

Analysis of the Western Balkans Territories Using the Index of Economic Freedom¹

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Abstract

The aim of the paper is to assess the current state of economic freedom in the Western Balkans region using the Index of Economic Freedom. From the Western Balkans territories, the best rating in the observed period of 2010 – 2019 is achieved by the Republic of North Macedonia and the worst by Bosnia and Herzegovina. According to the 2020 Index of Economic Freedom, the region belongs to the group of moderately free economies. The investment and business environment of the Western Balkans is at a low level. The reason is poor law enforcement, corruption, organized crime, or the shadow economy.

Key words

Index of Economic Freedom, investment and business environment, region, Western Balkans

JEL Classification: F14, F19

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Introduction

Geographically, the Western Balkans region is an important trade and power crossroads between East and West. The common goal of the EU and the Western Balkans is strong, stable and united Europe based on historical and cultural, geographical ties and common political, security and economic interests [the Council of the European Union, 2020].

The Western Balkans territories are among the poorest in Europe and their pace of convergence with European standards is slow. Due to unfavourable historical development, the economies of the Western Balkans are struggling with several problems such as high unemployment, corruption in government institutions, organized crime and shadow economy. In recent years, the region has achieved significant progress in the process of economic transformation, democratization and implementation of reforms.

Unemployment, the overall economic situation and corruption remain the main concerns of residents of the region. Lack of adequate work and nepotism are specified

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as two main barriers to employment. It follows that confidence in employers, whether private or public, is at a low level. Jobs are created in low-income sectors. Unemployment is also considered to be a major cause of social exclusion. Almost half of the population is dissatisfied with the security situation in the region [Regional Cooperation Council, 2020].

1 Methodology

The aim of the paper is to assess the current state of economic freedom in the Western Balkans region using the Index of Economic Freedom. In order to achieve the set objective, several general theoretical methods were used, especially methods of analysis, synthesis, induction, deduction and comparison. The Abstraction method was also used to disregard a number of less significant factors, relationships and facts in order to examine more closely the essential characteristics of the region as a whole.

The paper also analyses Kosovo, based on UNSC Resolution no. 1244/1999, and the opinion of the International Court of Justice on the declaration of independence of Kosovo. The most comprehensive source of information on the Western Balkans is the reports and publications of the EU institutions, the World Bank and the International Monetary Fund. Ministry of Foreign and European Affairs of the Slovak Republic annually publishes economic information about individual territories. Statistical databases of EU and the Western Balkans territories were used.

The main source of data used for research was the Index of Economic Freedom 2020. The Heritage Foundation in cooperation with the editorial staff of daily newspaper The Wall Street Journal has been compiling the Index of Economic Freedom for twenty-six years. The measurement of economic freedom is based on examination of twelve quantitative and qualitative components grouped into four pillars (Fig. 1).

Fig. 1 Index of Economic Freedom



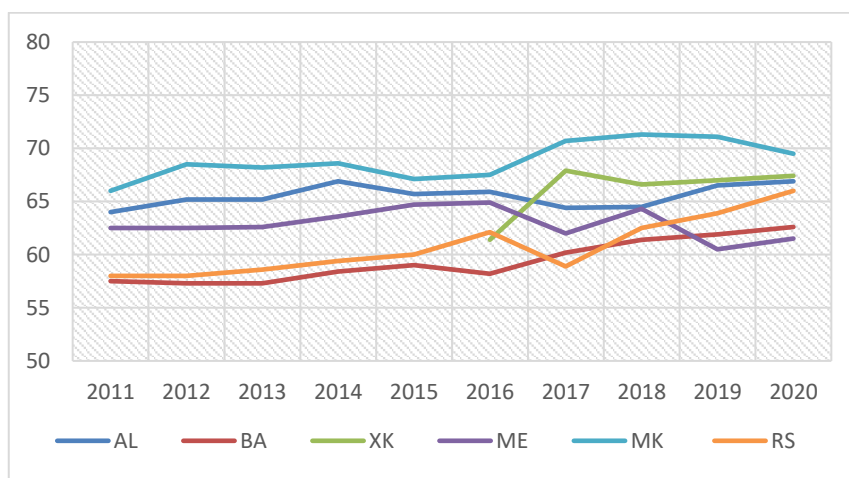
Source: own processing according to Index of Economic Freedom

Each of the twelve economic freedoms is rated on a scale from 0 to 100. The total score of a country is calculated as the average of the individual economic freedoms [Kittová & Steinhauser, 2018]. The Index of Economic Freedom is published at the beginning of a calendar year, the score for 2020 reflects the situation in 2019. In 2019, Hong Kong became the freest economy in the world, continuously at the first position since 1995. Singapore, New Zealand, Switzerland and Australia ranked in the top five in addition to Hong Kong.

2 Results and Discussion

Graph 1 shows the development of the 2011 – 2020 Index of Economic Freedom for Western Balkans. From the Western Balkans territories, the best rating in the observed period of 2010 – 2019 is achieved by the Republic of North Macedonia and the worst by Bosnia and Herzegovina. According to the 2020 Index of Economic Freedom, the region belongs to the group of moderately free economies.

Graph 1 Index of Economic Freedom 2011 – 2020



AL – the Republic of Albania, BA – the Republic of Bosnia and Herzegovina, ME – the Republic of Montenegro, MK – the Republic of North Macedonia, RS – the Republic of Serbia, XK – the Republic of Kosovo

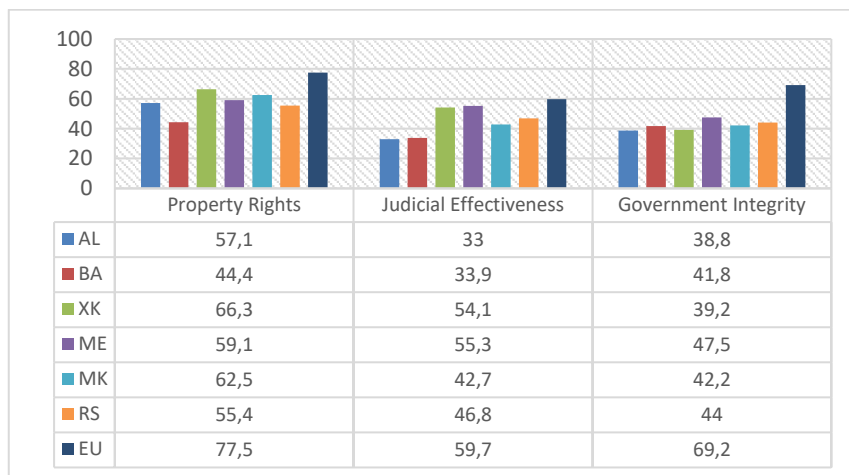
Source: own processing according to Index of Economic Freedom 2010 – 2020

According to the 2020 Index of Economic Freedom, the best score from the Western Balkans territories was achieved by the Republic of North Macedonia, ranking 51st out of 186 assessed economies. The total score of 69.5 decreased by 1.6 points compared to last year due to a decrease in the efficiency of the judiciary. Kosovo with the score of 67.4 became the 53rd freest economy. The score of the country increased slightly by 0.4 point year-on-year due to an improvement in the area of property rights.

The economic freedom score of Albania is 66.9, making it the 57th freest economy. The overall score increased slightly by 0.4 point year-on-year due to improvement in fiscal health. However, Albania fell by five positions in the ranking, reflecting the relatively better performance of other countries. Serbia is in the 65th place in the 2020 Index of Economic Freedom with the score of 66.0. The total score of the country increased by 2.1 points compared to last year. Bosnia and Herzegovina is in the 82nd place in the 2020 Index of Economic Freedom with the score of 62.6. In a year-on-year comparison, its overall score increased slightly by 0.7 point, which was helped by a sharp increase in the score for government integrity. The economic freedom score of Montenegro is 61.5, making it the 91st freest economy. Compared to last year, the country's overall score increased by 1.0 point, mainly due to the higher score of government integrity.

The "RULE OF LAW" pillar of the 2020 Index of Economic Freedom for Western Balkans is shown in Graph 2. This pillar assesses the protection of property rights, the independence and efficiency of the judiciary, and the integrity of the government indicators. According to the "RULE of LAW" pillar, the Western Balkans score is significantly below the EU average. Convincing progress regarding the rule of law in the Western Balkans remains a major challenge, often linked to the lack of political will, the continued existence of certain elements of state seizure, limited progress in the independence of the judiciary and increasingly challenging environment for civil society [European Commission, 2020a].

Graph 2 Index of Economic Freedom 2020 - RULE OF LAW



AL – the Republic of Albania, BA – the Republic of Bosnia and Herzegovina, ME – the Republic of Montenegro, MK – the Republic of North Macedonia, RS – the Republic of Serbia, XK – the Republic of Kosovo

Source: own processing according to Index of Economic Freedom 2020

Despite ongoing reform processes, protection of property rights in the Western Balkans remains weak. It is essential to ensure the independence, quality and efficiency of the judicial system [European Commission, 2018]. The judiciary is often under political

pressure and has a great number of unfinished cases. Insufficient funding of the judiciary is also a problem. There is widespread political interference in the media and their control. It is necessary to make an effort to ensure freedom of expression and the independence of the media throughout the region. Democratic systems in the Western Balkans are not functioning properly due to strong political polarization, limited democratic control function of the opposition in some cases and boycotts of elections and parliamentary work by the opposition [European Commission, 2020a].

Public administration is plagued by inefficiency, corruption and nepotism. Corruption is one of the most significant threats to the region's democratic transformation and economic progress. In the Western Balkans, corruption is endemic, systematic, well-organized, rooted in government institutions, including the judiciary and the police. Public procurement is particularly prone to widespread corruption. High-level corruption and political corruption need to be tackled more clearly and consistently. As a part of the Euro-integration process, the Western Balkans territories have committed themselves to eliminating corrupt behaviour and manifestation of corruption in all areas of social life. They have confirmed their efforts by adopting a number of international law documents, such as the United Nations Convention Against Corruption.

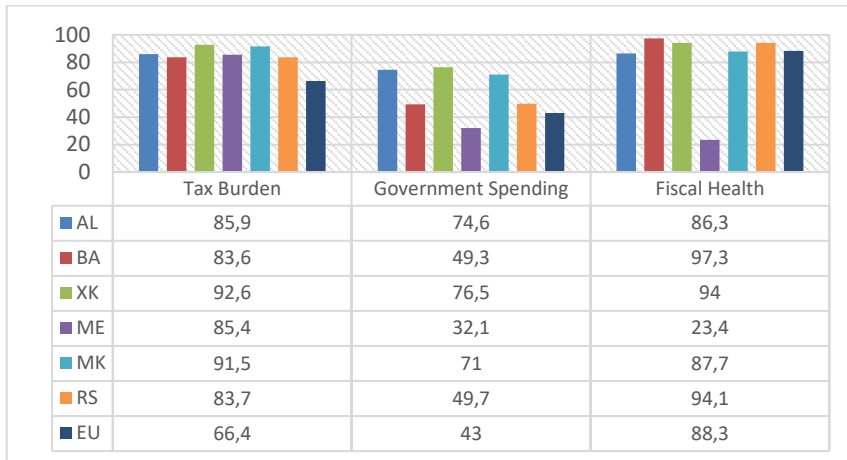
The task of the Western Balkans is to strengthen prosecution structures specializing in the fight against corruption and organized crime. The spread of organized crime in the Western Balkans is linked to the period of the break-up of Yugoslavia. This was mainly due to economic stagnation and rapidly changing political situation. Growing poverty, the absence of the rule of law, inefficient justice and open fighting in some areas have fuelled the rise of organized crime. At present, the presence of organized crime in the Western Balkans is significant in terms of human, drug and weapon trafficking or the infiltration of crime into the political and economic system [European Commission, 2018]. Attention is also paid to cyber security and the fight against cybercrime.

Graph 3 shows the "GOVERNMENT SIZE" pillar of the 2020 Index of Economic Freedom for the Western Balkans. Within this pillar, the tax burden, government spending and fiscal health indicators are assessed. According to the "RULE of LAW" pillar, the Western Balkans score is approximately equal to the EU average. The exception is Montenegro, whose Government Spending and Fiscal Health scores are well below the EU average.

The tax burden for 2019 ranged from 23.3 to 37.9% of total domestic income, with Kosovo having the lowest and Bosnia and Herzegovina the highest. In Albania, the highest personal income tax rate is 23%, the highest corporate tax rate is 15%. In Serbia, the highest personal income tax rate is 10%, the highest corporate tax rate is 15%. The rates of personal and corporate income tax are the equal in Montenegro (9.0%). In the Republic of Northern Macedonia, Kosovo, Bosnia and Herzegovina, corporate and personal income tax is 10%.

The region's indebtedness gradually decreases. The average level of public debt in the Western Balkans territories was 48.08% of GDP in 2019. The region's indebtedness gradually decreases. In 2019, Montenegro had the highest public debt (72.1% of GDP), Kosovo had the lowest (17.0% of GDP). Table 1 provides an overview of public debt and inflation rate indicators in the territories of the Western Balkans in 2019.

Graph 3 Index of Economic Freedom 2020 - GOVERNMENT SIZE



AL – the Republic of Albania, BA – the Republic of Bosnia and Herzegovina, ME – the Republic of Montenegro, MK – the Republic of North Macedonia, RS – the Republic of Serbia, XK – the Republic of Kosovo

Source: own processing according to Index of Economic Freedom 2020

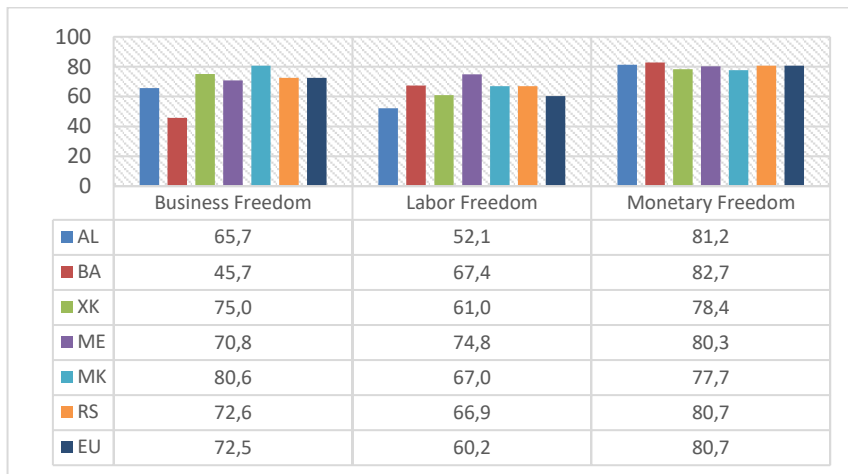
Tab. 1 Public debt and inflation rates in the territories of the Western Balkans in 2019

	Public debt (% GDP)	Inflation rates (%)
the Republic of Albania	68.6	2.0
the Republic of Bosnia and Herzegovina	37.0	1.4
the Republic of Kosovo	17.0	1.1
the Republic of Montenegro	72.1	2.6
the Republic of North Macedonia	39.5	1.5
the Republic of Serbia	54.3	2.0

Source: own processing according to Index of Economic Freedom 2020

Graph 4 shows the "REGULATORY EFFICIENCY" pillar of the 2020 Index of Economic Freedom for the Western Balkans. Within this pillar, the freedom of enterprise, labour market and monetary stability indicators are assessed. According to the "REGULATORY EFFICIENCY" pillar, the Western Balkans score is approximately equal to the EU average.

Graph 4 Index of Economic Freedom 2020 - REGULATORY EFFICIENCY



AL – the Republic of Albania, BA – the Republic of Bosnia and Herzegovina, ME – the Republic of Montenegro, MK – the Republic of North Macedonia, RS – the Republic of Serbia, XK – the Republic of Kosovo

Source: own processing according to Index of Economic Freedom 2020

The Western Balkans have significant untapped economic potential. The Western Balkans territories are sensitive to external influences, and the growth stimulation is based on significant international financial and technical assistance. Monetary and financial systems in the region are heavily dependent on the euro. Private sector development is essential for socio-economic development, regional integration, improvement of competitiveness and job creation. Small and medium-sized enterprises are extremely important, given that they account for 99% of all enterprises in the Western Balkans, generate around 65% of total added value in the business sector and account for 73% of total employment in the business sector [European Commission, 2020b]. In this context, it is appropriate to pay attention to the support of startups and small and medium-sized enterprises in strategic sectors of the Western Balkans, such as tourism and the digital sector.

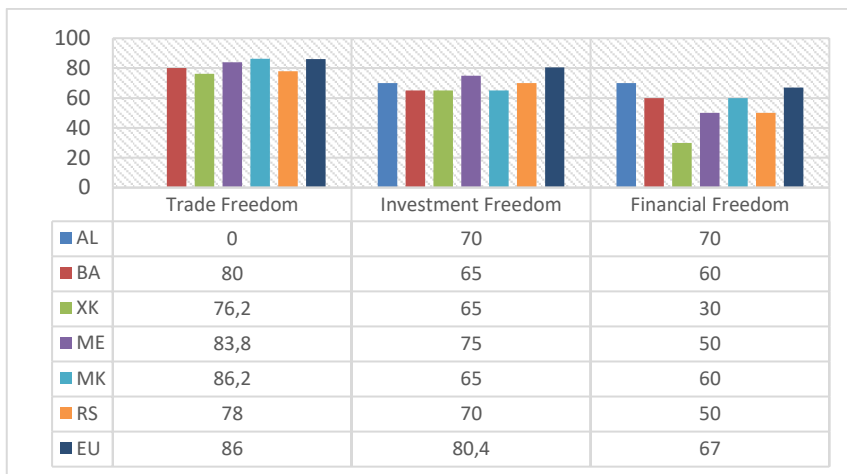
GDP growth is not sufficient to reduce the high unemployment rate, to ensure formal jobs or to reverse the trend of large-scale migration. The main reasons for emigration include poverty, unemployment and lack of opportunities. Pessimism, hopelessness, corruption and a lack of structural change are currently important factors supporting emigration. Making the labour market more efficient is one of the biggest challenges for the economic and social development of the region. Getting a job is a matter of connections, not knowledge and skills [Zubaľová, 2017]. The average unemployment rate of the six Western Balkans economies was around 17% in 2019 [Eurostat, 2020]. Kosovo had the highest unemployment rate (25.6%) and Serbia the lowest (10.5%).

In 2019, the employment rate in the Western Balkans region rose to a historic high of 45.6% for the 15-64 age group. Jobs were generated mainly in the service sector, followed by construction and industry. Employment continued to decline in agriculture. In 2019, Kosovo had the lowest minimum wage in the Western Balkans (EUR 130 for

workers under 35 and EUR 170 for workers over 35). The highest minimum wage in 2019 was in Serbia (EUR 344.4).

The "OPEN MARKETS" pillar of the 2020 Index of Economic Freedom for Western Balkans is shown in Graph 5. Within this pillar, the trade freedom, freedom of investment and financial freedom indicators are evaluated. According to the "OPEN MARKETS" pillar, the Western Balkans score is slightly below to the EU average.

Graph 5 Index of Economic Freedom 2020 - OPEN MARKETS



AL – the Republic of Albania, BA – the Republic of Bosnia and Herzegovina, ME – the Republic of Montenegro, MK – the Republic of North Macedonia, RS – the Republic of Serbia, XK – the Republic of Kosovo

Source: own processing according to Index of Economic Freedom 2020

Foreign trade holds an important position in the Western Balkans economy, largely contributing to the economic growth and production of gross domestic product, and also forms a substantial part of foreign exchange revenue [Kašćáková & Ružeková, 2019]. The EU is the Western Balkans' largest business partner, accounting for 69.4% to 82.9% of total exports and 61.8% of total imports in 2019 [European Commission, 2020a].

The major share of the Western Balkans economy is represented by agriculture, textile industry, energy and construction, which do not produce products requiring usage of advanced technologies and education of employees. Albania and Montenegro depend on tourism. Kosovo is an extremely complicated economic area, the business environment of which has discouraging parameters for investors despite the positive results in 2019 [Ministry of Foreign and European Affairs of the Slovak Republic, 2020].

The investment environment in the Western Balkans is characterized by a weak level of the rule of law, insufficient enforcement of state aid rules, shadow economy, insufficient access to finance and low levels of regional integration. EU companies are the biggest investors in the region, providing 73% of foreign direct investment. They

are thus the main external driver of growth and jobs in the region. The growing business and investment activity of third countries in the Western Balkans often does not take into account socio-economic and financial sustainability or EU rules for public procurement. The banking sector in Western Balkans remains relatively stable.

Conclusion

According to the 2020 Index of Economic Freedom, the best score from the Western Balkans territories was achieved by the Republic of North Macedonia. Montenegro had the worst score. All the countries scored 61.5 - 69.5, the global average was 61.6 and the European regional average was 69.8. The main obstacle to greater economic freedom in the Western Balkans territories is the very poor performance of the rule of law indicators.

The Western Balkans territories are criticized especially for the lack of austerity measures by the government and public institutions, the inflexible labor market and the slow implementation of necessary reforms. Emigration of young people and the "brain drain" are considered to be key problems for the region. The Western Balkans received weak rating also for corruption, which is still at a high level. Robust results in the fight against corruption are needed to mitigate the real threats to democratic structures and for a stable and transparent business environment. High level and political corruption need to be tackled in a clearer and more consistent way.

The Western Balkans territories have received high rating for their level of trade freedom and stable public finance. The EU is the largest trading partner, a source of incoming foreign investments and a major destination for external migration. These close economic relations have been supported by, inter alia, the Stabilization and Association Agreements between the EU and individual territories of the Western Balkans, which also include provisions on a deep and comprehensive free trade area. Implementation of these provisions means the removal of customs and non-tariff barriers, liberalization of trade in services, extensive harmonization of trade, investment regulations and institutions.

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