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IS STRENGTHENING OF THE MUTUAL ECONOMIC COOPERATION IN WESTERN BALKANS RIGHT POLICY?

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RESPONSE TO THE STANDSTILL OF EUROPEAN INTEGRATION IN THE WB

According to official statements by Tirana, Skopje, and Belgrade, due to the EU enlargement process' crisis, WB parties themselves are ready to make meaningful steps to improve mutual cooperation. Last of signs of this engagement was at the end of July 2021 with leaders of Albania, North Macedonia and Serbia signing a trilateral economic agreement (OPEN BALKAN INITIATIVE) at a regional business forum (Skopje). With opposition (Kosovo*, Montenegro) or ambivalence (B&H) of remaining WB's economies, 3 parties want to show they can do things alone, even without the EU's help. The goal is to create a common market for WB 6 economies (MINI-SCHENGEN AREA), with free movement of goods and citizens and equal access to labour markets.

The hope is that more harmonized standards and faster border crossings for goods and people would open up new markets for businesses and foster cross-border trade According to the optimistic projection by the World Bank, participating countries would save up to 2.7 bn EUR yearly (Euronews, 2021).

A LACK OF EMPIRICAL STUDIES ANALYZING TRADE BETWEEN WB ECONOMIES

Hence, the question arises whether enhanced cooperation, including the proposed customs union of WB 6, is the right step forward.

By calculating several trade indicators, this study aims to reveal the structure and consequently the quality of bilateral trade flows between WB 6. Based on the changes in their dynamics in the previous period, these parameters can help us estimate future tendencies of observed bilateral trade flows, among other things, by comparing them with the same indicators for WB-EU and total WB merchandise trade.

OUR GOAL IS TO SHOW THAT THE FURTHER INTENSIFICATION OF TRADE AND ECONOMIC INTEGRATION AMONG WB PARTIES MAKES NO SENSE...

...especially in comparison with the much stronger significance of the EU for every observed economy. I am even arguing that potential enhanced trade integration between WB 6 could have a negative political and economic impact, including the trade diversion effect.

Several hypotheses have been tested. In line with the empirical evidence, if trade integration is not necessary and beneficiary, a fall of shares of products at higher levels of processing as well as intra-industry trade among members of this trade integration would be expected. Export concentration coefficients would grow, while declining shares in bilateral exports and imports between parties of this trade area would be a sign of its irelevance. Everything of this is what we expect to be proven in the case of CEFTA.

In analysis we have used extensive empirical evidence - expressed through calculated indicators - sourced from bilateral flow data between WB6.

THE USAGE OF THE DISAGGREGATED PRODUCT-LEVEL BILATERAL EXPORT-IMPORT TRADE DATA AT THE 3-DIGIT SITC LEVEL IS A TECHNICAL CONTRIBUTION OF THIS STUDY

...as it allows us to avoid the biases of lower levels of disaggregation.

Also, this is the first empirical research of the dynamic of performances of bilateral trade among WB 6, and consequently of the economic effects of trade integrations to the WB. The existing literature is usually focused on the trade relations between the EU and WB parties and it is hard to find studies that examine the structure of trade between WB economies themselves.

REFFERENT STUDIES DEALING WITH WB ECONOMIES MUTUAL TRADE

...have shown that intra-regional trade appeared to be led by the level of economic activity, then by cultural aspects such as similarity between languages. In addition, the majority of authors also noticed that being neighbouring countries and sharing the legacy of former Yugoslav market connections are contributing factors to trade flows in the region. In contrast, non-tariff barriers, as well war effect, have a significant negative impact on trade between WB 6

{see: Ninka and Pere (2017), Klimczak and Trivic (2015), Tosevska-Trpcevska and Tevdovski (2014) }

Given that most of the relevant literature employs the gravity model, the very focus on the structural change of bilateral trade flows in WB 6 is a contribution.

DECREASE IN THE SIGNIFICANCE OF WB TRADE FLOWS

On the basis of our calculations - using values expressed in EUR - there are clear signs of a decrease in the significance of WB trade flows (CEFTA minus Moldova) for most WB economies.

Namely, because of slower trade growth among WB 6 in the observed period (compared with total, and trade with the EU), shares of exports/imports among those parties have decreased.

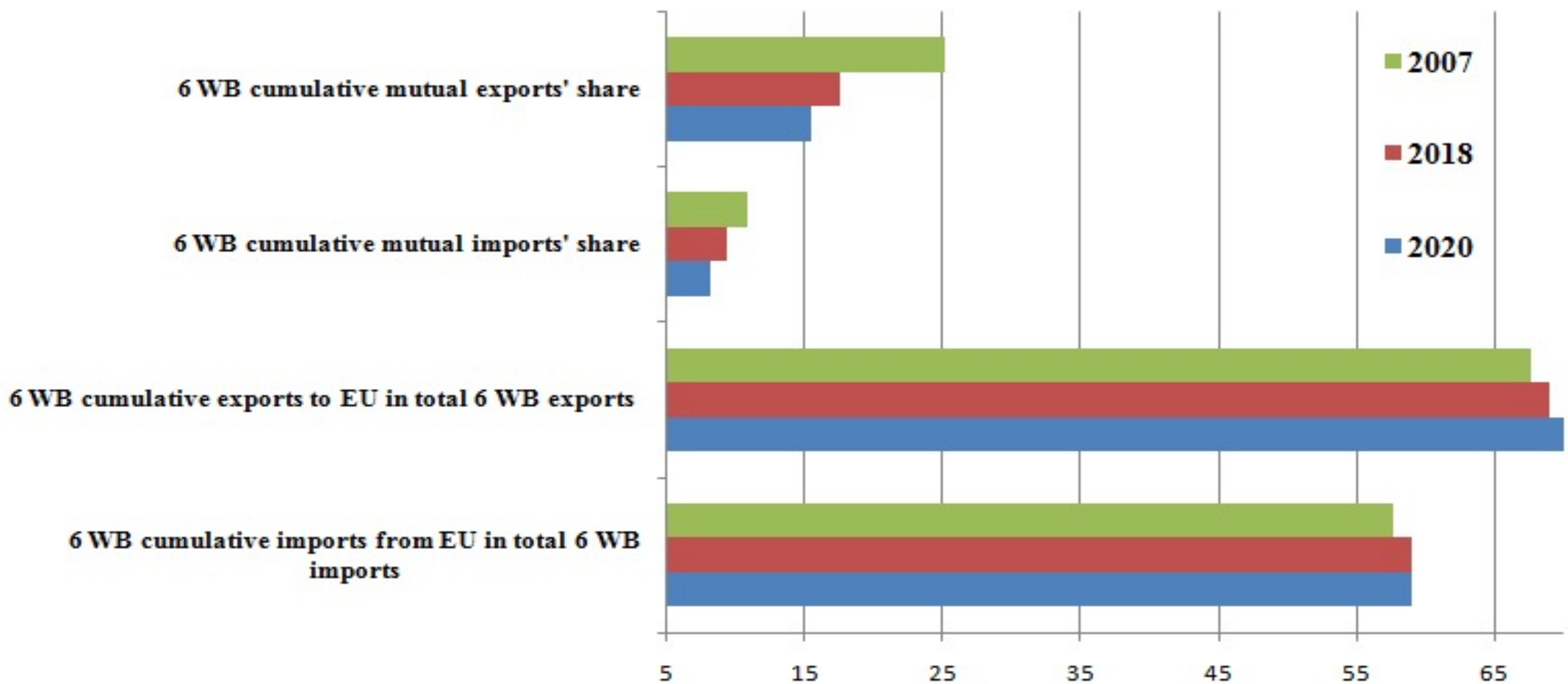
CUMULATIVE TRADE BETWEEN WB ECONOMIES, RELATIVE TO THEIR TOTAL TRADE, DECREASED SIGNIFICANTLY SINCE 2007

We aggregated merchandise exports (and imports) for all six observed parties and did the same with their intra-WB exports and imports.

Exports share fell from slightly more than 1/4 to 15.5%, while imports share decreased from 10.9% in 2007 to 8.2% in 2020.

In the observed period, cumulative exports (and imports) of WB parties have grown at high rates (6.6%, that is 3,5%, annually, on average), increasing their volumes (in EUR) 2.3 times, with similar growth rates of exports (imports) to (from) the EU - 6.9% (3.7%). At the same time, the exports of those economies to the remaining WB parties have grown at two times slower rates, thereby reducing their shares in total exports.

RISING SIGNIFICANCE OF 6 WB'S TRADE WITH EU ALONG WITH DECLINING WEIGHT OF 6 WB MUTUAL TRADE



THE RISING SIGNIFICANCE OF THE EU

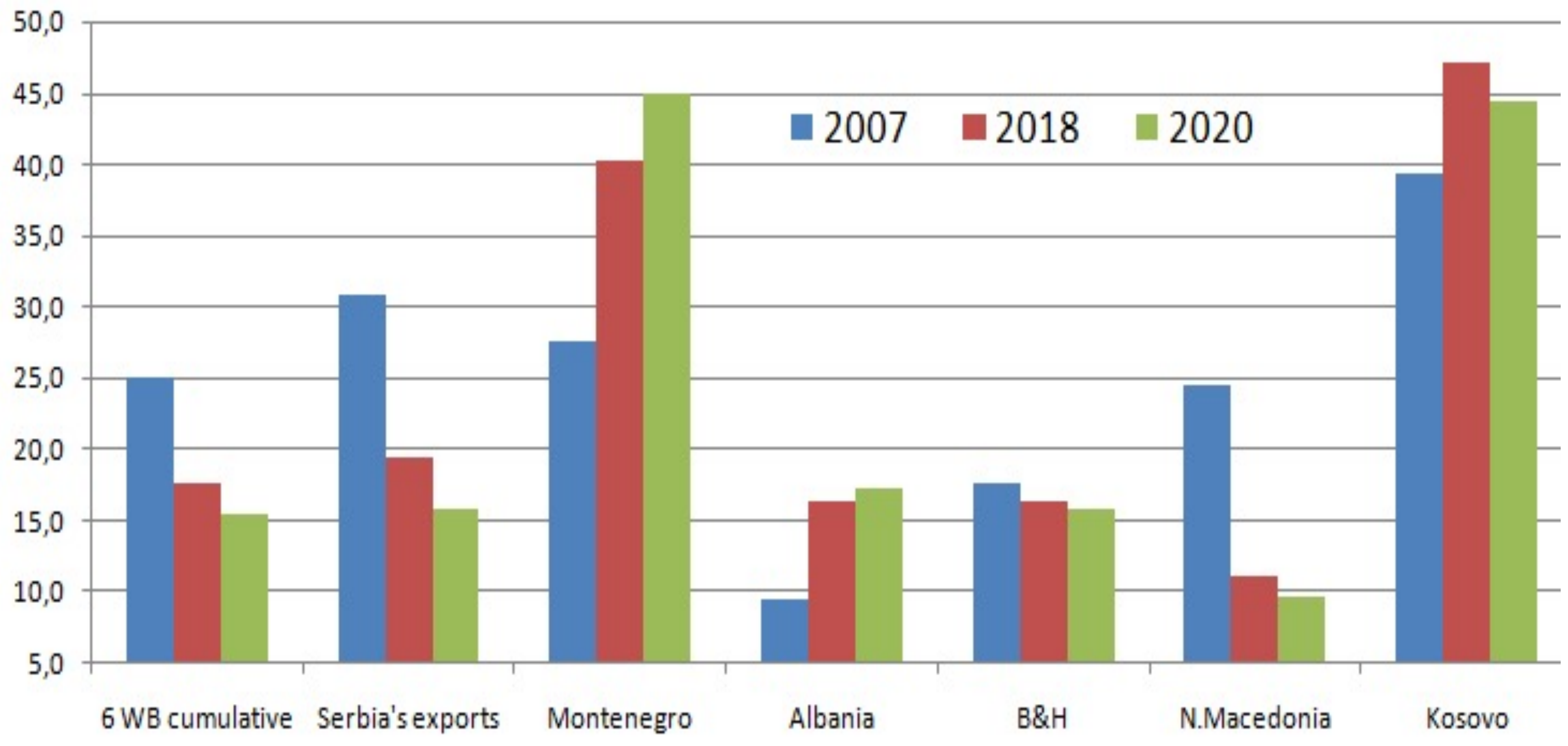
As we have seen, the opposite pattern was detected in the export of WB 6 to the EU 28 - the share of their cumulative export to the EU in their total export has grown from 67.7% in 2007 to 69% in 2018, and 70.4% in 2020.

The increment of EU import share in WB 6's total imports was something slower (by 1.4 percentage points, to 59% in 2018/20).

A tendency of the reduced significance of bilateral trade flow between WB 6, especially in view of the growing significance of trade with the EU, is clear.

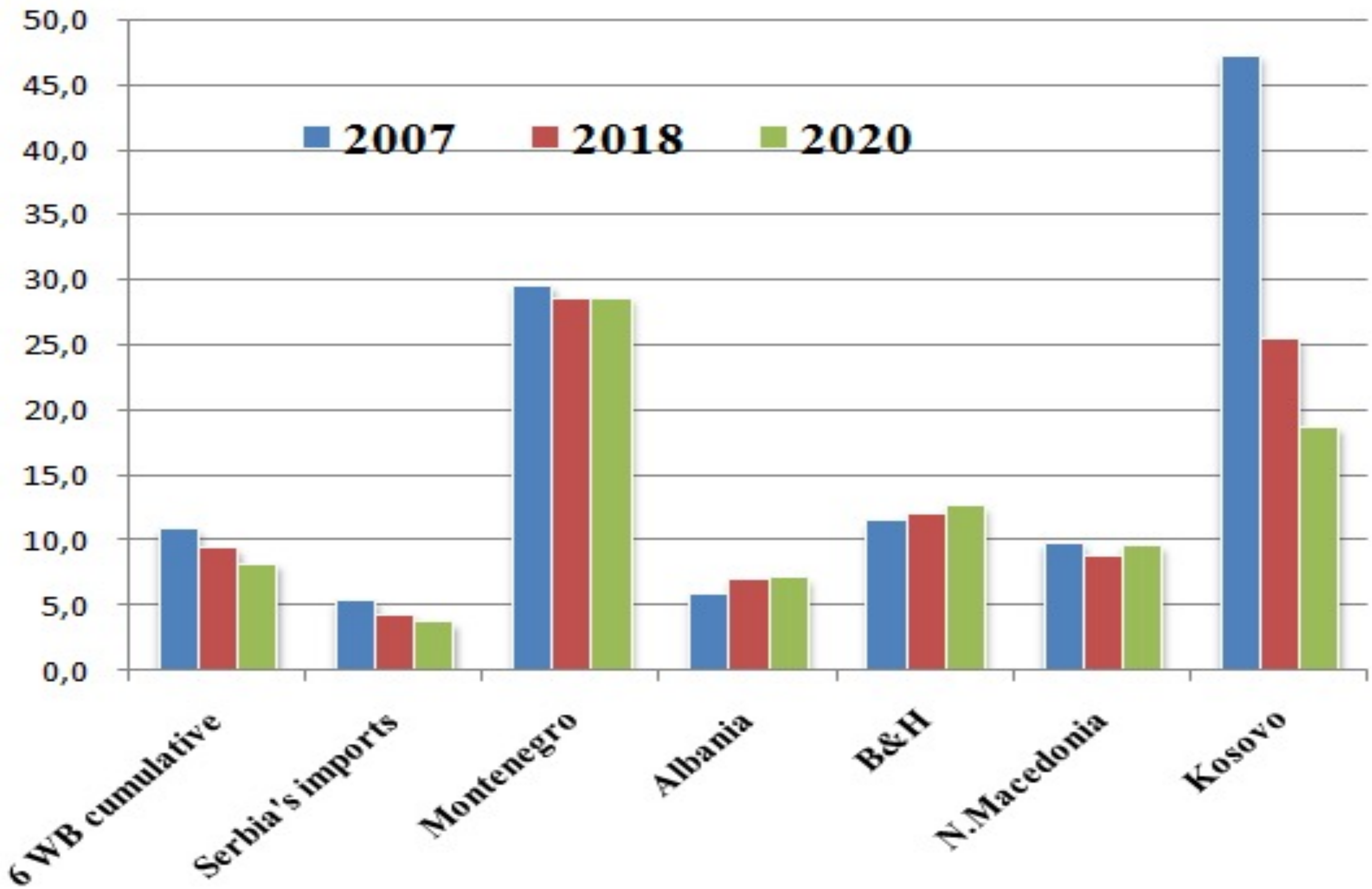
Mainly decreasing share of mutual exports among WB 6

(2021: Serbia 15.3%; B&H 15.6%; Montenegro 46.5%, Macedonia 9.6%)



LARGELY DECLINING SHARE OF BILATERAL IMPORTS BETWEEN WB 6

(2021: Serbia 3.9%; B&H 12.5%; Montenegro 28.2%, Macedonia 8.7%)



THE CHANGE IN THE QUALITY OF MUTUAL WB 6 EXPORTS/IMPORTS

All exports/imports classifications we deployed are based on the applied level of skill and technology.

First, UNCTAD (2019) methodology has been used with all merchandise groups (261 of them) classified into five categories, where one was focused on high-skill and technology-intensive manufactures.

Then, in line with the methodology developed by Mayer and Wood (2001), I extracted the shares of skill-intensive manufactures in WB bilateral export flows. The point is that manufacturing sectors (industries) are positioned by their skilled/unskilled labor ratios or other measures of skill intensity (chemicals, machinery, cars, aircraft, and instruments are classified as skill-intensive, which will be used as a proxy for the achieved level of exports sophistication).

Medium- and high-tech products' shares largely determine the overall quality of a country's exports

After that the methodology developed by Munkacsi (2009) was used. He classified exports according to technology structure into 4 categories, from which I extracted those with higher processing levels: medium- and high-tech products (the majority of products belonging to Sectors 5 & 7).

Possible growing shares of these products in bilateral trade flows would suggest a qualitative improvement of mutual trade between WB parties.

Shares of (Medium- and) High-Tech products, Skill-intensive manufactures, and High-skill and technology-intensive manufacture products in merchandise trade flows between WB economies in 2007 and 2018

	2007	2018	2007	2018
	Serbia-N. Macedonia		N. Macedonia-Serbia	
Medium + High products	21.5	27.9	18.1	17.4
Skill-intensive manufacture products	20.5	26.5	16.4	16.4
High-Skill & technology-intensive	14.5	18.2	11.2	14.1
HIGH-TECH	3.4	4.2	7.9	9.7
	N. Macedonia- Monten.		Montenegro- N. Maced.	
Medium + High products	27.9	22.7	35.1	4.9
Skill-intensive manufacture products	20.5	20.9	30.2	4.5
High-Skill & technology-intensive	12.5	16.3	5.7	1.7
HIGH-TECH	9.0	12.7	3.9	1.3
	Serbia - Montenegro		Montenegro - Serbia	
Medium + High products	29.4	34.2	15.5	13.5
Skill-intensive manufacture products	27.2	31.5	13.0	15.0
High-Skill & technology-intensive	16.6	19.7	10.5	14.3
HIGH-TECH	7.8	8.5	8.7	9.1
	N. Macedonia - B&H		B&H - N. Macedonia	
Medium + High products	24.1	27.8	21.3	14.7
Skill-intensive manufacture products	22.2	26.5	22.0	11.2
High-Skill & technology-intensive	14.2	22.3	11.0	6.2
HIGH-TECH	13.2	17.4	2.8	2.2
	Serbia - B&H		B&H - Serbia	
Medium + High products	24.4	26.9	17.2	9.4
Skill-intensive manufacture products	23.2	24.7	16.8	9.1
High-Skill & technology-intensive	16.8	15.2	9.1	7.0
HIGH-TECH	6.3	4.1	3.7	2.6
	N. Macedonia - Albania		Albania - N. Macedonia	
Medium + High products	17.6	22.9	18.4	4.4
Skill-intensive manufacture products	16.7	24.0	7.6	4.3
High-Skill & technology-intensive	14.8	21.6	12.3	2.7
HIGH-TECH	4.3	7.7	4.3	1.8
	Serbia - Albania		Albania-Serbia	
Medium + High	11.4	26.3	1.2	1.7
Skill-intensive manufacture products	11.3	25.2	1.2	1.4
High-Skill & technology-intensive	10.2	17.8	1.3	1.0
HIGH-TECH	5.6	5.6	0.0	0.1

Notes: Medium + High products = (Combined) Medium- and high-tech products; High Skill & technology-intensive = High-skill and technology-intensive manufactures; HIGH-TECH= High-Tech products.
Source: Author's own calculation based on the UN COMTRADE database.

THE CLASSIFIED PRODUCTS' CATEGORIES SHOWED DIVERGENT TENDENCIES REGARDING OBSERVED TRADING FLOWS

For example, looking at the Serbian export to North Macedonia, all four applied product categories detected a solid share growth, implying the improved quality of exports from Serbia to its southern neighbor. Yet, given a worldwide growing trend of this kind of products in international trade, achieved progress of Serbia's export sector is less relevant.

On the other hand, B&H's export to Serbia has strongly deteriorated from 2007 to 2018, as shares of cumulative Medium- and high-tech products and Skill-intensive manufacture products have almost halved.

Macedonia largely improved its export quality to Montenegro, while a strong deterioration of the export structure was detected in the opposite direction.

YET, EXPORT/IMPORT STRUCTURES (AND THEIR TENDENCIES) DETECTED AMONG WB 6 ARE UNFAVORABLE!

At first look, the results are inconclusive since in half of the observed 56 cases structures have deteriorated or stagnated from 2007 to 2018 (in the other half of observed cases, the structures were improved).

To make the analysis complete: we computed the same indicators of export-import structures regarding both the total and export to the EU (of WB6).

Almost all observed WB parties recorded an improvement of their export structure in 2018 compared to 2007, at the same time achieving a significantly higher level of export sophistication compared to regional trade flows. The same case is with their exports to the EU (See ANNEX!).

So, given the improvement of export structure not only worldwide, but also when export to the EU or the total export of those same parties is concerned, trade structures (and their tendencies) detected among WB 6 can be seen as unfavorable.

Is there a fall of export concentration coefficients among WB6?

I have calculated the export concentration ratio of WB6 in their trade with each other.

Based on empirical data, a fall in export concentration would be an expected tendency given the reciprocal mutual opening of these economies (diversification of import demand) in the last two decades and the growth of the absolute level of bilateral trade, which is in line with the increase in the purchasing power of their population.

Export concentration ratio (Herfindahl-Hirschmann index) in 2007 and 2018; merchandise export from one WB economy to another (calculation based on the UN COMTRADE database)

bilateral trade flows:		2007	2018	bilateral trade flows:		2007	2018
Serbia	N. Macedonia	0.089	0.075	N. Macedonia	Serbia	0.166	0.154
Serbia	B&H	0.075	0.075	B&H	Serbia	0.298	0.239
N. Macedonia	B&H	0.161	0.185	B&H	N. Macedonia	0.210	0.172
N. Macedonia	Albania	0.192	0.186	Albania	N. Macedonia	0.337	0.441
N. Macedonia	Montenegro	0.123	0.143	Montenegro	N. Macedonia	0.170	0.452
Serbia	Albania	0.127	0.063	Albania	Serbia	0.330	0.219
Serbia	Montenegro	0.074	0.063	Montenegro	Serbia	0.375	0.219

THE CALCULATIONS SHOWED THAT EXPORT CONCENTRATION RATIOS HAVE MOSTLY DECREASED

...excluding some rising bilateral trade flows, largely between smaller WB economies.

Also, there is a clear falling trend of both Serbian export concentration to B&H, and Bosnian export concentration to Serbia. The situation is the same with Serbia's trade with N. Macedonia.

THE LEVEL OF EXPORT DIVERSIFICATION HAS NOT ACHIEVED SIGNIFICANT IMPROVEMENTS GIVEN THE RELATIVELY HIGH LEVEL OF EXPORT CONCENTRATION RATIOS DESPITE A DECREASING TENDENCY, SO MAKING SOME CONCLUSIONS A TRICKY

To provide additional comparative insight, I computed the concentration ratios of both the total and exports of those economies to the EU. These ratios are lower than their bilateral ratios

Regarding exports to the EU, all WB recorded declining tendencies (See ANNEX!).

Given the tendencies of WB exports (totasl and to the EU), which recorded a significant improvement in the observed period, as well as the worldwide trend of decreasing export specialization, the basic assumption about unfavorable trend regarding export concentration, can be accepted with some reservation.

A FALL OF INTRA-INDUSTRY WAS DETECTED SINCE 2007 IN THE MAJORITY CASES

We calculated the Standard Grubel-Lloyd index, meaning intra-industry trade between WB parties for 2007 and 2018.

The only cases of growth of the G-L index were detected in merchandise trade between B&H and N. Macedonia and Macedonia and Albania.

Generally, there is a falling trend of intra-industry trade, notably between Serbia and B&H and Serbia and Macedonia, which is negative tendency.

Standard Grubel-Lloyd index 2007 and 2018 for merchandise trade between WB economies

trade partners:		2007	2018
Serbia	N. Macedonia	0.345	0.284
Serbia	B&H	0.260	0.244
N. Macedonia	B&H	0.192	0.264
N. Macedonia	Albania	0.125	0.144
N. Macedonia	Montenegro	0.067	0.065
Serbia	Montenegro	0.111	0.096
Serbia	Albania	0.133	0.096

Sources: Author's own calculation based on the UN COMTRADE database.

RELATIVELY LOW VALUES OF INTRA-INDUSTRY COEFFICIENTS, AS WELL AS THEIR FALLING DYNAMICS, ARE IMPLYING THE DIVERGENCE BETWEEN THE OBSERVED TRADE STRUCTURES

...creating in this way no conditions for quality improvement of bilateral merchandise trade and indicating a prospect of a further slowdown in export and import flows between these economies.

Things look worse given the empirically detected growing trend of these coefficients in general, but also of the total trade of WB economies.

Yet, the development of trade with the EU seems even more important. All WB parties detected a strong growth of intra-industry trade with the EU since 2007. In this regard, the transition experience of European countries is particularly important for WB (they detected a strong growth of G-L since the 1990s). See ANNEX!

A low and declining intra-industry trade between the WB 6 is showing that cooperation between WB 6 via GVCs, specific for CEEs, has practically not been achieved.

Conclusion: The existence of CEFTA is moderately beneficial, at least because it instigates peaceful cooperation among those states

Yet, before CEFTA's foundation, the dominant portion of merchandise trade among WB6 was covered by bilateral free trade agreements, so when the (revised) CEFTA was inaugurated in 2006, the existing trading patterns were mostly confirmed.

Additionally, the legacy of the former Yugoslavia's internal markets, along with their consumer habits, the large number of ethnicities living outside their own domicile states, as well as practically the same languages used in Albania and Kosovo or Serbia, B&H and Montenegro, are all factors pushing for stronger cooperation among those economies, regardless of CEFTA.

Signs of declining significance of CEFTA

The shares of trade among WB 6 decreased in most observed cases.

In line with this is the stagnant structure of merchandise trade among these economies. Additionally, only mildly declining, or even rising, export concentration coefficients are detected in trade flows among WB6. Everything of this is in contrast with the trend of the same indices in the total and trade with the EU, which was significantly improved in the observed period.

Also, decreasing intra-industry trade also imply the declining role of CEFTA, especially regarding growth of intra-industry indices in the total and trade of WB6 with the EU.

THERE IS NO SOLID REASON TO PURSUE POLICIES FOR STRENGTHENING MUTUAL ECONOMIC TIES IN THE WB!

...especially given the prospect of EU integration (whose acceleration is necessary), which is of vital economic significance for all these economies.

Our findings are in line with some other studies. A working paper done by World Bank (2017) showed that efforts towards economic integration through the CEFTA have not increased the shares of trade within the WB despite the proximity - the opposite happened as the EU increased its dominant trade position for all WB parties.

European Commission (2018) stated that overall intra-regional trade has been stagnant, and has even relatively decreased since the 2009 crisis. Exports and imports among WB economies have remained concentrated in goods with low value-added (consisting largely of minerals, base metals, and foodstuffs) and their structure didn't change significantly in 2007-16.

EVEN ASSUMING RESULTS OF THIS STUDY SHOWING DIFFERENT REALITY IT WOULD BE NUMEROUS PROBLEMS REGARDING POSSIBLE DEEPER INTEGRATION IN THE WB

There is no genuine willingness of WB6 to pursue economic cooperation with each other and there are fears that the larger countries would dominate.

The conditions for a successful customs union, such as the EU, are quite specific and work well when members have similar economic profiles and exchange similar products, which is not the case in the WB.

The idea that a Balkan customs union attached to the EU could be an emergency solution, without having to expand the EU, is unrealistic given the historical legacy of animosity in the region as well as the non-complementarity of those economies.

The proposal about establishing a sort of “pre-membership”, where WB6 would take part in EU decision-making processes as observers (without voting rights), is also not an encouraging solution for WB 6.

Final stance: Any form of a customs union among WB6 is not a good option for them.

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Annex

Shares of (Medium- and) High-Tech products, High-skill and technology-intensive manufacture products, and Skill-intensive manufactures in WB exports 2007 and 2018

	2007	2018	2007	2018	2007	2018	2007	2018
	High-Tech		High Skill Tech-Int.		Skill-Intensive		Medium + High	
SRB	6.4	7.5	13.5	12.8	23.4	36.7	25.4	38.4
MAC	2.9	4.1	4.4	25.0	7.9	34.9	27.2	58.3
KOS	9.8	1.7	2.2	7.1	14.3	10.0	27.1	27.1
B&H	2.4	3.2	6.0	10.3	17.1	21.5	16.9	20.5
ALB	2.2	0.1	2.4	0.1	4.4	0.4	12.2	2.0
MNE	3.3	0.7	6.4	1.0	9.9	15.4	12.0	16.6

Shares of goods at higher levels of processing in WB merchandise export to the EU 28

	SERBIA		B&H		ALBANIA		N. MACED.		MONTEN.		KOSOVO	
	2007	2018	2007	2018	2007	2018	2007	2018	2007	2018	2007	2018
Skill-intensive manufactures	21.2	40.5	20.0	25.0	4.6	7.8	4.1	61.5	2.2	23.8	19.0	8.0
Medium + High	23.2	41.1	20.2	22.3	4.8	9.2	26.5	62.2	5.4	24.2	21.7	12.6

Standard Grubel-Lloyd index of intra-industry trade of WB countries with EU28 in 2007 and 2018

SERBIA		B&H		ALBANIA		N. MACED.		MONTENEGRO		KOSOVO	
2007	2018	2007	2018	2007	2018	2007	2018	2007	2018	2007	2018
0.342	0.572	0.339	0.407	0.262	0.296	0.215	0.307	0.067	0.101	0.055	0.101

Standard G-L index of intra-industry trade, total trade (Nikolić & Nikolić, 2020)

	2007	2018
B&H (2008)	0.398	0.430
N. Macedonia (2008)	0.289	0.365
Serbia	0.420	0.540
Kosovo	0.085	0.127

Export Concentration Ratio, WB 6's total export (Nikolić & Nikolić, 2020)

	2007	2018
Serbia	0.088	0.080
N. Macedonia	0.208	0.218
Albania	/	0.541
B&H	/	0.106
Montenegro (2011)	0.784	0.339

Export Concentration Ratio (Herfindahl-Hirschmann index), WB6 - EU28

	SERBIA	ALBANIA	B&H	MONTENEGRO	N. MACED.	KOSOVO
2007	0.135	0.249	0.152	0.784	0.265	0.282
2018	0.104	0.254	0.126	0.339	0.261	0.211