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Getting Stronger After COVID-19:

Nearshoring Potential in the Western Balkans

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Executive summary

The COVID-19 pandemic threw global supply chains into disarray, decimating foreign direct investment and generating uncertainty unlike anything since World War II. It is unclear what global production, trade and investment will look like after the pandemic, but it is almost certain that they will look differently than in the pre-pandemic world.

Terms like ‘reshoring’, ‘back-shoring’, ‘near-shoring’ and ‘onshoring’ are on the rise, both in media and academia, reflecting the current trend among multinational companies, of reconsidering their supply chains. The disruptions brought by the COVID-19 pandemic have made companies think about increasing the resilience of their production through supply diversification, shorter supply chains, geographically closer locations, more production at home and increased inventories.

This study aims to analyse whether and how the Western Balkan economies could benefit from these trends after the COVID-19 pandemic.

The study begins by discussing recent trends in global supply chains, international trade and foreign investment. It then presents an econometric analysis of determinants of foreign direct investment in the Western Balkans and East Asia, trying to provide more detailed insights into the reasons for investing in the Western Balkan economies, compared to the East Asian economies. This is followed by a set of surveys, interviews and case studies, of different actors involved in global supply chains and investment, including foreign companies that have invested in the Western Balkans, foreign companies that are considering investing in the Western Balkans, local companies from the Western Balkans, and investment promotion agencies from these economies. Based on all this, conclusions and recommendations for the involved stakeholders are provided in the end.

The main take-aways from this study would be that the Western Balkan economies can indeed benefit from near-shoring trends in the post-pandemic world, but their governments will have to take a very active role and use available policy levers in a sensible way to achieve that.

Near-shoring to countries and regions closer to Western Europe is likely to emerge after the pandemic. Even if it turns out to be on a smaller scale, it can still have a major impact on the Western Balkan economies due to their small sizes. And the surveys undertaken as part of this study show that the Western Balkan economies appeal to Western European companies, not just because of their good geographical locations and competitive wage levels, but also because of ‘soft’ factors such as cultural proximity and the reputation of their workers as skilled and hard-working.

But in order to enhance their potential in the post-pandemic world, the analysis shows that Western Balkan economies could benefit from maximizing their (perceived) strong sides, and minimizing their (perceived) weaknesses. Building on the competitive advantage of low labour costs alone may not be sufficient to attract more investments in the future. Putting a focus on skilled labour, investment in education and training, and modernisation of the educational system would be beneficial for attracting

investors in the time to come. Improving infrastructure and governance would be similarly important from the perspective of current and potential investors.

The analysis also finds that improving the cooperation between domestic and foreign companies has the potential to ensure positive technological spillovers and supplier linkages with domestic companies, and would benefit local firms. Stepping-up regional cooperation and achieving a higher level of concrete regional integration would be also beneficial, both to foreign investors, as they would be able to source regionally, and to the local companies, as it would allow them to cooperate with foreign companies.

The COVID-19 pandemic is creating a new reality worldwide. Western Balkans economies could seize the opportunities arising from this new reality. Global economy and production networks will tend to become more resilient to shocks after the pandemic. Western Balkan economies can also emerge stronger, if they change as the world is changing.

Keywords: FDI, near-shoring, global value chains, Western Balkans, COVID-19

JEL classification: F21, E22

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TABLES AND FIGURES

LIST OF ABBREVIATIONS

AHK	German Chambers of Commerce Abroad
AIDA	Albanian Investment Development Agency
ALB	Albania
ASEAN	Association of Southeast Asian Nations
BiH	Bosnia and Herzegovina
CEFTA	Central European Free Trade Agreement
CESEE	Central, East and South-East Europe
CIS	Commonwealth of Independent States
RAS	Development Agency of Serbia
DIHK	Association of German Chambers of Industry and Commerce
DTIDZ	Directorate for Technological–Industrial Development Zones of North Macedonia
EFTA	European Free Trade Association
EU	European Union
EU-CEE	European Union member states from Central and Eastern Europe
EUR	Euro
FDI	Foreign Direct Investment
FIPA	Foreign Investment Promotion Agency of Bosnia and Herzegovina
GDP	Gross Domestic Product
GTAI	Germany Trade and Invest
ICT	Information and Communications Technology
IMF	International Monetary Fund
KOS	Kosovo
KIESA	Kosovo Investment and Enterprise Support Agency
MENA	Middle East and Northern Africa
MIPA	Montenegro Investment Promotion Agency
MKD	North Macedonia
OECD	Organisation for Economic Co-Operation and Development
SRB	Serbia
STEM	Science, technology, engineering, and mathematics
UNCTAD	United Nations Conference on Trade and Development
UK	United Kingdom
US	United States
USD	United States Dollar
VAT	Value Added Tax
WB	Western Balkans
WB6 CIF	Western Balkans 6 Chamber Investment Forum
wiiw	The Vienna Institute for International Economic Studies

1. Introduction

The COVID-19 pandemic turned the whole world upside-down. Things that were considered impossible happened in the blink of an eye. In the wake of the pandemic, borders were closed, the movement of people and goods was halted, and lockdowns were imposed in an effort to contain the spread of the virus. This interrupted global production and value chains, and although these measures were relaxed later on, the risk of unexpected disruptions remained. These factors have led multinational companies to start rethinking the way they organise their production.

During the previous several decades multinational companies' production went through a process of globalisation. Many activities were moved abroad in an effort to reduce production costs, and processes were organised in a just-in-time manner so that inventories were kept to minimum. Global value chains emerged and production was internationalised.

The pandemic revealed the vulnerabilities of this model, and many companies began to think about re-organising their production, in order to make it more resilient to shocks such as the COVID-19 pandemic.

Topics like near-shoring, back-shoring, on-shoring and re-shoring started receiving more and more attention in the public and academic discourse. This reflected a general trend among multinational companies, who started to consider bringing production closer to their home countries in an effort to address the new perceived vulnerability of extended supply chains.

But these terms are by no means new and were the topic of academic discussions even before the pandemic. The world was already going through a process of a slow-down in international trade and FDI after the global financial crisis of 2007-2008, which some called the ”globalisation slowdown”.

UNCTAD (2020) reported a slowdown in international production after 2010, i.e. after the Great Recession, identifying several reasons for this, such as: a return to protectionism, interventionism and policy uncertainty; a gradual decline in returns on FDI; and new technologies favouring asset-light forms of international production (digitalisation, robotisation, 3D printers etc).

Eurofound (2016), similarly, noted a slowdown in companies' offshoring activities in recent years, arguing that this may be due to increased global uncertainty, but also because the previous two decades might have been an exception in the history of globalisation due to the integration of China and Eastern Europe into the global economy. They also found that the slowdown in globalisation refers mainly to a slowdown in offshoring, and that reshoring has remained rather small in the last two decades.

Eurofound (2019) discussed reshoring in greater detail, noting that there has been an upward trend in these activities since 2014, the main reason being the poor quality of off-shored production.

UNCTAD (2020) has argued that these recent trends will now be strengthened by COVID-19, which will make companies think about increasing the resilience of their supply chains. They will try to reduce the risk of supply chain disturbances and to increase self-sufficiency and autonomy in production, which will lead to shorter supply chains and closer geographical locations.

This study aims to assess whether the Western Balkan economies of Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia can benefit from the possible changes in international production networks in the years to come. It discusses how potential nearshoring trends that may emerge, or strengthen, in the post-pandemic period, can be turned to these economies' advantage.

The study starts with a discussion of recent trends in FDI and supply chain developments. It first presents data on FDI in the Western Balkans, disaggregating them by country of origin and target industry. It then presents data on FDI originating from Germany, dissecting the data by host country and industry. Finally, COVID-19 developments are discussed for both of these aspects.

The study proceeds with an econometric analysis of determinants of FDI that originates in EU and OECD countries and goes to the Western Balkans, Central and Eastern Europe and East Asia. The purpose of this analysis is to shed light on the factors that are important for attracting FDI, as well as to see how the Western Balkan economies compare to other European and East Asian countries in this sense. Eastern and Central European and East Asian countries have been chosen because they are usually considered the main competitors of the Western Balkans when it comes to FDI. Following the literature on FDI, several groups of determinants are considered, referring to education, institutions, infrastructure, taxes, labour market variables, structure of the economy and economic stability.

The third section presents the results of several different surveys and interviews conducted with three different groups of German companies: German companies with international operations which are not necessarily related to the Western Balkans, German companies that are considering investing in the Western Balkans but have not yet invested, and German companies that have invested in the Western Balkans. The purpose of this analysis is to provide additional understanding of the factors that are important to multinational enterprises when it comes to investing abroad, the strong and weak sides of the Western Balkans, and what can be done to improve their position.

The fourth section complements the analysis from the previous chapter by presenting some additional insights obtained from surveys, interviews and case studies of local actors from the Western Balkans. First, the results of a survey conducted with local companies are presented, with the purpose of seeing how local companies view foreign investors, how they cooperate with them, whether they can cooperate more and the obstacles to more cooperation. Then, case studies of local success stories, i.e. domestic companies that are successfully cooperating with foreign companies, are presented, to reveal the reasons behind this success and lessons that can be learned from them. Finally, the chapter concludes with interviews with representatives of investment promotion agencies from the Western Balkans in order to see how these agencies view the process of attracting foreign investors, cooperation between local and foreign companies, and how these aspects have changed with the COVID-19 pandemic.

The final section summarises the main findings of the study and provides some recommendations for involved stakeholders.

2. Overview of FDI developments in the Western Balkans

From 2010 to 2019 EUR 45 bn of FDI has entered the Western Balkan economies. Half of that has been in Serbia and one fifth in Albania. As a share of GDP, during the same period, FDI inflows have averaged 6.1% per annum, one of the highest levels in the whole of CESEE. Montenegro has been on top with 11.8% of GDP and Albania second with 8.4% of GDP. FDI has been increasing in Serbia and North Macedonia, stagnating in Albania and Bosnia and Herzegovina and declining in Kosovo and Montenegro. Most of the FDI has been in manufacturing, followed by finance and trade. The top five investors in the Western Balkans have been the Netherlands, Switzerland, Austria, Russia and Germany.

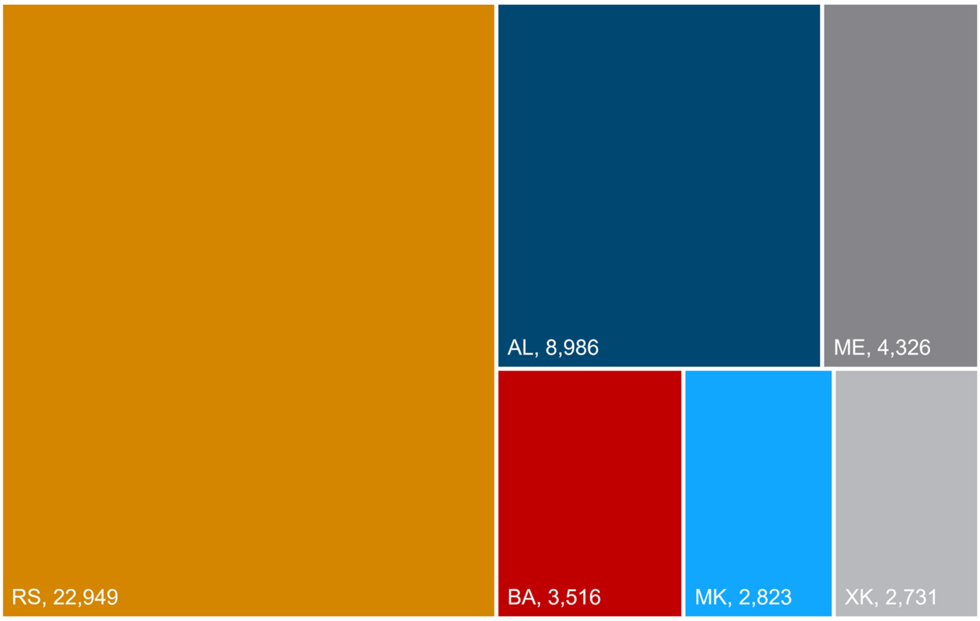
2.1. TRENDS IN FDI INFLOWS IN THE WESTERN BALKAN ECONOMIES

For the six Western Balkan economies – Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia – foreign direct investment (FDI) is a top priority. All these economies have special state agencies focused on attracting FDI, and some of them even have dedicated ministries; they all provide attractive benefit packages to foreign investors, consisting mainly of tax holidays for a certain period and direct financial support; and most of them have special investment zones where foreign investors can easily locate their facilities. Their policy makers and politicians constantly point out that they are very open to FDI. The concrete incentives that each of them provides are documented in Boxes 1-6 at the end of this chapter.

These policies have generally been effective over the past decade. In the ten years between 2010 and 2019 a total of EUR 45 billion of FDI has entered these six economies. Around half of this (EUR 23 billion) was invested in Serbia, Albania was second with EUR 9 billion, Montenegro was third with EUR 4.3 billion, while Bosnia and Herzegovina, North Macedonia and Kosovo each received between EUR 2.7 – 3.5 billion of FDI (Figure 1).

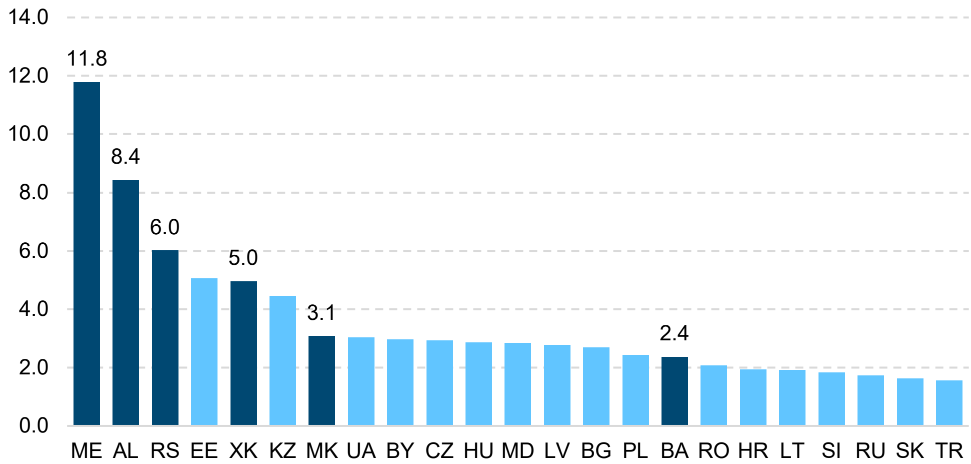
As a share of GDP the average inflows of FDI for the Western Balkan (WB) economies during 2010-2019 was 6.1% of GDP. As a percentage of GDP this is considerably higher than the other countries in Central, East and South-East Europe (CESEE), where the average during the same period was 2.6% of GDP. Five of the WB economies are in the top 7 for the whole CESEE region. The leader is Montenegro with an average of 11.8% of GDP, Albania is second with 8.4% of GDP, and Serbia is third with 6% of GDP. Kosovo is fifth for the whole region, right behind Estonia, while North Macedonia is seventh, behind Kazakhstan. Only Bosnia and Herzegovina is in the bottom half for the region (Figure 2).

Figure 1 / Total accumulated FDI inflows into Western Balkan economies between 2010-2019 (millions of euros)



Source: wiiw FDI database.

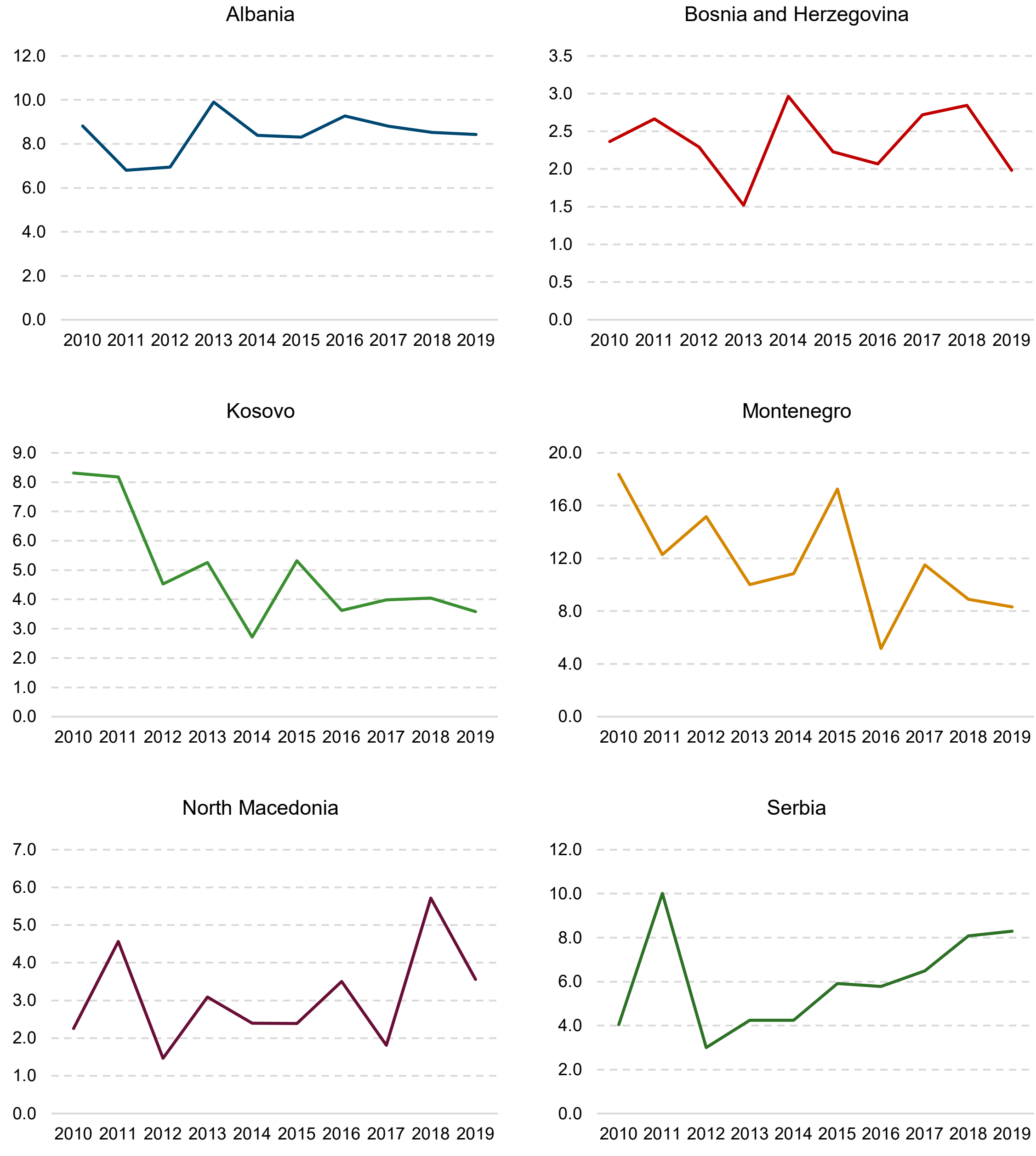
Figure 2 / FDI inflows in CESEE economies during 2010-2019 (% of GDP)



Source: wiiw FDI database.

Looking at the trends for each of the WB economies, one can note that in Albania and Bosnia and Herzegovina inward FDI has been stable during the period 2010-2019. In Kosovo and Montenegro, it has been on a downward trend, while in North Macedonia and Serbia FDI has been growing throughout the years (Figure 3).

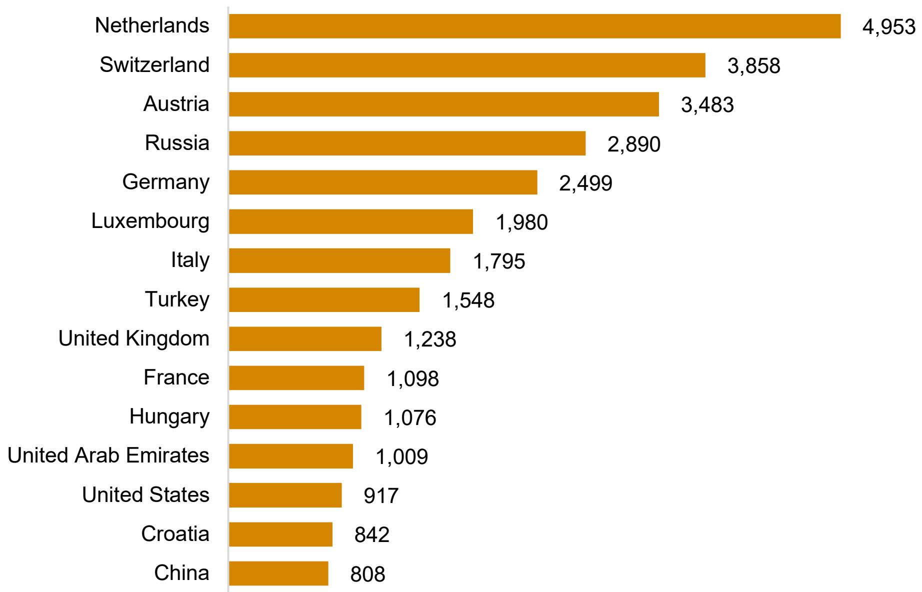
Figure 3 / FDI inflows in each of the WB economies during 2010-2019 (% of GDP)



Source: wiiw FDI database.

Most of the FDI in the WB in this period came from the Netherlands, for a total of EUR 5 billion; many multinational companies choose the Netherlands as their headquarters, due to its favourable tax regime. Switzerland and Austria were next with EUR 3.9 billion and EUR 3.5 billion. Russia and Germany followed, with EUR 2.9 billion and EUR 2.5 billion respectively (Figure 4).

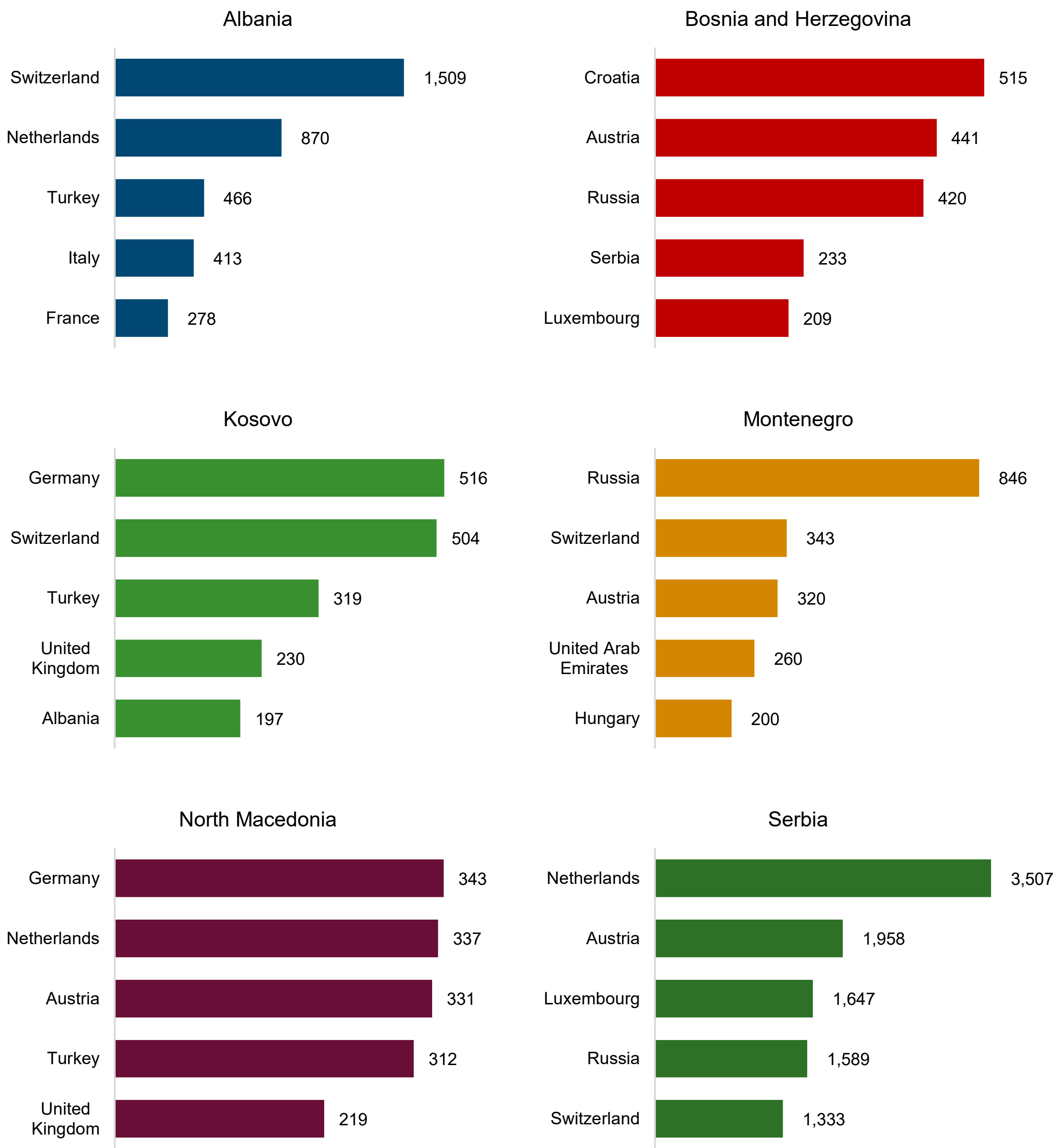
Figure 4 / FDI inflows into the WB during 2010-2019, by country of origin (EUR million)



Source: wiiw FDI database. Data for Albania refer to 2013-2019.

The top 5 origin countries for each of the six WB economies are shown on Figure 5. For Albania most of the FDI came from Switzerland, in Bosnia and Herzegovina the biggest investor was Croatia, in Kosovo and North Macedonia most of the FDI came from Germany, Russia was the biggest investor in Montenegro, while the Netherlands has been the biggest investor in Serbia.

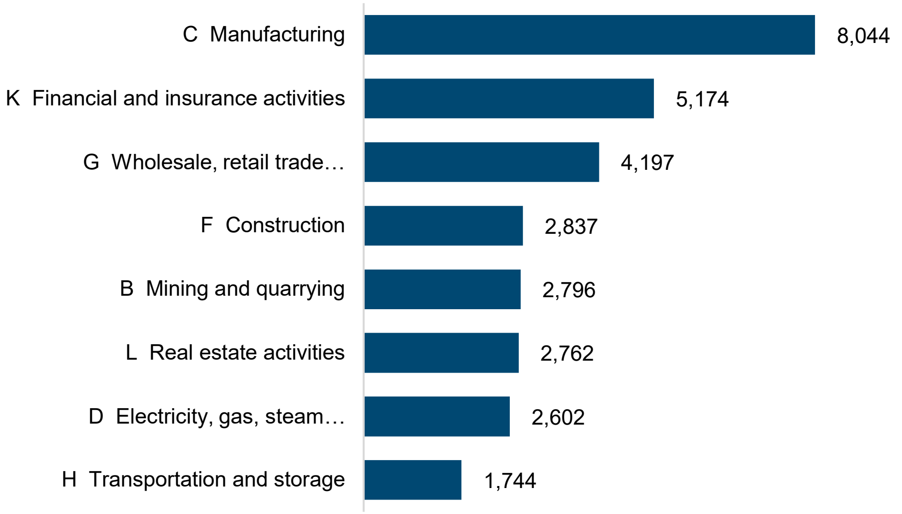
Figure 5 / Top 5 countries of origin of FDI for each of the six WB economies (EUR million)



Source: wiiw FDI database. Data for Albania refer to 2013-2019.

Most FDI in the WB during 2010-2019 was in manufacturing, at around EUR 8 billion. Finance and insurance came in second with EUR 5.2 billion of investment. Wholesale and retail trade received the third largest amount with EUR 4.2 billion of investment. Construction, mining, real estate and energy followed, with total investment in each of them of between EUR 2.6 – 2.8 billion (Figure 6).

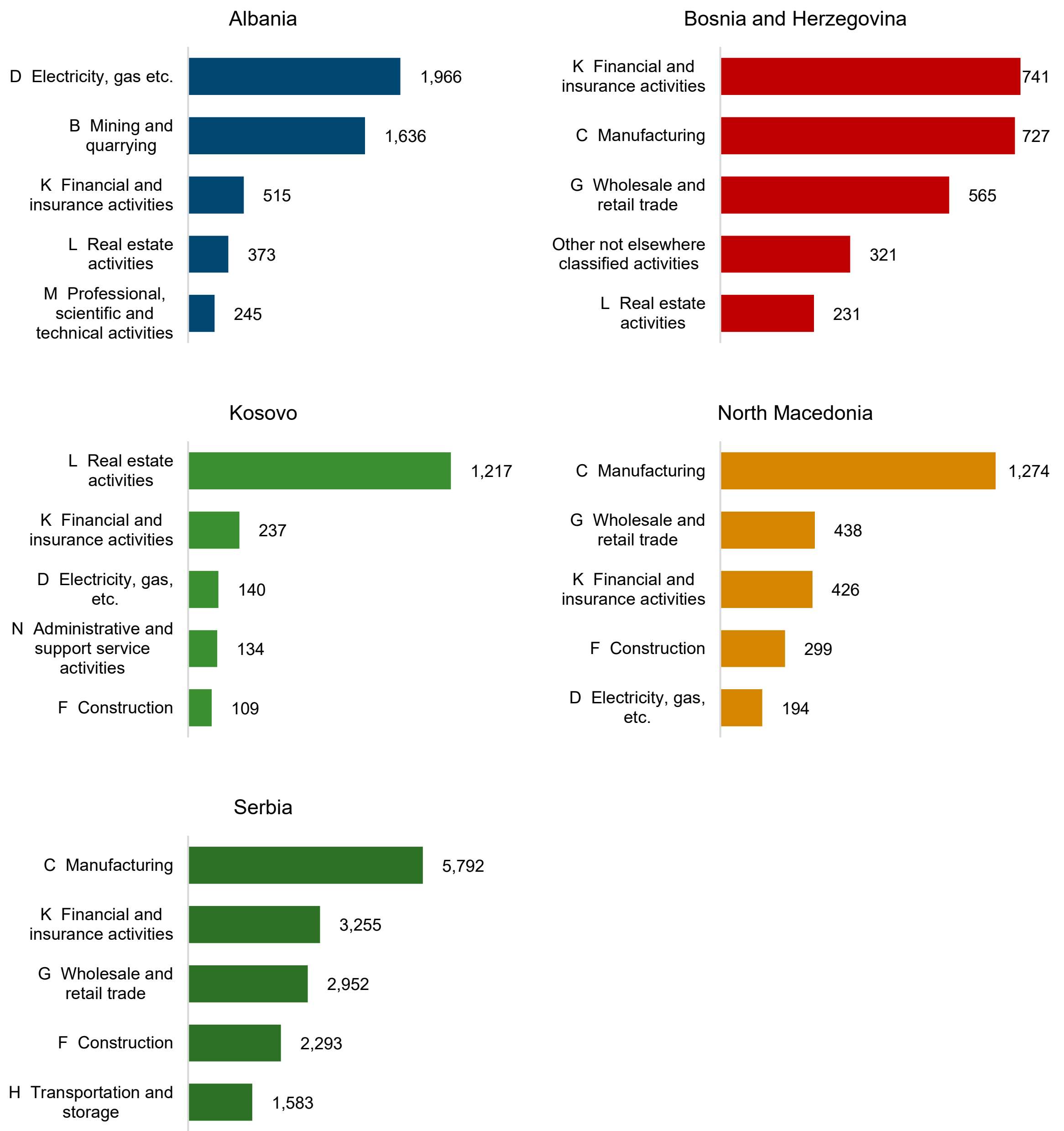
Figure 6 / FDI inflows in WB during 2010-2019, by sector (EUR million)



Source: wiiw FDI database. No data on Montenegro.

The sectors which have received most of the FDI differ for each of the WB economies. In Albania most FDI inflows are in the energy sector, followed closely by mining. In Bosnia and Herzegovina FDI in finance dominates, followed by manufacturing and trade. In Kosovo most FDI has gone into real estate. In North Macedonia and Serbia, manufacturing dominates. For Montenegro there are no data on FDI inflows by industry (Figure 7).

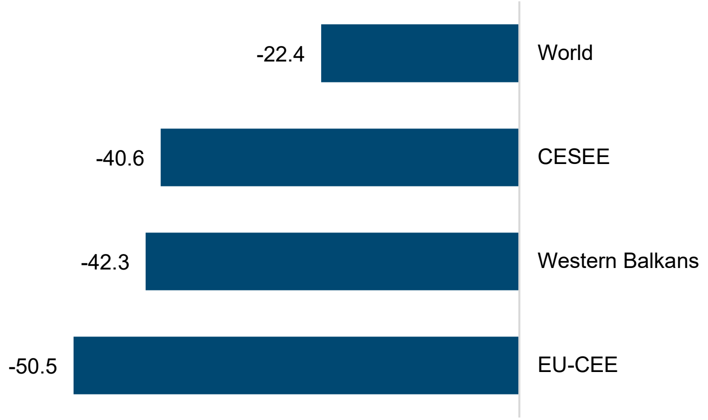
Figure 7 / Top 5 sectors for FDI inflows in the WB economies (EUR million)



Source: wiiw FDI database.

The COVID-19 pandemic strongly affected FDI in the WB. Total FDI inflows in the six WB economies was 42% lower in the second and third quarters of 2020 than in the same period the year before. This was almost twice as high as the decline in global FDI during the same period, which was 22%. The decline in the WB is similar to that for the whole of CESEE, which was 41%, and is slightly better than the decline in EU-CEE, which was 50% (Figure 8).

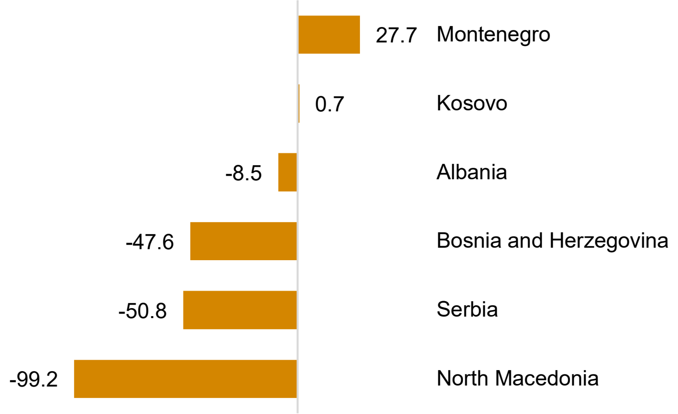
Figure 8 / Decline in FDI in Q2 and Q3 of 2020 compared to the same period in 2019 (in percent)



Source: IMF Balance of Payments Statistics

There were notable differences among WB economies during the pandemic in terms of FDI developments, with some of them experiencing an almost complete halt of FDI, while in some FDI continued to grow. The most severely hit economy was North Macedonia, where the decline in the second and third quarter of 2020 was 99%. In Serbia and Bosnia and Herzegovina the decline was 51% and 48% respectively, while Albania had a rather small decline of 8.5%. In Kosovo FDI grew slightly during the pandemic, by 0.7%, while in Montenegro it grew by 28% (Figure 9).

Figure 9 / Change in FDI in WB in Q2 and Q3 of 2020 compared to the same period in 2019 (in percent)



Source: IMF Balance of Payments Statistics.

2.2. TRENDS IN FDI OUTFLOWS FOR THE BIGGEST INVESTORS IN THE WESTERN BALKANS

Looking at the four European countries where most FDI in the Western Balkans originates (the Netherlands, Switzerland, Austria and Germany), one can note that the Western Balkan economies take up a minor share of their total outward FDI (Table 1). For the Netherlands, Switzerland and Germany, the share of outward FDI that goes to the WB is less than 1%. Only for Austria is the share of WB FDI more significant at 4.8%. Since the WB economies are relatively smaller than other CESEE countries, their share in FDI originated in other countries is relatively smaller.

Table 1 / Outward FDI from the Netherlands, Switzerland, Austria and Germany, total during 2010-2019

	Total outward FDI (EUR million)	FDI in the WB (EUR million)	FDI in the WB (% of total)
Netherlands	572,066	3,991	0.7%
Switzerland	479,529	3,858	0.8%
Austria	72,827	3,483	4.8%
Germany	705,169	2,499	0.4%

Source: OECD FDI Statistics. Data on the Netherlands refer to 2010-2018.

Most outward FDI from these four countries goes to Europe (including the Western Balkans), i.e. more than one half. North America and Asia are the next biggest destinations. For the Netherlands, Central and South America are also sizeable. Africa, Australia and Oceania take up a small share (Table 2)[1].

Table 2 / Geographical distribution of outward FDI from the Netherlands, Switzerland, Austria and Germany during 2010-2019

	Germany	Austria	Netherlands	Switzerland
Europe	61%	82%	51%	58%
Africa	1%	1%	4%	2%
North America	16%	7%	10%	27%
Central and South America	4%	-11%	20%	1%
Asia	16%	19%	9%	13%
Australia and Oceania	1%	2%	5%	-1%

Source: OECD FDI Statistics. Data on Netherlands refer to 2010-2018.

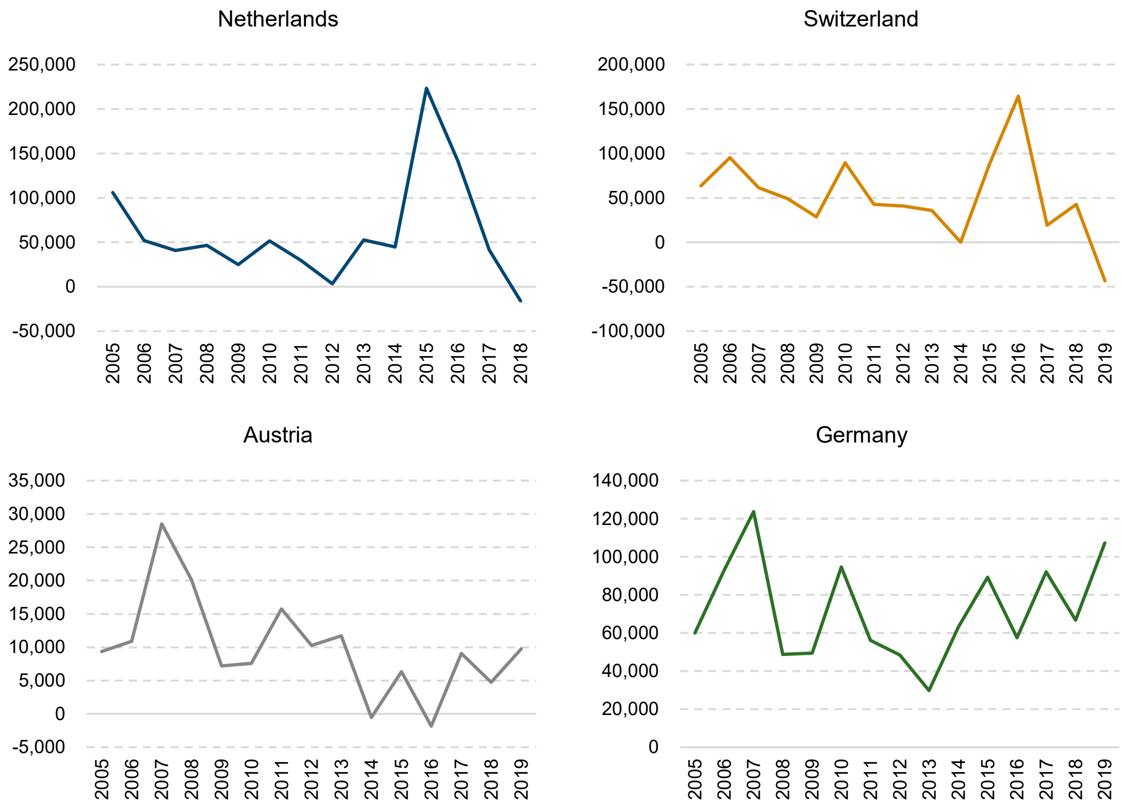
Outward FDI from these four countries has in general been declining during 2010-2019 (Figure 10). In 2018, total outward FDI from these four countries amounted to EUR 98 billion, compared to EUR 243 billion in 2010. There were some spikes in outward FDI for the Netherlands in 2015 and Switzerland in 2016, but this does not change the overall trend.

The negative trend over the past decade has been reinforced by the COVID-19 pandemic, which had a strong impact on outward FDI from the four countries. In the second and third quarters of 2020 outward FDI from Germany was EUR 19 billion below the level of the same period in 2019, in the Netherlands it

1 Negative values in FDI flows may indicate disinvestment in assets or discharges of liabilities.

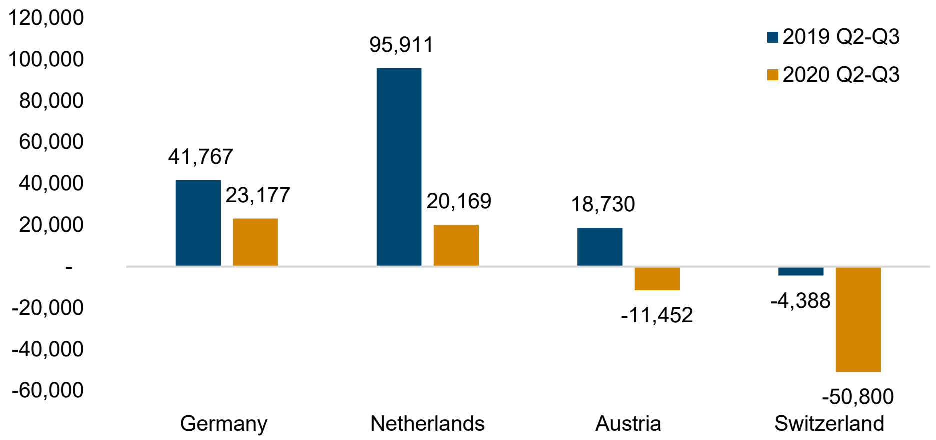
was down by EUR 76 billion, for Austria the decline was EUR 30 billion, while for Switzerland it was EUR 46 billion lower (Figure 11).

Figure 10 / Total outward FDI from the Netherlands, Switzerland, Austria and Germany (EUR million)



Source: OECD FDI Statistics. Data on the Netherlands refer to 2010-2018.

Figure 11 / Change in total outward FDI from the Netherlands, Switzerland, Austria and Germany during the pandemic (EUR million)



Source: Eurostat.

2.3. SUMMARY

The statistics show that the Western Balkan economies have been quite successful in the last decade in terms of attracting FDI. Annual FDI inflows have averaged 6.1% of GDP, which is considerably higher than for the other CESEE countries. Montenegro has been the leader for the whole CESEE region with an average of 11.8% of GDP, Albania has been second with 8.4% of GDP, Serbia third with 6% of GDP and Kosovo fifth, with 5% of GDP. Only North Macedonia and Bosnia and Herzegovina have been slightly worse, with 3.1% and 2.4%. Most investment has been in manufacturing, followed by finance and trade. The top 5 investor countries have been the Netherlands, Switzerland, Austria, Russia and Germany. The COVID-19 pandemic has brought about a decline in FDI in the Western Balkans, but this has been less pronounced than in the CESEE countries that are EU members.

BOX 1 / INVESTMENT INCENTIVES IN SERBIA

The Development Agency of Serbia acts as the country's investment promotion agency.

The country has 15 free zones, offering advantages such as a streamlined process for obtaining land, favourable geographic locations, ready-to-use infrastructure, leasing business premises, production space and warehouse under favourable conditions. There are also special benefits and privileged tax regime for the users of the free zones, such as exemption from VAT and customs duties for import of raw materials intended for the production of export goods, machinery, equipment and building material.

Financial incentives are offered for greenfield and brownfield projects in the manufacturing sector and services, to offset initial capital investments and ease the start-up of businesses. The maximum amount of support is 50% of eligible investment costs.

Corporate Profit Tax Holiday, for 10 years, is available for investors who hire more than 100 employees and invest more than 8.3 million euros (1 billion RSD). Tax holiday begins once the company starts making a profit.

Payroll tax incentives, for employment of people who were registered with the National Unemployment Agency for more than 6 months, reducing the taxes paid on net salary from the moment of employment, up to 75%. Payroll tax incentives cannot be combined with the financial incentives.

Awarding construction land at a price which is lower than the market price in support of an investment project that is of national importance (if the land is owned by the government), or an investment project that promotes local economic development (if the land is owned by the local municipality).

BOX 2 / INVESTMENT INCENTIVES IN NORTH MACEDONIA

North Macedonia has two government agencies dedicated to attracting and supporting foreign investors – the Agency for Foreign Investment and the Export Promotion and Directorate for Technological Industrial Development Zones. In addition, there are several government ministries with such competences.

The government has established **14 free economic zones** where foreign investors can easily start businesses, with ready-to-use infrastructure and other favourable conditions.

Investors can receive a 10-year tax holiday for profit and corporate tax and a 100% reduction in personal income tax for a period of up to 10 years. Investors are also exempt from payment of value added tax for goods from the free zones. Additionally, investors are exempt from payment of customs duties for capital and intermediate goods such as equipment, machinery and spare parts.

The land in the free zones in the Republic of North Macedonia is available under long-term lease for a period of up to 99 years at concessionary prices.

Investors are exempt from paying utility taxes to the local municipality and fees for land building permits.

Investors receive free connection to the natural gas, water and sewage network.

The government may support the growth of capital investments and income with a **return of 10% of investment costs in new machinery and equipment**, or investment in buildings and land up to a maximum of EUR 1 million during a 5-year period.

BOX 3 / INVESTMENT INCENTIVES IN MONTENEGRO

Benefits to foreign investors in Montenegro are regulated by the Decree on the Allocation of Funds for Fostering Direct Investments and Improving the Competitiveness of the Economy, which relies on the Program for Improving the Competitiveness of the Economy, enacted every year, no later than 31 March for the current fiscal year.

The Programme for 2019 envisaged:

Six financial support lines:

- Programme line for innovation promotion,
- A programme line for introducing international standards,
- Software lines for modernisation of manufacturing industry,
- Cluster development programme line,
- Programme line for incentives for direct investments,
- Software development line for crafts.

Two non-financial support lines:

- Programme for providing mentoring services;
- Programme for the development of entrepreneurship.

And two additional programme lines:

- The Business Zone Regulation and
- Promotion for increasing the competitiveness of products and services.

The Program is implemented in four phases:

- Publishing of a public call and submission of the application forms and accompanying documents, defined by the Programme;
- Evaluation of submitted documents, in line with the criteria specifically defined by the Programme;
- Start of the realisation of project activities, which were the subject of the agreed/granted activities, with defined deadlines for implementation;
- Payment of justified expenses of the project activities of a company, in line with the delivered documentation.

BOX 4 / INVESTMENT INCENTIVES ON KOSOVO

Kosovo has one government agency, the Kosovo Investment and Enterprise Support Agency (KIESA) which is mandated to promote and support investments, exports, tourism, SMEs, and special economic zones.

Kosovo has established 10 free economic zones which offer a favourable geographical location, a favourable business environment, lower operational costs, ready to use-infrastructure, leasing business premises, and other favourable conditions.

Kosovo still does not offer direct financial incentives for FDI. However, the Ministry of Labour and Social Welfare offers programmes that include: training at work; practice at work, and subsidy of salary. The Ministry, through the Office for Employment, issues a public call to job seekers, by specifying the manufacturing sector. The employer/ benefiter will be paid 50% of the wage of the employee for the period of 12 months. But this percentage will be paid only after the employer pays another half of 50% of the salary.

In Kosovo an investor can register a business in 2 days, free of charge with zero chartered capital (for LLCs). For foreign investment the Law on Foreign Investment ensures equal treatment of local and foreign investors.

The new fiscal package (from September 2015) offers:

- Standard VAT rate of 8% (for services and food basket) and 18% for other products;
- Dividend tax 0%.

Import liberalisation (i.e. no tariffs) refers to:

- Production lines and equipment for production;
- Raw material (not produced in Kosovo);
- Information Technology (IT) equipment.

BOX 5 / INVESTMENT INCENTIVES IN BOSNIA AND HERZEGOVINA

The Foreign Investment Promotion Agency (FIPA) of Bosnia and Herzegovina is the state agency responsible for attracting and promoting FDI in BiH.

Equipment imported by the foreign investor as part of share capital is exempt from paying customs duties.

BiH currently has 4 free trade zones. Users of free zones are exempt from paying VAT and import duties on equipment that will be used for production.

In the Federation of BiH, a taxpayer who from their own funds invests in production equipment with more than 50% of the total profit in the current tax period, shall receive a 30% reduction in the calculated profit tax in the year of investment.

Additionally, the taxpayer who in a period of 5 consecutive years makes investments from its own funds for a total amount of EUR 10 million, starting with the first year when the taxpayer has to invest at least EUR 2 million, shall receive a 50% reduction in the calculated profit tax in the year of investment.

The taxpayer is entitled to a tax-deductible expense double the amount of the gross wage paid to new employees if the duration of the employment contract is for a period of at least 12 months with full-time working hours, if the new employee was not employed by the taxpayer or a related person in the previous five years.

In Republic Srpska a taxpayer who invests in equipment, facilities and real estate for the purpose of carrying out production activities in the amount of more than 50% of realised profit (the tax base) for the current tax period, the income tax liability shall be reduced by 30%.

In Brcko district, there are:

- Compensation of expenses for connecting to the power, water and sewage network
- Compensation of paid fees necessary for obtaining the location conditions, building permits and approvals for the use of the facility
- Compensation of expenses in the amount of the difference in price of electricity and water paid by the company and the price paid by households
- Compensation for the paid employment contribution in the total amount for newly employed persons
- Compensation for salary for maternity leave in the amount of 100%
- Stimulation of the employer in the amount of 50% of total contributions for health insurance of newly employed workers
- Compensation for the amount of new investments invested in the purchase of fixed assets and up to the amount of determined and paid profit tax or income tax in the period for the year in which purchases of fixed assets was made.

BOX 6 / INVESTMENT INCENTIVES IN ALBANIA

Investment promotion in Albania is under the scope of the Albanian investment Development Agency (AIDA).

Albania offers special fiscal incentives for the **tourism sector**, for 4-star and 5-star hotel facilities with a 'special' status (given by the Council of Ministers), such as:

- Decreased VAT, from 20% to 6%;
- Exemption from profit tax (of 15%) for a 10-year period;
- Exemption from tax on new constructions;

In addition, the government provides incentives for other facilities. VAT is 6% for Accommodation Structures (Bed + Breakfast) and for Certified Entities in agrotourism (Sleeping + Restaurant (Non-Drinking)).

For entities operating as **software developers**, the profit tax is reduced from 15% to 5%.

For **agriculture**, the profit tax is 5%, for Agricultural Cooperation Companies.

In addition, VAT is exempted for imports of agricultural machinery and equipment and machinery for investment with value exceeding EUR 360,000.

Albania recently started to develop **free zones** and two zones are in the process of development, but are not active (Spitalla and Kopliku). Some of the incentives for the zones are:

- Developers of zones and companies operating in them benefit from a 50% reduction in profit tax for the first 5 years;
- Supply of Albanian goods destined for placement in the zones is considered as zero VAT export;
- Development projects are exempted from infrastructure tax (applicable to new constructions);
- New constructions are exempted from property tax for a five-year period;
- Developers and users are exempted from property transfer tax;
- Expenses for salaries and social and health contributions paid by the employer are recognised for tax purposes in amounts of 150% of their value during the first fiscal year;
- Costs of training of employees employed within the zone and R&D expenses are recognised as deductible tax expenses for the twice value of the amount for a 10-year period;
- Developers and users of zones benefit from recognition as deductible tax expenses in the level of 20% of annual capital expenses for the first 2 years;
- Single window for custom and tax procedures for the zones.

The country offers special support to **strategic investors**, both domestic and foreign, in sectors identified as strategic and having a major impact in the economy of Albania, such as energy. Strategic investors get support through: (i) assisted procedures, in which the public administration coordinates, assists, supervises, and makes available to the investor state owned property for the purpose of its investment and/or (ii) special procedures, in which support includes also expropriation and approval of investment agreements by the Albanian Parliament.

3. Econometric analysis of determinants of FDI

The econometric analysis presented in this chapter indicates that the important factors for FDI in the Western Balkans are governance, education, infrastructure, taxes and economic stability. The analysis points out that Western Balkan economies possess weaknesses in terms of governance, education and infrastructure. On the other hand, their clear advantage over other European countries is their lower level of wages.

This chapter presents an econometric analysis of determinants of FDI in the Western Balkan and East Asian countries. For that purpose, a gravity model is employed, using bilateral FDI data on both stocks and flows of FDI. The stocks of FDI refer to the total accumulated investment until a given period, while the flows show the investment that has occurred only in the corresponding period. Thus the results for stocks may be interpreted as referring to long-term effects, while the results for flows relate to short-term impacts.[2]

The chapter is organised as follows. First, the variables that are included in the analysis are presented. Then, the econometric model and methodology are explained. Subsequently the econometric results are shown, first for stocks, then for flows. Then, the strong and weak points of the WB are discussed in comparison to the other regions included in the analysis.

3.1. DATA AND VARIABLES

The FDI data used in this analysis refer to bilateral FDI originating in European Union (EU) and the Organisation for Economic Co-operation and Development (OECD) countries and invested in the Western Balkans, Central and Eastern Europe and Asian countries. While the origin of FDI is usually referred to as home of FDI, the destination of investment is referred as host of FDI. Both stocks and flows of FDI are analysed for the period 2001-2018.

Following the literature (Krugman, 1983; Markusen, 1984, 2013; Horstmann and Markusen, 1987; Brainard, 1993; Markusen and Venables, 1998, 2000; Helpman et al., 2004; Braconier et al., 2005; Davies, 2008; Sinha, 2010; Cieślik and Ryan, 2012; Bergstrand and Egger, 2007, 2013; Tintelnot, 2017; Ghodsi, 2020), we include the following groups of variables as potential determinants of FDI:

1. **Gravity variables:** GDP of the origin country, GDP of the destination country, difference in GDP between the two countries, distance between the two countries, whether the two countries share a common language, whether one of the countries is a former colony of the other. All these variables may be related to FDI – larger countries may attract more FDI, and larger countries usually invest more abroad, countries with similar level of development may also have larger bilateral FDI, and

[2] This is because usually the econometric analysis on levels of stock variables indicates the long-run relations, while taking the difference of levels usually reflect the short-run relationship. Since flows are similar to the difference in stocks, one can interpret it in this manner.

countries which are closer to each other geographically and culturally may have higher FDI among themselves.

2. **Institutions:** the World Bank's six Worldwide Governance Indicators (voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, control of corruption), plus ease of starting a business, from the World Banks' Doing Business indicators (this is the only Doing Business Indicator that is available for the whole period of analysis). Countries with better institutions may attract more FDI and invest more abroad.
3. **Education variables:** number of STEM graduates and number of ICT graduates, as a share of total tertiary graduates. Education is considered one of the most important determinants of FDI, as it determines the quality of the labour force. Higher skilled labour induces efficiency-seeking FDI.
4. **Infrastructure:** quality of overall transport infrastructure, rail intensity and liner shipping connectivity index. Better infrastructure might lead to higher FDI, as it provides a better environment for businesses.
5. **Taxes:** Personal income tax, corporate income tax, value added tax and other taxes (often referred to as "parafiscal fees"). Higher taxes might lead to lower FDI, due to higher overall operating costs.
6. **Labour market:** average wages in the economy and labour productivity. They may affect FDI, as they determine companies' operating costs and output.
7. **Fiscal stability:** General government budget deficit. Countries with lower government deficits may attract more FDI if they are perceived as more stable.

3.2. ECONOMETRIC MODEL, APPROACH AND TECHNIQUE

The analysis is done using the gravity model, which us inspired by the gravity equation in physics. Namely, according to this model, FDI stocks or flows between two countries depend on the size of the two countries, the distance between them, and other related variables:

$$FDI_{ijt} = e^{\left[\substack{\beta_1 GDP_{it} + \beta_2 GDP_{jt} + \beta_3 GDP_{pc\_}diff_{ijt} + \beta_4 dist_{ij} + \beta_5 lang_{ij} + \beta_6 colony_{ij} + \beta_7 other\_vars_{ijt} \\ + v_t}\right]} \times u_{ijt} \tag{1}$$

Where *i* stands for the origin country (EU + OECD), *j* stands for the destination country (WB, EU-CEE, CIS + Ukraine, ASEAN and other East Asian countries), *t* stands for the years (2001-2018); therefore, FDI_{ijt} is the amount of FDI (either stocks or flows) originated in country i invested in destination j in year t; GDP_{it} and GDP_{jt} are respectively the GDP of the origin and the host in logarithmic form; $GDP_{pc\_}diff_{ijt}$ is the square of the difference in GDP per capita of both partner countries in logarithm; $dist_{ij}$ is the geographical distance between the two countries in logarithm; $lang_{ij}$ is a dummy variable indicating whether the two countries share the same ethnic languages; $colony_{ij}$ is a dummy variable indicating whether the two countries share similar colonial history; $other\_vars_{ijt}$ are variables listed under points 2-8 above, v_t is the time fixed effect and u_{ijt} is the standard errors that are clustered by ij, to render estimates robust against heteroscedasticities. All the other explanatory variables are included both for the origin and destination countries, though in the tables below, only the coefficients for the destination countries are shown, for brevity.

The model is estimated using the Poisson Pseudo Maximum Likelihood (PPML) technique proposed by Silva and Tenreyro (2006) for gravity models (see also Head and Ries, 2008; Larch et al., 2019; Ghodsi,

2020) and incorporated in Stata by Correia et al. (2019a, b). This technique is appropriate when the dependent variable includes many zero values, which transforms to missing when taking its logarithm. This is also likely to be the case here as many of the country pairs have zero bilateral FDI. Furthermore, this technique is robust against heteroscedasticity in the error term.

Apparent challenge in estimating this model is the large number of other explanatory variables, which makes the estimation of the effects difficult, as many of the variables are correlated with the others. Or because there are many missing observations for each variable that make the whole sample including all variables too small. To address this issue, we do not include all the $other\_vars_{ijt}$ at once in a single regression, but we include them separately while controlling for the main gravity variables defined in equation (1). This will provide some insights on the role of each additional explanatory variable in determining bilateral FDI. Concretely, we first estimate the model with gravity model on education variables, then we estimate the gravity model with institutional variables and so on. In the next section, the results of the gravity estimations on bilateral FDI stocks are presented. Then, in the section after that, the results of the gravity estimation on bilateral FDI flows are presented.

3.3. GRAVITY ESTIMATION RESULTS ON BILATERAL FDI STOCKS

We first show the gravity estimation results on FDI stocks. Table 3 shows these results for the gravity model including the main gravity variables. They are in general in line with the existing literature and the theoretical expectations. The coefficients of GDP variables for both partner countries are statistically significant and positive, implying that bigger countries are likely to have larger bilateral FDI stocks, both outward (i.e. originating from them) and inward (i.e. coming to them). In other words, the coefficient of the reporter's GDP indicates that a 1% increase in the GDP of the host country would increase the inward stocks of bilateral FDI by 0.76%. Moreover, the results show that a 1% increase in the GDP of the home country is correlated with 0.52% larger outward stocks of bilateral FDI from the origin.

The coefficient on the square of the GDP per capita difference is significant and negative. This implies that countries tend to invest more in countries that are economically developed similar to them. In other words, when the GDP per capita of both countries diverges from each other stocks of bilateral FDI should be reduced. This is consistent with horizontal market seeking motives for bilateral FDI.

The distance variable is statistically significant and positive, implying that countries tend to invest more in geographically distant countries, which may be explained with the globalization of the value chains from recent decades. CESEE and WB economies are closer to the EU and OECD countries than Asian countries are. However, inward FDI stocks in Asian countries from the EU and the OECD is much larger than in CESEE and WB economies, which result in a positive coefficient on distance. The variables for the common language and the former colony are positive and statistically significant, implying that common culture and history are important for FDI. The ASEAN variable is positive, meaning that these countries have on average more inward FDI stocks than the other countries in the sample, while the WB variables is negative, meaning that the WB economies have on average less inward stocks of FDI.

Table 3 / Results for FDI stocks, for gravity variables

Stepwise Gravity estimations of inward stock of FDI with time and country-pair fixed effects	
reporter log GDP (constant 2010 USD)	0.76***
	(0.043)
partner log GDP (constant 2010 USD)	0.52***
	(0.049)
square of real GDP per capita differences	-0.28***
	(0.026)
log_distance	0.53***
	(0.13)
common_language	0.55***
	(0.13)
Colony	0.84***
	(0.15)
ASEAN=1	1.06***
	(0.18)
WB=1	-11.6***
	(0.18)
Constant	-12.9***
	(1.49)
Observations	10423
Pseudo R-squared	0.652
AIC	2.14577e+13
BIC	2.14577e+13

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively

Table 4 shows the results for the institutional variables, while keeping the main gravity variables presented in Table 3 as the main control variables. The data on institutional variables are downloaded from the World Governance Indicators and Doing Business of the World Bank. Inclusion of these institutional variables lead to higher explanatory power of the model, which is reflected in large Pseudo R-squared terms. As these institutional variables are all very highly correlated with each other (often exceeding 95%), we include the variables in separate specifications. It can be seen that all the variables are highly significant and positive, implying that if governance is better, FDI will be higher. One can take the goodness-of-fit measured as higher Pseudo R-squared and lower Akaike Information Criteria (AIC) in each model to compare which of these institutional variables have more importance in explaining the FDI. One would conclude that Government Effectiveness, Regulatory Quality and Rule of Law are the most important variables explaining FDI, while Voice and Accountability and Ease of Starting a Business seem to be less important in determining FDI.

Table 4 / Results for FDI stocks, for the governance variables

Stepwise Gravity estimations of inward stock of FDI with time and country-pair fixed effects

Voice and Accountability Estimate	0.43*** (0.25)						
Political Stability and Absence of Violence/Terrorism Estimate		0.84*** (0.082)					
Government Effectiveness Estimate			1.47*** (0.079)				
Regulatory Quality Estimate				1.42*** (0.085)			
Reporter Rule of Law Estimate					1.56*** (0.080)		
Control of Corruption Estimate						1.15*** (0.067)	
Starting a business score							0.048*** (0.0052)
Constant	-18.7*** (1.59)	-31.8*** (2.01)	-39.9*** (2.09)	-43.3*** (2.44)	-40.9*** (2.09)	-36.6*** (2.06)	-22.1*** (1.67)
Observations	9824	9824	9824	9824	9824	9824	8644
Pseudo R-squared	0.663	0.714	0.774	0.752	0.771	0.761	0.666
AIC	2.04e+13	1.73+13	1.37+13	1.50e+13	1.39e+13	1.45e+13	1.95e+13
BIC	2.04e+13	1.73e+13	1.37e+13	1.50e+13	1.39e+13	1.45e+13	1.95e+13

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively. Gravity variables, as well as variables for origin countries, are included in the estimations but omitted from the table, for clarity.

Table 5 shows the gravity estimation results while including additional education variables. The data on these variables are downloaded from World Bank's World Development Indicators database, and come originally from the UNESCO Education Database. The coefficients of both percentage of graduates in STEM and IT are significant and positive, suggesting that if a country has a larger share of graduates in STEM and IT, it will attract more FDI. This is in line with the literature that MNEs invest in countries with more abundant of skilled labour.

Table 5 / Results for FDI stocks, for education variables

Stepwise Gravity estimations of inward stock of FDI with time and country-pair fixed effects

Percentage of graduates from tertiary education graduating from IT	0.089* (0.053)
Percentage of graduates from STEM	0.18*** (0.034)
Constant	-43.5*** (7.38)
Observations	4044
Pseudo R-squared	0.842
AIC	1.86170e+12
BIC	1.86170e+12

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively. Gravity variables, as well as variables for origin countries, are included in the estimations but omitted from the table, for clarity.

Table 6 shows the gravity estimation results while including additional transport variables. The data on these variables are downloaded from the World Bank, UNCTAD and the World Economic Forum. The first specification, shown in first column to the left, includes an overall index of transport infrastructure quality, from the World Economic Outlook, which turns out to be positive and significant, implying that better transport infrastructure is associated with more FDI. The second specification, from the second column, shows the results when two sub-variables measuring specific aspects of transport infrastructure are included – lines shipping connectivity index (from UNCTAD) and rail intensity (from World Bank). Both are positive and significant, implying that both railway infrastructure and shipping connectivity are important for inwards FDI stocks.

Table 6 / Results for FDI stocks, for transport infrastructure variables

Stepwise Gravity estimations of inward stock of FDI with time and country-pair fixed effects

Transport infrastructure scores	1.16***	
	(0.062)	
Rail intensity in area		25.2***
		(6.00)
Liner shipping connectivity index		0.048***
		(0.0055)
Constant	-26.4***	-88.9***
	(2.14)	(6.95)
Observations	5070	3185
Pseudo R-squared	0.765	0.879
AIC	9.83460e+12	1.50296e+12
BIC	9.83460e+12	1.50296e+12

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively. Gravity variables, as well as variables for origin countries, are included in the estimations but omitted from the table, for clarity.

Table 7 shows the results for the tax variables, which are downloaded from the Global Revenue Dataset of the International Center for Tax and Development (ICTD). The first specification (first column) shows the results when the overall tax “burden” is included, while the second one (second column) shows the results when different types of taxes are included separately. The second model has a larger explanatory power. It can be seen that some tax variables are negative and significant here, implying that countries that have higher taxes tend to have at the same time lower stocks of FDI. It would be hard to suggest which taxes are more important, as when disaggregated by types of taxes, taxes on goods and services and taxes on personal income have negative coefficients, while taxes on company profits and other taxes (“parafiscal fees”) have positive coefficients. This could be potentially due to the high correlation between the different types of taxes.

Table 7 / Results for FDI stocks, for the tax variables

Stepwise Gravity estimations of inward stock of FDI with time and country-pair fixed effects

Taxes, all	-0.13***	
	(0.015)	
Taxes on goods and services total % of GDP		-0.083***
		(0.014)
Total income and profit taxes on corporations including taxes on resources		0.58***
		(0.057)
Total income capital gains and profit taxes on individuals % of GDP		-0.97***
		(0.087)
Other taxes		0.46***
		(0.10)
Constant	-3.07	-5.24
	(2.16)	(3.35)
Observations	8914	8914
Pseudo R-squared	0.688	0.788
AIC	1.5802e+13	1.0730e+13
BIC	1.5802e+13	1.0730e+13

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively. Gravity variables, as well as variables for origin countries, are included in the estimations but omitted from the table, for clarity.

Table 8 shows the results for labour market variables, which are obtained from the ILO and wiiw databases. Neither average wage nor labour productivity are significant. However, this should not be interpreted as implying that FDI does not seem to be driven by labour considerations. The insignificance may be because the destination countries that are analysed here have all much lower wages and productivity than the origin countries, because of what the differences between them in terms of FDI are not driven by labour markets, but by the other analysed factors.

Table 8 / Results for FDI stocks, for labour market variables

Stepwise Gravity estimations of inward stock of FDI with time and country-pair fixed effects

Log of wage	0.99
	(1.85)
Productivity PPP	-0.18
	(1.84)
Constant	-175.5***
	(29.7)
Observations	7466
Pseudo R-squared	0.951
AIC	4.86856e+11
BIC	4.86856e+11

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively. Gravity variables, as well as variables for origin countries, are included in the estimations but omitted from the table, for clarity.

Table 9 shows the results for fiscal variables, i.e. the budget deficit, which is from the IMF World Economic Outlook database. Its coefficient is significant and positive, implying that countries that have more positive budget balances (i.e. bigger surpluses, or smaller deficits) tend to have higher inward stocks of FDI. In other words, investors seem to like prudent fiscal policy, which may be because they associate it with greater economic stability.

Table 9 / Results for FDI stocks, for fiscal variables

Stepwise Gravity estimations of inward stock of FDI with time and country-pair fixed effects	
General government net lending/borrowing % of GDP	0.092***
	(0.010)
Constant	-19.3***
	(1.57)
Observations	10408
Pseudo R-squared	0.664
AIC	2.07485e+13
BIC	2.07485e+13

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively. Gravity variables, as well as variables for origin countries, are included in the estimations but omitted from the table, for clarity.

To sum up, the econometric analysis presented above indicates that FDI stocks in CESEE and ASEAN countries are driven by governance, education, transport infrastructure, taxes and fiscal stability. The labour market, perhaps a bit surprisingly, does not seem to be that important, which we explain through the relatively low wages and productivity in these countries, compared to the EU and OECD countries, because of what the differences between the countries are not explained by that, but by other considerations. Alternative explanation for the insignificance of the labour market variables may be that FDI in these countries is less for efficiency seeking of factors of production, but rather more for market seeking.

3.4. RESULTS FOR FDI FLOWS

Next, the results for FDI flows are presented. The econometric specifications here are similar as before. Only the dependent variable is changed. Besides, the coverage of the data is much better when the FDI flows are reported by the origin countries. Therefore, the data used as the dependent variable is the FDI outflows from the origin (i.e., EU and OECD countries) to the host countries (i.e., the WB, CESEE, and Asian countries).

Table 10 shows the results of the benchmark gravity model on inward FDI flows. The results are consistent with the results observed before on inward FDI stocks for some of the explanatory variables. However, the magnitudes of their coefficients differ. Moreover, distance now has the theoretically expected coefficient, that is negative. A host country whose distance to a home country is one percent larger than another home country attracts about 0,57% less FDI inflows from that country that is located further away.

Table 11 shows how FDI flows in CESEE and ASEAN are associated with governance. All the governance variables are significant and positive, as in the case of FDI stocks.

Table 10 / Results for FDI flows, for gravity variables

Stepwise Gravity estimations of outward flows of FDI with time and country-pair fixed effects

reporter log GDP (constant 2010 USD)	0.30*** (0.065)
partner log GDP (constant 2010 USD)	0.65*** (0.035)
square of real GDP per capita differences	-0.16*** (0.028)
log_distance	-0.57*** (0.074)
common_language	1.48*** (0.14)
colony	-0.030 (0.15)
ASEAN=1	0.84*** (0.14)
WB=1	-1.13*** (0.21)
Constant	-12.0*** (1.77)
Observations	7558
Pseudo R-squared	0.333
AIC	5082650.2
BIC	5082712.5

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively.

Table 11 / Results for FDI flows, for governance variables

Stepwise Gravity estimations of outward flows of FDI with time and country-pair fixed effects

Voice and Accountability Estimate	0.25* (0.15)						
Political Stability and Absence of Violence/Terrorism Estimate		1.01*** (0.15)					
Government Effectiveness Estimate			1.26*** (0.17)				
Regulatory Quality Estimate				1.26*** (0.16)			
Rule of Law Estimate					1.36*** (0.18)		
Control of Corruption Estimate						1.09*** (0.13)	
Starting a business score							0.068*** (0.0081)
Constant	-15.5*** (2.07)	-29.1*** (1.78)	-25.6*** (1.79)	-29.0*** (2.07)	-25.7*** (1.81)	-25.5*** (1.77)	-29.1*** (1.73)
Observations	7326	7313	7318	7318	7326	7326	5734
Pseudo R-squared	0.346	0.443	0.453	0.463	0.457	0.463	0.389
AIC	4877755	4150661	4074399	4002485	4047743	4003429	4056983
BIC	4877831	4150737	4074474	4002561	4047819	4003505	4057056

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively. Gravity variables, as well as variables for origin countries, are included in the estimations but omitted from the table, for clarity.

Table 12 shows the results for the education variables, and here another difference between the determining factors behind stocks and the flows of FDI can be observed. Namely, the education variables appear statistically insignificant for the FDI flows, while for the FDI stocks they were statistically significant. This implies that the effects of education on FDI is evident only over the longer run and on the accumulation of foreign capital, as on the short run FDI inflows are more volatile and driven by other factors.

Table 12 / Results for FDI flows, for education variables

Stepwise Gravity estimations of outward flows of FDI with time and country-pair fixed effects

Percentage of graduates from tertiary education graduating from IT	0.050 (0.031)
Percentage of graduates from STEM	0.016 (0.023)
Constant	-12.8*** (3.18)
Observations	2591
Pseudo R-squared	0.364
AIC	1217365.3
BIC	1217441.4

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively. Gravity variables, as well as variables for origin countries, are included in the estimations but omitted from the table, for clarity.

Table 13 shows the results for the transport infrastructure variables. Overall transport infrastructure is positive and significant for the FDI flows, like FDI stocks. However, what is different here is that rail infrastructure does not seem to be important for FDI flows, and the shipping connectivity is statistically significantly affecting FDI flows.

Table 13 / Results for FDI flows, for transport variables

Stepwise Gravity estimations of outward flows of FDI with time and country-pair fixed effects

Transport infrastructure scores	0.88*** (0.15)	
Rail intensity in area		-2.63 (5.64)
Liner shipping connectivity index		0.019*** (0.0041)
Constant	-11.0*** (2.39)	-32.0*** (3.01)
Observations	3140	2096
Pseudo R-squared	0.411	0.623
AIC	2718444.9	508942.6
BIC	2718511.5	509016.0

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively. Gravity variables, as well as variables for origin countries, are included in the estimations but omitted from the table, for clarity.

Table 14 shows the association between FDI flows and taxes, and here another difference emerges with respect to the results on FDI stocks. Namely, overall taxation does not seem to be important for FDI flows in CESEE and ASEAN. This may be explained by the notion that these countries often provide various incentives schemes to foreign investors, which exempt them from paying taxes in the first years after the investment. Thus, taxes seem to be important for FDI only over the longer run, when these tax exemptions are not present.

Table 14 / Results for FDI flows, for tax variables

Stepwise Gravity estimations of outward flows of FDI with time and country-pair fixed effects

Taxes, all	0.012 (0.020)	
Taxes on goods and services total % of GDP		-0.083** (0.037)
Total income and profit taxes on corporations including taxes on resources		0.099*** (0.017)
Total income capital gains and profit taxes on individuals % of GDP		0.34*** (0.064)
Other taxes		0.57*** (0.12)
Constant	-7.33*** (1.75)	-5.39** (2.51)
Observations	6188	6188
Pseudo R-squared	0.357	0.430
AIC	4118358.3	3650222.3
BIC	4118432.4	3650336.7

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively. Gravity variables, as well as variables for origin countries, are included in the estimations but omitted from the table, for clarity.

Table 15 shows the results for the coefficients of labour market variables, and they are insignificant like the results on FDI stocks.

Table 15 / Results for FDI flows, for labour market variables

Stepwise Gravity estimations of outward flows of FDI with time and country-pair fixed effects

Log of wage	-0.19 (0.22)
Productivity PPP	0.29 (0.27)
Constant	-22.1*** (6.27)
Observations	4326
Pseudo R-squared	0.390
AIC	1709182.8
BIC	1709265.6

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively. Gravity variables, as well as variables for origin countries, are included in the estimations but omitted from the table, for clarity.

Table 16 shows the results for budget deficit and it is positive and significant, the same as in the specification for FDI stocks.

Table 16 / Results for FDI flows, for fiscal variables

Stepwise Gravity estimations of outward flows of FDI with time and country-pair fixed effects	
General government net lending/borrowing % of GDP	0.099*** (0.011)
Constant	-18.4*** (1.50)
Observations	7529
Pseudo R-squared	0.365
AIC	4800942.6
BIC	4801018.8

Standard errors in parentheses. *, **, *** denote significance at 10%, 5% and 1% respectively. Gravity variables, as well as variables for origin countries, are included in the estimations but omitted from the table, for clarity.

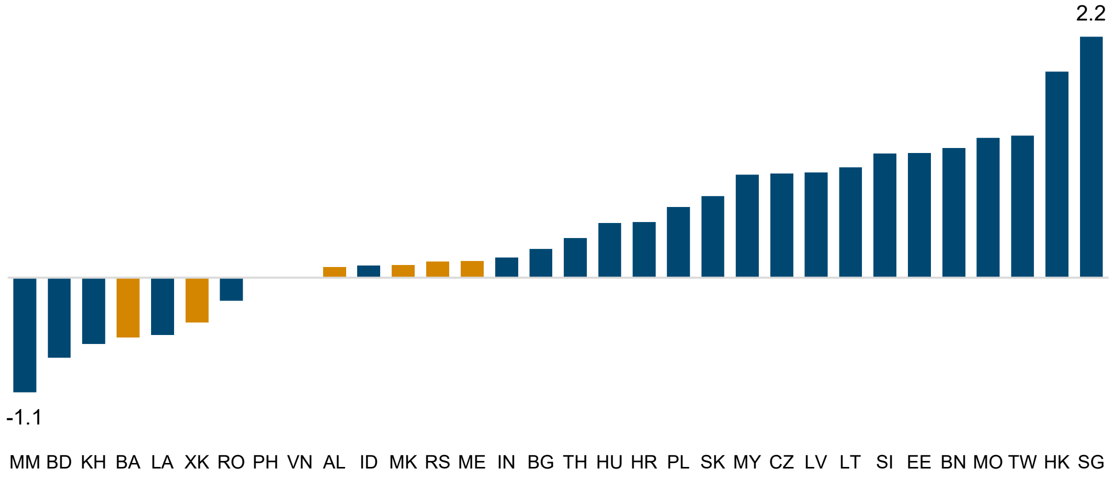
To sum up the econometrics results on FDI flows, they are in general very similar to the estimation results on FDI stocks. The two main differences are that for FDI flows, education and taxes do not seem to be important for the dynamics. We interpret the insignificance of education as signifying that its effect on FDI is evident over the long run, as short-run FDI dynamics are volatile and often driven by other considerations. An explanation for the insignificance of the taxes could be the government incentives schemes that many of the CESEE and ASEAN countries are offering to foreign investors, which exempt them from paying taxes for some initial time.

3.5. STRONG AND WEAK SIDES OF WESTERN BALKAN ECONOMIES

Next we discuss how WB economies compare to other countries in terms of the factors that turn out to be important drivers of FDI according to the econometric analysis. For brevity, only one explanatory variable from each of the groups of variables is discussed. In order to refer to the most recent period, average values for the period 2017-2019 are discussed (depending on data availability).

We begin with the governance indicators, and here we take the Government Effectiveness indicator. The governance indicators have usually high corelation with each other and presenting one of them will suffice. We can see from Figure 12 that all the WB economies are in the left half of the chart, which means that in general their government effectiveness is poorer than the majority of the analysed countries. Bosnia and Herzegovina is lowest ranked in this respect, closely followed by Kosovo. Albania, North Macedonia, Serbia and Montenegro are slightly better, though they are still performing less good than most of the included countries. Thus, governance is considered a weak side of the WB economies, and one of the reasons why they don’t attract more FDI.

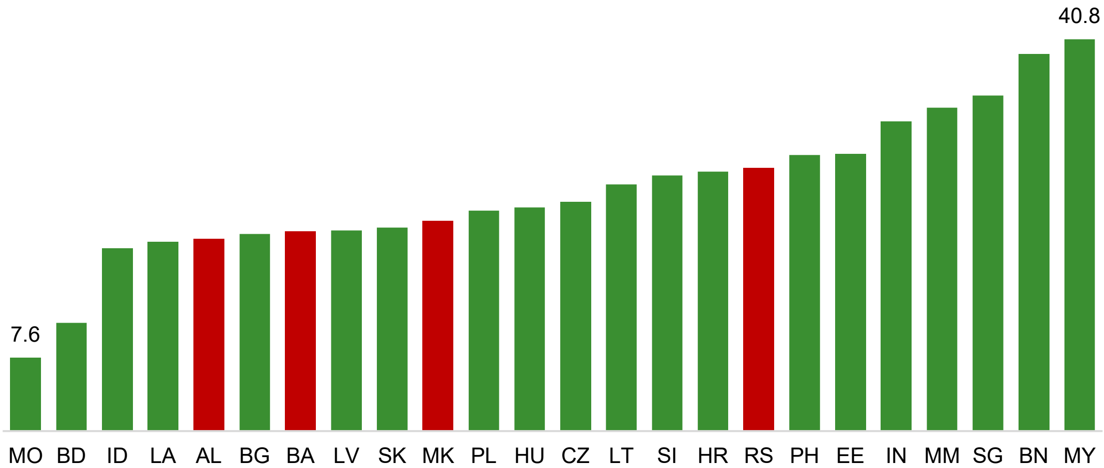
Figure 12 / Government Effectiveness Indicator (score, 2.5=best), average for 2017-2019



Source: World Bank Worldwide Governance Indicators.

Education is discussed next, through the percentage of STEM graduates (Figure 13). Here, the situation is more nuanced. Most of the WB economies have a low share of STEM graduates (Albania, Bosnia and Herzegovina and North Macedonia), but Serbia, on the other hand, is performing better in this respect. Albania is ranked lowest, having the least share of STEM graduates in whole of CESEE. Bosnia and Herzegovina is second, while North Macedonia is third. Serbia is ranking as the best of the WB economies, and also the second-best of all CESEE countries, which may explain why it has been attracting rather high amounts of FDI in recent years.

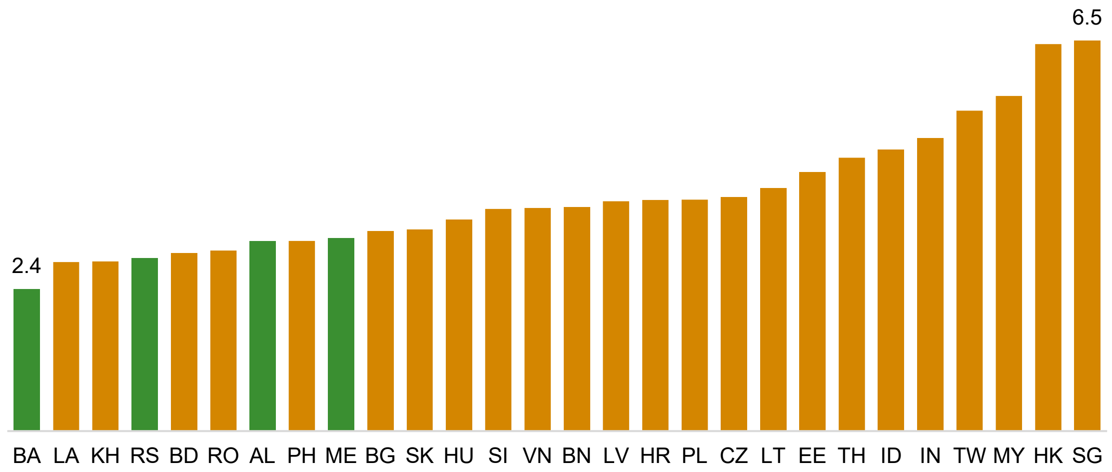
Figure 13 / Share of STEM graduates (% of total tertiary graduates), average for 2017-2019



Source: UNESCO's Education Statistics.

The quality of transport infrastructure is shown next, in Figure 14. Here, the picture is fairly straightforward – all the WB economies are at the bottom of the list in terms of transport infrastructure. Bosnia and Herzegovina is ranked lowest, followed by Serbia, while Montenegro and Albania are ranked slightly better, due to their ports, but they are also well below the average for the whole sample. This shows that transport infrastructure can be considered as an important structural problem of the WB economies, and one of the reasons why they do not manage to attract more FDI.

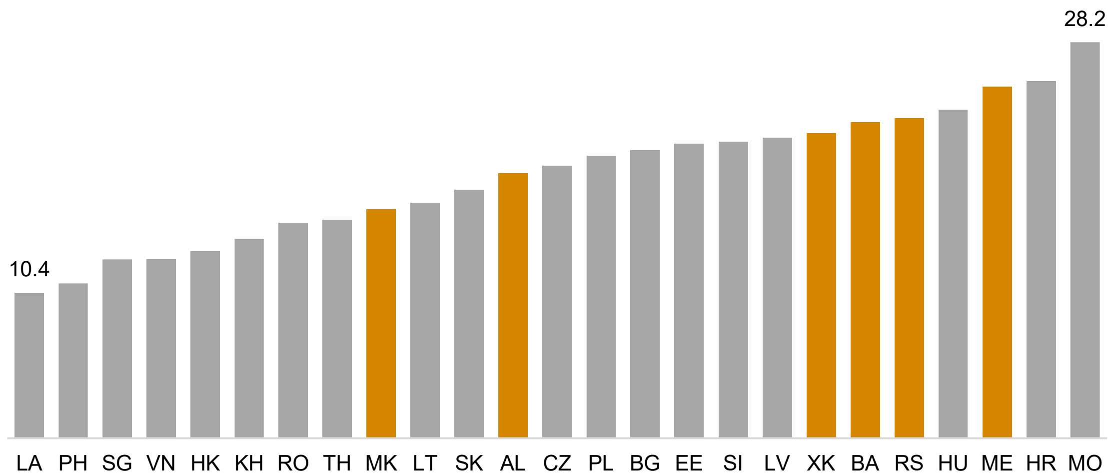
Figure 14 / Quality of overall transport infrastructure (score, 7=best), average for 2017-2019



Source: World Economic Forum's Global Competitiveness Report.

Taxes are shown next in Figure 15. We show the total tax revenues, which were used in the econometric analysis, i.e. taxes on income, profits, goods and services. The first thing to note here is that Asian countries generally have much lower taxes than CESEE countries. Albania and North Macedonia, which have among the lowest taxes in all of CESEE, are still above most Asian countries. The remaining four WB economies, on the other hand, are among the countries with the highest taxes from this sample. Thus, the tax situation is mixed – some WB economies are in the group of countries with lower taxes, while some are in the group with higher ones.

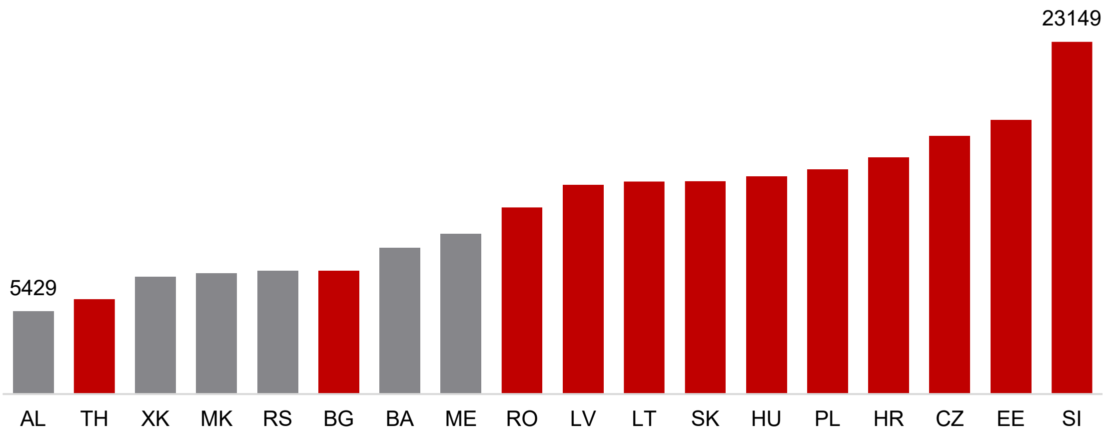
Figure 15 / Taxes on income, profits, goods and services (revenues in % of GDP), average for 2017-2019



Source: ICTD / UNU-WIDER Government Revenue Dataset.

Wages are discussed next. As can be seen from Figure 16, WB economies are among the countries with the lowest wages in this sample. Bosnia and Herzegovina and Montenegro, which have the highest wages in the WB, are still around the middle of the sample. Still, it should be noted that data on wages in Asian countries is fairly limited, which makes it hard to draw stronger conclusions regarding this factor.

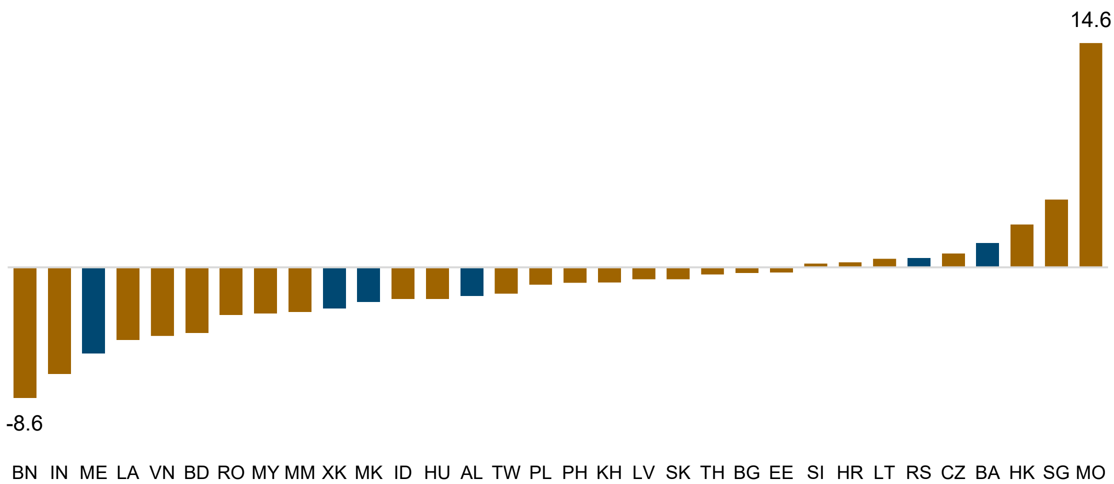
Figure 16 / Average annual gross wages (USD), average for 2017-2019



Source: wiiw and ILO.

Finally, the fiscal situation of the analysed countries is shown on Figure 17. Two of the WB economies – Bosnia and Herzegovina and Serbia, have had a budget surplus in the last two years. Kosovo, Albania and North Macedonia have had a small deficit (below 3% of GDP), while only Montenegro has had a deficit above 5% (among the highest in the sample).

Figure 17 / General Government budget balance (% of GDP), average for 2017-2019



Source: IMF World Economic Outlook Database.

3.6. SUMMARY

This chapter has presented an econometric analysis of FDI in the WB economies. The analysis points out that the most important factors for attracting FDI in these economies are governance, infrastructure and fiscal stability. Education and taxes appear important only in the long run. Labour market variables, surprisingly, appear insignificant, which might be explained by the similar characteristics of the labour markets in all of the analysed countries (i.e. low level of wages and productivity). The analysis shows that Western Balkan economies present weaknesses in terms of governance, infrastructure and education. This might be seen as disadvantages for investors, while the low level of wages might be considered as clear advantage to investors.

4. Insights from surveys and interviews with German companies

The survey of German companies working abroad indicates that 16% of them are planning changes in their supply chains while 12% are looking for new locations. The main reasons for this are cost optimisation and risk diversification. The survey of German companies working with companies from other countries indicates that 40% of them are experiencing supply-chain problems, and 68% of those with problems are thinking of changing their supply-chains. The most common changes are finding new suppliers and increasing inventories. These findings imply that nearshoring after the pandemic is quite possible.

The survey of German companies considering investing in the Western Balkans indicates that the main "rival" destinations of the Western Balkans are Eastern and Central Europe. The main factors for choosing between these locations are the availability of skilled labour and the stability and governance of the country. As the main weak points of the Western Balkans, companies point out instability and infrastructure.

The surveys and interviews show that most of the German companies which have invested in the Western Balkans are satisfied with their experience. The main reasons for investing in this region are the relatively low wages, the geographical location and the educated labour force. Also important is the cultural proximity to Germany, as well as the previous positive experiences German companies have had with people from the Balkan region. The surveys and interviewed investors see as main disadvantages of working in the Western Balkans the poor governance, primarily, political instability. The main reasons for not cooperating more with local companies is that, according to the survey, they are not considered to be in a position to provide the quality and standards that the German companies require.

This chapter presents the results of a variety of surveys and interviews conducted with several different groups of German companies. The first group are **German companies with international operations** which are not necessarily related to the Western Balkans. They are analysed in two surveys, and the purpose is to assess whether there are tendencies towards nearshoring. The second group are **German companies that are considering investing in the Western Balkans but have not yet invested.** They are analysed in a survey with the intention of seeing how companies perceive the region, why they are interested in investing in it, what are its perceived strong and weak points, etc. The third group of companies are **German companies that have invested in the Western Balkans**. They are analysed through a survey and interviews, with the purpose to investigate the reasons for investing in the Western Balkans, the satisfaction of the companies, the advantages and disadvantages of the region etc.

4.1. GERMAN COMPANIES WITH INTERNATIONAL OPERATIONS

To assess whether there is a tendency towards nearshoring among German companies with international operations, we use two surveys. The first one is the AHK World Business Outlook survey from October 2020. This is a regular survey conducted several times a year by the German Chambers of

Commerce Abroad, Delegations and Representative offices (AHKs), of their member companies. It includes more than 3,500 German companies, branches, subsidiaries and companies with close ties to Germany, all of them working abroad. Although the survey is regular, its questions are not always the same, and the October 2020 wave featured some questions which provide useful insights for discussing possible changes in supply-chains after COVID-19.

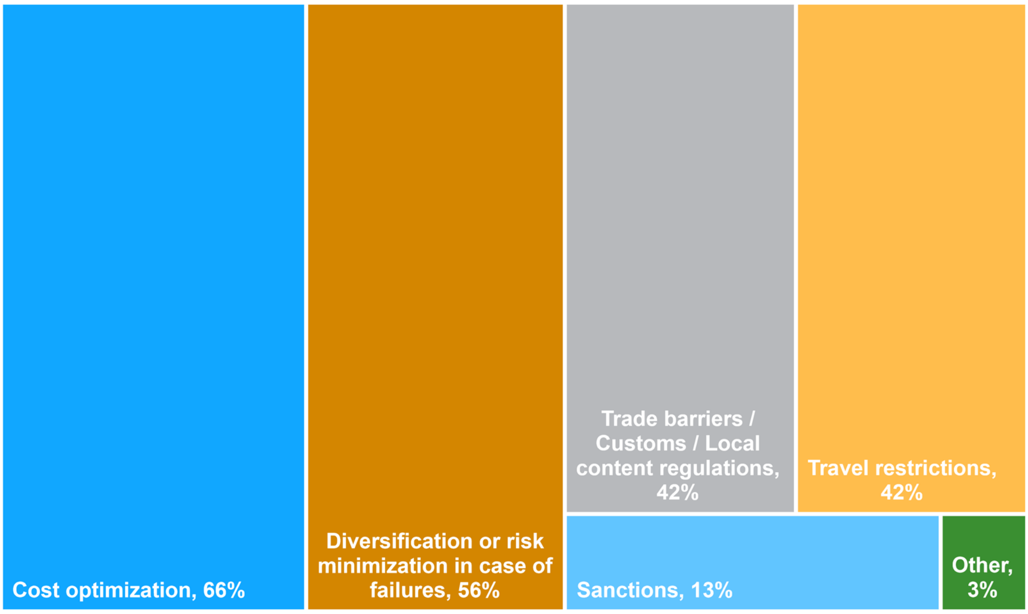
The second one is the DIHK survey "Going International 2021", also a regular survey conducted at the beginning of each year, with companies located in Germany which work with companies from other countries. The 2021 survey covered 2,400 companies.

In this way, we have two types of companies - companies working in other countries (covered by the first survey) and companies working in Germany (covered by the second survey), which should allow us to have a thorough overview of supply chain developments.

We first present the World Business Outlook 2020 survey. 16% of the surveyed companies stated that they are planning changes in their supply chains, a fairly high share. Given that total German outward FDI stocks are around 1.7 trillion USD, this implies the potential investment of billions of USD, even if just a small share of these plans come to be realised.

The reasons why companies are planning changes in their supply chains are shown in Figure 18. The most common reason is cost optimisation, referring to 66% of the companies that are considering changes. This may turn out to work in favour of Western Balkan economies, given that they are considered low-cost destinations. The second most common factor is diversification or risk minimisation, with 56%, which may be linked to supply chain disruptions during the COVID-19 pandemic.

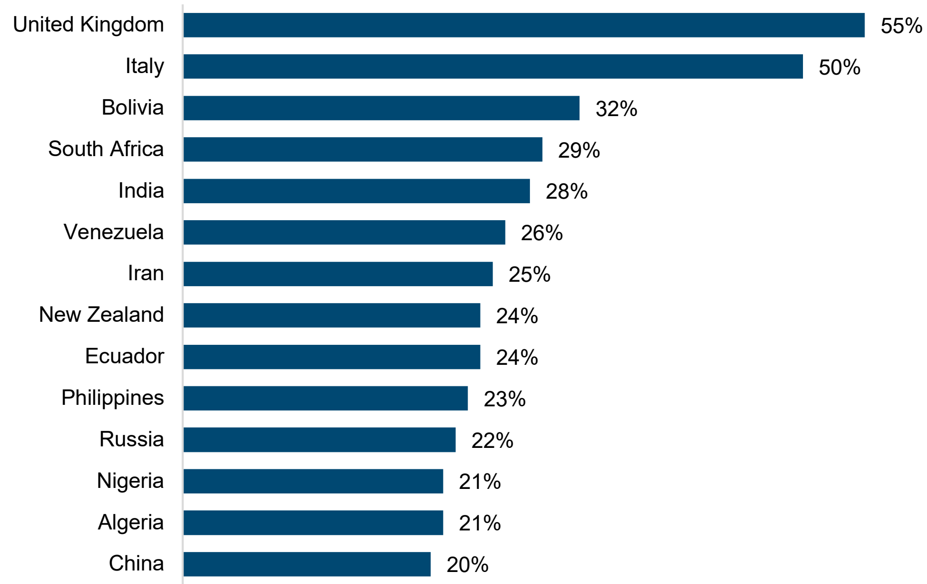
Figure 18 / Reasons why companies plan changes in their supply chain (multiple answers possible)



Source: AHK World Business Outlook survey from October 2020.

Looking at the countries in which companies are considering changes in supply chains, the UK is number one with 55% of German companies operating there planning some changes, obviously related to Brexit. Italy is second with 50% of German companies there saying they are considering supply chain changes. The remaining countries are those which are geographically distant from Germany, which may be a sign that these companies are considering near-shoring. The Western Balkans are not on the list, which can be considered an indicator that German companies operating there are not unsatisfied with their businesses and are not likely to pursue changes (Figure 19).

Figure 19 / Share of German companies considering supply-chain changes, by country (in %)

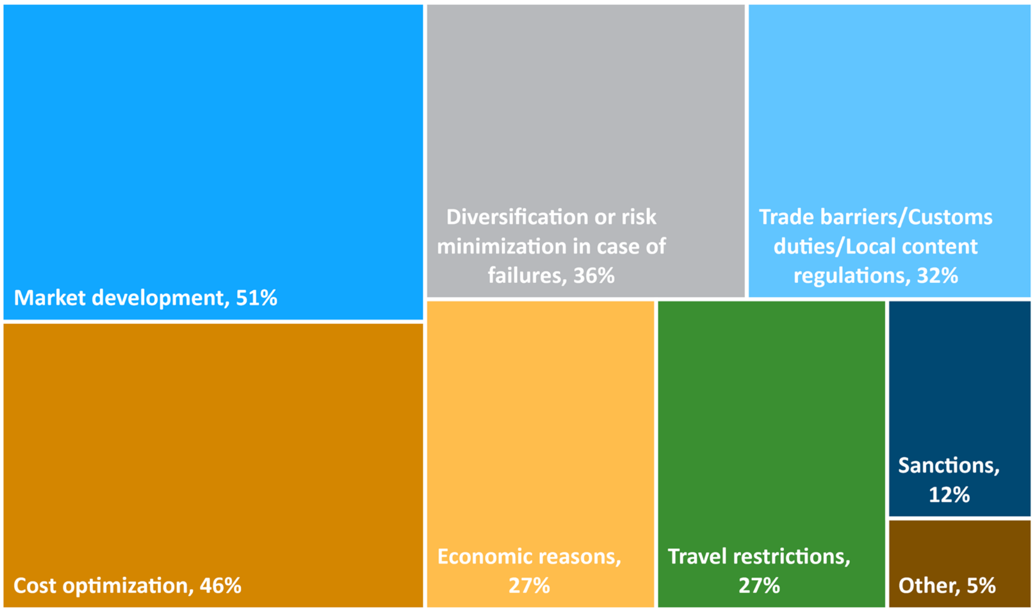


Source: AHK World Business Outlook survey from October 2020

Similarly, 12% of the surveyed companies stated that they are looking for new locations, again a sizeable share. The first reason why companies are looking for new locations is market development, with 51% of the respective companies selecting this option, which is mostly unrelated to the pandemic and nearshoring. The second and third reasons, however, chosen by 46% and 36% of the companies in question, are cost optimisation and diversification or risk minimisation, which can be related to the pandemic and might imply potential for nearshoring (Figure 20).

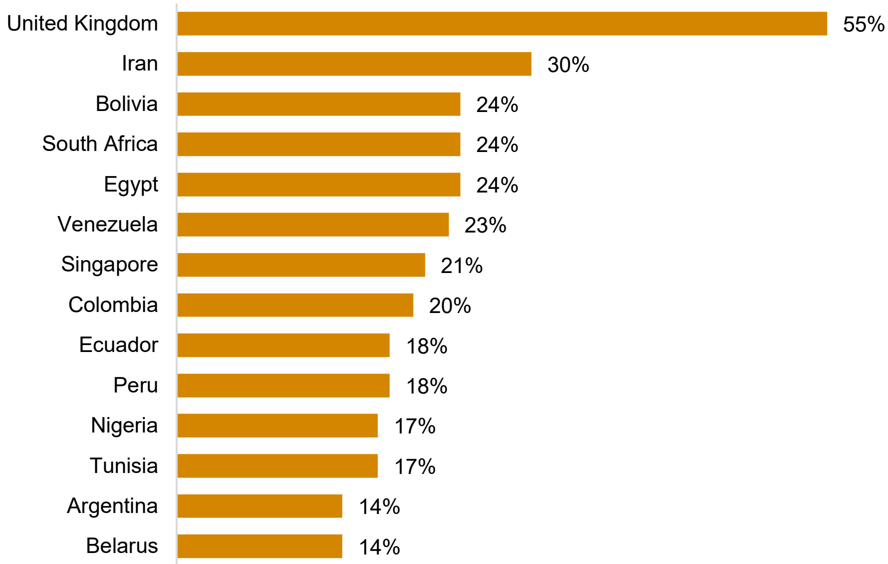
The share of companies looking for new locations is by far the highest for German companies operating in the UK, with 55% of them stating so. The remainder are in general countries which are geographically distant from Germany, which might be an indicator of possible nearshoring considerations. Again, the Western Balkan economies are not on the list, which signals that German companies in these economies might not be considering moving away from them (Figure 21).

Figure 20 / Reasons why companies are looking for new locations (multiple answers possible)



Source: AHK World Business Outlook survey from October 2020.

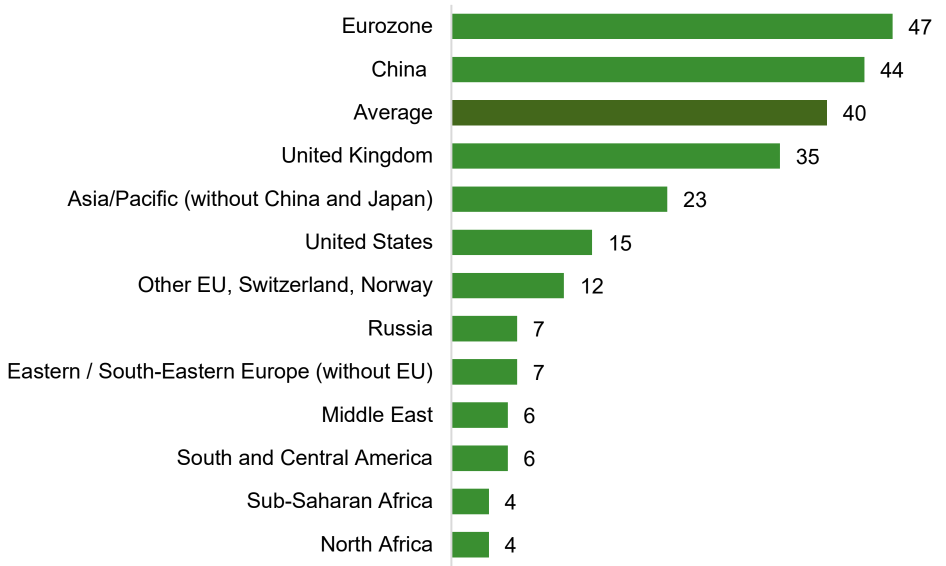
Figure 21 / Share of German companies looking for new locations, by country (in %)



Source: AHK World Business Outlook survey from October 2020.

The second survey, Going International 2021, reveals that 40 percent of foreign-active companies have problems with their supply chains. This is especially present in the Eurozone region and China, where almost one half of companies had supply chain problems (Figure 22). In the Eurozone the main issue is border closures and similar restrictions due to the COVID-19 pandemic. In China the main issue is increased transport costs due to bottlenecks for shipping containers.

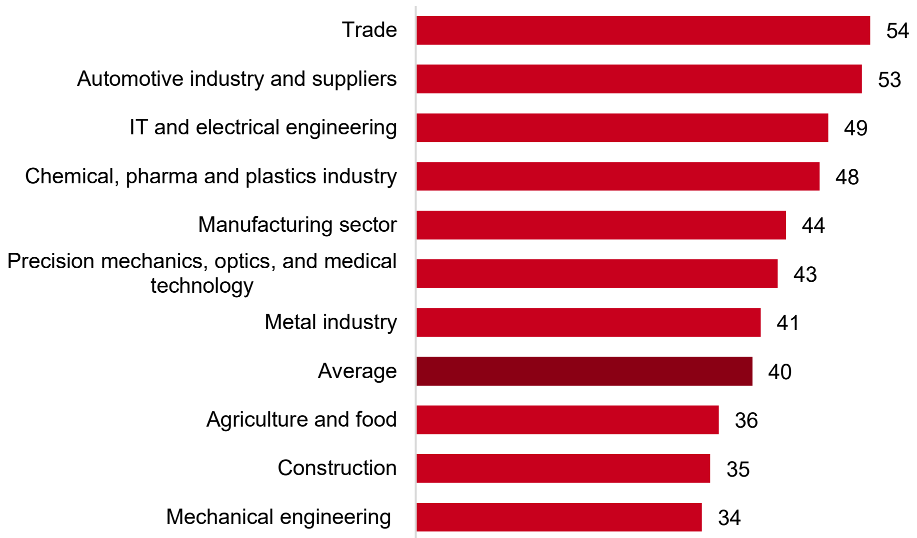
Figure 22 / Share of German companies with supply chain problems, by country/region (in %)



Source: DIHK Going International 2021 survey.

The industries most affected by supply chain issues are shown on Figure 23. Trade is affected most seriously (54% of companies), followed by the automotive sector (53%), IT and electrical engineering (49%) and chemicals (48%).

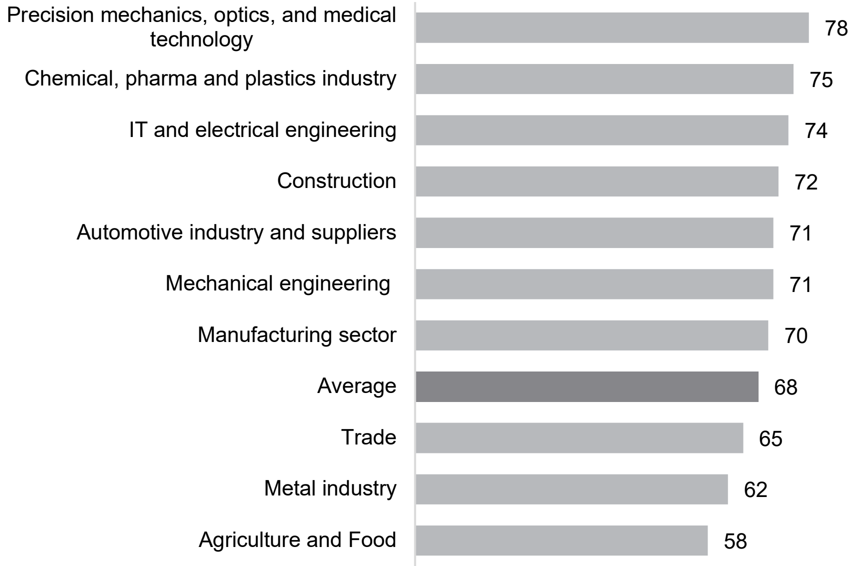
Figure 23 / Share of German companies with supply chain problems, by industry (in %)



Source: DIHK Going International 2021 survey.

Of the companies with supply-chain problems, 68% stated that they are planning changes in their supply chains. The percentage is highest in precision mechanics, optics, and medical technology (78%), followed by the chemical, pharma and plastics industry (75%), IT and electrical engineering (74%), construction (72%) and automotive (71%).

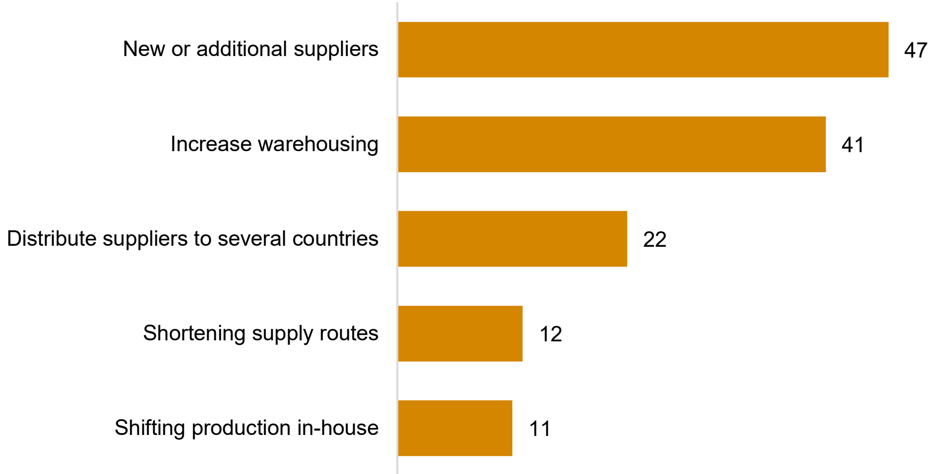
Figure 24 / Share of German companies that plan changes in supply chains, by industry (in %)



Source: DIHK Going International 2021 survey.

The most common changes companies are considering are finding new or additional suppliers (48%) and increasing inventories (41%).

Figure 25 / Changes in supply chains that companies are considering (% of companies responded, multiple answers possible)



Source: DIHK Going International 2021 survey.

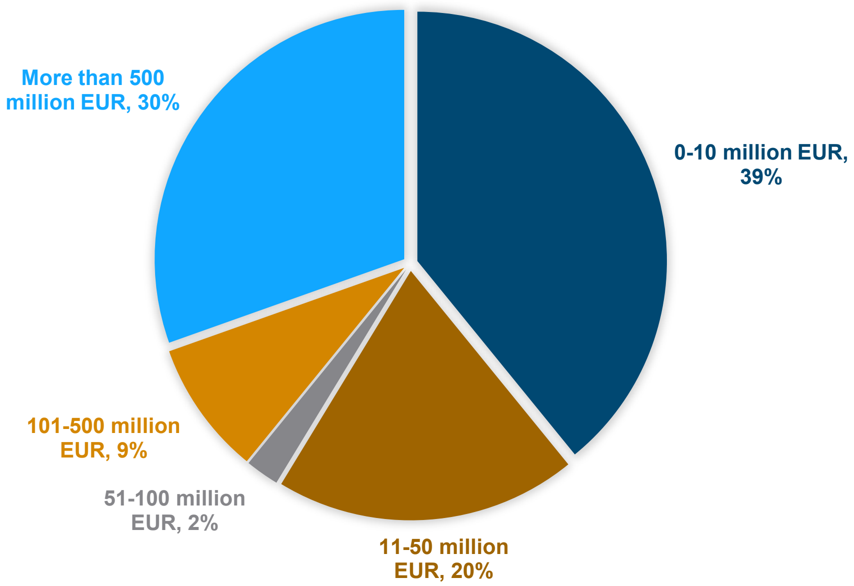
To sum up the two surveys, 16% of the surveyed 3,500 German companies located abroad stated that they are planning changes in their supply chains, while 12% stated that they are looking for new locations. The analysis shows that the main reasons for these changes are cost optimization and risk diversification. Of the 2,400 surveyed companies located in Germany but with international operations, 40% stated they are experiencing supply-chains problems, and 68% of those said they are thinking about changes in supply chains. Based on the surveys the most common changes are finding new suppliers and increasing inventories. All these findings imply that some nearshoring after the pandemic is possible.

4.2. GERMAN COMPANIES THAT ARE PLANNING TO INVEST ABROAD AND ARE CONSIDERING THE WESTERN BALKANS

To reveal the general reasoning of German companies planning to invest abroad, as well as reasons why they are considering the Western Balkans, a survey was conducted with German companies that are planning to invest abroad and are considering the Western Balkans as their destination. The survey was conducted by the Chamber Partnership Western Balkans, the Delegation of German Economic Affairs in Bosnia and Herzegovina, the Delegation of German Industry and Commerce in North Macedonia, the German-Serbian Chamber of Industry and Commerce and Germany Trade and Invest. The survey was conducted in November / December 2020, and is based on a questionnaire consisting of 10 questions structured into four topics – general questions about the company, reasons for investing abroad, reasons for considering the Western Balkans, and COVID-19. The full list of questions is provided in Appendix 1.

In total, 46 companies answered the questionnaire. Their size is shown in Figure 26. Around one-third of the companies (30%) are large and have an annual turnover of more than EUR 500 m. There are also smaller companies, with turnover of less than EUR 10 m (39%).

Figure 26 / Size of the surveyed companies (annual turnover)



Source: Survey conducted among companies that are planning to invest abroad and are considering the WB.

Companies state three main reasons for investing abroad. The first one is relatively lower labour costs abroad, with 32% of the answers. Entering new markets is second, with 21%, while finding workers which cannot be easily found at home is third, with 18% (Table 17). This shows that labour is the main reason for investing abroad, but also that this factor is not only price-driven but that quality is also important.

Interestingly, lower taxes abroad have minor importance, as well as incentive schemes that governments are providing to foreign investors. Relocation because of the pandemic also has a minor share, at least among these companies.

Table 17 / Answers to the question: "Why is your company considering investing abroad?"

Because of the relatively lower labour costs abroad	32%
Because we want to enter new markets	21%
We need workers which we cannot easily find in our home country	18%
Because of the higher taxes at home and lower taxes abroad	5%
Because of the benefits/incentives packages that other governments are providing to foreign investors in their countries	5%
Relocating because of pandemic-disrupted supply chains or uncertainty	4%
Other	16%

Source: Survey conducted among companies that are planning to invest abroad and are considering the WB.

The other regions that companies are considering, in parallel with the Western Balkans, are mainly Eastern and Central Europe. Other regions like South-East Asia, India, China and MENA, have a smaller share (Table 18). This is important because it shows that when Western Balkan economies are thinking about attracting foreign investors it might be useful for them to compare themselves to Central and Eastern Europe, not to Asian countries.

Table 18 / Answers to the question "Which other regions are you considering in parallel with the Western Balkans?"

Eastern Europe (including Turkey, Bulgaria, Romania, Ukraine)	28%
Central Europe (Visegrad countries)	20%
No other region	11%
South-East Asia	10%
India	7%
China	6%
Middle East and North Africa	6%
Central Asia	1%
Other	10%

Source: Survey conducted among companies that are planning to invest abroad and are considering the WB.

The survey shows that the most important factor for investors when deciding where to invest is the availability of skilled labour, while the second one is stability, governance and institutions of the country. Wages and geographical location are also seen as important, but still less than the first two. Very importantly, taxes and government benefits packages are on the bottom of the list (Table 19). These are a very important findings, pointing out that investors which are considering Western Balkans are looking for skilled workforce and stable and functional countries, not so much for low costs. As shown on Figure 16 in the previous chapter, costs in all countries from Central, Eastern and South-East Europe are rather low, at least compared to costs in Germany. These study findings can lead to the conclusion that when

German investors decide between these countries, they seem to not be driven by cost considerations, but by quality. Put differently, when selecting among several low-cost CESEE countries, the analysis shows that investors choose the country which has the best labour and institutions, not the country with lowest costs, as costs are low in all of countries. This can bear important implications for policy makers from the Western Balkans. Their strategy for attracting investors in recent years has been based primarily on presenting themselves as low-cost destinations, i.e. countries with cheap labour, low taxes, and generous incentives schemes for investors.

Table 19 / Answers to the question “Which factors are important to you as an investor when deciding where to invest?” (higher value indicates greater importance)

Availability of skilled labour	6.8
Stability of the country, good governance and functional institutions	6.7
Level of wages	6.2
Geographical location of the country	5.8
Quality of infrastructure	5.5
Size and the prospects of the market	5.1
Level of taxes	3.3
Benefits packages that the government provide to foreign investors	2.8

Source: Survey conducted among companies that are planning to invest abroad and are considering the WB.

Investors think labour is the Western Balkans’ strong point, both in terms of the low wages, and in terms of the availability of skilled workers (Table 20).

Table 20 / Answers to the question “Which of these factors do you think are STRONG sides of the Western Balkans?” (higher value indicates greater importance)

Wages are relatively low	7.0
Availability of skilled labour	6.9
Geographical location	6.1
Quality of infrastructure	5.5
Stability, good governance, functional institutions	4.8
Taxes are relatively low	4.3
Size and the prospects of the market	3.8
Government provides attractive benefits packages to foreign investors	3.5

Source: Survey conducted among companies that are planning to invest abroad and are considering the WB.

It is also interesting to observe what German investors think are the weak sides of the Western Balkans as economic location. Instability, poor governance and weak institutions top the list (Table 21). Recalling that this factor was one of the most important for German investors from the previous chapter, one arrives at the conclusion that the Western Balkans might not be attracting more foreign investment due to their perception of unstable and poorly governed countries. Poor infrastructure is second on the list, pointing out that there is a lot of room for improvement and that the countries might want to invest in this. Small size of the market is ranked third.

Asked how COVID-19 has affected their plans for investing in the Western Balkans, most of the companies say they were not affected (60%). 19% say they postponed their plans until after the pandemic, while 6% say they cancelled their investment completely (Table 22).

Table 21 / Answers to the question "Which of these factors do you think are WEAK sides of the Western Balkans?" (higher value indicates greater importance)

Instability, poor governance, non-functional institutions	7.4
Poor quality of infrastructure	6.6
Small size and weak prospects of the market	6.1
Unavailability of skilled labour	5.5
Poor geographical location	5.2
Benefits packages that government provide to foreign investors are not attractive enough, compared to other regions	3.7
Wages are relatively high	3.5
Taxes are relatively high	3.5

Source: Survey conducted among companies that are planning to invest abroad and are considering the WB.

Table 22 / Answers to the question "How has the Covid-19 crisis affected your plans for investing in Western Balkans?"

It has not affected them	60%
We postponed our planned investments in the WB	19%
We decided to invest less in the WB	8%
We cancelled our planned investments in the WB	6%
We decided to invest more in the WB	2%
Other	6%

Source: Survey conducted among companies that are planning to invest abroad and are considering the WB.

To summarise the survey of German companies which are considering investing in the Western Balkans, the main reasons why they are thinking about investing abroad are lower wages, new markets and the need for additional workers. Other locations they are considering, in parallel with Western Balkans, are Eastern and Central Europe. When choosing between these locations, the most important factors for them are availability of skilled labour and stability and governance of a country. As the main weak sides of the Western Balkans, companies point out instability and infrastructure.

4.3. GERMAN COMPANIES THAT HAVE INVESTED IN THE WESTERN BALKANS

To assess the reasons why German companies have invested in the Western Balkans, the strong and weak points of these countries, how COVID-19 has affected their operations, and the like, surveys and interviews were conducted by the Chamber Partnership Western Balkans, the Delegation of German Economic Affairs in Bosnia and Herzegovina, the Delegation of German Industry and Commerce in North Macedonia, the German-Serbian Chamber of Industry and Commerce and Germany Trade and Invest, in November-December 2020.

The survey consisted of 15 questions, grouped into 4 sections – general questions about the company, questions related to investing in the Western Balkans, questions about working with local companies and questions about COVID-19. The full list of questions is provided in Appendix 2.

The interviews were semi-standardised, with open-ended questions on the same topics as those in the survey. Interviews are a more flexible tool than the survey, as they allow companies to further elaborate on their answers, often leading to unanticipated responses. In this way it is a very useful complement to the survey as it may better explain some answers, strengthen them, and provide additional insights.

The survey was answered by 74 companies in total, 38 of them operating in Bosnia and Herzegovina, 18 in Serbia, 12 in North Macedonia and 6 in Albania. Almost one half of the companies are from the manufacturing sector (46%), 9% are from wholesale and retail trade, 7% are from ICT, while the other sectors have smaller shares. Even though the total number of companies is not very high, they do represent a sizeable amount of investment – EUR 1.6 billion.

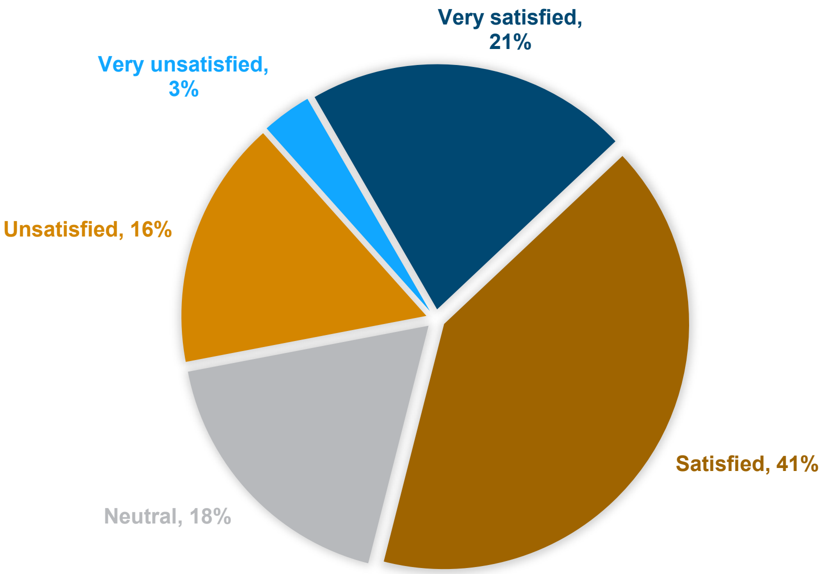
The interviews were conducted with representatives of 13 companies: Drager (SRB), Falke (SRB), GS TMT (BiH), Kostal (MKD), Lindner (ALB), Forschner (ALB), Marquardt (MKD), ODW (MKD), STIHL (SRB), Vossloh (SRB), Pax Lutec (BiH), Hueck (BiH) and a German company operating in BiH that did not want its name disclosed.

We next present the results of both the survey and the interview analysis, in parallel, organised around different topics covered by them. At the end of the section, we also present a brief qualitative thematic analysis of the interviews.

4.3.1. Overall satisfaction

The survey analysis indicates that German companies that have invested in the Western Balkans are in general satisfied with the overall experience of working in this region – 62% of the companies are either satisfied or very satisfied (Figure 27). Still, 19% of the surveyed companies stated that they are either unsatisfied or very unsatisfied, which is more prevalent in Albania then in the other analysed countries (Table 23).

Figure 27 / How satisfied are you with the overall experience of working in the Western Balkans? (results for all economies)



Source: Survey conducted among German investors in the WB.

Table 23 / How satisfied are you with the overall experience of working in the Western Balkans? (results for individual economies)

	MK	RS	BA	AL
Very satisfied	33%	22%	16%	17%
Satisfied	33%	56%	40%	17%
Neutral	17%	11%	20%	33%
Unsatisfied	8%	11%	20%	33%
Very unsatisfied	8%	0%	4%	0%

Source: Survey conducted among German investors in the WB.

4.3.2. Reasons for investing

According to the survey analysis, the three **most common reasons for investing in the Western Balkans** are: 1) relatively low wages; 2) geographical location; and 3) educated labour force. There are some cross-country differences regarding this, as can be seen in Table 24, but still, in all the countries, wages are among the top 2 reasons for investing, while location is among the top 3.

Table 24 / Answers to the question "Why did your company invest in the Western Balkans?" (multiple options possible)

	All WB	MK	RS	Ba	AL
Because of the educated workforce in the country	16%	4%	14%	25%	0%
Because of the relatively low wages	22%	15%	18%	28%	14%
Because of the relatively low taxes	9%	15%	6%	11%	0%
Because of the incentives scheme that the government provided	9%	23%	14%	0%	0%
Because of the good infrastructure in the country	4%	4%	8%	0%	0%
Because of the good institutions and governance in the country (rule of law, control of corruption, government effectiveness etc.)	2%	8%	2%	0%	0%
Because of the geographical location of the country	19%	12%	24%	18%	14%
Because of the prospects of the new market	14%	12%	10%	12%	71%
Other	5%	8%	2%	7%	0%

Source: Survey conducted among German investors in the WB.

The interviews generally confirm this. Half of the interviewed companies listed **geographical location** as an advantage and one of the main reasons for their investment in the Western Balkans. Some of the companies even stated that WB countries are better located than some EU member states, like Romania and Bulgaria:

> *"We can load the truck here on Friday afternoon and it will be in the parent plant on Monday or could be with the customer. You could never do anything like that from Morocco. (ODW, North Macedonia)"*

> *"For sure, the geographical position of the country. From a logistic point for view, it is quite attractive, because we are in a city called Tešanj and we are around 2,5 hours from Zagreb. That means, 9 hours far from Munich. Which is giving us a lot of advantages" (German investor in BiH)*

> *"When it is about the geographical position of the plant, we are surely more competitive than Bulgaria, because we are around 500 km closer than Sofia." (German investor in BiH)*

> *"Our customers are located in Europe. We can reach them through Italy, by ferry and also by land transport. So, it is also this position towards Europe, which we can reach in 24 hours in special transport and so on." (Forschner, Albania)*

The quality of the workforce is also stressed as one of the main reasons for investing and as an advantage of the region:

> *"The general level of education of the total population as compared to other regions is quite high. And one finds more easily highly skilled work force compared to other locations that Falke envisaged. So skilled workforce is a plus in Serbia." (Falke, Serbia)*

> *"What really impressed me was the honest and hard-working people who wanted to protect workplaces and wanted to work. Because the people are loyal, responsible, hard working. These 52 employees in 2004 founded the company together with us and created another 350 jobs in the following years. And I think that this satisfaction helps us with our clients in Germany, Switzerland, and Austria." (GS TMT, BiH)*

> *"And skilled work force is very important and easy to find. We have been planning to start some cooperation with some production companies from Serbia. And when colleagues from the HQ came over, they have been surprised how well people speak English with various education backgrounds." (Dräger, Serbia)*

> *"People are flexible. The people learn fast. I think it was a good decision, at least that is how it is seen in Germany, I think." (Forschner, Albania)*

Another of the main reasons for investing was the **availability of workforce.** Companies state that work force is in general still easy to find in the Western Balkans, due to high unemployment rates. Many companies underline that the availability of the workforce is a big plus in comparison to Visegrad countries where the competition for skilled workforce is much higher.

> *"The countries that are closer to Germany have three times the wage level compared to the wages here and have also dried up of workers." (ODW, North Macedonia)*

> *"At the beginning, it was only important for us that the unemployment rate was 34% and that the wage costs were € 250 gross per month." (ODW, North Macedonia)*

Low wages was also stated in the interviews as one of the reasons for investing in the Western Balkans:

> *"For sure, this is and will still be for a while, a low-labour-cost country, which we use as a competitive advantage, having a plant here." (German investor in BiH)*

But the importance of wages is more nuanced. One aspect that is often mentioned is that there are countries and regions which have lower wages:

“The danger that I see as a plant manager is that I am in competition with Tunisia”, because it is close to Europe and can offer direct labour cost more competitive.” (Marquardt, North Macedonia)

“I need wages that are comparable to China.” (Vossloh, Serbia)

Another aspect that is mentioned is that the low wages sometimes imply that the workers are low-skill and that companies have to invest in their training:

“If more trained workers were available here, we could install more advanced production and then wages would automatically be higher. Therefore, complaining about the lack of skilled workers and the concealment of the low wage level is actually unfair. It goes hand in hand. We are happy with the low wages, but we have to train the employees ourselves because we cannot find them. And that's okay too.” (ODW, North Macedonia)

4.3.3. Challenges of working in the WB

The main challenge of working in the Western Balkans according to the survey analysis is poor governance and institutions, and this holds for all countries. The second negative side pointed out by the companies is government support, while the third one is the availability of skilled workforce (Table 25).

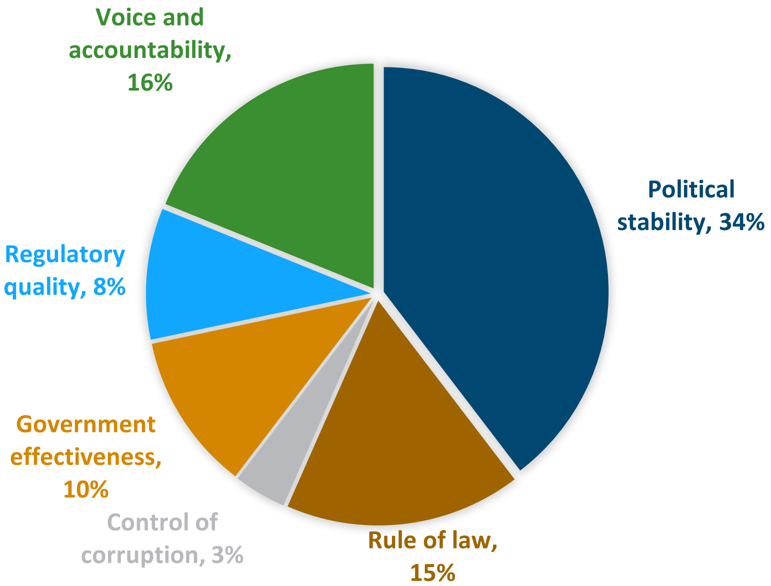
Table 25 / Which are the negative sides of working in the WB? (higher value indicates greater importance)

	All WB	MK	RS	BA	AL
Availability of skilled workforce	5.19	5.89	4.67	5.44	5.00
Wages are relatively high	2.54	0.00	3.61	3.67	4.00
Taxes are relatively high	3.83	4.00	4.5	5.86	3.00
Government does not provide enough support (incentive schemes, zones…)	5.52	6.00	4.17	5.95	6.40
Poor infrastructure	4.80	5.53	4.28	5.83	4.60
Poor governance and institutions (rule of law, corruption, government ineffectiveness)	5.72	6.67	4.33	5.86	6.17
Geographical location	2.70	4.67	2.44	5.00	1.00

Source: Survey conducted among German investors in the WB.

Political stability is the most important governance aspect for German companies when the Western Balkans are in question. Voice and accountability and rule of law come second and third (Figure 28).

Figure 28 / Which of the following aspects of institutions and governance was most important for your company to invest in Western Balkans?



Source: Survey conducted among German investors in the WB.

Interviews strongly confirm the importance of political stability. Companies mentioned three aspects – the legacy of past conflicts in the region, the protests that happen occasionally in these countries, and the frequent change of governments:

"The most important thing is political stability. So that there are no dramas like in Hungary, no dramas like in Ukraine. In the meantime, we have seen two or three changes of government here." (ODW, North Macedonia)

"Somewhere in the Balkans, where there used to be a war, it always takes some persuasion at the beginning to present the factory in a positive light. Until the people were there for the first time. For us it was important that this political stability was there. That there isn't a different prime minister or another president every two years. […] When the big demonstrations were there this year, some people were nervous." (Vossloh Serbia)

"Political Stability: This does play a role. Relative political stability needs to be in place before STIHL decides to start a subsidiary anywhere." (STIHL, Serbia)

An interesting observation was shared by Falke, Serbia, on the rule of law. They pointed out that EU candidate countries, which are closely monitored on their rule of law developments, might sometimes perform better in terms of rule of law than countries which have already joined the EU:

"I think that the efforts of joining the EU offer a certain guarantee that rule of law exists. So the effort of EU accession candidates to join the EU at some point might give more rule of law guarantee than the self-emancipation trends one can see in younger EU member states from Eastern Europe." (Falke, Serbia)

Corruption did not appear as one of the main issues regarding governance in the WB, according to the surveys, and this is also reflected in the interviews. Unlike local companies, foreign companies stated that they did not have to fear any repercussions for speaking up (e.g. tax office investigations, etc.). Foreign investors also stated that they think they are heard more than local companies. One of the reasons they mention for this is that they are quite independent from the local public market, as they don't usually depend on public tenders. Some of the strategies they have adopted for coping with the corruption risks is bringing cases before arbitration courts instead of national courts, and using their power and voice to carry out policy advocacy via international business associations like the Foreign Investors Council or the German Chambers Broad AHK network.

> *"At the time we founded this factory, we were still part of the Panasonic Group. That means that Panasonic has zero tolerance. It was always quite good for us because we were able to play out this tolerance margin. Because we were able to say that there is no room for manoeuvre, otherwise there is the threat of negative business. That is why I have always been very pleased that the fight against corruption has always been at the top of the government's agenda. I have to be honest, in all these years we have not even had the situation where we were pushed in this direction. This is also related to the fact that we are of course not so interesting because we are not in the public sector and have no public contracts." (Vossloh, Serbia)*

However, there are companies that suffer from corruption – even up to the point that they withdrew their investment from the WB:

> *"After we closed the Bosnia and Herzegovina venture, we were harassed by the authorities and had to pay fines. Fortunately, we had the support of an excellent lawyer, but I am glad that this project is over again" (ADV Pax Lutec, BiH)*

On dissatisfaction with government support, companies complained that **there have sometimes been changes in government policies,** which undermines legal certainty:

> *"There is limited legal certainty and predictability as governments and their approaches to FDI incentives, tax schemes, etc change over time. This approach should be a long term consensus-based policy in order to help investors and provide a stable business and legal investment environment (using the Irish example)." (Kostal, North Macedonia)*

Regarding the availability of skilled workforce, the two issues that have been raised in the interviews are the notion that **companies often have to train the workers**, and that many **workers leave the Western Balkans**. It was interesting to hear that there is a link between low wages and the willingness of companies to invest in the upskilling of their employees, which is perceived as necessary. The low labour costs in the country allow companies to invest in the training of their staff, due to the perceived low quality of education. In this way, they ultimately also indirectly influence the education system in the country:

> *"In the past there was a long-standing cooperation with former Yugoslav countries, for years and maybe even decades Falke cooperated. And the expectation was that the same people would still be in Serbia, that they know about textile manufacturing. But unfortunately, the time span was too big. So, the people were already retired or employed elsewhere or had a different set of skills*

than Falke demands nowadays. Therefore, the number of employees that we could employ without training was very low." (Falke, Serbia)

"In former Yugoslavia, the education system and also the dual education system was very good. End of the 80s beginning of the 90s still. But when I arrived at the plant, I started to realise that this good education system did not exist anymore. And why is that: Because people were for 5 years in wars, then in chaos, all the technologies worldwide kept developing, and they did not keep up. The „Know-how-chain" was broken because of the wars and chaos. And the entire educational system was broken, too. So actually, we really needed to start at the very beginning with the basics. And this was one of the reasons why we five years ago started a project together with GIZ focusing on vocational education and training and the special topics which we need here in our plant. But the bad condition of the educational system is still true today." (GS TMT, BiH)

"And for sure, the skills set and overall, the education system need to be improved. It is easier for us that we do not use so much effort currently but we do train our people. It would be better if we had people coming to the plant with a higher skill set." (German investor in BiH)

"I have been very strongly in favor of this dual education system. We were then quick to convince local politicians that this was the right way forward. Together with the TIC, we were able to implement this well and offer vocational school training as early as the fourth year. We initially started with mechanical training and now also offer electronic training. So we are now pursuing a multi-track approach. Why? Because we need the employees. We also have internal training." (Vossloh, Serbia)

"You try at all costs to lure companies into the country, but you don't do your homework. The available skilled labor that you need is nowhere near there. The result is that we have to fight over the available skilled workers. And that doesn't work well in the long run either. There is a huge deficit in terms of education and quality at universities." (Vossloh, Serbia)

"The educational system in Bosnia is allowing you to have influence on the curriculum with around 30%. And we use this opportunity, and we create our own programs together with the schools of course. And we applied this to the students which we have in our training program. This is a hot topic. We are one of the first companies in the country – and by the way, last year we received an award from AHK and the German Embassy for the best training program to increase practical knowledge of the students – and I think we are also initiating the process for the country to change the curriculum in a way that companies will be able to interfere in the official educational program at schools." (German investor in BiH)

"Know-how is available, but often only superficially. Emigration is a problem regarding availability of workforce (Marquardt, North Macedonia)

"Kostal thinks that the problem of emigration and skills mismatch exists, but can be mitigated by showing young people the good opportunities in foreign companies in the WB. However, career development needs to become solely merit-based, as this has not been usually the case, especially in domestic companies in the past." (Kostal North Macedonia)

Related to this, the survey included a question on **the type of education that is most important to companies**, which reveals that STEM graduates are most important (Table 26). This is due to the fact that most of the German companies in this region are in manufacturing and require engineers and similar skilled workers. North Macedonia is a small exception in this respect. There, vocational secondary education seems to be more important than STEM, which might have to do with the notion that German companies there are more labour intensive and employ lower-skilled workers.

Table 26 / Which of the following aspect of education was most important for your company to invest in the WB? (one choice)

	All WB	MK	RS	BA	AL
The number of STEM graduates (science, technology, engineering, mathematics)	38%	18%	33%	48%	50%
The number of ICT graduates (Information and Communication Technology)	12%	0%	17%	16%	0%
The number of vocational secondary education pupils	30%	55%	33%	20%	17%
Other	20%	27%	17%	16%	33%

Source: Survey conducted among German investors in the WB.

4.3.4. Cooperation with local companies

The survey analysis points out that **the most common way in which German companies cooperate with local companies is by buying goods and services from them** (37%), followed by selling goods and services to them (21%). Albania is the only exception here, as the most common way German firms cooperate with local companies there is by providing goods and services together (Table 27).

Table 27 / In which ways is your company cooperating with local companies? (multiple choice)

	All WB	MK	RS	BA	AL
We sell our products (goods and services) to them	21%	19%	21%	22%	18%
We buy goods and services from them	37%	50%	44%	33%	18%
We provide goods/services together	10%	0%	3%	13%	36%
We develop products together	10%	13%	6%	11%	9%
We exchange information related to our work	12%	13%	12%	15%	0%
We work/lobby together for a cause relevant to us	10%	6%	15%	6%	18%

Source: Survey conducted among German investors in the WB.

The two main reasons for German companies not cooperating more with local companies are that local companies cannot provide the quality and standard they need, and that local companies cannot provide the products and services they need. This is uniform for all the Western Balkan countries (Table 28).

Table 28 / What are the barriers to working more with local companies? (multiple choice)

	All WB	MK	RS	BA	AL
Local companies cannot provide the products and services that we need	26%	25%	31%	24%	18%
Local companies are not competitive in terms of price	12%	17%	8%	12%	9%
Local companies cannot provide the quality and standards that we need	31%	33%	27%	30%	36%
Our production process is specific and cannot integrate local companies more	18%	17%	19%	21%	9%
We have long-term relationships with other companies and cannot break them	7%	4%	8%	6%	18%
Other (please comment)	6%	4%	8%	6%	9%

Source: Survey conducted among German investors in the WB.

The interviews provide more insights into this.

“We have already shown the initiative to do so as one of the plants within the whole Falke group. However, we have not implemented this, because we were not sure, if the quality standards would be permanently met. We just have not made the step yet to try this out. I am convinced that we could try this on a limited scale. But before this we would have to check the ability of supplying high quality for a period of time.” (Falke, Serbia)

“The materials that we process are mostly not available in Serbia. I have the strategy and philosophy, whatever is possible, we bring to Serbia. Starting with packaging materials, cardboard boxes, etc. There we have built up suppliers together, so you have the right structure. So, we currently buy a lot in Serbia. Auxiliary and operating materials anyway. Spare parts, yes, our machines come mostly from Germany. But if I have a service partner here who can supply the spare parts, then I buy from them. But many do not have it. It's not so much a problem of wanting to, but of being able to. Wherever possible, we do it. But in most cases, it is not possible.” (Vossloh, Serbia)

“One of the reasons is specific material that isn’t available at local companies, but I can also clearly state that for the companies in the automotive industry and for tier 1 suppliers for OEMs the quality is required to be on a high level. Their quality systems, their technology level needs to follow our needs and that is not always the case locally.” (German investor in BiH)

“Usually very little, and mostly services are usedby local companies. Raw materials and semi-finished products are sourced intermittently from local companies. The reason is that in most instances local companies cannot provide the needed quality (by certified international standards) in the necessary quantities and delivery time frame (e.g. a company may need 2 million screws each month, and local companies could only provide that amount in 2 years)” (Kostal, North Macedonia)

“No major cooperation, only service contracts and short-term contracts; Marquardt is a global company that offers the same products everywhere, therefore it cannot rely on too many local suppliers; Unless there is a large provider that can provide this service worldwide; In any case, it

> *doesn't exist in North Macedonia, the availability is better in Serbia." (Marquardt, North Macedonia)*

> *"So, a lack of knowledge, a lack of experience, no standards, under-capitalisation, not even the awareness of what a premium automotive supplier expects from a local partner". (ODW, North Macedonia)*

> *"We cannot find raw materials in the quality or specifications that we need for our customers. We import all raw materials from outside, from Europe especially." (Forschner, Albania)*

It is interesting to note that some German companies have stated that they are working with their local suppliers to overcome these issues, by "mentoring" them. This points to an important potential way of improving cooperation between foreign and local companies.

> *"Kostal also starts "mentoring" programmes to make local suppliers adhere to quality standards." (Kostal, North Macedonia)*

> *"So, a simple example. We identified suppliers who simply did not meet the quality level we needed. Then we took them by the hand and together we developed the quality standard that we needed. And I had suppliers that we introduced to a specific quality level. So that they could deliver this to us. We are currently in the process of replacing a previous Czech supplier with a Serbian one. This involves special aluminium housings. Let me put it this way, this would not have been possible 10 years ago. It is not only that the country has developed, but also the companies." (Vossloh Serbia)*

The companies stated that they are ready to **work with regional suppliers across the region** in order to meet the demand for certain products. The removal of non-tariff barriers and the development of a Common Regional Market could further strengthen this trend and could ultimately become another locational advantage for FDI in the Western Balkans:

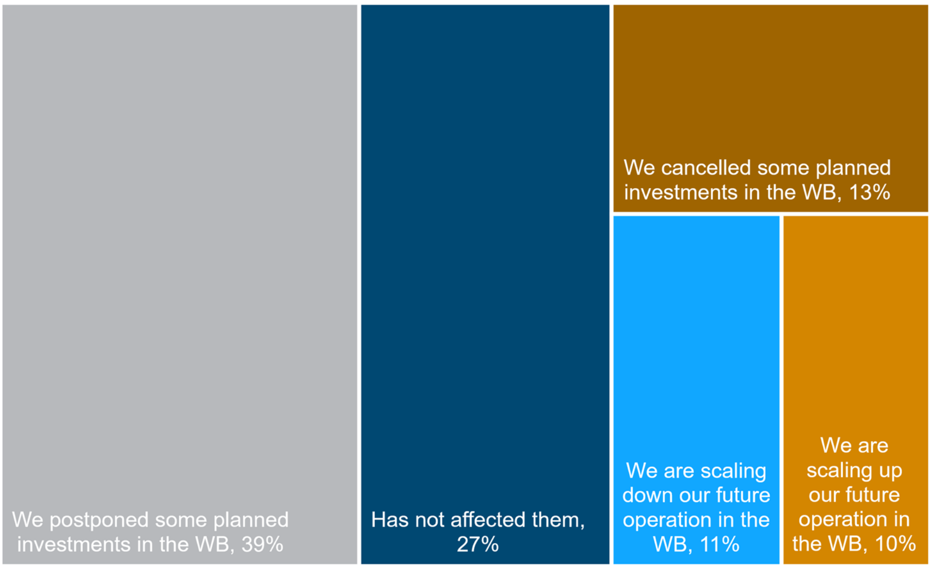
> *"All of our production is exported. But when it comes to sourcing and procurement, we buy steel here in BiH and import from Serbia and North Macedonia. So, in our procurement we work a lot with the region. And I think that is very good. If "Mini-Schengen" (or the Common Regional Market) will be implemented at some point, this would have a very positive effect for us. On the one hand the mobility of workers will give us better opportunities to develop our organisation further. And on the other hand, our trucks coming from North Macedonia and Serbia will not have to wait so long at the borders anymore." (GS TMT, BiH)*

> *"We are trying to work with them as much as possible. We have some limits. Currently we source 30% of our material and parts purchases from the region. And we would like to increase it because this is giving us additional competitiveness, pricewise, logistics-wise, and so on. But we have some specific materials which do not have so many options outside of EU countries. But it is one of our strategies to increase the purchasing volume from local companies as much as possible. And we do so not just from our country, here in Bosnia – of course the majority is coming from our country – but we also cooperate with companies from Serbia, from Croatia, North Macedonia." (German investor in BiH)*

4.3.5. COVID-19 and nearshoring

COVID-19 did affect German companies operating in the Western Balkans, but not seriously. Most of the surveyed companies stated that they had to postpone their investment due to the pandemic (39%), meaning that this investment is expected to be pursued after the pandemic is over. Just 13% stated that they had to cancel some investment projects, while 27% said that the pandemic has not affected them at all. 11% stated that they had to scale down their future operations in the region, but 10% said that they are scaling up their operations (Figure 29).

Figure 29 / How has Covid-19 affected your future plans for the WB?



Source: Survey conducted among German investors in the WB

When asked whether they consider transferring their investment from the Western Balkans to other countries closer to Germany due the pandemic, none of the companies answered positively, 85% answered negatively, and 15% said that they didn't know.

The interview analysis points out that the pandemic affected the Western Balkan facilities indirectly, through its effect on Germany and the facility there:

> *"Well, other textile production has been harder hit. Falke in its specialised segment has seen a decrease in turnover of around 40% in some months. But the plant in Serbia was impacted less. The impact mainly reached us via the impact Covid had in Germany, where our clients are based." (Falke, Serbia)*

> *"We are depending on the German economy via our orders. So, if the economy is going down, our orders will decrease. 92% of our turnover is export, 100% of our production is export. We are indeed very dependent on developments in Germany. We are producing production goods, machines to process paper, metal, etc. Liebherr, Thyssen Krupp, processing machines, train*

companies are among our clients. We have a good mix of clients. This diversification of clients and sectors really helped throughout the crisis." (GS TMT, BiH)

Where nearshoring is concerned, companies stated that there might be such tendencies in the time to come, and that the Western Balkans might benefit from this, but that this is also still unclear:

"As a conclusion from my side, I can say that judging how the automotive industry behaves at the moment that the Western Balkans will be a very important region for the automotive industry nearshoring. Because of the short supply chains in the automotive industry that OEMs would like to have […] For instance, when the global supply chains collapsed in February, March and when it wasn´t easy to get parts from China or India there is a clear trend that there will be regional nearshoring. And for Europe, I think the Western Balkans should play an important role." (German investor in BiH)

"German customers are asking for shortening of supply chain. Ten weeks supply from China may not be sustainable in the long term anymore for many products. These considerations have already started with the Fukushima earthquake and Thailand floods, the future of manufacturing should over time migrate to "in the region for the region". However, whether WB will benefit from this trend needs to be seen. Probably they might become rather an FDI location for new investments or reinvestments of existing companies in the future, and less for existing investments (e.g. from China) that then would be relocated / nearshored." (Kostal, North Macedonia)

"So I expect that here in Macedonia, for these reasons alone, companies that are based in Europe and that had global supply chains from Far Asia will definitely also settle here. It remains to be seen whether it will be Macedonia or Serbia." (ODW, North Macedonia)

Another factor which investors mentioned that is important for nearshoring and that may work in favour of the Western Balkans is that countries from Central Europe are saturated and that workforce is not easily available, differently from the Western Balkans:

"I believe when you look at countries such as Czechia and Poland and Hungary, you have a problem finding available people. Because the unemployment rate, especially in countries such as Czechia, is one percent – of course before the pandemic. I am not sure what the situation is now. But, for example I know that we had intentions to have a new plant somewhere in eastern Europe. And Czechia and Poland and Hungary were not the options. The options were Romania, Serbia and maybe one more plant in BiH." (German investor in BiH)

"I'm giving an outlook here: If we advertise a job position in production, for example – even the city of Tešanj is quite industrial compared to the other areas in our country – for 50 people that we want, we get 300 applications. Which is quite good. We had plans in Poland, we had plans in Czechia. There are so many companies, especially in the automotive industry. They are fighting about each available person, I guess – especially in some regions of the country where the industry is quite strong, like the Poznan region in Poland." (German investor in BiH)

4.3.6. Cultural proximity and positive experiences from the past

One of the findings of the interview analysis which was not expected *a priori*, is that German companies often stated that one of the reasons for investing in the Western Balkans was their cultural proximity to Germany, as well as the positive previous experiences they had had with people from the Balkan region. In some cases this went as far back as socialist times, and in some cases it was related to more recent migration from the region. This very important finding points out that not just “hard” facts play a role in investment decisions, like labour force, production costs etc. But that these “soft” advantages and the good reputation from the past can be decisive for the decision to invest in the Western Balkans. Western Balkans authorities could benefit from this potential by more awareness for this factor.

“And we have always found that we have had positive experiences with people from the former Yugoslavia in all areas. They are hard-working and resourceful employees”. (Vossloh, Serbia)

“In former Yugoslavia the education system and also the dual education system was very good. End of the 80s beginning of the 90s still.” (GS TMT, Bosnia and Herzegovina)

“Many young Bosnians were in Germany during the Balkan war, learned the language and got to know the culture. That makes it easy to work together. And the work attitude of the qualified employees is also absolutely convincing" (Hueck, BiH)

“It is a cultural area that is very similar to Germany. When you are raising a company, it's simply a matter of getting it right. Then I simply take the experience of how employees from other cultures develop over the years with us. How can we work with them? And there we agreed that people from the former Yugoslavia were the best match for us. That's why that gave us the last few percent in the end.” (Vossloh, Serbia)

“The Western Balkans has always been part of the "German cultural area" if that is politically correct. So here was always - in communism, when the local currency in Yugoslavia was weak, people always calculated in Deutsch-Mark. The euro is now a second currency everywhere. Officially in Montenegro and Kosovo, unofficially in the other countries. So, you can pay with euros everywhere in Macedonia, Serbia, Albania. But not in Ukraine or Russia, let alone in India or China. So that is deeply anchored in the local government and also in the local population. We are part of the German cultural area, industrial area, political area, whatever you want to call it.” (ODW, North Macedonia)

“And working in this country is very satisfying when it comes to nature, culture, history. And all the spheres, where politicians do not have an impact, are very optimistic.” (GS TMT, BiH)

“The country, if you live there or are there for a longer time, then you feel somehow like a member. And Albania in particular is a beautiful country. The people are super warm, are nice.” (Lindner, Albania)

“The company became aware of the Balkan state through personal contacts and their positive experiences in Southeastern Europe” (Hueck, BiH)

"Due to personal roots in Bosnia and Herzegovina, they finally found what they were looking for in the town of Maglaj, about 80 kilometers from Croatia." (Pax Lutec, BiH)

4.3.7. Summary of main findings

Most of the German companies which have invested in the Western Balkans are satisfied with their experience. The main reasons for investing in this region are the relatively low wages, the geographical location and the educated labour force. The main reported negative side of working in the Western Balkans is the poor governance, primarily, political instability. Companies have also complained about changes in government policies and about having to train the workers. The reported main reasons for not cooperating more with local companies is that they are considered not to be able to provide the quality and standards that the German companies require. For that reason, some German companies have started programmes of "mentoring" local companies. One of the unexpected findings of the interview analysis is that German companies often stated that one of the reasons for investment in the Western Balkans was their cultural proximity to Germany, as well as the positive previous experiences they had with people from the Balkan region.

4.3.8. Qualitative analysis of the semi-standardised Interviews with German companies in the Western Balkans

In this section the interviews conducted are systematically analysed with the help of so-called thematic analysis.[3] Witzel (1982) suggests that the first step in the text analysis is to identify the problem areas and topics in the interviews and to mark them accordingly.[4] The focus of this type of analysis is the identification of statements made by the interviewed persons on different topics, e.g. their investment activities. Therefore, the text has to be coded. Coding is the analytical process in which interview data are categorised to facilitate analysis. It makes the data quantifiable, and hence comparable, and ensures that the insights of the interviews actually reflect the respondents' reality.

The interviews were analysed with the qualitative text analysis tool MaxQDA, with the help of which the statements of the interviewees can be put into context in a structured way. For this purpose, the interviews were first transcribed and then the text material was thematically coded. The following overview shows the categories identified in the interviews.

3 Lueger, Manfred (2010): Interpretative Sozialforschung. Die Methoden. Wien: Facultas Verlags- & Buchhandels AG.

4 Witzel, Andreas (1982): Verfahren der qualitativen Sozialforschung. Überblick und Alternativen. Frankfurt: Campus Verlag.

Table 29 / Codes identified in the interviews

List of Codes	Frequency
Companies' response to Covid-19	0
Increase in Investments	1
Covid-19 had no impact on investment activity	1
Nearshoring Potentials	4
Reshoring/Backshoring	1
Postponement of investments	2
Institutions and Governance	18
Government Effectiveness	8
Control of Corruption (+)	9
Rule of Law	2
Barriers and Challenges for Foreign Companies	3
Political Stability	0
High income taxes + social security	3
Low Purchase Power	2
Brain Drain	9
Local Workforce	0
Different Work Culture	1
Lack of loyaty	3
Lower Availability	7
Lower Quality	7
Cooperation	6
Different work culture	2
Unavailability of materials/products (+)	7
Lack of experience	1
(Lack of) standards	11
Lack of needed quantity capacity	5
Lack of knowledge	2
Education	0
Lower quality of education	2
Education and Skill Set	1
Disappointment	3
National Education Systems	4
Private Sector Engagement in Education and Upskilling	23
STEM graduates	2
VET (+)	10
EU Accession Plans	1
Dependency on headquaters	6
Supply chains	1
Advantages / strategies as foreign companies over locals	7
Hope for growth potential	1
Regional integration	3
Infrastructure	2
Roads, Technology	8
Economic Infrastructure	1
Yugoslavia	5
Competitiveness of WB in the world	35
Ways of political influence/Lobbying	17
IPAs work	4
Interesting Quotes (+)	19

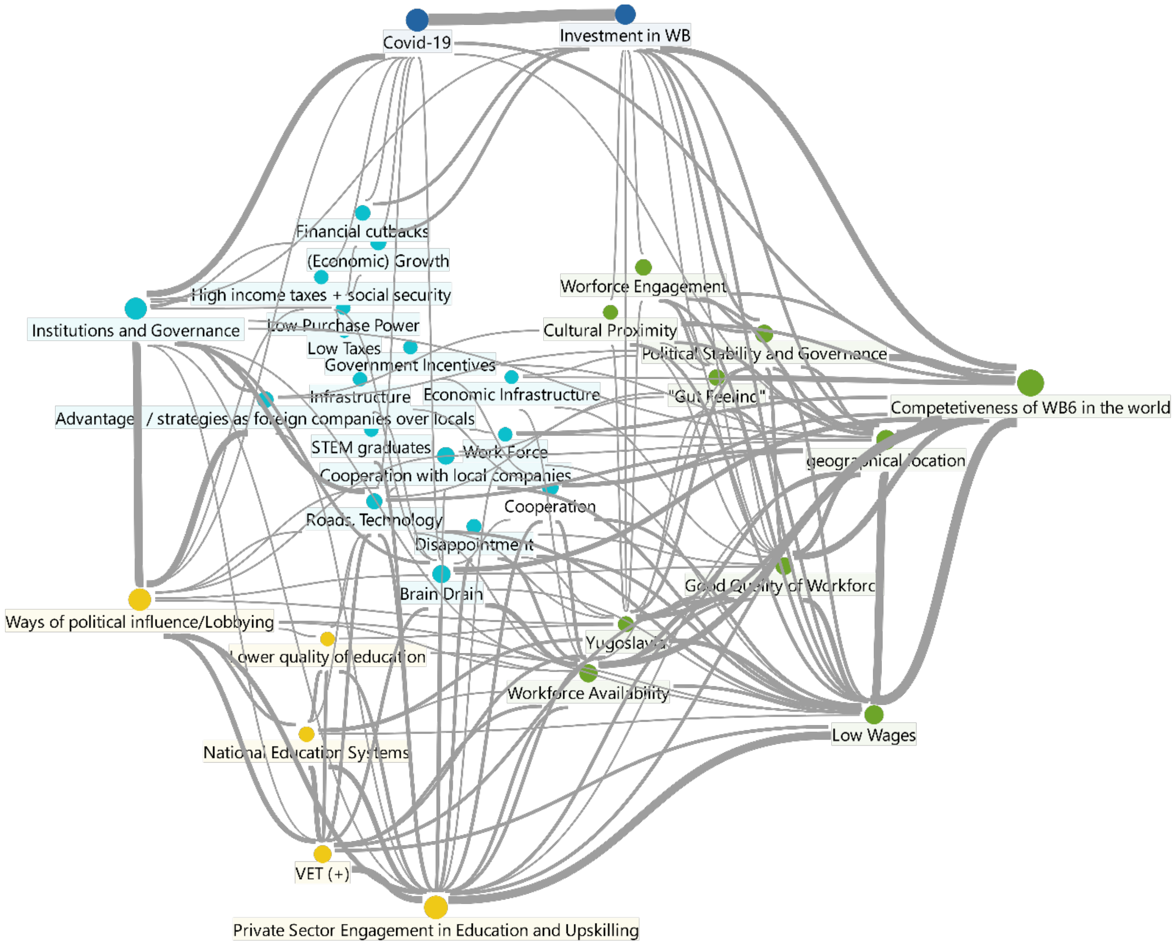
contd.

Table 29 contd. / Codes identified in the interviews

Covid-19	**23**
(Economic) Growth	5
Financial cutbacks	4
Cooperation with local companies	10
Developing / producing together	2
Acceptance of foreign company in WB	1
work/lobby together for a cause relevant	1
Buying goods and services	10
Investment Reasons	3
Mouth to mouth propaganda/reputation	2
Political Stability and Governance	12
Cultural Proximity	4
"Gut Feeling"	6
geographical location	15
Government Incentives	2
Free trade agreements	1
Low Taxes	3
Low Wages	13
Work Force	4
Worforce Engagement	7
Good Quality of Workforce	11
Workforce Availability	13
Investment in WB	16
Cooperation with foreign investors (+)	8
Cooperations fosters quality improvement	1
Networking	8
Progress over time	9
Government Incentives	1
FDI cooperation fosters innovation & growth	5
Faster and more reliable cooperation	2
Barriers for working with Foreign investors	0
Old and outdated technology	1
Reputation of WB markets	1
WB companies' knowledge about international norms / standards	2
Foreign investors ignorance about WB markets	7
Trade barriers / infrastructure /	3
Less flexibility of foreign investors	5
additional demands/needs for foreign investors	11

The following figure shows an overview of all codes/categories that emerged in the interview material and their textual proximity to each other - linked by the frequency of common mentioning in the same or at most the following paragraph. As can be seen, the recurring topics in all interviews can be divided into three main clusters in terms of content: Investment reasons (green), challenges (light blue) and spheres of political influence (yellow). We can also see which topics are closely interrelated. For instance, one can see that “Competitiveness of WB in the world” is closest to “geographical location”, but also to “good quality of workforce” and “gut feeling”, which indicates that the competitiveness of the region stems from these factors.

Figure 30 / Proximity of Codes in the interviews of German investors in the Western Balkans



5. Insights from surveys and interviews with local actors

The survey of local Western Balkan companies indicates that 55% of them already cooperate with foreign companies, making 35% of their turnover with them. The most common form of cooperation is that local companies sell products to the foreign, while softer forms of cooperation, like working together on a common activity, are less pronounced, even though more than one half of the local companies stated that they want to cooperate in these ways. Domestic companies are in general satisfied with foreign companies – 90% said they are either satisfied or very satisfied. The main reported reason for not cooperating more with the foreign companies is that local companies don't know foreign companies they can cooperate with. Thus, there could be a potential here for chambers of commerce to support more these soft forms of cooperation, like fairs, expos and events on which companies would get to know each other, as well as forums and platforms on which they could work together on common initiatives.

The case studies of six successful examples of local companies that cooperate with foreign companies point to several important success factors. The first is the implementation of strict international quality standards, such as ISO 9001. The second is investment in new equipment and technology, which results in high-quality products. The third is participation in business-to-business events, fairs, expos and other similar events, where domestic companies can meet foreign investors. The fourth is a qualified and skilled labour force and constant investment in education and training of workers. The fifth is long-term thinking and strategic orientation, as success in cooperating with foreign companies does not happen overnight. The sixth is dedication to innovation, continuous introduction of new products and not being afraid to take risks.

The interviews with representatives of investment promotion agencies from the Western Balkans show that existing FDI in these countries suffered much less than expected during the pandemic. Agencies are expecting, and in some cases already seeing, new waves of investment in their countries. Agencies usually point out the low-cost side of their economies as their strong point, not speaking too much about quality, Serbia being an obvious exception in this respect. Agencies are well aware that governance is a problem in their countries, but do not perceive infrastructure as problematic. They do not consider the lack of skilled labour to be a big problem yet, but are aware that it might become so soon. Some agencies are taking concrete steps towards improving cooperation between domestic and foreign companies.

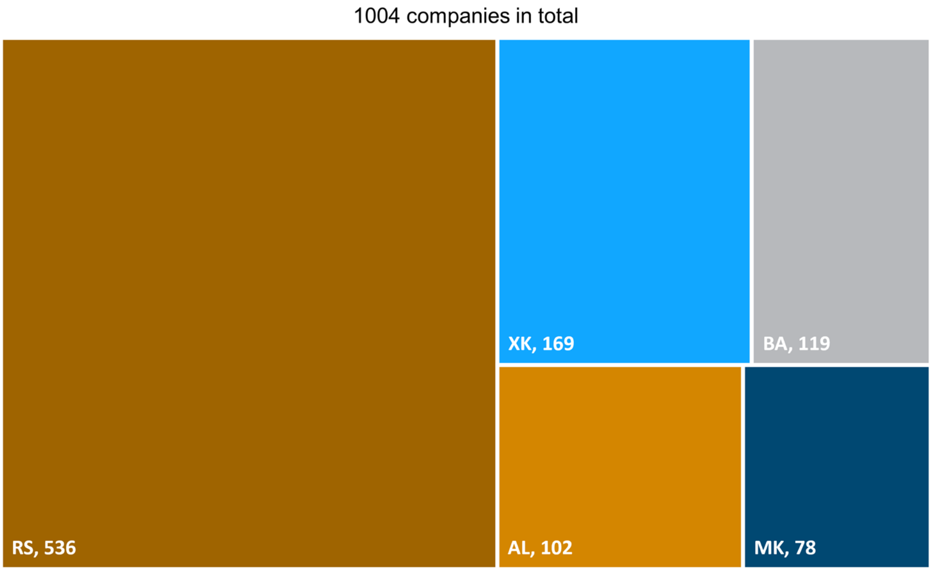
This chapter complements the analysis from the previous chapter by presenting some additional insights obtained from surveys, interviews and case studies of relevant local actors in the Western Balkans. More precisely, first, results from a **survey conducted with local companies** are presented, with the purpose of seeing how local companies perceive foreign investors, how they cooperate with them, whether they think they can cooperate more, obstacles to greater cooperation, etc. Then, **case studies of local success stories,** i.e. local companies that have successfully cooperated with foreign companies, are presented, with the purpose of revealing the reasons behind these successes and lessons that can be learned from them. Finally, the chapter concludes with **interviews with representatives of investment promotion agencies** from the Western Balkan economies, to see how these agencies look at the process of attracting foreign investors, cooperation between local and foreign companies, as well as whether the COVID-19 pandemic has changed the level of cooperation.

5.1. SURVEY OF LOCAL COMPANIES

To analyse the cooperation between local and foreign companies operating in the Western Balkans, a survey was conducted in November 2020, by the members of the Western Balkans 6 Chamber Investment Forum: Union of Chambers of Commerce and Industry of Albania, Foreign Trade Chamber of Bosnia and Herzegovina, Kosovo Chamber of Commerce, Chamber of Economy of Montenegro, Economic Chamber of North Macedonia, and the Chamber of Commerce and Industry of Serbia, . The survey was based on a questionnaire, designed specifically for this project, consisting of 12 questions, organised in two groups – general information about the company, and cooperation with foreign companies. The exact questions are presented in Appendix 3, while below we briefly present the main findings.

In total, 1,004 companies answered the survey, most of them from Serbia (536). Kosovo was second, with 169 companies, Bosnia and Herzegovina third, with 119 firms, Albania had 102, while North Macedonia – 78 (Figure 31).

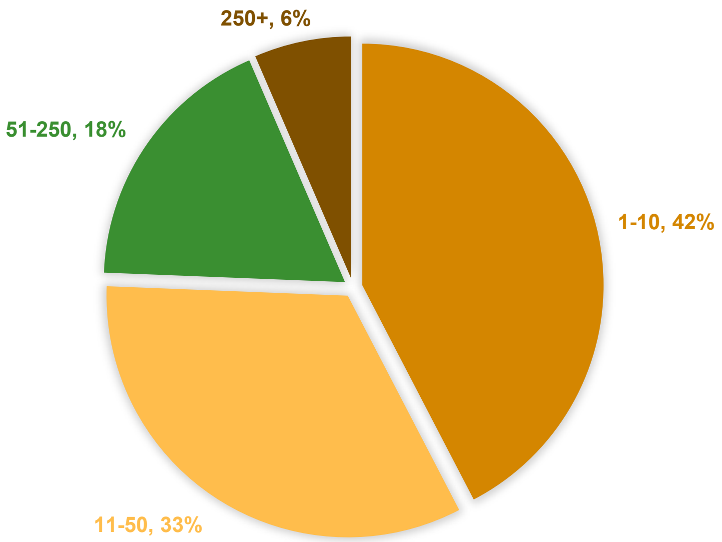
Figure 31 / Distribution of companies by economies



Source: Survey conducted among local companies from WB.

Most of the companies are micro, i.e. up to 10 employees (42%) and small, i.e. 11-50 employees (33%), while 6% were large companies (Figure 32).

Figure 32 / How many employees does your company have?



Source: Survey conducted among local companies from WB.

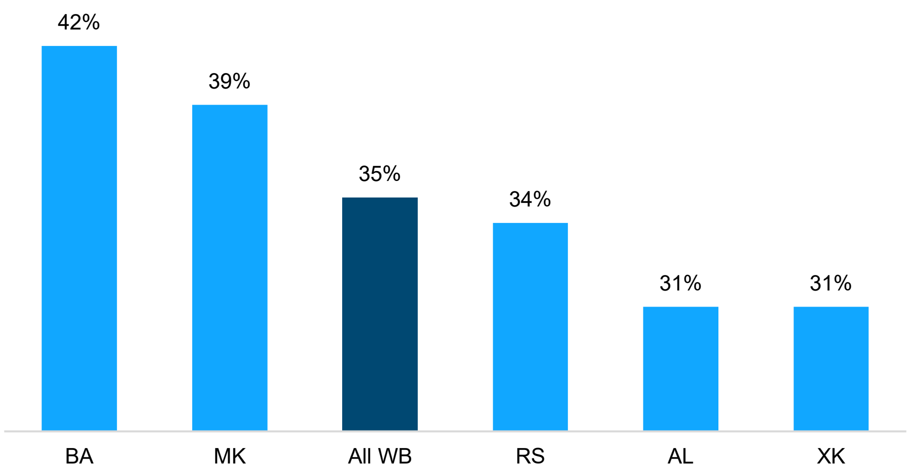
More than half the companies (55%) stated that they were working with foreign companies, but there are notable differences regarding this between countries. In North Macedonia, 86% of the companies are cooperating, in Serbia 64%, while in Kosovo, just 24% (Table 30).

Table 30 / Is your company working with foreign companies that are operating in your country?

	All WB	MK	RS	BA	AL	XK
Yes	55%	86%	64%	48%	40%	24%
No	45%	14%	36%	52%	60%	76%

Source: Survey conducted among local companies from WB.

Figure 33 / How much of your company's turnover is with foreign companies that are operating in your country?

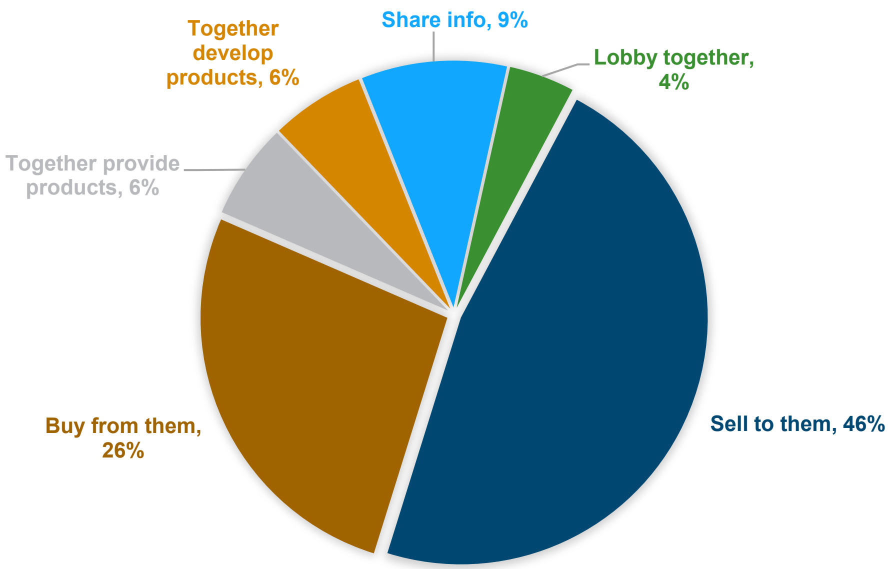


Source: Survey conducted among local companies from WB.

The companies that cooperate with foreign companies have an average of 35% of their turnover with them, with some minor differences between countries (Figure 33).

The most common way local companies cooperate with foreign is by selling them products (46%), while the second most common way is by buying goods and services from them (26%). Softer forms of cooperation are much less pronounced (**Fehler! Ungültiger Eigenverweis auf Textmarke.**).

Figure 34 / How is your company working with foreign companies?



Source: Survey conducted among local companies from WB.

There are some differences between countries regarding how local companies cooperate with foreign companies. In North Macedonia, for example, selling products to foreign companies is by far the most common form of cooperation, at 76%. In Kosovo the most common form of cooperation is buying products from foreign companies, at 39%. In Albania, softer forms of cooperation are 36% of all options (Table 31).

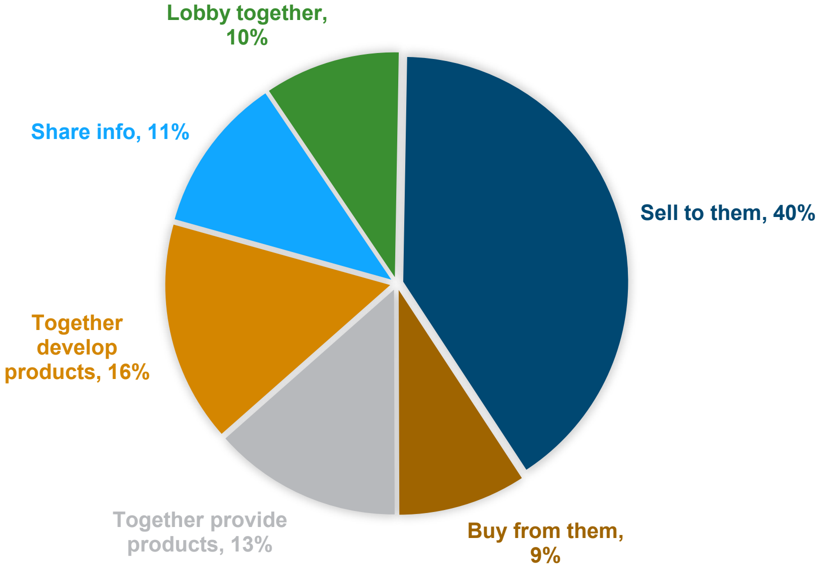
Table 31 / How is your company working with foreign companies?

	All WB	MK	RS	BA	AL	XK
Sell to them	46%	73%	45%	46%	41%	32%
Buy from them	26%	8%	28%	25%	23%	39%
Together provide products	6%	3%	6%	4%	7%	11%
Together develop products	6%	6%	4%	14%	14%	4%
Share info	9%	6%	10%	8%	10%	10%
Lobby together	4%	1%	5%	4%	5%	3%
Other	1%	3%	2%	0%	0%	1%

Source: Survey conducted among local companies from WB.

When asked in which ways they want to cooperate more with foreign companies, most of the local companies say that they want to sell products to them (40%). Still, softer forms of cooperation take more than one half of the companies' answers. This points out that there is a big potential for more ways of cooperation than the pure integration of local companies into global supply chains of foreign companies.

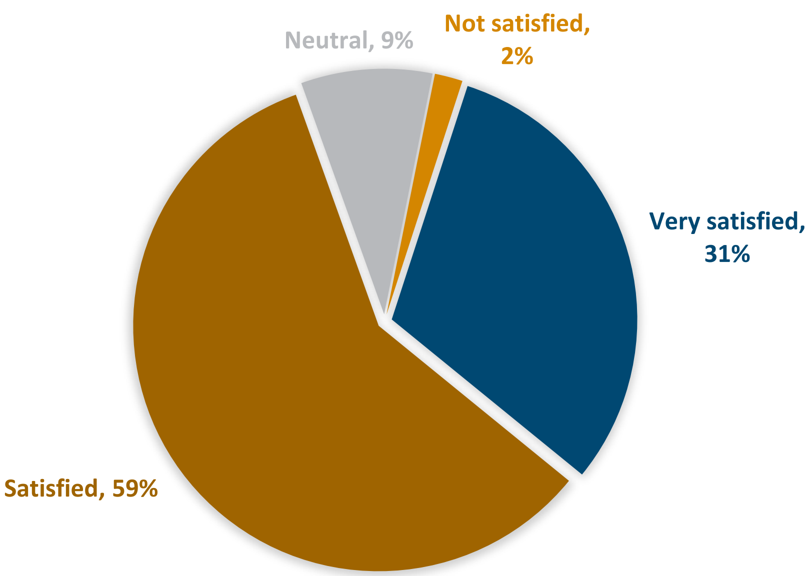
Figure 35 / In which ways would you like to cooperate more with foreign companies that are operating in your country?



Source: Survey conducted among local companies from WB.

The level of satisfaction with foreign companies is very high - 90% of companies said they are either satisfied or very satisfied with the cooperation. Just 2% stated they are not satisfied (Figure 36).

Figure 36 / How satisfied are you with the cooperation with the foreign companies?



Source: Survey conducted among local companies from WB.

When asked if they are more satisfied with cooperation with foreign or domestic companies, 57% of the surveyed companies states that they are equally satisfied, 29% state that they are more satisfied with the foreign, while 14% with domestic companies (Table 32). There are notable differences between countries in this respect. In BiH and in Albania companies are more satisfied with foreign companies, while in Kosovo they are more satisfied with domestic firms.

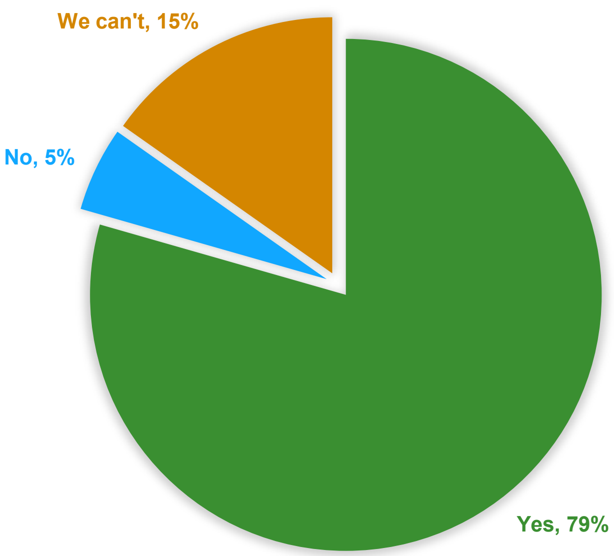
Table 32 / Are you more satisfied with cooperation with foreign companies, or with local companies?

	All WB	MK	RS	BA	AL	XK
Foreign	29%	39%	20%	58%	55%	29%
Equal	57%	56%	67%	31%	36%	33%
Domestic	14%	5%	13%	11%	9%	38%

Source: Survey conducted among local companies from WB.

Turning to companies that do not cooperate with foreign companies, a large majority of them stated that they want to cooperate (79%); 15% stated that they cannot, due to the nature of their business, while just 5% stated that they don't want to (Figure 37).

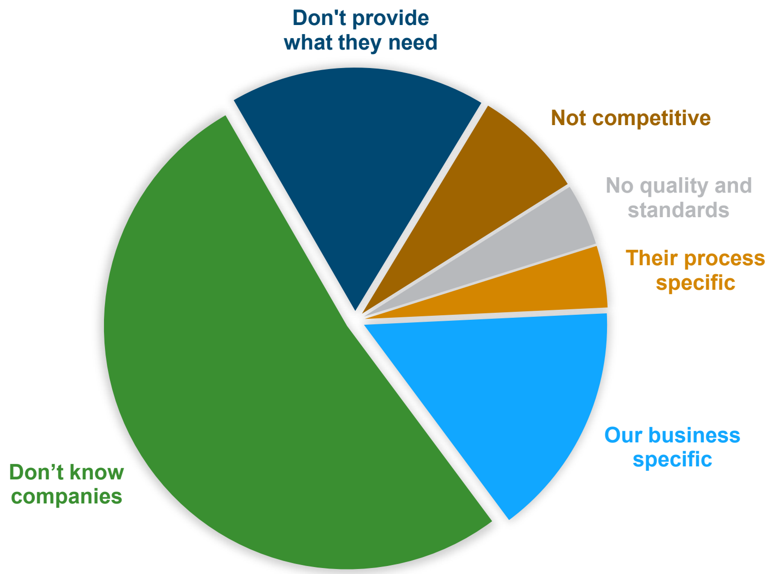
Figure 37 / Do you want to work with foreign companies that are operating in your country?



Source: Survey conducted among local companies from WB.

Asked why they don't cooperate with foreign companies, most of the local companies (52%) say that they don't know foreign companies with which they can cooperate; 17% say the reason is that they don't provide what foreign companies need, while 16% state that the reason is that their business is specific (Figure 38).

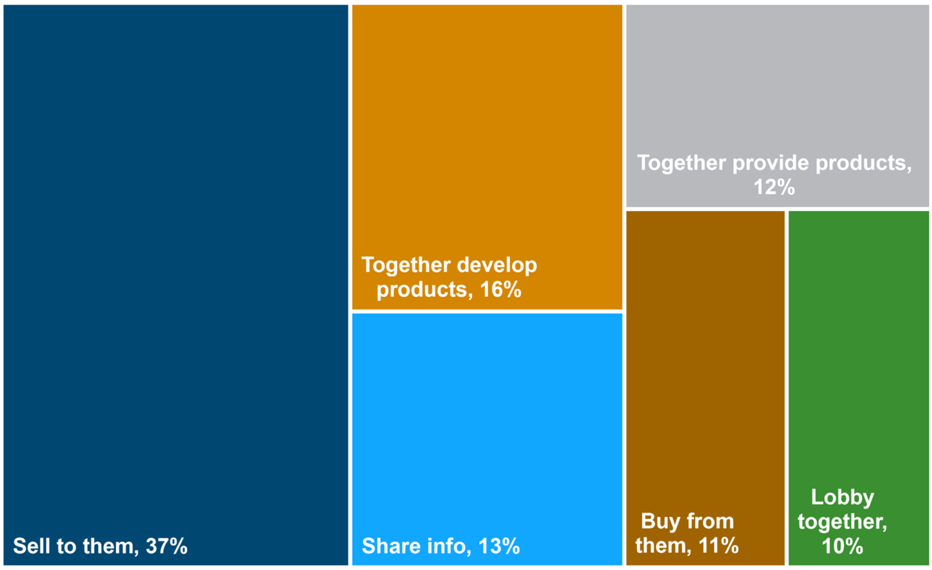
Figure 38 / What are the reasons why your company does not work with foreign companies operating in your country?



Source: Survey conducted among local companies from WB.

Asked about the ways in which they would like to cooperate with foreign companies, most local companies say they would like to sell their products to them (37%). Still, when soft forms of cooperation are taken together their share is 51%, showing that the most preferred mode of cooperation is actually these soft forms, which are easier to achieve (Figure 39).

Figure 39 / In which ways would you like to cooperate with foreign companies that are operating in your country?



Source: Survey conducted among local companies from WB.

To summarise the survey on local companies, one could say that cooperation between domestic and foreign companies is neither great nor terrible: 55% of local companies already cooperate with foreign companies, generating 35% of their turnover with them. There are some differences across countries in the Western Balkans, cooperation being the highest in North Macedonia and Serbia, and the lowest in Albania and Kosovo. The most common form of cooperation is local companies selling products to foreign firms, while the second one is domestic companies buying products from foreign ones. Soft forms of cooperation such as developing products together, providing products together, lobbying together, and sharing information are less pronounced, even though local companies want to cooperate in these softer ways. More than half of them stated they want to cooperate in these ways. In general, domestic companies are satisfied with foreign companies – 90% said they are either satisfied or very satisfied, and moreover, they are slightly more satisfied with foreign than with other domestic companies, even though there are some differences between countries in this respect, with companies from Kosovo being more satisfied with domestic companies. Of the companies that do not cooperate with foreign investors, 79% of them stated that they want to cooperate, and more than one half said that the reason they don't cooperate is that they don't know foreign companies with which they can cooperate. Softer forms of cooperation are the most preferred mode of cooperation for more than one half of the companies. Thus, the main take-away from this part of the analysis would be that these soft forms of cooperation between domestic and foreign companies could hold a big potential. It might be beneficial for both policy makers and chambers of commerce to support activities in this context.

5.2. CASE STUDIES OF LOCAL SUCCESS STORIES

This section presents the experience of six local companies from the Western Balkans that successfully cooperate with foreign companies. The stories first present general information about the companies such as their history, their activities, etc., in order to get acquainted with them. Then, excerpts from conversations with representatives of the companies are presented, with the purpose of illustrating concretely the mode of their cooperation with foreign companies, how the cooperation started, what were the factors that made it possible and successful, etc. The main findings from the six stories can be summarised as follows.

First, following international quality standards is often stressed as crucial for cooperating with foreign companies. Four of the six companies mentioned that they possess certificates for quality standards, such as ISO 9001, and that this has been an important factor for their success. This complements the finding from the previous chapter, where some of the German companies pointed out that the reason why they do not cooperate more with local companies is that they do not adhere to international standards.

Second, investment in new equipment and technology seems to be vital. Four of the six companies mentioned that investing in new equipment, machinery and technology is crucial for success in cooperating with foreign companies. Some of them also pointed out that local companies often fare poorly in this respect, and that for that reason, government support for the adoption of new technologies and investing in new machinery and equipment is very important. Existing government measures directed at this have been rated very positively.

Third, networking and sharing information is key: business to business events, fairs, expos and other similar events are emphasised as being very important for establishing cooperation between local and foreign companies, supporting the findings from the first section of this chapter about soft forms of cooperation. Three of the six companies mentioned this. These types of events allow local and foreign companies to meet, get to know each other, explore possibilities of working together, share experiences, etc. Some companies also pointed out that local chambers of commerce were doing a good job regarding this, and that these efforts should be further strengthened. Some local companies in the WB feel that their capacities are not rightly perceived by foreign investors and that there is a lack of information or even ignorance about the local availability of products and services. Especially in this respect bringing foreign and local companies together to share information is crucial.

Fourth, possessing qualified and skilled workers and their constant training is also raised as an important success factor by many of the companies (three out of six). Without quality workers, companies cannot deliver quality goods and services to foreign companies. In this respect, some companies also raise the positive sides of the dual education system, which is still not developed in these countries, and is often met with prejudice by people.

Fifth, long-term thinking and strategic orientation, including the capacity for constant gradual improvement, patience, trust, building long-term partnerships, and robust business planning, are all stressed as key success factors by three of the six companies. Success in cooperation with foreign companies cannot be expected over the night and companies themselves underline that there is hard work over a longer horizon in order to achieve their goals.

Finally, dedication to innovation, continuously introducing new products, not being afraid to go in new directions and taking business risks are also stressed as important success factors by some of the companies (two out of six). This may not be particularly related to cooperation with foreign companies, and may be linked to the general story of the entrepreneurial spirit, but nevertheless points to the fact that being courageous and taking risks also pays off where cooperation with foreign companies is concerned.

AZ Group (Albania)

(Processing of animal by-products, 130 employees)

AZ Group is a complex in Lezhe, Albania comprising four different companies that operate in the animal by-products processing industry, employing around 130 people. The first company, founded in 2008, was called “INCA” - which stands for "Industry of Natural Casings Albania." INCA started out as an outward processing company, providing foreign companies with the service of processing natural casings for the meat and sausage industry. In 2010 the company entered the domestic market, distributing and supplying Albanian meat and sausage companies with natural casings.

As part of its philosophy of vertical integration, in 2015 the company undertook its biggest challenge yet - to collect its own raw material from Albanian slaughterhouses. Up until 2015 Albanian slaughterhouses treated everything besides meat as waste. INCA was not just able to collect and turn this "waste" into products by giving them economic value, but it also started exporting these products to foreign markets. Nonetheless, only 15% of the waste that slaughterhouses were throwing away was being recovered as products. Therefore, in 2018, the second company of the group was born. Management decided to invest in a new line for manufacturing natural organic chews for domestic pets made out of animal by-products which cannot be destined for human consumption. This investment increased the percentage of slaughterhouse waste turned into product to 30%.

The third company of the group was founded in 2018. It started operating in 2020 to collect and process the remaining 70% of the organic waste generated by slaughterhouses and 100% of the waste generated by all animal and meat processing related industries in Albania. "AZ Rendering" is a rendering company that processes all animal waste that cannot be destined either for human consumption or domestic pets. The final products rendered from the company are animal protein and animal fat, and zero waste. The products find use in various industries but are mainly utilised as biodiesel and feed for the agricultural sector.

Since October 2020 the group has expanded its operations in the Kosovo market by establishing "Inca K". "Inca K" collects raw materials from the Kosovo Region and trades finished products. The company was established as part of AZ Group's plans to extend its influence in the Balkan Region.

According to Drini Zusi, the General Coordinator of the AZ Group, six years after deciding to start processing Albanian raw material, AZ Group now transforms nearly 2000 tons of Albanian animal by-products per year, in the process of which it has become one of the companies with the highest positive environmental impact in Albania and perhaps the only Albanian company operating in a full-scale circular economy business model.

AZ Group cooperates with more than 60 established companies, 20 of which are foreign. The share of turnover from cooperation with foreign companies is nearly 70%. The company exports to more than ten different countries and three different continents.

How did the company become successful?

The company considers the key reason behind its success to be its vision of investing in the expansion of processing capabilities and the expansion of the product range. Since 2009, the company's ownership has actively participated in every industry-related international fair to find new clients. Almost every time, the overwhelming feedback was that INCA and Albania presented financially attractive propositions, however operation-wise it was considered too small to fulfil orders for large (mainly European) clients. Therefore, to attract more prominent clients, the ownership undertook the risk of investing in machinery and processing capabilities without having guaranteed contracts. This type of investment philosophy has been driving new investments ever since. The company always focuses on diversifying its product and services portfolio, intending to create a full range of services for suppliers and customers. The company sees its success in the group's philosophy for continuous innovation, which has led to systematically introducing new products or services with diverging life-cycles as well as being able to create a platform for change, in an economic, environmental and social way.

Comparison between domestic and foreign companies

In terms of comparison between working with foreign and domestic companies, the mentality seems to be the main distinction for AZ Group. According to Mr. Zusi, foreign companies exist and operate in a more sophisticated business environment, which among many other things, has led them to understand the concept of life-time value and the benefits of long-term cooperation. This long-term approach is a precursor to companies building a vision for the future and strategies to achieve it. This kind of approach is generally what domestic companies lack according to Mr. Zusi. However, there has been a shift over the last few years, and one can see more and more companies adopting this mindset.

What can the government do?

Mr. Zusi further suggests several things than can be done to foster cooperation with foreign companies. Negotiating a free cooperation zone for the Balkan area would reduce border and logistics costs and loss of efficiency due to border waiting times (crossing the Albanian border costs an average of EUR 200-250/truck, fiscal tariffs excluded.) The number of business fairs related to the industry should also be increased.

“Along with globalisation, companies will need the vision of differentiating themselves and a strategic plan to keep them on a steady path during unstable times”, summarises Mr. Zusi.

Velbos DOO (Bosnia and Herzegovina)

(Steel and iron production, 90 full-time employees)

After 16 years on the German market, Velbos DOO was established in 2001 in Bosnia and Herzegovina, with the intention of bringing to the country the experience, knowledge, technology and work ethos adopted in Germany.

The company produces iron and steel products that are used in construction. Its products are included in many prestigious objects in Bosnia and Herzegovina and the region, including many tunnels in Croatia and Albania.

The company possesses two production facilities of 12,000 square metres each and employs 90 highly qualified workers, including engineers, metallurgists and highly skilled technicians. The company works with high technology and automated production and possesses the ISO:9001 standard.

The company started in 2001 with very limited production. It had 15 employees, and its primary production was tunnel grill beams and reinforcement baskets for pillars. After a large contract with one successful company from Bosnia and Herzegovina the company took out a loan from the local bank and expanded production. This meant a lot of hard work all by themselves. But eventually the company succeeded and received another big contract with a foreign company that was investing. It is now satisfied with its success. However, Velbos states that the government has done nothing to support it, and no one from the public sector cared about the company. On the other side, though, inspections, controls and checks happen on a regular basis.

Cooperation with foreign companies

About 80% of Velbos' business is with companies with foreign capital, the biggest partner being ArcelorMittal. The company is very satisfied with its cooperation with foreign companies and would like to expand its business by selling its products to partners from other countries.

The company claims that foreign companies have more respect for deadlines, are more responsible for payments and respect agreements.

The company said that it didn't have major problems during the pandemic because it had stored raw materials and was thus not affected by supply chain disruptions; also its production depends on partners whose construction projects were not stopped during the pandemic.

Comparison between domestic and foreign companies

When comparing working with foreign and domestic companies Velbos states that with domestic companies it sometimes has problems regarding adherence to the terms of payment. Sometimes it only receives the money with a delay of 6 months. With foreign companies it has established better communication and can charge them faster.

On the other side, it is a challenge for a BiH company to work with foreign companies, as foreign companies already have developed business.

What can the government do?

What is crucial for the development of a company is certainly the system of support that the state should provide. This entails policies which will systematically, financially and legally protect and improve the position of the company in the country of origin. Valbos is thus asking for less pressure and to prolong the payment requirements of value added tax to the government.

Lessons learned

The Chamber can and should find various opportunities to facilitate companies' work and improve their operations by providing continuity of information, monitoring and advice at various stages of work and contracting business cooperation with other foreign companies.

Local companies must certainly improve their business by cooperating with other companies and by continuously monitoring new trends in their business and the technological requirements that accompany each project.

KIVO LLC (Kosovo)

(Production of flexible plastic packaging, 30 employees)

KIVO LLC is one of the largest companies in the region producing flexible plastic packaging, established in 2014. The company is a co-investment by Dutch and Kosovar investors, a part of the KIVO Group, a group of factories focusing on the production of flexible plastic packaging, with two factories in the Netherlands and one in Kosovo. As a group, these companies are one of the largest producers of flexible plastic packaging in Europe, with 50 years of experience in this industry, offering KIVO in Kosovo a considerable advantage in expertise in the production of quality products, and access to Western European, Scandinavian, and South East European markets.

KIVO LLC offers a wide range of flexible PP, LDPE and HDPE packaging products for both industrial and consumer markets. The company produces semi-finished products for industrial markets, and final products for consumer markets. It specialises in the manufacturing of garbage bags, bread bags, crate bags, insulation film, magazine covers, and shrink film.

The company is ISO 9001:2015 certified, and is among the rare companies in the region certified with the rigorous BRC standard. KIVO Group, to which KIVO in Kosovo belongs, has won several prizes for the best digital printing at the Benelux and European levels. KIVO L.L.C in Kosovo was declared the top exporter and one of the largest companies in Kosovo, and was awarded the “European of the Year” award in 2019, by the EU office in Kosovo.

KIVO LLC is very active in the area of Corporate Social Responsibility (CSR) in Kosovo, where through programs in the fields of education, environmental protection, and support for sports, culture and infrastructure initiatives in the south of Kosovo, KIVO stands as one of the companies with more intensive activities in CSR in these areas. A testament to successful CSR activities by KIVO LLC in Kosovo is the award Company of the Year in CSR, by the CSR Network in 2020.

Lessons learned

The largest obstacle in working with foreign investors in Kosovo today is the perceived image of Kosovo as an unsafe investment location. KIVO LLC considers this image not be to be grounded in the actual reality of doing business in Kosovo. It is a result of political and security developments that have challenged Kosovo over the last two decades. Regardless, this perception is gradually changing, in large part due to intense endeavours by Kosovo entrepreneurs to attract investment from their international colleagues, as well as the collective efforts of Kosovo’s institutions and international institutions to improve various aspects of doing business in Kosovo.

In this respect, a key aspect to improving the investment climate in Kosovo is political stability, as well as simple and clear legal and other infrastructure welcoming foreign investors. Various economic chambers should continue to work with Kosovo institutions to highlight key areas already identified that are problematic, including image issues, and aggressively tackle and solve these issues in the future, showcasing to foreign investors that the institutions and chambers are energetically supporting all aspects of Kosovo’s infrastructure, so as to make foreign investment more welcome.

In order to follow KIVO LLC's story of success, it is paramount for local companies to engage in robust business planning before entering into any discussions with possible international partners. A proper business plan shows that local companies have a vision and a clear plan of how to achieve that plan, taking into account all external factors and possible challenges to achieving this vision. Developing advanced expertise in the products and services they offer, so they enter into negotiations on a more equal footing, is also a considerable advantage to attracting investment for their business ideas.

Home Systems Ltd (Montenegro)

(Wholesale of hardware, plumbing and heating equipment and supplies, 25 employees)

The main activity of Home Systems Ltd is the trade of equipment for the needs of installations in construction, primarily, heating, air conditioning, ventilation, plumbing, sewerage and solar systems. The company mainly cooperates with investors and large construction companies, though in recent years there has been a growing trend in the number of retail consumers.

Home Systems cooperates with 20 companies on a long-term basis, plus has additional short-term partners. Approximately 65% of its annual turnover is with foreign companies.

The company has grown from 3 founders in 2008 to 25 full-time employees currently. For the last 5 years it has been regularly included in the list of the 100 most successful companies in Montenegro.

Cooperation with foreign companies

The company had a so-called "easy start" with foreign companies, characterised by cooperation through intermediaries or other agents. After years of business, growth and development of the company, with the growth of market share and participation in large investment projects, it had the opportunity to directly cooperate with foreign partners.

The company recognises that cooperation has to develop gradually and thinking about the long-run, and over time, trust has developed, which has resulted in better understanding. All this has led to improved cooperation.

It takes time, patience and teamwork to succeed. It is not possible to develop an overnight cooperation model, so the company believes that the key to success is trust, combined with a common strategic orientation.

Comparison between working with foreign and domestic companies

Cooperation with foreign companies requires more time, strategic planning and significantly more operational work. In relation to the characteristics of domestic companies, cooperation with foreign companies requires detailed planning and daily monitoring of results.

On the other hand, cooperation with foreign companies is characterised by slower communication, taking into account the fact that communication takes place with large systems, which sometimes do not have an adequate degree of flexibility and adaptability for the rapid and dynamic changes that may occur in our market.

Koluks (North Macedonia)

(Telecommunication and electro industry, 14 employees)

Koluks is an ISO 9001:2015 certified company, founded in 2002 with the initial purpose of manufacturing low voltage and medium voltage cable fittings. Over the years Koluks has become a serious and loyal supplier to all local telecommunication companies, electro energetic companies, many local cable TVs, and other domestic companies in this sector. Some of its earliest clients included EVN, MEPSO, A1, Telekom MK, Telekabel, Vitaminka, and Komfiagel.

In 2017 the company saw a chance to establish cooperation with a foreign company from one of the free zones in the country, and decided to expand its field of operation in the sector of metal fabrication. Koluks offered cooperation to Kromberg & Schubert, a German company operating in the zone in Bitola, and the company accepted their offer. At first it was a big challenge for Koluks, because it had to work on products that were outside of their standard production range. However, this helped them grow in a whole new direction. In the words of Oliver Gjorgjioski, General Manager of the company:

> *"Cooperation with foreign investors reshaped "Koluks" from a small workshop into a modern and serious company based on high standards, quality assurance and defined and implemented strict procedures. For several years, we invested in company infrastructure, the quality of products and the education of employees to obtain satisfactory standards for product quality and procedure of operation. Only with investment in up to date and modern technology did "Koluks" become a recognised, acknowledged and accepted partner for foreign companies in Macedonia."*

In the meantime, another company from the Prilep zone, WIK, became interested in cooperating with it and Koluks became the only supplier of metal products for that company. So far it has produced transportation trolleys, metals racks, shelves, working tables, cranes, light metal constructions, food tables for canteen, outdoor fences, separating walls, etc., for them.

During these 2-3 years, the share of the companies from the zones increased to 15% of the total turnover of the company.

Cooperation with foreign companies

Among all the criteria to be able to become a supplier of foreign companies, the company stresses the following:

- always precise terms of sending offers and delivery of goods;
- flexible and fast communication between companies;
- before every delivery, always check quality;
- perfect and stable quality during the cooperation;
- adapt to customer needs.

They also point out that raising quality and standards is very important. Becoming the supplier of the two companies from the zones was a big challenge for them, so they had to upgrade the total working system in the company. In 2020 they were certified with the ISO 9001:2015 quality standard, thus proving that they could always answer to customers' needs with excellent quality.

The message of General Manager Gjorgjioski to domestic companies is that investment in modern technology always pays off:

> *"Quality products based on international standards, standardised procedures and establishing ways of working based on international standards are a must for viable cooperation with foreign investors. For the purpose of our cooperation with Kromberg & Schubert in TIDZ Bitola, we created a form that easily follows critical check points in production and procedure of products. In that way, we have streamlined the procedure and can quickly intervene if necessary."*

What can the government do?

The government should cater to the competitiveness of domestic companies by providing reasonable credit lines, supporting new employment, and supporting the development of companies. The most serious problem of domestic companies is old and obsolete machinery. Renewing machinery is in many cases impossible due to insufficient funds, while one of the priority activities for becoming a supplier of foreign companies is exactly that (new and competitive technologies).

Standard Furniture Serbia DOO (Serbia)

(Wood processing and production of furniture, 360 employees)

Standard Furniture Serbia DOO is a company in Ćuprija that produces beech wood products, manufactured on the basis of technical drawings from IKEA, Sweden. IKEA accounts for 95% of the company's total turnover (the remaining 5% coming from the sale of briquettes).

The company has had very dynamic growth over the past years - from 6 employees in 2005 to 360 in 2020. It is a true leader in its industry, with operating income 10 times higher than the average in the sector and profits 13 times higher.

Since 2017, the company has been 100% owned by DACCOMET AG, from Switzerland.

Cooperation with foreign companies

The cooperation with IKEA started in 2004, after IKEA organised the promotion of its brand in Serbia. The cooperation developed according to business standards, with regular communication and control of implementation of the standards of manufacturing and business operations (from environmental standards to employee rights).

This cooperation is defined on the basis of a long-term agreement between the companies. The plans for production and sale are defined on an annual level, along with expansion of the product range when necessary. The entire production is exported and distributed to 440 IKEA department stores across the world.

The company stresses that the key factor for its success has been adherence to business standards and constant improvement in that area, including continued training of employees according to the standards of the European and global market.

It will finish 2020 with a 20% increase in turnover in spite of the COVID-19 pandemic.

What can the government do to foster cooperation between local and foreign companies?

A positive example is the initiative of the Serbian Development Agency to support integration into the supply chains of multinational companies. They received support for machines and that meant a lot to them in terms of reducing the cost of investing in equipment.

Another positive example is qualifying the labour force through dual education, which however is not easy to implement because introducing a new educational profile for wood processing in the local secondary school in Ćuprija (where the company is located) is a challenge. It is necessary to have great readiness on the part of companies, the school and local community (with the accent on parents and children).

What can the chambers do to foster cooperation with foreign companies?

They have positive impressions from the Expo for wood industry, when a virtual meeting between wood processors and German consultants was organised, with the aim of presenting the production programme of local companies and trying to get connected with German buyers. There is a need for constant participation in B2B events.

Advice to other local companies?

Implementation of business standards and norms based on the model of modern foreign companies is the main recommendation for all companies that plan to expand their cooperation with foreign investors.

5.3. INTERVIEWS WITH REPRESENTATIVES OF INVESTMENT PROMOTION AGENCIES

This section presents some findings from the interviews that were conducted with representatives of investment promotion agencies from the six Western Balkan economies, in order to obtain additional insights into the dynamics of FDI during the pandemic, likely developments in the coming period and the perspectives of the investment promotion agencies on the issues that have been analysed so far in the study. The interviews were conducted during December 2020 – February 2021, with representatives of the Albanian Investment Development Agency (AIDA), Foreign Investment Promotion Agency of Bosnia and Herzegovina (FIPA), Kosovo Investment and Enterprise Support Agency (KIESA), Montenegro Investment Promotion Agency (MIPA), Directorate for Technological–Industrial Development Zones of North Macedonia (DTIDZ), Development Agency of Serbia (DAS),

The interviews were semi-structured, without strict questions, but with topics that were discussed, including: recent developments in FDI, the impact of COVID-19, and expectations for the future; strong points of their countries and the main reasons why companies are investing; weak points of their countries and the obstacles to attracting more FDI; and what the agencies are doing in order to improve cooperation between domestic and foreign companies.

5.3.1. Recent developments in FDI, the impact of COVID-19, and expectations for the future

All the WB investment promotion agencies said that FDI in their economies was affected by the COVID-19 pandemic, although the effect was less pronounced than expected. The pandemic mainly affected FDI by forcing companies to postpone their investment for some time in the future, rather than cancelling it. Cases of companies leaving their countries were very rare, and even if there were such cases, they were smaller companies. Agencies also stressed that companies which were already present in their countries fared rather well during the pandemic, often expanding operations, and sometimes even investing in new capacities.

"I can say with certainty that the companies that have already decided to invest in Serbia have not withdrawn. Prior to the Covid-19 pandemic, there were few smaller projects that were put on hold, which

was not because of the Covid-19 pandemic. We can say that for now the situation is better than we have expected. All the companies that started their investment projects at the end of the last year or at the beginning of this year managed to carry out their plans without major difficulties. As an example it may serve the German company Brose that realized its large investment project in Pančevo. The cornerstone ceremony was held at the beginning of March 2020 on the very day when the first Covid-19 infection was identified in Serbia. This company managed to build the whole factory covering an area of over 60,000 square meters, and the construction works were not suspended even during the first lockdown in Serbia. Other companies such as Continental in Novi Sad or Vorwerk in Čačak have also continued to implement their projects, expanding very often their initial plans. " (RAS, Serbia)

"But what I can say for sure now is that, and you can, of course, use it in your analysis, a number of the investors already present in the country, despite the pandemic, have already announced very specific plans to expand their activity. So, we're speaking about the expansion of an additional 50 to 100 percent of existing capacity. So we don't speak about something which is very limited in scope, we speak about at least 50 percent extra being added in the next year." (…) If you see the numbers on employment, exports and wages, you can actually notice that the overall economy within the zones has performed rather well. There was a sharp decline in activities in the period January to April compared to the same period the previous year. There was up to a 19 percent drop in exports. But this recovered. And then at the end of 2020, for the full year in comparison to 2019 the drop in exports was only 7 percent, meaning that the economy recovered. (…) Also something which is very interesting is that overall employment in the companies from the economic zones has increased. It increased by 0.6 percent, but still it increased compared to 2019, meaning that not only did the companies retain their capacities, but they also increased a bit. A bit, but they increased." (DTIDZ, North Macedonia)

"Companies that are planning to invest in Albania did not cancel their plans but rather postponed them. So, the work on these projects is still active, although the time plans for their realisation have become longer due to the pandemic. […] AIDA, before COVID had 120 companies serving in after care, existing companies. After COVID began we increased this number and now we have 200 companies. Most of them will postpone their investment, more or less 50 companies have declared they will reinvest, but are now going to wait due to the situation, but not cancel. These are investors which are already here and plan to reinvest."

Q: Did some of the companies already in Albania decide to move out of the country due to COVID?

"We don't have these cases to share with you, because, fortunately, we didn't have one case. But we still have companies that have reinvested, as well." (AIDA, Albania)

"We undertook a survey of foreign investors, with the 50 most important companies. Most will postpone investments for the next year or 2. Two of them announced they will leave BiH. But after the survey we visited them in order to check if it's possible to keep them in BiH. The company from the textile sector will leave, and the other one will not, since the government, the municipality and the company established a platform for sustainable recovery of the company, which is good news. Also, there are many companies that announced that they will have new projects. One company, Slovenian, which is in the energy sector, announced that they will have a new project and they will reinvest as planned, but not this year, they will reinvest next year. Some of the surveyed companies will decrease their investment, but many will keep their investment as planned." (FIPA, Bosnia and Herzegovina)

"As far as FDI is concerned, it has slowed down; we have not had a lot of new companies approaching us with new investments, but we have still had a lot of meetings, inquiries, interest in investing in tourism, plus investment in other branches, agriculture, etc. So FDI has slowed down, but still if we compare the first four months of 2020, they were the same as the first four months of 2019, and if we look at the first nine months of 2020, we had EUR 510 million of FDI in Montenegro. So, the figures are good. They could have been better, we had a catastrophic touristic season with 90% of tourism income lost, but we have identified that now, More than ever we have to diversify to other branches, not only to concentrate on tourism. The government has made efforts for a couple of years to diversify, but now the COVID pandemic has shown that this transformation should happen as soon as possible. So, to answer concretely your question, we did see a slowdown in FDI, but still FDI remained and there are still companies that have invested in Montenegro." (MIPA, Montenegro)

"What we have done this year is that we have tried to find ourselves in a situation based on the pandemic, even though it was a very tough time to deal with. We have managed to communicate with a lot of companies, especially from the Western Balkan countries, but also from the Eastern Europe, Western Europe and a little over all over the world. We have had interests from companies from Japan, from the United States, from Europe. We have had companies from Turkey who have visited Kosovo. We have had delegations that showed interest to invest in our country." (KIESA, Kosovo).

Almost all of the agencies stated that there is still interest from foreign companies to come to their countries, and in some cases, some of these new investments have already arrived.

"But the good news is that for example, we have actually one fairly larger case, not large, but it's, I would say a nice figure, it's approximately a EUR 15 million new investment coming from the States, that is about to be announced the first week of next month. Actually, we concluded negotiations with this investor at the meeting with the prime minister 10 days ago, and again, it's 15 million, maybe not a hundred, and they are new. What is important for us is that it is capital intensive and the added value of the company is rather high. And basically, they will to a large extent rely on local suppliers of materials, which means that basically we get an investment of high quality. We have talks currently with a number of new potential investors, but they are in a very early phase of discussions." (DTIDZ, North Macedonia)

"A significant number of the companies having already their footprint in Serbia are expanding their capacities now. The companies operating perhaps with certain difficulties in other locations in Europe consider to relocate their business operations in Serbia in order to lower some operating costs. In addition, there is an example of another German company - MTU that develops, manufactures and repairs parts of airplane engines only postponed the implementation of its project for a period of 6 months due to the pandemic crisis. Now it considers to make its project even bigger than the initially planned one. We have enough number of new inquiries concerning investments in Serbia this year, and we expect the following year to be good as well. If we take into account the number of the concluded investment agreements (these are planned investments, and not those that have already been implemented), the value of these investments was more than twice higher in 2020 relative to 2019. Therefore, the value of the agreements concluded in 2019 slightly exceeded EUR 800 million, whereas that amount in 2020 stood at EUR 1.8 billion. It should be pointed out that we are talking about the signed agreements only, and that Serbia had far more foreign direct investments in these years." (RAS, Serbia)

“We have some inquiries from companies which are selecting countries, thinking about repositioning their investment, repositioning from the Middle East. They are still in the phase of choosing their location. There are three such companies. The inquiries started during the pandemic. One is in real estate and tourism, one is production, and the third one didn’t mention the sector.” (FIPA, Bosnia and Herzegovina)

“It’s worth mentioning that during the pandemic we received some inquires for investment in personal protective equipment, i.e. to adapt their investment in this field. The high demand for this equipment, combined with the geographic location of Albania and the low labour costs made our country a possible destination for that kind of manufacturing.” (AIDA, Albania)

“It was a pure Japanese company, who was willing to establish its operations in Kosovo. And there are another two Bangkok companies who have already shown some interest with regards to the ICT sector, because Thailand is very well known for the ICT sector. So, these three cases are the ones that we're very closely looking into providing information and all kinds of supports, whenever they decide to visit.” (KIESA, Kosovo)

Agencies expect FDI in their economies to grow in the coming years. They expect to capitalise on their strengths in the post-pandemic world. Some of them explicitly mentioned that they see, or expect, investment to come from other countries, also possibly nearshoring.

“It's a very relevant question and I have also been following the whole trend, although it's not a trend actually, it's the beginning of a trend of nearshoring. (…) A number of companies that are already present in the region, have already announced very specific plans to expand their presence. We didn't go much into the analysis of what the basis of this is, but let's say moving some of their activities from other places or simply because the markets demand this and they're just creating new capacities. But it is something that we're going to look into definitely (…) Also, what is, I think, very relevant for you to know is that most of the capacities active in the free economic zones in Macedonia are basically related to, or are part of the automotive industry, meaning that the global situation where the automotive market is concerned has not affected the plans of the companies, which might lead, again, maybe not to a conclusion, but some line of thinking that the existing companies in Macedonia that work for the larger producers are possibly also taking part of their capacities from somewhere else and actually bringing them closer to the final producer. So I cannot say for sure that this is happening, but something is happening.” (DTIDZ, North Macedonia)

“We have something similar to nearshoring with some German companies, working in the textile industry. Everything stopped with the pandemic, with the lack of raw materials. AIDA in collaboration with the German chamber of commerce, managed to connect a German company that was willing to give work to Albanian companies to produce face masks for doctors. In this way the pandemic brought in new investment. This investment is continuing in smaller amounts now, not as much as during the peak of the pandemic, but it is still continuing.” (AIDA, Albania)

“Some of the companies that have a footprint in Serbia are moving part of the production from other countries to Serbia. We cannot say that we have many examples of European companies shifting their production from Asia to Serbia, but we do have Asian companies investing in Serbia, in order to come closer to the European market and their buyers.” (RAS, Serbia)

"We have projections that in 2020-2022 we'll have around 1.5 billion euros of FDI, most of which will be in tourism, but also in the energy sector, where we will have solar plants and wind plants that will be built in Montenegro, which will definitely boost the economy in the coming period. Also, in the electronic communications sector we will have a 100-150 million EUR investment in the next year or two." (MIPA, Montenegro)

5.3.2. Strong sides of WB economies and main reasons why companies are coming

When discussing their strong sides, as well as the reasons why investors choose to come to their economy instead of going somewhere else, all the agencies stress the geographical location. Similarly, most of the agencies mention the low taxes that their countries charge, Serbia being the only exception here (although it has similarly low taxes). Most of the agencies also mention the low level of wages in their countries, except from Serbia and North Macedonia (which may be because these two countries have been pursuing policies of minimum wage increases in recent years).

Regarding specific factors pointed out by individual agencies, Montenegro stresses its NATO membership, the pro-business orientation of the government and the benefits packages they are providing to investors:

"Montenegro has a lot to offer to investors, apart from geographical location, and apart from a pro-business-oriented government that is seeking to do everything in its power to attract FDI, we have a 9% corporate tax, which is the lowest in the region and one of the lowest in Europe, and is something that investors are interested in. We also have good skilled low-cost labour. In the past couple of years we have managed to lower the gap between the education system and the labour market. (…)

Being a NATO member and a potential EU member definitely matters. This shows that we are a stable country, politically. We have experienced investment from NATO countries since becoming a member state and in the period 2017-2018. One of the biggest things that we have here is that the government is oriented towards FDI. The government is looking at ways to answer to the needs of big investors who are considering investing in Montenegro, doing everything that any potential investor wants. The government is oriented towards serving the needs of investors. Our laws, our procedures and everything has been carefully processed and the final outcome is that we have really simple procedures for setting up a company, we have national treatment of foreign investors, which is very important, we have the after care... But in general, the pro-business oriented, or investor-oriented government is the main thing. Because from this you get everything else. (…)

After care is also something the government is excellent in doing, because we are not relying only on the initial investment. If the investor comes and says "I want to invest 600 million in a touristic resort", that's fine, but let's see what we can do for this investor afterwards. Let's see what their needs are after the initial investment. Investors feel that they are very well treated in the country, as every new investor is very important for Montenegro, so this strategy is proving to be very successful so far. (…)

The packages that we are offering in various industries in various parts of Montenegro are very interesting as far as the new investors are concerned and I can tell you this because we have already *had a couple of meetings with new investors and this is something they really like. Especially when you move towards the northern part of Montenegro, which is less developed than the southern and central part, and of course the possibilities and offers are greater in the northern part, as far as the subsidies for new workers, as far as the infrastructure development cost, as far as the taxation of different goods, the VAT, which has been reduced from 21% to 7% for all the companies working in the tourism sector and restaurants during the COVID pandemic." (MIPA, Montenegro)*

Some of the specific factors raised by the Albanian agency are the young population, speaking different languages, ability to learn fast and work hard, as well as the port of Durres, which is also used by companies from other countries from the region:

"What we get from the investors and the existing companies, Albania has the most competitive wages in the region, and has a labour force that can learn very fast and is highly productive." (…)

Albania applies a very liberal FDI regime. The law on FDI allows 100% ownership. Albania is committed to a favourable and predictable business climate, with some reforms in fiscal sectors aimed at reducing the national debt and investment in infrastructure and reform in education. What we said before, not only competitive labour force and low taxes, but we provide other incentives. We have a law for strategic investors. A young and well-educated population. Free access to key markets, such as the EU, Turkey, CEFTA. Optimal geographical location. Bridge between the north and south of Europe, with good networks of transport links – roads, ports and airports. High performance of exports, with FDI being the main contributor to this. Our government offers a wide range of public-private partnership opportunities. We have macroeconomic stability, stable prices, low inflation, a solid exchange rate. And the promotion agency is very committed to promoting investment. (…)

Seeing the type of investors we now have in Albania, most of them are focused on labour-intensive production, like they have 3-4-500 – 1000 employees in their factories. So, the first factor for coming to Albania are the competitive labour costs. The second is the young population, willing to learn fast, opportunities to speak different languages. The majority of the youth is bilingual, even speaking several languages, willing to adapt to new cultures. And very productive work force, able to learn very fast, we hear this from the foreign investors that have come to our country. As well as the location, being very near to everybody in Europe. This makes it easy to choose when it comes to logistics and transport costs of companies. They can use different ways. Close to Montenegro, Croatia and Italy. We have the port of Durres, through which we are connected to Italy, which makes us a very attractive destination. For the manufacturing sector the port is very important, because raw materials come through it. They come both by truck and by ship. When it comes to Italy, they come by ship from Bari, Ancona, and Trieste, and the route to Durres is only 8 hours. The port is a gateway to connect all the Balkans with Europe; Macedonian companies are using the port of Durres, Kosovar companies are using the port of Durres, and Serbian companies are using the port of Durres." (AIDA, Albania)

Bosnia and Herzegovina mentioned the conventional reasons, plus that companies wanted to gain access to their market:

"We visited more than 700 companies in BiH. And most of them said they came to BiH first of all to have a position on the market. After that, the geographical position of Bosnia and Herzegovina, low taxes, personal and profit taxes are at only 10 percent. And the labour force is competitive. And they are very

satisfied with the closeness to the European market. And they like the free trade agreements that BiH has, CEFTA, EFTA and so on. But the first reason they mention is the position on the market, they want to expand their operations in the market, low taxes, also our low operational costs are some of the lowest in the region, and our closeness to the borders of the EU." (FIPA, Bosnia and Herzegovina)

Kosovo, similarly, mentions the conventional factors, pointing out their regulatory system, rebuilt in 1999, which is aligned with EU requirements and is very pro-business:

"We as Kosovo have our advantages, we have very low labour costs, which is not comparable to any of the European countries, not even neighbouring countries. We have low operational costs, with very low wages, skilled labour force. We have different institutional centres that are providing specifically all necessary help and assistance to those companies that are willing to look at our country. We have the geographical location, which is one of the best for those companies that are willing to outsource something in Kosovo. Furthermore, we have a regulatory system rebuilt since 1999, which is very good and operates under the European Union standards, rules and regulations. We have very easy procedures of doing business, within an hour you can register a business, only five types of taxes are applicable to those businesses. So there's a lot of advantages for those companies who are willing to outsource, produce something, or use our lower operational cost. It makes Kosovo a country that can be a very good potential site for doing business." (KIESA, Kosovo)

North Macedonia stresses its favourable tax system, its good connection to the EU through the Corridor 10, and the culture. Interestingly, they claim that the benefits schemes that their government provides are not crucial, as companies rarely use them fully:

"I think the tax system is very favourable. Some of the largest investments actually came in not because of the money that the government is offering to them. I mean, eventually that state aid expires, but because of the favourable tax system afterwards, if you have a company that is actually invoicing to beneficiaries from Macedonia, they pay very favourable corporate tax in the end. So the tax system is quite favourable. And I think it will remain, unless it's changed, the tax system is definitely something to look at. Geography is very important, of course. And this is where the near-shoring thing comes into the picture. When it comes to infrastructure, it used to be of rather high importance, currently, I'm not so sure because the neighbouring countries like Bulgaria, Romania, have already invested a lot into this, meaning that Corridor 10 is already, let's say, of lesser importance, than it used to be before. Before it was key, now it's important, but not that much. But I would say a fairly developed infrastructure, this is something to look into, this is an opportunity. And then, yes, I think of course the culture, which is, in a way transferred also to the labour and how the companies behave, what the companies expect from the government. So I mean, very few of them actually come for the money the government is offering. Why? Because the government is currently offering up to 50 percent returns, but those returns are combined, cash, which is 20 percentage points of the 50 percent and that 30 percent is basically tax breaks, which very few of the companies actually use to the full extent. What we're currently developing is a more flexible model, meaning that not all will actually get the 50 percent. On the basis of the profile, we also see what the company might need. And then we are actually, we are already negotiating a deal with existing investors that are expanding capacity, to offer less than 50 percent, but to go with more cash rather than the tax breaks. Why? Because it is our idea that the company should, as soon as possible, exit the state aid scheme and start paying taxes and social benefits to the state budget, because this is the way it should be. It should be better for the country. So the state aid scheme will be important, but I

think it will be less important than before. I think the tax system is very important. The geographical location of the country is, of course, important. And the overall let's say social system, which is European, of course has an impact on what the companies actually can expect from the daily environment." (DTIDZ, North Macedonia)

Serbia is the only country from the WB region that does not raise the issue of low wages and taxes when speaking about its strong points, but emphasises the quality it provides foreign investors. They first mention the good reputation they have gained among investors in recent years, the good infrastructure that they are also developing further, the availability of skilled workers, as well as the good service that their agency is providing to foreign investors:

"What are the main reasons for the companies to invest in Serbia? I think it is a combination of different things. RAS, as well as the former agency dealing with the promotion of Serbia as an investment destination, has carried out one part of the marketing. However, the most important thing, I would say, is the so-called word of mouth propaganda, i.e. companies sharing their positive experiences from Serbia with other companies. In addition, it is important to emphasize both the stable political and economic situation. RAS, in collaboration with other competent institutions and ministries, provides its support in facilitating the implementation of investment projects. However, in addition to these reasons, the fact is that companies considering to expand their business across Europe do not have too many choices when it comes to locations. Almost entire Western, Central and East Europe are quite taken, and companies tell us that it becomes difficult to find blue-collar workers there, let alone engineers. Serbia can still offer enough number of workers of all profiles, although it is getting more difficult here as well to find high-qualified labour force. Blue- collar workers are still on the market, but it is not as it used to be 5-10 years ago, when you could go anywhere in Serbia and find enough people. That is why we are working together with investors, and giving them inputs where it would be a good place for them to go. (…) But still, if you offer reasonable salaries, not just the lowest ones, you will not have problems finding workers. It should be noted that Serbia has a very good education system, and it has implemented the dual education system modelled on the German pattern, which helps companies a lot to find or create workers with appropriate knowledge and skills. In addition, schools are willing to cooperate with companies from the private sector in order to educate students according to their needs. Finally, Serbia has a good infrastructure, and is located at the borders of four EU countries. (…)

The construction of Infrastructure is one of the main priorities of the Government of the Republic of Serbia. Several new highways are currently under construction, and the railway is being modernized. The highway to Montenegro is being constructed, which will contribute a lot to the development of the entire Western Serbia. As the construction makes progress it can be seen that the towns such as Valjevo and Čačak become much more attractive to investors. The City of Čačak is now only an hour from the Belgrade airport, while this city used to be located "there somewhere" toward the border with Bosnia. Smaller companies prefer smaller places, because bigger places have higher competition. If you have a highway leading to those places, it is much more interesting for investors.

Our Agency has a lot of accumulated knowledge and experience, as well as a good cooperation with all ministries, different institutions and public enterprises, which to a large extent facilitates the implementation of all projects, particularly large and complex ones. Good cooperation among the state institutions is also the result of the political stability Serbia has." (RAS, Serbia)

5.3.3. Weak sides of WB economies and obstacles to attracting more investors

When asked about the weak sides of their economies, WB agencies raise different issues.

The Albanian agency mentioned corruption, infrastructure, property rights, the informal economy and limited administrative capacity:

"As all WB, we are facing a bit of a corruption problem, we are still having a war on corruption, we are moving forwards, but investors are still facing this problem. The second one would be the lack of infrastructure in some areas, because Albania is still a country which is under construction, so being in this phase, we are still trying to put in place infrastructure. We have a project for revitalisation of the railway, so it is this lack of transportation infrastructure that doesn't put us sometimes in a favourable position. As well as property rights, now we have passed to a digitalisation of all the property owners and the land, so this is a transitory phase, the procedure sometimes takes too much time, you have to go from one institution to another, to another, it is bureaucratic sometimes. We can also add the large informal economy in our economy. And the limited administrative capacity. We need to provide some training, to increase our staff capacity, in order to be more effective related to the business services." (AIDA, Albania)

The BiH agency, on the other hand, says that corruption is not that big of a problem for foreign investors, and that they complain much more about the complex legal and regulatory framework, often related to the numerous levels of government in the country, and the lack of harmonisation between these levels. Infrastructure and the grey economy are also mentioned:

"During the meetings that we have with foreign investors, they don't complain so much about corruption, even though it's ranked as one of the most corrupt countries, but they mention as a big obstacle the complex legal and regulatory framework, non-transparent business procedures, weak judiciary system, long procedures for enforcement, lack of harmonisation of laws between different levels of government, different interpretations of regulations, infrastructure (highways, which are currently under construction and will be completed soon, and digital infrastructure). During the company visits they don't complain about corruption but about the grey economy." (FIPA, Bosnia and Herzegovina)

Some of the things that the Montenegrin agency mentioned were the need for digital transformation, the grey economy and the corruption:

"One of the things is digital transformation. This is something that needs to change to attract more FDI. Another thing is the grey economy. The grey economy is still a big part of Montenegro's economy, in any sector. We also have something that we mentioned before – the educational system, because the needs of the market are totally different from what we have now in the educational system. Also SMEs access to finance. This is something that has been a great challenge in the past and we need to change in the future. Access to finance during COVID was virtually non-existent. Something that you mentioned, corruption, we are aware of this, and the new government said that they will work on this. One of the things that also needs to be changed is the rule of law and the judicial system". (MIPA, Montenegro)

The Kosovo agency stressed several factors, such as infrastructure, the lack of land for investors, the low level of digitalisation and corruption, but the main problem, according to them was political instability:

“Even though we have invested in a lot of infrastructure in order to provide a location as good as possible for our potential investors, we, of course, as a country, we still miss a lot of things. One of the things, for example, that we miss is that we have the right, you know, the right ground, the right parcels for big investors that are willing to come into our country. Of course, with the new era of digitalisation, we don't have let's say the amount of people that are required for the digitalization process. And of course, we need resources and we need let's say know-how, we need the centers, research and development centers that are interested to come in our country and, of course, develop more of the skills of our employees and the skills of our people that are required specifically on the lower grade, and on the upper grade. And normally I would say, even though we have a very competitive law, laws that are applicable for foreign investors, they still need to update our laws, our secondary legislations, of course. And there's a perception, large perception of corruption, even though we have measured a lot of, let's say we have conducted a lot of surveys, a lot of research with the Chamber of Commerce of Kosovo and with different institutions. And the numbers are different from what people think. But still, one of the bad things that I consider for the moment is, say, the stability of our politics. So one of the things that investors from different surveys that they have found is that Kosovo suffers a lot with the political instability. So I would put this as a very, very first one problem that we're challenging ourselves with.” (KIESA, Kosovo)

The agency of North Macedonia emphasised bureaucracy as the main issue:

“It's a rather small country. And I would say a lot of bureaucracy, before that actually. Most of the investors are rather lucky if they’re dealing with only one institution, which is the Directorate, but often, often the case is that they have to deal with the Ministry of Interior or the Ministry of Labor for working permits or, the Ministry of Foreign Affairs for visas... And again, it's a very small country, everything should be easily put into one place or at least a service should be provided from one place regardless who's in the back. But at the end of the day, in practice, companies are basically faced with the bureaucratic procedures that very few of them actually understand. Serbian government is more flexible. Some investors who were looking to re-invest in Macedonia, went there. And I thought it was because of the money. Obviously, it was not. Although there are more flexible within the 50 percent in the state aid, I mentioned that it's not fixed, they can actually play with the numbers. This is something that we're implementing now, it was not the case before, but it was not the main reason. The main reason was actually that the government was more flexible. And when they say the government, they don't mean the cabinet of the government, they think about the state institutions. So, on the basis of the experience they had with our state institutions, they decided to move, I mean, they are keeping the current facility in Macedonia, but the expansion of the facility actually went to Serbia. And this is something that we should definitely try to avoid happening in the future. And I think the key here was basically the lengthy procedures for very practical things that actually cause a lot of headaches.” (DTIDZ, North Macedonia)

The Serbian agency pointed out that labour shortages might happen soon, mentioning also that infrastructure and corruption are not that big of a problem, at least for the foreign investors:

“I am convinced that there is no country without problems, so Serbia is no exception. Labour shortage in the labour market will probably happen as a problem at some moment. It will consequently raise salaries and wages. Such situation would make Serbia a less attractive destination for labour-intensive

projects, but Serbia would certainly be attractive for smaller investment projects with higher technology level, as well as research and development projects. This is the reason why the Government of the Republic of Serbia currently invests a lot in strengthening the capacities of the universities and institutions. In addition, the issue of infrastructure is partly a problem. It would be great if all works started for the purpose of expanding and upgrading the road network had already been finished. The railways in Serbia are certainly not at the level of those in the EU countries, but the largest number of investors has been using truck transportation for now. Siemens is the only company that has required to have railway connection, because it has its factory for the manufacture of wagons and trams near Kragujevac. The Government is connecting this factory with the railway corridor. Investors have not reported any corruption-related problems, and they probably would not come in so large number if some company had negative experiences in that matter. The largest number of foreign investors in Serbia exports their products to other countries. A problem could arise when companies participate in public tenders and sell their products directly to the state. However, Serbia has already done a lot in this area by adapting its regulations to the EU regulations." (RAS, Serbia)

The agencies do not consider labour shortages to be a big problem in their countries yet, although they are well aware that it might become one soon. They are also aware that their workers are not as skilled as German workers, but note that for the level of wages, the quality is still good, and also stress that this is easily dealt with by training provided by the companies. Often, this training is partly or fully financed by the governments. Agencies state that companies are in general satisfied with the quality of the workers, and stress some positive cultural characteristics, like the ability to learn fast, loyalty, hard-working etc. As one negative side in this area, some of the agencies raised the issue that workers leave the companies after some time, often to go abroad.

"Labour shortage is not yet a big problem, we haven't reached that point yet, but we have to take into consideration that many Albanians are finishing universities and master degrees and go to work abroad, sometimes also study abroad, and they usually don't come back. As all the Balkans, we are facing this fact, that young people are moving out of Albania. We are not at the point that we cannot fit investors' needs yet, but what we do in general is that we don't advise investors to all come to the same region. When we have some investor inquiries, we try to locate them in the right destination for them, try to do a distribution of them, not to have two big companies in the same city or region if they are labour intensive. If they reach 400-500 workers in the first phase, we try to keep them a bit distant from each other. (…)

Foreign companies sometimes have to provide training for workers, but these 3 months of training are paid by the government for them, so they don't have to pay salaries to workers for this time. In our country that's not a big deal, everybody who comes to Albania, especially in manufacturing, of course they have to train the workers. It's normal here that they train the workers, but this is paid by the government, with the condition that these workers then have to be hired by the company." (AIDA, Albania)

"I'm sure that there is this (labour shortages) in Montenegro as in other regional countries, but what we have experienced is that this has not happened that much. When you talk about skilled labour, there is a difference between jobs that Montenegrins are not willing to do, and jobs that they are not skilled to do. We have in the seasons many workers that come from abroad to work in tourism, because Montenegrins don't want to do these jobs. These jobs are short term, last a couple of months, they are not paid well, they are not long-term employment, you can work for 2-3-4 months, you get paid and you leave. It is not that we can't find Montenegrins who are not skilled to do them, but they don't want to do them, for some reason. But when we talk about skilled labour, I think that in the past couple of years we have excellently skilled

labour for many branches and I think in that sense investors are completely covered and there are many programs that the Employment agency is providing – educational training, etc, with companies. We have this slight or constant increase in skilled labour, for a fair price.” (MIPA, Montenegro)

“In BiH the unemployment rate is high, it is 18%, so we still have the possibility to secure the workforce. (…) On one hand companies complain about the labour force, because they invest in education and training of workers, but workers leave. And most often training is even paid by local or higher level of governments. It is a really big problem. In the last year, almost all companies, which were visited by FIPA complained about this. (…) Many companies that we visited from 2014 said that they have to invest in training and education, they send workers from BiH to the EU to train them, but the biggest problem is the fact that they invest in workforce, and then they leave them. The urgency of this issue varies from sector to sector. The IT sector is not as affected as others.” (FIPA, BiH)

“You cannot find the same quality of blue-collar workers in Germany and Serbia. You definitely have to invest in workers. But the surveys of the German companies operating in Serbia show that they are very satisfied with the quality of labour force. If you invest in them, they deliver. And they are loyal. This might change as unemployment declines, but so far, most of the companies are pretty satisfied. The tradition in Serbia is to have lifelong employment, so people do not want to change company just for a slightly higher salary.” (RAS, Serbia)

“One of the things that you have to know about the Kosovars is that they're easily adaptable people. We are very eager to work. We are people that learn very fast and with a very light training we can learn everything you want. So we are very flexible people, we can learn and adapt to the system and integrate to the system, basing on the needs of the market, basing also on the needs of the company. So when a lot of companies come to our country, they say there's a problem with employment, which I would not put it like this. I would put it that we need to have the right research and development centres so that they can help us to provide the right set of skills for the different companies. As I told you, we have created many professional schools. These professional schools are available for foreign investors or domestic companies to provide them with the right curricula, in order to send the right people to work in a specific company. We have about 34 professional schools and all of these professional schools with the support of the GIZ, the Chamber of Commerce and all the other institutions are ready, equipped with the specific equipment and ready to be given, you know, basically all the needs of the company to be provided, to provide the company with the employment that they're looking for. So Albanians, Kosovars are the easiest, let's say, workers to work with because they're very flexible.” (KIESA, Kosovo)

“What we have seen and we have also published this is that the average salaries in the free economic zones in 2019 were 10% lower than the average in the country, meaning that despite the general expectations that the foreign investors bring higher salaries, this is not the case. So what we're currently working at is we are basically developing measures within the state aid contracts, particularly the part of job creation, but we also develop these measures to increase skills, thus increase productivity of labour within the existing companies for the existing people, so to stimulate growth of salaries, so this is something that we definitely need to do, otherwise, the problem is that the existing investors that would like to expand capacities will actually have a substantial need for additional labour force, which is not there, because the labour market in Macedonia is currently something, we are not even now discussing quality now, we are just simply discussing quantity, and the quantity is not there. Then the quality is actually the next level.” (DTIDZ, North Macedonia)

5.3.4. Cooperation between foreign and domestic companies

Some of the agencies mentioned that their agencies or their governments are taking concrete measures to include domestic companies in the supply chains of foreign companies, or to cooperate with them in some other way:

"In the annual report to the Council of Ministers, this year, one of the proposals will be this connection between local and foreign investors. In fact, for all existing investors, in all the projects that I mentioned, the 200-300 projects, in metal processing, tourism and real estate, we connect them. We promote the existing network of investors and potential, as well." (FIPA, BiH)

"Another thing, which is also in our focus, and this should help us to go to another level, is to bring domestic companies in the supply chains of those big international companies that are already present in Serbia, or those that we are approaching through our "Outreach Campaign". When we approach companies abroad we offer them 3 possible scenarios: A – possible investment in Serbia, B – suppliers from Serbia, or C – which is most critical to implement, to organize a joint venture with domestic company. In addition, RAS has been implementing for the second year in a row a program of financial and consulting support for the development of domestic suppliers." (RAS, Serbia)

"Our companies are so eager to work with each other, so eager to develop something together that it's unbelievable to discuss it with them. And we're not the only one who is doing it. I mean, just watch other companies doing it. American chamber is doing it, the Business Alliance of Kosovo is doing it. Everybody is doing it, especially for those companies that are willing to network themselves. And we're not doing it only internally, we're doing it also externally with the Italian Business Communication Alliance, for example. We had a lot of discussions and we wanted to connect our businesses even though they are foreigners. We wanted to connect them with the Italian businesses, with Albanian business, Macedonian business, with Serbia. So we don't find any problem with that. And they just have to tell us which they consider as one of the most favourite counterparts and we'll try to find a way through our sister agency or through different chambers of neighbouring countries." (KIESA, Kosovo)

5.3.5. Summary of the interviews with the investment promotion agencies

In conclusion, the representatives of the WB investment promotion agencies from the WB economies stated that the impact of COVID-19 on existing FDI in their economies was much smaller than expected. Most of the companies that were supposed to invest, postponed their decisions, but did not cancel them. Very few companies left the countries, and many existing companies, in contrast, announced or already started new investment projects. Interest from new foreign investors is big and agencies even stated that they already see some developments similar to nearshoring, expecting these trends to grow in the future. Speaking of their strong sides, agencies usually raise the low-cost side of their economies, not speaking too much about the quality. Serbia is an obvious exception here, emphasising the quality their country is providing to foreign investors. With regard to their weak points, agencies are well aware that governance is a problem in their countries, while they generally rate the infrastructure as good. As for availability of skilled labour, they do not consider this to be a big problem yet, but are aware that it might become one soon. Some of the agencies are taking concrete action towards improving cooperation between domestic and foreign companies.

6. Conclusions and perspectives

A year after the COVID-19 pandemic started, many uncertainties have remained. Nobody knows how long the pandemic will last, whether vaccines will stop the spread of the virus for good, what kind of new variants of the virus will emerge, or how the race between these two aspects will evolve. And it seems unlikely that the world will be the same place after all this is over. This includes the global economy, whose weak points have been clearly revealed by the pandemic.

Some of these weak points refer to the globalisation of the production, which has been one of the most significant developments in the world economy in the past few decades. Technological development, the opening up of new markets and political normalisation led to the emergence of global value chains, whereby multinational corporations located their production in low-cost destinations, transporting it to final markets just-in-time, and thus saving money, both through cheaper production costs and lower inventories. This way of organising production was seriously undermined by the COVID-19 pandemic, which actually stopped these flows early on due to border closures, and constantly interrupted them later on, through lockdowns and other pandemic-related disruptions.

This shock came at a time when global value chains were already being called into question due to political tensions, the rise of nationalism and protectionism and the re-emergence of trade barriers and sanctions. Global trade and FDI have been slowing down for the last decade, and now the pandemic is likely to act as a further catalyst in this process.

All these developments are making multinational companies re-think the ways they have been organising their production, in an effort to minimise the risk and costs associated with interruptions in global flows. Shorter-supply chains, closer geographical locations, back-up production sites, and higher inventories are some of the options they are considering.

This study has assessed the questions – can Western Balkan economies benefit from these potential changes in global production, and if yes, how could this be achieved?

The answer to the first question would undoubtedly be yes, Western Balkan economies can certainly benefit from possible changes in global production in the coming years. Nearshoring, i.e. moving of production from locations which are more distant from home to ones which are closer, is likely to occur in the coming years, at least for some European companies. A survey of 3,500 German companies operating abroad shows that 16% of them are considering changes in supply chains, and 12% are thinking about new locations. A survey of 2,400 German companies that work with companies from other countries indicate that 40% of them have supply-chain issues, and 68% of those with issues are thinking about changes. Even if just a small fraction of this is realised, it is still likely to be significant for the small Western Balkan economies. Western Balkan economies come as a natural choice for nearshoring – they are geographically close to Germany (and Western Europe in general), and they have the lowest production costs in the whole of Europe. Some investment promotion agencies from the Western

Balkans have stated in their interviews with us that they are already seeing increased interest from foreign companies.

However, in order to fully benefit from these likely developments, the analysis suggests that Western Balkans may need to change the narratives around their economies, from destination which offer low costs for investors, to destinations which offer high quality.

In the past 15 years, their strategy for attracting foreign investors was based primarily on low costs and the availability of a cheap labour force, low taxes and generous government benefits for foreign investors. The success of this strategy has been mixed, with some of the economies being clearly among the best in Europe in terms of FDI, but some being just average, despite all the efforts. Investors already know that these economies are low-cost countries, with low wages and low taxes, and they know that these things are unlikely to change drastically in the near time. Although, convergence with EU development levels is likely, it will be slow and Western Balkan economies will remain the lowest-cost destinations in Europe for years.

In order to enhance the attractiveness of the Western Balkans as investment destinations, a strategy could be to look beyond cheap labour and low taxes. The econometric analysis that was conducted clearly supports this. Wages turned out to be insignificant for FDI in these economies. This does not mean that labour costs are irrelevant for investors, but just that all these economies have sizeably lower wages than Western Europe, because of what the factor that gives advantage to one country over another is not wages, but other things. The same holds for taxes, which appeared to be econometrically significant only in the long run, and were always rated towards the bottom of the list of the factors that are important to foreign investors in the surveys. No investor that was interviewed pointed out taxes or wages as an obstacle for investing in the Western Balkans, but many of them complained that the quality of the labour force was lower than expected, that institutions were weak, that education should be improved.

The availability of skilled labour is important for investors. The survey of German companies who are considering investing abroad, conducted for this study, pointed out that the first factor that these companies consider when deciding where to invest is the availability of skilled labour. At the same time, the survey of German companies that have already invested in the Western Balkans, also conducted for this study, has pointed out that some of these companies are not very satisfied with the quality of the labour in the Western Balkans, in the sense that their initial high expectations have not been met in reality. German companies think that Western Balkan economies have skilled and educated labour force, partly for historical reasons – in socialist times, many workers from this region were working in Germany. But after coming to the Western Balkans now, they realise that things have changed with the transition. The importance of the skilled labour force is further strengthened by the notion that concrete nearshoring cases from recent years have been motivated by quality considerations.

Improving the quality of the labour force presupposes an improvement in the educational system. None of the Western Balkan economies scores greatly on the PISA tests, and some of them even rank among the least performing in Europe in these tests. The amount of money they invest in education, as a share of their GDP, is on the European bottom. In order to enhance the attractiveness for investors as economic locations, education systems in Western Balkan economies would benefit from being reformed and modernised. The econometric analysis that has been presented in this study points out that FDI are strongly affected by the share of STEM graduates. In addition, the interviews conducted with both foreign and local companies show that companies see vocational education, provided in cooperation with companies, as very important. A reform of the educational system appears as crucial to take care of these two things, alongside others.

Closely related to the quality of the workforce is its availability, which is becoming a problem in the Western Balkans, due to the emigration. All Western Balkan economies have experienced sizeable emigration in recent years, especially among the young and the less educated. If these trends continue, the region may soon face labour shortages, even among low-skilled workers. Interviews conducted with Investment Promotion Agencies already indicate some signs of this in some of the countries. Thus, authorities might have an interest in looking at the issue of emigration and adopting appropriate measures for slowing-down this trend.

Governance is another thing that has appeared important for investment in the Western Balkans. The econometric analysis has found that government effectiveness, regulatory quality and rule of law are significant determinants of FDI in the Western Balkans, while company surveys have pointed out the importance of political stability. But at the same time, Western Balkan economies have appeared to be particularly weak when it comes to governance. Worldwide Governance Indicators rank them towards the European bottom, while surveys and interviews of foreign companies indicate that they consider political stability to be one of the main problems of the region. Even Investment Promotion Agencies have acknowledged that these aspects are weak sides of their countries, but still, very little effort has been invested in recent years in improving governance. If Western Balkan economies intend to appear as attractive destinations for FDI in the post-pandemic world, improving governance is a key factor.

Infrastructure has also appeared to be very important, both according to the econometric analysis and the company surveys, but the situation with infrastructure is even more complex. Investment Promotion Agencies have usually stated that their countries possess good infrastructure, which is not supported by the relevant data, as the data have clearly pointed out that transport infrastructure in the Western Balkans is among the lowest ranked in Europe. Thus, investing significantly in transport infrastructure would be beneficial. Many of the countries have been investing in infrastructure in recent years, but it seems to be important that this trend continues in the time to come, until infrastructure gets close to the EU level.

Regarding the benefits schemes that Western Balkan governments provide, the analysis has found that investors like them. They rarely use them completely, though, which means that the reason why they like them might not be just the direct financial benefit, but also the signal that they send of good intentions and hospitality of the government. Nevertheless, Western Balkans governments have an interest in avoiding the ‘beggar-thy-neighbour’ behaviour, i.e. promising to investors that they will match the benefits that other countries are offering them, and giving them more, which has often been the case. This is undermining regional cooperation, which is detrimental to the small Western Balkan economies. In addition, it is leading to a ‘race to the bottom’, where governments are left without valuable fiscal resources, necessary for providing public goods and services. Instead of engaging in this type of a behaviour, Western Balkan economies might have an interest to try to develop a common regional strategy towards attracting foreign investors, providing same, or at least similar, type of incentives.

Benefiting from nearshoring does not refer just to attracting more foreign companies, it also means that local companies get the most they can from the presence of these companies in their countries. An obvious potential first step to do here is to try to include domestic companies into the supply chains of the foreign companies, by making foreign companies use more local goods and services. Western Balkan governments are already trying to do this, but these efforts could be strengthened. The survey of the domestic companies indicates that companies often do not know foreign companies that they could work with. It also shows, and this is confirmed by the interviews with the several success stories from the region, that particularly useful are events like trade fairs, business summits and other similar meetings, where domestic and foreign companies could get to know each other, and possibly, start working together. Governments, Investment promotion agencies, chambers and other relevant entities have a role to play in this respect and could more systematically organise events, on which domestic and foreign companies will have a chance to meet and start cooperating.

A factor often stated by the foreign companies for the low level of cooperation with the local companies is the notion that local companies often do not have the required standards and certificates, which are very important to the foreign companies. Governments and chambers can work on this with local companies, trying first to explain them why these are important, and then also trying to help them get the required certificates.

Cooperation between domestic and foreign companies does not mean just local companies selling to foreign companies. Cooperation may also take other forms, like exchanging knowledge and information, developing products together, lobbying together for a cause of common interest etc. The survey of local companies has pointed out that these softer forms are the preferred way of their cooperation with foreign companies. For these reasons, authorities and chambers might have an interest in dedicate special efforts to easing the opportunities for local and foreign companies for collaborating in some of these ways.

Western Balkan economies could also try to use more the potentials that arise from regional cooperation and integration and the “Common Regional Market”, when it comes to local and regional sourcing. If foreign investors cannot find the goods or services they need from domestic companies in one of the Western Balkans economies, the investor could source from some of the other Western Balkan economies, which would keep the value chain regional and short.

Finally, building and maintaining good relations with foreign investors seems important for at least two reasons. The first is that these companies might want to invest again, so, if they decide to do that, Western Balkans economies have an interest that their first choice might be the Western Balkan economy in which they have already invested. Some Investment Promotion Agencies have stated that they are thinking of this, but it would be beneficial to make this the rule, not the exception. The second reason is reputation. Interviews with both companies and Investment Promotion Agencies have indicated that reputation of a country is a very important factor that drives the companies’ decision where to locate their production. If a country has a good reputation, due to its good relations with the investors, the word will spread among other companies, and will lead to other investors coming to that country.

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Appendices

APPENDIX 1 - SURVEY QUESTIONS FOR GERMAN COMPANIES THAT ARE CONSIDERING INVESTING IN THE WESTERN BALKANS

General questions about the company

1. Which is the main industry in which your company works? (one choice)
   - Agriculture, Forestry and Fishing
   - Mining and Quarrying
   - Manufacturing
   - Electricity, Gas, Steam and Air Conditioning Supply
   - Water Supply; Sewerage, Waste Management and Remediation Activities
   - Construction
   - Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles
   - Transportation and Storage
   - Accommodation and Food Service Activities
   - Information and Communication
   - Financial and Insurance Activities
   - Professional, scientific and technical activities
   - Education
   - Health and social work activities
   - Other (please comment)

2. What is the annual turnover of your company? (one choice)
   - Below 10 million EUR
   - 10-50 million EUR
   - 50-100 million EUR
   - 100-500 million EUR
   - More than 500 million EUR

Investing abroad in general

3. Why is your company considering investing abroad? (multiple choice)
   - We need workers which we cannot easily find in our home country
   - Because of the relatively lower labour costs abroad
   - Because of the higher taxes at home and lower taxes abroad
   - Because of the benefits/incentives packages that other governments are providing to foreign investors in their countries
   - Because we want to enter new markets
   - Relocating because of pandemic-disrupted supply chains or uncertainty
   - Other (please comment)

4. Which other regions are you considering in parallel with the WB? (multiple choice)
   - Central Europe (Visegrad countries)
   - Eastern Europe (including Turkey, Bulgaria, Romania, Ukraine)
   - South-East Asia
   - Central Asia
   - China
   - India
   - Middle East and North Africa
   - Other (please comment)

5. Which factors are important to you as an investor when deciding where to invest? (choose 3 and rank them)
   - Stability of the country, good governance and functional institutions
   - Quality of infrastructure
   - Geographical location of the country
   - Size and the prospects of the market
   - Quality of the workforce
   - Quantity of the workforce
   - Level of wages
   - Level of taxes
   - Benefits packages that the government provide to foreign investors
   - Other (please specify)

Investing in the WB

6. Which of these factors do you think are STRONG sides of the WB? (choose 3 and rank them)
   - Stability, good governance, functional institutions
   - Quality of infrastructure
   - Quantity of the workforce
   - Geographical location
   - Size and the prospects of the market
   - Quality of the workforce
   - Wages are relatively low
   - Taxes are relatively low
   - Government provide attractive benefits packages to foreign investors
   - Other (please specify)

7. Which of these factors do you think are WEAK sides of the WB? (choose 3 and rank them)
   - Instability, poor governance, non-functional institutions
   - Poor quality of infrastructure
   - Poor geographical location
   - Small size and weak prospects of the market
   - Low quality of the workforce
   - Not enough workforce
   - Wages are relatively high
   - Taxes are relatively high

- Benefits packages that government provide to foreign investors are not attractive enough, compared to other regions
- Other (please specify)

Covid-19

8. When do you expect to reach the pre-Covid-19 level of operation for your global company? (one choice)
   - By first half of 2021
   - In second half of 2021
   - In 2022
   - Never
   - Other (please comment)

9. How has the Covid-19 crisis affected your plans for investing abroad?
   - It has not affected them
   - We postponed our planned investments abroad
   - We cancelled our planned investments abroad
   - We changed the location of our investments abroad
   - We decided to invest less
   - We decided to invest more
   - Other (please comment)

10. How has the Covid-19 crisis affected your plans for investing in the WB?
    - It has not affected them
    - We postponed our planned investments in the WB
    - We cancelled our planned investments in the WB
    - We decided to invest less in the WB
    - We decided to invest more in the WB
    - Other (please comment)

APPENDIX 2 - SURVEY QUESTIONS FOR GERMAN COMPANIES THAT HAVE ALREADY INVESTED IN THE WESTERN BALKANS

General questions about the company

1. Which is the main industry in which your company works globally? (one choice)
   - Agriculture, Forestry and Fishing
   - Mining and Quarrying
   - Manufacturing
   - Electricity, Gas, Steam and Air Conditioning Supply
   - Water Supply; Sewerage, Waste Management and Remediation Activities
   - Construction
   - Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles
   - Transportation and Storage
   - Accommodation and Food Service Activities
   - Information and Communication
   - Financial and Insurance Activities
   - Professional, scientific and technical activities
   - Education
   - Health and social work activities
   - Other (please specify)

2. What is the size of your investment in the WB? (one choice)
   - 0-10 million EUR
   - 11-50 million EUR
   - 51-100 million EUR
   - More than 100 million EUR

Investing in WB

3. Why did your company invest in the WB country in which it invested? (multiple choice)
   - Because of the quality of the workforce in the country
   - Because of the quantity of the workforce in the country
   - Because of the relatively low wages
   - Because of the relatively low taxes
   - Because of the incentives scheme that the government provided
   - Because of the good infrastructure in the country
   - Because of the good institutions and governance in the country (rule of law, control of corruption, government effectiveness etc.)
   - Because of the geographical location of the country
   - Because of the prospects of the new market
   - Other (please specify)

4. Which of the following aspects of education was most important for your company to invest in WB? (one choice)
   › The number of STEM graduates (science, technology, engineering, mathematics)
   › The number of ICT graduates (Information and Communication Technology)
   › The number of vocational secondary education pupils
   › Other (please comment)

5. Which of the following aspects of institutions and governance was most important for your company to invest in WB? (one option)
   › Voice and Accountability
   › Political Stability and Absence of Violence/Terrorism
   › Government Effectiveness
   › Regulatory Quality
   › Rule of Law
   › Control of Corruption
   › Other (please comment)

6. How satisfied are you with the overall experience of working in the WB, compared to the other regions where your company works?
   › Very satisfied
   › Satisfied
   › Neutral
   › Unsatisfied
   › Very unsatisfied

7. Which are the positive sides of working in the WB? (choose 3 and rank them)
   › Quality of the workforce
   › Quantity of the workforce
   › Relatively low wages
   › Relatively low taxes
   › Good government support (incentive schemes, zones…)
   › Good infrastructure
   › Good governance and institutions (rule of law, control of corruption, government effectiveness)
   › Geographical location
   › Other (please specify)

8. Which are the negative sides of working in the WB? (choose 3 and rank them)
   › Quality of the workforce
   › Quantity of the workforce
   › Wages are relatively high
   › Taxes are relatively high
   › Government doesn't provide enough support (incentive schemes, zones…)
   › Poor infrastructure
   › Poor governance and institutions (rule of law, corruption, government ineffectiveness)
   › Geographical location

- Other (please specify)

Working with local companies

9. How much is your company working with local companies in the WB country where you have invested, as a % of your annual turnover? (Direct answer)
    - ___ %

10. In which ways is your company cooperating with local companies? (multiple choice)
    - We sell our products (goods and services) to them
    - We buy goods and services from them
    - We provide goods/services together
    - We develop products together
    - We exchange information related to our work
    - We work/lobby together for a cause relevant to us
    - Other (please comment)

11. What are the barriers to working more with local companies? (multiple choice)
    - Local companies cannot provide the products and services that we need
    - Local companies are not competitive in terms of price
    - Local companies cannot provide the quality and standards that we need
    - Our production process is specific and cannot integrate local companies more
    - We have long-term relationships with other companies and cannot break them
    - Other (please comment)

Covid-19

12. When do you expect to reach the pre-Covid-19 level of operation for your global company? (one choice)
    - By first half of 2021
    - In second half of 2021
    - In 2022
    - Never
    - Other (please comment)

13. When do you expect to reach the pre-Covid-19 level of operation for your WB company? (one choice)
    - By first half of 2021
    - In second half of 2021
    - In 2022
    - Never
    - Other (please comment)

14. How has Covid-19 affected your future plans for the WB? (multiple choice)
    - Has not affected them
    - We cancelled some planned investments in the WB

- We postponed some planned investments in the WB
- We are scaling down our future operation in the WB
- We are scaling up our future operation in the WB
- Other (please comment)

15. Do you consider transferring your investment from the WB region to other countries closer to Germany due the Covid-19?
    - Yes
    - No
    - Don’t know

APPENDIX 3 - SURVEY QUESTIONS FOR LOCAL COMPANIES FROM THE WESTERN BALKANS

This survey is part of the project “Near-shoring potential in the Western Balkans”, done DIHK, wiiw and the six chambers of the Western Balkans, as well as their umbrella organisation WB6 CIF. The purpose of the survey is to assess the potential for cooperation between foreign companies investing in the Western Balkans and the local companies. The survey consists of several questions and will take approximately 5 minutes of your time.

1. Which is the main industry in which your company works? (one choice)
   - Agriculture, Forestry and Fishing
   - Mining and Quarrying
   - Manufacturing
   - Electricity, Gas, Steam and Air Conditioning Supply
   - Water Supply; Sewerage, Waste Management and Remediation Activities
   - Construction
   - Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles
   - Transportation and Storage
   - Accommodation and Food Service Activities
   - Information and Communication
   - Financial and Insurance Activities
   - Professional, scientific and technical activities
   - Education
   - Health and social work activities
   - Other (please comment)

2. How many employees does your company have? (one choice)
   - 1-10
   - 11-50
   - 51-250
   - 250+

3. Is your company working with foreign companies that are operating in your country? (one choice)
   - Yes (if this option chosen, go to Questions 4-9)
   - No (if this option chosen, go to Questions 10-13)

4. How much of your company’s annual turnover is with foreign companies that are operating in your country? (Direct answer)
   - ___ %

5. How is your company working with foreign companies? (multiple choice)
   - We sell our products (goods and services) to them
   - We buy goods and services from them
   - We provide goods/services together
   - We develop products together

- › We exchange information related to our work
- › We work/lobby together for a cause relevant to us
- › Other (please comment)

6. In which ways would you like to cooperate more with foreign companies that are operating in your country? (one choice)
   - › We would like to sell more of our products (goods and services) to them
   - › We would like to buy more goods and services from them
   - › We would like to provide goods/services together
   - › We would like to develop products together
   - › We would like to exchange information related to our work
   - › We would like to work/lobby together for a cause relevant to us
   - › Other (please comment)

7. How satisfied are you with the cooperation with the foreign companies? (one choice)
   - › Very satisfied
   - › Satisfied
   - › Neutral
   - › Unsatisfied
   - › Very unsatisfied

8. Are you more satisfied with the cooperation with the foreign companies, or with the local companies? (one choice)
   - › More satisfied with foreign companies
   - › More satisfied with local companies
   - › Equal
   - › Other (please comment)

9. (Optional) Would you like to provide some details on the differences in cooperation between domestic and foreign companies? (space for comment)

   (Just for those who answer NO on the first question)

10. Do you want to work with foreign companies that are operating in your country? (one choice)
    - › Yes
    - › No
    - › We can't work because of the nature of our business
    - › Other (please comment)

11. What are the reasons why your company does not work with foreign companies operating in your country? (multiple choice)
    - › We do not provide products or services that they need
    - › We are not competitive in terms of price
    - › We cannot provide the quality and standards that they ask for
    - › Their production process is specific and cannot integrate local companies
    - › Our business is specific and cannot work with foreign companies

- We do not know foreign companies that we can work with
- Other (please comment)

12. In which ways would you like to cooperate with foreign companies that are operating in your country? (one choice)
    - We would like to sell our products (goods and services) to them
    - We would like to buy goods and services from them
    - We would like to provide goods/services together
    - We would like to develop products together
    - We would like to exchange information related to our work
    - We would like to work/lobby together for a cause relevant to us
    - Other (please comment)

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