Nella stessa collana:

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3. Francesco Orazi, *Le nuove comunità dello sviluppo locale. Democrazia, tecnologie e governance*, 2011.

THE ADRIATIC-BALKAN AREA FROM TRANSITION TO INTEGRATION

edited by

Giuseppe Canullo, Francesco Chiapparino and Giorgio Cingolani

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Introduction

This book collects the papers presented at the Conference on «The Adriatic-Balkan Area, from Transition to Integration» held in Ancona in May 2010. The Conference was organized by the Research Centre for the Adriatic and the Balkans (Centro interdipartimentale di ricerca sull'Adriatico e i Balcani, CIRAB), and the Faculty of Economics «Giorgio Fuà», with the support of the Regione Marche, the Adriatic-Ionian Initiative (AII) and the Central European Initiative (CEI).

Various motivations were at the basis of the Conference and it is useful to mention them in this introduction, in order to clarify the sense, objectives – and also limits – of these proceedings. The first, although not the principal one, is geographical. Oriented – at least historically – much more towards the sea than towards its rural hinterland, Ancona is in many respects one of the Italian towns from the which it is most natural to look at the Balkans. Not by accident was its harbour chosen by Trajan as the base for his expedition to Romania – and still today a sculpture of the emperor invites passers-by to turn to the other shore of the Adriatic Sea. But apart from these reminiscences – and their sinister echoes in the interwar imperialistic projects of fascist Italy towards the Balkan peninsula – Ancona is actually a place where there is a great interest in South Eastern Europe, albeit often scattered and fragmented. Tourist and cultural connections testify to this as do the commercial, migrational and entrepreneurial relations discussed in this book. Furthermore, the war of the recent past had an impact on both the town and the Marche as a whole region in terms of the deviation of traffic flows towards its harbour and of the solicitude for the people on the other side of the sea. The establishment in Ancona of the Permanent Secretariat of the AII –

Eleonora Cutrini, Giorgio Galeazzi and Francesca Spigarelli

Foreign Direct Investment and the Financial Crisis: a Spotlight on Italian-Balkan Countries Flows

Introduction

Foreign direct investment (FDI) is a mechanism important for international integration. Economic integration via FDI may induce development and structural change in both the host and source countries. This paper examines the role of FDI in bringing Italy closer to the group of countries designated 'the Western Balkans'. Political stability, required for EU membership, and the potential advantages in terms of costs and market access, make this area particularly important for the internationalization strategies of Italian firms. Geographical, cultural and historical similarities render the countries of the Western Balkans preferred economic partners for Italy.

This paper examines the evolution of Italian FDI flows to the Western Balkan countries. It focuses particularly on developments relative to the three years 2007 to 2009, when the global financial crisis (GFC) arose and negatively affected investment activity worldwide.

The first part of the paper focuses on global investment trends in order to provide a context for international investment in the Balkans. The second part describes the geographical and sectoral composition of FDI flows from Italy. The analysis aims at understanding the impact of the GFC across sectors and across the Balkan countries and the possible implications for development in those countries. The third part examines FDI flows between the Marche region of Italy and the Balkans, focusing on a very small economic entity with high international openness. Historically, the Marche region has been involved in export and investment flows to the Balkans in the traditional 'Made in Italy' sector, and through the outsourcing of production.

Our data and the perspectives adopted yield a fairly detailed picture of the role of FDI in the economic integration of Italy and the Western Balkans in the context of the GFC.

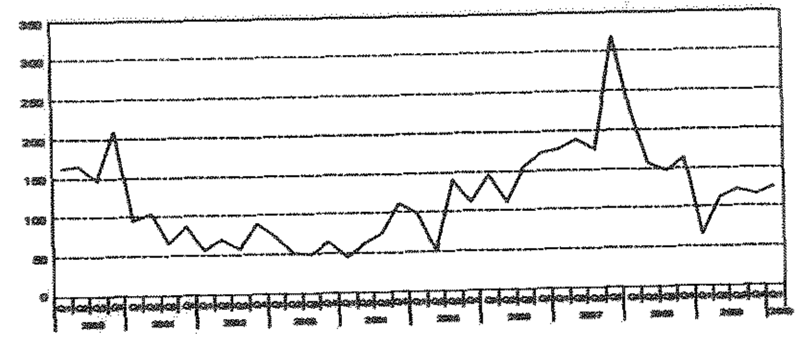
The Impact of the GFC on Global FDI Trends, and Emerging Countries

The complex events that have characterized the recent global financial and economic crisis have affected the fundamental drivers of FDI. The most prominent outcome has been a marked deterioration in the overall investment landscape. Several factors have contributed to this outcome. The first is the sudden and abnormal increase in uncertainty and risk aversion that has characterized the international financial system, in particular since the collapse of Lehman Brothers in October 2008. Not only have financial investments been negatively affected, but fixed investment has also slumped. The second outcome is the drop of current and expected corporate profits. High debts and default risks, low growth and persistent deflationary pressures on corporate margins have weakened profitability and constrained the willingness of companies to produce, hire workers, and invest. Last but not least, the credit crunch, the crisis of solvency, and the lack of liquidity have made the financing conditions of all economic activities very difficult, reducing the ability of banks to lend, households to spend, and companies to invest.

All these conditions led in 2008 to a deep recession and a fall in aggregate demand and international trade for all countries. The year 2008 also recorded the end of an approximately four-year period of increased FDI activity globally (Figure 1). UNCTAD (2010a) reports a decline of 16 per cent in 2008, following a historic peak in the final quarter of 2007, and it has recorded a further drop of 37 per cent in 2009. It forecasts a modest recovery in the first semester of 2010, and an increase to 2009 levels by the end of 2010[1]. In the context of this paper, it is interesting that the level of FDI activity by the developing and transition economies in 2009 was for the first time half that of global FDI inflow levels despite the crisis. Moreover, while flows to emerging countries have intensified in 2010, the flows to the major developed countries have decreased[2].

[1] I.e. a forecast of total flows in 2010 still 25% lower than the average in the pre-crisis years 2005-07 (UNCTAD 2010b).

Figure 1: *Global FDI Quarterly index, 2000 Q1-2010 Q1*



Source: UNCTAD (2010a)

The GFC rapidly spilled over from the United States to spread throughout the world. The key transmission mechanism in the real economy was the collapse of world demand and international trade, which was exacerbated by the increased openness of many countries. The negative consequences for investment activity and FDI flows in key industry sectors were amplified by the structural situation that had developed in the years preceding the crisis. The previous period of high real-world growth and low interest rates boosted the accumulation of excess capacity. The unfolding of the crisis and greatly reduced demand plunged the system into deep recession and reduced the investment propensity of firms.

The effect on FDI was less immediate than the effect on portfolio investments, whose short-term and temporary nature resulted in very rapid falls. During the whole of 2007, and for

[2] Flows to the Russian Federation and China rose by 30% and 20% respectively in the second quarter of 2010, while flows to the United States and United Kingdom fell sharply (UNCTAD, 2010b).

the developing and transition economies in 2008, FDI flows continued to grow. The reaction to the cyclical slowdown was delayed, reflecting the underlying higher average and less volatile growth rates. Emerging countries in particular consider FDI to be of strategic interest. FDI are often means to gain access to technology, markets, management skills, and to participate in the international division of labour.

We can also distinguish between cross-border mergers and acquisitions (M&A) and greenfield FDI projects. The former have been remarkably resilient to the crisis, reflecting the closer attention paid by TLC to internal growth, which involves new investment and expansions of internal initiatives, compared to external growth, or more M&A. The more recent concerns with some countries' sovereign debt and increased risk aversion have led to a decline in intra-company loans and reinvested earnings. The result is the recent tendency of TLC to withdraw resources invested in host countries.

A focus on the Balkan countries, as well as on Central and Eastern Europe, is particularly relevant for analysis of FDI since the latter contributed greatly to the transition to a market economy of many of those countries in the 1990s. Subsidiaries of transnational companies and inward FDI played an important role for these economies and for their transition processes. This is therefore a useful context in which to analyse the impact of the GFC on the behavior of foreign subsidiaries.

An Overview of Balkan Countries' FDI Inflows

During the past decade, the countries of the Western Balkans[3] have undergone significant economic integration through FDI.

[3] We focus mainly on the six countries of the Western Balkans (SEE-6 countries), namely Albania, Bosnia and Herzegovina, Croatia, Macedonia, Serbia and Montenegro. In some analyses we also include two further countries belonging to the Balkan region - particularly Bulgaria and Romania – in order to produce a comprehensive comparative overview. Throughout the paper we use South-East Europe as synonymous with the Western Balkan countries.

Low labour costs, increased institutional and political stability, and a general expectation of accession to the EU by the more advanced countries in the region, have increased the attractiveness of this area, especially for Germany and Italy. Several German firms have invested in Central Europe (Slovak Republic, Hungary, Czech Republic) while the focus of Italian firms has been on lower value added industries and Bulgaria and Romania, and increasingly the Western Balkan countries (Giovannetti and Luchetti, 2007).

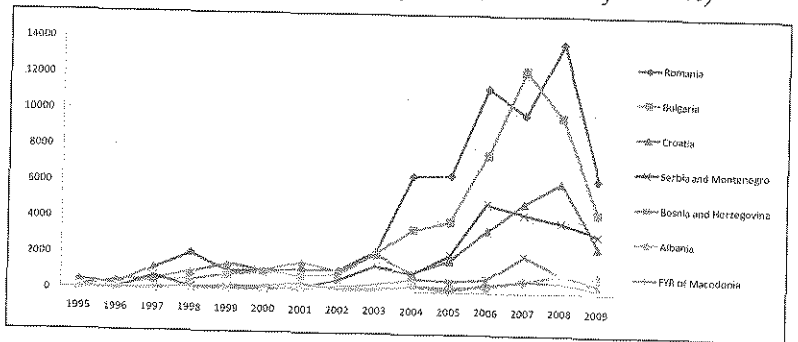
FDI inflows to the Western Balkans increased substantially in 2003-07, at an average annual growth rate of 50%, which was much higher than experienced by either developing countries or developed countries (Table 1). This improved capacity of the Western Balkan countries to attract FDI is closely related to their prospects for EU accession, which became clear only in 2000.

Table 1: *Average annual growth rate of FDI inflows (%), by period*

	2000-02	2003-07	2008-09
Western Balkan countries	8.9	49.6	-20.8
Developing economies	-8.1	26.9	-6.3
Developed economies	-13.7	30.4	-37.0
World	-12.6	29.7	-26.4

Despite the substantial increase in FDI inflows since 2000 – particularly during the last worldwide economic expansion (period 2003-2007) – inflows to the Balkan countries have been negatively affected by the recent global economic crisis. FDI inflows started to slow down in 2008 in Bulgaria, Serbia and Montenegro, Bosnia-Herzegovina, and Macedonia, and the decline became much steeper in 2009 (Figure 2). In fact, between 2008 and 2009, FDI inflows to the Western Balkans dropped by 21 per cent (Table 1) while between 2007 and 2008 FDI they decreased by 13.9 per cent, a rate similar to the average global decline (14%). The 'reaction' in the emerging and developing countries was very different: these countries appeared to be resilient to the GFC, at least until 2008, and between 2007 and 2008 inward flows to emerging and developing countries continued to increase by 15 per cent and 17 per cent, respectively.

Figure 2: *Inward FDI, annual flows (millions of dollars)*



Source: UNCTAD database and Unctad (2010)

Part of the recent slowdown has been due to the postponement of scheduled investments caused by the financial crisis. However, internal factors have also played a part, and particularly the different stages of the privatization process in each country, which should be taken into account by any analysis of the reasons for the FDI trends during the financial crisis. For example, in Bosnia-Herzegovina, privatization-related FDI were exceptionally high in 2006 and 2007, but not in 2008. In Albania, FDI increased by 45 per cent in 2008 as a result of the privatization of large state-owned companies and improvements in the business environment (UNCTAD, 2009). The path of the privatization process continued to influence FDI trends in 2009. While investor interest in Croatia and Serbia declined sharply, Montenegro saw an unprecedented surge in investments which peaked at US$1 billion (UNCTAD, 2010a, pp. 50-52).

Compared to neighboring regions, such as the Commonwealth of Independent States (CIS), this region has continued to attract foreign investors and market-seeking initiatives. This applies to the finance, trade and telecommunications sectors.

Investment trends in the banking industry warrant particular mention. The countries of South-East Europe (SEE) have

experienced a period of profound change: the restructuring of their internal banking systems resulting from an intense privatization process has been a major challenge for them. To give an example, 32 per cent of foreign investment flows in 2008 went to the financial sector, while 90 per cent of the banking system was in foreign ownership (UNCTAD, 2010a, p. 52). Banks from nearby European countries (Austria, France, Greece, Italy) were attracted mainly by a market with good potential, and with cultural and historical similarities. New branches were established and local banks were acquired. An important example is provided by Banca Intesa and Unicredito, which together held 20 per cent of Serbian bank assets in 2009.

The main sources of investment were the developed countries, mainly EU members. European FDI accounted for more than 80 per cent of total inward flows in the area (Redzepagic and Richet, 2008) and in 2008, EU members continued to account for the bulk of FDI in the region (UNCTAD, 2009).

Table 2: *Main source countries*

	Main source countries
Albania	Italy (1°), Greece
Bosnia and Herzegovina	Austria, Serbia, Croatia, Slovenia, Switzland, Germany, Russia, Netherlands, Italy (9°)
Croatia	Austria (26.5%), Netherlands (18%), Germany (11%), Hungary (9%), France (6%), Luxembourg (4%), Italy (4%) (8°)
Serbia	Austria, Greece, Norway, Germany, Italy (5°)
Montenegro	Greece, Slovenia, Russia, Italy (4°)
FYR of Macedonia	
Bulgaria	Netherlands (36%), Austria (11%), Germany (11%)
Romania	Netherlands, Austria, Germany, France, ... Italy (7°)

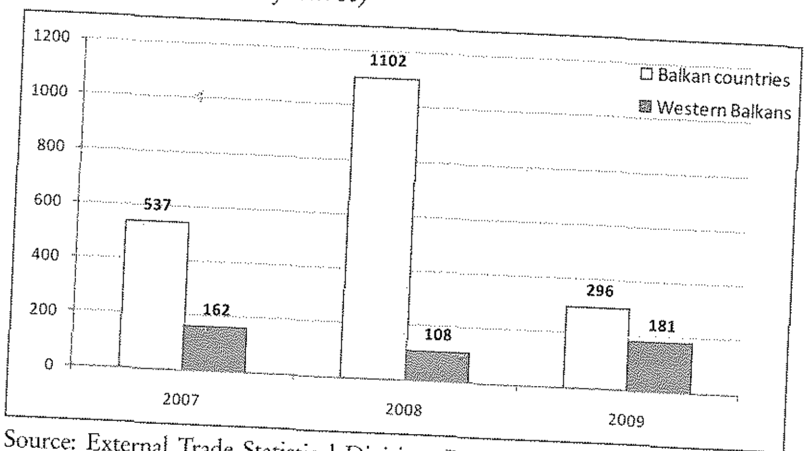
Source: Simest (2010), ICE country reports

Italy ranks as one of the ten major source countries in the Balkans group (Table 2). It is the leading source of FDI in Albania (roughly 48% from Italy and 34% from Greece) (Redzepagic and Richet, 2008). It represents the fourth investor in Montenegro after Greece, Slovenia, and Russia, while it ranks as the fifth investor in Serbia after Austria, Greece, Norway, and Germany (Simest, 2010; ICE countries reports).

Italy-Balkan Country Flows since the GFC

Among the Balkan country group, the SEE countries have become more important as the destination for Italian FDI. The trend is away from the traditional destinations of Bulgaria and Romania (Figure 2), where Italian investment declined by 88 per cent in the three years 2007-2009, towards Croatia, Serbia and Albania in particular. In 2007-2009, these three countries attracted 93 per cent of flows to the Western Balkans area (Figure 3).

Figure 3: *Italian FDI in the Balkan area during recent years (millions of euros)*



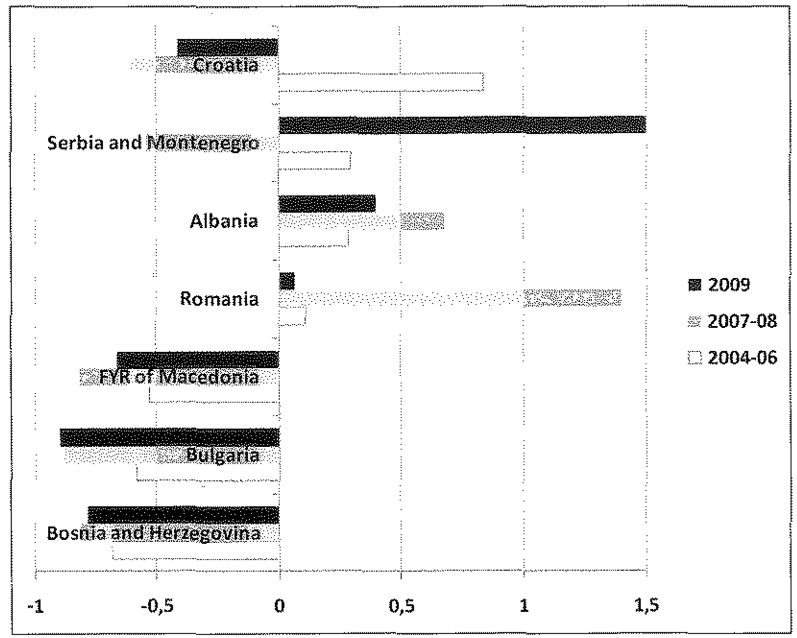
Source: External Trade Statistical Division, Bank of Italy

Two countries - Croatia and Serbia – accounted for 74 per cent of total Western Balkan FDI in 2007-2009. Albania attracted 19 per cent of FDI cumulative inflows in the same pe-

riod. Bosnia-Herzegovina, Montenegro, and Macedonia accounted for the remaining 7 per cent. However, compared to Romania, which received three times as much Italian investment, Croatia, Serbia and Albania are minor players (Figure A1). Nevertheless, the countries of the Western Balkans are important and may remain so given their current greater resilience to the GFC. In 2009, FDI inflows to Bulgaria and Romania declined by 54 per cent, while FDI to the Western Balkans decreased by only 40 per cent.

To obtain a better picture of the relative attractiveness of Balkan countries for Italian FDI, we computed a relative attractiveness index *(I)* on the basis of normalized shares of Italian FDI in the area.

Figure 4: *Relative attractiveness index*



Source: own calculations on UNCTAD data and Simest report 2010 data (for 2004-2006), External Trade Statistical Division, Bank of Italy (for 2007-09)

The relative attractiveness of each Balkan country for Italian FDI was calculated on the basis of the normalized country in the entire Balkan area. The resulting index compares each country's share of Italian FDI in the entire Balkan area with the country's share of global FDI in the area (see the Appendix for details). The results suggest that, by 2006, Italian firms and investors had found Croatia, Serbia and Montenegro, Albania, and Romania particularly attractive for FDI in the context of the overall Balkan area (Figure 3).

During the global financial crisis, Macedonia, Bulgaria, and Bosnia and Herzegovina did not change much in terms of their low relative attractiveness for Italian FDI. The same applies to the most attractive countries, except for Croatia, whose attractiveness was diminishing considerably. It should be noted that, between 2007 and 2008, this country was characterized by a substantial fall in Italian FDI flows (by 43 per cent) which occurred simultaneously with an increase (by 22 per cent) of total inward flows.

We complement this macroeconomic picture with firm-level data from the Reprint database. Information from companies' financial statements confirms the growing importance of the Balkans in the internationalization strategies of Italian firms. The number of foreign subsidiaries based on greenfield developments or acquisitions increased by 28 per cent between 2002 and 2008, while the share of controlled units increased from 77.8 per cent in 2002 to 79.2 per cent in 2008. This can be seen as the result of a long-term strategy by Italian entrepreneurs.

A sectoral analysis aids understanding of Italy's presence in the Balkans. Italian initiatives since 2000 have been related to the privatized sectors and manufacturing industry. Major Italian bank holding companies have become dominant in various local Balkan markets, and there has been heavy investment in public utilities (gas and electricity). In Albania, Bosnia-Herzegovina, Croatia, Serbia, and Macedonia, numerous initiatives related to textiles, clothing, footwear and furniture have been undertaken to support the outward processing strategies of Italian firms.

Table 3 presents the sectoral distribution of Italian FDI in

2007 and shows the percentage changes for 2008 and 2009. In 2007, the main economic activities attracting Italian FDI were, in descending order, manufacturing, household, services (market services)[4], finance and insurance. The predominance of manufacturing FDI for Italy applies to the main destinations of Serbia, Albania, Croatia, Bulgaria, and Romania.

During the first year of the financial crisis (until the end of 2008), Italian FDI flows in the Balkan countries more than doubled with respect to 2007, but in 2009 they decreased by 73 per cent. However, a detailed sectoral analysis highlights the significant differences across sectors. Some sectors had begun to lose their capacity to attract Italian FDI even by the end of 2008. The first sectors to be affected were information and communication (-100%), transportation and storage (-97%), agriculture, forestry and fishing (-86%), financial and insurance activities (-61%), other sector n.e.c. (-60%), accommodation and food service activities (-50%). Between 2008 and 2009, the sectors most affected were: manufacturing (-84%), accommodation and food service activities (-68%) and other service activities (-52%).

Figure 5 depicts the sectoral composition of Italian FDI and the prominence of certain countries as investment destinations. This has implications as to which of the Balkan countries is likely to be most affected by a reduction in FDI. In 2007, Italian FDI was directed mainly to Romania, Bulgaria, Croatia, Serbia, and Albania. Croatia and Romania were mainly recipients of tourism-related investment (accommodation and food service activities). The reduction of FDI in information and communication mainly affected Albania, Bulgaria and Croatia; while

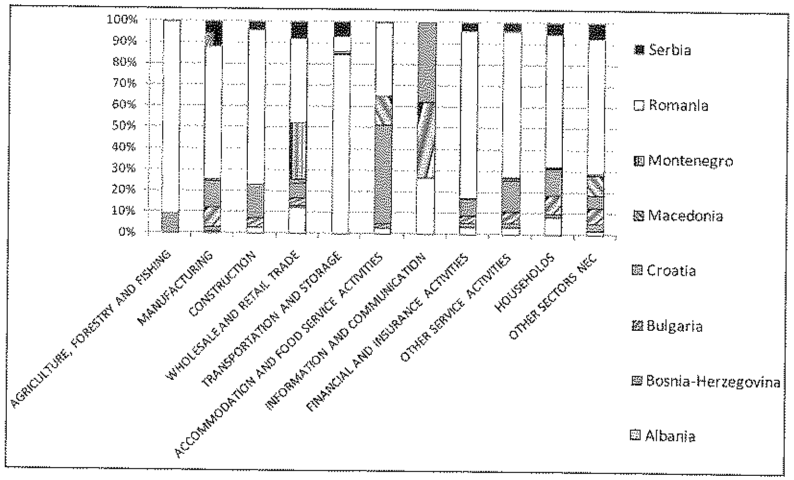
[4] *Household* includes: (1) employment of domestic personnel, and (2) undifferentiated goods- and services-producing activities of private households for own use. *Other service activities* include: (1) membership in organizations, (2) repairs to computers and personal and household goods (e.g. consumer electronics, household appliances and home and garden equipment, footwear and leather goods, furniture and home furnishings, watches, clocks and jewellery), (3) other personal service activities (laundy and (dry-)cleaning of textile and fur products, hairdressing and other beauty treatments, physical well-being activities) (Nace Rev. 2 classification).

Table 3: *Italian FDI towards Balkan countries by sectors, recent trends (values in thousands of euros and percentage changes)*

	2007 value	%	Percentage change 2007-08	2008-9
Manufacturing	162748	30.3	450	-84
Households	143825	26.8	-46	-6
Other service activities	102993	19.2	-39	-52
Financial and Insurance activities	39871	7.4	-61	-8
Construction	29419	5.5	-12	-49
Transportation and Storage	19945	3.7	-97	-30
Wholesale and Retail Trade	19700	3.7	-12	-41
Other Sectors n.e.c.	9795	1.8	-60	14
Agriculture, Forestry and Fishing	7694	1.4	-86	741
Accommodation and Food service activities	878	0.2	-50	-68
Information and Communication	186	0.0	-100	-
	537054	100.0	105	-73

Source: External Trade Statistical Division, Bank of Italy

Figure 5: *Sectoral composition of Italian FDI, by receiving countries, 2007*



Source: External Trade Statistical Division, Bank of Italy

the downward trend in transportation and storage FDI mainly involved Albania, where most of this investment is concentrated. Romania and Croatia were most affected by the reductions in agriculture and financial and insurance activities.

Italian investment in manufacturing industries in the Western Balkans were the most resilient to the first wave of the world economic downturn. However, after continuing to increase in 2008, they recorded a decrease of 84 per cent in 2009 (Table 3).

The industry composition of Italian manufacturing FDI in the area in 2007 reflects the Italian pattern of specialization. If we ignore the exceptionally high investment in the energy industry (coke, refined petroleum, etc.) the main manufacturing industries attracting Italian FDI are textiles, wearing apparel, leather and footwear, electrical equipment, machinery and equipment n.e.c. In 2008, the manufacturing sectors where FDI continued to rise were mainly the traditional light industries of Italian specialization (textiles, wearing apparel, leather and footwear, other non-metallic mineral products), motor vehicles, and coke and refined petroleum products. Interestingly, these industries were also among those least affected by the end of 2009. It should be noted that in 2009 FDI continued to increase in other non-metallic mineral products, motor vehicles, and fabricated metal products, rubber and plastic products.

Instead, in 2009 the industries that suffered the greatest decrease in FDI inflows were paper and printing, coke and refined petroleum products, manufacturing n.e.c., machinery and equipment n.e.c., electrical equipment, food, beverages and tobacco (Table 4).

Figure 6 depicts the main receiving countries by manufacturing sector. In 2007-09 Italian manufacturing FDI was concentrated mainly in Romania, Serbia, Bulgaria, and Croatia. Croatia was especially important for Italian FDI in the chemicals industry, and manufacturing n.e.c., Albania in other non-metallic mineral products, Montenegro in basic metals, and Serbia in textiles, clothing and footwear and in motor vehicles. Note that in September 2008 Fiat concluded a deal for the highest foreign investment in Serbia since the beginning of the tran-

Table 4: *Italian manufacturing FDI towards Balkan countries, recent trends (values in thousands of Euros and percentage changes)*

	2007 value	%	Percentage change 2007-08	2008-9
Food, Beverages and Tobacco	9378	6.3	-40	-75
Textiles, Wearing Apparel, Leather, Footwear	27155	18.4	2	-15
Paper and Printing	2233	1.5	-51	-100
Coke and Refined Petroleum Products	52453	35.5	1489	-100
Chemicals	7963	5.4	-89	-51
Rubber and Plastic Products	8082	5.5	-85	28
Other Non-Metallic Mineral Products	2204	1.5	72	86
Fabricated Metal Products	6718	4.5	-59	27
Electrical Equipment	13689	9.3	-82	-84
Machinery and Equipment nec	10827	7.3	-7	-86
Motor Vehicles	397	0.3	94	12644
Manufacturing nec	6774	4.6	-50	-94
	147873	100.0	504	-84

Source: External Trade Statistical Division, Bank of Italy

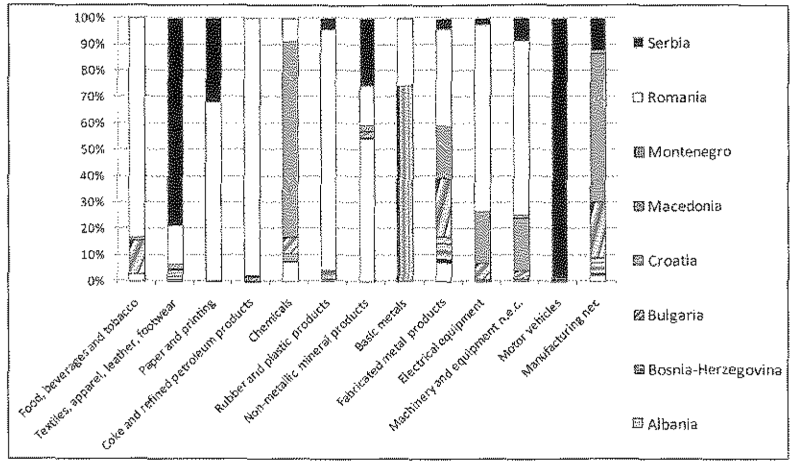
sition. Investment had previously involved mostly small and medium-sized Italian firms, whose investment activity played an important role in the country's privatization process.

Marche-Balkan Country Flows

Analysis of the data for the Marche Region confirms some of the trends highlighted in the country-level analysis. Between 2005 and 2009 the attraction of the entire Balkan area increased substantially (FDI flows increased by 162% overall), thanks specifically to the Western Balkans (+ 339%). In 2005 the Western Balkans accounted for half of the FDI from the Marche Region to the area, while in 2009 they accounted for 95 per cent of flows.

In 2008-09, the financial crisis reduced investment in Romania (-82%), but in 2009 investment in Croatia and Serbia in-

Figure 6: *Industry composition of Italian manufacturing FDI, by receiving countries, 2007-2009 (cumulative flows)*



Source: External Trade Statistical Division, Bank of Italy

creased substantially. As for Albania, despite a significant reduction in 2009 (-64%), FDI flows to this country were double the 2005 level.

Overall, based on cumulative flows in the period, the interest of entrepreneurs from the Marche region was focused mainly on Serbia and Romania. Investment in Serbia has continued to grow: this country accounted for 88 per cent of total flows to the area in 2009 compared to 44 per cent in 2005. Romania, on the other hand, has suffered a significant reduction in investment, accounting in 2000 for only 3 per cent of new investments.

Textiles, clothing, and footwear are the predominant manufacturing sectors in receipt of investment. Local entrepreneurs have been constantly active, especially in Serbia, but they are also investing in Bosnia-Herzegovina and Romania (although at a decreasing rate). Food and beverages is also important, although investments came to a halt in 2009 after two years of considerable increase.

Investment in Romania and Albania is highly diversified (textiles, wearing apparel, leather and footwear, electrical equipment, food, beverages and tobacco), while in Serbia it is concentrated in textiles, wearing apparel, leather and footwear. This implies that there is potential for more and fruitful cooperation agreements with Serbia.

Table 5: *FDI from the Marche region, by country (thousands of Euros)*

	2005	2006	2007	2008	2009
Albania	211	348	657	1760	627
Bosnia-Herzegovina		325	450	100	
Bulgaria	138	167	449		466
Croatia	959	1564	2099	479	893
Montenegro		160	22		
Serbia			11176	16034	21283
Serbia and Montenegro	4050	6790			
Romania	3829	3232	15009	6125	706
Balkancountries	*9187*	*12101*	*29875*	*24870*	*24075*
Western Balkans	*5220*	*8702*	*14417*	*18745*	*22903*

Table 6: *FDI from the Marche region, by country and manufacturing industry, thousands of euros*

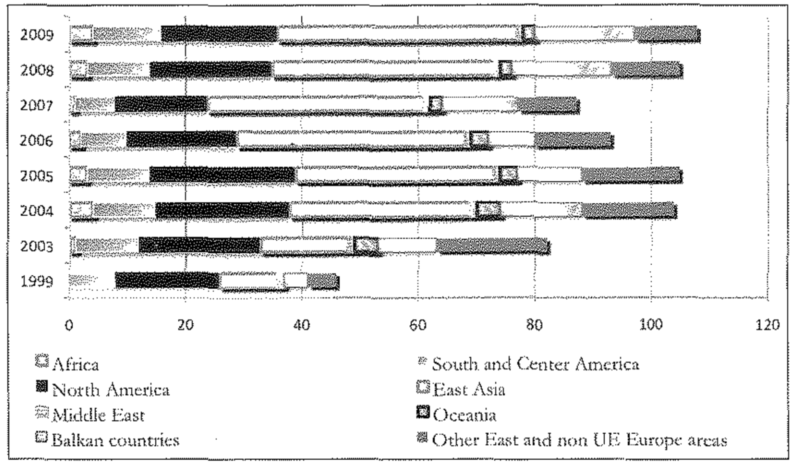
Industry	2007	2008	2009	Country Destination
Food, Beverages and Tobacco	-	350	-	Albania
Food, Beverages and Tobacco	3060	3060	-	Romania
Textiles, Wearing Apparel, Leather and Footwear	200	-	-	Bosnia Herzegovina
Textiles, Wearing Apparel, Leather and Footwear	625	1202	325	Romania
Textiles, Wearing Apparel, Leather and Footwear	11.000	16.000	21.225	Serbia
Coke And Refined Petroleum Products	200	-	-	Romania
Chemicals	100	-	-	Albania
Other Non-Metallic Mineral Products	200	185	55	Albania
ElectricalEquipment	7000	-	-	Romania
Total	*22.385*	*20.797*	*21.605*	

In terms of greenfield and non-greenfield investment by entrepreneurs from the Marche Region, trends in their internationalization strategies help explain the attractiveness of host countries, and the area as a whole.

This analysis is based on the Fondazione Merloni database, which provides information on the number and specific locations of foreign-controlled companies in the Balkans.

Since 2000, interest in the area has increased, even if the Balkans area remains marginal in the internationalization processes of local Marche firms. The most dynamic area is Asia, particularly China, where the number of foreign subsidiaries grew by 20 units (from 3 to 23), in a context of increasing propensity for foreign investment (Figure 7)

Figure 7: *Geographical distribution of foreign subsidiaries of companies based in the Marche Region (number)*



Source: own calculations on FMDB

In 1999 only 9 per cent of foreign subsidiaries outside UE involved the Balkans; in 2009 the figure had risen to 16 per cent. The countries involved are the more economically advanced Balkan countries: Croatia, Bulgaria, Romania, and Serbia. Similar to the situation for FDI flows, there is particularly high interest in Romania. From a sectoral perspective, firms in the footwear industry are the main investors in the area. Mechanical engineering firms are increasing, but there are only a few subsidiaries related to clothing, electrical tools, furniture, and food in the Balkans area. If we compare with Banca d'Italia data on FDI, we note differences especially in terms of the clothing industry, where there is a large share of FDI flows from the Marche region to the Balkans. This may be because even small companies – usually not included in the FMDB data – are involved in the internationalization process through direct investment.

Table 7: *Sectoral distribution of subsidiaries in the Balkans (number)*

	1999	2003	2004	2005	2006	2007	2008	2009
Food	0	1	1	1	1	2	2	2
Shoes	2	3	4	2	2	6	9	9
Mechanical engineering	1	4	4	4	3	3	4	4
Clothing	0	0	2	2	1	1	1	1
Electrical tools	0	1	1	0	0	0	0	0
Furniture	1	1	2	2	1	1	1	1
Total	*4*	*10*	*14*	*11*	*8*	*13*	*17*	*17*

Source: own calculations on FMDB

Table 8: *Geographical distribution of subsidiaries in the Balkans (number)*

	1999	2003	2004	2005	2006	2007	2008	2009
Bulgaria	1	1	1	1	2	2	4	4
Croatia	0	1	1	1	1	1	1	1
Romania	3	7	9	7	4	8	10	10
Serbia	0	1	3	2	1	2	2	2
Total	*4*	*10*	*14*	*11*	*8*	*13*	*17*	*17*

Source: own calculations on FMDB

The effects of the GFC have halted the internationalization process of Marche region companies, and especially in 2009.

As a consequence of the global economic downturn, investment in the Balkans, as in other regions, has come to a halt. 40 per cent of firms in the database experienced a decrease in their turnover of between 20 per cent and 40 per cent, and foreign sales decreased, on average, by 20 per cent. The only upward trend in the internationalization process, towards Asia and Africa, is related to a single firm with substantial investments, and which has opened three new branches in Kazakhstan and another in Taiwan.

The year 2009 is the first since 1999 in which there have been no new business initiatives in the Balkans. The fact that there has not been any disinvestment, however, is symptomatic of a generally positive assessment of future prospects, and also indicative that, in the past, and especially in the case of Romania and the footwear sector, there have been episodes of temporary and highly volatile investment activity.

Concluding Remarks

FDI are proving to constitute a highly significant mechanism of economic integration between the Italian economy and the Western Balkans. Italian companies – especially those in the Marche region – are strengthening their ties with overseas regions. In recent years, Italy and the Marche have become leaders in traditional manufacturing industries especially. Although the financial crisis has halted world investment, it has not reduced interest in the Western Balkans as a destination for FDI.

It has become clear that these countries are considered prime destinations for investment, much more so than other Balkan countries (Romania and Bulgaria), even though these latter have monopolized Italian FDI in the past. The interest in the Western Balkans is due to the characteristics of their structural economic change – growing demand, initial phase of economic development – and their location. They are markets with high potential, and they provide access to rapidly growing markets, such as Russia and the CIS. They have no absolute advantages in terms of cost, and other world countries can offer more favourable conditions in terms of access to labour, for example.

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Appendix

To obtain a better picture of the relative attractiveness of Balkan countries for Italian FDI we computed a relative attractiveness index *(I)* on the basis of normalized shares of Italian FDI in the area. The relative attractiveness index was constructed as follows:

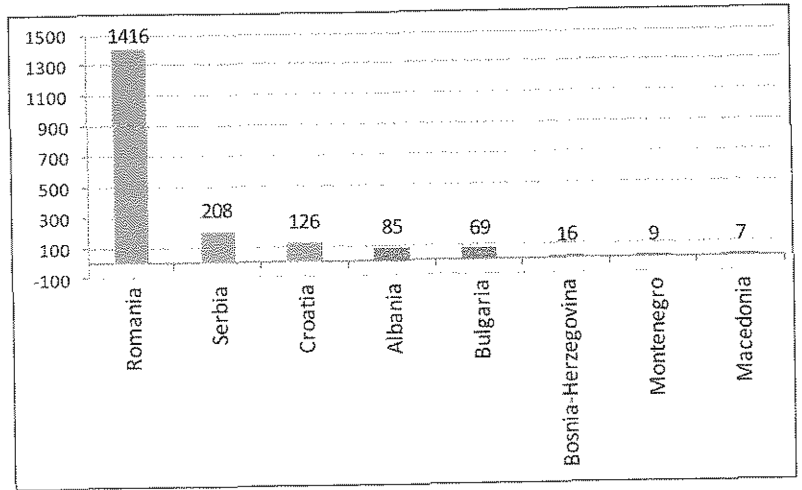
$$I = \frac{FDI^{C}_{Italy} \Big/ FDI_{Italy}}{FDI^{C}_{World} \Big/ FDI_{World}} - 1$$

where:

FDI^{C}_{Italy} : = Italian FDI toward each Balkan country
FDI_{Italy} : = Italian FDI toward the whole Balkan area
FDI^{C}_{World} : = World FDI toward each Balkan country
FDI_{World} : = World FDI toward the whole Balkan area

A value above 0 means that the country considered is more attractive than average to Italian FDI.

Figure A1: *Italian FDI by receiving country, cumulative flows 2007-09 (millions of euros)*



Source: External Trade Statistical Division, Bank of Italy