ECONOMIC CONVERGENCE OF WESTERN BALKAN COUNTRIES TO THE EUROPEAN UNION

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***Abstract*:**

Western Balkan countries are at various stages of their path towards future European Union membership. Formal accession procedures aside, in this paper we take a brief look at the economic convergence between them and the EU. We use several indicators to assess and compare the degree of real convergence of each country to the union, focusing on the level of GDP per capita and the production structures at the sector level. The results reveal a moderate convergence process, with some specifics by country, that paints a cautiously optimistic outlook regarding their future in the EU.

Keywords: *regional convergence; economic integration; Western Balkans; EU accession*

1. Introduction

Historically, the Western Balkans have been through many troublesome periods, with many episodes of political and economic instability. In recent years both the countries in the region themselves and the European Union have been working towards their integration in an effort to ensure regional prosperity and peace. Six countries from the region - Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia - are at various stages of the political process towards future European Union membership. According to EU legislation, these candidate countries are required to meet certain criteria, related to the functioning of their political, legislative, and economic institutions, in order to eventually become members of the Union.[1]

[1] The main criteria are laid out in the Treaty of Maastricht, art. 49, as well as the conclusions of the European Council in Copenhagen in 1993 and the European Council in Madrid in 1995.

As far as economic matters are concerned, the main requirement is that the country has a functioning market economy and that its economic agents are able to compete with others within the EU. While there are no formal quantitative criteria or thresholds in this area that have to be met, it is worth exploring the progress that Western Balkan countries have made in the economic area and assessing their current positions.

In this paper we look at the level of economic convergence between the countries from the Western Balkans and the European Union. Since they start from much lower income and price levels than those in the EU, with an economic structure that differs significantly from the Union, we could expect that over time their economies would „catch up" to the EU. This is one of the implications of the standard Solow (1956) growth model and of Fisher's (1939) three-sector model.

Large differences between individual candidate economies (or the group as a whole) and the EU economy may signal a lack of preparedness of these economies to handle the competitive pressures that come with membership, resulting in business failures, higher inflationary pressure, and increased external imbalances, among others. On top of that, the absence of a tendency to converge or a slow rate of convergence towards the EU could be an indirect indication of existing issues in other areas - judicial, political, etc.

The importance of achieving a reasonable degree of similarity between the members of an integrated group of countries has been highlighted in numerous studies in recent years. Del Hoyo, et al. (2017), for example, claim that the very low labor mobility within the EU would not help with equalizing income levels in the union.[2] This would make the initial differences in income levels between individual countries more difficult to overcome. Similarly, it has been shown that there is currently no effective risk sharing mechanism in the EU (Malkin & Wilson, 2013), that would help with overcoming asymmetric economic shocks, which are themselves more likely (and more asymmetric) when there are larger differences between economies. Such issues increase the importance of real economic convergence on the road to EU membership.

In order to assess the degree of convergence of the Western Balkan countries to the EU we explore several key macroeconomic indicators that are traditionally used to evaluate convergence processes, namely GDP per capita and the production structures at the sector level. The countries that we study in this paper are Albania, Montenegro, North Macedonia, and Serbia, while the period covered is from 2006 to 2021 (2020 for the analysis of GDP by PPS).[3] We use annual data provided by Eurostat and all comparisons are made to EU27 averages.

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[2] See also Jauer, et al. (2014).

[3] Lack of comparable data in some areas and/or countries limits the length of the time period under review and completely excludes Bosnia and Herzegovina and Kosovo from the study.

2. Real convergence

First, we take a look at the level of GDP per capita at purchasing power standards in the selected countries. A simple way to identify the existence of a convergence process is to compare the growth rates of economies with different starting levels of income (GDP). If economies with lower initial levels of GDP are growing faster than economies with higher initial levels of GDP, then the GDP level of the former will be catching up to the latter, i.e., the economies will tend to converge. The Western Balkan countries start the period with GDP per capita levels that are significantly below (3 to 4 times lower) the EU average (Table 1). They subsequently grow at higher rates which allows them to reduce these gaps by about 20% (in relative terms). However, the differences remain high and further progress is necessary. If we apply a simple extrapolation from the current point forward, maintaining the average growth rates from Table 1, the average GDP level for the group of Western Balkan countries will reach that of the EU in approximately 50 years.

Table 1. Levels and growth rates of GDP p.c. at PPS 2006 - 2020

	2006 GDP p.c.	2020 GDP p.c.	Average annual GDP p.c. % change
Albania	5219.2	9108.6	4.4
Montenegro	8312.7	13356.4	3.8
North Macedonia	6907.1	11391.3[4]	4.5
Serbia	8114.4	12758.1	3.7
Average	7138.4	11653.6	4.1
CV_{WB}	19.9	19.6	-
CV_{all}	70.4	57.2	-
EU27	23199.0	30002.7	2.1

Source: Eurostat data and authors' calculations.
Note: CV_{WB} - coefficient of variation between the four Western Balkan countries; CV_{all} - coefficient of variation including EU27.

Figure 1 also plots these variables for the group of Western Balkan countries and the EU27, confirming that a process of real convergence exists between them – there is an inverse relationship between the higher average growth rates of the economies and their lower starting GDP levels. This is true for the group of Western Balkan countries as well, if we exclude the EU from the comparison. It also appears that two groups of two countries each can be

[4] Value is for 2018 due to missing data.

identified - one consisting of Albania and North Macedonia and characterized by lower initial levels of GDP and higher growth rates, and another, consisting of Montenegro and Serbia, which is closer to the EU with higher starting GDP levels but experiences slightly slower growth.

The values of the coefficient of variation in Table 1 also indicate a moderate increase of the similarity between the four economies and the EU in terms of the level of output, but a significant gap still exists. Interestingly, there is little reduction of the differences between the countries themselves.

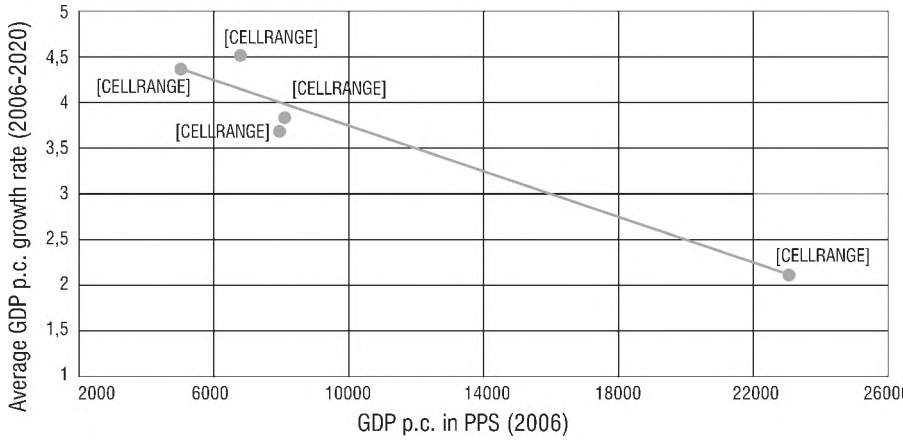

Figure 1. *Initial GDP p.c. and GDP growth rates 2006-2020*

Source: Eurostat data and authors' calculations.

The dynamics of the GDP growth rate in the countries over the selected period reveal more details about the process. Although the average rate for the group of countries is consistently above the EU27 growth rate (the only exception is 2020), there is a lot of variation among them (Figure 2). On several occasions individual countries experience growth rates that are lower than the EU, which slows down their convergence process (putting them below the regression line in Figure 1 above). This is most often the case for Montenegro, which is also the smallest among the four economies, and also for Serbia. Contrary to that, Albania appears to be maintaining the most stable growth rate, which also exceeds that of the European Union in all years.

There is also a pronounced change between the beginning of the period (2006 - 2009) and the rest of it in terms of the difference between the annual growth rates of the Western Balkan countries and the EU27. Initially, the average growth rate of the candidate economies is approximately three times higher than the EU average, but after the 2009 recession this difference falls and remains below 2 times even during the 2016 - 2019 period, characterized by the highest growth rates since 2009. This slows the convergence process and increases the time that Western Balkan countries need to catch up to the EU.

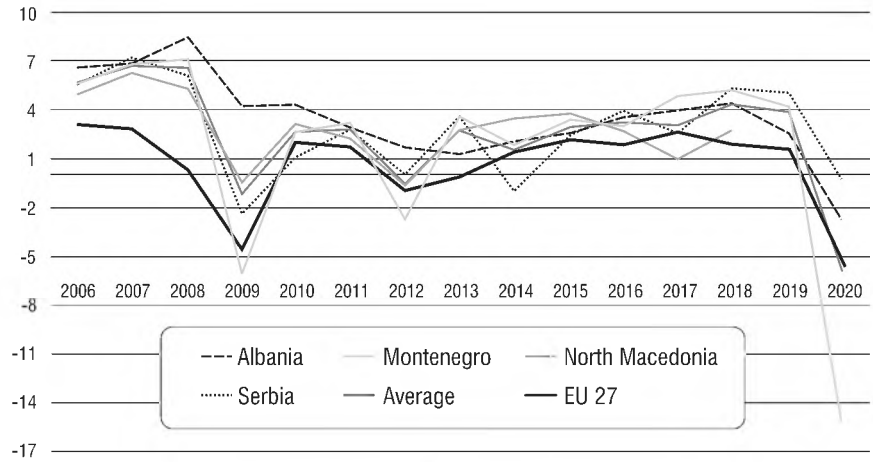

Figure 2. GDP growth rates (%) of Western Balkan countries 2006 - 2020

Source: Eurostat data and authors' calculations.

Overall, the four countries studied here tend to converge to the EU at a moderate pace, which is an optimistic outcome for their prospective future membership. The process is uneven, however, and on several occasions individual countries experience periods of divergence. The overall slowing of growth rates after 2009 also has a negative effect on it.

3. Production structures at the sector level

The increase in similarities in the GDP production structures of the studied countries to that of the European Union can be considered an essential characteristic of a structural convergence process. In addition, the convergence of production structures at the sector level is closely related to the progress of the real convergence process. In practice, the convergence in the relative shares of individual sector gross value added (GVA) may act as a factor for intensifying or restraining the convergence in real income.

The data for the agriculture, forestry, and fishing sector shows that in all four countries the relative share of this sector in GVA exceeds that of the EU (see Table 2).[5] In view of the degree of economic development of the countries in the region, this is not surprising. The most significant deviation is observed in Albania, where this share significantly exceeds the EU value. For the period 2006-2021 on average, the weight of agriculture, forestry, and fishing in GVA in Albania amounts to 21.2%, while the respective weight for the EU is 1.8%. Furthermore, there are no significant changes in the relative importance of this sector in Albania in the last year of the period compared to the first, with the difference in shares amounting to only 0.2 percentage points. In the other

[5] This is also typical for the EU countries from CEE; see Velichkov & Damyanov (2021), Raleva & Damyanov (2019).

three countries - Montenegro, North Macedonia, and Serbia, similar values are observed in the shares of agriculture, forestry, and fishing, which on average amount to 9.1%, 10.7%, and 8% for the interval. In all three countries, these shares in 2021 are lower compared to 2006, with the largest decrease registered in Montenegro - about 2.1 percentage points, while the decrease in Serbia is rather negligible - 0.4 percentage points.

Table 2. Relative share of individual economic sectors in GVA (%)

	Agriculture, forestry and fishing		Industry		Services	
	2006	2021	2006	2021	2006	2021
Montenegro	10,0	8,0	21,6	18,3	68,3	73,8
North Macedonia	10,3	9,0	24,9	25,3	64,7	65,7
Albania	20,5	20,3	29,2	25,0	50,3	54,7
Serbia	8,2	7,8	34,6	30,3	57,2	61,9
EU-27	1.9	1.8	27.4	25.7	70.8	72.5

Source: Eurostat data and authors' calculations.

In the industry sector, it was found that the differences of the four Western Balkan countries with the EU are less pronounced compared to those in the agriculture, forestry and fishing sector. The divergences with the EU in the average values for the percentage share of industry in GVA for the period 2006-2021 are relatively large in Montenegro, where this share is about 6.2 percentage points lower than the corresponding share for the Union. At the same time, a higher share of this sector in GVA was registered for Serbia compared to the EU, with the average excess for the time interval being about 5.7 percentage points. Although Montenegro and Serbia show relatively close values with an opposite deviation sign to the EU in the relative importance of the industry sector in GVA, these differences have positive macroeconomic projections in Serbia and negative for Montenegro. This is due to the fact that the industry sector includes such productions for which a higher GVA is inherent. In addition, this sector is characterized by higher levels of capital and technology, which has a favorable impact on labor productivity.[6] In view of this, the larger share of industry in Serbia also could be condition for a higher rate of economic growth in this country in the long run, which could contribute to a more pronounced convergence of real incomes to the EU. It is also interesting to note that there is a decrease in the weight of industry in the GVA in Serbia over time. This leads to a closer convergence of the industry's share with that of the EU.

Regarding the share of industry in Albania and North Macedonia, the average values for the observed time period show an insignificant deviation compared

[6] For a detailed analysis of labor productivity in North Macedonia see Stefanova, K. (2021).

to the European Union. In Albania during the first half of the period (between 2006 and 2013) this share is higher than the corresponding share for the EU, while in the rest of the years it is lower. For North Macedonia, between 2006 and 2012 the weight of industry in GVA was lower than that of the EU, between 2013 and 2020 it was higher, and in 2021 it was again lower. Specificities in the relative share of the industry sector by year in both countries are a reason to state that in Albania the tendency is more towards a decrease of this share, while in North Macedonia – towards an increase. This also corresponds to the observed relatively strong decrease in the share of this sector in GVA in Albania in the last year of the period compared to the first year – by about 4.2 percentage points, and accordingly with a slight increase in this share in North Macedonia – by about 0.4 percentage points. It can be noted that the continuation of this trend in Albania over time can be perceived as having a certain restraining effect on the long-term economic growth in the country, while in North Macedonia it is a prerequisite for its acceleration.

The relative share of GVA in the services sector in Montenegro is characterized by relatively close levels over the period to those in the EU, with an average deviation of about one percentage point. Significantly larger deviations are typical for the remaining three countries of the region. The deviation of this share is most significant in Albania, where on average for the time interval the share of services is about 19.7 percentage points lower than that of the European Union, amounting to 52.7%. This difference is due to the abovementioned high weight of agriculture, forestry and fishing in GVA in Albania. In Serbia, the average share of the service sector in GVA is 60.6%, which is about 11.9 percentage points lower than the EU value. The indicated deviation is due to the higher relative importance of the other two sectors compared to the EU. In North Macedonia, the share of services in GVA for the period 2006-2021 on average is about 8.7 percentage points lower than that for the EU. This corresponds to the reported higher weight of agriculture, forestry, and fishing in GVA in North Macedonia compared to the weight for the EU. It should be noted that all four countries witnessed an increase in the share of the service sector in the last year compared to the first year of the studied time period. However, the share of services in Albania in particular remains significantly lower than the EU value, which can be defined as a characteristic of the economy that is not inherent in highly developed economies. Taking into account the high relative weight of agriculture, forestry, and fishing in GVA, it can be noted that Albania occupies a leading position in terms of differences with the EU in two of the three economic sectors.

The outlined trends in the relative share dynamics of the three economic sectors in GVA of the studied economies also project their influence on the obtained values for the coefficients of variation (see Figure 3). The lowest values are observed for the service sector. This is indicative of the strongest homogeneity across economies in terms of the relative importance of this sector in GVA. In addition, there is also a tendency to reduce the existing differences, with the magnitude of the coefficient of variation decreasing from 13.5% in 2006 to 12%

in 2021. This is in line with the increase in the share of services, whose average magnitude for the four Western Balkans countries increased from 60.1% in the first year to 64% in the last year.

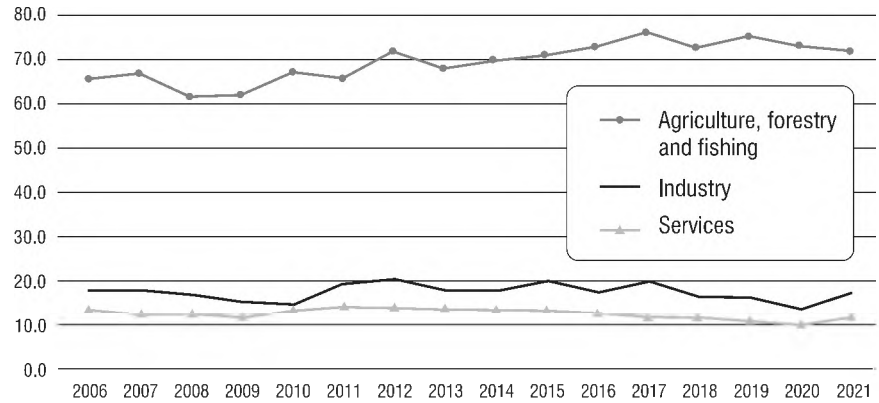

Figure 3. Coefficient of variation between different economies (%)

Source: Authors' calculations based on Eurostat data.

Higher values are typical for the coefficient of variation for the industry sector compared to that for the service sector. Its average value for the period amounts to 17.5%. At the same time, however, the dynamics of the coefficient of variation over time does not show a clear trend of increase or decrease. This indicates that the differences between individual economies in terms of the relative importance of the service sector to GVA are relatively stable over time. The reason for this is the existing heterogeneity in the changes in the share of this sector over time in individual economies.

The most significant differences between Montenegro, North Macedonia, Albania, Serbia and the EU are observed in the weight of the agriculture, forestry and fishing sector in GVA. On average for 2006-2021 the period, the coefficient of variation amounts to 69.2%. In addition, the value of this coefficient increased from 65.6% in 2006 to 71.6% in 2021. This is due to the fact that, despite a certain decrease in the share of agriculture, forestry and fishing in Montenegro and North Macedonia, for the big outlier in the studied set of economies in terms of this share, namely Albania, a highly pronounced stability of the level of the share of agriculture, forestry and fishing in GVA over time is inherent.

4. Conclusions

The Western Balkan countries studied here are undergoing a moderate convergence process towards the European Union during the 2006 - 2021 period. Their per-capita outputs are growing at an average annual rate that is just under twice that of the EU27, which has helped reduce the gap by about 20% in relative terms. There are negative developments as well, however. The slower

growth after 2009 and the unevenness of the process in some countries make it more difficult for the economies to reach the level of the EU. Overcoming these difficulties will probably require a lot of additional effort and they can benefit from the EU's stronger involvement in the process.

From the analysis of the production structures at the sector level, it is clear that the most significant differences to the corresponding values for the EU in the share of agriculture, forestry and fishing in GVA, as well as in the share of services, are observed in Albania. They find expression in the higher share of agriculture, forestry, and fishing relative to the EU and the lower share of services relative to the EU. Regarding deviations in the weight of industry in GVA, the largest discrepancies with the EU are observed in Montenegro and Serbia. Montenegro has a lower weight compared to the EU, while Serbia has a higher weight. The latter can be defined as having a favorable impact on economic growth in Serbia and negative in Montenegro. The reason is that the industry sector is characterized by higher GVA and higher productivity. The latter could induce relatively stronger convergence of Serbia with the EU in terms of real income.

For the countries of the Western Balkans in general, there are certain changes in the production structures at the sector level, which lead to their stronger convergence to those in the EU. At the same time, stronger convergence of certain sectors corresponds to the manifestation of positive effects for long-term macroeconomic dynamics, and convergence in other sectors has a restraining effect on growth. The above also projects certain peculiarities in the course of real convergence processes.

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