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Another Round of EU Enlargement:

What are the economic and institutional must-haves for candidate countries to make accelerated enlargement possible?

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Abstract

This study identifies the minimum economic and institutional conditions that candidate countries must meet to ensure macroeconomic stability, sustainable growth, and effective integration into the EU, under a politically accelerated enlargement process. In the area of external accounts, successful past accessions managed current account deficits through FDI into tradable sectors, while real effective exchange rate misalignments and FDI into non-tradables led to post-accession instability. Key reforms include building export capacity, targeting FDI to tradables, aligning wages with productivity, and reducing debt-financed imbalances. On fiscal policy, while fiscal discipline is essential, overly conservative approaches can hinder growth. Countries with high debt-to-GDP ratios at accession faced prolonged austerity. Reforms should focus on fiscal sustainability, growth-oriented spending, tax base expansion, and procurement transparency. Labour market challenges include depopulation, low productivity, and high poverty. Effective employment policies, migration strategies, regional equity, and education-labour market alignment are essential. Institutional quality remains a critical barrier. Weak rule of law, corruption, and governance backsliding threaten accession prospects and must be addressed before accession. The study concludes that a focused set of pre-accession 'must haves' can guide enlargement, supported by adapted EU tools to mitigate risks and foster convergence.

Keywords: EU Enlargement, EU Accession, Candidate Countries, Ukraine, Western Balkans

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Another Round of EU Enlargement: What are the economic and institutional must-haves for candidate countries to make accelerated enlargement possible?

EXECUTIVE SUMMARY

This study identifies the minimum economic and institutional conditions—termed ‘must haves’—that candidate countries must meet to ensure macroeconomic stability, sustainable growth, and effective integration into the EU, in the context of a politically accelerated enlargement process. Drawing on the experiences of past EU joiners (notably Romania, Bulgaria, and Croatia) and current candidate countries (Serbia, Montenegro, and Ukraine), the report distils key lessons and reform priorities across four critical domains: external accounts and competitiveness, fiscal policy, labour markets and social indicators, and institutional quality.

For **external accounts and competitiveness**, the experience of previous joiners shows that persistent current account deficits were manageable when financed by FDI into tradable sectors, as seen in Romania and Czechia. However, FDI inflows into non-tradable sectors (e.g., real estate in Bulgaria) failed to support sustainable export growth. Meanwhile real effective exchange rate (REER) appreciation, when not matched by productivity gains, led to competitiveness losses and post-accession crises (e.g., Croatia and the Baltics). This has important implications for the current candidate countries. Serbia shows strong FDI inflows and export growth but is increasingly reliant on Chinese investment, raising geopolitical and regulatory concerns. Montenegro faces chronic current account deficits and the highest external debt in Eastern Europe. Ukraine’s FDI stock is the lowest among past and current accession countries, and its economy remains undercapitalised and reliant on raw material exports. This points to at least four ‘must haves’ for the current candidates: 1) build export capacity and diversify trade structures, 2) ensure FDI targets tradable sectors and supports integration into EU value chains, 3) monitor REER developments and align wage growth with productivity, 4) reduce reliance on debt-financed current account deficits.

For **fiscal policy and public finances**, the experience of previous joiners shows that while fiscal discipline is essential, overly conservative policies (e.g. Bulgaria) can constrain growth. Countries with high debt-to-GDP ratios at accession (e.g., Hungary, Croatia) faced prolonged austerity and weak growth. And efficient public spending, especially on education, health, and infrastructure, supports long-term convergence. Regarding the current candidates, the picture is mixed. Serbia maintains stable debt and moderate deficits but has room to expand its tax base. Montenegro narrowly avoided a debt crisis during the pandemic, with public debt peaking at 105% of GDP in 2020. Meanwhile Ukraine faces unsustainable debt levels due to war-related borrowing and will require significant restructuring. Here we again identify four ‘must have’ reform areas for the candidate countries: 1) ensure fiscal sustainability

with credible medium-term frameworks, 2) prioritise growth-enhancing public investments, 3) strengthen tax administration and reduce informality, 4) improve transparency and efficiency in public procurement.

On **labour markets**, past accessions shows that demographic decline and emigration constrained labour supply and growth and that high inequality and regional disparities undermined social cohesion and political stability. However, countries that improved employment rates and aligned wage growth with productivity (e.g., Poland) achieved better convergence. Among the current candidates, most face severe depopulation and emerging labour shortages. Ukraine's labour productivity is low in most sectors except agriculture and ICT, and poverty remains high in Serbia and Montenegro, despite growth. Here, the 'must have' reforms for candidate countries are: 1) implement active labour market policies and vocational training, 2) promote circular migration and return incentives, 3) address regional disparities and social exclusion, 4) align education systems with labour market needs.

Finally, for **institutional quality and governance**, past accession rounds show that weak institutions at the time of accession (e.g., Romania, Bulgaria) led to post-accession governance challenges, improvements in rule of law and regulatory quality were uneven and often stalled post-accession. and effective use of EU funds requires strong administrative capacity and anti-corruption safeguards. Among the current candidate countries, the institutional challenges are huge. Serbia has seen a marked decline in governance indicators since 2014, with increasing authoritarianism, while Montenegro's governance indicators have stagnated or declined despite formal negotiation progress. However, Ukraine's institutions are weak but improving, supported by a vibrant civil society and external oversight. Based on this, we identify the following 'must have' reforms: 1) strengthen rule of law, judicial independence, and anti-corruption frameworks, 2) enhance public administration capacity, especially for EU cohesion fund absorption, 3) improve regulatory quality and a competitive business environment, 4) ensure political stability and democratic accountability.

The study underscores that while full compliance with the economic Copenhagen Criteria remains the long-term goal, a reduced and focused set of economic 'must haves' can guide accession under accelerated timelines. Some must be done before accession, while others can be done afterwards. Pre-accessions the focus should be on demonstrated capacity to manage external balances, maintain fiscal discipline, support inclusive labour markets, and uphold basic institutional standards. Post-accession, the focus can turn to continued convergence, deepening of EU integration, and effective participation in EU programs and funding mechanisms. The EU must also adapt its support tools—such as the Recovery and Resilience Facility and pre-accession assistance—to help candidates meet these conditions and mitigate potential spillovers to existing member states.

1. INTRODUCTION AND EXPLANATION OF THE CHOICE OF FOUR AREAS

1.1. Introduction and structure of the report

The rationale for undertaking this study is clearly stated in the tender specification for this project:

The main purpose of this tender is to commission work on identifying the minimal economic preconditions for the accession of candidates to the European Union, presuming a scenario under which there would be strong political pressure to admit new Member States much quicker than the current enlargement approach and procedures can deliver. In such a scenario, it would be important to define **minimum economic accession conditions which are considered essential to be fulfilled to ensure economic stability and prosperity in the newly acceded candidate country and prevent undue spillovers on others**. To identify **a smaller than ideal set of minimum conditions**, the economic accession criteria defined in Copenhagen in 1993 (i.e. a functioning market economy and the ability to withstand competitive pressures inside the EU), would be a natural reference and starting point. (our emphasis)

We argued in our submission for the call that in investigating the minimum economic accession conditions, we would be guided by the following considerations:

- › relevance to the provision of macroeconomic stability for longer-term growth (and convergence)
- › potential spill-over effects on existing member states
- › implications for proper use of EU funding and mutually beneficial participation in EU programmes

Given these criteria, the study will focus on the following **four areas**:

- › **External accounts/competitiveness**: Export capacity, foreign direct investment and integration into international production networks, trade/current accounts, external debt and debt composition (by institution, maturity structure), features of capital accounts (including role of remittances)
- › **Fiscal situation**: Evolution of fiscal deficits/surpluses, main characteristics of revenue and expenditure structure, public debt
- › **Labour markets and social indicators**: Demographic developments, migration flows, impact of remittances, regional and distributional disparities
- › **Institutional factors, with a focus on the business environment**: Relevant particularly for contract reliability, and appropriate use of EU funding and EU programme participation, the state of the banking sector and conditions for access to finance

The selection of these areas is based on the experience of previous accession countries that these areas are crucial to meeting the criteria outlined above – i.e. assuring macroeconomic stability along a sustainable growth (and income) convergence path; avoiding undue negative spill-over effects on existing EU member countries; and exploiting the potential of EU support programmes and ensuring the proper use of EU funding.

With regard to these areas, we also want to emphasise two points:

- (i) The focus should be not on year-to-year developments, but on **longer-term trajectories** that will allow a smooth process of economic development for the candidate countries. The monitoring should adopt a **forward-looking perspective** on the sustainability of longer-term trajectories in all four domains mentioned above.
- (ii) Emphasis should also be on the manifold **relationships between the four domains** outlined above – e.g. how demographic and labour supply conditions affect longer-term growth trajectories; how institutional conditions and effective regulatory structures support (or fail to support) business development (including FDI attractiveness, integration into global value chains, positive spill-overs to domestic businesses, access to finance); and how social and regional inequality indicators might indicate the build-up of political tensions, which could in turn impact economic stability.

The report is structured as follows:

Section 1.2 offers a preliminary explanation for why we have singled out the four areas above for special scrutiny, in order to identify the ‘must-have’ minimum accession conditions. We also relate these to the various sub-categories of the economic Copenhagen criteria.¹

Section 2 discusses the selection of a set of quantitative indicators related to the four focus areas presented above that can be compiled to assess economic developments in the candidate countries in the four areas.² We group these indicators in relation to how they can be viewed in an assessment of the economic Copenhagen criteria.

Section 3 then uses the quantitative indicators selected to discuss in more detail the experiences of previous accession countries (with a special focus on Bulgaria, Romania and Croatia). We show how they fared in the phases prior to and following accession in relation to the four areas. One aspect of this examination will also be to assess how they performed in relation to a number of ‘shocks’ (the global financial crisis, the COVID pandemic and the energy price shock).

Section 4 assesses the current state and development trends of the set of current candidate countries, with specific case studies of Montenegro, Serbia and Ukraine, again in relation to the four focus areas. We shall also point to possible country-specific features that may generate negative spill-over effects for current member countries and for the functioning of the EU as a whole.

Section 5 examines the extent to which an assessment through the indicators (and analysis) proposed in this report could change the current (more comprehensive) practice of the Commission to assess the economic Copenhagen criteria of candidate countries.³ It looks at how the identified focus on ‘must-haves’ would narrow down such assessments to provide minimum conditions that must be satisfied during any accelerated process of accession.

¹ For the economic Copenhagen (main and sub-) criteria, see https://economy-finance.ec.europa.eu/international-economic-relations/candidate-and-neighbouring-countries/enlargement/economic-accession-criteria_en ; see also Annex.

² For a compilation of some of the indicators, see also Grieveson et al. (2023).

³ See the most recent report: https://economy-finance.ec.europa.eu/publications/progress-towards-meeting-economic-criteria-eu-accession-2024-european-commission-assessments_en

1.2. A preliminary discussion of the four areas selected for special scrutiny

In what follows, we present a preliminary discussion of why we identify the four broad areas as focus areas that will allow us to assess ‘minimum economic accession conditions which are considered essential to be fulfilled to ensure economic stability and prosperity in the newly acceded candidate country and prevent undue spillovers on others’.

(i) External accounts and competitiveness

The experience of previous accession countries has shown that longer-term current account developments are crucial indicators of whether a country is able to follow an uninterrupted growth path. Countries at various times have suffered from real exchange-rate overvaluation (which can stem from a number of sources, such as misallocated financial inflows (including bank credits, remittances and external public supports), wage vs. productivity developments, monetary policy failures, etc.), which has caused sustained current account deficits, has imposed destructive pressures on the tradeable domestic sector and has led at times to serious interruptions to economic growth. Furthermore, current account crises have had important consequences for financial market stability, involving – at times – financial institutions/banks from EU member states. Hence tracking the build-up of sufficient export capacities provides an important indicator of whether a country can avoid longer-term imbalances in its trade accounts. The attractiveness of foreign direct investment (FDI) to tradeable sectors (manufacturing and tradeable services) and participation in cross-border value chains (and evidence of the upgrading of a country’s position in international production networks) are important indications that a country is able to build up export capacities and thereby avoid ‘structural’ trade deficits. Another aspect of monitoring current account developments is the tracking of the external debt situation of the different sectors of the economy (households, the non-financial business sector, financial institutions and the public sector). This allows the identification of sectors that are particularly responsible for external borrowing, which can turn into an unsustainable debt situation with problematic spill-over effects on domestic financial markets and the European banking sector, and can have a serious impact on the country’s domestic fiscal situation (in the form of bail-outs). We should also keep in mind that the situation and behaviour (of domestic borrowers and international lenders) can change quite sharply pre- and post-accession (or even in the years leading up to accession – as shown by the example of Slovenia, which moved from a very stable macroeconomic situation to a serious financial crisis in the years following accession).

(ii) Fiscal situation

The position of the state varies considerably in the different economies that are aiming to become members of the EU. Thus, for example, we expect Ukraine – which will (hopefully) have exited from a war situation – to enter into negotiations with a much higher level of state involvement (not least to facilitate economic reconstruction) and a higher level of public debt than other candidate countries. Despite this heterogeneity (and taking account of it), it will be important to monitor the role of the state in ensuring macroeconomic stability and – more generally – the part it plays in the development of an economy. On the one hand, there is the traditional issue of whether fiscal developments indicate a problem regarding the sustainability of fiscal borrowing, which could lead to serious adjustments (i.e. austerity phases that interrupt sustained growth and catching-up trajectories). On the other hand, a more detailed assessment of expenditure and revenue structures allows evaluation of whether a state is exploiting its potential to contribute to a successful longer-run growth trajectory. Here it is important to ensure the continuous monitoring of state spending on items that support economic growth (such as education/training, R&D,

physical and intangible infrastructure) and to analyse whether the tax base of a country with an equitable tax and revenue structure is being efficiently exploited. Furthermore, as a country progresses with its economic development, it is essential to monitor whether the expenditure and revenue structure is adapting to the fresh challenges demanded by the different phases of a successful catching-up process – such as building up domestic innovation capabilities, adjusting education/training structures, various parts of the infrastructure, etc. Finally – and linked with (iv) below – indicators of legitimate vs. illegitimate behaviour (e.g. corruption, inappropriate use of public resources, and illicit and non-transparent forms of public procurement) should be tracked.

(iii) Labour markets and social indicators

Especially in the current group of candidate countries, demographic developments are of the utmost importance to their growth prospects. It is well known that natural birth rates have suffered throughout the transition phase of the countries; and most importantly, all the current candidate countries (we exclude Turkey from our analysis) have undergone a dramatic population loss through emigration – sometimes due to military conflict, but also on account of economic, social and political instability. Furthermore, emigration has had a particularly problematic impact on human capital, as the composition of migrants is often biased towards the better educated and the young. This can act as a serious growth constraint – not only in a quantitative, but also a qualitative sense. It also leads to serious mismatch problems on the labour market, where there may be a shortage of skilled workers, technicians or civil servants; this can hamper the catching-up process and have a negative impact on sound social and institutional development. There are further aspects that require careful monitoring, such as the participation rates of women and the serious geographical disparities that are emerging, with important implications for a more balanced regional development pattern. The reduction in the share of the working-age part of the population is accompanied by deteriorating age profiles and sometimes still high rates of unemployment. An examination of the labour market, training/educational and regional policies that are put in place – and of how effective they are – will be important in evaluating the efforts made to alleviate the problematic demographic and labour market situation in the countries concerned. As for spill-over effects on current EU members, it is clear that large-scale migration flows are a highly sensitive issue that has, in the past, derailed the prospects for a smooth accession process. Hence, monitoring policy efforts to implement mutually beneficial mobility and migration policies (such as circular migration schemes, including incentives for the business sector) should be part of the assessment of the ‘essential conditions’.

(iv) Institutional factors/business environment

Institutional developments and governance are well-recognised factors for economic development. In the EU accession context, institutional and governance convergence with EU practices is of special importance. As the analysis of institutional and governance developments is a huge field, we propose to focus on the specific areas of how business and judicial practices develop in relation to contract reliability and contract enforcement; on how the countries have handled the EU funds they have received in the pre-accession phase; and on their ability to participate in EU programmes that are particularly important for education/training, business development, infrastructure and regional development. This includes an assessment of so-called ‘absorption capacity’ and of the proper use of such funds to meet the targets set out by these programmes (evaluation studies ordered by the Commission may be used for this purpose). An additional, and particularly relevant future-oriented aspect would be to analyse how countries might contribute to the ‘green and digital transition’ that is

emphasised by current EU programmes: some of the candidate countries could make a significant contribution to these areas for the EU as a whole. In the current changing geopolitical context, the contribution made by the various countries to strengthening Europe's security and military capabilities has also moved up the list of priorities on the EU political agenda.

2. SELECTION OF QUANTITATIVE INDICATORS TO ASSESS THE COPENHAGEN CRITERIA

To join the EU, countries need to fulfil the Copenhagen criteria. In economic terms, this means two things: 1) a functioning market economy; and 2) the capacity to cope with competitive pressure and market forces within the EU.⁴

The Copenhagen criteria are a set of qualitative benchmarks, rather than clear, quantitative targets that are objectively met (or not). However, by using the Commission's enlargement package reports published each year, we are able to identify those indicators that are used to track and measure progress. We can then quantify those indicators using publicly available data, and assess how the various countries of Central, East and Southeast Europe (CESEE) that have already joined the EU scored at the time of their accession. In doing this, we partly replicate the approach of Grieveson et al. (2023).

By then comparing those indicators at the time of accession against the then EU15,⁵ we can identify those areas in which the 2004-2013 joiners were relatively strong or comparatively weak. By doing this, we can then hypothesise that certain indicators were more or less important. For example, if we find that a country had a big external deficit relative to the EU15, but thrived anyway in terms of its convergence performance, we can postulate that reducing their external deficit is unlikely be a priority for the new accession countries. By contrast, if we find that a country had high inflation relative to the EU15 and then struggled to converge as rapidly as its peers that did not have high inflation, we can hypothesise that tackling inflation should be a priority for the new candidate countries. This methodology does not allow us to conclude definitively that one area is more important than another, but it does provide important context to reinforce or challenge findings in other sections of the report, and to support the overall conclusions.

In section 3 we look at macroeconomic, fiscal, trade, financial, labour market, business environment and institutional indicators. We track the performance of the 11 EU-CEE countries versus the EU15 at the time of their accession – but also in the years before and after, in order to get a full picture. As far as possible, we start five years before accession and follow developments until five years after.

We use these indicators to assess two fundamental elements of the enlargement experience of EU-CEE countries. First, overall growth performance (either headline GDP or per capita GDP or both). Second, macroeconomic stability, including the balance of payments, debt (public and private) and the financial

⁴ See https://economy-finance.ec.europa.eu/international-economic-relations/candidate-and-neighbouring-countries/enlargement/economic-accession-criteria_en

⁵ Since the UK left the EU, the EU15 no longer exists. Moreover, with the convergence success of parts of EU-CEE and the weaker performance of some 'older' member states, the idea of the EU15 or 'old' member states as a benchmark is increasingly redundant. However, as we are here chiefly concerned with countries that joined the EU before 2008 (the only exception being Croatia, in 2013), in this section we will use the EU15 as a benchmark.

sector. Both are relevant in attempting to judge what was important (or not) during past enlargements, as a guide for the next accession round(s).

3. EXPERIENCE OF PREVIOUS ACCESSION COUNTRIES – GENERAL EU-CEE PART, PLUS CASE STUDIES ON ROMANIA, BULGARIA AND CROATIA

3.1. General developments in EU-CEE before and after accession

To start with, we look at which countries did best after their accession to the EU. Overall, the results are what one would have expected: EU accession overall is a motor of convergence. The poorest countries (e.g. Romania) grew fastest, while the richest (e.g. Slovenia, Czechia) developed most slowly (Table 3.1). The two most disappointing cases in the years after accession are Hungary and Croatia, while the main positive cases are Romania and Lithuania. It will therefore be important to identify the particular conditions and circumstances of those countries. Although for most countries the inverse relationship between growth rate and development level is clear and as expected: in terms of their development level, those countries towards the top left corner of Figure 3.1 grew especially strongly after accession. Romania and Lithuania stand out, along with Estonia. On the negative side, Bulgaria stands out for having had by far the lowest level of economic development and only an average rate of convergence by regional standards (in the years up to 2019).

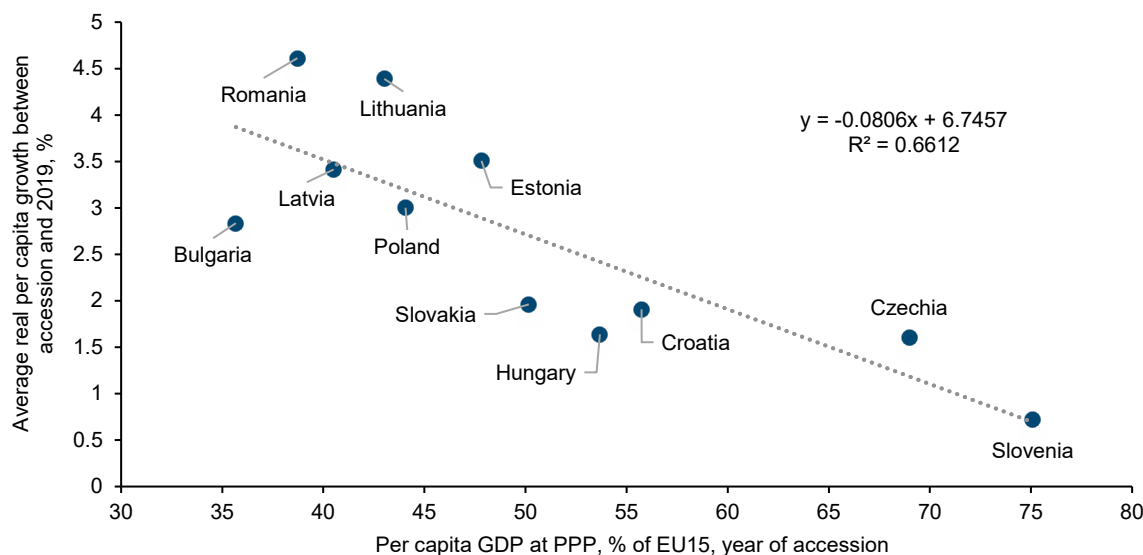
Table 3.1 / Real growth in per capita GDP, difference versus EU15

	5 years before accession	5 years after accession	Average since accession up to 2019
Bulgaria	5.6	3.6	2.8
Czechia	1.3	2.4	1.6
Estonia	5.2	4.3	3.5
Croatia	0.2	1.6	1.9
Hungary	4.2	1.6	1.6
Lithuania	5.2	4.0	4.4
Latvia	5.2	4.0	3.4
Poland	1.0	4.0	3.0
Romania	8.3	6.1	4.6
Slovenia	1.5	0.7	0.7
Slovakia	1.8	5.3	2.0

Sources: Eurostat, wiiw.

As outlined in section 2, alongside overall growth performance, we are also interested in macroeconomic stability. This will be examined more closely in the sub-sections below, but first here we look at two indicators of macroeconomic stability in its broadest sense: the volatility of GDP growth and the volatility of inflation. We hypothesise that high volatility in one or both of these indicators would point to deeper issues related to macroeconomic stability, which can then be followed up in the sub-sections.

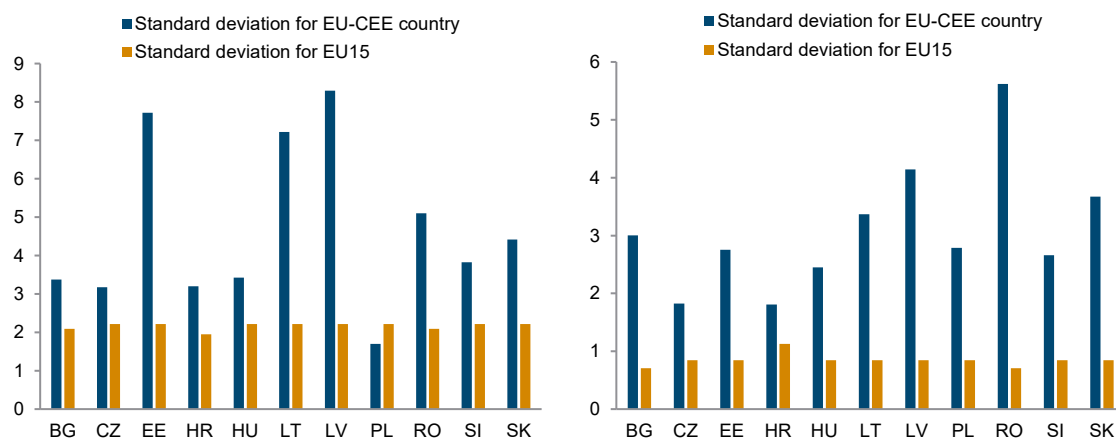
Figure 3.1 / Comparison of real per capita GDP growth after accession and the level of per capita GDP in year of accession



Sources: Eurostat, wiiw.

As Figure 3.2 shows, there is a big range in terms of outcome. As regards volatility of GDP growth, the Baltic states clearly show a much larger standard deviation than the other countries, testifying especially to the brutal post-2008 adjustments that they underwent, as well as to their rapid growth in the period leading up to accession. Romania and Slovakia also stand out with regard to volatility of GDP, although primarily for their rapid pre-2008 growth, rather than an especially severe post-crisis downturn. It will be crucial in the next accession round to avoid the Baltic scenario, with rapid pre-crisis growth fuelled by large external deficits and unsustainable private credit growth.

Figure 3.2 / Standard deviation of annual real GDP growth rates (left) and annual inflation rates (right) for five years before accession, year of accession and five years after accession



Note: In each case, the EU15 standard deviation is given for the same 11-year period as the EU-CEE country.

Sources: Eurostat, wiiw.

For inflation, the clear outlier is Romania, owing to its very high inflation in the years immediately preceding accession. Yet given Romania's impressive growth and convergence performance since, we can hypothesise that avoiding volatility in inflation rates (within reason) need not be a major priority in future accession rounds. Part of Romania's higher inflation rate was due to a generally looser real monetary policy stance than, for example, Bulgaria, which prioritised euro area accession. This again might be instructive for future accession rounds, in the sense that aiming for euro adoption as early as possible – and therefore submitting to the constraints of the Maastricht criteria – could come at the expense of economic growth.

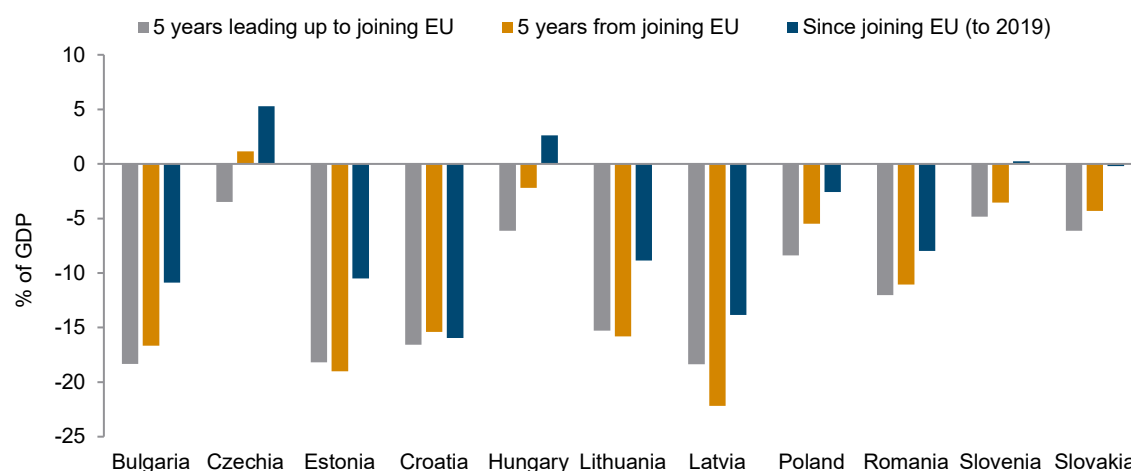
We now go through the indicators identified in the enlargement reports, organised in the four areas identified, with a particular focus on the countries that have done especially well or especially badly.

3.2. External accounts and competitiveness

3.2.1. TRADE BALANCE

Before EU accession, the entire region of Central and Eastern Europe (CEE) consistently ran a trade deficit – a trend typical of smaller, less-developed economies. These deficits were particularly pronounced in countries with a lower level of economic development, reflecting their reliance on imports to meet domestic demand and support industrial growth.

Figure 3.3 / Average trade balance as % of GDP in the 5 years preceding and succeeding EU accession and in the period from EU accession until 2019



Source: National sources, wiiw.

Upon joining the EU, all countries in the region managed to reduce their trade deficit, a testament to the positive impact of EU integration on trade dynamics. However, the extent of this improvement varied. Countries like Croatia – and to a degree Latvia and Romania – saw a more modest reduction in the trade deficit. By contrast, nations that started with a smaller trade deficit – such as Czechia, Hungary, Slovenia and Slovakia – achieved a significant improvement, with some even attaining a trade surplus or nearing balance.

Interestingly, despite these improvements in trade balances, it was not necessarily those countries that achieved the most significant reductions – or that turned a deficit into a surplus – that experienced the highest average GDP growth. This suggests that the persistence (or lack) of a trade imbalance alone does not provide a comprehensive picture of a country's potential for economic success. The important factor is how these trade balances are financed. The sustainability and nature of financing –whether through domestic savings, foreign investment or debt – play a crucial role in determining a country's economic prospects and resilience. Furthermore, whether foreign capital inflows play a significant role in building up a competitive tradeable sector is of great importance to avoid longer-term structural trade and balance of payments deficits.

3.2.2. EXPORTS OF GOODS AND SERVICES: EXPORT SHARE AND EXPORT GROWTH

An examination of export growth across these countries reveals the significant impact of EU accession on trade dynamics. It is important to note that exports as a percentage of GDP often correlate negatively with the size of the economy, as larger economies tend to have more diversified economic structures. Therefore, focusing on export growth provides a clearer picture of the economic benefits that derive from EU membership.

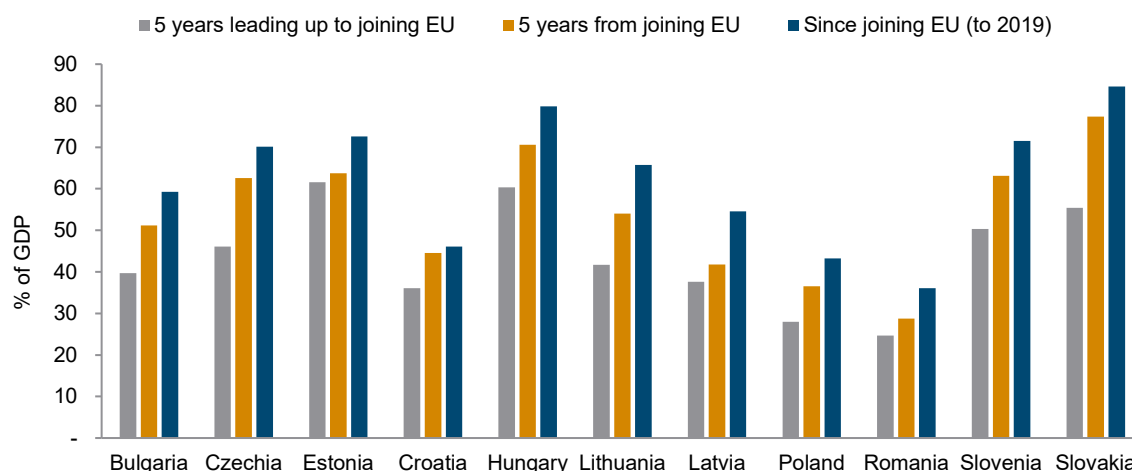
Joining the EU clearly boosted export growth in the region. Even countries that had little export growth before accession, such as Estonia and Latvia, caught up with the regional average in the years following accession. This trend highlights the positive influence of EU membership on trade, facilitating market access and fostering economic integration.

Croatia presents a unique case, where average export growth was negative before accession, a period that coincided with the global financial crisis. Post-accession, Croatia experienced only moderate export growth, roughly on a par with other countries in the region. This suggests that while EU membership may have stabilised Croatia's export sector, the benefits were tempered by policy decisions and the broader economic context (a theme to which we return below).

Bulgaria is another notable example where pre-accession export growth was significantly higher than post-accession growth. Romania, which joined the EU at the same time as Bulgaria, exhibited a similar trend, though the decline in average export growth was much smaller than in Bulgaria. The post-accession period for both countries was marked by economic crises, which likely impacted their export performance.

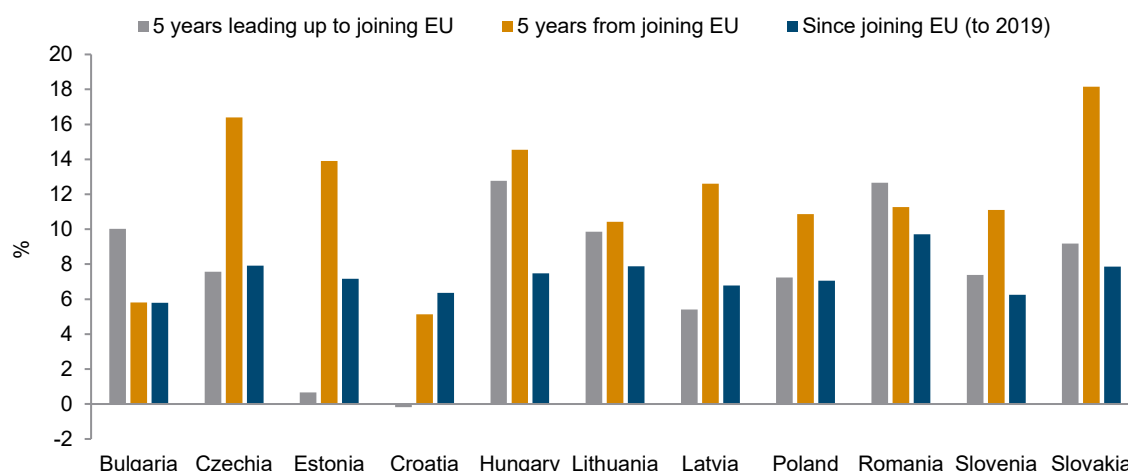
These observations underscore the complex interplay between EU accession, global economic conditions and national economic policies in shaping export growth trajectories. While EU membership generally fosters export growth, the extent of this impact can vary on the basis of specific economic contexts, pre-existing conditions and strategies that different countries followed. An important factor is foreign direct investment.

Figure 3.4 / Average exports as a share of GDP in the 5 years preceding and succeeding EU accession and in the period from EU accession until 2019



Source: Eurostat.

Figure 3.5 / Average growth in (real) exports in the 5 years preceding and succeeding EU accession and in the period from EU accession until 2019

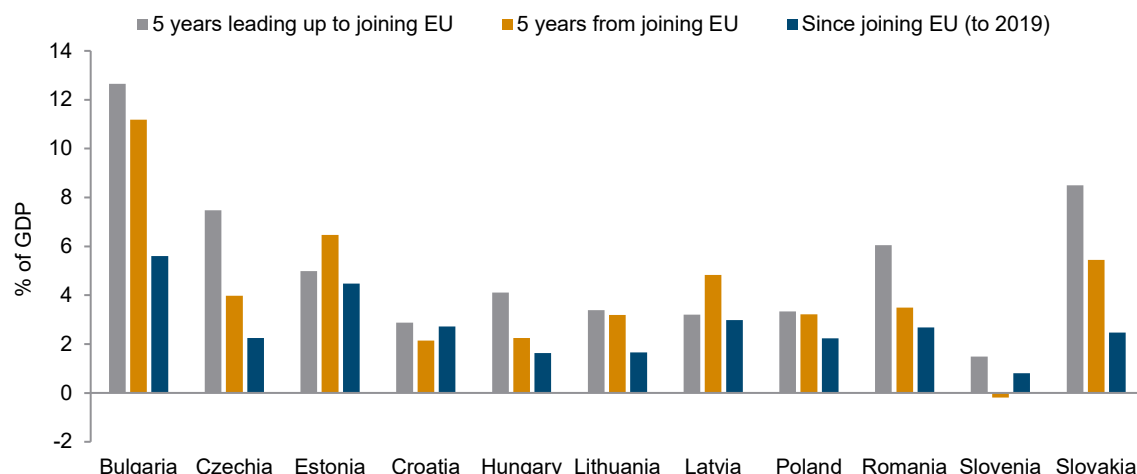


Source: Eurostat.

3.2.3. FOREIGN DIRECT INVESTMENT

Bulgaria was overall successful in attracting foreign investment. However, mismanagement and a delayed privatisation programme meant that its former industrial giants were unsuccessful in attracting foreign investment, and many of them did not survive. Rather than flowing into manufacturing or other tradeable sectors with the potential to boost exports, much of the FDI was directed towards real estate and retail. Romania was also successful in attracting FDI (as a percentage of GDP, larger economies would show a lower share), and enacted reforms in a more timely manner. This allowed FDI to flow into its manufacturing sector, particularly the automotive industry, which helped boost the country's exports and contributed to its more dynamic GDP growth (Dobrinisky, 2021).

Figure 3.6 / Average net FDI inflows as a share of GDP in the 5 years preceding and succeeding EU accession and in the period from EU accession until 2019



Source: National sources, wiiw.

Most countries in the region, especially those with an above-average reliance on FDI, reduced their net inflows as a percentage of GDP. This trend is particularly evident in Romania, Slovakia and Czechia, which all showed a significant reduction in their reliance on FDI post-accession.

Some countries, however, increased (or only minimally reduced) their reliance on FDI: Latvia and Estonia experienced an increase, while Croatia and Lithuania maintained a relatively steady level of FDI inflows. Despite these variations, the ability to attract foreign capital played a crucial role in the development of countries in the region. FDI was one of the main drivers of productivity, export growth and economic upgrading, especially if the effects of other potential financing options are taken into account.

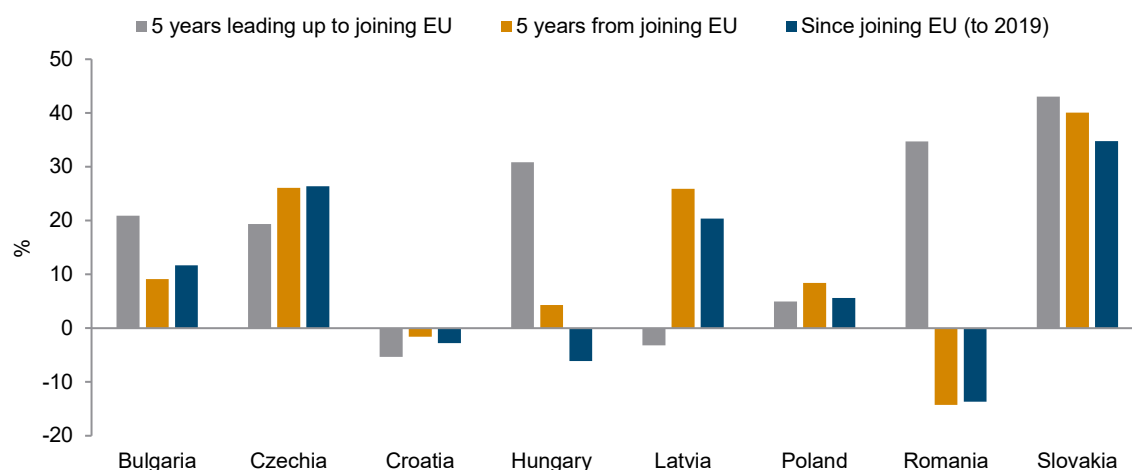
However, the impact of FDI on economic performance (growth, trade balance, productivity) is nuanced. While attracting FDI was important, not all countries that were successful at doing so achieved superior economic outcomes. It is generally recognised that a higher share of FDI in tradable sectors supports stronger economic outcomes. Countries like Czechia and Romania, where the share of FDI in tradable sectors remained relatively high, experienced stronger export growth after accession. In contrast, others with a larger shift toward non-tradable sectors saw more modest trade performance. This suggests that the sectoral allocation of FDI inflows is critical. Specifically, FDI that flows into sectors with a high potential for improving productivity and a tendency to export goods or services tends to yield better economic results.

3.2.4. REAL EFFECTIVE EXCHANGE RATE

Movements in the real effective exchange rate (REER) are a function of many factors, and they provide valuable insights into the dynamics of competitiveness. In general, one can expect countries that accede to the EU to witness an appreciation of their REER, as they experience capital inflows and – starting from lower price levels – will experience a price convergence process. At times, such appreciation pressures can be too strong and the country's competitiveness will suffer. The conduct of monetary policy and the choice of exchange rate regime (i.e. early pegging to the euro or an attempt to join the European Monetary

Union – EMU) has been an important determinant of real exchange rate movements. The example of Croatia stands out: it moved very early on to peg its currency to the euro, and then had little leeway to conduct an independent monetary policy, leading to a period of overvalued currency.

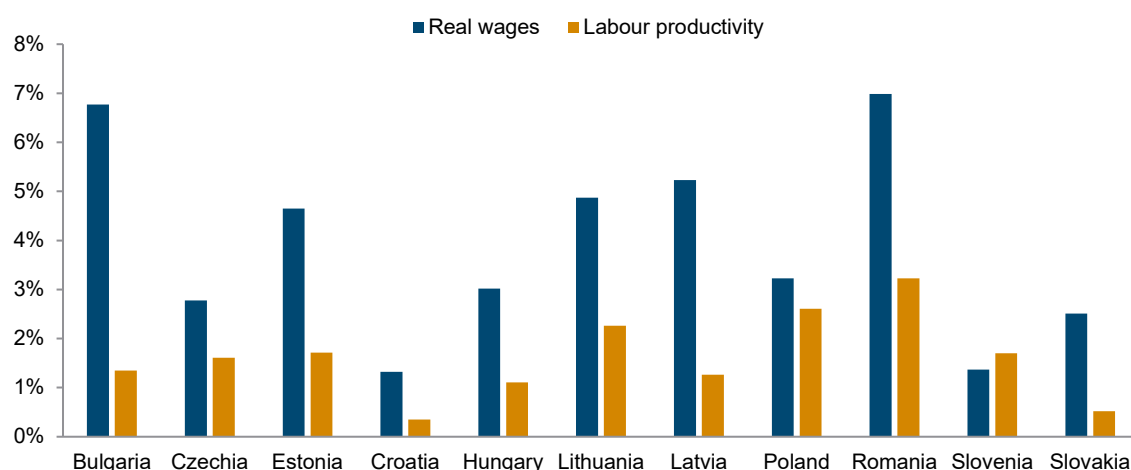
Figure 3.7 / Percentage change in the real effective exchange rate in the 5 years leading up to and 5 years from EU accession and in the period from EU accession until 2019



Note: The World Bank calculates uses the following definition for the REER: the Real effective exchange rate is as the nominal effective exchange rate (a measure of the value of a currency against a weighted average of several foreign currencies) divided by unit labour costs in manufacturing. Higher values stand for appreciation.

Source: World Bank.

Figure 3.8 / Average rate of growth in labour productivity and real wages since accession to the EU



Note: Labour productivity is calculated as ratio of GVA (reference prices 2019, in EUR m at 2019 fixed exchange rate) and employment. Wages are indexed to 2005.

Source: National sources, wiiw.

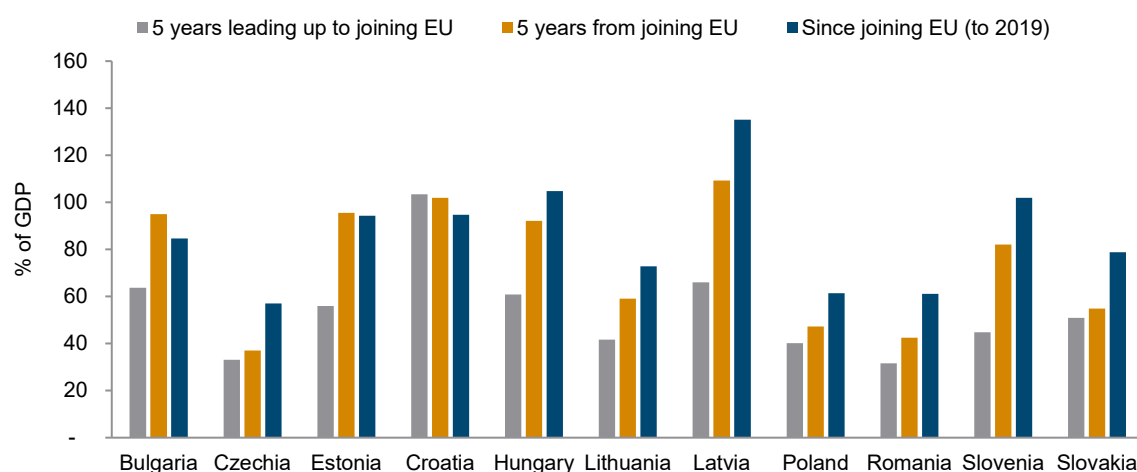
Apart from monetary and exchange rate policies, wage vs. productivity developments are an important determinant, and spells when the two variables do not move in a synchronised manner – such as strong

wage growth outstripping productivity growth – can lead to a serious loss of competitiveness. This happened in a range of countries, often during pre-election give-aways, as collective-bargaining processes are often not well institutionalised. As shown in Figure 3.8, which presents average growth rates in real wages and labour productivity since EU accession, the divergence between the two is striking in many cases. In some countries, real wages have grown more than five times faster than productivity, and in Bulgaria, the gap is especially large, with real wage growth nearly seven times that of productivity growth. However, there are also cases where the imbalance is much less pronounced—most notably in Poland, where average real wages have grown by 3.2% annually, closely aligned with a 2.6% increase in productivity. Finally, the dependence of a country's imports on important cost drivers – such as oil and gas – can transmit cost-push effects and hence impinge on a country's competitiveness. Hence, the monitoring of countries' REERs and their determinants is an important aspect of assessing the compliance of prospective accession countries with the economic Copenhagen criteria.

3.2.5. EXTERNAL DEBT

Pre-accession external debt, measured as a percentage of GDP, exhibited significant variation across the region. Croatia stood out for having the highest levels of external debt during the pre-accession period – a situation exacerbated by the global financial crisis, which led to a substantial increase in external debt levels across many countries.

Figure 3.9 / Average external debt as a share of GDP – rate in the 5 years preceding and succeeding EU accession and in the period from EU accession until 2019



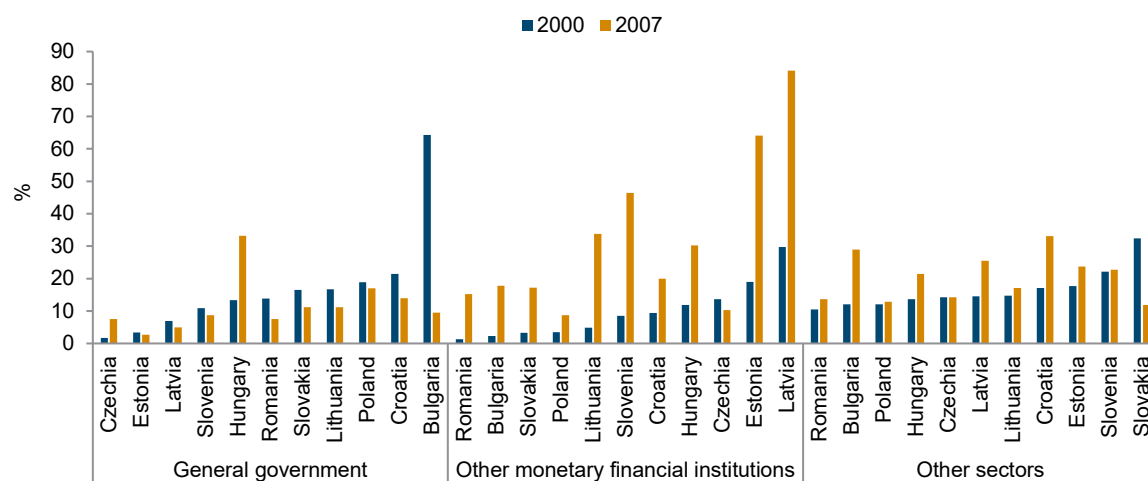
Source: National sources, wiiw.

The trajectory of external debt post-accession was diverse. Some countries, notably Czechia and Poland, managed to maintain relatively stable levels of external debt, while countries like Estonia and Hungary experienced significant fluctuations, with external debt levels initially rising, before being brought back down to more manageable levels of around 70-80% of GDP. On the other hand, countries such as Latvia and Slovenia saw a continuous rise in their external debt levels.

The analysis shows no clear link between pre-accession external debt levels and post-accession economic performance. Countries with high or low pre-accession debt did not consistently perform better

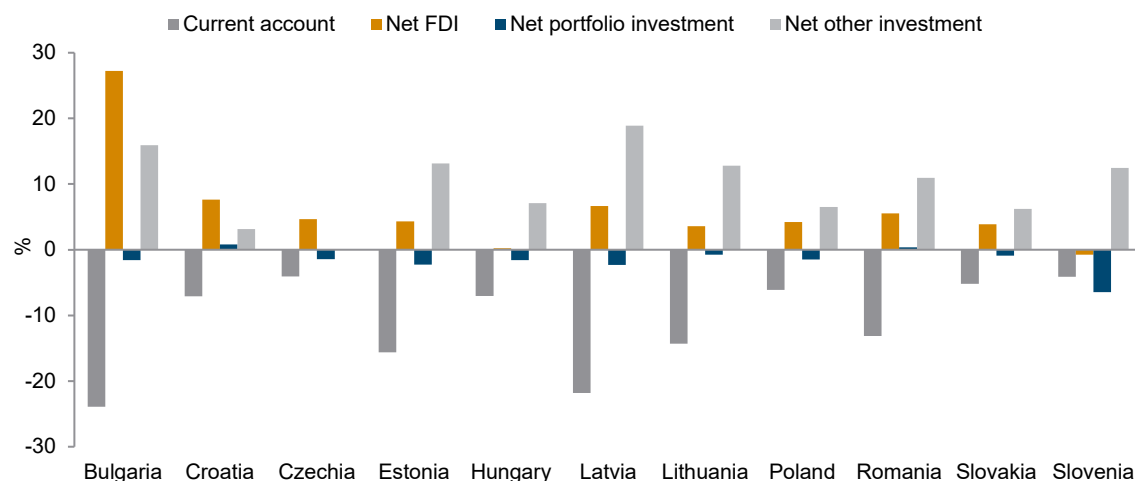
or worse after joining the EU. What is more illuminating, however, is external debt broken down by sector. Here we can see that there was a substantial increase in external debt/GDP in the years leading up to the 2008 global financial crisis, but this was concentrated in the financial sector and especially in four countries: the three Baltic states and Slovenia (Figure 3.10). These four would run into big difficulties after 2008, Slovenia with a domestic banking crisis and the Baltic countries with economic depression and painful external adjustments. By 2007 – the last year before the music stopped – all three Baltic countries were running current account deficits in the range of 14-22% of GDP and financing these primarily via ‘other’ investment, i.e. foreign credit (Figure 3.11). This points to a risk facing new candidate countries as well that must be avoided: the potential for large-scale debt-creating private capital inflows, financing unsustainable current account deficits, which then lead to painful adjustments once sentiment changes on the global financial markets.

Figure 3.10 / Gross external debt, by sector, % of GDP



Sources: National sources, wiiw.

Figure 3.11 / Balance of payments, selected components, 2007, % of GDP



Sources: National sources, wiiw.

On the basis of this section, we can draw four main conclusions that are relevant to future accession candidates. First, trade deficits in acceding countries should not themselves be seen as a bad or dangerous thing. If financed fully or primarily by net FDI inflows into the tradeable sector, trade shortfalls are likely to close and even flip into surplus after accession, as countries benefit from associated productivity upgrades and take advantage of full access to the single market. We cannot establish on the basis of our analysis here that the size of the trade deficit pre- or post-accession per se was a strong predictor of growth performance or macroeconomic stability. Second, the financing of these deficits is a much more important indicator to focus on than the deficits themselves. Trade and broader current account deficits financed primarily by debt can lead to unsustainable and destabilising credit booms, and may drive an appreciation of the real exchange rate that itself then reduces external competitiveness and keeps trade deficits high. This has been the experience of many Western Balkan countries. Third, and following on from this, real exchange rate developments in candidate countries should be very closely monitored. This pertains to the conduct of monetary and exchange rate policy, but also to finding an institutional anchor to aim for a balanced development of wage and productivity growth. Finally, FDI inflows should also be tracked in terms of the sectors they are going to. Even if FDI is the main method of financing the trade deficit, this in itself could be problematic if those FDI inflows are mostly going into the non-tradeable sector. Further issues are also important in this context, such as an undue degree of (sectoral) concentration of exports and adjustment problems of producers to the requirements of the single market when there is a heavy orientation of trade towards non-EU countries prior to accession.

3.3. Fiscal situation

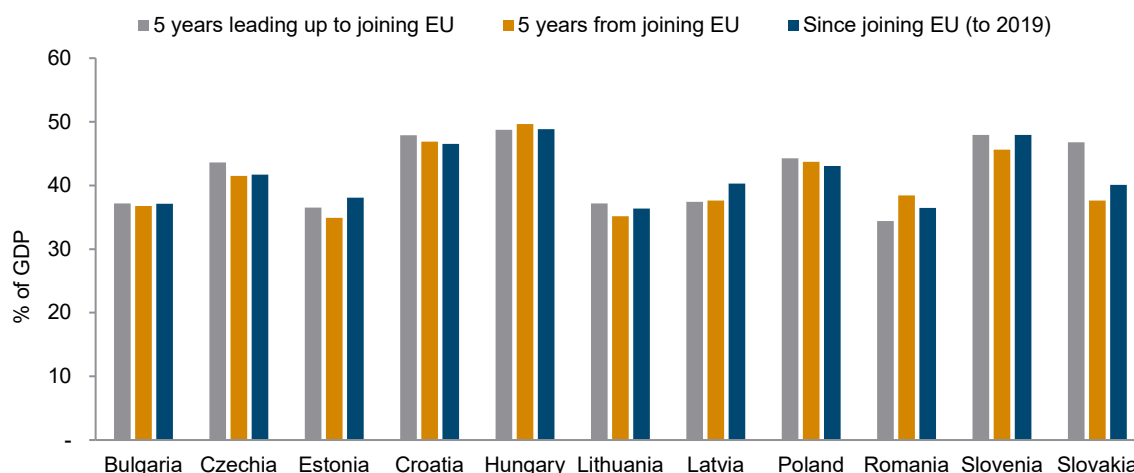
3.3.1. GOVERNMENT SPENDING

An analysis of government spending as a share of GDP across these countries reveals some intriguing insights into the relationship between public expenditure and post-accession economic performance. Countries such as Estonia, Lithuania, Latvia and Romania, which had maintained a relatively moderate share of government spending, generally achieved favourable economic outcomes post-accession. This suggests that in these economies, a balanced approach to public- and private-sector involvement fostered growth, potentially by allowing for effective public investment in infrastructure and human capital, which complements private-sector activities.

Bulgaria, however, presents a contrasting case. Despite having a government spending share comparable to the aforementioned countries, Bulgaria's post-accession economic performance was less impressive. This discrepancy underscores the complexity of the relationship between government spending and economic growth, indicating that the quality and focus of public spending are as important as its size. Effective governance and strategic public investment are likely to be critical factors in shaping economic outcomes.

Some countries with a higher share of government spending relative to GDP, such as Hungary, Croatia and Slovenia, faced challenges in achieving robust economic growth post-accession. This observation does not necessarily imply that public spending crowds out private-sector activity. Instead, it suggests that the composition and efficiency of public expenditure are crucial. In these cases, inefficiencies in public spending or structural issues may have hindered the positive impact that government investment can have on economic development.

Figure 3.12 / Average government spending as a share of GDP in the 5 years preceding and succeeding EU accession and in the period from EU accession until 2019



Source: Eurostat.

3.3.2. GOVERNMENT BALANCE AND DEBT LEVELS

Analysis of the fiscal deficits and debt levels of these countries reveals how different approaches to fiscal management influenced their economic trajectories.

Countries that have demonstrated a controlled deficit and a sustainable debt level often exhibit a favourable economic outcome. Estonia, for example, successfully maintained a surplus and kept gross debt levels low. This fiscal discipline coincided with impressive average GDP growth, suggesting a potential association between responsible fiscal policies and economic prosperity. However, it is important to recognise that economic performance can also influence fiscal positions, as robust growth may facilitate better fiscal outcomes.

Bulgaria presents a contrasting case. Despite achieving multiple government surpluses and reducing its gross debt, Bulgaria's average GDP growth was far from outstanding in the period following accession. This suggests that while fiscal restraint can be beneficial, excessively restrictive policies may inadvertently constrain economic potential by limiting productive investments. The contrast between Estonia and Bulgaria underscores the importance of understanding the specific context and characteristics of fiscal policy in order to assess its impact, and indicates the need for a nuanced approach that balances restraint with growth-oriented investment.

At the other end of the spectrum, countries with a high fiscal deficit and a rising public debt level, such as Hungary and Croatia, faced challenges in achieving robust economic performance post-accession. These nations experienced slower growth rates, which might suggest that excessive debt and deficits can weigh heavily on the economy. However, it is equally plausible that economic downturns necessitated increased fiscal spending as a means of stabilising the economy and mitigating the impacts of recession.

An often-overlooked factor in assessing fiscal sustainability and the effectiveness of public spending is the size of the informal sector, typically captured through the rate of informal employment. High levels of

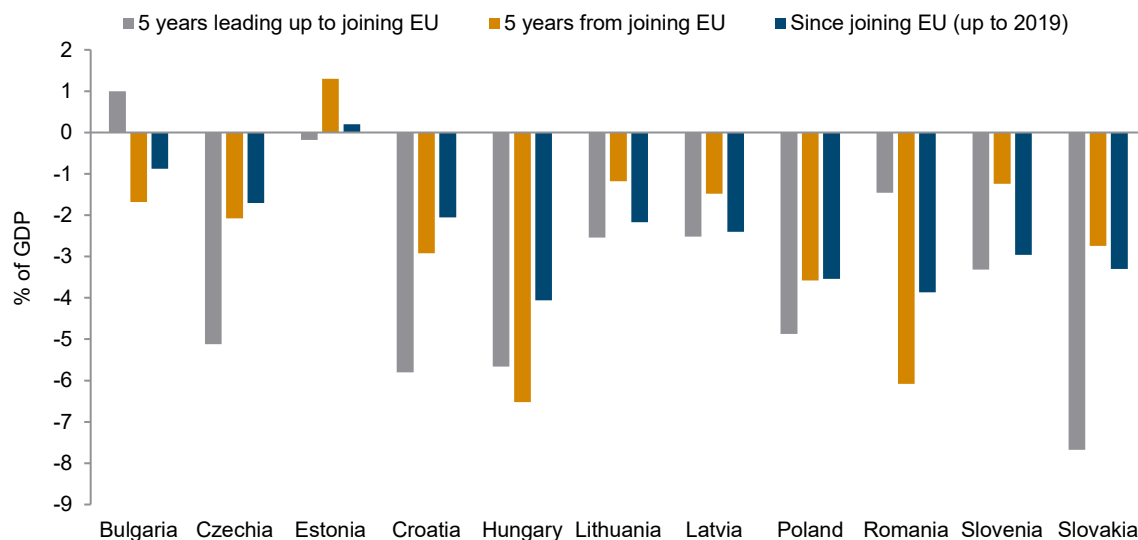
informality can erode the tax base, reduce the coverage of social protection systems, and distort labour market indicators such as productivity and wage growth. Encouragingly, most member states examined have managed to significantly reduce the share of informal employment in the post-accession period. Poland, which historically had one of the largest informal sectors, achieved a notable reduction in informal employment, cutting its share by half between 2010 and 2023. In several other countries, the rate of informal employment increased during the early 2010s, coinciding with some of the most difficult post-crisis years, but has since been on a decreasing trend. The only country that stands out from this general pattern is Slovakia, where informal employment has been rising again in the 2020s. This highlights the importance of effective labour market regulation and enforcement in strengthening fiscal resilience and improving the reliability of economic data used for policymaking.

Beyond the size of government spending, its quality and efficiency are equally important for understanding fiscal performance and long-term growth outcomes. A recent study by the Government Transparency Institute developed a Regional Public Spending Quality Score based on public procurement data, analysing over four million tender contracts across the EU between 2006 and 2015. The results reveal significant variation across the region. While Latvia ranks among the top performers, its Baltic peers, Estonia and Lithuania, are positioned more toward the middle of the distribution. In contrast, much of the Central and Eastern European (CEE) region scores poorly. Notably, Slovakia and Romania are ranked as the two lowest-scoring countries in the entire EU, pointing to persistent weaknesses in transparency, competition, and efficiency in public procurement (Fazekas & Czibik, 2021).

The experiences of these countries highlight the complex interplay between fiscal policy and economic performance. While it is important to keep track of fiscal imbalances, fiscal policy can also play a crucial role in both stabilisation and the stimulation of longer-term growth.

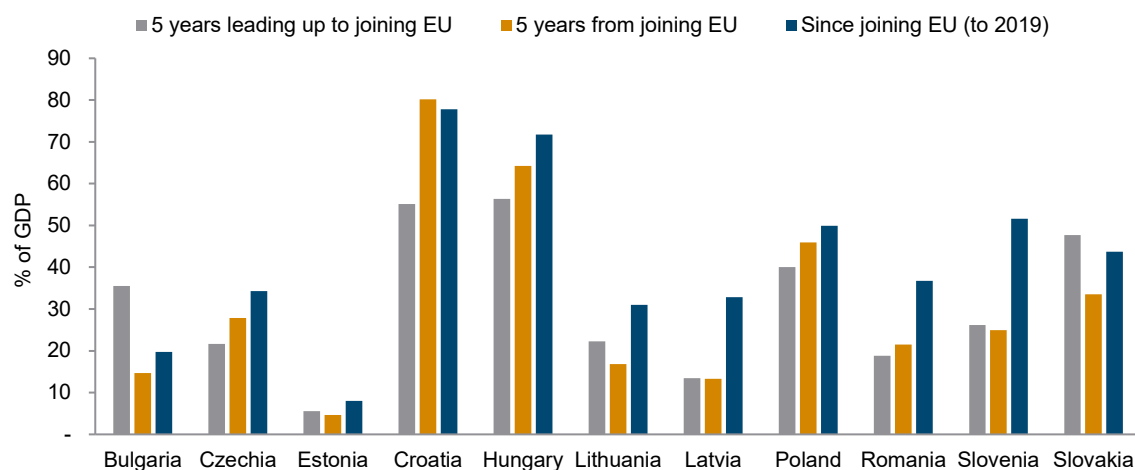
This section reveals two key insights for current candidate countries. First, the tightness or looseness of fiscal policy as a whole is not a strong predictor of economic outcomes. Countries with very conservative fiscal policies (Estonia) and those where the policies have been much looser (Romania) have both had good outcomes. While Romania has tended to run a big fiscal deficit, it has (at least until recently) more than offset this with rapid economic growth, and as a result public debt has stayed low relative to GDP. Second, the level of public debt relative to GDP seems to be more important. Those countries that joined the EU with the highest public debt/GDP ratios – Hungary and Croatia – have been among the weakest performers. Especially in the period after 2008, both underwent years of austerity, which placed a cap on their growth potential. The message to current candidates is therefore not to be overly restrictive on fiscal policy, especially where the public debt/GDP ratio is at a low level. The case of Ukraine will be rather special, as it will – hopefully – have emerged from a horrific war that will have taken its toll on public (and external) debt. There, sustained external support for economic reconstruction will be crucial to support a successful trajectory of economic growth and mutually beneficial integration with the EU – see further section 4.4.

Figure 3.13 / Average government fiscal balance in the 5 years preceding and succeeding EU accession and in the period from EU accession until 2019



Source: Eurostat.

Figure 3.14 / Average government consolidated gross debt in the 5 years preceding and succeeding EU accession and in the period from EU accession until 2019



Source: Eurostat.

3.4. Labour markets and social indicators

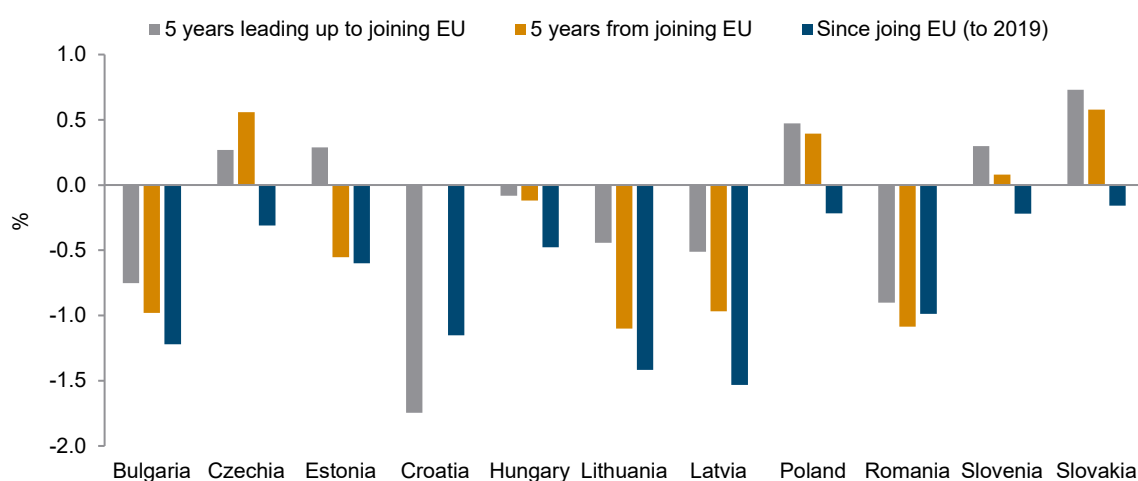
3.4.1. POPULATION GROWTH

Growth of the working-age population is a critical factor in shaping a country's economic trajectory, influencing both the labour market and consumer demand. It is typically driven by natural birth rates and net migration. Notably, all countries in the region experienced population loss (due to net migration) after EU accession, a trend that could be even more pronounced for the Western Balkans, Ukraine and Moldova, due to the significant wage differentials and other factors.

In the context of the countries of interest, population growth played a nuanced role in their post-accession economic performance. Countries such as Bulgaria and Croatia, which experienced the highest average population loss prior to accession, struggled to achieve robust economic growth. On the other hand, countries like Lithuania, Latvia and Romania, despite facing substantial population decreases, managed to achieve strong economic growth post-accession.

In some respects, population loss can also have a counterintuitive impact on economic indicators. Strong wage growth, a key driver of private consumption and GDP growth, is often fuelled by labour shortages caused by outward migration (Astrov et al., 2016). This may support GDP per capita growth, depending on its impact on output vs. population decline. This in turn can soften further outward migration flows and even stimulate return migration. An important aspect is the composition of net migration flows in terms of age and educational profile.

Figure 3.15 / Average year-on-year growth rate of the working-age population in the 5 years preceding and succeeding EU accession and in the period from EU accession until 2019



Source: OECD.

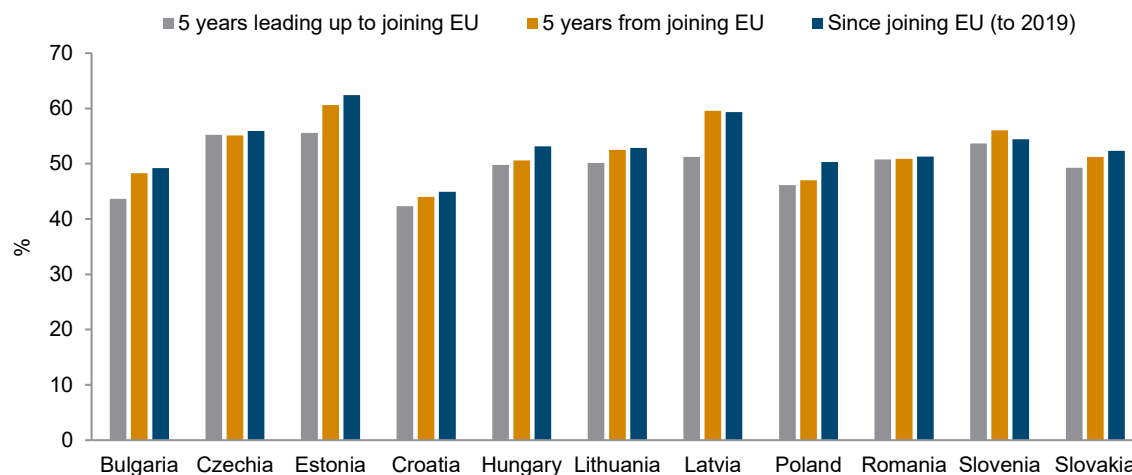
3.4.2. EMPLOYMENT RATES

Employment rates are a crucial indicator of a country's economic health and labour market efficiency. High employment rates typically suggest a robust economy with ample job opportunities, which can drive consumer spending and overall economic development. In the context of CEE countries, employment rates provide valuable insights into their performance following EU accession.

Countries with low employment rates, such as Bulgaria and Croatia, generally had worse economic outcomes. Low employment rates can be indicative of structural economic issues, including lack of job creation, skills mismatches and inadequate labour market policies. These challenges can hinder economic development and limit a country's ability to benefit fully from EU membership.

However, higher initial employment rates do not necessarily show up in better economic outcomes. Slovenia, for example, enjoyed a relatively strong employment situation, but did not achieve significant economic success post-accession, as reflected in growth performance. This indicates that while employment rates are important, they are part of a broader set of factors that influence economic performance. Other elements, such as the quality of jobs, productivity performance and overall business development, also play a critical role in shaping a country's economic trajectory.

Figure 3.16 / Employment rate (%) in the 5 years preceding and succeeding EU accession and in the period from EU accession until 2019



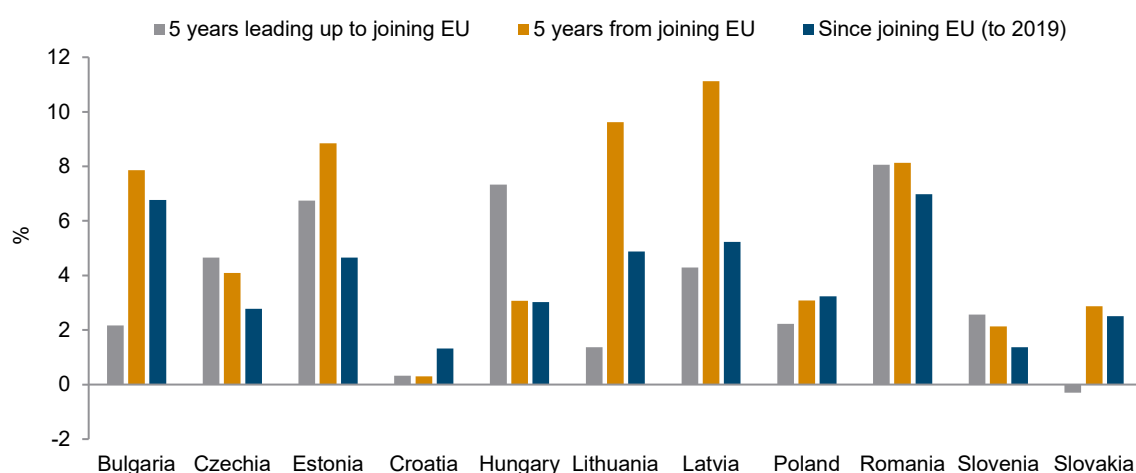
Source: National sources, wiiw.

3.4.3. REAL WAGES

Low real wage growth before accession can position an economy for a more export-oriented strategy, by keeping unit labour costs lower, thereby enhancing the competitiveness of exports and making the economy initially more attractive to capital investment. While this strategy can be effective in the short to medium term, it may hinder long-term growth prospects by constraining domestic demand. This phenomenon has been evident in economies like Germany, and has been a feature in China, where sustained low wage growth has supported export competitiveness, but has raised concerns about limited domestic consumption (Pettis, 2013).

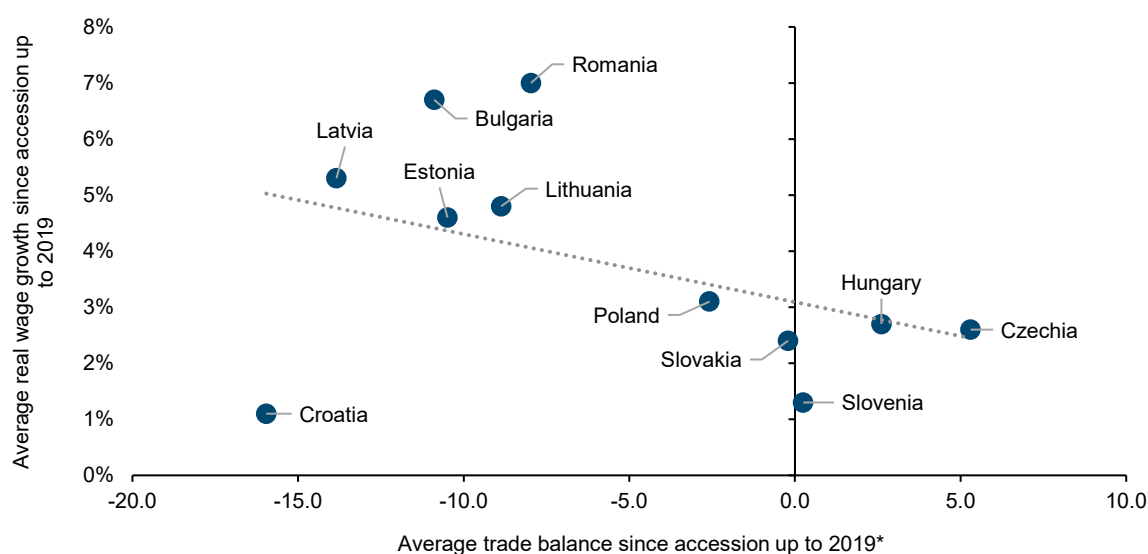
Despite these potential drawbacks, countries with lower real wage growth have generally been more successful in achieving balanced trade or even a trade surplus. As is illustrated by the data, nations that maintained lower wage growth were often able to improve their trade balances post-accession. However, Croatia stands out as a notable exception: despite having the lowest post-accession average wage growth, it experienced the largest average trade deficit.

Figure 3.17 / Average growth in real wages in the 5 years preceding and succeeding EU accession and in the period from EU accession until 2019



Source: National sources, wiiw.

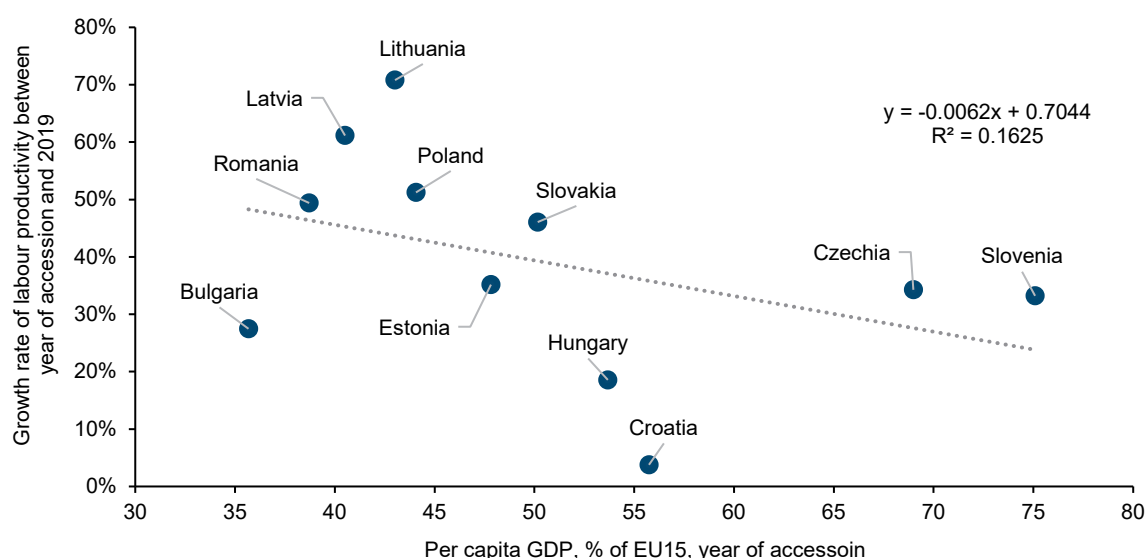
Figure 3.18 / Comparison of average real wage growth after accession and average trade balances after accession



Source: National sources, wiiw. Note: * refers to trade balance as a % of GDP.

In the long term, it is crucial to balance growth in labour productivity with real wage growth. This balance helps to sustain competitiveness, while fostering a healthy equilibrium between domestic market growth and exports. Initially, lower real wage growth relative to productivity growth may be important to attract FDI and shift the trade balance. Over time, however, real wage growth should align with the upgrading of labour skills and productivity improvements, ensuring that economic development is sustainable and inclusive. This approach allows for the benefits of export competitiveness to be realised without sacrificing domestic consumption and long-term economic health.

Figure 3.19 / Comparison of growth of labour productivity after accession and the level of per capita GDP in year of accession



Note: Labour productivity is calculated as ratio of GVA (reference prices 2019, in EUR m at 2019 fixed exchange rate) and employment.

Source: National sources, wiiw.

As Figure 3.19 shows, and as one would expect, those countries that started from a lower base in terms of GDP per capita generally showed a greater improvement in labour productivity following their accession to the EU. Bulgaria, however, stands out for having had less of an improvement in productivity than one might have expected. This can be attributed to the generally low growth performance and the concentration of foreign investment in sectors with limited added value, as previously discussed, which did not fully capitalise on the potential benefits of FDI.

On the positive side, Slovenia and Czechia serve as notable examples. Despite having had the highest GDP per capita at the point of accession, these countries achieved productivity improvements that were markedly higher than the cross-country regression relationship would have suggested. This highlights their ability to leverage existing advantages and enhance productivity, even when starting from a relatively strong economic position.

3.4.4. TERTIARY EDUCATION ENROLMENT

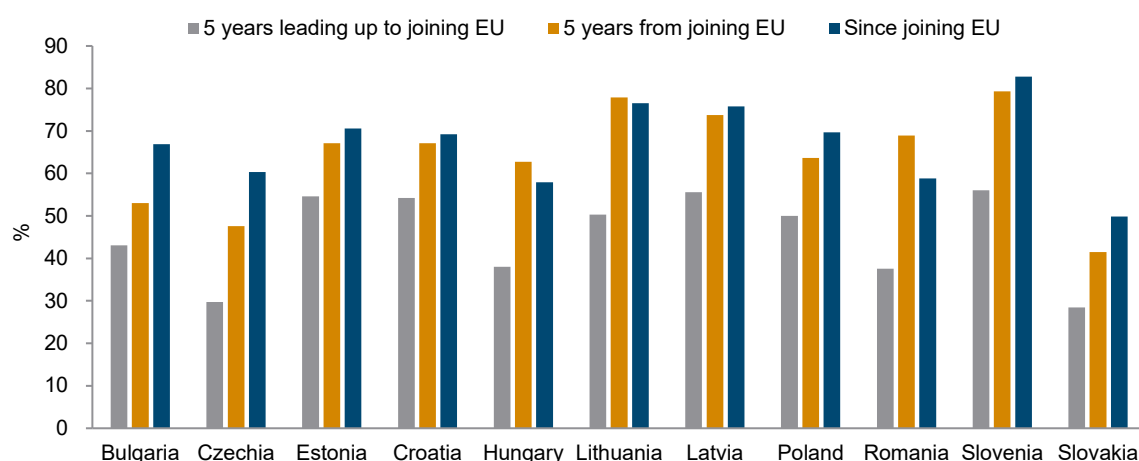
Enrolment in tertiary education is often seen as a key indicator of a country's human capital development. Higher enrolment rates are expected to enhance a country's ability to integrate into high-value EU supply chains, as a better-educated workforce can contribute to innovation and productivity. However, the relationship between tertiary education enrolment and post-accession economic performance in CEE countries is not straightforward.

Slovenia, for instance, had a relatively high tertiary education enrolment rate, but following its accession that was not reflected in particularly strong productivity or export growth. This could be due to various factors, including the quality of education, alignment of educational outcomes with market needs, attitude towards FDI and other policy areas. By contrast, Lithuania, Latvia and Estonia, which also had high enrolment rates, enjoyed some of the best economic outcomes in the region. These countries likely leveraged their educated workforce to drive innovation and attract investment, contributing to their economic prosperity.

Meanwhile, countries with lower enrolment rates (such as Romania, Croatia and Slovakia) also experienced varied outcomes. Romania, despite its fairly low enrolment rate in tertiary education, was one of the winners in terms of economic performance post-accession. On the other hand, the relative economic performance of Croatia – which also had a low enrolment rate – was rather poor.

Overall, it is important to keep track of how educational institutions support the growth performance in candidate and accession countries, and to find a proper balance between the skills on offer and the qualifications required by the labour market. This is, of course, heavily dependent on the development trajectory of the country; but it also influences that trajectory. The indicator shown above is, of course, inadequate to analyse this matching issue in detail: for example, the importance of vocational training should also be included in any proper investigation. Finally, the interaction between education and labour market developments is also a very important factor that influences migration dynamics (for a detailed study on the Western Balkans, see Mara and Landesmann, 2022).

Figure 3.20 / Average enrolment rate in tertiary education in the 5 years preceding and succeeding EU accession and since joining EU (to 2019)



Source: National sources, wiiw.

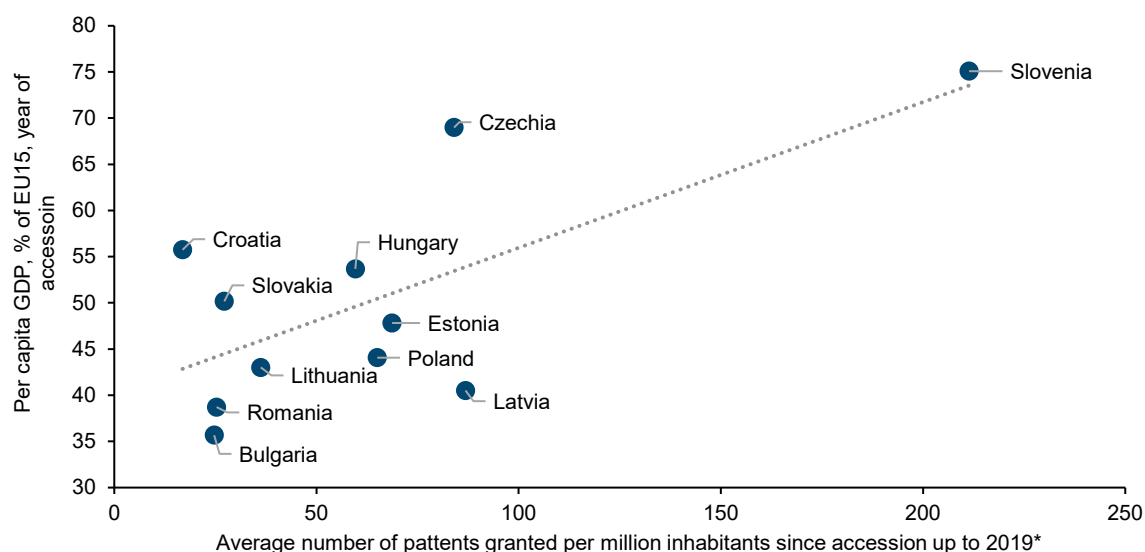
3.4.5. INNOVATION

Although only one of a variety of possible indicators, information on the number of patents granted per million inhabitants provides insights into the innovative capacity of a country. While the indicator correlates with the level of economic development as indicated by GDP per capita, it does not show a straightforward correlation with post-accession economic performance.

Despite having a notably lower number of patents granted compared to the regional average, for example, Estonia and Lithuania achieved some of the most robust economic outcomes post-accession. Similarly, Romania, which demonstrated exceptional average GDP growth after joining the EU, did not exhibit particularly high levels of innovation, as measured by granted patents.

Conversely, Hungary and Slovenia, which were among the leaders in the region in terms of patenting, did not translate their innovative prowess into superior economic growth performance post-accession. Those countries lagged behind others in the region in terms of average GDP growth.

Figure 3.21 / Comparison of average number of patents granted per million inhabitants following accession and the level of per capita GDP in year of accession



Source: National sources, wiiw.

To sum up, the data analysed in this section highlight the following conclusions for the current candidate countries. First, population growth is not a reliable predictor of later economic outcomes, particularly in the context of EU accession. The general experience of countries joining the EU often involves an immediate outflow of population to more developed Western member states. However, later developments regarding migration flows become a function of catching-up processes (in incomes and wages) and labour market developments. Some of the accession countries managed – by dint of successful economic development processes and well-designed educational and labour market policies – to halt the outflow of would-be migrants and even to encourage return migration. In this respect, it is particularly important to focus policies on retaining and attracting the well-qualified and also the younger sections of the labour force, so as to avoid a continued loss of human capital.

Second, employment rates and wage growth are crucial characteristics that can significantly influence economic success. High employment rates typically indicate a robust economy with ample job opportunities, driving consumer spending and overall economic development. Balancing wage growth with productivity is essential to sustain competitiveness and foster a healthy equilibrium between domestic market growth and exports. While employment and wage growth are important, they are just part of a broader set of factors that influence economic performance, including the quality of jobs and overall business development.

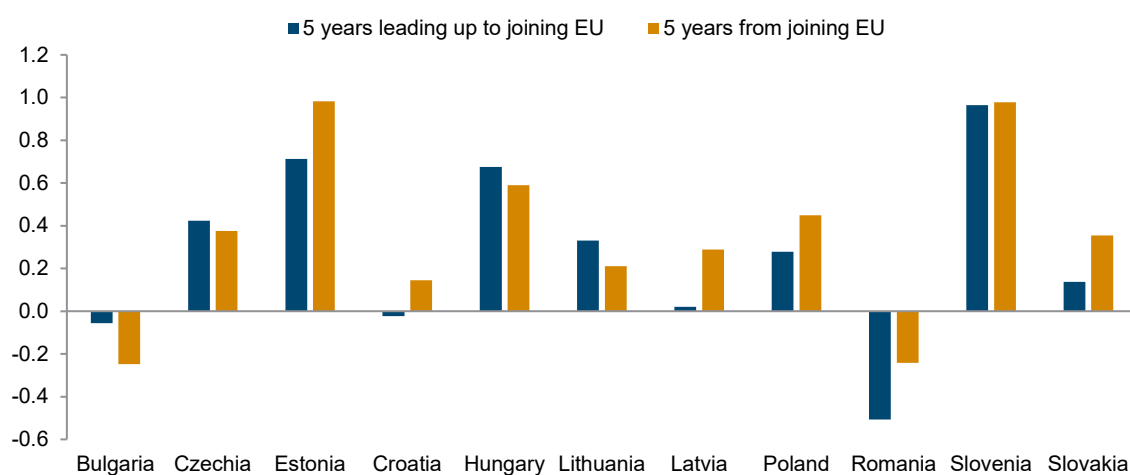
3.5. Institutions and the business environment

Institutional developments and governance play a pivotal role in shaping the economic trajectory of a country, particularly in the context of EU accession. One critical aspect is the reigning in corruption – a move that is essential to foster a stable and predictable business environment. In the following analysis we shall rely on a set of the World Bank's Worldwide Governance Indicators.

3.5.1. CONTROL OF CORRUPTION

Contrary to expectations, countries that had 'control-of-corruption' indicators that were only around or below the regional average often achieved superior economic outcomes post-accession. Notably, Lithuania and Latvia demonstrated commendable economic performance, despite not leading in corruption control. And here Romania stands out: it achieved remarkable economic growth, despite having a low score for control of corruption. On the other hand, countries like Slovenia and Hungary, which initially boasted better control of corruption, found themselves at the lower end of the economic performance spectrum within the region.

Figure 3.22 / Control of corruption in the 5 years preceding and succeeding EU accession



Note: The Worldwide Governance Indicators (WGI) are reported on a scale from approximately -2.5 (weak governance performance) to +2.5 (strong governance performance). Higher values indicate better outcomes (e.g. stronger rule of law, more effective government, lower corruption, etc.). The indicators are based on aggregated perceptions from multiple data sources.

Source: World Bank Worldwide Governance Indicators.

Access to EU funds significantly alters the landscape for newly admitted member states. Research by the Corruption Research Center Budapest (CRCB) highlights the fact that the accession countries rapidly developed their capacity to absorb EU funds. However, that increased capacity is often accompanied by a substantial rise in the corruption risk associated with government-awarded contracts. The Hungarian example illustrates this phenomenon, where the influx of EU funds correlated with heightened corruption risks (CRCB, 2024).

This trend is not unique to Hungary: similar patterns have been observed across the CEE region. EU funds, while intended to foster development and integration, inadvertently raise the risk of corruption (Fazekas et al., 2013). This underscores the need for robust governance and oversight mechanisms to ensure that funds are utilised effectively and transparently, mitigating the potential for corruption and ensuring that the benefits of EU membership are fully realised.

A further layer to this discussion concerns the capacity of member states to absorb and allocate EU funds in an efficient and timely manner. A study by DG IPOL (Ciffolilli and Pompili, 2024) on the absorption of Cohesion Policy funds (ERDF, ESF, CF, and YEI) during the previous funding phase revealed sizeable differences across countries. Much of the CEE region, including Estonia, Lithuania, Hungary, Poland, Latvia, Czechia, and Slovenia, performed strongly in terms of both absorption rates and timely implementation. In contrast, Croatia, Romania, and Slovakia initially lagged behind. Although all three countries improved their performance by the end of the funding period, their delayed absorption may have created pressures to prioritise rapid expenditure over the careful selection of high-quality and impactful projects. This raises concerns about whether late-stage spending surges can deliver the intended developmental outcomes, particularly in administrative environments that may already be under strain.

3.5.2. RULE OF LAW

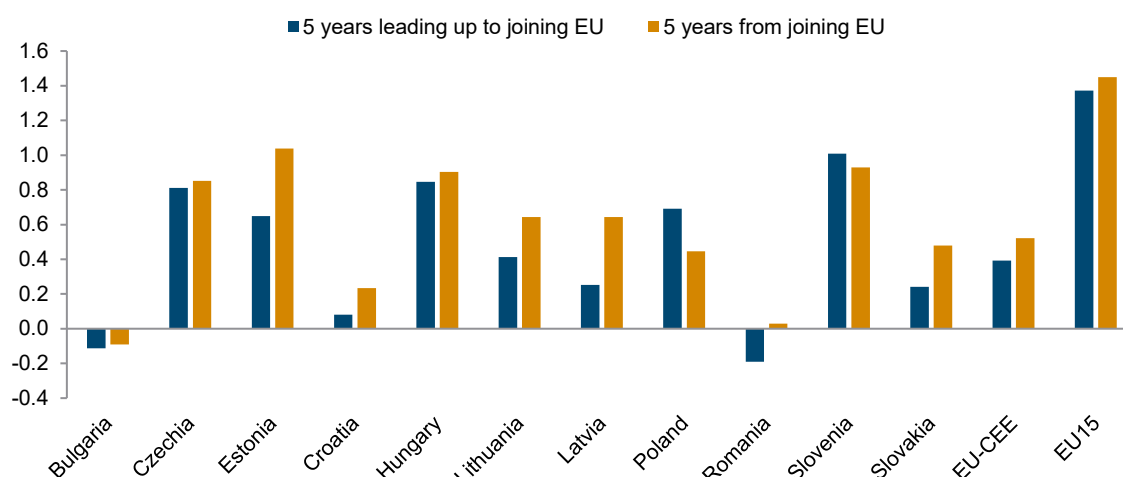
The rule of law is another critical institutional factor that influences economic development and stability of the business environment. Interestingly, the relationship between the rule of law and post-accession economic performance appears contradictory. Some of the best economic performers after EU accession were countries that had average (or even below-average) scores on this indicator. Conversely, countries that had the strongest rule of law scores in the region did not necessarily achieve a superior economic outcome. This mirrors the findings related to the control of corruption, indicating that a complex interplay of factors influences post-accession performance.

While institutional developments and governance, particularly the control of corruption and the rule of law, are important for fostering a stable business environment, their impact on the later economic success of EU candidate countries is not as pronounced as one might expect. Countries with control-of-corruption indicators that were only around or below the regional average, such as Lithuania, Latvia and Romania, often achieved superior economic outcomes post-accession. Similarly, some of the best economic performers after EU accession were countries with only average or below-average scores in terms of the rule of law.

The most important aspect for new EU members is their ability to implement reforms that enable them to fully leverage EU funds. Building the capacity to absorb and effectively utilise those funds is crucial for driving economic growth and development. This capacity building should be a focal point, as it allows new members to take full advantage of the opportunities presented by EU membership, despite the

challenges posed by corruption and governance issues. Robust governance and oversight mechanisms are essential to ensure that funds are used effectively and transparently, mitigating the risk of corruption and maximising the benefits of EU integration.

Figure 3.23 / Rule of law in the 5 years preceding and succeeding EU accession



Note: The Worldwide Governance Indicators (WGI) are reported on a scale from approximately -2.5 (weak governance performance) to +2.5 (strong governance performance). Higher values indicate better outcomes (e.g. stronger rule of law, more effective government, lower corruption, etc.). The indicators are based on aggregated perceptions from multiple data sources. Source: World Bank Worldwide Governance Indicators.

3.6. Specific country experiences before and after accession

All 11 EU-CEE countries have something to teach countries that aspire to join the bloc. However, because of higher starting points (Czechia and Slovenia, in particular), an accession date that is now over two decades ago (the eight 2004 joiners) or growth models that were very specific and difficult to replicate (the Baltic states), the experiences and challenges faced by many EU-CEE countries during their own accession process is not wholly relevant for aspiring new members. Consequently, in this section we will zoom in on the three most recent EU-CEE joiners: Romania, Bulgaria and Croatia. Those countries probably have the most relevance for the current candidate countries, not only because they joined the EU more recently, but also because they joined while facing some of the particular challenges that will confront the new members. Romania and Bulgaria were also seen as not fully 'ready' to join in 2007, owing to their low levels of economic development and – even more importantly – their weak levels of institutional development. In that sense, their enlargement round was 'geopolitical', in the same way as the current round is regarded as 'geopolitical'.⁶ Meanwhile, Croatia has some relevance for Ukraine, in that its accession also came after it had been engaged in a war, partially occupied and obliged to reconstruct itself – albeit not to the same extent as Ukraine and with many years having elapsed since the end of the conflict. It also, of course, is a successor state to the former Yugoslavia, and therefore its experience (both negative and positive) has direct relevance for five of the six Western Balkan countries.

⁶ If indeed the 2007 enlargement round was 'geopolitical', from today's perspective it was a resounding success. In terms of supporting Ukraine, Romania and Bulgaria have so far been two of the most crucial NATO countries – something that could have turned out very differently had they not been absorbed into euro-Atlantic institutions, including the EU, before the 2008 crisis. One lesson from this is that the EU should not shy away from another geopolitical enlargement now.

3.6.1. ROMANIA

Over the past 20 years or so, Romania has proved itself one of EU-CEE's great success stories. When it joined the EU, the country was the bloc's poorest member state and had its weakest institutions (as measured by the World Bank Worldwide Governance Indicators). Until quite recently it was subject to the EU's Cooperation and Verification Mechanism (CVM) and it has had a host of structural challenges to contend with (including 'twin' deficits throughout most of the post-accession period), as well as regional inequalities. However, for all that, Romania has thrived economically within the EU, consistently posting one of the bloc's fastest rates of economic growth and overtaking many EU-CEE peers in terms of per capita GDP. In this respect, Romania may well serve as the best case study (or best-practice example) for the current candidate countries. Given that it was also deemed not fully 'ready' for accession in 2007 – and even after almost two decades has significant room for improvement in terms of its institutional quality – Romania can serve as a guide and inspiration for potential new members facing many of the same challenges.

External sector

The current account (CA) imbalances, which had been widening significantly in the pre-accession era, experienced a notable reversal post-accession. This trend culminated in the CA balance approaching zero by 2014, reflecting a period of relative stability and economic adjustment. However, this stability was short lived, as the CA balance began to widen again in subsequent years, indicating renewed pressures on the external sector.

The trade balance has been characterised by a continuous deficit, with a brief respite in the mid-2010s, when it started to decrease. This period of improvement was, however, followed by a resurgence in the deficit, highlighting the persistent challenges in achieving a balanced trade position.

The growth of exports of goods and services played a crucial role in the external sector's dynamics. Exports, which had been stable at around 25% of GDP pre-accession, began a steady rise post-accession, eventually stabilising at just below 40% of GDP. This growth underscores Romania's increasing integration into global trade networks and the EU market. Imports of goods and services, which fluctuated between 30% and 40% of GDP, settled down at around 40% post-accession. This stability in imports reflects a balance between domestic consumption and production capacities.

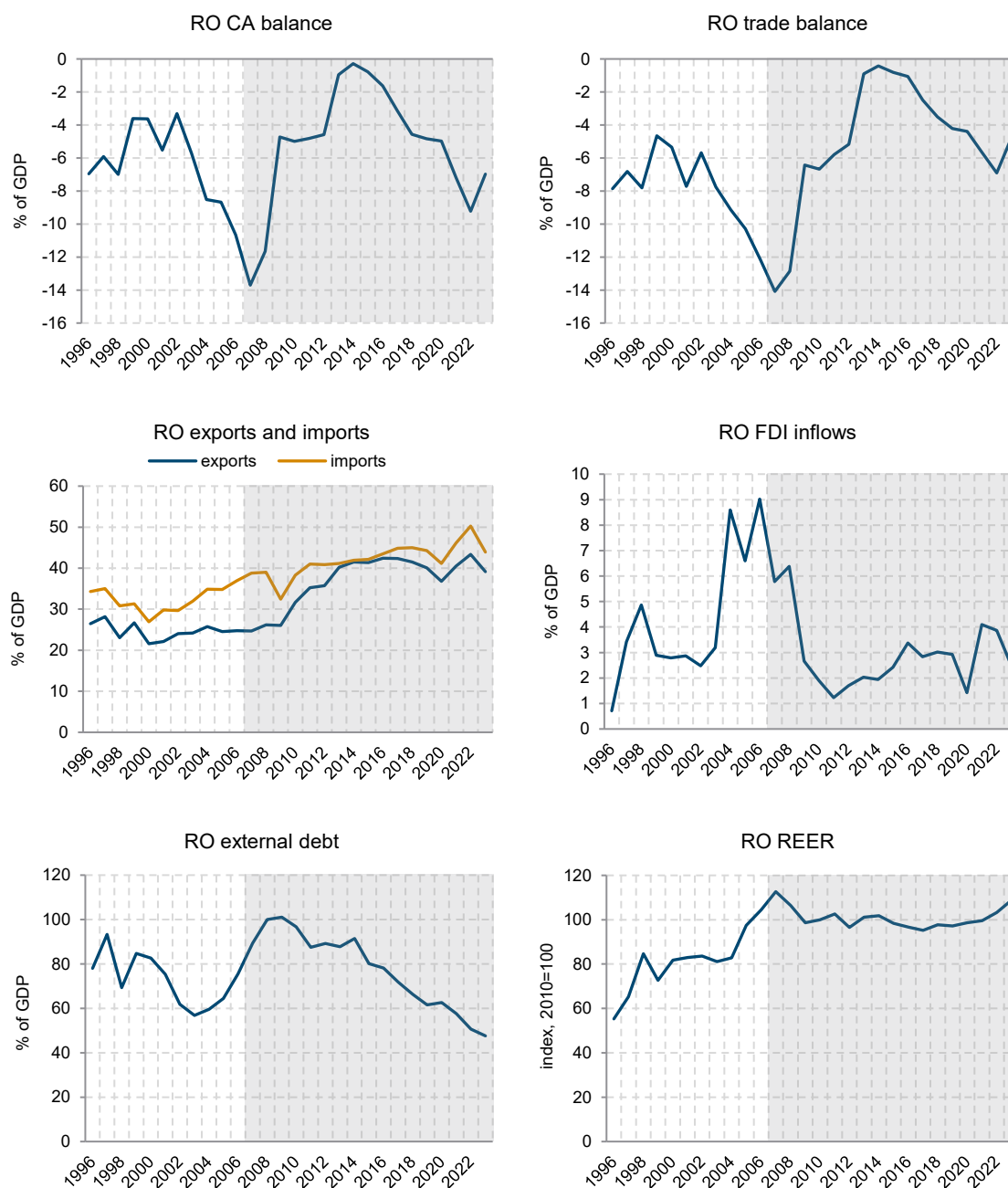
Inflows of foreign direct investment (FDI) experienced a rising trend before accession, peaking at 9% of GDP in 2006. This influx of investment was driven by expectations of improved market access and a better regulatory environment following EU accession. However, FDI inflows underwent a sharp decline until 2011, stabilising at around 2% of GDP thereafter.

External debt rose steadily until the point of accession in 2007, with the financial crisis exacerbating this trend between 2008 and 2010. The debt stabilised at above 70% of GDP between 2010 and 2013, since when it has declined moderately, reflecting efforts to manage fiscal and external vulnerabilities.

The real effective exchange rate appreciated sharply in the early 2000s until accession in 2007, driven by higher inflation in Romania than in its trading partners. This appreciation was followed by a few years

of depreciation, but since 2009 the exchange rate has remained relatively stable. This stability has been crucial in maintaining competitiveness on the international markets.

Figure 3.24 / External sector indicators in Romania before EU accession and after



Note: Shaded area indicates the period after EU accession. All data in percent of GDP, except REER, which is an index. REER is calculated as the nominal effective exchange rate deflated by unit labour costs in manufacturing. Higher value of REER stands for real appreciation. Trade balances, exports and imports include both goods and services
Source: World Bank World Development Indicators for all indicators, except for external debt, which is from wiiw Annual Database.

Fiscal side

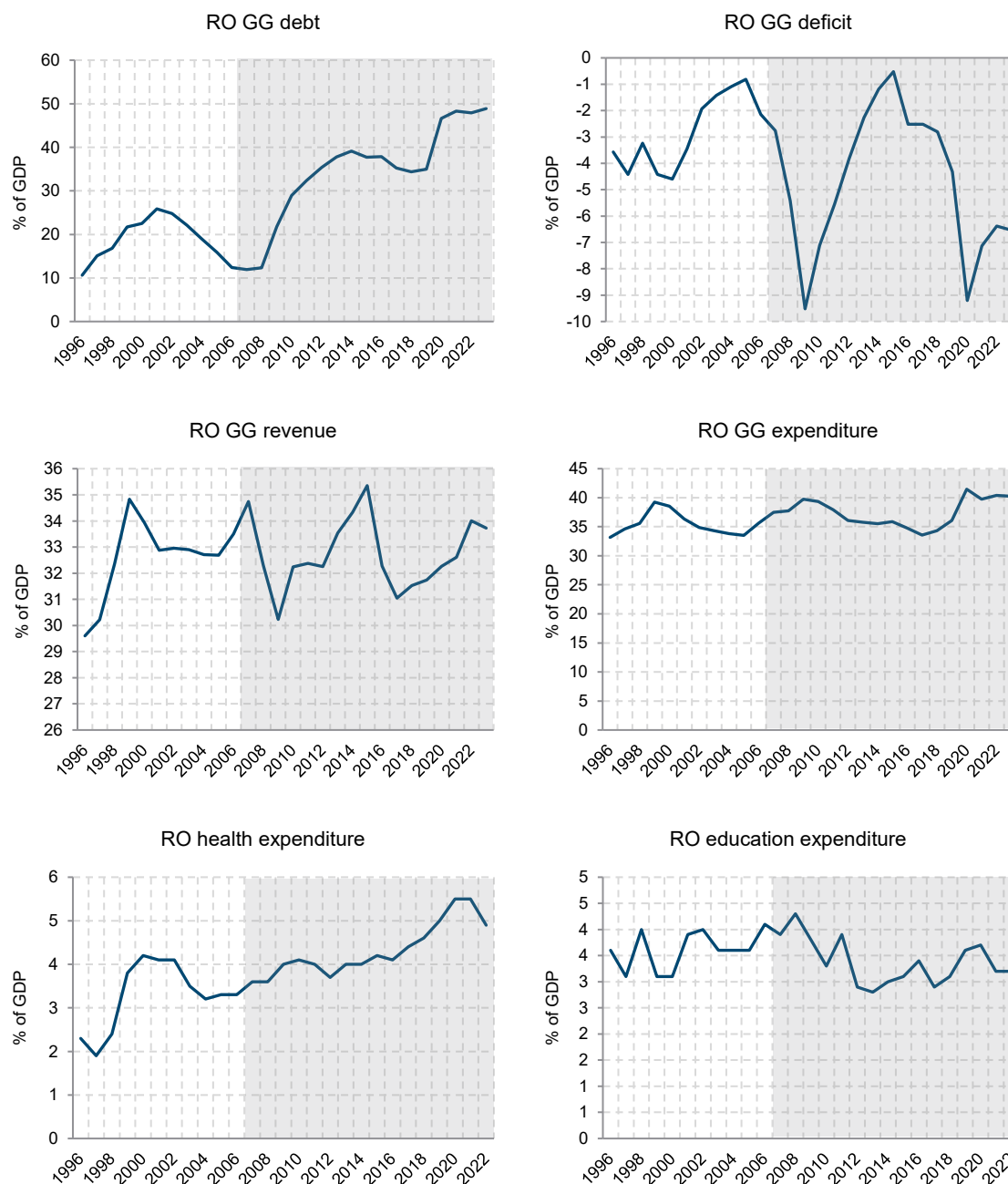
Romania's fiscal position post-EU accession has been marked by significant fluctuations, reflecting the challenges of economic integration and global financial pressures. General government debt, which fell from 25% in 2001 to 12% in 2006, began rising steadily after the financial crisis. It peaked around 40% in 2014 and has fluctuated at around that level ever since, indicating a managed approach to fiscal consolidation.

The budget balance showed a widening deficit before accession, continuing until 2009 when that deficit reached around 10% of GDP. This period was characterised by significant fiscal stimulus in response to the global financial crisis. The deficit fell until 2016, when it reached 2.5%, but then started to grow again, reaching 9% in 2020 owing to the COVID-19 pandemic.

Government spending as a share of GDP declined before accession – from 40% in 1999 to 33% in 2005; but the financial crisis meant that it started to rise again, peaking at around 40% in 2009. It was on a declining trend until 2020 when it rose again and stabilised around 40% again, reflecting the government's role in economic stabilisation and recovery.

Public healthcare spending fluctuated between 3.5% and 4% until 2016, when it began rising, reaching 5% in 2020. Education spending saw a gradual rise in the early 2000s, from below 3% in 2000 to nearly 4.5% in 2006; after the crisis it declined and has remained at between 3% and 3.5% since the early 2010s.

Another important indicator to consider here is the size of the informal sector. Romania has seen a significant improvement in this area over the past 2-3 decades, and the improvements accelerated following EU accession. In 1999, the informal economy was estimated to be around 33% of official GDP. By 2006, the year prior to EU membership, it had declined to around 31%. Following accession, the downward trend accelerated, with the informal sector shrinking to approximately 28% of GDP by 2010. Although the pace of decline moderated over the following decade, the reduction continued. By 2020, it was estimated at around 26% of GDP. These numbers refer to the dynamic general equilibrium model-based estimates by Elgin et al. (2021), reported in the World Bank Informal Economy Database.

Figure 3.25 / Fiscal sector indicators in Romania before EU accession and after

Note: Shaded area indicates the period after EU accession. All data as a percentage of GDP.

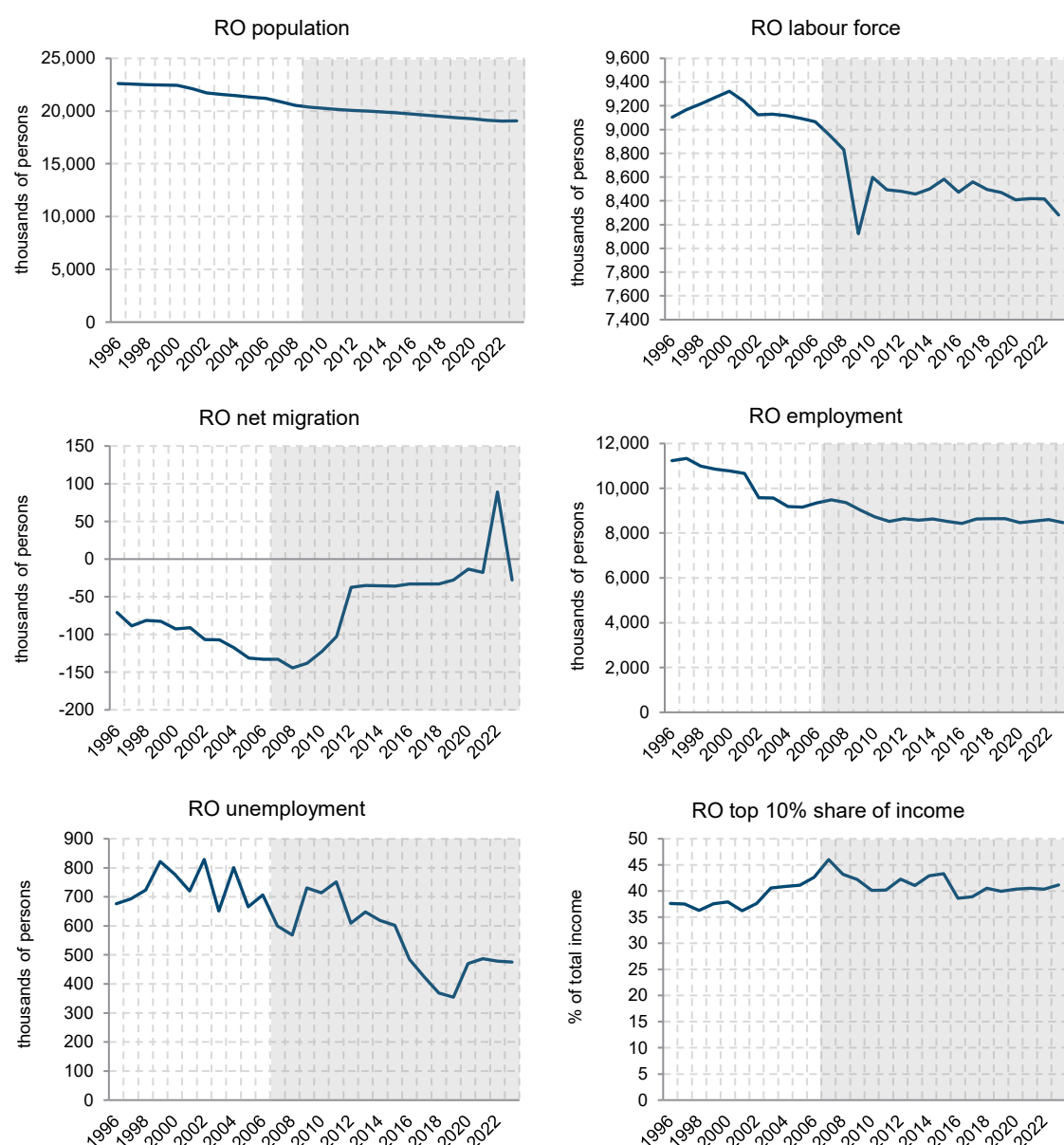
Source: wiiw Annual Database for general government (GG) debt, GG deficit, GG revenue and GG expenditure, and Eurostat for health and education expenditure.

Labour and social indicators

The population has been in steady decline, driven by factors such as emigration and demographic trends. Enrolment in tertiary education saw a sharp rise between the late 1990s and accession, increasing from the low 20% range to above 80%; but it has since declined and stabilised at around 50%.

The employment rate declined until 2002 and has remained stable at around 50% ever since. This stability masks underlying challenges, including structural unemployment and regional disparities in employment opportunities. Labour productivity, although very low, has been slowly approaching EU15 levels, rising from 15% of the EU15 average in 1999 to 30% in 2017. This improvement reflects gradual gains in efficiency and the adoption of technology, where developments like the decision of the Renault group to make Dacia its budget brand played an important role, although significant gaps remain. Real wages rose steadily until accession and the financial crisis, declined from 2009 to 2013, and have since been rising again, reflecting improvements in living standards and economic recovery.

Figure 3.26 / Labour and social indicators in Romania before EU accession and after



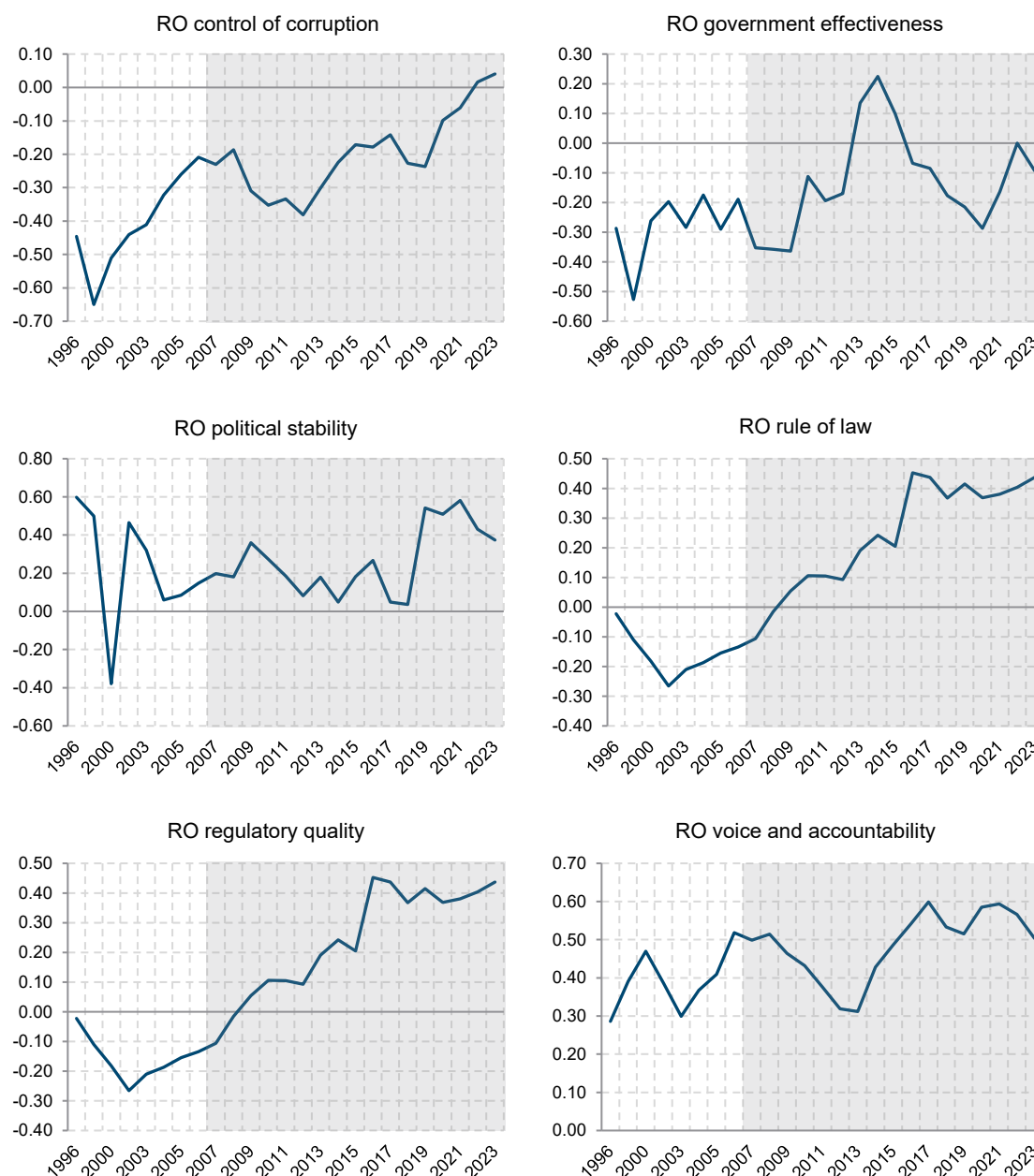
Note: Shaded area indicates the period after EU accession. All indicators in thousands of people, except the top 10% share of income, which is percentage of total income.

Sources: wiiw Annual Database for population, employment and unemployment, World Development Indicators for labour force and net migration, and World Inequality Database for the top 10% share of income.

Governance and institutions

Control of corruption improved until accession, but worsened as EU funds became accessible, highlighting the challenges of managing increased financial flows. However, efforts to address corruption have shown some progress since 2012, with a renewed focus on transparency and accountability.

Figure 3.27 / Governance and institutions indicators in Romania before EU accession and after



Note: Shaded area indicates the period after EU accession. All indicators are estimated values, with higher values representing better institutions. The Worldwide Governance Indicators (WGI) are reported on a scale from approximately – 2.5 (weak governance performance) to +2.5 (strong governance performance). Higher values indicate better outcomes (e.g. stronger rule of law, more effective government, lower corruption, etc.). The indicators are based on aggregated perceptions from multiple data sources.

Source: World Bank's Worldwide Governance Indicators.

Government effectiveness remained stable, at a low level, until 2012, at which point it declined sharply for a brief period; it has since returned to its previous level (or slightly above). This trend underscores the need for sustained efforts to improve public administration and service delivery. Political stability has been relatively robust since accession: there was a decline in 2017, since 2018 stability has risen to historically higher levels, with some decline again over the past two years.

The rule of law has shown a consistently rising trend since the mid-2000s, but has stagnated since 2017. This stagnation highlights the need for continued efforts to strengthen legal institutions and ensure independence of the judiciary. Regulatory quality increased sharply up until accession, remained stable from 2008 to 2014, but has been declining since. Voice and accountability have fared well, remaining more or less stable throughout, reflecting a commitment to democratic principles and citizen engagement.

Summary

Overall, Romania's post-accession journey has been marked by both improvements and challenges across various sectors.

- › The country has made significant strides in integrating into the EU and global markets, although persistent fiscal and institutional challenges remain.
- › Romania has shown remarkable economic growth, consistently ranking among the fastest-growing economies in the EU and surpassing many of its EU-CEE peers.
- › Fluctuations in the current account and a persistent trade deficit have impacted economic stability.
- › The decline in FDI inflows post-accession has limited economic growth potential.
- › In governance, stagnation in the rule of law and declining regulatory quality are trends of some concern.
- › Corruption control has improved, but managing increased financial flows remains a challenge.
- › Income inequality remains a persistent challenge.
- › Continued efforts to address these challenges will be crucial in supporting long-term economic growth and development.

3.6.2. BULGARIA

In this case study of Bulgaria, we examine the evolution of selected indicators from the four previously identified areas, before EU accession and since, to identify key lessons for the 'must-have' conditions for any future accessions. The analysis highlights both the benefits and the risks associated with accession. As one of the most recent and least-developed EU member states, Bulgaria provides valuable insights and potential silver linings.

External sector

An analysis of Bulgaria's external sector indicators following EU accession presents a generally positive picture. The current account balance, which had been widening before accession, reversed course and began narrowing soon after Bulgaria joined the EU. Within approximately five years, the deficit had even turned into a surplus, and since then it has mostly fluctuated at around the same level. A similar pattern can be observed in the trade balance: it had been in deficit since the late 1990s, but became roughly balanced in the early 2010s and has remained consistently in surplus since 2015.

This improvement was largely driven by the strong growth in exports of goods and services after EU accession. Although exports were already on the rise before accession, they were below 50% of GDP. Within just five years of joining the EU they had surpassed 60% of GDP, and have since fluctuated at around 65%. Imports of goods and services, on the other hand, have remained at a level similar to that seen before accession, though with some fluctuation. They initially surged after accession, rising from 64% of GDP in 2006 to 72% in 2008. However, the global financial crisis led to a sharp contraction in domestic demand, causing imports to fall significantly to around 50% of GDP. Since then, they have recovered to 60-65% of GDP, but for over a decade have remained consistently below exports.

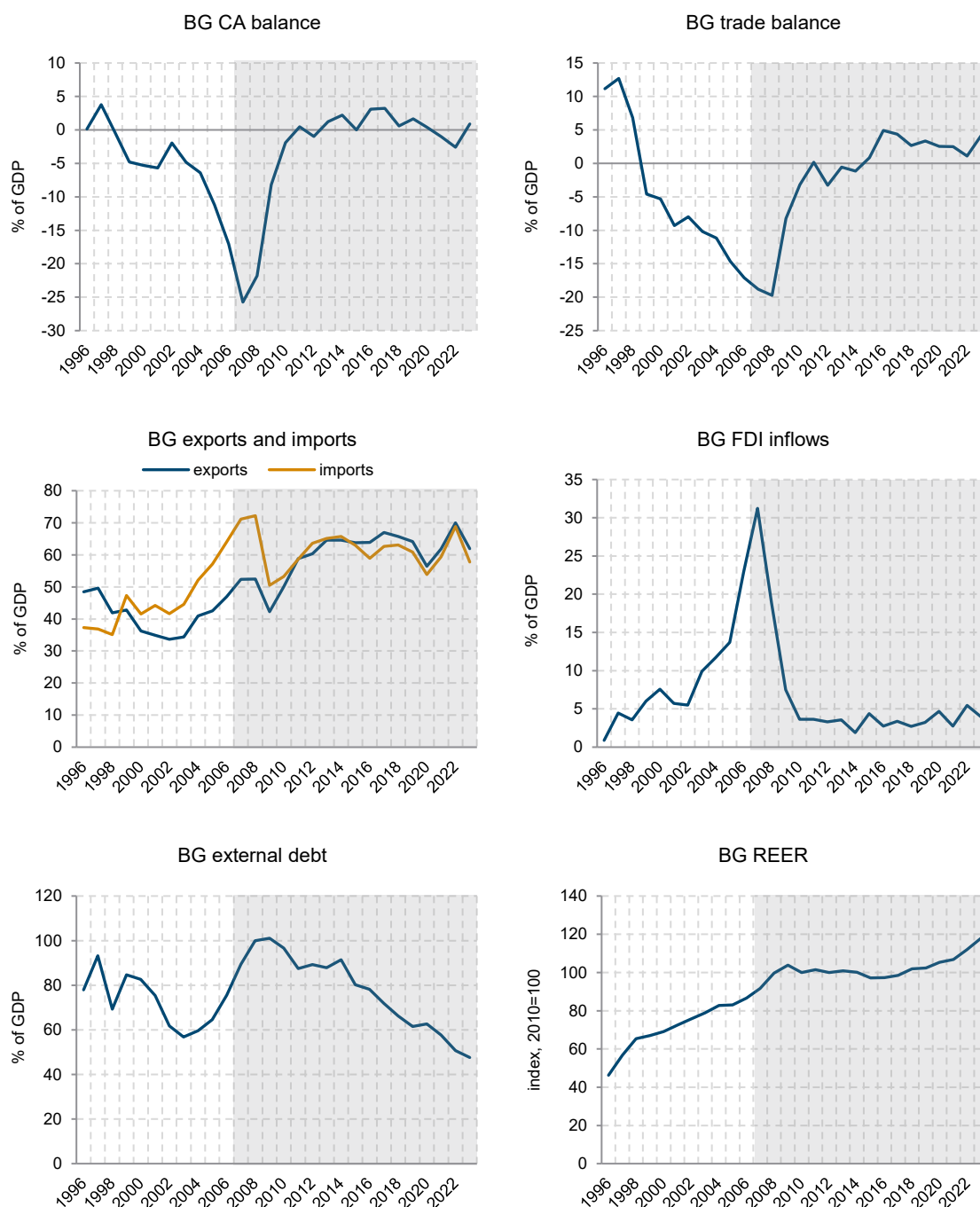
FDI inflows have followed the opposite trend. They were on an upward trajectory before EU accession, peaking at an extraordinary 31% of GDP in 2007 (the year Bulgaria joined the EU), driven primarily by real estate and construction investment. However, this trend went into reverse thereafter, and FDI inflows slowed considerably, stabilising at around 3% of GDP since 2010.

The dynamics of external debt have also been largely positive since EU accession. While external debt initially increased – from 75% of GDP in 2007 to 100% two years later – this was mainly a consequence of the financial crisis. Since then, external debt has been on a steady downward trajectory, falling below 50% of GDP in recent years.

These overall improvements in Bulgaria's external sector have occurred despite a significant real exchange rate appreciation following EU accession. The CPI-based real effective exchange rate appreciated sharply in the first three years – by 20% – driven by inflation, which was higher in Bulgaria than among its trading partners. Given the country's currency board arrangement, with the lev pegged to the euro, this appreciation was entirely price driven. Throughout the 2010s, the real exchange rate remained relatively stable; it is only in the last five years that it has started to appreciate again, rising by approximately 15%. Overall, since EU accession the real effective exchange rate has appreciated by around 36% – or roughly 2% per year – due to faster price rises in Bulgaria than in its trading partners. Still, despite this loss of price competitiveness, Bulgaria's external sector has performed remarkably

well, suggesting that improvements in non-price competitiveness have played a crucial role in supporting exports and overall external stability.

Figure 3.28 / External sector indicators in Bulgaria before EU accession and after



Note: Shaded area indicates the period after EU accession. All data in percent of GDP, except REER, which is an index. REER is calculated as the nominal effective exchange rate deflated by unit labour costs in manufacturing. Higher value of REER stands for real appreciation. Trade balances, exports and imports include both goods and services. Sources: World Bank World Development Indicators for all indicators, except for external debt, which is from wiiw Annual Database.

Fiscal side

If we look at the evolution of Bulgaria's fiscal position since EU accession, the picture is mixed, but overall there has been no sharp deterioration and nor have any significant fiscal risks emerged. General government debt, which was already low and on a downward trend, continued to decline after accession, falling to around 15% of GDP shortly thereafter. It later increased slightly to around 25% of GDP, but this remains among the lowest levels in Europe.

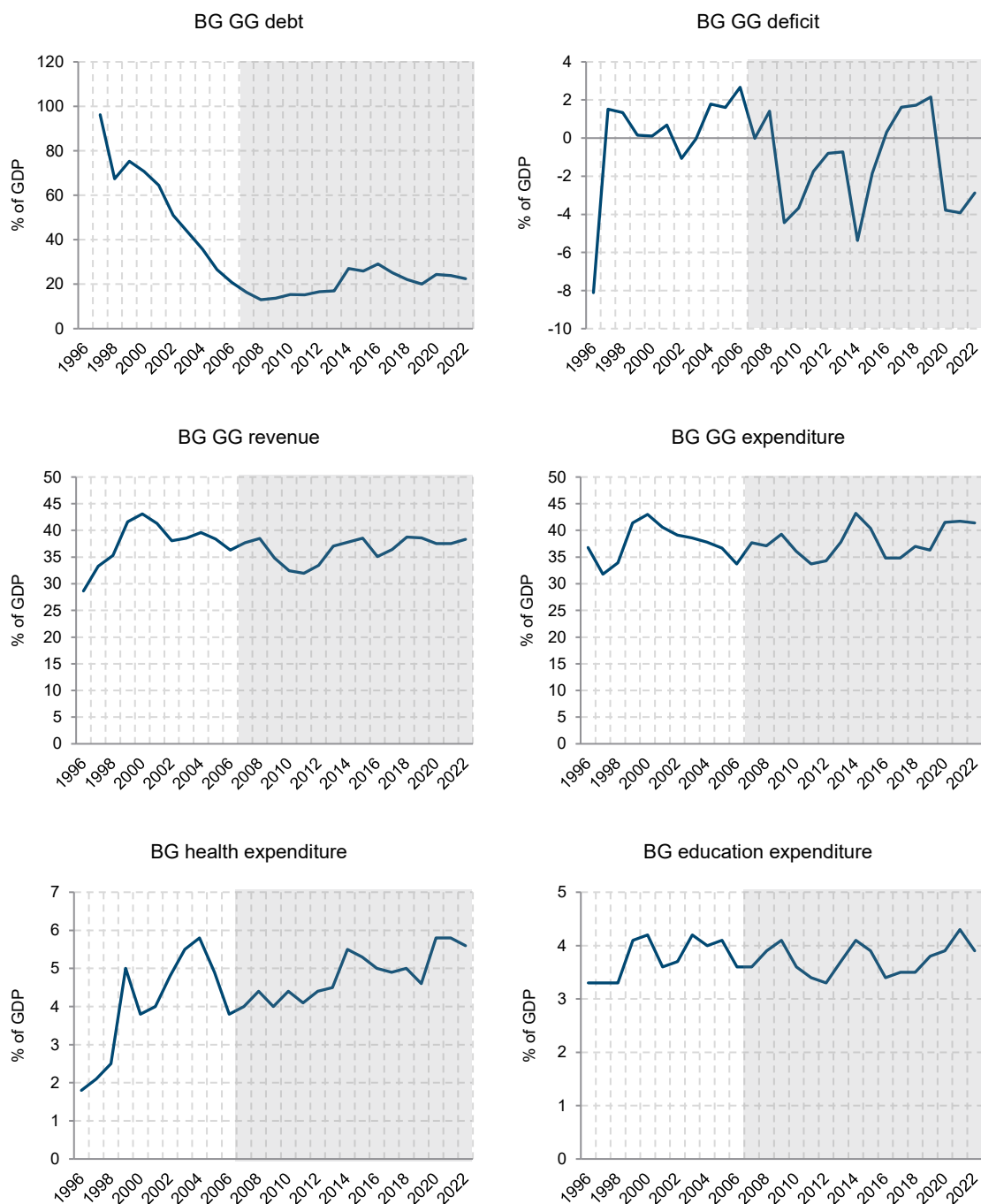
The budget balance, which was in surplus before accession, shifted to a deficit soon after, largely due to the global financial crisis and the euro crisis. However, the deficit remained moderate, averaging around 3% of GDP during those two crises. Toward the end of the 2010s, the budget balance returned to surplus, only to shift back into deficit with the onset of the pandemic and the inflationary crisis. Over the entire post-accession period, the deficit has averaged around 1% of GDP – well below the Maastricht criterion of 3%.

Government revenue, which was already on a downward trend before accession, continued to decline in the early years after the country joined the EU, falling from 37% of GDP to 32%. However, since 2013 revenue has been on an upward trajectory, reaching 37-38% of GDP, and roughly returning to pre-accession levels.

Total general government spending, which had also been declining before EU membership, has fluctuated significantly since accession, but has generally followed an upward trend. It stood at around 35% of GDP before accession and has risen to approximately 40% in the 2020s, indicating a greater role for the government in the economy.

Among the expenditure categories that have seen a notable increase is public healthcare spending, which has risen from around 4% of GDP before accession to nearly 6% of GDP in the 2020s. Education spending, on the other hand, has seen no major improvement, remaining in the range of 3.5-4% of GDP throughout.

Looking at the size of the informal sector in Bulgaria, one can observe a remarkable decline over the past 25 years, including the initial years following the country's accession to the EU. In the late 1990s, the informal sector was just below 40% of official GDP. By 2006, the year before EU accession, this had dropped to around 33%. In the first five years after joining the union, the decline continued at a similar pace, falling to below 30% by 2011. However, from 2012 onwards, the pace of reduction slowed somewhat, though the trend remained downward. By 2020, the size of the informal sector was estimated at around 28% of GDP (dynamic general equilibrium model-based estimates from Elgin et al., 2021).

Figure 3.29 / Fiscal sector indicators in Bulgaria before EU accession and after

Note: Shaded area indicates the period after EU accession. All data as a percentage of GDP.

Sources: wiiw Annual Database for general government (GG) debt, GG deficit, GG revenue and GG expenditure, and Eurostat for health and education expenditure.

Labour and social indicators

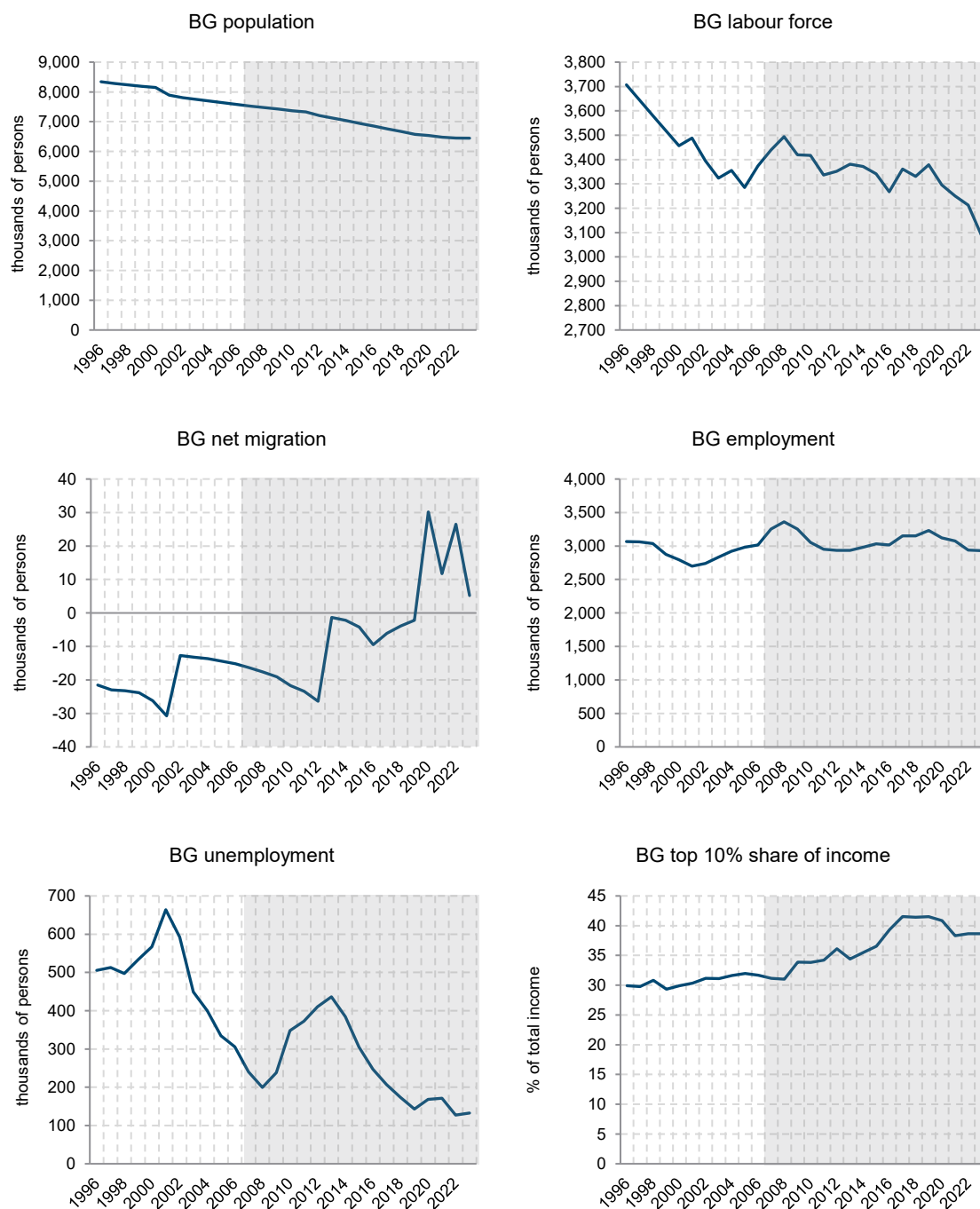
An examination of key labour and social indicators in Bulgaria following EU accession reveals both concerning trends and positive developments. The country's population decline, which had already been under way before accession, continued at a steady pace, showing no sign of a major slowdown. The average annual population decline was around 1% before accession and has remained at that level since, resulting in a total population loss of 1 million people since Bulgaria joined the EU. This demographic trend has also been reflected in the labour force, which shrank from approximately 3.4 million people in 2006 to below 3.1 million in 2023.

Employment initially increased after accession, likely driven by the improved economic prospects. However, over time, employment levels have declined, largely due to population shrinkage and a contracting labour force. While there have been some fluctuations, the number of people employed in 2023 remained below the 2006 level.

The trend in unemployment has generally been positive, following a steady downward trajectory – except for in the period following the global financial crisis, when there was an upward blip in the number of unemployed people in Bulgaria. Since then, unemployment has declined consistently, and the number of unemployed in 2023 stood at slightly above 100,000 – translating to an unemployment rate of below 5%, which is relatively low.

One of the most notable developments concerns net migration. While the net migration figures deteriorated in the early years following EU accession – indicating a surge in emigration – this trend later went into reverse. And since 2020, net migration has even turned positive. Over 2020-2023, Bulgaria has recorded a cumulative net immigration of 74,000 people. This suggests that while EU accession may initially act as a catalyst for emigration from new member states, improving living conditions over time can eventually lead to a reversal of the trend.

Another significant insight is the sharp rise in inequality. The share of income received by the top 10% (after tax) has risen from around 30% before accession to approximately 40% today. Moreover, the increase in inequality seems to have accelerated since the country joined the EU, having been relatively stable before accession. This suggests that the benefits of EU membership have not been distributed equally across society, but have instead been disproportionately captured by wealthier individuals. It also highlights an important consideration that must be borne in mind when assessing the EU membership prospects of current candidate countries.

Figure 3.30 / Labour and social indicators in Bulgaria before EU accession and after

Note: Shaded area indicates the period after EU accession. All indicators in thousands of people, except the top 10% share of income, which is percentage of total income.

Sources: wiiw Annual Database for population, employment and unemployment, World Development Indicators for labour force and net migration, and World Inequality Database for the top 10% share of income.

Governance and institutions

Bulgaria's accession to the EU has failed to bring significant improvements to the country's institutions. Most of the World Bank's Worldwide Governance Indicators have either stagnated or deteriorated since Bulgaria joined the Union in 2007. Even 16 years later, in 2023, some indicators remained worse than their pre-accession levels.

Control of corruption, which was already on a downward trend before accession, continued to decline for a decade afterwards. It only started to improve in the second half of the 2010s. Still, the latest figure for 2023 remains worse than in 2006.

Government effectiveness declined slightly after accession, but later improved. It has since fluctuated considerably, and as of 2023 stood at marginally above its 2006 level.

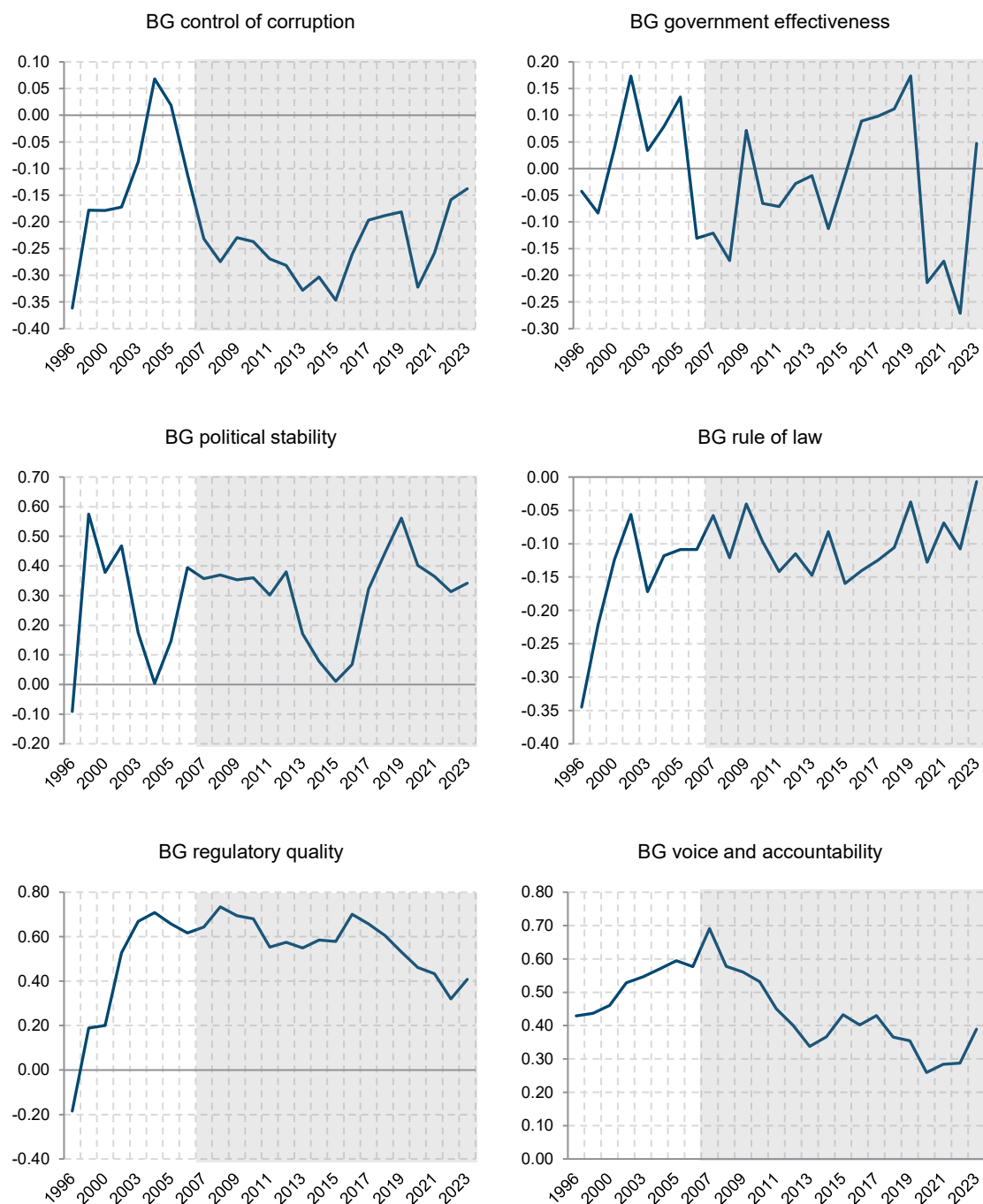
Political stability stagnated after Bulgaria joined the EU, saw a sharp decline in the mid-2010s, recovered around 2020, and then declined again. In 2023, it was still below the pre-accession level.

Rule of law remained largely stagnant after accession, worsened slightly in the latter half of the 2010s, and only began to improve after 2018. In 2023, it was better than before accession and at its highest recorded level.

Regulatory quality saw a modest improvement immediately after EU entry, but then declined in the mid-2010s. It improved briefly afterwards, but has been on a downward trend since 2017. In 2023 it was significantly below its pre-accession level.

The voice and accountability indicator has fared worst of all. It was on an upward trend before EU accession, but embarked on a steady decline immediately afterwards. Although there has been some recovery since 2019-20, in 2023 it remained well below pre-accession levels.

Overall, two of the six indicators – government effectiveness and rule of law – are slightly better than before EU accession; two – control of corruption and political stability – are slightly worse; and the remaining two – regulatory quality and voice and accountability – have deteriorated significantly.

Figure 3.31 / Governance and institutions indicators in Bulgaria before EU accession and after

Note: Shaded area indicates the period after EU accession. All indicators are estimated values, with higher values representing better institutions.

Sources: World Bank's Worldwide Governance Indicators.

Summary

Most of the indicators assessed for Bulgaria show a positive development, though some challenges remain. The main issues have related to the labour force and governance and institutions.

- › The decline in population, the labour force and employment has severely constrained GDP growth.
- › The rise in income inequality has also had adverse effects.
- › On the positive side, net migration, which was deeply negative in the early years, has turned positive, demonstrating that EU accession can have long-term benefits.
- › Concerning governance and institutions, the most worrying trends have been the deterioration in regulatory quality and voice and accountability.
- › Control of corruption and political stability have also worsened, though to a lesser extent.
- › The external sector has seen largely positive developments, including improvements in the current account and trade balance, as well as a reduction in external debt.
- › A downside in this area has been the decline in FDI inflows following accession, which has contributed to slower GDP growth.
- › The fiscal position has generally been stable, with low public debt, a modest deficit and improvements in government spending, particularly in healthcare.
- › However, the country may have been too fiscally conservative – the deficit has averaged around just 1% of GDP, suggesting that the fiscal policy has failed to support the economy, further contributing to sluggish GDP growth.
- › Fiscal conservatism also reflects the constraints of Bulgaria's currency board arrangement, which limits the scope for counter-cyclical fiscal policy.
- › All in all, the main reasons for Bulgaria's relatively low growth since EU accession – at any rate compared to other new member states – include population and labour force decline, institutional deterioration, fiscal conservatism and weaker FDI inflows after the accession.

3.6.3. CROATIA

In this case study of Croatia, we examine the evolution of selected indicators from the four previously identified areas, before and after EU accession, to identify key lessons for the 'must-have' conditions for any future accessions. The analysis highlights both the benefits and the risks associated with accession. As the most recent EU member state, Croatia provides valuable insights and important lessons for current candidate countries. Moreover, as a former Yugoslav republic, it shares a similar historical and institutional background with several current candidates, making its experience particularly relevant.

External sector

An overview of the dynamics in Croatia's external sector since EU accession reveals generally positive developments, although perhaps not as strong as in Bulgaria's case. Looking at the current account balance, Croatia consistently ran a deficit before it joined the EU, though the gap had been gradually narrowing in the years leading up to membership. After accession, the deficit turned into a surplus, and while it has fluctuated in recent years, it has remained close to balance on average. The trade balance has followed a similar trajectory, with a notable improvement after joining the Union. The deterioration in recent years can largely be attributed to two major factors – the pandemic and the cost-of-living crisis.

Examining exports and imports of goods and services individually, both increased significantly after EU accession. In 2012, they each accounted for around 40% of GDP; but by the 2020s, they had risen to 55-60% of GDP.

FDI inflows, however, followed a different pattern. They surged immediately after accession – rising from around 2% of GDP before to approximately 5% afterward – but have since slowed, with considerable fluctuations. The average FDI inflow in the post-accession period has been 3.9% of GDP, compared to 4.4% in the pre-accession period.

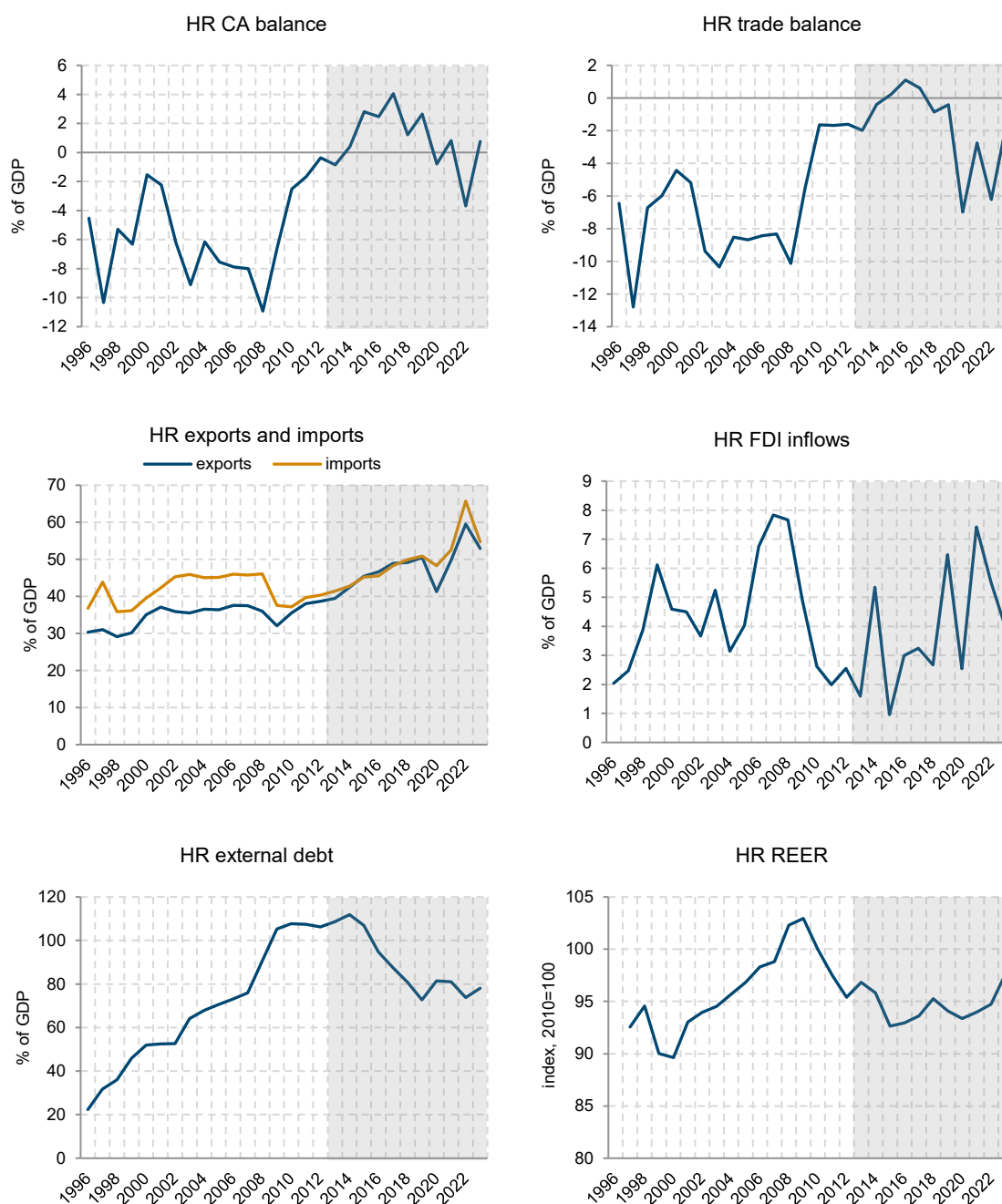
External debt increased slightly after EU membership, exceeding 110% of GDP in 2014, but it has since declined significantly, falling to around 80% of GDP in recent years and fluctuating at around that level.

The real effective exchange rate (REER) shows perhaps the most interesting dynamics. It initially depreciated after EU accession, due to the weakening of the Croatian kuna; it then stabilised as the kuna was pegged to the euro; and in recent years it has started to appreciate again, as prices have increased faster in Croatia than in its trading partners. However, the REER index remains below its level of the late 2000s, suggesting that there has been no major loss of price competitiveness since EU accession.

However, one also has to bear in mind that Croatia's REER appreciated significantly between 2000 and 2009 – by around 15% in real terms – which partly explains the subsequent depreciation. This appreciation was driven by a strong rise in domestic prices during the 2000s, fuelled by a booming tourism sector, credit expansion, and expectations surrounding EU accession. At the same time, the kuna was largely pegged to the euro, leading to a loss of price competitiveness. In the absence of improvements in non-price competitiveness, this had adverse effects on the tradable sector – particularly manufacturing. Combined with the global financial crisis of 2008 and the subsequent euro area crisis of 2011–2012, these developments contributed to a deep and prolonged recession. Between 2009 and 2014, Croatia experienced six consecutive years of economic contraction, with GDP declining

cumulatively by around 12%. This experience highlights the risks associated with rapid real appreciation in small open economies, particularly if it is not accompanied by improvements in non-price competitiveness, such as industrial and technological upgrading and increased innovation.

Figure 3.32 / External sector indicators in Croatia before EU membership and since



Note: Shaded area indicates the period after EU accession. All data in percent of GDP, except REER, which is an index. REER is calculated as the nominal effective exchange rate deflated by unit labour costs in manufacturing. Higher value of REER stands for real appreciation. Trade balances, exports and imports include both goods and services.

Sources: World Bank World Development Indicators for all indicators, except for external debt, which is from wiiw Annual Database.

Fiscal side

Croatia's fiscal performance after EU accession showed generally positive results, albeit with some caveats. The most significant issue was the general government debt, which had been on a steep upward trajectory in the years leading up to accession, rising from below 40% of GDP in 2008 to nearly 80% in 2013, largely due to the global financial crisis. Debt continued to grow in the first few years after accession, albeit at a more moderate pace. It later began to decline, falling to 70% of GDP in late 2010s, before surging above 85% during the pandemic, only to fall again to below 70% in recent years. Overall, general government debt is now at a similar level to before EU accession. While this may not pose severe fiscal risks, it also suggests that accession did not lead to a sustained reduction in debt.

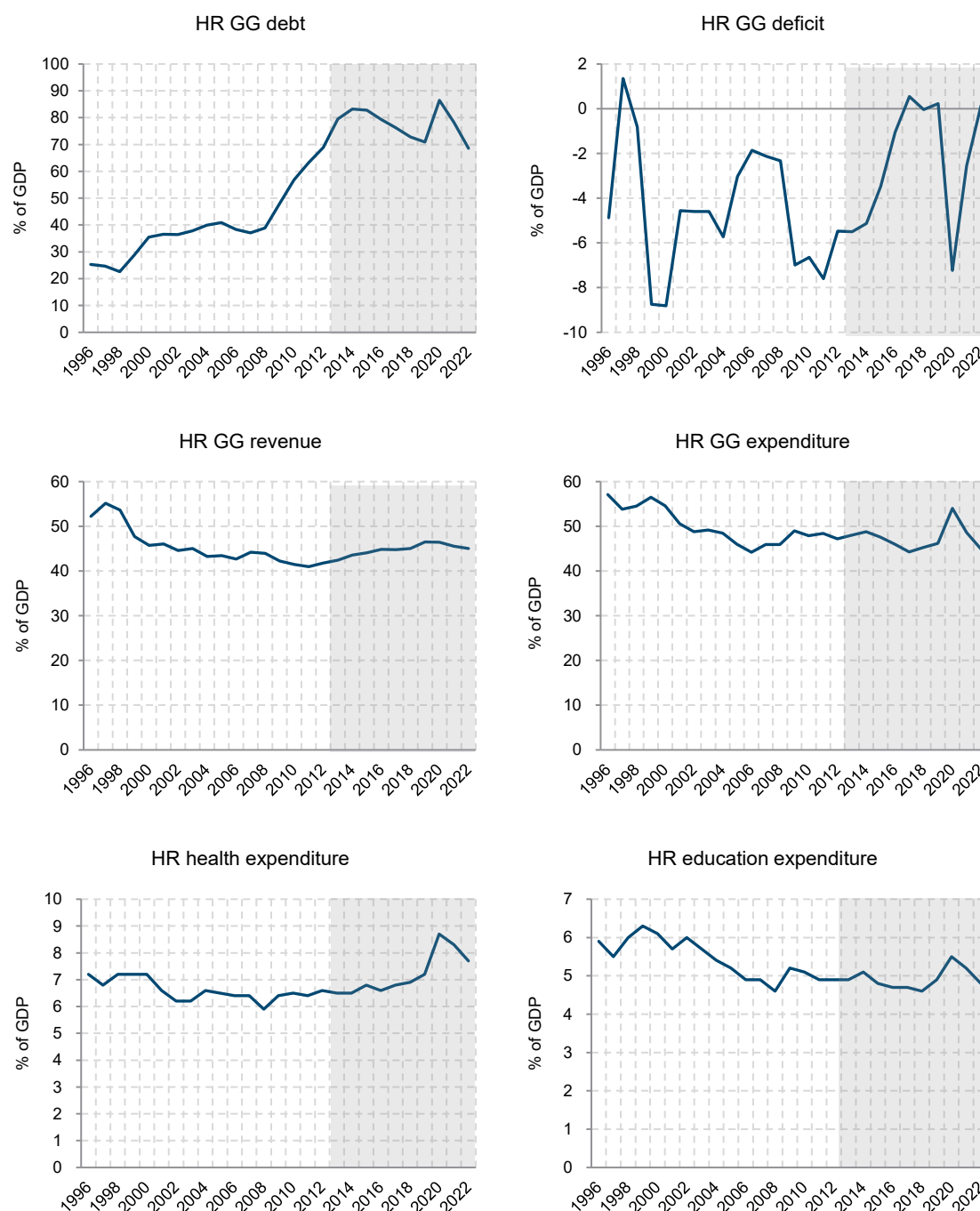
The government deficit followed a broadly similar pattern. It was very high in the years before accession – around 6-7% of GDP for several consecutive years – due to the global financial crisis. After accession, it gradually narrowed, reaching a balanced position in the second half of the 2010s, before widening again during the pandemic to 7% of GDP. It then narrowed once again in the subsequent recovery. Over the decade following accession, the average budget deficit slightly exceeded 2% of GDP.

Government revenue, on the other hand, showed a generally positive trend. It improved gradually, rising from around 42% of GDP before accession to 45% in the years following, driven mainly by improved tax collection.

Conversely, government expenditure declined somewhat after accession, from 48% of GDP before the country joined the EU to around 45% in the following years. It increased again during the pandemic, but has since declined.

Despite the overall reduction in government spending, some valuable categories of spending have seen an increase. Healthcare expenditure has increased since accession, rising from 6.5% of GDP to around 8% in the more recent years. Education expenditure, by contrast, has remained largely stable at around 5% of GDP, with some fluctuation from year to year.

Looking at the informal sector in Croatia, one can see that it also declined after EU accession, though to a lesser extent than in Bulgaria and Romania. In the late 1990s, Croatia was estimated to have a smaller informal economy, at around 31% of GDP. By 2012, the year before EU membership, this had decreased to 29%, which was a relatively modest improvement. Following accession, the pace of decline slowed further. By 2020, informality in Croatia was estimated at 28.4% of GDP – just 0.6 pp below the pre-accession period. Moreover, in 2020 Croatia had higher informality than Romania and Bulgaria (all figures refer to dynamic general equilibrium model-based estimates of Elgin et al., 2021). The relatively limited reduction in informality in Croatia may be partly explained by the absence of the Cooperation and Verification Mechanism (CVM), which was applied in the other two countries.

Figure 3.33 / Fiscal sector indicators in Croatia before EU accession and after

Note: Shaded area indicates the period after EU accession. All data as a percentage of GDP.

Sources: wiiw Annual Database for general government (GG) debt, GG deficit, GG revenue and GG expenditure, and Eurostat for health and education expenditure.

Labour and social indicators

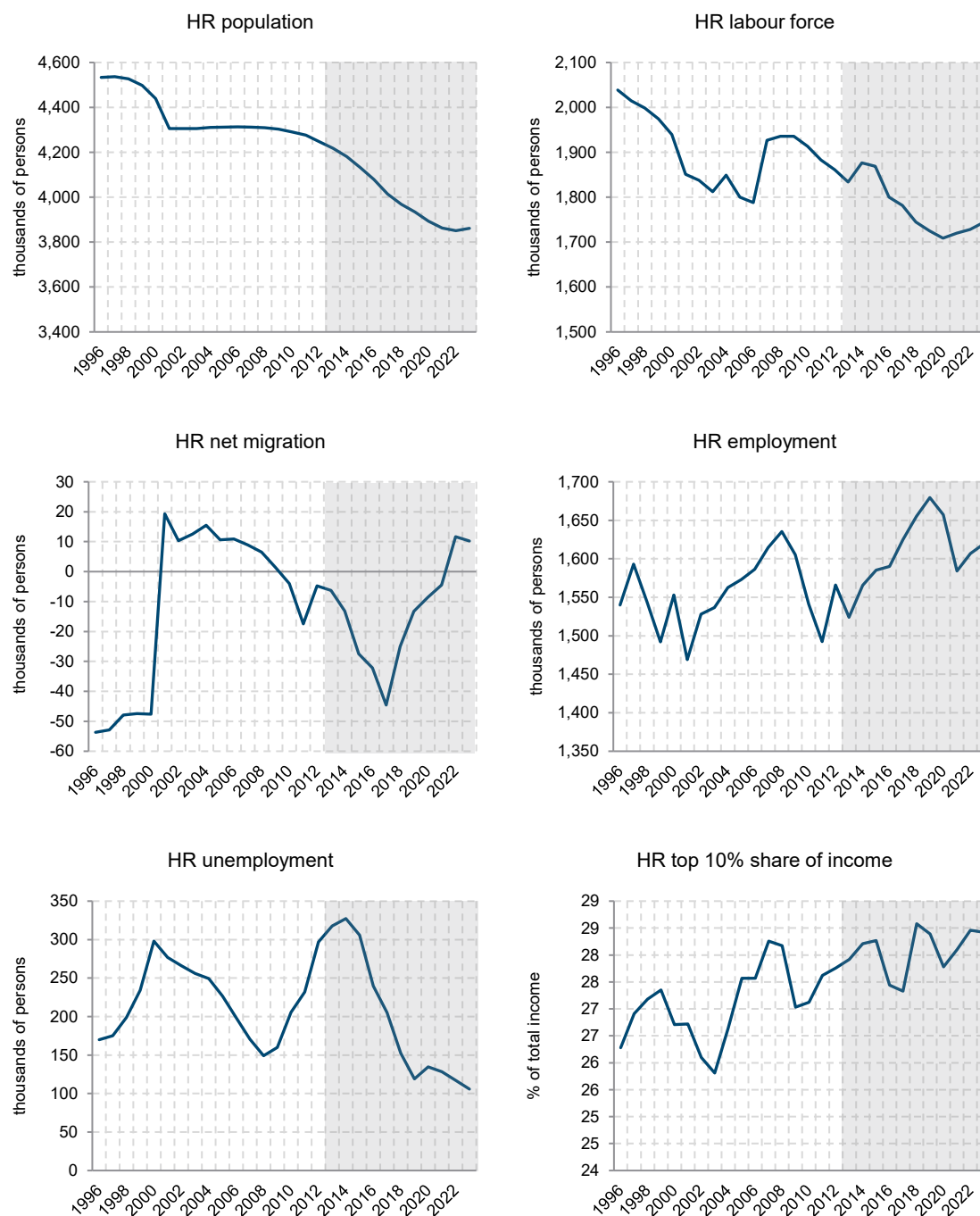
An analysis of Croatia's key labour and social indicators since EU accession reveals some challenges, but also several positive developments. The country's population decline, which had begun well before accession, continued at a steady pace afterwards. However, in the most recent year for which there are data available – 2023 – the population increased for the first time, by approximately 11,000 people. While it is too early to determine whether this signals a lasting reversal of the trend, the data suggest that the outlook may not be entirely negative.

The labour force followed a similar trajectory, continuing to contract after accession. However, since 2020, it has started to grow again, with a cumulative increase of around 35,000 people.

This reversal has been largely driven by net migration, which turned positive in 2022 and 2023, after having been negative for most of the previous two decades. Immediately following EU accession, net migration became even more negative than before accession, as easier mobility enabled more people to move abroad. Over time, however, as living conditions in Croatia improved, the pace of emigration slowed, and over the most recent period net migration has turned positive.

Employment has generally improved since accession, despite a notable decline during the pandemic. Unemployment has also followed a mostly downward trend, with the number of unemployed falling to 100,000 and the unemployment rate reaching around 6%.

Finally, as in many other countries, income inequality has increased since EU accession, although the rise in Croatia has been relatively modest. The share of income received by the top 10% (after tax) has increased by less than 1 percentage point since accession.

Figure 3.34 / Labour and social indicators in Croatia before EU accession and after

Note: Shaded area indicates the period after EU accession. All indicators in thousands of people, except the top 10% share of income, which is percentage of total income.

Sources: wiiw Annual Database for population, employment and unemployment, World Development Indicators for labour force and net migration, and World Inequality Database for the top 10% share of income.

Governance and institutions

Croatia had a much better experience than Bulgaria in terms of the performance of its institutions. Three of the governance indicators of the World Bank in 2023 were significantly better than before the country joined the EU in 2013 – control of corruption, rule of law and regulatory quality; two were marginally better – government effectiveness and voice and accountability; and only political stability was marginally worse.

Control of corruption improved significantly right after EU accession, reversing its previous stagnation. Following this initial improvement, the progress since has been mostly modest, but the latest figure for 2023 is still well above the pre-accession level.

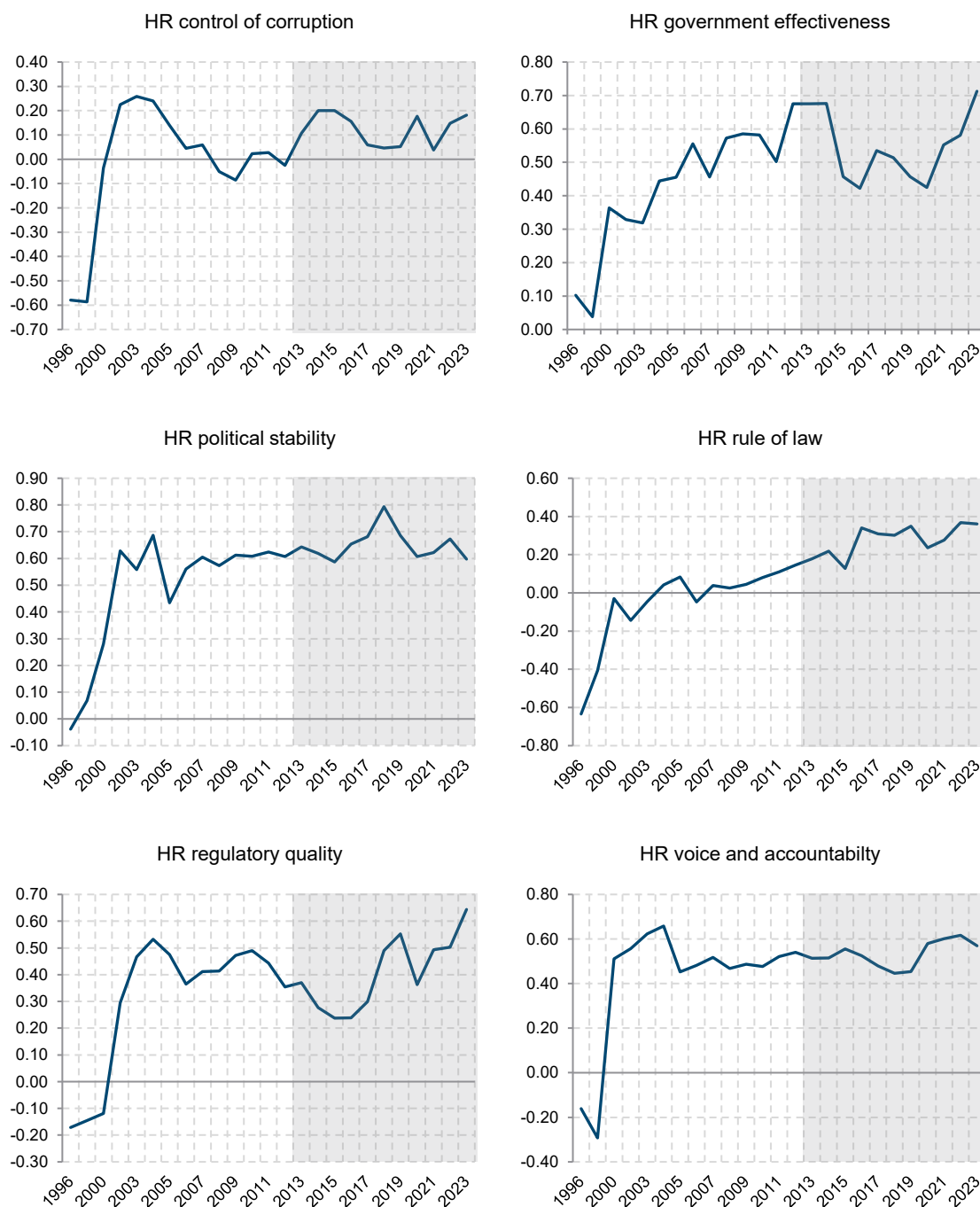
Government effectiveness stagnated right after accession, and even declined in the latter half of the 2010s. It started improving around 2020, and in 2023 the level remained marginally better than before accession.

Political stability remained relatively stable in the first few years after accession, but then improved significantly in the middle of the 2010s. It declined soon afterwards, and has largely stagnated in recent years. It is the only indicator that is currently worse than before EU accession.

Rule of law has strengthened considerably since EU accession. It was already on an upward trend before accession, and this trend has since continued, reaching the highest recorded level in 2023.

Regulatory quality has been something of a rollercoaster. It worsened after accession, continuing the trend from the years before, but then started to improve in the late 2010s. While there has since been some fluctuation, the level in 2023 was well above the pre-accession benchmark.

Voice and accountability improved only slightly after accession. While the trend has been largely stable, the 2023 figure is marginally higher than before EU entry.

Figure 3.35 / Governance and institutions indicators in Croatia before EU accession and after

Note: Shaded area indicates the period after EU accession. All indicators are estimated values, with higher values representing better institutions.

Sources: World Bank's Worldwide Governance Indicators.

Summary

Most of the indicators assessed for Croatia show an improvement after EU accession. The main challenges have been in the labour area and the fiscal sphere.

- › Population, labour force and employment declined even more after accession than before, due to net emigration.
- › However, this trend has reversed in recent years, with net migration turning positive, and population, labour force and employment growing again.
- › This highlights an important lesson – as living conditions improve (due in part to EU membership), so migration patterns and labour market trends can shift in a positive direction.
- › In the fiscal sphere, the most significant issue has been general government debt, which has fluctuated considerably since accession but remains close to 70% of GDP, similar to pre-accession levels.
- › The external sector has seen mostly positive developments, with external debt declining significantly, reaching around 80% of GDP in recent years.
- › The current account and trade balance improved after the country joined the EU, with the recent deterioration mainly due to the pandemic and the cost-of-living crisis.
- › Governance and institutions have generally improved since accession, with five of the six Worldwide Governance Indicators now better than before accession; only political stability has worsened slightly.
- › An especially important lesson from Croatia is the strong real exchange rate appreciation before EU accession, driven by rising prices and the kuna's euro peg, which eroded price competitiveness and contributed to a six-year recession after 2009 – highlighting the risks of prolonged real appreciation in small open economies if they are not accompanied by improvements in non-price competitiveness.

4. ASSESSMENT OF THE OF CANDIDATE COUNTRIES – CASE STUDIES FOR MONTENEGRO, SERBIA AND UKRAINE

4.1. Introduction

This section selects three of the candidate countries – two in the Western Balkans plus Ukraine – to assess the extent to which fulfilment of the economic Copenhagen criteria might pose a problem for their accelerated accession to the EU. Since the task of this report is to focus on a minimum set of conditions that (as far as can be evaluated ex ante) would forestall negative outcomes of an accelerated accession (for both the aspiring new members and the current members), we concentrate on the most problematic issues that we can detect in relation to the four different categories (external imbalances and competitiveness, fiscal issues, labour markets and demography, and institutional deficiencies) that have structured our report so far.

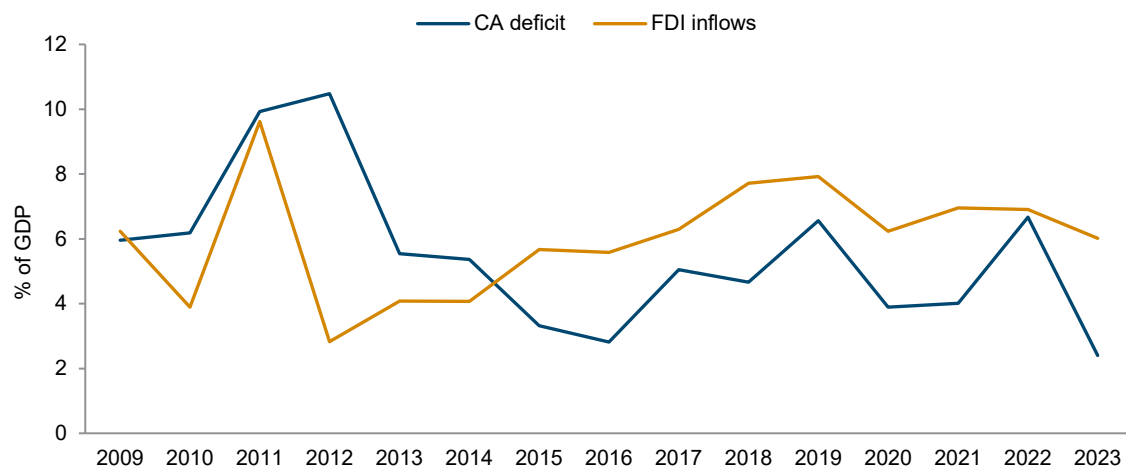
4.2. Serbia

Serbia's is the largest economy of those Western Balkan countries that are EU candidates, and the third largest of all candidates, after Turkey and Ukraine. It formally applied for EU membership in 2009, was granted candidate status in 2012 and began accession negotiations in 2014. However, progress has been slow, with only a limited number of chapters opened and provisionally closed – due largely to concerns over governance, the rule of law and the country's stance on foreign policy alignment.

Politically, Serbia is in a unique position. Beyond its economic weight in the region, it maintains strong ties with China and Russia, while simultaneously fostering cooperation with the EU and the US. This balancing act makes it a key geopolitical player in the Western Balkans.

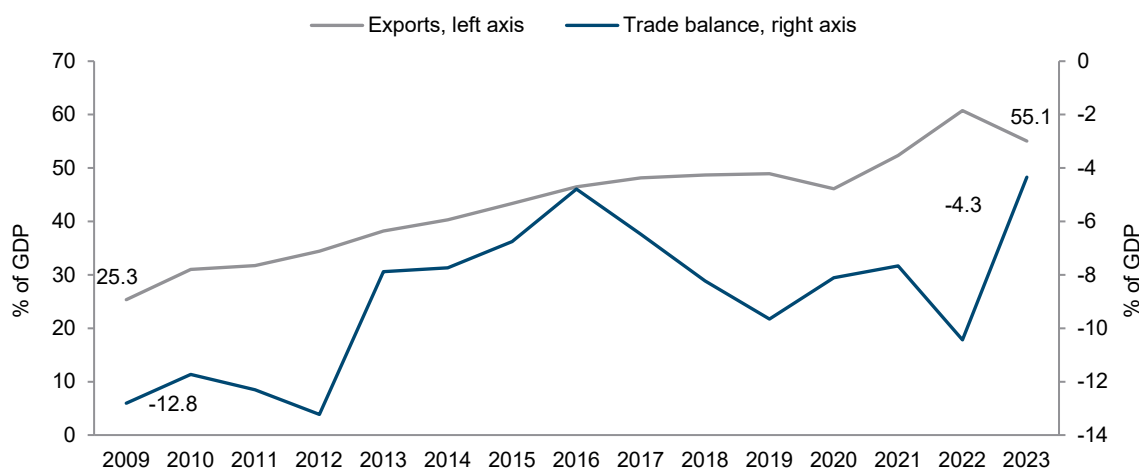
An examination of Serbia's EU prospects along four key dimensions – external factors, fiscal stability, labour and social issues, and governance and institutions – reveals both strengths and weaknesses. These insights are relevant not only for the EU, but also for other candidate countries in the Western Balkans and beyond.

The external position appears relatively strong overall. Gross external debt currently stands at around 60% of GDP, and has fluctuated between 58% and 73% over the past 15 years. One potential weakness is the persistent current account deficit, which has averaged 5.5% of GDP over the same period. However, this has not posed a significant problem, as Serbia has consistently attracted strong FDI inflows, averaging 6% of GDP. To a large extent, these inflows have covered the current account deficit. One can also say that the deficit itself reflects strong FDI, as new investments often drive higher imports, particularly in the initial stages of business operations (Figure 4.1).

Figure 4.1 / Serbia's CA deficit and FDI inflows between 2009 and 2023 (% of GDP)

Source: World Bank's World Development Indicators.

Strong FDI inflows have also contributed to a significant improvement in Serbia's export capacity. Exports of goods and services – measured as a share of GDP – have more than doubled over the past decade and a half – from around 25% in 2009 to 55% in 2023. While imports have also increased during this period, their growth has been more moderate, leading to a substantial reduction in the trade deficit. In 2009, the trade deficit stood at approximately 13% of GDP, but by 2023 it had narrowed to just 4% (Figure 4.2).

Figure 4.2 / Serbia's exports of goods and services and external balance on goods and services (% of GDP)

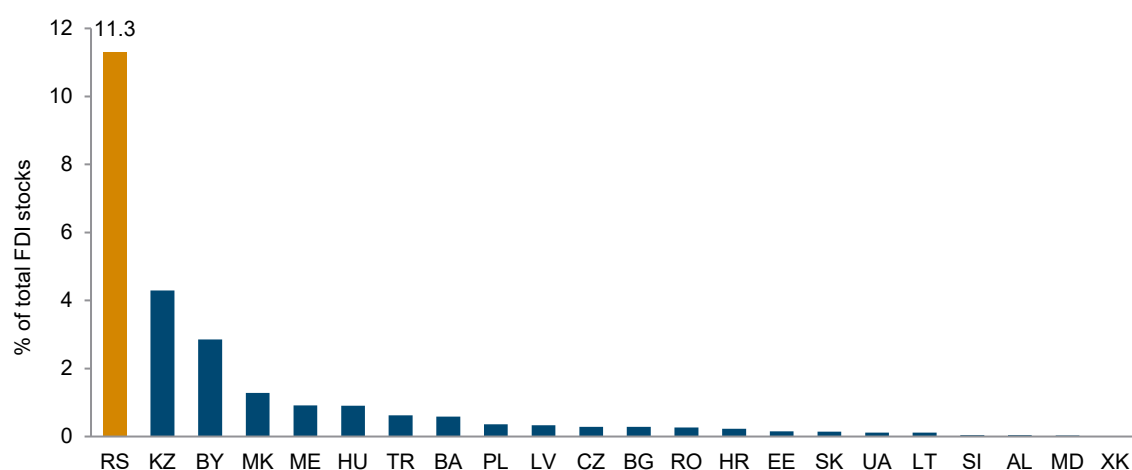
Source: World Bank's World Development Indicators.

One downside and potential risk has been China's growing investment presence in Serbia. In recent years, China has become the country's largest foreign investor, accounting for around a third of total FDI inflows – similar to the entire EU combined and more than any single EU member state. By 2023, Chinese FDI stocks in Serbia had reached 11% of the country's total FDI stock – second only to the

Netherlands, which accounted for 13%. This is by far the highest level of Chinese FDI concentration in the wider region of Central, East and Southeast Europe (Figure 4.3).

While these investments have supported industrial expansion, they also pose certain risks for both Serbia and the European Union. A key concern is economic dependence, as a large share of FDI from a single non-EU country could give China disproportionate influence over Serbia, particularly in strategic sectors. The EU is also increasingly vigilant about Chinese investments in Europe, especially regarding potential unfair subsidies. The European Commission recently launched a foreign subsidy probe into a BYD electric car plant in Hungary, to assess whether the company received unfair support from China. Given the similarities in investment patterns, Serbia could face similar scrutiny, which could, in turn, complicate its EU accession prospects.

Figure 4.3 / Chinese FDI in Central, East and Southeast Europe (% of total FDI stocks)



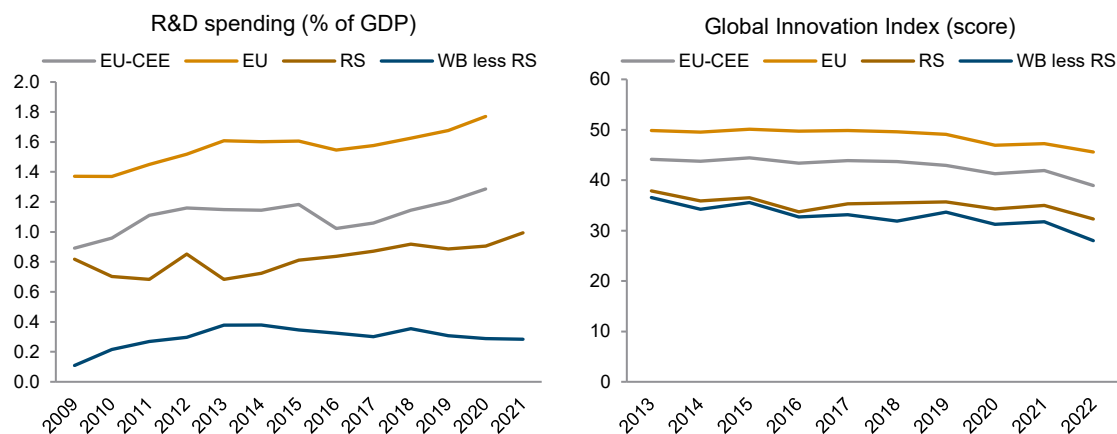
Source: wiiw FDI database.

In terms of innovation, Serbia performs better than other Western Balkan countries, but it still lags behind EU member states from Central, East and Southeast Europe (EU-CEE). Looking at R&D expenditure, Serbia reached 1% of GDP in 2021 – roughly three times more than the average for its Western Balkan peers. However, this is still below the EU-CESEE average of 1.3% (2020) and significantly below the EU-wide average of 1.8%.

A broader and somewhat different picture is provided by the Global Innovation Index (GII). This is a composite index that covers not only R&D spending, but also factors such as education quality, digital infrastructure, market sophistication and innovation outputs (for instance, patents and high-tech exports). According to the latest GII report, the ranking of countries follows a similar pattern: Serbia performs better than its Western Balkan neighbours, but lags behind the EU-CESEE countries and the EU average. There are, however, some important nuances. Serbia has been on a downward trend in innovation performance over the past decade, with its GII score gradually deteriorating, rather than improving. Moreover, while the gap between Serbia and the rest of the Western Balkans is large in terms of R&D spending, the difference in GII scores is much smaller – suggesting that higher spending has not yet translated into proportionately stronger innovation outcomes. At the same time, the gap

between Serbia and the EU – including EU-CEE members – is considerably wider when measured by the GII than by R&D expenditure alone (Figure 4.4).

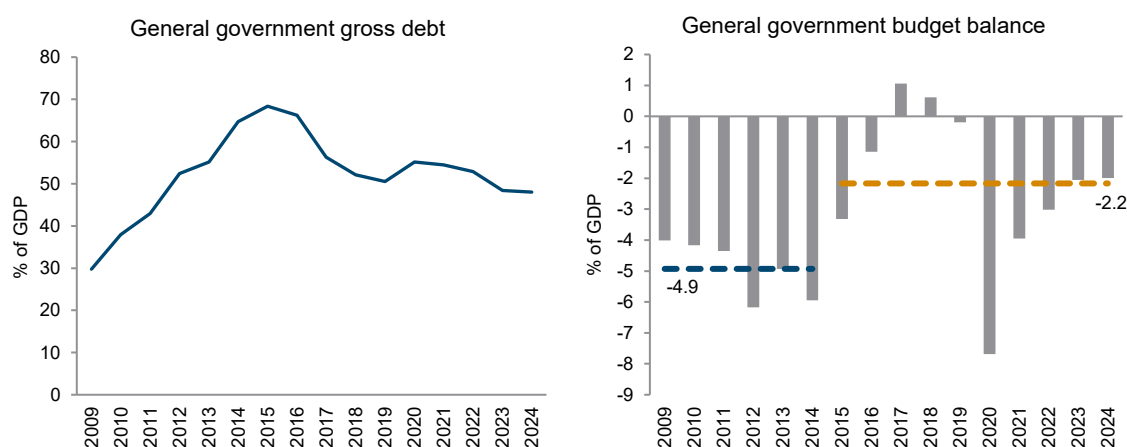
Figure 4.4 / Innovation indicators in Serbia and its European peers



Source: World Bank's WDI for R&D spending, World Intellectual Property Organization (WIPO) for the Global Innovation Index.

The fiscal position in Serbia has been relatively stable. General government debt has fluctuated at around 50% of GDP over the past 7-8 years, following a peak of 70% in 2014. Since that peak, it has generally trended downward. The fiscal deficit has also improved significantly. Between 2009 and 2014, it averaged nearly 5% of GDP, contributing to the rise in public debt. However, since 2015 the deficit has averaged around 2% of GDP and has narrowed further in recent years, following the strong support measures taken during the pandemic (Figure 4.5). At the same time, Serbia still has some fiscal space to increase revenue. General government revenue stands at around 40% of GDP – well below the EU average. Moreover, the country has relatively low personal and corporate income tax rates, which could be raised (if necessary) to strengthen public finances.

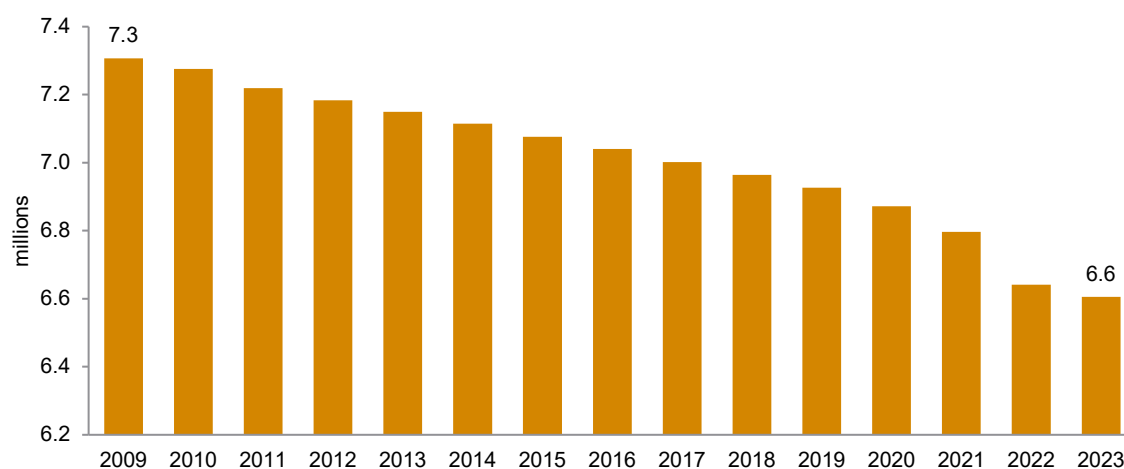
Figure 4.5 / General government debt and budget balance in Serbia (% of GDP)



Source: wiiw Annual Database.

Despite some positive labour and social developments over the past decade and a half, Serbia faces significant challenges that could pose serious risks in the coming years. The most pressing issue is its declining population. Between 2009 and 2023, Serbia lost 700,000 people, with its population shrinking from 7.3 million to 6.6 million – an average decline of 50,000 people per year (Figure 4.6). As in many other countries of CESEE, the causes are complex, but include low and declining birth rates. However, the primary driver has been massive emigration, largely to the EU, driven by poor living standards and limited economic opportunities at home.

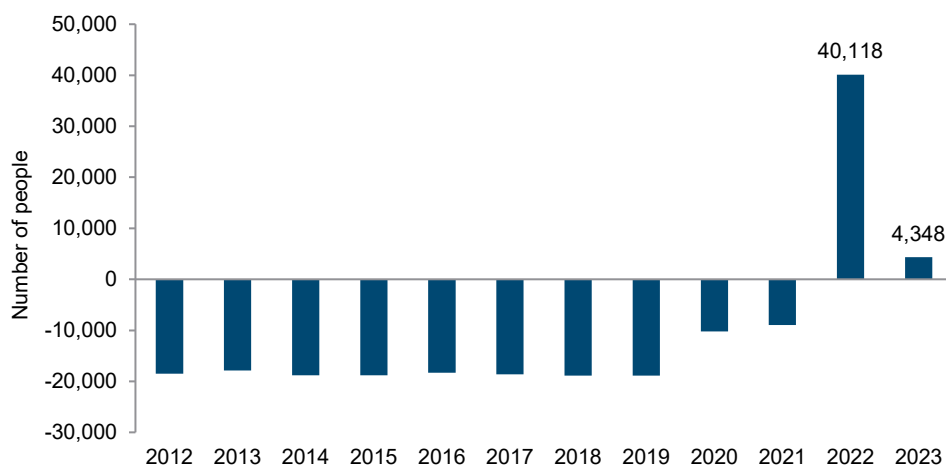
Figure 4.6 / Serbia's year-end population (millions)



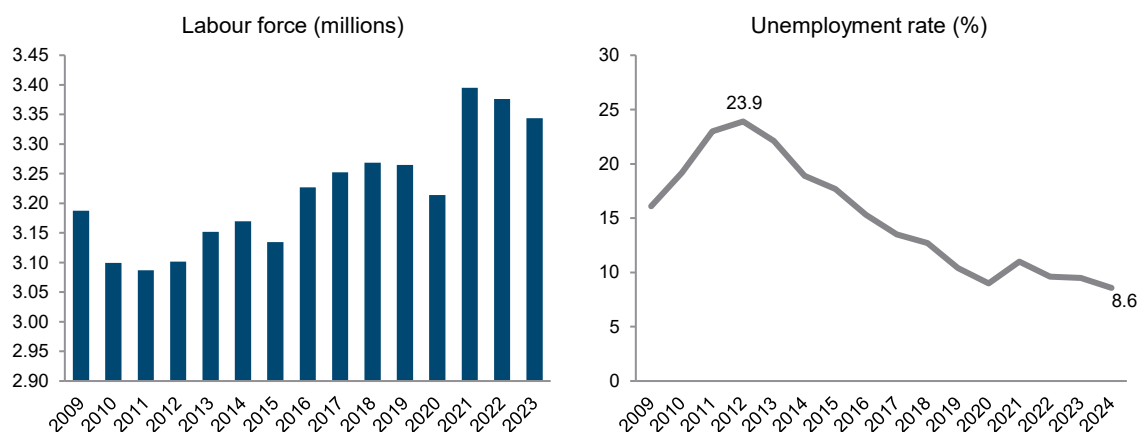
Source: wiiw Annual Database.

A positive trend for Serbia in recent years has been the influx of people from Russia and Ukraine. While there are no reliable official figures on how many people have arrived and remained in the country, net migration data for 2022 and 2023 indicate a clear shift, with persistent net emigration before 2022 turning to net immigration in 2022 and 2023 (Figure 4.7). Many of the Russian and Ukrainian migrants are highly skilled professionals, academics and intellectuals, who have the potential to contribute positively to the economy and society. However, their long-term presence remains uncertain, as many may choose to return home once the war ends.

Despite its declining population, Serbia's labour force has seen an upward trend over the past decade and a half, driven by activation policies. The active population grew from 3.1 million in 2010 to 3.3 million in 2023. However, the two years following 2021 saw a reversal, with a decline in the labour force, suggesting that activation is reaching its limits (Figure 4.8). Employment has been rising steadily, while unemployment has fallen, recently reaching 8.6% (down from 24% in 2012). Although around 270,000 people remain unemployed, it may only be a matter of years before Serbia runs out of additional workers to absorb into the labour market. Slowly but surely, the country appears to be approaching a state of labour shortage. Signs of this are already visible, as Serbia has begun attracting foreign workers, particularly from Southeast Asia.

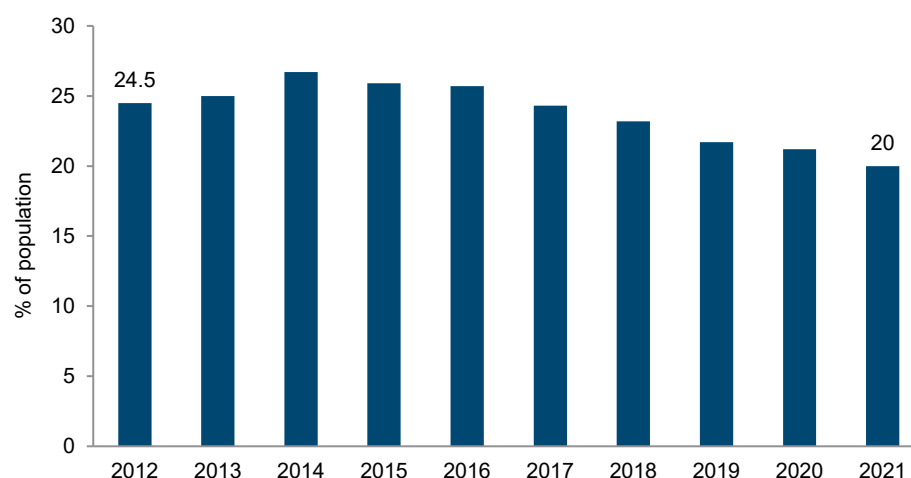
Figure 4.7 / Net migration in Serbia (number of people)

Source: World Bank's World Development Indicators.

Figure 4.8 / Labour force and unemployment in Serbia

Source: World Bank's World Development Indicators for labour force, wiiw Annual Database for unemployment rate.

Another major challenge has been the unequal distribution of economic growth. Despite solid overall growth, strong FDI inflows and declining unemployment, poverty remains alarmingly high. According to where the national poverty line is drawn, 20% of Serbia's population lived in poverty in 2021 – a decline of only 4.5 percentage points over the past decade, from 24.5% in 2012 (Figure 4.9). Given the effects of the pandemic and the ongoing cost-of-living crisis, this figure has likely increased in recent years. Persistently high poverty poses significant risks, including increased emigration and social instability. When large segments of the population see little benefit from economic growth, dissatisfaction rises and potentially fuels unrest. Moreover, poverty-driven emigration exacerbates Serbia's demographic and labour market challenges, accelerating workforce depletion and deepening long-term economic vulnerabilities.

Figure 4.9 / Poverty rate in Serbia, according to the national poverty line (% of population)

Source: World Bank's World Development Indicators.

Lastly, in the area of governance and institutions, Serbia has faced mounting challenges in recent years that could impact its EU accession. The European Union has consistently raised concerns in its progress reports about institutional weakness, citing issues such as democratic backsliding, weak rule of law and corruption. These problems have not only slowed Serbia's integration process, but have also raised concerns about the responsible use of EU funds and the broader stability of the region.

Serbia's institutional decline is evident in the World Bank's Worldwide Governance Indicators (WGI). The voice and accountability indicator has deteriorated steadily over the past decade and a half, with a particularly sharp decline since 2014, coinciding with the rise to power of President Aleksandar Vučić (who first served as prime minister) (Figure 4.10, top left chart). Since then, growing authoritarianism has led to restrictions on media freedom, suppression of dissent and weakening of democratic institutions – undermining core EU values and raising doubts about Serbia's readiness to participate in the Union's political structures.

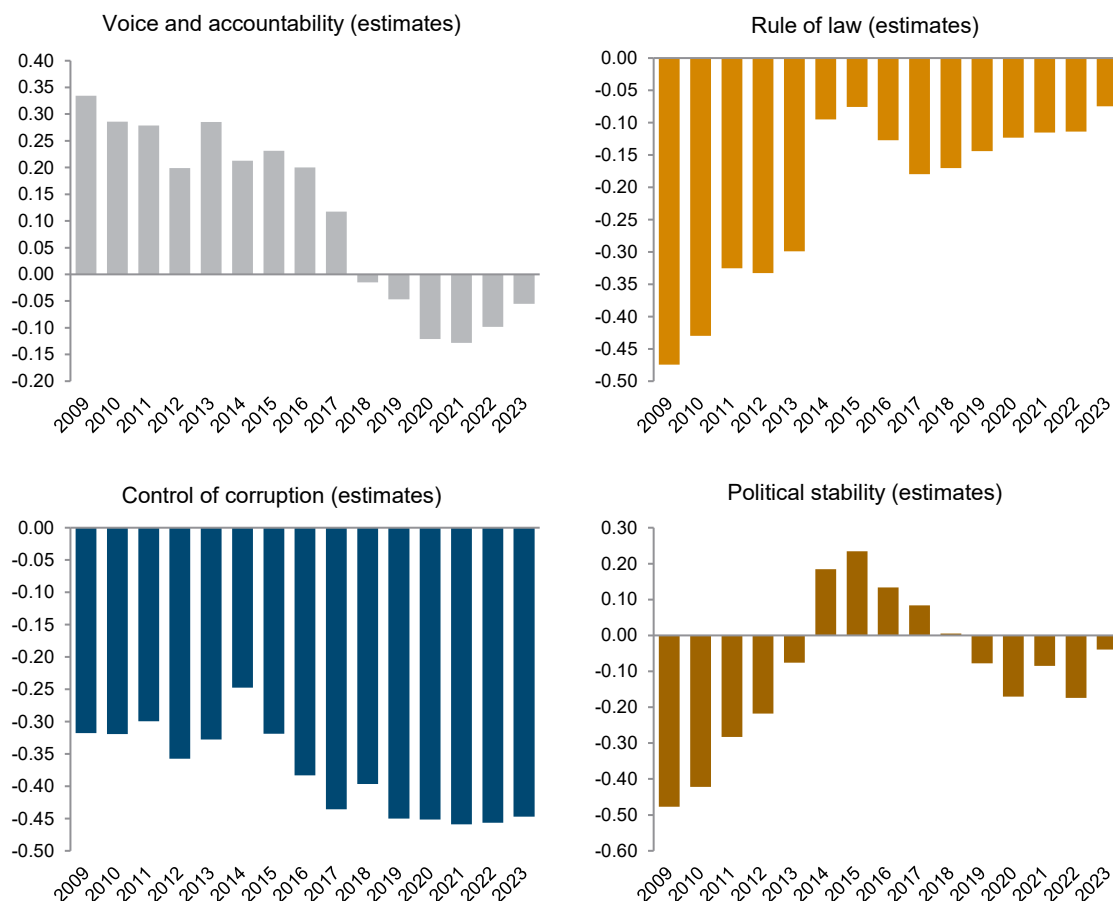
Similarly, the rule of law indicator improved between 2009 and 2014, but has since declined, albeit at a slower pace than voice and accountability (Figure 4.10, top right chart). This has significant economic implications, as weak legal institutions erode investor confidence and create an unpredictable business environment. The EU has repeatedly stressed that judicial independence and reliable contract enforcement are essential for accession, yet Serbia's stagnation in these areas continues to raise concerns.

Control of corruption is another area of serious concern. While there were improvements up until 2014, the trend has since gone into reverse (Figure 4.10, bottom left chart), with increasing evidence of mismanagement of public resources and potential misuse of EU funds. Without stronger governance reforms, there is a real risk that EU financial support could be misallocated, further delaying economic and institutional progress.

Finally, these institutional weaknesses – authoritarian tendencies, weak rule of law and corruption – have all contributed to increased political instability. The WGI indicator for political stability has declined significantly since 2015 (Figure 4.10, bottom right chart), raising concerns not just for Serbia, but for the

wider Western Balkans. Instability in Serbia could have spill-over effects across the region, posing a security risk and complicating the EU's engagement with the Western Balkans. The stakes are high, as prolonged instability would not only hinder Serbia's accession, but also create broader challenges for the EU itself.

Figure 4.10 / Governance indicators in Serbia (estimates)



Note: Higher values indicate better institutions.

Source: World Bank's Worldwide Governance Indicators.

Summary

The main challenges for Serbia's EU accession are:

- › While its external position is strong and stable, one potential risk is the strong and growing Chinese presence and influence.
- › In terms of innovation, Serbia is increasingly spending on R&D, but this is failing to deliver tangible results for now.
- › In the labour area, depopulation is a big issue. Serbia is losing 50,000 people every year (0.8% of its population), mostly due to emigration.
- › There have been improvements in the activation of people, but these are reaching their limits and the country will soon face labour shortages.

- › Another big issue has been the alarmingly high rate of poverty, which is still above 20% and is declining only marginally.
- › There are major issues in governance, with most governance indicators deteriorating over the past decade, due to the authoritarian rule of the current president.

4.3. Montenegro

Of all the countries that are candidates for EU membership, Montenegro has the smallest economy, but it is also the furthest forward in the negotiation process. It formally applied for EU membership in 2008, was granted candidate status in 2010, and began accession negotiations in 2012. Its path has been uneven – at times progressing swiftly, at other times stalling – with the pace largely determined by domestic political developments and changes, as well as by persistent governance challenges. By early 2025, Montenegro had opened all 33 negotiation chapters and had provisionally closed three. The government has recently committed to closing all chapters by the end of 2026 and aims to join the EU by the end of 2028 – an ambitious, but politically significant target.

Politically, Montenegro occupies a unique position in the region. It was part of a joint state (with Serbia) until it declared its independence in 2006. Since then, relations with Serbia have been marked by cycles of tension and rapprochement. For much of the post-independence period, Montenegro was led by a nationalist, pro-Western government that distanced itself from Belgrade and promoted a distinct Montenegrin identity. But this has begun to shift in recent years, following the electoral defeat of long-time ruler Milo Đukanović in 2020 and the emergence of more Serbia-friendly political forces. Ethnic Serbs make up roughly one third of the population, and ethnic issues remain very important in the country.

Montenegro is a NATO member, with just some minor political parties opposing this. Nevertheless, economic ties with Russia remain strong. Wealthy Russian nationals have invested heavily in real estate and tourism, and business linkages continued even after Montenegro adopted EU sanctions following the outbreak of war in Ukraine. Montenegro also maintains a significant financial relationship with China. Although Chinese financing has declined somewhat in recent years, China remains one of the country's major bilateral creditors.

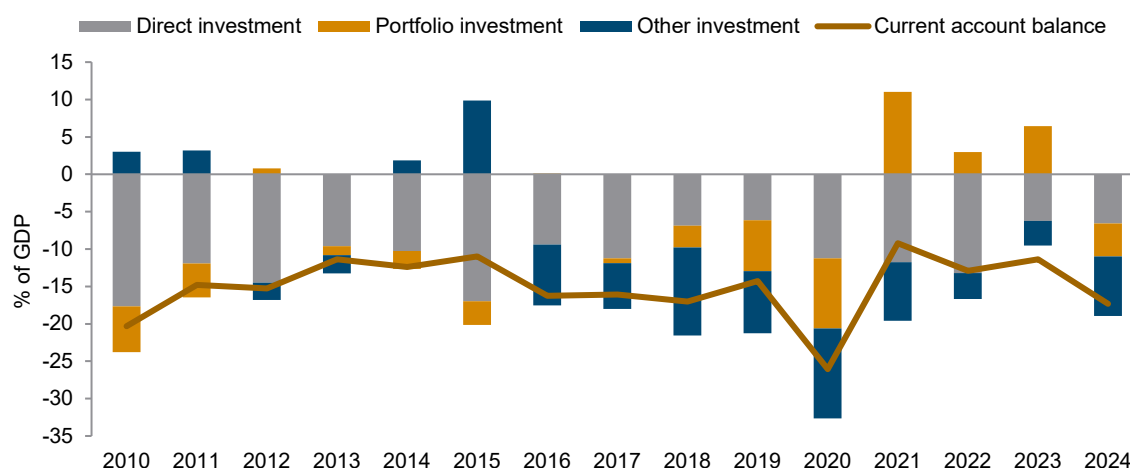
Montenegro was long known for having the longest-ruling political leader in Europe. Milo Đukanović, either as president or prime minister, led the country continuously from 1991 until 2023. His rule was marked by a highly centralised governance model, tight control over institutions and the economy, and allegations of corruption. In a country of just over 620,000 people, such prolonged dominance has left deep institutional and political legacies, which still affect the functioning of the state and the public's trust in reforms.

In this section, we examine Montenegro's EU accession prospects across the same four dimensions as before: external factors, fiscal stability, labour and social issues, and governance and institutions. The intention is to identify both the country's comparative strengths and its structural weaknesses in relation to EU accession. As the frontrunner in the negotiation process, Montenegro provides valuable insights – both positive and cautionary – for other Western Balkan countries. Its experience illustrates the complexity of balancing macroeconomic stability against entrenched governance issues; navigating political instability; and managing geopolitical ambiguities in a region marked by overlapping spheres of influence.

Montenegro's external sector is particularly vulnerable, posing significant risks to macroeconomic stability. The country's structural characteristics – small size, mountainous terrain, limited arable land and lack of significant natural resources – constrain its ability to develop a strong export-oriented industrial base. As a result, goods exports remain low, amounting to only around 10% of GDP, a level that has shown little change over the past decade. By contrast, goods imports consistently exceed 50% of GDP, as the country depends heavily on imported products to meet domestic demand. Its Adriatic coast has enabled the country to develop a strong services export sector, primarily driven by tourism. Exports of services have recently been around 38% of GDP, reflecting the growing importance of the tourist industry. This marks a notable increase compared to the early 2010s, when services exports stood at around 28% of GDP – a rise of approximately 10 percentage points over the last 15 years. Yet even with this, the overall trade balance remains in deep deficit – persistently around 20% of GDP.

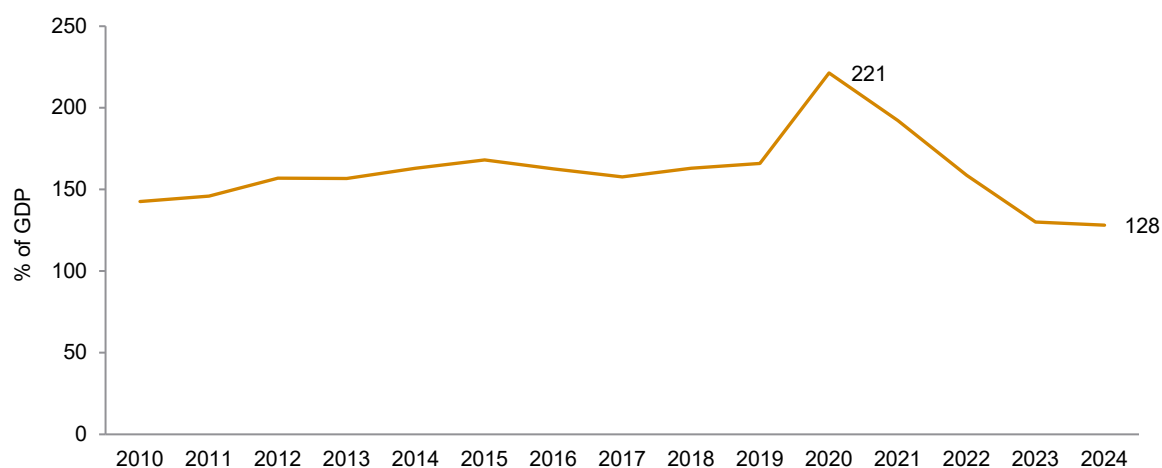
While remittances and other transfers have helped offset part of the trade deficit, Montenegro's current account deficit has remained persistently high, fluctuating at around 15% of GDP over the past 15 years. The current account deficit has been partly financed through FDI inflows, which historically have exceeded 10% of GDP, but in recent years have declined to around 6-7%. The remaining gap has been covered through a combination of portfolio and other investment flows (Figure 4.11). These include foreign issuance of Eurobonds and loans from abroad, but also often capital of dubious or illicit origin, especially in sectors such as real estate and tourism.

Figure 4.11 / Montenegro's current account deficit and how it is covered (% of GDP)



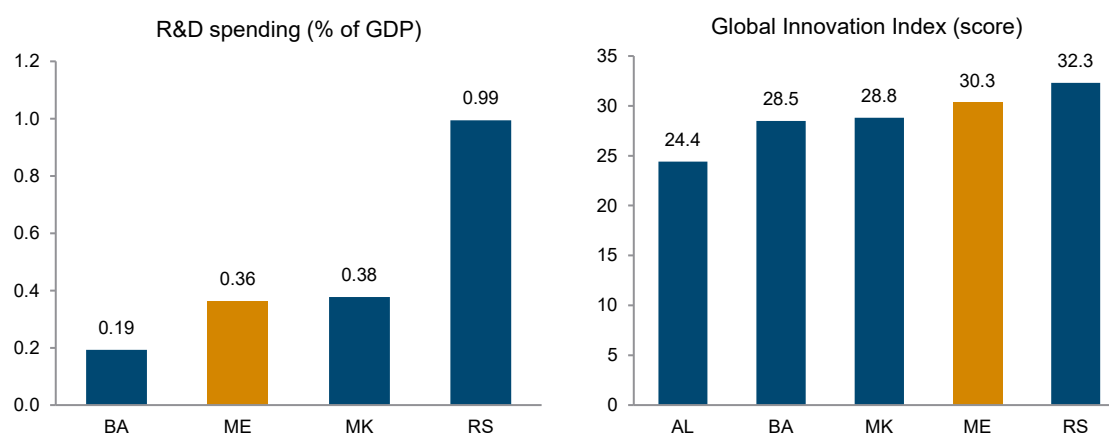
Source: wiiw Annual Database.

As a result of this persistent reliance on external financing to cover the current account deficit, Montenegro has by far the highest level of external debt as a share of GDP in all of Eastern Europe. In 2024, external debt stood at 128% of GDP. This is actually the lowest it has been over the past 15 years: it has typically hovered at around 150% or above, and peaked in 2020, during the COVID-19 pandemic, when external debt soared to 221% of GDP (Figure 4.12). This was accompanied by a sharp rise in public debt and marked the onset of a serious debt crisis, discussed in more detail below. Since then, however, debt has been on a gradual downward trajectory, supported by strong real GDP growth, thanks to the robust performance of the tourism sector, as well as high inflation.

Figure 4.12 / Montenegro's external debt (% of GDP)

Source: wiiw Annual Database.

As a tourism-based economy, Montenegro does not stand out in terms of innovation, but still puts in a decent performance compared to its regional peers. Only Serbia is notably better, both in terms of R&D spending and the Global Innovation Index. North Macedonia is close to Montenegro, performing slightly better in R&D expenditure, but ranking lower on the innovation index. By contrast, Bosnia and Herzegovina and Albania lag significantly behind. No publicly available data exist for Kosovo to allow comparison (Figure 4.13).

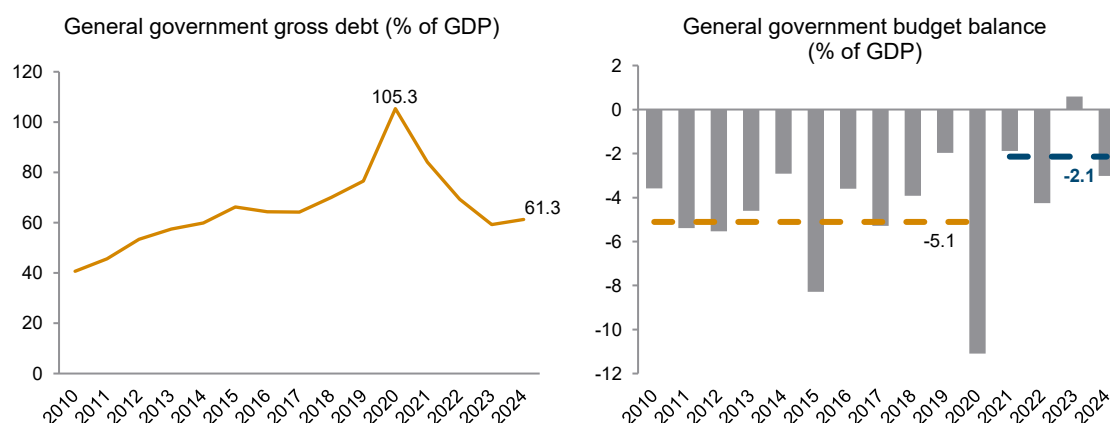
Figure 4.13 / Innovation indicators for Montenegro and the other Western Balkan economies

Source: World Bank's World Development Indicators for R&D spending, World Intellectual Property Organization (WIPO) for the Global Innovation Index.

Montenegro's fiscal position is currently stable, but the country came dangerously close to a serious fiscal crisis during the COVID-19 pandemic. Throughout the 2010s, the country was on an unsustainable fiscal path, with a persistent budget deficit that averaged around 5% of GDP. As a result, general government debt nearly doubled, rising from around 40% of GDP in 2010 to almost 80% by 2019. The situation deteriorated sharply in 2020, when the pandemic hit. Given Montenegro's heavy dependence

on tourism, the economy was severely affected by global travel restrictions. Tourism came to a standstill and the country experienced the largest GDP contraction in Europe, with output falling by around 15%. In response, the government introduced sizeable fiscal support measures, which pushed the budget deficit to an alarming 11% of GDP, while public debt surged to 105% of GDP (Figure 4.14). This spike in debt was the result not only of higher spending, but also of the sharp drop in GDP, which magnified the debt and deficit ratios.

Figure 4.14 / General government debt and budget balance in Montenegro (% of GDP)



Source: wiiw Annual Database.

The culmination of the debt crisis came with the difficulty experienced by the country in repaying a large Chinese loan taken out for construction of the Bar–Bolja motorway. In 2014, the government borrowed USD 1bn from China's Exim Bank – equivalent to around 20% of the country's GDP at the time – with the aim of improving transport connectivity with Serbia and, through it, with the EU. While the project was seen as strategic, it significantly increased Montenegro's debt burden. By 2020, when the pandemic triggered a sharp economic contraction, Montenegro found itself struggling to meet its repayment obligations, raising fears of a potential default. Media speculation suggested that China might seek control over a strategic asset, such as a port, as collateral. Although there was no concrete evidence that state property was at imminent risk, the situation was serious enough for Montenegro to reprogramme the loan by entering into a hedging arrangement with a consortium of European and American banks.

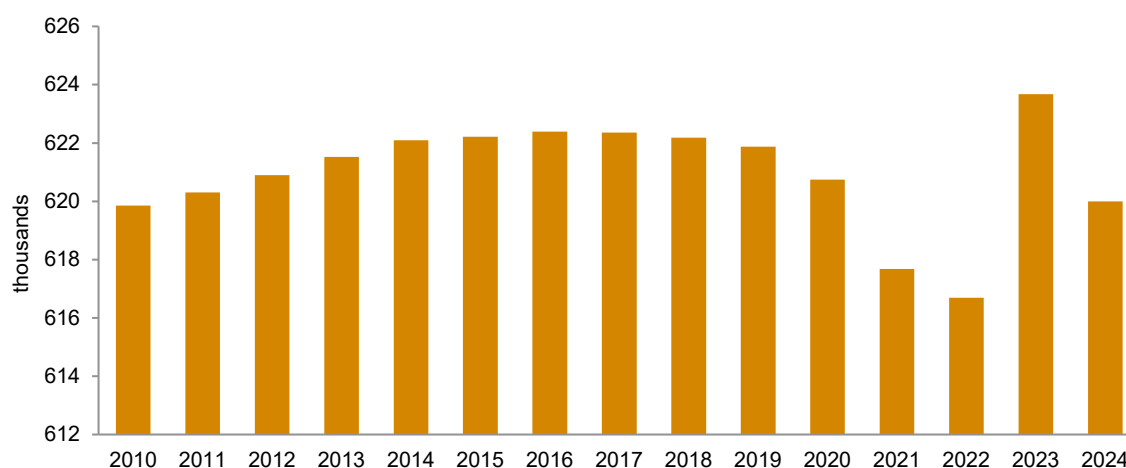
Following this episode – and partly as a result of a political shift after the 2020 elections, the new government adopted a more prudent fiscal policy stance and introduced a series of tax and social reforms. These reforms contributed to a narrowing of the fiscal deficit, which has since stabilised at around 2% of GDP, and supported a downward trajectory in public debt, now settling at around 60% of GDP. This adjustment was further supported by the post-pandemic recovery and high inflation.

This experience highlights the critical importance of maintaining fiscal discipline and the risks associated with high external debt, particularly for small, open economies dependent on external demand. It underscores the need for solid macroeconomic fundamentals to ensure that candidate countries can withstand external shocks and avoid the pitfalls of unsustainable financing. The case also illustrates the

importance of the support that the EU can provide to struggling countries when they face such adverse shocks.

Like all the countries of the region, Montenegro faces a demographic challenge, though to a lesser extent than its regional peers. Over the past 15 years, the population has fluctuated within a relatively narrow range of between 617,000 and 624,000 people. From 2016 to 2022, the population was on a gradual downward slope, reflecting natural decline and emigration. However, following the Russian invasion of Ukraine, the country experienced a temporary population increase, driven by the influx of Ukrainian and Russian nationals seeking refuge or relocating for business reasons. Many of these individuals stayed only briefly, and by end of 2024 the population had declined again, returning to closer to previous levels (Figure 4.15).

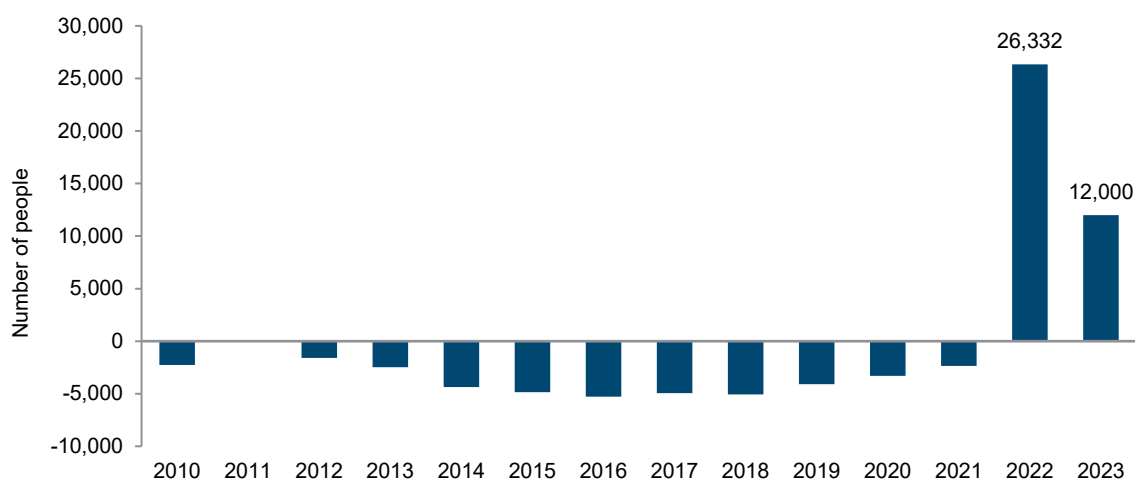
Figure 4.15 / Montenegro's year-end population (thousands)



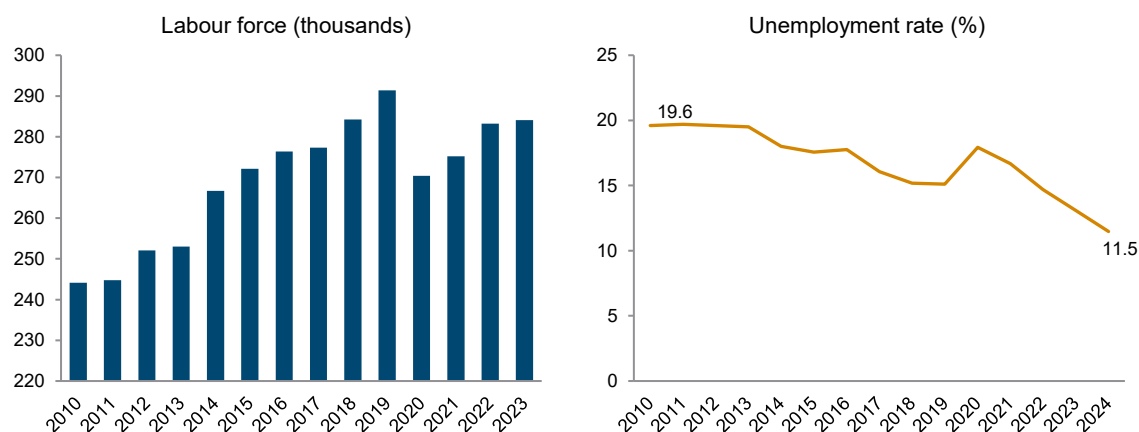
Source: wiiw Annual Database.

The data on net migration paint a similar picture. Until 2021, Montenegro consistently recorded negative net migration, with several thousand people leaving the country each year in search of a better life, mostly in the various EU member states. This trend reversed in 2022, when the war in Ukraine triggered a surge in inward migration, resulting in positive net migration of around 26,000 people. These dynamics continued in 2023, albeit at a lower intensity, with net migration estimated at around 12,000 people (Figure 4.16).

Demographic pressures are also reflected in labour market trends, although the situation is not yet alarming. Throughout the 2010s, Montenegro's labour force grew steadily, rising from around 245,000 in 2010 to over 290,000 in 2019. However, the onset of the pandemic in 2020 led to a sharp decline of approximately 20,000. Since then, the labour force has begun to recover, partly supported by the influx of Ukrainian and Russian nationals, though it remains below its pre-pandemic peak. The unemployment rate, which hovered near 20% in the early 2010s, has been trending gradually downward over the past decade, with only a brief interruption during the pandemic. Most recently, it has declined to around 11%, and there are growing reports of labour shortages, particularly of seasonal workers in the tourism sector (Figure 4.17).

Figure 4.16 / Net migration in Montenegro (number of people)

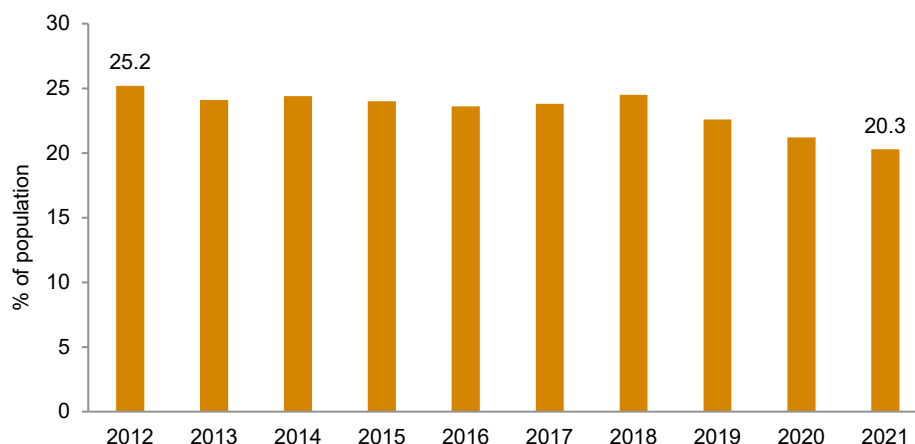
Source: wiiw Annual Database.

Figure 4.17 / Labour force and unemployment in Montenegro

Source: World Bank's World Development Indicators for labour force, wiiw Annual Database for unemployment rate.

As in Serbia, poverty and inequality remain pressing issues in Montenegro. Despite periods of solid economic growth, strong FDI inflows and a declining unemployment rate, poverty levels remain alarmingly high and have not fallen at a pace that reflects the country's overall development. On the basis of the benchmark national poverty line, poverty stood at around 25% in 2012, declining to approximately 20% by 2021 (Figure 4.18). However, given the combined impact of the COVID-19 pandemic and the ongoing cost-of-living crisis, this figure has likely increased in recent years. Montenegro also suffers from pronounced regional inequality, with the less-developed northern regions that border Serbia persistently lagging behind the more prosperous coastal south. Persistently high poverty drives emigration, which in turn exacerbates demographic and labour market pressures, contributing to workforce depletion and increasing the country's long-term economic vulnerabilities.

Figure 4.18 / Poverty rate in Montenegro according to the national poverty line (% of population)



Source: World Bank's World Development Indicators.

Lastly, in the area of governance and institutions, Montenegro continues to face systemic challenges that could weigh on its EU accession prospects. While the country has made the greatest formal progress of all the Western Balkan countries in terms of negotiation chapters, persistent governance shortcomings risk slowing the accession process and undermining public trust in reform.

The World Bank's indicator of government effectiveness, which captures people's perceptions of the quality of public services, policy formulation and the credibility of government commitments, has been on a long-term downward trend since 2014 (Figure 4.19, top left chart). This reflects challenges in public administration reform and the continued politicisation of state institutions. These issues not only hinder the implementation of EU-aligned policies, but also contribute to broader public dissatisfaction. While there was a notable improvement in 2023, the overall level remains well below the 2014 peak.

The rule of law indicator has shown cyclical fluctuations over the past 15 years, without any clear, sustained progress (Figure 4.19, top right chart). It deteriorated especially after 2018, reaching near-record lows in 2022, though some recovery was recorded in 2023. The lack of advances in judicial reform, the limited independence of key institutions and the weak enforcement of legal standards continue to undermine confidence and trust and to create uncertainty in society.

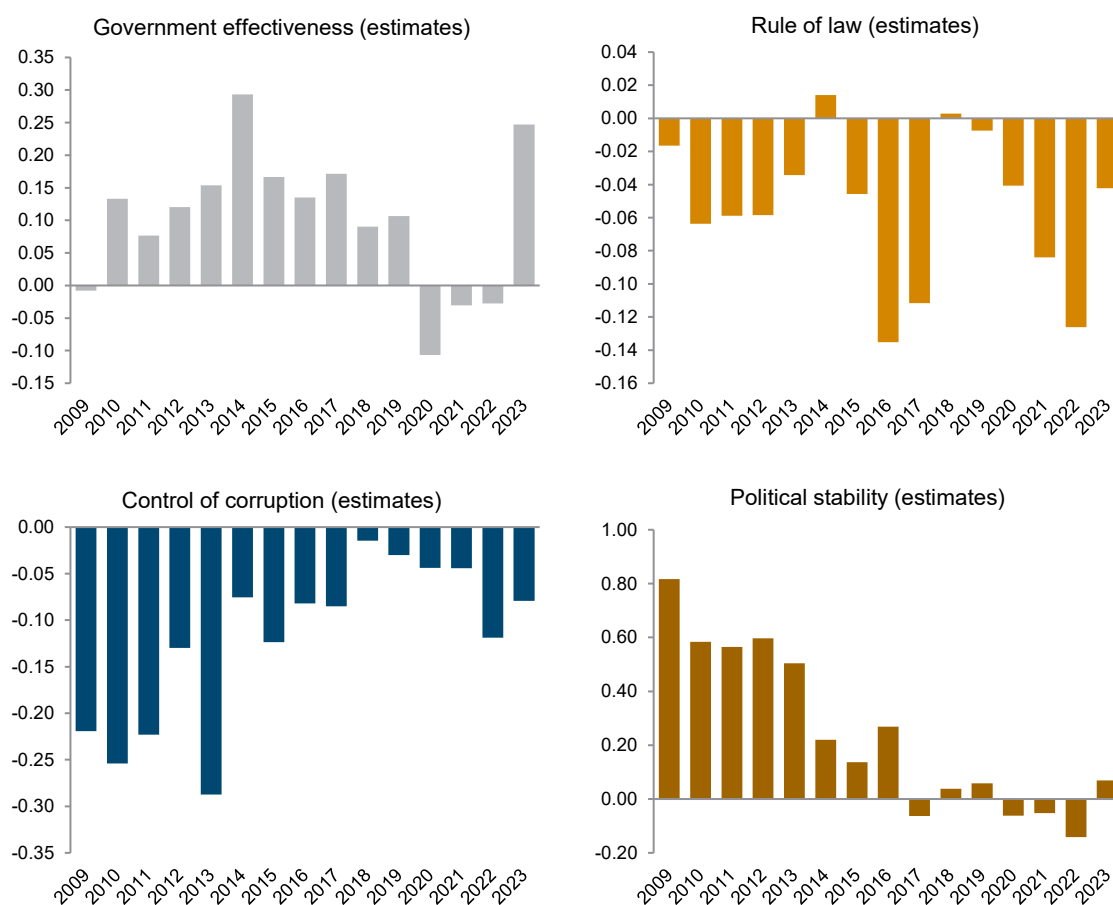
Control of corruption has improved over the long term, with recent assessments better than in the early 2010s (Figure 4.19, bottom left chart). However, the indicator has declined again in the years 2022 and 2023, reflecting ongoing concerns about the transparency of public procurement and the ineffective prosecution of corruption cases. These issues are particularly sensitive, given the scale of EU funding available to candidate countries, and the risk of misuse remains high without stronger accountability mechanisms.

The fourth indicator, political stability, shows a clear and steady decline over the entire period (Figure 4.19, bottom right chart), reflecting persistent domestic political tensions and societal divisions. Although there was a slight improvement in 2023, levels remain well below those observed in the early 2010s. Continued

instability risks obstructing reform efforts and undermining overall stability, which could in turn slow Montenegro's EU integration process.

Taken together, these governance challenges continue to cast a shadow over Montenegro's EU integration path. Even as the country leads the region in terms of chapters opened, its institutional stagnation and heightened political instability risk derailing the momentum and undermining the credibility of reforms.

Figure 4.19 / Governance indicators in Montenegro (estimates)



Note: Higher values indicate better institutions.

Source: World Bank's Worldwide Governance Indicators.

Summary

The main challenges for Montenegro's EU accession are:

- › The country's external position remains seriously vulnerable, with a persistent current account deficit of around 15% of GDP and extremely high external debt – 128% of GDP in 2024, the highest level in Eastern Europe.
- › Its fiscal position is currently stable, but the country narrowly avoided a debt crisis during the pandemic. Public debt surged to 105% of GDP in 2020, largely due to a decade of reckless fiscal policy prior to the crisis.
- › Though less severe than in other Western Balkan countries, there are demographic and labour market challenges. The temporary inflow of Ukrainian and Russian nationals following the war in Ukraine provided short-term relief, but labour shortages are already emerging, particularly in the tourism sector.
- › Poverty and inequality remain serious issues, especially in the underdeveloped northern regions. Poverty still affects around 20% of the population and is likely rising again amid the ongoing cost-of-living crisis.
- › Governance indicators show no sustained improvement, despite Montenegro's strong formal progress in EU negotiations. Rule of law and control of corruption remain weak, government effectiveness has declined over the past decade, and political stability has deteriorated.

4.4. Ukraine

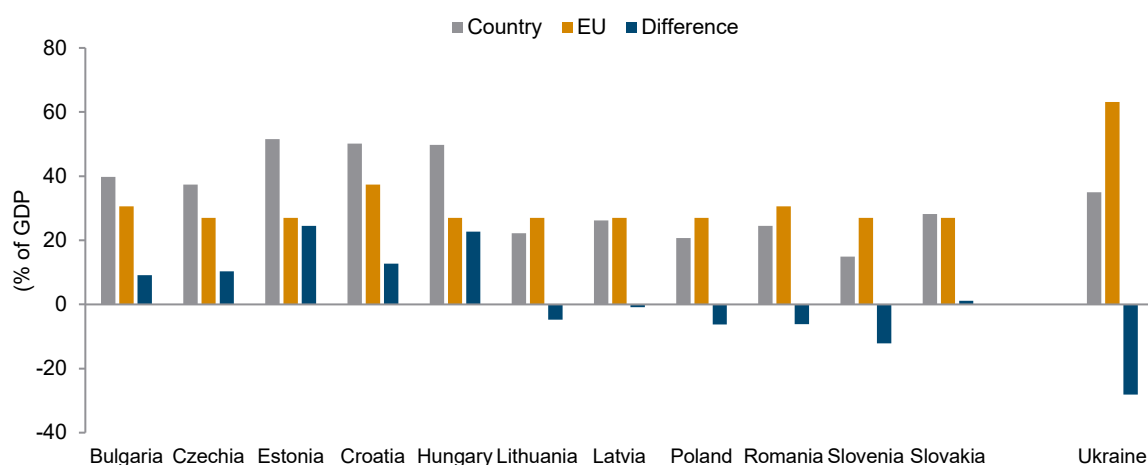
Ukraine has started its EU accession path in rather exceptional circumstances – amidst the full-scale invasion of the country by Russia. The war, which started on 24 February 2022, has not only caused great human suffering and significant destruction of Ukraine's infrastructure, but has also led to a marked shift in the structure of the economy and a derailment of the reform process. Many of the criteria that are traditionally used to assess a prospective member's progress in the necessary economic transformation and its readiness for accession cannot be applied under these circumstances. Still, we can focus on the underlying long-term economic trends, which can be crucial both for the EU accession success and for the post-war economic recovery of the country.

It is important to point out the biggest structural weaknesses of the Ukrainian economy, correction of which will be crucial to making the economy strong enough to withstand competitive pressures from other EU members in the future. Many experts agree that for Ukraine to achieve a higher level of economic development, it will need to follow the EU-CEE growth model based on FDI from Western Europe (Grieverson et al., 2023). Therefore, perhaps the economy's biggest weakness is its long-standing underperformance in attracting FDI (Figure 4.20) – and the war is making the task all the harder now. Relative to its GDP, Ukraine's inward FDI stock is lower than that of any previous accession country in the years before membership.

As developing or lower-middle-income countries tend to rely heavily on foreign sources of financing to generate investment, a poor record of FDI attraction is inevitably reflected in low capitalisation of the economy. Of all the EU-CEE countries and other EU neighbours, Ukraine had the lowest ratio of gross fixed capital formation in the 10 years prior to the full-scale invasion (Figure 4.21). Capital needs are

even higher now, as the country is faced with the need to reconstruct its economy, which has been badly damaged by Russia's missile attacks. According to the *Fourth Rapid Damage and Needs Assessment* (World Bank et al., 2025), as of end-December 2024, the recovery and reconstruction needs for a period of 10 years are estimated at almost USD 524bn – roughly 2.8 times the estimated nominal GDP of Ukraine for 2024. Initially, most of this financing is expected to come in the form of external public financing; but at a later stage FDI will have to play a crucial role in funding the reconstruction and new infrastructure projects.

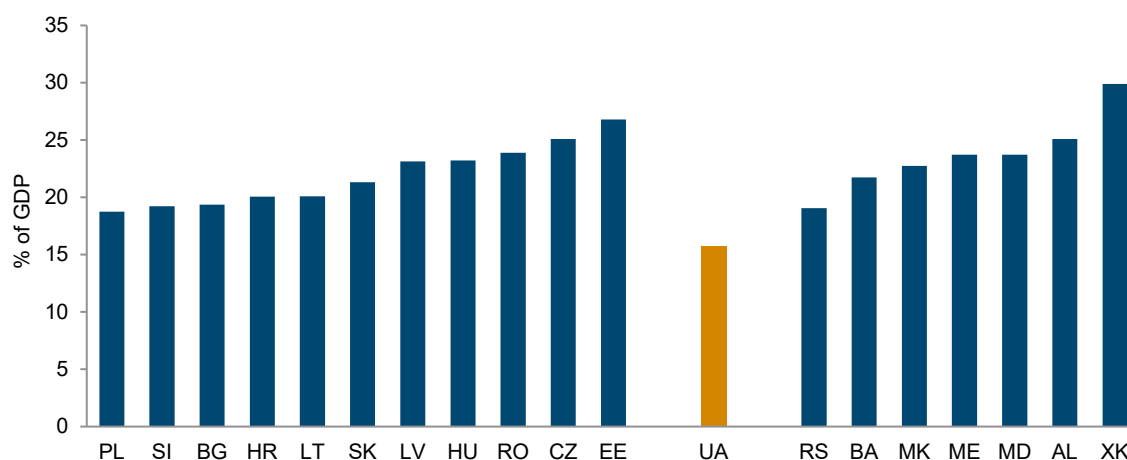
Figure 4.20 / Inward FDI stock on a five-year average (% of GDP)



Note: For EU-CEE countries, the five years are those before (but not including) the accession year, and the EU comparison is for the EU15 over the same period. For non-EU member states, the five years are 2017-2021, and the EU comparison is for the EU27 over the same period.

Sources: National sources, wiiw.

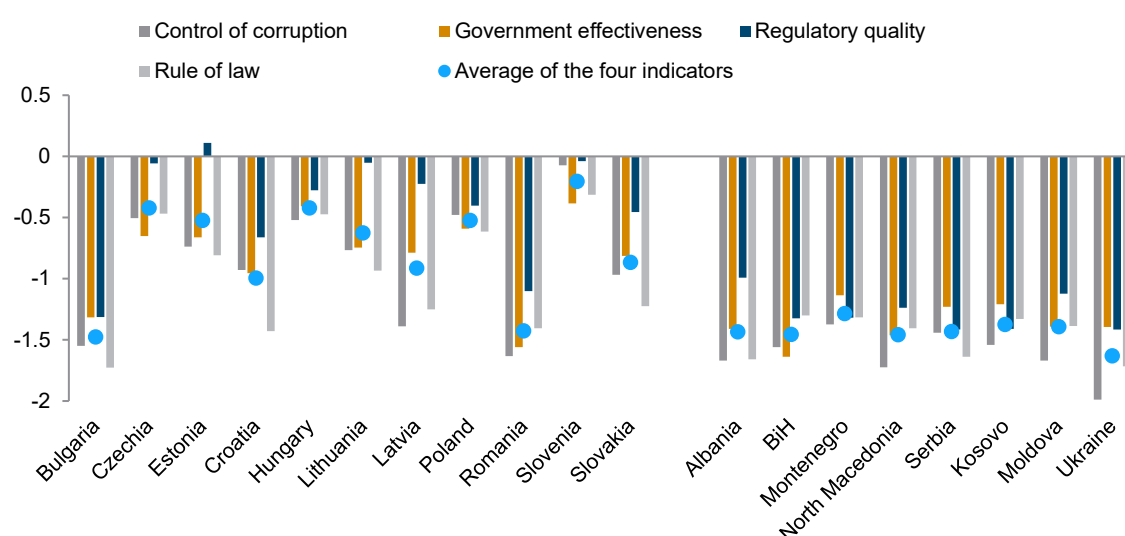
Figure 4.21 / Average gross fixed capital formation during 2012-2021 (% of GDP)



Sources: National sources, wiiw.

Part of the struggle to attract higher levels of FDI is linked to weak institutions – another of Ukraine's major failings. The country is currently a long way from the institutional standards of even the weakest EU-CEE countries at the time of their accession (as measured by the World Bank's governance indicators) (Figure 4.22). However, Ukraine is by no means a significant negative outlier in this respect (Grieveson et al., 2023). When Romania and Bulgaria applied to join the EU in the 1990s, their levels of institutional quality relative to the EU were comparable to that of Ukraine now. The Western Balkan countries (as well as Moldova) have similar levels of institutional quality as Ukraine.

Figure 4.22 / World Bank Worldwide Governance Indicators relative to the average of France, Germany and Italy at the time of each CESEE country's application to join the EU



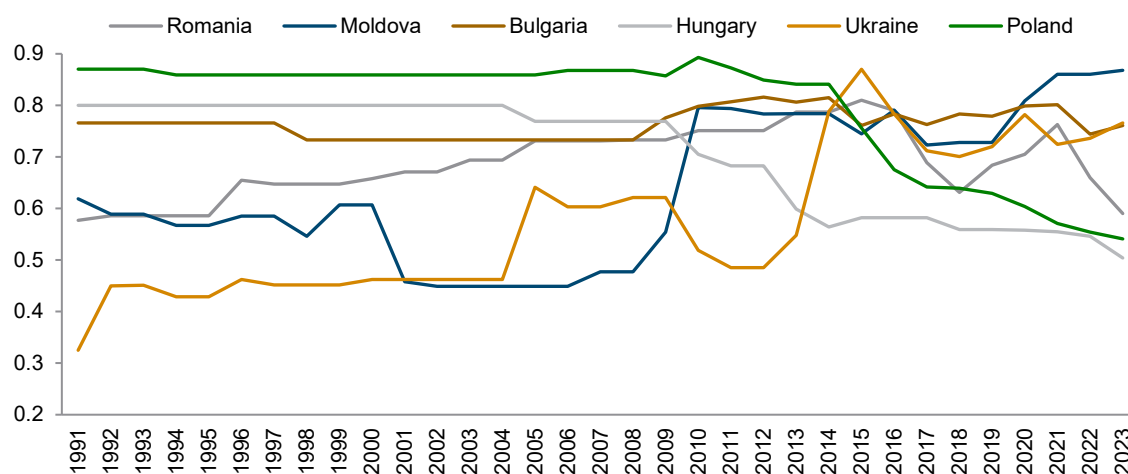
Note: For those that applied in 2022, 2021 data are used (latest available).

Source: World Bank.

Of course, in order to reach the institutional level that Romania had relative to the EU at the time of accession in 2007, Ukraine still needs to achieve significant progress in its efforts to combat corruption and anchor the rule of law. However, several factors – such as Ukraine's strong civil society (Figure 4.23), the continued fight against corruption since the invasion and the likely heavy involvement of donor countries during reconstruction – are likely to galvanise implementation of the future reforms.

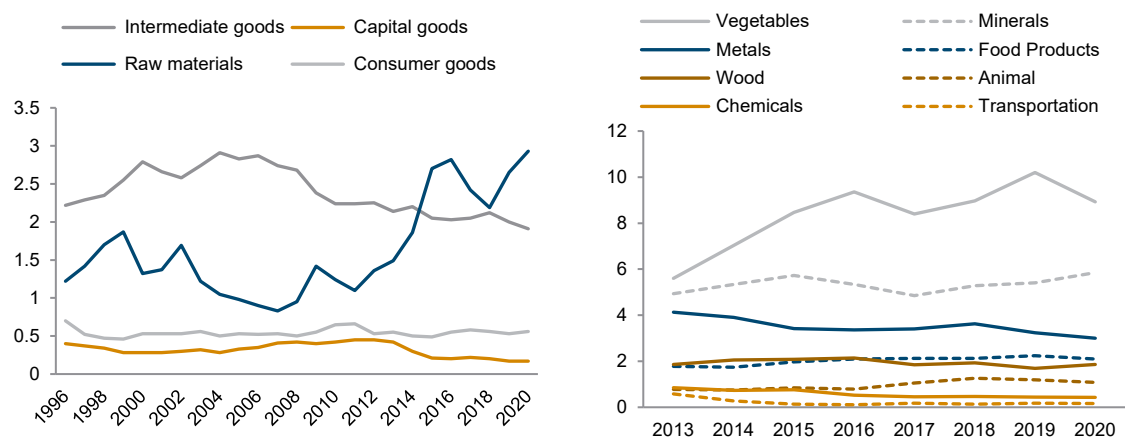
Another of the Ukrainian economy's structural weaknesses is its lack of economic complexity. In order for it to meet the Copenhagen criteria and accede, Ukraine needs to have an internationally competitive economy that can handle the competition of the EU and global markets. This requires its successful integration into global value chains, which would facilitate technology transfer and functional upgrading, and thus provide a reasonable degree of economic complexity.

Over the years, Ukraine has been drifting toward specialisation in raw materials (particularly vegetables and minerals) and intermediate goods (Figure 4.24). In so doing, it has been contributing to global value chains at the early and middle stage, rather than specialising in the supply of final products to consumers or producers (Kosmehl et al., 2024). Regarding aggregated product categories, Ukraine is globally competitive in vegetables, foodstuffs, metals, minerals and wood products.

Figure 4.23 / Civil society participation index for Ukraine and selected CESEE countries

Note: Civil society participation index provides a measure of a robust civil society, understood as one that enjoys autonomy from the state and in which citizens freely and actively pursue their political and civic goals, however conceived. Values lie in the interval (0-1), with 0 meaning the lowest level of civil society development.

Source: V-Dem Dataset, Varieties of Democracy (V-Dem) Project. <https://doi.org/10.23696/mcwt-fr58>.

Figure 4.24 / Revealed comparative advantage (RCA) of Ukraine

Note: RCA>1 suggests a competitive advantage.

Source: World Integrated Trade Solution (WITS).

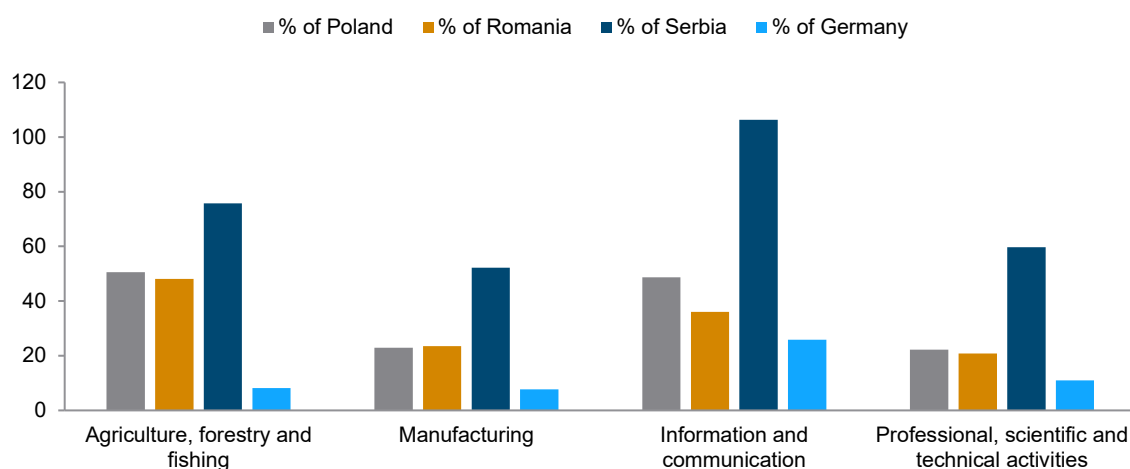
According to the Observatory of Economic Complexity,⁷ Ukraine's export complexity, which is measured by the Economic Complexity Index (trade), declined between 2013 and 2023, as reflected by its drop in the rankings from 38th to 47th place. Over that period, the country was outperformed by Bulgaria, which now holds 38th place (up from 43rd in 2013); meanwhile Romania widened the gap with Ukraine, having shifted from 34th place in 2013 to 28th in 2023. The changes can primarily be attributed to the loss of industrial assets and technological exports to Russia and the destruction of the country's industrial capacities by Russia during the full-scale invasion.

⁷ <https://oec.world/en/rankings/eci/hs6/hs96?tab=ranking>

Ukraine's top competitive advantages in goods trade are highly sensitive to trade-protection measures, including in the EU, as has been shown by the various bans on selected Ukrainian agricultural products in Poland, Hungary and Slovakia. While Ukraine's strong competitive edge in agriculture remains crucial for global food security, the country's accession to the EU will require it to regain, strengthen and/or expand its competitive advantage in technologically advanced sectors.

Structural issues of the economy manifest themselves in the low labour productivity of many sectors. Whereas the agricultural and IT industries in Ukraine show relatively high levels of productivity, the manufacturing industry and other services are lagging behind (Grieverson et al., 2024). In agriculture, the labour productivity level in Ukraine is close to 50% of the level in Poland and Romania and close to 80% of that in Serbia (Figure 4.25), whereas the manufacturing productivity level is much lower (about 20% of the level in Poland and Romania, and 50% of that in Serbia). Among tradeable services, there is also a big divergence, with productivity in the IT industry much higher relative to the country's peers than in professional, scientific and technical services. Given the very low wage level in the economy as a whole, some industries – especially agriculture and IT – are currently very competitive as regards relative labour unit costs, and this is reflected in their strong export performance.

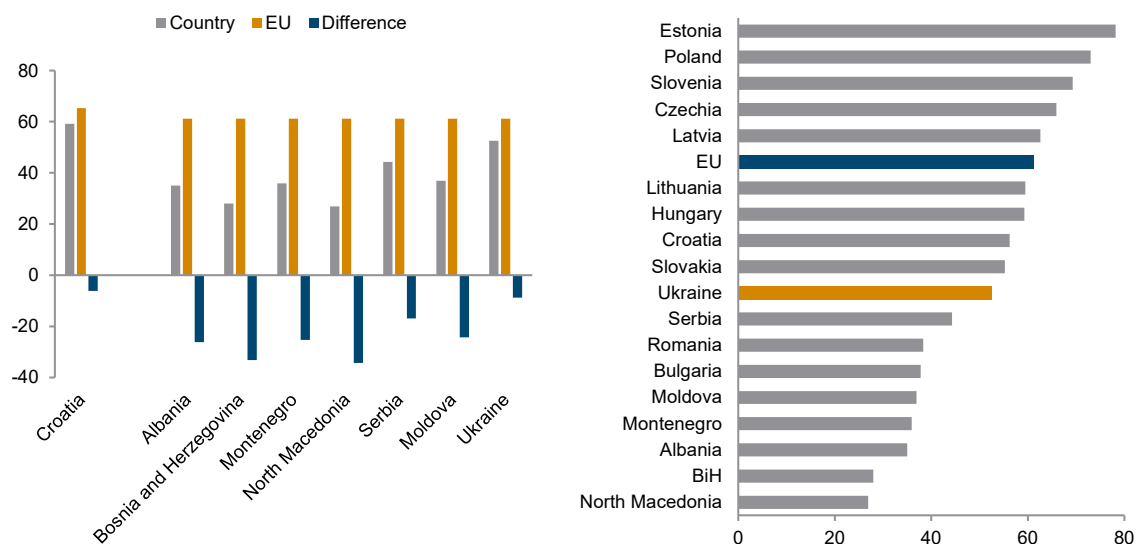
Figure 4.25 / Ukraine's labour productivity in 2022 (% of selected peers)



Sources: National sources, wiiw.

An optimistic interpretation of these trends would suggest that the success of the currently more competitive industries (i.e. agriculture and ICT) could also be replicated in other industries. A strong performance by Ukraine in education in the regional context also points to this possibility. Data for PISA scores show that although Ukraine does have an education deficit versus the EU, it is comparable with that of Croatia at the time of its accession and much smaller than the deficits of all the other accession hopefuls (Figure 4.26, left). As of 2022, Ukraine's PISA score was higher than Bulgaria's or Romania's (Figure 4.26, right). According to the European Centre for the Development of Vocational Training (CEDEFOP), depending on the subject considered, Ukraine is comparable on the PISA metric to EU member states Croatia, Greece, Italy, Luxembourg, Malta and Slovakia – a very healthy position for a country that is just starting its EU accession process (CEDEFOP, 2022).

Figure 4.26 / Difference of PISA scales in reading, maths and science versus the EU (left) and PISA scales in reading, maths and science in 2022 (right)



Note: Data on the left show PISA scales in reading, maths and science as of 2013 (Croatia) and 2022 (all other countries), and the difference versus the EU for the relevant year.

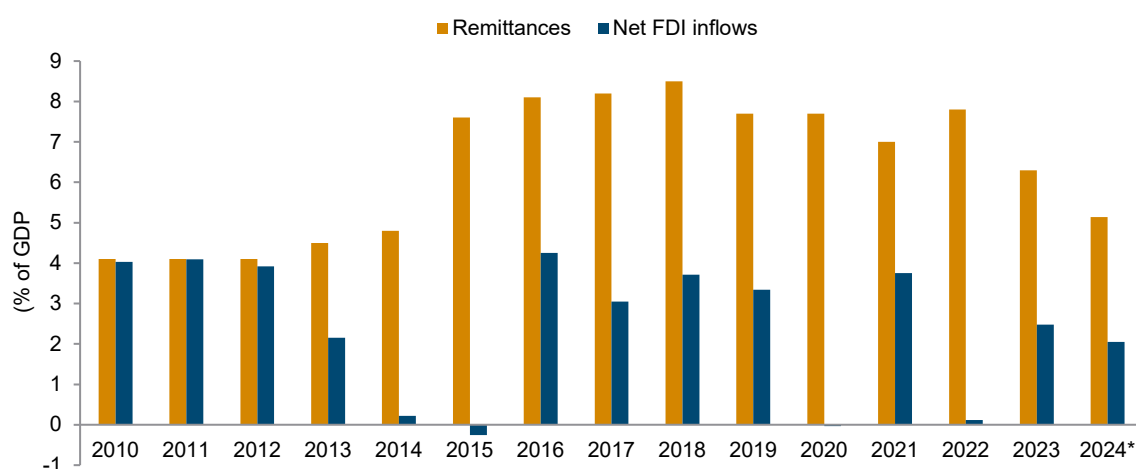
Source: World Intellectual Property Organization (WIPO).

However, the demographic challenges of a dwindling Ukrainian population could seriously constrain the country's competitiveness. The population declined from approximately 52 million in 1990 to 42 million in 2021 owing to multiple factors, including low fertility rates, high mortality and persistent outmigration (Tverdstup, 2023). The war with Russia has aggravated the situation, as it has forced many people to flee the country. Ukraine's population has declined further: according to the UNHCR⁸, there are more than 6.5 million refugees from Ukraine recorded globally.

Surveys show that the share of refugees planning to return to Ukraine is continuing to decline. Toward the end of 2024, for the first time it had fallen below half of all respondents (Mykhailyshyna et al., 2025). Many who had previously expressed a definite or likely intention to return have now reconsidered, shifting towards staying abroad. The main obstacles to return remain both military and economic. Ongoing security risks and uncertainty, housing that has been destroyed, low living standards and challenges in finding employment in Ukraine are among the key factors discouraging refugees from going back.

A silver lining to all this is the strong inflow of remittances, which have been a crucial source of foreign financing, having been consistently much higher than FDI inflows ever since 2013 (Figure 4.27). However, given the vast cost of post-war reconstruction, these are unlikely to be large enough to cover the country's financing needs.

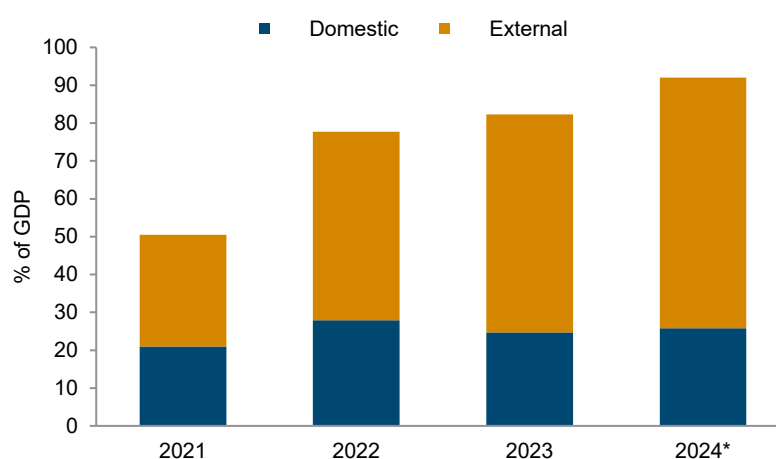
⁸ <https://www.unhcr.org/news/briefing-notes/full-scale-ukraine-war-enters-third-year-prolonging-uncertainty-and-exile>

Figure 4.27 / Remittances and net FDI inflows (% of GDP)

Note: *GDP for 2024 is estimated.

Sources: National Bank of Ukraine, own estimates.

High public debt represents a future potential threat to the country's macro-financial stability. Most of the financial aid that Ukraine has been receiving since the onset of the full-scale invasion has come in the form of loans (and guarantees), while grants have accounted for less than a third of total financial aid. This has led to a rapid public debt accumulation (Figure 4.28). Although most of the loans provided over the last three years have been highly concessional and very long term,⁹ Ukraine is already faced with high debt repayment needs: in the period 2025-2027, the country will have to spend on average more than 7% of its annual GDP each year on debt repayment (Pindyuk, 2024).

Figure 4.28 / Total public and publicly guaranteed debt (% of GDP)

Note: * GDP for 2024 is estimated.

Source: Ministry of Finance of Ukraine, IMF, wiiw annual database, own estimates.

⁹ In the case of the EU's Macro-Financial Assistance Plus (MFA+) instrument for Ukraine, loans have a 35-year maturity, including a 10-year grace period, as well as subsidised interest rate costs.

Under these conditions, Ukraine's economy has been increasing its macro-financial imbalances, which may pose a threat to its sustainable recovery. The country has been running a very high fiscal deficit ever since the onset of the full-scale invasion – in excess of 20% of GDP (excluding grants) – and rapid fiscal consolidation is unlikely (and is anyway not recommended) in the next few years, given the high costs of the reconstruction process (Bogdan, 2024). The current account deficit widened to about 7% of GDP in 2024 and is likely to increase still further, as the reconstruction process will be accompanied by a surge in imports.

All this makes the issue of debt sustainability quite serious. The emerging consensus is that Ukraine's debt is not likely to be sustainable and, consequently, that significant debt relief will have to be negotiated.

Summary

The main challenges for Ukraine's EU accession are:

- › The low level of inward FDI is largely due to a poor investment climate, in particular inadequate control of corruption and lack of the rule of law.
- › Demographic trends are leading to a dwindling population – exacerbated by the outflow of refugees due to Russia's war in Ukraine.
- › Macro-financial imbalances are accumulating because of the large fiscal deficit and growing public debt.
- › The economy has a low level of complexity, with increasing specialisation in raw materials and (low value-added) intermediate products.
- › Leaving aside ICT and agriculture, many sectors have low labour productivity.
- › FDI will play a crucial role in the post-war economic reconstruction and recovery, as well as for mitigating external imbalances; it is therefore crucial for Ukraine to create such conditions as will encourage FDI.
- › Significant debt relief will have to be negotiated, in order to ensure macro-financial stability and sustainability of economic growth.
- › Government policies to promote the return of refugees will be crucial to relieve the demographic challenges; investment in the education sector will be crucial to maintain and increase labour productivity.

5. SUMMARY OF FINDINGS

5.1. How they could help to narrow down the Copenhagen criteria and identify the 'must-haves' that should provide the focus in an accelerated accession process

This section examines the extent to which an assessment using a selection of indicators and the associated analysis conducted in this report could lead to a more focused approach in how the Commission assesses progress towards satisfying the economic Copenhagen criteria for candidate countries. The stated aim of the analysis was to assist the Commission in coming up with a set of 'must-haves' to provide the minimum conditions that must be satisfied in the event of an accelerated accession process.

We undertook a number of cross-country and individual country studies to obtain a picture of what could be seen as the most sensitive areas that need to be scrutinised in the case of the particular set of candidate countries that are most likely to form part of an accelerated accession process (i.e. countries of the Western Balkans and Ukraine).

Drawing on our knowledge, gleaned over many years of following developments in both EU member countries and candidate countries of Central, East and Southeast Europe, we chose the following four areas in which to assess economic developments in this set of countries:

- › External accounts and competitiveness
- › Fiscal situation
- › Labour markets, demography and social indicators
- › Institutional factors

Having chosen these four areas, we undertook (i) a cross-country analysis of EU-CEE states that joined the EU in the course of three waves of 'Eastern Enlargement' – in 2004, 2007 and 2013; (ii) three specific country studies of recent EU members (Bulgaria, Croatia, Romania); and (iii) an analysis of developments in three of the candidate countries (Montenegro, Serbia, Ukraine).

In the following, we first provide a summary covering:

- › What we learned from the cross-country comparison
- › What we learned from the individual country studies

We then briefly address the issue of the context in which

- › the next accession will take place, compared to previous accessions

We then refer back to how our analysis relates to

- › the set of the economic Copenhagen criteria and how this might provide a basis for a stronger focus for country assessments

And finally, we suggest – from today's perspective

- › the main areas to which 'must-have' conditionalities should pay most attention: (i) for the Western Balkan countries; and (ii) for Ukraine

Let us address each of these issues in turn.

5.2. What did we learn from the cross-country comparison?

If the task of an assessment of a candidate country is to focus on 'minimum economic accession conditions which are considered essential to be fulfilled to ensure economic stability and prosperity in the newly acceded candidate country and prevent undue spillovers on others', then the focus should be on the experiences of recent accession countries with regard to (i) economic stability and (ii) longer-term growth and income convergence.

With regard to the four areas, we extracted the following from the analysis.

External accounts and competitiveness

Negative trade and balance of payments (BoP) accounts are a typical feature both pre-accession and during the early phases following accession. The reason is the backlog of import needs both for final consumption and for strengthening domestic production capacities. Such net imports need to be financed through external financial flows. The crucial issue is then whether the conditions are in place to achieve a turnaround in trade accounts within a reasonable timeframe.¹⁰ Many of the accession countries achieved such a turnaround, but it is not a given. Much depends on the characteristics of financial inflows that cover initial BoP deficits: credit flows to finance real estate booms and unbalanced financial flows into the non-tradeable (retail and hospitality) sector can cause long-term structural imbalances, bring the real exchange rate into misalignment, destabilise the financial sector and move private-sector debt into dangerous territory. This can also have serious spill-over effects in terms of the exposure of banks in the rest of the EU. It would be an important condition that regulatory mechanisms must be in place to avoid such developments. It also involves proper monitoring of the flows and some kind of early-warning system and mechanisms to put pressure on a country to change its policies if the flows start to look problematic.

Furthermore, for a turnaround in trade balances it is very important to have conditions that encourage foreign direct investment in the tradeable sector (both goods and services). Conditions would include institutional features such as a well-functioning legal system, but also industrial parks, export processing zones, good infrastructure and training, and supportive research and labour market policies. This would all encourage a process of qualitative upgrading, integration into European production chains and improved prospects for the employment of a qualified labour force. In some of the countries, oligarchic interests might be at odds both with the creation of an atmosphere conducive to foreign investment and with the active participation of a wider range of domestic companies that could benefit from newly

¹⁰ This does not mean that trade accounts have either to be balanced or to become positive. The aim must be for external accounts to show longer-term 'sustainability' – i.e. should not lead to a build-up of unsustainable external debt. Policies directed at external accounts should also seek to build a buffer capable of absorbing external shocks (such as interruptions in supply chains or an energy price hike).

established supply chains and spill-over effects. Hence, we emphasise here a forceful and independent competition authority and careful monitoring of institutional and policy developments in this regard.

Finally, in this context we advocate a careful assessment of three issues relevant to REER developments that support sustainable external account developments. First, there needs to be a competent monetary and exchange rate policy: if 'euroisation' is not already well advanced, we counsel caution in pegging the national currency too closely to the euro and in membership of EMU. Second, in any case – and especially if euroisation is far advanced – it is important to aim at wage-bargaining structures that avoid any strong divergence in wage–productivity dynamics and that contain politically driven pre-election salary and income hikes. And third, the danger of a heavy dependence on the import side must be reduced, as that can generate cost and price shocks. Diversification and integration into external energy-supply and buffer schemes are important in this respect.

Fiscal situation

Fiscal policy can have an important stabilisation function, but it should also be considered in relation to longer-term considerations, as it could be either growth constraining or growth enhancing. On the one hand, it is important to have sustainability of the public debt and an associated fiscal policy trajectory, but we also stress the need to monitor whether the structure of state expenditure and the implementation of public policies supports growth-enhancing features (such as emphasising education, and supporting infrastructure and research), and to check the evidence for due processes of public procurement and contract fulfilment. The track record shows that the two top performers – Romania and Estonia – are at opposite ends of the spectrum when it comes to how loose or tight fiscal policy has been.

Given that electoral processes bring about changes in government, one cannot be sure what will happen post-accession simply by observing the track record of fiscal policy pre-accession. Some institutional features could help, however, such as the creation (or even the constitutional anchoring) of a 'fiscal policy committee'. It is obviously not desirable for a country to join the EU with high, unsustainable public debt, and there need to be conditionalities applied here to ensure that proper policies are in place to achieve a sustainable trajectory before accession can go ahead. Ukraine – emerging from a war situation – will be a special case, as its progress towards a sustainable path will depend on significant external support, with additional features that would not apply to other candidate countries. Given the starting point of a large informal sector in all the current candidate countries, the issue of planning incentives (both carrots and sticks) to widen the tax base in this regard will be important to ensure that the revenue side of public finance is duly considered.

Another issue refers to the distributional features of fiscal policy structures: countries obviously make different political decisions on the distributional consequences of their fiscal policy frameworks (on both the expenditure and the revenue side). However, it is important to learn from the experience of several of the new member states that the issue of 'fairness' with regard to fiscal policy is important to maintain legitimacy in the eyes of the population for longer-term stability of state-economy relations.

Furthermore, we emphasise that an analysis of how effective the use of pre-accession support from the EU has been (checking on the record of utilisation and of proper procedures being applied) will be an important indicator of how a country might utilise the more considerable support available to it on accession, as well as its full participation in the spending programmes of the EU. Regarding the 'quality'

of public institutions, there are indicators that should be used (see also evidence presented in this report). We also recommend paying attention to the administrative capabilities of local authorities, which – given the significance of cohesion funds in the case of accession – will play an important role (see the ‘quality of governance’ indicators compiled at the sub-national, regional level by the University of Gothenburg; Charron et al., 2024).¹¹

Demography, labour markets and social indicators

The situation facing the countries that are hoping to join the EU in the coming round of accessions will likely be worse than the situation that pertained in the CEE-EU states that joined earlier. Demographic trends as regards age profile, cumulative net migration flows and current unemployment rates (especially among the young) are considerably worse than in the comparator EU-CEE economies – even prior to their accession. There are three policy areas where we recommend careful monitoring: (i) what policies are in place to increase the employment rates of particular groups of the population (especially the young and women)?; (ii) what policies are in place to provide incentives to reduce the outflow specifically of the better qualified and to encourage return migration (e.g. after study or periods spent working abroad)?; and (iii) what labour market (plus educational and training) policies are in place to achieve a good longer-term matching between supply and demand on the labour market? Regional (labour market/training/education) policies are especially relevant here to deal with the cross-regional disparities in labour market outcomes.

Given that labour market problems (including outward migration of the young and the better skilled) have long been a pervasive feature both in the Balkans and Ukraine (where the problem is even more pronounced, due to the recent/current context in which the country finds itself), there is already some ‘history’ in terms of how countries have reacted and have set up institutions or designed policies to deal with these problems. All this should be considered, including any reform of the educational and training systems; the creation of labour market exchanges and active labour market policies; features of wage structure developments that might incentivise well-qualified persons to be available to both the private and the public sector; how wage-bargaining or wage-setting institutions operate; and finally, how specific policies have tackled the issues of integrating the labour market across regions and thereby influencing regional demographic developments. (For a project that covered the interaction between migration, labour market developments and educational/training facilities in the Western Balkan candidate countries, see the ETF project ‘Migration and Human Capital in the Western Balkans’;¹² for the synthetic report on the project, see Mara and Landesmann, 2022.)

Institutional factors

Here we emphasised that checking on the effective absorption and use of pre-accession EU financial support could provide an important indication of whether a country’s integration into support programmes post-accession will be properly employed. The institutional quality of the monitoring and allocation mechanisms should be checked: in the particular area of the prospective utilisation of cohesion funds, it is important to check up on the institutional set-up of regional authorities. For better labour market outcomes, the use of active labour market policies and of training (and retraining) institutions is relevant; this will also be important to prevent further migration outflows and to provide

¹¹ <https://www.gu.se/en/quality-government/qog-data/data-downloads/european-quality-of-government-index>

¹² <https://wiiw.ac.at/migration-and-human-capital-in-the-western-balkans-pj-237.html>

incentives to encourage return migration. Finally, the formulation of effective policies and the establishment of an institutional infrastructure to encourage FDI inflows directed towards building up and upgrading export activity should be checked and supported in the pre-accession phase, as should the drafting of competition policy and business-support policies to encourage new entrants and prevent existing businesses from dominating the market. These are the areas of institutional governance that we would emphasise as priority areas that can support a push towards successful integration into EU-wide economic and policy-making structures, and that are capable of setting a country successfully on the road to economic development and catching-up.

5.3. What were the specific features that we learned from the individual country studies?

Bulgaria: While Bulgaria has seen positive trends (such as improved migration patterns and a stable fiscal position), challenges like a declining population and labour force, rising income inequality and deteriorating governance institutions have hindered its growth. The decline in FDI and overly conservative fiscal policies have contributed to slower GDP growth. These lessons suggest that, for future EU members, mitigating population decline and promoting return migration, strengthening institutions, attracting FDI and adopting balanced fiscal policies will be crucial to ensure long-term economic success post-accession.

Romania: Romania has experienced significant economic growth and successful integration into EU and global markets, but persistent challenges, such as a fluctuating trade deficit and stagnation in the rule of law, have limited its full potential. While improvements in corruption control have been made, issues like regulatory quality and income inequality remain ongoing concerns. For future EU members, Romania's experience emphasises the need for sustained efforts to manage financial flows, enhance institutional quality and address economic disparities, in order to ensure long-term stability and growth.

Croatia: While Croatia initially faced such challenges as labour force decline and high government debt, the reversal of the negative migration trend and improvements in living conditions post-accession highlight the fact that EU membership can lead to a positive shift in migration and employment patterns. Additionally, Croatia shows that stabilising external debt and improving the trade balance are achievable objectives. The country's improvements in governance and institutions also demonstrate the benefits of EU integration. These lessons underscore the importance of fostering favourable migration trends, managing fiscal discipline and strengthening institutions to ensure sustainable development post-accession.

Serbia: Serbia faces several key challenges in its EU accession process and its long-term convergence with the Union. While its external position is currently strong and stable, one potential risk lies in the growing presence and influence of China, which raises concerns over strategic alignment and external dependence. In the area of innovation, Serbia has gradually been ramping up its R&D spending, but this has so far failed to deliver any meaningful results, and broader innovation outcomes remain limited. Depopulation is continuing, with the country losing around 50,000 people annually – approximately 0.8% of its population – mostly due to emigration. Although recent years have seen some improvements in labour market activation, these gains are reaching their limits, and the country is expected to face a labour shortage in the near future. Social outcomes also remain a weak point. Poverty continues to affect over 20% of the population and has been declining only marginally. Perhaps the most serious

challenge, however, lies in the area of governance. Most governance indicators have worsened over the past decade, reflecting a gradual erosion of democratic institutions and rule of law under increasingly authoritarian rule. Addressing these issues will be essential for ensuring not only progress in the accession process, but also the broader resilience and sustainability of Serbia's development model.

Montenegro: In the past, Montenegro has shown severe vulnerability in terms of external imbalances, with a big deficit in goods trade that is only partly compensated by robust income from the tourism sector. This sector is, however, subject to fluctuations, given seasonal variations and external shocks (such as during the COVID-19 crisis). The current account deficit is consistently around 15% of GDP and external debt in 2024 stood at 128% of GDP. The other vulnerability lies in the conduct of fiscal policy, which has led in the past to a near-default situation during the COVID crisis (public debt reaching 105% of GDP); however, since 2020 this has improved sharply under the new government (to hover now at around 60% of GDP), and the situation has benefited from rapid post-COVID growth and also the recent inflation bulge. It is specifically the country's governance indicators that are problematic: these continue to show low legal standards, ineffective prosecution of corruption cases and persistent politicisation of state institutions. This remains Montenegro's Achilles' heel in ongoing negotiations regarding its EU membership prospects.

Ukraine: Ukraine faces several significant challenges on its EU accession journey and in its ability to thrive economically within the Union. Key obstacles include a poor investment climate characterised by inadequate control of corruption and weak rule of law, which has led to low FDI. Demographic trends, exacerbated by the outflow of refugees due to Russia's war, place a further strain on the economy, while accumulating macro-financial imbalances, such as the high fiscal deficit and rising public debt, undermine stability. Additionally, Ukraine's economy is overly reliant on raw materials and products with low value added, while labour productivity is low in most sectors, apart from ICT and agriculture. To overcome these issues, Ukraine must create favourable conditions to attract FDI, negotiate significant debt relief, implement policies that encourage the return of refugees and invest in education to enhance labour productivity. All this will be vital to sustain post-war economic recovery and growth.

5.4. The context in which the next accession will take place, compared to previous rounds

The international and European context in which the next round of accessions will take place will differ from that of previous rounds – although, of course, the context in which Bulgaria and Romania joined in 2007 (just before the international financial crisis) and in which Croatia acceded in 2013 (not long after the crisis) differed from the earlier accession wave in 2004. The next wave of EU enlargement will take place in the context of a greatly changed geopolitical situation following the Ukraine–Russia war and the emergence of a world with more acute trade policy conflicts. Regionalist bloc formations will play more of a role, and the need for the EU to adjust (and in some areas widen) its network of trade relations and to adopt more diversification and 'resilience' policies has moved up the agenda. The next wave of enlargement and the role that prospective new members can play in this context have to be considered and worked on.

Furthermore, EU policy directions and programmes have developed since previous enlargements: following the COVID crisis the bloc set up its Recovery and Resilience Fund – the first time that the EU had ever jointly taken on debt to finance an important programme to combat a crisis. It has made

industrial policy and especially the green and digital transformation a central plank of current and future policy direction. It has strengthened its joint energy policy. And most recently, in the wake of the Russia–Ukraine war and the second Donald Trump presidency, the formulation of a coordinated defence and security policy has become a matter of the utmost urgency. These developments have induced much stronger geo-strategic considerations in formulating EU policies (in alliance with other non-EU European partners). This relates particularly to the sphere of defence, but also covers other areas such as trade policy, energy policy, technology policy, access to critical materials, etc. The nature of the next accession will be guided by this sharply altered geopolitical context. Hence, it should also be imperative to think about instances in which conditionalities in the economic field also serve geopolitical and geo-strategic interests. This will definitely be the case when considering how new members might make a significant contribution to the build-up of military capacity, to coordinated efforts in defence, to EU energy security, to access to important materials and to digital/IT capacities. There is, of course, another side to the coin: given the heterogeneity of the geopolitical orientation of the group of candidate countries (just think of the various Western Balkan states), arriving at an effective coordination of policies at the EU level might not be made any easier by the accession of a sizeable group of new members. Thinking about imposing conditionalities in this much more complex and demanding geopolitical context should hence also be on the agenda.

5.5. The reduced set of economic Copenhagen criteria that we suggest focusing on

Let us return to the main concern that led to this study being commissioned: that is to ‘... identify a smaller than ideal set of minimum conditions, [whereby] the economic accession criteria defined in Copenhagen in 1993 (i.e. a functioning market economy and the ability to withstand competitive pressures inside the EU), would be a natural reference and starting point’. The economic Copenhagen criteria are defined in very general terms and reflect the historical context in which the Central and Eastern European economies were still at the beginning of their transition to become market economies. This historical context has changed in fundamental ways since then, and so have the annual assessment exercises by the Commission.¹³

Our analysis suggests a particular focus within the set of sub-criteria defined as economic Copenhagen criteria (see Annex) that we deem particularly relevant to any assessment of the prospects for ‘economic stability and prosperity in the newly acceded candidate [country]’. The four focus areas that have guided the analysis of the report are again shown in Table 5.1, and we sub-divide the attention that should be devoted to specific issues pertaining to these areas into a ‘pre-accession’ and a ‘post-accession’ phase. We hope that this will provide a contribution for future assessments of the candidate countries, specifically in the context of an accelerated accession.

¹³ The latest assessment report for 2024 can be found here: https://economy-finance.ec.europa.eu/publications/progress-towards-meeting-economic-criteria-eu-accession-2024-european-commission-assessments_en

Table 5.1 / Focus areas on which fulfilment of the economic Copenhagen criteria should focus in the pre- and post-accession phase

	Pre-accession	Post-accession
External accounts and competitiveness	Attention to expansion and structure of export sector: institutional environment to attract FDI and facilitate cross-border production linkages; check ownership concentration in key sectors; put in place effective competition policy to facilitate new entrants. Infrastructural and logistics support. Reduce danger of real exchange rate misalignment: aim for balanced wage–productivity developments (wage bargaining/wage setting in public and private sectors); avoid premature pegging of the nominal exchange rate to the euro or EMU membership; financial market supervision to control undue build-up of household and corporate external debt.	Add elements of domestic industrial and innovation policies to escape middle income trap. Deepen integration with European and global production networks and support spill-over effects from FDI; avoid undue extreme specialisation, support upgrading and diversification. Financial system (external supports and domestic financial institutions) should support specifically the entire range of business activity in the tradeable sector. Well-functioning financial market supervision and regulation (to prevent household and corporate debt accumulation). Avoid undue long-term real exchange rate appreciation and bubbles that generate structural external imbalances and crises.
Fiscal situation and policy	Concentrate on long-term fiscal trajectories and sustainability of public debt Monitor the structure of public spending on key issues like education, healthcare, infrastructure (i.e. growth-enhancing components). Also check on structure of revenue: widen tax base, support growth-encouraging structure of tax rates and streamline subsidies Check use of pre-accession EU support, whether it inhibits markets, through corruption and oligarchic structures	Continuously improve design of fiscal instruments to support business and competitiveness; avoid undue capture of tax and subsidy policy by oligarchic interests. Aim for a gradual reduction of the informal sector. Fiscal policy should not become addicted to EU money. Avoid becoming a tax haven. Pay attention to 'fair' taxation – to distributional implications.
Labour markets and social indicators	Functioning labour market institutions, including social dialogue, adapted to local conditions; wage-setting mechanisms (public/private sector). Active labour market policies, targeting especially the young, women, minorities. Prepare incentives for return migration and policies. Support regional authorities to address regional labour market problems (both supply and demand side); interact with regional policies.	Education policies consistent with diversification of economy (balanced development of vocational/tertiary education; support of future-oriented fields). Income-support policies to reduce poverty and inequality. Balanced wage and working conditions in the public vs. private sectors – both require well-qualified personnel. Further develop incentive structures for return migration and circular migration – schemes in cooperation with private and public sector. Regional development policies, address regional inequalities – monitor effective use of cohesion funds.

contd.

Table 5.1 / Continued

	Pre-accession	Post-accession
Institutional factors/ business environment	Competition authority and policy. Functioning of the judiciary with respect to business. Capacity to absorb EU support effectively. Safeguards with respect to rent seeking. Transparency of public procurement. Anti-corruption policies – learn from best practices.¹⁴	Sustain all the efforts from pre-accession policies and programmes, plus: Social policies to address inequalities. Cooperation and Verification Mechanism, implemented in the case of Bulgaria and Romania could be used for some of the current candidate countries. Technical support for weak institutions, especially local authorities.
Spill-over effects for existing EU members	There will be items that risk conflict with existing members in the pre-accession phase: fear of the reallocation of EU funds; fear of agricultural support and competitiveness of agriculture (particularly of Ukraine); fear of further migration waves. But there will also be prospects for positive spill-overs: energy, critical mineral, defence, extensions of economic space, geopolitical weight.	Policies to support positive spill-overs: › Integrate energy system and support renewables › Support integration of markets, of cross-border infrastructure and logistics integration › Exploit the benefits of cross-border labour market and educational/training integration › Support benefits of cross-country labour mobility and counter the perceived costs (integration programmes, labour market matching, etc.)

5.6. What specific areas should the ‘must-have’ conditionalities pay most attention to: (a) for the Western Balkan countries and (b) for Ukraine?

5.6.1. WESTERN BALKAN COUNTRIES

External sector and competitiveness

The pre-accession requirements for the Western Balkan countries must include a clear strategy for expanding and diversifying the export base, with policies that attract high-quality FDI and deepen integration within European value chains. Countries like Serbia and North Macedonia have made great strides on FDI and export growth, but their over-reliance on low-tech manufacturing related to the German automotive industry presents many risks, not just because of the high level of short-term sensitivity, but also because of a potential long-term middle-income trap.

Another key point relates to real exchange rate appreciation. A particularly important lesson is offered by Croatia: real exchange rate appreciation in the pre-accession years, combined with the national currency being pegged to the euro and a lack of innovation in manufacturing, resulted in a major loss of competitiveness and a deep recession during the 2010s. All Western Balkan economies have been experiencing real exchange rate appreciation lately, and this trend is likely to continue in the coming years. The only way to prevent this from leading to a severe loss of competitiveness – and perhaps a

¹⁴ See e.g. the SOAS Governance & Integrity Anti-Corruption Evidence (GI ACE) research programme: <https://giace.org/about/>

recession, or at least stagnation – is through well-designed industrial and innovation policies to strengthen non-price competitiveness.

After accession, attention must shift to avoiding extreme functional specialisation, with an over-reliance on low-tech labour-intensive manufacturing. Support for industrial and technological upgrading is key, as is ensuring that domestic companies enjoy spill-over effects from FDI, through cooperation initiatives. The case of Bulgaria is instructive here. Despite a sharp REER appreciation post-accession, Bulgaria succeeded in sustaining export growth and even managed to significantly narrow the wide trade deficit it had before accession. This suggests that improving non-price competitiveness can offset the inevitable loss of price competitiveness associated with EU accession.

An additional priority should be to support spill-over effects from FDI through targeted initiatives that encourage cooperation between foreign and domestic companies. This includes support for the transfer of technology and know-how, and mechanisms to help local companies enter the value chains of international firms.

Fiscal policy and public finances

Attention should be paid to headline public finance indicators such as debt and deficit, and to avoiding situations that may lead to unsustainable fiscal paths. In Montenegro, the COVID-19 crisis exposed the dangers of reckless pre-accession borrowing, especially when compounded by opaque deals like the China-financed motorway. Romania's experience also shows that poorly structured fiscal expansion – especially when accompanied by meagre fiscal revenue – can lead to a significant rise in public debt and persistent fiscal risks.

However, pre-accession fiscal criteria should also go beyond headline debt and deficit figures. What matters more is the structure of public spending and revenue. Spending on key areas such as education, healthcare and infrastructure must be a priority – not only to foster economic growth, but also to support social cohesion, human development and long-term sustainability.

Attention should likewise be paid to revenue structures. Revenue should be increased by widening the tax base, improving compliance and collection, and streamlining tax breaks and subsidies. Equally important is ensuring that everyone pays their fair share: flat-tax systems, common across the region, should be reconsidered.

The use of pre-accession EU support must be closely monitored to avoid capture by oligarchic or corrupt networks. Bulgaria's difficulties with corruption and weak public procurement mechanisms after accession highlight how, without safeguards, EU funds can become a liability.

After accession, the focus should shift both to ensuring that tax systems are fair and not shaped by vested interests, and to gradually reducing the informal sector. Tax havens and flat-tax regimes that disproportionately favour elites risk undermining both equity and EU solidarity. At the same time, while informality does tend to decline after EU accession, the pace of that decline often slows in the post-accession period – as seen in Bulgaria, Romania and Croatia. Notably, Croatia experienced a more modest reduction in informality, which may partly reflect the absence of the Cooperation and Verification

Mechanism (CVM). This suggests that robust post-accession monitoring mechanisms like the CVM can help sustain reform momentum and ensure continued progress in curbing informality.

Labour markets, demography and social policy

In the areas of labour markets, social policy and demographics, Western Balkan economies face numerous challenges: persistently high unemployment, labour mismatches, high poverty and inequality, and declining populations.

Short-term efforts should focus on establishing functioning labour market institutions, including public employment services capable of implementing targeted and effective active labour market policies for youth, women and minorities.

Equally important is the establishment of effective social dialogue to ensure that labour and social policies are not dominated by (vested) business interests.

Regional development initiatives are also needed to make full use of the still-high unemployment pockets in poorer regions. While some developed areas and regions around capital cities are beginning to experience labour shortages, others still grapple with widespread joblessness.

A coherent education policy aligned with economic diversification and knowledge upgrading is essential. Particular focus should be placed on STEM and vocational education.

The Croatian and Bulgarian cases show that accession often accelerates emigration in the short term. However, if living standards improve, net migration can turn positive – as seen in Croatia post-2021 and Bulgaria post-2020. For this to happen, candidate countries must start planning early: designing return and circular migration schemes and addressing regional inequalities.

Post-accession, cohesion funds must be used not only for infrastructure, but also for balanced regional development and labour market resilience. Reversing net migration is possible, but only if economic and institutional improvements are credible and sustained.

Institutions, governance and the business environment

Institutional capacity is the most difficult to build, but also the most crucial. The post-accession deterioration in governance indicators in Bulgaria – especially in control of corruption and voice and accountability – shows what happens when institutional weaknesses are tolerated before entry. In contrast, Croatia, while not perfect, has seen modest but broad improvements in governance since 2013.

Serbia and Montenegro provide a couple of cautionary tales. Serbia's backsliding in media freedom, rule of law and corruption control has already slowed its accession process. Montenegro, while formally more advanced, remains vulnerable to instability and elite capture. These risks are not just internal – they threaten the cohesion of the EU as a whole.

As a basic precondition, there must be freedom of expression, media freedom and political pluralism. The 'voice and accountability' indicator has worsened significantly in some countries of the region.

Several have faced periods of authoritarian rule and serious democratic backsliding. That some current EU member states also face similar issues only reinforces the urgency of addressing them.

Another key requirement is the existence of functioning and independent institutions to control corruption: effective anti-corruption bodies, transparent public procurement systems, a capable competition authority and strong oversight of public spending. These elements should not be viewed in isolation, but as part of a broader system of checks and balances.

If there are doubts, mechanisms like the CVM – as applied to Romania and Bulgaria – should be extended to Western Balkan countries after accession to monitor institutional reforms and deter backsliding. The experiences of Bulgaria and Romania show that this mechanism can work. Both countries faced major challenges in these areas, which impeded their economic development; but they have recently become success stories in both corruption control and economic performance.

5.6.2. UKRAINE

External Accounts and Competitiveness

In order for Ukraine to meet the Copenhagen criterion requiring it to be internationally competitive, the country needs to aim for a reasonable degree of diversification and economic complexity in its export sector even prior to EU accession. While the country has a strong competitive edge in agri-food and IT, other sectors where comparative advantage would appear to be feasible (such as defence, critical minerals, renewable energy, machinery and equipment, and metallurgy) need to be adequately developed. This would help Ukraine avoid a mono-specialisation trap (as was the case with Slovakia) and would create opportunities for it to integrate into regional production chains and benefit from technology transfer. This could be achieved with smart industrial policies and FDI attraction programmes.

Ukraine's wage levels are very low compared to the EU; however, this cannot be regarded as benefiting competitiveness in the longer run. Potential investors no longer focus on labour costs, but instead prioritise productivity – in addition to political stability and quality of infrastructure. Labour productivity in Ukraine has been growing much more slowly than wages; this itself will benefit from attracting FDI. Labour productivity can be boosted by advancing digitalization and automation across different sectors of the economy and modernising the infrastructure as a part of the 'Buil back better' reconstruction programmes.

In the medium term (possibly post-accession) it will also be essential to devote attention to educational and training institutions (especially vocational).

Fiscal Policy and Macro-financial Stability

Ukraine has seen its budget deficit and public debt surge following the full-scale invasion by Russia. The country's needs in terms of external financial support are likely to persist – or even grow – when large-scale reconstruction gets under way, as that will require the mobilisation of significant resources. The size of the fiscal deficit should therefore not in itself be the focus of macro-management prior to EU accession. Instead, the country should aim at formulating a solid plan to reduce the budget deficit over the medium term – both by expanding the tax base and minimising tax evasion, and by achieving

sufficiently high economic growth rates. This implies that the government should return to medium-term budgetary planning that sets key priorities for financing, establishing a ceiling on spending and outlining possible fiscal risks. While achieving fiscal discipline in the medium term is important, that should not come at the expense of social, health and education-related expenditure, which has shrunk as a share of GDP during the war.

In monetary policy it is important for Ukraine to unwind the emergency capital controls introduced under martial law, and to restore an inflation-targeting framework and flexible exchange rate as a precondition for EU accession. The stability of the financial sector needs to be safeguarded by resolving the issue of non-performing loans. Regulations both of banking and non-banking financial sectors need to be aligned with the EU *acquis*.

Labour Markets, Demography, and Social Policy

Ukraine's labour market suffers from labour and skills shortages, aggravated by the exodus of refugees and military mobilisation, and at the same time by high rates of structural unemployment, especially among internally displaced people. This could seriously constrain the country's competitiveness in the future. The pre-accession conditions for EU accession should thus emphasise that adequate resources should be devoted to active labour market policies, aimed at increasing the participation in the labour market of internally displaced people, women and young people, addressing regional mismatches and protecting vulnerable groups (veterans, older and disabled workers). At the same time, policies aimed at facilitating return migration need to be developed.

Institutions, Governance, and the Business Environment

For Ukraine, which is in its fourth year of functioning under martial law, it is crucial that peacetime institutions, especially those that regulate public procurement, should be fully restored, and that anti-corruption and judicial reforms should be advanced to a 'point of no return' prior to EU accession. This should prevent the re-emergence of oligarchic control and avoid any backsliding leading to state capture by vested interests. The risks of this happening are likely to rise with the increased inflow of EU funds to support Ukraine's reconstruction, macro-financial stability and regional cohesion. As the Hungarian example shows, such funds can be misused by politicians and oligarchic interests to achieve state capture.

Public administration reform that promotes merit-based recruitment will be crucial for the country's capacity to efficiently and effectively absorb the inflows of funds from the EU. It should include the implementation of job classifications as a precondition for comprehensive salary reform and rolling-out of the Human Resources Management Information System¹⁵.

For the long-term sustainability of democratic control in the country and the continuation of anti-corruption efforts, it will be crucial to encourage a strong civil society to engage actively with the government, including in the use of public funds.

Public investment management needs to be improved by restoring the medium-term budgetary framework (which has been put on hold due to the war), increasing the transparency and openness of

¹⁵ <https://nads.gov.ua/en/news/the-governments-priority-action-plan-for-2024-identifies-the-implementation-of-hrmis-professional-training-and-remuneration-reform-as-the-main-priorities-for-the-naucs>

the budgeting process and strengthening the role of the Ministry of Finance in managing public investment. The digitalised system of public procurement (Prozorro) will need to be fully restored to ensure that there is as little misuse of public funds as possible, and the laws on public procurement should be brought into full alignment with the EU *acquis*.

Judicial reform needs to be continuously advanced so that there is a transparent and meritocratic process for the selection of judges and prosecutors. This is a precondition for attracting significant FDI inflows, which are crucial for the post-war economic recovery of Ukraine.

The independence and capacity of the *anti-corruption institutions* need to be strengthened, including the allocation of relevant resources and the removal of undue legal restrictions on the verification powers of the National Agency on Corruption Prevention. Lobbying regulations need to be established in line with European standards, as part of the anti-oligarch action plan¹⁶. The institutional independence of the Specialised Anti-Corruption Prosecutor's Office should be bolstered by transforming the body into a separate legal entity, with improved selection procedures for top and key officials and with established robust mechanisms for external and internal control and discipline.

Anti-monopoly policies need to be strengthened to facilitate the entry of new businesses and prevent the development of market dominance. The implementation capacity of the Antimonopoly Committee of Ukraine needs to be enhanced, in order to speed up the resolution of cases – increasing the number of commissioners and introducing specialised commissions for public procurement.

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¹⁶ Ukraine's anti-oligarch action plan consists of several laws designed to align with EU requirements for rule of law and democratic institutions, particularly regarding the judiciary, corruption, and media regulation, and the recommendations from the Venice Commission.

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ANNEX

The following are the economic Copenhagen criteria, as stated in European Commission (2024). They cover the following main and sub-criteria:

A functioning market economy requires

- › high quality of economic governance
- › macroeconomic stability (including adequate price stability, as well as sustainable public finances and external accounts)
- › proper functioning of the goods and services market (including business environment, state influence on product markets, and privatisation and restructuring)
- › proper functioning of the financial market (including financial stability and access to finance)
- › proper functioning of the labour market

Being competitive in the EU requires

- › a sufficient amount of human capital, education, research, innovation and future developments in this field
- › a sufficient amount and quality of physical capital and infrastructure
- › changes in the sector and enterprise structure in the economy, including the role of SMEs
- › a sufficient degree and pace of economic integration with the Union, and price competitiveness

The progress of EU candidate countries towards the economic accession criteria is then assessed each year by the Commission in an annual progress report.¹⁷

¹⁷ The latest assessment report for 2024 can be found here: https://economy-finance.ec.europa.eu/publications/progress-towards-meeting-economic-criteria-eu-accession-2024-european-commission-assessments_en

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