

# 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

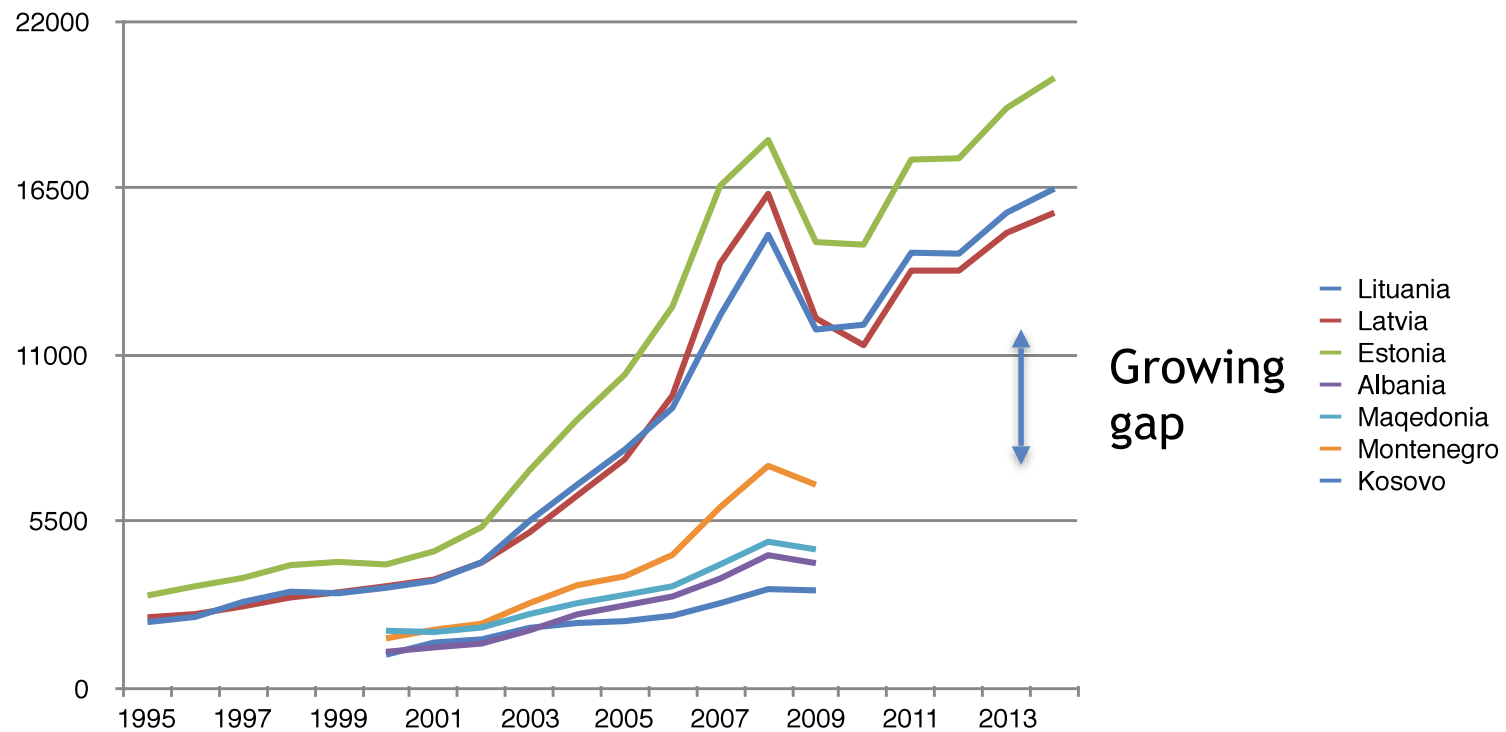
## Competitiveness through Integration

- Baltic States: Lithuania, Latvia and Estonia
- Wester Balkans: Albania, Bosnia&Herzegovina, Serbia, Montenegro and FYR of Macedonia
- SEE: Croatia, Sllovenia and Sllovakia

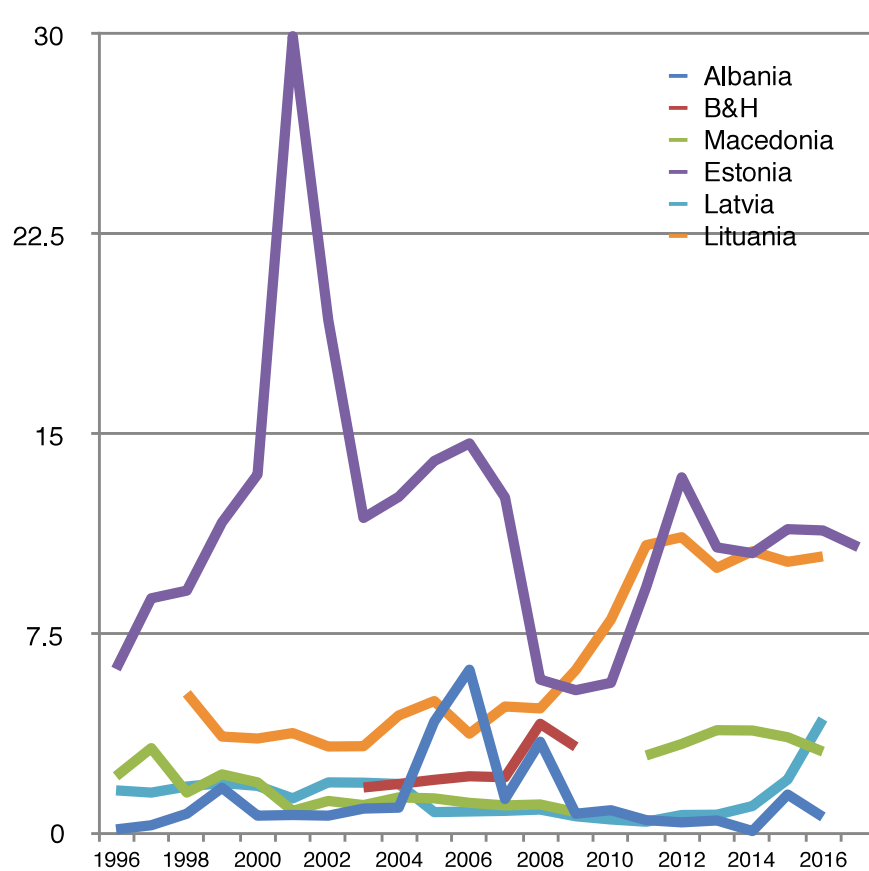
## A region of...

- 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

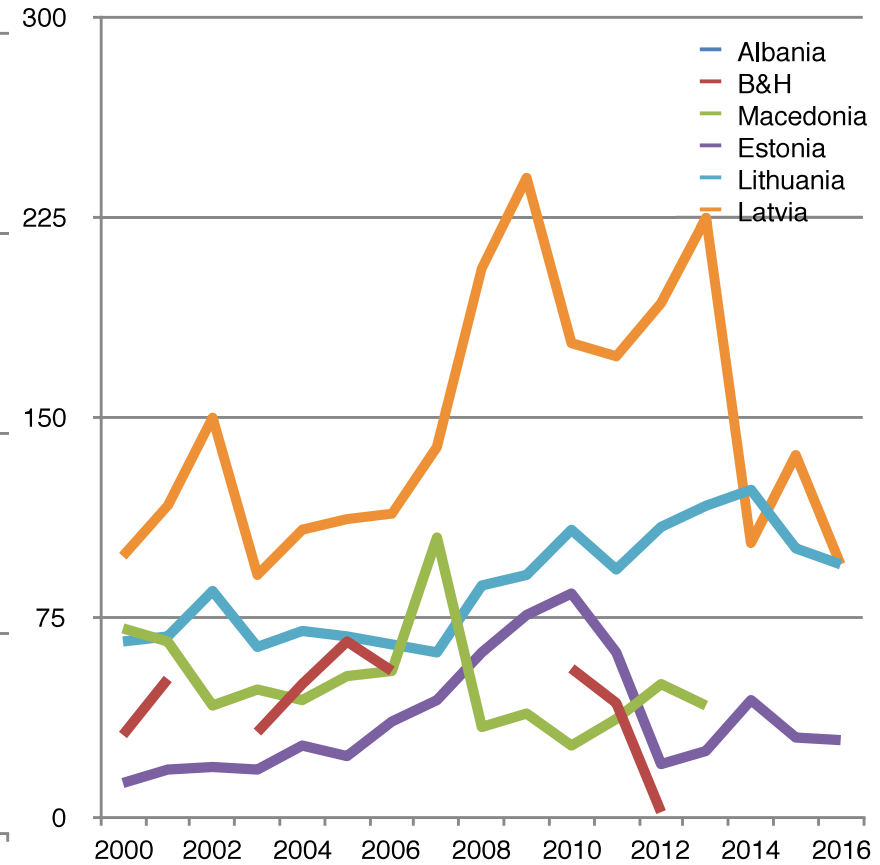
# GDP per capita



## Low level of manufactured exports Poorly integrated in world markets

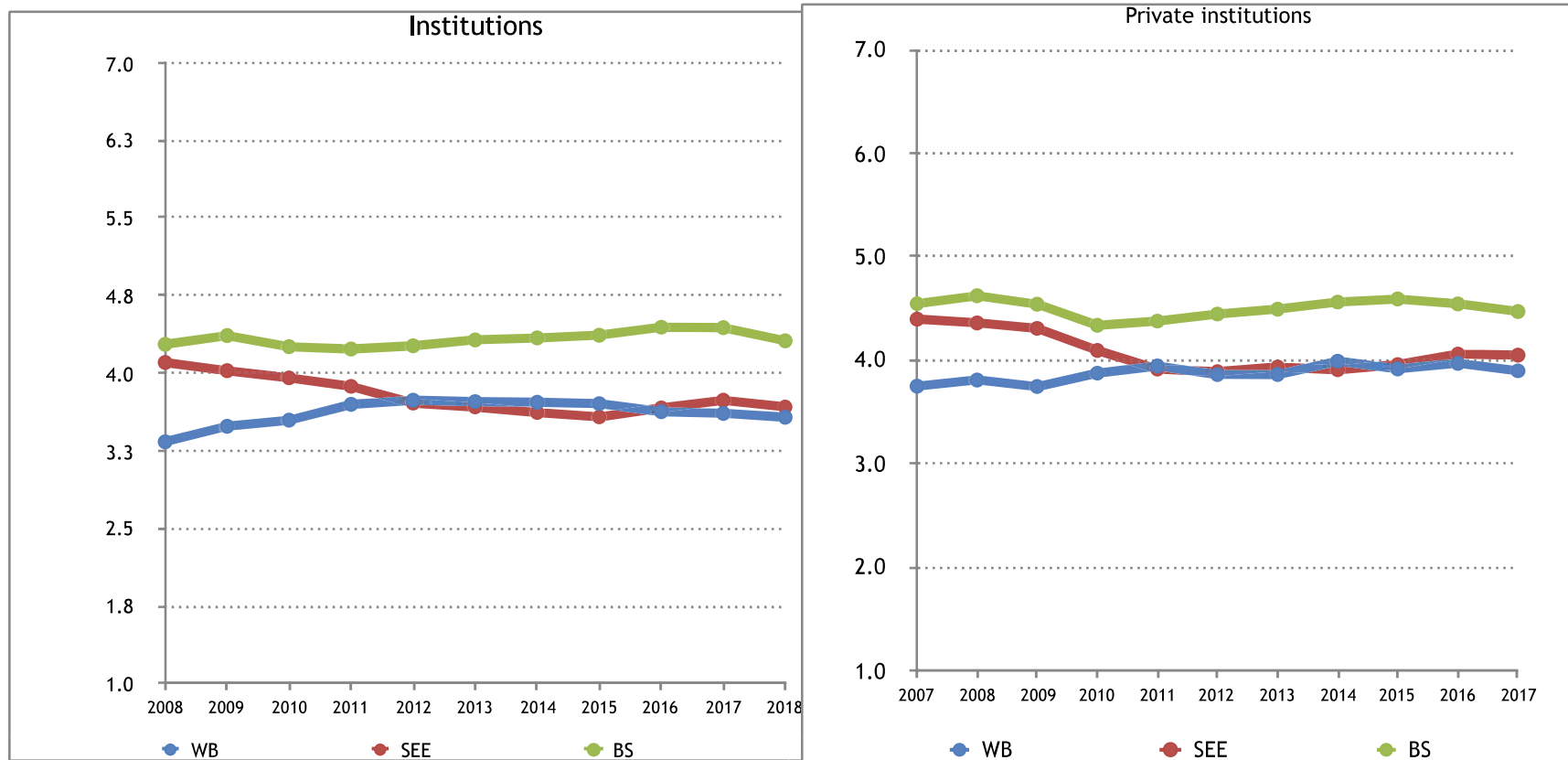


## Weak linkages of research with the business sector





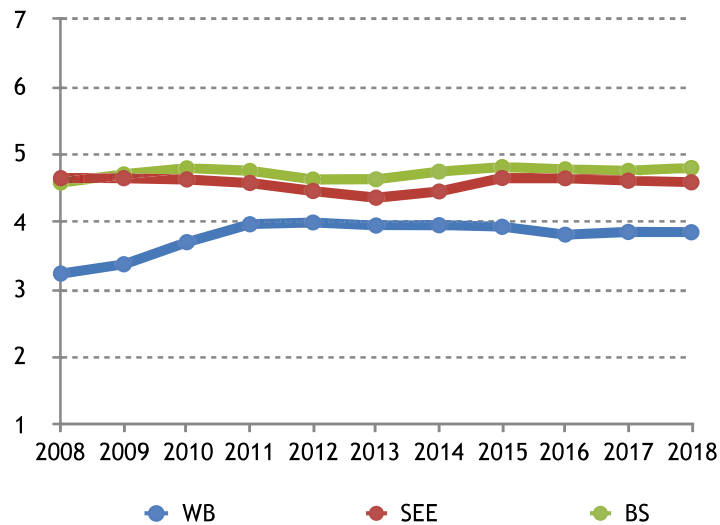
# Competitiveness - Institutions



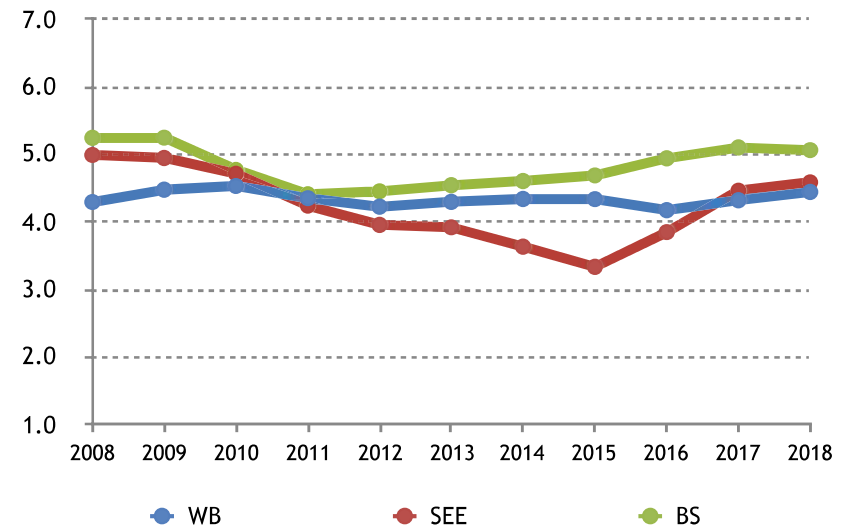
- Small transition states integrated in EU, stronger better institutions
- There is a slight lift up on institutional pillar of competitiveness after EU integration for SEE

# Market Efficiency

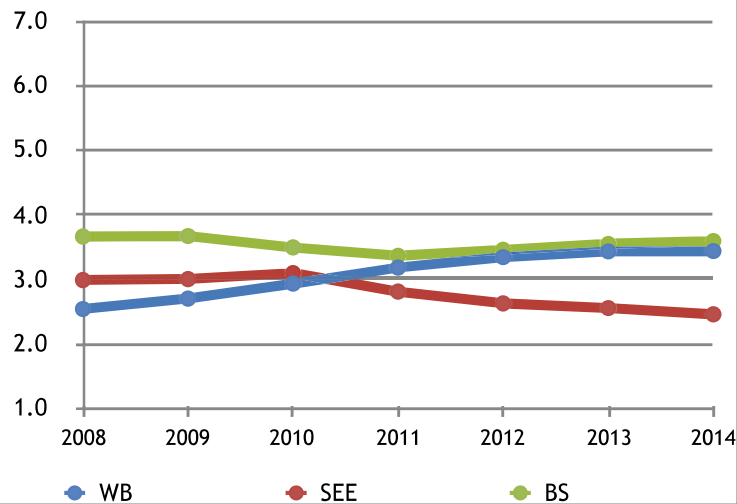
Burden of customs procedures, 1-7 (best)



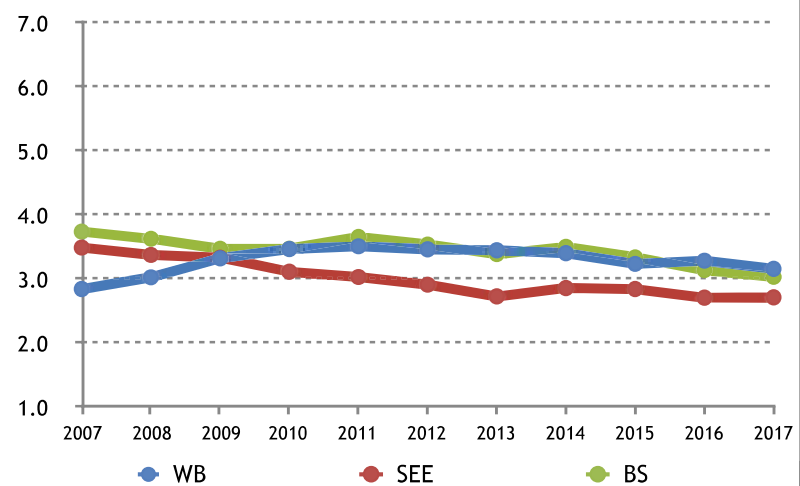
Business impact of rules on FDI, 1-7 (best)



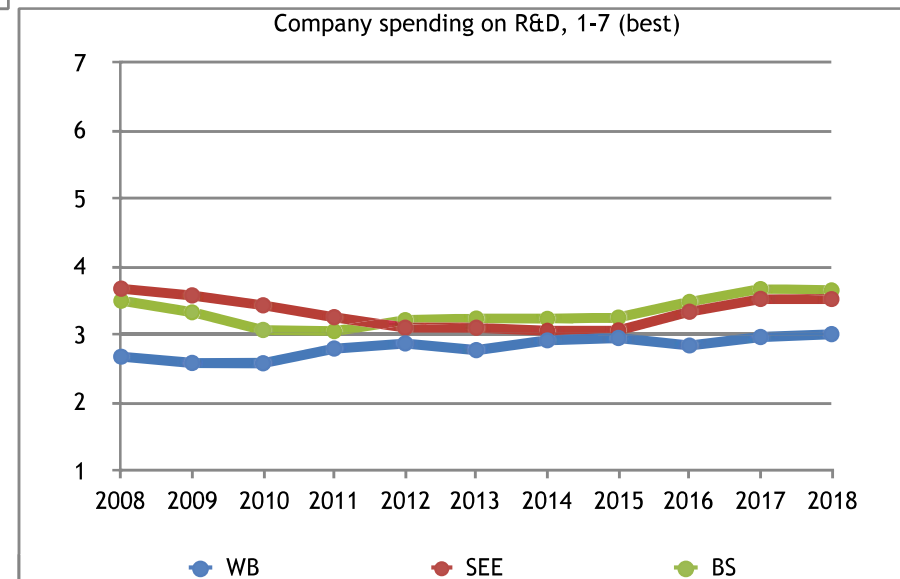
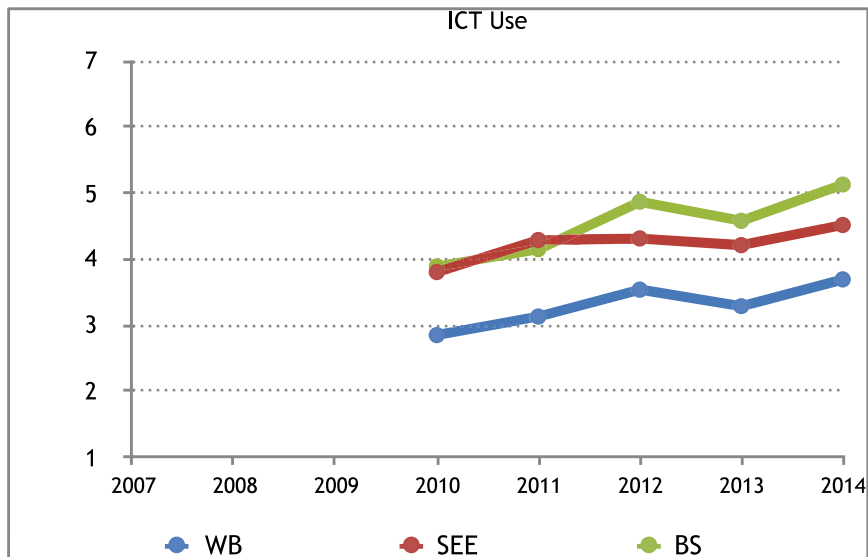
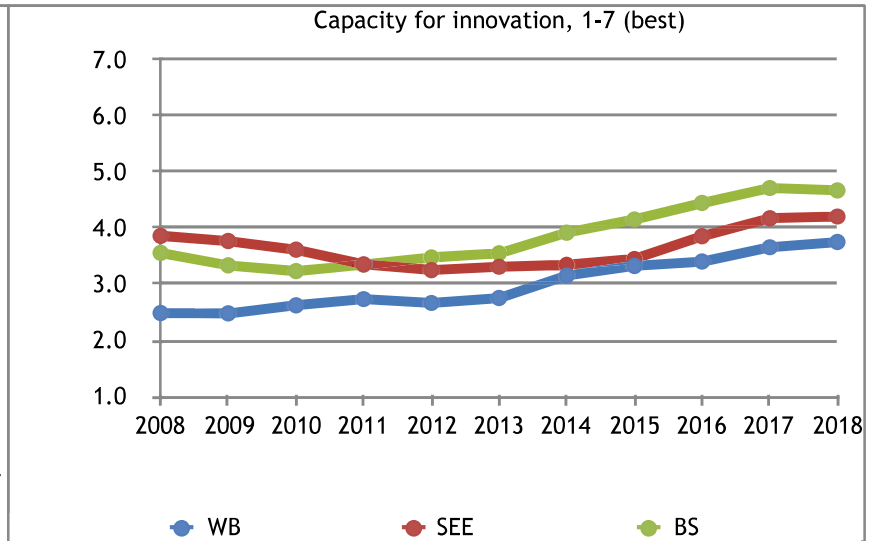
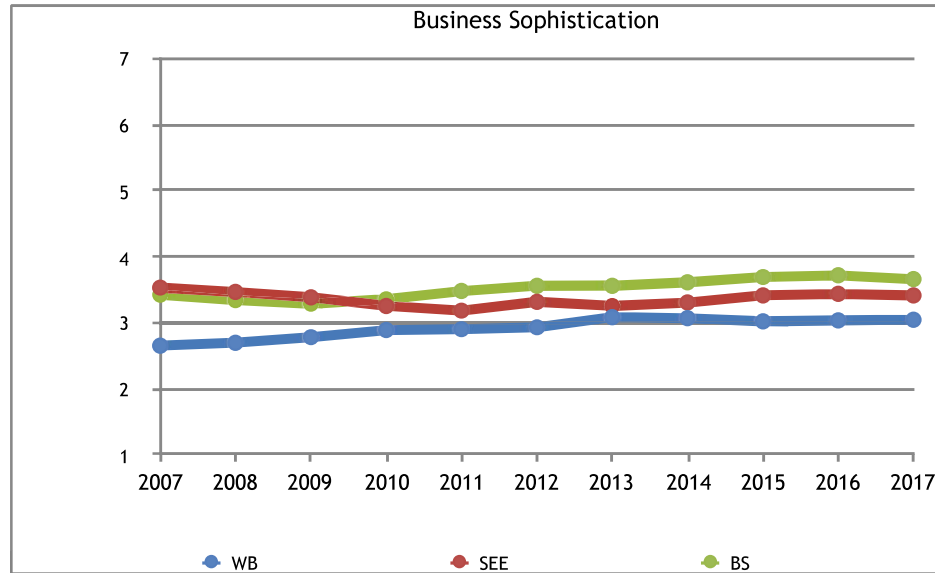
Burden of government regulation, 1-7 (best)



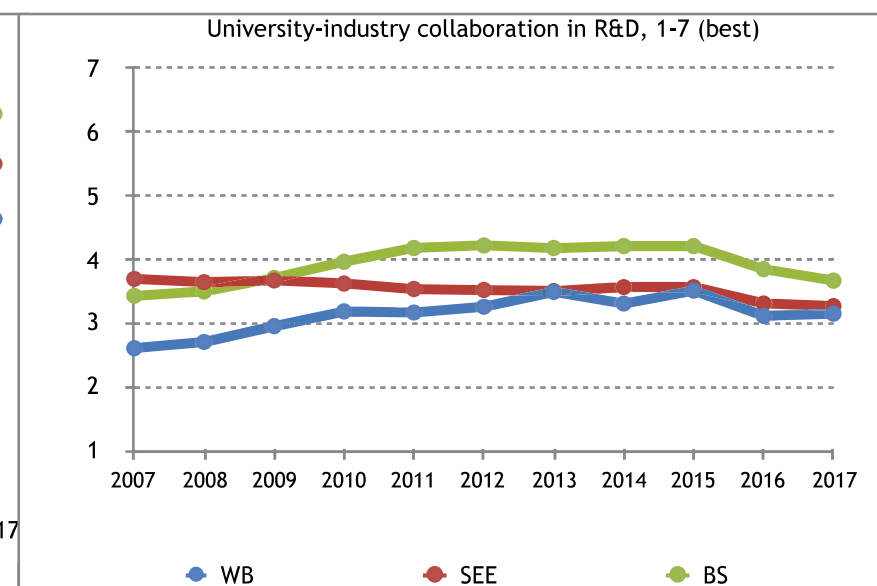
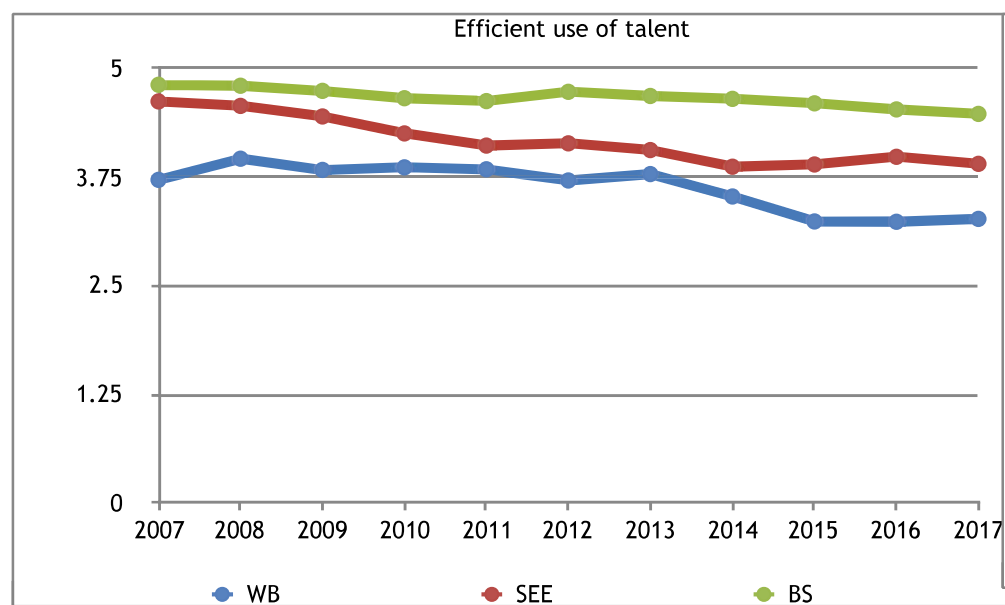
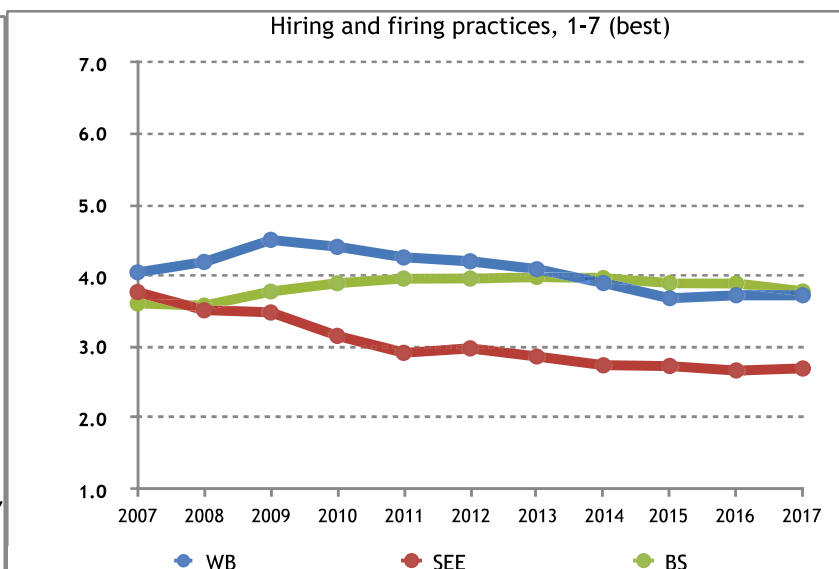
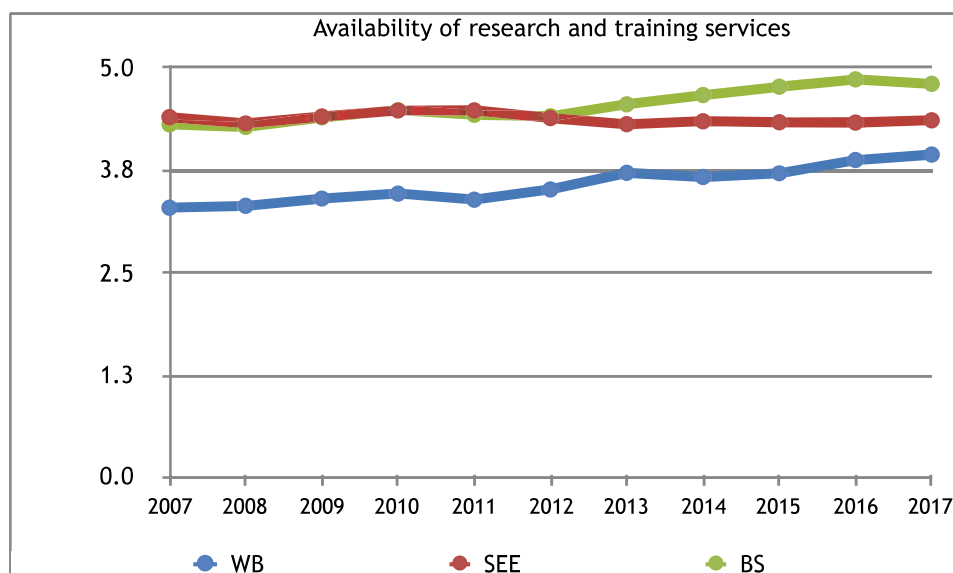
Gov't procurement of advanced tech products, 1-7 (best)



# Business Sophistication



# Labour Market/Human Capital



# 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)

| <b>Institution Pillars</b>     | <b>Competitive Index Equation</b> | <b>EU Integration Equation</b> |
|--------------------------------|-----------------------------------|--------------------------------|
| Government Spending Efficiency | 0.078 ( 1.83 )*                   | 0.298 (3.17)***                |
| Property Rights                | 0.25 (7.13)**                     | 0.478 (6.23 )**                |
| <b>Market Efficiency</b>       | <b>Competitive Index Equation</b> | <b>EU Integration Equation</b> |
| Government Policy Burden       | 0.019 (0.55 )                     | 0.091 (0.74)                   |
| FDI rules                      | 0.18 (5.83)                       | -0.126 (-1.18 )                |
| Market Dominance               | 0.131 (3.53)***                   | 0.075 (0.58)                   |
| Local Competition              | -0.029 (-0.99 )                   | 0.037 (0.36)                   |
| Trade Barriers                 | -0.089 (-1.75 )*                  | -0.134 (-0.76)                 |
| <i>t-stats in parentheses</i>  |                                   |                                |

- 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)

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



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