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## Developments of the economies, macroeconomic indicators and challenges in south-east European countries

### Abstract

*This article provides an overview of the main trends of social and economic developments in the western Balkans. The contribution originates from member inputs from the network of south-east European trade union economic experts operating under the umbrella of the International Trade Union Confederation's Pan-European Regional Council (ITUC-PERC).<sup>1</sup> The contribution focuses on the main social and economic challenges faced by the western Balkans region at a period marked by enduring crises and framed by the prospect of EU accession. In spite of these difficulties, this contribution strives for a comparative overview of economic trends, public finances, unemployment, employee compensation and income inequality in the countries of the western Balkans. The aim is to identify the major challenges for individual countries, but also for the region as a whole in the course of post-crisis consolidation and in the process of European integration, among others, with particular concern for trade union experts and decision-makers.*

**Keywords:** *economic growth, convergence, crisis, FDI, competitiveness, knowledge economy, banking reforms, tax competition, unemployment, employment rate, wage developments, income inequality, poverty ratios, IMF policy advice, conditionality*

### Introduction

In starting our review, we must make an initial comment on the different status of individual countries with respect to EU integration. This is an important framework condition of which we must be aware. Furthermore, the economic situation and the challenges on the labour market are also highly differentiated, while no less important are differences in data availability, which make it necessary to compile data from different sources. This limits the compatibility of the data but, at the same time, provides the reader with a general overview as well as helping to put these countries 'on the map' for the wider audience. For further help and better economic comparisons, some statistical data provide data on Germany, Greece, Poland and the EU-27 as a benchmark.

1 Experts from trade unions across south-eastern Europe collected national data and drafted national reports for debate, within the framework of the Network of Economic Experts from south-east European trade unions, which is supported by the LO TCO Project for the Balkans.

## Overview of macroeconomic dynamics

The region's heterogeneity is evident, as is its divergence from core Europe and, with the exception of Croatia, from central and eastern Europe, too. GDP per capita illustrates the countries' general level of development. We can see from the snapshot provided by Table 1, which focuses on GDP per capita (at purchasing power parity) and which uses 2010 data, the countries' general level of development. Kosovo, Albania and Bosnia and Herzegovina are the poorest countries in the region, with per capita income levels between 21 and 28 per cent of the EU-27 average. Serbia, FYR Macedonia and Montenegro represent middle-income countries, with shares between 35 and 42 per cent of the EU-27 figure. Croatia, the most developed state in the region, has a relative income level comparable with Poland, holding an income share of 62 per cent of the EU-27 average.

Monthly average remuneration per employee also shows a wide variation. Here, the data show average wages in national currency converted into euros at the market exchange rate (note that Montenegro and Kosovo have adopted the euro unilaterally). Albania has by far the lowest average wage level, at less than one-tenth of the EU-27 average. Serbia, FYR Macedonia and Bosnia and Herzegovina have wage levels of between one-seventh and one-fifth of the EU average. Montenegro has a wage level comparable to the poorer central and east European countries (some of the Baltic States), while Croatia has higher wage levels than Poland and most countries in central and eastern Europe.

With the exception of Croatia, however, south-east Europe has been recovering from the crisis and shows more dynamic growth than the EU-27. Inflation, an important indicator of economic stability, is generally moderate although Serbia has higher values.

A negative note is the size of the shadow economy in Croatia, FYR Macedonia and Albania which, in 2006, stood at 35.1 per cent, 36.7 per cent and 37.9 per cent, respectively, according to Schneider, Buehn and Montenegro (2010).

**Table 1 – South-east Europe, data at a glance**

Country	Population (end-year, million)	Real GDP change, in % 2011, (a)	GDP per capita at PPP (€) 2011	Annual inflation rates (consumer prices), 2011 (a)
Albania	3.2	3.0	6 800	3.4
Bosnia and Herzegovina	3.8	1.3	6 800	3.7
Croatia	4.4	0.0	15 100	2.3
Kosovo	2.1	5.0	5 080 (b)	7.3
Macedonia	2.1	3.1	9 200	3.9
Montenegro	0.6	2.4	10 500	3.1
Serbia	7.3	1.6	8 800	1.1
Germany	81.8	3.1	28 700	2.5
Greece	10.8	-6.9	21 500	3.3
Poland	38.1	4.3	15 300	4.3
EU-27	501	1.5	24 400	3.1

Source: Vienna Institute for International Economic Studies (2011)

(a) IMF (2012b) World Economic Outlook Database (b) Based on CIA Factbook, 2012.

## Economic growth

The main measure of economic development is GDP growth, especially relative to the EU-27 if we are to consider the degree of economic convergence. There is an important message behind this figure that, despite the region's economic and political instability in the first half of the decade and the effects of the 2008-2010 economic crises, all countries have managed a significant catch-up. Serbia, Albania and Montenegro have achieved the most dynamic growth, nearly doubling their GDP per capita. Croatia has moved almost in line with Poland, although starting at a somewhat higher level in 2000 and ending up slightly lower (albeit that Poland has been the only country in the EU not to fall into recession during the crisis).

Given the positive indication of economic convergence (Galgóczi and Sergi, 2012), Table 2 shows recent domestic economic developments, using real growth rates for industrial production. This shows that economic growth was highest in Albania and lowest in FYR Macedonia. In correspondence with the principles of convergence, all countries outpaced the EU-27, with the exception of Croatia and FYR Macedonia. Industrial production saw especially high growth rates in Albania and Bosnia and Herzegovina (both outpacing Poland), but these were rather moderate in Serbia in 2010 and 2011, while they were negative in Croatia (since 2009) and in FYR Macedonia, in both 2009 and 2010. Montenegro, on the other hand, suffered a contraction of industrial

activity during the decade (except for 2010 which saw a growth of 17.5 per cent), even though it saw, at the same time, significant growth in the economy as a whole.

**Table 2 – Annual growth rates for industry (%)**

Country	2008	2009	2010	2011
Albania	8.7	10.6	18.6	10.0
Bosnia and Herzegovina	7.3	1.5	3.7	5.6
Croatia	1.2	-9.2	-1.4	-1.2
Macedonia	5.1	-8.7	-4.8	3.3
Montenegro	-2.0	-32.2	17.5	-10.3
Serbia	1.4	-12.6	2.5	2.1
Germany (a)	-0.1	-16.3	10.9	7.6
Greece (a)	-4.2	-9.2	-6.6	-8.1
Poland	2.4	-3.7	10.8	7.2
EU-27	-1.8	-13.7	6.8	3.2

Source: Vienna Institute for International Economic Studies (2011) (a) Eurostat (excluding construction).

**Table 3 – Inwards FDI stock (% of GDP)**

Country	2000	2005	2010
Albania	6.78	12.48	36.67
Bosnia and Herzegovina	19.66	27.54	42.50
Croatia	13.10	32.74	56.68
Macedonia	15.05	35.88	47.98
Montenegro	-	-	138.18
Serbia	-	-	46.51
Montenegro and Serbia	8.87	20.03	-

Source: UNCTAD (2011) World Investment Report.

One source of economic growth is foreign direct investment (FDI), which may also help with regard to the modernisation and catching up of a country's economic base. Table 3 shows the build-up of FDI stock as a share of GDP for individual south-east European countries.

The data show a substantial increase in FDI stock – albeit from a very low level – but the dynamism and share of FDI stock, by the end of this period, remains behind the new member states of central and eastern Europe. Montenegro is the sole exception,

with a stock of FDI equal to 138.18 per cent in 2010. This is illustrative of foreign investments being directed not towards industry but more towards non-tradable sectors, such as real estate development and services.

Nevertheless, much more should be done as regards these economic systems in terms of competitiveness so as to nurture production and foreign investment.

One additional aspect of analysis is the extent to which the regulatory environment in the region is more or less conducive to the start-up and operation of a local firm, when considering variables such as ‘dealing with construction permits’, ‘registering a property’, ‘obtaining credit’, ‘protecting investors’, ‘paying taxes’, ‘trading across borders’, ‘enforcing contracts’ and ‘closing a business’. Ranked from 1 (the easiest country in which to do business) to 185 (the most difficult country in which to do business), a high ranking on the ease of doing business index means that a country’s regulatory environment is more conducive to the start-up and operation of a local firm. The index averages each country’s percentile rankings on a variety of indicators, giving equal weight to each topic. The rankings for all economies were most recently benchmarked in June 2012 (see Table 4).

**Table 4 – Ranking on the ease of doing business**

Country	Doing Business (2013)	Doing Business (2012)
FYR Macedonia	23	22
Montenegro	51	57
Croatia	84	80
Albania	85	82
Serbia	86	95
Kosovo	98	126
Bosnia and Herzegovina	126	125
Germany	20	18
Greece	78	89
Poland	55	74

*NB: To provide a comparable time series for the research, the data set is back-calculated to adjust for changes in methodology and any revisions in the data due to corrections.*

*Source: World Bank (2013) Doing Business Database. The data time series for each indicator and economy are available on the Doing Business website <http://www.doingbusiness.org/rankings>.*

Despite a few notable improvements in Kosovo, Montenegro and Serbia, only FYR Macedonia is ranked high and most countries rank low globally. This tenth in the *Doing Business* series finds that Serbia was the 9th top global reformer in the past year (Greece was 8th). Macedonia and Croatia are also among the twenty top global improvers.

*Doing Business* captures some key dimensions of regulatory environments for domestic businesses; however, it does not measure all aspects of the economic environ-

ment that matter to regional and international competitiveness, such as macroeconomic stability and corruption. Both are important factors on the trade union agenda. Moreover, the *Doing Business* index utterly ignores crucial indicators about trade unions and competitiveness, such as labour skills and working conditions and the underlying quality of institutions and infrastructures, among others.

The global competitiveness index (GCI) has been developed by the World Economic Forum's Centre for Global Competitiveness and Performance (see Table 5). The GCI aims to mirror the business operating environment and competitiveness of over 140 economies worldwide, by identifying advantages as well as impediments to national growth. It is based on twelve pillars of competitiveness (i.e. institutions; infrastructure; macroeconomic environment; health and primary education; higher education and training; efficiency of product markets; labour market efficiency; state of development of the financial market; technological readiness; market size; business sophistication; and innovation) and provides a comprehensive picture of the competitiveness landscape in countries around the world across all stages of development.

**Table 5 – The global competitiveness index**

Country	Rank 2012-2013	Rank 2011-2012	Rank 2010-2011	Rank 2009-2010
Germany	6	6	5	7
Poland	41	41	39	46
Montenegro	72	60	49	62
Macedonia	80	79	79	84
Croatia	81	76	77	72
Bosnia and Herzegovina	88	100	102	109
Albania	89	78	88	96
Serbia	95	95	96	93
Greece	96	90	83	71

Note: *World Economic Forum Global Competitiveness Report 2012-2013* available at: <http://reports.weforum.org/global-competitiveness-report-2012-2013/>.

In line with this, the economic freedom ranking provides an additional analytical perspective. For over a decade, the Heritage Foundation, in partnership with the *Wall Street Journal*, has tracked economic freedom around the world with its influential Index of Economic Freedom. The ranking is intended to comprehend the extent to which individuals are free to work, produce, consume and invest in any way they please, with that freedom both protected and unconstrained by the state, as well as the level to which governments allow labour, capital and goods to move freely (Table 6).

The economic freedom indicator is a composite of the following freedom-related variables: business freedom; trade freedom; fiscal freedom; government spending;

monetary freedom; investment freedom; financial freedom; property rights; freedom from corruption; and labour freedom.

**Table 6 – Economic freedom ranking**

	World rank 2012	World rank 2011
Germany	26 [71]	23 [71.8]
Macedonia	43 [68.5]	55 [66]
Albania	57 [65.1]	70 [64]
Poland	64 [64.2]	68 [64.1]
Montenegro	72 [62.5]	76 [62.5]
Croatia	83 [60.9]	82 [61.1]
Serbia	98 [58]	101 [58]
Greece	119 [55.4]	88 [60.3]
Bosnia and Herzegovina	104 [57.3]	104 [57.5]

*Note: countries' freedom scores are in square brackets: 100 – 80: free; 79.9 – 70: mostly free; 69.9 – 60: moderately free; 59.9 – 50: mostly not free; 49.9 – 0: repressed.*

*Source: Heritage Foundation (in partnership with Wall Street Journal) available at: <http://www.heritage.org/Index/ranking>*

FYR Macedonia's economic freedom score is 68.5, making its economy the 43<sup>rd</sup> freest in the 2012 Index. Its overall score has increased by 2.5 points from last year, reflecting improvements in six of the ten economic freedoms as well as an especially large gain in the business freedom component. FYR Macedonia is ranked 21<sup>st</sup> out of 43 countries in the Europe region and its overall score is above the world and regional averages. FYR Macedonia has undertaken significant reforms in many sectors of the economy over the past few years, inspiring economic growth and the development of a thriving entrepreneurial sector. Despite the level of progress, however, corruption and an inefficient legal framework remain major concerns.

Albania is ranked 57<sup>th</sup> in the 2012 Index and it is thus the 26<sup>th</sup> freest among the 43 countries in the Europe region; its overall score is above the world average. Some improvements in the areas of freedom from corruption and in business freedom may be detected; although poor protection of property rights (largely a result of political interference in the judiciary) and pervasive corruption also feature.

Other countries in the region have emerged from the global economic downturn substantially damaged, especially in terms of labour market conditions, although are striving to continue their transition to being more flexible economies. In particular, Bosnia and Herzegovina, Serbia and Croatia, ranking 104<sup>th</sup>, 98<sup>th</sup> and 83<sup>rd</sup>, respectively, in the 2012 Index, are distant from FYR Macedonia.

Serbia is below the world average position (Serbia is ranked 37<sup>th</sup> out of 43 countries in Europe, while its overall score is below the regional average), reflecting the modest

improvements that have been made in trade and monetary freedom, offset by losses in the areas of business freedom and the management of government spending. Despite some progress, Serbia's overall economic freedom continues to be constrained by a lack of political will to undertake the bold reforms that are required. Government spending remains inefficient, high and poorly managed. Deeper institutional reforms are needed to tackle bureaucracy, reduce corruption and strengthen the judicial system from political interference.

Bosnia and Herzegovina's level of economic freedom, being 38<sup>th</sup> out of 43 countries in the European region, remains below the regional average. The foundations of economic freedom are fragile and uneven across the country. The rule of law is weak, and local courts are subject to substantial political interference.

Croatia's economic freedom score is due largely to a deterioration in the management of government spending and in business freedom. Despite some significant improvements over the past five years, Croatia's scores on most components of economic freedom remain decidedly average. The lack of an independent and efficient legal framework undermines the foundations of economic freedom, while corruption remains a serious concern, hampering the rule of law and eroding long-term development potential. At the same time, institutional weaknesses still hold back economic freedom and prevent dynamic growth. In particular, the foundations of economic freedom remain challenged by corruption and an inefficient judicial system that is vulnerable to political interference. The accumulation of large fiscal deficits in recent years also risks undermining macroeconomic stability and long-term competitiveness, and highlights the need for more disciplined management of public finance.

The foundations of economic freedom are still fragile and uneven across the region. Powerful business networks control national economies; while policy-making maintains these regimes at all levels. Poor protection of property rights, widespread corruption, a disorganised bureaucracy and costly registration procedures generate additional hitches and discourage entrepreneurial activity. This is a hot issue for debate among trade unions in the region; this is where development is heading if profound measures are not taken in time to prop up the real functioning of markets and to stabilise at least some decent level of real competition across the Balkans.

The Knowledge Economy Index (Table 7) is calculated on the basis of four pillars: economic incentives and institutional regime; education and human resources; the innovation system; and information and communications technology. The Knowledge Index – a sub-set of the Knowledge Economy Index – is a simple average of the latter three pillars. The Knowledge Index measures a country's ability to generate, adopt and diffuse knowledge. That is, the Index takes into account whether the environment is conducive for knowledge to be used effectively for economic development and provides an indication of the overall potential of knowledge development in a given country.

Croatia and Serbia are the south-east European countries that rank the best in the index (40<sup>th</sup> and 53<sup>rd</sup>, respectively), but we note that all the region's countries have improved their ranking since 2000.

Table 7 – Knowledge indices

Rank	Change in rank from 2000	Country	2009 Knowledge Index	2009 Knowledge Index
1	+2	Denmark	9.52	9.49
12	+3	Germany	8.96	8.92
27	+3	Hungary	8.00	7.88
37	-2	Poland	7.41	7.38
38	-7	Greece	7.39	7.58
40	+4	Croatia	7.28	7.28
43	+8	Bulgaria	6.99	6.94
47	+13	Romania	6.43	6.25
53	+20	Serbia	5.74	6.32
58	+14	FYR Macedonia	5.58	5.66
79	+7	Bosnia and Herzegovina	4.58	4.68
93	+10	Albania	3.96	3.92

The variables are normalised on a scale from 0 to 10.

Source: [http://info.worldbank.org/etools/kam2/KAM\\_page5.asp](http://info.worldbank.org/etools/kam2/KAM_page5.asp).

The Knowledge Index, as well as the other indices that concern the ease of doing business, position of global competitiveness and level of economic freedoms, must be taken seriously as must the vital importance of the international dimension of today's economic reality. Improving the investment climate, broadening access to finance, increasing competition in product and service markets and/or diversifying the economy are all potentially ways forward.

One attention-grabbing part of the liberalisation process remains the banking sector. Tables 8 and 9 record data on banking sector reforms and interest rate liberalisation, and the level of loans to the private sector.

Table 8 records the developments in an index calculated by the European Bank of Reconstruction and Development, on a scale of 1 (minimum) to 4.33 (maximum). This shows that banking sector reform and liberalisation is closest to that of the EU in the case of Croatia (at 4, this is even higher than Slovenia: 3.33).

Meanwhile, Table 9 is concerned with loans-to-GDP ratios (i.e. loans to the non-financial private sector). The data here depict that loans (expressed as a percentage of GDP) have dramatically increased in Montenegro since 2006 and now stand at 81.4 per cent, although this is lower than Greece and Poland. Croatia presents at 70.2 per cent and other countries have lower ratios.

Furthermore, banking and financial vulnerability indicators are given in Table 10.

**Table 8 – EBRD Index for Banking Reform and Interest Rate Liberalisation**

	Albania	Bosnia and Herzegovina	Croatia	FYR Macedonia	Montenegro	Serbia	Slovenia
2000	2.33	2.33	3.33	2.67	n.a.	1	3.33
2001	2.33	2.33	3.33	2.67	n.a.	1	3.33
2002	2.33	2.33	3.67	2.67	n.a.	2.33	3.33
2003	2.33	2.33	3.67	2.67	n.a.	2.33	3.33
2004	2.67	2.67	4	2.67	2.3	2.33	3.33
2005	2.67	2.67	4	2.67	2.3	2.67	3.33
2006	2.67	2.67	4	2.67	2.7	2.67	3.33
2007	2.67	2.67	4	2.67	2.7	2.67	3.33
2008	3	3	4	3	3	3	3.33
2009	3	3	4	3	3	3	3.33
2010	3	3	4	3	3	3	3.33

Note: 1 is the minimum; 4.33 is the maximum implying a level of development close to the EU.

Source: EBRD.

**Table 9 – Loans-to-GDP ratios (%) (loans to the non-financial private sector)**

	Albania	Bosnia and Herzegovina	Croatia	Greece	FYR Macedonia	Montenegro	Poland	Serbia
2004	9.6	32.3	51.8	n.a.	22.1	16.8	n.a.	24.8
2005	15.3	36.5	56.4	75.6	25.1	20.7	89.6	30.7
2006	22.2	39.5	64.0	79.5	30.2	39.4	93.1	30.8
2007	30.0	44.4	67.1	88.0	36.8	83.0	98.0	35.3
2008	35.2	50.9	68.1	92.2	43.9	90.7	101.8	41.4
2009	37.2	50.2	69.6	90.3	42.9	80.4	107.5	45.0
2010	38.2	51.9	70.2	92.1	44.9	81.4	109.6	47.5

Sources: up to 2009, EBRD; for 2010, author's own calculations based upon data from central bank websites; for Greece and the euro-zone, ECB.

Table 10 – Banking sector and financial vulnerability indicators

	Banking system			Bank dep.	Loans/ dep.	Country risk	Non-performing loans	
	(end of 2010)/4			Latest		12.10.11		
	Total assets as share of GDP	Share in total assets:		% of GDP	Private sector, in %		(CDS spread, bps)	NPL in % Dec 2010 /6
		State-owned banks	Foreign owned banks					
Albania	77.0	0.0	92.4	68.3	58.8	...	7.6	8.7
Bosnia and Herzegovina	86.7	0.8	94.5	34.8	161.8	...	...	...
Croatia	116.8	4.3	90.3	61.8	117.5	492.5	...	...
FYR Macedonia	65.4	1.4	93.3	50.2	94.3	...	...	...
Montenegro	97.4	0.0	88.4	51.2	126.5	...	21.0	...
Poland	76.8	22.9	70.5	45.5	116.3	268.6	8.8	8.4
Serbia	65.3	16.0	75.3	...	...	...	16.9	17.1

Source: EBRD.

### Energy sector

No less important in our analysis is the gas and electricity sectors, which are characterised by outdated infrastructures. This is especially the case in Serbia, Bosnia and Herzegovina and Kosovo, all of which are characterised by high losses in the transformation, transmission and distribution networks as well as households' high levels of energy consumption due to the poor insulation of buildings and the low efficiency of appliances. There is wide variation between countries in terms of transmission losses, with Croatia and Kosovo being the most and the least efficient systems in the region, respectively; but the high-energy intensity of the region is higher than the European OECD average by a factor of two.

To deal with electricity shortages and volatile electricity production, the region is now entering its second decade in the creation of a regional energy market and is integrating it in the EU's internal energy market via the so-called Athens Process. This dates from a treaty signed in 2005 establishing an Energy Community designed with a view to enabling the countries of south-east Europe to become part of the EU's internal market even before their formal accession to the EU.

An important milestone towards the success of this initiative was the decision of the Ministerial Council of the Energy Community of October 2011 to implement the third package of EU internal market legislation. The crunch in the electricity market, due to extreme weather conditions, has clearly demonstrated the fragility of the regional

market, while the need to address existing barriers to cross-border trade (especially given the issue of insufficient generation and transmission adequacy) represents a decisive step.

Searching for a balance between securing reliable and affordable energy supplies, to support economic recovery and energy efficiency measures and the penetration of renewable energy sources, is a big challenge here. Following the EU's efforts to introduce an unprecedented level of integration of electricity markets up to 2014, the region has recently commenced implementing the EU's target market model, planning to join the EU-wide market coupling scheme by 2015.

### *Tax competition*

Finally – yet importantly – we ought to note the increasing impact of China as regards the agenda for structural adjustment, product upgrading and deeper integration of south-east Europe with western Europe. A broad view of European economic integration is crucial given that spill-over and contagion were major issues in the recent economic crisis (Nowotny, Mooslechner and Ritzberger-Grünwald, 2012). Therefore, the debate has to be firmly based on long-term astuteness and we cannot overlook competitiveness taken as a whole. Competition in Europe calls for innovative policies; rejuvenating Europe rests on technological innovation, a lower tax wedge and the like, and much less on a flat-tax regime. To retain the attractiveness of the Balkans region to international investors, decision-makers have responded by cutting tax rates while underscoring the importance of additional incentives (e.g. cash grants, fixed-term tax relief, labour subsidies).

In some respects, tax competition in eastern Europe resembles Ireland's strategy of adopting a friendly tax regime for income, capital and corporations in the 1980s. This – alongside other investment incentives to investors – ended up being the foundation stone for the Irish economic success which then took place (and prior to a subsequent crash). The first country to implement a uniform flat-rate tax in post-communist Europe for all incomes was Estonia in 1991; many other countries followed, including Balkans countries. A national level flat-tax rate was understood to reduce red tape and inequity among taxpayers; counter-balance tax dodging and cheating; and create more incentives to work, save and invest. Theory supports the notion that too-high a level of taxation could not discipline governments which would, instead, spend through the imposition of higher taxes resulting from increased levels of ineffectiveness and inefficiency. A conclusion cited by some researchers is that flat-tax type successes depend on the actual level of the tax rate: the lower this is, the more efficient it might become in swelling tax revenues and sparking economic growth. Tax rivalry could equalise effective tax burdens, or otherwise put them very close to nominal balance, and such an outcome would, in terms of fiscal policy advantages, become ultimately 'neutral' (Sergi, 2005; Hauptman, Kubicová and Mulej, 2009).

Trends in the equalisation and convergence of corporate income tax rates and value added tax, especially between neighbours and countries of a similar size, are shown in Figure 1 and Figure 2.

Yet, how much of a country's competitiveness and investment decisions are tax-driven? How much of the economic growth achieved in the western Balkans was (and

could be) realised through further tax reductions? These two questions continue to be controversial issues among the tax and economic experts affiliated to European trade unions. The tax competition argument has been emphasised, especially if one regards it as leading to an ultimate convergence in tax burdens across countries, leaving this fiscal tool with no impact, or else a 'neutral' one, on investors' international strategic decisions.

We do not want to deny the importance that some tax incentives can have for economic growth and investment decisions. However, economic growth must be rooted in deep economic reforms and fair and efficient labour markets, and no longer on the flat-tax system which has proved unreliable in many countries. Foreign investment flows largely helped to implement privatisation programmes in central Europe in the 1990s – and no 'flat-tax competition' was in place then. Therefore, granting the new flat-tax system with the precedent of economic growth in central and eastern Europe is not entirely truthful: economic growth could not have happened in the 1990s if not grounded on positive expectations of market liberalisation and new pro-western trade linkages.

In the end, the flat-tax system cannot be attributed with positive outcomes in terms of the privatisations and economic growth we saw right after the collapse of the Soviet bloc system. Recently, even the International Monetary Fund has raised the issue with Romania, Bulgaria and Hungary in order for these countries to qualify for credits.

A real strategy to overcome the current economic and social crises, and implement modern growth policies, rests on the ground on improving the comprehensive quality of national governance, coupled with a renewed focus on corporate strategies; trade unions must play a shining role in this context.

Figure 1 – Corporation income tax rates, 2011

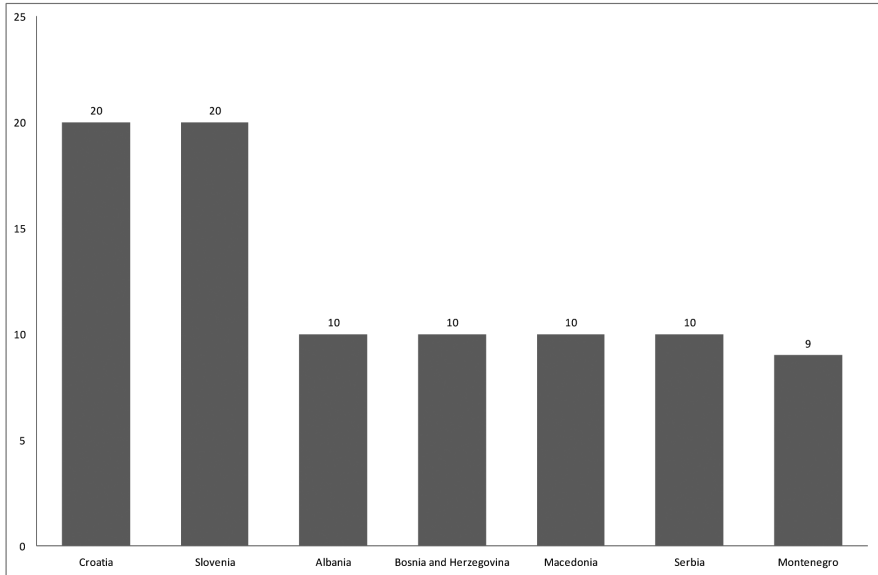
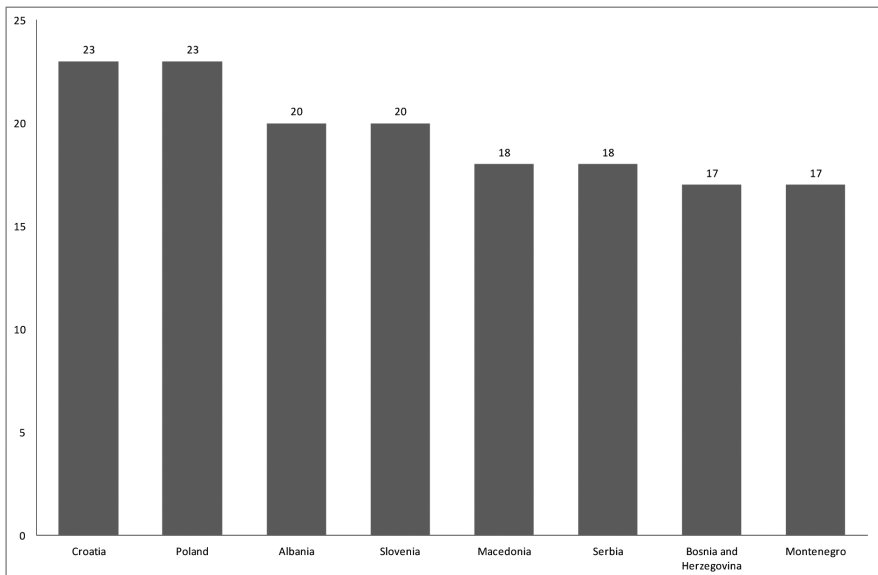


Figure 2 – Rates of value added tax, 2011



Aside from a narrow tax-on-corporate-profits approach, labour costs – such as wages, payroll taxes and so forth – are equally important in investment decisions. Laying the emphasis on tax advantages, especially in the case of a major investor looking for long-term commitment in a given country, is an oversight. Shifting profits to tax havens is another way of skipping national tax disadvantages and this could induce major corporations to have plants in one country while exploiting, at the same time, another country's tax advantage on profits.

Simply, the phenomenon of FDI, outsourcing and international business, whether conducted in south-east Europe or globally, requires a comprehensive rather than a narrow scrutiny.

### Economic equilibrium

Public debt, which is at the epicentre of the second wave of the economic crisis in Europe, has remained at relatively low levels in south-east Europe (see Table 11). Debt ratios are all below, or on, the recommended Maastricht criterion of 60 per cent and range from 27.7 per cent of GDP in FYR Macedonia, 39 per cent in Bosnia and Herzegovina, 46 per cent in Croatia and Montenegro, and 49 per cent in Serbia, to 60 per cent in Albania (the highest in the region) (IMF, 2011).

If we compare gross external debt as a percentage of GDP in Bosnia and Herzegovina, Montenegro and Albania, this looks less vulnerable, with ratios of 26.1 per cent, 32.9 per cent and 49.5 per cent respectively. By contrast, gross external debt in Macedonia, Serbia and Croatia is thorny at 64.4 per cent, 79.5 per cent and 103.1 per cent respectively (although in Croatia and Serbia, long-term debt makes up 85 per cent and 95 per cent of the total respectively, thereby plummeting the immediate roll-over risk).

**Table 11 – Fiscal balance and public debt, 2011**

Country	Fiscal balance, in % of GDP	Public debt, in % of GDP
Albania	-3.6 %	60.0 %
Bosnia and Herzegovina	-1.3 %	39.0 %
Croatia	-5.0 %	46.0 %
FYR Macedonia	-2.5 %	27.7 %
Montenegro	-4.1 %	45.9 %
Serbia	-5.0 %	49.0 %
Germany	-0.8 %	80.5 %
Greece	-9.4 %	170.6 %
Poland	-5.0 %	56.4 %
EU-27	-4.4 %	82.5 %

Sources: Eurostat and Vienna Institute for International Economic Studies.

As regards external economic balance, the current account position of south-east European countries shows high levels of deficit, especially in the pre-crisis boom period, as reported in Table 12. This makes them similar to the Baltic States, which suffered most during the crisis in Europe; generally, this indicates a lack of competitiveness. The situation is particularly alarming in Montenegro, where the balance of payments deficit reached 40 per cent of GDP at the peak of the economic boom and, even in 2010, remained at dangerous levels. The high foreign investment levels for Montenegro in the past decade and the contraction of industrial activity, taken together, clearly indicate that the country is experiencing an unsustainable investment bubble. Albania shows persistently high levels of external deficit, but these do seem to be more manageable. Other countries seem to have corrected their previously high current account deficits.

**Table 12 – Current account balance, as percentage of GDP**

Country	2004	2005	2007	2010	2011
Albania	-4.0	-6.1	-10.4	-11.4	-12.3
Bosnia and Herzegovina	-16.2	-17.1	-10.7	-5.7	-8.8
Croatia	-4.1	-5.3	-7.3	-1.1	-1.0
Kosovo	-8.4	-7.4	-8.3	-17.4	-20.3
FYR Macedonia	-8.1	-2.5	-7.1	-2.1	-2.7
Montenegro	-7.2	-16.6	-39.5	-24.6	-19.5
Serbia	-12.2	-8.8	-16.1	-7.4	-9.5
Germany	4.7	5.1	7.4	6.0	5.7
Greece	-5.8	-7.6	-14.6	-10.1	-9.8
Poland	-5.2	-2.4	-6.2	-4.7	-4.3
EU-27	0.5	0.1	-0.4	0	0.2

Source: IMF (2012b) *World Economic Outlook Database*.

### The labour market and social developments

Most economic indicators pertaining to south-east European countries do not seem shocking to the average European observer, but the labour market is somewhat different. For some countries, the labour market indicators are rather less shocking, although employment rates are generally significantly lower than in the EU. The employment rate is particularly low in Bosnia and Herzegovina and in FYR Macedonia, but even that in Croatia, the best performer, is lower than the lowest value in the EU. Meanwhile, unemployment rates in the region are significantly higher than the EU-27 average, as Table 13 shows. With the exception of Croatia and Albania (13.5 per cent and 14 per cent, respectively), Bosnia and Herzegovina (27.6 per cent), FYR Macedonia (31.4 per

cent) and Serbia (23 per cent) show particularly high values. Neither do the trends of the past four years indicate any consistent improvement, except in Albania (a slight increase from 13 to 14 per cent) and Macedonia (a 2.4 percentage points shrinkage). All this was happening at a time when the region was achieving significant economic growth and was catching up with the more developed parts of Europe.

**Table 13 – Unemployment rate (LFS, %)**

Country	2008	2010	2011
Albania	13.0	13.7	14.0
Bosnia and Herzegovina	23.4	27.2	27.6
Croatia	8.4	11.8	13.5
FYR Macedonia	33.8	32.0	31.4
Montenegro	17.2	19.6	19.7
Serbia	13.6	19.2	23.0
Germany	7.5	7.1	5.9
Greece	7.7	12.6	17.7
Poland	7.1	9.6	9.7
EU-27	7.1	9.7	9.7

Sources: *wiiw (2011) Handbook of Statistics 2011: Central, East and Southeast Europe Vienna Institute for International Economic Studies, Vienna; Eurostat.*

The phenomenon of rising unemployment and jobless growth has often been mentioned in the European context, particularly for central and eastern Europe, but the negative champion in this field is, without doubt, south-east Europe.

Concerning the euro-zone, the number of unemployed might rise to twenty million in 2013. This would be a historical record, well above the total number of unemployed people in 2012 (18.7 million, the highest level reached after the launch of the euro), while in 2010, 15.9 million citizens of euro-zone countries were without work.

Turning to the western Balkans, even if signs of normalisation are clearly discernible in the economy as a whole, this is unfortunately not true of the labour market. Active labour market policies are required such as, for example, vocational training and educational programmes for workers. If policy reforms were essential to restore competitiveness, boost job creation and make it more inclusive, this would impose a burden of wide-ranging social consequences. Extensive consultations between the social partners are crucial to maintain social cohesion while restoring overall competitiveness and engineering a successful and lasting economic recovery.

Our data speak not only of an already high level of unemployment in the western Balkans region but, in many cases, also of an increased level in the aftermath of the global economic crisis. Yet, the difference remains easily discernible, with unemployment rates in the region being significantly higher than the EU-27 average (Galgóczy

and Sergi, 2012). Despite sustained economic growth and stability, labour markets have not shown any significant scale of improvement, with the region having high unemployment rates in general and ones that are especially stark when looking at the cases of Bosnia and Herzegovina, Kosovo and FYR Macedonia. Indeed, the effects of the global economic crisis are clearly associated with this equation. The observed statistics, showing significantly high values of unemployment, indicate an overall poor level of social welfare, in particular among the countries of the narrowly-defined western Balkans region, one that is also poorly situated to boost, in any clear or meaningful way, positive forms of cross-cultural communication and interaction.

Richard Dobbs, a researcher with McKinsey, authored the survey ‘Why the jobs problem is not going away’ in 2012, offering an analysis of a mismatch between the demand for and the supply of graduates that will have expanded even further by 2020. In advanced economies, the system could fail to respond by between sixteen and eighteen million graduates, a level of supply which is 11 per cent less than the demand, with potentially damaging consequences for GDP growth. This mismatch between the demand for and supply of highly-qualified professionals is a major problem and overcoming it is essential for growth.

The competitiveness of the western Balkans also relates to people’s skills, quality, innovation and the existence of a national (and regional) system capable of enhancing these ideas. It is essential that young people be placed in conditions of a choice of training which is lined up with business needs. Not surprisingly, companies have increased their focus on the issue of the quality of human resources, focusing even more on excellence in the context of regional and international competition. However, apart from in a few cases, the region has a very traditional model of development, based on low technology; well-prepared graduates emigrate to find good job opportunities.

If, on the other hand, we look at wage developments in the region, we again see signs of consolidation. Wage dynamics – for those who work – seem to be impressive, as Table 14 shows. Serbia and Montenegro, which also had a comparably more balanced labour market, take the lead with real wage increases of 145 per cent (in Serbia) and 95 per cent (in Montenegro). Among the south-east European countries for which data were available, only Croatia had a lower real wage increase than the EU-27 average over the decade, but Croatia also has an outstandingly high wage level for the region.

**Table 14 – Monthly remuneration per employee, 2010**

Country	Euros	% (EU-27=100)	Index of real wages, 2009 (2000=100)
Albania	246	8.9	n.a.
Bosnia and Herzegovina	622	22.4	n.a.
Croatia	1 054	38.0	121
FYR Macedonia	491	17.7	159
Montenegro	715	25.8	195
Serbia	461	16.6	245
Poland	883	31.8	125
EU-27	2 776	100	134

*Note: Data for south-east Europe refer to average gross monthly wages.*

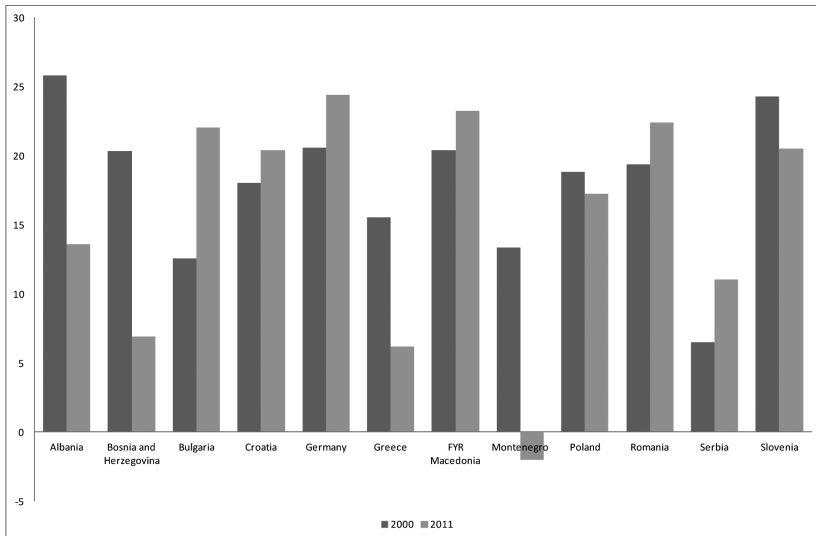
*Source: Vienna Institute for International Economic Studies (2011).*

The Gini index measures the extent to which the distribution of income among individuals or households deviates from a perfectly equal distribution. A Gini index of zero represents perfect equality – everyone has the same income – while an index of one (100 on the percentile scale) implies perfect inequality in the income distribution (one person has all the country's income; everyone else has nothing).

Growing income inequality is a general trend in Europe and there is no evidence to support the assumption of an equality-efficiency trade-off. The depressing of wages has caused a loss of efficiency while the purchasing power of the population has been maintained only through taking loans that contributed to the development of an unsustainable trend and concluded, eventually, in a debt crisis (Galgóczy, 2011). Gross national savings are quite low; except for Macedonia (23.4 per cent in 2011), while the averages for western Balkans countries are well below the ratios in Germany, Bulgaria, Slovenia and Poland (Albania's savings ratio plummeted from 22.3 per cent in 2004 to 12.7 per cent in 2011) (see Figure 3).

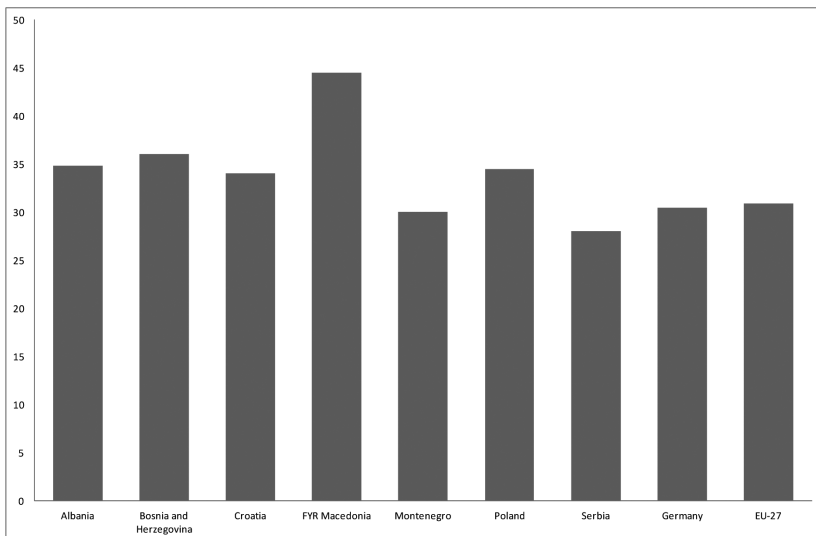
This was not the case in all the western Balkan countries, but the search for a trade-off between equality and efficiency is misleading when applied to the complexity of the region. The risk of growing income inequality can lead to social, economic and efficiency damage, while missing the positive external effects of greater equality for society. The value of statistical income inequality data may be questioned for countries which have extreme labour market conditions, but Figure 4 nevertheless provides an overview for 2008. Surprisingly (or not), south-east European countries fare rather well in European comparison, FYR Macedonia being the only significant outlier. Serbia and Montenegro, on the other hand, have better results than Germany or the EU-27 average, as far as the formal economy is concerned.

**Figure 3 – Gross national savings as % of GDP**



Source: IMF (2012b) World Economic Outlook Database. Montenegro data is 2001 and 2011.

**Figure 4 – Income inequality: Gini Index, 2008**



Note: 2006 data for Bosnia and Herzegovina.

Source: World Bank; for Germany and EU-27: Eurostat.

Table 15 reports national poverty rates; that is, the percentage of the population living below the national poverty line. National estimates are based on population-weighted sub-group estimates drawn from household surveys. This indicator is one of a core set of poverty and social exclusion indicators on poverty and social exclusion and is referred to as the Laeken indicators, after the European Council meeting of December 2001, held in the Brussels suburb of Laeken. They were developed as part of the Lisbon Strategy of 2000, which envisioned the co-ordination of European social policies at country level based on a set of common goals.

**Table 15 – Poverty headcount ratio at national poverty line (% of population)**

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008
Albania			25.4			18.5			12.4
Bosnia and Herzegovina	19.5			17.7			14		
Croatia			11.2		11.1				
FYR Macedonia			19.1	19.2	18.5	20.4	19		
Montenegro						11.2	11.3	8	4.9
Serbia			14		14.6		9	6.6	
Poland	14.8	15.6	16.6						

Source: World Bank.

**Table 16 – IMF advice ‘tailored’ to individual country circumstances**

Country	Labour market institutions and policies						Broader policies		
	Min. wage	Unemployment benefits	Labour tax	Employment protection legislation	Collective bargaining	Active labour market policies	Public wage bill	Pensions	Growth reform
Greece	√		√		√		√	√	√
Iceland						√			
Latvia	√						√	√	
Portugal	√	√	√	√		√			
Romania							√	√	
Serbia							√	√	
Ukraine								√	

Source: IMF (2012a).

Table 16 highlights the policy advice of the IMF on labour market issues tailored to each individual country's circumstances. Several countries are currently facing the challenge of having to regain competitiveness to boost growth. Euro-zone membership implies that the nominal exchange rate cannot be devalued and that interest rates cannot be adjusted in an individual country. Furthermore, productivity increases only take hold over time. Advisers may disagree with the IMF's suggestion that improving the competitiveness of the region may require a reduction in its labour costs, but it is sensible to advise that, in such circumstances, it is vital to have a social safety net in place to protect the most vulnerable in society.

### Next important steps towards growth and capital

Advisers among trade unions need to keep networking and to develop direct contacts and communication links, as well as to exchange experiences and ideas. To this end, work needs to be undertaken on both national and regional strategies in the fight against corruption and on how to revive economic growth. Corruption and fraud are diseases that continue to plague public administration and, from what we know, this phenomenon does not allow for optimism. In justice, health care and other vital sectors, progress towards a sound economic and social betterment is intertwined, and with surprising ease, with real examples of episodes of a poor reputation based around issues of bad management, sometimes occasioned by weaknesses in state controls.

A strong attempt should be made to have a more effective regional agency for fighting corruption than the current Regional Anti-Corruption Initiative (<http://www.rai-see.org/secretariat.html>). This would provide a real impetus in the fight against corruption in south-east Europe and would also provide another target for research and development. In addition, we need additional platforms with which to approach the debate on anti-crisis measures regarding unemployment, poverty and wealth disparities. Poverty and wealth disparities are of extreme concern, while the latter is divided by extremes in an 'unfair' manner and has grown during the last few decades. If we then ask how ethical is the growth of wealth disparity, we again find a history in answering questions which have great economic resonance.

We argue here that growing wealth disparity differs from simple income inequality and that this is irrefutable. If income disparity can be fairly and reasonably associated with market-type examples of growth, then our extreme, and growing, wealth disparity is, therefore, equally not acceptable under current living arrangements. This is primarily because recent economic fluctuations, and the contemporary financial and general economic crisis of the world economy since 2007, have meant that several regions in the world are no longer tied to sustainable market functions but, rather, to forces that prevent the market from working properly. This is partially the case in the region of south-east Europe. This means that trade unionists, representatives of the business community and governments need to be aware of how their interaction might mitigate the growing wealth disparity as well as the severity and longevity of economic downturns.

The debate may be seen in terms of social consequences followed by developments in public opinion, creating the necessary path ahead for policy-makers. The public itself is the intended recipient of economic policies designed and implemented at the policy level. It therefore makes great sense to study whether policy-makers justify, or attempt

to legitimise, specific economic policies based on their evaluations of current economic problems. That this is problematic is a problem common to all policy-making. We can document growing wealth disparity over several centuries and we all agree that disparities in wealth are unsafe, unstable and destabilising. Not keeping pace with the right expectations of people and workers now can therefore lead to serious economic and social problems in the future.

A number of factors have contributed to economic collapse, followed by the rise in inequality. Incomplete market reforms, high levels of bureaucratic corruption, and the capture of national governments by powerful business elites account for some of the differences in poverty and inequality outcomes among countries. No less important are the traits of national institutions as the major cause of income level differences; while, perhaps, geography and resource endowments might also be determinants. Instead, a negative effect of the economic and financial crisis is that more and more workers are forced into various forms of precarious work – about 50 per cent of the global workforce, according to the International Labour Organisation. In fact, 2009 was the 60<sup>th</sup> anniversary of the ILO Convention on the Right to Organise and Collective Bargaining, while countries such as Canada, China, India, Iran, Republic of Korea, Mexico, Thailand, United States and Vietnam have still not ratified it. Thus, the Convention covers approximately one-half of the world's economically active population.

Many instruments may be necessary to assess such ethical outcomes, including the quality of institutional design and the part that geography and natural endowments may play as additional causes of gaps in socio-economic development.

Other economists, such as Joseph Stiglitz, a Nobel Laureate in economics, have written about the ethical problems concerning the ineffective practices of the international financial organisations and institutional policy-making overall. There should be no autonomous approach at either extreme; that is, conditionality should neither be simply forced nor inspired by these organisations, and nor should donor countries with spare cash be in the same position without being asked to adopt a reliable domestic commitment. However, we should take care to cherish the right programmes and to discuss, in concert with domestic actors, the degree of conditionality on loans, which should be made more accessible and functional to economic recovery. More than 80 per cent of all IMF missions meet national trade union representatives to gain a better understanding of what is happening in local labour markets, and there are extensive policy consultations with the ITUC, but the IMF does report that more judicious attempts are required, while it also posits (IMF, 2012a):

*If such reforms are undertaken, they should be implemented according to individual country circumstances, and with care, especially for the most vulnerable members of society.*

It is also worth recalling that the IMF also suggests (IMF, 2012a) that too high a level of protection can lead to labour market distortions in which some groups, such as the young, end up with very high unemployment rates and that, in some instances, it may be necessary to lower labour costs.

In the past, the massive injections of funds we have seen go into eastern Europe and other regions have not been constructive because the conditions imposed were

wrong. This was the case in Thailand and Indonesia, for example, where the condition was put in place of cuts in public spending, including social spending, which led to an increase in poverty and to shrinking social support for reforms. What is suspected is that the objectives underlying such prior approaches were not credible because they were defective in the social sphere, while tight economic policies had too low a level of credibility to be implemented. This led either to uncertain commitment by domestic authorities or, at best, to compromises when a country was in a place to be able to influence international decision-making.

Yet, policies become credible as long as all actors come to an agreement, by avoiding economic guidance of a pure ethical orthodox nature that lacks adequate domestic knowledge: this fact has often brought about inconsistency and failure in the past. The recent commitments of the IMF and the World Bank are to proceed in the direction of a new ethical approach, via a broadening of the involvement of national actors and, in certain cases, to exemptions from the usual numerous conditions. However, overall, standard conditions still apply (e.g. Hungary, Iceland and Ukraine).

Definitive operational procedures must enable policy-makers to commit to realistic programmes, while agents must introduce the right balance between ethical long-term outcomes and judicious internal commitments. The IMF and other multilateral economic agencies still serve an essential global task. However, recent economic fears, and the call to extend further aid to deprived populations, give trade unionists an opportunity to suggest a way in which these organisations might operate in a better manner and we should not pass it up. We must therefore re-think the logical involvement of the international and domestic actors in line with a country's best interests, because what has been done so far has been largely ineffective.

If the risks are that these organisations continue to draw on their naive approaches, domestic players need to occupy a position of greater trust in which all players would come to each other's support. The failure of the approach of the international financial institutions lay in an over-emphasis of mainstream theories which have been applied everywhere without considering the differing national state of affairs and social circumstances.

## Summary

Trade unionism in the western Balkans brings a new cross-cultural perspective on the role of trade unions at the European level. The development agenda needs to focus on the effectiveness of trade unionism in this region of Europe where it was born through a shared understanding of the many challenges and opportunities that national economies face today. In the light of the economic crises of capitalism on a global as well as a national scale, placing particular emphasis upon its explanations and its nature, as well as upon the multi-role of the state and other economic actors, is vital.

Notwithstanding the relative results in terms of increases in GDP, excluding the presumably temporary effects of the global economic downturn, the region suffers from a number of phenomena that prevent it from growing into a strong and stable economic arena, and, hence, one that is conducive to a flourishing environment for stable cross-cultural interaction. Therefore, the study of both the economic and the social situation of the western Balkans is fascinating in seeking an understanding of the current realities

and possible trajectories of the region. A stable political climate, including a functioning institutional system and a state of effective rule of law, a constantly increased net for social welfare and a strong or sustainable economy appear to be of decisive value.

One of the region's most persistent challenges is a strengthening of the rule of law, in particular of those institutions that are empowered to enforce the law (Qerimi and Sergi, 2009; Sergi and Qerimi, 2006, 2007 and 2008). The problem of corruption has been one of the most enduring dilemmas confronting governments throughout history and it remains one of the most serious problems in the western Balkans nowadays, along with organised crime. High values of corruptive behaviour testify to the difficult path of reforming institutional structures and strengthening the rule of law as a matter of policy, as well as a part of broader programmes aimed at governance and capacity building.

We have shown here that the labour market situation is alarming in most countries. This is the biggest social challenge for trade unionists across the region, as well as for those whose purpose is the interpretation of economic and social facts. This provides unique opportunities to highlight the great challenges of the region and to allow trade unions to do so in a way that is appealing to the international institutions. Positive wage developments and positive results on the conventional measures of income inequality only show that a large part of the economy is not visible. On a more positive note, signs of consolidation are discernible in the region's economic performance.

To conclude, western Balkan countries have been very diverse over the past decade and this has been reflected in their economic growth rates. The so-called 'latecomers' – following the example of those countries that experienced economic growth and foreign investment earlier – need to strengthen their competitiveness. If there are grounds for foreign capital inflows to be released by the last 'round' of privatisation, the region calls for much greater efforts designed for constructive outcomes. The underlying purpose remains that of becoming aware of the 'EU factor', greater regional co-operation in the advancement of industry clusters, various incentives, etc. – all these factors being of equal worth to foreign investors.

Last, but not least, it is important that those working with trade unions continue to pioneer rigorous methodological designs, allowing a focus on social and economic betterment, better public administration and a wiser internationalisation leap. Trade unions can offer sound suggestions, analyses and ways out of the crises and, as long as such a line of thought and action are both pursued to their natural conclusion, there might yet be a success story for trade union organisations themselves.

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