REGIONAL INVESTMENT REFORM AGENDA IN THE WESTERN BALKANS: REVIEW AND POLICY PROPOSALS

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Abstract - The Berlin Process is an initiative to boost regional cooperation among the Western Balkans (WB6) countries and their European integration in four areas: trade, investment, mobility and digital integration. Investment is the major component expected to have a major impact on promotion of intern-regional investment and attract FDI into WB6. WB6 have a common interest to deal with shared impediments to foreign investment that should be removed in order to make the region more attractive to foreign investors and promote WB6 as a single investment destination. However, they also compete with one another to attract foreign direct investment (FDI), which makes it challenging for policymakers to reach agreements on harmonizing their investment promotion policies and cooperation. This policy research contributes to the ongoing debate of Berlin Process Agenda by providing policy advice to promote regional economic cooperation and boost investment. Our proposal is to identify key areas of common interest in order to encourage cooperation among WB6 and recommend solutions with common interest.

Index Terms - Western Balkans, regional cooperation, FDI, SMEs.

I. INTRODUCTION

The need for investment policy convergence in Western Balkans

Creating friendly business environment is crucial for boosting entrepreneurship, investment and growth [1]-[2]-[3]-[4]. The WB6 economies have a greater need for FDI given their limited domestic potential due to limited savings [5].The economic potential of EU will benefit WB6 economies, given that the EU is experiencing positive economic trends and is WB6' main trading and investment partner. In addition to absorbing about half of their exports, the EU also offers these economies the best opportunity to integrate into the global value chains [6]-[7].

Foreign investors are in search for stable political regimes, rule of law, legal protection or property rights, investment incentives, and favorable tax policies as well as larger supply bases for their global value chains. To become an attractive player in the global value chain the WB6 region should take serious steps to harmonize investment policy and increase the supply capacities of local companies. Most of the trade involving international production chains in the WB6 economies is with the EU [8]. Having in mind that sustainable investment and effective global trade systems are crucial driving force of an economy and that the WB6 region has great potential to perform better in terms of attracting FDI in the region, the need for greater coherence is recognized.

Upgrade of physical infrastructure, development of technology and innovation capacity and creation of employment are the main focuses for achieving the goals of Berlin process and SEE 2020 Strategy [9] as well. Sustainable investment, as one of the tools for achievement of these goals, will help to further integrate and enhance the investment environment of the region, particularly in areas pertaining to investor entry, mutual protection and incentive schemes, supplier cooperation to increase absorption capacities of large scale byers.

The WB6 economies need to join efforts in increasing horizontal and vertical cooperation of companies. The UNCTAD Investment Policy Review [10] argues that WB6 economies need greater cooperation on improving the business climate in order to attract increased inflows of FDI. WB6 economies compete to attract FDI, which makes it challenging to reach agreements on harmonizing their investment promotion policies. On the other hand they have a common interest to deal with common impediments to foreign investment that should be removed in order to make the region more attractive to foreign investors and promote WB6 as joint investment destination.

II. STATE OF THE PLAY IN INVESTMENT REFORM IN WESTERN BALKANS

The major component of the Berlin Process is investment reform agenda with aim to boost the WB6' attractiveness for investments by utilizing appropriate legal instruments for implementation, monitoring investment reforms and other necessary joint actions. Despite its importance the investment reform agenda has been hindered by bilateral issues between the WB6 which always been an impediment to any regional cooperation initiative, regardless of how profitable regional initiatives sound.

For example, recent evidence warns that attracting FDI to the Western Balkans is turning into a "race to

the bottom"?, by introducing tax breaks, fiscal and non-fiscal incentives and heavy subsidies often not in line with EU state aid rules [6]. Thus, the problem of strong national FDI attraction policies that are against the EU state aid regulations makes the cooperation between WB6 more complex and difficult to implement. Implementation of the national legislative frameworks in line with EU state aid regulation would provide a stronger impetus for regional cooperation. There is a necessity to work on identifying common interest to deal with shared impediments to foreign investment, such as arbitrary processes that should be removed in order to make the region more attractive to foreign investors.

The trade barriers poses another challenge which deterrents to investment in the region. [11] shows that WB6 have entered into numerous free trade agreements with key regional trading partners, but non-tariff barriers to trade, such as quality standards and long, cumbersome customs procedures remain high and discourage effect on investment. The data from World Development Indicators shows that FDI inflows into WB6 still remain low compared to EU level. Western Balkan countries lag significantly behind the EU-11 in terms of FDI stock per capita received.

The average FDI stock per capita in the Western Balkans is around €2,600, compared with almost €6,000 in the EU-11 [12]-[13]. These investment figures remained low despite efforts of WB6 countries to encourage investors with a range of incentives, low labour cost, and designation of special economic zones.

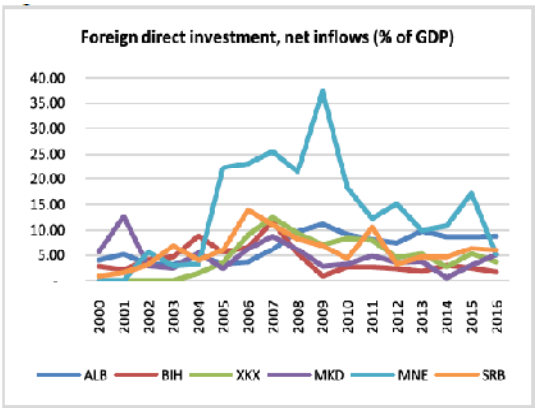


Figure 1
Source: Data from database: World Development Indicators 2018.

The FDI inflow data depicted in the figure 1 show that already low FDI net inflows as percentage of GDP in Serbia fell between 2010 and 2016, after a continuous increase from 2004-2009. The relatively high investment rates (% of GDP) in Albania and Kosovo. Nearly 50% of total FDI inflow into the WB6 region are directed to Serbia, followed by Albania and Montenegro (Figure 2).

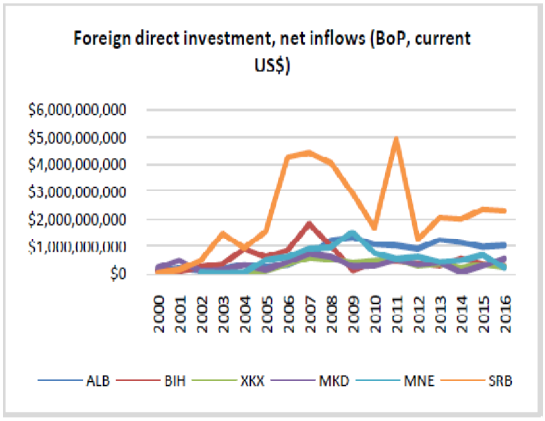


Figure 2.
Source: Data from database: World Development Indicators 2018.

From 2000 (with exception of MKD in 2002), FDI inflows have been increasing in all countries by 2008 in general, but after the global financial crisis its volume decreased sharply and still has not restored the level of 2008 FDI for most of the countries . To better understand diversity of FDI inflows in WB6 we compared the WB6 regional averages with Central Europe and the Baltics (CEB) (Figure 3). The FDI inflows as a share of GDP increased from 3.3 percent in 2000 to around 12 percent at their peak in 2007 in theWB6, while in CEB from 5.5 percent in 2000 to 12.6. Although, in the period of 2007-2015 WB6 outperformed CEB, the main challenge remains the spillover effects of FDI to local economy due to limited capacities of private sector of WB6 [6]-[7].

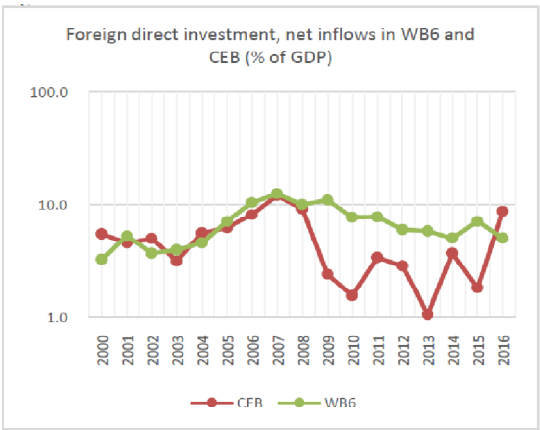


Figure 3:
Source: Data from database: World Development Indicators 2018.

Note: Logarithmic scale

The institutional framework is an important factor influencing, both domestic and foreign investment [1]-[14]-[15]-[16]-[17]. With rather small differences, all WB6 countries struggled in developing sound institutional framework. In this respect, the WB6 score much lower compared to their EU counterparts. For reference we have compared WB6 with Slovenia (ex-Yugoslav country, now EU member) outperforming all WB6 in all dimensions of world

governance indicators (Figure 4). The improvement of the governance environment and institutional framework of WB6 is considered to be an important feature of EU accession as well as prerequisite for attracting FDI.

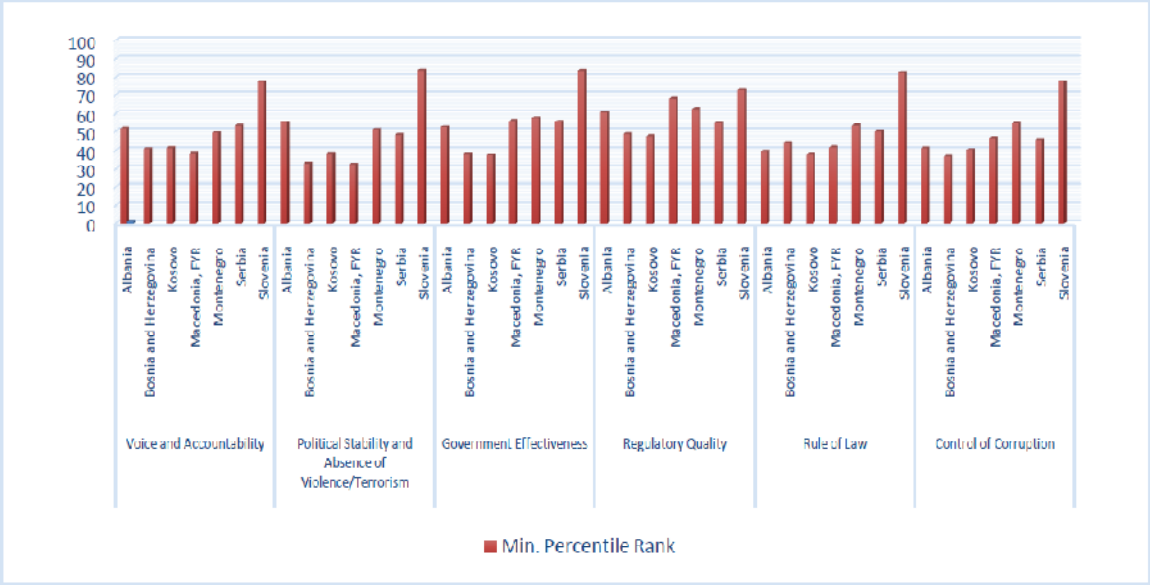


Figure 4
Source: World Governance Indicators (2018)

Note: Percentile Rank (0-100) Indicates rank of country among all countries in the world. 0 corresponds to lowest rank and 100 corresponds to highest rank.Due to these institutional challenges and insufficient human capital, effects from FDI were much less apparent in the Balkans and Russia than in other transition economies [5]. In this vein, [18] notes that recent emphasis on the "fundamentals first" approach indirectly calls for a focus on state building and strengthening the "infrastructure of the state" to perform its core functions and install level playing field for investors. Notwithstanding, WB6 has made some important steps to promote investment. OECD Competitiveness Report identified that the WB6 economies have made progress in providing a sound, predictable investment framework that is conducive to foreign investment. Foreign and domestic investors are treated on an equal footing, and investment procedures are increasingly transparent [19, p. 66]. ones, clusters and value chains, with the aim of increasing connectivity, efficiency and density. Investment promotion activities should support regional cooperation in attracting foreign investors to selected sectors. Some international examples can offer lessons and insights for joint investment promotion policies in the WB6 region [10, p. 57). As yet, no progress has been made in promoting the WB6 region as a single investment destination. Only two of the WB6 economies are members of the World Association of the Investment Promotion Agencies (Bosnia and Herzegovina and Kosovo).

The presence of FDI in WB6 can have a major development impact on the local supply base, since demand for inputs from local suppliers can expand the market for domestic enterprises; in turn this can have a multiplier effect on local employment and sales [22]. Local companies that supply FDIs in WB6 may broaden their activity to become suppliers within a wider global value chain, expanding to international markets [23]. In turn, these suppliers will be able to drive the development of small firms as a sub-contractors having and spillover effect in terms of employment and growth. However, the study by [6] and [11] and found only limited evidence of such effects in the WB6. Both studies show that FDIs main concern was the limited supply base capacities often leading to need for greater cooperation between local suppliers in the WB6 to become attractive player for attracting FDIs to a region. The fragmentation leading to a lack of scale economies is a serious handicap of the Western Balkan countries that cannot be overcome

Despite this progress, investors continue to struggle with complex taxation systems, unfriendly business environments, and unpredictable legal systems [20].

III. CAN WB6 REGION BE PROMOTED AS A UNIQUE INVESTMENT DESTINATION?

The SEE 2020 Strategy sets out an objective to increase the overall annual FDI inflows to the region by at least 160% [21]. It aims to promote regional investment policies that are non-discriminatory, transparent and predictable. The South East Europe Economic and Transport Corridors (SEETEC) study has identified potential areas of cooperation based on infrastructural and economic corridors in the WB6 region. Economic corridors are spatial organisations of economic activity between entrepreneurs, companies, industrial z

through more intensive regional cooperation and integration [24]-[25]. The development of the national and regional support programs and packages to link FDI with local SMEs can increase the supply capacities of local companies. There is a need to go beyond individual borders of WB6 by helping local companies cooperate together regionally and increase their contracting capacities. By developing such programmes, the WB6 region could perform better in terms of attractingFDI to the region. At the same time, this cooperation will be likely to have positive impact on inter-regional investment.

CONCLUSIONS AND POLICY PROPOSALS

Although some progress in investment policy reform has been noted across the region, more could be done to consolidate those efforts and translate those in concrete results. In order to avoid possible distortion caused by bilateral and political issues the first step would be to identify the areas that are beneficial to all WB6 participating economies. Besides the obvious competition of individual economies in WB in attracting FDI, there is plenty of room for cooperation with regard to promotion of investment opportunities. The WB6 countries should move towards joint policy actions to boost FDI in the region. To do so, there is a need for more investment policy convergence in order to increase capacities to absorb more FDI in the region. The following steps include;

- The need for restriction of strong national policies to attract FDI which are against the state aid regulation would be a first step towards joint investment agenda. The implementation of the legislative framework in line with EU will easy regional cooperation.
- Formalizing the regional investment reform agenda through appropriate instruments requires
- WB6 for FDI but a challenge remains to implement more appropriate government policies,
- The WB6 should concentrate efforts in building strong institutional framework and improve quality of the business environment in the region (as a determinant of FDI inflows). In this vein, the rule of law is precondition that should be addressed at national and regional level.
- The the WB6 should remove the barriers to trade that still exist within the CEFTA countries which is likly to foster the development of regional intraindustry trade.

  In addition, policymakers should consider pursuing strategies to unlock FDI potential and improve the gains from FDI activity in their country. Promotion of WB6 as a single destination is also a key consideration here. Some strategies include:
- The promotion of the WB6 region as a unique investment destination should be based on studies of selected areas of cooperation between the WB6 economies, including on integrating the WB6 consensus among the WB6 authorities. In order to facilitate an agreement a study should be carried out on appropriate regional investment promotion instruments acceptable to all WB6 governments. This would assist the WB6 authorities to agree on potential areas of cooperation including which sectors should be prioritized.
- Upon agreement of an investment reform agenda and the identification of priority areas of cooperation, a monitoring mechanism for the implementation of the agenda should be established. This would enable the WB6 authorities, the RCC, CEFTA, regional chambers of commerce, and other relevant institutions and organisations to evaluate progress in the investment reforms and to identify the resources needed to implement the regional investment reform agenda. Strengthening the capacities of the relevant institutions through joint meetings and workshops should be a priority. In addition, impact assessment studies should be carried out to review progress in implementing the reform agenda.
- The WB6 economies could improve the regional business climate by increasing cooperation on investment policy, including in the areas of FDI-specific laws and international investment agreements, competition policy and business and trade facilitation. A comprehensive framework to align key investment policies is needed. This should be based on a comprehensive review of studies to synthesize all available information on FDI, on policy barriers and on good practices. Legal harmonization with the EU acquis could improve attractiveness of the Invest Regional Platform the

  economies into international value chains. This requires joint efforts to create supply chain linkages, intra-regional investments in specific sectors, and harmonizing tax incentives. The regional investment reform agenda could benefit from lessons from other regional initiatives around the world [see 10].There are some specific sectors that can be potential candidates for joint promotions such as tourism, and local suppliers in certain industries. The EBRD Investment Regional Platform is a good example of cooperation in promoting the WB6 region as an investment destination. This internet-based platform will enables investors to accesses information on investment conditions at country and regional levels.
- In line with international experiences, cooperation between WB6 Investment Promotion Agencies should be encouraged to promote foreign investment in the region. The formation of a formal structure of investment promotion agencies with key target on specific sectors with

common interest. Some activities may include: investment promotion portals, organize international investment conferences, promote the use of technology-based solutions, organize sector briefings and participate jointly at international and regional trade industry shows, especially within the target sectors. Advocate the regional investment reform agenda, appointing specialized staff for regional promotion within investment promotion agencies, assist in creating a database of suppliers' in the WB6 region, organize Regional B2B meetings with local suppliers from the WB6 economies and foreign investors.

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