CHAPTER 11.

EVALUATION OF TRANSITION PROCESS BY USING SELECTED MACROECONOMIC INDICATORS AND RECOMMENDATIONS FOR MORE ADVANCED ECONOMIC GROWTH[1]

Sonja DJURIČIN[2], Isidora BERAHA[3]

Abstract

The main objective of the paper is to evaluate the effects of transition on economic trends in the Western Balkan (WB) countries by using the selected economic indicators and to elicit recommendations for more advanced economic growth. The economic trends in the WB countries in the last two decades are characterized by unsatisfactory level of actual gross domestic product, high unemployment and foreign trade deficits, insufficient foreign direct investments and growing indebtedness. Given that the above economic trends are caused by different political and economic circumstances as well as dynamics and the way they implemented a comprehensive economic reform in order to shift from a centrally planned to a market based economy and integrate into the EU, the paper reviews the basic characteristics of the transition in the WB countries and evaluates their effects on the level of economic development of each country.

Key words: *economic trends, Western Balkan countries, transition, gross domestic product, external debt, foreign direct investments, unemployment, foreign trade deficit*

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[2] Sonja Djuričin, MSc, Research Associate, Institute of Economic Sciences, Belgrade

[3] Isidora Beraha, MSc, Research Associate, Institute of Economic Sciences, Belgrade

INTRODUCTION

The paper is aimed at tracking down the effects of the transition on the countries in the Western Balkan region, identifying macroeconomic trends and eliciting recommendations for more advanced economic growth. The transition process is evaluated by looking at a set of macroeconomic indicators across countries and across time in the countries of the region. The evaluation is based on the assumption that recent economic growth of Western Balkan countries is closely linked to the transition process and that the effects of transition are best reflected in the selected macroeconomic indicators, as a true and comprehensive measure of how well an economy is doing.

The paper reviews the most important current trends of economic development of the Western Balkan countries with relation to the process of transition. Given that in a centrally planned economy the government is in control of all major economic decisions, thus not allowing the supply and demand of the market to define prices, wages and the production of goods, the process of transition requires a comprehensive reform of economic and political life. An economic transition is associated with an economy which is changing from a centrally planned economy to a free market. The implementation of the elements of the market economy is not an easy task and is followed by many problems embodied in a so called transition crisis. The transition crisis can be recognized by the fall in GDP, decrease in industrial and agricultural production, decrease in investment, a drop in productivity and employment rates, purchasing power loss and high inflation rates [1] in first years of transition.

Apart from having achieved notable progress in transition and reform implementation, there is a significant development gap between Western Balkan countries and they still have a long way to go to maintain a solid economic growth. This paper is intended to compare progress across the countries of the region and recommend future steps in order to generate more balanced and sustainable economic growth.

ECONOMIC TRANSITION IN THE WESTERN BALKAN COUNTRIES

The Western Balkan region is composed of relatively small sized and unevenly developed economies that are at different stages on their road towards EU membership, whereby Croatia is the most economically advanced country. Significant differences in the level of economic development make it rather difficult to observe the region as a whole and to look at where the countries of the

Western Balkan stand today in terms of the progress achieved in various aspects of transition.

Since the mid 1990s, the countries in the Western Balkan have made great progress towards achieving fully democratic governments and modern market oriented economies. The first years of transition, though, were characterized by recession and output decline including distortions in the economy such as severe inflation and increasing unemployment. Due to the various initial conditions of geography, history, and price and output distortions at the start of transition and the external economic shocks arising from the breakup of the SFRY, war and civil strife (The World Bank, Transition, The First Ten Years, Analysis and Lessons for Eastern Europe and the Former Soviet Union, 2002, pg. 16), differences across countries in the Western Balkans occurred during the early stage of transition process.

In the 2000-2008 period after the Western Balkan region recovered from political instability and armed conflicts, a sustained economic growth was maintained despite the slowdown of the world economy. Though growth rates showed considerable differences among the countries, a notable progress was made in all of the Western Balkan region not only in terms of growth in real GDP but also in reducing inflation, increasing international trade, attracting foreign capital to the region, improving labor market conditions and in the overall process of reforming the economies, particularly in the area of privatization and trade liberalization.

The positive economic trends were interrupted by the outbreak of the world financial crisis in the mid 2008, although they need to be observed with a special precautious having in mind several moments. First, significantly poor level of economic performance in the Western Balkans in the year 1999, then economic growth mainly driven by strong domestic demand followed by credit and wage growth and progressively increasing trade deficits in the region resulting from a substantially faster import growth than the growth of exports, and finally the ongoing need to complete other reforms, namely the transparency of the legal framework, the fight against corruption, and the establishment of a business-friendly environment.

Despite many successes that were achieved in 2000-2008 period, above all in terms of macroeconomic stabilization and structural reforms, world financial crisis came as a surprise challenging the existing growth models in the region. Towards the end of 2008, the growth declined in the entire Western Balkans. The growth model that was being pursued in many countries in the region showed a number of weaknesses. While strong domestic demand followed by credit and wage growth was a key driver of economic activity, the contribution of net exports to GDP growth was negative in the entire region. With the first signs of the crisis, a decline in domestic consumption was recorded. Throughout the year 2009, many Western Balkan countries were faced with falling revenues, shrinking domestic consumption, higher financing costs both domestically and internationally for liquidity and debt management operations, decreased FDI inflows, rising unemployment and extra pressure on policy makers to protect social transfer and public wage budgets, while progress in the reform process was significantly slowed down.

The crisis brought about a number of negative effects on the Balkans. First, being incapable of preventing economic shocks and having to reach for intervention of the International Monetary Fund, they slowed down their development. Second, it put attention and resources of the governments of the Balkan countries away from the necessary transition reforms. Third, unemployment which was already very high in all of the Balkan countries increased during the crisis, thus putting pressure on the state welfare systems, burdening the public budgets, and posing a great challenge as the high unemployment level usually leads to an increase in the grey economy or various patterns of crime.

Table 1. Transition indicators scores 2010

			Enterprises			Markets and trade			Financial institutions		Infrastructure
	Population mid- 2010 (million)	Private sector share of GDP mid-2010 (EBRD estimate in per cent)	Large-scale privatisation	Small-scale privatisation	Governance and enterprise restructuring	Price liberalisation	Trade and foreign exchange system	Competition policy	Banking reform and interest rate liberalisation	Securities markets and non-bank financial institutions	Overall infrastructure reform
Albania	3.2	75	4-	4	2+	4+	4+	2	3	2-	2+
Bosnia and Herzegovina	3.8	60	3	3	2	4	4	2	3	2-	3-↑
Croatia	4.4	70	3+	4+	3	4	4+	3	4	3	3
Montenegro	0.7	65	3+↑	4-	2	4	4	2	3	2-	2+
FYR Macedonia	2.00	70	3+	4	3-	4+	4+	2+	3	3-	3-
Serbia	9.9	60	3-	4-	2+	4	4	2+↑	3	2	2+

Source: Transition indicators scores 2010, EBRD

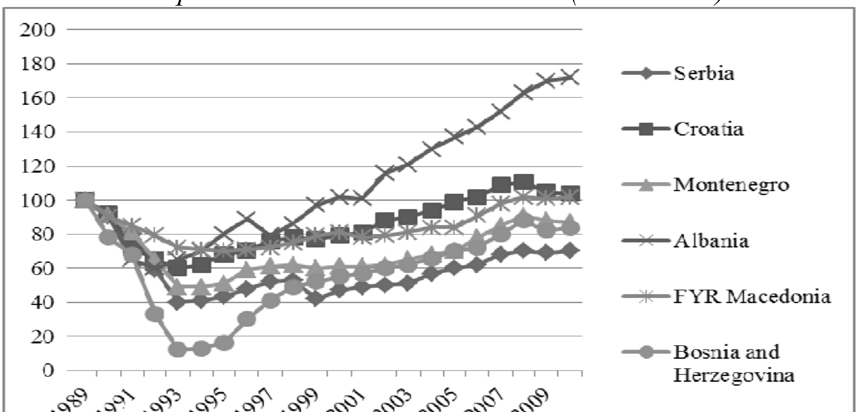
Despite comparable growth levels, differences in terms of transition reforms are significant within the Western Balkan countries. The level of progress achieved in various aspects of transition is quantified by using EBRD transition indicators. There are nine indicators covering three broad aspects of transition: enterprises (incorporating small-scale and large-scale privatization and enterprise restructuring); markets and trade (price liberalization, competition policy, and trade and foreign exchange system); financial institutions (banking reform and securities markets and non-bank financial institutions) and infrastructure (telecommunications, electric power, railways, roads, and water and wastewater). The indicators are measured on a scale from 1 to 4, where 1 represents little or no progress in reform and 4 means that a country has made significant progress in a particular aspect of a transition. An arrow indicates a change from the previous year. One arrow indicates a movement of one point (e.g. from 4 to 4+). Up arrows indicate upgrades, down arrows indicate downgrades. Pluses and minuses are used to allow for finer distinctions among the different categories.

According to the transition indicators presented in the previous table, Croatia is the most advanced country. All Western Balkan countries made a significant progress in the aspect of market and trade (price liberalization and foreign trade exchange system) while the worst progress was achieved in governance and enterprise restructuring, competition policy and securities markets and non-bank financial institutions. All of them are doing poor regarding the infrastructure reform, as well.The standards and performance of Croatia in terms of small-scale privatization and trade and foreign exchange system are typical of advanced industrial economies.

EVALUATION OF SELECTED MACROECONOMIC INDICATORS

Implementing various privatization models, differences in economic policy, stability of political environment, sanctions and weakening of mutual economic relations led to a slower flow of the transition from planned to a market based economy in the former Yugoslav republics, whose economic developments hardly reach or are below the level of economic activity in 1989.

Graph 1. Real GDP in WB countries (1989 = 100)



Source: According to EBRD, Transition report 2010

Unlike the former republics of Yugoslavia, Albania reaches up to 70% higher GDP than the level reached in 1989. The 1989 level of GDP was exceeded by Croatia in 2006 and Macedonia in 2008, while Serbia, Montenegro and Bosnia and Herzegovina are still characterized by weaker economic activity and their GDP still lags some 20% behind the level from 1989.

Table 2. Growth in real GDP in WB countries, Annual change in %

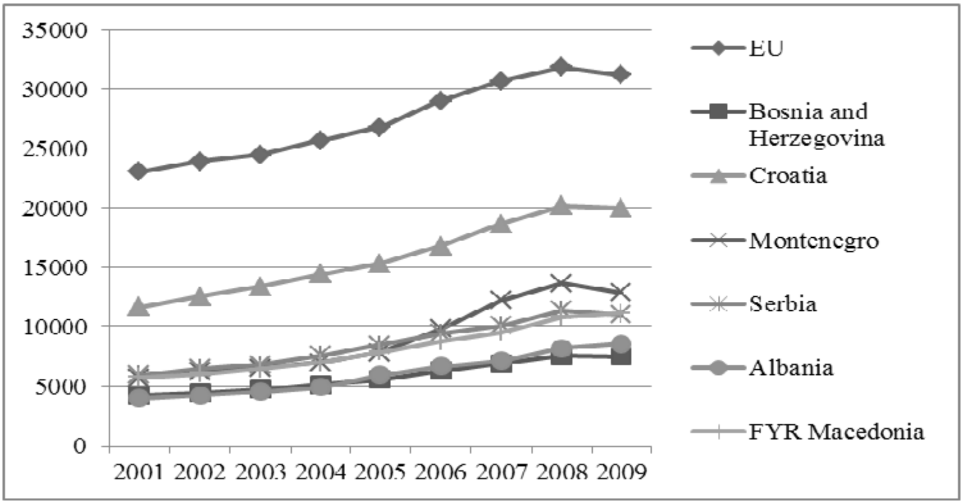
Country										**Estimate**		
	Average 1993-2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2016**
Bosnia and Herzegovina	..	3.5	6.3	4.0	6.1	6.1	5.7	-3.1	0.8	2.2	4.0	5.0
Croatia	2.9	5.0	4.2	4.2	4.7	5.5	2.4	-5.8	-1.4	1.3	1.8	3.0
Montenegro	..	2.5	4.4	4.2	8.6	10.7	6.9	-5.7	1.1	2.0	3.5	3.8
Serbia	..	2.4	8.3	5.6	5.2	6.9	5.5	-3.1	1.8	3.0	5.0	5.0
Albania	6.7	5.8	5.7	5.8	5.4	5.9	7.7	3.3	3.5	3.4	3.6	4.5
FYR Macedonia	..	2.8	4.6	4.4	5.0	6.1	5.0	-0.9	0.7	3.0	3.7	4.0

Source: International Monetary Fund, World Economic Outlook, April 20011

Since the beginning of the transition until the emergence of the global economic crisis, the Western Balkan countries accounted for a relatively high annual rate of GDP growth but with low initial economic base. Monitoring of the movements of real GDP growth in the Western Balkans and its realized value per capita indicates a much lower growth in economic activity than it appears at first glance. All Western Balkan countries have significantly lower GDP per capita in relation to the EU average. As a consequence of the global economic crisis in 2009, the highest decline in GDP of 5.8% was recorded in Croatia, while Macedonia had the lowest GDP fall of 0.9%. On the other hand, in the same year, Croatia achieved approximately 64% of GDP per capita according to the EU average, and Macedonia only 35%.

Compared to other Western Balkan countries, the highest level of GDP per capita is recorded in Croatia, while the lowest is recorded in Bosnia and Herzegovina. The available data and the IMF estimates indicate the growth of economic activity in the Western Balkan countries, but well below the level achieved in the pre-crisis period. Despite the progress made in the implementation of the first phase of transition, respectively in the liberalization of prices and foreign trade, in the absence of macroeconomic stability in the Western Balkans a growing foreign trade deficit, foreign debt and inflation occurred, which resulted in the reduction of the overall economic activity.

Graph 2. GDP per capita in WB countries, 2001‒2009



Source: According to UNECE Statistical Division Database, compiled from national and international (CIS, EUROSTAT, IMF, OECD) official source

Table 3. Trade balance in WB countries, in billions of USD

Country	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Bosnia and Herzegovina	-1,98	-2,07	-3,34	-4,16	-4,57	-4,89	-4,29	-5,70	-7,09	-4,75	..
Croatia	-3,19	-4,09	-5,65	-7,90	-8,35	-9,34	-10,49	-12,93	-18,96	-10,28	-9,90
Montenegro	-0,19	-0,44	-0,40	-0,41	-0,52	-0,65	-1,06	-1,83	-3,05	-1,90	-1,87
Serbia	-1,58	-2,30	-3,23	-4,02	-6,47	-5,29	-6,27	-9,13	-11,26	-6,66	..
Albania	-0,82	-1,03	-1,16	-1,14	-1,58	-1,82	-2,09	-2,90	-3,55	-3,22	..
FYR Macedonia	-0,69	-0,53	-0,81	-0,85	-1,14	-1,06	-1,26	-1,64	-2,57	-2,16	..

Source: Source: EBRD, Economic Macro data

All countries of the Western Balkans have a high foreign trade deficit, but at the beginning of the world financial crisis the highest increase was recorded in Croatia whose foreign trade deficit amounted to around 18.96 billion dollars. In the same year, the Serbian foreign trade deficit amounted to approximately 11.26 billion dollars and Bosnia and Herzegovina's to around 7.9 billion dollars. Albania, Montenegro and Macedonia had a lower trade deficit which continued to decline in the following period. The extremely high trade deficit is mostly a result of low competitiveness of the Western Balkan economies. According to the World Economic Forum's Global Competitiveness Index for 2010, Bosnia and Herzegovina, at 102nd place, was the worst ranked country among the Western Balkans, while Montenegro at 49th place had the most convenient position. Low level of competitiveness of the Western Balkans is mostly a consequence of insufficiently successful privatization process which led to deindustrialization and decline of once the largest exporters of the region. Insufficient inflow of FDI, low competitiveness of domestic products and services and loss of market share in international markets due to the economic isolation in the 1990s, further justify the high foreign trade deficit and weak economic activity, particularly in some of the former Yugoslav republics. Also, some of the former republics had a long period of economic isolation which caused non-refundable loss of foreign markets, which along with low inflow of FDI and low competitiveness of domestic products and services, additionally implied high foreign trade deficit and low economic activity.

Table 4. External debt / GDP in WB countries, in %

Country	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Bosnia and Herzegovina	52.1	51.1	57.9	53.5	51.3	45.5	44.0	42.5	37.9	46.6
Croatia	53.0	53.3	53.9	66.3	70.0	72.1	74.9	77.6	85.1	98.3
Montenegro	..	..	65.7	27.1	23.6	22.8	34.8	75.8	95.6	96.9
Serbia	154.7	97.6	74.1	68.8	59.8	61.6	66.1	64.9	65.5	73.6
Albania	29.8	29.5	26.6	21.9	20.8	20.4	25.3	25.8	27.6	34.1
FYR Macedonia	41.5	43.9	43.6	39.7	52.4	51.1	51.5	52.5	49.1	58.8

Source: EBRD, Economic Macro data, downloaded from: http://www.ebrd.com/downloads/research/economics/macrodata/sei.xls

One of the factors influencing the success of the transition process in the Western Balkans is certainly the high public debt inherited from the former SFRY. The inherited debt crisis is a result of intensive borrowing in the 1970s and rising interest rates in the 1980s. The inability to service debts due to the inadequate economic policy, lack of consistent reforms, wars, imposed sanctions, inherited hyperinflation and re-borrowing, has imposed the problems of the today's high indebtedness in the most Western Balkan countries.

Observed through the share of the external debt in GDP, today, only Bosnia and Herzegovina, out of all former republics of SFRY, could be categorized into the group of countries with low gearing; however, given the fact that in the year 2009, the external debt in the total export had a share of 165.9%, it is categorized into the group of middle geared countries. Amongst all the countries of the Western Balkans, Albania is the one to have the lowest gearing of all, the gearing being almost three times as low as the gearing of Croatia and Montenegro and two times as low as Serbia's gearing. In Albania, the external debt in the total export in the year 2009 had a share of 119.7%, which simultaneously categorizes the country into the group of countries of small gearing. In the time period from the year 2000, Croatia, with its 53% of the share of the external debt in GDP reaching 98.3% in the year 2009, climbed the ladder from a middle geared country to a highly geared one, which was also additionally confirmed in an extremely big share of the external debt in the total export in the year 2009. For the time period from the year 2003 to the year 2006, Montenegro was typically geared little. It became a highly geared country after having reached 96.9% of the share of the external debt in GDP and 29.6% of the share in the total export.

Table 5. External debt / Exports of goods and services in WB countries, in %

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Bosnia and Herzegovina	225.1	218.0	249.6	203.6	174.2	152.4	133.3	128.8	116.4	165.9
Croatia	130.2	125.9	136.1	151.3	161.0	168.6	172.2	181.2	197.2	265.8
Montenegro	..	..	178.7	88.6	56.1	52.6	70.1	159.8	242.3	296.0
Serbia	524.2	456.9	379.3	311.5	253.7	234.2	223.7	220.1	213.3	267.0
Albania	154.1	143.1	128.9	107.4	95.0	91.6	101.2	91.3	93.9	119.7
FYR Macedonia[4]	..	..	..	..	..	..	..	98.8	93.9	155.1

Source: EBRD, Economic Macro data, downloaded from: http://www.ebrd.com/downloads/research/economics/macrodata/sei.xls

Until the year 2003, Macedonia had been a country with small gearing only to become a country with middle gearing because of the share of the external debt in

[4] Country review Macedonia, FYR, Euler Hermes Kreditversicherungs-AG 2011

GDP higher than 50% and a 155.1% share in the total export. After the year 2000, Serbia succeeded in transferring into the group of middle geared countries, and simultaneously, given the growth of the share of the external debt in GDP, there is a growth of the risk of its being moved into the group of countries with high gearing. If the fact that, in Serbia, the external debt had a 267% share in the total export in the year 2009 is added to that, then it certainly accounts for a country with high gearing and an instable economic growth.

Apart from high gearing, the majority of the countries of the Western Balkans have a modest amount of foreign currency reserves. Foreign currency reserves should at least be kept up to the level which is a necessary one for the repayment of matured short-term gearings[5], and the fact that, in all the countries of the Western Balkans, the external debt significantly exceeds the amount of the foreign currency reserves highlights the lack of a successful macroeconomic policy and stability. So, in the year 2009, in Croatia and Serbia, an external debt which was higher than the foreign currency reserves by 49,400.5, i.e. 16,879.7 million dollars, respectively, was recorded.[6] Amongst the countries of the Western Balkans, Albania has the lowest difference between the external debt and the amount of foreign currency reserves, totaling 1,825.7 million dollars.

Table 6. Net foreign direct investments in WB countries, in mil.USD

Country	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Bosnia and Herzegovina	146.4	119.0	266.0	381.8	708.3	607.8
Croatia	1,104.8	1,397.8	552.5	1,927.3	732.3	1,551.0
Montenegro	..	10.0	84.0	44.0	63.3	481.9
Serbia	50.0	165.0	475.0	1,365.0	966.0	1,550.0
Albania	143.0	207.3	135.0	178.0	324.0	258.0
FYR Macedonia	215.7	446.3	105.5	117.5	321.9	94.2
Bosnia and Herzegovina	**2006**	**2007**	**2008**	**2009**	**2010**	
Croatia	718.4	2,040.2	1,043.8	255.6	261.5	
Montenegro	3,193.7	4,735.8	4,653.1	1,600.0	390.4	
Serbia	585.3	717.4	806.4	1,264.4	407.9	
Albania	4,264.0	2,523.2	2,716.9	1,864.8	1,364.1	
FYR Macedonia	314.7	647.4	888.5	942.0	693.6	
	424.0	700.2	600.5	234.8	240.7	

Source: EBRD, Economic Macro data, downloaded from: http://www.ebrd.com/downloads/research/economics/macrodata/sei.xls

[5] According to Guidotti-Greenspan rule

[6] According to EBRD, Economic Macro data, taken

Given the low growth of the economic activity, the foreign-trade deficit and a high external debt, the Western Balkans' countries should more intensively be dedicated to the creation of a stabile business environment which would attract a more significant amount of FDIs, in which way the growth of exports, GDP and regular debt servicing would be contributed to

In the time period until the year 2009, amongst the countries of the Western Balkans, Croatia recorded the highest inflow of FDIs. The inflow of the foreign capital, for the most part from the EU countries, was the highest in the time period between the year 2007 and the year 2008, and, in the majority of cases, it was related to the service providing sector, i.e. banking, trade, the chemical industry and telecommunications. In the time period from the year 2009 to the year 2010, the highest inflow of FDIs was recorded in Serbia. Observed per country, in the past eleven year, the highest amount of Serbia's FDIs came from Austria, Greece, Holland, Norway, and Germany (the National Bank of Serbia, The Net FDIs per country, 2010), and observed per branches of activity, the highest inflow of FDIs was reached in the processing industry, the financial mediation sector, wholesale and retail trading, whereas the lowest inflow of FDIs was reached in agriculture as the most promising economic branch. The highest amount of FDIs in Montenegro, totaling 1,264.4 million dollars, was recorded in the year 2009 as the consequence of the privatization of Montenegro's Electric Power Industry. In the next year already, FDIs in Montenegro lowered to no more than just 407.9 million dollars, which was only 32% of the value of the realized investments from the previous year. In the time period from the year 2000 to the year 2010, the highest FDIs amounting to 21,838.70 million dollars were recorded in Croatia in the second place was Serbia with 17,304.00 million dollars, whereas in the case of the other Western Balkans' countries a much lower inflow of the foreign capital was typical. The foreign capital should, for the most part, be directed towards the establishment of new enterprises and an additional capitalization of those with a high production and exporting potential, which, together with stimulating measures of the economic policy, would have an impact on the growth of export and the economic activity, which would have a positive influence on the labor and capital markets' conditions and more successful servicing of the external debt.

The signals which the countries of the Western Balkans are sending to international institutions and foreign investors are best seen through the degree of economic freedoms which are the basic presupposition to a higher inflow of FDIs and the economic growth.

According to the rank of the Economic Freedoms Index, which classifies the Western Balkan countries on the world scale, the absence of a more substantial inflow of FDIs is justified, and the need for upgrading the business environment is an issue that cannot be disregarded. Bosnia and Herzegovina and Serbia, with their 57.5- and 58-point coefficient of economic freedoms, respectively, are categorized into the group of countries in which, mostly, there are no economic freedoms (mostly un-free), whereas Croatia, Montenegro, Albania and Macedonia are categorized into the group of countries which are characterized by moderate economic freedoms (moderately free).

Table 7. Index of economic freedom of WB countries, 2011

World rank	Country	Freedom score	Change from previous
55	**FYR Macedonia**	66.0	+0.3
70	**Albania**	64.0	-2.0
76	**Montenegro**	62.5	-1.1
82	**Croatia**	61.1	+1.9
101	**Serbia**	58.0	+1.1
104	**Bosnia and Herzegovina**	57.5	+1.3

Source: Heritage Foundation

The reasons for the worse positioning of all the countries of the Western Balkans when it regards the degree of economic freedoms primarily lies in an inefficient legal system and unresolved proprietary and legal relations especially in the domain of real estates and land, which foments subversion of a more substantial inflow of the foreign capital and the economic development. For all the countries of the Western Balkans, it is typical that they have widely spread corruption which is accompanied by politically motivated investigations and a significant number of criminal groups which are engaged in illegal affairs. Apart from that, in Serbia, Bosnia and Herzegovina, and Montenegro, there are high public expenses and inefficient budgetary consumption, which, to a significant extent, represents a burden to GDP, whereas in Croatia, unarranged regulations of labor and high costs of providing employment to new workforce are slowing down the growth of employment and productivity.

The removing of administrative barriers, political risk and fighting against corruption are a precondition to the growth of the inflow of FDIs, the liquidity and profitability of the countries of the Western Balkans; at the same time, too, it should not be forgotten that the growth of inflation, instability of the exchange rate and legal insecurity lead to investors' negative selection. According to the data provided by the IMF, amongst the countries of the Western Balkans in the year 2010, the highest inflation rate of 6.17 per cent was recorded in Serbia, whereas the lowest inflation rate of 0.5 per cent was recorded in Montenegro. The IMF estimates that, in the year 2011, the inflation rate will be recording a growth in all the Western Balkans' countries, especially in Serbia, where the inflation rate is expected to grow to 11.3 per cent. In order to be able to control the inflation trend, all the countries of the Western Balkans, first of all Serbia, should be taking through a more intensive macroeconomic policy and make an effort not to give up the institutional reforms they have initiated so as to remove its structural causes. The amount of the inflow of FDIs has a direct impact on the labor market circumstances. For that reason, in order to keep the existing jobs and establish new ones, the countries of the Western Balkans must be consistent in doing with the stated barriers.

The monitoring of the movement of the labor market trends enables one to gain an insight into the degree of structural changes and the depth of conducted economic reforms in the process of transition. In the majority of countries of the Western Balkans, the restructuring of the public sector enterprises which was initiated by transition has had as a consequence a reduction in the huge number of jobs whereas the establishing of new jobs in the private sector is not being carried out in a satisfactory pace. For those reasons, in the majority of countries of the Western Balkans, there is a high demand for work, which, in the former republics of SFRY, is additionally observable because of an increased number of displaced persons, and a low offer of work, which appears as a consequence of an insufficient economic activity.

The process of privatization has influenced the change of the ownership structure of the economies of the countries of the Western Balkans; however, the entrepreneurial business spirit has not fully become observable in all countries yet, nor has it had an impact on the establishing of a stable labor market. In the majority of countries of the Western Balkans, the privatization whose consequence was the absence of an economic activity that would generate new jobs resulted in a labor market which is typically characterized by high unemployment, a low share of employment in the private sector and the insufficient mobility of workforce.

Compared with the other countries of the Western Balkans, Croatia has by far the lowest unemployment rate, whose value has come closer to the average value of the EU countries' unemployment rate in the last years of the observed time period. Albania records a somewhat higher unemployment rate, whereas the other countries of the Western Balkans significantly lag behind the average unemployment rate in the EU. Bosnia and Herzegovina and Macedonia have far higher unemployment rates than is the case with Montenegro and Serbia, while, in these countries, the reduction in the rate of unemployment after the year 2005, i.e.

2006, is rather the consequence of the growth of the number of inactive population than it is the consequence of a real growth of the economic activity. In the year 2010, Serbia and Montenegro recorded a higher unemployment rate than Croatia and Albania have ever had in the time period since the year 2000.

Table 8. Unemployment rate in WB countries, in %

State	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
EU – 27	8.7	8.5	8.9	9.0	9.1	9.0	8.3	7.2	7.1	9.0	9.7
Bosnia and Herzegovina	..	..	..	..	..	..	31.1	29.0	23.4	24.1	27.2
Croatia	16.1	15.8	14.8	14.2	13.7	12.7	11.2	9.6	8.4	9.1	11.8
Montenegro	..	..	..	..	27.7	30.3	29.6	19.4	16.8	19.1	19.7[7]
Serbia	12.1	12.2	13.3	14.6	18.5	20.8	20.9	18.1	13.6	16.1	19.2[8]
Albania	16.8	16.4	15.8	15.0	14.4	14.1	13.8	13.5	13.0	13.8[9]	..
FYR Macedonia	32.2	30.5	31.9	36.7	37.2	37.3	36.0	34.9	33.8	32.2	26.7[10]

Source: UNECE Statistical Division Database, compiled from national and international (CIS, EUROSTAT, IMF, OECD) official source

RECOMMENDATIONS FOR MORE ADVANCED ECONOMIC GROWTH

By looking at a set of macroeconomic indicators across countries and across time in the countries of the Western Balkan region, it can be summarized that they are facing severe economic difficulties embodied in the low level of economic activity, rising unemployment, high foreign trade deficit and external debt, low share of employment in private sector and lack of labor mobility. Although significant progress has been made in all Western Balkan countries in the past two decades, a lot of transition challenges remained to be tackled in years to come.

[7] According to the National Statistical Office of Montenegro, the Labor Force Survey, Report no. 56, Podgorica, 2010

[8] According to data of the Statistical Office of Serbia, the Labor Force Survey, April 2011, the data for October 2010

[9] According to the National Statistical Office of the Republic of Albania, available at http://www.instat.gov.al/

[10] According to Central Bureau of Statistics of the Republic of Macedonia, Statistical Yearbook, Sustainable Development, Skopje, 2011

Western Balkan countries need to discover new sources of growth and significantly improve their business and particularly investment environment. Private sector development and foreign capital inflow represent a developing opportunity for the countries of the Western Balkans. There is a need for a clear framework to guide the countries of the region towards strengthening private sector and attracting foreign capital to sectors with certain competitive advantages. In most of the Western Balkans, the process of transition has led to sectoral changes in the composition of output in favor of the services sector and at the expense of manufacturing. It significantly contributed to dependence and vulnerability of these economies. Economic weakness of these countries is bringing to light the need to revive manufacturing sectors, create goods producing economies and foster exports.

Attraction of FDI is becoming increasingly important under assumption that it promotes economic development and leads to an increase in productivity and competitiveness of host countries, as well as generates employment, promotes exports, rebalances growing trade deficits and fosters economic reconstruction. The presence of foreign capital enables the adoption of new technologies and know-how, fosters investments in machinery and equipment, restructuring and modernization and introduction of standards in order to increase competitiveness of domestic products on the global market. Attracting FDI to Western Balkans should be focused on the sectors with competitive advantages such as qualified and cheap labor force, long tradition and experience, and favorable geographical position along the corridor 10, with an aim to enable the revitalization of industries with the potential of becoming major contributors to economies in the region. A series of incentives should be established to attract foreign capital to certain strategic sectors of the economies that may take a leading role in promoting economic growth and development.

The governments of the Western Balkan region need to identify the sectors that offer competitive advantages and help attract foreign capital in order to promote their development. The traditional apparel manufacturing sector certainly is the sector in which the Western Balkan countries have demonstrated a notable competitive advantage in terms of cost competitiveness and relatively high productivity. Because of its proximity to EU markets, geographical position along the Corridor 10 and the fact that apparel products can be shifted in the shortest time, the Western Balkans represents an effective location for investors to diversify risk by spreading suppliers across geographical areas and have great potential for becoming key suppliers of Western European markets.[11] Apparel

[11] Sector Specific Sources of Competitiveness in the Western Balkans, Key conclusions and next steps, OECD, 2009, pg.4

products have significant share in the total exports of the Western Balkan countries, particularly of Croatia, Serbia and Former Yugoslav Republic of Macedonia, thus pointing out to the important role of regional manufactures in increasing export performances of the region. One of the key problems of the apparel manufacturing sector refers to the difficulties in obtaining favorable financing for investments necessary to overcome infrastructure and skills gap and reduce the time to complete an order.

Attracting FDI to the apparel manufacturing sector is seen as a convenient strategy for overcoming the key obstacles to the sector's more dynamic development and greater contribution to economic development of the countries of the Western Balkan region. The Western Balkan countries are faced with the low level of foreign capital inflows mostly as a result of circumstances that are in tight relation with the negative scores of their economic freedoms. Improvements in the field of business freedom, freedom from corruption, property rights, investment freedom, monetary freedom and financial freedom should be an overarching objective and an important challenge for policy-makers in the Western Balkans. Political risk is still very high in some of the Western Balkan countries and foreign investors are discouraged by investment environment which is characterized by corruption and regulatory uncertainty, high costs of doing business, high inflation rates, insufficient enforcement of the legal regime for intellectual property rights, underdeveloped capital markets.

The key policy recommendations to overcome the major constraints on the road to attracting foreign capital in the Western Balkan region, particularly to sectors with competitive advantage, refer to four fields of activity. First, joint efforts should be put into strengthening the economic cooperation among the countries of the Western Balkans in order to increase trade volume and promote the region as a safe, good and stable place to invest. Second, the governments are to be more determined in their attempts to implement deeper reforms to tackle bureaucracy, reduce corruption and vulnerability of judicial systems to political interference. Governmental spending must be significantly reduced and better managed and the privatization process needs to be completed in order to eliminate state-owned enterprises that are operating at a loss and to promote the development of private sector. Improving the overall economic freedom of the Western Balkan countries should be an imperative. Third, upgrading the efficiency of the regulatory system by reducing time-consuming requirements is necessary. The fourth set of actions is specifically related to the apparel manufacturing sector, as it is recognized as a potential engine for the development of the Western Balkan economies. Because of its potential to increase economic opportunity, growth and employment, the apparel sector should be more intensively promoted to foreign investors and more actively present in international fashion and trade fairs. More attention and support should be focused on the operational improvements of the regional manufacturers in terms of internal process changes to reduce time to market and increase in profitability by introducing more value-added services in order to make them more attractive for foreign investors.

CONCLUDING REMARKS

A part from achieving different levels of economic development and the variability in transition performance across countries, all of the Western Balkans still have a long way to go before they reach sustainable economic growth and development. The evaluation of the selected macroeconomic indicators, that are believed to be in a close relation with the transition process, points out to the fact that the Western Balkan countries suffer from low level of economic activity, rising unemployment, high foreign trade deficit and high external debt. In order to overcome current unfavorable economic trends and achieve more advanced economic growth, new sources of growth need to be discovered. One of the possible developing opportunities refers to the private sector development and foreign capital attraction, particularly to sectors that can offer significant competitive advantages, such as the apparel manufacturing sector.

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