EUROPE AND CENTRAL ASIA

Economic growth in Europe and Central Asia (ECA) remains the slowest of all developing regions of the world. The ECA region is expected to see almost no growth this year as much of the region suffers a marked slowdown, or outright recession, due the direct and indirect impact of the oil price shock and ongoing geopolitical tensions. The negative effects of these factors are only being partially offset in the other parts of the region that are expected to see stable to moderately improving growth.

Countries highly dependent on oil exports, or on trade and remittances from oil exporting countries, are showing signs of a sharp slowdown, compounded by ongoing geopolitical tensions due to the conflict in Ukraine. However, EU-Central and South Eastern Europe (EU-CSEE) and the Western Balkans are seeing initial signs of recovery with an increased pickup in net exports as the Eurozone is experiencing a nascent recovery with expansionary monetary policy and declining oil prices serving to boost consumer and business confidence. Still, while cheaper oil will contribute to growth and downward currency adjustments will help to rebalance demand away from imports and stimulate exports, long-term benefits will depend on improvements in the business climate and ongoing efforts to reduce the debt overhang in many ECA countries.

EU-CSEE countries are expected to see growth remain roughly the same in 2015 as in 2014 – about 2.7 percent – which is a significant improvement from the previous two years when growth was very modest (0.5 percent in 2012 and 1.2 percent in 2013), but it still remains far below potential. Unemployment rates remain stubbornly above 10 percent in many EU-CSEE countries and consumption growth is sluggish.

Economic growth in the Western Balkans is expected to be a modest 1.2 percent in 2015, up from 0.7 percent in 2014 as a pick-up in net exports is expected to offset slowing investment and consumption. The Western Balkans still remain heavily burdened by lack of new credit and non-performing loans are the highest in the ECA region (above 16 percent).

GDP growth in Russia was just 0.6 percent in 2014, compared to 3.5 percent in 2012 and 1.3 percent in 2013. Looking ahead, the baseline scenario calls for a sharp recession, with a projected contraction of 3.8 percent in 2015 and 0.3 percent in 2016. This forecast is based on expectations of an ongoing slump in oil prices (oil prices remaining in the USD 50-60 range) and no immediate resolution of the geopolitical tensions. The flexibility introduced into the exchange rate regime (the ruble has depreciated nearly 40 percent over the last year) has allowed the country to avoid a balance of payments crisis and has facilitated rebalancing of demand and production away from imports and toward domestic products and exports, although the country has had to adjust to substantially lower income.
Overall, the South Caucasus, Eastern Europe, and Central Asia have been hard hit by the downturn in Russia and the oil price shock, directly and indirectly through the fall in oil prices, remittances and trade. Growth rates in 2015 are expected to be half those seen in 2014 in the South Caucasus and Central Asia, while Eastern Europe, which includes Ukraine, is expected to fall further into recession. In Turkey, growth slowed to 2.9 percent in 2014, but is expected to increase modestly to 3 percent in 2015.

For countries directly and indirectly adversely affected by lower oil prices, GDP tells only a small part of the story when it comes to the sharp decline in spending power available to their citizens. Real domestic income of a country includes real GDP and also remittances received from abroad as well as gains or losses from changes in export and import prices. The effect of the oil price shock and devaluation of the ruble has had a much stronger adverse impact on buying power than what is reflected simply by GDP.

Given the weaker buying power of many households in the region, poverty rates are expected to rise in several countries. This is a reversal of the downward trend toward lower poverty rates across the region. Poor households in oil-exporting countries and remittances-receiving countries are hit by higher import prices due to devaluations, the disappearance of jobs in construction and other non-tradable sectors and because of fiscal pressures. This highlights the need for a quick adjustment to the new economic reality. Only if countries seize new opportunities in tradable sectors, can the deterioration of poverty rates be stopped.

Exchange rate adjustments, along with prudent monetary policy to keep domestic inflation under control, will help countries regain competitiveness in global markets in the Eastern part of the region. For the EU-CSEE part of the region, projected low oil prices and monetary policy easing in the Eurozone should help to mitigate the impact of low capital inflows and remaining uncertainty, including that arising from high debt levels, vulnerabilities in the banking sectors, geopolitical tensions and Greece’s current financial turbulence.
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 jobs is a challenge in many ECA economies, especially in Central and South East Europe (CSEE) where unemployment has remained 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.

  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 benefits 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. The Bank is helping the Central Asian countries, Moldova, Romania, and the Western Balkans to strengthen their knowledge, strategy, and institutions for adapting to and mitigating climate change, including through regional approaches. In Azerbaijan, Montenegro, Kazakhstan, and Russia, the Bank supports the clean-up of heavily contaminated and industrial waste sites and prevention of their reoccurrence in the future, resulting in major health, environment, and economic benefits.

  The Bank is 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 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.
RESULTS:

World Bank Assistance

The World Bank (IBRD/IDA) has provided $5.9 billion of support to the ECA region so far during fiscal year 2015, aimed at reducing poverty and boosting shared prosperity in the region. In addition to its traditional lending, the World 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 of 2014.

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 171 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, Kyrgyz Republic, Latvia, Poland, the Republic of Cyprus, Romania, the Russian Federation, San Marino, the Slovak Republic, Slovenia, Spain, Turkey, and Turkmenistan.

Some notable outcomes of our lending and RAS work include:

- In Romania, Rovana Plumb, the Romanian Minister of Labor, Family, Social Protection, and Elderly presented the country’s National Strategy for Social Inclusion and Poverty Alleviation 2014-2019 during the UN 53rd session of the Commission for Social Development. This Strategy is a result of a RAS, and close collaboration between the client and Bank.

- In Poland, following 200 years of flooding of the Odra River Basin, thousands of homes and 2.5 million of residents are now protected against the flooding through improved flood forecasting to allow for better prevention of flood damage and the minimization of damages, as part of the flood protection project work along Poland’s Odra River.

- Since the start of the World Bank’s engagement in Greece in 2012, the Government implemented reforms in three areas supported by the World Bank Group, and became top improver in starting a business in Doing Business 2014 and top improver in registering property in Doing Business 2015.

- 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 83 percent in 2014.

- 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 39 days. In addition, Trade & Competitiveness Global Practice of the World Bank Group has supported the Government of Tajikistan in joining the Hague Apostille Convention of 1961. The Convention contributes toward strengthening Tajikistan’s credibility in the international trade arena, making it a more attractive place for investors to do business because the legalization of documents will require less time and money.

- 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 *What’s Next in Aging Europe: Aging with Growth in Central Europe and the Baltics* report finds that with their populations aging faster than their neighbors in the rest of the European Union, the countries of Central Europe and the Baltics would benefit from a focus on promoting active, healthy, and productive aging.

Steady growth over the past decades has brought Turkey to the threshold of becoming a high-income economy, prosperity has been broadly shared across income groups in the society, and the size of the middle-class was doubled, according to the *Turkey’s Transitions: Integration, Inclusion, Institutions* report. However, challenges remain. The report examines Turkey’s experience in the transition from a lower middle-income to an upper middle-income economy, and looks at what has worked well and what needs to change.

The *Serbia Judicial Functional Review* found that Serbia’s judiciary lags behind EU Member States, including the EU11, and those areas that are under-performing need to be addressed. The Review provides a comprehensive assessment of the functioning of the judiciary, and of what is needed to reach EU benchmarks. The Review comes at the start of work under Chapter 23 of the *Acquis*, and will provide the baseline for future efforts to align the country’s judiciary with EU standards.

According to the *Turn Down the Heat: Confronting the New Climate Normal* report, as the planet warms further, heat-waves and other weather extremes that today occur once in hundreds of years, if ever, would become the “new climate normal,” creating a world of increased risks and instability. The report, prepared for the World Bank Group by the Potsdam Institute for Climate Impact Research and Climate Analytics, says that the consequences for development would be severe as crop yields decline, water resources shift, sea-levels rise, and the livelihoods of millions of people are put at risk.

A series of reports on skills in Central Asia, entitled *The Skills Road: Skills for Employability in Uzbekistan, The Skills Road: Skills for Employability in Tajikistan, and The Skills Road: Skills for Employability in the Kyrgyz Republic* provides policy goals and recommendations for improving skills in the Kyrgyz Republic, Tajikistan, and Uzbekistan based on an assessment of both cognitive and non-cognitive skills.

The *Ukraine: Soil Fertility to Strengthen Climate Resilience* report takes a close look at the challenge of accelerating soil erosion in Ukraine and provides recommendations on how to better address soil erosion, excessive land tillage and climate change in Ukraine.

The *Open Data for Economic Growth in Russia* report draws on the most recent developments in Russia’s Open Data initiatives and provides recommendations for policies and actions that could maximize economic growth from the open data initiatives.

The ECA region also provides timely monitoring of economic trends and prospects in the region through its Economic Reports for *Armenia, Belarus, Croatia, the EU Regular Economic Report (RER), Georgia, Moldova, Poland, Russian Federation, South East Europe Regular Economic Report (RER)*¹, *Tajikistan, 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**

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

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¹ Six countries are included in South East Europe (SEE6) — Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, Montenegro, and Serbia.
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 CEE 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 CEE. 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 CEE countries' transport systems and energy sectors to strengthen competitiveness and sustainable energy generation. Total capital flows under the initiative reached €42.7 billion at closing in end-December 2014, exceeding the initial commitment of €30 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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Updated:  April 2015