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The Rule of Law and Foreign Direct Investment in the Western Balkans: The Greek Experience

By Nikolaos Tzifakis, Anastasios Valvis
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Policy Recommendations

1. Western Balkan states should reinforce the regulatory and institutional framework and empower independent authorities so as to mitigate political bargaining and interventions.

2. Western Balkan states should establish appropriate environmental standards for business activity in line with the EU's acquis communautaire in order to attract 'green' Foreign Direct Investments.

3. The EU should focus on the genuine compliance of Western Balkan states with EU standards and on the comprehensive application of adopted legislation.

Abstract

The rule of law is positively correlated to the attainment of economic growth and sustainable development and to the attraction of Foreign Direct Investment. However, the Western Balkan countries feature inconsistent application of laws, the absence of a solid regulatory framework equal for all, corruption and clientelism. These countries' weak rule of law systems renders their economies less attractive to 'healthy' investors. Important reforms should take place to speed up the path towards sustainable development and European Union (EU) accession. Taking as an example the Greek business/investing experience, the Policy Brief articulates some recommendations that are useful for the European investment community in general. The Western Balkan countries should vigorously carry out structural reforms in the judiciary, improve the legal and institutional framework, and contain corruption. On its side, the EU must pay more attention to the genuine (rather than procedural) implementation of reforms and hold the local leaderships accountable for persistent rule of law deficiencies and state capture practices.

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Rule of Law and Foreign Direct Investment

The rule of law is an indispensable dimension of a liberal democracy. It entails the protection of political rights and civil liberties, the maintenance of order, and the establishment of mechanisms of government accountability that are essential to safeguard 'the political equality of all citizens and constrain potential abuses of state power' (O'Donell, 2004: 32). It implies that no one is above the law, which is enforced consistently by an independent judiciary. Thus, the prevalence of rule of law contributes to building mutual trust among all sides of the triangle formed by the justice and its institutions, political institutions, and the citizens (RCC, 2020: 32).

Strong institutions, mechanisms of checks and balances, and an independent judiciary also have a positive impact on economic development. A solid legal system, supported by a set of political checks on state power, reduces the uncertainty of doing business. It also implies the protection of property rights and the reliability of contractual relations. The rule of law also seems to stimulate the attraction of Foreign Direct Investment (FDI). The political risk (which is about political stability, the quality of institutions, and the transparency of transactions) is the most important factor affecting the decisions of prospective foreign investors (IMF, 2018: 14; CEA, 2020: 35). Having said that, some analysts have found out that deficiencies in the rule of law, manifested, for example, in widespread corruption, have not impeded the flow of FDI to countries in transition, which have not established solid market institutions yet. The question is what kind of investors who take advantage of loopholes in the regulatory system an economy attracts. In these cases, governing elites create favorable conditions to potential investors who would have not under different circumstances entered the market at all. In other words, the quality of FDI attracted is directly related with the state of the rule of law in a country. Yet, anticipating sustainable FDI requires a robust legal framework and an independent and competent judiciary.

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Rule of Law and FDI in the Western Balkans

During the last decade, the Western Balkans have experienced democratic backsliding. Semi-authoritarian regimes have been consolidated in the region that rely heavily on weak rule of law mechanisms, which allow them to exercise unrestrained power and control various aspects of a country's activities, including its economy. Although this trend has not clearly impeded economic development in the region per se, it raises questions about the sustainability of economic growth and the cost in both institutional and environmental terms.

"There is also a rising concern about the environmental standards of recent investment projects."

As observed by several institutions assessing the business environment across the region (World Bank, European Commission, U.S. Department of State), the rule of law in all Western Balkan countries is practically under siege. Judicial reforms (e.g. vetting of judges) are taking place at a very slow pace. The backlog of pending court cases remains a major issue (see the 2021 European Commission reports for the six Western Balkan countries and the RCC 2020 Report: 33), while in most cases legislation at all levels of government must be aligned with the EU's acquis communautaire. Lack of transparency in public procurement and poor enforcement of contracts (SELDI, 2020: 9), along with problems in establishing property rights are manifested in all Western Balkan countries (with the exception of North Macedonia that strives to make some progress during the last years). The investigation of cases of corruption often remains incomplete. Even in cases like Montenegro, where the institutional framework against corruption has been set up and considered adequate, there are issues in functioning and coordination of the related agencies. The Anti-Corruption Agency, for instance, faces challenges regarding its independence and the quality of the decisions issued among other things (European Commission country report, 2021: 24). Examples of selective application of laws or court decisions not being implemented strengthen public mistrust, casting doubts about the fairness in the business arena and thus preventing 'healthy' private investments. The lack of public trust in institutions, such as the judiciary, has been registered in several region-wide surveys (Regional Cooperation Council 2021: 89-90). There is also a rising concern about the environmental standards of recent investment projects. Indeed, recent studies confirm that the Western Balkan countries are attracting investments with negative environmental footprint as a result of weak and easy to penetrate environmental legislation (Pavlovic et al. 2021: 16). Although these investments may have a positive economic impact, they raise questions about the sustainability of development in the region. Therefore, the Western Balkan countries need to find 'optimal solutions and balances' between the need of attaining economic growth, on the one hand, and the need for avoiding environmental degradation, on the other (Pavlovic et al. 2021: 16).

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Not surprisingly, a series of reports (European Commission country reports, World Bank Doing Business reports) concur on the assessment that the business climate has deteriorated for the entire region during the last years (see figure 1). With almost no exception (only Serbia shows a small recovery from last year), the position of Western Balkan countries went downhill, indicating a deterioration of the basic rule of law principles. Although the prospect of EU accession sets up a positive momentum for the attraction of sustainable FDI, yet structural deficiencies deter investors from perceiving the region as a secure destination.

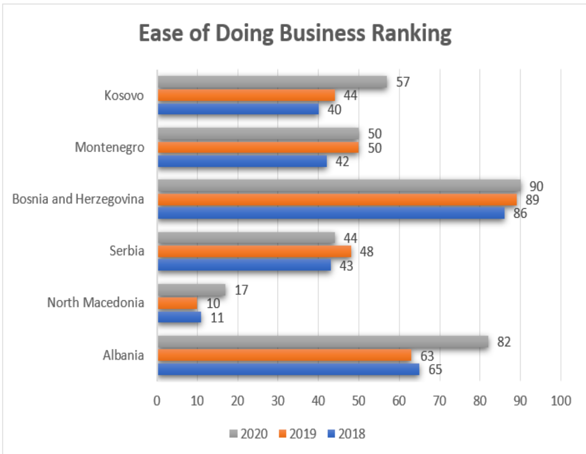

Figure 1: Data collected from World Bank Doing Business Reports (2018,2019,2020)

Captured institutions and corruption remain the major impediments to economic development and democratic consolidation in the region. Progress seems to be inadequate at best so far, denoting a procedural rather than genuine compliance with prescribed reforms. Loopholes in the generally accepted far-reaching legal framework are still present, mainly in terms of its implementation. This is best manifested in the engagement of specific non-Western countries in business deals in the region. Indeed, grand-scale projects in the Western Balkans have been implemented under state-level agreements with countries such as China, Russia, and the United Arab Emirates. The conclusion of these agreements has been frequently kept under a mystery veil, with very little publicly released information about their specifications. This kind of agreements has been described with the term 'corrosive capital', which, according to the Center for International Private Enterprise (CIPE) refers to business deals that "not only exploit governance gaps in countries with weak or corrupt structures, but also make the gaps wider". It concerns big agreements, which are not properly documented and may even result in countries losing "ownership of key resources" to their business partners (CIPE, 2018: 2).

"Captured institutions and corruption remain the major impediments to economic development and democratic consolidation in the region."

Very worryingly, while the pandemic deteriorated the macroeconomic outlook of all countries in the region, local leaderships have used the health emergency as an excuse for the delay in the reforms pertaining to the rule of law.

The Greek Experience

During the first decade of the new millennium, Greece established itself as the largest investor in Albania and in North Macedonia and constantly figured among the three most important investors in Serbia. The economic crisis and the sell off by the Greek banks of most international subsidiaries inevitably impacted upon Greek businesses, many of whom disinvested from the region. Still, while the Greek economy has been recovering since 2016, the departure of Greek businesses from the Western Balkans has not been halted (see figures 2 & 3). In 2019, Greece was the 3rd larger investor in North Macedonia (Larda & Xydia, 2020: 21) and the 8th most important investor in Albania (Greek Embassy in Tirana, 2020: 31), while the stock of Greek FDIs in Serbia amounted to €1.5 bn, which is more than €1bn down, in comparison to a decade ago (Skronias & Belibasakis, 2020: 61-62).

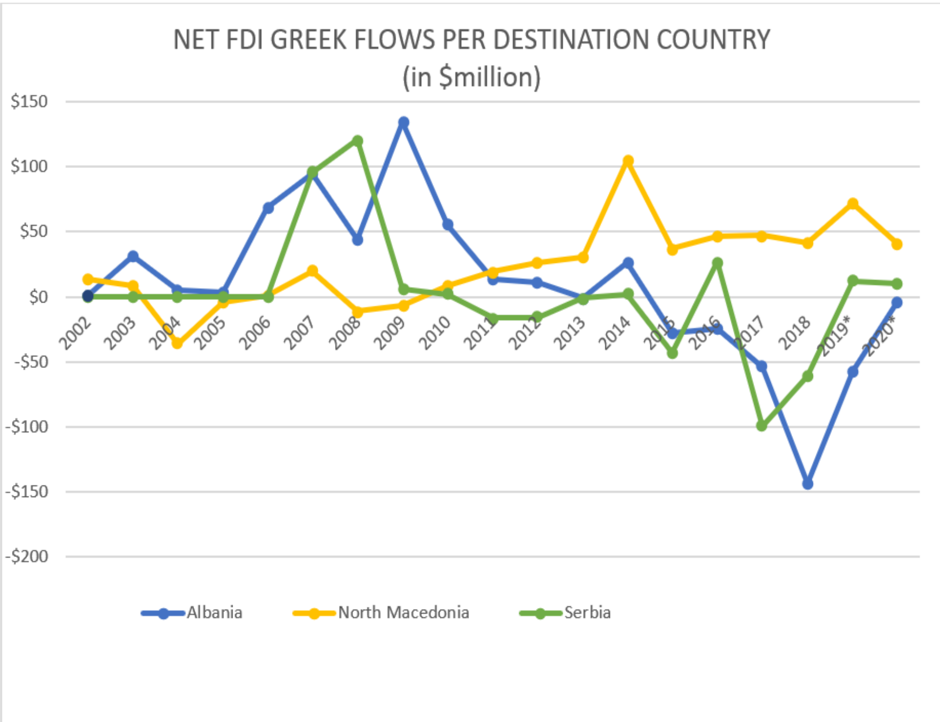

Figure 2: Data collected from the Bank of Greece

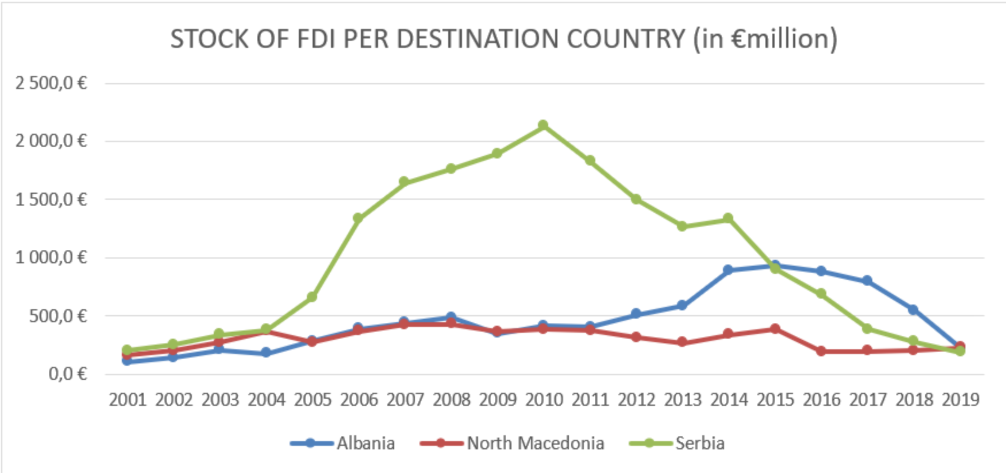

Figure 3: Data collected from the Bank of Greece

"Still, while the Greek economy has been recovering since 2016, the departure of Greek businesses from the Western Balkans has not been halted (see figures 2 & 3)."

Notwithstanding the region's proximity, its low labor cost, and the very favorable corporate tax regimes for foreign businesses in most Western Balkan countries, many Greek corporations have shifted their attention to other markets. To get acquainted with the problems facing Greek enterprises in the region, it suffices to review the most recent annual reports by the Economic and Commercial Affairs Offices of the Greek Embassies in the region. The 2020 report by the Greek Embassy in Albania outlined a series of problems that Greek corporations faced in the country. These included issues pertaining to the rule of law such as: corruption and informal economy, practices of unfair competition, and poor justice performance. The Greek Embassy in Tirana also disclosed that it has received complaints by Greek businesses about cases of trademark infringements and industrial plan thefts that the Albanian authorities have been unable to investigate and stop from occurring (Greek Embassy in Tirana, 2020: 32, 34). Likewise, the corresponding Report by the Greek Embassy in Serbia presented a long list of obstacles to the everyday work of Greek corporations, most of them related to the country's weak rule of law institutions. These comprised: the gap between the adopted legislation and its practical application; non-transparent public procurement processes for the selection of contractors; unfair competition and uneven treatment between national and foreign investors; very slow judicial processes; vaguely determined legal requirements for imports of commodities subject to different interpretations by the relevant custom officers; and inadequate protection of land use rights (Skronias & Belibasakis, 2020: 73-76). As for the Greek Embassy in North Macedonia, its 2019 Report (released in 2020) pointed to the main challenges that had already been mentioned in the Foreign Investors Council's White Paper, which among others, consist of the informal economy, uneven competition, the slow operation of judicial institutions, and instances of arbitrary administrative decisions (Larda & Xydia, 2020: 21).

"However, we cannot refrain from remarking the simultaneous increase of the economic footprint in the Western Balkans of foreign corporations, coming from countries with authoritarian regimes and similarly very weak rule of law institutions such as China, Russia, Turkey and the Gulf countries."

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The Greek disinvestment from the region should not be exclusively attributed to the deteriorating state of the rule of law. However, we cannot refrain from remarking the simultaneous increase of the economic footprint in the Western Balkans of foreign corporations, coming from countries with authoritarian regimes and similarly very weak rule of law institutions such as China, Russia, Turkey and the Gulf countries. Admittedly, the Western Balkans business playfield does not look that unfamiliar for many businesses coming from these countries. As Prelec (2020: 75) explained, a "vicious cycle" is at play in the Western Balkans where semi-authoritarian leaders facilitate the entry in their countries of corrosive capital from external illiberal actors, which in turn contributes to the consolidation of those local leaders' rule and the entrenchment of state capture in the region. Therefore, the weak state of rule of law in the Western Balkans has been a pull factor for business deals and investments by illiberal external actors, at a time when the EU interest in the region waned due to the emergence of issues and problems elsewhere in the world (Bieber and Tzifakis 2019: 8-10).

Policy Recommendations

The Western Balkan countries should move on with the implementation of all prescribed rule of law reforms to boost competitiveness and re-calibrate their business environment. Indeed, the World Bank (2021:2) anticipates an economic rebound of the region with a 4.4% expansion in the economic activity in 2021 and a growth rate of 3.7% in 2022 and 2023 respectively. Likewise, the Vienna Institute for International Economic Studies, foresees that the Western Balkan economies will grow over the next two years, by 4.1% in 2022 and 3.9% in 2023.[1] Yet, the Western Balkan countries should not downplay the need to render their economies more competitive to meet these expectations.

To this end, the Western Balkan countries should:

1. Reinforce the regulatory and institutional framework so as to mitigate political bargaining and interventions.
2. Speed up the examination of pending court cases.
3. Complete the vetting of judges.
4. Empower independent authorities by assigning to them the necessary human and material resources.
5. Establish appropriate environmental standards for business activity in line with the EU's acquis communautaire in order to attract 'green' FDI.

The EU should:

1. Focus on the genuine compliance of Western Balkan states with EU standards and on the comprehensive application of adopted legislation.
2. Defend more efficiently the rights of European corporations investing in the region when they are treated unevenly and fall victims of weak rule of law practices. Improving the rule of law in the Western Balkans is fundamentally about the everyday lives of people in the region. Having said that, we should not pretend that it is not also a question of an EU enlightened self-interest.

1) https://wiiw.ac.at/overview-2019-2020-and-outlook-2021-2023-dlp-5866.xlsx

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About the authors

Nikolaos Tzifakis is Associate Professor at the Department of Political Science & International Relations of the University of the Peloponnese; member of BiEPAG; and Research Associate of the Wilfried Martens Centre for European Studies. He recently co-edited (with F. Bieber) the book ***The Western Balkans in the World: Linkages and Relations with Non-Western Countries*** (Routledge, 2020).

Contact: tzifakis@uop.gr

Dr. Anastasios Valvis has been adjunct lecturer at the Department of Political Science and International Relations, University of the Peloponnese (2016-2020). Over the last years, he has participated in various research projects with a focus on the Greek NGO ecosystem, the refugee crisis and on Greek Foreign Policy in the Balkans (Southeast Europe Programme, ELIAMEP).

Contact: avalvis@uop.gr

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Austrian Society for European Politics (ÖGfE)
Rotenhausgasse 6/8-9
A-1090 Vienna, Austria

Secretary General: Paul Schmidt

Responsible: Susan Milford-Faber, Vedran Džihić

Tel.: +43 1 533 4999
E-Mail: policybriefs@oegfe.at
Website: ÖGfE Policy Briefs

Website: WB2EU