The impact of EU Accession Process on the Western Balkans FDI inflows

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Abstract
The successful FDI performance of CEE(Central and East Europe) countries during their preparation for the EU accession in the last years shows that economic integration can have an important impact on the FDI(Foreign Direct Investments) inflows.
The Western Balkans process of integration has two important aspects: on one side the intra-regional economic cooperation within this region after the long period of disintegration before the nineties and a lot of ethnic conflicts after the nineties will improve the economic relations and create a common market in this region, on the other side all the countries of this region aspire to access to the EU.
This paper analyses whether these economic integration processes, which progress at the same time could bring a positive impact on the FDI into the Western Balkans.

Keywords: Western Balkans, FDI, EU integration.

Introduction

The enlargement* of the EU (European Union) from 15 to 25 states, on 1 May 2004, has been a great success, pointing to the enormous transformative power of the prospect of European integration. Now that the Central and East European Countries (CEEC-s)and two Balkan countries (Bulgaria and Romania) have been accepted as new member states, only five South East European countries remain outside the Union. These non-EU countries fall into two categories: Croatia, which has candidate status; and Albania, Bosnia and Herzegovina, Serbia and Montenegro, and FYROM (Former Yugoslavia Republic of Macedonia), (the 'Balkan four') which are considered 'potential candidates'. The first group of countries is progressing quickly towards accession:

Croatia has a good chance of catching up in 2009 or 2010, now that it seems to be cooperating fully with the International Criminal Tribunal for the Former Yugoslavia. Experience shows that the prospect of EU membership increases foreign investments because risks and transaction costs are reduced. There is a direct correlation between European integration prospects and foreign direct investment (FDI) inflows.

The experience of the six countries that joined the EU between 1973 and 1986, and also that of the CEEC-s, shows that candidate countries for EU accession are able to attract more FDI inflows than non-candidate countries. The prospect of membership and the process of preparing for accession in themselves attract more outward and inward investments because foreign investors anticipate completion of reforms once clear political prospects effectively guarantee their implementation (Bevan, Estrin and Grabbe, 2001). The CEEC-s attracted the largest amount of FDI inflows from 1998 to 2002, when a clear prospect for accession to EU had been defined; Also, Bulgaria and Romania started increasing their share of FDI when the accession process started in spring 1998. On the other hand, more investment allows improved economic performance stimulating in this way, further FDI inflows. This implies that clear EU accession prospects, is the most important factor in continuing the reform process and thus attracting FDI. Accession countries are more attractive as a production location because they guarantee access to the European market and protect investors against sudden changes in trade policy and arbitrariness in market policies (Marie-Janine Calic, 2005).

The prospect of accession has also contributed strongly to improving good-neighborhood relations and regional cooperation in South East Europe (Anastasakis and Bojicic-Dzelilovic, 2002).

The relation between transition and FDI

It’s a fact that, FDI inflows are higher in those countries which have been successful in implementing market economic reforms: The CEE countries have been able to attract more FDI than the SEE (South East Europe) countries. The interaction of FDI and the progress of transformation is not only limited to the impact of the latter on the former; both processes are strongly inter-related. On the one hand, market economic reforms and a satisfying macroeconomic performance guarantee a solid basis for profitable investment and – as a result – raise the attractiveness for foreign investors. On the other hand, the increased FDI inflows can speed up the transformation process tremendously and decisively. This is shown by the example of the development of FDI inflows in the CEE countries (Zakharov and Kusic, 2003).

Before nineties, FDI into socialist countries were limited to joint ventures with state owned enterprises. After this period, foreign capital began to flow into the CEE and SEE countries. During the initial phase of transition, public inflows dominated the entire flow of capital. However, after the market economic reforms were able to show an improvement, the public flows declined. Since 1992, private flows of capital started to surpass the flows of public capital and FDI inflows into the CEE countries increased rapidly. Until 1998, there was a flow of 74.4 billion USD of FDI into all Eastern European transition countries, a share of 67 % went to the CEEC (50.5 billion USD) (Zakharov and Kusic, 2001).

The experience of after- nineties shows that FDI flows into the CEE region were concentrated on a few countries. At the first phase of the transition process, a considerable part of the foreign capital entered through the privatization of the state-owned enterprises in these countries. So the countries that decided immediately to sale their state possessions to foreign investors profited the largest part of FDI inflows, i.e. especially Hungary, but also Poland which choose the direct

sale as the privatization strategy at an early stage. More than half of the entire FDI designated to the whole region went into these two countries. Even though the Czech Republic faced some difficulties during the first half of the nineties linked to the voucher privatisation, it became the third largest recipient of foreign capital flows in the region. The proportion of the CEE-3 countries (Hungary, Czech Republic and Poland) during the first decade of transition rose to as high as 78 % (Kaminski,2001).
In Poland, there were two important factors which contributed to the successful FDI performance: the privatisation strategy and the size of the local markets . The low cost of labour, and also the geographic closeness to the EU core countries has caused a high level of FDI inflows into the CEE region. Hungary and the Czech Republic, by focusing on EU markets, have attracted a large amount of the export oriented FDI appearing mostly in the form of Greenfield Investments.

Importance of FDI flows for the Transition Economies

Foreign investments facilitate the necessary economic modernization and the transfer of technology and know-how. Another positive effect in the domestic economy is that many domestic enterprises can profit from the foreign investments, i.e. sub-contractors and -suppliers. Furthermore, international production creates additional employment in the recipient countries. Foreign capital does not only supply modern technologies but also advanced management techniques. Positive effects especially come out through businesses that continuously train their employees in order to improve the expertise of human capital. Also FDI bring to the recipient country new technology and investment goods. This will improve the competitiveness of goods and services produced in the recipient country, leading to increased sales on the international markets.

Positive spillover effects for domestic companies and branches can be expected from the foreign investments when domestic firms profit from foreign investors’ knowledge in the fields of marketing and technology. An example of these positive spillover effects is the case of the car industry in Eastern Europe. The cooperation of Volkswagen AG and Skoda provides hundreds of subcontractors with modern technology and a better technical standard. 70% of the components for the Skoda production come from Czech contractors. Suzuki and General Electric have decided to modernize sub-contractor firms in the Czech Republic.(Protsenko,1999) FDI can also have a positive impact on the economic growth. For example, a study of the polish economy shows that that FDI have been responsible for 39 % of the growth rate in Poland during the period of 1991 to 1995(Kusic,1997).

FDI facilitate access to new markets and contribute to increased export incomes in the recipient countries because new technologies and advanced management methods introduced by foreign investors can help to raise the competitiveness of the transition economies products. At present, many Hungarian firms produce exclusively for the export to the EU. For example, the Czech car producer Skoda, which belongs to the German Group of VW since the beginning of the nineties, exports the largest amount of its products to developed industrial countries. FDI are an important source for financing performance balance deficits and thereby improve credit liability in the recipient countries which in turn facilitates access to other financial sources. The positive correlation of the EBRD (European Banc for Reconstruction and Development) indicators with the FDI inflows could be – as we have already mentioned above – interpreted as follows: the countries that experienced high FDI inflows in the earlier phase of transition are more advanced in the implementation of reforms leading to a market-based economy than countries with lower FDI inflows. The advanced reformist countries comply faster with the two economic criteria for the EU accession and can start the integration process earlier (Zakharov and Kusic,2003). This fact explains the role of foreign capital in the EU integration process: FDI can strongly contribute to the improvement of the economic conditions for EU membership. An example of this is the South expansion of the EU: at the end of the 1970s and the beginning of the 1980s, foreign capital played an important role in the modernization of the Spanish economy, what facilitated the preparation for the EU membership. The announcement of a membership perspective could contribute to the increase of FDI inflows into the regions to be integrated.

FDI Flows and Economic Integration

Economic integration generates many effects that influence FDI flows. Analysis of the economic impacts of the EU integration show that this integration process has brought to a medium- and long-term increase of growth rates in the participating economies. These increased growth rates make the region as a whole more attractive for foreign investors. Inter- and intra-regional FDI is an important catalyst for dynamic integration effects. Higher FDI inflows increase competition which in turn motivates local producers to apply efficiency enhancing strategies.

Earlier theoretical and empirical literature on FDI tends to view cross-border trade and capital movements as two possibilities to serve foreign markets which exclude each other. This point of view is based on the existence of tariff barriers in trade causing import substitutive investments. Therefore, an abolishment of tariff limitations is to reduce FDI flows and stimulate repatriation of foreign owned assets. There is a similar relationship between FDI and non-tariff barriers: the weakening or even the abolishment of non-tariff barriers stimulates export but reduces FDI inflows (Zakharov and Kusic, 2003). An increase of FDI inflows will not be equal in all the countries of the integrated region: countries which offer more favorable location advantages will gain higher profits from this development than the others. Such an "investment creation" is a reaction to trade diversion caused by the Regional Integration Agreements (Di Mauro,2000). The economic considerations are the driving forces behind the Regional Integration Agreements(RIA).It is, possible that a RIA reduces investment flows outside the integrated regions. When the FDI structure of integration consists of horizontally organized affiliates in several countries of a region, such a structure is likely to be suboptimal after the RIA has been introduced.

The point of view that avoiding trade barriers is the main factor for attracting FDI becomes more and more questionable. Recent theoretical FDI and MNC (Multinational Corporations) literature claims another factor as responsible for attracting direct investments which is the exploitation of the firm specific intangible assets. To enter new markets in which local firms have better knowledge concerning markets, consumer preferences, and business policies, an international company needs to own some specific intangible assets if it wants to compete successfully. The analysis of the effects of an RIA on FDI flows shows that the establishment of an RIA tends to attract more investments than the several national markets. The predominant static effect is the internalization by use of the firm specific intangible assets. The most important dynamic effect is the increased attractiveness of an integrated region for investors, hence leading to additional intra- and inter-regional FDI flows (Zakharov and Kusic, 2003).

Macroeconomic Performance in the CEE and SEE

As we all know, the Western Balkans is part of the South East Europe. These countries are often called the SEE-5(Albania, Serbia-Montenegro, Bosnia-Herzegovina, Croatia, FYROM). As far as the statistics show a large difference between the total of FDI in the CEEC compared to the FDI in the SEE countries now we are going to make a short comparison of the macroeconomic performance of CEE and SEE countries.

During the last two decades, former planned economies in the Central East Europe (CEE)and the South East Europe (SEE) have embraced, the transition process towards market economy. Cheap production opportunities have led a number of multinational enterprises to move into the emerging markets driving FDI flows to unprecedented level. Such a development had had a huge impact on the domestic economies contributing significantly to the long process of transition (Protensko,2003).

Despite the fact that both the CEE and SEE countries set off from the same starting point there appears to be a rather different picture shaping up as to the economic trajectories that those regions are on. The SEE countries do share some common features whereas CEE countries are characterised by a more diverse denominators (Hunya, 2000).

The current economic environment in the SEE region is exposed to a number of political risks and instability which have that have prolonged their process towards market economy. In spite of this, during the last years the overall image of the region appears to be improved, making steps towards their objective, i.e. creating the appropriate economic conditions for future EU membership (Uvalic, 2003). Economic indicators show different economic performance for the two regions. The CEE countries have achieved a higher level of development than the SEE mainly due to efficacy of the reforms adopted by the CEE countries as well as the political stability that the region has enjoyed over the last decades. More specifically, GDP in the SEE is less than one third of the GDP in the CEE (Alexiou and Toro, 2006). The GDP per capita of the SEEC in 2002 was about two to three times lower than that in the CEEC.GDP growth in the CEEC has been rather robust. In the SEE, on the other hand, some economies started exhibiting signs of recovery only after the war in Kosovo was over. But even then, the overall picture did not change dramatically mainly due to the negative effects that the deep recession had had on the output. High inflation rates in countries such as FRY (Former Republic of Yugoslavia), Bosnia and Herzegovina add to the macroeconomic instability that characterises the entire region.On the employment front, in the SEE the picture is rather alarming. The social costs that the process of transition entails have not been matched by adequate job creation. Thereby, unemployment in countries such as FYROM, Bosnia and Herzegovina or Yugoslavia has reached unprecedented levels, adding to the already existing problem of social exclusion and poverty.

Despite the above macroeconomic performance that the entire SEE region has experienced, reports coming from economic institutions such as the European Bank for Reconstruction and Development (EBRD), are optimistic. According to EBRD, key areas such as enterprises, infrastructure, financial institutions, have improved considerably, and therefore there are no large differences between the CEE and SEE (Zakharov and Kusic, 2003).Nevertheless SEE countries face still a number of economic, political and social problems, the overall forecasts for the future of the SEE region are nowadays much brighter than some years before. The improvement of conditions for achieving more constant stabilisation and sustainable growth will make easier the integration of the SEE region into the EU (EBRD, 2004).

The Impact of EU Integration on FDI Flows

The impact of EU integration on FDI flows has been researched in many empirical studies. After the creation of the EU, a notable increase of intra- and inter-regional FDI flows was observed among the member countries. A successful story of EU integration is the accession of Spain to the EU in 1986. The way of this country, from a backward, closed economy to one of the furthest developed market economies in Europe, is often called the “Spanish Economic Miracle”. The high FDI inflows resulting from the EU integration process have been responsible for the strong economic performance of the country. FDI inflows were especially intensive between 1988 and 1992, when they reached an average of 2 % of the BIP.(Barrios et al, 2002). Also Ireland experienced a real FDI boom after its EU accession in the year 1973. Many US multinationals chose Ireland as their starting point to expand in Europe. After Austria, Finland and Sweden had joined the EU in 1995, they became more attractive to foreign investors and are still the main destination for FDI in the EU (Galego et al, 2002). The EU integration process positively affected also the FDI flows into CEE candidate countries during last years. FDI inflows into these countries increased considerably since 1994, after the public commitment of the EU to eastern enlargement made by member-states at the Essen European Council (1994). Bevan and Estrin (2000) studied the impact of these issues on FDI flows into the CEEC-s and found out that the Essen Council announcement was associated with a significant increase of FDI flows to the possible candidates for EU accession. The decision of the EU to open the negotiations with five CEE applicants (1997) led to an increase in the growth rate of FDI to the most successful applicant countries (Bevan et al, 2001).

Kaminski (2001) underlines that the “EU factor” explains the high level of FDI inflows into CEEC-s compared with FDI received by the former Soviet republics. But the EU integration factor played a significant role only in countries that early started the radical economic reforms.

The prospects of the Western Balkans for The EU Integration

The Western Balkans process of integration has two important aspects: on one side the intra-regional economic cooperation within this region after the long period of disintegration before the nineties and a lot of ethnic conflicts after the nineties will improve the economic relations and create a common market in this region, on the other side all the countries of this region aspire to access to the EU.

The region does not present itself homogeneously regarding European integration:

Accession negotiations with ***Croatia*** are progressing: following the completion of the screening process in October 2006, sixteen negotiation chapters have been opened and two provisionally closed by February 2008. Croatia's progress sends a signal to the other Western Balkan countries on their own membership prospects, once they fulfill the necessary conditions.

Provided that the government works with resolve to meet benchmarks and other conditions, substantial progress in accession negotiations with Croatia is possible over the coming year. For Croatia to make 2008 a decisive year in its accession process, the country needs to make further progress with judicial and administrative reforms, fighting corruption, minority rights, and refugee return, as well as further restructuring in the shipbuilding sector. Croatia also needs to pay increasing attention to solving open issues with its neighbors. In particular, it needs to address without delay and in line with the Council Conclusions of February 2008, the issue of the Ecological and Fisheries Protection Zone.(Commission of the European communities, 2008)

The ***former Yugoslav Republic of Macedonia*** was granted candidate status in December 2005. While the pace of reforms has, on the whole, been slow during the past two years, there have recently been signs of reforms gaining momentum.

Improved cooperation among political parties and between the Prime Minister and the President has led to increasing consensus on EU-related reforms. These include appointments to the Judicial Council by Parliament and the adoption of laws on the Public Prosecutor's Office, on the Council of Public Prosecutors and on the Composition of the Committee on Inter-ethnic Relations. Progress has also been made in police reform and decentralisation. Ensuring good neighborly relations and finding negotiated and mutually acceptable solutions to unresolved issues with neighbors, in line with the Council conclusions of December 2007, remains essential. The Accession Partnership adopted by the Council on 18 February 2008 identifies eight key priorities for progress in the accession process by the former Yugoslavia Republic of Macedonia. These cover proper implementation of all commitments undertaken under the SAA, dialogue between political parties, implementation of the law on police and anticorruption legislation, reform of the judiciary and public administration, as well as measures in employment policy and for enhancing the business environment. The Former Yugoslav Republic of Macedonia needs to meet these key priorities in order to demonstrate its readiness to undertake accession negotiations. The Commission considers that, with sufficient political will and cross-party cooperation, the necessary progress can be made in 2008. The Commission will assess these key priorities as benchmarks in its autumn regular report. A recommendation on the start of accession negotiations will depend on the results achieved. (Commission of the European communities, 2008)

Major milestones have also been reached in completing the Stabilization and Association Agreements (SAA-s) with the other countries of the region. Agreements were signed with Albania in June 2006 and with Montenegro in October 2007; the trade-related provisions under the corresponding Interim Agreements have already entered into force. The Commission encourages Member States to proceed swiftly with the ratification of these Seas so that they enter into force as soon as possible. The Seas with Serbia and Bosnia and Herzegovina were initialed by the Commission in November and December 2007 respectively. These agreements will be signed as soon as Serbia and Bosnia and Herzegovina meet the necessary conditions. A satisfactory track record, notably in implementing obligations arising from an SAA, including the trade-related provisions, is an essential element for each country's progress towards membership. (Commission of the European communities, 2008)

The actual intra-regional integration in the Western Balkans

The EU has made it clear from the beginning that it views the intra-regional integration of this region as an indispensable component of the European integration process, not least because it is one of the founding principles of the European Union itself. Conditionality includes proven readiness to promote good-neighborhood relations as a precondition of EU membership and thus serves the mutual interests of all participating countries. Through the Stability Pact for South East Europe, created in the aftermath of the Kosovo war in June 1999, participating states have undertaken a number of credible initiatives. (www.stabilitypact.org).For instance, Western Balkan countries have liberalized their trade regimes significantly by concluding a network of bilateral free trade agreements that shall shortly be transformed in a multilateral one. Furthermore, substantial progress has been made in improving the investment climate, creating a common energy market and developing regional infrastructure strategies. The recent level of intra-regional integration can be illustrated by the level of intra-regional trade. The actual intra-regional trade in the Western Balkans is mainly characterized by the revitalization of traditional trade links. In the Western Balkans, a lot of both non-economic and economic factors representing serious barriers to the development of the regional trade still exist. The following aspects mark some of the non economic obstacles of regional integration: ethnic nationalism, political instability, lack of laws, a "fragmented" region with numerous state borders on the small area, visas, bureaucracy, etc. Economic barriers result among others from a low level of economic development, individual markets with low buying power, underdeveloped infrastructure, numerous trade restrictions, and a large share of shadow economy (Zakharov and Kusic, 2003).

FDI Inflows into the Western Balkan Countries

Before starting talking about FDI in the region of Western Balkans we are going to make a short presentation of some characteristics of these countries concerning FDI. According to Ranieri (2007), the countries of this region face some common location key advantages which are:

- Highly competitive overall cost structure (labor, land and utilities cheaper than new EU member countries).
- Labor availability, cost and quality (well educated and experienced workforce, technical expertise).
- Strategic location and proximity (Adriatic access and adjacent to both Western and Central Europe).
- Local availability of raw materials and supply network (wood, metals, agricultural products).
- Improving fiscal and incentive regimes (regulatory, fiscal and tax reforms and investor incentives).

The most interesting sectors for FDI in these countries are:

Croatia
- Tourism
- Information and communication technology (Siemens,Ericsson are already present)
- Pharmaceutics (Pliva, Belupo, GlaxoSmithKline)
- Biotechnology (project for a tech-park in Varaždin)
- Business services (e.g. processing data, call centers, data entry, telemarketing, back office, etc.)

Bosnia Herzegovina
- Textile and shoe industry
- Metals (Birac Zvornik, Aluminium Mostar, Bh Steel Company-Mittal Zenica)
- Automotive (Skoda, Volkswagen) and mechanics
- Wood processing industry and agriculture
- Tourism (mountains-Sarajevo Olympic games)
- Information and communication technology
- Privatization (TLC, public utilities)
- Infrastructure

Serbia
- Automotive (Zastava Kragujevac) and supply chain
- Mechanics
- Specialized manufacture (e.g. jewelry)
- Furniture production
- Privatization
- Other manufactory sectors

Montenegro
- Tourism and infrastructure

- Wine industry
- Privatization (public utilities e.g. Telecom Montenegro- Matav and ProMonte-Telenor)
- Automotive (Daido Kotor)

FYROM

- Textile and shoe industry
- Informatics and telecommunications (software production, etc. USAID wireless Project)
- Business services (data entry, data processing etc.)
- Chemical industry
- Agriculture, food and beverage processing industry
- Tourism

Albania

- Textile and shoe industry
- Agriculture, food and beverage processing industry
- Tourism
- Other manufactory sectors
- Privatization

The Western Balkan countries have received significantly less FDI than the CEEC-s. The political and economic uncertainties in the Balkans undermined the attractiveness for international investors: FDI inflows were generally very low until 2000 with the important exception of Croatia, receiving higher amounts of FDI from 1997 onwards. During the first half of the 90s (1989-1996),the cumulative net inflows into four Western Balkan countries have amounted to only 900 million USD what corresponds to 2.1% of total FDI inflows into 27 transition economies. During the period between 1989 and 2001, SEE-5 has reached a share of only 6.3% (9,170 million. USD) (Uvalic,2003). More than half of the cumulative FDI inflows in the Western Balkans have been destined to Croatia. The table below shows the FDI inflows in the SEE-5 during the last years:

Table 1: FDI flows in millions of Dollars in the Western Balkans (2000-2006)

Countries	2000	2001	2002	2003	2004	2005	2006
Croatia	1085	1407	591	2025	899	2000	1200
Bosnia-Herzegovina	150	130	266	382	490	400	570
Serbia-Montenegro	25	165	562	1405	1031	2020	2000
FYROM	175	441	78	96	156	97	200
Albania	143	204	135	178	322	265	300

Source: EBRD, 2006

The inflow of FDI in the SEE-5 region has been significantly lower than in the CEE countries. Due to political and economic uncertainty in this region FDI inflows were usually very low until 2000. In her article Uvalic(2003), states that:

'During the first half of the 1990s (over the 1989-1996 period), the cumulative net inflows of FDI into six SEE countries (without Bosnia and Herzegovina, for which data are not available), have amounted to only $2.8 billion-corresponding to 6.6 per cent of total inflows into all 27 transition economies. The situation has improved over the last five years. Since 1997, the annual FDI inflow into SEE has been at the level of around $3 billion (therefore equal or even higher than during the entire period 1989-1996)'(p.76).

According to the above statement it's obvious that one of the challenges that SEE-5 countries should actually face is the creation of a legal framework in order to be able to increase the level of FDI inflows. The increase in the level of FDI inflows recently has been attributed to the new era of globalization. International trade barriers have been dismantled and a number of trade agreements have been signed around the globe. Actually, almost all countries have liberalized their FDI policies and offer different forms of investment incentives in order to attract FDI. Privatization in the SEE-5 region has been looked upon as means to an end. Even though the economies are far from ready to fully adapt to the new economic conditions that the process toward privatization entails, governments in the SEE-5 are trying hard to raise the low levels of capital accumulation (Hunya, 2000). In doing so, new steps towards reforming the obsolete institutional framework conducive to attracting new investment has been put into place. The new framework, should be transparent reflecting the governments' intentions in relation to taxation and trade policies, corporate governance, public administration, etc.

FDI in the Western Balkans are mainly attracted through privatization issues. For example, one-third of FDI in Croatia in 2000 and two-thirds of the inflow in Albania in the same year were generated by sales of a bank and the award of a mobile telephone license. The sale of the state's stake in the FYROM national telecom operator in 2001 generated as much FDI as the preceding ten years (World Bank,2001). There is a small share of export-oriented foreign investment in the region.

Regarding the structure of FDI, there is not much difference between the CEEC and the SEE-5: the most attractive sectors are manufacturing (with the clear dominance of domestic market oriented industries like breweries and tobacco), financial intermediation, the trading sector, telecommunication, and transport. Investments in these sectors contributed significantly to the efficiency of resource allocation, but only insignificantly to the generation of sustainable growth (Zakharov and Kusic, 2003). Even though this region has made a lot of efforts in attracting FDI during the last years it is evident that a higher level of FDI flows in the Western Balkan can be reached. This depends on the improvement of the overall climate for private activity (private sector development, the legal and regulatory framework for business, progress in privatization, development of small- and medium-size enterprises, and the deepening integration in the EU. The successful FDI performance of the CEEC-s during their preparation for the EU accession in the last decade and the experience of the earlier EU enlargements show that economic integration can seriously contribute to an increase of FDI inflows.

Summary

During the last decades the CEE and Western Balkans have faced a lot of challenges in their way toward the market economy. One of these major challenges has been the FDI attracting.

While the CEE countries have been very successful in this direction, for the Western Balkans remains a lot of work to do in attracting FDI. The Western Balkans is facing also a long and difficult way toward the EU integration. This integration process has two very important aspects, which are inter-regional and intra- regional integration.

FDI in the Western Balkans are mainly attracted through privatization issues.
Even though, the countries of this region face some common location key advantages such as, highly competitive overall cost structure, Labor availability and strategic location, the flow of Foreign Direct Investments to these countries shows large differences. The most favorite country seems to be Croatia which has also done further steps to the EU integration compared with the other Western Balkans.

The current economic environment in the SEE region is exposed to a number of political risks and instability which have that have prolonged their process towards market economy. In spite of this, during the last years the overall image of the region appears to be improved, making steps towards their objective, i.e. creating the appropriate economic conditions for future EU membership.

FDI brings many positive effects to the host country such as the transfer of technological know-how, implementation of advanced management structures and modernization of the manufacturing sector, increased competitiveness, facilitation of the access to western markets and stimulation of economic growth.

The successful FDI performance of the CEEC-s during their preparation for the EU accession in the last decade and the experience of the earlier EU enlargements shows that economic integration can seriously contribute to an increase of FDI inflows.

An increase of FDI inflows is very important for the Western Balkans. The EU integration process is hoped to have positive effects in the FDI inflows of this region at the same way as in the other countries which joined EU.

This depends on the improvement of the overall climate for private activity (private sector development, the legal and regulatory framework for business, progress in privatization, development of small- and medium-size enterprises, and the deepening integration in the EU.

The EU has made it clear from the beginning that it views the intra-regional integration of this region as an indispensable component of the European integration process, not least because it is one of the founding principles of the European Union itself. According to this, Western Balkan countries have liberalized their trade regimes significantly by concluding a network of bilateral free trade agreements that shall shortly be transformed in a multilateral one.

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