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Discussion Paper

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The Great Gap

Assessing the New Growth Plan's Potential to Address Socioeconomic Disparity

The New Growth Plan (NGP) for the Western Balkans marks a significant departure from the existing Instrument for Pre-Accession Assistance (IPA). While the latter lacks reform-related conditionalities, the NGP's funding will hinge upon the successful implementation of fundamental and socioeconomic reforms. By gradually providing increased financial benefits ahead of accession (amounting to roughly €6 billion, comprising €2 billion in grants and €4 billion in favourable loans),[1] the initiative seeks to unlock the political will for reforms to take place and to facilitate socioeconomic convergence.[2] According to the European Commission, the region's convergence stands at approximately 35% of the EU average. Given the magnitude of this disparity, the pertinent question arises: Will the NGP prove sufficient to address the pressing socioeconomic gap and contribute to catching up with the EU average?

Answering this question entails examining multiple facets. Thus, this analysis first identifies key socioeconomic trends and gaps to be addressed and then tests the two claims made by the Commission regarding the effects of the NGP. The first claim is that the financial assistance through NGP and IPA III combined will provide the WB with "roughly the same aid intensity per inhabitant as cohesion policy does on average in the EU." The second claim is that the NGP "has the potential to double the size of the WB economies within the next 10 years." Based on the analysed socioeconomic indicators and the evaluation of the Commission's claims, the analysis concludes that the NGP can serve as a solid foundation for stimulating economic growth and expediting EU integration. However, its effect on reducing the socioeconomic gap will remain limited.

1 Out of €2 billion of non-repayable funds, 1.5% of the funds (€30 million) is earmarked for technical and administrative expenses. Furthermore, 360 million is allocated to the Common Provisioning Fund, leaving €1.610 billion as genuine non-repayable funds that countries will benefit from. For the sake of this analysis, the administrative and provisioning expenses have been excluded to maintain clarity and focus solely on the actual financial assistance provided. Therefore, all calculations conducted in this analysis are based on the premise that NGP totals €5.610 billion, including NGP grants amounting to €1.610 billion.

2 Reform-related financing conditionality before the accession, with a special focus on fundamental reforms, is a key component of CEP's Staged Accession Model. This even led Gert Jan Koopman, head of Directorate-General Neighbourhood and Enlargement Negotiations (DG NEAR), to publicly describe the NGP as "a form of Staged Accession."

Identifying the key socioeconomic trends and gaps to be addressed

The level of socioeconomic development in the region, as reflected by Gross Domestic Product (GDP) per capita in Purchasing Power Standards (PPS),[3] remains significantly lower compared to both the EU27 average and its less developed member states. Data presented in Table 1 illustrate that as of 2022, GDP per capita in PPS within the WB stood at a mere 39% of the EU average. Notably, Montenegro leads the region with a GDP per capita in PPS reaching 50%, while Kosovo trails behind at a mere 27%. In contrast, neighbouring EU member states demonstrate higher figures: Slovenia is at 90%, Romania and Hungary at 76%, Croatia at 73%, and Bulgaria at 62%.[4] Furthermore, a comparative examination of data spanning from 2012 to 2022 reveals a notable trend.[5] The analysis underscores that the five aforementioned EU member states experienced more rapid growth than their non-EU counterparts. While the former narrowed the socioeconomic gap with the EU average by 12 percentage points, the latter advanced by only 6. These discrepancy levels hinder the WB's competitiveness, impacting both local prosperity and integration within the broader European market.

Table 1: GDP per capita in PPS in the WB and neighbouring EU countries

	2012	2017	2022
EU 27 average	100	100	100
Slovenia	83	86	90
Hungary	67	69	76
Romania	57	63	76
Croatia	62	64	73
Bulgaria	47	50	62
EU5 average	63	66	75
Montenegro	40	46	50
Serbia	40	39	44
North Macedonia	34	37	42
Bosnia and Herzegovina	30	31	35
Albania	30	30	34
Kosovo[6]	23	24	27
WB Average	33	35	39

Source: Eurostat

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Moreover, the charts of other socioeconomic indicators conspicuously place WB countries after EU countries and towards the lower end of the European continent.[7] For instance, concerning unemployment rates, while the EU averaged 6.1% in 2022, the latest World Bank data for the WB presents a less optimistic outlook.[8] Serbia reported an unemployment rate of 8.7%, followed by Albania at 11.5%, Kosovo at 12.1%, Bosnia and Herzegovina at 12.7%, North Macedonia at 14.4%, and finally Montenegro at high 16.5%. More comprehensive multidimensional socioeconomic indicators, such as the Human Development Index[9] or the Legatum Prosperity Index,[10] consistently rank EU countries at the forefront. In contrast, WB countries lag behind. Tables 2 and 3 illustrate the positions of WB nations[11] alongside comparable countries from the broader region, including Slovenia, Croatia, Hungary, Romania, and Bulgaria. Consequently, the region's socioeconomic situation, comparably inferior to the EU average (as well as to a larger number of neighbouring EU countries), fosters economic migration towards the West.

3 GDP per capita is depicted here in Purchasing Power Standards (PPS), which, as per Eurostat's definition, serve as "a common currency that adjusts for price level disparities between countries, enabling meaningful volume comparisons of GDP." The volume index of GDP per capita in PPS is expressed in relation to the EU average set at 100. If a country's index is higher than 100, its GDP per capita exceeds the EU average, and vice versa.

4 These countries have been chosen for comparison due to their frequent association with a broader region and to guarantee representation from all three previous rounds of EU enlargement. Additionally, Slovenia and Hungary have been included because they more closely mirror the socioeconomic characteristics of the EU average.

5 The socioeconomic trends are discernible through the comparison of data from 2012 and 2022. Table 1 supplements this comparison with data from 2017, strategically chosen as the midpoint within this timeframe, aiming to highlight the temporal (un)evenness of progress in respective countries.

6 Data on Kosovo's GDP per capita in PPS has been absent from Eurostat reports. The figures presented in this table have been sourced from the World Bank database and obtained through a comparison of data between the EU and Kosovo.

7 The Western Balkan countries typically show better performance only than the three eastern EU candidate countries (Ukraine, Moldova, Georgia), Belarus, Armenia, and Azerbaijan.

8 The most recent available data is from 2022 for Bosnia and Herzegovina, Kosovo, North Macedonia, and Serbia, from 2021 for Montenegro, and from 2019 for Albania.

9 According to the United Nations Development Programme's definition, the Human Development Index is "a summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable, and having a decent standard of living. The HDI is the geometric mean of normalised indices for each of the three dimensions."

10 The Legatum Prosperity Index is an annual ranking developed by the Legatum Institute, a London-based think tank. The index measures socioeconomic prosperity across various countries based on a wide range of factors (presented as nine sub-indices), including economic quality, business environment, governance, education, health, safety and security, personal freedom, social capital, and natural environment.

11 The data for Kosovo is absent for both indicators. Nevertheless, it is reasonable to assume, with a high degree of certainty, that the data for Kosovo cannot surpass that of the region.

Table 2: Human Development Index rankings in the WB and neighbouring EU countries.

Country	Human Development Index ranking (2022)
Slovenia	22
Croatia	39
Hungary	47
Romania	53
Bulgaria	70
Montenegro	50
Serbia	65
Albania	74
Bosnia and Herzegovina	80
North Macedonia	83

Source: UNDP, Human Development Report

Table 3: Legatum Prosperity Index rankings in the WB and neighbouring EU countries

Country	Legatum Prosperity Index ranking (2023)
Slovenia	27
Croatia	41
Hungary	42
Romania	45
Bulgaria	48
Montenegro	49
Serbia	52
North Macedonia	55
Albania	65
Bosnia and Herzegovina	72

Source: Legatum Prosperity Index

At this stage of development, migration continues to pose a significant challenge for the WB region. According to OECD, in the period 2012-2022, the emigration rate from the region increased by 10%, and by 2022, one-fifth of the WB population resided abroad, primarily in EU countries. It is indicative that the number of first residence permits for remunerated activities issued to citizens of WB was between five and ten times higher in 2019 than in 2011. This situation exacerbates an already bleak demographic picture, leading to skill shortages and hindering productivity growth. The outflow of human capital affects both non-skilled and skilled workers and is further intensified by the attractive immigration policies of EU countries such as Germany and Sweden. The labour shortage in the WB cannot easily be filled with immigrants from less developed countries in Asia and Africa, as these are also more inclined to migrate to the EU rather than to the WB. Additionally, while there might be an expectation that the WB would gain from remittances originating in the West, this is only partially true. Remittances primarily flow through informal channels, bypassing the banking system, and can also diminish the recipients' motivation to join the workforce, rendering them a less sustainable form of income. Overall, the economies of the WB can be seen as disadvantaged in migration dynamics, whereas EU countries benefit from absorbing the WB's human capital. These circumstances further complicate achieving socioeconomic convergence between the two.

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Comparative Allocation Analysis: Western Balkans and EU Member States

The NGP is the first EU initiative to put forward the reduction of the socioeconomic gap between EU27 and WB6 as one of its primary objectives. The Commission has declared that "the financial impact of the facility, combined with the funds still available under Instrument for Pre-Accession Assistance (IPA III) for the remainder of the Multiannual Financial Framework (MFF) 2021-2027, will provide the WB with roughly the same aid intensity per inhabitant as cohesion policy does on average in the EU." A meticulous comparative analysis of the funds allocated per capita in both the WB6 and the EU for the year 2024 was undertaken to test this assumption. The decision to concentrate on 2024 is purposeful, taking into account the differing durations of the Cohesion Policy and IPA funds (extending over seven years) and the NGP (covering four years). The funds the WB expects to receive in 2024 were calculated using the formula:

$$\frac{\frac{\text{IPAIII}^{12}}{7} + \frac{\text{NGPgrants}}{4}}{\text{WB population size}^{13}}$$

While for the EU, the allocation was determined by the following formula:

$$\frac{\frac{\text{Cohesion policy funds}^{14}}{7}}{\text{EU population size}^{15}}$$

The analysis revealed that the funds allocated per capita in the WB amounted to approximately €122 per person per year. In contrast, in the EU, it was approximately €125 per person per year. Despite minor differences, the disparity between the funds allocated per capita in the WB and the EU is relatively negligible, supporting the Commission's claim regarding the comparable aid intensity per inhabitant.

However, the Commission's assertion oversimplifies the situation by comparing disparate elements. While it aggregates all non-repayable funds received by WB countries, it solely focuses on *cohesion policy funds*, which represent just one aspect of the financial infusion assigned to member states. For instance, examining *the total funds* from the MFF earmarked for country allocations (€108.5 billion) over one year reveals an allocation of €242 per capita, which is double the amount allocated to the WB (€122). Additionally, when incorporating Next Generation EU grants, this figure rises to €356 per capita, nearly three times higher than the WB's average. Furthermore, comparing WB's allocations with the average cohesion policy funds per capita may not provide an accurate representation, as the EU average is heavily influenced by the large populations of highly developed EU countries, such as Germany, where these funds are relatively smaller due to their high socioeconomic status. Hence, a more meaningful comparison for the WB would involve examining the appropriations of less developed EU member states.

Comparison with member states of similar socioeconomic status paints a different picture and yields more insightful conclusions. Croatia might be an illustrative case in point. As the most recent addition to the EU, Croatia still has a fairly comparable socioeconomic status with the WB region and also strong economic ties with it. Moreover, prior to joining the EU, Croatia itself was considered part of the WB region. When examining solely the cohesion policy funds in 2024, an average Croatian citizen receives €332 from EU funds, in contrast to the €122 per capita for WB residents from IPA III and NGP grants. However, Croatia benefits from a larger share of the MFF beyond just cohesion policy funds: this raises the average per capita allocation to €509, and with the inclusion of NGEU grants, it escalates to €740—four to six times greater than the average allocations for the WB respectively. Nonetheless, considering that WB countries do not contribute to the EU budget, a more objective assessment involves examining the net inflows per capita after subtracting Croatia's contributions to the MFF from its total receipts. Under this lens, the scenario shifts: €368 from the total MFF and €569 when NGEU grants are also incorporated, which are three to four and a half times more generous than WB's €122, respectively. Having in mind these disparities, the gap between Croatia and the WB remains significant, contributing to the widening socioeconomic divergence between the two.

Table 4: Allocations for the WB in 2024 (in million €)

	Allocation
IPA III	1,742.9
NGP grants	402.5
IPA III + NGP grants	2,145.4

Source: Authors' calculations

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12 The estimated allocation of IPA III funds for the Western Balkans stands at approximately €12.2 billion, though this figure may vary in practice. Nevertheless, these variations are unlikely to significantly impact the conclusions drawn regarding the aid intensity and socio-economic convergence potential of the Growth Plan. This estimation was obtained by excluding funds designated for Turkey within the overall IPA III budget (13.8 billion if administrative costs are deducted). Furthermore, overall funds for Turkey were calculated based on the average annual allocation over the preceding three years (€225 million), with this trend extrapolated over a period of 7 years (resulting in a total of €1.6 billion).

13 The population of the Western Balkans amounts to approximately 17.6 million inhabitants.

14 The total cohesion policy resources in MFF 2021-2027 amount to €392 billion.

15 The population of the EU amounts to approximately 448.4 million inhabitants.

Table 5: Allocations for the WB in 2024 per capita (in €)

	Allocation
IPA III	99
NGP grants	23
IPA III + NGP grants	122

Source: Authors' calculations

Table 6: Allocations for Croatia in 2024 (in million €)[16]

	Gross allocation	Contributions	Net allocation (contributions deducted)
Cohesion Policy	1,002.9	N/A	N/A
MFF	1,986.9	549.9	1,437
NGEU grants	900	0	900
MFF + NGEU grants	2,886.9	666.9	2200

Source: For gross allocations: European Commission, Directorate-General for Budget; For contributions: European Commission

Table 7: Allocations for Croatia in 2024 per capita (in €)

	Gross allocation	Contributions	Net allocation (contributions deducted)
Cohesion Policy	332	N/A	N/A
MFF	509	141	368
NGEU grants	231	0	231
MFF + NGEU grants	740	171	569

Source: Authors' calculations based on the data obtained from the same sources as Table 6

It is important to note that the above analysis assumes the full absorption of all funds potentially accessible to candidate countries. However, in reality, the positive impact of the NGP financial injection may face additional challenges related to financial management issues within the region. The widespread corruption and the presence of captured states in the WB6 cast doubt on the prudent allocation of funds. Even in the best-case scenario in which political elites and public servants have the best intentions to manage finances with integrity, the fact remains that the region grapples with a deficit in human capacity. Concerns have already been raised regarding the weak absorption capacity of candidate countries, sometimes resulting in funds being underutilised.[17] Hence, the NGP implementation requires national governments to renew their focus on enhancing human capacities in financial management and, more generally, strengthening the retention policy in public administration.

16 In Tables 6 and 7, data on Croatia's contributions to cohesion policy funds are not available as the Commission has not provided precise data or estimates, but only the total amount Croatia contributes to the MFF

17 Further details on deficiencies in the implementation of IPA funds can be found in: Milena Mihajlović, with contributions by Ruggero Tabossi, Reforming the EU's pre-accession funding instrument: Effective membership preparation through the Staged Accession Model, European Policy Centre (CEP)

Doubling the WB Economies in a Decade?

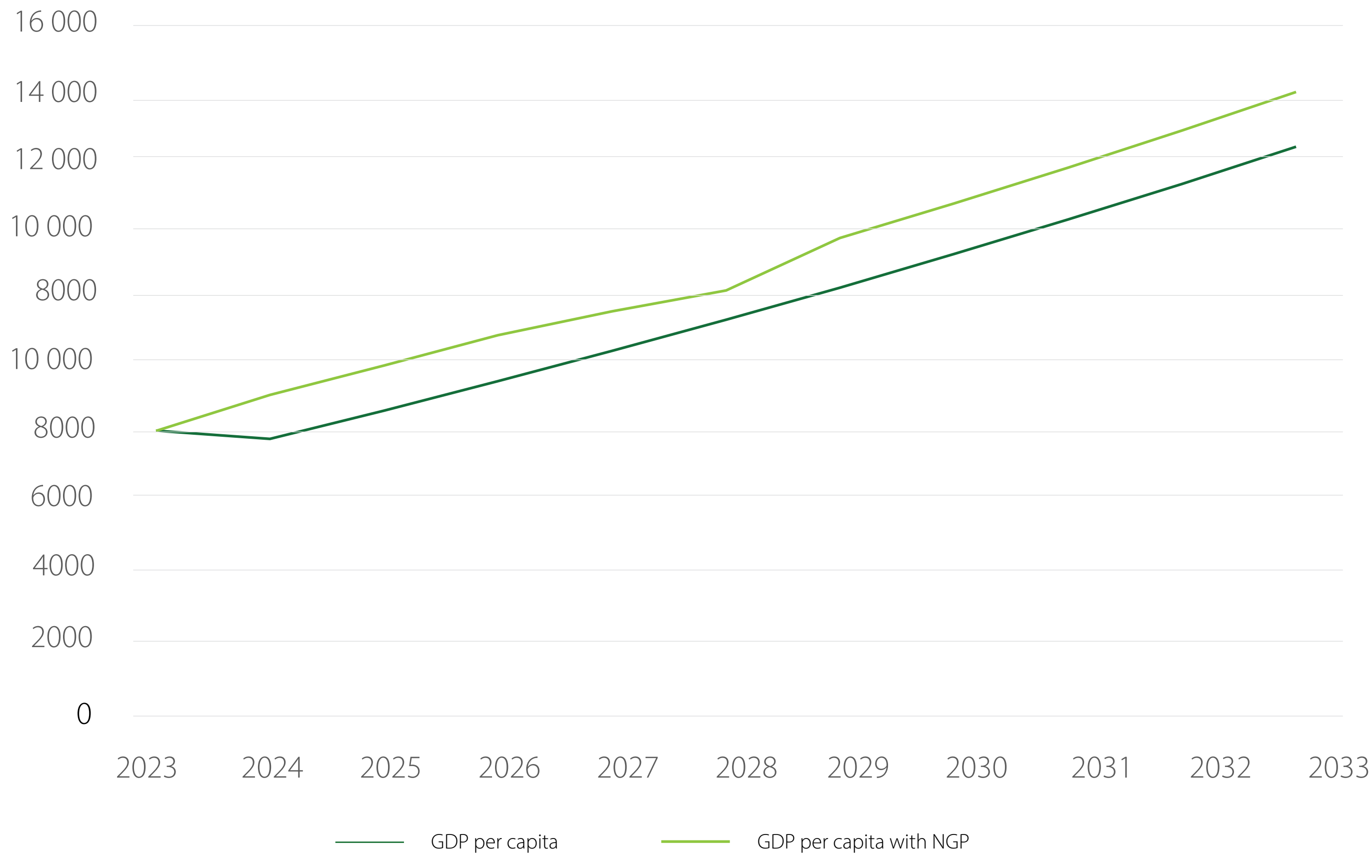
Besides the pledge to closely match WB allocations with the Cohesion Policy average, another key aspect of the NGP's commitment is its reported potential to enhance the region's economy significantly. Namely, according to the Commission, its introduction could help the WB6 to double their economy in the course of ten years, meaning that the nominal GDP per capita would increase from an estimated $9,959 in 2024 to $19,918 in 2034. This ambitious target implies an annual growth rate of approximately 7.2% over the ten-year period. However, the analysis conducted for this paper shows a somewhat less optimistic outlook. The estimated growth rate is around 6.4% per year with the implementation of the NGP and 5.9% without the NGP. Therefore, the scenario with NGP included shows somewhat better performance, particularly in the initial years. This suggest that the financial boost of €5.61 billion provided by the NGP, even though significant, may not be sufficient to double the size of the WB economies in 10 years.

While the NGP promises to stimulate socioeconomic growth in the WB, it is important to recognise that the EU economy will also progress during the same period. The EU's GDP per capita is projected to grow nominally by 4% per year. With inflation rates in the range of 1-2%, this translates to real yearly growth rates of 2-3%,[18] which is still lower than projected real growth rates for the WB. However, this difference is insufficient for the WB to catch up to the EU standard of living in the near future. Thus, despite the NGP implementation, the absolute disparity between the region and the EU27 will likely widen, with only modest relative improvements. Given their relative underdevelopment compared to the EU, WB countries would require significantly higher growth rates to catch up. This underscores the need to not only rely on the NGP but also consider supplementary measures to address structural challenges and foster sustainable development in the region and pay attention to where the financial support coming from the NGP is directed.

There is a hope that the reform-related conditionalities introduced by the NGP hold the potential to create a more stable and predictable business environment. By fostering these reforms, the NGP has the potential to facilitate more robust economic growth and development in the WB, although it is unlikely to double GDP per capita within ten years.

18 IMF and Authors' calculation

Graph 1: Projected GDP per capita in current prices in the WB region for 2023-2033[19]



Nonetheless, there is hope that the reform-related conditionalities introduced by the NGP[20] hold the potential to create a more stable and predictable business environment. By fostering these reforms, the NGP has the potential to facilitate more robust economic growth and development in the WB, although it is unlikely to double GDP per capita within ten years. Directing financial resources where they can yield the best results is crucial for making initiatives like the NGP meaningful in the WB. This applies, as the root of the region's challenges lies in low productivity, stemming from years of under-investment, unfavourable demographics, and a challenging business environment. Consequently, the solution lies in addressing these issues. Reforms should prioritise improving the quality of governance, fostering cross-border linkages,

The EU's NGP presents an opportunity to accelerate reforms in these areas, catalysing economic growth and convergence more effectively than mere financial injections could achieve alone. If successful, a region with a more resilient economy and a positive socioeconomic outlook should better equip the candidate countries to navigate the future complexities of the EU single market.

19 The projection is derived from fixed-effect regression analysis using panel data collected from the World Bank data centre for six WB countries and 2014-2022 period. After estimating the growth model and its determinants, achieving an R-squared of approximately 96%, projected values for each explanatory variable—including imports, exports, household consumption, government consumption, political stability, urban population, economic structure and others—were used to forecast data from 2023 onward.

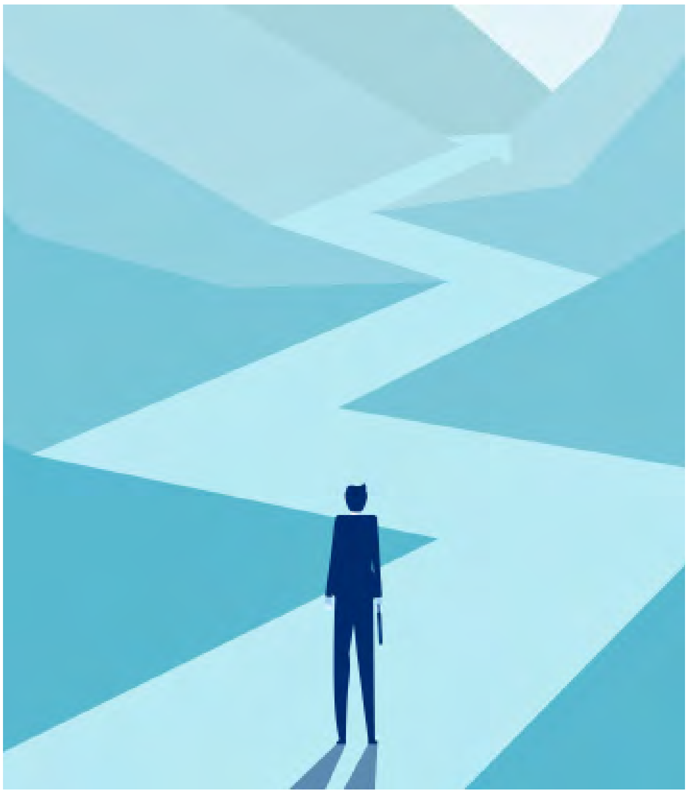
20 One of the NGP's innovative features is that the disbursement of funds to WB countries will be contingent upon meeting the objectives outlined in the national Reform Agendas, particularly in the realm of upholding the rule of law. Following the Commission's biannual evaluations, decisions will be made regarding the allocation and extent of funds, with resources potentially reallocated among peer countries if stagnation or regression is observed in any of them.

and promoting sustainable practices.[21] Progress in these core areas could reverse demographic trends, enhance competitiveness, and strengthen resilience to future shocks. The EU's NGP presents an opportunity to accelerate reforms in these areas, catalysing economic growth and convergence more effectively than mere financial injections could achieve alone. In turn, such a scenario could generate domestic income and support the region's self-growth. If successful, a region with a more resilient economy and a positive socioeconomic outlook should better equip the candidate countries to navigate the future complexities of the EU single market.

The Road Ahead

Perhaps presented somewhat grandiosely with promises of significantly reducing socioeconomic disparities between the EU and the WB, the NGP should not be viewed as a magic wand that will instantly narrow these gaps. The socioeconomic differences between the region and the European average are substantial and rooted in systemic problems that require years of dedicated efforts to overcome. While it is true that the NGP, together with IPA III, provides aid intensity on par with the average offered by the Cohesion Policy in the EU, this claim is rather minimalistic as it overlooks the additional funds available to member states through the MFF and Next Generation EU. The allocated funds alone are insufficient to double the economy of the WB, but the NGP's provisions—such as integration into elements of the EU Single Market, fundamental reforms, and the Common Regional Market—are steps in the right direction that can gradually stimulate economic activity. After all, the NGP can be lauded as a dynamic initiative that not only fosters a donor-recipient relationship but also rewards proactivity, reforms, and regional integration.

21 For a detailed analysis on the importance of these reforms, see "Can the Western Balkans converge towards EU living standards?", European Bank for Reconstruction and Development (EBRD)



As a clear indication that the enlargement policy has regained prominence and is now high on the EU's agenda, NGP is also instrumental in overcoming the fatigue in the region, a consequence of the prolonged nature of the region's accession process. Faced with tangible benefits from NGP's direct financial and indirect societal impact, citizens will be more inclined to support further accession efforts, as democratic theories emphasise that a stable economy and a strong middle class are conducive to building vibrant democracies. In the WB, known for many ethno-nationalist tensions and bearing the legacy of war, socioeconomic prosperity is likely to mitigate tensions and contribute to overall stability. In short, should the NGP demonstrate its effectiveness, it will be a badge of success for both the EU officials and WB6 leaders, as well as a beacon of progress for the general public, finally igniting the motivation of all stakeholders to forge ahead with enlargement.

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