January 2015, the WB6 countries submitted to the European Commission the first NERPs, which included clear timelines and detailed budgetary implications. Since the approved regional projects need highly specialized competencies and have a long-term implementation period, the ‘Berlin Process’ and Vienna Final Declaration envisage that the economic policy and its governance in the Western Balkan countries will be further enhanced through the preparation and coordination among these annual National Economic Reform Programs.

The 2016 EU Commission’s Overview on National Economic Reform Program of the Albanian and Serbian government outlines the following common obstacles to growth:

- Macroeconomic vulnerabilities and high risk premium related with high public debt level;
- High level of NPL, which is constraining banks to expand lending activities;
- Rule of law and a not so friendly business environment;
- Large informality still reigning in the economy and hampering competition;
- Structural problems in different sectors, such as the energy one
- Low level of tradeable sectors, that impede the boost in productivity and the expansion of the export base

³ Madlitz, A. (June, 2014). Economic Development in the Western Balkans: On the road to competitive market economies? The Aspen Institute Germany. <http://www.aspeninstitute.de/wp-content/uploads/Agenda-LOP-and-Report-Economic-Development.pdf>

- Low level of FDIs cover the current account deficit.

Based on the NERPs and the overall agenda of the ‘Berlin Process’, this policy brief will analyze the current dynamics of economic cooperation between Albania and Serbia by focusing on the areas of trade, energy, transportation, tourism and financial sector. The policy brief will also recommend potential paths on which economic relations between Albania and Serbia could enhance bilateral economic cooperation. Overall the study aims serve as a guide for determining comparative advantages of each country and for developing strategic plans for sustainable regional economic cooperation.

II. Analysis of the current dynamics of economic cooperation

Since its inception, the ‘Berlin Process’ has been focusing on the concept of connectivity, as the new regional approach that would enhance regional cooperation among the WB6 countries, would provide new prospects for sustainable economic growth and employment, and would allow for positive spillover effects. The so-called ‘Connectivity Agenda’ consists of complex investments in transportation and energy infrastructure, which positively affect the trade and ICT exchanges and all together directly enhance growth rates. Such investments are facilitated by regional financial cooperation, which at the same time reduces the impact of volatile financial markets, thus providing macro-economic stability. Based on the composition of the ‘Connectivity Agenda’, this policy brief will analyze the Albanian-Serbian economic cooperation by taking in consideration trade relations, energy sector, transportation developments, financial sector and tourism sector. This last one is considered particular important due to the contribution that tourism sector have in and Serbian and particularly Albanian GDP, due to the importance this sector has to create ‘a good country image’ and due to the fact that this sector is related with people’s mobility that is enhanced by transportation developments.

2.1 Trade⁴

The trade sector can provide a good basis for bringing closer and triggering economic interdependence between these two countries that retain a wider political influence in the

⁴ For further more information, please refer to: Lleshi, S & Selcebe, D. (2016). Trade relations between Albania and Serbia. Albanian Institute for International Studies. <http://www.aiis-albania.org/sites/default/files/1-Trade%20Relations%20July%202016.pdf>

Western Balkans. There exist a number of mechanisms at different levels that enhance and facilitate the trade relations between Albania and Serbia. At the governmental and expertise level, the existing mechanisms such as RCC, CEI and CEFTA have provided an appropriate ground for mutual trade cooperation.

The trade cooperation between Albania and Serbia has experienced a boost since the establishment of bilateral free trade agree between the two countries in 2004 and particularly after their accession to the Central European Free Trade Association (CEFTA) 2006. In the frame of CEFTA, Serbia is Albania's leading import partner with 41% of the total imports. During 2014, trade volume between the two countries was at 180.528.571 Euros. Exports from Albania amounted to 11,500,000 Euros, while exports from Serbia to Albania reached 169,028,571 Euros⁵. Due to the fact that the economic structure of Serbia is focused on industrial production which is more tradable, while the Albanian economy is oriented towards tourism, services, manufacturing and agriculture there is a stark trade disproportion (exports vs imports) in favor of Serbia.

Overall, CEFTA agreement has had important effects, since full liberalization of the import duties on industrial goods and special regime of liberalization for agricultural products was achieved. However, a major problem not enabling the agreement to fully achieve its goals has been the numerous non-tariff barriers to trade applied by its members, which include: complicated border-crossing procedures; extensive administrative work and mutual non-compliance of customs activities and inspection departments; insufficient number of internationally recognized accreditation and certification bodies, as well as authorized laboratories and institutions; non-recognition of quality assurance certificates; corruption and smuggling⁶.

Another factor that has a very good potential for sustaining and increasing trade relations between Albania and Serbia is the existence of joint enterprises between Albanian and Serbian citizens. In addition, they represent a prospective opportunity for interest group pressure on national government policy in favor of increased cooperation. With this regard, a limitation

⁵ ISAC Policy Perspective, "Serbian-Albanian trade tripled since 2006: Why there is room – and need – for more?", pg. 1, Online: <http://www.isac-fund.org/download/ISAC-POLI-CY-PERSPECTIVE-5e.pdf>

⁶ Moraliyska, M. (2015). Regional Economic Cooperation in the Western Balkans. Economic Alternative, Issue 1. http://www.unwe.bg/uploads/Alternatives/9_Moraliyska.pdf

can be the similar patterns of specialization and a dominance of labor intensive production that offers little room for differentiation. Therefore, structural reforms of the economy remain an important complementary and necessary aspect of making both economies reciprocally advantageous.

In addition, the current climate calls for a more proactive and comprehensive approach, a need to link the improvements in infrastructure with the investments in order to create opportunities. By using this approach, both countries could address broader investment issues and promote economic activity, such as special productions and trade zones. A potential field for the future strategic cooperation can be the area of industrial production, where each of the countries can specialize in complementary stages of production.

1.2 Energy sector⁷

The energy sector constitutes one of the most strategic sectors of the economy, which is part of the EU policy recently framed as Energy Union. The Western Balkan is considered an important area for the diversification of the energy production and transmission in Europe. With this regard, the cooperation in the energy sector between the WB6 countries increases the chances that the EU attains energy security, without depending on external sources such as Russia.

However, cooperation in the energy sector (electricity, gas, oil) is crucially important even among WB6 themselves. That is why, even prior to the Connectivity Agenda of the Berlin Process, it was in place the Energy Community Treaty, contracting partner of the which Albania and Serbia have been since 2005. Since the energy sector in both countries (particularly the electricity sector) is characterized by structural problems related to limitations in transmission systems, insufficient metering and unpaid bills, as well as depreciated infrastructure and old technology, both countries can enhance energy self-sufficiency through the integration of the local electricity networks in the electricity network of the region⁸.

⁷ For further more information, please refer to: Lleshi, S & Selcebe, D. (2016). Energy cooperation between Albania and Serbia. Albanian Institute for International Studies. <http://www.aiis-albania.org/sites/default/files/Energy%20Cooperation%20between%20Albania%20and%20Serbia.pdf>

⁸ Popovici, Vlad: Energy Sector Progress and Setbacks for Balkan States Noted in the EC 2011-2012 Enlargement Strategy Package.

In the case of Serbia the energy production has been countered by the use of coal and lignite, which has led the country to reach considerable levels of energy self-sufficiency, yet producing damage to the environment. In Albania, the hydropower energy is the most used source to produce energy. Despite the fact that hydropower would be more preferable to coal for energy production, the main concern is the absence of energy security and self-sufficiency in Albania. Due to these structural composition of the energy sector, the electricity trade Serbia – Albania in 2015 was 2305 GWh, while the energy transmitted from Albania to Serbia was at 663 GWh⁹. Cooperation in this area has been intense during the last two decades, but lack of infrastructural capacities for enabling large volumes of energy to be transmitted, has been an obstacle for the further enhancement of the energy links between the two countries.

Both countries' priorities in the energy sector include:

- Reducing/ unbundling monopoly position of energy production/transmission firms
- Increasing transparency and energy choices for consumers
- Diversifying energy producing by primarily using renewable energy (coal free energy)
- Maintaining energy security throughout the year
- Enhancing cooperation on energy trade

Reaching these goals by taking advantage of local potentialities could hardly be achieved without regional cooperation. For example, the Patos-Marinza oil field in Albania is the largest on-shore oil field in Europe. However, its oil is crude and needs refinements, which ARMO (the company in charge for oil extraction) does not have the capacities to perform. With this regard, NIS Serbia could play an important as a foreign investor, since it is more experienced and has better refinement capacities.

In the framework establishing a regional energy market, both countries have made progress in removing legal and regulatory obstacles. However, the Energy Community reports indicate that both countries are far from the reaching the level of the cooperation between the neighboring countries and furthering the regional cooperation. The Projects of Energy Community Interest (PECI)¹⁰ approved in the Vienna Summit 2015 were mostly national

⁹ Ymeri, H & Xhafa, F. (2015). Third Actors in the Western Balkan and Energy Security, p.20.

<http://www.energija.gov.al/al/njoftime/lajme/masterplani-i-gazit-gjknuri-piketate->

¹⁰ Energy Community WB6 Monitoring Report 03/2016. https://www.energy-community.org/portal/page/portal/ENC_HOME/DOCS/4116432/30EB0B9DF4064FEFE053C92FA8C041F9.pdf

projects or project which didn't include the Albania-Serbia collaboration - ex. Albania proposed projects linking it with Macedonia and Kosovo and projects related to TAP, while Serbia proposed thermal power cooperation with Romania and gas cooperation with Bulgaria. The only common project is a tri-partial project with Italy, which aims to improve regional cooperation between these countries, including the energy sector.

Regarding renewable energy such as wind, solar energy and bio-mass, the existent potential has not been properly materialized. There have been development programs such as the Country Program of Albania under the Global Solar Water Heating Market Transformation and Strengthening Initiative, supported by the Albanian government, GEF and UNDP, which made possible the installation of 75,000 of solar thermal collector area into the facilities of different Albanian public institutions and other foreign investments such as wind farms in Albania from Italian investors, but no project/ investment has been with Albania-Serbian partnership. However, such type of collaborations are more ambitious and require further expertise. Since the Paris Summit 2016 gave priority to the hydropower energy production in the region, the focus on hydropower renewable energy could be the most feasible cooperation between the two countries, which could be strengthen throughout the year and not only during peak season.

2.3 Transportation linkages¹¹

Albania and Serbia constitute two countries of the Western Balkan region that are strategically positioned as nodal linkages of transport routes. Albania is in a favorable position that links the Mediterranean basin with the East and Serbia links the Western Balkan region with the Danube basin and henceforth with North of Europe. Despite differences in terms of infrastructure development and investment, both countries are characterized by “insufficient length of highways, non-uniform transport infrastructure, and lack of high-speed railway lines”, which make them lag behind compared to other EU countries¹².

¹¹ For further more information, please refer to: Lleshi, S. (2016). Transportation linkages between Albania and Serbia. Albanian Institute for International Studies. <http://www.aiis-albania.org/sites/default/files/3-Transport%20Linkages.pdf>

¹² Tsvetan, I. & Matov, D (2013). European Transport Networks- The Road to Economic Connectivity in South East Europe. <http://top100.seenews.com/2013/10/european-transport-networks-the-road-to-economic-connectivity-in-southeast-europe/>

However, given the salient role of regional inter-state organizations such as the RCC and the SEETO “whose most obvious areas of cooperation include transport and energy infrastructure”, and the EU push towards connectivity in the region via also the Berlin Process, the countries of Western Balkans such as Albania and Serbia in particular, have a more conducive environment to engage in improvements of the transport interconnections and mutual projects of cooperation in this policy field. The South East Europe Transport Observatory (SEETO) has estimated that it would cost EUR 7.7 billion to implement the priority projects. Findings of a study by the Vienna Institute for International Economic Studies show that such a comprehensive infrastructure investment package in the WB6 could lead to an additional growth push of up to one percentage point per year for the countries of the region over a period of 15 years. and some 200.000 new jobs could be created in the region¹³.

The current agreements between the two countries have intensified the relation between Serbia and Albania in the transport sector by increasing the potential for the free movement of goods and peoples. Apart from the standard agreements on transport policies, both countries have envisioned concrete major transport investment in infrastructure that would enhance the position of the countries in the region. A central investment in infrastructure for the Republic of Serbia is the construction of the Corridor X and the railway network that it entails. While regarding Albania, one of the most important investments in the transport infrastructure is related to the Corridor VIII both in the road sector and the railway sector. This corridor stretches throughout the Southeast Europe and links the Port of Durres to the other countries of the region such as Macedonia and Bulgaria. The railway part of the Corridor VIII in Albania include Tirane-Durres-Lin and Vore-Han i Hotit.

In terms of the infrastructure projects that link Albania and Serbia two of them are of important note. One of these is the highway that links Niš-Prishtina-Durres. This particular project has the support of both governments. The representatives of both countries are aware of the interconnectivity effects that the transport infrastructure project have for Albania and Serbia. Another infrastructure project that is suggested by the Serbian government includes the Belgrade-Podgorica-Shkoder highway.

¹³ Final Remarks. Western Balkan Summit, Vinna 2015. http://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/policy-highlights/regional-cooperation/20150828_chairmans_conclusions_western_balkans_summit.pdf

In terms of prospective shared project, an important one is the railway path that starts in Milot, Albania to Prizren, Kosovo and ends in Niš, Serbia. Another favorable investment in infrastructure that would be profitable to both countries would be the development of the Port of Shengjin as a hub for transportation, besides that of Durres. As transport experts claim this port reduces the distance between sea and land in the road networks of the region.

2.4 Tourism sector ¹⁴

Tourism is a powerful tool to bring different countries together. By better knowing one another, people of different cultures and backgrounds will find it much harder to generate feelings of hatred and animosity against each other. Thus, the consolidation of interaction in the area of tourism between Serbia and Albania is very important for the further stabilization of the relations between the countries, since it will not only trigger better economic prospects but it will also positively change the perception that both nations have towards each-other.

On the other hand, tourism was understood by the business economic policies of governments as an important potential in boosting economic growth and employment. For a considerable time, tourism industry has been considered as a national industry in competition with other countries in the region. However, recently the EU has set the agenda for a macro-regional approach to economic development and connectivity through the establishment of EUSAIR and Interreg Adrion. The EUSAIR initiative stresses the necessity to achieve economic growth and prosperity in the region by making improvements in the region's attractiveness, competitiveness and connectivity. In this respect, the individual members of the Adriatic Ionian region, which include also Albania and Serbia, due to the positive impact of an enlarged market and coordination, by branding their region as a tourist attraction shall have more profits rather than remain fragmented into national tourist trades. The suggestion by the EU is to: "... create a network of sustainable tourism businesses and clusters, to stimulate innovation and create synergies with complementary sectors"¹⁵.

¹⁴ For further more information, please refer to: Lleshi, S & Selcebe, D. (2016). Energy cooperation between Albania and Serbia. Albanian Institute for International Studies. <http://www.aiis-albania.org/sites/default/files/2%20-%20Tourism%20cooperation%20July%202016.pdf>

¹⁵ European Commission, 2014 http://ec.europa.eu/regional_policy/sources/cooperate/adriat_ionian/pdf/brochure_250914.pdf

For 2014, tourism contributed to 6,1% of the Serbian GDP, while the total contribution on employment was at 2,6% - 35,000 Jobs¹⁶. During 2014, the number of foreign tourists visiting Serbia amounted to 2,192,268. In 2014, 3,673,000 foreign visitors came to Albania, contributing to 21% of GDP and 19,2% of employment¹⁷. As tourism products in Serbia and Albania are different (respectively mostly cultural vs mostly summer sessional), the long-term governmental strategies on tourism have included common touristic regional packages, that would also create the premises to a fruitful cooperation between the relevant providers in both countries. More concretely these strategies includes integration in regional touristic routes, exchange of the successful practices of tourism industry and common touristic itineraries in adventure and nature tourism across borders. As a result, economic prospects would grow and the relations between both countries would experience a new momentum. Infrastructural projects bringing both countries together, such as the Nis-Durres highway would constitute a huge contribution in this respect.

Lastly, some positive steps have recently been taken that increase the cooperation between Albania and Serbia in the sector of tourism. In September last year, the Albanian government and the Serbian government signed an agreement on tourism cooperation. The agreement is part of the broader effects of the Berlin Process that enhances regional cooperation in Western Balkans. This particular agreement foresees Serbian investments in the tourism sector, especially in Durres. The initial practices and steps of closer contacts between Albania and the Republic of Serbia are rather positive. Yet, improvements are needed to enhance and normalize the relations.

2.5 Financial Cooperation

The strategic policy documents of Western Balkan countries, compiled in collaboration with EU Institutions, underline the objective of establishing a unified regional market in the Balkans. The South East Europe Strategy (SEE 2020), the central platform of economic cooperation in the Western Balkans, focuses on several shared projects in the areas of trade,

¹⁶ WTTC. 2015. Travel&Tourism: Economic Impact Serbia” p.1, Online: <https://www.wttc.org/-/media/files/reports/economic%20impact%20research/countries%202015/serbia2015.pdf>

¹⁷ Statistics Institute of Albania, INSTAT, Tourism, Online: <http://www.instat.gov.al/en/themes/tourism.aspx>

tourism, transport and energy in order to foster the formation of the regional market. Most of these projects are expected to be co-financed by the IPA II funds (approximately EUR 1 billion available for the ‘Connectivity Agenda’ related investments over the 2015-2020 period)¹⁸ and by the respective countries involved in the projects. Due to the co-financing scheme, Western Balkan countries have recognized the importance of having an efficient financial cooperation with the concerned lead International Financial Institution. However, despite the cooperation with International Financial Institutions, the role of regional financial cooperation in facilitating the creation of the regional market has been less pronounced in the policy documents¹⁹. In fact, such financial cooperation has historically not been present between Albania and Serbia, neither during the socialist or transition period.

Financial cooperation is one of the aims of Stabilization and Association Process in both countries. Nevertheless, the efforts towards financial cooperation should not be observed as a fulfilment of the EU membership requirements only, but also as a factor contributing to reforms on the way to sound regional market. A regional network of financial institutions, by providing liquidity and development financing, macroeconomic surveillance and consultation, and peer review of prudential regulation, would in fact act as a function of economic development and integration in the region.

Due to common financial market characteristics and common goals, there are two forms of financial cooperation that Albania and Serbia can prioritize:

(1) Development financing, the area where there is more extensive experience, including novel ideas, such as initiatives to strengthen regional bond markets. This might be too ambitious given the experience of Albania-Serbia financial markets and their final aim which is not to create a regional financial market, but to be integrated in the EU one. However, there might be scope for a regional development bank or other mechanisms (commercial banks of the other countries) to support investments in regional infrastructure and other “regional public goods”.

(2) Mechanisms for macroeconomic and related financial cooperation (liquidity financing during balance-of-payments crises), which include mechanisms of policy dialogue and peer

¹⁸ Viena Summit 2015. http://ec.europa.eu/enlargement/pdf/policy-highlights/regional-cooperation/20150828_chairmans_conclusions_western_balkans_summit.pdf

¹⁹ Various research (Odedokun, 1996; Rousseau and Wachtel, 1998; Rousseau and Sylla, 2005; Burhop, 2006) has shown that the development of a regional financial system improves regional economic growth.

review; more elaborate systems of macroeconomic surveillance and policy consultation/coordination; and reserve funds and swap arrangements among central banks. This type of cooperation is feasible and should be adapted by Albania and Serbia. Several research have shown that the exchange of information and periodic technical meetings involved in integration processes help to build knowledge and mutual trust, to preserve the regional financial stability from external shocks and to foster regional trade by discouraging competitive devaluations²⁰.

Despite of the lack of bilateral financial cooperation, both countries try to adapt the *acquis* on financial services and have been part of several same/common integration project, mostly related to the banking sector. An important achievement in 2015, has been the memorandum of understanding signed between the European Banking Authority (EBA), the Bank of Albania and the National Bank of Serbia, as well as other WB6 central banks²¹. The consideration these non- EU national supervisory authorities to be equivalent to the one prescribed in the EU is an important condition for non-EU authorities to take part, to get and to share experience in the work of EU colleges of supervisors.

In addition, European Central Bank has offered several assistance programs for both Albania and Serbia. During 2010-2012 both countries were part of a program designed to strengthen macro and micro-prudential supervision in the Western Balkans Both countries' central banks have also been part of ECB programs, aiming to identify areas in which the two central banks will need to make progress in order to reach a level compatible with that of the European System of Central Banks.

Moreover, Albania and Serbia are part of SPI Adriatic²², a Convergence Program to promote financial sector modernization in the Adriatic countries through micro-regulatory reforms designed in partnership with authorities and market participants, and with the assistance of World Bank and Italy. Some of the project in 2009 include: Enhancing banks' liquidity risk management; Debt Procurement; Unique and rationalized reporting system Revising

²⁰ José Luis Machinea and Guillermo Rozenwurcel. Regional Integration and Public Policy: Evaluation of the European Union case. United Nation Publication 2005.

²¹ European Banking Authority. Memorandum of understanding. 2015.
<https://www.eba.europa.eu/documents/10180/1244268/Memorandum+of+Cooperation.pdf/950f264e-8b3b-48b1-b6c6-e01634188bcb>

²² SPI Adriatic Program. <http://spi-albania.eu/en/2009-program/unique-and-rationalized-reporting-system/>

regulatory act on Execution of Procedures on Bank accounts; and Revising Foreign Currency Open Position. However, these project are last reported in 2009 and since then there is no update of projects in the Convergence Program.

Some more recent forms of financial cooperation include the creation of Network of Parliamentary Committees for Economy and Finance of the Western Balkan countries (NPC) in 2009, primarily including the committees on economy and finance. Following several years of regional parliamentary cooperation, in 2013, NPC decided to set up a clear governance and organizational structure with MPs participants from all WB6 countries. Other form of financial cooperation has been central banks conferences, such as the “European Economic Governance and EU membership process: The role of central banks,” hosted by National Bank of Serbia in Belgrade in May 2015. The general agreement among WB6 central bank governors was that central banks in the region need to cooperate and share expertise on economic modelling, analysis and financial projection. Meanwhile the regional networks would help with coordination of these issues and process enhancement in the framework of European economic governance and EU membership process.

As the Regional Economic Issue of IMF²³ states: *‘Without bridging the gap of financial development, WB6 countries would find it challenging to ensure economic convergence with the rest of Europe’*. Despite the improvements in the banking sector, domestic savings and deposits alone are unlikely to be sufficient to finance credit, investment and GDP growth that will be needed to enable the WB6 countries to converge to EU income level. Thus, there is scope for an increased share of regional funding in WB6 countries and for the development and application of common macro prudential policy framework, still at a nascent state in Western Balkan. In the longer term, the extension of euro payment area in the Western Balkan countries would be another building block for fostering regional financial cooperation and for developing of a truly regional market

²³ IMF. Regional Economic Issues: Central, Eastren and Southeastern Europe – Effective government for stronger growth. <https://www.imf.org/external/pubs/ft/reo/2016/eur/eng/pdf/rei1116.pdf>

III. Conclusions: The future of economic cooperation

Regional economic cooperation between Albania and Serbia provides a new impetus for the enlargement and integration process in the EU. Such cooperation offers a unique opportunity for both countries to be better prepared and coordinated, so as to increase their weight in different negotiations, not only with EU, but also with other international organizations. Through regional cooperation, it will be created a business environment that will provide for foreign and national direct investments, which will create much needed jobs and that will encourage individual initiatives, and so add to an increase in the living standard of the whole population. In many areas, such as trade, energy, transport, tourism and finance, because of the limited size of each of the two countries and the fragmentation of the economic space in the region, there is no other option but to embark on intense regional cooperation as the only realistic way forward.

Therefore, it is highly appreciated that in ‘Berlin Process’ the economic cooperation plays a bigger role. However, balanced growth needs a comprehensive approach. The development cannot be based only on the infrastructure projects. The region needs a parallel development of the infrastructure including better and faster rail connections and local public transport on the one hand, and a re- industrialization in connection with digital services and SMEs support on the other hand. Only such a balanced development may foster economic growth and create jobs for the younger, often better-educated and trained generation.

With this regard, two main common policies can be of help:

- Focus on *industrial policy*. The key objectives of such an industrial policy would be to ensure some reindustrialization of the strongly de-industrialized Balkan economies. This could be done through measures that would facilitate the development of new industries and/or strengthen those sectors that, presently, contribute the largest part of exports.
- Invest in *human capital*. More efficient policies are needed to stimulate R&D and innovation, along with better quality reforms of the system of education, that are essential for reducing the present mismatch between demand and supply of specific labor skills.

In addition, the future regional economic cooperation should be more factual and institutional. For example, CEFTA has its base, but both Albania and Serbia have other main trading partners that are not CEFTA members (only Montenegro has a significant share of its total trade within CEFTA). Both Albania and Serbia have orientated their trade towards the EU, with the which they sustain a stable negative trade balance. That is why, now that most institutions and agreements are in place, a concrete collaboration is needed to make Albania and Serbia main economic partners.

Lastly, the regional economic cooperation between Albania and Serbia has mostly been top-down till now – from EU to the region. The future of economic cooperation indicates toward a more mixed approached, combined with bottom-up approached. Both Albania and Serbia should be the ones willing to initiate new regional economic projects, after having realized that the creation of regional market provides grounds for a ‘win-win’ situation for all participants. Regional integration goes beyond being a precondition for EU integration in unfolding its value for prosperity and stability. Only by adapting the approach of fostering regional economic cooperation beyond just the scope of fulfilling EU integration criteria, such cooperation will be sustainable in the long term. In this framework, certain guidelines can be of help:

- Regional Economic Cooperation should be based on equality, equity and mutual benefit taking fully into account the economic social disparity as well as the differences in the level of development among countries in the region.
- Regional Economic Cooperation should involve commitment towards the common goals on the part of all participating countries with equal respect for each other.
- Regional Economic Cooperation should be based on consultation, deliberation, and consensus on all economic and other related issues.
- Regional Economic Cooperation should complement and build upon existing bilateral and other kind of arrangements among member countries.
- Regional Economic Cooperation should be based on modalities of economic openness and interdependence
- Regional Economic Cooperation should focus on common economic governance by establishing working groups so as to effectively manage regional economic cooperation project

IV. Recommendations

The following recommendations include actions that both governments and other regional economic actors can undertake to enhancing regional economic cooperation and integration in each respective sector.

Trade

–□ Due to the interconnectedness and multiplier effects of infrastructure (highways, regional corridors, energy interconnection) in relation to trade between the two countries it is commendable that investments and improvements in infrastructure be considered as a priority

–□ A more detailed scrutiny is needed in order to address the profile and activities of the business companies that have joint ownership of Albanian and Serbian citizens and that operate in one or both of the countries. A better understanding of the role of these companies can help assess the potential for interest groups lobbying for certain economic policies in mutual interest.

–□ In a mid-term and long-term perspective it is recommended that the Albanian economy should undertake structural reforms that will lead to a more advantageous profile and to increased production.

– Remove non-trading barriers in the framework of regional agreements such as CEFTA

–□ The regional cooperation mechanisms, such as CEI, RCC can be used at their full potential as venues of elite socialization of various levels (country expert representatives, business representatives and leading ministries) and as venues of norm diffusion in solving mutual problems and issues in a cooperative way rather than as venues for the defense a single country's interest.

Energy sector

- Establish a regional energy market, along the energy stock exchange, which was already discussed in the Vienna summit by the EU officials and the relevant actors from the Western Balkans Region
- Establish a natural gas market in Albania after the inclusion in the TAP and IAP network. This could increase the interest of Serbian firms in investing in the distribution of gas networks in the household market
- Collaborate with Serbian Oil companies for the development of the Albanian Oil industry: Exploration of new reserves, exploitation and refining industry
- Increase of Albanian crude Oil exports towards Serbia
- Increase the role of Serbian companies in Albania's Hydropower sector, especially with regard to concession contracts for the construction of Hydro Power plants

Transportation sector

- Reinvigorate transport linkages between the two countries in order to constitute a sustainable investment that yields positive spill-over effects in economic growth and interconnectivity
- Focus on more environmental friendly transport sectors should continue to be a priority in infrastructure investments in both countries

Tourism sector

- Promote common tourism packages by the relevant line ministries, including the most valuable tourist attractions of Albania and Serbia

- Establishment of intergovernmental working groups addressing the potential cooperation of tourism industries in both countries and exchanging best practices in touristic products of mutual interest such as rural tourism
- Construct the Durres-Nis highway and establish regular flights between Tirana and Belgrade
- Transform regional initiatives such as Adrion, Interreg, and Adriatic-Ionian Initiative into loci of policy development in relation to tourism
- Increase the flow of youth exchange through educational and cultural programs between the two countries.

Financial sector

- Foster the cooperation in the context of improving the regulatory and legal systems in financial area (ex. Regional Network of Central Banks, Regional Network of Parliamentary Committees for Economy and Finance of the Western Balkan countries). One of the main prerequisite of the financial development is the efficiency of the legal system²⁴. Cooperation between Albania and Serbia can contribute to the improvements in the legal system to be harmonized with EU directives. In addition, a Regional Network of Central Banks can also help sharing signals of external shocks and coordinating common prudential measures.
- Sign a memorandum of understanding to foster cooperation among regulators of financial sectors and agencies for law enforcements on fight against frauds in financial system and money laundering. The money laundering often takes form of cross-border transactions, implying the importance of collaboration among the countries in order to prevent or detect it

²⁴ Rafael La Porta et al. Legal determinants of External Finances. The Journal of Finance. 1996. Volume 52. Issue 3. pp.1131-1150.
<http://socsci2.ucsd.edu/~aronatas/project/academic/la%20Porta%20et%20al%20on%20law%20and%20finance.pdf>

- Form cooperation linkages between stock exchanges²⁵ – harmonization of listing rules, connectivity between trading platforms (in order to achieve scale economics), cross-border listing and product development

- Share knowledge and experience in the field of finance through educational/training programs, conferences and forums, and staff exchanges particularly among Central Banks' staff and staff of common banks in both countries

- Organize a Regional Association of Financial Experts, including experts from financial institutions, representatives from universities and other study institutes. Sharing experience would be beneficial for all the parties in managing IPA II funds, in developing new financial products and services and in developing study programs closer to the financial institutions' need

²⁵ With this regard Tirana Stok Exchange, which is practically inexistance, needs further development to at least reach the level of Belgrade Stock Exchange



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