

Ardian Fullani: The western Balkans – from regional cooperation to EU membership

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the conference “The western Balkans: overcoming the economic crisis – from regional cooperation to EU membership”, Brussels, 9 December 2009.

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During the last 20 years the region has undergone significant structural changes, which have fueled economic incentives and economic growth. In the early stages of transition a fast and significant transformation in the labor and later in the capital market reoriented all factors of production toward more productive sectors. This contributed to higher total factor productivity and consequently fast economic growth.

The final stage of transition was dominated by a robust financial deepening process fueled among others from EU based capital inflows. This financial intermediation busted credit growth and consumption yielding to absorption led growth model in the region.

In the aftermath of crises our policy choices are limited. From a broad prospective the region should chose a new philosophy, different from the boom-bust model of the last decade. I strongly believe this must be the focal point of the Regional Policies.

The current crisis pointed out several problems in our growth models. The so called catching up process was a model of unsustainable consumption behavior rather than sustainable long run equilibrium. Despite the overall fiscal consolidation and relatively high rate of growths, it resulted in increasing macroeconomic imbalances mostly evidenced in the fast enlargement of current account deficits. From a micro analysis point of view that was reflected on unsustainable financial position of enterprises and households balance sheets, ***lead by persistent fighting for market share in products and services in the banking system.***

It is for that reason that hard gained achievements attained during the last 15 years in eastern Europe, got reversed within one week.

Today, one year after the eruption of the financial crisis, I have to affirm that all the measures undertaken by central banks of countries in the region resemble one another. Generally speaking, in my opinion the measures adopted during this period are of an extreme nature; they are unusual and go against the “constitution” of the modern central bank with regard to liquidity, money market and monetary policy transmission channels. However, we have embraced the philosophy that “the end justifies the means”.

Nevertheless, I think the central bank has become more vulnerable in terms of independence and monetary policy efficiency. Providing liquidity in any case, in any quantity, with any maturity and accepting any kind of collateral would definitely damage the monetary policy, with potential second round effects on financial stability. If central banks in the short run shift their focus from the primary objective to supporting economic growth at any cost, it would indirectly create premises for long rung economic imbalances.

The current polices pursued by both monetary and fiscal authorities should not be considered as a new normality. While the global economy is adjusting toward a new equilibrium, solid macro-prudential long run policies should replace current stimulating efforts. Therefore the challenge for our economies in the long run is to address current problems and the inherited ones based on a new model of growth, based on: (i) higher savings and investments, aiming toward a contained consumption matched by domestic production; (ii) persistent FDI inflows oriented toward tradable sectors; (iii) regional cooperation.

Let me briefly share with you some of my thoughts on the **importance of this last remark, namely regional cooperation**. Following arguments illustrate the benefits of cooperation, at several levels:

- **From a development point of view**, increased cooperation and integration on a regional level creates a greater scope for **economies of scale**. This would increase incentives for local and foreign investors to undertake big investment project that would not be profitable otherwise. A related advantage would be **increased specialization** of our economies, leading to a higher economic performance.
- **On a policy level**, coordinated macroeconomic policies, legal and prudential frameworks, would tend to improve the allocation of resources and to prevent beggar-thy-neighbor policies. This race to the bottom type of philosophy would not benefit the region as a whole.
- **From a strategic point of view**, our region is in competition with several emerging regions on a global scale. It's not sufficient any more to be the best guy in the village; especially when there are an increasing number of villages on a global scale, with an ever increasing number of clever guys.
- **From a convergence point of view**, the sharing of experiences would avoid costly errors, while coordinated policies and steps would make a stronger case for a faster EU integration. We should demonstrate that the region is fit to enter the club, by firstly adopting the rules of the club among ourselves.

In a more technical and concrete approach, the efforts of the public authorities in our region to achieve a real and meaningful cooperation should consider the followings:

First, the mentality of the societies in our region should change. It is noted that this region has a history full of conflicts and many other disputes. It is now up to the young generations and to the people with an open-minded approach in our region, to find solutions and to promote behaviors that will build our future path toward Europe.

Second, the commitment to full integration with the European Union, **should serve as a solid platform for cooperation, and as an anchor** for pursuing sound policies and coordinated structural reforms.

Third, a very important precondition will be the strengthening of countries domestic anchors, specifically in the form of medium-term fiscal rules, fiscal councils, or embedding fiscal constraints in countries' constitutions.

Fourth, the legal basis that supports such international cooperation should be fully in place. It is important that such cooperation be guided from a set of consolidated principles with regional relevance.

Fifth, there is urgent need for policies that would encourage stronger inward FDI and other non-bank flows. The region's growth model might need to be more self-reliant, emphasizing domestic savings, better mobilization of labor resources, and a much greater role for the traded good sector as an engine of growth.

Dear participants,

Let me conclude by pointing out that our region offers an interesting combination of countries, languages, culture and geographical composition. Analyzed individually, it is difficult to think that our economies generate substantial incentives for foreign investors, particularly for strategic and technologically advanced investors, able to use the advantages provided by the economies of scale. Moreover, the cost associating different strategic projects at a national level would be higher for our still lagging economies. I do believe that there is plenty of room to establish a joint regional market and our duty is to make utmost use of it. There are still a few gaps in the region with respect to infrastructure, energy, tourism, financial architecture, mining and agriculture. Our task is to jointly identify missed opportunities, to jointly incorporate those into realistic business plans and to jointly present

these regional projects in a contemporaneous way to private investors and supranational agencies, to benefit their political, financial and technological support and finally ensure a stable growth model. On a national level, there is still the need for deep structural reforms and all efforts should be made for them to operate in a concerted way across the SEE region. I believe that the European Union structures should closely orientate, monitor and assess this process. This is the only way to steadily convert our countries into highly productive economies, attractive to foreign investors against the backdrop of favourable labour cost. This all makes sense once we fully re-dimension our educational capacities, particularly in technology and other areas where we could discover and explore advantages compared to other economies. Instead of looking at each other merely as competitors, we should approach the regional cooperation as a non-zero-sum game, where each country has to gain in partnership.

Summarizing, this process calls for risk adverse macro and development policies; well coordinated policy mix; stronger cross border co-operation, and concerted efforts – perhaps harmonized and motivated across the region – to deepen the quality of structural reforms. Structural reforms targeted to improving the business environment will help foster new capital inflows and strong and sustainable growth.

In this respect (and in the light of the last crisis lessons), countries can make better use of the EU fiscal surveillance process as explicit policy commitment devices. Candidate and potential candidate countries on one side and the EC on the other have the opportunity to transform this surveillance process (possibly enhancing it with an analytical input from IMF) into an efficient foreign anchor.