Studies on obstacles and opportunities for doing business in the region

Study no.6

Automotive Industry in the Western Balkans:

State of Play, Competitiveness and Challenges on Europe's Doorstep

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1 INTRODUCTION

Foreign Direct Investment (FDI) has played a crucial role in shaping the economic landscape of the Western Balkan region in recent years. Comprising a group of six countries located in Southeastern Europe – Albania, Bosnia and Herzegovina, Kosovo, Montenegro, and Serbia (the so-called WB6), the region has emerged as an attractive destination for foreign investors seeking potential opportunities for growth. The region, once plagued by political instability and economic challenges, has made significant strides in improving business environments, implementing structural reforms, and enhancing regional cooperation.

The strategic location of the WB6, connecting Central Europe with the Adriatic Sea, Turkey and the Middle East, serves as a gateway to the wider European market. Moreover, the region boasts a young and educated workforce, all contributing to its investment attractiveness. Over the past decade, this region has witnessed a surge in FDIs, with both established and emerging economies recognizing the region´s potential for investment ventures.

The accession efforts of the WB6 into the European Union and the close link to EU markets have been a significant catalyst for foreign direct investment. As these countries strive to align their economies with EU standards and regulations, they have been able to attract greater FDI flows from the surrounding EU member states and beyond. The promise of increased market access, improved infrastructure and harmonized business practices under EU membership prospects have fuelled investor confidence.

The sectors driving foreign direct investment in the WB6 include manufacturing, energy, tourism, information technology, agriculture, infrastructure development and real estate.

While the WB6 have made notable progress in attracting FDIs, challenges persist like bureaucratic hurdles and red tape, corruption, inadequate infrastructure, necessity for improved and demand-based education and health care systems and the need for further regulatory reforms. However, governments in the region have recognized these issues and, in cooperation with foreign partners and organizations, are working to address them, creating a more favourable investment climate and an increased level of success in encouraging further FDI inflows.

In general, the FDIs has played a pivotal role in the economic development of the WB6. With its strategic location, growing market potential and ongoing efforts towards EU integration, the region offers promising investment opportunities across various sectors with the automotive industry being one of the most promising and successful for several countries in the region so far. As the WB6 continue to implement necessary reforms and improve their business environments, they are poised to attract even greater levels of foreign direct investment, contributing to sustainable economic growth and regional prosperity.

2 REGIONAL ECONOMIC PARAMETERS

2.1 General Parameters

The WB6 region has come a long way over the last 2 decades in achieving economic progress. With a population of 17.6 million, the region today boasts a combined gross domestic product (GDP) of over 112 billion EUR and a comprehensive process of accessions to the EU. The region's location, its deep relationships with Europe and its industrial tradition from the socialist era present many opportunities for future development, especially at a time when distances are shrinking further with digitalization. Yet, proximity to the Western European markets matter more than ever.

Making the most of this potential will require collaboration in tackling challenges which have been further exposed during the COVID-19 pandemic. Boosting competences and education, strengthening social cohesion and ensuring a green transformation towards green business models and renewable energy sources, the valuation of the region's natural resources and nourishing of its human capital emerge as strategic priorities. Beyond practical and financial constraints, future solutions must address considerable institutional and governance challenges that remain across the region.

	Population (million)	GDP in current USD billion	GDP per capita, PPP	Exports of goods and services (% of GDP)	Net FDI inflows (% of GDP)
Albania	2 854 191	15.3	13 680	31.6	7.9
Bosnia and Herzegovina	3 301 000	20.0	14 875	40.1	1.9
Kosovo	1 788 878	7.9	11 402	29.2	3.6
Montenegro	622 028	5.5	21 534	43.7	7.6
North Macedonia	2 083 459	12.7	16 607	62.3	4.4
Serbia	6 945 235	51.4	18 292	51.0	8.3

https://www.oecd-ilibrary.org/sites/2cc279e8-en/index.html?itemId=/content/component/2cc279e8-en

2.2 Regional Comparison

According to the latest W Western Balkans Regular Economic Report of the World Bank the economies of the WB6 have seen their resilience tested over the last three years. Growth in the WB6 economies started strong in early 2022, before moderating toward year-end, but the impact of major shocks, such as electricity and heating outages, has been less severe than expected. Inflation surged to a two-decade high in 2022 in almost all economies, but now shows signs of easing due to slowing global growth. However, price pressures remain elevated in early 2023.

Based on the last available Doing Business Report the ranking varies significantly between the six economies - overall ranking:

	DB 2020 Rank	DB 2020 Score	DB 2019 Score
Albania	82	67.7	67.0
Bosnia and Herzegovina	90	65.4	65.4
Kosovo	57	73.2	71.0
Montenegro	50	73.8	73.7
North Macedonia	17	80.7	80.7
Serbia	44	75.7	73.9

https://archive.doingbusiness.org/en/doingbusiness

Note: Beginning in 2021, the World Bank discontinued the worldwide assessment in the Doing Business Report

Albania

Investments are concentrated in extractive industries and processing, real estate, energy sector, textile and apparel industry, banking and insurance, information and communication technology. More than 200 000 employees work in the tourism industry and in same time, the high dependency on tourism is also a risk factor. During the Covid-19 pandemic, not only the number of tourists but also the entire economic output collapsed due to travel restrictions.

The most important export products include clothing and shoes. They represent about 38.3% of total exports (2020) and more than 40% of the labour force is in the processing industry. International clothing brands use contract manufacturers in the country. Raw material is delivered to Albania, processed and exported as a finished product. Having this experience and skilled labour force, Albania offers a potential to diversify its own economy by "graduating" from the textile and footwear industry initially to labour-intensive automotive industry. Exports of machinery, equipment and spare parts increased by 7.2% from 2019 to 2020 with an increase of 24.4% over the two-year period. The main markets are Italy, Germany, Greece, France and the Netherlands.

Referring to data from the Bank of Albania for the year 2022 the FDIs marks the value of 1.37 billion EUR, marking a record figure in the flow of foreign direct investments in the country. Compared to 2021, when the flow was 1.04 billion EUR, this marks an increase of 337 million EUR or 32.5%.

Dominant origin country for FDIs in 2022 was the Netherlands (about 16%) followed by Italy Germany and Austria. The main source of FDI inflows in terms of flow was Real Estate sector, which represented about 21.2% of the total flow. Other economic sectors with a high contribution are the Extractive Industry sector, electricity, gas and water supply, Financial and insurance activities and the processing Industry.

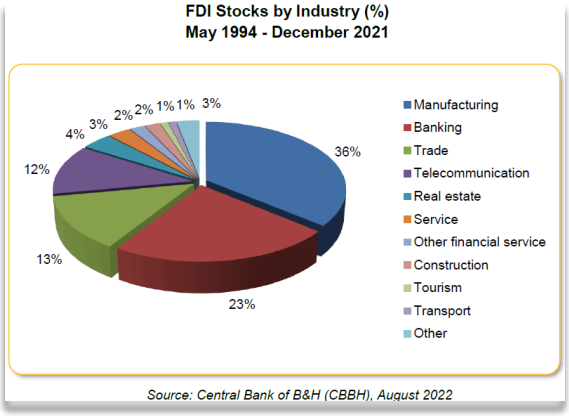
Bosnia and Herzegovina

Economic reforms to complete the transition from a socialist past to a market-oriented future have proceeded slowly and the country has a low level of FDI. Official data on FDI in BiH for 2022 are expected in August this year. According to the first preliminary data of the Central Bank within the Balance of Payments of B&H (the item Net financial liabilities) for the period January - December 2022 amounts 615 million EUR, which is an increase of 16.3% compared to 2021. In the World Bank's 2020 Ease of Doing Business Report, BiH was among the least

attractive business environments in Southeast Europe, with a ranking of 90. The Report ranked BiH particularly low for its lengthy and arduous processes to start a new business and obtain construction permits.

In Bosnia and Herzegovina, real GDP is expected to decelerate to 2.5 % in 2023 as private consumption growth halves due to weakening real disposable income, and negative net exports further deteriorate due to subdued output growth in BiH's main export markets in the EU.

In the period 1994 - 2021 top investors countries in BiH are Austria, Croatia and Serbia followed by Slovenia Germany and UK. In the same period the most attractive sectors for FDI were manufacturing and banking.

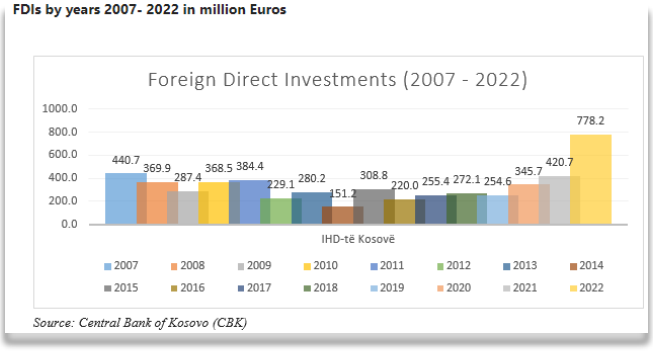


http://www.fipa.gov.ba/informacije/statistike/investicije/FDI%20Position%20and%20Performance_March%202023_E.pdf

Kosovo

In Kosovo, in 2022 growth moderated to 3.5 % driven by exports and private consumption—which continues to show resilience despite inflationary pressures. A large inflow of remittances and diaspora tourism combined with increased exports contributed to this growth. According to the World Bank, Kosovo's GDP growth is expected to pick up modestly, reaching 3.7 % in 2023. There are risks as pressures could rise in case of an inflation rebound and weaker-than-expected EU growth.

In 2021, the net flow of FDI in Kosovo was estimate at 420 million EUR, a significant increase over the 2020 amount of 345 million EUR while the 2022 ended up with 778 million EUR.



Real estate activities were dominating sector for FDI was Real estate activities (67%), followed by financial and insurance, ores and quarries, electricity supply and steam gas. The production had less than 2% of the net flow. The food, IT, infrastructure and energy sectors are growing and are likely to attract additional FDI in the forthcoming years. For 2022 Germany was the leading source country of FDI in Kosovo (29%), followed by Switzerland, USA and Albania.

Analyses of the capabilities embodied in the current export basket reveal considerable long-term potential for growth in the automotive industry (vehicle and engine parts), as well as in various other machinery and metal products. In the short to medium term there is growth potential in boosting exports of car seats, chemical products, metals and metal-based products, wood-based products, and agro-processing products (OECD, 2019).

Montenegro

Based on the Western Balkans Outlook, estimated real GDP growth for Montenegro in 2022 is 6.1% while the forecasted growth for 2023 is 3.5%. The tourism sector officially accounts for about 25 % of GDP, although some analysts believe it accounts for over one-third when taking into account the grey economy. In the energy sector, the most important development project in the transmission system was the construction of a one-way underwater electricity cable to export power to Italy, which included the development of a 433-kilometer-long connection approximately 1 200 meters below the Adriatic Sea surface. The project cost was 800 million EUR and began operation in December 2019. There are several other ongoing energy projects, including the controversial ecological reconstruction of the coal-fired thermal plant in Pljevlja in partnership with China's Dongfang Electric Corporation, as well as the development of a 55-megawatt wind power plant in Gvozd, a project supported by the EBRD. The Montenegrin government signed concession agreements for exploratory offshore oil and gas drilling, which began in March 2021.

In 2022 FDI net inflow in Montenegro was 782 million EUR which is increase of 35% compared to the 2021. 448 million EUR were invested in a real estate market. Although no one source country dominates FDI, significant investments come from Italy, Hungary, China, Russia, and Serbia, with other investments also coming from the United Arab Emirates, Azerbaijan, Turkey, and the United States.

The sectors attracting most FDIs are tourism, real estate, energy, telecommunications, banking and construction.

North Macedonia

According to the Outlook estimated real GDP growth for N. Macedonia in 2022 is 2.1%. Macedonian Government support cushioned the impact of the crisis on the labour market, with unemployment falling to 14.4 % in Q1 of 2023. In its Growth Acceleration Plan, the government set targets to double average annual GDP growth rate from 2.5 % to 5 % in the period 2022-2026, create 156 000 new jobs, and reduce unemployment to 8.6 %. It also committed to "green growth" by accelerating the energy transition and reducing greenhouse gas emissions in accordance with the Declaration on Green Agenda signed November 2020. While doing business is generally easy in N. Macedonia and the legal framework is largely in line with international standards, corruption is a consistent issue.

The medium-term growth outlook is positive, while downside risks have subsided. Growth in 2023 is expected to increase to 2.4 %, although this is 0.3 pp below the World Bank's autumn round forecast. Growth is projected to remain below potential, but to moderately accelerate as the large public investment starts and nearshoring of FDI continues.

FDI into N. Macedonia totalled 126 million EUR in the first quarter of 2023, compared to a net inflow of 136 million EUR in the like period of 2022. In 2022, FDI into North Macedonia totalled 753 million EUR, up from 512 million EUR in 2021.The majority of inflows arrived in the Q4 of the 2022 (246 million EUR).

According to figures by the Central Bank, the main investing countries Austria and the UK, followed by Greece, the Netherlands, Germany and USA. Manufacturing is the sector that attracts the most FDI (34.8%). The highest number of investment projects are in renewable energy, automotive, software and IT services.

Serbia

GDP grew in 2022 by 2.3 % and is forecasted to remain at same level for 2023. Serbia's investment climate has modestly improved in recent years, driven by macroeconomic reforms, financial stability, and fiscal discipline. Attracting foreign investment is an important priority for the government. In 2020, Serbia improved four places to number 44 on the World Bank's Doing Business index. Challenges remain, particularly bureaucratic delays and corruption as well as loss-making state-owned enterprises (SOEs), a large informal economy, and an inefficient judiciary.

As value-added industries with specific state support are chemicals and chemical products; basic pharmaceutical products and medications; electrical equipment; computers, electronic, and optical products; motor vehicles, trailers, and semi-trailers; production of other means of transport and rubber and plastic products.

For 2023 the growth outlook remains positive with expectation to grow steadily at around 3 % annually. The main driver of growth over the medium term will be consumption (with average contribution to GDP growth of 2.2 percentage points annually during 2023–25), and to a lesser extent investment (on average contributing 0.7 % points to annual growth). According to the World Bank Faster growth would be possible if, structural reforms were implemented to boost potential output, also through higher productivity and attracting higher-quality FDI.

Serbia Foreign Direct Investment - Historical Data

Year	Inflows, US $	% of GDP
2021	$4.57B	7.24%
2020	$3.49B	6.53%
2019	$4.27B	8.29%
2018	$4.07B	8.04%
2017	$2.89B	6.55%
2016	$2.36B	5.79%
2015	$2.34B	5.91%
2014	$2.00B	4.25%
2013	$2.06B	4.26%
2012	$1.28B	2.94%
2011	$4.93B	10.01%
2010	$1.69B	4.05%
2009	$2.93B	6.49%
2008	$4.06B	7.77%
2007	$4.42B	10.25%

Source: Serbian National Bank

In the first quarter of this year, the level of foreign direct investments in Serbia amounted to 783 million EUR, which is 39 % more than in the same period of the previous year, which was a record. In 2022, Serbia attracted totally 4.3 billion EUR of net FDI, which is the year- on-year increase of 17.7%.

The largest number of investment projects in Serbia are in the Automotive, Agriculture, Food and Beverage, Textile & Clothing and Electric & Electronics and most often they come from Germany, Italy, China, USA and Austria.

3 AUTOMOTIVE HERITAGE

The history of the automotive industry in the region, mainly in the countries of former Yugoslavia, stems from the 1950s. Serbia's Zastava in Kragujevac signed an agreement with Italian giant FIAT that would last, in some form or another, until 2008. In 1965 Zastava started exporting abroad. The United States imported over 140,000 Zastava vehicles, sold as Yugos. In 1989 Zastava produced a record 230,570 units. In total, Zastava produced over 4 million vehicles between 1953 and 2001 and exported to 74 countries, making Kragujevac the centre of the automotive industry of Serbia and the entire Yugoslav federation.

In 1967, a Slovenian company IMV reached an agreement with British Austin Motor Company to assemble models such as 1300, 1500, 1750 and, the worldwide famous, Mini. In 1972, IMV made a strategic partnership with Renault and started producing the popular Renault 4. Besides this model, they also produced the Renault 5, 12, 16 and 18 for the Yugoslav market.

Another Slovenian company, Tomos, and French manufacturer Citroën created a joint venture named Cimos in 1984. They portfolio included Citroën 2CV, DS, Ami, Dyane, AX, BW, CX, Visa and GS.

The TAS factory in Bosnia and Herzegovina entered into a joint venture partnership with Volkswagen and in the period of early 1970s until the onset of the Bosnian war in 1992 the Beetle and Golf 2 models were produces. Up to 25,000 vehicles were assembled annually at its peak for the local market.

After several years of successful co-operation, the iron foundry in IDA Kikinda signed a joint venture and long-term co-operation manufacturing contract with Adam Opel AG (Opel) in 1977. The export of locally made metal parts allowed IDA to import mostly finished Opels and have them treated as Yugoslav products. Up to 3,000 cars per year were "produced" in this way in the early 1980s.

Local assemblers had to form joint ventures with Western operators to sell their products in Yugoslavia, usually exporting locally made parts in return for Complete Knock-Down (CKD) kits. There was also a brief attempt by a company called Invest-Metali to assemble Peugeots in Kosovo, starting with 750 cars delivered in 1985.

Trucks and buses have been built not only in Slovenia (TAM Tovarna Automobilov in Motorjev Maribor with trucks under license from Praga and Magirus-Deutz), but also in FAP Fabrika Automobila Priboj under license of Mercedes-Benz. Buses have been produced by SANOS Skopje under license of Mercedes-Benz. Small quantities are still produced in all these locations. Buses are also produced by Ikarbus Serbia and INDBUS Skopje.

4 THE AUTOMOTIVE INDUSTRY TODAY

4.1 Overall Significance of the Automotive Industry

According to the available data from the national banks of the six countries, it can incontestably be concluded that the total number of directly employed persons in this industry exceeds 130,000 employees with revenues over 8.6 billion EUR. Publications by investment promotion and business development agencies (such as RAS in Serbia) primarily highlight the number of newly created jobs through FDI companies. Thus, the total number of jobs (FDIs, direct and indirect suppliers) in the sector is significantly higher.

The locally supplied products and services from domestic companies show continuous growth and diversification as a result of the development of these companies in their respective supply chains in terms of technological development, more frequent communication with foreign representatives, acquisition of new knowledge and certificates and of course the mood of the present companies for near-shoring and acquisition of close suppliers.

Equally, business development support services (lawyers, consultants, accountants etc.) drawn locally and before the establishment of the legal entities significantly contribute to the production processes. At same time, energy is sourced locally. Automotive FDIs start seeking for suppliers with qualitative input in their production process through the procurement of materials, semi-finished products or components. In the commercial vehicle sector, local purchases of up to 30 % of the productive material could be achieved.

Initially, processes of extremely hard physical labour were deployed. In the meantime, investments have become increasingly technologically oriented. Increasingly, not the price or quality (both factors are expected as a "minimum entrance ticket") but the technical superiority, innovativeness or sustainable character of the product is key for new supplier contracts. Electric vehicle powertrains, other vehicle systems and even entire trams come from the region. Currently, the focus is mostly on Serbia, which attracts approximately 70 % of all investments from Germany, according to the GTAI Head for the Western Balkans Martin Gaber.

Exports generated by these companies from WB6 countries reach over 8.5 billion EUR cumulatively. The exact determination of this amount cannot be reliably confirmed because there is no systematized database for the automotive sector in the six countries. If we take the annual value of the exports of these countries and knowing the economic structure of the largest importer, Germany, it is enough to draw a conclusion on the influence this sector has on the economic growth and development in the region.

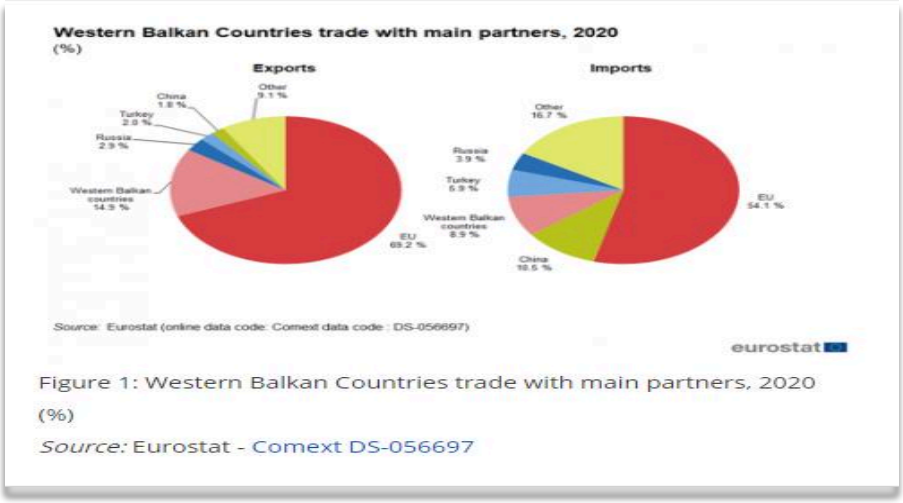


Figure 1: Western Balkan Countries trade with main partners, 2020 (%)

Source: Eurostat - Comext DS-056697

Between 2015 and 2022, trade in goods grew by more than twice to reach 16.7 billion EUR and German companies are increasingly investing across the WB6 – more than 4 billion EUR have been invested by the end of 2021.

With still relatively low labour cost and competitive infrastructure, there is currently hardly a better investment location choice than the WB6 on the EU's doorstep. A more detailed review of the strong growth of German imports in the past year from Kosovo (+46 %), Serbia (+42 %), Bosnia and Herzegovina (+35 %), Albania (+34 %) and North Macedonia (+11 %) shows the increased importance of the Western Balkans as a procurement market," according to the Competence Centre Southeast Europe of the Ulm Chamber of Commerce and Industry (IHK Ulm).

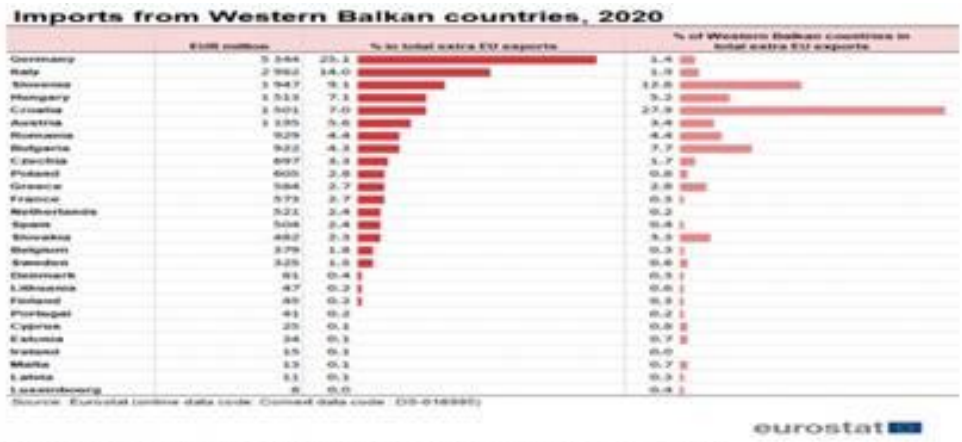


Table 2: Imports from Western Balkan countries, 2020 (EUR million and %)

Source: Eurostat - Comext DS-018995

The Wiiw Policy Notes and Reports 66 concludes that the automotive sector should turn towards higher-value-added activities that are based on high technology, instead of relying mainly on cheap labour.

Even though detailed analysis by the authors has not been performed to generate hard evidence to dispute these findings, initial examination into the net exports and contribution of the automotive industry for Serbia and N. Macedonia to their local economies in employment, export and overall perceived importance leads to an initial conclusion that the GDP contribution is of a higher value than the above-mentioned research.

Automotive is a large industry with a structured purchasing approach. Through the highly competitive situation and the regular product production cycle of about seven years, the industry is used to look for the optimum location. This is an advantage for regions like WB6 that offer good conditions for production locations.

4.2 Individual Country Situation

Albania provides a lower rate of corporate income tax for companies in the automotive industry than the regular tax rate. The plan for its first special economic zones near the capital Tirana is to give priority to the automotive industry. Foreign companies such as Forschner, PSZ Albania, Delmon, Giobert, Sews Cabind (Sumitomo) and Yura have already invested in the sector, especially in plastic components and wire harness manufacturing employing more than 3,500 workers.

BiH has a long tradition and wide experience in the automotive industry. Before the 1992, Volkswagen produced passenger and commercial vehicles at a plant near Sarajevo, while Kosmos (in Banja Luka) and Soko (in Mostar) produced buses. BiH companies in the automotive sector are producers of a wide spectrum of parts and components, such as: engines and gear components, high-quality metal precision parts, drive shafts, brake parts and systems, clutches, steering parts and systems, pumps, filters, automotive electric parts (signals, relays, electronic switches), textile and leather products, plastic injection moulded parts, aluminium wheels, car batteries, and various small parts such as springs, screws and hoses.

Prevent, MANN+HUMMEL, Cajavec FSU, FUSOL Nevesinje, Aluminij, Wagner Automotive, Jajce Alloy Wheels, Veritas Automotiv, Volkswagen Sarajevo, Plamingo, GAT, Enker, EMKA Bekto, Pobjeda are the main companies in the automotive industry in BiH employing a total of 12,280 workers. Projected annual revenue of this companies is over 300 million EUR (official data is not easily available or accessible).

In **Kosovo**, FDIs in manufacturing are incomparably lower than in neighbouring countries. The growth of the automotive sector is constrained by factors such as gaps in infrastructure, customs and logistics, lack of skills and flaws in the business environment. The potential for attracting new labour-intensive investors is supported by the still present young population and the high unemployment rate.

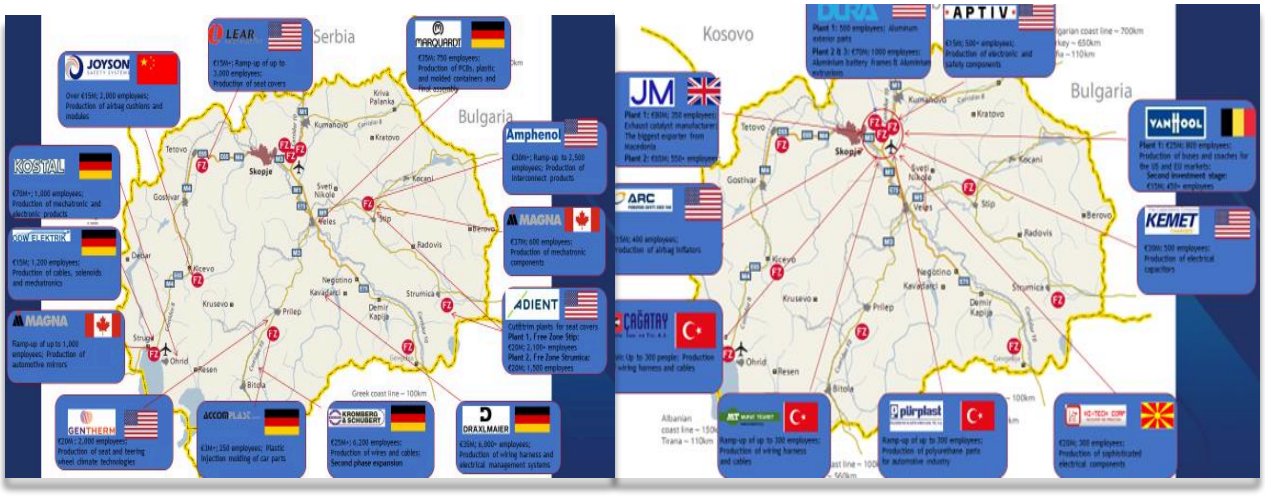
In **Montenegro**, the level of automotive FDI remains low and is not supported with structured approaches and specific subsidy measures. The lack of legacy, man-power and technological centers are additional factors for the underdeveloped automotive sector. The number of employed persons in the manufacturing industry is estimated at around 15,600 while the unemployment rate in 2022 was 14.7%. Aluminium casting pasts are produced in DAIDO Metal Kotor as one of the Yugoslavian car industries.

In **North Macedonia**, the automotive industry has a very important role for the economy in terms of its exports contribution. The automotive companies are largely integrated into the supply chains of the European automotive industry. These are companies that are mostly export-oriented and have a large share in the country's exports. The number of employees in foreign investors from the production sectors are above 30,000 persons.

Company	Location	Origin
Adient	Strumica	USA
Adient	Shtip	USA
Aphenol	Kochani	USA
Tab MAK	Probishtip	Slovenia
Aktiva	Shtip	MKD
Cranfield Foundry	Propishtip	RUS
Ruen Automotive	Kochani	MKD
DRÄXLMAIER Group	Kavadarci, Kumanovo	Germany
Kemet Electronics & Yageo	Skopje	USA
Aptiv	Skopje	USA
Chagatay Cablo	Skopje	Turkey
ARC Automotive	Skopje	USA
Dura	Skopje	USA
Lear Corporation	Tetovo	USA
Kiel	Tetovo	Germany
Te-Te Plast	Skopje	MKD
Telamon	Skopje	Canada
Gentherm	Prilep	USA
Akomplast	Prilep	Germany
ODW Elektrik	Struga	Germany
LTH Castings	Ohrid	Slovenia
KOSTAL	Ohrid	Germany
Johnsot Matthey	Skopje	UK
Van Hool	Skopje	Belgium
Murat Ticaret	Skopje	Turkey
Pureplast	Skopje	Tureky
Kromberg&Schubert	Bitola, Skopje	Germany
Joyson Safety Systems	Kichevo	China
Magna Mirrors	Struga	Canada
Magna Mechatronics	Shtip	Canada
Marquardt	Veles	Germany

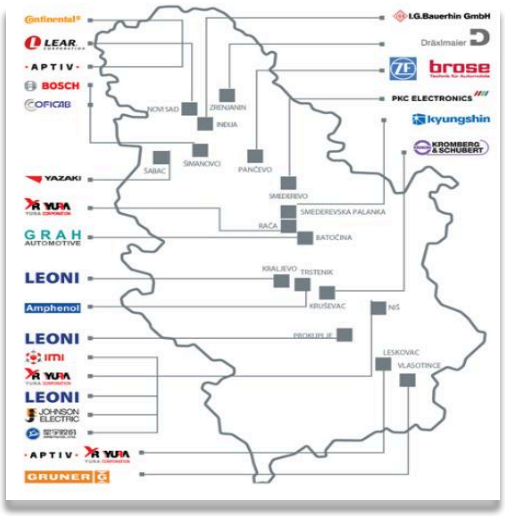
In the last three years mainly investors from USA, Canada and Germany takes the largest portion of the foreign investments in the country. Unlike Serbia there is no final production of cars mostly due to the limititation of large available workforce (except production of buses as final products by Van Hool). An investment of the German company e.GO into a small EV production with 30,000 units annually in Tetovo, N.Macedonia has been announced in 2022, but still has to materialize as the total demand for those vehicles is still to be proven. The number of employees in this sectore in 2022 was around 28,000 jobs of which the largest portion in the wire harnesss end mechatronics. At the current stage it is to early to envision R&D developments in this segment based on the low workforece availability and the underdeveloped technical educaational system. Total revenue from these companies in 2022 reached 4.0 bilion EUR.

Many of the investors have opted for the Technological-Industrial Development Zones for their projects. Around 80% of the companies in the TIDZ have an automotive focus.



Present investors in the automotive industry are Johnson Matthey, Van Hool, Kromberg & Schubert, Kostal, Marquardt, Kemet & Yageo, Aptiv, Dura, Adient, ARC Automotive, Dräxlmaier, Lear, Magna Mirrors, Magna Mechatronics.

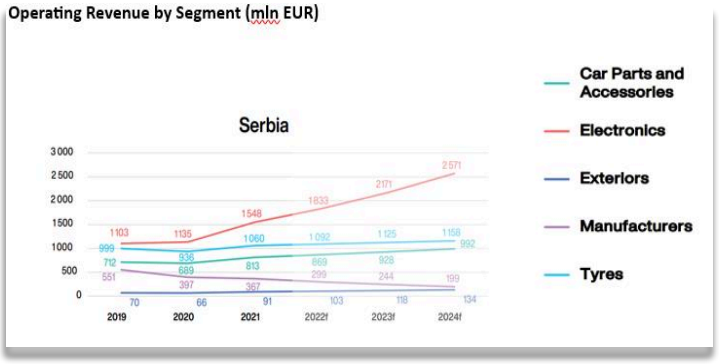
Serbia's automotive industry has become a massive magnet for foreign investment over the last decade, attracting both greenfield projects and revitalizing the country's rich industrial history through brownfield ventures. The automotive industry topped the list of the most attractive investment sectors in Serbia, slicing a 25.4% share in the total number of investment projects, according to data published by the Development Agency of Serbia (RAS) in March 2023.



The number of companies active in the automotive industry is significantly higher compared to the other countries (not only in the WB6), reaching more than 100 in 2023. This includes foreign investments but also companies with local capital established and developed in cooperation with the Tier 1 and Tier2 international supplier companies.

A total of 84,500 workers are employed in the automotive sector of which the highest percentage being engaged in companies manufacturing fabricating metal products, wire harnesses and production of final motor vehicles.

Based on revenues, exports value contribution is generated from the product groups like wire harness, tires and electric motors (revenue by segment available in Study at: https://seenext.org/reports/automotive-industry-in-southeast-europe-2023-edition/.



The majority of present companies (Adient, Aptiv, Auto-Kabel, Aunde, Dräxlmaier, Grammer Systems, Leoni, Magna, Yanfeng, Yura etc.) have invested additionally in the same or other locations. Yet, there is a new and growing trend of establishing R&D centers in area where engineering, IT/software development and technical staff is available and key to the development of new technologies, processes, products and services (BOSCH, Continental, ZF, Rivian, Nidec, P3 etc.).

Some of the major investors present in the automotive industries are Adient, Aptiv, BOSCH, Brose, Continental, Stellantis, Linglong, Michelin, Toyo Tires, Yanfeng, Johnson Electric, Leoni, Magna, Yura, ZF etc. German and Chinese companies dominated Serbia's investment landscape over the last three years as they sought to expand their production capacity and get closer to European customers. Rather than following nearshoring or offshoring trends and fully relocating production, most foreign investors chose Serbia as a springboard into the European market, either by expanding their existing presence in the country or selecting it as an initial point of entry to supply chains across the continent.

Product Group	Estimated revenue in Mio. EUR (2022)
Sum	**4362**
Wiring Harness	1047.9
Tyres	980.7
Electric Motors	516.6
Passenger Cars	408.45
Rubber Parts	261.45
Casted & Machined Parts	256.2
Car Seats & Components	229.95
Plastic Parts	98.7
Other	561.75

In 2008, Italian carmaker Fiat took over the Zastava plant in an investment project worth 940 million EUR. The plant was upgraded to facilitate the production of the Fiat 500L mini MPV. Currently operated by Stellantis, as joint venture with Serbia, the site has almost 3,000 employees. Until 2024 Stellantis invests additional 200 million EUR to upgrade its production facility to then initiate production of e-vehicles.

According to all analyses available for the period 2010-2022, the top 5 origin countries of FDI for each of the WB6 economies are EU countries.

5 NEARSHROING, RE-SHORING & ADVANTAGES FOR AUTOMOTIVE INVESTMENTS

Nearshoring - Global geopolitical developments over the last 18 months, as well as the strain on the supply chains due to the COVID pandemic and the over reliance on China and Asia overall has created an increased sense of urgency for nearshoring and localization of production on each continent and in the proximity of the final customer. Furthermore, additional "**friendshoring**" tendencies in countries that are NATO members, following common EU and Western policy on sanctions against Russia have also emerged recently.

Latest data for industrial real estate leasing in Eastern Europe for end of 2022 and Q1 2023 have shown a 29% increase in manufacturing and logistic space requirements amid a 'nearshoring' rush. WB6 countries are perfectly suited to benefit and at least participate in getting 'slice of this cake' from the companies looking to set up operations though the nearshoring principle in the vicinity of their final customers. Proactive investment promotion and presenting investment opportunities of the region directly to large industrial companies in automotive industry and similar sectors should be the mantra that all regional IPA agencies and governments engage in with additional vigour.

Re-shoring - Additionally, part of the Ukraine based automotive production (Tier 1 and Tier 2 suppliers) were heavily affected by the war and have already taken steps in finding alternative locations. Companies like ODW Elektrik, Gentherm, Kromberg & Schubert, Leoni and ZF have plan or already transferred part of their production to their existing facilities in North Macedonia and Serbia or have taken additional expansion decisions with building of new footprint. As the war Ukrainian drags on, there may be more opportunities for similar transfer of business to WB6 countries (both though expansion or new investment). The competition for this is fierce, especially from countries of North Africa – Morocco, Tunisia and lately Egypt. Considering that Moldova (security

concerns and proximity to Ukraine) and Turkey (political and economic instability) have been somewhat sidelined for investment decisions in the recent past.

Due to its geographic location, the WB6 is gaining attention from international companies and citizens, not only for doing business but also for tourism and recently short-term (nomads) or permanent relocations (mainly retirement). Relatively good and continuously improving level of connectivity allows fast moving of goods and people. This connectivity is further fostered by constant capital investment in infrastructure (road and rail link, airports). Workforce availability, culture proximity, cost competitiveness and existing regional supply base are additional advantages that aid the region's advantage and attractiveness.

For **potential automotive industry investors**, the WB6 region offers an already established track record of successful wide array of existing automotive FDI well embedded in the European supply chain. Coupled with long-term experience in industrial manufacturing of the region and the recent foray by companies in R&D activities on both software and hardware product development, process R&D activities, IT and shared services.

On top of and in parallel with general investment promotion efforts, **state aid and incentives are most common measures** used by the governments of the WB6 to influence the investors´ location decisions and attract more FDIs. The hard competition among countries seeing investment has created an increase in the offers to foreign investors. Several examples of incentives are corporate and personal income tax reliefs, tax holidays and tax reductions over certain time period, CAPEX and job creation grants, free or low-cost land plots with prepared infrastructure (available for purchase or long-term lease), customs exemptions, salary cost offsets, etc. As the whole region is already on various level of progress on its EU path, national incentives must be aligned with EU rules and regulations of state aid. Therefore, aid intensity based on level of investment amounts has to follow strict EU rules and guidelines and is overseen by local Completion Authorities.

6 IMPACTS AND MAIN FACTORS FOR FDIs

FDIs are a driving force of globalization and an important engine of economic growth. Historically, developed countries pioneered by transnational or multinational corporations benefited immensely by FDI while developing countries, via public policy measures, increasingly began to seek and attract FDI due to its many advantages for economic development.

Positive effects of FDI for the host country are widely known: transfer of technological know-how, implementation of advanced management structures and modernization of the manufacturing sector raise the competitiveness of the economy, facilitate access to western markets and stimulate growth. An increase of FDI inflows is crucial for the catching-up process and international competitiveness of the WB6 and consequently for the acceleration of the EU integration process.

Economic considerations are the driving forces behind the struggle to join EU: Countries expect economic advantages from the cooperation. In the short term, it is expected that integration stimulates inter-regional trade and investment; long-term expectations amount to an increase of growth rates by combining larger markets, intensified competition, and a more effective resource allocation.

In general, FDIs are done when the economic environment in a foreign country is more favourable for the investor than in his home country. This can be because of custom savings for selling his product, but between countries with free trade agreements the key reasons are cost advantages, e.g. transportation cost (especially in the FMCG sector), cost of primary and secondary materials or labour cost. Lower labour cost can be a result of availability of workforce, lower social charges or lower salaries. For the WB6 of special importance is that salaries

are close to the Chinese industrial averages, but for the supply of European markets the transportation costs are much lower, which makes this region very competitive in comparison to Asia (the same applies for Mexico).

Tax advantages and incentives are also an incentive, even so they tend to be limited in time. Labour cost advantages tend to be more long-term. Even with much higher increases in the country than in the home country, the lower base of departure shows that an equalization will mathematically need several years. Inflation effects in Europe normally spread over all countries. But statistics in other countries like the US also show that the gap between more and less expensive locations needs 20 and more years to close.

General Factors for FDI Attractiveness

Based on academic research and numerous empirical reviews, the **most important factors influencing the attractiveness of a location for FDIs** are:

- Market size and potential,
- Institutional and regulatory quality,
- Trade openness,
- Infrastructure quality,
- Economic and political stability,
- Labour quality and costs,
- Cultural links,
- Natural resources and
- State aid and government subsidies.

7 RECOMMENDATIONS TO IMPROVE THE WB6'S ATTRACTIVENESS FOR (AUTOMOTIVE) FDIs

Main Factors for the WB6 Countries

When discussing the attraction of FDIs in the WB6 context, the most important common factors and framework conditions for all WB6 countries are:

1. Business Climate & Framework Conditions,
2. Political Stability & Rule of Law,
3. Skilled and Available Labour,
4. Innovation Capabilities,
5. Green Transition and Sustainability and
6. Investment and Business Support Services.

7.1 Business / Investment Climate & Framework Conditions

Recommendation: Reducing Red Tape and Bureaucracy

Business and investment climate elements such as strong institutions and investor-friendly regulations are very important for developing and transitioning economies seeking to attract additional FDI. In a poor investment climate, foreign investors and host economies may not be able to benefit fully from business opportunities created by market size and growth potential. An economy that has a poor investment climate is therefore unlikely to attract good FDI than it otherwise could and should. Overcoming the bureaucratic and the red tape mentality of the public administration in the region, in many cases as a reminiscence of the past socialist system, is absolutely necessary to create an efficient, effective, welcoming and customer service-oriented approach. This includes the introduction or further rollout of digital services and the digitalization of administrative procedures (Serbia is already among the leading countries to that end in Europe).

This will create not only better and more conducive investment climate and business environment, but also speed up the necessary alignment to a modern EU-like public administration.

Selected key examples (being listed in surveys and research):

- General: lack of initiative, proactiveness and customer service orientation,
- Permits: Issuing of construction permits, residence and work permits (especially for expats) and
- Opening bank accounts and business registration.

Recommendation: New or Upgraded of Infrastructure

Generally, countries with a good and readily available (physical) infrastructure such as roads, highways, ports, bridges, railways, electricity, gas connections and telecommunications are likely to attract more FDIs and affect the location decisions in multiple ways. Infrastructure improves the business investment environment for FDI by reducing the cost associated with total investment by foreign investors and thus raising the rate of return from the investment. The presence of a good infrastructure can significantly reduce the company's' output costs, providing a positive incentive for vertical foreign direct investment or investment where transnational firms base their location decisions purely on a cost basis. Thus, availability of infrastructure directly influences the productivity and thereby attracts higher levels of FDI.

The overall effect of regional infrastructure and regional connection therefore a priori depends on the existing stock of domestic infrastructure in each host region/country. The infrastructure connection could also enhance access to intermediate goods suppliers in neighbouring countries, providing a positive incentive for complex FDI location strategies, where transnational companies locate different production activities in separate geographic regions.

Infrastructure can be a factor for attracting FDIs, but also can be a benefit from having an FDI in the country. There are many examples where the presence of an investor with significant impact on the local economy, the export or employment, is requiring and initiating improvements in the infrastructure (roads, telecommunication, water supply systems, etc.), and thus encouraging governments and local authorities to start capital investments which will later contribute positive on the economic growth.

Selected key examples:

- Provision of (regional) road and highway connection to and between main automotive hubs (Western Macedonia, Kragujevac etc.),

- Provision of fully functional and working infrastructure in industrial parks before investors start their operations,
- Provision of efficient freight railway systems and road-rail connecting points to railway network,
- Upgrade railway networks to EU standards,
- Support to extensions of regional destinations or big airline carriers in the region and
- Rollout of fibre optical cable networks.

7.2 Political Stability & Rule of Law

WB6 is in need of profound and continuous improvement of the business and investment climate, economic reforms and political stabilization, as well as overall alignment with EU rules and regulations, as the region aspires to become a member of the European family. Economic and political stabilization lead to an improvement of investment conditions. Combined with the reforms of the legal systems and the efforts in combating corruption, this will definitely increase inflows of FDI in the region. The domestic investments should be also encouraged in order to further aid economies to grow, develop and diversify. The implementation of a common market in the WB6 (CEFTA, Open Balkan Initiative, etc.) decisively increases the attractiveness of this region to foreign investors. Higher FDI inflow will enable easier access of the EU region.

Recommendation: Increase the Effectiveness of Legal Systems

The rule of law is a fundamental aspect of good governance. With laws that serve public interests and an independent judicial system, those responsible for a crime can be held to account. Since the early 1990s, with the prospect of joining the European Union, countries in the WB6 have taken steps to develop and strengthen their anti-corruption systems. Progress has been slow, however, and the implementation of laws and policies lags far behind political commitments.

One of the main obstacles to membership of the EU is weak rule of law, often the result of highly corrupt government and capture of public decision-making by private interests – powerful individuals, groups and organizations undemocratically shaping nation's policies, legal institutions and economies to illicitly enrich themselves.

The rule of law and corruption has a different influence by sector. In general, foreign investors are less faced by corruption, which is confirmed by several pools. On the other hand, administrative (in)efficiency is more an issue for foreign investors who do not have the possibility to "grease the mechanics" like local investors.

While EU membership may be an incentive, weak rule of law, state capture and impunity for corruption is undermining social and economic progress. This needs urgent and systemic action. Clean governments embodying democratic values and good governance will not only strengthen these countries in the European landscape but will enable development for the common good. Positive changes in this field will improve governance, transparency and accountability of the judiciary and democratic law-making and eliminate shortcomings of the criminal justice system when handling corruption cases, exposing tailor-made laws created to protect the private interests of a few.

The Common Regional Market in the WB6 builds on the achievements of the Regional Economic Area (REA) and with implementation of a (CRM) 2021-2024 Action Plan (RCC, CEFTA, Open Balkan Initiative, etc.) through targeted actions in four key areas:

- Regional trade area: free movement of goods, services, capital and people, including crosscutting measures, such as the Green Lanes, to align with EU-compliant rules and standards and provide opportunities for companies and citizens,
- Regional investment area, to align investment policies with the EU standards and best international practices and promote the region to foreign investors,
- Regional digital area, to integrate the Western Balkans into the pan-European digital market and
- Regional industrial and innovation area, to transform the industrial sectors, shape value chains they belong to, and prepare them for the realities of today and challenges of tomorrow.

Inclusive and democratically elected Governments, holding elections in a normal 4-year election cycle versus politically/crises motivated early elections, accountability of both elected and nominated public office holders are paramount for the region to become more politically stable and FDI attractive.

Recommendation: Increase the Timely Fulfilment of Contractual Obligations

Fulfilling contractual obligations means respecting the other party and the business itself. When a government is one of the contractual parties, then it's even more important to fulfil the contractual obligations timely and completely. Because if a government is not respecting the contracts, then it is not in a position to ask the same from the companies, and it's a bad example for other investors.

The core recommendation here can be summed up as state and public sector actors delivering their promised or contractually obliged services and payments such as state aid, infrastructural measures, legal permits.

7.3 Skilled and Available Labour

Recommendation: Reduce Emigration and Brain Drain

The labour shortage (in some locations and sectors massive shortages) is evident in all the countries in the region due to increasing rates of emigration on one hand and decreasing birthrates on the other. The main aim is to maintain positive demographic rates and structure by encouraging locally educated workforce to find suitable employment with adequate pay and career prospects in their respective home country.

Governments should initiate and lead the process of improvement of this situation and the FDIs will assist in this quest for mutual benefits for all. One of the main factors attracting the FDIs is the available and skilled labour in a best cost environment. With the current rates of emigration and brain drain, the region is slowly but surely losing its main factor of FDI attractiveness, and this is why governments should be strongly encouraged to reduce, manage and ultimately reverse this process.

<u>Concluding the following activity recommendations are suggested:</u>

- Improvement of educational system with a focus on universities and technical schools (e.g. overall quality of teaching, update of technical curriculum, usage of modern technologies and equipment like robotics and mechatronics, increased competitive of regional education institutions, specialized automotive and engineering research and research centres in relevant faculties/schools),
- Strengthening of soft skills training in education curricula, e.g. project management, team & communication skills, innovation techniques etc
- Additional university funding,

- Attractive educational programs (e.g. dual education) with a high potential to employment in the local industry (domestic or foreign investors),
- Open Balkan Initiative to support regional movements of the workforce and easier employment of expats and
- Regarding the lack of available skills, all WB6 have a strong diaspora of often highly skilled individuals, some of whom could perhaps be persuaded to apply them in their home countries.

Recommendation: Enlarge Offer of Vocational Training and Dual Education Programs, Pre-university and University Level, with a Cross-Border Offer and Increased Share of In-company Training (50:50 %)

The vocational training should be extended to at minimum 50 different professions in the next five years, and the share of in-company training increased to at least 50 % of the time. Through agreements, the final exam should follow the standards of Western European countries like Austria, Germany or Switzerland, as countries that have most experience in the field of dual education and technical training. The qualification of the teachers shall be enhanced through mandatory in-company traineeships of at least two weeks per year and 24 months in the first four years of activity. The engagement of experienced outside staff, e.g. senior workforce – engineers or experienced technicians, should be strongly encouraged.

7.4 Innovation Capabilities

Recommendation: Establish Education and Research Focus on Industrial Electronics, Industry 4.0/5.0 and Other Production-Related Subjects

Most of the WB economies have a low share of STEM graduates (Albania, Bosnia and Herzegovina and North Macedonia), but Serbia, on the other hand, is performing better in this respect. Albania is ranked lowest, having the least share of STEM graduates in whole of CESEE. Bosnia and Herzegovina is second, while N. Macedonia is third. Serbia is ranking as the best of the WB economies, and also the second-best of all CESEE countries, which may explain why it has been attracting rather high amounts of FDI in recent years. *(Source: UNESCO's Education Statistics)*

In this context, a program to reinforce STEM studies in relevant areas should be started. This could be part of the Smart Specialization Strategy. Current curricula should be assessed and only supported if a sufficient labour market demand exists (Also see the *Finance Think* conclusions on the Regional Integration of Labour Market from spring 2023). Funds and means should be reoriented accordingly. Outside inputs like teachers and seminars from potential employers should be facilitated. At the same time, academic staff should be given the possibility for traineeships in companies in order to be up-to-date with the latest technological advances applied in advanced companies and industries.

A new structure should allow educational institutions to work for companies, but the received compensations should be for the institutions, similar to the model of other countries like Germany. Paid research should be encouraged but ultimately benefit the institutions.

In this context, a separate organization of laboratories and training workshops might be necessary, where the income comes either via the students (who receive a voucher to pay for this), the companies (who are invoiced) or the academia itself (who receive funding through research funds or paid research). The income would then be used to compensate the technicians, pay for materials, repairs and investments in new equipment.

In this regard, unilateral donations from the leading investments in the automotive sector to equip cabinets with advanced technologies and equipment are especially welcome, knowing the budgetary limitations of universities. (e.g. Johnson Matthey in Pharmaceuticals faculty , KOSTAL in Mechatronics, Continental in Technical Studies etc.) A credit scheme for such support, similar to Romania or France, would support this.

Most of all, in order to stop the emigration and brain-drain from the region, the WB6 governments should bring better quality of life and trust in the system itself, institutions, the legal system and health care system.

Recommendation: Establish Cross-Technology (Excellence) Clusters, e.g. Battery Technologies, AI, Embedded Software, Digital manufacturing etc.

The automotive industry is undergoing several massive changes triggered by global technology trends, climate change and changing consumer expectations – e-mobility, decarbonization, circular economy, software-defined vehicles, connected cars, in-car entertainment etc. To give one example in this context, the development costs for a passenger car are expected to rise from 40% for software in 2023 to 60% in 2030. Therefore, the automotive industry will increasingly be a digital and software industry with resulting requirements towards staff, processes, suppliers, technology, innovation.

It was already mentioned above that the regional is still struggling with the image of "low cost, mainly manual jobs" in this sector. But there are clear signs (like the massive R&D investment into software development capacities by Continental in Serbia) that a shift towards higher value-adding jobs and therefore different positioning in the automotive value chain(s) are ongoing. So, it´s essential for this value chain upgrade that regional companies develop the respective skills, knowledge and business models needed to participate in this trend and thus inherently increase their chance of attracting and retaining highly qualified talent desperately needed.

At the same time, these new trends and technologies will lead to increased FDIs focusing on software development and at the same time allow a whole new set of (start-up and established) companies to enter the automotive industry and value chain as suppliers. With software operational systems logic familiar from mobile phones or PC (e.g. iOS, Android, Windows) now entering the operational systems of passenger cars, new business opportunities arise.

One instrument in this context are Smart Specialisation Strategies which exists in all countries in various stages of development. These strategies include the creation of clusters should be supported. Clusters could be university and school installations at the same facilities as industrial companies, e.g. near industrial zones, shared laboratories for common use or similar. It could also be a research and development space near university institutions (e.g. science and technology parks) and campuses with the possibility for companies to obtain standard offices and common facilities in these shared settings. A good example is the Textile Cluster Facility in Boras, Sweden where university, vocational schools, textile marketing and companies share the same facility including machines, canteens, research laboratories etc. Positive experience is recognised from the established KfW Regional Challenge Fund for WB countries as instrument for stimulating the communication on long term between the manufacturing companies and the vocational school in applying the request, equipping the school's laboratories and training students based on the needs of the companies.

Concluding the following activity recommendations are suggested:

- Evaluate and map the market requirements (customer perspective) and current capabilities of regional automotive, software and tech companies (supplier perspective) in a comprehensive ecosystem mapping.

- Strengthen the capabilities of existing automotive ecosystems and clusters in regard to new technologies and trends.
- Support and enable cross-industry and cross-technology initiatives and clusters to assess and exploit the new opportunities.
- Evaluate new skill demands from OEM/tier 1 etc. perspective as a precondition for FDIs in this field and initiate respective training and qualification schemes.

Recommendation: Enable Industrial Clusters and Proximity

Small economies and regional industrial co-operation are issues which are both no less important to recognize in the WB countries. However, they generate more interest in these regions because of the small size of the countries which, indeed, form a strategic area to be evaluated. There has been a consciousness regarding the importance of geographical proximity in determining the location of industrial activity. Industrial clusters may develop as long as the availability of skilled local workers is adequate, when the key inputs from suppliers and rapid technological improvement is spread out between firms.

There're strong linkages between the foreign capital and localized industrial clusters and they upgrade innovation and competitiveness of the whole region.

- clusters may embody short- and long-term competitive advantage for multinationals,
- local suppliers are essential in the long-term sustainability of clusters, because it is known that a stronger local supplier industry represents a basis for long-term sustainability,
- clusters may embody short- and long-term competitive advantage for multinationals as they can source from a competitive local base,
- FDIs play an important role in fostering industrial clusters across borders, regionally.

These lines of research are important taking into consideration the small nature of single Balkan economies, while a component of their competitive advantage in Europe and internationally may come through the formation of effective industrial strategies.

Recommendation: Integrate Key Topics and Requirements of the Automotive Industry Into the Industrial Policies of WB6 Countries

As part of Chapter 20 of the EU accession process each candidate country is obliged to develop an industrial policy. Some WB6 countries like Serbia already have such policies covering different strategic and industry-specific topics. The automotive industry as one of the biggest employers and driver of innovation in the region (increasingly together with the IT services and development industry) needs to have its main topics and concerns being reflected in these policy instruments (many outlined in this report)

It is strongly suggested that all WB6 countries run regional and country-specific public-private-dialogue schemes to collect and evaluate industry input for the drafting, review and implementation of industrial policies.

<u>Concluding the following activity recommendations are suggested:</u>

- Initiate and facilitate (through Chamber of Commerce, Business Development Agencies, Investment Promotion Agencies etc.) public-private-dialogue schemes.

- WB6 decision-makers in the public and business sector should include the suggested input and recommendations from these public-private-dialogue schemes and other advocacy instruments into the national or preferably even regional industrial policies.

7.5 Green Transition and Sustainability

Recommendation: Increase Awareness and Fast-Track Implementation of Sustainability and Greenhouse Gas Emissions (GHG) Management and Green Technologies Along All Supply Chain Elements

The transportation sector is responsible for over 20% of the global greenhouse gas (GHG) emissions with the individual transport being one of the main sources. Respectively, globally government increasingly intervene and bring in ever tighter GHG and other regulations (see Paris Agreement, EU/WB Green Deal, ETS/CBAM, EU/German supply chain laws etc.). In parallel, consumer expectations equally change towards low carbon and sustainable products, especially e-vehicles/-mobility and transport alternatives. Therefore, the automotive industry is at the forefront of global efforts to reduce this footprint through sustainable raw material sourcing and decarbonization of production and transport processes.

More than three quarters of the greenhouse gas (GHG) emissions associated with many industry sectors come from their supply chains. For that reason, a growing number of leading companies (OEMs/Tier 1) are engaging their suppliers in about managing GHG emissions. Over the past few years, these companies have incorporated systems for reducing GHG emissions into their own business practices and are now seeking ways to drive down emissions beyond their own operations. The application of Environmental, Social & Governance (ESG) and sustainability criteria as part of OEM/Tier1/Tier 2 supplier qualification processes and reviews (equally for new and established suppliers) is standard behaviour and expected to be tightened through external (3rd party) audits.

<u>Concluding the following activity recommendations are suggested:</u>

- Increase awareness and information sharing of company ESG/sustainability requirements through the automotive supply chain (e.g. online campaigns, conferences, trainings, meet-ups).
- Increase information/knowledge sharing and exchange and implementation of regulations among countries (governments and business sector alike) at regional conferences to increase awareness of these trends and implement necessary legislation and/guidelines on the subject. The existing or additionally necessary events should be coordinated to avoid repetition. In order to increase reach, they should rotate through WB6 countries on an annual basis. The Green Agenda for the WB should be used as one of the underlying policy coordination instruments.
- Connect the region to global and industry-specific initiatives like Drive Sustainability and Responsible Supply Chain Initiative (RSCI) for information and process support.
- Prepare and support companies for ESG/sustainability assessment and audits - the automotive ESG assessment standard “Drive Sustainability” questionnaire should be used as the basis for training and qualification measures. Concrete actions include trainings (online/offline) and consulting.
- Prepare and support companies with their understanding and implementation of key industry standards such as ISO 14.001, 45.001. Concrete actions include trainings (online/offline) and consulting.
- Support supplier companies in the establishment and running of their sustainability risk assessment/management and carbon management systems as part of their capability building towards global supply chains. Concrete actions include trainings (online/offline) and consulting.

- Support supplier companies in their rollout of sustainability criteria and practices throughout their supplier networks (going through the whole supply chain along the EU/German supply chain logic of OEM/tier 1 etc. to direct and indirect suppliers). Concrete actions include trainings (online/offline) and consulting.
- Support to the establishment of regional supplier peer group mechanisms for information, knowledge and best practice exchange.
- Support to the establishment of pools of experts and consultants providing automotive-specific support in carbon management, ESG and sustainability topics and requirements.

7.6 Investment and Business Support Services

Recommendation: Professionalize and Depoliticize Investment Promotion Agencies (IPAs)

IPAs can help increase FDI inflows, attract higher quality FDI, and transform the economies of their home countries. Many IPAs are struggling to reach their full potential. They are not nimble enough to respond to new market realities, lack strategic focus and they do not adequately provide services most valued by investors, such as advocating for improvements in business climate. Foreign investors appreciate IPA services offered across their investment life cycle - not just during the investment attraction and entry/establishment stages but also when considering and implementing expansion or diversification investments.

Concluding the following activity recommendations are suggested:

In order to increase their impact, IPAs should be strongly focused on the following:

- Sharpen their strategic focus based on competitive and comparative advantages of the host country and long-term vision on most important and relevant sectors,
- Participate at most relevant industry conferences, fairs and networking opportunities with clear message of the investment advantages and getting the country on the investment map,
- Build a coherent institutional framework locally and regionally,
- Provide high-level government support in transparent and impartial manner,
- Proactively engage in policy advocacy (see above chapter in industrial policy) and aftercare – understanding of the development needs and the institutional hurdles facing the existing investors and how to best support them in overcoming these obstacles and improving the local business environment,
- Be allowed to have a high degree of institutional and financial autonomy to avoid political interference and disruptions during political transitions,
- Retain and attract professional staff preferably educated abroad and with specific sector knowledge or prior relevant work experience; attracting young and motivated professionals that have studied abroad and worked in consulting, banking or industrial sectors (automotive/manufacturing) in Germany, US, Canada is always a plus; finding an appropriate remuneration scheme to entice and retain such professionals may be a challenge that can be overcome with creative practices and out of the box thinking (e.g. IPS staff should be regarded and treated as civil servants but as a private sector business developer and project manager).

These elements should help IPAs to strengthen their delivery of relevant and high-quality investor services across the investment life cycle. They should also be able to rapidly adapt to sudden changes in the FDI landscape, such as those presented by the COVID-19 pandemic, and to respond with relevant services to investors.

Recommendation: Establish a Heat Map of Needed Suppliers / Processes in the Region

An in-depth study of the needs for production material, key non-productive materials and services (e.g. training and management up-skilling, certification, quality audits, etc.) should be established through all countries focussed on the existing investors and automotive component (Tier 1, 2 and 3) suppliers. The study should detect aggregate needs across the region and automotive and similar industries (light manufacturing, medical devices) in the sectors of metal treatment (galvanisation, cathodic dip painting, etc.) injection moulding (including panting and finishing). New potential FDI's will need a potential base of several suppliers before relocating and making an ultimate investment decision. Another outcome could be upgrading of existing local companies in view of these needs. The goal is to strengthen the local supplier base that would bring the cost efficiencies of the countries down in the supply chain while reducing transportation costs and along with that, environment concerns – i.e. emissions.

For this study, several sponsors have been already sought, but in the end the effort was not successful. This should be further explored and actively promoted. The content of the study are technological processes, the quantity searched and some base dimensions (e.g. weight for presses, sizes for cathode dip painting, etc.).

<u>Concluding the following activity recommendation is suggested:</u>

- Conduct an in-depth study of the needs for production material, key non-productive materials and services (e.g. training and management up-skilling, etc.).

- This study needs to include a specific chapter dealing with horizontal/general automotive industry specific requirements for suppliers in regard to quality, security, sustainability and data protection standards, namely ISO 9001, IATF 16949, ASPICE, ISO 27.001, TISAX, ISO 26.262, ISO 14.001, ISO 45.001 and GDPR. Interview with many procurement and supplier management officials repeatedly and uniformly confirmed the lack of implementation of such standards as one of the main barriers to entry into new supplier contracts.

- Accordingly, company support services need to be established to overcome this underlying problem for many potential WB6 suppliers.

Recommendation: Establishing FDI Screening Mechanics (per EU/US Requirements)

According to the OECD, the EU Member States rank among the jurisdictions most open to FDI, having in mind that he EU is the largest recipient of FDI on a global level. The European Commission describes FDI as "essential for our economic growth, competitiveness, employment and innovation". However, FDI also triggers a list of concerns, the most prominent of which relate to industrial espionage, technology transfer, a lack of reciprocity in investment opportunities and state-controlled enterprises taking over national champions. Concerns in this respect have grown in the context of a weakened European economy resulting from the COVID-19 crisis. The EU FDI Screening Regulation aims at enhancing transparency, coordination and cooperation regarding the various national screening mechanisms applied by the EU Member States.

15 out of 27 EU Member States have FDI screening mechanisms in place, according to a list maintained by the European Commission. FDI screening mechanisms vary widely in scope and operation. Some EU Member States

rely solely on antitrust instruments to block acquisitions on national security grounds, while others have dedicated FDI screening mechanisms for this purpose.

EU Member States may require prior notification and authorization, may block investments completely, or make these subject to conditions. In most EU Member States, screening is carried out by executive agencies, often with the input of various ministries and the national security services.

Concluding the following activity recommendation is suggested:

- WB6 countries should also start up some form of FDI screening which in terms of small economies, interconnected economies, should provide a significant security for the whole region.

Recommendation: Enhance supplier networking, via fairs or similar events to improve integration of local suppliers. Improve and connect existing databases

Local and regional fairs like SuBEx (Supplier Balkan Expo) or SEE Automotive Conference should be supported and enlarged. AHK Western Balkans purchasing initiative and events of similar nature organizes by donors or bilateral Chambers additionally enhance the regional local supplier base opportunities. The existing databases like WB6-CIF should be enhanced to reach a level like the Chinese competitors in the B2B sector by introducing Data Lake links, web crawling and applying AI tools.

Recommendation: Enhance Investment Promotion to Similar Products like Commercial Vehicles and Machines to Reduce Cluster Risk from Passenger Cars

Passenger car suppliers need a high volume of parts due to the larger production series. Commercial vehicles might need an even larger range of parts, but at much lower quantities. This is a chance for local suppliers. It is no accident that the Belgium bus factory Van Hool located in North Macedonia with a production of up to 1000 vehicles/year has the highest share of local production materials and local content of all companies investigated in the supply chain study 2022.

Based on this knowledge, the activities of the FDI agencies should be focused on companies that are looking for nearshoring and are in need of productive material that can be supplied by the local industry. In focus could be producers of commercial vehicles, agricultural material, forklifts, special moving equipment and of other machinery like robots which are technically similar to passenger cars in their technical structure (engine, transmission, chassis, batteries, electric motors and drives, moving elements, driver workplace, accessories).

8 2023 – 2025 REGIONAL FDI OUTLOOK

The current impact of automotive FDIs on the local economies of the six countries will be maintained in the upcoming short to mid-term period while recording moderate growth caused by geostrategic developments on a wider scale. The bottom reached by the automotive industry and low levels of vehicle sales in Europe in 2022 will be recovering going forward, but it will still take several years to reach pre-pandemic levels due to geopolitical as well as economic factors and still lingering supply chain recovery from the chips crisis, etc. Additionally, the growth

Net foreign direct investment inflows (% of GDP) forecast according to World Bank			
	2023	2024	2025
BiH	2.9	2.9	2.9
Serbia	5.6	5.5	5.6
Montenegro	8.8	7.7	7.5
Kosovo	5.7	5.5	5.5
N. Macedonia	5.2	5.9	6.2
Albania	6.8	6.8	6.9

of the Chinese EV brands and their European market push may put further strains of European OEMs to maintain competitiveness and use lower cost supply locations to successfully fend off its turf and maintain market share. This may pose both a risk but also an opportunity for automotive industry FDI in the WB6 region.

The spillover effect from the closely related industries is also significant. These include plastic, textile and paints industries, road transport, electronic component manufacturing, and basic iron, steel, and aluminium production. Plastic companies in SEE can anticipate further growth with the emergence of electric vehicles (EV), which is expected to drive carmakers to incorporate more plastics and other light materials to offset the heavier battery weight. In light of this, the plastic industry is poised to become an even more integral part of the car manufacturing process and the broader automotive ecosystem in the future.

9 ABBREVIATIONS

Abbreviation	Term
BiH	Bosnia and Herzegovina
CAPEX	Capital Expenditure
CBAM	(EU) Carbon Border Adjustment Mechanism
CEFTA	Central European Free Trade Agreement
CKD	Complete Knock-Down
e.g.	for example
ESG	Environmental, Social & Governance (assessments)
ETS	(EU) Emissions Trading System
FDI	Foreign Direct Investment
GHG	Greenhouse Gas Emissions
ICT	Information and Communication Technology
IP	Industrial Policy
IPA	Investment Promotion Agency
p.c.	per capita
OEM	Original Equipment Manufacturer
Q	Quarter
RAS	Razvojna agencija Srbije Development Agency of Serbia
RSCI	Responsible Supply Chain Initiative
ROI	Return on Investment
RCC	Regional Cooperation Council
SME	Small and Medium-Sized Enterprise
SOE	State-owned Enterprises
SW	Software
WB6	Albania, Bosnia and Herzegovina, Kosovo, Montenegro, and Serbia