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CHAPTER 2.

ATTRACTIVENESS OF WESTERN BALKAN COUNTRIES FOR FDI

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Abstract

Based on standard classification of competitive advantages of a country as investment location and complex international assessments of countries' competitiveness, the paper identifies competitive advantages and disadvantages of five Western Balkan countries (WB5), as FDI location. WB5 as a region lags behind EU27 and EU10 average in almost all relevant indicators of locational competitiveness.

The identified competitive advantages of WB5 as a location for FDI are the following: stable macroeconomic environment, fast economic growth, geographical proximity to major EU markets, stable and relatively well developed financial system, relatively low cost and qualified labor, and EU Stabilization and Association Agreement with EU, CEFTA and other bilateral trade agreements.

*The most prominent weaknesses inhibiting more FDI inflows in WB5 are: **s**mall domestic market with low per capita income, relatively high country risk, slow progress in structural and institutional reforms, underdeveloped infrastructure, inefficient government bureaucracy and high administrative barriers.*

The papaer concludes that the main policy message arising from theoretical findings and empirical evidence suggest that the best way for WB5 to attract more FDI in the future is to strengthen the structural reforms and to speed up their EU approximation processes. Any specific FDI policies are only of a secondary importance.

Key words: *FDI, location criteria, WB5, EU10, attractiveness, EU approximation process*

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INTRODUCTION

Foreign direct investment (FDI), their size, structure and stability of flows, are generally recognised as a potentially important source of economic growth (se, for instance, Billington, 1999; Bevan and Estrin, 2000; Dunning and Lundan, 2008). Apart from increased capital capacities, FDI brings a number of other positive effects. First of all, FDI represents an addition to domestic accumulation, meaning an increase of production capabilities and, consequently, of employment (Buckley et al. 2002). FDI also results in the inflow of new knowledge and technology (Buckley et al. 2002), with positive spillover effects on the rest of the economy (Lucas, 1993; Borensztein et al. 1998). Foreign investors may also open new markets and transfer management knowledge. Nowadays, many countries successfully exploit development opportunities which are brought in by FDI. Expansion of production by means of FDI and, consequently, foreign know-how is one of the most widely used growth models of the present time (see, for instance, Moran et al., 2005; Herzer et al., 2008; O'Sullivan, 1993; Doyle, 1998; Shan and Song, 1997 etc.).

FDI inflows in five Western Balkan Countries (WB5) - Albania, Bosnia and Herzegovina, Macedonia, Montenegro and Serbia – recorded permanent growth in the period 2001-2007. The inflows culminated in 2007 with USD 7,820 million. FDI was mostly related to large privatizations. Since 2008, all countries of the region except Albania experienced a decrease in FDI inflows, mostly due to the impact of the global economic crisis. This decline continued during 2009, except in Albania and Montenegro, due to some important privatizations (an oil refinery in Albania and the power sector in Montenegro). The largest fall in FDI inflows has been in Macedonia and Bosnia and Herzegovina (see Table 1). Increased FDI inflows to WB5 countries in the last decade resulted in the increase of inward FDI stock to GDP ratio from average 19.2% in 2002 to 52.8% in 2009. Comparison to FDI penetration in new EU member states (NMS), however, shows that there is still a room to increase FDI in WB5. Namely, average inward FDI stock to GDP ratio in NMS was 78.3% in 2009 (see Table 2).

Table 1: Inflows of FDI in WB5 countries in 2001-2010 (in million USD)

	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Albania	206	135	178	346	264	325	662	988	979
Bosnia and Herzegovina	119	265	381	704	613	766	2 077	1 064	501
Macedonia	447	106	118	323	97	424	699	587	248
Montenegro	-	72	49	65	478	618	921	916	1 311
Serbia	177	495	1 357	963	1 573	4 350	3 462	2 995	1 920
WB5	**950**	**1 073**	**2 083**	**2 401**	**3 025**	**6 484**	**7 820**	**6 550**	**4 960**

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

Table 2: FDI inward stock as % of GDP in NMS and WB5 countries, 2002-2009

	2002	2003	2004	2005	2006	2007	2008	2009
NMS	**37,3**	**41,4**	**46,8**	**45,7**	**60,3**	**68,7**	**63,4**	**78,3**
Bulgaria	26,1	31,9	41,0	50,9	74,2	95,7	89,1	107,7
Cyprus	46,6	50,9	54,1	50,7	76,0	83,7	83,4	114,1
Czech Republic	51,4	49,6	52,3	48,7	56,0	64,5	52,4	60,9
Estonia	57,7	71,1	83,6	81,4	76,5	78,4	71,1	85,1
Hungary	54,3	57,3	61,3	56,1	107,0	143,6	163,8	194,3
Latvia	29,5	29,3	32,9	30,7	37,5	37,7	34,1	44,8
Lithuania	28,1	26,7	28,3	31,6	36,6	38,5	27,3	37,4
Malta	58,4	66,8	72,8	72,3	102,5	112,1	98,9	118,5
Poland	24,4	26,7	34,3	29,9	36,8	42,0	31,1	42,5
Romania	17,1	20,5	27,0	26,0	37,0	36,9	33,2	45,9
Slovakia	34,9	43,8	51,8	49,4	60,2	60,3	48,5	57,1
Slovenia	19,0	22,5	22,6	20,2	23,1	30,4	28,1	31,4
WB5	**19,2**	**21,7**	**25,2**	**27,8**	**43,1**	**54,2**	**42,1**	**52,8**
Albania	8,1	8,7	11,4	12,5	15,2	22,8	21,3	28,7
Bosnia and Herzegovina	26,2	26,0	28,0	27,9	34,0	45,5	39,8	45,9
Macedonia	31,9	34,9	40,8	35,9	43,4	47,2	46,5	51,9
Montenegro	6,3	8,9	11,4	29,1	51,3	69,1	72,3	109,8
Serbia	11,2	15,5	16,9	22,1	33,7	33,1	39,5	49,3

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

The objective of this paper is, first, to see which are the factors that attract and divert foreign investors in WB5 countries and, second, to propose some policy measures to increase attractiveness of the region for foreign investors. The paper is structured as follows. In section two, we first try to identify the main determinants of host country's attractiveness for FDI, i.e. which are the factors that make a country more or less attractive to FDI. In section three, we then apply the identified determinants of country's attractiveness for FDI on the situation in WB5 countries, i.e. based on the identified host country determinants of FDI inflows we analyze advantages and disadvantages of WB5 countries as FDI location. Section four concludes.

DETERMINANTS OF COUNTRY'S ATTRACTIVENESS AS FDI LOCATION

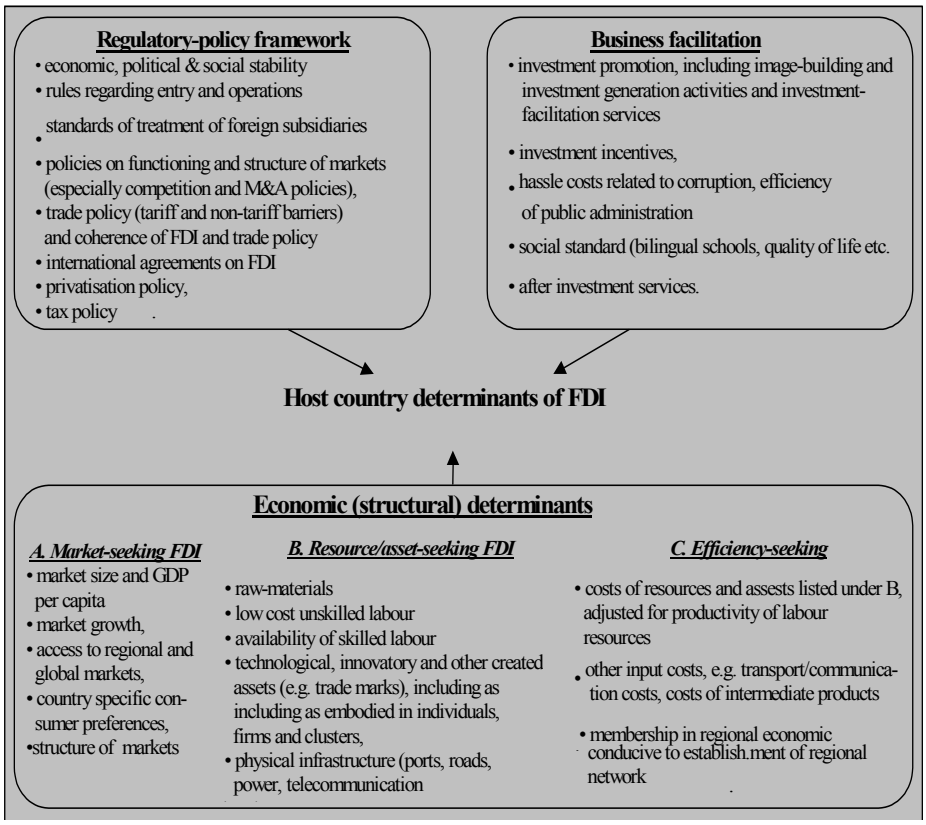
Which are the factors that determine the attractiveness of a country for FDI, factors that make some countries more and others less attractive location for FDI? The answer is provided by the so called OLI paradigm of FDI (concept of ownership-location-internalization advantages/determinants of FDI; for detail see Dunning, 1993). Integral part of OLI paradigm is the concept of location-specific advantages/determinants, which explains why a firm would rather invest abroad than at home and which countries have advantages as FDI location, that is for establishing a certain activity. Location specific factors could be classified into main economic (structural and market) factors, which represent the basic reason/motive of foreign investor for investing in particular country (market size and growth, availability and price of production factors, possibility of more efficient production etc.), and into factors of investment climate with regulatory economic policy framework, and broader investment climate, including support to entrepreneurship. Regulatory-policy framework and business environment represent more or less favorable framework for the realization of basic motives (see UNCTAD, 1998: 91). Empirical analyses of foreign investors' motivaiton and of location specific factors of FDI clearly show that:

a) Basic structural characteristics of an economy, i.e. market characteristics (market size and per capita income, market growth, access to regional and global markets etc.), and availability / quality / costs of factors of production (labor, raw materials and other inputs, technological, innovatory and other created assets, physical infrastructure etc.) are of primary importance for the attractiveness of a country as FDI location.

b) These are followed by general regulatory and policy frameworks, which define investment climate in its broadest sense. They include elements such as economic, political and social stability, privatization policy, trade regime and policy, tax rates and tax structure, labor market and product markets regulations and policies, etc.

c) Only if these basic preconditions are in place, specific FDI regimes and policies can become relevant for attracting foreign investors (see, for instance, Dunning, 1993; UNCTAD, 1998; Business International, Creditanstalt, 1992; A.T. Kearney, 1998; Meyer, 1998; Rojec, Redek in Kostevc, 2007 etc.) (see Graph 1).

Graph 1: Host country determinants of FDI



Source: UNCTAD: World Investment Report 1998, Geneva, 1998, p. 91.

OECD inter-country variations in inward FDI stocks show that slightly over one half of the variation is explained by countries' structural characteristics and slightly less than half by policy factors. The most important among the policy factors are labor market policies explaining more than 25% of the inter-country variations, followed by other border barriers, FDI restrictions and product market policies. The latter three combined account for approximately 20% of the variations in inward FDI stocks (OECD, 2003). Although the investment climate and FDI policy factors are in a certain sense of a secondary importance they undoubtedly have a crucial impact on the decision of a foreign investor whether or not to go ahead with the realization in line with his primary motivation determined with structural factors. In short, an inadequate investment climate, regulatory and policy framework could turn away a foreign investor, who would otherwise choose to invest as far as market, resource / asset or cost considerations are concerned.

Analyses of various international institutions, which assess countries' attractiveness for inward FDI are more or less based on the above theoretical concept. Let us briefly look into some of them. *UNCTAD's Inward FDI Potential Index* (UNCTAD, 2004*)* takes into account the following factors: real GDP growth, GDP per capita, total exports as a share of GDP, density of telephone lines and mobile phpnes, energy consumption, R&D expensitures, students in tertiary education, country risk, exports of natural resources (as a share of world total), imports of parts for electronic and automobil industry (as a share of world total), exports of services (as a share of world total), stock of inward FDI (as a share of world total). *UNCTAD's Investment Compass* (http://compass.unctad.org) takes into account six groups of factors: sources and assets (market size, availability of naturaql resources and human capital), infrastructure (basic and technological), operational costs (labour and other costs), economic performance and governance, taxes and regulatory framework. *World Investment Prospect Survey (WIPS) 2008-2010* (UNCTAD, 2008), based on the survey among the largest MNEs claims that:

- Market access is by far the most important location determinant (50% of answers, see Graph 1). "Market size" (18%) favours large countries, while "market growth rate" (18%) gives priority to dynamically growing economies. Criteria "access to international and regional markets" (14%) is in favour of small and medium sized countries offering access to large regional markets. Graph 1 clearly shows high market growth (26%) and access to EU market (18%) have above average importance for NMS[1].
- Availability and costs of labour ara also frequently mentioned by the surveyed MNEs (16%). Here, we have two aspects. The first is access to skilled labour (8%), and the other is low labour costs (8%). NMS are above-average attractive in the criteria of low labour costs (14%), but as far as access to skilled labour is concerned they also don't lag very much behind the world average (7%).
- Technical quality of business environment relates to the quality of infrastructure (7% for world average and 4% for NMS), availability of suppliers (6% and 5% respectivly) and access to domestic capital markets (3% and 1% respectively). All these criteria are in favour of more developed countries as FDI location.
- As far as legal and administrative environment is concerned, the survey cleary shows that incentives play a more or less marginal role (3% in the case of world average and 5% in NMS). In general, foreign investors

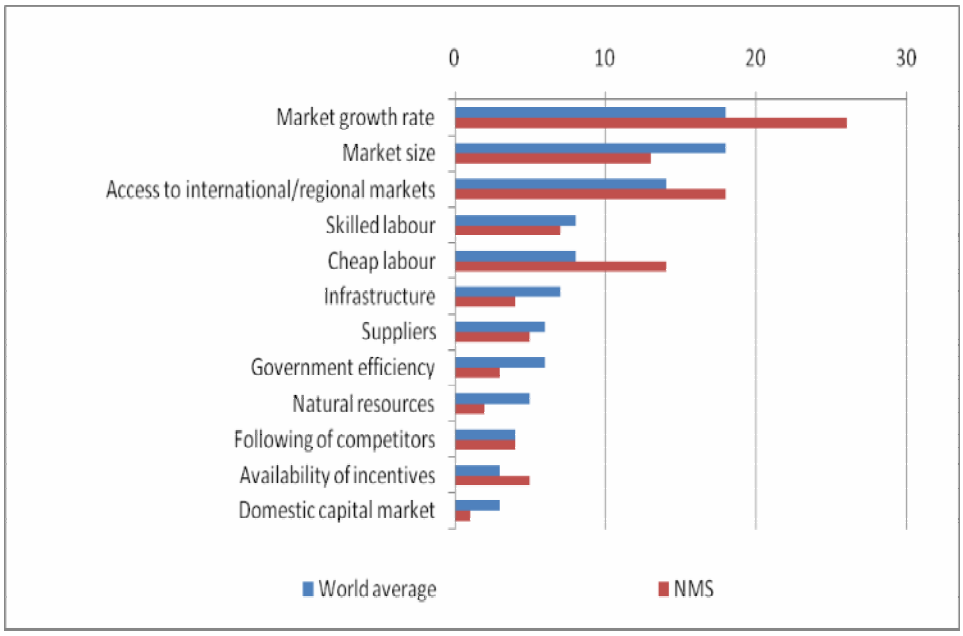
[1] We present results for NMS as a kind of comparative benchmark for WB5. As NMS, WB5 are also European countries with the legacy of the socialist system and aspiration of becoming the EU member states.

seem to be more sensitive to governmment efficiency (6% in world average), where NMS are less attractive (3%).

- Acess to natural resources and following of the competitors seem to be less important determinants of FDI inflows (see Graph 2).

FDI Confidence Index of A.T. Kearneya (2004: 4) lists the following location factors of FDI: market size, market growth potential, access to export markets, government subsidies, production/labour costs, infrastructure, financial/economic stability, economic reforms, quality of life, political/social stability, tax regime, presence of competitors, consumers' sophistication, availability of acquisition targets, regulatory environment, cultural barriers, transparency, rule of law, managerial talent, highly educated labour force. Forbes's *Capital Hospitality Index* (http://www.forbes.com/lists/) takes into account general economic factors, such as GDP growth, GDP per capita, trade balance, population and unemployment, and other factors, such as liberalisation of trade and capital flows, ownership rights, innovations, technology, bureaucracy, investors' protection, corruption, personnal freedom, tax burden, market performance.

Graph 2: Location criteria for FDI; world average and average for NMS, 2008-2010 (% of answers of surveyed MNEs)



Vir: WIPS 2008-2010, p. 38

The list of factors that determine attractiveness of FDI locations as suggested by the concept of OLI paradigm fits very well with the factors suggested by various international systems of assessing attractiveness of FDI locations. We always have market swize and growth, including access to international and in particular regional markets, we always have availability, quality and costs of factors of production (human capital, infrastructure, technology, suppliers' networks, raw materials etc.), we always have various elements of regulatory and economic-policy framework (taxes, foreign trade, economic and political stability, competition policy, labour market policy etc.) and we always have various factors of business environment and entrepreneurship promotion (entrepreneurship incentives, FDI incentives, administrative costs, corruption, social standard, quality of life etc).

ASSESSMENT OF WB5'S ATTRACTIVENESS FOR FDI

Based on the above identification of factors that determine a country's attractiveness for FDI, in this section we provide empirical data for assessing WB5's attractiveness for FDI, i.e. advantages and disadvantages of WB5 as investment locations. In doing that, we use the following sources: UNCTAD Inward FDI Potential Index, Global Competitiveness Report of WEF, EBRD Transition Indicators, and World Bank Doing Business Rankings, World Bank Worldwide Governance Indicators, which are relevant for the estimation of locational competitiveness for FDI. All these sources enable comparison of FDI locational competitiveness of WB5 countries with EU10 (new EU member states, except Cyprus and Malta) and EU27. As expected, WB5 as a region lags behind EU27 and EU10 average in almost all relevant indicators of locational competitiveness (see Appendix).

Further on we provide a more detailed evaluation of FDI locational competitiveness of individual WB5 countries as far as main economic determinats (Table 3), regulatory framework (Table 4) and business climate and promotion of entrepreneurship (Table 5) is concerned. We use the same data sources as above. All the indicators are presented in relative terms, i.e. they are expressed in percentage of EU10 average. Values above 100% mean that a particular WB5 country is better in particular indicator than EU10 average, and vice versa for values below 100%. Due to general lagging of WB5 behind EU10, we presume that value above 80% for a particular indicator makes it advantageous for WB5. To better present the results in the tables, all the values above 80% are in grey color.

In Table 3, **main economic (structural) determinants**, which are relevant for a countriy's FDI locational attractiveness are classified into three groups: (i) market size and market growth (market-seeking FDI), (ii) availability of resource / factors of production (resource/asset-seeking FDI), and (iii) costs of resources / factors of production and productivity (efficiency-seeking FDI). The data put forward the following conclusions:

- In spite of the fact that most of the existing FDI in region is of a market seeking character (mostly services, i.e. financial sector and telecommunications), individual WB5 countreis do not have locational advantages for market-seeking FDI. Market size and standard of living (GDP p.c.) in all individual WB5 countries is not attractive for foreign investors, while growth of the markets (GDP growth) is a potential advantage for attracting market-seeking FDI. Access to regional and global markets may be attractive for foreign investors, as all the countries are members of CEFTA and have preferential access to EU market.
- WB5 may be attractive for some types of resource/asset-seeking and efficiency-seeking FDI. Potential advantages for attracting this type of FDI are: (i) low cost and qualified labor and (ii) relatively well developed segmets of the physical infrastructure (telecomunications, roads). UNCTAD's Inward FDI Potential Index ranks the WB5 high in the field of telecomunication (telephone lines and mobile telephones). According to the Global Competitiveness Index (WEF), WB5 as a group are best ranked with respect to: (i) education, especially for the secondary education enrollment rate, quality of the educational system, quality of mathematics and science education, quality of management schools and extent of staff training, and (ii) FDI and technology transfer as a sub-indicator of technological readiness. However, there is a lot of space for improvement, which would make WB5 countries more attractive for this type of FDI. This relates espetially to: (i) some segments of infrastructure (railroads, water supply and electricity power), (ii) quality and quantity of tertiary education, (iii) availability of experts, (iv) low rate of internet users, and (iv) insufficient supply of specialized research and training services.
- Among innovation and sophistication factors, WB5 have relatively high scores for a number of sub-indices, including: control of international distribution, extent of marketing, quality of scientific research institutions and university-industry collaboration in R&D. However, if we compare these WB5 and EU10 with the average of EU27 (see Appendix), it is obvious that both of these regions are lagging much behind the well developed EU countries, and are not very competitive, when this two areas are in question.

Table 3: Main economic (structural) determinants of FDI relevant for the locational competitiveness for FDI (in % of EU10 average)

	Albania	BH	Macedonia	Montenegro	Serbia	WB5 Average
INWARD FDI POTENTIAL INDEX (UNCTAD, 2008a)						
Rate of GDP growth (%, average 2001-2009)	140%	111%	59%	98%	118%	105%
GDP per capita (US$, average 2006-2009)	29%	34%	31%	47%	42%	37%
GDP per capita PPP (US$, average 2006-2009)	43%	46%	54%	70%	58%	54%
Share of exports in GDP (% , 2008)	53%	65%	90%	68%	56%	66%
Average number of telephone lines per 100 inhabitants (2008)	38%	95%	77%	201%	108%	104%
Mobile telephone subscriptions per 100 inhabitants (2009)	90%	76%	110%	106%	88%	94%
Share of R&D spending in GDP (%, 2008)	n.a.	3%	24%	136%	39%	51%
EBRD TRANSITION INDICATORS - 2009						
Overall infrastructure reform	72%	72%	72%	72%	72%	72%
Telecommunications	91%	64%	100%	91%	73%	84%
Railways	57%	86%	57%	57%	67%	65%
Electric power	85%	85%	85%	66%	66%	78%
Roads	84%	96%	84%	84%	96%	89%
Water and waste water	49%	58%	68%	58%	49%	56%
WEF GLOBAL COMPETITIVENESS INDEX: 2010–2011 (WEF 2010)						
2nd pillar: Infrastructure	81%	74%	81%	89%	79%	81%
2.01 Quality of overall infrastructure	81%	74%	81%	89%	79%	81%
2.02 Quality of roads	98%	50%	87%	78%	70%	77%
2.03 Quality of railroad infrastructure	36%	47%	58%	72%	47%	52%
2.07 Quality of electricity supply	74%	100%	85%	72%	85%	83%
5th pillar: Higher education and training	80%	79%	84%	93%	83%	84%
A. Quantity of education						

5.01 Secondary education enrollment rate	90%	104%	96%	99%	102%	97%
5.02 Tertiary education enrollment rate	29%	51%	61%	79%	73%	59%
B. Quality of education						
5.03 Quality of the educational system	103%	82%	103%	116%	87%	98%
5.04 Quality of math and science education	91%	102%	91%	102%	97%	97%
5.05 Quality of management schools	93%	95%	98%	110%	88%	97%
5.06 Internet access in schools	72%	72%	84%	82%	67%	75%
C. Training						
5.07 Local availability of specialized research and training services	77%	75%	66%	86%	79%	76%
5.08 Extent of staff training	69%	107%	84%	76%	102%	87%
9th pillar: Technological readiness	81%	78%	83%	95%	79%	83%
9.03 FDI and technology transfer	95%	87%	85%	103%	83%	90%
9.04 Internet users	68%	62%	86%	74%	69%	72%
9.05 Broadband Internet subscriptions	17%	45%	62%	82%	35%	48%
9.06 Internet bandwidth	16%	10%	0%	10%	80%	23%
11th pillar: Business sophistication	90%	81%	88%	97%	78%	87%
A. Network and supporting industries						
11.02 Local supplier quality	81%	81%	89%	89%	89%	86%
B. Sophistication of enterprise operations and strategies						
11.04 Nature of competitive advantage	86%	75%	72%	106%	69%	82%
11.05 Value chain breadth	72%	80%	96%	90%	77%	83%
11.06 Control of international distribution	109%	80%	101%	111%	88%	98%
11.07 Production process sophistication	93%	73%	80%	85%	68%	80%
11.08 Extent of marketing	107%	75%	82%	98%	70%	86%
12th pillar: Innovation	77%	78%	86%	105%	88%	87%
12.01 Capacity for innovation	77%	71%	80%	98%	80%	86%
12.02 Quality of scientific research institutions	60%	72%	84%	105%	93%	87%
12.03 Company spending on R&D	87%	83%	83%	109%	83%	87%
12.04 University-industry collaboration in R&D	58%	79%	92%	100%	92%	85%

Note: Values above 80% of the EU10 average for values of the indicators in the table represent a potential advantage for FDI in WB5 and are marked by gray.

Main determinants of the r**egulatory and policy framework** relevant for the locational competitiveness for FDI are given in Table 4, which clearly shows that the region is considerably lagging behind the EU10 with respect to quality of laws and rule of law (World Bank Worldwide Governance Indicators). Country risk can also be considered a disadvantage for investing in WB5. Ease of Doing Business according to the World Bank Doing Business is also a disadvantage of WB5, as they are lagging in rank far behind the EU10. However, WB5 have some competitive advantages in comparison with the average of the EU10 group. These include:

- Protection of investors, as WB5, on average, are better ranked than EU10 (World bank Ease of Doing Business Rank and WEF Global Competitiveness Index);
- Several sub-indicators related to the quality of institutions, including Burden of government regulation and Transparency of government policymaking (WEF Global Competitiveness Index); Financial market development, and Legal rights (WEF Global Competitiveness Index), and
- Macroeconomic stability, especially government debt, as one of macroeconomic stability's sub-indicators (WEF Global Competitiveness Index).

Table 4: Regulatory and Policy Framework (in % of EU10 average)

	Albania	**Bosnia and Herzegovina**	**Macedonia**	**Montenegro**	**Serbia**	**WB5 Average**
Country risk (September 2010) (EUROMONEY, 2010)	76%	57%	71%	44%	83%	66%
Ease of Doing Business Rank (World Bank 2010)	62%	26%	115%	74%	56%	67%
Protecting investors	171%	65%	164%	154%	92%	129%
WEF Global Competitiveness Index: 2010–2011						
1st pillar: Institutions						
1. Property rights						
1.02 Intellectual property protection	75%	59%	83%	97%	70%	77%
2. Ethics and corruption						
1.03 Diversion of public funds	110%	104%	107%	128%	88%	107%
4. State inefficiency						

1.09 Burden of government regulation	132%	93%	103%	123%	76%	105%
1.12 Transparency of government policymaking	111%	65%	101%	116%	96%	98%
3rd pillar: Macroeconomic stability						
3.04 Interest rate spread	71%	97%	139%	74%	48%	76%
3.05 Government debt	69%	125%	169%	77%	114%	100%
6th pillar: Goods market efficiency						
2. Foreign competition						
6.09 Prevalence of trade barriers	94%	84%	88%	98%	86%	90%
6.10 Trade tariffs	27%	18%	17%	20%	17%	19%
6.13 Burden of customs procedures	90%	81%	97%	97%	81%	89%
8th pillar: Financial market development						
A. Effectiveness						
8.04 Ease of access to loans	92%	88%	81%	138%	92%	98%
8.05 Venture capital availability	82%	74%	98%	133%	86%	95%
8.06 Investors protection						
B. Reliabiklity and trust						
8.09 Legal rights index	123%	68%	96%	123%	110%	104%
Worldwide Governance Indicators 2009; World Bank						
Regulatory Quality	80%	70%	81%	73%	69%	74%
Rule of Law	62%	66%	71%	79%	65%	69%

Note: Values above 80% of the EU10 average for values of the indicators in the table represent a potential advantage for FDI in WB5 and are marked by gray.

Selected factors of **business environment/entrepreneurship promotion**, which determine the attractiveness of a country for FDI are given in Table 5. Potential advantages of WB5 related to business environment/ entrepreneurship promotion seem to be in the field of:

- Starting a business (WEF Global Competitiveness Index, World Bank Ease of Doing Business Rank),
- Security – several sub indicators (WEF Global Competitiveness Index),
- Health – several sub indicators (WEF Global Competitiveness Index) and
- Primary education (WEF Global Competitiveness Index).

However, Closing a Business and a number of other administrative barriers, including Registering Property, Dealing with Construction Permits and Enforcing Contracts (World Bank Ease of Doing Business Rank), are serious impediments for investing in these countries.

Table 5: Business environment/promotion of entrepreneurship determinants from selected international assessments of competitiveness, relevant for the locational competitiveness for FDI (in % of EU10 average)

	Albania	**Bosnia and Herzegovina**	**Macedonia**	**Montenegro**	**Serbia**	**WB5 Average**
Ease of Doing Business Rank (World Bank 2010)						
Starting a Business	115%	19%	149%	82%	92%	92%
Closing a Business	1%	105%	60%	122%	71%	72%
WEF Global Competitiveness Index: 2010–2011						
1st pillar: Institions						
Security						
1.13 Business costs of terrorism	96%	102%	91%	104%	85%	96%
1.14 Business costs of crime and violence	97%	93%	93%	112%	82%	95%
1.15 Organized crime	99%	92%	92%	109%	82%	95%
5th pillar: Health and primary education	80%	79%	84%	93%	83%	84%
4.09 Quality of primary education	92%	94%	88%	101%	90%	93%
4.10 Primary education enrollment rate	97%	n.a.	93%	106%	102%	99%

Note: Values above 80% of the EU10 average for values of the indicators in the table represent a potential advantage for FDI in WB5 and are marked by gray.

CONCLUSIONS

WB5 as a region lags behind EU27 and EU10 average in almost all relevant indicators of locational competitiveness. In spite of visible diferences among the WB5 countries, with Montenegro and Macedonia as the best positioned countries

in the region, and Bosnia and Herzegovina, by far the worst positioned country among the WB5, in this papaer we observed WB5 as a region, as the differences among the WB5 countries themselves are much smaller than lagging of WB5 behind EU10.

The main strengths of WB5 relevant for attracting FDI are: (i) stable macroeconomic environment, (ii) fast economic growth, (iii) geographical proximity to major EU markets, (iv) good business environment (v) stable and relatively well developed financial system, (vi) high share of young people involved in education (primary and secondary), (vii) relatively low cost and qualified labor, (viii) well developed telecommunication sector, (ix) protection of investors, and (x) EU Stabilization and Association Agreement with EU, CEFTA and other bilateral trade agreements.

The most prominent weaknesses inhibiting more FDI inflows in WB5 are: (i) **s**mall domestic market with low per capita income, (ii) relatively high country risk, (iii) slow progress in structural and institutional reforms (iv) low share of exports in GDP, (v) high unemployment, (vi) poor railway and water supply infrastructure, (vii) Inefficient government bureaucracy, (viii) Low tertiary education enrolment, (ix) low share of R&D in GDP, (x) High level of corruption, (xi) High administrative barriers, (xii) Poor implementation of laws.

The main policy message arising from theoretical findings and empirical evidence suggest that the best way for WB5 to attract more FDI in the future is to strengthen the structural reforms and to speed up their EU approximation processes. Any specific FDI policies are only of a secondary importance.

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APPENDIX

Selected indicators of WB5 compared to EU10, relevant for the estimation of locational competitiveness for FDI

	Albania	Bosnia and Herzegovina	Macedonia	Montenegro	Serbia	WB5 Average	EU10 Average	EU27 Average
INWARD FDI POTENTIAL INDEX (UNCTAD 2009, rank among 141 countries)	79	n.a	100	n.a.	n.a.	**n.a.**	**45**	**34**
Rate of GDP growth (%, average 2001-2009)	5,6	4,4	2,4	3,9	4,7	**4,2**	**4,0**	**1,5**
GDP per capita (US$, average 2006-2009)	3717	4347	3997	6027	5320	**4681**	**12801**	**29660**
GDP per capita PPP (US$, average 2006-2009)	8020	8757	10090	13183	10887	**10187**	**18836**	**29031**
Share of exports in GDP (% , 2008)	29,5	36,5	50,0	38,1	31,1	**37,0**	**55,8**	**41,9**
Average number of telephone lines per 1,000 inhabitants (2008)	11	27	22	58	31	**30**	**29**	**41**
Mobile telephone subscriptions per 100 population (2009)	100	84	123	118	98	**105**	**111**	**124**
Share of R&D spending in GDP (%, 2008)	n.a.	0,03	0,21	1,18	0,34	**0,4**	**0,9**	**1,5**
Tertiary education enrollment rate (%, 2008)	19,1	36,9	35,5	41,1	35,8	**33,7**	**64,7**	**61,2**
Country risk (September 2010) (rank among 185 countries)	82	113	90	140	70	**99**	**48**	**30**
Share of world FDI inward stock (% 2009)	0,02	0,04	0,03	0,03	0,12	**0,23**	**4,80**	**41,98**
WEF GLOBAL COMPETITIVENESS INDEX: 2010–2011 scores	3,9	3,7	4,0	4,4	3,8	**4,0**	**4,4**	**4,7**
Basic requirements	4,4	4,1	4,5	4,9	4,2	**4,4**	**4,8**	**5,2**
1st pillar: Institutions	4,0	3,1	3,8	4,5	3,2	**3,7**	**3,9**	**4,7**
2nd pillar: Infrastructure	3,5	3,2	3,5	3,8	3,4	**3,5**	**4,3**	**5,0**
3rd pillar: Macroeconomic stability	4,2	4,5	4,9	5,1	4,1	**4,6**	**4,9**	**4,9**
4th pillar: Health and primary education	5,9	5,4	5,7	6,2	6,0	**5,8**	**6,0**	**6,2**
Efficiency enhancers	3,8	3,6	3,8	4,1	3,8	**3,8**	**4,4**	**4,7**
5th pillar: Higher education and training	3,9	3,8	4,0	4,5	4,0	**4,0**	**4,8**	**5,1**
6th pillar: Goods market efficiency	4,2	3,6	4,2	4,4	3,6	**4,0**	**4,3**	**4,6**
7th pillar: Labor market efficiency	4,5	4,2	4,4	4,7	4,1	**4,4**	**4,6**	**4,5**

8th pillar: Financial market sophistication	3,7	3,5	4,0	4,7	3,8	**3,9**	**4,2**	**4,5**
9th pillar: Technological readiness	3,5	3,4	3,6	4,1	3,4	**3,6**	**4,3**	**4,8**
10th pillar: Market size	2,8	3,1	2,8	2,1	3,6	**2,9**	**3,9**	**4,3**
Innovation and sophistication factors	3,1	2,9	3,2	3,7	3,0	**3,2**	**3,7**	**4,3**
11th pillar: Business sophistication	3,6	3,3	3,5	3,9	3,2	**3,5**	**4,0**	**4,6**
12th pillar: Innovation	2,6	2,6	2,9	3,5	2,9	**2,9**	**3,3**	**4,0**
EBRD TRANSITION INDICATORS - STRUCTURAL REFORMS 2009								**n.a**
Large scale privatization	3,7	3,0	3,3	3,0	2,7	**3,1**	**3,7**	**n.a**
Governance and enterprise restructuring	2,3	2,0	2,7	2,0	2,3	**2,3**	**3,2**	**n.a**
Competition Policy	2,0	2,0	2,3	2,0	2,0	**2,1**	**3,2**	**n.a**
Banking reform & interest rate liberalization	3,0	3,0	3,0	3,0	3,0	**3,0**	**3,7**	**n.a**
Securities markets & non-bank financial institutions	1,7	1,7	2,7	1,7	2,0	**1,9**	**3,3**	**n.a.**
Overall infrastructure reform	2,3	2,3	2,7	2,3	2,3	**2,4**	**3,2**	**na.**
Average structural reform	2,5	2,3	2,8	2,3	2,4	**2,5**	**3,4**	**n.a**
EASE OF DOING BUSINESS RANK (World Bank 2010, rank among 141 countries)	82	116	32	71	88	**78**	**46**	**41**
Starting a Business	46	160	6	85	73	**74**	**64**	**62**
Dealing with Construction Permits	173	136	138	160	174	**156**	**81**	**61**
Employing Workers	105	111	58	46	94	**83**	**100**	**104**
Registering Property	70	139	63	131	105	**102**	**55**	**65**
Getting Credit	15	61	43	43	4	**33**	**30**	**42**
Protecting Investors	15	93	20	27	73	**46**	**67**	**70**
Paying Taxes	138	129	26	145	136	**115**	**98**	**72**
Trading Across Borders	66	63	62	47	69	**61**	**57**	**38**
Enforcing Contracts	91	124	64	133	97	**102**	**52**	**45**
Closing a Business	183	63	115	44	102	**101**	**69**	**40**
WORLD BANK WORLDWIDE GOVERNANCE INDICATORS 2009;	-0,12	-0,34	-0,03	0,10	-0,17	**-0,11**	**0,80**	**1,07**
Voice and accountability	0,16	-0,05	0,13	0,30	0,32	**0,17**	**1,08**	**1,15**
Political stability	-0,07	-0,57	-0,22	0,55	-0,50	**-0,16**	**0,90**	**0,73**
Government Effectiveness	-0,20	-0,65	-0,14	-0,03	-0,15	**-0,23**	**0,70**	**1,14**
Regulatory Quality	0,28	-0,06	0,32	0,03	-0,10	**0,09**	**0,99**	**1,21**
Rule of Law	-0,52	-0,39	-0,22	0,04	-0,41	**-0,30**	**0,70**	**1,13**
Control of corruption	-0,40	-0,31	-0,03	-0,32	-0,19	**-0,25**	**0,41**	**1,03**

Sources and notes:

Inward FDI potential index

Rate of GDP growth, GDP per capita and GDP per capita PPP and Share of R&D spending in GDP

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