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Study on existing business linkages between SMEs from the European Union and the Western Balkans: A focus on FDI in manufacturing sectors

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DRAFT FINAL REPORT

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The usual caveats apply: the research team is responsible for any deficiencies in the report.

[1]Under United Nations Security Council Resolution 1244/99

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Abbreviations and Acronyms

AIDA	Albanian Investment Development Agency
B&H	Bosnia and Herzegovina
BPM	Balance of Payments Manual
CEE	Central and Eastern Europe
CEFTA	Central European Free Trade Agreement
DG NEAR	Directorate-General for Neighbourhood and Enlargement Negotiations
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EEN	Enterprise Europe Network
ERP	Economic Reform Programme
EU	European Union
EULEX	European Union Rule of Law Mission in Kosovo
EUR	Euro
FDI	Foreign Direct Investment
FIAA	Foreign Investors Association of Albania
FIC	Foreign Investors´ Council
FIE	Foreign investment enterprises
FIPA	Foreign Investment Promotion Agency
fYRoM	Former Yugoslav Republic of Macedonia
GDP	Gross Domestic Product
ICT	Information and Communication Technology
ILO	International Labour Organisation
IMF	International Monetary Fund
IPA	Instrument for Pre-accession Assistance
KE	Key expert
KFOR	Kosovo Force
KIESA	Kosovo Investment and Enterprise Support Agency
MDD	Montenegro Development Directions
MIPA	Montenegrin Investment Promotion Agency

NIPA	National Investment Promotion Agency
MNC	Multinational Corporation
MSME	Micro, Small and Medium Enterprises
MTI	Ministry of Trade and Industry
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne
NARD	National Agency for Regional Development
NATO	North Atlantic Treaty Organisation,
NDS	National Development Strategy
NIPA	National Investment Promotion Agency
OECD	Organisation for Economic Co-operation and Development
PPP	Public-Private Partnerships
R&D	Research and Development
RDA	Regional Development Agency
RCC	Regional Cooperation Council
SEE	South East Europe
SIEPA	Serbian Investment and Export Promotion Agency
SMEs	Small and Medium-sized Enterprises
TAT	Technical Assistance Team
TEDA	Technical and Economic Development Area
TEDZ	Technology and Economic Development Zones
TL	Team Leader
TNCs	Transnational Companies
ToR	Terms of reference
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organisation
UNMIK	United Nations Interim Administration Mission in Kosovo
VAT	Value Added Tax
WB	Western Balkans
WiiW	Vienna Institute for International Economic Studies

1 INTRODUCTION

This report focuses on Manufacturing Foreign Direct Investment (FDI) by European Union (EU) Small and Medium-sized Enterprises (SMEs) in the Western Balkans (WB), covering the following six countries: Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia (fYRoM), Kosovo[2], Montenegro and Serbia.

The Terms of Reference (ToR) for this assignment note that the following five elements form the core of the EU SME manufacturing FDI in WB project:

- Mapping manufacturing FDI in WB;
- Analysis of main manufacturing sub-sectors;
- Country specific analyses;
- Analysis of three EU SME manufacturing case studies;
- Conclusions and recommendations.

The material, analysis and recommendations contained in this report are fairly unique.

This is because although there has been extensive research and analysis on the issue of Foreign Direct Investment (FDI) in general, it has covered almost exclusively Multinational Corporations (MNCs), rather than SMEs per se. In addition, although many regions of the world have been extensively studied and much data exist, this does not necessarily apply to the geographical focus of this report, namely the WB region. In the six countries covered, there is relatively limited FDI data and such data that exist do not always cover the manufacturing sector well, do not necessarily distinguish SME investment from any other form of FDI and definitional issues constrain comparability across countries or across a 10 year time period on a consistent basis (the data sources include World Bank, UNCTAD, Eurostat, WiiW and local sources such as central banks and national statistics offices of the individual countries). Furthermore, available data on FDI in the WB region are composed of FDI inflow and outflow, as well as stock of FDI and at the country level differentiate according to the type of activity but not by size of enterprise. The above has implications for what is possible for this report to map. Nevertheless, there is sufficient information to provide a comprehensive picture of the situation in the WB. This is what Chapter 1 focuses on (and annexes 1-4), to the extent that the data allow.

The country specific analyses are also a useful new development. Although much has been done in terms of research and technical assistance, this is the first analysis that presents all six countries on a comparable basis. Chapter 3 takes each country in turn and highlights the FDI trends and manufacturing sector in the last decade. The analysis then focuses on the policy environment that they operate within, as well as the institutional basis for FDI generally, which tends to be in the form of National Investment Promotion Agencies (NIPAs), through their nature varies a great deal across the WB. The Chapter concludes with some pointers for possible future development.

The final and most novel part of the research concerns the presentation of three EU SMEs originating from respectively Belgium, Germany and Slovenia that have invested in the WB region. These were selected as case studies to illustrate the types of investment that have been made and the effect that such FDI can have on the companies themselves and on the countries that they operate in, namely Serbia (Machinery production sector), Bosnia and Herzegovina (Metal processing sector) and Former Yugoslav Republic of Macedonia (Food and beverages sector). The sectors that the SMEs invested in were selected based on the potential they offer in the WB region. Among other things, the case studies assess the extent to which they have received support from the national Investment Promotion Agencies (NIPAs). Generally, such support has been very limited, but greater levels of EU SME manufacturing FDI have the potential to be a win-win situation for both the investing companies and for the countries / regions / localities receiving such investment.

The final chapter focuses on policy recommendations. It has to be read in the context of the South East Europe 2020 Strategy, which contains many elements of a development model that could deliver faster economic growth in the WB region. The 2020 Strategy seeks to stimulate key long-term drivers of growth through a set of interlinked development pillars, which include specific sectoral dimensions of regional cooperation, including investment, trade, employment, energy, transport, R&D, innovation, social development and governance. A key target of the 2020 Strategy is to increase overall annual FDI inflows to the region by at least 160% by 2020 (SEE 2020, p.12). In view of the extensive level of

[2]Under United Nations Security Council Resolution 1244/99

deindustrialisation that has taken place in the WB region, a regional growth model must seek to strengthen the real sector of the WB economies, as this is a crucial element for improving export performance and increasing competitiveness in European as well as global markets.[3] Therefore, the final chapter presents a series of recommendations for stimulating greater levels of investment in the manufacturing sector, including a greater emphasis on attracting EU manufacturing SMEs to invest in the WB region.

In the preparation of this study on the SME FDI to WB economies, the expert team carried out desk research to better understand the key macroeconomic aggregates in determining FDI trends, especially from the SME sector for the six economies. Additionally, data on the international trade of the WB economies was also analysed to see the potential influence of trade flows in these countries with the EU and determine possible links with FDI export. Since this research is relevant to the preparation of this report but not central to it, the relevant data and the key findings are presented in Annexes 1: "Economy and Industry Development of Western Balkans" and 2: "Development of trade relations between EU and Western Balkans" of the report.

[3] Milica Uvalic, *Economic development in the Balkans: Is it possible to grow faster, smarter, better*? 2015

2 MAPPING FDI IN THE WB

2.1 Context

This Chapter maps the nature of FDI in the six selected WB economies, with the aim of providing an overview of trends in FDI, emphasizing EU international activities in WBs and, subject to data, availability; trade and FDI relations, using of existing literature and data from UNCTAD/WiiW and other sources such as national banks of WB economies, World Bank, Eurostat and national statistical offices.[4]

It is important to stress that there is relatively limited available FDI data and those available do not always cover different economic sub-sectors, do not distinguish SME FDI from any other form of FDI and may not be comparable across six countries or available on a consistent basis over the period of the last decade. In general, available data on FDI in the WB region are composed of FDI inflow and outflow, as well as stock of FDI and at the country level include their differentiation according to the type of activity but not by size of the company. This has implications for what is possible to map, as well as for the country specific analysis (see Chapter 3) below.

As FDI determinants depend on country, industry and company specific characteristics, the focus of this part of analysis is on the economic and industrial framework of WB economies, its international relations, particularly relations with EU, influencing development levels of each country under observation and consequently their attractiveness for foreign investments.

The fact is that the countries of the WB have undergone a major economic transformation over the past 15 years. During 2001-2008, the countries in the region experienced relatively fast economic growth, gradual macroeconomic stabilisation, major inflows of FDI and implemented many important economic and institutional reforms (see Annex 1 for further details). The fresh start in economic development was sustained by a new strategy of the EU which facilitated economic integration of the WB through increasing trade, FDI, banking and financial integration. Economies have become increasingly export-oriented which has been accompanied by increasing diversification of their export markets, with greater trade within the region and concomitantly, less reliance on exports to advanced EU economies(see Annex 2 for further details).

However, regardless of increasing investments, improved export and macroeconomic performance, FDI inflows in WB region have been directed much more into non-tradable sectors, such as financial services, real estate, and construction, rather than tradable sectors such as manufacturing. Consequently, the impact of FDI may vary greatly depending on characteristics of the sector and its linkages to the rest of the economy.

Generally, the scale and direction of the FDI impact on the host economy are conditional on factors such as the level of development (Meyer and Sinani, 2009) or minimum levels of human capital, financial market development and market linkages (Bruno and Campos, 2014). Foreign firms generally possess technology that is more advanced and have more advanced management practices compared to domestic competitors. Once foreign firms have entered a domestic market, the diffusion of ideas and transfer of technology resulting from interaction with the local economy are likely to occur via a variety of formal and informal contacts and exchanges (Haskel et al., 2007; Javorcik, 2004). These are the source of spillovers to domestic firms, and are typically considered to operate either within an industry (horizontal) or up and down a value chain of industries (vertical).

Unlike the primary and manufacturing sectors where output is tradable, services are mostly non-tradable and require close proximity between producers and consumers. Therefore, much of the FDI in the sector is market seeking where forward linkages for FDI are well defined and potential impact of

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[4]Concerning past and current FDI trends, the analysis focuses on FDI inflows and FDI inward stock:
- *FDI net inflows* measure the value of inward direct investment made by non-resident investors in the reporting economy, including reinvested earnings and intra-company loans, net of repatriation of capital and repayment of loans;
- *FDI stocks* measure the total level of direct investment at a given point in time, usually the end of a year. The inward FDI stock is the value of foreign investors' equity in and net loans to enterprises resident in the reporting economy. From the point of export potential, the structure of FDI stocks is of relevance because it includes accumulated FDI in specific sectors and excludes tendency of high fluctuation in FDI flows per annum in different sectors that could be influenced by short-term factors.

FDI in the sector is great. For example, in the highly capital-intensive infrastructure sector, FDI can provide the necessary funding and technology to improve capacity to meet increasing demand, as well as improve the quality and lower the cost of the services. In the same vein, FDI in the banking sector can have an important impact on both the efficiency and stability of the banking system through increased competition and increased access to global financial markets. If FDI in the sector improves these services in a country, almost all other sectors will be positively affected.

This Chapter presents an overview of FDI at the regional level (WB) and then presents an in-depth analysis of FDI to sub-sectors of manufacturing within WB economies, except for Kosovo[5] and Montenegro, which do not record FDI inflows and stock per sectors.

In the preparation of this study on the SME FDI to WB economies, the expert team carried out desk research to understand better the key macroeconomic aggregates in determining FDI trends for the six economies. Data on the international trade of the WB economies was also analysed to see the potential influence of trade flows in these countries with the EU and determine possible links with FDI export. Therefore, the Annexes to this report supplement the analysis presented in this chapter. The annexes are as follows:

- Annex 1: Economy and Industry Development of Western Balkans;
- Annex 2: Development of trade relations between EU and Western Balkans;
- Annex 3: FDI Incentives and Utility Prices in Western Balkans.

2.2 FDI and related indicators in WB

2.2.1 FDI impact on economic development

FDI Definition:
Investment in a given country is regarded as FDI if the share of a foreign investor makes up at least 10% of the target firm's equity capital; that share can be as much as 100%.

Source: The IMF Balance of Payments Manual, Revision 5.

According to UNCTAD (2007), FDI has three components: equity capital (shares of foreign enterprise), reinvested earnings (share of earnings not distributed as dividends or not remitted to the direct investor) and intra - company loans (short or long - term borrowing and lending of funds).

FDI can have a positive direct impact on domestic firms' total factor productivity and export. FDI is considered to positively influence welfare increases in the host country due to advantages related to the introduction of new technologies and innovation, new managerial techniques, development of additional skills, increased capital, job creation and improvement of working conditions, and the development of the industrial sector in the host country. Also important are the acceleration of learning processes and creation of knowledge spill-over, changes in managerial culture, raise of quality standards, encouragement of formation of cross-border cooperative alliances and similar. Therefore, FDI assists the formation of human capital, contributes to trade integration, enhances enterprise development and is crucial in increasing competitiveness. FDI is a key to growth especially when domestic investment and savings are low. Overall, FDI is crucial in order to intensify competitiveness and economic development.

All the above can but does not automatically happen because of FDI. An important question concerning transition economies, has been whether FDI had had any effects on economic growth or export (export growth is usually considered as the main source of economic growth). The results are not clear. Campos and Kinoshita (2002) researched 25 transition countries between 1990 and 1998, and the results indicated that FDI had a significant positive effect on the economic growth/export of the each of the selected countries. However, other studies, such as Carkovic and Levine (2002), have not found a significant relationship with economic growth/export for transition countries and FDI (cited in Lyroudi et al., 2004). These conflicting results could be explained by different countries having different determinants for attracting FDI, but also by differences between the transition countries themselves, both in their regulatory and political systems and also in how predictable and stable the country is (Lyroudi et al., 2004).

A *less expensive labour force* together with a *rich base of raw materials* is favourable geographical factor for foreign investors relocating part of their production from their home country. The second

[5]Under United Nations Security Council Resolution 1244/99. From now on, the report simply refers to Kosovo.

motive for foreign investors might be the *possibility to expand their own market* either by just organising production in other countries (and thereby reducing transportation costs among other costs) or by using the organised production as a platform for market expansion to even more distant regions. This market expansion argument is related to yet another factor, namely that all the countries in the WB region have made clear their intention to join the European Union (EU). This implies that the investors would have the advantage of entering segments of the future common market prior to its actual integration. The third factor is related to the EU *accession process*, which gradually introduces a familiar business environment and familiar standards in WBs, together with friendly FDI environment thereby enabling foreign investors to have more similar business conditions to their own than in locations which are not so 'close to home'.

2.2.2 FDI indicators in WBs

For many developing countries, FDI inflows are a major source of external financing and thereby provide an important means of implementation of sustainable development goals and growth of the private sector. FDI inflow maybe expressed as absolute net inflows and as per capita inflows.

FDI net inflows are the value of inward FDI made by non-resident investors in the reporting economy, including reinvested earnings and intra-company loans, net of repatriation of capital and repayment of loans. FDI is a key element in international economic integration because it creates stable and long-lasting links between economies and could be an important channel for the transfer of technology between countries; it also promotes international trade. In line with this, *FDI inward stocks* measure the value of foreign investors' equity in and net loans to enterprises resident in the reporting economy. FDI stocks are measured in absolute amounts and as a share of GDP.

FDI has played an important role in enterprise restructuring in the whole region during transition, in this way greatly strengthening the private sector and contributing to structural changes. Kekic (2005) analyses trends in FDI in the Balkans during the early 2000s, concluding that the upsurge in FDI has been based also on following minimal conditions – the restoration of peace and basic security, the beginnings of economic recovery and modest improvements in the business environment.

Macroeconomic stabilisation, relatively strong GDP growth, increasing foreign trade and gradual catching up with the more developed countries characterised the WB economies between 2001 and 2008. Acceleration in economic reforms also took place, even in countries that until 2000 had been lagging behind (Serbia, for example). Since 2001, the WB countries have implemented trade liberalisation with the EU and within the Balkan region, gradually improved the business environment, and privatised many enterprises and almost the entire banking sector.

Such positive trends in political and economic environment during beginning of previous decade together with active policy of attracting FDI had direct impact on FDI inflow in WB economies.

Table 1. FDI inflow in period 2005-2014

(in million EUR)

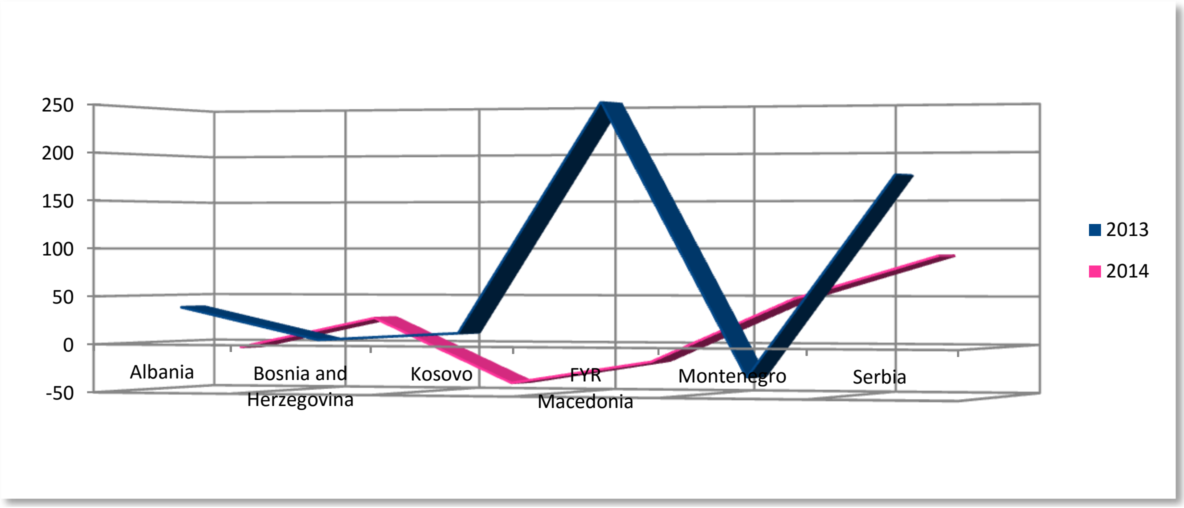
Indicator/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Albania	213	259	481	665	717	**793**	630	666	923	869
B&H	282	442	**1329**	684	180	307	355	**285**	300	378
fYRoM	77	345	**506**	400	145	160	337	**72**	251	205
Kosovo	108	295	**441**	366	287	366	394	**229**	259	151
Montenegro	403	496	**683**	656	**1099**	574	401	**482**	337	498
Serbia	1268	3392	**2513**	2018	1410	1003	1949	**284**	779	1500

Source: WiiW database.

As the Table above illustrates, the FDI in the WB has been notably weak since a peak in 2006-07 and with the emergence of a new crisis in all countries except Albania and Montenegro, and annual FDI inflows collapsed in 2012-2014 also due to fact that most of the FDI into WB economies was related to the privatisation process (which is, more or less, exhausted in most countries) and the interest of foreign investors was thus related to the buying out of existing and potentially profitable enterprises.

Under the impact of the global economic crisis, for the analysed WB countries as a group, the decline amounted to 25% in 2009 in FDI inflow. The largest drop was recorded in the country that received most FDI in the previous period. In Bosnia and Herzegovina decline reached 74%, following by fYRoM (64%) and Serbia (30%). The remaining countries, such as Albania and Montenegro, actually recorded increases of FDI in 2009. The data shown in this section reveal that FDI in the region has been significantly affected by the crisis and could not contribute much to economic growth.

Chart 1. FDI inflow growth in WBs in 2013-2014 in %



Three countries of WB region recorded FDI inflow growth in 2013, namely Albania, fYRoM and Serbia. In absolute amounts, Albania was the country with largest the FDI inflow in 2013, but in respect to inflow growth in same year fYRoM experienced rise of 249%, the largest growth between WBs, followed by 174% of FDI inflow growth by Serbia. Albania hosted more foreign projects in the energy sector while the other two countries continued their FDI-friendly policies attracting greenfield investments. fYRoM and Serbia recovered from an exceptionally low level registered in the previous years (drop in FDI growth in 2012 by 68,9% in fYRoM and 85,9% in Serbia). fYRoM had intensive promotion activities that contributed to high FDI inflow growth in 2013. Montenegro experienced a significant drop in FDI inflow compared with other WB economies in 2013, but with Serbia and Bosnia and Herzegovina recorded FDI Inflow growth in 2014.

Table 2. Inward FDI stock in period 2005-2014

(in million EUR)

Indicator/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Albania	865	1057	1830	2061	2261	2436	3400	3503	3700	4553
B&H	1951	2432	3666	4385	4815	4978	5439	5605	**6000**	**5953**
fYRoM	1769	2099	2545	2969	3141	3322	3695	3746	4012	4023
Kosovo	-	-	924	1291	1582	1961	2326	2524	2774	3000
Montenegro	580	1076	1759	2414	3514	3167	3253	3567	3900	-
Serbia	4116	7508	10021	13892	14487	16689	19070	19716	**21223**	**22900**

Source: WiiW database.

Despite the fact that most WB economies started attracting FDI rather late, some only after 2003, the share of the six WB countries in total inward FDI stock of the transition region (CIS countries, CEE and SEE countries) increased from 0,85% in 2001 to 3,24% in 2014. All WB economies have attracted significant amount of FDI during decade but the increase has been uneven. By 2014, the inward FDI stock, in comparison to ten years earlier, increased in Albania and Serbia 5-fold (17-fold in Albania and 20-fold in Serbia compared with 1999), while in Montenegro inward FDI stock increased 6-fold in 2013 comparing with 2005. The only two countries that had a less impressive increase in inward FDI stock during the 2000s were B&H (a 3-fold increase) and fYRoM (2-fold increase). Regarding Kosovo, a 3-fold increase was recorded in 2014 compared with 2007.

Table 3. FDI inflow per capita in period 2005-2014

(in EUR)

Indicator/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Albania	71	87	164	228	249	278	223	238	325	307
B&H	73	115	346	178	47	80	92	74	78	99
fYRoM	38	169	248	195	71	78	164	35	121	121
Kosovo	66	177	261	213	164	206	219	126	142	84
Montenegro	646	794	1109	1063	1778	927	647	778	542	801
Serbia	170	458	340	274	193	138	269	39	108	209

Source: WiiW database.

In order to account for the very different size of the individual WB countries -Montenegro has a population of just 0.6 million while Serbia has 7 million - data on FDI inflow and inward FDI stock per capita can be used, though it can also lead to inappropriate conclusions. Montenegro, as the smallest WB country, is ahead of all other WB economies in FDI per capita terms, followed by Kosovo.

Table 4. Inward FDI stock per capita in period 2005-2014

(in EUR)

Indicator/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Albania	290	358	625	711	788	857	1207	1257	1309	1608
B&H	508	633	954	1141	1253	1295	1417	1461	1563	1.555
fYRoM	867	1027	1245	1448	1530	1615	1794	1817	1929	1909
Kosovo			547	751	905	1105	1292	1390	1517	1662
Montenegro	930	1722	2853	3909	5677	5107	5237	5748	**6290**	-
Serbia	554	1015	1360	1894	1983	2294	2656	2745	2956	3197

Source: WiiW database

In comparison with some CEE countries, Montenegro actually comes close to Hungary and Slovakia in terms of FDI stock per capita. Although in the ranking of countries in FDI per capita, Montenegro ranks in top position while five other WB countries occupy the bottom places, this indicator may be misleading because larger countries generally attract more FDI. Looking at the data, Montenegro received the largest FDI inward stock per capita, almost twice that in Serbia, which is another WB country with a notable amount of FDI inward stock as a percentage of GDP. Such large FDI inward stock per capita maybe explained, as in case of FDI inflow per capita, by fact the that Montenegro has a relatively small population (621,383 according to census data for 2011) and GDP of 3,4 billion EUR.

FDI inflow in WB economies as percent of GDP in the last ten years was on average 8%. This is significantly above the FDI inflow as percent of GDP in the CEE (an average of 3%).

Table 5. FDI inflow in period 2005-2014

(in % of GDP)

Indicator/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Albania	3,2	3,6	6,1	7,5	8,2	8,9	6,9	6,9	9,4	8,6
B&H	3,2	4,4	11,8	5,4	1,4	2,4	2,7	2,2	2,2	3
fYRoM	1,6	6,6	8,5	6	2,2	2,3	4,5	1	3,3	2,3
Kosovo	3,6	9,4	12,7	9,3	7,2	8,5	8,3	4,7	5	2,6
Montenegro	22,2	23,1	25,5	21,2	36,9	18,5	12,4	15,3	10,1	14,4
Serbia	6,2	14,6	8,8	6,2	4,9	3,6	6,2	1	2,4	6,8

Source: WiiW database.

Recent data suggest that FDI has contributed quite substantially to gross fixed capital formation in all the WB economies from 2005 onwards. During 2005-14, the ratio of FDI to gross fixed capital formation has been, on average, 13% for the whole WB region but it has been particularly high in Montenegro. In the WB economies countries it was mostly below 20% before the financial crisis and has been around 9% in later years, which suggests a smaller contribution of FDI to economic growth.[6]

Table 6. Inward FDI stock in period 2005-2014

(in % of GDP)

Indicator/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Albania	13,2	14,7	23,4	23,2	26	27,5	37,2	36,3	37,6	45
B&H	22,3	24,3	32,5	34,3	38,7	39,1	41,3	42,6	44,7	42,7
fYRoM	36,7	40,1	42,7	44,2	46,9	47,1	49,4	50,3	52,1	47,3
Kosovo			26,7	32,8	39,5	45,7	48,8	51,3	53,3	53,5
Montenegro	32	50,1	65,6	78,2	117,9	102	100,6	113,3	**116,9**	-
Serbia	20,3	32,2	35,2	42,5	50	59,6	60,6	66,6	66,3	68,7

Source: WiiW database.

The foreign capital as a share of GDP played a more important relative role, on average, in the WB than the CEE countries. The inward FDI stock represented, on average, 47% of GDP of the six WB economies in last ten years in comparison to the average of 40% of GDP of the CEE and Baltic states. This is most relevant for Montenegro but in all other WB economies, there is a trend of increasing share of inward FDI stock in GDP.

[6] WiiW, FDI report, 2014.

Looking at the latest data on FDI flows from last two years, FDI experienced a modest recovery at global level in 2013. UNCTAD reported a 5,5% increase during 2013, but global FDI inflows fell by 16% in 2014, The decline in FDI flows was influenced mainly by the fragility of the global economy, policy uncertainty for investors and elevated geopolitical risks. The sluggish performance in most of 2013-2014 is ascribed to a number of uncertainties that were discouraging multinational enterprises from investing, such as slow economic recovery in the euro area, slowing growth in China, and fears regarding the financial stability of emerging markets.

Table 7. FDI in WBs in 2013 - 2014

Indicator	Inflow mil. EUR		FDI net mil. EUR		Inflow per capita		Inward stock per capita		Inward stock % GDP	
Country	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014
Albania	923	869	893	720	325	307	1309	1608	37,6	45
Bosnia and Herzegovina	300	378	290	-	78	99	1563	1555	44,7	42,7
Kosovo	259	151	241	124	142	84	1517	1662	53,3	53,5
fYRoM	251	205	253	197	121	121	1929	1909	52,1	47,34
Montenegro	337	498	324	354	542	801	6290	-	116,9	-
Serbia	779	1500	769	1236	108	209	2956	3197	66,3	68,7

Source: WIIW database, national central banks sources.

Indicators for WB region from 2013 - 2014, in summary were slightly below the level of 2011, the year with the highest FDI inflow since 2008. The modest amount of recent FDI inflow in the last couple of years suggests its marginal support to economic growth, but according to UNCTAD projections, FDI to and from transition economies, including WB economies, is expected to decline further in 2015 due to the continued economic recession and low oil prices.[7]

2.3 Manufacturing FDI in WB

The manufacturing sector is important for strengthening export potential and accelerating economic growth and development. The different empirical findings suggest that FDI inflows could have an impact on:

- Manufacturing value-added;
- Manufacturing employment;
- Manufacturing exports of other countries.

These initiate questions of the type of policies that governments might implement to influence the quality of FDI in sectoral distribution.

The empirical findings performed by London School of Economics, suggest that FDI inflows have had no impact on manufacturing value-added, manufacturing employment and manufacturing exports of the WB economies during 2002-12.[8]In the manufacturing sector of the WBs, greenfield investments with export-orientation have been rather sporadic because of problems with the business environment and low level of infrastructure, which functioned as an important barrier to these types of investments.

The WB economies are today much more de-industrialised than most CEE countries. This is particularly visible from the output structure and manufacturing value added and its shares in GDP. **The average share of manufacturing value added in GDP for the six WB economies was 12% in 2014 and average share of services was 62% of GDP.**

Table 8. Structure of output of WBs in 2006, 2010 and 2014

(in % of GDP)

Years	2006			2010			2014		
Country	agriculture	industry	services	agriculture	industry	services	agriculture	industry	services
Montenegro*	-	-	-	-	-	-	10	18	72
fYRoM	13	29	58	11	28	61	10	25	65
Albania	23	22	55	20	19	61	23	25	52
Serbia	13	26	62	9	27	64	10	30	61

[7]UNCTAD, World Investment Report, 2015.

[8]The spillovers will be conditional on the host economy institutions and absorptive capacity. According to most indicators, absorptive capacity was limited in the WB countries. Foreign investors have tended to focus on the banking sector rather than manufacturing industry or agriculture, thus failing to address the long-run structural weaknesses of the WB economies. Saul Estrin, London School of Economics and Milica Uvalic, University of Perugia, "*Foreign Direct Investment in the Western Balkans: What role has it played during transition*", 16th June 2015.

Years	2006			2010			2014		
Bosnia and Herzegovina	10	25	65	8	28	64	8	27	66
Kosovo*	-	-	-	12	20	68	14	27	59

*Data for Kosovo and Montenegro are included in data for Serbia in 2006 as well as for Montenegro in 2010.
Source: WDI, World Bank.

Although the service sector dominated in output structure in all WB economies in 2006, its share mainly increased until the end of 2014 at the account of agriculture sector and less on the account of industry.

Table 9. Manufacturing value added of WBs 2005-2014

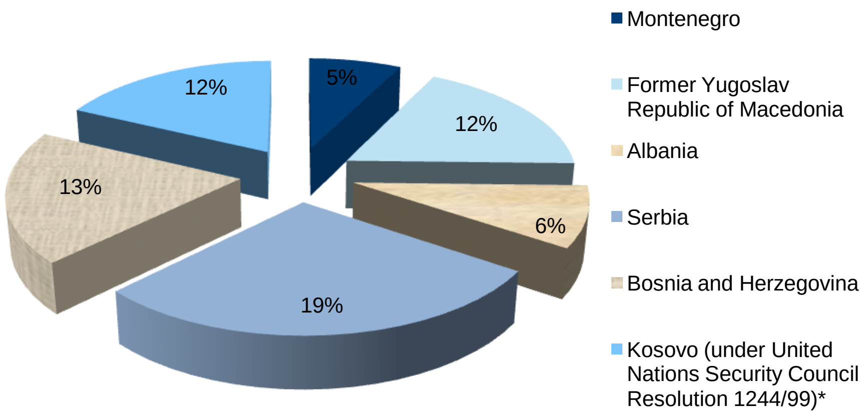
(in % of GDP)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Albania	10,19	10,76	8,84	5,76	6,01	6,27	6,51	5,33	5,58	5,57
Bosnia and Herzegovina	12,14	**12,68**	**13,83**	**13,66**	**12,73**	**13,30**	**13,34**	**12,93**	**13,24**	**13,29**
Kosovo	-	**11,30**	**11,96**	**13,05**	**14,20**	**13,27**	**12,52**	**13,18**	**13,18**	**12,47**
fYRoM	11,29	**11,75**	**11,84**	**11,35**	**10,21**	**11,44**	**13,26**	**11,84**	**11,83**	**12,35**
Montenegro	9,78	9,40	6,80	6,72	5,90	5,45	5,93	4,86	4,93	4,79
Serbia	17,28	16,63	16,78	16,66	16,67	16,36	16,79	18,07	19,10	19

Source: WDI, World Bank

Based on World Bank statistics, Serbia is the most industrialised Western Balkan country with a 19% share of manufacturing value added in GDP (2014), but its share is still lower than the shares in the Czech Republic (25%), Romania (24%), Hungary (23%), Slovenia (22%) or Slovakia (21%). Details on manufacturing value added are in Annex 1.

Chart 2. Share of manufacturing in GDP in 2014 in %



Analysis of the manufacturing FDI in each WB country based on available data is presented above, while data on FDI inflow and per home country are presented for each country within Country Profiles.[9]

2.3.1 Manufacturing FDI in Albania

The manufacturing sector in Albania is known for having attracted foreign investors since the early 1990s, especially in the sub-sector of textiles, clothing and footwear, where their role is significant in the share of this sector to exports and employment. However, data on FDI inflow per sub-sectors in Albania are not available in last two years of analysis, except data on FDI inflow per main economic activity.

[9]Available data on FDI in manufacturing per country do not cover the 10 year period. Also, "zero" values in the fields of tables mean the absence of the inflow or stock in that year, but "minus" in the fields of tables means lack of data in that year.

Table 10. FDI flow by economic sectors in 2013-2014

(in million EUR)

Activity	2013	2014
Fishing	0	-3
Mining and quarrying	**589**	**504**
Manufacturing	**-114**	**38**
Electricity, gas and water supply	107	75
Construction	-3	-24
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	-9	45
Hotels and restaurants	0	-2
Transport, storage and communication	**16**	**112**
Financial intermediation	77	37
Real estate, renting and business activities	238	71
Education	1	2
Health and social work	-4	-2
Other community, social and personal service activities	0	4
Extra-territorial organisations and bodies	14	10
Other	32	0
Total	**945**	**869**

Note: The table represents the annual flow of FDI in Albania according to BPM6. The "minus values" refer to outflow.
Source: Bank of Albania

Regardless of FDI inflow, data on inward FDI stock indicate that during the time **capital-intensive industries** have predominated in the Albanian inward FDI stock due to its rich raw material base and skilled workforce.

Table 11. Stock of FDI by economic activity in 2005-2012

(in million EUR)

Sector/Time	in million EUR							
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Agriculture, hunting and forestry	6,8	7,4	5,6	10,6	6,4	7,3	3,9	1,9
Fishing	0	0	0.1	-59,1	3,2	1,7	3,8	4,1
Mining and quarrying	**24,5**	**48,5**	**9,3**	**18,6**	**146,6**	**311,4**	**611,8**	**809,5**
Manufacturing	**120,2**	**135**	**223,7**	**320,6**	**407,8**	**416**	**951,8**	**891,7**
Electricity, gas, steam, air conditioning supply	8,5	0	0,9	3	95,2	117,8	246,5	102,5
Construction	29,6	35,9	135,9	305,9	188,8	-0,9	10,8	80,1
Wholesale, retail trade, repair of motor vehicles etc.	62,2	77	83,6	140,1	252,7	240,1	216,7	189,1
Transportation, storage and communication	**347,8**	**415,4**	**587,7**	**466,6**	**356,7**	**399,5**	**388,8**	**402,3**
Hotels and restaurants	14,4	13,7	20,3	19,3	78,5	76,2	69,9	68,6
Financial intermediation	**220**	**304,7**	**550,9**	**662,7**	**613,9**	**699,6**	**715,3**	**749,1**
Real estate and business activities	9,3	13,7	56,1	78,8	42,3	62,6	82,9	89,8
Education	0,9	1,1	1,5	1,6	2,7	4,4	5,9	8,2
Human health and social work activities	-	-	0,1	-0,6	47,5	63,9	46,9	42,1
Other service activities	0,9	1,1	12,8	17,8	8,9	12	8,8	18
Activities of extra-territorial organisations & bodies	0,8	1,1	-	-	10,3	24,4	36,2	45,7
Total by activities	**846,2**	**1054,3**	**1688,5**	**1986**	**2261,4**	**2436**	**3399,9**	**3502,8**

Source: WiiW database.

The branch of manufacturing with the largest FDI stock is the **production of non-metallic mineral products** (construction materials) whose share in total manufacturing stock in 2012 was 25,4%. Another important investment target, **the production of basic and fabricated metals**, also uses local ores. A further industry with relatively high FDI is the production of **food and beverages**. This is based both on imported, as well as on local raw materials. The higher-technology industries, like the production of electrical machinery and equipment, are almost entirely missing.

Table 12. Stock of FDI in manufacturing in million EUR and in % for 2008-2012

Manufacturing	in million EUR					% of total manufacturing				
Sub-sectors	2008	2009	2010	2011	2012	2008	2009	2010	2011	2012
Food, beverages and tobacco	58,2	56,5	63,8	51,5	42,4	**13,2**	**13,9**	**15,3**	**5,4**	**4,8**
Textiles and textile products	33	33,6	34,4	30,1	19,8	7,5	8,2	8,3	3,2	2,2
Leather and leather products	34,8	43	38,5	35,8	12,1	7,9	10,5	9,3	3,8	1,4

Manufacturing	in million EUR					% of total manufacturing				
Wood and paper and printing	2,3	2,1	2,1	1,2	0,9	0,5	0,5	0,5	0,1	0,1
Pulp, paper and paper products, publish/printing	7,9	9	18,1	21,7	12,5	1,8	2,2	4,4	2,3	1,4
Chemicals and chemical products	9,4	10,7	13,2	12,6	14,2	2,1	2,6	3,2	1,3	1,6
Rubber, plastics, other non-metall. mineral products	14,2	8,9	9,2	4	2,8	3,2	2,2	2,2	0,4	0,3
Other non-metallic mineral products	119,7	111,6	124,5	205,9	226,7	**27,3**	**27,4**	**29,9**	**21,6**	**25,4**
Basic metals, fabricated metal product.	61,8	52,8	51,2	45,8	48,5	**14,1**	**12,9**	**12,3**	**4,8**	**5,4**
Machinery and equipment i.e.	0,2	0,2	0,3	0,5	0,6	0	0	0,1	0,1	0,1
Electrical and optical equipment	13,8	13,7	14,4	13,8	13,9	3,1	3,4	3,4	1,5	1,6
Other manufacturing	8	10	8,5	8,2	7,5	1,8	2,5	2	0,9	0,8
Other not elsewhere classified	76	55,7	37,9	520,6	489,7	17,3	13,7	9,1	54,7	54,9
Manufacturing	439,1	407,8	416	951,8	891,7	100	100	100	100	100

Source: WiiW database.

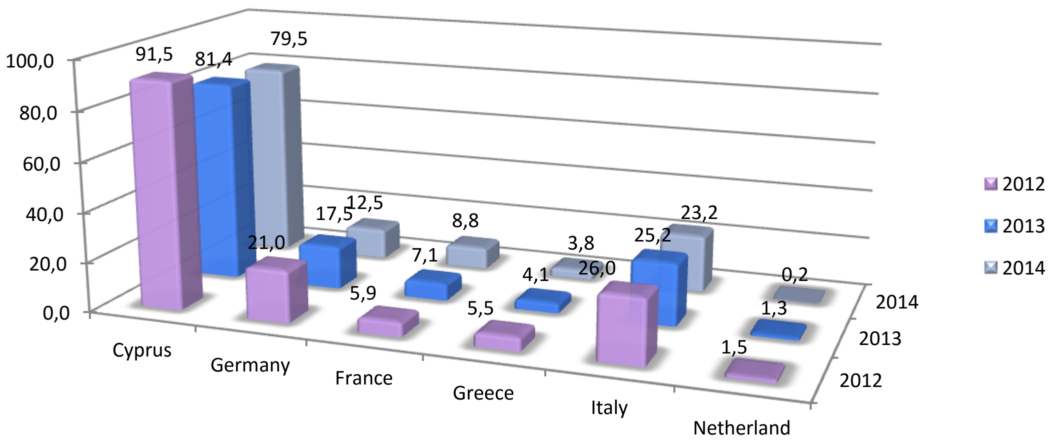
Over the years under observation, there has been an expansion of FDI **in the extractive industry sector,** as well as oil and mineral, where 2% of the stock of FDI in 2008 rose to 13% in 2010, while it reached 23% at the end of 2012 but 15% at the end of 2014. The percentage of FDI in the oil extraction sector increased 100 times compared to 2007, which was a negligible figure.

If we observe FDI by country, we can conclude that in the manufacturing sub-sector major investments made by Cyprus whose share in manufacturing investments accounted 79,5% at the end of 2014. The second largest investor in manufacturing is Italy, whose share in manufacturing was 23,2% of the total investments.

Key FDI in manufacturing

ANTEA Cement Sh.a is one of the biggest greenfield investments in Albania, with a total value exceeding 200 million EUR and one of the biggest industrial companies operating in Albania. The investment has been made jointly by the *TITAN Group*, a Greek multinational cement company, the International Finance Corporation (IFC) - an organisation of the World Bank - and the European Bank for Reconstruction and Development (EBRD).
ANTEA Cement Sh.A has been built and operates to high standards and available techniques for energy efficiency and environmental performance.
Canada's Bankers Petroleum Ltd is one of Albania's largest foreign investors but other Canadian firms operating in Albania include *Stream Oil and Gas (SKO-TSXv) and Petromanas (PMI-TSXv).*

Chart 3. Shares of FDI in manufacturing of EU investors in 2012-2014 in %



The available data from previous table reveals dominance of following manufacturing sub-sectors:

- Other non-metallic mineral products: 25,4% share in manufacturing;
- Basic metals, fabricated metal products: 5,4% share;
- Food products, beverages and tobacco products: 4,8% share in total inward FDI stock in manufacturing.

Albania - SWOT analysis for investment in manufacturing

Strengths	Weaknesses
- strategic location, - low labour costs, - middle to high levels of quality, just-in-time flexible production in shoes and leather, - strong tradition in some manufacturing sub-sectors such as leather and shoe production, - experienced workforce in specific industries, - low transportation costs in the country, - proximity to the key Italian market, - growing local market opportunities, - tradition in the oil and fish subsectors, - low operating costs and utilities.	- national trademarks have not yet emerged, - marketing channels underdeveloped, except for re-exported products, - limited availability of industrial sites - lack/limited availability of technical workers, - travel-to-work transportation needs improvement, - need for a more competitive approach to governmental incentives and sector support, - relatively high levels of imported inputs.
Opportunities	**Threats**
- FDI potential: shoe uppers, raw and processed leather, - potential for niche products, - potentially opportunities in other non-metallic mineral products and basic metals, fabricated metal products, - potential for improvement with food products and beverages through the leveraging of emerging critical mass in the sector to develop the supply chains, - significant opportunity for engagement in import-substitution investment because domestic supply of agricultural products does not meet domestic demand in many sub-sectors, - early-stage FDI opportunities exist in product diversification, building quality brands and products, import substitution, exporting to the EU, and attracting joint ventures with foreign companies to fast-track market access.	- global competition in main manufacturing sub-sectors from China, India, North Africa etc. - regional competition from EU accession candidates, - vulnerable industry which relies on contracts with firms from neighbouring countries - small-scale producers do not consolidate or adopt the latest production processes and procedures compatible with European standards and export requirements.

Note: The SWOT is the result of findings from research

2.3.2 Manufacturing FDI in Bosnia and Herzegovina

During the period of observation, the FDI inflow was only positive in sub-sector coke, refined petroleum products and nuclear fuel, but in this sub-sector like in all others within manufacturing industry, a decreasing trend in FDI inflow has been visible since 2008. In 2009, the global economic crisis hit the inflow of FDI, which decreased to 180 million EUR amounting to 1,4% of GDP.

Table 13. FDI Inflow per manufacturing sub-sector 2005-2012 – old methodology

(in million EUR)

Manufacturing sub-sector	2005	2006	2007	2008	2009	2010	2011	2012
Food and beverages	32,7	61,8	56,1	12,6	28,1	-8,6	10,6	3,8
Textile	-	-	-1,5	8,7	0,6	-0,4	1,4	0,0
Clothing	-	-	0,6	0,4	0,9	-0,7	0,1	-0,1
Leather and products of leather	5,7	-	-1,3	2,8	1,8	2,9	1,9	2,9
Wood and wood products, except furniture	3,2	2,7	7,8	7,1	-4,4	-2,1	6,3	-0,1
Paper and products from paper	-	-	-2,1	10,3	-5,0	26,6	-0,8	-0,4
Printing and publishing	-	-	-0,5	1,5	-0,6	-0,8	-0,1	-0,5
Coke, refined petroleum products and nuclear fuel	-	-	161,3	110,0	23,7	17,2	22,3	1,3
Chemicals, chemical products and man-made fibbers	13,6	29,7	3,0	9,7	26,7	-14,1	9,0	16,0
Rubber and plastic products	1,4	1,4	7,6	6,5	0,7	0,8	1,2	2,7
Other non-metallic mineral products	7,1	25,2	0,2	47,6	9,1	17,1	-3,7	1,7
Basic metals	-1,1	18,1	67,9	18,9	-65,4	24,3	-12,3	-13,3
Metal products except machinery/equipment	2,7	17,2	21,2	2,4	-10,6	5,3	2,0	0,2
Machinery and equipment n.e.c.	4,2	0,1	4,3	11,3	4,7	8,4	-0,4	0,7
Office equipment and computers	-	-	3,8	7,0	4,5	0,7	-0,6	0,6
Electrical equipment	-	0,5	-0,7	2,6	-3,1	-0,5	-0,4	-1,3
Medical and optical equipment	-	-	-	-	-	0,0	0,1	0,0
Transport equipment	9,4	6,5	8,5	10,8	7,5	-4,3	-2,8	3,4

Manufacturing sub-sector	2005	2006	2007	2008	2009	2010	2011	2012
Furniture	1,6	-	1,3	-1,0	-0,6	2,5	-1,6	1,2
Recycling	-	-	3,2	0,7	-2,6	-0,5	-0,1	0,4
Total Manufacturing	**80,5**	**163,2**	**340,8**	**270,1**	**16,0**	**73,7**	**31,9**	**19,4**

Source: Central Bank of B&H

During the period 2005-2012, the Central Bank of B&H had an outdated classification of transactions in Balance of Payment and FDI inflow per sectors/sub-sectors according to methodological standards and instructions of the International Monetary Fund (IMF) and Organisation for Economic Cooperation and Development (OECD). The new data for 2013-2014 based on the NACE industry classification of Balance of Payment transactions by Central Bank of B&H according to sector/sub-sector FDI inflow in B&H is presented in the following table. Differences are recorded in sector classification of some sub-sectors (e.g. Sector of food and beverages, “Basic metal”, “Metal products”) and production of different kinds of equipment is integrated.

Table 14. FDI Inflow per manufacturing sub-sector in 2013-2014 - new methodology

(in million EUR)

Manufacturing sub-sector	2013	2014
Food	-1,90	-6,76
Beverages	6,97	4,50
Tobacco products	-	8,26
Textile	1,72	0,95
Clothing	0,85	1,46
Leather and products of leather	0,55	2,24
Wood and wood products	1,20	-2,62
Paper and products from paper	1,60	2,61
Printing and publishing	-0,14	-0,19
Coke, refined petroleum products and nuclear fuel	-51,69	91,00
Chemicals, chemical products and man-made fibres	12,94	1,88
Rubber and plastic products	1,29	3,56
Other non-metallic mineral products	7,42	-14,25
Basic metals and fabricated metal products	2,07	12,31
Finished metal products except machinery and equipment	4,56	11,51
Electrical and optical equipment	5,18	2,37
Machinery and equipment n.e.c.	-0,61	3,19
Transport equipment	2,88	-31,41
Other not elsewhere classified industries	0,4	-8,26
Total Manufacturing	-4,76	82,35

Source: Central Bank of B&H

The inward FDI stock by economic activity during period 2009-2012 reveals that manufacturing retains the largest share in total FDI inward stock in whole period with 30,6% followed by Financial services sector with 23,5% in 2012. Coke, refined petroleum products and nuclear fuel is the sub-sector within manufacturing with the biggest FDI inward stock (24,3%) at the end of 2012.

Table 15. Inward FDI stock by economic activity 2009-2012

Sector/sub-sector	in million EUR				% of total			
	2009	**2010**	**2011**	**2012**	**2009**	**2010**	**2011**	**2012**
Agriculture, hunting and forestry	17,6	19,5	19	24,5	0,4	0,4	0,3	0,4
Mining and quarrying	84,6	74,7	97,1	167,7	1,8	1,5	1,8	3
Manufacturing	1569,7	1639,3	1659,2	1715,8	32,6	32,9	30,5	30,6
Electricity, gas, and water supply	31	41,6	69	71,9	0,6	0,8	1,3	1,3
Construction	32,8	45,5	50,1	38,3	0,7	0,9	0,9	0,7
Wholesale, retail trade, repair of motor vehicles etc.	696,7	764,8	712,9	677,7	14,5	15,4	13,1	12,1
Hotels and restaurants	60	69,3	74,7	78,9	1,2	1,4	1,4	1,4
Transport, storage and communication	864,4	868	889	882,6	18	17,4	16,3	15,7
Financial intermediation	1122	1077,8	1263,5	1317,9	23,3	21,7	23,2	23,5
Real estate activities	172,2	203,6	422,6	442,1	3,6	4,1	7,8	7,9
Health and social work activities	12,8	20,1	26,3	26,5	0,3	0,4	0,5	0,5
Other community, social and personal services	8,8	9,3	11,3	13,6	0,2	0,2	0,2	0,2
Other not elsewhere classified activities	142,4	144	145	147,8	3	2,9	2,7	2,6
Total by activities	**4815**	**4977,5**	**5439,5**	**5605,3**	**100**	**100**	**100**	**100**

Source: WiiW database.

In the 2014 Progress Report, the EC concludes that the external imbalances have narrowed but remain a source of vulnerability, especially in view of the potential adverse impact of the volatile environment on FDI inflows. Due to the stalled privatisation process and unsupportive business environment, net FDI flows in 2013 continued their downward trend reaching 1,9% of GDP, targeting the energy sector and infrastructure projects. Investments in the energy sector were directed mainly towards hydro and coal-burned power plants, while investments in infrastructure were mainly driven by construction works on the highway of Pan-European Corridor but with slow progress.[10] In total, inward FDI stock reached 5,6 billion EUR or 43% of GDP by end of 2012 and 45% of GDP at the end of 2013 (Table 6).

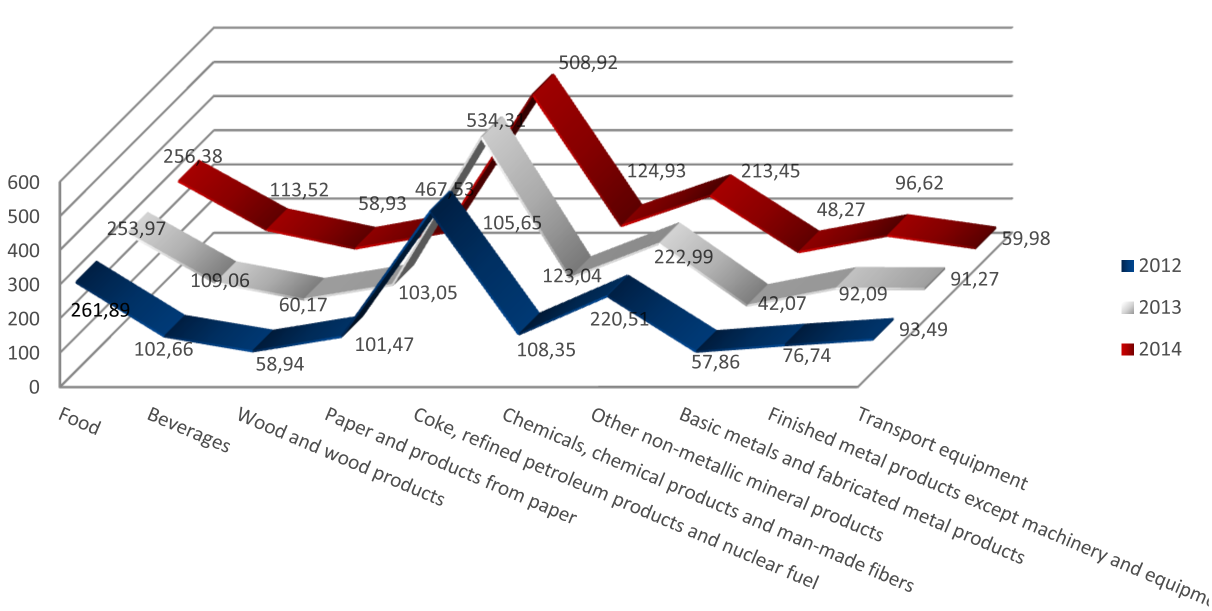
Table 16. Inward FDI stock by manufacturing sub-sectors in 2009-2012

Sector/sub-sector	in million EUR				% of manufacturing			
	2009	2010	2011	2012	2009	2010	2011	2012
Food products, beverages and tobacco products	349,4	329,6	338,4	372,9	**22,3**	**20,1**	**20,4**	**21,7**
Textiles and textile products	17,4	16,3	20,4	20,4	1,1	1	1,2	1,2
Leather and leather products	20,5	28,7	30	33	1,3	1,7	1,8	1,9
Wood and wood products	59,2	56,1	56,6	57,2	3,8	3,4	3,4	3,3
Pulp, paper and paper products, publish & printing	80	107,6	104,9	104,3	5,1	6,6	6,3	6,1
Coke, refined petroleum products and nuclear fuel	374,9	386	408,5	416,5	**23,9**	**23,5**	**24,6**	**24,3**
Chemicals, chemical products and man-made fibbers	129,5	116,2	125,6	149,1	8,3	7,1	7,6	8,7
Rubber and plastic products	18,8	18,7	18,4	22	1,2	1,1	1,1	1,3
Other non-metallic mineral products	209,9	225,5	220	218,6	**13,4**	**13,8**	**13,3**	**12,7**
Basic metals and fabricated metal products	117	146,6	131,9	112,5	7,5	8,9	8	6,6
Machinery and equipment n.e.c.	35,4	41,2	40,6	39,9	2,3	2,5	2,4	2,3
Electrical and optical equipment	37,7	47,4	38,3	37,5	2,4	2,9	2,3	2,2
Transport equipment	84,6	80,5	81,2	86,1	5,4	4,9	4,9	5
Manufacturing n.e.c.	**33,4**	**37,3**	**42,4**	**43,4**	**2,1**	**2,3**	**2,6**	**2,5**
Other not elsewhere classified industries	1,9	1,6	2,1	2,3	0,1	0,1	0,1	0,1
Manufacturing	**953,4**	**1053,1**	**1308,8**	**1281,5**	**100**	**100**	**100**	**100**

Source: WiiW database.

As in previous years, the sub-sectors *Food, Other non-metallic mineral products and coke, refined petroleum products and nuclear fuel* remain the sub-sectors with largest inward FDI stock at the end of 2013 and 2014.

Chart 4. Inward FDI stock in manufacturing in 2010-2104 in million EUR



[10]EC BIH PR 2014, Brussels, 8.10.2014, SWD(2014) 305 final

Key FDI in manufacturing

"The Heidelberg Cement Group has invested more than €60 million in modern technology in B&H and an additional 50 million EUR is earmarked for further investment. ***Bekto Precisa*** was established in June 2005 and today employs over 350 employees with a tendency towards further development. Bekto-Precisa produces sophisticated tools for plastic and non-ferrous metals, as well as a combination of metal-plastic in accordance with European standards and requirements of customers.

Bosancara part of the Bosanska Krupa, is owned by an Italian company established in 2005. They produce cabins for working machines and employ 42 workers. It has invested an additional 2,5 million euro in to a new building and manufacturing capacities and plans to employ 35-40 people more. d It is typical example of a company operating in B&H is ***Elchy - tex Ltd Zepce*** opened in June 2007 by "Profile - Isolation" Ltd. The company creates various work clothes.

Bosnia and Herzegovina - SWOT analysis for investment in manufacturing

Strengths	Weaknesses
- stable national currency, - lowest inflation rate in WB, - growing financial sector, - -skilled labour is abundantly available, particularly in engineering and other technical areas, as well as unskilled and semi-skilled labour force, - low operating costs, - the distribution networks have extensive reach, - a strong tradition in certain sectors such as base metal and machinery production, - considerable experience in supplying Western Europe with metal products, - good-quality fresh fruits and vegetables due to excellent soil quality, pure wells /water springs, - labour market flexibility.	- outdated image of its economy, especially with regard to political stability, - low productivity (affected by outmoded technology in manufacturing), - slow harmonization of taxes, customs, and key commercial legislation between the entities, - some investors think that FDI policy could be improved in area of business registration in B&H and Republic Srpska, - not yet fully developed a coordinated export promotion strategy and institutional policy, - limited availability of managerial, marketing and sales talent, - -under-developed transport infrastructure, - limited storage facilities including cold chains for temperature controlled food products, - limited availability of locally sourced raw materials and packaging.
Opportunities	**Threats**
- potential as a production platform for the region, - preferential market access agreements, - prospect of tax-based incentives and other economic advantages, - exports should benefit from growing markets in Turkey and the Middle East, - substantial market-seeking opportunities, as local market demand is not fully satisfied, - potential to be regionally competitive in organic produce based on the strength of its low-tech farming methods.	- disinvestments and relocations by existing investors e.g. in the dairy sub-sector, - possible delays in implementing an aggressive FDI strategy, - delays in granting incentives, - perceived over-regulation, - competition from inexpensive subsidised imports.

Note: The SWOT is the result of findings from research.

2.3.3 Manufacturing FDI in fYRoM

Manufacturing is an important economic activity in fYRoM, with a share of 30% or more of the total inward FDI stock. Structural reforms that supported the industrial zones — notably infrastructure investments and tax exemptions for foreign investors, together with skilled workforce and base of raw material — have helped promote fYRoM as a FDI destination. These appear to have contributed to FDI inflows averaging 4,2% of GDP per year between 2006 and 2014. Still, backward linkages between foreign firms and domestic firms in fYRoM are limited and FDI-related net exports represented only about 2% of GDP in 2014.

Table 17. FDI inflow in the fYRoM - by manufacturing activity in 2009-2015

(in million EUR)

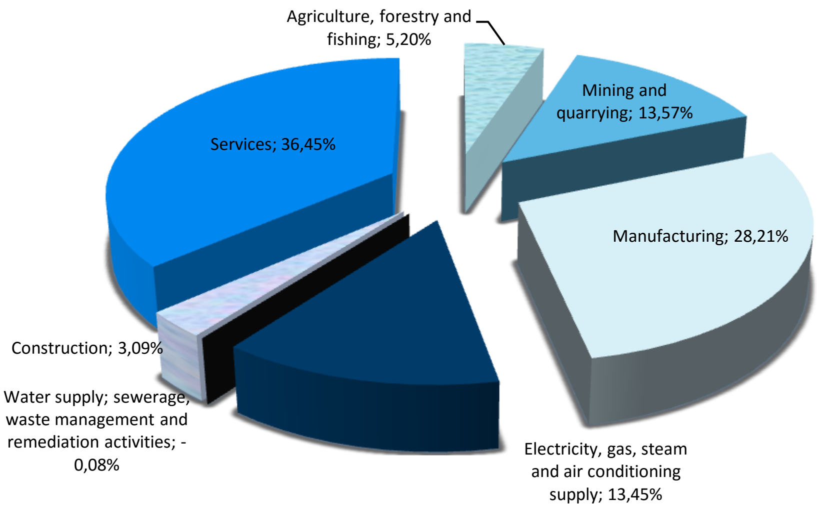
Manufacturing sub-sectors/Years	2009	2010	2011	2012	2013	2014	2015
Food products, beverages and tobacco products	34,01	13,81	49,27	**-17,43**	**-5,87**	**-2,11**	34,42
Textiles & wood activities	4,15	7,88	28,69	23,45	17,10	8,01	-13,22
Petroleum, chemicals, pharmaceutical products, rubber & plastic products	4,53	-0,18	2,50	-10,79	-4,10	-3,90	3,06
Metal & machinery products	-47,22	-12,41	39,69	11,68	-43,59	-12,99	9,25

Manufacturing sub-sectors/Years	2009	2010	2011	2012	2013	2014	2015
Vehicles & other transport equipment	54,67	69,03	88,34	24,04	**99,44**	**90,10**	-24,53
Other manufacturing	-1,95	6,46	0,27	18,40	22,18	-21,24	2,31

Source: National Bank of fYRoM

FDI-related exports, especially in the automobile and electrical machinery industries, were a key driver of export growth, contributing to around 6% of the growth of net exports.[11] The sub-sector *Motor vehicles, trailers and semitrailers*, located in Technological Industrial Development Zones (TIDZ) attracted the largest amount of FDI inflow, especially in 2013-2014. In addition, the sector of *Food products, beverages and tobacco* products also experienced significant FDI inflow during previous years. In sum, the manufacturing sector recorded 28,21% in total FDI inflow in 2014.

Chart 5. Share of sectors in FDI inflows in 2014 (%)



Key FDI in manufacturing

The fYRoM possesses both metal ores and water resources, making it an attractive destination for steel production. **Duferco (Switzerland)** entered the country in 1997 upon privatisation and reconstruction of the former Mines and Iron & Steel works Skopje. Duferco started a modernisation programme, with an initial investment of €15 million in 1999, and a subsequent investment of €22 million in 2007. Additionally, the company invested €20 million on projects related to environmental protection.

In 2004, another strategic investor, the Netherlands-based company **Mittal Steel (now ArcelorMittal)**, entered the market of the fYRoM, which led to a sharp rise in base metal production in 2005. The company obtained a €25 million loan from the EBRD to improve energy efficiency, to provide the company with working capital, and to further promote regional integration of the steel industry.

The United Kingdom-based affiliate of the Mumbai-listed **Binani Industries Ltd.** bought the Zletovo and Toranica lead and zinc mines, and restarted production, yielding over 2,000 tons of lead and just under 1,000 tons of zinc since December 2006.

The German company **Knauf** has been producing building systems such as gypsum plasterboards in Debar since 1998. The affiliate in the fYRoM is a subsidiary of Knauf GmbH, Austria. Knauf acquired an existing company in the fYRoM, upgraded the production and started to export most of its output to SEE. [12]

Table 18. Inward FDI stock in manufacturing sub-sectors in 2009-2012

Manufacturing industry/Year	in million EUR				% of total manufacturing			
	2009	2010	2011	2012	2009	2010	2011	2012
Food products, beverages and tobacco products	249,7	261,6	293	261,1	**26,2**	**24,8**	**22,4**	**20,4**
Textiles, apparel, leather, related products	37,3	46,7	73,6	74,4	3,9	4,4	5,6	5,8
Wood and paper products and printing	14,9	16,9	19,4	11,5	1,6	1,6	0,5	0,9
Coke and refined petroleum products	71	72,1	71,1	63	7,5	6,8	5,4	4,9
Chemicals and chemical products	29,4	30,3	33,9	32	3,1	2,9	2,6	2,5
Pharmaceuticals, medicinal chemical &botan products	19,9	21,3	22	21,5	2,1	2	1,7	1,7
Rubber, plastics, other non-metal mineral	5,2	5,6	7,1	6,2	0,5	0,5	0,5	0,5

[11] World Bank Group, *FYR Macedonia Partnership Country Program Snapshot*, October 2015.
[12] United Nations Conference on Trade and Development, Investment Policy Review of the former Yugoslav Republic of Macedonia, 2012

Manufacturing industry/Year	in million EUR				% of total manufacturing			
	2009	2010	2011	2012	2009	2010	2011	2012
products								
Basic metals, fabricated metal production excluding machinery & equipment	331	334	433,8	392,7	**34,7**	**31,7**	**33,1**	**30,6**
Computer, electronic, optical products	0	0,1	4,1	18,6	0	0	0,3	1,4
Machinery and equipment n.e.c.	6	5,5	6	5	0,6	0,5	0,5	0,4
Transport equipment	88,4	165,1	249,8	264,5	**9,3**	**15,7**	**19,1**	**20,6**
Other manufacturing, repair, install. of mach.& equipment	97,3	93,9	95	131,1	10,2	8,9	7,3	10,2
Other not elsewhere classified industries	3,2	-	-	-	0,3	-	-	-
Manufacturing	**953,4**	**1053,1**	**1308,8**	**1281,5**	**100**	**100**	**100**	**100**

Source: WiiW database.

Based on available data, three manufacturing sub-sectors have a dominant share in the total inward FDI stock in manufacturing in fYRoM:

- *Food products, beverages and tobacco products* share in total inward FDI stock in manufacturing decreased from 26,2% in 2009 to 20,4% in 2012;
- *Basic metals, fabricated metal products, except machinery &equipment* share in total inward FDI stock in manufacturing declined from 34,7% in 2009 to 30,6% in 2012;
- *Transport equipment* share in total inward FDI stock in manufacturing significantly increased from 9,3% in 2009 to 20,6% in 2012.

Table 19. Inward FDI stock in manufacturing in 2010-2104

(in million EUR and % of total FDI)

MANUFACTURING Sub-sector	2010		2011		2012		2013		2014	
	Value	Share (%)	Value	Share (%)	Value	Share (%)	Value	Share (%)	Value	Share (%)
Total	**1.0530**	**32,3**	**1.308,8**	**36,2**	**1.281,5**	**34,8**	**1.388,9**	**34,9**	**1.435,8**	**35,7**
Food products, beverages and tobacco products	**261,6**	**8,0**	**293,0**	**8,1**	**261,1**	**7,1**	**250,3**	**6,3**	**240,4**	**6,0**
Textiles and wearing apparel	46,7	1,4	73,6	2,0	74,4	2,0	89,5	2,2	90,4	2,2
Wood, paper, printing and reproduction	16,9	0,5	19,4	0,5	11,5	0,3	11,6	0,3	11,2	0,3
Coke and refined petroleum products	72,1	2,2	71,1	2,0	63,0	1,7	61,0	1,5	54,5	1,4
Chemicals and chemical products	30,3	0,9	33,9	0,9	32,0	0,9	30,3	0,8	31,3	0,8
Basic pharmaceutical products and preparations	21,3	0,7	22,0	0,6	21,5	0,6	20,5	0,5	19,4	0,5
Rubber and plastic products	5,6	0,2	7,1	0,2	6,2	0,2	6,7	0,2	12,9	0,3
Basic metals and fabricated metal products	**334,0**	**10,3**	**433,8**	**12,0**	**392,7**	**10,7**	**378,5**	**9,5**	**362,6**	**9,0**
Computer, electronic and optical products	0,1	0,0	4,1	0,1	18,6	0,5	17,5	0,4	17,2	0,4
Machinery and equipment	5,5	0,2	6,0	0,2	5,0	0,1	6,9	0,2	5,2	0,1
Motor vehicles, trailers and semitrailers	**152,2**	**4,7**	**238,4**	**6,6**	**252,8**	**6,9**	**346,8**	**8,7**	**433,3**	**10,8**
Other transport equipment	12,9	0,4	11,4	0,3	11,8	0,3	14,0	0,4	16,6	0,4
Other manufacturing	**93,9**	**2,9**	**95,0**	**2,6**	**131,1**	**3,6**	**155,3**	**3,9**	**140,9**	**3,5**

Source: National Bank of fYRoM

Share of Food products, beverages and tobacco products in total manufacturing continued to decrease in last two years; from 18% in 2013, it dropped to 16,7% in 2014. The same trend exists in case of the *Basic metals, fabricated metal products, except machinery & equipment* sub-sector, whose share in total inward FDI stock in manufacturing declined in from 27,25% to 25,25% in 2014. Contrary to this trend, the share of the *Transport equipment* sub-sector in total inward FDI stock in manufacturing increased to 26% in 2013 and to 31,3% in 2014.

Complementary to the manufacturing sector, the table above indicates that the previously mentioned three sub-sectors also have the largest share in total inward FDI stock in 2014: *Food products, beverages and tobacco products* 6% in 2014; *Basic metals, fabricated metal products, except machinery & equipment* 9,6% and *Transport equipment 11,2%*.

fYRoM - SWOT analysis for investment in manufacturing

Strengths	Weaknesses
- cost advantage - improving business environment and advanced after-care service of FDI support, - abundant low-cost skilled and unskilled labour, - relatively affordable industrial land, - development of free economic zones and TIDZ with substantial incentives for investments, - automotive components sector is export oriented, with firms exporting 80% of production, - the Food and beverages sub-sector offers potentials such as in production of wine, - production advantages in locally grown fruits and vegetables and tradition in textile industry, - sub-sector of basic metals, fabricated metal products has strengths due to large number of small companies that are flexible and connected with large producers.	- limited technological/design expertise and experience, - limited production of major inputs (e.g., special steel, plastic materials) for automotive component manufacturing, - reliance on imports may result in time and cost disadvantages due to logistics and storage costs, - country lacks strong track record in highly engineered precision components, - few factories focus on high-level R&D, - food and beverage processing sector has had little greenfield investment, e.g. in processing of local raw fruits and vegetables.
Opportunities	**Threats**
- there are opportunities in areas that are labour intensive and can achieve economies of scale, such as seat belts and seat covers, - opportunities to develop existing brands for a wider market, - opportunities in leveraging raw material production advantages to establish downstream processing operations, - potential to be self-sufficient in many food products.	- political instability is a key non-commercial challenge, - -competition from Serbia for labour-intensive investments until it develops a specialised expertise, - frequent changes of laws create an unpredictable business environment.

Note: The SWOT is the result of findings from research.

2.3.4 Manufacturing FDI in Kosovo

It must be stated up front that Kosovo has limited data when it comes to FDI and this is reflected in the analysis presented in this part of the report.

Over time, the situation in Kosovo has evolved. In 2007, the major share of FDI was concentrated in the sector of **processing industry**. During 2007, about 129,24 million EUR have been invested in the sector, up from a total of 440,74 million EUR of FDI. Another important sector 2007 has been also **agriculture**, with over 100 million EUR invested.

Table 20. Total FDI inflows per sectors 2007-2014

(in million EUR)

Year	Production	Real estate	Transport & Telecomm.	Electricity	Mining	Processing industry	Agriculture	Trade, cleaning, collection	Sanitarian activity
2007	41,5	74,8	2,5	5,2	12,7	129,2	102,0	30,9	16,9
2008	17,4	53,7	16,7	13,5	10,1	51,0	109,6	62,2	23,0
2009	7,0	57,6	8,7	35,5	16,2	21,9	75,3	43,9	11,3
2010	17,7	101,1	-	54,2	6,8	-15,9	39,4	75,5	87,6
2011	**-5,2**	46,9	0,2	133,1	11,6	**29,0**	33,0	60,5	63,2
2012	**-25,0**	27,4	2,2	31,1	9,3	**32,4**	22,4	115,7	11,0
2013	-14,1	11,5	48,8	17,3	14,6	51,0	4,4	136,1	6,2
2014	4,2	-34,0	13,4	-19,9	8,4	-9,1	41,9	142,1	1,4

Source: Central Bank of Kosovo

During the period of observation, share of FDI inflow in manufacturing industry fluctuated from 31% of total FDI inflow in 2007 to 7% of total FDI inflow in 2011 and outflow in 2014.

The Central Bank of Kosovo does not record FDI inflow and stock per sub-sectors, which prevents more detailed analysis.

Kosovo - SWOT analysis for investment in manufacturing

Strengths	Weaknesses
- geographical location, - low costs of labour force, - significant natural resources for industrial production, - government willingness to develop economy and undertake reforms, - young workforce, - improved basic metal production.	- small size of economy/small market, - perception of high level of risk, - significant degree of informal economy, - lack of e-services in central and local levels, - lack of objective data and benchmarking of different sectors, - low level of regulatory implementation, - low level of economic development. - persisting disputes over internationally recognised political status
Opportunities	**Threats**
- -opportunities for the production of metal products based on rich natural resources, - potential for competitive export of metal products and basic metals.	- high population growth rate, - high levels of graduates whose qualifications do not match the demands of private sector, - the economy strategies and policy framework not sufficiently implemented, - extensive informal economy.

Note: The SWOT is the result of findings from research.

2.3.5 Manufacturing FDI in Montenegro

The Central Bank of Montenegro does not record FDI inflow and stock per sub-sectors, which prevents detailed analysis of FDI trends per activities.

Considering the FDI inflow during previous decade, the Central Bank of Montenegro concludes that:[13]

- A significant part of the FDI inflow relates to the real estate (particularly in 2006 and 2007);
- The highest amount of FDI was in the area of tourism, banking, industry and telecommunications;
- The structure of FDI (real estate, company and banks and other FDI) has been recovering gradually in 2008, with the decrease of the FDI share in the real estate sector and the increase of the FDI in the real sector.

According to the Montenegrin Investment Promotion Agency (MIPA), after a sudden jump in FDI in the industrial sector in 2009 (caused by an Italian investment in EPCG, the power company), the next year there was a significant decrease (down from 48% to 22%), even though the share of FDI in industry in 2010 was double that of the whole period from 2006 to 2008. This trend continued also in 2011.[14]

The net FDI in Montenegro reached 10,7% of GDP up to June 2015, partly due to fact that it has privatised its large aluminium complex which is the dominant industry. This means that, together with the tourism and finance sectors (where in 2010 a significant role was played by insurance companies), the industrial sector has now become one of the top sectors attracting high levels of FDI.

Key FDI in manufacturing

The Belgian company ***Interbrew*** purchased the brewery Trebjesa in Niksic, a local brewery that has been producing beer since 1896, for DEM 41 million[15]. After purchasing over 70% of the shares, Interbrew introduced new packing for the beer as well as new products such and light beer and bottled water, which are exported to the WB region.

The Japanese ***Daido Company***, founded in 1939, bought the majority of Factory of Ball Bearings - now called Daido Metal Kotor. The Japanese investor produces lubricated bearings (used for automobiles, shipping and other industries) and has 1,260 employees.

IN 2002, the Greek company ***Hellenic Petroleum S.A***. bought 54,4% of shares of **Jugopetrol AD Kotor**, the previously state owned company for exploration, exploitation and trade of petroleum and petroleum products. Hellenic Petroleum invested in expanding its activities, including wholesale, retail, distribution of petroleum. In cooperation with partners from UK´s Jugopetrol, it is involved in exploration of gas in the Adriatic Sea.

[13]Central Bank of Montenegro, "Foreign Direct Investments as a Driving Force of Economic Development of Montenegro", Working Paper no. 16, 2008.
[14]Montenegrin Investment Promotion Agency (MIPA), "Annual Overview of the of the FDI in Montenegro", 2012.
[15] Please note that this cannot be converted to EUR because the Euro did not exist at the time.

Montenegro - SWOT analysis for investment in manufacturing

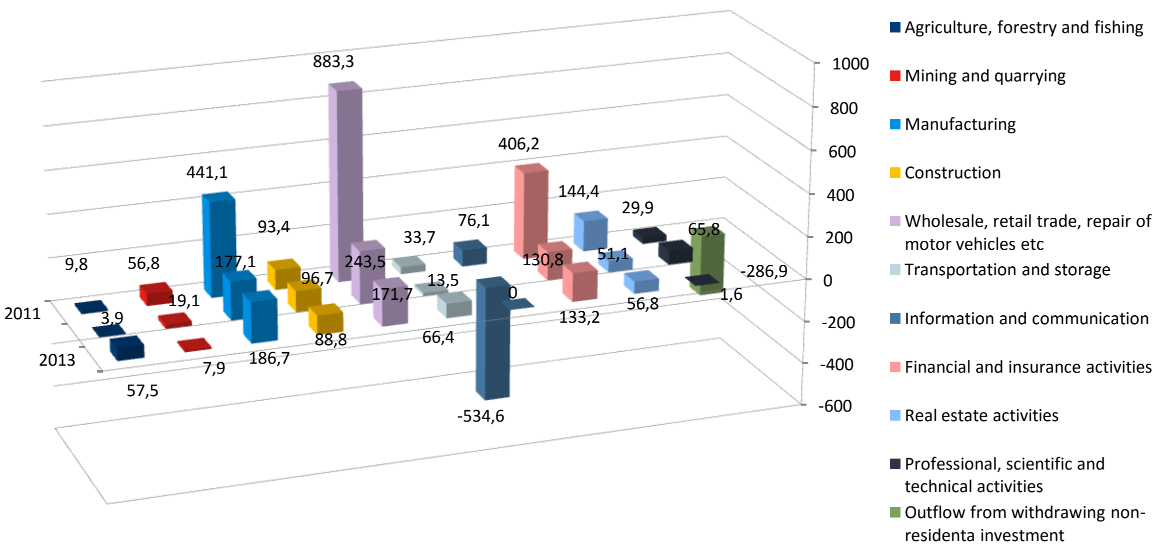
Strengths	Weaknesses
- -stable financial and macroeconomic environment, - available incentives for FDI, - natural advantages for the production high-quality grapes and other fruits, - potential for food processing investment, - favourable tax incentives and investment climate - Bar port and other good transport connection, - easy to start-up new businesses.	- small size of economy/small domestic market, - a higher cost structure relative to some of its neighbours, - -underdeveloped infrastructure and transport systems may inhibit access to export markets, - relatively high logistics costs.
Opportunities	**Threats**
- Niche opportunities for the production of high-quality traditional foods (e.g. for the tourism market), - stability of the financial market, - development of goods with higher added value, - good use of private-public partnership, - increases of linkages between business and R&D sector, - relatively rapid adoption and implementation of EU rules and standards.	- existing manufacturers could potentially elect to relocate to lower labour costs countries such as Serbia, - insufficient investment in education of employees, - lack of capital for development of industrial sector, - limited funds for investment in infrastructure, - slow process of adjustment legislation for economy development.

Note: The SWOT is the result of findings from research.

2.3.6 Manufacturing FDI in Serbia

Over the past ten years, the service sectors have proven to be the most attractive sector in Serbia for international investors. Banking and insurance recorded the largest FDI inflow and manufacturing industries held the 2nd spot with 4.8 billion EUR, followed by wholesale, retail and repair of motor vehicles and real estate activities.

Chart 6. FDI inflow in main sectors in 2011-2013 in million EUR



Within the Serbian manufacturing sector, the sub-sectors with biggest share of FDI inflow in 2011 were *basic metals, fabricated metallic products* and *machinery and equipment*. FDI inflow in this sub-sector dropped significantly the next year in which the sub-sector of Transport equipment recorded the highest share in all manufacturing FDI inflow. However, regardless of this trend in previous years, in 2013 the *Food products, beverages and tobacco* sub-sector recorded the largest share in total manufacturing FDI inflow.

Bearing in mind that Serbia has not completed the process of privatisation, the largest part of FDI inflow in the country could be explained by the privatisation policy and dynamic. However, it must be pointed out that Serbia has a good deal to offer in terms of the costs and quality of the labour force.

Table 21. FDI Inflow in manufacturing in 2011-2013

Sub-sector	in million EUR			in % of manufacturing		
	2011	2012	2013	2011	2012	2013
Food products, beverages and tobacco products	72,5	-4,3	54,9	**16,4**	**-2,4**	**29,4**
Textiles, apparel, leather, related products	21,8	14,9	28,9	4,9	8,4	**15,5**
Chemicals and chemical products	4,5	1	15,2	1	0,6	8,2
Rubber, plastics, other non-metall. mineral products	25,5	61,9	23,9	**5,8**	**35**	**12,8**
Basic metals, fabricated met. prod., mach.& equip.	187,7	17,9	20,3	**42,6**	**10,1**	**10,9**
Computer, electronic, optical products	2,4	3,7	0,5	0,5	2,1	0,3
Electrical equipment	16,4	3,8	16,7	3,7	2,2	8,9
Machinery and equipment n.e.c.	8,7	8,1	4,1	2	4,6	2,2
Transport equipment	93,4	65,4	16,2	**21,2**	**36,9**	8,7
Other manufacturing, repair, install. of mach.& equipment	5,5	1,9	1,2	1,3	1,1	0,6
Manufacturing	***441,1***	***177,1***	***186,7***	***21,2***	***36,9***	***8,7***

Source: WiiW database.

The FDI inflow in the *Food products, beverages and tobacco* sub-sector has manifested high oscillations during 2011-2013, but it retains the largest share in total FDI inflow in manufacturing. The *Textiles, apparel, leather, related products* sub-sector has the second largest share in FDI inflow in manufacturing in 2013 and experience almost double growth every year during 2011-2013. The *rubber, plastics, other non-metal mineral products* sub-sector had a share of 12,8% of FDI inflow in manufacturing in 2013 and was the third most important sub-sector in terms of investments.

However, the FDI inflow in this sector in 2013 decreased dramatically (almost three times) compared with 2012 when it recorded a 35% share of the FDI inflow in manufacturing. The FDI inflow in the *Basic metals, fabricated metal products, machinery& equipment sub-sector* amounted to 10,9% in 2013, which is significant decline against 2011, when it accounted for 42,6% of total FDI inflow in manufacturing.

Data on FDI inflow per manufacturing sub-sector in 2014 were collected from national sources and are presented in the table below.

Table 22. FDI inflow during 2014 by manufacturing activity

(in million EUR)

Activity	2014
MANUFACTURING	**535,204**
Food products, beverages and tobacco products	**108,522**
Textiles and wearing apparel	67,468
Wood, paper, printing and reproduction	15,110
Coke and refined petroleum products	-0,107
Chemicals and chemical products	46,301
Basic pharmaceutical products and pharmaceutical preparations	28,246
Rubber and plastic products	**172,561**
Basic metals and fabricated metal products	2,948
Computer, electronic and optical products	2,091
Machinery and equipment n.e.c.	9,623
Motor vehicles, trailers and semi-trailers	37,782
Other transport equipment	-1,563
Air and spacecraft and related machinery	0,037
TOTAL of other manufacturing	46,185
TOTAL FDI INFLOW	**1.500,450**

Source: National Bank of Serbia

NOTE: Branches of activity are in line with NACE Rev. 2 and the table is in accordance with data available until 29 March 2015, and is subject to correction in line with the change in official data sources.

Based on data of National Bank of Serbia on FDI inflow during 2014 by manufacturing activity, the three sub-sectors with largest FDI inflow were the following:

- Food products, beverages and tobacco products: 20,3% share in total manufacturing FDI inflow;
- Textiles and wearing apparel: 12,6% share in total manufacturing FDI inflow;
- Rubber and plastic products: 32,2% share in total manufacturing FDI inflow.

The *basic metals and fabricated metal products* sub-sector, despite of the inflow in previous years, only had a 0,55% share in total FDI inflow in manufacturing in 2014.

Key FDI in manufacturing

Since the onset of economic reforms, Serbia has grown into one of the premier investment locations in Central and Eastern Europe and the WB region. A list of leading foreign investors is topped by world class companies and banks such as **FCA, Bosch, Michelin, Siemens, Panasonic, NCR, Yura, Magna, Continental, Calzedonia, Eaton, Stada, Falke, Swarovski, Ball Packaging, Sitel, Microsoft, Gorenje, Schneider Electric, Geox, Tarkett, Johnson Controls, Johnson Electric, Leoni,** and many others.

***Fiat Automobili Srbija* (FAS)** invested 1 billion EUR in 2008, which ranks as the largest investment in the history of Serbian industry.

In September 2012, Germany's **Bosch** laid the foundation stone on its first plant in Serbia, just outside Belgrade, which will make windscreen wipers. Bosch plans to invest 70 mio. EUR by 2019, and employ about 630 people.

Many of the advantages the car manufacturers enjoy also apply to electronics. Significant investments include those by Slovenian white goods manufacturer **Gorenje**. It has invested 50 mio. EUR in three factories since 2006, with the objective of exporting to the rest of Europe and Russia. **Siemens**, the German technology firm, manufactures components for renewable power plants at Subotica, near the Hungarian border, and has been expanding its operations. So, too, has **Panasonic**, the Japanese electronics company, which manufactures energy-efficient parts for lighting fixtures.

The pharmaceutical industry benefits from Serbia's high skills base and access to the Russian market. The market is dominated by **Hemofarm**, bought by Germany's **Stada** for 480 mio. EUR in 2006.

Serbia - SWOT analysis for investment in manufacturing

Strengths	Weaknesses
- abundance of highly skilled, low-cost labour force, - workers with engineering and technical skills applicable to the manufacturing sub-sectors, - advanced distribution networks, extending throughout the WB region, - tradition of supplying Western Europe in machinery products and "lohn" agreements[16] - -boasts strong regional brands, - significant national domestic market can serve as a platform for establishment of a regional export base.	- limited availability of "soft" managerial skills among an abundant pool of managerial workers, - -outmoded technology in operation may contribute to reduced productivity, making it difficult to assess the potential capability, - direct availability of industrial land or modern industrial property is also very limited, - country does not yet have internationally recognised brands, - portions of the raw material production chain may require rationalisation for competitive production.
Opportunities	**Threats**
- potential to re-emerge as the WB regional hub for supply capability in automotive sector, machinery and equipment and food processing, - low labour costs present competitive advantage in labour-intensive manufacturing operation, - due to the high standard of skills, engineering design services are a promising subsector, - further intensive development of ICT sector, - first-mover advantage with Russia via free trade and preferential market access agreements, - early-stage FDI opportunities in product diversification, building quality brands and products, and exporting to the EU, - foreign investors can use it as a base for WB and Eastern European market entry strategies.	- lacks image as an emerging business location combined with the perception of political risk among potential investors, - competition from larger-brand Western European produce may undermine existing national brands, - investor's perceptions still revolve around political uncertainty, - frequent changes in legislation create additionally uncertain business environment, - emigration by young skilled population.

Note: The SWOT is the result of findings from research.

2.4 EU SME Manufacturing FDI in WB

2.4.1 EU FDI in WB economies

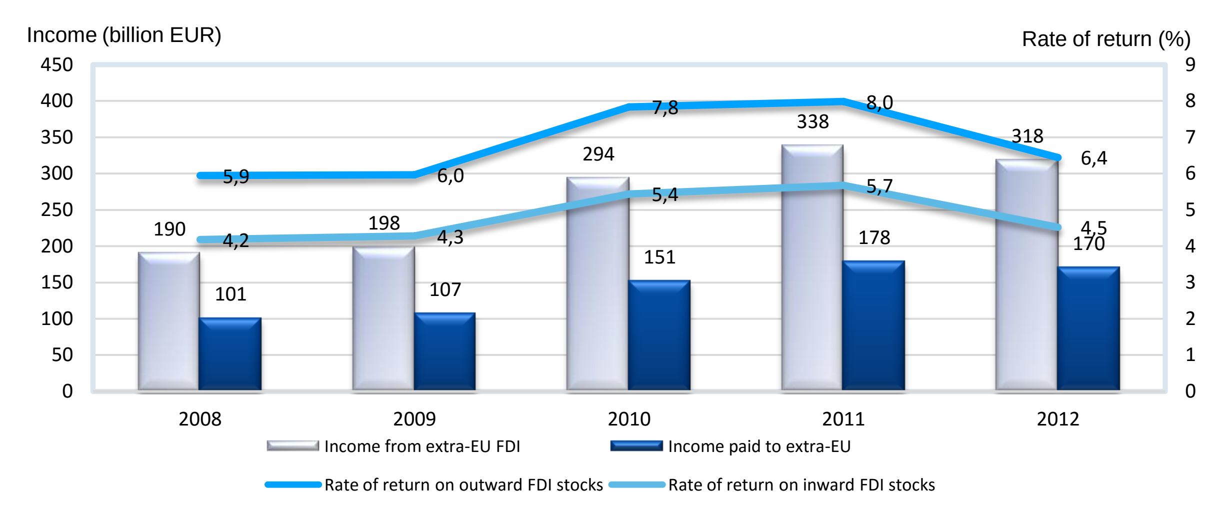
The EU considers FDI to be a key tool for promoting economic development and growth in member state as well as accession countries. Among other things it seeks to develop a set of international

[16] Lohn jobs are a special form of processing, which is performed under a contract concluded between a foreign legal entity as a customer and the domestic company under approval of the customs authorities, and shall be carried out continuously (long term period). The approval of the customs authority gives the domestic company the authorization, according to which it is entitled to import raw materials or goods for its processing and re-export..

principles in relation to FDI which can contribute to an improvement of the economic environment by increasing legal certainty for investors, by introducing the principle of national treatment for all investors, by reducing the perception of risk to invest, etc. particularly in current and future accession countries.

The total EU-27 FDI outflows increased by 57% in 2011, mainly due to a substantial increase inequity capital and reinvested earnings. In 2012, outward flows of FDI dropped significantly once more by 46%, due to a sharp decline in equity capital invested outside the EU-27, though partially compensated by an increase in reinvested earnings and steady levels of other capital. EU-28 outward flows were 34% higher in 2013 than were EU-27 outflows in 2012; many of the EU's principal investment partners contributed to these developments.

Chart 7. EU (27) FDI income and rates of return, 2008–2012



Note: Available data cover only mentioned period.
Source: Eurostat database.

The EU has been and remains the single most important foreign investor in the WB economy. The FDI inflow contributed to the rise of total inward FDI stocks in WB economies, but in general, in all WB economies under analysis, FDI inflow from the EU fluctuated significantly since 2009. The decreasing trend is the result of the general economic climate in the EU which, to a large extent, influences economic activities in WBs (and other regions) due to the tight economic interdependence between these two regions.

Table 23. EU (27) Direct investment flows to the WBs in 2005-2012

(in million EUR)

WB country	2005	2006	2007	2008	2009	2010	2011	2012
Montenegro	-	-	120	327	-136	-37	72	66
fYRoM	-	229	233	123	241	95	190	61
Albania	45	130	377	190	631	**2.272**	-63	-678
Serbia	-	-	1.493	1.916	239	550	**1.401**	-512

Note: Available data cover only mentioned period.
Source: Eurostat

Since 2005, the EU investment in the four WB economies **for which data are available** ranged between 50% -82% of inward FDI stock, depending on the country and particular year. During this decade, FDI was affected by the global financial and economic crisis, but significant EU FDI outflow to selected WB economies was recorded by Albania in 2010 and Serbia in 2011. This especially high level of net FDI in Serbia in 2011 is mainly due to the sale of "Delta Maxi" and in Albania, FDI during 2010 has been in greenfield investments, with a total absence of privatisations.[17]

Table 24. EU (27) Direct investment stocks in WBs in 2005-2012

(in million EUR)

WB country	2005	2006	2007	2008	2009	2010	2011	2012
Montenegro	-	-	609	833	761	1.179	1.375	1.186

[17] Large foreign companies that came to Serbia in 2011 include: Belgian retailer Delhaize, German electronics manufacturer Bosch, Italian manufacturer Benetton, US rubber and tires company Cooper Tires and Austrian crystal company Swarovski.

fYRoM	-	657	1.350	1.463	1.743	1.804	1.758	1.680
Albania	1.518	234	1.002	1.206	1.420	3.724	2.117	2.018
Serbia	-	-	8.006	10.623	12.651	12.684	12.647	11.756

Note: Available data cover only mentioned period.
Source: Eurostat

The EU FDI flow and stock in WB economies in all years for which data are available were significantly higher in Serbia. Serbia had the lowest corporate tax rate in Europe and its economy was in full expansion during the past decade. Serbia's human capital is also interesting for foreign investors because the workforce is very young compared to the rest of Europe and very well educated.

However, the situation has stagnated since 2009. A reduction in the FDI stock levels was recorded in the last two years. The reduction in outward FDI was almost exclusively due to the fall in equity stock and/or a strong net outflow of intra-company crediting. A noticeable reduction was also recorded in Albania in 2011 compared with 2010, the year in which Albania received significant FDI inflow in the exploration and drilling oil / gas and energy sector concessions.

Table 25. EU (27) Direct investment net income in WBs in 2005-2012

(in million EUR)

WB country	2005	2006	2007	2008	2009	2010	2011	2012
Montenegro	-	-	44	69	11	-56	-3	-2
fYRoM	-	-32	146	101	85	61	67	94
Albania	39	89	163	211	158	115	195	-130
Serbia	-	-	464	429	144	147	488	-372

Note: Available data cover only mentioned period.
Source: Eurostat

Direct investment income (which comprises income on equity and income on debt) from WBs increased slightly in 2010 after two years of decline, but then resumed its downward trajectory in 2012, meaning that the rate of return on EU outward stocks fell. Excluding the last year of analysis when the income was negative, in all previous years EU income from FDI was largest from Serbia. This was because Serbia accounts for by far the largest EU FDI outward stock in the WB.[18]

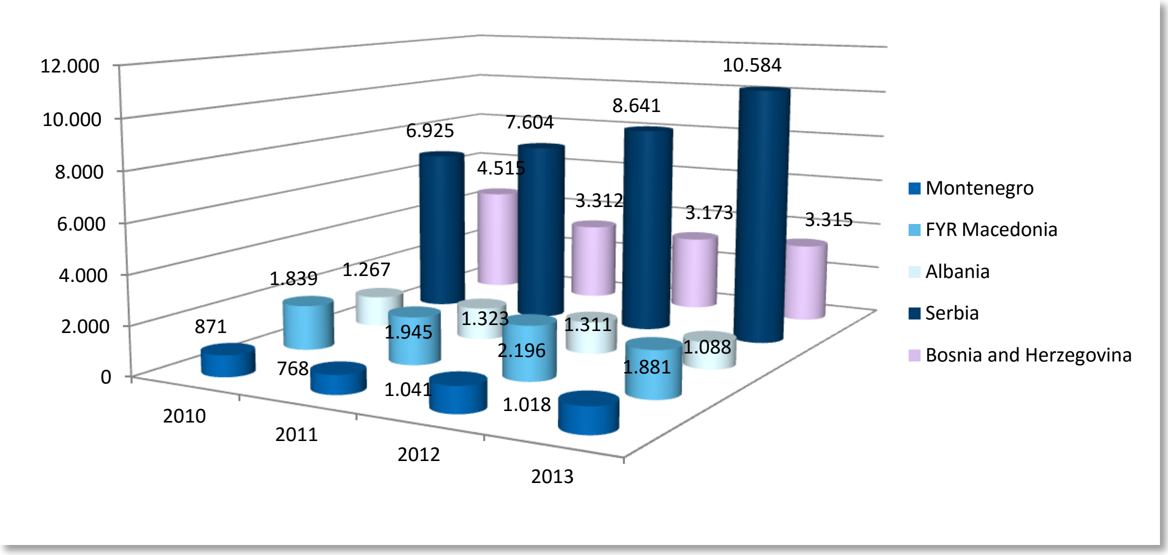
Based on EU statistics, the number of EU-27 enterprises in 2013 was largest (1.025) in Serbia. In Albania, the number of EU - 27 enterprises increased to 208 in 2013 and to 248 in fYRoM. However, in Bosnia and Herzegovina it actually decreased significantly from 453 in 2012 to 413 in 2013. There are no recent data for Montenegro, but in 2012 there were 104 EU-27 enterprises.

Based on the presence of EU-27 enterprises in the WB region, the EU affiliates generate the largest turnover in Serbia, which is consistent with the disproportionate number active in the Serbian market.

The turnover is illustrated in the graphic below.

[18] The ups and downs reported in the past few years can be explained neither by the common driving forces of FDI such as economic growth or by changes in location factors nor by one-time mergers and acquisitions (M&A). A possible explanation is that some components of FDI (equity capital, reinvested earnings and other capital) are more mobile than others.

Chart 8. Turnover of EU 27 affiliates in million EUR in 2010-2013



Regarding number of employees of EU27 affiliates in the WB economies (see Table 26), the numbers generally rose until 2012, but the trend only continued in following year in fYRoM and Serbia.

Table 26. Number of persons employed in affiliates of EU 27 enterprises in 2010-2013

Country	2010	2011	2012	2013
Montenegro	8.370	9.399	10.388	9.326
fYRoM	14.499	14.480	15.362	18.988
Albania	16.837	17.837	21.500	18.964
Serbia	104.738	105.703	116.686	118.399
Bosnia and Herzegovina	30.414	29.483	30.114	29.978

Source: Eurostat

FDI in the WB economies was growing rapidly before crisis in part because of the progress in EU accession and the strengthening of relations with EU.

However, the intensity of growing competitiveness and economic development depends on the type of FDI. The empirical findings by Universitat Autònoma de Barcelona related to FDI attraction in WB region, show that the higher the GDP and the higher the anti-corruption activities, the more FDI will be attracted, while an appreciation of the national currency tends to deter foreign investors.[19] Most importantly, the market size, together with skilled human resources, political stability and country risks highly are of critical importance to investors from EU.

2.4.2 EU-SME FDI in WB economies

Although there is extensive research and analysis on FDI in general, this covers almost exclusively Multinational Companies (MNCs), rather than SMEs per se. Due to methodological reasons, FDI statistics of WB economies do not distinguish SME FDI from any other form of FDI, meaning that available data on FDI in the WB region do not differentiate according to the size of company. Consequently, such data are not also available in international databases such as that of Eurostat.

The only available information on the activities of EU SMEs and the internationalisation of their operations is the Flash Eurobarometer.[20] The Flash Eurobarometer is a survey that explores the international business activities carried out by SMEs inside and outside the internal market. In the last year for which data are available (2015) about 14,513 SMEs active in the manufacturing, retail,

[19] RutaVesaite, *FDI from European Union to Western Balkan Countries: Is The Economic Development Being Intensified in the Region?* UAB, edició 2013-2014.

[20] The European Commission's priority is to ensure that enterprises can rely on a business-friendly environment and make the most out of growth markets outside the EU. Increasing the internationalisation of SMEs and helping them access third markets is crucial for Europe’s competitiveness, economic growth and innovation Benefits of internationalisation include:

- An estimated 90% of global growth will originate outside the EU in the coming years.
- Developing and emerging markets are expected to account for 60% of world GDP by 2030.
- Given increased market integration, SMEs can play an important role in global value chains.

services and industry sectors have been interviewed for the purpose of supporting EU SMEs to internationalise. Elements investigated include export and import markets, real and perceived barriers related to export and import and measures that would help SMEs internationalise. Although the analysis is not specific to the WB region, it is worth reporting some of the relevant findings:

EU SMEs engaged in international business activities:[21]

- 39% of EU SMEs have imported from another country in the past three years. Of these, 36% had imported from another EU country and 19% from a non-EU countries;
- 33% of EU SMEs have been involved in exports to another country. Of these, 30% targeted the Internal Market and 20% addressed markets outside the EU.
- 16% of EU SMEs have used a subcontractor based abroad and 13% of SMEs in the EU have worked as a subcontractor for a company based abroad.
- 8% of EU SMEs have worked with a partner based abroad for research and development.
- 4% of EU SMEs have invested in a company based abroad.

SMEs not engaged in international business activities:

- 49% of EU SMEs have not engaged in any of the above mentioned business activities inside and 69% outside the Internal Market in the last three years.

The Report on Opportunities for Internationalisation of European SMEs, published by DG Enterprise and Industry, emphasises following conclusions based on research:[22]

- *There is a negative correlation between the size of the SME's home country population and its level of international activity*. Countries such as Estonia, Denmark, Sweden, the Czech Republic and Slovenia have a much higher percentage of exporters than the EU average of 25%. Germany, France and UK score below average. SMEs located close to an international border show much higher activity rates with their cross border regions but this is not *followed* by being more internationally active in general;
- Trade, manufacturing, transport and communication, and research are the most international sectors. The highest percentage of internationalised SMEs is found in wholesale trade, mining, manufacturing and sale of motor vehicles. Within services, the research sector scores very highly. Sectors with the highest share of SMEs export within the total sale are mining (58%), manufacturing (56%), wholesale trade (54%), research (54%), sales of motor vehicles (53%), renting (39%) and transport and communication (39%);
- Exporting and importing activities increase in intensity by age of enterprise. The percentages of SMEs that are exporting gradually increases from just over 15% for enterprises up to 4 years of age to nearly 30% for enterprises that have existed for 25 years or more;
- SMEs often start international activities by importing. If SMEs are both importing and exporting, they start with import twice as often (39%) as starting with exports (18%). 42% started with imports and exports in the same year.

2.5 Conclusions

After a decade of high political and economic instability in the WB region, the 2000s brought a number of positive developments, including a major improvement in macroeconomic performance and acceleration of transition-related economic reforms. Until the severe impact of the global economic crisis in late 2008, the WB countries experienced rapid economic growth and increasing macroeconomic stability. Trade liberalization after 2000, with the EU and other countries in the region, has contributed to a remarkable increase in the volume of foreign trade. Following positive economic environment in the WB economies during the 2000s, there was an upsurge in FDI in the first half of the decade, prompted by privatisations of enterprises and banks and improved economic prospects.

After the years of dynamic economic growth followed by increasing FDI inflow, with emerging of financial crises FDI inflows to the WB region halved in 2009, falling to about the 2005 level. With the financial crisis, the region has gained only marginally in FDI inflows, which suggests a smaller contribution of FDI to economic growth.

[21]Flash Eurobarometer 421, *Internationalization of Small and Medium-sized Enterprises, October 2015.*
This survey was carried out in the 28 EU countries and the participating non-EU countries – Albania, FYR Macedonia, Iceland, Moldova, Montenegro and Turkey – to investigate SME's experience with international business activities.
[22]DG Enterprise and Industry, *"Opportunities for the internationalization of European SMEs*", 2011.

From the standing of sectoral distribution, the WB economies have a diversified structure of FDI stock. The significant shares are in transport, storage and communication (Albania and Serbia), manufacturing as a part of industry (Bosnia and Herzegovina and fYRoM), financial intermediation (Serbia, Bosnia and Herzegovina and fYRoM) and real estate, renting and business activities (Kosovo, Montenegro). Some countries, notably Albania, have attracted a significant amount of FDI into natural resources.

The sectoral distribution of FDI in the WB economies probably contributed to the relative decline of manufacturing. By 2010 the services sector accounted for the largest part of inward FDI stock in all WB economies - just over 60% of total inward FDI stock in Bosnia and Herzegovina and fYRoM, but as much as 75% in Serbia. Foreign investors have invested mostly in non-tradable services of the Balkan economies, primarily banking, telecommunications, real estate, wholesale and retail trade.

In contrast to the services, by 2010 only two countries had attracted a considerable amount of FDI in manufacturing - Bosnia and Herzegovina (35% of total FDI stock) and fYRoM (31%). The average share of FDI inward stock in manufacturing in 2010 was 24,6% in the five WB economies (information for Kosovo is not available), as compared to 29,4% in the five Central East European countries (without Bulgaria, Romania and the three Baltic states).

Since the bulk of FDI in WBs has been in services, FDI could not have contributed in a major way to industrial diversification and upgrading, nor to promoting of manufacturing exports.

The dominance of services in the structure of the WB economies is not a problem per se, and it indicates that the region is following similar trends of structural change as other European countries where services also contribute well over 60% of GDP. Moreover, in the context of global supply chains, the distinction between ‘tradables’ and ‘non-tradables’ is less important, since many services add value to manufactured goods exported abroad. The problem lies in the fact that the WB economies have become predominantly service economies at a relatively low level of economic development and manufacturing added value (see Annex 1). Since foreign companies and banks have invested predominantly into non-tradable services, such investments can contribute only indirectly to developing these WB countries´ export potential.

Firms in manufacturing are more inclined to undertake innovation and research, and productivity growth is higher in manufacturing than in the rest of the economy. Moreover, the economic crisis has underlined the importance of the real economy, particularly the manufacturing sector, for economic growth. These features of manufacturing are at the background of present initiatives of the European Commission to re-industrialise the EU economy and increase the share of manufacturing value added from the current EU average of 15% to 20% by 2020 (European Commission, 2012).

The analysis of FDI inflows in manufacturing sectors in the WBs showed that there were significant reductions in FDI inflows from 2007 to 2010 in majority of manufacturing sub-sectors (coke and petroleum products; food products, beverages and tobacco; textiles and textile products; wood and wood products; rubber and plastic products, and chemicals and chemical products).

In 2010 FDI inflows increased compared to pre-crisis levels in basic metals and fabricated metal products; leather and leather products; pulp and paper products; and other manufacturing and recycling. FDI inflows rebounded to near pre-crisis levels in transport equipment. This means that the post-crisis recovery process has seen an increase in FDI though this remains below the pre-crises levels in almost all countries.

The creation of a favourable business environment is one of the key preconditions for economic recovery and growth of the WB region. Many elements of a sound business environment – such as efficient and predictable government institutions, an educated labour force, good physical infrastructure, and access to finance – have direct links to economic growth. A country’s economic performance is intertwined with enterprise growth and innovation, which in turn reflects the state of the business environment. The entire region (with the exception of fYRoM) lags significantly behind the average rankings of new EU member states, indicating a much more burdensome environment for doing business (World Bank Doing Business Surveys).

Much of the FDI in last 10 years in WB economies has happened in the context of privatisations and in sectors intended primarily for domestic consumption, such as financial services and telecommunications. Foreign investors have tended to focus on the banking sector rather than manufacturing industry or agriculture, thus failing to address the long-run structural weaknesses of the WB economies. As this source of FDI has largely dried-up, countries in the WB region started to pay attention on attracting FDI in tradable sectors, which contribute to export capacity, rather than domestic consumption. Since the policies applied so far do not appear to have led to the desired effect, as far as manufacturing investment is concerned, governments may need to play a more pro-active role regarding inward FDI. The recent experience in the WBs indicates that there is a need for a stronger link between investment promotion and industrial policy.

Given the degree of integration of the WBs with the EU economy, the immediate growth prospects will depend on future growth in the EU to a large extent. At the same time, FDI is unlikely to return in larger volumes in the near future, since in most WB economies privatisation opportunities have been mostly exhausted, while FDI at the global level has not yet fully recovered. In early 2015, the global FDI flows were still only 66% of their peak in 2007. Since the short-term prospects for growth in the EU are for the moment uncertain while major FDI inflows are unlikely in the medium term, the WB economies will need to become more proactive regarding attracting investment finance and economic restructuring policies.

The EU accession agenda has given impetus to reforms across WB economies. In this respect if successfully implemented, reforms may boost FDI inflows to the region. For example, FDI inflows to Serbia and Bosnia and Herzegovina are likely to see increases of 0,2–0,3% of GDP in 2015. In many countries worldwide, governments have played a key role in inducing structural change, sectoral upgrading and economic diversification in order to promote growth, employment and an increase in productivity. How to define a sensible industrial policy will remain a major policy challenge, but one should be worked out in line with comparative advantages of each country.

A possible focus on reindustrialisation of the WB economies could be in line with the recent EU policy objectives that aim at increasing the share of manufacturing value added from the current 15% to 20% of GDP by 2020. If reindustrialisation is a key element for strengthening EU competitiveness, this applies doubly as a potential explicit objective of the WBs. A regional industrial policy that would facilitate the creation of transnational networks and supply chains could also be helpful.

3 COUNTRY PROFILES: FDI ATTRACTION POLICIES AND INSTRUMENTS IN THE WESTERN BALKANS

3.1 Introduction

This part of the report analyses the FDI environment in the six countries in question. Much of the analysis focuses on the policies and instruments in general, institutions, relevant statistical data on sectors and sub-sectors policies. The aim is not only to set out what is available to support FDI, but also to establish the capacities that exist in respect to SMEs engaged in manufacturing investment.

Each country profile contains the following type of information:

- FDI Trends: inflow, stock and FDI in manufacturing presented by tables and charts;
- FDI Policies and extent of SME/manufacturing focus: Industrial/FDI policy, strategy, etc.;
- FDI Institutions and extent of SME focus: institutions, resources and capacities;
- Manufacturing sectors / sub-sectors: the extent to which there is a policy focus;
- FDI instruments: with a focus on i) SMEs and ii) manufacturing;
- Brief conclusions.

It should be noted that the material presented below is based mainly on a desk research based on existing materials, combined with discussions with key relevant institutions in the six countries. It represents the view of the research team. It was designed to provide an overview of the situation for the six countries concerned, rather than a detailed and comprehensive assessment of the FDI landscape, which would have required a dedicated research exercise.

Moreover, it should also be noted that the statistical / policy / institutional basis varies significantly across the six countries. Although efforts were made to ensure as much consistency as possible across the country profiles, the variation in information reflects the reality of the situation on the ground at the present time.

3.2 Albania

3.2.1 FDI Trends

Thanks to progress in economic transformation and a supportive external environment, economic growth in Albania was robust between 2000 and 2009. Albania achieved an average annual GDP growth of 6% in this period. Albania is ranked 18th among 141 countries according to UNCTAD's Inward **FDI Performance Index** for 2010, **up sharply from the 68th place it occupied in 2005**. This improved position reflects an increasingly investor friendly business environment and opportunities opened up by the privatisation of state-owned enterprises. In terms of UNCTAD's Inward **FDI Potential Index**, Albania was ranked 81st in 2009. The slowdown in 2010 and 2011 was also less serious than in other countries of the region. The industrial sector (including manufacturing and mining) accounted for almost 50% of the inflow of FDI in 2010 and 2011, with mining and metal working being the main recipients. Still, per capita GDP at purchasing power parity is only 25% of the EU27 average, less than of Bulgaria – the EU member State with the lowest income.

Table 27. Main FDI indicators of Albania in period 2005-2014

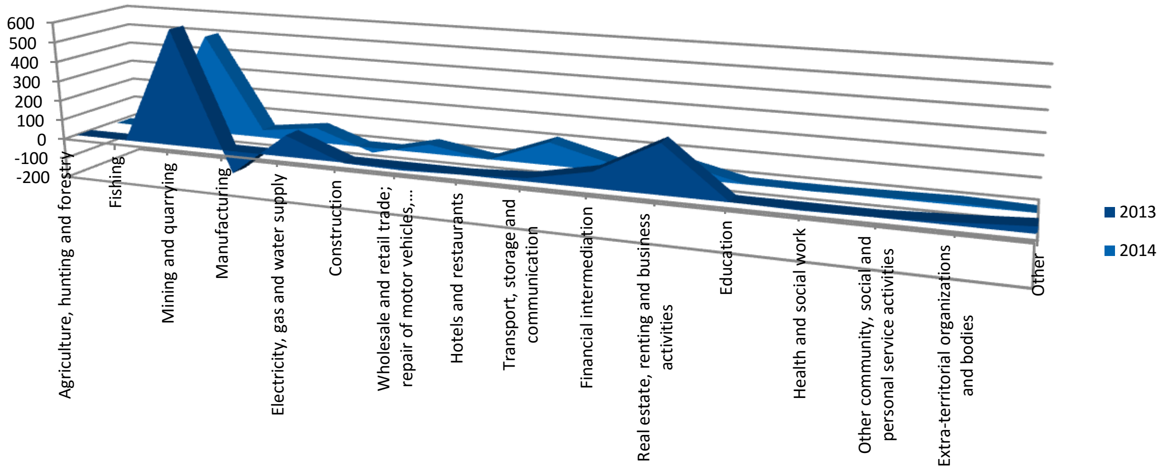
Indicator/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
FDI inflow, EUR million	213	259	481	665	717	793	630	666	923	869
FDI net, EUR million	209	250	464	610	689	789	609	648	893	720
Inward FDI stock, EUR million	865	1057	1830	2061	2261	2436	3400	3503	3700	4553
FDI inflow per capita in EUR	71	87	164	228	249	278	223	238	325	307
Inward FDI stock per capita in EUR	290	358	625	711	788	857	1207	1257	1309	1608
FDI inflow as a percentage of GDP	3,2	3,6	6,1	7,5	8,2	8,9	6,9	6,9	9,4	8,6
Inward FDI stock as a percentage of GDP	13,2	14,7	23,4	23,2	26	27,5	37,2	36,3	37,6	45

Source: WiiW database; Bank of Albania.

FDI inflows in Albania have grown significantly over the last eight years, increasing by more than 3,5 times and the value of FDI inflow in 2013 reached a historical level of 923 million EUR. The share of

FDI in GDP increased from 3,2% in 2005 to approx. 9,4% in 2013. Although the FDI stock per capita in 2013 is 4 times greater than in 2006, it is still the lowest in the WB region.

Chart 9. Annual flow of FDI in Albania by economic activity in 2013-2014 in million EUR



The turnover of foreign investment enterprises (FIE) represented 29% of the country's total in 2010, and 51% of the turnover in manufacturing. Both these shares are 1–2 percentage points higher than they were two years earlier. The turnover of FIEs is generated by three main economic activities, trade (24%), manufacturing (21%) and transport and telecommunications (18%). The income of the foreign investors in Albania amounted to 81 million EUR in 2011, down from 288 million EUR in 2010. According to Albanian statistics, in 2010, foreign companies employed 18% of all employees at national level. The contribution of foreign companies is higher in the manufacturing sector, which employs 39% of the total manufacturing industry, while turnover provided by them constitutes 51% of the total manufacturing industry.

The largest number of greenfield projects in Albania in previous years was in sales and marketing followed by transport and other business services. The largest investor, with the highest amount invested in greenfield projects outside services, is "Titan Cement" from Greece, which announced its second factory in 2011. Another large investor is Moncada Costruzioni (Moncada Energy Group) from Italy. The Italian food-store cooperative Conad also had to deal with a competitor in the retail sector, the French Carrefour.

Table 28. Annual stock of FDI in Albania by economic activity 2007-2014

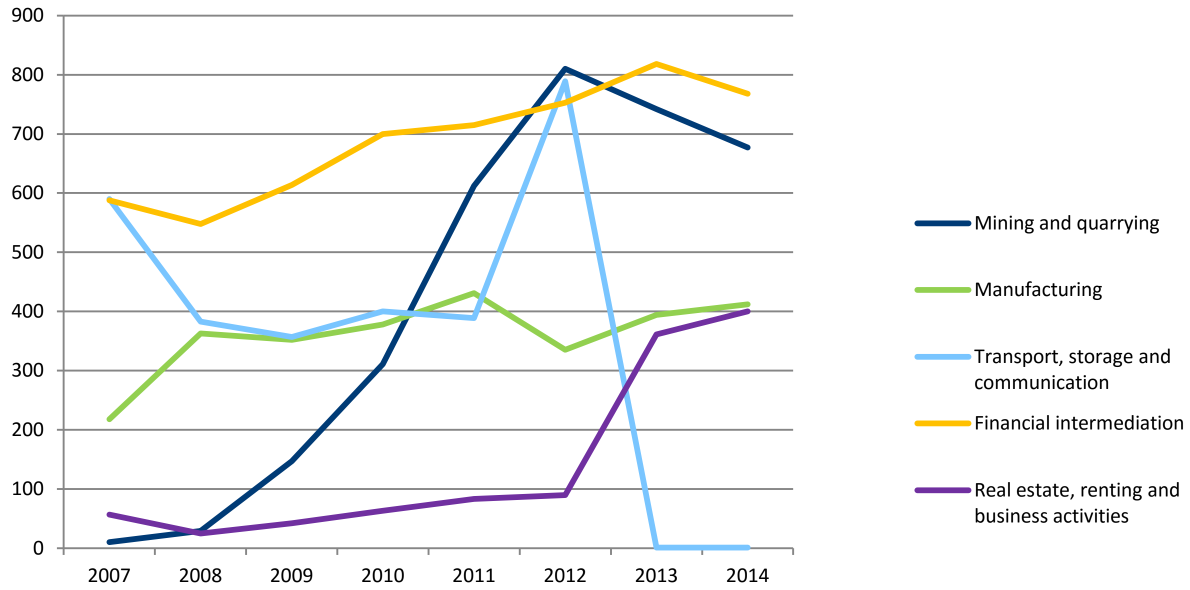
(in million EUR)

Sectors	2007	2008	2009	2010	2011	2012	2013	2014
Agriculture, hunting and forestry	6	19	6	7	4	1	1	1
Fishing	-	2	3	2	4	-	-	-
Mining and quarrying	**10**	**29**	**147**	**311**	**612**	**810**	**742**	**677**
Manufacturing	**218**	**363**	**352**	**378**	**431**	**335**	**394**	**412**
Electricity, gas and water supply	10	18	95	118	247	30	-4	399
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	99	271	253	240	217	157	156	189
Hotels and restaurants	94	94	79	76	70	63	63	60
Transport, storage and communication	**590**	**383**	**357**	**400**	**389**	**789**	**1,157**	**1,219**
Financial intermediation	**588**	**548**	**614**	**700**	**715**	**753**	**818**	**768**
Real estate, renting and business activities	57	25	42	63	83	90	**361**	**400**
Education	2	3	3	4	6	7	13	17
Health and social work	0	26	48	64	47	36	33	29
Other community, social and personal service activities	13	8	9	12	9	18	19	26
Extra-territorial organisations and bodies	-	-	10	24	36	46	60	60
Other manufacture	10	76	56	38	521	616	160	189
Total FDI	**1,83**	**2,061**	**2,261**	**2,436**	**3,4**	**3,893**	**4,113**	**4,553**

Source: Bank of Albania

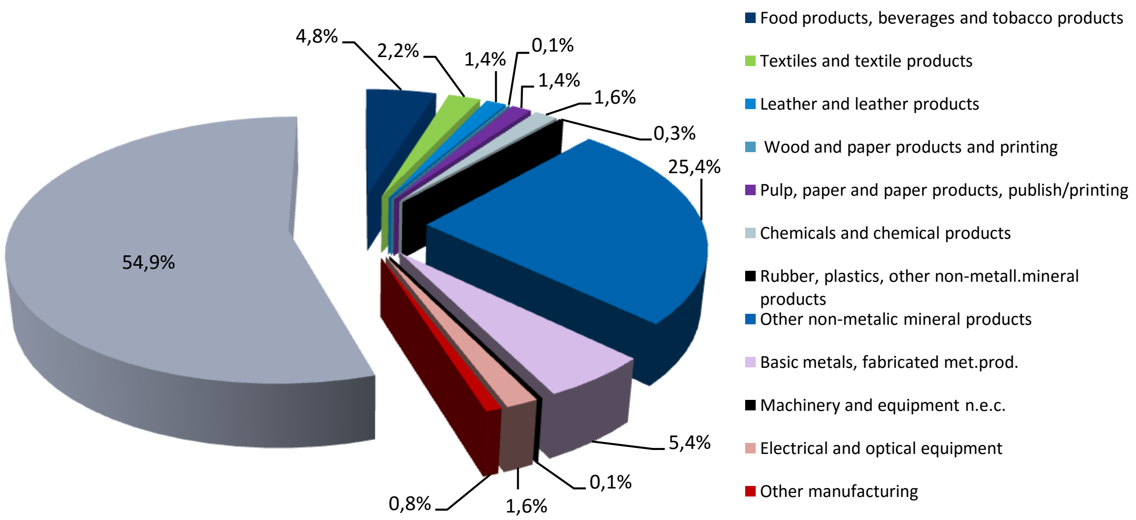
The inward FDI stock in Albania reached 2,436 million EUR in 2010, according to the results of the Bank of Albania's (BOA's) and 4,553 million EUR in 2014. This level is 11% above the level of the previous year and 150% higher than in 2007. However, Albania has the lowest FDI stock relative to GDP among the countries of WB. The share of FDI in GDP increased from 3,2% in 2005 to 9,4% in 2013. Nonetheless, FDI stock per capita in 2013 is 4 times greater than in 2006 it remains the lowest in the Western Balkan region.[23]

Chart 10. Annual stock of FDI in Albania by most relevant activities in mil. EUR in 2007-2014



According to the most recent Albania data, the structure of the stock of FDI has changed from year to year and especially during 2011-2014. In 2008 and 2010, the service sector dominated with respectively 66% and 65% of total FDI stock, while in 2012 this stock was reduced to 46%. Within the services sector, FDI stock inflows in the financial sector have fallen from 28,7% in 2010 to 21,4% at the end of 2012. In 2008, the services sector - *Financial intermediation services* - dominated with 33% of the total FDI stock, though its share fell to 17% in 2014. During these years the main beneficiary was *Mining,* whose share in total FDI stock increased from a negligible 0,9% in 2008 to 15% in 2014. Also, “Transport, storage and communications” had the largest share in the distribution of the stock of FDI by sector of the economy in 2014. Major investments in this sector were absorbed by “posts and telecommunications” (approximately 96.8% of investment in “Transport, storage and communications”).

Chart 11. Stock of FDI in manufacturing in % in 2012



[23] In regards to productivity Albania is assessed to be the lowest in the region. Its productivity counts as 19% of the EU average productivity in 2012.

A detailed breakdown of the FDI stock in manufacturing reveals the **dominance of capital-intensive industries**, before all N**on-metallic mineral products** (construction materials). The weight of other industry is low: the metallurgical industry represents 5,4% of the FDI stock, the food industry 4,8% and textile and shoes accounted for just 3.6% even though these activities use labour intensively and offer good potential for export. What is observed during the last 3 years is the significant reduction of the FDI stock in 2012 compared to 2010: -68% in the shoe and leather industry; -58% of the timber industry; -42% in the clothing industry; -33% in the food industry; -31% in printing & publishing; -5% in metallurgy & metal works and -3% in the manufacture of electrical equipment. This downward trend is partly the result of economic cycles in global economy, which had a strong impact on Albanian economic growth.

Data on the distribution of FDI by country of origin indicate a slight decrease in their concentration. Italy and the Netherlands have almost the same share in the total stock of FDI. Canada was a very important country as a source of FDI in 2012, with 20% of total FDI stock. Italy ranks in fifth place with 12% of the total stock of FDI, down three places compared to 2010, although it increased by 12% compared to 2010.[24] The stock of FDI from the countries of the region is negligible (e.g. Croatia, Bulgaria, fYRoM, Kosovo and Serbia).

Table 29. Inward FDI stock by home countries in 2012-2014 in mil. EUR

Country and sector/ Years	2012	2013	2014
Austria	**391**	**432**	**357**
Electricity, gas and water supply	86	89	70
Construction	33	58	59
Canada	**705**	**797**	**755**
Greece	**782**	**1,093**	**1,169**
Manufacturing	43	45	44
Italy	**457**	**508**	**526**
Manufacturing	119	128	122
Netherland	**338**	**389**	**505**
Manufacturing	5	1	1
Other	1.220	1.986	2.409
Total FDI	**3.893**	**4.113**	**4.553**

Source: Bank of Albania

As usual with small countries, Albania receives an exceptionally large part of its FDI from a neighbouring country, in this case Greece. The largest investor, with the highest amount invested in greenfield projects, is Titan Cement from Greece, which announced its second factory in 2011. FDI from Greece accounted for 25% of the FDI stock in 2010 and it reached 38% in 2013, meaning more than the FDI stock from Canada (28%).

The main points arising from the above illustrations are as follows:

- At the end of 2014, the stock of FDI was 4.553 million EUR. Compared with a year earlier, the stock of FDI rose by 10,7%. The structure of the stock of FDI has changed from 2008 when the service sector was dominant but over the years there has been an expansion of FDI **in the extractive industry sector,** as well as oil and minerals where 2% of the FDI stock in 2008 rose to 13% during 2010 and reached 23% at the end of 2012;
- The branch of manufacturing with the largest FDI stock is the **production of non-metallic mineral products** whose share in total manufacturing in 2012 was 25,4%. Another important investment target is **the production of basic and fabricated metals,** which also uses local ores. A further industry with relatively high FDI is the production of **food and beverages**. The higher-technology industries, like the production of electrical machinery and vehicles, are almost absent among the investment targets;
- Six of the largest investors per country accounted for about 81,4% of the total FDI stock in 2014. Greece has 25,7% followed by Canada with approximately 16,6% of the total FDI stock in 2014. Due to significant investments from non-EU countries (Canada, Switzerland, Turkey, etc.), the share of EU-28 in inward FDI stock in Albania decreased from 57% in 2011 to 50% in 2012.

[24] 29 % of the greenfield FDI projects come from Italy, 7% from the United States, 6% from Greece, Turkey and Italy each. The largest new project announced in 2010 was Hidroelektra Niskogradnja from Croatia in the construction sector. Smaller projects in services came from Austria, Bosnia-Herzegovina and Serbia.

Albania was ranked 97th in the World Bank's ''Doing Business 2016'' report, performing exceptionally well in three indicators: paying taxes, registering property and providing investor protection (ranked 7th in the world, and best in the region). According to the EBRD, Albania was the top reformer country in the region in 2014. The Heritage Foundation's 2016 Index of Economic Freedom ranks Albania very favourably with other countries in the region and it scores highest in the trade, fiscal and investment freedom indicators.

3.2.2 FDI Policies and extent of SME focus[25]

Attraction of foreign investment is one of the main Albanian economic goals. The Albanian economy is open to all investors and prior authorisation for investments is not required. As a rule, all sectors are open to foreign investment. In the frame of the new economic model and in harmony with the EU policy**,** Albania sees itself as a country that has developed and improved the business climate, an open competitive market, a developed industrial SME sector and an attractive investment destination for inclusive and sustainable growth. Still, Albania has the lowest FDI stock relative to GDP among the countries of South-East Europe. Albania faces several challenges in FDI promotion: the small domestic market and limited purchasing power, high competition posed by neighbouring countries that are pursuing aggressive foreign investment promotion strategies. Albania lags in construction permits, payment of taxes/tariffs, obtaining of ownership titles, enforcement of contracts, etc.

For the purposes of improving the competitiveness of its economy and attracting more FDI, Albania adopted several laws and strategies .The most relevant ones are discussed below.

Law on Foreign Investment:
This Law (no. 7764) was adopted in 1991 and then amended several times It aims to create a favourable investment climate for foreign investors in Albania. According to the Law, no sector is closed to foreign investment and no prior government authorisation is needed to invest. There is no limitation on the percentage of share for foreign participation in companies (100% foreign-owned companies can be established). Foreign investments cannot be expropriated or nationalised except in exceptional circumstances. Foreign investors have the right transfer all funds and contributions in kind related to a foreign investment including:

- Revenues;
- Compensation in accordance with the Law in case of expropriation or nationalisation;
- Payments deriving from an investment dispute;
- Payments made pursuant to a contract, including loan and interest payments made;
- Revenues deriving from the sale or the partial or complete liquidation of an investment;
- Revenues deriving from reduction of the capital of the company in accordance with the legislation.

There is equal treatment in respect to foreign and domestic investors. Albania's tax system also does not discriminate against foreign investors. Likewise, legislation concerning the public procurement process makes little distinction between foreign and domestic firms.

The Law is of quite general nature and does not prescribe priority sectors for investments. It targets all investments and investors, and does not prioritise SMEs in relation to investments.

Law on Strategic Investments, No. 55/2015
With the aim to facilitate the investments, in 2015 the Law on Strategic investments was passed, including the following two decisions, which support the strategic investment climate in the country:

- Council of Minister Decisions No. 1023, 2015, "On strategic subsectors and development areas of priority";
- Council of Minister Decisions No. 1024, 2015, "On approval of projects with the status of potential strategic status".

The law not only defines the strategic sectors for Albanian economy, it also sets out the incentives for investments in those strategic sectors, namely: Energy and mining; transport, telecommunications, infrastructure and urban waste; tourism and agriculture and fisheries.

The law also allows for the establishment of the Albanian Investment Development Agency (AIDA) to be in charge of investors in strategic sectors. AIDA performs the role of the assisting agent and is

[25] This analysis elaborates policies, institutional framework and incentives at the central level.

responsible for the administrative procedures in realising the investment projects. Investors are required to pay administrative fees, namely administrative service and cost fees (approx. 510 EUR) and strategic investment procedures fees (approx. 110 EUR) to AIDA. In return, they are entitled to make use of AIDA´s services.

A decree was also passed to define the participation of Albanian state in strategic investments. Before a decision on state support in investment is made, an opinion should be obtained by the Competition Authority, the State Aid Commission and other specialised bodies. This Decree also establishes the Strategic Investment Immovable Property Fund (state owned properties such as buildings/facilities, development land, agricultural land, forests, grassland and pastures in the ownership of central institutions or local governing units) that can be offered to potential investors in the strategic sectors.

A special Decree was also passed in order to establish a Strategic Investment Register, which is a public inventory containing information and data on the strategic investments implemented in Albania. This Register is the responsibility of AIDA, which also lists all the support provided by the Albanian Government to a strategic investment.

This Law and its by-laws represent an effort of the Albanian Government to modernise legislation for support to investments and to provide additional support to sectors considered important for development of Albanian economy. It is a unique example in the WB of the definition of strategic sectors and mobilisation of resources in support to the realisation of investment in those sectors.

Based on this law, the strategic investor may apply for one of the preferential strategic statuses. The proposers may first apply for the status of "potential strategic project" when the investment project is at the stage of a project idea and needs to collect information, data, technical expertise, preliminary assessments and documentation available to the state bodies. The usefulness of this procedure is related to the fact that AIDA enables the project proposers to collect all the information, data, documentation, expertise, and knowledge they need within a short time from public administration bodies to complete the drafting of a strategic project. In case a concrete project is already prepared and ready for evaluation by the relevant authorities, the proposers may apply for the status of "Strategic investment/investor, assisted procedure" or for the status of "Strategic investment/investor, special procedure". Through the assisted or special procedure, the investor benefits from the procedures, logistic services, and support measures applicable to the investment. The key difference between the assisted and the special procedure is that a special procedure provides logistics for investors in completing all of administrative procedures and obtaining necessary permits in the shortest time, even as low as 15 days.

Business and Investment Development Strategy 2014-2020

The vision of this Strategy is to create "a competitive Albania with a dynamic entrepreneurship and productive industry". The main four pillars are as follows: SME and entrepreneurship, Industry, export and FDI. The aim is to increase the volume of foreign investment, increase diversification of exports and stimulate the creation of new businesses.

Increasing foreign investments is a crucial objective for Albania's economic development and an important Government priority. In order to attract more FDI, Albania needs to improve business climate, PPPs and business infrastructure. The Strategy also enables Albania establish industrial zones which will offer land, infrastructure and business support services for investors as well as free trade areas close to ports and airports and offer sites of government-owned industrial factories.

In order to remove administrative barriers and lower costs, a "One-stop-shop" for foreign investors is established to process administrative procedures on their behalf from the moment an application is submitted until the strategic investments are completed.

There are four specific objectives of this strategy linked with promotion of foreign investments:

- To maintain a high level of FDI to GDP for the next 7 years;
- To achieve long term sustainability of investments by promoting reinvestment and expansion of existing investments;
- To increase the share of green field and export-oriented investments;
- To increase the share of value added and high tech investments.

To achieve the objectives by 2020, the Government is committed to implement various measures:

- Strengthening of the capacities for investment promotion, mainly AIDA's capacities;
- Targeting of the investors (AIDA will ensure that FDI complies with following criteria: export oriented; labour intensive and new technologies);
- Improving the image of Albania in international markets;
- Developing economic zones (industrial parks and free zones);
- Completing the privatisation process.

The Strategy also defines the importance of manufacturing industry for the economy of Albania, but it does not define priority manufacturing sectors of special importance.

Albania's Economic Reform Programme (ERP) (2016 – 2018)

As in all other WB countries, the ERP is based on the EU Enlargement Strategy. It outlines the main macroeconomic and fiscal policy aspects, as well as priority structural reforms planned by the Government of Albania in the medium term for strengthening the domestic economy and stimulating sustainable growth and increase competitiveness. The main fiscal priorities are oriented toward fiscal consolidation and strengthened public expenditure management, reduction of infrastructure deficits, regulatory and institutional reform and improvement of social protection systems. The planned reforms are directed towards addressing binding constrains to growth and boosting competitiveness, enabling Albania to compete and effectively participate in the regional and global value chains.

One reform priority (no. 13) is related particularly with investments and foresees that effective implementation of recent legislative changes promoting new investment should be secured. Other reform measures for improvement of business climate also can influence and improve attraction of FDI. The ERP also stresses agriculture and tourism as priority sectors and reform measures target these two sectors.

Industrial Policy

There is no specific industrial policy document. The relevant issues related to support of industrial policy development are included in the Business and Investment Development Strategy 2014-2020. The relevant institutions do not plan a separate industrial policy document at present.

3.2.3 FDI Institutions and extent of SME focus

Although an institutional framework for FDI is not prescribed by the law, several institutions are dealing with FDI promotion and attraction, though none of them is manufacturing oriented nor target SMEs specifically. The key institutions for investment promotion are:

- *Committee of Strategic Investments*: this committee is established as a collegial body of the Council of Ministers and is headed by the Prime Minister. The members of the Committee include the vice Prime Minister, Minister of Finance, Minister of Labour, Minister of Urban Development and Minister for public administration. AIDA is its technical secretariat. The Committee can award investments associated or specific strategic investments status. The Law and its by-laws came into force in 2016, but it is not clear if this Committee has been established yet;
- *Albania Investment Council:* was established by Decree of the Council of Ministers no. 294, 2015. The main objective of the Council is to facilitate dialogue between representatives of the business community, international organisations, donors and the Government for the development of a favourable, non-discriminatory and transparent business and investment climate in Albania;
- *Ministry of Economic Development, Tourism, Trade and Entrepreneurship:* defines the overall economic policy in the country with the aim to improve the business environment, entrepreneurship and business support services. It has policy and regulatory responsibility;
- *Albanian Investment Development Agency (AIDA):* was established by the Law "*On the creation and organisation of Albanian Investment Development Agency"* in 2010[26]. AIDA's main objectives include attracting FDI and increasing the competitiveness of the economy through SME support, as well as a focus on innovation. Within AIDA, the one stop-shop for strategic investors has been established (see below for further information on AIDA).
- *Technology and Economic Development Zones (TEDZ):* there are also zones with certain development advantages, with a focus on local self-government. TEDZ should work towards

[26]The Law no. 10303, adopted on 15.07.2010, entered into force on 26 August 2010. AIDA replaced the Albanian Agency of Investment and Business.

stimulating economic development, encouraging of employment, improving of living conditions and efficient use of public infrastructure;

- *Foreign Investors Association of Albania* was established by several foreign investors in Albania as non-profit organisation bringing up the need of such an organisation in the country. Main aim is to improve the investment and business climate in Albania by defining concrete reform proposals on legislation and product development and to promote dialogue between the FIAA members and the Albanian Authorities
- *Enterprise Europe Network (EEN):* the EEN has been operating in Albania since May 2016.

AIDA is the key FDI institution, so it is worth setting out its role and function is more detail.

AIDA has 15 staff, instead of 34 expected, covering FDI (7 staff), SME development (4 staff), export (2 staff).

Within AIDA the After Care Unit, helps investors to provide faster permits, licenses and other requirements for company start-up and operations. In addition, one of its main tasks is launching "intelligent tools" (questionnaires for foreign investors), to identify existing problems relating to the investment climate in Albania. Based on feedback from potential and existing investors, the After Care Unit develops and implements the aftercare strategy for supporting the existing investors. It also maintains the database of all foreign investors, including visiting them and facilitating contact with government authorities, responding to their investors´ requirements, etc. Albania has not yet established appropriate policy and institutional support to cluster and value chains to develop potential links between the local SME sector and FDI.

It is still early days to assess various aspects of the new institutional environment and services provided by AIDA, however, the basis for effective operation in attracting and establishing FD appears to exist.

3.2.4 Manufacturing sectors and subsectors supported

Albania is one of the few countries in the region that has clearly defined its strategic investment sectors. The Law on Strategic investments has prescribed following priority sectors: Energy and mining; Transport, telecommunications, infrastructure and urban waste; Tourism; and Agriculture and fisheries; ERP focuses on the following: Agriculture and Tourism (with Agriculture and Fisheries and Tourism defined as investment sectors). The sectors supported by AIDA are Renewable Energy; Mining Industry; Tourism; Manufacturing; Agriculture; Transport and logistics; and ICT.

Despite the prioritisation, there does not appear to be a definition of manufacturing sub-sectors that are targeted. Sectorial prioritisation for FDI in relation to SMEs has not been defined within the strategic documents.

3.2.5 FDI instruments with focus on SMEs and manufacturing

Almost all FDI support instruments in Albania are horizontal in nature. However, in contrast with other countries in the region, Albania has developed specific instruments in support of manufacturing industry (sub-sectors of textile and footwear) and agriculture, as discussed below.

In 2014 the Government implemented the “Textile and Footwear Industry Package 2014”, designed to stimulate the fashion industry. This package included:

- Possibility to rent a Government property for a symbolic 1 EUR;
- Immediate reimbursement of VAT for “zero risk” taxpayers and within 30 days of exporters;
- Exemption from VAT on machinery and equipment;
- Financing incentives for job training;
- Facilitation of customs procedures;
- Simplification of procedures on the Employment and Social Security;
- One-stop shop dedicated solely to textiles and footwear investors (within AIDA).

In 2016, the Government revised the "Agriculture 2014 package" and adopted measures to support agriculture development including:

- Direct support for farmers by making VAT reimbursable from 6% to 20%;
- Removing custom duties and VAT for many basic agricultural and livestock products;

- Changes in the directive of the Ministry of Finance "For the compensation scheme for farmers", in order to support farmers, manufacturers and collectors in the agricultural sector.

Albania is looking to the free economic zones to spur the development of the economy through the new Technical and Economic Development Areas (TEDAs) programme. There are currently three TEDAs established in Koplik (Shkodër district, approx. 61 hectares), Spitalla (Durrës district, approx. 213 hectares) and Vlora (Vlorë district, approx. 230 hectares). The tender for strategic developers and investors for one additional TEDA was published in 2016. The TEDAs include strategic investments related to construction, maintenance and administering of industrial/technological and innovation parks, as well as infrastructure for production and industrial development. Albania may also offer additional support measures to ensure implementation of strategic investments in TEDA, such as:

- Support of the investment through support infrastructure;
- Use of state immovable properties to ensure implementation of strategic investments;
- Expropriation of private immovable properties in favour of the public interest;;
- Approval by the Strategic Investment Committee based on AIDA proposal;
- The right to use river banks;
- State participation in strategic investments.

Other additional instruments to support investors are horizontal with no distinction made between domestic and foreign investors.

Similar to other countries in the region, there are no instruments that specifically focus on SME manufacturing FDI/investments. However, during 2015 AIDA enabled support to SMEs through three available funds amounting in total to 230,000 EUR, to increase competitiveness, stimulate start-ups, develop creative industries, etc.

VAT is assessed, applied and paid the moment goods enter the Albanian custom territory. The VAT rate is 20% of the taxable value. According to the amended Law No. 7928 dated 26.12.2007 "For VAT", exemptions include:

- Import of goods placed in the transit regime;
- Import of goods declared to fall under Temporary Allowance Regime;
- Import of goods in active processing;
- Import of goods or services relating to the performance of exploration and development phases of petroleum operations, carried out by contractors who work for these operations;
- Import of live animals of origin, coming from different donors;
- Import of goods coming from NATO;
- Import of goods of appliances that help the integration of people with disabilities in daily life.

Albanian exports are exempted from VAT (VAT rate 0%).

3.2.6 Conclusions

Despite low level of FDI compared to other WB economies, Albania has elaborated a legal and strategic framework in support of FDI, which appears to be comprehensive, even if most of it is relatively new (and in some cases, not yet fully established).

Unlike other countries in the WB region, it has defined its strategic sectors in the recently adopted Law on Strategic Investment. There are sector support financial instruments for textile and footwear industry and for agriculture. Sectors currently supported by AIDA are renewable energy; mining industry; tourism; manufacturing; agriculture; transport and logistics; and ICT.

However, specific subsectors of manufacturing industry do not appear to be prioritised and SME FDI is not specifically targeted. Nevertheless, it is important to note that a relatively large number of foreign investors in Albania are Small scale investors, traditionally coming from neighbouring countries Italy or Greece, but also from Austria and Switzerland where are significant Albanian diaspora. According to the data on inward FDI stock in 2012, these four countries are ranked from second to fifth place. This may explain in part why there does not appear to be a particular orientation or focus on the SME sector / EU SME sector by the relevant Albanian institutions.

Except for tax and customs incentives that are available to all companies, foreign investors do not appear to receive financial support, although the strategic investor framework is in the process of evolving.

The central role in attraction of FDI is played by AIDA, though it also has other responsibilities as well, including SME development. It is still not fully staffed, though this is expected to happen in the future. AIDA is a relatively young institution and will need further capacity building support by the EU and other donors.

AIDA´s aftercare service is being developed, including the “one stop shop”. Its main focus is on the large investments and services dedicated to investor needs and priorities. For strategic investments over 50 million EUR, a fast procedure is established connected with the Committee of Strategic Investments.

A number of strategic bodies are being established at government level, based on the Law on Strategic Investment/ TEDZ development. This is still at an early stage of development and institution building support is likely to be required in order to develop efficient and accountable procedures. Regarding statistical base for FDI, Albania would need to improve its statistics by paying more attention to FDI inflow and its classification per sub-sector, instead of focusing exclusively on FDI stocks.

3.3 Bosnia and Herzegovina

3.3.1 FDI Trends

Bosnia and Herzegovina (B&H) is a transition economy burdened with many non-economic problems due to complex legal and regulatory framework. Under the Dayton Constitution, the establishment of governmental structures at the State (national) and entity levels created a multi-tiered legal and regulatory framework that is often duplicative and contradictory. Bosnia and Herzegovina is divided into two sub-state “entities,” one of which is known as the Federation of BiH and the other of which is called the Republika Srpska. For example, current employer contributions on wages total 69% in the Federation of BiH (FBiH) and 52% in the Republic Srpska (RS).

The lack of a single economic space has a chilling effect on job creation in the formal economy and creates difficulties for companies trying to do business in the entire country. Its economic problems include a disconnected market and inappropriate macroeconomic policy, which constrain foreign investing activities. Still, a relatively large endowment of natural resources combined with its good geographical location offer attractions for FDI.

In the B&H Progress Report 2014, EC argues that B&H´s external imbalances have narrowed but remain a source of vulnerability, ***especially in view of the adverse impact of volatile environments on FDI inflows.*** According to the “Doing Business 2015” B&H was ranked in 2014 at 82nd position but based on “Doing Business 2016”, the country improved its ranking by 3 places to 79th position.

FDI in B&H during 2006 amounted to 442 million EUR, which is by 57% higher compared to 2005. In 2007 B&H attracted 1,3 billion EUR, which is the highest amount recorded in the last 20 years, mainly thanks to the privatisation of certain large state-owned enterprises (i.e. the sale of telecom operators and oil industry in the Republic of Srpska). When compared with other countries, FDI inflows amounting to 12% of GDP in 2007 is on the same level as successful transition countries. Based on the analysis of Central Bank of B&H (CBBH), a significant part of the investment (17,7%) is related to reinvested retained profits in previous years, but significant inflows of FDI were recorded in the financial mediation sector, followed by the processing industry and trade.

Table 30. FDI indicators for Bosnia and Herzegovina (2005-2014)

Indicator/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014*
FDI inflow, EUR million	282	442	1329	684	180	307	355	285	300	378
FDI net, EUR million	282	439	1309	675	185	271	346	277	290	-
Inward FDI stock, EUR million	1951	2432	3666	4385	4815	4978	5439	5605	6000	5953
FDI inflow per capita in EUR	73	115	346	178	47	80	92	74	78	99
Inward FDI stock per capita in EUR	508	633	954	1141	1253	1295	1417	1461	1563	1.555
FDI inflow as a percentage of GDP	3,2	4,4	11,8	5,4	1,4	2,4	2,7	2,2	2,2	3
Inward FDI stock as a percentage of GDP	22,3	24,3	32,5	34,3	38,7	39,1	41,3	42,6	44,7	42,7

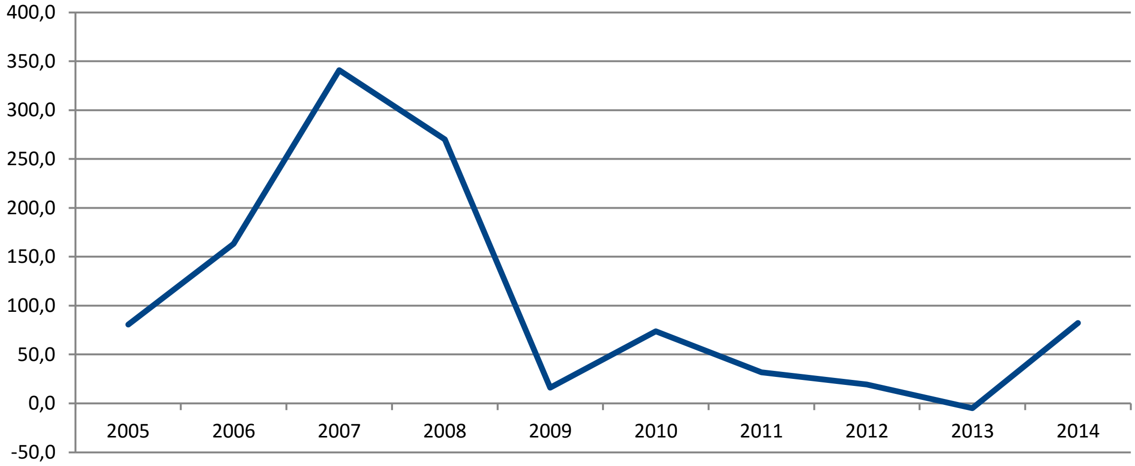
Source: WiiW database; * National Bank of Bosnia and Herzegovina.

In spite of the beginning of the global economic crises, in 2008 B&H realised relatively high inflows of FDI, reaching 5,4% of the GDP. In 2008, FDI inflows worth 684 million EUR without the expected privatisation must be considered as satisfactory, especially if we take into account its positive structure (investment in production sector and high contribution of greenfield investments). This was the second largest annual FDI since the record amount in 2007. Since 2009, FDI inflows have recovered slowly.

According to the CBBH data, the inflow of FDI in 2011 amounted to 355 million EUR or 2,7% of GDP, which is more than in 2010 and it is evident that B&H has not been able to attract anything like the volume of investments prior to the recession. Unfortunately, despite a promising start, FDI in 2012 and 2013 did not increase much. However, according to the official CBBH data, FDI inflow in 2014 was 378 million EUR, which is 65,8% higher than in 2013.

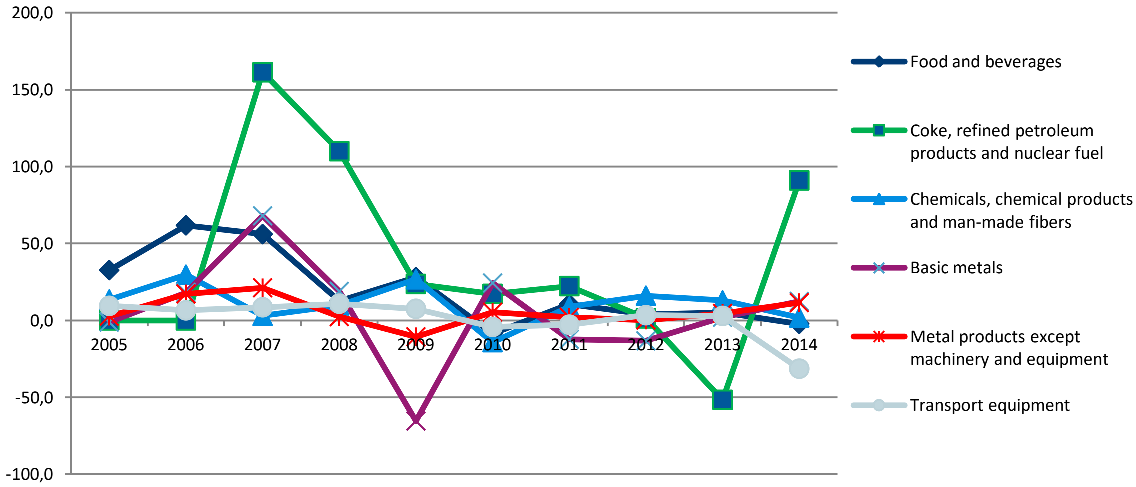
The Chart below highlights the level of manufacturing FDI during 2007-2008. In that period, 44% was invested in industry branches, 32% in financial sector (mostly banks) and 11% in trade. The period was characterised by a significant share of investments in the industry branches, comparing with the previous period, when the financial sector and telecommunications dominated.

Chart 12. FDI inflow in manufacturing 2005-2014 in million EUR



Bearing in mind the total inward stock, significant investments were made in financial intermediation, trade (wholesale and commission trade) and real estate. Investments in financial intermediation are largely in the banking sector, which in 2011 again recorded high levels of profit, indirectly influencing the level of retained earnings. However, due to the relatively good reputation and long industrial tradition of B&H, the manufacturing sector accounted for a large amount of FDI (30,6%) in 2012. Within the manufacturing sector, FDI inflows were particularly visible in sub-sectors “Coke, refined petroleum products and nuclear fuels” whose share in manufacturing was 24% at the end of 2012.

Chart 13. FDI inflow by major manufacturing activities in 2005-2014 in million EUR



The inward FDI stock by manufacturing sub-sectors during the period 2010-2014 reveals that owing to FDI inflow in the sub-sector "coke, refined petroleum products and nuclear fuel" within manufacturing, the accumulated FDI stock in this sub-sector accounted for 534,31 million EUR at the end of 2013 and slightly less in 2014. It constituted 28,9% of total inward FDI stock in manufacturing in 2014.

Table 31. Inward FDI stock in manufacturing in 2010-2104 in million EUR

Manufacturing sub-sector	2010	2011	2012	2013	2014
Food	235,21	252,64	261,89	253,97	256,38
Beverages	109,27	100,76	102,66	109,06	113,52
Wood and wood products	57,07	58,97	58,94	60,17	58,93
Paper and products from paper	105,84	104,00	101,47	103,05	105,65
Coke, refined petroleum products and nuclear fuel	386,03	408,44	467,53	534,31	508,92
Chemicals, chemical products and man-made fibres	92,47	98,40	108,35	123,04	124,93
Other non-metallic mineral products	227,80	224,68	220,51	222,99	213,45
Basic metals and fabricated metal products	84,44	71,32	57,86	42,07	48,27
Finished metal products except machinery and equipment	84,22	84,37	76,74	92,09	96,62
Transport equipment	82,15	83,53	93,49	91,27	59,98

Source: Central Bank of B&H

Other non-metallic mineral products, together with the food processing sub-sectors, were the next most attractive sectors. The accumulated FDI inflow accounted for respectively 12,1% and 14,1% of inward FDI stock in manufacturing at the end of 2014.

Total stock of FDI at the end of 2006 was 633 million EUR, which means that the level of FDI has more than doubled compared to three years previously. The largest share of investments in B&H in that year came from Austria (45%), followed by Croatia (15%) and Slovenia (14%). The main investment during 2007 came from Serbia (45%), Austria (23%), Russia (11%), and Croatia and Slovenia (5% each). The highest inflow of investments in the subsequent years came from Austria, Slovenia, Russia, Croatia and Serbia. Significant investments were realised by companies from Serbia (17,1%), Switzerland (4,6%), Russia (8,4%), Turkey (2,7%) and USA (1.7%) decreased the level of FDI originating from EU-28 during 2009-2011.

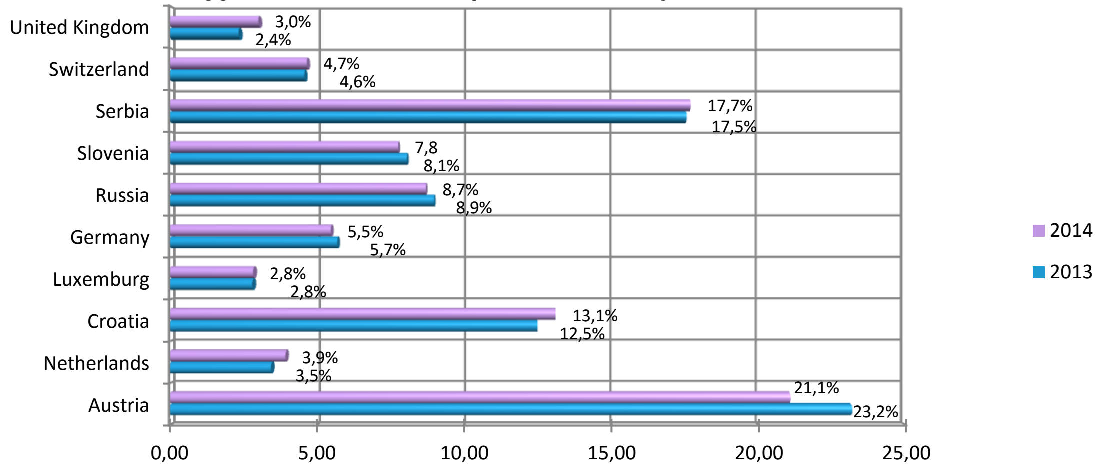
Table 32. Inward FDI stock by home countries 2009-2012

Country	in million EUR				% of total			
	2009	**2010**	**2011**	**2012**	2009	2010	2011	2012
Austria	1016,2	970,9	1299,3	1336,3	21,1	19,5	23,9	23,8
Serbia	879	904,6	960,1	958,5	18,3	18,2	17,7	17,1
Croatia	705,6	747	702,7	754,1	14,7	15	12,9	13,5
Russia	470,9	460,7	485,2	470,7	9,8	9,3	8,9	8,4
Slovenia	562,2	552,5	539,6	523,7	11,7	11,1	9,9	9,3
Germany	259,1	278,9	287,3	309,1	5,4	5,6	5,3	5,5
Switzerland	199,7	256,9	253,5	257,4	4,1	5,2	4,7	4,6
Netherlands	147,2	156,7	161,3	167,8	3,1	3,1	3	3
Turkey	104	125,5	145,1	149,4	2,2	2,5	2,7	2,7
Italy	110,8	118,2	123,6	130,9	2,3	2,4	2,3	2,3
Slovakia	29,1	29,3	29,3	29,1	0,6	0,6	0,5	0,5
Czech Republic	5	3,8	4,2	7,6	0,1	0,1	0,1	0,1
Other	326,3	372,5	448,4	510,6	6,8	7,5	8,2	9,1
Total	**4815**	**4977,5**	**5439,5**	**5605,3**	**100**	**100**	**100**	**100**
EU-28	2961,3	3003,1	3344,1	3489,6	61,5	60,3	61,5	62,3

Source: WiiW database.

According to the Central Bank of B&H, the total amount of FDI inward stock until December 2014 was 5,953 million EUR. The largest shares were held by Austria (1.3 billion EUR), Serbia (1 billion EUR), Croatia (780 million EUR) and Russia (518 million EUR). The biggest share of investment in 2014 was in the production sector (30,8%), followed by the real estate sector (22,8%) and banking (20,3%).

Chart 14. Shares of ten biggest FDI inward stock per home country in 2013-2014 in %



The main points arising from the above illustrations are as follows:

- Comparing with other countries and with an FDI inward stock of 6 billion EUR in 2013, B&H ranked in second place as the WB country with largest amount of accumulated FDI;
- The inward FDI stock by economic activity during 2009-2012 reveals that manufacturing obtained a significant share of total FDI inward stock (30,6%) followed by the financial intermediation sector (23,5%). The share of manufacturing in total inward FDI stock in 2014 was 29,5%;
- During observed period FDI inflow in manufacturing sector was particularly large in the coke, refined petroleum products and nuclear fuel sub-sector, but in this sub-sector like in all others within manufacturing industry, there is a decreasing trend in FDI inflow since 2008;
- The vast majority of foreign investments in B&H (62,3% in 2012 and 60,1% in 2014) came from EU but significant investments were realised by investors from Serbia 17,1%, Switzerland 4,6%, Russia 8,4% or Turkey 2,7%, decreasing the level of FDI from EU-28.

In B&H, the Foreign Investors´ Council´s White Paper favours prioritising reforms to make the labour market less rigid and ensuring that employees have the relevant skills for the labour market. The White Paper also contains recommendations to improve liquidation procedures. These include defining these procedures better, making a list of companies under liquidation available in the Court Registry and harmonising court practices for the submission of documents for liquidation.

3.3.2 FDI Policies and extent of SME focus[27]

As in other WB countries, the attraction of FDI is one of the most important economic priorities for B&H. The focus of policy is on promotion of investments in state and socially owned companies following privatisation and restructuring.

B&H is a complex state, comprised of two entities (Republic Srpska and Federation of B&H) which have broad competences especially, in the areas relevant for this analysis (e.g. FDI, SMEs, manufacturing industries, etc.). Various EU/IPA projects have supported the drafting of a number of strategies (e.g. country development strategy and the SME strategy), which have not been adopted and implemented due to the unique nature of the country.[28] Still progress is being made. For example at the central level, the Law on Foreign Investments has been adopted and provides a legal framework for promotion and attraction of foreign investments. Furthermore, in 2015 the B&H Reform Agenda was adopted setting the broad scope covering economic, social, administrative and rule of law measures. These are presented below, among other policy initiatives.

Law on the Policy of Foreign Direct Investments

This Law was first adopted in 1998 and amended in 2003, 2010 and 2015. The Law regulates the main policies and principles of investing in B&H´s economy and offers liberal treatment for FDI and defines the rights and obligations of foreign investors. Basically, foreign investors have the same rights and obligations as residents of B&H and except for defence industry and public information, foreign

[27] This analysis elaborates policies, institutional framework and incentives at the central level.
[28] Indicative Strategy Paper for BiH (2014 – 2017)
http://ec.europa.eu/enlargement/pdf/news/annexe_acte_autonome_nlw_part1v1.pdf

investors are not limited in terms of investment shares. In case of investment in those sectors, ex-ante approval from the competent authority is needed and the share cannot exceed 49%. Investors are also protected from changes in the Law on Foreign Investment: should the legislation change, the investor may choose the most favourable regulations to apply.

The Law also prescribes that the institution that will work on foreign investment promotion will be established by the Council of Ministers (see below), but it does not define the priority sectors for investments and makes no special reference to SMEs or the manufacturing sector.

B&H Reform Agenda 2015 - 2018

Adopted in 2015, Reform Agenda represents the main mid-term strategic document, which was approved at all levels (central, entity and cantons level). It was adopted with the aim to strengthen sustainable, efficient, socially just and stable economic growth, create new jobs, increase and target better social contributions and thus creation of sustainable and fair social environment.

The Reform Agenda targets seven priority areas: public finances, taxation and fiscal sustainability; business climate and competitiveness; employment; social protection and pensions reform; rule of law and good governance; and public administration reform. In the framework of the second priority area, namely business climate and competitiveness, the aim is to reduce barriers to investments and improve business environment. The measures identified (e.g. simplification of business registration, faster issuing of construction permits, etc.) seek to improve investors' rights though the document does not identify priority sectors for attraction of FDI.

Economic Reform Programme for B&H 2016 - 2018

The ERP defines the mid-term structural reform priorities and was based on EU Enlargement Strategy. The key challenge identified in the ERP is to achieve higher rates of economic growth, to reduce or eliminate the key obstacles that hinder the achievement of faster growth and more employment. Although specific FDI measures are not identified in the ERP, some of them target improvement of the business environment, elimination of barriers to trade and re-industrialisation, which do affect FDI.

Law on Public Private Partnership

This Law regulates the principles and condition for implementation of public-private partnership (PPP), as well as the procedure for approval and implementation of PPP projects and the relevant institutional structure. The Law is important as it enables foreign companies to implement PPP projects on the same terms and conditions as domestic firms.

Law on Free Zones

This Law, adopted in 2009, regulates the conditions for the establishment of free zones. The key requirement for free zones and for companies operating in them is that at least 50% of the total value of goods and services produced has to be exported. The free zones offer several advantages to investors, whether domestic or not. Companies operating in free zones are exempt from VAT and custom duties. Investment in the free zone, transfer of profit and transfer of investment are all free of charge. The import of equipment for manufacturing within the free zone is also exempt from customs duties and fees.

3.3.3 FDI Institutions and extent of SME focus

Although an institutional framework for FDI is not been prescribed by law, as in other countries such as Albania, Serbia or Montenegro, there are several institutions at the central level[29] that deal with FDI promotion and attraction, though none of them is manufacturing oriented or target SMEs specifically. The key relevant institutions are:

- *Ministry of Foreign Trade and Economic Relations:* is responsible for investment policy and cooperates with others on the laws and regulations relating to foreign investment;
- *Ministry of Foreign Affairs:* via its Economic Diplomacy Department, this Ministry is involved in the promotion of FDI in B&H. As in the case of other WB countries, the competences of the diplomatic missions dealing with attraction of investments are fairly limited and often combined with other tasks, such as access to new markets and export promotion;
- *Foreign Investment Promotion Agency (FIPA):* FIPA was established by the Council of Ministers with the mission to attract FDI and stimulate existing investors to reinvest. It also

[29] At the level of entities there are also different institutions in charge of attraction of foreign direct investments.

seeks to improve cooperation between the public and private sectors through measures to improve the business environment and presentation of B&H as an attractive location for investment. The Agency assistance in dealing with government institutions, works directly with investors and assists in improving the legal framework for foreign investment. FIPA also assists investors to develop contacts with the public and private sector, including providing aftercare service at local, entity and state levels. FIPA provides data, information, analysis and advice on the business and investment environment, identifies investment opportunities and assists potential new investors and existing investors. It has 30 staff members, mostly based in Sarajevo, with regional offices in Banja Luka and Mostar. Its annual budget is around 710,000 EUR[30];

- *Free Zones*: Based on Law on Free Zones from 2009 four Free zones have been established in B&H. Three zones are 100% privately owned and one is in mixed public private ownership. The following free zones have been established: Vogošća, Lukavac, Mostar and Visoko;
- *Foreign Investors Council (FIC):* FIC was established in 2006 as a not-for-profit business association representing the interests of foreign businesses in the country. It has 45 members, mostly large firms covering a variety of different sectors. FIC seeks to improve the investment climate and business environment in B&H, through the promotion of dialogue and cooperation between the investors and the public authorities;
- *Enterprise Europe Network (EEN):* EEN operate in B&H via two networks: one based in the Federation and another based in Republic Srpska. The combined networks have seven contact points (in Banja Luka, Bihac, Istocno Sarajevo, Mostar, Sarajevo, Tuzla and Zenica) hosted by different organisations such as Chambers of Commerce, Regional/Local Development Agencies, etc.

The B&H has not establish institutional support for cluster and value chains at the national level. At the entity level, a few clusters are in the development phase but are not connected with FDI.

Bearing in mind the sheer complexity of the B&H state, which can be barrier to investment as well as general business operations, B&H has established a system that provides pre-investment and aftercare service. Furthermore, based on the agreement signed by the Council of Ministers of B&H and International Financial corporation, it has established a **Collaborative Network** with the participation of representatives of 12 municipalities, entities and 5 cantons and representatives from FIPA. This body enables dialogue between foreign investors and the public sector representatives, with the aim to meet the priorities and needs of investors. According to FIPA, out of 16 requests of made by foreign investors for improvements in the business environment and investment conditions, 9 were solved in 2015.

3.3.4 Manufacturing sectors and subsectors supported

In the absence of an umbrella development document at the central level, as well as sector specific strategies, there are relatively few documents highlighting potential priority sectors in B&H. Support programmes are horizontal in nature, but the following two documents refer to sectoral issues:

- Economic Reform Programme 2016 - 2018: Agriculture; Metal Processing; Wood processing and Furniture; Chemicals; Spare Parts for Automobiles; and Energy;
- Priority sectors for FIPA: Agriculture and Food Processing; Automotives; Banking and financial Services; Construction; Energy; Wood Processing; ICT; Mining and Metal Processing; Tourism; and Textile.

It is worth noting that prioritisation of sectors for SME FDI is not currently considered.

3.3.5 FDI instruments with focus on SMEs and manufacturing

As previously discussed, there are no specific instruments for support to manufacturing industry or other priority sectors. All support instruments are horizontal and can be used by investors in any sector. There are also no instruments to focus specifically on SME manufacturing FDI/investments. The potential opportunities for investors are local companies that have been prepared for restructuring and privatisation. B&H is accelerating the privatisation process for companies of strategic importance in order to increase economic growth and enhance the volume of foreign investment. An estimated 60% of small companies and more than 30% of the large ones are now privately owned or publicly traded.

[30] UNCTAD "BiH Investment Policy Review", page 35

The rights and benefits of foreign investors are set out that the Law on the Policy of FDI.

In order to attract direct investments, BIH has established free trade zones as important FDI instruments. Free trade zones are part of the customs territory of B&H and are managed by the founder of the zone. Investors in the free zones do not pay taxes and contributions, with the exception of those related to salaries and wages. Investors are free to invest capital, transfer their profit and re-transfer capital. Customs and tariffs are not paid on imports into the free zone. The import of equipment used for manufacturing within the free zone is also exempt from customs duties and fees.

B&H seeks to attract foreign investors based on its favourable tax policy: VAT rate is 17% while corporate tax rate is 10%. All other incentives, tax and customs exemptions are granted at the level of entities.

In the Federation, based on Law on Corporate Income Tax, foreign investors have following benefits:

- Firms that invest more than 50% of the total profit in production equipment are relieved of the obligation of 30% income tax on the amount in the year of investment;
- Firms that invest during a period of 5 consecutive years a total of 10 million EUR (starting with at least 2 million EU in the first year), are relieved of the obligation of 50% income tax on the amount in the year of investment;
- Firms are entitled to a tax-deductible expenses double amount of the gross wage paid to newly employees if the duration of the employment contract is at least 12 months (full-time) and the new employee was not employed in the firm or an associated company in the previous five years.

In the Republic of Srpska, based on Law on Profit Tax, reductions apply for:

- Investment in equipment intended for the firm´s production activities;
- Investment in plant and fixed assets used for manufacturing and processing activities.

Tax reductions are also available on Personal Income Tax and mandatory employer contributions firms that employ 30 workers during a calendar year (i.e. people registered with the Employment Office of RS).

The District of Brčko also offers incentives based on the Law on Incentives for Economic Development. For taxpayers who invest in land, buildings, plant, equipment (machines) and vehicles, the Corporate Income tax is reduced by the amount of the respective investment, but the reduction cannot exceed 50% of the taxable base. Taxpayers that employ new workers on a permanent basis may reduce the tax base by the amount of gross wages paid to newly hired workers.

The withholding tax in the Brčko District is regulated in the same way as in the entities of B&H:

- Exemption from utility fees for the display of the company name;
- Refund of court fees for registration of a business entity for newly established enterprises;
- Refund of expenses of connection to power, water and sewage network;
- Refund of fees for obtaining building permits and approvals;
- Refund of expenses of the difference in price of electricity and water paid by the company and the price paid by households;
- Refund for paid employment contributions for newly employed persons;
- Refund for salary for maternity leave at 100%;
- Refund for the employer of 50% for health insurance for newly employed workers;
- Compensation new investments in fixed assets and up to the amount of paid profit tax or income tax for the year in which the purchase of fixed assets was made.

3.3.6 Conclusions

The attraction of FDI is high policy priority for economic development of B&H. There has been some progress in implementing a suitable policy environment at the central level to achieve this objective, as illustrated by the FDI Law and the establishment of FIPA. However, the fact remains that the political, administrative and institutional framework for FDI policy development and implementation in B&H is complex and fragmented.

Attraction of SME FDI in general and SME manufacturing FDI has not been a policy priority so far. The focus of policy is on promotion of investment into state and socially owned companies following privatisation and restructuring. Re-introduction of FDI support at the central level should be considered and coordination should be strengthened for SMEs, especially through the Collaborative Network.

FIPA, as a key institution for the investment promotion, is focused on large, multinational investors but intends to add an EU SME FDI orientation to its work in the future. Together with other stakeholders, FIPA has established the Collaborative Network as important element of aftercare services.

FDI policy cannot be seen in isolation: it is evident that further efforts are required in a range of related areas, including SME policy and export policy, as well as FDI policy. Regional and industrial policy development at the national and entity level would contribute to FDI development in the future.

The FDI policy of B&H is based on the Laws on the Policy of Foreign Direct Investments and on Free Trade Zones. The incentives policy is not based on finance but on tax and customs relief of various sorts.

A positive aspect related to FDI data in B&H is that the country has adjusted its system of national accounts and its methodology of Balance of Payments, allowing for more sophisticated FDI statistics (large time-series and sectoral analysis), which should result in high quality FDI data in the future.

3.4 Former Yugoslav Republic of Macedonia

3.4.1 FDI Trends

fYRoM's relatively strong growth performance (reduction of its income gap -GDP per capita in purchasing power parity, with the new EU member states from 30,7% in 2006 to 36,6% in 2014) is partly the result of growing FDI-financed exports and a pick-up in domestic demand. Between 2002 and 2008, fYRoM grew at an average of 4,3% annually in real terms, which was 0,7 percentage points below the regional average. Since 2009, fYRoM's average growth has been 1,8%, exceeding the regional average of 1,3%. FDI-related exports, especially in the automobile and electrical machinery industries, were a key driver of export growth (export growth reached 3,3% in 2013 and 17,1% in 2014), contributing to around 6% of the growth of net exports.

The EU is the WBs' largest trading partner, accounting for over 75% of the region's total trade. fYRoM´s share of overall EU trade was 0,20%. The average share of manufactured goods in total exports of fYRoM is around 80% due to its strong pro-FDI policies, mostly in tradable sectors such as car components. In contrast to services, by 2010 only two WB economies had attracted a considerable amount of FDI in manufacturing, namely B&H (35% of total FDI stock) and fYRoM (31%).

fYRoM government undertakes many activities to attract foreign investors. This field is one of the primary government priorities to revive the economy. Lacking sufficient domestic resources for starting and developing domestic production, government bodies are actively working on attracting foreign capital. In the Constitution of fYRoM all investors are guaranteed with national treatment. Foreign investors are protected from political risk and receive tax benefits, customs benefits and advantages in the Technology Development Industrial Zones (TIDZs). 100% foreign-owned capital faces no restrictions on repatriation of profits, investors can purchase land via companies registered in fYRoM. The government established a one-stop shop and a separate office for large taxpayers. Finally it is formed an Agency for Foreign Investments of the Republic of Macedonia.

Although fYRoM is constantly making efforts to attract FDI and has undertaken many measures to significantly simplify the position of investors, the level of investment in fYRoM remains below 10% (excluding production) and in 2012, FDI inflow reached the lowest level since 2006 due to the wider regional and global economic situation.

Table 33. FDI indicators for fYRoM (2005-2014)

Indicator/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014*
FDI inflow, EUR million	77	345	506	400	145	160	337	72	251	205
FDI net, EUR million	75	345	507	409	137	159	337	78	253	197
Inward FDI stock, EUR million	1769	2099	2545	2969	3141	3322	3695	3746	4012	4023
FDI inflow per capita in EUR	38	169	248	195	71	78	164	35	121	121
Inward FDI stock per capita in EUR	867	1027	1245	1448	1530	1615	1794	1817	1929	1909
FDI inflow as a percentage of GDP	1,6	6,6	8,5	6	2,2	2,3	4,5	1	3,3	2,3
Inward FDI stock as a percentage of GDP	36,7	40,1	42,7	44,2	46,9	47,1	49,4	50,3	52,1	47,34

Source: WiiW database; * National Bank of fYRoM.

FDI in fYRoM averaged 36,3 million EUR from 2003 until 2015, reaching an all-time high of 506 million EUR in November of 2007 and a record low of -48,03 million EUR in July of 2010. During the period 2000 - 2007, FDI flows were larger due mostly to the privatisation of state-owned firms and acquisition of major companies and banks by foreign investors. During 2008 and 2009, FDI slowed again, largely due to a deteriorating international economic environment. Until 2008, 38% of the total FDI was attracted in greenfield projects (including projects in the free economic zones). fYRoM experienced a significant increase in FDI flow in 2011 but recorded very low levels of FDI in 2012, which was the lowest level of FDI flow since 2005. FDI in fYRoM decreased by 23,95 million EUR again in November of 2015, but FDI inflows averaged 4,2% of GDP per year between 2006 and 2014.

During period 2005-2009, the dominance of the service sector was particularly visible after 2007, while in period before that the manufacturing sector also received significant FDI inflow.

Table 34. Direct investment flow in the fYRoM by activity in 2005-2009

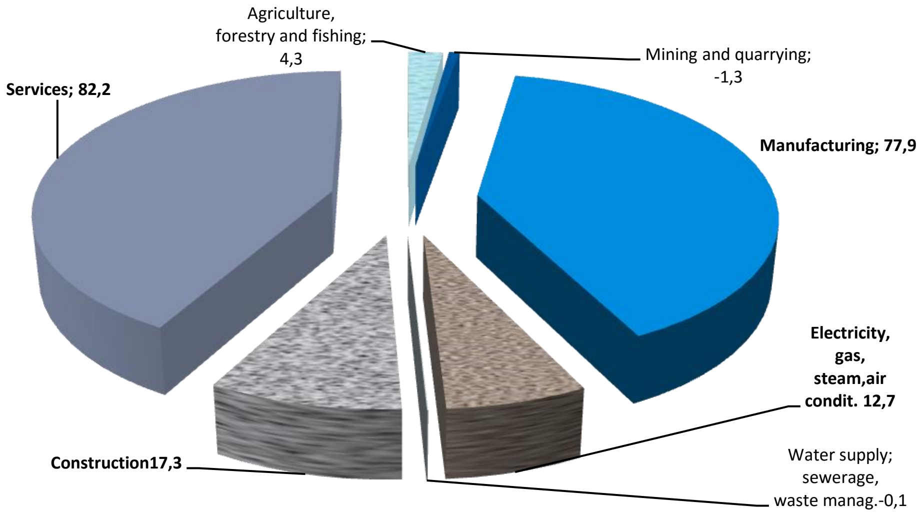
(in million EUR)

Sectors/Years	2005	2006	2007	2008	2009
Agriculture, hunting and fishing	-0,84	2,13	10,46	4,06	0,08
Mining and quarrying	16,44	0,60	8,92	70,24	-5,77
Manufacturing	19,53	99,40	126,80	-15,50	48,44
Electricity, gas and water	-0,03	119,20	-3,57	26,23	24,42
Construction	-1,63	3,27	14,80	20,52	10,04
Services	42,90	118,87	339,01	295,23	69,35
Unallocated	0,91	1,36	9,58	-0,05	-1,49

Source: National Bank of fYRoM

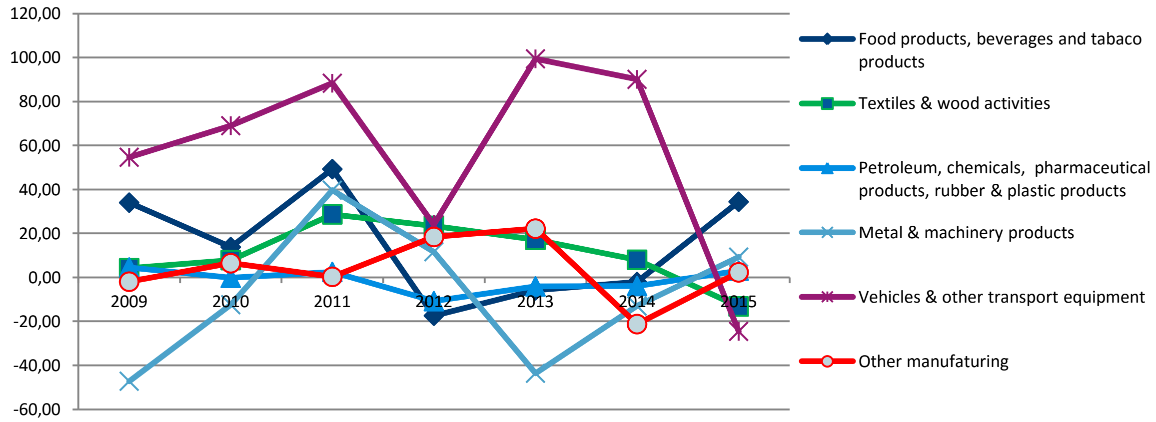
However, the service sector is the most attractive sector for foreign investors with an average inflow of 82,2 million EUR during 2009-2015, followed by manufacturing with 77,9 million EUR.

Chart 15. Average FDI flows per sectors in million EUR in 2009-2015



Within the manufacturing sector, significant transactions were recorded in *Vehicles and other transport equipment*, especially during 2013-2014. Despite this historical trend and 88,27 million EUR FDI inflow in 2014, this manufacturing sub-sector recorded outflows in 2015 amounting to -25,50 million EUR. The *Food products, beverages and tobacco products* sub-sector is the second most significant, recording FDI inflows of 49,27 million EUR in 2011 and 34,42 million EUR in 2015.

Chart 16. Direct investment flow by manufacturing activity in 2009-2015 in million EUR



In accordance with FDI inflow, the accumulated inward FDI stock in fYRoM in period 2009-2012 predominated in the Service sector (all services included together) and particularly in Financial and insurance activities. However, the manufacturing sector is second largest activity in terms of accumulated inward FDI stock.

Table 35. Inward FDI stock by economic activities

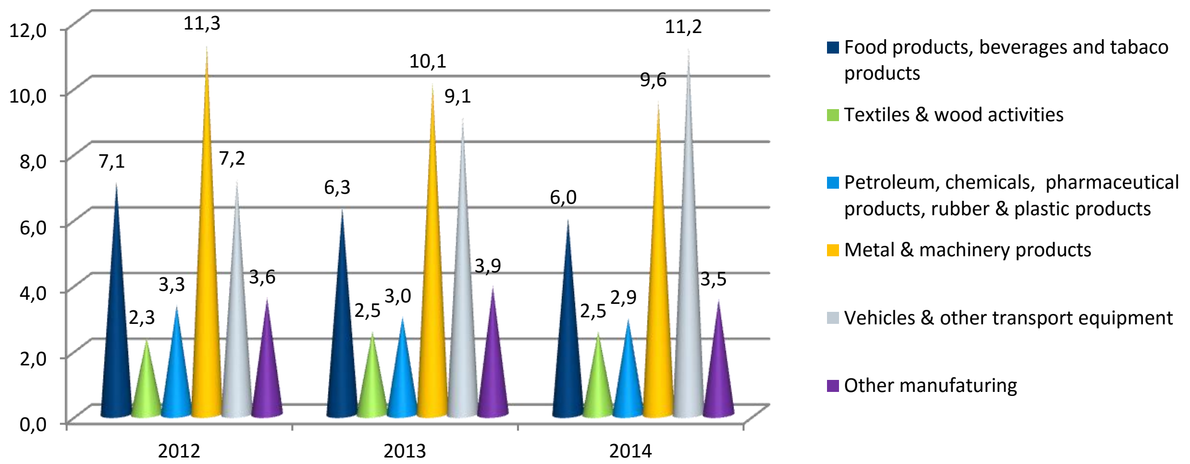
Sector- sub-sector/Years	in million EUR				% of total			
	2009	**2010**	**2011**	**2012**	**2009**	**2010**	**2011**	**2012**
Agriculture, forestry and fishing	16,3	29,2	30,9	36,5	0,5	0,9	0,8	1
Mining and quarrying	89,3	133	179,4	156,4	2,8	4	4,9	4,2
Manufacturing	**953,4**	**1053,1**	**1308,8**	**1281,5**	**30,3**	**31,7**	**35,4**	**34,2**
Electricity, gas, steam, air conditioning supply	228,3	228,3	232,9	278,8	7,3	6,9	6,3	7,4
Water supply, sewerage, waste manag., remediation	1,3	0,5	-0,4	2,9	0	0	0	0,1
Construction	129	133,8	137	157,1	4,1	4	3,7	4,2
Wholesale, retail trade, repair of motor vehicles etc.	372	391,4	405	453,9	11,8	11,8	11	12,1
Transportation and storage	17,7	21,8	46,1	39	0,6	0,7	1,2	1
Accommodation and food service activities	47,7	55,9	54,9	41,5	1,5	1,7	1,5	1,1
Information and communication	189	207,5	118,5	158,3	6	6,2	3,2	4,2
Financial and insurance activities	**911**	**889,7**	**976,2**	**950,7**	**29**	**26,8**	**26,4**	**25,4**
Real estate activities	66,5	61,3	68,8	62,2	2,1	1,8	1,9	1,7
Professional, scientific and technical activities	34	38,8	63,7	29,1	1,1	1,2	1,7	0,8
Administrative and support service activities	32,6	39,3	40,7	54,2	1	1,2	1,1	1,4
Public administration, defence, compulsory soc. security								
Education	1,6	1,6	3,3	6,1	0,1	0	0,1	0,2
Human health and social work activities	4,2	3,6	3,5	3,2	0,1	0,1	0,1	0,1
Arts, entertainment and recreation	43	29,7	21,9	33	0,1	0,9	0,6	0,9
Other service activities	2,9	3,8	3,7	2	0,1	0,1	0,1	0,1
Activities of households as employers and for own use								
Activities of extra-territorial organisations& bodies								
Other not elsewhere classified activities	1,6	0,2	0,1	0,1	0	0	0	0
Private purchases & sales of real estate								
Total by activities	**3141,4**	**3322,3**	**3695**	**3746,4**	**100**	**100**	**100**	**100**

Source: WiiW database.

Based on the National Bank of fYRoM data, which integrated inward FDI stock by the main activities in national economy, the dominance of the service sector is evident with a share of 46% of total inward FDI stock at the end of 2014, as compared with the manufacturing sector with a share of 36%.

In accordance with national data sources, the *Vehicles & other transport equipment* sub-sector had the largest share in inward FDI stock at the end of 2014 (11,2%) owing to its accumulated FDI inflow. It was followed by the *Metal& Machinery* (9,6%) and the *Food, beverages and tobacco* (6,0%) sub-sectors.

Chart 17. FDI inward stock in manufacturing in % of total in 2012-2014



At the end of 2012, almost 21% of FDI stock originated from The Netherlands, followed by Austria and Greece with similar share albeit almost for half the size. The EU-28 accounted for 82% of FDI in fYRoM.

Table 36. fYRoM: Inward FDI stock by home countries in 2009-2012

Country name/Year	In million EUR				% of total			
	2009	2010	2011	2012	2009	2010	2011	2012
Netherlands	523,6	550,4	740,4	783	16,7	16,6	20	20,9
Austria	362,6	371,7	416,8	441,6	11,5	11,2	11,3	11,8
Greece	380,3	431,2	442,9	436,2	12,1	13	12	11,6
Slovenia	391,2	398,7	405,7	363,2	12,5	12	11	9,7
Hungary	388,7	346,9	346,6	346,4	12,4	10,4	9,4	9,2
Turkey	49,7	48,3	117,2	145,3	1,6	1,5	3,2	3,9
Bulgaria	92,3	117,3	120,3	142,8	2,9	3,5	3,3	3,8
France	26,1	129,5	131,5	134,8	0,8	3,9	3,6	3,6
Saint Vincent and Grenadines	48	94,6	139,2	112,9	1,5	2,8	3,8	3
Switzerland	202,1	153	126,4	89,6	6,4	4,6	3,4	2,4
Croatia	55,5	72,1	77,6	85,4	1,8	2,2	2,1	2,3
Germany	62	71,4	86,8	83,9	2	2,2	2,3	2,2
Virgin Islands, British	58,1	67,2	94,3	81,8	1,8	2	2,6	2,2
Serbia	83,7	80,3	70,9	77,7	2,7	2,4	1,9	2,1
Italy	55,8	58,5	65,2	62,7	1,8	1,8	1,8	1,7
United States	48,8	37,4	42,8	59,5	1,6	1,1	1,2	1,6
Cyprus	47,9	46,2	48,8	57,7	1,5	1,4	1,3	1,5
United Kingdom	76,7	102,5	48,1	39	2,4	3,1	1,3	1
Other	188,3	145,1	173,5	202,6	6	4,3	4,5	5,5
Total	**3141,4**	**3322,3**	**3695**	**3746,1**	**100**	**100**	**100**	**100**
EU-28	**2534**	**2727,5**	**2995,6**	**3062,9**	**80,7**	**82,1**	**81,1**	**81,8**

Source: WiiW database.

The main points arising from the above illustrations are as follows:

- From 2000-2007, the large FDI inflows were due mostly to the privatisation of state-owned firms, and acquisitions of major companies and banks by foreign investors;
- Besides services, the manufacturing is a very important part of FDI with an average share of 34% in the total inward stock and with an average share of 40% in FDI flows during 2009-2015;
- Within manufacturing sector, significant transactions were recorded in the motor vehicles, trailers and semitrailers sub-sector, especially during 2013-2014. Also, sector of food products, beverages and tobacco products is the second most important one, with significant FDI inflows;
- Within the manufacturing sector, the sub-sectors with significant inward stock were food, beverages and tobacco, vehicles and other transport equipment and metal and machinery.

According to the Doing Business 2016, fYRoM was the best-ranked country in the WB (12) followed by Montenegro (46).

3.4.2 FDI Policies and extent of SME focus

FDI has been and continues to be one of the top policy priorities of recent Macedonian governments. Under Macedonian law, there is no single regulation on foreign investments. There is also no specific FDI strategy for the country, though there are numerous strategies, policies, action plans, etc. that intersect with the FDI theme. The most important ones are set out below.

Competitiveness Strategy and Action Plan (2016-2020)

The strategy has recently been approved by the Government and is directly connected with the Instrument for Pre-accession (IPA) II and the related Sectoral Planning Document on Competitiveness and Innovation. The Competitiveness Strategy identifies a series of priorities for development:

- Foreign Direct Investments (see below);
- Industrial policy;
- Business environment;
- Small and Medium-sized enterprises;
- Access to markets/ internationalisation;
- Entrepreneurial skills;
- Access to finance.

The Competitiveness Strategy (2016) highlights a number of FDI priorities:

- Mobilising Diaspora remittances for investment;
- Eliminating potential blockages to inward investment;
- Increasing the number of investments;
- Increasing the number of new jobs created from foreign investors;
- Improving the climate for investments;
- Establishing a one-stop-shop for domestic and foreign investors;
- Increasing backward linkages between foreign and domestic companies;
- Increasing the transfer of sophisticated technology from FDI companies;
- Increasing the introduction of innovations from FDI companies;
- Increasing the transfer of management skills from FDI companies.

The Competitiveness Strategy highlights four main priorities for support using IPA II and other funds:

- Strengthening linkages between FDI/TIDZs and domestic companies;
- Stock-take of FDI obstacles and systematic reform, including Public-Private sectors dialogue;
- Mobilising Diaspora remittances for entrepreneurship;
- Improve data collection, analysis and reporting of FDI, export and State Aid data.

The strategy does not specifically emphasise either a manufacturing or an SME focus in relation to FDI policy. Although approved in 2016, it is not clear whether implementation has started, partly because of the recent general elections.

Industrial Policy of the Republic of Macedonia (2009-2020)

This strategic document focuses on knowledge, innovation and research as the drivers of industrial development, leading to a more conducive business and investment climate and supporting enterprises to improve their competitive capabilities through the acquisition of new technologies and new markets. It was written with IPA I funding regime in mind and is in need to updating. It identifies five key pillars for enhancing the competitiveness of the industrial base:

- International cooperation with key economic stakeholders and stimulation of FDI;
- International cooperation and FDI stimulation;
- Applied research, development and innovation;
- Eco-friendly products and services for sustainable development;
- Development of SME and entrepreneurship;
- Collaboration in clusters and networks.

Although the first pillar refers to FDI stimulation, the focus is limited. The emphasis is on helping companies to forge active relationships with suitable business partners internationally, stimulating companies to train and upgrade skills of their managers and staff by international knowledge exchange (study visits to the places of best practice in selected fields) and improvement of their management and systems capabilities (implementation of productivity and efficiency increase methods). Other parts of the strategy refer to issues such as empowering SMEs through training and improved access to credit; developing supplier linkages to strengthen potential supply chain partnerships between SMEs and MNCs, and fostering the creation of clusters to generate synergies among SMEs; and using the Technological Industrial Development Zones (TIDZs) to pro-actively seek new investors, including local firms.

A recurrent theme of fYRoM strategies is that they are rarely implemented effectively due to a lack of budget of implementation capacities. Both issues are of relevance to the industrial policy, which was written with IPA I in mind and is now out of date, though the Competitiveness Strategy does highlight important new priorities for development (see above). The strategy does not specifically emphasise either a manufacturing or SME in relation to FDI policy.

The current industrial policy is under revision and intention is to revise it this year. The government is also planning to revise the Law on Industrial and Green Zones.

Strategy for Export Promotion
This was prepared in 2010 and subsequently adopted by Government, with the Ministry of Economy in the policy lead, although actual implementation is mostly the responsibility of the Agency for Foreign Investments and Export Promotion (InvestMacedonia - see below). The strategy is a roadmap for increasing the value of exports, generated by domestic Macedonian companies, from $1.12 billion to $1.45 billion and for fortifying the institutional framework for export promotion with InvestMacedonia as the focal point. It identifies a number of sectors that are important to future export (see discussion below), but due a lack of funding is has not been implemented and is now out of date.

There are many other related strategies, such as the innovation and R&D strategies, both of which are up-to-date, and of some relevance to the FDI theme. There is current no Strategy for SME Development thought this is currently being prepared by the Ministry of Economy with the assistance of the International Labour Organisation (ILO).

None of the strategies focus specifically on the main theme of this report, namely SME manufacturing FDI.

3.4.3 FDI Institutions and extent of SME focus

fYRoM has a multiplicity of FDI related institutions, including one dedicated to attracting SME FDI, though it does not have a specific manufacturing orientation. The key institutions are briefly described below:

- *Agency for Foreign Investments and Export Promotion (Invest Macedonia)*: Invest Macedonia is the NIPA in charge of attracting foreign investments to the country, while also having responsibility for implementing the export promotion activities. Its other main areas of activity include aftercare service and some aspects of state aid. It has an annual budget of 8 million EUR and just under 50 staff members for FDI, export, aftercare, state aid, legal issues, HRD, etc. It is worth noting that a large number of employees are devoted to aftercare services;
- *Economic Promoters*: Invest Macedonia is also directly responsible for a network of 33 Economic Promoters who are based in different target countries in various parts of the world (some countries have several of them), based in the respective Embassies. Their role is to promote the country as both an investment and an export location, and to interact with the rest of the FDI infrastructure;
- *Ministers without Portfolio*: there are currently five Ministers without Portfolio, whose cabinets lead the FDI activities, with a focus on Multinational Corporations (MNCs) in pre-allocated geographical locations, rather than on the basis of industry or specific sectors. In addition to the ministers, several other individuals (such as the Minister of Transport, the Director of DTIDZ, the Deputy Director of InvestMacedonia, etc.) are involved in making contact with potential investors;
- *Cabinet of the Prime Minister*: there is an FDI unit in the PM’s cabinet that focuses on trying to attract SME FDI. The FDI Unit works in the countries where the Economic Promoters are located to avoid overlaps and to amplify geographical reach. Team members focus on particular geographical locations (just as the Ministers without Portfolio do). After one year of operation an estimated 20 companies had visited the country, of which 3 were considered to be close to signing an investment deal;
- *Directorate for Technological Industrial Development Zones (DTIDZ)*: the Directorate manages and administers all zones, including some elements of FDI and state aid. There is a clear

connection between much of the greenfield FDI effort and the TIDZs. The DTIDZ is also involved in Aftercare services and state aid matters connected with investment in the zones;

- *The Ministry of Economy* is responsible for the preparation of the Programme for stimulating investments, the last one of which covered the period 2011 – 2014 and seeks to increase the country's attractiveness for both domestic and foreign investments. It is technically the lead ministry in relation to investment but its role has declined over time;
- *Free zones*: the concept of operation of TIDZ is a similar to the concept of free zones operations.[31]
- *Foreign Investor Council (FIC)*: is established within Chamber of Commerce of Macedonia as a Chamber Council. The members are foreign investors and companies from the free zones. The main goal of FIC is, through partnership with government, to make recommendations for improvement of the business environment through the White book, which is published annually;
- *Enterprise Europe Network (EEN)* is operating in fYRoM and it is hosted by Chamber of Commerce of Macedonia. Their activities are not connected with FDI issues, though they focus on SMEs.

Institutional support to clusters and value chains has a relatively long history but still not established on appropriate basis. The focus on clusters was much more of a government priority in the past but there is no direct connection with foreign direct investment. The FDI impact on clusters is thus limited and value chains are not established on a systematic basis.

Aftercare services are an important part of FDI policy and are supported at national level. At the government level there is an FDI Committee, which is chaired by Prime Minister with participation of the ministers without portfolio, Ministry of Economy and representatives of other ministries and institutions, as well as NIPA and TIDZ and local municipalities. The sessions are held every two months and include foreign investors in order to discuss improvements to the investment / business environment.

There is an extensive FDI infrastructure that benefits from national policy prioritisation, which results in notable financial and institutional capacity. The approach includes a focus on SME FDI, though this does not appear to be specifically targeted at EU SMEs or manufacturing SMEs. It is the only SME FDI-oriented institution in the WB, though the information available suggests that it has not yet converted SME interest into formal investment deals.

3.4.4 Manufacturing sectors and subsectors supported

fYRoM lacks a coherent and consistent sectoral focus to its economic development activities. There are sectoral emphases, such as the current focus on tourism and the automotive sector, however, the current industrial policy does not set out explicit sectors or sub-sectors that the country should focus on in the long term. There is a lack of explicit analysis to prioritise the selection of sectors and sub-sectors. Consequently, different policies focus on slightly different sectors, as illustrated below:

- FDI policy: Machine and Automotive Components; Information and Communication Technology; Medical Devices and Pharmaceuticals; Agribusiness and Food Processing; Energy; Mineral Resources; Textiles; and Tourism;
- SME FDI: Automotive Industry, Machinery, Manufacturing Parts, Pharmaceuticals, Medical, Agriculture, etc.;
- Export Strategy: Textiles and Clothing; Agribusiness and Food Processing; Metal Industry and Precision Engineering (including automotive components); and Information and Communication Technology.

Although manufacturing is generally seen as an important sector to support, it is only one of several. For example, the Government is also emphasising the tourism sector. The overall approach is focused on MNCs and SMEs are not specifically targeted, except in relation to the activities of the SME FDI Unit. Manufacturing in general is a focus but if other opportunities arise, those are also considered.

3.4.5 FDI instruments with focus on SMEs and manufacturing

There are few instruments to support either manufacturing or SMEs. The Annual Programme of support for SMEs, industrial policy and export amounted to less than € 270,000 in 2015. This is

[31] More about Free zones is presented within 3.4.5 point.

supplemented by various government, donor, IFI, etc. initiatives. However, the country has invested heavily in the Technological Industrial Development Zones (TIDZs), which are a key part of the FDI policy. By definition, TIDZ investment involves greenfield investment and based on data of National Bank of Macedonia, such FDI was worth 1.081 million EUR in 2014.

Under the Law on Technological Industrial Development Zones, the TIDZs are used to facilitate economic activities to be performed under special conditions, including tax and other incentives for zone users (see below). The aim of the TIDZs is to support the development of modern high technologies and the application of high environmental standards. The establishment, development and monitoring of the TIDZs is carried out by the Directorate for Technological Industrial Development Zones. In addition to the currently operational TIDZs (Skopje I and II and Stip), there are a further twelve Zones planned in the following cities: Skopje III, Prilep, Gevgelija, Kicevo, Strumica, Rankovce, Struga, Radovis, Delcevo, Vinica, and Berovo, and one based on a Public Private Partnership in Tetovo. It is not clear whether these are policy intentions or actual investment priorities at present.

The tax exemptions and incentives available in the TIDZs include:

- Corporate Income Tax exemption for a period of up to ten years if business activities start no later than two years after obtaining the official decision for work to commence in the TIDZ;
- Personal Income Tax exemption on salary payments for a period of up to ten years, from the moment the investor commences its business activities in the TIDZ;
- VAT exemption on the sales of goods and services within the TIDZ, excluding the sales of goods and services considered as final consumption under the VAT law;
- VAT exemption on the import of goods into the TIDZ, which are ultimately intended for export, excluding the goods intended for final consumption as per the VAT Law;
- Exemption from taxes and other duties related to the utilisation of construction land, connections to water, sewerage, heating, gas and the power supply networks.

The TIDZ users are also entitled to customs duties exemption and relief in accordance with the domestic customs legislation. These incentives, together with the infrastructure within the zones, have proved attractive to potential greenfield foreign investors and resulted in FDI inflows, especially in medium- and high-tech manufacturing industries. The FDI located in and around the TIDZs employed around 5,300 workers in 2015.

Apart from the budget connected with the various institutions associated with FDI, the main form of support is state aid. Based on received information by institutions, there is scope for large investors to obtain support in form of grant. The process of providing grants is based on negotiation and grants are established per employee up to a maximum of 3,000 EUR. The process negotiation, assessment and decision decision-making may need to be considered from the consistency perspective.

Due to the extensive government FDI engagement, international donors are not actively engaged in this area. The main exception is the Word Bank’s activities to pilot greater linkages between FDI and domestic SMEs in the automotive industry (TIDZs), which is expected to be expanded in the future. This is an exception in the WB region, where relatively little emphasis is currently placed on maximising the benefits of FDI for the local economy through enhanced economic linkages.

There are no instruments to specifically focus on SME manufacturing FDI. Indeed, the focus is almost exclusively on MNCs, except for the SME FDI Unit, which has not yet realised any investments.

3.4.6 Conclusions

fYRoM continues to conduct a very strong policy on attracting FDI. This is reflected in the large number of institutions engaged in this area, as well as the relatively generous state funding devoted to FDI support, including state aid and infrastructure provision in the form of zones. In addition, fYRoM has developed an aftercare service system, enabling foreign investors to smooth their business operation.

There are various relevant policies and strategies in operation. Although none focuses specifically on FDI, a notable gap, some do cover related themes such as industrial policy, SMEs, export, etc. albeit most are in need of updating, such as SME and export. None has a consistent and structured sectorial approach, with the consequence that although the manufacturing sector is of importance in general, so are other sectors and sub-sectors.

The key issue to note in relation to the FDI institutional system is that it is complex, if not fragmented, leading to potential problems including overlapping, competition among FDI players, as well as confusion among potential and existing investors. There is no lack of FDI policy priority, human resources and finance, unlike many other NIPAs and related institutions in the WB region. There is policy recognition of the potential importance of SME FDI, but not necessarily of SME manufacturing FDI per se since it is only one of several sectors targeted. The SME FDI Unit has, however, not yet been able to secure any SME FDI, whether in manufacturing or any other sector.

Concerning FDI statistics, fYRoM has developed statistical records and adjusted its national system of accounts, enabling international comparison of all type of FDI data per sub-sectors through time-series of FDI flow and stocks.

3.5 Kosovo

3.5.1 FDI Trends

Kosovo is one of only four European countries the recorded positive growth rates every year in the post-crisis period since 2008. The average growth of 3,5% during 2011–14 contrasts favourably with the WB region, even if it has remained slightly below the global average. However, with per capita GDP estimates of close to 3,000 EUR, Kosovo remains one of the poorest countries in Europe. Average per capita income is about one-tenth of EU levels and the incidence of poverty remains high.

Even though exports of goods rose by 10% to 324 million EUR over the previous year, Kosovo again registered a massive trade deficit of 2,2 billion EUR in 2014 The structure of exports of Kosovo is still dominated by raw materials. Base metals accounted for 51% of exports in 2014 and mineral products for 14%. The countries of the Central European Free Trade Agreement (CEFTA) received a share of 39% of Kosovo's exports in 2014 and EU countries accounted for 30%. The most important buyers of Kosovo's exports were Italy (15%), Albania (14%), China (13%) and fYRoM (11%).

FDI in Kosovo averaged 67,52 million EUR from 2007 until 2015, reaching an all-time high of 440,70 million EUR in 2007 and a record low of -19,10 million EUR in April of 2014.

Table 37. Main FDI indicators of Kosovo in period 2005-2014

Indicator	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
FDI inflow, EUR million	108	295	441	366	287	366	394	229	259	151
FDI net, EUR million	-	289	431	341	277	331	378	213	241	124
Inward FDI stock, EUR million	-	-	924	1291	1582	1961	2326	2524	2774	3000*
FDI inflow per capita in EUR	66	177	261	213	164	206	219	126	142	84
Inward FDI stock per capita in EUR	-	-	547	751	905	1105	1292	1390	1517	1662
FDI inflow as a percentage of GDP	3,6	9,4	12,7	9,3	7,2	8,5	8,3	4,7	5	2,6
Inward FDI stock as a percentage of GDP	-	-	26,7	32,8	39,5	45,7	48,8	51,3	53,3	53,5

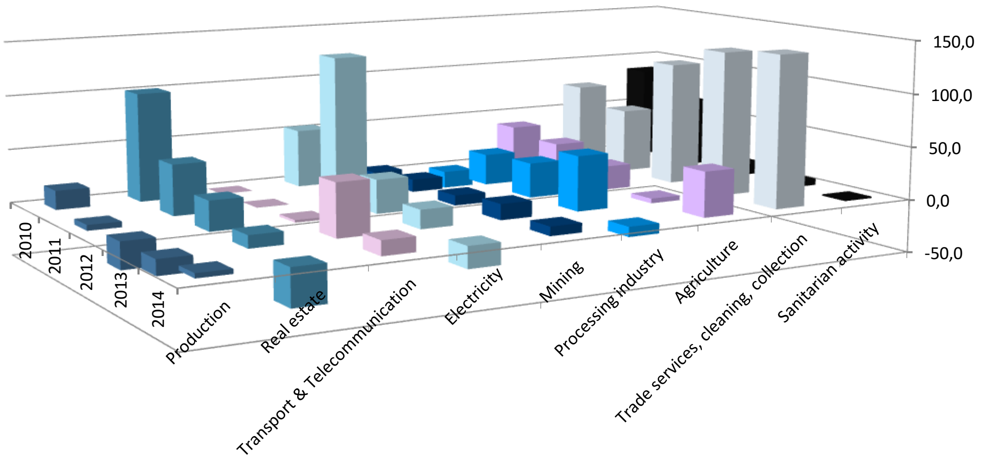
* Estimated amount.
Source: WiiW database; Bank of Kosovo.

While FDI inflows in 2007, 2008, 2010 and 2011 exceeded 360 million EUR, a sharp decrease to 229 million EUR was observed in 2012. In 2013, FDI picked up again and reached 259 million EUR, before dropping to 151 million EUR in 2014. In the first quarter of 2015, FDI was twice as high as in the first quarter of 2014 and increased by 11,2 million EUR in November of 2015. This growth was mainly attributable to the real estate and financial sector investments.

The inflow of FDI amounted to 2,6% of GDP in 2014, the lowest in the last ten years, which averaged 6,7% of GDP. The bulk of financial inflows was informal and unrecorded (5% of GDP).[32] The lowest level of net FDI since 2005 was in 2009, reflecting the impact of the global crisis on Kosovo's economy. This is because FDI in Kosovo is highly sensitive to developments in EU economies, where most of the FDI originates. FDI began to recover during 2010, while significant increase in FDI was registered in 2011 with an inflow of EUR 394,6 million, 14,4% increase from 2010. However, downturn trend started with 2012 and continued until the end of 2014.

[32]EC, *2015 Progress Report, Commission Staff Working Document Kosovo*, Swd (2015) 215 Final, Brussels, 10.11.2015

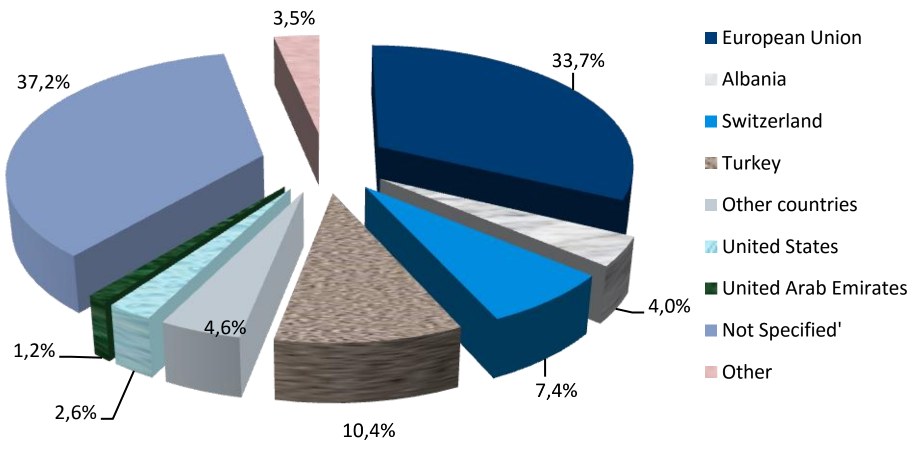
Chart 18. FDI inflow per sectors in 2010-2014 in million EUR



In 2007, the major share of FDI was concentrated in the **processing industry**. During this year, 129.24 million EUR was invested out of a total of 440,74 million EUR of FDI. During 2008-2010 the situation changed in favour of the **Trade services, cleaning, collection** sector and **Real estate** sector. During last two years most investment flowed into the **Trade services, cleaning and collection** sector.

In the first seven years since its declaration of independence (2008-2014), most FDI that Kosovo attracted came from Germany (377 million EUR), Turkey (252 million EUR) and Switzerland (244 million EUR). Other notable investors were Slovenia (152 million EUR), Austria (150 million EUR) and the United Kingdom (147 million EUR).

Chart 19. FDI stock by main investors in 2015 in %



The main points arising from the above illustrations are as follows:

- The balance of direct investments in 2014 continued to be negative and marked an annual increase of 4,4%, meaning that more FDI was invested in Kosovo compared to FDI that have Kosovo residents invested abroad;
- The **stock** of total FDI amounted to 3 billion EUR at the end of 2014 which is 5,1% higher than the stock of FDI at the end of 2013. An increase was noted in the stock of direct investments realised out of the Kosovo's economy by Kosovo residents, which recorded an annual growth of 18,4% and reached 174.6 million EUR;

- FDI in Kosovo is concentrated in the following economic sectors: trade, agriculture, real estate and the financial sector, followed by the transport and telecommunications;
- The EU countries' share of the total inward FDI stock of Kosovo was only 33,7%.

According to the Doing Business 2016 ranking, Kosovo was in 66th position, a drop in 2 positions compared with 2015.

3.5.2 FDI Policies and extent of SME focus

Law on Foreign Investment

Kosovo does not distinguish between foreign investors and local ones. It provides foreign investors and their investments with full protection and security. Kosovo recognises and respects foreign investors' rights, such as relating to immovable and movable property, intellectual property and other assets, contract rights, etc. Foreign investors also have the right to have disputes resolved in accordance with any applicable requirements or procedures. In the event of a conflict between a provision of the laws and a provision of a bilateral or multilateral international agreement related to foreign investment to which Kosovo is a party, the international agreement prevails.

The Ministry of Trade and Industry maintains a registry of foreign investors and investments, which is regularly up-dated. The register is operated by the Kosovo Investment and Enterprise Support Agency (KIESA) and has over 300 entries. Since foreign investors are not required to provide information for the register, it is not clear how up-to-date and accurate the register is.

The Law enables KIESA to be authorised to support the establishment and development of a suitable environment for MSME (Micro, Small and Medium Enterprises). Furthermore, two legislative developments are planned:

- The Draft Law on strategic investments: sets out rules and procedures to stimulate foreign investment of a strategic nature and is expected to be approved during 2016;
- The Administrative Instruction: the Ministry of Finance is finalising tax breaks for a period of 2-10 years for new business activities in the manufacturing sector that involve over 500,000 EUR investment and employ over 20 people.

The Private Sector Development Strategy 2013-2017

The Ministry of Trade and Industry (MTI) drafted the “Private Sector Development Strategy 2013 – 2017” to coordinate activities for the development of the private sector in the medium term. The PSD strategy mainly focuses on the development of SMEs, investment promotion, enhancing the internal market, respectively free movement of goods, as well as improvement of the trade policies. Its purpose is to address the challenges, as well as to adopt changes in the legal, institutional and policy framework dealing with industry and private sector development. The Strategy provides a frame for intervention by central and local level of government, private and non-governmental sector and consists of three pillars:

- Development, support and promotion of investments and businesses;
- Improvement of Free Movement of Goods or Regulation of Internal market;
- Advancement of Trade Policies.

MTI has made the decision to revised and update the PSD strategy during 2016. Among other issues, such as SME development, the new PSD will take into consideration the Concept of Kosovo Industrial Policy (2014), whose priorities are:

- Industrial modernisation;
- Access to finance at all stages of enterprise development;
- Internationally competitive clusters;
- Industry and agricultural development and efficient use of natural resources;
- Environment for entrepreneurship development.

National Development Strategy 2016-2021 (NDS)

The National Development Strategy 2020 (NDS) is the overarching official strategic document. Kosovo is committed to improving the economy by delivering the NDS, which serves as an umbrella for all the sector strategies and policies, including industrial policy. This the first time that such a comprehensive document has been put in place; it includes 34 policy measures that are considered the “priorities of priorities”. The NDS is a document prepared by Kosovo’s institutions under the coordinating role of the Strategic Planning Office (SPO) mandated by the Prime Minister and supported by the European

Union Office. It is built upon four thematic pillars: Human Capital, Rule of Law and Good Governance, Competitive Industry Development, and Infrastructure Development. Councils coordinate the work of the pillars and engage in public-private dialogue.

The NDS aims to support a re-industrialisation process of Kosovo, so that private and public enterprises can grow, engage in value adding activities and produce marketable products and services for export. This means creating facilities and incentives for strategic investors and initiatives fostering competitiveness of enterprises, especially in reaching the quality standards required for export.

Measures most relevant to FDI include:

- Expanded access in finance for enterprises;
- Networking and development of enterprise clusters;
- Fostering SMEs into higher added value activities (enable businesses to manufacture more sophisticated and more expensive products, export-ready products; thereby, generating income);
- Promotion of FDI and expansion of diaspora’s role economic development (service its financing needs, ensure transfer of technology / know-how and reduce trade imbalance);
- Agricultural land regularisation;
- Utilisation of mineral resources;
- Restructuring and revitalisation of Trepça;
- Unfreezing privatisation funds and utilising funds for development;
- Good governance and satisfactory performance of state-held corporations.

In the context of the key institution responsible for investments, the following should be noted:

- The SME development strategy has been subsumed within the PSD (to be revised);
- The FDI strategy lapsed in 2014 but there are plans to create a new one;
- The Export strategy: the Investment Promotion Agency of Kosovo is currently developing a new Strategy for promoting exports. It will aim to increase the value of exported goods and services. Moreover, it is intended to improve and strengthen the legal framework for foreign investors that choose Kosovo as their production facility location and export goods and services.

3.5.3 Manufacturing sectors and subsectors supported

The Concept of Kosovo Industrial Policy identifies the following sectors as contributing the most to the economy in terms of employment, turnover and exports: Food processing; Metal processing; Textile industry; and Wood products. Based on their **growth potential**, the following priority sectors are also emphasised: IT; Rubber; Plastics; Chemicals; and Tourism.

3.5.4 FDI Institutions and extent of SME focus

The key relevant institutions in Kosovo are briefly described below:

- *Ministry of Trade and Industry (MTI):* has overall policy responsibility for the issues covered in this report, namely FDI, export, SMEs, industrial policy, etc. There are also others that influence this agenda, such as the Ministry of Economic Development and the Prime Minister´s Office (PMO);
- *Kosovo Investment and Enterprise Support Agency (KIESA):* the pre-eminent institution, as far as implementation is concerned, is KIESA, which operates under the Ministry of Trade and Industry, though there is a discussion as to whether it should report to the PMO. KIESA is the result of an institutional merger in 2013 and is responsible for a range of policy areas including FDI, SME development, economic zones, export and tourism promotion. The merger resulted in institutional turbulence and staff turnover, however, it has received some institutional strengthening support, including from the EC. The new staff is young and language and technical skills need to be enhanced. Although KIESA makes efforts to engage with all potential investors, SMEs included, it recognises that its FDI related activities are constrained by two main factors: its remit is extensive but it only comprises 18 staff (14 in place): the FDI complement amounts to 3 people which constrained its ability to be proactive in relation to FDI. Aftercare, though recognised as being critical (various interviewees indicated that investors have chosen to leave in recent years), is not currently feasible. Furthermore, its annual budget for 2016, covering all five thematic areas, staff and operational resources, amounts to 1,2 million EUR. This is on the low side and constrains performance. KIESA had

made proposals for a new FDI strategy and draft Law on Strategic Investments and Administrative Instruction for manufacturing incentives. Should these be approved, it anticipates being able to compete more effectively in the WB region in terms of incentives;
- *The European Investors Council (EIC):* is a non-for-profit association of 16 investors from EU countries committed to improve the business environment and increase FDI, thus enhancing Kosovo's competitiveness and capacity for citizens and businesses alike;
- *Economic Zones:* A long-standing policy objective is the establishment of a network of Economic Zones. It is not clear the extent to which these have benefited from feasibility studies but in 2014, the Government established three economic zones in Mitrovica, Gjakova and Prizren. Because of issues such as land preparation and funding, they are at varying stages of development, with Mitrovica being most advanced;
- *Enterprise Europe Network*: Kosovo is not currently a member of the Enterprise Europe Network.

Kosovo has not yet establish support to clusters and value chains at the national level, though some initiatives have been carried out, such as value chain analysis (wood processing and non-wood forest products in Mitrovica region), cluster analysis ("natural-born clusters") and sector profiles (tourism, wood processing industry and metal processing). An EU project has started which will analyse their potential and the results are expected to feed into the revised PSD Strategy planned for 2016, including the sector / clusters / value chains to be prioritised;

3.5.5 FDI instruments with focus on SMEs and manufacturing

There are currently few or no financial incentives, except for grants and Credit Guarantees, for example to promote enterprise development and growth. Some investment incentives are in preparation (see KIESA discussion) but the current incentives cover the following issues:
- Loss carry forward: tax and capital losses can be carried forward for up to seven successive tax periods and are available as a deduction against any income during those years;
- Special allowances for new assets: if a taxpayer purchases new capital goods for its economic activity, a special deduction of 10% of the cost of acquisition of the asset is allowed in addition to depreciation;
- Double Taxation: a resident taxpayer in receipt of income from business activities outside of Kosovo through a permanent establishment outside of Kosovo, and who pays tax on that income to any state, is allowed a tax credit under this regulation in an amount equal to the amount of tax paid to such state. Bilateral agreements on the avoidance of double taxation supersede these provisions.
- Customs: to promote local production, a reduced rate of zero customs duty on the import and export of certain capital goods, raw materials, agricultural production inputs, and services applies;
- Investment guarantees: the Multilateral Investment Guarantee Agency (MIGA) guarantees investments in Kosovo up to the value of €20 million;
- Land: municipalities have the right to lease movable and immovable property to foreign investors. The lease can be granted for a term of ten years with an extension opportunity of up to 99 years.

3.5.6 Conclusions

Kosovo has a relatively clear policy and institutional framework for FDI: the Ministry of Trade and Industry is largely responsible for policy and KIESA is responsible for implementation. However, in reality, there is a need of strengthening and reform.

There is a very detailed overarching policy framework in the form of the National Development Strategy. This is extremely useful, but the details are to be developed by a new Private Sector Development Strategy planned for 2016, including the SME development, industrial policy, export, sectoral focus (including cluster and value chain development). Furthermore, the FDI strategy is out of date and is expected to be redone in 2016.

KIESA has a large remit covering SMEs, FDI, export, economic zones and tourism promotion, but is constrained from rising to the challenge with only 18 staff members, staff turnover and a limited annual operational budget. Its staff complement of three FDI people is mainly reactive and aftercare is not feasible. Although KIESA recognises the importance of developing a structured approach for targeting

EU SMEs in terms of manufacturing and other FDI, it is not able to develop the approach to implement it.

The compilation of the Balance of Payments Statistics is based on International Transactions Report System, International Trade Statistics, surveys and other sources of information, which include data collected through questionnaires from institutions such as EULEX, UNMIK, KFOR, government and other institutions. As regards classifications and registries, not all the latest versions of the different classifications are in place. While the introduction of the European classification of economic activities (NACE Rev.2) in the business register has been completed, consistency problems exist. The statistical business register in Kosovo needs to be updated and the quality of the data improved.

Regarding the methodology for recording FDI, the central banks broadly accept a methodology based on BPM6 updates of the fifth edition of the IMF´s Balance of Payments Manual (BPM5). In addition, the “OECD Benchmark Definition of Foreign Direct Investment, 4th edition 2008” replaces the third edition.[33] Therefore, the Bank of Kosovo should reform its FDI recording methodology and system of national accounts to enable statistical surveys on sub-sectoral bases and ensured the comparability of time series data with international methodologies.

3.6 Montenegro

3.6.1 FDI Trends

Montenegro has been recording a very high inflow of net FDI since 2005, which places it among the top European transitional economies. In order to attract FDI, Montenegro has created an attractive legal framework and based on the share of FDI net inflow in the GDP during 2005 – 2007, Montenegro was first in the group of European transitional economies.

Total FDI in Montenegro reached a record 1 billion EUR in 2009. In per capita terms, Montenegro topped the list of FDI in Eastern and Central Europe. However, a good proportion of investment in period 2006-2008 was in real estate, with the coast in particular enjoying a significant construction boom.

Table 38. FDI indicators for Montenegro (2005-2014)

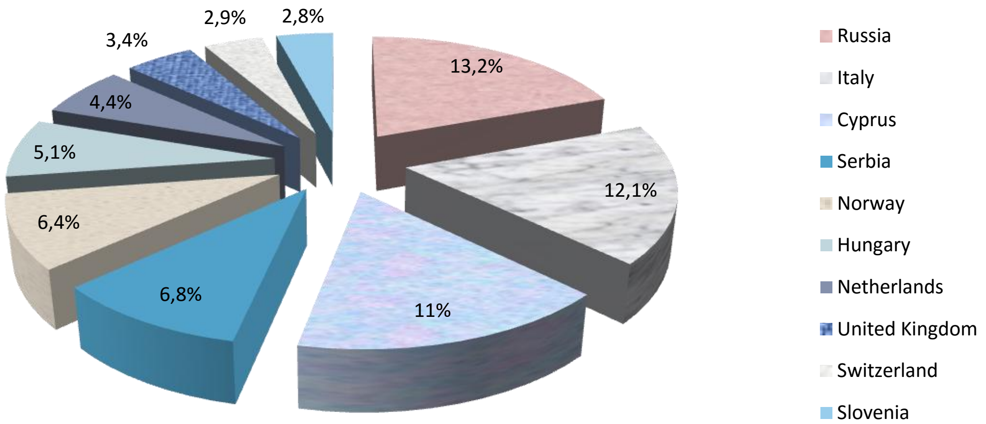
Indicator/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014*
FDI inflow, EUR million	403	496	683	656	1099	574	401	482	337	498
FDI net, EUR million	399	470	568	582	1066	552	389	462	324	354
Inward FDI stock, EUR million	580	1076	1759	2414	3514	3167	3253	3567	3900	-
FDI inflow per capita in EUR	646	794	1109	1063	1778	927	647	778	542	801
Inward FDI stock per capita in EUR	930	1722	2853	3909	5677	5107	5237	5748	6290	-
FDI inflow as a percentage of GDP	22,2	23,1	25,5	21,2	36,9	18,5	12,4	15,3	10,1	14,4
Inward FDI stock as a percentage of GDP	32	50,1	65,6	78,2	117,9	102	100,6	113,3	116,9	-

Source: WiiW database; * Central Bank of Montenegro.

Based on Central Bank of Montenegro data, the total FDI inflow in Montenegro amounted to 498 million EUR in 2014, up by 3.9% on the year, while outflows totalled 144 million EUR, down by an annual 7.2%. However, it this the biggest increase since 2011. Net FDI stood at almost 354 million EUR in 2014, essentially unchanged from a year earlier. At 230.3 million EUR, intercompany debt was the largest component of FDI inflows, followed by investment in real estate, which stood at almost 181 million EUR. Investment in companies and banks, at 80.4 million EUR, was the third most important component of FDI flows.

[33] **Definition - OECD:** FDI is defined as cross-border investment by a resident entity in one economy with the objective of obtaining a lasting interest in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the enterprise. Ownership of at least 10% of the voting power, representing the influence by the investor, is the basic criterion used. **Inward stocks** at a given point in time refer to all direct investments by non-residents in the reporting economy; outward stocks are the investments of the reporting economy abroad. Corresponding flows relate to investment during a period of time. Negative flows generally indicate disinvestments or the impact of substantial reimbursements of inter-company loans. The components of FDI are equity capital, reinvested earnings and other capital (mainly intra-company loans).

Chart 20. Largest FDI Inward stock per countries in 2012 in %



Russia was by far the most important source of investment, particularly in the real estate sector, accounting for more than half of total investment inflows. Local sources estimate that around 40% of all real estate in Montenegro is owned by Russians. In addition, English and Irish citizens are buying real estate while Austrian and Slovene companies are investing in tourism. Deutsche Telecom has bought Montenegrin Telecom through its Hungarian subsidiary. French, Austrian, Slovene and American companies have all invested in the banking sector.

The main points arising from FDI inflows are as follows:

- Most FDI is related to the privatisation process while the greenfield investments are relatively small;
- A significant part of the FDI inflow relates to the real estate sector (particularly in 2006 and 2007);
- The highest amount of FDI inflow, based on Central Bank of Montenegro, were in the area of tourism, banking, industry and telecommunications;
- The volume of FDI has been recovering gradually in 2008, with a decrease in the FDI share in the real estate sector and an increase in the real sector;
- Russia remains the most important source of foreign investments, accounting for 13% of the total. Italy and Cyprus were the second and third most important sources in 2012, accounting for 12% and 11% respectively;
- The share of EU-27 countries in total inward FDI stock accounted for 82% of FDI in 2012.

According to the Doing Business 2015 the Republic of Montenegro was ranked in 47th position, behind fYRoM but ahead of all other WB economies. Montenegro improved its ranking by 1 place to 46th place, retaining second position in the WB region according to “Doing Business 2016”.

3.6.2 FDI Policies and extent of SME focus

FDI is seen as a key driver of economic growth, but also as a factor in the trade / current account deficit. FDI has affected economic development, albeit mostly focused on privatisation and tourism. The highest levels of FDI were in area of tourism, real estate, energy sector, telecommunications, banking sector and construction, however, there has been relatively little investment in the manufacturing sector. The energy sector and tourism industry have the greatest potential for attracting FDI in the future.[34]

Until recently (2013 – 2015) Montenegro had a separate policy for FDI, the Strategy for Attraction of Foreign Direct Investments, but it has now expired. The vision was to develop Montenegro as a leading platform for business development in the Adriatic area and focused on four priorities: continuation of regulatory reform; improvement of competitiveness; fostering of institutional capacities for FDI attraction and development of partnerships at national and national level; and promotion and communication for targeted sectors and targeted markets. The sectors targeted included exploitation of mineral resources, agriculture and forestry, tourism, energy, manufacturing industry, financial

[34] Ibid

intermediation and ICT. A new FDI Strategy is being prepared and is expected to be approved during 2016.

The SME Strategy also expired last year. Its objective was to contribute to creation of more favourable business environment and enable improved SMEs competitiveness, innovation and export, employment growth and balanced regional development. The measures and activities were grouped around four strategic objectives focusing on: improvement of business environment; strengthening of financial support; strengthening of SMEs competitiveness and promotion of entrepreneurship; and support to start-ups. It did not target specific sectors, being horizontal in nature. A new SME also being prepared and is expected to be approved during 2016.

There are several policy documents that, among others, cover FDI. The most important ones are presented below.

Montenegro Development Directions 2015 - 2018

The Montenegro Development Directions (MDD) was adopted in 2013 and proposes solutions for harmonising the objectives of sectorial and national strategies in various development fields. The "directions" have been prepared in line with the Europe 2020 Strategy. The document stresses of the importance of "smart growth", "sustainable growth" and "inclusive growth", including proposed investments/development measures.

The strategic objective of MDD 2015 – 2018 is the enhancement of the quality of life in the long-term. The mid-term focus of economic policy in Montenegro is to remove barriers to economic growth and development and improvement of competitiveness of the economy. The MDD also defines priorities is the areas of competitiveness, where the main priorities are increase of FDI, establishment of a larger number of functional business zones and increase of employment. Many other areas indirectly connect with the issue of FDI. For example, if the business environment is improved, it will affect the level of FDI.

The main objective of the competitiveness theme, as defined by the MDD, is to increase FDI by creating a favourable investment environment. Several measures are proposed to achieve this objective: further development of business zones; establishment of one or more one-stop-shops for FDI issues; increase of the number of economic bilateral and multilateral agreements and further activities to improve the investment climate; establishment of a new Agency for Investments by merging the Agency for Foreign Investments and the Secretariat for Development Policies (see below); improve the system of standardisation and training of personnel and establish an FDI aftercare programme. The institutional and policy basis for FDI is consequently in a state of flux at present.

The following structural reforms are identified in the MDD:

- Implementation of the Strategy for Sustainable Economic Growth of Montenegro by introducing business clusters during 2012 - 2016;
- Amendments to the Law on Foreign Investments (see below) during 2016;
- Adoption and enforcement of the Law on Public-Private Partnership and Concessions;
- Implementation of the SEE 2020 Strategy to increase of FDI in the region and in Montenegro.

These "directions" conclude that FDI is a necessary development component but needs "smart" orientation, for example in the ICT sector (SME for software development, etc.), however, this conclusion has not yet been converted into specific measures.

Law on Foreign Investments

The Law on Foreign Investments was adopted in 2011 ("Official Gazette of Montenegro", no. 18/11) and regulates the forms of foreign investment, rights of foreign investors and their protection and promotion relevant to foreign investments. The Law also stipulates that support to FDI is defined by the Strategy on Foreign Investments, but as previously discussed, this strategy has expired. The tasks and activities of Agency for Promotion of Foreign Investments are also prescribed with this Law. However, the institutional base for FDI is about to change and the Law will also be amended in 2016.

Montenegro Economic Reform Programme 2015 - 2017

The Montenegro Economic Reform Programme is divided into two parts: Macroeconomic Framework, Public Finances, Structural Reforms and Sectoral Structural Reforms to Promote Competitiveness and Growth. One of the aims of the Programme is to deliver structural reforms and ensure fiscal and financial stability in order to create the conditions for a long-term sustainable growth and development.

The Programme identifies several segments of importance, including Trade Integration, whose main objectives are to increase and diversify export and to create conditions for stable FDI inflow into the production sectors. Priority measure 18 relates directly to FDI and highlights the need to improve the institutional framework for the promotion and encouragement of investment, with an emphasis on the manufacturing sector. Accordingly, the Ministry of Economy is implementing a project defining mechanisms for attracting new investments related particularly to business zones and incentives to investors. This measure aims to strengthen managerial capacities within the business zones, define promotional activities for attracting FDI and simplify the process of establishing and managing the business zones under local government management. This measure also envisages preparation and adoption of the Law on Public Private Partnership and anticipates adoption of decrees providing incentives for FDI.

Strategy for Development of the Manufacturing Industry of Montenegro 2014 - 2018

This Strategy was adopted in 2013 and defines the strategic sectors of manufacturing industry and seeks to strengthen competitiveness and enhance development potential in all parts of Montenegro. The main objectives of the strategy for manufacturing industry are to: increase of employment; improve competitiveness; strengthen export; and generate GDP growth. However, the strategy does not define concrete measures and activities that would contribute to achievement of the objectives and is more a detailed analysis of manufacturing industry than anything else, though it does define the priority sectors in manufacturing (i.e. metal and metallic products and wood processing and furniture).The Strategy neither mentions FDI nor the Industrial policy (see below). Although some of the policy documents clearly define priority manufacturing sectors, none of them focus specifically on the main theme of this report, namely SME manufacturing FDI.

It is also important to note that an EU-funded project is assisting the preparation of a comprehensive industrial policy, which would embrace the main elements of the Europe 2020 strategy, as reflected in the South East Europe 2020 strategy (SEE 2020). This document, already drafted, is expected to be approved during 2016.

3.6.3 FDI Institutions and extent of SME focus

The institutional framework for FDI in Montenegro is defined by the Law on Foreign Investments but is in the middle of a process of change. The key institutions are briefly described below:

- *Ministry of Economy:* is in charge of FDI and creates policy, cooperates with other ministries on drafting and implementation of the laws and regulations that affect the issue of FDI; promotes Montenegro as an attractive investment location, etc. The Ministry also contains the SME Development Directorate (SMEDD), with limited responsibility for SME policy implementation;
- *Montenegrin Investment Promotion Agency (MIPA):* MIPA was established in 2015 with a mission to engage with foreign and domestic investors, the public and private sector, international organisations and private individuals in order to boost business opportunities and foreign investment. MIPA promotes FDI as well as the available incentives through of network of Montenegrin embassies. It also keeps a register of foreign investments and foreign investors. In 2016, it has budget of 120,000 EUR per annum, which includes the costs of 4 permanent and 6 annually appointed temporary staff members;
- *Secretariat for Development Projects:* was established in 2012 and has 12 employees, four of whom are employed on a full-time basis. Its total budget for 2016 for investment incentives[35] is 1 million EUR for the following sectors: manufacturing and services, and hospitality and hotel industry;
- *National investment Committee (NIC):* is a government body chaired by prime minister of Montenegro and its members include the Vice President of the Government, Ministry of Finance, Ministry of Foreign Affairs and European integrations and National Coordinator of Regional Projects. The NIC´s activities focus on infrastructural projects in the energy, transportation, environment and social sectors;
- *Business Zones:* these are based in 8 municipalities and are aimed at enhancing the development of SMEs in the light industry sector, namely: food processing, textile and tobacco, furniture, electronics, manufacturing of final products, etc.;[36]
- *Montenegrin Foreign Investors' Council* aims to support FDI by provide guidelines on strategic activities for promotion and other support. It also monitors the implementation of the Strategy

[35]More details about incentives are presented in Section 3.6.5.
[36]More details about incentives are presented in Section 3.6.5.

on Foreign Investments. The President of the Council is Prime Minister and other members include three ministers appointed by the Government, President of the Board of Union of Municipalities of Montenegro, president of Montenegrin Chamber of Commerce and Industry, and a nominee of the foreign investors' associations. Since the Strategy on Foreign Investments has expired, it is unclear whether the Council is still functional;
- *Enterprise Europe Network (EEN);* has been operating since 2006 and it is coordinated by Ministry of Economy's Directorate for Development of Small and Medium Enterprises. The EEN activities focus on SMEs but are not connected with FDI matters.

In addition, institutional support to clusters is on the early stage development and it is still not linked to FDI.

As discussed above, the institutional environment set out above is in the process of being changed during 2016 or early 2017. A new structure will emerge which is likely to include the following:
- New Agency for Investments merging the current Investment Promotion Agency with the Secretariat for Development Policies;
- At least one one-stop-shop for FDI issues to be created;
- After-care programme for FDI to be established;
- A new SME and a new FDI strategy to be prepared covering 2016-2020;
- A new law on FDI and new decree on FDI incentives.

3.6.4 Manufacturing sectors and subsectors supported

Several strategic documents define the priority sectors, including for manufacturing:
- Montenegro Economic Reform Programme: Tourism; Construction; Metal processing; Wood Processing; and Food Processing;
- MDD: Tourism; Manufacturing Industry; Energy; Agriculture and Rural Development;
- Strategy for Development of Manufacturing Industry of Montenegro: Metal Complex; Wood Processing and Furniture;
- Priority sectors for MIPA: Agriculture; Energy; Tourism and Banking;
- Sectors presented by Montenegro at the bilateral screening: Food Processing; Metal and Aluminium Production; and Tourism;
- Strategy for Attraction of FDI (2011 – 2015):Mineral Resources; Agriculture and Forestry; Tourism; Energy; Manufacturing; Financial Intermediation; and ICT.

While priority sectors have been defined, sector-specific support measures have not, with the exception of the tourism sector. This might be due to the lack of an approved Industrial strategy, which is expected to define measures and activities to achieve the industrial development goals. Besides the lack of sector-specific support measures and instruments, it is also evident that prioritisation of sectors for SME FDI/investment in is not currently being considered.

3.6.5 FDI instruments with focus on SMEs and manufacturing

Apart from the tourism sector, there are no specific instruments for support to manufacturing in Montenegro. All existing support instruments are horizontal, so can be used by investors in all sectors. The two main documents relating to investment support are the Decree on Direct Investments Incentives and the Programme of Business Development - Business zones, both of which are discussed below.

The key instrument that focuses on SME manufacturing FDI/investments is the ***Programme of Business Development-Business zones***. Eight municipalities have established business zones that are in the process of becoming operational: Berane, Bijelo Polje, Cetinje, Kolasin, Mojkovac, Niksic, Podgorica and Ulcinj. They are expected to encourage the development of micro and small enterprises, locating inland connected to utilities, to increase employment in less developed municipalities, as well as harness capital from domestic and foreign investors. The local authorities are expected to facilitate investment through the following:
- Payment of utility or other charges;
- Reduction in the price of lease/ownership of premises within the business zones;
- Reduction or exemption from tax on individual income;
- Reduction property taxes;
- Favourable Public Private Partnership model;
- Provision of infrastructure.

Investors, whether domestic or foreign, can also expect logistical support to facilitate their business operations.

The ***Decree on Direct Investments Incentives*** ("Official Gazette of Montenegro", no. 80/2015) governs the conditions for attracting FDI in the manufacturing and services sectors, as well as criteria for the award of financial incentives. Such incentives may be used for FDI projects that create jobs and contribute to the economic and regional development of Montenegro. Incentives are awarded up to a maximum of 50% of the investment project value for Large Business Entities, 60% for Medium Business Entities or 70% for Small Business Entities. Investment Incentives can be awarded for investment projects with a minimum investment value of 500,000 EUR that will provide jobs for at least 20 new employees within a period of three years, and to obtain funds amounting to 3.000 EUR to 10.000 EUR per newly created job[37]. For investments in the northern and central parts, investment incentives may be granted for a minimum investment value of 250,000 EUR that will provide city jobs for at least 10 employees within a period of three years. During 2015, one public call for proposals was made and three companies were awarded in the manufacturing and service sectors.

Potential investors in Montenegro can be incentivised by other forms of support such as:

- Tax Credit: tax can be reduced by 25% of the amount invested in fixed assets for the relevant tax period up to 30% of the total tax liability;
- Incentives for non-developed areas (northern part of the country): start-ups in the area of production are free of Corporate Income Tax during the first three years of operation. Newly established production entities in underdeveloped municipalities are exempt from profit tax for the first eight years. A taxpayer starting manufacturing activities in an underdeveloped municipality is exempt from income tax for the first eight years. This tax exemption does not apply to primary production;
- Loss Carry Forward: losses resulting from business relations, excluding those resulting in capital gains and losses, may be carried forward to offset profit generated in future periods not exceeding five years;
- Investments in securities: if profit from capital investment is used to purchase new securities, such profit is not taxable if it is reinvested within 12 months. Profit from sale of securities held by a taxpayer for more than two years is exempt from taxation;
- Import of raw materials: if such raw materials that are converted into finished products and then exported, they are free of customs duties;
- Import of equipment as the equity of foreign investor: in such cases no customs duties are paid, except for VAT;
- Exported goods: are customs free.

3.6.6 Conclusions

Economic development in Montenegro relies heavily on FDI. Although the FDI Strategy has expired and a new one is in the process of being prepared, many other strategic documents touch upon the theme of FDI. The current institutional framework is prescribed by the Law on Foreign Investments, but this is in the process of being radically reformed and reoriented, including the law itself. At the point when a new institutional system comes into being, it would be important to develop a new FDI strategy, though local discussions indicate that a new FDI strategy is being prepared which will be approved before the new FDI structure is in place.

The current FDI institutions are relatively small and have limited capacities in terms of staff and resources. Therefore, the proposed institutional reforms offer the prospect of creating a more efficient FDI institutional environment, if implemented effectively and combined with a degree of institution building support.

As is typically the case in the other WB countries, there is a focus on FDI and SMEs, but not necessarily on EU SMEs in the manufacturing sector. Very little investment has been attracted into the country in this sector and it is quite possible, given the size of the domestic market, that SME FDI could have an important role to play in the future development of the country.

[37]See more at: http://www.bizniszona.me/en/the-public-announcement-for-participation-of-the-allocation-of-funds-for-stimulating-direct-investments-was-published-2/#sthash.Ub15pfox.dpuf

In terms of data, the Central Bank of Montenegro might consider adjusting its methodology of balance of payments and improve system of national accounts for recording FDI flow and stocks per sector and sub-sectoral and ensured the compatibility of time series data with international methodologies.

3.7 Serbia

3.7.1 FDI Trends

Starting with the privatisation process during 2001 - 2005, FDI inflow in Serbia reached a level of around 3,1 billion EUR. The largest portion of the FDI was invested in the privatisation of companies with a profitable range of activities (e.g. cement plants, tobacco industry, breweries, some food processing and metal processing industrial groups) and the acquisitions of commercial banks.

In the period 2006 - 2008 the FDI inflow amounted to about 6,3 million EUR, but no substantial greenfield investments were forthcoming, nor were there significant investments in the interchangeable goods sectors. The greatest volume of FDI during this period was realised in 2006 (3,3 billion EUR) when the largest transaction in the history of direct investments in Serbia (in excess of 1,5 billion EUR) totalling 14,6% of GDP and it was realised through the sale of mobile operator Mobtel to Norwegian giant Telenor.

During the financial crisis of 2009-2011 FDI inflow reached a total of around 4,4 billion EUR. In other words, FDI inflows decreased by about 50%, though investments in the manufacturing sector actually increased, especially in the domain of Basic metals, fabricated metal products, machinery & equipment and transport equipment. During this period the largest single deal was in 2011 through the sale of Serbia's biggest retail chain Delta-Maxi, to the Belgian chain Deleuze for 933 million EUR. By far the greatest volume of FDI during the 2004-2011 period (official FDI data by sector unavailable for previous years) was invested in the service sector (about 42% of total FDI volume). About 90% of FDI was related to the purchase of the assets of private, state- and socially-owned enterprises and commercial banks in the process of tender and auction privatisation. Greenfield investment remained very low and was mostly generated through retail and real estate investments.

The financial account saw a reversal of the FDI trend in early 2012 and net FDI amounted to only 242 million EUR. The government repurchased the remaining 20% of shares of "Telekom Srbija" from Greek "OTE", and capital of the mobile operator "Telenor" was partially withdrawn. As a result, net FDI amounted to only 231,9 million EUR. Some recovery started in 2013 with a net FDI inflow of 769 million EUR at the end of year and 1.236 million EUR of net FDI inflow in 2014.

Table 39. FDI indicators for Serbia (2005-2014)

Indicator/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014*
FDI inflow, EUR million	1268	3392	2513	2018	1410	1003	1949	284	779	1500
FDI net, EUR million	1250	3323	1821	1824	1372	860	1827	242	769	1236
Inward FDI stock, EUR million	4116	7508	10021	13892	14487	16689	19070	19716	21223	22900
FDI inflow per capita in EUR	170	458	340	274	193	138	269	39	108	209
Inward FDI stock per capita in EUR	554	1015	1360	1894	1983	2294	2656	2745	2956	3197
FDI inflow as a percentage of GDP	6,2	14,6	8,8	6,2	4,9	3,6	6,2	1	2,4	6,8
Inward FDI stock as a percentage of GDP	20,3	32,2	35,2	42,5	50	59,6	60,6	66,6	66,3	68,7

Source: WiiW database; * National Bank of Serbia.

During 2008-2011, the volume and share of FDI in manufacturing industry was on average significantly higher than in other previous comparable periods. During the course of 2012, 25,3% of net FDI was invested in retail and wholesale trade, 24,2% in manufacturing and 13,6% in the financial sector. Net FDI inflow amounted to 769 million EUR in 2013 and a good deal of the foreign capital was invested in manufacturing industry (24,0%), notably production of beverages (6,0%), trade (22,1%), finance (17,1%) and construction (11,4%).

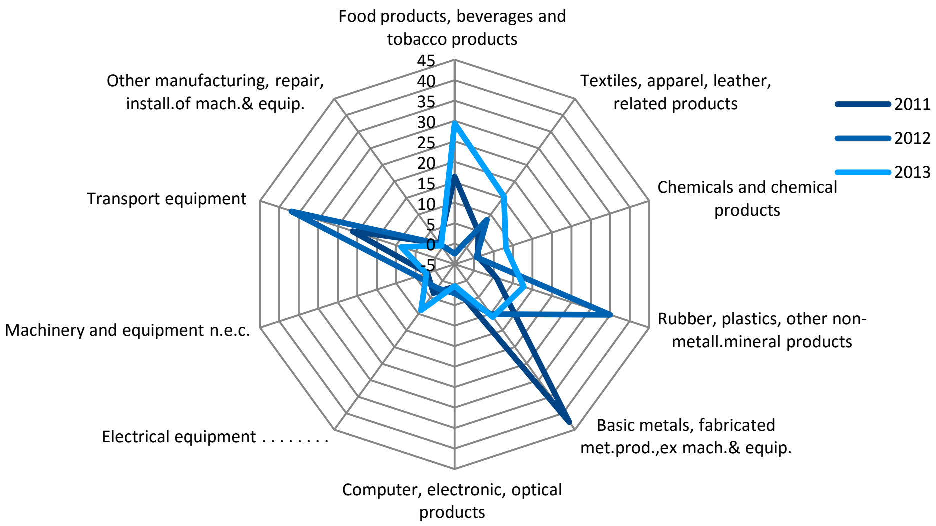
Table 40. FDI inflow in Serbia in period 2011-2013 per sectors/sub-sectors

Sector/sub-sector	in million EU			% of total		
	2011	**2012**	**2013**	**2011**	**2012**	**2013**
Agriculture, forestry and fishing	9,8	3,9	57,5	0,5	1,4	7,4
Mining and quarrying	56,8	19,1	7,9	2,9	6,7	1,0
Manufacturing	441,1	177,1	186,7	22,6	62,3	24
Electricity, gas, steam, air conditioning supply	12,9	9,2	10,3	0,7	3,2	1,3
Water supply, sewerage, waste manag, remediation	10,8	0,9	3,5	0,6	0,3	0,5
Construction	93,4	96,7	88,8	4,8	34	11,4
Wholesale, retail trade, repair of motor vehicles etc.	883,3	243,5	171,7	45,3	85,7	22
Transportation and storage	33,7	13,5	66,4	1,7	4,8	8,5
Accommodation and food service activities	14,9	-5,5	-6,7	0,8	-2,0	-0,9
Information and communication	76,1	-534,6	-15	3,9	-188,2	-1,9
Financial and insurance activities	406,2	130,8	133,2	20,8	46	17,1
Real estate activities	144,4	51,1	56,8	7,4	18	7,3
Professional, scientific and technical activities	29,9	65,8	1,6	1,5	23,2	0,2
Administrative and support service activities	19,2	2,6	2	1,0	0,9	0,3
Education	0,6	0,5	1,2	0	0,2	0,1
Human health and social work activities	0	0	2,5	0	0	0,3
Arts, entertainment and recreation	0,4	0,4	0,6	0	0,1	0,1
Other service activities	1,1	0,4	0,7	0,1	0,1	0,1
Other not elsewhere classified activities	1,2	8,9	8,9	0,1	3,1	1,1
Outflow from withdrawing non-resident investment	-286,9			-14,7		
Total by activities	**1948,9**	**284,1**	**778,6**	**100**	**100**	**100**

Source: WiiW database.

The most popular area for investments within the manufacturing industry was the production of *Food products, beverages and tobacco products* with 29,4% flowing into manufacturing in 2013, *Basic and fabricated metal products* that reached 42,6% inflow into manufacturing in 2011, *Rubber, plastics, other non-metallic mineral products* whose share accounted for 12,8% in 2013 and *Transport equipment* whose share was 8,7% in the same year.

Chart 21. FDI inflow in manufacturing in 2011-2013 in % of total manufacturing



During the observation period, The Netherlands was the leading investor; it accounted for 26% of net FDI in 2014. In the first half of 2009, Russia ranked first owing to its investment in oil industry (419 million EUR), but until the end of 2014 Austria was the best ranked country with 16,8% in total FDI inward stock.

At the end of 2014 net FDI was insignificantly lower than in 2013, down to 1,2 billion EUR. However, the structure of FDI was favourable: investment in equity capital rose by 321,5 million EUR to 951,2 million EUR, while reinvested earnings and intercompany borrowing were down by 74,6 million EUR and 308,7 million EUR, respectively. During 2014, the sector with highest FDI inflow was manufacturing with 535 million EUR, followed by sector of Financial and insurance activities with 358 million EUR.

Table 41. FDI inflow during 2014 by activity

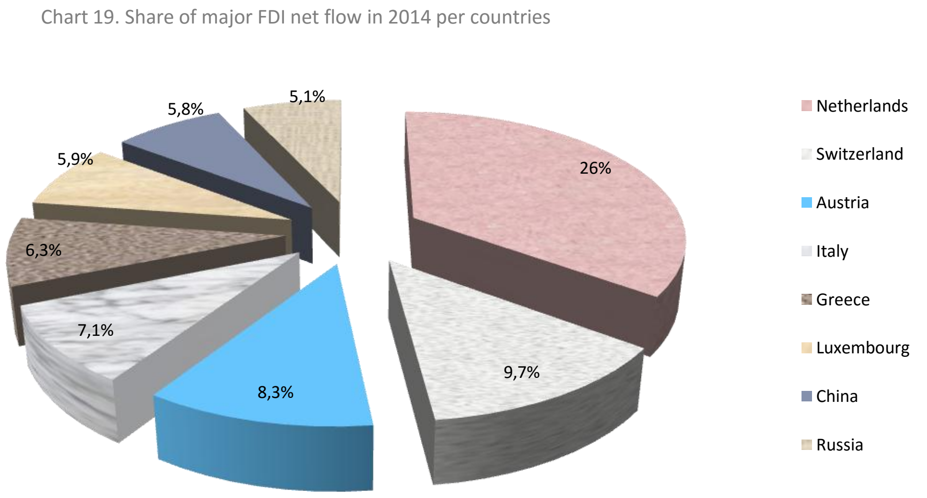
(in million EUR)

	Activity	2014
A.	**AGRICULTURE, FORESTRY AND FISHING**	**-0,330**
B.	**MINING AND QUARRYING**	**26,030**
C.	**MANUFACTURING**	**535,204**
	Food products, beverages and tobacco products	108,522
	Textiles and wearing apparel	67,468
	Wood, paper, printing and reproduction	15,110
	Coke and refined petroleum products	-0,107
	Chemicals and chemical products	46,301
	Basic pharmaceutical products and pharmaceutical preparations	28,246
	Rubber and plastic products	172,561
	Basic metals and fabricated metal products	2,948
	Computer, electronic and optical products	2,091
	Machinery and equipment n.e.c.	9,623
	Motor vehicles, trailers and semi-trailers	37,782
	Other transport equipment	-1,563
	Air and spacecraft and related machinery	0,037
	TOTAL of other manufacturing	46,185
D.	**Electricity, gas, steam and air conditioning supply**	**9,899**
E.	**Water supply; sewerage, waste management and remediation activities**	**17,684**
F.	**Construction**	**162,662**
G.	**Wholesale and retail trade; repair of motor vehicles and motorcycles**	**224,769**
H.	**Transportation and storage**	**-9,422**
I.	**Accommodation and food service activities**	**-1,889**
J.	**Information and communication**	**46,814**
K.	**Financial and insurance activities**	**357,957**
L.	**Real estate activities**	**24,723**
M.	**Professional, scientific and technical activities**	**83,597**
N.	**Administrative and support service activities**	**-9,645**
P.	**Education**	**1,388**
Q.	**Human health and social work activities**	**0,081**
R.	**Arts, entertainment and recreation**	**-14,925**
S.	**Other service activities**	**1,435**
Not allocated		**44,418**
TOTAL FDI INFLOW		**1.500,450**

Source: National Bank of Serbia

NOTE: Branches of activity are in line with NACE Rev. 2. and table is in accordance with data available until March, 20th 2015, and are subject to correction in line with the change in official data sources.

Chart 22. Share of major FDI net flow in 2014 per countries



The main points arising from the above illustrations are as follows:

- The level and dynamics of FDI in the 2005 - 2014 proved to be volatile because of both internal and external factors. The key internal factors included perceived instability, underdeveloped institutions, as well as varying political priorities in terms of structural reform and European integration. The key external factors affecting FDI were a relative abundance of capital until late 2007, when the financial crisis struck, followed by the withdrawal of FDI, especially portfolio investors, from 2008 onwards;

- Total net FDI in Serbia during the entire 2005-2014 period amounted to about 15 billion EUR. By far the greatest volume of FDI flowed into the service sector or about 42% of total FDI. About 90% of FDI flowed into assets of private, state- and socially-owned enterprises and banks in the process of privatisation, while greenfield investments remained very low;
- Within the manufacturing sector, the sub-sectors with largest share of FDI inflow in 2011 were "Base metals, fabricated metallic products and machinery and equipment" (42,6%). The FDI inflow in this sub-sector decreased significantly the following year in which sub-sector of "Transport equipment" recorded the highest share in all manufacturing FDI inflow (36,9%) and in 2013 it was sub-sector "Food products, beverages and tobacco "with a share of 29,4% in total manufacturing FDI inflow. During 2014, the sub-sector "Rubber and plastic products" had a share of 32,2% in total manufacturing FDI inflow;
- The FDI structure in terms of the countries of origin remained fairly stable. Investors from the EU accounted for 78% in total inward FDI stock in Serbia. At the end of 2013 in terms of the total inward FDI stock, Austria had a share of 16,8% followed by Netherlands with 10,4%, while in 2014 Netherlands contributed the most with 26% of the total FDI inflow.

According to the "Doing Business 2015" ranking list for the 2014 the Republic of Serbia was ranked in 68th position, behind fYRoM and Montenegro. During 2015, based on "Doing Business 2016", Serbia improved its ranking position by 9 places (59th place), but remained in third position in the WB region.

The Serbian White Paper (Foreign Investors Council of Serbia) provides the following recommendations to improve the investment climate in that economy:
- Accelerating the pace of reforms with the dual goal of improving business conditions and bringing Serbia closer to the European Union;
- Reducing and simplifying bureaucratic procedures at both the national and local level;
- Creating conditions for market competition in a well-regulated market by providing equal rights to all competitors, as well as a proper regulation of monopolies;
- Intensifying the fight against corruption, since this is seen as one of the most problematic factors for doing business in Serbia.[38]

3.7.2 FDI Policies and extent of SME focus

The transition model of economic growth in Serbia was largely based on attracting foreign direct investments through privatisation in order to modernise and recover economy by acquiring new knowledge, technologies and new techniques of management and sales. FDI has been and continues to be one of the top policy priorities for all Serbian Governments since 2001. Although no specific FDI strategy or export has ever been designed and adopted, a number of other different policies, strategies, actions plans include the FDI theme within their scope. The most important ones are set out below.

Law on Investment

In 2015, the Law on Investment was passed and it now provides the framework for attraction of FDI. The Law ("Official Gazette of the Republic of Serbia", no. 89/2015) defines the general legal framework for investments. The Law aims to improve investment environment, promote direct investment in order to foster economic development and employment growth, establish equal treatment of domestic and foreign investors, increase efficiency of the services provided by public sector in order to stimulate investments and create more attractive business environment for all investors. The Law does not recognise priority sectors for investments.

It is important to note that the Law differentiates between the investments of particular interest for Serbia as a whole and the ones of local character. It also provides the general criteria to determine the category of an investment and sets out the obligation to define the criteria in detail. This division is of importance since it enables the Government to grant state aid for investments of particular interest for the country without resort to a public call / tender. As mentioned above, the Law eliminates the difference between foreign and domestic investors and instead of term FDI, makes reference only to direct investments. One of the biggest challenges connected with the Law is the merger of the former Serbian Investment and Export Promotion Agency (SIEPA) with the former National Agency for Regional Development (NARD), resulting in the Serbian Development Agency (RAS) in January 2016. In this context, it is also worth noting that, unlike the practice in EU countries, especially those with a

[38] OECD Investment Compact For South East Europe For The Western Balkans Working Group On Investment Policy And Promotion, *A Review of Investment Policy and Promotion in the Western Balkans,* 2013.

strong investment promotion agency, contracts about incentives for investors are not signed with the regional Development Agency(RAS) but with the Ministry of Economy, based on the Decree on investment incentives (Official Gazette 28/2015).

Strategy and Policy for Development of Industry in the Republic of Serbia (2011-2020)

This strategic document defines the main industrial development priorities in Serbia in a comprehensive manner. The Strategy stresses that export and investment in manufacturing industry are of crucial importance for growth, and that SMEs are the main driver of industrial growth and employment. Consequently, it aims to support investment growth, increase of investment and employment growth in industry. It has an Action plan for implementation of the strategy, with 13 thematic areas: investments support; reform of education; technological development; innovation; SME development; employment; competition; privatisation and restructuring; corporative governance in public enterprises; ICT; regional development; energy efficiency and environment.

Although this Strategy and Action Plan present a comprehensive agenda for industrial development, in reality they have never been implemented. The Ministry of Economy is in the process of preparing a revision or a new industrial strategy during 2016. Also in preparation are the Sector Policy Development Strategies in order to identify major opportunities in four manufacturing sectors, namely: food processing, wood and furniture, rubber and plastics, and machinery and equipment. The Ministry of Economy is also developing a sector strategy for the domestic and international market, including an Action Plan outlining specific activities for the sector. The whole process is supported by the World Bank.

Fiscal Strategy for 2016 with the projections with 2017 and 2018

The Fiscal Strategy identifies the promotion of FDI as a priority. The Strategy stresses several activities to be implemented to reform the investment promotion system and enhance export such as prioritisation of industry sectors with the greatest growth and development potential, reform of agencies in charge of implementation of programmes for support to investment and export and development of monitoring and evaluations system. However, it does not define any specific measures and activities.

Strategy for Support to Development of SMEs and Competitiveness 2015 – 2020

A new Strategy for SME Development was adopted in March 2015, together with a two-year implementation plan. The vision is the development of entrepreneurship and competitiveness based on entrepreneurial initiative, knowledge and innovation, with the aim of strengthening SMEs and entrepreneurship to prepare them for competition within the Single market, thus contributing to higher living standards in Serbia. The SME Strategy consists of VI pillars:

- Improved Business Environment;
- Improved Access to Finance;
- Continuous Development of Human Resources;
- Strengthened Sustainability and Competitiveness of SMEs;
- Improved Access to New Markets;
- Development and Promotion of Entrepreneurial Spirit and Encouragement of women entrepreneurship, youth entrepreneurship and social entrepreneurship.

SME policy in Serbia is horizontal in nature and aims to support all SMEs and to create conditions for development of entrepreneurship in general; it does not focus on particular industrial sectors.

A system for monitoring and evaluating the Strategy and Action Plan exists, together with a detailed set of indicators for assessing its achievements. To monitor implementation and support the development of SME policy, a Council for SMEs and Competitiveness was also established.

The SME Strategy is focused on strengthening small business´ competitiveness. Although special measures for attraction of FDI in SMEs are not envisaged, the “Strengthened Sustainability and Competitiveness of SMEs” pillar aims to support development of value chains.

If properly funded and implemented, the Strategy has the capacity improve the competitiveness of the Serbian small business sector and create the conditions to attract FDI, especially through the pillars focusing on “Improved Business Environment", "Strengthened Sustainability and Competitiveness of SMEs“ and “Improved Access to Finance“.

In this context, it is worth noting that the Serbian government has nominated 2016 as the "Entrepreneurship Year" and through various support programmes has provided more than 130 million EUR for this purpose, including over 30 million EUR worth of grants.

Overall, none of the Serbian strategies focus specifically on the main theme of this report, namely SME manufacturing FDI.

3.7.3 FDI Institutions and extent of SME focus

The new Law on Investment prescribes a new institutional framework for the promotion of investments. The key institutions are described below.

- *Economic Development Council:* the aim of the Council is to monitor investments and economic development, promote economic development, approve the award of investments incentives and perform related tasks based on the Law on investment. Its president and members are appointed by the Government;
- *Ministry of Economy:* is in charge of promotion of economic development; create measures to support investment; oversee the privatisation and restructuring of state and socially owned companies; oversee SME policy; monitoring of the work of the Serbian Development Agency (RAS), etc. The Ministry prepares the annual investment incentives which is then approved by the Government, as well as signing the contracts for incentives to be provided to investors;
- *Cabinet of the Prime Minister*: the Delivery Unit for Investments was established in the PM's Cabinet to attract more investments into the country. The PM and his Cabinet are directly involved in negotiations with strategic investors, especially those connected with the privatisation process and/or restructuring of state- and socially-owned enterprises;
- *Serbian Development Agency (RAS):* was established by the Law on Investments and created by merging SIEPA and NARD. RAS was established on 01 January 2016 with the remit to support investment promotion, export promotion, development and improvement of all business entities, as well as to promote regional development. With the establishment of RAS, support to businesses is under the competence of one institution so that overlaps can be avoided. That said, RAS has a very demanding remit and there is a major institution building process ahead before it becomes fully operational. Within the area of FDI, the capacities are such that, for example, an aftercare service is not yet well developed. Discussions indicate that a focus on the manufacturing potential of the country will be a priority for to FDI. RAS is currently in receipt of World Bank assistance in order to determine its future FDI and export policy. RAS is in a transition phase and employs 55 people with a budget of under 60 million EUR, including FDI incentives (the final budget for 2016 was to be defined after establishment of the new government). During 2015, the annual employment incentives amounted to approximately 60 million EUR;
- *Units for local economic development and investments promotion in local self-governments*: these are expected to provide support to investors, including provision of incentives from local budgets. They are also expected keep records on investments of importance and reports regularly to RAS. Discussions with MoE and RAS indicate that it will take time and support for this remit to be implemented effectively;
- *Foreign Investors' Council (FIC):* it was established in 2001 by the foreign investors operating in Serbia and its members are mainly large firms, though it also includes a few medium-sized companies. The main goal of FIC is to engage in dialogue with the government and to highlight recommendations fort the improvement of the business environment via its annual White book;
- *Free Zones*: based on Law on Free Zones (2006), these are managed by Free Zones Administration under responsibility of the Ministry of finance. There are currently 11 free zones in operation and they are accessible to both domestic and foreign investors[39];
- *Enterprise Europe Network (EEN):*has been operating in Serbia since 2009 and is now hosted by Chamber of Commerce of Serbia. The EEN activities are currently not connected with FDI issues.

Cluster development has been actively supported by the Ministry of Economy since 2005. The Ministry estimates that there are currently about 110 registered clusters, 50 of which are active. A Programme of Innovative Cluster Development is being implemented by RAS, which supported about 20 clusters with 1,5 million EUR during 2015. There is currently no link between this programme and FDI

[39] More about free zones is presented in 3.7.5 point.

attraction. Supply / value chains are not systematically analysed and supported at the present point in time.

3.7.4 Manufacturing sectors and subsectors supported

Serbia lacks a coherent and consistent sectoral focus to its economic development activities. The documents that explicitly mention priority sectors are the Action Plan for Implementation of Strategy and Policy for Development of Industry 2015 – 2020. RAS (and formerly SIEPA) also emphasises certain sectors in terms of investment and export promotion. Aside from the tourism sector and, to a certain extent the ICT sector, specific support measures have not been created:

- Action Plan for Implementation of Strategy and Policy for Development of Industry 2011 – 2020 Food processing; Transportation; ICT; Metal Industry, including automotive components; and Pharmaceuticals;
- Priority Sectors for RAS - investments: Aerospace and Defence; Automotive industry; ICT/Shared Services; Agriculture, Food and Beverages; Textiles; Forest based Industry; and Metalwork and Machine Building Industry;
- Priority sectors for RAS - export: Automotive Industry; Electrical Appliances; Agribusiness and Food Processing; Textiles and Clothing; and Metal Industry, including automotive components;
- Sectors presented by the Republic of Serbia at the bilateral screening: Food Processing; Automotive Industry and Transport; ICT; Metal Industry; Construction; Tourism; Defence; and Chemicals and Pharmaceuticals.

In addition to a lack of sector specific support measures and instruments, prioritisation of sectors for FDI/investment in SMEs is not evident. On the other hand, discussions with MoE indicate an intention, following the preparation of the new FDI, export and industrial strategies, to develop a more coherent sectorial approach in the future, including a stronger orientation towards manufacturing.

3.7.5 FDI instruments with focus on SMEs and manufacturing

The Law on Investment lists the incentives prescribed by the regulations on state aid, tax incentives, mitigations and exemptions from duties and fees payment, customs incentives and social security system. The criteria, conditions and records on incentives granted are elaborated by the Government. It is important to note the Government is now requiring the alignment of the award of incentives with the state aid regulations.

Apart from the tourism and ICT sectors, there are no specific instruments to support the manufacturing industry and other priority sectors, since they are horizontal in nature. Neither is there a specific focus on SME manufacturing FDI/investments. Indeed, the current focus is geared towards MNCs, especially in relation to companies under privatisation or restructuring.

Based on the Decree on Investment Incentives, the Ministry of Economy and RAS implement the Programme of State Grants to investment projects in the manufacturing and the services sectors subject to international trade.[40] The amount of funds that can be awarded to large enterprises is capped at 50% of the eligible costs for the implementation of the investment project. The amount of funds may be increased by up to 20 percentage points for small companies and up to 10 percentage points for medium-sized companies. For eligible costs above 50 million EUR, the amount may not exceed 25% of the total value of the eligible costs. For eligible costs greater than 100 million EUR, the percentage may not be greater than 17% of the eligible costs.

Investment project for which funds can be allocated:

- Creates at least 20 jobs and a minimum of 150,000 EUR of the eligible costs of investment in IV group local authorities (development and devastated areas);
- Creates at least 30 jobs and a minimum of 300,000 EUR of the eligible costs of investment in III group local authorities (development);
- Create at least 40 jobs and a minimum of 600,000 EUR eligible costs of investment in II group local authorities (development);

[40]Except for investments in: primary agricultural production, fishery and aquaculture, transportation, hospitality, lotteries, trade, the production of synthetic fibres, coal and steel, tobacco and tobacco products, weapons and ammunition, ship building (construction of naval vessels - at least 100 gross registered tons - at least 100 gross registered tons), airports, energy industry, broadband networks, and companies in difficulties which are not eligible to receive funding.

- Create at least 50 jobs and a minimum of 600,000 EUR eligible costs of investment in I group local authorities(development);
- Investment projects in the services sector, which is subject to international trade and in which the minimum value of investment is 150,000 EUR, providing at least 15 new jobs.

A number of other regulations concern the types of incentives that can be allocated, regarding creation for new jobs, investment in fixed assets or for labour-intensive projects. The selection of eligible projects is the responsibility of RAS, but the final approval is made by a Committee established by the Ministry of Economy (Ministry of Economy, Ministry of Finance, Ministry of trade, Ministry for infrastructure and Ministry of employment). The Commission for the Control of State Aid announces its decisions online. Decisions include the name of the investor, size of the investment, 24-month salaries and amount of the approved incentives. The system has moved from annual calls for applications to a case-by-case approach under which domestic and foreign enterprises may apply for incentives. However, it is not clear the extent these incentives are supporting initiatives that would otherwise not have occurred without public sector intervention. The initiative is reportedly not being used to only stimulate new investments and out of the 150 domestic firms that have accessed such incentives, some 80% have not actually delivered the number of new jobs which they were committed to generate. This suggests a need for review and reform to secure value for money and additionality.

There are 14 active free zones in Pirot, Subotica, Zrenjanin, Novi Sad, Kragujevac, Aback, Užice, Smederevo, Kruševac, Svilajnac, Apatin, Vranje, Priboj and Belgrade. The business operation within the free zones is equal for both domestic and foreign companies. The Law provided following benefits:

- Fiscal benefits for FDI: exemption from tax burdens such as, VAT and local taxes;
- Custom duties: exemption from import of goods, equipment and raw material used in exporting production and construction material for construction of infrastructure;
- Financial benefits: free cash flow of capital and profit;
- Efficient administration: through one-stop-shops;
- Simple and fast customs procedures: Customs Administration Office in each zone;
- Local subsidies for using free zone infrastructure

In addition, potential investors can be incentivised by other forms of support, such as:

- Exemption from Corporate Income Tax for a period of 10 years, starting from the first year in which they report taxable profit if they invest an amount exceeding 9 million EUR in fixed assets, and employ at least 100 additional employees throughout the investment period;
- Tax relief and contributions paid on net salaries from the moment of employment until the end of 2017 (1-9 new jobs: 65% reduction; 10-99 new jobs: 70% reduction; 100+ new jobs: 75% reduction);
- Customs free imports of raw materials and semi-finished goods;
- Customs free imports of machinery and equipment;
- A wide array of incentives is also available at the local level such as land lease fee exemptions or deductions / exemptions for displaying the company's name, etc.

3.7.6 Conclusions

Serbia is strongly oriented towards the attraction of FDI. However, the institutional framework was recently recreated by the Law on Investment, but the key player (RAS) was only created in 2016 and will need to go through a process of institution building before it can perform its demanding remit, which is extremely challenging. Aftercare services are of importance and will need to be developed.

It is not only central level institutions that have responsibility to promote investment. Local government also has a major role to play in attracting FDI, however, there is recognition that it will take time and effort for them to grow into this role and responsibility over time. Support is also needed at this level.

There is no shortage of strategies in the country. That said, the industrial strategy is redundant and there is neither an FDI nor an export strategy at present, though the Ministry of Economy indicates that all three will be created during the course of 2016. In terms of what currently exists, there is not a consistent and structured sectorial approach, with the consequence that although the manufacturing sector is of importance in general, so are other sectors and sub-sectors. This is a common story in the WB region.

A significant amount of the annual budget is allocated to support domestic and foreign investors, in the form of state grants, subsidies, tax exemptions to incentives, etc. also from local self-government budgets. Based on the information available, some 50 million EUR was allocated to employment incentives in 2015, but there would appear to be a need to evaluate and fine-tune the procedures and criteria to secure additionality. Furthermore, both central and local government must now ensure that all incentives are granted in line with the state aid regulations.

All instruments for support to investors in manufacturing industry are horizontal in nature. The attraction of SME FDI in general and in manufacturing specifically is not considered in policy terms, though there are indications that RAS intends to prioritise manufacturing FDI in the future. The focus of FDI policy is primarily on the attraction of investments into state- and socially-owned companies in relation to the privatisation and restructuring process by Multinational Corporations.

Regarding FDI statistics, the country could improve its statistical presentation and adjust its methodology to pay more attention to FDI stocks and its classification per sub-sector, instead of concentrating exclusively on FDI inflow.

3.8 Overall Conclusions

Key Conclusions

All six countries of the WB covered by this study are putting significant policy efforts into attracting FDI to their economies.

Each country has its own approach in respect to FDI policies, strategies, institutions, sectors, subsidies, etc. This reflects the varying degrees of political priority attached to FDI, as well as the specificities of each country.

With the possible exception of fYRoM, there is little evidence that the various NIPAs are focusing specifically on the key themes of this report, namely:

- SMEs;
- Manufacturing sector;
- EU SMEs in the manufacturing sector.

To the extent that the NIPAs are proactively pursuing FDI, the FDI effort is concentrated on Multinational Corporations (MNCs).

There is evidence of a sectorial approach to economic development, however, this appears to be neither based on detailed analyses of the potential of the countries in question nor systematically parsed and prioritised into focused efforts to target particular sectors and sub-sectors for FDI purposes.

There are indications that the WB countries are beginning to recognise the importance of the above themes, including the potential value of a resurgence of industrial policy. However, it is not clear whether this is driven by accession imperatives as opposed to internal policy prioritisation by the respective counties. The research team tends towards the possibility that EU policy is the more likely driver.

Each country is ploughing its own FDI furrow, given their resource base, capacity and changing policy priorities over time.

A common regional approach to FDI matters is not actively being considered presently, though all NIPAs acknowledge the potential benefits (as well as challenges) of such an approach.

FDI Priorities

For FDI to be attracted, it is necessary to develop a policy framework that prioritises it. The Table below summarises some of the key issues though inevitably, there is some degree of simplification involved in preparing such tables.

Table 42. Priorities overview

Prioritisation	ALB	B&H	KOS	MAC	MNE	SER
FDI	Yes	Yes	Yes	Yes	Yes	Yes
EU FDI	No	No	No	No	No	No
Multinational Corporations	Yes	Yes	Yes	Yes	Yes	Yes
SMEs	No	No	No	Yes	No	No
Industry/Manufacturing	Yes	No	Yes	Yes	Yes	No

The Table illustrates the following points:

- All six countries are prioritising FDI and MNCs;
- None of the six countries are explicitly prioritising the attraction of EU FDI;
- None of the six countries are explicitly prioritising SMEs (fYRoM has established an SME FDI Unit but it has not yet converted interest into investment deals);
- There are indications that industry and manufacturing particularly are starting to be recognised as a priority for economic development and, to a lesser extent, for FDI.

FDI Regulations

In order to attract FDI it is necessary for countries to establish a legal environment which reflects the key priorities defined by the strategic policies that have a major influence on attracting FDI, as well as their effects on the overall economic development.

Table 43. Regulation and policy overview

	ALB	B&H	KOS	MAC	MNE	SER
Legal Framework						
Law on investment	Yes	Yes	Preparation	No	Yes	Yes
Law on foreign investment	Yes	Yes	Yes	No	No	No
Law on zones/free trade, business	No	No	Yes	Yes	Yes	Yes
Policy framework						
Umbrella policy/strategy	Yes	No	Yes	Yes	Yes	No
FDI	Yes	No	Yes	No	No	No
Competitiveness	No	Yes	No	Yes	No	No
Industry	No	No	No	No	Preparation	No
Manufacturing	Yes	No	Yes	No	Yes	Preparation
SME	No	Entity Level	Yes	No	No	Yes
Export	No	No	No	No	No	No

The Table illustrates the following points:

- In most economies, except fYRoM, the legal environment for investment is based on some form of Investment Law. The legal environment for the establishment of free / economic zones is directly connected to FDI attraction;
- Several economies (Albania, fYRoM, Kosovo and Montenegro) approved strategic national umbrella documents and each of them recognise the importance of direct investment and has defined a direction for FDI policy creation. Usually, focus is on business environment improvement and FDI instruments creation in line with foreign investors´ needs;
- Most of the economies lack a modern enterprise policy (combining SME development, competitiveness and innovation with industrial policy) designed to ensure an increase in competitiveness at the enterprise level with a focus on manufacturing growth sectors, especially focusing on export-oriented SMEs.

The current situation in the WB region indicates a tendency to attract FDI based on specific instruments set out in legislation, but these may not be directly related to the priorities set out in the FDI and other complementary policies.

FDI Institutions

The critical importance of the institutional infrastructure for FDI is widely recognised. The table below illustrates the points that is varies a good deal from country to country in the WB.

Table 44. Institutional infrastructure

Institutional infrastructure	ALB	B&H	KOS	MAC	MNE	SER
Prime minister/Minister level bodies	Yes	No	No	Yes	No	Yes
NIPA	Yes	Yes	Yes	Yes	Yes	Yes
Aftercare service	Yes	Yes	No	Yes	No	No
Zones/free trade, business	Yes	Yes	Yes	Yes	Yes	Yes

Institutional infrastructure	ALB	B&H	KOS	MAC	MNE	SER
Clusters/value chains	No	Entity	No	Yes	Preparation	Yes
FIC	Yes	Yes	Yes	Yes	Yes	Yes

The Table illustrates the following points:

- All six NIPAs report to a higher level Ministry/Prime Minister´s Office, which is responsible for policy and legislation;
- All six countries have established an NIPA;
- FDI aftercare services have been established in a subset of NIPAs;
- All six countries are planning strong emphasis on zones of various sorts, but the degree to which they are integrated into the FDI process varies;
- Clusters and value chains are being developed but the degree to which they are integrated into the FDI process is low;
- Foreign Investors' Councils exist in all six countries, though the quality of PPD varies;

FDI Incentives

Different types of FDI support instruments are available in the six WB countries, as illustrated below.

Table 45. FDI incentives overview

FDI incentives/support	ALB	B&H	KOS	MAC	MNE	SER
Financial support	No	No	No	Yes	Yes	Yes
Tax relief	Yes	Yes	Yes	Yes	Yes	Yes
Custom relief	Yes	Yes	Yes	Yes	Yes	Yes
Assisted/special procedure	Yes	No	No	Yes	No	No
Impact analysis	No	No	No	No	No	No

The Table illustrates the following points:

- Financial support has a direct effect on the state budget, with the consequence that only half of the WB economies are currently offering such support. This varies significantly between the three economies and over time, but are relatively hard to pin-down with accuracy;
- All six economies offer some form of tax credit/relief, partly because it is a deferred cost to the budget though there is still a real cost to the countries;
- All six economies offer some form of customs relief, but this is hard to quantify;
- All six economies neither undertake systematic assessments of the FDI incentives awarded nor appear to evaluate the impact of such subsidies in terms of costs and benefits (e.g. employment, tax revenue, etc.), as well as additionality and deadweight effect. Consequently, they are unable to justify either the FDI policy focus or the cost (direct and indirect) of the financial / tax and customs incentives involved.

4 CASE STUDIES: SME MANUFACTURING FDI

4.1 Introduction

Chapter 2 mapped the FDI and manufacturing situation in the WB region. One of the conclusions was that there was relatively little FDI flowing into the manufacturing sector and that a process of deindustrialisation has been occurring in the region. Chapter 3 presented the overall trends, policies and institutions responsible for FDI. One of the key conclusions was that the policies/strategies and institutions have rarely implemented a strong and well-funded industrial/manufacturing policy and, to the extent that FDI has targeted the manufacturing sector neither the EU in general nor EU SMEs have been accorded policy priority in their FDI-related activities. MNCs have been the almost exclusive target for FDI activity.

One of the novel aspects of this report is that it includes a focus on EU SMEs that have invested in the Western Balkans (WB) region in the past. It is instructive, from a policy-making perspective, to examine the experience of EU SMEs that have invested in the WB region. This is precisely what this Chapter aims to do in the form of three EU SME case studies from Belgium, Germany and Slovenia that have invested respectively in Serbia, B&H and fYRoM.

It should be stressed that the focus is on presenting three case studies, rather than three examples of "good" or "best" practice. The emphasis is on exploring their pre- and post-investment experiences and to use this information as the basis, together with the material from the preceding two Chapters, to present conclusions and recommendations in the final Chapter (5).

4.2 Methodology

A case study is a flexible information collection method and allows a combination of qualitative and quantitative information. This makes it well-suited for business research with complex interactions. As a research strategy, it is an attempt to examine contemporary phenomena in a real life context. Case studies can be further categorised as exploratory, descriptive or explanatory to create a profile of situations and events that describe the different characteristics, for example of FDI investment decisions, and explain how they came about and what was achieved. The case study approach's particular strength is its ability to handle complex situations, illustrate different perspectives and provide insights into how processes develop over time.

This Chapter focuses on the case study evidence based on three EU SMEs and their experiences. The analyses of the data (Chapter 2), the country profiles (Chapter 3) as well as the case studies (this Chapter) enables information to be combined and recommendations for FDI policy to be developed (next Chapter) on how to increase the attractiveness of the WB region for investors, especially EU SMEs.

The selection of the potential case studies involved the following steps:

- Nomination of possible case studies: given the absence of databases and other sources of information on EU SME manufacturing FDI in the WB region, the research team contacted all six NIPAs directly in order to obtain nominations of possible case studies. Each NIPA was requested to fill-in a template with information enabling a preliminary assessment to the made of the suitability of nominated case studies. In addition, the research team participated at the meeting of the Regional Cooperation Council (31 March 2016) during which the project was presented and the participants from the WB countries were invited to present nominations of possible case studies;
- Pre-selection: based on the nominations received, the research team prepared a preliminary analysis in order to screen out ineligible nominations and identify a short-list of possible case studies. This resulted in three priority case studies, as well as a reserve list;
- SME Contact: the research team then contacted the top three SMEs on the list in order to double-check eligibility criteria (EU origin, SME status, manufacturing in the three 3 selected sub-sectors), etc., as well as to ascertain further information on a qualitative basis focusing on the following issues:
    - Pre-selected sectors with linkages between the EU and local markets;
    - Investments which exploit EU-WB value chains (to the extent possible);
    - Investments for the production of goods in the WBs to be exported in the EU market;

- Possible spillover effects in terms of technology and know-how transfer/sharing between EU and WB SMEs.

4.2.1 Selection of Manufacturing Sub-sectors

Based on the Kick Off meeting with DG NEAR and the Inception Report, the decision was taken that three case studies to be selected would be in three separate manufacturing SME sub-sectors and in three separate WB countries.

The research team used the following approach to determine the sectors that the three SME case studies could focus on:

- Three sub-sectors with most important FDI stocks;
- Three sub-sectors with most important share in the manufacturing industry;
- Analysing contribution of sub-sectors in total export to EU in the three most important sub-sectors.

The three manufacturing sub-sectors identified as most attractive for FDI inflow from the point of view of their contribution to domestic output, domestic export and its share in inward FDI stocks were:

- Food products, beverages and tobacco: based on the relevance of this sector and its contribution to domestic production in all WB countries;
- Base metals and articles thereof: based on export share and relevance of this sub-sector in EU import from WB economies;
- Machinery and appliances: based on export share and relevance of this sub-sector in EU import from WB economies.

These three manufacturing sub-sectors were discussed with DG NEAR, CEFTA and Regional Competitiveness Council representatives before being agreed.

4.2.2 Longlist

Based on the selected sub-sectors of manufacturing industry, the six NIPAs were invited to propose up to three potential EU SME case studies which matched not just the sub-sectoral focus, but which also met certain pre-defined criteria. The research team also presented the project and invited submission of EU SME case studies at the Investment Committee meeting of the Regional Cooperation Council on 31 March 2016 in Belgrade.

A template was developed to enable the NIPAs/Ministries to provide the necessary information by a predefined deadline. The template is illustrated below.

Nominated SMEs			
Criterion for Selection			
Eligibility			
Is the proposed firm an SME?	Yes/No	Yes/No	Yes/No
Is the proposed SME engaged one of the following manufacturing activities: food products, beverages (excluding tobacco), base metals and articles thereof and machinery and appliances?	Yes/No	Yes/No	Yes/No
Please specify the particular manufacturing sub-sector			
Is the proposed SME from a European Union country?	Yes/No	Yes/No	Yes/No
Contacts			
Name of the proposed EC SME			
Managing Director of the proposed EC SME			
Telephone			
Email			
FDI characteristics			
Size of investment in the country			
Number of Full Time Equivalent jobs created directly by the SME			
Degree of technology transfer / R&D	Low/Medium/High	Low/Medium/High	Low/Medium/High

Degree of engagement with local value chains	Low/Medium/High	Low/Medium/High	Low/Medium/High
Degree of know how / sharing	Low/Medium/High	Low/Medium/High	Low/Medium/High
Degree of overall FDI impact	Low/Medium/High	Low/Medium/High	Low/Medium/High
Any other relevant information / description / data			

For each nominated case study, the research team assessed whether the potential case studies fulfilled the necessary criteria or not. Where they did not comply, the NIPAs/Ministries were given the opportunity to nominate alternatives. This proved to be a more difficult exercise for the NIPAs than originally anticipated. The NIPAs had no problem finding potential MNC case studies, but finding SMEs in the three sub-sectors proved to be somewhat harder. The task of finding EU SMEs was the next challenge. In some cases, the challenge proved to be insurmountable: some NIPAs appeared to have either limited contact or their databases were not capable of locating EU SMEs in the three manufacturing sub-sectors. This in itself is a noteworthy research finding.

4.2.3 Shortlist

Once the full list of potential EU SME case studies was available, the research team sorted and prioritised the eligible nominated SMEs by sub-sector of activity, ensuring that at least three WB countries were involved, as per the agreed process.

Two possible case studies per sub-sector were prioritised, namely the top option and the next one in the list as a reserve.

The SME representatives of the top option for each of the manufacturing sub-sectors were contacted and the information on the template was checked and cross-referenced.

Where the information was correct, the EU SMEs were asked to decide whether they wished to participate in the exercise or not (in some cases, they had not been contacted by the relevant NIPA, prior to being nominated as a potential case study). The SMEs were given the option of contacting their Head Quarters in the EU, in order to ensure that the case studies could proceed.

Once this was clear, the research team provided information on the case study methodology, agreed the appointments and carried out the fieldwork based on face-to-face meetings in the WB countries. All were informed that the results of the analysis would be published (this Chapter).

4.2.4 Selection and fieldwork

Based on previously discussed process, the following the three case studies were chosen for further analysis, visits and interview.

Criterion for Selection	1. Metech	2. Bader	3. Puklavec
Eligibility			
Is the proposed firm an SME according to size?	Yes	Yes	Yes
Is the proposed SME engaged one of the following manufacturing activities: food products, beverages (excluding tobacco), base metals and articles thereof and machinery and appliances?	Yes	Yes	Yes
Please specify the particular manufacturing sub-sector	Sheet metal and light metal construction	Metal processing	Food processing - wine production
Is the proposed SME from a European Union country?	Belgium	Germany	Slovenia
Contacts			
Name of the proposed EC SME	Metech doo, Smederevo, Serbia	Bader d.o.o. Šamac, Bosnia and Herzegovina	Puklavec & Prijatelji doel, Skopje
Contact	Walter Knabe/ Marjana Suleic	Holger Kruger / Tanja Krstanović	Tihomir Petreski
FDI characteristic			
Size of investment in the country	cc 3 mil. EUR	cc 2,3 mil. EUR	cc 1,4 mil. EUR

Criterion for Selection	1. Metech	2. Bader	3. Puklavec
Number of Full Time Equivalent jobs created directly by the SME	100	52	107
Degree of technology transfer / R&D	High	Medium	High
Degree of engagement with local value chains	Low	High	Medium
Degree of know how / sharing	High	High	High
Degree of overall FDI impact	Low	High	Medium
Other relevant information	www.metes.be/about-us	www.bader-metallbau.de	www.puklavecandfriends.com

The fieldwork was carried out during May-June 2016. The research team travelled to each of the six countries to hold discussions with the relevant public sector institutions, business sector representatives, as well as the visiting the three selected SME case studies for detailed discussions with the nominated individuals. The case study analyses were prepared by the team and the draft was sent to each of the three case studies for comment and feedback, prior to finalisation.

The rest of the above process is set out in the following three SME profiles. The research team has sought to present information that is relevant to this research as concisely and consistently as possible. Inevitably, the nature of the enterprises and the information available varies from case study to case study. However, the analysis to follow provides useful policy insights in relation to the central theme of this report, namely what was the motivation for the EU SMEs to invest in the WB region, what was the experience of the investment and what was the impact on the SMEs, in broad terms.

It should be noted that the case study research was not an academic research exercise. Rather, it is a practitioner-oriented research exercise designed to extract policy relevant conclusions. It should, therefore, be read in this light.

4.3 Case study 1: Metech

4.3.1 Introduction

Name: METECH
Country: Serbia
Location: Djure Salaja 17, 11300 Smederevo
Legal form: d.o.o. (LTD)
Identification number: 20014245
Date of Establishment: 21.02.2005
Website: http://www.metes.be/sr
Ownership structure: 100% owned by METES, Belgium
Contact: Walter Knabe
phone: +381 26 240 352
e-mail: walterknabe@metech-srbija.com

Nature of company

METES *(Belgium)* and METECH *(Serbia)* are full-system suppliers for sheet metal and light metal construction projects. The customers identify their needs and METES/METECH develops and delivers the required solution, such as the industrial design. To enhance its quality and capacities, the company continuously invests in the latest machinery and technology with a focus on its knowledge base, products and organisational skills. METES and METECH focuses on four areas:

- The market;
- Technology;
- Organisation;
- Production.

The METES-METECH group has over 100 clients from the Benelux countries, Central and Eastern Europe. METES-METECH´s main goal is to create added-value for its clients by joining forces, thinking together and offering customised solutions to complex issues. Its motto is “Experts in total concept.”

History

METES was created in 1971 when Siemens AG founded a factory in Dilsen-Stokkem (Belgium). The company became known for its high-end products for the medical and telecommunications industry within the Siemens group. In the 1990s it developed known-how in the fields of sheet metal operations, printed circuit boards (PCB), electronics and specialised assembly for customers throughout Western Europe. To strengthen its market position, Siemens become a part of the Alro group in 1999 and the company was re-named “METES".

The cooperation with Alro Group, known for its surface treatments for the automotive and truck industry, created the basis for METES to increase its quality and logistics performance. In 2004, METES took over the company IQSEC NV, which specialises in highly secured transport solutions.

In 2008 METECH become a member of the METES group. METECH is a leading sheet metal company in Eastern Europe and Western Balkans.

Business activities

Products and services:

- Sheet metal;
- Tube technology;
- Surface treatments;
- Engineering and Development;
- Assembly and Testing;
- Logistics solutions.

Markets and capacities

The independent group METES-METECH provides its customers throughout Europe with flexible, high quality and cost-driven solutions. METES tends to focus on Belgium, Holland, France, northern Germany, etc. while METECH focuses on southern Germany, Italy, Hungary, Czech Republic, Romania, etc. As such, it covers much of Central and Eastern Europe as well as the Balkans. However, there is very little difference in the two operations in terms of capabilities. Belgium tends to deal with contracts but in terms of production, this can be done equally in both locations. A key consideration is how much human capital input will be required for the contracts. Serbia tends to deal with the more intense human capital operations while Belgium tends to deal with the more automated procedures. This is a cost issue, not a capacity one. In principle, the two are equal, though the Belgium operation is still a little more productive overall.

Financial information (2014 – EUR):
Turnover: 7.717.535
Export: 5.413.940 (70%)
Balance sheet: 6.067.760
Net income: 166.586
Number of employees: 292 (by the end of 2016) / 70 in Belgium

4.3.2 Decision to invest (pre-investment)

METES had no experience of FDI prior to this investment. The only experience it had was that it had worked with a Belgian company that had a joint venture with METECH. Through this relationship, experience was gained of working with partners beyond the EU and in Serbia in particular.

The main reasons why METES decided on FDI were the following:

- It had downsized, reduced number of employees from 240 to 70 and expected to close within one year without radical action;
- Its competitors had already relocated the whole or part of their production eastwards, for example to Romania, Poland etc. METES was the last mover;
- It was in desperate need of staff, such as welders; it had invested in a Technology School in Belgium but there were too few people interested in this type of work;
- It needed to reduce the costs of production in order to regain competitiveness.

The main reasons why METES decide to look at the WB region included the following:
- The wages in Central Europe were going up and METES wanted an alternative;
- Cooperation with another Belgian company that had a joint venture with METECH;
- A visit which demonstrated the clear fit between METES and METECH;
- The desire to buy METECH, rather than to establish a partnership or joint venture.

In 2007/8, METES considered various countries in deciding how to proceed, including analyses of possible location such as Romania, Bulgaria, Croatia, Bosnia and Herzegovina and fYRoM. In some the labour costs were considered to be too high and in others no potential partners were found. In Croatia, a strategic partner found but after a few meetings, it was concluded that it was not a suitable partner. In the meantime, it became increasingly evident that METECH would be a good match, not least because of the experience of doing business together, confirmed by a visit to Smederevo.

The main reasons why METES decided to invest in Serbia, as opposed to the other countries, included the following:
- Previous experience of working with METECH and thus confidence in the firm as a possible business partner;
- A production unit that had been created in 1970 with Belgium architectural plans / technical specifications;
- Confidence that METECH´s systems and knowledge base was comparable to the levels in the EU;
- Professional and business-like discussions regarding possible strategic cooperation.

The predominant motivation for METES to invest was efficiency seeking FDI. That said, there were other factors, including a pool of suitable human capital, the desire to reach a wider market than just Serbia in the medium to long term (i.e. Western Balkans, Central and Eastern Europe), as well as tangible assets in the form of the production, storage and warehousing, as well as scope to expand.

It should be noted that neither the Serbian NIPA nor any other public institution or ministry played a role in attracting and realising this particular investment. The transfer of ownership was negotiation entirely by the two private partners without contacts with state institutions.

The Serbian NIPA only became involved several years after the initial investment in 2008. METECH decided to apply for employment subsidies for initially 100 staff in 2013 (300,000 EUR) and subsequently a further 60 staff in 2013 (300,000 EUR). The incentives available and its location in a free zone (which was established subsequently) did not influence the decision to invest in Serbia.

METECH invests heavily in training its staff, often sending them to Belgium. It would like to receive training subsidies, for example from the National Employment Agency, but has not yet been able to under the current criteria and procedures.

4.3.3 Experience of realising investment (post investment)

In the period from 2008 to 2014 METES´ operations were based in a rented production hall of around 2,000 m² and office space of 200 m². Investment in company development took place from 2008 to 2016. METES´ production is now extended to 60,000 m² with an office building of 1,200 m², covering a total area of 7.5 hectares.

The investment made by METES was phased over several years and has so far amounted to 12 million EUR, as illustrated in the Table below.

Phase and Type	Total Investment (€)	Number of Employees	Government incentives (€)	Description
2008	500,000	15		Purchase of a machinery and equipment
2009	2,5 million 500,000	50		Investment in land and building Purchase of machinery and equipment
2010	1 million 500.000		300,000	Construction of a new production hall Purchase of a machinery and equipment
2011	0,5 to 1 million	110		Purchase of a machinery and equipment
2012	0,5 to 1 million	140		Purchase of a machinery and equipment
2013	0,5 to 1 million	160		Purchase of a machinery and equipment
2014	2 million 500.000	200	300,000	Investment in land and building Purchase of a machinery and equipment
2015	1 million	206 plus 86 on probation period		Purchase of a machinery and equipment

The investment went largely as planned. Since METECH was an on-going operation, rather than a greenfield investment, planning, licenses, permits, etc. were unproblematic. There were still issues to be confronted in realising the investment, such as:

- METECH staff were used to different machinery and technology and had to adjust over time;
- As the business developed, other sources of human capital had to be explored such as local high school / university graduates;
- Although these possess good theoretical knowledge, their practical knowledge has to be developed through further specialisation;
- METECH became involved in establishing the Smederevo free zone in 2012, together with the municipality and four other firms. This required a significant amount of managerial effort to establish and a process of making jointly beneficial decisions.
- The free zone has brought significant advantages: firms do not pay VAT on goods, electricity and gas; do not pay customs duties for imported new and used machinery; do not pay customs duties on raw materials, etc.

METECH is not aware of the existence of NIPA aftercare services. METECH has developed ways to engage with government and other stakeholders in seeking solutions to FDI related issues, including the following:

- Smederevo municipality to resolve local issues;
- Belgian Embassy;
- Serbian ministries;
- Serbian NIPA;
- Prime Minister.

METECH is a member of the compulsory Chamber of Commerce, as well as the voluntary Belgian - Serbian Business Association. Through these, it is an indirect member of the Foreign Investors´

Council of Serbia. These are considered useful mechanisms that have achieved results in some cases, such as overturning regulations that would have had a negative impact on business.

METECH has invested mainly in equipment, as well as land/buildings. The technology in Serbia is the equivalent of what is available in Belgium. METES intends to continue investing in upgrading the equipment in the future, as well as possibly adding further production space. Its approach is to focus exclusively on Serbia.

4.3.4 Impact of investment

The investment has had a development impact on the HQ firm, on METECH, on the economy and local community through employment, incomes, etc. The Table summarises some of the key findings, including the main spill-over effects, for the first year of investment as well as the latest situation in 2016.

Impact	**Start year : 2008**	**Year: 2016**
Land	**Sqm:** 5 ha **Own/lease**	**Sqm:** 7.5 ha **Own/lease**
Building	**Sqm:** 4,000 production, 200 office Own/**rent**/lease	**Sqm:** 60,000 production, 1,200 office **Own**/rent/lease
The production facility was initially leased. In the meantime, the whole production space, including the surrounding land (7.5 ha) is owned by the firm. This is an indication of a long-term commitment to the location.		
Employment	PT: **0** FT: **15**	PT: **86** FT: **206**
Employment at METECH has consistently expanded, reflecting increasing business activity. The point was reached this year where METECH will break through the SME barrier to become a large enterprise in employment terms, if the part time employees are added to the full time ones. Further employment growth is anticipated in the future. In the meantime, METES in Belgium has stabilised around 70 employees.		
Training	Numbers: **10** Type: **Technical**	Numbers: **All** Type: **Technical, general, administrative**
Serbian government subsidies are being used to retrain the labour force. All are trained on the basics of working for METECH. Some require additional training in METES in Belgium, including all 45 engineers.		
Incomes	Average wages (month) **N/A**	Average wages (month): **about 310 EUR**
METECH indicates that salaries are at least the equivalent of the regional average, which is around 310 EUR per month (net). The national level average is around 375 EUR per month (net).		
Suppliers	Domestic %: 0 EU %: **100** Other %: 0	Domestic %: **30** EU %: **70** Other %: 0
The company has gone from zero domestic suppliers to about 30% being sourced locally within six years. These include: sheet metal 3-4 companies (quality remains a concern); screws and bolts 3-4 companies; electronics 3 companies; packaging 3-4 companies; surface protection 3-4 companies; machine parts 5-6 companies; and transportation 3 companies. METECH would like to source 100% of supplies from Serbia but cannot find domestic suppliers with appropriate quality and standards.		
Value Chains	Domestic: 0% EU: **100%** Other: 0%	Domestic: 0% EU: **95%** Other: 5%
During the last year METECH was established cooperation with the Italian company Officina, which is producing office furniture in Serbia. METECH produces metal parts for incorporation into the furniture. METECH would like to develop this type of value chain cooperation and with other producers of final products in Serbia, but this is at an early stage of development.		
Export	Domestic %: 0 EU %: **100**	Domestic %: **5** EU %: **93**

	Other %: 0		Other %: **1-2**
METECH production is connected with its customers´ needs. Since the customers are operating in the EU, the focus is also European. There are some new developments, however, and contracts have been realised with a Canadian. The engagement with the domestic market is increasing over time, though price remains an inhibiting factor for the moment.			
Technology transfer	High/Medium/**Low**		High/**Medium**/Low
The technological content is increasing in Serbia. The equipment is becoming more sophisticated over time, including the introduction of robotics in 2016. Both locations perform broadly similar tasks, including programming, engineering, etc. Initially, there was little or no technology transfer to domestic suppliers. However, in recent years, several METECH suppliers have improved the quality of production, mainly through technological upgrading, partly in connection with METECH activities.			
R&D	High/Medium/**Low**		High/Medium/**Low**
R&D is not a core competence of this firm. METECH regularly provides technical advice to its clients to meet their needs, so there is an element of supporting clients to design the product in support of R&D, rather than R&D per se. 10% of METECH staff are engineers who contribute to R&D in this sense.			
Knowledge transfer	High/Medium/**Low**		High/**Medium**/Low
Most domestic suppliers are family-run businesses. Consequently, METECH spends a good deal of time advising and supporting such domestic suppliers, to raise their knowledge and contribution. Working with METECH has resulted in some improvement in managerial and business practices on the part of domestic suppliers over time.			
Production efficiency transfer	High/Medium/**Low**		High/**Medium**/Low
The baseline of production efficiency for METECH is METES´ productivity levels in Belgium. In 2008, METECH attained approximately 65% of METES´ productivity. In 2016 it is estimated to be 85%. In the next year or two, it is predicted that parity will be reached with Belgium. The main reasons are neither technology nor know-how deficiencies: it is that METECH has seen a rapid increase in employment but faces constraints in training the new staff because of the pressure to deliver client orders. This will change when employment growth stabilises.			
International standards & quality requirements	High/Medium/**Low**		High/**Medium**/Low
In 2008, there was already a good knowledge base and systems in place at METECH. This has one the main reasons for the decision to invest in Serbia. These are now 100% the same as in Belgium. If METECH produces for clients that want to sell in the EU, it must meet EU standards. Clients can and do audit METECH and its standards. The company introduced ISO 9000 certification in 2014 and is raising its standards for the railway and the medical industries. The METES METECH internal standards and systems are very high but are not internationally recognised.			

METECH has opted for a long-term business model in Serbia, as well as integration into the local economy. It has invested in technology, purchased land and buildings, expanded production and enhanced staff capacities, while also establishing the basis for a long-term presence in the local community, including the establishment of the free zone.

Investment, business growth and development have transformed a small company of 15 employees into a large company with close to 300 employees, if part-time employees are considered. By investing its own resources in staff training, mostly in Belgium, METECH has developed specific technical knowledge and skills, as well as the generic and administrative skills of its Serbian employees. In this way, it has contributed to the creation of a high-quality workforce, including a significant number of highly educated employees. The salaries are comparable to the average level in the region, which has positive spill-over effects on the local market and community.

Bearing in mind that over 90% of production is exported to the EU market, and now Canada, METECH applies high business standards in accordance with international requirements, especially those of the EU market. This approach is based on constant investment in technology and people. METES considers this to be unavoidable, if it is to continue to provide its growing customer base with customised solutions, consistent with its motto of being "Experts in total concept".

METECH´s orientation towards cooperating with local firms to the largest extent possible is important for the future SME development in the region specifically and Serbia more generally. At the beginning of the investment in Serbia, METECH suppliers were all from the EU. Six years later, around 30% of the suppliers are from Serbia. These are local SMEs from different spheres of business participating in the METECH production process or in providing specialised services. It has established long-term cooperation with 30 local SMEs that have enhanced their business models in accordance with METECH needs or indirectly in meeting the requirements of end customers from the EU market.

By cooperation with METECH, local firms raise their managerial and technical know-how and thus also their level of competitiveness. Cooperating with METECH, local SMEs must meet international standards, as well as raising their management standards. By upgrading their technology and equipment in accordance with METECH´s needs while raising the knowledge of management, local SMEs are preparing to explore other markets in the region and in the EU. By encouraging the transfer of technology and knowledge of local employees (and SMEs to some extent), there is an influence that is reflected the production efficiency of METECH, with the expectation that this will reach comparable levels to those pertaining in METES, Belgium.

A very specific impact is connected with METECH´s initiative to enhance the local business infrastructure by establishing a Free Zone in Smederevo in 2012. The founders of the Free Zone include the local municipality, METECH and another four companies. By forming the Free Zone, they are stimulating further investments aimed at production for export, as well as generating employment. The Free Zone also provided additional business infrastructure and services. This greatly influences the development of local SMEs, raising the level of competitiveness via cooperation with companies located in the Free Zone.

Taking into account the fact that it still lacks domestic suppliers (it would like to raise the proportion from the current 30% to 100%) METECH organises visits by foreign companies to Smederevo, especially those it has business relations with in Belgium and the EU, and promotes the potential benefits to foreign partners of investing in Serbia and Smederevo.

By attracting partners to invest in the Smederevo Free Zone (a role normally be performed by NIPAs or municipalities), METECH seeks to reduce its imports (i.e. increase local suppliers), thus reducing transport and production costs, which also raising competitiveness and profitability. At the same time, this initiative offers the prospects of other EU SMEs relocating part or all of their production to Serbia. This would further stimulate the development and growth of local SMEs through partnerships with new customers, access to new markets, etc., thus also generating employment and incomes that benefit the local economy.

4.3.5 Conclusions

METES considers the decision to invest in Serbia to have been fully justified. It stresses that before it

took the decision, METES was in crisis mode because of its deteriorating levels of competitiveness and its inability to win tenders compared with its main competitors. It had downsized and it was possible that it might have become bankrupt within the year. METES points to the fact that some of its competitors in the EU have closed-down in the meantime. This may in part be because they did not have the vision or did not wish to take the risk of targeting other locations. METES has been able to not only maintain its market share, clients and geographical reach, but also expand its business across the board.

The Belgian operation has been scaled back from 250 employees in 2008 to 70 staff in 2016. The opposite has happened in Serbia, where METECH has increased from 15 to a planned 206 full time and 86 part time staff by the end of 2016. An EU SME has managed created a large enterprise, growing from base of 15 employees, within 6 years.

Although the Belgian office is mostly responsible for sales and marketing, the two operations are equivalent to one other. The staff are fairly equal in terms of technology, machinery and knowledge and this becomes more so over time. The key differentiating factor is how labour intensive the contract requirements are: if it is labour intensive, it tends to be performed in Serbia, otherwise in Belgium.

There is still a degree of variation in productivity, with Serbia reaching an estimated 85% of Belgium´s productivity. However, the differential is expected to be negligible in future as the machinery and equipment is equalised and the expanding Serbia labour force receives additional training and beds down, thus raising its productivity over time.

The investment has brought a package of capital, management expertise and production technology which not only helps boost host country’s economic development by supplying capital and facilities but also spurs industrial improvement through positive spill-overs. The investment has been a “win-win” gain for the Belgian firm and the Serbian economy.

4.4 Case study 2: Bader

4.4.1 Introduction

Name: BADER
Country: Bosnia and Hercegovina
Location: Njegoševa bb, 76230 Šamac,
Legal form: d.o.o. (LTD)
Date of Establishment: 2005
Website :http://bader-metallbau.de
Ownership structure: 100% owned by Bader Metallbau GmbH, Germany
Contact**:** Holger Kruger (director) and Tanja Krstanović (industrial engineering)
phone: +387 54 621 290
e-mail: info@bader-samac.com;

Nature of company

Bader Metallbau GmbH from Germany and its daughter company Bader Šamac d.o.o. deal with steel structures. The processing undertaken focuses on a range of steels: mild, stainless, special and heat resisting. Bader develops complete systems, as well as individual components, depending on the specific customer requirements. Bader collaborates closely with the customer in order to realise the specific objectives of the contracts. The company recognises the need to constantly invest in upgrading its machinery and invest in its staff, to be able to generate sufficient expertise to offer a complete solution for commissioned projects. The notable features of Bader Metallbau are as follows:

- Cutting of metal sheets to size;
- Production of steel construction;
- Manufacturing of conveyors and pipe bridges;
- Fine CNC plasma systems;
- Drilling / Turning / Milling.

Bader Šamac is producing exclusively as a supplier for the mother company Bader Metallbau which re-exports products to clients in the EU market and internationally. Bader Metallbau has also established a representative office in the Philippines in 2014.

The total number of employees in both companies is 92. The production area is 1,400 m² in 3,200 m² of land in Germany and 2,500 m² production space in Bosnia and Herzegovina on a 6,000 m² plot of land.

History

The company Bader Metallbau was established Franz Bader in 1921 and wood processing was initially its core business. Later, the focus was gradually changed to metal processing. The key milestones in the company´s development include the following:

- 1952 Bernhard Schneider took over the company;
- 1957 Bernhard Schneider, joined the company as an engineer;
- 1999 Bernhard Schneider took over the corporate management;
- 2005 Establishment of the daughter company Bader Šamac d.o.o in BIH;
- 2014 Establishing Metal Trading Philippines, as representative of Bader Metallbau.

Business activities

Products and services:

- Steel structures;
- Fabricated structural metal;
- Silos;
- Special purpose machines;
- Ventilation systems;
- Separators;
- Pipelines.

Markets and capacities

The Bader Metallbau / Bader Šamac business is based on "Lohn Production" or outward processing trade. Under this arrangement, steel is temporarily exported for outward processing in Bosnia and Herzegovina and the manufactured products are subsequently re-imported, with duties being paid only on the value added, namely the costs of labour. Under this arrangement, Bader Metallbau exports sheet metal and other raw materials to Bader Šamac. Bader Šamac processes the sheet metal and exports the finished products back to Bader Metallbau. This type of business brings benefits for both companies. Bader Metallbau enlarges its production capacity and Bader Šamac, through Lohn Production, exports processed products to Germany, EU and international customers.

Through this arrangement, Bader has developed a flexible business approach to customers throughout Europe with creativity, accuracy, high quality and cost-driven solutions. Bader Germany is responsible for strategic development and costumer relations, commercial arrangements and contracts. Bader Bosnia's production capacities are twice as large, including the number of employees. According to the technology level and capabilities, however, both companies are equal.

A key consideration for allocating work to the two operations is how large the new contracts will be and how much human input will be required. Further production expansion will be feasible in Bader Bosnia. This is both a cost and a capacity issue.

Regarding financial data, no financial data is available for this EU SME case study.
Number of employees: 60

4.4.2 Decision to invest (pre-investment)

Bader had no experience of FDI prior to the decision to open the firm in Bosnia. The main reasons why Bader decided on FDI were the following:

- It had steadily increased its production according to new contracts and requirements of its customers in Germany and the EU. However, capacity limitations were constraining growth;
- A significant new contract could not be delivered with the German production capacity. This was an important driver for the decision to invest elsewhere;
- Opportunities for expansion of production at the German location were not feasible, given the lack of available land around the existing plant;

- Competitors had already relocated part or the whole of their production to Slovakia and Eastern Europe, mainly in order to lower production costs.

The main reasons why Bader Metallbau decided to look at the WB region included the following:

- The production costs, including wage levels, in Central Europe were going up and Bader Metallbau wanted to find alternative options;
- The company determined that operational costs of production were lower in the WB than in Central and Eastern Europe, as well as EU countries;
- The previous business experience between German and ex-Yugoslav companies in the sector were considered to be very positive;
- The "Lohn Production" arrangements between Bosnian and EU companies were well developed in the manufacturing sectors.

Bader also considered Slovakia in deciding how to proceed and prepared some analyses. Comparing the cost of production in Slovakia and the WB in general, Bader decided to give-up the search for other locations, but it still needed concrete possibilities for expanding its capacity in the WB region.

The main reasons why Bader Metallbau decided to invest in Šamac, included:

- An employee originated from Bosnia and knew the possibilities for business development in Šamac and had good contacts with local administration;
- A visit confirmed the possibility of concluding a favourable long-term contract with the local administration for the production facility;
- An empty production hall in Šamac fit the Bader Metallbau production, development and expansion needs;
- The cost of utilities was lower than in Germany and other EU countries;
- The necessary utility infrastructure for the investment was prepared by the local authority, ready for use by the Bader;
- The costs of renting the facility, renovation and installation of equipment was compatible with profitable production;
- The local working force was available at suitable wages levels.

The key driver for Bader to invest was quick creation of production capacity to meet the needs of the large contract, as well as the growing customer needs in Germany and EU. There were also other factors, including the transport connection with EU market (quick access to Croatia and motorway connection of Germany), availability of human capital, as well as appropriate tangible assets in the form of the production, storage and warehousing, as well as scope for expansion.

As in the previous case study, the Bosnian NIPA did not play a role in this investment. The investor used his own contacts and made an agreement with the local authority, resulting in rapid decisions and activation of the production facility.

4.4.3 Experience of realising investment (post investment)

The initial investment occurred in September 2005 and continued until 2014. During this period, the Bader Šamac operation was based in a rented production hall of around 2,200 m², including a small office. However, this production facility was destroyed in the floods that have engulfed Šamac and other parts of Bosnia and neighbouring countries in 2014.

The municipality of Šamac offered production unit in a different location. Bader Šamac signed a new contract to lease the facility for 10 years. The new production hall has an area of 4,800 m² on a plot of 6,000 m².

The overall investment made by Bader Šamac amounted to 2,3 million EUR, as illustrated in the Table below, which illustrated the main phases of gradual investment, most of which focused on the upgrading of the technological base.

Phase and Type	Total Investment (€)	Number of Employees	Government incentives (€)	Description
2005	150,000 1.000.000	10	0	Refurbishment of production hall Purchase of machinery and equipment
2008	0	50	0	Investment in land and building Purchase of additional machinery and equipment
2015	175.000 1.000.000	60	35,000	Construction of a new production hall Purchase of additional machinery and equipment

The first investment went largely as planned. The second investment, which was implemented after the flood, coincided with Bader Šamac´s realisation of the need to expand the production capacity in and modernise the equipment. In this sense, if no other, the flood damage was timely.

Issues such as planning, licenses, permits, etc. were resolved by Bader Šamac with the full cooperation of local authority. It was clearly in the interest of both parties to ensure that the new, enlarged investment went ahead without endangering the employment and other benefits arising from the investment. There were still issues to be resolved in realising the investment, such as:

- Bader Šamac selects and recruits its employees without the support of public institutions;
- Bader Šamac staff were used to different machinery and technology than what was brought in, requiring investment in training;
- The practical knowledge, skills and capacities of staff had to be developed through further specialisation;
- Bader Šamac continues to face a lack of quality local suppliers and raw materials that can meet the high standards of production.

It is worth noting that the period from 2012 to 2014 was very difficult for the metal industry but Bader Šamac continued its operations in Bosnia without a negative impact on their employees or the local community.

Bader Šamac is not aware of the existence of the Bosnian NIPA or of the activities of the Foreign Investors´ Council. Bader has not had to develop mechanisms to engage with government and other stakeholders for solutions to FDI related issues. It simply developed its own communication with the institution that matter as far as it is concerned, namely the local authority. Bader Šamac is also a member of the three Chambers of Commerce that operate at different levels. These are considered useful mechanisms to achieve results in the future, but have not been used so far.

Bader has invested mainly in equipment, as well as land/buildings. The technology in Šamac is the equivalent of what is available in Germany. The owner, Bader Metallbau, intends to continue investing in upgrading the equipment, as well as possibly expanding the production space. Its approach is to focus exclusively on Bosnia without expansion on other WB economies. The other markets can be served from Bosnia.

4.4.4 Impact of investment

The foreign direct investment has flowed in a phased manner and there had been a development impact on the company itself, as well as on local community and economy. Some key findings are presented in the following Table.

Impact	**Start year : 2005**		**Year : 2016**
Land	**Sqm:** 4 ha Own/**lease**		**Sqm:** 6 ha Own/**lease**
Building	**Sqm:** 2,200 m² production, small office Own/**lease**		**Sqm:** 4.800 m² production, including 200 m² office Own/**lease**
The production facility was initially leased. Following the flood in 2014, the new one is also leased but the expectation is that both the land and the building will be purchased by Bader Šamac in the future.			
Employment	PT: **10** FT: **10**		PT: **0** FT: **60**
Employment at Bader Šamac significantly expanded in the period up to 2008, reflect the increasing business activity. In 2008 Bader Šamac broken through the barrier to become a medium enterprise in employment terms (50 employees). In the meantime, Bader Metallbau has 30-33 employees, including two employees in the Philippines. Further employment growth of 10 new employees is anticipated in the near future in Bader Šamac.			
Training	Numbers: **10** Type: **Technical**		Numbers: **All** Type: **Technical, general, administrative**
All staff are trained on the basics of working for Bader. About 20 employees acquired additional training in Bader Metallbau, so as to obtain certification, including a few engineers. The training was organised and financed by Bader Šamac, without support from Bosnian institutions.			
Incomes	Average wages (month) **N/A**		Average net wages (month): **about 450 EUR**
Bader indicates that salaries are larger than the national level average which is around 420 EUR per month (net).			
Suppliers	Domestic %: 0 EU %: **100** Other %: 0		Domestic %: **0** EU %: **100** Other %: 0
Bader Bosnia has not been oriented towards the local market. The production capacities are used for the implementation of the “Lohn Production” agreement with Bader Metallbau. The raw materials are 100% imported and the finished products are 100% exported. Bader Šamac recognises that an opportunity exists to work in the domestic market, but this is currently not an option, partly because of its costs are considered to be higher.			
Value Chains	Domestic: 0% EU: **100%** Other: 0**%**		Domestic: 0% EU: **100%** Other: 0%
The Bader Šamac business model is production on a contractual basis for Bader Metallbau which is both contractor and supplier of the raw materials. Bader Šamac is a fully integrated "Lohn Production" in respect to the following activities: cutting, processing, assembling, packaging and transport.			
Export	Domestic %: 0 EU %: **100** Other %:0		Domestic %: 0 EU %: **100** Other %: 0
Bader Šamac´s production is 100% connected with Bader Metallbau´s customers. Since the customers are in Germany and other EU countries, the focus is also EU. The new Philippines operation may change part of the orientation over time.			
Technology transfer	High/**Medium/**Low		High/**Medium**/Low
The technological content is increasing in Bosnia since the equipment is becoming more sophisticated over time. Both locations have the same technologies and perform the same operations, including programming, engineering, etc. However, since there is little or no engagement with domestic enterprises, there is also no obvious technology transfer to domestic suppliers.			
R&D	High/Medium/**Low**		High/Medium/**Low**
R&D is a peripheral focus for this SME. Bader Metallbau provides technical advice to its clients to meet their needs but does not perform R&D per se. Bader Šamac is rarely involved in this process.			
Knowledge transfer	High/Medium/**Low**		High/Medium/**Low**

Bader Bosnia is fully oriented to the Bader Metallbau activities. Although there is a high level of knowledge transfer between the Bader operations there is very limited cooperation with local SMEs. There is limited knowledge transfer.			
Production efficiency transfer	High/Medium/**Low**		**High**/Medium/Low
The baseline of production efficiency for Bader Šamac is Bader Metallbau´s productivity levels. In 2016, it was estimated to be 100%. Both companies now use same technology and possess comparable levels of know-how. Both companies do the same things but the Bosnia production capacities are larger.			
International standards & quality requirements	High/**Medium**/Low		High/**Medium**/Low
Bader Šamac produces for Bader Metallbau, which in turn sells its products mainly in EU, so must comply with European standards. Bader introduced DIN 1019 certification regarding processing of steel bars, hot Rolled Bulb Flats, etc., which is important for product development in Germany and EU.			

Through direct investment in Bosnia, Bader Metallbau overcame the key challenges facing its operations in Germany, namely production capacity constraint.

It is worth emphasising that from the very beginning Bader established strategic cooperation with the Municipality of Šamac. Under favourable conditions, the municipality rented the land and the building for the development of the Bader capacities. On this basis, Bader was able to develop rapidly the production unit with full business support from the established parent company in Germany. Bader Metallbau invested in technology and staff capacities of Bader Šamac, as a key precondition for company business development and growth.

The initial investment was in a small operation of 10 employees and this has transformed into a medium-sized company with more than 60 employees, with plans for further expansion. By investing from its own resources in staff training in Bosnia and Germany, Bader has developed the technical know-how and skills of its Bosnian employees. In this way, it is contributing directly to the creation of a high-quality workforce. The salaries are higher than the average level in the region and country, which has positive spill-over effects for the local community.

Bearing in mind that 100% of production is exported to Germany and then on to the rest of the EU market, Bader Metallbau invested in technology and equipment similar to that which is used in Germany and applies business and technological standards compatible with EU requirements.

With this investment, Bader Metallbau increased its network of global/European buyers and suppliers with capacities to serve customers in other countries.

Bader Šamac´s impact on the local economy is important. It is visible through an increase in employment and salaries, as well as elevated levels of human capital. Strengthening domestic capabilities to increase export and to serve new markets and improved managerial practice at all levels are additional positive impacts of the investment. The domestic company has raised its capabilities to meet international quality standards.

Since the focus on the Bader Šamac business model is "Lohn Production" via contracts exclusively with Bader Metallbau, the current level of production capacity is fully absorbed in one shift. Bader Šamac´s suppliers are 100% from Germany and EU (except for energy and other utilities) and are organised by Bader Metallbau. At this moment in time, there is little scope for engagement with local suppliers because of the nature of the current arrangement, as well as the relatively low quality of raw materials, which may adversely affect equipment and/or prevent the manufacture of products in accordance with the quality requirements of customers from EU.

The long-term contracts that Bader Metallbau has with customers in Germany and the EU provide a stable business framework for Bader Šamac. In the future Bader Šamac will consider the scope to establish cooperation with local companies. Previous attempts to make metal products for local companies have been ineffective: although local firms recognise and value what Bader Šamac can do, the domestic market is not yet able to bear the relatively high prices, though this may change in the future.

4.4.5 Conclusions

Bader considers its decision to invest in Bosnia to have been fully justified. It stresses that before it took the investment decision, it had difficulties with production capacities and realisation of new contracts. Bader was faced with land constraints in terms of expanding production capacities. Alternatives locations in Germany and Slovakia were considered too expensive. Bader concluded that the most suitable solution was to develop a new production unit in Šamac, Bosnia. It did so on its own and was somewhat fortuitous since an employee was able to facilitate the visit to Šamac. The initial decision to start with a 10-year lease has now been extended for another 10 years with the possibility of eventually buying the land and building. The new production unit is much larger, as is the office, and includes space for expansion of production.

Based on the “Lohn Production "agreement with Bader Šamac, Bader Metallbau has been able to not only maintain its market share, clients and geographical reach, but also to expand business and even open a representative office in the Philippines. This represents a new phase of its internationalization.

The Bader Metallbau now has a stable operation of around 30 employees, while Bader Šamac has gone from being a start-up to becoming a medium-sized enterprise within four years and now employs 60 people, with expectations of further growth. Bader Šamac has experienced stable growth in capacities and competitiveness. Its turnover has increased over time and it has grown its market presence, including seeking new markets outside Europe. The plan for future is to buy the land and the building and establish the basis for a long-term presence in the local community.

Bader Metallbau is mostly responsible for sales and marketing, however, the two operations are comparable. The staff is fairly equal in terms of technology, machinery and know-how. The production capacity in Bosnia is, however, significantly larger.

The EU SME investment indicates positive economic impact on local economy and some positive spill-over effects, though these are constrained by the Lohn Production arrangement, though it is possible that this will change in the future.

4.5 Case study 3: Puklavec and Friends

4.5.1 Introduction

Name: PUKLAVEC & FRIENDS
Country: fYRoM
Location: Dolni Disan BB, Negotino
Legal form: D.O.O.E.L.
Date of Establishment: 2011
Website: http://www.jeruzalem-ormoz.com
Ownership structure: 100% owned by P&F HOLDING VINO d.o.o, Ormož, Slovenia
Contacts:
Mitja Herga (director), tel.: +386 27415724, info@jeruzalem-ormoz.com
Director: Tihomir Petreski (director), tel.: +389 2 3136 237, tihomir@petreskipartners.mk

This is a business owned by the Puklavec family, comprising several wineries, including the well-established P&F JERUZALEM d.o.o., which the family Puklavec took over at the beginning of the nineties. Puklavec Holding was formed to enable efficient operations in export markets and the development of distributor networks in the EU, especially in The Netherlands and Germany.

Nature of company

The Puklavec family and their P&F wineries produce only quality white wines and sparkling wines in Slovenia. The most prominent grape variety is Jeruzalemcan but others include Welsh Riesling, Sipon, Rhein Riesling, Sauvignon, Chardonnay, Traminer, White Pinot, Grey Pinot, etc. The P&F vineyards are located in the Podravje region of Slovenia and 650 out of the 1,100 hectares of vineyards are owned by the Puklavec family.

P&F wanted to add red wines to its portfolio. In fYRoM they found the perfect conditions for growing red grapes and producing red wines. The Negotino region is a mountainous area of mineral rich territory, the soil being a perfect balance of clay, silt and sand particles. The vineyards are at an altitude of 250 - 280 meters where the grapes benefit from sunshine from the early morning through to late afternoon, resulting in conditions similar to those pertaining in South Africa.

History

The Puklavec family wine business started in the 1930s when the oenologist, Martin Puklavec, became involved with the cooperative of winegrowers. In the 1950s and 1960s he was the driving force of the winery.

Partly through his efforts, the area has developed into one of the world’s best wine regions. Vladimir Puklavec and his two daughters, Tatjana and Kristina, work alongside the other wine growers in an effort to grow the finest possible wines. In 2009, the Puklavec family took full management of the company.

Business activities

Most of the production processes take place in Ormož. P&F has invested in the latest technologies and equipment to process the grapes with almost no oxygen and ferment them at low temperature, resulting in wines that retain much of their antioxidants, influencing the quality. Its cellar enables the wines to be stored under optimal conditions, including round-the-clock monitoring, before the wines are bottled in an oxygen-free bottling line.

Products and services:

The P&F winery´s trademark wines include:

- JeruzalemCan - quality wine;
- Prlek - table wine;
- PeninaJeruzalem - quality sparkling wine;
- Ormoškapenina - quality sparkling wine;
- Muškatnapenina: quality sparkling wine;
- Different kinds of wines designed for gastronomy.

Markets and capacities

The P&F winery produces 6,5 million litres of wine and is the largest exporter of wines in Slovenia, with 55% exports. Its wines are found in more than 20 markets but they are also served by several international airlines.

The most important export regions and countries are:

- Austria;
- Belgium;
- Bosnia and Herzegovina;
- Croatia;
- Germany;
- Italy;
- Netherlands;
- United States.

Through the investment in fYRoM, P&F sought to further develop its overall offer by introducing full-bodied red wines. Cabernet Sauvignon and Merlot grapes are grown, as well as the Vranec grape. The wines are very well-known and present on the WB and EU markets.

In the first phase of investment, the wine will be prepared in the Negotino winery, exported to Slovenia in tanks where it will be bottled and distributed on Slovenian and other markets. In the second phase of investment, the wine will be bottled in Negotino and distributed directly to the domestic and WB market. Part of the production will be bottled and distributed by the Slovenian part of the company.

Financial information (2014 – EUR):
Turnover: 178.916
Export: 100%
Balance sheet: 1.203.616
Net income: 81.325
Number of employees: 11 (and 10 part time)

4.5.2 Decision to invest (pre-investment)

P&F had some experience prior to this investment linked to development of representative offices in Germany, Netherlands, USA and Croatia and the development of a distribution network. The main reasons why P&F decided on to invest outside Slovenia were the following:

- It has steadily increased its white wine production and export, which represented a sound basis for expanding the offer and developing new red wine products;
- It recognised that there is strong market demand for red wine production and distribution, but it only had access to white wines.

The main reasons why P&F decide to look at the WB region included the following:

- Expanding of P&F wine portfolio with the introduction of quality red vine as the WB is known for its wine conditions;
- Costs of growing vines, wine production and operational costs are lower in countries such as Bulgaria, fYRoM, Serbia and Montenegro than in the EU;
- Climatic conditions and quality of land well-suited to growing vines;
- The quality of red grapes is very high;
- The logistical and other costs of processing red wine on site and export in tanks to Slovenia for bottling are lower than other countries.

In making its investment decision, P&F considered Bulgaria and Hungary in EU, as well as fYRoM in the WB, especially the cost of production. Other analyses included the climate and soil characteristics, which confirmed the excellent conditions in the south region, such as Negotino, which are comparable to those in South Africa, renowned as an excellent location for growing vines and wine production. Based on the analyses, P&F discontinued the search in other countries and focused exclusively on fYRoM.

In seeking the possible investment, P&F did not go through the Macedonian Investment Promotion Agency. Rather, it chose to contact a former president of Macedonian Chamber of Economy who then recommended to P&F two potential partners. One of them was a winery in Dolni Disan village nearby Negotino. P&F visited the winery and immediately recognised the long-term value of investing in the development of the winery. The vineyards are on a 5-degree slope, which provides excellent drainage. The hills of Negotino enjoy more than 2,180 hours of sunshine a year, with an average temperature of 12.6° Celsius, which comprises perfect conditions for high quality wine production.

The main reasons why P&F Holding decided to invest in fYRoM as opposed to the other countries included the following:

- Good relations with a local contact to connect P&F Holding with potential partners;
- A visit confirmed the possibility of takeover of the local winery in Dolni Disan;
- The building was not yet fully completed but offered potential for expansion of capacities;
- The equipment for processing grapes and wine production was acceptable to start with;
- The winery has a 1 ha vineyard, 25% of which is terraced on a 5-degree slope;
- The possibility of buying red grapes from local suppliers for processing in the winery;
- Export in tanks for bottling to Slovenia was feasible;
- Average wages of labour force were lower than in other countries.

The predominant motivation for P&F was to meet customer needs in Slovenian market and to expand its wine portfolio to include red wine. There were other considerations, including wine production of medium quality for sale in the local market. The possibility for expansion of production, including establishment of the bottling line and export to other WB countries, were additional considerations. In addition, further investment in the vineyards and growing good quality grape were considered to be realistic options.

It should be noted that the Macedonian NIPA did not play a role in attracting and realising this particular investment, as was the case with the other two EU SME case studies. The investment was coordinated with the support of a private consulting firm based in Skopje, with experience of company acquisition, as well as the beverages business. It is still involved in the management of the investment on behalf of P&F.

4.5.3 Experience of realising investment (post investment)

Before deciding to purchase the winery, P&F tested the quality of the wine produced in Dolni Disan and a potential placement on the Slovenian market. The involved the purchase and sale of an initial 400,000 litres, followed by a further 600.000 litres of wine. The positive market reaction and the profitable outcome led P&F to invest in the winery.

Investment in company development started in 2011 with the acquisition of majority ownership (75%) of the winery in Dolni Disan. Initially P&F invested in the renovation and further construction of cellar and expansion of the winery. P&F imported and installed additional modern equipment enabling larger capacity in the processing of red grapes and wine storage. The production capacity increased from 120.000 to approximately 500.000 bottles per year. Based on the preliminary investment, the company started processing and producing its own red Cabernet Sauvignon and Merlot 2013 wine, which were awarded the Silver medal at the „Concours Mondial de Bruxelles“, an international wine and spirits competition. This reinforced the expectation that the quality of the red wine will be high.

Furthermore, the winery started buying grapes from four long-term and four optional local suppliers, which allowed the creation of red wine based on the particular needs of customers from the EU market. The prepared and aged wine is streamed into tanks and exported to Slovenia to be bottled and re-exported to the EU market.

The investment made by P&F amounts to 1,2 million EUR so far, as illustrated in the Table below.

Phase and Type	Total Investment (€)	Number of Employees	Government incentives (€)	Description
2010	260.000	2 full-time	-	Takeover of 75 % of ownership
2011-2012	200.000 220.000	11 full-time 26 part-time	-	Purchase of equipment Investment in cellar and the building and utilities and infrastructure
2015-2016	500.000	3 full-time 10 part-time	-	Purchase of remaining 25% of winery Purchase of additional equipment Investment in the building, utilities and infrastructure

However, the investment did not proceed as planned. P&F invested over 6 million EUR in a cellar in Slovenia during 2013 - 2014, which led to a temporary delay in the plans for fYRoM. P&F resumed investment in 2015 with the aim of completing the construction of the winery, purchasing the necessary equipment and starting wine producing at full capacity by the end of 2016. Also, after the planned investment completion, P&F Slovenia will move part of their bottling line as the final step in the P&F Macedonia winery development.

There were other issues to be resolved in realising the investment, such as:

- Lack of resources for investment in completion of building as planned;
- Inability to develop complementary tourism and catering activities in the winery, which has a negative impact on the expected winery revenues and market promotion

These issues were resolved with the assistance of the local consulting firm hired by P&F to manage the investment. The most important reasons why these have been solved, include excellent knowledge of the business and legal environment, effective communication with public sector institutions and relevant management experience in the country of several established enterprises.

P&F is aware of NIPA´s aftercare services and the investment activities of state institutions but has opted not to use them as they are considered to be oriented towards large scale FDI. However, with the support of the local consultancy firm, P&F has solved the investment issues, including:

- Completion of the procedure to acquire 100% ownership of a winery;
- Documentation for the change of ownership of the vineyard and harvesting grapes;
- Other administrative procedures related to vine processing, production and export.

P&F is a member of the Association of Winemakers and Oenologists of Macedonia. Through this association, P&F seeks to resolve issues with the Ministry of Agriculture. P&F is also a member of the Chamber of Commerce.
Based on its experience, the Chamber of Commerce is considered a useful tool, including for export promotion to the WB region.

P&F has invested mainly in equipment and in the winery building. The modern technology installed in winery in Negotino is similar to what is available in Slovenia, but with significantly smaller capacity: 500.000 compared with 8 million litres in Slovenia. P&F intends to continue investing in capacity and upgrading the equipment, such as the bottling line. An important part of future plans is developing the production monitoring system through internet links between the Slovenian and the local wineries, combined with the use of the highest oenologist expertise available to the Slovenian company. P&F is seeking to expand supplies and is in the process of finding an additional 50 ha of vineyard based on concession agreements.

Its medium to long-term approach is to focus on the production of Macedonian red wines of medium class for the local market and the production of red wines in the high level class for the EU market, including the Slovenian one.

4.5.4 Impact of investment

In the following table, some key findings are presented.

Impact	Start year : 2011		Year : 2016
Land	Sqm: 1,3 ha **Own**/lease		Sqm: 9 ha **Own**/lease
Building	**Sqm: 1400** **Own**/lease		**Sqm: 2000** **Own**/lease
P&F bought the shares of local company together with assets and started investing in the in building and equipment. P&F is now exploring the possibility of establishing concessions covering 50 ha, to increase the volume of wine production.			
Employment	**PT: 26 FT: 11**		**PT: 10 FT: 3**
Employment at P&F is result of different phases of investment. In the initial phase of investment in the building and equipment, the employee count went from 2 full-time employed to 11. Because of the seasonal nature of production, the number of part-time employees also went up to 26. Due to the large investment in cellar in Slovenian winery and delay of investment in fYRoM, P&F operations were scaled back during 2013-15, so the employees are now at the same level as at the beginning of the investment. P&F expects to increase the employees, as the volume of production expands.			
Training	Numbers: **0** Type: **Technical**		Numbers: **0** Type: **Technical**
P&F has organised a study visit to Slovenia for the workers from the vineyard. However, new trends of breeding and protection of vines applied in Slovenia are not yet accepted in fYRoM, which still uses traditional approaches.			
Incomes	Average net wages (month): N/A		Average net wages (month): N/A
P&F indicates that the salaries of its employees are higher than the regional average and national level average and range from 250 up to 1000 EUR.			
Suppliers	Domestic: **100%** EU: 0% Other: 0%		Domestic: **100%** EU: 0% Other: 0%
P&F are fully oriented towards local suppliers in terms of grapes. The current production capacity is 500.000 litres. The supply from its own vineyards amounts from 50.000 to 100.000 litres. This is supplemented with 450.000 litres from other local vineyards. P&F is currently looking into negotiating concessions for 50 ha.			
Value Chains	Domestic: 0**%** EU: **100%** Other: 0**%**		Domestic**:** 0% EU: **100%** Other: 0%
The P&F business model is production of local autochthon (original) types of wine without imports of any component of production. The final phase of production consisting of bottling, packing and distributing to the market is performed in Slovenia. In this sense, the company is fully integrated in EU value chain. However, the plan is for all this activity to be performed in fYRoM in due course.			
Export	Domestic: 0% EU: **100%** Other: 0%		Domestic : 0% EU: **100%** Other: 0%
The current production is connected with customers´ needs, which currently stem from the EU market. Since the customers are in the Slovenia, Croatia, Netherlands Germany and other EU countries, the focus is EU. However, the intention is eventually to produce wine for sale in fYRoM (medium range) as well as the EU (high range).			
Technology transfer	High/**Medium**/Low		**High/**Medium/Low
The equipment provided by investor is technologically sophisticated and there is also an automatic cooling system and fermentation, which are controlled remotely from Slovenia.			
R&D	High/Medium/**Low**		High/Medium/**Low**
P&F Slovenia regularly examines the preferences of its potential customers in order to meet their needs. Oenologists from Slovenia are responsible for grape processing and wine production, so the R&D component is not applied in P&F Macedonia at this stage of business development.			
Knowledge transfer	High/Medium/**Low**		High/**Medium**/Low

The Macedonian partner is fully oriented to P&F Slovenia and there is no engagement with local SMEs, other than in the form of concessions to supply red wine. Knowledge transfer is expected to occur in the process of protecting vine cultivation and harvesting of grape in next phase of investment development			
Production efficiency transfer	High/Medium/**Low**		High/**Medium**/Low
Both companies use the same technology and know-how in grape processing. Because the investment process is not yet completed, the Macedonian production efficiency remains lower than Slovenia, although it has increased significantly since the investment was first made. This will continue in the future.			
International standards & quality requirements	High/**Medium**/Low		**High**/Medium/Low
Since P&F produces red wine for the EU market and it must comply with the necessary standards, so the HACCP standard has been implemented by the investor.			

P&F Slovenia has invested in the winery in phases. After the initial investment and takeover of majority ownership, the second phase was in expanding the cellar, purchase of additional state of the art technology and invested in expansion of the building, resulting in a production capacity of 100.000 - 500.000 litres. The third phase was directed to the purchase of additional equipment and the completion of the building, including utility and infrastructure works, albeit with delays due to the large investment in a Slovenian winery cellar. In late 2015, P&F Slovenia invested a further 200,000 EUR. By the end of 2016, in addition to wine production with full capacity, it is expected to have three guest suites and two rooms for wine tasting and dining, which will enable it to benefit from wine tourism. P&F is also concluding contracts with two vineyards to expand its supply of grapes.

The potential for business growth is self-evident. The equipment was imported from Bulgaria and the technology is at the same level as it is in Slovenia. P&F started with 2 employees and transformed the winery into a small company of 26 employees, including part-time workers. The current business operations are constrained by the unfinished construction works and the number of full time employees was reduced. It is set for rapid expansion in 2017 and 2018 with investment finalisation, including the relocation of old Slovenian line for bottling. Distribution of red wine to the Slovenian and EU markets has already been achieved, based on P&F´s own grapes, supplemented with that of other local suppliers.

The history of interrupted investment means that the current impact of the investment is limited. However, its effects on the P&F business and on the local economy are set to increase. The salaries are higher than the average level and employment is expected to increase by over 30 including part time workers in the future. The winery is fully oriented towards local suppliers (50 ha of vineyards in the Negotino region), which has positive spill-over on local grape producers and the local community.

The fact that 100% of the production is currently exported to Slovenia for EU markets means that P&F´s production and sales have increased, at the same time the company has achieved its strategic objective of diversification into red wines. There is the possibility that this investment will accelerate rural business development in the region, bearing in mind the fact that P&F is seeking concession for more than 50 ha of new vineyards for growing and harvesting grapes, to be processed and eventually bottled in the country for both domestic consumption and export to the EU.

In parallel to wine production, the potential for tourism development will grow when the accommodation and catering facilities are completed, echoing similar developments happening in nearby Kavadarci. Implementation of the current and planned investments are expected to increase turnover and profitability, diversity the palette of P&F wines, create new jobs, stimulate a degree of technological and know-how transfer in primary production and processing of grapes, etc.

4.5.5 Conclusions, good practice, recommendations arising

P&F already considers that its decision to invest in fYRoM has been justified, even at the current stage of business development.

It is important to stress that before it took the decision to invest, P&F was not in any business difficulty in terms of capacities, competitiveness and profitability. The main reason for the investment was the desire to fulfil a strategic decision to expand its product offering in accordance with the expressed needs of the market for red wine. Based on the investment in fYRoM, P&F will be able to increase its market share in existing markets, but also enter the market for red wine for the first time.

The investment plan demonstrates the intention of P&F to stay in fYRoM for the long-term, as shown by its investment in land, technology and primary production of grape for wine. A key milestone is the extension of the building and production capacity, which allow an increase in the share of red wine in the P&F wine portfolio. The investment in modern technology means that the productivity of the fYRoM operation will be on par with the Slovenian one.

After the significant investment in Slovenia during 2013 and 2014 and continuation of investment in fYRoM, P&F will have the capacity to produce more than 8 million litres of different types of white and red wines. White wine will remain the main product and will be maintained in Ormož, Slovenia, which is responsible for sales and marketing. P&F will develop the market for red wine, but with the planned transfer of the bottling line from Slovenia, the Macedonian operation will be responsible for sales and marketing of red wine in the WB.

4.6 Issues

It is not possible to draw very firm conclusions based on three case studies of EU SMEs that have invested in the WB region. Nevertheless, a number of issues of policy relevance are worth highlighting:

- Two of the SMEs took the decision to invest because they were driven by increasing levels of competition and/or a business motive, such as a contract that could not otherwise be delivered;
- The third saw a market opportunity to expand its product range and found the perfect climatic and other conditions in the WB;
- In all cases, various countries were considered, including in Central and Easter Europe, but the deciding factors were connected with cost reduction;
- The prospect of raising competitiveness by reducing the cost base, primarily labour costs, was an important factor in the decision to invest in the WB, even if it is was not the only one;
- By contrast, issues such as financial incentives, tax / customs relief and other aspects such as zones, etc. do not appear to have been motivating factors in EU SMEs´ decisions to invest;
- In one case it was pure chance that an employee originated from the WB region and was able to facilitate contact with a municipality leading quickly to the decision to invest;
- In another it was a case of having some indirect experience of a firm (through a joint venture), leading to contact and agreement to purchase the WB enterprise outright;
- The third used a local consultancy to facilitate a shortlisting of possible investment targets and then contacted the same firm to managed and coordinate the local investment;
- All three SMEs have used the local tools and mechanisms available for PPD but have concentrated on their direct local counterpart, namely the local authorities;
- All SMEs have made gradual but consistent investments over time in the three countries which are designed to introduce the same technological standards as in the EU;
- All three SMEs are offering comparable regional/national wages but do seek to exceed them;
- All SMEs have sought to invest in the human capital levels of the local employees;
- All SMEs are making long-term investments in the local companies that will bind them to the locality, country and region in the short to medium term and expect to remain long term too;
- All three local labour markets / local communities appear to have benefited from the investments;
- Where the NIPA has been involved in one case, it was just to obtain employment subsidies long after the original investment was made;
- In all likelihood, the new jobs would have been created with or without the NIPA/state subsidies, calling into question the value of such initiatives and the need to review the subsidy procedures;

- All six NIPAs had difficulties identifying potential EU SME case studies in the three manufacturing sub-sectors, with some having finding it much more difficult than others;
- In none of the three case studies were the NIPAs involved in the process of assisting the SMEs to realise their investments, even though they would appear to be the obvious starting point;
- Since neither MNCs (they have the resources and capacities to contract high quality business services instead) nor the SME case studies appear to use the NIPAs very intensively, the policy question that arises: what exactly should be the role of NIPAs in relation to satisfying SMEs´ FDI needs? This sensitive policy issue would need to be addressed through another study.
- A related question is whether NIPAs should reduce their focus on MNCs and instead devote some of their limited capacities and funds to target EU SMEs more effectively than hitherto, regardless of whether such as focus is on manufacturing or other economic sectors.

5 Conclusions and Policy Recommendations: supporting EU SME manufacturing FDI

The aim of this report is four-fold:

- To provide an overview of FDI and manufacturing situation the six WB countries covered: this was done in Chapter 2, which also presents a series of conclusions;
- To provide six country profiles in terms FDI and manufacturing trends, FDI policy, institutions and support: this was done in Chapter 3, which also presents a series of country-specific conclusions. Some issues of a generic nature are also covered in the Chapter;
- To provide three case studies of EU SMEs that have invested in different manufacturing sub-sectors in half of the six countries covered by this study: this was done in Chapter 4, which also presents a series of conclusions arising from the qualitative analysis;
- To provide policy recommendations at the WB regional level to further support EU SME manufacturing FDI: this is done in this Chapter.

The Inception Report emphasised that this assignment was: *"… not meant to be an academic exercise: the emphasis of the project is to understand the situation, the challenges and the potential for supporting manufacturing SMEs to invest in the WB region. This means assessing what is currently on offer (policy, institutions, funding, etc.) to EU manufacturing SMEs, as well as the constraints faced by potential small business investors in the WB."* The research team believes that the preceding chapters have achieved this objective.

The Inception Report also stressed that the recommendations were to focus on the regional level as: *"The project fits with the wider "Berlin Process" and the "Connectivity Agenda", which stress not only the importance of regional cooperation and integration, but also take into consideration the fact that the WB as a whole might be more attractive to investors as a regional market, rather than as six individual and relatively small markets... Furthermore, the emphasis of the policy recommendations is to be mainly regional, while not forgetting the national perspective."* This is attempted in the remainder of this chapter.

5.1 Summary of key findings

In last ten years, the WB economies have demonstrated progress regarding their policies for attracting and treating FDI in a non-discriminatory manner and for improving their activities for promoting themselves as attractive destinations for FDI. This resulted in significant progress over the past years in developing transparent investment policies. However, this is not enough and the WB economies will need to continue to attract FDI inflows so as to improve their industrial base and competitiveness, increase export and GDP, enable transfer of knowledge and good practice, transfer of technology and integration in global value chains.

The conditions which render the WB region interesting as a destination for attracting FDI are primarily the level of price and quality of the workforce, prevailing operating costs, availability price and quality of raw materials and the proximity of the EU market.

At the same time, many SMEs in EU operating in the manufacturing sector are faced with challenges in relation to maintaining competitiveness, innovation, development and growth, which can negatively impact their position in the EU market and beyond. Key factors include high labour and utility costs, human capital restrictions, constraints connected with infrastructure, land and premises, as well as supply of raw materials. Depending on their particular needs, investment in the WB region may be good choice in overcoming some of those challenges.

Bearing in mind all the above, the policy issue is how to match the need for greater investment on WB with the need of EU SMEs to improve their competitiveness. ***Better matching of EU SMEs´ needs with available resources in the WB could represent a winning combination for both sides***. Improving performance at the enterprise level through the release of innovative potential, increases competitiveness and generates better access to existing and new markets, while also creating positive ripple effects leading to increasing levels of industrial competitiveness in the WB and the EU.

A number of top line recommendations follow from the main conclusions of this study:

- There is lack of the FDI policy as an integrative part of the overall economic policy framework. There is not a clear strategic approach regarding how FDI may contribute to economic and industrial development at the national / local level and what type of spillover effects may be created regarding sectors, cluster or value chain development. FDI instruments are not so much a key part of the FDI policy implementation, as a means to resolve some of urgent problems faced, such as the high unemployment rate and uneven regional development. Consequently, there ***is a need to recalibrate national FDI policy*** based on evaluation of FDI effects on local economies and clear recognition of FDI as an important pillar of economic development in respect to industrial development, competitiveness, innovation and export orientation;
- Industrial policy in the six countries covered is under-developed, under-prioritised and consequently also under-resourced. However, there is increasing recognition that industrial policy is important and there is a good foundation to build-upon. ***Most countries are looking to develop a new industrial policy, in part because the EU accession agenda is shifting in this direction***. Regardless of the reason, it is important to support this development.
- ***There is a need to raise awareness of the critical importance of manufacturing to future economic competitiveness, including exports****.* There is also a need to strengthen the awareness and knowledge of the policy-makers about the importance of SME FDI.
- A key argument is that in order to develop further their export potential, the WB economies need to strengthen their potentially promising manufacturing sub-sectors. Without some leading manufacturing industries, it will be difficult for the other sectors in the economy to ensure increasing exports and higher-level integration into the global economy. ***FDI promotion, therefore, needs to be linked to important objectives within industrial policy development and promotion of potentially promising manufacturing sub-sectors in national WB economies***.
- Within the FDI policy community, whether this is Ministries (policy and legislation) or National Investment Promotion Agencies (implementation), the priority continues to be large firms / MNCs. This is partly a short-term rationale because of political pressure to secure large investment deals (e.g. in terms of employment generated or export orientation), but mainly because most NIPAs automatically equate their role with attraction of MNCs. To the extent that they are oriented towards SMEs, they are neither proactive nor committed; there is an underlying sense that SMEs are more trouble than they are worth. Yet, EU SMEs are on average bigger in size than WB ones and have higher productivity rates, therefore, EU SMEs represent a very relevant target group for the WB region. This means that NIPAs require a more refined understanding of their potential targets and how to effectively approach them. ***The mentality needs to change into an appreciative and a proactive one, underpinned by policies and resources***;
- Relatively small economies and thus relatively small domestic/regional markets are more likely to be of potential interest to small and medium-sized firms than MNCs. Furthermore, the level of competition in attempting to woo potential investors is likely to be much lower than in the case of MNCs, which by definition represent less than 0,1% of all enterprises. The efforts / time / costs of attracting such investment to a WB country are likely to be disproportionate compared with a targeted sub-set of specially selected small and medium-sized enterprises. ***Awareness needs to increase of the potential value of small and medium sized-firms***, combined with the development of the necessary tools to target and access them;
- Besides the fact that there is a lack of SME FDI, it is also evident that the policies of WB countries tend to focus on promotion of investments in companies in the process of privatisation and restructuring, and partially greenfield sites, while investments into the privately-owned SMEs are not particularly promoted. ***This emphasis may require a degree of rebalancing through better crafted and integrated FDI policies;***
- The common experience of the three case studies demonstrates that they can achieve a great deal within a relatively short period of time with their own resources: one investment has reached large company status from the point of view of employment generated. There is a need to raise awareness of the potential long-term effects of SMEs on the local economy, as well as the relatively modest incentives that they may demand, an important consideration in the WB environment. ***The publication of materials demonstrating the SME investment effect should be encouraged as part of the change in mindset***;
- There is little evidence in the six countries of NIPAs targeting SMEs or targeting EU SMEs or indeed targeting EU manufacturing SMEs at the present point in time despiteit being logical for WB countries to develop such an approach. Geography does matter and such investors are on the WB region´s “doorstep.” The three case studies demonstrate that the WB countries have a good deal to offer to this type of enterprise and that such investment can have significant effects on the

local economy and ultimately the regional / national economy too. This reinforces the point that ***WB countries should target this type of investment in a proactive manner in the future.***

- EU SMEs do not appear to be greatly aware of the advantages that the WB region may offer to their business development. In addition, there is a lack of information on WB FDI policies, NIPAs and support at the national and local level that may be offered to EU SME in specific manufacturing sub-sectors. The benefits and potential of the WB / CEFTA market and other trade regimes could be better promoted to the EU SME community. ***There is generally a need to establish effective promotion and communication between the WB´s FDI institutional infrastructure and EU SMEs as potential investors in the region.***

5.2 Country level recommendations

Chapter 3 has already discussed the six country profiles and the conclusions include recommendations. However, the preparation of the IPA II funding regime means that the EU has an important role to play in supporting FDI in the future. The general national recommendations are as follow:

- Significant support has already been delivered in the past by the EU to the various Ministries and IPAs on FDI matters. However, this does not mean that the job is done and that further support is not necessary;
- The country profiles demonstrate that the institutional basis for FDI is constantly changing, remains weak and is in need of institutional strengthening. It would be important to continue supporting the NIPAs in their efforts to improve their services and generate further FDI, but also to link them with other relevant institutions of importance to FDI development, including SME development, Employment support, State Aid, Education, etc., offering related support;
- What were previously NIPA institutions have increasingly evolved and merged into organisations with a wider role. This means that that they no longer focus exclusively on FDI; they increasingly combine a variety of responsibilities in addition (e.g. export, SME development, etc.). The future institution building support will need to recognise the broader nature of these institutions and seek to deliver support more holistically;
- Such support should encourage the relevant institutions to undertake a much more thorough analysis of the potential that they offer to for economic development, including SME development, FDI attraction and export orientation. This means that there is a need for detailed analysis of the sectors and sub-sectors offering potential, including use of cluster / value chain analysis to zero-in on such potential;
- Furthermore, there is a need for more sophisticated strategies that take into consideration not only the potential, but also develop integrated Action Plans which are fully costed and approved by Government / Parliament to ensure that they are credible and have the necessary financial and other resources to be implemented effectively. FDI and related strategies without action plans should be discouraged; so should action plans which are wish lists with no indications of costs/budgets;
- The discussions with the various stakeholders in the six countries demonstrated consistently that the Enterprise Europe Network (EEN) appears to be a poorly understood tool among both EU and WB SMEs. However, it has the potential to become extremely useful in identifying and connecting potential investors. There is a case for developing the EEN in an FDI match-making direction in the future. However, this would require a substantial increase in the profile and promotion of the EEN in the WB region, as well as EU member countries, combined with greater cooperation between the EEN and the FDI/NIPA institutions;
- Future assistance should be premised on the notion that future FDI support (financial, fiscal and other incentives for attracting investment) be catalogued, monitored and evaluated to assess costs, benefits and impact. The same points applies to SME development, export, etc. support. The necessary tools and techniques will need to be developed over time to ensure that this is the default position in future;
- Although there are examples of investment aftercare services in the WB, in reality it is the exception rather than the rule in these countries. Consequently, this type of FDI service will require assistance to be established in the WB countries, so as to maximise the benefit from FDI.

5.3 Regional level recommendations

This section covers the recommendations from the regional perspective. The research team confirms, based on findings from interviews made with public and private sector representatives from all six economies, the basic premise that there is a need for WB countries to operate at the regional level, as well as the individual country level, as far as FDI promotion is concerned.

While WB economies have implemented reforms to attract greater flows of FDI, weaknesses in the more general business climate nevertheless continue to hamper investment. A range of investment climate issues confronting the WB economies require reforms and action at the national and sub-national level. However, there is scope for exploring other forms of co-operation at the regional level to find efficiencies, exchange best practices and improve the image of the region as a whole to potential investors.

The logic for the regional approach is clear:

- It fits with the aims of the Regional Cooperation Council (RCC) and the SEE Strategy 2020;
- It fits with the “Berlin Process” and the “Connectivity Agenda”;
- These are small countries ranging from 600,000 to 7,5 million inhabitants;
- All face similar challenges in terms of human capital, policy development and institution building;
- All face similar constraints in terms of resources (state and other) to promote their countries.

However, a regional approach is never easy to implement and requires effort, time, patience and resources in order to reap medium- to long-term rewards. This applies generally to all such initiatives, and it applies doubly in the case of the WB region and the six countries concerned, given the history of the region.

Preconditions

Therefore, in proposing a regional approach to FDI issues, the research team would highlight some preconditions for a successful regional approach:

- *It must have a medium- to long-term perspective:* such an approach should start during the period 2017-2020 as Phase I, with a planned Phase II covering the EU funding cycle (2021-2028);
- It must start with small / quick wins and gradually build-up intensity over time: there is a degree of scepticism that can only be overcome through achievement of visible success. Success leads to better cooperation and eventually to trust being built-up over time. Seeking to achieve overly-ambitious aims in Phase I may undermine effective cooperation;
- *It must focus on the technical rather than the political:* there is a good deal of scepticism about “taking shops”, international “jollies”, training for “training´s sake” and similar. To ensure active participation and engagement, the regional activities should focus on mixing Ministries (policy makers); NIPAs (implementers); and private sector representatives (Chambers and other associations and FICs), with a focus on technical inputs (with clear eligibility rules for participants) that have the capacity to propel the participants forwards in a professional sense;
- *It must have funding to achieve progress*: the funding should be predicated on testing pilot projects and extending the successful ones to the whole region. The EC would need to ensure that meaningful resources are available as an incentive for effective engagement, otherwise expectations will be low and impact too.

The most obvious implementing body is the Regional Cooperation Council (RCC). The only other option is CEFTA, which is well-respected in the region, but it is probably too small and its remit too specific to pursue the FDI agenda being proposed. The RCC is considered to be a political body for the SEE region but it has a growing technical secretariat that has the capacity to run such a medium- to long-term regional initiative. However, it is currently viewed as an academic/research-oriented institution, rather than a practitioner-oriented one so would need to secure the requisite calibre of technical staff to be able to implement the regional programme proposed below.

The focus of the recommendations would cover Phase I, which would last 4 years. The regional programme would then be evaluated, leading to Phase II for another 7 years (full EU funding cycle) or closed, depending on the outcome of the evaluation.

2017-2020: focus on quick wins, common problems, uncontroversial issues

Operational Issues

- Develop the regional programme, secure funding, sign agreement, etc.;
- Select Implementing Body: e.g. RCC / recruitment of suitable staff;

- Establish a Project Steering Committee (PSC): jointly chaired by RCC and EC, including WB representatives including private sector representatives and investors (SMEs);
- Establish Overall Work Plan and Log Frame;
- Establish Working Groups for each project Component;
- Establish Quarterly PSC / Working Group Meetings;
- Produce Quarterly Progress and Annual Reports;
- Establish Monitoring and Evaluation mechanism for the regional programme.

Component 1. Data and Statistics
This report shows that the statistics available for FDI remain quite limited. This also applies to SME data, use of NACE classification, etc. An uncontroversial but important part of the regional project would be to develop the statistical basis and annual reporting for SMEs/FDI/NACE on a consistent and comparable basis for the WB region.

- Analysis of FDI data within comparable sector classification and statistics in WB region;
- Analysis of SME data and statistics in WB region;
- Recommendations for reform based on EUROSTAT/UNCTAD/OECD best practice per country;
- Implementation of reformed data/statistical collection system (FDI flow/stocks per sector/sub-sector);
- Preparation of annual FDI/SME reports for individual countries/WB/EU28.

Component 2. Regional Marketing
Each country currently markets itself, resulting in an inconsistent and fragmented awareness and presence, as well as information on the individual countries and sometimes no visibility at all for some countries and certainly for the WB region as a potential market. There is, therefore, scope for a regional marketing electronic platform that would also allow each country to present its priorities. This would need to be managed and coordinated (e.g. RCC) yet allow each nation to be responsible for its particular information, potential and priorities:

- Create an electronic platform and promote WB and its potentials and advantages as an attractive investment destination for EU SMEs;
- Determine nature of the regional platform based on regional consultation;
- Regional electronic platform which allows scope for regional information (WB) as well as national data (with overview on countries potentials and locations for investment, etc.) to be presented;
- RCC to populate and update regional information (e.g. population, CEFTA market and other trade regimes, infrastructure, costs, taxes, standards, available natural resources and other potentials, WB indicators, etc.);
- Each NIPA to populate and up-date country specific information: sectors and sub-sectors with potential, clusters, value chains, contact information and links (NIPAs, Ministries, One Stop Shops, EEN, Chambers, policies, strategies, action plans, promotional materials, etc.);
- RCC to manage and maintain the overall system.

Component 3. Knowledge Development
The policy-makers in the line ministries and PM Cabinets and FDI / SME / Industrial institutions are in a state of constant change. Policy priorities consequently change over time. However, there remains a significant need to raise the level of knowledge and know-how, as well as learn from each other: each of the WB countries has experiences to share that others can benefit from and knowledge development can focus on FDI (or be broader, since many aspects are crosscutting in nature):

- Undertake a Training Needs Analysis for each of the NIPAs;
- Prioritise the areas of common interest;
- Develop a three year programme of knowledge development;
- Use international / WB / NIPA staff to undertake high quality, practitioner-oriented training;
- Ensure that all training is interactive;
- Ensure that all training is disseminated within participating countries;
- Ensure that all training leads to action points for implementation;
- Monitor implementation of action points.

Component 4. Sectorial Focus
The WB economies implement a broad package of investment incentives in attracting FDI that are usually administered through national Investment Promotion Agencies. Common fiscal incentives include tax holidays, with either tax exemptions or reductions under some conditions, concerning corporate income tax, VAT or import/export duties and tax loss-carry-forward exemptions (see Annex

3). All of these countries have set-up economic zones, business parks, trade zones and similar initiatives, which offer tax exemptions as one of the benefits, though not all of them are fully functional. Besides these kinds of incentives, some of WB countries apply direct state grants as a part of FDI support. All of them apply principle of national treatment in investment laws and all have signed a number of international investment agreements to add a further layer of predictability and security for investors. The existence of business opportunities in different manufacturing sub-sectors of WB economies, investment incentives for foreign investors provided by individual WB countries, still to be privatised SME manufacturing companies, legal regulations that enable national treatment for foreign and domestic investors in WB economies could be promoted and brought closer to EU good practice:

- Undertake key sector analyses, including resource identification (e.g. raw materials), human resources, Research and Development institutions, local leading companies, export potential, key export markets, etc.;
- Identify and promote the sectors with growth potential common for all six economies (e.g. food processing, metal products, tourism, etc.);
- Identify and promote potential for cooperation at the WB level, including cluster mapping and value chain development with a focus on the manufacturing sector / sub-sectors, etc.

Component 5. EU SME FDI window

How to attract SMEs / EU SMEs to WB is one of emerging priorities for WB economies and their NIPAs. MNCs come and go but the case study SMEs appear, through their investment, to have the intention to solve some of the problems they are faced with and stay in the country of investment on a long-term basis (a theme that will require further research in the future). Changing the NIPAs´ focus from MNCs to EU SMEs would represent a strategic evolution which will require a gradual approach not only in the WB but also the EU; EU SME need to be better aware of how investment in the WB region could help them overcome some of the competitiveness and innovation challenges they are faced with in their countries:

- Review and redevelop the Enterprise Europe Network´s (EEN) role in an FDI match-making direction;
- Increase the profile and promote the EEN in the WB region and EU member countries, combined with greater cooperation between the EEN and the FDI/NIPA institutions;
- Deliver business advisory support for EU SMEs towards WB investment investigation, market and other type analysis via local Business Development Service providers, with costs being co-financed through a scheme similar to the EBRD´s Small Business Service in WB and elsewhere;
- Provide specific financial EU SME FDI support through established WB financial schemes, especially for investment in knowledge and technology transfer, including local clusters or/and integration in value chains.

Component 6. Campaign targeting EU/WB SMEs

The potential value of EU SME FDI in the WB region could be emphasised through a campaign to promote the region and its advantages to predefined priority target groups of small businesses. It would not be enough to create an electronic platform (see Component 2 above). Significant efforts would need to be invested by the implementing body (e.g. RCC, if selected), the NIPAs and the Chambers / Business Associations, supported by the Berlin process so as to:

- Identify EU and national level associations to work with;
- Develop a communication and promotion strategy with a focus on bringing EU/WB SMEs together;
- Delivery a medium term promotional campaign including information and regular B2B events;
- Development of SME support via the national / regional / local Chamber/Association networks.

Component 7. FDI Project Development

This component will assist FDI agencies to develop “practical tools” to improve their performance. If they are developed once, they can be applied to all NIPAs, enabling costs to be reduced and benefits to be shared between the countries, including upgrades, training, etc. The possible “tools” could include the following, but need to be tested prior to specification and commissioning:

- Client Management and Tracking System;
- Good Practice Aftercare package;
- Good Practice State Aid calculation and monitoring: FDI/SMEs;
- Calculating Costs and Benefits of Incentives (financial, fiscal, etc.).

The achievements of Phase I would need to be monitored and evaluated.

Assuming the evaluation demonstrates value for money, the lessons learned would be applied to Phase II, which would run from 2021 for a period of a further seven years, with a mid-term and a final evaluation.

The second phase would build on the trust, cooperation and capacities built-up during Phase I.

The ambition of Phase II could be enhanced to include much more demanding topics, such as harmonization of FDI incentives and their alignment with the EU state aid rules, free zones and similar.

ANNEXES

ANNEX 1 – ECONOMY AND INDUSTRY DEVELOPMENT OF WESTERN BALKANS

Development level and GDP growth

The Western Balkan (WB) region with six countries under observation has a population less than 20 million and a relatively low level of development. Its total GDP was 76,5 billion EUR in 2014, which accounts for 7% of the EU-10's GDP and 0,5% of the EU-27's GDP. Size, population and level of economic development vary among the countries of the region. In 2011, the Western Balkans' average GDP per capita in terms of purchasing power parity (PPP) was 7.850 EUR, 31% of the EU-27 average and 49% of the EU-10 average.

However, the countries of the WB have undergone a major economic transformation over the past 15 years, and many are unrecognizable compared with where they stood at the turn of the century. After 2000, the WB countries enjoyed sustained economic growth up until the global financial crisis. During this pre-crisis period, real GDP per capita in the region increased by more than 40% on average, riding the tide of deeper financial and trade integration with the rest of Europe, high capital inflows, rapid credit expansion, and productivity growth.

During 2001-2008, the countries in the region experienced fast economic growth, gradual macroeconomic stabilisation, major inflows of foreign direct investment (FDI) and implemented many important economic and institutional reforms. The fresh start in economic development was sustained by a new strategy of the EU which facilitated economic integration of the WB through increasing trade, FDI, banking and financial integration. With average economic growth across the region exceeding 5% per year over 2000–2008, income per capita increased significantly and partially closed the gap with the standards of living of Europe's richest countries.

Indeed, the WB experienced investment booms in the 2000s owing to substantial capital inflows and low global interest rates. The large productivity gains likely resulted from the transformation toward market economies, although the relatively small contribution of labour inputs and the consequent high importance of productivity could be also partly explained by the large informal economies in the WB countries.

Economies have become increasingly export-oriented, with fYRoM and Serbia experiencing particularly noticeable gains. And this has been accompanied by increasing diversification of their export markets, with greater trade within the region and concomitantly, lesser reliance on exports to advanced EU economies. Moreover, FDI inflows were directed into investment in non-tradable sectors, such as financial services, real estate, and construction, rather than tradable sectors that can generate stronger export performance.

While macroeconomic stability is necessary for sustained income growth, it is not sufficient; structural issues must be tackled so that the WB countries can accelerate growth and restart their EU convergence process.

Clear evidence of the weakness in the region's economic model can be found in the extremely high unemployment rates, which remained above 20% in many countries even at the height of the pre-crisis boom. The WB countries also need to generate jobs to reverse the weak labour market outcomes that are leaving so many behind. Carefully prioritising economic policies is essential to manage development risks. Like the macro-fiscal policy agenda, the structural reform agenda is multipronged: stimulate employment by eliminating disincentives and barriers to formal jobs, support investment by improving governance and the business environment, and deepen international integration and connectivity.

Table 1. Gross domestic product of WBs 2005-2014 (current prices)[41]

(in million EUR)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	1.815	2.149	2.681	3.086	2.981	3.104	3.234	3.149	3.327	5.379
fYRoM	5.032	5.472	6.095	6.772	6.767	7.109	7.544	7.586	8.112	8.533
Albania	6.561	7.168	7.828	8.800	8.661	8.997	9.268	9.586	9.629	9.956
Serbia	21.103	24.435	29.452	33.705	30.655	29.766	33.424	31.683	34.263	33.059
Bosnia and Herzegovina	8.768	10.005	11.282	12.774	12.428	12.720	13.177	13.158	13.674	13.937
Kosovo [42]	3.003	3.120	3.461	3.883	4.070	4.402	4.815	5.059	5.327	5.600

Source: Eurostat.

Looking at the GDP in absolute values during period 2005-2014, Serbia stands out as most developed country of WB region followed by Bosnia and Herzegovina. However, looking at the annual grow rates for each country under observation in the same period, Serbia had the lowest average growth rate of 2,04%, instead Kosovo which growth rate of GDP averaged at 4,09% and fYRoM which average growth rate in the period of analysis was 3,87%.

Table 2. Real GDP growth rate of WBs 2005-2014

(in %)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	4,2	8,6	10,7	6,9	-5,7	2,5	3,2	-2,5	3,3	1,8
fYRoM	4,7	5,1	6,5	5,5	-0,4	3,4	2,3	-0,5	2,7	3,8
Albania	5,7	5,4	5,9	7,5	3,4	3,7	2,5	1,4	1,1	2,1
Serbia	5,5	4,9	5,9	5,4	-3,1	0,6	1,4	-1,0	2,6	-1,8
Bosnia and Herzegovina	3,9	5,7	6,0	5,6	-2,7	0,8	1,0	-1,2	2,5	1,1
Kosovo	6,0	3,4	8,3	4,5	3,6	3,3	4,4	2,8	3,4	1,2

Source: Eurostat, World Bank.

The positive trends of economic growth were interrupted by the global economic crisis which severely hit the WBs in late 2008. Thereafter, the WB countries have registered negative or much lower real GDP growth rates in comparison to the pre-crisis period. In 2014 real GDP in the WBs was still almost 10% below its 1989 level, whereas it was almost 60% higher on average in the countries that joined the EU in 2004-07. GDP per capita in the WBs was only 27% of the average level in the EU15 countries.

The financial integration and strengthening trade relations with EU countries (especially with Austria, Germany, Slovenia and Italy) led to the harmonization of business cycles between the WBs and the European Union. As a result, economic growth here now increasingly depends on the performance of the European economy.

Economic activity in the WBs is picking up speed, and growth in the region is expected to average 1,8% for 2015. The highest growth rates projected for 2016 are 3,4% for Montenegro and 3,2% for fYRoM; the lowest is Serbia's 0,5%. Also, the medium-term growth prospects are positive. The regional growth rate is forecast to rise to an average 2,6% in 2016–2017, stimulated by recovering domestic demand and low oil prices, but moderated by tightening global financing conditions.

Employment in Western Balkan region

The last economic crisis brought to the surface many structural problems of the WBs that have been accumulating during the past two decades. The WB countries have had large external imbalances that have led to increasing trade and current account deficits and rising external debt. Their labour markets have been characterized by "jobless growth" that has brought exceptionally high unemployment and low employment rates. While the recovery has encouraged job creation, unemployment is still very high, especially for the young. Employment throughout the region is slowly picking up, but it is above

[41]**Gross domestic product (GDP)** is the sum of gross value added by all resident producers in the economy plus any product taxes (less subsidies) not included in the valuation of output. It is calculated without deducting for depreciation of fabricated assets or for depletion and degradation of natural resources. An economy's gross domestic product (GDP) represents the sum of value added by all its producers. That is the value of the gross output of producers less the value of intermediate goods and services consumed in production, before accounting for consumption of fixed capital in production.

[42]Under United Nations Security Council Resolution 1244/99.

2008 pre-crisis levels only in fYRoM and Montenegro. In Serbia and fYRoM, with growth firming up, the employment rate has moved up to 42% in Q2 2015, the highest level since 2009 in each country. Despite this positive development, unemployment, which averaged 21,6% in Q2 2015, is still a central structural issue for the region.

Table 3. Employment rate (15 to 64 years) for WBs in 2005-2014

(in %)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	40,9	41,0	49,2	50,8	48,7	47,6	45,9	47,0	47,4	50,4
fYRoM		39,6	40,7	42,0	43,3	43,5	43,9	44,0	46,0	46,9
Albania			56,4	53,8	53,4	53,5	58,7	55,9	49,9	50,5
Serbia	51,0	49,8	51,5	53,7	50,4	47,2	45,4	45,3	47,5	49,6
Bosnia and Herzegovina		35,0	36,8	40,7	40,1	39,0	38,7	38,5	38,5	39,0
Kosovo	28,5	28,7	26,2	24,1	26,1	n.a	n.a	25,5	28,4	26,9

Source: Eurostat

Unemployment rates in WBs during period of analysis is significantly reduced only in Montenegro, and increased only in Albania, while in all other countries they are at the same level or slightly decreased.

Table 4. Unemployment rates for WBs in 2005-2014

(in %)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	30,3	29,6	19,3	16,8	19,1	19,7	19,7	19,7	19,5	18,0
fYRoM	37,3	36,1	34,9	33,8	32,2	32,0	31,4	31,0	29,0	28,0
Albania	14,1	13,8	13,5	13,0	13,8	14,0	14,0	13,4	15,9	17,5
Serbia	20,8	20,9	18,1	13,6	16,1	19,2	23,0	23,9	22,1	18,9
Bosnia and Herzegovina	43,9	31,2	29,1	23,5	24,1	27,3	27,6	28,2	27,6	27,6
Kosovo	41,4	44,9	43,6	47,5	45,4	n.a	n.a	30,9	30,0	35,3

Source: Eurostat

Table 5. Employment in industry of WBs 2005-2014

(% of total employment)

Country name/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	18,9	18,2	17,6	21,5	20,8	20,0	19,0	18,2	17,4	17,3
fYRoM	32,2	32,6	31,3	31,3	30,9	30,5	30,0	29,9	29,6	29,6
Albania	13,5	13,5	18,7	18,0	21,0	20,8	20,6	20,4	21,5	21,8
Serbia	27,4	29,3	29,4	26,2	25,3	26,1	26,9	26,5	26,0	26,1
Bosnia and Herzegovina	28,6	30,6	32,6	32,4	31,5	30,8	28,8	30,2	31,7	31,7
Kosovo	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	28,4

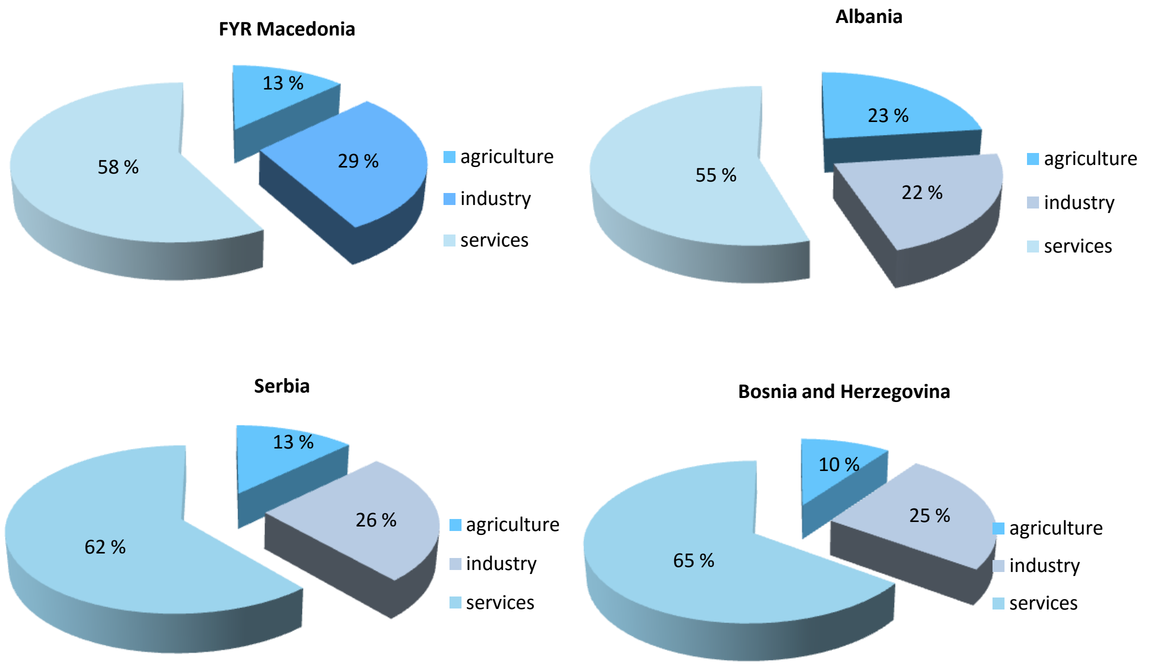
Source: International Labour Organisation Statistics.

Employment in industry between WB countries varied during the time in different directions. While the employment in industry increased in Albania and Bosnia and Herzegovina at the end of observed period it has fallen in Montenegro and Serbia. However, employment in industry in WB is higher in all countries except in Montenegro and Albania comparing with employment rate in industry of Euro area which in 2014 was recorded at 23,86%.

Structure of output of Western Balkan region

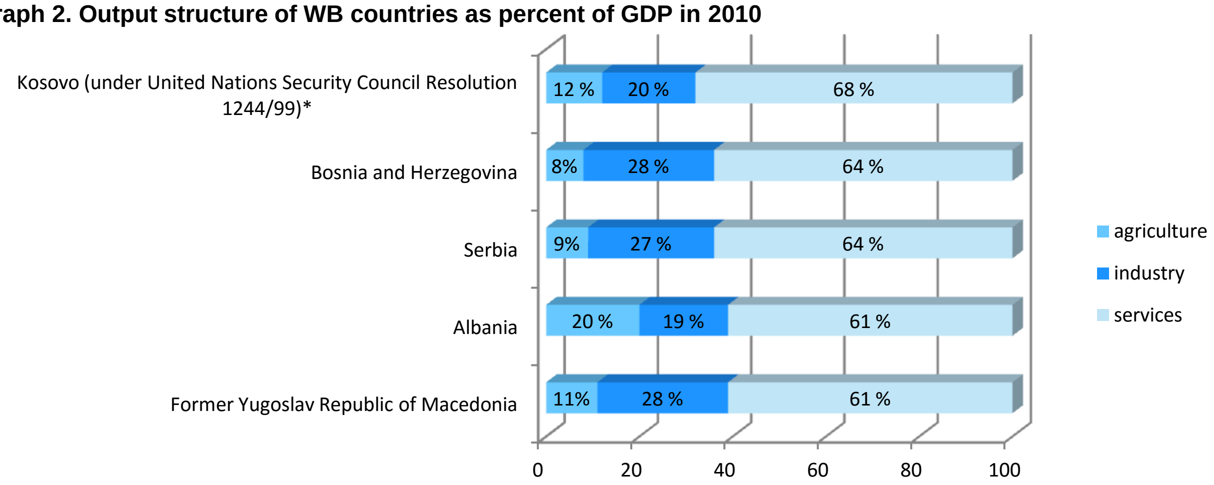
A further problem is connected to structural changes in WB economies. The WBs have become prevalently service economies after a prolonged process of deindustrialisation. Although some deindustrialisation was inevitable in all former socialist countries at the beginning of the transition since they had an oversized industrial sector, in the WBs the process continued also in the 2000s. This contributed to a decline of the share of tradable goods, dominated by manufacturers, thus impeding faster export growth. The structure of FDI has greatly contributed to such structural change, since around two thirds of FDI has gone into non-tradable services - banking, telecommunications, retail trade, real estate.

Graph 1. Output structure of WB countries in % of GDP in 2006



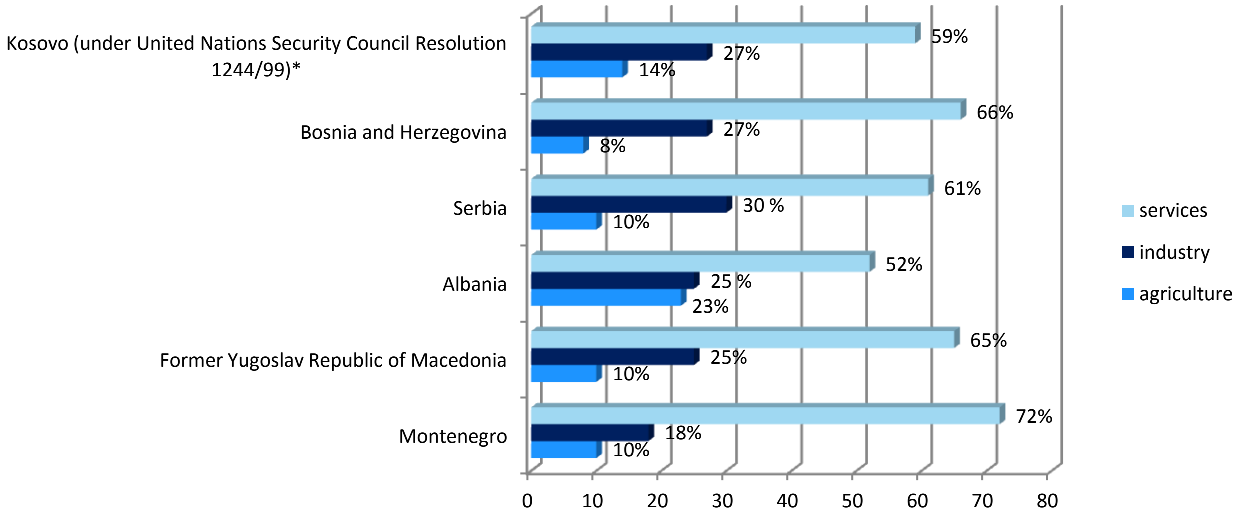
All countries under survey had approximate shares of all three main sectors in economy in 2006 with Albania that has lowest level of service sector 55% and highest level of agriculture 23%. Data for Kosovo and Montenegro are included in data for Serbia and could not be separately observed.

Graph 2. Output structure of WB countries as percent of GDP in 2010



Looking at the output structure of WBs in 2010, in all countries the share of agriculture in GDP was reduced, the share of the service sector in GDP increased in Albania and fYRoM, but the share of industry in GDP slightly increased only in Bosnia and Herzegovina and Serbia, while it further decreased in Albania and fYRoM on the account of the service sector. Such structural changes were largely affected by FDI inflows during transition period.

Graph 3. Output structure of WB countries as % of GDP in 2014

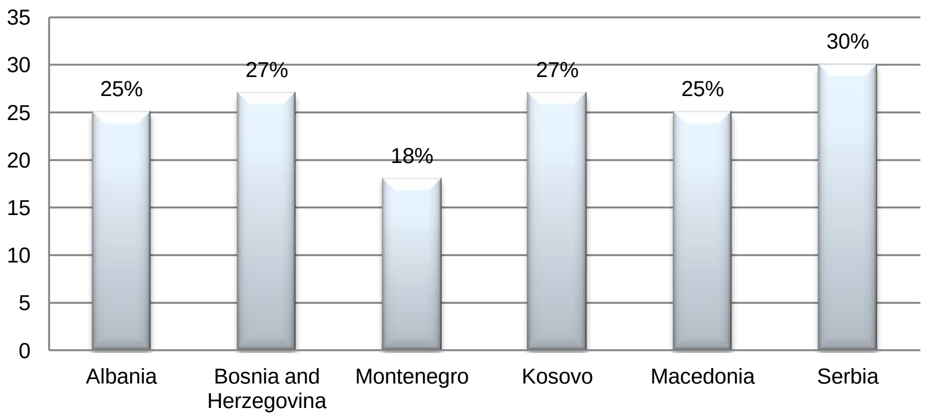


In 2014, the output structure of the WBs significantly changed in the case of some countries. Kosovo, for example notably increased its share of industry and reduced its share of the service sector in GDP against 2010 (share of service sector reduced from 68% of GDP in 2010 to 59% of GDP in 2014, and share of industry increased from 20% in 2010 to 27% in 2014). Albania experienced the same trend, which reduced the share of the service sector in GDP from 61% of GDP in 2010 to 52% of GDP in 2014 and increased the share of industry from 19% of GDP in 2010 to 25% of GDP in 2014. Such notable movement in the output structure indicates that structural changes occurred over the time remarkably affected by FDI inflow.

Output in manufacturing of Western Balkan region

Based on classification and methodology of accounting output structure by World Bank, **Industry** is the sum of gross output less the value of intermediate input used in production for industries which cover mining, manufacturing (also reported separately), construction, electricity, water, and gas. **Manufacturing** is the sum of gross output less the value of intermediate input used in production for industries.

Graph 4. Industry share in GDP in 2014 in %



Based on presented data for WB countries in last observed year, remarkable differences are visible in its share of manufacturing in GDP, starting with only 5% in case of Montenegro to 19% in case of Serbia. Such different levels of manufacturing between countries in the same region resulted from different economic and industry policies, different levels of FDI inflow, and different directions in economic developments and effectiveness of economic transformation during the last two decades.

Value added in industry of Western Balkan region

Industry value added is the net output of a sector after adding up all outputs and subtracting intermediate inputs. Gross output can also be measured as the sum of an industry's value added and intermediate inputs. Industrial value added and industrial production are both very informative indicators of developments in industrial activity.

Table 6. Industry of WBs, value added 2005-2014

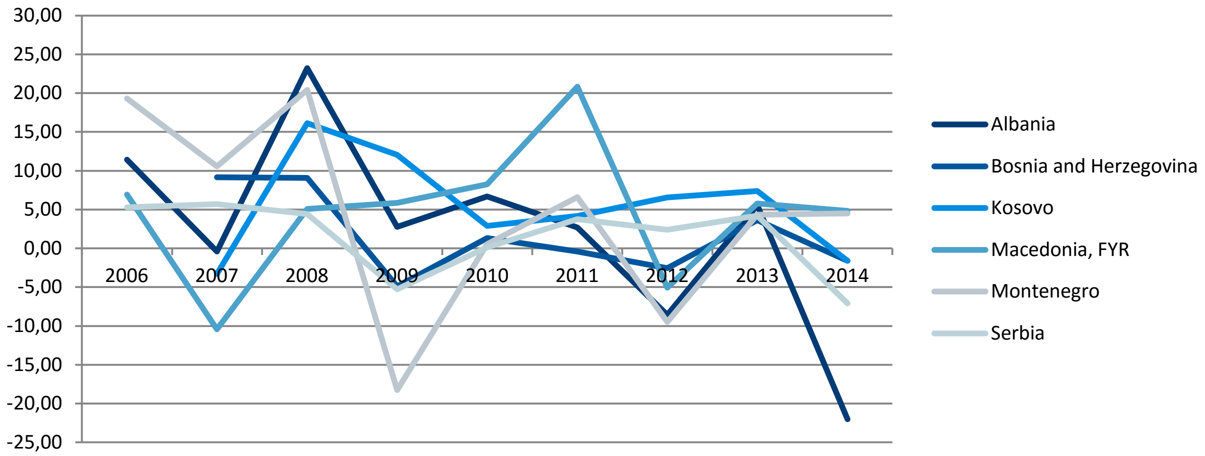
(in % of GDP)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Albania	25,22	26,41	25,33	29,02	28,22	28,69	28,15	26,45	26,37	25,16
Bosnia and Herzegovina	26,38	26,77	27,87	28,90	27,90	27,60	27,26	26,63	27,10	26,78
Kosovo	n.a	27,10	24,69	27,63	28,01	28,40	28,84	28,06	28,23	26,66
fYRoM	23,71	24,92	23,88	22,69	21,95	24,40	25,10	24,37	24,55	24,81
Montenegro	20,71	20,41	20,87	21,15	20,08	20,54	18,02	17,75	18,84	17,67
Serbia	29,3	29,33	28,31	28,65	28,67	28,40	29,50	30,29	31,66	29,80

Source: Eurostat, WDI, World Bank

The annual change in *industry value added* correlates with the pace of economic recovery that has been slower than in pre-crisis period. All countries experienced an unstable trend in industry production after the crisis but stronger global demand and export levels in some years restored the pre-crisis production despite the weak domestic demand. The reduction was remarkable in Albania, particularly in 2014 when industry value added declined by 22%, while it increased to 4,85% in fYRoM and 4,5% in Montenegro.

Graph 5. Annual change in industry value added in WB countries in period 2005-2014 in %



Annual changes in gross industrial production in WBs during last five years (presented in the next chart) indicate that only Albania had constant rise in industrial production. The majority of other economies of WB experienced a fall in 2011, but positive trends in 2013 due to rise of domestic and foreign demand. In 2014 only Kosovo and fYRoM had an increase in gross industrial production.

Table 7. Annual change in gross industrial production of WBs 2010-2014

(in %)

Country/Year	2010	2011	2012	2013	2014
Montenegro	17,5	-10,3	-7	10,7	-11,4
fYRoM	-4,9	6,9	-2,7	3,2	4,8
Albania	36,2	19	15,7	28,4	7,6
Serbia	1,2	2,5	-2,2	5,3	-6,8
Bosnia and Herzegovina	4,3	2,4	-3,9	5,2	0,2
Kosovo (under United Nations Security Council Resolution 1244/99)	1,8	-5,7	-3,3	0	10

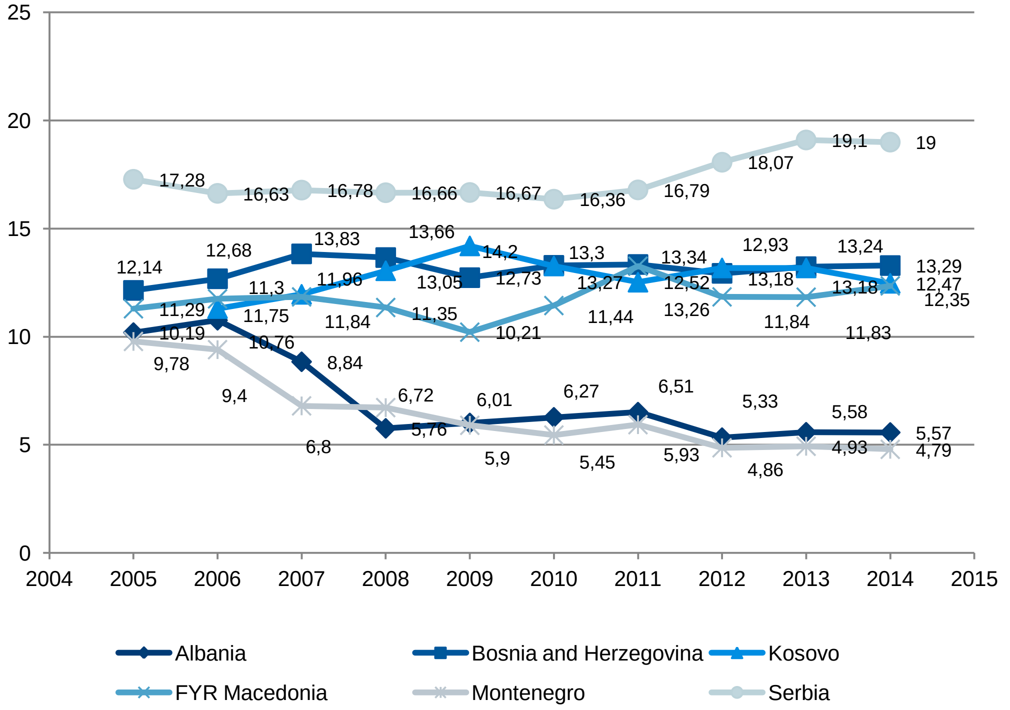
Source: WiiW databases incorporating national statistics and IMF.

Manufacturing value added in Western Balkan region

Manufacturing value added is the sum of gross output less the value of intermediate inputs used in production for industries. Based on World Bank statistics, Serbia is the most industrialised WB economy with a 19% share of manufacturing value added in GDP (2013), but its share is still lower than the shares in the Czech Republic (25%), Romania (24%), Hungary (23%), Slovenia (22%) or Slovakia (21%).

The WB economies have become largely service economies, with an average share of services in 2014 of 62% of GDP, slightly lower than the share of the 10 new EU member states (64,2%) (World Bank, 2015).

Chart 6 . Manufacturing value added of WBs in 2005-2014 in % of GDP



Manufacturing value added in percent of GDP systematically decreased over time in Montenegro and Albania, achieving 4,79% of GDP and 5,57% of GDP, respectively in 2014. In all other WB economies the share of manufacturing value added in GDP during the time 2005-2014 increased, even slightly.

Table 8. Manufacturing value added of WBs 2005-2014

(annual growth in %)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Albania	13,02	13,16	-12,54	3,23	7,19	16,80	-1,46	-15,04	16,73	3,63
Bosnia and Herzegovina			12,05	6,15	-5,53	6,86	0,06	-0,86	4,79	-2,49
Kosovo			9,69	15,36	11,48	1,75	-5,73	14,94	6,52	-1,28
fYRoM	11,01	12,60	-13,03	-2,41	4,82	-0,08	12,37	-1,22	9,00	9,78
Montenegro	18,31	4,50	9,30	-6,38	-27,08	-3,87	10,74	-12,88	6,52	-2,05
Serbia	-0,04	1,90	9,47	3,33	-4,52	-0,33	1,86	7,66	5,67	n.a

Source: WDI, World Bank

Manufacturing is the predominant industrial subsector, especially in Serbia, fYRoM and Kosovo. The utilities subsector of industry, including energy production, is important for Bosnia and Herzegovina and Montenegro. The mining subsector plays a minor role; from 1% to 3% of the economy in the case of Kosovo. However, the average share of manufactured goods in total exports is much lower in the WB compared to EU-11 (55% versus 71%). However, this varies widely across the countries, from only 20% in Montenegro to around 80% in fYRoM (due to the strong pro-FDI policies mostly in tradable sectors).

This reflects the fact that the region is not well integrated into EU (or global) supply chains. Also, the sophistication of the exported manufactured goods is worse than in EU-11. Over 50% of the regions' manufactured goods are either labour and resource intensive or low-skill and technology intensive, in comparison to about 30% in the EU-11. However, only 18% fall into the category "*high-skill and tech-intensive goods*" in comparison to 27% in the EU-11.

The results indicate that the WB region is integrated mostly into the final stages of international supply chains in *food, beverages and tobacco* in addition to *textiles and clothing*, and mostly the intermediate stages of *wood and cork, paper, printing and publishing, other non-metallic mineral products and fabricated metal products*, as well as in first and intermediate stages of *basic metals*.[43]

Table 9. Manufactures exports of WBs 2005-2014

(% of merchandise exports)[44]

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Albania	43,47	27,00	70,23	33,41	70,15	62,05	60,08	55,25	52,29	31,36
Bosnia and Herzegovina	57,56	62,06	63,32	64,00	60,74	56,98	57,72	61,40	61,50	64,98
Kosovo	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
fYRoM	71,65	69,43	76,07	n.a	50,87	68,07	70,90	71,80	75,30	79,84
Montenegro	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Serbia	64,15	63,68	65,93	n.a	n.a	n.a	n.a	n.a	n.a	n.a

Source: UN, Comtrade.

Although, the manufacturing sector has substantial weight in most WB economies and accounts for a significant share of domestic or regional merchandise exports and imports, the net result is only permanently positive in case of fYRoM where manufacturing export exceeds manufacturing imports. However in all WB economies share of manufacturing exports in merchandise exports slightly increase during period while share of manufactures imports continually decreased over the years.

In the manufacturing sector greenfield investments with export-orientation have been rather sporadic because of problems with the business environment. Also, most of the FDI in the WB countries has been channelled into the services sectors or in retail trade and much less into manufacturing industry that otherwise would be important from the perspective of an export-oriented strategy.

Table 10. Manufactures imports of WBs 2005-2014

(% of merchandise exports)

Country name/ Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Albania	71,30	64,10	65,12	63,36	67,61	63,57	60,67	59,02	61,49	37,34
Bosnia and Herzegovina	66,07	63,25	64,88	63,27	62,19	58,43	56,91	57,00	58,49	62,54
Kosovo	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
FYRoM, FYR	63,52	62,81	62,46	62,04	62,22	61,65	55,74	53,92	58,98	58,31
Montenegro	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Serbia	65,52	65,11	69,47	n.a	n.a	n.a	n.a	n.a	n.a	n.a

Source: UN, Comtrade.

In order to develop further their export potential, the WB economies need to strengthen the fastest growing (and new potentially promising) manufacturing sectors, that are also likely to give an important push to domestically provided commercial services. Without some leading manufacturing industries, it will be difficult for the service sector alone to ensure increasing exports and a faster integration into the global economy.

[43] EBRD, Peter Sanfey, JakovMilatović and Ana Krešić, "How the Western Balkans can catch up", January 2016
[44] **Manufactures** correspond to the commodities chemicals, basic manufactures, machinery and transport equipment and miscellaneous manufactured goods.

ANNEX 2. DEVELOPMENT OF TRADE RELATIONS BETWEEN EU AND WESTERN BALKANS

Overview of International trade of Western Balkans

Accompanied with global financial crises, in WB countries, total trade fell to its lowest point in 2009, a decline of 20,5% from its peak in 2008. Since then, it has gradually recovered, increasing by 23,2% across the region in 2013. As of 2014 the trends in international trade were largely driven by the sluggish economic growth and the persisting economic and political turmoil in various part of the world.

In line with above, recent economic outcomes in WBs have been influenced by three major developments in the global economy:

- Gradual pick-up in activity in the EU;
- falling global oil prices since mid-2014;
- The weakening of the euro and strengthening of the USD.

First, the recent growth recovery in main trading partners had a positive effect on WB exports. All countries in the WBs realise that sustainable growth must be built on an improved export performance, rather than on cheap and plentiful supplies of foreign capital and credit.

The underlining causes of the trade slowdown manifest themselves in their different effects on the various typologies of products. For example, macroeconomic cycles affect the trade of investment goods more directly. Similarly, commodity cycles are greatly reflected in the trade of primary products. Besides, structural changes in the international patterns of production should be reflected more in the trade of intermediate products, while weakness in demand should affect consumers' goods and services relatively more.

The exceptional growth of international trade in the last two decades was undoubtedly also a consequence of the vertical specialisation brought by global value chains. The production structure of the past where goods, services, people, technology and capital remained within national borders was internationalised so as to take advantage of lower cross-border transaction costs driven by technological innovations and more open trade policies. The consequence of this process was a steady increase in trade, particularly in intermediate products. However, the global value chain production model started to slowly lose steam during the last decade and is thought to have now largely stabilised. The rationale is that the benefits from communication and information technology innovations have been already reaped, while trade liberalization and regulatory harmonization has not progressed fast enough to provide new incentives to further delocalisation of production processes.[45]

However, trade integration, within the region and with the rest of the world, is below potential. The region's average trade openness (exports plus imports divided by GDP) is at 70% of the EU-11. This is due to different reasons. The cost and time to export tend to be higher in WB countries vis-à-vis EU members.

In the WB countries the foreign trade liberalisation resulted in rapid export growth, but the initial figures were extremely small while imports increased even faster, which led to a massive trade deficit. External balance started to improve after the first years of the crisis, but the major drive behind it was the larger drop of imports compared to exports.

The signing of CEFTA 2006 was an important step in terms of external trade development as it laid down the foundations for free trade among the WB countries both in respect of industrial and agricultural products by replacing the complicated system of bilateral free trade agreements in the region with a single multilateral framework. CEFTA has a relatively high share in the member states' external trade indicating the importance of existing economic ties in the region.

The share of EU in their export is 40-60%, which is considerably smaller than was the case of the Central European countries (60-70%) when they joined the EU in 2004. Albania shows a different pattern particularly because of its intensive economic relations with Italy (the EU

[45] UNCTAD, „Division on International Trade In Goods and Services, and Commodities", 2015.

accounts for 80-85% of its exports). But, the fYRoM leads the region in trade policy reflecting its advanced trade policy implementation.

Deepen trade integration, improving the physical and institutional connectivity of the WB countries within and across countries and the rest of the world would help make the region more competitive, supporting domestic and foreign firms in reaching beyond established markets and products. Advancing in the EU accession process represents an opportunity for the WB countries to pursue an EU integration agenda that will have positive impact on potential growth through improved trade and export performance.

Box 1. Trade Policy and Facilitation Dimension in the SEE 2020 Strategy[46]

Trade Policy and Facilitation is a key element of the Integrated Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The central objective of the Integrated Growth Pillar is to promote regional trade and investment linkages through non-discriminatory, transparent and predictable policies that will enhance the flow of goods, investment, services and people within the region.

SEE 2020 sets the following main trade-related headline targets:

- *Boost total SEE trade in goods and services from EUR 94.4 billion to EUR 209.5 billion by 2020;*
- *Reduce SEE trade deficit from 15,7% to 12,3 % of GDP by 2020;*
- *Increase SEE intra-regional trade in goods by more than 140% by 2020.*

Furthermore, SEE 2020 focuses on a number of free trade actions: fully liberalise trade in agricultural products; address distortive sanitary and phytosanitary (SPS) measures; remove unnecessary technical barriers to trade; employ regional transparency tools to systemise detection of trade irritants; eliminate non-automatic input licenses that contravene WTO and EU regulations; modernise customs interconnectivity; and reduce trade in services restrictions.

Table 1. Import of goods and services of WBs 2005-2014

(in % GDP)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	61,08	79,10	86,70	94,00	65,42	62,74	64,31	68,09	61,43	59,98
fYRoM	51,03	54,76	61,98	68,35	54,37	58,09	66,07	66,84	61,91	65,10
Albania	47,47	48,52	54,79	56,44	53,76	53,02	56,75	51,99	53,48	47,25
Serbia	47,14	50,60	52,66	54,14	42,74	47,92	49,37	53,60	51,91	54,26
Bosnia and Herzegovina	73,73	64,60	57,68	60,59	49,72	52,27	56,79	56,87	55,18	57,63
Kosovo[47]		47,82	50,66	54,25	51,93	55,41	56,76	52,37	48,94	50,55

Source: WDI, World Bank

Table 2. Export of goods and services of WBs 2005-2014

(in % GDP)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	43,55	49,37	44,39	39,48	32,12	37,04	42,35	43,67	41,34	40,14
fYRoM	34,81	37,79	44,12	43,22	32,81	39,79	47,12	45,37	43,79	47,86
Albania	22,82	24,93	28,08	29,59	29,60	32,44	34,01	33,35	35,45	28,25
Serbia	27,14	30,27	28,36	29,12	26,85	32,93	33,98	36,93	41,20	44,34
Bosnia and Herzegovina	32,56	35,90	27,69	27,42	25,51	30,28	32,61	32,77	34,21	34,34
Kosovo		12,62	15,48	15,66	17,06	19,85	19,56	18,25	17,34	19,61

Source: WDI, World Bank

Presence of manufacturing products in export of Western Balkans

Across the region, *exports of goods* make up a larger and faster-growing share of all exports than services. In 2013, they accounted for 65% of aggregate exports, against 35% for services. From 2009 to 2013, the average annual growth rate in regional exports of goods was 15%, while in services it was 4%. At 26%, the contribution of trade in services to WB regional GDP lags behind the EU, where it accounted for 41% in 2013.

[46] OECD, "Competitiveness and Private Sector Development Competitiveness in South East Europe", A POLICY OUTLOOK, 2016

[47] Under United Nations Security Council Resolution 1244/99.

Table 3. Share of main manufacturing products in total exports of WBs 2012-2014

(in %)

Indicator	Albania			Bosnia and Herzegovina			fYRoM			Montenegro			Serbia		
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Food	4,6	4,5	5,0	7,4	7,5	7,0	**14,9**	**15,1**	**12,7**	**15,6**	**15,0**	**27,6**	**23,5**	**18,6**	**20,1**
Fuels	**26,6**	**31,0**	**25,5**	**9,0**	**11,4**	**9,6**	6,5	2,5	1,8	**13,9**	**28,9**	**15,2**	3,6	4,8	3,7
Iron and steel	9,8	8,1	8,1	6,5	5,4	5,5	**20,8**	**18,3**	**14,7**	4,5	3,2	1,3	3,3	2,8	3,3
Chemicals	0,6	0,8	0,7	6,0	5,8	6,5	**16,9**	**19,4**	**21,3**	3,2	2,4	3,8	8,1	8,5	8,0
Machinery and transport equipment	3,6	3,3	3,6	**12,4**	**13,1**	**14,0**	**9,9**	**13,3**	**21,1**	7,0	6,9	6,7	**22,7**	**31,1**	**30,1**
Textiles	0,4	0,4	0,5	0,9	0,9	0,9	1,5	1,8	1,6	0,0	0,0	0,0	1,2	1,1	1,3
Clothing	**14,8**	**14,0**	**14,0**	3,4	3,6	4,0	15,0	14,5	13,6	0,2	0,2	0,4	4,5	4,1	4,2
TOTAL	**60**	**62**	**57**	**46**	**48**	**48**	**86**	**85**	**87**	**44**	**57**	**55**	**67**	**71**	**71**

Source: WTO

Looking at the data presented, the export of goods and services increased during the period of observation in all countries except in Montenegro and it has been stable and at the almost same level in case of Bosnia and Herzegovina. Generally, in all WB economies imports of goods and services makes a bigger share to GDP than export of goods and services and it fell during the period in case of Bosnia and Herzegovina and significantly in case of Montenegro.

Exports of manufacturing products of the countries are published each year by World Trade Organisation (WTO). All product groups in WTO classification are defined according to Revision 3 of the Standard International Trade Classification (SITC).Unless otherwise indicated, exports are valued at transaction value, including the cost of transportation and insurance to bring the merchandise to the frontier of the exporting country or territory (f.o.b. valuation). Imports are valued at transaction value plus the cost of transportation and insurance to the frontier of the importing country or territory (c.i.f. valuation).[48]

Concerning the share of manufacturing products in total export of WBs in 2014 for the individual WB economies, indicators show wide differences:

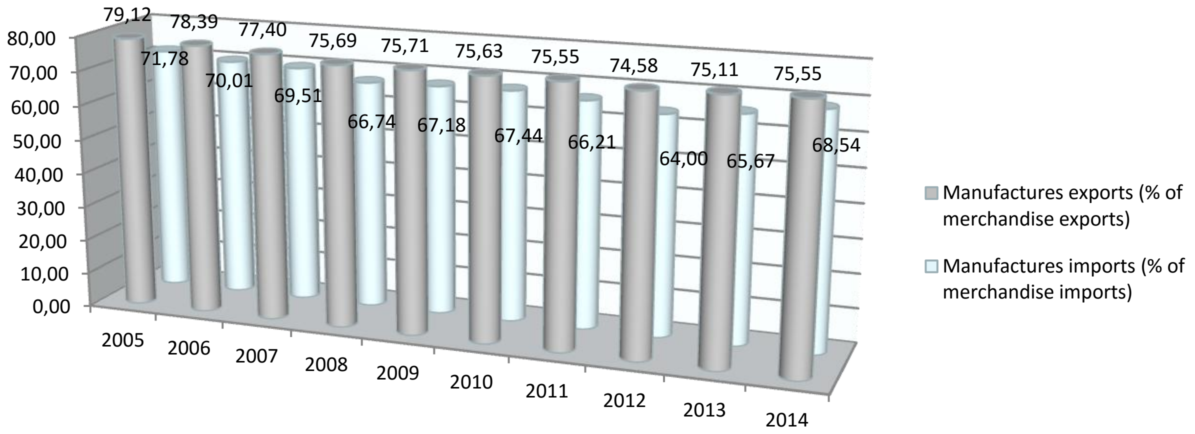
- Dominant manufacturing products in total export of Albania in 2014 are fuels (25% of export) and clothing (14% of export);
- Dominant manufacturing products in total export of Bosnia and Herzegovina in 2014 are machinery and equipment (14% of total export) followed by fuels (9,6%);
- In total export of fYRoM Chemicals have biggest share in 2014 (21,3% of export) and machinery and equipment (21,1% of total export);
- Leading manufacturing products in total export of Montenegro in 2014 are food (27,6%) and fuels(15,2%);
- Leading manufacturing products in total export of Serbia in 2014 were Machinery and transport equipment (30,1%) followed by food (20,1%).

Manufacturing trade of EU

Merchandise trade of EU in percent of GDP has been steadily increasing over the period of analysis from 57,5% GDP in 2005 up to 65,74% GDP in 2014 and reached the highest value of 67,71% GDP in 2012. Unlike the WB countries, manufacturing exports of EU exceeds manufacturing imports as percent of merchandise trade in all years under observation (Chart 1).

[48] Total merchandise exports from each region are aggregated from country figures published by the International Monetary Fund in International Financial Statistics, other international organisations, and national statistical authorities. The total merchandise exports of each region are distributed by destination and then by product. The regional and commodity breakdown is based on OECD, Monthly Statistics of Foreign Trade; UNSD, Comtrade, database, International Trade Statistics Yearbook, and Monthly Bulletin of Statistics; national statistics and Secretariat estimates

Chart 1. Manufactures exports and imports of EU as % of merchandise trade in 2005-2014



The Standard international trade classification distinguishes four main categories of manufactured goods:

- Chemicals (SITC 5);
- Manufactured goods classified chiefly by material (SITC 6);
- Machinery and vehicles (SITC 7);
- Miscellaneous manufactured articles (SITC 8).

The EU exports consist mainly of manufactured products: their share has annually been around 80 % of total EU exports. In 2013, exports of 'machinery and vehicles' and 'other manufactured goods' together reached EUR 1.365 billion, with an increase of about 50 % in comparison with the lower level of 2009.

About 60 % of EU imports are manufactured goods. The breakdown diverges from exports: 'machinery and vehicles' and chemical products account for a smaller share while the share of 'other manufactured goods' is similar to that for exports.

The surplus in trade of manufactured goods reached a peak of EUR 392 billion in 2013, more than double of the surplus registered in 2008.

Relatively small increases in the level of exports outside the EU-28 were reported for the two product groups with the highest level of exports in 2014, namely, machinery and transport equipment (up 0,1 %) and other manufactured goods (up 1,1 %). The highest growth rate for EU-28 exports in 2014 (up 3,1 %) was recorded for food, drink and tobacco exports, where the level of exports reached a record value of EUR 107.7 billion.

The EU-28's trade surplus for goods of EUR 22.4 billion in 2014 was driven by a positive trade balance in relation to machinery and transport equipment, which stood at EUR 258.4 billion, and in relation to chemicals (EUR 114.1 billion).

Table 4. Extra EU-28 trade by main products, EU-28, 2009, 2013 and 2014

Years	2009		2013		2014	
ITEMS	**(billion EUR)**	**(%)**	**(billion EUR)**	**(%)**	**(billion EUR)**	**(%)**
EXPORTS						
Total	**1.094,0**	**100,0**	**1.736,6**	**100,0**	**1.702,9**	**100,0**
Food, drinks & tobacco	62,3	5,7	104,4	6,0	107,7	6,3
Raw materials	27,9	2,5	45,5	2,6	43,3	2,5
Mineral fuels, lubricants	58,7	5,4	122,5	7,1	109,5	6,4
Chemicals & related prod.	195,6	17,9	273,3	15,7	279,0	16,4
Other manufactured goods	257,3	23,5	382,7	22,0	386,8	22,7
Machinery & transport equip.	459,3	42,0	708,6	40,8	709,0	41,6

IMPORTS						
Total	**1.235,6**	**100,0**	**1.685,0**	**100,0**	**1.680,5**	**100,0**
Food, drinks & tobacco	73,8	6,0	93,6	5,6	98,3	5,9
Raw materials	47,3	3,8	76,2	4,5	72,9	4,3
Mineral fuels, lubricants	299,9	24,3	500,6	29,7	443,5	26,4
Chemicals & related prod.	112,5	9,1	157,9	9,4	164,8	9,8
Other manufactured goods	296,5	24,0	381,9	22,7	407,5	24,2
Machinery & transport equip.	352,9	28,6	434,5	25,8	450,6	26,8
TRADE BALANCE						
Total	**-141,7**		**51,6**		**22,4**	
Food, drinks & tobacco	-11,5		10,8		9,3	
Raw materials	-19,4		-30,8		-29,6	
Mineral fuels, lubricants	-241,2		-378,1		-334,0	
Chemicals & related prod.	83,1		115,4		114,1	
Other manufactured goods	-39,2		0,9		-20,7	
Machinery & transport equip.	106,4		274,1		258,4	

Source: Eurostat

EU SME Internationalisation

International markets offer significant potential for the growth of businesses – and especially of SMEs. Based on Competitive Intelligence in European Business from 2011, about 44% EU SMEs are internationally active (any mode of internationalisation), while about 29% are importing, 25% exporting and only 2% are investing abroad. In addition some 7% have technical cooperation with partners abroad. It is important to note that roughly half of these enterprises are active only in European markets, and that only 13% export to and 14% import from markets outside the EU.

The percentage of European SMEs that are involved in at least one of the forms of internationalisation over the last 3 years remained the same. They are known as '*internationalised SMEs'*. The share of internationalised SMEs increases significantly by size of firm. The larger the company, the more it tends to internationalise, something that applies to any single mode of internationalisation. For exports, 24% of micro, 38% of small and 53% of medium-sized SMEs are active, for imports the respective percentages are 28%, 39% and 55%.

The average firm gets nearly 90% of its total turnover from within the internal market. 8% of internationalised SMEs have foreign establishments; half of them also have establishments outside the EU. These foreign establishments are mostly sales offices (47%), representatives' offices (38%) and/or local production facilities (32%).[49]

The Flash Eurobarometer survey explores the international business activities carried out by SMEs inside and outside the internal market, with a strong focus on export and import. 14,513 SMEs from the manufacturing, retail, services and industry sectors have been interviewed in the survey with following findings:

Main findings:

Company characteristics

- **Size**: the larger the company, the more likely it is to have engaged in international business activities;
- **Sector**: manufacturing companies are the most likely to have engaged in business activities both inside and outside the Internal Market.

Target markets for export

The survey revealed that the main target market of exporting EU SMEs is the Internal Market (81%), followed by Middle East and North Africa (15%), Eastern Europe, Caucasus and Balkans (14%), the USA (13%), India and South East Asia (11%), Russia, China and India (all 10%).

Barriers encountered when exporting

The main export barriers identified by exporting EU SMEs are:

- Administrative procedures when exporting are too complicated;
- Delivery costs are too high;
- Identifying business partners abroad is too difficult;
- The financial investment is too high.

[49]Source: Survey 2009-2010, Opportunities Internationalisation SMEs, EIM/GDCC (EU27, N=6649).

Support for internationalisation

According to the survey, the most likely measures to help SMEs internationalise are:

- Grants, subsidies or low interest loans;
- Tax incentives;
- Support for finding business partners;
- Networking.

Other measures include opportunities to take part in international trade fairs, information on market opportunities, information on rules and regulations and advice or training

EU trade with Western Balkans

The EU is the Western Balkans' largest trading partner, accounting for over 75% of the region's total trade. AS a whole the region's share of overall EU trade was 1,1% in 2014, however, individual countries' shares were very low - Serbia (0,50%), Bosnia and Herzegovina (0,20%), the fYRoM (0,20%), Albania (0,10%), Montenegro (0,0%) and Kosovo (0,0%).

In 2014, the EU's main imports from WBs were:

- Machinery and transport equipment (26,5%);
- Miscellaneous manufactured articles (21,3%);
- Manufactured goods classified chiefly by materials (19,8%).

The EU's exports to the WBs were mainly:

- Machinery and transport equipment (27,0%);
- Manufactured goods classified chiefly by material (23,4%);
- Chemicals (14,2%);
- Mineral fuels (12,3%).

All countries of WB region have a trade deficit with the EU.

Table 5. European Union (28 countries) exports to WBs 2005-2014

(in million EUR)

Country name/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	n.a	520	833	1.135	693	715	786	893	912	973
fYRoM	1.634	1.899	2.171	2.643	2.170	2.532	3.038	3.372	3.397	3.820
Albania	1.395	1.564	1.855	2.203	2.121	2.187	2.333	2.444	2.327	2.471
Serbia	n.a	5.898	8.492	9.700	7.071	7.777	9.016	9.659	9.927	10.363
Bosnia and Herzegovina	3.886	3.922	4.420	5.209	3.938	4.202	4.746	4.830	4.777	5.025
Kosovo	n.a	277	424	533	624	681	736	714	724	729

Source: Eurostat

In absolute amounts the EU exports mainly to Serbia, bearing in mind that Serbian market is the biggest in the region of WBs and imports also the biggest amount from Serbia. The second biggest EU partner from WB countries is Bosnia and Herzegovina, followed by fYRoM.

Table 6. European Union (28 countries) imports from WBs 2005-2014

(in million EUR)

Country name/Time	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	n.a	293	352	276	172	185	225	298	188	251
fYRoM	1.134	1.447	2.019	1.949	1.321	1.852	2.281	2.110	2.386	3.024
Albania	418	498	631	681	651	895	946	1.118	1.234	1.248
Serbia	n.a	2.869	3.896	4.335	3.436	4.316	5.111	5.053	6.588	7.107
Bosnia and Herzegovina	1.697	2.202	2.368	2.493	1.934	2.488	2.951	2.991	3.244	3.329
Kosovo	n.a	28	47	86	78	149	140	124	125	96

Source: Eurostat.

European Union (28 countries) trade of chemicals and related products by partner

The chemicals sector contains various chemical goods such as organic chemicals, inorganic chemicals, plastics and pharmaceutical products.

Trade in chemicals has grown steadily from 2009 to 2012 but it showed a contraction in 2013; its share of the total EU trade has remained quite stable: in 2013 - 2014 chemicals accounted for 16% of exports and 9% of imports.

After machinery and vehicles, the chemicals sector is the product group where the EU posts the second bigger trade surplus. The surplus reached EUR 115 billion in 2013. The most important products within the group, both for exports and imports, are pharmaceutical products and organic chemicals. Majority of imports come from a small number of countries: in 2013 the six biggest suppliers accounted for almost two thirds of total EU imports. The USA was the main source, with a proportion of 28%, followed by Switzerland with 21%. The USA (23% in 2013) and Switzerland (9%) were also the main partner countries for exports.

Table 7. EU export of chemicals and related products to WBs 2005-2014

(in million EUR)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	n.a	39	60	77	65	67	69	70	80	69
fYRoM	199	270	257	292	288	417	384	409	471	403
Albania	130	161	193	211	230	239	243	244	238	262
Serbia	n.a	895	1.340	1.446	1.284	1.421	1.570	1.777	1.770	1.758
Bosnia and Herzegovina	423	444	531	617	554	594	645	687	685	721
Kosovo	n.a	41	44	59	67	86	96	101	105	105

Source: Eurostat

Table 8. EU import of chemicals and related products by WBs 2005-2014

(in million EUR)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	n.a	1	1	8	1	1	1	1	2	2
fYRoM	20	24	31	37	38	197	443	436	533	718
Albania	1	1	2	2	2	3	2	20	5	10
Serbia	n.a	226	393	463	204	335	365	313	506	482
Bosnia and Herzegovina	42	62	69	97	83	121	155	160	179	212
Kosovo	n.a	0	0	0	0	0	0	0	1	2

Source: Eurostat

The EU imports significant amounts of chemicals and related products from fYRoM. It is visible that EU has a deficit in bilateral trade of chemicals and related products only with fYRoM from WB region. Looking the individual countries within WBs, Serbia is the biggest importer of EU chemicals and related products followed by Bosnia and Herzegovina, while the EU import of chemicals and related products to the greatest extent comes from FYRoM. All countries of WB have a small share in total EU import (the biggest share has fYRoM with 0,4% in EU import) while in case of export of chemicals and related products the biggest share has Serbia with 0,7% of EU export.

European Union (28 countries)trade of food, drinks and tobacco by partner

The EU export of food, drinks and tobacco to the WBs is significant and has increasing during the observed period. The biggest importer between WB countries of food, drinks and tobacco in 2014 is Serbia, which is at the same time the biggest WB exporter of same goods to EU. The EU imports food, drinks and tobacco mainly from Serbia which privatised its main domestic companies under this sector (production of tobacco in Serbia is performed by foreign companies/investors and this sector is completely privatised by FDI inflow) and Serbia is only country from WB region that realised permanent surplus in trade of that goods with EU.

Table 9. EU (28) exports of food, drinks and tobacco to WBs 2005-2014

(in million EUR)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	n.a	77	107	124	116	123	135	185	160	195
fYRoM	188	184	189	226	213	227	278	305	304	293
Albania	189	213	226	293	290	309	311	311	328	322
Serbia	n.a	288	379	458	416	417	466	569	650	733
Bosnia and Herzegovina	543	533	577	679	615	621	680	717	700	705
Kosovo	n.a	61	71	107	111	125	156	164	173	191

Source: Eurostat

Table 10. EU (28) imports of food, drinks and tobacco from WBs 2005-2014

(in million EUR)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	n.a	4	5	6	7	5	6	5	5	6
fYRoM	141	182	195	177	171	181	182	199	224	253
Albania	22	26	27	29	29	35	34	42	50	57
Serbia	n.a	498	547	483	636	609	826	808	762	839
Bosnia and Herzegovina	68	73	93	103	110	123	130	129	124	104
Kosovo	n.a	3	3	3	4	4	5	6	7	9

Source: Eurostat

During period of analysis, EU imports of food, drinks and tobacco from WB countries shows slightly increasing trend with all countries, except in case of Serbian and Bosnia and Herzegovina which recorded reduction of EU imports in 2012-2013.

However, all countries of WB have an insignificant share (less than 1% of total imports or exports, except in case of Bosnia and Herzegovina imports) in the trade of Foods, drinks and tobacco products with EU.

European Union (28 countries) trade of other manufactured goods by partner

Other manufactured goods is a heterogeneous group consisting of manufactured goods which range from basic semi-manufactured goods such as leather, rubber, wood, paper, textiles, metals, building fixtures and fittings to more labour-intensive products like clothes, shoes and accessories, scientific instruments, clocks, watches and cameras.
The structure of exports and imports, in terms of products, differs to some extent. The EU exports more semi-manufactured goods such as metals and metal products while for imports manufactured goods are more relevant, in particular clothing.

After a fall of EU trade in 2009, the value of exports rose constantly from 2010 to 2013, while imports reached a peak in 2011 and then reduced in both 2012 and 2013. As a result, the EU trade balance in 2013 was positive for the first time since the beginning of the series (2002).

China is the biggest supplier to the EU in this product group, representing a share of 31% in 2013. Other important suppliers include the USA, Switzerland and Turkey. The main destinations for exports are the USA, Switzerland, Russia and China.

Table 11. European Union (28 countries) exports of other manufactured goods 2005-2014

(in million EUR)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	n.a	146	224	302	201	186	187	189	188	202
fYRoM	697	816	905	1.045	810	984	1.169	1.248	1.318	1.680
Albania	590	651	720	810	785	809	809	781	775	864
Serbia	n.a	2.009	2.698	2.880	2.228	2.457	2.625	2.762	2.918	3.015
Bosnia and Herzegovina	1.244	1.171	1.390	1.537	1.253	1.349	1.487	1.471	1.548	1.688
Kosovo	n.a	66	96	120	132	166	190	185	188	194

Source: Eurostat

Table 12. European Union (28 countries) import of other manufactured goods 2005-2014

(in million EUR)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	n.a	259	318	233	105	142	165	178	100	83
fYRoM	855	1.049	1.528	1.433	906	1.051	1.158	969	1.018	1.056
Albania	316	347	411	455	422	523	582	576	636	753
Serbia	n.a	1.672	2.136	2.312	1.572	2.104	2.344	1.974	2.113	2.420
Bosnia and Herzegovina	934	1.237	1.382	1.459	1.150	1.408	1.646	1.651	1.760	1.818
Kosovo	n.a	4	18	60	54	93	103	83	79	58

Source: Eurostat

In EU export of other manufacturing goods to WBs is noticeable decrease in export in period after 2008 (in all WB countries except in Kosovo) that is explained by financial crises and effects of crisis on manufacturing production and export. Certain recovery in EU export of manufacturing goods occurred in 2013-2014 when pre-crises level of exports achieved in almost all countries with exception of Montenegro. The Republic of Montenegro is also which shows decreasing trend of export of manufacturing goods to EU since 2008 followed by Kosovo that recorded same trend after 2011.

The EU has a significant trade of other manufacturing goods with WB countries. European Union (28 countries) exports of other manufactured goods dominantly to Serbia that is also its biggest supplier of other manufacturing goods between WB countries which is followed by fYRoM and Bosnia and Herzegovina. **Moreover, the EU in this group of products has a deficit in trade with Bosnia and Herzegovina, meaning that imports more than it exports.**

European Union (28 countries) trade of machinery and transport equipment by partner

The “Machinery and vehicles” is the most important individual product group in the international trade of the EU, accounted for 42% of the total EU export and 27% of import in 2014.

The group records also the largest surplus in EU trade: EUR 275 billion in 2013. The main exported products within the group are road vehicles, industrial machinery and electrical machinery, while the imports are dominated by electrical machinery, telecommunications equipment and IT products.

Table 13. European Union (28 countries) exports of machinery and transport equipment to WBs 2005-2014

(in million EUR)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	n.a	167	307	388	221	189	194	247	276	302
fYRoM	355	428	561	737	562	519	560	567	602	761
Albania	354	337	443	576	565	486	466	436	406	446
Serbia	n.a	2.143	3.054	3.539	2.286	2.277	2.785	2.969	3.451	3.476
Bosnia and Herzegovina	976	911	1.182	1.349	905	904	1.069	1.020	1.022	1.149
Kosovo	n.a	92	126	157	213	220	209	168	159	188

Source: Eurostat

Table 14. European Union (28 countries) imports of machinery and transport equipment from WBs 2005-2014

(in million EUR)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Montenegro	n.a	5	8	12	45	13	24	69	50	106
fYRoM	47	57	54	95	67	106	189	259	373	721
Albania	21	24	26	34	78	59	57	48	50	53
Serbia	n.a	266	492	727	682	732	862	1.307	2.301	2.515
Bosnia and Herzegovina	291	373	408	425	308	377	467	495	533	589
Kosovo	n.a	4	2	2	5	19	4	10	4	3

Source: Eurostat

Due to financial crises the EU exports of machinery and transport equipment to WBs in subsequent years has not still achieved pre-crises levels. On the other hand, the EU import of machinery and transport equipment from WBs shows much faster recovery and permanently increasing trend with exception of oscillations in case of Albania and Kosovo.

In the trade of machinery and vehicles with WB countries, the EU has steadily increasing trade with all countries during the observed period excluding Kosovo and realises trade surplus. The biggest partner of the EU in the trade of these products from the WB region is Serbia. However, the biggest growth in export of this group of products in 2014 was realised by fYRoM, whose export to the EU increased by 93%.

Annex 3 – FDI Incentives and Utility Prices in Western Balkans

Table 1. Summary of FDI incentives in WB region

Country/ Indicator	Albania	B&H	fYRoM	Kosovo	Montenegro	Serbia
Incentives	No prior government authorisation is needed and no sector is closed to foreign investment • There is no limitation on the percentage share of foreign participation in companies • Foreign investment may not be expropriated or nationalised directly or indirectly, except for designated special cases, in the interest of public use as defined by law • Full profit and dividend repatriation (after taxation) is permitted • Foreign investors have the right to expatriate all funds and contributions in kind of their investments • Concession rights on natural resources and on resources of common interest, as defined by the law on concessions, are available to both residents and foreign investors	Law on the Policy of Foreign Direct Investments of Bosnia and Herzegovina (Official Gazette of B&H, 17/98, 13/03, 48/10 and 22/15) ensures: - National treatment of foreign investors, i.e. foreign investors have the same rights and obligations as residents of B&H. - Foreign investors are entitled to open accounts in any commercial bank in domestic and/or any freely convertible currency on the territory of B&H. - Foreign investors are entitled to freely employ foreign nationals, subject to the labour and immigration laws in B&H. - Foreign investors are entitled to transfer abroad, freely and without delay, in convertible currency, proceeds resulting from their investment in B&H - Foreign investors may own real estate in B&H. Foreign investors enjoy the same property rights in respect to real estate as B&H legal entities. - Foreign investors are protected against nationalisation, expropriation, requisition or measures having similar effects; such measures may take place only in the public interest in accordance with	The establishment of Technological Industrial Development Zones (TIDZs) has supported the FDI policy. TIDZs aim at attracting higher technology companies and are regulated by a specific legislation. A Directorate for Technological Industrial Development Zones has been established in 2000 and is operational since January 2002 so as to develop and supervise the zones. The first company to be operational in one of them was Johnson Controls (automotive components, USA) at the end of 2007. Since then, major German, American, British, and, more recently, Belgian firms have started outsourcing the production of components for the automobile industry in fYRoM's TIDZs. Those have replaced traditional trade partners—Kosovo, Bulgaria, and Serbia—as the main export destination. This move has reflected a marked shift in the production of tradable goods, which now predominantly consists of manufacturing goods. There are currently four operational zones (Skopje	The Multilateral Investment Guarantee Agency (MIGA) guarantees investments in Kosovo up to the value of €20 million. The US Overseas Private Investment Corporation (OPIC) also provides political risk insurance for foreign investors in Kosovo. .	Investment Incentives may be awarded for Investments Projects with a minimum investment value of EUR 500,000 that will provide jobs for at least 20 new employees within a period of three years from the day of concluding the Direct Investment agreement. The amount of Investment Incentives that may be awarded to a Large Business Entity cannot exceed 50% of the total value of investment in the Investment Project, 60% for Medium Business Entities and 70% for Small Business Entities.	**Incentives for eligible costs of gross salaries for new jobs per groups of municipalities classified on the basis of development level:** - 20% for group I municipalities, 25% (for group II) and 30% (for group III), 35% (for IV group) and 40% (for devastated regions). These amounts are limited to a maximum of 3.000 (for group I), 4.000 (for group II), 5.000 (for group III), 6.000 (for the IV group) and 7.000 euros per new job created (for devastated regions). **Incentives for eligible investment costs in fixed assets** - an increase in the amount of grants may be approved for: up to 10% (for I group of municipalities), 15% (for II group of municipality), 20% (for III group of municipalities), 25% (for the IV group of municipalities) and 30% (for devastated regions). **Additional incentives for labour-intensive projects** - an increase

Country/ Indicator	Albania	B&H	fYRoM	Kosovo	Montenegro	Serbia
		the applicable laws and regulations and against the payment of an appropriate compensation, i.e. compensation that is adequate, effective and prompt. - The rights and benefits of foreign investors granted and obligations imposed by the Law on the Policy of Foreign Direct Investment (mentioned above) cannot be terminated or overruled by subsequent laws and regulations. Should a subsequent law or regulation be more favourable to foreign investors, the investor will have the right to choose the regime by which the investment will be regulated.	1, Skopje 2, Stip, and Kicevo) while ten others are at various stages of development. **Liberalisation of real-estate market** - Foreigners free to purchase realestate and construction land **Simplification of procedures for obtaining construction permits** from 21 to 3 steps The investments are protected with **Government guarantees**			in the amount of grants may be approved for: 10% of the eligible costs of gross salary (for any increase in the number of new jobs created over a number of 200 new jobs), 15% (for any increase in the number of new jobs created over a number of 500 new jobs) and 20% (for any increase in the number of new jobs created over a number of 1,000 new jobs).
Tax	VAT is assessed, applied and paid at the moment goods enter the Albanian custom territory. The VAT rate is 20% of the taxable value. **Local tax on small business** Amendments to the law no. 9632, dated 30.10.2006 "On local tax system", as amended (in force as of 1 January 2016) Local tax on small business is paid in four equal rates. The first rate has to be paid by 20th of April, the second one not later than the 20th July, the third one not later than 20th of October and the fourth one not later than 20th December of the next year. **Tax Brackets** The corporate income tax brackets have been changed as follows:	In Federation of B&H: **Law on Corporate Income Tax** enables foreign investors to enjoy the following benefits - The taxpayer who invests, from its own funds, in production equipment more than 50% of the total profit in the current tax period, shall be reduced of the obligation of the calculated tax for 30% of the amount in the year of investment. - The taxpayer who in a period of 5 consecutive years makes investments from its own funds, in the total amount of 10 million €, starting with the first year when taxpayer has to invest at least 2 million €, shall be reduced of the obligations of the calculated income tax for 50% of the amount in the	fYRoM has a flat tax **rate of 10%** for corporate and personal income tax purposes. Investors are eligible for reduction in the profit tax base by the amount of prior profit reinvested in tangible assets (such as real estate, facilities and equipment) and intangible assets (such as computer software and patents) used for expanding the business activities of the entity. Property tax is 0,1% - 0,2% VAT is 18% and 5% preferential tax rate for computer software and hardware. Sales tax on real estate and rights 2-4%	Based on the Law on Corporate Income Tax (No. 03/L- 162), **tax and capital losses can be carried forward for up to seven successive tax periods**, and shall be available as a deduction against any income in those years. **Special Allowances of new assets** In accordance with the Corporate Income Tax Law (No.03/L-16), if a taxpayer purchases new capital goods for the purpose of the taxpayer's economic activity between 1 January 2010 and 31 December 2012, a special deduction of ten percent (10%) of the cost of	Montenegro's tax regime has become one of the most competitive in whole of Europe. With **9% corporate profit tax rate** companies operating in Montenegro enjoy not only a business friendly environment but also a low tax burden, thus maximising their operational profit. VAT: Standard rate – 19% Lower rate – 7 % Zero rate – 0 % Corporate Profit Tax - Flat rate – 9 % Personal Income Tax-As from February 2013,	**Corporate Profit Tax Holiday** Companies are exempt from Corporate Profit Tax for a period of 10 years starting from the first year in which they report taxable profit if they invest an amount exceeding approximately €9 million in fixed assets, and employ at least 100 additional employees throughout the investment period. **Carrying Forward of Losses** The tax loss stated in the tax return can be carried forward and offset against future profits over a period up to 5 years. **Avoiding Double**

<table>
<tr><th>Country/ Indicator</th><th>Albania</th><th>B&H</th><th>fYRoM</th><th>Kosovo</th><th>Montenegro</th><th>Serbia</th></tr>
<tr>
<td></td>
<td>Annual turnover 5-8 million - Until 2016,5% of the taxable profit
Annual turnover 8 million - Until 2016, 15% of the taxable profit

Social Insurance
Social insurance are calculated on the gross salary:

<table>
<tr><td>Contribution Rate</td><td>Social Security</td><td>Health Insurance</td></tr>
<tr><td>Paid by employer</td><td>15%</td><td>1.7%</td></tr>
<tr><td>Paid by employer</td><td>9.5%</td><td>1.7%</td></tr>
<tr><td>Paid by self-employed persons</td><td>23%</td><td>3.4%</td></tr>
</table>

Luxury Cars
Luxury cars will be considered any vehicles with four + one seats and either:
a)cylinder equal to or greater than 3,000 cm3; or
b)value / price greater than or equal to ALL 7,000,000.
A new initial registration and annual tax will be introduced for these vehicles, independent of the annual tax obligation for used vehicles.
The following tax rates will apply for luxury cars:
a)Initial registration tax of 70,000 ALL;
b)Recurring annual tax of 21,000 ALL.

Insurance Premiums
The tax on insurance premiums, with the exception of insurance premiums for life, travel health</td>
<td>year of investment.
- The taxpayer is entitled to a tax-deductible expense in the double amount of the gross wage paid to newly employees if it meets the following conditions:
- duration of the employment contract must be at least for a period of 12 months with full-time working hour
- New employee was not employed with the taxpayer or a related person in the previous five years.

In Republic of Srpska:
Law on Profit Tax RS introduced tax base reduction in the value of investment for:
- Investment in equipment intended for the company production activity
- Investments in plants and immovable property used for manufacturing and processing activities

And tax base reduction in amount of paid personal income tax and mandatory contribution for the employer:
- Employing 30 workers during a calendar year (workers who were on the official evidence of Employment Office of RS).

Brcko district incentives
Law on Incentives to Economic Development of Brcko District ensures:
- Exemption from utility fees for displaying the company
- Compensation of court fees for registration of a</td>
<td>Inheritance and gift tax is 2-3% or 4-5%.</td>
<td>acquisition of the asset shall be allowed in the year in which the asset has been first placed into service. This deduction is available in addition to the normal allowable depreciation deduction.
Avoiding Double Taxation
Based on the Law on Corporate Income Tax (No.03/L-16), a resident taxpayer who receives income from business activities outside of Kosovo through a permanent establishment outside of Kosovo, and who pays tax on that income to any state, shall be allowed a tax credit under this regulation in an amount equal to the amount of tax paid to such state.
Any tax credit under the present section is limited to the amount of tax that would be paid under this regulation on the income made in such state.
Any applicable bilateral agreement on the avoidance of double taxation shall supersede the provisions above.</td>
<td>salary up to EUR 720 (EUR 480 net) remains subject to 9% tax; salary in excess of this amount is taxed at a rate of 15%. The increased tax rate will apply until the end of 2015.

Property Tax-Proportional tax ranging between 0.08 % - 0.8 % of the immovable property's market value</td>
<td>Taxation
If a taxpayer already paid tax on the profit generated abroad, he is entitled to a Corporate Profit Tax credit in Serbia to the already paid amount. The same right is enjoyed by a taxpayer who earns revenue and pays Personal Income Tax in another country, provided there is a Double Taxation Treaty with that country.
Reduced Salary Load
Starting from July 1st, 2014 new employment entitles employers to a sizeable relief of taxes and contributions paid on net salary from the moment of employment until December 31st, 2017.
1-9 new jobs: 65% reduction;
10-99 new jobs: 70% reduction;
100+ new jobs: 75% reduction.

This reduces the total salary load to very competitive 20%*
*an estimate for an average salary in Serbia
Annual Income Tax Deductions
For non-Serbian citizens, the annual income is taxed if exceeding the amount of threefold the average annual salary in Serbia. The tax rate is 10% for</td>
</tr>
</table>

Country/ Indicator	Albania	B&H	fYRoM	Kosovo	Montenegro	Serbia
	and green card products, has been increased from 3% to 10% of the premium's value. **Tax on Minerals** The tax on minerals has also changed for a number of items. Instead of a fixed percentage, the taxation mechanism has become weight- or volume-indexed, based on tonnes or m3 for several items including coal, granite, construction tiles, etc.	business entity and the change entry in the register for newly established enterprises and entrepreneurs - Compensation of expenses of connection to power, water and sewage network - Compensation of paid fees necessary for obtaining the location conditions, building permits and approvals for the use of the facility - Compensation of expenses in amount of the difference in price of electricity and water paid by the company and the price paid by households - Compensation for paid employment contribution in the total amount for newly employed persons - Compensation for salary for maternity leave in amount of 100% - Stimulation of the employer in amount of 50% of total duties for health insurance of newly employed workers from the moment of obtaining the benefit - Compensation for amount of new investments invested in purchase of fixed assets and up to the amount of determined and paid profit tax or income tax in period for the year in which purchases of fixed assets was made, provided that the difference between the amount of profit tax or income tax, and made supply cannot be transferred to next year				the annual income below the amount of 6 times average annual salary in Serbia, and 15% for the annual income above the amount of 6 times average annual salary in Serbia. The taxable income is further reduced by 40% of an average annual salary for the taxpayer and by 15% of an average annual salary for each dependent member of the family. The total amount of deductions cannot exceed 50% of the taxable income.
Incentives per			fYRoM has state grants for employment of new	-	The amount of the Investment Incentives	The National Employment Service

Country/ Indicator	Albania	B&H	fYRoM	Kosovo	Montenegro	Serbia
employees			employees ranking between 500-2000 EUR per employee.		that can be awarded based on the award criteria shall be as follows: 1) EUR 3,000 per new employee, for the score from 76 to 85; 2) EUR 4,000 per new employee, for the score from 86 to 95; 3) EUR 5,000 per new employee, for the score from 96 to 105; 4) EUR 6,000 per new employee, for the score from 106 to 115; 5) EUR 7,000 per new employee, for the score from 116 to 125; 6) EUR 8,000 per new employee, for the score from 126 to 135; 7) EUR 9,000 per new employee, for the score from 136 to 145; 8) EUR 10,000 per new employee, for the score from 146 to 150.	Grants per employees: 1. the Employment Subsidies Program - 850-1700 EUR 2. the Apprentice Program 170 -210 , and 3. the Re-Training Program- 850
Business zone	One of the Albanian Government's objectives is the development of economic zones (i.e. industrial parks and free zones) on the basis of public-private partnerships. The Government has approved nine economic zones, eight of which have the status of "industrial parks" and one of which has the status of "free zone".		-	**Offered Services** • Parcels ready for accommodation • Easy access and free parking space • Provides Security • Access to electricity power, water, gas, phone, internet and heating.	The main reasons for the establishment of business zones include: encouraging investment, new jobs, new technologies and equipment, modernisation and improvement of industrial connectivity.	
Free trade zones		Advantages of Free Trade Zones: •Free zone users of do not pay taxes and contributions, with the exception of those related to salaries and wages. •Investors are free to invest	Incentives cover a broad range of benefits. fYRoM's free economic zones provide a 10-year corporate tax holiday, and a broad range of additional incentives, including: • no customs duties and			Income generated through commercial activities in the Free Zones in Serbia is exempted from Value Added Tax. Foreign companies can establish a privately-

Country/ Indicator	Albania	B&H	fYRoM	Kosovo	Montenegro	Serbia
		capital in the free zone, transfer their profit and re-transfer capital with no charge. •Customs and tariffs are not paid on imports into the free zone. •The imports of equipment that will be used for manufacturing within the free zone are exempt from paying customs duties and fees.	VAT on imported raw materials, equipment & construction materials; • 0% personal income tax for 10 years; • 0% property tax; • 0% excise taxes; • free connection to utilities; • up to EUR 500,000 subsidies for construction costs; • 'green' customs channel at the border for expeditious export to EU countries; • long-term land lease for a period of up to 99 years; • grants for training and job creation.			owned Free Zone based on the project approved by the government. **Benefits:** •Fiscal benefits (exemptions from any tax burden for FDI, VAT and specific local taxes) •Free of custom duties on import of goods, equipment and raw material used in exporting production and construction material for building of infrastructure •Financial benefits (free cash flow) •Efficient administration (one stop shop) •Simple and fast customs procedures (each zone has a Customs Administration Office) •Local subsidies for using free zone infrastructure (Community offers low prices and service cost) •A set of services is available to users under preferential terms (transportation, loading, reloading, freight forwarding services, insurance and banking services

Country/ Indicator	Albania	B&H	fYRoM	Kosovo	Montenegro	Serbia
Customs	**According to the Law No. 7928 dated 26.12.2007 "For VAT"** as amended, the exempt from VAT is applied to: - Import of goods placed in the transit regime. - Import of goods declared to fall under Temporary Allowance Regime - Import of goods in active processing - Import of goods or services relating to the performance of exploration and development phases of petroleum operations, carried out by contractors who work for these operations. -Import of live animals of origin, coming from different donors. -Import of goods coming from NATO. -Import of good of appliances that help the integration of people with disabilities in the everyday life. Albanian ***exports*** are exempted from VAT (VAT rate 0%)	Equipment of the foreign investor being imported as part of share capital is exempt from paying customs duties (with the exception of passenger vehicles, slot and gambling machines).	In addition to the tax incentives, this Law also provides for certain customs exemptions, exemptions from fees for preparation of the construction site, free connection to the water, sewerage, heating, gas and power supply networks, and other incentives.	In order to promote local production, the new Kosovo customs and excise code No. 03/L- 109 applies a reduced rate of zero percent customs duty on the import and export of certain capital goods, raw materials, agricultural production inputs, and services.	**Import of raw materials** is exempt of customs in case that finished products made by imported raw materials will be exported. **Import of equipment** is exempt of customs, but VAT should be paid. **No exports custom** – custom on exported goods does not exist, and VAT rate is 0% according to the Law on VAT. This means that investor who paid VAT on raw materials, and then when exports finished products does not have to pay VAT, and have right for refunding VAT on raw materials.	Foreign investors in Serbia can enjoy the benefit of customs free import of raw material and semi-finished goods for export oriented production. This benefit can either be achieved by operating in one of the free zones in Serbia or by a permit from custom office for outward processing production. In both cases finished products must be 100% designated for export. Foreign investors are exempt from paying customs duty on imported equipment and machinery which represents the share of a foreign investor in a capital of a company in Serbia
Local incentives				According to the Law on Local Self Government (No. 03/L-040), the municipalities in Kosovo have the right to lease movable and immovable property to foreign investors. The lease can be granted for a term of ten years with an extension opportunity of up to 99 years	For investment in Investment Projects carried out in the territory of local self-government units in the northern and central regions, excluding the Capital City of Podgorica, Investment Incentives may be granted for Investment Projects with a minimum investment value of EUR 250,000 that will provide jobs for at least 10 new employees within a period of three years from the date of signing	A wide array of incentives is also available at the local level, varying in scope and size from one city to another. The major ones comprise the following: City construction land lease fee exemptions or deductions, including the option of paying in instalments, with the prior consent of the Serbian Government; City construction land development fee relief such as fee exemptions or discounts for one-off payments;

Country/ Indicator	Albania	B&H	fYRoM	Kosovo	Montenegro	Serbia
					the Direct Investment Incentive Agreement.	Other local fees exemptions or deductions (e.g. the fee for displaying the company's name).
After care	Among its everyday activities, the After Care Staff, helps the investors to provide faster permits, licenses and other requirements for company start-up and operations; One of the main tasks of the sector, is launching "intelligent tools" (questionnaires for foreign investors), in the framework of identifying existing problems of the investment climate in Albania. Based on direct feedback from potential and existing investors, After Care Staff develop and implement an aftercare strategy, for further supporting the existing investors in the Republic of Albania, to further improve the investment climate, encouraging them to develop their activities in the future. Other tasks that the sector follows with professionalism and dedication is also to develop and maintain a database of all foreign investors in the Republic of Albania and their visits, putting in contact with the government authorities or possible Albanian partners, tracking and maintaining correspondence with potential investors responding to their spontaneous requirements, as well as follow-up of the held meetings.	Aftercare is a regular activity of the Agency where FIPA try, in discussion with foreign investors, to get information on the basis of which they can suggest certain activities that lead to the business environment improvement. Improving the business climate is a task of all institutions, considering that investments bring new technologies and knowledge, new job places and opening the new markets.	After care is institutionalised activity within Investment Promotion Agency and includes different kind of operational and institutional support to foreign investors.	Pre/post-recession, aftercare is a key priority for IPAK. granted, a continued thrust is needed to increase the stock of companies to provide aftercare to but anchoring and motivating existing investors to upgrade activities in Kosovo will lead to concrete results. Secondly, aftercare is not an isolated reactive ‘hand-holding’ exercise. It is a proactive strategic process. Aftercare is essential for anchoring investors and for persuading them to upgrade activities in Kosovo. However, there is more to aftercare than ‘handholding’– it is a proactive and sustained process covering the ten steps set out in this chapter. While the pressure is on IPAK to increase the stock of investors to offer aftercare services to, safeguarding existing investors is a priority post-recession.	-	-

Table 2. Comparative prices of utilities in Western Balkans and EU in euro

Country/	Unit	Albania	B&H	fYRoM	Kosovo	Montenegro	Serbia	EU 28

Indicator								
Electricity	2 500 kWh < consumption < 5 000 kWh	0,0812	0,081	0,082	0,0625	0,0982	0,0575	0,2082
Average salary	PPP	329	422	458	466	519	480	1.469
Petrol	Litre	0,40	0,44	0,60	0,51	0,65	0,54	0,3-0,9
Mobile phone	1 min. of Prepaid Mobile Tariff Local	0,21	0,10	0,08	0.05	0,11	0,09	n.a
Internet	10 Mbps, Unlimited Data, Cable/ADSL	15,33	13,58	9,92	7,88	23,68 €	12,62	n.a
Petrol	Litre	1,145	1,100	0,986	0,900	1,070	1,062	1,09-1,6
Basic (Electricity, Heating, Water, Garbage)	85 m2 apartment	51,03	111,07	116,99	81,87	106,37	119,42	

Source: Eurostat and Numbeo database.