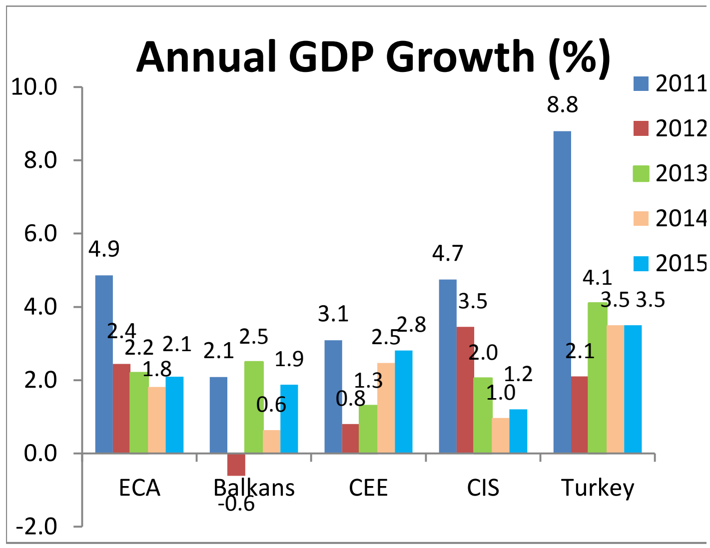
EUROPE AND CENTRAL ASIA

CONTEXT:

The Europe and Central Asia (ECA) region is still struggling to return to robust growth following a short-lived rebound after the global economic crisis of 2009. A slowdown in the pace of structural reforms, accompanied by tepid growth in the global economy and uncertainty arising from the conflict in Ukraine, continue to cloud the outlook.



Economic growth in ECA remains slower than most other regions of the world. In 2014, GDP growth for ECA as a whole is expected to be only 1.8 percent, improving slightly up to 2.1 percent for 2015.

Central and East European (CEE) countries are expected to see growth accelerate to 2.5 percent in 2014 and to 2.8 percent in 2015 – a significant improvement from the previous two years when growth was very modest (0.8 percent in 2012 and 1.3 percent in 2013). Unemployment rates, however, remain above 10 percent in several CEE countries.

Due to structural rigidities and fiscal consolidation, economic growth in the Western Balkans is expected to drop from 2.4 in 2013 to only 0.6 percent in 2014, and then recover modestly to a projected 1.9 percent in 2015.

GDP growth in Russia was just 0.8 percent in the first half of 2014, compared to 0.9 percent in the first half of 2013. Looking ahead, the baseline scenario is one of stagnation, with projected 0.5 percent growth for 2014, 0.3 percent in 2015, and 0.4 percent in 2016. This baseline is paired with two alternative scenarios. An optimistic scenario foresees a small growth recovery to 0.9 percent in 2015 and 1.3 percent in 2016. A pessimistic scenario sees a projected 0.4 percent growth for 2014, and the economy slipping into a low-level recession, contracting by 0.9 percent in 2015 and 0.4 percent in 2016.

The Commonwealth of Independent States (CIS) economies have been hard hit by the crisis in Ukraine and stagnation in Russia. Growth is expected to be a meager 1 percent in 2014 and to rise only slightly to 1.3 percent in 2015.

In Turkey, growth has also slowed from over 4 percent in 2013, but is projected to stabilize at about 3.5 percent in 2014 and 2015.

The weak external environment, particularly slow growth in Western Europe, has dampened growth prospects for ECA in 2014. Western Europe continues to face sluggish demand and structural challenges, which are contributing to below-target inflation. Expectations of quantitative monetary easing policy in the Eurozone and the resulting weakening of the Euro may help lift demand in the short-term, including in several ECA countries for which the Euro Area is an important export destination. However, the external environment for ECA economies is not expected to become particularly favorable in coming years.

Remaining debt overhang and lost competitiveness in several new EU member states and Balkan countries are other factors that will continue to constrain the recovery. High levels of external debt and needs for large-scale external financing make some ECA countries particularly vulnerable to changing conditions in international financial markets. The high levels of Non-Performing Loans (NPLs) in the region, together with the ongoing restructuring of the banking sector, are likely to continue to restrain investment and consumer demand in 2015.

At the same time, fiscal positions are slowly improving, and many countries in the region are gradually regaining competitiveness after wage adjustments. Projected stability in oil prices, down from high levels in prior years, should also mitigate uncertainty among energy importers in the ECA region. This all makes it likely that the recovery in the western part of ECA continues, albeit not at a fast pace.

In the eastern part of ECA, Russia and some neighboring countries are slowing as past drivers of strong growth have largely run their course. In addition, the conflict and sanctions affecting Ukraine and Russia has tipped Ukraine into deep crisis and created headwinds of uncertainty for much of the region, though it has not materialized into a major factor in altering the underlying economic trends in the region. In Russia, geopolitical tensions and an uncertain policy environment are casting the longest shadow on Russia's medium-term prospects.

STRATEGY:

In order to reach the World Bank Group's twin goals of ending extreme poverty within a generation and boosting shared prosperity, the ECA region's strategy focuses on two main pillars: 1) competitiveness and shared prosperity through jobs, and 2) environmental, social, and fiscal sustainability, including through climate action. Governance and gender continue to be thematic priorities within interventions of both pillars.

- **Competitiveness and shared prosperity through jobs**

  In the past decade, most ECA countries have done well in terms of shared prosperity. This means that the incomes of the lower-earning 40 percent of the population have grown. Jobs and access to quality public services are key to ensuring that economic growth benefits the less well-off. Creating quality jobs is a challenge in many ECA economies, especially in Central and South East Europe (CSEE) where unemployment remains stubbornly high since the crisis. Creating new, quality jobs will require structural reforms to strengthen the competitiveness of ECA economies. Such reforms include improving governance and the investment climate, ensuring the stability of the financial sector, upgrading the skills of the labor force, building and maintaining energy and transport infrastructure, and maintaining a sound macroeconomic framework.

  To achieve these ends, the Bank has helped improve workers' skills and support job creation opportunities, modernize tax administrations, improve roads, strengthen the business environment and policies conducive to innovation, increase access to finance for small- and medium-enterprises (SMEs), stabilize public finances, and strengthen financial sector regulations in ECA countries.

- **Environmental, social, and fiscal sustainability**

  To be sustainable in the longer term, economic growth and shared prosperity need to be fiscally affordable, environmentally responsible, and socially inclusive. The Bank supports ECA countries in designing and implementing reforms to improve the efficiency and fiscal sustainability of their pension, social protection, and health care systems so that these systems can adapt successfully and continue to benefit the people of ECA countries for generations to come.

  We are also working with ECA clients to strengthen social cohesion by supporting community-driven development and social accountability so that citizens' voices are heard in designing social policies and improving public services. Improving economic opportunities and public services for disadvantaged communities is also an important element of the Bank's social sustainability work. This includes support for Roma inclusion in CSEE countries through advocacy and evidence-based analysis, as well as through lending and technical assistance from the Bank's budget.

  Climate adaptation and energy efficiency remain strategic priorities for Europe and Central Asia, the most energy-intensive region in the world. Greater energy efficiency delivers both environmental and economic gains. In Belarus, Bosnia and Herzegovina, Serbia, and Turkey, the Bank is working to achieve these gains both through policy reforms (such as energy pricing) and investments in public infrastructure and private industry, including renewable energy and energy efficiency. Cumulative energy savings from the portfolio of Bank-supported projects in the region are equivalent to taking 1.4 million cars off the roads.

RESULTS:

World Bank Group Assistance

The World Bank Group provided $11.9 billion to Europe and Central Asia (ECA) during fiscal year 2014, aimed at reducing poverty and boosting shared prosperity in the region. Of this, IBRD/IDA provided $5.6 billion of support to the region, IFC delivered $4.7 billion in commitments, and MIGA provided $1.6 billion in political risk insurance and credit enhancement coverage.

The World Bank supports clients' needs with innovative, demand-driven operations. The Bank also acts quickly and effectively to respond to urgent situations, such as the crisis in Ukraine, and the catastrophic floods in Bosnia and Herzegovina and Serbia in May.

Reimbursable Advisory Services (RAS)

Middle-income countries interested in highly specific knowledge services that exceed what the Bank can finance from its own resources are increasingly accessing Bank technical expertise using Reimbursable Advisory Services (RAS). Under RAS programs, the Bank works with countries at their request and provides reimbursable technical advice. ECA has been engaged in 158 RAS programs since 2006. Countries that have signed RAS agreements include: Albania, Bosnia and Herzegovina, Bulgaria, the Czech Republic, Estonia, Georgia, Greece, Hungary, Italy, Kazakhstan, Latvia, Poland, the Republic of Cyprus, Romania, the Russian Federation, the Slovak Republic, Slovenia, Spain, and Turkmenistan.

Some notable outcomes of our lending and RAS work include:

- In Poland, following 200 years of flooding of the Odra River Basin, thousands of homes – and millions of residents – are now protected, and 60,000 ancient artifacts were found and conserved during archaeological excavations as part of the flood protection project work along Poland's Odra River.

- In Greece, technical support from the WBG has helped the country climb 28 ranks in the last two *Doing Business* rankings through our RAS work focusing on improving the business environment.

- In FYR Macedonia, the Conditional Cash Transfer (CCT) program has increased secondary education enrollment by 10 percentage points. Approximately 7,500 children from poor families, who would not otherwise attend school, regularly attended secondary school in the school year 2013–14 thanks to the new CCT benefit. The coverage of the CCT secondary education program increased from about 67 percent of eligible children in the first year of implementation to about 86 percent in 2012-13.

- In Tajikistan, regulatory reforms aimed at improving the business environment have cut the length of time that it takes to start a business from 62 days to 24 days. In addition, the number of required business permits was reduced from 609 down to 85 – a measure that is expected to help the private sector save around US$18 million annually.

- In Albania, 607 classrooms and laboratories were constructed or rehabilitated, and over 24,000 computers and internet connectivity to schools were provided, reducing the students per computer ratio from 46 to 14 students per computer in urban centers and from 133 to 13 students per computer in rural areas.

Please go to "Results in ECA" for more examples of the Bank's work in ECA.

Analytical Work Highlights

In addition to its financial products and RASs, the Bank produced important research about critical issues in the region during the past fiscal year. Through its analytical work, the World Bank aims to bring global knowledge and adapt it to the needs of ECA countries.

The *Shared Prosperity: Paving the Way in Europe and Central Asia* report finds that countries in ECA have done relatively well in ensuring that their populations have shared in overall prosperity, but that progress has been uneven and its long-term sustainability is under question. The report says that the average income of the bottom 40 percent of the income scale across the entire region increased by 3.8 percent, about 20 percent more than average income growth at the national level, between 2005 and 2010. However, this growth was not distributed equally across countries.

ECA followed up its *Golden Growth: Restoring the Lustre of the European Economic Model* report with its *Diversified Development: Making the Most of Natural Resources in Eurasia* report, produced in partnership with the Eurasian Development Bank. This report finds that having natural resources does not have to be a curse – it can be a blessing if the countries ensure proper management of revenues from natural resources, invest earnings in building up physical and human capital, and improve institutions. Going forward, sustained growth of the bottom 40 percent will require structural policies that facilitate access to assets and reconcile equity and growth for all.

A package of analysis entitled the *Face of Poverty in Europe and Central Asia* focuses on the specific challenges of poverty in the ECA region, where some 80 million people live on less than $5 per day and struggle to meet basic needs. High heating bills during long, harsh winters, and the higher caloric intake required to survive the cold make for a higher cost of subsistence than in other regions. Unemployment and low wages are the major factors that keep people in poverty in ECA.

The Inverting Pyramid: Pension Systems Facing Demographic Challenges in Europe and Central Asia report examines how pension systems in ECA are facing increasing pressures from the region's aging populations and shrinking labor force. These demographic pressures make it imperative for countries to work on comprehensive, long-term, and socially sustainable reforms to put in place pension systems that protect the elderly poor and future generations.

The *Back to Work: Growing with Jobs in Europe and Central Asia* report recommends actions to create more and better jobs in ECA in two main policy areas: 1) laying the fundamentals for job creation through an enabling macroeconomic and business environment that allows existing firms to grow and new firms to emerge and succeed or fail quickly and at low cost; and 2) supporting workers to tap into new job opportunities so that they have the right skills and work incentives, unhindered access to the labor market, and are able to move to places that offer more job opportunities.

The recent *Looking Beyond the Horizon: How Climate Change Impacts and Adaptation Responses Will Reshape Agriculture in Eastern Europe and Central Asia* publication and the subsequent country-specific reports examine the challenges and opportunities being created in the agriculture sector in Albania, the Former Yugoslav Republic (FYR) of Macedonia, Moldova, and Uzbekistan. Through economy-wide modeling of water supply and demand, the analysis finds that, in many cases, water availability for irrigation will be severely curtailed by climate change. This will greatly exacerbate the effects of climate change on crops – especially irrigated crops – with potential yield reductions of 20–50 percent by 2050. The report also offer countries practical advice on how to help their agricultural sectors adapt to shifts in climate, in a combined effort to both decrease the vulnerability of farmers to climate variability and bolster their ability to capitalize on potential gains presented by a changing climate.

The ECA region also provides timely monitoring of economic trends and prospects in the region through its Regular Economic Reports for the EU11[1], Belarus, Moldova, Russian Federation, South East Europe[2], Turkey, and Ukraine.

Individual Country Program Snapshots are updated twice a year, and include analyses of the economy, sectors, and the World Bank's activities in country. They also include Project Briefs, which detail the projects' objectives, results, and financing.

PARTNERS:

European Union, European Commission, and other institutions

[1] The EU11 refers to the 11 European Union (EU) member states that joined the EU after 2004 – Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic, and Slovenia.

[2] Six countries are included in South East Europe (SEE6) — Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, Montenegro, and Serbia.

The World Bank's ECA region has a strategic partnership with the European Union (EU), and is working with the European Commission (EC) and European international financial institutions (IFIs) to improve the capacity of ECA's EU-member clients to absorb EU funds.

The Bank works closely together with EU institutions, European IFIs (European Investment Bank [EIB] and the European Bank for Reconstruction and Development [EBRD]), and the International Monetary Fund (IMF) as part of the second Vienna Initiative, which aims to improve banking systems and coordination among banking regulators in EU and non-EU countries.

Against the background of weak growth and even economic contraction in CSEE countries, the World Bank Group, the EBRD, and the EIB Group came together in November 2012 for a new Joint International Financial Institution (IFI) Action Plan, pledging to ensure continued capital flows to the region of up to €30 billion over the two years 2013/14 in an effort to protect economic growth in CSEE. One of the most important priorities under the Action Plan was to ensure continued financing for SMEs that are key drivers of innovation and job creation in the region. The IFIs have channeled this financing through financial institutions active in the region. They have also provided guarantees for lending to SMEs and equity finance for new firms. The Action Plan has also supported investments in CSEE countries' transport systems and energy sectors to strengthen competitiveness and sustainable energy generation. Total capital flows under the initiative had reached €33.5 billion by the end of July 2014, exceeding the initial commitment of €30 billion. To date, under the 2013/14 Action Plan, the EIB has provided €21.4 billion, the World Bank Group has provided €6.7 billion, and the EBRD has delivered €5.5 billion.

ECA works on Roma inclusion across the region in collaboration with various partners, including the European Commission, the Roma Education Fund, and a variety of national Roma agencies.

The Bank is also working with the EurAsian Economic Community's (EURASEC) Anti-Crisis Fund and with the Eurasian Development Bank to provide parallel financing for low-income ECA countries.

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