
PRELIMINARY REPORT

Key Features and Challenges of the China-Western Balkan Countries Merchandise Trade Development

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ABSTRACT

The Western Balkan countries' economic growth and development largely depend on the integration of national economies into international trade flows. Bearing in mind the expanding presence of China in the Western Balkans and the considerable increase in bilateral trade over the previous decade, it is of great importance to focus on the strategies for overcoming main challenges and fostering more balanced trade in the forthcoming period. Regarding that, the main aim of the research was to analyze trade flows and patterns and investigate the trade intensity between the Western Balkan countries and China. Furthermore, the research attempted to determine the main challenges and to consider the strategic approach to their overwhelming, including better exploiting the opportunities provided by trade cooperation with China in the rapidly changing global environment.

The paper used desk research - a descriptive analysis of data on merchandise trade between six Western Balkan countries (Albania, Bosnia and Herzegovina, Montenegro, Croatia, North Macedonia, and Serbia) and China. The analysis was based on the data available in the UN Comtrade, Trade Map, and WTO statistical databases for the period 2016-2021. In addition, the Trade intensity index (TTI) was also used in the paper in order to discover how intensively the Western Balkan countries were trading with China.

However, despite the rapid trade growth with China, its share in the WB countries' total trade remains at a relatively low level of about 8%. The trade deficit also increased significantly, indicating a deepening of the asymmetry in the economic relations of the observed countries. Although the trade intensity index (TII) also confirms the deepening of trade relations, the TII value of 0.24 in 2021 indicates that trade between the Western Balkans and China is not developed at a desirable level, and there is considerable room for improvement.

Keywords: *China, Western Balkan countries, merchandise trade, exports, imports, challenges*

JEL Classification: F1, F5

INTRODUCTION

Being almost non-affected after the 2008 financial crisis, China has continued its “go global” approach, which led to the increase of various Chinese actors' presence around the world (Shambaugh, 2013). Since 2008, Chinese outward foreign direct investments have grown significantly (Dong et al., 2011; Jin et al., 2016), while China became the world's leading exporter and second-major importer of merchandise goods in 2012 (Gurría, 2014).

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Along with the intensification of China's economic presence worldwide, and especially in the region of Central and Eastern Europe, the previous decade was marked by the dynamic development of relations with the countries of the Western Balkans (WB) in the field of economic and other aspects of bilateral and multilateral cooperation. China committed itself to expanding economic and political ties with Central and Eastern Europe (CEE), including the Western Balkan countries, by initiating the so-called China-CEE mechanism (formerly known as the "16+1" and later as the "17+1" mechanism or platform). Namely, the CEE-China mechanism was founded in 2012 in Warsaw as an initiative that will gather countries from CEE and China with the aim of enhancing mutual economic, political and cultural relations (Zakić & Radišić, 2019).

Since 2015, China has been deeply engaging the WB countries to an unprecedented degree and has had a profound impact on this region in recent years (Pavličević, 2019). Trade and investment activity have both been significantly increasing, attracting Chinese companies' interest in different strategically important investments and infrastructure projects in the WB region (Vangeli, 2019).

Intensive economic cooperation between Western Balkan countries and China continued even during the Covid-19 pandemic crisis, and there was a rise in the total trade exchange recorded (the highest growth rate of trade of the Western Balkans countries was achieved precisely with China). This positive dynamic was primarily the result of the effective realization of measures to prevent the spread of the virus and the role of China in providing assistance to the countries of the Western Balkans in the fight against the pandemic, primarily as the most important or even the sole supplier of protective and other medical equipment and pharmaceutical products necessary for the treatment of the sick (Beraha & Jovičić, 2021).

Although the growing trade and expanding investments are often mentioned in the context of the deepening cooperation between the Western Balkans and China, it seems that investments still attract much more attention from scholars than trade. Trade, again, could play a vital role in the Western Balkans' efforts to promote its economic growth and more stable and balanced trade relations with China.

In accordance with the above-mentioned, the main aim of the research was to analyze trade flows and patterns and investigate the trade intensity between the Western Balkan countries and China. In addition, the research attempted to determine the main challenges and to consider the strategic approach to their overwhelming, including discovering the measures for better exploiting the opportunities provided by trade cooperation with China.

THEORETICAL BACKGROUND

International trade, i.e. exports and imports, is one of the key drivers of economic development (Bakari & Mabrouki, 2017). The scientific literature extensively discusses the relationship between trade openness and economic growth, and the majority of empirical studies' findings support the idea that trade openness promotes economic growth (Çetintaş & Barışık, 2009; Busse & Königer, 2012; Huchet et al., 2018; Marjanović & Domazet, 2018; Gurgul and Lach, 2014). In addition to promoting faster growth, international trade supports productivity improvement, providing better living standards and lower income inequality (Cerdeiro & Komaromi, 2017).

In terms of international trade significance, an enhancement of exports is of particular importance. Eberhard-Ruiz and Calabrese (2018) claim that a country's level of export competitiveness is crucial for its successful participation in the global economy and international trade but also for managing the eventual deterioration of the trade balance. Nguyen (2011) and Atkinson (2013) consider exports to support increased specialization in production by more efficient resource allocation, which boosts productivity and consequently promotes more robust economic growth. Countries could benefit from export-led economic

growth because it facilitates foreign exchange inflows, increases production, creates new employment opportunities, and increases the overall commercial volume (Temiz Dinç & Gokmen, 2019). Furthermore, export trade diversification is essential since it makes economies more adaptable to changes in demand, enables more effective inclusion of small and medium-sized enterprises, and promotes innovation (Songwe, 2019).

Export-led growth is essential for boosting economic growth in developing countries (Hakobyan, 2017). It may be especially significant for small (or relatively small) open economies (like Western Balkan countries), which rely much more on cooperation with external partners (Baranenko & Đukić, 2012). This confirms Ilahi et al. (2019) claiming that *“in the past several years, exports have contributed strongly to growth and economic convergence in many small open countries, aspiring Western Balkan countries to embark on an export-led growth and convergence path.”* Although most countries experienced the positive effects of net exports on growth in the post-crisis period, the WB region still lags behind, primarily due to *“a lack of openness, reliance on low-value products, and weak structural competitiveness”* (Ibid).

Shimbov, et al. (2019), by using an export sophistication index, reveal that export sophistication has a positive and significant impact on the WB countries' economic performance, while the research outcomes support the idea that greater involvement in global production networks, along with improved institutional environments, promotes the export enhancement and, as a result, accelerates economic growth. On the other side, authors found that this process in the WB countries *“is driven more by the sophistication in medium-skill and technology-intensive manufactured goods rather than through sophistication in high-skill goods”* (Ibid).

In this regard, bearing in mind its growing presence in the region, China appears as one of the trade partners that could encourage export growth as well as more effective involvement of the companies from the WB countries in the global value chains (GVCs). However, most of the authors (Zakić, 2022; Beraha & Jovičić, 2021; Gigov & Poposka, 2022; Szunomár et al., 2020; Jaklič & Svetličič, 2019; Jacimovic, et al. 2018; Yue, 2018; Matura, 2019; and others) generally conclude that despite the intensive development of economic cooperation, the WB countries have not fully benefited from trade with China – trade remains unbalanced, leading to significant trade deficit growth in most countries in the region.

DATA AND METHODOLOGY

The paper used desk research - a descriptive analysis of data on merchandise trade between six Western Balkans countries (Albania, Bosnia and Herzegovina, Montenegro, Croatia, North Macedonia, and Serbia) and China. For the purpose of the research, the data was retrieved from the UN Comtrade, Trade Map, and WTO statistical databases for the period 2016-2021. Merchandise trade structure was observed at the Harmonized Commodity Description and Coding Systems (HS) 2-digit level.

For the sake of a more coherent approach, the data was collected so that China was observed as a reporting country on merchandise exports and imports (Reporter), while the countries of the Western Balkans were considered partner countries (Partner).

In addition, the Trade intensity index (TTI) was also used in the research in order to measure how heavily the Western Balkan countries were trading with China. TTI is defined as *“the share of one country's exports going to a partner divided by the share of world exports going to the partner”* (World Bank, 2010). The TII approach determines whether the value of trade between two countries exceeds or falls short of what would have been anticipated based on their relative significance in world trade by evaluating bilateral trade status based on both a country's global trade status and its trade partner's economy size (Maryam et al., 2018).

The mathematical definition of TII is as follows:

$$Tij = (xij/Xit)/(xwj/Xwt) \quad (1)$$

Where xij and xwj are the values of the country i 's exports and of world exports to country j , while Xit and Xwt are the country's total exports and total world exports respectively (World Bank, 2010).

An index with a value greater than one denotes a high level of trade intensity between the two economies. Conversely, a lower estimate of the index (if it is less than one) denotes less bilateral trade intensity between the partner countries.

RESULTS AND DISCUSSIONS

According to the UN Comtrade data, the total merchandise trade between the WB countries and China was steadily growing in the period 2016-2021, so the total trade volume amounted to 7.3 billion US dollars in 2021, which represents an almost threefold increase compared to 2016 (Figure 1). Continuous positive annual growth rates were also recorded on both the WB countries' imports and exports sides, except for 2016 and 2018, when there was a slight y-o-y decline in total exports. Robust import volume growth overshadowed an increase in exports, which resulted in a worsening of the trade balance. Namely, the trade deficit significantly widened to around 3.3 billion US dollars in 2021, or it was almost 99% higher compared to 2016.

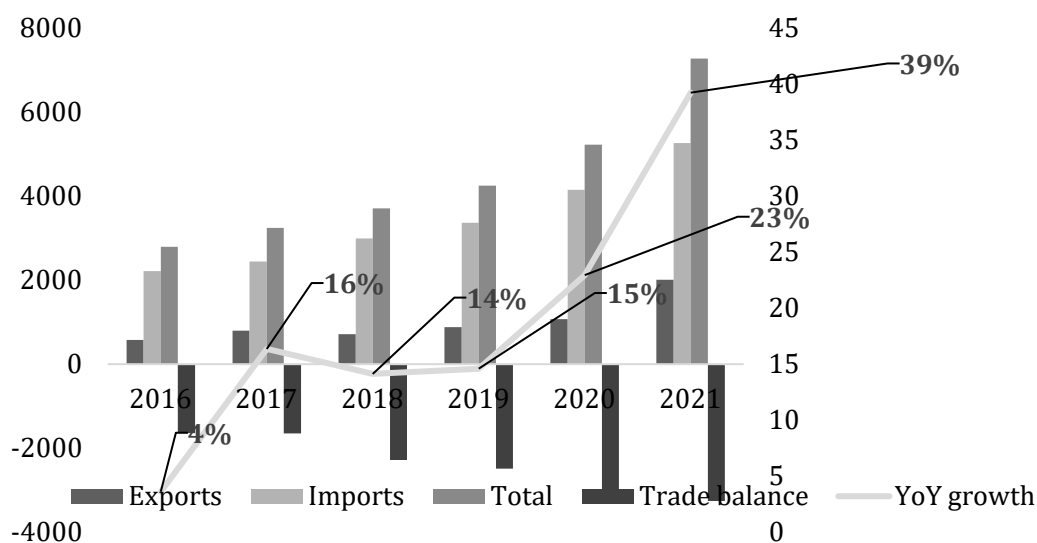


Figure 1. The WB-China trade dynamics over the period 2016-2022, in mil. USD

Source: UN Comtrade database

Compared to 2020, the total WB countries' trade with China saw a remarkable rise of almost 40% in 2021, driven by a sharp increase in exports (87%) and a more moderate increase in imports (27%). The significant export growth contributed to the trade deficit reduction in 2021—the trade deficit increased by only 6% compared to the previous year. Such an impressive dynamic determined by high y-o-y growth rates was, among other things, the result of a low base from 2020 caused by a decrease in economic activity as well as trade flows due to the negative impact of the Covid-19 pandemic. However, it should be mentioned that a proactive approach enabled China to position itself as an important external participant in the Western Balkans region during the pandemic and accelerate bilateral trade relations. Due to the success in the fight against the COVID-19 virus, i.e. the speed with which it managed to restore full production after the complete lockdown of provinces and cities and take advantage of the

increase in demand, China, for instance, became one of the few countries with which trade growth has been achieved in 2020 (Beraha & Jovičić, 2021).

Observed by individual countries, the largest share in the total trade with China in 2021 was achieved by Serbia (44%), followed by Croatia (32%), while the share of other countries was much more modest: Albania 10%, North Macedonia 8%, Bosnia and Herzegovina 4%, and Montenegro only 1% (Figure 2). In terms of exports, the dominant position of Serbia was even more pronounced, with a share of as much as 49%, while the shares of North Macedonia, Croatia, Albania, Bosnia and Herzegovina, and Montenegro were 18%, 17%, 8%, 7%, and 1% respectively.

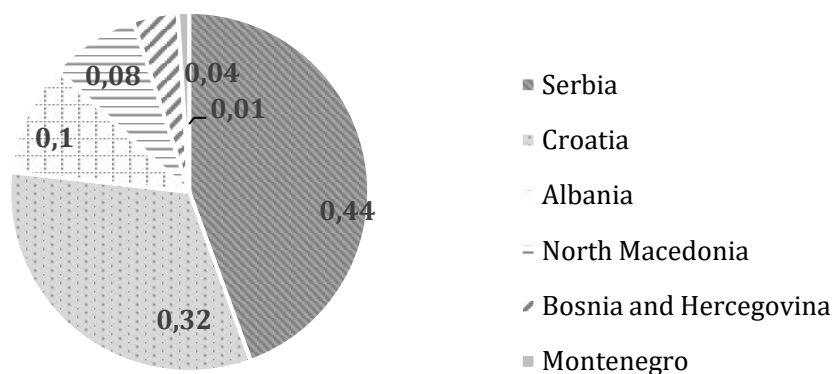


Figure 2. The share of individual countries in total trade between the WB countries and China

Source: UN Comtrade database

During the period 2016-2022, Serbia was the only country that recorded a continuous annual increase in total trade (see Figure 3), but also in both exports and imports, confirming the fact to be the most important Chinese trade partner among the other five countries. However, apart from Montenegro, the positive growth rates of total trade in 2021 compared to 2020 were achieved by all countries: North Macedonia and Serbia's trade with China saw an increase of 55% and 52%, respectively, followed by Bosnia and Herzegovina (42%), Croatia (36%), and Albania (16%), while trade between Montenegro and China reduced by 37%.

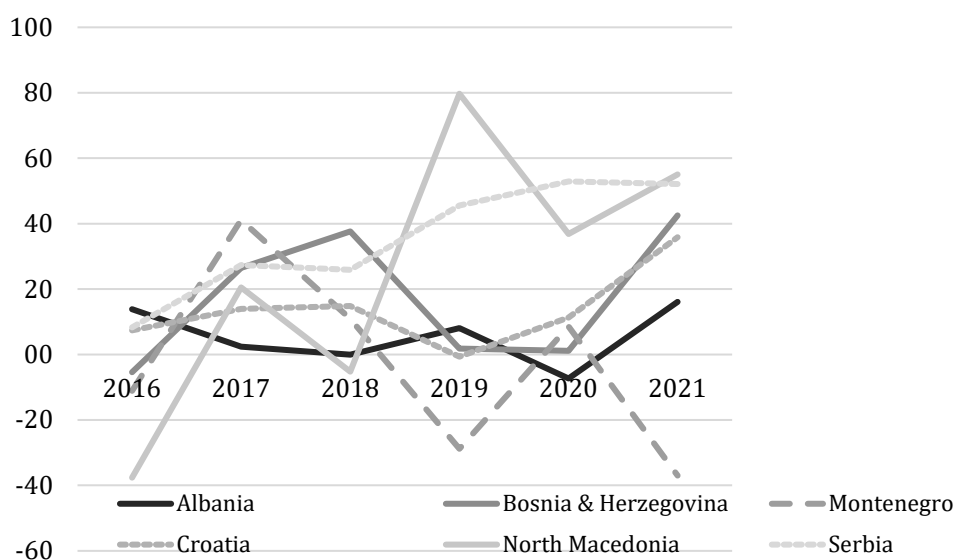


Figure 3. The Western Balkans-China total trade annual growth rates

Source: UN Comtrade database

Based on the analysis of the trade structure, it could be concluded that there were no significant changes during the observed period. The low-value-added goods were the backbone of the Western Balkan countries' exports, while the more sophisticated goods were imported from China (Table 1).

Table 1. The Western Balkans-China exports/imports composition in 2021: key commodity groups*

	Exports	Imports
Albania	<ul style="list-style-type: none"> • Ores, slag and ash (55%) • Iron and steel (24%) • Articles of apparel and clothing accessories, not knitted or crocheted (9%) 	<ul style="list-style-type: none"> • Machinery, mechanical appliances, nuclear reactors, boilers; parts thereof (18%) • Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, etc. (12%) • Furniture; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings (8%)
Bosnia & Herzegovina	<ul style="list-style-type: none"> • Articles of apparel and clothing accessories, not knitted or crocheted (26%) • Wood and articles of wood; wood charcoal (26%) • Ores, slag and ash (17%) 	<ul style="list-style-type: none"> • Machinery, mechanical appliances, nuclear reactors, boilers; parts thereof (27%) • Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, etc. (14%) • Pharmaceutical products (11%)
Croatia	<ul style="list-style-type: none"> • Ships, boats and floating structures (50%) • Wood and articles of wood; wood charcoal (16%) • Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, etc. (12%) 	<ul style="list-style-type: none"> • Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, etc. (24%) • Machinery, mechanical appliances, nuclear reactors, boilers; parts thereof (15%) • Toys, games and sports requisites; parts and accessories thereof (7%)
Montenegro	<ul style="list-style-type: none"> • Ores, slag and ash (56%) • Beverages, spirits and vinegar (14%) • Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof (13%) 	<ul style="list-style-type: none"> • Iron and steel (12%) • Plastics and articles thereof (11%) • Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, etc. (11%)
North Macedonia	<ul style="list-style-type: none"> • Iron and steel (61%) • Miscellaneous chemical products (11%) • Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, etc. (10%) 	<ul style="list-style-type: none"> • Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, etc. (26%) • Machinery, mechanical appliances, nuclear reactors, boilers; parts thereof (21%) • Miscellaneous chemical products (6%)

	Exports	Imports
Serbia	<ul style="list-style-type: none"> • Ores, slag and ash (39%) • Copper and articles thereof (31%) • Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, etc. (10%) 	<ul style="list-style-type: none"> • Machinery, mechanical appliances, nuclear reactors, boilers; parts thereof (34%) • Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, etc. (21%) • Articles of iron or steel (7%)

* the percentage share of major commodity groups in WB countries' imports from/exports to China

Source: authors' based on the Trade Map data

In terms of imports, there was a remarkable average annual growth rate over the previous five years in imports of *Pharmaceutical products* in all WB countries except Albania and Croatia: Montenegro had a 938% increase, Bosnia with 210%, Serbia with 138%, and North Macedonia with 120%. On the export side, Serbia had a record average annual growth rate of *Copper* exports of 809%, while Albanian *Iron and steel* exports increased by 248% on average.

Despite these positive tendencies, the share of the WB countries' goods in total Chinese imports is still negligible, with about 3% in 2021. Observed by the individual countries, it is even less. If taking a look at the sum of the main three export commodity groups in each country, not one country reached even 1% in the imports of China. For instance, even the sum of the 3 top commodity groups (*Ores, slag and ash + Copper and articles thereof + Electrical machinery and equipment and parts thereof, etc.*) of exports of Serbia (that otherwise has a leading position among other WB countries) was less than 1% of total imports of China in 2021.

Trade intensity index development

It was chosen to employ the Trade intensity index (TTI) approach in the study to carry out a more thorough analysis of trade relations between Western Balkans and China. As already mentioned in the Methodology part, this approach enables the assessment of the bilateral trade intensity level based on the country's status in international trade and its trade partner's economy size (Jovičić et al., 2020).

As can be seen in table 2, although the TTI value has been rising over the last six years, reflecting the fact that the trade relations between the WB countries and China have been strengthened, the TII value of 0.24 in 2021 indicates that trade between given partners is "under-represented." This implies that there is undoubtedly considerable room for improvement.

Table 2. Trade intensity index of the WB region and China

2016	2017	2018	2019	2020	2021
0.14	0.16	0.12	0.15	0.18	0.24

Source: authors' calculations based on UN Comtrade and WTO databases

The evaluation of TTI between the individual WB countries and China gives a more complicated picture (Table 3). Namely, the value of TTI has been changing across the countries during the period 2016-2022. Albania and Montenegro were the only two countries that closed (Albania) or surpassed (Montenegro) the value of TTI numerically equal to one in some particular years. Trade between the rest four countries (Bosnia & Herzegovina, Croatia, North Macedonia, and Serbia) and China has been underrepresented. Meanwhile, the value of TTI has been increasing in the last few years.

Table 3. Trade intensity index of the WB individual countries and China

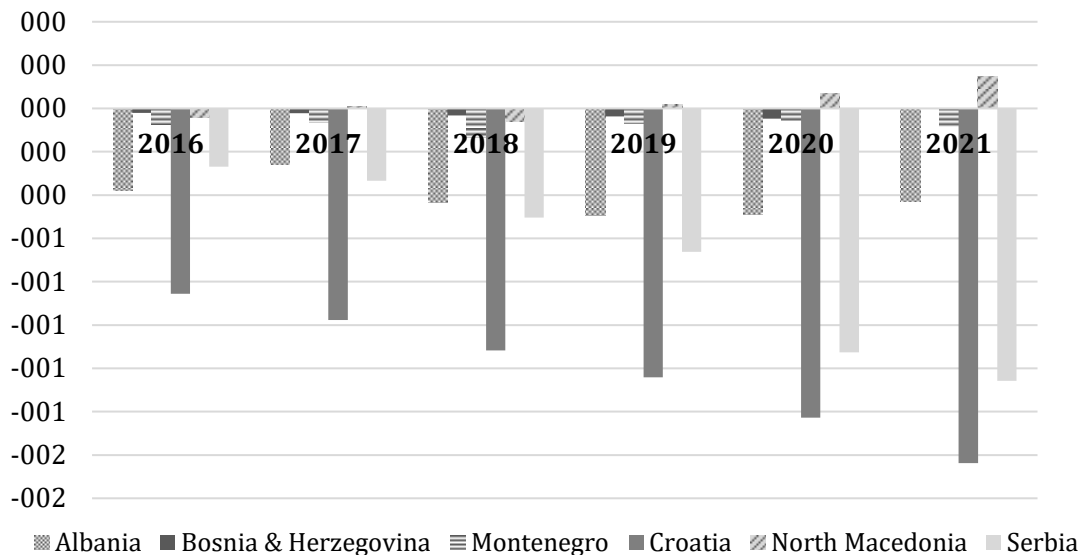
	Albania	Bosnia & Herzegovina	Montenegro	Croatia	North Macedonia	Serbia
2016	0.66	0.08	0.93	0.12	0.10	0.11
2017	0.82	0.09	1.72	0.11	0.15	0.12
2018	0.34	0.10	0.97	0.11	0.06	0.11
2019	0.35	0.11	0.96	0.08	0.19	0.17
2020	0.28	0.10	1.34	0.07	0.29	0.22
2021	0.42	0.13	0.22	0.12	0.34	0.32

Source: authors' calculations based on UN Comtrade and WTO databases

Main challenges hampering the trade relations enhancement

Regardless of the deepening economic relations with China, which was, among other things, reflected in an increase in the trade volume, the WB countries still face many challenges and issues that should be overwhelmed. One of the main challenges is the fact that despite the intensive dynamic of trade relations development with China, its share in the WB countries' total trade still remains at a rather modest level of around 8%. In 2021, China's participation in total imports of the WB was 11%, and in exports only 3%, while the EU appeared as the most important foreign trade partner of the countries of the Western Balkans with a share of 81% in exports and 58% in imports (Eurostat, 2022).

Another issue is the fact that the trade is strongly in favor of China, which means that the countries of the WB record a continuous deficit. This fact in itself would not be so worrying because China generally has a positive balance with most countries around the world, but the challenge is that when it comes to the WB region, the trade deficit with China has been steadily deepening over the last few years, and this is particularly relating to Serbia, Croatia and Albania (Figure 4).

**Figure 4.** The Western Balkans-China trade balance, in bln. USD

Source: UN Comtrade database

One of the key obstacles that remain is poorly diversified exports, which applies to all Western Balkans countries. Namely, the backbone of exports in the previous period comprised

ores, iron and steel, coppers, wood and wood products, as well as construction materials such as sand and concrete. All these products represent products with low added value, which means a very unfavorable position for the WB countries compared to China.

Furthermore, trade cooperation is often slowed down by barriers to market access like subsidies, capital restrictions on foreign investments, lack of transparency, and complicated regulation in China. The delay in the agreements' implementation, which refers primarily to acquiring export licenses, could also be mentioned in this concern.

A challenge that also defines trade cooperation is the absence of a strategic approach and lack of institutional support, which is the problem all six countries continuously face. In addition to that (but in some manner as a consequence of the lack of a strategic approach), "*insufficient access to information, language and cultural barriers, mistrust and risk of fraud*" appear as serious obstacles as well (Gigov & Poposka, 2022).

The global market situation should also be considered in the context of the key obstacles. Namely, the trade flows, as well as global value chains, had barely recovered after the disruptions caused by the Covid-19 pandemic when the Ukraine-Russian Federation conflict and consequent energy crisis took over the role of the major blow to the global economy. The growing geopolitical tensions and economic turbulences have already had a negative impact on the GVCs and global trade flows, which means the new disruptions in the trade relations between China and other countries worldwide, including the WB region, could also be expected in the forthcoming period.

Recommendations for the overwhelming of key obstacles

Considering the above-discussed key challenges, one can get the impression that the prospects for the development of trade relations in the upcoming period are not very promising. However, it should be borne in mind that there is still a significant potential that, with an appropriate strategic approach, the WB countries can use to improve the current situation.

Regarding the opportunities, the size of the market should be taken into account, as well as the growth of the purchasing power of Chinese consumers, which means that there is definitely room for more intensive promotion of domestic companies to enter the Chinese market. With full appreciation of China's economic superiority, the countries of the Western Balkans have certain comparative advantages on which the further development of trade relations with China should be based. This primarily refers to the price competitiveness of highly educated human resources in the field of advanced technologies and potential in the field of agricultural production and processing food (Beraha & Jovičić, 2021).

It is necessary to encourage the attraction of investments in strategically important sectors that could produce greater added-value products. In this regard, work should be done to promote the inclusion of the countries of the Western Balkans in the global value chains of Chinese producers and, in this way, also contribute to increasing exports of higher value-added products and helping productivity gains and income growth.

Having in mind similar trade patterns of the Western Balkan countries and close economic and trade cooperation inside the region, it is worth considering the development of a joint tactical approach to exports enhancement, the removal of trade barriers, and to the better positioning of the domestic companies on the Chinese market. Moreover, the cooperation in this context should be deepened not only among the WB but also with other countries of the CEE region since most of them are participating in the China-CEE mechanism.

The authors completely agree with the crucial recommendations offered by Gigov and Poposka (2022) regarding the fact that "all WB countries, except Serbia, have a limited understanding of China in terms of its goals, opportunities, politics and public policies", which appears as one of the major challenges that should be overwhelmed. Namely, Gigov and Poposka (2022), in this context, conclude that it is necessary to acquire expertise and knowledge and

create a strategy that will enable policymakers to make decisions based on current and adequate information. Along with attracting Chinese investments, Western Balkan policymakers should be more proactive in initiating negotiations to improve trade relations and promote exports to maximize national interests. It should be mentioned in this regard that Serbia was the first country in the WB region to take an important step on the path of the development of the strategic approach towards trade relations encouragement with China by the announcement of the free trade agreement conclusion that should be signed by the end of 2022. Currently, it is difficult to predict all benefits and risks the FTA will bring since all details and obligations are yet to be specified. Nevertheless, it is expected that the FTA would further strengthen the economic relations between Serbia and China by delivering enhanced investment and trade opportunities.

CONCLUSION

Involvement in international trade flows contributes to the improvement of competitiveness and encourages economic growth and development of national economies. International trade is of special importance for developing countries since it, among other things, enables the realization of the effects of economies of scale, a higher degree of capacity utilization, attracting foreign direct investments, increasing employment, and technological advancement.

Trade undoubtedly represents a very important aspect of economic cooperation between the countries of the Western Balkans and China, and the deepening of relations during the past decade has resulted in the continuous growth of bilateral trade. Whereby the intensification of trade cooperation and the acceleration of foreign trade occurred, especially after the accession of the countries of the Western Balkans to the Belt and Road initiative, i.e. the China-CEE mechanism, which is an integral part of the Belt and Road initiative aimed at the development of China's economic relations with Central and Eastern Europe.

Regardless of the deepening economic relations with China, which was, among other things, reflected in an increase in the trade volume, the WB countries still face many challenges that should be overcome. Primarily, it refers to the deepening trade deficits, poorly diversified exports, lack of the appropriate strategic approach and support to the domestic companies willing to enter the Chinese market, and, finally, the situation on the global market.

In the forthcoming period, efforts should be made to attract Chinese investments in strategically important sectors as well as to promote the inclusion of domestic companies in the GVCs of Chinese producers in order to enable greater production of higher added value products and as well as contribute to export diversification. Of great importance also is the development of comprehensive strategies and more proactive Western Balkan policymakers' approach to export promotion and initiating negotiations that would lead to the enhancement of economic relations with China based on better benefits stemming from more balanced trade.

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