Improved Business Climate and FDI in the Western Balkans

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Abstract: *The process of economical and political transition in the Western Balkans, up to this point has shown a high correlation between achieved economical results and the determination of national authorities for drawing and implementing policies for economical stabilization and development as well as structural reforms with the support of the International Monetary Fund, the World Bank and other relevant international institutions.*

The analyzed countries from the Western Balkans region have managed to achieve appropriate levels of macroeconomic stability and an improvement of the business climate due to the implemented reforms, these countries have not been successful enough in attracting Foreign Direct Investments as a precondition to ensure a more dynamic economical development and an appropriate fall in the level of unemployment and poverty.

A comparative analysis of the real economic indicators of the Western Balkans countries as contracted to the EU average shows that these countries are well under the real convergence levels of the EU countries.

The main objective of the paper is to provide some additional arguments regarding the potential positive or negative correlation between the business climate and the levels of Foreign Direct Investments in the Western Balkans countries, some of which are already members of the EU and others aspiring to become members in the future, having in mind the asymmetric economic positions of the countries being analyzed.

Keywords: *Busines Climate, Structural Reforms, Foreign Direct Investment, Economic Development, Western Balkan Countries, Europian Union*

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Introduction

The complex political and economic transition in the countries of the Western Balkans in the past two decades has been accompanied by numerous economic and political asymmetrical strokes.

During this complex process the governments of the countries of the Western Balkans (WB) with the assistance of the IMF and World Bank implemented the economic policies that aimed to achieve macroeconomic stabilization, transformation and privatization of state owned enterprises and to reform the economic system and public institutions.

After two decades of implementation of intensive economic policies the countries of the Western Balkan have achieved macroeconomic stabilization but the results in reforming the economy, reforming the public sector and the public institutions are in insufficient level and continue to remain challenges for these countries in the future.

In fact, the asymmetric development during the previous system and the low levels of economical growth in the first decade of the transition followed by increasing levels of unemployment, poverty, the large informal sector and fiscal evasion were the main obstacles in implementing deep institutional reforms and establishing a functional market economy in the Western Balkan's (Osmani & Mazllami, 2014).

The process of economic and political transition in the Western Balkans due to achieved asymmetric results do not solve in approriate level three main problems of economic transition (Commander, 1991).

1) Finding a new balance between private sector and public sector,
2) Finding the balance between profits and wages in the private sector, and
3) Finding the balance between monetary and fiscal policy within the strategy that aim macroeconomic stabilization and economic development.

Three balances realized at transition countries of the Western Balkans are in suboptimal levels as a result of numerous deficits and economic and social problems, lack of voluminous local and foreign investment and significant delays in the implementation of economic and institutional reforms as a result of lack of national political consensus.

Delays and poor quality of structural reforms still remain as the major obstacles in attracting foreign investment although as serious progress was made in terms of creating a more favorable environment business largely of formal nature.

As a consequence, that indicator "Ease of Doing Business" does not include areas such as: the level of corruption, independence of the judiciary, the size of the market, political and economic risk and functionality of public institutions, this indicator does not reflect the full attractiveness of business environement as crutial precondition in attracting foreign direct investment.

Despite the fact that Macedonia on the basis of the indicator, Doing Business, in the period 2010-2015 is listed as a leader in the West Balkans, country has realized the lowest level of foreign direct investment in volume and quality compared to the West Balkans and EU countries.

Due to the low level of foreign direct investment, the lack of national investment, the hesitation of the banking sector in financing new investments as a result of the growth of bad loans and considerable reduction of economic remittances Macedonia remains as the country with the highes level of unemployment and poverty in Europe.

The research aims to analyze the correlation between the level of ranking of countries according to the indicator, Doing Business, and the level of foreign direct investments in countries such as Croatia and Bulgaria that are part of the EU and the countries aspiring to join the EU with special emphasis in the case of the Republic of Macedonia.

The importance of correlation between the quality of business environment and attraction of foreign direct investment is linked closely with the aspiration of the countries of West Balkans for integration into the EU as a precondition have the fulfillment of the Maastricht and Copenhagen criteria.

These criteria aim of improving the business environment, attracting foreign investment, creating a functional market economy as a prerequisite for a qualitative integration of the economies of the West Balkans into the largest market of the EU.

Literature Review

Rich literature exists on the field of doing business and on the field of foreign direct invesment. The "Doing Business" website reports more than 100 academic papers in 50 academic journals, as of December 2014. However, only two papers have examined the Ease of Doing Business indicator and its correlation with foreign direct invesment in the ex-socialist countries in Westren Balkan (Petreski & Jovanovic2014).

Petreski is focused on the growth aspecst of the ease of doing business, in 30 ex-socialist countries, for the period 2005-2011. Petreski's paper titled Regulatory Environment and Development Outcomes: Empirical Evidence from Transition Economies, measures the ease of doing business by the aggregate index and by the 10 sub-indices.

The study of Jovanovic "Ease of doing business and FDI in the Ex–socialist countries" investigates the ease of doing business, measured through the Doing Business indicators of the World Bank, and aspects of foreign direct investment in 27 ex-socialist countries.

Results point out that there is a lot of uncertainty regarding the effects, with most of the indicators being either insignificant or lacking robustness. It also seems that investors are discouraged by bureaucracy, because four of the five indicators that are significant in either of the estimations refer to bureaucratic impediments, not to financial cost (Jovanovic & Jovanovic, 2014).

Research Methodology

In order to meet the set objectives of this paper, that is to determine correlation between the ranking of the countries of the Western Balkans by indicator, Doing Business, and the level of realized foreign direct investment.

The timeframe for the research is 2007-2013 including the following countries: The Republic of Macedonia (MKD), The Republic of Albania (ALB), the Republic of Kosovo (RKS), Montenegro (MNE), Bosnia and Herzegovina (BIH), Serbia (SRB), Croatia (CR) Bulgaria (BG), the average of West Balkan and the average of European Union countries (EU27).

By using common statistical and descriptive methods we provide a proper empirical and comparative analysis of the process of improving the business environment, the realization of foreign direct investment and remittances among these countries and compared to the EU27 averages.

Structural Elements of the Doing Business Indicator

The Doing Business Indicator of the World Bank includes 11 areas based on standard methodology with the objective of measuring the attractiveness of the business environment in 189 countries worldwide.

Table 1: *Structural Elements of Doing business,*

Structural elements of ,,Doing business,,	Eleven areas of business regulation
I.Complexity and cost of regulatory processes	Six areas of business regulation
1.Starting a business	Procedures, time, cost and paid-in minimum capital to start a limited liability company
2.Dealing with construction permits	Procedures, time and cost to complete all formalities to build a warehouse
3.Getting electricity	Procedures, time and cost to get connected to the electrical grid
4.Registering property	Procedures, time and cost to transfer property
5.Paying taxes	Payment, time and total tax rate for a firm to comply with all tax regulations
6.Trading across borders	Documents, time and cost to export and import by seaport
II.Strength of legal institutions	Five areas of business regulation
7.Getting credit	Movable collateral laws and credit information systems
8.Protecting minority investors	Minority shareholders right in related - party transactions and in corporate governance
9.Enforcing contracts	Procedures, time and cost to resolve a commercial dispute
10.Resolving insolvency	Time, cost, outcome and recovery rate for a commercial insolvency and the strength of the insolvency legal framework
11.Labor market regulation	Flexibility in employment regulation, benefits for works and labor dispute resolution

Source: World Bank group, Doing Business 2015, Going Beyond Efficiency, 12th edition.

In the framework of the many areas assessed by Doing Business, two are key structural elements: the complexity of the legislation and the cost of making business; and the strengthening of legal institutions in the function of doing business.

Doing Business, integrates 11 business areas that manifest the complexity and cost of regulatory processes and the area of strengthening the legal institutions in the function of improving the business environment.

It should be emphasized that despite the fact that indicator "Doing Business" includes a representative number of regulations of business fields, in different contries the importance of the specific criteria directly depends on the level of economic and social development, functionality of institutions and courts in particular, the level of corruption, organization of trade unions and political and social stability of the country.

Western Balkan countries with weak public institutions have many institutional problems that reflect negative effects on the attractiveness of the business environment and in attracting investment in general and foreign direct investment in particular.

Within the 11 criteria assessed by the Doing Business indicator, there is a high level of asymmetry in some structural elements such as: permits for construction, registration of property, enforcement of contracts, payment of taxes, protection of the minority shareholders, market regulations, quality of labor force and the minimum wage paid.

Asymmetric Business Environment in the Capitals of the Western Balkan Countries

Analysis of key criteria of doing business in terms of starting a business, obtaining the construction permit, registration of property and execution of contracts in the capitals of the countries of BP argues highly asymmetric business environments of the analysed countries.

Table 2: *City Differences: A Comparative Analysis of WB Capitals*

Description		Belgrade	Podgorica	Prishtina	Sarajevo	Skopje	Tirana
Starting a Business	Procedures (number)	7	7	10	12	3	5
	Time (days)	13	10	58	50	3	5
	Cost (% of income per capita)	8	2	29	15	3	31
	Paid-in min. capital (% of income per capita)	6	0	112	30.5	0	0
Dealing with constr. Permits	Procedures (number)	21	18	21	19	15	no practice
	Time (days)	349	287	320	182	129	no practice
	Cost (% of wareh.value)	1,782	2,132	856	1,166	1,792	no practice
Register property	Procedures (number)	6	7	8	7	5	6
	Time (days)	91	71	33	33	58	33
	Cost (% of property value)	2.7	3.1	0.6	5.3	3.1	3.4
Enforcing contracts	Time (days)	635	545	420	595	370	390
	Cost (% of claim)	29	26	61.2	40.4	33	36
	Procedures (number)	36	49	53	37	37	39

Source: Author's own calculations based on World Bank: Doing Business.

The capital of Macedonia (Skopje) is the place where most functional economic areas are concentrated and represents the most attractive business environment compared with other capitals of West Balkan countries.

Skopje has an edident administrative advantage of 50% for doing business compared with other Balkan capitals, Podgorica (Montenegro) is second accompanied by the

Kosovo capital Pristina, while Sarajevo (BiH) and Tirana (AL) are capitals which are characterized by significant administrative barriers and bureaucracy.

Ranking of Countries of the WB and the EU on the Basis of the Indicator of the World Bank "Doing Business"

Data published by the World Bank for the period 2007-2013 show a business environment with trends of improvement in all the countries of the Western Balkans with the exception of Bosnia and Herzegovina, the country in which the business environment marked a fall in 16 places compared with the previous analysed period.

Table 3. *A comparative Analysis of Ranking of Countries of WB (2007-2013)*

Countries	2007	2008	2009	2010	2011	2012	2013
Macedonia	93	79	69	32	38	22	23
Montenegro	72	80	77	71	66	56	51
Bulgaria	47	44	42	44	51	59	66
Croatia	116	105	110	103	84	80	84
Albania	132	136	89	82	82	82	85
Serbia	83	91	90	88	89	92	86
Kosovo	-	-	107	113	119	117	98
Bosna and Herzegovina	110	118	119	116	110	125	126
Average for WB	82	82	88	81	80	79	77

Source: Author's own calculations based on World Bank, Doing Business.

Analysis of Doing Busness, for the period 2007-2013 shows quite asymmetric positive trends in the countries analyzed except Bosna and Herzegovina, the country in which the business environment has deteriorated compared with 2007.

Greater improvement of business environment has highlighted Macedonia progressing for 70 places and ranging in the position 23rd worldwide. Many institutional reforms made in terms of reducing the cost of doing business, reducing the bureaucratic procedures, facilities in the labor market, putting into function of real estate market, increasing the efficiency of executions in contested proceedings, the tax cuts and investment in infrastructure funded by the government of the country in function of attracting FDI contributed to the improvement of the business environment in the period (2010-2015) in the case of Macedonia.

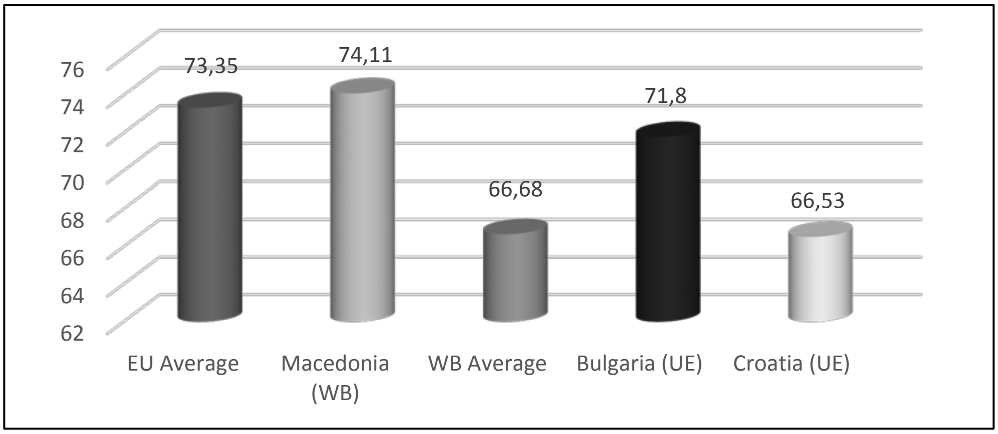
Macedonia is accompanied by Montenegro in the 51st, Bulgaria in the 66th and then followed by other countries of WB; Bosnia and Herzegovina is ranked at the bottom of the WB countries in terms of business attractiveness.

Two EU member countries of the Western Balkans (Bulgaria and Croatia) have highlighted asymmetric trends in terms of business attractiveness despite the fact that during the process of EU integration by fulfilling the Copenhagen criteria the two countries have implemented deep institutional reforms with the objective of creating a functioning market economy supported by functioning institutions.

The slow progress of Kosovo in the sense of creating attractive business environment is addressed mainly to political and security risks as a result of the contestation of independence from neighboring Serbia and the fact that the local Serb population has created protected area of the informal economy, smuggling and tax evasion that is out of control of the legal government of Kosovo.

The reasons for a low ranking of BiH are mainly political in nature as a result of political instability and numerous political risks and security risks that directly affect the creation of aversion of investors for investing in the country where institutional guarantees are minimal for protection and development of business as a result of permanent conflicts between institutions of local, regional and central levels.

Figure 1. *Ease of Doing Business: A Comparative Analysis of some countries of WB (2105)*



Source: Author's own calculations based on World Bank, Doing Business.

Assessment made on the basis of Ease of Doing Business by the World Bank and reflected in Figure 1 highlights a minimal difference of 2.3 points advantage of Macedonia in relation with Bulgaria despite the fact that based on the same criteria Macedonia is ranked 43 places higher.

Assessment made on the basis of the Ease of Doing Business criteria, for 2015 substantially cancels ranking based on the indicator, Doing Business, and imposes the need for a harmonized structure of both indicators in function of objective reflecting the real attractiveness of the business environment and the ranking of the countries analyzed.

The particularity of this ranking lies in the fact that there is a substantial difference in the level of ranking for different countries of the Western Balkans despite the fact that all governments of the analyzed countries are implementing similar policies with the objective of attracting foreign direct investment in the sense of tax level, fiscal facilities, elimination of the of bureaucracy and reducing business costs and other bareers for foreign investors.

The Trend and the Level of FDI in the Countries of the Western Balkans

There are promising trends in global foreign direct investment (FDI) flows for developing and transition economies. Each year more and more FDI is flowing not only from developed into developing economies but also from one developing or transition economy to another.

Indeed, developing and transition economies'share of global FDI inflows rose from roughly 19 percent in 2000 to 52 percent in 2010—for the first time exceeding half the total. And half the top 20 FDI recipients in 2010 were developing or transition economies (Hornberger et al, 2011).

This improvement in principle addresses the improvement of business environment, lower business cost and taxes and elimination of administrative and bureaucratic barriers in countries in transition.

Analysis of the trend and volume of foreign direct investment realized in the period 2007-2013 in the Western Balkan countries shows opposite trends compared to the trend observed by the report of the World Bank in the period 2000-2010.

Table 4: *The FDI ($) in the Western Balkan's (2007-2013) (milions $)*

Countries	2007	2008	2009	2010	2011	2012	2013
Croatia	4947	5812	3400	845	1242	1336	588
Serbia	3432	2996	1935	1340	2700	3553	1377
Bulgaria	1387	1030	3897	1867	2124	1578	1888
Albania	652	1240	1343	1089	1049	920	1478
Montenegro	937	975	1549	758	556	618	446
Bosna&Herzegovina	1804	1005	1385	444	469	350	322
Kosovo	603	537	408	487	546	293	343
Macedonia	733	612	259	300	495	283	376
Average of WB	1812	1776	1772	891	1148	1116	852

Source: Author's own calculations based on IMF and World Bank reports.

Analysis of the trend of foreign investments in the countries of WB has been heavily influenced by the world financial crisis which consequently produced substantial decreasing of FDI. In the WB in 2007 were realized in total FDI $ 12.684 million, while in 2013 the FDI were realized at the level of $ 5.694 million, that represents a decrease of $ 6.990 million a fact which demonstrates a negative trend and decrease of the interest of foreigner's investors for investing in a region identified as high-risk political with fragile and corrupted institutions.

Table 5. *FDI in Countries of Western Balkan (2007-2013) (millions $)*

Country	Total FDI	Average FDI
Croatia	18.172	2.596
Serbia	17.332	2.476
Bulgaria	13.832	1.976
Albania	7.770	1.110
Montenegro	5.838	834
Bosnia and Herzegovina	5.775	825
Kosovo	3.213	459
Macedonia	3.052	436
Average for WB	9.373	1.339

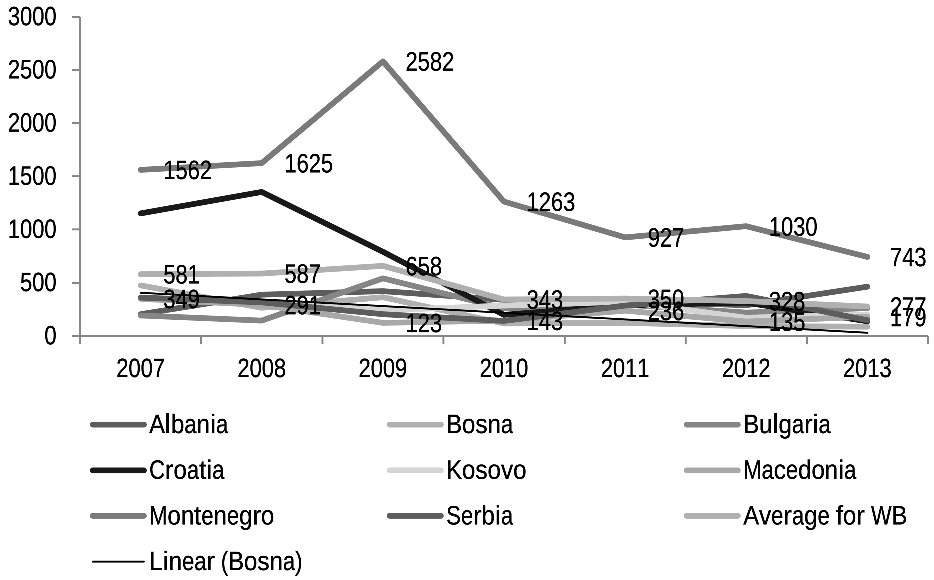
Source: Author's own calculations based on IMF and World Bank reports.

Based on the analysis of the volume of realized FDI in WB countries in the period 2007-2013 Croatia ranked first with a total of 18.172 million US dollars of FDI accompanied by Serbia and Bulgaria $ 17.332 million with $ 13.832 million.

Despite the fact that Croatia has achieved the highest level of cumulative FDI, investments carried out in this country in 2013 were at level of 10% of FDI realized in 2008 that argues a very high negative trend which is characteristic for all countries of WB and it can not be explained only by using the financial crisis as an aliby.

The trend of decreasement of investment is characteristic of all countries of WB without exception with high negative effects at the countries with the lowest level of economic development (Kosovo, Bosnia and Herzegovina and Macedonia) ,the countries that are suffering from the syndrome of low investment , high unemployment and poverty in WB and in Europe.

Figure 2: *Foreign Direct Investment – per capita ($) (2007-2013)*



Source: Author's own calculations based on IMF and World Bank reports.

The comparative analysis of FDI per capita in the countries of WB reflects very low levels of FDI of all countries with the exception of Montenegro. FDI per capita despite the negative trend continue to be several times over the average of countries of WB as a result of the fact that this country has only half a million residents who live in this country.

While in the case of Bosnia & Herzegovina and Kosovo the political and security reasons that produce large risks for serious foreign direct investment, in the case of Macedonia we have a paradoxical phenomenon of very high level of ranking of this country based on indicator, Doing Business, and very low level of FDI.

The Trend and the Level of Remittances in the Countries of the Western Balkans
The level and trend of remittances in the countries of the Western Balkans is in direct dependency on the number of economic migrants. On the basis of financial flows leads Serbia with over $ 4.3 billion as a result of the fact that it is the country with the largest number of population and emigrants in WB.

Table 6: *Remittances in the Western Balkan's (in millions $US)*

Country	2010	2013
Albania	779	1.156
Bulgaria	1.611	1.331
Bosnia and Herzegovina	1.895	1.822
Croatia	1.500	1.213
Montenegro	357	300
Serbia	4.357	4.345
Average for WB	1.508	1.558

Source: Author's own calculations based on IMF and World Bank reports.

The highest level of economic remittances compared to FDI despite the fact that the authorities of the countries of the WB do not provide economic and fiscal facilities, needs to be in focus of economic policies in the future as an important opportunity for investment and economic development.

Low Level of FDI despite Attractive Business Environment in Macedonia
In the analyzed period (2007-2013) Macedonia has had serious progress in improving the business environment. In 2014 Macedonia was ranked as the leader of WB countries (23 worldvide), a fact that requires a special analysis having in mind that this progress did not produce positive trends of FDI.

Table 7. *WB Ranking: A Comparative Analysis of WB Average, Macedonia and Croatia*

Countries	2007	2008	2009	2010	2011	2012	2013
Macedonia	93	79	69	32	38	22	23
Croatia	116	105	110	103	84	80	84
WB Average	82	82	88	81	80	79	77

Source: Author's own calculations based on World Bank reports.

Analysis of the level of realized FDI in comparison with economic remittances and set in correlation with ranking of countries of WB based on Doing Business reflects large discrepancies. The low level of realized FDI in Macedonia denies positive correlation between FDI and the ranking of attractiveness of the business environment.

This asymmetry is quite large in the case of Macedonia; this country is ranked as a leader in terms of business attractiveness while at the level of FDI has realized the lowest level of FDI.

Table 8. *FDI: A Comparative Analysis of WB Average, Macedonia and Croatia*

Countries	2007	2008	2009	2010	2011	2012	2013	Average 2007-2013
WB Average	1812	1776	1772	891	1148	1116	852	1339
Macedonia	733	612	259	300	495	283	376	436
Croatia	4947	5812	3400	845	1242	1336	588	2596

Source: Author's own calculations based on IFM and World Bank reports.

In a research made by Osmani and Deari (2009) regarding the measurement of political, economic and financial risk in Macedonia it is concluded that the majority of businessmen have serious remarks on: poor quality of public administration, huge policy influence on functioning of the judicial system, high level of corruption and implementation of fiscal selective controls by fiscal authority.

This low level of FDI reached in Macedonia is quite symptomatic taking into account the fact that the law for free economic zones in Macedonia ofer numerous fiscal, administrative and infrastructure convenience for foreigner investitors.

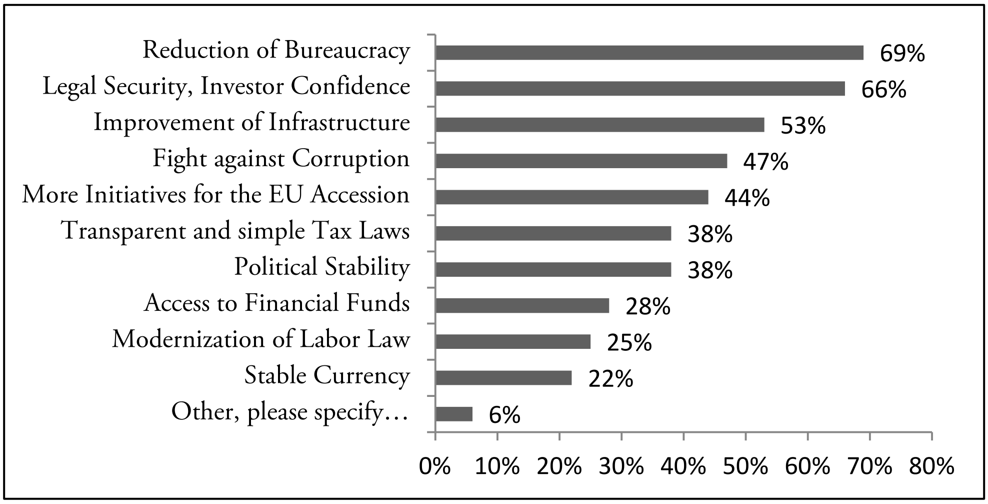
The law on free economic zones of Macedonia provides numerous facilities for foreign companies that decide to invest in Macedonia. These foreign companies are obligated to the period of 2-10 years to export at least 50-70% of total production realized in free economic zones as a prerequisite for exploiting the numerous benefits of fiscal and infrastructure.

Foreign investors in the framework of free economic zones if export 70% of total production are released in a period of 10 years from the payment of corporate income tax, property tax and sales tax within the economic zone.

Foreign companies that invest in economic zones can buy the building land or industrial land with a symbolic price (of 1 euro per m^2). A great facility for business in free economic zones is the fact that at major economic areas of the country the government has invested in the construction of basic infrastructure for full functionality of economic free zones.

A survey done by business investment office of the Austria (Schlattl, 2013) in Skopje pointed out these concerns which directly affect the low level of foreign investments in Macedonia: Reduction of bureaucracy with 69%, the legal security of investments by 66%, improved infrastructure with 57%, fighting corruption by 47%, delays in EU integration and political instability with 45%.

Figure 3: *What are Requirements of Business Community from the Macedonian Government*



Source: Author's own calculations.

The report of EBRD 2014, survey done with managers of 15,500 companies who work in 29 countries mainly in Eastern Europe emphasizes the main problems as: the informal economy and tax evasion, difficult access to finance for private companies, unequal treatment of tax administration and other administrative bareers.

The transition experience from centrally planned to market economy is an historically unprecendented process (WB Report), and that process is not finished in many contries in Eastern Europe and Former Soviet Union.

In the context of an unprecedented process of political and economic transition that the countries of WB have undergone, it is possible to have unprecedented results, in one side significantly improving of the business environment and in other side very low levels of FDI, as is the case of Macedonia.

Conclusions

The Western Balkan countries in a permanent cooperation with the IMF, the World Bank, and during the integration process in the EU have implemented many institutional reforms as a function of preserving economic stability and creating suitable business climate as a precondition for dynamic economic development.

Implementing permanent economic and political reforms by the Western Balkan countries have resulted to formal improvements of their business climate measured by the World Bank ”Doing Business” indicator.

Despite the improvement of business climate of the Western Balkan countries, this positive trend of business climate has not been accompanied by an increase of investments in general and FDI in particular.

In this direction, Macedonia is a paradoxical case because the country is ranked as 23rd at the global level for suitable business climate but it has the lowest level of FDI among the Western Balkans countries.

The lack of positive correlation between ”Doing Business” and the level of FDI in the case of the Western Balkan countries signals the need for structural modification of this indicator with more qualitative elements concerning the real functionality of the institutions that directly affect the business climate.

Despite the low fiscal burden and numerous investing easiness of doing business provided to foreign investors there is still a low level of FDI in the Western Balkan countries which is due to the fact that these countries are characterized by high levels of informal sector and tax evasion, bureaucratic procedures, politicization of public institutions and volatility of public institutions. Improvements in this area are the main investing and developing challenges for all governments of the countries of Western Balkan without any exclusion.

A faster integration of all Western Balkan countries in NATO and the quality fulfillment of the criteria of Maastricht and Copenhagen in the process of integration to EU are substantial prerequisites for minimizing the political and security risks especially in the case of Kosovo, Bosna and Herzegovina and Macedonia which are prerequisites for improving the business climate and realizing more FDI in all the Western Balkan countries as a common economic and investment market.

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