

ASSESSING AND STREAMLINING THE POTENTIAL OF THE OPEN BALKANS INITIATIVE

VOLUME 2 ANALYSIS OF THE TERRITORIAL CHALLENGES, NEEDS AND POTENTIAL OF THE SIX WESTERN BALKAN COUNTRIES: AN ECONOMIC VIEW

Center for Economic Analyses – CEA

May 2023, Skopje



Financial support provided by the Open Society Foundations

- Project:** Assessing and streamlining the potential of the Open Balkans Initiative
- Implemented by:** Centre for Economic Analyses – CEA Skopje
- Title:** Analysis of the territorial challenges, needs and potential of the six Western Balkan countries: An economic view
- Authors:** Country experts (alphabetical order):
Albania: Merita Toska
Bosnia and Herzegovina: Adnan Cerimagic
Kosovo: Ramadan Ilazi
Montenegro: Institute for Entrepreneurship and Economic Development
North Macedonia: Centre for Economic Analyses; Stefan Ristovski
Serbia: Centre for Advanced Economic Studies

This study has been supported by Open Society Foundations through the “Assessing and streamlining potentials of Open Balkan Initiative” project implemented by CEA. The views expressed in this document do not necessarily reflect the view of the Open Society Foundations.

Reproduction is authorised for non-commercial purposes provided that the source is acknowledged.

Impresum

Title: Assessing and streamlining the potential of the Open Balkans Initiative
VOLUME 2: Analysis of the territorial challenges, needs and potential of the six
Western Balkan countries: An economic view

For the Publisher: Marjan Nikolov
Center for Economic Analyses – Skopje
Blvd. Jane Sandanski 63/3
1000 Skopje

Authors (in alphabetical order):
Adnan Cerimagic;
Lazar Ivanovic
Marjan Nikolov;
Merita Toska;
Ramadan Ilazi;
Stefan Ristovski;
Vesna Dakovic;

Peer review: Prof. Marjan Petreski, PhD

Language editor: Murray James Bales

Editor: Marjan Nikolov

Free download of the publication is available at:

<https://cea.org.mk/open-balkans-initiative-volume-2-analysis-of-the-territorial-challenges-needs-and-potential-of-the-six-western-balkan-countries/?lang=en>

CIP-Каталогизација во публикација Национална и универзитетска библиотека "Св. Климент Охридски", Скопје

341.232(497-15)(047.31)

ASSESSING and streamlining the potential of the open balkans initiative / Merita Toska... и др. Vol. 2, Analysis of the territorial challenges, needs and potential of the six western balkan countries: an economic view. - Текст во ПДФ формат, содрж. 24 стр., илустр. - Skopje : Centre for Economic Analyses – CEA, 2023

Начин на пристапување (URL): <https://cea.org.mk/open-balkans-initiative-volume-2-analysis-of-the-territorial-challenges-needs-and-potential-of-the-six-western-balkan-countries/?lang=en>

. - Фусноти кон текстот. - Наслов преземен од екран. - Опис на изворот на ден 07.06.2023 година. - Останати автори: Adnan Cerimagic, Ramadan Ilazi, Vesna Dakovic, Marjan Nikolov i Lazar Ivanovic. - Assessing and streamlining the potential of the Open Balkans Initiative Финансиер: Open Society Foundation

ISBN 978-608-4731-74-0

1. Toska, Merita [автор] 2. Cerimagic, Adnan [автор] 3. Ilazi, Ramadan [автор] 4. Dakovic, Vesna [автор] 5. Nikolov, Marjan [автор] 6. Ivanovic, Lazar [автор]

а) Иницијатива „Отворен Балкан“ -- Имплементација -- Западен Балкан -- Истражувања

COBISS.MK-ID 60604421

Contents

About the Project	6
Introduction.....	7
Profile of economic and external trade activities in the WB6 countries	8
A mixed economic performance of the WB6 countries.....	12
Differences are less pronounced on the NUTS 2 and NUTS 3 levels	14
Priorities could be given to policies harnessing the similarities on the NUTS 2 and NUTS 3 levels.....	15
Policies could address the potential of the NUTS 2 and NUTS 3 regions and the capital stock gaps	17
The way forward	21
Reference List	25

About the Project

CENTRE FOR ECONOMIC ANALYSES – CEA IS CONDUCTING A 1-YEAR OSF PROJECT ENTITLED: ASSESSING AND STREAMLINING THE POTENTIAL OF THE OPEN BALKANS INITIATIVE (OBI)

BACKGROUND

Recognising the EU's lack of interest in enlargement towards the Western Balkans, Serbian President Aleksandar Vučić, Prime Minister of North Macedonia Zoran Zaev, and Albanian Prime Minister Edi Rama decided to “take destiny into their own hands” and launch a “mini-Schengen” in October 2019. In July 2021, this idea evolved to become the regional initiative “**Open Balkans¹**”. While the initiative is no substitute for membership in the EU, it provides a path to accelerated membership and the utilisation of existing yet not fully used potential in these countries, which might facilitate additional economic growth and development and, in turn, welfare for their citizens.

CHALLENGES IN KEEPING UP THE MOMENTUM

Developing and cultivating neighbourly relations in the Western Balkans in expectation of economic prosperity will require that border controls and other barriers be eliminated in order to facilitate the movement of people, goods and services, and capital around the region. Regional disparities analyses (e.g., coastal vs. internal, NUTS 2 and NUTS 3 regions, urban vs. rural, capital cities vs. other cities) of the Open Balkan countries might offer insights while setting priorities for more accelerated growth and internal convergence of the Open Balkans region. **At the moment, there is a lack of properly elaborated analyses to be able to assess the existing challenges.**

The COVID-19 pandemic, the food and energy crises, and the war in Ukraine show the importance of internal cooperation and coordination and the need for mutual understanding and solidarity among Open Balkan countries. Internal coordination and cooperation, exchanges of experiences, and solidarity in the region bring value to future EU integration if the Open Balkan countries can speak with one voice.

TOOLS AND INSTRUMENTS FOR ASSESSING THE POTENTIAL FOR ACHIEVING COOPERATION AND COORDINATION

While on the highest political level there is still evidence of political will for the Open Balkans, on the administrative level (or ‘on the ground’) people cannot really sense the benefits of this initiative just yet. **At the very least, what is missing is more evidence-based policy research on the bottlenecks in cooperation and potential of the six countries of the Open Balkans.**

¹ The Open Balkans Initiative refers to the territorial space of six countries of the Western Balkans – WB6: Albania, Bosnia and Herzegovina, Montenegro, North Macedonia, Kosovo, and Serbia.

ACTIVITIES OF THE PROJECT

An independent pool of experts from the six countries diagnosing and investigating the bottlenecks for cooperation and coordination among the Open Balkan countries will add value to the already demonstrated political will for the Open Balkan Initiative, leading to its more structured, priority-focused, and systematic development.

Introduction

This document illustrates the disparities and similarities within and among the WB6 countries. We analyse the disparities and similarities in the EU's NUTS 2 and NUTS 3 regions depending on the data available. The idea is that, given the OBI MoUs and the OBI Agreements and the EU's freedom of movement, some regions of the WB6 countries may be more similar than others. Thus, those NUTS regions that are converging towards a certain cluster, e.g., are showing similarities in some demographic attributes and/or some socio-economic attributes might be a platform for the more efficient implementation of the EU's freedom of movement and the objectives of the OBI MoUs and OBI Agreements. Yet, this does not mean that regions with larger disparities cannot achieve the same objectives. It simply demonstrates that for more similar regions the policies might be implemented more efficiently because they face similar challenges. Those regions that reveal more disparities will need probably greater resources to reach convergence and fewer inequalities. We believe this information is important for policymakers to bring welfare to the citizens of the WB6 countries.

Volume 1 of Task 2 presents a summary of the country reports prepared by the experts. This text, Volume 2 of Task 2, presents the economic view of the territorial challenges, needs and potential, while Volume 3 of Task 2 presents cluster analysis of the NUTS 3 regions (where data are available).

Profile of economic and external trade activities in the WB6 countries

Trade, transport, accommodation and industry are driving the gross value added of the WB6 countries.

Figure 1 shows that the economies in the WB6 countries are mostly driven by tourism, trade, accommodation activities (23%), industry (19%), public administration (16%), agriculture (10%), which together total some 68% of the gross value added (GVA).

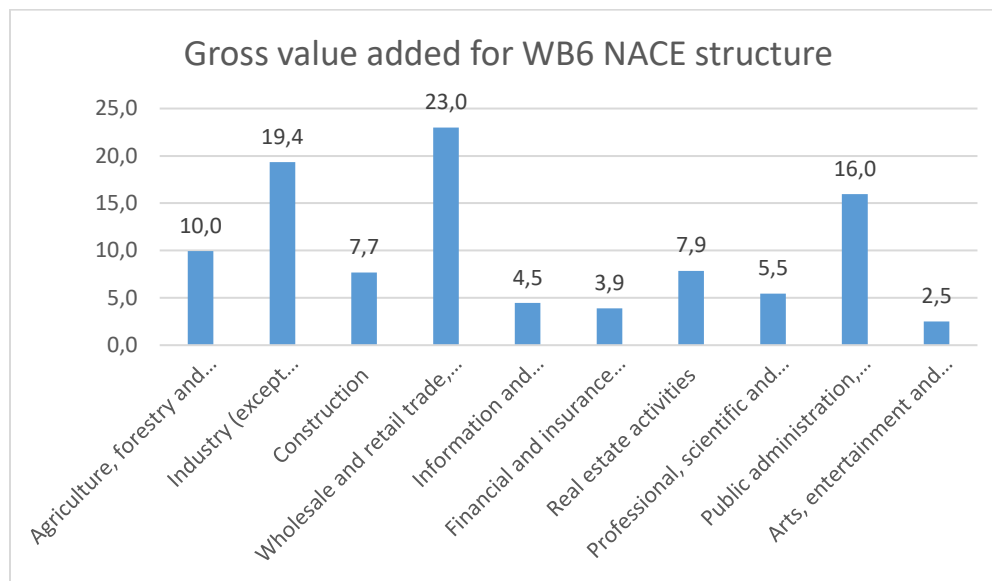


Figure 1. Structure of gross value added, average of NACE activities of the WB6 countries in 2021.

Source: Adapted from EUROSTAT data.

Albanian GVA depends primarily on agriculture, and North Macedonian GVA on real estate.

However, on the country level the situation, as illustrated in Figure 2, is less homogenous. Namely, while agriculture (21%) is the most important activity for the Albanian economy, it is less important for Serbia (7.6%). Industry is of smaller importance for Montenegro (12.5%) and Albania (12.9%), yet important for Bosnia and Herzegovina (24.5) and Serbia (23.0). Construction is important for Albania (10.9%) and Kosovo (10.6%). Real estate is the most important for North Macedonia compared to the other countries and its share in gross value added is almost double that in the other WB6 countries (North Macedonia's share of real estate is 12.1%, which is even higher than in the EU-27, namely 10.8%). Professional, scientific and technical activities are the highest in Serbia (7.0%) and Albania (7.1%) and the lowest in Kosovo (2.6%). Compared to the EU-27, the WB6 countries have around half the share of professional, scientific and technical activities. Note that the share of gross value added accounted for by public administration is higher in the EU-27 (19.3%) than in the WB6 countries (16%).

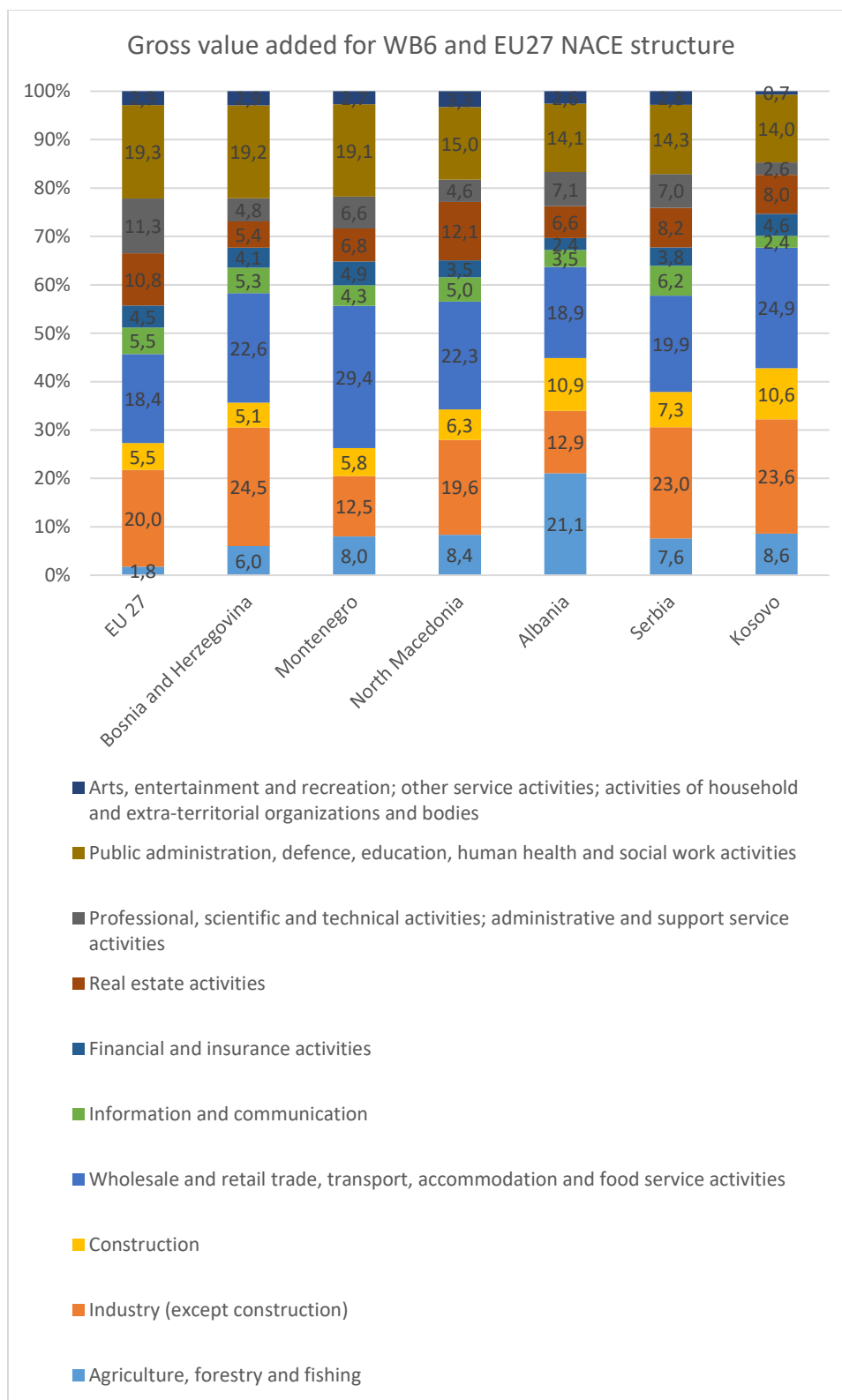


Figure 2. Structure of gross value added, NACE activities for WB6 countries in 2021.
Source: Adapted from EUROSTAT data.

The WB6 countries are generally net importers

The worst trade balance performers are Montenegro and Kosovo. Serbia has a more balanced trade performance, while North Macedonia is the most open country when measured as trade volume as a percentage of GDP. The countries depend on remittances, especially Montenegro (13.5% of GDP) and Kosovo (18% of GDP). Montenegro has the highest FDI inflow of all the WB6 countries at almost 12% of GDP, while the lowest FDI inflow is received by Bosnia and Herzegovina (2.7%), followed by North Macedonia (5.0%) (Table 1).

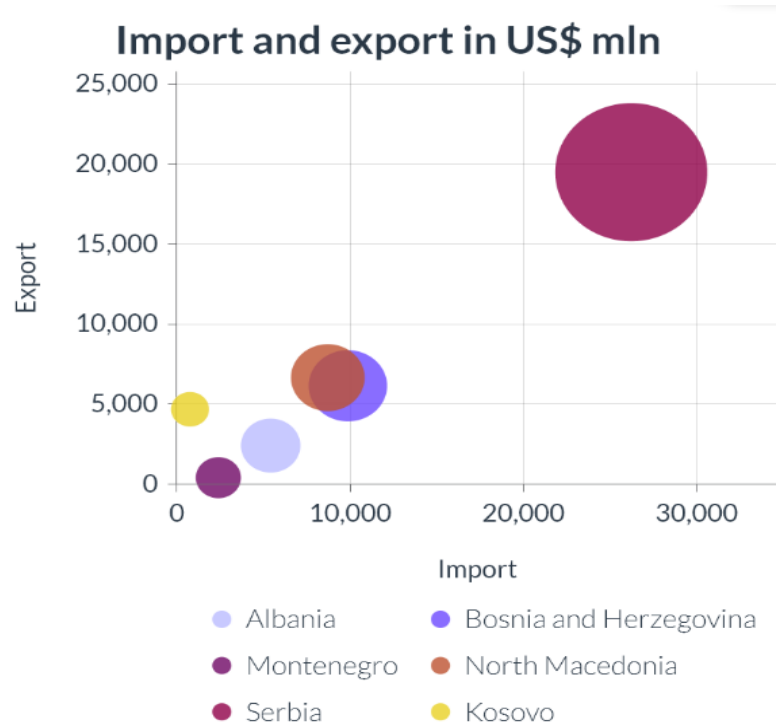
The WB6 countries do not trade much among themselves when measured as the top five trade partners. Serbia is prominent as an importer in all of the WB5 countries (Germany as well, except for Montenegro). Albania has a high concentration of exports to Italy (of 45%) and similarly North Macedonia to Germany (47%). Serbia and Albania do not include even one WB6 country as their top five importers (Table 1).

Table 1. World Bank – World trade integrated solution for 2020 and AKS for Kosovo

	FDI inflows as % of GDP*	Remittances as % of GDP*	Current account balance as % of GDP*	Import and export in USD mill. and as % of GDP***	Top five export partners (% of total exports)**	Top five import partners (% of total imports)**
Albania	6.7	9.4	-7.5	Import 5,411 Export 2,416 Import 38 Export 23	Italy - 45 Serbia - 12 Spain - 6 Greece - 5 Germany - 5	Italy - 25 Turkey - 10 China - 9 Greece - 9 Germany - 8
Bosnia and Herzegovina	2.7	10.2	-2.4	Import 9,868 Export 6,153 Import 49 Export 34	Germany - 15 Croatia - 13 Serbia - 12 Italy - 10 Austria - 10	Germany - 12 Italy - 12 Serbia - 11 Croatia - 9 China - 8
Montenegro	11.8	13.5	-9.2	Import 2,394 Export 410 Import 61 Export 26	Serbia - 28 Slovenia - 10 China - 12 Hungary - 6 Bosnia and Herzegovina - 6	Serbia - 20 China - 10 Germany - 10 Italy - 6 Bosnia and Herzegovina - 6
North Macedonia	5.0	3.5	-3.0	Import 8,709 Export 6,663 Import 71 Export 58	Germany - 47 Serbia - 8 Bulgaria - 5 Greece - 3 Hungary - 3	UK - 16 Germany - 11 Serbia - 8 China - 7 Greece - 6
Serbia	7.2	7.3	-4.3	Import 26,228 Export 19,501	Germany - 13 Italy - 8	Germany - 14 China - 13

				Import 57 Export 48	Bosnia and Herzegovina - 7 Romania - 7 Hungary - 5	Italy - 8 Russia - 6 Hungary - 5
Kosovo	5.1	18.0	-8.7	Import 756 Export 4,684	Germany - 13 Turkey - 13 China - 10	USA - 16 Albania - 15 North Macedonia - 12
				Import 65 Export 33	Serbia - 7 Italy - 6	Germany - 8 Italy - 8

Source: *World Bank. **Adapted from UNCTAD database. **World Bank – World trade integrated solution: <https://wits.worldbank.org/countrystats.aspx?lang=en>. ***AKS for Kosovo and <https://tradingeconomics.com/kosovo/imports-of-goods-and-services-percent-of-gdp-wb-data.html>.



Serbia's international trade amounts to half of the WB6 countries' trade, i.e., Serbia's exports and imports are basically equal to the sum of the other five countries'.

A mixed economic performance of the WB6 countries

The WB6 countries are slowly converging to the EU-27 and the German economy

The WB6 countries' GDP share compared to EU-27 GDP is shown in Figure 3. The share increased from 0.66% to 0.82% of EU-27 GDP (left-hand axis) and from 2.7% to 3.3% of the German GDP (the axis on the right) in almost a decade.

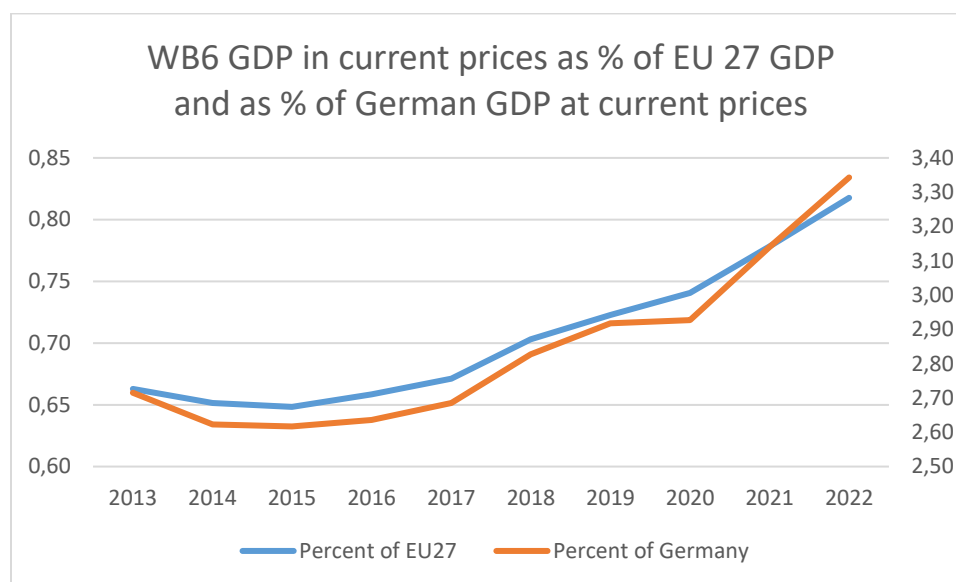


Figure 3. WB6 countries' GDP at current prices as a percentage of EU-27 GDP and German GDP at current prices: the axis on the left for the EU-27 and the one on the right for Germany.

Source: EUROSTAT data.

Purchasing power in the WB6 countries is crawling relative to the EU-27

The WB6 countries GDP per capita in PPS² relative to the EU-27 rose from 33% to 38% in 10 years (Figure 4). At this pace, the WB6 countries might catch up to the purchasing power in the EU-27 in around 70 years, suggesting these WB6-transition countries have become stuck in transition and are in danger of failing to match the living standards of more advanced market economies (EBRD 2013).

² PPS are purchasing power standards, i.e., a common currency that eliminates differences in price levels between countries allowing meaningful volume comparisons of GDP between countries (Eurostat).

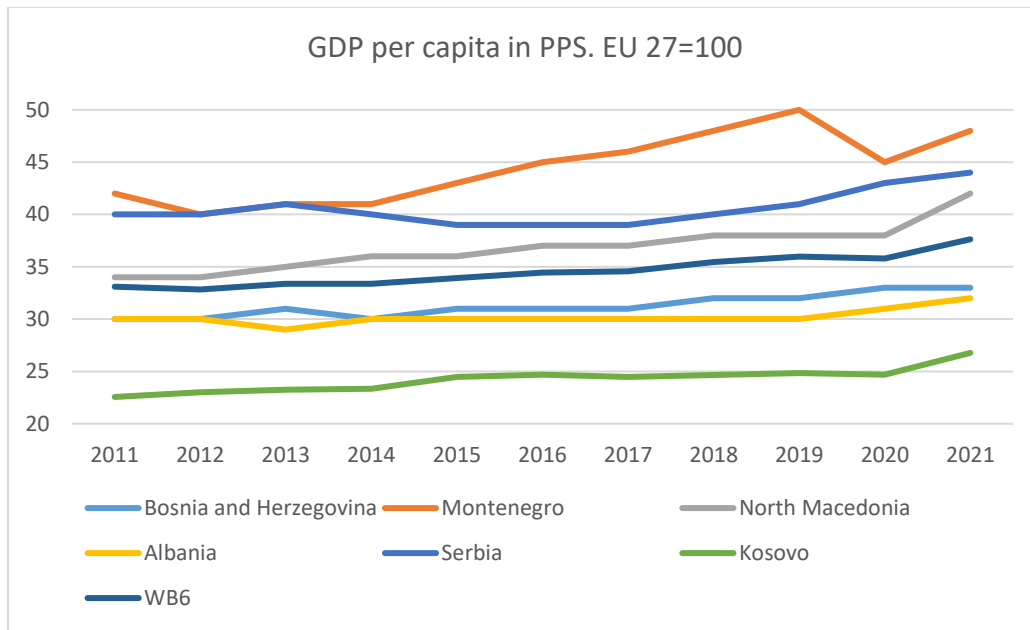


Figure 4. GDP per capita in PPS for the WB6 countries
Source: EUROSTAT data.

Figure 5 displays the coefficient of variation³ of GDP per capita in PPS for the WB6 countries. The differences in GDP per capita in PPS for the countries of the WB6 region as a group between 2015 and 2019 were growing, but then in 2021 the differences started shrinking mainly due to the deterioration of GDP PPS from 50% to 45% seen by Montenegro.

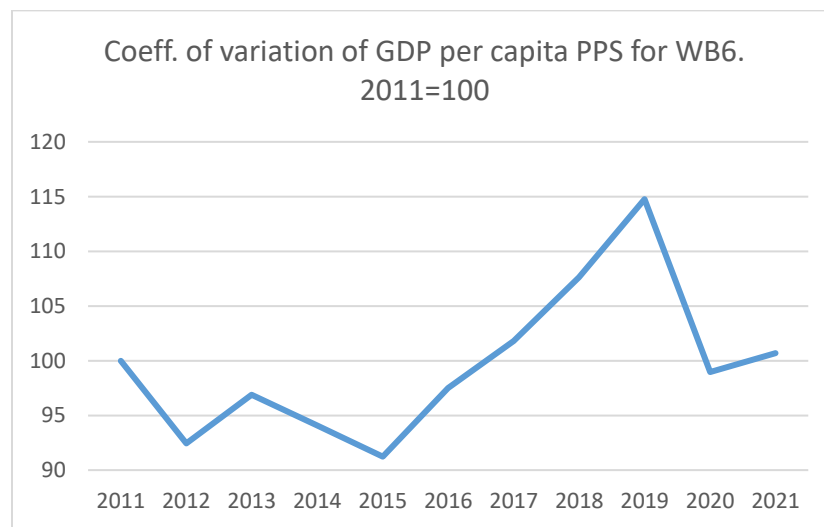


Figure 5. Coefficient of variation of GDP per capita PPS for the WB6 countries (2011–2021); 2007=100.
Source: EUROSTAT data.

³ The coefficient of variation measures the average dispersion of distribution of outcomes and is defined as the ratio of the standard deviation to the mean of a set of outcomes from a variable. In our case, it measures the average dispersion of GDP PPS for the WB6 countries.

Figure 6 below illustrates the average growth rates for the WB6 countries. The 2012 drop is an outcome of the double dip effect⁴ of the global financial crisis while the 2020 drop is due to the COVID-19 pandemic. After the pandemic, North Macedonia has not picked up as strongly as the other WB6 countries.

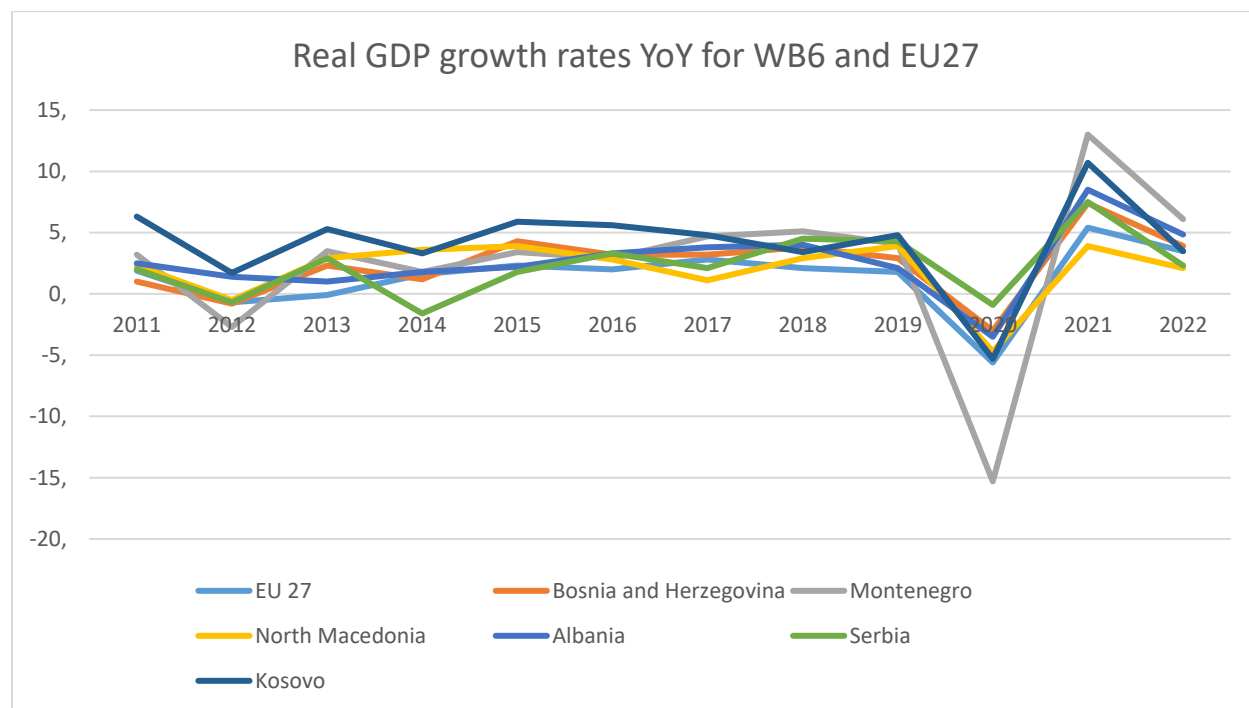


Figure 6. Real GDP growth rates for the WB6 countries (2011–2022).

Source: Adapted from EUROSTAT data.

Differences are less pronounced on the NUTS 2 and NUTS 3 levels

With respect to the heterogeneity of the WB4 countries⁵, the situation is less challenging when looking more closely at the regional levels (NUTS 2 and NUTS 3) than the NUTS 1 country level.

Even though the inequalities among the WB6 countries as NUTS 1 regions were increasing after 2015 (Figure 7), the regional inequalities within the countries reveal that on the local level (NUTS

⁴ After the recession following the global financial crisis of 2007–2008, the EU area was affected by another recession that started at the end of 2011 and continued into 2012–2013.

⁵ No data for Bosnia and Herzegovina or Kosovo.

2 and especially NUTS 3) the inequalities are less pronounced, as shown in Figure 7 and measured by the coefficient of variation⁶ of GDP per capita at current market prices.

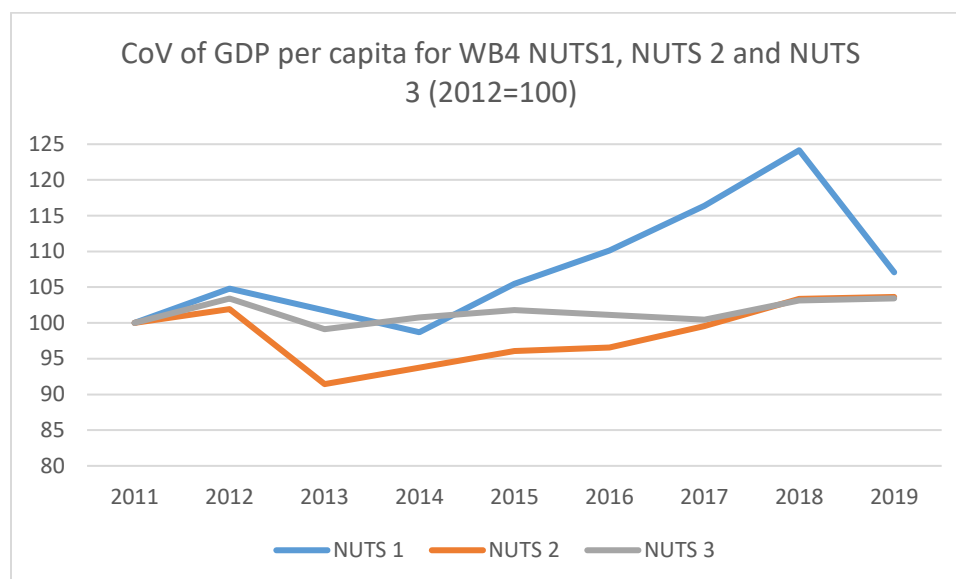


Figure 7. Coefficient of variation of GDP per capita at current market prices for the WB4 countries (North Macedonia and Montenegro NUTS 1=NUTS 2; no data for Bosnia and Herzegovina and no data for Kosovo on NUTS 2 and NUTS 3) at NUTS levels 1, 2 and 3 (2012–2020); 2011=100.

Source: EUROSTAT data.

Priorities could be given to policies harnessing the similarities on the NUTS 2 and NUTS 3 levels

As depicted in Figure 7, despite though the differences in GDP per capita, PPS are on average still increasing across the WB6 countries (NUTS 1 level) for the period, while on the local NUTS 2 and especially NUTS 3 levels the differences are not as dramatic. **This means that giving priority to addressing the regional potential of the similarities in the NUTS 2 and NUTS 3 regions over addressing convergence with the EU on the NUTS 1 level might be a more efficient policy choice for creating the opportunity for the equality of the regions' potential, e.g., the focus could be given to economic growth that is inclusive to ensure that the benefits are spread to all regions.**

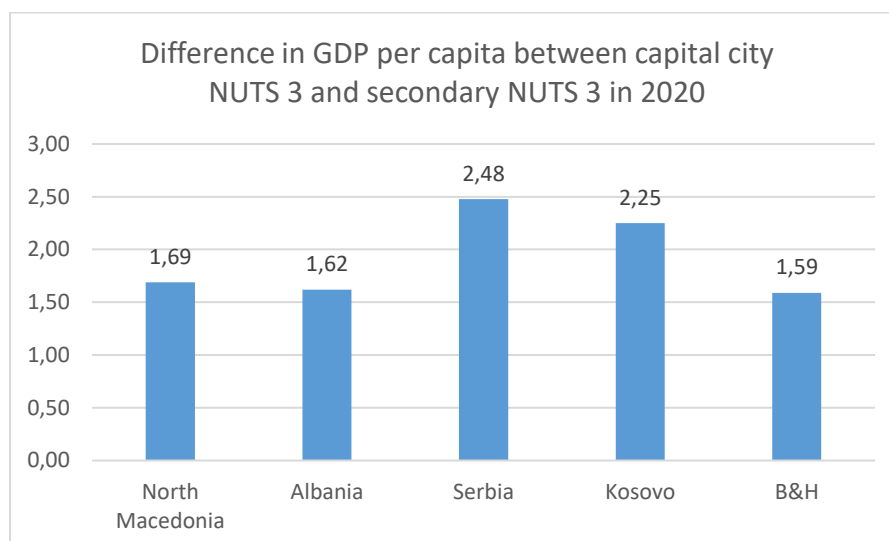
The potential of local-level (regions) capacity to generate quality (productive) jobs and assure equality of opportunity for individuals to achieve their potential on the regional level is important (World Bank 2018). Macroeconomic and economic policies can thus affect inequality differently depending on the design of policies and structure of the economy. For example, policies geared to

⁶ The coefficient of variation measures the average dispersion of distribution of outcomes and is defined as the ratio of the standard deviation to the mean of a set of outcomes from a variable. In our case, it measures the average dispersion of GDP per capita at market prices for regions within a set of NUTS regions (NUTS 1, NUTS 2, NUTS 3).

boosting productivity on the macro level could widen inequality if accompanied by the displacement of the poor or low-skilled labour on the regional level. In contrast, if designed well, reforms seeking to help raise the income and productivity of the poor or of low-skilled labour could boost growth while reducing inequality (IMF 2017). As described below, the need to investment in infrastructure, improve human capital, and address labour market deficiencies, especially long-term unemployment, could be priorities on the regional level for the WB6 countries⁷.

The magnetic attraction of the metropolitan areas of the capital cities on the NUTS 3 level exacerbates the differences compared to the secondary NUTS 3 areas in WB5 countries.

The agglomeration effects of the NUTS 3 areas of the NUTS 3 capital cities attract people to these hubs of productivity growth and higher earnings in the WB6 countries (no data were available for Montenegro). Figure 8 below shows the percentage difference between NUTS 3 capital cities and NUTS 3 secondary areas in WB5 countries in 2020. The NUTS 3 region of Skopski has 69% higher GDP per capita than the average of the other NUTS 3 regions in North Macedonia. The NUTS 3 region of Tirana has 62% higher GDP per capita than the average of the other NUTS 3 regions in Albania, whereas the NUTS 3 region of Beogradska oblast has 148% higher GDP per capita than the average of the other NUTS 3 regions in Serbia. The Prishtina NUTS 3 region has GDP per capita more than twice the average of the other NUTS 3 regions in Kosovo. The Canton Sarajevo has 59% higher GDP per capita compared to the average for BiH.



⁷ The World Bank (2018) highlights five horizontal policy priorities for cohesion policy: (1) Addressing macro-structural weaknesses that limit regional *growth potential* – for example, national fiscal and external debt in countries with “low growth” lagging regions cripples growth potential; (2) *Improving the regional business environment*: firms in lagging regions are smaller, less productive, and much more likely to be engaged in non-tradable than those in “non-lagging” regions, in part as a result of weak local and regional business environments; (3) *Leveraging the productivity potential of cities*: investment in secondary cities – which generate 45% of EU GDP – as sources of productivity, human capital accumulation and locations of opportunity, is central to achieving policy objectives in the EU’s lagging regions; (4) *Investing in skills as a ‘no-regrets’ policy*: addressing entrenched the regional gaps in foundational skills is critical for delivering on the potential of regions and enabling individuals to reach their own potential; and (5) *Strengthening institutional endowments*: weak institutions are one of the defining features of lagging regions and addressing them is essential for expanding regional potential and delivering regional policy. These five horizontal priorities can support smart sectoral policies, which build on the unique comparative advantages of each region.

Figure 8. Percentage difference in GDP per capita at market prices between NUTS 3 capital cities and secondary areas on the NUTS 3 level in 2020 for North Macedonia, Albania, Kosovo, B&H and Serbia. Capital city NUTS 3 and secondary NUTS 3 defined as: Albania: Tirana vs. other NUTS 3 areas; North Macedonia: Skopski region vs. other NUTS 3 areas; Serbia: Beogradska oblast vs. other NUTS 3 areas, Sarajevo Canton vs. other NUTS 3 areas, Pristina and other regions. Source: Adapted from EUROSTAT data and country expert's data.

However, as presented in Figure 9, the NUTS 3 capital cities still cannot compete with the EU-27 average for GDP per capita at market prices.

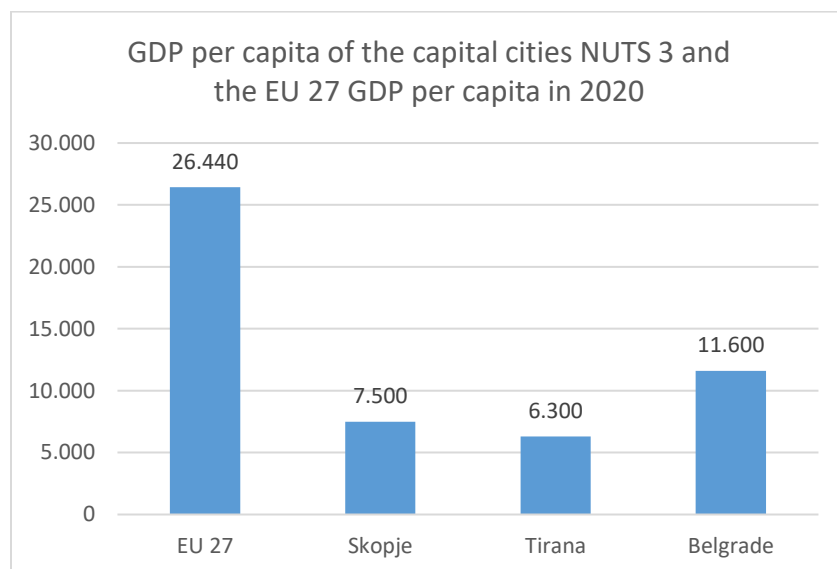


Figure 9. GDP per capita at market prices among capital cities on the NUTS 3 level and the EU-27 average in market prices for 2020. Source: Adapted from EUROSTAT data.

Policies could address the potential of the NUTS 2 and NUTS 3 regions and the capital stock gaps

There is a need for more effective policies to support the potential of the NUTS 3 secondary regions.

Focusing on the NUTS 3 level, the inequalities within countries reveal that the secondary NUTS 3 level are failing to realise their full potential compared to the capital cities NUTS 3 level. This is important for the WB6 countries because cities are driving growth and the NUTS 3 regions in which the secondary internal cities are located can to a considerable extent improve the growth of the WB6 countries. This explains why giving the opportunity for the equality of potential across regions can raise their competitiveness and finally accelerate the countries' convergence with the EU-27 average. Yet, the challenge of course is to find the right policy to identify and help the potential growth poles in the secondary and internal cities (challenges arising from urban/rural

differences, proximity/remoteness to high growth gravity centres, coastal/internal dichotomies such as in Albania and Montenegro). **Policies could focus more on the equality of potential across the NUTS 3 and NUTS 2 regions and its better utilisation.**

Let us consider the neoclassical approach and discuss the issue from the aspect of human capital and physical capital in the production function.

1. Human capital – youth

The way that the potential of human capital in the WB6 countries is used could be improved. In Figure 10, we illustrate the percentage of young people in the age group of 15–24 who were neither in employment nor in education and training (NEET) in 2020. The worst situation is seen in Kosovo with more than 1/3 of young people there being neither in employment nor in education and training.

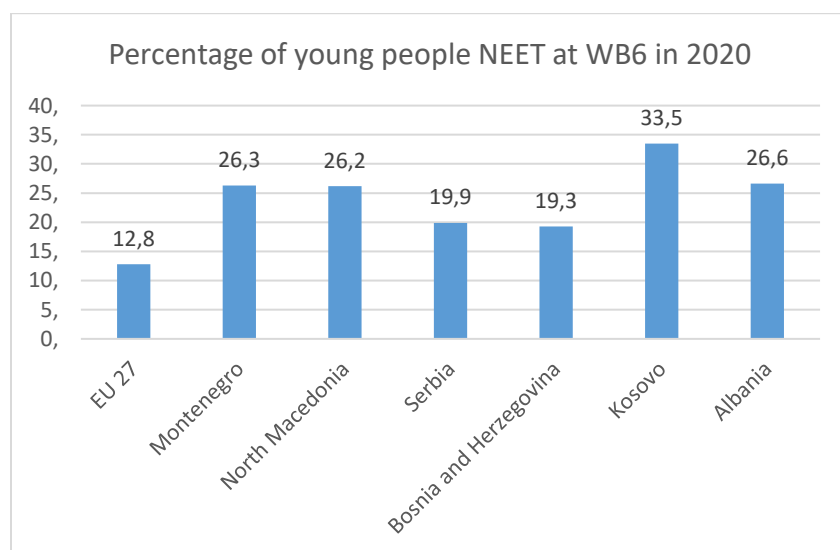


Figure 10. Percentage of young people NEET in the WB6 countries in 2020.
Source: Adapted from EUROSTAT data.

2. R&D

Figure 11 below presents R&D for WB4 countries as a percentage of total employment. Serbia is closest to the EU-27 average (0.686% of total employment is employed in R&D). The worst situation is found in North Macedonia with only 0.211% of total employment being employed in R&D.

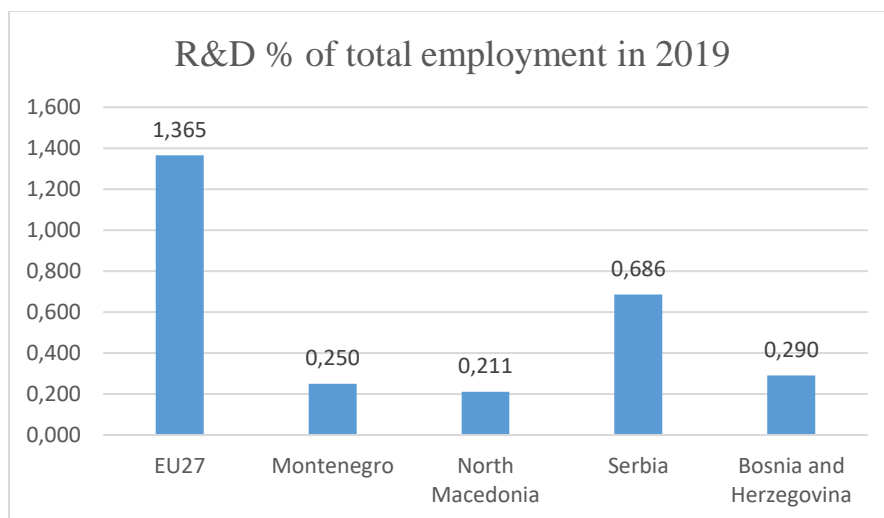


Figure 11. R&D share of total employment by sectors in 2019 (no data for Albania and Kosovo).
Source: Adapted from EUROSTAT data.

3. Unemployment and unemployment structure

Figure 12 illustrates unemployment rates and long-term unemployment as a percentage of the unemployed in the WB6 countries. Unemployment rates in these countries are two-digit (except for Serbia). Yet, what is concerning is the long-term unemployment in all WB6 countries, except perhaps Serbia. Long-term unemployment brings negative effects by making the labour force less employable due to a lack of skills or maybe barriers to employment. Long-term unemployment, particularly among the young, may hold adverse effects in terms of future employment and wages in the WB6 countries.

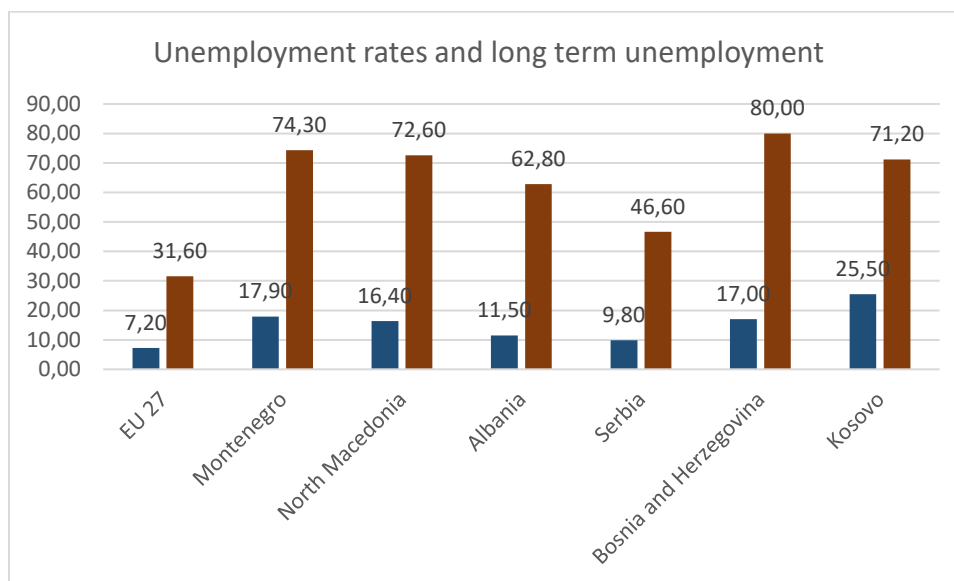


Figure 12. Unemployment rates and long-term unemployment as a percentage of the unemployed in the WB6 countries in 2020. For Montenegro: <https://china-cee.eu/2022/07/25/montenegro-economy-briefing-labour-market-trends-in-2022/>; for Kosovo: <https://ask.rks-gov.net/media/6953/labour-force-survey-q2-2021.pdf>; for Bosnia and Herzegovina: <https://www.elibrary.imf.org/view/journals/002/2015/299/article-A003-en.xml>.

Source: Adapted from EUROSTAT data.

4. Capital stock gap

There is a significant gap in the capital stock of the WB6 countries compared to other economies at a similar level of development.

The EBRD (2018) reports a significant capital stock gap⁸ for Serbia and Bosnia and Herzegovina, but also in Montenegro, Albania and North Macedonia relative to reference countries. For example, in 2014 the EBRD region had a total estimated capital stock deficit of EUR 2.2 trillion compared to other economies at a similar development level, of which around EUR 500 billion was due to lower levels of investment between 2008 and 2014 (around 40% of that gap was accounted for by insufficient infrastructure, with the remaining 60% corresponding to other forms of capital stock like machinery and equipment, buildings and intellectual property). That gap is equivalent to 18% of the region's total capital stock and 47% of the EBRD region's annual GDP (EBRD 2018).

Accordingly, road and rail transport infrastructure must be improved in the WB6 countries.

While Serbia has a medium level of accessibility to road and rail transport; Albania, North Macedonia, Montenegro, and Bosnia and Herzegovina all have insufficient accessibility for all transport modes according to the World Bank Logistic Performance Index (LPI) in 2018 (see Figure 13). The LPI considers six dimensions of a country's performance in terms of logistics and compares it to 160 countries around the world.

⁸ Capital stock is important as a factor of economic production. The capital stock gap is a gap calculated as the difference between the capital stock of the EBRD countries and the capital stock of the reference countries at a similar level of development, e.g., fixed capital investment has been lower in the EBRD countries compared to the reference countries at a similar level of development. The capital stock gap in EBRD countries is 40% due to insufficient infrastructure, with the remaining 60% corresponding to other forms of capital stock like machinery and equipment, buildings and intellectual property.

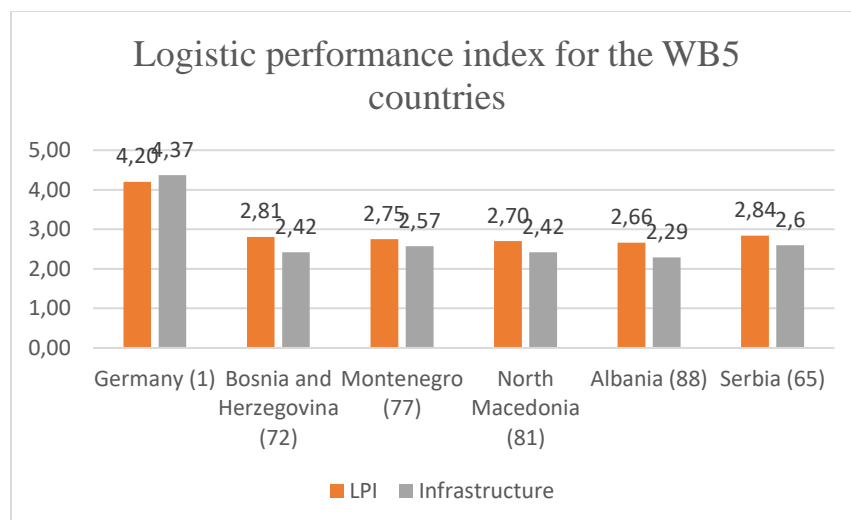


Figure 13. Logistic performance index for the WB5 countries in 2018.

The LPI is an interactive benchmarking tool created to help countries determine the challenges and opportunities they face in their trade logistics performance and what they can do to improve it. The LPI 2018 allows comparisons across 160 countries. The overall country ranking among 160 countries is shown in brackets.

Source World Bank: <https://lpi.worldbank.org/international/scorecard>.

The way forward

In a post-transition phase, the WB6 countries are not even in the middle-income trap, but have instead fallen into the trap of becoming and staying poorer. Progress with the transition has been closely correlated with political systems: countries which are more democratic and encompasses regulation, effective government, a strong rule of law, low corruption, and other positive aspects of the business environment have come further in reform terms than their less democratic counterparts (EBRD 2013).

Type I transition reforms focusing on macro-stabilisation, price liberalisation and the dismantling of institutions of the communist system were completed a long time ago (Svejnar, 2002). However, type II reforms involving good governance, the development and enforcement of laws, regulations and institutions to ensure a successful market-oriented economy are slowing down.

Namely, it might be that the WB6 countries' poor performance of the Type II reforms means they cannot grow faster than the poorer countries because they have exhausted their capacity to lower wages and to compete and are unable to grow faster than their richer peers since their capital stock is depreciated, have a capital stock deficit while their capital investments and FDI are on a lower level compared to their peers.

The point here is not about the convergence theory but the fact that in the past the WB6 countries were middle-income countries and today are still trapped in mediocrity and becoming poorer (Figure 14; also see World Bank 2013).

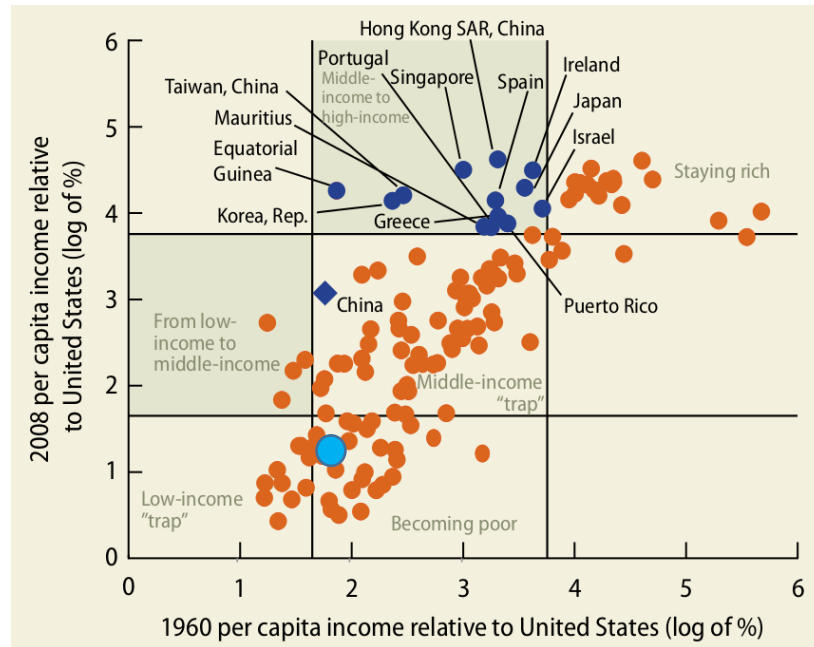


Figure 14. Illustration of the middle-income trap.

The light-blue dot calculation is made by the author for Albania and the Western Balkan countries that were once in former Yugoslavia. The countries are not even trapped in mediocracy but are instead growing poorer. Source: World Bank 2013.

Worse still, the sharp decline in working-age population combined with a larger share of NEET, as well as regions experiencing the significant departure of young people, puts the WB6 countries at risk of becoming caught in a talent development trap (EU 2023). The ageing and shrinking working-age population (see, e.g., the age pyramid for North Macedonia in Figure 15) along with the lack of economic dynamism have led to a decrease in the supply of highly skilled and younger workers.

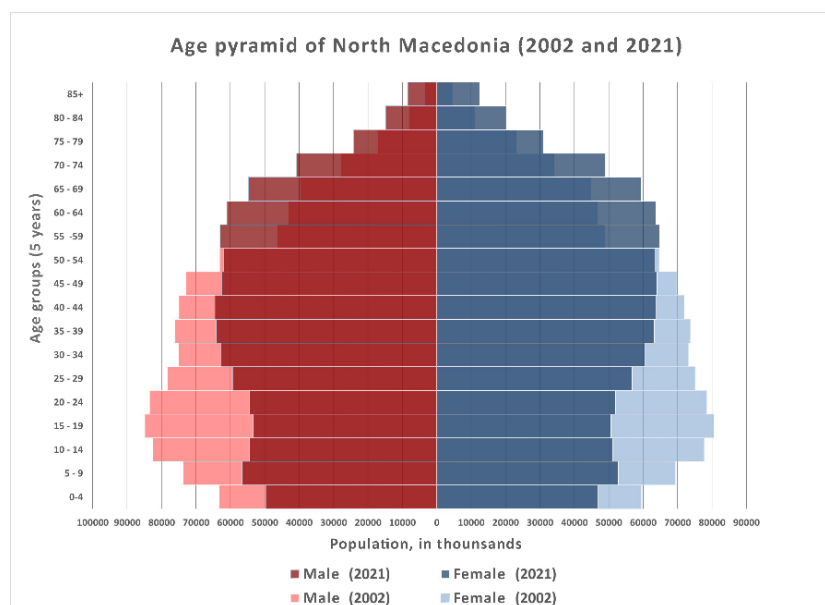


Figure 15. Age pyramid for Macedonia based on the 2002 and 2021 censuses showing an ageing and shrinking working-age population.

We have already described how the WB6 countries are facing considerable socio-economic challenges like the lack of economic dynamism, over-reliance on declining sectors, and low innovation capacity. This is closely linked to underperforming labour markets burdened by long-run unemployment rates and low participation rates, citizens becoming poorer and thus leading to poorer economic and social outcomes. This combination of challenges limits the WB6 countries' capacity to build sustainable, competitive and knowledge-based economies and keeps them poor and caught in a talent development trap.

This combination of growing poorer in a talent development trap, the environment of a low value-added sector, and the lack of an innovation-friendly R&D environment ensures the WB6 countries off the tracks of convergence with the EU.

There is a need for more effective policies to support the potential of the NUTS 3 secondary regions. This is important for the WB6 countries because cities are driving growth and the NUTS 3 regions in which the secondary internal cities are located can to a considerable extent improve the growth of the WB6 countries. Yet, the challenge of course is to find the right policy to identify and help the potential growth poles in the secondary and internal cities

Let us consider the neoclassical approach and discuss the issue from the aspect of human capital and physical capital in the production function.

One way out of the mentioned trap, at least in theory, could be to rely on innovation or imitation given that capital earns higher yields when it is scarce. The way out of the trap can no longer rely on lower wages policies simply because the wages are already on a low level given, for example, the heated 'race to the bottom' competition in the region to attract FDI with "the cheapest labor force in the world campaign" (CEA 2020).

This means that in the race for better wages and a higher quality of life the WB6 countries cannot compete with their poorer peers as the average wages are already low. In order to achieve higher wages and improved quality of life, the WB6 countries must compete with their richer peers by making investments in higher technology and skills to offset the need for higher wages.

With regard to higher economic growth, the following ways to achieving this are put forward:

- Short- to mid-run policies based on increasing efficiency:
 - Structural reforms by building human capital and moving the labour force towards more productive sectors
 - Greater investment in capital stock and infrastructure
- Long-run based policies based on the knowledge economy:
 - The augmentation of capital and labour, which requires more time and efforts for diffusion
 - Innovation in technology

All of these policies should be designed, worked on, coordinated and implemented parallel to each other. Note that these will not produce results if good governance is not fully ensured in the WB6 countries. Capital investments in hard infrastructure, improving both the efficiency of public spending and the education sector, introducing the knowledge economy concept with a view to the augmentation of capital and labour should be assured.

Reference List

CEA (2020): Attracting foreign investments in the Western Balkans region and state aid: race to the bottom or necessity? <https://cea.org.mk/wp-content/uploads/2020/07/0.-STUDIJA-FINAL-State-Aid-and-FDI-designed-ENG.pdf>

EBRD (2013): Stuck in transition? <https://www.ebrd.com/news/2013/ebd-transition-report-2013-stuck-in-transition.html>

EBRD (2018): Transition report 2017-2018: <https://www.ebrd.com/transition-report-2017-18>

EU (2023): Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Harnessing Talent in Europe's Regions: https://eur-lex.europa.eu/resource.html?uri=cellar:3c43b2f5-9690-11ed-b508-01aa75ed71a1.0001.02/DOC_1&format=PDF

IMF (2017): Fostering inclusive growth: <https://www.imf.org/external/np/g20/pdf/2017/062617.pdf>

Svejnar J. (2002): Transitional economies: Challenges and perspectives. Journal of Economic Perspectives, 16(1), 3–28: <https://pubs.aeaweb.org/doi/pdf/10.1257%2F0895330027058>.

UNCTAD data base: <https://unctadstat.unctad.org/CountryProfile/GeneralProfile/en-GB/004/index.html>

World Bank (2013): China 2030: Building a modern, harmonious, and creative society: <https://openknowledge.worldbank.org/server/api/core/bitstreams/74a6d2cc-ffb6-5340-86bb-ece1507f52ca/content>

World Bank (2018): Rethinking lagging regions; World Bank report on the EU: <https://www.worldbank.org/en/region/eca/publication/rethinking-lagging-regions>.