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Growth without development: institutional barriers to convergence in EU candidate states

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Abstract: This research analyzes the effect of institutions on economic growth in eight EU candidate transition countries, combining quantitative (β-convergence models) and qualitative (integration maturity framework) methodologies. Drawing on three sets of theories – convergence, institutional economics, and integration maturity – we analyze whether the transition countries have experienced growth without development. The research question is: Why have they lagged on their path towards EU membership? To answer this, we test the research hypothesis that institutions have not had a sufficient impact on the convergence of transition countries towards the EU. The analyzed period is 2004-2022. Countries with efficient institutions tend to experience faster economic growth. This research shows that inefficient institutions are a reason why transition countries have not seized their 'advantage of backwardness'.

Keywords: European integration, transition, convergence, integration maturity, institutions

Introduction

The convergence hypothesis states that 'poor countries tend to grow faster than rich countries' (Barro & Sala-i-Martin, 1992), or, as the late Nobel laureate Robert Solow explained, less developed countries will grow faster until they reach a steady state, and after that their growth will slow (Solow, 1956). Yet, for the transition countries currently seeking deeper integration with the European Union (EU), this no longer seems the case, as their growth, and consequently, development has stalled. They have experienced some convergence, but the pace remains slow (Organization for Economic Co-operation and Development [OECD], 2023; 2025), which presents a major issue (European Commission, 2023c).

This study analyses the convergence process of eight EU candidate countries over the period 2004–2022, in order to analyse the reasons why the current transition countries have lagged on their path towards EU membership and what is the role of institutions in the process. We use β-convergence and the integration maturity

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framework, focusing on the Western Balkans[1] and DCFTA[2] countries due to their similar transition histories and current EU aspirations.

The current transition countries share a similar economic history with the Central and Eastern European Countries (CEEC) that joined the EU between 2004 and 2013. If only analysing macroeconomic data, one would conclude that these countries do not deviate much from the EU average. However, their transition process has lasted for over 30 years, and their economic development performance has been poor.

The further question is, why have they lagged? To answer this question, the main research hypothesis that institutions have not had a sufficient impact on convergence of the transition countries towards the EU is tested. We apply the classic convergence analysis, followed by a qualitative analysis employing the integration maturity framework (Palánkai, 2010). We supplement these approaches with institutional economics.

That efficient institutions have a positive effect on economic growth is well established (Aralica et al., 2018; Liko, 2024; Šiljak & Nagy, 2023). This research shows that inefficient institutions are a major reason why the transition countries have not seized their 'advantage of backwardness'. This term, coined by Alexander Gerschenkron in the 1950s, suggests that 'being relatively poorer might allow low-income countries to grow more quickly… Poor countries can borrow and adapt existing technology and have the potential to grow faster and to catch up to the more advanced economies' (Perkins et al., 2013). By their failure to turn their disadvantages to an advantage, the transition countries have not achieved sufficient maturity to advance towards deeper European integration.

The structure of the paper is as follows: Section 1 presents background information on the transition countries and on convergence in the EU, as well as the conceptual frameworks employed, integration maturity and institutional economics. Section 2 outlines the methodologies employed in the paper. Section 3 shows the convergence process, followed by section 4, which, through integration maturity and institutional economics, analyses the reasons for the slower transition process. Section 5 concludes the paper.

1. Background

Achieving convergence has long been a goal of the European Union (EU). The Treaty of Rome (1957) introduced common policies to promote "harmonious

[1] Albania, Bosnia and Herzegovina (BiH), Montenegro, North Macedonia, and Serbia, all having signed Stabilization and Association Agreements with the EU. Kosovo is excluded from the analysis due to the datasets being incomplete.

[2] Deep and Comprehensive Free Trade Agreement (DCFTA) – Georgia, Moldova, and Ukraine.

economic development and balanced expansion" (Yin et al., 2003, p. 188). The biggest challenge, though, was the enlargement to eight former socialist CEEC in 2004.

The CEEC started their transition from centrally planned to market economies in the early 1990s. Then, as now, candidate countries had to fulfill the Copenhagen criteria (1993) - economic, political, and institutional. To help the countries transform and become competitive, functioning member states (MS), the EU created different pre-accession funds, later, post-accession, replaced by cohesion funds. The approach has been successful in the CEECs (Csaba, 2025) as growth accelerated after enlargement, and the countries started converging at a high rate (Rapacki & Próchniak, 2019), leading to the EU being called a convergence machine (Ridao-Cano & Bodewig, 2018).

The current transition countries are expected to join the EU next. The official relations between the Western Balkan (WB) region and the EU started when the Stabilization and Association Process (SAP) was launched in 1999. The Thessaloniki summit in 2003 declared that all SAP countries were potential candidates for EU membership. North Macedonia, Montenegro, Serbia, and Albania were granted candidate status by 2014, followed by BiH in 2022. Kosovo is a "potential candidate" due to several countries' non-recognition of its sovereignty. The countries signed Stabilization and Association Agreements (SAA) with the EU, which constitute the framework of relations. They provide visa free travel, establish a free trade area between the parties, identify common political and economic objectives and encourage regional cooperation (European Commission, 2023d). The SAA is signed for an indefinite period and aims for the country's eventual accession to the EU. North Macedonia signed the SAA in 2001 (the same year as Croatia), followed by Albania in 2006, Montenegro in 2007, BiH and Serbia in 2008, and Kosovo in 2015, but these countries will not be ready for EU membership any time soon. The accession negotiations with Montenegro and Serbia began in 2012 and 2013, respectively, and with Albania and North Macedonia in 2020.

The EU developed the Eastern Partnership (EaP) in 2009 as a special framework for Georgia, Moldova, and Ukraine together with Armenia, Azerbaijan, and Belarus, aimed at deepening and strengthening relations, but without offering any membership perspective. In 2014, the first three countries signed Association Agreements (AA) with the EU, a major part of which is the Deep and Comprehensive Free Trade Agreement (DCFTA). The agreements entered into force in 2016 for Georgia and Moldova, and in 2017 for Ukraine. Through these agreements, the three countries gained a high degree of access to the EU single market (the main exception being free movement of labour). After Russia's invasion in 2022, Ukraine formally applied for membership, soon followed by the other two.

Different studies have shown that the EU countries converge. The process has been successful and the dispersion of per capita GDP between the older members and those joining since 2004 has decreased over time (Bernardelli et al., 2021; Cieślik & Wciślik, 2020). However, it is not homogeneous as the MS converge faster

than regions within the states (Grzelak & Kujaczyńska, 2013). Studies confirm the negative effects of the Global financial crisis on convergence (Bisciari et al., 2020; Rapacki & Próchniak, 2019), as well as the negative effects of the Covid-19 pandemic and Russia's war on Ukraine (Fedajev et al., 2022; Licchetta & Mattozzi, 2023).

Research on the current transition countries' economies is scarce. The WB states converge towards the EU, but the process has been slow and negatively affected by the Global financial crisis and the COVID-19 pandemic (Grodzicki & Jankiewicz, 2024; Krstevska, 2018; Meksi & Xhaja, 2017). Depending on different studies, convergence towards EU-15 MS has been slow (Gockov & Antovska, 2019) or non-existent (Botrić, 2013; Stanišić et al., 2018). The region also converged toward the CEECs (Šiljak, 2018). Convergence between former Soviet countries and the EU exists, although only few studies have investigated the process (Colak, 2015; Nielsen & Šiljak, 2025; Pipień & Roszkowska, 2018; Šiljak & Nagy, 2018).

Next to the classical approach to convergence analysis, this paper adds the integration maturity framework (Palánkai, 2010). This was developed during the CEEC's transition to show that the Copenhagen criteria were too formalistic and technical in nature, and thus insufficient to ensure that acceding countries were, in fact, prepared, or 'mature' enough to maximize all benefits of integration. The integration maturity framework originally listed five economic dimension factors – macroeconomic stability, access to foreign finance, functioning market economy, competitiveness, and convergence – as necessary conditions, but without elaborating on the relationship between them. The framework has since been updated, to emphasize the causal linkages between the factors and that convergence is essentially a function of the other four (Nielsen & Šiljak, 2025; Šiljak & Nielsen, 2023).

Institutional economics provides further insight into the functioning market economy dimension in particular. Institutions are defined as "the rules of the game in a society or, more formally, […] the humanly devised constraints that shape human interaction" (North, 1990, p. 3), and represent the collective choices of a society (Acemoglu & Robinson, 2010, p. 141). There are three types of institutions: political, economic and "other" institutions. Political institutions determine constraints and incentives for key actors (Acemoglu et al., 2005). Economic institutions shape incentives and influence investment in physical and human capital; determine economic outcomes; ideally provide protection of property rights. However, these institutions are hard to sustain (Acemoglu et al., 2005, p. 389). Other institutions provide enforcement mechanisms such as the judiciary and the police (Pejovich, 1999).

Efficient institutions should provide protections of property rights (Acemoglu et al., 2005), defined as the rights of individuals over their own labor and the goods and services they possess (North, 1990, p. 33), because it contributes to better economic performance (Redek & Sušjan, 2005). Inefficient economic institutions arise from the desire of political elites to protect their political power, and they may

therefore oppose changing the economic institutions in ways that would make them more efficient and thus stimulate economic growth (Acemoglu et al., 2005, p. 432). History matters for institutional developments (North, 1990, p. vii), and for transition countries the process of building the independent institutions that did not exist in socialism has been long and expensive. Yet, countries with efficient institutions tend to experience higher economic growth (Acemoglu et al., 2005). Successful economic transition is, therefore, a process of institutional change and of building the new institutions required by a capitalist economy (Redek & Sušjan, 2005, p. 995).

2. Methodology

This study employs both qualitative and quantitative approaches. The former is based on several indices such as the World Economic Forum (WEF) Competitiveness Index and the Heritage Foundation's Property Rights Index, as well as reports from the EU institutions, the ILO, the World Bank, and non-governmental research institutes. These round out the data compiled through the quantitative analysis of convergence.

β-convergence analysis, as popularized by Barro and Sala-i-Martin (1992), tests the aforementioned convergence hypothesis. If countries do not differ in their structures, they converge towards the same steady state and convergence is absolute. The β-coefficient is obtained by estimating a regression model with the average growth of per capita GDP in the analyzed period as a dependent variable and the initial per capita GDP (in PPP) computed in a natural logarithm as an independent variable (equation 1). Since convergence implies a negative relationship between the variables, the β-coefficient must be negative.

$$\Upsilon_{i.0,T} = \alpha_i + \beta\log(Y_{i,0}) + \varepsilon_i \quad (1)$$

If countries do differ in their structures, they converge towards different steady states, and convergence is conditional. The β-coefficient is obtained by estimating an augmented absolute convergence model, with a set of macroeconomic (economic openness, inflation, unemployment, general government debt) and institutional variables (the control of corruption, regulatory quality, and political stability) added as independent variables (equations 2 and 3).

$$\Upsilon_{i.0,T} = \alpha_i + \beta_1\log(Y_{i,0}) + \beta_2 EO_{i.0,T} + \beta_3 Inf_{i,0.\,T} + \beta_4 Debt_{i,0.\,T} + \beta_5 Unemp_{i,0.\,T} + \varepsilon_i \quad (2)$$

$$\Upsilon_{i.0,T} = \alpha_i + \beta_1\log(Y_{i,0}) + \beta_2 CC_{i.0,T} + \beta_4 RQ_{i,0.\,T} + \beta_5 PS_{i,0.\,T} + \varepsilon_i \quad (3)$$

The β-coefficient can be used to calculate the half-life of convergence — defined as the number of years it takes for the per capita GDP gap to be cut in half (Ben-David, 1996, p. 286) — by using the following formula (Rapacki and Próchniak, 2019, p. 8):

$$t* = \frac{log 0.5}{\beta} \quad (4)$$

Following the classical approach to convergence analysis (Sala-i-Martin, 1996), we use cross-sectional annual data to estimate Ordinary Least Squares (OLS) regression for each period. As part of model diagnostics, Breusch-Pagan tests were performed to detect heteroskedasticity, and Variance Inflation Factors (VIF) were calculated to check for multicollinearity among independent variables. When heteroskedasticity was detected, models with robust standard errors were estimated. Cross-sectional data are appropriate for the objectives and structure of this study for two reasons: first, the shortest time period for using panel data should be 5 years (Islam, 1995); and second, "the cross-sectional data are free of the distortions caused by business cycles, as well as various demand- and supply-side random shocks that deviate the economy from the path toward a steady state" (Vojinović et al., 2009, p. 127).

The analysed period is 2004-2022 (Models 1, 6, and 11), with four sub-periods: pre-crisis period 2004-2008 (Models 2, 7, and 12), Global financial crisis period 2009-2013 (Models 3, 8, and 13), post-crisis period 2014-2019 (Models 4, 9, and 14), and stagflation period 2020-2022 (Models 5, 10, and 15). The analyzed groups are presented in Table 1.

Table 1. Analysed groups of countries[3]

Group	Countries
Western Balkans	Albania, BiH, Montenegro, North Macedonia, Serbia
DCFTA	Georgia, Moldova, Ukraine
CEEC	Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia
EU14+1	Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, the United Kingdom

Source: authors' representation

Table 2 presents the descriptive statistics for the variables used in the estimation of the convergence models across thirty-six countries, those listed in Table 1 and Cyprus and Malta, during the period 2004-2022.

[3] Cyprus and Malta are, for historical reasons, not included in the 14+1 group, although they resemble them the most. In the subsequent parts, when reference is made to EU averages, they are included.

Table 2. Descriptive statistics

Variable	Description	Mean	Standard deviation	Minimum	Maximum
Per capita GDP growth	Annual percentage growth rate of GDP per capita	2.37	1.56	-0.08	11.08
Log (initial per capita GDP)	Natural logarithm of per capita GDP	9.74	0.70	8.38	11.08
Economic openness	A sum of exports and imports, as percentage of GDP	117.70	58.75	55.81	328.35
Inflation Rate	By the Harmonized Index of Consumer Prices	3.19	2.27	1.49	12.82
General government debt	Percentage of GDP	58.98	30.67	9.09	158.78
Unemployment rate	Percentage of labor force	9.98	5.53	2.42	27.61
Control of corruption	On a scale from 0 to 100; the lower value indicates a more corrupt government	63.76	18.40	31.69	96.32
Political stability	On a scale from 0 to 100; the lower value indicates less political stability	59.88	11.11	31.99	76.94
Regulatory quality	On a scale from 0 to 100; the lower value indicates less regulatory quality	68.45	12.60	41.31	85.82

Source: authors' calculations based on World Bank, Vienna Institute for International Economic Studies (WIIW), and WEO data

The data for per capita GDP growth rates, per capita GDP, economic openness, unemployment, control of corruption, regulatory quality, and political stability are from the World Bank, whereas the World Economic Outlook (IMF, 2024) and Vienna Institute for International Economy databases provide data for the inflation rate.

3. Results of absolute and conditional convergence analysis

The following section analyses the transition countries' convergence towards the EU. Table 3 presents the results of the regression analysis.

Table 3. Estimation of Absolute Convergence Models Using Cross-Sectional OLS

Denomination	Model 1 (2004-2022)	Model 2 (2004-2008)	Model 3 (2009-2013)	Model 4 (2014-2019)	Model 5 (2020-2022)
			β(t)		
Log of initial per capita GDP	-1.61*** (-6.13)	-3.04*** (-8.13)	-1.80*** (-4.02)	-0.98** (-1.95)	-0.07 (-0.09)
Half-life (years)	43	23	39	71	-
Number of observations/ countries	36	36	36	36	36
F statistics (p value)	37.55 (0.0000)	66.13 (0.0000)	16.14 (0.0003)	3.80 (0.0595)	0.01
R^2	0.5248	0.6604	0.3220	0.1006	0.0002
Breusch-Pagan test	0.8912	0.4859	0.7825	0.1894	0.3307

Notes: β-coefficients from cross-sectional OLS regressions of absolute convergence. Periods: 2004–2022, 2004–2008, 2009–2013, 2014–2019, and 2020–2022. Dependent variable: average annual per capita GDP growth; independent variable: log of initial per capita GDP. Significance: ***p<0.01, **p<0.05, *p<0.1. Half-life indicates time for per capita GDP to halve. Breusch–Pagan test checks for heteroskedasticity.
Source: authors' calculations based on World Bank data

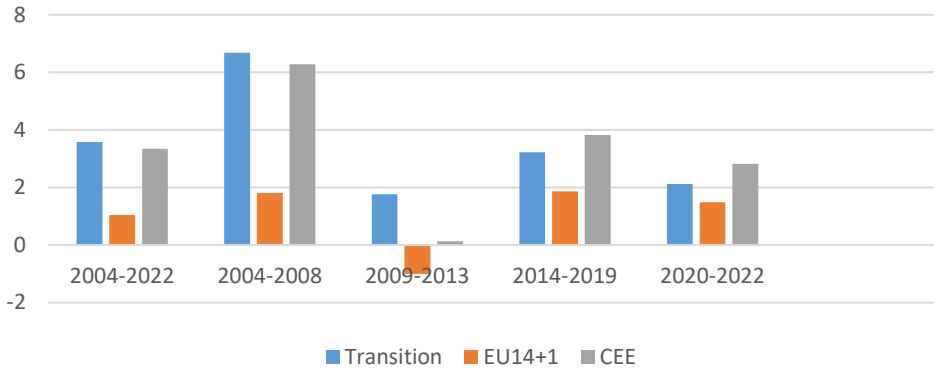
The β-coefficient between 2004 and 2022 was negative, at -1.61 (p-value=0.0000). Following Rapacki and Próchniak (2019), we calculate the half-life of convergence, which is approximately 43 years. Compared to the benchmark of around 35 years by Barro and Sala-i-Martin (1992), this reflects slow convergence. The transition countries, whose per capita GDP in 2004 was only 25.5% of the EU average and 44% of the CEEC average, grew at an average rate of 3.6%. This was not sufficient to generate faster convergence considering that the CEEC's rate was only 0.3 percentage points lower.

The β-coefficient was highest in the pre-crisis period, -3.04, and, as expected, decreased to -1.8 during the Global financial crisis, corresponding to a half-life increase from 23 years to 39 years. Therefore, this crisis had a negative impact on the convergence process. The process was the slowest in the following six years as the β-coefficient was only -0.98, a half-life of 71 years. While the transition countries on average grew faster than the EU MS, their growth rate was 0.6 percentage points lower than the CEEC's, hence a slower convergence.

The only period with no convergence was the stagflation period, as the β-coefficient was not statistically significant. In line with economic theory, the results

indicate that this crisis had a more negative impact on convergence than the financial crisis. A recession is characterized by a negative GDP growth rate, which brings deflation and increased unemployment. Stagflation combines economic stagnation with an increase in both inflation and unemployment, making it harder for policymakers to manage (Mankiw, 2013). During the stagflation period, the transition countries grew at a rate almost identical (2.12%) to the EU average (2.08%), but at a lower rate than the CEECs (2.83%) (Figure 1).

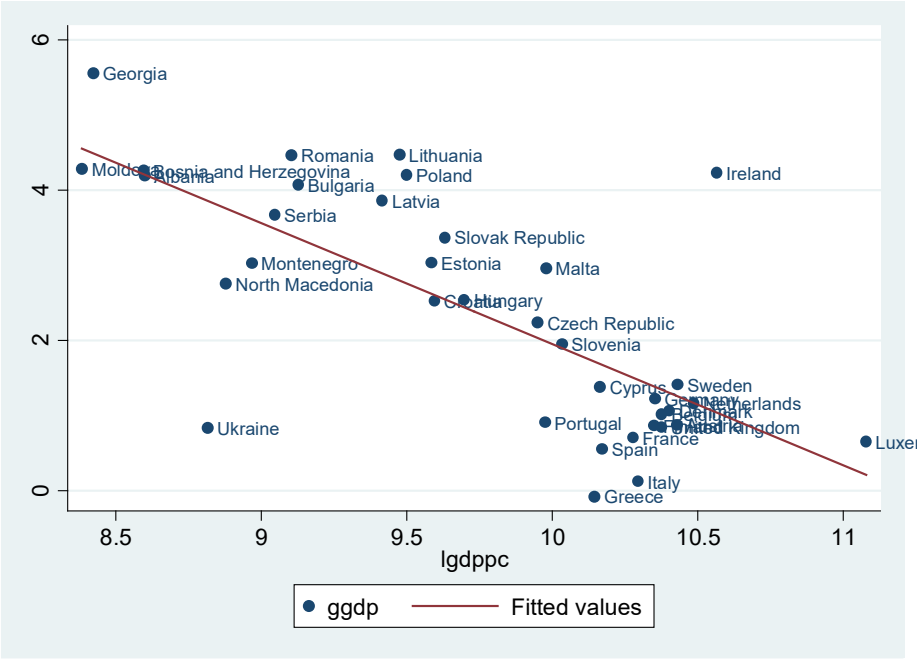
Figure 1. Comparison of average GDP growth by group



Note: The figure shows average annual GDP growth rates for groups of transition countries and the EU over 2004–2022 and its sub-periods.
Source: authors' calculations based on World Bank data

Figure 2 indicates absolute convergence in the analysed countries. It plots per capita GDP in 2004, computed in a natural logarithm (X-axis) against the average per capita GDP growth rate in the period 2004-2022 (Y-axis). The line of fitted values has a downward slope, consistent with a negative β-coefficient. There is a high degree of heterogeneity among the transition countries, and a polarization between the CEECs and the EU14+1. While the EU14+1, together with Cyprus and Malta, converge as a club, the CEECs form several clubs. However, Romania and Bulgaria are closer to the transition countries than to the EU MS, as they have a slightly higher per capita GDP than the transition countries, yet similar growth rates.

Figure 2. Absolute convergence (2004-2022)



Notes: The X-axis shows the natural log of initial GDP per capita in 2004; the Y-axis shows the average annual GDP per capita growth for 2004–2022. The downward-sloping fitted line reflects the negative β-coefficient found in the analysis.
Source: authors' calculations based on World Bank data

The countries conditionally converged in every period, except the stagflation period, when economic variables are included in the model (Table 4). In that sense, the results are consistent with absolute convergence. However, the pattern of convergence is different. The β-coefficient for the conditional convergence model in the entire analysed period is higher than the absolute one, indicating structural differences, but is the lowest during the pre-crisis period. With convergence being the fastest in the post-crisis period, the results again indicate the negative effects of the financial crisis on the process, but the stagflation impact was more severe.

Analysing the determinants of per capita growth, it can be concluded that all selected variables had the theoretically expected impact on growth in at least one analysed period. While economic openness positively impacted growth, the other three variables (inflation, general government debt and unemployment) had a negative impact.

Table 4. Estimation of conditional convergence models with economic variables using Cross-Sectional OLS

Denomination	Model 6 (2004-2020)	Model 7 (2004-2008)	Model 8 (2009-2013)	Model 9 (2014-2019)	Model 10 (2020-2022)
			β(t)		
Log of initial per capita GDP	-2.48*** (-6.69)	-2.70*** (-4.34)	-2.24*** (-3.55)	-2.78*** (-4.54)	-2.15 (-1.61)
Half-life (years)	28	26	31	25	-
Economic openness	0.01** (2.02)	0.002 (0.730)	0.01 (1.29)	0.01** (2.65)	0.005 (0.64)
Inflation rate	-0.32*** (-3.51)	0.05 (0.681)	-0.37 (-1.31)	-0.35*** (-4.01)	-0.46* (-1.73)
General government debt	-0.1** (-2.19)	-0.04*** (-3.82)	-0.02* (-1.94)	0.00 (0.09)	-0.01 (-1.07)
Unemployment rate	-0.1** (-2.21)	-0.04 (-0.84)	-0.05 (-1.12)	-0.12** (-2.15)	-0.16 (-1.21)
Number of observations/ countries	36	36	36	36	36
F statistics (p value)	19.69 (0.0000)	24.96 (0.0000)	6.30 (0.0004)	6.36 (0.0004)	0.93 (0.4731)
R^2	0.7664	0.8062	0.5120	0.5145	0.1347
Breusch-Pagan test	0.8520	0.1519	0.6788	0.9669	0.1926
Mean VIF	2.13	2.39	1.65	1.78	2.21

Notes: β-coefficients from cross-sectional OLS regressions of conditional convergence, controlling for openness, inflation, government debt, and unemployment. Periods: 2004–2022, 2004–2008, 2009–2013, 2014–2019, and 2020–2022. Robust standard errors used where necessary. Significance: ***p<0.01, **p<0.05, *p<0.1. Half-life shows time for per capita GDP to halve. Breusch–Pagan test checks for heteroskedasticity.
Source: Authors' calculations based on World Bank, WIIW, and WEO data

Table 5 shows conditional convergence and determinants of growth when institutional variables are included. Again, the only period when countries do not converge is during the stagflation period. However, the highest β-coefficient among the fifteen estimated models is in the crisis period, -5.12, indicating that the financial crisis did not have a negative impact on this process. The rates are higher for both the entire and the pre-crisis periods, indicating that institutional aspects contribute to differences among the countries.

Among the selected institutional variables, only the control of corruption, which should have a positive impact on growth, is not a statistically significant variable in any of the analysed periods. It did not have any impact, as the transition countries are among the most corrupt countries in Europe, and anti-corruption measures were clearly insufficient. Political stability and regulatory quality had a

positive but weak impact in the three analysed periods. None of the selected variables were a determinant of growth during the stagflation, indicating institutional inefficiency during this period.

The problem of heteroskedasticity is present in Models 13 and 15. When regressions with a heteroskedasticity robust standard error are estimated (Models 13' and 15'), the issue of heteroskedasticity is corrected. The β-coefficients and their significance did not change.

Table 5. estimation of conditional convergence models with institutional variables using Cross-Sectional OLS

Denomination	Model 11	Model 12	Model 13	Model 13'	Model 14	Model 15	Model 15'
	β(t)						
Log of initial per capita GDP	-3.13*** (-7.46)	-4.40*** (-4.72)	-5.12*** (-6.91)	-5.12*** (-4.88)	-2.52** (-2.60)	-0.95 (-0.54)	-0.95 (-0.34)
Half-life (years)	22	16	14	14	28	-	-
Control of corruption	-0.03 (-1.32)	-0.04 (-1.32)	0.04 (1.19)	0.04 (1.26)	-0.07 (-1.48)	-0.05 (-0.58)	-0.05 (-0.61)
Political stability	0.06** (2.56)	0.07** (2.03)	0.05 (1.63)	0.05 (1.56)	0.90*** (2.76)	0.13* (1.74)	0.13 (1.07)
Regulatory quality	0.10** (2.50)	0.08 (0.168)	0.10* (1.99)	0.10** (2.26)	0.11 (1.56)	0.01 (0.09)	0.01 (0.08)
Number of observations/ countries	36	36	36	36	36	36	36
F statistics (p value)	23.71 (0.0000)	21.87	13.44 (0.0000)	7.70 (0.0002)	4.93 (0.0034)	1.25 (0.3092)	1.23 (0.3183)
R^2	0.7537	0.0000	0.6342	0.6342	0.3889	0.1392	0.1392
Breusch-Pagan test	0.2637	0.3314	0.0243	-	0.7758	0.0172	-
Mean VIF	7.99	6.96	5.70	-	7.91	10.35	-

Notes**:** β-coefficients from cross-sectional OLS regressions of conditional convergence, controlling for corruption, regulatory quality, and political stability. Periods: 2004–2022, 2004–2008, 2009–2013, 2014–2019, 2020–2022. Models 13 and 15 use robust standard errors. Significance: ***p<0.01, **p<0.05, *p<0.1. Half-life: time for initial per capita GDP to halve. Breusch–Pagan test for heteroskedasticity.
Source: authors' calculations based on World Bank, WIIW, and WEO data

4. Growth without Development? – The Integration Maturity Analysis

As noted, for all transition countries, past and present, EU membership was/is a major objective, predicated on fulfilling the Copenhagen criteria. While most CEECs joined the EU less than fifteen years after starting the transition, for the

current candidates the process has lasted more than thirty years. To understand the reasons for this, we now turn to assessing the countries' integration maturity.

4.1. Macroeconomic stability and access to foreign finance

Macroeconomic stability is an integral part of the accession process since the countries have free trade agreements with the EU and all must eventually join the single currency. Although not a Copenhagen criterion, macroeconomic stability enhances the performance of a market economy (European Commission, 2019).

Macroeconomic stability was of extreme importance for CEECs during their transition and was achieved to a certain degree during the first years of their membership (Csaba, 2018). Foreign direct investment (FDI) and access to pre-accession funds helped the transformation, but they still struggled with higher inflation than the EU14+1 after price liberalization, and with higher unemployment rates because state-owned enterprises (SOE) collapsed or were privatized.

The current transition countries have had time to adjust, and before the Covid-19 pandemic they enjoyed a fair degree of macroeconomic stability. As the previous section showed, their economies grew, though not at the rate they could and should have. After an early period of hyperinflation – a consequence of price liberalization – inflation rates stabilized in the mid-1990s in the WB and in the early 2000s in the DCFTA countries. Inflation rates had a negative impact on growth (Table 4) as it was, on average, still higher than in the EU. The countries made progress, their average inflation rate decreasing from 7.6% in 2004-2008 to 4.1% in 2014-2019. However, the rate increased to 7.3% during the stagflation period, compared to 4.7% in the EU. The inflation in this period was at least to some extent imported, i.e., it was caused by two supply shocks: the Covid-19 pandemic in 2020 and the Russian invasion of Ukraine in 2022.

Unemployment also had a negative impact on growth (Table 4). The transition countries decreased their unemployment rate from 18.5% in the pre-crisis period to 14.7% in the post-crisis period, and to 12% during the stagflation. During the same time, the average rate in the EU decreased from 7.5% to 6.3%. After the transition began, many SOEs—employing most workers—went bankrupt due to uncompetitive, low-quality products and lack of economies of scale. In most cases, privatisation was poorly managed and remains incomplete. In CEECs, by contrast, the inflow of FDI from the West revitalized former SOEs, employed the labour force, and was the most important determinant of growth (Próchniak, 2011).

The primary reason for falling unemployment, though, is not new companies opening or existing ones hiring more people. Rather, the labour force is shrinking as people migrate, mostly to EU countries. The Human flight and brain drain index (Fund for Peace, 2024) is higher for six of the eight analysed transition countries than for the EU (between 6.4 and 8.9 of 10). Croatia has the highest Index value in the EU (6.1) and is the only one positioned within the analysed group; Serbia and

Montenegro have lower values (6 and 5.4, respectively). For reference, Sweden has the lowest Index value, 0.6. People leave for several reasons, among them low wages, poor prospects, and political instability. According to the regression results (Table 5), political stability had a small, but positive impact on growth. Even though the Political Stability Index (World Bank, 2024) increased between 2004 and 2022, the analysed group remain some of the least stable countries in Europe, burdened by either ongoing or very recent conflicts with their neighbours.

Another indicator of macroeconomic stability is the ratio of general government debt to GDP, which according to the Maastricht criteria should not exceed 60% (European Central Bank, 2024). CEECs do not have high levels of debt; only Croatia and Hungary exceeded the rate (on average) during the analysed period, even as Croatia joined the Eurozone in January 2023. Theoretically, increases in general government debt have a negative impact on GDP growth, which this research bears out (Table 4). The average ratio in the transition countries is not excessive, as it increased from 34.6% in the pre-crisis period to 56.6% during the stagflation period, compared with an increase from 46.3% to 73.6% in the EU. However, with a high level of corruption, the question is whether the money borrowed is invested in growth-generating projects or used for improper purposes (Šiljak, 2022).

Transition is a slow and expensive process, and the transition countries, being among the poorest in Europe, need access to foreign finance. All are members of international financial organizations (IFO), such as the International Monetary Fund (IMF), the World Bank, and the European Bank for Reconstruction and Development (EBRD) (Nielsen & Šiljak, 2025; Šiljak & Nielsen, 2023). The EU has been the main investor, providing FDI, pre-accession funds, and grants. The EU also provides €11.6 billion in macro-financial assistance loans and grants for the period 2021-2027 (European Council, 2024). However, financial assistance from the EU typically comes with stricter conditionality than IFO loans. Given the countries' struggle with corruption, the latter source of finance is therefore often preferred by governments.

Despite political instability, the transition countries may, on the surface, seem better performers than most EU member states. A deeper qualitative analysis, however, reveals problems and shortcoming that are not easily resolved.

4.2. Functioning market economy

A functioning market economy, both an integration maturity factor and a Copenhagen criterion, "requires that prices, as well as trade, should be liberalized and that an enforceable legal system, including property rights, is in place" (European Commission, 2019, p. 71). None of the analysed countries can currently be considered fully functioning market economies, with BiH, Ukraine, and Moldova being at an "early/some stage of preparedness", other Western Balkan countries have made "some or good progress"', while Georgia is "moderately prepared" (European

Commission, 2023a, p. 41). According to the BTI Economic Transformation Index (Bertelsmann Stiftung, 2024), BiH, Serbia, and the DCFTA countries have only made limited progress, while other countries have advanced in the process.

With only a few exceptions in the former Yugoslavian states and Ukraine, price liberalization has been achieved (European Bank for Reconstruction and Development, 2024). The transition countries also liberalized their trade. All are small, open economies with economic openness rates ranging from 75% in Albania to 115% in North Macedonia, which has a positive effect on per capita growth (Table 4). The average rate increased only slightly between the pre-crisis and the stagflation periods – from 97% to 103%. The EU's average rate increased from 110% to 140% between the same periods.

The main trade partner for both regions is the EU. Imports from the EU range between 24.6% of total imports in Georgia to 59% in BiH, while exports range from 11.6% in Georgia to 77.3% in North Macedonia. Between 2013 and 2022, imports from the EU increased by rates between 62% in Georgia to 607% in Montenegro; exports increased by between 29% in Ukraine and 149% in Serbia. However, even though the EU is Georgia's single-largest trade partner, no individual MS is among the country's top 5 partners (World Trade Integrated Solution, 2024). Germany is among the top 5 individual partners for other analysed countries, followed by Italy, and neighbouring EU MS. Intra-regional trade is not pronounced, as in the WB region only Serbia appears among top 5 partners, but the country does not have strong trade relations with Albania (European Commission, 2023b).

There are two reasons for limited trade within regions. First, the WB countries fought wars in the 1990s. While they have diplomatic relations today and cooperate in different areas, the relationships are still strained. Second, these economies have similar structures and are weakly diversified to the extent that there is no need for intra-regional trade. Instead, they turn to the EU, where significant diaspora – formed by refugees from the 1990s or economic migrants in the past 10 years – maintain ties with their old countries.

The transition countries mostly export raw materials (on average 9.3% of total exports) and labour-intensive, low value goods, resulting in current account deficits with the EU (except for North Macedonia) (European Commission, 2023b). The trade composition shows that in four out of five WB countries exports consists of manufactured goods (on average 34.4%); North Macedonia mostly exports chemicals (34.2%). The lowest share in exports is food (BiH), mineral fuels, lubricants and related goods (North Macedonia and Serbia), and chemicals (Montenegro and Albania) (European Commission, 2023b). Ukraine's main exports to the EU are cereals (16.5%), oil seeds (11.7%), animal or vegetable fats and oils (10.7%), iron and steel (9.3%), and ores, stag and ash (8.4%) (European Commission, 2024c); EU imports from Georgia include mineral products, chemical products, and textiles (European Commission, 2024a). The main EU imports from

Moldova are mineral products, machinery and appliances (European Commission, 2024b).

While the countries have made progress in liberalizing trade and prices, the institutional aspect of a functioning market economy is lacking. Most Soviet successor states and the WB countries, those where the transition has already lasted more than twenty years longer than in CEEC, generally have worse property rights institutions and more corruption today (Uberti, 2018, p. 7). The CEECs, although they still have less efficient institutions than the Western European countries, have made greater progress. According to the Heritage Foundation Property Rights Index (Heritage Foundation, 2024), the transition countries' index values range between 39.7 (Ukraine) and 61.3 (Montenegro). In the EU, Finland has a perfect score of 100, while property rights are the least protected in Hungary (75.8) and Poland (72.3). Efficient institutions protecting property rights contribute to economic performance, as foreign investors will not come to a country where they fear for the security of their property, tangible or intangible. Inefficient institutions are one of the major reasons why the transition countries are not competitive and attract little FDI.

4.4. Competitiveness

Competitiveness is defined as "the set of institutions, policies and factors that determine the level of productivity of a country" (Schwab, 2019, p. xiii). In terms of this criterion, Serbia, Montenegro, and North Macedonia are "moderately prepared", Albania and Georgia have "some level of preparation", BiH and Moldova are at an "early stage / have some level of preparation", while Ukraine is at an "early stage" (European Commission, 2023a, p. 42). Thus, according to the WEF Competitiveness Index, these countries are the least competitive in Europe. Croatia, the least competitive country in the EU, is positioned just above Serbia, while the Netherlands is the most competitive in the EU and the world (Schwab, 2019).

A lack of competitiveness affects the countries' ability to attract FDI, without which going through the transition is impossible. Foreign investors bring new technologies, management know-how, improve existing business procedures, open new jobs and increase production, open new markets, and increase the potential for trade, hence induce economic growth and convergence (Botrić, 2010).

Economic history shows that countries grow the fastest during their industrialization periods (Perkins et al., 2013). All countries went through a transition recession, or a "Schumpeterian structural crisis" characterized by the decline of old industries due to obsolete technology and the rise of new leading sectors due to technological revolution (Berend, 2016, p. 183). The CEEC went through the transition process successfully partially due to FDI from the West. It was initially expected that these countries would produce labor-intensive products. However, they soon started producing capital-intensive products, and, consequently, there was trade creation instead of the expected trade diversion (European

Commission, 2009). The main source of competitiveness was the level of productivity, its relatively rapid increase, the relatively good quality and low cost of their human capital (Palánkai, 2010, pp. 12–13), and improving institutions that also converged to EU standards.

The current transition countries potentially offer a lot to investors – macroeconomic stability, the prospect of integration into the EU, favorable taxes, low wages, and diverse economies (World Bank, 2019). Yet, the WB countries receive less FDI than CEEC due to their economic size, geographical distance from investors, and the low quality of institutions. This is attributable to the negative "Western Balkan" effect – recent conflicts, political fragmentation, and slow economic growth – which has a negative effect on FDI prospects (Estrin & Uvalić, 2014). While FDI inflow has increased, its level is not sufficient to affect growth as most is in the service sector (Estrin & Uvalić, 2013), which comprises on average 56.6% of GDP and mostly consists of non-tradable services. FDI is more needed in the industrial sector (21% of GDP on average).

Influx of export processing FDI had a positive effect on growth only in North Macedonia and Serbia (OECD, 2021). As service-based economies, transition countries skipped the step of industrial modernization. Manufactured products remain of low value and quality, and most are not competitive in the EU market. Service-based economies should be developed economies, which these countries are not. Also, without developed industrial production, the countries are dependent on imports and therefore accumulate deficits with trade partners. The transition period is the period when they should grow and develop the fastest. Unfortunately, the countries' Human Development Indices (HDI) are the lowest in Europe. The only EU countries with similar institutional performance are Romania and Bulgaria. The transition countries demonstrate that there can be growth without development, but not vice versa.

Low labour costs are the WB's main advantage because over 50% of the region's manufactured goods are classified as labour and resource-intensive (Sanfey et al., 2018, p. 25). The average wage in the transition countries in 2016 (the latest data available) was only 16% of the EU average. The level of productivity in the transition countries, however, is only 32% of the EU average (International Labour Organization, 2024). Productivity growth has been undermined by weak labour reallocation from less to more productive sectors, as well as by decline in within-sector productivity growth (OECD, 2021).

The business environment remains challenging due to corruption, weak and uncertain contract enforcement, lengthy and costly procedures for obtaining licenses and permits, and unfair competition from the informal sector, among others (OECD, 2021). The Business Freedom index, which comprises factors that impact starting a business, such as the number of procedures and the cost, indicates that North Macedonia and Serbia perform better than Bulgaria, Croatia, Slovakia, Romania, and Greece. At the same time, as indicated in Table 4, the control of corruption did not

affect growth. The analysed countries are the most corrupt countries in Europe; in the EU, only Bulgaria is more corrupt than Montenegro, the best performing transition country, while BiH is the most corrupt in the group (World Bank, 2024). Infrastructure gaps further undermine competitiveness, investment – particularly export-oriented FDI – and integration into global value chains (Schwab, 2019). The quality of road infrastructure is among the worst in Europe, with only a few EU member states having similar or worse quality roads than the transition countries (Schwab, 2019). These factors all hamper the transition and convergence processes.

Conclusion

This paper analyses the reasons why the current transition countries have lagged on their path towards EU membership and the role of institutions in the process between 2004 and 2022 by applying three sets of theories – convergence, integration maturity, and institutional economics.

The empirical results suggest that EU candidates exhibited tended to convergence with the EU Member States during the analysed periods, except during the stagflation period. However, the extent and sustainability of this convergence appear to depend on underlying structural factors, as reflected in the fact that conditional convergence is faster than absolute convergence. While the economic variables included in the models affect convergence, that is not the case with the institutional variable, as the control of corruption was not statistically significant. However, as shown in the qualitative analysis, this does not mean that corruption is unproblematic. Rather, it indicates that institutions were not sufficiently efficient. The effects of other variables, although positive, were low. Therefore, the hypothesis that the institutions have not had a sufficient impact on convergence of the transition countries towards the EU cannot be rejected.

Future research can adopt the following steps. First, convergence models can be estimated using panel data to overcome some of the limitations of cross-sectional analysis. Building on this, although dividing the analysed period into several sub-periods is common, a single convergence model that incorporates time dummy variables can be estimated to capture economic shocks. Finally, as post-2022 data become available, the full extent of the economic downturn caused by the COVID-19 pandemic and the war in Ukraine will become clearer. Therefore, it will be valuable to assess how these shocks affected convergence of transition countries toward the EU.

This research shows that the current transition countries did not seize the "advantage of backwardness" to develop their economic potential and catch up with the more advanced neighbours in Europe. Despite making progress in macroeconomic stability, and having access to foreign finance, these countries are unprepared and immature for EU integration. The main reason is the lack of progress in building efficient institutions. Without efficient institutions, transition countries

struggle to attract FDI, modernize their economies, develop sectors with high growth potential, and become diversified, competitive, functioning market economies. Most of all, they grow slowly and do not converge. At this pace, they will remain far behind and will not complete the transition process anytime soon.

EU membership is not a right, but a privilege, and the current EU candidate countries are not mature for integration. It should be in their own interest to conduct reforms, with or without EU membership. They should focus on strengthening institutions through anti-corruption measures and protecting property rights; promoting economic diversification by supporting development of not only services, but sectors with high growth potential; building infrastructure that will facilitate trade and connectivity; and facilitating integration with the EU market by adopting EU standards and regulations. Such policies will address institutional weaknesses and create a better business environment, thereby attracting FDI. Only this will unlock the transition countries' full potential and accelerate their EU accession process.

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