Impact of European Integration in the competitiveness of small states.

Selami Xhepa
European University of Tirana

Mimoza Agolli
Canadian Institute of technology

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Competitiveness through Integration

• *How integration process of after transition small states has impacted competitiveness*

• EU integration agenda affects many areas of national policy and regulation that impact competitiveness, especially of small economies.

• Policy-wise it is important to identify areas where pursuing one policy improves or enforces the other
Competitiveness through Integration

- We looked at a set of small economies, that went out of transition, transformed and then followed the process of EU integration: Baltic States, SEE countries being EU member and Western Balkan countries.

- Using Global Competitiveness Indexes we have identified areas that are impacted by the EU integration.

- Under the assumption that the two processes happened simultaneously the impact of EU integration on competitiveness was estimated through a simple simultaneous equation estimation procedures using seemingly unrelated regression (SUR).
Competitiveness through Integration

• EU Integration process requires countries to reform institutions and establish market economy in compliance with EU (acqui)
  • Institutions Pillar
  • Market Efficiency Pillar

• SME agenda and social inclusion agenda at EU level impact
  • Business Sophistication
  • Labour Market Efficiency
Competitiveness through Integration

- Baltic States: Lithuania, Latvia and Estonia
- Western Balkans: Albania, Bosnia & Herzegovina, Serbia, Montenegro and FYR of Macedonia
- SEE: Croatia, Slovenia and Slovakia
A region of...

- Poor levels of income:
  - poor and very poor countries
- Substantial catch up potential
- Structural underdevelopment and low competitiveness
  - High unemployment rates, especially among the young
  - Quality of education and level of skills
  - Very low productivity levels
- Small transition states integrated in EU, stronger better institutions
- There is a slight lift up on institutional pillar of competitiveness after EU integration for SEE
Market Efficiency

Burden of customs procedures, 1-7 (best)

Business impact of rules on FDI, 1-7 (best)

Burden of government regulation, 1-7 (best)

Gov’t procurement of advanced tech products, 1-7 (best)
Business Sophistication

Business Sophistication

Capacity for innovation, 1-7 (best)

ICT Use

Company spending on R&D, 1-7 (best)
Some insides observing the dynamics of GCI

- Western Balkans performs generally poorly on GCI vs Baltic States and SEE (except indicators that relate to old legacy of the economic centralized system)

- There is variation in competitiveness level among the group of countries

- Institutions and firm level competitiveness made up the difference!

- Mixed evidence on how EU integration impacts dynamics of the competitiveness
A short note on estimations

• Simultaneous processes modeled through Seemingly unrelated equation

• SUR estimates a system of equation on dependent variables that are determined simultaneously by the same set of explanatory variables and they correlate through error terms (or unobservable)

• The system of equations consist of the Competitiveness equation and EU membership equation (Dummy variable)

• Panel data with 11 countries, starting from 2007-2017 have been used with data from World Economic Forum

• We have presented here the preliminary results
## Estimation results (preliminary)

<table>
<thead>
<tr>
<th>Institution Pillars</th>
<th>Competitive Index Equation</th>
<th>EU Integration Equation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Spending Efficiency</td>
<td>0.078 (1.83)*</td>
<td>0.298 (3.17)***</td>
</tr>
<tr>
<td>Property Rights</td>
<td>0.25 (7.13)**</td>
<td>0.478 (6.23)**</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Market Efficiency</th>
<th>Competitive Index Equation</th>
<th>EU Integration Equation</th>
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</thead>
<tbody>
<tr>
<td>Government Policy Burden</td>
<td>0.019 (0.55)</td>
<td>0.091 (0.74)</td>
</tr>
<tr>
<td>FDI rules</td>
<td>0.18 (5.83)</td>
<td>-0.126 (-1.18)</td>
</tr>
<tr>
<td>Market Dominance</td>
<td>0.131 (3.53)***</td>
<td>0.075 (0.58)</td>
</tr>
<tr>
<td>Local Competition</td>
<td>-0.029 (-0.99)</td>
<td>0.037 (0.36)</td>
</tr>
<tr>
<td>Trade Barriers</td>
<td>-0.089 (-1.75)*</td>
<td>-0.134 (-0.76)</td>
</tr>
</tbody>
</table>

*t-stats in parentheses

- Institutions are determinants of competitiveness for small states - EU integration process strongly and positively affects the quality of institutions

- Market Efficiency measures mainly because of the small market size are weakly determining competitiveness

- Some of these indicators when countries are integrated show signs of improvement but they are still insignificant
## Estimation results (preliminary)

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<th>Business Sophistication</th>
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<tr>
<td>ICT Usage (at national level)</td>
<td>0.0705 (6.22 )***</td>
<td>0.372 (7.56)***</td>
</tr>
<tr>
<td>Firm Technology Adoption</td>
<td>-0.08 (-2.78)**</td>
<td>0.368 (2.94)***</td>
</tr>
<tr>
<td>Local Supply Quality</td>
<td>-0.013 (-0.52)</td>
<td>0.202 (1.77 )*</td>
</tr>
<tr>
<td>Patents Registered</td>
<td>-0.003 (-5.92)***</td>
<td>0.0026 (1.14 )</td>
</tr>
<tr>
<td>Product Sophistication</td>
<td>-0.01 (-0.36)</td>
<td>0.437 (3.12)**</td>
</tr>
<tr>
<td>Professional Management</td>
<td>0.123 (4.75 )***</td>
<td>0.135 (1.20)</td>
</tr>
</tbody>
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<td>Attract Talents</td>
<td>-0.129 (-2.46 )**</td>
<td>-0.176 (3.82)***</td>
</tr>
<tr>
<td>Retain Talents</td>
<td>0.295 (5.94 )***</td>
<td>-0.323 (-1.81)</td>
</tr>
<tr>
<td>Flexible Wage Determination</td>
<td>.098 (5.90 )***</td>
<td>-0.187 (-3.39)***</td>
</tr>
</tbody>
</table>

*t-stats in parentheses*
Conclusions: Channels through which EU integration might impact competitiveness for WB

- **Institutions** - low credibility in public institutions and Brussels is highly credible and trusted!
- **Market efficiency:**
  - Business rules and regulation for FDI - more inflow of FDI
- **Business sophistication:**
  - Capacity for innovation
  - Company spending on R&D
  - Use of ICT
  - Increasing collaboration between industry and university research
  - Labor market through improving skills
Variables with no or negative impact:

• Trade channel
• Make harder the working of labor market
  – Hiring/firing
  – Maintaining the talent - brain drain especially among the young and highly educated - experience of Lithuania
Some short and long run policy measures

- Use of exchange rates?

- Fiscal measures - rise of VAT and lower SSC?

- In the long run:
  - Improved institutions and rule of law
  - Infrastructure and connectivity
  - Innovation through increased R&D and better linkages with private sector