ATTRACTING
foreign investments in the
Western Balkans region
and state aid:
race to the bottom or necessity?

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Attracting
foreign investments in the Western Balkans region and state aid: race to the bottom or necessity?

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Skopje,
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Attracting foreign investments in the Western Balkans region and state aid: race to the bottom or necessity?

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Introduction

The state aid control policy covers the rules and mechanisms that ensure the protection of competition through state aid control. State aid control is of utmost importance because it prevents a benefit in any form that state public authorities provide on a selective basis to economic agents, giving them advantage over others.

Countries in the Western Balkan (WB) region, as signatories to the Stabilization and Association Agreement (SAA) with the EU, should abide by EU rules on competition and state aid, including regulation / control and assistance received by economic operators, both domestic and foreign investors. Most WB countries have fully adopted EU state aid legislation in their national laws. However, enforcing these rules remains "inefficient", especially in terms of introducing an effective and efficient state aid control system.

At the same time, the policies of attracting foreign investment in the WB region in the last decade have been implemented through a significant number of programs, measures, forms of investment support that include fiscal and non-fiscal measures that fall into the category of state aid.

While countries in the region, according to the EU, do not effectively and transparently control state aid, and provide a range of incentives for foreign investment, in the race to attract investments, countries in the region are in "competition" to provide better conditions for investors that could lead to the so-called "race to the bottom."

The aim of this study is to review the current situation regarding the development of state aid policies in countries in the region in the context of attracting foreign investment and to identify possible implications for the regional economies from incentive-based policies.

The study provides an overview of the placement and status of state aid to support foreign investment in countries in the region to understand the place and importance in the context of building a functioning market economy according to EU standards and highlighting both shortcomings and opportunities through such policies. This study also seeks to establish a link between the inflow of foreign investment and the impact of state aid. The study provides an overview, conclusions, and recommendations for progress in this area, which are addressed to both decision makers and the public.

The primary methodological approach in the conducted research is a qualitative method used to gain insight into the key issues as well as the reasons arising from the findings to formulate the proposed recommendations. Qualitative data are collected through a review of regulations and policies of countries in the region, EC progress reports on countries, other research in the field of attracting investment through incentive measures for the region and other countries, data and information by policy holders and implementing parties. This analysis includes a quantitative review of relevant indicators related to state aid and foreign direct investments and an analysis to determine the degree of correlation and causality between direct aid and foreign investments and the growth of gross domestic product in the region.

1. STATE AID POLICIES IN THE EUROPEAN UNION AND THE WESTERN BALKAN COUNTRIES

State aid is of great importance within the EU and is defined as an advantage / benefit in any form that the state public authorities provide on a selective basis to enterprises / economic agents.[1] It is part of the competition policy, covered by Chapter Eight of the EU acquis, the negotiation chapter. This chapter has not yet been opened by a candidate country or a country that has started negotiations, and it is expected to be the last of a series of chapters.[2]

The main reason why state aid is controlled is that any enterprise / business entity that receives support from the state (at any level) gains an advantage over its competitors. Therefore, the Treaty for the Functioning of the EU - TFEU[3] - generally prohibits state aid, unless justified by reasons for achieving general economic development.[4]

In order to ensure compliance with this prohibition and the rules of exemption, the EU legal acts apply equally to the whole of the EU, and the European Commission (EC) is responsible for ensuring that the state aid granted complies with EU rules.

According to the EU acquis, to be State aid,[5] a measure needs to have these features:[6]

- *there has been an intervention by the State or through State resources which can take a variety of forms (e.g. grants, interest and tax reliefs, guarantees, government holdings of all or part of a company, or providing goods and services on preferential terms, etc.);*
- *the intervention gives the recipient an advantage on a selective basis, for example to specific companies or industry sectors, or to companies located in specific regions;*
- *competition has been or may be distorted;*
- *the intervention is likely to affect trade between Member States.*

Despite the general prohibition of State aid, in some circumstances, government intervention is necessary for a functioning and equitable economy. Therefore, the Treaty leaves room for several policy objectives for which State aid can be considered compatible or allowed in the internal market in line with EU rules.[7]

1) Note: Thus, subsidies granted to individuals or general measures that are open to all enterprises are not state aid (e.g. general tax measures or employment legislation).

2) Status May 2020, for the two WB countries that have started negotiations with the EU, according to the 11th accession conference from 11/12/2019 in Serbia, 18 out of 35 chapters were opened and two closed. According to 12th conference for accession of Montenegro as of 10/12/2018, 32 chapters out of 33 are opened and 3 pre-closed, while the last chapter 8 is expected to be opened during the year and is conditioned by the initial five benchmarks. https://www.consilium.europa.eu/en/policies/enlargement/montenegro/

3) Treaty on the Functioning of the EU, TFEU, Lisbon Treaty.

4) Article 107 (3) of the Lisbon Treaty states that the following may be considered to be compatible with the common market: a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation; b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State; c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest; d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest; e) such other categories of aid as may be specified by decision of the Council on a proposal from the Commission.

5) European Commission, Competition, State Aid Control, seen February 2020, available at https://ec.europa.eu/competition /state_aid/overview/index_en.html

6) https://www.europarl.europa.eu/factsheets/en/sheet/101/regional-state-aid

7) European Commission, Competition, State Aid, State Aid Procedures, available at: https://ec.euroition.ecom /state_aid/overview/state_aid_procedures_en.html

Western Balkan countries, as signatories to the Stabilization and Association Agreement (SAA) with the EU, should abide by EU rules on competition and state aid, including regulation / control of the assistance received by economic operators, both domestic and foreign investors, including those in the special economic zones.

The European Union regulates incentives offered by the member states to the companies in line with competition and state aid provisions of the Treaty on the Functioning of the European Union (TFEU). In this Treaty, Articles 101, 102, 107 and 108 cover the parts related to competition and state aid - prohibiting any distortion or restrictive practices that may affect competition in the internal market, but allowing some exceptional granting of state aid.

The EU recognizes three general types of state aid: horizontal, regional, and sectorial assistance:

1) ***Horizontal aid*** is aimed at solving or mitigating market failures, usually covering some kind of externalities (i.e. the social costs caused by a particular business activity, regardless of business expenses or income). Such externalities can be associated with any type of business, regardless of the location or sector of the firm. Funding for this type of state aid is mainly channeled into R&D projects, saving and restructuring, encouraging employment, protecting and promoting the environment, and creating (and sustaining) small- and medium-sized enterprises (SMEs).

2) ***Regional aid*** is aimed at a (geographical) territory / region where the standard of living is significantly lower than the EU average or toward regions that are at a disadvantage compared to national averages, for example, due to unusually high unemployment rates or other problems of a socio-economic, geographical or structural nature. The purpose of the regional aid financing is to promote activities that can provide a basis for long-term regional development; as such, the focus is on initial investment assistance, and operational assistance is granted only under very exceptional circumstances.

3) ***Sectorial aid*** focuses on specific sectors that go through conversion processes, such as the coal, steel and shipbuilding sectors, or special sectors that are considered difficult to fully adapt to market competition powers (such as banking, airlines or the automotive sector). Sectoral assistance, however, is administered in such a way as to reduce as much as possible any damage that would be inflicted on competitors.

The Western Balkans region[8] in more than a decade has recorded a strong investment support policy, and especially foreign direct investments, by providing various benefits and support measures through various fiscal and non-fiscal measures.

Many of them are visible through the so-called "boom" of the establishment and opening of special economic zones (SEZ).[9] The users of these zones, mainly foreign companies, were provided with state aid, significant both in terms of amount and type with an opportunity cost as a direct cost or through lost income.

8) The Western Balkans refers to the six countries in the region: North Macedonia, Albania, Kosovo, Serbia, Bosnia and Herzegovina and Montenegro.

9) Special or free economic zones in the region have different names, but are essentially forms belonging to the general definition of SEZ example: "geographically delimited areas administered by a single body, offering certain incentives (generally duty-free importing and streamlined customs procedures, for instance) to businesses which physically locate within the zone"; definition of WB, or OECD: Special Economic Zones (SEZs): are larger estates and could be considered cities on their own. They usually cover all industrial and service sectors and target both foreign and domestic markets. They provide an array of incentives ranging from tax incentives to regulatory incentives. In addition, they permit on-site residence.

State aid granted to enterprises / companies in these zones largely falls into the category of regional state aid. According to Article 107, paragraph 3a,[10] of the TFEU, regional assistance is defined as "*aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment*."[11] The level of state aid granted is conditioned by the level of development of the region, measured through the GDP of the region in relation to the average GDP of the EU28. Hence, only regions with GDP per capita that is below 75% of the EU28 average are eligible for state aid.[12]

In addition, poorer regions have the right to receive more value as a percentage of investment in the form of state aid than more developed regions. The amount of state aid also varies depending on the size of the investor or recipient of state aid. The intensity of aid is lower for large enterprises than for small and medium enterprises. Horizontal aid aimed at SMEs is also available and compatible with regional aid in some cases.

Table 1: Maximum allowable limit / intensity of state aid in the EU

Regional GDP as % of EU28 GDP average	Max. rates in % for large enterprises	Additional assistance for small and medium enterprises
<75%	15-10%	+20% for small
>75%	30%	
<60%	40%	
<45%	50%	+10% for medium

Source: Adapted from Monitoring Special Economic Zones in the Western Balkans, OECD; for more details see https://ec.europa.eu/competition/state_aid/legislation/compilation/state_aid_15_04_14_en.pdf, page 320

The countries in the WB region are currently at different stages of the European integration process and all have signed a Stabilization and Association Agreement (SAA) with the European Union, albeit at different times. With the signing of the Stabilization and Association Agreements (SAAs), which include provisions relating to state aid, including competition protection, countries are also committed to meeting them within a given timeframe. Namely, Albania signed the SAA in 2006 (it was awarded the status of EU candidate in 2014), Bosnia and Herzegovina signed the SAA in 2008 (application for EU accession in 2016), North Macedonia signed the SAA in 2001 (awarded EU candidate status in 2005, and is still awaiting a date for the start of negotiations), Kosovo signed the SAA in 2014 (EU has facilitated high-level dialogue between Kosovo and Serbia since 2012), Montenegro signed the SAA in 2007 (awarded EU candidate status in 2010) and is already deeply involved in negotiations, Serbia signed the SAA in 2008 and was awarded EU candidate status in 2012, and it is also in the advanced stages of negotiations.

The SAA is an important requirement to the accession to the European Union, which calls for the introduction of a national system of state aid control. The obligation to introduce state aid monitoring systems stems from the SAA, but also from the Central European Free Trade Agreement (CEFTA) as well as the Energy Community Treaty. National state aid control systems (competent control bodies that have different forms and institutional setups) are provided as transitional mechanisms, as monitoring state aid after countries join the EU will be carried out by the supranational body, the European Commission. As the ex-

10) "aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment"

11) Regional Aid, defined in the Law on State Aid Control of the Republic of Macedonia Official Gazette 145/2010, Article 4, paragraph 11 states: Regional aid is aid that is in line with the objectives of the regional policy of the Republic of Macedonia and which improves productive initial investments or job creation related to investments.

12) RN Macedonia according to the nomenclature for regions, target territory is NUTS 2, written in the Regulation on Regional Aid, 2012, Article 4, paragraph 6.

perience of Central and Eastern European countries shows, the effective implementation of national state aid rules is one of the basic conditions for concluding negotiations on the competition policy chapter.

Each of these SAAs contains an article prohibiting state aid as a distortion of competition[13] and needs to be applied. The SAA is part of the process of integrating candidate countries into the European Union, through which they are committed to harmonizing their national legislation with the EU acquis. While none of the WB candidates have yet opened negotiations on Chapter 8 of Legislation,[14] which regulates competition policy and state aid, as SAA signatories, all those SAA countries have pledged to align their state aid with the Treaty on the Functioning of the European Union within five years of the respective agreements.

State aid granted to enterprises in the special economic zones within the economies of the Western Balkans generally falls into the category of regional aid and is subject to quantitative restrictions similar to those in EU economies by transposing part or all of EU regulation into national legislation. According to state aid laws, and in line with EU regulations,[15] the level of aid granted to each enterprise is calculated based on the size of the investment and number of employees.

In practice, this means that the countries of the Western Balkans are currently limited in the amount of state aid they can provide, but not in the type of aid that companies can receive. They can provide a wider range of fiscal and non-fiscal incentives for investors than in EU countries. This gives significant advantages especially to regional competitors who are already members of the EU, who according to the EC Guidelines for Regional State Aid for 2014-2020[16] should provide detailed evidence that the selected aid tool has the least distorting effects on competition compared to any other available instrument: a condition that often more aggressive forms of subsidies, such as direct labor subsidies, fail to meet.

Even though EU members cannot provide labor-related incentives, Western Balkan countries that are not yet full members of the EU still can attract investment in labor-intensive industries by providing state aid to subsidize labor. Additionally, the manner and degree of regional division of the countries on the NUTS levels also provide regional assistance to the entire territory of the country, as is the case with North Macedonia. This can also be viewed from the perspective of neighboring EU member states such as Bulgaria and Romania, which have similar labor costs to Western Balkan countries, while as EU member states have significant advantages, which is why foreign investors would probably rather choose to be located in a country that is a member of the EU than in a country that is outside, mainly due to the overall environment and conditions for business operations offered by the Union.

13) SAA with Albania, Article 71, SAA with BiH, Article 71, SAA with Macedonia, Article 69, SAA with Kosovo, Article 75, SAA with Montenegro, Article 73, SAA with Serbia, Article 73, for Macedonia see https://eur-lex.eurohtpa.eu/resource = cellar: 3ce414a8-cc67-4879-a8cc-17b9c4745465.0007.02 / DOC_1 & format = PDF

14) May, 2020

15) https://eur-lex.europa.eu/

16) https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52013XC0723%2803%29

1.1. Overview of the institutional setting of state aid control in the Western Balkan countries

Table 2: Review of laws in the field of state aid, the institution in charge of implementing and controlling state aid policy and state agencies for investment support

Country	Law	Competent institution for state aid control	Investment Support Agency
Albania	Law on State Aid	State Aid Commission	Albanian Investment Development Agency (AIDA)
Bosnia and Herzegovina	Law on the state aid system	State Aid Council	Foreign Investment Promotion Agency in Bosnia and Herzegovina (FIPA)
Kosovo	Law on State Aid	State Aid Commission	Kosovo Investment and Enterprise Support Agency (KIESA)
North Macedonia	Law on the state aid system	Commission for the Protection of Competition	Agency for Foreign Investments and Export Promotion of the Republic of North Macedonia (Investinnorthmacedonia)
Serbia	Law on state aid control	State Aid Control Commission	Development Agency of Serbia (RAS)
Montenegro	Law on state aid control	Competition Agency	Montenegro Investment Agency (MIA)

Albania

Albania	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Population (mil.)	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9
GDP (in mil. USD $	12,044	11,927	12,891	12,320	12,776	13,228	11,387	11,861	13,025	15,103
GDP growth (%)	3.4	3.7	2.5	1.4	1.0	1.8	2.2	3.3	3.8	4.1
FDI (% of GDP)	11.2	9.1	8.1	7.5	9.8	8.7	8.7	8.8	7.9	8.0
FDI (in mil. USD $)	1,345	1,090	1,049	918	1,254	1,150	990	1,044	1,023	1,204
State aid (% of GDP)	0.6	0.8	1.3	1.6	1.5	0.2	0.26	0.11	0.14	0.22

Source: Data from World Bank data and annual reports of state aid competent authority.

State Aid Legislation

To align its legislation in the field of state aid with the EU legislation, Albania adopted the Law on State Aid in 2005[17] and the amendments to the Law and the relevant bylaws in 2016. The state aid law covers all sectors except agriculture and hatcheries.

Competent body for control of state aid

The competent body for implementation and control of state aid is the State Aid Commission (SAC) - Komisioni i Ndihmës Shtetërore. Pursuant to Article 16 of the Law on State Aid, the SAC is an operationally independent body. The Commission is composed of five members and is chaired by the Minister of Finance and Economy. The other members are appointed by the Council of Ministers (Government). According to Article 17 of the Law, the Commission is responsible for preparing an annual report on state aid and submitting it to the Council of Ministers.

17) Law on state Aid, Albania, http://www.mete.gov.al/doc/20060509102817_law_on_state_aid.pdf

State aid transparency

According to the 2019 EU Progress Report, state-related legislation is in line with the acquis and the SAA and is largely in line with Articles 107 and 108 of the EU Treaty.[18] The law prescribes the conditions and procedures for granting state aid and aims to align the country with the EU General Block Exemption Regulation of 2014.[19] According to the EC, further improvement of state aid control is needed. The Ministry of Finance and Economy, which is the institution in charge of approving state aid, determines the institutional setting of the SAC. Therefore, the SAC cannot be considered a fully operational independent body as it is set by Law and in line with the SAA requirements. The Law on State Aid requires that before the introduction of any new measure, it should be approved by the SAC as compatible with the Law. The SAC has the right to order the entities to return any illegally acquired or incompatible state aid, and such a decision may be challenged before a competent court. However, so far, the SAC has not ruled to return the state aid. This calls into question the administrative capacity of the Commission for the enforcement of state aid return decisions, and it must be seriously strengthened. The Commission must show that it is still implementing the provisions of the Law. Namely, the SAC's state aid inspection track record is insignificant. In the last reporting period (referring to the first half of 2019), the SAC inspected ten state aid schemes, six of which were ex officio, without rejecting a single scheme. It is extremely important that the rules of state aid are reflected in the public finance management strategies and to increase the advisory role of the SAC before adopting any provision of state aid at the central and local levels. The implementation of state aid rules must also be monitored during the implementation of major projects between Albania and other countries. It is also recommended that state aid providers, in accordance with the Law, notify the SAC of state aid measures before they appear, so that the corrective function ex-ante can be performed. It is considered that due to the fact that the SAC directly reports to the Government, there are not enough instruments for parliamentary oversight of state aid, but it is realized indirectly through the parliamentary oversight of the Government.

Investment support measures

The Law on Foreign Investments[20] in Albania provides equal treatment for domestic and foreign investors in the use of state aid. The Albanian Investment Development Agency (AIDA) - Agjencia Shqiptare e Zhvillimit të Investimeve, which is in charge of supporting investment in Albania, lists specific measures to stimulate investment:[21]

- Profit tax of 8% if the profit is distributed as a dividend and 0% if the company's turnover is lower than 8 million leks (65,000 euros). The general profit tax rate is 15%;
- Personal income tax of 0% for gross salary of 26,000 leks (210 euros), which is defined by law as the minimum wage; 13% for gross salary between 26,000 leks and 150,000 leks (210 euros and 1,210 euros) and 23% for gross salary over 150,000 leks (1,210 euros);
- Value added tax of 0% for procurement of raw materials for export production and for goods from a special list determined by the Council of Ministers and preferential rates of 6% and 10% for certain products (the general VAT rate is 20%);
- Use of AIDA Funds for Competitiveness, Creativity, Innovation and Start-Up Businesses;
- Stimulation for capital investments by allowing deferred tax payment for up to 12 months (or more, if the investment lasts longer and under exactly certain rules set by the Ministry of Finance and Economy);

18) Commission staff working document, Albania 2019 Report, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-albania-report.pdf

19) Commission regulation EU No 651/2014, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02014R0651-20170710&from=EN

20) Foreign Investment Act, Albania, https://investmentpolicy.unctad.org/investment-laws/laws/3/albania-foreign-investment-act

21) Albanian Investment Development Agency, http://aida.gov.al/

- Protection of foreign investments from direct or indirect measures for expropriation or nationalization, except in special cases defined by law and in the public interest;
- The right of foreign investors to repatriate income and assets;
- Judicial protection of foreign investors in terms of legal rights related to their investments;
- Positive discrimination against foreign investors - by decision of the Council of Ministers, the Government provides financial support to foreign investors in civil proceedings with third parties;[22]
- Foreign investment companies are allowed to own land;[23]
- Exemption from customs duties - for emigrants who have continuously lived in another country for a period of not less than 12 months and who are returning to Albania.

Bosnia and Herzegovina

Bosnia and Herzegovina	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Population (mil.)	3.7	3.7	3.7	3.6	3.5	3.5	3.4	3.4	3.4	3.3
GDP (in mil. USD $)	17,614	17,177	18,645	17,227	18,179	18,558	16,212	16,913	18,080	20,162
GDP growth (%)	-3.0	0.8	0.9	-0.7	2.4	1.1	3.1	3.1	2.1	3.6
FDI (% of GDP)	0.8	2.6	2.5	2.3	1.7	2.9	2.4	1.9	2.6	2.4
FDI (in mil. USD $)	139	444	472	392	313	545	383	313	464	489
State aid (% of GDP)	n/a	n/a	1.2	1.5	0.8	0.6	0.5	0.7	0.5	n/a

Source: Data from World Bank data and annual reports on state aid from the competent authority.

State Aid Legislation

To harmonize the legislation in the field of state aid with the EU legislation, Bosnia and Herzegovina (BiH) passed the Law on the State Aid System in 2012,[24] and it has partially adopted the relevant bylaws. The Law on the State Aid System covers all sectors except agriculture, fisheries, and the military industry.

Competent state aid control body

Pursuant to Article 4 of the Law on the State Aid System, the competent authority for approval, monitoring and control of state aid is the State Aid Council (SAC) - Vijeće.[25] Article 7 of the same Law states that the SAC is a public institution that carries out its activities independently and is obliged to ensure consistent application of the Law on the State Aid System to the entire territory of BiH. The Council is composed of eight representatives appointed by the Council of Ministers of BiH (3), the Government of Republika Srpska (2), the Government of the Federation of BiH (2) and the Government of the District of Brcko (1), with a term of four years. The chairmanship of the Council is on a rotating basis with a one-year term of office of the Chairman. The Council has a Secretariat in charge of organizational, technical and administrative matters. According to Article 19 of the Law, the SAC is accountable to the Council of Ministers of

22) http://www.mete.gov.al/doc/web_fdi_report_english.pdf
23) http://www.ey.com/Publication/vwLUAssets/Doing_business_in_Albania_2012/$File/Doing_business_in_Albania_2012.pdf
24)http://www.fmf.gov.ba/v2/userfiles/userfiles/file/D_Pomoc/Zakon%20o%20sistemu%20drzavne%20pomoci%20u%20Bosni%20i%20Hercegovini.pdf
25) http://www.szdp.gov.ba/?lang=bs

BiH (Government) for its work and is required to prepare an annual report on state aid and submit it to the Council of Ministers. The competent bodies for designing and implementing state aid measures are the Council of Ministers of BiH (for the entire territory of BiH) and the governments of the three entities: Federation of BiH, Republika Srpska and Brcko District.

State aid transparency

According to the 2019 EU Progress Report, state-related legislation is partially in line with the acquis and the SAA.[26] Namely, the relevant bylaws regulating the state aid policy have not been adopted equally throughout the country. For example, acts of de minimis aid and assistance for services of general economic interest were adopted only in the Federation of BiH, but not in the other two entities. Also, the map of forms of regional aid has not yet been prepared. It should show the different forms of state aid that companies can receive in the second level geographical areas (NUTS II). The functioning of the SAC is quite burdened with decision-making procedures along ethnic lines, i.e. at least one representative from each ethnic community needs to support a decision for it to take effect (Badinter's rule). As a result, any state-sponsored bylaw, even if in full compliance with the acquis, may not be adopted or put into practice. The SAC should demonstrate independence in relation to state aid institutions (governments and ministries at central, entity and local levels) and establish a solid system of state aid control and implementation of its decisions, especially in the area of major projects being implemented between BiH and other countries. According to the Law on the State Aid System, the state aid provider must inform the SAC on the state aid measures before their implementation starts. The SAC may order a refund of state aid funds increased for interest, if it is determined that it is illegally acquired or incompatible with the Law and bylaws. The Council may initiate ex officio official investigations into state aid if there are sufficient indications that it was illegally granted. The capacity of the SAC to execute decisions is weak. Namely, the Secretariat, which has only seven employees, is not able to meet its obligations. Republika Srpska still does not fully pay its share to finance the Council, despite a ruling by the competent court. In the last few years, the SAC has made very few decisions, all of which have been either positive or have not established existence of state aid elements. This raises additional serious concerns about the SAC's capacity to enforce its decisions. Many of the state aid measures have been introduced by the competent authorities without them informing the Council at all and having been approved by it. The compliance of existing state aid schemes with EU rules arising from SAA obligations is still at a very early stage. BiH must ensure the transparency of all state aid measures that are being implemented. It is considered that due to the fact that the SAC directly reports to the Council of Ministers, there are not enough instruments for parliamentary oversight of state aid, but it is ensured indirectly through the parliamentary oversight of the work of the Government.

Investment support measures

Due to the specific state governance system, the state aid policies in terms of attracting foreign direct investments differ from the central to the entity level. What is identical is that the Law on Foreign Direct Investment Policies of BiH[27] and the Law on Foreign Investments of the Federation of BiH[28] and the Law on Foreign Investments in Republika Srpska[29] equate foreign with domestic legal entities in the possibility of

26) https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-bosnia-and-herzegovina-analytical-report.pdf
27) https://investmentpolicy.unctad.org/investment-laws/laws/35/bosnia-and-herzegovina-foreign-investment-law
28) http://www.fic.ba/uimages/zakoni/FBiH%20Law%20on%20Foreign%20Investments.pdf
29) http://www.fipa.gov.ba/publikacije_materijali/zakoni/CLEANSED%20TEXT%20OF%20THE%20LAW%20ON%20FOREIGN%20INVESTMENTS%20RS.pdf

using state aid. The Foreign Investment Promotion Agency in Bosnia and Herzegovina (FIPA) - Agencija za unapređenje stranih investicija u Bosni i Hercegovini, which is the central state agency for attracting investments, states the specific state aid policies in order to stimulate investments:[30]

General policies that apply to the entire territory of BiH are:

- National treatment of foreign investors;
- Opening an account in a domestic business bank in any convertible currency;
- Free employment of foreign nationals, unless otherwise provided by law;
- Protection from nationalization, expropriation and requisition, except in case of public interest and with fair market compensation;
- National real estate ownership treatment;
- Free repatriation of operating profit;
- Exemption from customs and tax duties for the purchase of equipment, except for passenger vehicles and vending machines and games of chance;
- Use of benefits from free zones (exemption from VAT on imported products, use of public goods with preferential compensation, etc.).

Policies that apply only to the territory of the Federation of BiH are:

- Exemption from 30% of the profit tax, if reinvestment in production equipment is made in the amount of at least 50% of the value of the current profit;
- Exemption from 50% of the profit tax for all years, if in a period of five years there is reinvestment in equipment from own funds in the total value of 20 million KM (10 million euros) of which at least 4 million KM (2 million euros) in the first year;
- Tax exemptions for new employees who will stay at work for at least one year.

Policies that apply only to the territory of Republika Srpska are:

- Reduction of the profit tax base for the value of each investment intended for procurement of equipment and real estate in function of the production activities;
- Reduction of the tax base in the amount of personal income tax and contributions for employers that provide at least 30 new jobs per year;
- Subsidies for employments for investments with a minimum value of 2 million KM (1 million euros) and at least 30 new jobs depending on the level of development of the area in the amount of 3,500 KM (1,750 euros) per employee in the developed and medium developed units, and 5,000 KM (2,500 euros) per employee in the underdeveloped and especially underdeveloped local self-government units;
- Financial support of 15% of the value of the investment for investments worth over 25 million KM (12.5 million euros) and which create at least 100 new jobs, regardless of the level of development of the area in which they invest.

Policies that apply only to the territory of Brcko District are:

- Company fee exemption;
- Reimbursement of court costs for registration of newly established enterprises;

30) http://www.fipa.gov.ba/informacije/povlastice/strani_investitori/default.aspx?id=141&langTag=sr-SP-Cyrl

- Reimbursement of utility costs;
- Reimbursement of construction permit costs and approvals;
- Reimbursement of costs in the amount of the difference between the cost of utilities paid by the company and the price paid by households;
- Reimbursement of paid employment contributions for newly employed persons;
- Remuneration in case of maternity leave in the amount of 100%;
- Stimulation for the employer in the amount of 50% of the total health insurance duties for newly employed persons;
- Compensation for new investments in fixed assets up to the amount of the determined and paid profit or income tax for the year in which the procurement was performed.

Kosovo

Kosovo	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Population (mil.)	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
GDP (in mil. USD $)	5,654	5,830	6,692	6,500	7,072	7,387	6,440	6,715	7,228	7,939
GDP growth (%)	3.6	3.3	4.4	2.8	3.4	1.2	4.1	4.1	4.2	3.8
FDI (% of GDP)	7.1	8.4	8.0	4.5	5.3	2.7	5.3	3.6	4.0	4.0
FDI (in mil. USD $)	403	490	535	293	371	200	343	244	287	319
State aid (% of GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Source: Data from World Bank data and annual reports on state aid from the competent authority.

State Aid Legislation

To align the legislation in the field of state aid with the EU legislation, Kosovo passed the new Law on State Aid in 2017,[31] and by 2019 had adopted a part of the relevant bylaws. The Law on State Aid covers all sectors except agriculture, fisheries, and agricultural processing.

Competent state aid control body

According to Article 9 of the Law on State Aid, the competent authority for approval, monitoring and control of state aid is the State Aid Commission (SAC) - Komisioni i Ndihmës Shtetërore. The SAC is an independent body composed of five independent expert members appointed by the Assembly of the Republic of Kosovo, with a term of three years and the possibility of re-election. According to Article 8 of the Law, a Sector for State Aid (SSA) was established within the Ministry of Finance with seven employees, which provides professional, technical and administrative assistance to the Commission. The SSA is required to prepare an annual report on state aid and reports to the Assembly for its work.

State aid transparency

According to the 2019 EU Progress Report, state-related legislation is largely in line with the acquis and the SAA and is largely in line with Articles 107 and 108 of the EU Treaty.[32] The European Commission observes that the SAC members were first elected at the beginning of 2019 due to which formally the SAC is the body that really has the operational power to assess, approve or prohibit certain measures, to per-

31) https://mf.rks-gov.net/desk/inc/media/AB373100-5DE7-45A4-BE96-CD1EF11E79AE.pdf
32) https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-kosovo-report.pdf

form ex post control, i.e. to request the return of illegally or incompatibly acquired state aid. The SAC administrative capacity is constantly being strengthened with the support of the British Embassy and the IPA Twinning Program.[33] Nevertheless, the SAC's capacity to enforce the law is considered inappropriate, making it ineffective. In the last five years, the SAC has not made a single decision regarding state aid, and its role has been reduced to drafting texts of bylaws on state aid. The department does not have the capacity to analyze existing state aid schemes and to keep an appropriate register for them. That process is still ongoing, while preventing the possibility for state aid ex-ante notification and ex-post control. As a result, several state aid measures implemented at central and local levels, especially for large companies from different sectors (e.g. telecommunications), have not been properly reported and are insufficiently researched. Awareness of state aid providers about the rules in this area is very weak and must be significantly strengthened. It is believed that because the SAC is now directly accountable to the Assembly, this is a useful tool for parliamentary oversight of state aid policies in the future.

Investment support measures

The Law on Foreign Investments[34] in Kosovo provides equal treatment for domestic and foreign investors in the use of state aid. The Kosovo Investment and Enterprise Support Agency (KIESA) - Agjencia për Përkrahjen e Investimeve dhe të Ndërmarrjeve në Kosovë, as a state agency aimed at encouraging investment, lists specific measures to stimulate them:[35]

- A flat 10% profit tax paid quarterly;
- Taxpayers with income of less than 50,000 euros may choose to be taxed at 10% on the basis of real income or on an assumed tax basis;
- Dividend income tax is 0%;
- Company losses can be transferred for up to 7 years;
- Profit tax paid abroad by residents is approved up to the maximum amount of tax liability in Kosovo;
- The personal income tax rate is scalable: 0% for salary up to 960 euros per year, 4% for salary between 961 and 3,000 euros per year, 8% for salary between 3,001 and 5,400 euros per year and 10% for salary over 5,400 euros per year;
- Subsidy of 50% of the salary for each newly employed person who will be kept at work for more than 1 year;
- Certain goods are exempt from customs duties.

33) http://www.legalpoliticalstudies.org/wp-content/uploads/2019/08/GLPS-State-Aid-Eng.pdf
34) https://investmentpolicy.unctad.org/investment-laws/laws/211/kosovo-law-on-foreign-investment
35) https://kiesa.rks-gov.net/page.aspx?id=2,3

North Macedonia

Macedonia	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Population (mil.)	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
GDP (in mil. USD $)	9,402	9,407	10,495	9,745	10,818	11,362	10,065	10,672	11,280	12,672
GDP growth (%)	-0.4	3.4	2.3	-0.5	2.9	3.6	3.9	2.8	0.2	2.7
FDI (% of GDP)	2.8	3.2	4.8	3.5	3.7	0.5	2.9	5.1	3.4	5.1
FDI (in mil. USD $)	260	301	508	338	402	61	297	549	381	649
State aid (% of GDP)	0.1	0.0	0.4	0.1	0.1	0.1	0.1	0.2	0.3	0.4

Source: Data from World Bank data and annual reports on state aid from the competent authority.

State Aid Legislation

To align the legislation in the field of state aid with the EU legislation, North Macedonia in 2010 passed the new Law on State Aid,[36] and it has adopted the relevant bylaws. The state aid law covers all sectors except agriculture and fisheries.

Competent state aid control body

According to Article 10 of the Law on Control of State Aid, the competent body for evaluation and supervision of any form of state aid is the Commission for Protection of Competition (CPC).[37] Pursuant to Article 26 of the Law on Protection of Competition,[38] the CPC is an independent state body with the capacity of a legal entity, independent in its work. The CPC is composed of five members appointed by the Assembly of the Republic of North Macedonia with a five-year term and the right to one re-election. The Commission has a Professional Service that is responsible for the professional, normative-legal, administrative, administrative-supervisory, material-financial, accounting, information, and other matters. The CPC is accountable to the State Assembly with the obligation to submit an annual report on its work.

State aid transparency

According to the 2019 EU Progress Report, state-related legislation is in line with the acquis and almost fully in line with the SAA and is largely in line with Articles 107 and 108 of the EU Treaty.[39] There is a need for certain amendments to the Law in terms of support of minor importance (de minimis) and in the implementation of the Law in certain forms of state aid and specific sectors in order for it to be fully aligned with the acquis. It is noted that the state aid map at the central and local levels is outdated and not fully transparent. According to the Law, state aid providers must notify the CPC of state aid measures for assessment. Otherwise, the CPC has the right to conduct an ex officio investigation and, if it finds that the state aid is inappropriate or against the Law, can order its return. In this section, the EC notes that the administrative capacity of the Commission required to control and enforce decisions related to state aid is not sufficient, and that it is poorly staffed, with outdated equipment and a small budget. For example, in 2012-2014 and 2015-2018, the Ministry of Transport and Communications introduced a state aid scheme to support an airline. For the period 2018-2021, although the public call was twice unsuccessful, in the third attempt, state aid was granted to the same airline. The CPC must confirm the compliance of this decision with the principles of the market economy, aviation and the provisions of the SAA. Moreover, the provisions of the Law on Fi-

36) http://kzk.gov.mk/category/zakon-za-drzhavna-pomosh/
37) http://kzk.gov.mk/
38) https://dejure.mk/zakon/zakon-za-zashtita-na-konkurencijata

nancial Support of Investments adopted in 2018, which provides for state subsidies for the private sector, are not harmonized with the acquis. In 2018, the approved state aid was 0.2% of the GDP. In the future, the implementation of state aid rules in major projects implemented by North Macedonia in cooperation with other countries must be under the control of the CPC, and protective measures must be introduced to ensure that state aid measures are free from conflict of interest. It is believed that because the SAC is now directly accountable to the Assembly, this is a useful tool for parliamentary oversight of state aid policies.

Investment support measures

The Constitution and laws in North Macedonia provide equal treatment to domestic and foreign investors in the use of state aid. Institutions directly responsible for attracting investment are: the Agency for Foreign Investments and Export Promotion of the Republic of North Macedonia (Investinnorthmacedonia)[40] and the Directorate for Technological Industrial Development Zones - a body within the Government that manages the unification of administrative affairs in all industrial zones in the country.[41] The Government is involved in this process with the Minister without portfolio in charge of attracting foreign direct investment and the Sector for Attracting Investments within the Ministry of Economy. In case of receiving state aid, the Agency for Foreign Investments and Export Promotion signs the agreement with the investor on behalf of the Government. The main policies and measures of state aid for attracting investments in North Macedonia are:[42]

- 10% flat tax rate (with certain exceptions provided by law);
- 0% profit tax on reinvested net profit before tax;
- Financial support for new employments (20% of the paid net salary for the newly employed person, if the net salary is at least 50% higher than the minimum net salary provided by law);
- Financial support for establishing and promoting cooperation with suppliers registered in RNM (1% of the value of the total performed procurements, provided that 15% of the total production input in the previous year is performed by suppliers registered in RNM);
- Financial support for the establishment of organizational forms for technological development and research (up to 50% of the total justified costs for industrial research);
- Financial support for investment projects of significant economic interest (funds in the amount of between 2,000 and 4,000 euros per employee; funds in the amount of up to 10% of the realized amount of investment, but not more than 1 million euros; exemption from paying income tax and personal income tax; up to 50% of the total justified investment costs for an investment project up to 5 million euros, up to 25% of the total justified investment costs for investment projects between 50 and 100 million euros, up to 17% of the total justified investment costs for an investment project over 100 million euros);
- Financial support for the growth of capital investments and revenues (10% of the realized investment, but not more than 1 million euros);
- Financial support for the purchase of material assets from business entities with difficulties (10% of the costs for purchasing material assets of the business entity in bankruptcy or liquidation, but not more than 1 million euros);
- Financial support for business entities that have increased their competitiveness in the market (10% of justified investment costs, but not more than 1 million euros per year);

40) http://investnorthmacedonia.gov.mk/
41) http://fez.gov.mk/?lang=MK
42) https://dejure.mk/zakon/zakon-za-finandzidzka-poddrdzhka-na-invedzticii

- Financial support for conquering new markets and increasing sales (20% of justified costs for conquering new markets, but not more than 30,000 euros);
- Utilizing the benefits of free economic zones that are managed as state aid in the form of regional state aid (exemption from paying personal and corporate income tax for the first 10 years; exemption from VAT and customs duties on goods, raw materials, equipment and machinery up to 500 thousand euros, depending on the value of the investment and the number of employees; lease of land up to 99 years; free connection of utilities; exemption from paying local utility bills and duties for construction permits, as well as green customs channels for goods).

Serbia

Serbia	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Population (mil.)	7.3	7.3	7.2	7.2	7.2	7.1	7.1	7.1	7.0	7.0
GDP (in mil. USD $)	45,163	41,819	49,258	43,309	48,394	47,062	39,629	40,630	44,120	50,597
GDP growth (%)	-2.7	0.7	2.0	-0.7	2.9	-1.6	1.8	3.3	2.0	4.4
FDI (% of GDP)	6.5	4.0	10.0	2.9	4.3	4.2	5.9	5.8	6.6	8.1
FDI (in mil. USD $)	2,929	1,693	4,931	1,275	2,059	2,000	2,343	2,355	2,895	4,107
State aid (% of GDP)	1.9	1.4	1.6	1.4	1.2	1.6	1.8	1.5	1.5	1.3

Source: Data from World Bank data and annual reports on state aid from the competent authority.

State Aid Legislation

To harmonize the legislation in the field of state aid with the EU legislation, Serbia adopted the new Law on State Aid Control in October 2019,[43] which replaced the Law on State Aid Control from 2009. At the same time, the state has adopted the relevant bylaws. The state aid law covers all sectors except agriculture and fisheries.

Competent state aid control body

According to Article 9 of the Law on State Aid Control, the competent body for assessment, supervision, control and decision making on the basis of the measures and scope of state aid is the Commission for State Aid Control (CSAC) - Комисија за контролу државне помоћи.[44] CSAC is an independent and autonomous organization that exercises public authority in accordance with the Law. The CSAC is composed of a Council composed of four members and one President. The bodies are elected by the National Assembly of the Republic of Serbia (Parliament) for a term of five years, with the right to a maximum of two re-elections. The Commission has a Professional Service that is responsible for performing the professional activities within the competence of the Commission. The CSAC is accountable to the State Assembly with the obligation to submit an annual report on its work.

State aid transparency

According to the 2019 EU Progress Report, state-related legislation is in line with the acquis and almost fully in line with the SAA and is largely in line with Articles 107 and 108 of the EU Treaty and SAA provisions.[45] However, the provisions that allow exceptions to the rules of state aid, which apply to companies in the process of restructuring and privatization, are not in accordance with the SAA and the acquis. Ex-

43) http://www.kkdp.gov.rs/doc/propisi/zakon_o_kontroli_drzavne_pomoci_2019.pdf
44) http://www.kkdp.gov.rs/
45) https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-serbia-report.pdf

isting schemes that include fiscal incentives, which are part of the Law on Profit Tax, the Law on the Personal Income Tax, and the Law on Free Economic Zones, must be aligned with the acquis. To be in line with Article 73 (5) of the SAA, the CSAC must adequately inform the EC of decisions relating to the approval of large amounts of state aid to large economic operators. Moreover, a regional map on state aid has not yet been developed. In terms of institutions, the EC addresses the work of the Commission for State Aid Control, which according to the old Law on State Aid Control functioned until mid-October 2019. The work of the old Commission has been assessed as operationally dependent on the Government, with extremely poor administrative and financial capacity to execute decisions. In one year (January 2018 - February 2019), CSAC received 64 notifications and made 15 ex-post controls, but no decision was made to ban or return any measure of state aid that was not in accordance with the law. Significant strengthening of the control over the harmonization of the measures for accumulation of state aid and the provisions of the intergovernmental agreements concluded with non-EU countries is necessary. These agreements must not guarantee third countries exceptions to Serbia's national law. The state must ensure that the assistance provided to Železara Smederevo before it is privatized is properly displayed and recorded in the balance sheets. In January 2019, the competent commercial court declared bankruptcy of this company, and the court has still not recognized the claims of the state based on the given state aid. Awareness of state aid rules for both providers and recipients remains extremely low. This is particularly striking with the small number of complaints in the second instance of the CSAC's decisions, as well as the small number of ex-ante notifications to the Commission on Introduced or Planned State Aid Measures. It is expected that the adoption of the new Law on State Aid Control and the start of operation of the new CSAC will remove much of the noted remarks in the report. The new CSAC will now be directly accountable to the Parliament, which is a useful tool for parliamentary oversight of state aid policies.

Investment support measures

The Constitution and laws in Serbia provide equal treatment to domestic and foreign investors in the use of state aid. Institutions directly responsible for attracting investments are: the Development Agency of Serbia (DAS) - Развојна агенција Србије[46] and the Directorate for Free Zones - an administrative body within the Ministry of Finance and Economy that performs state administrative affairs in the area of free zones.[47] The main policies and measures of state aid for attracting investments in Serbia are:[48]

- Financial support for existing jobs (between 20% and 40% of the justified costs for gross salary for a period of 2 years, depending on the sector, the volume of investment and the level of development of the region in which it is invested);
- Financial support for newly created jobs (between 3,000 and 7,000 euros for each newly created job, depending on the manufacturing sector, the volume of investment, the level of development of the region in which the investment is made and the number of newly created jobs);
- Financial support for procurement of tangible and intangible assets that will be realized during the duration of the investment project (minimum amount of investment must be between 100,000 euros and 20,000,000 euros, and the support is between 5% and 30% of the justified costs for investment depending on the importance of the investment for the development, the production sector, the level of development of the region in which the investment is made and the planned number of newly created jobs);

46) http://ras.gov.rs/

47) http://www.usz.gov.rs/

48) http://www.ras.gov.rs/podrska-investitorima/zasto-srbija/podsticaji-za-investiranje

- Financial support for greenfield and brownfield investments that may be subject to international trade;
- Subsidies for transfer of construction land (sale of state land at a price lower than the market price in case of investment of national importance or municipal land in case of investment that promotes local economic development);
- Exemption from profit tax for a period of 10 years (for investors who employ more than 100 workers and invest more than 1 billion dinars, i.e. 8.5 million euros);
- Exemption from profit tax for a period of 5 years (for investments in underdeveloped regions under special conditions provided by law);
- Company losses can be transferred for up to 5 years;
- Utilization of the benefits of free economic zones (exemption from VAT, customs duties, certain taxes and contributions; free flow of capital; simple and efficient one-stop-shop administration; exemption from payment of certain local fees and charges; use of transport services, freight forwarding, insurance and other associated services at preferential prices).[49]

Montenegro

Montenegro	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Population (mil.)	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
GDP (in mil. USD $)	4,159	4,139	4,538	4,088	4,464	4,588	4,053	4,374	4,845	5,504
GDP growth (%)	-5.8	2.7	3.2	-2.7	3.5	1.8	3.4	2.9	4.7	5.1
FDI (% of GDP)	37.3	18.3	12.3	15.1	10.0	10.8	17.3	5.2	11.6	8.8
FDI (in mil. USD $)	1,550	758	557	618	446	497	700	227	561	486
State aid (% of GDP)	1.58	2.1	1.77	1.11	2.88	0.76	0.53	0.48	0.43	0.75

State Aid Legislation

To align the legislation in the field of state aid with the EU legislation, Montenegro adopted the new Law on State Aid Control in October 2019,[50] which replaced the Law on State Aid Control from 2011. At the same time, the state has adopted the relevant bylaws. The state aid law covers all sectors except agriculture and fisheries.

Competent state aid control body

According to Article 5 of the Law on State Aid Control, the competent authority for control of adequacy, purposeful use and return of illegally granted and inadequate state aid is the Agency for Protection of Competition (APC) - Agencija za zaštitu konkurencije.[51] Pursuant to Article 19 of the Law on Protection of Competition,[52] the APC is an independent state body with the capacity of a legal entity. The bodies of the APC are a Council composed of three members (President of the Council and two members) and a Director. The Director has one deputy and two assistants, one of whom oversees state aid. The bodies are elected

49) http://www.ras.gov.rs/podrska-investitorima/zasto-srbija/podsticaji-za-investiranje
50) http://www.azzk.me/dp/doc/Pravni%20okvir/Zakon%20o%20kontroli%20drzavne%20pomoci%202018.pdf
51) http://www.azzk.me/jml/index.php/
52) http://www.azzk.me/dp/doc/Pravni%20okvir/Zakon%20o%20zastiti%20konkurencije%202018%20-%20precisceni%20tekst.pdf

by the Montenegrin government for a four-year term, with the right to re-election. The Agency has a State Aid Sector that is in charge of professional, administrative and technical matters related to state aid. APC is accountable for its work to the Government with the obligation to submit an annual report to the Government, but also to the Parliament of Montenegro.

State aid transparency

According to the 2019 EU Progress Report, state aid related legislation is largely in line with the acquis and with Articles 107 and 108 of the EU Treaty and the SAA provisions.[53] The adoption of the new Law on State Aid Control and the Amendments to the Law on the Protection of Competition, which strengthens the independence of the APC in the area of state aid control, is welcomed. However, it is noted that certain important parts of the acquis, such as banking communication, are still not aligned. Funding rules of services from general business interest are aligned with EU rules to a considerable extent, but greater demonstration is required during execution. The APC was launched in July 2018 after the dissolution of the State Aid Control Commission (SACS), which operated under the old law. Therefore, it does not have a satisfactory track record of performed controls. The capacity to enforce decisions of both the old and the new institution is assessed as extremely insufficient, although the unit for state aid control with seven employees who functioned under the old SACS from the Ministry of Finance was transferred to the newly formed APC. Regarding the operation of the old SACS, from 2015-2018, a total of 85 decisions were made, of which only 2 were negative. During the same period, no complaints were received, which indicates the low awareness of participants of the state aid rules in the process. There is evidence that the SACS has not been properly informed of some measures approved at the central and local levels (VAT exemption or written off claims for some large companies) or that it has investigated them improperly. For example, with the 2012 plan to restructure Montenegro Airlines, the state undertook to financially assist the airline with respect to the "only once and never again" principle. But even though the plan was partially realized, the state continued to finance the company in order to keep it in working condition. It is recommended that in the future the APC to strengthen its control over the implementation of state aid rules in major projects that Montenegro is implementing with third countries. It must have access to all the necessary information to give appropriate opinions and make binding decisions. According to the law, the APC's decisions can be further appealed to the Administrative Court. It is also necessary to further strengthen the awareness of the rules for state aid of both the providers and the recipients. The APC is directly accountable to the government, but also submits an annual report to parliament, which is a useful tool for parliamentary oversight of state aid policies.

Investment support measures

Laws in Montenegro provide equal treatment to domestic and foreign investors in the use of state aid. Institutions directly responsible for attracting investments are: the Secretariat for Development Projects, which is a body within the Government, and the Montenegro Investment Agency (MIA) - Agencija za investicije Crne Gore.[54] Pursuant to Article 102 of the Law on Public-Private Partnership, starting in February 2020, the MIA has taken over the affairs, assets, liabilities, documentation and employees of the Montenegrin Investment Promotion Agency (MIPA).[55] The main policies and measures of state aid for attracting investments in Montenegro are:[56]

53) https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-montenegro-report.pdf
54) http://www.mia.gov.me/naslovna/Agencija
55) https://www.mipa.co.me/me/
56) https://www.mipa.co.me/me/uredba-o-podsticanju-direktnih-investicija/

- Competitive tax system (9% profit tax; 9% PIT for income up to 720 euros and 15% PIT for income over 720 euros; three tax rates for VAT - 0%, 7% and 19%);
- Subsidies for newly employed persons (between 3,000 euros and 10,000 euros per new employee. Scoring is performed depending on the amount, sector, effects on exports, technological development, environment and regional development of the investments, i.e. references and cooperation of the investor with domestic legal entities);
- For capital investments of more than 10 million euros, which provide at least 50 jobs, funds are allocated in the amount of 17% of the value of the investment project, without conducting a scoring procedure;
- Utilization of benefits from the free economic zone "Port Bar" (exemption from VAT payments, profit tax and customs duties; exemption from customs control; preferential treatment in relation to fees for arranging construction land; use of land and buildings with long-term lease, under fixed conditions).

1.2. Regional State Aid in the Western Balkans

In most of the countries in the region, the manner of distribution of regional state aid is determined by secondary regulation, which is to some extent harmonized with the EU, and where the EU rules regarding the intensity or limitation of the amount of state aid are mirrored into the national legislation.

RN Macedonia - Regulation on regional aid [57]

In RN Macedonia, regional aid is regulated according to the Regulation on Regional Aid, and it is allowed on the entire territory of RNM.[58] The maximum intensity of regional investment aid is up to 50% of the justified costs, while the maximum intensity of regional investment aid for small and medium enterprises (SMEs) is covered by an additional +20% above the established maximum for small enterprises or +10% for medium enterprises. The beneficiary of the aid is required to provide a financial contribution of at least 25% of the justified costs.

Serbia - Regulation on rules for granting state aid [59]

The same restrictions, i.e. allowed intensity of state aid, are established in Serbia as in North Macedonia according to the Decree on state aid, from Article 7 to Article 17 (Part 2), with the maximum intensity of state aid as a percentage decreasing with increasing investment. For example, for justified costs up to 50 mil euros, the maximum intensity is up to 50%, from 50 to 100 mil euros, it is 25%, and for over 100 mil euros, the intensity is up to 17%.

Montenegro - Regulation on the criteria conditions and manner of granting state aid [60]

Regional aid is allowed on the whole territory of Montenegro, and the maximum intensity of regional investment aid is up to 50% of the justified costs, while the maximum intensity of regional investment aid for small and medium enterprises (SMEs) is covered by an additional +20% above the established maxi-

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57) Regulation on Regional Aid of RNM, Article 4 Aid intensity and Article 5 Maximum aid intensity Official Gazette 109/2013, http://kzk.gov.mk/%d1%83%d1%80%d0%b5%d0%b4%b4%d0%b1%d0% b0-% d0% b7% d0% b0-% d1% 80% d0% b5% d0% b3% d0% b8% d0% be% d0% bd% d0% b0% d0% bb% db% d0% bd% d0% b0-% d0% bf% d0% be% d0% bc% d0% be% d1% 88 /

58) RNM of NUTS 1 and NUTS 2 is the whole territory of the country (https://ec.europa.eu/eurostat/documents/345175/7773495/MK.pdf)

59) Uredba o pravilima za dodelu državne pomoći ("Sl. Glasnik RS", br. 13/2010, 100/2011, 91/2012, 37/2013, 97/2013 i 119/2014), http://www.kkdp.gov.rs/doc/propisi/UREDBA%20drzavna%20pomoc.pdf

60) Uredba o bližim kriterijumima, uslovima i načinu dodjele državne pomoći ("Sl. List Crne Gore", br. 27/10 34/11, 2014), article 7 and 8 http://www.azzk.me/dp/doc/Pravni%20okvir/Uredba%20o%20blizim%20kriterijumima%20uslovima%20i%20nac-inu%20dodjele%20DP.pdf

mum for small enterprises or +10% for medium enterprises. The beneficiary of the aid is required to provide a financial contribution of at least 25% of the justified costs. There is a list of sectors where such assistance is or is not allowed. In addition, the maximum intensity of state aid for regional development as a percentage decreases with increasing investment for large investments for justified costs from 50 to 100 million euros, with the maximum amount for over 100 million euros being up to 34%.

Bosnia and Herzegovina - Regulation on the purpose, criteria and terms for granting state aid [61]

The regulation in Bosnia and Herzegovina sets a maximum for the area - a maximum of 50% of the investment if the GDP per capita (NUTS 3) is lower than 45% of the EU level, a maximum of 35% in areas where the per capita GDP is between 45% and 60% of the EU GDP, and a maximum of 25% for areas with more than 60% of the GDP per capita compared to the EU level. An additional intensity of +10% exists in municipalities in which the development index is between 50% and 75% of the Federation average, and +20% in municipalities in which the development is 75% of the FBH average. For large investments, the intensity decreases as the investment increases, with the maximum amounting to 100 million euros.

Kosovo - System establishment status

Kosovo is in the process of establishing and restructuring state aid control and oversight institutions, as well as adopting a new state aid law. To date, there is still no decree or act laying down details regarding the conditions, criteria and / or maximum intensity of establishing regional state aid. [62]

Albania - Decision on approval of the regulation "On the conditions and procedures for granting and approving certain categories of state aid [63]

At the end of 2018, Albania decided to regulate the conditions and procedures for determining the scope and limits of state aid intensity. The maximum determined assistance depends on the coefficient of development of the regional map. Albania has three regions at the level of NUTS II, of which no GDP per capita exceeds 75% of the EU average, which is why regional aid is allowed throughout the country. The intensity of regional aid should not exceed 50% of the investment, with the possibility of an additional 20% when the aid recipient is a small enterprise or +10% in the case of medium enterprises . The amount of state aid is also determined by the size of the investment for all investments up to 50 million euros, up to 50% for the investment between 50 million euros and 100 million euros, and 0% for investment over 100 million euros.[65]

1.3. Progress in WB countries: State aid according to the EC annual progress reports

Most WB countries have fully adopted EU state aid legislation in their national laws. However, enforcement of these rules remains "ineffective", especially in terms of introducing an internal system of state aid control and reducing the total amount of aid relative to their GDP.

Recommendations from EU reports on countries in the region have been widely repeated over the years, with poor or partial readiness in the area and with moderate or no progress for the given year. Recent reports from 2019 on progress in 2018 for all countries state that the legal framework is more or less

61) Uredbu o namjeni, kriterijima i uslovima za dodjelu državne pomoći u Federaciji Bosne i Hercegovine (Sluzbene novine Federacija BiH, 27/2008), article 12 http://www.szdp.gov.ba/data/dokumenti/pdf/Uredba%20o%20namjeni%20i%20kriterijima%20-%20bos.pdf

62) State Aid Guideline, Republic of Kosovo, Government, https://mf.rks-gov.net/desk/inc/media/B7F80FAF-32A8-4DC0-BB5A-C959B70F4759.pdf, January 2019

63) Official Gazette of Albania 132/2018, Official Gazette of the Republic of Albania No. 132, Date 14/09/2018, On the approval of the regulation "On the conditions and procedures for granting and authorizing certain categories of state aid".

64) Official Gazette of Albania, Regional State Aid Map, On the Approval of the Regional State Aid Map, Official Gazette of the Republic of Albania No. 131, Date 9/10/2012

Official Gazette of Albania 132/2018, Official Gazette of the Republic of Albania No. 132, Date 14/09/2018, On the approval of the regulation "On the conditions and procedures for granting and authorizing certain categories of state aid".

harmonized to some extent, but each of the countries is experiencing the problem of insufficient implementation of the law on state aid control, hence the possibility of granting state aid without it being noticed at all by the institutions, granting state aid that should not be allowed, and insufficient awareness among state aid providers of their duties, rules, and the need for improved transparency. For all countries in the region there is still the need to more strongly develop state aid control and for the competent authorities to perform their functions adequately and fully. The notes from the 2018 reports are given in more detail for each country in the table below.

Table 3: Review of Parts of the 2018 EC Reports on WB Countries Relating to State Aid Control

MK Progress Report	Report from 2019 for 2018, Chapter 08, part State aid State aid The Legislative Framework for State Aid Control is still broadly aligned with Articles 107 and 108 of the TFEU and with corresponding provisions of the SAA. The Law on State Aid and the Regulation for granting aid of minor importance (de minimis) still need to be amended. Implementing the legislation on certain forms of aid and specific sectors still needs to be aligned with the acquis. In addition, the state aid inventory and the regional aid map are outdated and lack transparency. With regard to the institutional framework, the CPC is also responsible for implementing the Law on State Aid. State aid grantors must notify the CPC of their plans to grant new or alter existing state aid so that it can assess its compatibility. If an aid measure is not notified, the CPC has the power to investigate it ex-officio, and can order its recovery. CPC's administrative capacity to deal with state aid control and enforcement remains insufficient with only three staff, outdated equipment and budget constraints.
ALB Progress Report	State aid The legislative framework is broadly in line with the acquis and the SAA. Amended in 2016, the Law on State Aid largely reflects Articles 107 and 108 of TFEU. Legislation was adopted on the conditions and procedures for granting State aid. This legislation aims to partially align Albania's legislation with the 2014 General Block Exemption Regulation. Further alignment with implementing EU legislation on State aid control is still needed. On institutional framework, the State Aid Commission (SAC) is responsible for implementing the Law on State Aid. The Ministry of Finance and Economy, which is an aid granting institution, continues to determine its organizational set-up. This means that the SAC cannot be considered an operationally independent authority, as required by the SAA. The enforcement capacity of the SAC's secretariat raises serious concerns, as it is currently insufficient and needs to be significantly strengthened. It has yet to be shown that the Law on State Aid is being implemented effectively. The state aid control enforcement record is very low.
BiH Analytical Report	State aid ... the legislative framework is partially aligned with EU legislation and the provisions of the SAA. It consists of the Law on the State Aid System in Bosnia and Herzegovina and the regulations adopted by the Council of Ministers and the entities of the District Governments in Brcko. .... In general, the relevant bylaws have not been adopted equally throughout the country. ... A regional aid map has yet to be drawn up. This aid map will show the geographical areas identified at NUTS II level where companies have the right to receive regional state aid in defined intensities in accordance with the regional guidelines for state aid. As for the institutional framework, the State Aid Council is responsible for ensuring consistent implementation of the Law on the State Aid System. The functioning of the State Aid Council is significantly hampered by ethnic-based procedures.

	.... As a result, the relevant provisions in the field of state aid, even if harmonized with the legislation, could potentially fail to be implemented in practice. ... The implementing capacity of the State Aid Council is insufficient. .... This raises significant concerns about its enforcement capacity. A significant majority of state aid measures are implemented by grant before they are notified and approved by the State Aid Council. The harmonization of the existing state aid schemes arising from the SAA and EU state aid rules is at a very early stage. Bosnia and Herzegovina should ensure the transparency of all granted state aid measures....
Serbia Progress Report	State aid As regards the legislative framework, the law on State aid control broadly reflects Articles 107 and 108 of the TFEU and the relevant provisions of the SAA. However, provisions providing exemption from State aid rules for companies undergoing restructuring and privatization are not compliant with the SAA and not aligned with the acquis. Existing aid schemes, including the fiscal State aid schemes part of the law on corporate income tax, the law on personal income tax and the law on free zones, need to be aligned with the acquis to comply with the SAA, the CSAC needs to step up its efforts to provide the European Commission with information on a number of individual decisions approving large amounts of State aid to major operators in the economy, in line with its obligation under Article 73(5) of the SAA. The regional aid map has yet to be drafted. ... The Commission cannot be considered as operationally independent, as required by the SAA. The enforcement capacity of the CSAC remains very weak and insufficient...There was no progress made on implementing the law on State aid. From January 2018 to February 2019, the CSAC took 64 decisions upon notification and another 15 decisions in ex post procedure (illegal aid). However, the CSAC has not yet taken a single decision prohibiting state aid nor a decision in favor of recovery...
Montenegro Progress Report	State aid The legislative framework is to a large extent in line with the EU acquis and the SAA as well as with Articles 107 and 108 of the TFEU. The rules on the financing of services of general economic interest are largely aligned with the EU State aid acquis, however Montenegro needs to demonstrate their proper enforcement. Amendments to the Law on the protection of competition entered into force in March 2018. They expanded the mandate of the APC to include State aid control, in order to meet the SAA requirement on the operational independence of the State aid authority. As regards the institutional framework, the State Aid Control Commission (SACC) was dismantled in July 2018. In line with the Law on State aid control, the newly established Council of the APC took over its responsibilities. ...The State aid authority has yet to establish a solid track record on enforcement. The enforcement capacity of the former SACC and the current APC Council remains significantly insufficient ... There is continued evidence that some aid measures granted at central or local level (e.g. through VAT exemptions or debt relief), in particular to large companies, were not notified or properly investigated by the SACC/APC. In the future, the State aid authority should also further monitor the implementation of State aid rules in large projects undertaken in cooperation with third countries. It should thus have access to all necessary information to provide opinions and take binding decisions. Awareness of State aid rules among aid grantors is still insufficient and advocacy must be stepped up considerably
Kosovo Report	State aid The legislative framework is largely in line with the acquis. The Law on state aid is broadly aligned with Articles 107 and 108 of the TFEU. A Regulation on Procedures and Forms of State Aid Notification was adopted in October 2018. As regards the institutional framework, the members of the State Aid Commission, responsible for implementing state aid control, were appointed in March 2019. Formally, the State Aid Department in the Ministry of Finance has

	the power to verify notified aid measures, prohibit aid, carry out ex post control of aid and recover incompatible aid. However, its capacity to enforce the law remained inadequate over much of the reporting period. As a result, there has been no effective enforcement. The State Aid Department has not adopted any decisions on state aid in the last five years and has been devoted to drafting secondary legislation. The Department did not have the capacity to screen existing aid schemes and establish a comprehensive inventory of aid schemes by the SAA deadline (April 2019). Moreover, the identification of granting authorities is still ongoing, hindering ex ante notifications and ex post control. A number of aid measures, granted at central or local level, in particular to large companies in various sectors (e.g. telecommunications) are not notified or properly investigated. Awareness of state aid rules among aid grantors is very weak and must be improved significantly.
Sources:	МК: https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-north-macedonia-report.pdf, страна 64 ALB: https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-albania-report.pdf, страна 64 БиХ: https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-bosnia-and-herzegovina-analytical-report.pdf, страна 102 СР: https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-serbia-report.pdf, страна 65 ЦГ: https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-montenegro-report.pdf, страна 65 КС: https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-kosovo-report.pdf, стана 63

2. FOREIGN INVESTMENTS IN THE REGION AND DIRECT AID POLICIES

The policies of attracting foreign investments in the WB region in the last decade have been implemented through a significant number of programs, measures, forms, among which it is important to highlight the appearance of the FEZ, i.e. since the enactment of the laws on free economic zones in the early 2000s, in Montenegro in 2004, Serbia in 2006, Albania in 2007, Bosnia and Herzegovina in 2009, RN Macedonia in 2007 and Kosovo in 2013. Since then, a significant number of free zones have been established and / or functional: in Albania 3, in BiH 4, in RN Macedonia 15, in Kosovo 3, in Montenegro 1, in Serbia 14.

Support is provided through fiscal and non-fiscal incentives reflected in financial but also economic costs and benefits. The level of transparency and capacity to implement laws in the region, seen in the notes of the EU reports, also indicates the high probability that the amount of state aid is higher than the one recorded, but also to some extent contrary to the rules for granting state aid in terms of competition protection. In its research on the costs and benefits of foreign investment in the free zones, CEA clearly identifies the problem of non-transparency and lack of accountability that leaves a veil of secrecy and inability to clearly assess the benefits of granted aid and the extent to which these policies' goals are achieved, i.e. the efficiency in spending public funds or "...the price for political and economic instability and non-transparency is compensated by direct outflows from the budgets of those countries and by the relatively low prices for labor and tax exemptions".[66]

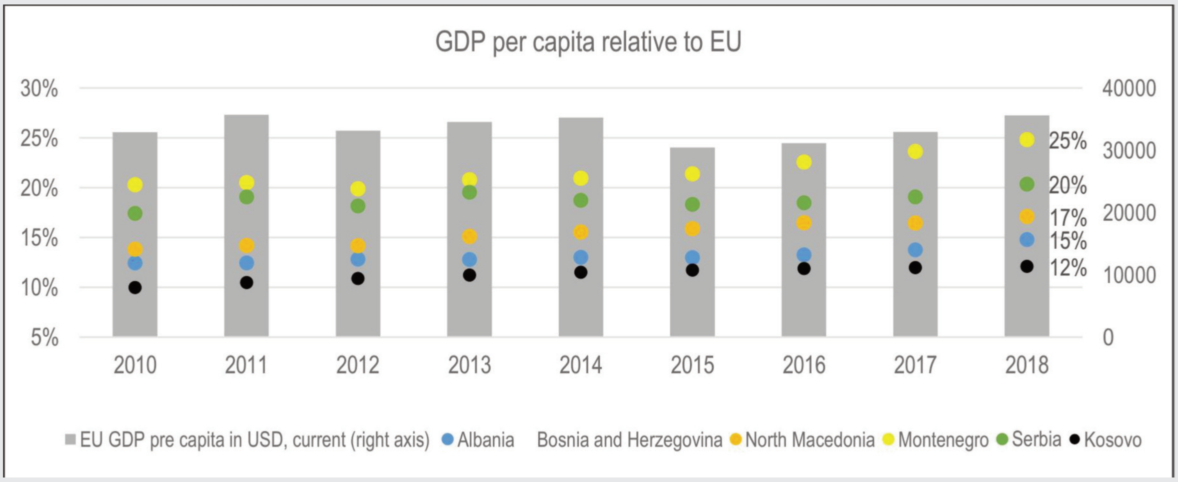
2.1. Foreign direct investment in the WB region

GDP per capita in the countries of the WB compared to the average GDP per capita in the EU indicates significant differences. Expressed as a ratio, Montenegro ranks highest in the region with GDP per capita at 25% compared to the same indicator at the EU average, with Kosovo at only 12%, and the convergence toward the EU average is evidently slow.

The inflow of FDI in the Western Balkans region over the past decades has seen different trends at different times, but also differences by countries. In the second half of the 1990s, all countries in the region saw a poor inflow of FDI over GDP. From 2000 until the financial crisis in 2008, all countries in the region note a significant increase in FDI, following which it decreases in some of the countries. After this period, the rates stabilize, but with a trend of stable average growth. In the period 2008-2010, Montenegro had significantly higher rates than the average FDI inflows in the region, which reached the levels of several tens of percent of the GDP (in 2009, 36.7%). The same is observed in Albania where FDI in relation to the GDP continuously has a value of ~8% to ~10% per year. RN Macedonia, which has a significant number of benefits / incentives to attract foreign investments (at least in terms of the number of benefits introduced since 2007), recorded a higher share of FDI in the period 2007-2008, after which the rate stabilized at around 2% to 3% of the GDP. In the same period in Serbia (which also offers significant benefits) there is on average at least twice the annual share of FDI.

66) Center for Economic Analyses (CEA), 2016, "Benefits and Costs from Foreign Direct Investments in the Technological Industrial Development Zones in the period of 2007–2014", Skopje. http://cea.org.mk/wp-content/uploads/2016/04/1.-Benefits-and-costs-from-FDI-in-TIDZ-ENG.pdf.

Graph 1: GDP per capita in the WB countries relative to the EU



Source: Data from World Bank data.

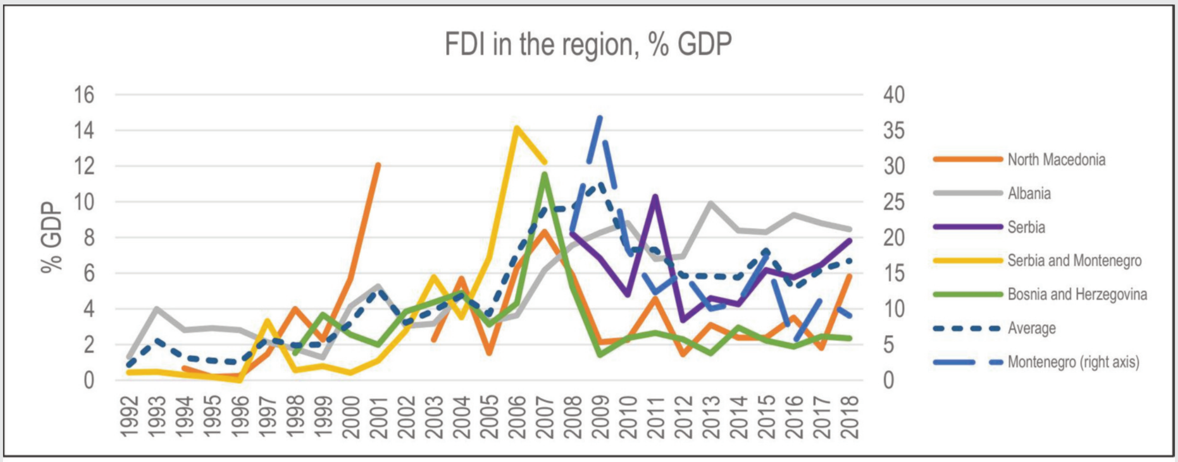
On average, the FDI (as a percentage of the GDP) per year in the last decade (2010-2018) for each of the countries was: 3% in RN Macedonia, 8.4% in Albania, 6% in Serbia, 12.3% in Montenegro, and 2.3% in BiH.

Table 4: Foreign direct investment in WB countries as % of GDP

	1995	2000	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Avg. (2010-2018)
North Macedonia	0.2	5.7	1.5	6.3	8.3	5.9	2.1	2.3	4.6	1.5	3.1	2.4	2.4	3.5	1.8	5.8	3.0
Albania	2.9	4.1	3.3	3.6	6.2	7.6	8.3	8.8	6.8	6.9	9.9	8.4	8.3	9.3	8.8	8.5	8.4
Serbia						8.2	6.8	4.8	10.3	3.4	4.6	4.3	6.2	5.8	6.5	7.8	5.9
Serbia and Montenegro	0.2	0.4	6.9	14.1	12.2												
Montenegro						21.1	36.7	18.4	12.3	15.2	10.0	10.8	17.2	5.2	11.5	9.0	12.2
Bosnia and Herzegovina		2.6	3.1	4.3	11.5	5.2	1.4	2.4	2.7	2.3	1.5	3.0	2.2	1.9	2.5	2.4	2.3

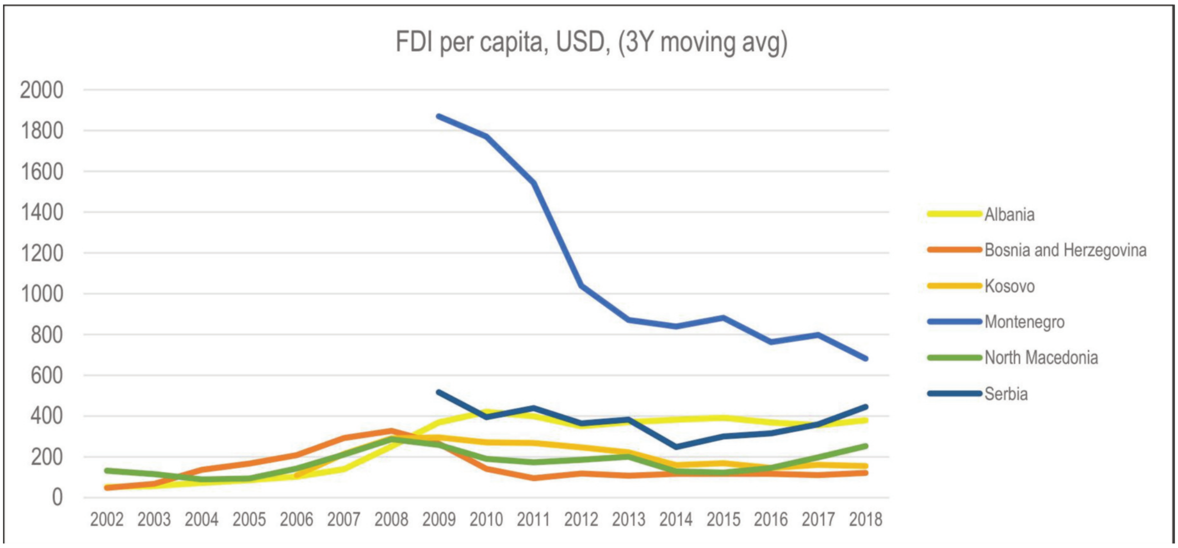
Source: UNCDAT database.

Graph 2: FDI in the region as % of GDP



Source: UNCDAT database.

Graph 3: FDI per capita in the WB countries



Source: Data from World Bank data.

2.2. State aid in the region

The data on the value of the state aid directly intended for FDI and / or in the free zones do not exist, i.e. they cannot be separated from the available data from the information of the competent bodies. Namely, as an illustration, RN Macedonia has lacked full transparency on this issue since the introduction of the law on state aid control, although it is harmonized to some extent with the EU acquis. Until 2017, the value of state aid to foreign companies was considered "confidential" and classified data. In its study of FDI costs and benefits and as early as 2016, the CEA clearly indicated the need for data opening and transparency of full state aid following EU recommendations in order to analyze, but also make informed decisions.[67] With the decision for declassification of these data at the 35th session of the Government (29.08.2017) in 2018, the CPC report published for the first time the total value (cumulative) of assistance provided to foreign companies, i.e. the total per provider with a list of users (but not an individual value per user).

Therefore, we will provide an overview of the amount of state aid in countries to the extent that it is available, presented as % of the GDP for comparability. This value is the granted state aid expressed as a percentage of the GDP of the countries in the region with available data, not including the value of the granted state aid in agriculture and traffic (or other relevant sectors) for comparability.[68] The data are based on published reports by the national body responsible for state aid control in each of the WB countries. However, considering the remarks in the EU reports on the countries concerning the level of implementation of the regulation, the volume of state aid is probably even higher.[69]

If we analyze the trends of the countries in the region, the state aid in the last decade (2008-2018) ranges from 1.3% with a decrease to 0.7%, while in the same period at the average level of EU-28, the

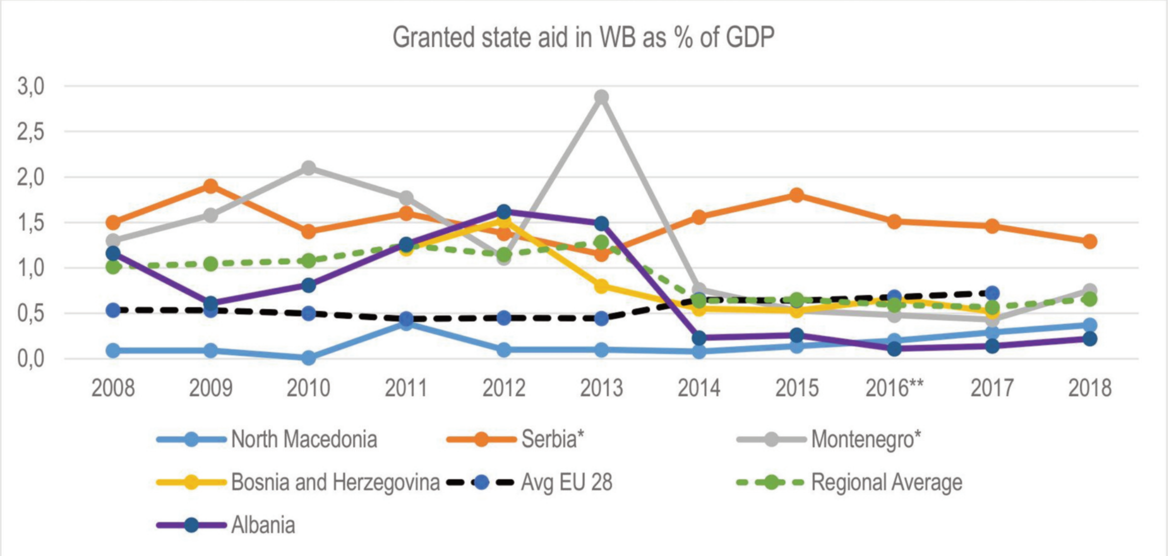
67) Ibid.

68) Of all the countries in the region, only RN Macedonia through its competent body does not report over subsidies in agriculture as part of the state aid reports. The agriculture subsidies are also fully exempt from the law. Other countries in the region for which reports are available separately report on state aid in agriculture, as do EU member states through various parameters and in the absolute and relative ratio of the Scoreboard database.

69) The inefficiency of the implementation of the policies for control of the state aid in parallel as in Macedonia with the findings of the SAO for state aid providers. See more in the audit reports for INVESTINMACEDONIA, DTIZ, etc.

relative value of state aid ranges from 0.5% to 0.7%. If we analyze each country separately, the high relative annual indicators above 1% of the national GDP stand out, especially in Serbia (average for 2008-2018, 1.5%) and Montenegro (average for 2008-2018, 1.2%), which has a relative index several times higher than the EU average, while in RN Macedonia, the index is significantly lower (average for 2008-2018, 0.2%). The trend of convergence, or reduction of the relative indicators toward the EU average, is visible in the countries, especially as of 2014.

Graph 4: Awarded state aid



Source: State Aid Scoreboard for EU,[70] annual reports for all separate years of national state aid control bodies for WB countries.

Table 5: State aid as % of GDP

State aid as % of GDP	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*	*2015*	*2016***	*2017*	*2018*
North Macedonia	0.1	0.1	0.0	0.4	0.1	0.1	0.1	0.1	0.2	0.3	0.4
Albania	1.2	0.6	0.8	1.3	1.6	1.5	0.2	0.26	0.11	0.14	0.22
*Serbia**	1.5	1.9	1.4	1.6	1.4	1.2	1.6	1.8	1.5	1.5	1.3
Kosovo	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
*Montenegro**	1.3	1.6	2.1	1.8	1.1	2.9	0.8	0.5	0.5	0.4	0.8
Bosnia and Herzegovina	n/a	n/a	n/a	1.2	1.5	0.8	0.6	0.5	0.7	0.5	n/a
Average EU-28	0.5	0.5	0.5	0.4	0.4	0.4	0.7	0.6	0.7	0.7	n/a
Average in the region	1.0	1.0	1.1	1.2	1.1	1.3	0.6	0.7	0.6	0.6	0.7

*SA without agriculture and traffic, Montenegro, BiH and Serbia report them together and separately, RN Macedonia does not report on state aid in agriculture in the reports of the competent bodies.

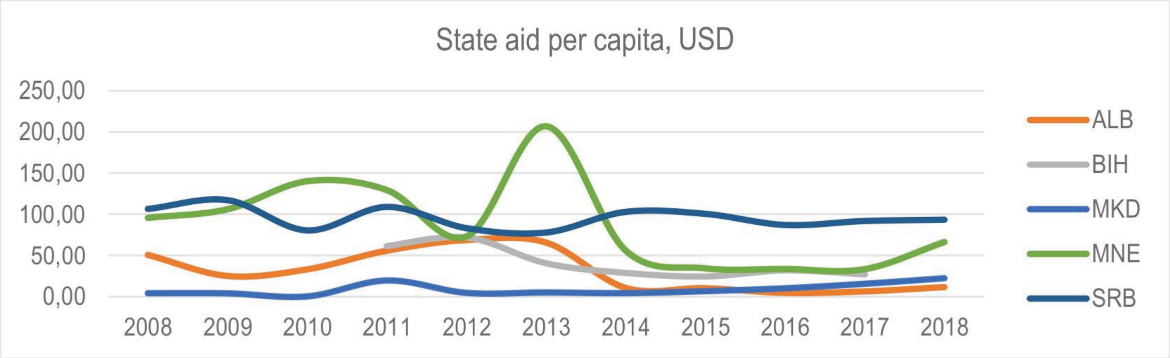
**2016 for MK allowed not granted.

Source: State Aid Scoreboard for EU,[71] annual reports for all separate years of national state aid control bodies for WB countries.

70) State Aid Scoreboard 2018: Results, trends and observations regarding EU28 State Aid expenditure reports for 2017, https://ec.europa.eu/competition/state_aid/scoreboard/state_aid_scoreboard_2018.pdf

71) State Aid Scoreboard 2018: Results, trends and observations regarding EU28 State Aid expenditure reports for 2017, https://ec.europa.eu/competition/state_aid/scoreboard/state_aid_scoreboard_2018.pdf

Graph 5: State aid per capita



Source: Data based on years of reports from national bodies, population and investments from World Bank data.

2.3. Regional competition for FDI through fiscal and non-fiscal measures

According to the economic literature, regional competition for attracting investment through a series of incentives can have a significant negative impact on economies if it leads to:

1) deadweight loss - i.e. approving and awarding incentives to investors who would invest anyway, resulting in unnecessary costs; or

2) beggar-thy-neighbor, i.e. when countries try to outdo each other in terms of incentives in order to attract investors.

The OECD (2013) *Checklist for FDI Incentive Policies*[72] (short excerpts) states the following on their usefulness: ... the most effective policies for attracting FDI are those that improve the general economic and business environment of a country, rather than those aimed at tax breaks, financial subsidies and regulatory exceptions aimed at foreign enterprises and some investors above others. ...OECD recognizes that incentives can help in efficient FDI allocation, but that they can also distort competition, which can represent a high cost both for the international community and in the long term for the host country as well...Therefore, the OECD guide cites FDI incentives that are available to policy makers, both positive and negative. Here are five key pointers that make FDI incentives wasteful:

- ***Ineffectiveness*** - the usage of FDI incentives fails to produce benefits to the host economy that exceeds the budgetary costs. This situation may arise where authorities apply faulty cost-benefit analysis or no cost-benefit analysis at all, to their incentive;
- ***Inefficiency*** - here incentives produce benefits that outweigh the cost, but authorities fail to properly maximize the benefits and minimize the costs;
- ***Opportunity Costs*** - when the resources available to attract FDI are scarce, the issue of alternative usage of funds arises;
- ***Deadweight loss*** - subsidizing investment projects that would have taken place in the absence of incentives; inadequately targeting the intended recipients that has only resulted in spillover to non-target groups; authorities, in order to maintain a reasonably level playing field in their domestic business sector, feel obliged to match FDI incentives by offsetting subsidies to other enterprises; au-

72) OECD (2003), Checklist for Foreign Direct Investment Incentive Policies, https://www.oecd.org/investment/investment-policy/2506900.pdf

thorities, by offering particularly generous FDI incentives to some projects, effectively "raise the bar", creating a reference point that future investors will use to expect the same or better subsidies;

- ***Triggering competition*** - when long-term costs of an incentive scheme include the economic burden that arises if other jurisdictions put in place matching measures.

The incentives, subsidies, and state aid through fiscal and non-fiscal measures offered by the countries in the region are significant, and as they are listed in the table below (the list may not be exhaustive due to frequent regulatory changes, policy changes and measures), may already indicate the possible effects of the aforementioned potential negative implications, i.e. that countries in the region are in competition with what country will "give" more. Moreover, this may be an indication of possible inefficiencies and in-effectiveness (in the absence of clear expectations that would be compared) as well as the generation of unnecessary / permanently lost assets. On the other hand, of course, there are expected benefits.

Table 6: Overview of fiscal and non-fiscal incentives for investment in economic zones

Overview of fiscal and non-fiscal incentives for investments in economic zones and in general for investments in the countries of the Western Balkans		
Country	Fiscal and tax incentives	Other non-fiscal / non-tax incentives
Albania	• Albanian products entering technical and economic development zones exempt from VAT and customs duties (0% in zones, standard VAT rate 20%) • Capital expenditures are deducted up to 120% • Customers additionally exempt from 50% of tax on profit (at 7.5% as opposed to the standard rate of 15%) for 5 years • Exempted from property taxes • Wages and social contributions are recognized costs up to 150% for the first year • Training costs are doubled over a period of 10 years • Research and development costs are doubled (200%) in 10 years • Income tax in economic zones 0% (standard rates depend on the level of personal income and are taxed at 0%, 13% and 23%)	• For all investors - 1 € long-term lease of land and buildings for 99 years • Priority / fast procedures and services from state institutions • Infrastructure in the zones (water, electricity, sewerage, etc.) • Promotion through the promotion agency
Bosnia and Herzegovina	• Free zone users do not pay VAT and customs duties on equipment (standard VAT rate 17%) • Reduction of profit tax (30-50% of profit tax) or tax exemptions based on job creation (exemptions) in both entities: FBiH, profit tax reduced to 7% if 50% of profit is reinvested, to 5% if the investment is >10 mil euros, 200% recognized gross wage costs for new employment; while in RS the investment is tax exempt as well as income tax and contributions if more than 30 employees are employed (standard profit tax rate 10%, personal income tax 10%) • Exemption from excise duties on goods intended for export • Release or reduction of property taxes (standard rates in RS 0.2%, in FBiH different in different cantons)	• Infrastructure in the zones (water, electricity, sewerage, etc.) • Grants for international promotion for both foreign and domestic companies

North Macedonia	• FEZ - tax holiday - investors in economic zones are entitled to a 10-year profit tax exemption (standard 10% profit tax rate) • The zones offer a 100% reduction in personal income tax for 10 years - effective rate 0% (standard 10% personal income tax rate) • Investors are exempt from paying VAT on goods, raw materials and equipment in the zones (standard rate 18%) • Exemption from customs duties on goods, raw materials, equipment and machinery (standard rates 5-20%) • Investors are exempt from paying local utility fees or construction permit fees (standard property tax rates 0.1-0.2%, property transfer tax 3%)	• Long-term lease of land in the zones for a period of up to 99 years • Up to 0.5 mil euros cash grant for the cost of construction of facilities, depending on the number of new jobs and the amount of the investment • Exemption from customs duties on equipment and spare parts used for the zone • Infrastructure (water supply, sewerage, etc.) • Preferential / fast / priority services from the state: approvals for design and infrastructure, issuance of building and operation permits, customs administration, contacts with other state and local authorities and the like • Equalization of assistance to domestic and foreign investors
Serbia	• 0% customs duties and 0% VAT (standard rate 20%, preferential 10%) • 0% profit tax in and out of investment zones >8 mil euros and >100 employees for up to 10 years (standard rate of profit tax 15%) • Investors are exempt from paying local property taxes or have reduced rates (standard property tax rates 0.6-1%, property transfer tax 3%), in certain zones and other local taxes such as utilities and fees are exempt or reduced	• One-stop-shop system for administration services • Simple and fast customs procedures (each zone has a customs office) • Local subsidies for using infrastructure of the free zone • Services under preferential conditions for the zones (transport, banking services, etc.)
Kosovo	• 0% import duties • Deferred payment of VAT on equipment for the facility in FEZ	• Exemption from local duties • Providing infrastructure (electricity, gas, water, sewerage) and preferential land costs
Montenegro	• 0% customs duties and 0% VAT on goods entering the zone (standard VAT rate 19%) • Reduction of 40% to 70% on all local duties as building permits in the free zone (Bar) • State-sponsored incentives for investors such as job creation grants, as well as exemption from paying social security contributions and personal income tax for employment of special groups applicable to all investments (standard income tax rate 9% and 11% with additional exemptions for employment) • Reduced profit tax rates from 0% for a period of up to 3 years in underdeveloped profit areas up to 20 thousand euros, applies to all (standard profit tax rate 9%)	

Source for:

Serbia	http://www.usz.gov.rs/pogodnosti.php
Macedonia	http://fez.gov.mk/why-invest/#1516709706334-5b5d1d63-4d2e
Bosnia and Herzegovina	http://www.fipa.gov.ba/informacije/povlastice/strani_investitori/default.aspx?id=141&langTag=en-US
Montenegro	http://www.mek.gov.me/program_za_unapredjenje/podsticaj_investicija/
Albania	https://invest-in-albania.org/investment-tips-2/investment-incentives-in-albania/
Kosovo	https://kiesa.rks-gov.net/desk/inc/media/A4BBAEFE-05E8-4768-A7B2-BA36E4A1B9A8.pdf

2.4. Decisive motives for investing

In 2018, the World Bank, as part of the Global Investment Competitiveness Report, published a detailed report on the motives and reasons of foreign investors in deciding where to invest.[73] Investors consider a wide range of factors, the most important one being the existence of political stability and security, as well as the business-legal and regulatory environment. These are the primary factors that rank according to importance before other factors such as infrastructure, qualifications, talent, and skills of the workforce as well as low labor costs and inputs. For 86% of multinational investors, the regulatory environment and laws are an important or critically important factor that indicates the weight of this deciding factor in making an investment decision. Significantly lower on the list of priorities, but still important, are low taxes and cheap labor, real estate access and access to finance.

Regarding the level of critical importance of incentive measures, which are used and present in both high-income countries and developing countries, investors rank them in fourth place out of six characteristics for the business investment environment. The incentives are ranked after the priorities for: transparency and predictability in the behavior of government and public agencies, the existence of guarantees for protection of investments with laws, and simplicity in founding and establishing business activity. Overall, only one in five investors believes that the absence of investment incentives is a decisive factor in investing, while one third believes that incentives are important, but not decisive.

This suggests that incentives cannot be fully eliminated, but on their own, they are unlikely to persuade investors to choose a given location / country for their investment. Hence, the basic recommendation for policies and policy makers is that the investment climate must first be addressed before resorting to incentives as a means of attracting investors.

As such, given that the WB region faces unpredictable political crises and instability, a low level of rule of law, an unpredictable regulatory environment, etc., we note that these are significant factors that have had a large share in the volatile and relatively low level of past foreign investments. At the same time, the success of investments to a certain extent in each of the countries has not been realized as a result of incentives as a key deciding factor, pointing to the effect of deadweight losses and inefficient public spending. According to the above, despite the improvement of the business climate and the progress of the past decade, the priority of the countries should be to create an environment for political stability, predictability, and legal certainty.

2.5. Regional Strategic Platforms for Economic Cooperation in WB: Protection of competition and state aid control

The need for regional cooperation in the Western Balkans has been acknowledged as necessary given the European aspirations of all countries in the region, as the EU values countries not only separately but also as a "package". This approach is also seen through neighborhood policies, the enlargement strategy for the Western Balkans,[74] as well as group progress reports for the region[75] and enlargement policies. Regional cooperation is seen from the perspective of multiple dimensions, the political, security and economic one. From an economic point of view, as development is a priority for all WB countries, due to their

73) World Bank. 2018. Global Investment Competitiveness Report 2017/2018: Foreign Investor Perspectives and Policy Implications. Washington, DC: World Bank. doi: 10.1596 / 978-1-4648-1175-3.

74) A credible enlargement perspective for an enhanced EU engagement with the Western Balkans, COM(2018) 65 final, https://ec.europa.eu/commission/sites/beta-political/files/communication-credible-enlargement-perspective-western-balkans_en.pdf, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-communication-on-eu-enlargement-policy_en.pdf

75) https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-communication-on-eu-enlargement-policy_en.pdf

size and fragmented economic space, intensive regional cooperation is a chance for economic progress. Achievements in the past have been marked by the liberalization of trade as one aspect of all SAAs. From regional summits in recent years, this policy of the EU toward the countries of the Western Balkans, as well as SEE, has resulted in the RCC (Regional Cooperation Council), which leads the key strategic platforms that have emerged from there in the past. They clearly identify the need for cooperation in the field of investment, as well as the need for improved policies to protect competition. Key strategic documents adopted by the countries in the region are:

- The SEE 2020 Strategy (South East Europe 2020 Strategy), inspired by the Europe 2020 Strategy, focuses on regional cooperation through a common approach to the EU.[76] The document clearly identifies the protection of competition and state aid control as being among the key pillars of the advanced competitiveness of the regional economy:

  ◆ *"[Strengthening competitive economic environment in the region is of key importance to support free flow of goods and services as well as to level the playing field in facilitating FDI inflows. The main issues to be addressed in the Integrated Growth agenda are trade related aspects of the competition rules, intellectual property rights and public procurement. Hence, these are the areas where an accelerated alignment with the EU acquis and international rules would have a direct positive impact on both promotion of regional trade and investment]*[77]

  ◆ In Pillar 3 Sustainable Development, one of the main direct measures and activities for Chapter 8 is to promote cooperation in the area of competition policy by [...*establishing a network of competition authorities and a coordination body; developing regional guidelines on the State aid transparency; developing a common methodology for peer reviewing*),] ... but also indirectly related to this chapter through measures for regional market liberalization and trade, promotion of transparency, anti-corruption, full openness of regional competition in the field of public procurement, regional promotion of the energy sector, coordination of common tax policies, etc.

  ◆ Progress: In terms of state aid from the strategy in the annual progress report for implementation in 2019, prepared by the RCC, relatively insufficient progress was made in relation to the planned goal for 2020: .. [*There is clear evidence that private investments have led to higher economic growth, but investments are needed in tradable sectors to sustain growth. The investment climate has remained largely unchanged and is characterized by weak rule of law, lack of proper implementation of state aid control, a strengthened gray economy, poor access to finance and low levels of regional integration and connectivity.*[78]][79]
  The initiative for a joint CEFTA Competition and State Aid Committee was discussed at the CEFTA meeting in 2018, which is in line with the CEFTA Agreement and the MAP REA (Multi-annual Action Plan for Regional Economic Area).[80] [*In the area of Competitive Economic Environment a deeper cooperation should be undertaken on topics of competition, state aid and public procurement. ERPs of the region pointed out a strong sense of unfair competition primarily fueled by large and inefficient state-owned enterprises, the large informal economy and the large state aid schemes for FDIs....*][81]

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76) South East Europe 2020 Strategy, https://www.rcc.int/pages/86/south-east-europe-2020-strategy
77) Ibid. page 17
78) 2019 Communication on EU Enlargement Policy, 2019 https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-communication-on-eu-enlargement-policy_en.pdf
79) South East Europe 2020: 2019 Annual report on implementation, https://www.rcc.int/docs/479/south-east-europe-2020-2019-annual-report-on-implementation-rn
80) As of May 2020, we have not found publicly available information on the official establishment of such a body.
81) South East Europe 2020: 2019 Annual report on implementation, https://www.rcc.int/docs/479/south-east-europe-2020-2019-annual-report-on-implementation-rn

◆ The main recommendation in the area is [B. Competitive economic environment: (i) Implement competition policies and cooperate by exchanging best practices and information between competition and state aid authorities in view of attracting investment and creating a trade defense measures free region, and (ii) introduce measures to improve the level of regional harmonization rather than fostering a race to the bottom and eliminate remaining discriminatory practices in public procurement markets.][82]

- At the Western Balkans Summit in Trieste in 2017, the Western Balkan countries accepted / adopted the MAP REA[83] - Multi-annual Action Plan for Regional Economic Area of the Western Balkans, which clearly identifies and clarifies the key pillars of cooperation in the next period, coordinated by the RCC and supported by the EC, which is in line with the SEE 2020 Strategy. In the latest progress report of MAP REA from 2019[84] (prepared by the RCC with the Secretariat of CEFTA), in the part of policies aimed at 1.3. Creating a region free of (non-tariff measures) NTM and (trade defense measures) TDM, the assessment of implementation in the area of cooperation is a 3.3 on a scale of 1 to 5.[85]
- The Regional Investment Reform Agency (RIRA) was approved by the representatives of the six economies of the Western Balkans at a ministerial meeting of the Investment Committee of Southeast Europe held in Tivat in 2018. RIRA's goal is to further harmonize investment policies with European Union (EU) standards and international best practices, within the framework of the SEE 2020 Strategy, the Central European Free Trade Agreement (CEFTA) and the EU's pre-accession and accession processes. In the framework of Attracting and Promoting Investment policies, the reform area Streamlining incentives, and improving their transparency and governance indicates the need to implement incentive standards and principles related to transparency, governance and predictability in accordance with the obligations stemming from the EU pre-accession process (chapter on competition and state aid), further access to information on incentives for investments, peer-to-peer learning of methodologies for cost-benefit evaluation, and experiences with the monitoring and evaluation of incentives to assess the effectiveness and cost-benefit considerations at the economy level.[86]

82) Ibid, page 33
83) Multi-Annual Action Plan for Regional Economic Area in the Western Balkan Six,
https://www.rcc.int/docs/383/consolidated-multi-annual-action-plan-for-a-regional-economic-area-in-the-western-balkans-six
84) Извештај 2019 https://www.rcc.int/priority_areas/39/map-rea
85) For more see the full report for 2018 and 2019 https://www.rcc.int/priority_areas/39/map-rea
86) See more https://www.rcc.int/docs/ 410 / regional-investment-reform-agenda-for-the-western-balkans-six

3. THE IMPACT OF STATE AID ON FOREIGN DIRECT INVESTMENTS

In this part of the study, we focus on state aid policies in the countries of the region and their relevance in terms of attracting foreign direct investment - which is considered one of their main goals. Typically, countries that are formerly planned economies in the transition phase to market economies use different forms of taxation and other alleviation to attract foreign companies in order to acquire foreign capital.[87] The purpose of this quantitative analysis is to assess the relevance of these policies at the regional level measured by the growth of foreign direct investment in the region - which is used as the main argument in support of state aid for foreign companies.

The issue of state aid in the Western Balkans region was a subject of analysis at the Center for Economic Analyses in the past.[88] According to a 2014 study by the Center for Economic Analyses (CEA), parliaments in the Western Balkans are responsible for overseeing state aid policies, but focus more on the formal aspects of annual reports from the audit institutions of state aid, rather than the essence of oversight, without paying due attention to the efficiency and effectiveness of these policies in attracting foreign direct investment without compromising market competition. Hence, the main motive for this part of the analysis arises - in the absence of effective oversight and evaluation of state aid policies, we believe that it is up to the civil society not only to initiate the discussion, but also to contribute with concrete findings and recommendations in the field of state aid control. Otherwise, there is a danger that countries will make discretionary, non-transparent and harmful decisions on granting state aid when attracting foreign direct investment, instead of implementing them as part of socio-economic policies for better functioning of national economies.

Our analysis will include an overview of relevant indicators for countries related to state aid and will statistically assess the relationship between the level of granted state aid and the level of foreign direct investment, as well as the growth rate of gross domestic product and foreign direct investment. In the first part of this analysis, we refer to a review of the literature related to the policies for state aid in the region and their relationship with foreign direct investment as well as other determinants of foreign direct investment in the region. The second part focuses on data analysis that is key to this part of the analysis, i.e. the amount of foreign direct investment for each of the countries, economic growth rate, corporate tax rates, unemployment rate of the highly educated population, average net level wages, the global competitiveness index, the level of openness of the economy and the volume of exports. In the third part, we establish the degree of correlation and causality among the selected variables and present the results of the econometric analysis.

Review of literature on the determinants of foreign direct investment in the countries of the region and their relationship with state aid

State aid control is a specific and unique concept for the European Union in order to protect the internal European common market and, as such, is not found under other legislation - for example, at the federal level in the United States there are no provisions to limit subsidies within individual states.[89] Since European national economies and markets are not as homogeneous as those in the United States, supra-

87) Nikolov, M. & Stojanovic, S. (2017), 'Corporate Tax Incentives in Transitory Economies: Case of the Republic of Serbia and Republic of Macedonia', MEST Journal

88) Nikolov, M., Cuculoska, S. & Garvanlieva, V. (2014), 'Parliamentary Oversight of Competitiveness Policies, State Aid and Attracting Foreign Direct Investment in the Western Balkans', p. 43

89) Philipsen, N. J. (2016), 'From Market Integration to Fiscal Discipline: Analysing the Goals of EU State Aid Policy from an Economic Perspective', SSRN Electronic Journal

national state aid control is more than necessary from a public interest perspective. According to Philipsen, in order to avoid competition in the domestic market, government subsidies are justified only when it is an attempt to correct market deficiencies or when it is done in order to achieve certain social goals or environmental measures.[90] According to Article 88 of the Treaty on the Functioning of the European Union, the European Commission has a duty to control state aid. Among other things, state aid measures must meet the criterion that they, as such, are an economic advantage for the recipient, which would not result in normal market conditions. This means that state aid has the potential to affect competition and trade among member states.[91]

Although the European Union imposes a certain limit on Western Balkan countries on the amount of approved state aid, the Union is not so restrictive as to the forms of state aid, which puts them in a favorable position vis-a-vis member states in attracting foreign direct investments, at least in the short term.[92] However, the question remains of what is the effect of state aid on attracting foreign direct investment, and how much of it is due to other factors such as physical and social capital, the development of which is closely linked to public spending, and which on the other hand may be eroded as a result of irresponsible state aid schemes. Other competitive advantages that characterize this region are its geographical proximity to the large European market, free trade agreements with the European Union and other major economies such as Russia and Turkey, low tax rates and cheap labor.[93]

Whether the spending of state money by subsidizing foreign companies is beneficial to the economy depends on how the presence of these companies affects the economy. According to Bhandari et al.[94] in a study analyzing the period from 1993 to 2002 for several Eastern European countries, the results show that the inflow of foreign direct investment has a positive effect on economic growth in these countries. Atoyan & Jankulov (2015),[95] using micro data for four Balkan countries - Bosnia and Herzegovina, North Macedonia, Kosovo and Serbia - as well as for Bulgaria, Poland and Romania for the period 2006 to 2013, also show that if inflows of foreign direct investments per capita increase by ten percent, unemployment falls by two to three percent, which then has a positive effect on economic growth.

On the other hand, Mencinger (2003)[96] analyzed the relationship between foreign direct investments and economic growth in eight countries during their transition phase (Slovenia, Estonia, Hungary, Lithuania, Poland, Slovakia, Czech Republic and Latvia) from 1994 to 2001, showing the inverse-proportional relationship between foreign direct investments and economic growth, and explaining this phenomenon with the appearance of less favorable forms of foreign direct investment such as the taking over of domestic companies by large foreign companies and smaller domestic companies giving in to the pressure of foreign competition.

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90) Ibid.

91) Nikolov, M., Cuculoska, K. & Garvanlieva, V. (2014) "Parliamentary Oversight - over Policies of Competition, State Aid and attracting Foreigh Direct Investments in the Countries of the Western Balkans", Center for Economic Analyses (CEA)

92) OECD (2017), 'Tracking Special Economic Zones in the Western Balkans: Objectives, Features and Key Challenges', Global Relations – South East Europe, accessible in 2020 at http://www.oecd.org/south-east-europe/SEZ_WB_2017.pdf

93) Ibid.

94) Bhandari, Rabindra, Dharmendra Dhakal, Gyan Pradhan, and Kamal Upadhyaya, (2007) "Foreign Aid, FDI and Economic Growth in Eastern European Countries." Economics Bulletin, Vol. 6, No. 13 pp. 1-9

95) Atoyan, R. and Jankulov, I., 2015, "Western Balkans: the Quest for Jobs", in Regional Economic Issues, April 2015: Europe: The Western Balkans: 15 Years of Economic Transition, Washington DC

96) Mencinger, J. (2003), 'Does Foreign Direct Investments Always Enhance Economic Growth?, KYKLOS, Vol. 56 – 2003 – Fasc. 4, 491–508

In addition to achieving the goal of attracting foreign direct investments, states are at risk of increasing public spending on state aid, and of reducing public revenue by often lowering tax rates in order to increase attractiveness as a destination for foreign capital. The danger of the so-called "race to the bottom" typically arises when states offer large tax breaks to attract more foreign companies than neighboring countries, resulting with erosion of public revenues in each country individually and in the region as a whole. This phenomenon is particularly present if at the same time foreign direct investments do not contribute to an adequate increase in economic growth in the countries. In this race to the bottom, sometimes the opportunity costs are high in the sense that tax breaks and state aid are provided to FDI that would come anyway to the countries that provide those benefits and that assistance. For example, the analysis of the Center for Economic Analyses from 2016[97] estimates that the opportunity cost for North Macedonia could be up to 36 million euros from lost taxes due to state aid granted to FDI that would have come anyway without state aid.

A study of Hungary, Poland and the Czech Republic shows that state aid policies introduced in those countries in the early 1990s, which cover 10-year tax breaks, have proven effective in attracting foreign direct investments.[98] However, the study points out that state aid in these countries was successful for the period under analysis because it was followed by job creation in the manufacturing and construction industries, especially in less developed regions, with no restrictions on ownership (residents and non-residents) and was made in a completely transparent manner so as not to disrupt market competition.

If countries reduce taxes in order to attract foreign direct investment, and therefore public revenues and public expenditures, or increase public debt, while foreign companies do not contribute to economic growth, this policy would have a negative effect on the whole economy. A study measuring tax elasticity in terms of inflows of foreign direct investments in Eastern European countries for the period 1990 to 2002 shows that changes in tax rates do not contribute to higher inflows of foreign direct investments. Additionally, according to Nikolov (2017), in order to achieve the goal of attracting foreign investments, it is necessary to abandon narrow fiscal measures such as tax breaks for foreign companies and focus on building political and economic stability as well as civil society and quality social infrastructure.[99] Such stability implies rule of law, building trust in institutions, and controlling corruption.

In the analysis of the Center for Economic Analyses from 2016,[100] which assesses the costs and benefits of foreign direct investment in Macedonia, the main recommendation is to change the FDI attraction, which should be improved in order to maintain existing investments by creating a second generation of structural reforms that will involve sustainable working conditions, mostly toward stabilizing the political environment, creating a predictable business climate, reducing perceptions of corruption, and so on. In the region, however, governments mostly base FDI attraction on narrow measures that include pricing criteria (fiscal, labor cost, direct assistance for lower capital costs, and other). Governments in those same countries as Serbia and Macedonia seem to be competing over who will pay more to foreign investors to come to the country. Of course, the price for political and economic instability and non-transparency is offset by direct outflows from those countries' budgets and relatively low labor costs and tax exemptions.[101]

97) Center for Economic Analyses (CEA), 2016, "Benefits and Costs from Foreign Direct Investments in the Technological Industrial Development Zones in the period of 2007–2014"

98) Sedmihradsky, M. & Klazar, S. (2002), 'Tax Competititon For FDI in Central-European Countries', CESifo Working Paper No. 647 (1)

99) Nikolov, M. (2017), 'Opportunity cost of PT (Profit tax) to other taxes regarding the audit: Are the tax holidays in Macedonia worth the cost?', Fiscal Reform Project

100) Center for Economic Analyses (CEA), 2016, "Benefits and Costs from Foreign Direct Investments in the Technological Industrial Development Zones in the period of 2007–2014"

101) Ibid.

The functioning of the market economy is closely related to healthy market competition and therefore it is expected that foreign companies will seek foreign markets that operate under fair market conditions. A study investigating the relationship between market competition and the inflow of foreign direct investment for 60 countries for the period 2007-2017 proves that there is a statistically significant and positive relationship between these two phenomena.[102] However, when it comes to a small economy, the results of the study indicate that the positive impact on the level of market competition is declining, and countries must make up for it by expecting further progress in the functioning of state institutions, the financial system, economic development, development of the internal market, etc. In addition, a study of EU member states analyzing the period from 2003 to 2006 empirically shows that a crucial factor for foreign companies expanding into the markets of South Europe member states is for countries to have an efficient government in addition to other important factors such as economic performance, business climate and infrastructure - concluding that the role of governments is much more pronounced in building healthy competition in the markets of southern Europe and is a crucial factor in foreign companies making decisions to expand their business.[103]

Political and economic stability is a key factor in the inflow of foreign direct investments. A study analyzing 52 countries for the period from 1985 to 2000 shows that bureaucracy, corruption, the banking sector and the legal system are important determinants of foreign direct investments.[104] These factors are so important that a change in these factors from lower to higher levels of institutional quality has an impact on the inflow of foreign direct investment as if the country is a neighboring country with the country of parent foreign companies.

The review of the literature shows that state aid and low tax rates or tax exemptions as measures to attract foreign direct investment that positively affect the economic growth of countries are effective if they are accompanied by the existence of quality institutions in functioning market economies, whose markets are characterized by fair market conditions and are granted in a transparent manner under previously determined requirements that solve certain market imperfections or encourage the achievement of a certain social goal in the host country.

Analysis of indicators for attracting foreign direct investments in the countries of the region

The following is an analysis of indicators important for explaining the trends of state aid and foreign direct investments in the countries of the region for 2017 as the last year[105] for which we have comparative data, for each of the countries and for each of the indicators, as follows:

1) Amount of foreign direct investment in absolute amount and as a percentage of gross domestic product;
2) Amount of granted state aid in absolute amount and as a percentage of gross domestic product;
3) Economic growth rate;
4) Corporate tax rate;
5) Average monthly net salary and percentage of unemployed with higher education;

102) Velickovski, I. & Petreski, M. (2019), 'Size, competitiveness and FDIs: Small or transition country curse?', Small States & Territories, Vol. 2, No. 1, 2019, pp. 23-40.

103) Anastassoupulos, G. (2007), 'Countries' International Competitiveness and FDI: an Empirical Analysis of Selected EU Member Countries and Regions', Journal of Economics and Business Vol. X - 2007, N° 1 (35-52)

104) Bénassy-Quéré, A., Coupet, M. & Mayer, T. (2007), 'Institutional Determinants of Foreign Direct Investment', The World Economy, doi: 10.1111 / j.1467-9701.2007.01022.

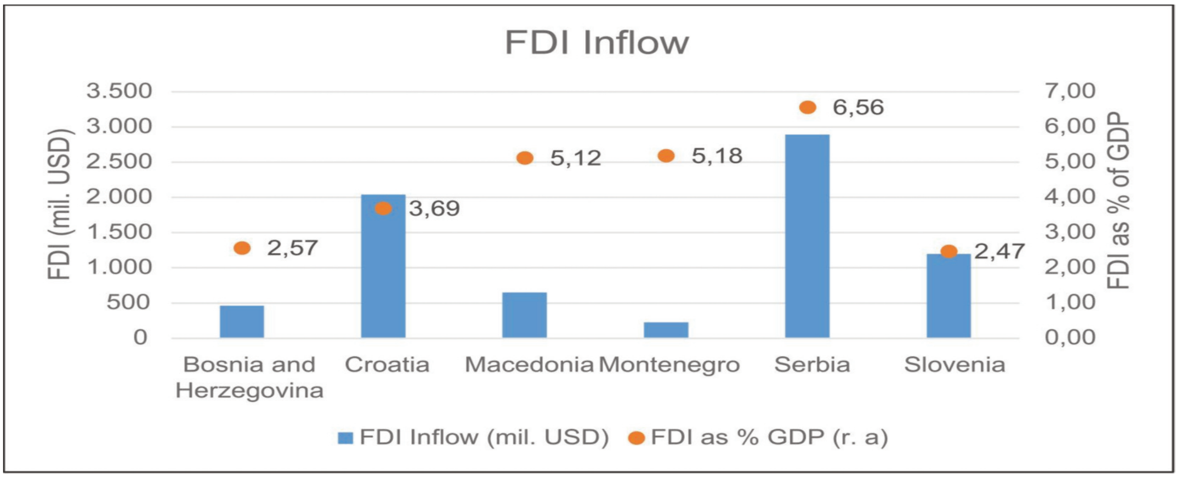
105) With certain exceptions for individual countries and indicators for which a period of one year is taken before and after 2016 due to the unavailability of data, i.e. for Macedonia the data are taken for 2018, which is the first year in which the Commission for the Protection of Competition and state aid control announced a transparent amount of state aid, and for Montenegro data are taken for 2016 as those are the last publicly available data on the amount of state aid in the country.

6) Global Competitiveness Index and Trade Openness Index;
7) Export in absolute amount and as a percentage of gross domestic product;

The analysis covers the following countries: North Macedonia, Serbia, Bosnia and Herzegovina, Montenegro, Croatia and Slovenia. Albania and Kosovo are not part of the sample due to a lack of publicly available data. The presentation below shows Serbia holds the largest amount of foreign direct investments in absolute terms in the region and Montenegro the lowest. On the other hand, foreign direct investment is the least involved in gross domestic product in Bosnia and Herzegovina, and the most again in Serbia.

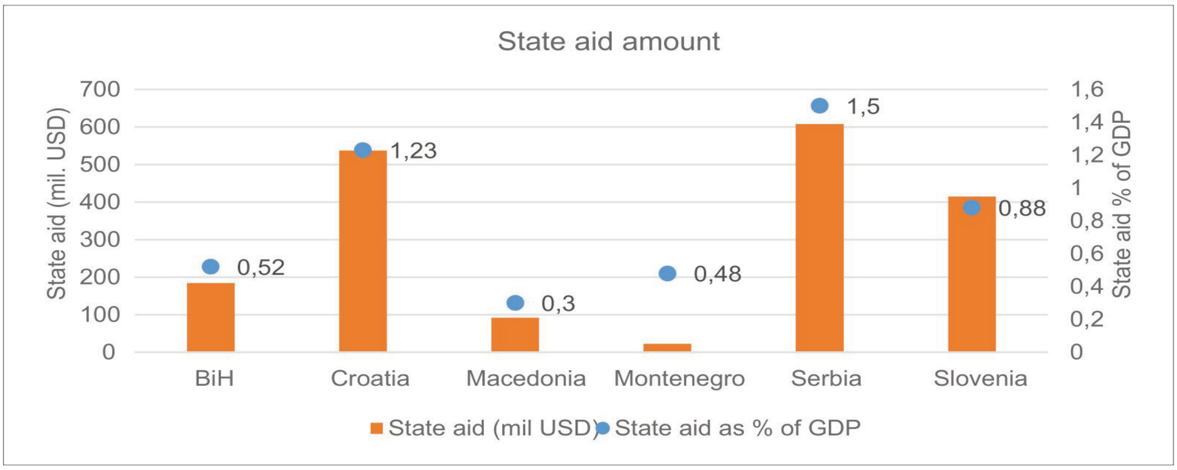
From the descriptive analysis of the data in Graph 6 we can see that Serbia has the highest amount of state aid in both absolute and relative terms (as % of the GDP). It is interesting to note from the visual presentation of Graph 6 and Graph 7 that the level of state aid granted to countries corresponds to the level of foreign direct investments in absolute terms.

Graph 6: Foreign direct investments in the Western Balkans



Source: Data from the World Bank https://data.worldbank.org/.

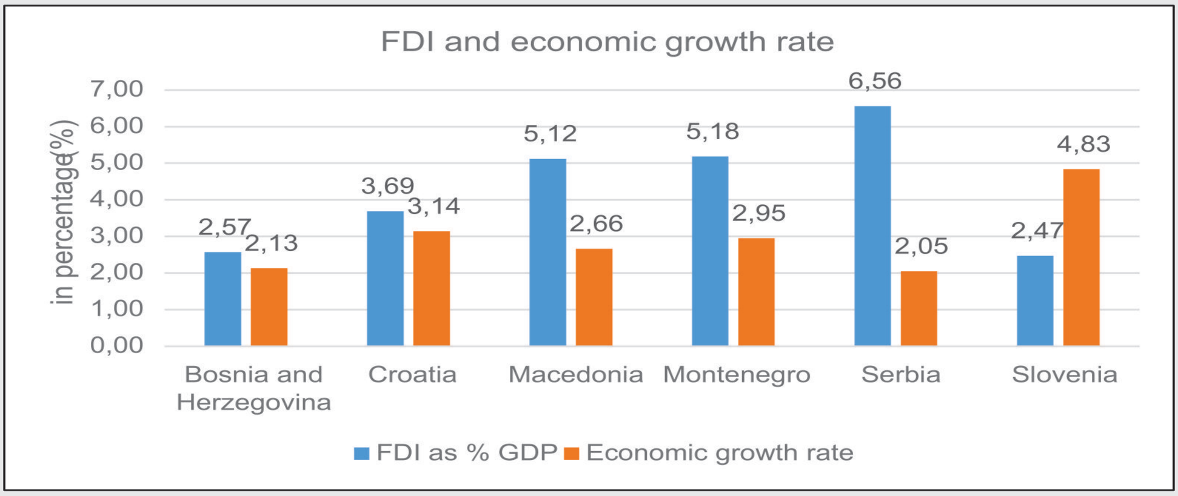
Graph 7: Regional state aid in the Western Balkans



Source: Data from the annual reports of the competent authorities on state aid control in the countries and from https://ec.europa.eu/competition/state_aid/scoreboard/index_en.html.

In the following graph, we can compare the economic growth rate with foreign direct investments as a percentage of gross domestic product. The data show that Slovenia has the highest economic growth, with the lowest percentage of foreign direct investments in gross domestic product, while Serbia has the lowest economic growth and the highest percentage of foreign direct investment in gross domestic product.

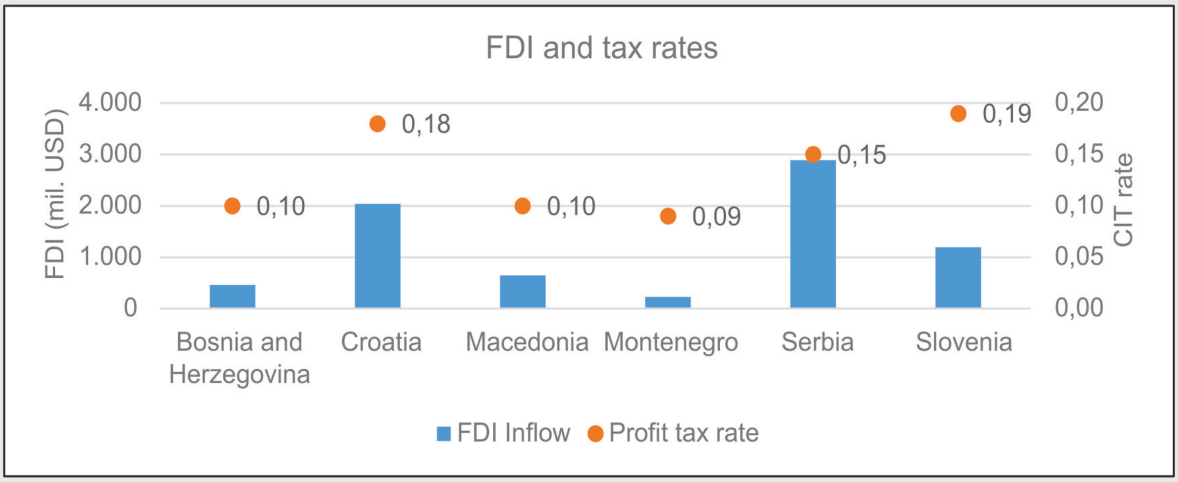
Graph 8: Foreign direct investment as % of GDP and economic growth in the Western Balkans



Source: Data from the World Bank https://data.worldbank.org/.

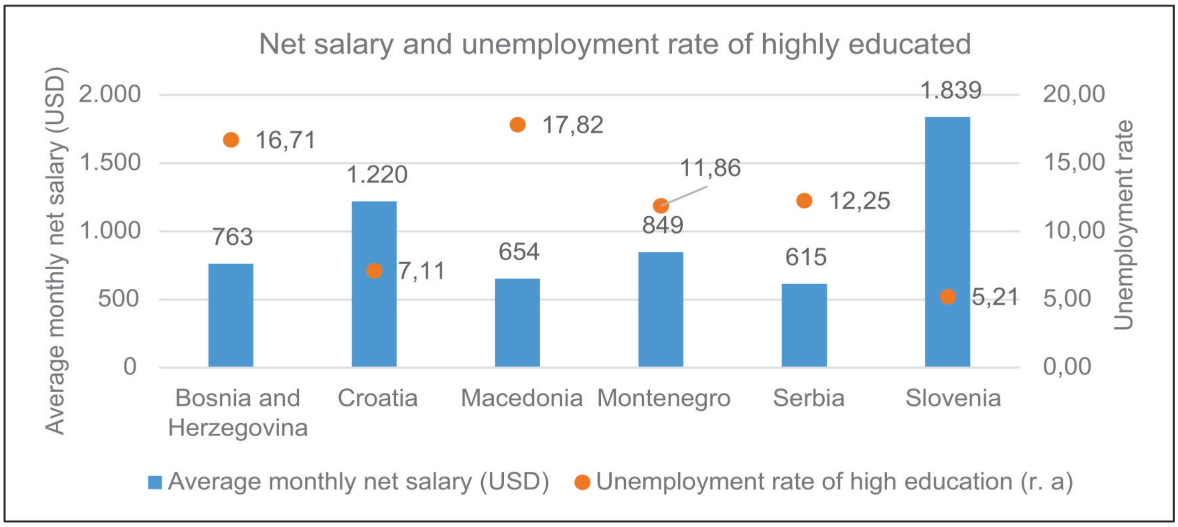
The data in Graph 9 indicate that, contrary to expectations, the three countries with higher corporate tax rates (Serbia, Slovenia and Croatia) have higher inflows of foreign direct investment, while countries with lower corporate tax rates (profit tax) (Macedonia, Bosnia and Herzegovina and Montenegro) have lower inflows of foreign direct investment.

Graph 9: Foreign direct investments and fiscal rates in the Western Balkans



Source: Data from the World Bank https://data.worldbank.org/ and https://taxsummaries.pwc.com/.

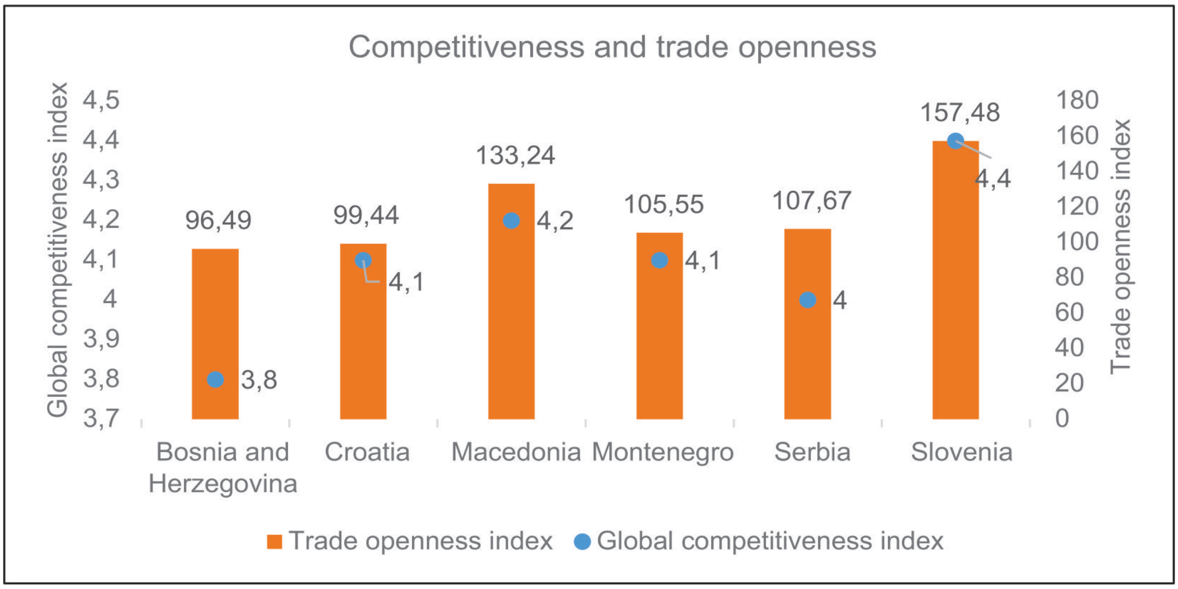
Graph 10: Net monthly salaries and unemployment of educated personnel in the Western Balkans



Source: Data from the World Bank https://data.worldbank.org/ and https://en.wikipedia.org/wiki/List_of_European_countries_by_average_wage#Net_average_monthly_salary_(2017).

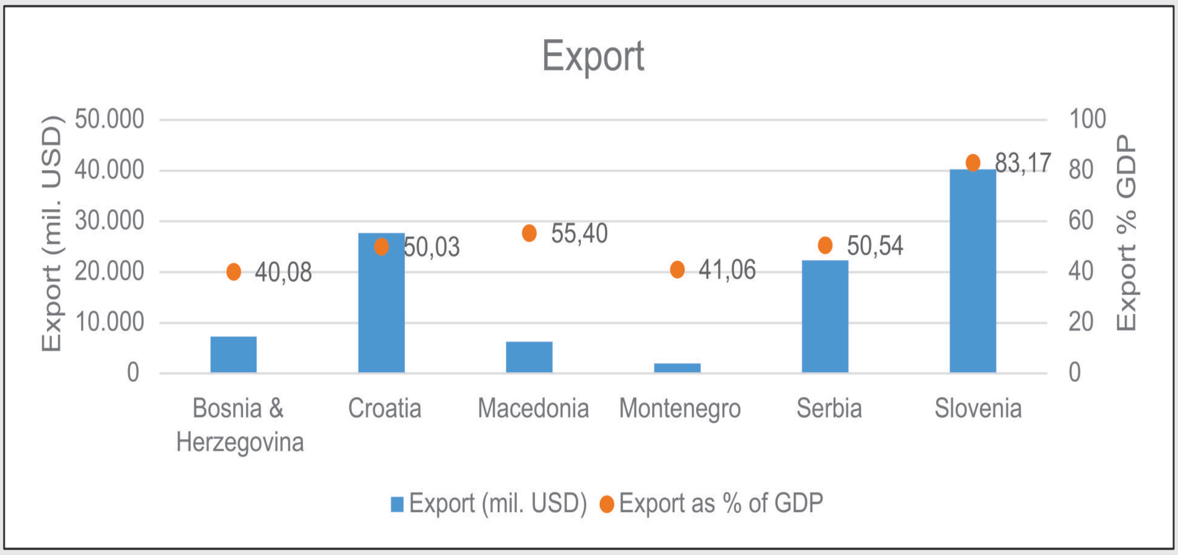
From the net wage display, we note that Serbia, as the country with the highest absolute amount of foreign direct investment, has the lowest average monthly net salary in the region. The attached data show that the region is characterized by high unemployment of the highly educated population, with the highest rate in Macedonia at 17.82%, and the lowest in Slovenia at 5.21%. The combination of cheap labor and a high percentage of the unemployed with higher education makes the region attractive to foreign companies.

Graph 11: Indices of Global Competitiveness and Trade Openness in the Western Balkans



Source: Data from http://reports.weforum.org/global-competitiveness-index-2016-2017/competitiveness-rankings/ and https://www.theglobaleconomy.com/rankings/trade_openness/.

Graph 12: Exports from the Western Balkan countries



Source: Data from the World Bank https://data.worldbank.org/.

Во однос на индексот на глобална конкурентност и трговска отвореност, Словенија е земјата од регионот која има највисоки вредности на овие индикатори. Дополнително, Словенија бележи највисока вредност на извозот во апсолутна вредност и како процент од бруто домашниот производ. Од анализата на приложените податоци се чини дека приливите на странски директни инвестиции не се тесно поврзани со извозната ориентираност на земјата што е спротивно од очекуваното имајќи предвид дека странските компании се воедно извозни компании.

Is there a connection between FDI and GDP, and does state aid affect FDI decisions?[106]

Moreover, we would like to assess whether there is a correlation between the GDP and FDI for the countries we have analyzed, and also to assess whether state aid affects decision making for FDI. This is important because we want to assess whether indirect state aid has helped GDP growth and through what mechanism, but we also want to assess whether there are indications of deadweight loss, i.e. approval and awarding of incentives to investors who would invest without incurring an opportunity cost, or to assess whether there are indications for beggar-thy-neighbor, i.e. when countries try to outdo each other in terms of incentives in order to attract investors. We evaluate a linear regression equation:

$$\log(FDI) = \alpha + \beta_1 \log(GDP) + \beta_2 \log(State\ aid) + \varepsilon$$

Of the available panel data for the following countries: Macedonia, Bosnia and Herzegovina, Serbia, Montenegro, Croatia and Slovenia. At the same time, the dependent variable "FDI" is the inflow of foreign direct investments as a percentage of gross domestic product. The independent variables are "GDP", for which we use the growth rate of gross domestic product, and "State aid", which is the allocated state aid in the country as a percentage of gross domestic product.

Because the evaluation of panel regression coefficients depends on the stationary time series of the variables before evaluating the regression, we performed Unit root tests for stationarity. The results of the Levin Lin

106) Detailed calculations from the econometric analysis are available at the request of the reader.

and Chu test show stationarity of all variables in the regression, i.e. consistency in the process of generating variables, with the data having an arithmetic mean and a variable that does not change over time.

For the purposes of selecting the correct model of calculation of panel regressions (model of fixed effects versus model of random effects), we used Hausman's test, whereby the null hypothesis that the random effect method is adequate for regression assessment was not rejected because the p- test value is 0.5860, which is more than 5%.

Using the model of random effects, the assessed regression equation and the regression results are presented below (Table 7):

*LOG (FDI) = 0.2238 * LOG (GDP) - 0.1851 * LOG (State Aid) - 1.2863*

Table 1: Results of regression analysis

Variables	Coefficient	t-statistic	p-value
GDP growth	0.2238	1.8504	0.0698
State aid	0.1851	1.9000	0.0628
Determination coefficient (R^2)	0,0954		

Source: Calculation of authors, econometric package Eviews8.

The results of the linear regression analysis show that the model has a low coefficient of determination or 0.0954, which means that the independent variables incompletely explain the change of the dependent variable, i.e. there are no variables left in the model. However, this is not an academic-formal analysis, but a policy analysis for us and these results are enough for us to show indicative knowledge.

The results show that there is a positive correlation between foreign direct investment and the growth of gross domestic product, but also between foreign direct investment and the granted state aid in the country.

The results of the Granger causality test indicate that there is a one-way causality between the variable GDP growth rate and foreign direct investments with a time delay of six periods - **the GDP growth trend predicts the FDI trend**. In addition, the results of the Granger causality test indicate one-way causality between the variable state aid and foreign direct investment with a time delay of two periods - **the trend in the granted state aid predicts the trend in foreign direct investment.**

These findings point to several things for decision makers. First, GDP growth affects FDI in companies making their decisions to invest in this group of countries. This impact is likely to cover a longer period of monitoring of the GDP situation by FDI. Second, state aid affects FDI attraction. It is natural for GDP growth to attract FDI as relatively higher results are expected in faster-growing countries.

Conclusions

The "race to the bottom" phenomenon occurs when countries reduce taxes on the one hand and increase state aid for foreign companies on the other in order to attract more foreign direct investment in the country compared to neighboring countries. At the same time, if such policies are not adequately designed and implemented in a transparent manner, they can cause erosion of public revenues in each of the countries individually, but also regionally. This phenomenon is especially pronounced if at the same time foreign direct investments do not contribute to an adequate increase of economic growth in the countries, i.e. they do not cooperate with local suppliers and transfer profits from work and investments to the countries of the parent companies.

According to the findings of the literature review that analyzes foreign direct investment and state aid in the region, state aid and tax relief as measures to attract foreign direct investment are effective only if they are accompanied by quality institutions in functioning market economies and are awarded in a transparent way under previously determined conditions that solve certain market imperfections or encourage the realization of a certain social goal in the host country, such as reducing unemployment, developing economically underdeveloped regions, or transferring technology and knowledge. In its regular progress reports, the European Commission has for years pointed to non-transparency in the provision of state aid in countries in the region.[107] According to the conclusions of the European Commission,[108] countries in the region should make efforts to build functional and transparent institutions. Moreover, existing narrow measures covering price criteria for attracting foreign direct investments (subsidies, low labor costs, direct assistance for lower capital expenditures, etc.) should be expanded to retain existing investments by creating a second generation of structural reforms, which will result in permanent and sustainable working conditions, mostly toward stabilizing the political environment, creating a predictable business climate, reducing the perception of corruption, etc.

The analysis findings show that countries in the region that have higher amounts of state aid also have a higher inflow of foreign direct investment. However, it is also noteworthy that countries in the region with higher economic growth have more foreign direct investments than lower-growth countries. On the other hand, in contrast to the generally accepted paradigm, the countries we consider and which have lower tax rates also have lower inflows of foreign direct investments than countries with higher tax rates, which is an indication of the race to the bottom in attracting FDI with narrow measures that they apply. In the literature this is known as beggar-thy-neighbor, when countries try to outdo each other in terms of incentives (in this case, fiscal) in order to attract investors. Slovenia and Croatia are EU member states, and they are better in the rule of law, transparency, and perception of corruption than North Macedonia, Montenegro and Bosnia and Herzegovina. It is clear that these EU member states are using broad measures to attract FDI compared to Macedonia, Montenegro and Bosnia and Herzegovina, which are using lower tax rates to attract FDI. In other words, Macedonia, Montenegro and Bosnia and Herzegovina must pay a higher premium to attract FDI with lower taxes on the GDP due to their inability to compete with the rule of law, corruption control, and trust in institutions with Croatia and Slovenia. This leads these countries to choose the beggar-thy-neighbor practice, meaning they try to outdo each other in terms of incentives to attract investors, which is a race to the bottom.

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107) 2019 Communication on EU Enlargement Policy, available at https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-communication-on-eu-enlargement-policy_en.pdf and EC country progress reports for different years (2016-2019)

108) Ibid.

In the long run, policy makers in North Macedonia should keep in mind that higher tax countries have higher public revenues, and thus higher investments in infrastructure and education, which are key to attracting sustainable FDIs. The ratio of tax revenues (not counting mandatory social contributions) and the GDP of countries in the region compared to the EU and OECD countries is significantly lower, and while this ratio at the EU level is ~27%, in the region this indicator ranges from ~18% to 20% depending on the country and the year.

While the Western Balkan region is characterized by low profit tax and personal income tax, it should be noted that there were no additional tax rate reductions, on the contrary in 2013 Serbia and in 2014 Albania increased profit tax rates by five percentage points. As profit tax and personal income tax rates have not changed during the analyzed period, and the amounts of state aid as a percentage of the gross domestic product have stagnated, while the regional state aid average as a percentage of the GDP is below the average of European Union countries, we can say that there are indications that the region has currently reached the bottom of the "race to the bottom", without suggesting that the risk of recurrence is reduced.

The granting of state aid without transparent procedures entails discretionary spending of public funds, especially in the absence of quality analysis of costs and contributions from foreign companies receiving state aid. Moreover, the lack of effective national oversight and regional cooperation in the field of state aid control is an indicator that countries trying to attract foreign direct investment without having a common strategy and goals in the field of state aid control can compete with each other and easily fall into the "race to the bottom" trap. The absence of these oversight and cooperation mechanisms is critical and poses a kind of threat to the region from the "race to the bottom" phenomenon. Sometimes it is possible, due to non-transparency and improper supervision of state aid, to approve and grant state aid to FDI that would have invested in the country without it, which leads to high opportunity costs and to the so-called deadweight loss.

Empirical analysis of the relationship between the variables inflow of foreign direct investments, growth of gross domestic product, and state aid shows that there is a positive correlation between foreign direct investment and growth of gross domestic product, but also between foreign direct investments and state aid. The causality test showed that with a time lag of six periods, the trend in gross domestic product growth predicted the trend in foreign direct investment. Moreover, the results of the Granger causality test indicate one-way causality between the variables state aid and foreign direct investment with a time delay of two periods, meaning the trend in the granted state aid predicts the trend in foreign direct investments. **Hence, we suggest that the empirical analysis of the sample countries for the analyzed period, shows that state aid positively affects FDI attraction in the short term, however that in the long run foreign companies direct their capital to countries with high growth rates. On the other hand, this may indirectly mean that sustainable FDIs look for stable and developed markets with rule of law and where there is trust in the institutions and which, in addition to narrow measures and state aid, require broader measures for adequate and efficient business market economy conditions.**

4. RECOMMENDATIONS FOR PUBLIC POLICIES

Foreign investment is an important catalyst for the development of the host country, and thus Western Balkan countries offer various incentive policies as a way to attract foreign direct investment. The incentives offered to investors include various fiscal measures from tax cuts, tax exemptions to subsidizing the investment, as well as non-fiscal measures that prioritize foreign investors. One of the most widely used instruments for attracting investment in the Western Balkans is that of free economic zones. There are around forty FEZ in the Western Balkans, most of them in the RN of Macedonia and Serbia, which is probably beyond the economic justification for such a number. As more countries start to operationalize them, there is an increasing risk of mutual competition based on state aid, and of the adverse effects on all affected economies in the region that are part of the mutual "race" for foreign investments.[109] In order to reduce the potentially negative effects of the race, which generates inefficiencies and ineffectiveness, we believe that regional policies need to alter their manner of attracting foreign investments:

1) Regional approach to attracting foreign investments:

- Implementation of regional policy for attracting foreign investments and creation of a system, followed by a system for essential assessment of the value, effect and impact while considering the principles of free competition and effective state aid control. As such, policy makers need to rethink the added value of such parallel economies to which different rules apply.
- The need for regional cooperation and access have already been identified in EU-supported regional plans. Countries in the region should not distort, delay or circumvent the principles of free competition, state aid control and transparency due to their inability to establish an efficient system and oversight, or "delay" the necessary changes for full EU membership.
- State aid may be a factor contributing to investment in the region. However, policy makers need to weigh the benefits of such incentive-backed investments and the possible spill overs in the domestic and regional economies, as well as all associated expenses and lost revenues from tax exemptions. These assessments should also consider the sustainability of the investments, especially because of the risk that companies may decide to relocate after the “ending” of the incentive periods.
- The potential negative impacts of encouraging regional competition in the race for foreign investment through incentives require intensified regional dialogue. Because economies are not required to adhere to a specific package of incentives at this pre-accession stage until they reach the EU's state aid limits, there is a possibility of distorting effects with a negative impact both on domestic and international competition, which can lead to unsustainable investments.

2) Efforts to improve the investment and business environment through non-selective law enforcement, predictability of the regulations, stability and accountability:

- The WB region has significant competitive advantages outside of the direct incentives such as its proximity to the EU market, free trade agreements with the EU and other countries outside the EU, already low tax rates and relatively cheap skilled labor. But at the same time, it is a region facing challenges in terms of the rule of law, predictability of regulations, political stability, policy pre-

109) Montenegro has one free zone, but in terms of % of FDI from GDP, it is significantly above other countries in the region.

dictability, corruption, labor market challenges, and others, which are the primary factors contributing to investors' decisions on where to locate investments and focus on their promotion.

- Recognition of the importance of broader measures to attract FDI, namely the rule of law, trust in institutions, corruption control, building adequate infrastructure, and improving the quality of the education system according to the needs of the labor market, as key in the process of building an image of an attractive destination for foreign companies.

3) Greater efficiency in control and effectiveness in granting state aid:

- Conducting adequate ex-ante and ex-post evaluations and analyses of all projects to which state aid is granted, in order to assess the performance and the degree of the objectives achieved. The recommendation remains that the strategy for attracting FDI should be improved in order to sustain the existing investments by creating a new generation of structural reforms that will not be based on narrow fiscal measures[110]

4) Greater transparency and accountability in state aid policies:

- The policy creators, policy makers, control and oversight should ensure accountability in front of the taxpayers for the economic justification of the allocated public funds and their contribution to the economy as the "best" chosen mechanism, as opposed to other possible alternatives to attracting investments.
- Countries in the region need to enhance their efforts to improve the level of transparency in the provision of state aid, strengthen the role of control bodies, better the effectiveness of parliamentary oversight, and increase the role of civil society in monitoring state aid.
- Clarity and transparency of the criteria and procedures for granting state aid, the selection of recipients and the justification of the costs. Transparency and the availability of information are needed not only regarding the allocated amounts of state aid, but also for the analysis of the costs and benefits of the granted state aid.

110) See more https://cea.org.mk/wp-content/uploads/2016/04/1.-Analiza-Benefiti-od-FDI-TIRZ-Makedonija.pdf

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ATTRACTING

foreign investments in the
Western Balkans region
and state aid:
race to the bottom or necessity?