

ENDRŐDI-KOVÁCS VIKTÓRIA<sup>1</sup>

## Economic prospects of the Western Balkan countries' accession to the European Union

### A nyugat-balkáni országok európai uniós csatlakozási perspektívái gazdasági szempontból

*According to the European Union's strategy, the Western Balkan countries will be the next Member States. Since the Thessaloniki Summit in 2003, when the European Council declared that these countries could join in the future, not much has happened. The 2008-2009 economic and the Eurozone crisis played a significant role in it. Croatia joined the European Union in 2013. Since then, although some progress has been made, the accession negotiations are moving slowly. The aim of this study is to analyze, by using literature and data analysis, how Albania, Bosnia-Herzegovina, Northern Macedonia, Kosovo, Montenegro and Serbia fulfil the economic criteria of accession and what economic problems hinder it.*

*A Nyugat-Balkán államai az Európai Unió stratégiája alapján az integráció következő tagállamai lesznek. Mégis, a 2003-as thessaloniki csúcs óta, amikor az Európai Tanács kinyilvánította, hogy ezen országok csatlakozhatnak majd a jövőben, nem sok minden történt. Ebben a 2008-2009-es gazdaság válságnak, majd az ezt követő eurózóna válságnak is jelentős szerepe van. Horvátország 2013-ban csatlakozhatott. Azóta történtek előrelépések, de mégis lassan haladnak a csatlakozási tárgyalások. Jelen tanulmány célja irodalom- és adatelemzés segítségével bemutatni, hogy Albánia, Bosznia-Hercegovina, Észak-Macedónia, Koszovó, Montenegró és Szerbia hogyan teljesítik a csatlakozás gazdasági kritériumait, illetve azon gazdasági problémákat, amelyek ezt hátráltatják.*

## INTRODUCTION

For the Western Balkan (WE) countries, the European Union (EU) offered the possibility to join the integration at Thessaloniki Summit in 2003. It declared that 'The EU reiterates its unequivocal support to the European perspective of the Western Balkan countries. The future of the Balkans is within the European Union.' [European Commission, 2003: 1]. The EU hopes that with membership, it can reach permanent peace, enhance freedom and economic prosperity in the region [European Commission, 2020a], thus stability in its neighbourhood.

In the accession process, these countries stand at different stages. North Macedonia (FYR Macedonia) is a candidate country since 2005 but the accession negotiations haven't been

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started yet (mainly due to name dispute with Greece). Albania has been also a candidate country since 2014. The European Council discussed enlargement and the stabilization and association process as regards Albania and the Republic of North Macedonia together and it seems that the negotiations will start soon with them. According to the European Union's Western Balkan strategy, Montenegro and Serbia can join in 2025 at earliest; several negotiation chapters have been already opened. Bosnia and Herzegovina (BiH) and Kosovo are potential candidate countries, there are several problems with their accession, mainly BiH's fragile political system [Kemenczky, 2017] and the acceptance Kosovo's independence [European Commission, 2020b].

Behind the slow accession process there are several reasons including the 2008-2009 crisis and the following euro crisis; the negative experiences from the previous accession rounds; enlargement fatigue; the different point of view about the European Union's future. Finally, in 2018 the European Union was committed to further enlargement by announcing its Western Balkan Strategy. In its document of 'A credible enlargement perspective for and enhanced EU engagement with the Western Balkans', the EU stated that the region is 'the Union's very own political, security and economic interest' and described the European future of the region as a 'geostrategic investment in a stable, strong and united Europe based on common values' [European Commission, 2018: 2]. The EU set out six initiatives to form concrete actions, which help these countries to join [European Commission, 2018].

The aim of this study is to analyze the accession process of Albania, Bosnia-Herzegovina, Northern Macedonia, Kosovo, Montenegro and Serbia from economic and EU point of view; how these countries fulfil the economic criteria of accession and what economic problems may hinder it. Economic readiness to join is one of the most important accession criteria, which is needed to allow these countries to develop and the European Union to deepen. The study first introduces how the economic criteria have changed since the establishment of Copenhagen criteria, then sets a methodology how economic readiness can be measured. Based on these aspects, the paper analyzes the most important economic trends, which are important related to future accession. Finally, after the summary, some concerns will be mentioned, which can be future research directions and hinder the implementation of Western Balkan strategy.

## **THE ECONOMIC CRITERIA OF EU MEMBERSHIP – METHODOLOGY**

### **THE CHANGES IN ECONOMIC CRITERIA**

Every integration has its own criteria to let new members in. In the case of the European Union, the first criteria were introduced by the Treaty of Rome. These were the followings: the candidate country should be European and democratic [Palánkai et al, 2014]. As integration enlarged, candidates' integration preparedness has become more and more relevant. As a result, the European Communities formulated concrete accession criteria in 1991 in connection with the transition to economic and monetary union. Following the Maastricht criteria for the introduction of the euro, new conditions were created in connection with Eastern enlargement in 1993, the so-called Copenhagen criteria, which introduced a political, an economic, an administrative and an institutional criterion. So, if a country would like to join the European Union, it has to fulfil the Copenhagen criteria and the European Commission prepare reports how the candidate fulfils the criteria. But based on the lessons of the previous accession rounds, it became obvious that these accession requirements do not reflect readiness of candidate countries to enter the Union [Palánkai

et al, 2014]. If we analyse the content of the enlargement policy documents, it is quite obvious that besides the Copenhagen criteria other aspects are implemented and economic criterion is more emphasised than before; further aspects were involved besides a functioning market economy.

In the new Western Balkan strategy, adopted in 2018, the EU focuses on the following aspects: strengthening democracies, rule of law (including fundamental rights, good governance, corruption, judicial system, democratic institutions), strengthening the economy, security and migration, regional cooperation and reconciliation, applying EU rules and standards. As economic aspects, the European Union emphasises the economic potential of the region, its economic integration with the Union, the necessity to increase competitiveness (by e.g. decreasing high unemployment, particularly youth unemployment), to create business opportunities and favourable business environment, to implement the necessary structural reforms to handle structural weaknesses such as inefficient and rigid markets, to increase productivity, to erase limited access to finance, to make clear property rights and a cumbersome regulatory environment, and to decrease the role of grey economy [European Commission, 2018].

In the latest, 2019 communication from the European Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, the followings were mentioned as economic criteria besides and related to functioning market economy: investment climate, regional integration, raising living standards, trading relations with the European Union, better economic governance, competitiveness, economic growth and the situation of labour markets and reforms in order to booth economic development and convergence to the European Union [European Commission, 2019]. These are in line with the EU's Western Balkan Strategy as well as reflects the former economic problems, which occurred related to the previous enlargement rounds.

## **APPLIED METHODOLOGY**

From the above mentioned, the following aspects will be analysed as Western Balkan countries' readiness and economic prospects of accession by using the following indicators to be measured (see Table 1). These are in line with the Western Balkan strategy and official communications of enlargement, but also reflect a more complex approach than the economic criteria of Copenhagen.

First of all, the convergence of WB countries is crucial for the future. So first, the paper introduces the development of this region compared to the European Union to see whether these countries could catch-up and when the EU member states' standard of living. Economic development and convergence can be measured by different indices; this study highlights the two most important ones: GDP per capita (in PPP) and the Human Development Index (HDI). To catch-up, enhancing economic capacities is indispensable. In the EU documents [see e.g. European Commission, 2018 and European Commission, 2019] economic capacity is usually mentioned in relation to economic growth and unemployment rate. Labour potential means a huge economic factor for these countries.

The next aspect is competitiveness, which is crucial for both EU and WB companies and WB countries to exploit the possibilities and advantages of EU market. Since it is hard to measure it, based on Palánkai's integration maturity theory [Palánkai, 2014] it will be measured by a complex indicator (competitiveness index of World Economic Forum), and by Doing Business indicators. Competitiveness can be also measured by single indices – considering the region's characteristics and the EU's competitiveness goals – the study highlights two of these: labour productivity

(expressed by annual growth rate of output per worker (GDP constant 2011 international \$ in PPP) in relation with average wages and R&D capacities (R&D expenditure in % of GDP). As competition can be seen as FDI attractiveness, FDI retaining and outsourcing capability, inward and outward FDI will be analyzed, too.

For the European Union, close economic relations with future member states are important. The region's economic integration with the European Union can be represented by the Stabilization and Association Process/Agreements (SAP/SAA). The SAP is the strategic framework supporting the gradual rapprochement of the Western Balkan countries with the EU. It is based on bilateral contractual relations, financial assistance, political dialogue, trade relations and regional cooperation. The contractual relations take the form of stabilisation and association agreements (SAAs). These establish free trade areas with the countries concerned to enhance trade activities with the partners. Since the entry into force of the SAA with Kosovo in April 2016<sup>2</sup> [European Parliament, 2017], SAAs are now in force with all Western Balkan candidates and potential candidates. So, to analyse close economic relations, besides main investors and FDI trends, trade partners and trade composition will be analysed.

**Table 1: Applied methodology to analyse Western Balkan countries' economic readiness and economic prospects to join the European Union**

Aspects in EU official documents	Indicator(s) for measuring
Economic development and convergence	GDP per capita (PPP), Human Development Index (HDI)
Economic potential	Economic growth, unemployment rate
Competitiveness	Competitiveness index of World Economic Forum, Doing business indices of World Bank (starting a business), R&D capacities (R&D expenditure in % of GDP), inward FDI stock
Productivity	Labour productivity (Annual growth rate of output per worker (GDP constant 2011 international \$ in PPP) compared with increase in wages
Economic integration with the European Union	Main trading partners and investors, trade composition, current account
Structural reforms to handle structural weaknesses such as inefficient and rigid markets	EBRD Transition Reports and its indicators
Role of grey economy	Corruption Perception Index (by Transparency International)

**Source: author's own table based on enlargement documents, Palánkai et al [2004] and Endrődi-Kovács [2017]**

<sup>2</sup> In the case of Kosovo, the SAA is an EU-only agreement, which Member States do not need to ratify, since five Member States (Spain, Slovakia, Cyprus, Romania, and Greece) do not recognise Kosovo as an independent state.

Finally, introducing structural reforms are crucial for these countries to develop. Since it is hard to express these in one indicator, the most relevant studies, papers will be introduced like EBRD's Transition Report. The role of the grey economy can be linked to this aspect. Since it is hard to measure it, this paper uses the Corruption Perception Index as an indicator, which shows the corruption level of these countries by capturing the informed views of analysts, businesspeople and experts [Transparency International, 2020].

In sum, the paper uses both quantitative and qualitative methodological tools to show the most important economic issues of accession negotiations. The quantitative analysis is based on data from Eurostat and international organisations (like the World Bank and the United Nations). Although these aggregate data weren't collected directly for this purpose, can be used to show these countries' readiness to join and the economic challenges that countries face. As qualitative methodological tools, the most important literature, documents, analyses, journals and papers will be introduced. As a timeframe, the article discusses the economic trends between 2006 and 2018. The timeframe was chosen mainly based on data availability and to show the effect of the 2008-2009 crisis on the region's economies since it affected the accession negotiations. The slow progress of accession partly can be derived from the 2008-2009 financial crisis. Not just due to the European Union wasn't ready to accept these countries, but the 2008-2009 financial crisis harmed these countries' macroeconomic stability. Although the Serbian-Montenegrin dissolution happened in 2006 and Kosovo became independent just in 2008, there are estimations, available data from 2006 in the case of these countries. 2018 is the latest year, from where available data can be found at the time when this study was closed.

## **ECONOMIC ANALYSIS OF THE WESTERN BALKAN COUNTRIES FROM THE POINT OF VIEW OF ECONOMIC CRITERIA**

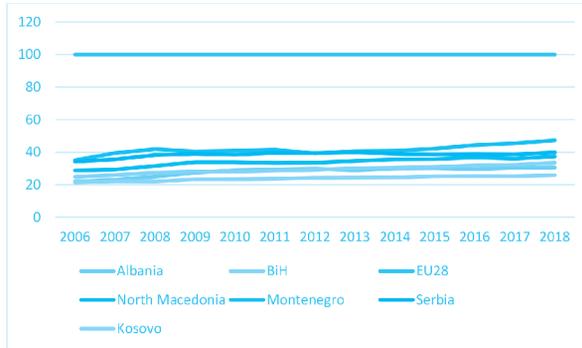
### **ECONOMIC CONVERGENCE, DEVELOPMENT AND POTENTIAL**

Based on the experiences of previous accession rounds for the next accession round(s) the most important economic issue is the economic development of candidate countries and whether they can catch-up to the average of EU members.

The current average GDP per capita for the six WB countries is only 35% the average in the EU28 member (see Figure 1); half of the states of Eastern Europe and just one-quarter of the most advanced Western European countries. So the Western Balkan countries face a major convergence challenge. [Sanfey-Milatovic, 2018] However, a slow convergence, some catch-up can be seen between 2006 and 2018.

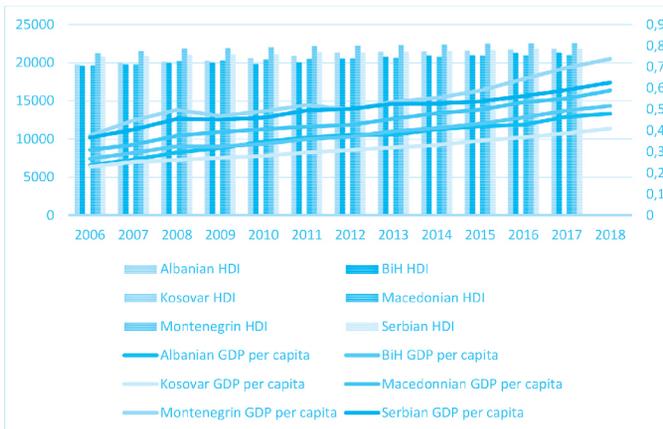
This can be verified by the increase in the Human Development Index from 2006 to 2018, too (see Figure 2). However, these countries – with the exception of Montenegro – are not in the country group of 'very high human development'. There is a room for improvement in this area since all EU member states can be found at 'very high human development' country group. Data for Kosovo are not available related to HDI, but the UNDP prepared a report about Kosovo in 2016 and estimated a 0.741 HDI. The report found that this result is one of the lowest in the region next to Albania and Bosnia and Herzegovina. It is also an important finding that almost a third of the population in Kosovo lived below the poverty line (1.72 EUR per adult equivalent per day), while 10.2% lived with less than 1.20 EUR per adult equivalent per day [UNDP, 2016]. It is a challenge for the country to reduce poverty.

Figure 1: GDP per capita (PPP, current international USD) in the Western Balkan countries compared to the European Union average (EU28=100) from 2006 to 2018 (%)



Source: World Bank (2020a)

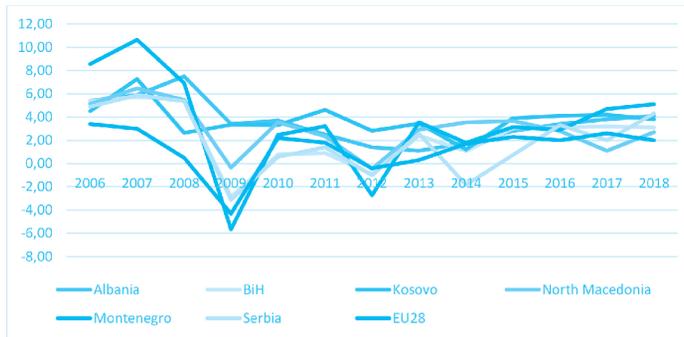
Figure 2: GDP per capita (PPP, international current USD; on the left vertical axis) and HDI (on the right vertical axis) in the Western Balkan countries between 2006 and 2018



Source: UNDP [2020], World Bank [2020a] and \* UNDP [2016]

The economic growth of these countries is higher than the economic growth of the EU28 average (see Figure 3), which also shows the slow convergence. We can also observe that the impact of the crisis on the Western Balkan countries follows the general European (and global) trends, but with a certain time lag of a year behind the development of the crisis in the EU and the subsequent stabilization and recovery there. It can be stated that the Western Balkan countries' business cycles are in line with the European Union's business cycle; the 2008-2009 crisis affected negatively GDP growth and convergence [Siljak – Nagy, 2019]. After the crisis, we can observe lower economic growth than before and a more permanent decline in the case of Serbia, which recovered later from the crisis. The process of convergence slowed down, too.

Figure 3: Real GDP growth in the Western Balkan countries between 2006 and 2018 (%)

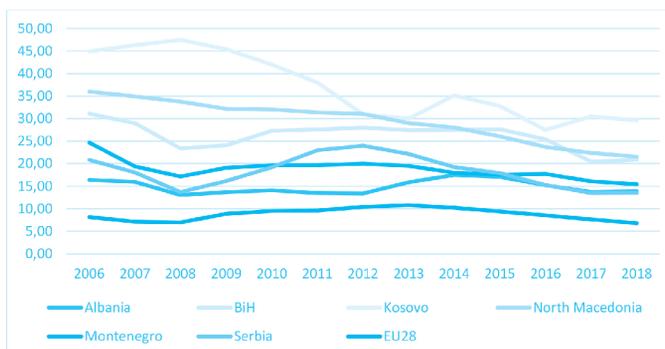


Source: Eurostat [2020]

Based on EBRD estimations full convergence with average EU living standards could take many decades. According to the baseline scenario (which uses the average growth rates for the period of 2001-16) it will take 60 years, while the optimistic scenario (which uses pre-crisis growth rates) predicts 40 years. The pessimistic scenario (which uses the post-crisis average growth rates) indicates 200 years for these countries to catch-up to the EU28 GDP per capita level. The speed of catch-up mainly depends on the pace of addressing the challenges that hinder the region from developing its full potential [Sanfey – Milatovic, 2018].

One of these challenges is to handle the high unemployment rate in the Western Balkan countries. Although it is showing a decreasing trend, it is at least two times higher than the EU average (see Figure 4). In the region, the historically high unemployment rate, especially among women and youth, hinders economic growth, productivity and competitiveness.

Figure 4: The unemployment rate in the Western Balkan Region and in the EU28 between 2006 and 2018 (%)



Source: World Bank [2020a] and CEIC [2020]

Among Western Balkan countries, Kosovo has the highest unemployment rate (Figure 4) and the widest gender gap in unemployment. While unemployment continues to remain around

30%, the unemployment rate for women in Kosovo is significantly higher compared to all the countries in the region, as is the gap in the unemployment rate between women and men. Women need more education and experience to get employed. Kosovo has the lowest labour force participation rates for young women and men in the region [UNDP, 2016].

Youth unemployment is also relevant and persistent in the region. Although it fell to 35% in 2018, it was twice as high as the EU average. More than one-fifth of the youth population was not in employment, education or training, which shows a decreasing trend, but it is still high by international standards [World Bank Group – Wiiw, 2019].

## COMPETITIVENESS

If we analyse the global competitiveness indices (GCI) of the World Economic Forum between 2006 and 2018<sup>3</sup>, we can observe that in general, the Western Balkan countries lag behind EU countries. There are just a few exemptions when some countries were ahead of some EU member states like in the years from 2014-2015 to 2017-2018 when Albania and Montenegro were ahead of Greece in the ranking or the year of 2016-2017 when Macedonia was ahead of Hungary [WEF, 2015-2018]. Countries in this region typically score poorly relative to EU countries on annual cross-country measures of competitiveness due to poor business environment and poor innovation capacity. Enterprise surveys suggest that one of the biggest obstacles to doing business is the role of the informal sector, which cause unfair competition. Other relevant obstacles include corruption, getting electricity and access to finance. Competitiveness is also hampered in some countries by a still-large state presence in key industries and inadequate implementation of the competition policy framework [Sanfey – Milatovic, 2018].

The most problematic components of competitiveness are technological readiness and innovation, such as information and communications technology (ICT) use and low scores of spending on research and development (R&D) [Despotovic et al, 2014; Sanfey – Milatovic, 2018]. Table 2 catches the problem appropriately; the R&D expenditures are extremely low in the Western Balkan countries and with the exception of Serbia it shows a decreasing trend in the last years.

Table 2: Research and development expenditure (% of GDP)

Country/Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Albania	n/a	0.09	0.15	n/a									
Bih	0.02	0.02522	0.02	0.02	n/a	n/a	0.27	0.32	0.26	0.22	0.22	0.2	n/a
Kosovo	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
North Macedonia	0.19	0.17	0.22	0.2	0.22	0.22	0.33	0.44	0.52	0.44	0.43	0.35	n/a
Montenegro	1.23	1.15	n/a	n/a	n/a	0.31	n/a	0.37	0.36	0.37	0.32	n/a	n/a
Serbia	0.47	0.62	0.71	0.87	0.74	0.72	0.91	0.73	0.77	0.87	0.89	0.93	n/a
European Union	1.76	1.77	1.83	1.93	1.92	1.97	2	2.02	2.04	2.04	2.05	2.06	n/a

Source: World Bank [2020a]

<sup>3</sup> Taking into consideration that the methodology of GCI has changed from 2017 to 2018

Although the region scores relatively high in indicators associated with the perceived quality of health and primary education, the most problematic areas are labour market efficiency, business sophistication, lack of well-developed business clusters and the poor quality of overall infrastructure, including roads, railways and ports [WEF, 2018].

Related to doing business indices, overall, with the exception of Bosnia and Herzegovina, to start a business in the Western Balkan countries is easy and shows an improving trend (see Table 3). Although related to the World Bank's Ease of Doing Business ranking, the countries' doing business performance is different. In 2018, FYR Macedonia is ranked 11th out of 190 countries, the highest ranking in the region and just some current EU countries could ahead in the ranking (Denmark, United Kingdom and Sweden). Macedonia has seen significant improvements in the efficiency of construction regulation and reduced the number of procedures and time it takes to build a warehouse. Kosovo, Montenegro and Serbia are ranked between 40th and 43rd position, Albania is 65th, while Bosnia and Herzegovina are ranked the lowest in the region at 86th position. Kosovo recently introduced several numbers of reforms and can be seen as the second most-reformed country in the fragile state's group [World Bank, 2018]. Common problems across the region include: dealing with construction permits and getting electricity [Sanfey – Milatovic, 2018].

Table 3: Starting a business in the Western Balkan countries

Country/Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Albania	67.3	69	68.2	82	87.2	87.3	87.6	90.2	90.3	91.7	91.7	91.4	91.5
BIH	50.4	51.2	52.6	51.4	53.7	50.4	54.3	56.6	56.6	56.7	56.9	58.4	59.4
Kosovo	n/a	95.4*											
North Macedonia	54.1	66.9	76.2	81	86.8	88.5	88.5	90.3	90.3	90.4	92.2	92.1	92.1
Montenegro	n/a	72.1	72.2	73.2	78.6	85.1	86.6	86.6	86.6	86.6	86.6	86.6	86.6
Serbia	77.7	77.9	78	78.3	87.2	86.7	86.7	88.8	88.9	89	89.1	91.8	92.6

Source: World Bank [2020b]

Note: Scores are reflected on a scale from 0 to 100, where 0 represents the lowest and 100 represents the best performance.

\*: the score refers to the year of 2019. No data is available for the previous years.

Table 4: FDI Inward Stock (in millions of USD) and top 5 investors in Western Balkan countries

Country/Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Top 5 investors
Albania	1392	2693	2869	3258	3255	4399	4303	3931	4295	4337	4985	6739	7902	CH, GR, NL, CA, IT
BIH	3203	5397	6103	6936	6709	7127	7564	8231	7267	6946	6918	8247	8330	AT, HR, BS, SI, NL
Kosovo	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	CH, TR, GB, DE, AL
North Macedonia	2764	3747	4132	4525	4351	4678	4863	5489	4885	4790	4909	5634	5961	AT, GB, GR, DK, SI
Montenegro	n/a	n/a	n/a	n/a	4231	4209	4707	5143	4844	4881	4572	5325	5559	HU, DE, GB, CY, AZ
Serbia	n/a	n/a	19333	20870	22299	24675	26014	31490	29569	29073	30369	37573	39833	NL, AT, LU, RU, GE

Source: UNCTAD [2019], Financial Observer [2020] and KPMG [2017]

Competitiveness can be captured as FDI attracting, keeping ability. If we examine the inward FDI data from 2006 and 2018 (see Table 4) it can be concluded that more and more FDI arrive in these countries. However, if we compare these data to global FDI flows or inward FDI stock in Central and Eastern European countries, we can see that the amount of FDI flows to the Western Balkan region is relatively low. In general, the region suffers from a lack of capital, besides increasing household saving rates, more FDI would be needed to develop [Endrődi-Kovács, 2017]. Increasing doing business scores in the above-mentioned areas and increasing productivity can be appropriate solutions besides introducing the necessary structural reforms (see 3.4 subchapter).

The top investors vary among Western Balkan countries (see Table 4). However, it can be concluded that the major investors are EU member states and intra-regional investments are important in these countries. Outward FDI from this region is not relevant (range between 79.8 and 3805 million USD) [UNCTAD, 2019].

**Table 5: Annual growth rate of output per worker (GDP constant 2011 international \$ in PPP)**

Country/Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Albania	6.5	6.8	5	4.8	4.3	-0.5	-1.2	10.2	1.9	-2.5	0.1	1	2.2
BH	6	0.8	-4	-2	4.3	3.1	0.1	2.1	2	5.1	1.2	-1.8	1.1
Kosovo	n/a												
North Macedonia	2.3	3	1.7	-3.9	2.1	1.1	-0.8	-1.4	1.7	1.5	0.5	-2	0.2
Montenegro	-0.4	-0.6	3.5	-3.7	3	3	-5.1	2.6	-4.6	0.7	2	2.5	1.6
Serbia	10.2	3	1.9	3.2	7.2	7.5	0	-1	-5.5	0.7	-2.6	-0.9	2.7

Source: ILO [2020]

Labour productivity is relatively low (see Table 5) in these countries and reflect the economic situation of the region (e.g. the effect of 2008–2009 crisis in Bosnia Herzegovina and North Macedonia, Serbian and Albanian economic problems which led to IMF loans). One of the major challenges of these countries is to increase its productivity e.g. by adapting Industry 4.0 technologies. Low productivity is a fundamental problem, which holds back the region's economic development and reflects the years of underinvestment, weak institutions and a difficult business environment [Sanfey - Milatovic, 2018]. If we compare these data with the change in average wages in these countries [CEIC, 2020] we can conclude that although the average wages are much lower than the EU28 average, the change in wages was higher than a change in productivity, which deteriorates these countries' competitiveness. Moreover, when average wages and its increase are compared to labour productivity, the apparent labour cost advantage of the Western Balkan countries disappears since Bulgaria and Romania have similar or even lower labour costs but higher productivity than some Western Balkan countries, so these EU members seem more competitive than some Western Balkan countries [World Bank Group – Wiiw, 2019].

## ECONOMIC INTEGRATION WITH THE EUROPEAN UNION

As Table 4 has shown, the main investors are mainly EU member states, but the relation is unequal: for Western Balkan countries the EU member states are more important than vice versa.

Analysing the most important trading partners and trade composition of these countries, we can conclude the same. For all WB countries, the EU is the leading trade partner accounting for over 72% of the region's total trade; while the region's share of overall EU trade is only 1.4%. By examining the trade composition, it can be concluded that in general less value-added products are exported from Western Balkan countries and higher value-added products are imported. Moreover, the region is facing negative trade balances (see Table 6).

**Table 6: Main trading characteristics of the Western Balkan countries in 2017**

Country	Top5 export destinations	Top5 import origins	Main export products	Main import products	Trade balance (in billion USD)
<b>Albania</b>	IT (42%), ES (5.3%), FR (4.7%), DE (4.7%), GR (4.2%)	IT (30%), GR (9.3%), DE (8%), RS (3.9%), ES (2.2%)	Leather (14%), footwear parts (8%), chromium ore (7.2%), ferroalloys (5%), crude petroleum (4.2%)	Cars (5.5%), packaged medicaments (3.4%), refined petroleum (3.4%)	-1.82
<b>BiH</b>	DE (14%), IT (13%), RS (9.8%), AT (9.1%), SI (9%)	RS (12%), DE (12%), IT (11%), HR (7.4%), SI (5.2%)	Seats and other furnitures (4.9+3%), electricity (4.7%), leather footwear (4%), sawn wood (3%), raw aluminium (2.6%)	Refined petroleum (5.4%), cars (4%), coal briquettes (2.2%)	-3.83
<b>North Macedonia</b>	DE (43%), SR (6.6%), BG (5.8%), CZ (4.3%), GR (3.9%)	DE (12%), GB (10%), GR (8.1%), SR (7.5%), IT (5.4%)	Reaction and catalytic products (21%), centrifuges (9.6%), insulated wire (7.4%), vehicle parts (3.8%), buses (3.1%)	Platinum (13%), refined petroleum (6.1%), laboratory ceramic ware (4.2%), cars (2.5%)	-1.48
<b>Montenegro</b>	RS (13%), BiH (11%), HU (7.2%), IT (4.6%), SI (4.25)	RS (25%), DE (7.4%), BiH (7.2%), IT (6.9%), GR (5.3%)	Aluminium ore (18%), raw aluminium (16%), special purpose ships (6.6%), cars (4.9%), packaged medicaments (3.8%)	Refined petroleum (6.4%), cars (4.8%), electrical transformers (2.4%), packaged medicaments (2.3%)	-2.26
<b>Serbia</b>	DE (13%), IT (13%), BiH (7.4%), RU (6.2%), RO (4.1%)	DE (12%), IT (9.7%), RU (7%), HU (5.3%), PL (4.3%)	Cars (6.3%), insulated wire (5.3%), rubber tires (3.5%), electric motors (2.3%), frozen fruit and nuts (2.3%)	Crude petroleum (4.3%), vehicle parts (3.6%), packaged medicaments (3.3%), refined petroleum (2.8%), cars (2.7%)	-3.28
<b>Kosovo*</b>	AL (16%), IN (14%), MK (12.1%), SR (10.6%), CH (5.6%), (6.DE -5.4%)	DE (12.4%), SR (12.3%), TR (9.6%), CN (9.1%), IT (6.4%)	Mining and processed metal products, scrap metals, leather products, machinery, appliances,	Foodstuffs, livestock, wood, petroleum, chemicals, machinery	-0.47

Source: OEC [2020], \*: Index Mundi [2019]

The trade volume has more than doubled since 2006 and the total trade between the EU and the Western Balkans exceeding 54 billion EUR in 2018. It seems that SAA has already had a positive effect on Western Balkan countries' trade since in the last 10 years, the region increased its exports to the EU by 130% - against a more modest increase of EU exports to the region of 49% [European Commission, 2020c]. Exports should be further stimulated and these countries would have specialized on higher value-added products. However, in sum, trade products are diversified. In some countries (e.g. Albania and North Macedonia), the diversification of trade partners would be wise (see Table 6).

## **STRUCTURAL REFORMS**

In Albania, the most needed reform is about to decrease high public debt (in 2018, it was 68% of GDP). The Albanian banking sector has undergone further consolidation. The banking sector is stable but faces important challenges, including the relatively low quality and quantity of lending, high exposure to sovereign debt and high euroisation. At the same time, there is an ongoing shift in ownership away from Eurozone banks towards domestic and foreign non-EU owners. Non-performing loans (NPLs) have halved since 2014 but still remain at double-digit levels. Informality remains one of the most important obstacles for doing business, and further measures are needed to tackle the problem. The necessary measures include a simplified tax system and procedures, strengthened capacities for inspections, the fight against corruption and bribery in public administration. Moreover, energy sources should be diversified by reducing the country's dependency on the hydro generation and continuing reforms to improve governance and transparency in the power sector [EBRD, 2019].

In Bosnia and Herzegovina, the reforms are moving slowly. In the last year, delay in forming governments has blocked much-needed reforms. The Federation entity- and state-level government are still not in place after the October 2018 elections, and the IMF programme continues to be stalled. In May 2019, the European Commission adopted its opinion on BiH's EU membership application. This set up 14 key priorities in the areas of democracy/functionality, rule of law, fundamental rights and public administration reform, which the country needs to fulfil in order to progress with EU approximation. Related to economic issues, business climate needs to be improved significantly. The business environment remains one of the most complicated in Europe, with different regulations in the two entities and the Brčko district. Harmonised regulations, the reduction of 'red tape' and para-fiscal charges would have benefits for the private sector. Moreover, inefficient state-owned enterprises (SOEs) impose a significant fiscal burden and have negative effects on other businesses. They should be depoliticised and restructured [EBRD, 2019].

Kosovo stepped up the fight against informality by adopting a revised strategy and action plan for fighting informality for the period 2019 to 2023. Instead of this, further efforts are needed in this area to accelerate the growth of the private sector. Moreover, financial oversight, corporate governance, accountability and efficiency of SOEs are areas that need improvement. In addition, the privatisation of non-strategic SOEs should be stepped up. Diversification away from coal as a source of electricity is urgent. The country should increase the share of renewables in power generation. Also, a broader green agenda is needed, including steps to improve energy efficiency at the residential, private sector and municipal level, and the construction of new wastewater treatment plants [EBRD, 2019].

In North Macedonia, further measures are needed to improve its business climate. The focus should be on implementing measures to reduce the informal economy, in accordance with the government's 2018-22 strategy and 2018-20 action plan. Simplification of rules for the establishment and operation of businesses (especially in the case of entrepreneurs and micro-enterprises) is needed, too. Reforms related to the labour market is also necessary. Addressing skills shortages and aligning better vocational training with business needs is necessary in order to enhance the country's competitiveness. Finally, to ensure the sustainability of public finances and more ambitious fiscal consolidation measures are crucial. The public debt is relatively high and the structure of government spending worsened further in the past year, shifting from capital to current expenditures. The government should further improve revenue collection, reduce tax exemptions, rationalise subsidies and ensure long-term pension sustainability. The introduction of fiscal rules is also needed; North Macedonia is the only Western Balkans country lacking such rules [EBRD, 2019].

In Montenegro, rising public debt causes the biggest challenge: it has increased further from already elevated levels and reached almost 75% of GDP. This is mainly due to the large highway project, which is financed by a Chinese loan. In addition, the private sector would benefit from less informality. More comprehensive measures, focusing on the regulatory burden, weak enforcement capacity and corruption, should be put in place in order to reduce unfair competition from the informal sector, which affects negatively the small- and medium-sized enterprises (SMEs). The financial system needs strengthening. A bank asset quality review and stronger banking supervision would be necessary. In addition, the central bank should closely monitor the rapid growth of cash loans with long maturities in order to limit potentially negative systemic effects [EBRD, 2019].

Serbia has to strengthen the rule of law, fighting corruption and increasing domestic private and public investment to reach improvements and could raise its low economic growth. The governance of SOEs and public projects need to be improved, too. A single pipeline for all public projects should be developed, enabling proper cost-benefit assessment and monitoring while project implementation should be strengthened further. Public administration reform is urged. Planned reform measures, including the introduction of a new public-sector pay grade system, as well as professionalization and de-politicisation of public administration, have been postponed several times and should be implemented without further delay [EBRD, 2019].

In general, consumption continues to be the main driver of economic activity in Western Balkan countries, fuelled by higher public spending and near double-digit growth in household lending. This raises questions about the sustainability of the consumption-driven growth in the region. Moreover, internal and external imbalances are rising in the region. Growth is slowing despite a surge in public spending stimulated by cyclical revenues. The rise in revenues has not been enough to offset the rise in current spending dominated by public wages and social benefits. External imbalances also started to rise as exports slowed, due to falling demand from EU trading partners amid rising trade tensions. Sizeable internal and external imbalances in several Western Balkan countries, along with elevated public debt, expose the region to adverse economic shocks. The higher public spending has compromised an opportunity to build the much-needed fiscal buffers to be able to cushion the impact of rising external uncertainties [World Bank, 2019].

Another important common problem is the role of the grey economy and corruption in the region (see Table 7). In sum, further efforts are needed to decrease corruption, informality in the region in order to boost SMEs economic performance, thus competitiveness.

**Table 7: Corruption Perception Index in Western Balkan countries between 2006 and 2018**

Country/ Year	2006	2007	2008	2009	2010	2011	2012*	2013	2014	2015	2016	2017	2018
Albania	2.6	2.9	3.4	3.2	3.3	3.1	33	31	33	36	39	38	36
BiH	2.9	3.3	3.2	3	3.2	3.2	42	42	39	38	39	38	38
Kosovo	n/a	n/a	n/a	n/a	n/a	n/a		34	33	33	33	36	37
North Macedo nia	2.7	3.3	3.6	3.8	4.1	3.9	43	44	45	42	37	35	37
Monte negr o	n/a	3.3	3.4	3.9	3.7	4	41	44	42	44	45	46	45
Serbia	3	3.4	3.4	3.5	3.5	3.3	39	42	41	40	42	41	39

Source: Transparency International [2020]

\* Until 2011, TI measured corruption on a scale from zero (highly corrupt) to ten (highly clean). From 2012 a country or territory's score indicates the perceived level of public sector corruption on a scale of 0 - 100, where 0 means that a country is perceived as highly corrupt and 100 means it is perceived as very clean. A country's rank indicates its position relative to the other countries and territories included in the index.

## CONCLUSIONS

Having passed a kind of accession fatigue it seems that the European Union would like to see Western Balkan countries within the European Union. After analysing the most important economic aspects, which are important from the point of view of accession, it can be stated that all countries in the region need much higher, better quality and sustainable growth.

More has to be done to fight high unemployment and to continue structural reforms in administration and education in order to improve SMEs' competitiveness and the level and skills of the labour force.

The study has many limitations. As a future research direction, more economic and non-economic indices can be involved (e.g. migration). Moreover, this study analyses future accession from the point of view of the EU. It is another future research question what the Western Balkan countries would like and whether EU accession will be beneficial for them. It seems they are ready to join, however, EU's credibility in candidate countries, which has been already damaged by accession delays, would erode further. The solutions might be more economic incentives, tightened regional cooperation and intense political engagement [Lőrinczné, 2018]. Homegrown nationalist movements are more dominant in the region and there is a real threat of rejecting Western ties and make ties tighter with Russia and China, which are seems more active in the region [Norman, 2019].

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