

Barriers to Backward Spillovers from FDI in the Western Balkans: Will the Common Regional Market Action Plan Help?

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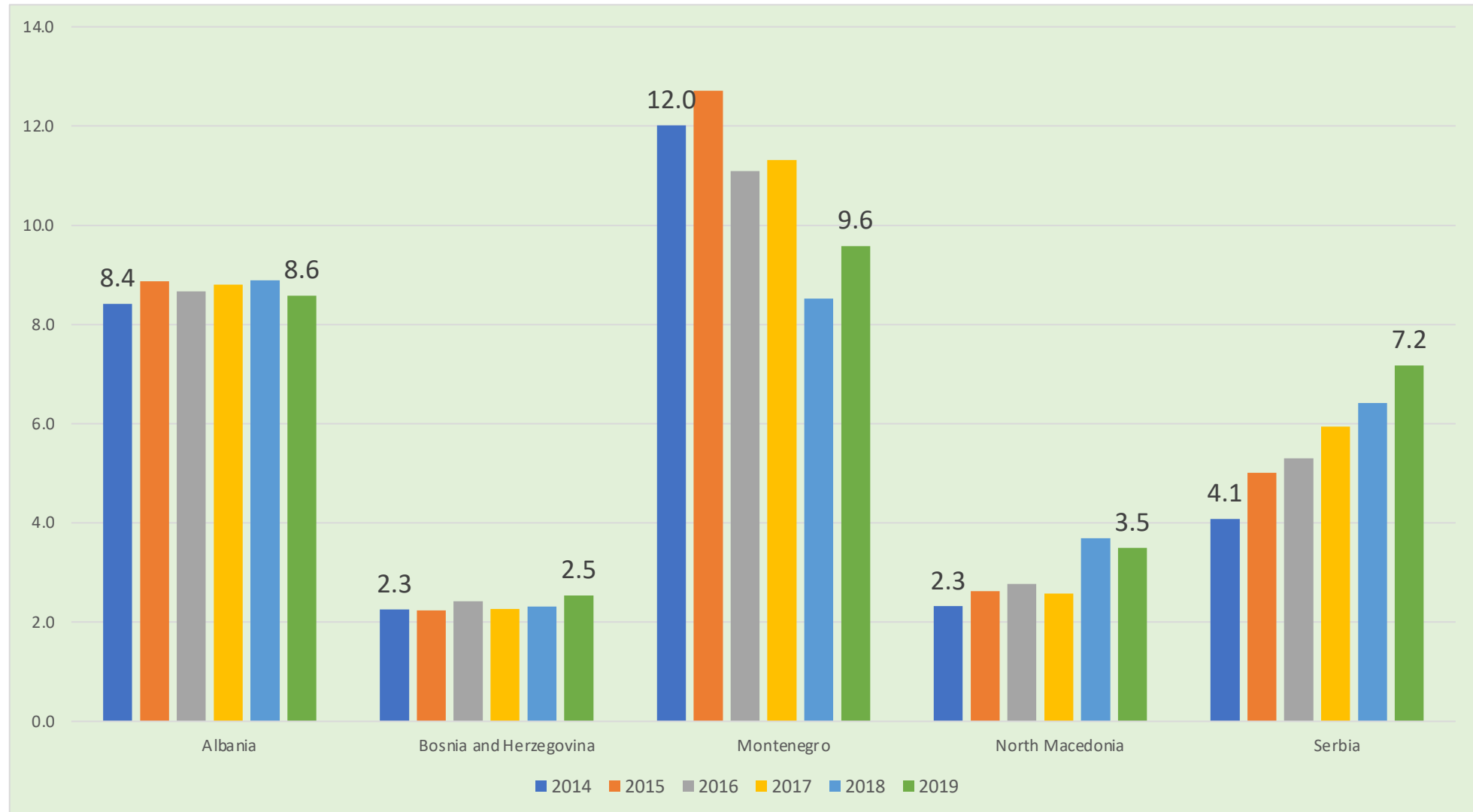
Introduction

- This presentation considers the role of CEFTA in the Common Regional Market Action Plan in the context of backward spillovers from FDI
- Backward spillovers refer to the sales of local companies as suppliers to multinational corporations which have located in the regional market
- I argue that FDI will generate positive benefits if it is economically embedded through regional supply chains
- CEFTA has a major role to play in easing trade restrictions on the development of such regional supply chains

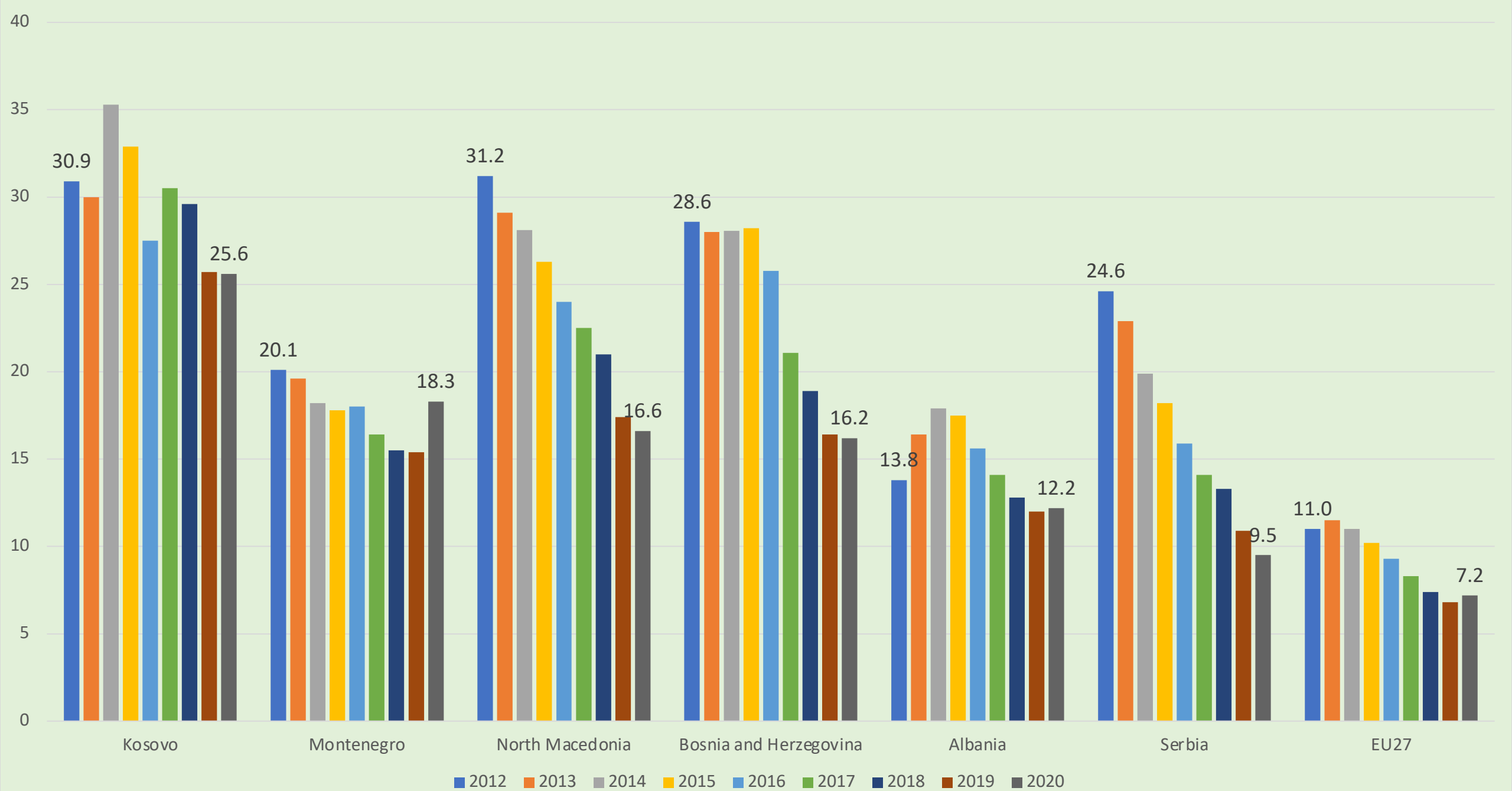
Benefits of backward spillovers

- Direct knowledge transfer from multinational companies located in CEFTA region to domestic suppliers
- Higher requirements regarding product quality and on-time delivery introduced by such multinationals,
 - providing incentives to domestic suppliers to upgrade their production management or technology
- Indirect knowledge transfers through movement of labour
- Increased demand for intermediate products from the multinationals, which benefits local suppliers due to scale economies

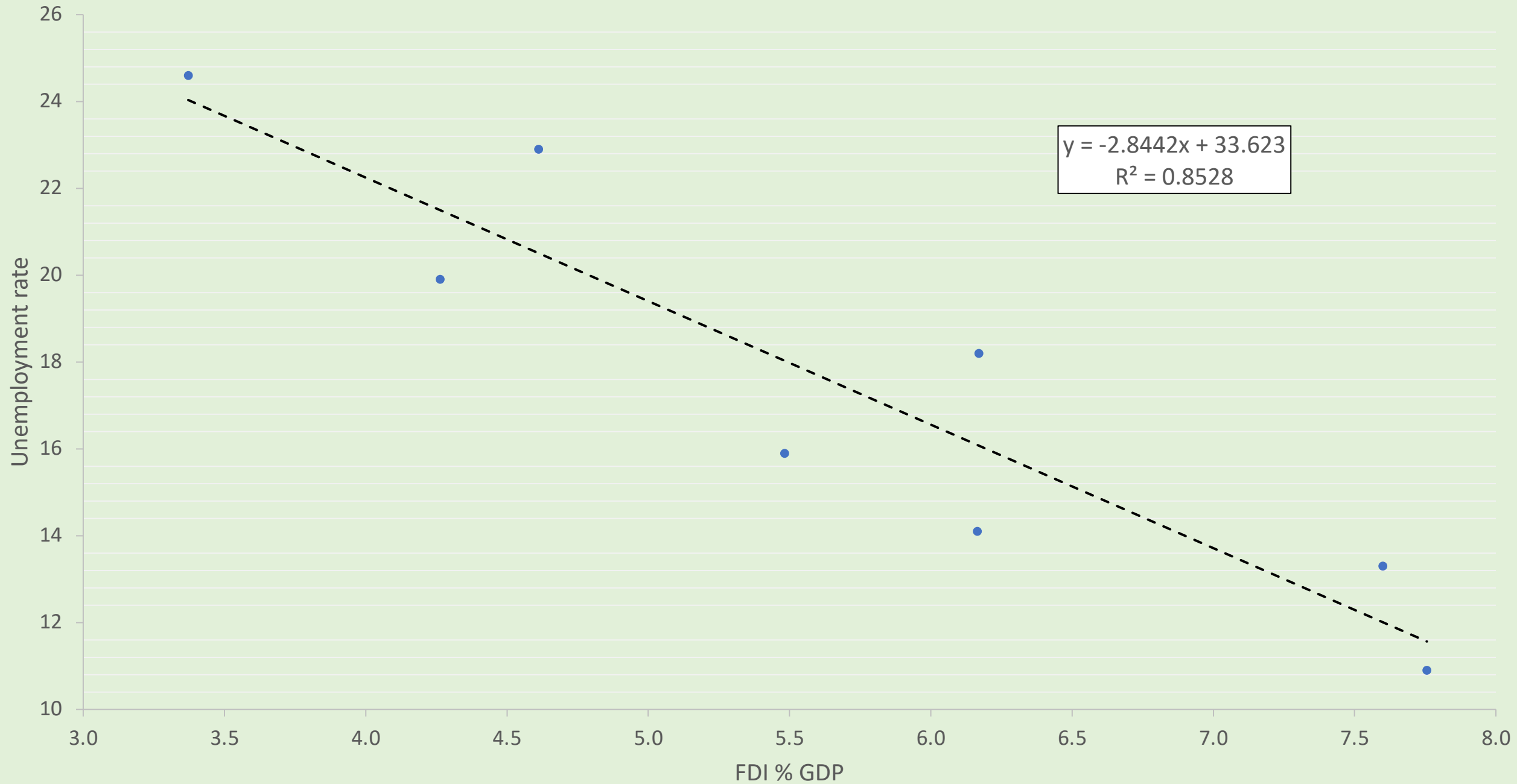
FDI inflow 2014-2019 (% GDP)



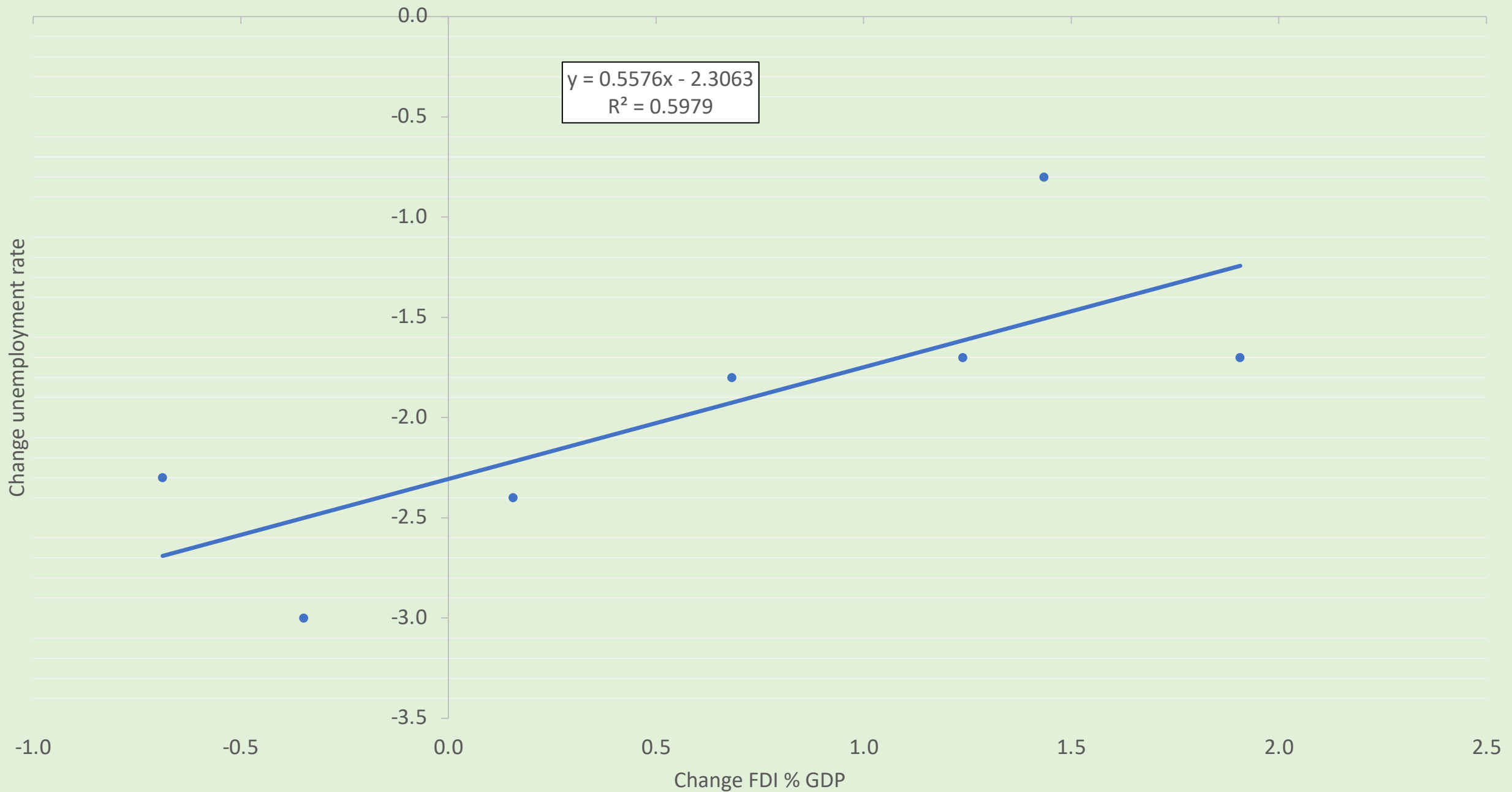
Unemployment rates 15-64 age group, 2012-2020 (%)



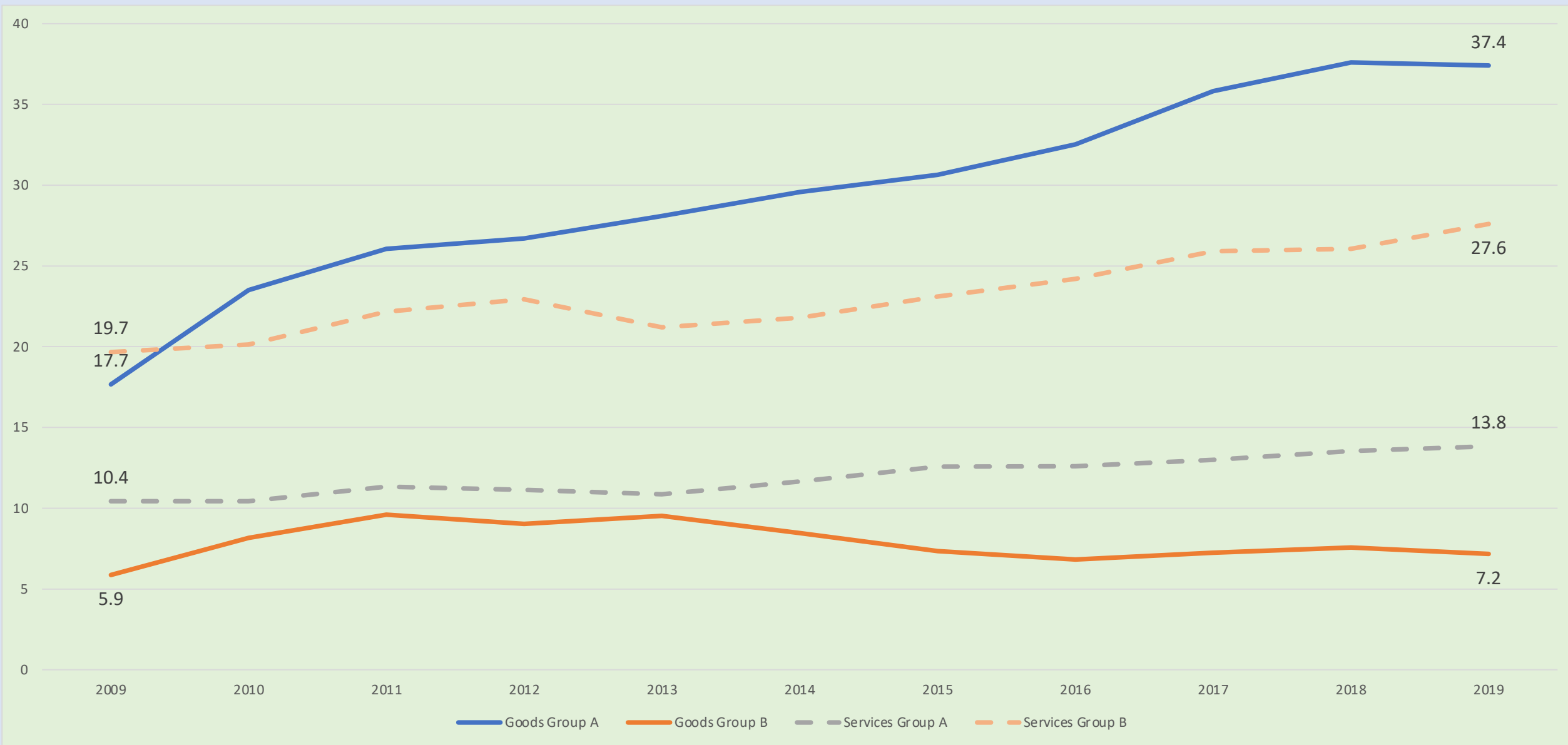
Unemployment rate vs FDI % GDP (Serbia, 2012-2019)



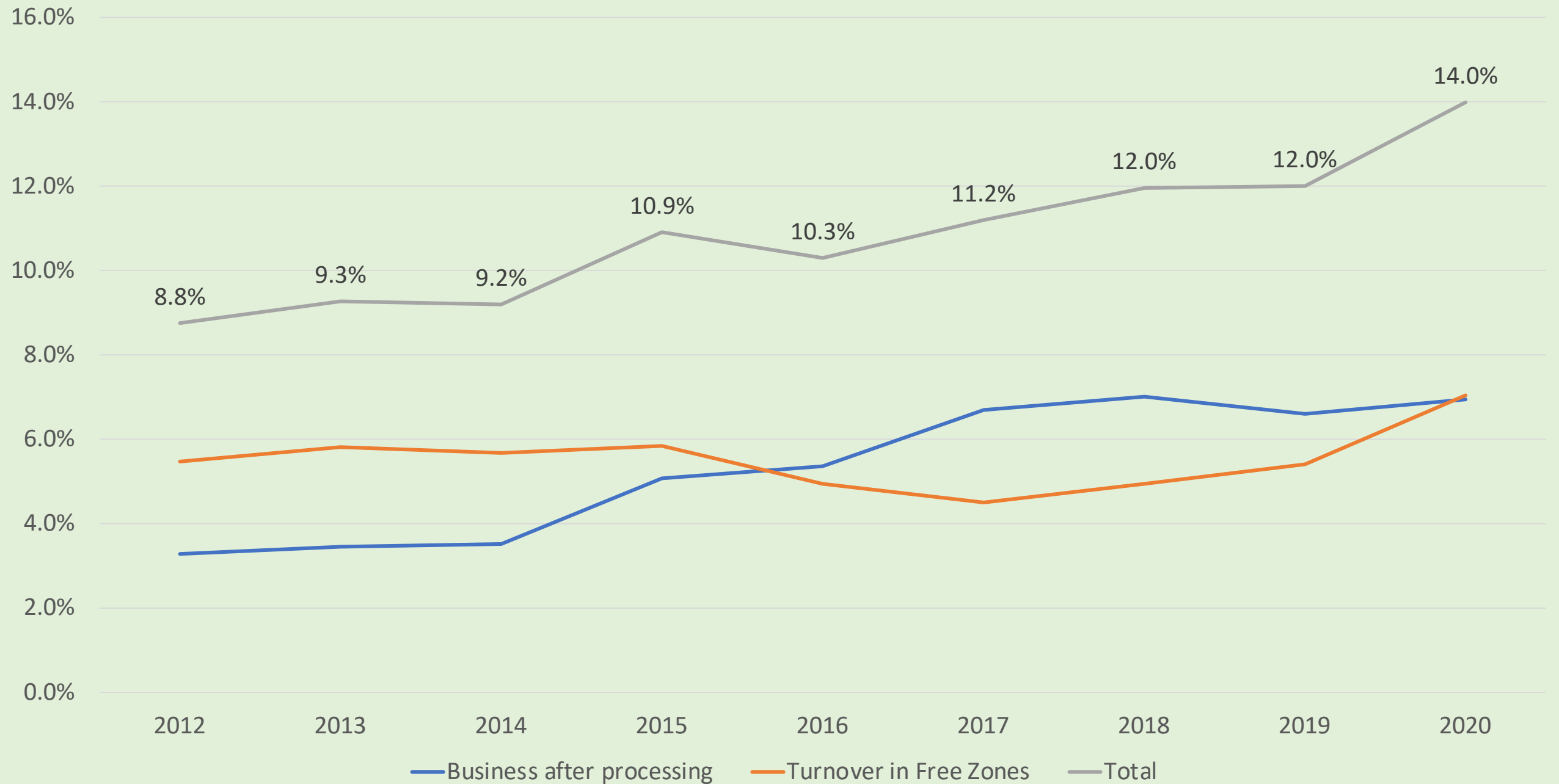
Change in unemployment vs change in FDI % GDP (Serbia 2012-2019)



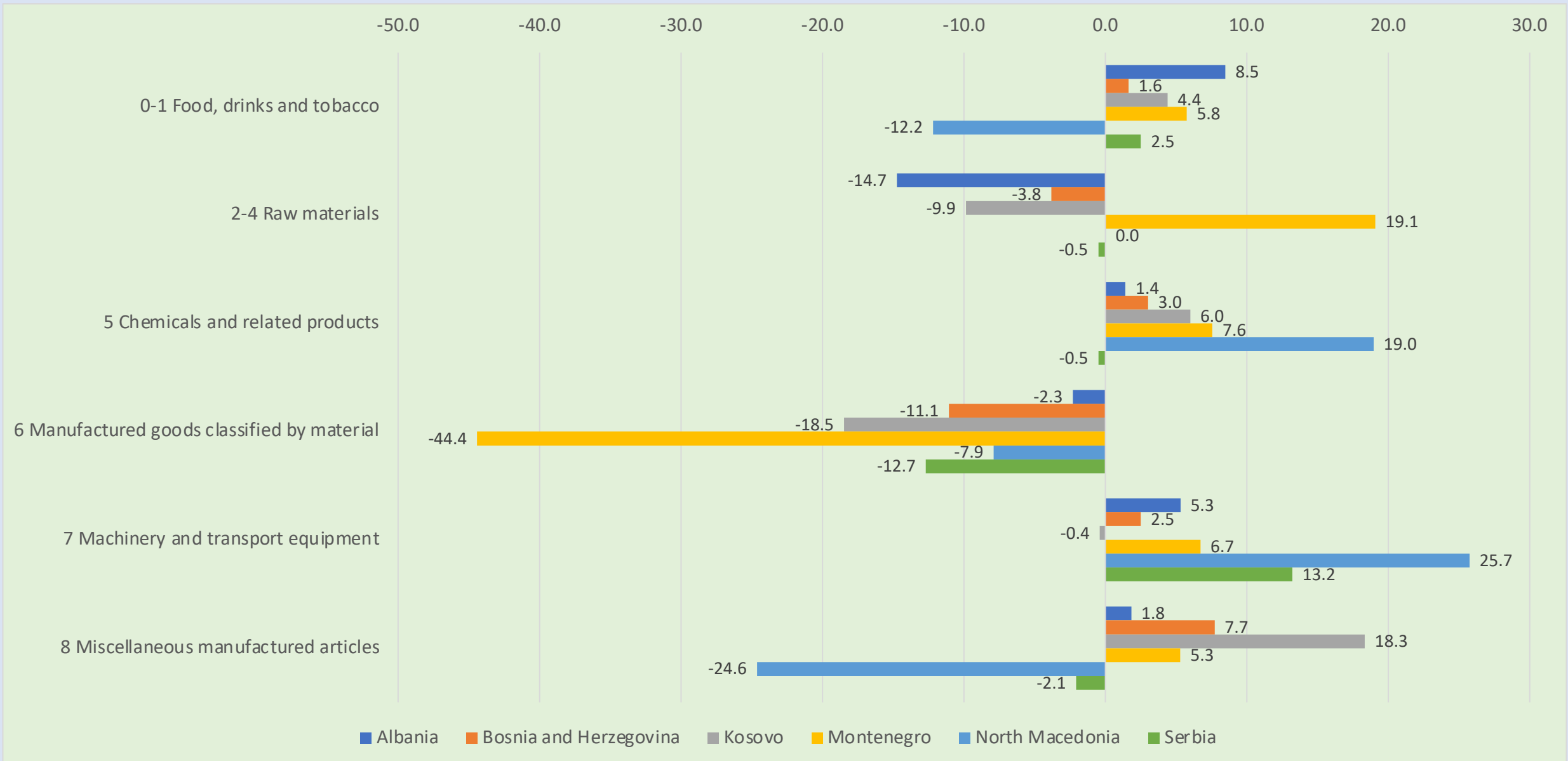
Exports/GDP (%) goods trade and services trade Country groups A (BA, MK, RS) and B (AL, XK, ME)



Exports from inward processing, Serbia (% Total Exports)



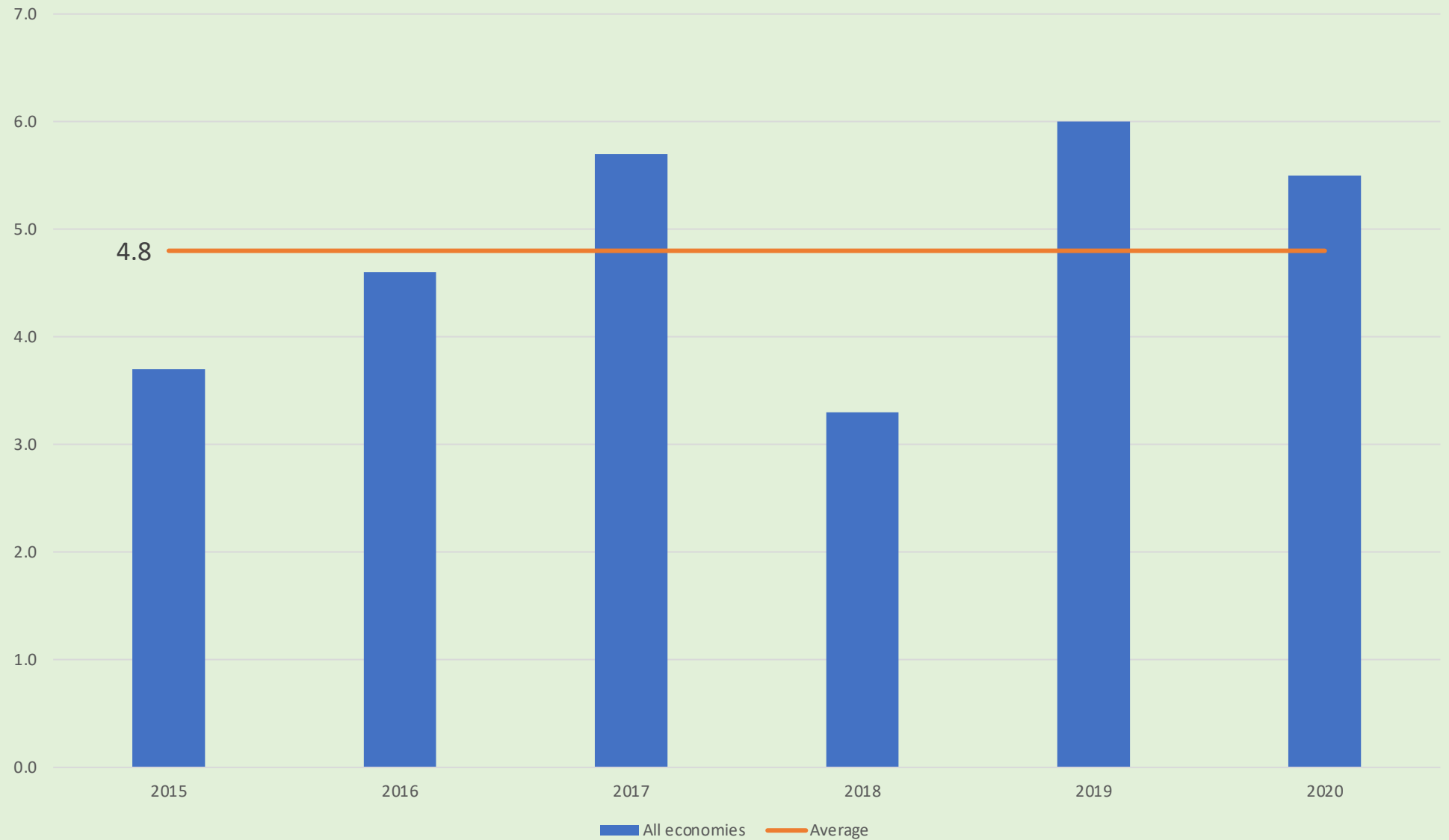
Restructuring of the manufacturing sector, 2008-2020



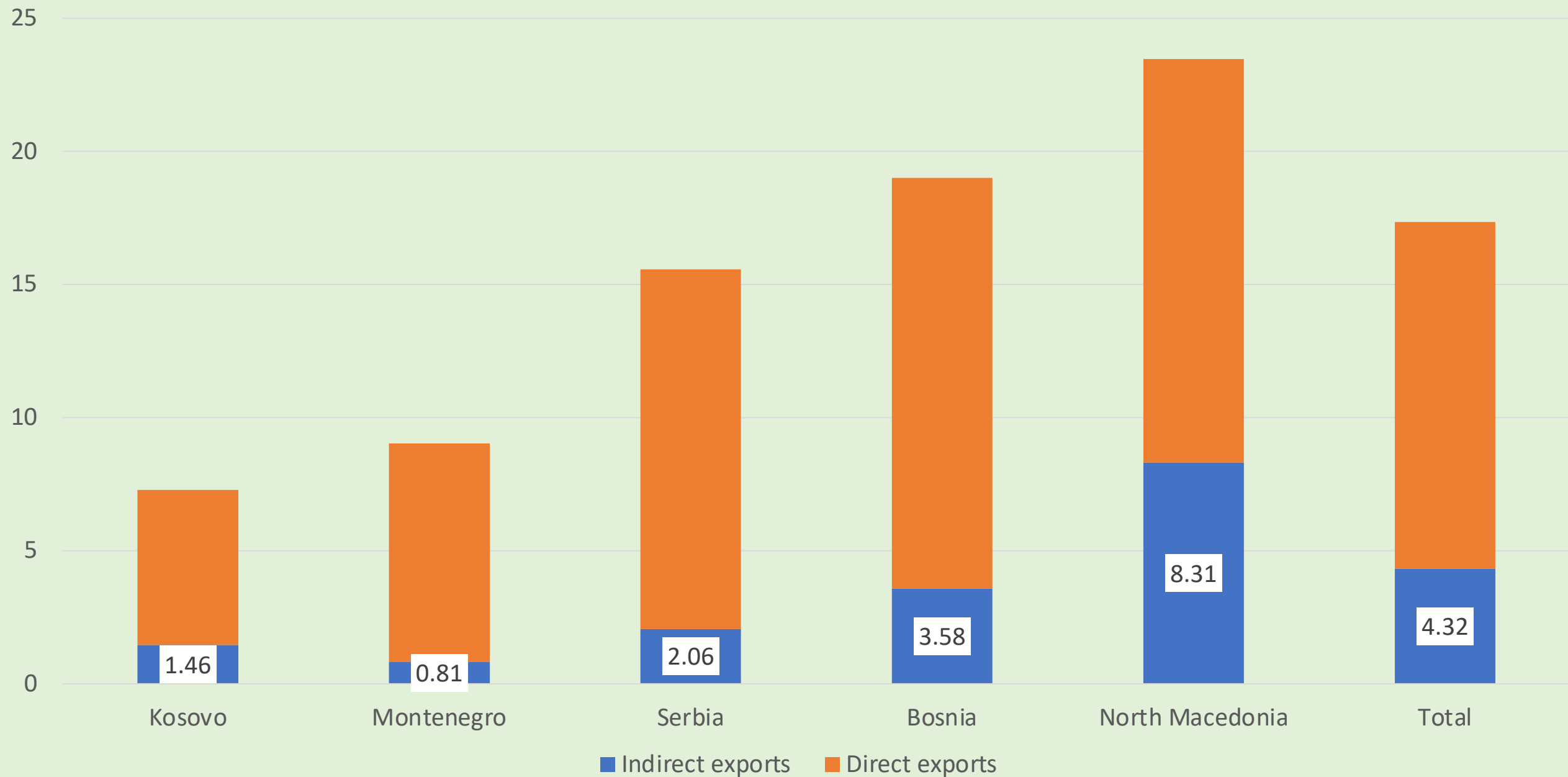
FDI backward linkages to local economies

- Multinational companies based in Special Economic Zones and elsewhere are mainly engaged in export processing and have **few links to local companies**
- There is **little evidence of spillover effects** from FDI to local economic development through development of supply chains
 - Estrin & Uvalic (2016) found no evidence of backward linkages (quantitative methods)
 - Bartlett, Krasniqi & Ahmetbasić (Croatia Economic Survey, 2019) found some evidence of backward linkages, but rather minimal (qualitative methods)
 - Popovic-Pantić, et al. (2020) survey of SMEs found late payments and lack of information are key barriers to developing regional supply chains to MNCs

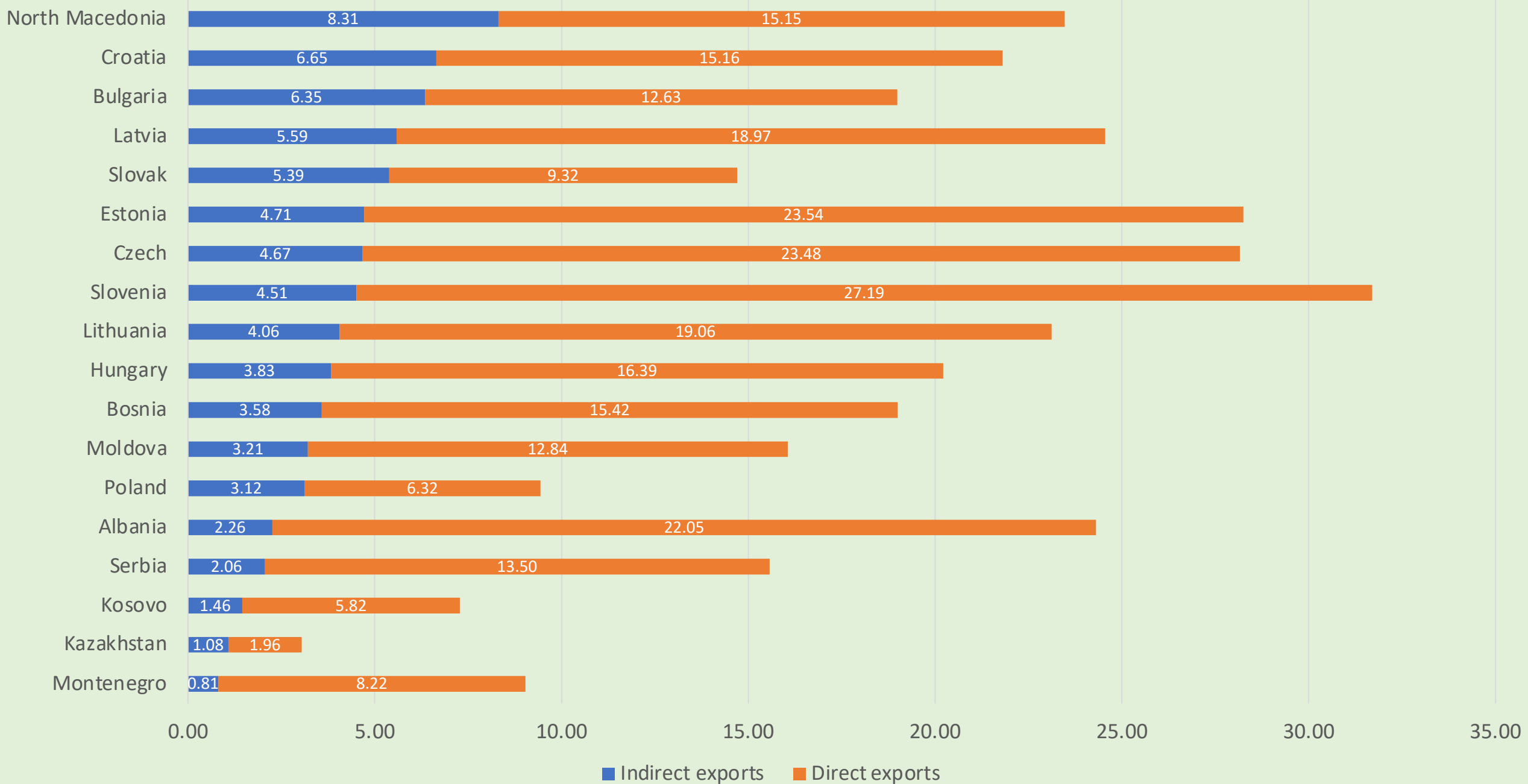
% of your respondents' sales made to multinational companies in Western Balkans home countries
(Source: Balkan Business Barometer survey)



Share of total sales in WB6 that are indirect and direct exports (%) (EBRD BEEPS survey, 2019, N=1,500)



Indirect and direct exports in total sales in CESEE (%) (EBRD BEEPS survey, 2019)



North Macedonia Supplier Development Pilot Programme 2015

- Targeted interventions to increase the sophistication of local SMEs, help them compete more effectively, and integrate them into the global and regional supply chains of large foreign companies located in and outside the special technological industrial development zones (TIDZs)
- The supplier development programme main elements:
 - Technical support, particularly on quality standards
 - A sourcing database to match local suppliers with investors
 - Introduction of participant companies for joint tendering
 - Organizational support for networking events

Effects of COVID 19

- Contraction of economic activity by 3.4% in 2020
 - Resurgence of infections in winter and spring 2021
 - Recovery depends on vaccine rollout
- Regional cooperation more urgent than ever to deal with this situation
 - Regional “roaming free” agreement came into force on 1 July 2021
 - Common Regional Market (CRM) Action Plan 2021-2024 agreed

Common Regional Market (CRM) Action Plan

- **CRM Action Plan for the Western Balkans:**
 - **Regional trade area:** Enhances CEFTA to promote regional trade
 - **Regional investment area:** Aims to attract FDI on a regional basis
 - **Regional industrial and innovation area:** develop regional value chains
 - **Regional digital area:** integration into pan-European digital market
- Builds on Regional Economic Area (REA) Action Plan since 2017
 - Underpinned by **EU Economic and Investment Plan** for the Western Balkans
 - Coordinated by RCC and CEFTA Secretariats

CRM: Regional trade area

- **Cross-cutting trade measures**
 - Green lanes, eliminate NTBs, trade related (state aid), and other
- **Free movement of goods**
 - MRPs, risk management, SEED+, harmonise rules of origin with EU
- **Free movement of services**
 - AP6 – further liberalisation of services, tourism, financial services, postal services, professional qualifications (7 professions), electronic commerce
- *Free movement of capital*
- *Free movement of people*

CRM: Regional industrial and innovation area

- Inclusion of domestic firms in international supply and value chains and **developing new regional value chains**
- Focus on key sectors
 - Automotive supply chains
 - Green and circular economy
 - Packaged tourism
 - Agro-food industry
 - Creative industries
 - Metal processing industry

Regional Industrial (and Innovation) Area

- **Regional industry development**
 - Conclude regional supply chain protocol as a result of the **regional supplier development programme** (RCC, CEFTA, WB6 CIF)
- Expected results:
 - Regional economic interconnectedness fostered by overcoming supply chain challenges
 - Enabling complex collaboration between enterprises in the region
 - Safeguarding supply chains against future disruption
- **Automotive industry value chains**
 - Map and establish regional automotive cluster initiatives (WB6 CIF, CEFTA, RCC)
- **Sustainable tourism** (RCC, CEFTA)

Conclusions: weak backward linkages from SEZ policies

- North Macedonia and Serbia have made **progress in attracting foreign investors**
 - But high cost in subsidies
- Many **new jobs have been created**, and some improvements in export competitiveness has occurred, but:
 - Little evidence of labour productivity growth or widespread technology spill-over
 - The import intensity of production is high, with few spillovers to local economies.
- **Few multinational companies source their inputs locally**
 - Local SMEs find it difficult to supply foreign companies in SEZs due to limited production capacities and large technology gaps

Conclusions: Lack of backward spillovers may hinder success of CRM pillar on industrial development

- Governments have **failed to develop the capacities of local businesses** to engage with SEZ-based MNCs linked to global value chains.
- Governments should **provide greater support to local SMEs to expand their capacity to supply inputs to multinational companies based in the region.**
 - Upgrade the technological level of local suppliers
 - Provide fiscal support to local SMEs rather than subsidies to large foreign investors
 - **Remove remaining barriers to trade to support regional supply chains**

Thank you for your attention!