The South East Europe 2020 Strategy – Integration through Trade and Investment

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Abstract

The topic of this research is a deeper analysis and comparison of one of the pillars of the South East Europe (SEE) 2020 Strategy - SEE 2020 Strategy: Jobs and Prosperity in a European Perspective. The SEE 2020 as a regional strategy is inspired and based on EU 2020 principles, reflecting the commitment and determination of all governments in South Eastern Europe for achieving a higher level of socioeconomic growth and facilitates integration within the EU. The SEE 2020 Strategy, especially the Integrated growth pillar focuses on increased regional trade and investment flows, by strengthening cooperation and creating transparent national policies. In order to reach these targets, as well as the creation of new jobs and prosperity, key importance is placed on increased regional trade and investments that actually increase the competitiveness and integration of the region on a European and global level. The main research question of this chapter is the level and the dimension of the implementation of trade and investment integration targets in South East European countries, with the aim of increasing intra-regional trade in goods by more than 140% and increasing the overall FDI annual inflow to the region by at least 160%. The research methodology for this chapter is a comparative analysis of quantitative data and a review of the official reports and scientific articles published last year. The authors will provide an updated overview of the situation in South East European countries with a critical analysis of different respective actions and projects needed if the SEE 2020 targets are to be achieved for the Integrated Growth Pillar. This work will add value to research in the area of trade and investments and will provide important recommendations for the further activities of policy makers.

Keywords: South East Europe 2020 Strategy, trade, investment, economic growth, competitiveness, integrated growth.

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Introduction - SEE 2020 Joint Vision of the Region

Seven South East European countries (Albania, Bosnia and Herzegovina, Croatia, Kosovo, Montenegro, Serbia and the Republic of Macedonia) under the auspices of the Regional Cooperation Council (RCC) developed and adopted the South East Europe 2020 Strategy ('SEE 2020' or 'Strategy'), in November 2013. This ten year strategy is a document of commitment and interest for political and economic cooperation in the region in order to enable the economic growth of the countries concerned, as well confirming and emphasizing the importance that these countries attach to the European perspective. All countries are strongly linked with the European Union (EU) economy, not only geographically, but also economically they and they see their future within EU. (http://ec.europa.eu/enlargement/countries/check-current-status/index_en. htm)

The Strategy was inspired by the EU's Europe 2020 Strategy, both in terms of the issues addressed and the concept of advancing progress through better cooperation of the region in areas that are of common interest. SEE 2020 is based on the same pillars as the Europe 2020 strategy: 1) Smart growth, 2) Sustainable growth 3) and Inclusive growth, with the inclusion of two more pillars: 4) Integrated growth and 5) Governance for growth due to South East European priorities (*EUROPE 2020 a strategy for smart, sustainable and inclusive growth*, EC, 2010). The SEE Strategy 2020 outlines a new approach and sets out a vision for a new development pathway that seeks to give fresh impetus to economic growth and development in the region as well as contributing to greater prosperity, the creation of more jobs and stronger ties with the EU, based on closer integrative links and common European values. The economies of South East Europe endorsed their own 2020 vision by adopting 11 regional and 77 national headline targets and charting out a comprehensive cooperation agenda.

According to Kersan-Skabic et al. (2009) regional cooperation is of major importance to the stability and development of this region, as well as becoming more competitive worldwide alongside the developed EU countries. The implementation of the SEE 2020 vision is headed by existing regional structures, such as CEFTA (the Central European Foreign Trade Agreement), SEEIC (the South East European Investment Committee), as well as on a national level with National Action Plans. After 2016 these will be integrated into the National Economic Reform Program (NERP). The NERP focuses on national structural reforms for long term growth and competitiveness, as well as keeping macroeconomic stability, fiscal sustainability and prosperity, aligned with national and regional strategic documents.

SEE 2020 Pillars and the Integrated Growth Pillar – Pillar 1

The adoption of the SEE 2020 Strategy is a significant step forward in a process aimed at the political and economic cooperation of the region. It pursues a holistic pattern of development for the region and seeks to stimulate the key long-term drivers of growth such as innovation, skills, FDI and the integration of trade. The projected activities should be achieved along the five following pillars (SEE 2020 Strategy, RCC 2010):

• Integrated growth: through the promotion of regional trade and investment linkages and policies that are non-discriminatory, transparent and predictable.

• Smart growth: by committing to innovating and competing on value-added rather than labor costs.

• Sustainable growth: by raising the level of competitiveness in the private sector, the development of infrastructure and encouraging greener and more energy-efficient growth.

• Inclusive growth: by placing greater emphasis on developing skills, creating employment, inclusive participation in the labor market and health and wellbeing.

• Governance for growth: by enhancing the capacity of public administration to strengthen the rule of law and reduce corruption, the creation of a business-friendly environment and the delivery of public services necessary for economic development.

The efficiency of the Strategy is closely related to a growth in trade, so four of the targets (as part of overall targets and within different pillars) demonstrate an increase in trade in different aspects as an indicator for the competitiveness, growth and prosperity of the region: Total trade in goods and services in millions of euros; Trade balance as a percentage of GDP; Intra regional trade in goods in millions of euros; Exports of goods and services per capita. The progress in all five pillars is required for SEE economies to reach the overall developmental goals presented in the strategy.

According to Strategy 2020, the capacity of the South East European economies to attain these ambitious headline targets is strongly influenced by the macro-economic context in which implementation takes place. One of the key pillars related to regional economic integration and economic growth is based on the expectations for increased trade in the region and the larger inflow of FDI. Within this pillar actions are promoted aimed at further development under the three following dimensions: a free trade area, a competitive economic environment - increasing the competitiveness of the region as a destination of FDI, and integrating the region more fully into the European and global economy. The pillar has very ambitious headline targets, so by 2020 the region should achieve the following:

Increase South East European intraregional trade in goods by more than 140% (from 12459 mil. EUR, to 30500 mil. EUR)

Increase annual FDI to the region by at least 160% (from €3,396 million to €8,800 million)

Being among the SEE 2020 priorities and prerequisites for growth, the South East European region must establish a free and open investment regime by removing intra-regional investment barriers, facilitating the free flow of factors of production (goods, services, and human capital), pursue policies that support the attraction and inflow of FDI, as well as intra-regional investments, and promote the further integration of the regional markets. The removal of barriers to regional trade and investment offers the opportunity for economies of scale, geographically diversified businesses, and overall a more efficient allocation of resources within the regional markets.

On a concrete level, this means the potential for investor subsidiary networks, as firms seek efficiency gains through a fragmentation of their production processes by allocating individual segments of value addition in places of comparative economic advantage. The progressive liberalization of cross-border transactions reduces time and costs to trade and investment within a region. It fosters the development of regional value chains and leads to increased diversification and the sustainability of economic growth. The SEE Strategy 2020, is a prerequisite for better intraregional trade and higher attractiveness for investment in the Region.

CEFTA 2006 Importance towards SEE 2020 Implementation

The main goals of CEFTA 2006 are to increase the intra-regional trade and competitiveness of the region as a whole. CEFTA 2006 provides a comprehensive framework for the development of mutual relations and economic cooperation among the SEE countries and builds their competitiveness (Petreski, 2013). As the author has demonstrated, the effects from CEFTA 2006 are much larger and better than the effect of the previous Stabilization and Association Agreement. This conclusion is based on the fact that it encompasses a much larger number of issues than the individual bilateral agreements that had been regulating this area until recently, as well as the original CEFTA agreement. The new opportunities for cooperation pertain to the following areas: trade in goods and services, investments, public procurement and the protection of intellectual procurement.

CEFTA 2006 opens up opportunities for the development of cooperation among its members, so as to achieve progressive liberalization and the mutual opening of their markets for preferential access. It also provides opportunities for initiating concrete negotiations for the liberalization of trade in services among members. CEFTA 2006 mandates that its members should encourage mutual investment initiatives through the promotion of the right kind of conditions and that they should facilitate administrative procedures in investment in order to create a transparent regional environment for investors. In this context, members are obliged to provide equitable treatment, as well as full protection and security for investments coming from other members,

The CEFTA Joint Committee has formally aligned the CEFTA agenda with that of the SEE 2020 Strategy. A number of other actions, particularly those relating to attracting investment are at a more preliminary stage of research and analysis, but they are very important for developing an increased level of intra-regional and global trade.

Results for Total and Intraregional Trade in Goods

The statistical data in Table 1 presents the total trade of South East European countries up to 2012/2013, showing a slower than expected convergence towards the 2020 targets. For example, the increase of total trade annually in the period 2010/2013 is performed by 7%; 1.5% and 2% annually, while the gap between the projections for 2020 in relation to 2013 is very large at 100%. The difference in the trend in the first three years of the implementation of Strategy SEE 2020 is difficult to realize.

Table 1: Total trade of goods of SEE countries

Eur. million

Country	2010 baseline	2011	2012	2013	2020 target
Albania	7,695	8,154	7,596	7,498	1,7500
Bosnia and Herzegovina	12,138	11,418	11,323	11,609	24,500
Croatia	35,400	37,092	37,752	36,701	80,000
Kosovo	3,321	3,681	3,576	3,573	6,000
Macedonia	7,834	9,670	9,683	9,747	15,500
Montenegro	3,118	3,489	3,555	3,530	6,000
Serbia	24,907	27,557	29,093	32,004	60,000
Total	94,413	101,061	102,578	104,662	209,500
% of increase of total trade annually		+7	+1,5	+2	

Source: CEFTA intra-regional trade, http://www.cefta.int/statistics

This especially relates to trade indicators, given that around 14% of the total trade volume of South East European countries goes to intra-regional trade. In Table 2, intra-regional trade presents an increase in 2011, but then a slight decrease in 2012 and 2013, making the gap between the 2013 value and the 2020 target very large at 120%. Country-by-country comparison indicates that the 2020 targets are between 102% (Republic of Macedonia) and 170% (Serbia), higher than the 2012 values in all the other economies, with the exception of Montenegro, which has a modest 15% gap between 2012 and 2020 target.

Table 2: Intra-regional trade of goods of SEE countries

Eur. million

Country	2010 baseline	2011	2012	2013	2020 target
Albania	425	509	533	497	1,150
Bosnia and Herzegovina	3,100	3,450	3,231	3,297	7,100
Croatia	2,474	2,809	3,004	2,860	6,200
Kosovo	872	955	946	853	2,000
Macedonia	1,243	1,452	1,336	1,239	2,700
Montenegro	800	1,003	1,040	984	1,200
Serbia	3,544	3,818	3,755	3,837	10,150
Total	12,458	13,996	13,845	13,567	30,500
% of increase/decrease of total trade annually		+12	-1	-2	

Source: CEFTA intra-regional trade, http://www.cefta.int/statistics

The main objectives for development are to enact specific steps to deepen the free trade area, to promote greater trade facilitation and to identify measures and actions that will improve the intra-regional trade and attractiveness of the region as a destination for foreign investment and therefore enhance its competitiveness. Mutual trade cooperation in the South East European countries can be further enhanced by the greater activity of business associations and chambers of commerce of the countries in order to improve the opportunities for bigger economic cooperation and increased intra-regional trade.

FDI as a Driver for Economic Growth

Attracting FDI is one of the key strategies and pillars for enabling economic growth. They contribute to the expansion of productive capacity, job creation, income growth, knowledge and technology diffusion, the inflow of new skills, enterprise development, and the diversification of exports. All countries, whatever their level of development and historical background, have to host inward-FDI to stay competitive. The countries from the South East European region identified attracting FDI as one of the key pillars in their development strategies. In general the level of FDI inflow into a country is an indicator that shows the attractiveness of its market, the favorability of its business environment, reforms that have been realized, political stability and the predictability of the economy, as well as the potential of the market for growth and access to other markets, the availability of attractive investment potentials and incentives that are offered, and the efficiency of the promotional activities in order to attract attention and convince investors to come and invest in the country.

Global competition for foreign investment is fierce, in addition to the competition between South East European countries. There are various motives for companies to engage in FDI, such as: seeking markets, seeking resources, seeking strategic assets, and seeking greater efficiency. . Foreign investments are coming into the region through the process of privatization especially in Bosnia and Serbia, where this process has still not been completed, as well as in the development of infrastructure projects, economic zones, and brown-field and green-field investments. Attracting FDI has been one of the key objectives of those governments which have transitional economies throughout the course of the transition. They therefore put in place regulatory frameworks (namely, removing legal barriers and regulatory obstacles to foreign capital inflows) and institutional settings (such as, the use of public agencies to attract FDI) with the agenda of promoting a favorable environment for foreign investors. In addition to classical measures including a wide range of fiscal privileges (such as tax concessions and tax exemptions), the creation of special economic/industrial zones, and investment in physical infrastructure. Governments have not been reluctant to offer special arrangements and negotiate terms individually, based on the mode, function, and objective of the entrance of multinational enterprises (Mehic, Silajdzic, Babic-Hodovic, 2013). FDI policies in the region are focused on improving the environment for investment; active promotion, image building, and the creation and promotion of economic zones, such as industrial estates, business zones and free zones.

Creating a business environment that is conducive to all forms of investment is an important policy challenge for emerging and transitional economies. One of the most relevant is the attractiveness of the business environment that can be followed by different ways, but the most commonly used ones are the rankings by the international organizations like World Bank - Doing Business Report as well as the World Economic Forum (WEF) - Global Competitiveness Index.

According to the latest report of the World Bank "Doing Business 2015'' comparing the results of 189 economies, South East European countries are ranked between the 30th and 107th place. The Republic of Macedonia is ranked in the high 30th position among 189 countries in the world and is a leader in the region in creating the right kind of conditions for doing business. It is followed by Montenegro at 36th, Croatia at 65th, Albania at 68th, Kosovo at 75th, Serbia at 90th and Bosnia and Herzegovina at 107th. The rankings are distributed in 10 pillars, so the countries vary in the rankings, due to internal legislation and procedures defined for starting and leading businesses.

From the point of view of competitiveness, the World Economic Forum develops the Global Competitiveness Index as a set of institutions, policies, and factors that determine the level of productivity of a country followed in 12 pillars. The level of productivity, in turn, sets the level of prosperity that can be reached by an economy. The productivity level also determines the rates of return obtained by investments in an economy, which in turn are the fundamental drivers of its growth rates. In other words, a more competitive economy is one that is likely to grow faster over time. The concept of competitiveness thus involves static and dynamic components. According to data from the latest GCI 2014-2015 of the World Economic Forum, the Republic of Macedonia is ranked in the 63rd position; Montenegro is ranked at 67th, Croatia at 77th, Serbia at 94th and Albania at 97th. Bosnia and Herzegovina and Kosovo are not included in the rankings. The most problematic factors for doing business identified in the WEF for each country are as follows: for Croatia - inefficient government bureaucracy, the instability of policies, and corruption: for Macedonia - access to finances, poor working ethics in the national labor force, and an inadequately educated work force; for Serbia - inefficient government bureaucracy, access to finances, and corruption; for Montenegro - access to financing, corruption, poor working ethics in the national labor force; and, for Albania - corruption, access to finances, and inefficient government bureaucracy. These areas with identified weaknesses should be addressed by the South East European countries in order to improve their competitiveness and attractiveness for doing business, increasing the trade and FDI.

Results for Foreign Direct Investments in South Eastern Europe

The Investment Policy and Promotion Dimension are contained within the Integrated Growth Pillar of the South-East Europe 2020 Strategy. This pillar aims at fostering integrated growth through the promotion of regional trade and investment linkages and policies which are non-discriminatory, transparent and predictable.

Due to the fact that one of the defined targets that should be reached in order to enable economic growth in these countries and the region is the increase of FDI in the region by 160%, the countries have individually made different projections based on their strategies, so it lies in the range of between 22% to 360%. In the following section we will analyze the sustainability of the projected FDI targets and the ability for the fulfillment, country by country and as a region. The targets that are given in the SEE 2020 Strategy are for the year 2020, and the baseline data is for 2010. It is a fact that FDI data are very volatile, due to the strong influence of internal and external factors in each of the countries concerned. This fact creates difficulties in defining the required average growth rate in order to reach the target.

Above all, the most important fact is that all countries define and target FDI as a pillar for economic growth, projecting higher FDI inflow in 2020 compared to 2010. FDI can be followed in different ways as absolute values of FDI per country, FDI per capita or FDI as a percentage of GDP. These figures provide different aspects of this very important topic. In Strategy SEE 2020, the targets are given in absolute values as volume of FDI (Table 3). Also, in order to analyze the effects of FDI on the domestic economy it should be linked to further analysis of created new working places, created links with the domestic companies, sectors of the economy that have attracted FDI, and the inflow of new technology.

Table 3 - FDI by countries in mil. EUR - SEE 2020 and Baseline data

Country	2010 Baseline data	2011	2012	2013	2020 Target	% of growth 2020/2010
Albania	793	717	727	741	2200	177
Bosnia and Herzegovina	174	342	273	320	500	187
Croatia	326	1,087	1,066	437	1,500	360
Kosovo	366	379	213	286	800	119
Macedonia	160	337	72	252	600	275
Montenegro	574	495	634	479	700	22
Serbia	1,003	1,827	242	756	2,500	149
Total	3,396	5,184	3,227	3,271	8,800	160

Source: Authors calculations based on the SEE 2020 Baseline Report, Towards Regional Growth, 2014, Publisher, Regional Cooperation Council, p. 89

The South East European countries have identified different targets for FDI inflow in 2020 presented in the table 3. The expected average growth of FDI in the region is 160%, the lowest projections have Montenegro at 22% growth, and highest expectations were projected by Croatia 360% and Macedonia of 275% growth. These projections are provided according to governmental calculations based on their strategic documents and programs. The indicator for overall FDI inflow is subject to one-off annual data and therefore it is difficult to extrapolate a clear trend. Actual data for FDI up to 2012/2013 shows slower than expected convergence towards the 2020 targets. However, given the 2010-2013 annual values, the 2020 targets also seem very ambitious, with the regional 2020 target inflow being 169% higher than the 2013 inflow. This is due to many internal and external factors.

In general, in comparing the targets it seems that Montenegro will attract much more FDI than the figures that have been projected as well as Macedonia which has projected far too ambitious a figure. The key characteristics of FDI in the region followed by countries can be summarized as follows:

• Albania has a projected growth of 177% that will be based mainly on inflows in energy infrastructure. Bosnia has a projection of 187% growth, based on expected FDI in energy infrastructure, and the privatization of existing facilities and plants. Kosovo bases its expectations of 119% growth in FDI inflow on investments in infrastructure. The Macedonian figure of 275% projected growth focuses on attracting FDI in Free Economic Zones as well as new green field and brown field investments in different sectors. Montenegro projected a modest growth of 22% and Serbia expects 149% FDI growth coming from the energy sector, manufacturing, and privatization.

• The most attractive sectors for FDI in the region are energy and transport infrastructure, manufacturing, agriculture and tourism as well renewable energy sectors.

• The volatility of FDI annual inflows is due to both internal and external factors.

• The EU and a few strategic partners provide the key source of FDI,

• FDI attraction is positioned high in the economic policies, with a commitment to do "investment friendly" structural reforms and the creation of a favorable business climate attractive for FDI,

• Albania, Macedonia, Bosnia, Serbia, Croatia and Montenegro have created specialized institutions for FDI promotion and in some cases have created a network of promoters abroad.

• The key sector that attracts FDI in the region will be energy, infrastructure, and privatization in some cases, as well the Free Economic Zones.

The risks to achieving the projected amounts of FDI are possible EU and World recessions, EU internal problems, political instability in South East European region, and a a deterioration in image of the region.

Conclusions

Regional cooperation is one of the most important elements in creating new relations in South Eastern Europe, which will bring political stability and economic development, which are important preconditions for the countries in this region in their EU accession processes. Analyzing the data for trade and FDI inflow in the region after the adoption of the SEE 2020, and comparing the baseline data with the targets we can conclude that:

• The SEE Strategy 2020 target was to increase SEE intraregional trade in goods by more than 140%, from the €12.46 billion in 2010 to €30.5 billion by 2020, for some countries it may imply that the 2020 targets are too ambitious.

• The legally binding regional free trade agreement, CEFTA acts as the main driver for actions in this pillar. Many of the actions to be carried out in this period relate to the implementation of specific trade liberalization and facilitation measures already agreed on as part of the Agreement and/or subsequent ministerial decisions and further technical work and negotiations to prepare the next set of trade measures required by CEFTA and/or SEE 2020.

• The SEE Strategy 2020 target was to increase the FDI levels from 3.4 billion in 2010 to 8.8 billion by 2020, for some countries it may imply that the 2020 targets are too ambitious.

• Due to the global economic crisis, the weak Euro zone economy and some internal factors, the region has so far performed well blow projected expectations. The actual data show heterogeneous country experiences with relatively small progress or mixed/reverse trends in 2010–2012/2013. In order to reverse the negative trend, countries will need to implement aggressive measures and to work together.

• The South East European countries are relatively small economies that continue to undergo transition and have strong aspirations towards increasing integration into the EU. They compete for investors primarily based on cost efficiency, in which they progressively offer more generous investment incentives with limited clarity on the opportunity cost.

• Regional integration on investment matters offers opportunities through a higher degree of market integration.

• The removal of barriers for regional trade and investment increases the market size and offers an opportunity for economies of scale, geographically diversified businesses, and overall a more efficient allocation of resources within regional markets.

• The efforts at regional integration lead to increased FDI and intra-regional investments by creating a bigger market and attracting market-seeking investments; contributing to the development of stronger and more wide-spread regional value chains which are attractive for efficiency-seeking investments; increasing connectivity among businesses, thereby reducing risks of conflict; and, creating commitment mechanisms that positively influence domestic policy reforms.

• The main objective of the SEE Strategy 2020 of increasing overall FDI inflows by at least 160% can only be achieved through the removal of the remaining intra-regional trade barriers, a lasting commitment to pursue policies that support the upturn of inward FDI and further trade-facilitation measures, coupled with the free movement of a skilled regional workforce.

• On a national level a favorable investment environment and the successful implementation of reforms are vital and key prerequisites for attracting more FDI. So the countries should continue to improve the conditions on a national level and take an active role in regional projects and actions for promoting and attracting FDI.

• Due to continuous competition in giving incentives for attracting FDI, key to this should be to conduct further cost/benefit analysis of FDI and calculating the price of every new work place.

In order to raise regional competitiveness and future growth prospects and achieve the targets defined in the SEE Strategy it is necessary to increase integration and collaboration in the region, by exploiting all potentials. Key areas should be focused on increasing the facilitation of trade, liberalization and integration as well as acknowledging the fact that all the countries in the region are individually competing for FDIs places potential obstacles against closer cooperation in this area. There are also challenges to mobilizing resources in order to attract more FDI in the region. By creating and promoting bigger markets it will result in attracting market-seeking investments that will also contribute to the development of stronger and wide-spread regional value chains which are also attractive to efficiency-seeking investments. This will have an influence on re-branding the image of South Eastern Europe and will build the perception of an attractive business location. The success of SEE strategy depends on the further commitment of countries in the implementation and development of the process, and a readiness to collaborate and provide finances for the implementation of the measures and incentives.

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