25th MIC
Management International Conference
Koper, Slovenia • 3–6 June 2026

Economic Spillover Effects from Slovenia to the Western Balkans: A Panel VAR Analysis

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Abstract. This study investigates the economic spillover effects from Slovenia to selected Western Balkan (WB) economies, namely Bosnia and Herzegovina, Croatia, Kosovo, Montenegro, North Macedonia, and Serbia. As an economically relatively advanced and European Union (EU)-integrated economy, Slovenia is hypothesised to function as a regional transmission hub through which economic shocks, capital flows, trade linkages, and policy signals propagate to geographically and historically approximate countries.

The study uses a Panel Vector Autoregression (PVAR) framework to capture the interdependence among key macroeconomic and proximity variables using annual panel data from 2010 to 2024. The data was isolated from the secondary World Bank Development Indicators (WDI), Bank of Slovenia, and Republic of Slovenia Statistical Office (SiStat) databases. Gross domestic product (GDP) growth in WB countries is used as the dependent variable, while Slovenia's GDP growth, foreign direct investment (FDI) outflows and exports, respectively, from Slovenia to WB countries (SiStat), and interest rates (WDI) are used as the main explanatory variables in the model. The data is isolated for all six WB countries, and a panel is performed. Additionally, up to three dummy variables were utilised: first, EU membership; second, euro adoption; and third, Central European Free Trade Agreement (CEFTA) membership. This approach enables the analysis of both direct and indirect transmission mechanisms over time. Additionally, the distances between the capitals are added to the econometric model.

Impulse response functions and variance decomposition analyses are used to determine the magnitude, direction, and duration of spillover effects. It is expected that the results will show that Slovenia's performance has a significant impact on growth paths in the WB countries through export and investment, with interest rate changes sending either positive or negative signals, depending on the economic cycle stage.

The study contributes to the literature on regional economic integration by providing empirical evidence on spill-over effects from Slovenia to WB countries. It also offers important policy implications, which show the need for enhanced regional coordination and strategic alignment to foster sustainable and inclusive economic development.

The study's limitation concerns the data vector, which excludes some shocks, such as Slovenia's euro adoption or Montenegro's or Kosovo's de facto euro use since 2001. However, the influence of

international shocks might be underestimated if no external variables linked to the main global shocks are incorporated.

Keywords: Economic Spillover, Capital Flows, Trade Linkages, Policy Signals

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