

# Market Economies of the Western Balkans Compared to the Central and Eastern European Model of Capitalism

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## Abstract

Using the Central and Eastern European model of capitalism, this paper compares the market economies of the Western Balkan countries to the post-socialist European Union member states. It analyzes the main institutional areas of a socio-economic system such as product markets, innovation system, financial system, labor market and industrial relations, social protection and the educational system. The comparison of institutional systems does not provide an unambiguous answer to the question of whether the Western Balkan market economies fit into the model. There are many similarities between the institutional arrangements of the two regions, and the differences seem to be a consequence of delayed reforms rather than of an alternative model. However, the question

of whether the current differences will be institutionalized or whether they will create a new normality—a new, distinct model of capitalism—remains open.

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**Keywords:** Central and Eastern European model of capitalism, economic transformation, Western Balkans, institutional comparison

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**JEL classification:** P16, P30, P52

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## 1 Introduction

The communist system collapsed in the Western Balkan (WB) countries at the same time as in the Central and Eastern European (CEE) countries. However, the conflicts and wars which accompanied the dissolution of Yugoslavia impeded the economic transformation from a socialist self-management system to a market economy. The reforms of transition have been achieved over the past 15 years. In 2015 both the International Monetary Fund (IMF) and the Vienna Institute for International Economic Studies (wiiw) published comprehensive reports on the economic transition and current challenges of the WB countries (Murgasova et al., 2015; Gabrisch et al., 2015). The question arises regarding the similarities between institutional settings of this region and CEE countries' institutional arrangements. Relying on the results of an empirical investigation, I assume in this paper that a distinct model of CEE capitalism can be outlined in the European Union. First, I summarize the essential features of this model, then I compare the institutional areas of the socio-economic system in the CEE model to the institutions of the WB countries. It must be emphasized that it is a very preliminary analysis and the aim of this paper is to provide ideas for further research rather than to reach final conclusions.

## 2 The Model of Capitalism in Central and Eastern Europe

Globalization and the fall of the Soviet Empire have made it timely to question whether countries are heading for a single model of capitalism as a result of international competition. The most influential line of literature in institutional comparison over the last fifteen years was the school of varieties of capitalism (VoC). Peter A. Hall and David Soskice (2001) published their volume of studies titled *Varieties of Capitalism. The Institutional Foundations of Comparative Advantage*. In its introduction, they elaborated a new theoretical framework for the survey of developed national economies. They introduced the two ideal types of capitalism, the coordinated and liberal market economy through the cases of Germany and the U.S.

Another line of economic literature studies particularly the member states of the European Union. In the 1990s, increasing attention was drawn to the national differences experienced among EU member states. Here I note three frequently quoted works on this topic: Ebbinghaus (1999), Boeri (2002), and Sapir (2006) described and verified the Anglo-Saxon, Nordic, Continental and Mediterranean models empirically. This approach also ignores the CEE countries.

In the last two decades, several attempts have been made to compare CEE countries with the existing models, but these cover only a few countries, or the scope of the applied data and viewpoint is not as wide as in the case of the old capitalist countries (e.g., Blanke and Hoffmann, 2008; Buchen, 2007; Cernat, 2006; Csaba, 2009; Feldmann, 2007; Lane, 2007; King, 2007; Knell and Srholec, 2007; Mykhnenko, 2007; Schweickert et al., 2013).

Nölke and Vlieghe (2009) prepare a thorough inventory of the attempts made so far in the framework of VoC to classify the market economies that have emerged in the transition countries. They note the discrepancy in these attempts because some studies have argued that the CEE countries converge towards the liberal model, while others claim that a convergence towards the coordinated

market economy occurred. A third group regards these countries as the hybrid variation of the two models. Nölke and Vliegenhart (2009) argue that the contradictory results can be attributed to the premature, mechanistic application of quantitative approaches. In their study, they prove the existence of a new capitalism model, which they termed a dependent market economy, but their investigation covers Visegrád countries only. The authors derive all features of the dependent market economy model from the essential role of foreign capital, which has a huge impact on the system of corporate governance, industrial relations, education and training, as well as the innovation system. It is without doubt that the role of foreign direct investment (FDI) has its special features compared to the developed, old-market economies, and it has an explanatory power concerning the evolution and operation of the institutional system. However, in their study, the authors apply FDI unilaterally as a single universal explanatory factor. In comparison with the study and book by Bohle and Greskovits (2007, 2012), it is striking how important elements are left out from the attempt to understand the institutional systems of the countries concerned.

Bohle and Greskovits (2007, 2012) argue that after the fall of the socialist system, three versions of capitalism emerged in Central and Eastern Europe: a purely neoliberal type in the Baltic states, an “embedded” neoliberal type in the Visegrád countries and a neo-corporatist system in Slovenia. When creating these types, the authors address new aspects, not those described so far. In addition to the usually examined fields of the welfare state and labor relations, industrial structural change, macroeconomic stability and even the dynamism of the political systems were subject to scrutiny. When compared to the studies above, an additional originality these authors bring to the discussion has to do with the fact that they take the specific features of the socialist legacies into account and, starting from here, present the evolution of the models from a historical perspective. In addition, they integrate the impacts of the EU and the transnational companies into their explanation.



north-western countries. Nowhere can state-induced research and development (R&D) compensate for this lack. To sum up, the CEE model did not emerge arbitrarily but as a response to the starting conditions—it cannot be regarded as a transitional state that will automatically progress toward some other European model of capitalism, and one could surmise that this institutional arrangement might be capable of reproducing itself.

The complementarity between the elements of the institutional arrangement described in the foregoing certainly suggests the likelihood of the model's sustainability. The capital flowing into less developed countries seeks out relatively cheap but suitably skilled labor and this attraction can be retained with a liberalized labor market. The survival of the liberalized labor market is assisted by weak unionization, but the former also limits the strengthening of trade unions. The lower productivity resulting from the underdeveloped domestic economy and the lower added value of the production conducted at foreign corporations permit a relatively low level of investment in human capital both in education and in the social services. This result, however, not only makes the residual welfare state durable but also limits the development of R&D&I systems, which, in turn, maintains the asymmetric dependence on the OMS and the highly developed countries in general. This type of institutional complementarity can be dismantled if the FDI can fulfill the role that economists expected of it at the time of change in the political system, in other words, if the spillover effect enables the domestic economy to converge with that of the highly developed countries in terms of productivity. There are possibilities of upgrading along the value chain for both subsidiaries and domestic suppliers, but the outlook on upgrading experiences in CEE is very mixed (see, e.g., Éltető, Magasházi and Szalavetz, 2015).

Overall, on the one hand, the development model of the CEE countries undoubtedly led to successes. Even in the unfavorable global economic situation, the pace of growth is slower, but in this region—unlike in the Mediterranean region—convergence continues in the majority of the countries (Table 1). On

the other hand, it is clear from the foregoing that the features of the current CEE model do not support the prevalent thinking that the new, post-socialist member states are on a development path that differs from the OMS only in quantitative terms and that convergence is only a matter of time. Table 1 also shows that the non-EU member WB countries, which started from a low base line at the beginning of the 2000s, have made very little progress in convergence toward the EU average GDP level. This begs the question of whether this lag has institutional or other reasons.

**Table 1:** *Economic Performance of the CEE EU Member States and the WB Countries in GDP Per Capita*

	<i>Real GDP 1989=100</i>	<i>GDP per capita in PPS, EU-28=100</i>				<i>Convergence to EU average in pp</i>
	<b>2003*</b>	<b>2004**</b>	<b>2008</b>	<b>2009</b>	<b>2014</b>	<b>2004–2014</b>
<b>EU member states</b>						
Estonia	104.9	55	68	62	76	21
Latvia	87.9	47	60	53	64	17
Lithuania	86.7	50	63	56	75	25
Poland	134.5	49	54	59	68	19
Czech Republic	107.4	79	81	83	85	6
Slovakia	114.2	56	72	71	77	21
Hungary	115.3	62	63	64	68	6
Slovenia	119.5	86	89	85	83	-3
Croatia	91.2	57	63	62	59	2
Romania	92.6	34	48	49	55	21
Bulgaria	87.0	35	44	45	47	12
<b>Western Balkan countries</b>						
Montenegro	50.1	30	41	40	41	11
FYR Macedonia	81.4	27	33	35	37	10
Albania	123.6	22	26	29	30	8
Serbia	50.1	32	36	36	37	5
Bosnia and Herzegovina	:	24	27	28	29	5

Notes: \* Due both to the quality of the statistical data from that time and to the quality of the commodities making up GDP back then, this comparison is suitable only as a very approximate guide. \*\* Data are available for Montenegro, FYR Macedonia, Albania, Serbia, and Bosnia and Herzegovina from 2005; data are not available for Kosovo.

Source: Author's construction based on Eurostat online databases and UNECE (2004: 80).

In many cases, data on WB countries are missing, which hinders the performance of a cluster analysis to compare these countries to the CEE countries. Thus, I use descriptive statistics. In the comparison it is reasonable to scrutinize the achievement of three subgroups of the CEE model: the Baltic states (Estonia, Latvia, and Lithuania), the Visegrád countries (Poland, the Czech Republic, Slovakia, and Hungary), Slovenia (CEE5), and Bulgaria and Romania (SEE2). Due to its later EU accession, Croatia is shown separately. Not only do institutional analyses support this distinction (e.g., Bohle and Greskovits, 2012), but recent research applies CEE5 as a reference group (Gabrisch et al., 2015; Murgasova et al., 2015). Despite its special characteristics, Slovenia is closer to Visegrád countries than to others. The Baltics consists of small market-sized economies, which are comparable to the WB countries in this respect, apart from Serbia. The comparison to SEE2 may indicate the impact of the common legacy of the Balkan countries. The data of non-EU member WB countries are not aggregated because their differences may be interesting. Croatian experts emphasize that in spite of seven decades of common history and institutional systems, their economies have become different very soon after the dissolution of Yugoslavia (Bićanić, Deskar-Škrbić and Zrnc, 2016).

### **3 Transformation of the Product Markets, the Innovation System and the Financial System**

It is generally accepted that in the CEE countries, transformation FDI inflows accompanying privatization played an outstanding role. These countries have benefited from the integration into global supply chains—especially the Visegrád countries—and by being part of the German supply chain in machinery and transport equipment sectors, they have become export-driven, open economies. Estrin and Uvalic (2013) find a different role of FDI in the WB countries. On the one hand, due to lower national savings and investment in these countries (and SEE2), FDI has a much more significant contribution to the gross fixed capital



formation in the Balkans than in the CEE5 and Baltic states. On the other hand, even taking into account the greater distance to the major investor countries, the WB countries have received less FDI than the EU members, especially the non-Balkans. Table 2 also shows an ambiguous situation. The average inward FDI stock as a percentage of GDP is not lower in the WB countries when compared to other country groups of CEE EU members. However, the per capita inward FDI stock is much lower and the WB countries remained significantly less open economies in terms of exports than the EU members. It suggests that the business environment is not able to attract and to absorb more FDI.

*Table 2: Trade Openness and the Inward FDI Stock*

	<i>Exports of goods and services, in % of GDP</i>	<i>Inward FDI stock, as a % of GDP</i>	<i>Inward FDI stock per capita, in EUR</i>	<i>Share of manufacturing as a % of inward FDI stock</i>	<i>High-tech medium high-tech export*</i>
	2014	2013	2013	2012	2013
Baltic states average	74.8	56.4	7,262	17.7	34.7
CEE5 average	77.8	57.0	7,099	30.1	59
SEE2 average	53.1	69.3	4,168	24.4	38.7
Croatia	46.3	54.3	5,529	26.8	37.6
Albania	28.1	37.6	1,309	25.5	4
Bosnia and Herzegovina	n.a.	44.7	1,563	30.6	19
Kosovo	19.6	53.3	1,517	n.a.	7
FYR Macedonia	47.8	52.1	1,929	29.9	27
Montenegro	40.1	116.9	6,290	n.a.	11
Serbia	43.4	66.3	2,956	n.a.	32

Note: \* The source of the EU members data is the European Commission (2015c), the others' source is Gabrisch et al. (2015). European Commission (2015c) publishes a higher value of high-tech and medium high-tech export for FYR Macedonia (45.6 percent) and Serbia (41.1 percent).

Source: Author's construction based on European Commission (2015c: 82–83), Eurostat online databases, Gabrisch et al. (2015: 75), and Hunya (2014: 35, 39, 51–52).

The share of manufacturing in FDI stock is not smaller in the WB countries where data are available, than in the EU members (Table 2). However, the composition of FDI in manufacturing is less advantageous than in the CEE5 countries. Tables 2 and 3 clearly show that FDI has gone to manufacturing sectors of lower

value added products, which is reflected in the smaller ratio of high-tech and medium high-tech exports. In addition, the capital inflows followed the Baltic patterns, and FDI was directed into non-tradable sectors rather than tradable sectors (Murgasova et al., 2015: 48).

**Table 3:** *Inward FDI Stock by Top 3 Economic Activities, in 2012*

	<b>Top 3 activities in inward FDI stock</b>	<b>Top 3 activities within manufacturing</b>
Croatia	Financial intermediation	Coke, refined petroleum products, and nuclear fuel
	Manufacturing	Chemicals, chemical products, and man-made fibers
	Real estate, renting, and business activities	Other non-metallic mineral products
Albania	Manufacturing	Other, not elsewhere classified industries
	Mining and quarrying	Other non-metallic mineral products
	Financial intermediation	Food products, beverages, and tobacco
Bosnia and Herzegovina	Manufacturing	Coke, refined petroleum products, and nuclear fuel
	Financial intermediation	Food products, beverages, and tobacco
	Real estate, renting, and business activities	Other non-metallic mineral products
FYR Macedonia	Manufacturing	Basic metals, fabricated metal products, except machinery and equipment
	Financial and insurance activities	Transport equipment
	Wholesale, retail trade, repair of motor vehicles etc.	Food products, beverages, and tobacco products

Note: Data are not available for Kosovo, Montenegro, and Serbia.

Source: Author's construction based on Hunya (2014: 58, 97, 99, 101).

Services have an approximately 70 percent share in the gross value added in both the EU members and the WB countries. Although the export of services—seen as a percentage of GDP—is higher in the WB countries when compared to the CEE5 countries, and although their trade balance is positive, they cannot offset the deficit of trade of goods. The most significant activities of service exports are tourism and transport (Gabrisch et al., 2015: 86–93).

The difference between the EU members and WB countries is pronounced in their economic structures in terms of gross value added by the other two sectors. Whereas the share of industry in gross value added is lower in Albania, FYR Macedonia, and Montenegro, even in the Baltics, agriculture, forestry, and fisheries represent a substantially higher share in the WB countries than in the EU members (Table 4).

**Table 4:** *Gross Value Added by Sector, in %*

	<b>Agriculture, forestry, and fisheries</b>	<b>Industry</b>
Baltic states average	4.1	21.5
CEE5 average	3.4	27.0
SEE2 average	5.6	29.7
Croatia	4.4	21.0
Albania	22.5	14.4
Bosnia and Herzegovina	8.0	21.6
Kosovo	14.4	20.3
FYR Macedonia	11.0	17.9
Montenegro	9.8	13.8
Serbia	9.4	26.6

Source: Author's construction based on Eurostat online databases and European Commission (2015a: 77; 2015b: 67; 2015d: 65; 2015e: 79; 2015f: 76; 2015g: 77).

Considering the economic structure and the composition of FDI, it is not surprising that gross domestic expenditures on R&D in the WB are well below the level of the Baltic states and CEE5 countries (Table 5). Even these data are uncertain in some WB countries and only Serbia and Macedonia are involved in the European Innovation Scoreboard analyzing the performance of their innovation systems. Serbia belongs to the group of moderate innovators and Macedonia to the modest innovators (European Commission, 2015c). However, it is more encouraging that 18 percent of firms are engaged in either product or/and process innovation, and 29 percent in organizational or/and marketing innovation (Sanfey, Milatović and Krešić, 2016: 33).

*Table 5: Indicators of Business Environment and R&D Expenditure*

	<b>Doing Business scores 2016</b>	<b>EBRD Transition indicators* 2014</b>	<b>Gross domestic expenditure on R&amp;D, as % of GDP** 2013</b>
Baltic states average	78.99	3.9	1.09
CEE5 average	74.84	3.8	1.52
SEE2 average	73.75	3.7	0.52
Croatia	72.71	3.8	0.81
Albania	60.50	3.5	≈0.4
Bosnia and Herzegovina	63.71	3.1	0.33
Kosovo	66.22	2.9	<0.2
FYR Macedonia	80.18	3.6	0.44
Montenegro	71.85	3.3	0.38
Serbia	68.41	3.2	0.73

Notes: \* The measurement scale for the indicators ranges from 1 to 4+, where 1 represents little or no change from a rigid centrally-planned economy, and 4+ represents the standards of an industrialized market economy. The Czech Republic and Estonia are not assessed. \*\* The source of the data for the EU members, Montenegro, and Serbia is the Eurostat database, and European Commission reports for all other countries.

Source: Author's construction based on EBRD's online databases, Eurostat online databases, European Commission (2015a: 66; 2015b: 70; 2015d: 47; 2015g: 80), and World Bank (2016a: 5).

As we have seen above, the scale of FDI inflows indicates that the business environment in the WB countries has not sufficiently developed yet. Their World Bank's Doing Business scores have increased, but they are lower than the EU members' scores, with the exception of FYR Macedonia. These scores measure how easy it is to do business, and this ranking does not comply fully with the EBRD transition indicators, which measure the progress of privatization and liberalization reforms (Table 5). The price and trade liberalization is completed in each WB country, but many inefficient state-owned enterprises with weak governance remain to be privatized. The indicator of large scale privatization is equal or below 3 in Bosnia and Herzegovina, Kosovo, and Serbia, and the indicator of governance and enterprise restructuring is between 2 and 2.7 in each country.

Financial sectors underwent significant transformation in the WB countries prior to the 2008 global crisis. The new institutional setting is very similar to

the CEE financial systems. Financial deepening has been driven by FDI, and the banking system has been dominated by foreign owners. Financial systems are bank-based, and the role of financial markets in funding is meager (Table 6). The assets of investment, insurance, and pension funds are less than 20 percent of the assets of the financial sectors in WB countries (Gabrisch et al., 2015: 43). In the aftermath of the crisis, the slowdown of economic growth and credit demand affected both the banking sector and stock market capitalization. The deleveraging process has decreased the banks' assets, and the rate of stock market capitalization has also diminished, but the institutional system remains unchanged. The monetary regimes of the Balkan countries are just as different as those of the EU members: Montenegro and Kosovo unilaterally adopted the euro; Croatia and Serbia introduced a managed float; Macedonia pegs against the euro; Bosnia and Herzegovina has a currency board; Albania adopted a floating exchange rate (EBRD online databases).

**Table 6:** *Some Important Indicators of the Financial System*

	<i>Deposit money banks' assets to GDP*, in %</i>	<i>Foreign bank assets among total bank assets**, in %</i>	<i>Bank deposits to GDP, in %</i>	<i>Private credit by deposit money banks and other financial institutions to GDP*, in %</i>	<i>Stock market capitalization to GDP, in %</i>
	<b>2013</b>	<b>2013</b>	<b>2013</b>	<b>2013</b>	<b>2012</b>
Baltic states average	75.9	82	42.6	72.2	7.1
CEE5 average	72.0	66	55.6	57.1	16.3
SEE2 average	58.2	71	50.5	52.9	11.9
Croatia	97.5	90	68.7	69.9	37.0
Albania	62.7	81	68.9	37.7	n. a.
Bosnia and Herzegovina	59.5	86	46.5	51.9	n. a.
Kosovo	32.8	n. a.	37.7	35.1	n. a.
FYR Macedonia	55.5	66	53.3	47.8	5.8
Montenegro	61.4	89	50.1	53.3	85.8
Serbia	60.7	74	42.9	48.2	17.7

Notes: \* Data are available for Bulgaria, the Czech Republic, Hungary, Latvia, Lithuania, and Poland from 2008; for Croatia from 2012; for Kosovo from 2011. \*\* Data are available for Lithuania, Hungary, Poland, and Romania from 2012.

Source: Author's construction based on World Bank's Global Financial Development online database.

Although before the global crisis the banking systems of the WB countries—except for Montenegro—relied less on fast-moving wholesale funding than CEE EU members, the level of non-performing loans has increased more than in the CEE5. The Baltic states, which also reached a very high immediate post-crisis peak, were able to reduce the level of non-performing loans very soon due to comprehensive reforms. This comparison highlights the fact that in the WB countries, financial sectors require further reforms (Table 7). In the areas of supervision of financial institutions, crisis resolution, financial safety nets, and the introduction of the Basel Framework, WB countries have not kept pace with the CEE EU members. Furthermore, the strengthening of enforcement power is unavoidable (Murgasova et al., 2015).

*Table 7: Transition Indicators of the Financial System*

	<b>Banking</b>	<b>Insurance and other financial services</b>	<b>MSME finance</b>	<b>Private equity</b>	<b>Capital markets</b>
Baltic states average	3.3	3+	3	2.3	3
CEE5 average	3.5	3+	3.2	2.7	3.2
SEE2 average	3	3+	3	3-	3-
Croatia	3+	3+	3-	2+	3+
Albania	3-	2	3-	1	2
Bosnia and Herzegovina	3-	2+	2+	2-	2
Kosovo	2+	2	3-	1	1
FYR Macedonia	3-	3-	3	1	2-
Montenegro	3-	2+	3	1	2
Serbia	3-	3	3	2	2

Note: The measurement scale for the indicators ranges from 1 to 4+, where 1 represents little or no change from a rigid centrally-planned economy and 4+ represents the standards of an industrialized market economy. The Czech Republic is not assessed. MSME: micro, small, and medium enterprise.

Source: Author's construction based on EBRD (2015: 91).

The 2011 euro zone crisis and the following risk aversion induced a new wave of deleveraging from the region. The Vienna II initiative launched in March 2012 could have decelerated but not prevented the withdrawal of funds from the region. Between 2011 and 2014, the Western Balkans lost around eight percent

of the region's GDP in external bank funds. This loss was smaller in comparison to the eleven CEE EU member states, where it amounted up to 18 percent of the region's GDP. The restructuring continues for several global banking groups operating in the region though on a smaller scale than earlier (Sanfey, Milatović and Krešić, 2016: 36).

## **4 Labor Market Performance, Industrial Relations, Social Protection and the Education System**

The most critical issue of the WB countries' transformation is the performance of labor markets. Unemployment rates were high even in the boom years of the 2000s, and the increase of unemployment exceeded the contraction of GDP through the years of global crisis, with the unemployment rates of 2014 remaining around the level of 2000 (see Table 8 and Gligorov, Ognjenović and Vidovic, 2011: 78). The difference in unemployment rates is enormous between the WB countries and EU members (with the exception of Croatia), and in youth unemployment the difference is dramatic. In such cases a rigid labor regulation usually hinders better outcomes. However, in general, the employment protection regulation (EPL) composite indicators are not higher in the WB countries than in their EU member peers (Table 8). Some sub-indicators in some countries are relatively high but these cannot explain the poor labor market performance of the WB countries. As anecdotal evidence suggests, it is more likely that differences between legislated and actual practices continue to persist (Kovtun et al., 2014). Furthermore, during the crisis, most countries resorted to passive measures to address rising unemployment or to prevent it. Despite governmental efforts, active labor market policy instruments are less used (Alishani, Shabani and Gjonbalaj, 2013).

Wages grew rapidly before the global crisis and productivity gains did not keep up with wage increases. Since the onset of the crisis, Albania has experienced

a downward wage adjustment similar to the Baltic states. In Bosnia and Herzegovina the unit labor cost has decreased due to productivity growth, and Serbia has improved its wage competitiveness through currency depreciation. In Montenegro, wages continued to outpace productivity. Similarly, there is no general trend in minimum wages and tax wedges. While in some WB countries minimum wages are higher when compared with their peer counterparts, in some other countries the tax wedges are higher (Kovtun et al., 2014). To sum up, labor costs can contribute to poor labor market performance but are not the main factors triggering them.

*Table 8: Some Important Labor Market Indicators*

	Employment rate, age group 20–64, in %, 2014	Unemployment rate, age group 15–74, in %, 2014	Youth unemployment rate, age group 15–24, in %, 2014	EPL 2007	Personal remittances, received, in % of GDP, 2014
Baltic states average	72.2	9.6	17.9	2.5	4.1
CEE5 average	68.0	9.1	22.0	2.0	1.9
SEE2 average	65.4	9.1	23.9	2.4	2.4
Croatia	59.2	17.3	45.5	2.7	3.8
Albania	56.6	17.5	39.0	2.1	8.6
Bosnia and Herzegovina	43.2	27.6	62.7	2.6	11.4
Kosovo	31.3	35.3	61.0	2.5	n. a.
FYR Macedonia	51.3	28.0	53.1	3.1	3.2
Montenegro	55.6	18.0	35.8	2.2	9.4
Serbia	53.5	18.9	47.1	2.2	8.4

Note: EPL for EU member states and Kosovo is available from the early 2000s.

Sources: Eurostat online databases, European Commission (2015a: 79; 2015b: 69; 2015d: 66; 2015e: 81; 2015f: 78; 2015g: 79), Gabrisch et al. (2015: 111), Kogan, Gebel and Noelke (2008: 55), and World Bank's online databases.

It seems to be more important that due to the delayed transition, diversification from traditional sectors and private sector job creation is still lagging compared to CEE EU members. As a consequence of the weak functioning of formal sectors, vast informal sectors have developed. The estimates of informality (and the used methodologies) vary. Schneider, in collaboration with A.T. Kearney and Visa (2013: 4) suggests that the informal (shadow) economy accounts for 20 percent



of GDP in CEE5, 27 percent in the Baltics, and 30 percent in the SEE2. The European Commission (2008: 43) and Arandarenko and Bartlett (2012: 122) accept that about one third of the GDP is being produced informally in the WB countries, and, in some cases, such as in Kosovo, Albania and FYR Macedonia, that share is even higher. In terms of employment, the informal sectors' share varies between 30 and 60 percent of total employment. Gabrisch et al. (2015: 105) refer to the 2012/2013 data, which show an improving trend in Serbia and FYR Macedonia with 19.3 and 22.5 percent informal employment, respectively.

The striking difference between the CEE EU members and the WB countries is the level of remittance inflows as percentage of GDP (Table 8), which is very high in the WB countries despite the decrease during the crisis years (Bartlett and Prica, 2012: 15). This difference influences the behavior of employees because these transfers can allow job seekers to extend the period of job search and increase reservation wages. In addition, large-scale migration is associated with the brain drain (Kovtun et al., 2014).

Industrial relations in WB countries resemble those of CEE EU members. Although trade union density is higher than in the Baltics and CEE5 (Table 9), it is due to strong union presence in public sectors. Trade union density is low in the private sector, thus the trade unions' bargaining power has declined. The inherited centralized organization systems have become more fragmented. Collective bargaining is largely dominated by company agreements. In most countries, except in Bosnia and Herzegovina and Kosovo, a council for tripartite consultations exists, but in many cases only on paper (European Commission, 2008; Kohl, 2010). The self-management system of the former Yugoslavia has not been transformed to social partnership in a market economy. According to the Global Competitiveness Index (GCI), executive opinion surveys reflect low levels of cooperation in labor–employer relations, except in Albania and FYR Macedonia (Table 9).

A comparison of social protection systems is much more difficult to draw than that of the above analyzed areas due to an almost complete lack of comparable data. As in many CEE countries, in the WB countries Bismarck's legacy of social insurance, which was delivered by the Austro-Hungarian Empire and the Kingdom of Yugoslavia, was incorporated in the welfare system of the communist regime. The system covered a range of social risks but in a dual structure, only those employed in the socialist industrial sector received work-based benefits, while others (e.g., small farmers, professionals such as lawyers etc.) could access a voluntary insurance scheme. In Albania, the social insurance system was established for the first time in 1991. The transformation since the 1990s has not resulted in a single "Western Balkan way" but in a variety of social protection systems (Bartlett, 2012; European Commission, 2009). The recession of transformation, wars and conflicts eroded the economic basis of social services and transfers. Furthermore, the social consequences of the 2008 global crisis were especially severe in the region (Bartlett and Uvalic, 2013). It is not easy to compare the current level of social inequalities and poverty between the CEE EU members and the WB countries. According the GINI index, social inequalities are higher than in the CEE5 countries but similar to those of the Baltics and SEE2. The share of population which lives below a 5 USD threshold (measured at PPP) is very different among the WB countries, and the data—even if reliable—are collected from various years. The data of Eurostat on the share of people at risk of poverty or social exclusion are gathered from the same year using the same methodology, but Serbia and FYR Macedonia are the only non-EU members which have the available data. The latter data suggest that the extension of poverty or social exclusion is similar to SEE2 countries but substantially higher than in the Baltics and CEE5 countries. The comparison of social protection expenditure is also only an estimate. IMF data on the general governments' social benefit expenditures are not available for three WB countries. The Eurostat data on social protection expenditures include the activities of both the public and private bodies (non-profit institutions serving households), but in four WB countries there are only earlier data on public expenditures (Table 9).

**Table 9:** *Some Indicators of Industrial Relations and Social Protection*

	<i>Trade union density, in %</i>	<i>Cooperation in labor–employer relations, GCI score</i>	<i>GINI index</i>	<i>Absolute poverty at 5 USD PPP per day, % of population</i>	<i>People at risk of poverty or social exclusion<sup>2</sup>, in %</i>	<i>Expenditure on social protection, % of GDP</i>	<i>Social benefits, % of GDP</i>
	2008	2015	2014*	Latest data before 2010**	2014	2013***	2013
Baltic states average	12	4.7	35.3	15.0	28.7	14.8	13.9
CEE5 average	21	4.2	26.9	13.5	22.0	20.4	17.6
SEE2 average	27	4.0	35.0	32.5	40.2	16.2	13.2
Croatia	33	3.6	30.2	2.0	29.3	21.7	18.1
Albania	23	5.0	29.0	33.4	n. a.	6.7	9.3
Bosnia and Herzegovina	30	3.5	36.2	8.0	n. a.	15.1	15.8
Kosovo	20-25	n. a.	n. a.	82.0	n. a.	14-17	n. a.
FYR Macedonia	30	4.4	35.2	37.0	43.2	n. a.	n. a.
Montenegro	35	3.9	26.2	49.2	n. a.	12.7	n. a.
Serbia	33	3.4	38.6	17.1	43.1	23.3	19.5

Notes: \* Data are available for Albania from 2012, for Bosnia and Herzegovina from 2007, and for Montenegro from 2013. \*\* Data are not available for the Czech Republic, Lithuania, Slovakia, and Slovenia. \*\*\* Data are available for public expenditures in the case of Albania from 2005, of Bosnia and Herzegovina from 2006, of Montenegro from 2007, and excluding health expenditures, of Kosovo from 2007. EU definition of social protection encompasses interventions from both public and private bodies.

Source: Author's construction based on European Commission (2009: 44–45; 2015e: 82), Eurostat online databases, IMF's Government Finance Statistics online database, Kohl (2010: 6, 11), Schwab and Sala-i-Martin (2015), UNU-WIDER (2015), and World Bank (2010).

With the exception of Kosovo, which has introduced universal social benefits, other WB countries maintain the social insurance schemes accompanied by low-level social expenditures. This institutional arrangement is also typical in the

2 This indicator corresponds to the sum of persons who are at risk of poverty, severely materially deprived or living in households with very low work intensity. Persons are only counted once even if they are present in several sub-indicators. At risk of poverty are persons with an equivalized disposable income below the risk-of-poverty threshold, which is set at 60 percent of the national median equivalized disposable income (after social transfers). Material deprivation covers indicators related to economic strain and durables. Severely materially deprived persons have living conditions severely constrained by a lack of resources, they experience at least four of the following nine deprivation items: cannot afford: (i) to pay rent or utility bills; (ii) keep their home adequately warm; (iii) face unexpected expenses; (iv) eat meat, fish or a protein equivalent every second day; (v) a week holiday away from home; (vi) a car; (vii) a washing machine; (viii) a color TV; or (ix) a telephone. People living in households with very low work intensity are those aged 0-59 living in households where the adults (aged 18-59) have worked less than 20 percent of their total work potential during the past year.

CEE EU members. The social insurance system in Albania is associated with residual means-tested social assistance for those not covered by social insurance and extremely low expenditures. In the other WB countries, the social assistance benefits are targeted at politically influential groups such as the veterans of 1990s wars and pensioners, and the systems have become fragmented and discretionary with very little impact on poverty. Due to low formal employment, large informal economies, emigration, and ageing societies, WB countries are forced to reduce public pension spending, which exceeds the level of CEE EU members' average—except in Albania and Kosovo. The introduced pension reforms widely varied in their structure and scope (Bartlett, 2012; European Commission, 2009; Murgasova et al., 2015). Strong status preservation is similar to that of the CEE5 systems.

Unlike other institutional areas, the educational system has no elaborated models in the literature on institutional comparison of socio-economic systems, and there are few obtainable indicators which could support a well comparison. Even the data, which reveal some elements of educational systems, are incomplete concerning Bosnia and Herzegovina, Kosovo, FYR Macedonia, and Montenegro. The level of enrolment in primary and secondary education was high in the socialist countries in general. Similarly to most post-socialist countries, during the transition period, there was little investment in upgrading the educational systems. Therefore, in WB countries, the skills of the workforce have deteriorated despite the relatively advantageous inheritance from the previous system.<sup>3</sup> Nowadays, Croatian students' performance is close to the results of the CEE5 countries, the Serbian results are closer to the SEE2 average. Both public expenditure and total enrolment in tertiary education are below the level of the Baltics and CEE5 (Table 10).

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3 “By 1981, in Yugoslavia, illiteracy rates had fallen to 9.5% of the population, from 25.4% in 1948, albeit with some regional differences, ranging from 0 % in Slovenia and 5.6% in Croatia to 14.5% in Bosnia and Herzegovina and 17.6% in Kosovo. The proportion attending high schools rose in the same period from 0.6% to 5.6%, with much smaller regional variations” (European Commission, 2009: 9).

**Table 10:** *Some Indicators of the Educational System*

	<i>PISA results 2012</i>			<i>Public expenditure on education as a % of GDP*, 2011</i>	<i>Total enrolment in tertiary education, in %**, 2013***</i>
	<i>Mathematics</i>	<i>Reading</i>	<i>Science</i>		
Baltic states average	497	494	513	5.09	71
CEE5 average	495	488	503	4.78	66
SEE2 average	442	437	443	3.44	59
Croatia	471	485	491	4.21	62
Albania	394	394	397	3.3	59
Bosnia and Herzegovina	n. a.	n. a.	n. a.	n. a.	n. a.
Kosovo	n. a.	n. a.	n. a.	4.4	n. a.
FYR Macedonia	n. a.	n. a.	n. a.	n. a.	38
Montenegro	410	422	410	n. a.	n. a.
Serbia	449	446	445	4.3	56

Notes: \* Data are available for Albania and Kosovo from 2014, and Serbia from 2013. \*\* Total enrolment in tertiary education (ISCED 5 to 8), regardless of age, expressed as a percentage of the total population of the five-year age group following on from secondary school leaving. \*\*\* 2013 or the latest available data.

Source: Author's construction based on European Commission (2015a: 80; 2015d: 67; 2015f: 79), Eurostat online databases, OECD (2014), and World Bank's online databases.

However, the real problems of educational systems are analyzed in county reports and in-depth case studies. Higher education reforms are marked by privatization, marketization, and introduction of the Bologna system. The insufficient capacity and financial resources of state universities have led to a boom in establishing private institutions. In 2010–2011, 47 state universities and 250 private institutions existed in the WB countries including Croatia. As a consequence, the organizations of higher education have become fragmented, the average student number in private universities has been around 500, and satisfactory quality assurance has not been solved yet. The largest share of students attending private universities can be found in Kosovo (37 percent), and the smallest in Croatia (6 percent). In addition to high tuition fees at private universities, a significant number of self-financing students at state universities also entails that education has become less accessible to the lower socio-economic classes, and this exacerbates inequality in education (Gabrisch et al., 2015: 112; Babović and Vuković, 2015: 22–24).

Recently, vocational education and training has been given more attention all over in Europe in relation to economic competitiveness. Based on country case studies, Bartlett et al. (2014) report on different enrolment rates in WB countries: while the share of students following vocational programs is very low in Albania—Serbia, Croatia, and Montenegro have maintained their vocational system and have relatively high shares of students enrolled in vocational programs. According to this report, critical problems of vocational education are the poor teaching quality and the lack of appropriate skills taught in many vocational schools in the region.

The problems of both higher and vocational education are reflected in the skill mismatch which can be experienced in the labor markets of the WB countries (Arandarenko and Bartlett, 2012). This skill mismatch is another important factor explaining the persistently high unemployment rates.

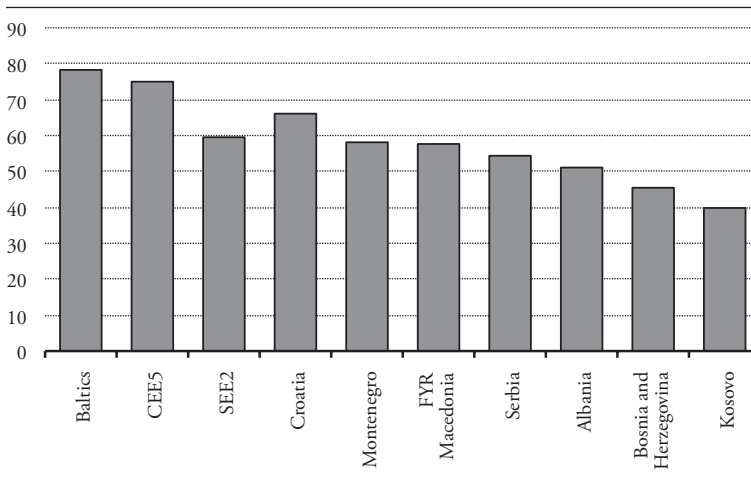
## 5 The Quality of Governance

Recent institutional comparisons in the EU and the CEE countries have shown that the state plays a fundamental role not only in running social services and the educational system, but directly in the performance of the economic system. Therefore, the operation method of the state has to be integrated more organically into the models because the professionalism of regulation, the level of corruption, and other elements of good governance fundamentally affect the operation as well as the competitiveness of the institutional system of economy (Farkas, 2016; Szanyi, 2013).

The World Bank also has a research dataset—Worldwide Governance Indicators (WGI)—focusing on good governance in terms of both efficiency and rule of law. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, international organizations, and private sector firms. Although the composite indicators based on opinion surveys are “soft” data, we have no other comparable datasets. The Worldwide Governance

Indicators project constructs aggregate indicators of six broad dimensions of governance: voice and accountability, political stability and absence of violence/terrorism, government effectiveness, regulatory quality, rule of law, and control of corruption. The results of surveys are converted into a percentile ranking of all countries, in which the northern and north-western EU members are above 90 percent. The average value of the indicators of six broad dimensions of governance is between 70–80 percent in the Baltics and CEE5 countries and below 60 percent in the Balkan countries, except in Croatia (Figure 1). This great difference suggests that the above outlined unfinished reforms in several areas are not only a consequence of delayed transformation but also that of the weaker administration capacity of the WB countries. However, the administration capacity depends also on transformation. Sanfey, Milatović and Krešić (2016: 6, 29) display a close correlation between WGI and transition indicators in the CEE and WB countries. The latter made substantial progress between 2000 and 2014.

**Figure 1:** *Worldwide Governance Indicators Ranking of the CEE EU Members and WB Countries in 2014*



Source: Author's construction based on Kaufmann and Kraay (2015).

The importance of governance is indicated by the fact that the key finding of the recent research of the Global Development Network Southeast Europe is “that processes of state-building and their failure have been mostly responsible for both spurts and failures of industrialization” (wiiw, 2016).

## 6 Conclusion

The comparison of institutional systems does not provide an unambiguous answer to the question of whether the Western Balkan market economies fit the capitalism model of the CEE EU members. FDI inflows have not modernized the economies of Western Balkans to the extent seen in the CEE EU members, and they have remained less open economies with weaker competition. However, this can partly be explained by the delayed and unfinished reforms and the differences between the two regions’ product markets, which seem to be structural rather than the consequence of an alternative institutional arrangement. The delayed and unfinished product market reforms entail the poorer development level of innovation systems especially in the smaller WB countries. The financial systems in WB countries are strongly bank-based, dominantly foreign-owned, and the institutional difference in comparison with CEE EU members is seen in some uncompleted regulation reforms.

We can find more pronounced differences in institutional areas related to human capital. The extremely low formal employment, the extended informal employment, and the large share of remittances in personal incomes highlight not only parametric but institutional differences between the CEE EU members and the WB countries, which can, in turn, lead to different rules in the actors’ behavior on labor markets. In contrast to labor markets, industrial relations follow basically similar patterns in the two regions. In the majority of WB countries, the basic elements of the social protection system, that is, the social insurance scheme with the—in European terms—low level of social expenditures, comply with the CEE model, but, as we have seen, there are unique features in the region.



The available data does not allow an assessment of whether the differences in educational systems between the two regions are quantitative or qualitative, and the differences seem to be substantial even among the WB countries.

Differences in good governance are worrying, especially between the Baltics, CEE5 countries and the WB countries, because the achievement of all the above mentioned reforms depends on the administration capacities of the states.

The reform policy agendas in WB countries—partly induced by international and EU institutions—set the target for the achievement of further reforms, which would result in the CEE model of capitalism. Will such a model be realized or will the current differences be institutionalized, creating thereby a new normality, a new and a distinct model of capitalism, remains an open question.

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