

# THE EFFECTS OF ECONOMIC CRISIS IN THE WESTERN BALKAN COUNTRIES

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**Abstract**—The end of the first decade of the twenty-first century will be remembered by appearance of one of the greatest economic crisis. This time, it had a global character. The crisis has been appeared, almost unexpectedly, in the middle of 2007 in the US, but very soon it was transferred to other countries in the world as well. Very likely, it will last durably, with wide devastating consequences.

Balkan economies are more or less in crisis for more than two decades. The current economic crisis has made the existing unfavorable situation more complex and deepened the present imbalances and risks. The reform processes that have been carried out during this period did not achieve expected results, due to various circumstances, so the Western Balkans remained the least developed part of Europe.

**Keywords**—economic crisis, the Western Balkans countries, the effects of the crisis, the recovery possibility.

## I. INTRODUCTION

At the beginning of the nineties of the previous century the countries emerged from the breakdown of former Yugoslavia had a more favorable business environment in relation to the countries of Central and Eastern Europe. The occurred changes have enabled higher degree of economic freedom of economic entities, and the affirmation of the market and free market economy. Only in Albania existed planned and guided system of economic management, parallel with socialistic structure (1).

But collapse of the former Yugoslavia and the consequences arisen from it - inter-ethnic armed conflict, UN sanctions, boundary disputes, NATO aggression and so on, led to the downturn of the emerged economies, bringing them a few steps backward. The economic activity suddenly declined, many companies have bankrupt, a large number of employees have lost their jobs, and parallel with increasing macroeconomic instability, the poverty of citizens has been increased. The undeveloped state institutions were occupied with issues related to breakdown of the former Yugoslavia more than with the current state of the economy.

But, even in such circumstances, some measures and actions were carried out in order to reform the economic

and social system. The most of them were short-term measures aimed to maintaining of the satisfactory macroeconomic stability and, hence, the sustainable development.

Western Balkans has started the deep reforms after 2000, lagging behind the other transition countries (2). They implemented neoliberal transition model, imposed by the International Monetary Fund and the World Bank, which is based on the postulations of the so-called Washington consensus such as liberalization of markets, prices and foreign trade, rapid privatization, macroeconomic stability and deregulation of economic flows. Although this model is applied in many CEE countries, due to the situation and circumstances in the Western Balkans it was less successful in this region, manifesting numerous weaknesses (3). Without taking into account the existing specifics, it had, according to J. Stiglic, a serious "system error" and greatly contributed to emergence of many disturbances and imbalances, primarily in the economic sphere. After all, it is one of the reasons why the expected effects of transition were absent and why the economies of these countries are now in a far worse position with respect to the CEE transition countries (4).

Observed by country, the reform processes have been carried out with different intensity. The greatest progress was made in Croatia, which becomes a member of the European Union this year (2013). Montenegro and Macedonia have greatly improved their business environments, while some visible improvement has been achieved in Serbia, Albania and even in Bosnia and Herzegovina. Precisely, the reform processes and achieved political stability have enabled the revival of economic activities in the Western Balkans countries. But, this trend was stopped with the emergence of the global crisis. New instabilities and disorders with severe consequences emerged from it.

## II. DIMENSIONS AND CONSEQUENCES OF ECONOMIC CRISIS

Underdeveloped and vulnerable Balkan economies manifested many weaknesses due to global economic crisis (5). The economic activity was slowed rapidly, unemployment was increased, external and internal

imbalance was worsened, indebtedness was increased, inflow of foreign direct investment was slowed and standard of living was reduced. All of this will be discussed more detailed in this paper.

### 1.1. Slowed down economic activity

The best way to observe the effects of the economic crisis is monitoring the economic activities (6). There is a decline or slowdown in economic growth. The gross domestic product (GDP) is often used as an indicator of economic activities.

The Western Balkan countries had solid GDP growth in the pre-crisis period. In 2007 it ranged between five and six percent, and in Montenegro even more than ten percent.

Table 1 - Real GDP growth rates (in%) [14]

Country	2007	2008	2009	2010	2011
Montenegro	10.70	6.90	-5.70	2.50	2.80
Croatia	5.06	2.08	-6.95	-1.41	-0.01
Macedonia	6.15	4.95	-0.92	2.90	3.11
Serbia	5.40	3.80	-3.50	1.00	1.60
Albania	5.90	7.50	3.30	3.70	3.00
Bosnia and Herzegovina	6.12	5.58	-2.91	0.72	1.26

The adverse effects of crisis were already visible in the following (2008) year. All observed countries, except Albania, experienced the stagnation of economic activity and perceptible decline in the GDP. But, that was just the beginning of the crisis period, because in the next year the crisis manifested in the even more severe form. Economic growth rates were negative - in Croatia 6.95%, in Montenegro 5.70%, in Serbia 3.50% and in Macedonia it was the lowest amounting 0.92%. Since 2010 there was the period of slow recovery in economic activity.

The crisis consequences were mostly manifested in the largest economies, Croatia and Serbia. Albania is the only Balkan country that did not have a negative growth of GDP, although the economic stagnation is present there as well. It is not due to an increase in economic activity, but to the low starting position, or, in other words, the low level of economic development in previous period.

A similar situation is when GDP per capita is used as an indicator of the development level. And there is also the decline of this indicator in 2009.

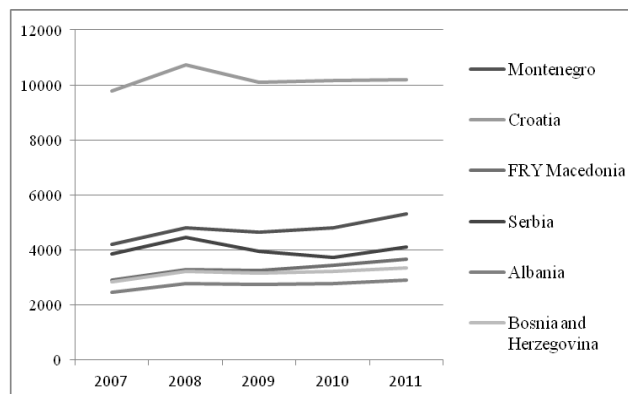


Fig. 1: GDP per capita (in EUR) [14]

The Western Balkan countries have very low GDP per capita. In this regard, they are well behind other CEE transition countries in transition. Only Croatia, with a GDP per capita amounting over 10,000 euro, is far ahead of other countries from this region and it has even caught up with some present members of the European Union.

In addition, these countries also have a rather low competitiveness of their economies. Such situation is present during the long period.

Table 2 – The ranking of the Western Balkans by competitiveness of their economies in 2007 and 2011 [14]

Country	Ranking position	
	2007.	2011.
Montenegro	82	60
Croatia	57	76
Macedonia	94	79
Serbia	91	95
Albania	109	78
Bosnia and Herzegovina	106	100

The best ranked is Montenegro, which occupied the 60 position (out of 142 countries) in 2011, and in the last five years it has moved up 22 places. Albania, Macedonia and Bosnia and Herzegovina have also progressed. Only Croatia and Serbia have worsened their positions in the observed period, the first mentioned from 57th to 76th, and the second mentioned from 91st to 95th position according to World economic forum.

### 1.2. Unemployment

Increase of unemployment is a constant companion of economic crises. Reduced economic activity, underutilized capacity and bankruptcy of numerous businesses entities, lead to the occurrence of redundancy and dismissal of employees. Otherwise, unemployment has become a global problem, which is present even in the most developed countries (8).

In the Balkans, the unemployment problem is

particularly evident since the nineties of the last century, with the emergence of political and economic crisis. In addition, the situation was further worsened by the transition processes, particularly privatization of social and public capital.

**Table 2: Unemployment rate (%)**[14]

Name of country	2007	2008	2009	2010	2011
Montenegro	19.30	16.80	19.10	19.70	19.70
Croatia	9.60	8.40	9.10	11.80	13.50
Macedonia	34.90	33.80	32.20	32.00	31.40
Serbia	18.27	13.63	16.34	19.18	22.95
Albania	13.50	13.00	13.80	13.51	13.32
Bosnia and Herzegovina	29.00	23.40	24.10	27.20	28.00

Although the situation has been improved in a certain sense, Macedonia has high unemployment, among the highest in Europe, over 30%. In Bosnia and Herzegovina the number of unemployed has been increasing steadily in recent years (28%). Also, this problem is more pronounced in Croatia, and especially in Serbia, where nearly 23% of the active population is not working. In Montenegro, this rate amount about 20% and in Albania 13%.

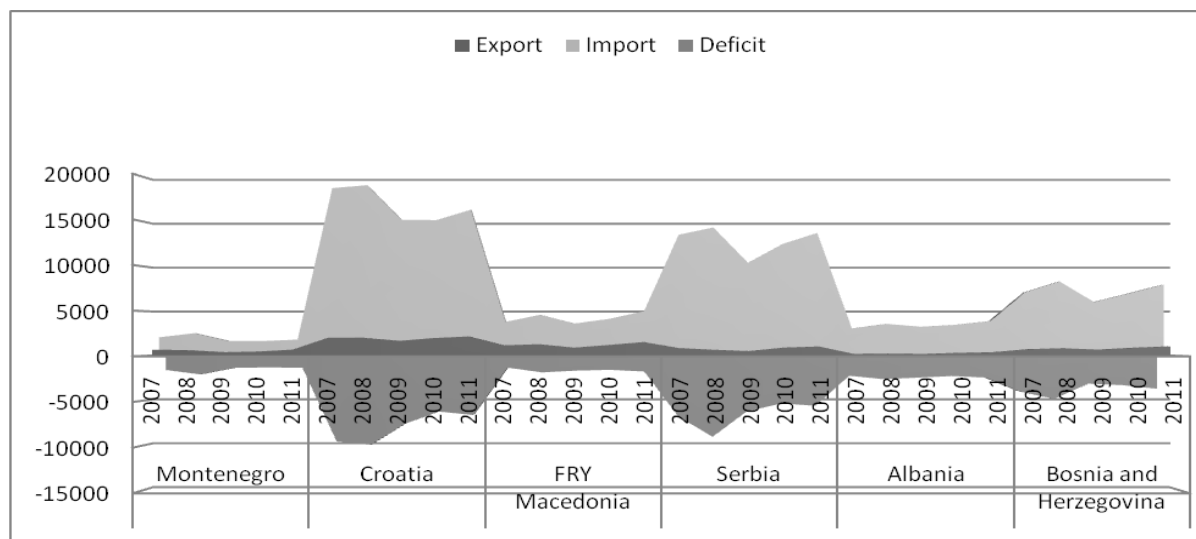
In the structure of unemployed a there is a significant share of young people, that are expecting their first job after the graduation. The situation would be even worse if a large number of citizens from these countries did not seek job abroad. According to "brain drain", the Balkan region has an infamous record. In this respect, Albania is 32nd, Croatia is 17th, Macedonia is 13th, Serbia is 4th and Bosnia and Herzegovina is on 2nd position according to World Economic Forum ranking of 193 observed countries. There is also significant number of people with lengthy tenures that have lost their jobs because of the transition process.

Unemployment is a major challenge for the Western Balkan countries. It is unrealistic to expect any significant progress in this field in a short run. The domestic savings rate is low, inflows of foreign direct investment are low, and thus the ability of creating new jobs is limited. Moreover, the situation could be worsen due to the privatization of the public sector and solving the final status of enterprises that are in the process of restructuring, because many people will lose their job because of the redundancy and the declaration of bankruptcy. In addition, it should be expected the return of a rather large number of migrant workers in developed countries, particularly from Western Europe, who has lost their jobs due to the economic crisis.

### 1.3. External and internal imbalance

Imbalances, external and internal, are "chronic diseases" of modern economies. Almost there is no country that does not face with the current account deficit, in foreign trade relations, or with the budget deficit. The implications of this are numerous, negative and they are manifested primarily in the area of macroeconomic stability.

Balkan countries consistently have deficit of the trade balance. Since 2000, due to increased economic expansion, the deficit has increased, and then, after the emergence of the crisis (in 2009), it has declined rapidly, mainly due to lower imports. The largest economies, Croatia and Serbia have the highest foreign trade deficit.



**Fig. 2: Foreign trade in the period of 2007-2011** [14]

Insufficient export is the main reason for high trade deficit. The Western Balkan countries have not developed the production of tradable goods, which would be placed in foreign market. This particularly refers to industry, whose recovery has been slow and difficult (9). The exports of agricultural products have a solid share in total export, although it fluctuates yearly depending on the fertility. In some countries significant contribution to increased exports has service sector – like in Croatia, Montenegro and Albania.

The evidence that the situation is alarming, in respect to exports of goods and services in this region, is the data on exports per capita. Croatia has the highest export per capita, and, in turn, Albania and Montenegro have the lowest export per capita.

**Table 3:** Trend of export per capita in Western Balkans [14]

Country	2007	2008	2009	2010	2011
Montenegro	713	650	433	512	733
Croatia	2030	2022	1683	1997	2177
Macedonia	1196	1316	938	1234	1551
Serbia	896	702	559	942	1065
Albania	249	289	244	364	434
Bosnia and Herzegovina	774	873	726	930	1080

Also, export/import ratio is low. In recent years, the state is getting better, with the exception of Albania. Albania and Montenegro have the lowest export/import rate, while other countries are in somewhat the better position.

Along with the trade deficit, the Western Balkan countries also face with balance of payments deficit. Until the emergence of the economic crisis, it has had a dynamic growth.

**Table 4:** The share of the current account deficit in GDP [16]

Country	2007	2008	2009	2010	2011
Montenegro	-29.4	-50.7	-29.6	-24.6	-19.5
Croatia	-7.6	-9.2	-5.1	-1.1	-1.0
Macedonia	-7.6	-12.8	-6.8	-2.1	-2.7
Serbia	-15.7	-17.9	-7.1	-7.4	-9.5
Albania	-10.7	-15.4	-14.0	-11.4	-12.3
Bosnia and Herzegovina	-9.3	-13.3	-6.3	-5.7	-8.8

Since 2009 the deficit of payment balance current account deficit has been decreasing, but it is still high, except in Croatia and Macedonia. Montenegro, Albania and Serbia had the highest deficit. The deficit was covered by cash inflows from the sale of the companies to foreigners, green-field, brown-field and port investments and foreign loans.

Also, Balkan countries have been facing with an internal imbalance, in terms of the budget deficit. This is especially evident with the emergence of the economic crisis.

**Table 5:** Budget deficit (% share of GDP) [14]

Name of country	2007	2008	2009	2010	2011
Montenegro	6.650	-3.271	-5.677	-4.867	-6.490
Croatia	-2.118	-1.308	-4.153	-5.059	-5.174
Macedonia	0.590	-0.926	-2.653	-2.429	-2.478
Serbia	-1.356	-1.973	-3.716	-3.702	-4.201
Albania	-3.282	-5.131	-7.414	-4.190	-3.468
Bosnia and Herzegovina	0.175	-3.675	-5.896	-3.910	-3.089

Three out of six observed countries had a budget surplus in 2007 - Montenegro, Macedonia and Bosnia and Herzegovina. The very next year the deficit is present in all observed countries, due to the crisis and insufficient inflow of budget revenues, and in the majority of them it had a tendency of constant growth. In 2001, Montenegro had the most pronounced budget deficit and, in turn, in 2007 it had a surplus, amounting even 6.650%. Croatia and Serbia have increased the deficit for several times.

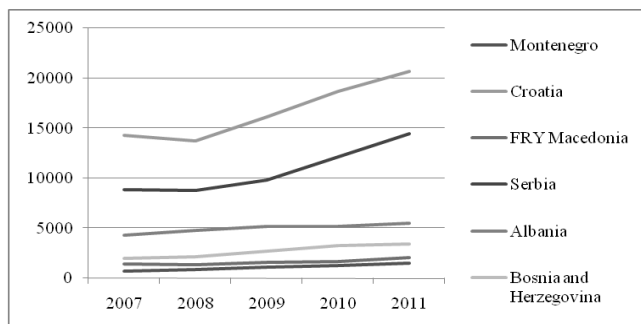
Western Balkan countries have made a little progress to reform the public sector. There are still a large number of employees in public administration at all levels, and also there are significant expenditures for pensions and various social benefits. Precisely, high public spending is a constant threat to the macroeconomic stability of these countries.

#### 1.4. Indebtedness

Indebtedness is a global problem today. The state, companies, individuals are in debt. It is estimated that the total global debt amounts more than 55,000 billion dollars, which is about 140% of the world gross domestic product. Moreover, it is increasing at a rate of 6 to 8% per year, four times faster than the growth of gross national product (10). Many countries are in the category of highly indebted, and some of them are even on the brink of bankruptcy.

In addition to the low level of development, Western Balkan countries are faced with high indebtedness. The total amount of external debt in Croatia (94.9%) and in Montenegro (94.6%) in 2011 approached the achieved level of GDP. In somewhat more favorable position is Serbia (84.9%), but it also passed the limit of high indebtedness. Mentioned countries are followed by Macedonia (65.0%), Bosnia and Herzegovina (46.5%) and finally, the least indebted Balkan country is Albania (33.7%).

In addition to the total debt, the Balkan countries have quite high public debt as well. This is particularly evident since 2008, with the emergence of the global economic crisis.



**Fig. 3:** Trend of public debt [14]

The leading economies have the highest debt. At the end of 2011, public debt of Croatia is 20,712 million euro, and it is higher than five years ago for 45%. Serbia also increased its indebtedness by even 63% in this period, and now (2011) it amounts to 14,467 million euro. Albania also has a high debt, amounting 5,534 million euro.

The best insight in Balkan countries high indebtedness is provided by data on the share of their public debt in GDP. The situation has been worsening from year to year.

**Table 6:** The share of public debt in GDP (in %) [14]

Country	2007	2008	2009	2010	2011
Montenegro	27.50	29.00	38.25	40.94	45.20
Croatia	32.90	28.90	35.98	41.64	46.11
Macedonia	23.97	20.64	23.83	24.24	28.60
Serbia	31.17	26.87	34.02	43.47	46.45
Albania	54.78	53.82	59.50	58.50	58.90
Bosnia and Herzegovina	18.14	17.13	21.76	25.58	26.09

Public debt in Albania has been approaching 60% of GDP, and the countries with high public debt are also Serbia with 46.45%, Croatia 46.11% and Montenegro 45.20% of GDP. Two other Balkan countries have lower debt - Bosnia and Herzegovina 26.09% and Macedonia 28.60%.

The dark picture of indebtedness of the Western Balkan countries is completed by taking into account the public debt/export ratio.

**Table 7:** Public debt/export ratio in 2011 [14]

Country	Public debt/export ratio (in%)
Montenegro	327,5
Croatia	216,2
Macedonia	65,4
Serbia	179,5
Albania	395,3
Bosnia and Herzegovina	80,9

Nowadays, indebtedness is the major problem of the countries of the Western Balkans. Given that the budget deficit is growing, it is reasonable to expect further

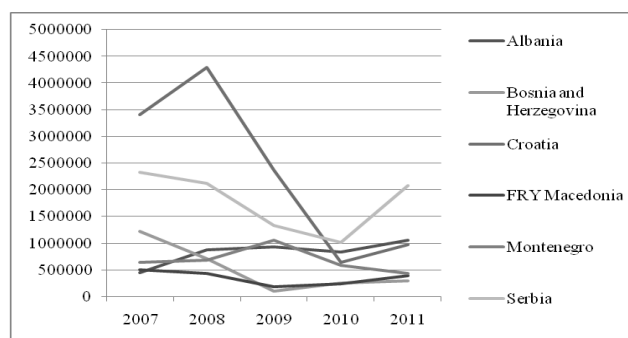
deterioration in this area. This will further make more complex the already difficult government debt servicing.

### 1.5. Foreign direct investment

Due to the poor state of their economies, the Balkan countries expect from foreign direct investments to make a special contribution to the exit from the current economic crisis (11). They should contribute to the revitalization of production, especially in industry and agriculture, reduction of unemployment and long-term sustainable development.

Considered as a whole, investments in the Western Balkan countries were insufficient. In the period 2007 – 2011 the total net inflow of foreign direct investment amounted to about 32.5 billion euro. The economic crisis has affected the further decline of already insufficient investment.

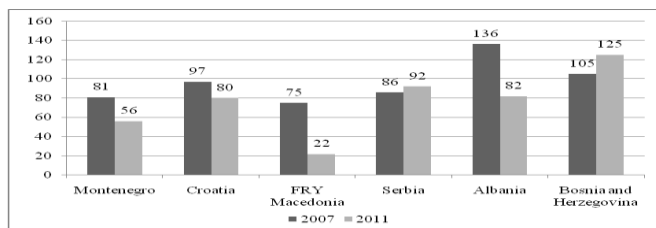
In the observed period, the most was invested in Croatia, nearly 12 billion euro, or 36% of total foreign direct investment in this area. Then comes Serbia with 8.9 billion or 27% of total investment in this region. Only in these two countries constitute 63% of total investment in the Western Balkans. The lowest foreign direct investments inflow had Macedonia and Bosnia and Herzegovina. Given the level of economic development Albania has a solid amount of foreign direct investment, which amounted more than 4 billion euro.



**Fig. 4:** Net inflow of foreign direct investment

In addition to lack of investment, the investment patterns are quite different from the countries of Central and Eastern Europe. Approximately 2/3 of investment in the Balkan countries has been invested in the sectors such as banks, telecommunications, real estate, trade. Therefore, those are the sectors which do not produce tradable goods and therefore do not contribute to the increase in exports.

The causes of insufficient foreign direct investment inflow should be sought in the presence of numerous risks, primarily of political and economic nature. The Western Balkan countries have not yet created a favorable business environment to attract foreign direct investment. In this respect they are very poorly rated.



**Fig. 5:** Ranking of the Western Balkans countries according to the business environment [17]

Macedonia has made the greatest progress, given that it was ranked at 22<sup>nd</sup> position in 2011. In this regard, it is far ahead of many countries in the European Union - Bulgaria, Poland, Czech Republic, Romania. Albania has greatly improved its business environment from 136<sup>th</sup> to 82<sup>nd</sup> position, and it is followed by Montenegro at 56<sup>th</sup> and Croatia at 80<sup>th</sup> position. Only Serbia and particularly Bosnia and Herzegovina worsened their business environment. In 2011 Bosnia and Herzegovina was ranked at 125<sup>th</sup> position out of 183 observed countries.

### 1.6. Living standard of population

The long lasting economic crisis has had a significant impact on the living standards of citizens in observed Balkan countries. There has come to a drastic reduction in the already low incomes. The downfall began in the nineties, with the collapse of the former Yugoslavia. Certain recovery registered after 2000 did not significantly contribute to improving the general welfare of the people. Today, Western Balkan is the region with the lowest standard of living in Europe.

The salaries are extremely low. In somewhat more favorable position is Croatia, although it lags behind many in transition countries in CEE.

**Table 8:** Paid salaries in March 2011 (in EUR) [10]

Country	Amount
Montenegro	484
Croatia	755
Macedonia	367
Serbia	357
Bosnia and Herzegovina	418

Differences in salaries are present among the Balkan countries themselves as well. Croatia has twice as high salaries in relation to Serbia and Macedonia.

The pensioners are in even more unfavorable position. The pensions are low, so the numerous of them are living on the poverty threshold. But even for such low incomes the funds are hard to be provided.

In addition, there is a significant degree of social inequality (income inequality) in these countries. These inequalities have arisen since the nineties with the collapse of socialism and the transition to a capitalist (market) way of doing business. It is also shown by Gini

coefficient, named after the author Corrado Gini, which measures the extent to which the distribution of income or consumption among individuals or households in the economy deviates from a perfectly equal distribution.

In addition, the percentage of zero indicates perfect equality, all the values are the same, and hundred percent indicates the highest inequality between values. Regarding the Balkan countries, Gini coefficients have different values.

**Table 9:** State of inequality in society according to Gini coefficient [17]

Country	Gini coefficient (in %)	Year
Montenegro	24,3	2010
Croatia	32,0	2010
Macedonia	44,2	2008
Serbia	28,2	2008
Albania	34,5	2008
Bosnia and Herzegovina	36,2	2007

Although the observation year is different, Macedonia and Bosnia and Herzegovina have the highest social inequalities and the lowest inequalities are in Montenegro and Serbia. At the European Union level Gini coefficient amounted to 30.7% in 2011.

Finally, as an important indicator of the living standard is the state of poverty in the society. The consequences of a long crisis in this area are visibly pronounced. Living existence of a large part of the population is threatened; a considerable number of people are living below the poverty threshold.

**Table 10:** Population below poverty threshold [18]

Country	Population below the poverty threshold (in %)	Year
Montenegro	6.6	2010
Croatia	20.6	2010
Macedonia	30.9	2010
Serbia	9.2	2010
Albania	12.5	2008
Bosnia and Herzegovina	18.6	2007

About one third of Macedonians live below the poverty threshold, while in Croatia quintile of population live below the poverty threshold. Montenegro (6.6%) and Serbia (9.2%) are in more favorable position, but in Serbia in absolute terms the large number of population live below poverty threshold, about two hundred thousand.

### III. CONCLUSION

Global crisis has worsened already complex economic reality of the Balkan countries. The crisis recession has emerged. The consequences are the most pronounced in the leading economies, Croatia and Serbia.

Underdeveloped, lagging and exhausted by long

crisis, the economies of these countries have experienced a new decline. The former solid economic growth has been stopped, business environment exacerbated, the economy competitiveness reduced. Under such circumstances, but also due to the global crisis, foreign direct investment inflow was very low, which, with modest domestic accumulation, did not provide any radical changes in the field of new employment. In addition, the standard of living is alarmingly low, with a tendency of constantly poverty increasing.

Today, the Western Balkan countries tend to achieving two basic goals – achieving sustained political stability and finding exit from crisis with the sustainable economic growth. In fact, certain countries even after twenty years since the breakup of the former Yugoslavia have not been able to overcome some of the open questions of a political nature - the status of Kosovo and Metohia in Serbia, interethnic relations in Macedonia, Bosnia and Herzegovina and Croatia. Their solution would reduce the political risk and that would enable conditions for economic stability and prosperous development.

At the same time, all the Balkan countries are implementing the intensive transitional reform processes. They are aimed to build a new model of economic growth that should enable exit from the current crisis. The orientation is on the higher production of tradable goods, primarily by re-industrialization, increasing export and reduction of the high public spending. This would lead, along with the employment increase, to significant reduction of the present imbalances, indebtedness, and improvement of general welfare of the people.

Time series of economies of Balkans countries can be modeled using polynomial regression models according to the methodology presented in the papers [19-20].

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