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The Integration of Western Balkan Industries into the EU Internal Market

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## **The Integration of Western Balkan Industries into the EU Internal Market: Recent Trends in the Trade of Manufactured Goods**

Aleksandra Branković, Elena Jovičić

### **Abstract**

*The EU accession process of the Western Balkan countries has been accompanied by a major increase in commodity trade with the EU Member States. Consequently, the EU has become the most important trading partner of the Western Balkan countries, but exports from the Western Balkans have been mainly based on low value-added products (resource- and labor-intensive ones). This chapter sets out to analyze changes in the dynamics and pattern of trade in products of the manufacturing industry between the Western Balkan region and the EU over the past couple of years. Particular attention has been paid to changes that occurred in the wake of the recent global economic crisis. For the purpose of analysis, the data on commodity trade provided by Eurostat has been used. Based on the results of this analysis, we have concluded that the region, as a whole, continues to specialize in the export of labor-intensive products, such as garments and footwear, and resource-intensive products, such as metals and wood. When more sophisticated goods, such as machinery and transport equipment, are considered, an increase in the volume of exports, as well as their share, can be observed. It also seems that some of the countries are specializing in the production and export of certain types of machinery and transport equipment, but we could not observe a common regional pattern.*

*Keywords: export, import, manufacturing, Western Balkan, European Union, commodity trade.*

## 1. Introduction

The trade performance of the Western Balkan countries has been discussed in only a small number of academic papers. The prevailing point of interest has been the region's underperformance in respect to its export potential, and a subsequent failure to contribute more substantially to the growth of GDP. The 2008 World Bank study not only found that in most of the Western Balkan countries exports did not sufficiently contribute to growth, but actually identified commodity exports as "*the weak link in growth*" (Kathuria, 2008, p. 4). Dealing with the broader region (South-Eastern Europe), this World Bank study draws conclusions that are applicable in the case of individual Western Balkan countries. It shows that the pattern of trade was not favorable, since the composition of commodity exports, heavily reliant upon unskilled-labor and natural-resource-intensive products, makes exports vulnerable to low-cost competition from other countries (Kathuria, 2008, p. 26). A subsequent World Bank study from 2010 also tackles the trade performance of the Western Balkan countries, but focuses on intra-regional trade within CEFTA 2006 (Handijski, Lucas, Martin, & Guerin, 2010).

Trade relations with the European Union (EU) are of the utmost importance for the Western Balkan countries, who all aspire to become full members of the European Union. Interestingly, literature on trade relations between the two has not been abundant, particularly in recent years. An EU Commission report from 2008 (Jakubiak & Oruc, 2008) points to the magnitude of the Western Balkans' dependence on trade with the EU, but also reveals that this dependence has declined since the beginning of the 2000s. Such a high level of dependence has been observed as the main channel for the transmission of the global crisis to the Western Balkan markets (Bjelić, Jaćimović, & Tašić, 2013). As far as the general composition and dynamics of trade are observed, Botrić (2012) finds that they have not been satisfactory, since the pattern resembles the classical South-North trade pattern. She also analyses trade with the old and new EU Member States separately, and concludes that Western Balkan trade with the old member states is larger, and includes a more diverse and more complex product composition. Mardas and Nikas (2008) deal with intra-industry trade between the Western Balkans and the EU, and find that it remains to be at low levels.

Obviously, the trade performance of the Western Balkan countries has not been satisfactory so far. The structure of exports, dependent mainly upon low value-added products, has been particularly problematic. At the same

time, their capacity to produce and export more sophisticated goods has been constrained by the fact that they underwent a process of deindustrialization during the 1990s (Estrin & Uvalic, 2014). However, since the beginning of the 2000s a modest recovery of industrial production, as well as the introduction of autonomous trade preferences by the EU, established a framework in which qualitative changes in the composition of the region's manufactured exports could have taken place. But, according to our knowledge, there are no papers that have specifically focused on trade in manufactured goods between the Western Balkan region and the EU. We therefore intend to fill this gap and analyze the main tendencies over the previous couple of years.

The paper is organized as follows. Firstly, a brief overview of the methodology is given. Then, the main tendencies in commodity trade between the Western Balkan countries and the EU will be analyzed. Afterwards, the paper focuses on the analysis of mutual trade in manufactured goods. For that purpose, an overview of the main tendencies in industrial and manufacturing production in the Western Balkan countries is presented, followed by an overview of developments concerning trade in manufactured goods. Subsequently, an in-depth analysis of the composition of manufactured exports from the Western Balkan region to the EU is given, encompassing the analysis of the most important commodities, as well as the composition of exports by individual Western Balkan countries. Finally, a summary of the main conclusions is provided.

## **2. Methodology**

In this paper we analyze the main characteristics of trade in manufactured goods between the Western Balkan region and the EU, and in particular exports from the Western Balkans. The Western Balkan region is comprised of Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia and Kosovo. Throughout the article, unless otherwise noted, the term EU refers to the Union comprised of 27 Member States, except for 2001, when the term referred to 15 Member States. The period from 2001 to 2012 is observed, although on several occasions references to 2013 are made.

Data on trade in manufactured goods have been collected from the Eurostat on-line database. Firstly, data on commodity exports and imports by the Standard International Trade Classification (SITC) were collected; and then the Correspondence tables from the Eurostat's Metadata Server were used in

order to single out the SITC groups that refer to the products of manufacturing industry. In order to make comparisons over time, we deflated data using the Harmonized Index of Consumer Prices (HICP) for the Euro area. Therefore, all growth rates and indices refer to real changes over time. The following databases provided by the Eurostat's online Statistics Database have been used: *DS\_018995*, *cpc\_etsitc*, *cpc\_insts*, *sts\_inpr\_a* and *prc\_hicp\_aind*.

### **3. An Overview of Trends in Commodity Trade between the Western Balkans and the EU**

The relative stabilization of the economic and political situation in the Western Balkan region since the beginning of the 2000s, along with the launch of the Stabilization and Association Process (SAP) with the EU, and in particular the granting of autonomous trade preferences, significantly contributed to the intensification of mutual trade (see Handijski et al., 2010). The value of commodity exports from the Western Balkan region to the EU27 increased more than twofold (in real terms) in 2012 in relation to 2001, while imports increased by more than 1.5 times. The EU has become the major trading partner of the Western Balkan countries, constituting around 60% of the region's commodity trade.

However, trade flows have been adversely affected by the global economic downturn in 2008. While before 2007 both exports and imports grew, on average, by around two-digit rates annually, since 2008 one can observe only a mild increase in exports from the Western Balkan countries, while imports to the region have declined (refer to Table 1).

Similar results can be observed in Figure 1. During the 2007-2012 period commodity exports increased by the modest rate of 9%, while imports decreased by 5%. As a consequence, the value of the Western Balkan deficit in trade with the EU also decreased, but nevertheless remained relatively high, only slightly lower than the value of exports.

The composition of commodity trade between the Western Balkans and the EU has been dominated by manufactured goods (Table 2). Their share in the values of Western Balkan commodity exports and imports has stood at around 90%. However, a recent decrease in the share of manufactured goods in commodity exports can be observed, while their share in commodity imports has been more stable. According to preliminary data for 2013, these tendencies remain, since the share of manufactured goods in Western Balkan

exports to the EU27 remained unchanged in relation to 2012, while the share in imports increased by 1 percentage point.

Such tendencies stand for most of the individual Western Balkan countries as well. Namely, since 2007 a decrease in the share of manufactured exports can be observed for all of the countries, with the exception of Bosnia and Herzegovina, in which case the share has been stable and at relatively high levels (92-94%). Albania is an outsider; the declining share of manufactured goods in the total value of exports to the EU has been so prominent since 2001, that the corresponding share in 2012 stood at only 60%. As for imports, the manufactured products have constituted over 90% of imports from the EU throughout the Western Balkan region, most notably in the case of Montenegro (with a share of 97% in 2012).

#### **4. Tendencies in Trade in Manufactured Goods between the Western Balkans and the EU**

##### **4.1 Overview of the Industrial Production in the Western Balkan Countries**

After a period of decline during the 1990s, a modest recovery of industrial production can be observed between 2001 and 2008. As can be seen from Figure 2, during the observed period the index of industrial production in most of the Western Balkan countries has generally been increasing. The highest growth rates were recorded in the cases of Albania and Bosnia and Herzegovina, and the lowest ones in the cases of Serbia and Montenegro. Due to the lack of comprehensive data for all of the countries, it is not possible to analyze the performance of the manufacturing industry of the whole region prior to the global economic crisis; nevertheless, available data suggest that, along with industrial production, positive tendencies were recorded in the case of manufacturing as well.

But the modest recovery of industrial production and manufacturing in most of the Western Balkan countries was jeopardized by the beginning of the global economic crisis, so that in 2009 the indicators of industrial production recorded a drastic decline. Serbia was most severely affected by the crisis, since indicators for both industrial production and manufacturing recorded the largest declines. However the smallest decrease was recorded in the case of Bosnia and Herzegovina. Albania is the exception, because after the occurrence of the crisis it even recorded an increase in the industrial

production index (however, one should bear in mind that such an enormous change in the index is actually the result of the low base effect). As of 2010, a modest recovery in manufacturing production occurred in Macedonia, Bosnia and Herzegovina and Serbia, while in the cases of Croatia and Montenegro a continuous decline in the value of the index has been recorded (Fig. 3).

#### **4.2 Trade in Manufactured Goods Prior to the Global Economic Crisis**

Due to unfavorable developments during the 1990s, the Western Balkan export of manufactured goods to the EU at the beginning of the 2000s relied primarily on low technology products. Garments and footwear, the main products exported from the Western Balkans to the EU, were almost entirely based on outward processing activities. This meant that the low-cost labor from the Western Balkans simply executed the finishing work, while the entire pre-production (including the production of textiles, and design) had already been carried out abroad. Other major product groups exported from the region included metals, furniture and wood (Fig. 4), which also happened to be low-tech products.

Another problem was that, besides being labor-intensive and low value-added, exports from the Western Balkans to the EU were highly concentrated on several product groups. For instance, in 2001 garments and footwear constituted as much as a third of the region's total manufactured exports to the EU (garments alone had a share of 24%) (Fig. 4).

The export performance of individual Western Balkan countries followed the regional pattern. Garments and footwear were among the most important products exported to the EU in all of them, and most notably in the case of Macedonia, since garments alone constituted as much as 45% of the value of manufactured exports to the EU. Other countries specialized in some other manufacturing as well. The major exporters of furniture were Bosnia and Hercegovina, Yugoslavia (in other words, present-day Serbia, Montenegro and Kosovo) and Croatia, Serbia and Montenegro also exported aluminum and copper; furthermore, Bosnia and Herzegovina exported wood, Yugoslavia dried mushrooms, frozen fruit and tires, Macedonia steel, and Croatia electrical devices.

As opposed to exports, the manufactured imports from the EU were more dispersed among different product groups. In 2001 the most important group was road vehicles, with a share of 9% in the value of manufactured imports from the EU; the total share of the machinery (SITC section 7) stood at

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32%. It is important to note that other major import products included textile fabrics and garments, which were used as inputs in outward processing activities; this additionally highlights the unfavorable export performance of the region at the time. All of the individual Western Balkan countries exhibited an import pattern similar to the one described above.

After 2001 one can observe that the structure of exports from the Western Balkan region to the EU started to change. Commodity exports became more dispersed across different product groups, and at the same time the Western Balkans were slightly less dependent upon outward processing activities. For instance, despite the fact that the exports of garments and footwear to the EU increased in real terms in 2007 in relation to 2001, their share in the value of total manufactured exports to the Union decreased by ten percentage points. Instead, steel became the major export product, constituting with other metal products more than a quarter of the region's manufactured exports to the EU. Serbia, Montenegro and Macedonia were the region's leading exporters of metals. In the case of the latter two, the export structure was so strongly biased towards metal products, that in 2007 they constituted as much as 94% of the total Montenegrin manufactured exports to the EU, while steel alone made up a half of the corresponding exports of Macedonia. Although less based on labor-intensive activities, such an export structure, driven by rising demand on the global market, was unfavorable and proved to be rather weak, since changes in global demand in the following years led to a sharp decrease in the exportation of steel. As far as the composition of manufactured imports from the EU is concerned, it did not change significantly between 2001 and 2007.

### **4.3 The Main Tendencies in the Trade in Manufactured Goods since the Outbreak of the Global Economic Crisis**

The occurrence of the global economic crisis in 2008 has had an adverse impact on trade flows between the Western Balkans and the EU. Commodity imports to the region decreased by 5% in 2012 in relation to 2007, and exports increased by 9%, but this was negligible in relation to the overall increase of 89% recorded between 2001 and 2007. Unfavorable tendencies were even more pronounced in the case of manufactured goods. In 2012, in relation to the 2007 figures for exports from the Western Balkan countries to the EU, the figures increased by only 4%, while imports decreased by 7%. However, as is shown in Figure 5, after an initial drop (of nearly a quarter in

2009 in relation to 2008), manufactured exports seem to have managed to recover, while manufactured imports from the EU have stabilized, but at lower levels than those recorded before the crisis.

#### **4.3.1 Changes in the Composition of Manufactured Goods Exported from the Western Balkans**

The most notable changes in the composition of Western Balkan manufactured exports to the EU that took place between 2007 and 2012 include a declining share of goods classified by material and an increasing importance of machinery and transport equipment (Fig. 6). The occurrence of the global economic crisis had a short-term reverse impact, but the aforementioned tendency seems to have been re-established. Namely, due to the declining exports of steel, the share of goods classified by material increased in 2010 and 2011, but continued to decline afterwards; as far as machinery is concerned, a short-lived decrease in 2010 and 2011 was offset by the subsequent increase in exports of transport equipment, electrical equipment and certain industrial machinery. The three most important SITC sections – goods classified by material, machinery and miscellaneous goods - had a share of a quarter each in the value of Western Balkan manufactured exports to the EU in 2012.

The composition of the top five SITC divisions of manufactured goods exported from the Western Balkans to the EU did not change substantially over the 2007-2012 period. As presented in Table 3, this list includes the same product groups throughout the observed period. However, what did change is the relative importance of these product groups. At the beginning of the period, steel and non-ferrous metals (aluminum and copper) were among the top three product groups; however, their relative importance has subsequently declined. An interesting finding is that, in the wake of the global economic crisis, apparel and clothing re-emerged as the most important SITC division. As far as electrical appliances are concerned, their importance has been steadily increasing.

If we consider preliminary data for 2013, we can observe that road vehicles have become the top product group exported from the Western Balkan region to the EU. Thus, the composition of the top five product groups has changed, so it includes two groups of machinery and transport equipment (SITC section 7), while non-ferrous metals have dropped off the list. If these data prove to be valid, this could point to the conclusion that the composition



of manufactured exports from the Western Balkans to the EU has improved, and the relative importance of technology-intensive product groups has increased.

#### **4.3.2 The Composition of Manufactured Exports of Individual Western Balkan Countries**

Croatia and Serbia are the two main exporters of manufactured goods from the Western Balkans to the EU. Croatia has been the dominant exporter, but its share has generally been decreasing, while Serbia's share has been relatively stable (Fig. 7). These two countries together make up around two thirds of the total value of manufactured goods exported from the Western Balkan region to the EU. Bosnia and Herzegovina and Macedonia comprise another group of countries, with individual shares of around 15%; however, while Macedonian exports seem to have been negatively affected by the global economic crisis, Bosnia and Herzegovina's share has been on the increase since 2007. The contribution of the remaining Western Balkan countries has been less significant, and stands at around 7%.

We have also examined the changes in the shares of individual countries in the region's exports of manufactured goods classified by SITC divisions over the 2007 - 2012 period. The general tendency is that the shares of Croatia have been declining, while the relative importance of Serbia, and to a lesser extent of Bosnia and Herzegovina, has been on the increase.

In particular, in 2007 Croatia was the dominant exporter of manufactured goods to the EU (with a share exceeding 50%) in the case of 34 SITC divisions, while in 2012 it was true for 23 SITC divisions. Croatia's position relative to the other Western Balkan countries worsened especially in the case of machinery and transport equipment; for example, between 2007 and 2012 the share in the region's exports of road vehicles to the EU declined from 58% to 19%, and in the case of electrical machinery and appliances from 73% to 43%. However, product groups in which Croatia remains by far the most important exporter from the region include most of agrifood products; energy products; fertilizers, pharmaceuticals and various organic chemicals; leather products; cement and glassware; combines, civil-engineering machinery and machinery for working rubber or plastics; railway and aircraft equipment; and thermostats.

Serbia had over a 50% share in regional exports in the case of 10 SITC divisions in 2012, which was 2 more than it had been in 2007. Its share

particularly increased in the case of machinery and transport equipment, at the expense of Croatia's declining share. In 2012 Serbia was the region's principal exporter of frozen fruits and animal foodstuffs; synthetic rubber and plastics; car tires and copper; office machines, electric generators and road vehicles.

Bosnia and Herzegovina has had over a 50% share in the region's exports of crude manufactured goods, in particular hides, coal briquettes and coke, but during the 2007-2012 period it also became the dominant exporter of inorganic chemicals. Bosnia and Herzegovina is also the region's leading exporter of furniture and footwear to the EU, but with shares below 50%.

During the observed 5 year period Macedonia became the region's dominant exporter of catalysts to the EU, and it is also the leading exporter of steel products and garments. The remaining Western Balkan countries did not have a leading position in exports of any of the SITC divisions that include manufactured goods.

## **5. Conclusions**

The EU is the major trading partner of the Western Balkan countries, with the share of around 60% in the region's commodity trade. Manufactured goods prevail in mutual trade; they comprise over 90% of the region's commodity imports from the EU, while their share in the region's exports has been slightly lower (around 85% in 2012), and has declined over the recent period.

Given that industry in the Western Balkans was faced with massive problems during the 1990s, at the beginning of the 2000s the region was unable to offer sophisticated industrial products. Instead, manufactured exports to the EU were based upon unskilled-labor-intensive (garments and footwear) and resource-intensive products (metals, wood, furniture). As economic transition progressed, manufactured production started to modestly recover, but up until the mid-2000s no major changes occurred in the composition of the region's trade with the EU. The significant change was that metals (and in particular steel) became the most important articles of manufacturing industry exported to the EU, which was due to a growing demand in the global market.

The occurrence of the global economic crisis had a negative influence on trade with the EU in the Western Balkans. Particularly, since 2007 when imports of manufactured goods from the EU continued to decrease, while

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exports initially declined, but since 2009 a year-to-year growth was reestablished (with the exception of 2012, when decline was again recorded). We have observed that, due to the crisis and the declining exports of steel, the labor-intensive production (in particular garments) regained its relative importance, but it also seems that some other more sophisticated products managed to gain in importance. Namely, shares of certain machinery and transport equipment in the region's manufactured exports to the EU have been steadily increasing. This is in particular true for road vehicles, electrical devices, and industrial machinery, which have managed to become some of the top exported products from the Western Balkans. The tendency of the rising share of machinery and transport equipment seems to have continued in 2013 as well, as is suggested by preliminary data.

As far as some patterns of the region's specialization in the exports of manufactured goods to the EU are concerned, the analysis does not point to favorable conclusions. The fact that in all of the Western Balkan countries garments and footwear constitute a major part of trade with the EU, and that in most of them products such as metals and wood are also important, leads to the conclusion that the region continues to be specialized in the exports of unskilled-labor and resource-intensive products. When more sophisticated products, such as machinery and transport equipment, are considered, their exports to the EU, as well as their share in the value of the total manufactured exports to the EU, have increased over the previous couple of years. The highest shares in that regard have been recorded in the cases of Serbia and Croatia, which are the region's main exporters of machinery and transport equipment. However, despite the growing importance of such products in most of the Western Balkan countries, we cannot observe a common pattern for the region as a whole, since each country seems to be specializing in distinct types of production.

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### Tables and figures

Table 1.

Average annual growth rates (in real terms) of the Western Balkans' exports and imports with EU27, in %

	2001-2012	2001-2007	2008-2012
Exports	6.8	11.2	2.0
Imports	4.4	9.0	-3.5

Source: authors' calculations based on the Eurostat databases *DS-018995* and *prc\_hicp\_aind*.

Table 2.

Share of manufactured goods in total commodity trade between the Western Balkans and the EU

	2007	2008	2009	2010	2011	2012
Export	89%	91%	87%	86%	86%	85%
Import	94%	93%	93%	94%	92%	92%

Source: authors' calculations based on the Eurostat database *DS-018995*.

Table 3.

Shares of top five SITC divisions of manufactured goods exported from the Western Balkans to the EU, 2007-2012

2007		2008		2009		2010		2011		2012	
67	13%	67	13%	84	13%	84	11%	84	10%	84	10%
84	12%	84	12%	67	7%	67	10%	67	9%	77	8%
68	8%	68	7%	77	7%	77	8%	77	7%	68	6%
85	6%	77	5%	85	6%	68	7%	68	7%	85	6%
77	5%	85	5%	68	6%	85	6%	85	6%	67	5%
45%		42%		40%		41%		39%		36%	

67-Iron and steel, 68-Non-ferrous metals, 77-Electrical machinery, apparatus and appliances, 84-Apparel and clothing accessories, 85-Footwear

Source: authors' calculations based on the Eurostat database *DS-018995*.

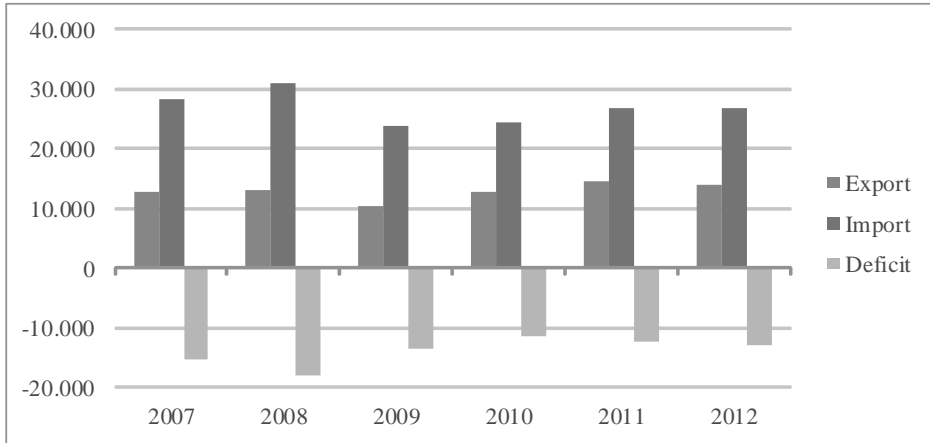


Figure 1. Commodity trade between the Western Balkans and the EU, EUR mill., 2005=100. Source: authors' calculations based on the Eurostat databases *DS-018995* and *prc\_hicp\_aind*.

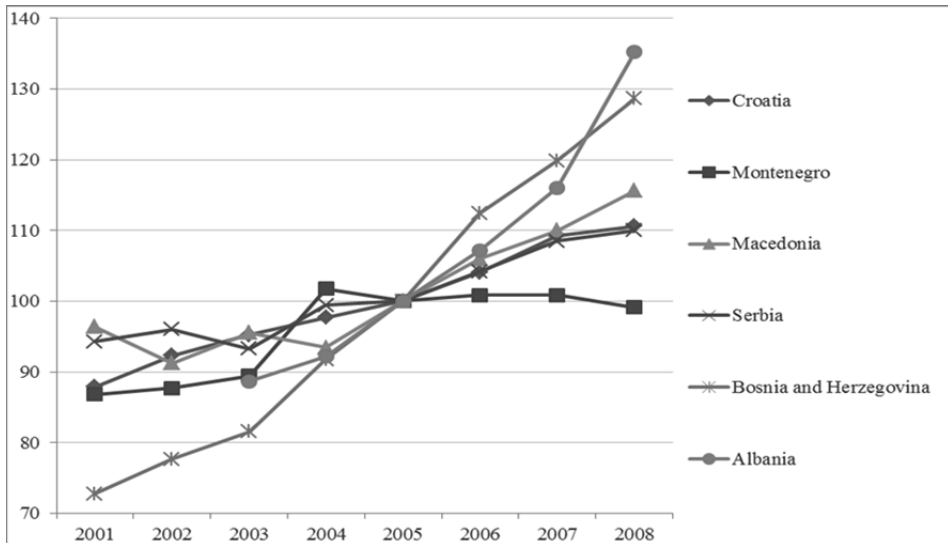


Figure 2. Industrial production index in the Western Balkans countries, 2001-2008 (2005=100). Source: authors' calculations based on the Eurostat database *sts\_inpr\_a*.

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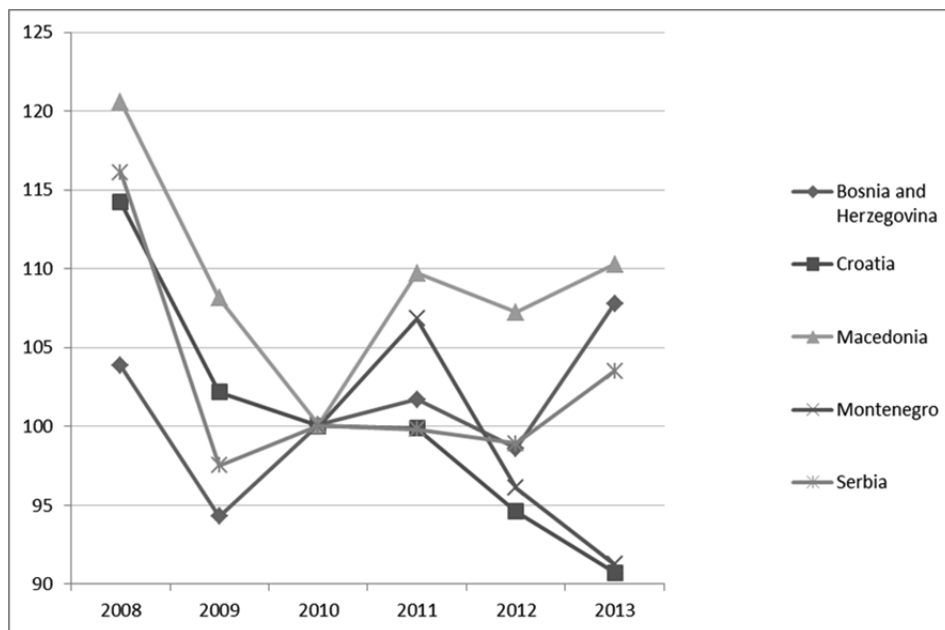


Figure 3. Manufacturing production index in the Western Balkan countries, 2008-2013 (2010=100). Source: authors' calculations based on the Eurostat database *sts\_inpr\_a*.

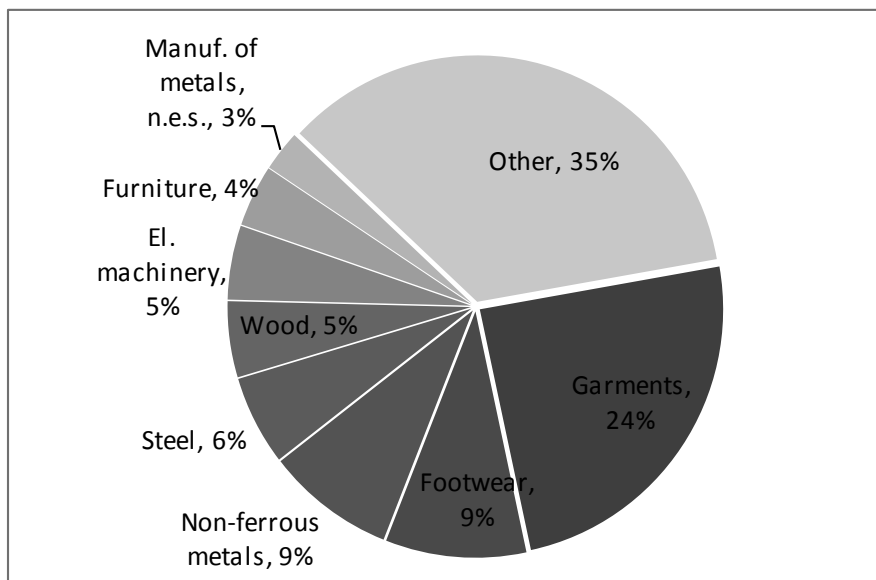


Figure 4. Composition of manufactured exports from the Western Balkans to the EU in 2001, according to the SITC divisions. Source: authors' calculations based on the Eurostat database *DS-018995*.

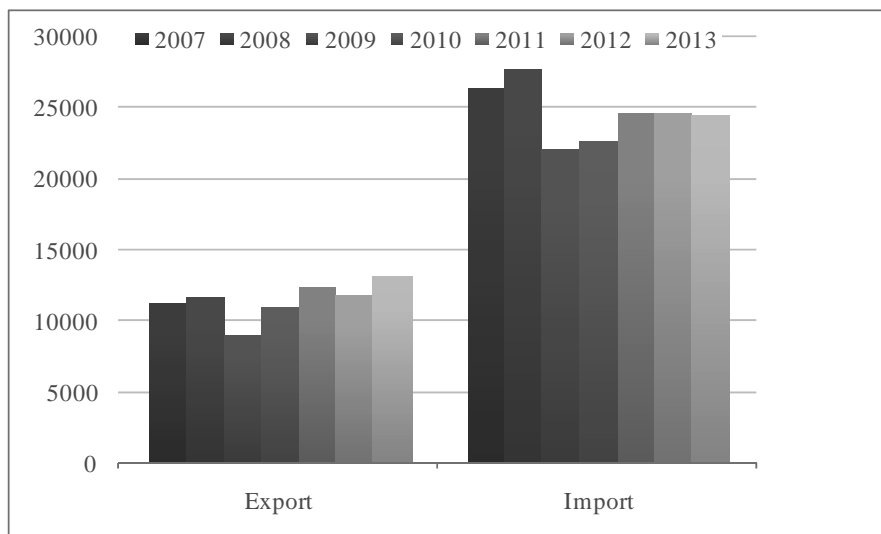


Figure 5. Trade in manufactured goods between the Western Balkans and the EU, EUR mill., 2005=100. Source: authors' calculations based on the Eurostat database *DS-018995*.



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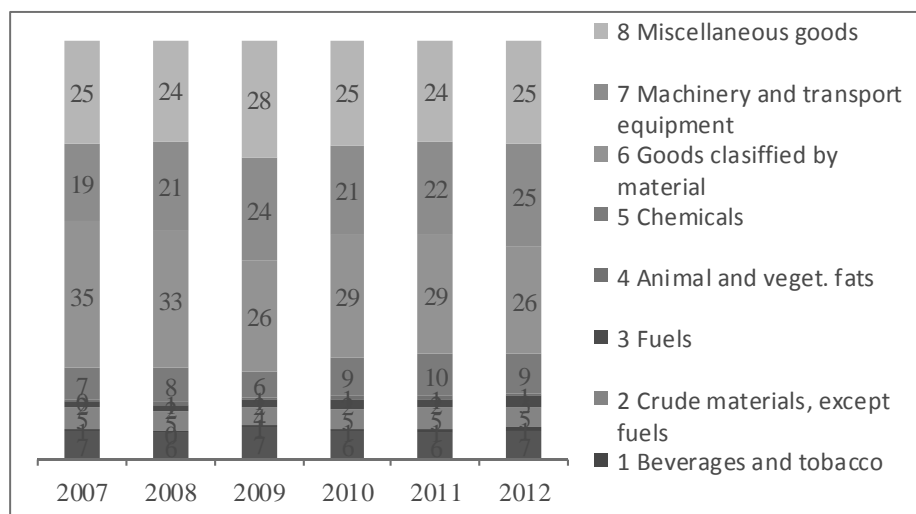


Figure 6. Composition of manufactured exports from the Western Balkans to the EU according to the SITC sections, 2007-2012. Source: authors' calculations based on the Eurostat database *DS-018995*.

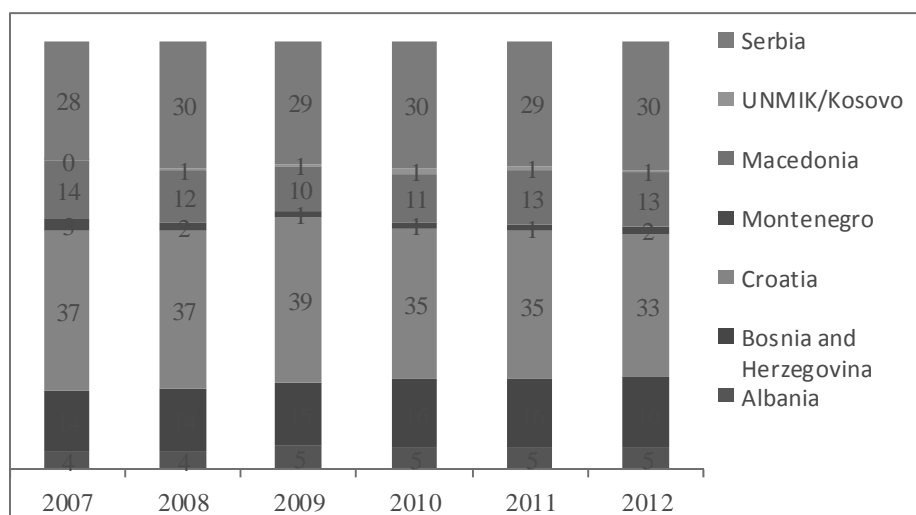


Figure 7. Shares of individual countries in the Western Balkans' manufactured exports to the EU, in %. Source: authors' calculations based on the Eurostat database *DS-018995*.