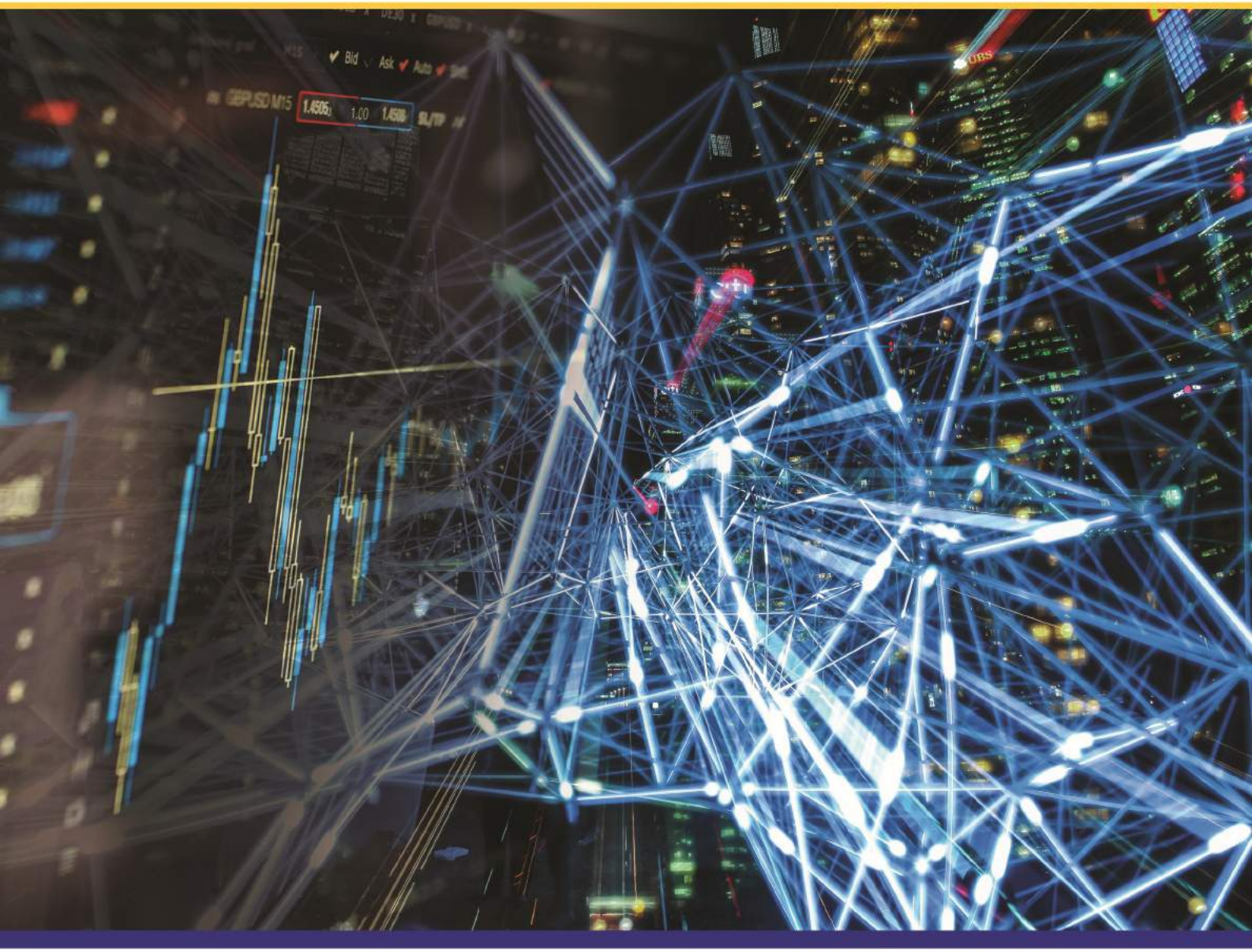
CEFTA
Investment Report 2017



The European Union

CEFTA
Central European Free Trade Agreement

CEFTA Investment Report 2017

This report has been prepared by Gábor Hunya, Senior Expert at the Vienna Institute for International Studies, wiiw, within the framework of the CEFTA Secretariat Project CPF III: 2016-10: Technical Assistance for the Preparation of CEFTA Investment Report

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Foreword

The year 2017 marks the tenth anniversary of implementation of the first regional trade agreement, CEFTA 2006. The last decade has seen steady progress towards achievement of the goals set by the Ministers and has provided a framework for further growth and deeper integration. Full liberalisation of trade in goods, the successful conclusion of negotiations over trade in services, the opening of public procurement markets and the implementation of diagonal cumulation have created solid foundations for more ambitious objectives.

The Republic of Serbia's chairmanship of CEFTA in 2017 set out to promote the importance of trade policy in the formulation of broader economic policy and to support the strong implementation of CEFTA as a complementary process for its Parties and their economies in facilitating and improving their readiness in the processes leading to their membership of the European Union.

The efforts of the Western Balkans' leaders in Trieste on 12 July 2017 to establish a regional economic area on the basis of World Trade Organization (WTO) rules and in compliance with EU policy were aimed at making the region more competitive and proactive on the global scene. CEFTA is playing a major role in this endeavour, fully underpinning the dimension on trade and providing interlinkages with investment, mobility and digital integration. Deeper economic integration is aimed at achieving greater harmonisation across economies and a convergence framework for EU accession, creating an area of common regional targets, where goods, services, investment and skilled people can move freely. Building on the Connectivity Agenda for better integration of the transport and energy systems within the region and with the EU, the region is positioning itself on the global value chains scene, enabling the private sector – an important driver of economic growth – to reap the benefits of the economies of scale offered by a market with 20 million people.

We present the first regional Investment Report for the CEFTA region. It offers readers comprehensive information on current and projected regional investment trends and flows. The analysis here should enable policy makers, investment partners and academics to grasp the region's potential for investment, taking into account its geographical proximity to the EU and the complementarities of the economic structure, while benchmarking the region in a wider international context. The report acknowledges the progress made in the region over recent years in attracting foreign direct investment (FDI) and highlights the importance of pursuing this through sound economic policies to underpin macroeconomic stability, a key factor in creating a favourable environment for investment.

We trust that you will find this publication an excellent source of information. We hope to have regular editions in future, and in the meantime wish you pleasant reading.

Stevan Nikčević

State Secretary
Ministry of Trade, Tourism and Telecommunication
Republic of Serbia
CEFTA Chair in Office

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Note on methodology

This report follows the example of UNCTAD-assisted investment reports in terms of the way in which it provides a presentation of FDI-related data and some major investors, and analyses an economic area that is especially important for economic development by FDI. Macroeconomic and FDI-related data have been collected from official sources in the CEFTA region with the active participation of relevant institutions of CEFTA Parties. EU Member States that joined the Union in 2004 or later were used as peers, enabling international comparison of the CEFTA economies. CEFTA Parties received various versions of the report, and their comments have been incorporated by the authors of the final version.

Executive summary

CEFTA economies have expressed their commitment to enacting policies that would help to attract more foreign direct investment (FDI). Achieving export-led and FDI-driven economic growth in Southeast Europe is also among the goals of the Southeast Europe (SEE) 2020 strategy of the Regional Cooperation Council (RCC). To that end, participating economies are determined to improve the environment for FDI by implementing the recommendations of the United Nations Conference on Trade and Development (UNCTAD) Investment Policy Review. The CEFTA FDI Report supplements these efforts by providing information on the current stage of FDI in the region.

A careful data-based examination of the main features of FDI is provided in this report, to inform potential investors and policy makers. FDI is set in the broad context of economic growth, foreign trade and transport infrastructure development (Part I). Drawing on central bank data and international resources (including company news), Part II presents the salient features of FDI inflows and inward stocks, analyses the entry mode of foreign investors and discusses the extent to which CEFTA economies utilise their potential for FDI. The manufacturing sector is in the focus of Part III, as it has a central role in driving technological progress, boosting productivity and creating a market for advanced services, while its development depends on FDI, which can connect CEFTA economies with international value chains.

CEFTA economies have undergone a prolonged and weak recovery from the global financial crisis, with investments in particular lagging. They have attained a level of economic development (per capita GDP at purchasing power standards) only half of the Central and Eastern European EU members (EU-CEE), and their current rate of economic growth of 3% is not enough for any significant catch-up. Slow growth is partly a result of inadequate FDI inflow.

The post-crisis recovery has taken place with only a modest rise in FDI, and a very limited shift to export-oriented FDI. With annual FDI inflows of about EUR 4 billion and a 2016 FDI stock of EUR 54 billion, CEFTA economies have accounted for only 0.3% of global annual FDI inflow in recent years, and 0.2% of global inward FDI stocks, as of 2016. Their record is similar to the EU-CEE in terms of attracting FDI relative to their size (measured in FDI/GDP), but this is mainly on account of relatively low GDP levels.

The size of FDI inflows differs greatly across the CEFTA economies. In absolute terms, Serbia receives by far the most, reflecting its large size; it is followed by Albania and Montenegro. As a share of gross investment, Montenegro is comfortably the top CEFTA performer, while Macedonia fares best in terms of FDI in manufacturing. Differences between economies reflect the economic backdrop, the advances in privatisation and the specific features of particular sectors of each economy.

Greenfield FDI has been preferred to mergers and acquisitions (M&A) **as an entry mode for FDI,** although the largest projects originate in privatisation deals. The remaining assets waiting for privatisation may present interesting opportunities for those foreign investors that assess the risks accurately. A revival of the currently sluggish greenfield investment activity in the tradable sectors is the key to further increase in FDI and economic growth.

The FDI that CEFTA economies have been able to attract so far has had a beneficial impact. Foreign capital and know-how transmission have played an important role in improving quality in many economic sectors. Foreign affiliates are, on average, larger than domestic companies and have higher labour productivity. They have also contributed to the export recovery of the last five years.

However, in order to follow the successful example of FDI-driven economic growth demonstrated in the EU-CEE, CEFTA economies require stronger levels of FDI inflows into the higher-value tradable sectors. At present, there is a general shortage of export-oriented FDI, especially in higher-technology segments. CEFTA economies lag far

behind their EU-CEE peers in attracting FDI into professional services and research and development (R&D). They have also (with some exceptions) struggled to attract significant amounts of FDI in high-value manufacturing.

The manufacturing sector generally represents a low share of GDP in CEFTA economies, particularly in comparison with EU-CEE economies. This is problematic and explains the small export base and less-diversified export structure relative to the EU-CEE. Around two thirds of CEFTA exports come from low-tech industries, reflecting the specialisation patterns of manufacturing and FDI. Significant room for further growth therefore remains. Even in economies where the manufacturing sector is more important in production, specialisation is largely outdated. Medium and low-tech industries tend to be more prevalent than higher-tech industries. While the technology-driven sector of machinery and vehicle manufacturing is the backbone of industry in the EU-CEE, it is still very small in CEFTA, although it is expanding in some economies.

It follows, therefore, that one of the main challenges now for CEFTA economies is to shift towards medium-tech industries in production and exports. Higher production and exports of manufactured products would help to lower current account deficits further (thereby reducing external vulnerabilities), while at the same time driving stronger real GDP growth and per capita income gains. The necessary sectoral shift is attainable by relying on FDI and integration into international value chains. Manufacturing and IT services may attract future FDI, as several foreign companies are already successful in these sectors in some economies. Within manufacturing, opportunities exist either through joining existing value chains (such as in the food, agriculture, tourism and textile industries) or by finding niches in sectors such as transport equipment and electronics.

Given the lower GDP starting point compared with the EU-CEE, this report concludes that CEFTA economies have significant potential to further increase the amount of FDI they receive. Investors with experience of the EU-CEE will not find conditions in CEFTA economies too different, particularly in the institutional sense, with most CEFTA economies working towards EU membership. One potential attraction for investors is that labour costs in CEFTA are lower than in the EU-CEE.

However, there are also challenges in attracting more FDI into the CEFTA economies, and further reforms are required to ensure conditions that are conducive to investment. The external environment is not as supportive as it was before the 2008–09 global financial crisis. Certain aspects of the investment climate in some CEFTA economies put many investors off. Transaction costs are higher than in the EU-CEE, reflecting weak governance standards and infrastructure deficiencies. In particular, there is a need to improve the regional transport infrastructure. Steps to do so have been taken under the umbrella of the Berlin Process.

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Abbreviations

AL	Albania
BA	Bosnia and Herzegovina
MD	Moldova
ME	Montenegro
MK	Macedonia
RS	Serbia
XK	Kosovo*
CEFTA	Central European Free Trade Agreement 2006
CESEE	Central, East and Southeast Europe
EU-28	European Union 28 countries
EU-Baltic	European Union – Baltic States: Estonia, Latvia, Lithuania
EU-CEE	European Union – Central and Eastern Europe: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia
EU-SEE	European Union – South-East European countries: Bulgaria, Croatia, Romania, Slovenia
EU-V4	European Union – Visegrád countries: Czech Republic, Hungary, Poland, Slovakia
WB	Western Balkans: Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Serbia, Kosovo*
SEE	Southeast Europe
EUR	euro
MKD	Macedonian denar
RSD	Serbian dinar
USD	US dollar
BOP	balance of payments
BPM5	Balance of Payments Manual Fifth Edition
BPM6	Balance of Payments and International Investment Position Manual Sixth Edition
CEB	Council of Europe Development Bank
COSCO	China Ocean Shipping Company
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EIB	European Investment Bank
FATS	foreign affiliates statistics
FDI	foreign direct investment
GDP	gross domestic product
GFCF	gross fixed capital formation
GVC	global value chain
ICT	information and communication technology
IFI	international financial institution
IMF	International Monetary Fund
IPA	Instrument for Pre-accession Assistance
M&A	mergers and acquisitions
MNE	multinational enterprise
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne (Statistical classification of economic activities in the European Community)
NACE Rev. 1	first revision of the original NACE (1970)
NACE Rev. 2	revised classification introduced in 2008
OECD	Organisation for Economic Co-operation and Development
OEM	original equipment manufacturing
R&D	research and development
RCC	Regional Cooperation Council
REBIS	Regional Balkans Infrastructure Study
SAA	Stabilisation and Association Agreement
SEETO	South East Europe Transport Observatory
SIC	Standard Industrial Classification
TAP	Trans Adriatic Pipeline
TIA	Tirana airport
ULC	unit labour costs
UNCTAD	United Nations Conference on Trade and Development
WBIF	West Balkan Investment Framework
wiiw	Vienna Institute for International Economic Studies
WTO	World Trade Organization

CEFTA Investment Report 2017 – Introduction

CEFTA economies (Albania, Bosnia and Herzegovina, Macedonia, Moldova, Montenegro, Serbia and Kosovo* have received about EUR 4 billion annual foreign direct investment (FDI) inflow in recent years, 0.3% of global inflows. These figures may not look very impressive, but the region has a respectable record of attracting FDI relative to its size: as a share of GDP, the inward stock of FDI in CEFTA economies is similar to what a medium-sized EU Member State receives.

The location of the region is attractive to investors interested in the EU and neighbouring markets. Six CEFTA economies are situated in the Westerns Balkans in Southeast Europe, connecting Central Europe with Turkey; meanwhile Moldova lies along the eastern border of the European Union. CEFTA economies also provide opportunities for investors interested in the expanding local market of 22 million people.[1]

This report will show potential investors that they are not breaking new ground, but can join a successful and established foreign investor community.

There is a commitment in the region to pursue economic policies that will attract more FDI. Achieving export-led and FDI-driven economic growth is among the goals of the Southeast Europe (SEE) 2020 strategy of the Regional Cooperation Council (RCC).[2]

A specific target of the Integrated Growth Pillar of the SEE 2020 strategy (Regional Cooperation Council, 2013) is to 'Increase overall annual FDI inflows to the region by at least 160%' by 2020 (to EUR 8,800 million). It is expected that robust export performance, higher investment and FDI inflows will enhance integration with the EU.

Attracting FDI could help the region address the challenges it faces, including high unemployment, a lack of capital, and a deficit in managerial and technical know-how. The extent to which these direct and spill-over effects of FDI materialise will depend, among other factors, on the size, structure and market orientation of future foreign investment. The volume of FDI inflows will further depend on features of the host and home economies. It can be expected that the currently stabilising economic growth and improving business sentiment across Europe will stimulate further investments in the CEFTA region.

This report provides a data-based examination of the main features of inward FDI, with special attention paid to manufacturing industries.[3] Part I provides the broad context for development, in terms of economic growth, foreign trade and transport infrastructure. Part II outlines the salient features of FDI inflows and inward stocks, analyses the entry mode of foreign investors and discusses the extent to which CEFTA economies utilise their potential for FDI. The manufacturing sector provides the focus for Part III, because this sector has a central role to play in driving technological progress, boosting productivity and creating a market for advanced services. Finally, an analysis of the participation of CEFTA economies in global value chains outlines the main directions of future FDI.

* This designation is without prejudice to positions on status, and is in line with UNSC 1244 and the ICJ Opinion on the Kosovo declaration of independence.

[1] Annex Table A.1 provides an overview of the main macroeconomic indicators of the CEFTA economies.

[2] 'The Regional Cooperation Council serves regional cooperation and European and Euro-Atlantic integration of South East Europe in order to spark development in the region to the benefit of its people' (www.rcc.int).

[3] FDI data for the CEFTA economies used in this report have been updated and verified by the central banks of the CEFTA region and were processed by wiiw in February 2017. The data were included in the CEFTA FDI database prepared within the framework of this project. Data for 2016 were compiled in June 2017. Data on the entry mode of foreign investors and the list of foreign affiliates were provided by UNCTAD in February 2017. General economic data were taken from central statistical agencies, Eurostat and wiiw. Company news has been processed to highlight recent investment projects in major economic activities.

Part I – Macroeconomic conditions of FDI in the CEFTA region

The level of FDI inflow into an economy is strongly linked to the level of development, economic stability, openness and other macroeconomic factors. Improving economic conditions can attract more FDI, while FDI itself can stimulate economic growth. Economic growth means growing markets for the products of investors, and regional integration further enlarges the easily accessible market. Macroeconomic stability allows easy access to external finances and provides a more or less stable currency, which together lead to low vulnerability to external shocks. This allows for predictable returns on investments. The conditions for investors have improved considerably in CEFTA economies over the past 20 years.

Most CEFTA economies have faced a difficult transition period over the past few decades, but in recent years they have embarked on a sustainable growth path. For most, conflicts of the 1990s in the former Yugoslavia set back development significantly, and this was compounded by Central and Eastern European economies missing out on the earlier (2004–07) waves of EU accession. Many CEFTA economies also went into the 2008 global financial crisis with huge external vulnerabilities, leading to deep recessions, prolonged and painful adjustments, and slow recoveries. As a result, per capita GDP in the region lags substantially behind most EU-CEE members (Annex Table A.1). Nevertheless, the region offers potentially attractive opportunities for foreign direct investors.

This section will provide an overview of the last two decades, discuss how CEFTA came to be created, look at its links with the EU and examine the current macroeconomic conditions in its economies. It will detail the post-crisis adjustment process and outline what current macroeconomic conditions mean for FDI inflows. Finally, it will look at how the poor state of transport infrastructure is to be improved by international investment.

I.1 Economic integration, growth and external stability – factors of investment location quality

I.1.1 CEFTA and EU integration

Over the past two decades, CEFTA economies have become increasingly integrated both with each other and with the EU in economic terms. This has increased their appeal as a destination for FDI, both in terms of being viewed as an economic area, and with respect to their potential role as a base from which to export to the EU.

The regional free trade agreement of Southeast Europe (i.e. the Western Balkans and Moldova), CEFTA, developed out of bilateral free trade agreements between the signatory parties in 2006.[4] All economies, except Moldova, had had tariff-free access to the European Union (EU) since 2001 and were at various stages in the stabilisation and association process (which assumed the negotiation of a Stabilisation and Association Agreement (SAA) with the EU and the eventual achievement of EU membership, once the Copenhagen Criteria were fulfilled). They now all have an SAA with the EU and only Kosovo* has yet to fully implement it. Moldova's SAA includes a Deep and Comprehensive Free Trade Agreement with the EU, which came fully into effect in mid-2016. As a result, CEFTA economies operate for the most part within a regime of free trade with the EU, even though not all of them are members of the World Trade Organization (WTO) – Bosnia and Herzegovina, Serbia and Kosovo* have yet to join.

In addition, as part of the SAAs, cross-border investments and trade in services have been largely liberalised. Macroeconomic policy coordination between the CEFTA economies is to be strengthened within the SEE 2020 process, which has been entrusted to the RCC.[5]

[4] www.cefta.int
[5] www.rcc.int

Under the RCC framework, the CEFTA economies (except Moldova) have adopted a strategy for development which sets out policies with the aim of achieving common goals. The progress is monitored, while implementation depends largely on the firmness of the members' commitments.

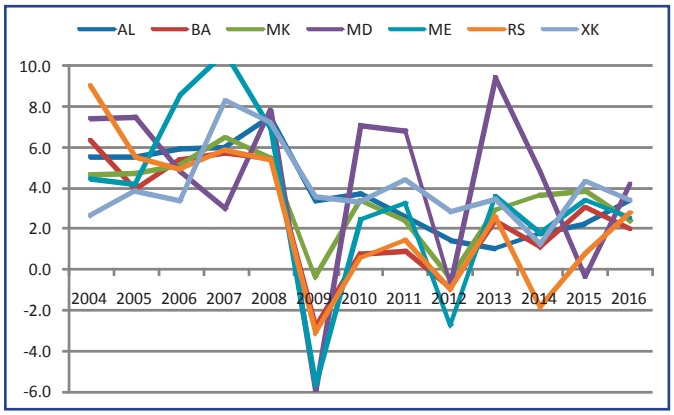
Even before CEFTA economies accede to the EU, investments in the region are spurred from outside and within through the creation of a larger regional market, supporting greater regional cooperation and underpinning political stability. In addition, the EU aims to support private sector involvement with public regional infrastructure projects. Such projects have been a priority for the EU since the creation of the Stability Pact for SEE in 1999, and they have recently been revived as part of the Berlin Process (see section I.2).

I.1.2 Macroeconomic developments since 2008

The launch of CEFTA in 2006 was soon overshadowed by the outbreak of the global financial crisis in 2008–09. Though the crisis affected the SEE economies differently, the overall impact was quite negative. The main reason for this was high external imbalances and associated real exchange-rate misalignments ahead of the crisis. Current account deficits peaked for most economies in 2008 at levels which ranged from 10% to almost 50% of GDP (trade deficits were even larger; remittances and other transfers compensated in part). The drop in (or outright cessation of) capital flows immediately following the crisis forced a sharp reduction in external imbalances from 2009. Current account and trade deficits narrowed rapidly across the region, while consumption and investments fell in most places. This went hand in hand with a decline in FDI inflows.

In most CEFTA economies, economic growth in the period since 2008 has been slow by historical and regional standards. Growth rates initially plummeted, and recovery has been generally muted and quite uneven (Figure I.1 and Annex Table A.1). Albania and Kosovo* did not suffer setbacks after the crisis, as they had started development from very low levels and had limited exposure to international markets. These have been the fastest-growing economies, but they are still among those with the lowest per capita GDP (Annex Table A.1). The setback in Macedonia was modest, and so was growth in subsequent years. Moldova, the poorest of the seven, has witnessed huge fluctuations, producing the steepest declines followed by sharp recoveries, due to both external and internal shocks. There are further important differences as regards the main demand factors driving economic growth. Investments and public consumption were sluggish, while private consumption and especially net exports expanded.

Figure I.1 / GDP real annual growth rate, in %, 2004–16



Source: wiiw database relying on CEFTA economies statistics, 2016 preliminary.

After the global financial crisis, investments were the part of the economy that suffered most all over Europe, including in the CEFTA economies. Some of them saw particularly big falls in investments in the immediate post-crisis years. Sluggish investment activity is seen in the declining share of investment in GDP from 25–30% in 2008 to 20–25% by 2014 for most economies. Average annual real gross fixed capital formation growth in 2009–16 was just 0.7% (in Serbia, Bosnia and Herzegovina and Montenegro it was negative). Within overall investments, public investment has been more resilient than private, and domestic investment more resilient than foreign. This is, in part, due to the process of deleveraging, in particular towards foreign creditors – a process that has been taking place throughout the period. But investments staged a broad recovery in 2015–16 (except in Moldova). Albania, Montenegro and Kosovo* reported especially large increases, mainly in construction, including transport infrastructure.

Private consumption fared better than investments, growing by an annual average 1.1% across the region in 2009–2016. However, this was still well below the average rate of headline GDP growth (1.9%). In Moldova and Kosovo* private consumption has been relatively strong, while elsewhere it has been much weaker. Its growth was negative in both Montenegro and Serbia across the period. There was also a particular weakness in public spending in the post-

crisis years. This component of GDP rose by an average of 0.4% over the period, and was negative in Moldova and Kosovo*. However, the most significant development on the expenditure side of GDP since the crisis has been with regard to net exports.

I.1.3 Export dynamics

Expanding exports in both goods and services were visible across several CEFTA economies in 2009–16 (Table I.1). Serbia, Macedonia and Kosovo* have been particularly successful in terms of exports of both goods and services (although in the case of Kosovo*, the low base must be borne in mind). On the services side, the export of information and communication technology (ICT) services is on the rise in all CEFTA economies, but especially in Serbia and Macedonia. In Albania, goods exports declined because oil was hit by low international prices in 2016. Montenegro is particularly interesting, with trade in goods plummeting and the economy specialising even more in the export of services, mainly tourism. Bosnia and Herzegovina expanded their export of goods, but not of services. (For 2016 data, see Annex Table A.1.)

Table I.1 / Exports of goods and services, 2009–16 change in % (in current EUR terms)

	Goods	Services
Albania	-15	26
Bosnia and Herzegovina	79	-3
Macedonia	59	69
Moldova	28	0
Montenegro	-30	60
Serbia	83	6
Kosovo*	56	13

Source: wiiw database relying on national statistics.

Trade adjustment was supported by real exchange-rate developments. Serbia and Moldova devalued strongly, while the rest (except for Albania) had to adjust in real terms because they have fixed exchange-rate regimes or else use the euro. In any case, most economies experienced real exchange-rate depreciation, with most exchange rates currently lower than in the period before the crisis. There has been some stabilisation in the last few years, which perhaps indicates that whatever overvaluation there was has been corrected. With exports continuing to grow, that should mean that the region has become sufficiently competitive and that the excesses of the pre-crisis period have been corrected. This is likely to increase the region's appeal from an FDI perspective.

All economies except Montenegro have posted average real goods export growth of over 5% since 2008, with Kosovo* and Macedonia above 8% (albeit the former starting from a very low level). Real exports in goods and services for the CEFTA economies rose by 6.1% on average over the period, while the rise in imports was just 1.8%, reflecting persistently weak domestic demand. As a result, the net export contribution to growth has been significant and positive. The average (unweighted) share of exports/GDP for the CEFTA economies rose from 31.5% in 2008 to 38.9% in 2016 (2015 data for Bosnia and Herzegovina). This is, however, still low by the standards of other small economies in the EU-CEE. (For the relationship between exports, FDI and manufacturing, see section III.2.4.) Exports to the EU roughly doubled over 2009–16 (in nominal terms), while those to other CEFTA economies were largely flat. Even though many big Western economies grew slowly in the immediate post-crisis years, their large size and high wealth level in relation to CEFTA economies meant that they still represented an important and growing source of demand for CEFTA exports.

While exports within CEFTA are demand constrained, sales to economies outside the region are supply constrained. In practice, because of the disparity in size and wealth level, more-developed markets in Western Europe can consume whatever CEFTA partners can produce. Some economies, notably Serbia and Macedonia, have been able to increase their export capacity to take advantage of this. However, in general, export capacity across the region remains quite low by EU-CEE standards, in part because of inadequate attraction of FDI into the tradable sector (see details in Parts II and III).

I.1.4 Improved macroeconomic environment for FDI also acknowledged by investors

In 2015–16, more broad-based growth returned across most CEFTA economies, and the outlook is increasingly positive. Given that most underlying fundamentals have not changed or have improved since 2008, the potential growth

rates of the CEFTA economies should be somewhere between 4% and 5% annually, significantly above those in most of Western Europe. Since they are currently running at around 3% (Figure I.1 and Annex Table A.1), this suggests that a further improvement in growth rates is quite likely in the coming years. In addition, macroeconomic imbalances have been reduced and structural indicators improved.

However, despite structural improvements, challenges persist: the share of consumption in CEFTA economies remains high compared with EU-CEE standards, while industrial production is low. CEFTA economies need to follow the lead of the more advanced CEE members of the EU in increasing the size of their tradable sectors, moving up the value chain and converging further with Western European per capita income levels. Achieving sustainable development requires a sustained rise in productivity and higher-value exported goods.

So far, the role of FDI in driving expansion in tradable sectors of the CEFTA economies has not (with some notable exceptions) been particularly significant. The post-crisis recovery in economic growth took place with only a modest rise in FDI and a slow shift of FDI to higher-value technologies (see Part III for details). In order to follow the example of the EU Visegrád countries (EU-V4), this will need to change. Therefore, a clear focus for the CEFTA economies should now be to further improve the region's attractiveness as a destination for FDI, and to attract this FDI into higher-value parts of the tradable sector.

Many of the conditions for higher FDI inflows exist in the region. Strengthening trade integration with the EU is likely to be regarded positively by foreign direct investors. Moreover, regional surveys, such as the Balkan Barometer and CEFTA Barometer,[6] suggest that there is growing support for both regional and EU economic cooperation, both of which are positive from the perspective of a foreign direct investor. In the last three years, these surveys have shown rising support for foreign investment, with the proviso that domestic investors should be treated at least as well as foreigners. It is also worth noting that the views of business and politics on FDI are more positive than those of the public.

One of the key barriers to higher FDI in CEFTA economies, at least according to the Balkan Barometer, is the low internationalisation of businesses within the region. The intention of CEFTA to make the regional market attractive to large-scale foreign investment has yet to bear fruit. However, with macroeconomic imbalances now greatly reduced, and CEFTA economies in general much more open, the incentives for foreigners to invest in the value chains of the region are higher than they were a decade ago.

I.2 Regional transport infrastructure on the road to improvement

The backwardness of the infrastructure is still a substantial drawback for FDI and reindustrialisation in the CEFTA region. Both intra-economy connections and links across borders are poorly developed. Rail infrastructure in particular was neglected for decades. Apart from various types of transport infrastructure, the energy infrastructure also needs to be upgraded. With this in mind, the so-called **Berlin Process** began with the 2014 Conference of Western Balkan States in Berlin. The aim of the process is to support the region's economies on their path to EU membership. Within this, there is a particular focus on infrastructure development, human capital and regional cooperation. The EU supports infrastructure development in the region through its Instrument for Pre-accession Assistance (IPA) II for the period 2015–20). The IPA II funds that are earmarked for the co-financing of infrastructure investment amount to EUR 1 billion. Additional funds (mostly loans) are available from a number of international financial institutions (IFIs). Better infrastructure has the potential to reduce substantially the costs of production, and can therefore be regarded as an incentive for current, as well as future, investment by domestic and foreign companies in the region. In addition, the construction works are a business opportunity in themselves. In some cases, a private–public partnership could be a realistic option.

Infrastructure development is coordinated by the South East Europe Transport Observatory (SEETO),[7] a regional transport organisation established under the Memorandum of Understanding for the development of the Core Regional Transport Network, signed in 2004 by Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro and Serbia, and the

[6] Balkan Barometer 2015, 2016, 2017 and CEFTA Barometer 2016.

United Nations Mission in Kosovo* and the European Commission. The aim of SEETO is to promote cooperation in the development of the main and ancillary infrastructure in the Western Balkans, and to enhance local capacity for the implementation of investment programmes, as well as data collection and analysis on the Indicative Extension of TEN-T Comprehensive Network to the Western Balkans.[8] The list of priority infrastructure projects was signed in 2015, and in 2017 a Transport Community Treaty will be signed between the EU and the six Western Balkan parties.

Over the past 12 years, the transport sector in the Western Balkan economies has received considerable investment, estimated by SEETO at EUR 12.2 billion. Road (EUR 9.9 billion) and rail (EUR 1.8 billion) account for the bulk of that. The financing sources have mostly been the national budgets, as well as loans and grants from IFIs. The West Balkan Investment Framework (WBIF) was created at the end of 2009 as a so-called 'blending instrument', combining grants and loans, as well as technical assistance. WBIF involves cooperation between the Council of Europe Development Bank (CEB), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), the KfW development bank (Frankfurt) and the World Bank, as well as bilateral donors. These efforts to improve the regional infrastructure have apparently been successful. Improvements in infrastructure have most likely been an important factor underpinning FDI in the region. Nevertheless, the WBIF-supported Regional Balkans Infrastructure Study (REBIS) - Transport concluded that 30% of the region's comprehensive road network required immediate maintenance and/or upgrade. It also identified capacity constraints on more than 30% of the rail network and stressed the urgent need for rail rehabilitation and maintenance.[9]

The future SEETO investment in transport infrastructure in the Western Balkans amounts to EUR 7.7 billion. This could have potential multiplier effects of EUR 11.5 billion or 15.5% of the region's GNP. Translating this into long-term (15 years) growth contributions, the effect is about one percentage point per annum, a non-negligible value. Employment would rise by about 200,000 persons (approximately 4% of the workforce) – an annual long-term employment growth contribution of almost 0.3 percentage points would be expected.

As for Moldova, the development of the transport and logistics sector is seen as a priority in the Moldova 2020 strategy and by international donors (EU, World Bank, EBRD, EIB). It will be achieved through public investment and an increase in private sector and foreign involvement.[10]

China has emerged as an important infrastructure developer in the Western Balkans. It is financing transport and energy infrastructure (Table I.2), which is also related to its new Silk Road initiative ('One Belt, One Road'). The Chinese aim is for improved transport and energy infrastructure to support the flow of Chinese goods from the Chinese-acquired Greek port of Piraeus further north, towards wealthier EU economies; China has identified the Greek Port of Piraeus as a new European logistics hub. The China Ocean Shipping Company (COSCO) won a 35-year concession in 2009 for two of the three port terminals, and in January 2016 formally acquired a 67% stake for EUR 370 million. Furthermore, the company has announced another EUR 350 million investment over the next five years, increasing the port's capacity from 1 million to 7 million containers. Along the Balkan route, high-speed railway lines, motorways and power stations are being planned, financed and built by Chinese companies. Current Chinese infrastructure projects in the wider SEE region total an estimated EUR 9 billion. This is also the sum which the Chinese government has earmarked for the financing of these projects, mostly through loans by Chinese development banks. These projects are typically executed by Chinese construction companies, employing Chinese technology and, to a significant extent, also Chinese workers.

The political framework for these activities is the cooperation between Central and Eastern European economies and China in the '16+1' initiative, i.e. China and the 11 EU-CEE economies, plus five non-EU Western Balkan economies. At the 2016 Riga summit, the Chinese prime minister announced a EUR 10 billion investment fund run by

[7] www.seetoint.org/ – the organisation does not include Moldova
[8] www.seetoint.org/
[9] www.wbif.eu/sectors/transport
[10] www.east-invest.eu/en/investment-promotion/Moldova-2/MD-transport-and-logistics

Table I.2 / China's investment and construction in the Western Balkans, 2005–16

Host Economy	Year	Month	Chinese entity	Project value EUR mn	Sector	Subsector	Type of contract
BA	2010	July	Dongfang Electric	536	Energy	Coal	Construction
BA	2013	July	Power Construction Corp	211	Energy	Gas	Construction
BA	2014	August	China Energy Engineering	958	Energy	Coal	Construction
BA	2015	October	Dongfang Electric	460	Energy	Coal	Construction
ME	2014	March	China Comm. Constr.	1012	Transport	Autos	Construction
MK	2013	November	Power Construction Corp	301	Transport	Autos	Construction
RS	2010	April	China Comm. Constr.	260	Transport	Autos	Construction
RS	2010	December	Sinomach	257	Energy	Coal	Construction
RS	2013	January	China Comm. Constr.	640	Transport	Autos	Construction
RS	2013	June	Shandong Gaosu	249	Transport	Autos	Construction
RS	2013	November	Sinomach	542	Energy	Coal	Construction
RS	2014	September	Sinomach	1084	Energy		Investment
RS	2016	June	China Comm. Constr.	208	Transport	Autos	Construction
RS	2016	June	Sinomach	208	Energy	Gas	Construction
RS	2016	October	Huawei	154	Technology	Telecom	Construction
RS	2016	November	China Comm. Constr. & Railway Eng.	145	Transport	Rail	Construction
RS	2016	December	Hebei Iron	108	Metals	Steel	Investment

Notes: Converted from USD at annual average exchange rate; many of these projects are not FDI but public investment. Abbreviations stand for the economies Bosnia and Herzegovina (BA), Montenegro (ME), Macedonia (MK) and Serbia (RS).
Source: China Global Investment Tracker, January 2017.

the Sino-CEEF Holding Company, set up for this purpose.[11] The fund will focus on developing infrastructure, high-tech manufacturing and mass consumption industries in the region. Data provided by the China Global Investment Tracker show that of an estimated EUR 6 billion of contracts during the period 2010–16 in the Western Balkans (projects observed include the 17 activities in Bosnia and Herzegovina, Macedonia, Montenegro and Serbia, as indicated in Table I.2), about 60% were related to energy and 40% to transport construction contracts. Marginal amounts were related to projects in the technology (telecom) and metals (steel) sectors. Only two projects were labelled investments rather than construction contracts. Both were located in Serbia – Sinomach's 2014 investment in the energy sector and Hebei Iron and Steel Group's 2016 investment in a steel mill.

The improvements generated by the projects will lead to more international trade and investment. Simulations by García-Herrero and Xu (2016) show that it is the landlocked (Eastern) European economies that will gain most in terms of trade creation from China's Belt and Road infrastructure initiative, via substantial reductions in transportation costs. Under the assumption of a 50% cut in rail and 5% cut in maritime transport costs, economies such as Moldova and Bosnia and Herzegovina are among the Top 10 trade growth winners (in the order of 8% to 9%). Given that FDI and trade generally complement one another (Martínez et al., 2012), infrastructure improvement based on reductions in transport costs are also expected to attract more FDI into the economies of the Western Balkans. China's Silk Road initiative should therefore support domestic and foreign investment in the region in years to come.

[11] www.china.org.cn/business/2016-11/07/content_39649966.htm; Moldova is not part of the project.

I.3 Conclusions for Part I

Part I has found that the CEFTA economies have undergone a prolonged and weak recovery from the global financial crisis, with investment in particular lagging, and in most places still not back to pre-crisis levels as a share of GDP. During this period, the area of the economy that has performed most strongly has been exports, reflecting both real exchange-rate adjustments and the fact that many trade partners are richer and have started to grow and import more from CEFTA economies. As a result, exports/GDP ratios have increased, and the CEFTA economies have become more open. However, most of these exports continue to come from fairly low-tech industries, and the Balkan Barometer survey suggests that the internationalisation of businesses is still low in the region.

Competitiveness has improved, and regional cooperation efforts have been strengthened. The main priorities for policy makers in the region include attracting higher amounts of FDI, which is needed to step up economic growth, exports and employment. More FDI should flow especially into the tradable sector, to support CEFTA economies moving up the value chain.

The CEFTA region has many transport infrastructure deficiencies, which are a drawback for higher FDI inflows and reindustrialisation. The Berlin Process, launched in 2014, has a particular focus on improving the region's infrastructure, and significant funds are available. Infrastructure development is coordinated by the South East Europe Transport Observatory. China's 16+1 initiative and related investment commitments could also have a significant positive impact on regional infrastructure. These factors, combined with stronger growth and better policies in the future, could attract higher FDI inflows for CEFTA economies.

Part II – Characteristics of FDI in the CEFTA region

CEFTA economies are small players in terms of global FDI flows, but each of them has specific features that make them unique FDI locations. This part analyses the level of FDI inflows received by CEFTA economies in absolute terms, then relative to GDP and total investment, and puts this into the wider context of the EU-CEE economies. It looks at the evolution of FDI inflows over time, the main industries that these flows go into, and the key economies where FDI flows originate. Separate sections will deal with the entry mode of foreign investors and the weight of foreign affiliates in the CEFTA economies. Finally, an assessment will be provided of how well CEFTA economies do in attracting FDI inflows, relative to their potential.

II.1 Small economies in global and regional comparison

The CEFTA region has received roughly 0.3% of the global annual FDI inflow in recent years and has accumulated 0.2% of global inward FDI stocks, as of 2016.[12] There have been only marginal fluctuations in these shares over the past decade, due to the region's relatively small size (22 million inhabitants; Annex Table A.1).

The annual FDI inflows of about EUR 4 billion and the 2016 FDI stock of EUR 54 billion in the CEFTA economies are similar to the figures for a medium-size EU Member State.[13]

If nominal GDP is used as a measure for the size of an economy, it is noticeable that the CEFTA region receives more FDI than would be expected. With FDI stocks of about 60% of GDP, the CEFTA region has higher FDI intensity than either the global average of 35% or the EU average of 47%. Although the combined nominal GDP of the CEFTA region in 2015 was EUR 77 billion (similar to Slovakia, with EUR 78 billion, but only half of the figure for Romania), the CEFTA region recorded FDI stocks that were larger than Slovakia's (EUR 40 billion) and only 23% lower than Romania's (EUR 64 billion).

The standard FDI projects in the region are of medium size, but there are exceptions, mainly in Serbia (the region's largest economy), such as NIS (an oil company, part of Russian Gazprom), FIAT (a joint venture with FIAT-Chrysler), Maxi retail (part of Belgium's Delhaize), etc. The size of the economy plays a part mainly in local market-oriented investments: only relatively small amounts of capital are necessary for an investor to achieve a dominant position in individual CEFTA markets. This allows medium-sized companies from neighbouring economies which are not active on the broad international scene to find investment opportunities in CEFTA markets. Small economies can further specialise in niches integrated in cross-border value chains.

The EU-CEE economies are natural peers for benchmarking the CEFTA region in terms of size and conditions for FDI. Not only are they close in geographical terms, but they also have common historical features: CEFTA economies have undergone similar economic and political transformations as the EU-CEE and are now on the road to EU membership. Although the wars in the CEFTA region delayed transition and have left a legacy that creates some differences from the EU-CEE, foreign investors who gained local knowledge in EU-CEE economies in the 1990s will find conditions in the CEFTA economies familiar. In both regions, privatisation has offered a unique opportunity for foreign penetration, by which foreign banks and telecom companies have achieved dominant positions in local markets.

The peer region EU-CEE can be split into three separate groups, based on different times of their EU accession and their geographical location: the Visegrád group (EU-V4),[14] the Southeast European EU members (EU-SEE)[15] and the

[12] UNCTAD, World Investment Report 2017.
[13] See methodological note to CEFTA FDI statistics in the notes to Figure II.3.
[14] EU-V4 including the Czech Republic, Hungary, Poland and Slovakia.
[15] EU- SEE including Bulgaria, Croatia, Romania and Slovenia.

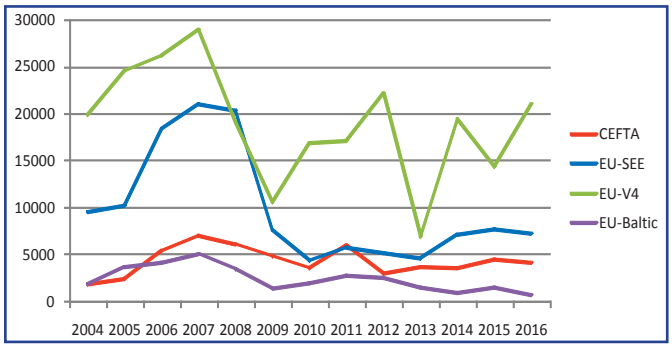
Baltic States (EU-Baltic).[16] The EU-V4 has received high volumes of FDI, especially in manufacturing, and has enjoyed FDI-supported economic growth. The EU-SEE is less integrated into international value chains than the EU-V4, but it hosts a number of large multinational enterprise (MNE) subsidiaries, particularly in Romania. The Baltic economies are small in size, similar to the CEFTA economies, and therefore multinational investments tend to be more narrowly specialised in component production and outsourced services.

The peer regions are also competitors of the CEFTA region in attracting FDI. Investors targeting relatively low-wage economies in or around the huge EU market may consider both the EU-CEE and the CEFTA economies as suitable locations. Labour costs are generally lower in the CEFTA region, but transaction costs are still high, mainly on account of less-favourable infrastructure and poorer governance standards (see Box III.1 for more detail).

II.2 FDI inflows into the CEFTA region: increasing modestly since 2012

A boom-bust cycle of economic growth and FDI inflows took place between 2004 and 2015. Both economic growth and FDI took off during the years before the global financial crisis. They then subsided, but have undergone a moderate recovery in recent years. Although FDI inflows increased year on year up to 2007 both in the CEFTA economies and among their peers (Figure II.1 and Annex Table A.2), in the immediate pre-crisis years (2004–07), the fastest FDI growth took place in the CEFTA region (360%). In these years, the CEFTA region exited its previous depression, privatisation progressed, and investors in particular took advantage of opportunities to invest in real estate. In the EU-SEE region, inflows increased by 220% over the same period, driven by the same factors as in the CEFTA economies; meanwhile the figure was only 46% in the EU-V4, as this region had already undergone large-scale privatisation during an earlier period.

Figure II.1/ FDI inflows into CEFTA, EU-SEE, EU-Baltic, EU-V4, EUR million, 2004–16



Note: See detailed data in Annex Table A.2.

Source: CEFTA and wiiw FDI database incorporating central bank statistics.

The onset of the 2008–09 global financial crisis had a negative impact on FDI inflows into the CEFTA region, but the decline was less than among its peers. In 2009, inflows to the CEFTA economies were 30% lower than in 2007, whereas they fell by 63% in both the EU- V4 and the EU-SEE. The reason for CEFTA's relatively better performance could be that the economies stepped up their efforts to privatise and open up to FDI; they also still enjoyed the bonus of being newcomers, which saved several foreign investment projects from being put on ice in the way they were in parts of the EU-CEE. A modest recovery of inflows occurred in 2011 in all three regions, in line with global trends and on account of the improving economic sentiment among European investors. The subsequent euro crisis, however, depleted investors' optimism (which had anyway been only moderate), and FDI inflows declined both in the CEFTA economies and in the EU-SEE region. Only the EU-V4 benefited from increasing inflows in 2011–12, on account of the restructuring of foreign affiliate banks' portfolios; other FDI was modest.

FDI inflows to the CEFTA region have increased from the lowest point in 2012, while they remained unstable in the EU-V4. The stabilisation of FDI inflows went hand in hand with improving economic stability and growth in the majority of the CEFTA economies. In the EU-V4 region, fluctuations were the result of large shifts in capital flows not linked to foreign investments in physical assets. In these mature FDI receivers, the capital restructuring of financial assets and the re-capitalisation of banks significantly influenced the FDI statistics.[17] In the EU-SEE, FDI has

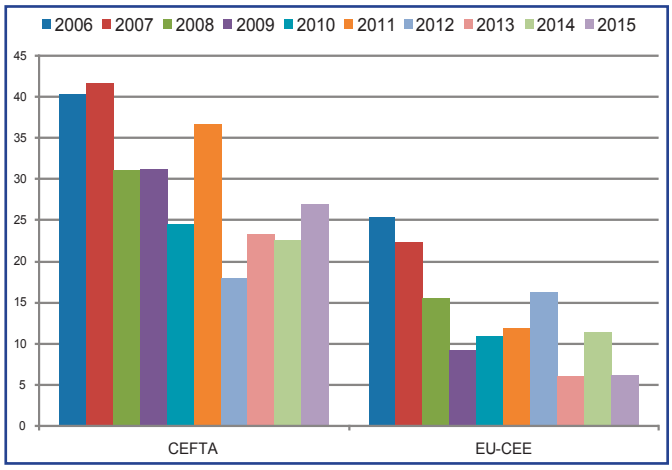
[16] EU-Baltics comprising Estonia, Latvia and Lithuania.
[17] Hunya (2016); note that the data for Hungary underlying Figure II.1 have been corrected for assets restructuring.

recovered even more than in CEFTA since 2013, while it has stayed depressed in the EU-Baltics. The year 2016 has brought a new high of FDI inflows in the EU-CEE and minor declines in the other three regions.

The CEFTA economies have received higher amounts of FDI inflows than their peers as a percentage of gross fixed capital formation (GFCF).[18]

FDI inflows have averaged 20–25% of GFCF in the CEFTA economies – higher than in the peer economies (Figure II.2). Unfortunately, this is mainly due to the low overall investment rate in these economies – even below 20% of GDP in Bosnia and Herzegovina and Serbia. The two regions diverged especially markedly in 2013–15, when FDI/GFCF fell to very low levels in the EU-CEE due to upbeat investment activity, but increased in the CEFTA economies. The main reason for the investment boom in the EU-CEE was the inflow of EU funds, which also exist in the CEFTA region, but in small amounts.

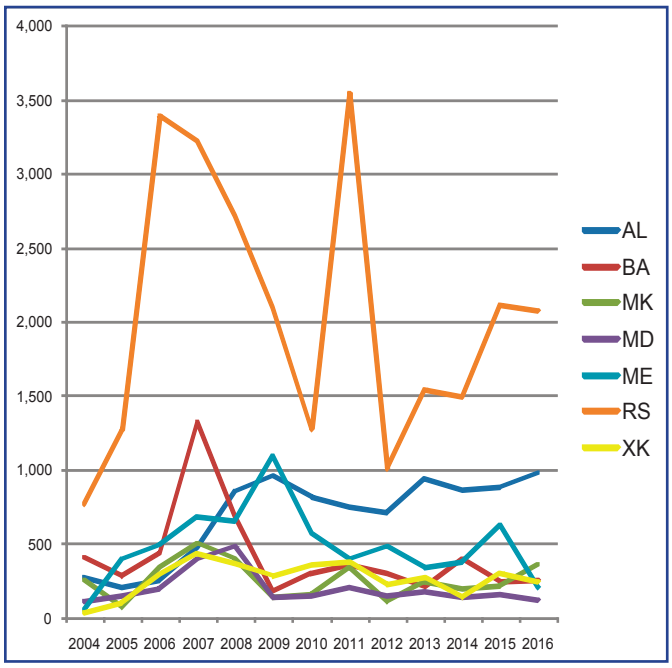
Figure II.2 / FDI inflow as % of gross fixed capital formation in the CEFTA and EU-CEE regions, 2006–15



Source: CEFTA and wiiw FDI database incorporating central bank statistics.

The differences between individual CEFTA economies are significant in terms of their annual FDI inflows (Figure II.3). Serbia absorbs about half of all regional inflows: annual fluctuations have been relatively large here, mainly due to some larger foreign acquisition deals, as in 2011 (see Table II.7 further below). Diverse projects, mainly of small and medium size, have contributed to the stability of inflows in more recent years. The second largest inflows have been recorded in Albania, stabilising in the range EUR 0.8–1.0 billion in recent years. Montenegro has come third in most years since 2005. Inflows into Bosnia and Herzegovina, Macedonia and Kosovo* have fluctuated at similar levels. Overall, 2015 was a more successful year than 2014 across the region mainly on account of higher inflows into Montenegro, Serbia and Kosovo*, while the only economy reporting a decline was Bosnia and Herzegovina. In 2016, inflows subsided in Montenegro to their lowest level since 2005, while other economies received similar amounts as in the previous year.

Figure II.3 / FDI inflow into CEFTA economies 2004–16, EUR million



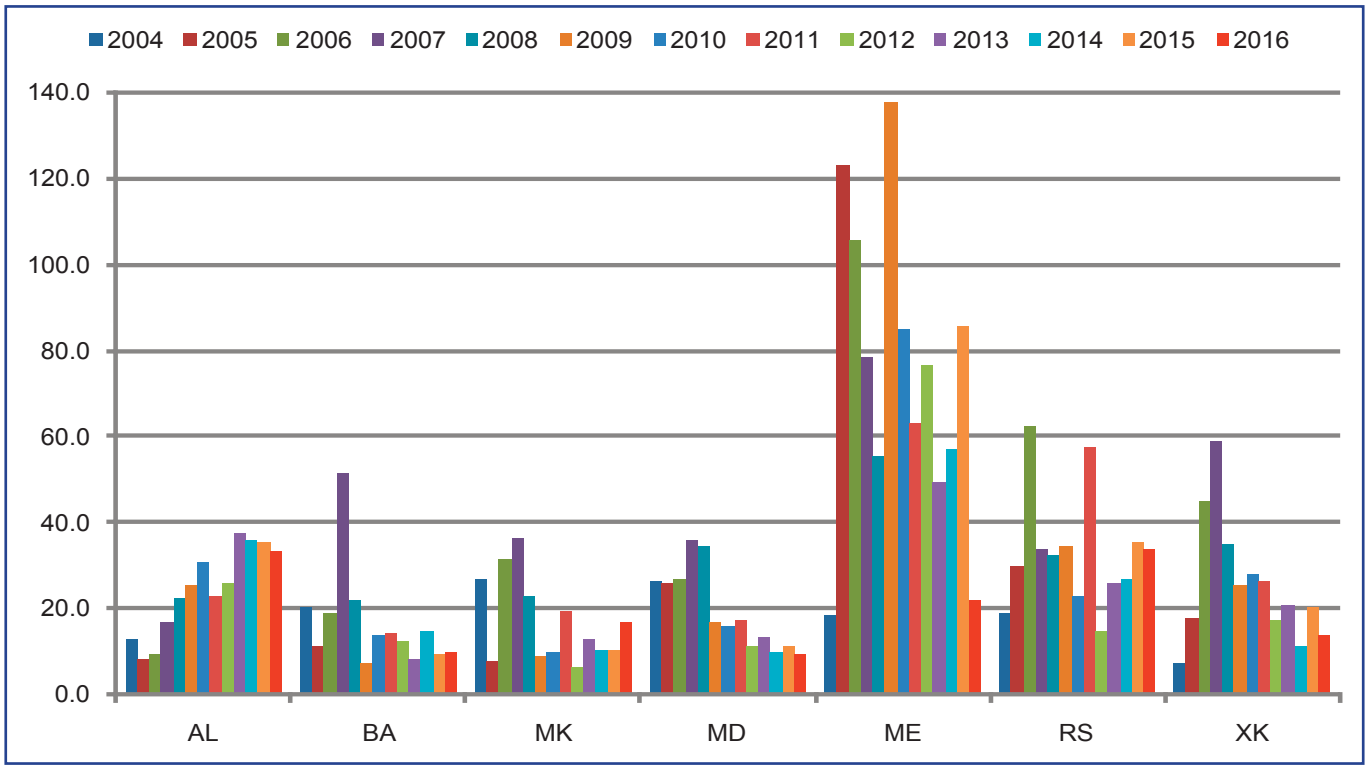
Notes: Based on BPM6 directional principle, except Moldova: BPM5;

Albania and Kosovo* since 2008 and Serbia since 2007: BPM6, asset/liability principle and BPM5 before 2007.

Source: CEFTA and wiiw FDI database incorporating central bank statistics.

[18] FDI in percentages of GFCF measures FDI flows in relation to the size of the economy and should not be interpreted as the share of foreigners in GFCF.

Figure II.4 / FDI inflow as % of gross fixed capital formation in CEFTA, 2004–16



Source: CEFTA and wiiw FDI database incorporating central bank statistics.

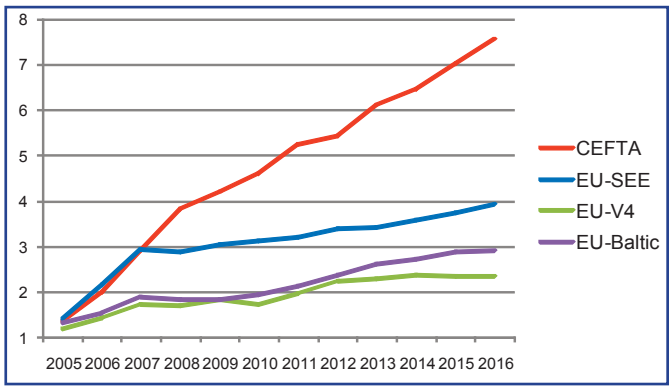
In terms of FDI inflows measured as a percentage of GFCF (Figure II.4), **Montenegro received by far the highest amounts, while Moldova, Bosnia and Herzegovina, and Macedonia received the lowest.** Fluctuations in Bosnia and Herzegovina were large, mainly determined by the ups and downs in GFCF, in contrast to the relatively stable GFCF in Macedonia. Albania and Serbia have both had robust growth in GFCF in recent years, which has led to a decline in the relative size of FDI.

Taking a more stable benchmark than GFCF, per capita FDI inflows have been especially low in the same three economies of Moldova, Bosnia and Herzegovina, and Macedonia, but the differences between them has been larger and more stable. Disregarding fluctuations, Moldova has received EUR 40–50 per capita over the past eight years, Bosnia and Herzegovina about EUR 80 and Macedonia about EUR 100. Per capita inflow into Serbia was about EUR 200 in 2011–14 on average, increasing to EUR 300 in more recent years; in Albania the increase was from EUR 220 to EUR 340. CEFTA economies with higher values would be in the mid-field of the EU-CEE; those with low values are below any of the EU-CEE economies, except Slovakia, which is an outlier for methodological reasons. (See Annex Table A.1 for 2016 data.)

II.3 FDI stock growing fast in CEFTA

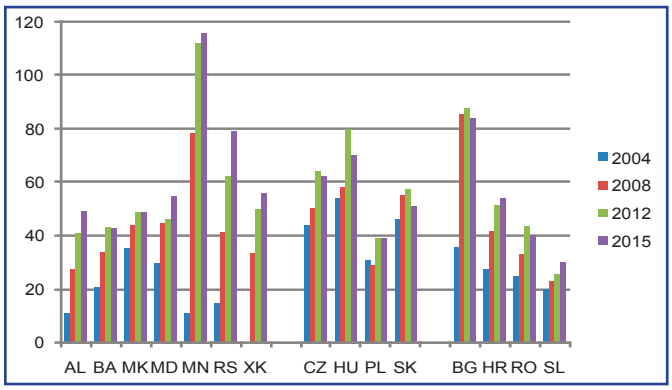
The amount of FDI stock invested in the CEFTA region has been increasing rapidly in the past 10 years, ahead of the peer regions (Figure II.5 and Annex Table A.3). This may have methodological reasons, partly due to the asset/liability-based data used, instead of data based on the directional principle. In addition, most CEFTA central banks value stocks at book value, which may lead to overestimation compared with the present value used generally in the EU-CEE, especially during crisis periods. Therefore, FDI stocks in the CEFTA economies have grown much more rapidly and steadily than in the peer economies, both in absolute terms and as a percentage of GDP. This is seen in Figure II.5, which shows a slightly modified post-crisis slope for CEFTA vs. a clear break in the case of its peers. That said, and given the lack of alternative data, the subsequent analysis relies on FDI stock data for the various analyses regarding the size and structure of FDI.

Figure II.5 / FDI stock increase, 2004 = 1



Source: CEFTA and wiiw FDI database incorporating central bank statistics.

Figure II.6 / FDI stock as % of GDP in selected years



Notes: Data refer to BPM6 directional principle with the following exceptions:
Moldova: BPM5; Montenegro BPM5 until 2009;
Albania and Kosovo* since 2008 and Serbia since 2013: BPM6, asset/liability principle, BPM5 before that year.

Valuation of FDI stocks is calculated based on own funds at book value; for Serbia since 2013.

See detailed data in Annex Table A.3.

Source: CEFTA and wiiw FDI database incorporating central bank statistics.

The FDI stock as a percentage of GDP in the CEFTA economies is very similar to, or even higher than, that in the EU-CEE economies (Figure II.6). Thus, the CEFTA economies have not received less than the amount of FDI expected, based on their relative levels of economic development compared with their peers. This is all the more remarkable, as the inflow of FDI started later than in the EU-CEE. Ten years ago, Serbia and Montenegro had very low FDI stocks due to stuttering transformation and unstable political and economic conditions.[19] In 2015, they became the frontrunners not only among the CEFTA economies, but also in a wider perspective. The increase in FDI stock in Albania and Kosovo* has also been quite rapid, but only due to the late start of privatisation. Macedonia was ahead of the other CEFTA economies in 2004 in terms of FDI stock as a percentage of GDP and also based on the progress of its transformation, but this economy has not managed to move on from that point. A stagnating FDI stock/GDP ratio between 2012 and 2015 may be considered an indicator of concern in the case of Macedonia, and also of Bosnia and Herzegovina. As also indicated by inflow data, the latter economies could not improve FDI attraction compared with earlier years.

The size of the FDI stock alone, however, is not enough to judge either the attractiveness of an economy to foreign investments or the impact such investments have on the host economy. There are several reasons for this, such as the difference in the capital intensity of economic sectors. Structural features are also important in terms of economic activity and the investing partner. The sections below first present the overall picture along the two structural characteristics (II.4 and II.5). As the structure of activities, the nationality of investors and home economy characteristics are all interlinked, a detailed presentation (II.6) will take all three aspects into consideration and adduce examples for some of the most important FDI projects.

[19] Progress in transition as reflected in the EBRD Transitions Indicators: www.ebrd.com/what-we-do/economic-research-and-data/data/forecasts-macro-data-transition-indicators.html

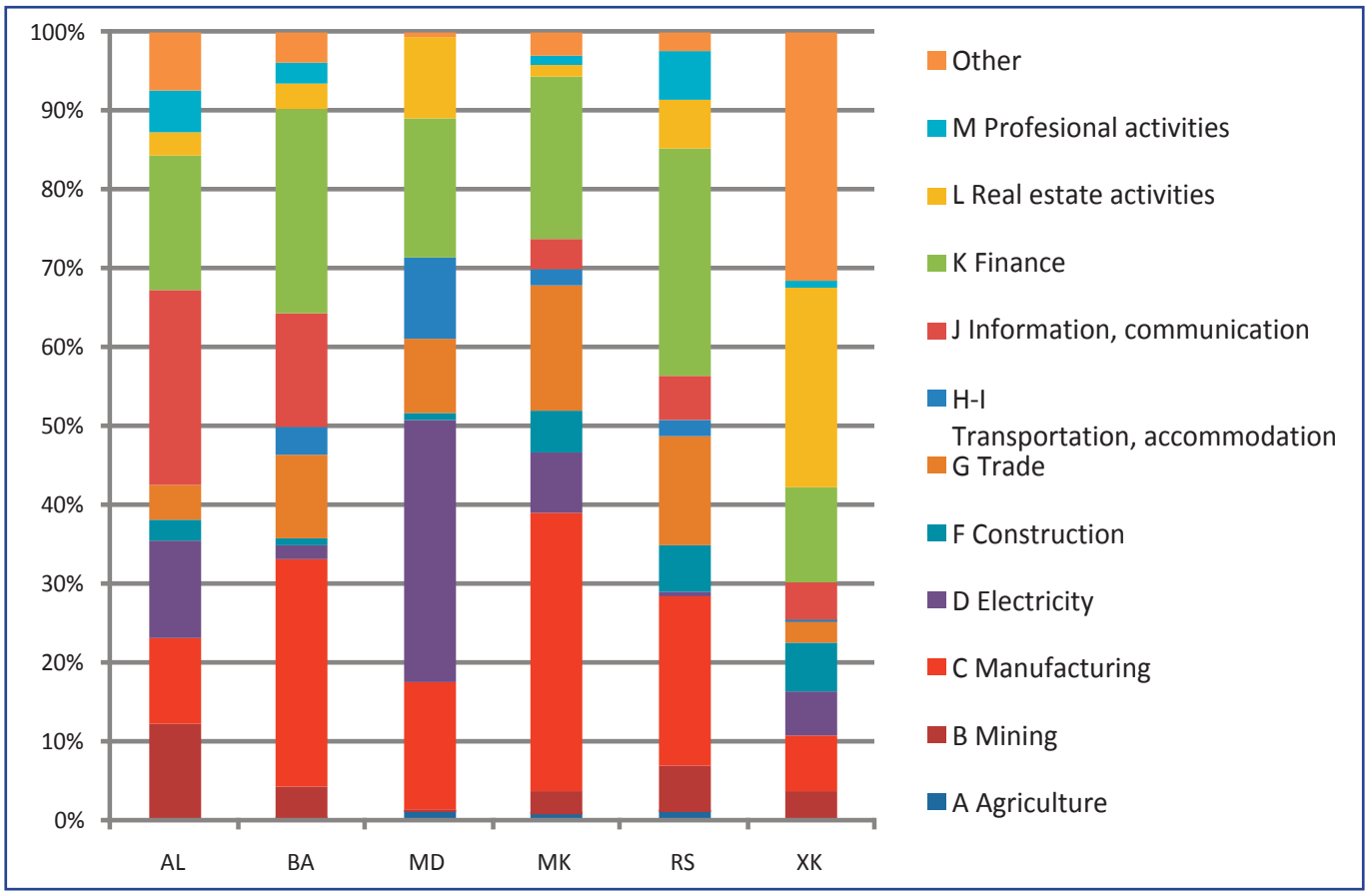
II.4 FDI stocks by economic activity – an overview

The distribution of FDI by economic activity reflects in part the overall structure of an economy, and in part the attractiveness of certain economic sectors to FDI. Large amounts of FDI in some sectors have supported the transformation to a market economy and have improved the level of services in sectors such as finance and telecommunications. FDI has also played a positive role in the restructuring of industrial enterprises. Once transition-related FDI is over, inflows have to shift towards efficiency-seeking, export-oriented ventures, and if this is sustained, the structure of the FDI stock reflects the sectoral upgrading to higher value-added activities.

There are large differences in the sector component of FDI stock in the CEFTA economies. The financial sector and manufacturing industries have attracted the largest amounts of FDI. Here the financial sector has a similar share in each economy, whereas the manufacturing sector's share is very diverse (Figure II.7).[20] Outliers are Albania (where info-communication has the largest segment of FDI stocks), Moldova (where electricity dominates) and Kosovo* (where real estate development and non-classified activities are both more important than other sectors).

The share of the financial sector is between 12% (Kosovo*) and 29% (Serbia). The CEFTA economies are very similar to the EU-CEE economies in this respect. Foreign banks came into most transition economies via the privatisation of earlier publicly owned banks, which were not in a position to operate as commercial banks under market competition.

Figure II. 7/ FDI stock by economic activity, 20151}1}



Notes: NACE Rev. 2 classification (short names, full names in Annex B); NACE Rev. 1 adapted for Moldova; no data available for Montenegro.

Source: CEFTA FDI database incorporating central bank statistics.

[20] All CEFTA economies except Montenegro provide data for the breakdown of FDI stocks by economic activities. These do not cover the whole FDI stock in Moldova and contain a very large segment of undistributed stock in Kosovo*.

Subsidiaries of foreign banks and insurance companies carried out the transformation of the former public banks and introduced modern financial services across the transition economies. They were hit by the financial crisis, asset quality declined and re-capitalisation became necessary in the form of additional FDI. Banks are now better capitalised than before, but are still struggling with high levels of non-performing loans. Moldova is a special case, as it is just recovering from the 2014/15 banking crisis.[21] (See more on the banking sector in section II.6.)

Manufacturing sector FDI is very unevenly distributed across the CEFTA economies: its share in FDI stocks varies between 7% (Kosovo*) and 35% (Macedonia). Relatively low shares are also recorded in Albania and Moldova, and high shares in Bosnia and Herzegovina and Serbia. These differences reflect the economic structure inherited from the communist past – economies with stronger manufacturing traditions have attracted more FDI in this sector than economies that started out in the post-communist era with lower levels of industrialisation. The transition to a market economy offered opportunities for foreign investors to participate in the privatisation of industrial enterprises, which was often followed by restructuring and downsizing. A number of companies could not survive under market conditions in the absence of foreign investors. A larger traditional manufacturing sector also meant a more skilled industrial labour force available for greenfield investors. Nevertheless, skills need permanent improvement, and mismatch has become an impediment to economic growth (World Bank Group and wiiw, 2017).

The share of the mining sector in FDI is highest in Albania (12%), followed by Serbia (6%) and Bosnia and Herzegovina (4%). Albania has oil wells, many economies can rely on domestic coal production, while metal ores are widespread in the region. In Albania, the chromium and nickel mines have been privatised to foreign investors, while 30-year concessions have been granted for the copper mines. Foreign ownership is widespread in Serbia, which has 250 active metal mining fields for lead, zinc and copper. There are more than 150 active mines in Macedonia, exploiting mostly lead, zinc, copper, nickel and gold. The main investors in the mining sector are as follows:

UK-based metal miner Mineco invested EUR 12.5 million in the Bosil-Metal lead and zinc mine in eastern Serbia and plans to open it officially in the course of 2017. This mining group also operates the Veliki Majdan mine acquired from liquidation in 2007, with production restarted in 2010, and it is about to increase the workforce to above 300. It also acquired the Rudnik mine near Gornji Milanovac through privatisation in 2004.

Mineco is also active in Bosnia and Herzegovina, where it operates the Gross mine and develops the Goražde and Olovo mines.

The main investors in Macedonian mining include Euromax Resources and Nevsun Resources from Canada and the Solway Group from Switzerland. The production is mainly export oriented.

Electricity generation and distribution attracted a high share of the FDI in Albania, on account of its large hydropower capacities, and in Moldova, where the distribution system has been privatised to foreign companies. Most of the electricity generation in the region is based on thermal energy, except for in Albania and Montenegro, where hydropower dominates. Recent projects seek to expand the role of renewable energy other than hydropower. Wind energy projects are in the planning stages in Serbia, Bosnia and Herzegovina and Montenegro, where small-scale hydro capacities are also being put out to tender (Box II.1). In 2017, Albania updated its legislative and regulatory framework for green energy, which paves the way for private investors.[22]

Box II.1 / Renewable energy – the example of Serbia

Serbia forecasts that the share of renewable energy in gross electricity consumption will rise to 27% in 2020, from 21% in 2009, with wind accounting for nearly half of all new renewable capacity. The government has set a 500 MW target for wind farm development, which it expects to reach in 2019; the wind potential is estimated at some 1.3 GW. The first investment was the 9.9 MW Kula project, developed by MK Fintel Wind, a joint venture, with 54% owned by Italy's Fintel Energia Group and 46% by the Serbian conglomerate MK Group. Much larger projects have concessions to be implemented: the US company Continental Wind Partners is developing a 158.5 MW project, and the Electrawinds Group, headquartered in Belgium, is working on a 104.5 MW one; a third project of similar size involves NIS Energowind, which is 50% owned by Gazprom.

[21] www.bnm.md/en/content/financial-situation-banking-system-2015 and www.bnm.md/en/content/financial-situation-banking-sector-2016
[22] www.rs.undp.org/content/serbia/en/home/library/environment_energy/guides-for-investors-in-renewable-energy-in-serbia.html

The CEFTA economies are contracting partners of the European Energy Community, whose mission it is to extend the EU internal energy market to Southeast Europe and beyond on the basis of a legally binding framework.[23] The objectives of the Energy Community include attracting investments and creating an integrated energy market. It has achieved progress in interconnecting national energy systems, thus improving the security of supply. Also the regulatory framework is being improved and coordinated within the framework of the Energy Community.

Beyond private investments, all CEFTA economies can benefit from the sustainable energy finance facilities of the EBRD, which extends credit lines to local financial institutions for on-lending to finance investment projects in energy efficiency and small-scale renewable energy projects. The USAID Clean Energy Investment Project supports the development of renewable energy and energy efficiency technologies and industries. These international donor programmes may provide financing to FDI projects, but their primary role is to establish the infrastructure for other future projects.

FDI in wholesale and retail trade has a share of about 10% in the CEFTA economies, lower than in the EU-CEE. Currently domestic companies dominate international supermarket chains. Opportunities for foreign retailers are increasing as the population's income rises and the development of transport infrastructure improves. Serbia has the highest share of FDI in this sector, following the foreign takeover of its largest supermarket chain.

Information and communication has a high share in the FDI stock in economies where foreign investors have captured the dominant market positions in telephony (Albania, Bosnia and Herzegovina). IT firms are mushrooming in the region, although large foreign investment projects are rare. Back office and call-centre services have also appeared, but are less significant than in the EU-CEE. Professional scientific and technical activities such as consultancy services, research and development (R&D) and testing have a low presence. The underdevelopment of such activities is the main difference between the CEFTA region and its peers, among whom professional services have attracted a much larger share of FDI.

On the whole, FDI inflows have mainly been directed into the non-tradable sectors, such as financial services, real estate and construction, rather than tradable sectors that can generate stronger export performance – Macedonia and Serbia are partial exceptions.

II.5 FDI stocks by main investing partners – an overview

The main investing partners in the CEFTA region are the Netherlands, Austria, Cyprus, Greece and Russia (Table II.1 and Figure II.8). Often these immediate owners of foreign investments are economies that are frequented by multinationals for reasons of tax optimisation, such as the Netherlands, Cyprus and Luxembourg. These were also among the most dynamic investing partners in the five years to 2015: their share in CEFTA inward FDI stocks increased from 13% in 2010 to 27% in 2015. Relatively high amounts were invested on aggregate by 'other economies', which either invested smaller amounts individually or could not be identified by the FDI surveys.

Table II.1 / Inward FDI stock by main partners in CEFTA economies, 2010–15

	2010	2015	2015/2010%
Netherlands	2617	8041	307.2
Austria	4199	6015	143.3
Cyprus	745	3723	499.6
Russia	1792	3318	185.2
Greece	2445	2936	120.1
Italy	1841	2466	134.0
Switzerland	943	2197	233.0
Slovenia	1040	2125	204.3
Germany	1761	2081	118.2
Luxemburg	466	1322	283.8
France	798	1251	156.8
UK	679	1172	172.4
Turkey	403	894	222.0
US	221	502	226.7
Other economies	8848	10165	114.9
Total by partners	**28798**	**48719**	**169.2**
EU-28	20544	29565	143.9
CEFTA-7	1568	1934	123.3

Notes: For Montenegro 2015 is estimated on the basis of 2014 and partial 2015 data; excl. Kosovo* in 2010.

Ranking of investing partners is based on FDI stock in the region in 2015.

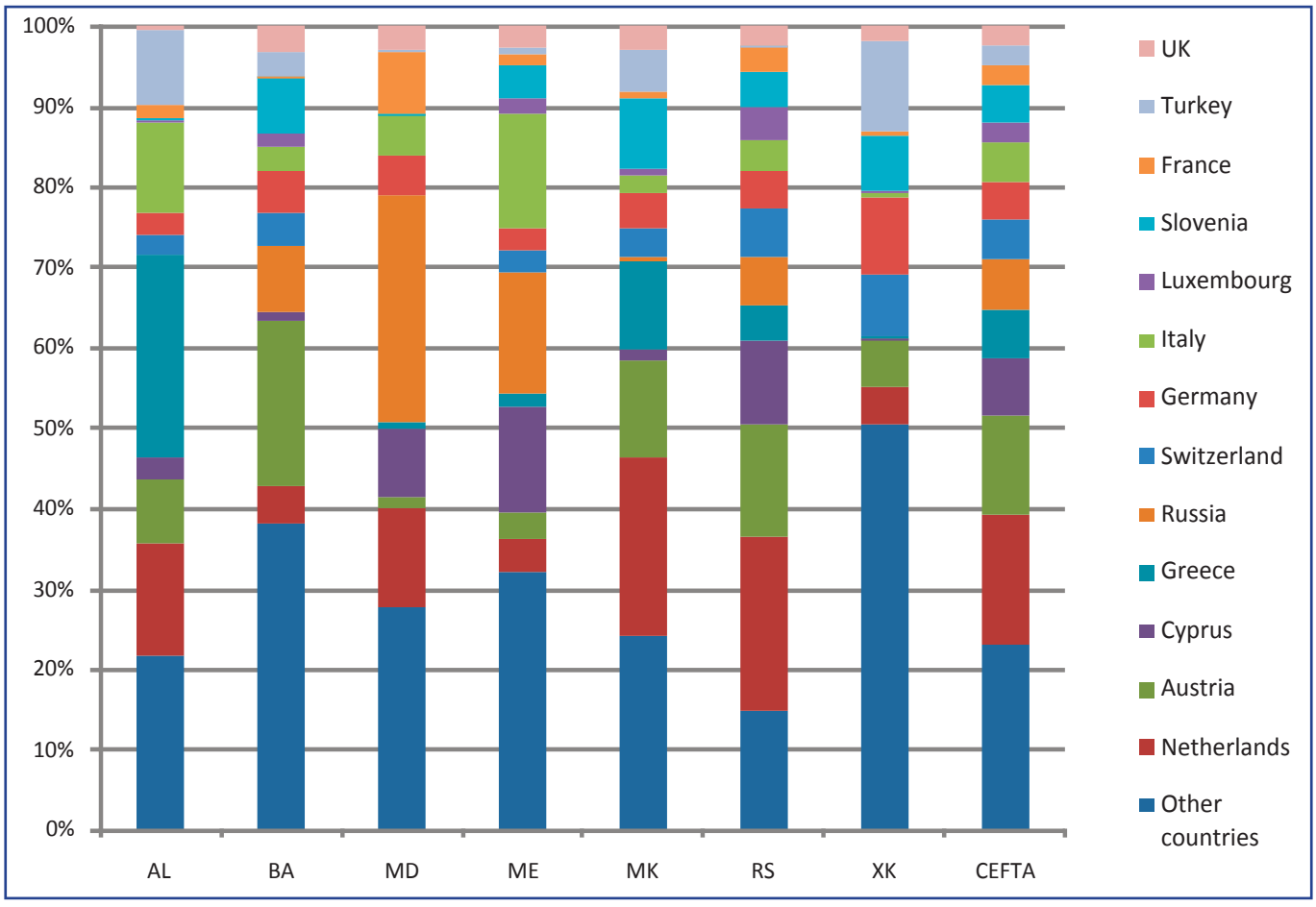
Source: CEFTA FDI database incorporating central bank statistics.

[23] www.energy-community.org

FDI from those EU members that do not host tax-optimising headquarters grew very slowly between 2010 and 2015. As a result, the EU's overall share in the CEFTA FDI stock declined to 61% in 2015, from 71% in 2010. Growth was especially sluggish in the case of FDI from Germany, Italy and France, the very economies that are usually known for technology-intensive manufacturing and services subsidiaries. It is probable that some companies from these economies now invest more via tax havens; thus they will not have reduced their presence in the region, but merely shifted headquarters. Swiss and US investments expanded more rapidly than EU investments over the same period, and Turkish investments doubled.

Austria is the second most important investor in the CEFTA region, after the Netherlands. The country was among the first to enter the region after peace was established there. It has the highest share of FDI stocks in Bosnia and Herzegovina and Macedonia, and the second highest in Serbia and Macedonia. Most Austrian FDI entered the region before the global financial crisis. Since then, the Austrian economic recovery has been relatively slow and investments have been scaled back. The main Austrian investors in the CEFTA banking sector made losses in the post-crisis years, and withdrew capital from their subsidiaries initially, but increased capital after agreement was reached within the framework of the Vienna Initiative 2.0 in 2011 (Box II.2).[24]

Figure II.8 / FDI stock by major investing partners (at least 10% of an investing partner in an economy), 2015



Note: For Montenegro 2015 is estimated on the basis of 2014 and partial 2015 data.

Source: CEFTA FDI database incorporating central bank statistics.

[24] http://vienna-initiative.com/

Box II.2 / Austrian banks are the leading financial sector investors

Bank Austria used to act as a sub-holding company of the UniCredit Group with responsibility for overseeing the group's banking activities in the CEE region (though the inward investor could have been registered as either Italian or Austrian by the host economies). UniCredit is one of the leading banks in the CEFTA market, and operates a wide network throughout the region. It is among the top five banks in Serbia; a UniCredit subsidiary is the biggest bank in Bosnia and Herzegovina; and as of 31 March 2016 the group had representative offices in Macedonia and Montenegro.* Later in 2016, UniCredit reassigned responsibility for the CEE to its Italian headquarters, which will have triggered a shift in FDI stocks in 2017. Austria's Raiffeisen International is the second largest bank in the CEFTA region. Although the bank's activities have been streamlined in recent years, this has not affected its subsidiaries in Albania, Bosnia and Herzegovina, Serbia and Kosovo*. These subsidiaries are among the leading banks in each of these economies, as measured by the volume of customer loans: it is first in Albania and Kosovo*, second in Bosnia and Herzegovina and fifth in Serbia.** Erste Group (investing via Steiermärkische Sparkasse) is present in Bosnia and Herzegovina, Macedonia, Montenegro and Serbia.

* www.bankaustria.at/en/about-us-our-cee-banking-network.jsp
**www.rbinternational.com/eBusiness/01_template1/829189269477841370-829189081458940844_852338273333048514-852338273333048514-NA-2-EN.html

Austrian investors are also prominently represented in hydropower generation. EVN, Verbund, Kelag, ENSO and WienStrom (Energy Eastern Europe Hydro Power GmbH) have several projects and plan many more. ENSO currently operates two relatively small hydropower stations in Albania, at Lengarica and Mati. EVN invested in a hydropower project – Energji Ashta SHPK – in Albania, and is involved in energy trading companies in Macedonia and Serbia. The company is also involved in water supply and waste water services. Further sectors with strong Austrian FDI activity include real estate development, retail trade and tourism.

Like their Austrian counterparts, Greek investors have taken advantage of the shift to a market economy that is taking place in their neighbourhood. Greek companies had not been engaged in outward FDI before the 1990s. Following an early phase of small investments in the 1990s, large companies consolidated their presence in the Western Balkans in the 2000s. By 2009, Greece's outward FDI stock in the Balkans (including Croatia and Bulgaria) accounted for 26.5% of its outward FDI stock worldwide. The greatest amount was invested in Albania. In the second largest destination, Serbia, rapid Greek penetration took place until 2007, followed by near stagnation. The Serbian government became the largest owner of Telekom Srbija, but this was followed by the withdrawal of EUR 300 million Greek FDI in 2012. The Greek sovereign debt crisis has claimed more victims among Greek investors, mainly banks that have decided to sell their subsidiaries in the CEFTA region.

The largest European investing economies, such as Italy, Germany, France, Switzerland and the UK, are important investors throughout the CEFTA region. Italian investors have used their proximity advantages and are among the leading investors in the closest economies, across the Adriatic Sea in Albania and Montenegro; but the highest amount has been invested in Serbia. German investors occupy seventh place in the CEFTA region, with 4.2% of FDI stocks in 2015. Their presence in the region is much lower than in the EU-CEE, where they occupy second position, with 13%, after the Netherlands. The relatively small size of German investments is connected with the comparative weakness of the manufacturing sector in the region (a sector in which Germany is particularly strong). Also, the long distances and the small size of CEFTA economies are important to efficiency-seeking investors. Deutsche Telekom is the largest German investor, owner of several telephony companies either directly or indirectly, through subsidiaries. More than half of the German FDI in the region went to Serbia, followed by Bosnia and Herzegovina and Kosovo* (where, at 10%, German FDI makes up the largest single contribution). The German presence in Kosovo* is most probably covered by the real estate investments of the Kosovo* diaspora living in Germany.

Slovenia and Croatia also own high amounts of FDI in the region, especially relative to their size. Slovenia is the eighth largest investor, with important FDI stocks in Serbia, Bosnia and Herzegovina and Macedonia. Slovenian FDI stocks grew more rapidly than the investments of many larger EU members in the period 2010–15, with investors taking advantage of proximity, language and market knowledge. Croatia has the largest share in the Bosnian FDI stocks and has some further investments in Serbia. A specific feature is that investments go beyond the traditional sectors of food industry and retail and have entered the IT sector (Box II.3).

Box II.3 / M SAN Grupa DD, a Croatian regional investor in the IT manufacturing and services sector

Founded in 1995, the company's core business is wholesale distribution of modern technologies. M SAN Grupa has branches across the Western Balkans, with over 400 employees manufacturing IT products, consumer electronics, toys and baby equipment.* The partners in the region provide distribution and other services in Serbia, Bosnia and Herzegovina, Macedonia, Montenegro and Kosovo*. Among the subsidiaries, KING ICT in Bosnia and Herzegovina specialises in advanced information and communication technology solutions.

* www.msangrupa.com

Turkish FDI more than doubled in the period 2010–15. It is concentrated in Albania, Bosnia and Herzegovina, Kosovo* and, to a smaller extent, in Macedonia (thanks to historical ties). Turkey is currently experiencing a slowdown in economic growth, linked partly to increased political risk, which negatively affects both inward and outward FDI flows. This has led to the weakening of its influence in the CEFTA region.

Russia is the fourth largest investor in the CEFTA region, with 7% of stocks. CEFTA economies that attract high volumes of Russian FDI also receive high FDI from Cyprus, which in fact represents indirect Russian FDI. In Moldova, Bosnia and Montenegro, Russian FDI has typically (although not always) been in greenfield projects, whereas in Serbia the FDI has entered via mergers and acquisitions (M&A). In Montenegro and Moldova, Russian FDI is relatively high and diverse; in Serbia and Republika Srpska, it is concentrated in the energy sector; and in the rest of the CEFTA region there is basically no Russian FDI. There has been no significant increase in Russia's investment commitments in the region. Even Moldova has managed to reduce somewhat the dominance of Russian investors and to reorient its trade relations away from Russia and towards the EU, with Romania becoming its main trading partner.

Chinese investments still have a rather meagre representation in the FDI data: only Macedonia and Serbia report any FDI stock from China. China appeared in Macedonia with EUR 10 million in 2015. Chinese investments in Serbia soared to EUR 115.3 million in 2014 (EUR 139 million in 2015) from previously very low levels. It is bound to increase in the future, given the 2016 takeover of the Smederevo steel company by the Hebei Iron and Steel Group. There are several other Chinese projects that are not yet covered by the statistics, including major acquisitions in Albania.

The share of intra-CEFTA FDI declined from 5.4% to 3.9% in the FDI stock between 2010 and 2015. Most of the mutual FDI stock is either historical or privatisation related, mainly reflecting the Serbian equity holdings in Bosnia and Herzegovina and Montenegro. There is also FDI from Montenegro in Serbia, thanks to shared ownership of companies in the old Yugoslavia. CEFTA is thus rather weakly integrated by direct capital flows.

II.6 Interlink between investing partner and sectoral features of FDI in individual CEFTA economies

Beyond the broad picture outlined in the sections above, there are large differences in terms of the partner and sectoral specialisation of FDI in the individual CEFTA economies. For example, manufacturing FDI is mainly of German and Italian origin, with concentrations in Serbia and Macedonia; banking sector FDI is mainly Austrian, Greek or Italian and spread across the Western Balkans. Russian investors are most frequent in the energy sector, while Turkish companies invest across a large number of activities. The details for individual CEFTA economies are highlighted in this section. (See also the list of major foreign affiliates in Annex D.)

Albania

Albania has received almost steadily rising amounts of FDI over the last 10 years, with only a minor setback in the years following the global financial crisis. Privatisation-related sales and greenfield investments in the mining and energy sectors have been the main drivers of FDI. The construction of the Trans Adriatic Pipeline supports the recent upswing. Inflows as a share of GFCF have been the second or third highest in the region.

The main investing partners in Albania are Greece (25% of the stocks), the Netherlands and Canada (Figure II.9). Greek investments dominate the two main destinations of FDI, telecommunications and financial services. They mostly came to the economy via privatisation and follow-up

investments to restructure privatised companies. Canada shows up in the statistics due to Bankers Petroleum, which was the main investor in the oil industry until 2015. It began exploration in Albania in 2004 and operated one of the largest onshore oil fields in continental Europe. The company was acquired by affiliates of Geo-Jade Petroleum Corporation of China for USD 442.34 million (EUR 400 million). In the wake of the Chinese takeover, Canada will cease to be among the largest investors in Albania.

Italian investors, ranked fourth in Albania, are present in a number of activities, including trade, manufacturing and services. Small and medium-sized Italian companies use the advantage of proximity, as well as their historical ties. They are increasingly investing in previously under-represented activities, such as manufacturing, shared services and call centres.

The Turkish FDI stock in Albania has more than doubled in euro terms since 2011 and is now the fifth largest. It targets mainly mining, construction and telecommunications. In 2007, Cetel Telecom – which is 80% owned by Çalik Holding – bought 76% of the fixed-line operator ALBtelecom. Eagle Mobile, Albania's third biggest mobile operator, was also acquired by Cetel Telecom as part of the deal. Following the acquisition, Çalik Holding increased the length of fibre optic cables from 500 km to 1,500 km, and paved the way for the connection of the Albanian telecoms network with those of Greece, Macedonia, Kosovo*, Croatia and Italy. Çalik Holding also bought a majority stake in Banka Kombetare Tregtare, the second biggest bank in 2006.

Figure II.9 / Albania: FDI stock by investing partner, 2015

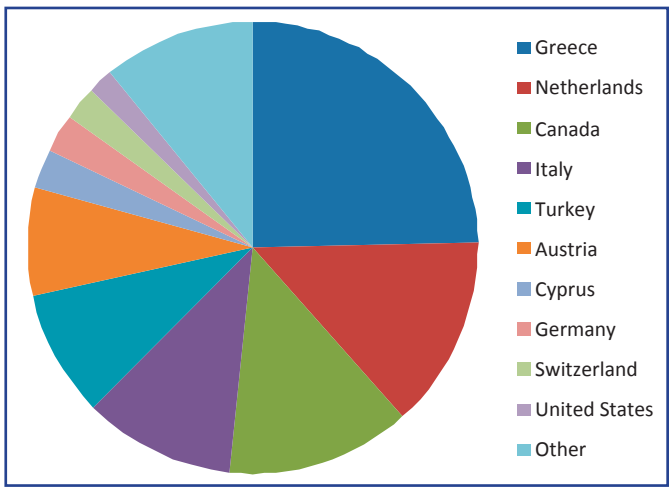
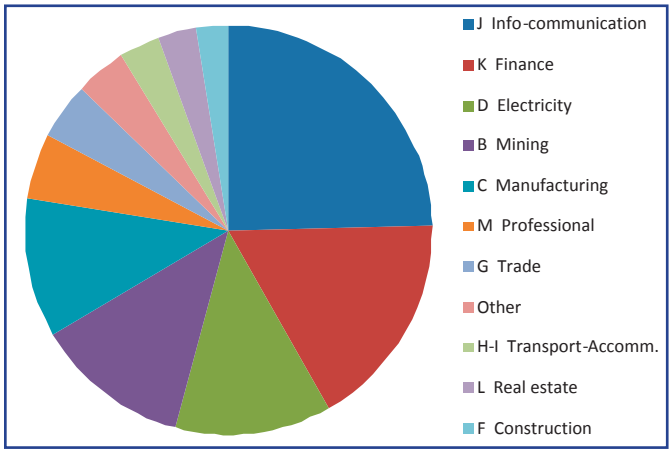


Figure II.10 / Albania: FDI stock by economic activity, 2015



Source: CEFTA FDI database incorporating central bank statistics.

Chinese FDI is rising in Albania, but in 2015 the economy was still not among the top investors. The purchase of Bankers Petroleum is certainly the largest project. Tirana airport (TIA) was sold to Chinese investors in 2016, when China Everbright Limited, an international investment and asset management company based in Hong Kong, acquired 100% of the shares in TIA.[25]

The largest current activity of a foreign investor in Albania is the construction of the Trans Adriatic Pipeline (TAP, Figure II.11). TAP will transport Caspian natural gas to Europe across northern Greece, Albania and the Adriatic Sea, before coming ashore in southern Italy and connecting to the Italian natural gas network. TAP's shareholding comprises BP (20% – UK), SOCAR (20% – Azerbaijan), Snam (20% – Italy), Fluxys (19% – Belgium), Enagás (16% – Spain) and Axpo (5% – Switzerland). The company has its headquarters in Baar, Switzerland and offices in Athens, Tirana, Rome and Lecce. Currently, TAP employs approximately 80 oil and gas specialists from many economies and more than 200 experts from contracted service companies. The total cost of TAP is EUR 6 billion, financed by EBRD, EIB, and several private and public investors.[26]

Thus the project is partly FDI and partly loan financed. Construction of the project will be completed in 2017, at which point it is expected to generate EUR 57 million for Albanian GDP and to create 4,200 jobs (part time and full time). As part of the project, TAP AG is investing EUR 60 million in Albania's road infrastructure.[27]

[25] www.tirana-airport.com
[26] www.tap-ag.com
[27] www.oxfordeconomics.com/Media/Default/economic-impact/economic-impact-home/Economic-Impact-trans-Adriatic-Pipeline.pdf

Bosnia and Herzegovina

Bosnia and Herzegovina received the highest amounts of FDI inflows in 2007 and 2008, when the pre-crisis boom coincided with large privatisation deals, including the sale of Bosnian Telecom in 2007 to Telekom Srbija which is one of the biggest intra-CEFTA FDIs. In recent years, the economy has recorded fairly low amounts of inflows relative to its size.

The most significant part of the FDI stock comes from investors from post-Yugoslav neighbours, such as Serbia, Croatia and Slovenia, as well as from Austria (Figure II.11). The two entities, Republika Srpska and the Federation of Bosnia and Herzegovina have legislative power of their own. They have separate privatisation agencies and tax systems. FDI from Serbia is concentrated in the Republika Srpska, while Croatian investors are mostly active in the Federation. Slovenian companies and banks have subsidiaries in both parts. Investments from these investing partners are concentrated in trade, financial services and construction.

Foreign takeovers have helped to restructure the manufacturing sector, which now hosts 29% of the FDI stock (Figure II.12). The Zenica Steel Company was sold to the world's largest steel producer, the ArcelorMittal Corporation (with headquarters in Luxembourg), in 2004. It restarted steel production in 2008 (the facilities had been damaged and closed down during the Yugoslav wars). Iron ore concentrates are supplied to Zenica by ArcelorMittal Prijedor, a joint venture of ArcelorMittal and RZR Ljubija AD Prijedor. Another metal processing company, KRUPA KABINE became part of the Siac Group from Italy after privatisation in 2006.

Figure II.11 / Bosnia and Herzegovina: FDI stock by investing partner, 2015

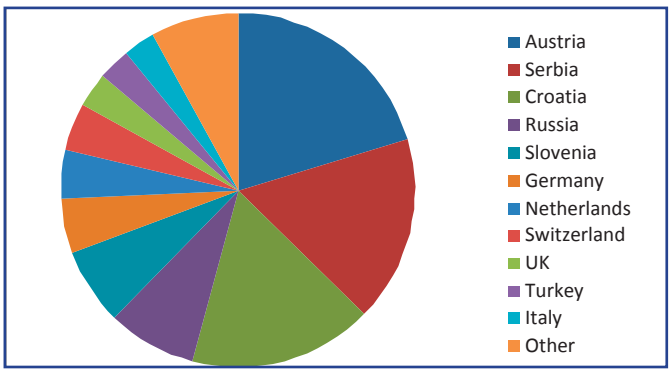
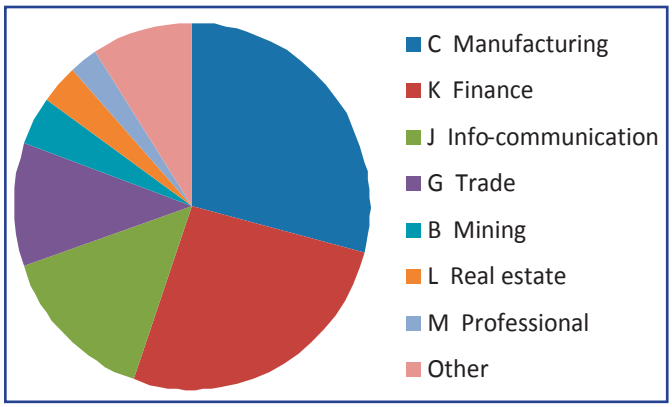


Figure II.12 / Bosnia and Herzegovina: FDI stock by economic activity, 2015



Source: CEFTA FDI database incorporating central bank statistics.

The financial sector is the second largest receiver of FDI capital, after manufacturing, and Austrian banks are the main investors. Austria's role declined in 2015 compared with the previous year, due to the collapse of the Hypo Alpe-Adria Bank. Raiffeisen Bank Bosna i Hercegovina is the largest bank, with 17% of banking assets. Italian banks (UniCredit and Intesa Sanpaolo) own 16% of the banking capital, followed by Turkey (10%) and Russia (8%).

The fourth largest investor, Russia has been active primarily in the energy sector in Republika Srpska. Russia's OAO Zarubezhneft ought a 62.3% stake in Rafinerija ulja Modriča, a 75% stake in Bosanski Brod refinery, and a 70% stake in Banja Luka Petrol from Republika Srpska in 2007, for which it paid USD 157 million (EUR 115 million). The deal involved commitments from the Russian side to repay the three companies' debts and to invest an additional EUR 600–700 million in the modernisation of the oil industry in the Republika Srpska. It operates the businesses under the Optima Group Holding.[28] In 2012, publicly owned RusHydro invested EUR 165 million in hydropower projects in the Republika Srpska. Neftegazinkor and Lukoil made smaller investments in the Bosnian energy sector in 2011 and 2008, respectively. One Russian investment in Bosnia outside the energy industry was that of the St Petersburg-based East-European Finance Corporation (EEFC), which spent EUR 25 million in 2007 to set up the bank EEFC Banja Luka.

Arab investors discovered the Bosnian mountains after the Arab Spring, when many traditional holiday

[28] www.zarubezhneft.ru/en/about_company/structure

destinations such as Libya, Tunisia and Egypt became risky. The attractiveness of Bosnia and Herzegovina was underpinned by more direct flights, new resorts and the end of visa restrictions. Related FDI projects are in the real estate and services sectors. Smaller but rising shares of the banking sector FDI is attributed to banks from Arab economies providing Islamic banking services.[29]

Macedonia

Inflows to Macedonia have fluctuated over the post-crisis years and stabilised in 2013–15 at fairly low levels, followed by a take-off in 2016. On the positive side, the economy has a relatively diversified foreign sector, a high share of manufacturing (including automotive suppliers) and provides a good institutional environment for foreign investors, only tarnished by recent government instability. Macedonia was ranked tenth overall (out of 190 economies) in the World Bank's 'Doing Business' report rankings in 2017 – far ahead of other CEFTA economies. While energy and banking sector FDI is also present in CEFTA economies with less-favourable business environments, export-oriented manufacturing concentrates in the economy with the best institutional frameworks.

Macedonia is the CEFTA economy with the highest share of manufacturing in the FDI stock (36%, Figure II.14). The high degree of industrialisation is partly a historical legacy. The presence of industrial skills has been rewarded by foreign investors, even though the economy is relatively small and cannot accommodate very large firms. (See details in Part III.)

Austria has the second largest investment stock (Figure II.13)**, which is concentrated in manufacturing, rather than in the financial sector (as in other CEFTA economies).** There are several manufacturing projects in the light and food industries, as well as in car components production. In 2006, the Austrian energy company EVN acquired the Macedonian electricity distribution company; since 2008, it has operated under the name EVN Macedonia. Germany is a leading investor in the manufacturing sector, primarily with greenfield investments. This is what lies behind Macedonia's strong export orientation towards Germany (40% of exports).

Figure II.13 / Macedonia: FDI inward stock by investing partner, 2015

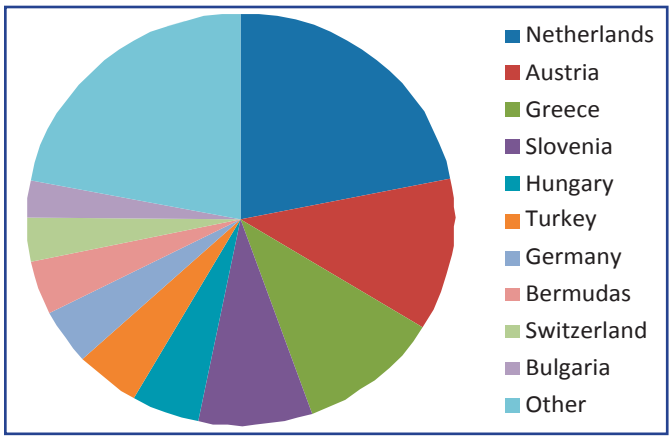
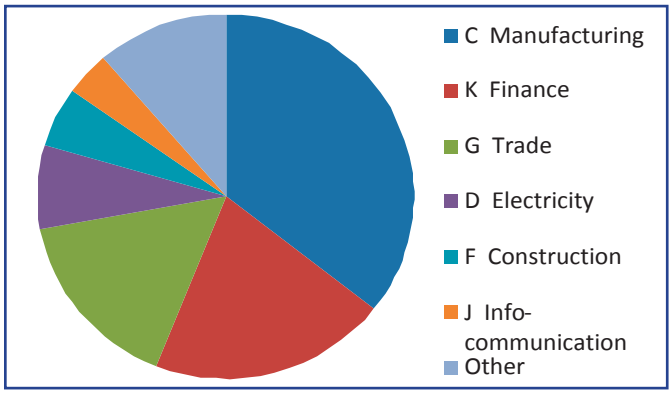


Figure II.14 / Macedonia: FDI inward stock by economic activity, 2015



Source: CEFTA FDI database incorporating central bank statistics.

Steel making in the Macedonian capital Skopje is a legacy of Yugoslav industrialisation policy. Two companies emerged from the corporatisation and privatisation of the former Mines and Iron & Steelworks Skopje, and both have become subsidiaries of large international companies. Makstil AD produces hot rolled heavy plates. It was established in 1997 as a privatised independent company, when Duferco Group acquired 54% of its capital. With headquarters based in Luxembourg, Duferco is originally a Brazilian company that went global in the 1980s and expanded in Italy and Eastern Europe in the 1990s.[30] Another part of the former Skopje Steelworks is ArcelorMittal Skopje; the company split off in 1999 and there was a partial foreign takeover in 2004, when Mittal (headquartered in Luxembourg) acquired 44.5% of the stocks.[31] It is one of the largest steel product manufacturers

[29] Banking Agency of the Federation of Bosnia and Herzegovina: www.fba.ba
[30] www.makstil.com
[31] http://arcelormittal.com.mk

in the Balkans, offering cold rolled coils and sheets, as well as galvanised and pre-painted coils.

The large banks in Macedonia were already overwhelmingly foreign owned by 2007, while 40% of small and medium-sized banks were domestically owned (Table II.2 and Table II.3). By the end of 2015, foreign ownership of large banks had declined, mainly on account of the emergence of a publicly owned development bank. Smaller banks shifted to the foreign sector after the global financial crisis, but domestic bank ownership has recovered recently. Of the five largest banks, four have a single majority foreign owner. In the largest bank, minority foreign financial investors provide the management, and the majority of shares are in dispersed ownership.

Moldova

FDI inflows into Moldova have generally been the lowest in the region, which is in line with the economy's low level of GDP. They have not recovered from the slump after the global financial crisis and have stagnated in recent years. The economy was hit by a banking sector crisis in 2014/15 and the vulnerabilities with respect to ownership, governance and supervision are still being resolved in order to restore investor confidence. Moldova has also felt the negative impacts of the recent Russian crisis more than the other CEFTA economies.

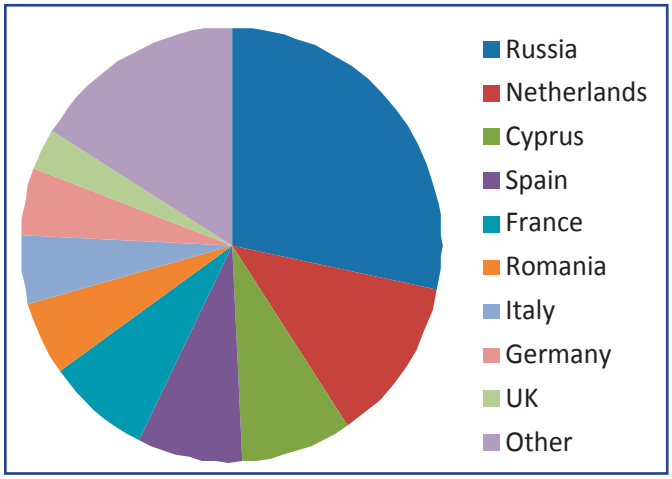
Table II.2 / Macedonia: share of foreign ownership by bank size*

	2007	2012	2014	2015
Large banks	82,8%	78,1%	76,3%	75,0%
Medium-sized banks	60,2%	69,0%	76,3%	76,1%
Small banks	61,5%	87,0%	75,7%	69,8%
Total banking system	**69,1%**	**75,2%**	**76,2%**	**74,8%**

* Nominal value of issued common and preference shares in foreign ownership as a % of total nominal value of issued common and preference shares.

Source: www.nbrm.mk

Figure II.15 / Moldova: FDI inward stock by investing partner, 2015



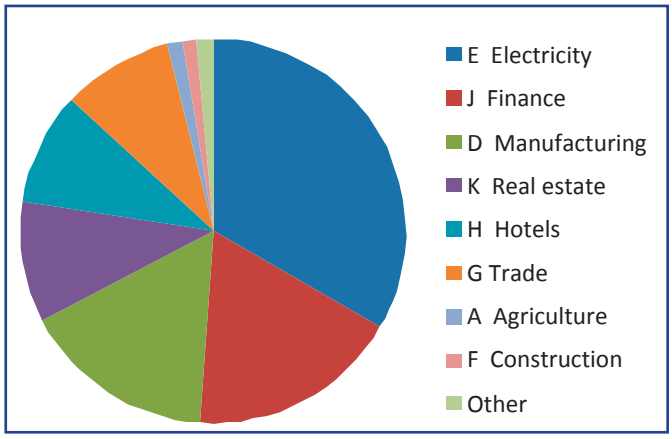
Source: CEFTA FDI database incorporating central bank statistics.

Table II.3 / Macedonia: largest banks by main shareholders, end 2015

	KOMERCIJALNA BANKA AD SKOPJE	STOPANSKA BANKA AD SKOPJE	NLB TUTUNSKA BANKA AD SKOPLJE	OHRIDSKA BANKA AD OHRID	HALK BANKA AD SKOPJE
Main shareholders	East Capital Explorer Investments Sweden 13.1%, EBRD 5.25% Rest: dispersed entities	National Bank of Greece Athens 93.40%	NLB dd Ljubljana 86.97%	Societe Generale SA Paris 70.02%	Turkiye Halk Bankasi AS Ankara 99.03%
Assets, MKD mn % of all banks	97,193 22.9%	84,886 20.0%	69,434 16.4%	32,962 7.8%	30,198 7.1%
Gross loans, MKD mn	**59,856**	**61,847**	**49,725**	**23,061**	**21,309**

Source: www.nbrm.mk

Figure II.16 / Moldova: FDI inward stock by economic activity, 2015



Source: CEFTA FDI database incorporating central bank statistics.

The largest segment of FDI originates in Russia (Figure II.15). (FDI from Cyprus usually also represents Russian capital.) The Russian FDI stock in Moldova amounted to 28% of the total in 2015 – significantly higher than in 2011 (22%). Typically, the entry mode was greenfield rather than M&A. Russian FDI has gone into a wide range of sectors, including energy, financial services, communications, metals, software and IT services, and construction. Thus, the impact of Russian FDI in Moldova has been quite broad across the economy, in contrast to some other CEFTA economies, where it is more closely concentrated in particular sectors.

Larger Russian investments are concentrated in the energy sector, including the acquisition by the Inter RAO Unified Energy System of Russia (UESR) of the Kuchurgan power plant in Transnistria in 2005. Itera invested EUR 150 million in 2004 to build a gas-steam power plant, with a capacity of 450 MW. Moldovagaz, a distributor of gas was established in 1999 as a joint venture between the Moldovan government and Gazprom (with the latter taking a 50% stake).

On the whole, the energy sector is in foreign hands, making it the primary investment target, with a third of the FDI stocks in 2015 (Figure II.16). Foreign investment in this sector has also increased in recent years on account of new biogas plants. The high share of Spanish FDI in Moldova is due to Gas Natural Fenosa providing electricity to customers in the central and southern regions, including the capital Chişinău since 2000. The financial sector is the second largest target, with 18% of the stocks and increasing investments in recent years.

The manufacturing sector, which represented 16% of the FDI stock in 2015, has received some export-oriented projects recently. The Japanese car parts maker Sumitomo is building a EUR 27 million plant for electric cable systems in Moldova's free economic zone Balti. German auto wiring systems maker LEONI is moving part of its Romanian production to Moldova, with its lower labour costs, but will not close its factories in Romania.

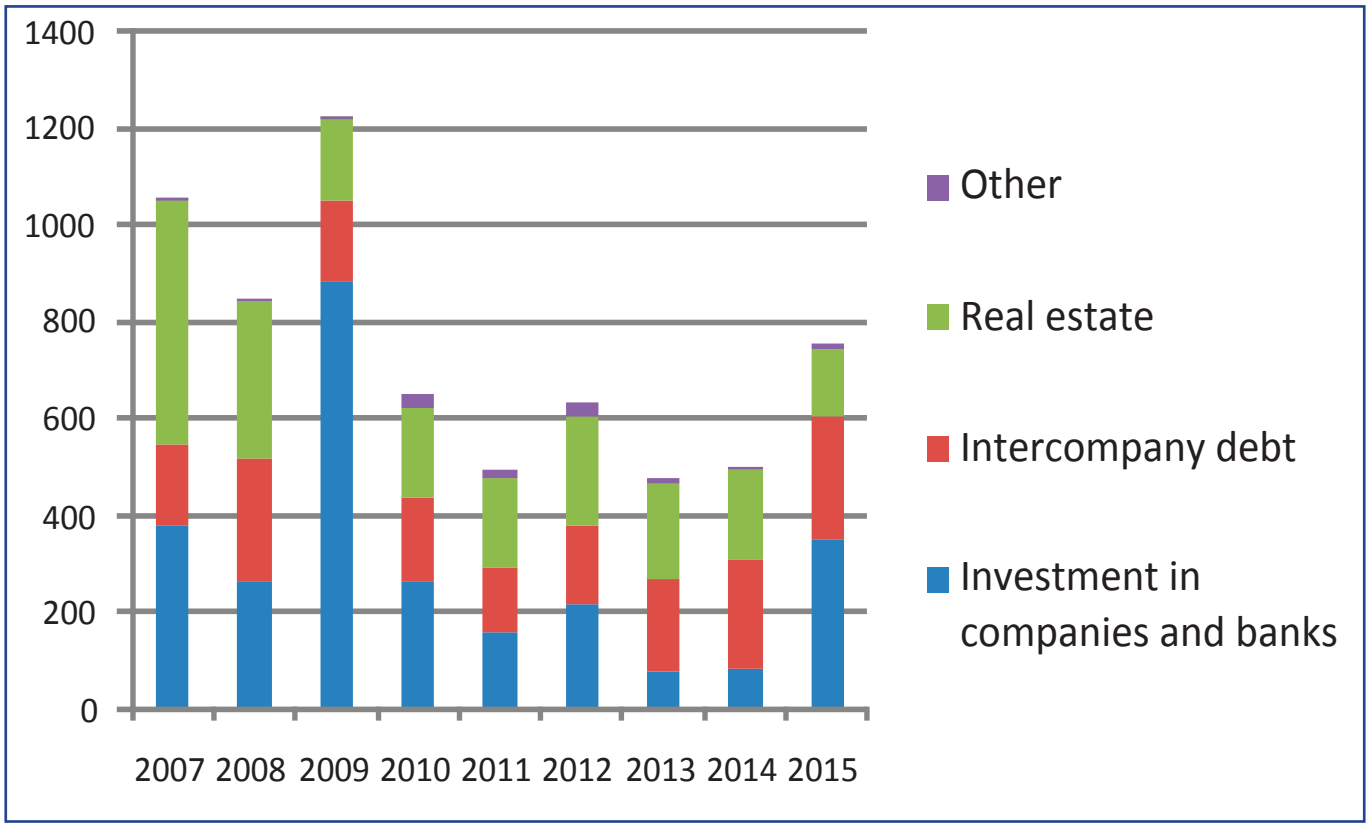
Montenegro

Montenegro stands out for the high amount of FDI inflows relative to its size, not just in the region but also globally. It received especially high amounts in 2009, and the recovery in 2015 was also stronger than in the other CEFTA economies. This success is due to widescale privatisation and the excellent tourism potential, which has generated a lot of real estate investment. The weaker 2016 inflow may be because Russian investors have had their trust shaken by Montenegro's accession to NATO.

Montenegro has the highest FDI stock in relation to the size of its economy (by GDP and population), but the sectoral composition is not available. The central bank separates only the real estate investments, which have made up about one third of the inflows over several years (Figure II.17). Having attractive coastal and mountain resorts, tourism-related real estate projects are booming.

Most of the real estate projects involve Russian investors entering the economy either directly or via Cyprus and other tax havens (Figure II.18). Surveys suggest that 40% of real estate belongs to Russian politicians and businessmen. In 2015, Russia and Cyprus together provided about one quarter of the FDI in sectors other than real estate. According to the Montenegrin statistics office, 32% of the 4,200 firms are owned by Russians (Box II.4).

Figure II.17 / Montenegro: Real estate investments and components of FDI inflows, EUR million



Source: Central Bank of Montenegro.

After Russia, Italy and Serbia are the second and third largest investors, respectively; both take advantage of their proximity. There are several other economies with investments of more than a EUR 100 million each – a fairly big diversity for a small economy. Individual investors built Porto Montenegro, a luxurious nautical-tourist complex and mega-yacht marina in Tivat. The project was sold to the Investment Corporation of Dubai in 2016.

Energy production represents the main sector of Italian investments in Montenegro. Group A2A from Brescia became a strategic partner in the privatisation of EPCG (Elektroprivreda Crne Gore), buying 43.7% of the capital for a total of EUR 436 million in 2010 (the public retained majority ownership). The company owns two large and seven small hydroelectric power plants. Also in 2010, a second Italian energy company, Terna rete elettrica SPA, acquired a 22.1% minority stake in CGES (the publicly controlled energy distribution company). Currently EPCG is investing in the

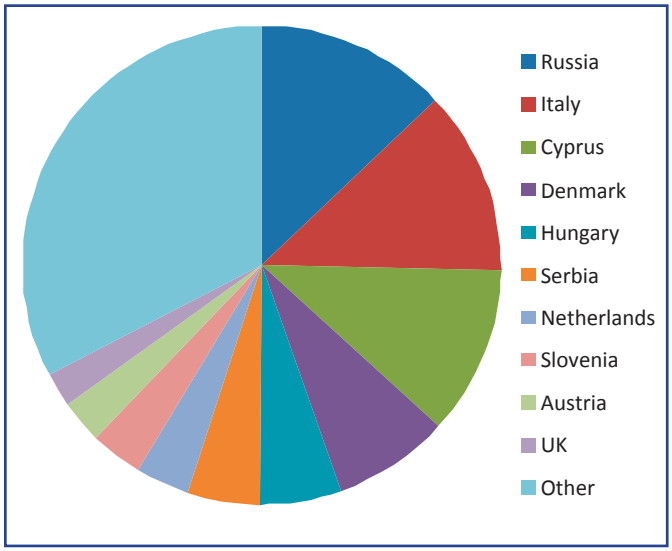
Box II.4 / Russian investment project not FDI anymore

The largest Russian investment in Montenegro was Kombinat Aluminijuma Podgorica (KAP), an aluminium smelting company. In 2005, Salomon Enterprises Limited, a company based in Cyprus, bought 65% of the shares for EUR 48.5 million. Salomon Enterprises was later renamed Central European Aluminium Company (CEAC), which is owned by the EN+ Group, a Russian energy company. Later, in 2006, CEAC claimed that it had been misled on the deal. The company has become the subject of controversy between CEAC and the Montenegro government. In October 2013, KAP was declared bankrupt. In June 2014, it was sold for EUR 28 million to Uniprom, a local company. In November 2016, CEAC announced that it would sue the Montenegrin government for 'hundreds of millions of euros'. CEAC has lost the arbitration against Montenegro and investments in KAP are now carried out by the new owner. Despite legal controversy in the past, aluminium and aluminium products have been the largest single item in Montenegro's exports (20% of the total in 2016).

installation of a power cable interconnection between Italy and Montenegro. The EUR 800 million project is planned to go into operation in 2018. Simultaneously, high voltage connections with neighbouring CEFTA economies are under construction, allowing for energy interlinkages in the region and exports to Italy.

Hungary was, until recently, the main investor in the telecommunication sector and fifth in the ranking of foreign investors in Montenegro. In 2005, Hungary's Magyar Telekom obtained a 76.5% interest in Crnogorski Telekom and thus became the dominant provider of telephone services. This was, in fact, an indirect German investment, as Deutsche Telekom AG holds 59.21% of Magyar Telekom shares. On 10 January 2017, another Deutsche Telekom subsidiary, Hrvatski Telekom of Croatia, obtained Magyar Telekom's share in Crnogorski Telekom. The restructuring of the German company will substantially reduce the share of Hungary and increase the share of Croatia among foreign investors in Montenegro. In addition, Hungary's OTP owns the largest commercial bank in Montenegro (Table II.4). Further banking sector investments originate in France, Italy, Russia, Slovenia and Austria.

Figure II.18 / Montenegro: FDI inward stock by investing partner, 2015



Source: CEFTA FDI database incorporating central bank statistics.

Table II.4 / Montenegro: larger commercial banks by main shareholder and total assets, end 2015

	Main shareholders	Total assets, EUR mn
Crnogorska komercijalna banka AD Podgorica (member of OTP Group)	OTP Hungary	585.6
Hipotekarna banka AD Podgorica	Italian investors	486.6
Societe Generale banka Montenegro AD	Société Générale France	436.1
Invest banka Montenegro AD Podgorica	Atlas Group Russia	411.3
Prva banka Crne Gore AD Podgorica	Domestic private	369.2
ERSTE Bank AD Podgorica	ERSTE Group, Austria	322.4
Atlas banka AD Podgorica	Atlas Group Russia	262.8
NLB banka AD Podgorica	NLB, Slovenia	229.2
Komercijalna banka AD Budva	Kombank, Serbia	110.4
Addiko Bank AD Podgorica	Addiko Bank, Austria (Advent International, US)	86.0

Source: Central Bank of Montenegro, www.cb-cg.org

Serbia

In relation to its size, Serbia ranks second or third in CEFTA in terms of FDI inflows. Inflows have fluctuated a lot, which has also determined the fluctuations in the CEFTA aggregate figures. Having implemented some structural reforms, the economy moved up the World Bank's 'Doing Business' ranking and became the site for diverse investments from a large number of economies. Due to its size and location, as well as the existing interest of greenfield investors, Serbia has the potential to join the Central European manufacturing hub.

The largest share of the FDI stock is concentrated in the financial sector (Figure II.20). Three quarters of the banking assets in Serbia are owned by foreign banks, mainly Italian, Austrian and Greek. An acceptable degree of competition is granted, as the three largest banks hold less than half of the assets.

Komercijalna banka is one of the biggest domestic banks and is under public ownership (Table II.5). The government is searching for a suitable buyer, which will enable Komercijalna banka to remain an important part of the banking system. The list of potential investors is quite long and ranges from investment funds to Austrian, French and German banks. The main recent development in the Serbian banking sector is the merger of two big banks, AIK banka and Alpha Bank. The Greek investor of Alpha Bank left and a domestic investor took over.

Figure II.19 / Serbia: FDI inward stock by investing partner, 2015

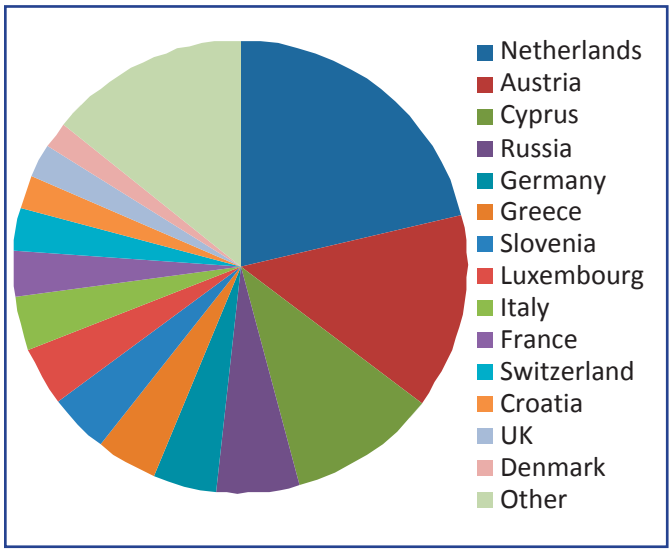
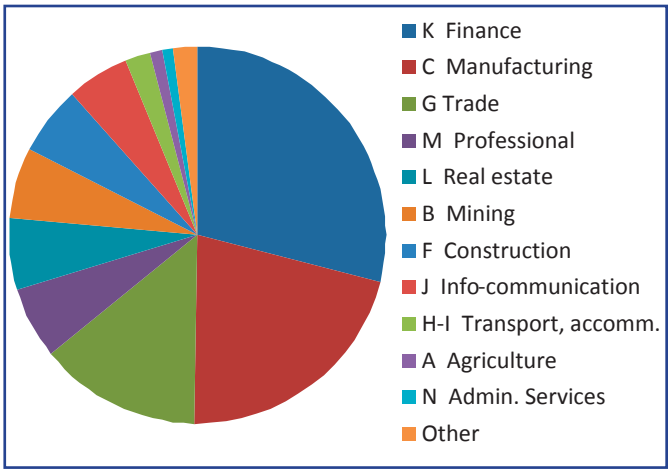


Table II.5 / Largest commercial banks in Serbia by banking assets, end 2015

Name	Nationality of owner bank	RSD bln	%
Banca Intesa AD	Italy	487.8	16.0
Komercijalna banka AD	Serbia	391.9	12.9
Unicredit Bank Srbija AD	Italy	308.3	10.1
Raiffeisen banka AD	Austria	234.4	7.7
Société Générale banka Srbija AD	France	230.5	7.6
Agroindustrijska komercijalna banka 'AIK banka' AD	Serbia	179.1	5.9
Eurobank AD	Greece	140.6	4.6
Banka Poštanska štedionica AD	Serbia	129.9	4.3
Vojvođanska banka AD	Greece	120.3	3.9
Erste Bank AD	Austria	117.5	3.9
Sberbanka Srbija AD	Russia	106.8	3.5
Hypo Alpe-Adria-Bank AD / Addiko Bank	Austria	101.5	3.3

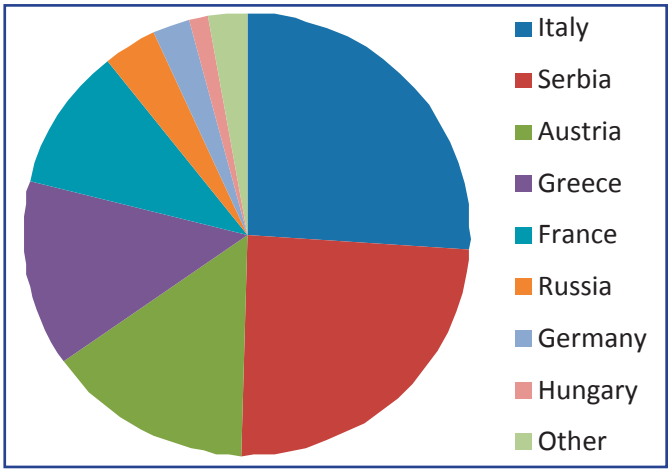
Source: National Bank of Serbia, www.nbs.rs/internet/english/55/55_4/index.html

Figure II.20 / Serbia: FDI inward stock by economic activity, 2015



Source: CEFTA FDI database incorporating central bank statistics.

Figure II.21 / Serbia: commercial banking assets by nationality of owner, end 2015



Source: National Bank of Serbia, www.nbs.rs/internet/english/55/55_4/index.html

Manufacturing accounts for 21% of the FDI stock in Serbia, of which the largest shares are in the food industry, chemicals and pharmaceuticals and machinery, including the automotive sector. The leading company in car manufacturing is Fiat Automobiles Serbia in Kragujevac, founded by privatisation in 2008. Fiat Chrysler Automobiles, registered as a Dutch multinational corporation with headquarters in London, entered into a joint venture with the Serbian government to build a new assembly plant in April 2012, with more than EUR 1.3 billion investment.[32] Producers of car parts followed and formed an automotive cluster that is now one of the most important exporters in Serbia. Further big foreign-owned exporters are found in the food, beverages and tobacco sector. New projects can benefit from government support (Box II.5).

Box II.4 / New investment law attracting new projects in Serbia*

During 2016, incentive agreements for 21 projects were signed. The total value of investments is EUR 232.2 million and the value of the incentives is EUR 85.9 million. The realisation of these projects will create at least 16,434 new workplaces. The largest projects are Johnson Electric Niš, worth EUR 50 million, of which EUR 19.2 million are in the form of incentives, and Delphi Packard DOO Novi Sad with EUR 30 million, of which EUR 17.9 million are incentives. In the first eight months of 2017, the Ministry of Economy signed a further 14 agreements worth EUR 107.5 million, of which the value of the incentives is EUR 38.9 million. The largest projects are Integrated Micro-Electronics DOO Niš and ZG Lighting / Zumtobel SRB DOO Beograd-Stari Grad, both worth about EUR 30 million.

* All information in this box is based on information provided by the Ministry of Trade, Tourism and Telecommunications of the Republic of Serbia

Foreign-owned companies in the information and communication sectors, as well as professional activities, provide ICT services. Initially, Serbian IT development was based mainly on entrepreneurs and individual initiatives, which resulted in a large number of IT companies. In the early 2000s, the best – for example, DMS, ASSECO and SAGA – were bought and reorganised by foreign investors. The top five software exporters in foreign ownership comprise the major outsourcing companies: Schneider Electric DMS NS, G-Tech (USA), Levi9 Global Sourcing, ELSYS, youngculture. In addition, there are local branches of big international players, including Microsoft, IBM, HP, Cisco, Oracle, and SAP (Matijević and Šolaja, 2015). In 2012, a strategic partnership of three IT clusters was created in Serbia – Vojvodina ICT Cluster, ICT Network and NiCAT. In 2014, another cluster, ICT Cluster of Central Serbia, was established and has joined this alliance. Also in 2014, Serbian IT clusters participated in founding the Balkan and Black Sea ICT Network.[33] The clustering and regionalisation helps companies, both foreign and domestic, to get larger orders and improve their international presence.

[32] http://ras.gov.rs/en/why-did-we-invest-in-serbia-2016
[33] http://vojvodinaictcluster.org/wp-content/uploads/2014/08/ICT-in-Serbia-At-a-Glance-2015.pdf

With a share of more than 80% of FDI stock, EU countries represent the largest proportion of investors in Serbia. The Netherlands and Cyprus, headquarters of international holdings, are among the most important individual countries of origin of foreign investors. Austria (due to its proximity), Germany and Italy (manufacturing sector) are also among the most important investing partners.

Next to EU investors, **Russian companies have a special role, mainly in the energy sector, and are also present in the financial sector.** The most important Russian investment in Serbia is the oil and gas company Naftna industrija Srbije (NIS), started as a joint venture between Gazprom and the Serbian government. In January 2008, the Serbian government and Russia signed an agreement giving 51% of NIS's shares to Gazprom Neft for EUR 400 million in assets and EUR 550 million in investment commitments to be fulfilled by 2012. In 2010, 20% of shares in NIS were distributed by the government to Serbian citizens and NIS was transformed into an open joint-stock company listed on the Belgrade stock exchange.[34] Gazprom increased its presence also in other areas of the Serbian economy by acquiring a 12.7% stake in the publicly owned chemical company HIP-Petrohemija in 2014.

Another key area of Russian involvement in the Serbian energy industry is via the oil company Lukoil. The company has a significant position in the oil industry, thanks to its EUR 110 million purchase of Beopetrol, which has a network of 180 petrol stations. The terms of the privatisation agreement stated that Lukoil should invest EUR 93 million in improving the infrastructure related to Beopetrol operations.

There have also been Russian investments in sectors other than energy and chemicals. Sberbank set up a subsidiary and has opened 33 branches since 2003, building up almost EUR 1 billion in assets. Another Russian bank, VTB, entered the Serbian market in 2012. The power engineering company Harvinter acquired the engineering company Termoelektro, a company that provides engineering and construction services for power plants, for EUR 1 million. Metropol bought 75% of Putnik, Serbia's largest travel agency, for around EUR 40 million.

*Kosovo**

Kosovo* stands out for the high share of real estate activities and the low share of productive sectors in the FDI stock (Figure II.23). Furthermore, a significant part of the FDI is not allocated by the central bank, which publishes cumulated inflows rather than stocks. Manufacturing and financial services both play a minor role in this economy, in terms of both output and FDI. Eight of the ten banks operating in Kosovo* are foreign owned and account for 89% of the assets. ProCredit Bank of Germany and Raiffeisen of Austria are the largest banks.

Figure II.22 / Kosovo*: FDI inward stock by investing partner, 2015

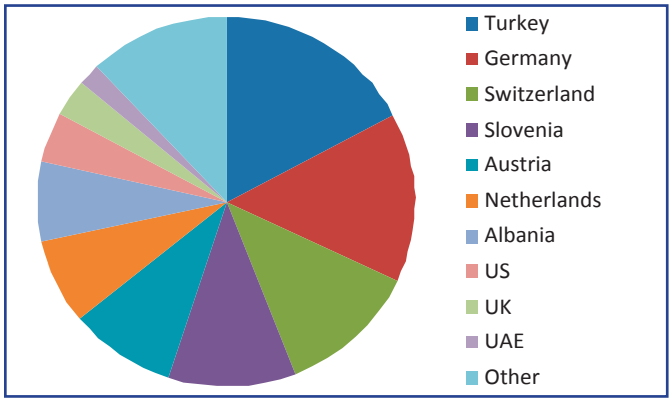
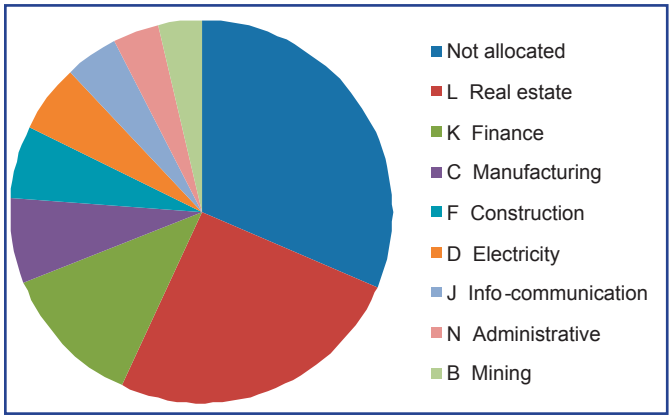


Figure II.23 / Kosovo*: FDI inward stock by economic activity, 2015



Note: Distribution by investing partner is available for 62% of the FDI stock.

Source: CEFTA FDI database incorporating central bank statistics.

[34] www.nis.eu

Turkey is the biggest source of FDI stock in Kosovo*, with EUR 349 million or 17% of the allocated stock in 2015. This represents an increase from EUR 174 million, or 7% of the total, in 2012. As of 2015, according to the Kosovo* Investment and Enterprise Support Agency, 62 businesses in Kosovo* were Turkish owned. This was the second highest from a particular economy – after Albania (78 companies) – and ahead of Germany (43 companies). Germany and Switzerland host a large number of people from the Kosovo* diaspora, who are investors in real estate, construction and services in Kosovo*.

Turkish investment in Kosovo* is across a wide number of sectors, including transport, power generation and supply, and finance. Limak–Aéroport de Lyon, a Turkish-French company, operates Pristina International Airport under a 20-year licence obtained in 2011. A new terminal has been built, and was opened in October 2013. The Turkish consortium Limak-Çalik won the tender for the privatisation of Kosovo* Electrical Distribution and Supply (KEDS), with a bid of EUR 26.3 million in 2013. Under the terms of the deal, KEDS invested EUR 300 million in the electricity distribution grid.[35]

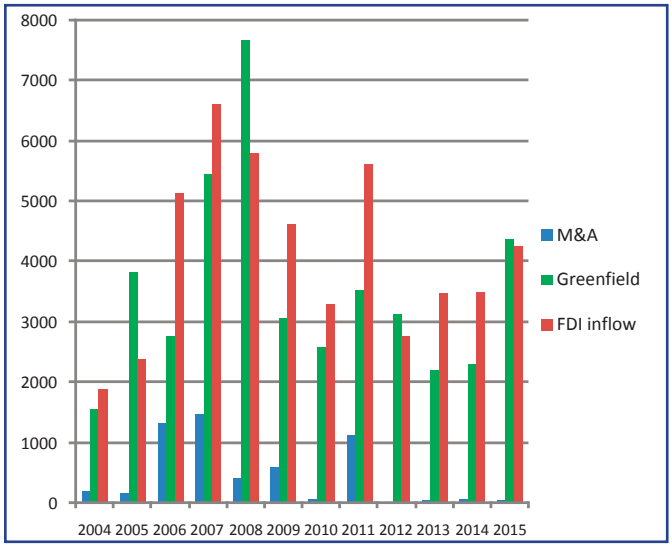
II.7 Entry mode of foreign investors – switch from M&A to greenfield

II.7.1 Relationship between M&A and greenfield cross-border investments

The first entry of a foreign investor can proceed in two basic modes: either through the takeover of an existing company (merger and acquisition, M&A) or by establishing a new company (greenfield investment). Once the foreign investor has established itself by either of these modes, it usually makes follow-up investments to restructure and enlarge the company. FDI in the form of new entry may subside over time, and a larger part of FDI may come in the form of follow-up investments; however, the expansion can be reported as a new FDI project and registered as a greenfield investment.[36]

Greenfield has been the more favoured entry mode in CEFTA; the value of M&A has only constituted a fraction of it (Figure II.24). M&A was more important before 2007, when the main privatisation deals were concluded. The value of the deals was modest even at that time, because the majority of former socially or publicly owned enterprises were in financial distress, and so investors got them for a depressed price. The value of the announced greenfield projects peaked in 2008, before falling to less than half of that amount the following year; after a short revival in 2011, it bottomed out in 2014 and recovered again in 2015. The value of projects announced was higher than the FDI inflow in several years, when investors were especially active in going in for long-term investment commitments.

Figure II.24 / Value of M&A, value of pledged capital in greenfield projects and FDI inflow (balance of payments), 2004–15, EUR million



Note: M&A and greenfield data were converted from USD using the average annual exchange rate.

Source: CEFTA FDI database, fdimarkets.com, UNCTAD M&A database.

II.7.2 Mergers and acquisitions – what is left to be privatised?

In the period 2004–16, the volume of M&A purchases by foreign investors was EUR 6 billion in the CEFTA

[35] www.keds-energy.com/en/about.asp

[36] Information on the amount of FDI by entry mode (Figure II.24) relies on press reports and company information; thus it differs from the FDI inflow figures reported in the balance of payments (BOP). M&A data reflect the value of actual deals over a year, while greenfield investments are investment commitments announced. M&A data include the price of the initial purchase and not the value of follow-up investments, which may be much larger.

economies.[37] In the five years prior to the global financial crisis, 74 deals were made, amounting to EUR 3.7 billion; in the eight post-crisis years, the number of deals was 63, worth EUR 2.3 billion (Table II.6 and Table II.7). M&As reached their highest value in 2006 and 2007, when the bulk of privatisation took place in the region, and the value was also high in 2011. In 2012–15, the annual amounts of M&A deals were insignificant. This was partly because the number of companies available for privatisation subsided, and partly because governments faced difficulties in finding investors due to a lack of global demand for assets and capacities.

Serbia was by far the most frequent target for M&A takeovers, with more than half of the value in the region, not only over the whole period but also in recent years (Table II.6). This is due to the size of the economy and the fact that the government has clearly been in favour of privatising publicly owned assets, while business conditions have also improved. Montenegro is ahead of other economies in terms of M&A value per capita, mainly due to privatisations in the energy sector and metallurgy. The lowest revenue from M&A accrued in Moldova – the poorest of the CEFTA economies – where companies have a low value of assets.

Table II.6 / Number and value of M&A deals in 2004–16 cumulated

	Number	Value EUR mn	Value per capita EUR
Albania	13	587	203
Bosnia and Herzegovina	25	1134	382
Macedonia	15	563	190
Moldova	14	310	87
Montenegro	5	312	501
Serbia	67	3076	434
CEFTA-6	139	5981	294

Note: Data in USD converted by the period average exchange rate 0.777 EUR/USD. No data available for Kosovo*.

Source: UNCTAD.

Table II.7 / Number and value of M&A deals and the largest deals by year, 2004–16

Year	Number of deals	Value EUR mn	Major project of the year
2004	6	205	Raiffeisen Zentralbank, Austria buys Albanian Savings Bank (commercial banking)
2005	6	152	Mittal Steel Co., India acquires Mittal Steel Zenica (steel)
2006	17	1326	STADA Arzneimittel AG, Germany buys Hemofarm AD, Serbia (pharmaceuticals)
2007	24	1474	Telekom Srbija AD, Serbia buys Telekom Srpske, Bosnia and Herzegovina
2008	22	410	Fondiaria SAI SPA, Italy buys DDOR Novi Sad AD (life insurance)
2009	11	599	A2A SpA, Italy buys Elektroprivreda Crne Gore AD Nikšić (electric services)
2010	6	60	National Bank of Greece SA acquires Stopanska banka AD, Macedonia (banking)
2011	15	1118	Delhaize Group SA, Belgium buys Delta Maxi Group, Serbia (grocery stores)
2012	6	16	None
2013	5	33	Vienna Insurance Group, Austria acquires QBE Makedonija (life insurance)
2014	4	55	None
2015	5	33	None
2016	12	250	He Steel Group Co. Ltd, China acquires Železara Smederovo DOO (steel)
Total	138	5732	

Note: Converted from USD; see Annex D for the average annual EUR/USD exchange rates.

Source: UNCTAD.

[37] Summarising available data regarding 139 recorded individual M&A deals; courtesy of UNCTAD; USD data converted by the average exchange rate 0.777 EUR/USD.

The largest M&A deals before 2009 were primarily banks, energy and telecom companies (Table II.7). The main investing partners included Austria, Italy and Russia. One of the largest projects does not even show up, as the sale of the Serbian telecom provider Mobtel went through several stages until Telenor, from Norway, bought it for EUR 1.5 billion.[38] There was only one deal of similar magnitude after 2009: in 2011, Belgium's Delhaize acquired 100% of Delta Maxi Group (which operated 450 stores in five economies in the CEFTA region) for EUR 932.5 million, including a net debt of approximately EUR 300 million. The most recent large deal of the region was also in Serbia: He Steel Group Co. Ltd, China acquired the steel producer Železara Smederovo in 2016. The company was first privatised to US Steel for EUR 18 million in 2003, plus a pledged investment of EUR 120 million in plant modernisation. After some years of successful operation, the collapse of international steel prices drove the company into bankruptcy; the owner sold it to the Serbian government for USD 1 in 2012. The Chinese investor appeared after several failed privatisation attempts.

State-owned enterprises were usually making losses when they were slated for privatisation; thus the price was low, compared to the investment necessary to make them profitable. Botrić (2010) found a positive relationship between the privatisation process in Western Balkan economies (including most CEFTA economies) and FDI inflows, indicating that privatisation was an important opportunity for foreign investors to enter the market and restructure existing facilities. (Foreign investors appeared less interested in starting their own businesses.) Most privatisation was in the service sector, fitting the pattern of FDI. According to European Commission (2016), this has improved financial capabilities and risk management skills, and has allowed for the development of increasingly sophisticated products.

There are still a number of enterprises slated for privatisation and offered to foreign investors in most CEFTA economies. The current privatisation policy and the current offers are as follows.

In **Albania**, the government planned to privatise the publicly owned oil company Albpetrol in 2016, and specifically targeted foreign investors, but plans were put on hold due to low global oil prices. The EBRD noted in its 2016–17 Transition Report (EBRD, 2016) that the company will require significant restructuring before it is ready for sale. A new Law on Strategic Investments came into force in January 2016, with the aim of facilitating large investments, notably from foreign investors.

In **Bosnia and Herzegovina,** the EBRD (2016) argued that more progress needed to be made on privatisation, which would send a major positive signal to foreign investors.[39] In 2016, a new FDI law was adopted in the Federation.[40] This followed several previous failed attempts to sell government stakes in companies. In 2015, the Federation government published a list of 14 companies that it planned to sell its stake in. On previous occasions, attempts to sell these companies had failed due to the poor state of their operations and/or the over-high price tag. The 2016 privatisation plan aimed to sell stakes in drug producer Bosnalijek, aluminium smelter Aluminij, petrol firm Energopetrol, engineering firm Energoinvest and insurer Sarajevo Osiguranje. The Federation managed to sell a 19.3% stake in the drug-maker Bosnalijek for USD 13.4 million (EUR 12.1 million) via the Sarajevo stock exchange (meaning that the identity of the buyer is secret; it is not known if it was a foreign company). Luxembourg-based Haden is the biggest shareholder in Bosnalijek, with a 30% stake. The Federation also sold its 39.9% stake in tobacco factory Fabrika duhana Sarajevo to British American Tobacco.

In **Montenegro**, most of the economy is already in private hands. Global Ports Holding (Turkey) acquired the operating rights of the Port of Adria in Bar through privatisation in 2013. However, some big assets have remained in public hands, and the EBRD suggests that these would benefit from privatisation. The 2016 Privatisation Plan aimed at privatisation of the key transport companies: Montenegro Airlines, Montecargo (the rail freight operator) and the remaining part of the port of Bar. Publicly owned owned tourism assets were also due to be privatised, notably Institute Igalo. However, little progress could be made in that year; nevertheless, the government continues to invite investors.[41]

The government has also been trying to sell a 61.57% stake in the shipbuilding Port of Bijela concession. A consortium of Porto Montenegro and Dutch-based Damen were the sole bidders for the 30-year concession in 2016.

[38] www.telenor.com/about-us/global-presence/serbia/
[39] EBRD, Transition Report 2016 – 17.
[40] www.fipa.gov.ba, law dated 05.08.2016
[41] www.savjetzaprivatizaciju.me/en/

Discussions are ongoing, in part because of the responsibility for environmental clean-up (which will be financed by the World Bank).

In **Moldova,** privatisation is at an advanced stage; smaller assets are periodically put up for sale. In 2016, seven public property assets were privatised by the Public Property Agency. Some companies were sold on the stock exchange, and some properties sold at Dutch auctions. Another round of privatisation in February 2017 put up several food-processing companies for tender. The current IMF programme in Moldova reckons with modest but constant annual privatisation revenues until 2019.[42]

The government also intends to privatise the publicly owned airline Air Moldova in 2017.

In **Serbia**, privatisation is a big focus of government policy, as stipulated in the IMF Stand-by Arrangement. The government has 502 companies in its privatisation portfolio. Most of these went bankrupt in 2015.[43]

Lender banks have typically opted for debt write-downs and restructuring for most companies. The bankruptcy protection of the remaining 17 strategic companies was removed in May 2016, but 11 of these cases remain to be resolved. Of these, seven have adopted or are in the process of adopting reorganisation plans; one has issued a public invitation for strategic partners; and three are negotiating with creditors or have specific consolidation plans.[44] The interest of investors is uneven, but may increase as the Serbian economy improves in terms of growth and stability. Many privatisation attempts have failed during previous years, but the following assets are open for bids again:

- Telecommunications company Telekom Srbija, in which the government has a 58% stake, could be attractive when offered again. The privatisation was originally due to take place in 2015. Before that the government had turned down a bid from Telekom Austria in 2011. The EBRD recommends a sale, but the privatisation of the company is very unpopular with the public, making politicians cautious.

- In the case of the publicly owned copper mine and smelting combine RTB Bor, Serbia has issued a tender for the provision of consultancy services, in a project to attract a strategic investor.[45] The court has approved the restructuring plan, allowing 90% of its unsecured debt to be written off. Under the plan, the remaining 10%, or EUR 300 million, will be paid back over the next eight years with a one-year grace period, and the secured debt will be converted into equity. The plan also envisages cutting 1,500 of the 5,000 jobs over five years, starting from 2017.

- Resavica coal mine is another candidate for privatisation. The government suspended privatisation of the mine in 2015, but is still aiming for an eventual sale. It had debts of over EUR 93 million, but it was relieved of these in 2016, making it more attractive for investors.

- The government has called for applications for a strategic partnership in the pharmaceutical company Galenika. In October 2016, it was reported that the government was in talks with a UK-Russian consortium to sell a 25% stake. Talks were extended by three months in December 2016 and declared to have failed in March 2017.

- A privatisation advisor has been appointed for the sale of Belgrade airport and Komercijalna banka, Serbia's second biggest bank. Privatisation of Komercijalna banka is under way, and it was expected that tenders for expressions of interest would be published in August 2017, with the aim of finalising privatisation by the end of June 2018, according to the IMF.[46]

In **Kosovo*,** there has been little progress on privatisation in recent years, according to the EBRD, which urged the authorities to put some assets up for sale in 2017, in order to send an encouraging message to investors.[47]

Some privatisation plans had been pending for years before any political decision was taken. The largest industrial entity to be revitalised by new investments is the Trepça complex, comprising several lead and zinc mines, concentrator plants, one smelter and one zinc plant. A law of October 2016 transformed it into a majority publicly owned company and this may make the Trepça complex viable for privatisation. In a major tender for the 99-year lease on the Brezovica ski resort, the winning bidder could

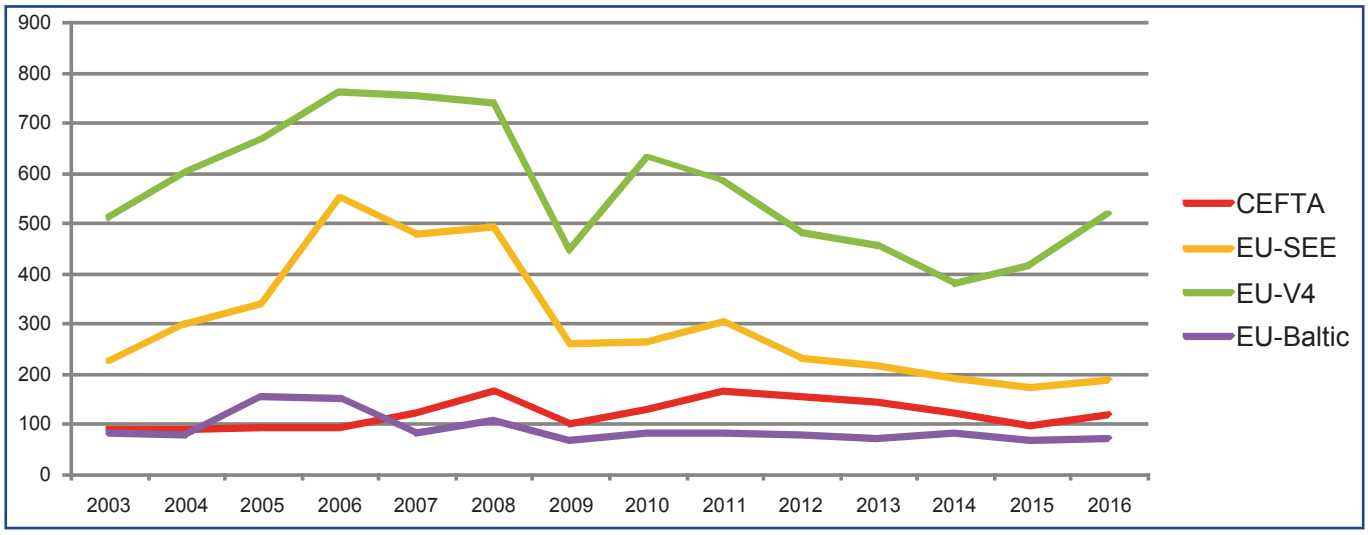
[42] IMF Country Report No. 16/343: www.imf.org/external/pubs/ft/scr/2016/cr16343.pdf
[43] EBRD 2016–17 Transition Report on Serbia.
[44] IMF Sixth Review under Stand-by Arrangement, December 2016.
[45] http://rtb.rs/en/tenderi-2/
[46] IMF Seventh Review under Stand-By Arrangement, September 2017.
[47] EBRD 2016–17 Transition Report for Kosovo*.

not provide the necessary financing. However, the authorities are planning to re-tender this project, where large investments are expected to make the resort attractive to tourists.

II.7.3 Greenfield FDI projects in the CEFTA region

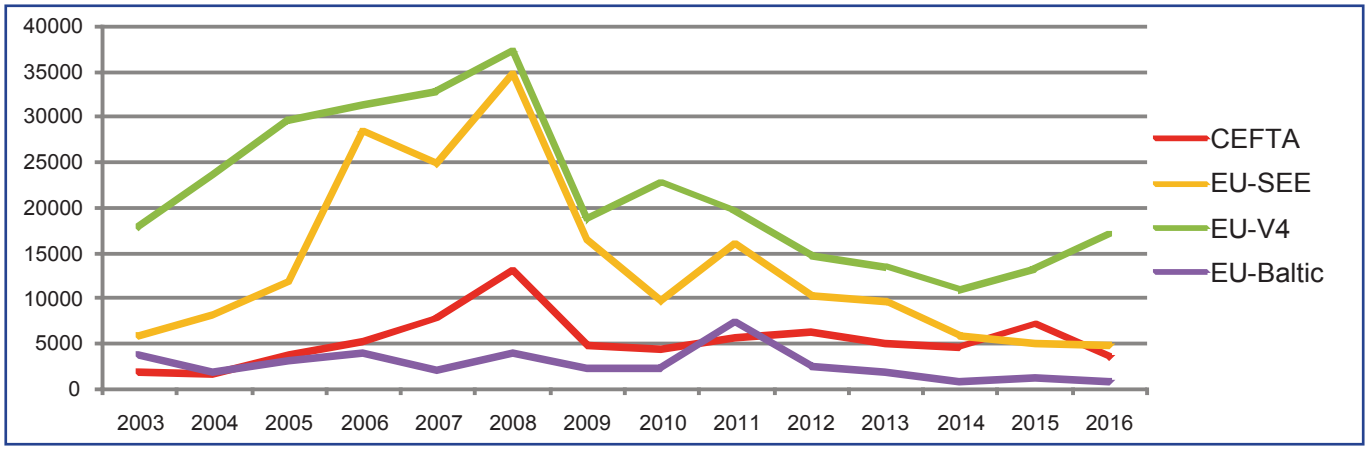
The number and value of newly announced greenfield FDI projects expresses the confidence of investors in a host economy.[48] In aggregate for CEFTA, both indicators peaked in 2008 and fell back in the two subsequent years; 2011 and 2012 were better; 2013 and 2014 again worse (Figure II.25 and Figure II.26). In the years 2013–16 the number of projects was lower than in the previous four years in all CEFTA economies; Albania and Moldova suffered especially big declines. As for the two latest years, the investment value was higher in 2015 than the year before, but the number of projects was lower. In 2016, the project number recovered a bit, while the investment value fell to its lowest since 2005.

Figure II.25 / Number of greenfield investment projects in CEFTA-6 and peers, 2003–16



Note: Excluding retail projects; downloaded April 2017.
Source: fdimarkets.com

Figure II.26 / Value of greenfield investment projects in CEFTA-6 and peers, EUR million, 2003–16



Note: Excluding retail projects; downloaded April 2017.
Source: fdimarkets.com

[48] The data from fDiMarkets (www.fdimarkets.com, a division of Financial Times Ltd) used in this section are based on media reports on individual investment projects. The database also includes (often estimated) data on the value of investment commitments and the number of jobs that are supposed to be created. Compared with the balance of payments, which records financial flows in a given period of time, fDiMarkets data refer to intended investment projects that are to be realised over a longer period of time. The forward-looking character of the database may support forecasts, but there is a good deal of uncertainty, as the realisation time of individual projects may differ substantially. We exclude retail outlets and shops from its coverage. The investing country is the final home country of the investor; thus tax havens do not show up. Projects have been recorded by fDiMarkets since 2003 and are continuously updated. The data used in this report have been downloaded on 2 March 2017. Kosovo* is not covered by the database.

Annual fluctuations in investment capital depended on individual larger projects, while the big picture shows a rather modest interest on the part of investors in the region. The relatively high amount in 2015 was the result of two large real estate development projects, both announced by investors from the United Arab Emirates. Eagle Hills started a EUR 2.6 billion development of the Belgrade waterfront. As announced, this is a long-term construction project, which will be carried out over several years in a number of phases. Heavy works on one of the residential buildings have already been completed. In Bosnia and Herzegovina, the Buroj Ozone City will be built by a Dubai investor; its value is EUR 2.27 billion.[49] The planned holiday city of 40,000 people will include private villas, luxury hotels and a shopping mall, and it should be completed by 2025. Without these two projects, the decline in the greenfield investment value has been continuous since 2011.

In the EU-V4, the development has been more positive: greenfield FDI has recovered since 2014 both in terms of the number of projects and in terms of the amount of pledged capital investment. This has not been due to a single economy or a dominant project: the recovery has been shared by all four Visegrád economies. In the EU-SEE and EU-Baltics, greenfield investments developed along a similar trajectory as in the CEFTA region, showing declines since 2011 and only a modest recovery in 2016.

Serbia is the most frequent destination for FDI projects in the CEFTA region, in terms of both the number and the value of announced projects (Figure II.27 and Figure II.28). Bosnia and Herzegovina and Macedonia are second and third. These two economies fare significantly better in terms of greenfield investments than in terms of FDI inflow. The other economies of the region attract very low numbers of projects.

Macedonia and Serbia are almost equal and ahead of other economies in terms of attracting greenfield investments, relative to their population size. Their greenfield investment indicators are similar to those of EU-CEE economies of comparable size.

Figure II.27 / Number of greenfield FDI projects, 2010–16

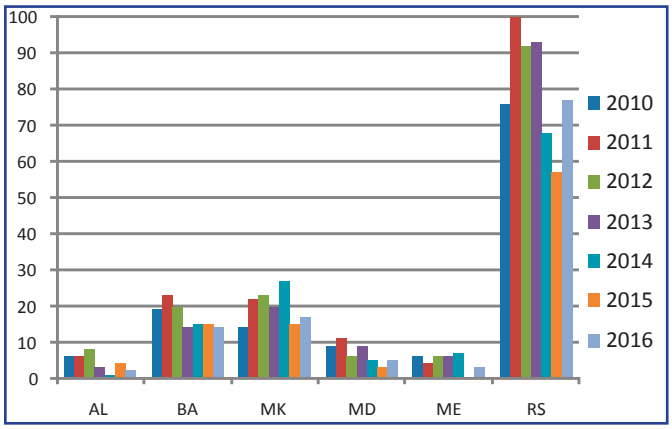
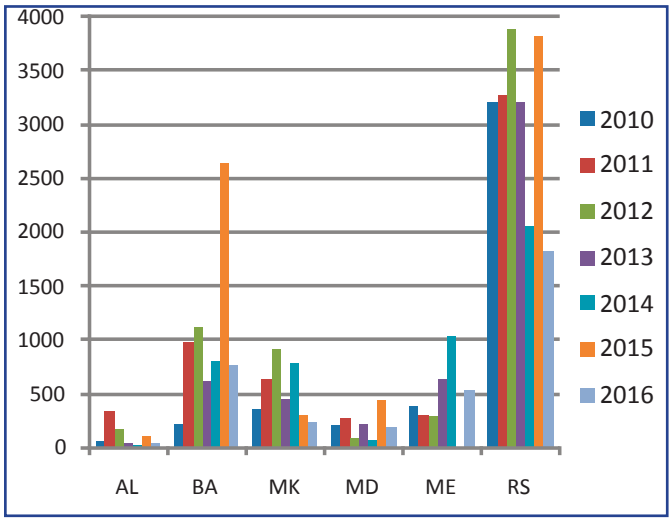


Figure II.28 / Pledged investment capital of greenfield FDI projects, EUR million, 2010–16



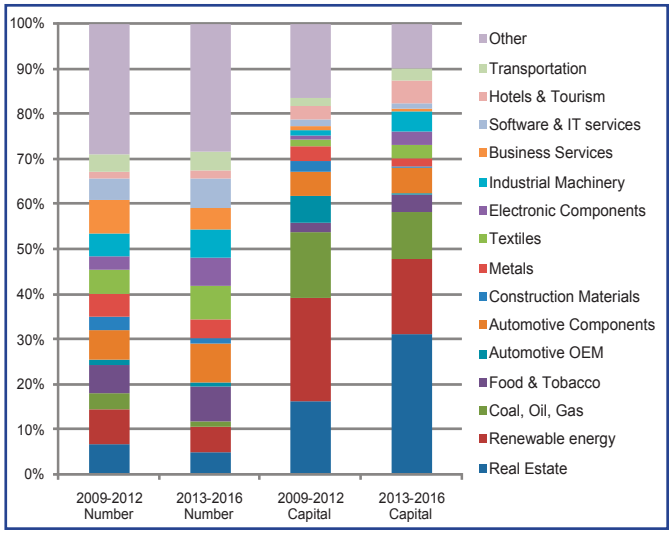
Note: CEFTA-6 excludes Kosovo* not covered by the source.
Source: fdimarkets.com

Capital-intensive sectors, such as real estate, renewable and traditional energy have attracted the highest amounts of greenfield investments in both 2009–12 and 2013–16, with a combined share of 54% in the first and 59% in the second period (Figure II.29 – see the decline in investment value and project number from one period to the other in the notes). The share of real estate investments increased from one period to the other, while it declined for energy projects. Greenfield investment in automotive original equipment manufacturing (OEM) production was the most

[49] www.burojo3.ba/

important manufacturing activity in 2009–12, but has almost disappeared in the last four years. But investments in the automotive components sector increased in amount from one period to the other. Increases were also registered in the electronic components, industrial machinery, textiles and food sectors. Beyond manufacturing, transportation, hotels and tourism were further expanding sectors, while investments in business, software and IT services declined.

Figure II.29 / Share of important economic sectors in the number and value of greenfield projects in CEFTA-6 in 2009–12 and 2013–16



Notes: Kosovo* not covered by the source; sectors are similar to NACE categories; OEM = original equipment manufacturing.

Total 2009–12 Number: 552; 2013–16 Number: 480;

Total 2009–12 Capital: EUR 21,465 million; 2013–16 Capital: EUR 20,772 million.

Source: fdimarkets.com

The number of greenfield projects is very dispersed by economic sector. The share of real estate and energy projects is relatively small and shrank between 2009–12 and 2013–16. There was a shift towards manufacturing projects, most notably in the automotive components, textiles, electronic components and industrial machinery sectors. The decline in business services projects was compensated for by a boost in software and IT projects. IT services have become larger in number and capital, but they are mostly active in distribution, rather than production of services. Shared service centres or R&D labs are rare, constituting about 0.2% of the projects in 2013–16. These activities are not capital intensive and thus have low investment value.

The modest shift to higher value-added sectors in manufacturing and IT took place mainly in Serbia and Macedonia. These economies have projects in all the most important manufacturing and services sectors displayed in Table II.8. Serbia has more greenfield projects, and of a higher value, than the other economies in all but two sectors. Macedonia is ahead of Serbia in terms of investments in the manufacturing of medical devices and textiles, as well as in IT-related services. Bosnia and Herzegovina is represented in six out of seven activities, but with less than half the number of projects announced in Macedonia. Moldova is present in only five activities, with half as many projects as Bosnia and Herzegovina, but with much higher investment capital in such modern activities as automotive and electronic components. Albania has no greenfield projects in the selected sectors, except in the metalworking industry.

Table II.8 / Greenfield FDI in selected manufacturing and IT sectors in CEFTA economies by number (No.) and pledged investment capital (EUR million) in 2013–16 cumulated

	Al No.	AL EUR mn	BA No.	BA EUR mn	MK No.	MK EUR mn	MD No.	MD EUR mn	RS No.	RS EUR mn
Metals and minerals	1	1.1	7	187.4	2	15.0	0	0	13	120.8
Industrial machinery and equipment	0	0	3	13.2	6	110.4	1	1.4	15	157.9
Automotive components	0	0	1	10.4	15	337.7	3	462.8	25	407.9
Electronic components	0	0	4	46.8	4	129.0	4	89.2	16	362.1
Medical devices	0	0	0	0	4	90.6	0	0	7	54.4
Textiles	0	0	4	28.7	5	378.4	0	0	24	217.1
Software & IT services, Business services, Design-development-testing	0	0	2	44.5	11	97.6	2	10.7	8	61.7
Total above	1	1.1	21	331.0	47	1158.7	10	564.1	108	1381.9

Note: Activities not in line with NACE categories; Montenegro has no matching projects; Kosovo* not covered by the source.
Source: fdimarkets.com

Greenfield investments in Albania have subsided over the past four years. Albania received 90 greenfield projects in the years 2003–16, of which only 10 were announced in 2013 or later. The total value of the projects is EUR 8.9 billion, of which only EUR 2 billion were in the four latest years. The largest projects were in the energy sector – one of ENEL Italy and one of EVN Austria, both announced in 2007, though only the EVN project entered the implementation stage. The third largest project involves the Italian Falcione Group, which planned a liquefied gas production unit and the product's transport to Italy; but the project is still at the planning stage. These three projects together make up half of the investment capital pledged. Only one manufacturing project has been announced since 2013: in 2016, Turkey's Kiliç Deniz announced the setting up of a fish production company.

In Bosnia and Herzegovina, fewer greenfield projects were announced in the last four years than before, but the value of the projects has not declined. The economy has received 265 greenfield projects to the value of EUR 13.5 billion over the years 2003–16; of these, 54 were in the last four-year period. The largest project was that of Buroj Property Development (see above). Leaving aside this project, the economy received investment announcements to the value of EUR 4 billion in the last four years – just as much as in the previous four years; thus the interest of investors has not declined. Another large new project is being implemented in the energy sector: the 300 MW Stanari thermal power plant (Republika Srpska) is being built by the EFT Group, an energy distribution and investment company based in London.[50] The total value of the project, which includes the expansion of the attached coal mine, the connection to the transmission grid and the construction of additional capacities, amounts to EUR 550 million and the investor plans to employ 900 people.

In Macedonia, greenfield projects have shifted to higher technologies in recent years. In the last two years, the economy recorded lower interest than before among foreign investors, but this is mainly on account of the absence of capital-intensive real estate, telecom and renewable energy projects, which were dominant in earlier years. Automotive and electronic components manufacturing continued attracting FDI. Electronics was the upcoming sector in the last three years. Software and IT services first appeared in 2012, and in 2016 they attracted the highest amount of greenfield investment capital.

Moldova has received only five projects a year on average; the pledged capital was very low in 2012 and 2014, but it reached a new high in 2015. Also, this economy moves up the technology ladder in terms of industrial sectors attracting greenfield projects. There have been no energy or real estate projects in recent years, but more automotive and electronics component manufacturing. The number of manufacturing projects is still small and they tend to be simple and labour intensive, such as cable harnesses for the automotive industry.

Montenegro usually receives more projects than Moldova, and with greater capital. The exception was 2015, when no greenfield project was registered in Montenegro. The most attractive economic sector is hotels and tourism; in certain years it was renewable energy. Manufacturing and IT services are almost totally missing, reflecting the very tight specialisation of this small economy.

In Serbia, 2016 was marked by a higher number of projects than the year before, but a lower amount of investment capital. The economy received 90–100 projects annually in the years 2011–13, with an annual value of about EUR 3.3 billion, but the number of projects fell in the two subsequent years. The capital investment pledged reached a high figure in 2015 due to the Eagle Hills real estate project (see above). In the last few years, Serbia has received about 60 new projects and EUR 2 billion in sectors other than real estate. Automotive components, food and machinery production have been the most attractive manufacturing sectors; in 2016 electronic components was first, with 10 newly announced projects and the highest amount of pledged capital outside the real estate sector, which is a sign of further upgrading.

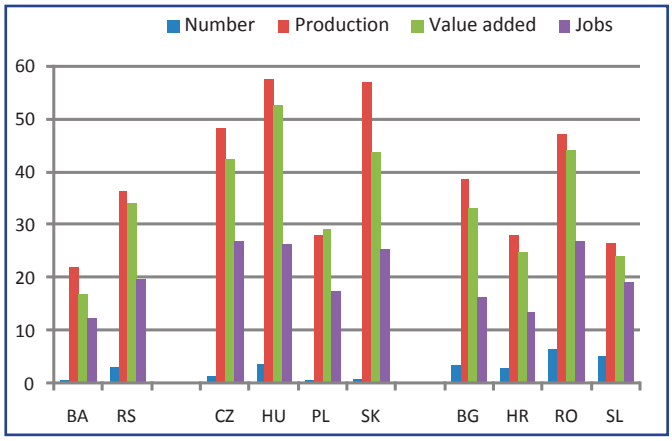
II.8 Role of foreign affiliates in CEFTA economies

This section aims to provide a clearer indication of the actual impact of foreign investors' presence in terms of their contribution to gross value added and employment. This can be partly assessed on the basis of foreign affiliates statistics (FATS), which provide information on the share of majority foreign-owned subsidiaries in the non-financial business economy (comprising industry, construction and services, except financial services) by various indicators. The

[50] www.eft-group.net/index.php/investments/tpp-stanari

absence of the financial sector, one of the top targets for foreign investors, limits the scope of this assessment. Another limiting factor is that FATS data are compiled only by Bosnia and Herzegovina, Montenegro (no aggregate data, just some sectors) and Serbia.

Figure II.30 / Share of foreign affiliates in the non-financial business economy, Bosnia and Herzegovina, Serbia and peers, %, 2014



Full name of indicators: Number of enterprises, Production value, Value added at factor cost, Gross investment in tangible goods, Number of persons employed.

Note: No data for the other CEFTA economies.

Source: Eurostat FATS, Statistical Office of the Republic of Serbia, own calculations.

In Serbia foreign affiliates provided 34% of the value added and 20% of the employment in the non-financial business economy in 2014. These are fairly high shares, given the short history of FDI in the economy and also compared to some EU-CEE economies. Foreign penetration in Serbia is higher than in Croatia, Poland and Slovenia; it is similar to Bulgaria, but much lower than in the Czech Republic, Hungary, Romania or Slovakia (Figure II.30). Bosnia and Herzegovina has a much lower rate of foreign penetration than Serbia and any of the peers: 17% in terms of value added and 12% in terms of employment. The overall importance of FDI in the Bosnian economy is thus about half that in Serbia.

The low degree of foreign penetration means that the economy derives limited benefit from the advantages of foreign affiliates. In such an economy, more room is left for domestic companies. If the business environment is supportive of their growth and safeguards competition, domestic companies may develop in the absence of foreign competition. But in the absence of FDI, slow technological change, capital shortage and limited international competitiveness would hinder the development of the economy. The advantages of foreign affiliates (in terms of size, openness and productivity) in comparison with domestic companies underpin this conclusion.

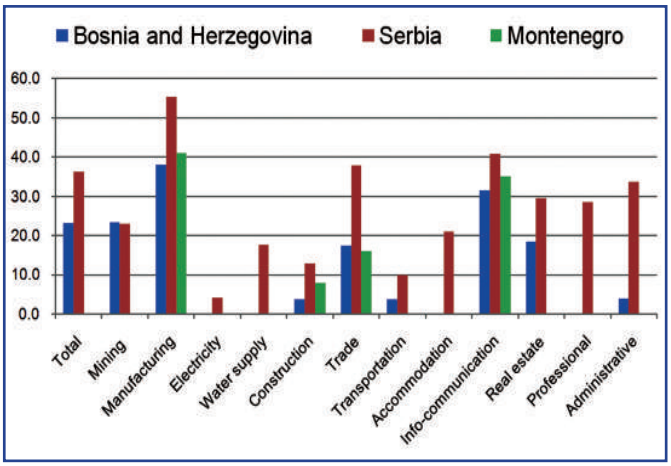
Foreign affiliates are much larger than domestic companies. This conclusion can be derived from a comparison of the foreign affiliates' shares in the economy by number and by the other indicators included in Figure II.31. Foreign affiliates have a small share in terms of the number of enterprises, and thus all production and employment-related indicators per enterprise are higher in the foreign than in the domestic sector. In the comparison between economies, a larger relative size of foreign affiliates does not correlate with the size of the economy or the amount of FDI stock. Foreign affiliates are relatively large in Bosnia and Herzegovina, the Czech Republic and Slovakia, while they are relatively small on average in Serbia, Hungary and Slovenia (but still much bigger than domestic companies). The explanation for bigger foreign enterprise size could be that foreign investors are active mainly in economic activities where companies are larger (e.g. energy, heavy industries), or entry barriers are high for smaller investors, due to institutional/regulatory factors. In fact, the large enterprises are usually foreign owned in a new market economy if they have not been kept under public control. (For a list of major foreign affiliates, see Annex D.)

Foreign affiliates rely more on imported inputs than do domestic companies, as indicated by higher shares in production than in terms of value added. The gap between output and value added is higher in smaller economies with large foreign affiliates, such as Slovakia or Bosnia and Herzegovina, than in relatively large and more complex economies with a greater possibility of local sourcing (Serbia, Romania).

Foreign affiliates have higher labour productivity, as indicated by their lower weight in terms of employment than in terms of production or value added. Aside from possible differences in the specialisation patterns by sector, higher labour productivity can be the result of superior technology and better corporate organisation in foreign affiliates than in domestic companies. The advantages of foreign affiliates also explain the correlation between indicators such as FDI/GDP, foreign affiliates' share in value added and export intensity.

The weight of foreign affiliates is higher in the manufacturing sector than in the rest of the economy in the three CEFTA economies providing data. In Serbia, foreign affiliates provide 55% of the production value; in Bosnia and Herzegovina and in Montenegro it is around 40%. Information and telecommunications has the second highest foreign penetration: between 30% and 40% of production can be attributed to foreign affiliates that provide telephone and internet services (Figure II.31). Investors have offered technology and services improvements and have gained local market access, in some cases dominance. In wholesale and retail trade, the weight of foreign affiliates is almost 40% in Serbia, but less than 20% in Bosnia and Herzegovina and in Montenegro. In the other activities, especially professional services, only Serbia has a significant foreign sector, with about 30% of the production value. The weight of foreign affiliates is only 10% or less in electricity generation and distribution, construction and transportation: though FDI is relatively large, these sectors tend to have majority public ownership.

Figure II.31 / Share of foreign affiliates in the main economic sectors in CEFTA economies providing data, as % of production value, 2014



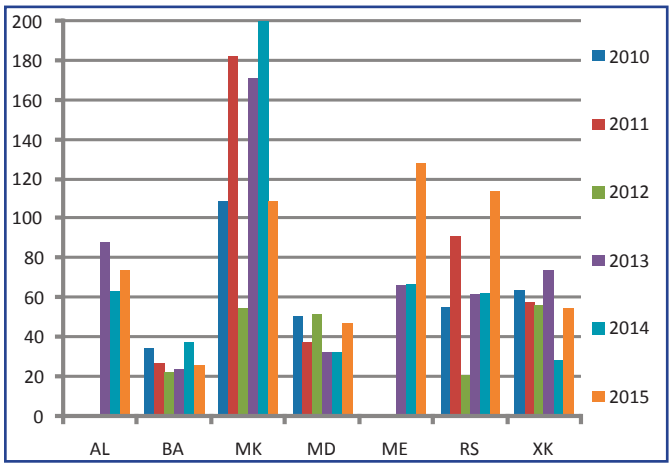
Source: Eurostat FATS, Statistical Office of the Republic of Serbia, own calculations.

The share of foreign-owned banks in the banking assets hovered at above 80% in both the CEFTA and the EU-CEE economies between the mid-2000s and 2012. The two regions have since diverged, as domestic ownership has expanded in the EU-CEE. By 2015, foreign banks' share of the sector was significantly higher in the CEFTA economies than in the EU-CEE: about 85% in Albania and Bosnia and Herzegovina, 75% in Serbia, but only about 60% in Hungary and Poland.[51] Also in the EU-SEE, foreign banks' shares have declined slightly since 2010, as local banks have gained some strength in a consolidating market. In the CEFTA economies, the number of commercial banks is rather high compared with the size of the markets, and a slow consolidation is under way.

II.9 Role of FDI in external stability

FDI inflows are much needed in the CEFTA economies as financial resources for the balance of payments. Net FDI inflows covered around 60% of the current account deficit in 2010–15 (Figure II.32). This rate is adequate for the current stage of development. However, Bosnia and Herzegovina and Moldova receive lower FDI inflows as a share of their current account deficits, and may need more FDI on account of external stability. Kosovo* has also been in this position in recent years, while Macedonia is an exception, having very low current account deficits, which in most years have been more than covered by net FDI inflows. In fact, all economies would be able to afford more imports if they were able to attract higher amounts of capital inflows, including FDI.

Figure II.32 / Coverage of current account deficit by net FDI (BPM6 – assets/liability principle)



Note: Macedonia 2014: 457%.

Source: wiiw database incorporating central bank statistics, own calculations.

[51] Raiffeisen Bank International, CEE Banking Sector Report 2016

FDI represents a longer-term commitment on the part of foreign investors than portfolio or other investments, which are usually more volatile and can be withdrawn more quickly, creating financing difficulties and potentially forcing a sharp current account narrowing that pushes the economy into recession.

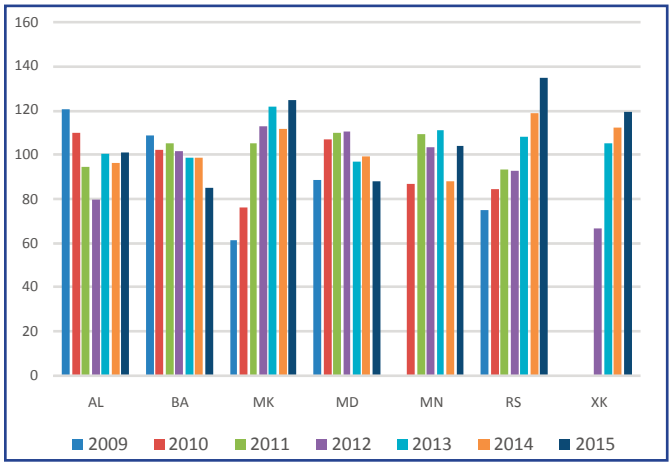
FDI is also the largest source of international investment capital inflows for the CEFTA economies. EU funds play only a small role, because the pre-accession funds represent only a fraction of transfers available to EU-CEE economies. However, other international donor programmes, and multilateral and sovereign credit schemes, are also important for financing investments in the CEFTA economies.

FDI also contributes to the current account deficit, as the income of foreign investors is booked as outflow of primary income. The size of these outflows is much lower in most CEFTA economies than in the EU-CEE; they are in the range of 1–2% of GDP. FDI incomes reach 4% of GDP in Serbia and Macedonia, which has to do with higher profitability of FDI. Higher profitability usually coincides with higher FDI in the tradable sectors (see Part III) and lower deficits on the trade account. The combined impact of FDI on trade and income – and thus on the current account – is generally positive.

II.10 Potential FDI and what it means for policy makers and investors

The size of FDI stock received by Macedonia, Serbia and Kosovo* has increased above potential, while that received by Albania and Moldova has fallen below potential, given their level of development and other features. This is the finding of an estimation of the potential level of FDI when correcting for the impact of the size of the economy (GDP), level of development (GDP per capita), bilateral trade, capital stocks, economic stability (inflation and exchange rate) and other variables in the years 2009–15 in 23 CESEE economies.[52] The average potential level for each economy over the period is 100; thus there are years with underperformance and overperformance (above or below 100 in Figure II.33).

Figure II.33 / FDI performance, deviations from the average/potential of an economy (100) over the years 2009–15



Source: Own calculation based on World Development Indicators (WDI), CEPII, UN Comtrade, CEFTA FDI database.

The improving FDI performance in Serbia and Macedonia depicted in Figure II.33 is due to the improving investment environment. Albania, by contrast, had its lowest FDI attractiveness in 2012, with an index of 80, which means underperformance of 20% compared to its potential. Due to high FDI inflows in subsequent years, it again reached its potential in 2015. The performance of Bosnia and Herzegovina deteriorated from a peak in 2009 (with an index of 109), falling to 85 in 2015, meaning that the economy could not regain its potential attractiveness. Moldova performed at above its potential in 2010–12 but fell back in more recent years. FDI performance in Montenegro was moving around the average, with underperformance of 15% in 2010 and overperformance of 11% in 2013. The performance of Kosovo* rose above potential in 2013–15.

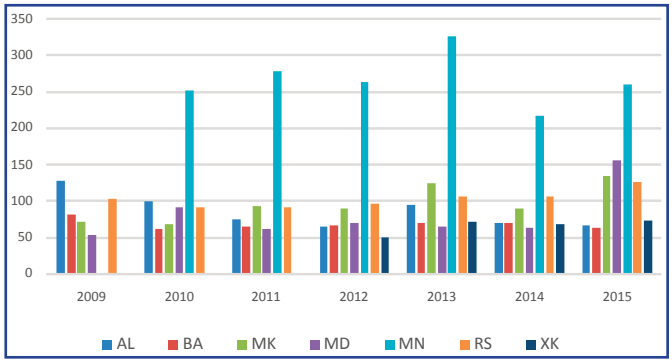
As the model explains most of the possible factors determining FDI, the deviation in the actual values from the potential values must be due to the investment environment changing within the economy. Underperformance in a given year can be interpreted as deterioration in the investment environment. If this goes on for several years, action may be necessary to correct it. Governments may need to improve the location factors of their territory in order to attract more FDI. Foreign investors present in locations with deteriorating performance may need to urge the government to improve its policy.

[52] For methodological details, see Hunya (2017)

In the comparison of the performance of economies, Montenegro performed best in attracting FDI for each of the years 2010 to 2015. This is the outcome of another model calculation, where economies are compared within a given year with the average potential over the 23 CESEE economies. This indicator shows the deviation in FDI performance from the potential, which can be attributed to investors' preference (Figure II.34). Serbia changed from underperformance to overperformance in 2013. Macedonia is the third best economy, attracting FDI at 34% above its potential in 2015. Overperformance means that investors prefer the economy more than its potential and may see good opportunities for investment there.

Kosovo* and Bosnia and Herzegovina have been underperforming over the whole period, with an average index of 65 and 68 of the potential, respectively. Albania was performing at 28% over its average potential in 2009, and but gradually deteriorated to 33% underperformance in 2015.[53] This is an interesting result, as simple comparison of FDI stock to GDP suggests a constantly good performance of this economy in attracting FDI; but more should be expected, if compared with other economies and controlling for size, development level and a number of other characteristics.

Figure II.34 / Deviation of FDI performance from the average potential FDI (100) across CEFTA economies



Source: Own calculation based on World Development Indicators (WDI), CEPII, UN Comtrade, CEFTA FDI database.

The FDI promotion activity in the underperforming economies may need improvement, because underperformance means that investors are unwilling to exploit the potential of the host economy. From the investors' viewpoint, they may not need to wait for promotion, but scrutinise the location with unused potential and go in for investments there.

Looking at the model results by investing partners,[54] Russia, the Netherlands and Cyprus are the major economies that perform well above their global potential in terms of sending FDI to the CEFTA region. Austria, Italy, Germany, Great Britain and the United States have relatively stable and high overperforming FDI in the CEFTA region over the period. Greece and France have sent FDI at higher than the average potential, but with a decreasing trend.

Belgium, Denmark, Finland, Ireland, Japan, Norway, Spain and Sweden are advanced economies and major originators of FDI in the world, but they underperform in terms of sending FDI to CEFTA. Investment attraction in the region is not strong enough for these economies to send as much FDI as their potential level, defined according to their economic indicators. Targeting these economies with promotion may increase their interest in CEFTA economies.

II.11 Conclusions for Part II

On average over the past 10 years, FDI inflow to CEFTA has performed quite well in relation to GFCF, but less well in per capita terms and compared to inflow to CEFTA's peers. FDI inflows grew very strongly in the pre-crisis years, even in comparison with the EU-CEE, reflecting the fact that the process started later than in the peer region. These inflows also did not fall as much immediately after the crisis as in the EU-CEE, but they have recovered only modestly in the past two years.

The post-crisis recovery of FDI inflows into the CEFTA economies (just as in the EU-CEE) has been hindered by sluggish overall investment activity in Europe. Outward FDI has fallen in Europe because potential investors are risk averse, and the level of investment in general is lower than in the pre-crisis years. In this context, host economies are finding it increasingly difficult to attract investors. With economic growth stabilising in Europe, companies may again step up the search for new and more efficient locations, including the border regions of the EU. CEFTA economies may

[53] Moldova has generally underperformed; 2015 is an outlier with no plausible explanation by the model.
[54] This model controls for home country economic variables, bilateral gravity variables such as distance, and host-time fixed effects to normalise for each host economy comparing the home countries at each point in time.

provide attractive alternatives to more established locations by improving the business environment.

Serbia is by far the biggest and most diversified recipient of FDI inflows among the CEFTA economies. As a result of significant FDI inflows, foreign affiliates account for a particularly high share of employment and gross value added, even in comparison with the EU-CEE. The second and third largest inflows have been recorded in Albania and Montenegro since 2009, except for in 2016. Inflows to Macedonia have fluctuated together with those into Serbia. Low FDI inflows have characterised Bosnia and Herzegovina and Moldova.

CEFTA economies' FDI stock as a share of GDP is quite similar to, or even higher than, that of the EU-CEE economies, but the sectoral structure is different. Compared to the size of the economy, Montenegro is by far the biggest FDI recipient. Bosnia and Herzegovina, Moldova and Macedonia have performed at below their potential. Broken down by industry, FDI distribution varies significantly across the CEFTA economies, but the financial sector is heavily foreign owned everywhere. Manufacturing and business services FDI is most advanced in Serbia and Macedonia, which also means that foreign affiliates are more export oriented than in the other economies.

The Netherlands and Austria are by far the biggest sources of FDI inflows, while Cyprus, Russia and Greece are also important. Inflows from EU countries have been quite sluggish compared with non-EU sources, and within the EU only the Netherlands and Cyprus expanded investments in 2010–15.

FDI trends reflect particular features of the investing partners and their relationship with different CEFTA economies. Russian and Turkish FDI is concentrated in particular economies, based on cultural or political preference. Austrian and Greek investors have taken advantage of both their historical links and their good local knowledge of CEFTA economies in the Western Balkans. German and Italian FDI is concentrated in the manufacturing sector, while that of Austria is particularly prevalent in finance and energy.

Foreign investors in the CEFTA economies have preferred greenfield to M&A investment as their entry mode. Greenfield investments can rely on existing skills and knowledge, as well as clustering in the region. First of all, Serbia and Macedonia could attract numerous manufacturing and IT projects. But the number of projects received over the past four years is lower than previously; the value of projects increased only in 2015, due to real estate investment commitments. Almost all of the M&As that did take place occurred in the context of privatisation and happened before 2008. Such investments have been rare in recent years, due to increased risk avoidance on the part of investors and the often complicated legal and financial status of companies slated for privatisation. Still, privatisation is an ongoing process, presenting several potentially interesting opportunities for foreign investors.

FDI in the CEFTA region could grow beyond its present stage; for that, the sectoral composition of FDI needs to change. A turnaround in the structure of FDI could be achieved mainly by attracting greenfield investments. The current sluggish investment activity and its backward structure need to be replaced by investments that incorporate a higher level of technology and that generate more exports integrated into international value chains. Some shift of greenfield projects in the right direction can be observed, but the number of projects and the capital pledged within these projects are still relatively small.

Efficiency-seeking, export-generating investments in manufacturing and IT services can generate growth and spill-overs more than the current, mainly domestic market-oriented FDI. It is above all FDI in manufacturing that can support the much-needed growth in productivity and improvement in competitiveness.

Part III – Manufacturing: a promising sector for FDI in CEFTA

There is a growing awareness among economists that the manufacturing sector is of special importance for economic development, especially in medium-income countries. A growing manufacturing sector in CEFTA economies would boost productivity, increase the size of the tradable sector, create more and better-paid jobs, and have positive spill-over effects for other sectors of the economy.

This section explains the need for a bigger manufacturing base and outlines how FDI can contribute to this reindustrialisation process. It will then look at the relationship between FDI and output patterns, before going on to examine the export specialisation of CEFTA economies. Finally, it will describe the position of CEFTA economies in global value chains.

III.1 Need for a manufacturing imperative

III.1.1 Deindustrialisation and industrial policy

Manufacturing is underdeveloped in most CEFTA economies, as reflected in low output and export indicators. The region was not highly industrialised even before transition, and manufacturing output declined in the 1990s due to economic disintegration, political conflicts and meagre investments. Weak manufacturing gives rise to high trade deficits, modest intra-CEFTA trade flows and limited demand for services and R&D, as manufacturing generally has an important carrier function for services and is a main source of innovation. Manufacturing contributions to GDP ranged from 4% (Montenegro) to 16% (Serbia) in 2015, far below the EU-V4 average of 20%. In the CEFTA economies, FDI mainly went into services and thus did not promote manufacturing to the same extent as in the EU-CEE (see Part II above and Uvalić , 2015). However, the contribution of manufacturing to GDP increased slightly between 2010 and 2015 (except in Montenegro and Kosovo*) and a slow structural change towards higher value-added sectors (machinery and transport equipment in Macedonia and Serbia) took place, also helped by FDI in these sectors. A strong inflow of FDI into the manufacturing sector could contribute to successful structural change towards higher value-added products, as has been the case in the EU-CEE.

The manufacturing sector has been the focus for policy makers at the national and the regional level. At the national level, industrialisation strategies have been adopted in many CEFTA economies, as reviewed in the EU Commission Progress Reports (EU Commission, 2016). For example, in January 2016, the Federation of Bosnia and Herzegovina adopted an action plan for industrial policy for 2016–19, harmonised with the Reform Agenda priorities; in Macedonia, a number of strategies have been adopted, including a strategy for competitiveness; in Montenegro, the government adopted its industrial policy for the years until 2020 in June 2016. Serbia adopted several strategies with the aim of promoting sustainable development, support the development of industry, innovations, investments and competitiveness.[55] In Moldova, the Industrial Development Strategy was approved in 2016, while in Kosovo* the industrial strategy is being finalised. These programmes are in line with the results of the latest economic research, which attaches great importance to the development of the manufacturing sector.

The arguments for the vital role of manufacturing include the sector's innovativeness, high productivity compared to the economy as a whole, its contribution to the production of tradable goods, the provision of relatively highly paid jobs and its strong linkages to other parts of the economy (see Stöllinger et al., 2013).

[55] 'Strategy and policy of industrial development of Serbia 2011–2020', 'Strategy of scientific and technological development 2016–2020', 'Strategy of development of free trade zones', 'Strategy of development of IT industry'.

Manufacturing processes increasingly rely on services inputs, and therefore create the necessary demand also for the services sector to thrive. In this capacity, manufacturing is a carrier for services, many of which are barely tradable by themselves, but can be exported easily by being embedded in manufactured products. These features of manufacturing are outlined in the sections below.

III.1.2 Manufacturing: the main source of innovation and technological progress

One main argument in favour of a strong manufacturing base is that the manufacturing sector is the major source of technological progress (e.g. Aiginger and Sieber, 2006; Helper et al., 2012). Firms' business expenditure on research and development in European and non-European economies clearly supports this claim.[56] Manufacturing firms are more inclined to undertake R&D than are firms in the rest of the economy, resulting in higher shares of the sector compared to its value-added share. On average, the share of the manufacturing sector in business R&D exceeds that of the value-added share by a factor close to 4 in the EU Member States. Despite marked variations in the business R&D share of manufacturing firms in the EU, ranging from almost 90% in Germany to 29% in Estonia, it exceeds the value-added share of manufacturing in all Member States. Also in the CEFTA region, economies with a higher share of manufacturing in GDP and FDI spend more on R&D: in Serbia, R&D expenditure amounts to 0.23% of GDP (EU average: 1.3%), of which 22% is business R&D (compared to Montenegro with 0.14% of GDP, of which 7% is business R&D).

Manufacturing production facilities contribute to innovation in industries where a lot of technological progress is incremental and takes place 'on the job', in a process of learning by doing (such as machine-building). MNEs usually keep headquarter functions – and in particular R&D activities – in their home economy, but outsource manufacturing production to low-wage (or otherwise attractive) destinations, in order to reduce costs and increase productivity. But they may also outsource such activities or locate them in foreign subsidiaries. With the emergence of international value chains, the specific tasks assigned to a subsidiary have narrowed within the internationally organised production process. MNEs often follow a stepwise engagement in catching-up economies. This typically starts with rather simple production activities; if successful, it is followed by more complex activities. This way, MNEs – given their technological advantage – increase the general stock of knowledge, competences and skills (often embodied in the workforce) and institutions (including supplier networks) relevant for modern manufacturing activities that can be shared and accessed by the manufacturing sector as a whole (Pisano and Shih, 2009).

III.1.3 Manufacturing – a source of productivity growth

The most common argument for the particular significance of manufacturing – which is strongly related to the innovation argument, but is nevertheless distinct from it – is that productivity growth is higher in manufacturing than in the rest of the economy (Nordhaus, 2008). If the rate of productivity growth in manufacturing is higher than in the rest of the economy (which is very well documented in the data), it is obviously detrimental to economy-wide productivity development if the share of the manufacturing sector declines. However, this is exactly what might occur if high productivity growth in manufacturing takes place in the following environment: (i) if the institutional framework, especially the wage bargaining process, provides for a uniform increase in wages across economic sectors, and (ii) if lower prices for manufactures (which result from higher productivity growth observable, for example, in consumer electronic industries) does not induce a strong increase in demand for these products, and rising incomes lead to a reorientation of expenditure towards services. Under these conditions, so called 'unbalanced growth' will occur, which implies that the nominal share of manufacturing in GDP will decline, imposing a 'structural growth burden' on the economy. Hence, the maintenance or creation of a sufficiently large manufacturing base is an attempt to avoid the structural growth burden stemming from unbalanced growth.

Total factor productivity (TFP) growth in the manufacturing sector generally outperforms TFP growth in business services, as well as the total economy. Among EU economies, the TFP growth differential between the manufacturing sector and the total economy is particularly large in Austria and Germany, but it is also present in the service-oriented British economy. The reason for higher productivity growth in the manufacturing sector is partly

[56] www.ec.europa.eu/eurostat/web/products-datasets/product?code=rd_e_berdsize .

related to technological aspects of manufacturing, such as increasing returns to scale or externalities.

The presence of increasing returns to scale is a technological feature of the manufacturing production process that is essential in the context of multinational firms. It means that the unit cost of production declines as production increases. Firms can increase production size by splitting the production process between various locations, including small economies at various levels of development. Industries with increasing returns to scale are dominated by larger firms, which may be subject to fierce competition, but still possess important degrees of market power. This market power allows firms to charge prices that are above their unit costs, leading to higher profits. Profits drive further investments in locations where above-average returns can be achieved. In this respect, CEFTA economies are feasible locations for various stages of manufacturing production.

III.1.4 The 'carrier function' of manufactures

Manufacturing products are essentially tradable. In times of globalisation, with ever diminishing trade costs and communication costs, basically all goods and services have become internationally tradable. Nevertheless, there remain huge differences in the extent to which goods or services are really tradable. Empirical evidence suggests that the manufacturing sector produces most of the tradable goods. A large part of value added originates in service industries, such as R&D, marketing, etc. Since by themselves, these services are much less tradable, a sufficiently large manufacturing base is also essential for a wide range of service industries, whose access to foreign markets depends on manufacturing exports.

More sophisticated manufacturing products, such as smartphones, embody an ever-growing share of IT services, but there are also design and marketing services to go into the product. This implies that manufactures assume an important 'carrier function' for services. This carrier function stems from the fact that many services by themselves are less easily tradable, as evidenced by the relatively small (though growing) international inter-industry trade in services. Conventional trade statistics do not reveal these embedded services. The 'carrier function' of manufactures becomes obvious when a value-added perspective on trade flows is added to the conventional gross-flows perspective. Conventional trade statistics record exports (and imports) by industry; where the export industry is the one recording the export flow, this is the gross perspective. This view, however, masks the issue of where – in which industry – the value added that is exported was actually created. If one thinks of cars, only a part of the value added is generated in the car industry itself, with other parts of value added being generated in the rubber industry (tyres), the metal industry (car body) or the textile industry (cloth for the seats), to name just a few.[57]

According to the tradability hypothesis, economies which specialise in the production of tradable output tend to export more and run current account surpluses. While the tradability–current account nexus is far from perfect, simply because of the complexity of the current account and the multiplicity of factors affecting it, the positive relationship between countries' specialisation in tradable sectors and the current account position is robust. Therefore, the tradability of output is important for economies struggling with external imbalance, as is the case with the CEFTA economies. The positive correlation between manufacturing sector development and current account is valid also in the CEFTA region: the two CEFTA economies with the largest manufacturing sectors and the highest share of FDI in manufacturing, namely Serbia and Macedonia, have the lowest current account deficits in the region (see also Part I). Increasing the tradability of output by fostering the development of manufacturing through implementing related national strategies in other economies, too, can increase the exports of goods and embedded services and reduce the current account deficits.

III.2 Role of FDI in the CEFTA industrialisation processes

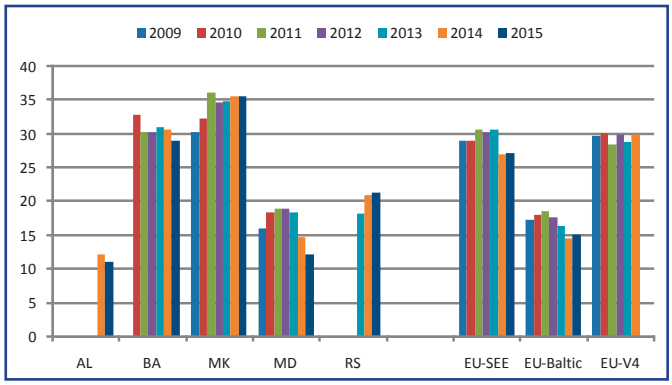
III.2.1 Regional overview of manufacturing sector FDI

The manufacturing sector's share in the FDI stock ranges from 11% in Albania and Moldova to 35% in

[57] This may lead to confusion as to the sectoral structure of manufacturing revealed in some of the economies.

Macedonia (see Figure III.1). The manufacturing sector is a less prominent target for FDI in the CEFTA economies than in the EU-V4 economies (where manufacturing accounts for about 30% of the total FDI stock).

Figure III.1 / Inward FDI stock in manufacturing, as % of total FDI stock



Notes: Based on NACE Rev. 2 classification, except for Moldova based on NACE rev. 1. No data for Montenegro and Kosovo*.

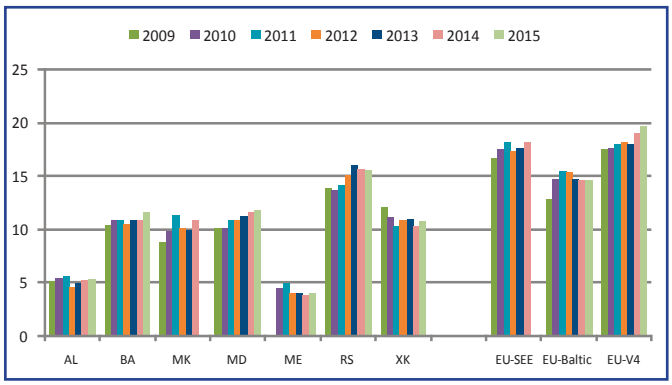
Source: CEFTA FDI database and wiiw.

The reasons for the differences in the share of manufacturing are manifold, including the first-mover advantage of the EU-V4: FDI inflow started very soon after the collapse of the communist system. Industrial skills were ubiquitous, while inefficient former publicly owned companies went out of business. In comparison, several of the CEFTA economies had a lower level of industrialisation before transition. In addition, they lost a decade due to war, sanctions and the resulting destruction and decay of industry. During this, some of the industrial skills were also lost.

Over time, the attractiveness of manufacturing to FDI remained stable in the EU-V4 economies, but fell in the other regions, including CEFTA. Among the CEFTA economies, the manufacturing sector has increased its share of FDI stocks in Macedonia and Serbia. But even in the more industrialised economies, FDI stock in manufacturing is much smaller than any of the EU-V4 economies. The manufacturing FDI stock of Serbia (EUR 5.7 billion) is similar to the EU-SEE economies of Croatia (EUR 5.8 billion) and Slovenia (EUR 4 billion). However, the figures for FDI stock as a percentage of GDP for Serbia and Macedonia are slightly higher than the level for the EU-V4 (see Figure III.1).

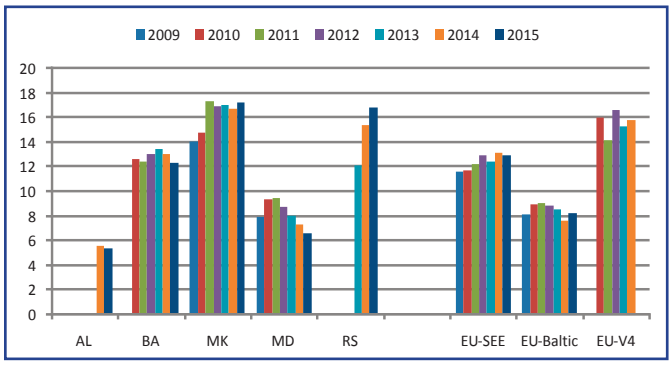
The contribution of manufacturing value added to GDP ranges from 4% in Montenegro to 16% in Serbia (see Figure III.2). Compared to the peer regions, the weight of manufacturing in the CEFTA region is smaller than in the EU-SEE (18%) and especially the EU-V4, where it is 20% on average.

Figure III.2 / Manufacturing value added, as % of GDP



Source: wiiw Annual Database, Eurostat, National Bureau of Statistics of Moldova.

Figure III. 3/ Inward FDI stock in manufacturing, as % of GDP



Source: wiiw FDI Database incorporating national bank statistics.

Comparing the share of manufacturing value added in GDP with the share of manufacturing FDI in the total FDI stock in 2015 (Figures III.2 and III.3), we find broadly similar shares for the two indicators in Moldova and the EU-Baltic economies. The FDI shares are higher (6–10 percentage points higher) in Albania, Serbia, the EU-SEE and the EU-V4, and there is even more FDI dominance (18–25 percentage points) in Bosnia and Herzegovina and Macedonia. Thus, the large FDI share in Bosnia and Herzegovina and

Macedonia has had only a small effect on industrialisation, as FDI has gone into low value-added segments of production. The relationship between the two indicators is just the opposite in the peer regions. In the EU-V4 the share of manufacturing in the FDI stock has been about 16%, but it has increased from 17% to 20% in the GDP. This may be a result of specialisation in higher value-added products and the maturing of the manufacturing FDI stock, which does not increase in absolute terms while its productivity improves.

The CEFTA economies are more similar to the EU-V4 in terms of manufacturing employment, than in terms of value added. Manufacturing employment in total employment ranges from 7% in Montenegro to 19% in Bosnia and Herzegovina and Macedonia. The largest differences between employment and value-added shares are found in the two most industrialised economies, indicating a highly labour-intensive manufacturing structure and/or lower labour productivity. This implies that more FDI is necessary, even in those CEFTA economies with a relatively high level of industrialisation, in order to improve the structure and productivity of manufacturing.

Box III.1 / Labour cost competitiveness in the CEFTA region

The CEFTA economies have relatively low wages, compared to their EU peers. Average monthly gross wages amount to between EUR 230 in Moldova and EUR 751 in Montenegro. In neighbouring Hungary, the average monthly gross wage reached EUR 846 in 2016, but in Romania it is only EUR 666. However, not only wages, but also productivity levels are important for a meaningful measure of competitiveness. Taking productivity levels into account, unit labour costs (ULC) are also lower than in neighbouring economies. Compared to the Austrian level, unit labour costs range from 21% in Kosovo* to 44% in Montenegro. Compared with the EU-SEE, only Kosovo* has lower UCL than Bulgaria and Romania, while Albania is lower than Romania. But the ULC level of Serbia, Bosnia and Herzegovina, Moldova and Montenegro is higher than that of Hungary and Slovakia. This means that most CEFTA economies have a productivity problem; productivity should increase with no wage increases, in order to improve competitiveness. Over the past five years, unit labour costs have improved (i.e. declined) for only two CEFTA economies, namely Albania and Bosnia and Herzegovina; meanwhile they have worsened (i.e. grown) for the others. However, increases have been smaller than in Romania, Hungary and Bulgaria. The average yearly unit labour cost increase was largest for Kosovo* and Bulgaria. Although the CEFTA economies have become slightly less competitive in terms of labour cost in recent years, they still provide moderate wages and unit labour costs, thus remaining attractive for FDI.

Source:wiiw database.

III.2.2 Industrial allocation of FDI and specialisation patterns

This section provides a comparison of the industry structure of manufacturing both in terms of FDI stock and in terms of the output structure in the CEFTA economies and the EU-V4. It will show whether FDI patterns are similar to output patterns, or whether there are major differences. Has FDI followed output patterns or did it go into newly emerging sectors? Analysis is limited to the three CEFTA economies for which data are available in the NACE Rev. 2 classification system: Bosnia and Herzegovina, Macedonia and Serbia.

In the CEFTA region, the highest share of manufacturing sector FDI is in the production of food, beverages and tobacco, accounting for 21% of the FDI stock in 2015 in Bosnia and Herzegovina, 17% in Macedonia and 26% in Serbia (see Table III.1). The coke and petroleum industry is a prominent target for FDI in Bosnia and Herzegovina (27%), as is the transport equipment industry in Macedonia (36%) and Serbia (11%). Rubber and non-metallic mineral products hold a large share of FDI stocks in Bosnia and Herzegovina (13%) and Serbia (12%), while basic metals and fabricated metal products have a pronounced share in Macedonia (22%), and smaller shares in Bosnia and Herzegovina and Serbia (both 7%). In comparison to the EU-V4, a strong FDI presence in the transport equipment sector (22% in EU-V4) was attained in Macedonia. On the other hand, the food industry, basic metals and fabricated metal products, and rubber and non-metallic mineral products have large FDI shares in both the EU-V4 and the CEFTA economies.

Table III.1 / Overview: inward FDI stock in manufacturing by industry, as % of manufacturing, 2015

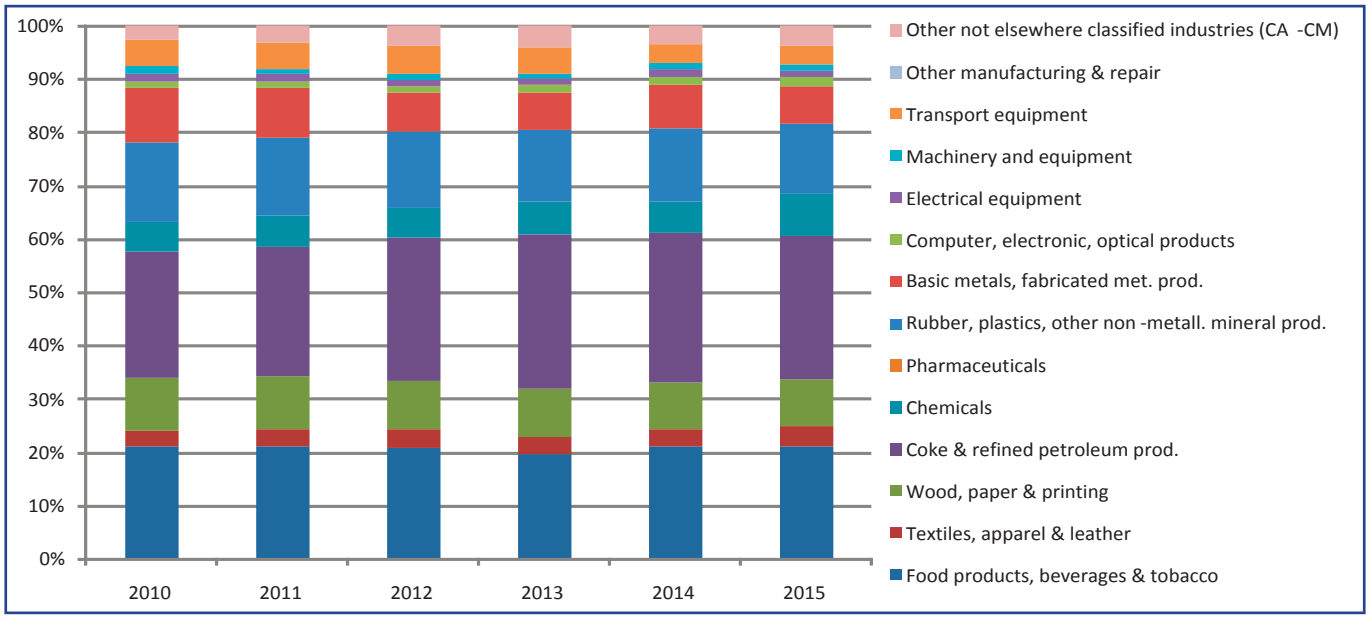
	BA	MK	RS	EU-V4
CA Food products, beverages and tobacco	21	16.8	25.9	13.2
CB Textiles, apparel, leather, related products	3.9		5.1	1.3
CC Wood and paper products and printing	8.9	0.8	3.0	6.5
CD Coke and refined petroleum products	26.9	4.7	0.6	1.5
CE Chemicals and chemical products	7.8	1.7	7.4	4.5
CF Pharmaceuticals			5.1	5.5
CG Rubber, plastics, non-metallic minerals	13.2		12.0	11.3
CH Basic metals, fabricated metals	7.1	21.6	6.7	11.5
CI Computer, electronic, optical products	1.6	1.8	0.5	4.9
CJ Electrical equipment	1.1			2.8
CK Machinery and equipment n.e.c.	1.3	0.6	2.0	5.8
CL Transport equipment	3.6	35.7	10.8	22.1
CM Other manufacturing, repair			1.1	9.2
Other not elsewhere classified	3.8	16.3	19.9	
C Manufacturing	**100.0**	**100.0**	**100.0**	**100.0**

Note: EU-V4 includes the Czech Republic (data for 2013), Hungary (data for 2014), Poland (data for 2015) and Slovakia (data for 2014).
Source: CEFTA FDI database, wiiw FDI database incorporating central bank statistics.

Bosnia and Herzegovina

There has been almost no change in Bosnia and Herzegovina either in the size or in the sectoral specialisation of manufacturing production and the FDI stock over the past five years. The three most important FDI targets in manufacturing have been the coke and refined petroleum products industry, food products, and the rubber and other non-metallic mineral products industry. They accounted for 61% of the total FDI stock in 2015 (Figure III.4). However, the wood, paper and printing industry (9%), chemicals (8%) and the production of basic metals and fabricated metal (7%) also held large shares. Smaller recipients of FDI were the textiles, apparel and leather industry (3.9%) and the transport equipment sector (3.6%).

Figure III.4 / Bosnia and Herzegovina: inward FDI stock in manufacturing by industry, as % of total manufacturing, 2010–15



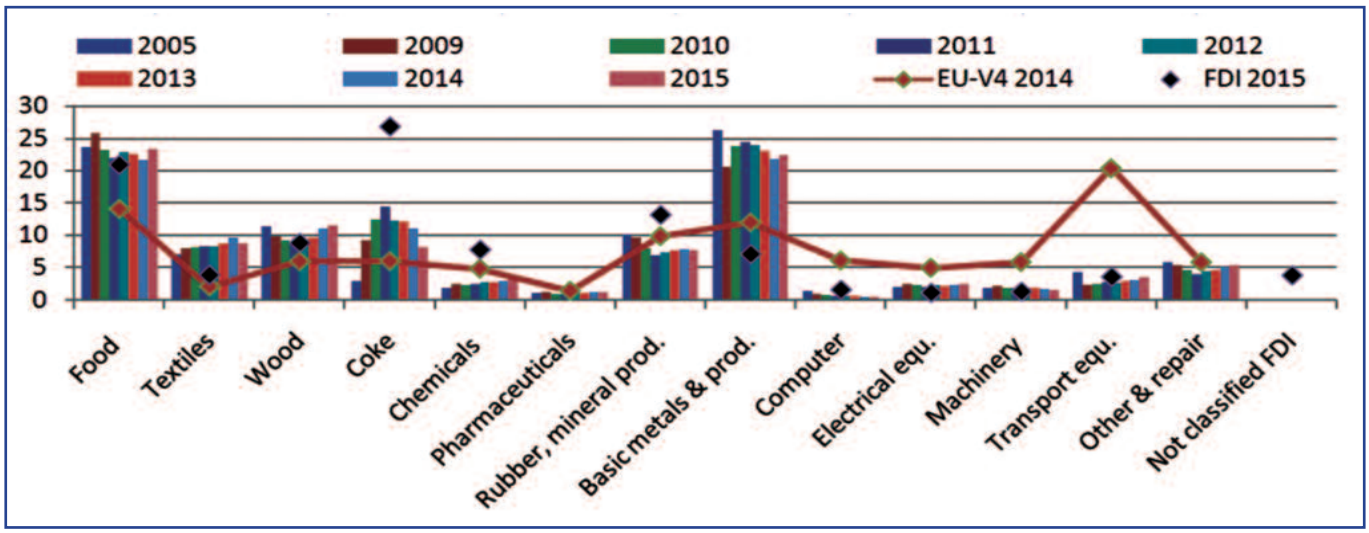
Note: No data for pharmaceuticals and other manufacturing & repair.
Source: CEFTA FDI database.

Between 2010 and 2015, the share of the food industry remained stable, at broadly 21%. Shares grew slightly for two sectors: coke and refined petroleum products and chemicals. At the same time, shares fell for basic metals, the rubber and non-metallic mineral products sector, transport equipment and the wood, paper and printing industry.

As for the output structure, a strong specialisation appears in the food industry and in basic metals and fabricated metal products (comparison with EU-V4, Figure III.5). Also, textiles, wood and the coke and petroleum industry are more pronounced in Bosnia and Herzegovina than in the EU-V4 economies. On the other hand, Bosnia and Herzegovina is not specialised in the medium-high-technology industries (computer, electrical equipment, machinery and transport equipment). The output structure remained broadly stable between 2005 and 2015.

Comparing the output to FDI patterns, both were equally dominant in the food industry (columns and dots in Figure III.5). FDI stock was also in line with the manufacturing output share in the wood industry. FDI was more prominent in the coke and petroleum industry, surpassing the manufacturing output share. FDI also had larger output shares than production in the chemicals industry and in rubber and non-metallic mineral products manufacturing. FDI was less pronounced in basic metals and fabricated metal products, and also in textiles.

Figure III.5 / Structure of manufacturing output in Bosnia and Herzegovina 2005–15, in EU-V4 in 2014 and structure of FDI in 2015 by manufacturing industry (total manufacturing = 100)



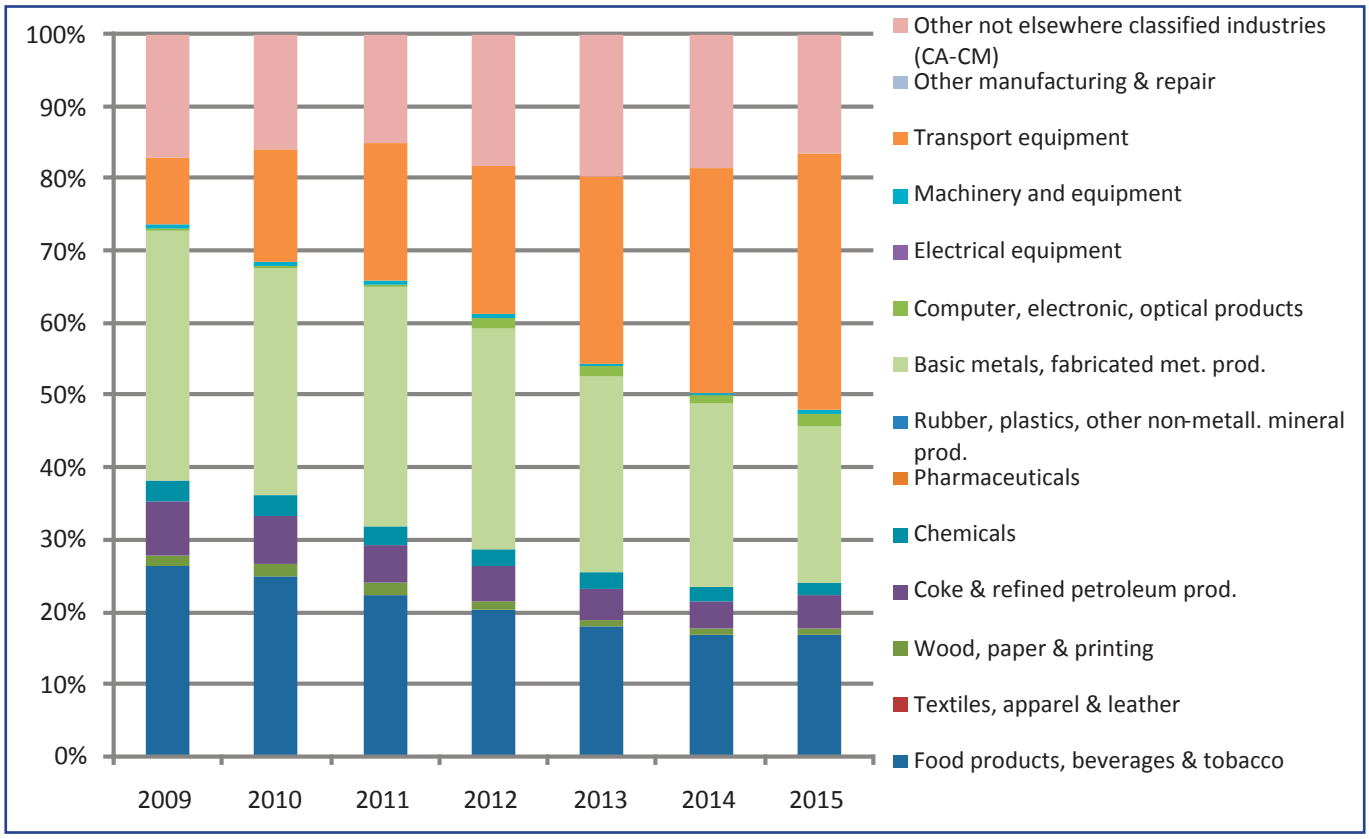
Source: National accounts based on National Statistical Institute, Eurostat, CEFTA FDI database.

Macedonia

The Macedonian manufacturing industry FDI stock is concentrated in three major sectors, accounting for 74% of total FDI stock in 2015 (Figure III.6)**: the transport equipment, basic metals and fabricated metals products, and the food industry.** The coke and petroleum products industry has received a smaller share of FDI, with 5%. One has to take into account the fact that FDI data are not available for a number of sectors; these are included in the 16% of FDI stock labelled 'other not elsewhere classified'.

FDI has shifted to higher value-added, more skill-intensive industries. The share of food products declined from 25% in 2010 to 17% in 2015, and the share of basic metals and fabricated metal products fell from 32% to 22%; meanwhile the share of the transport equipment industry increased from 16% to 36% in 2015.

Figure III.6 / Macedonia: inward FDI stock in manufacturing by industry, as % of total manufacturing, 2009–15



Note: No data for textiles, pharmaceuticals, rubber and other non-metallic mineral products, electrical equipment and other manufacturing & repair.

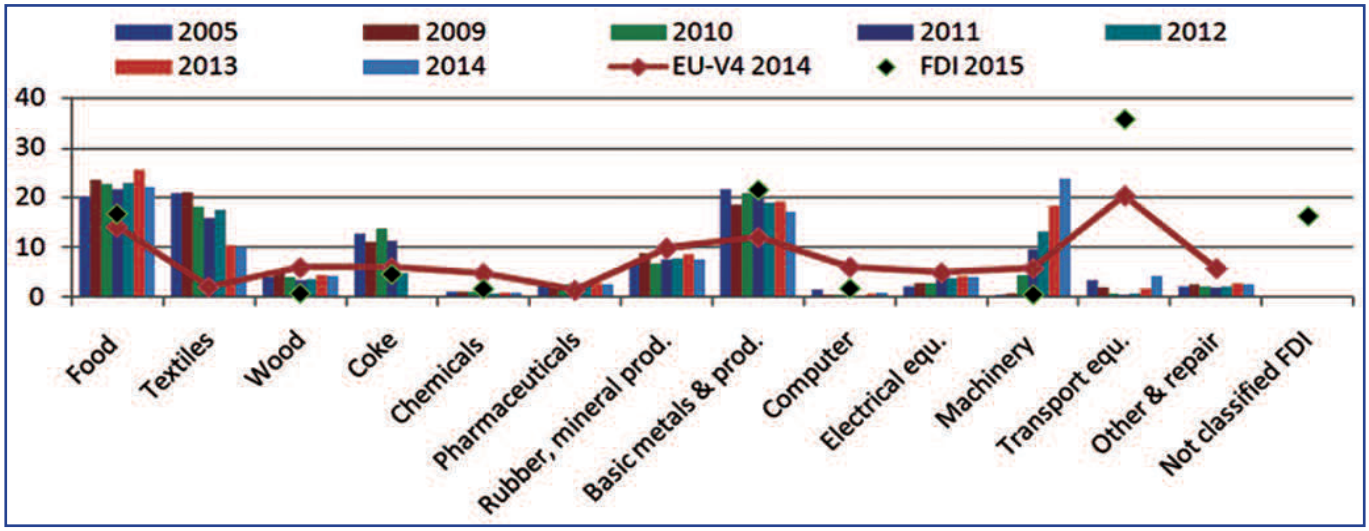
Source: CEFTA FDI database.

In terms of production, Macedonia has pronounced specialisation in the food industry, textiles, basic metals and fabricated metal products, the coke and petroleum products industry, and recently also machinery (Figure III.7). Macedonian shares are much smaller than those of the EU-V4 in the high-technology sectors, except machinery. Between 2005 and 2014, some remarkable shifts took place in the output structure, which were partly due to the sharp decline in the coke and petroleum industry. While the output share of the textiles industry dropped significantly, that of machinery increased swiftly. FDI inflow patterns have followed the manufacturing specialisation pattern in the food industry and in the basic metals and fabricated metal products sector. The large share of FDI in the transport equipment sector is not visible in the output structure, where it has a very small share. The machinery sector output share expanded rapidly between 2010 and 2014, while the FDI share is rather small – most probably on account of differences in classification (Box III.2).

Box III.2 / Which industry?

The differences between the FDI pattern (concentrated on transport equipment), output pattern (strong machinery sector) and export structure (main export sector is chemicals) can be explained by a company example. Johnson Matthey DOOEL was the largest company in Macedonia by turnover, as well as the largest exporter in 2015. The company was classified either in the chemical industry or as an automotive components producer. In fact, the UK-based company Johnson Matthey is one of the largest manufacturers of auto catalysts and has operations in more than 30 economies worldwide. It opened its emission control catalyst manufacturing plant in Macedonia in 2010 and doubled its capacity in 2012. The product is a chemical industry-based automotive component which is part of a machine.

Figure III.7 / Structure of manufacturing output in Macedonia 2005–15, in EU-V4 in 2014 and structure of FDI in 2015 by manufacturing industry (total manufacturing = 100)



Note: No FDI data for textiles, pharmaceuticals, rubber and mineral products, electrical equipment, other and repair.
Source: National accounts based on National Statistical Institute, Eurostat, CEFTA FDI database.

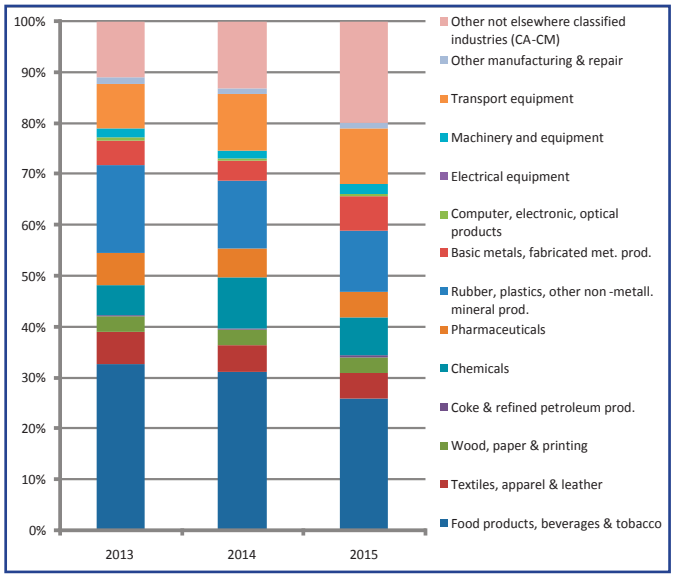
Box III.3 / Survey in the automotive sector

Foreign investors and domestic companies from the automotive sector have established the Association of the Automotive Industry within the Foreign Investors Council of Macedonia. The Association has 19 foreign members, including Van Hool from the Netherlands, Dräxlmaier of Germany and Delphi (US). In a brief survey, participating companies declared their satisfaction with the location in Macedonia. As to their cooperation pattern, they mostly trade with a small number of foreign partners, mainly with other members of the multinational group.

Serbia

In Serbia, the three main manufacturing sector FDI targets have been the food industry, rubber and other non-metallic mineral products, and the transport equipment sector, together accounting for 49% of manufacturing FDI in 2015 (Figure III.8). The concentration in the three main sectors is smaller than in the other two economies, which could be a result of the larger size and greater diversity of the manufacturing sector. Smaller shares are registered in the chemical industry and the basic metals and fabricated metal products (both 7%), and in pharmaceuticals and the textiles, apparel and leather sector (both 5%). However, the share of non-classified industries was very large in 2015, accounting for 20%. Compared to the stock in 2013, the largest growth in absolute terms was recorded in transport equipment, basic metals and fabricated metal products, with smaller growth in food products, beverages and tobacco, machinery, and wood and paper products. However, one should bear in mind that the non-classified sector showed the largest increase, partly due to preliminary data.

Figure III.8 / Serbia: inward FDI stock in manufacturing by industry, in % of total manufacturing, 2015

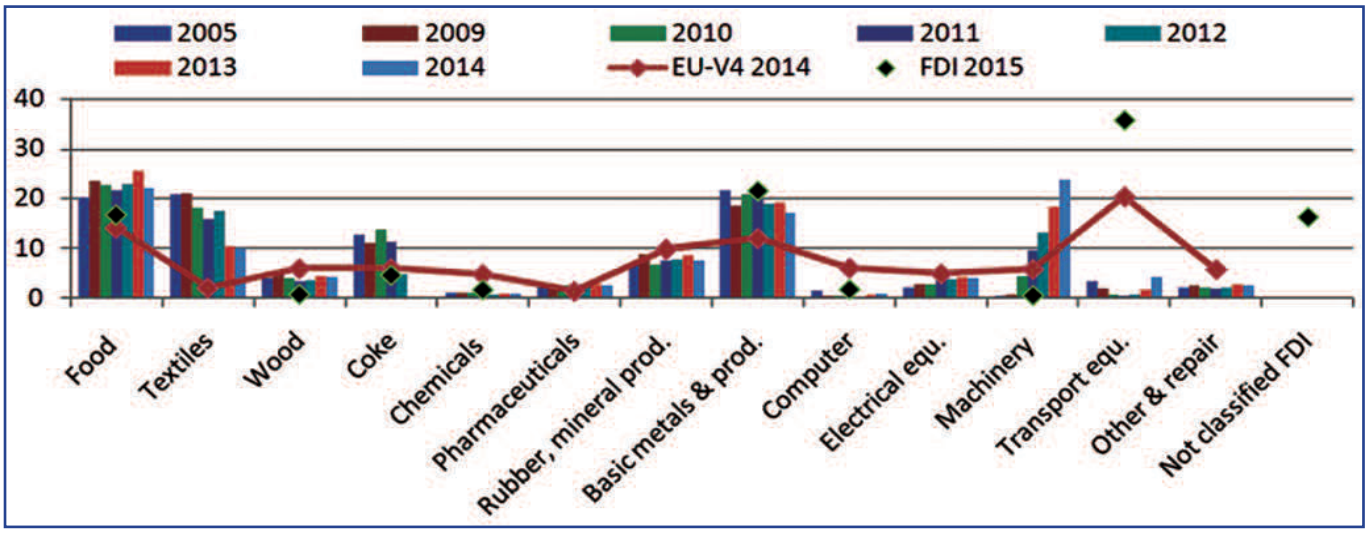


Note: No data for other manufacturing and repair.
Source: CEFTA FDI database.

The Serbian manufacturing output structure (Figure III.9) **shows a high concentration and specialisation in the food industry, with lower shares in the medium-high technology sectors, compared to the EU-V4** (computer, electrical equipment, machinery and transport equipment), although there is a growing trend in the production of transport equipment. The other sectors have broadly similar shares as in the EU-V4.

Comparison of output to the FDI stock shows that shares are similar for the food industry and textiles. The FDI share is slightly larger than the output share for chemicals, pharmaceuticals and rubber and non-metallic mineral products, but smaller for the wood industry. Recent FDI into the transport equipment sector has contributed noticeably to increasing output shares and exports.

Figure III.9 / Structure of manufacturing output in Serbia 2005–15, in EU-V4 in 2014 and structure of FDI in 2015 by manufacturing industry (total manufacturing = 100)



Note: No FDI data for other and repair.
Source: National accounts based on National Statistical Institute, Eurostat, CEFTA FDI database.

III.2.3 Industrial specialisation pattern in economies with no comparable data on FDI and output[58]

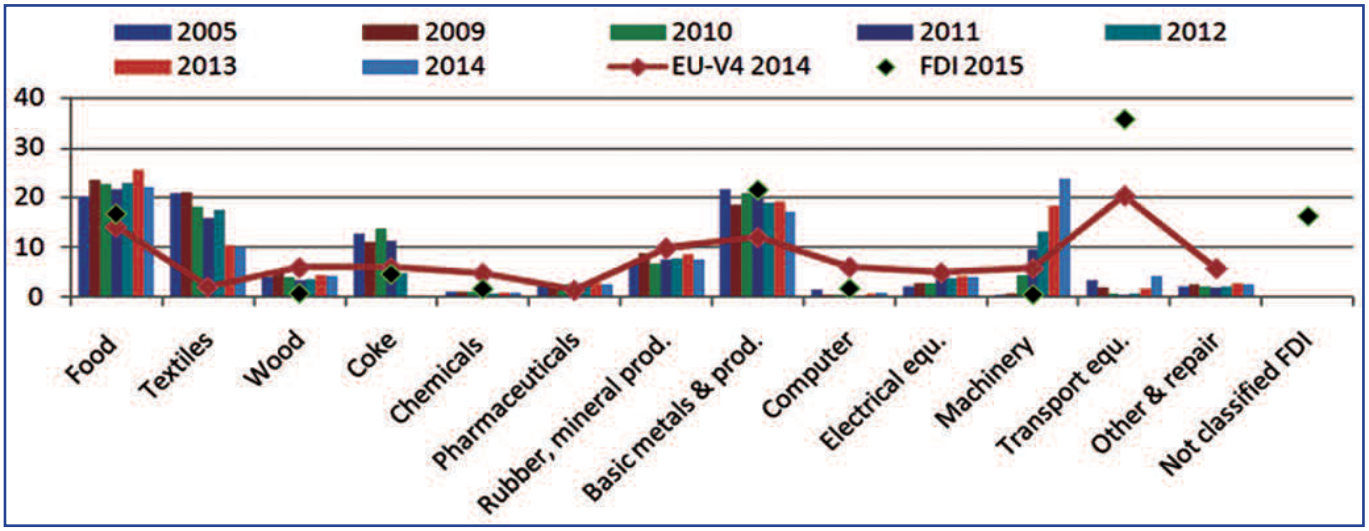
Albania

The small manufacturing FDI inward stock in Albania is heavily concentrated in one industry: the rubber and other non-metallic mineral products sector accounted for 55% of the manufacturing FDI inward stock (based on NACE Rev. 1). In 2010, a new cement plant went into operation by Antea Cement, which is 80% owned by Titan, a Greek multinational cement company. In addition, the food industry (16%) and the textile industry (13%) were main targets for FDI, while basic metals and fabricated metal products was a smaller recipient (6%). Between 2010 and 2014, the share of rubber and non-metallic mineral products gained strongly in importance, while that of textiles and of basic metals and fabricated metal products declined.

Albanian manufacturing is strongly concentrated in four industries, each accounting for about 20% of manufacturing output: food, textiles, rubber and other non-metallic mineral products, and basic metals and fabricated metal products (Figure III.10). While the food industry share is only slightly larger than that of the EU-V4 economies, the other three industries are much larger than in the EU-V4. There is no transport equipment industry in Albania. FDI stock in the food and the textiles industry is similar to the output share, while in the rubber and non-metallic mineral products sector, FDI has a larger share than in output.

[58] Different classification by NACE.

Figure III.10 / Structure of manufacturing output in Albania 2005–15, in EU-V4 in 2014 and structure of FDI in 2015 by manufacturing industry (total manufacturing = 100)



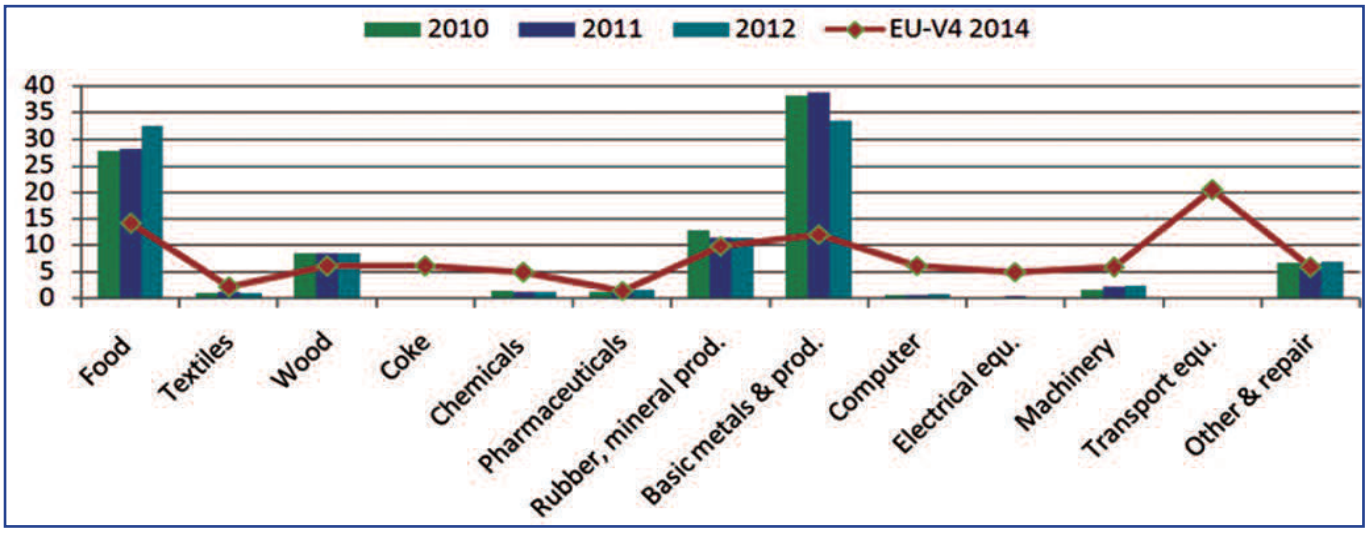
Note: C20–C21 together (chemicals and pharmaceuticals), C26–C28 together (computer, electrical equipment and machinery and equipment). Transport equipment: no enterprise activities in NACE 29–30.

Source: National accounts based on National Statistical Institute, Eurostat.

Montenegro

The share of manufacturing is very small (only 4%) in GDP and is 7% in total employment. As depicted in Figure III.11, the output structure of Montenegro's manufacturing shows a strong concentration on the basic metals and fabricated metals sector, and the food industry (both with more than 30% of manufacturing output) – also quite high in comparison with the EU-V4 economies. (Inward FDI stock is not available for detailed manufacturing industries.) The rubber and mineral products sector holds 10% of manufacturing output, which is in line with the EU-V4 output share. Major companies in the basic metals and fabricated metals sector have witnessed a difficult privatisation process, with changing foreign investors. For example, the bankrupt steel plant Željezara Nikšić was sold to a Turkish metals company in 2012. The bankrupt aluminium conglomerate Kombinat Aluminijuma Podgorica (KAP), previously owned by the Cyprus-based Central European Aluminium Company (CEAC), was sold to the local company Uniprom in 2014, thus ceasing to be a foreign affiliate.

Figure III.11 / Output structure in Montenegro in 2010–12 and EU-V4 in 2014 as % of manufacturing



Note: ESA 95. Latest available data.

Source: Monstat and national accounts based on Eurostat.

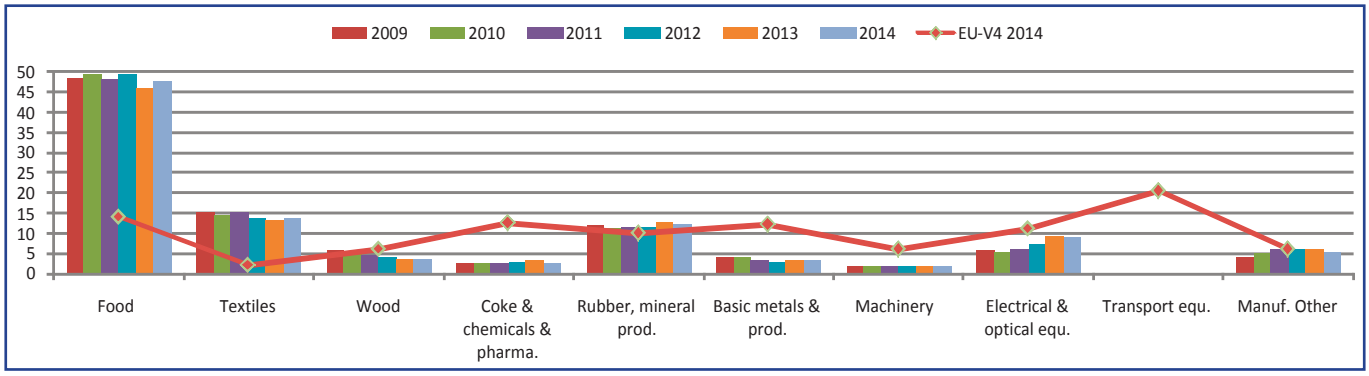
One of the few manufacturing sector foreign subsidiaries in Montenegro is a Japanese investment in the metalworking sector, Daido Metal Kotor, established on the basis of a former bearing production company in 2002.

Moldova

The share of manufacturing in total FDI inward stock reached about 19% between 2011 and 2013, but fell to 12% in 2015. (There are no data available for inward FDI stock for manufacturing industries.) In terms of importance within the economy, manufacturing accounts for 12% of both GDP and employment (2015). Manufacturing output is strongly concentrated on the food industry, with more than 45% of manufacturing output (Figure III.12). As such, it is more specialised in food than the EU-V4 economies. Other important industries are textiles, and rubber and non-metallic mineral products, with 14% and 12%, respectively in 2014. Recently the electrical and optical equipment sector has gained in importance and now reaches 9% of manufacturing output. Foreign investment is prevalent in the food sector, textiles, and also the automotive industry (which is probably reflected in the growth in the electrical and optical output share). Examples of major foreign investors include:

- Lafarge, France, cement production
- Südzucker, Germany, food production
- Dräxlmaier, Germany, automotive components
- Lear Corporation, US, automotive components

Figure III.12 / Output structure in Moldova 2010–14, EU-V4 in 2014, as % of manufacturing



Note: NACE Rev. 1
Source: National accounts based on National Statistical Institute, Eurostat.

III.2.4 Export specialisation of CEFTA economies influenced by FDI

CEFTA economies have lower trade intensities than the EU-V4. The share of exports of goods as a percentage of GDP (Table III.2) is particularly small in Kosovo* (only 6% in 2015), Albania (7.5%) and Montenegro (9%). It is larger in Moldova (23%), Bosnia and Herzegovina (24%), Macedonia and Serbia (both 34%), but still much smaller than in the EU-V4 (72% in the Czech Republic, 75% in Hungary and even 85% in Slovakia).[59]

Table III.2 / Overview of main trade indicators, 2015

	AL	BH	MK	MD	MN	SR	XK	EU-V4	
Exports of goods, as % of GDP	7.5	24.3	33.6	23.2	9.0	33.9	5.6	55.5	
Exports of services, as % of GDP	19.8	10.1	15.1	14.9	33.5	12.8	16.4	11.3	
Imports of goods, as % of GDP	29.9	50.2	53.7	55.4	49.3	45.8	41.9	53.4	
Imports of services, as % of GDP	14.6	2.9	11.3	12.9	11.7	10.6	8.5	8.8	
Inward FDI stock as % of GDP	48.7	42,6	48.6	54.3	115.8	79.0	56.0	53.0	*)
Manufacturing inward FDI stock as % of GDP	5.4	12.4	17.3	6.7		16.9		15.8	*)

[1)]Note: 1) 2014.
Source: wiiw Annual Database, relying on the balance of payments of individual economies, CEFTA FDI database.

[58] Based on BOP data

As the CEFTA economies exhibit only a small manufacturing base, their export base is small as well, and the export structure is less sophisticated and diversified than the EU-V4 economies. Exports from the CEFTA economies are characterised by a relatively large share of low- and medium-low-tech industries, while the share of medium-high and high-tech exports is rather limited. Looking at the detailed structure of exports by means of the six main export sectors in Table III.2, in Albania all six main export items are in the low- and medium-low segments; in Bosnia and Herzegovina, Montenegro and Kosovo* there are five low- and medium-low export sectors. In Macedonia, Moldova and Serbia, three of the six main export sectors are low- and medium- low-tech industries, while the other three are medium-high to high-technology industries (for classification of manufacturing industries according to technology intensity, see Annex C).

Table III.3 / Six main export industries in the CEFTA region, 2015, EUR million (NACE Rev. 2) and by technology intensity (low, medium-low, medium-high and high technology)

ALBANIA: Exports EUR million			as % of GDP
Six main export industries		1010	9.8
14	Wearing apparel (L)	324	
15	Leather and related products (L)	323	
24	Basic metals (ML)	164	
10	Food products (L)	70	
19	Coke and refined petroleum products (ML)	66	
25	Fabricated metal products (ML)	63	

BOSNIA AND NERZEGOVINA: Exports EUR million			as % of GDP
Six main export industries		2328	15.8
24	Basic metals (ML)	514	
31	Furniture (L)	453	
25	Fabricated metal products (ML)	380	
10	Food products (L)	350	
15	Leather and related products (L)	345	
28	Machinery and equipment n.e.c (MH)	285	

MACEDONIA: Exports EUR million			as % of GDP
Six main export industries		2829	31.2
20	Chemicals and chemical products (MH)	821	
24	Basic metals (ML)	534	
14	Wearing apparel (L)	476	
28	Machinery and equipment n.e.c (MH)	460	
29	Motor vehicles, trailers and semi-trailers (MH)	312	
10	Food products (L)	227	

MOLDOVA: Exports EUR million			as % of GDP
Six main export industries		1204	20.6
14	Wearing apparel (L)	397	
10	Food products (L)	218	
27	Electrical equipment (MH)	202	
11	Beverages (L)	151	
29	Motor vehicles, trailers and semi-trailers (MH)	118	
21	Basic pharmaceutical products and pharmaceutical prep (H)	117	

MONTENEGRO: Exports EUR million			as % of GDP
Six main export industries		190	5.2
24	Basic metals (ML)	90	
10	Food products (L)	27	
11	Beverages (L)	21	
16	Wood and of products of wood and cork (L)	21	
28	Machinery and equipment n.e.c (MH)	15	
19	Coke and refined petroleum products (ML)	15	

SERBIA: Exports EUR million			as % of GDP
Six main export industries		6400	18.8
29	Motor vehicles, trailers and semi-trailers	1730	
10	Food products (L)	1358	
24	Basic metals (ML)	966	
22	Rubber and plastic products (ML)	927	
27	Electrical equipment (MH)	830	
20	Chemicals and chemical products (MH)	590	

KOSOVO*: Exports EUR million			as % of GDP
Six main export industries		212	3.7
24	Basic metals (ML)	101	
10	Food products (L)	31	
22	Rubber and plastic products (ML)	24	
11	Beverages (L)	23	
25	Fabricated metal products (ML)	17	
28	Machinery and equipment n.e.c (MH)	17	

Note: Technology intensity: Low (L), medium-low (ML), medium-high (MH) and high-technology (H) intensity. For classification of manufacturing according to technology intensity, see Annex C.

Source: Eurostat Comext, UN COMTRADE

The most important low- and medium-low-technology export sectors include basic metals and food products in all CEFTA economies (only exception: basic metals exports from Moldova are small). Also, wearing apparel (Albania, Macedonia and Moldova) and leather products are quite significant (Albania, Bosnia and Herzegovina). Fabricated metal product exports are important in Albania, Bosnia and Herzegovina and Kosovo*, and rubber and plastics in Serbia and Kosovo*. Of the various economies' top six export sectors, furniture is to be found only in Bosnia and Herzegovina, and wood only in Montenegro.

The main medium-high and high-tech export industries in the CEFTA region include machinery and equipment exports from Bosnia and Herzegovina, Macedonia, Montenegro and Kosovo*. Recently motor vehicles have become the major export item in Serbia; in Macedonia it is chemical exports. In addition, chemical exports are also important for Serbia, while motor vehicles are important for Macedonia and Moldova. Electrical equipment exports are among the six main export sectors in Moldova and Serbia. The only high-tech export to feature among the six main export sectors of any of the CEFTA economies is basic pharmaceutical and pharmaceutical preparations, exported from Moldova.

Food industry, textiles and basic metals and fabricated metal products form the backbone of the CEFTA region's exports and are underpinned by FDI. On the one hand, foreign investors have taken advantage of the previous existing manufacturing base, e.g. taking part in the privatisation of steel companies or investing in the food or textiles industry. On the other hand, FDI has also gone to other sectors, such as the rubber and non-metallic mineral products industry and the chemicals sector. More recently, FDI has contributed to newly emerging export specialisation patterns in medium-high-tech industries, such as the transport equipment sector, machinery or electrical equipment. This technological upgrading is still rather slow.

III.3 CEFTA value chains

International production, trade and investments are to a large extent organised within global value chains (GVCs) where the different stages of the production process are located across different economies.[60] Globalisation motivates companies to structure their operations internationally and optimise their production processes, by locating the various stages across different sites. The significance of value chains in an economy can be broadly measured by the size of exports as a percentage of GDP and, more precisely, by the share of imported inputs in domestic production and the share of exported inputs in foreign production. As the production process has become more fragmented and distributed across economies, trade in intermediate products has increased.

The significance of GVCs for the CEFTA economies is limited, as they are only weakly to moderately integrated into international trade (see also Gabrisch et. al, 2015)**.** The availability of new input-output data covering the CEFTA economies provides an opportunity to investigate the integration patterns of the region in more detail.[61]

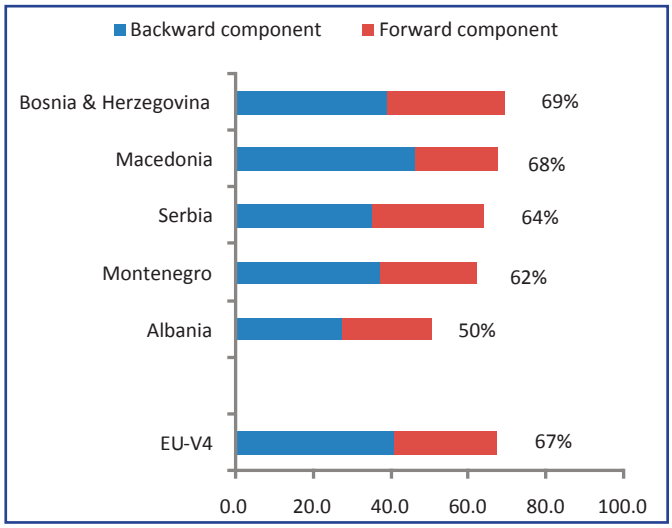
An indicator reflecting the participation of the CEFTA economies in GVCs is calculated, and this captures both backward linkages and forward linkages of the economy (see Koopman et al., 2010 and UNCTAD, 2013).[62]

[60] www.oecd.org/sti/ind/global-value-chains.htm

[61] Information in this section is based on the forthcoming wiiw European Integration Input Output Database (wiiw EUI-WIOD). These multi-country input-output tables cover 50 economies, including all 28 economies of the European Union and 15 major economies of the world. The following CEFTA economies are included: Albania, Bosnia and Herzegovina, Macedonia, Montenegro and Serbia. It provides data for the period 2008–14 and comprises 32 industries based on the NACE Rev. 2 classification system (of which 13 are manufacturing industries). The global value chain participation index put forward by Koopman et al. (2010) is used. For details see www.wiod.org

[62] For methodological details, see UNCTAD (2013). Based on this source, 'A country's exports can be divided into domestically produced value added and imported (foreign) value added that is incorporated into exported goods and services. Furthermore, exports can go to a foreign market either for final consumption or as intermediate inputs to be exported again to third countries (or back to the original country). The analysis of GVCs takes into account both foreign value added in exports (the upstream perspective), and exported value added incorporated in third-country exports (the downstream perspective).' The upstream perspective is also called the backward component, the downstream perspective – the forward component.

Figure III.13 / Relationship between GVC participation index and manufacturing FDI intensity



Source: wiiw European Integration Input Output Database (wiiw EUI-WIOD) and FDI database.

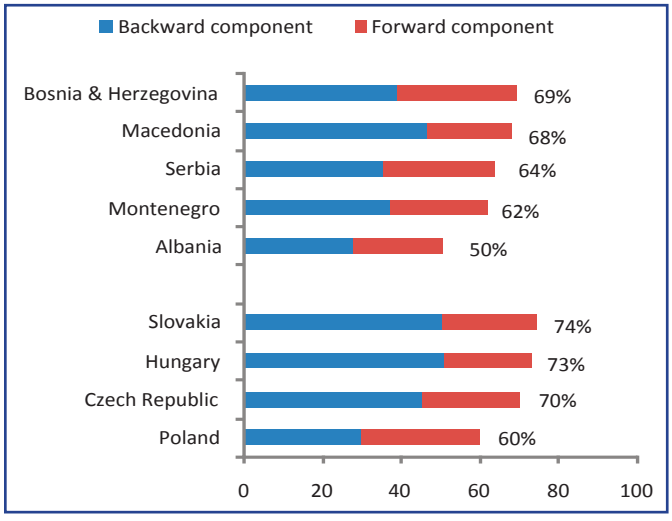
FDI and transnational corporations shape international production networks to a large extent and countries with a higher presence of FDI stock relative to the size of their economies have higher GVC participation rates. FDI tends to be 'an important avenue to gain access to GVCs' (UNCTAD, 2013). When broadly comparing the manufacturing FDI stock as a percentage of GDP and the GVC participation index in the CEFTA region, we can also find this relationship (Figure III.13): in Albania, the manufacturing FDI stock reaches only 5% of the total and the GVC rate is low, whereas in the EU-V4 (except Poland) manufacturing FDI stock as a percentage of GDP is high and so are GVC rates. The picture is less clear when we compare total FDI stock as a percentage of GDP to the GVC rates. Here the relationship is only slightly positive.

The total GVC participation index in the region is largest for Bosnia and Herzegovina and for Macedonia, somewhat smaller for Serbia and smallest for Albania (Figure III.13). The GVC indices of the CEFTA economies are smaller than in the EU-V4 economies (except for Poland, which shows a smaller GVC index). The very low GVC for Albania may be due to its low trade intensity and the dominance of mineral products in exports. The total GVC participation index suggests that Bosnia and Herzegovina and Macedonia are the most integrated in global value chains, followed by Serbia, with Albania the lowest. Between 2010 and 2014, GVC participation has risen in all economies, except Montenegro. Also trade and FDI went up in these years, which may explain the increased trade in components.

The backward component of the GVC reflects the use of intermediates as inputs and is largest in Macedonia, followed by Bosnia and Herzegovina, Montenegro, Serbia and Albania. This component is much smaller than in the Czech Republic, Hungary and Slovakia. Between 2010 and 2014 this component increased, except in Albania, Montenegro and Hungary.

The forward component of the GVC participation index reflects the supply of intermediate goods to partners, and is largest for Bosnia and Herzegovina, followed by Serbia; it is somewhat smaller for the other three CEFTA economies. Interestingly, this component is larger or about the same size as the component in the EU-V4 economies. Between 2010 and 2014, the forward component increased slightly in Albania, Montenegro and Serbia, while it remained constant in Bosnia and Herzegovina and declined in Macedonia. Also in two of the V4 economies, this component declined (Czech Republic, Slovakia), while it increased in the other two (Hungary, Poland).

Figure III.14 / GVC participation index, 2014



Source: wiiw European Integration Input Output Database (wiiw EUI-WIOD).

A larger forward component than backward component in the CEFTA region indicates that these economies are rather at the starting point of GVC participation. For the EU-V4, large backward linkages are also due to integration into more fragmented GVCs (e.g. transport equipment

sector), which have also built up recently especially in Macedonia and Serbia, helped by the more recent inflow of FDI.

The list of the 10 main partners for the backward component of the GCV participation index for individual CEFTA economies (shown in Figure III.15 (left side)) provides the following important findings (the category 'rest of the world' has been omitted here, but takes a large share):

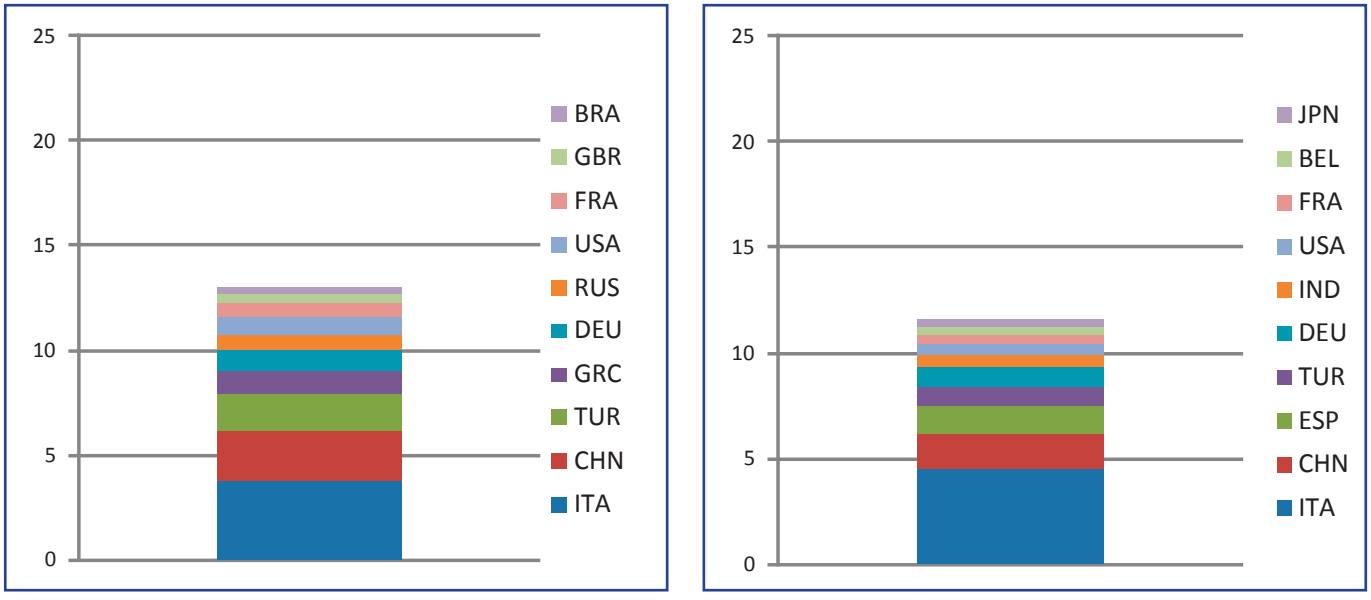
- There are some differences in the three largest partners across the economies. These are for Albania: Italy, China and Turkey; for Bosnia and Herzegovina: Russia, Croatia and Serbia; for Macedonia: Great Britain, Germany and Serbia; for Montenegro: Serbia, China and Bosnia and Herzegovina; and for Serbia: Russia, Germany and China.
- Linkages to Russia, Germany, China, Italy and Turkey are important in all economies.
- Linkages to Greece are important for Albania and Macedonia.
- Linkages within CEFTA, in fact to Serbia, are most important for Bosnia and Herzegovina, Macedonia and Montenegro.

The list of the 10 main partners for the forward component of the GCV participation index for individual CEFTA economies (shown in Figure III.15 (right side)) provides the following important findings (the category 'rest of the world' has been omitted, here but takes a large share):

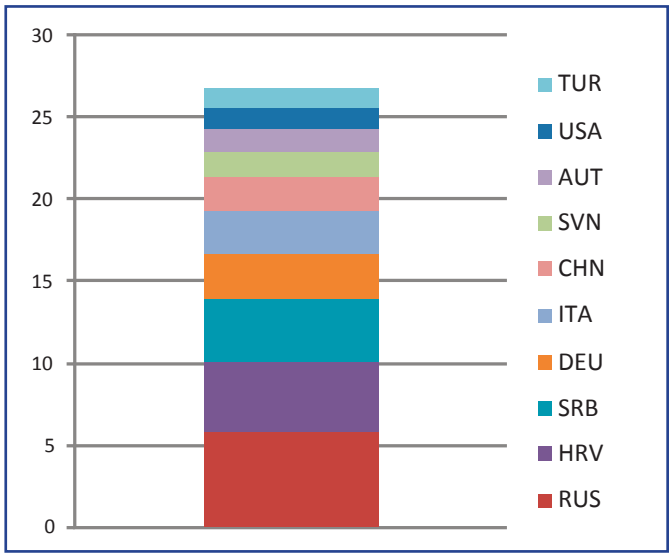
- There are slight differences in the three largest partners across economies. These are for Albania: Italy, China and Spain; for Bosnia and Herzegovina: Germany, Serbia and Croatia; for Montenegro: Serbia, China and Germany; and for Serbia: Germany, Italy and Bosnia and Herzegovina.
- For Bosnia and Herzegovina, Macedonia and Serbia (those more integrated when measured by exports as a percentage of GDP), the largest forward linkages are those to Germany.
- Linkages between CEFTA economies do matter, especially to Serbia.
- Linkages to Austria and Slovenia are also important in some CEFTA economies.
- Forward linkages to China, Italy and Turkey are important, just like backward linkages.
- There are no main forward linkages with Russia.

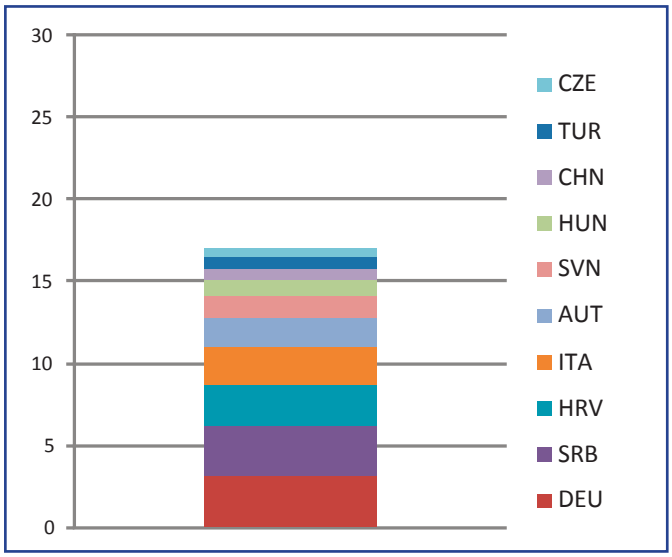
Table III.3 / Six main export industries in the CEFTA region, 2015, EUR million (NACE Rev. 2) and by technology intensity (low, medium-low, medium-high and high technology)

BACKWARD COMPONENT **Albania** **FORWARD COMPONENT**

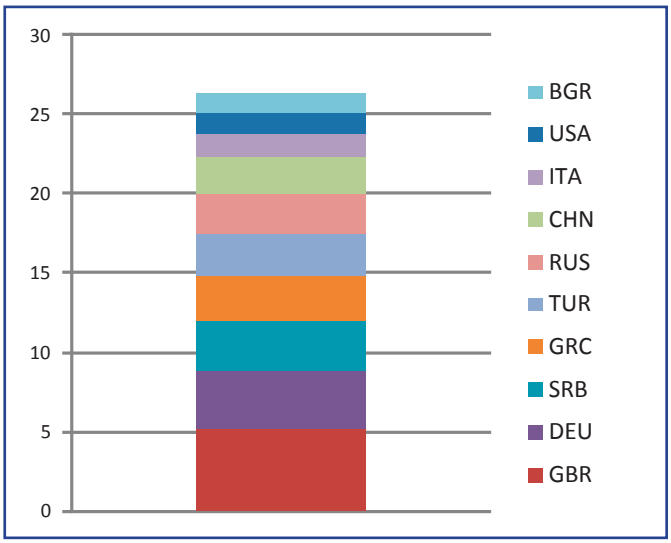


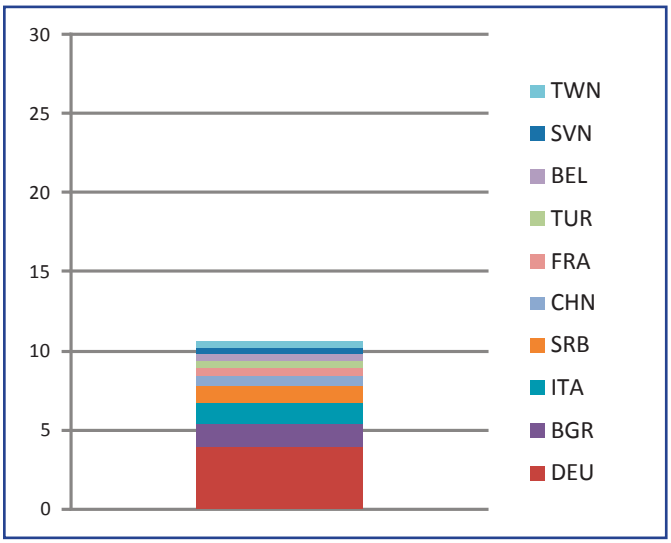
BACKWARD COMPONENT — Bosnia and Herzegovina — FORWARD COMPONENT



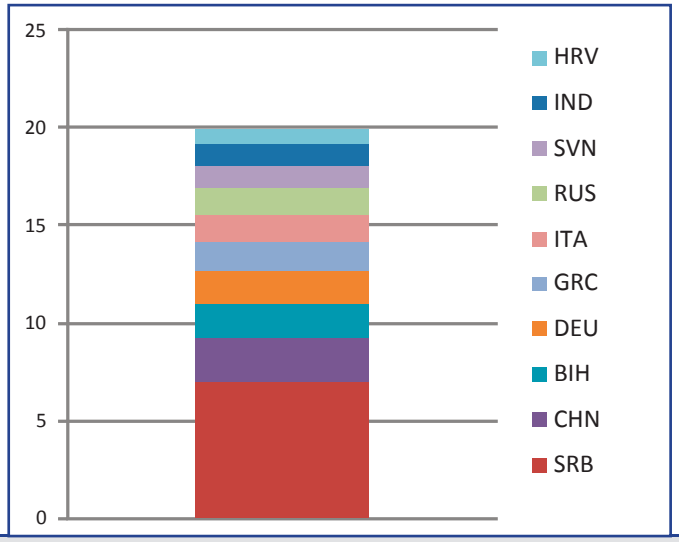


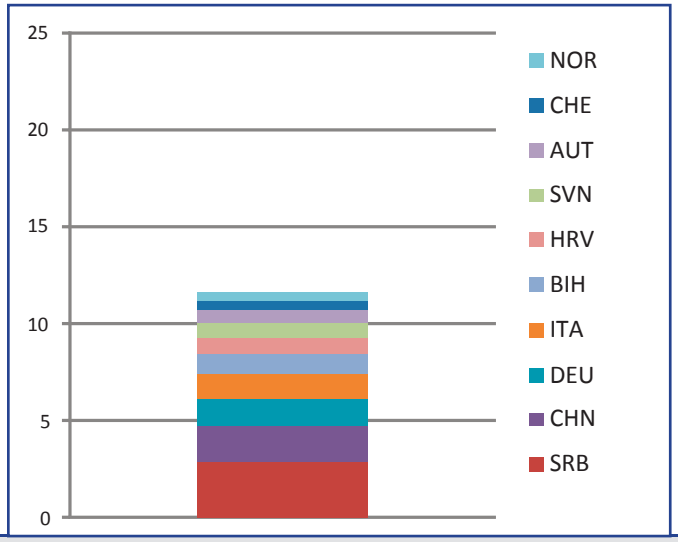
BACKWARD COMPONENT — Macedonia — FORWARD COMPONENT

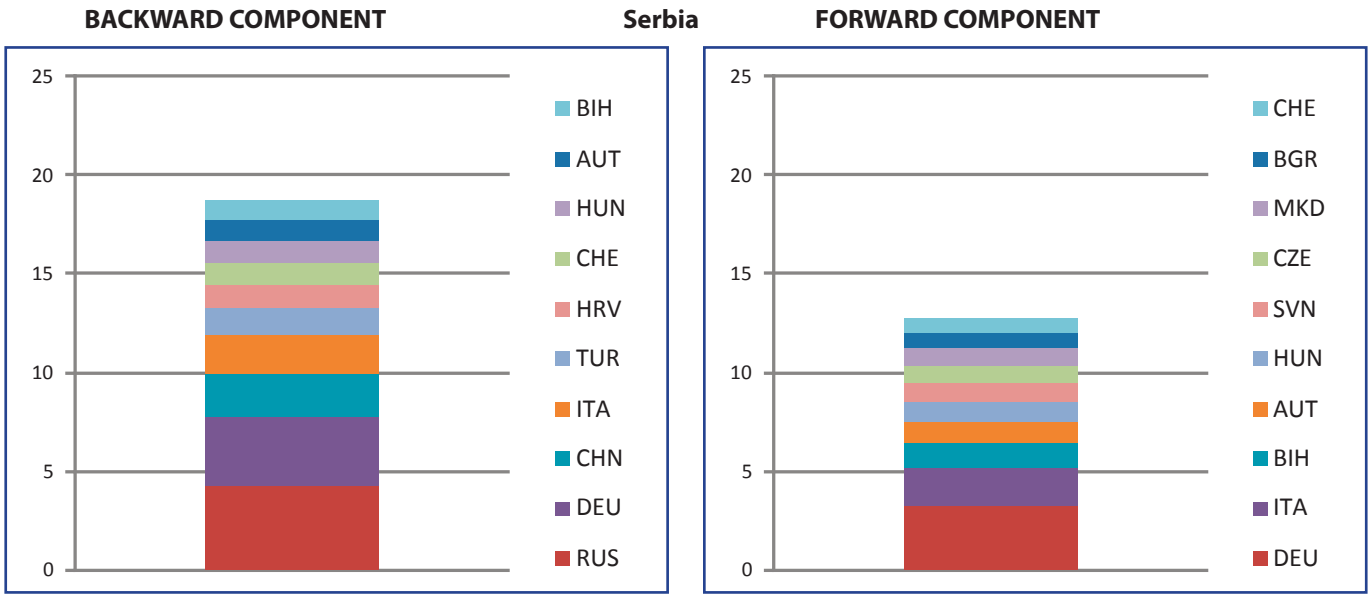




BACKWARD COMPONENT — Montenegro — FORWARD COMPONENT







Note: Category Rest of the world takes a large share but has been omitted in these graphs.
Source: wiiw European Integration Input Output Database (wiiw EUI-WIOD).

The main GVC partners are similar to the main trading partners and also to the FDI partners in the manufacturing sector that provides most of the trading goods (disregarding those investing partners that are prominent due to tax optimisation). In this context, Germany and Italy are the most prominent partners of the CEFTA economies for which data are available. Intra-regional and post-Yugoslav partners constitute another group of economies interlinked with CEFTA.

III.4 Conclusions – manufacturing sector development, value chains and future opportunities for foreign investors

Manufacturing is a major source of innovation and productivity growth, providing higher-paid jobs, creating a larger tradable sector, adding additional demand for services, and providing a carrier function for services exports. This potential is underutilised by the CEFTA economies and there is a need for reindustrialisation in most of them.

Foreign investors have taken advantage of the previous existing manufacturing base (e.g. taking part in the privatisation of steel companies, food industry, textiles), have gone to some smaller sectors (rubber and non-metallic mineral products, chemicals industry), or have shaped new specialisation patterns (slowly emerging medium-high-tech industries, such as the transport equipment sector, machinery or electrical equipment). Problems encountered in the region connected to the restructuring of heavy industry have become visible; on the other hand, so have the advantages, since the CEFTA economies are still cost competitive in terms of lower wages and unit labour costs. The inflow of FDI may lead to the creation of new specialisation patterns, but that is taking place rather slowly.

The CEFTA region is weakly to moderately integrated into international trade and production networks. Only Macedonia and Serbia have goods export/GDP shares over 30%, compared with over 70% in the Czech Republic and Hungary and over 80% in Slovakia. The total GVC participation index suggests that Bosnia and Herzegovina and Macedonia are the most integrated in global value chains, followed by Serbia and Montenegro, with Albania the lowest. There is a positive relationship between FDI stock in

manufacturing relative to GDP and GVC participation. FDI inflow into manufacturing has recently fostered integration into global supply chains. The use of intermediate products in production processes (i.e. backward linkages) as well as the supply of intermediates to partners (i.e. forward linkages) is, however, also prevalent in the CEFTA region.

Linkages among CEFTA economies do matter, especially with Serbia. Some of the links in terms of FDI, trade and GVC have been inherited from the former Yugoslavia. Linkages to Germany, Italy and Turkey, the main investors in the manufacturing sector, are also important for almost all economies, depending on their level of manufacturing sector FDI.

In the CEFTA economies, the backward component is smaller than in the EU-V4 economies, but the forward component is relatively larger. This indicates that EU-V4 economies are doing more assembly and are exporting more finished products than the CEFTA economies, which do not have this specialisation and which import and export components in a more balanced pattern.

Beyond the state of play, opportunities for further investments exist in a wide range of manufacturing activities. Foreign investors may join existing value chains/specialisation patterns utilising agglomeration effects. The food industry, together with agriculture and tourism, and the textiles industry offer just such an opportunity. This would have more local and regional focus. A further opportunity would exploit and process the ores and minerals in the region, increasing local value added in these industries. But finding niches in more sophisticated manufacturing sectors (such as the automotive industry, machinery and electronics) would also contribute to the upgrading of the production structure and facilitate trade in the longer run.

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Annex A: General data

Table A.1 Overview of main economic indicators, 2016

	Albania	Bosnia and Herzegovina	Macedonia	Moldova	Montenegro	Serbia	Kosovo*	*EU-CEE*[1)]	*EU-28*[2)]
Area, km²	28,748	51,197	25,713	33,846	13,812	88,361	10,908	1,135,090	4,422,773
GDP									
EUR bn, at ER	10.7	15	9.9	6.1	3.8	34.1	6	1,181	14,833
EUR bn, at PPP	25.1	32.1	23.7	14.3	7.9	76.9	13.8	2,094	14,833
per capita, EUR, at PPP	8,700	9,100	10,700	4,000	12,400	10,900	7,800	20,200	29,000
in %, EU-28=100	30	31	37	14	43	38	27	69.7	100
growth, 2007=100	130.2	112.2	125.5	136.8	115.9	107.5	139.1	118.7	106.3
Industrial production									
2007=100	267.3	120.1	111.3	113.6[3)]	66.1	100.4	203.5	124.3	97.5[4)]
Population									
in thousand, average	2,876	3,515	2,085	3,554	625	7,076	1,185	103,487	511,391
Employed persons, LFS									
in thousand, average	1,157	801	724	1,220	224	2,703	332	45,049	224,177
Unemployment rate, LFS									
in %	15.2	25.4	23.7	4.2	17.4	15.3	27.5	6.5	8.5
Average gross monthly wages									
EUR	334	665	533	231	751	516	463[5)]	1,058[6)]	3,067[6)]
EU-28=100	10.9	21.7	17.4	7.5	24.5	16.8	15.1	34.5[6)]	100.0[6)]
General government balance									
% of GDP	-1.8	-1	-2	-2.2	-1.6	-1.3	-1.9	-1.6[7)]	-1.7[7)]
Public debt, % of GDP	72.4	45.2	50	27.7	63.7	74	13.2	50.5[7)]	83.5[7)]
BOP items, % of GDP									
Current account	-9.6	-4.5	-3.1	-4.1	-19	-4	-9.2	0.7	2.2
Exports of goods	6.7	25.9	34.4	22.9	9.2	37.3	5.1	50.8	31.4
Imports of goods	30.9	50.5	53.2	53.4	53.1	47.5	43.4	13.2	29.4
Exports of services	22.3	10.3	14.7	15.5	33.3	13.4	17.4	13.2	12.5
Imports of services	14.9	2.9	10.6	12.4	12.9	10.8	7.9	8.8	10.9
FDI inflows, EUR mn	983	258	358	129	205	2,078	216	29,020	442,061[3)]
FDI outflows, EUR mn	24	11	4	8	-167	217	40	9,737	.
Inward FDI stock									
EUR mn	5,696	6,500	4,798	3,426	4,400	28,787	3,443	583,399	6,320,975[3)]
per capita, EUR	1,980	1,849	2,309	964	7,039	4,079	1,953	5,643	12,402[3)]
% of GDP	53.1	43.4	48.6	56.2	116.6	84.4	57.5	49.4	43.0[3)]

Notes: EU-CEE: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.
PPP: Purchasing power parity. LFS: Labour Force Survey. ER: Exchange rate.

1) wiiw calculations. 2) wiiw calculations and Eurostat. 3) 2015. 4) Working-day adjusted. 5) Average net monthly wages in public administration. 6) Gross wages plus indirect labour costs, according to national account concept. 7) EU definition.

Source: wiiw Annual Database, Eurostat, CEFTA FDI database, wiiw FDI database.

Table A.2 FDI inflow in CEFTA, EU-SEE, EU-V4 and EU-Baltic, EUR million, 2004–16

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
AL	278	213	259	481	863	962	824	755	713	945	869	890	983
BA	412	282	442	1,329	684	180	307	357	307	208	399	244	258
MK	261	77	345	506	400	145	160	344	111	252	205	217	359
MD	118	153	206	396	483	149	157	207	152	183	144	164	129
ME	53	403	496	683	656	1,099	574	401	482	337	375	630	205
RS	772	1,268	3,392	3,219	2,711	2,100	1,278	3,544	1,009	1,548	1,500	2,114	2,078
XK	43	108	295	441	370	287	369	384	229	280	151	309	256
CEFTA	*1,936*	*2,504*	*5,434*	*7,055*	*6,167*	*4,922*	*3,669*	*5,994*	*3,004*	*3,753*	*3,643*	*4,569*	*4,268*
BG	2,736	3,152	6,222	9,052	6,728	2,437	1,170	2,119	1,321	1,384	1,161	2,535	702
HR	950	1,468	2,576	3,600	3,626	2,217	871	1,217	1,162	694	2,772	244	1,577
RO	5,183	5,213	9,061	7,250	9,131	3,357	2,263	1,700	2,489	2,713	2,421	3,461	4,132
SI	665	473	513	1,106	832	-343	80	782	264	-114	791	1,465	831
EU-SEE	*9,534*	*10,305*	*18,372*	*21,009*	*20,316*	*7,668*	*4,383*	*5,818*	*5,236*	*4,677*	*7,145*	*7,705*	*7,242*
CZ	4,007	9,374	4,355	7,634	4,415	2,110	4,637	1,668	6,217	2,769	4,141	419	6,104
HU	3,439	6,172	5,454	2,852	3,087	1,289	1,232	1,557	3,942	1,926	4,989	2,058	4,226
PL	9,978	7,069	12,720	15,896	8,415	7,239	9,659	11,453	9,667	2,730	10,755	12,138	11,000
SK	2,441	1,952	3,741	2,618	3,200	-4	1,336	2,512	2,321	-455	-386	-176	-267
EU-V4	*19,865*	*24,567*	*26,271*	*29,000*	*19,117*	*10,633*	*16,864*	*17,190*	*22,147*	*6,969*	*19,498*	*14,439*	*21,063*
EE	771	2,307	1,432	1,985	1,249	1,324	1,139	723	1,218	565	455	117	787
LV	513	568	1,326	1,698	863	68	286	1,045	863	680	590	600	114
LT	623	826	1,448	1,473	1,341	-10	604	1,040	545	353	-18	785	-188
EU-Baltic	*1,906*	*3,701*	*4,206*	*5,156*	*3,453*	*1,382*	*2,029*	*2,809*	*2,626*	*1,598*	*1,027*	*1,502*	*713*

Notes: Based on BPM6 directional principle, except Moldova: BPM5;
Source: CEFTA FDI database, wiiw FDI database.

Table A.3 FDI inward stock in CEFTA, EU-SEE, EU-V4 and EU-Baltic, EUR million, 2004-2016

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
AL	614	865	1,057	1,830	2,417	2,818	3,027	4,060	3,893	4,113	4,564	5,005
BA	1,679	1,951	2,432	3,666	4,385	4,815	5,021	5,508	5,733	5,937	5,947	6,238
MK	1,610	1,769	2,099	2,545	2,969	3,141	3,256	3,615	3,686	3,980	4,024	4,400
MD	620	862	972	1,276	1,831	1,935	2,237	2,535	2,614	2,631	2,971	3,172
ME	178	580	1,076	1,759	2,414	3,514	3,167	3,253	3,567	3,729	3,990	4,197
RS	2,848	4,116	7,508	10,021	13,892	14,487	16,689	19,070	19,716	22,851	24,376	26,467
XK	.	.	.	924	1,294	1,590	1,971	2,326	2,524	2,816	2,961	3,254
CEFTA	*7,548*	*10,142*	*15,143*	*21,096*	*27,908*	*30,711*	*33,396*	*38,041*	*39,209*	*43,242*	*45,870*	*49,481*
BG	7,421	11,757	17,830	25,770	31,658	34,170	33,655	35,304	36,846	36,475	38,793	37,957
HR	9,114	12,332	20,782	30,607	20,008	22,867	23,587	21,800	22,469	21,645	23,916	23,730
RO	15,040	21,884	34,512	42,771	46,532	48,827	51,414	53,723	57,851	59,957	60,198	64,433
SI	5,580	6,134	6,822	9,765	8,598	7,828	7,983	8,880	9,249	8,897	10,202	11,565
EU-SEE	*37,154*	*52,106*	*79,947*	*108,912*	*106,796*	*113,692*	*116,639*	*119,706*	*126,415*	*126,973*	*133,109*	*137,684*
CZ	42,035	51,424	60,621	76,338	81,302	87,330	96,153	93,184	103,456	97,311	100,076	103,850
HU	45,134	51,644	60,876	65,044	62,491	68,659	67,999	66,009	78,892	78,870	81,400	76,672
PL	63,332	75,231	91,072	115,980	105,355	116,143	87,823	127,220	150,843	166,441	174,018	167,091
SK	16,068	19,968	25,517	29,058	36,226	36,469	37,665	40,173	41,780	42,072	40,969	40,129
EU-V4	*166,570*	*198,268*	*238,086*	*286,420*	*285,374*	*308,601*	*289,640*	*326,587*	*374,970*	*384,693*	*396,463*	*387,741*
EE	7,374	9,561	9,644	11,386	11,101	10,996	11,638	12,636	14,352	16,009	17,041	17,462
LV	3,324	4,159	5,702	7,466	8,126	8,072	8,184	9,360	10,258	11,570	12,311	13,545
LT	4,690	6,921	8,377	10,283	9,191	9,206	10,031	11,029	12,101	12,720	12,747	13,497
EU-Baltic	*15,388*	*20,640*	*23,723*	*29,135*	*28,417*	*28,274*	*29,853*	*33,025*	*36,711*	*40,298*	*42,099*	*44,505*

Note: BPM6 directional principle except Moldova: BPM5.
Source: CEFTA FDI database, wiiw FDI database.

Annex B: NACE Rev. 2 classification system, letter-level and 2-digit level

C MANUFACTURING

CA Manufacture of food products, beverages and tobacco

10 Manufacture of food products

11 Manufacture of beverages

12 Manufacture of tobacco products

CB Manufacture of textiles, apparel, leather and related products

13 Manufacture of textiles

14 Manufacture of wearing apparel

15 Manufacture of leather and related products

CC Manufacture of wood and paper products, and printing

16 Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials

17 Manufacture of paper and paper products

18 Printing and reproduction of recorded media

CD Manufacture of coke, and refined petroleum products

19 Manufacture of coke and refined petroleum products

CE Manufacture of chemicals and chemical products

20 Manufacture of chemicals and chemical products

CF Manufacture of pharmaceuticals, medical chemical and botanical products

21 Manufacture of basic pharmaceutical products and pharmaceutical preparations

CG Manufacture of rubber and plastic products, and other non-metallic mineral prod.

22 Manufacture of rubber and plastic products

23 Manufacture of other non-metallic mineral products

CH Manufacture of basic metals and fabricated metal product, exc. machinery and equipment

24 Manufacture of basic metals

25 Manufacture of fabricated metal products, except machinery and equipment

CI Manufacture of computer, electronic and optical products

26 Manufacture of computer, electronic and optical products

CJ Manufacture of electrical equipment

27 Manufacture of electrical equipment

CK Manufacture of machinery and equipment n.e.c.

28 Manufacture of machinery and equipment n.e.c.

CL Manufacture of transport equipment

29 Manufacture of motor vehicles, trailers and semi-trailers

30 Manufacture of other transport equipment

CM Other manufacturing, and repair and installation of machinery and equipment

31 Manufacture of furniture

32 Other manufacturing

33 Repair and installation of machinery and equipment

Annex C:Classification of manufacturing industries according to technology intensity

Based on NACE Rev. 2 at 2-digit level

High-technology:

21 Manufacture of basic pharmaceutical products and pharmaceutical preparations
26 Manufacture of computer, electronic and optical products

Medium-high-technology:

20 Manufacture of chemicals and chemical products
27 Manufacture of electrical equipment
28 Manufacture of machinery and equipment n.e.c.
29 Manufacture of motor vehicles, trailers and semi-trailers
30 Manufacture of other transport equipment

Medium-low-technology:

19 Manufacture of coke and refined petroleum products
22 Manufacture of rubber and plastic products
23 Manufacture of other non-metallic mineral products
24 Manufacture of basic metals
25 Manufacture of fabricated metal products, except machinery and equipment
33 Repair and installation of machinery and equipment

Low-technology:

10 Manufacture of food products
11 Manufacture of beverages
12 Manufacture of tobacco products
13 Manufacture of textiles
14 Manufacture of wearing apparel
15 Manufacture of leather and related products
16 Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials
17 Manufacture of paper and paper products
18 Printing and reproduction of recorded media
31 Manufacture of furniture
32 Other manufacturing

Source: Eurostat revised according to Hatzichronoglou (1997).

http://ec.europa.eu/eurostat/cache/metadata/Annexes/htec_esms_an3.pdf

Annex D: Foreign affiliates in the CEFTA region

More than 11,000 foreign affiliates are registered in the CEFTA region. They are very unevenly dispersed between economies: Albania 158, Bosnia and Herzegovina 1,247, Macedonia 1,392, Montenegro 411, Moldova 212, Serbia 7,561 and Kosovo* 92. The following tables list the foreign affiliates with the largest turnover by various characteristics, based on the UNCTAD foreign affiliates database.[63] Data refer to 2015 or the latest available year. The financial intermediation sector is not included.

Average exchange rate EUR/USD in 2006–16

2004	0.80485
2005	0.80429
2006	0.79678
2007	0.73061
2008	0.68321
2009	0.71895
2010	0.75464
2011	0.71876
2012	0.77806
2013	0.75316
2014	0.75354
2015	0.90090
2016	0.90372

[63] The SIC (US Standard Industrial Classification) code is often missing, e.g. in Serbia, the eighth largest foreign affiliate in manufacturing – Comtrade Distribution – is classified under Manufacturing of computer and office equipment (357), but should in fact be classified under Services; in Albania, Antea Cement is classified under Wholesale, but should be classified under Cement manufacturing; Johnson Matthey DOOEL Skopje, the main manufacturing affiliate in Macedonia, is classified as a Moldovan company; etc.

Top 25 foreign affiliates in the CEFTA region by turnover

Company name	Economy	Core activity (based on US SIC code)	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.
NIS AD Novi Sad	RS	Oil and gas field services	PUBLIC JOINT STOCK COMPANY GAZPROM	RU	1914648
FCA Srbija (Fiat Chrysler Automobiles)	RS	Motor vehicles and motor vehicle equipment	EXOR NV	NL	1254762
Mercator-S DOO Novi Sad	RS	Grocery stores	POSLOVNI SISTEM MERCATOR DD	SI	1008834
Delhaize Serbia DOO Beograd	RS	Grocery stores	KONINKLIJKE AHOLD DELHAIZE NV	NL	695200
HOLDINA DOO Sarajevo	BA	Metals and minerals, except petroleum, wholesale dealing in	MOL MAGYAR OLAJ-ES GAZIPARI RT	HU	636344
Idea DOO Beograd	RS	Machinery, equipment, and supplies, wholesale dealing in	AGROKOR PROJEKTI DOO	HR	524510
Yugorosgaz AD Beograd	RS	Pipelines, except natural gas	PUBLIC JOINT STOCK COMPANY GAZPROM	RU	497368
Nelt CO DOO Beograd	RS	Groceries and related products, wholesale dealing in	NEREGELIA TRADING LIMITED	CY	476396
KONZUM DOO Sarajevo	BA	Groceries and related products, wholesale dealing in	AGROKOR PROJEKTI DOO	HR	473126
EVN Makedonija Skopje AD	MK	Combination electric and gas, and other utility services	EVN AG	AT	432576
ArcelorMittal Zenica, DOO	BA	Steel works, blast furnaces and rolling and finishing	ARCELORMITTAL SA	LU	409634
Telenor DOO Beograd	RS	Communications services, not elsewhere specified	TELENOR ASA	NO	408105
Železara Smederevo DOO	RS	Steel works, blast furnaces and rolling and finishing	NEW-SILKROAD (HONG KONG) HOLDING CO. LIMITED	CN	401997
Optima Grupa DOO	BA	Metals and minerals, except petroleum, wholesale dealing in	NAFTEGAZINKOR OAO	RU	391706
Okta AD	MK	Petroleum refining	HELLENIC PETROLEUM SA	GR	353831
Tigar Tyres DOO	RS	Tires and inner tubes	COMPAGNIE GENERALE DES ETABLISSEMENTS MICHELIN (CGEM) SCA	FR	347704
OMV Srbija DOO Beograd	RS	Metals and minerals, except petroleum, wholesale dealing in	OMV AKTIENGESELLSCHAFT	AT	286937
Phoenix Pharma DOO, Beograd	RS	Drugs, drug proprietaries, and druggists' sundries, wholesale dealing in	PH VERMÖGENSVERWALTUNG GmbH	DE	285760
Lukoil Srbija AD Beograd	RS	Gasoline service stations	PUBLIC JOINT STOCK COMPANY OIL COMPANY LUKOIL	RU	285190
PETROL BH OIL COMPANY DOO Sarajevo	BA	Gasoline service stations	PETROL, SLOVENSKA ENERGETSKA DRUZBA, DD	SI	278005
Mercata DOO Beograd	RS	Machinery, equipment, and supplies, wholesale dealing in	ULTSERT TRADING LIMITED	CY	274024
Philip Morris Operations AD	RS	Miscellaneous nondurable goods, wholesale dealing in	PHILIP MORRIS INTERNATIONAL INC.	US	268123
C Market AD	RS	Grocery stores	KONINKLIJKE AHOLD DELHAIZE NV	NL	248842
Hemofarm AD Vršac	RS	Drugs	STADA ARZNEIMITTEL AG	DE	244791

Top 10 foreign affiliates in Albania by turnover

Company name	Core activity	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.	Number of employees
Vodafone Albania	Electrical goods, wholesale dealing in	VODAFONE GROUP PUBLIC LIMITED COMPANY	GB	125345	
Taci Oil	Crude petroleum and natural gas	COSTIERI GENOVEZI PETROLIFERI	IT	114386	
Telekom Albania	Machinery, equipment, and supplies, wholesale dealing in	DEUTSCHE TELEKOM AG	DE	91802	
Philip Morris Albania	Miscellaneous nondurable goods, wholesale dealing in	PHILIP MORRIS SA	US	84160	
Albtelecom	Miscellaneous special trade contractors	CETEL TELEKOM ILETISIM SANAYI VE TICARET ANONIM SIRKETI	TR	80841	862
Everest Oil	Machinery, equipment, and supplies, wholesale dealing in	ESTROSA SOCIETA' PER AZIONI	IT	55275	6
Trema Engineering 2	Miscellaneous special trade contractors	STRABAG SE	AT	54558	416
Antea Cement	Machinery, equipment, and supplies, wholesale dealing in	TITAN CEMENT COMPANY SA	GR	47071	192
GEN - I Tirana	Commercial fishing	GEN ENERGIJA DOO	SI	42659	
ARMO	Machinery, equipment, and supplies, wholesale	HEANEY ASSETS CORP	AZ	32797	1200

Top 10 foreign affiliates in Bosnia and Herzegovina by turnover

Company name	Core activity	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.	Number of employees
HOLDINA DOO Sarajevo	Metals and minerals, except petroleum, wholesale dealing in	MOL MAGYAR OLAJ-ES GAZIPARI RT	HU	636344	409
KONZUM DOO Sarajevo	Groceries and related products wholesale dealing in	AGROKOR PROJEKTI DOO	HR	473126	4154
ArcelorMittal Zenica, DOO	Steel works, blast furnaces and rolling and finishing	ARCELORMITTAL SA	LU	409634	2545
Optima Grupa DOO	Metals and minerals, except petroleum, wholesale dealing in	NAFTEGAZINKOR OAO	RU	391706	128
PETROL BH OIL COMPANY DOO Sarajevo	Gasoline service stations	PETROL, SLOVENSKA ENERGETSKA DRUZBA, DD	SI	278005	209
Philip Morris BH DOO Sarajevo	Miscellaneous nondurable goods, wholesale dealing in	PHILIP MORRIS INTERNATIONAL INC.	US	152733	35
Adista BH DOO	Miscellaneous nondurable goods, wholesale dealing in	BRITISH AMERICAN TOBACCO PLC	GB	152286	120
MERCATOR BH DOO Sarajevo	Grocery stores	POSLOVNI SISTEM MERCATOR DD	SI	146335	1655
GLOBAL ISPAT KIL DOO Lukavac	Miscellaneous products of petroleum and coal	GLOBAL STEEL HOLDINGS LIMITED	GB	142098	958
Nelt DOO	Groceries and related products, wholesale dealing in	NEREGELIA TRADING LIMITED	CY	111647	241

Top 10 foreign affiliates in Macedonia by turnover

Company name	Core activity	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.	Number of employees
EVN Makedonija Skopje AD	Combination electric and gas, and other utility services	EVN AG	AT	432576	2040
Okta AD	Petroleum refining	HELLENIC PETROLEUM SA	GR	353831	419
Makedonski Telekom AD	Communications services, not elsewhere specified	DEUTSCHE TELEKOM AG	DE	189598	1335
ArcelorMittal (CRM) AD	Miscellaneous primary metal products	ARCELORMITTAL SA	LU	107103	471
Van Hool Makedonija Ilinden DOOEL	Motor vehicles and motor vehicle equipment	IMMOROC	BE	103951	668
Veropulos DOOEL	Grocery stores	VERO A E HOLDING	GR	74643	870
Cementarnica Usje AD	Cement, hydraulic	TITAN CEMENT COMPANY SA	GR	73035	301
Buchim Radovish DOO	Miscellaneous metal ores	SOLVEJ INDASTRIS SENT VINSENT	GB	62621	706
Sokotab DOOEL Bitola DOOEL	Miscellaneous nondurable goods, wholesale dealing in	SOKOTAB FRANA S A ZHENEVA	CH	51423	535
Imperial Tobako TKS Skopje AD	Cigarettes	IMPERIAL BRANDS PLC	GB	46001	223

Top 10 foreign affiliates in Moldova by turnover

Company name	Core activity	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.	Number of employees
Petrom-Moldova SA ICS	Gasoline service stations	OMV AKTIENGESELLSCHAFT	AT	64040	59
RomPetrol Moldova SA IM	Metals and minerals, except petroleum, wholesale dealing in	NATIONAL COMPANY KAZMUNAYGAZ JSC	KZ	64040	502
Sudzucker Moldova SA Alexandreni-zahar	Sugar and confectionery products	SÜDZUCKER AG	DE	52950	540
Moldcell SA IM	Communications services, not elsewhere specified	TELIA COMPANY AB	SE	50869	324
MoldovaGaz SA	Gas production and distribution	PUBLIC JOINT STOCK COMPANY GAZPROM	RU	50869	185
Red Union Fenosa SA ICS	Combination electric and gas, and other utility services	GAS NATURAL SDG, SA	ES	50869	637
Orange Moldova SA IM	Communications services, not elsewhere specified	ORANGE	FR	50869	767
LUKOIL-Moldova SRL	Gasoline service stations	PUBLIC JOINT STOCK COMPANY OIL COMPANY LUKOIL	RU	50869	244
Metro Cash & Carry Moldova SRL ICS magazin Chisinau 1	Machinery, equipment, and supplies wholesale dealing in	METRO AG	DE	50869	643
Lear Corporation SRL ICS	Miscellaneous fabricated textile products	LEAR CORP	US	48030	1458

Top 10 foreign affiliates in Montenegro by turnover

Company name	Core activity	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.	Number of employees
Jugopetrol AD	Metals and minerals, except petroleum, wholesale dealing in	HELLENIC PETROLEUM SA	GR	149724	130
Mercator-Cg	Department stores	POSLOVNI SISTEM MERCATOR DD	SI	121519	1314
Crnogorski Telekom AD	Communications services, not elsewhere specified	DEUTSCHE TELEKOM AG	DE	107505	588
Telenor	Communications services, not elsewhere specified	TELENOR ASA	NO	75579	218
Neregelia	Drugs, drug proprietaries, and druggists' sundries, wholesale dealing in	NEREGELIA TRADING LIMITED	CY	61350	171
Rudnik Uglja AD	Bituminous coal and lignite mining	A2A SPA	IT	59943	
Mtel	Communications services, not elsewhere specified	TELEKOM SRBIJA AD BEOGRAD	RS	45357	226
Lukoil Montenegro DOO	Gasoline service stations	PUBLIC JOINT STOCK COMPANY OIL COMPANY LUKOIL	RU	33808	132
China Road & Bridge Corporation DOO - DIO Stranog Društva Podgorica	Heavy construction, except highway and street construction	CHINA ROAD AND BRIDGE CORPORATION	CN	32699	421
Trebjesa	Beverages	MOLSON COORS BREWING CO	US	31468	259

Top 5 foreign affiliates in Kosovo* by turnover

Company name	Core activity	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.	Number of employees
Futura Plus DOO Beog -Predstav. Mit.	Machinery, equipment, and supplies wholesale dealing in	PROPERTY PLUS ESTABLISHMENT	LI	12963	970
Sharr Beteiligungs GmbH SHPK	Cement, hydraulic	THE TITAN GROUP OF COMPANIES LIMITED	GB	12688	719
Newco Ferronikeli Complex LLC	Iron and steel foundries	BSG RESOURCES LIMITED	GB	11998	1000
Sharrcem SHPK	Cement, hydraulic	TITAN CEMENT COMPANY SA	GR	11033	503
Grand Casino	Miscellaneous amusement and recreation services	PORTMANTEAU INVESTMENT LTD	IL	1696	80

Top 20 foreign affiliates in Serbia by turnover

Company name	Core activity	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.	Number of employees
NIS AD Novi Sad	Oil and gas field services	PUBLIC JOINT STOCK COMPANY GAZPROM	RU	1914648	
FCA Srbija	Motor vehicles and motor vehicle equipment	EXOR NV	NL	1254762	3338
Mercator-S DOO Novi Sad	Grocery stores	POSLOVNI SISTEM MERCATOR DD	SI	1008834	8723
Delhaize Serbia DOO Beograd	Grocery stores	KONINKLIJKE AHOLD DELHAIZE NV	NL	695200	7801
Idea DOO Beograd	Machinery, equipment, and supplies, wholesale dealing in	AGROKOR PROJEKTI DOO	HR	524510	3290
Yugorosgaz AD Beograd	Pipelines, except natural gas	PUBLIC JOINT STOCK COMPANY GAZPROM	RU	497368	24
Nelt Co. DOO Beograd	Groceries and related products, wholesale dealing in	NEREGELIA TRADING LIMITED	CY	476396	1620
Telenor DOO Beograd	Communications services, not elsewhere specified	TELENOR ASA	NO	408105	882
Železara Smederevo DOO	Steel works, blast furnaces and rolling and finishing	NEW-SILKROAD (HONG KONG) HOLDING CO. LIMITED	CN	401997	5037
Tigar Tyres DOO	Tires and inner tubes	COMPAGNIE GENERALE DES ETABLISSEMENTS MICHELIN (CGEM) SCA	FR	347704	2825
OMV Srbija DOO Beograd	Metals and minerals, except petroleum, wholesale dealing in	OMV AKTIENGESELLSCHAFT	AT	286937	46
Phoenix Pharma DOO, Beograd	Drugs, drug proprietaries, and druggists' sundries, wholesale dealing in	PH VERMÖGENSVERWALTUNG GmbH	DE	285760	382
Lukoil Srbija AD Beograd	Gasoline service stations	PUBLIC JOINT STOCK COMPANY OIL COMPANY LUKOIL	RU	285190	155
Mercata DOO Beograd	Machinery, equipment, and supplies, wholesale dealing in	ULTSERT TRADING LIMITED	CY	274024	308
Philip Morris Operations AD	Miscellaneous nondurable goods, wholesale dealing in	PHILIP MORRIS INTERNATIONAL INC.	US	268123	602
C Market AD	Grocery stores	KONINKLIJKE AHOLD DELHAIZE NV	NL	248842	3267
Hemofarm AD Vrsac	Drugs	STADA ARZNEIMITTEL AG	DE	244791	2157
Tetra PAK Production DOO Beograd	Paperboard containers and boxes	TETRA LAVAL HOLDINGS BV	NL	236584	189
VIP Mobile	Communications services, not elsewhere specified	AMÉRICA MÓVIL SAB DE CV	MX	232948	995
Metro Cash & Carry DOO, Beograd	Groceries and related products, wholesale dealing in	METRO AG	DE	228190	1371

Top 10 of the 240 foreign affiliates in the food, beverages, tobacco sector (US SIC codes 201–211)

Company name	CEFTA economy	Core activity	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.	Number of employees
Sunoko DOO Novi Sad	RS	Sugar and confectionery products	AGRI HOLDING AG	CH	132343	490
Frikom DOO Beograd	RS	Dairy products	LEDO DIONIČKO DRUŠTVO	HR	108075	960
Nestle Adriatic S	RS	Miscellaneous food preparations	NESTLE SA	CH	103106	679
Soko Štark DOO Beograd	RS	Bakery products	ATLANTIC GRUPA DD	HR	92770	993
Marbo Product DOO, Beograd	RS	Miscellaneous food preparations	PEPSICO INC.	US	90859	943
Carlsberg Srbija DOO Čelarevo	RS	Beverages	CARLSBERG A/S	DK	83660	539
DOO Konzul Novi Sad	RS	Grain mill products	AMEROPA HOLDING AG	CH	80549	68
Grand Prom DOO Beograd	RS	Miscellaneous food preparations	ATLANTIC GRUPA DD	HR	74522	235
Heineken Srbija DOO Zaječar	RS	Beverages	HEINEKEN NV	NL	69223	267
CRVENKA Fabrika Secera AD	RS	Sugar and confectionery products	HELLENIC SUGAR INDUSTRY SA	GR	69045	197

Top 10 of the 98 machinery production foreign affiliates (US SIC codes 351–356)

Company name	CEFTA economy	Core activity	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.	Number of employees
Grundfos Srbija DOO	RS	General industrial machinery and equipment	GRUNDFOS HOLDING AS	DK	107030	366
Daido Metal	ME	General industrial machinery and equipment	DAIDO METAL CO. LTD	JP	13505	185
Rapp Zastava DOO Kragujevac	RS	Metalworking machinery and equipment	NORD II AS	NO	13206	143
Albon DOO Šimanovci	RS	Engines and turbines	ALBON ENGINEERING AND MANUFACTURING	GB	13148	68
Muehlbauer Technologies DOO	RS	Special industry machinery, except metalworking	MÜHLBAUER HOLDING AG	DE	13051	138
Metech	RS	Metalworking machinery and equipment	METECHCO	BE	12068	250
De Rigo Refrigeration DOO	RS	General industrial machinery and equipment	DE RIGO HOLDING SRL	IT	11452	98
Wacker Neuson Kragujevac	RS	Construction, mining machinery and equipment	WACKER NEUSON SE	DE	11350	254
GS-TMT DOO Travnik	BA	Metalworking machinery and equipment	GLOBAL SOURCING TECHNISCHE PRODUKTE GmbH	DE	10838	202
NN DOO Konjic	BA	General industrial machinery and equipment	NN INC	US	10458	177

Top 10 of the 100 electrical machinery foreign affiliates (US SIC code 357–369)

Company name	CEFTA economy	Core activity	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.	Number of employees
Gorenje DOO Valjevo	RS	Household appliances	GORENJE APARATI DD	SI	190301	1411
Comtrade Distribution	RS	Computer and office equipment	COMTRADE GROUP BV	NL	169196	128
Yura Corporation DOO Rača	RS	Miscellaneous electrical machinery	YURA CO., LTD	KR	152006	5199
Robert Bosch DOO Beograd	RS	Miscellaneous electrical machinery	ROBERT BOSCH INDUSTRIETREUHAND Kommanditgesellschaft	DE	90580	532
Kromberg Shubert	MK	Miscellaneous electrical machinery	KROMBERG AMP SHUBERT HOLDING FN 202181 9999	AT	86751	2265
VISTEON ELEKTRONIKS DOOEL SKOPJE	MK	Miscellaneous electrical machinery	VIHI LLC AD	US	72796	227
TF Kable FKZ DOO Zaječar	RS	Electronic components and accessories	TELE-FONIKA KABLE SA	PL	65503	392
Drekslmajer Manufakturing DOOEL	MK	Miscellaneous electrical machinery	FRITZ DRÄXLMAIER HOLDING GmbH	DE	55189	5730
Saga DOO Beograd	RS	Computer and office equipment	NEW FRONTIER SOUTH EAST, SRO	SK	51297	273
Kim-Tec DOO Beograd	RS	Computer and office equipment	M SAN GRUPA DIONIČKO DRUŠTVO	HR	47367	67

Top 10 of the 55 foreign affiliates in motor vehicles and motor vehicle equipment production (US SIC code 157)

Company name	CEFTA economy	Core activity	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.	Number of employees
FCA Srbija	RS	Motor vehicles	EXOR NV	NL	1254762	3338
Van Hool Makedonija Ilinden DOOEL	MK	Motor vehicles	IMMOROC	BE	103951	668
Johnson Controls Automotive	RS	Motor vehicles	JOHNSON CONTROLS INTERNATIONAL PLC	IE	77820	171
TMD Ai DOO	BA	Motor vehicles	CIMOS DD AVTOMOBILSKA INDUSTRIJA	SI	70192	410
Livnica Kikinda Al DOO	RS	Motor vehicles	CIMOS DD AVTOMOBILSKA INDUSTRIJA	SI	40588	854
Jcmm Automotive	RS	Motor vehicles	EXOR NV	NL	34062	152
Streit Nova DOO	RS	Motor vehicles	MEITA	TW	33946	304
Magneti Marelli DOO	RS	Motor vehicles	EXOR NV	NL	30059	154
VOLKSWAGEN SARAJEVO	BA	Motor vehicles	PORSCHE AUTOMOBIL HOLDING SE	DE	25188	245
Knott-Autoflex YUG DOO	RS	Motor vehicles	AUTÓFLEX-KNOTT KFT	HU	19773	213

Top 20 of the 405 foreign affiliates in computer programming, data processing, and other computer related services (US SIC code 737)

Company name	CEFTA economy	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.	Number of employees
RRC DOO Beograd	RS	TIANJIN TIANHAI INVESTMENT CO., LTD.	CN	43827	40
Asseco SEE DOO Beograd	RS	ASSECO POLAND SA	PL	36118	474
Comtrade System Integration	RS	COMTRADE GROUP BV	NL	33710	132
Microsoft Software DOO Beograd	RS	MICROSOFT CORP.	US	20941	125
Schneider Electric DMS NS DOO	RS	SCHNEIDER ELECTRIC ESPANA SA	ES	20870	851
Atos IT Solutions and Services	RS	ATOS SE	FR	17907	112
Komtrejd Distribucija Skopje DOOEL	MK	COMTRADE GROUP BV	NL	17275	21
Društvo za Informatičku Tehnologiju Seavus DOOEL	MK	SEAVUS GROUP HOLDING BV	NL	13180	366
Oracle DOO Beograd	RS	ORACLE CORP	US	11089	20
S&T Serbia DOO Beograd	RS	HON HAI PRECISION INDUSTRY CO., LTD.	TW	10831	79
IBM-International Business Machines	RS	INTERNATIONAL BUSINESS MACHINES CORP.	US	10596	66
ORACLE BH DOO, Sarajevo	BA	ORACLE CORP	US	9709	14
KING ICT DOO Sarajevo	BA	KING ICT DOO	HR	9346	21
Nites DOO	BA	NE&ES HOLDING AB SUNDSVALL	SE	8723	47
ComTrade DOO Sarajevo	BA	HERMES SOFTLAB DOO	SI	6556	108
S&T Makedonija Skopje DOOEL	MK	S&T SLOVENIJA INFORMACISKI RESHENIJA I USLUGI	SI	6167	33
GL Trade Software DOO Beograd	RS	SUNGARD DATA SYSTEMS INC	US	5847	153
TeleSign DOO Beograd	RS	TELESIGN MOBILE LIMITED	GB	5531	142
Netcetera Eksport Import Skopje DOOEL	MK	NETCETERA AG	CH	4817	122
Huawei Technologies DOO	BA	HUAWEI INVESTMENT & HOLDING CO., LTD	CN	4243	12

Top 20 of the 322 foreign affiliates in transportation services (US SIC codes 401–478)

Company name	CEFTA economy	Core activity	Name of ultimate owner	Country of owner	Operating revenue (turnover) USD th.	Number of employees
Yugorosgaz AD Beograd	RS	Pipelines, except natural gas	PUBLIC JOINT STOCK COMPANY GAZPROM	RU	497368	24
Centrosinergija	RS	Trucking and courier services, except air	PROPERTY PLUS ESTABLISHMENT	LI	162342	590
Avia Invest SRL	MD	Airports, flying fields and airport terminal services	TOVARISHCHESTVO S OGRANICHENNOI OTVETSTVENNOSTYU TB TIM MENEDZHMENT	GB	38151	631
Moldovatrans-Gaz SRL	MD	Pipelines, except natural gas	PUBLIC JOINT STOCK COMPANY GAZPROM	RU	38151	604
Delta Transportni Sistem - DTS DOO Beograd	RS	Trucking and courier services, except air	HITOMI MANAGEMENT LTD	VG	29549	218
Kuhne + Nagel DOO, Beograd	RS	Miscellaneous services incidental to transportation	KÜHNE + NAGEL INTERNATIONAL AG	CH	26832	463
TAV MAKEDONIJA DOOEL	MK	Airports, flying fields and airport terminal services	TAV HAVALIMANLARI HOLDING ANONIM SHIRKETI	TR	25945	812
Gebruder Weiss DOO Dobanovci	RS	Trucking and courier services, except air	SENGER-WEISS GmbH	AT	25358	190
Jetoil Serbia DOO Beograd	RS	Public warehousing and storage	MAMIDOIL-JETOIL HELLENIC OIL PRODUCTS SOCIETE	GR	24339	18
DHL International Beograd DOO	RS	Postal services	DEUTSCHE POST BETEILIGUNGEN HOLDING GmbH	DE	22596	185
Naftagas - Transport DOO	RS	Trucking and courier services, except air	PUBLIC JOINT STOCK COMPANY GAZPROM	RU	22255	109
Veolia Transport Litas AD Požarevac	RS	Local and suburban passenger transportation	VEOLIA ENVIRONNEMENT	FR	17789	696
Cargo-Partner DOO Beograd	RS	Miscellaneous services incidental to transportation	CARGO-PARTNER GROUP HOLDING AG	AT	17182	81
PSG Banatski Dvor DOO	RS	Public warehousing	PUBLIC JOINT STOCK COMPANY GAZPROM	RU	15563	50
Kuehne und Nagel Skopje DOOEL	MK	Trucking and courier services, except air	KUEHNE + NAGEL	DE	13159	19
Schenker Skopje DOOEL	MK	Miscellaneous services incidental to transportation	SHENKER & CO. AG	AT	11654	49
Hödlmayr Zastava DOO Kragujevac	RS	Trucking and courier services, except air	HÖDLMAYR INTERNATIONAL AG	AT	11562	42
Danube Logistics SRL ICS	MD	Miscellaneous services incidental to transportation	HEIDELBERGCEMENT AG	DE	11207	170
Ralu DOO Beograd	RS	Trucking and courier services	LUKA RAJIC	CH	9924	81
City Express DOO Beograd	RS	Postal services	ÖSTERREICHISCHE POST AKTIENGESELLSCHAFT	AT	9873	399

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CEFTA
Central European Free Trade Agreement
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