Iskra Hristova-Balkanska, Senior Research Fellow, Ph.D.

THE POSSIBLE EFFECTS OF FOREIGN DIRECT INVESTMENTS ON THE SOUTHEASTERN EUROPEAN COUNTRIES IN THE CONTEXT OF THE EU ENLARGEMENT

This article is an attempt to contribute to the analysis of foreign direct investments (FDI) inflows to the Southeastern countries by examining, on a macroeconomic level, the empirical evidence for attracting capital flows. Since the beginning of the century the interest of foreign investors towards the Southeastern European countries increased and respectively this event provoked discussions concerning the continuity of this process as well as factors influencing the decisions of the foreign investors. Indeed in 2003 the FDI inflows in SEECs constitute 73.03% of the FDI attracted by Central European countries (CECs) and 39.096% of the FDI inflows in Eastern Europe. Using a recent data about the FDI inflows in the SEECs, some factors have been demonstrated related to the host countries. The latter can be seen as reflecting the Dunning theory of determine location-specific advantages. The data and the macroeconomic evidence enable to examine how the FDI activities may change the economic environment in one specific country.

JEL: F02; F21; F34

Immediately after the start of the transition in Southeastern European countries[1] (SEECs), liberalization in trade and capital flows in many countries became the first vehicles of the reintegration of these countries into the world economy. In most SEECs countries, trade liberalization has been accompanied with radical measures aimed to liberalize the capital inflows in the way of adapting their economies to the liberal principles of the market economy. The attraction of foreign capitals under the form of foreign direct investments (FDI) has been believed to be a powerful vehicle for the restructuring of their economies.

FDI are attractive because capital inflows such as bank loans and bond funds tend to crowd out domestic investment; however FDI tends to increase national investment in an equal amount. A country may gain the benefits from FDI without also being dependent on net capital inflows or by increasing its net external debt. FDI is generally considered less volatile during financial crises and unlike debt, which is fixed in nominal terms, it is re-priced as conditions evolve and triggers not a currency or maturity mismatch. FDI are also an instrument to provide with much needed technological and managerial expertise.

In this paper an attempt is made to contribute to the analysis of FDI inflows to the SEECs by examining, on a macroeconomic level, the empirical evidence for attracting capital flows. Using recent data of FDI inflows in the Southeastern countries, some factors have been demonstrated related to the host countries. The

[1] Albania, Croatia, Bosnia and Herzegovina, FYR Macedonia, Serbia and Montenegro, Bulgaria, Romania.

latter can be seen as reflecting the Dunning theory of determine location-specific advantages. The data and the macroeconomic evidence enable to examine how the FDI activities may change the economic environment in one specific country.

The Inwards FDI Trends in the Southeastern Countries

From the beginning of the 90s the principal countries benefiting from the entering of FDI were the front-runners in the process of reforms towards market economy and namely the Central European countries CECs (Hungary, Poland and the Czech Republic), where the accumulated FDI for the period 1996-2003 was 79.69% of the FDI invested in Eastern Europe. The liberal economic policy course in these countries made foreign investments easy. The larger size of these economies, the start of privatization by sale to foreigners and a more friendly FDI policy framework contributed to high FDI inflows in the past few years. In comparison the stock of FDI entering the SEECs is only 20.64%.

The steady performance of many CEE countries in attracting inward FDI at the beginning of the century means that the majority of these countries continue to keep their position as high potential, high-performance recipients of FDI. Of the 17 CEE countries' covered by UNCTAD's Inward FDI Performance and Inward FDI Potential Indices, nine countries were already front-runners in the early phase of transition (1992-94), combining high FDI potential with high FDI performance.[2] With the exception of the Republic of Moldova, these countries combined a favorable geographical location (closeness to Western European markets) with good initial conditions for transition. Three countries were below-potential recipients (low performance despite high potential)[3] and 2 countries (Romania and the FYROM) were under-performers low potential combined with low performance). With the exception of Slovenia, the two latter groups were characterized by greater geographical distance from Western European markets and difficult initial conditions for transition.[4]

At the end of the 21st century, the number of front-runners remained the same – nine. The composition of this group was fairly stable: only Bulgaria joined it as a newcomer, while the Republic of Moldova moved out into the group of above-potential economies. The above-potential group lost Albania but gained, besides The Republic of Moldova, Romania and the FYROM.

In the Southeastern countries and especially those of the Western Balkans political insecurity, the fragmentation of markets and hesitant market reforms hindered economic development and kept away foreign investors during most of the 1990s. Consumption increased while production stagnated and the current

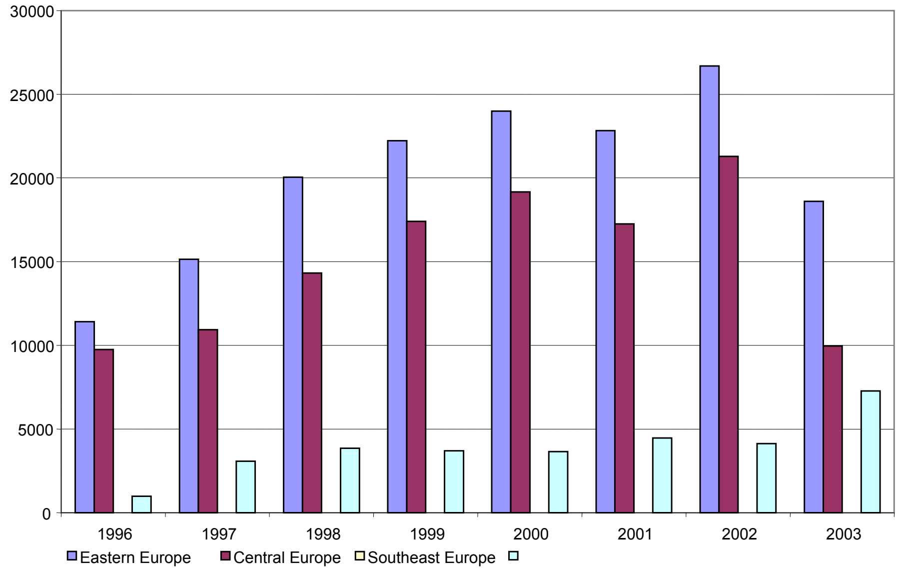
[2] Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Republic of Moldova and Slovakia. Albania also fell in the above-potential category as it had high performance despite low potential

[3] Belarus, the Russian Federation and Slovenia.

[4] World Investment Report. Transnational Corporations and Export Competitiveness, UN, 2002.

account gap was financed by foreign aid. FDI in these countries came in the form of smaller ventures mainly supporting the import and distribution of consumer goods. The FDI stock in Central Europe for the period 1996-2003 constitute 74.61% from the total accumulated FDI inflows in Eastern Europe, against only 19.32% invested in SEECs. (Graph 1)

Since the beginning of the century the interest of foreign investors towards the Southeastern European countries increased and respectively this event provoked discussions concerning the continuity of this process as well as factors influencing the decisions of the foreign investors. Indeed in 2003 the FDI inflows in SEECs constitute 73.03% of the FDI attracted by Central European countries (CECs) and 39.096% of the FDI inflows in Eastern Europe.



Error!

Fig. 1. Inflows of FDI in Eastern Europe, Central Europe, Southeastern Europe 1996-2003

Source. Economic Survey of Europe, UN, 2005, 1.

This change may be explained partly with the end of the big privatization deals in CECs at the end of 2002. The integration of CECs in the UE was accompanied with the increase of the labor cost which is a start for a slowdown in the investor interest. The decline in FDI flows to Central Europe (which followed four years of massive inflows (See Graph 1) could be a delayed effect of the large overall decline in global FDI in 2001 and 2002. But it also reflected a change in the structure of the FDI inflows: a large fall in the share of privatization-related acquisitions (with privatization in Central Europe diminishing) and the increasing importance of greenfield investments, and investment from retained earnings.[5] For example, in 2002-03 the absorption of short-term funds increased in most of the new EU members (Czech Republic, Estonia, Hungary and Poland), whereas the demand for long-term funds and portfolio investments was more pronounced in countries with smaller FDI inflows such as the Southeast European countries.

The increased amounts of direct investment from abroad in the Southeastern European economies changed the dispersion of the FDI stock in Eastern Europe, which may be a sign that the previous asymmetrical distribution of FDI in the region is about to be corrected.

During the period 1996-2003 the stock of FDI invested in Bulgaria, Romania, Croatia are 80.55% from the total accumulated FDI attracted in the Southeastern countries. Amongst the SEE countries the predominant volume of FDI have been attracted by Romania with 31.28 % from the total FDI in SEECs for the period 1996-2003, Croatia with 29.62 %, Bulgaria with 19.64 %. The FDI inflows in Serbia and Montenegro increased last year. The smallest amount has been attracted by Albania with 2.85 %, and FYROM with 3.18 %. Bosnia and Herzegovina continue to be aid dependant from the main donor countries according the Dayton Agreement. The slow inward FDI flows mainly in the West Balkan countries is due to the war in ex-Yugoslavia, to the delay in privatization processes and also to the slowdown of mergers and acquisitions of companies in the world. The graph shows that the FDI are really in progress in all the countries of the region, bearing in mind that all the mentioned countries started from a very low base in the process of attracting FDI.

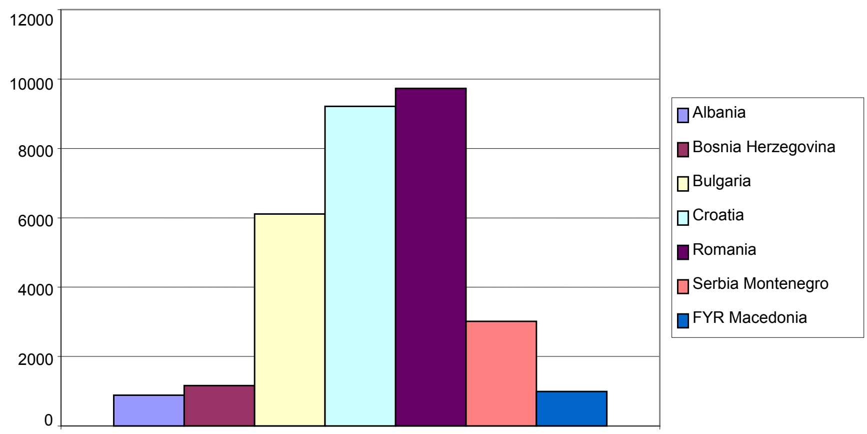


Fig. 2. FDI stock inflows for the period 1996-2003, million dollars

Source. SEE Online, WIIW, Investment guide for Southeast Europe 2004

---

[5] This provides a new and more robust evidence for the conjecture put forward in *Andreff, W*. The newly emerging TNCs from economies in transition: a comparison with third World outward FDI. - Transnational Corporations, August 2003, Vol.12, N 2.

The FDI stock in *Bulgaria* for 1992-June 2004 reached USD 8.2 billion. 85% has been attracted since the new start of economic reform in 1997. (For January-June 2004 FDI are EUR 978.6 millions, or 5% of the GDP, against EUR 651 mlns (3.7% of the GDP) for the same period of 2003.) The FDI inflow in 2003 and 2004 was the highest since the start of the reforms and was due primarily to FDI transactions with the “Privatization Agency”.

The EU – 15 countries reached nearly 70% of the stock of investments. The FDI coming from the New EU members (especially Hungary, Czech Republic, Slovenia, and Malta) account for 6.9% of the total. The main investors in Bulgaria are Greece (USD 1092.0 millions), Austria (USD 965.4 millions), Netherlands (USD 734.6 millions), Germany (USD 715.2 millions), Belgium and Luxembourg (USD 690.7) etc. FDI have been more important for the period 1998-2004 in the service sector. (Especially those in the financial activities reached USD 1468.7 millions). As comparison the Graph 3 demonstrates the low level of investments in the sector of machine building in the years 1998-2003 – only 2.82% of the total FDI inflows for these years. It is obvious that the changing of the industrial structure and the slowdown of the Bulgarian economy make this sector unattractive for foreign investors. Nevertheless it is also surprising that the investments in the tourism which was declared priority for the economic structure of Bulgaria also attracted at least 2.3% FDI of the total for the mentioned period.

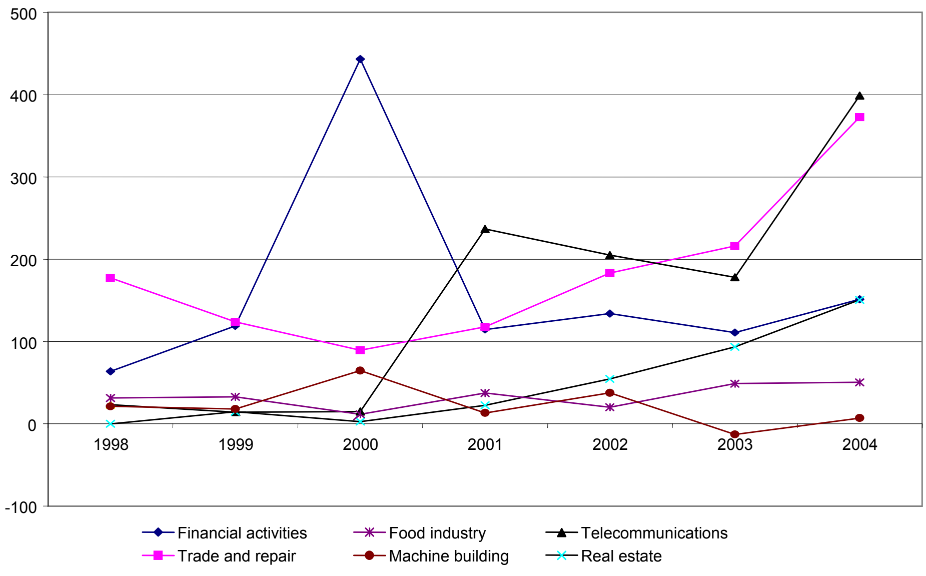


Fig. 3. FDI in some economic sectors in Bulgaria (In USD mlns)

In 2002 the Bulgarian government identified appreciatively 6 sectors, which have been considered as such sectors with comparative advantages, which are in a position to attract foreign investments or delocalization of foreign companies. Some of the traditional sectors are preserved, such as production of leather products, of new technologies in the field of information and communications, tourism as well as rural, energy and biological agriculture. A large part of FDI went into trade and services. Foreign retail networks are expanding rapidly riding the tide of some increase in the purchasing power. The high level of trade with the EU-25 (approximatively 50% of the total export) promote the coming out of foreign capitals from the EU despite the remaining difficulties of access of Bulgarian-made products to the EU markets.

For *Romania,* the FDI stock for the period 1991-2003 reached USD 10.433 billion. The EU countries have accounted for over 60% of the FDI stock. The most important investors in Romania are from the Netherlands, France, Germany, USA, Italy, Dutch Antilles, Austria, Cyprus, Turkey, UK. This 10 top investors accounted for 73.11% of the total stock of FDI. Manufacturing has a prominent role among the economic activities favored by foreign investors with almost half (54%) of the invested foreign capital. Romania can also be considered as the only SEEC with an important export-oriented foreign manufacturing sector. The manufacturing industry concentrates in the capital-intensive steel and chemicals as well as in the labor-intensive clothing and leather industries. In the services has been invested 16%, in the trade 17% and in the agriculture only 1%. In 2003, there were 6.594 companies with foreign participation in the subscribed capital. Some manufacturers in the field of car components and electrical machinery have chosen Romania for their location.

The FDI stock in *Croatia* for the period 1993-2003 reached USD 7.7 billion and the EU countries generated about 80% of the investment stock. The top investors in Croatia are Austria, Germany, the USA, The United Kingdom, Luxembourg and Italy. The main FDI are in the telecommunications sector (26.1%). In 2003 due to privatization sales, the banking sector was the main beneficiary of capital inflows. Privatization has been done also in Oil Company. The growing economy and the local market attracted investments in the consumer goods and real estate sectors. The Croatian industrial sector has the characteristics of a less developed country than the level of economic development. There are important FDI inflows in the manufacturing industry, namely chemicals, metals, food. The industries are generally domestic-market-oriented and the export orientation is increasing in the last years especially to the neighboring countries. FDI have been received also in the financial intermediation, transport and telecommunications.

FDI inflow to *Albania* was low until 2000, when it reached USD 143 million – about 3 times higher than in 1999. The stagnation of FDI during 1999-2003 is due to the fact that the privatization of most state-owned small- and medium-sized enterprises (SMEs) has been completed, while more of the largest enterprises still remain to be privatized. This progress was mainly a result from the privatization of Albanian Mobile Communication and the Albanian Cooper industry. FDI in Albania comes mainly from neighboring countries – Italy and Greece, Macedonia and Turkey. The main FDI are in trade (67%).

The FDI stock of *Bosnia and Herzegovina* for the period 1994-2003 is of EUR 1074.8 million. In 2002 the FDI more than doubled. The main factors that influenced the high level of FDI in 2002 were improvements of the business climate, speeded up privatization process and enhanced presence of foreign banks – currently about 65% of the banking capital in Bosnia and Herzegovina is controlled by foreigners. The most important FDI stock is in the manufacturing sector. Privatization is underway and Austrian and Slovenian companies have bought the strategic companies.

The FDI stock in the *FYROM* reached nearly USD 912 million by the end of 2002. 2001 marked the biggest amount of FDI inflow, as a result from the sale of the Macedonian Telecom for USD 310 mlns to Matav, Hungary. The most significant FDI inflow came from the privatization process as well as the post-privatization transactions through the Macedonian Stock Exchange. Apart from the larger investment that came through the privatization in telecommunications, the biggest part of FDI inflows have been attracted by the sectors of manufacturing, ferrous metallurgy, cement production, crude oil processing, as well as banking and insurance.

The interest of foreign business towards investment in the economy of *Serbia and Montenegro* increased significantly in 2003[6] compared to previous years (almost USD 1.35 millions (FDI net in the balance of payments), reflecting namely the progress in the privatization deals, despite the continuing volatility in the political frame. The EU countries invested EUR 41 million or about 25% of the FDI inflows in 2001.The FDI inflows may be pursued by events in the privatization policy. Firms have been sold at auctions and tenders. The orientation towards the development of a market economy and the adaptation of laws stimulating the development of international economic relations has led to a general improvement of the investment climate. Cash investments have grown about 6 times. For Serbia and Montenegro, but to some extent also for Macedonia, a main political hindrance to larger and quality FDI inflows remains the unresolved problem with Kosovo. The potential of further conflict discourages investors as they can choose from a long list of countries eager to be host countries.

Factors behind the Rise in FDI Inflows in SEECs

In deciding to invest in the Southeastern region the foreign investors have been motivated by some well-known determinants leading the transnational corporations (TNC) and namely the incentives of a firm to localize on other domestic market or a decrease in the production costs.

This conception has been supported by the FDI literature, which has usually concentrated on either the question of why a company engages in FDI, or what

[6] The total inflows in 2002 were about 300% higher compared to the figure reported in 2001.

factors make a country an attractive FDI location, i.e. why FDI inflows occur in a particular country. One of the important questions, discussed in the FDI literature is what factors make a country an attractive FDI location; the analyses take the willingness of corporations to invest internationally for granted and apply a more macroeconomic perspective. R. Vernon (1966) points to specific characteristics of a country that can pull production facilities to a specific location during a particular phase in the life cycle of a product. R. Z. Aliber (1970) emphasizes differences in economic stability as an important factor in attracting FDI. A. M. Rugman (1979) reasons that some locations are particularly useful for firms in meeting their need to diversify business risks. J. H. Dunning's so-called OLI paradigm states that FDI is undertaken if ownership specific advantages ("O") like propriety technology exist together with location-specific advantages ("L") in host countries, e.g. low factor costs, and potential benefited from internalization[7] ("I") of the production process abroad.

There are some factors influencing the TNCs incentives to localize on foreign markers. There are several "push"[8] and "pull" factors that motivate companies to invest abroad. Companies from developed countries are searching for higher returns and lower risks through portfolio diversification. Faced with increased competition and limited market-growth opportunities in domestic markets, these are investing in market-seeking activities in other countries. Other "push" factors are the need to improve export competitiveness and to defend the exports markets after increased competition, which is extremely important to sustain economic growth and reduce unemployment. It is the well known from some recent researches that TNCs dominate global FDI flows and are also the main source of innovation, and innovation is often the main competitive factor that allows them to become the main instrument of international technology transfer. Their role is naturally larger in high-technology activities where they posses the strongest advantages.

It is location advantages that form the core of much of the discussion on the determinants of FDI especially in developing countries. Dunning's (1973, 1981) analysis set in train a number of econometric studies designed to identify the main determinants of FDI.[9] The main conclusions of these studies can be briefly summarized as follows:

- Host countries with sizeable domestic markets, measured by GDP per capita, measured by growth rates of GDP attract relatively large volumes of FDI;

---

[7] Internalization is synonymous with the ability of firms to exercise control over operations essential for the exploitation of ownership and location advantages.

[8] The reasons for the increase in SEECs inflows include "push" factors such as economic slowdown and lowering of interest rates in capital exporting developed countries. Other reasons for the rise in inflows are "pull" factors in developing such as high growth rates, capital account opening, liberalization of the domestic economy and other policy reforms.

[9] Here are the works of Agarwal and Salisu (1991); Root and Ahmed (1979); Balasubramanyam and Salisu (1991).

• Resource endowments of host countries, including natural resources and human resources are a factor of importance in the investment decision processes of TNCs.

• Infrastructure facilities (including transportation and communication networks.

• Macroeconomic stability supported by stable exchange rates and low rates of inflation, is a significant factor in the FDI decisions of TNCs.

• A stable and transparent policy framework towards FDI is attractive to potential investors.

• Export-oriented industries attract relatively large volumes of FDI.

• Fiscal and monetary incentives in the form of tax concessions do play a role in attracting FDI, but these are of little significance in the absence of a stable economic environment.

There is a strong indication that sustained efforts to promote political and macroeconomic stability and the implementation of the essential structural reforms have been the key elements contributing to some success that SEE countries have achieved in attracting FDI.

First: The macro-economic indicators in the SEE region remain stable and the Table shows that the region has achieved price and financial stability. There is a positive trend in economic growth in the region after 2000. The economic growth is one of the important criteria for ameliorating the living standards and one of the main determinants attracting foreign investors.

The increase in the GDP is a continuous trend for the SEECs countries: *Albania* has witnessed growth in recent years, although the country remains saddled with serious structural shortcomings, particularly in the area of governance and rule of law. Since the end of the war of 1992-95, *Bosnia and Herzegovina* has received considerable, if declining, international reconstruction assistance and it permits to maintain positive real growth. *Bulgaria,* following a deep financial and economic crisis in 1996-97, has overall favorable macroeconomic development. GDP has on average expanded by 4 to 5% annually, the inflation is moderate and the unemployment dropped with almost 7%. The same is for the *Croatian* economy, which has registered a steady growth. Inflation has almost without exception been in the low single digits for a decade now. But Croatia suffered from twin deficits – budget and current account. The *Macedonian* economy has so far witnessed a rather hesitant recovery in the wake of the economic destabilization triggered by the ethnic and security crisis in 2001. Macroeconomic policies have been prudent in recent years. The budget deficit has been considerably reduced and a generally tight monetary stance has kept inflation under control. After a protracted period of sluggish reforms and stagnation, followed by an economic and financial crisis (1997-99), *Romania* has experienced some robust growth since 2001. However, the country is so far saddled with its twin deficit problem. The exports became a driving force of the economic growth in Romania (increase by 20% in 2004 against 6% for 2003), in Bulgaria (7.2%), Serbia (17.7%).

Table 1

Key macroeconomic indicators in some SEECs

	2001	2002	2003	2004
GDP growth (real,%)				
Albania	6.5	4.7	6	6.3
Bosnia&Herzegovina	4.4	5.5	3.5	4.6
Bulgaria	4.1	4.9	4.3	5.2
Croatia	4.4	5.2	4.3	3.6
Macedoina	-4.5	0.9	3.1	3.6
Romania	5.7	5	4.9	5.8
Serbia	5.8	4.1	2.8	4.2
Inflation CPI end-year, %				
Albania	3.5	2.1	3.3	3.3
Bosnia&Herzegovina	3.2	0.3	0.1	0.9
Bulgaria	4.8	3.8	5.6	4.7
Croatia	2.6	2.3	1.8	2.8
Macedoina	3.7	1.1	2.6	3.1
Romania	30.3	17.8	14.1	10.5
Serbia	40.7	14.8	7.8	8.5
Unemployment rate average, % of labor force				
Albania	16.4	15.8	15.2	14.5
Bosnia&Herzegovina	40.3	40.9	42	
Bulgaria	19.7	17.8	13.7	13.1
Croatia	15.9	14.8	14.3	14
Macedoina	30.5	31.9	36.7	36
Romania	6.6	8.4	7	8
Serbia	12.9	13.8	14	15.5
Gross foreign debt end of year, % of GDP				
Albania	28	24.2	23	21.5
Bosnia&Herzegovina	49.8	41.3	34.7	33
Bulgaria	79.4	65.1	59.1	56.4
Croatia	57.9	60.9	73.3	76.5
Macedoina	39.8	40.2	36.1	36.5
Romania	31.2	30.8	30.9	33.5
Serbia	104	78.2	71	67

Government budget balance, % of GDP				
Albania	-8.2	-6.7	-4.7	-6.2
Bosnia&Herzegovina	-10.4	-7.3	-3	-3.4
Bulgaria	-0.9	-0.6	-0.3	0.5
Croatia	-6.8	-5	-6.3	-4.5
Macedoina	-7.2	-5.7	-1.6	-2
Romania	-3.3	-2.5	-2.2	-1.8
Serbia	-1.2	-4.6	-4	-3.7
Trade balance, % of GDP				
Albania	-24.2	-23.8	-21.9	-21.5
Bosnia&Herzegovina	-32.8	-36.8	-34.5	-30.3
Bulgaria	-11.7	-10.3	-12.5	-13.5
Croatia	-20.9	-24.3	-27	-26
Macdoina	-15.6	-23.7	-19.9	-19.6
Romania	-7.4	-5.7	-7.9	-7.9
Serbia	-26.6	-27.4	-25.5	-24
Current account balance, % of GDP				
Albania	-6.2	-9	-7.6	-7.8
Bosnia&Herzegovina	-23.3	-23.8	-21.3	
Bulgaria	-7.3	-5.6	-8.5	-8.6
Croatia	-3.7	-8.5	-6.6	-5.7
Macedoina	-8.2	-11.3	-8.3	-8.9
Romania	-5.5	-3.3	-5.8	-5.5
Serbia	-11.6	-15.6	-12.7	-11.4

* Data for 2003.

Source: Bank of Albania; INSTAT; Central Bank of Bosnia and Herzegovina; Bulgarian National Bank; National Statistical Institute; National Bank of Romania; Bank of Serbia; IMF.

Second, the appreciation of the nominal effective exchange rate of the national currency to the euro supports the macroeconomic stability as well and a moderate inflation (most of the SEECs apply a fixed exchange rate regime to the euro).

The Third factor is some increase in the labor productivity in the industry, which in some cases is higher that the increases in the salaries in most of the SEECs economies. The increase in incomes and the bank credit expansion in some countries like Bulgaria push ahead the consumption. For example in Bulgaria in 2003 some boost of the inflation was registered due to the growing up of the consumption, sustained by the increase in the real wages and the bank credit expansion.

The Forth important factor is the extension of the privatization processes. In *Albania* have been offered for sale companies in the telecommunications and the energy sector s– Albtelecom s.a. About 51-76% of the company will be sold through international tender; also preparations are underway in Albanian Energy Corporation (KESH s.a.) for the privatization of the electricity transmission sector). Privatization procedure will be opened in the field of hydrocarbons industry, the water supply and transportation, the insurance.

In *Bosnia and Herzegovina* the total income from privatization for the period 1999-2003 amounts to approximately EUR 4.5 billion. For 2003 the income from privatization through legal tenders reached EUR 24.6 million, in addition to EUR 9.9 million in cash. In the period 1999-2003 the privatizations deals have been completed for 960 enterprises, or 66.20%. Large companies in the steel, the aluminum and food industries have been sold to foreign investors.

The privatization process in *Bulgaria* is far ahead in comparison with the West Balkan countries, but only recently 65% of the shares in the Bulgarian Telecommunications Company (BTC) have been sold. CEZ. A.S. ratified a EUR 281.5 million privatization contract for 67% of the shares in West Bulgaria electricity transmission companies. 67 % of North-East Bulgaria electricity transmission companies were sold to E.ON Energies for EUR 140.7 million in 2004. The financial effect of the deals signed in 2004, amounted to USD 1012 million, including; USD 414 million in payments agreed on deals, USD 89 million due commitments and USD 509 million in investment commitments. The food processor Sofia “MeIAD” was bought by an investor from Cyprus; the trading company “Interpred STC”, Sofia was purchased by a Luxembourg-based investor, OTP from Hungary bought DSK Bank, the state savings bank of Bulgaria. This was the largest single deal in the financial sector and this sector received more than 1/3 of the 2003 FDI inflows. The result was that about 85% of the banking assets are now controlled by foreign owners.

As the table shows in the past 5 years, greenfields have considerably outnumbered privatization investments. (Greenfields increased from USD 180.0 million in 1996 to USD 464.1 million in 2002 and privatization deals from USD 76.4 million to USD 135.6 million for the same period).

Table 2

Type of investment, USD mlns

	1999	2000	2001	2002	2003*	01-06 2004
Privatization	226.7	366	19.2	135.6	370.1	297.5
Non-privatizations**	592.1	635.5	793.7	769.1	1049.3	901.1
Total	818.8	1001.5	812.9	904.7	1419.4	1198.6

* Preliminary data.

** Non-privatization – greenfield investments, additional investments, reinvestments, credits by direct investors.

Source. Invest Bulgaria Agency.

The *Croatian Privatization Fund (CPF)* is responsible for the management of shares in all state-owned enterprises and the technical implementation of privatization. Two methods of privatization are applied: public tender and public auction. The CPF's portfolio is comprised of shares and stakes in a total of 1112 companies. The equity base of these companies is HRK 177.6 billion, while the equity of the State's portfolio amounts to HRK 21.8 billion (12.3%).

Privatization in *Macedonia* is almost complete with more than 95% of the state-owned companies sold. According to the Government Strategy, state-owned assets, which have not been sold after December 31, 2004 will be transferred to the Pension Fund. The companies' assets (buildings, machines and other equipment) owned by the Macedonian Privatization Agency (MPA) will be transferred to a public company for real estate management and MPA is already closed (March 31, 2005). The share of foreign capital in the total banking sector equals 47.2 %, invested in 15 banks, 8 of which are owned by foreign shareholders.

In *Romania* over the period 1993-2003, 9.784 share sale-purchase contracts were signed for ROL 53.066.1 billion, of which 52.2 % have accounted to foreign investors. The main part of the sold share capital amounting to about 60 % has been realized between 2001-2003. Three of the largest manufacturing companies sold in 2003, namely ARO Campulung (all-terrain vehicles) to Cross Lander (USA), Roman (trucks producer) to the Malaysian Pesaka Astana, and Tractorul Brasov (tractors and agricultural equipment) to Landini (Italy). At the end of 2003, the portfolio of the Authority for Privatization and Management of State Ownership (AVAS) comprised 122 state-owned companies, subject to privatization in the next couple of years.

Privatization transactions in *Serbia* are governed by the Privatization Law (of June 29, 2001) and a number of ordinances. A maximum of 70% of the socially and/or state-owned capital of a company can be sold in the privatization procedure. One of the important features of the Serbian privatization is the restructuring of the large companies like a necessary step preceding their privatization. Until mid-2003, 20 companies were sold by the method of public tenders and 603 were put to public actions. Share capital in 103 companies has been sold. The Government of Serbia intends to complete the privatization process by 2005, which is not a very convincing period to finish all the work in this field.

The fifth factor with a positive impact on the behavior of foreign investors is the accepting of the legal framework with the purpose of the creation of suitable conditions for the attraction of FDI. All the countries set up the necessary legal instructions with the purpose to aid and facilitate the localization of foreign companies on domestic markets. In *Albania* there are 3 main Government institutions in the field of foreign investments – Albanian Foreign Investment Promotion Agency (ANIH), Albanian Export Promotion Agency, Albanian Small and Medium Enterprise Promotion Agency. The activity of ANIH is mainly oriented towards the promotion of Albania's comparative advantages, the presentation of sectors with high investment potential, the establishment of relations with foreign investors and to present Albania like a growing emerging market.

In *Bosnia and Herzegovina* the Foreign Investment Promotion Agency of Bosnia and Herzegovina (FIPA) was set up in July 1999 with the purpose of provide a wide range of services to foreign investors, to generate new investments, to create a favorable environment to retain existing foreign investments, etc. In *Bulgaria*, the main body responsible for the investment policy of Bulgaria is the Ministry of Economy. In August 2004 Bulgarian Foreign Investment Agency (BFIA) was transformed into Invest Bulgaria Agency (IBA) with the Ministry of Economy in line with the new Law on Encouragement of Investments. The Agency assists both foreign and domestic investors, providing special information about investment marketing, administrative services, advices on investment opportunities, identification of suitable investment sites and potential Bulgarian suppliers and partners. In *Croatia* the Investment Facilitation Division with the Ministry of Economy is the government institution in charge of promoting the investment business environment of Croatia. In *Macedonia* the Agency for Foreign Investment of the Republic of Macedonia was just established at the end of 2004. In *Romania,* The Romanian Agency for Foreign Investment (ARIS) is responsible for the implementation of the Government policy aimed to attract FDI, to promote Romanian business and investment opportunities, to develop investment projects and to retain foreign investors in the country, facilitating their activities. In *Serbia and Montenegro* the Serbian Investment and Export Promotion Agency (SIEPA) promote the good locations for investments, analyze Serbian business environment, and assist investors in locating attractive greenfield investments.

The *sixth* factor is linked with the credibility of the economic and financial policies. All the countries of the Region of the Western Balkans have made progress despite the unpromising background and meager starting points. Bulgaria and Romania have ameliorated their credit ratings delivered by Standard&Poors. The credit rating on Bulgaria's international debt was increased from BB+ to BBB with stable outlooks for investments and increased the price of the global bonds on the external debt. This puts Bulgaria in strong positions in the pre-accession period. Since the upheavals in 1997, Albania has consolidated law and order, has reformed the economic and social life. It has improved relations with international institutions. Since the Dayton peace accords Bosnia&Herzegovina, has had the challenge to transform into a self-sustainable state. But it continues to depend on international aid and the elaboration of the legislative framework for the needed economic reforms.

The seventh factor which is significant only for Romania and Bulgaria is the nearest perspective those countries to become EU members in 2007. Croatia has a free trade agreement with the EU, and Serbia has already received some signals of a pending start of negotiations with the EU. Croatia has taken decisive steps towards implementing the necessary European practices. Macedonia and Serbia and Montenegro have been heading towards profound economic reforms, but progress has been slower than anticipated.

According to a study conducted by the OECD and EBRD in 2000 of the behavior of foreign enterprises in the SEECs, the reasons for foreign companies to expand in the region are not far to seek. They prefer to invest in this region for the following reasons: *First,* the foreign investors have been attracted with the purpose to settle and to be present on another market, which they consider to be a perspective for marketing of their production or for further investments. Dunnig is qualifying them like market-hunters. The estimation is that around 69 % of the foreign firms are searching such opportunities in the SEECs. The investors are coming from the neighboring countries like Greece for example. *Second,* the small firms prefer to buy a business in the domestic country and to benefit from the already known market, than to undertake greenfield investments. There is a little interest for launching new projects for investments in the high technological industries and such investments are only around 4.12 % in the SEECs. Such investments are extremely efficient for the SEECs, but the firms engaged in such deals prefer to localize on markets with developed infrastructure and technological stance, which cannot be said for most of the countries in Southeastern Europe. The efficiency-seeking (so-called by Dunning) firms form the core of the new information-based economy. Other investors are seeking ownership in the financial sector and the data shown above demonstrate clearly that foreign capital is present in most of the banks in the SEECs (approximately 16.18 % of the firms). Most of the firms settle for reasons to benefit from the low labor costs and small salaries in SEECs (approximately 59.14 % of the firms are factor-hunters). Most of the firms are location-hunters (around 48.89 %) and are interested to locate on a definite market, with the purpose to have easy access to other strategic markets.

The estimation of the kind of factors determining the incentives of foreign enterprises to invest in the SEECs markets are namely traditional “push” factors, linked with the overall macroeconomic and financial development of the host-countries. The others, non-traditional factors, aiming at investments in high efficiency industries, cannot be evaluated because of the lack of viable data.

Generally, in Bulgaria and Romania are present firms from the EU because of the proximity of host markets and the opportunities for access to others. Several firms from the EU are resource-seekers, buying enterprises working with materials picked from a nearby mine with ores mineral resources. (For example Solvay, Belgium buying chemical industry in Bulgaria; Union Miniere, (Belgium) – the excavation of copper; Total (France) investing in Romanian oil excavation industry etc.)

The FDI Impact on Host Southeastern European Countries’ Economies

The belief that FDI can be an important factor contributing to growth is well established although the empirical evidence is more nuanced than is generally believed and the evidence for technological spillovers to domestic firms is weak. Undoubtedly, FDI is like other aspects of international integration such as trade openness, in that a country needs to have in place the appropriate domestic institutions in order to fully benefit from it.

Countries in the region that have received more FDI are usually more advanced in the process of restructuring their economies, in the privatization processes, or experienced the last years higher growth. The exception is Romania, which might be in a position to attract much more investments relatively to the size of the country and the industrial basis, but foreign investors have been influenced obviously by other potential risks.

Countries like Bosnia and Herzegovina, Albania continue to be dependent on the inflow of foreign capital from official sources or international financial institutions, covering one third of the deficits of their current accounts. In these countries the inflow of FDI completes the international commercial relations of these countries.[10]

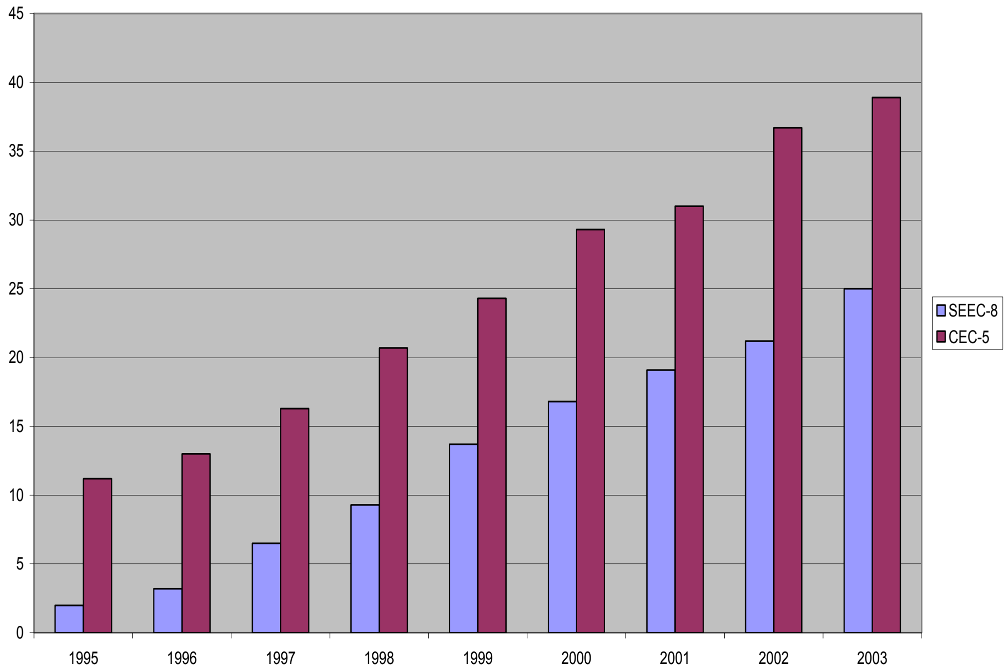


Fig. 4. FDI Stock as a % of the GDP

Source. Economic Survey of Europe, 2005, N 1, WIIW.

[10] *Christie, E*. FDI in Southeast Europe. Working Papers N 24, March 2003.

The importance of FDI has been especially large for countries with very low domestic capital formation like Albania and Bulgaria. Initially, there were wide differences between countries in terms of the share of FDI in fixed capital formation. In the beginning of the 1990s, only small open economies like the Baltic States and Hungary received FDI in the order of 20% of gross fixed capital formation (GFCF). Other countries such as Bulgaria, the Czech Republic, Poland and Slovakia followed suit later.

The estimation of the effect of the invested capital has an importance for the development of some sectors. In Bulgaria, according to data collected by some foreign companies located in the country, the activity of the enterprise changes the rules and the conditions in the economic sector where the firm is located. The appearance of a powerful competitor reduces, on the one hand, the market share of the national enterprise, but on the other, is an incentive to modernize and develop its production or activity. For example, Danon Serdica holds approximately 32 % of the Bulgarian market of dairy products, but the other firms had to increase their competitiveness in order to stay in business.

The question of the importance of foreign investors for SEE countries has in fact two sides and the important thing is for the investors located in this region to be interested in the development of a specific sector, to sustain employment, to make greenfields in relation to the comparative advantages of the countries. The problem is that very few of the foreign investors, investing capitals in SEE countries, are really keen to develop a specific activity stimulating the development of some sector. In Bulgaria with the exception of Unicredito, Solvay, Union Miniere, LUKoil, there are no other strategic investors, who are in a position to increase their capitals and enlarge their location in the country. Here arises the question of the quality of FDIs and their contribution to build up the host country's new capital stock. And this contribution remains insignificant nevertheless the restructuring of some enterprises and industries bought by foreign investors. The problem is that this privatization deals and projects have not changed the structure of an entire sector; neither influenced the emergence of new ones.

This is due also to the fact that in SEECs are present a lot of small production entities. They are located especially in the poorest regions (this is the case also in Bulgaria) and they are working as small-scale sub-contractors of foreign companies. Their presence is mainly motivated by the possibility to exploit lowest production and labor costs. Due to the lack of a method for tracking FDIs, it is difficult to assess their amount, size and production.

The impact of FDI in SEECs is also limited because of the foreign investors' caution concerning investment prospects especially in the countries of the Western Balkans because of the persisting insecurity and political turmoil. SEE continues to be a fast growing but still poor region with limited possibilities to expand. The economic size of the region of the Western Balkans remains small. Its total GDP is estimated to be around EUR 40 billion – again similar to that of Romania. Total exports from the West Balkan countries constitute less than three-quarters of Romania's exports, with over half going to the EU which also supplies over half of the region's imports. Trade is growing steadily, if unevenly, across the region but intra-regional trade remains low, about 7% of the total regional trade.

One of the most troubling indicators remains SEE countries' weak external position, with deficits in the current account and the trade balance expanded constantly. To some extent, the current account deficits are due to the increased demand of the economic entities, which are dependent on the import of energetic resources. The increased demand for imports combined with a relatively small per cent of FDI has been one of the primary reasons for the emergence of deficits in the current accounts. As the Table 2 shows, the ratios Current account deficit/ GDP are negative in all SEECs, which is an unfavorable signal for a possible deterioration of the economic and the financial stability of the country.

The trade balance of Bulgaria for example deteriorated after 1999 because of the growing up of the imports reflecting the efforts for modernization of the industrial equipments. The trade deficit for 2004 reached EUR 2718 mlns or 14% of the GDP (against EUR 2199.6mlns, or 12.5% from the GDP in 2003). After 2003 the deterioration of the trade balance increases, especially due to the stronger euro and the going up oil prices.[11] The correlation analysis shows that the financing of large external imbalances with the recourse to FDI accumulated inflows raises the issue of the sustainability of these inflows. The data shows that the relationship between the current account deficits and the FDI is not very clear because in general a higher degree of volatility is associated with portfolio flows rather than with FDI. This is so, because FDI, once they have been made, cannot be easily reversed in the short run.

Table 3

Correlation between the current account deficit and the annual inflow of FDI, 1996-2003

Albania	0.526284
Bosnia&Herzegovina	-0.96836
Bulgaria	-0.87249
Croatia	0.026403
Macedoina	0.089354
Romania	-0.45708
Serbia&Montenegro	-0.87249

Source. Estimates on data from National statistics. Economic Survey of Europe, 2005, 1.

[11] In fact the part of transactions paid for in euros increase in 2004. The part of the export denominated in euro is 60% and the import - 64%. The deficit in the trade balance exacerbate because of the stronger euro against the dollar. Also oil and gas account for 12.8% of the total imports and oil products constitute 7.8% of Bulgarian export. In 2004 the current account deficit of Bulgaria has been covered by FDI by 103.4%, while in January-June 2003, FDI covered 70.7%.

The SEE countries have a lot of institutional reforms to make. Bulgaria (and Romania) has to complete the reform in the legal sector and win the fight against corruption and organized crime. The countries of the so-called Western Balkans have just made their first steps towards a functioning market economy, and are on their way to make institutional reforms. Trade and investment barriers are a common phenomenon, even between neighboring states. Serbia and Montenegro have restrictions on financial transactions, while Macedonia has restrictions on trade.

*

The inflow of capital in the SEECs is quite different from the trends of FDI received by Central Europe (CEECs-5). In Central Europe the privatization process is almost over and the local market is to a high extent controlled by the settled foreign companies. New investments are oriented mainly into export-oriented projects in the already privatized companies or FDI "rreenfield investments". FDI activity did not expand because of the saturation of the local market and the highly competitive economic environment. In comparison, the FDI inflows in the SEECs have been low because of the high investment risk related to conflicts, the poor public governance, and the lack of transparency, the corruption and other investment risks.

The distribution of FDI by economic activity reflects the modest endowment of SEE countries with natural resources, as well as with an industrial high-technological infrastructure. Most FDI in CEE countries comes from the EU member states. The importance of EU investors depends on the proximity of a particular country with a EU member state, its (small) size, and its EU accession date. The share of EU in total FDI is above 80% for CEE countries. But in most Southeastern European countries, the EU share is 60% or less.

The composition of FDI is also changing. The FDI inflows to Eastern Europe have also been changing in their qualitative characteristics.[12] In Central Europe and Estonia the production of components within multinational supply networks has been an important source of export growth since the mid-1990s. At present, between one third and one half of these countries' exports to the EU comprise components for the automotive, electronic, electrical, office equipment, information technology and others. Another new development is the widening of the linkages between local suppliers and the mother Investment Company, which has increased even more the share of integrated products in their exports. Emerging clusters of supply and demand chains, based mainly in Central Europe, have the potential to become with the EU enlargement the nucleus of future industrial agglomerations with the SEE countries, and they will be included gradually.

[12] *Campos, N. and Y. Kinoshita*. Why Does FDI go where it goes? New evidence from the Transition Economies. - IMF Working Paper N 03/228, Washington D.C., November 2003. The issue of incentives is discussed in *Sass, M.* Competitiveness and Economic Policies Related to FDI. Ministry of Finance, Working Paper N 3, Budapest, September 2003.

References

Anastassopoulos, G., L. Maroudas, Y. Rizopoulos. The Locational Determinants of Direct Investments in the Bulgarian Manufacturing. - In: International and Monetary Aspects of Transition in Southeastern Europe. Petrakos, G., A. Kotios, D. Chionis (eds.). SEED, University of Thessaly Press, 2003.

Andreff, W. The newly emerging TNCs from economies in transition: a comparison with Third World outward FDI. - Transnational Corporations, August 2003, Vol. 12, N 2.

Blomstrom, M., A. Kokko. How Foreign Investment Affects Host Countries. Policy Research Working Paper, 1745, March 1997.

Campos, N., Y. Kinoshita. Why does FDI go where it goes? New evidence from the Transition Economies. IMF Working Paper, WP/03/228, IMF, 2003.

Dunning, J. H. Globalization and the theory of MNE activity. Discussion Papers in International Investment and Management, N 264, 1999.

Lucas, R. E. On the determinants of direct foreign investment: evidence from east and Southeast Asia. - World Development, 21, 3, 1993, p. 391-406.

Nunnenkamp, P., J. Spatz. Determinants of FDI in developing countries: has globalization changed the rules of the game? - Transnational Corporations, August 2002, Vol. 11, N 2.Investment Guide for Southeast Europe. Bulgarian Economic Forum, December 2004.

Resmini, L. The Determinants of Foreign Direct Investment into the CEECs: New Evidence From Sectoral Patterns. Katholieke Univrsiteit Leuven, Licos Centre for Transition Economies, N 83/1999.

Shiells, C. R. FDI and the Investment Climate in CIS Countries. IMF Policy Discussion Paper, PDP/03/5, IMF, 2003.

Slaveski, T. Foreign Direct Investment in the framework of Cross-Border Co-operation in Selected Balkan Countries. - In: International and Monetary Aspects of Transition in Southeastern Europe. Petrakos, G., A. Kotios, D. Chionis (eds.). SEED, University of Thessaly Press, 2003.

Economic and Banking Market Developments and Prospects in Southeastern Europe. UNB, A Member of NBG Group, 2004.

World Investment Directory, Vol. VIII, Central and Eastern Europe, 2003. UN, New York, 2003.

United Nations Conference on Trade and Development (UNCTAD). World Investment Report, 1996, p. 97.

20.VI.2005