FINANCING THE EUSAIR
The EU Strategy for the Adriatic and Ionian Region
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Foreword

Three years after the launch of the EU Strategy for the Adriatic and Ionian Region, the need is felt to put more teeth in building a functional macro-region, implementing a realistic scenario of development and enhance the existing performing tools such as data-based policy proposals in order to trigger the actual financial capacity of the whole process.

Important results are already being delivered thanks to the financial ecosystem put in place so far by EU Institutions and financial Institutions to support investments in the Western Balkans and EUSAIR Region and especially in Pre-Accession Assistance countries.

In order to implement the Macro-region's connectivity agenda, a new "smart financing" strategy is needed, able to tackle both the post-crisis decreasing inflow of foreign capitals and the rising societal pressures, in terms of unemployment, poverty and migration. This strategy should include he traditional financial blending facilities, but also other potential resources, to be leveraged at regional, national and European level and directed towards the solution of most urgent infrastructural and societal problems.

As stated in the recent Ioannina Declaration at the outcome of the 2017 EUSAIR Ministerial Meeting, in order to rise to the challenge the Macro-region not only needs the mobilization of capitals, but also the engagement of the civil society at large, in a spirit of cooperation involving Cities, Regions, Universities, public bodies and private stakeholders.

"Financing the Eusair " is an opportunity to take stock of all the successes achieved so far and to define the steps to be taken in order to make the Adriatic-Ionian Region an ever more connected, sustainable, competitive and democratic community.

Sandro Gozi

Secretary of State for European Affairs - Italy
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- From 2007 to 2015 as Official Development Assistance (ODA) from donors all over the world, about **18 bn euros** have targeted the Western Balkans, including resources from EUSAIR EU Member States (Italy, Greece, Slovenia) of which 69% were grants;
- 8.2 bn, or 45% of all ODA funds to the area originated from EU Institutions;
- from 2014 to 2020 EU introduced a new budget support initiative to accession countries (IPA II) with allocated resources of **7.2 bn euros** (not including the budget support initiative for Turkey) and which comprises 2.9 bn euros of multi-country initiatives of which 395 mio euros dedicated to territorial cooperation;
- EU through its European structural Investment Funds has committed **606 mio euros** in territorial cooperation with EUSAIR countries for the period 2014-2020;
- the Western Balkan Investment Framework since 2009 has financed 144 projects thanks to its funding resources of **1.4 bn euros** that have generated 600 mio of grants and 15 bn worth of investment;
- the EUSAIR area attracted, between 2014 and 2016, **85 bn euros** of FDI (an average of 33 bn euros per year) of which 11 bn euros (13%) to Western Balkan countries (average of 4 bn euros...
INTRODUCTION: THE CHALLENGE OF INVESTMENT COORDINATION

The amount of resources flowing into the EUSAIR region (Italy, Slovenia, Croatia, Greece, Albania, Serbia, Bosnia Herzegovina, Montenegro), under various chapters of intervention and investment is a relevant phenomenon.

Whereas there is general recognition on the importance of the regional level support in South East Europe to enable and speed up investments—especially in core projects which are relevant not only for the Western Balkan countries but for the entire region and the interconnection to the European Union—the implementation of such coordinated scenario poses a fundamental challenge to single countries and European Institutions.

The South Eastern Europe (SEE) 2020 Strategy provides the framework to guide national development plans towards greater regional integration in investment policy. The objective of the SEE 2020 Integrated Growth pillar is to deepen regional trade and investment links. Programming and implementation of the Integrated Growth pillar are largely based on Central Europe Free Trade Agreement (CEFTA) 2006 and its structures as well as South East Europe Investment Committee (SEEIC) competences.

The agenda of the Integrated Growth

![Fig. 1 - SEE 2020 Strategy Goals: Integrated Growth pillar](#)

Source: SEEIC
pillar reflects interdependence, interaction and synergies, in achieving the goal of increasing overall SEE intra-regional trade in goods by more than 140% and annual foreign direct investment (FDI) inflows to the region by at least 160%.

The background of the SEE 2020 Strategy goals sets the reference scenario for all the macroregion’s coordination programs.

The **EU Strategy for the Adriatic and Ionian Region** encompasses eight countries (Italy, Slovenia, Croatia, Greece, Albania, Serbia, Bosnia Herzegovina, Montenegro) and pursues an agenda of smart, sustainable and inclusive growth through four pillars:

- **Blue Growth**
- **Connecting The Region**
- **Environmentale quality**
- **Sustainable tourism**

The history of Eusair, although rooted in Intergovernmental agreements that date back to early 2000s, is a recent one in terms of implementation, and compared to other cooperation frameworks (see fig. 1) therefore any action of stocktaking has to take into consideration the correct time perspective required for multi-actor and multi-regional platforms to produce results.

This overview analyses the flow of economic resources that has been recently reaching South East Europe and the Eusair region from different sources (Foreign Direct Investment, Official Development AID, EU funds, private investments) to highlight policy and investment gaps and the 'mobilization potential' in terms of additional private resources that can be leveraged through grants and other funds.

**Fig. 2- A timeline of regional cooperation**
1. ATTRACTING INVESTMENT: FDI FLOWS AND STOCKS

From 2000 to 2016 the increase of FDI flows into the EUSAIR region* has been 1.58 (158%). The picture of this inflow by country performance is highly erratic (Fig. 3).

Since 2014 FDI inflow into EUSAIR region has occurred at an average of 33 bn dollars per year, but only 4.4 bn dollars yearly have reached EUSAIR countries that are not currently EU members (Albania, Bosnia-Herzegovina, Serbia, Montenegro and Macedonia) and the annual rate of increase of this inflow has somehow stalled at -0.32% over the last 4 years.

*= this section includes also the non EUSAIR Former Yugslav republic of Macedonia

Fig. 3 - Inflow of FDI to EUSAIR countries. 2000=100

Fig. 4 - Stock of FDI in EUSAIR countries. 2000=100

Source: elaboration on UNCTAD
Moreover, the pattern of inflow from 2009 to 20016 diverges from the one before the crisis from 2000 to 2008 in that it occurs at a slower pace and with a higher diversity across recipient countries (table 1 and fig. 5). Therefore the scenario set by SEE2020 of a 160% increase of FDI inflow by 2020 if justified in a six year perspective, appears a daunting challenge given recent FDI performances in the entire region.

In terms of origin of FDI stock, 30% originates from "Berlin process" countries (Germany, Italy, Austria, France, Slovenia and Croatia), 19% from Netherlands, 14% from Luxembourg and 7% from United Kingdom (fig. 6).

**Fig. 5- FDI flow as GDP% 2015**

<table>
<thead>
<tr>
<th>Table 1 - FDI inflow to EUSAIR (subperiods in mio US dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2000-2008</strong></td>
</tr>
<tr>
<td>total inflow (mio US dollars)</td>
</tr>
<tr>
<td>average inflow per country</td>
</tr>
<tr>
<td>coefficient of variation</td>
</tr>
</tbody>
</table>

**Fig. 6 - FDI bilateral flows. Origin of FDI flows to EUSAIR countries (2012)**

Source: elaboration on UNCTAD
1.1 ANALYSIS: THE EUSAIR FDI NETWORK

The network connecting EUSAIR countries with countries of origin of FDI stock can be approached with a measures of centrality to assess the relative influence and attraction potential. The hub centrality measure depicts a network that gives more weight to “well connected” countries in terms of investment flows. A node is hub-central to the extent that its out-links are to nodes that have many in-links. Technically, an agent is hub-central if its out-links are to agents that have many other agents sending links to them. In our picture (fig.6) this reveals that Serbia and Bosnia Herzegovina benefit from an intense network of capital flows.

Why Serbia?
Since 2000, Serbia has received USD 25 billion of FDI. FDI mainly targeted the following sectors: financial mediation, manufacturing, trade, real estate and logistics. Serbia ranked 47th in the 2017 Doing Business Report published by the World Bank, higher than in the previous year (59th place). The most significant progress concerns the granting of building permits and the tax payment system.

The financial and banking sectors have become important in the country’s economy and have, in fact, helped reduce the trade deficit. FDI flows have been positive since 2012, so the stock of FDI has not stopped growing. In 2016, FDI amounted to USD 2 billion (as in 2015) for the period between January and November. The Netherlands, Austria, Italy and Norway were among the biggest investors in the country. The EU accounts for over 70% of foreign investment in Serbia (source: Santander Trade Portal)

Why Bosnia Herzegovina?
Although FDI inflows remain significantly lower than the level reached in 2007 Bosnia Herzegovina has attracted 3.9 bn dollars since 2008. According to FDI stock figures 2012, the largest investors in Bosnia and Herzegovina are Austria (1.8 bn dollars), Serbia (1.3 bn US dollars), Croatia (994 million dollars) and Russia (621 million dollars). The sectors that attract the most foreign investment are the manufacturing, banking and telecommunications sectors, although a significant portion of FDI is invested in trade, financial services and other service sectors. (source: elaboration on UNCTAD data and Santander Trade Portal).

A standardized matrix represents the rectangular matrix connecting EUSAIR countries with countries of origin of FDI stock. 2012 is the last available year on Unctad open data
1.2 ANALYSIS: THE EUSAIR VALUE CHAIN

The EUSAIR value chain

% Import of intermediate goods from area on total national export of goods

Some countries (Albania, Bosnia and Serbia) have a high import rate of intermediates. Montenegro is an outlier given the import rate of intermediates is high above the total export. Italy is the country with lowest rate of import of intermediates from the area.

Factory EUSAIR?

What is the contribution of Adrion manufacturing to EU leading manufacturers

The Adrion factory represents 0.4% of manufacturing input (intermediates) of Germany global manufacturing export and its contribution to German manufacturing has increased by 27% from 2010 to 2014.

The Adrion factory represents 1% of manufacturing input (intermediates) of Italy global manufacturing export but its contribution to Italian manufacturing has increased by just 6% from 2010 to 2014.

Here comes China

China FDI stock (2012). Mio dollars

China exported 35.5 billions worth of goods to EUSAIR Area in 2015. 78% was absorbed by Italy; 10% by Greece.

China Export diversification

Countries with higher than average import of intermediate goods from China: ALBANIA, SLOVENIA, ITALY

Countries with higher than average import of capital goods from China: SERBIA, BOSNIA-HERZEGOVINA

Countries with higher than average import of consumption goods from China: CROATIA, GREECE, ALBANIA

Chinese exports to Albania, Bosnia, Slovenia and Serbia has increased by 33% from 2011 to 2015. Chinese value of imports from the area has substantially remained unchanged but intermediates' imports from Bosnia, Slovenia and Montenegro have witnessed a twofold increase.
1.3 STOCKTAKING #1 FOR FINANCING THE EUSAIR: FDI AND VALUE CHAINS

In OECD countries, thanks to the increase in information technology and innovation in the transport sector, production has become globalized and fragmented along "global value chains" (GVC): workers from different countries now contribute to the design, to the production, marketing and sale of the same product. On average, in OECD countries, a third of jobs in firms depend on demand in foreign countries. Thirty percent of OECD export value is now coming from overseas (OECD, 2017).

Non-OECD countries are not immune from the widespread role of GVCs, and Western Balkan countries also have a diversified although restrained share of intermediate goods trade that is an indicator of trade integration (fig. 7). The rise of GVCs partially modifies the development scenario based on foreign direct investment, as countries can focus on key determinants without having to attract entire value chains and instead target specific multinationals to attract specific productions. For example, less advanced developing countries could specialize primarily in basic components for a particular GVC, depending on their comparative advantage, and then work to switch to other segments / production phases. Yet the limited intra-regional trade is a barrier to such scenario of FDI attraction and calls for policy measures and coordinated actions to foster a "productive platform" environment across the entire macroregion.

**Financing the EUSAIR recommendation #1: increase budget support to actions directed to strengthening EUSAIR GVCs**

**Fig. 8- Trade in intermediate goods within and without the EUSAIR Region**

Apart from Montenegro which is an outlier, the average interdependence is presently less than one third (31%). Albania, Croatia and Bosnia and Herzegovina are above average.
2. ATTRACTING INVESTMENT: MERGERS AND ACQUISITIONS

An additional component of investment is represented by mergers and acquisitions. In this section we present an analysis conducted on 12,000 operations carried out over the last five years in the manufacturing sector in all EUSAIR countries which led to a majority acquisition (our analysis on Zephr database). Acquisitions "country on country" (or the so called "country bias") is prevalent for Italy, thus confirming the weak industrial interaction between Italy and the rest of the EUSAIR region.

A country bias effect is also present in Serbia and Bosnia Herzegovina. Looking at the 20 top regional destinations of M&As Milan ranks first followed by Central Serbia and Vojvodina.

Fig. 8 - M&As in the manufacturing sector. Operations country on country (country bias)

Fig. 9 - Top 20 regional destinations of acquisitions
2.1 ANALYSIS: THE EUSAIR M&As NETWORK

Projecting the data of M&As into a matrix connecting acquirer countries and target countries enables the illustration of M&As dynamics in terms of a bimodal network to detect patterns of relationship.

Central countries in this network are primarily Italy in term of "hub position" and Slovenia in terms of higher number of links (i.e. M&As operations).

This network allows the detection also of a "direct mobilization potential", that is countries with the higher number of resources and knowledge, (i.e. links) expressed as a sum and as a percentage of the total number of nodes in the original meta-network (ORA net software package). This potential is again high for Slovenia and Italy, followed by Croatia and Greece, suggesting a scenario of investment through M&As that should try to leverage the connections and resources of these countries.

![Fig. 10 - M&As network. Hub centrality](image1)

![Fig. 11 - M&As network. Betweenness centrality](image2)

![Fig. 12 - M&As network. Mobilization potential](image3)
2.2 CORPORATE INVESTMENT AND PRODUCTION PLATFORMS

Based on an analysis of a sample of EUSAIR businesses (our analysis on AMADEUS database for the year 2014), the sectors with the highest investment per employee are energy utilities (€ 568) and local public services such as waste management and refinancing (257), together with real estate (301) and construction (258), public administration and defense (232), transport and storage (207), information and communication services (150), and professional, scientific and technical activities (146). In these are activities Slovenia and Croatia have the largest average investment per employee. Important sectors for the economy of the country, such as agriculture (114) and manufacturing (89), are less capitalized, except for the case of Italy (168) and Greece (189).

The average investment of firms in the Adriatic-Ionian area varies considerably in regional terms. For example, in the field of mechanics, the regional variation coefficient is 2.4 for investment and 1.8 for employment. In the services sector, the variation coefficient is 2 for investment and 1.8 for employment. This variability is reflected in a very marked territorial diversity in terms of investment capability.

There are, for example, only 18 regions with investment levels above the average in mechanical manufacturing (7 in Italy, 5 in Croatia, 2 in Serbia, 2 in Slovenia and 3 in Greece).

Investment models differ on the basis of a strong presence of multinationals (predominantly in Serbia, Slovenia and Bosnia-Herzegovina) or widespread medium-sized companies (Italy).

It is possible to distinguish between regions with high propensity to manufacturing investments (Figure 13) and regions with high propensity to invest in services (Figure 14).

In both cases, the comparison is also based on the employment absorption capacity. The normalized values of the two figures allow you to distinguish near and distant investment values and thus highlight the regions that are more distant from high investment and employment capability (the sector at the top right of the chart).

In the case of mechanics there are situations such as that of the Slovenian region of Gorenjska (Figure 13), which presents a high investment and employment absorption rate determined by a strong presence of foreign investors (German and US multinationals).

For Basilicata the presence of the Melfi FCA factory is a possible explanation. In the upper right hand quadrant there is also Vojvodina, which is affected by multinationals and foreign investments.

In the case of services, some regions of Slovenia, such as Spodnjeposavska (Figure 14), emerge which benefit from the centrality of pan-European networking links and attract foreign investment.
Fig. 13 - Investment and employment in the manufacturing sector (2014). Standardized values

Fig. 14 - Investment and employment in the service sector (2014). Standardized values
2.3 STOCKTAKing #2 FOR FINANCING THE EUSAIR: LEVERAGING ON PRODUCTION SYNERGIES

A useful perspective for the strengthening of sectoral and territorial investment synergies is provided by the scenario of linking sectoral investments across the regions of the area. Sectoral and regional bilateral relations can be used to explore potential collaboration areas between businesses and between territories.

There exists, for example, a relationship between the average investment of the mechanical chain (our elaboration on corporate investment data referring to NACE code 25 to 30) and regions specialized in the mechanical chain, giving centrality to the regions with a greater diversification of investments in this supply chain.

For example, the Veneto region has a strong centrality, thanks to the presence of companies that invest in all segments of the mechanical chain. Further synergies may be spotted by isolating some regions with strong manufacturing specialization but complementary in specialization on different segments: for example, Vojvodina is connected to the electronics and machinery segments, Emilia Romagna is more peripheral than the segment of electronics, but central to the manufacture of cars; the Gorenjska region is strongly connected to the electronics segment.

Furthermore, the logic of synergies in investment can be applied to strategic territorial investments.

This perspective could be applied to the Adriatic-Ionian macro-region, provided it leads to projects that maximize the integration and linkages' impact, especially in the touristic and the logistic sectors. For example, in the logistics chain, a specialization is highlighted in the territories of Slovenia, which also has a higher investment capability. This evidence could lead to reinforcement of certain territories' trans-regional hub position thus exploiting economies of scale and proximities.

The inter-EUSAIR logic of cross-regional investment could also represent a viable strategy to strengthen the EU macro-regional process vis a vis the growing inflow of foreign (e.g. chinese) capital targeted at geo-strategic initiatives of market expansion.
3. BLENDING PUBLIC FINANCE WITH PRIVATE FINANCE

The Western Balkans Investment Framework (WBIF) is a regional blending Facility (WBIF) supporting EU enlargement and socio-economic development in Albania, Bosnia and Herzegovina, Kosovo, the former Yugoslav Republic of Macedonia, Montenegro, and Serbia. The WBIF was established in 2009 as a joint initiative of the European Commission, the Council of Europe Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, and several bilateral donors. The WorldBankGroup and the KFW Development Bank subsequently joined the Framework. In June 2017, the KFW became partner organisatio nto the WBIF. The WBIF provides financing and technical assistance to strategic investments in the energy, environment, social, and transport sectors. It also supports private sector development initiatives. As of December 2016, the WBIF has allocated €600 million in grants to Western Balkans, out of which €492 million represent EU contribution. The grant allocation is matched by €5 billion in signed loans.

Fig. 15
Total project financing (grants, loans and other sources) by country and sector. Projects completed

Average value: 24 mio

Private sector development projects value: 193 mio euros (Western Balkan Enterprise Development and Innovation Facility)
'Blending' is a mechanism that links a grant element, provided by official development assistance (ODA), with loans from publicly owned institutions or commercial lenders.

Fig. 16
Total project financing (grants, loans and other sources) by country and sector. Projects in preparation

THE PROs and CONs of BLENDING
The European Commission released in December 2016 an Evaluation Report on the current strategy of "blending". Over 75% of blending operations are in capital-intensive infrastructure sectors that due to large project size would face problems of viability if funded by grants alone. Whereas blending grants are recognized to have had a significant contribution to the mobilization of private sector financial resources for projects with a development multiplier effect, there is evidence that special lending schemes to new and risky borrowers (eg. agricultural sector and small enterprises) are reluctantly taken into consideration by banks and Financial Institutions.

It is estimated that about 10% of European Aid assistance is blended and this has certainly a value added in terms of unlocking available finance and creating high quality projects, due also to Financial Institutions skills and vetting expertise. Whereas blending works efficiently at a macro-economic development level (due to the multiplier effect of its quality infrastructural projects) it raises a few concerns regarding the capacity to tackle societal issues like poverty or targeting less privileged segments of the market.
IPA II - MULTI-COUNTRY REGIONAL INVESTMENT POLICY PROGRAM

The objective of the IPA II Multi-country Indicative Strategy Paper 2014-2020 is to support efforts for improving the currently low levels of competitiveness, intra-regional trade and trade integration in global markets and the regional investment support. The Strategy Paper indicates that the regional level support is needed to enable and speed up investments in core projects which are relevant not only for the Western Balkan where the investment takes place, but for the entire region and/or the interconnection to the Union. EU support will be articulated around three main programme components:

COMPONENT 1: Support with the development and implementation of a regional investment policy reform agenda, through a specific sectoral/policy approach, including the strengthening of the regional dialogue between the governments, the private sector and the policy advisors. Build capacity and support the identification and implementation of a set of specific reform measures to contribute to a greater harmonization of the regional investment framework.

COMPONENT 2: Support with the horizontal implementation of economy level investment policy reforms in the economies of the region, taking into account the priorities of the ERPs and the regional agenda, and aiming at the gradual harmonisation of investment policies to EU standards and regulations. This will entail assisting governments with the implementation of investment policy reforms on economy level addressing pertinent issues identified at the regional dialogue and ensuring de-facto reform implementation on ground.

COMPONENT 3: Support with the implementation of narrowly targeted investment promotion efforts to help translate investment policy reforms into increased investments in specific regional value chains. This will entail support with the implementation of narrowly targeted investment attraction efforts focused on one of the priority sectors defined in the SEE 2020 strategy.
3.1 FINANCING A CONNECTED REGION: A FOCUS ON CONNECTIVITY (EXCERPTS FROM IPA II MULTI COUNTRY ACTION REPORT - CO-FINANCING OF CONNECTIVITY PROJECTS IN WESTERN BALKANS)

The EU adopted, in January 2014, a new transport infrastructure policy to put in place a powerful European transport network across the 28 Member States. These new guidelines refocus transport financing on a tightly defined new core network, the Trans-European Transport Core Network (TEN-T core network), which will form the backbone for transportation in Europe’s single market.

Within the WB6 framework, the European Commission and the six Prime Ministers from the Western Balkans agreed, on 21 April 2015 in Brussels, on indicative extensions of the TEN-T core network in the Western Balkans region.

In Riga, on 22 June 2015, the WB6 Transport Ministers confirmed the maps of the comprehensive and core networks extending the TEN-T network in the Western Balkans and introduced the corridor coordinators. The regional core transport network, including road, railway, inland waterways as well as port infrastructure, shall be implemented through specific infrastructure projects as well as through soft measures implementing EU standards.

Under the new approach, funds from the Instrument for Pre-Accession (IPA II) will support the development of infrastructure in the Western Balkans not only by technical Assistance (financing studies and preparatory documents etc.), but also by financing a share of the investment costs. This is vital to cope with the lack of fiscal space in the budgets of the IPA II beneficiaries and to favour economic development as a response to the continuous stagnation of the economies.

The support of the European Commission and DG NEAR to the connectivity agenda is reflected in the substantial increase of the available funding: around € 100-150 M per annum of regional IPA II funds have been earmarked for connectivity projects – for co-financing in the period 2015-2020. The Western Balkans Investment Framework (WBIF) has been identified as the most suitable instrument to allocate these funds and to ensure efficient and coordinated fund allocation. Initially, IPA II regional funds will be only available for projects under the connectivity agenda for co-financing, while the technical assistance (TA) will continue for all four WBIF sectors (energy, transport, environment, social). National IPA allocations might also contribute towards regional projects, in a coherent approach of the Connectivity Agenda/Berlin Process of DG NEAR.
3.2 ANALYSIS: WBIF FINANCIAL LEVERAGE

We conducted two exercises on the leverage effect of blending finance within the WBIF facility for "projects in the preparation" stage of the current financing pipeline (our elaboration on WBIF data, October 2017). First we analyzed the leverage effect of loans on grants; secondly we analyzed the leverage of the total financial aid of each single project on grants. WBIF declares to operate with a leverage of approximately 8; projects in preparation considered for the present analysis point to a leverage of 12. There is a negative correlation between the leverage index and the coefficient of variation (CV) of projects’ leverage within countries, indicating that a more heterogenous financing portfolio is associated with lesser capacity to raise finance. This is an interesting point which should provide food for thought for a well-coordinated priority investment agenda within each country and across the entire region. Single projects’ leverages are heterogeneous (high variance in Kosovo) and show expected higher returns on energy.

Financing capacity - Leverage effect (total loans on total grants) of WBIF by sector and country (projects in preparation)

<table>
<thead>
<tr>
<th>Country</th>
<th>Leverage</th>
<th>CV</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multicountry</td>
<td>9</td>
<td>1.91</td>
<td>9</td>
</tr>
<tr>
<td>Kosovo</td>
<td>3.08</td>
<td>2.31</td>
<td>10</td>
</tr>
<tr>
<td>Albania</td>
<td>18.06</td>
<td>1.53</td>
<td>9</td>
</tr>
<tr>
<td>Bosnia</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Herzegovina</td>
<td>34.44</td>
<td>1.2</td>
<td>9</td>
</tr>
<tr>
<td>Croatia</td>
<td>276.81</td>
<td>0.55</td>
<td>4</td>
</tr>
<tr>
<td>Macedonia</td>
<td>74.43</td>
<td>1.63</td>
<td>5</td>
</tr>
<tr>
<td>Montenegro</td>
<td>4.18</td>
<td>1.66</td>
<td>8</td>
</tr>
<tr>
<td>Serbia</td>
<td>12.99</td>
<td>0.79</td>
<td>11</td>
</tr>
</tbody>
</table>

Total financing capacity Leverage effect (total financial aid except grants on total grants) of WBIF by sector and country (projects in preparation)
3.3 STOCKTAKING #3 FOR FINANCING THE EUSAIR: FINANCIAL BLENDING FOR CAPACITY BUILDING AND SOCIETAL PURPOSES

The new paradigm in Development AID assistance requires effectiveness of development aid as stated in the 2005 Paris declaration following 5 principles: ownership, alignment, harmonization, results, mutual accountability.

Today the paradigm seems to be shifting from a donor-recipient relationship to a more cooperative framework (as stated recently by the European Parliament briefing as of April 2017) but it runs the risk of losing ground on the ownership and alignment principles, due to blended forms of aid that tend to concentrate on less risky and more profitable projects and weaken the ownership of projects on the part of local communities and the civil society.

As stated in the European Commission Evaluation Report on Blending, there is an opportunity for micro-finance institutions to complement the blending mechanism allowing for unbanked and risky borrowers to be supported in their ventures.

This kind of micro-financing approach could in turn elicit an increased contribution of Institutions like the Council of Europe Development Bank on projects regarding the social sector, or eventually lead to innovative schemes based on social impact investment and social impact bonds.

In view of a rising necessity to tackle societal issues linked to migration, poverty and education, a strategy to financially tackle these problems may be in order for the next few years.

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**Social impact investment (SII) - the provision of finance to organisations addressing social needs with the explicit expectation of a measurable social, as well as financial, return - has become increasingly relevant in today’s economic setting as social challenges have mounted with public funds in many countries under pressure. New approaches are needed for addressing social and economic challenges, including new models of public and private partnership which can fund, deliver and scale innovative solutions from the ground up (OECD, 2015)**
4. IPA II

The Instrument for Pre-accession Assistance (IPA) is the means by which the EU supports reforms in the 'enlargement countries' with financial and technical help. The IPA funds build up the capacities of the countries throughout the accession process, resulting in progressive, positive developments in the region. For the period 2014-2020 IPA had a budget of € 11.7 billion.

"IPA is used pro-actively for supporting negotiations with the governments of the beneficiaries for taking the necessary measures leading to reforms. This includes rewards, but also de-commitment of funds, together with a number of other measures. Evidence suggests a positive assessment as concerns the usefulness of IPA II for increasing the political and policy engagement by the respective beneficiary. IPA II has also managed to create considerable financial leverage. As the biggest donor in the beneficiaries, IPA funds offer a reliable financial basis, where other donors and IFIs can provide additional funds for the financing of the decided programs and actions. IPA II provides not only the major financing source of the development programs of the beneficiaries but is also the major factor in the overall leverage of funds for the implementation of the biggest possible part of the development framework of the recipients" (excerpt from the section on "leverage" in External Evaluation of the Instrument for Pre-accession Assistance (IPA II) - Mid-term 2017")

Table 2 - IPA II indicative allocations by country and sector

<table>
<thead>
<tr>
<th>IN MILLION EUROS</th>
<th>ALBANIA</th>
<th>BOSNIA &amp; HERZ</th>
<th>KOSOVO*</th>
<th>PR of MACEDONIA</th>
<th>MONTENEGRO</th>
<th>SERBIA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Democracy &amp; governance</td>
<td>223.5</td>
<td>31</td>
<td>111.3</td>
<td>123</td>
<td>46.9</td>
<td>278</td>
</tr>
<tr>
<td>2. Rule of law &amp; fundamental rights</td>
<td>97</td>
<td>33</td>
<td>123</td>
<td>83</td>
<td>52.3</td>
<td>265</td>
</tr>
<tr>
<td>3. Environment &amp; climate action</td>
<td>68</td>
<td>/</td>
<td>/</td>
<td>113</td>
<td>37.5</td>
<td>160</td>
</tr>
<tr>
<td>4. Transport</td>
<td>56</td>
<td>/</td>
<td>/</td>
<td>113</td>
<td>32.1</td>
<td>175</td>
</tr>
<tr>
<td>5. Energy</td>
<td>/</td>
<td>/</td>
<td>100</td>
<td>/</td>
<td>/</td>
<td>125</td>
</tr>
<tr>
<td>6. Competitiveness &amp; innovation</td>
<td>44</td>
<td>63.8</td>
<td>133</td>
<td>73</td>
<td>21.2</td>
<td>105</td>
</tr>
<tr>
<td>7. Education, employment &amp; social policies</td>
<td>69</td>
<td>38</td>
<td>94.2</td>
<td>53</td>
<td>28.1</td>
<td>190</td>
</tr>
<tr>
<td>8. Agriculture &amp; rural development</td>
<td>92</td>
<td>/</td>
<td>79.7</td>
<td>106</td>
<td>52.4</td>
<td>210</td>
</tr>
<tr>
<td>9. Regional &amp; territorial cooperation</td>
<td>/</td>
<td>/</td>
<td>/</td>
<td>/</td>
<td>/</td>
<td>/</td>
</tr>
<tr>
<td>TOTAL</td>
<td>649.4</td>
<td>165.8</td>
<td>645.5</td>
<td>664</td>
<td>270.5</td>
<td>1508</td>
</tr>
</tbody>
</table>

Source: External Evaluation of the Instrument for Pre-accession Assistance (IPA II)
4.1 TERRITORIAL COOPERATION

In this section we provide data on the territorial cooperation instruments regarding the EUSAIR region and originating from European Structural and Investment Fund ESIF (European Regional Development Fund) and IPA II. In particular we highlight the distribution of resources by sector of intervention and program of intervention.

![Fig. 17 ERDF and IPA Interreg funds](image)

**Fig. - 17 ERDF and IPA Interreg funds**

**Fig. - 18 IPA Interreg**

**Fig. - 19 ERDF Interreg**

![Graph showing distribution of resources by sector of intervention and program of intervention for EUSAIR region](image)
4.2 BUDGET SUPPORT TO EUSAIR PILLARS

It is possible to reconstruct the flow of Official Development Assistance (ODA) to EUSAIR pillars on the basis of the sectoral classification contained in OECD CRS Database. Data regarding 23 sectors (matched with EUSAIR pillars' objectives) have been analyzed with regard to 5 EUSAIR countries (Albania, Bosnia-Herzegovina, Serbia, Montenegro and Croatia), and 2 non EUSAIR countries (Kosovo, FYR).* The adoption of a more extensive time span (2007-2015) than that of EUSAIR proper (2014-to date) allows to perform a "what-if" exercise and test for discontinuity after the launch of the strategy. This exercise can also be read as an estimate of the impact of the Instrument of Pre-Accession Assistance (which actually represents the total EU ODA funds to the area) on EUSAIR sectors.

The pillar that has attracted the highest resources since 2007 is the second pillar "connecting the region", followed by the third pillar "environmental quality". Sustainable tourism is the pillar receiving the lowest quantity of resources. Since OECD data allow to distinguish between ODA and "other official finance" (OOF, i.e. non concessional loans) a proxy of leverage in the financial blending for EUSAIR pillars can be produced. Table 4 contains the ratio between ODA resources and OOF resources for each pillar. Pillars 2 and 3 present a balanced blending between grants and non concessional loans; pillar 1 is totally financed by grants, whereas pillar 4 rest for close to 60% on OOF.

**ODA are:**

i. **provided by official agencies,** including state and local governments, or by their executive agencies; and

**ii. each transaction of which:**

a) is administered with the promotion of the economic development and welfare of developing countries as its main objective; and

b) is concessional in character and conveys a grant element of at least 25 per cent (calculated at a rate of discount of 10 per cent)

Table 3 - Stock of ODA to EUSAIR countries* (mio US dollars, 2006-2015)

<table>
<thead>
<tr>
<th>Donor</th>
<th>Recipient</th>
<th>sum 2006-2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>all sectors</td>
<td>EUSAIR countries</td>
<td>21.601</td>
</tr>
<tr>
<td>all donors</td>
<td>USAIR sectors</td>
<td>4.706</td>
</tr>
<tr>
<td>EU donors</td>
<td>EUSAIR countries</td>
<td>9.807</td>
</tr>
</tbody>
</table>

* Due to the inclusion of 2 non-EUSAIR countries, the total ODA figures may overestimate EUSAIR recipients' impact. This applies particularly to pillar 2 investment in which both Kosovo and FYR received the highest quantity of resources, compared with other pillars.
**Fig. 20- Stock of ODA and OOF to EUSAIR countries (5 countries). 2007-2015**

**Table 4 - ODA aid channelled into EUSAIR pillars. Mio euros**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Pillar 1 - Blue Growth</td>
<td>€ 528.360.00</td>
<td>€ 10.920.00</td>
</tr>
<tr>
<td>Pillar 2 - Connecting the region</td>
<td>€ 5026.560.00</td>
<td>€ 1294.440.00</td>
</tr>
<tr>
<td>Pillar 3 - Environmental quality</td>
<td>€ 1003.80.00</td>
<td>€ 420.840.00</td>
</tr>
<tr>
<td>Pillar 4 Sustainable tourism</td>
<td>€ 88.20.00</td>
<td>€ 20.160.00</td>
</tr>
</tbody>
</table>

our elaboration on OECD

**Table 5 - Ratio of ODA component on other official finance (comprising non concessional loans). 2007-2015**

<table>
<thead>
<tr>
<th>Pillar</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pillar 1 - Blue Growth</td>
<td>97%</td>
</tr>
<tr>
<td>Pillar 2 - Connecting the region</td>
<td>57%</td>
</tr>
<tr>
<td>Pillar 3 - Environmental quality</td>
<td>56%</td>
</tr>
<tr>
<td>Pillar 4 - Sustainable tourism</td>
<td>39%</td>
</tr>
</tbody>
</table>

our elaboration on OECD
4.3 ANALYSIS: EUSAIR SECTORAL STRATEGY AND THE REGION'S ECONOMY

We conducted an exercise on ODA data (OECD Creditor Reporting System) from 2008 to 2016 distinguishing financial aid to all sectors of the EUSAIR economies and financial aid only directed to EUSAIR sectors as included in the 4 EUSAIR pillars. The EUSAIR sectoral re-classification was conducted on data obtained from the OECD ODA open data database. Since ODA from EU Institutions to the western Balkans and EUSAIR region goes under the chapter of Instrument of pre-accession Instrument (IPA II), the present exercise estimates the correlation between EUSAIR allocations and some key the region economic indicators.

We selected additional variables from the World Bank Indicators. These variables are: gross national income per capita (current US dollars); ODA originating from EU Institutions; receipts of international tourism (current dollars); FDI flow as % of GDP; trade as % of GDP; Gross fixed capital formation as % of GDP. The control variables were used along the dependent variable (amount of ODA to EUSAIR sectors from 2007 to 2016) to build a panel model to verify the correlation between EUSAIR strategy and the selected economy variables.

We use two specifications (in one the dependent variable is the gross capital formation, in the other is the openness of trade). The selected time series extends purposefully beyond the EUSAIR actual time span (2014-2016) since it aims to understand if investment towards EUSAIR sectors was already achieving any results prior to EUSAIR official launch and if the launch of the strategy has altered somehow this effect. The adopted panel model distinguishes between a fixed effect and a random effect specification and introduces a year effect in both cases. The random effect model proves to be more conclusive in both specifications, highlighting that each country characteristics still weigh on the regional economy (no "macro-regional effect"). Two additional specifications with GNI per capita and FDI as dependent variables proved not significant with all control variable. As for the year effect, apparently the launch of the strategy has officialized a sectoral investment prioritazation that was already taking place effectively.

<table>
<thead>
<tr>
<th>Gross capital formation</th>
<th>Trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total ODA</td>
<td>-0.3</td>
</tr>
<tr>
<td>Total EU ODA</td>
<td>-0.1</td>
</tr>
<tr>
<td>ODA to EUSAIR sectors</td>
<td>0.17</td>
</tr>
<tr>
<td>Trade</td>
<td>-0.27</td>
</tr>
<tr>
<td>FDI</td>
<td>-0.01</td>
</tr>
<tr>
<td>Tourism</td>
<td>0.055</td>
</tr>
<tr>
<td>Gross capital formation</td>
<td></td>
</tr>
</tbody>
</table>

Source: elaboration on data from OECD and World Bank. ***= sig. at 0.05. Year effect: yes

EUSAIR sectoral strategy contributes significantly to gross capital formation but less significantly to trade openness. Investment appears to be spurred also by income from tourism.
4.4 STOCKTAKING #4 FOR FINANCING EUSAIR: IMPROVING IPA AND ERDF TERRITORIAL COOPERATION LEVERAGE

Since one of the challenges of EUSAIR is to enhance the capacity of the entire region to generate synergies at economic, financial, environmental and societal level, a crucial instrument is provided by regional and cooperation measures.

Whereas the leverage of IPA funds is ascertained with regard to general terms of budget support, particular attention should be paid to the generation of additional finances and investment based on grants directed to territorial cooperation.

Certainly IPA funds, form a territorial perspective tackle soft instruments and can hardly generate high investment multipliers; however territorial cooperation is a unique opportunity to build the micro-infrastructures of the region along the connectivity agenda.

In this perspective the experience of ADRION can represent the example of a territorial cooperation program, with a limited endowment but with a huge potential to generate framework partnership projects with an impact in the medium-to-long term.

In this case the financial blending to be pursued should correct the imbalances between pillars (for example blue growth could be brought to search for higher financial leverage while tourism could be supported by more grants).
5. A MAP FOR INCREASING EUSAIR FINANCIAL IMPACT

Financing the EUSAIR recommendation #1: increase budget support to actions directed to strengthening EUSAIR GVCs

Financing the EUSAIR recommendation #2: increased budget support to macroregional industrial synergies should become pivotal to attract FDI

Financing the EUSAIR recommendation #3: blending should be applied also to social innovation investment

Financing the EUSAIR recommendation #4: IPA and ESIF territorial cooperation as a platform to leverage additional resources