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Balkans: the South-Eastern gateway to a New Europe

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Introduction*

The area we call Balkans is a group of countries in Eastern Europe, a melting pot of people, languages, religions that in the last decades (just a few years ago) was characterized by a strong political instability culminated in the dissolution of Yugoslavia[1]. During the Nineties, all these countries changed their economic structure from a centrally planned to a market economy going through an important period of reforms and improving their social, political and economical situation. European countries, and especially Italy, have had an important role to help Balkans in reaching these goals through several economical and institutional instruments. This situation, together with the geographical nearness, has created strong links among them. Within this group of countries, Romania and Slovenia are already part of the European Union while Serbia, Montenegro, Croatia, and Macedonia are undertaking their accession process.

The recent financial crisis has demonstrated the strength of the link between the European Union and these countries: the slump was particularly hard in Europe and Balkans have slipped into an economic crisis mainly due to their exposure to the European economy. In particular, trade with European Union countries represents Balkans' largest trade volumes while strong capital flows and the large presence of European firms represent other two important links.

In this paper we focus on these links, trying to assess the degree of economic and commercial integration between the European Union and Balkans, with a specific focus on Italy. Economic relations of Balkans with Italy have been particularly intense during the last decades. The most interesting aspect is that perhaps the one experienced with the Balkan area has been one of the few examples, if not the only one, of a "systemic" integration, involving not only commercial exchanges, but also investment flows, presence of credit and financial institutions, labour mobility (through migration flows), security cooperation and technological and cultural exchanges. These relations are extremely important both for the countries of the region, as an opportunity to grow and integrate faster, and for the Italian enterprises as for many of them (especially the small ones) the experience in this area can be considered a "first step" to the internationalization process which, as we know from the economic theory, can help them growing in competitiveness and efficiency.

* We would like to thank Giampaolo Bruno for his helpful comments and Area Studi ICE for the permission to use data from ICE's dataset in this work. The authors are the only responsible for the views or errors expressed in this paper. The paper was accepted for publication in June 2011.

1 Bosnia, Croatia, Macedonia, Serbia and Slovenia belonged to it, Moldavia was part of the Soviet Union while Albania, Bulgaria and Romania were satellite States of USSR.

In the first chapter of the paper we will analyse trade relations of the Balkans with the European Union and Italy while in the second chapter we will focus on investments.

1. Balkan Countries in world trade

As the fast spread of world crisis demonstrated, Balkans are well-integrated in the global economy (Table 1): the level of trade openness index[2] has constantly increased during the last ten years, reaching 80% in 2007. In 2009, it decreased as a consequence of the global crisis hitting trade and GDP of these countries; nevertheless, it remained above 60% while growing again in 2010. This is somehow a positive feature for Balkan Countries because most of these export-oriented economies could recover faster thanks to their trade openness.

In fact, if we exclude Albania, in 2008, all these countries had a propensity to export[3] (an index measuring the amount of total production sold abroad) higher than 20% and, particularly for Slovenia, this indicator reached 62%. However, lack of demand in world markets and especially in Europe has affected this indicator which averaged 26% in 2009 (it was around 30% in the period 2005-2008). Pre-crisis level has been regained in 2010 (31.7%). Balkan Countries' share on world exports has grown during the last ten years, reaching 0.9% in 2007 (in 2001 was 0.6%). Despite the crisis, in 2009 Balkans' share remained at the 2007 level.

Falling commodity prices in world markets have hindered the countries in the Region heavily relying on steel and metal exports. Balkans' share on world imports remains low and it has been equal to 0.8% since 2007. Furthermore the degree of import penetration[4] has decreased in 2009 which could be linked to the fact that processing trade[5] has been strongly affected by the crisis.

	2002	2004	2006	2008	2010
Trade openness	69.3	73.0	79.0	79.6	74.9
Propensity to exports	27.3	27.9	31.1	29.4	31.7
Market Share (% on world exports)	0.6	0.7	0.8	0.9	0.9

Table 1. Balkan Countries: main trade indicators
Source: based on IMF-DOTS and World Economic Outlook (April 2011) data

1.1. *Balkans and the European Union*

The European Union is the main trade partner of Balkan Countries. Euro area countries, in particular, rank first among the Area's trade partners: Germany and Italy are respectively the first and the second partner for both exports and imports but also Austria and France stand out as important partners (Table 2). Af-

2 X+M/GDP

3 X/GDP

4 M/GDP

5 According to this process, intermediate goods and components are exported towards another country to undergo some treatments and then re-imported. For Balkans it happens mainly with European Union countries.

ter the breakdown of trade flows during 2009, with a 29.3% contraction of EU exports towards the Balkans and 16.2% for imports, in 2010 trade flows between the EU and the Balkans countries regained momentum (5.7% increase for exports and 16.4% for imports). The European Union's share on Balkans imports and exports is around 62%[6].

European countries altogether are important trade partners for Balkan

Rank	Country	"export value (thousand of euros, 2010)"	% change 2009/2010	"import value (thousand of euros, 2010)"	% change 2009/2010
1	Germany	20,072,708	15.8	24,575,625	4.8
2	Italy	17,290,768	15.8	20,848,471	5.3
3	France	7,384,673	14.1	10,407,374	16.9
4	Austria	5,798,371	53.5	9,800,844	13.9
5	Turkey	5,194,484	15.5	8,993,679	-2.1

Table 2. Balkans main partners
Source: based on IMF-DOTS data

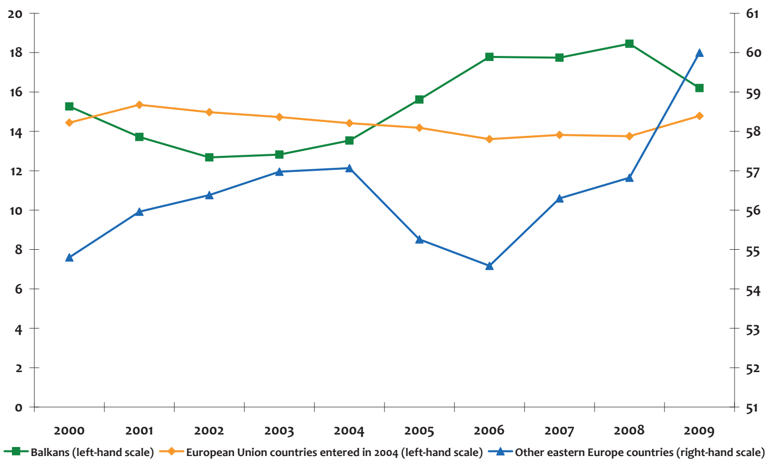

Figure 1. Dissimilarity Index
based on IMF-DOTS data

Countries: among Extra European Union countries, in fact, we have to highlight the important role played by Turkey (as the 4th export market) and Russia (as the 3rd supplier). Outside Europe, we should pay attention to the growing role of China between Balkans' suppliers (in 2010 occupies the 6th position): the value of Balkans' purchases from China has grown at a rate higher than 40% annually in the period 2000-2006. This is particularly important at this stage whereby China constitutes the driving force of global recovery[7].

In order to outline the trade relations between the Balkans and the European Union, we shall use a Dissimilarity Index[8] (figure 1), allowing us to describe the

6 We do not include Romania, Bulgaria and Slovenia in the European Union.

7 Congiuntura Ref., Aprile 2010.

8 $x = \frac{1}{2}\sum_i |a_i - b_i|$ where a_i is the Balkans' share in the area under consideration and b_i is the European Union share in the same area.

	Albania		Bosnia Erzegovina		Bulgaria		Croatia	
	1999	2008	1999	2007	1999	2007	1999	2008
Products of agriculture, fishing and forestry	4.1	3.2	....	1.7	4.9	3.1	2.1	1.9
Mining products	4.8	9.9	....	3.4	1.3	1.0	0.6	4.2
Food products, beverages and tobacco	3.8	3.8	....	3.7	7.9	5.8	5.5	5.7
Textiles	0.5	0.7	....	0.8	3.3	3.8	2.2	1.4
Clothing (also in leather)	40.6	32.6	....	6.6	22.0	16.6	18.0	6.7
Leather products (excluding furs)	30.2	21.6	....	11.2	5.7	2.7	6.2	3.5
Wood and wood products (excluding furniture)	1.9	1.2	....	6.6	2.4	1.2	6.5	4.7
Chemical products	0.5	0.2	....	3.4	5.8	4.7	7.9	7.1
Pharmaceutical and medicinal products	....	....	....	0.1	1.0	0.6	4.0	1.1
Rubber and plastic products	0.4	0.6	....	1.7	1.8	2.1	1.7	1.5
Metal products	2.3	3.8	....	16.4	18.1	21.6	3.4	4.2
Finished metal products, ecluding machinery and equipment	2.3	6.1	....	6.2	2.1	2.0	2.1	4.9
Computer, electrical equipment and electrical, electronic and optical apparatus	1.3	0.4	....	1.1	1.6	4.2	1.3	4.2
Electrical equipment and apparatus	1.5	2.9	....	2.4	2.4	4.9	5.6	6.9
Mechanical machinary and equipment	1.2	0.3	....	14.4	6.8	6.7	3.6	7.7
Motor vehicles and trailers	0.7	0.1	....	2.3	0.5	1.4	1.6	2.7
Other transport equipments	1.3	0.5	....	4.9	0.5	1.5	10.5	18.1
Furniture	0.4	0.9	....	4.6	1.2	1.5	2.6	1.8
Other products and activities	0.5	5.0	....	4.5	2.5	5.8	5.7	3.4

Table 3. Share of total exports towards the European Union
Source: based on Un-Comtrade data

differences between the geographical structures of both Balkans' and European Union's exports. This index shows the existence of some differences in the trade structures of these two groups of countries. The higher the value of the index, the larger the difference between the trade structures for the years under consideration. The average index value for the last ten years equals 15.4. In 2002 – 2004, following the crisis broken out after September 11 and up to the first wide European Union's Eastern enlargement, the value of the index decreased, due to the gradual orientation of Balkans' exports towards East Asia but also to the expansion of European Union's trade with Eastern Europe in view of the accession of new members. In fact, the differences shown in Figure 1 depend on the fact that the Balkans are more oriented towards Eastern Europe than the European Union while the EU maintains a strong trade orientation towards North America and East Asia. Data for 2009 show that the index value is decreasing again as a consequence of the international crisis forcing all countries to change the orientation of their exports towards emerging markets. Figure 1 also shows that the index for the Balkans is very similar to the one for the new EU countries (joining the EU after 2004); this circumstance contributes to identify a strong link between the EU and the Balkans. On the contrary, the index for the Balkans is very different

Macedonia		Moldavia		Romania		Serbia		Slovenia	
1999	2007	1999	2008	1999	2008	1999	2008	1999	2008
6.5	5.6	20.2	10.0	3.5	3.0	5.3	2.5	0.5	1.3
2.7	3.7	0.2	..	0.4	0.2	0.3	0.4	..	0.1
7.5	4.6	24.8	13.1	1.5	2.9	18.1	11.0	1.8	2.4
3.8	1.4	1.5	2.1	1.9	2.5	1.0	0.7	2.5	1.4
38.5	28.1	25.4	28.8	31.6	11.2	12.8	7.1	6.5	1.3
3.2	3.6	5.4	8.8	10.7	5.1	5.0	3.3	1.5	0.7
0.6	0.4	0.3	0.7	4.1	2.0	5.6	1.9	4.2	2.6
0.8	0.6	1.6	1.1	3.2	4.3	7.1	9.4	5.4	5.4
0.3	0.2	3.5	0.1	0.2	0.2	0.4	0.5	3.1	5.0
0.3	0.6	0.3	1.1	1.1	3.9	10.0	5.7	4.0	4.5
27.3	42.8	0.3	5.0	8.2	8.3	9.2	28.6	7.7	10.2
1.2	0.5	0.4	0.8	2.0	3.0	2.6	3.3	4.5	5.2
0.3	0.4	1.2	1.6	3.2	6.4	0.4	2.3	3.3	4.1
3.5	1.0	0.3	10.4	3.3	8.1	2.8	6.6	12.4	10.4
0.5	0.7	2.8	1.4	3.4	7.4	5.1	3.7	8.0	10.6
0.6	0.5	0.9	2.1	4.4	13.7	1.7	2.1	17.0	19.2
0.4	0.3	0.1	0.3	3.8	4.1	0.6	3.9	5.5	3.6
0.4	0.4	0.1	1.5	5.7	3.0	1.8	1.0	2.8	1.6
0.9	2.4	8.8	3.6	2.0	3.9	3.0	2.2	1.1	2.0

from the one calculated for the other Eastern European countries[9] whose exports have a slightly different geographical orientation. This could be linked to the fact that these countries include some large commodity exporters.

Under a sectoral standpoint, the structure of Balkans' exports to European Union's countries is concentrated on unskilled labour and natural resource intensive products (Table 3). Comparing the share of their total exports towards the European Union in 1999 and 2008[10] in fact, *Clothing and Apparel* represents the sector in which these countries record the highest share, even though in 2008 it strongly decreased everywhere compared to 1999. The only exception is Moldova, although in this case exports' values are lower. On the contrary, with regards to natural resource-intensive sectors, the share of Balkans has grown. In particular, the Balkans have increased their specialization in *Metal products:* Serbia's share tripled with respect to 1999 while for Macedonia it was nearly 50%. Only Albania, Croatia and Moldavia show a lower share in this sector.

An interesting change has happened during the last ten years: some of the countries considered in the paper have strengthened their export share in advanced products like *Computer and Ict Products* and *Electrical Equipment and Electrical, Electronic and Optical Instruments*[11]*.* This is the case for Romania, Bulgaria, Slovenia and Croatia which reached the best results in ICT Products and Electrical Equipment showing an intense shift towards skilled-labour-intensive exports. This phenomenon, probably related to their integration with the European Union market[12], bears several positive consequences because it assures a more sustainable specialization in the long run[13].

9 Namely Russia, Ukraine, Belarus and Turkey.

10 Data for Bosnia Herzegovina, Bulgaria and Macedonia are available until 2007.

11 The share in this sector is lower than the share they have in Clothing.

12 Croatia, Macedonia, Montenegro, and Serbia official candidates.

13 "Western Balkan integration and the Eu", The World Bank, 2008.

1.2. Balkan Countries and Italy

As said, Italy represents an important trade partner for Balkans. The Trade Intensity Index[14] (Figure 2) demonstrates the existence of intense trade relations even if its value decreased in the last ten years. Index values higher than 1 mean intense trade relations and for Italy these values have usually been above 6. The gradual reduction of the index value (5.6 in 2009 and in 2010) depends more on the growth of the Balkans' share on world imports rather than on the decrease of the share of this area on Italy's exports (that is nonetheless growing).

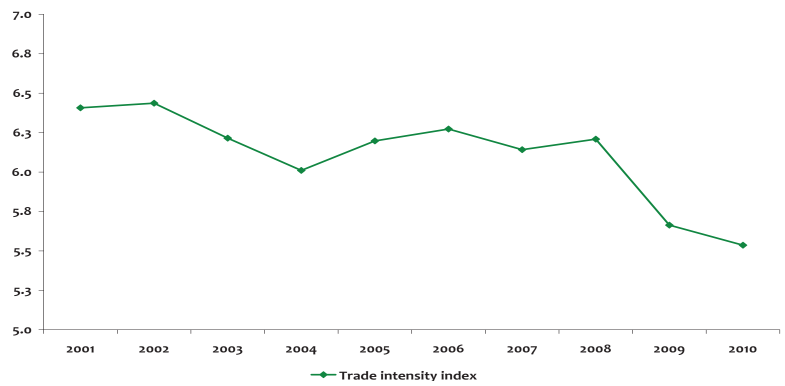

Figure 2. Geographical Orientation Index
Source: based on IMF-DOTS data

Furthermore the index of Balkans' geographical orientation supports the thesis that Italy is a main trading partner for the Balkans. This index allows us to describe the orientation of a country or of a group of countries toward a specific market compared to the orientation of another group of countries[15]. In our case we wish to compare the Balkans with the nine countries which joined the European Union after 2004[16]. If the index shows a higher value than 100, it means that the country under consideration enjoys a strong specialization in the specified market. Table 4 shows that Balkan countries exhibit a clear orientation toward the Italian market compared to the new members of the European Union; the index value was nearly 260 in 2010 even though it was almost equal to 400 in 2003. This change means that the Balkans are gradually changing their orientation but Italy still represents an important partner for them, more so than the new countries of the European Union.

As mentioned before, Germany too is a main trading partner for the Balkans. In this case, however, the value of the index is low because the orientation of the Balkans toward this market is lower compared to the new European Union countries. The value of the index was higher than 100 also for France, United States and Russia but it decreased during the last years. On the contrary, the Balkans' trade orientation toward China is very high.

14 The Trade Intensity Index is the ratio between the Italian exports' share in Balkan markets and the Balkans' share on world imports.

15 The index is the ratio between the percentage share of a country on Balkans' exports and the percentage share of the same country on New European Union countries' exports.

16 Czech Republic, Cyprus, Estonia, Latvia, Lithuania, Malta, Poland, Slovakia and Hungary. We do not include Romania, Slovenia and Bulgaria as they belong to the Balkans.

	2002	2004	2006	2008	2010
Italy	357.1	372.0	320.4	272.0	256.6
Germany	53.8	47.7	53.6	59.0	62.0
France	113.5	123.5	101.9	92.7	98.3
Russia	115.4	100.0	100.0	66.7	57.1
United States	115.9	107.5	90.6	77.7	92.8
China	470.7	213.7	194.4	161.1	226.7

Table 4. Geographical Orientation Index
Source: based on IMF-DOTS data

Italian exports' share toward the Balkans is very high (12.1 in 2010%) but it lost value during the last ten years (it was 18% in 2001). It should be noted that, in 2009, Italy lost market shares almost on every market[17] while it strengthened its share on Balkans' market.

Italian exports towards the Balkans include either investment goods (machinery, chemical and pharmaceutical products, metal products….) or other goods linked to outsourcing (processing trade) that many Italian firms have implemented in some sectors like clothing, textile and footwear.

Romania represents the first partner for Italy in this area; it occupies the 15th position among Italian client countries and the 18th position among Italian suppliers. The Romanian economy has developed many links with the Italian manufacturing system. As said, in Romania there are more than 1.000 firms with participations by Italian firms. Cultural ties and language similarity, for example, helped consolidating closer economic and commercial relations between companies from the two countries. Also Slovenia, Croatia and Bulgaria are among the first 50 Italy's partner countries both for exports and imports.

The return to normal economic conditions in these countries after the 2009 crisis and the new risks linked to the worsening situation in Greece are of great relevance for Italy. The recovery will remain modest in the advanced economies[18]; in this situation, Italy and the other main EU countries need to explore opportunities for a robust recovery in emerging markets. Asia is leading the growth momentum but also Eastern European countries are currently in the position of driving the recovery after the crisis.

Recent estimates of Balkans' demand for Italian goods in 2011-2012[19] look positive for all the countries considered in this paper. Estimates for Bulgaria in 2011 show a recovery for Italian exports that is going to consolidate in 2012; Italian exports towards Romania will grow more than in the other countries considered in the paper, while estimates for Croatia indicate a more moderate growth compared to the other countries within the area. Demand for Italian goods from Albania will grow around 10% in 2011-2012.

As we will show in the second section of the paper, due to the strong economic integration of the Balkan area with the EU, and particularly with Italy, the recovery of production levels following the international economic crisis is going to support a rebound of trade and investment flows in the area contributing to promote its growth and development.

	2011	2012
Albania	10.3	9.8
Bulgaria	9.6	12.2
Croatia	6.0	5.8
Romania	13.5	11.7

Table 5. Estimates of Balkans' demand for Italian goods (% change at constant prices)
Source: Ice - Prometeia Report 2011

17 Refer to the Italian Institute for Foreign Trade's Report "Italy in the world economy", July 2010.

18 IMF World Economic Outlook update, July 2010.

19 Ice-Prometeia's estimates, March 2011. Estimates are available only for Albania, Bulgaria, Croatia, Romania and Slovenia.

2. Trends in FDIs towards Balkans

After analysing trade integration of Balkan region with the rest of the world, and in particular with the European Union and Italy, we will now look at FDIs' flows.

In this chapter we will investigate the integration process of Balkan countries in the world economy under the point of view of foreign direct investment with a special focus on the integration with the EU and Italy. Integration through foreign trade, as seen in the previous chapter, and attraction of investments need to be considered as two complementary facets of the capacity to integrate in global markets. The linkage comes from two sides.

On the one side, the attraction of Foreign Direct Investment (FDI) is considered extremely important in helping the economic system of transition countries to catch up not only for firms and sectors directly affected by the investment inflows but also for the positive spill-over effects to other sectors and firms, thanks to the transfers of technology, know how, managerial skills, labour relations.

On the other side, FDIs can even be beneficial in the improvement of export performance, multinational enterprises being more export-oriented than domestic firms[20]. As shown in figure 4, data confirm the existence of a positive correlation between FDIs and exports even in Balkan countries: countries with a lower investment attraction are characterized by a relative worse export performance.

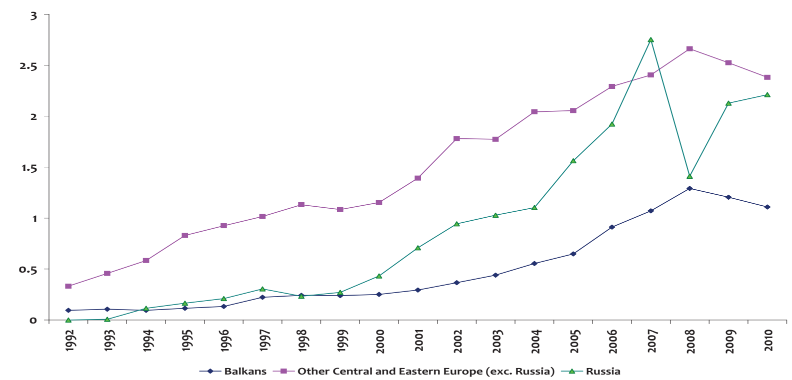

Figure 3. **FDIs in Balkan countries and in Central and Eastern European countries (*)**
(share on world FDI stocks, in percentage)
Source: based on Unctad, WIR 2011
(*) Czeck Rep., Hungary, Estonia, Latvia, Lithuania, Poland, Slovakia.

Since the beginning of the transition to a market economy, especially after 2003, there was a clear upward trend in FDI inflows (Figure 3). However, the share of the Balkan area on the stock of inward FDIs is equivalent to less than a half in comparison with Central and Eastern European countries. There is a strong lack of homogeneity inside this region as far as FDI inflows among different countries are concerned. Looking at FDIs' stocks, Romania and Bulgaria, already members of the EU, are the first two recipients with, respectively, 70 and 48 billion dollars in 2010 (Table 6). Croatia is ranking third with 34 billions. The other

20 See World Bank (2008).

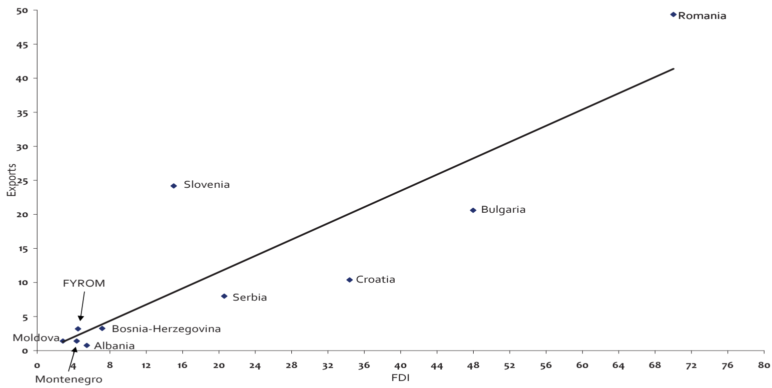

Figure 4. **FDIs and Export Perfomance**
(2010, for FDI inward stocks, data in billions of dollars)
Source: based on IMF, Dots, and Unctad World Investment Report, 2011

	FDI Stock				FDI stock per capita in dollars		FDI stock on GDP in %	
	2000	2008	2009	2010	2000	2010	2000	2010
Albania	247	2,797	3,537	4,355	82	1,386	6.8	36.7
Bosnia-Herzegovina	1,083	7,191	7,642	7,152	285	1,788	19.7	42.5
Bulgaria	2,704	43,993	49,183	47,971	330	6,293	21.0	100.2
Croatia	2,796	30,883	35,955	34,374	636	7,752	13.1	56.8
Macedonia	540	4,132	4,525	4,493	270	2,202	15.0	48.0
Moldova	449	2,567	2,650	2,837	125	781	34.8	49.2
Montenegro	-	3,353	5,055	5,456	-	9,093	-	138.2
Serbia	1,017	18,964	20,584	20,584	-	2,801	-	46.5
Slovenia	2,893	15,638	15,127	15,022	1,447	7,511	14.5	31.5
Romania	6,953	67,911	72,007	70,012	316	3,272	18.6	43.9
Balkans	18,681	197,428	216,265	212,256	331	3,775	16.3	42.5
Czech Rep.c	21,644	113,174	125,827	129,893	2,122	12,371	38.2	67.6
Estonia	2,645	16,387	16,788	16,438	1,889	12,645	46.6	85.6
Hungary	22,870	88,529	98,757	91,933	2,242	9,193	48.3	71.0
Latvia	2,084	11,537	11,602	10,838	868	4,712	26.6	45.2
Lituania	2,334	13,074	14,010	13,449	667	4,075	20.4	37.1
Poland	34,227	164,307	186,115	193,141	889	5,083	20.0	41.2
Slovakia	4,762	51,034	52,641	50,678	879	9,385	23.3	58.1
Other CEE (excl.Russia)	90,565	458,041	505,741	506,368	1,265	7,152	27.6	37.7

Table 6. Stock of Foreign Direct Investment by country (in millions of dollars) and other selected indicators
Source: based on Unctad and IMF data

countries follow at a large distance. It can be useful to normalize for the dimension of the countries. Considering per capita FDIs' stocks, it emerges that in 2010 three of these countries, namely Croatia, Slovenia and Bulgaria, received an amount of capital not far from what it was received on average by Central and Eastern Europe and comparable, for instance, to that of Slovakia. Some laggard countries like Albania and Moldova attracted a much lower amount of FDIs in this period.

Albany	(2006)
Italy	51.1
Greece	24.3
Turkey	3.8
Usa	1.9
China	1.7
Germany	1.7

BHR	(2007)
Austria	28.9
Serbia	13.7
Croatia	11.8
Slovenia	9.3
Switzerland	7.4
Germany	5.9
Netherland	2.5
Italy	2.3

Bulgaria	(2009)
Netherland	37.4
Austria	11.9
Germany	9.0
France	6.8
Belgium Luxem-bourg	5.0
United Kingdom	4.7
Russia	4.4
Italy	1.0

Croatia	(2009)
Austria	27.0
Netherlands	17.5
Germany	11.5
Hungary	9.0
France	5.7
Luxemburg	5.2
Slovenia	4.4
Italy	4.2

Macedonia	(2008)
Greece	15.2
Netherlands	14.7
Hungary	13.8
Austria	11.3
Slovenia	8.9
Switzerland	6.8
United Kingdom	4.9
Bulgaria	2.9
Italy	1.87

Moldova	(2009)*
Romania	15.0
Turkey	11.0
Russia	10.0
Italy	10.0
Ukraine	8.0
Usa	5.0
Germany	5.0
Cyprus	3.0

Romania	(2009)
Netherlands	19.9
Austria	14.9
Germany	12.3
France	8.8
Greece	6.1
Cyprus	5.9
Italy	5.5
USA	4.3

Serbia	(2009)
Austria	12.7
Greece	7.8
Norway	7.5
Germany	6.3
Italy	3.9
Slovenia	3.0
Russia	2.8
Luxembourg	2.1

Slovenia	(2008)
Austria	46.0
Switzerland	11.0
Netherland	7.0
France	7.0
Germany	5.0
Italy	4.0
Belgium	3.0
Luxembourg	3.0

Table 7. Top investors in Balkan countries (share on total inward stocks)
*Percentage share on the number of foreign firms
Source: ICE on national sources

2.1. FDIs by country of origin

The source of investment in Balkan countries is highly concentrated: the largest amount of FDIs originates from the near EU countries. The region enjoys clear advantages from its proximity to the EU. Austria, Germany, Italy, Greece and, for some countries, France are among the main sources of investment (Table 7). Many studies have verified that gravity factors[21] matter for FDIs as well as for trade flows: in some studies it emerged that their role accounts for about 60 percent of total FDIs[22].

An interesting phenomenon is the rising importance of some of the most advanced countries of the region as investors in other countries of the same region. For example, firms from Hungary, Poland, Slovenia and Czech Republic are

21 Gravity factors are linked with market size and proximity to the investors.

22 See D. Demekas et al. (2005).

investing in Bosnia and Herzegovina or Former Yugoslav Republic of Macedonia especially in service sectors like telecommunication, banking and retail trade. Sometimes the subsidiaries of transnational corporations relocate to countries characterized by lower labour costs.

	Number of firms		Employees		Turnover (mln of euro)	
	2003	2009	2003	2009	2003	2009
Albania	123	137	6,602	6,420	298	375
Bosnia Herzegovina	46	54	1,245	1,482	46	76
Bulgaria	128	169	9,663	10,775	645	1,501
Croatia	113	154	4,824	9,474	343	869
FYR of Macedonia	8	11	1,069	1,142	91	119
Moldova	18	27	282	679	13	26
Romania	836	1,082	62,566	82,408	2,025	4,441
Slovenia	120	139	6,098	6,728	530	791
Montenegro	7	10	48	80	4	10
Kosovo	1	1	20	20	1	1
Serbia	116	146	12,169	9,781	618	329
Balkan's countries	1,516	1,930	104,586	128,989	4,615	8,539
Central Eastern Europe	1,127	1,376	93,267	114,362	10,479	23,062
World	18,435	22,715	1,216,558	1,352,070	287,194	460,513

Table 8. Balkan's firms participated by Italian enterprises
Source: based on ICE Reprint database

2.2. FDIs by sector

According to Eurostat data, during past years, investment in Balkan countries were concentrated in banking, distribution and manufacturing sectors. The banking sector in these countries has a share of foreign ownership of above 80 percent, with the exception of Former Yugoslav Republic of Macedonia which still shows a low share in terms of foreign presence.

As far as the other sectors are concerned, FDIs are concentrated in manufacturing (Croatia and Serbia), electricity, gas and water (Macedonia), transport and communication (Serbia) and trade (Bosnia Herzegovina).

It should be noted that there is a very strong linkage between privatisation processes and foreign investment in these countries, as shown by the modest attraction of greenfield FDI projects; therefore, presumably, after the acceleration recorded during past years, the growing trend could stop or slow in the future. This could be one of the reasons behind the decline of the inflows in the last two years (2008-2009).

2.3. Presence of Italian firms

Italian firms have shown a strong and growing interest in this area: ICE-Reprint database[23] about the participation in foreign firms by Italian enterprises exhibits that, at the end of 2008, there were 1,930 participated firms in Balkan

23 Database ICE Reprint, created by professors Mariotti and Mutinelli by Politecnico University in Milan for Ice, collects data on presence, turnover and activity of foreign multinational enterprises in Italy and of Italian multinationals abroad.

countries (Table 8), employing almost 130 thousands employees and reaching a turnover of 8.5 billions of euro. However it is worth noting that, while the number of firms and employees working in participated companies is higher than in Central and Eastern Europe, the turnover is lower than in those countries, indicating that the dimension of Italy's investments in the Balkans is either generally small or that they are concentrated in more labour intensive sectors: the average turnover from a participation in the Balkans is equal to 4 million euros while that in Central and Eastern Europe is equal to 17 million (an amount more similar to the average turnover of Italy's participation of 20 million euro) .

A half of Italy's participations is concentrated in the manufacturing sectors (Table 9): the most important are Italian typical productions (textiles, clothing,

	Number of participations in foreign firms	*Employees in foreign firms participated by Italy's firms*	*Turnover of foreign firms participated by Italy's firms (million of euro)*
Mining products	0.6	0.1	3.8
Manufacturing products	48.5	76.7	51.8
Food products, beverages and tobacco	3.5	2.6	3.3
Textiles	4.2	8.5	5.7
Clothing (incl. in leather and fur)	7.7	17.8	5.6
Leather products (excl. clothing)	4.9	10.5	3.5
Wood and wood products (excluding furniture); prod. of straw and woven products	2.9	3.4	1.7
Paper products, products of printing and publishing	1.9	1.5	3.1
Coke, refined petroleum products	0.2	0.1	0.0
Chemical substances and products	2.1	0.9	1.2
Pharmaceutical, medicinal and botanical products	0.2	0.2	0.4
Rubber and plastic products	2.6	4.6	4.3
Non-metallic mineral products	2.4	3.1	5.5
Basic metals and fabricated metal products (excl. machinery and equipment)	6.7	9.1	8.9
Computers, electronic and optical apparatus	1.0	0.8	0.4
Electrical apparatus	1.5	4.2	2.1
Mechanical machinery and equipment	2.9	3.5	2.9
Motor vehicles	0.6	1.1	0.0
Other transport equipment	0.2	0.1	0.0
Furniture	1.5	2.7	0.0
Other manufactured products	1.4	2.1	1.3
Energy, gas e water supply	3.0	5.1	7.4
Building	8.8	3.8	4.4
Wholesale trade	28.2	9.2	19.3
Logistic and transports	5.0	2.4	8.7
Information and telecommunications services	1.7	1.3	3.7
Other professional services	4.1	1.3	0.8

Table 9. Presence of Italy's firms in Balkan (1) countries
(% share of each sector on total, at 1.1.2009)
Source: based on Database Reprint, Politecnico di Milano - ICE
(1) Albany, Bosnia-Herzegovina, Bulgaria, Croatia, Greece, Kosovo, Macedonia, Romania, Serbia-Montenegro, Slovenia

leather and leather products) along with metals and metal products. Another half of Italy's participation is directed to the services' sector: primarily wholesale trade and distribution, followed by building, logistic and transport services.

In Serbia, the agreement between Fiat, Zastava car company and the Serbian government will lead to the creation of the joint ventures Fiat Automobile Serbia (FAS), whose shares will belong for 67% to Fiat and for 33% to Serbian Government: for a total amount of 700 million dollars, it will represent the most considerable industrial investment in the country, perhaps in the entire area, since the beginning of the transition period, not only from Italy.

2.4. An assessment of the presence of foreign investors in the area

The presence of foreign investors in the area has remained below its potential, as many empirical studies[24] have clearly demonstrated. We hereby indicate the main possible causes of the still modest attraction of FDIs:

(a) the limited dimension of the countries that can reduce the attraction of investment in comparison with large domestic markets, even though it could be objected that in Europe other small countries attracted a large share of investment in recent years (like Ireland, for instance) ;

(b) the fact that these countries are located in Europe's "periphery" and they are not well linked to "core" countries and, at the same time, the still modest intra-regional integration. Infrastructures in the Balkans have considerably improved but there still remain many important challenges[25]: cross border and intra-regional cooperation in developing motorways and road infrastructures should be enhanced, rail network is still underdeveloped as well as airfreights and overall airport facilities. Another important constraint comes from energy supply: in some countries there are still frequent black outs in power supplies so that many firms have to buy their own power generators bringing about relevant costs' increase.

(c) there were some difficulties linked with the transition process to a market economy: some countries encountered obstacles in the process of firms' privatisation (an example may be the Markovic law about privatisation of firms in Serbia in the '90s leaving most of the shares to insiders, workers and managers[26]). Looking at the transition towards a market economy and at the reform process of these countries' economic structures, one can see that, even in this context, there is a large variety among countries. For example the private sector's share of GDP varies from 40 percent in Serbia Montenegro to 75 per cent in Albania (see indicators from EBRD Transition Report 2009). On average transition indicators reveal that Western Balkans, with some exceptions, namely Croatia, still lay behind Central and Eastern Europe as far as structural reforms are concerned.

(d) the Balkan area was characterized by strong political instability and

24 See D. Demekas (2005).

25 See Investment Reform Index 2010, OECD.

26 M. Uvalic (2001).

many conflicts originating from ethnic, political or other reasons (like between Croatia and Serbia, between Serbia and Kosovo, between Macedonia and Greece). Some empirical studies have found that "the costs of instability in terms of foregone investment inflows are quite high"[27]. Investors are clearly discouraged by such an unstable political climate.

(e) In most recent years and in the near future, there could be a risk of contagion effects from the Greek crisis especially concerning the financial and credit sector. According to the most recent Unctad's World Investment Report (2011) the adverse effects of the crisis in the region have been relatively contained so far. Due to the crisis there was a lending reduction even though, as concerns foreign banks, parent companies often provided capital support to their local affiliates and their credit reduction turned out to be lower than that from domestic banks. Greek banks have a strong presence in the region, especially in Serbia, FYR of Macedonia and Albania. If bankruptcy risk seems far away, main rating agencies, such as Moody's or Fitch, downgraded nine Greek banks in May 2010 and also their affiliates in Bulgaria and Serbia: as a consequence of the crisis they will probably reduce their loans to Greek companies with participations in the area. Due to the crisis in 2010 FDI inflows recorded a reduction (47 per cent in 2010) for the third consecutive year. The countries with the strongest decline were Croatia and Serbia, while flows to Albania rose. Due to the persistence of financial instability in Europe, it is still impossible to evaluate the dimension of the contagion effect to the area.

FDIs are very important at helping countries in the catching up process, as indicated in many theoretical and empirical studies: "the technological know how, the implementation of advanced management structures and the modernisation of the manufacturing sector strengthen the economy's competitiveness, facilitate access to western markets and stimulate growth[28]". The relation in the opposite sense is also true: in fact, it is acknowledged that there is a strong positive correlation between the reform process and the capacity of attracting FDIs, as good climate for investors raises country's attractiveness .

In conclusion, the creation of an even more integrated area between the European Union, the rest of Eastern Europe and the Mediterranean Basin (Middle East and Northern Africa) would undoubtedly be favourable also for investment attraction. Geographical position can be of some help, but it must be accompanied by improvement of infrastructure, modernisation of telecommunication and financial systems, improvement of legal framework and development of a network of small an medium size enterprises.

Conclusion

Balkan countries represent a specific responsibility for European Union

27 J. C. Brada, A. M. Kutan, T. M. Yigit, (2004): in this paper the authors find that countries with conflicts or serious political instability suffer from significant shortfalls in FDI inflows.

28 V. Zakharov, S. Kusic (2003).

countries and especially for Italy, as they absorbed a great deal of European human, financial and military resources during the last decades; at the same time, Balkan countries represent an important challenge for European Union countries: only if Europe will be able to guarantee a European perspective to these countries, safe and strong borders can be built ensuring regional growth. Therefore economic instruments are among the most effective tools that can contribute to change for Balkan countries in the Europe's South Eastern gateway. As many indicators confirm, the integration process through trade and foreign direct investment flows is already important but, especially for FDIs, data signal that the capacity of attraction by this region can be improved. This means that the economic integration between Balkan countries and the European Union, and in particular their already strong economic link with Italy could grow even more in the future. Although geographical proximity facilitated the strengthening of this link, other specific efforts in many directions need to be put in place.

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