

Regional Investment Reform Agenda for the Western Balkans Six

11 May 2018

Prepared with technical support of the



Funded by the European Union

CONTEXT AND RATIONALE

Enabling regional economic integration in the Western Balkans

The Western Balkans economies have made considerable progress in boosting economic growth and increasing shared prosperity. Between 2000 and 2008 the region's GDP grew on average 5% a year, living standards expanded faster than the EU and world averages, and the region's per capita GDP was 8.5% closer to the EU average.¹ This economic growth however, has slowed considerably in recent years. The average pace of convergence with the EU has stagnated and the WB6 economies remain some of the poorest in Europe.

It is within this context that the Western Balkans economies of Albania, Bosnia and Herzegovina, Kosovo*, The Former Yugoslav Republic of Macedonia, Montenegro, and Serbia (WB6) are stepping up their efforts to implement reforms that will further economic cooperation and create a dynamic investment space in the region. At the 2017 Western Balkans Trieste Summit the WB6 committed to work together to promote economic cooperation and regional integration. To translate these goals into actionable reforms the Multi-Annual Action Plan for Regional Economic Area in the Western Balkans (MAP REA) was developed in the CEFTA legal framework. The MAP REA reform agenda centers on four pillars – investment, trade, labor mobility and digital integration – and aims to enable the unobstructed flow of goods, services, capital and skilled labor. These reforms will align with EU and international best practices and standards, and are designed to make the region more attractive for investment and commerce, and accelerate convergence with the EU.

Economic benefits of greater regional harmonization of investment policies with EU standards and international best practices

The World Bank Group (WBG) surveyed more than 750 executives of multinational corporations (MNCs) to find out what motivates investors' decision-making. The results, published in the 2017/18 Global Investment Competitiveness Report, found that close to 90% of investors are motivated by access to new markets or new customers. For many investors this motivation applies not only to the domestic market in which they are investing, but also to regional markets. In fact, this motivation was commonly selected for investments in small emerging economies with an extensive network of trade and investment agreements with other economies, suggesting that the respondents were interested in accessing new regional markets and consumers, rather than just the domestic market of one host economy. The survey also found that roughly half of respondents are motivated by lowering production costs or establishing a new base for exports, while two-fifths of respondents were motivated by the coordination of a value chain.²

These results imply that access to larger and more sophisticated regional markets is desirable to investors, as it allows them to benefit from economies of scale and organize their production processes more efficiently in a given region. If goods, services and investments can circulate freely in a region, investors – once established in one economy – can easily expand their businesses across the region. This is especially useful to efficiency-seeking and domestic market-seeking investors that can benefit from larger, more integrated markets. For example, in the case of efficiency-seeking

¹ World Bank. 2017. Western Balkans: Regional Economic Integration Issues Notes. Washington, DC: World Bank Group; and *Consolidated Multi-annual Action Plan for a Regional Economic Area in the Western Balkans Six*.

* This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence

² World Bank. 2018. [Global Investment Competitiveness Report 2017/2018: Foreign Investor Perspectives and Policy Implications](#). Washington, DC: World Bank.



investment the investors will chose to locate in a particular economy only if that economy is well integrated with neighboring markets (e.g. well performing cross-border infrastructure, streamlined export procedures, licensing requirements, standards, etc.). Similarly, a domestic market-seeking investor will have greater business opportunities in an integrated economic region with a large consumer base than it would serving individual economies. Increased coherence of investment policies and integrated markets also allows firms to fragment their production processes across a region which reduces the time and cost of investing and can foster the development of regional value chains.

A good example of investor behavior in integrated regions is the Association of Southeast Asian Nations (ASEAN) where intra-regional foreign direct investment (FDI) accounts for a quarter of all FDI flows to the region. In fact, intra-regional investment flows have been steadily increasing for more than a decade. Much of this growth is due to the growing presence of firms in multiple ASEAN member economies and an overall expansion of firms' regional footprint.³ By contrast, investment flows within the WB6 account for just 5% of total investment⁴, and the region has had mixed results in attracting FDI overall. The average FDI stock per capita in the WB6 is \$3,200 versus roughly \$7,400 received by the EU-11.⁵

A bottom-up approach to greater regional harmonization of investment policies with EU standards and international best practices

Despite the evidence that, on a global level, enhanced regional economic cooperation can facilitate the expansion of investment and economies of scale, regional economic integration efforts to date have not always rendered the desired results at growing intra-regional economic spaces for expanding investments on a cross-border basis. In fact, with the unique exception of the European Union, despite having started more than half a century ago, regional economic integration processes in many parts of the world are still striving to create open regional economic spaces for FDI. Often economies dismantle barriers to trade, but struggle to address the main inhibitors to FDI within the region such as unaligned technical standards, lengthy investment registration and screening procedures and restrictions on capital flows. These limit the huge dynamic effects that trade and investment can forge.

The failure of regional integration schemes to actually integrate economic activity in a meaningful way has a lot to do with the top-down integration model used in many cases. The problem with this approach is that it is State-led, based on legal instruments, protocols and declarations that in the end are not fully implemented, eroding the credibility of the integration process as a whole vis-à-vis the private sector.

Recent experiences in successful integration schemes suggest a more pragmatic approach is to follow a bottom-up model in which the private sector plays a key role. Extensive consultations with key private sector actors enable governments to drill down to the sectoral and horizontal issues inhibiting cross-border investment and trade. Starting with key priorities and bottlenecks in the existing policy framework as identified by the private sector, this approach allows policy makers to focus on a more targeted set of reforms that are politically feasible, economically necessary and will generate more buy-in with private investors.

³ *ASEAN Investment Report 2017: Foreign Direct Investment and Economic and Economic Zones in ASEAN*. Association of Southeast Asian Nations, 2017.

⁴ UNCTAD FDI bilateral dataset

⁵ *Regional cooperation in the Western Balkans*, Oleg Levitin and Peter Sanfrey, February 2018, European Bank for Reconstruction and Development.



THE PATH FORWARD FOR GREATER HARMONIZATION OF WESTERN BALKANS SIX INVESTMENT POLICIES WITH EU STANDARDS AND INTERNATIONAL BEST PRACTICES

The Regional Investment Reform Agenda sets out the pathway for creating a dynamic investment space in the Western Balkans Six, according to the MAP REA, within the context of the SEE 2020 Strategy and CEFTA legal framework, and pursuant to the individual economy SAAs. It puts the priorities of the private sector center stage while recognizing the individual development priorities of the WB6 economies. In line with these twin objectives, the agenda focuses on core areas of investment policy and related policies that matter most to the private sector and the governments of the region. It provides a comprehensive framework for achieving greater harmonization of investment policies of the WB6 economies with the EU standards and international best practices, while focusing on a targeted set of reforms that are politically feasible, economically necessary and that will generate tangible results in the near term.

The regional investment reform agenda is intended to contribute and add value to individual investment reform efforts undertaken by the economies of the region. The agenda acknowledges the differing reform baselines as well as implementation capacities across the economies of the region, as well as the different stages of EU integration process. In support of an effective implementation of the reform agenda, tailored approaches will be developed for addressing the range of constraints faced by the economies of the region, including through peer-to-peer learning and knowledge exchange activities, targeted capacity building, institutional development support, and through bringing in best practice guidelines as necessary to achieve reforms.

The regional investment reform agenda will ensure transparent and fair competition among the economies by mitigating a “race to the bottom” whilst not hindering the interests of the WB6 economies. The ultimate goal of the agenda is to improve the attractiveness of the region for foreign and intra-regional business, and hence facilitate higher inflow of investments and generate higher entrepreneurial activity, trade, and ultimately jobs.

A step-by-step approach to the Regional Investment Reform Agenda in the Western Balkans Six

The regional investment reform agenda of the WB6 economies is formulated based on a bottom-up approach prioritizing and sequencing issues in investment-pertinent policies to be addressed through a regional dialogue in short-term, medium- term and long- term timeframe. This approach entails a sequence of steps to arrive at a shared understanding and cooperation among the WB6 concerning the formulation and implementation of the reform agenda.

The main regional platform in charge of the development, implementation and overseeing the effectiveness of the regional investment reform agenda will be the SEE Investment Committee (SEEIC) - CEFTA Joint Working Group on Investments (JWGI), which will align the MAP REA priorities along with those stipulated by the SEE 2020 Strategy and CEFTA Agreement; while doing so, the JWGI will take due account of relevant individual economy priorities and different levels of development and EU integration processes of the participating economies, so as to avoid duplication of work and ensure effective policy reform making and implementation, with the ultimate goal to improve the investment environment and facilitate higher flows of investments into and throughout the region.



Step 1: Identification of regional investment barriers

The identification and prioritization of regional investment policy barriers is based on literature research as well as in-depth private sector consultations at the economy level throughout the region. This approach facilitates the identification of existing de facto investment barriers facing the private sector. The result is a detailed mapping of technical reform issues that currently hinder investments in the WB6.

Step 2: Formulation of the regional investment reform agenda

Inputs derived from step one directly informed the formulation of the regional investment reform agenda for the WB6. Political stakeholders agree on a reform agenda based on the identification of private sector barriers and strategic government considerations.

Step 3: Reform implementation and benchmarking of progress

To introduce accountability to the reform agenda, a specific benchmarking tool will be deployed to monitor progress of reform implementation and track the outcomes and impact of specific regional commitments. A benchmarking scorecard will allow for the continuous evaluation of success in removing barriers and alignment of economy level policies with the regional investment reform agenda. It will also provide “real time” insight into economies’ progress, allowing adjustments to be made where needed and ensuring economies are on track for successful reform implementation.

Step 4: Effective implementation of the regional investment reform agenda

During the final stage of regional reform implementation, the economies of the region and relevant institutions (RCC and CEFTA) will engage with the private sector to obtain feedback on reforms and ensure the regional reform agenda is being effectively implemented. This will entail consultations with business associations, chambers of commerce and representatives of regional businesses interested in cross-border trade and investment. Consultations will be targeted to specific sectors where possible. This engagement with the private sector acts as a feedback mechanism and can be an engine for further reform.

Acknowledgement of implementation risks and mitigation strategies

As with any other major reform program, the successful implementation of the regional investment reform agenda is subject to different categories of risk, including political, administrative, financial, etc. Ownership and buy-in are required not only from key policy decision-makers, but also from the officials that must implement the agenda in practice and may face varying capacity constraints in doing so. It is acknowledged that in some economies officials will require training on how to best implement reforms (e.g. legislative reforms, implementing new mechanisms), in other economies the necessary institutions for guiding reforms may be lacking resources and support will be needed to facilitate institutional development. In such cases, the political processes required to provide agencies with appropriate mandates, and the required budget and staffing could present barriers or slow the ability to move through the reform agenda. These risks and obstacles are acknowledged, and efforts will be made by all supporting organizations to enhance the capacity of economies to move forward. Additionally, each economy will conduct capacity building needs assessments, organize financial planning and identify agency gaps as part of the implementation efforts to ensure the reform agenda is successful over the long term.



Fit within the MAP REA framework

With the formulation and adoption of the regional investment reform agenda the economies of the region have achieved a major milestone on the pathway towards greater regional harmonization of investment policies in the Western Balkans with EU standards and international best practices. Defining the main policy reform areas and priorities, the regional investment reform agenda provides the overarching framework for specific reform actions to be undertaken by the economies of the region as they continue to implement their commitments outlined under the investment pillar of the MAP REA. As the next step going forward, each of the WB6 economies will formulate, adopt and implement an individual economy level policy action plan that reflects the regional investment reform agenda as well as economy level reform priorities and baselines.



POLICIES FRAMEWORK AND REFORM ACTIONS

Policy Area	Reform Topic	Reform Actions
I. Investment Entry & Establishment	<i>1. Enhancing entry and establishment opportunities for investors</i>	<p>1.1 Review domestic laws and regulations in the WB6 for inconsistencies with entry and establishment non-discrimination principles (Entry Gap Analysis) and publish a consolidated list of legal entry barriers to increase transparency for investors.</p> <p>1.2 Use the above to inform a discussion on existing barriers to investment in the WB6 region.</p>
	<i>2. Improving business establishment policies and procedures</i>	<p>2.1 Support the development of a business portal to catalogue, provide and compare information on procedures to establish and operate a business in the region by building upon the initiated and already existing cooperation of the region's business registration agencies.</p> <p>2.2 Compare, review and align where possible business registration requirements on regional level.</p> <p>2.3 Facilitate and expedite work permit and affiliated procedures on economy level.</p>
II. Investment Protection & Retention	<i>3. Aligning the legal frameworks for investment, including IIAs, with international good practice and EU standards</i>	<p>3.1 Undertake a detailed mapping and in-depth comparative review of the WB6' international investment agreements (IIAs)⁶, with particular focus on BITs, benchmarking them with new generation IIAs to enhance alignment with reform-oriented standards in new generation IIAs / EU standards⁷</p> <p>3.2 Perform a gap analysis of the economies' specific domestic investment legislations with their IIAs and new generation IIAs, based on a comprehensive analysis of the economies' legal investment frameworks that will be carried out after the adoption of the regional investment reform agenda.</p> <p>3.3 Upgrade domestic legislations in line with standards provided in new generation IIAs</p> <p>3.4 Strengthen the mandate of the SEEIC-CEFTA Joint Working Group on Investments to establish it as a mechanism for regional exchange on IIA standards, modernizing IIAs, and, if deemed necessary by the participating economies, for</p>

⁶ Collectively, any international agreement that regulates investments is referred to as international investment agreement (IIA). International investment commitments are set out in treaties, either bilateral, or in regional or multilateral agreements. Some treaties deal only with foreign investment (usually referred to as bilateral investment treaties, or "BITs"). Others address investment alongside other related issues, such as trade, government procurement, competition and intellectual property (preferential or free trade agreements, or "PTAs"). Further, there are some multilateral treaties that provide special protections in the energy sector (the "Energy Charter Treaty") or that provide for access to dedicated dispute resolution bodies (the ICSID Agreement). Further, numerous legal instruments, including for example double taxation treaties (DTTs).

⁷ The CEFTA agreement will not be affected by this reform action.



		enabling development of a strategic approach to negotiating / revising IIAs.
	<i>4. Strengthening investment retention mechanisms in the region</i>	<p>4.1 Upgrade established investor grievance mechanisms in interested economies, while taking into consideration the differing levels of development and support needed for capacity building.</p> <p>4.2 Strengthen the mandate of the SEEIC-CEFTA Joint Working Group on Investment to establish it as a regional platform for exchange of experiences on managing grievances and preventing investment disputes.</p>
III. Investment Attraction & Promotion⁸	<i>5. Developing a regional investment promotion initiative</i>	<p>5.1 Establish a regional framework for coordination and information exchange among individual economy investment promotion intermediaries (IPIs) or agencies (IPAs), considering the option of creating a coordination unit within the existing regional structures.</p> <p>5.2 Support the development of a regional investment portal on regulatory requirements and investment opportunities across the region that builds on the existing regional investment portals, such as that of the WB6 Chamber Investment Forum and others, where deemed appropriate.</p> <p>5.3 Support the individual economy investment promotion intermediaries to contribute effectively to the regional investment promotion initiative.</p> <p>5.4 Undertake an in-depth sector scan to identify sectors and value propositions for regional investment promotion, with clear horizontal links to the MAP REA pillar on smart specialization.</p>
	<i>6. Streamlining incentives, and improving their transparency and governance</i>	<p>6.1 Implement incentive standards and principles related to transparency, governance and predictability in accordance with the obligations stemming from the EU pre-accession process (chapter on competition and state aid)</p> <p>6.2 Improve access to information on incentives by publishing economy level inventories that centralize key provisions and data related to these instruments.</p> <p>6.3 Engage in peer-to-peer learning on methodologies for cost-benefit evaluation and experiences on incentives' governance and administration in the context of the SEEIC-CEFTA Joint Working Group on Investments.</p> <p>6.4 Systematically engage in monitoring and evaluation of incentives to assess the effectiveness and cost-benefit considerations on economy level.</p>

⁸ Opportunities for linking with WBIF (EIF) funding will be explored for the reform actions on investment promotion where possible and deemed appropriate.



ANNEX: SUPPORT WITH IMPLEMENTING THE REGIONAL INVESTMENT REFORM AGENDA

Support with the development and implementation of the regional reform agenda, including with economy level reform implementation, is provided through the '*Western Balkans Regional Investment Policy and Promotion Project*'. The project is delivered by the World Bank Group with the financial support of the European Union and in close cooperation with the Regional Cooperation Council RCC.

The project provides practical advisory support and technical assistance to the economies of the region with the implementation of the investment pillar under the MAP REA. This includes support with the implementation of the different priority areas outlined by the MAP REA as per the overview graph below.

Figure 1. Support with implementing the regional investment reform agenda.



In addition to the support outlined above, the World Bank Group can leverage its portfolio of existing technical assistance and advisory projects throughout the region to provide capacity building and support the actual implementation of investment policy reforms on economy level.

