Policy Brief

ESG IN THE WESTERN BALKANS: FROM COMPLIANCE TO COMPETITIVENESS

Executive Summary

Environmental, Social and Governance (ESG) considerations are no longer a future obligation for the Western Balkans, they are already influencing how companies access markets, how governments attract investment and how closely the region aligns with the European Union. While awareness of ESG has increased significantly, implementation remains uneven, fragmented and largely driven by external pressure rather than domestic strategy. Larger companies are beginning to integrate ESG into their operations, while small and medium-sized enterprises often struggle with limited capacity and unclear expectations. Without targeted policy action, ESG risks becoming a framework that benefits only a narrow group of firms rather than a driver of broad-based economic transformation. At the same time, ESG presents a real opportunity to modernise economies, strengthen resilience and support EU convergence if approached in a practical and coordinated way.

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1. Why ESG Matters for the Western Balkans

ESG has become a central feature of Europe's economic and regulatory landscape and its impact is already being felt across the Western Balkans. The region's strong trade links with the EU mean that sustainability requirements increasingly affect companies well beyond EU borders. European firms now require ESG-related data from suppliers, banks are beginning to assess environmental and social risks in lending decisions and international financial institutions attach ESG conditions to financing. In this environment, ESG is no longer optional, even for countries that are not yet EU members.

Beyond compliance, ESG matters because it is closely linked to competitiveness and economic resilience. Companies and economies that manage environmental risks, invest in human capital and strengthen governance are generally better prepared for regulatory change, climate shocks and shifts in global markets. Conversely, weak ESG performance can limit access to finance, increase costs and undermine long-term growth prospects. For the Western Balkans, ESG is therefore not an abstract sustainability agenda, but a practical framework shaping future economic opportunities.

2. Where the Region Stands Today

Across the Western Balkans, ESG awareness has grown steadily over the past decade. Governments have adopted climate strategies and sustainability commitments aligned with European frameworks and larger companies particularly exporters and foreign-owned firms are becoming more familiar with ESG expectations. Financial institutions are gradually incorporating ESG considerations into their policies, often influenced by EU regulation and international partners.

However, progress remains uneven. ESG implementation is frequently fragmented, with policies existing on paper but applied inconsistently in practice. Institutional capacity is limited, coordination across ministries and agencies is often weak and reliable ESG data remains scarce. As a result, the region can be described as ESG-aware, but not yet ESG-ready. Much of the momentum still comes from external actors, rather than from a coherent domestic approach.

3. ESG Performance by Pillar

Environmental (E). Environmental issues represent both the area of greatest pressure and the area of highest risk. The Western Balkans remain heavily dependent on coal and other carbon-intensive industries, while environmental enforcement is often weak. Air pollution, waste management and water treatment continue to pose serious challenges, particularly at the local level. At the same time, climate-related risks such as floods, droughts and heatwaves are becoming more frequent and more costly. EU measures such as the Carbon Border Adjustment Mechanism are turning these environmental challenges into direct economic risks for exporters. While renewable energy and energy-efficiency investments are expanding, progress is often slower than the pace of regulatory change, leaving parts of the economy exposed.

Social (S). The social dimension of ESG receives growing attention, but practical implementation remains limited. Labour shortages, outward migration and skills mismatches affect most economies in the region. Companies increasingly recognise the importance of employee well-being, inclusion and workforce development, yet these issues are rarely managed through structured systems or measured consistently. Social policies tend to be reactive rather than strategic and ESG-related social indicators are often underdeveloped. This limits the ability of companies and governments to manage social risks and to use ESG as a tool for improving productivity and social cohesion.

Governance (G). Governance remains the weakest ESG pillar across the Western Balkans. Fragmented institutional structures, limited administrative capacity and uneven enforcement undermine the effectiveness of ESG-related reforms. While legal frameworks have improved, transparency, accountability and corporate governance practices vary widely across sectors and company sizes. Weak governance not only slows progress in environmental and social areas, but also affects investor confidence and trust in corporate reporting. Without stronger governance, ESG risks remaining a formal requirement rather than a driver of real change.

4. Key Risks if Current Trends Continue

If ESG adoption remains slow and fragmented, the Western Balkans face several concrete risks. Companies may lose access to EU markets and supply chains as sustainability requirements tighten. Financing costs may rise for firms and projects perceived as environmentally or socially risky. Carbon-intensive industries may become stranded as EU climate policies advance faster than domestic reforms.

There is also a strategic risk that ESG becomes concentrated among a small group of large companies, widening the gap between ESG leaders and the broader business community. In such a scenario, sustainability would reinforce existing inequalities rather than supporting inclusive growth.

5. Policy Recommendations for Key Economic Actors (Public Institutions, Financial Institutions and Companies)

Making ESG work in practice in the Western Balkans is less about designing new strategies and more about changing how existing ones are applied. Progress depends on a small number of key actors: public institutions, financial institutions and companies, each of which plays a distinct but interconnected role. Clear responsibilities, realistic expectations and practical support are essential if ESG is to move beyond formal commitments and become part of everyday economic decision-making.

Public Institutions and Policymakers. For governments and public institutions, the main challenge is not a lack of policy frameworks, but the difficulty of turning them into consistent action. Many ESG-related laws, strategies and commitments are already in place, yet enforcement remains uneven and coordination across ministries and agencies is often weak. Strengthening institutional capacity, improving coordination and applying existing rules more consistently would likely have a greater impact than adopting additional strategies or action plans.

Public authorities also play a crucial role in reducing uncertainty for businesses. Clear, predictable and well-communicated rules make it easier for companies to plan investments and adapt to new requirements. In this context, investing in ESG data systems and reporting infrastructure is not just a technical exercise it is a prerequisite for credible policymaking, investor confidence and public accountability.

It is equally important that ESG policies are designed with the structure of the region's economies in mind. Small and medium-sized enterprises make up the vast majority of firms in the Western Balkans, yet many lack the resources and expertise to respond to complex ESG demands. Overly rigid or technical requirements risk excluding these firms rather than helping them improve. More proportionate approaches, simplified guidance and phased implementation especially when linked to tangible benefits such as access to finance, public procurement or EU-funded programs can help ensure that ESG supports inclusive growth.

Financial Institutions and Development Actors. Financial institutions are often the bridge between ESG principles and real-world practice. Banks and development lenders increasingly translate sustainability expectations into lending criteria, making them powerful drivers of change across the economy. By integrating environmental, social and governance risks into their assessments, they can encourage better risk management and longer-term thinking among their clients.

However, finance alone is rarely sufficient. Many companies, particularly smaller ones, need guidance to understand what ESG requirements mean in practical terms. When lending is combined with technical assistance, clear explanations and realistic timelines, ESG becomes more manageable and less intimidating. Over time, access to finance is likely to become one of the strongest incentives for ESG adoption, reinforcing the link between sustainability, competitiveness and economic resilience.

Companies and the Private Sector. For companies, ESG increasingly needs to be seen as part of how the business is run, not as a separate sustainability exercise. Many firms in the Western Balkans already engage in environmental or social activities, but these efforts are often informal and disconnected from management structures, risk assessment and long-term planning.

Companies that begin to integrate ESG into core decision-making by clarifying responsibilities, strengthening internal controls and improving data and reporting are likely to be better prepared for regulatory change and investor scrutiny. While this requires upfront effort, early movers often gain greater flexibility, improved access to finance and stronger positioning in EU-linked markets. In a context where sustainability standards are tightening, waiting carries its own risks.

6. Conclusion

The Western Balkans have made certain progress on ESG over the past decade. Awareness has increased, policy frameworks are largely in place and sustainability considerations are becoming harder to ignore for governments, financial institutions and companies alike. Yet the region still struggles with uneven implementation, limited capacity and a persistent gap between commitments on paper and change in practice.

Whether ESG becomes a genuine driver of economic modernization or remains a compliance exercise will depend on execution. Stronger institutions, better data and more inclusive and realistic approaches are essential. Above all, ESG needs to be treated as a long-term investment in competitiveness, resilience and EU convergence rather than a short-term obligation imposed from outside.

If public institutions, financial actors and companies move in the same direction, ESG can serve as a practical framework for transformation across the Western Balkans. The opportunity is real, but translating it into results will require sustained commitment and a willingness to turn intentions into action.

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