Strengthening Economic Cooperation Between South East Europe and Turkey

Diagnostics
Business Ideas
Policy Recommendations

RegionalCooperationCouncil

IN PARTNERSHIP WITH

tepav

THE UNION OF CHAMBERS AND COMMODITY EXCHANGES OF TURKEY
TOBB

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Trg Bosne i Hercegovine 1/V, 71000 Sarajevo
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Tel. +387 33 561 700, Fax. +387 33 561 701
E-mail: rcc@rcc.int
website: www.rcc.int

Authors: Group of authors

Editor: Dragana Djurica, RCC

Consulting Editor: Esen Çağlar, TEPAV

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RegionalCooperationCouncil

STRENGTHENING ECONOMIC COOPERATION BETWEEN SOUTH EAST EUROPE AND TURKEY

Sarajevo, 2015

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LIST OF ABBREVIATIONS AND ACRONYMS

AITA Albanian ICT Association
AIDA Albanian Investment Development Agency
ALB Albania
ATTC Albanian-Turkish Chamber of Commerce and Industry
BACI Base pour L'Analyse du Commerce International - Database for International Trade Analyzes
BEC Classification by Broad Economic Categories
BHEPA Bosnia and Herzegovina, Export Promotion Agency
BIGMEV Center for Development of Relations with Bosnia and Herzegovina
BIH Bosnia and Herzegovina
BKT Banka Kombetare Tregtare
CAGR Cumulative Aggregate Growth Rate
CEED Center for Entrepreneurship and Executive Development
CEFTA Central European Free Trade Agreement
CEPII Centre d'Etudes Prospectives et d'Informations Internationales
CIRSD Center for International Relations and Sustainable Development
CIS Commonwealth of Independent States
CIT Canadian Institute of Technology
DBI Doing Business Index
DTIDZ Directorate for Technological Industrial Development Zones
EBRD European Bank for Reconstruction and Development
ECB European Central Bank
ECHO European Commission's Humanitarian Aid and Civil Protection Department
EIDHR European Instrument for Democracy and Human Rights
EU European Union
FIC Foreign Investors Council
FDI Foreign Direct Investment
GDP Gross Domestic Product
HS Code Harmonized Commodity Description and Coding System
ICT Information and Communication Technology
IMF International Monetary Fund
IOM International Organization for Migration
IPA Instrument for Pre-Accession Assistance
KfW German Development Bank
KSV*[1] Kosovo*
MASIT Macedonian Chamber of Information and Communication Technologies
MENA Middle East and North Africa
MKD The Former Yugoslav Republic of Turkey
MNE Montenegro
NATO North Atlantic Treaty Organization
NGO Non-Governmental Organization
NMS New Member States (EU)
ODI Outward Foreign Direct Investment
OECD Organization for Economic Cooperation and Development
PPP Public-Private Partnership
PRODY Average Productivity Content
RCA Revealed Comparative Advantage
RCC Regional Cooperation Council
R&D Research and Development
SAM Serbia Association of Managers
SBAN Serbia Business Angels Network
SEE South Eastern Europe
SEE-6 Albania, Bosnia and Herzegovina, Kosovo*, Montenegro, Serbia, The Former Yugoslav Republic of Macedonia
SEECEL South East European Centre for Entrepreneurial Learning
SEEIC SEE Investment Committee
SIEPA Serbia Innovation Fund, Serbia Investment and Export Promotion Agency
SME Small and Medium Enterprise
SPEA Serbia Venture Capital Association
SRB Serbia
TEPAV The Economic Policy Research Foundation of Turkey
TIKA Turkish Cooperation and Coordination Agency
TOBB The Union of Chambers and Commodity Exchanges of Turkey
TUBITAK The Scientific and Technological Research Council of Turkey
TUR Turkey
TURKSTAT Turkish Statistical Institute
UCCIAL Union of Chambers of Commerce and Industry of Albania
UN United Nations
UNESCE United Nations Economic Commission for Europe
UNDP United Nations Development Programme
UNEP United Nations Environment Programme
UNIDO United Nations Industrial Development Organization
USD United States Dollars
WB World Bank
WTO World Trade Organization

1 This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence

FOREWORDS

I am delighted to present to you the report entitled "Strengthening Economic Cooperation between South East Europe and Turkey." This study is the first product of our fruitful collaboration with the Regional Cooperation Council. I believe that it is timely and important that we support our economic approach towards Turkey and South East Europe with analytical studies.

As both sides pursue their agendas towards European Union membership, there are great synergies to be achieved. Business-to-Business connectivity will be an important pillar of this synergy.

What can we do to foster and deepen the economic relations between Turkey and the economies of South East Europe, namely Albania, Bosnia and Herzegovina, Kosovo*, Montenegro, Serbia and The Former Yugoslav Republic of Macedonia? Where are the opportunities for business people? How could governments pave the way for deepening economic relations? What is the role of chambers?

I am confident that you will find answers to these questions and many others in this report, prepared by the Economic Policy Research Foundation of Turkey (TEPAV).

Back in 2004, as the Union of Chambers and Commodity Exchanges of Turkey (TOBB), we established the TEPAV, with a view to inform policy discussions in Turkey through rigorous research. Today, TEPAV has come to be Turkey's foremost think-tank on competitiveness, regional economic integration and regional development issues. In carrying out studies like this one, TEPAV is on its way to become a think-tank not only on Turkey, but also one on our wider region, covering extensively the European Union, Balkans, Caucuses, Middle East, North Africa and Central Asia.

This report aims to inspire business people and inform policy-makers through its concrete recommendations. There are also several suggestions to the chamber community of the region. I see the capacity building process of the chambers in the Balkans as a key priority, not only at the national level but also at the local level. I firmly believe that an independent and strong grassroots chambers movement is the backbone of a healthy private sector development process, something very much needed in the Balkans.

I hope this study will have an impact on deepening and strengthening the economic linkages between Turkey and South East Europe. If the report changes or challenges the way you think about the region, and better yet, encourages you to act, it will have served its purpose.

M. RİFAT HISARCIKLIOĞLU
President, TOBB
Chair, B20

In the past couple of years, economic cooperation has established itself as the major force pushing forward not just growth in South East Europe (SEE)'s, but also the region's political stability. RCC's SEE 2020 strategy is one of the cornerstones for improving competitiveness and regional integration, trying to open new jobs, enlarge regional trade and raise the region's GDP per capita and bring it closer to the EU one.

In order to reach ambitious objectives, SEE economies are continuing to foster and deepen their internal relations by vigorously advancing economic and trade cooperation, and at the same time actively exploring opportunities for collaboration with high-growth countries in its neighborhood. There, Turkey is a recognized important and viable partner. Considering the geographical proximity, cultural similarities, and complementarities of the economic structures of SEE and Turkey, it has become obvious that the connectivity and economic relations between these two partners should be enhanced in order to become better than they are today.

In order to provide a roadmap and unlock the potentials for further cooperation and strengthen the links between Southeast European and Turkey's private sectors, we in the RCC have engaged in successful cooperation with our partners from the Union of Chambers and Commodity Exchanges of Turkey (TOBB) and the Economic Policy Research Foundation of Turkey (TEPAV). As a first result of this collaboration, we are proud to unveil the report on "Strengthening Economic Relations between South East Europe and Turkey". In this report, we have identified the specific complementarities between SEE and Turkish businesses, key strategic areas of government to government collaboration, and formulated an agenda for addressing key bottlenecks with concrete project ideas for SEE-Turkish business ventures. We anticipate that converting these diagnostics into actionable activities on the ground will contribute to achieving SEE 2020 targets, as well as Turkey's 2023 objectives.

Last but certainly not least, we strongly believe that strengthening economic ties between Turkey and SEE will have significant positive impacts not only on their own prosperity, but will also play a significant role in the international arena, and, ultimately, assist our mutual aspirations for EU membership.

South East Europe is open for business with Turkey.

I trust that you will find our report a useful resource.

DR. GORAN SVILANOVIC
Secretary General
Regional Cooperation Council

ACKNOWLEDGEMENTS

This study has been prepared by The Economic Policy Research Foundation of Turkey (TEPAV) in collaboration with the Regional Cooperation Council (RCC). The study was supervised by Esen Çağlar and led by Timur Kaymaz. The core team comprised Ayşegül Taşöz, İrem Kızılca and Omar Kadkoy. We also owe thanks to Güven Sak, Ozan Acar, Ali Sökmen, İdil Bilgic Alpaslan, İdil Özdogan, İpek Aydin, Andrea Stover, Selim Koru and Sara Agun Yalçın for their contributions throughout the various stages of the project. Several RCC members also made major contributions, including Secretary General Goran Svilanović, Sanjin Arifagić and Dragana Đurica from the SEE 2020 Strategy Coordination Unit, and Erhan Türbedar from the Political Department of the Regional Cooperation Council.

For this study, we conducted fact finding mission to all seven economies and held over one hundred in-depth interviews.

In Albania, we held meetings with a variety of businessmen, chambers and officials including H.E. Hidayet Bayraktar, Turkey's Ambassador to Albania as well as Muharrem Can, Turkey's Commercial Councilor. Other stakeholders we met with are from the following institutions: the Albanian ICT Association (AITA), Albanian Investment Development Agency (AIDA), Albanian-Turkish Chamber of Commerce and Industry (ATCC), Banka Kombetare Tregtare (BKT), Canadian Institute of Technology (CIT), European Delegation in Albania, Kürüm International and Union of Chambers of Commerce and Industry of Albania (UCCIAL).

In Bosnia and Herzegovina, the TEPAV delegation conducted meetings with H.E. Cihad Erginay, Turkey's Ambassador to Bosnia and Herzegovina, Sedat Yıldız Turkey's Commercial Councilor in Bosnia and Herzegovina, as well as representatives from Chamber of Economy of the Federation of Bosnia and Herzegovina, Council of Ministers of Bosnia and Herzegovina, European Bank for Reconstruction and Development (EBRD) Bosnia and Herzegovina, Export Promotion Agency (BHEPA), Foreign Investment Promotion Agency (FIPA), Ministry of Foreign Trade and Economic Relation of Bosnia and Herzegovina, University of Sarajevo and Ziraat Bank Bosnia and Herzegovina.

In Kosovo*, we met with H.E. Songül Ozan, Turkey's Ambassador to Kosovo*, Tamer Topaloğlu, Turkey's Commercial Councilor in Kosovo* as well as representatives of the United Nations Development Programme (UNDP) and TEB Sh. A. (BNP Paribas Joint Venture).

In Montenegro, we held meetings with H.E. Mehmet Niyazi Tanılır, Turkey's Ambassador to Montenegro and representatives of the Center of Excellence in Bioinformatics, Chamber of Economy of Montenegro, Gintaş, Ministry of Economy Director General of Directorate for Investment and Transformation and University of Montenegro Biotechnical Faculty.

In Serbia, we held meetings with H.E. Mehmet Kemal Bozay, Turkey's Ambassador to Serbia, the Embassy's counsellor Anıl Kayalar and İsmail Bozdemir, Turkey's Commercial Councilor in Serbia. Our other meetings were held with representatives of chambers, businessmen, cluster managers and officials from different institutions such as the Center for International Relations and Sustainable Development (CIRSD), European Bank for Reconstruction and Development (EBRD) Serbia, FCA FIAT Chrysler Automobiles in Kragujevac, Foreign Investors Council (FIC), Halkbank Serbia (Cacanksa Bank), Htech High Tech Engineering Center, Kragujevac City Council, Kragujevac Regional Chamber of Commerce, Kragujevac textile industry representatives, Ministry of Trade and Sumadija Association of Entrepreneurs, Novi Sad ICT Cluster, Serbia Association of Managers (SAM), Serbia Business Angels Network (SBAN), Serbia Innovation Fund, Serbia Investment and Export Promotion Agency (SIEPA), Serbia Venture Capital Association (SPEA), Serbian Chamber of Commerce and Industry, Subotica Free Zone, Zastava Inpro and University of Novi Sad Faculty of Technical Sciences.

In The Former Yugoslav Republic of Macedonia, we held meetings with H.E Ömür Şölendil, Turkey's Ambassador to The Former Yugoslav Republic of Macedonia, Bünyamin Kutlu, Turkey's Commercial Councilor in The Former Yugoslav Republic of Macedonia, as well as representatives of the Center for Entrepreneurship and Executive Development (CEED), Directorate for Technological Industrial Development Zones (DTIDZ), Economic Chamber of Macedonia, European Bank for Reconstruction and Development (EBRD) Macedonia, Halkbank Macedonia, Investment Promotion Agency, Macedonian Chamber of Information and Communication Technologies (MASIT), Ministry of Economy of the Republic of Macedonia, Ss. Cyril

and Methodius University Business Start-up Centre, Sütaş and the World Bank.

We also owe many thanks to the international Turkish companies whom we held meetings with through personal interviews and teleconferences. Representatives of Avitaş, Şişecam, Kastamonu Entegre, Çilek Mobilya, Sütaş, Tahsildaroğlu and Standard Profil helped us identify patterns of Turkish investment in the Balkans.

Last but not least, we would like to extend our warmest gratitude to colleagues and institutions that went the extra mile in their efforts to assist the TEPAV team: the Turkish Embassy in Belgrade, Ece İdil Kasap of Viveka, Halkbank Skopje AD, Turkey's Commercial Counselor to Sarajevo Mr. Sedat Yıldız, the BIGMEV Sarajevo Office, Vojvodina ICT Cluster, SIEPA and Katarina Urosevic of OECD.

The first draft of this study was presented and discussed in the "SEE Investment Committee Meeting" held on 18 June 2015 in Podgorica, Montenegro. We are grateful to the members of the Investment Committee from SEE-6 economies as well as multilateral institutions such as CEFTA, SEECEL and OECD for their constructive and valuable comments. A Synthesis Workshop for this study was held on 21 July 2015 in Sarajevo, Bosnia and Herzegovina. The workshop was attended by high-level policy makers and representatives from Albania, Bosnia and Herzegovina, Croatia, Kosovo*, Montenegro, Serbia, The Former Yugoslav Republic of Macedonia, Turkey and regional and international institutions. Two development agencies from Turkey, the Trakya Development Agency and the South Marmara Development Agency were also represented in the workshop to reflect on regional synergies. We sincerely thank all of the participants of this workshop who provided highly constructive feedback on the first draft of our study. We tried to incorporate all feedback into the final version of this report. The usual disclaimer applies: all errors are ours.

EXECUTIVE SUMMARY

TURKEY AND SOUTH EAST EUROPE (SEE) HAVE STRONG HISTORICAL TIES. FOR CENTURIES, PEOPLE OF BOTH SIDES SHARED THE SAME GEOGRAPHY AND CULTURE, INTERACTED WITH EACH OTHER AND WITNESSED MASSIVE MIGRATION FLOWS IN BOTH DIRECTIONS. IN THE LAST TWO DECADES, AFTER THE DEVASTATING COLLAPSE OF THE FORMER YUGOSLAVIA, THE POLITICAL AND ECONOMIC LANDSCAPE IN THE REGION HAS CHANGED DRASTICALLY. THERE ARE NOW MANY SMALL ECONOMIES, SOME OF WHICH ENTERED THE EU, SOME OF WHICH ARE IN THE ACCESSION PROCESS, AND OTHERS THAT ARE TRYING TO TACKLE POLITICAL DISPUTES.

CAN SEE TRANSFORM INTO A HIGH-GROWTH, COMPETITIVE AND VIBRANT ECONOMIC STRUCTURE? WHAT WILL THE ECONOMIC TIES BETWEEN TURKEY AND SEE-6 LOOK LIKE IN THE TWENTY FIRST CENTURY? WHERE ARE THE OPPORTUNITIES FOR BUSINESSES? WHICH SECTORS YIELD SYNERGIES AND COMPLEMENTARITIES? WHAT CAN THE GOVERNMENTS DO TO ENHANCE CONNECTIVITY BETWEEN THE TWO SIDES? WHAT ARE THE ROLES FOR THE CHAMBERS?

THIS REPORT, PREPARED BY TEPAV AND FUNDED BY RCC AND TOBB, WILL AIM TO PROVIDE ANSWERS TO THESE QUESTIONS. IT WILL FOCUS ON SEVEN ECONOMIES: THE SEE-6 (ALBANIA, BOSNIA AND HERZEGOVINA, KOSOVO*, MONTENEGRO, THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, AND SERBIA) AND TURKEY.

DIAGNOSTICS

The first section focuses on the diagnostics, particularly regarding economic transformation. One key finding is that, from the eyes of potential investors, the current situation in the region is not as attractive as its true potential. Most economies are yet to become fully functioning market economies. There are series of challenging structural reforms that await the governments throughout the region. Unemployment is as high as 23 percent and outward migration drains the region's human capital.

On the positive side, the possibility of EU membership could be a game changer in the region. In terms of converging to EU income levels, integrating into European production networks and adopting the EU acquis, SEE economies are likely to go through what Eastern European economies have achieved in the last fifteen years. This process can multiply the business opportunities available in the region. Also, the production capabilities inherited from the Former Yugoslavia, be it in medium-technology manufacturing or in ICT, if reignited with appropriate business models, can create a lot of synergies.

EXISTING ECONOMIC TIES

The second section presents an overview of the existing bilateral economic relations. Turkey is one of the four countries, together with Italy, Germany and the USA, to have investments over 100 million USD in each economy. Through our data analysis and extensive interviews in the region and Turkey, we identified a series of critical patterns. First, the entry of Turkish banks into the region has been one of the most important developments for upgrading bilateral economic relations. Second, Turkish investors are seeking to enter the SEE-6 economies mainly through brownfield investments. Third, a significant share of established industrialists in the Marmara and Aegean regions of Turkey has strong personal and family ties with the SEE-6 region. Fourth, the SEE-6 is perceived as a springboard on the way to establishing global operations. Fifth, multiple daily flights operated by Turkish Airlines to all capitals enhances the region's connectivity with the global economy. Sixth, Turkish Universities

offer important opportunities to find Turkish speaking high quality human capital. Seventh, Turkish investors' image throughout the region is not uniform and may require intervention to be rectified in the medium term. Last but not least, in terms of bilateral trade, each side's basket reflects its own production structure. Hence, to boost trade volumes, going through a jointly orchestrated structural transformation process on both sides can yield substantial gains.

BUSINESS IDEAS FOR THE FUTURE

The third section aims to provide inspiration to business people. The SEE-6 region's challenge will be to increase its capacity to compete not only through cheaper costs, but also through high quality, innovation and speed. As the Turkish private sector has gone through a similar process of learning in the last three decades, there is a lot more room for cooperation at the macro level. With this in mind, we tried to identify win-win forms of economic cooperation at the meso and micro levels that could strengthen the bridge between SEE and Turkish economies. Some of the business opportunities are already viable today. For some, viability will depend on the future transformation patterns on both sides of the bridge. The extent of Southern European firms' ability to tap into the opportunities that Turkish markets presents also depends on the growth of high performance firms in the region.

One key message of this section is that businesses should not see the other side of this bridge only as a market, but rather as potential partners to form joint ventures in the global economy. From this perspective, the SEE region's proximity to the EU market and potential EU membership are the major advantages. Turkey, being the most diversified economy between Italy and China, can assist SEE firms to tap into a wide array of sectors and markets in the Middle East, North Africa, the Caucuses and Central Asia. There is indeed a wide array of business cooperation models:

GLOBAL VALUE CHAIN INTEGRATION

We expect the SEE region to integrate into global value chains in the near future. The flying geese paradigm, which stipulates the process of decentralization of industrial activities from the more expensive core areas to cheaper periphery areas, is likely to hold true for SEE-6 economies, especially given the increasing costs in economies such as Poland, Hungary, Czech Republic and Slovakia. Furthermore, a similar push may come from the Marmara region. For those Turkish companies that export to the EU from Istanbul's vicinity, where productions costs are on an upward trend, it may be more feasible to consider relocating part of their value chains to the SEE-6 region to become more competitive in price and speed while maintaining quality.

BUSINESS PROCESS OUTSOURCING

As business gets more complex, firms providing specialized niche services make important contributions to competitiveness. The quality of human capital, coupled with the low cost of living in relatively decent standards (compared to Istanbul and Ankara), render certain urban centers in the SEE region as potential service hubs for niche business services. This imminent trend is becoming visible in Belgrade and Sarajevo. These cities offer opportunities in high value-added business services such as information communication technologies, design, media, marketing and consulting.

JOINT VENTURES FOR THIRD MARKETS

There is a high degree of complementarity between Turkey and SEE-6 export markets. Today's SEE's exports concentrate mostly on the EU markets (+60%), while MENA, Asia and American markets can get very limited shares. On the other hand, while the EU has around a 40 percent share, the MENA market has around a roughly 25 percent share of Turkey's exports. Beyond MENA, high growth markets in Russia and Asia could be platforms where Turkish and SEE firm could cooperate. Access to certain raw materials in SEE, such as forestry and metals, could be entry points for such joint ventures for third markets.

TAPPING INTO THE EXISTING TRADE ROUTES

Positioned right between Turkey and the largest EU markets, SEE's geographic location creates natural business opportunities, especially in logistics, packaging and types of manufacturing that requires rapid delivery. For example, The Route 10 highway that forms the transportation backbone of Serbia on the North-South axis is placed in the middle of the Turkey-Germany trade route. By one estimate, about 190,000 Turkish trucks passed through Serbia in 2014, which amounts to an average of 500 trucks per day. The already existing stream of trucks creates very favorable conditions for Turkish investors to service the European market from an alternate location.

TAPPING INTO DOMESTIC ECONOMIC GROWTH

The growth potential of the SEE economies is a direct function of the EU convergence process and success of the SEE 2020 Strategy. If accomplished, the region's GDP per capita relative to the EU average may go up from 36.5 percent to 44 percent, its total trade from 94.4 billion USD to 200 billion USD in a decade. Add to these benefits the increasing urbanization rates and modernization of the domestic urban economies. This will bring opportunities for SMEs, particularly in the areas of energy, construction and tourism. As such, if the growth trends continue, the region will likely get on the radar of private equity and venture capital funds.

TRILATERAL COOPERATION MODELS BETWEEN TURKEY, SEE AND EU

Both, the SEE and Turkish economies have strong links with a large number of EU economies. These links are not only limited to financial or commercial spheres, but also include the presence of strong Diasporas in countries like Germany, France and Italy. Trilateral business models could also be formulated by tapping directly into the networks in EU countries via different methods. First, SEE and Turkish firms, though their joint ventures, could target integrating into the supply chains of EU multinationals (such as FIAT automotive). The second method would be leveraging the multilaterals such as the European Investment Bank, European Bank of Reconstruction and Development (EBRD) or German Development Bank (KfW) for larger scale infrastructure or productivity-enhancing projects.

We came across ten strong sectors during our research process: (i) agrofood, (ii) automotive, (iii) electronics, (iv) metal processing, (v) textile and apparel, (vi) wood processing, (vii) construction and real estate, (viii) energy, (ix) ICT, and (x) tourism. It is possible to see a lot of activity in each of these sectors in one or several of the SEE economies. Some are prioritized by the governments, some are seen as growth areas by the local banks, and in some of them investment opportunities are already seized by Turkish investors and entrepreneurs. We evaluated this preliminary list of sectors for each economy on three basic main criteria: (1) The compatibility of sectors with the policy priorities in each economy, (2) whether the sector carries a high growth potential in the domestic economy; (3) the current degree of connectivity to global value chains.

Based on this, we focused on five sectors in detail:

1. Agrofood industry,
2. Automotive industry,
3. Textile and apparel industry,
4. Tourism, and,
5. Information and Communication Technologies.

For each sector, we tried to trace and shed light on opportunities based on data and expert views. These are not meant to be exhaustive sector analyses. We only hope that these short sector sheets will encourage business people from these sectors to look at the region through a different lens.

POLICY RECOMMENDATIONS

In the fourth and last section, we present a number of items as homework for the public sector, business associations as well as the RCC. These policy recommendations are meant to complement and strengthen future business synergies, as well as contribute to the RCC's Flagship Initiatives on skills & mobility, sector competitiveness and industrial development, and soft connectivity.

RECOMMENDATION #1: TARGETED POLICY DIALOGUE ON ECONOMIC TRANSFORMATION AND DIVERSIFICATION

Turkey's structural reform experience, especially spanning the periods 1980-1987 and 2001-2007, can illuminate current policy debates in the region. Following our fact-finding missions, we identified five critical policy areas in which dialogue could most benefit Turkey and SEE-6: (i) Industrial policy, SMEs and entrepreneurship development, (ii) Improving the investment climate, (iii) Public-private partnership frameworks, (iv) Tourism strategy and implementation, and (v) Agriculture policy, targeting bottlenecks in the entire food chain. Policy learning in these realms could be facilitated via two mechanisms. First, formal knowledge transfer programs could be established on a thematic basis, with the formation of task forces that would bring together high-level bureaucrats and experts. Second, mechanism would form policy exchange platform such as joint symposia, policy workshops and conferences, as well as formal joint ministerial committees. To foster these platforms, second track (unofficial) networks would also be built and strengthened with the active engagement of think tanks, academia and NGOs. The RCC, the Turkish Ministry of Development and TEPAV could be the main facilitators of this policy dialogue.

RECOMMENDATION #2: COLLABORATIVELY UTILIZING EU PRE-ACCESSION FUNDS AND RESOURCES

Financial and technical support is available to SEE-6 and Turkey as EU candidates through a long list of international organizations and institutions. Pre-Accession, currently IPA II, is the means by which the EU supports reforms in the candidates during the period of 2014-2020 with €11.7 billion in funds. IPA II not only outlines strategic plans for each candidate economy, but unlike IPA I, it includes multi-economy strategy papers that will address priorities for regional and territorial cooperation. The EU identified two areas best managed through regional cooperation: (1) democracy and the rule of law and (2) competitiveness and growth. Consultation mechanism across Turkish and SEE-6 Regional Development Agencies and Chambers could be established to exchange ideas and collaborate for jointly targeting these funds.

RECOMMENDATION #3: ESTABLISHMENT OF SPECIAL ECONOMIC ZONES

How can SEE-6 economies overcome their institutional and regulatory shortcomings to create a more favorable climate for new investments, both local and foreign? One effective solution to this is the special economic zone model. Designating certain areas and equipping them with superb infrastructure and regulatory powers can be an effective short-term solution. As a large country that still suffers from investment climate problems, Turkey could trigger private sector development and attract large volumes of manufacturing FDI throughout the last three decades, mostly thanks to its special economic zone regime. Particularly, “organized industrial zones” have not only delivered high quality utilities services at favorable rates, but also provided one-stop-shop services; i.e. issuing licenses and permits much more effectively compared to municipalities. We recommend instituting a brand new zone regime in SEE-6. This new regime should be undertaken at the regional level, i.e. having the same zone legal and regulatory framework in different economies of the region. Since certain problems arising from national differences are inevitable, a pre-feasibility of a common legal & regulatory framework would be highly beneficial. Based on our initial assessment, we recommend that pre-feasibility assessments can be undertaken for two sites: Subotica and Skopje. These are also two zones that can rapidly attract Turkish investments.

RECOMMENDATION #4: INTEGRATING THE ENTREPRENEURSHIP ECOSYSTEMS OF THE REGION WITH TURKEY

The extent to which SEE-6 economies states successfully nurture a sustainable entrepreneurship ecosystem will be one of the key determinants for their economic transformation. Some SEE-6 economies have strong technical skills, particularly in programming, and have a cost advantage compared to Turkey. Despite their competence however, they lack marketable products that create more value added. There is a need to merge the technological capabilities of the ICT clusters with more conventional industries, especially in agrofood and healthcare. Turkey can play an important role in this process, with its large domestic market, where innovative products can be tested and then scaled up through the surrounding markets such as Russia and MENA. It is possible to significantly increase the level of connectivity between the two ecosystems through networking events, startup weekends, and joint incubation centers that would lead to cooperation in development stages and perhaps partnership during commercialization stages. These events can take place in both Turkey and SEE-6 hubs, where young startup enthusiasts, successful startup founders, venture capitalists, angel investors, accelerator and technology transfer office managers, and thought leaders on entrepreneurship from Turkey and SEE-6 can meet each other. Depending on the success of these events, various other initiatives such as incubation partner programs, mentoring training programs, and angel investment trainings could be organized.

RECOMMENDATION #5: CONDUCTING TARGETED MATCHMAKING PROGRAMS ACROSS CITIES AND CHAMBERS

Upon our interviews with public and private actors in the region, we have identified the need to deepen economic relations between Turkey and SEE-6 at the sub-national level. This means connecting not only the major hubs, but also cities and their relevant institutions, such as chambers and development agencies. Based on our analysis of economic structures (patterns on complementarities and similarities), we identified various economy-city pairs. The chambers of these pairs could come together at the outset and formulate joint action plans. These action plans could comprise B2B events, capacity building and knowledge exchange programs and entrepreneurship development activities. Indeed, we believe chamber-to-chamber dialogue is of vital importance for the future of Turkey and SEE-6 economic relations.

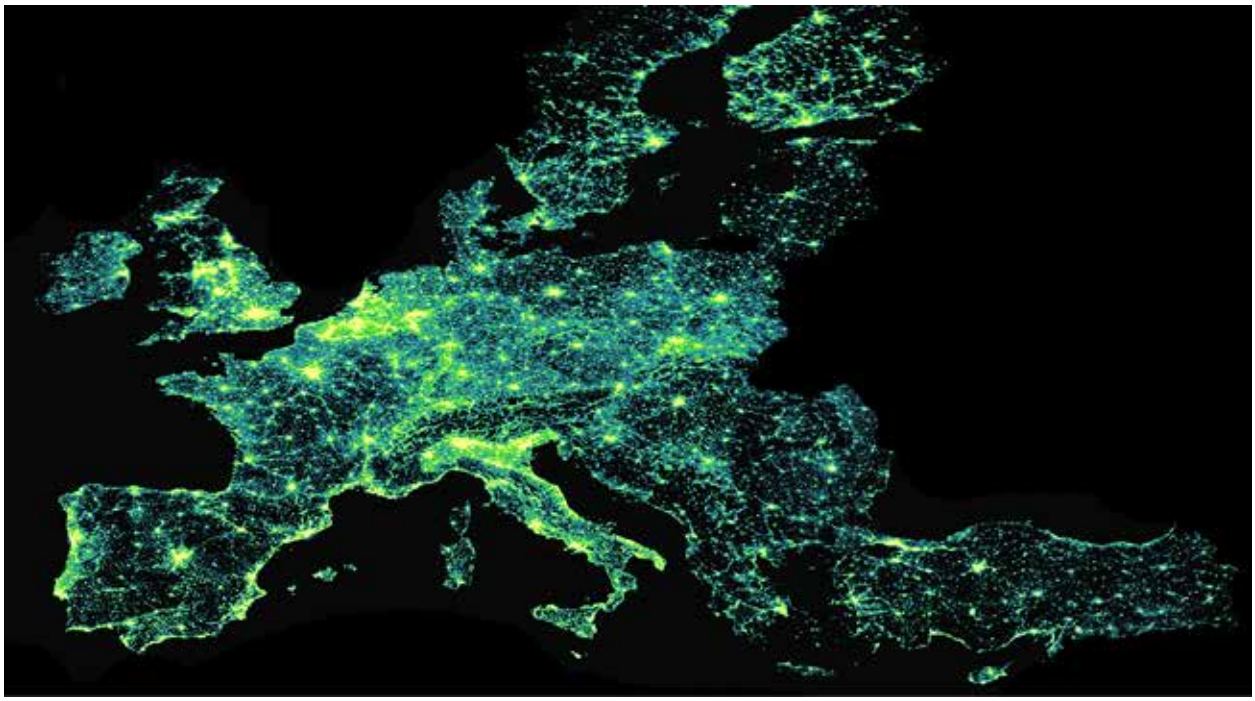
RECOMMENDATION #6: DEVELOPING A COMPREHENSIVE RESEARCH AGENDA

At the outset, in line with our recommendations in previous sections and to follow up on the critical research questions raised in this project, we recommend carrying out more in-depth research in three critical areas: (i) In depth value chain analyses on Agrofood, Automotive, ICT and Tourism, (ii) Content and coordination for policy dialogue, and (iii) special economic zone feasibility studies. Such studies would further support a regional policy making process.

RECOMMENDATION #7: IDENTIFYING FAST GROWTH COMPANIES IN SEE-6 ECONOMIES

Economies that aspire to become a global actor need fast growth companies that build new industries and disrupt traditional ones. Such companies create employment opportunities, focus on product and management innovation, create and supply new and more efficient products to the markets, and therefore are much more likely to attract new investments from abroad. A SEE-50 program would aim at single out top performing companies in the region and analyze their success stories to identify winning formulas and business patterns that can in turn provide inspiration for aspiring SMEs and entrepreneurs. Being identified as a SEE-50 company would increase a company's visibility, strengthening brand awareness, and facilitate internationalization through networking. SEE-50 companies may also be introduced with Turkey-100 companies through networking events.

FIGURE 1 EU-28, South East Europe and Turkey, at night in 2013, from outer space, without borders.



SOURCE: National Geophysical Data Center, National Oceanic and Atmospheric Administration.
Visualized by TEPAV using 2015 Natural Earth 1:10m national boundary shapefiles in ARCGIS with a constant gamma stretch value of 2.0

INTRODUCTION

THE AMBITIOUS SEE2020[1] GOALS THAT THE GOVERNMENTS OF ALBANIA, BOSNIA AND HERZEGOVINA, KOSOVO*, MONTENEGRO, SERBIA AND THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA PLEDGED TO PURSUE REFLECT THEIR ASPIRATIONS TO IMPROVE SOCIOECONOMIC PROSPERITY AND FACILITATE EVENTUAL INTEGRATION WITH THE EUROPEAN UNION.

THIS REPORT AIMS TO COMPLEMENT SOUTH EAST EUROPEAN ECONOMIES' TRANSFORMATION AGENDA BY INSERTING TURKEY INTO THE PICTURE.

THROUGHOUT THE REPORT, WE PURSUE AVENUES WHERE WIN-WIN MECHANISMS OF COOPERATION MAY BE ESTABLISHED BETWEEN THE PRIVATE SECTORS, ENTREPRENEURSHIP ECOSYSTEMS, CIVIL SOCIETIES AND GOVERNMENTS OF SEE-6 AND TURKEY. AS SUCH, THIS REPORT IS THE FIRST STEP TOWARDS FORMULATION OF A SYMBIOTIC AND COMPLEMENTARY TRANSFORMATION AGENDA IN THESE SEVEN ECONOMIES' BID TO REACH HIGH INCOME LEVELS.

WHY THE TIME IS RIGHT

The global economy is on track to transition out of the Global Financial Crisis of 2008 and into a period of stable growth. Latest economic forecasts anticipate annual global growth rates returning to around 4.0 percent between 2015 and 2020. Both international trade and capital flows are recovering, with trade flows having already surpassed their pre-crisis levels and foreign direct investment (FDI) volumes projected to do so by 2018. However, as the aftershocks of the crisis fade out, economic success will be increasingly tied to structural reforms that unlock underlying growth potential. The current global investment climate increasingly marks a return to a reality in which country and region-level policy decisions and developments will be more important than global trends.

This insight is especially relevant for SEE-6, all of which are small economies in the process of opening up their markets. What boosts the prospects of rapid transition in these economies is the existence of multiple anchors of political stability and economic transformation, as coordinated by the SEE2020 Strategy. Candidacy processes to the European Union, the programs pursued in coordination with the IMF, membership in the NATO security framework as well as comprehensive domestic transformation agendas are all important pillars of change in the region.

Turkey stands in contrast to SEE-6 with its recent spur of economic growth, large domestic market, young population, prospering middle class, vibrant urban centers and relative economic stability. With its aim to achieve 25,000 USD per capita GDP and become one of the world's top 10 economies, Turkey is rapidly increasing its presence in the MENA, Caucuses and South East European markets.

However, as will be argued in the following pages, Turkey's recent economic performance is no longer sustainable and the country must seek new recipes of structural transformation if it is to avoid the middle-income trap. It is against this backdrop that Turkey's economic relations with the SEE-6 economies must be reevaluated in order to seek win-win transformative opportunity areas for both sides.

PROJECT OBJECTIVES

How can two regions that are different in terms of population size and structure, income level, economic performance and institutional structure enhance their economic cooperation through win-win scenarios?

This is the fundamental question that drives this report. We believe that the answer lies in the formulation of a joint transformation agenda that capitalizes on untapped or underutilized areas of opportunities and reveals potential synergies between SEE-6 and Turkey.

The research design and methodology of the report have been developed in order to render its findings innovative and unique across four main objectives:

I. Producing a comprehensive economic diagnosis of SEE-6 to uncover the region's transformation potential (Section 1),
II. Assessing the current state of bilateral economic relations and identifying the overarching patterns and bottlenecks (Section 2),
III. Carving out actionable business ideas and inspirations with the aim of enhancing economic relations between SEE-6 and Turkey (Section 3),
IV. Formulating policy recommendations, project ideas and flagship initiatives aimed at complementing the region's institutional transformation outlook in line with the SEE2020 strategy (Section 4).

PROJECT METHODOLOGY

The research design and methodology of the present report was shaped by the conviction that basing the analysis only on production and export data prevents us from understanding the full economic transformation potential. We need to find more analytical ways to connect the reality on the ground with actors who can change that reality: government officials, businesspeople and NGOs.

Our methodology has three key features. It is data driven, bottom-up and non-linear. It is data-driven, as quantitative and qualitative assessments are combined in order to capture the transformation potential of the region. It is bottom-up, because priority is assigned to the local needs and growth potential of the economies in question. It is non-linear, since different levels of assessment feed on each other and findings are synthesized in light of the project's objectives.

Data is the main driver of our thinking process. For the purposes of this study, we analyzed trade and investment flows through the United Nation's Comtrade and CEPII's BACI[2] as well as fdimarkets' datasets. These datasets have two key merits. First, they cover a long time horizon, enabling assessment of historical and long-term trends. Second, they show bilateral linkages between economies at detailed sector and product levels, which allow us to assess the global integration trends of SEE-6 economies and Turkey in depth.

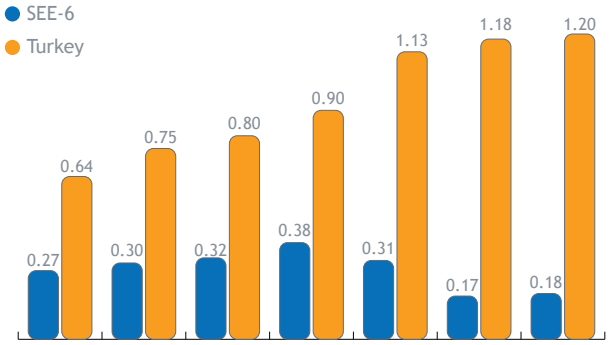
Still, though, quantitative data often falls short of explaining reality, and most of all, of exploring potential. Hence, in order to get a better grip on the situation, as well as a feeling for the future the region, we turn to ideas. Not our own ideas per se, but those we gathered in over one hundred in depth interviews with ecosystem leaders, sector representatives, entrepreneurs, managers of fast-growth companies, companies that are already active in SEE-6 and Turkey, as well as government officials and experts from academia and think-tanks.

Throughout the research process, we worked with a large number of hypotheses related to economic cooperation between the sides, not only at region or national levels, but also at sub-national levels. We tested their viability with both data analysis and by consulting with key experts. The workable ones are refined through various consultations and the main results are presented in this report.

SECTION 1 DIAGNOSTICS

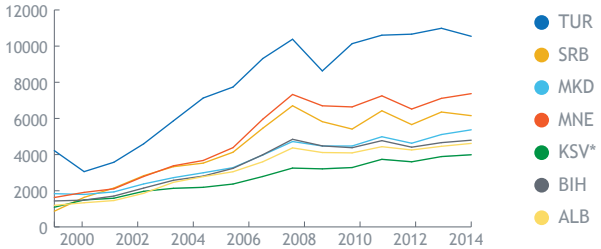
THE FIRST OBJECTIVE OF THE REPORT IS TO PROVIDE A COMPREHENSIVE ECONOMIC DIAGNOSTIC OF THE SEE-6 ECONOMIES AND TURKEY AT THE REGIONAL, NATIONAL AND LOCAL LEVELS WHILE PAYING ATTENTION TO THE CURRENT INSTITUTIONAL SETUP, REFORM AGENDA, ISSUES OF CONNECTIVITY, STANDARD OF HUMAN CAPITAL AND EU MEMBERSHIP HORIZONS.

FIGURE 2 SEE-6 and Turkey's share in total world GDP, 1950-2008, %



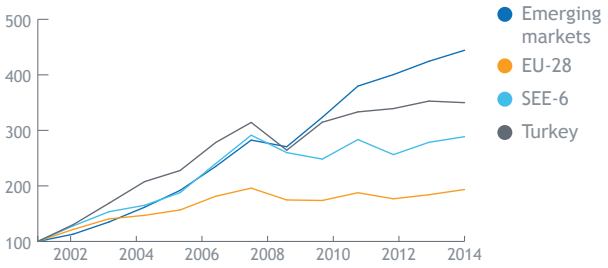
SOURCE: Maddison Project, TEPAV calculations

FIGURE 3 GDP per capita of Turkey and SEE-6, current USD, 2000-2014



SOURCE: World Bank World Development Indicators

FIGURE 4 Pre- and post-crisis growth trends, 2002 GDP = 100, 2002-2014



SOURCE: IMF, TEPAV calculations

HISTORICAL TRENDS

In contrast to Turkey, which is categorized as an emerging market, SEE-6 is currently not a region of growth and has not been one for over three decades. In fact, since 1980s, shares of SEE-6 and Turkey in the world's total GDP have been moving in opposite directions (see Figure 2).

In 1950, the economies of Turkey and SEE-6 combined constituted about 0.9 percent of the global economy. Prior to the financial crisis of 2008, the same figure for Turkey and SEE-6 economies had increased to about 1.4 percent. However, whereas Turkey's share in the world economy has grown rather steadily since the 1950s, SEE-6's story is much more complicated. Analysis shows that the region achieved relative growth until the Former Yugoslavia's final years. However, economic conditions rapidly deteriorated following its breakup. As a result, while Turkey and SEE-6's combined share in world economy remained around 1.4 percent between 1980s and 2000s, it did so because Turkey's growth balanced the dwindling SEE-6.

During the past few decades, Turkey's economic transformation became a source of inspiration for a number of developing economies. This transformation was driven by three key processes:

1. **Rapid urbanization**. Since the 1960s, Turkey experienced one of the fastest urbanization episodes in the world. Over 30 million Turks

rushed to urban centers, leaving their low-productivity agriculture jobs to be employed in higher value-added sectors in cities.

2. **Opening up.** Key reforms undertaken by Özal government in the 1980s such as price reforms, trade liberalization and capital market liberalization enabled Turkey to open up to the world, resulting in enhanced integration into the global economy and increasing export volumes.
3. **Stabilization and normalization.** The 1990s proved to be a lost decade for Turkey, with inflation rates hovering over 60 percent for years, onset by frequent political crisis. Following Turkey's 2001 crisis, an extensive wave of first generation reforms were carried out, driven by strong domestic political will and outside support from the IMF and the EU, leading to much stronger macroeconomic fundamentals, modernization in most industries and a growing middle class.

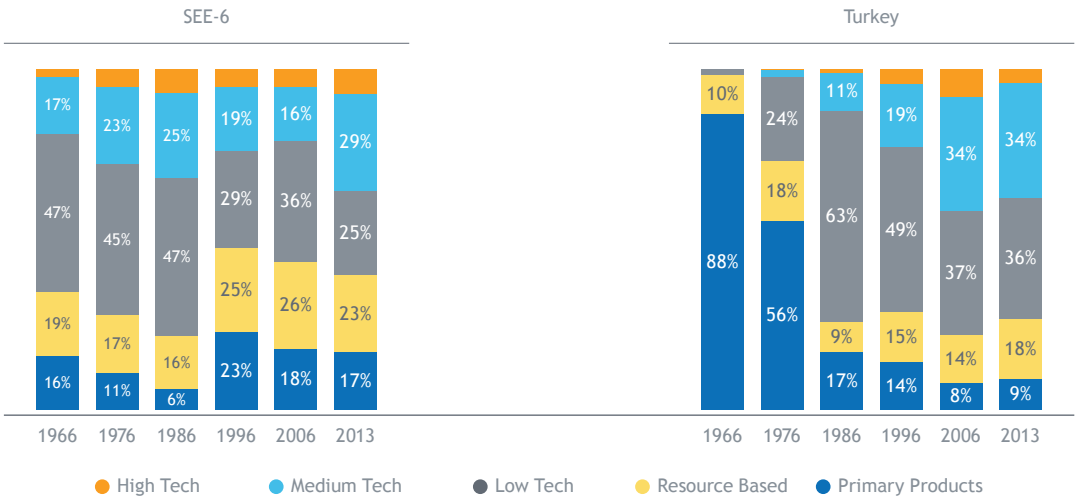
As a result, Turkey had an impressive growth episode averaging over 6 percent annual growth between 2002 and 2007. During this period, Turkey grew faster than the emerging market averages (see Figure 4). Over the past few years, however, Turkey's growth rate halved to a modest 3 percent average, leaving the country lagging behind the emerging markets. Aside from the negative spillover effects of the global financial crisis, this slowdown may be attributed to Turkey exhausting the gains of its primary engine of growth: urbanization.

The positive impact of Turkey's rapid urbanization on its production capacity may be observed by analyzing the historical sophistication levels of Turkey's export basket (see Figure 5). The share of primary products in Turkey's exports shrunk from 98 percent in 1964 to 20 percent in 2004. Hence, Turkey's top exports evolved from mainly labor intensive and unprocessed agricultural products such as nuts, cotton and tobacco in 1980 to mid-tech goods such as automobiles, white goods and mechanical machinery by 2013 (see Figure 6). Furthermore, Turkey's export basket also diversified during this period, with the share of top 5 products decreasing from 51 percent to 33 percent.

Since analyzing historical trends prior to the 1990s for the SEE-6 economies is difficult due to data limitations, we replicate the same analysis by benchmarking the post-breakup performance of the SEE-6 region as a whole against the Former Yugoslavia's performance going back to the 1960s (see Figure 5). This analysis spotlights the extent of region's lost capabilities due to political instability. By the mid-1980s, a third of the Former Yugoslavia's exports were mid-tech goods; transport equipment, mechanical machinery and electrical machinery (see Figure 7). However, this share declined to 16 percent for SEE-6 economies by 2006.

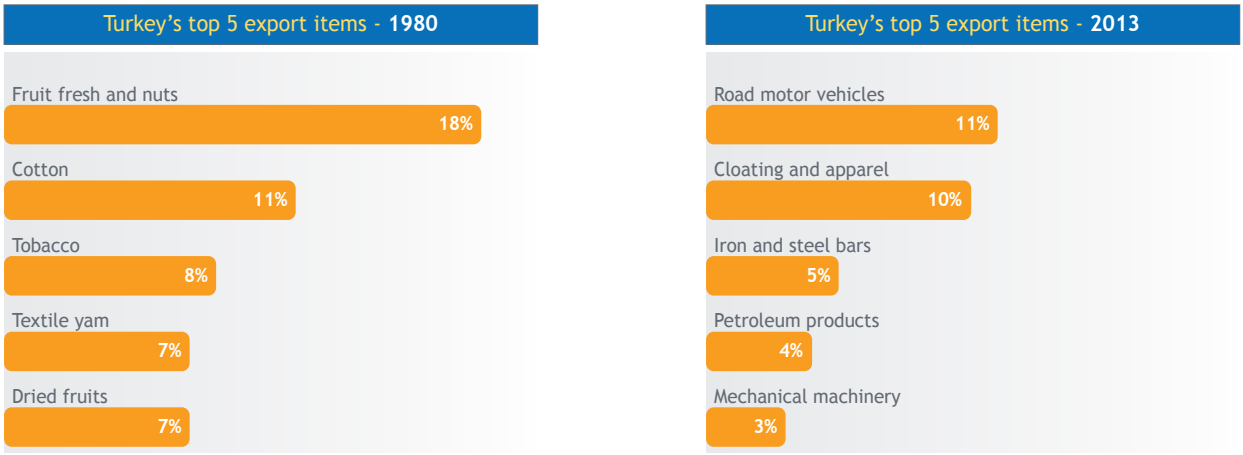
A comparison of the region's export baskets in 1980 and 2013 shows significant similarities: in both years, the region's top exports were automotive, textile and machinery. Therefore, even though it took them about two decades, SEE-6 economies are

FIGURE 5 Export sophistication of Turkey and SEE-6, 1966-2013



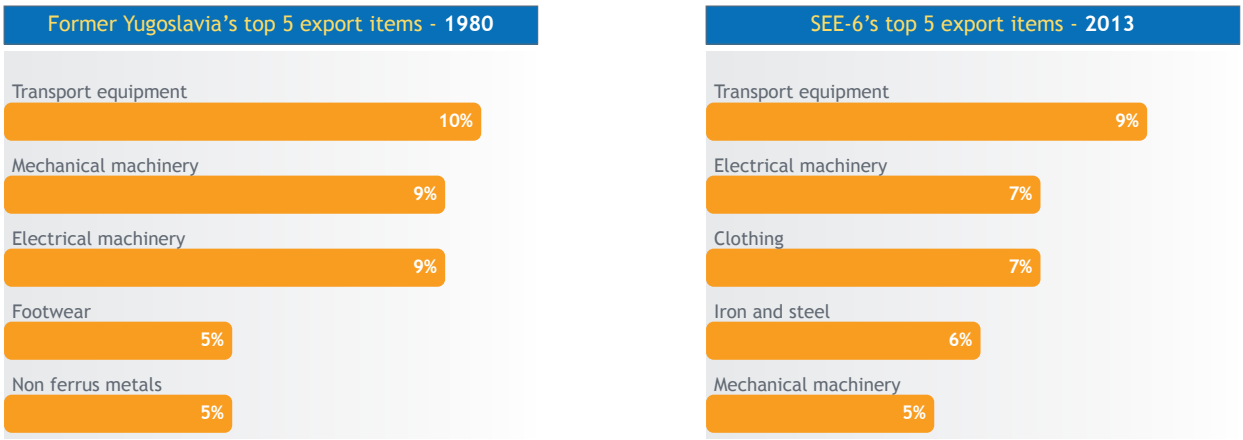
SOURCE: UN Comtrade, TEPAV calculations at STIC Rev. 1 and Rev 3. at 3 digit level

FIGURE 6 Turkey's top 5 export items in 1980 and 2013



SOURCE: UN Comtrade, TEPAV calculations at SITC Rev. 1 at 3 digit level

FIGURE 7 The Former Yugoslavia and SEE-6's top 5 export items in 1980 and 2013



SOURCE: UN Comtrade, TEPAV calculations at SITC Rev. 1 at 2 digit level

about to reach the level of the Former Yugoslavia's capabilities prior to its break up. Similarly, as Turkey's urbanization rates caught up with those of advanced industrial economies, its GDP per capita reached the $10,000 level. In the aftermath of the financial crisis, both SEE-6 and Turkey must strive to make the jump from low and mid-tech to being innovative economies.

So far however, neither Turkey nor SEE-6 economies have been able to make the jump to exporting high technology products. As of 2013, the share of high technology products in both Turkey's and SEE-6's exports remain below 5 percent. This is a significant shortcoming, given that in the current global setting, pre-crisis easy growth rates are simply no longer attainable.

As such, both Turkey and SEE-6 are in need of structural reform agendas aimed at preparing their institutions, infrastructure, companies and human capital to make the jump. This means equipping them with strategies to move away

SOPHISTICATION STRUCTURE OF TURKEY'S EXPORT BASKET SIGNIFICANT CHANGED SINCE 1960S, WITH THE SHARES OF PRIMARY AND RESOURCE BASED PRODUCTS DECLINING RAPIDLY, TO BE REPLACED BY MID-TECH GOODS. IN CONTRAST, SOUTH EAST EUROPE'S EXPORT SOPHISTICATION LEVELS REMAINED RELATIVELY STALE DURING THIS PERIOD.

from relying simply on cheap labor, consolidate their competitiveness in medium technologies and become high-tech players. Given their geography, the logical way for both SEE-6 and Turkey to achieve this transformation is to integrate further with the European Union. As will be discussed in the following pages, the EU membership horizon functions as a virtuous cycle for the New Member States (i.e. Poland, Hungary etc.) by both converging their institutions and integrating their economies with the EU. Similarly, any discussion on the future transformation of Turkey and SEE-6 must center on how to utilize the EU as an anchor for reform to complement and facilitate domestic economic transformation agendas.

TRADE TRENDS

REGIONAL TRENDS

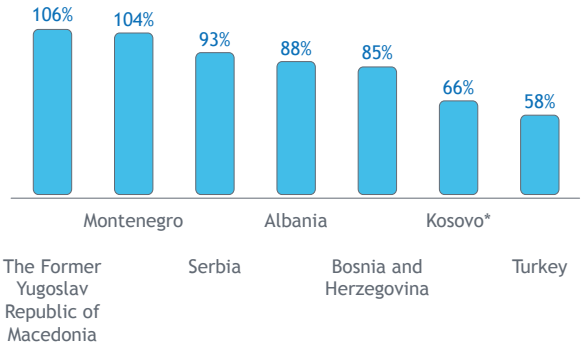
Despite the slowdown in global growth, export volume of SEE-6 continues to increase at rates well over the world average. SEE-6 exports grew by 9.1 percent in 2013 and by 9.3 percent in the first half of 2014, over triple the global average of 2.8 percent. This growth was to a large extent driven by Serbia's and The Former Yugoslav Republic of Macedonia's FDI-financed high value industrial product exports to core EU countries. In contrast, Turkey's export volume displayed a lackluster performance, shrinking by 0.4 percent in 2013 only growing by 3.8 percent in 2014.

As small economies in the middle-income range, SEE-6 economies can be classified as open economies. With the exception of Kosovo*, all SEE-6 economies have trade-to-GDP ratios of near or over 90 percent (see Figure 8). Compounded by their proximity to EU markets, such trade openness rates lead to the region being highly reliant on the growth trends in the Eurozone. In 2013, the share of goods exports to the EU constituted 62.4 percent of SEE-6's total exports. Moreover, the share of intra-regional trade in total SEE-6 exports was 24.7 percent for the same year. As a result, nearly 90 percent of all goods exported from SEE-6 goes either to the EU or the SEE-6 region itself. This figure goes a long way in explaining the adverse effects of the Eurozone's continuing economic slump on the vulnerable SEE-6 economies.

In Figure 9 and Figure 10, we visualize the world map in accordance with bilateral trade volumes of SEE-6 and Turkey, where other economies are both sized and colored in proportion to their shares in SEE-6's or Turkey's total trade.

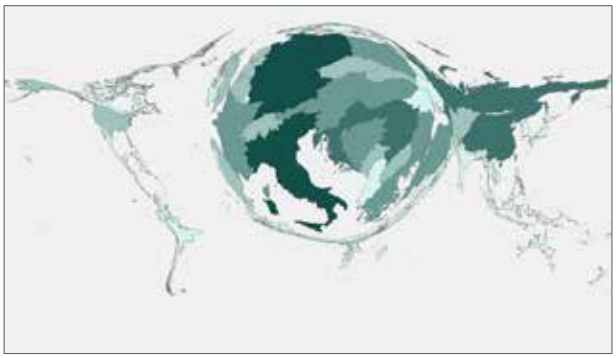
The resulting images stress the need for SEE-6 to diversify its trade partners as a risk management strategy given the recent disappointing rates of recovery in the EU-28. In contrast, although far from being perfect, Turkey's trade cartogram displays that the country was able to diversify its export destinations by adding MENA markets to the mix. Indeed, between 2005 and 2013, share of EU in Turkey's export basket decreased from 59 percent to 43 percent, whereas MENA's share increased from 16 percent to 26 percent. However, neither the SEE-6 economies nor Turkey are able to compete in two of the largest and most stable markets in the world: Asia and North America.

FIGURE 8 Openness of SEE-6 and Turkish economies, share of total trade as % of GDP, 2013



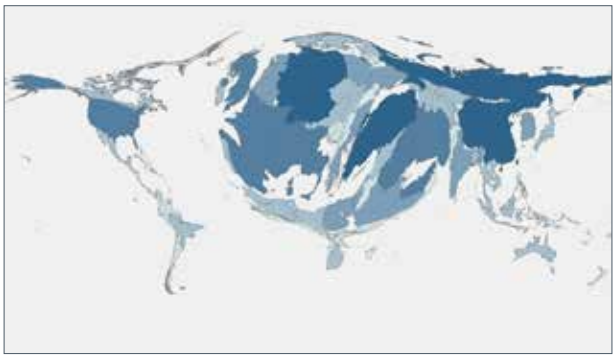
SOURCE: IWorld Bank World Development Indicators

FIGURE 9 SEE-6's trade cartogram, 2013



SOURCE: UN Comtrade, TEPAV calculations at HS1996

FIGURE 10 Turkey's trade cartogram, 2013



SOURCE: UN Comtrade, TEPAV calculations at HS 1996

SECTORAL TRENDS

Not all sectors' performance runs parallel to the macro trends of the region. Therefore, we start by analyzing trade data at the two-digit level which covers 99 sub-sectors. This analysis in turn will feed directly into our analysis for section 3, in which we dig deeper into the performances of key sectors in order to uncover opportunity areas and generate business inspirations.

Analyzing trade data at the sectoral level enables us to see the sectors in which the region is a net exporter and net importer. The top 10 sectors in terms of traded total volume in 2013 by SEE-6 economies are energy, automotive, electrical machinery, mechanical machinery, plastics, iron and steel, pharmaceuticals, aluminum and business services (see Figure 11). Out of its 10 most traded sectors, SEE-6 runs a trade deficit in eight, only having a surplus in two metals sectors. As a result, in 2013, SEE-6 had a trade deficit of 12.2 billion USD. About 40 percent of this deficit is constituted by the region's energy imports, which surpassed 7 billion USD, translating into 400 USD of energy imports per capita for the region as a whole. Even though the region runs a trade deficit in automotive and machinery sectors, there are also a significant amount of local capabilities in these sectors, as indicated by the region's export performance (see Figure 11).

In order to assess the region's competitive capabilities, we look at the top 10 sub-sectors with a trade surplus (see Figure 12). All these sub-sectors can be grouped under four main areas: textile, wood processing, metal processing, and agrofood. To make sure that we have not overlooked any key sectors, we analyzed the region's sectoral export growth performances overtime (see Figure 13). By juxtaposing the pre-crisis and post-crisis average annual growth rates of SEE-6's exports, we are able to see the sectors that sustained growth throughout the crisis (top right quadrant; such as electrical machinery) and the sectors that were jumpstarted during and following the crisis (top left quadrant, such as automotive). Products in the bottom quadrants have been performing poorly in comparison and require attention to revive (or are simply outmoded industries).

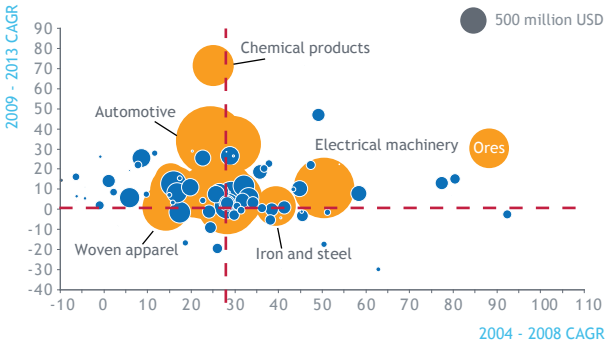
FIGURE 11 SEE-6's top traded sectors, billion USD, 2013

SOURCE: UN Comtrade, TEPAV calculations at HS 1996 2 digit level

FIGURE 12 SEE-6's top 10 surplus sectors, billion USD, 2013

SOURCE: UN Comtrade, TEPAV calculations at HS 1996 2 digit level

FIGURE 13 Growth performance of SEE-6's exports at sectoral level, 2004-2013



SOURCE: UN Comtrade, TEPAV calculations at HS 1996 2 digit level.
Note: Bubble sizes indicate SEE-6 total export volume in 2013. Sectors with volumes larger than 500 million USD indicated with red color. Axes' marked at average growth rates of respective periods.

DEMOGRAPHICS

MIGRATION

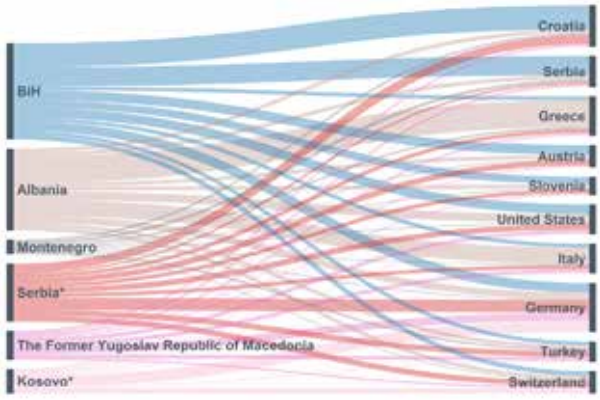
SEE-6's population is declining. According to World Bank data, between 1990 and 2014, the region's total population shrank from 19.9 million to 18.4 million, translating to an average decrease of 60,000 people every year.

The primary cause of this dynamic is the significant levels of outward migration from SEE-6 economies to mainly EU member states. By one estimate, between 1990 and 2010, over 2 million people migrated from the region in search of a better life. The economy that lost the most people due to migration was Bosnia and Herzegovina, followed closely by Albania and Serbia (see Figure 14). In comparison to these economies, migration levels from The Former Yugoslav Republic of Macedonia and Montenegro remain limited. This trend still exists, with over 100,000 people from SEE-6 applying for asylum in the EU-28 in 2014, though only about 4 percent of all claims were recognized (see Figure 15).

Top destinations for South East European migrants outside the SEE-6 region are to Greece, Italy, Croatia, Germany and Austria. However, each SEE-6 economy has a different migration profile (see Figure 14). Whereas Bosnians to a great extent migrated to Croatia, Serbia and Germany, Albanians migrated mainly to Greece and Italy. In contrast, Serbians migrated to Germany, Bosnia and Herzegovina, the United States and Switzerland. Even though there is no data on the education level of the South East European migrants, in our interviews with academics and employers, the commonly voiced pattern was migration of the best graduates to either the core EU countries or the United States to be employed in well-paying jobs.

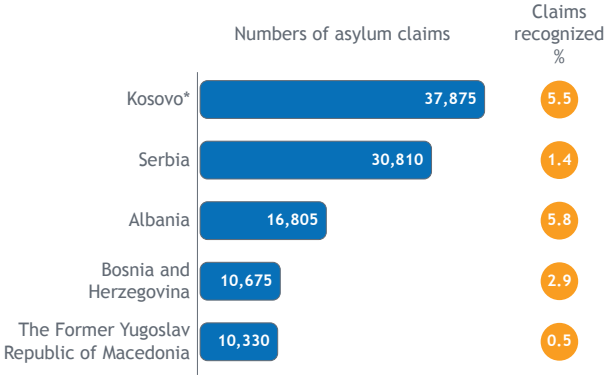
As a result of the significant numbers of South East Europeans living abroad, remittance flows have become important part of SEE-6 economies. Although their overall share has been decreasing, in 2014, remittance flows to SEE-6 still constituted 7.8 percent of regional GDP (see Figure 16). Remittance inflows are particularly important for Bosnia and Herzegovina and Kosovo*, constituting over 10 percent of their respective GDPs. One important factor driving the decrease in remittance inflows to SEE-6 economies is the lackluster growth performance and increasing unemployment in EU-28 countries. Especially the sharp decrease in remittance inflows to Albania may be explained by the fact that most Albanians migrate to Greece and Italy, two of the economies that were hit most significantly by the Eurozone crisis (see Figure 16).

FIGURE 14 Migrants from SEE-6 economies, by source and destination, 2013



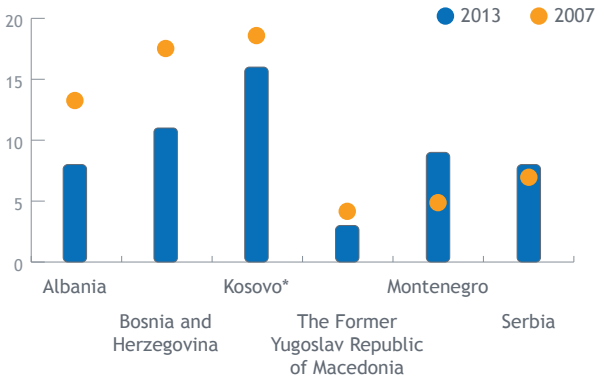
SOURCE: World Bank Bilateral Migration Database

FIGURE 15 Asylum claims by SEE-6 residents in the EU-28, 2014



SOURCE: Eurostat, The Economist, TEPAV calculations

FIGURE 16 Remittance inflows, 2007 and 2013, % of GDP



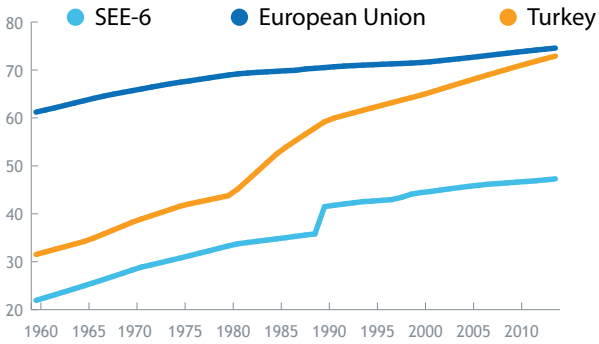
SOURCE: World Bank World Development Indicators

GROWTH OF URBAN ECONOMIES

Differences in urbanization trends may explain part of the economic performance gap between Turkey and SEE-6. Turkey's rapid urbanization experience that sped up especially in the 1980s, was the primary engine of economic growth. As Turkey moved its population away from lower value-added agricultural jobs to higher value-added jobs in services and manufacturing, the value of its total output increased automatically.

Figure 18 displays the urbanization trends of Turkey, SEE-6 and EU-28 since 1960. The 1980s constitute a rupture in which Turkey's urbanization levels diverged from the SEE-6 levels and started to converge towards those of the EU. Even though Istanbul, Ankara and Izmir were the most important attraction centers for Turkey's urbanization, there emerged secondary centers in Anatolia such as Bursa, Konya, Kayseri, Denizli and Gaziantep, and functioned as hubs for their immediate surroundings. Therefore, density in Turkey occurred in two dimensions simultaneously: from poorer Eastern Turkey to more prosperous Western Turkey and from rural districts with limited opportunities to city centers with more abundant resources.

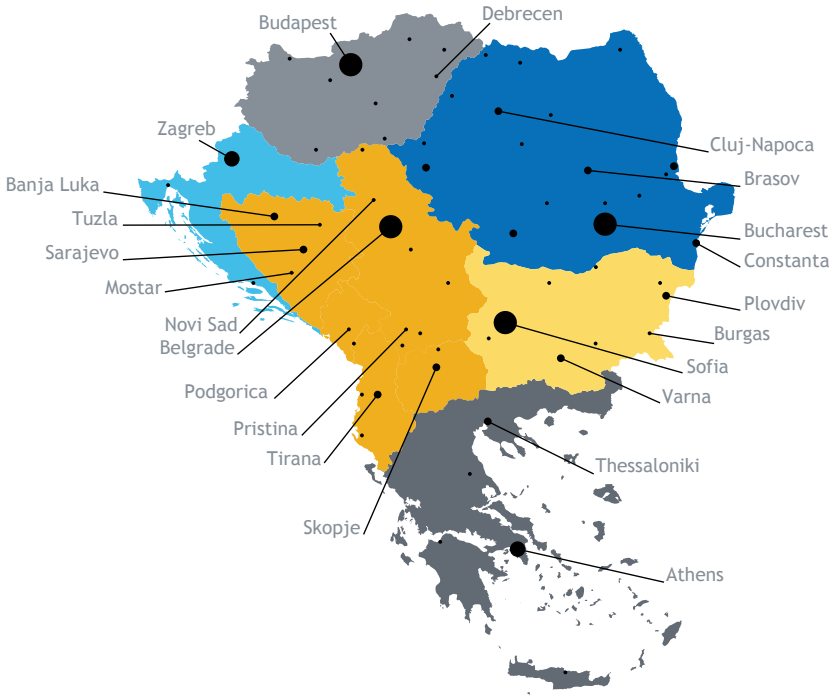
FIGURE 18 Urbanization levels of SEE-6, Turkey and EU-28, urban population as % of total population, 1960-2014,



SOURCE: World Bank World Development Indicators, TEPAV calculations

Whether SEE-6 economies experience a rapid episode of urbanization in the near future remains to be seen. If they do though, such a transformation will surely drive up overall productivity in the region, accelerating convergence in living standards to EU levels. However, it is debatable whether the basic infrastructure of the region's principal urban areas is ready to host a potential influx of arrivals from the countryside.

FIGURE 17 Settlements larger than 100.000 people in an around the SEE-6 economies (2014, compiled by TEPAV team)



SOURCE: National Geophysical Data Center, National Oceanic and Atmospheric Administration.
Visualized by TEPAV using 2015 Natural Earth 1:10m national boundary shapefiles in ARCGIS with a constant gamma stretch value of 2.0

BOX 1 Measuring growth from outer space

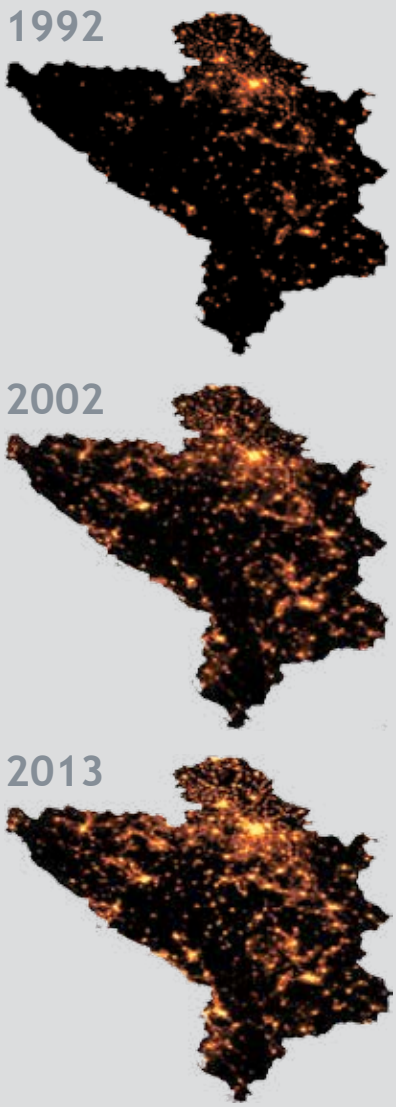
During the last two decades, the Defense Meteorological Satellite Program of the United States launched nine satellites with Operational Line Scanners to detect and collect data on global atmospheric events. The optical lenses of these scanners were also able to observe and record visible to near-infrared emissions, such as city lights. Since the establishment of a digital archive in 1992, the generated nighttime imagery has been increasingly used by the scientific community.

Very recently, this data has been utilized by social scientists as a proxy to research numerous social phenomena. Among these, the satellite imagery enables us to monitor human settlements without man-made borders, estimate urban populations, track economic activity trends through electricity and energy consumption, and calculate damage from natural disasters and armed conflicts.

The TEPAV team decided to make use of this novel methodology as it allows us to identify both sub-national growth pockets and supra-national settlement clusters and growth corridors in SEE-6 economies, Turkey, as well as the wider neighborhood for the past two decades. We are thus able to comment on the recovery performances of SEE-6 economies from the devastating effects of the Former Yugoslavia's breakup, detect zones that are either prospering or lagging behind, trace newly forming corridors of growth, and visualize the missing links between settlements.

Here, we to calculate the growth of national light emissions of each SEE-6 economy between 1992-2002 and 2002-2013. We are able to do this, because the satellite images are made up of millions of pixels (each corresponding roughly to 0. 9 km2) and each pixel has a value ranging from 0 to 63 in accordance with its brightness. So, we add up the brightness value of each pixel within the boundaries of an economy to track changes in total brightness between years (see Table 1).

The results are interesting to say the least. Bosnia is the top performer during both, the 1992-2002 and the 1992-2013 periods, probably due to the low base effect of the ongoing armed conflict in 1992. In the second period though, Sebia's nightlights grew over 50 percent while The Former Yugoslav Republic of Macedonia was able to increase its light emission by only 12 percent.



SOURCE: National Geophysical Data Center, National Oceanic and Atmospheric Administration.
Visualized by TEPAV using 2015 Natural Earth 1:10m national boundary shapefiles in ARCGIS with a constant gamma stretch value of 2.0.

TABLE 1 Luminosity growth in SEE-6 economies, 1992-2013

	1992 total pixel value	2002 total pixel value	2013 total pixel value	1992-2002 growth	2002-2013 growth	1992-2013 growth
Albania	149973	212227	280124	41.51%	31.99%	86.78%
Bosnia and Herzegovina	335729	507248	710066	51.09%	39.98%	111.50%
Montenegro	93074	110867	155821	19.12%	40.55%	67.42%
Kosovo*	89729	121244	169227	35.12%	39.58%	88.60%
Serbia	748177	955310	1434281	27.69%	50.14%	91.70%
The Former Yugoslav Republic of Macedonia	175724	261557	293952	48.85%	12.39%	67.28%

Using the same dataset, we can trace the spatial development patterns in Turkey. These patterns offer a useful way to understand where and how change in Turkey is taking place.

In 1992, Turkey looks like a country with a few major urban agglomerations. Istanbul and its hinterland (Kocaeli-Bursa) appear to be the major growth corridors. The other major centers in 1992 were the cities of Ankara, Izmir and Adana-Mersin. In addition to these, there are a few discrete centers in inland Anatolia, such as Konya and Gaziantep, around which there is, as it appears, very limited economic activity.

When we come to 2013, we witness a drastic change in the spatial dynamics of the country. The three main patterns can be summarized as follows:

i. There is a striking increase in luminosity all around the country, with several districts lighting up. This may be a testament to the inclusive growth process that Turkey has gone through in the last two decades.
ii. The number of regional centers has increased and has become much more luminous. In addition to the ones that already existed in 1992, we now have industrial cities such as Denizli, Kayseri and regional attraction centers such as Antalya, Erzurum and Sivas.
iii. A number of regional corridors have become much more visible. One corridor is in the Marmara Region, connecting Istanbul, Tekirdağ, Kocaeli, Sakarya as well as Bursa and Eskişehir. A second corridor is visible in the Aegean Region, connecting Izmir with its hinterland, mostly Manisa and Denizli. The third growth corridor is in the South, connecting Mersin-Adana-Iskenderun-Gaziantep as well as Şanlıurfa. The growth of this corridor is largely due to Turkey's increasing ties with the MENA market, particularly Iraq's reconstruction process.

1992

2013

SOURCE: National Geophysical Data Center, National Oceanic and Atmospheric Administration.
Visualized by TEPAV using 2015 Natural Earth 1:10m national boundary shapefiles in ARCGIS with a constant gamma stretch value of 2.0

INSTITUTIONAL BENCHMARKING

Having a very narrow domestic private sector base, the SEE-6 economies significantly depend on continuous flows of foreign capital to increase competitiveness and sustain economic growth. The region enjoyed increasing FDI inflows in the pre-crisis period due to high risk appetite in the global economy, but these inflows halted to a great extent after 2009. In the post-crisis economic environment, the quality of the region's national institutions is expected to increasingly affect foreign investor's decisions for new investments or upgrades of existing ones.

All of the SEE-6 economies are categorized by the World Economic Forum as being in the 'efficiency driven' stage of development, whereas Turkey is categorized as a economy in transition from being 'efficiency driven' to 'innovation driven.' In order to increase competitiveness, economies in the efficiency driven stage of development need to upgrade their production processes and increase product quality. Hence, improvements in competitiveness in such economies may be achieved by:

1. Improving higher education and training,
2. Increasing efficiency of goods markets,
3. Streamlining the functioning of labor markets,
4. Upgrading financial markets,
5. Utilizing the benefits of existing technologies, and,
6. Establishing and maximizing levels of access to domestic or foreign markets.

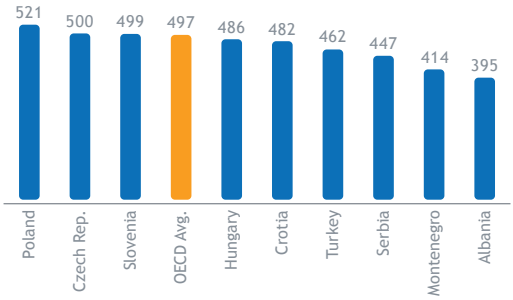
Indeed, in these pillars, SEE-6 economies score between 3 to 5 points on a 7 point scale (i.e., WEF competitiveness pillars 5, 6, 7, 8, 9, 10). As such, improving institutional quality in the above cited areas would substantially increase the prospects of the region for boosting FDI inflows.

In terms of education, indicators for the region tell a mixed story. The OECD's Programme for International Student Assessment (PISA) test was carried out in 65 countries with over 500,000 15-year olds provides and provides an important avenue to benchmark available SEE-6 participants against the rest of the world. Serbia, Montenegro and Albania's average scores in mathematics, science and reading tests were significantly below the OECD average, with Albania consistently scoring in the bottom decile (Figure 19). However, in terms of mean years of schooling, SEE-6 economies appear to be doing much better than Turkey (see Figure 20). Therefore, in education, quality, not quantity seems to be a problem of SEE-6 economies.

TABLE 2 Luminosity growth in SEE-6 economies, 1992-2013

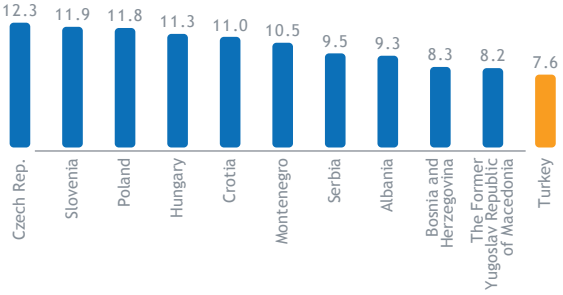
	ALB	MKD	MNE	SRB	TUR
Institutions	3.4	4.3	4.0	3.2	3.9
Infrastructure	3.5	3.7	4.1	3.9	4.6
Macroeconomic env.	3.8	4.9	4.5	3.5	4.8
Health & primary educ.	5.8	5.6	6.3	5.8	5.8
Higher education	4.5	4.3	4.7	4.3	4.7
Goods market efficiency	4.2	4.6	4.3	3.8	4.6
Labor market efficiency	4.0	4.2	4.2	3.7	3.5
Financial markets	3.4	4.5	4.3	3.5	4.2
Technological readiness	3.3	4.0	4.3	4.4	4.3
Market size	2.9	2.9	2.2	3.7	5.3
Business sophistication	3.6	3.8	3.7	3.2	4.3
Innovation	2.7	3.3	3.4	2.9	3.4

FIGURE 19 OECD PISA average scores for Turkey, SEE-6 and other economies, 2012



SOURCE: OECD average scores for math, science and reading tests.

FIGURE 20 Mean years of schooling in Turkey, SEE-6 and other economies, 2014



SOURCE: Human Development Index

In terms of physical connectivity, bar some exceptions, the region as a whole is a long way off from reaching the EU-28 level. However, to a certain extent, this is counterbalanced by the short distances between destinations in the region. Furthermore, a nontrivial share of primary roads are not yet dual carriageways. As of 2010, 2600 kilometers of the 6000 kilometers of regional core road network was rated as being in medium, poor or very poor condition. Similarly, 3800 kilometers of the existing 4600 kilometer long railway network was rated to be at or below medium condition. Therefore, inclusion of the SEE-6 economies in the Pan-European Transport Corridors provides an important opportunity to boost the connectivity of the region, both within itself and with the EU-28 (see Figure 21). Still, physical infrastructure is not the only factor in which SEE-6 lags behind when compared to its EU member neighbors. Table 3 benchmarks SEE-6 economies' performance in the Logistics Performance Index with each other and with Turkey. It indicates that SEE-6 economies trail behind Turkey in efficiency of the clearance process (i.e., speed, simplicity and predictability of formalities) by border control agencies and in competence and quality of logistics services (e.g., transport operators, customs brokers).

TABLE 3 Logistics Performance Index scores for Turkey and SEE-6, 2015

	BIH	MKD	MNE	SRB	TUR
Customs	2.4	2.4	2.8	2.4	3.2
Infrastructure	2.6	2.5	2.8	2.7	3.5
International shipments	2.8	2.4	3.1	3.1	3.2
Logistics quality and competence	2.7	2.5	2.5	3.0	3.6
Tracking and tracing	2.6	2.5	2.8	2.9	3.8
Timeliness	3.4	2.8	3.2	3.6	3.7

SOURCE: World Bank, Logistic Performans Index

The Doing Business Index (DBI), also an important benchmarking tool for comparing business environment. Table 4provides a breakdown of SEE-6 economies' and Turkey's performance in multiple pillars in the DBI's 2015 edition. Accordingly, there are significant disparities in the region's regulatory environments on starting and operating firms, ranging from The Former Yugoslav Republic of Macedonia's position as 3rd to Bosnia and Herzegovina's position as 147th in the Starting Business sub-index. An important point of which the implications will be further discussed in the upcoming sections are the widespread issues with construction permits, getting electricity and registering property sub-indices, signaling the need for an improved regulatory framework for greenfield foreign direct investment projects. This shortcoming is further exacerbated by the inadequate investment promotion frameworks in effect in the SEE-6 economies. The OECD's investment policy review of SEE-6 economies comment that while there have recently been improvements in investment promotion and facilitation mechanisms in the region, the region significantly underperforms compared to the EU, scoring on average 2 out of 5 points.

FIGURE 21 Planned Pan-European Transportation Corridors, 2015

SOURCE: Wikimedia Commons

TABLE 4 Doing Business Index scores for Turkey and SEE-6, 2015

	ALB	BIH	KSV*	MKD	MNE	SRB	TUR
Doing Business Rank	107	75	30	36	91	55	55
Starting Business	147	42	3	56	66	79	79
Dealing with Construction Permits	182	135	89	138	186	136	136
Getting Electricity	163	112	88	63	84	34	34
Registering Property	88	34	74	87	72	54	54
Getting Credit	36	23	36	4	52	89	89

SOURCE: World Bank, Doing Business

EU MEMBERSHIP PROSPECTS

One of the most attractive features of the EU is probably the growth prospects it offers to poorer countries in its neighborhood. The EU economic model has served as a "convergence machine," taking in low and middle-income countries and helping them transform into advanced industrial democracies.

The most recent episode of this economic and institutional convergence was observed in Eastern Europe following the end of the Cold War. With the signing of the first EU Association Agreements by Eastern European economies in 1993, national governments began undertaking necessary reforms to join the Union. By late 1990s, the Eastern Bloc countries had covered enough ground for the Commission to rule in favor of starting membership negotiations. During this period, significant sums of foreign direct investments were channeled from the core EU countries, as numerous companies set up production facilities in Eastern Europe to take advantage of significantly lower costs.

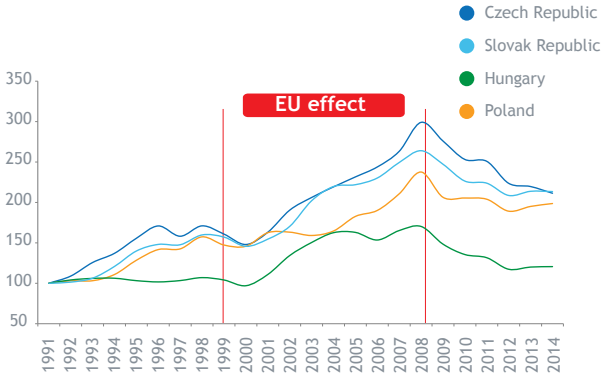
As a result, the period from the mid-1990s up until the outbreak of the global financial crisis produced a decade of convergence in living standards, production capabilities and institutional quality in the member states of the 2004 Enlargement wave.

Figure 22 shows that between the start of negotiations in 1999 until 2008, the Czech Republic, Poland and Hungary experienced significant boosts in their GDPs, primarily as a result of the spillover effects of the accession, and later on membership.

For the SEE-6 economies and Turkey, the European Union membership horizon remains a vital structural reform anchor that has the potential to facilitate further institutional convergence and economic integration with European markets. Currently, Albania, The Former Yugoslav Republic of Macedonia, Montenegro, Serbia and Turkey are EU candidate economies, whereas Bosnia and Herzegovina and Kosovo* are qualified as "potential candidates" by the EU. Therefore, all seven economies are and will be undergoing similar processes in order to align their political and economic institutions in accordance with the acquis *communautaire*.

In Figure 23 we attempt to show the 'EU effect' once again, employing satellite imagery to trace the luminosity patterns of the continent recorded from outer space as a proxy of economic activity. Three satellite maps of the wider European region on 1992, 2002 and 2012 clearly display how the New Member States (NMS) 'light up' in a timespan of two decades.

FIGURE 22 Change in the Czech Republic, Poland and Hungary's share in the world's total GDP, 1991-2013, 1991=100



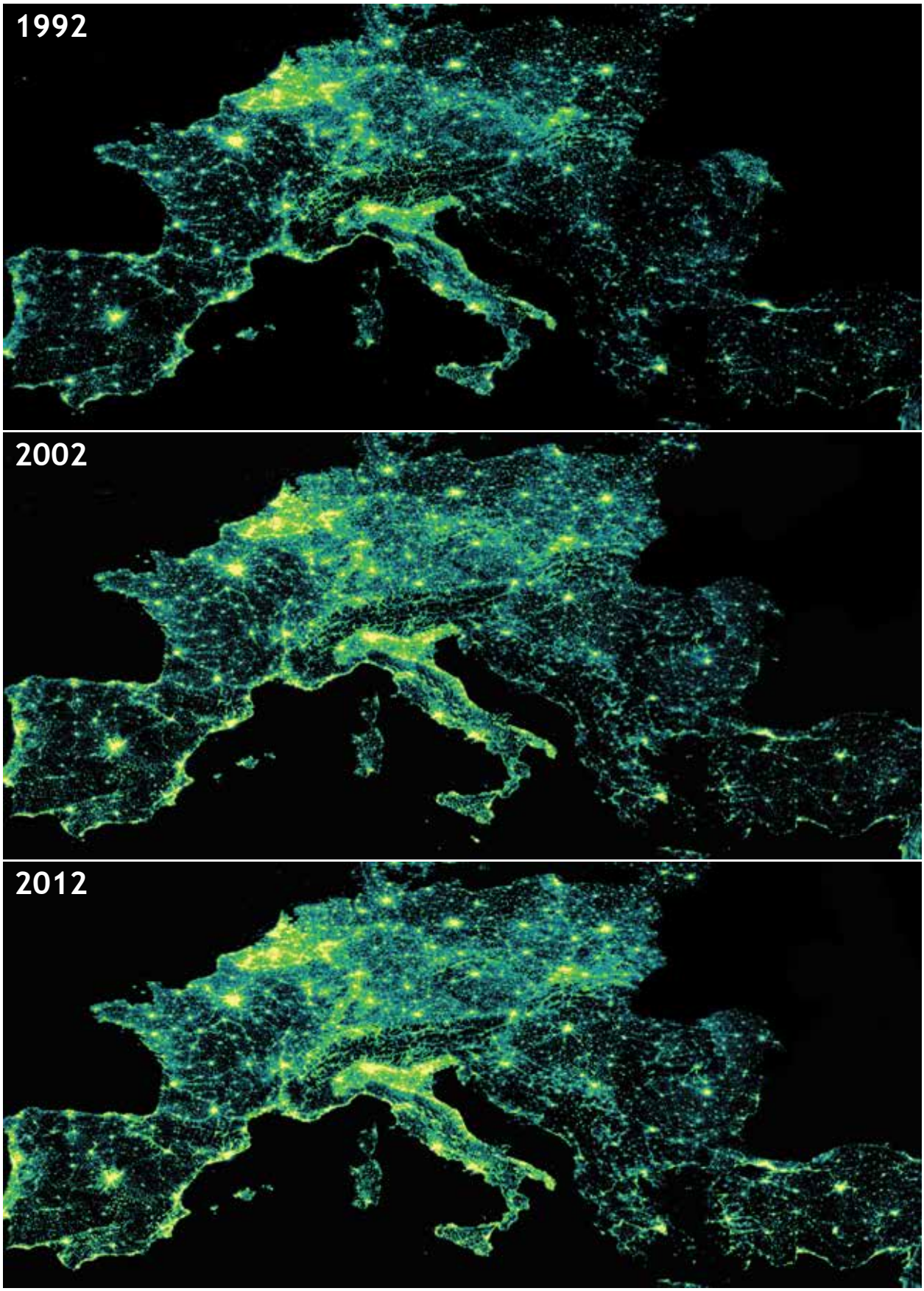
SOURCE: World Bank World Development Indicators, TEPAV calculations

This rapid increase in luminosity in NMSs also attests to the de-industrialization process of core EU countries in which production centers were relocated to the periphery of Europe. As such, the increases in luminosity levels in Poland, the Czech Republic and Romania are especially important indicators of investment inflows and the establishment of value chains around investments in these economies.

The light map of 2012 puts the need of economic transformation for SEE-6 economies into perspective. Although there were sizable improvements in the past two decades, South East Europe remains one of the darkest regions in the triangle between Turkey, Germany and Italy. Hence, SEE-6 economies are the most likely candidates for the future growth spillover from the EU's convergence machine.

However, this potential transformation process will not unfold automatically. If the SEE-6 economies are to become the continent's new production hub, they need to avoid being entrapped in institutional inertia and carve out a path of reform. It is exactly at this stage of transition that an increasing involvement of the Turkish private sector in SEE-6 may prove to be a crucial driver of competitiveness.

FIGURE 23 Light maps of the wider European region in 1992, 2002 and 2012



SOURCE: National Geophysical Data Center, National Oceanic and Atmospheric Administration.
Visualized by TEPAV using 2015 Natural Earth 1:10m national boundary shapefiles in ARCGIS with a constant gamma stretch value of 2.0

VALUE CHAIN INTEGRATION

As the world's economies focus on their comparative advantages, production lines have been diversified across continents. Today, most of the manufactured goods being traded are parts to be assembled in another country[3]. The production structure has became globally interlinked in the last two decades with the help of a significant decrease in trade costs and liberalization of trade and investments.[4]

A value chain is defined as, a "full range of activities that firms and workers do to bring a product from its conception to its end use and beyond".[5] Vertical integration processes of firms provide the opportunity to get involved in different stages of adding value.

Building a whole production line from scratch is neither optimal nor possible, especially for small economies that meet the demands of a small market. Expertise on a business function can yield a chance to benefit from large scale of economies both in terms of quantitative output and qualitative dimensions such as knowledge accumulation. In addition to the effectiveness of vertical integration, firms choose to be globally linked and adopt a market-seeking approach in order to be close to the demand side of the goods in question.[6]

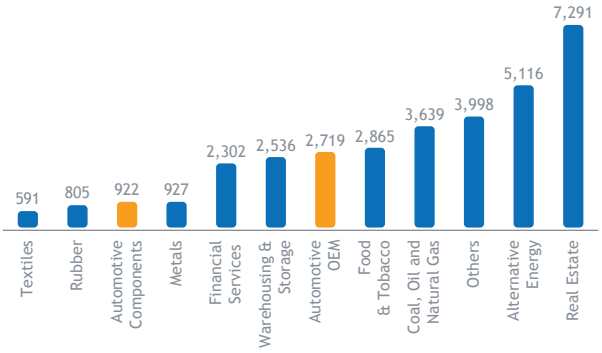
As small markets, SEE-6 economies have limited domestic capital bases, requiring mobilization of foreign savings in the form of direct, greenfield and long term investments in order to upgrade their productive capacity and trigger export growth. Therefore, basing the analysis only on production or export data does not allow us to grasp the full economic transformation potential of the region; we also have to uncover the linkages between investment inflows and product outflows.

In order to emphasize the transformative capacity of key investments, we go over two examples experienced in Serbia and The Former Yugoslav Republic of Macedonia in the past few years.

Serbia has received significant amounts of FDI inflows to numerous sectors between 2003 and 2014. One of the most important investments to Serbia recently was Fiat's new plant in Kragujevac, which constitutes the bulk of the automotive industry investments to the economy (see Figure 24). Fiat invested €1 billion into the plant, which became operational in 2011. In order to highlight this single facility's impact on Serbia's exports, we trace the volume of motor cars and vehicle outflows between 2005 and 2014 (see Figure 25). As can be seen, following Fiat's investment, Serbia's motor cars and vehicles exports skyrocketed from being virtually nonexistent, to 2 billion USD in just two years.

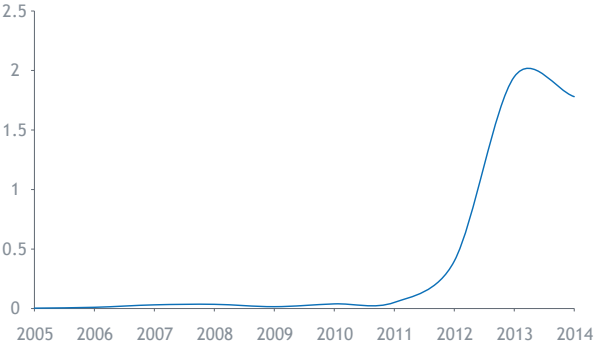
A similar narrative, again in the automotive sector, is encountered in the case of The Former Yugoslav Republic of Macedonia. Johnson Matthey invested €80 million to build an emission control catalyst manufacturing plant in Skopje TIDZ in 2010. In 2012, the company further invested €60 million to expand their production capacity. This plant currently supplies auto catalysts to various brands, mostly located in Germany. Similar to the Fiat case, we trace the growth of the economy's exports in the specific product that this plant manufactures and exports: Following Johnson Matthey's investment, the economy's exports of automobile reaction initiators and catalysts catapulted to reach 1

FIGURE 24 FDI inflows to Serbia by sector, million USD, 2003-2014



SOURCE: fdimarkets, TEPAV calculations

FIGURE 25 Serbia's automobile exports, billion USD, 2005-2014

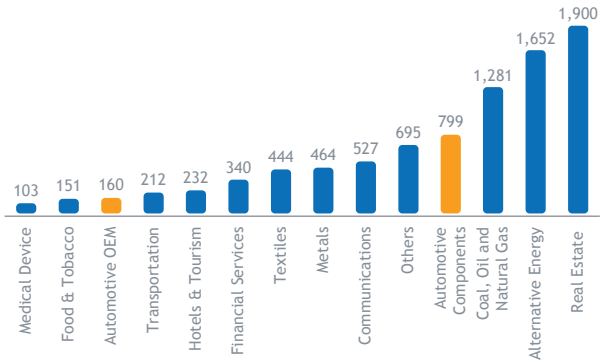


SOURCE: UN Comtrade, TEPAV calculations, at HS 1996 2 digit level: 87

billion USD in a matter of four years, with the expansion of the project visibly increasing export performance (see Figure 27). Owing to the success of this investment, The Former Yugoslav Republic of Macedonia is the only SEE-6 economy to have a trade surplus with Germany. Furthermore, following this success story, other automotive OEM suppliers also started to invest, signaling the formation of a larger supply chain (see Figure 26).

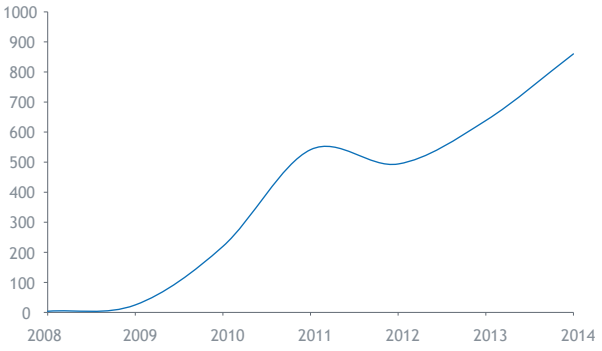
These two short case studies go a long way in illustrating the transformative potential of the 'right' investments in developing economies. Foreign investments in high-tech manufacturing sectors boost competitiveness by upgrading the skills of the workforce, facilitating the creation of an SME-based value chain around larger investments, and leading to export growth.

FIGURE 26 FDI inflows to The Former Yugoslav Republic of Macedonia by sector, million USD, 2003-2014



SOURCE: fdimarkets, TEPAV calculations

FIGURE 27 The Former Yugoslav Republic of Macedonia's reaction initiator exports, million USD, 2008-2014



SOURCE: UN Comtrade, TEPAV calculations at HS 1996 4 digit level: 3815

SINERGIES IN VISIONS

Inspired by the Europe 2020 strategy, both in scope and methods, the SEE 2020 goals comprise a strategy devised with the aim of achieving economic development in order to facilitate the region's eventual integration with the European Union. Perhaps the most significant feature of the SEE 2020 strategy is the legitimacy of its framework. The strategy was prepared under RCC's oversight in a collaborative process that brought together national administrations, regional bodies and relevant actors first to deliberate on and then to act for the region's common future.

The SEE 2020 strategy rests on three simple, yet ambitious overall strategic goals: expedite economic convergence with the EU-28, expand trade volume, and reduce trade deficit. More specifically, at their time of inception, these goals targeted increasing the region's GDP per capita relative to the EU average from 36.5 percent to 44 percent, its total trade from 94.4 billion USD to 200 billion USD, and reducing its trade deficit from -15.7 percent of GDP to -12.3 percent of GDP in the span of a decade. The process of moving towards these goals is also expected to yield 1 million new jobs in the region as a whole.

These three goals will be achieved through a set of five interlinked pillars of integrated, smart, sustainable and inclusive growth and good governance. The integrated growth pillar aims at strengthening SEE-6's inner economic integration through increased intra-regional trade and by increasing the regions' global integration through increasing investment inflows. The smart growth pillar aims at transforming the SEE-6 to become more knowledge-based economies by designing policy actions aimed at increasing value added per worker and the stock of human capital. The sustainable growth pillar aims at creating resource-efficient national economies by improving the use of resources, upgrading physical infrastructure and increasing the competitiveness of the private sector. The inclusive growth pillar aims at making sure that all groups of society reap the benefits of regional economic growth equally through the design of all-embracing labor market institutions and health reforms. The good governance pillar is a cross-cutting component that aims to ensure efficient implementation of policies and measures in the previous four pillars by setting up and sustaining a conducive institutional framework.

Regarding Turkey's growth strategy, the ambitious Vision 2023 introduced in 2011 by the Turkish

government aims at making Turkey one of the world's top 10 economies by 2023. The two most well-known overall targets in the strategy are increasing GDP to 2 trillion and total exports to 500 billion USD by 2023.[7] This vision remain the main pillars of milestone documents such as the Tenth Development Plan.

A basic comparison of the two visions reveals significant similarities. The fact that both the SEE and Turkey concentrate their efforts in increasing GDP, GDP per capita, exports, labor force participation etc. signals similar paths for reform may be taken by SEE-6 and Turkey. Furthermore, Turkey's rapid transition from 5,000 USD per capita income to 10,000 USD per capita income following the structural reforms of the early 2000 may also provide insights for the SEE-6 agenda in accelerating their economic development.

In sum, both Turkey and SEE-6 are driven by change. At the macro level, it is not difficult to see the win-win side of economic cooperation. Both sides want to go beyond competing based simply on cheap costs, increase the share of higher value added activities and converge with the EU's income levels.

The challenge is then to identify the win-win forms of economic cooperation at the meso and micro levels.

TABLE 5 Fundamental macro-targets of the Vision 2023 and SEE 2020 documents

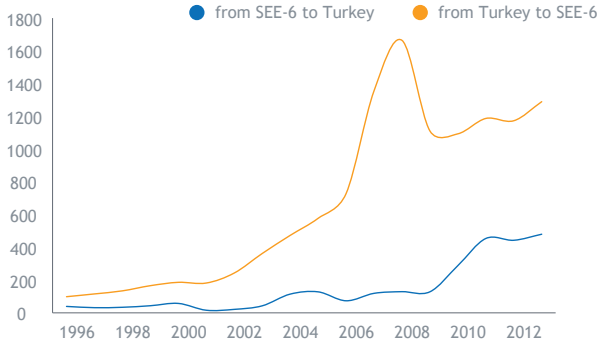
Indicator	SEE2020	BIH
GDP per capita	44% of EU average	25.000 USD
GDP	-	2.000 billion USD
Trade	278 billion USD	1100 billion USD total trade 500 billion USD export
Labor force	44.4% employment rate	50% employment rate
Investment	11 billion USD inflow	100 billion USD outflow
Tourism	-	50 billion USD revenue
R&D	2 million highly qualified persons in the workforce	R&D personals per thousand > OECD average
Private Sector Ecosystem	33,760 new business per year	2% of GDP, private sector R&D
Governance Effectiveness	2.9 WB Gov. Index	-
Energy	9% energy saving by 2018	30% increase share of renewables
Transportation	20% decrease in cost of transport	10,000 km high-speed railway

SOURCE: SEE-2020 Baseline Report, SEE 2020 Strategy, The Tenth Development Plan (2014-2018), TUBITAK, Republic of Turkey Ministry of Economy. Exchange rates are converted to USD with using European Central Bank and Central Bank of Republic of Turkey as sources. For converting targets, 2014 values are used.

SECTION 2
BILATERAL ECONOMIC RELATIONS

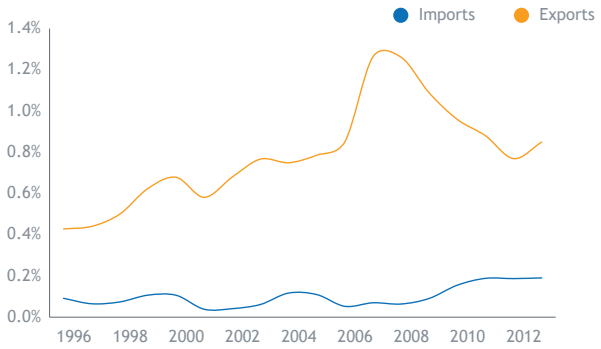
WE HEAR IT AGAIN AND AGAIN. LEVELS OF ECONOMIC INTERACTION BETWEEN TURKEY AND SEE-6 ARE FAR BELOW THEIR POTENTIAL. BUT WHAT EXACTLY IS THAT POTENTIAL? AND HOW CAN WE FULFILL IT? THIS SECTION PROVIDES A BRIEF HISTORICAL OVERVIEW OF BILATERAL TRADE AND INVESTMENT BETWEEN TURKEY AND SEE-6 ECONOMIES.

FIGURE 28 Trade flows between SEE-6 and Turkey, million USD



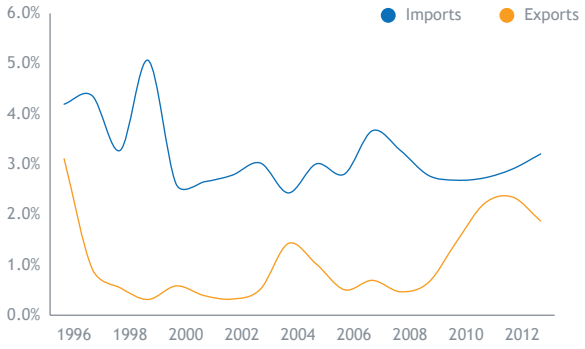
SOURCE: UN Comtrade, TEPAV calculations at HS 1996

FIGURE 29 Trade with SEE-6's share in Turkey's total trade, %



SOURCE: UN Comtrade, TEPAV calculations at HS 1996

FIGURE 30 Trade with Turkey's share in SEE-6's total trade, %



SOURCE: UN Comtrade, TEPAV calculations at HS 1996

BILATERAL TRADE

In this section we delve into the history, current state and future potential of bilateral economic relations between Turkey and the SEE-6 economies. When assessed in light of the section on transformation diagnostics' findings, this analysis will expose whether current relations are at their potential levels and what could be done to improve bilateral economic relations moving forward.

In the past two decades, bilateral trade between Turkey and SEE-6 flourished, growing at an average rate of 13.2 percent annually (see Figure 28). In 2014, total trade between Turkey and the region reached its historical high of 2.45 billion USD, surpassing the pre-crisis peak of 2.2 billion USD in 2008. About 1.8 billion USD of this volume was comprised of Turkey's exports to the region, whereas SEE-6's exports to Turkey came to about 650 million USD. Turkey's exports to the SEE-6 economies reached 2 billion USD following an incredible performance of 38 percent annual growth between 2005 and 2008. The crisis reversed most of the gains however, as Turkey's exports to the region have yet to reach pre-crisis levels.

In contrast, SEE-6's exports to Turkey remained relatively stable at below 200 million USD annually between 1996 and 2009. Interestingly, following the crisis, SEE-6 economies had a spur of export growth to the Turkish market, growing 50 percent annually

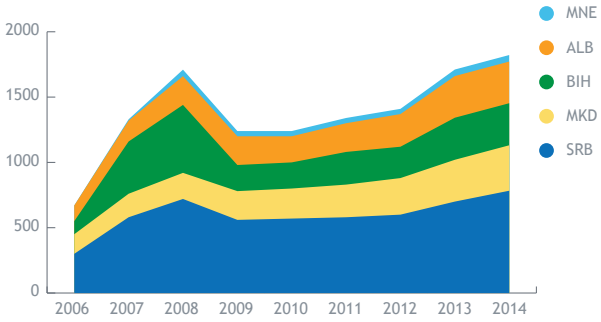
between 2008 and 2011 to reach 500 million USD and remain there. This increase was not a result of any sector or economies specific growth: share of each SEE-6 economy remained exactly the same in the region's total exports to Turkey between 2008 and 2011, signaling a very positive trend of extensive economic integration. Furthermore, such an increase in SEE-6's exports to Turkey during the financial crisis was extremely important, as it softened the blow of the decrease in the region's exports to the EU-28 in 2008 and 2009.

In 2013, Turkey's exports to SEE-6 economies were slightly above 1 percent of the country's total exports and had a market share of 4 percent in the region (see Figure 29 and Figure 30). In contrast, in the same year Turkey received only 0.2 percent of its total imports from SEE-6 economies, which constituted 2 percent of the region's total exports. Compared to other regional economies such as Bulgaria, Georgia and Romania in which exports to Turkey constitute at least 5 percent of total exports, SEE-6 has been under-utilizing the growing Turkish demand as an impetus for economic transformation.

In 2013, Turkey exported 800 million USD worth of goods to Serbia, almost half of its total exports to the region. The Former Yugoslav Republic of Macedonia, Bosnia and Herzegovina and Albania all received about 300 million USD Turkish exports (see Figure 31). Furthermore, Turkey's export volumes to each SEE-6 economy have been rather stable since 2006, indicating established business networks. The only exception to this stability is the volatility of Turkish exports to Bosnia and Herzegovina between 2006 and 2009, increasing from 150 million USD to 570 USD in the first two years, only to decrease down to 220 million USD in 2009. This jump was due to a two-year episode of Turkey exporting refined petroleum oil (HS 271000) to Bosnia and Herzegovina worth over 200 million USD annually.

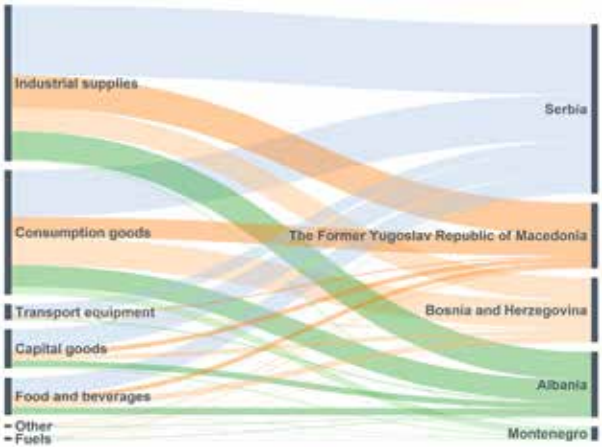
More than 70 percent of Turkey's 1.8 billion USD of exports to SEE-6 economies are classified as industrial supplies and consumption goods by Broad Economic Categories (see Figure 32). These items are followed by capital goods (200 million USD), food and beverages (150 million USD) and transport equipment (90 million USD). Industrial supplies constitute the largest item in Turkey's exports to each SEE-6 economy except to Bosnia and Herzegovina. Turkey's largest export item to Bosnia and Herzegovina is consumption goods, especially semi-durable goods such as clothing and apparel, tableware, glass and ceramics.

FIGURE 31 Distribution of Turkey's exports to SEE-6, million USD



SOURCE: UN Comtrade, TEPAV calculations at HS 1996

FIGURE 32 Turkey's exports to SEE-6, by broad economic categories, 2014



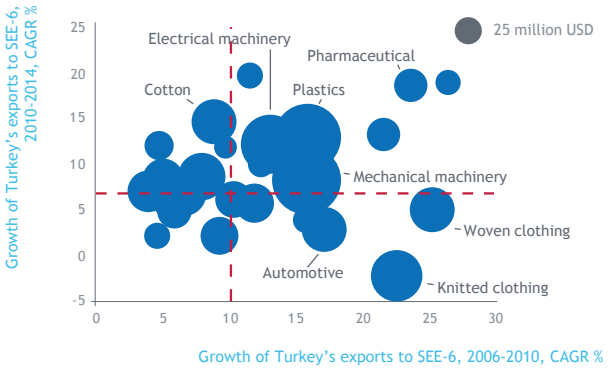
SOURCE: UN Comtrade, TEPAV calculations, BEC classification at 1 digit

To take a more detailed look at the traded goods between Turkey and SEE-6, we also analyze the growth trends of sub-sectors between the economies. Since 2006, Turkey's major export sub-sectors to SEE-6 which consistently grew at faster rates than the average annual growth of all exports are electrical machinery, mechanical machinery, plastics and pharmaceuticals (see Figure 33). In contrast, three sub-sectors in Turkey's exports to SEE-6 economies that stand out with a slowdown in their rates of growth are automotive, woven clothing and knitted clothing, with the last sub-sector being the only item to record negative growth rates since 2010.

SEE-6's exports to Turkey include a very limited range of sub-sectors that are traded at small volumes. In 2014, the region was able to export only 9 sub-sectors at volumes larger than 15 million USD to Turkey (see Table 6). An important share of the region's exports to Turkey were in metals, with Albania's 71 million USD exports of iron and steel largely driven by Kürüm Holding's plant in Elbasan, followed by Serbia's 61 and 46 million USD exports in iron and copper, respectively. Automotive exports from the region to Turkey have been increasingly driven by Fiat's plant in Kragujevac. In 2013, the plant exported 3400 of its 500L models to Turkey, translating to a volume of 50 million USD. The number of 500L's exported to Turkey from Serbia decreased to 2300 in 2014, but the item is still the 5th largest exported good from all SEE-6 economies to Turkey.

Aside from these broad economic categories, the level of technological sophistication and its evolution over time in bilateral trade between Turkey and SEE-6 reveals significant information needed for assessing the transformation potential.

FIGURE 33 Turkey's major export sectors to SEE-6, 2006-2014



SOURCE: UN Comtrade, TEPAV calculations with HS 1996 at 2 digit level
Bubble sizes represent volume of Turkey's exports to SEE-6 in 2014

In 2013, about half of Turkey's exports to SEE-6 economies were medium and high technology goods, compared to 20 percent in SEE-6's exports to Turkey (see Figure 34). Furthermore, SEE-6 exports included virtually no high-tech goods to Turkey, indicating significant industrial capacity constraints in the region. This analysis also displays that since 2000, technological sophistication levels of bilateral trade between Turkey and SEE-6 was not subject to major changes.

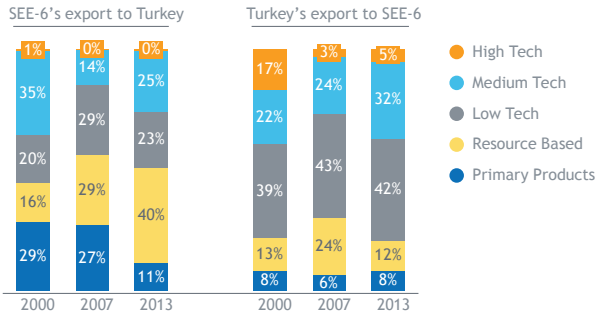
When we further break down technological sophistication to observe patterns at the economy level, a noteworthy image emerges (see Figure 35). Turkey consistently exports about 5 percent in high-tech goods, about 30 percent in mid-tech goods, about 40 percent in low-tech goods, about 10 percent in resource based products and about 5 percent in primary products to each SEE-6 economy.

TABLE 6 SEE-6's major export sectors to Turkey, 2014

	2006-2010 CAGR, %	2010-2014 CAGR, %	2014 export, million USD
Iron and steel	23.8%	8.3%	195
Copper	7.2%	53.1%	55
Cereals	162.9%	17.4%	53
Animal or vegetable fats	0.0%	639.9%	43
Automotive	9.4%	132.0%	39.
Rubbers	5.8%	6.1%	22
Papers	134.2%	-1.5%	18
Plastics	30.1%	64.0%	16
Mechanical machinery	69.3%	-12.2%	16

SOURCE: UN Comtrade, TEPAV calculations with HS 1996 at 2 digit level

FIGURE 34 Technological classification of Turkey's exports to and imports from SEE-6, 2000-2007-2013



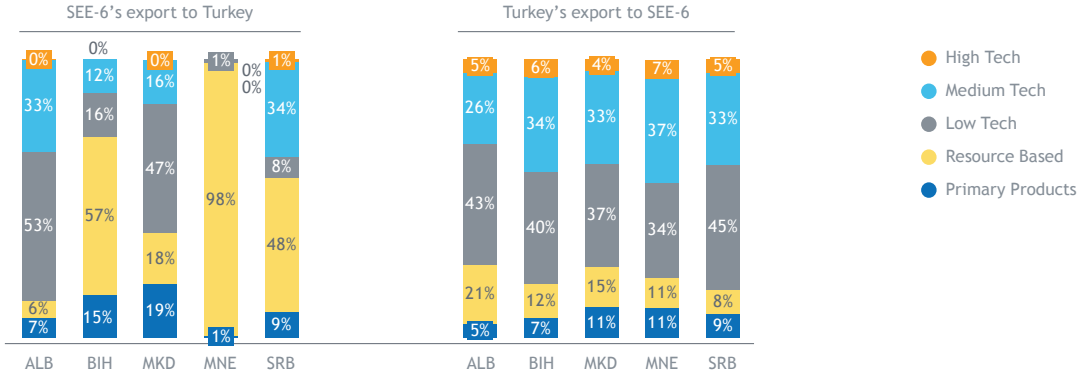
SOURCE: UN Comtrade, LALL, TEPAV calculations at SITC Rev.3 at 3 digit level

However, technological sophistication of exports coming from the region varies significantly for each economy, ranging from 98 percent resource based products from Montenegro to 33 percent mid-tech goods from Serbia. Hence, this image is a good reminder that when dealing with regional integration of SEE-6 economies, one-size fits all solutions should be approached with caution.

INVESTMENT FLOWS

Foreign direct investment (FDI) inflows is a part of the Integrated Growth pillar of the SEE 2020 Strategy, with the objective to promote

FIGURE 35 Technological classification of Turkey's exports to and imports from each SEE-6 economy, 2013



SOURCE: UN Comtrade, LALL, TEPAV calculations at SITC Rev. 3 at 3 digit level

FIGURE 36 Economies in which Turkey is top investor in at least one sector

SOURCE: fdimarkets, TEPAV calculations

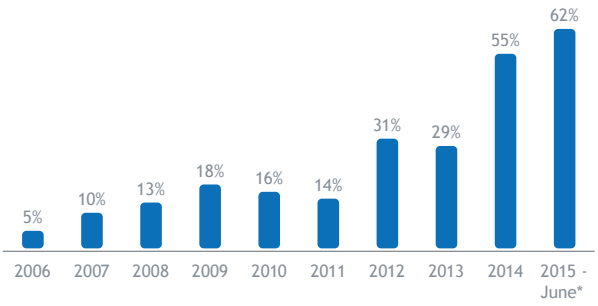
regional trade and investment linkages by further integrating the region into the European and global economy through enhanced participation in international supply chains. The headline target for investments is to increase overall annual FDI inflows to the region by at least 160 percent by 2020. This ambitious target translates into a jump to 8.8 billion USD of FDI inflows to the region, up from 3.4 billion USD in 2010.

The Turkish private sector is integral to this goal as Turkey is one of four countries to have active investments over 100 million USD in all SEE-6 economies (other three are Italy, Germany and the USA). In return, SEE-6 is also crucial for the Turkish private sector's regionalization efforts that emerged in the past decade. Although there is still little to no research done on this phenomenon, Turkish firms have initiated a process of opening up, especially since the mid 2000s. This trend may be observed from the ratio of outward investment flows to Turkey to inward investment flows to the country, which increased from 5 percent in 2006 to 55 percent in 2014 (see Figure 37). This ratio reveals the outward orientation level of a country's private sector, given that investment inflows are not stagnating.

Naturally, Turkish investors first turned to markets that were located near their headquarters. As the number of firms that set up shop outside Turkey increased, Turkey evolved into a regional investment powerhouse. Figure 36 shows the economies in which Turkey is the top investor in at least one sector.

The outward investments Turkey made in various sectors between 2003 and 2014, Turkey became the leading source of foreign capital in at least one sector in all of its immediate neighbors (except Armenia) as well as a number of economies in the wider region. Perhaps a more important trend is that, sectors in which Turkey leads in the wider region are usually manufacturing sectors such as textile, chemicals, machinery, wood products and other consumer products. Investments in such sectors are usually export oriented and facilitate the host country's integration to regional and global value chains.

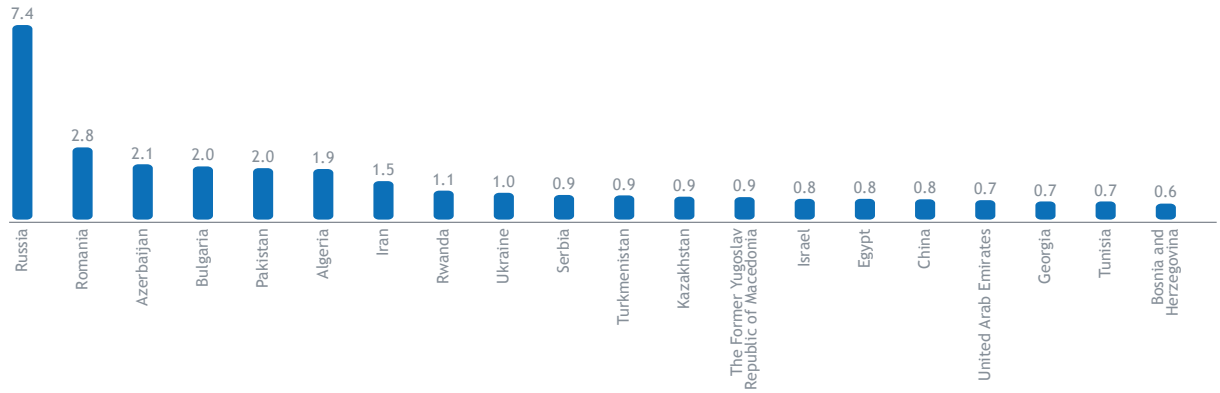
FIGURE 37 Turkey's ODI to FDI ratio, 2006-2015, %



SOURCE: Central Bank of Turkey, 2015

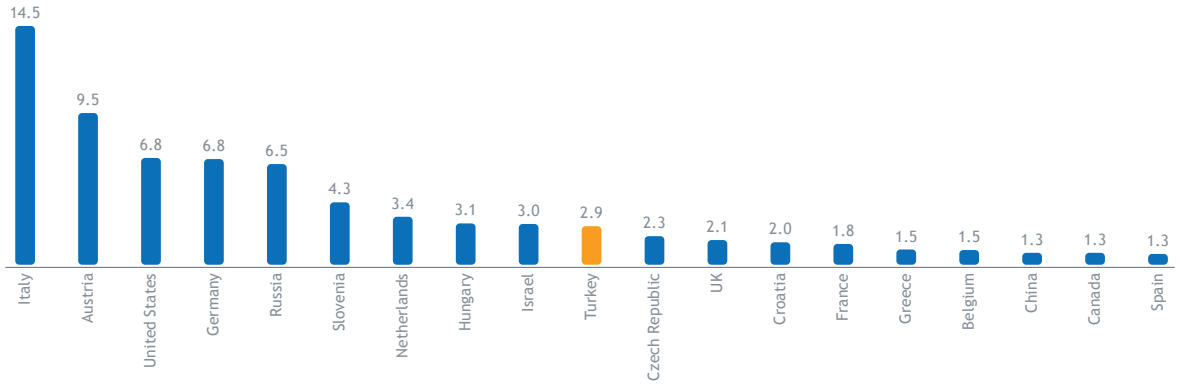
A CLEAR PATTERN OF REGIONALIZATION HAS BEEN GOING ON FOR THE TURKISH PRIVATE SECTOR IN THE PAST DECADE, WITH INVESTMENTS FOCUSING ON MENA, CAUCASUS AND THE BALKANS REGIONS. THIS TRANSFORMATION IS ESPECIALLY IMPORTANT FOR THE SEE-6 ECONOMIES AS TURKEY IS ONE OF THE FOUR COUNTRIES, TOGETHER WITH ITALY, GERMANY AND THE USA TO HAVE INVESTMENTS OVER 100 MILLION USD IN EACH ECONOMY.

FIGURE 38 Investment outflows from Turkey by destination, billion USD, 2003-2014 cumulative



SOURCE: fdimarkets, TEPAV calculations

FIGURE 39 Investments in SEE-6, by source economy, billion USD, 2003-2014 cumulative



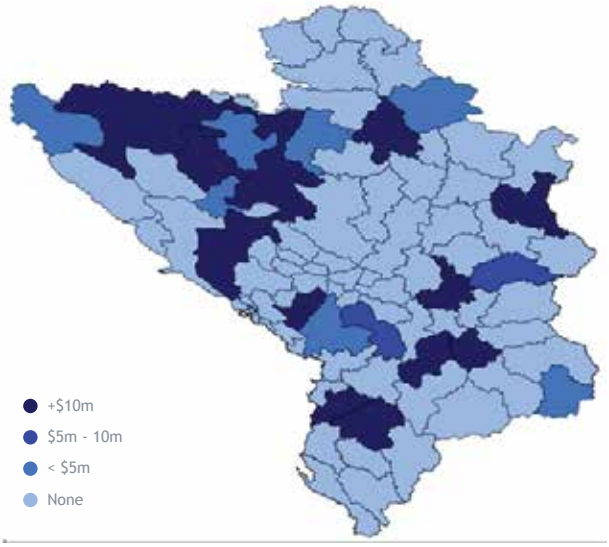
SOURCE: fdimarkets, TEPAV calculations

Figure 38 provides a breakdown of Turkey's cumulative outward investments between 2003 and 2014 by destination economy. Russia is the leading destination of Turkish FDI by a significant margin, followed by Romania, Azerbaijan and Bulgaria. From the SEE-6 economies, only The Former Yugoslav Republic of Macedonia and Bosnia and Herzegovina received Turkish investments of above 500 million USD. As such, even though Turkey is one of the few countries to have investments over 100 million USD in each of the SEE-6 economies, it is ranked 10th in terms of cumulative inflows to the region (see Figure 39).

The 2.9 billion USD worth of Turkish investments into the region between 2004 and 2013 constitutes roughly 7 percent of all Turkish ODI during the period. One important characteristic of Turkish investments in SEE-6 is that, sector wise, in contrast to the general characteristics of Turkish ODI mentioned above, manufacturing industries are significantly underrepresented. More than half of all Turkish investments in SEE-6 economies are in the energy sector. This is followed by investments in real estate, tourism, financial services and metals. The top manufacturing sector in Turkey's investments to the SEE-6 economies is medical devices, with a cumulative figure of merely 66 million USD. So while the Turkish private sector has been investing in manufacturing industries in the wider region, its investments in the SEE-6 economies are dominated by non-tradable sectors.

In Figure 40, we break the SEE-6 economies down to their sub-national NUTS 1 regions in order to further probe the dispersion patterns of Turkish investments in the region. The resulting image displays a significant trend. In The Former Yugoslav Republic of Macedonia, Kosovo*, Serbia and Montenegro, Turkish investments cluster in the single most important center of economic activity: capital districts. Whereas for Albania and Bosnia and Herzegovina, the map shows that significant Turkish investments occurred outside the capital districts as well. This difference can be explained by the involvement of the Turkish private sector in the privatization processes of these two economies. In fact, Turkish investments were able to go to Maglaj, Tuzla and Elbasan strictly as a result of privatization waves in these economies. In contrast, the Turkish private sector was not a major player during the privatization processes in the remaining four economies, resulting in investments to being largely limited to capital cities.

FIGURE 40 Turkish investments in SEE-6, NUTS1 regions, million USD, 2003-2014 cumulative



SOURCE: fdimarkets, TEPAV calculations

BOX 2 Key Turkish investments in SEE-6 and their impacts

Turkey is one of the four countries to have at least 100 million USD of investment in each of the SEE-6 economies. Some Turkish companies invest in the region as a first step towards becoming regional players while others invest in line with their firm's global strategy. Employment generated by Turkish investments in SEE-6 economies between 2003 and 2014 is estimated to be over 12,000 for the whole region.

Turkish firms active in the region have already made important contributions to the private sector competitiveness of the region by creating employment opportunities, vocational training, transfer of management know-how, and increased exports.

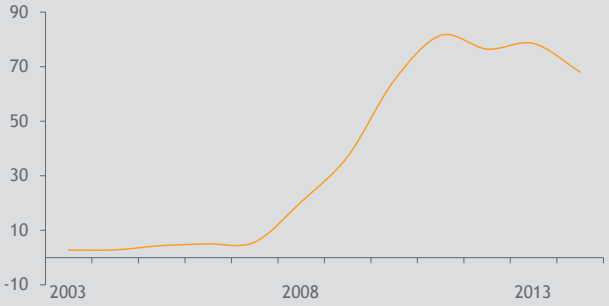
Export-oriented SMEs or large firms strengthen their respective value chains and facilitate regional integration all the while creating jobs. This is clearly the case for both Kastamonu Entegre's and Şişecam's investments in Bosnia and Herzegovina. Both of these firms have bought and upgraded production plants previously owned by state owned enterprises during the mid-2000s privatization wave of Bosnia and Herzegovina.

In 2005, Kastamonu Entegre created a joint venture company with Natron Maglaj d.o.o. to invest in and revitalize the paper plant in Maglaj. Similarly, in 2006 Şişecam acquired 80 percent of Soda Plant Lukavac located in Tuzla. As both companies operate in sectors where proximity to primary input goods is important and investment costs are high, acquisition through privatization was an important opportunity for them.

Both companies decided to keep working with the local labor force and initially brought plant managers from Turkey. However, as the know-how transfer intensified, the number of Turkish managers and engineers significantly declined. Both Şişecam and Kastamonu Entegre executives emphasize the importance of integrating locals into top management positions to create harmony and increase efficiency of the workforce.

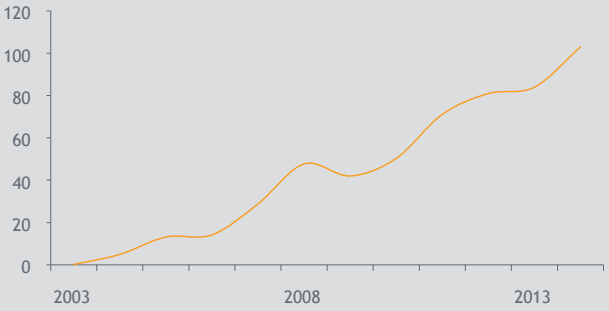
As a result of streamlined operating practices, the availability of labor and primary products nearby, both investments turned out to be success stories. Today, both Natron Hayat and Şişecam are among the top 10 exporters of Bosnia and Herzegovina. Figures on the right hand side of this box highlight the jumps of Bosnia and Herzegovina's exports in specific products produced by both plants.

FIGURE 41 Bosnia and Herzegovina's paper exports, 2003-2014, million USD



SOURCE: UN Comtrade, TEPAV calculatios at HS 1992 at 4 digit level: 4809, 4819

FIGURE 42 Bosnia and Herzegovina's sodium bicarbonate exports, 2003-2014, million USD



SOURCE: UN Comtrade, TEPAV calculatios HS 1992 at 6 digit level: 283620, 283630

A LIST OF OTHER LARGE TURKISH FIRMS ACTIVE IN SEE-6 ECONOMIES

Acıbadem
ASELSAN
Çalık Group
Cevahir Group
Enka
Halkbank
Sütaş
TAV
TEB
ZiraatBank

INVESTMENT PATTERNS

In this section, we condense our observations from over 100 in depth interviews conducted with economic actors across seven economies in order to identify potential support mechanisms for future Turkish investors, as well as share the winning formulas of existing ones.

We were able to identify seven key catalysts for future investments in our survey of Turkish investors in the region:

1. The entry of Turkish banks into the region has been one of the most important developments for upgrading bilateral economic relations;
2. Turkish investors are seeking to enter the SEE-6 economies mainly through brownfield investments;
3. A significant share of established industrialists in Marmara and Ege regions in Turkey have their ancestral roots in the SEE-6 region;
4. The SEE-6 is perceived as a springboard on the way to establishing global operations;
5. Multiple daily flights operated by Turkish Airlines to all capitals in the region facilitates integration;
6. Turkish Universities offer important opportunities to find Turkish-speaking high quality human capital;
7. Turkish investors' image throughout the region is not uniform and may require intervention to be rectified in the medium term.

In the following pages, we expand on each item.

ENTRY OF TURKISH BANKS

Turkish banks have been present in the SEE-6 economies for over two decades. Halkbank AD Skopje became operational in The Former Yugoslav Republic of Macedonia in 1993. Similarly, ZiraatBank opened its Sarajevo branch in 1997. In Albania, Kentbank initially acquired 60 percent of Banka Kombetare Traktere (BKT)'s shares in 2000. In 2006, Çalık Holding bought these shares, began expanding to Kosovo* in 2007, and later on also purchased the remaining 40 percent of shares from IFC and EBRD. TEB Paribas joint venture also entered the Kosovo* market in 2008. The latest entry in this series came from Halkbank once again, as the bank acquired 77 percent of Serbian Cacanska Bank in 2015 and is in the process of transferring ownership.

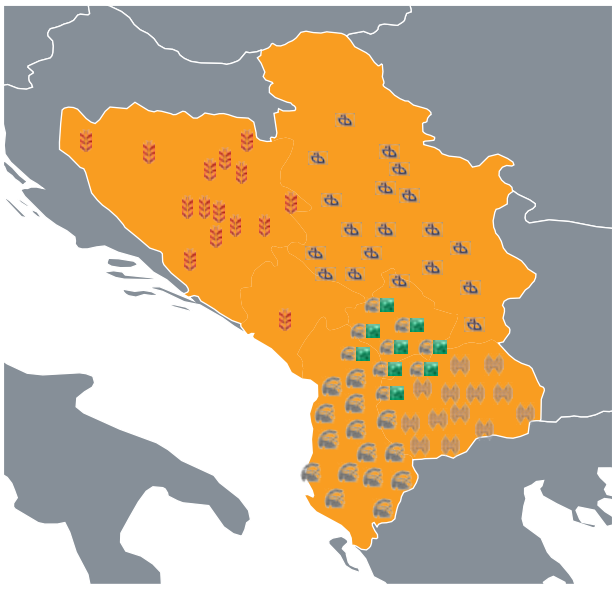
All of the banks cited above have a vision to become, or already are, one of the top banks in their respective economies. BKT is Albania's largest bank, Halkbank Skopje is The Former Yugoslav Republic of Macedonia's third largest bank, ZiraatBank is rapidly rising in ranks and targets top 5 by 2018. As a result of this expansionary mindset, there are currently nearly 150 branches of Turkish banks across the SEE-6 region (see Figure 43).

Aside from being financial institutions of national significance, the existence of Turkish banks in the region create two crucial advantages for Turkish investors. These banks make it possible for Turkish investors to get in contact with bank managers and commercial banking representatives who can speak their language. Given that one of the most significant constraints for growth in Turkish SMEs is language skills, the existence of Turkish speaking financial institutions in foreign markets appears to be an invaluable asset.

Perhaps more importantly however, if utilized correctly, these banks are actually the best places to provide market intelligence for investors who are seeking to expand their operations to new destinations. As local players, senior level managers of these banks know in detail the national investment climate, the sectoral situation, potential barriers to entry and ways to overcome them. Additionally, they have a network of key economic and political actors that they can mobilize for serious investors.

As a result, in our interviews with them, executives of all of the largest Turkish investors in the region; Kastamonu Entegre, Kürüm Holding, Sütaş and Şişecam, confirm that following their initial

FIGURE 43 Turkish bank branches in South East Europe, 2015



Source: TEPAV research

dialogue with Turkish commercial counselors regarding their investment ideas, the next stop for them was talking with the managers of the Turkish banks. The fact that all of the Turkish banks in the region have expansionary visions and growth plans in place is a good indicator of their contributions to the connectivity between Turkey and SEE-6 economies.

ENTRY THROUGH BROWNFIELD INVESTMENTS

Six of the largest Turkish investments in the region; BKT, Halkbank Serbia, Natron Hayat, Kürüm Holding, Sütaş and Şişecam all entered their respective markets through making brownfield investments.

This phenomenon has both positive and negative implications for the region. Firms report that one of the factors that led them to prefer brownfield over greenfield investment was the administrative barriers to entry. One of the most effective ways to overcome such barriers was by acquiring existing facilities so that the firm is not bogged down with oftentimes troublesome permits such as those needed for construction and registering property. Furthermore, acquiring active facilities allows investors to take over the existing workforce, significantly reducing the time until operations can start.

Moreover, most of the brownfield investments were done through privatization deals in which Turkish firms acquired state owned enterprises that were in the red due to either lack of necessary capital to upgrade production technology, or poor management practices. The only exception to this rule was Sütaş, which bought Swedmilk's bankrupt state-of-the-art dairy plant in Skopje. However, as investment climate reforms speed up and the EU accession talks progress, we expect to see a surge in greenfield investments to the region by Turkish investors.

FAMILY AND PERSONAL CONNECTIONS

A non-negligible number of successful Turkish industrialists from Izmir, Bursa, the Thrace region as well as the wider Aegean and Marmara regions of Turkey have their family histories rooted in South East Europe. While some of these businesspeople have already invested in the SEE-6 economies both in terms of business and social responsibility, the majority has yet to do so. Hence, one significant potential source of investments that may be easier to mobilize from Turkey to SEE-6 is through these industrialists with existing personal and cultural bonds in the region.

SEE-6 AS A SPRINGBOARD

The SEE-6 are small market economies in which competition is not strictly cut-throat, almost all economic actors know each other, the culture of doing business is similar to that in Turkey, and it is possible to find Turkish-speaking employees. As a result, investing in SEE-6 as a firm's first business outside Turkish borders appears to be a low cost, low risk and high reward enterprise.

Naturally, such an environment offers the necessary conditions for a firm to experience a non-Turkish market for the first time and enables creation of an organizational structure and operational flow that, once perfected, is implementable in following expansions to third markets. Hence, in a way, SEE-6 economies provide fertile ground for firms to streamline their internationalization process in management and production practices. In turn, once confident with their internal functioning, such firms would have an easier time establishing their practices and competing in more competitive EU-28 markets. In this regard the SEE-6 economies are better than other investment markets of Turkey especially in MENA because in terms of doing business, they are positioned in the middle on the spectrum of business practices of Turkey and the EU member states.

TURKISH AIRLINES AND ROLE OF İSTANBUL AS A HUB

The SEE-6 economies significantly suffer from a lack of strong regional and international air connectivity. To give an example, there are no direct flights from Sarajevo to Paris, from Skopje to Madrid, from Podgorica to Munich, or from Tiran to Moscow. This deficiency increases the costs of traveling to and from the region in terms of both time and money.

Against this background, Turkish Airlines is doubly important for improving economic relations between Turkey and SEE-6. The airline not only connects the SEE-6 to Turkey, with multiple daily flights, but it also is one of the few airlines that connect the region to the world. Together with Vienna, Zurich and Munich, İstanbul is one of the top four regional hubs that offer the greatest number of connecting flights from SEE-6 economies to the rest of the world.

In July 2015, Turkish Airlines had 84 weekly flights to the SEE-6 capitals. In a scenario with 80 percent capacity on all flights operated with Boeing 737-800s, this translates into 10,500 passengers carried from Istanbul to the region per week, and vice-versa. Furthermore, the region also shines due to

its proximity to Istanbul: flying to the region takes the same time as flying from Istanbul to Kayseri. In turn, this makes it possible for businesspeople to make one day trips to the region.

TURKISH UNIVERSITIES

The existence of Turkish universities such as International Balkan University and International University of Sarajevo across SEE-6 has the potential to significantly support Turkish investors to the region.

Turkish students can attend these universities through the Turkish Undergraduate Placement Exam that every Turkish high school graduate student takes. Perhaps more importantly, most of these universities have equivalence certificates from Turkey's High Board of Education so that graduates do not have a hard time converting their diplomas for acceptance within the Turkish system.

The most important impact of these universities from the perspective of potential Turkish investors to the region is their ability to generate Turkish-speaking human capital. However, currently there are no existing mechanisms in place that link education and training institutions to investors on the ground. Therefore, in order to optimally utilize the graduates of Turkish universities in the region to positively impact Turkish investments, links between investors and universities must be established.

THE IMAGE OF TURKEY IN SEE-6

Turkey is very visible in the SEE-6 economies as a successful transformation case, a regional powerhouse, a tourist destination, a source of investments and as the successor of an important historical legacy in the region.

Interestingly, the most significant sources of the regions perceptions of Turkey come from Turkish soap operas. In 2013, 18 Turkish soaps were broadcasted across six economies. These go a long way in branding Turkey, especially Istanbul, as the primary hub of contemporary consumer culture in the region. Furthermore, as in most cases soap operas are broadcasted without being dubbed and only with subtitles, which enables the audience to learn common phrases and increase the general level of familiarity with the Turkish language.

Unfortunately however, there are also negative influences on perceptions of Turkey that require fast and decisive action in order to isolate their effects. The most significant being Turkish individuals or delegations that visit the region, portray themselves as serious investors who are important players in Turkey, and promise greenfield investments, but never return. The frequency of such groups is especially high in Bosnia and Herzegovina and Kosovo*, two of the economies with which Turkey has the most cordial political and cultural relations with in the region. As a result, the perception of Turkish businesses in these two economies has deteriorated rapidly in the past few years. In contrast, perhaps the most positive perception of Turkish investors in the region can be seen in Serbia, due to limited interaction with non-serious business delegations.

Turkish Embassies and especially Commercial Counselors are aware of this issue and already working overtime to limit the potential damages such delegations may cause. However, given the volume of Turkish citizens that visit these economies, it is nearly impossible for Embassies to tackle this issue alone. Turkish banks in each economy can play a critical role in this regard as they have the capacity to check the credit rating, financial record and economic activity of such individuals in Turkey.

MOVING FORWARD…

Bilateral trading patterns between Turkey and SEE-6 economies indicate that increasing the volume and quality of bilateral trade between the two regions requires two things: further foreign investment inflows in higher value added sectors and simultaneous economic transformation.

We leave this section with these questions: How can SEE-6 economies become Turkey's manufacturing frontier for the EU market? How can Turkish firms go beyond making brownfield investments in the region and become key actors in medium and high-technology value chains? How can SEE-6 economies go beyond exporting primary products to Turkey? In which sectors can Turkey's and SEE-6's private sectors cooperate for joint targeting of third markets?

It is clear that there are significant areas of untapped potential to increase economic relations between Turkey and SEE-6. Hence, all of the "how" questions cited above require us to deepen our analysis to identify and expand on areas of potential business opportunities and policy recommendations targeting increased economic interaction. For this, we proceed to Section 3 and Section 4, in which we elaborate on five key sectors and develop seven policy recommendations for the future path of Turkey – SEE-6 economic integration.

SECTION 3
BUSINESS IDEAS

THIS SECTION IS INTENDED FOR THE BUSINESS COMMUNITY. OUR AIM IS TO IDENTIFY AND INTRODUCE A NUMBER OF FEASIBLE BUSINESS OPPORTUNITIES THAT COULD STRENGTHEN THE BRIDGE BETWEEN SEE-6 AND TURKISH ECONOMIES. SOME OF THESE OPPORTUNITIES ARE ALREADY VIABLE TODAY. FOR SOME, VIABILITY WILL DEPEND ON THE FUTURE TRANSFORMATION PATTERNS ON BOTH SIDES OF THE BRIDGE. AS THE SEE-6 ECONOMIES DIVERSIFY AWAY FROM COMMODITIES AND AS QUALITY AND SPEED BECOME IMPORTANT DRIVERS OF COMPETITIVENESS -AS OPPOSED TO LOW WAGES- IN THE REGION, OPPORTUNITIES WILL MULTIPLY FOR TURKISH FIRMS. THE EXTENT TO WHICH SOUTH EUROPEAN FIRMS' CAN TAP INTO OPPORTUNITIES PRESENTED BY TURKISH MARKETS ALSO DEPENDS ON THE GROWTH OF HIGH PERFORMANCE FIRMS IN THE REGION.
BUSINESSES SHOULD NOT SEE THE OTHER SIDE OF THIS BRIDGE ONLY AS A MARKET, BUT RATHER AS POTENTIAL PARTNERS TO FORM JOINT VENTURES INTO THE GLOBAL ECONOMY. FROM THIS PERSPECTIVE, ON THE ONE HAND, THE SEE-6 REGION'S PROXIMITY TO THE EU MARKET AND EU MEMBERSHIP POTENTIALS ARE MAJOR ADVANTAGES. ON THE OTHER HAND, TURKEY, BEING THE MOST DIVERSIFIED ECONOMY IN BETWEEN ITALY AND CHINA, CAN ASSIST SEE-6 FIRMS TAP INTO A WIDE ARRAY OF SECTORS AND MARKETS IN THE MIDDLE EAST, NORTH AFRICA, CAUCUSES AND CENTRAL ASIA.

COOPERATION MODELS

Based on our assessment, we identified feasible business cooperation models. These proposed models are not mutually exclusive, i.e. most business can find inspiration in merging two or three of these models. They will help the business sector leverage both Turkish and SEE-6 resources, knowledge, skills, and assets into the global economy.

GLOBAL VALUE CHAIN INTEGRATION

As a result of a series of trends, we expect integration of the SEE-6 economies into global value chains in the near future. Similar to what took place in new member states of the EU, as market institutions converge with EU norms and standards, doing business in the region will become much more feasible and less costly not only for large companies but also for SMEs. The flying geese paradigm, which postulates that more advanced industrial activities will continuously transfer from developed core countries to lesser developed periphery countries in a region, is likely to hold true for SEE-6 economies. This is especially true given the increasing labor costs in economies such as Poland, Hungary, Czech Republic and Slovakia. Furthermore, a similar push may come from the Marmara region. For those Turkish companies that export to the EU from the Istanbul vicinity, where productions costs are on an upward trend, it may be beneficial to consider relocating part of their value chains to the SEE-6 region to become more competitive in terms of quality, price and speed. All these trends will multiply the existing opportunities in SEE-6 economies, particularly in subcontracting and outsourcing at early stages and as greenfield investments at latter stages (see Box 3).

BUSINESS PROCESS OUTSOURCING

As business gets more complex, firms providing specialized niche services make important contributions to competitiveness. Quality of human capital, coupled with low cost of living but relatively decent standards (especially compared to tier-1 Turkish cities such as Istanbul and Ankara),

render certain urban centers in the South East Europe as potential service hubs for niche business services. This imminent trend is becoming especially visible in Belgrade and Sarajevo. These cities offer opportunities in high value added business services such as information communication technologies, design, media, marketing and consulting. Supported by relevant private equity and venture capital funding schemes, it will be up to the entrepreneurs' creativity and perseverance to tap into these advantages and generate business opportunities, bridging Turkey and SEE with the global markets.

JOINT VENTURES FOR THIRD MARKETS

There is a high degree of complementarities between Turkey and SEE-6 export markets. Today's SEE's exports concentrate mostly on the EU markets (+60 percent), while MENA, Asia and American markets get very limited shares. In contrast, while the EU has around 40 percent share, MENA market has around 25 percent share in Turkey's exports. In addition to the MENA region, high growth markets in Russia and Asia could be platforms where Turkish and SEE could cooperate. Access to certain raw materials in South East Europe such as forestry and metals could be entry points for such joint ventures in third markets. In 2013, Russia imported commodities worth in total over 300 billion USD, nearly twice the volume of Turkey and SEE-6's exports combined. Strategic partnerships between Turkish and SEE-6 enterprises may be established in order to ease barriers of entry and penetrate the Russian market more effectively.

TAPPING INTO THE EXISTING TRADE ROUTES

Positioned right between Turkey and the largest EU markets, SEE's geographic location creates natural business opportunities especially in logistics, packaging and manufacturing that requires rapid delivery. For example, The Route 10 highway that forms the transportation backbone of Serbia on the North-South axis is placed in the middle of the Turkey-Germany trade route. By one estimate, over 200,000 Turkish trucks passed through only Serbia in 2014 while delivering goods to the EU markets, which amounts to an average of over 500 trucks per day. The already existing stream of trucks creates very favorable conditions for Turkish investors to service the European market from an alternate location in SEE-6. With China recently expanding its One Belt One Road initiative to include the South East Europe, the Silk Road Fund may become an important source of capital for the region as well.

TAPPING INTO DOMESTIC ECONOMIC GROWTH

The growth potential of the SEE economies is a direct function of the EU convergence process and success of the SEE2020 Strategy. If accomplished, by 2020, the region's GDP per capita relative to the EU average will increase from 36.5 percent to 44 percent, its total trade from 94.4 billion USD to 200 billion USD. Add to these the gradually increasing urbanization rates and modernization of the domestic urban economies, and there will be a number of opportunities for SMEs, particularly in the areas of consumer goods, construction, retail and tourism. As such, if the growth trends continue, the region will likely get on the radar of private equity and venture capital funds.

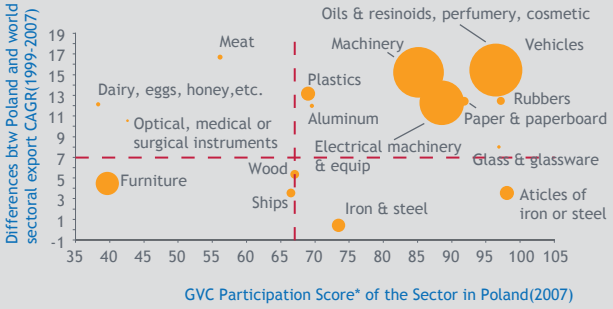
TRILATERAL COOPERATION MODELS INVOLVING THE EU

By adding third parties, SEE-6 and Turkish firms may create trilateral investment schemes to mobilize either funds or networks for their joint projects. First, SEE-6 and Turkish firms, through their joint ventures, could target integrating into the regional supply chains of EU multinationals (such as FIAT automotive). Second method would be leveraging the multilaterals such as the European Investment Bank, European Bank of Reconstruction and Development (EBRD) or German Development Bank (KfW) for larger scale infrastructure or productivity enhancing projects. Furthermore, both the SEE and Turkish economies have strong diasporas in EU such as Germany, Italy and Austria. These populations speak home and abroad languages and have access within EU markets. Through tapping directly into these networks, trilateral business models could also be formulated.

BOX 3 Global Value Chain (GVC) integration case study: Poland

The paths of structural transformation that SEE-6 may experience are likely to resemble those of previously EU-acceding economies such as Hungary, Czech Republic, Poland, Romania or Slovakia. Integration into EU value chains will be a process that needs to be accompanied by a series of structural reforms as wells as enhancing the readiness of the domestic firms. Hence, a closer look into the GVC integration experience of new member states may bring some inspiration to debates in SEE-6. Here, we take a closer look at the Polish case.

FIGURE 44 GVC participation* and growth rates of sectors in Poland, 1999-2007

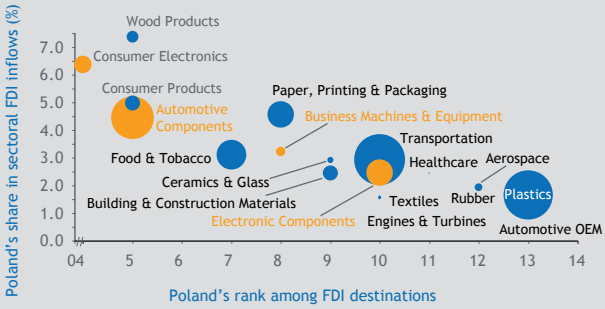


SOURCE: BACI, TEPAV calculations
*Grubel Lyold Index is used as a proxy for global value chain (GVC) participation. Bubble sizes (diameter sizes) represent Poland's export in the sector in 2007.
Selection filters: For these sectors, growth rate of the sectoral export in Poland is more than sector's world export growth between 1999 and 2007. In 2007, Poland exports more than one billion US $ in the sector.

In terms of Poland's transformation, integration to the global value chain (GVC) was a major growth accelerator. In fact, sectors in which Poland's growth rate was higher than the world average are those that are most GVC-integrated (see Figure 47). While Poland is just 16th demanded destination in terms of total cumulative FDI inflows, for GVC-integrated sectors; consumer electronics, automotive components, electronic components and business machines & equipment; Poland has become globally attractive with higher rank among FDI destinations as well (see Figure 46). Adopting the acquis communautaire, possessing cheaper production costs vis-à-vis Germany and other advanced EU countries, and being in close proximity to these markets, made Poland an attractive investment hub. At first stage of transformation, more competitive labor costs (see Figure 45) and similar proximity to EU market may be some leverage of the SEE-6 region to replicate/upgrade FDI patterns in SEE-6 economies.

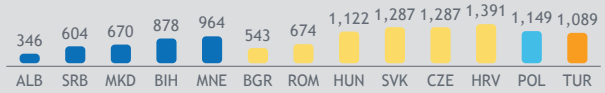
In addition to attracting FDI to upgrade/replicate the GVC integration pattern of Poland, the integration of SEE-6 may be triggered by potential capability spillovers from neighboring economies. In order to identify potential products for spillover, following criteria are taken into consideration:

FIGURE 46 Poland's FDI inflows by sectors*, 2003-2014



SOURCE: fdimarkets, TEPAV calculations
Note: Bubble sizes represent Poland's cumulative sectoral FDI inflows (2003-2014). *Selection filters: Sectoral FDI inflow share is greater than total share of Poland's, and real estate is excluded.

FIGURE 45 Gross average monthly wages, US $, 2013



SOURCE: United Nations Economic Commission for Europe (UNECE) Statistical Database, TURKSTAT, TEPAV calculations
Note: Latest available data for Serbia, Turkey and Albania are respectively for 2010 and 2012.

I. Products that SEE-6 Neighborhood economies export more than their fair share (RCA ≥ 1),[8]
II. Products that SEE-6 have production capacity but difficulty exporting (RCA ≤ 1),
III. Products with higher growth rates than world average (CAGR of the product ≥ CAGR of the world export).

Once these three conditions are operationalized, the original dataset of 1239 products at the 4 digit level shrinks to specific 68 products that simultaneously fulfill all three conditions. Among these 68 products, some products are more likely to create spillover effect to the region. Especially, for electric lights, arms, revolution and production counters, railway material, swine, chemical wood pulp, wires, and ceramic wares are identified as potential spillover areas with high market share of neighbor economies and more sophistication with higher PRODY scores.[9]

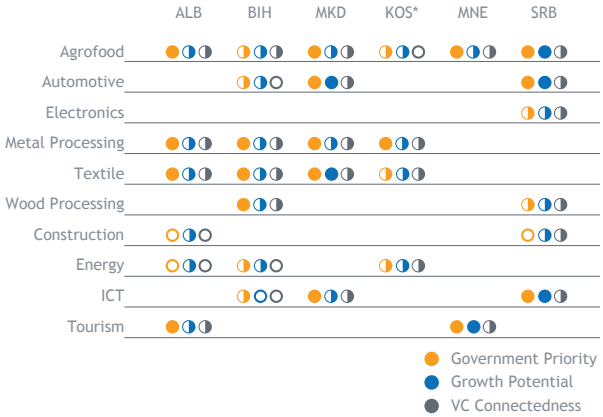
SECTOR IDENTIFICATION

Through our surveys of the existing literature on SEE-6 economies, analysis of trade, investment and production data, and most importantly, our in-depth interviews with regional stakeholders, we identified ten broad sectors that are likely to be the drivers of the region's future economic transformation: (i) agrofood, (ii) automotive, (iii) electronics, (iv) metal processing, (v) textile and apparel, (vi) wood processing, (vii) construction and real estate, (viii) energy, (ix) ICT, and (x) tourism. It is possible to see a lot of activity in each of these sectors in one or several of the SEE economies. Some are prioritized by the governments, some are seen as growth areas by the local banks, and in some of them investment opportunities are already being seized by Turkish investors and entrepreneurs.

We first evaluated this preliminary list of sectors for each economy on three main criteria: (i) compatibility of sectors with the policy priorities in each economy; (ii) whether the sector carries a high growth potential in the domestic economy; and, (iii) the current degree of connectivity of local actors with global value chains. The resulting list is presented in Figure 45 If a sector performs well above regional average in any of the criteria, we assign a full circle; if a sector neither excels nor falls behind we assign a semi-full circle; and if a sector performs poorly in relation to the national and regional averages we assign an empty circle.

It should be emphasized that our evaluations are based on qualitative stakeholder consultations and quantitative data analysis regarding performances of each sector in each economy. We tried to capture the current reality on the ground with strong emphasis on prospective value chain upgrading and integration.

FIGURE 47 TEPAV's SEE-6 sector identification criteria



From these ten broad sectors, we further narrowed down the scope of our analysis to five based on three criteria:

POTENTIAL FOR REGIONAL COOPERATION

If the region is to achieve the ambitious headline targets of the SEE 2020 strategy, sectors in which multiple economies have existing capabilities must be targeted to maximize the impact of further integration and upgrading. For this reason, our first criterion of selection is the importance of a sector in multiple economies.

TURKISH PRIVATE SECTOR'S COMPETITIVENESS

As our primary aim is to increase Turkish presence in South East Europe and generate both technology and knowledge transfers to facilitate value chain integration, sectors in which we develop business ideas must be those in which Turkey is already an regional or global player in.

LACK OF ENTRY BARRIERS TO SMEs

Our final criterion is related with the small and medium sized enterprise focus of our research perspective. As larger firms can afford to set up their own research departments or commission specialized research, our report is targeted at SMEs operating in both regions. SMEs are backbone of any economy and play key roles in sustaining private sector development, spreading of innovation and job creation.

Once we finalize this two-stage assessment of the sectors, we are left with five key sectors. The sectors that will be analyzed in depth in the following pages with a view to find business synergies between Turkey and SEE-6 economies and inspire businesspeople to act are:

1. Agrofood industry,
2. Automotive industry,
3. Textile industry,
4. Tourism, and,
5. Information and communication technologies.

Analysis of each section is structured similarly in order to simplify our main findings. We start by a review of the recent global trends in the sector, followed by a historical narrative of both Turkey's and SEE-6 economies' development paths. Next, we identify the markets or target audience that Turkey and SEE-6 can jointly develop capacity to expand their existing linkages. Finally, for the manufacturing industries, we carry out quantitative analysis at the product level to further specify the opportunity areas and compatible cooperation models.

AGRICULTURAL PRODUCTS

Defined as all edible processed and unprocessed goods (see Table 7), the agribusiness and food processing industry is one of the most resilient sectors in the world. Between 2000 and 2013, global agrofood exports grew at an average of 10 percent annually to reach a volume of 1.35 trillion USD. The financial crisis of 2008 did not create a major setback to the growth performance of agrofood exports; the 2013 trade volume is already 30 percent higher than the trade volume of 2008. Furthermore, due to significant decreases in poverty rates across the world and with the emergence of the middle class in developing economies, agrofood exports are expected to increase at a steady rate for the foreseeable future.

One important piece of information when talking about potential synergies between Turkey and SEE-6 economies in agrofood industry is the importance of the European market. With 38 percent of all global imports, the EU-28 is the largest importer of agricultural products in the world (see Figure 48). However, more than three quarters of the EU-28's total agrofood imports result from intra-regional trade, which signifies the difficulty of establishing trade links with the region due to both trade barriers and competitiveness issues.[10]

The agrofood industry is also perceived to be a key area of opportunity for foreign investments by the governments of all SEE-6 economies. During our interviews across the SEE-6, Agrofood was probably the only industry that was mentioned as an area of underutilized potential by each and every expert, investor and bureaucrat.

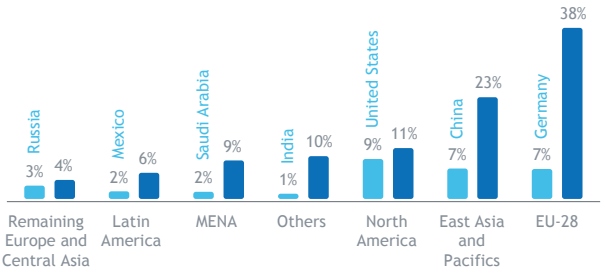
Even though food and beverage exports of the country reached and stayed over 1 billion USD after 1980, share of these products in the overall export basket of the Former Yugoslavia declined significantly (see Figure 49). By 1990, agrofood products constituted merely 5 percent of all exports from the country. However, throughout this period, the Former Yugoslavia's imports of food and beverages did not make a jump and hovered between 5 to 7 percent of all imports. Hence, while we can interpret the decrease in share of agrofood exports as a result of healthy diversification towards more value added goods of the industry, the country was not dependent on the outside for food imports and was able to sustain its needs to a large extent. This point will become important in the following pages when we discuss

TABLE 7 Agribusiness sub-sectors as covered by HS Coding System

HS	Definition
01	Live animals
02	Meat & edible meat offal
03	Fish & crustaceans
04	Dairy, eggs, honey, & ed. products
05	Products of animal origin
06	Live trees & other plants
07	Edible vegetables
08	Ed. fruits & nuts, peel of citrus/melons
09	Coffee, tea, mate & spices
10	Cereals
11	Milling industry products
12	Oil seeds/misc. grains/med. plants/straw
13	Lac, gums, resins, etc.
14	Vegetable plaiting materials
15	Animal or vegetable fats, oils & waxes
16	Ed. prep. of meat, fish, crustaceans, etc
17	Sugars & sugar confectionery
18	Cocoa & cocoa preparations
19	Preps. of cereals, flour, starch or milk
20	Preps of vegs, fruits, nuts, etc.
21	Misc. edible preparations
22	Beverages, spirits & vinegar

SOURCE: UN Comtrade, Foreign Trade On-Line

FIGURE 48 Shares of geographical regions in total world agrofood imports, 2013, %

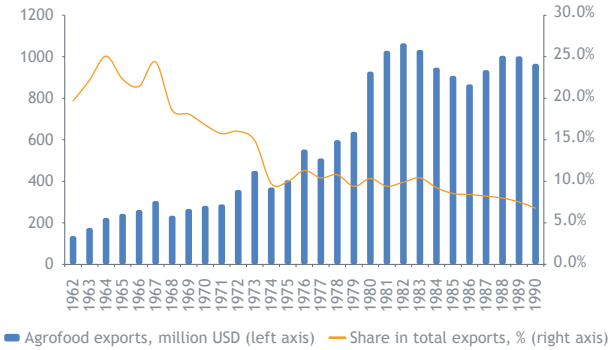


SOURCE: BACI, World Bank, TEPAV calculations

the intra-regional trade of agrofood exports of the SEE-6 economies.

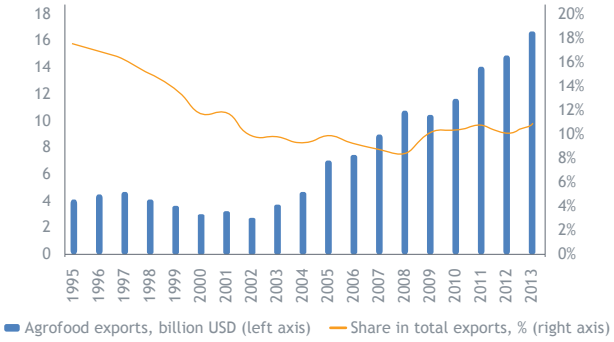
A similar pattern can be observed in the more recent period of Turkey's agrofood exports as well. Even though the absolute volume of Turkey's exports in this sector quadrupled from 4 billion USD to over 16 billion USD since 1996, their share in the total export basket of the country decreased from 18 percent to 10 percent (see Figure 50). Once again,

FIGURE 49 Volume and share of agrofood exports of The Former Yugoslavia, 1962-1990



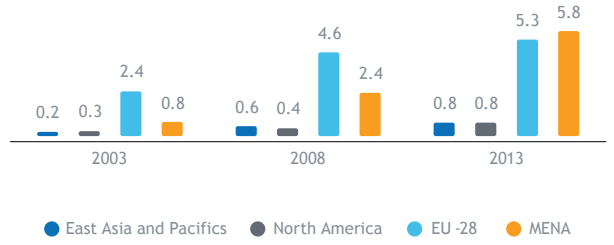
SOURCE: BACI, TEPAV calculations

FIGURE 50 Volume and share of agrofood exports of Turkey, 1995-2013,



SOURCE: BACI, TEPAV calculations

FIGURE 51 Turkey's agrofood exports by region, billion USD, 2003-2013



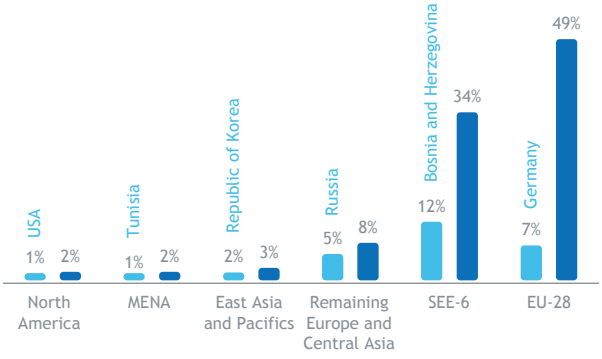
SOURCE: BACI, World Bank, TEPAV calculations

this decline can be interpreted as a byproduct of Turkey's economic transformation towards other higher value added sectors.

However, agrofoods' decline in relative importance in Turkey's total exports stabilizes in the mid 2000s and the industry was able to maintain its share in the past decade. A big part of this is due to the emergence of MENA as a destination market for Turkish agrofood exports (see Figure 51). Whereas Turkey's agrofood exports to the EU market stagnated at around 5 billion USD in the post crisis period, its exports to MENA increased more than sevenfold since 2003 to finally takeover the EU-28 as the largest destination market of Turkish agrofood exports. This trend is the most significant piece of information for potential collaboration between Turkey and SEE-6 economies in the agrofood industry. It implies that Turkish producers may be in need of an alternative place for production to increase their exports to the EU and SEE-6 can diversify its export destinations towards MENA through joint investments with the Turkish private sector.

Diversifying SEE-6's agrofood exports portfolio to include the MENA market would be an important step towards mitigating the risks of over-reliance on the stagnant EU market. In 2013, with a total volume of 7.2 billion USD, agrofood products constituted 13.2 percent of SEE-6's total exports. From this volume, half of the products were exported to the European market whereas one third was distributed within the SEE-6 region (see Figure 52). The 34 percent intra-regional trade of agrofood products is striking considering that SEE-6's share of intra-regional trade in all goods is 13 percent. Furthermore, the top three sub-sectors in terms of intra-regional trade share are all in the agrofood industry. These figures may be indicating two issues: (1) the SEE-6 agrofood industry has a hard time competing in the EU market due to tariff barriers or quality standards and instead focuses on exporting to the internal CEFTA market, or, (2) the production volume in the region is limited and more heavily aimed at supplying intra-regional needs, while exporting remaining production to the EU market.

FIGURE 52 SEE-6's agrofood exports by region, 2013



SOURCE: BACI, World Bank, TEPAV calculations

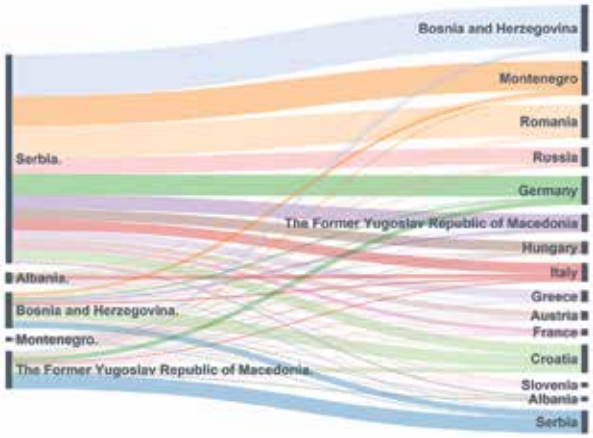
When we analyze the region's agrofood exports by source and destination economies, interestingly the top two destinations appear to be Bosnia and Herzegovina and Montenegro (see Figure 53). These two economies are followed by Romania, Germany, Croatia, and once again another regional economy, Serbia. According to the distribution trends: 11 out of the top 15 agrofood export destinations are either intra-regional or an immediate border neighbor economies. SEE-6 economies seem to have an issue exporting agrofood products to distant markets. Lastly, similar to the textile industry, the only economy in the region to have agrofood export capacity to the Russian market is Serbia.

Serbia is the only economy in the region to have a surplus in agrofood trade and the economy owes this performance to a significant extent to FDI inflows in the sector (see Figure 54). The remaining SEE-6 economies mostly produce just for local markets and heavily export traditional and low value-added products. OECD's competitiveness analysis suggests medium term region-wide competitive advantages in fruits and vegetables as well as in grains for Serbia, in dairy for Bosnia and Herzegovina and Kosovo*.[11]

One method to analyze production capabilities and generate value-added products in the agro-food industry is by classifying the products as primary or processed goods. If primary products constitute a significant share of an economy's agrofood exports, then most likely the economy's food and beverage processing industry is weak and its position in the agrofood value chain is as a supplier of raw materials. In contrast, if an economy predominantly exports processed agricultural products it indicates a strong agribusiness industry as well as the likely existence of packaging and logistics capabilities.

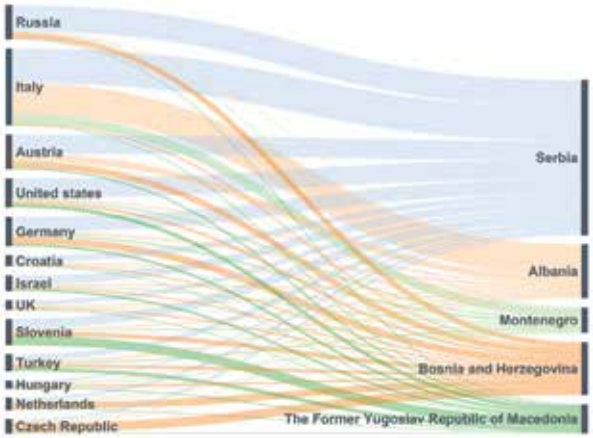
Throughout the past decade, the balance between primary and processed food and beverages exported by SEE-6 economies was stable and remained at roughly 40 percent primary and 60 percent processed (see Figure 55). Interestingly, this balance is exactly the same for Turkey, although in contrast to SEE-6 economies, the country has been gradually increasing the share of processed food and beverages. When we look at the trade performances of SEE-6 economies in terms of primary and processed goods, all economies except Serbia appear to be significant net importers of processed food and beverages (see Figure 56). The primary vs. processed classification is also useful for analyzing the value chain positions of respective economies in bilateral trade. For example, the region supplies predominantly primary agrofood products to Romania, Germany, Russia and France (see Figure 57). In contrast, intra-regional exports

FIGURE 53 SEE-6's agrofood exports by source and destination, 2013



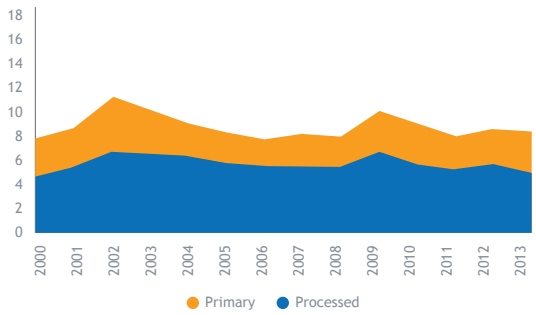
SOURCE: BACI, TEPAV calculation

FIGURE 54 Food FDI inflows to SEE-6 economies by investor economies, 2003-2014, cumulative



SOURCE: fdimarkets, TEPAV calculations

FIGURE 55 SEE-6's agrofood exports, primary and processed goods, 2000-2013, % of total exports



SOURCE: UN Comtrade, TEPAV calculations at BEC 2 digit level

to Bosnia and Herzegovina, Montenegro and The Former Yugoslav Republic of Macedonia are mostly processed goods. Such differences indicate that in the agrofood sector the region has multiple modes of trade linkages with it's surrounding.

AREAS OF OPPORTUNITY

Following expert interviews and extensive data analysis, in the agrofood industry we were able to identify three modes of potential economic cooperation between Turkey and SEE-6:

1. Turkish firms investing in SEE-6 or establishing joint ventures with SEE-6 firms to target exporting to the EU market;
2. Expand Turkey-Russia agrofood trade networks by investing in agricultural producing or processing capacities in the SEE-6 to service the Russian market;
3. SEE-6 firms tapping into Turkish firms' existing networks in the MENA region to diversify their exports and decrease dependence on EU demand.

Opportunities in EU markets

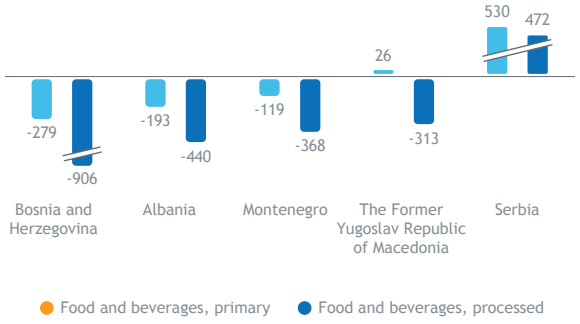
In order to determine potential opportunity areas that can be exploited in the EU market, we analyze Turkey's and SEE-6's agrofood exports to the EU-28 economies at the product level. The two guiding questions are as follows:

i. **In which agrofood products have both Turkey and SEE-6 been increasing their market shares in the European market?**

ii. **In which agrofood products has Turkey been losing while SEE-6 has been gaining market share?**

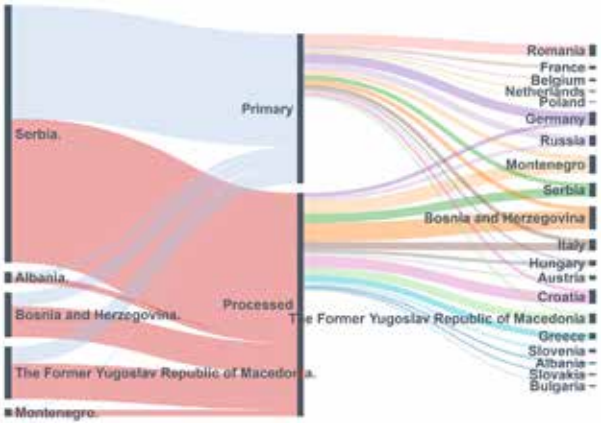
Each circle in Figure 58 is a product that is exported by both Turkey and SEE-6 to EU-28 at a volume greater than 1 million USD, and the bubble sizes are proportional with combined export volumes. The figure has been shaped to include only those products in which SEE-6 exports have been performing well in order to display potential opportunity areas for Turkish investors. Products on the top-right hand side are those in which both Turkey and SEE-6 have been increasing their shares in the EU market, such as fermented beverages, sunflower seeds, fruit jams (see Table 8). Products on the top-left hand side are those in which Turkey's market share in the EU have been declining., however, Turkish producers of these products may invest in SEE-6 to sustain and expand their capacities. These products include, but are not limited to, frozen berries, wheat, apricots, cherries, peaches, and frozen vegetables.

FIGURE 56 SEE-6's net balances in agrofood products, primary and processed goods, 2013, million USD



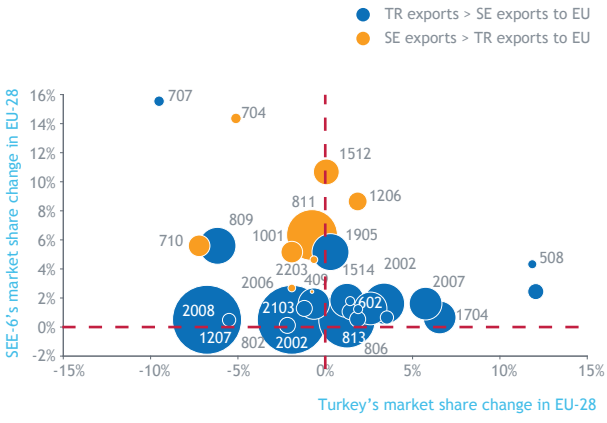
SOURCE: Uncomtrade, TEPAV calculations at BEC 2 digit level

FIGURE 57 SEE-6 agrofood exports by primary/ processed and destination economy, 2013



SOURCE: UN Comtrade, TEPAV caculations at BEC 2 digit level

FIGURE 58 Opportunities for Turkish agrofood firms to enter EU-28 market through SEE-6, 2006-2013



SOURCE: UN Comtrade, TEPAV calculations at HS1996 4 digit level
Bubble sizes represent Turkey's and SEE-6 combined exports to EU-28

Opportunities in Russian market

The Russian market represents a significant source of opportunities for SEE-6 and Turkish firms to target jointly. In 2013, Russia imported over 40 billion USD of agrofood products, making it the 9th largest market in the world. In 2013, Turkey's exports represented 4 percent and SEE-6 exports had 0.6 percent market share in Russia's agrofood imports, respectively. Moreover, due to being the only economy in the region to have a Free Trade Agreement with Russia, Serbia's exports constituted 90 percent of the SEE-6's exports to Russia.

TABLE 8 Products of opportunity for Turkish agrofood firms to enter EU-28 market through SEE-6

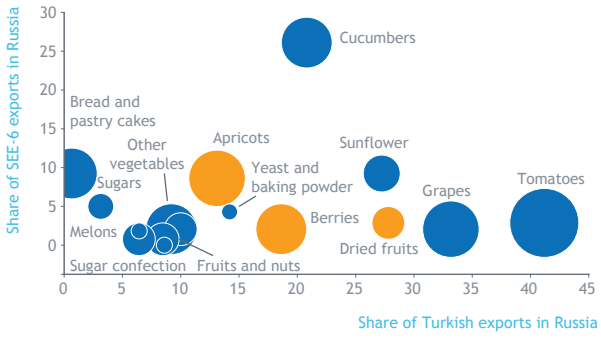
	EU-28 imports (million USD)	Turkey's exports to EU-28 (million USD)	CAGR of Turkish exports to EU-28	SEE-6 exports to EU-28 (million USD)	CAGR of SEE-6 exports to EU-28
Fermented beverages	1922	195	10.3%	39	19.5%
Sunflower seed oil	1077	5	7.9%	116	48.6%
Sweetened waters	1054	36	13.2%	30	11.4%
Frozen fruits and nuts	973	39	3.4%	311	9.7%
Bread and pastry cakes	745	95	9.2%	71	18.6%
Apricots, cherries, peaches and plums	462	145	-1.1%	28	27.0%
Sunflower seeds	409	28	8.6%	34	47.1%
Frozen vegetables	402	37	-7.4%	40	11.0%
Fruit jams, jellies and marmalades	153	81	14.4%	10	16.3%
Fresh cucumbers and gherkins	30	12	-1.7%	7	16.1%

SOURCE: UN Comtrade, TEPAV calculations at HS1996 4 digit level

In order to assess which agrofood products SEE-6 economies and especially Serbia could sell to Russia, we use the region's market shares in EU-28's imports as a proxy of product level competitiveness. If SEE-6 is able to compete in certain products in the EU-28 market, then it is also possible that the same products could be exported to Russia, given there is sufficient demand and no legal barrier. Hence, in order to reveal potential complementarities between agrofood industries of Turkey and SEE-6 economies that could result in boosting exports to Russia, it is essential to cross reference products in accordance with (I) Turkey's market share in Russian demand, and (2) SEE-6 competitiveness levels. Figure 59 shows the results of our analysis by taking into account Russia's total import volume (bubble size) and existing trade linkages between SEE-6 and Russia (red colored products are those which SEE-6 already exports at a volume greater than 5 million USD). Some of the products that fulfill all the criteria cited above are tomatoes, apricots, sunflower seeds, cucumbers, grapes and berries (see Table 9).

The final opportunity area we have analyzed is the possibility of firms active in SEE-6 agrofood sector to establish export links with the MENA market by utilizing Turkey's networks. In 2013, only 2 percent of SEE-6's agrofood exports were shipped to MENA. Considering that MENA's total agrofood imports grew 14 percent annually to reach 118 billion USD in 2013, opportunities for SEE-6 economies to diversify their agrofood exports by creating stronger links with MENA is certainly possible.

FIGURE 59 Opportunities for joint ventures targeting Russian market, 2013



SOURCE: UN Comtrade, TEPAV calculations at HS1996 4 digit level
Bubble sizes represent Russia's import volume for 2013

Once again, since SEE-6's agrofood export volume to MENA is too little to observe patterns, we proxy the region's exports to the EU-28 market as an indicator of product level competitiveness. Then, for each product, we cross reference SEE-6's presence in EU-28 with Turkey's presence in MENA. The products in which both regions are competitive exporters in their respective target markets are the products which agrofood producers in SEE-6 may also sell to MENA. Figure 60 displays the results of this analysis by taking into account MENA's demand volume (bubble size) and SEE-6's export capacity

TABLE 9 Products of opportunity for joint ventures targeting Russian market

	Turkish exports' market share in Russia, %, 2013	SEE-6 exports' market share in EU-28, %, 2013	Russia's total import volume, (million USD)	SEE-6 export volume to Russia (million USD)
Tomatoes	40.8%	1.4%	1,104	2.5
Grapes	33.7%	0.2%	576	4.8
Dried fruits	28.7%	1.9%	120	6.9
Sunflower seeds	28.1%	8.5%	235	3.2
Cucumbers	20.6%	25.1%	291	0.1
Berries	18.6%	1.0%	601	7.2
Yeast and baking powder	14.4%	2.8%	23	0.2
Apricots	13.1%	6.1%	613	51.2
Sugar confection	10.1%	1.6%	242	0.1
Other vegetables	9.2%	2.2%	487	0.1
Oil seeds	8.4%	0.4%	40	0
Fruits and nuts	8.1%	0.7%	230	0.1
Melons	6.1%	1.8%	20	0
Onions and garlic	5.7%	0.7%	203	0
Bread and pastry cakes	1.0%	9.5%	524	1.5
Sugars	3.4%	5.8%	105	0

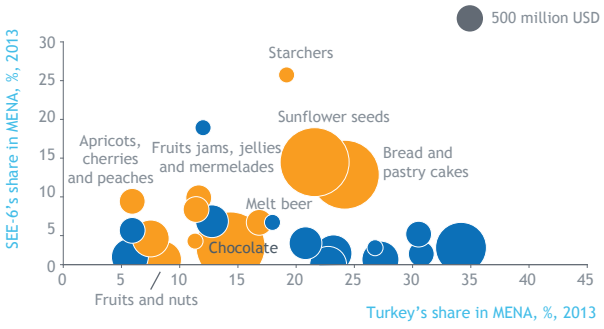
SOURCE: UN Comtrade, TEPAV calculations at HS1996 4 digit level

(products in red are those in which SEE-6 exports over 10 million USD to EU-28).

Even though the geographical distance between SEE-6 and MENA may be an important barrier to boost export volumes, interestingly, the majority of the products in our analysis are not fresh products (see Table 10). Products such as chocolate, pastry cakes, sunflower seed, canned vegetables, malt beer, fruit jams, starches and sugar syrups may be exported by SEE-6 to MENA without being negatively impacted by shipping times.

All in all, the products that we shortlisted in all three of our analyses present important opportunities for improving cooperation between Turkey and SEE-6 in agrofood industry. These products are sunflower seeds, fruit jams, jellies and marmalades, apricots, cherries and peaches, and fresh and pickled cucumbers and gherkins.

FIGURE 60 Opportunity areas for SEE-6 agrofood firms to diversify to MENA market



SOURCE: UN Comtrade, TEPAV calculations at HS1996 4 digit level
Bubble sizes represent MENA's import volume for 2013

TABLE 10 Products of opportunity for SEE-6 agrofood firms to diversify to MENA market

	MENA total imports, million USD, 2013	Turkey's market share in MENA, %, 2013	SEE-6 export volume to EU-28 million USD, 2013
Bread and pastry cakes	2,185	25%	71
Chocolate	2,006	15%	14
Sunflower seed	1,965	22%	116
Fruits and nuts	627	9%	13
Canned vegetables	552	8%	22
Apricots, cherries and peaches	273	6%	28
Malt beer	231	17%	15
Fruit jams, jellies and marmalades	218	13%	11
Lactose, Glucose and Fructose	206	13%	15
Starches	139	19%	15

SOURCE: UN Comtrade, TEPAV calculations at HS1996 4 digit level

BOX 4 Sutas investment in The Former Yugoslav Republic of Macedonia

Turkish dairy company Sütaş entered The Former Yugoslav Republic of Macedonia in 2011 thorough purchasing Swedmilk's cutting edge dairy production facility in Skopje. The company currently employs over 80 workers, although the plant is said to be operating with around 15-20 percent capacity. Sütaş also supports employment in animal husbandry sector by purchasing milk from nearly 500 farmers. Currently, their products are diversified including UHT milk, ayran, cheese and drinkable yoghurt.

During their move for internationalization, the company tried to find possible locations for their investment specifically in the Balkan area because of proximity and natural similarities. Following this analysis, the company picked The Former Yugoslav Republic of Macedonia primarily because of the similarity of the tastes and cuisine between the two markets. However, their targeted market is not just The Former Yugoslav Republic of Macedonia but the region as a whole.

Company executives report issues in establishing distribution networks during their first two years, though now the situation is said to be better. Furthermore, the company sees their Skopje experience as an opportunity to streamline the internationalization process of their management and production practices and perceives it as an appropriate testing ground for operating at a global level. Once confident with the internal functioning, Sutas will seek to springboard from Skopje to EU markets in terms of both trade and investment.

Even though the company is not export oriented, one with a less share of export in their revenue side, management is aware of the need to scale up production and diversify their target markets. The success story of Sütaş can be an important example for other large Turkish companies to start their internationalization process in SEE-6 economies.

HOW TO GET INTO ACTION FOR INVESTORS IN AGROFOOD SECTOR

In order to get further information regarding agrofood industry potential investors can get in touch with following contacts:

FOR ALBANIA:

- Banka Kombetare Tregtare (BKT); info@bkt.com.al; +35542250955
- Invest-in-Albania: contact@invest-in-albania.org; +355 44 80 85 65
- Republic of Turkey's Commercial Councilor in Albania; embassy.tirana@mfa.gov.tr; +35542380350
- Union of Chambers of Commerce and Industry of Albania; info@uccial.al; +35542247105

FOR BOSNIA AND HERZEGOVINA:

- BIGMEV; bigmev@bigmev.org; +38733264485
- Chamber of Economy of the Federation of Bosnia and Herzegovina; info@kfbih.com; +387033217782
- Foreign Investment Promotion Agency (FIPA); fipa@fipa.gov.ba; +38733278080
- Republic of Turkey's Commercial Councilor in Bosnia and Herzegovina; embassy.sarajevo@mfa.gov.tr; +38733568791
- Ziraat Bank Bosnia and Herzegovina

FOR KOSOVO:*

- Kosovo* Investment and Enterprise Support Agency (KIESA): info@invest-ks.org; +38103820036585
- Republic of Turkey's Commercial Councilor in Kosovo*; embassy.prishtina@mfa.gov.tr; +38138226044

FOR MONTENEGRO:

- Chamber of Economy of Montenegro; pkcg@pkcg.org; +38220230545
- University of Montenegro, Biotechnical Faculty; rektor@ac.me; +38220414255

FOR SERBIA:

- Chamber of Commerce and Industry of Serbia; info@pks.rs; +381113300900
- Halkbank Serbia (Cacanksa Banka); office@cacanskabanka.co.rs; +38132302100
- Republic of Turkey's Commercial Councilor in Serbia; embassy.belgrade@mfa.gov.tr; +381113332410
- Serbia Investment and Export Promotion Agency (SIEPA); office@siepa.gov.rs; +381113398550

FOR THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA:

- Agency for Foreign Investments and Export Promotion of the Republic of Macedonia - Invest Macedonia; fdi@investinmacedonia.com; +38923100111
- Economic Chamber of Macedonia; www.mchamber.mk; +389023244000
- Halkbank A.D. Skopje; CorporateMarketingHO@halkbank.mk; +389023240800
- Republic of Turkey's Commercial Councilor in Macedonia; embassy.skopje@mfa.gov.tr; +38923104710

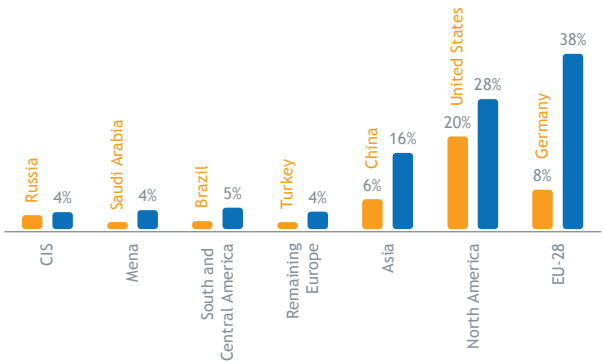
AUTOMOTIVE INDUSTRY

With a total volume of over 1.3 trillion USD, or roughly 7.5 percent of total world trade, automotive industry was the fourth most traded sector in the world in 2013, only to be surpassed by energy, electrical machinery and mechanical machinery. As a region, EU-28 is the largest buyer of automotive with a share of 38 percent in world's total imports, followed by North America and Asia (see Figure 61).[15] At the national level, United States is by far the largest importer of automotive, followed by Germany and China; these three countries constitute about 35 percent of total world automotive value chain demand. In this chapter, we analyze regional trends and prospects in the automotive industry by taking into account not just exports of finished automobiles but the whole automotive value chain.

In 2014, Turkey exported 7.2 billion USD and the SEE-6 exported 1.8 billion USD worth of cars. These volumes make cars the single largest export item of both Turkey's and SEE-6's export baskets. However, whereas automotive industry's evolution in Turkey was a gradual and organic process, in the case of SEE-6 it was one of rapid formation. Automotive FDI began coming to Turkey as early as the 1950s, although exports of the produced vehicles did not start until the aforementioned liberalization reforms of the 1980s (see Figure 62). Share of automotive industry in Turkey's total exports increased steadily following key investments by giants such as Toyota, Hyundai and Honda that set up production plants in the Marmara region. Prior to the 2008 crisis, share of automotive industry in the country's exports had reached 11 percent. However, stagnating demand in EU-28 decreased Turkish exports and the industry is yet to reach its pre-crisis volumes.

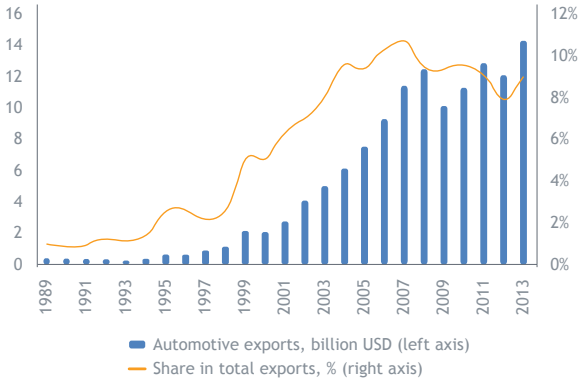
The SEE-6 economies' story stands in significant contrast when compared with the Turkish case. During the 1980s, the Former Yugoslavia's car exports already constituted over 10 percent of the country's total exports, a figure Turkey was able to attain only in late 2000s. However, as with many other capabilities in the region, the break up eroded capabilities and dismantled value chains in the region, and the automotive industry was not able to recover for two decades (see Figure 63). Only after 2011 was the region able to reintegrate itself into the global automotive value chain, largely due to Fiat's brownfield investment in Kragujevac, Serbia to take over Zastava Automobile's manufacturing plant.

FIGURE 61 Geographical regions and top economies by share in total automotive imports, 2013



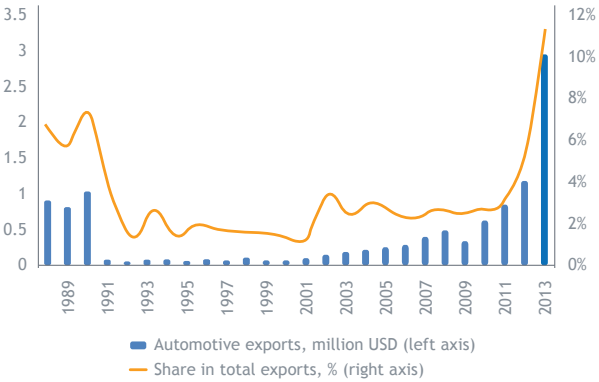
SOURCE: UN Comtrade, WTO, WB UNIDO, TEPAV calculations
Note: Product list is in line with UNIDO. (2010).[12]

FIGURE 62 Turkey's automotive value chain exports, 1989-2013



SOURCE: UN Comtrade UNIDO, TEPAV calculations
Note: Product list is in line with UNIDO. (2010).[13]

FIGURE 63 SEE-6's automotive value chain exports, 1988-2013



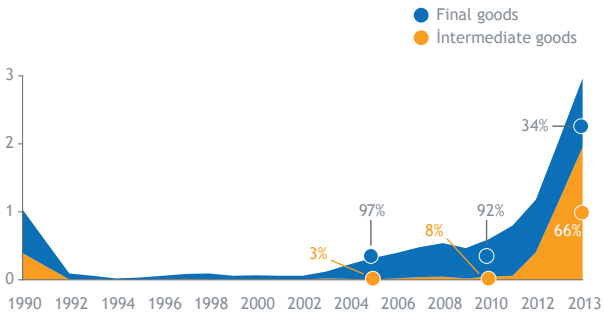
SOURCE: UN Comtrade, UNIDO, TEPAV calculations
Note: Product list is in line with UNIDO. (2010).[14]

The best way to observe the evolution of automotive value chain in an economy is to break down the imports and exports by intermediate and final goods. Intermediate goods in the automotive industry are those that are used as inputs to production of other intermediate and final goods. For example, both the automotive seats exported by Bosnia and Herzegovina and diesel catalysts exported by The Former Yugoslav Republic of Macedonia are categorized as intermediate goods, whereas Fiat 500Ls exported by Serbia are final goods. Hence, tracing the import sources and export destinations of goods in the value chain also enables us to visualize global and regional linkages.

The breakup of the Former Yugoslavia significantly damaged the automotive industry in the region. During 1970s and 1980s, the country was one of the top 15 exporters of transport equipment in the world. Following the breakup, however, the value chain was damaged significantly, and the region's capability to produce and export final goods (i.e., cars) was completely erased (see Figure 65). Throughout this period, remnants of the automotive industry remained, however, their export volume and integration with global value chains remained extremely limited. Only with Fiat's investment in Serbia was the region able to restart its final good exports in the automotive value chain.

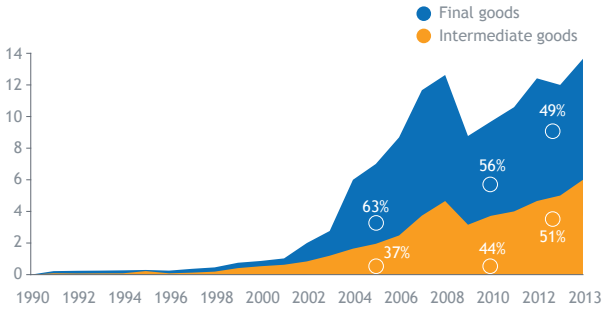
In contrast, Turkey's integration to the global automotive value chain expanded consistently during the past two decades. In 2013, Turkey imported 9.5 billion USD of intermediate automotive goods, mostly from EU member states such as Germany, UK, France, Italy and Poland (see Figure 64). In turn, the country exported 14 billion USD of automotive goods, divided equally between intermediate and final goods (see Figure 66).

FIGURE 65 SEE-6 economies' automotive industry exports, intermediate and final goods, billion USD, 1990-2013



SOURCE: UN Comtrade, UNIDO, TEPAV calculations
Note: Product list is in line with UNIDO.[16]

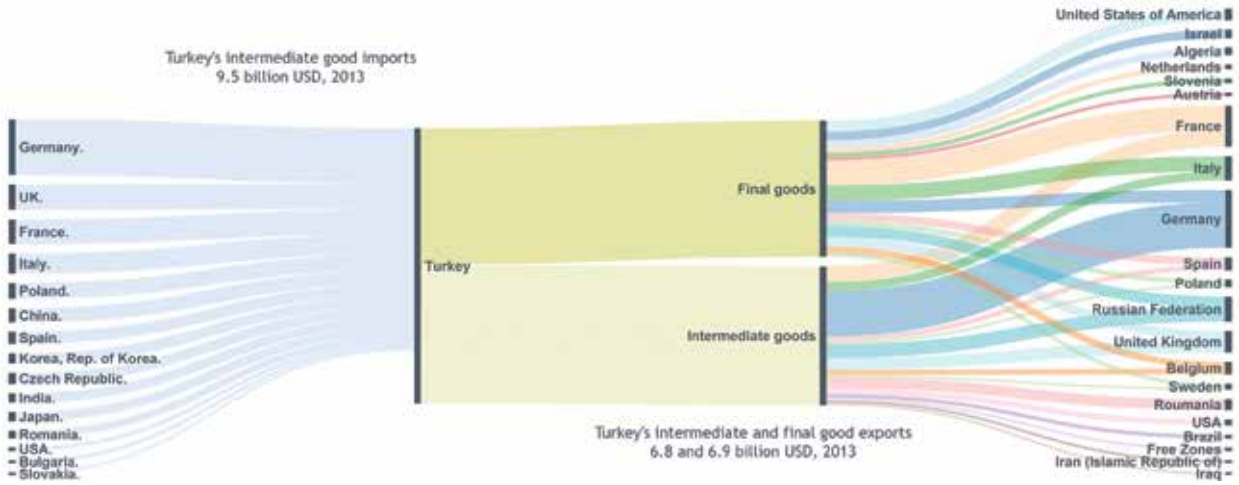
FIGURE 66 Turkey's automotive industry exports, intermediate and final goods, billion USD, 1989-2013



SOURCE: UN Comtrade, UNIDO, TEPAV calculations
Note: Product list is in line with UNIDO. (2010).[17]

Whereas Turkey exports mostly intermediate goods

FIGURE 64 Turkey's automotive industry imports and exports, by intermediate and final goods, 2013



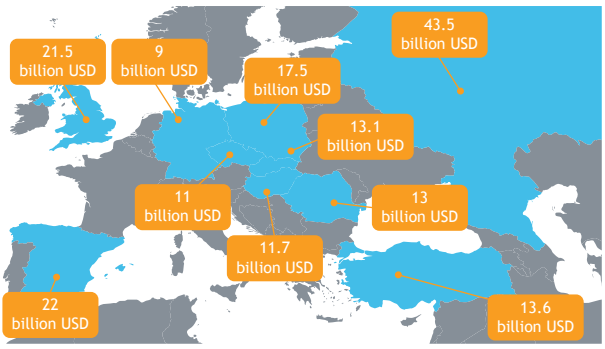
SOURCE: UN Comtrade, UNIDO, TEPAV calculations
Note: Product list is in line with UNIDO. (2010). Mapping Global Value Chains: Intermediate goods trade and structural change in the world economy. except including of product 59883 under SITC Rev. 3.

to Germany and Romania, its exports to Italy, USA, Netherlands and Israel are predominantly finished cars.

The driving force behind Turkey's booming automotive industry has been foreign direct investments. As a direct effect of these investments, a local supplier base have developed and clustered around large automotive plants. As a result, the share of intermediate automotive goods in Turkey's total automotive goods exports has consistently increased from 37 percent in 2005 to 51 percent in 2014, getting local producers integrated with global production networks.

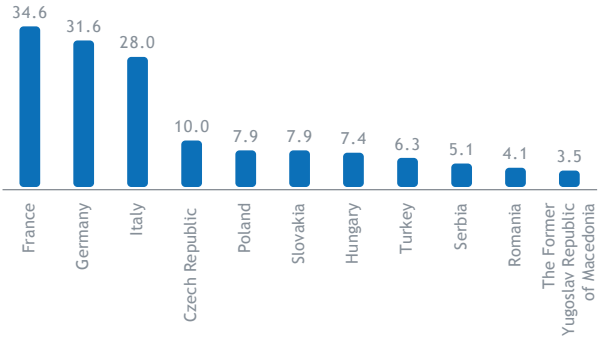
A similar trend of increased automotive FDI is observed for the EU's new member states. Between 2003 and 2014, Poland, the Czech Republic, Slovakia, Hungary and Romania were one of the top 20 economies in terms of automotive FDI inflows (see Figure 67). This trend is in line with the 'flying geese paradigm,' an economics theory that postulates industrial activities will continuously transfer from developed core countries to lesser developed periphery countries in a region due to advantages in costs. As wages and other related costs in these economies start to rise, we are likely to see yet another shift in regional production patterns that favor SEE-6 economies. Indeed, except Romania, in the top automotive destination new member states such as Czech Republic, Poland, Slovakia and Hungary labor costs are 50 percent higher than Serbia, and at least double that of The Former Yugoslav Republic of Macedonia (see Figure 68). Hence, Fiat's investment in Serbia may be one of many automotive industry investments to follow given the region's, and especially Serbia and The Former Yugoslav Republic of Macedonia's, developing capabilities in mid and high-tech manufacturing.

FIGURE 67 European economies that are one of top 20 automotive FDI destinations worldwide, between 2003 and 2014, $ billion



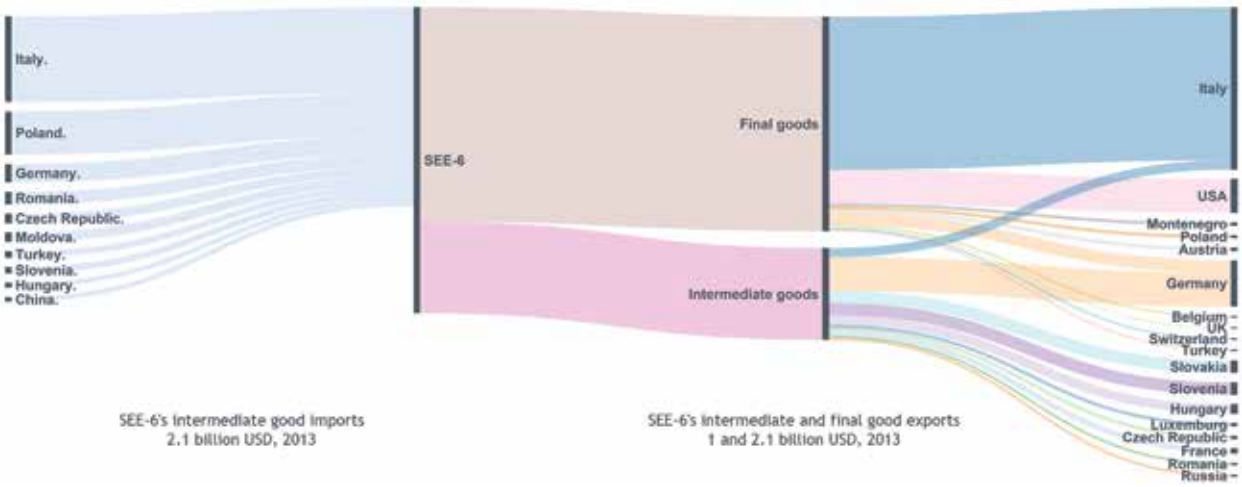
SOURCE: fdimarket, TEPAV calculations

FIGURE 68 Average hourly labor costs in core EU, new member states and SEE, €, 2012



SOURCE: Eurostat

FIGURE 69 SEE-6's automotive industry imports and exports, by intermediate and final goods, 2013



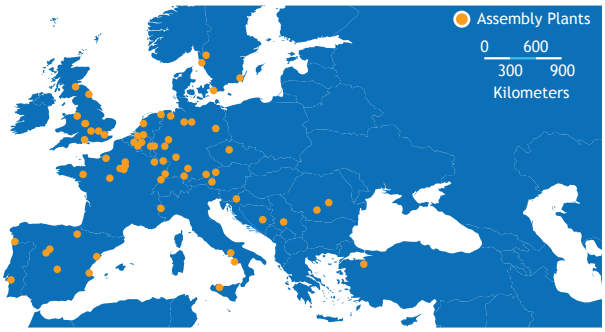
SOURCE: UN Comtrade, UNIDO, TEPAV calculations
Note: Product list is in line with UNIDO. (2010). Mapping Global Value Chains: Intermediate goods trade and structural change in the world economy. except including of product 59883 under SITC Rev. 3.

In 2013, the SEE-6 imported 2.1 billion USD of intermediate goods, almost all from surrounding EU member states such as Italy, Germany, Poland, the Czech Republic, and Romania. In turn, the region exported about 2 billion USD each of intermediate and final automotive goods (see Figure 69). Whereas virtually all final good exports were done by Serbia, The Former Yugoslav Republic of Macedonia also exported a significant portion of the region's intermediate goods. A recent significant development in the export patterns of the region is the exports of intermediate automotive goods to neighboring automotive manufacturing economies such as Slovenia, Slovakia and Hungary. Despite still in relatively smaller quantities, these exports indicate the forming linkages between SEE-6 economies and EU automotive industry.

Indeed, SEE-6 appears to be the next natural spillover region for the European automotive industry. In 1980, a significant majority of the automotive manufacturing plants in the continent was clustered in Western Europe (Figure 71). However, following the end of the Cold War and with the EU's enlargement process, automotive industry expanded its production centers to the Eastern Bloc. Currently, SEE-6 economies are the only region between Germany, Italy and Marmara region which do not have multiple automotive manufacturing plants (see Figure 70). However, given the positive experience of Fiat's investment that is operating much more cost efficiently compared to automotive plants in Slovakia, this is likely to change (see Figure 72).

Currently, one of the best ways to increase the level of cooperation and integration between Turkey's and SEE-6's automotive production networks is to engage Association of Automotive Parts and Components Manufacturers of Turkey (TAYSAD) in order to make sure Turkish automotive parts producers are aware of the increasing potential of the region. In our interviews Turkish automotive parts producers that have investments

FIGURE 71 Automotive manufacturing plants in Europe, 1980



SOURCE: Klier and Rubenstein, 2011

FIGURE 72 Benchmarking automotive productions of Serbia and Slovakia, 2012-2013

	Slovakia	Serbia
Car producers	Volkswagen, Peugeot, Citroen, KIA	Fiat, Chrysler
Total car produced	927,000 (2012)	~200,000 (2013)
Total employees in car plants	~17,000	~3,500
Total exports	16.3 billion €	1.5 billion €
Cars produced per employee	~54	~60
Monthly grose wage in sector	800 to 1500	~650

SOURCE: World Bank, 2014. Data for Slovakia is from 2012, and for Serbia from 2013.

FIGURE 70 Automotive manufacturing plants in EU-28, Turkey and SEE-6, 2015

SOURCE: European Automotive Manufacturers Association, 2015, TEPAV visualization

in Romania and Bulgaria already expressed interest in either moving their facilities or expanding to SEE-6 once investment climate and ease of doing business in the region improves. Likewise, Turkish automotive parts producers that do not currently have manufacturing faclities outside Turkey but supply their products to the EU markets from the Marmara region also expressed interest to invest in SEE-6 in the future primarily due to rising land and labor costs. Hence, the region offers significant opportunities to Turkish automotive value chain suppliers that seek to cut labor costs and improve productivity levels while decreasing their distances to the EU automotive value chain.

BOX 5 Serbia and Fiat case

One of the main hypotheses of our project is that capabilities inherited from the Former Yugoslavia times, if rightly mobilized, can be still relevant for business. A good example of this is the automotive cluster in Kragujevac, Serbia. Automobile production has started in 1960s in the city and Italian car manufacturer Fiat scaled up this production in 2008. The only automotive exporter at significant amounts in the region is Serbia and one large scale factory boosts the production capacity after 2008.

Today, Kragujevac is known with its automotive cluster formed around the Fiat factory. With inherited knowledge from Former Yugoslavia times and qualified labor force from the University of Kragujevac with 14,000 graduates every year, Kragujevac is both a hub in the region and beyond the region. Also, there is already a highly active commercial link between the region and Turkey in terms of automotive cluster. For instance, Standard Profil which is a Turkish supplier of automotive sealing systems and operates a plant in Bulgaria, is among the trusted suppliers of the Fiat factory.

The next step can be connecting the single suppler-driven Kragujevac with Bursa's automotive cluster, which is structured around multiple big players and supported by a vibrant SME auto part producers' base. Such cooperation would entail not only investment and skills transfer at the automotive industry level, but also know-how transfer between local chambers and municipalities regarding building a healthy and well-functioning private sector and city life around automotive industry clusters.

BOX 6 The Former Yugoslav Republic of Macedonia and its emerging automotive cluster

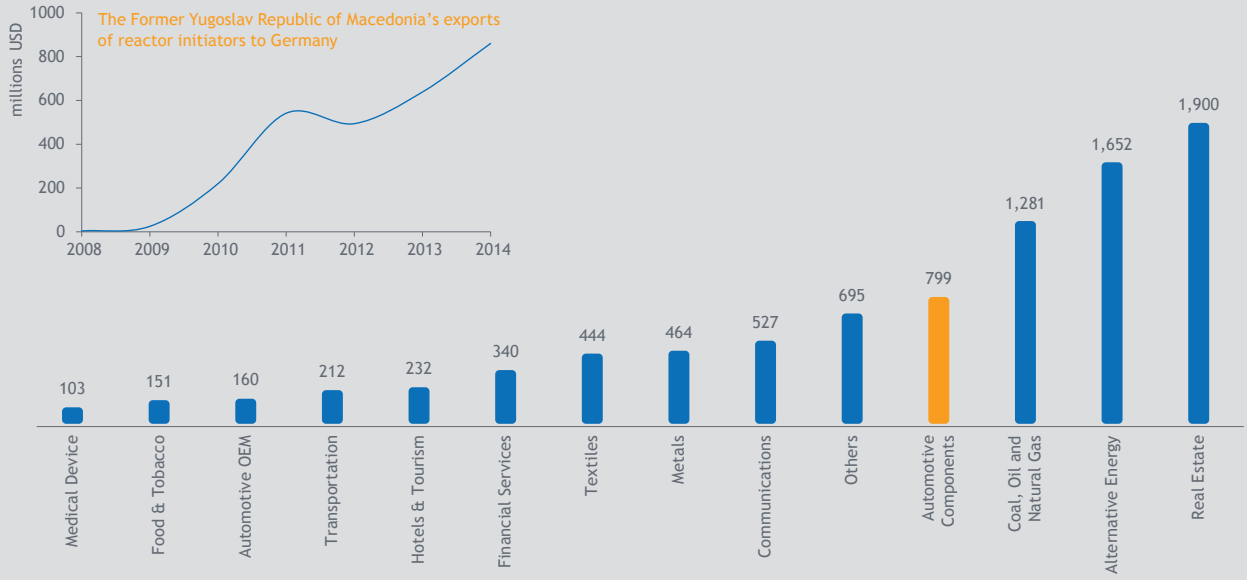
SEE-6 economies mostly attract FDI inflows into mostly non-tradable sectors such as real estate, banking and energy. For The Former Yugoslav Republic of Macedonia, presence of foreign investors starts to concentrate on medium technology sectors such as automotive. Currently, large American, British and German automotive part producers have invested in the Technological Industrial Development Zones in Skopje. Belgian bus and coach producer Van Hool has also invested in TIDZ Skopje 2, and is exporting busses to the United States and other countries from this location.

Even though the sector is not organic, it seems to be succeeding and increasingly attracting large investments. While these investments made automotive components as the most attractive tradable FDI sector in The Former Yugoslav Republic of Macedonia, they have also significantly boosted the export performance of the country especially to German market (see Figure 73).

The experience of already existing companies seems to be positive till now. For instance, Johnson Controls has plans to increase its number of employees from 150 to 500 after six years of production in the country.[19] If the experience of the already existing companies continues to be positive, it is definitely possible for The Former Yugoslav Republic of Macedonia to increasingly become an automotive industry hub in the next decade.

As World Bank states that with one exception; seat belt; there is lack of link between domestic SMEs and large multinationals hence the supply chain is very limited. Once, The Former Yugoslav Republic of Macedonia was a components supplier to Zastava. With production scale up in Zastava by Fiat, there is again potential for intra-regional supply chain. However, bottlenecks to growth include problems in supply of natural gas because of undeveloped gas infrastructure and high cost of energy. As a whole, the next challenge for the economy is establishing a link between this newly emerging cluster and domestic SMEs to benefit from knowledge spillover and technology diffusion with upgrading its infrastructure.[20]

FIGURE 73 FDI inflows to The Former Yugoslav Republic of Macedonia, million US $, cumulative, 2003-2014



SOURCE: fdimarkets, UN Comtrade, TEPAV calculations
Note: 3815 under HS categories at 4 digits corresponds to reaction initiators

HOW TO GET INTO ACTION FOR INVESTORS IN AUTOMOTIVE SECTOR

In order to get further information regarding automotive cluster and investment ecosystem, potential investors can get in touch with following contacts:

FOR THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA:

- Agency for Foreign Investments and Export Promotion of the Republic of Macedonia - Invest Macedonia; fdi@investinmacedonia.com; +38923100111
- Automotive Cluster of Macedonia; www.mchamber.mk; +389 (02) 3244000
- Economic Chamber of Macedonia; www.mchamber.mk; +389023244000
- Halkbank A.D. Skopje; CorporateMarketingHO@halkbank.mk; +389023240800
- Republic of Turkey's Commercial Councilor in Macedonia; embassy.skopje@mfa.gov.tr; +38923104710

FOR SERBIA:

- Foreign Investment Council; office@fic.org.rs; +381113281958
- Halkbank Serbia (Cacanksa Banka); office@cacanskabanka.co.rs; +38132302100
- Kragujevac Chamber of Commerce; komora@rpk.kg.co.rs; +38134335805
- Republic of Turkey's Commercial Councilor in Serbia; embassy.belgrade@mfa.gov.tr; +381113332410
- Serbia Investment and Export Promotion Agency (SIEPA); office@siepa.gov.rs; +381113398550
- Chamber of Commerce and Industry of Serbia; info@pks.rs; +381113300900
- Subotica Free Zone; mayor@subotica.rs; +38124666666

FOR TURKEY:

- TAYSAD, Association of Automotive Parts & Components Manufacturers; info@taysad.org.tr; +902626589818 -

TEXTILE INDUSTRY

As mentioned in the Diagnostics section, textile industry is one of the few sectors in which the region runs a trade surplus. In this section, we analyze the textile industry in more detail with the aim of uncovering areas of opportunities by taking into account global, regional and national trends both at the sub-sector and product levels. Table 11 outlines the 14 textile sub-sectors as classified by the Harmonized Commodity Description and Coding System. Sub-sectors 50 through 60 cover primary or intermediate textile goods such as yarns, fabrics and fibers (see Table 11). As these goods have little to no value added and their contribution to the transformation potential of an economy is rather limited our analysis mainly focuses on sub-sectors 61, 62 and 63 which comprise final products; i.e., finished apparel, clothing and home textile goods.

Global textile trade has been growing rather steadily in the past two decades. Between 1996 and 2013, total textile final products market grew at an annual rate of 7 percent, reaching a market size of almost 500 billion USD (see Figure 74). Furthermore, textile exports firmly bounced back from the global financial downturn to grow at an annual rate of 15 percent during 2010-2011 and 10 percent in 2013.

In the past two decades, the most important structural change in the textile industry has been the increasing dominance of Chinese goods. Since 1996, China's finished textile product exports grew at an annual rate of 12.7 percent, skyrocketing its share in the world's final textile good exports from 17 to 41 percent. Therefore, in our analysis of potential areas of opportunities for Turkish and SEE-6 cooperation in textile industry to target third markets, we also take into account the presence of China and other important low-cost Asian players in key markets.

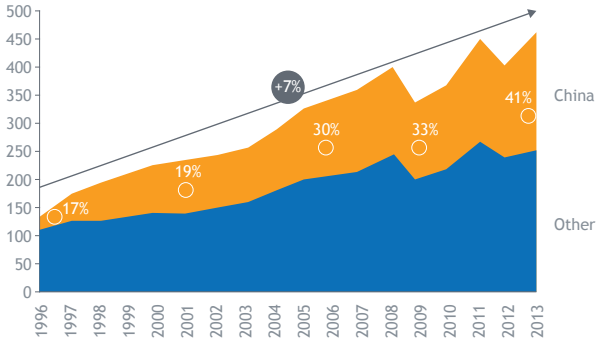
TEXTILE IS LISTED BY GOVERNMENTS OF ALL SEE-6 ECONOMIES AS AN AREA OF OPPORTUNITY FOR POTENTIAL INVESTORS. EXISTENCE OF A TEXTILE MANUFACTURING LEGACY IN THE REGION MEANS ACCESS TO SKILLED LABOUR AND ACTIVE SUPPLY CHAINS. PROXIMITY TO THE EU MARKET AND COMPETITIVE LABOUR COSTS, RENDER SEE-6 AN IMPORTANT INVESTMENT OPPORTUNITY FOR EXPORT ORIENTED TURKISH TEXTILE PRODUCERS.

TABLE 11 Textile sub-sectors as defined by HS Coding System

HS	Definition
50	Silk, including yarns and woven fabrics thereof
51	Wool, including yarns and woven fabrics thereof
52	Cotton, including yarns and woven fabrics thereof
53	Vegetable textile fibers
54	Man-made filaments
55	Man-made staple fibers
56	Wadding, felt other special yarns
57	Carpets and other textile floor coverings
58	Special woven fabrics
59	Coated, covered or laminated textile products
60	Knitted or crocheted fabrics
61	Articles of apparel and clothing, knitted or crocheted
62	Articles of apparel and clothing, not knitted or crocheted
63	Made-up textile articles

SOURCE: UN Comtrade, Foreign Trade On-Line

FIGURE 74 World final textile goods exports, 1996-2013, billion USD



SOURCE: UN Comtrade, TEPAV calculations at HS 1996 2 digit level

Textile industry's importance for SEE-6 economies is clearly observed both through analyzing trade data and looking at government priorities. To begin with, all of the SEE-6 economies' investment promotion agencies list textile as an 'area of opportunity' or a 'key industry.' The current significance attributed to the textile sector in the region is rooted in the historical prominence of the industry dating back to

the Former Yugoslavia. Figure 75 displays the share of all textile exports in the Former Yugoslavia's total exports between 1962 and 1990. Throughout these three decades, share of textile exports hovers between 10 to 15 percent of all exports of the country. In 2014, the same figure for the SEE-6 economies was at 11.3 percent, in a way signaling the continuation of textile industry's historical importance in the region.

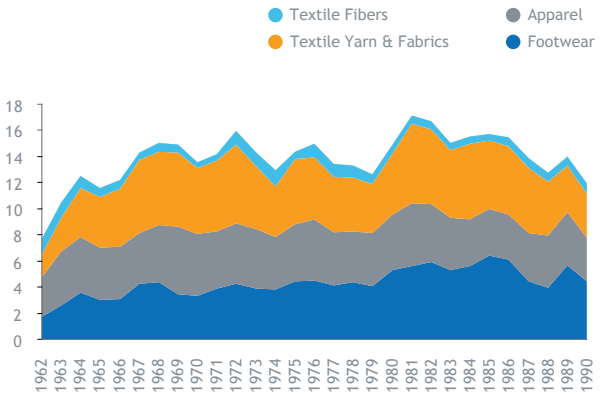
However, structure of the textile industry in the region has changed significantly since the Former Yugoslavia period. Whereas formerly the region was also exporting primary products and intermediate goods such as yarn and fabrics (see Figure 75), currently SEE-6 economies almost only export finished products (see Figure 76). As such, in the 15 textile sub-sectors, the region runs a trade deficit in primary products and intermediate goods and a trade surplus in finished goods. This indicates that the region's textile industry imports raw material such as cotton, fibers and yarn (HS 52, 54, 55, 59 and 60), manufactures finished goods and exports them (HS 61, 62 and 64).

In 2013, the SEE-6 economies exported over 1.83 billion USD worth of finished textile products (HS 61, 62 and 63) in total, which constituted 0.3 percent global textile exports. A significant majority of these exports were done by The Former Yugoslav Republic of Macedonia and Serbia with shares of 35 percent and 34 percent of total textile exports respectively. In contrast, Albania's share in the region's textile exports was 19 percent, with Bosnia and Herzegovina trailing behind at 11 percent.

Throughout the past decade, SEE-6's textile exports grew at rates close to or slightly below regional averages. Figure 77 displays the textile sub-sectors within all sub-sector export performances of the region. Position of a sub-sector along the horizontal axis shows its growth performance during the booming years prior to financial crisis, whereas vertical placement reflects growth performance

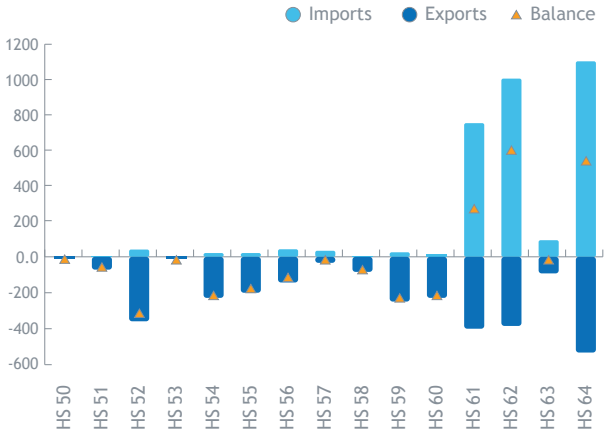
EVEN THOUGH TEXTILE IS A KEY INDUSTRY FOR THE SEE-6 ECONOMIES, IT DOES NOT NECESSARILY FURTHER ECONOMIC INTEGRATION. SEE-6 EXPORTS OVER 60 PERCENT OF ALL FINISHED TEXTILE PRODUCTS TO ONLY TWO COUNTRIES: GERMANY AND ITALY.

FIGURE 75 The Former Yugoslavia's textile exports, % of GDP



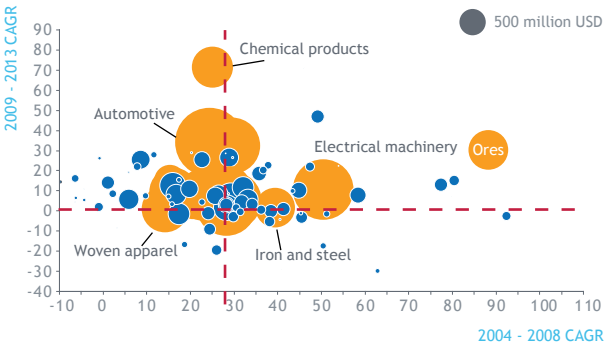
SOURCE: UN Comtrade, TEPAV calculations at HS 1996 2 digit level

FIGURE 76 SEE-6's trade balance in textile sub-sectors, 2013, million USD



SOURCE: UN Comtrade, TEPAV calculations at HS 1996 2 digit level

FIGURE 77 Sectoral export growth in SEE-6, 2004-2013, % annual growth



SOURCE: UN Comtrade, TEPAV calculations at HS 1996 2 digit level
Bubble sizes represent SEE-6 export volume in 2013

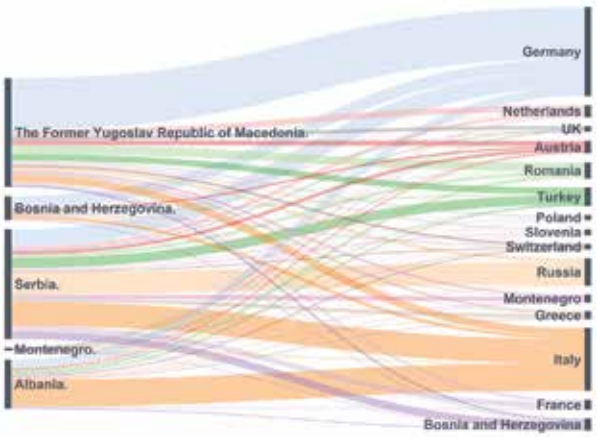
during and right after years of crisis. The lines that divide the graph in four quadrants do so at the regional average export growth rates during these two periods. So, sectors at bottom right are ones which grew rapidly prior to the crisis but failed to do so after (for example, iron and steel), sectors at bottom left are ones that have been consistently shrinking in the past decade (for example, woven apparel), sectors at top left are emerging sectors which have been growing at faster rates since 2009 (for example, automotive), and sectors at top right have been able to sustain their growth for the better part of the decade (for example, electrical machinery and ores).

Despite its significant volume of exports, the existing structure of the SEE-6 textile industry does not necessarily facilitate global trade integration. This is because, only two countries, namely Germany and Italy, receive over 65 percent of SEE-6's finished textile product exports. However, there is no single regional trend for export flows as each SEE-6 economy exports finished textile products to a different set of destinations (see Figure 78). Whereas The Former Yugoslav Republic of Macedonia exports the majority of its textile products to Germany, as a result of Italian FDI in its textile sector Albania exports almost all of its production to Italy.

The EU market is the primary textile exports market of not only SEE-6 economies but also Turkey. Turkey's finished textile product exports grew at par with the world between 2000 and 2013. Almost all of this growth was due to an increase in Turkey's exports to the EU-28 market up until the crisis years (see Figure 79). Following the crisis, however, as Europe's demand dwindled, Turkey began its search for alternative markets to ship its textile goods to. Still, as of 2013, the EU-28 economies received three quarters of Turkey's textile exports.

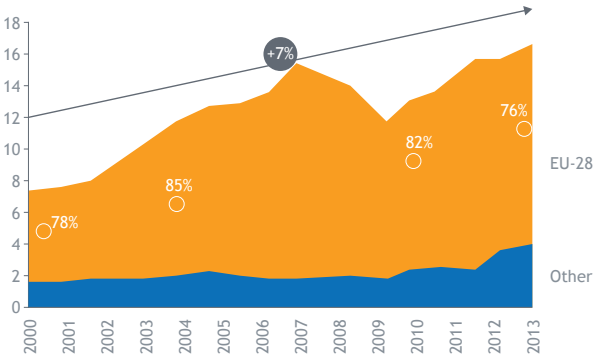
So the question is whether the EU textile demand is likely to grow in the upcoming years and if there is room for SEE-6 economies and Turkey to increase their market shares in EU against extremely price competitive textile sectors of China, Bangladesh and India. Figure 80 shows the finished textile product imports of EU-28 and its four major non-EU sources of imports since 2000; China, Bangladesh, India and Turkey. In 2013, these four countries supplied nearly three quarters of EU-28's total finished textile product imports that reach over 100 billion USD. Whereas Turkey's market share in the European market has been relatively stable since 2000, China and Bangladesh have doubled their market shares. Nevertheless, since 2010, China's

FIGURE 78 Source and destination of SEE-6 final textile good exports, 2013



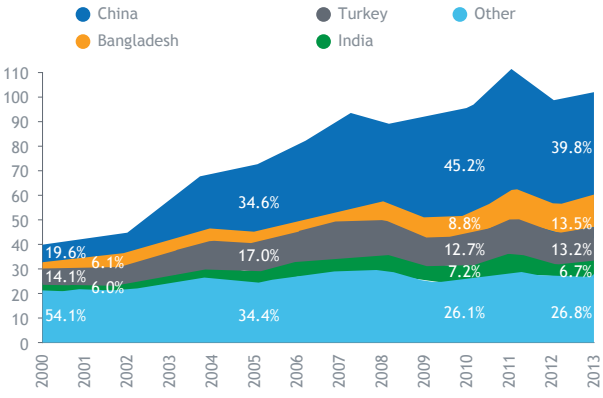
SOURCE: UN Comtrade, TEPAV calculations at HS 1996 2 digit level

FIGURE 79 Turkey's final textile good exports, 2000-2013, billion USD



SOURCE: UN Comtrade, TEPAV calculations at HS 1996 2 digit level

FIGURE 80 EU-28 final textile good imports, 2000-2013, billion USD



SOURCE: UN Comtrade, TEPAV calculations at HS 1996 2 digit level

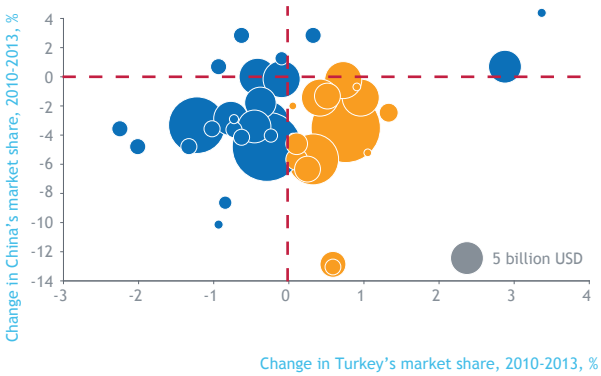
hold over the EU market has been weakening and has dropped from over 45 percent to below 40 percent.

In order to see the potential opportunities that gradual shift away from China in Europe's textile demand may open up, in Figure 82 we juxtapose Turkey's and China's performance at the product level. Figure 81 displays the products in which China has been losing and Turkey has been gaining market share in the European market, and also takes into account the demand volumes of the EU member states (bubble sizes). These products are where most of the opportunities for new entries and expansion of existing capacities in textile are likely to be at. Investing in SEE-6 is one of the best ways Turkish textile producers can capitalize on China's decreasing market share in these products by both cutting down labor and logistics costs while being able to maintain production standards.

Table 12 lists the products visualized in the bottom right quadrant of Figure 81 in terms of European demand and market shares of China, Turkey as well as the SEE-6. In 2013, over 40 billion USD worth of the products listed was imported by the EU-28 countries, indicating a significant opportunity for the Turkish private sector to increase its presence in the European market. Furthermore, SEE-6 economies also export all of the listed products to the EU member states at varying rates, signaling the existence of production capabilities in the region.

Finally, in order to see the quality of the final textile goods produced by the SEE-6 economies, we benchmark the unit price of a pair of jeans exported by SEE-6 economies and Turkey against cheaper Asian producers as well as premium

FIGURE 81 China's and Turkey's performance in final textile goods in the EU-28 market, 2010-2013



SOURCE: UN Comtrade, TEPAV calculations at HS 1996 4 digit level
Bubble sizes indicate EU-28 import volume in 2013

TABLE 12 Textile products with opportunities in the EU market

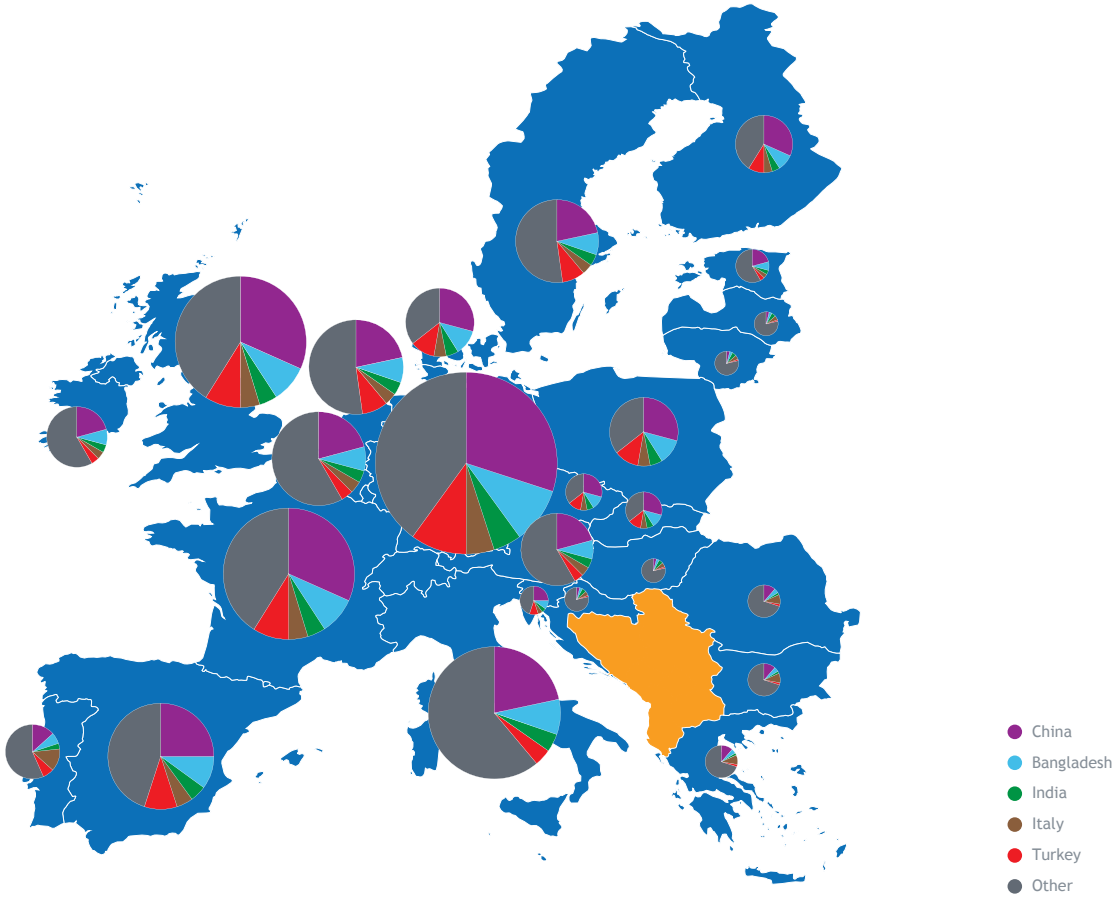
Product	EU-28 import volume, billion USD, 213	China's share in EU-28 imports	Turkey's share in EU-28 imports	SEE's share in EU-28 imports
Men's, boy's suits	23.80	23%	8%	1%
Sweaters, pullovers, vests	21.30	33%	7%	0%
Babies' garments & accessories	19.50	19%	8%	1%
Track suits, ski-suits & swimwear	6.96	15%	14%	0%
Garments, knit etc., coated etc., rubber	6.22	19%	9%	2%
Pantyhose, socks, & other hosiery	5.82	16%	8%	2%
Men's or boys' suits	5.61	19%	17%	3%
Men's or boys' shits	3.00	38%	4%	0%
Women's, girls' blouses, shirts	2.22	24%	9%	0%

SOURCE: UN Comtrade, TEPAV calculations

quality exporters (see Figure 83). We can calculate the average unit price per exporter because the UN Comtrade database provides both the quantity of the exported goods at the product level and the total value of the transaction. As can be seen, with the exception of Albania, at around 17 USD, three SEE-6 economies and Turkey have very similar unit prices for a pair of jeans they produce and export. Such similarity in unit prices hint at comparable level of qualities of manufactured textile items in these four economies.

All in all, textile industry has the potential to contribute to the region's future transformation while enabling Turkish private sector to further penetrate the European market. However, the region's textile value chain also needs upgrading. Due to the smaller scale of its production facilities, SEE-6 economies cannot compete with bulk suppliers such as China or Bangladesh in terms of unit price. If supported with the right public and private visions, this has the potential to transform apparel manufacturing in the region. As a whole, SEE-6 economies must begin moving away from supplying international brands with only simple assembly services and develop more complex capabilities such as product design, finishing and packaging.

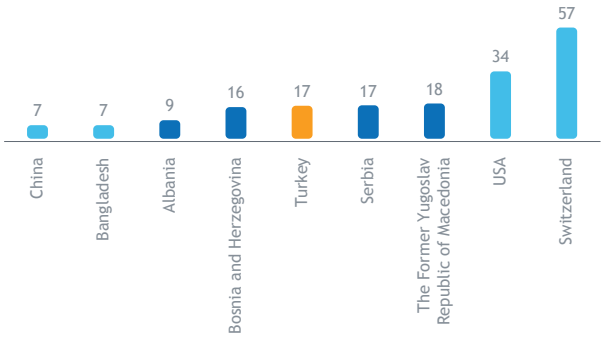
FIGURE 82 Market share of top exporters in the EU-28 final textile good imports, 2013, %



SOURCE: TEPAV visualization of UN Comtrade bilateral trade data

The Turkish private sector successfully managed the transition from assembly-driven value added to design and brand-driven value added not long ago. Hence, Turkish investments in textile carry the potential of bringing both the mindset and the know-how to the SEE-6 economies. In turn, outward oriented Turkish textile firms can become much more competitive by extending their value chains to in the region. Surprisingly, across EU-28, Turkey has the highest market share in final textile products in Germany (see Figure 82). Given that Germany is probably the toughest market to achieve competitiveness in all of Europe, Turkish textile products are ready to achieve higher market shares in other EU countries. This process may be facilitated by establishing and strengthening the links between Turkey's and SEE-6's textile sectors.

FIGURE 83 Unit price of an exported pair of jeans, 2013, USD



SOURCE: UN Comtrade, HS96 620342

BOX 7 Zara's production in Edirne

Prioritizing textile and apparels in a development program should be done with caution because of the nature of the sector: it is highly labor intensive and relying solely on cheap labor could result in losing competitive advantage to other low cost economies.

Turkey, being an important textile and apparels producer since the 1980s, have been going through an important transformation process. With various support programs of the government and chambers, Turkish firms are trying to upgrade their technology and branding.

Today, more and more companies are going beyond using cheap labor as a competitive advantage and instead focus their efforts on quality, speed and branding. Edirne, a province in Turkey, has a success story with Şahinler Holding which seems to have gone through a similar process of transformation, and has moved towards producing high value added goods.

Edirne, once the capital of the Ottoman Empire, is located in the Northwest part of Turkey and the city is Turkey's gate to the European market. Currently, Şahinler Holding, through its subsidiary Modavizyon based in Edirne, employs more than ten thousand people. It is one of the major suppliers of the global textile giant Zara.

The collaboration between Şahinler holding and Zara brings a need to increase production capacity which means employing five thousand people more. The firm representatives state two factors as their major drivers of competitiveness: speed and quality.

SEE-6 economies success in textile and apparel will depend on the degree to which companies with similar approaches start operating in the region.

HOW TO GET INTO ACTION FOR INVESTORS IN TEXTILE SECTOR

In order to get further information regarding textile cluster and investment ecosystem, potential investors can get in touch with following contacts:

FOR ALBANIA:

- Banka Kombetare Tregtare (BKT); info@bkt.com.al; +35542250955
- Invest-in-Albania: contact@invest-in-albania.org; +35544808565
- Republic of Turkey's Commercial Councilor in Albania; embassy.tirana@mfa.gov.tr; +35542380350
- Union of Chambers of Commerce and Industry of Albania; info@uccial.al; +35542247105

FOR BOSNIA AND HERZEGOVINA:

- BIGMEV; bigmev@bigmev.org; +38733264485
- Chamber of Economy of the Federation of Bosnia and Herzegovina; info@kfbih.com; +387033217782
- Foreign Investment Promotion Agency (FIPA); fipa@fipa.gov.ba; +38733278080
- Republic of Turkey's Commercial Councilor in Bosnia and Herzegovina; embassy.sarajevo@mfa.gov.tr; +38733568791
- Ziraat Bank Bosnia and Herzegovina

FOR KOSOVO:*

- Kosovo* Investment and Enterprise Support Agency (KIESA); info@invest-ks.org; +38103820036585
- Republic of Turkey's Commercial Councilor in Kosovo*; embassy.prishtina@mfa.gov.tr; +38138226044

FOR SERBIA:

- Chamber of Commerce and Industry of Serbia; info@pks.rs; +381113300900
- Halkbank Serbia (Cacanksa Banka); office@cacanskabanka.co.rs; +38132302100
- Republic of Turkey's Commercial Councilor in Serbia; embassy.belgrade@mfa.gov.tr; +381113332410
- Serbia Investment and Export Promotion Agency (SIEPA); office@siepa.gov.rs; +381113398550

FOR THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA:

- Agency for Foreign Investments and Export Promotion of the Republic of Macedonia - Invest Macedonia; fdi@investinmacedonia.com; +38923100111
- Economic Chamber of Macedonia; www.mchamber.mk; +389023244000
- Halkbank A.D. Skopje; CorporateMarketingHO@halkbank.mk; +389023240800
- Republic of Turkey's Commercial Councilor in Macedonia; embassy.skopje@mfa.gov.tr; +38923104710

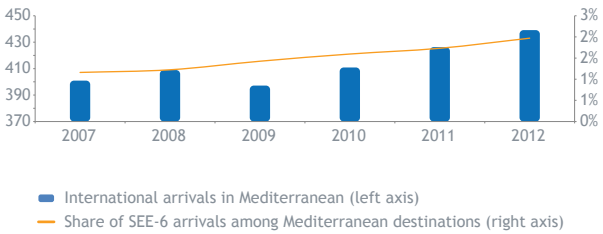
TOURISM

In 2013, tourism's overall contribution to SEE-6 economies in terms of GDP and direct employment was at 4.2 and 4.1 percent respectively. This is on par with the world average: travel and tourism value chain generated 3 percent of global GDP and 3.5 percent of global employment.[22] Destination wise, Europe is the world's most popular tourism destination and hosted more than half a billion international tourists in 2014. Europe owes a significant share of this high performance to Spain, Italy and Turkey, ranked third, fifth and sixth place among the most visited destinations in the world. SEE-6 is not only a sub-region in the world's most visited continent, but has experienced a steadily increasing share of Southern and Mediterranean Europe international arrivals since early 2000s (see Figure 84).

However, the tourism sector in all SEE-6 economies has substantial room for improvement. According to the World Economic Forum's Travel & Tourism Competitiveness Index, the region lacks high quality infrastructure and the tourism sector is not sufficiently prioritized by decision makers. Nevertheless, SEE-6 economies do have the basic building blocks for a flourishing tourism sector: price competitiveness, human capital, security and hygiene are at levels very close to the European average (see Figure 85). Given that the region is surrounded by top summer and winter tourism destinations such as Croatia, Italy, Greece and Turkey, government prioritization and private investments in niche areas is required to shape SEE-6 into an attractive tourist destination in the medium term. Furthermore, the small size of the cities and economies in the region make regional cooperation a strategic priority for the tourism industry, as depicted in the SEE 2020 strategy.

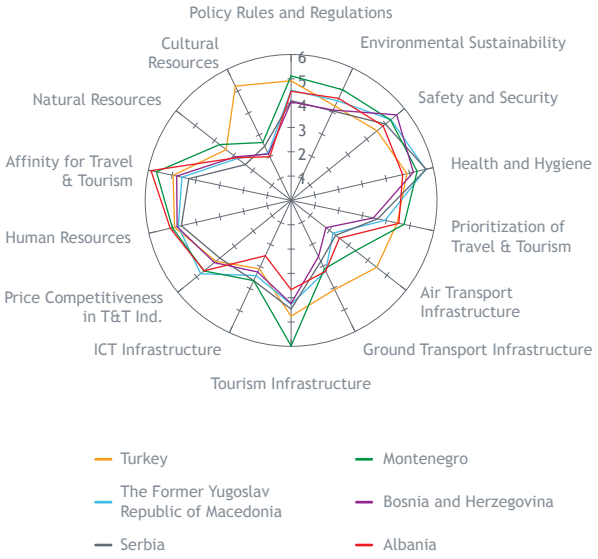
An element of this regional strategy can be seen in the number of regional tours that package together multiple SEE-6 cities. Unfortunately, as of today, a significant majority of the regional tours visit Kosovo*. Turkish tourism tours usually bundle the region with Bulgaria, Greece and Croatia. One example of a 7 night-8 day regional tour includes visits to the following cities: Kavala - Selanik - Uskup - Tetova - Struga - Ohrid - Elbasan - Tiran - Iskodra - Bar - Petrovac - Budva - Kotor - Herceg Novi - Neum - Dubrovnik - Mostar - Saraybosna - Belgrad - Sofya - Plovdiv. The sheer number of cities visited in this short time eliminates any opportunity to expand tourism activities at any one destination.

FIGURE 84 Share of SEE in Southern and Mediterranean Europe international arrivals



SOURCE: World Bank World Development Indicators, TEPAV calculations[21]

FIGURE 85 Travel & Tourism Competitiveness Index, 2013



SOURCE: World Economic Forum

Instead, well thought out bundles that are categorized for different types of tourists with different fields of interest (i.e., families, couples, large friend groups, company retreats etc.) are likely to yield much better returns for both the tourists and the region.

Regional tourism branding is a complex process that requires establishing well connected value chains that transcend not only intra-SEE-6 borders but also links local sectors (see Figure 87). However, the link between tourism and other industries (i.e. food & beverages, real estate, financial services and retail) has not been sufficiently developed in the region. This means that SEE-6 tourism development is threatened by the potential for high leakage rates, as a few vertically integrated players (located mainly in developed countries) could come

to dominate the main investments in tourism. To avoid high leakage rates and build a sustainable regional tourism sector, SEE-6 needs to strengthen this regional value chain by partnering with regional and local investors, especially ones that demonstrate strong corporate social responsibility, and by increasing the number of local products and service offerings available to tourists.

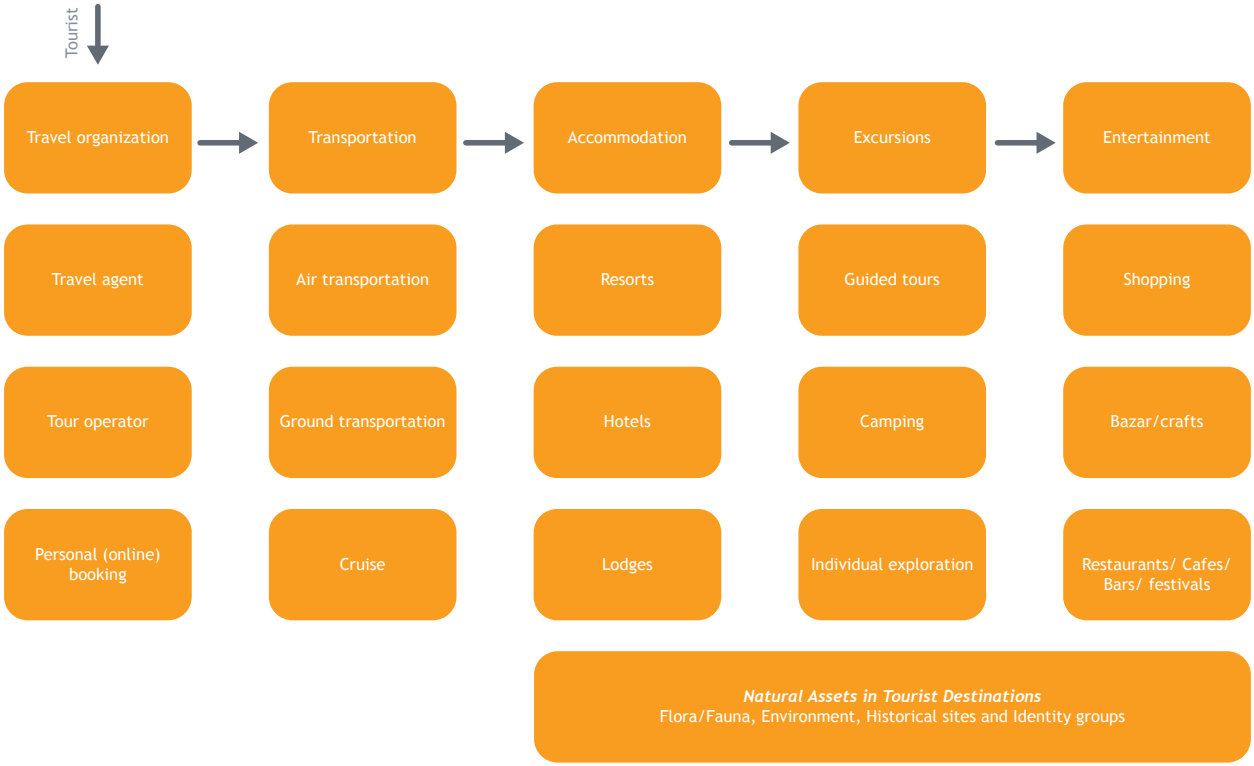
The lack of a regional value chain also hinders knowledge transfer across sub-industries in the tourism sector and builds on the frequently cited bottleneck of insufficient skills in the services sector. To overcome this skills gap, the SEE-6 region could benefit from the know-how of Turkish tourism investors. For example, potential investors from Turkey could open up existing hotels to potential local workforces as vocational training centers. Following exposure to Turkey's tourism sector, SEE-6 workers can return home with a toolkit of skills for later investments/employment endeavors.

One of the most attractive sites for summer tourism in the region is Albania and Montenegro's Adriatic coastline that stretches over 600 kilometers. These two economies must find ways to utilize their Adriatic coastline to be able to compete with Croatia in the north and Greece in the south. For Albania, this requires tackling the property ownership hurdles due to disputes in land registration. Addressing this hurdle will help investors gain easier access to property in order to set up premium hotels. Latest developments on transportation infrastructure of Durres Port also provide an opportunity to new investments in the close region.[23] For the case of Montenegro, the tourism development strategy for 2020 indicates the main concern as the inadequate link between hinterland and the coast; *'Creating a complex Montenegrin tourism product as an integrated whole consisting of the coast and the hinterland is seen as the best way to extend the season and give an impetus to developing the hinterland'*.[24]

Yet another avenue which Montenegro and Albania can capitalize on their coastline is through cruise tourism. Tourist arrivals by vessels to Montenegro have increased five folds since 2007 to constitute a quarter of all arrivals in 2013 (see Figure 87). Whereas Kotor has created a noticeable brand as a coastal destination and is currently included in the Adriatic cruises, the cruise ships do not visit any Albanian destinations. Albania can improve their brand by mobilizing targeted public-private partnerships that prioritize tourism investments across the coastline and dwell on improving the tourism value chain as a whole.

Interestingly, Croatia's accession to the EU in 2013 created an opportunity for SEE-6 economies. As Croatia started to require Schengen visas from non-EU citizens following its EU accession, especially

FIGURE 86 Tourism value chain

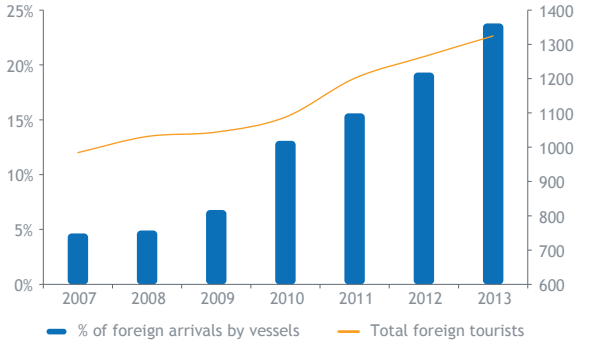


Montenegro and Albania evolved into alternative destinations, comparable in terms of natural beauty but less costly to travel to. For instance, tourists from Russia and Turkey were allowed to enter Croatia prior to the 2012 without visa. After the regulations regarding visa requirements were implemented, Russian and Turkish tourists increasingly began to head towards Montenegro as an alternative destination to Croatia (see Figure 88 and Figure 89). However, this shift occurred without any targeted government intervention and therefore there is room for significant improvement if the visa free feature of the SEE-6 region is commercialized.

Moreover, summer tourism and the Adriatic are not the only attractions of the region. The SEE-6 climate allows for year round tourism. Winter tourism, for instance, is a high value niche and is feasible given high mountain ranges in Sarajevo and Montenegro. Sarajevo still clings to its 1984 Winter Olympic Games heritage. While ski infrastructure exists, it can be improved along with better promotion of the region as a winter sports destination.

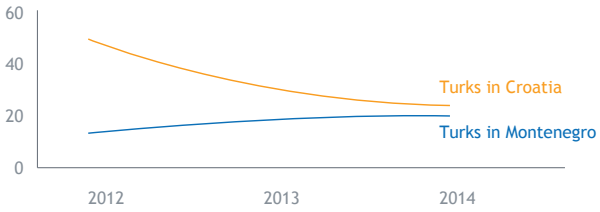
In addition to winter sports, there are a number of other niche market activities that could be further developed within a regional marketing strategy. Some of them are long hiking trails and bird-watching trips in The Former Yugoslav Republic of Macedonia near Ohrid and festivals in Bosnia and Herzegovina. Branding these destinations under one region, that is the SEE, will better promote these assets and increase participation in these high value niche activities.

FIGURE 87 Share of foreign arrivals by vessels in Montenegro



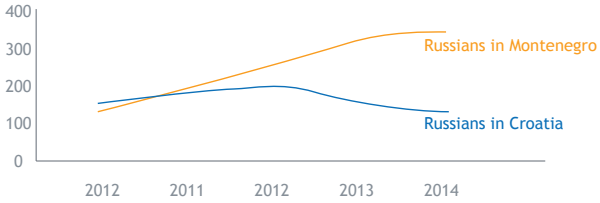
SOURCE: Montenegro National Institute of Statistics, TEPAV calculations

FIGURE 88 Russian tourists after Croatia's accession to the EU



SOURCE: Croatian Bureau of Statistics

FIGURE 89 Turkish tourists after Croatia's accession to the EU



SOURCE: Croatian Bureau of Statistics

BOX 8 Tourism and Sustainability[25]

Another critical issue to consider is sustainability. Current trends indicate that responsible and sustainable tourism is becoming increasingly important to the tourism industry. A 2012 report by The Travel Foundation and Forum for the Future found that 75% of consumers want a more responsible holiday. This is important not only for branding purposes, but also as a contributing aspect to a more sustainable local economy in general.

As the tourism industry develops it produces significant impacts on natural resources, consumption patterns, pollution and social systems. The need for sustainable and responsible planning and management is imperative for the industry to survive as a whole. According to the UNWTO sustainable tourism can be defined as: "Tourism that takes full account of its current and future economic, social and environmental impacts, addressing the needs of visitors, the industry, and the environment and host communities".

Evidence of sustainable tourism can be seen in the "Peaks of the Balkans" initiative with the German Development Cooperation in Albania, Montenegro, and Kosovo*. The initiative was awarded the "Destination Stewardship Award" from the World Travel & Tourism Council in 2013 for its transnational hiking trail that preserves the natural, cultural, and spiritual heritage of the region; offers training, capacity building and support for the development of tourism micro-enterprises; as well as for facilitating trans-border movement of visitors. The SEE-6 regional tourism development strategy should develop the sector with similar initiatives.

BOX 9 Dogus Group's Investment in Croatia and Greece

Turkey is not only one of the major tourism destinations; it is also one of the major tourism investors with 2.8 billion USD of cumulative foreign direct investments between 2003 and 2014. Out of this sum, 217 million USD has been invested in the SEE-6 economies making in the fourth largest investor in tourism in the region. Currently, large Turkish investors appear to be increasingly seeking investment opportunities in tourism sectors of Croatia and Greece. As a result, these two countries received nearly 200 million USD of investments which is on par with the SEE-6 total for the past decade.

One of such investors is Dogus Group which concentrates its investment in hotels and marines across Croatia and Greece with Villa Dubrovnik, D-Marin Mandalina Marina, D-Marin Dalmacija, D-Marin Borik and similar other investments. D-Resort Šibenik in Croatia is the the group's most recent investment which was also awarded with a Croatian state medal in 2014.

At its initial process of employment in Croatia, Dogus Group pursued a business model that is worth mentioning. The firm representatives state that while they were eager to work with locals, existing labour force was in need of modernization. Hence, the firm decided to bring the local labor force to their facilities in Turkey where they were trained and employed for more than a month. In turn, this model facilitated the know-how transfer between Turkish and Croatian tourism sectors. This process lead to the Dogus Group being awarded the Star of Croatia by President of the Republic of Croatia Ivo Josipovic, a medal which is given to persons who have made significant contributions to the economy of the nation.

HOW TO GET INTO ACTION FOR INVESTORS IN TOURISM SECTOR

In order to get further information regarding tourism cluster and investment ecosystem, potential investors can get in touch with following contacts:

FOR ALBANIA:

- Banka Kombetare Tregtare (BKT); info@bkt.com.al; +35542250955
- Invest-in-Albania: contact@invest-in-albania.org; +355 44 80 85 65
- Republic of Turkey's Commercial Councilor in Albania; embassy.tirana@mfa.gov.tr; +35542380350
- Union of Chambers of Commerce and Industry of Albania; info@uccial.al; +35542247105

FOR BOSNIA AND HERZEGOVINA:

- BIGMEV; bigmev@bigmev.org; +38733264485
- Chamber of Economy of the Federation of Bosnia and Herzegovina; info@kfbih.com; +387033217782
- Foreign Investment Promotion Agency (FIPA); fipa@fipa.gov.ba; +38733278080
- Republic of Turkey's Commercial Councilor in Bosnia and Herzegovina; embassy.sarajevo@mfa.gov.tr;+38733568791
- Ziraat Bank Bosnia and Herzegovina

FOR MONTENEGRO:

- Chamber of Economy of Montenegro; pkcg@pkcg.org; +382 20 230 545

FOR SERBIA:

- Chamber of Commerce and Industry of Serbia; info@pks.rs; +381113300900
- Republic of Turkey's Commercial Counselor in Serbia embassy.belgrade@mfa.gov.tr; +381113332410

FOR THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA:

- Economic Chamber of Macedonia; www.mchamber.mk; +389023244000
- Republic of Turkey's Commercial Councilor in Macedonia; embassy.skopje@mfa.gov.tr; +38923104710

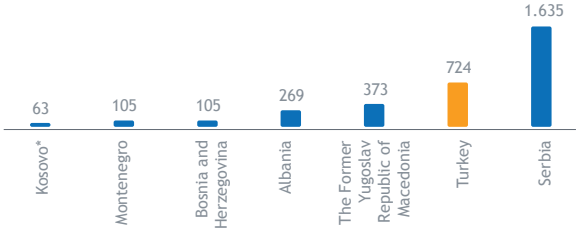
INFORMATION & COMMUNICATION TECHNOLOGIES

A STRIKING REVOLUTION HAS TAKEN PLACE IN THE LAST FIFTEEN YEARS IN THE AREAS OF INFORMATION AND COMMUNICATION TECHNOLOGIES (ICT). THIS REVOLUTION, IN THE FORM OF NEW INNOVATIONS AND THE DIFFUSION OF ICT IN THE LIVES OF BILLIONS OF PEOPLE, IS LEADING TO ECONOMY-WIDE GAINS, FROM PRODUCTIVITY INCREASES TO HIGH-GROWTH RATES. THESE GAINS COME IN PROPORTION TO THE READINESS OF SOCIETIES TO ABSORB AND FURTHER DEVELOP SUCH INNOVATIONS. SEE REGION IS NO EXCEPTION. AS DEPICTED IN THE SEE 2020 STRATEGY, FUTURE GROWTH OF THE SEE-6 ECONOMY IS HIGHLY DEPENDENT ON THE DIFFUSION OF ICT IN THE BUSINESS SECTOR AMIDST A GROWING DIGITAL SOCIETY.

FROM AN ECONOMIC PERSPECTIVE, ICT PROMISES TWO CHANNELS OF GROWTH. FIRSTLY, THROUGH ITS PENETRATION INTO A WIDE RANGE OF SECTORS SUCH AS AGRICULTURE, RETAIL, MANUFACTURING AND SO FORTH, LEADING TO HIGH PRODUCTIVITY GROWTH RATES. SECONDLY, WITHIN THE ICT SECTOR ITSELF, BY GENERATING HIGH QUALITY JOBS, MANY DIFFERENT ENTREPRENEURSHIP SUCCESS STORIES, AND HIGH VALUE ADDED EXPORTS.

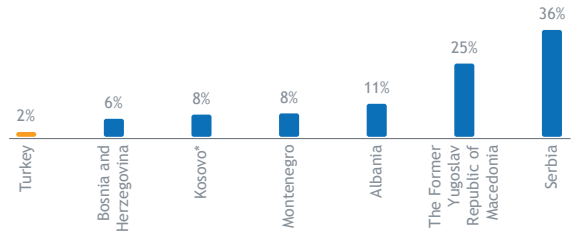
The current situation for the ICT sector in South East Europe is highly promising. SEE-6, as a region, exported USD 2.5 billion worth of ICT services to the global economy in 2013. In the same year, Turkey's ICT services exports amounted to USD 724 million. Serbia's impressive capacity in ICT services exports should be noted, with a volume of around USD 1.6 billion, twice the volume of Turkey (see Figure 90). In addition, Serbia, The Former Yugoslav

FIGURE 90 ICT service exports, current million USD, 2013



SOURCE: World Bank World Development Indicators

FIGURE 91 ICT service exports (% of service exports, BoP), 2013



SOURCE: World Bank World Development Indicators

Republic of Macedonia and Albania not only export considerable volume of ICT services, but also have successfully doubled their export volumes in the last 10 years. About 88 percent of Macedonian ICT firms and 82 percent of Serbian ICT firms export directly to foreign clients.

ICT companies in the SEE region are mostly oriented towards software and IT services. While Windows and Linux are the most commonly used operating systems, Java/JavaScript and .NET are the most common programming languages among the region's ICT firms. Price, quality and technical know-how are listed as key competitive advantages. Most companies are currently linked directly with EU markets, but they see the greatest growth potential in the North America market. A majority of the companies expect further growth in the coming years of about 10 percent annually. Developers, project managers and system administrators are among the highest paid employees. One of the main assets of the ICT sector is its high quality human capital and, particularly, its competitive costs and foreign-language capabilities. English is widely spoken among ICT employees, followed by German and Italian. The main problems, as quoted by firms in a GIZ survey, are listed as lack of government support (i.e. export financing schemes), lack of branding of the local IT industry in foreign markets, and lack of export oriented trainings and business development / consulting services.[26]

In the region, the strongest ICT cluster is in Serbia. The firms in the ecosystem consist of four different

types of players: (i) startups, (ii) outsourcing-focused firms, (iii) firms that focus on development and export of original software products, and (iv) development centers of large multinational companies.[27] Serbia's competitiveness in ICT comes as a result of the capacity of its universities located at regional centers. Technical competence of young graduates from these universities appears to be world class. Serbian youth is said to have a knack especially for sciences and math, resulting in top level engineers graduating from the universities. As a result, Belgrade University ranks among top 101-150 universities in the world in maths and sciences. These graduates are increasingly more involved in entrepreneurship activities and most attempt to set up their own companies after a few years of work experience. In addition to Belgrade, the city of Novi Sad has a strong university excelling in engineering and ICT training and is home to a vibrant ICT cluster.

A SNAPSHOT OF TURKISH ICT

Similar to the dynamic scene in the SEE-6 economies, Turkey has also been enjoying a steady growth in ICT and carries the potential of becoming a regional hub. Thanks to Istanbul's high level of connectivity and attractiveness for expats as well as centrality in the high-growth Turkish economy, many global ICT corporations such as Microsoft, Google, Intel and HP have been choosing Istanbul as their regional hubs. Demographic advantages, high appetite in the domestic market as well as the government's spending in e-government related initiatives (i.e. Fatih Project that targets equipping every single student in the country with a tablet computer) as well as banking, communication and manufacturing modernization are all important features of Turkish ICT growth. Every year, more than one hundred thousand fresh graduates enter the ICT sector. Most of the innovation takes place in more than 40 technology development zones (technoparks) around the country with Istanbul and Ankara being the main centers. Lastly, the ICT sector still has a lot of room for growth: it represents only 3.5 percent share of GDP, while in Korea, by comparison it represents 7.9 percent .

In sum, both Turkey and the SEE-6 economies offer a thriving cooperation channel in the ICT industry. There are already quite impressive success stories on both sides. Some of these are summarized in Box 7. Successes of these companies are not only a testament to the growth potential of each ecosystem but also serve as a source of inspiration for young entrepreneurs.

OPPORTUNITY AREAS

COMBINING SEE TALENT AND TURKISH DOMESTIC MARKET FOR SCALABLE PRODUCTS

A mechanism to smartly combine the ICT talent in SEE-6 economies and the high growth demand of the Turkish domestic market for scalable global products appears to be a viable business opportunity area (i.e. Agriculture ICT, medical technologies, FIWARE-future internet ware). Leveraging productivity gains from ICT penetration in traditional industries can be a good playing field in both sides. For example, there are significant efforts to couple technological innovations with more conventional industries in Serbia, especially in the agrofood and medical technologies industry. Turkey can play an important role in this process through its experience in integrating high tech products and ICT solutions with the agriculture sector and by providing a testing ground for Turkish-SEE joint ventures in software and smart systems as a market.

DEVELOPMENT OF SMART SYSTEMS

Cooperation in smart system development and commercialization represents a strong potential investment opportunity. In our meetings with the ICT Cluster in Novi Sad, we were introduced to a few promising smart systems based projects that target increasing productivity in the Vojvodina plains. Cooperation between Turkish and Serbian smart system development networks would yield scalable projects that would be commercialized in the Turkish domestic market at first and exported to third countries after proven successful.

PROJECT SERVICES / OUTSOURCING

System integration, custom application development and IT consulting are areas in which Turkish and SEE ICT clusters can generate win-win cooperation models. Outsourcing is also an important area in which large European and American firms outsource part of their information processing and handling functions to other companies for efficiency gains. Eastern Europe has become an important hub for such services in recent years, and Serbia and Turkey have considerable advantages. The main objective of such cooperation would be focusing effectively on higher value added solutions and going beyond basic price competition. Lastly, there can be several synergies in joining forces for projects in the e-government realm, especially in education and health.

Leveraging talent in the region and using the Turkish domestic market for scalable global products can be the next step. It is possible to significantly increase the level of connectivity between these ecosystems through networking events, startup weekends, joint incubation centers that would lead to cooperation in development stages and perhaps partnership during commercialization stages (see Recommendation #4).

BOX 10 NORDEUS, ZIRA Technologies and Yemeksepeti: A tale of three ecosystems

Entrepreneurship ecosystems in the region are in their infancy, but there are several success stories which represent a positive signal in regards to the future of the region. Three success stories belong to NORDEUS from Serbia, ZIRA Technologies from Bosnia and Herzegovina and Yemeksepeti from Turkey,

NORDEUS is a software company that was set up by three graduates of Belgrade University. Following their graduation, these friends went to work in the Microsoft Software Center in Copenhagen for a few years. After this period, they decided to return to Serbia to start their own company developing web-based games. Currently, NORDEUS' valuation is at $400 million, which stands larger than all of Serbian entrepreneurship ecosystem combined, while generating more than 160 jobs. Today, their most famous product is Top Eleven which is one of the most popular social sports games in the world.

ZIRA is a business support system (BSS) provider in the telecommunications industry that was set up in 1995 by local entrepreneurs from Bosnia and Herzegovina. With its initial mission of being a leading ICT company in the region, ZIRA has expanded to the world with services now offered in 22 countries, with its headquarters in Sarajevo and two offices in Turkey and the United States. With twenty years of experience, the company provides risk management, revenue management, CRM and develops ICT solutions for clients that consist of prime country operators in the telecommunications industry.

Yemeksepeti is an online food ordering company established in 2000 by three Turkish entrepreneurs. The website is an online intermediary platform between user and delivery restaurants that does not charge the user but delivery restaurants for each order instead. In 2010, Foodonclick was set up by an extension of Yemeksepeti targeting Middle East and North Africa market. In May 2015, Yemeksepeti was sold to a German firm, Delivery Hero, for $589 million.

HOW TO GET INTO ACTION FOR INVESTORS IN ICT SECTOR

In order to get further information regarding ICT clusters and investment ecosystems, potential investors can get in touch with the following contacts:

FOR ALBANIA:

- Albanian ICT Association; aita@aita-al.org;+355694047901
- Banka Kombetare Tregtare (BKT); info@bkt.com.al; +35542250955
- Invest-in-Albania; contact@invest-in-albania.org; +35544808565
- Republic of Turkey's Commercial Councilor in Albania; embassy.tirana@mfa.gov.tr; +35542380350
- Union of Chambers of Commerce and Industry of Albania; info@uccial.al; +35542247105

FOR BOSNIA AND HERZEGOVINA:

- BIGMEV; bigmev@bigmev.org; +38733264485
- Chamber of Economy of the Federation of Bosnia and Herzegovina; info@kfbih.com; +387033217782
- Foreign Investment Promotion Agency (FIPA); fipa@fipa.gov.ba; +38733278080
- Republic of Turkey's Commercial Councilor in Bosnia and Herzegovina; embassy.sarajevo@mfa.gov.tr; +38733568791
- Ziraat Bank Bosnia and Herzegovina

FOR SERBIA:

- Chamber of Commerce and Industry of Serbia; info@pks.rs; +381113300900
- Foreign Investment Council; office@fic.org.rs; +381113281958
- Halkbank Serbia (Cacanksa Banka); office@cacanskabanka.co.rs; +38132302100
- Republic of Turkey's Commercial Councilor in Serbia; embassy.belgrade@mfa.gov.tr; +381113332410
- Serbia Investment and Export Promotion Agency (SIEPA); office@siepa.gov.rs; +381113398550
- Serbia Innovation Fund; office@inovacionifond.rs; +381116555696
- Vojvodina ICT Cluster; contact@vojvodinaICTcluster.org;

FOR THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA:

- Agency for Foreign Investments and Export Promotion of the Republic of Macedonia - Invest Macedonia; fdi@investinmacedonia.com; +38923100111
- Economic Chamber of Macedonia; www.mchamber.mk; +389023244000
- Halkbank A.D. Skopje; CorporateMarketingHO@halkbank.mk;+38902324080
- Macedonian Chamber of Information and Communication Technologies (MASIT); contact@masit.org.mk; +38975280507
- Republic of Turkey's Commercial Councilor in Macedonia; embassy.skopje@mfa.gov.tr; +38923104710
- Ss. Cyril and Methodius University Business Start-up Centre; ukim-bsc@mf.edu.mk; 38923099482

SECTION 4
WAYS FORWARD

AS SHOWN IN PREVIOUS SECTION, THERE IS A PLETHORA OF BUSINESS OPPORTUNITIES FOR ENTREPRENEURS TO CONNECT SEE-6 WITH TURKEY. THE BALKANS CAN BE A SPRINGBOARD FOR TURKISH COMPANIES TO ACCESS THE EU MARKET AND TURKEY CAN BE A GROWTH OPPORTUNITY FOR SEE-6 BUSINESSES, BOTH AS A MARKET AND AS A STEPPING STONE INTO MENA AND ASIAN MARKETS. MOREOVER, ECOSYSTEMS CAN BE MORE TIGHTLY LINKED SO THAT JOINT VENTURES CAN TARGET FIRST THE REGIONAL AND THEN THE GLOBAL ECONOMY. TO COMPLEMENT THESE POSSIBLE FUTURE BUSINESS FLOWS, WE ALSO PRESENT A NUMBER OF ITEMS AS HOMEWORK FOR THE PUBLIC SECTOR, BUSINESS ASSOCIATIONS AS WELL AS THE RCC.

POLICY AND PROJECT IDEAS

In this section, we present our policy recommendations and project ideas that can boost economic relations. These are divided into seven areas: (1) Targeted Policy dialogue, (2) collaboratively utilizing EU pre-accession funds and resources, (3) establishing Special Economic Zones with a common regulatory regime, (4) integrating the entrepreneurship ecosystems of the region with Turkey, (5) conducting targeted matchmaking programs across cities and chambers (6) developing a comprehensive research agenda on the economics of the region, and (7) identify the fast growth companies in SEE-6 and create platforms for them to network with each other and their Turkish counterparts. These recommendations are meant to complement RCC's flagship initiatives through creating additional synergies between Turkey and SEE-6 economies.

RECOMMENDATION #1: TARGETED POLICY DIALOGUE ON ECONOMIC TRANSFORMATION AND DIVERSIFICATION

The deepening of economic relations between Turkey and SEE-6 depends on the extent to which both sides transform and diversify their economies. This, in turns depends on implementing structural reforms. SEE-6 could draw lessons from Turkey's successes and mistakes in this regard, particularly in market liberalization reforms and managing urbanization, industrialization and global integration.

Turkey's structural reform experience, especially spanning the periods 1980-1987 and 2001-2007, can illuminate current policy debates in the region. Turkey's reforms to strengthen the banking sector, enhance its labor market institutions and improve the investment climate is considered an effort of structural reform by many experts, including the ones we met with in all SEE-6 economies. In the coming years, the region will be going through a very similar process of structural reform, with much depending on successful policy implementation and monitoring. Dialogue on policy making and technical assistance would greatly benefit both sides during this time.

Following our fact-finding missions, we identified five critical policy areas in which dialogue could most benefit Turkey and SEE-6:

INDUSTRIAL POLICY, SMEs AND ENTREPRENEURSHIP DEVELOPMENT

The impending privatization waves in the region may be transformed into a significant industrial policy tool if the right initiatives are put in place. Almost all of the SME owners we spoke with were previously workers in socially owned enterprises that were laid out in the privatization wave of early 1990s. With the right financial backing, a viable

BOX 11 RCC's Flagship initiatives

Flagship initiatives; undertaken by RCC; represent joint endeavors by several regional organizations and/or implementers as partners executing mutually reinforcing activities towards the same SEE 2020 goal. Integrating activities of various actors represents one of the main challenges of effective coordination of the SEE 2020 process and flagship initiatives are designed to deal with this challenge. The initiative consists of three flagships; skills and mobility, soft connectivity, sector competitiveness and industrial development.

The overall goal of this initiative is enhancing human capital development and increasing employment in the region by promoting skills acquisition and upgrading. Some of the proposed actions under this flagship include a regional observatory on skills and jobs through the production of a regular labor market analysis and the establishment of an online regional platform on labor markets in Western Balkans economies.

Currently, transport connectivity and energy infrastructure, as two major parts of the SEE connectivity agenda, vary in their level of development in different SEE economies. Soft connectivity stands for need of widening access to markets and making the private sectors and societies at large in SEE better integrated regionally and with the EU. Hence, the region will need to make substantial upgrades in its connectivity to enhance movement of goods, services and human capital across the region.

The overall objective of the last flagship; *sector competitiveness & industrial development*; is to contribute to the efforts of supporting the competitiveness and the industrial policy of the region through policy communications, specific recommendations and actions, and support to creation of business-friendly environment in the SEE. The region lacks still means to identify the challenges to competitiveness subsequently weak policy recommendations for total industrial development in the region. The cooperation of RCC and OECD lead to identifying two priority sectors; agribusiness and tourism. Agribusiness competitiveness lacks economies of scale and the inability to meet EU export standards despite the existence of an open trade regime between SEE and EU. Enhancing the business environment for better competitiveness through linking SMEs to FDI is a proposed action to address the competitiveness hurdle. Tourism on the other hand suffers from fragmentation across value chains and poor marketing/branding of a tourism product. Addressing skills gap – identified as major challenge in tourism development – plus a marketing strategy to promote the region assets under on brand are proposed solutions to enhance tourism competitiveness in SEE region.

Overall, our recommendations are meant to strengthen and complement these initiatives at the horizontal level.

exit strategy for the current workers in socially owned enterprises may be formulated in order for them to set up their own SMEs. Here, Turkish Banks, especially Halkbank and TEB, with their vast experience in SME support schemes, may become key partners. A targeted policy dialogue on how to orchestrate industrial policy, privatization, and SME and entrepreneurship support schemes for the benefit of domestic private sector development would be highly beneficial. Turkey's expertise from the 1980s and 1990s would be highly relevant to these reforms.

IMPROVING THE INVESTMENT CLIMATE

Improving the investment climate in order increase FDI inflows is a common objective in the region. Turkey's 2001-2007 reform wave introduced numerous reforms and improvements aimed at enhancing the investment climate. Furthermore, Turkey reformed its investment incentive system in 2009 and 2012 to be more comprehensive and yet more nuanced. The transfer of this know-how to relevant policy makers and investment promotion agencies would help in diversifying the existing investment incentive frameworks that consist of generous state grants based on generated employment.

PUBLIC-PRIVATE PARTNERSHIP (PPP) FRAMEWORKS

Making the transition from their Former Yugoslavian heritage to a new economic structure, most SEE-6 economies currently lack effective PPP frameworks. Though the period prior to the 2008 global financial

crisis saw limited development in this regard, SEE-6 economies still have considerable fiscal constraints to much-needed physical infrastructure projects, such as airports, large-scale agriculture projects and industrial zones. Private participation could significantly help to fill this gap. Turkey's policy experience in this realm, together with is strong construction companies, can help to take them to the next level.

TOURISM STRATEGY AND IMPLEMENTATION

Most of the governments in the region see tourism as a top priority and are in the process of revamping their strategies in the sector. Surrounded by traditional best-practices such as Italy and Greece, the region suffers from severe coordination failures and faces a number of policy problems before moving to the world stage. Turkey, where tourism is not a traditional sector but rather a deliberately developed after the 1980s, can be a learning ground for SEE-6 economies. Infrastructure development, encouraging private tourism investments, branding and global promotion are some the of the policy areas in which dialogue between Turkey and SEE-6 could yield fruit.

AGRICULTURE POLICY, TARGETING BOTTLENECKS IN THE ENTIRE FOOD CHAIN

Today, most arable lands in the region remain underutilized due to sub-optimal state policies, as well as outdated modes of production. Furthermore, setting up of quality based support systems in agriculture holds the potential to increase the number of greenhouses and increase the production of organic crops. According to experts, both vertical and horizontal integration in the agro-food value chain are lacking in the SEE-6. Especially the vertical integration part, i.e. linkages between farms to shelves, requires a new policy approach to redesign and oversee the entire process. Overcoming the coordination failures in trade policy, agriculture policy and industrial policy will also be of vital importance. Policy dialogue with relevant Turkish institutions to increase agricultural productivity and integrating value chains appears to be an area in which further economic complementarities may be established. TİKA's rice growing project that was implemented in collaboration with the Ministry of Agriculture, Forestry and Water between 2013-2015 in the Kocani region of The Former Yugoslav Republic of Macedonia is a good example that can be both diversified and scaled up.

Policy learning in these realms could be facilitated via two mechanisms. First, formal knowledge transfer programs could be established on a thematic basis. These programs would entail the formation of task forces that bring together high-level bureaucrats and experts. The task forces would conduct study tours, meet with their counterparts/stakeholders and produce concise policy reports that summarize main findings and recommendations on their selected policy issues.

Second, mechanism would form policy exchange platforms. Such platforms could be joint symposia, policy workshops and conferences, as well as formal joint ministerial committees. To foster these platforms, second track (unofficial) networks shall also be built and strengthened with the active engagement of think tanks, academia and NGOs.

Building on the experience of previous policy dialogue programs, we can derive certain prerequisites for these mechanisms to succeed. First, the three Cs: the Content of the engagement should be fully relevant and sufficient; Coordination among the critical agencies should be effectively facilitated; and, the Commitment of the final decision makers on the subjects in question should be fully ensured. Second, this policy dialogue could take place at two different levels: at local level, in the form of bilateral relations between Turkey and each one of SEE-6 economies. Or, at the regional level, in which the same policy issue could be discussed with a regional perspective. This would necessitate RCC's role as a convener and more technical and regional approach from Turkey's side. One good emerging example to this is the committee on industrial policy, which is in the process of being established by the RCC.

Last but not least, RCC, TEPAV and the Turkish Ministry of Development could be the main facilitators of this policy dialogue. RCC's recent efforts to form the working group on Industrial Policy as part of the SEE Investment Committee could be a viable platform to jumpstart the discussions.

RECOMMENDATION #2: COLLABORATIVELY UTILIZING EU PRE-ACCESSION FUNDS AND RESOURCES

To date, SEE-6 economies and Turkey have largely competed for available funds and support from international organizations such as the World Bank, OECD, the Council of Europe, the International Office for Migration (IOM) and UN organisations, the European Central Bank (ECB) or the International Monetary Fund (IMF).

TABLE 13 IPA II funding allocations for EU candidates

	2014	2015	2016	2017	2018- 2020
Albania	83.7	86.9	89.7	92.9	296.3
The Former Yugoslav Republic of Macedonia	85.7	88.9	91.6	94.9	303.1
Kosovo*	83.8	85.9	88.7	91.9	295.2
Montenegro	39.6	35.6	37.4	39.5	118.4
Serbia	195.1	201.4	207.9	215.4	688.2
Turkey	620.4	626.4	630.7	636.4	1940

SOURCE: European Commission, 2014

Even though priorities in SEE 2020 Strategy as well as Turkey's 2023 vision offer significant synergies, collaboration towards accessing available funds of multilateral institutions and attempts at designing crosscutting, cross-border programs in both Turkey and SEE-6 have so far been non-existent. There are a number of policy areas identified in this report that have been likewise identified especially by the EU. Financial and technical support is available to SEE-6 and Turkey, as EU candidates, from a long list of international organizations and institutions.

Pre-Accession, currently IPA II, is the means by which the European Commission supports reform efforts in EU candidates during the period 2014-2020 with 11.7 billion EUR in funds. IPA II not only outlines strategic plans for each candidate, but it also includes multi-country strategy papers that will address priorities for regional and territorial cooperation. In addition, IPA II claims to advocate a switch from financing individual projects to instead support a sector approach to financing.

Financial assistance available to each beneficiary is mainly given to projects based in five policy areas:

i. reforms in preparation for Union membership and related institution-and capacity-building,
ii. socioeconomic and regional development,
iii. employment, social policies, education, promotion of gender equality, and human resources development,
iv. agriculture and rural development, and
v. regional and territorial cooperation.

By further examining the specific programs supported by the European Commission in 2013, it is evident that the bulk of IPA support was delivered to national programmes whereas only around 9 percent of available funds were allocated through multi-beneficiary programmes. It begs the question: Why only focus on supporting Roma inclusion in Bosnia and Herzegovina, for instance, when Romas are present in all IPA II beneficiaries? Why is air quality monitoring only supported in Kosovo* when air quality is a regional issue? Why only focus on building preschools in Serbia? And so forth. The chambers of commerce and relevant government agencies in both Turkey and SEE-6 should encourage the EU to spend less on disconnected single-beneficiary programs and more on strengthening existing programs with best practices that can be replicated in all beneficiaries and create a more recognizable brand for EU investors.

In addition to funds available directly through the EU pre-accession program there are additional EU organizations with funds for projects and programs that promote European values. For instance, the European Instrument for Democracy and Human Rights (EIDHR), Instrument for Stability (IfS), and The European Commission's Humanitarian Aid and Civil Protection Department (ECHO). Individual EU member states also have funds for EU enlargement such as the Creative force Western Balkans and Turkey program from the Swedish Institute. Unfortunately, a database of all available funds does not currently exist. It would be in the best interest of Turkish and SEE-6 Regional Development Agencies and Chambers to research and create a platform of available funds. In addition, setting up of a networking and consultation mechanism between Turkey and SEE-6 economies for exchanging ideas and jointly targeting these funds may also yield important opportunities for prospective project-based collaborations.

RECOMMENDATION #3: ESTABLISHMENT OF SPECIAL ECONOMIC ZONES

Improving the business environment in SEE-6 and institute the basics of a free market economy and private sector development will take a long time. Currently, the region as a whole scores 2/5 in the OECD's investment policy review evaluation. The

binding constraints to growth at the micro level are often cited as regulatory uncertainty, dealing with construction permits, access to land, getting electricity, registering property etc. As a result of these constraints, per capita FDI, as well as, the growth rates of domestic manufacturing and services firms, are at low levels. One testament to this diagnostic is the investment trends of Turkish entrepreneurs in SEE-6. These are investors who have chosen brownfield investments through either privatizations or merger/acquisitions rather than setting up completely new greenfield investments.

How can SEE-6 economies overcome these shortcomings to create a more favorable climate for new investments, both local and foreign? One effective solution to this are special economic zones. The rationale of forming these zones is straightforward: in most developing countries, improving the investment climate in the entirety of an economy is a highly costly long term goal. Therefore, designating certain areas (such as 1000 hectares of land in a large city's vicinity) as "more equal" and equipping them with superb infrastructure and regulatory powers can be an effective short-term solution. These, however, should not be seen as real estate development projects but rather as industrial development initiatives. The focus should be on tackling the binding constraints to investment growth in the designated areas. The issue is not only to provide empty land or factory buildings, but making sure all the necessary ingredients of industrial development exists around these zones, such as vocational training, logistics and appropriate tax regimes. Also, complementary efforts such as supplier development programs to link FDI with domestic SMEs, providing training on technology, general management operations, quality control would further contribute to success of such regimes.

FIGURE 92 Skopje and Subotica as potential locations for Special Economic Zones

SOURCE: TEPAV

As a large country that still suffers from investment climate problems, Turkey could trigger private sector development and attract large volumes of manufacturing FDI throughout the last three decades, mostly thanks to its special economic zone regime. Particularly, "organized industrial zones" have not only delivered high quality utilities services at favorable rates, but also provided one-stop-shop services; i.e. issuing licenses and permits much more effectively compared to municipalities. These zones were developed through unique forms of public-private partnerships, where Turkey's chambers of commerce and industry played leading roles at the local level; and the Ministry of Industry and Trade provided regulatory oversight at the national level. Today, there are about 150 zones fully operational and hosting more than 50 thousand firms, with more than 1.5 million employees. It was not only Turkey that used this model. In addition to Asian economies, we can also see similar examples in new member states of the EU such as Poland and Hungary, where Industrial parks and special economic zones have been among the most powerful tools for attracting FDI.[28]

Considering these examples, we recommend instituting a brand new zone regime in SEE-6.[29] If effectively executed, this regime could lead to a set of desired outcomes. The first such set of outcomes would include direct employment, exports, investments, all of which are among the high priority objectives of the SEE 2020 strategy. The second set of outcomes includes SME development, industrial development, cluster development and environmental improvements. Third, these zones could help in piloting reforms that can be scaled up in the areas of tax policy, vocational training, property rights etc. These features are also directly related to the SEE 2020 Flagship Initiative on Sector Competitiveness and Industrial Development. Finally, transferring the Turkish Industrial Zone experience to the region may help both in the development and management of the zones and put these zones on the radars of Turkish firms as greenfield investments.

This new regime should be undertaken at the regional level, i.e. having the same zone legal and regulatory framework in different economies of the region. Since certain problems arising from national differences are inevitable, a pre-feasibility of a common legal & regulatory framework would be highly beneficial. This would require out of the box thinking for regional integration, coupled with a regional industrial policy approach. Such an approach may also help in avoiding a race to the bottom for small national economies that currently try to compete in attracting FDI through unsustainable fiscal incentives.

Based on our initial assessment, we recommend that pre-feasibility assessments can be undertaken for two sites: Subotica[30] and Skopje. These are two zones that can rapidly attract Turkish investments. To carry out this initiative at the regional level, RCC's direct involvement will be of the utmost importance.

RECOMMENDATION #4: INTEGRATING THE ENTREPRENEURSHIP ECOSYSTEMS OF THE REGION WITH TURKEY

Save some national variation, entrepreneurship ecosystems in the region are all in their infancy and in need of policy support and prioritization. Strengthening the region's entrepreneurial activities and networks may provide the long-sought remedy for reversing the outflow of the creative class. Industry-academy linkages will need to be established and supported as the first steps towards a vibrant entrepreneurship ecosystem. The region's policy makers need to concentrate their states' political and financial efforts to create entrepreneurship clusters, as well as establish technology parks and incubation centers to transform them into pockets of excellence. The extent to which states successfully nurture a sustainable entrepreneurship ecosystem will be one of the key determinants for their economic transformation in the medium to long term.

Some SEE-6 economies (i.e. Serbia) have strong technical skills, particularly in programming, and have a cost advantage compared to Turkey.[31] Despite their competence however, they lack marketable products that create more value added. There is a need to merge the technological capabilities of the ICT clusters with more conventional industries, especially in agrofood and healthcare. Turkey can play an important role in this process, with its large domestic market, where innovative products can be tested and then scaled up through the surrounding markets such as Russia and MENA. SEE-6 and Turkish companies/entrepreneurs can form joint ventures with the aim of combining technical competence and market access in certain niche areas such as technology for healthcare, agribusiness, and the internet economy.

The small market size of individual SEE-6 economies is a significant constraint that increases the potential value added of connecting them to Turkish ecosystems. Currently, none of the economies is big enough to be a market on its own. The region's proximity to Europe however, as well as its absence of a language barrier, are significant advantages that the sector could use if it thinks on a regional level. Furthermore, better connectivity with Turkey would not only open up that country's large domestic market, but would also be a potential gateway to its surrounding economies.

Upon our interviews, we noted that the currently entrepreneurship ecosystem in SEE-6 economies appears to be more integrated with other ecosystems (i.e. Tel Aviv, Berlin, London etc.) than it is with that of İstanbul. It is possible to significantly increase the level of connectivity between the two ecosystems through networking events, startup weekends, and joint incubation centers that would lead to cooperation in development stages and perhaps partnership during commercialization stages.

In order to culminate an exchange between the ecosystems, a series of events can be organized. These events can take place in both Turkey and SEE-6 hubs, where young startup enthusiasts, successful startup founders, venture capitalists, angel investors, accelerator and technology transfer office managers from Turkey and SEE-6 can meet. With such a mixed grouping of entrepreneurs, it would not be difficult to electrify the room with new business ideas.

The first idea would be to organize a startup weekend covering all SEE-6 economies and Turkey. This would be a 54-hour event where developers, designers, marketers, product managers and startup enthusiasts come together to share ideas, form teams, build products and launch startups. These events are expected to lead to new opportunities for cooperation amongst the participants. Strategic interactions between entrepreneurs based on their comparative advantages are also the most effective way to promote long-lasting links in the region (see Box 12).

Second idea would be to organize "Entrepreneur Delegations" from Turkey to SEE-6 and vice versa in order to jumpstart a fruitful exchange. The delegations to be formed should be selected meticulously among a wide list of senior candidates. They should be nominated by multiple sources and represent a diverse set of actors in Turkey's and SEE-6's existing entrepreneurial ecosystems. The overall participants of the Exchange should include start-up entrepreneurs, investors, established entrepreneurs, and other Information and Communication Technologies (ICT) experts from SEE-6, Turkey, as well as major market/source countries such as the US, UK and Germany.

BOX 12 Armenia- Turkey Start-up Weekend

The Armenia-Turkey Start-up Weekend marks the first instance in which entrepreneurs from two countries with no diplomatic relations jointly worked on developing business ideas.
The event kicked off on November 7th 2014 in Yerevan. It then continued on November 8th to 9th at the Gyumri Technological Center.

The event brought together 60 startup entrepreneurs and investors from the two countries.

The prototypes developed throughout the Startup Weekend were assessed by a panel of judges and the winning teams were announced on November 9th during the closing ceremony.

We believe that, if such a successful event was able to be carried out between two sides that do not exactly have cordial relations, the potentials between Turkey and SEE-6 economies seem limitless.

Depending on the success of these events, various other initiatives such as incubation partner programs, mentoring training programs, and angel investment trainings could be organized. This set of recommended activities would fall under the RCC Flagship initiative on soft connectivity which aims to achieve "Improved People-to-people connectivity in the ICT sector." These activities would also be relevant for the flagship initiative on skills and mobility.

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RECOMMENDATION # 5: CONDUCTING TARGETED MATCHMAKING PROGRAMS ACROSS CITIES AND CHAMBERS

Upon our interviews with public and private actors in the region, we have identified the need to deepen economic relations between Turkey and SEE-6 at the sub-national level. This implies, connecting not only the major hubs (as we suggested in the previous recommendation), but also connecting cities and their relevant institutions such as chambers and development agencies. For instance, an effort shall be put into connecting Kragujevac's automotive cluster that is structured around one big player to Bursa's automotive cluster structured around multiple big players. Such cooperation would entail not only investment and skills transfer at the automotive industry level, but also know-how transfer between local chambers and municipalities regarding building a healthy and

well-functioning private sector and city life around automotive industry clusters.

Based on our analysis of economic structures (patterns on complementarities and similarities), we identified three different sets of economy-city pairs. First set of pairing is based on export-export similarity. This would help us identify which economy's production capabilities would be most similar to which cities in Turkey. Second and third set of pairs are based on export-import baskets; assessing the degree to which one side's exports are correlated with the other's imports, and vice versa. The results presented in the table could serve as a starting point for focusing matchmaking efforts at the sub-national level.

Beyond the export-import based assessments, we could also identify significant avenues of potential economic complementarities that could be explored between SEE-6 and Turkish cities. Some examples to these pairs could be the following:

- Serbia: İstanbul and Belgrade, Bursa and Kragujevac, İzmir and Novi Sad, Denizli and Nis, Adana-Mersin and Vojvodina, and Tekirdağ-Edirne-Kocaeli and Subotica.
- Bosnia and Herzegovina: Sarajevo and Bursa, Tuzla and Afyon-Uşak-Kütahya;
- The Former Yugoslav Republic of Macedonia: Skopje and Kayseri;
- Montenegro: Budhva and Muğla
- Albania: Tiran and Gaziantep

The chambers of these pairs could come together at the outset and formulate joint action plans. These action plans could comprise B-2-B events, capacity building and knowledge exchange programs and entrepreneurship development activities. Indeed, we believe chamber-to-chamber dialogue is of vital importance between the future of Turkey and SEE-6 economic relations. Except for Montenegro, chamber membership is voluntary in all economies. However, in some of them, there is a discussion on going back to the previous, mandatory membership structure. Such a change will restore the capacity of chambers to function more effectively and become catalysts of private sector development, as was the case in Turkey. Perhaps more importantly, chambers, as the primary representatives of the private sector, may play an active role in normalization of political disputes through economic confidence building measures, particularly in the case of Kosovo* and Serbia. For instance, TOBB is leading such a mechanism for the Cyprus Peace Process which may provide inspiration in the case of the Serbia-Kosovo* conflict, and another one, namely the Ankara Forum to bring together Palestinian and Israeli chambers.

It is important to find the right type of SMEs to participate in these matchmaking efforts. During our fact-finding missions, we were also told of the possible frustration stemming from receiving too many business delegations that deliver no results. When forming such delegations for matchmaking events, finding those at the margin, i.e. those that are not yet internationalized but ready and capable to do so should justify (or legitimize) allocation of public resources. In other words, it would also be waste of resources to include those companies who have only very limited intention and capacity to internationalize. Hence, finding those companies that are at the verge of internationalisation is basically the main challenge of the company selection process; and chambers can play a vital role in this process.

TABLE 14 Trade similarities between Turkish cities and SEE-6, 2013

	Export baskets of Turkey and SEE	Exports of Turkey and imports of SEE	Exports of SEE and import of Turkey
ALB	Kastamonu, Elazığ, Rize, Adıyaman, Bartın	Ağrı, İstanbul, Kocaeli, Manisa, Konya	Zonguldak, Karabük, Hatay, Osmaniye, Sivas
BIH	Kayseri, Şanlıurfa, Düzce, Ankara, İstanbul	Kocaeli, Ağrı, Konya, Manisa, Aksaray	Aksaray, Düzce, Kocaeli, İzmir, İstanbul
MNE	Osmaniye, Bilecik, Konya, Düzce, İstanbul	Kocaeli, Ağrı, Manisa, Konya, Bursa	Bilecik, Van, Kayseri, İzmir, Kütahya
SRB	Kocaeli, Bursa, Manisa, İstanbul, Ağrı	Kocaeli, Ağrı, Bursa, Manisa, Konya	Sakarya, Siirt, İzmir, Bursa, İstanbul
MKD	Karabük, Muş, İzmir, Şırnak, Iğdır	İstanbul, Çorum, Kocaeli, Ankara, Ağrı	Karabük, Hatay, Sivas, Osmaniye, Kocaeli

SOURCE: BACI, TURKSTAT, TEPAV calculations
Note: Similarities are calculated with the correlation of the corresponding trade baskets. Five cities which have highest scores are represented in the figure. Share of products in 2 digits export or import baskets for 2013 values is used in the calculation of correlation.

In light of this challenge, we propose the adoption of a set of company selection criteria:

GROWTH PERFORMANCE

Focusing on companies with high growth performance would the right way since such companies would have more appetite for additional markets. Company contests that systemically identifies and ranks fast-growth companies, such as Turkey 100 can be good platforms to identify the "good-fit" companies.[32] In the next recommendation, we propose to conduct a similar exercise for identifying the fastest growing firms of the SEE region.

POTENTIAL CLUSTER LEADERS

Companies that strive to play a proactive role in their value chains / clusters, so they would have more appetite for networking with complementary firms from other markets. This could be only understood through a direct contact with the company (from their company vision/mission, short term and long term strategic plans).

CONNECTIVITY CAPACITY

Companies that have the capability for connectivity so they would have the human resources to operate in multi-country settings. Language skills, IT infrastructure, and background of owners and managers could be considered as sub-criteria for understanding the connectivity capability of SMEs.

RECOMMENDATION #6: DEVELOPING A COMPREHENSIVE RESEARCH AGENDA

During our research process we came across the fact that not much research is carried out on the economics of the region by Turkish economists and from a business perspective. Significant majority of credible research is undertaken by multilaterals (OECD, World Bank, EBRD) and The Vienna Institute for International Economic Studies. We propose to complement these institutions' research agendas with a more business and Turkey-flavored research program.

At the outset, in line with our recommendations in previous sections and to follow up on the critical research questions raised in this project, we recommend carrying out more in-depth research in critical areas.

IN DEPTH VALUE CHAIN ANALYSES

In this report, we attempted to shed light on the 'big picture' of key sectors for SEE-6 economies. A series of more detailed studies that examine the status of regional value chains in transformative sectors such as automotive industry, agrofood industry, ICT, and tourism sectors is required. Some of such studies are already carried out at national levels (e.g. World Bank's sectoral analysis reports for The Former Yugoslav Republic of Macedonia[33]) and regional levels (e.g. the OECD's NGCI studies on agrofood and tourism sectors). However, they also need to be carried out taking into account opportunities in and synergies with the EU and Turkey markets.

CONTENT AND COORDINATION FOR POLICY DIALOGUE

As highlighted in the diagnostics section, there are various areas in which Turkey's past experiences and current capabilities may be transferred to the SEE-6 economies. Privatization processes, financial liberalization, setting up of a sound financial system, EU acquis driven reforms are some of the areas where Turkish know-how can be put into good use for SEE-6.

SPECIAL ECONOMIC ZONE FEASIBILITY STUDIES

As elaborated under Recommendation #3, setting up of special economic zones in key locations as micro-investment havens should be pursued. Feasibility studies for these zones, including both technical details such as assessment of suitable locations, access to highway/railroad/port/airport, land expropriation processes, private development opportunities as well as demand from the local and international business community and target sectors should be carried out.

RECOMMENDATION # 7: IDENTIFY THE FAST GROWTH COMPANIES IN SEE-6 AND CREATE PLATFORMS FOR THEM TO NETWORK WITH EACH OTHER AND THEIR TURKISH COUNTERPARTS

Compared to traditional SMEs, fast growth companies play an even more critical role in stimulating economic development. Economies that aspire to become a global actor need fast

growth companies that build new industries and disrupt traditional ones. Such companies create employment opportunities, focus on product and management innovation, create and supply new and more efficient products to the markets, and therefore are much more likely to attract new investments from abroad. Hence, one important strategy for transition economies to sustain their growth performances is to increase the number of their fast-growth companies and by creating and sustaining fertile economic institutions and policies.

Although fast growth companies are real change agents, most government policies, including those in SEE-6, have a tendency to focus disproportionately on traditional SMEs. This bias emerges due to statistics showing that overwhelming majority of firms fit into this category, taking the lion's share from total employment. All around the world, one-size-fits-all types of traditional SME-focused policies that mostly target keeping SMEs alive in the face of ever increasing competitive pressures (e.g., tax holidays or subsidized loans) have proven to be ineffective for the more advanced high growth companies.

Programs designed to support high growth companies should focus on facilitating their access to new markets, investors and talent. Most of the time, these companies have a track record of excellence in execution that should be complemented with new opportunities. One way of increasing potential opportunities for such companies is through increased visibility. In that respect, we recommend to start the SEE-50 Program to increase the visibility of fastest growing companies and help them become more internationalized.

The SEE-50 program could be started to identify the fastest growing companies of SEE-6 economies. It should be an application only program. The final list should consist of companies that are vetted on the basis of past three years' turnover growth rates. Applications to the program would be open to privately owned, non-listed, and for-profit companies. Applicant companies could be incorporated in outside of the South East Europe but their primary location should be in one of the SEE-6 economies. Eligible companies for the program must not be 51% or more owned by a publicly traded company or a government entity. The applications of holding companies, franchise units, auto dealerships, banks or utility companies would not be accepted. However, independent incorporated entities owned by a holding company should be allowed to apply.

Applicant companies will be asked to submit their audited financial statements and their growth performance will be evaluated on the basis of the data presented in the financial statements. Other than growth performance, credentials of the applicant companies will be checked from publicly available data sources. The program will be implemented in five stages.

OUTREACH

RCC may take on lead and dissemination responsibilities of the program. The success of the program depends on the partners that will join forces with the RCC. Involvement of private sector organizations of SEE-6 economies would have a positive impact on the number of applicant companies. Media outlets and social media platforms should be used as much as possible to increase the publicity of the program.

COLLECTING APPLICATIONS

An application form should be prepared and posted on the program website that is going to be created in SEE-6 languages. All the applications should be collected through the program website. A team composed of experts should be formed to evaluate the incoming applications.

FINALIZING THE LIST

Applicant companies should be ranked with respect to their turnover growth rates in the last three years. The one with the highest growth rate should be placed as the number one company.

AWARDS EVENT

The winner companies should be honored at an awards event and a gala dinner. Representatives of the program partners, business associations, media, and high level government officials should be invited to the event.

DOCUMENTING THE SUCCESS STORIES

After the list is finalized the success stories of the companies on the list should be collected in the SEE Fast Growth 50 publication. That publication should be distributed to the media outlets, financial institutions, and relevant government agencies.

In turn, the success stories of SEE-50 companies will be analyzed for patterns which could provide inspiration for innovative SMEs and entrepreneurs alike to create new business ideas and opportunities.

Fast growth SEE-6 companies should apply to the program for the following reasons,

VISIBILITY

SEE-50 ranking will put successful SEE-6 companies on the global radar screen. Visibility will draw to them new customers, investors, growth partners and talent. The program aims to fix the visibility deficit of high growth companies to unlock their potential. In the digital economy, visibility is a high impact multiplier generating vast amounts of new opportunities.

INTERNATIONALIZATION

Placing on the SEE-50 list will help winner companies strengthen their global business relations. In order to achieve this target, a series of business trips to major economic centers would be organized by RCC and program partners. The business trip programs would contain visits to business associations, information sessions on the market structure of the economies that are visited, meetings with investors, and B2B meetings.

NETWORK

SEE-50 companies will become part of a common network of high growth companies. Being part of the same network would provide an opportunity to start new business partnerships with other fellow companies.

The SEE-50 program would help strengthen the economic relations between the South East Europe and Turkey. The Union of Chambers and Commodity Exchanges of Turkey in partnership with TEPAV and U.S. based AllWorld Network have been conducting a similar program for Turkey since 2011. The awards events and business trips of SEE-50 and Turkey 100 would be combined to help successful companies from both sides to build relationships with each other.

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ENDNOTES

[1] Source: Regional Cooperation Council. (2013a), Regional Cooperation Council. (2013b), Regional Cooperation Council. (2014a), Regional Cooperation Council. (2014b).

[2] We used disaggregated bilateral trade flow data provided by the United Nations Statistical Division, which is available in the UN Commodities Trade Statistics Database (COMTRADE). Although COMTRADE is the most comprehensive database on world trade, it does not capture certain trade flows. Many economies do not report on time and some economies report data compiled at too high a level of aggregation to accurately capture sectoral activity. Moreover economies' import and export volumes are not consistent with each other as discrepancies can be found when comparing an economy's exports with its corresponding partner's import flows. In order to address some of these problems, we complemented COMTRADE data with the BACI (Base pour L'Analyse du Commerce International – Database for International Trade Analyzes) database for the product assessment analyses. BACI database offers values for trade data to a higher degree of disaggregation in product (more than 5,000 products) and spatial (more than 200 economies) dimensions. Furthermore, the BACI database corrects discrepancies found between one economy's exports and its corresponding partner's import flows. BACI is available with versions 1992, 1996, 2002 and 2007 of the Harmonized System (HS) with 6-digit disaggregation.

[3] Source: De Backer, K. & Miroudot, S. (2014).

[4] Source: De Backer, K. & Miroudot, S. (2013)

[5] Source: Gereffi, G. & Fernandez-Stark, K. (2011).

[6] Source: De Backer, K. & Miroudot, S. (2013).

[7] Source: Republic of Turkey Ministry of Development (2014a).

[8] Revealed comparative advantage represents the result of comparison between weight of an exported product in a country/economy's export basket and weight of an exported product in world's export basket. For a given product p and country c, RCA is calculated with following formula which is originally introduced by Balassa(1965). C indicates set of the countries which export the specific product and cεC represents each country which exports the specific product.

[9]
$$RCA_{p,c} = \frac{x_{p,c} \Big/ \sum_P x_{p,c}}{\sum_C x_{p,c} \Big/ \sum_C \sum_p x_{p,c}}$$

Associated productivity level of a product is represented by weighted average of GDP per capita of its exporters. For a given product p, share of the product in the exporters' baskets are taken in the numerator. Then in the dominator, the same ratio is summed among all exporters of the product. In this case, weighted average of GDP per capita (Y_c) is calculated where weights are the share of the products in the exporter's basket.

In the PRODY of a product, GDP per capita of the country would affect the result as much as how much share of the good can get in its export basket. For instance, if a country is allocating more share for the product in its export basket then its economy would affect the result more.

In this case, GDP per capita is taken as GDP per capita PPP, constant 2011 international USD. PRODY scores are calculated in line with formulation of Hausmann, R., Hwang, J., & Rodrik, D. (2007).

$$PRODY_p = \sum_c \frac{(x_{p,c}/\sum_p x_{p,c})}{\sum_C (x_{p,c}/\sum_p x_{p,c})} Y_c$$

[10] Further information regarding competitiveness of agroofood industry in especially in The Former Yugoslav Republic of Macedonia can be found in World Bank (2012a).

[11] Source: OECD (2015).

[12] Source: UNIDO. (2010). Mapping Global Value Chains: Intermediate goods trade and structural change in the world economy.

[13] Source: Ibid.

[14] Source: Ibid.

[15] Source: Ibid.

[16] Source: UNIDO. (2010). Mapping Global Value Chains: Intermediate goods trade and structural change in the world economy.

[17] Source: Ibid.

[18] Seminal paper on this theory belongs to Akamatsu (1962). Recent literature review also can be found in UNCTAD (2013).

[19] Source: World Bank. (2012b).

[20] Source: World Bank. (2012b).

[21] Geographic grouping regarding Mediterranean countries is in line with country grouping of World Travel & Tourism Council (2014).). It covers Albania, Algeria, Bosnia Herzegovina, Croatia, Cyprus, Egypt, France, Greece, Israel, Italy, Lebanon, Libya, Malta, Montenegro, Morocco, Serbia, Slovenia, Spain, Syria, Tunisia, Turkey, Jordan, The Former Yugoslav Republic of Macedonia and Portugal. Due to lack of data Libya and Jordan could not be included.

[22] Source: World Travel & Tourism Council Database, TEPAV calculations

[23] Durres Port is introduced as an alternative destination to Thesselonike most of the times. Detailed information on its infrasturcture's development can be found in İktisadi Araştırma Vakfı (2013).

[24] Source: Montenegro Ministry of Tourism and Environment (2008).

[25] Sources: The Travel Foundation and Forum for the Future. 2012. Survival of the fittest: sustainable tourism means business. United Nations Environment Programme and World Tourism Organization. (2005). Making tourism more sustainable: A guide for policy makers.

[26] Source: GIZ (2015).

[27] More information on the current situation of ICT ecosystem in Serbia can be found in FCI (2014).

[28] Source: Wiiw (2014).

[29] Currently there are two types of zone regimes in SEE-6 that stand out. Firstly, The Former Yugoslav Republic of Macedonia has the most developed industrial zone regime in the region. Investing in the Technological Industrial Development Zones (TIDZs) offer both significant tax cuts as well as logistical and infrastructural advantages. Despite this, and even though the investments into the TIDZs have been increasing, they are still below potential and only three of the fourteen zones initially planned are operational. Second, Serbia's industrial zone regime is integrated with a free zone regime which offers significant advantages to investors. Nevertheless, there are only 12 Free Zones in the country and there does not appear to be high demand for investing in these.

[30] Access to relatively cheap and relatively skilled labor in relation to the wider region's workforce, increased highway connectivity with and proximity to the EU, access to cheap industrial land, advantageous electricity prices, nearby traffic of Turkish trucks and passengers are some of the competitive advantages such a zone would provide. Already existing flagship investments in the Subotica Free Zone by Siemens, Continental and Swarowski would go a long way in persuading Turkish investors to the desirability of the location and the business model. Source: Free Zone Subotica (2015).

[31] Serbia has a high potential for entrepreneurship activities especially in creative industries as a result of comparative excellence in the universities located at regional centers. Technical competence of young graduates from these universities appears to be at the world class level. Serbian youth is said to have a knack especially for sciences and math, resulting in top level engineers graduating from the universities. As a result, Belgrade University ranks among top 101-150 universities in the world in math and sciences. These graduates are increasingly more involved in entrepreneurship activities, and most attempt to set up their own companies after a few years of work experience.

[32] See Allworld Network WebSite <*http://www.allworldlive.com/about/overview*>

[33] Source: World Bank (2012b), OECD (2015).

RegionalCooperationCouncil

@rccint

RegionalCooperationCouncil

RCCSec

Trg Bosne i Hercegovine 1/V
Bosnia and Herzegovina

Fax. +387 33 561 701
Tel. +387 33 561 700

mail: rcc@rcc.int
website: www.rcc.int

Powered by RCC.